

ILO/UNDP TSS1 Report

INDONESIA

Self-Employment and Micro Enterprise Development (SEMED)

A consolidated report on the SEMED Programme (INS/93/021)

June, 1998



INTERNATIONAL LABOUR ORGANIZATION (ILO)
South-East Asia and the Pacific Multidisciplinary Advisory Team (SEAPAT)

FOREWORD

This report consolidates the findings and recommendations of seven studies carried out under the UNDP/ILO programme on self-employment and micro enterprise development in Indonesia during 1993-94. Significant economic and political changes have taken place in Indonesia since the time studies were completed. But the findings of the studies are highly pertinent to the present day situation in Indonesia.

Indonesia is presently beset by problems of a negative business environment and increasing unemployment. Self-employment has become the only possible refuge for the vast number of people losing their employment in the formal sector. Actually, the formal sector even during the fast paced economic growth did not create enough employment opportunities to absorb the labour supply. Absence of linkages between the expansion of large scale enterprises and small and medium enterprises incurred a situation where economic growth did not translate into increasing job creation in the small and medium enterprises. Withdrawal of investments from large enterprises has sharply focused the need for promoting small and medium enterprises and improving incomes and productivity in self-employment.

Given the present economic turmoil in the country, the only viable safety net for the jobless workers would be to present them with the opportunity for self-employment. Massive efforts are immediately required to address the situation of joblessness to mitigate the social costs of the turmoil. Therefore, in this context, it is hoped that by consolidating the findings of the studies in this report serious consideration would be given by policy makers, ILO's social partners and the donor community to the suggestions to maintain and stimulate employment opportunities.

The report was prepared by Mr. Moise Allal of ENT/MAN, ILO Geneva. I would like to express my sincere gratitude to UNDP Jakarta and ILO Jakarta for making it possible to complete this report.

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INTRODUCTION

1.0. The economic crisis: urgent need for large numbers of new jobs

The recent economic crisis resulting, to a large extent, from turmoils in the financial market and currency depreciation, has considerably aggravated the employment situation in the country. The structural adjustment programme, adopted as a response to this crisis, and layoffs in the manufacturing and other sectors, have considerably reduced prospects for the large numbers of job seekers: the educated youth, rural workers and those who lost their private or public sector job. According to Repelita VI (1994-99) estimates, which were based on pre-crisis optimistic growth rates, 11.9 millions new jobs needed to be created. These estimates must now be adjusted upward. Strategies for creating much larger numbers of new jobs must be reviewed, taking into consideration the fact that medium and large enterprises will not be able to generate the required number of new jobs in the near future. Indeed, many such enterprises must go through an extensive restructuring process which will further reduce their job creation potential.

2.0. Unlocking the job creation potential of micro and small enterprises

The economic recovery will hopefully help reduce the current high unemployment and under-employment. However, much more time is required before the economy resumes its previous high growth path. Meanwhile, urgent measures are needed in order to create large numbers of jobs which will allow people to meet their most basic needs and reduce social tensions. While the government may initiate emergency employment schemes, such as labour-intensive public works programmes, budgetary constraints would limit the scope of these schemes. Other measures, which will not depend on heavy public expenditures, are therefore required. Unlocking the job creation potential of micro and small enterprises seems, under these circumstances, the most promising avenue for reducing the current high unemployment and under-employment rates at a minimum cost to the government. This option is based on the fact that micro and small enterprises have been and will remain the main source of jobs for all those entering the labour market. Given the right business environment and some support and assistance, the future contributions of these enterprises to job creation and economic growth could be substantially increased.

In 1993, over 34 millions micro enterprises (i.e. enterprises with assets of less than 5 million rupiah) accounted for 98% of the total number of enterprises, and provided employment to over 57 millions people (close to 85% of the total labour force). A very high fraction of these enterprises are found in the informal sector. They include self-employed people (15 millions enterprises), self-employed people assisted by family workers (18 millions enterprises) and small businesses with permanent workers (1.2 millions enterprises). 450,000 small enterprises (i.e with assets of less than 600 million rupiah) accounted for 1.35% of the total number of enterprises and generated 3,650,000 jobs (approximately 5% of the total labour force). The corresponding numbers for medium and large enterprises are respectively 200,000 enterprises (0.65% of the total) and 6,700,000 jobs (10% of the labour force).

enterprises to employment and economic growth could be further enhanced through various policies and support measures.

The percentage of small enterprises is relatively small when compared to that of mature economies in industrialized countries (e.g. close to 7% in the EU against 1.65% in Indonesia). Increasing this percentage through appropriate policies and measures will help generate large numbers of jobs since the average number of workers per small enterprise is approximately six times that of micro enterprises (8 workers against 1.4 workers per micro enterprise). However, the focus should be on small enterprises requiring limited capital investments in order to reduce the cost per job created.

The percentage of small and micro enterprises in the manufacturing sector is also relatively low: 7% against 57% in agriculture and 36% in trade and services. Increasing this percentage through appropriate inducements could have an important impact on the overall development of the industrial sector in an increasingly globalized economy.

The contributions of micro and small enterprises to gross output- and therefore to GNP- could also be substantially enhanced through measures to increase productivity. The average gross output per small enterprise is only 34 million Rp and that of a micro enterprise is 3 million Rp. 97.6% of small and micro enterprises generated in 1994 output/sales of up to 5 million Rp per annum.

Unlocking the full potential of micro and small enterprises- both in terms of job creation and their contribution to economic growth- will require intensive efforts in various areas and at different levels. The central and local governments will need to promote a truly conducive business environment, reduce unnecessary regulatory constraints and initiate incentive programmes in favour of these enterprises. Innovative mechanisms and effective support structures- involving the private sector, NGOs, chambers of commerce, sectoral organizations, associations of small enterprises and of the informal sector, cooperatives and other relevant bodies- will need to be established or strengthened with a view to facilitating access to relevant and effective business services and training by small and micro enterprises. In line with current best practice, these mechanisms and structures should achieve some level of financial sustainability. This will be indicative that the services they offer are both relevant and effective.

Similarly, micro and small enterprises should have easier access to financial services or instruments required for starting a business or expanding existing businesses. This will require a review of current lending regulations applied by the formal banking sector, and the streamlining of the very large number of special credit schemes operated by NGOs and other bodies for the benefit of micro enterprises. The special problem of small enterprises, which usually are not covered by these credit schemes and face difficulties in accessing bank loans, also require an urgent solution.

3.0 Need for a comprehensive, integrated, high impact and cost-effective programme for micro and small enterprise development.

61 The Government of Indonesia recognizes the importance of micro and small enterprises in job creation and economic growth. A wide range of programmes in favour of these enterprises are being currently implemented by a number of government agencies at both the central and local levels. Various para-statal organizations, NGOs, associations of micro and small enterprises, employers' and workers' organizations and other bodies in the private sector have also initiated specific programmes addressing the various needs and constraints of micro and small enterprises. A number of international agencies and donors provided technical and/or financial assistance to some of the above programmes.

Over the past few years, the ILO provided technical assistance to the Government of Indonesia (GOI) in the area of micro and small enterprise development including, among others, assistance to the cooperatives sector through the Ministry of Cooperatives & Small Enterprise Development (DEPKOP & PPK). In 1994, the ILO initiated a UNDP-funded project the objective of which was to prepare an Integrated Self-Employment and Micro Enterprise Development Programme (SEMED). This project's (INS/93/021) main purpose was to recommend an appropriate institutional framework for the promotion of self-employment and micro enterprise development as well as to prepare a comprehensive programme of activities covering the main areas of intervention. Other recommendations on further research, delivery mechanisms, and on appropriate financial and technical resources required to achieve SEMED objectives were also expected from the project. The latter was then to be submitted to UNDP and other donors for funding short to medium term (up to five years) projects based on the proposed SEMED programme.

The project was completed in 1995 and produced all the planned outputs. These consisted of a number of studies covering major issues and areas of intervention: the policy and regulatory environment, vocational training, delivery mechanisms for business services and support to micro and small enterprises, identification of business opportunities, entrepreneurship development, access to financial services and women's issues. These reports were submitted to all government agencies concerned and UNDP.

Subsequently, it was decided to consolidate the findings, recommendations and proposals from these studies into a single shorter report, to take the form of a master plan for a national self-employment and micro and small enterprise development programme under SEMED. This report is the outcome of this decision. In addition to consolidating and integrating the various reports prepared under the SEMED project, it incorporates recent thinking on the most effective approaches and best practices for micro and small enterprise development.

This report aims at developing a comprehensive, integrated, high-impact and cost-effective strategy and programme for self-employment and micro and small enterprise development based on the results of the SEMED project and current best practice.

The report will cover the following main issues:

- The need for research and surveys in order to ensure that the future design of programmes and projects are based on the real characteristics, needs and problems of micro and small enterprises.
- The respective roles of the GOI, private sector organizations, employers' and workers' organizations, NGOs, associations of enterprises, financial institutions and other relevant bodies in self-employment and micro and small enterprise development.
- Improving the policy and regulatory environment, using a consultative and participatory process whereby the relevant social partners (including in particular the micro and small enterprise sector representatives) will be able to fully participate in such a process.
- Access to business development services (information, consulting services, access to markets, etc.). The main issue under this topic is to ensure that the providers of these services are knowledgeable of the needs of micro and small enterprises and can achieve a sufficient degree of financial sustainability.
- Access to skills and business training, taking into consideration the characteristics of the trainees and the need for the training delivery mechanisms to be sustainable.
- Access to financial services and instruments. A number of issues will be covered under this topic: the sustainability of credit schemes; the problem of small enterprises which require loans larger than those available under micro credit schemes but face difficulties in accessing loans from banks; and other financial instruments that could be made available to micro and small enterprises in place of loans, such as leasing.
- The gender issue in micro and small enterprise development, including the need for greater participation by women in fast growing small enterprises.

4.0 Content of the report

The report will include the following three main parts:

- Part A:** a brief review of available studies carried out by the ILO/UNDP project for the promotion of self-employment and micro enterprise development (SEMED studies under project INS/93/021). Information from these studies is partly used for the elaboration of the micro and small enterprise development strategy proposed in this report.
- Part B:** Guiding principles for the design and implementation of relevant, high impact, cost-effective and sustainable policies and programmes for micro and small enterprise development.
- Part C:** Strategies and programmes for micro and small enterprise development, taking into consideration the lessons learnt from the SEMED project and the above guiding principles.
- Part D:** Proposed follow-up action

PART A

Brief review and analysis of SEMED studies

This part of the report will review the seven studies prepared under the SEMED project and extract the main findings of these studies as a basis for developing a micro and small enterprise development strategy in Part C of the report. A more detailed review and analysis of these studies are provided in an annex to this report.

The first study concerns the business environment and the role of the Ministry of Cooperatives and Small Business Development (DEPKOP/PPK). The findings of the study are altogether not surprising: they reflect the situation of the MSE sector in the large majority of developing countries and the way governments have attempted to promote this sector. The report recommendations are also generally in line with current thinking and best practice on how to improve the policy and regulatory environment and to facilitate access to MSEs to financial services, training and business services. As member of the Committee of Donors' Agencies for MSE development, the ILO has been recently entrusted with the task of preparing two papers on current promising experiences and best practices on financial and business delivery mechanisms, including the type of structures that should be established for facilitating access to financial and business services. The reports prepared by the ILO on these issues include many of the recommendations made by the author.

As recommended by the author, the promotion of a truly enabling business environment (external environment) will go a long way in promoting growth-oriented and competitive enterprises. Furthermore, the recommendation to establish a national Small Business Development Forum (or Small Business Coordinating Council), involving DEPKOP/PPK and other ministries is also very welcome. However, this recommendation elicits the following comments. First, it should make it very clear that the Forum should include membership from both the public and private sectors. Furthermore, MSEs should be strongly represented in such a Forum. The author does not emphasize sufficiently this point, and does not provide details on how to ensure strong private sector representation in the Forum. Second, given the size of the country and its large population, there is also a need to establish regional bodies which will implement some of the functions of the national Forum. The laws and regulations affecting MSEs differ from province to province or district to district. Similarly, the provincial economic structures and the environment within which MSEs operate differ from one locality to the other. Therefore, provincial bodies should be able to better assess the needs of local MSEs and to elaborate solutions in line with these needs.

The report also makes a number of recommendations on the internal environment, particularly the role of DEPKOP/PPK in facilitating access by MSEs to training, finance and business services and information.

In relation to finance, the author insists on the delivery mechanisms rather than on the availability of capital. While this may reflect the economic situation of the country at the time the report was prepared, the current economic crisis adds an additional constraint: capital may not be as plentiful as in the past. Furthermore, micro credit schemes available for micro enterprises requiring loans

of Rp. 500,000 or less are not helpful to small enterprises requiring Rp. 2,000,000 or more. The situation of these enterprises is particularly difficult since they cannot also access loans from the banking system. Therefore, there is an urgent need to improve the effectiveness and efficiency of the current micro credit schemes as well as to initiate innovative measures to facilitate access to larger loans to small enterprises. Furthermore, in a situation of tight money supply, maximum efforts should be made by the Government in order not to reduce the size of government-funded micro credit programmes.

Regarding the access of business services and information by MSEs, the author recommends the establishment of 300 Small Business Development Clinics at the district level. This is a commendable proposal since business services providers should be established as close as possible to their clients. However, the author implies that these clinics will be operated under the responsibility of DEPKOP/PPK. This contradicts to some extent the author's earlier recommendation that DEPKOP/PPK should be mostly involved in promoting an enabling business environment and other general MSE promotional efforts, in collaboration with other government agencies. Furthermore, most MSE development specialists agree that the offer of business services should not be under the responsibility of government agencies. Instead, they should be offered by private or semi-private bodies - including possibly NGOs- on a commercial basis whenever possible. The ultimate objective will be for these bodies to achieve a large degree of financial sustainability. Many approaches have been developed to achieve this objective (see later). This recommendation therefore requires further clarification and should be spelled out in greater detail.

The recommendation to promote small business associations is also very important for many reasons. First, it is much more cost-effective to provide assistance and support to associations to small businesses than to individual ones. Second, these associations are needed to represent their members in the proposed Forum and to play an important lobbying role. Finally, associations can be the source of important business and other services to their members. While the report recommends the establishment of associations, it does not provide sufficient details on how this objective could be achieved.

The topic of the second study is the elaboration of a mass communication and training strategies. The author makes a number of proposals which should help promote an entrepreneurial spirit and facilitate access to training by large numbers of people. It may be noted that the author proposes the establishment of a National Small Enterprise Council as well as regional councils. This proposal is in line with the proposal made in the previous report (regional councils added), although it is not clear whether the councils will have the same functions as the proposed Forum. On the other hand, the authors proposes that private sector membership in the councils be at least 30%.

The report presents a few weaknesses. First, as in the previous report, it assigns most of the responsibility for the four projects to DEPKOP/PPK. Second, it implies that the proposed information centres will be fully subsidized: this is not in line with current thinking on the need for the providers of business services and information to be financially sustainable. Finally, many will question the offer of information services in isolation to other business services, training and

even financial services (although some specialists prefer to have financial services separate from business services).

The third study proposes a strategy for developing a vocational training for self-employment programme. The main weakness of the study is the lack of concrete operational measures to apply the proposed models. However, the approaches and methodologies proposed should form a good basis for initiating concrete vocational training programmes. It will also be useful to take into consideration similar proposals made in the other reports, since most of the other SEMED reports also touch on the issue of training. It may be noted that, as stressed in these other reports, the consultant suggests that DEPKOP/PPK be the coordinating agency for vocational training activities but should not itself be involved in training.

The fourth study concerns the type of delivery mechanisms that should be promoted in Indonesia. It proposes an approach which is in line with current thinking and best practice in three important areas. First, the approach clearly focusses on the development of local capacity - particularly that of the KUDs at the district level- to deliver support and services to SMED enterprises. Second, the approach aims at integrating all types of services required by MSEs, including the integration of both financial and non-financial services. Finally, the approach seeks the involvement of the private sector in MSE development at the local level.

However, the recommended approach contains an inherent weakness which may prevent the establishment of a long-term sustainable local capacity for MSE development: it uses the same government structures at both the national and local levels as the main conduits for the delivery of financial and non-financial services, assuming that a change in working procedures and the establishment of alliances among the above structures will remove past constraints preventing them from performing their functions in an effective and efficient manner. Thus, the proposed approach is basically at odds with current thinking based on the establishment of non-governmental bodies using, to the largest extent possible, commercial principles in dealing with MSEs, and capable of achieving a sufficient level of financial sustainability. Such sustainability is particularly important at a time when budgetary constraints, brought about by the current economic crisis, will prevent heavy government budgetary contributions for the development of the MSE sector.

The fifth study concerns the integration of financial and non-financial services. While many questions still remain un-answered in relation to the delivery of non-financial services, much progress has been achieved on access to financial services. The ILO has recently published a report on best practice in this area, based on successful experiences initiated in a number of countries as well as approaches developed by various donor agencies and the ILO. The consultancy report does not cover in a comprehensive manner these new innovative approaches. It mostly focusses on well known traditional approaches. For example, the report does not discuss the option of promoting financial instruments other than loans, such as leasing or venture capital. A number of such instruments could be more easily accessible to entrepreneurs and will do away with the need to seek loans.

The report does not either discuss in depth the possible linkages between financial and non-financial services. There are many arguments for and against such linkages, while some new

approaches tend to favour these linkages. The report could have benefitted from a more in-depth coverage of this issue.

Finally, the report recommendation to focus on the strengthening of KUDs presents the same weakness as similar recommendations made in previous reports. Questions on the autonomy of KUDs and on their prospects to achieve long-term financial sustainability remain un-answered.

The sixth study concerns the identification of business opportunities for self-employment and micro enterprise development. It reviews international and Indonesian experiences in relation to business opportunities identification (16 Indonesian case studies are discussed and evaluated). However, the report does not provide a concrete operational plan for creating a national capacity for business opportunities identification. It only suggests ways on how this could be achieved. Another weakness of the report is that it does not establish linkages between business opportunities identification and other services required by MSEs. This is an important issue since this should determine who or which structure should be responsible for business opportunities identification. Finally, the consultant also tends to assign responsibility for this task to government officers: as indicated earlier, this may not prove very effective.

The last study covers the issue of women. While it provides a good analysis on the main problems and constraints faced by women engaged in business, and while it makes a number of general recommendations for reducing such constraints, it fails in recommending concrete measures and plans to that effect. Many approaches have been developed to increase women participation in micro and small businesses. However, the author rarely refers to these approaches. Furthermore, one of the most burning issues related to the implementation of MSE development programmes for women is not at all covered by this report. The issue is whether it is necessary to design separate programmes and projects for women-headed MSEs, or whether to include specific women components in general MSE development programmes. There is no consensus on this issue. It would have been useful for the consultant to assess this issue in the context of the Indonesian environment.

Altogether, and despite some of the weaknesses discussed above, the SEMED reports constitute a major contribution to the understanding of the various issues underlying the promotion of self-employment and MSE development in the Indonesian context. They provide a wealth of very useful information which must be taken into consideration in any future programme or project for MSE development. They all present strengths and weaknesses. However, the weaknesses are probably due to the fact that they have been prepared in the early nineties when new thinking and approaches on how to best promote self-employment and the MSE sector were just starting to take shape. Parts B and C of this report will attempt to correct the shortcomings of these reports by incorporating the most recent approaches and best practice for self-employment and MSE development, in line with SEMED original objectives.

PART B

Guiding principles for the elaboration of a self-employment and MSE development strategy and programmes

Prior to spelling out a concrete strategy for self-employment and micro and small enterprise development, provided in Part C of the report, this part of the report lists below the major guiding principles underlying the elaboration of such a strategy.

- 1. Micro and small enterprises will always exist irrespective of government interventions and of the existence of a policy and regulatory environment.**

This fact implies that any government intervention, including interventions at the policy and regulatory levels, would be justified only if they can improve the growth of MSEs and help them achieve their full job creation potential.

- 2. Strategies and programmes intended to promote self-employment and MSEs require action at a number of inter-related levels:**

- Action-oriented research to better understand the characteristics, constraints and needs of MSEs and to develop relevant and innovative approaches and methodologies in line with the findings of research.
- Development of MSE development strategies based on the selected approaches and methodologies. These strategies must be flexible and forward-looking in view of the evolving needs of MSEs and the changing socio-economic environment.
- Creating and/or strengthening the national and local structures responsible for implementing the adopted strategies. These structures will most probably involve not only government agencies, but also private sector bodies, NGOs, various types of associations, etc.
- Allocating sufficient financial and human resources for an effective implementation of the adopted strategies. All the structures involved in MSE development should contribute resources to complement those contributed directly by the target beneficiaries.

- 3. Restructuring government agencies and/or involving new partners in MSE development should be carefully phased over time in order to avoid creating a vacuum in current programmes and projects.**

Changes in the MSE support structures and in MSE development strategies will be required from time to time. These changes are needed as more knowledge is acquired and new approaches are developed. However, changes must be introduced gradually in order to avoid harmful disruptions

in on-going programmes and confusing the target beneficiaries. A clear implementation plan should therefore be adopted whenever extensive restructuring is required.

4. **Clear identification of the potential clients is a pre-requisite to the elaboration of any MSE development strategy.**

The SEMED clientele includes the self-employed and the micro and small enterprises. Most groups within this clientele have similar characteristics, face similar constraints and have similar needs. It is not necessary to use an unduly restrictive definition for each group: the self-employed to-day could graduate into a successful small entrepreneur to-morrow given the right environment and support. If definitions are needed for administrative or policy reasons, they should ensure that the total SEMED clientele is covered by the adopted definitions. Quantitative definitions could be used (e.g. number of workers, value of assets) but should not lead to restrictions in terms of the type of support that could be provided to any particular group. On the other hand, qualitative definitions - based on the characteristics and needs of the clientele - would be useful for adapting support and assistance to these characteristics and needs.

5. **A consultative and participatory process in promoting an enabling business environment is essential for achieving the intended objectives**

Many MSE development specialists are of the opinion that an enabling business environment (i.e. a set of policies, laws and regulations which fosters the development of MSEs) will go a long way in helping MSEs grow and increase their competitiveness. However, a top-down approach has often been used by governments in elaborating the policy and regulatory framework. The views of the intended beneficiaries are often not taken into consideration. Consequently, the business environment is often unduly restrictive or at best unhelpful. It is, therefore, important to adopt a consultative and participatory process involving all the social partners concerned, including in particular the representatives of MSEs.

6. **The role of the government in MSE development should be restricted to promoting an enabling environment, coordinating MSE development efforts, undertaking general promotional activities and providing financial support. The government should limit its direct interventions in the areas of financial services, training and access to business services.**

In industrialized countries, the role of governments in MSE development is that described above. The private sector enterprises, banks, sectoral organizations, specialized magazines, etc are the main sources of information and of financial and business services. This is the ultimate objective to be pursued by developing countries. This objective is also in line with new privatization policies of government services, and the need to reduce public expenditures as a result of the current economic crisis. This objective will, however, take time to achieve in view of the weak linkages existing between the small enterprises and the larger ones. Thus, support structures outside the government should be established or strengthened in order to facilitate access to financial and non-financial services by MSEs.

7. **MSEs should be able to access most of the services they need in a single location close to their place of business.**

MSEs need finance, information, training and various business services (e.g. assistance for accessing more profitable markets, increasing productivity, selecting the right processing technique, etc). They should be able to access these services in a single location close to their place of business, or at least be able to obtain information on how to access services, finance or training not available at that location. The offer of an integrated package of services and assistance close to the place of business is an important pre-requisite for the successful implementation of MSE development programmes. The issue of whether financial services should be provided separately from business services is discussed in Part C of this report.

8. **MSE support structures, offering training, business and other services should enjoy maximum autonomy, operate to the largest extent possible on a commercial basis, and be able to achieve a large degree of financial sustainability.**

Most MSE development specialists agree that MSE support structures (semi-private bodies, business centres, NGOs, local economic development agencies, etc.) should be able to enjoy a large degree of autonomy, operate in a business-like way, be fully knowledgeable of the business world and be capable of generating sufficient resources for achieving financial sustainability. Achieving this objective is the main indicator of their performance. This means that the support structure is offering relevant and effective services to MSEs, and that the latter are willing to pay the full or part of the cost of these services. Part C of the report will indicate how financial sustainability could be achieved.

The above guiding principles will now be used in the following part of the report for elaborating a strategy for MSE development adapted to the Indonesian environment, and taking into consideration the lessons learnt from the SEMED project.

PART C

National strategy for self-employment and micro and small enterprise development

1.0 Introduction

The national strategy elaborated in this part of the report covers three main areas of intervention: improvement of the policy and regulatory environment; access to training and business services; and access to financial services. The implementation of the strategy will, on the other hand, require a review and adjustment of the MSE support structure at both the national and local levels. Action in relation to the main areas of intervention and the adjustment of the support structure would have to be initiated simultaneously.

The proposed strategy should be implemented over a five year period, including an initial period of two years during which pilot projects will be tested. Some parts of the strategy may be implemented immediately, without the need for substantial resources (see below). Other parts will require donor funding (e.g. UNDP and multi-bilateral donors).

Actions that could be initiated immediately include:

- Organization of a national seminar to review the proposed strategy and amend it if necessary. The strategy will then be submitted to the relevant national authorities for adoption.
- Establishment of a national Small and Micro Enterprise Development Council (SMED Council), with membership made up of representatives of relevant government agencies, private sector organizations, MSE associations and major NGOs involved in MSE development. The Council will be the main focal point for ensuring the effective implementation of the strategy.
- Establishment of two to three Provincial SMED Councils. These Councils will collaborate closely with the national Council.
- Organization of a workshop for the donors' community to present the strategy and obtain feedback on funding possibilities. While donors may be represented at the national seminar, this workshop is needed as it will discuss more technical matters and will focus on the funding of projects under the overall strategy.
- Preparation of a number of pilot projects, in line with the adopted strategy, and submission of these to potential donors.
- Review of on-going MSE development projects with a view to determining whether they should be adjusted in line with the adopted strategy.

All the above immediate actions will be further elaborated in this part of the report.

2.0 Establishment of a National and Provincial SMED Councils

There is an urgent need to establish national and Provincial bodies which will ensure the effective implementation of the self-employment and micro and small enterprise development strategy. Through these bodies, it will be possible to enhance the impact, outreach and cost-effectiveness of the various MSE development programmes and projects. Thus, it is proposed to establish immediately a national SMED Council and Provincial SMED Councils in two selected pilot provinces. Subsequently, Provincial Councils should be established in all provinces. The role and functions of Provincial SMED Councils will be partly similar to those of the national Council, the main difference being their focus on the special needs of the MSE sector in the province.

2.1 *Functions of the National SMED Council*

The national SMED Council will perform the following main functions.

- Coordination of national and provincial programmes for self-employment and small and micro enterprise development. However, coordination should not mean direct control of these programmes. The latter should be left under the direct control of the bodies which initiated the programmes. Rather, coordination should ensure synergy among the programmes and prevent duplication of efforts.
- To review the policy and regulatory framework, and to advise the government on the existence of unduly constraining policies and regulations and on the need to adopt a more favourable business environment. The Council should play an important lobbying role on behalf of the MSE sector.
- To review incentive programmes in favour of private sector development, and to advise the government on the possible existence of biases against the MSE sector which prevent the latter to take full advantage of these programmes.
- Promoting research by relevant bodies, such as universities, on specific issues on MSE development.
- To collaborate with the government agency in charge of census surveys in order to ensure that the agency will collect all the necessary statistical data on MSEs. Such data is very important for better assessing the contributions of MSEs and for elaborating effective support programmes.
- Mobilizing resources for MSE development programmes. The Council should establish for this purpose close collaboration with the donors' community.
- To maintain a roster of all governmental, non-governmental and private sector bodies involved in MSE enterprise development with a view to obtaining information on their activities on a regular basis and to better coordinate and support such activities.

- To initiate promotional activities in favour of the MSE sector.

2.2 Composition of the National SMED Council

Membership in the SMED Council should ensure representation of key partners involved in MSE development. The most important ministries implementing MSE development programmes or which could contribute to such programmes should be represented. Similarly, the ministries of planning and finance should be represented in view of their important role in the areas of overall economic development and financial policies.

The private sector, including representatives of employers' organizations, sectoral organizations, chambers of commerce, etc. should also be represented. Special efforts should also be made to include representatives of MSEs which are not generally represented in the above organizations.

National NGOs which could clearly contribute to MSE development programmes should also be represented in the Council.

While it is desirable to have a wide representation of partners in the Council, the size of the latter should remain manageable in order to allow it to perform its many functions effectively.

2.3 Secretariat of the Council and Task Forces

The government should decide in which government agency the Secretariat should be hosted. However, it would seem that DEPKOP/PPK could be the more appropriate host in view of its mandate in MSE development.

The role of the Secretariat will be to facilitate the work of the Council by providing it all the information required for its deliberation, as well as assistance in following-up the Council's sessions.

The Council may also decide to establish special Task Forces to deal with special issues on MSE development.

2.4 Provincial SMED Councils

These Councils will have most of the functions of the national Council, but will focus essentially on provincial issues related to MSE development. The membership of the provincial Councils will also be similar to that of the national Council, the main difference being the presence of provincial authorities.

3.0 Defining the MSE development strategy clientele

3.1 *Selecting a definition for MSE*

In Indonesia, as in many other countries, enterprises have been defined on the basis of various criteria. The two most used criteria are: the number of workers; and the size of assets. These two criteria are also the ones used for statistical purposes, and for defining the beneficiaries of incentive programmes and policies.

The SMED reports indicate that the following definitions were used a few years ago, and may still be used:

	Number of workers	Size of assets
Micro enterprises	1-4	<Rp.5,000,000
Small enterprises	5-9	Rp.5-600 million
Medium and large	>10	>Rp.600,000,000

Other definitions are also used in Indonesia: turnover, sales, distinctive enterprise characteristics, etc.

It is proposed that these definitions be reviewed in relation to the asset size of micro enterprises (Rp.15,000,000 to 20,000,000 as a maximum seems more adequate), and the number of workers of small enterprises (20 workers seems more appropriate, considering that many small enterprises use labour-intensive production techniques). The number of workers of medium and large enterprises should also be larger than 20.

While the above quantitative definitions are useful for statistical purposes and for defining those enterprises which should benefit from incentive programmes, in practice MSE support structures should be able to decide which MSEs should avail of their assistance and support on the basis of a number of qualitative criteria, such as the type of technology used, market access, the entrepreneur's skills, the type of premises used for production or trade, etc. These characteristics will quickly and clearly differentiate MSEs from the medium and large firms. Furthermore, it is very doubtful that these larger firms will be interested in seeking assistance from the MSE support structures. On the other hand, there is no particular reason to differential between small and micro enterprises: they generally face similar problems and constraints. It is only necessary to adjust the support and assistance to the specific problems faced by each individual MSE or association of MSEs.

3.2 *Maximizing the impact of MSE support programmes: selecting the potential winners.*

The objective of any MSE support programme is to unlock the job creation potential of small enterprises and to maximize their contribution to economic growth. Furthermore, in view of the limited resources of MSE support programmes, it is important to maximize the impact of the latter by focussing efforts on those individuals which can make the best use of the assistance provided: individuals exhibiting an entrepreneurial spirit and capable, given the right business

environment and support and their intrinsic skills, of establishing growth-oriented and sustainable MSEs which should create large number of jobs. Focussing efforts on individuals who do not exhibit this type of characteristics will considerably reduce the impact of MSE support programmes. It is, therefore, necessary to clearly separate MSE development programmes from those with a social welfare objective requiring a complete different approach and resources clearly allocated for this purpose. Careful selection of MSE clients, using effective selection criteria, is therefore an important pre-requisite for the success of any MSE development programme.

3.3 Promoting MSEs in the manufacturing sector

Current statistics on MSEs show that the manufacturing sector is not sufficiently represented, the large majority of MSEs being found in the trade and services sectors. This imbalance should be corrected since the larger enterprises in the manufacturing sector need close linkages with the smaller enterprises. In an increasingly globalized economy characterized by fierce competition, downsizing, subcontracting, franchising and other types of linkages play an important role in increasing the competitiveness of all sizes of enterprises and helping them access foreign markets. An MSE development strategy should, therefore, include attractive incentives for promoting small enterprises in the manufacturing sector.

4.0 Promoting a truly enabling business environment.

4.1 The role of the government

Promoting an enabling business environment should, by itself, go a long way in promoting the growth and competitiveness of all sizes and types of enterprises. On the other hand, such environment does not imply that enterprises are free to operate without due regard to various regulations (e.g. those related to working conditions, safety and health procedures, minimum wage laws, social protection of the workers, and so on). The role of the government is, therefore, double: removing undue constraints which may affect the growth of enterprises while at the same time ensuring that the latter apply the national laws and regulations related to the establishment and operation of a business.

In order to promote an enabling business environment, the government will need to act at four inter-related levels.

First, businesses need an enabling macro economic environment: the most important components of such environment are the monetary, foreign exchange, fiscal and foreign trade policies. The right balance should be established between the needs of businesses in these areas and the needs of other sectors in the economy, taking also into consideration the international economic agreements entered by the government with international agencies and trading partners in the region.

Second, public investments policies should facilitate the establishment and growth of businesses. The latter need educated and skilled workers and a good infrastructure (power, water, roads, transport facilities, telecommunication network, etc.). Public investments in education, training

facilities and infrastructure development are therefore essential for nation wide promotion of enterprises.

Third, the laws and regulations should not impose undue constraints on the creation or growth of businesses. Often, they exist without any justification or because they were useful in the past under different circumstances. Streamlining the laws and regulations affecting businesses, removing un-necessary duplications and facilitating their application is an important role of the government. How this can be achieved is further discussed later.

Finally, the government may promote various sizes and types of businesses through incentive programmes. However, these programmes must be justified and ensure that they will not be biased against a particular group of enterprises. They should also be designed in such a way as to avoid the introduction of market distortions, thus defeating their purpose. Finally, they should be easily accessible to the intended beneficiaries.

More details on how the government may play all the above roles, in close collaboration with its social partners, are provided later in this part of the report.

4.2 The business environment and the MSE sector.

All sizes and enterprises are affected by the macro economic policies adopted by the government, although the larger ones are more able to adjust to these policies than the smaller ones. The same applies to public investment policies.

On the other hand, the effects of the regulatory environment and of incentive programmes vary greatly according to the size of the enterprise. In Indonesia, the large majority of micro enterprises are not registered. They operate outside the regulatory environment, although in practice they must comply willingly or unwillingly with some local regulations. Furthermore, being unregistered, they cannot often avail of the benefits of incentive programmes put in place by the government. Even those micro and small enterprises which are registered face difficulties in taking advantage of incentive programmes either because they are not aware of such programmes or because they are unable to comply with complicated administrative procedures. In general, the regulatory framework and incentive programmes concern a very small fraction of the total number of enterprises, mostly the larger size ones.

Under these circumstances, there is an urgent need to review the regulatory framework and the way incentive programmes are applied with a view to inducing a much larger fraction of MSEs to join the formal sector of the economy. In particular, measures should be taken in order to reduce the cost of compliance to regulations by MSEs, while at the same time providing incentives which will make the benefits of compliance larger than the incurred cost. Proposals along these lines are made later in this part of the report.

4.3 *Improving the policy and regulatory framework: need for an effective consultative and participatory process*

The various reports reviewed by the authors as well as interviews with representatives of government agencies clearly yield to the following main findings:

- Most macro policies-- monetary, fiscal-- and foreign trade policies have been biased towards big business. Few are directly favourable to micro and small enterprise (MSE) development.
- There is no comprehensive and effective national MSE policy. There are only ad-hoc programmes which have not always been successful in achieving their intended objectives.
- In some cases, policies had negative effects on MSEs (e.g. the 10% VAT which was applied to all sizes of enterprises in the early 1990's and then withdrawn after protests from MSEs. In the interim period, up to 30% of MSEs supplying large department stores were put out of business). This illustrates the fact that insufficient efforts were made to assess the effects of policies before they are adopted.
- There is a lack of policy formulation coordination at both the national and local levels: policies initiated by some of the government agencies at these levels are not usually reviewed and discussed with the other agencies.
- Most importantly, MSEs are not consulted before policies are adopted and their representatives do not participate in their formulation. Information at hand clearly show a lack of consultative and participatory process in policy formulation and application. Only large business organizations are able to play a lobbying role on behalf of their members.

Under these circumstances, it is essential to review the process leading to the formulation of policies and regulations and to ensure the full involvement of the social partners in such a process, particularly the representatives of MSEs. It is, therefore, recommended that this matter be reviewed by the proposed SMED Council if it is decided to establish such a Council. Indeed, it would be difficult to adopt a truly consultative and participatory policy formulation process in the absence of a SMED Council. The latter should be responsible for coordinating consultation and policy formulation on all issues affecting MSE growth and competitiveness, including monetary, fiscal, trade, infrastructure, labour and regional development policies. It should also be responsible for the formulation of regulations and their application. In particular, the Council's responsibilities should include the following:

- Initiating studies on various aspects of MSE development, and using the findings of these studies for improving the existing policy and regulatory framework, in line with the characteristics and needs of MSEs.

- Coordinating and assessing all proposals for modifying existing policies and regulations and initiating new ones. Such coordination is essential since a number of bodies, within both the legislative and executive branches of government are involved in this area. These bodies should be instructed by the highest authorities to inform the SMED Council of all proposals emanating from these bodies with a view to allowing the Council to advise them about possible conflicts, duplications or inherent weaknesses.
- Following-up all proposals for policy and regulatory reforms, and providing advice to the bodies involved in the processing of the proposed reforms.
- Ensuring the active participation of all social partners in the review, assessment and modification of policy reforms with a view to reaching a consensus on the content of the latter, taking into consideration the characteristics and needs of all sizes and types of enterprises (i.e. establishing a truly consultative and participatory process).
- Establishing a system for the effective dissemination of information on policies and regulations adopted by the government, using clear language understandable by MSEs.
- Reviewing and improving the application of regulations by various bodies, taking into consideration difficulties encountered by MSEs which must abide by these regulations (e.g. facilitating the registration of enterprises.).
- Systematically studying and evaluating the effects of policies and regulations on MSE growth and competitiveness with a view to being able to advise the government to initiate corrective measures whenever necessary.

By performing all the above functions, the SMED Council should help promote a truly conducive business environment and help MSEs unlock their full job creation potential.

5.0 Access to financial services

All enterprises, small or large, need funding for investment and working capital. In Indonesia, a very small fraction of micro and small enterprises can access loans from various credit schemes, and an even smaller fraction has access to bank loans. Most micro and small enterprises use their own savings or borrow money from family and friends. Others rely on money lenders and must pay them very high interest rates. Small enterprises face a much more difficult situation: they cannot offer the type of guarantees required by banks, and small loans available from credit schemes operated by NGOs or government agencies are not usually sufficient from their needs. The creation of new micro and small enterprises therefore requires urgent action at a number of levels.

5.1 Guiding principles for promoting and supporting financial intermediaries

Different types of MSEs have different characteristics and needs, and require different financial services. In Indonesia, a large fraction of MSEs, particularly the micro enterprises, rely on their

own savings, loans from family members or friends or money lenders. A smaller percentage of MSEs have been able to benefit from bank loans or special credit schemes managed by NGOs or government agencies. However, banks have not been responsive to the financial needs of MSEs (see Section V.2), while special credit schemes have reached a relatively small fraction of MSEs (available estimates indicate that less than 10% of MSEs have benefitted from these credit schemes) and have not performed well (many such schemes are characterized by low loan recovery rates). In the long-term, banks should be the main sources of loans for MSEs: measures to achieve this objective are discussed below. However, other financial intermediaries may be required in the short and medium terms. This section provides a few guiding principles for promoting and supporting effective financial intermediaries capable of achieving financial sustainability.

Financial intermediaries outside the banking system are usually established with the assistance of the government or donors, or by associations of MSEs relying on contributions from their members. Financial intermediaries seeking government or donor support should exhibit a number of characteristics which may be verified in their current operations or clearly described in their requests for assistance. These characteristics are briefly described below.

A capacity for the effective delivery of financial services to a significant number of clients. Such capacity requires the following characteristics:

- A sound governing structure, good knowledge of the local socio-economic environment, competent and stable staff, a realistic business plan for achieving financial sustainability, and adoption of measures to ensure full accountability.
- An information system for effective and efficient management, to be used actively for decision-making and keeping track of financial transactions.
- A management system for the achievement of high productivity with a view to minimizing operating costs and, therefore, maintaining a low interest rate. Various variables may be used for measuring productivity (e.g. loans per staff member, operating costs as a percentage of average loan portfolio).
- Adoption of a meaningful and transparent financial reporting system, in line with banking standards and which allows prospective funders to evaluate performance adequately.

High quality services and capacity to offer these services to a sufficient number of clients with specific characteristics.

- Contrary to banks, financial intermediaries are supposed to deliver loans to the type of clientele specified by the funder. This clientele includes, in general, individuals who cannot access bank loans because they cannot provide guarantees. However, the financial intermediary should be allowed to select within this clientele, those individually who exhibit an entrepreneurial spirit and are capable of making a good use of the loans.

- Offer of services appropriate to the clients' characteristics: quick, simple and convenient access to small loans, requiring limited paperwork, and which can be renewed once previous loans have been repaid according to schedule. Collateral substitutes, such as peer guarantee, should also help those who cannot offer physical assets as a guarantee. Business plans for small loans should be simplified, while cash flows and project appraisals may be required for larger loans.
- Promoting savings services to complement funding from donors or the government.
- Capacity to increase outreach and thus demonstrate that clients are satisfied with the services offered.

Financial performance

- Adoption of an appropriate interest rate, sufficient for covering the full operational costs and for expanding the total amount of loanable funds (i.e. reaching financial sustainability) while remaining attractive to the loanees. Such an interest rate should cover the opportunity cost of capital (including inflation), administrative costs, losses and a minimum return on equity.
- Maintaining an adequate portfolio quality: arrears should be low enough that late payments and defaults should not threaten the viability of the financial intermediary.
- Achieving self-sufficiency: the financial intermediary should demonstrate a capacity to achieve financial self-sufficiency within an adequate period, without having to rely on subsidies (international experience shows that successful intermediaries have been able to achieve operational self-sufficiency in three to seven years and financial self-sufficiency-- meaning being able to cover all administrative costs, losses and non-subsidized financing costs-- within five to ten years. These periods could be further reduced with improved management. The ultimate objective is for the intermediary to achieve full financial independence by building up a solid and growing financial basis (e.g. through mobilization of commercial funds from depositors and the financial system).

It is recommended that the above guiding principles for promoting and supporting financial intermediaries outside the banking system be systematically applied to both established and future intermediaries seeking funding from donors or the government. The effectiveness of already established intermediaries should be reviewed (using some of the criteria implied in the above guiding principles) with a view to deciding whether they should continue to benefit from such funding. Special training should be provided to the staff of intermediaries which have the potential to achieve self-sufficiency. Other intermediaries, with little hope to achieve this objective (e.g. inadequate structure or management, poor record after a number of years in operation), should be excluded from further funding.

It is also recommended that a roster of financial intermediaries, indicating their performance over the years, based on some of the above criteria, be prepared (and regularly updated) for the benefit of donors and government agencies which provide funding to the financial intermediaries. This roster will be useful in ensuring that only the better performing intermediaries will benefit from funding.

5.2 *A more responsive banking system*

In most developing countries, banks are not very responsive to the financial needs of micro and small enterprises: bank managers feel, contrary to findings from many studies, that MSEs present a higher risk than larger enterprises, especially those which cannot offer a guarantee; loan processing costs are supposedly higher than for large loans; etc. On the other hand, owners of micro and small enterprises do not feel at ease approaching a bank for a loan, and may find the paper work too complicated. Furthermore, many banks are not sufficiently represented in small towns and rural areas.

In the long-term, banks should constitute the main sources of loans and financial services for MSEs: special credit schemes should be considered as short or medium term solutions to the financial needs of MSEs. A number of measures may be initiated to achieve this objective.

- Strengthening linkages between MSEs and banks

Banks confidence in MSEs would be enhanced if entrepreneurs were to open deposits or savings account in banks. This would build up trust between bank managers and MSEs, and would make banks more receptive to the financial needs of MSEs.

- Reducing loan processing costs and risks

Banks may be more willing to offer loans to MSEs if loan processing costs are reduced and if the risks can be minimized. One approach to respond to these legitimate requirements of banks would be to have loan requests processed by a business services providers (see below) before they are submitted to banks for funding. The service providers would help the entrepreneur prepare a business plan, and would follow up loan recovery. They may also provide training and business services to ensure that the enterprise will be able to pay back the loan. The service providers would negotiate a fee for the package of services to be provided, and the fee may be added to the loan and paid to the service provider once the loan has been approved. This approach will reduce loan processing and recovery costs, and also minimize risks for the bank.

- Establishing a loan guarantee fund

This approach has been used by many countries with varying success. The main issue concerns the recovery rate: a high recovery rate (e.g. over 95%) should, combined with an appropriate interest rate (see below), ensure the sustainability of the fund while at the same time enhance the banks confidence in MSEs. On the other hand, a low recovery rate

will quickly deplete the fund. Under these circumstances, a loan guarantee fund should complement the earlier proposal for reducing processing costs and risks.

- **Establishing a special bank window for MSEs**

Banks may open a special window for MSEs staffed with officers knowledgeable with MSEs needs and characteristics. This should reduce the reluctance of MSEs to visit banks and should help establish trust between entrepreneurs and bank managers.

Other measures have been adopted by countries in order to make banks more responsive to the needs of MSEs. However, many such measures have not been very successful. In particular, measures which force banks, by law, to dedicate part of their lending portfolio to MSEs have failed to achieve their intended purpose. It is the author's opinion that measures of this type should not be used.

5.3 *Interest rate policy*

In most developing countries, access to loans by MSEs is by far a much more important constraint than the interest rate charged on loans. MSEs are usually willing to accept very high interest rates applied by money lenders. Therefore, they welcome the much lower interest rates applied by banks or organizations operating a credit scheme even if these rates were to be justifiably higher than the market rate. Under these circumstances, rates should be set at a level that takes into account the basic banks rate adjusted for inflation, loan processing costs and an estimate of losses due to loan defaults. Techniques for establishing the appropriate interest rate are well-known and available in various manuals/guidelines.

Different rates may be applied for different types of loans. However, it is important to adopt clear guidelines on the range of interest rates which should be applied by banks and those operating credit schemes, and to induce the latter to apply these guidelines.

5.4 *Promoting new financial instruments*

In some cases, the availability of various types of financial instruments could be a more effective substitute to loans.

- **Leasing:** the leasing of equipment have been successfully tested in a number of countries. The main attractiveness of leasing is the reduction of risks for the entrepreneur: in the event the enterprise must close down or production capacity must be reduced, the entrepreneur will simply return the leased equipment and will not have to face the necessity of paying back a loan for the purchase of equipment. Properly operating leasing systems should actually reduce the cost of using processing equipment.
- **Joint ventures and partnerships:** Established small enterprises of a sufficiently large size may also expand their business without having to secure loans by entering into joint venture or partnership agreements with medium/large enterprises. These latter enterprises may be interested in such agreements whenever they could reduce costs and allow for

more production flexibility, in line with the current trend in downsizing large enterprises. The large/medium enterprises would provide funding for working capital and/or equipment for use by the small enterprises. Joint ventures and partnerships should be investigated on a sectoral basis. The Government, through the proposed SMED Council may organize workshops to promote this approach among interested partners.

6.0 Promoting the offer of business services by the private sector

6.1 Introduction

Any enterprise, whatever its size, requires finance, qualified and trained manpower and easy access to various types of business services, in addition to an enabling business environment. Medium and large enterprises are generally able to access all the above financial and non-financial services, either by using their own financial and human resources or by recruiting specialized consultants or consulting firms when they lack the required specialized staff.

MSEs, on the other hand, face great difficulties in accessing financial and non-financial services. The various SMED studies clearly show that less than 5% of MSEs can get loans through banks or special credit schemes operated by NGOs or government agencies. The percentage of those MSEs which can access training and business services is even smaller. The SMED studies also clearly show that the majority of NGOs and government agencies focus their limited financial and human resources on the operation of micro credit schemes, with little effort allocated to training and business services. The studies show that most NGOs and government agencies do not have qualified staff for performing the above functions. Furthermore, bureaucratic procedures and an often centralized approach reduce the effectiveness of training and business services. This, in turn affects the effectiveness of micro credit schemes as loans are approved without due consideration of the potential enterprise profitability (low loan recovery rates).

The question is, therefore: how MSEs managers and workers get their training and how do they access business services? Studies in Indonesia and elsewhere (economies in transition and developing countries) clearly show that entrepreneurs (who are also involved in production) often get their training on-the-job as apprentices in a family business or as hired workers in other MSEs. A small percentage of entrepreneurs and their workers may also get training from NGOs or vocational training schools. The studies also show that the main sources of business information (few access other business services) are, for over 95% of the cases, family members, friends, other businesses, suppliers, newspapers, magazines and clients. In most countries, less than 5% of MSEs access business services through NGOs or government agencies. MSEs which are members of business associations may also get services from these associations.

The lack of business services and training provided by professional trainers and consultants constitutes a severe constraint on MSE development, especially at a time when global competition and market liberalization tend to eliminate the weaker MSEs.

This situation may be compared with that of MSEs in industrialized countries. In these countries, entrepreneurs get their training in vocational training schools complemented by a formal apprenticeship system. Some of them may also be graduate of business management schools.

They access business services provided by the private sector: equipment manufacturers and suppliers ensure that MSEs get the most advanced equipment through active advertizing and after sale services; wholesalers, trade fairs and magazines are the main sources of market information; active sectoral and other MSE associations provide the most recent information to their members on markets, new technology, etc.; and accountants and other consultants provide the other services required by the MSEs. Government agencies in these countries are very seldom involved in the provision of business services, most of the latter being mostly provided to special vulnerable groups.

In Indonesia, the private sector plays a limited role in the provision of business services to MSEs. Efforts should, therefore, focus on strengthening this role of the private sector with a view to making it the main source of business services for MSEs. This, however, is a long-term objective which may require 10 to 20 years to achieve. In the short and medium terms, effective structures for the delivery of business services and training will be required. What types of structures should be established? How to ensure that they will offer quality services in line with MSEs requirements? How will they achieve financial sustainability with a view to reducing reliance on subsidies from donors and the government? Answers to these questions are provided in the remaining part of this section (private sector services) and in the next section of the report (non-private structure for the delivery of business services).

6.2 Promoting access to business services through the private sector

As indicated earlier, the private sector should become, in the long-term, the main source of business services for MSEs. Although this is a long-term objective, action should be initiated now to achieve the latter.

In Indonesia, studies clearly show that the private sector plays a limited role in the delivery of business services to MSEs, although it is a more important source for such services than NGOs and government agencies. MSEs are often forced to use inappropriate tools and equipment, face difficulties in finding quality materials at fair prices, lack information on markets and improved technologies, cannot afford consultancy fees, etc.

Little is known about the constraints preventing the private sector from playing this important role for the mutual benefit of both small and large firms. Is it a lack of information on demand for business services? Is the demand structure for these services not sufficiently attractive for the larger firms? Are the latter unable to respond to such demand in view of a limited production capacity?

The above and other questions must first find an answer before a long-term programme for promoting the offer of business services by the private sector can be initiated. Research in this important area should, therefore, be initiated soon. Such research may cover the following issues:

- Lack of appropriate tools and equipment which could be manufactured by medium or large engineering firms for the benefit of MSEs.
- Distribution and after sale services by equipment manufacturers and suppliers.

- Demand for private consulting services by MSEs, and availability of such services from private consultants and consulting firms (supply-demand analysis).
- Potential market for specialized trade magazines.
- Sub-contracting, leasing and franchising arrangements (these will be discussed later. They are referred to in this section since they also constitute a source of business services).
- Assessment of the capacity of business associations, sectoral organizations, etc. to provide business services to their members.
- Access by MSEs to trade fairs and other events which may be helpful to their business.

It is recommended that the above and other research topics be initiated by the SMED Council in very close collaboration with KADIN and its provincial branches (KADINDAs) as well as representatives of MSE associations. A programme for promoting the offer of business services by the private sector may then be elaborated on the basis of the research findings.

6.3 *Promoting corporate citizenship*

The offer of business services by the private sector are based on commercial principles, with both the larger and smaller firms benefitting from the commercial relationship. In addition, medium and large firms, especially the large corporations, can play a very important role in promoting MSEs. This role is often referred to as "corporate citizenship". There are no short-term benefits for the larger firms which agree to play this role. On the other hand, long-term benefits will be derived from the promotion of a strong MSE sector since the larger firms require strong linkages with the smaller enterprises. Corporate citizenship may take many forms. The most important ones, related to MSE development (other forms relate to other domains, such as the protection of the environment), include:

- **Sponsorship of MSEs:** larger firms may offer the services of their staff for consulting services free of charge; they may also offer technical or business training within the enterprise; they may facilitate access to markets; or they may offer financial assistance, such as interest-free loans.
- **Partnership with MSEs:** larger firms may establish a partnership with MSEs which may start as free-of-charge assistance and build up to a mutually beneficial commercial relationship. In this case, the larger firms take a risk since the commercial relationship may never materialize.

It is recommended that KADIN and Chambers of Commerce and Industry induce their members to play the role of sponsors or partners of MSEs, and to elaborate programmes for this purpose.

7.0 Promoting the offer of effective services by semi-private, sustainable structures.

7.1 *Introduction*

Prior to making proposals for facilitating access to business services by a large majority of MSEs, it will be useful to review a few important facts.

First, it is important to review a few important numbers

The total number of micro enterprises in Indonesia is currently estimated at 34,000,000 millions. This number may increase in the future in view of the current economic crisis (those who lost their salaried jobs will be forced to become self-employed), although little is known about the birth and mortality rates of micro enterprises in Indonesia.

The total number of extension officers working in NGOs or government agencies involved in MSE development (e.g operating a credit scheme or offering training and business services) is estimated at best at 20,000, excluding non-professional staff. Each extension officer can at best handle 50 MSEs per year (one MSE per week), assuming a minimum package of services required by each MSE. Obviously, this number can be increased if the extension officer is dealing with groups of MSEs at a time (e.g providing general information of interest to MSEs, or organizing group training). However, this is not sufficient. MSEs require individual attention because they each face different problems. Thus, a group approach would fail in solving their specific problems.

Therefore, the current number of extension officers will be able to provide effective services to only 1,000,000 MSEs per year (i.e. at best 3% of the current population of MSEs). This percentage is slightly cumulative since MSEs do not require services each year, and the net yearly increase of MSEs may be small. Thus, the total cumulative percentage may reach at best 5%.

Since most MSEs could benefit from effective business services, and even if a reasonable target may be set at 50% of the total population of MSEs (in this case, an MSE may have to wait for two years before it is able to avail of business services or training), the total number of extension officers required to reach this target would be 200,000.

In view of the current economic crisis and the need to reduce the government budget, it is unrealistic to hope that the government will be able to increase substantially the number of extension officers to meet the above target. It will also be unrealistic to hope for a substantial increase of donor funding for MSE development.

Under these circumstances, a new bold and significantly different approach is needed in order to reach a significant number of MSEs.

Second, the current structures offering training and business services to MSEs (NGOs, field offices of government agencies, etc.) have not been able to respond effectively to the needs of MSEs.

The SEMED studies show that there is a large proliferation of government agencies/departments involved in MSE-related activities: nine key agencies/departments plus 12 or more minor departments. To these government agencies, one must add the very large number of NGOs, banks, associations, primary rural cooperatives (KUDs), etc. which are partly or fully involved in MSE development.

The studies also show that there is a lack of coordination among these agencies, leading to a wasteful duplication of activities. Very few agencies or NGOs have been able to establish themselves as centres of excellence for MSE development. Few have sufficient qualified staff capable of offering a minimum package of essential services to MSEs: most bodies focus their efforts on training or the delivery of loans. Efforts to improve coordination and a more effective use of limited resources have, up to now, failed to succeed.

Third, the very large majority of government agencies and NGOs involved in MSE development have not been able to achieve a minimum level of financial sustainability: they must still depend on government or donor funding.

This is a disturbing fact. It indicates that agencies and NGOs supposed to promote profitable businesses are not capable themselves to apply good business practices and to reduce their dependence on government and donor subsidies. This also means that, without a substantial increase of government and donors contributions, the fraction of MSEs benefitting from training and business services will continue to remain relatively low.

7.2 *Promoting financially sustainable structures capable of offering quality training and business services to a large majority of MSEs.*

Given the above facts, a new approach is needed for facilitating access to quality training and business services by a large majority of MSEs without having to rely principally on funding from the government and donors. The proposed approach will complement the long-term approach for promoting the offer of business services by the private sector (see above). It has been successfully tested in a number of countries and should also succeed in Indonesia. It may be noted that a similar approach was tested in Indonesia through an ILO/UNDP project under the responsibility of the Ministry of Manpower (INS/90/004). It is not clear why this approach has not been widely replicated elsewhere in the country.

The main features of this approach are briefly described below.

- Quality business training and services (and possibly credit) will be offered by a network of autonomous district level Enterprise Development Agencies (EDAs). Initially, these agencies will be established as semi-private bodies since they will benefit from government or donor funding. At a later stage, they could become private sector bodies, similar to private consulting firms.
- A realistic and clear business plan will be elaborated soon after the establishment of the EDAs, the objective being the achievement of financial sustainability within a given period of two to four years, depending on local circumstances. EDAs may start with a

small number of staff, but could grow and reach a large fraction of the district potential clientele. The EDAs may not count on continuous government or donor funding, and should expect to close down if they are not capable of achieving financial sustainability.

- Further funding by the government and donors to facilitate access to business training and services by MSEs will be gradually devoted principally for the establishment of new EDAs. Thus, funds should not be anymore used for sustaining existing government agencies or NGOS. Government agencies will gradually discontinue their business training and services functions, and will instead focus their efforts on other important areas described earlier (promoting an enabling business environment, coordination of MSE development efforts, research, promotional activities, resources mobilization for MSE development programmes, etc.).
- Depending on circumstances, EDAs may be established as new bodies within the districts or may be hosted within existing local bodies (NGOs, Community based organizations, KUDs, etc.). However, the host organizations must first agree to adjust their legal status, functions and staff if they wish to play the role of local EDAs and benefit from government or donor funding.

Detailed information on the network of EDAs, their legal status and functions, and funding requirements for the establishment of the network is provided below.

7.3 The network of EDAs

Network of district level EDAs

It is proposed to establish an EDA in each district whenever there is a sufficiently large potential clientele in the district which will ensure the financial sustainability of the EDA. In the event this is not the case, an EDA could cover two or more contiguous districts.

Each district level EDA will start with a small number of staff members: three to five professionals and supporting staff (secretary, driver, etc.). Subsequently, the number of staff members may increase according to needs. The initial number of staff members will be determined on the basis of the business plan to be prepared prior to the establishment of the EDA, taking into consideration to achieve financial sustainability within a given period.

The functions of each district level EDA will be limited to training, the offer of various business services, revenue-generating commercial activities and possibly the operation of a credit scheme (see below). For this purpose, appropriate training will be provided to the EDA staff in order to enable it to perform the above functions. In addition, each EDA will be provided with appropriate tools and instruments which will help them perform these functions.

Provincial and National EDAs

In addition to the district level EDAs, it is proposed to establish a national EDA in Djakarta and, possibly, provincial EDAs. These EDAs will perform the normal functions of district level EDAs in the cities where they are located, as well as the following additional functions:

- Maintaining a comprehensive information system on all aspects of MSE development and making stored information available to the district level EDAs since the establishment of an information system at the district level would be too costly and not altogether justified.
- Promoting networking among the established district level EDAs: exchange of information, joint activities, etc. an association of EDAs at the provincial or national level could also be considered.
- Involvement in the establishment of future district level EDAs: it is assumed that the first EDAs will be established in the context of a technical cooperation project with some donor funding. Subsequently, EDA-Djakarta and the provincial EDAs should be able to directly help establish new EDAs, at a much lower cost, in the districts not covered by the project since international expertise will not be anymore required. EDA-Djakarta and the provincial EDAs will train the staff of the future EDAs and will provide them with the tools and instruments required for performing their functions.

7.4 *Legal status of the EDAs*

The EDAs will be not-for-profit agencies working under the over-all aegis of a Board of Directors (BOD) made up of representatives of the district/provincial authorities, banks, NGOs, business associations, major ministries involved in MSE development, etc. The BOD will provide guidance, formulate the EDA policy, review its programme of work and perform an auditing function. The EDA will enjoy a very large degree of autonomy in its day-to-day running of the agency (e.g. establishing its own salary structure), the BOD limiting strictly its role to that defined above.

The legal status of the EDAs should include a clear definition of the respective role of the BOD and the EDA management, especially in relation to administrative and financial procedures. In particular, the EDAs should be able to enjoy a degree of freedom similar to that of a commercial firm, but using surpluses for development projects under the guidance of the BOD.

7.5 *Functions of the EDAs:*

The EDAs will perform the following functions:

- Implementing various studies on the local MSE sector which will help EDA to better perform its various functions (sectoral and marketing studies, business opportunities assessments, study of the policy and regulatory framework);

- Providing business training, using training materials such as the ILO Improve Your Business (IYB) or Start Your Business (SYB);
- Providing information, advice and consulting services to entrepreneurs (e.g. in relation to marketing, technology, productivity improvement, acquisition of equipment and materials, organization of production);
- Promoting new organizations of production (e.g. industrial districts, common facilities services centres), subcontracting and networking with local and foreign enterprises;
- Promoting the establishment of business associations, and providing training and other services to NGOs, cooperatives and other organizations involved in MSE development.
- Organizing local promotional activities for the benefit of MSEs;
- Operating, eventually, a credit delivery scheme in the event there are no credit providers in the area covered by EDA or available credit terms are not suitable for the main clientele of the EDA. However, EDA will discontinue credit delivery whenever financial services improve in the area under its responsibility; and
- Undertaking various commercial activities for the dual purpose of achieving financial sustainability and helping MSEs in a number of ways (see below).

7.6 *The EDAs financial sustainability*

Achieving financial sustainability will be the *litmus test* of the success of EDAs in providing effective services and training to MSEs. Furthermore, financial sustainability is necessary since EDAs cannot expect to be continuously subsidized by the government or donors. In order to achieve financial sustainability, the EDAs will gradually undertake the following activities:

- **Providing training and consulting services for a fee.** However, this activity will generate at best 10% to 15% of the cost of training and services in view of the reluctance or capacity of entrepreneurs to pay the fee. One approach to increase this percentage will be to include the fee in the amount of the loan for start-up businesses in the event training and services are provided as part of a loan. Two options may be used for this purpose:
 - In the event the loan is provided directly by the EDA, the interest rate may be increased to cover the cost of the services. The loan agreement may, in this case, indicate the services to be provided along with the loan.
 - In the event, the loan is provided by another agency, with EDA providing help in the preparation of a business plan and a loan request, the cost of the services may be added to the loan, and EDA may be re-imbursed for the services once the loan has been approved and disbursed.

- **Undertaking commercial activities which will also be of benefit to the MSEs.** Experience from other countries shows that EDAs may generate substantial revenues from the following types of commercial activities:
 - commissions on subcontracting arrangements;
 - leasing of equipment;
 - operating a business services centre (secretarial and accounting services, fax, photocopying, etc.);
 - managing an industrial district or a common facilities services centre;
 - joint ventures with other local enterprises;
 - and other types of commercial activities.

Feasibility studies should be carried out before initiating any of the above activities with a view to ensuring that they will generate a surplus for the EDAs. The latter may need to secure loans for the launching of some of the above activities and hire additional staff for this purpose. From past experience, it is estimated that up to 50% of the running costs of EDAs could be generated through these activities.

- **Undertaking studies or implement projects under subcontracts from donors or the government.**

These activities could generate substantial revenues, but require highly qualified staff. EDA-Djakarta or the provincial EDAs may be in a better position for undertaking these income-generating activities.

- **Operating a credit scheme or providing technical assistance to MSEs for accessing loans from other sources**

30% to 40% of the EDAs revenues may be generated through the operation of a credit scheme or through the payment of fees by MSEs seeking financial assistance. The two options described above may be used for this purpose.

Experience in a number of countries, including countries in Eastern Europe, show that it is possible for EDAs or similar structures to achieve financial sustainability within two, to four years. Indeed, when the EDAs were established, the staff of these agencies knew that their future income will depend on their performance and on the generation of sufficient revenues to cover all running costs. Thus, the business plan indicates that salaries paid out the project budget will gradually decrease over the project period, with the difference being paid out of the EDA revenues. In order to increase staff motivation, the better performing staff members are offered bonuses which significantly increase their basic pay. By using commercial principles in the operation of the EDAs, it will be possible to ensure that they offer relevant and quality services, in line with the needs of MSEs.

Achievement of financial sustainability should also solve the problem of outreach. As indicated earlier, government agencies and NGOs currently reach less than 5% of the total population of micro enterprises. This percentage cannot be increased if these agencies and NGOs must be

constantly subsidized by the government or donors. Financial sustainability will allow a much greater outreach of MSEs since limited government and donors resources will be used exclusively for the establishment of new EDAs rather than for subsidizing government agencies or NGOs which are not able to cover their running costs.

7.7 *Establishment and funding of the EDAs*

Should the EDA approach be adopted by the government (e.g. through the proposed SMED Council), it is proposed to test this approach in five to ten districts before generalizing it to the whole country. Funding of these EDAs, including possibly EDA-Djakarta and a provincial EDA, could be partly covered by a donor (e.g. UNDP). Experience from other countries shows that the establishment of an EDA may cost US\$100,000-150,000, an amount sufficient for the period to reach financial sustainability. This amount could be much lower if the EDA can be established within an existing organization since fixed costs will be much lower. A project of a three years duration, with a budget of approximately US\$1,500,000, should enable the establishment of the pilot EDAs, including the cost of international expertise.

Following the establishment of the pilot EDAs, and assuming that an EDA-Djakarta and a provincial EDA are included in the pilot EDAs, additional EDAs could be established at a much lower cost by the provincial EDA and EDA-Djakarta.

8. Increasing productivity through an improved organization of production

MSEs can improve their productivity and competitiveness by adopting different types of organization of production. Two approaches which have been used in a number of countries with various degrees of success (the approaches are basically sound, but they have not always been applied properly) are briefly described below. They could be tested in the Indonesian context, if this has not already been the case.

8.1 *Common facilities centres (CFCs)*

If a sufficiently large number of MSEs, working in the same sector or sub-sector, are located in the same geographical area (e.g. an area with a radius of 10 to 20 Km), it would be possible to establish a CFC which will help them improve their productivity and competitiveness. The CFC will allow the MSEs to avail of the following facilities and services:

- Renting expensive equipment (e.g. on a hourly or piece rate basis) which they cannot afford in view of their limited scale of production. Such equipment will help them improve productivity and quality.
- The CFC may play the role of an intermediary between a client interested in making a large order and the CFC members (e.g. the CFC will guarantee the timely delivery of quality goods).
- The CFC may order large volumes of quality materials at a lower price than the local market price, and make these available to the members.

- The CFC may organize skills and business training courses for the members.

The above and other services and facilities may be offered to the members of the CFC, depending on the sub-sector and on the wish of the clients. In general, CFCs should cover their full fixed and variable costs. Experience shows that the success of CFCs depends on the following:

- The decision to establish a CFC should be based on the results of a full technical and feasibility study.
- The CFC should have the full support of the members (they should be consulted before deciding to establish a CFC) and should be immune of political interference.
- The CFC should be run by qualified managers and technical staff. It may be necessary, in most cases, to hire these people from outside the region where the CFC is located and to pay them attractive salaries.

It may be noted that the CFC members continue to operate from their own workshop. This is the reason for the CFC to be located close enough to the premises of the members.

8.2 *Establishment of MSEs clusters*

MSEs clusters may take many forms: industrial estates, industrial districts, micro enterprises villages, etc. The main differences between MSEs clusters and CFCs are the following: MSEs are actually located in these clusters; they do not need to work in the same sector or sub-sector; and they do not need to be a member of an association.

The main advantages of clustering MSEs, in a way or another, are the following:

- Offering appropriate premises to MSEs at an advantageous rent or price if the MSE decides to buy the premises (i.e. premises connected to water, electricity, gas, telephone, fax, etc.).
- Offering shared services, such as secretariat and accounting services, to MSEs
- promoting flexible specialization in production: for example, some MSEs may specialize in the production in parts of a good to be completed by other MSEs in the cluster. Such specialization will improve productivity and competitiveness of individual enterprises.

MSEs clustering has proved to be very successful in both developing and industrialised countries (e.g. in Italy, Spain). However, their success depends on a number of factors, similar to those for establishing CFCs. The reasons for the failure of some of the MSEs clustering are:

- Lack of a survey of MSEs with a view to determining whether they will be interested to establish themselves in a cluster and whether they will be able to afford the cost.

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- Lack of a technical and financial feasibility study with a view to ensuring the appropriateness of the premises and the financial sustainability of the cluster.
 - Poor management of the cluster by non-qualified staff.
 - Political interference.

PART C

FOLLOW-UP ACTION

The strategy outlined in this report for promoting self-employment and micro and small enterprise development may be implemented within a four to five years period. The various implementation stages are briefly described below.

- Stage 1: Distribution of the report to relevant government agencies, UNDP, donors and major NGOs with a view to getting their feedback on the proposed strategy.
- Stage 2: Organization of a national seminar to discuss the strategy and to come up with a long-term plan of action.
- Stage 3: Revising and expanding the current report on the basis of the results of the seminar. The revised report may then be used as the basic document for designing and implementing a comprehensive MSE development programme.
- Stage 4. Establishing the SMED Council and its Secretariat. The Council will be the main body responsible for implementing the above programme.
- Stage 5: Preparing a programme document, covering the various proposals described in this report (plus other proposals which may be suggested during the seminar), for submission to UNDP and other donors.
- Stage 6: Gradual implementation of the programme, taking into consideration the lessons learnt at various stages of its implementation.

ANNEX

Seven studies carried out under the SEMED project (ILO/UNDP Project INS/93/021) are reviewed and analysed in this annex. They served as a basis for elaborating the micro and small enterprise development strategy described in the main body of this report.

- 1) The Enabling Environment and the Role of the Ministry of Cooperatives and Small Business Development (DEPKOP & PPK). By Dr. Gene Ward;
- 2) A Strategy for Developing a Programme for Cost Effective Mass Communication and Training Strategies in Indonesia. By Peter Klar and Ir Bramantyo Djohanputro;
- 3) A strategy for Developing a Vocational Training for Self-Employment Programme in Indonesia. By John P. Grierson and Aris Pongtuluran;
- 4) A Strategy for Developing a Programme for Delivery Mechanisms in Indonesia. By Chris O'Connell and Sri Rusminingtyas.
- 5) Strategies for developing a programme for integration of financial and non-financial services in Indonesia. By Dasril Zainuddin.
- 6) Business opportunity identification for self-employment and micro enterprise programme in Indonesia. By Supramono and H. Sandee
- 7) Women Issues (the role of women in the SEMED programme). By Dra. Soejatni;

1.0 The Enabling Environment and the Role of the Ministry of Cooperatives and Small Business Development (DEPKOP & PPK).

This SEMED report is by far the most important one dealing with self-employment and the promotion of micro and small enterprise (MSE) development. While the other reports deal with specific aspects of MSE development (e.g. training or credit), this report covers both the overall external and internal environments affecting MSE growth and competitiveness. All other policy and support interventions will have to be implemented within the overall environment recommended by the author of this report.

1.1 *Main findings and recommendations of the report*

This report presents a set of recommendations aiming at creating an environment conducive to the development of self-employment and micro enterprises in Indonesia.

i) The external environment

The external environment is recognized by MSE development specialists as the most important factor (some say the main factor) affecting MSE promotion and growth. Its main components include: the macro economic environment (e.g. monetary and fiscal policies); the socio-cultural environment; incentive policies and programmes; the policy and regulatory environment; etc. The external environment is, to a large extent, shaped by the national, provincial and local governments. The role of these authorities in promoting a truly conducive business environment is therefore central to any intervention aimed at promoting a growth-oriented MSE sector capable of sustaining international competition in an increasingly globalized economy. The external environment should create a climate that enables rather than impedes the growth of SEMED enterprises.

In view of the above, the author recommends that the main role of DEPKOP/PPK (the focal government agency for MSE development) should be to promote an enabling business environment rather than that of an agency implementing MSE development programmes (an interventionist role). According to the author, DEPKOP/PPK may reach at best 5% to 10% of MSEs. On the other hand, an enabling environment should benefit all MSEs all the time.

The author's views is that DEPKOP/PPK is not playing this main role to the extent required. Furthermore, whatever attempts have been initiated in relation to promoting a favourable business environment for MSEs, these attempts have not sufficiently other important partners, such as other relevant ministries and representatives of the intended beneficiaries (i.e. the MSEs themselves). There is at present no single unified voice or lobbying group representing the small enterprise sector. This may explain that most policy interventions have, for a long time, favoured mostly the larger enterprises which are well represented through various powerful organizations. This also explains why the large majority of MSEs face difficulties in accessing financial services: the author believes that constraints on access rather the availability or cost of capital is the problem (thus the need for reforming banking policies and regulations).

ii) The internal environment

The author also reviewed the constraints limiting the effectiveness of government interventions in favour of MSE development, these interventions being the implementing arms of the overall macro economic and policy environments. The following constraints were identified by the author:

- DEPKOP/PPK suffers from a number of problems: low staff capacity, departmental organization and roles, and ideological biases. There is also a lack of coordination between DEPKOP/PPK and other ministries. the author notes that the assignment of DEPKOP staff members, formerly cooperative specialists, to the new Directorate for small business development may not create the necessary capacity for promoting small businesses: the skills required for this purpose are significantly different from those required for cooperative development. the same comments apply to the organizational structure of DEPKOP/PPK.
- The compulsory requirement for individual MSEs to join cooperatives in order to avail of the support and services of DEPKOP/PPK may limit the scope and outreach of DEPKOP/PPK interventions.
- A lack of integrated business support services such as credit, training and counseling. The extent to which all the above services should be integrated is an intricate issue discussed by the author.
- A lack of coordination between government departments in sharing information and resources so as to avoid duplication and redundancies.

- A lack of an articulated national policy on micro and small businesses which can assure the allocation of appropriate resources and attention for the systematic development of these businesses.
- A lack of coordination at the national, provincial and district levels in the formulation and execution of micro and small business programmes.

In view of the identified shortcomings, the consultant made a number of specific proposals which are summarized below.

- A master plan should be drawn up by DEPKOP/PPK in consultation with other concerned ministries in order to ensure the effective coordination and cooperation between different governmental departments for the development of small and micro businesses.
- DEPKOP/PPK and other ministries should form a Small Business Coordinating Forum through which the coordinating role of DEPKOP/PPK can be directly exercised. The mandate of this forum is envisioned as follows:
 - To plan and implement the Repelita VI targets for the establishment of 555,000 new SEMED businesses over a five years period.
 - To coordinate the various programmes for self-employment and micro enterprise development initiated by different ministries and agencies and assess the quality of such programmes.
 - To ensure the linkage between programme results and policy development through evaluation and feedback.
 - To co-ordinate the donors' activities in the area of small and micro business development.
- Small Business Development Centres (Small Business Development Klinics) should be established in 300 districts in order to provide nation-wide business consulting services. The role of these centres is to ensure the access of small and micro businesses to: credit; management expertise; information about business development programmes; training; the identification of business opportunities and markets; and technology transfer.
- Sector-specific Small Business Associations should be created at the district level. The Small Business Development Centres can be the focal points of these associations. In order to encourage the formation of Small Business Associations, two incentives are proposed:
 - the provision of consultancy services to each Association formed; and
 - access to business conventions and awards.

- Large-scale training should be made available to entrepreneurs by franchising the generic training operations to NGOs.
- Self-employed people and micro businesses should not be forced to join cooperatives in order to avail of the services and support of DEPKOP/PPK. The report is particularly concerned about this danger, given the overriding emphasis in Indonesia on cooperatives. It is strongly advised that entrepreneurial spirit and market realities should be respected and that cooperatives should not be favoured over small individual businesses in technical and financial assistance.
- Small business training should be provided to the DEPKOP/PPK staff. This can counterbalance the strong orientation of the government towards cooperatives.

The report also makes specific recommendations on the respective roles of the other ministries in relation to MSE development; the percentage of total loans for various sizes of loans (average loan: 1,000,000 Rupiah); training targets under the responsibility of various ministries; the percentage of SEMED businesses in agriculture (50%), small industry (20%) and in trade and services (30%). Finally, the other makes a number of specific proposals for ILO/UNDP interventions: small business development clinics; proposal for the promotion of small business associations; and a proposal for generic franchising for overall promotion of MSEs (an innovative approach for massive business creation for SEMED).

1.2 Assessment of the findings and recommendations of the study.

The findings of the study are altogether not surprising: they reflect the situation of the MSE sector in the large majority of developing countries and the way governments have attempted to promote this sector. The report recommendations are also generally in line with current thinking and best practice on how to improve the policy and regulatory environment and to facilitate access to MSEs to financial services, training and business services. As member of the Committee of Donors' Agencies for MSE development, the ILO has been recently entrusted with the task of preparing two papers on current promising experiences and best practices on financial and business delivery mechanisms, including the type of structures that should be established for facilitating access to financial and business services. The reports prepared by the ILO on these issues include many of the recommendations made by the author.

As recommended by the author, the promotion of a truly enabling business environment (external environment) will go a long way in promoting growth-oriented and competitive enterprises. Furthermore, the recommendation to establish a national Small Business Development Forum (or Small Business Coordinating Council), involving DEPKOP/PPK and other ministries is also very welcome. However, this recommendation elicits the following comments. First, it should make it very clear that the Forum should include membership from both the public and private sectors. Furthermore, MSEs should be strongly represented in such a Forum. The author does not emphasize sufficiently this point, and does not provide details on how to ensure strong private sector representation in the Forum. Second, given the size of the country and its large population, there is also a need to establish regional bodies which will implement some of the functions of the national Forum. The laws and regulations affecting MSEs differ from province to province

or district to district. Similarly, the provincial economic structures and the environment within which MSEs operate differ from one locality to the other. Therefore, provincial bodies should be able to better assess the needs of local MSEs and to elaborate solutions in line with these needs.

The report also makes a number of recommendations on the internal environment, particularly the role of DEPKOP/PPK in facilitating access by MSEs to training, finance and business services and information.

In relation to finance, the author insists on the delivery mechanisms rather than on the availability of capital. While this may reflect the economic situation of the country at the time the report was prepared, the current economic crisis adds an additional constraint: capital may not be as plentiful as in the past. Furthermore, micro credit schemes available for micro enterprises requiring loans of 500,000 Rh or less are not helpful to small enterprises requiring 2,000,000 Rh or more. The situation of these enterprises is particularly difficult since they cannot also access loans from the banking system. Therefore, there is an urgent need to improve the effectiveness and efficiency of the current micro credit schemes as well as to initiate innovative measures to facilitate access to larger loans to small enterprises. Furthermore, in a situation of tight money supply, maximum efforts should be made by the Government in order not to reduce the size of government-funded micro credit programmes.

Regarding the access of business services and information by MSEs, the author recommends the establishment of 300 Small Business Development Clinics at the district level. This is a commendable proposal since business services providers should be established as close as possible to their clients. However, the author implies that these clinics will be operated under the responsibility of DEPKOP/PPK. This contradicts to some extent the author's earlier recommendation that DEPKOP/PPK should be mostly involved in promoting an enabling business environment and other general MSE promotional efforts, in collaboration with other government agencies. Furthermore, most MSE development specialists agree that the offer of business services should not be under the responsibility of government agencies. Instead, they should be offered by private or semi-private bodies - including possibly NGOs- on a commercial basis whenever possible. The ultimate objective will be for these bodies to achieve a large degree of financial sustainability. Many approaches have been developed to achieve this objective (see later). This recommendation therefore requires further clarification and should be spelled out in greater detail.

The recommendation to promote small business associations is also very important for many reasons. First, it is much more cost-effective to provide assistance and support to associations to small businesses than to individual ones. Second, these associations are needed to represent their members in the proposed Forum and to play an important lobbying role. Finally, associations can be the source of important business and other services to their members. While the report recommends the establishment of associations, it does not provide sufficient details on how this objective could be achieved.

All these recommendations will be further discussed and elaborated in Part C of this report.

2.0 A Strategy for Developing a Programme for Cost Effective Mass Communication and Training Strategies in Indonesia.

2.1 *Findings and recommendations of the study*

The objective of this consultancy report is to identify strategies for using the Indonesian mass media for *social marketing* and *mass training* for the development of self-employment and micro enterprises. Social marketing in this context refers to the promotion of self-employment and micro-enterprises as a career option. This report approaches the issue of self-employment and MSE development in a non-traditional manner and makes proposals for a number of particularly innovative approaches.

The target groups of these social marketing and training strategies are identified as follows:

- The emerging self-reliant (i.e. graduates from income generation projects and self-employed with family workers.).
- The existing business owners (i.e. micro-enterprises with employees and "front runners").
- Youth in schools.
- The ministry of cooperatives and small enterprise development(DEPKOP/PPK)

An extensive review of the Indonesian mass media, the current social marketing programmes, and the existing training programmes and manuals was undertaken. It is concluded that there have been significant efforts made in the programme development for social marketing, and that a wide range of comprehensive training programmes and materials have been developed. However, it is also found that there are several areas in which further improvement should be made.

- There is a general lack of interest in micro-enterprises as a career option.
- Despite the existence of many MSE development programmes, relatively few people have been reached.
- Not many training materials are readily available to clients.
- There has been little research into actual training needs.
- There are insufficient linkages with the private sector.
- There exists no formal coordination mechanism between/among programmes and organizations.

- There is a lack of formal evaluation of the current programmes in terms of their effectiveness.

Given the above areas of concern, it is noted that finding the right solutions will not be an easy task. It is necessary to build on past achievements and to find new and innovative ways to address the difficulties encountered in previous programmes. Therefore, the author recommends the implementation of a programme which aims at increasing the desirability of self-employment as a career option, making available training materials more available, providing assistance to existing programmes and supplying an information service to clients. In order to achieve the above objectives, the author recommends the following four inter-related projects.

Project # 1

- Research into the social, gender and cultural barriers to the development of micro enterprises and the training needs of the existing micro businesses.

Project #2

- Social marketing through various forms of mass media in order to promote the concept and desirability of entrepreneurship, and to cover basic enterprise concepts.

Project #3

- Mass training for the existing entrepreneurs through mass media and particularly through the effective linkages of current programmes.

Project #4

- The establishment of a support system in order to ensure the effectiveness of programme components through setting up the following physical facilities:
 - Small Enterprise Information Centres to be run by DEPKOP/PPK
 - Small Enterprise Promotion Councils at the national and regional level in order to provide the linkages with the private sector.

2.2 *Comments on the study*

These proposals are very welcome and should help promoting the entrepreneurial spirit and facilitate access to training by large numbers of people. It may be noted that the author proposes the establishment of a National Small Enterprise Council as well as regional councils. This proposal is in line with the proposal made in the previous report (regional councils added), although it is not clear whether the councils will have the same functions as the proposed Forum. On the other hand, the authors propose that private sector membership in the councils be at least 30%.

The report presents a few weaknesses. First, as in the previous report, it assigns most of the responsibility for the four projects to DEPKOP/PPK. Second, it implies that the information centres will be fully subsidized: this is not in line with current thinking on the need for the providers of business services and information to be financially sustainable. Finally, many will question the offer of information services in isolation to other business services, training and even financial services (although some specialists prefer to have financial services separate from business services). All these issues will be further discussed in Part C of the report.

3.0 A Strategy for Developing a Vocational Training for Self-Employment Programme in Indonesia.

3.1 Findings and recommendations of the study

Vocational training for self-employment is relatively new. However, it is expected to play an important role in the reorientation of the Indonesian work force. Given the continuing population growth, the employment prospects of much of the future labour force lies in self-employment and micro enterprises.

In preparing his report, the consultant made use of the following underlying assumptions:

- In the foreseeable future, most employment opportunities will be created by informal sector micro enterprises and self-employment.
- An enabling business environment is a pre-requisite to any effort for small business promotion.
- Training does not create jobs, although training can enhance the capacity to take advantage of emerging economic opportunities.
- The principal weakness of vocational training in Indonesia is its remoteness from market reality and its limited interaction with enterprises and entrepreneurs.
- Any training methodology to be used in Indonesia cannot be simply imported from overseas: it must be adapted to the Indonesian context.
- Vocational training is unduly expensive and inefficient. Ways need to be found to reduce training costs.

The consultant collected information from the following sources of vocational training: the Ministry of Education and Culture; the Ministry of Manpower; the Ministry of Religious Affairs; and DEPKOP/PPK. He also collected information from existing private sector vocational training systems. The total training capacity available in both the public and private sectors is impressive. However, its effectiveness and the relevance of the training programmes can be greatly improved.

The findings of this consultancy report show that the current Indonesian formal vocational training is characteristically lengthy, expensive, and theoretical. Its programmes are not designed to meet the needs arising from market realities. In addition, the students of the vocational institutions are often not motivated to pursue skilled vocations. On the other hand, informal vocational training (for example in the form of traditional apprenticeship) is generally market oriented, easy to access and inexpensive. However, it has its own disadvantages such as low technical levels, weak pedagogical methods, and modest contributions toward the improvement of productivity.

The report first notes that there is a broad general agreement that reducing the role of the public sector and increasing private sector participation is fundamental to the success of self-employment and small business development. It also notes that vocational training institutions pay little attention to the training needs of those seeking self-employment, although there is an un-used capacity to do so. Vocational training offered by these institutions is not market-driven or demand-oriented. Under these circumstances, the author recommends two approaches to vocational training to promote self-employment and small business development.

The first approach is referred to as the "dual system approach" (*sistem ganda*), meaning an approach based on the existing informal dual training models which have daily demonstrated their effectiveness.

The second approach is referred to as the "link-and-match approach", meaning that training should be linked to enterprises needs, and matching training to employment opportunities. The application of the "link-and-match" approach includes both downstream linkages with enterprises as well as upstream linkages with a very specific group of entrepreneurs: the prospective self-employed. These two approaches are further described below.

- a) The Link-and-Match approach for self-employment focuses on the identification of people with significant self-employment needs, motivation and potential as well as on the design of vocational training that can facilitate all the stages of the self-employment process. There are three key stages where intervention can facilitate self-employment: the stage prior to training; the stage during training; and the stage after training.
- b) The Dual System approach or enterprise-based training includes a wide range of training methods such as apprenticeship, traditional apprenticeship (*magang*) on-the-job training (OJT), secondments and attachments. In the Indonesian formal vocational training, these methods have not been used extensively; however recent evidence shows that they are successfully used in the informal sector and private sector. Therefore, the formal vocational training institutions should incorporate these methods into their programmes. However, the challenge is that these methods need to be modified so that they can effectively facilitate self-employment.

Finally the report proposes a five year programme comprising: a research component; and the implementation of eight pilot projects through selected vocational training institutions and programmes. The proposed methodologies draw on both the dual system approach and traditional apprenticeship training, and apply these "enterprise-based" training techniques within an

expanded concept of "Link-and-Match". In the proposed Link-and-Match concept, emphasis is given to expanded access for those with particular needs, ability or wish to become self-employed. This programme seeks to answer the following main questions:

- Are enterprise-based training methodologies an effective approach to vocational training for self-employment?
- Do Indonesia's vocational training systems have the institutional capacity and flexibility to adopt vocational training for self-employment programmes?
- Can the operational requirements of these programmes be largely met through expanded private sector participation and the mobilization of existing under- used vocational training capacity?

The consultant answers by the affirmative the above three questions. He proposes a number of models for vocational training to promote self-employment and small business promotion. Various options are discussed under each model.

3.2 *Comments on the study*

The main weakness of the report is the lack of concrete operational measures to apply the proposed models. However, the approaches and methodologies proposed should form a good basis for initiating concrete vocational training programmes. It will also be useful to take into consideration similar proposals made in the other reports, since most of the other SEMED reports also touch on the issue of training. It may be noted that, as stressed in these other reports, the consultant suggests that DEPKOP/PPK be the coordinating agency for vocational training activities but should not itself be involved in training.

4. **A Strategy for Developing a Programme for Delivery Mechanisms in Indonesia.**

4.1 *Main findings and recommendations of the consultancy report*

Despite the growing interest in SEMED and the development of small enterprises on the part of the Indonesian government, donor agencies and NGOs, long-term political commitment has not yet developed. This report is particularly concerned with the leadership capability of DEPKOP/PPK in the policy review for SEMED and the development of programmes. The report includes two main parts: a review and assessment of existing delivery mechanisms for self-employment and small business development; and a draft project document based on the consultancy findings

The consultancy report identifies seven delivery channels which will cooperate in the implementation of six intervention strategies covering 20 delivery mechanisms. It does not propose new delivery channels, but rather describes new adjusted roles they could play in implementing the SEMED programme. The programme focusses mostly on interventions at the district level, taking into consideration the administrative structure of the country.

The seven delivery channels are identified as follows:

- 1) Technical staff and facilities provided by such ministries as DEPKOP/PPK, the Ministry of Agriculture, the Ministry of Industry, the Ministry of Planning, the Ministry of Finance, etc.
- 2) The local level bodies representing these Ministries: KUDs, BAPPEDAs, BUPATIs, KANDEPKOPs as well as other district-level government bodies.
- 3) Sub-bank financial institutions, loans and savings associations, etc, which could be funded by BUMN contributions.
- 4) Non-governmental organizations.
- 5) Community-based organizations such as self-help farmers groups in the P4K programme.
- 6) Private sector organizations (KADIN branches) and individual business people.
- 7) Universities.

Several recommendations as to how partnerships can be built among these channels are provided in the report as follows:

- 1) It is important to provide appropriate incentives to partners in order to motivate them to more actively participate in government programmes.
- 2) The SEMED programme should have a strong market orientation. It is also recommended that programme planning and market analysis should be conducted with flexibility at the district level. In order to facilitate this, a strategic alliance between the district managers of DEPKOP/PPK and Bupati (the district-level planning body) is needed.
- 3) Business development consultants hired for the programmes should ideally operate in the same manner as in the private sector. In other words, they are expected to recover their own salary and operational costs.
- 4) NGOs should be provided with a solid business training. However, there are some associated problems as to the possible conflict between the conventional NGO values and business values. Traditionally, NGOs have had a strong social orientation and promote communal values. Thus, profit making and individualism inherent in business development may be resisted by certain NGOs. Similarly, the staff members of NGO's may not have aptitude in business management.
- 5) KADIN--the umbrella organization which brings together about 200 producer associations and representatives of medium and small firms--should be encouraged to work in the SEMED programme. Their cooperation will be particularly useful in the area

of marketing. KADIN can also assist in the development of entrepreneurs networks and associations.

- 6) The Indonesian university should play an important role in the following areas:
 - Human resource development for the SEMED field staff.
 - The examination of SEMED business opportunities in collaboration with BUPATIs and BAPPEDAs.
 - The evaluation of SEMED projects.
- 7) The importance of sub-bank and non-bank financial intermediaries should be formally recognised in the development of SEMED. To achieve this objective, the SEMED project team should lobby Bank Indonesia and the Ministry of Finance for not regulating the quasi-formal and informal financial institutions which provide small loans to SEMED in Indonesia.
- 8) The access of SEMED producers to credit should be improved through channeling the government BUMN funds into LEDUs. For example, these funds can be used as:
 - revolving funds;
 - local loan guarantee funds;
 - underwriting of the operational costs of LEDU (Local Enterprise Development Unit) at the provincial level; and
 - provincial development funds for SEMED producers.
- 9) The SEMED programme should develop a co-operative relationship with community-based organizations such as Self-help farmers groups in P4K programme of the Ministry of Agriculture.
- 10) Based on the analysis of the identified delivery channels, the report proposes six intervention strategies and 20 delivery mechanisms for their implementations:
 - i) Efficient Financial Supply.
 - strategies focusing on BUMN Funds;
 - provincial revolving funds;
 - local loan guarantee funds.
 - ii) Improved Access to Finance.
 - improved KUD (village unit cooperatives) savings and loans units;
 - strengthening and expansion of LDKPs;
 - linkage services to financial intermediaries.

- 1 - (iii) Marketing / *marketing/alliance*
- business opportunity identification;
 - marketing systems;
 - improved product distribution arrangements;
 - product development.
- iv) Improved Programme Integration
- stronger district leadership;
 - improved programme hands-offs;
 - HRD for selected DEPKOP/PPK staff.
- v) SEMED Business Consultancy Services
- business development advice;
 - business brokerage services;
 - SEMED information dissemination.
- 2 - (vi) Building SEMED partnerships.
- strengthening the delivery capability of NGOs;
 - developing and resourcing LEDUs;
 - developing and resourcing SEMED networks and associations;
 - linking government agencies with other delivery channels.
- leading to credit*

The consultants' report also includes a draft project document based on the proposed approach, strategies and areas of intervention. It provides various options on possible ministries which could host the project (BAPPENAS, DEPKOP/PPK, The Ministry of Finance, the Ministry of Industry or the Ministry of Agriculture, BAPPENAS being given the preference). The project has four immediate objectives, the three main ones being: the improved management of self-employment and micro enterprise development in the districts of 5-8 provinces; a professional and commercial involvement by the rural cooperatives in each district (KUD Mandiri Inti) in the development of existing and new self-employment and micro businesses; and delivery of competent business consultancies by partner NGOs and the private sector.

4.2 Comments on consultancy report

This consultancy report proposes an approach which is in line with current thinking and best practice in three important areas. First, the approach clearly focusses on the development of local capacity - particularly that of the KUDs at the district level- to deliver support and services to SMED enterprises. Second, the approach aims at integrating all types of services required by MSEs, including the integration of both financial and non-financial services. Finally, the approach seeks the involvement of the private sector in MSE development at the local level.

However, the recommended approach contains an inherent weakness which may prevent the establishment of a long-term and sustainable local capacity for MSE development: it uses the same government structures at both the national and local levels as the main conduits for the delivery of financial and non-financial services, assuming that a change in working procedures and the establishment of alliances among the above structures will remove past constraints

preventing them from performing their functions in an effective and efficient manner. Thus, the proposed approach is basically at odds with current thinking based on the establishment of non-governmental bodies using, to the largest extent possible, commercial principles in dealing with MSEs, and capable of achieving a sufficient level of financial sustainability. Such sustainability is particularly important at a time when budgetary constraints, brought about by the current economic crisis, will prevent heavy government budgetary contributions for the development of the MSE sector.

5. Strategies for developing a programme for integration of financial and non-financial services in Indonesia

5.1 *Main findings and recommendations of the study*

This report starts by reviewing the most likely sources of business finance for SMED clients. These are: the KUDs, the non-bank financial institutions known as Lembaga Dana Kredit Pedesaan (LDKP), smallholder credit banks known as the Bank Perkredian Rakyat (BPR) and the Bank Kredit Desa (BKD) of Java and Madura. Bank Rakyat Indonesia (BRI), through its unit system, is by far the largest supplier of financial services in the rural and urban areas, but they do not target micro enterprises.

All of the above suppliers of finance have special and common features. Some require collateral, some do not (LDKP and BKD), some are satisfied with informal collateral (KUD), while others require a combination of formal and informal collateral (BPR). Most institutions concentrate on working capital loans, predominantly for business expansion and survival. Most LDKP borrowers are women. Collectively, the institutions have over 20,000 active service points throughout the country.

The main problems faced by these financial institutions are: low manpower capabilities; underdeveloped savings mobilization services; insufficient staff for full-time operation; weak supervision capacity; many KUDs are inactive; and BPRs target larger loans, often for consumption purposes.

The author next discusses the issue of linking financial and non-financial services. He recognizes that the offer of non-financial services is more complex and results may only be expected in the longer term. It is unreasonable to expect a clear relationship on return of funds invested between the two types of intervention. He suggests that non-financial services should be limited to basic, low cost interventions to be provided through structures that have very low overhead. KUDs would seem to be the most promising structures capable of linking financial and non-financial services, and facilitating access to finance by both members and non-members (e.g by facilitating linkages with banks). However, the capacity of KUDs is weak and must be strengthened before they can play this role effectively.

The BKDs, KUDs and the ex-LDPKs that have gained BPR licensing are responsive to the business financing needs of micro entrepreneurs. However, many weaknesses prevent them from achieving the outreach required: they only help a very small percentage of all those in need for loans.

The author suggests a few changes in the way credit is provided in order to expand the number of people who could benefit from loans: poor individuals could join self-help groups in order to overcome collateral and minimal loan requirements; establishment of revolving funds within banks; simplifying loan applications around a business plan, and using facilitators to help process the loans; and promoting linkages with the larger enterprises (e.g. through subcontracting) in order to increase the chances for obtaining a loan.

The report makes a number of recommendations for future action: preferred institutional focus; use of BUMN; coordination of MSE development programmes; and increasing cost-effectiveness in the delivery of non-financial services.

The first recommendation relates to the strengthening of model KUDs to become the focal point for MSE development at the district level. The KUDs will develop:

- An information and new project identification section.
- Improved lending and savings mobilization procedures.
- Improved office administration procedures.
- Improved reporting system.
- Training materials to increase manpower capabilities.
- A new position for a multi-skilled technical adviser.
- Criteria for new members selection

The second recommendation concerns the need to undertake research on organizational restructuring, using a selected number of KUDs and NGOs as field laboratories

5.2 *Comments on the study*

While many questions still remain un-answered in relation to the delivery of non-financial services, much progress has been achieved on access to financial services. The ILO has recently published a report on best practice in this area, based on successful experiences initiated in a number of countries as well as approaches developed by various donor agencies and the ILO. The consultancy report does not cover in a comprehensive manner these new innovative approaches. It mostly focusses on well known traditional approaches. For example, the report does not discuss the option of promoting financial instruments other than loans, such as leasing or venture capital. A number of such instruments could be more easily accessible to entrepreneurs and will do away with the need to seek loans.

The report does not either discuss in depth the possible linkages between financial and non-financial services. There are many arguments for and against such linkages, while some new approaches tend to favour these linkages. The report could have benefitted from a more in-depth coverage of this issue.

Finally, the report recommendation to focus on the strengthening of KUDs presents the same weakness as similar recommendations made in previous reports. Questions on the autonomy of KUDs and on their prospects to achieve long-term financial sustainability remain un-answered.

6.0 Business opportunities identification for self-employment and micro enterprise programme in Indonesia

6.1 Main findings and recommendations of the study

The purpose of the consultancy was to develop specific analyses and methodologies to ensure that self-employment and micro enterprise opportunities identified by the SEMED programme deliverers are sustainable in terms of the underlying market potential, local resources, skills availability, etc. Identification of the most promising business opportunities should increase the impact and cost-effectiveness of the programme, considering the limited resources available for this programme.

The consultancy included a review of current business opportunities identification practices in Indonesia. This review concludes that there is a very wide gap between the identification practices used by the various government agencies involved in MSE development programmes and the practices used by banks, specific projects, some NGOs and private intermediaries. More specifically, the review identified the following shortcomings:

- Nation wide programmes are characterized by top-down approaches focussing on target setting (annual number of participants in the programmes) and training as a key instrument. They do not pay sufficient attention to the real business prospects of the entrepreneurs.
- The banks, specific projects carried out in selected provinces and some NGOs screen, on the contrary, the self-employed and micro enterprises with regard to their potential to generate income and profits.
- The private sector is not systematically taken advantage of in relation to its potential contributions to business opportunities identification. There are numerous middlemen, traders and agents who must assess the potential of target groups to engage in specific economic activities for their own interest. Thus, the private sector could be a very good source of information on promising business opportunities.

Based on the above review, the consultancy report outlines the possibilities for the nation wide programmes to approach target groups by economic sub-sector, and to increase the participation of these groups in programme implementation at the local level. The report also discusses a number of operational strategies regarding the involvement of banks, NGOs and the private sector in developing local business opportunities into viable economic activities.

The consultancy report also recommends a number of projects based on the findings of the consultancy. These are briefly described below.

- Establishment of a data base generated by the Economic Census of 1996 for macro level assessment of business opportunities, and development of local data

bases monitoring system by local government agencies in collaboration with local universities.

- Research project to evaluate the impact of on-going or completed nation wide programmes for self-employment and MSE development, including a study on the role played by private intermediaries in business identification and development of target groups.
- Training projects for local government officers to strengthen their capacity to execute sub-sector based local development programmes for the target groups. Another project will focus on improving access to information by local government officers and entrepreneurs with a view to facilitating identification of business opportunities.

6.2 *Comments on the consultancy report*

This report makes an extensive review of international and Indonesian experiences in relation to business opportunities identification (16 Indonesian case studies are discussed and evaluated). However, the report does not provide a concrete operational plan for creating a national capacity for business opportunities identification. It only suggests ways on how this could be achieved. Another weakness of the report is that it does not establish linkages between business opportunities identification and other services required by MSEs. This is an important issue since this should determine who or which structure should be responsible for business opportunities identification. Finally, the consultant also tends to assign responsibility for this task to government officers: as indicated earlier, this may not prove very effective.

7.0 *Women Issues (the role of women in SEMED programme)*

7.1 *Main findings and recommendations of the consultancy report*

Available statistics show that about 60 % of the Indonesian male workers and 68% of the female workers are engaged in economic activities in the informal sector. Between 1980 and 1990, women's employment in this sector increased by 41.8%. As the overall Indonesian work force is projected to increase by 2.4% per year (2.7% for women and 2.1% for men), the informal sector is expected to absorb even more workers during Repelita VI. Therefore, self-employment and micro-enterprise programmes will be an important component of the overall economic plan of the country.

In the Indonesian informal sector, there is a clear division of gender. Women from the lower economic class particularly predominate the street vending sectors. These women have low levels of education or often no education at all. Because of this, their employment opportunities are extremely limited. They are also unaware of their rights as workers and are highly susceptible to detrimental working conditions. Moreover, informal female workers often work as unremunerated labour in their family business. These workers are invisible in the statistics.

The constraints facing women workers are identified as follows: they do not have access to credit; nor do they have sufficient control over their family business. Even as independent entrepreneurs (e.g. as crafts producers), their status is low in the society.

Other constraints come from the recent industrialisation in Indonesia. For example, non-farm workers are increasingly "de-skilled" and poorly paid as they are hired at assembly plants. Finally, their culture and tradition are obstacles as they limit women's business opportunities through gender biases.

Given the above findings, the report presents the following recommendations in order to further integrate women issues into the context of SEMED.

- Considering that a large part of women in the informal sector are employed workers and not necessarily business owners or self-employed, it is important to ensure the improvement of working conditions as well as the generation of employment through business creation.
- Since numeracy and literacy are often prerequisites for business development, it is important to ensure women's participation in development efforts in the area of education and literacy.
- To include awareness raising on gender issues in training programmes for planners and policy makers.
- The institutional capacity of the organizations which work with women should be strengthened.
- Information on women workers should be gathered and disseminated to increase awareness about women's issues. In addition, training and promotional materials which are specifically designed for women should be produced.

The consultancy report also reviews all the previous SUMED reports, indicating for each one how to incorporate women issues in these reports

7.2 *Comments on the consultancy report*

While the report provides a good analysis on the main problems and constraints faced by women engaged in business, and while it makes a number of general recommendations for reducing such constraints, it fails in recommending concrete measures and plans to that effect. Many approaches have been developed to increase women participation in micro and small businesses. However, the author rarely referred to these approaches. Furthermore, one of the most burning issues related to the implementation of MSE development programmes for women is not at all covered by this report. The issue is whether it is necessary to design separate programmes and projects for women-headed MSEs, or whether to include specific women components in general MSE development programmes. There is no consensus on this issue. It would have been useful for the consultant to assess this issue in the context of the Indonesian environment.

8.0 Overall assessment of the seven SEMED reports.

The SEMED reports constitute a major contribution to the understanding of the various issues underlying the promotion of self-employment and MSE development in the Indonesian context. They provide a wealth of very useful information which must be taken into consideration in any future programme or project for MSE development. They all present strengths and weaknesses. However, the weaknesses are probably due to the fact that they have been prepared in the early nineties when new thinking and approaches on how to best promote self-employment and the MSE sector were just starting to take shape. Parts B and C of this report will attempt to correct the shortcomings of these reports by incorporating the most recent approaches and best practice for self-employment and MSE development, in line with SEMED original objectives.

