



Unleashing Small Business Growth

The Asia Foundation Experience in Indonesia



The Asia Foundation



The Asia Foundation

The Asia Foundation is a non-profit, non-governmental organization committed to the development of a peaceful, prosperous, and open Asia-Pacific region. The Foundation supports programs in Asia that help improve governance and law, economic reform and development, women's participation, and international relations. Drawing on nearly 50 years of experience in Asia, the Foundation collaborates with private and public partners to support leadership and institutional development, exchanges, and policy research.

With a network of 17 offices throughout Asia, an office in Washington, D.C., and its headquarters in San Francisco, the Foundation addresses these issues on both a country and regional level. In 2003, the Foundation will provide grants, educational materials, and other resources of more than \$60 million to 22 countries and territories.

Throughout Asia, small businesses are a critical component of local economies. The Asia Foundation has developed an innovative approach to helping small businesses grow — rather than providing direct assistance to firms, the Foundation directs its activities towards improving the business environment, working with grassroots business groups that advocate market reforms, and providing technical assistance to local institutions tasked with implementing reforms. The Foundation has six years of experience implementing such programs in Indonesia and is a leader in the field of building private-sector engagement in policy reform. This approach complements the efforts of other organizations that provide business development services or financial services to the small business sector. Building on the lessons learned in Indonesia and adapting the framework to suit local needs, The Asia Foundation is in the process of developing significant programs directed at the small business community in Bangladesh, Nepal, the Philippines, and Cambodia.

Businesses employing fewer than 20 people employ roughly 90 percent of the population in Indonesia, a statistic similar to that of other developing countries in Asia. Traditionally overlooked by economic development strategies that emphasized the creation of large and often state-owned companies, small businesses have garnered increasing recognition in recent years for two primary reasons. The first is their ability to generate employment — thereby reducing poverty — with limited capital. As large, well-connected firms continue to founder in the wake of the Asian financial crisis, small businesses have absorbed the unemployed and played a fundamental role in ensuring the economic survival of many families. Small businesses are important for growth, as well. The presence of a dynamic private sector made up of all sizes of business is an important indicator of a healthy economy.

In much of Asia, however, small businesses operate in an environment where state-owned enterprises or well-connected large companies continue to be granted privileged access to resources, procurement contracts, and regulatory concessions. Small businesses, in contrast, face a heavy burden of restrictive regulations, levies, and licenses. They bear tremendous financial costs and must allocate considerable amounts of time to obtain the multiple licenses that are required to operate legally. Moreover, these local regulations are frequently amended, and this constant state of flux leads to new opportunities for corruption. Sometimes the problems are unintentional, but still costly, for small businesses. Poor governance in some countries produces regulations and procedures so obtuse that entire industries of middlemen spring up to expedite the processes. Even when institutions do not formally exclude them, small businesses owners may find themselves on the outside looking in. For example, cultural barriers prevent many from approaching lending institutions, even those that exist to serve small borrowers.

FOSTERING GROWTH IN INDONESIA

The Asia Foundation is a nonprofit, nongovernmental organization dedicated to the development of a peaceful, prosperous, and open Asia-Pacific region. Working out of 17 offices across Asia, the Foundation sponsors a wide array of programs that support the reform process by strengthening local partners who actively advocate greater openness, greater transparency, and greater participation. These programs fall into the broad areas of governance and law, economic reform and development, women's participation, and international relations.

In Indonesia, the Foundation has been responding to the real and pressing needs of small businesses since 1996. The Partnership for Enterprise Policy Reform program, funded by USAID, works to improve the business environment by broadening private sector participation in government decisions on small business policy. The program is also enabling greater access to credit at the local level through a better functioning financial system. Lastly, the Foundation works to increase the availability of relevant technology and information to and among small and medium enterprises (SMEs).



Ibu Rasmidar and Ibu Emmy, Pontianak Association

EMPOWERING ENTREPRENEURS

Rasmidar and her husband Wahid fled their home during the ethnic riots in Kalimantan (Borneo) in 1999. As a young single woman, Rasmidar learned to weave baskets and other products, but she and her husband had worked as rice traders. Returning to Pontianak, her home town, without any savings, she fell back on this earlier skill.

Barely scraping by on what she could earn weaving and selling, Rasmidar approached the local small business association for help. The Pontianak Association, founded with assistance by The Asia Foundation, is very active in helping its members to market their products through local trade booths, bulk selling to department stores, and even tradeshows in Malaysia and other parts of Indonesia. They helped her find buyers and, combining her skills as a weaver with her husband's knowledge of trading, she was able to save money and expand her business.

Two years later, Rasmidar subcontracts to 30 women, many of them refugees themselves. She sells the bulk of her products to buyers in neighboring Malaysia, where she receives nearly US\$1 more per piece than in the domestic market, and she has bought land to build a showroom for her products, all developments that she attributes to support she received from the business association.

The Pontianak Association is also working to formalize its members' businesses. They have requested that The Asia Foundation provide technical assistance to the local licensing office. Following this assistance, Rasmidar hopes to get a business license which will allow her to access credit and expand further.

The Asia Foundation has succeeded in making substantial improvements to small business policy and its implementation:

POLICY REFORM THAT BENEFITS SMEs

Accomplishments:

- Simplified licensing of SMEs through local one-stop licensing and registration, resulting in a dramatic increase in the formalization of small businesses in some areas;
- Supported the drafting of anti-monopoly legislation that includes state-owned enterprises and continues support of advocacy for the bill's passage;
- Convened the first independent National SME Owners Congresses in Indonesia in 1997, and supported subsequent congresses in 1998, 2000, and 2002;
- Facilitated the creation of more than 60 independent, regional small business associations across the country; these associations represent more than 1,500 small businesses in a wide range of sectors;
- Initiated and institutionalized the mechanisms that incorporate input from these business associations into local policy processes;
- Identified and reduced special levies and other costs imposed on SMEs;
- Ensured stakeholder input on a bill to regulate microfinance institutions for the first time;
- Deregulated the *halal* certification process (which formally identifies food that is allowable for consumption by Muslims). Advocacy by local business associations led to the retraction of a decree requiring labeling by a monopoly office that was placing an onerous burden on SME food producers;
- Convened dialogues between the regional and national business associations and big retailers on consignment practices that resulted in new payment practices to better meet the needs of SME producers;
- Created an advocacy fund to support local efforts to improve the policy environment. The fund has disbursed \$80,000 over 4 years to more than 40 business associations; and
- Conducted an unprecedented 10-city survey of local business environments for SMEs that was designed to reveal the strengths and weaknesses of each city and to promote healthy competition for the best business environment. A second survey, currently in process, has received substantial support from Indonesian companies, which have contributed \$20,000.

IMPROVED FINANCIAL SERVICES DELIVERY

Accomplishments:

- Worked with the Asian Development Bank to reduce the number of government-subsidized credit schemes for SMEs from 17 to 3, thereby increasing the transparency of the system, reducing the scope for corruption and political interference, and reducing unfair competition to sustainable microfinance institutions;
- Supported audits of 100 microfinance institutions, allowing regulators to improve supervision and restructuring of the sector;
- Supported best-practice certification by microfinance practitioners to increase the sustainability of lending institutions;

INCREASED ACCESS TO MARKETS AND INFORMATION

Accomplishments:

- Created an Internet portal linking small business associations in order for SMEs to access a variety of services and information; and
- Conducted research and advocacy on ways to expand SME engagement in eCommerce.

A NEW APPROACH TO ACCELERATING SME GROWTH

The majority of SME programs focus on business training or the provision of credit, approaches designed to overcome perceived weaknesses in the sector. This conventional wisdom is not without some basis in reality. Small businesses often operate in environments where capital is scarce and where knowledge of best-management practice is limited. Nevertheless, this view ignores that the SME sector across Asia includes a rich array of entrepreneurs who survive despite business environments that are often hostile to their business interests. Time and resource-intensive interventions at the firm level cannot be fully effective when the market itself is heavily distorted, as in many Asian countries.

The Asia Foundation has found that helping to create a regulatory environment in which SMEs can operate unencumbered by structural and political barriers is a far more effective way to ensure their sustainability and growth. A country need not conspire to create a large SME sector to generate economic growth. Rather, a healthy, growing economy is characterized by a healthy small business sector, where impediments to growth – which usually lie in the policy and regulatory environment – are eradicated.

The Foundation's approach is also distinguished from other SME programs in that it explicitly addresses the fundamental political interests that may impede or propel reform, rather than relying on technical assistance to government officials to improve the policies and practices that have been shown to block economic growth. Officials, bureaucrats, and cronies with a vested interest in existing arrangements have frequently

A LEADER IN POLICY REFORM

The Asia Foundation SME policy advocacy program is the largest ever conceived and implemented by a foreign donor in Indonesia. The Foundation's political economy approach to the improvement of SME policies was unprecedented when it was introduced in 1996 and, since that time, the donor community has recognized the effectiveness of the Foundation's approach by incorporating elements of it into their SME programs. Some donors have even provided direct support for components of the Foundation's SME work.

For example, the Asian Development Bank has funded associated research activities and Swisscontact has contributed occasional financial support.



stymied strategies that overlook the political dimension of policy reform. The wave of democratization and decentralization taking place in many Asian countries enables local communities, including the small business community, to engage policymakers in new and important ways, applying pressure that may be able to overcome resistance in the system.

To address the fundamental political interests that often impede reform, the Foundation uses a strategy that commissions research, identifies problems, and produces market-oriented policy recommendations. Then, relying on its connection with local interest groups, the Foundation brings together proponents for reform, from both within and outside government in dialogue sessions. All efforts have local ownership, and the program works to create sustainable indigenous constituencies based on local communities and their concerns. To strengthen advocacy activities, the local media are often involved in the dialogue sessions to ensure that government commitments made at meetings are on the record and widely broadcast.

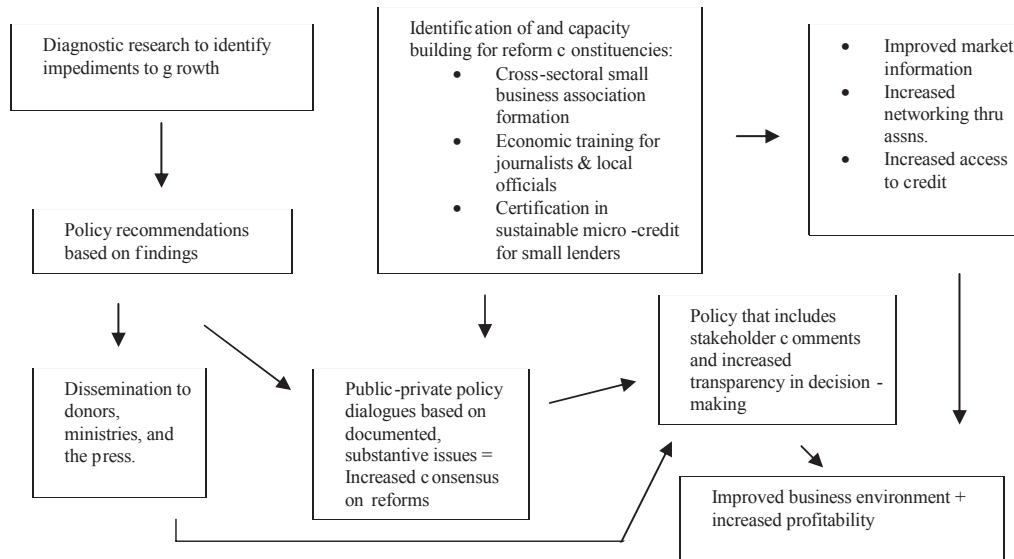
Years of direct experience and the substantial successes of the program speak to the effectiveness of the Foundation's philosophy.

POLICY REFORM: CREATING A MORE COMPETITIVE ENVIRONMENT FOR SMEs

The Asia Foundation strategy is rooted in three mutually supportive areas of activity: convening public dialogues around policy recommendations that emerge from diagnostic research, building constituencies to support reforms as they move through the policymaking process, and providing technical assistance to the agencies and institutions that implement reforms.

TAF Approach to Policy Reform

(yellow = process; blue = outputs; green = goal)



The starting point of the policy reform process is research, often focus groups of SME owners, to measure the impact of existing policies, identify barriers to growth as perceived by the business community, and help formulate a local reform agenda. Research has proven invaluable in ensuring that programs address the priority issues constraining SMEs and in some cases has helped debunk misperceptions regarding SME needs. Foundation studies evaluating the effects of the Asian financial crisis on the SME sector found that contrary to expectations, SMEs were surviving the financial crisis better than many large companies because they were not burdened by foreign-dominated debt. Moreover, many small businesses displayed great agility in switching sectors in response to changing market demand than larger business. Other studies have found that middlemen, often reviled as exploiting small businesses, in fact play a valuable role in assisting SMEs to access markets and gain information to improve their products.

Following the completion of diagnostic research, the Foundation works with a variety of potential stakeholders, including the private sector, reform-minded officials, the media, nongovernmental organizations (NGOs), and universities to build consensus on needed reforms. A key facet of this work is regular public-private dialogue sessions that the Foundation has instituted at both local and national levels. In some cases, Foundation-sponsored research and policy recommendations are presented for discussion. In other cases, small businesses identify areas of concern, such as local infrastructure weaknesses or inefficient licensing practices, and apply for support from the Foundation to convene a dialogue to demand action by their local government. In many cases, the dialogues increase government responsiveness to small business constituencies and produce more conducive regulatory environments.

BUSINESS ASSOCIATION DEVELOPMENT: MOBILIZING FOR GROWTH

When the Foundation began its work with small business in Indonesia, existing business associations involved selected groups of well-connected businesses. These business groups, often organized along sectoral lines, usually advocated behind closed doors for advantageous treatment of their own businesses or industries. The Foundation initiated the establishment of the first independent small business associations in 1997. Today, there are more than 60 small business associations serving more than 1,500 member businesses across Indonesia – from Sumatra to Papua – and they have engaged successfully with local and national government on issues ranging from corruption to monopolies, credit, and relations with large companies.

EXAMPLES OF FOUNDATION SUPPORT FOR ADVOCACY ACTIVITIES BY LOCAL BUSINESS ASSOCIATIONS:

South Sulawesi Business Association. The Asia Foundation supported a policy dialogue on “Monopolistic Practices at the Port of Makassar” in 2000. Speakers from the local parliament and the department of industry and trade discussed the Law No.5 / 1999 on Anti-Monopoly and Unfair Competition. The participants got first-hand information about monopolistic practices of PT Pelabuhan, a state-owned company, at the port in Makassar. Representatives of PT Pelabuhan subsequently took actions to open access to the port, resulting in improved service for SMEs using the port.

Pontianak Small Business Association. Following the example of other associations supported by the Foundation, the Pontianak Association held a workshop with local government officials to demand better service in licensing and registration. The mayor responded by promising that future complaints could be addressed directly to the head of the local licensing office. This licensing office is now receiving technical assistance from The Asia Foundation to improve practices. The head of the association, Ibu Emmy, says a difference is already being felt. “Before, you had to be related to someone high up in the government to be treated correctly,” she says. “Today, all businesses are receiving better treatment.”

Makassar Small Business Association. At a workshop in 2001, the association invited the Head of the City Licensing Bureau in Makassar and Deputy Chairman of the Commission on Licensing in the Makassar city parliament to speak on the local licensing process. The speakers attending outlined inconsistencies between local regulations and mayoral decrees on licensing policy, as well as inconsistencies in implementation. The Head of the City Licensing Bureau encouraged the business association to continue offering recommendations to the mayor. The Asia Foundation is now offering technical assistance to streamline the licensing process.



The Asia Foundation has supported the creation of more than 60 independent, regional small business associations, or Fordas, across the country.

The business associations are initiated by local businesspeople, often after they have enjoyed exposure to other Foundation-supported business associations, and are driven by members' interests. Often run by volunteers, they function essentially as local chambers of commerce, representing the interests of independent small businesses in the principal cities and towns. In addition to their advocacy activities, the associations play an important role in circulating market information and providing networking opportunities. The value of these services is evident in the associations' ability to collect dues: associations receive no operational support from the Foundation for rent or salaries, only technical assistance and grants for policy-related activities.

Every two years, the Foundation supports a national conference that brings together the local business associations from across the country. These conferences give national prominence to the needs of small business by applying their collective political weight to issues of common interest in front of prominent officials from the national, provincial, and local governments. More than 100 SME owners from more than 20 provinces attended the third national conference, held in 2000 in Yogyakarta, as did representatives of central and local government agencies, analysts, the private sector, and the media. The fourth conference, in August 2002, enjoyed even greater numbers. In addition to bringing regional concerns to the capital, the national meeting allows businesspeople from across the country to trade information on markets and technology and to share ideas and experiences on organizing business associations.

The Foundation also created and manages an advocacy fund that receives proposals to fund business association activities related to the local business environment. Business associations apply for funds on a competitive basis, and proposals are judged by a joint group of The Asia Foundation and its partners on the basis of their potential impact and demonstration of cost sharing. Activities supported under the fund include: advocacy on unclear bureaucratic procedures for business licensing, advocacy on anti-competitive behavior by state-owned enterprises which reduces opportunities for SMEs, advocacy on unfair business practices by large retailers, and advocacy on illegal levies that have to be paid by SMEs. Over the past four years, approximately \$80,000 has been distributed to more than 40 business associations.



CHALLENGES FOR WOMEN ENTREPRENEURS

Female entrepreneurs are burdened by the same bureaucratic constraints in the business environment as men, yet they face discriminatory regulatory and informal practices that make starting and expanding a business even more difficult. For instance, obtaining a business license requires that the business owner show proof of a tax identification number. However, regulations provide for only one tax identification number per household, which is automatically given to the husband. Women are also required to have recommendation letters by their spouse or parent, which are not required for men.

While the business associations are not specifically targeted at women business owners, overall, women comprise 20 percent of association membership and several are led by women. The associations are thus able to work on issues of concerns to women business owners, as well as on

genera regulatory issues. The Foundation is supporting this work and is careful to ensure that research on barriers to SME growth includes gender-specific impediments.

While fighting an uphill battle, some discriminatory issues are becoming more egalitarian. Previously, women obtaining a loan using common property as collateral were required to have permission from their spouse. That regulation applies to men, as well, who must also obtain concurrence from their wives. Through advocacy and monitoring exercises, The Asia Foundation is working with small business association members to identify and address such discriminatory practices.

STREAMLINING THE LICENSING PROCESS

Another key policy-reform initiative from The Asia Foundation that is making substantial improvements to Indonesia's business policies has been the revamping and streamlining of one-stop licensing services (OSS) for obtaining government permits. A look at the irregularities in obtaining licenses required for an SME to legally open its doors shows the dire need for such assistance.

INFORMAL PAYMENTS AND DELAYS IN OBTAINING LICENSES

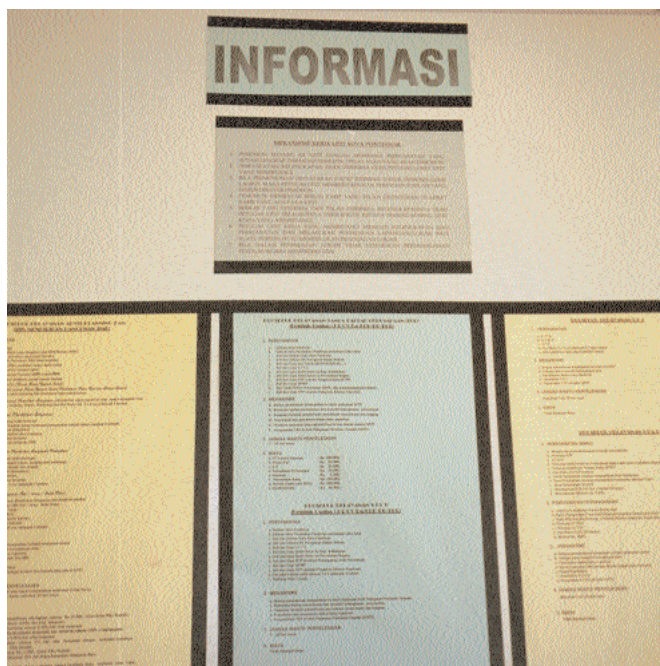
Officials often create artificial delays in processing licenses in order to extract bribes. Information on the official processing time or fee may not be available because of deliberate obfuscation by officials. This chart shows the official processing time and fees for licenses and the actual time and fees experienced by SMEs owners in towns in three different parts of Indonesia.

Type of licenses	Official time required	Actual time spent			Official fee required (rupiah)	Actual fee spent (thousand rupiah)		
		Yogya	Medan	Bandung		Yogyakarta	Medan	Bandung
License for location	Not available	1m	1-3m	2w-2m	Not available	125- 250	120	325
License for building	Not available	1w-4m	1.5 m	No data	Several classification	125	0- 700	500- 2000
License for disturbance	Not available	2d-2m	1.5 m	2w-2m	Several classification	50- 2000	0- 250	500- 770
Registration for trade	5 days	No data	1w-1m	1 w	0	175	No data	200- 750
License for trade	5 days	1d-1m	2w-3m	1w-2m	0	50- 750	0- 75	125- 1000
Registration for industry	14 days	2 d	1w-1m	2d-1m	0	75- 250	0- 10	200- 750

D=day, w=week, m=month.

The Foundation has provided technical assistance to improve the performance of OSS centers in seven cities in Java, making the issuance of permits more efficient and predictable. With the active cooperation of local governments, the Foundation provides a range of capacity building to help existing one-stops increase transparency and reduce processing time. Assistance includes the provision of a private consultant, who performs an organizational assessment, convenes meetings between local SME owners and officials to discuss how to improve services, and drafts recommendations for enhancing the functioning of the one-stop shop. Local officials, local parliaments, SME owners, and the media are also taken on study tours to districts with well-regarded systems for issuing business licenses and permits so that they can be exposed to best practices. Finally, the Foundation provides computer hardware and software to one-stop shops to increase efficiency in business-licensing procedures.

The program has succeeded in a variety of ways. SME owners are increasingly aware of the importance of having the necessary business licenses if they want their business to grow. At the same time, the Foundation has received enthusiastic requests from several local governments for help in replicating the success of OSS centers. In Gianyar, Bali, for example, where Indonesia's first one-stop service center was established, the number of registered businesses grew from less than 16,000 to more than 21,000 in the first five years after its services were improved. During that same period, Gianyar increased local tax revenues by more than 330 percent. The Foundation has been asked to work with the Department of Home Affairs and local governments to spread the lessons learned in Bali to other provinces in Indonesia.



Posting information on official times and fees encourages efficient and transparent licensing.

FINANCIAL SERVICES DELIVERY: EXPANDING ACCESS

The Asia Foundation is also working to improve access to credit needed by small businesses looking to expand. In most countries, entrepreneurs prefer to use seed capital either from personal savings or borrowed from family members. Indeed, a 1999 survey conducted by The Asia Foundation showed that only 17 percent of small businesses in Indonesia had ever used formal credit to launch their operations. However, while most business owners eschew startup capital, constraints on the availability of capital may pose a significant obstacle to the expansion of their operations, despite the availability of numerous subsidized credit schemes.

Indonesia has a relatively well-developed financial system that caters to the needs of micro and small enterprises. The system works particularly well for small businesses on Java and Bali, where financial sector resources have been concentrated to serve these densely populated areas. However, the expansion of microfinance institutions (MFIs) has proceeded faster than the capacity to regulate them. To ensure that microfinance institutions can continue to expand, capacity on both the regulatory and practitioner sides must be increased.

The Foundation is undertaking a number of activities to address these barriers, including:

- Support to Bank Indonesia, the government regulator, to audit small lenders. This effort supplements broader efforts to merge, close, or recapitalize small lenders to ensure a healthier financial sector;



- Provision of grants to microfinance practitioners to obtain World Bank certification in best practice;
- Convening focus groups of microfinance practitioners around the country to consider a draft bill that will initiate prudential regulation of the MFI sector; and
- Undertaking surveys to measure unmet demand for capital at market rates by qualified small business owners, an exercise being undertaken in cooperation with Bank Rakyat Indonesia (BRI), a leading MFI.

USING TECHNOLOGY TO INCREASE ACCESS TO MARKETS AND MARKET INFORMATION

Dynamic entrepreneurs are always seeking ways of expanding their operations. This requires access to information regarding consumer demands and alternative production technologies. Usually, entrepreneurs collect this information from the market. But small businesses in remote locations face higher costs in accessing this information, and these costs may be prohibitive, effectively locking efficient producers out of the market. Information technology makes it possible to reach new markets and lower communications and marketing costs.

The Foundation is helping SMEs to take advantage of these opportunities. Activities thus far include a survey of eCommerce use by SMEs in Southeast Asia. As in the Foundation's general policy activities, this research formed the basis of policy recommendations that are being promoted in public-private dialogue meetings around Indonesia. While the impact on local businesses was discussed, the regional aspect of the survey also allowed policymakers to see how the regulatory environment and adoption rate in Indonesia compares to competitor countries, such as Thailand and the Philippines.

The Foundation is also supporting the development of an SME web portal that will increase access to critical business information and foster ongoing communication between the business associations and their members. The website will disseminate locally gathered information, including changes to local and national business regulations. Having a centralized source of information will offer businesses the additional advantage of comparing differences in regulation across provinces. This online service will also provide information on areas of interest to SMEs, including the local business environment, contact information for association offices and members, relevant market data, and the product information of members in order to create linkages between upstream and downstream producers.

The Asia Foundation is sponsoring a major marketing effort through the business association offices to build the user base of the website and to encourage participants to contribute information and content. In addition, the Foundation is working with government agencies to formulate a process for posting government data and content. The Foundation is also providing grants to local business associations to support the buildouts of their local portal websites, as well as to purchase computer hardware and Internet access.

LESSONS LEARNED: HOW THE ASIA FOUNDATION IS MOVING FORWARD

The importance of the business environment is often acknowledged, yet it is infrequently the focus of programs to assist SMEs. Policy change can be a long-term process that is difficult to fit into the timeframes and the quantitative outputs expected in the development field. But as this program in Indonesia shows, the potential rewards of working to improve the policy environment can be great. With relatively limited resources, reforms can occur that benefit a significant portion of the small business community. Unleashing small business growth by fostering a conducive environment holds out the prospect of significant job creation, and hence poverty reduction.

The Asia Foundation is using its rich experience garnered by this groundbreaking work to advance SME growth in Asia. The specific challenges faced by small business owners obviously differ across (and often also within) countries. However, the approach of grounding programs in solid research, identifying constituencies for reform, and empowering local entrepreneurs to engage in the governance issues that affect their ability to do business has relevance and value for all the countries in which The Asia Foundation works.

The Foundation is careful to adapt this strategic framework to the prevailing political and economic conditions in each country. In the Philippines, the Foundation supports business associations to address problems of corruption and supported passage of the country's eCommerce law, one of the first in Southeast Asia. In Nepal, the Foundation helps business associations form networks to explore points of common interest. In Cambodia, the Foundation provides support to business associations to increase their ability to serve their members' needs, and in Bangladesh, the Foundation is working to improve the business environment in secondary towns through research and public dialogues.

Through these programs and others, The Asia Foundation is making concrete contributions to the livelihoods of small business people and the growth of local and national economies.



The Asia Foundation

Headquarters

P.O. Box 193223
San Francisco, CA 94119-3223 USA
Tel: 415.982.4640
Fax: 415.392.8863
Email: info@asiafound.org

Washington, D.C.

1779 Massachusetts Ave., NW Suite 815
Washington, D.C. 20036-2109 USA
Tel: 202.588.9420
Fax: 202.588.9409
Email: info@asiafound-dc.org

Indonesia, Malaysia

Jl. Adityawarman No. 40
Kebayoran Baru
Jakarta 12160, Indonesia
Tel: (62) 21-7278-8424
Fax: (62) 21-720-3123
Email: general@tafindo.org

www.asiafoundation.org