Development of Small and Medium Enterprises and Their Access to Finance: The Story from Indonesia

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Abstract

Based on secondary data analysis and a review of key literature, including official reports and other publications from government and non-government organizations on credits development for SMEs in Indonesia, the main aim of this paper is to examine two related issues. First, recent development of credits from formal sources, i.e. banks and other non-bank financial institutions for SMEs in Indonesia. The main questions here are whether all credits schemes special designed for SMEs have reached the majority (if not all) of existing SMEs in the country, and if not, what have been the main constraints? Second, government policies to improve access to formal finance for SMEs. The main questions here are: have the policies been effective in supporting financially SMEs, and of not what are the main constraints, or if yet what lessons could be drawn.

INTRODUCTION

From a worldwide perspective, it has been recognized that SMEs play a vital role in economic development, as they have been the primary source of job/employment creation and output growth, not only in developing but also in developed countries. Based on a survey of country-studies in the 1990s, Tambunan (2009a,b) shows that there were 12 million or about 63.2 per cent of total labor force in the United States of America (US) worked in 350,000 firms employing less than 500 employees, which considered as SMEs. They, often called the foundation enterprises, made up more than 99 per cent of all business entities in the country, and they are the core of the US industrial base. SMEs are also important in many European countries. In the Netherlands, for instance, they accounted for 95 per cent or more of total business establishments. As in the US, also in other industrialized/OECD countries such as Japan, Australia, Germany, French and Canada, SMEs are an important engine of economic growth and technological progress.

In Indonesia, since the New Order era (1966-1998) up to now, the government has been supporting the development of SMEs with various programs. Among those programs, providing credit schemes has been the most important element of Indonesian SMEs development policy.

Based on secondary data analysis on SMEs (performance and constraints) and a key literature review, the main aim of this study is to examine the development of SMEs in Indonesia and to discuss the Indonesian experience with efforts to give more access to credits for the enterprises.

PERFORMANCE OF INDONESIAN SMES

Historically, Indonesian SMEs have always been the main players in domestic economic activities, accounting for more than 99 percent of all existing firms across sectors (Table 1) and providing employment for over 90 percent of the country's workforce, mostly women and the youth. As explained before, the majority of SMEs are MIEs, and this category of SMEs is dominated by self-employment enterprises without wage-paid workers. In 2009, for instance, the share of these tiny enterprises in total SMEs or in total SMEs plus LEs is about 98.88 percent. They are scattered widely throughout the rural areas, and, therefore, are likely to play an important role in helping to develop the skills of villagers, particularly women, as entrepreneurs (Tambunan, 2009a,b).

Table 1

Total enterprises by size category in Indonesia, 2000-2009 (000 units)

Size category	2000	2001	2003	2004	2005	2006	2007	2008	2009
MIEs & Ses	39,705	39,883.1	43,372.9	44,684.4	47,006.9	48,822.9	47,720.3	52,327.9	52,723.5
Mes	78.8	80.97	87.4	93.04	95.9	106.7	120.3	39.7	41.1
Les	5.7	5.9	6.5	6.7	6.8	7.2	4.5	4.4	4.7
Total	39,789.7	39,969.9	43,466.8	44,784.1	47,109.6	48,936.8	49,845.0	52,262.0	52,769.3

Source: State Ministry for Cooperative and SMEs (www.depkop.go.id) and Indonesian Central Bureau of Statistics (BPS) (www.bps.go.id)

MAIN CONSTRAINTS FACING INDONESIAN SMES

Based on government data from a national survey (BPS) on MIEs and SEs in the manufacturing industry, the main constraints faced by MIEs and SEs in the manufacturing industry in Indonesia. Surprisingly, data in this table does not suggest that all surveyed producers consider the lack of capital as their most serious business constraints. Those facing capital constraints are primarily MIEs that are located in the rural or backward areas where the access to financial credit from banks or various existing government-sponsored SME credit schemes is either minimal or absent. Consequently, these MIEs depend fully on their savings, funding from other relatives and credit from informal lenders for financing their daily business operations. Majority of the sampled producers use their own money to finance their businesses, with the share of 82.41 per cent and 68.85 per cent of the total sampled MIEs and SEs, respectively. Only very few producers borrow money to finance their business, about approximately 2.9 per cent and almost 1.8 per cent of the total sampled MIEs and SEs, respectively. They borrow money not only from bank or other formal non-bank financial institutions, but also from informal sources.

The reason for such diversification in sources of capital is mainly because formal credits they received are often not enough, so they also borrow money from their relatives or friends. [1]

Table 2

Number of SEs and MIEs in the manufacturing industry by main obstacles in Indonesia,2005

	Ses	MIEs	Total
Have no serious obstacles	46,485	627,650	674,135
Have serious obstacles:	192,097	1,862,468	2,054,565
-Lack or high prices of raw materials	20,362	400,915	421,277
-Marketing difficulties	77,175	552,231	629,406
-Lack of capital	71,001	643,628	714,629
-Transportation / distribution obstacles	5,027	49,918	54,945
-High price or short supply of energy	4,605	50,815	55,420
-High labor cost	2,335	14,315	16,650
-Other main constraints	11,592	150,646	162,238
Total	**238,582**	**2,490,118**	**2,728,700**

Source: Tambunan (2009a,b).

[1]There are various reasons why most of MIEs and SEs in Indonesia have limited or no access to formal credit, such as lack of valuable assets to be used as collaterals, their unfeasible businesses from the banks perspective, and their informal way of doing businesses (i.e. not well organized activities or businesses without a well developed structure of organization and a good management system). SME finance in Indonesia, however, had some institutional development successes in the years up until the 1997/98 Asian financial crisis. These successes included the development of a comprehensive set of institutions serving all levels of the market. But, the financial institutions concerned were less efficient and comprehensive and they faced certain difficulties even before the crisis. Many of the financial institutions were financially and structurally weak, was manifest in high transactions costs and limits on their penetration of the market. The overwhelming number of MIE and SEs was not served.

Table 3

Sources of Capital of MIEs and SEs in the Manufacturing Industry in Indonesia, 2005 (% of total sampled enterprises)

Source of capital	MIEs	SEs
Own Money	82.41	68.85
Borrow	2.86	1.75
Own money and borrow	14.73	29.40
Total	100.00	100.00

Source: BPS (www.bps.go.id)

Table 4

The Origin of Loans in Manufacturing MIEs and SEs in Indonesia, 2005
(% of total sampled enterprises)

Origin of loan	MIEs	SEs
Formal Sources		
Bank	54.54	15.62
Cooperative	5.57	3.83
Ventura capital	1.63	1.34
Non-bank institutions	4.75	3.06
Informal Sources		
Family	12,61	11.21
Friends	23,64	44.35
Others	14,24	28.35

Source: BPS (www.bps.go.id)

INDONESIAN EXPERIENCES WITH SMES CREDIT POLICIES

Based on many studies[2], a general picture on sources of financing SMEs in ASEAN is the following:

(1) SMEs draw financing primarily from internal funds and the informal sector. Formal sector financing makes up less than 25% of funding needs. Or, about 75-90% of ASEAN SME rely on internal savings, retained earnings and borrowing from family, friends and informal money lenders as opposed to the 3-18% which have access to formal sector finance (banks, capital markets, venture capitalists etc);

[2] E.g. RAM Consultancy Services Sdn Bhd (2005), and Malhotra, et al., (2006)

(2) the rate varies by member economies. For example, only 12% of SME in Indonesia had access to bank financing while in Singapore, it is estimated between 20 to 49% (from various sources). In Malaysia, 47.3% of SME had access to bank funds compared to 32.4% that relied on internal funds and 11% from family and friends;

(3) many banks and non-bank institutions in ASEAN are generally keen to lend to SMEs as they realise that on a portfolio basis, SME loans provide higher returns and lower risk compared to large corporate loans. However, these funding institutions face several impediments in financing SMEs;

(4) governments in ASEAN have generally been supportive of SME development by initiating various financing programs and support measures in various forms: e.g. interest rate subsidies, grants, credit guarantee schemes, loan quotas, export financing, development finance institutions, specialized institutions, etc.;

(5) there are many constraints that have made these governments' programs and support measures have not been successful. The constraints include: lack of coordination of governments' development policies or their ad-hoc implementation, lack of legal and regulatory framework to provide the right support infrastructure to facilitate SME lending by the formal sector, lack of protection for creditors and enforcement of collateral rights, lack of commercial dispute settlements and arbitration, archaic laws which are not business friendly, lack of fiscal incentives for SMEs, strict prudential regulations which restrict flexibility of banks and unduly complex administrative procedures, and lack of a consistent definition or enabling law for SMEs;

(6) banks and other formal non-bank financial institutions have difficulties in providing credit to SMEs, which include lack of information on SMEs as potential lenders (while, on the other hand, high cost of obtaining information on SMEs), lack of staffs with skills to understand and evaluate SMEs, high costs of credit monitoring, and lack of supporting facilities/infrastructure;

(7) difficulties faced by SMEs in accessing bank financing are including banks' insistence on collateral, lengthy and tedious loan processing (in some banks, the process from approval to drawdown could take several months), stringent documentation requirements, complicated procedures in applying for loans that include from government

schemes (many SME entrepreneurs/owners are not formally educated nor have the resources to help them with bank procedures), high interest rates, lack of required documents (e.g. financial data/reports, business plan), lack of knowledge about financial assistance schemes, banking services and financial institutions that SMEs can take advantages of, lack of collateral, not all MSMEs are considered feasible (market prospects are not promising) or they are well considered as feasible businesses but not bankable, and limited service coverage of financial institutions

(8) Indonesia and the Philippines have well over 200 and 900 bank institutions respectively including to SMEs. There are also numerous non-bank financial institutions such as finance companies, credit & leasing companies, cooperatives and thrifts, credit unions etc that are involved in SME financing;

(9) common commercial credit programs initiated by the public sector and implemented throughout ASEAN include: interest subsidies, credit guarantees, insurance schemes, loan quotas, export financing, and promissory notes (Thailand). These programs are delivered to the SME either via private bank and non-bank institutions such as cooperatives and associations and/or state-owned bank institutions and government line agencies.

In Indonesia, the banking sector is divided into two groups, namely commercial banks and rural banks. Further, the first group of bank consists of conventional commercial banks and Sharia commercial bank. Whereas, the rural bank also consists of conventional rural bank and sharia rural bank. As of March 2010, there were 2,015 banks with 17,903 offices with the following specifications: 121 conventional commercial banks with 12,933 total offices; 1,718 conventional rural banks with 3,718 offices; 8 sharia commercial banks with 934 offices; 25 sharia business unit of commercial banks with 299 offices; and 143 sharia rural banks with 266 offices

Financial service providers for SMEs in Indonesia are not only banks but also non-bank institutions.[3] Banks are (1) rural banks: Bank Kredit Desa (BKD), BRI Unit Desa, Bank Perkreditan Rakyat (BPR), and (2) commercial banks. Non-banks can be formal as well as informal institutions. Formal institutions are: saving and loan cooperatives (KSP), saving-loan unit (USP), cooperative/KUD, pawnshop (*Perum Pegadaian*), state-owned companies (BUMN) initiated Partnership dan Environment

[3]Sources are from e.g. from BI (2010a,b), Rahayu (2005), Lestari (2007), Wijono (2007)

Supporting Program (PKBL) (e.g. *Program Kemitraan* Bank Mandiri, max. Rp 20 juta for 3 years with 6 per cent interest rate), Village Credit Fund Institute (LDKP), District (*kecamatan*) Credit Agency, Indonesian Export Financing Institute/LPEI), Venture Capital (2004: 61 companies). Whereas, non-formal institutions are Baitul Maal Wa Tanwil (BMT), Multi finance/leasing company, *Lembaga Swadaya Masyarakat*/NGO (KSM and LSM), *Lembaga Ekonomi Produktif Mandiri* (LPEM), Saving and Loan Village Economic Unit (UESDP), profit sharing from state-owned companies (BUMN), *Arisan*, Grameenbank model of financing (e.g. Bakrie Microfinance Indonesia: loan for business capital max Rp 1 million/year/person without collateral), credit union, others run by NGOs, Foundations, and religious institutes, and informal money lenders.

Next figures and tables show the growth of SME credit in Indonesia. In the history of financing SMEs in Indonesia, only Bank Rakyat Indonesia (BRI) has the success story which is also international recognized.[4]BRI was established in 1968 as a state-owned agricultural development bank with the following facts: (1) now it has: 18 regional offices (and 16 regional audit offices) from Banda Aceh (Aceh region) up to Papua, 422 branches, 471 sub branches, 4,652 BRI units, 447 Cash offices, 517 *Teras* BRI, 4,861 ATMBRI, and e-banking facility; (2) today BRI's Unit Desa system is the largest and one of the most successful microfinance institutions in the world. The growth of BRI is regarded as the beginning of Indonesian rural banking; (3) as per 2010 about 56.8 per cent shares owned by the government and 43.2 per cent by public; (4) BRI units primarily serve small savers and borrowers in rural areas. BRI's lending program does not specifically target those below the poverty line, but rather the working poor who have viable economic activities; (5) BRI's unit system focuses on one lending product: microcredit to micro business entrepreneurs, and a few deposit products, namely, simple passbook savings accounts, time deposits, and demand deposits. The lending part of the business is non-targeted and is available to any creditworthy customer for any kind of productive enterprise; (6) in 1984, only 14 percent of the units were profitable; two years later, 72 percent were. The entire unit system became profitable in 1986; (7) by 2003, BRI was providing services to about 3.1 million small borrowers with average outstanding loans of US$540 and 30 million small savers with average accounts of US$108. Loan expansion is more on commercial/business activity. As by December 2010, total loans: US$ 28.39 billion (with total deposits US$37.76 billion); (8) BRI was reorganized into four strategic business units in 1997. The Micro-banking Unit provides microloans in rural areas, the

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[4]Sources are from Malhotra (2004), Malhotra, et al., (2006); Maurer (1999); Patten, et al.(2001); World Bank (2004); and Rachmadi (2010).

Retail Banking Unit is responsible for BRI branches providing full banking services and lending to SMEs, the Corporate Unit makes large corporate loans, and the Treasury and Investment Unit handles treasury functions; (9) even though the unit system's microcredit is non-targeted, borrowers must provide sufficient collateral to cover the value of the loan, usually in the form of titles to land, but they can also pledge buildings, motorcycles, or other property; and (10) at least 80 percent of total business portfolio for MSME loan (2010), and by sector: 44 percent in small trade, 18 percent in agriculture, 2 percent in small industries, and 33 percent in services and consumption (2005).

In response to the fact that most SMEs (especially MIEs and SEs) in Indonesia have problems with collateral, Indonesia established Credit Guarantee Corporation (CGC) with the Presidential Instruction (*Inpres*) No. 6/2007 of Real Sector and SMEs Development Policy on June 2007, which mentions the task to strengthen credit guarantee system for SMEs. This *Inpres* backed up by Presidential Regulation (Perpres) No. 2/2008 of Guarantee Corporations and Regulation of the Ministry of Finance (MoF) No. 222/PMK.010/2008 of Credit Guarantee Company and Credit Re-guarantee Company. The main aim of CGC is to help SMEs which: do not have any or not enough collateral, or have collateral but no formal license (for instance: the land certificate) (BI 2010a,b).

SME credit guarantee system in Indonesia has two levels, i.e. national level and provincial level. At the national level, there are two companies to provide technical assistance to SMEs, namely PT ASKRINDO and PT JAMKRINDO. At the regional level, it called regional CGC provided by e.g. PT JAMKRINDO Jatim (regional credit guarantee company in East Java Province) for SMEs in the province of East Java.

PT ASKRINDO provides two types of services: (1) credit guarantee: bank and non-bank credit guarantee, counter bank guarantee, and regional credit guarantee; and (2) credit insurance: trade credit insurance, surety bond, customs bond, and reinsurance. PT JAMKRINDO with the main aim to provide credit guarantee services to SMEs including government program and commercial credit, has various SMEs credit Guarantee products: micro credit guarantee, guarantee for construction, goods and services procurement loans, commercial credit guarantee, counter bank guarantee, multipurpose credit guarantee, guarantee for distribution, islamic financial guarantee (Kafalah), loan program credit guarantee (KUR). PT JAMKRINDO has various products: micro and small credit guarantee, multipurpose credit guarantee, credit guarantee for construction, and goods and services procurement, contra bank guarantee.

Stakeholders of the CGC are (1) Indonesian Bank Central, i.e. Bank Indonesia (BI) which provides facilities and regulations, (2) insurance institutions (e.g. PT. ASKRINDO, PT. JAMKRINDO, other insurance institutions) which provides technical assistance, re-guarantee services, investment, (3) banks (as potential investors or customers).

Until today, the Indonesian has several government-sponsored SME credit schemes:

(1) *Kredit Ketahanan Pangan & Energi* (KKPE):

- aim: to secure food and energy
- purpose: loans for working/investment capital
- for: farmers through farmers association/ cooperative
- interest rate: 5%-7% p.a
- period: max 5 year

(2) Kredit Pengembangan Energi Nabati dan Revitalisasi Perkebunan (KPEN-RP)

- aim: to support development program of energy based on plantation commodities
- purpose: loans for working/investment capital
- for: farmers through farmers association/cooperative
- interest rate: 5%-7% p.a
- period: 13-15 years

(3) Kredit Usaha Pembibitan Sapi (KUPS)

- aim: to support financing seed breeding of cow
- purpose: loans for working/investment capital
- for: farmers through farmers association/cooperative
- interest rate: 5%-6% p.a.
- period: max 6 years

(4) Kredit Usaha Rakyat (KUR) (see Table 19 and Figure 4)

- aim: to help financing feasible but not bankable MSMEs
- purpose: loans for working/investment capital
- for: individual producers/owners of MSMEs and cooperatives
- interest rate: 14% (KUR retail)-22% (KUR micro) p.a.
- period: max 10 year

The SME credit scheme KUR is guaranted by insurance companies (70%), i.e. Perum Sarana Pengembangan Usaha (perum SPU) and PT. Asuransi Kredit Indonesia (PT. Askrindo). The scheme is 100 per cent financed by commercial banks: BRI, Bank Mandiri, BNI, BTN, BUKOPIN, Bank Syariah Mandiri, and 13 regional development banks (BPD), i.e. Bank DKI, Bank Nagari, Bank Jabar Banten, Bank Jateng, BPD DIY, Bank Jatim, Bank NTB, Bank Kalbar, BPD Kalsel, Bank Kalteng, Bank Sulut, Bank Maluku and Bank Papua.

Table 5

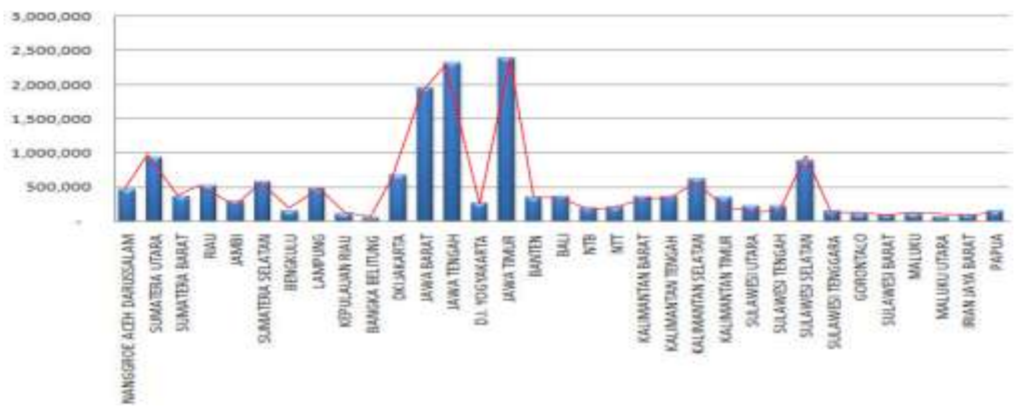
Realised Distribution of KUR through state-owned banks (BUMN) 2008 –2010

Bank	Credit (Rp trillion)				Total debitors (000)				Average per debitor (Rp million), 2008	
	2008		2008 - Dec 2009	Up to June 2010	2008		2008- Dec. 2009	Up to June 2010		
	Nov	Dec.			Nov.	Dec.			Nov.	Dec.
BNI	1.2	1.2	1.5	0.2	8.98	8.95	11.6	1.8	129.49	129.99
BRI	8.6	9.2	12.8	3.9	1,511.0	1,615.98	2,316.6	546.2	5.69	5.69
Mandiri	1.1	1.1	1.5	0.2	36.97	37.0	36.8	0.6	30.56	30.88
BTN	0.2	0.2	0.3	0.5	0.98	1.0	2.5	1.0	161.10	160.27
Bukopin	0.6	0.6	0.7	0.1	2.95	2.9	3.1	0.7	212.23	211.68
BSM	0.3	0.3	0.4	0.1	5.96	5.7	4.3	0.4	55.69	57.19
BPD	-*	-	-	0.5	-	-	-	6.5		
Total	12.0	12.6	17.2	5.4	1,566.9	1,671.6	2,374.9	557.1	7.67	7.55
				13.6**				1,400.0**		

Notes: * no data available;** up to December 2010.

Source: *Deputi Bidang Pengembangan dan Restrukturisasi Usaha*, BI (www.bi.go.id), Ministry of State-owned companies (Bisnis Jakarta, Monday, 3 January 2011: 2), BI (2009), Kompas newspaper (B&K, Monday, 16 March 2009: 18).

Figure 4
Distribution of KUR by Province, November 2009



Source: quoted from *Grafik* 4.18 in BI (2009).

CONCLUSIONS AND RESEARCH AGENDA

In Indonesia, small and medium enterprises (SMEs) have made significant contributions to the country's economy especially in terms of employment, formation of GDP and development of manufactured export. Development of these enterprises is considered as an important element of poverty alleviation policies in Indonesia, as they are the main sources of incomes for poor households. For these reasons, the Indonesian government has been giving supports to the enterprises through various programs, with credit schemes as the main important element of Indonesian SME development policy.

However, as in many other developing countries, the development of SMEs in Indonesia is not without many constraints, including their lack of access to finance. Many studies on these enterprises in Indonesia show that one main reason that most of them do not have access to bank credits is lack of collateral. So, most of SMEs in the country finance their activities by their own money or borrowed from informal sources.

Based on secondary data analysis and a review of key literature, including official reports and other publications from government and non-government organizations on credits development for SMEs in Indonesia,

The main aim of this paper was to examine two related issues. First, recent development of credits from formal sources, i.e. banks and other non-bank financial institutions for SMEs in Indonesia. The main questions here were whether all credits schemes special designed for SMEs have reached the majority (if not all) of existing SMEs in the country, and if not, what have been the main constraints? Second, government policies to improve access to formal finance for SMEs. The main questions here are: have the policies been effective in supporting financially SMEs, and of not what are the main constraints, or if yet what lessons could be drawn.

It has been shown in this paper that the Indonesian government has been implementing a variety of credit schemes special designed for SMEs, with the most recent introduced one is KUR. This KUR scheme can be seen as the response of the government for SMEs with collateral problems. Official data also show that total credits for SMEs in Indonesia tend to increase annually.

However, such evidence could not answer the question: whether all those credit schemes ever introduced for SMEs have been effective. This question should be answered by the SMEs ever used these government-sponsored credit facilities. Therefore, there is a need to do a research based on field surveys to examine the effectiveness of the schemes. A credit scheme can be said effective if the business performance of SMEs using that scheme has been significantly improved, and for this, no evidence is available.

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