

SMALL BUSINESS FINANCING

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Abstract

This paper attempts to analyse the development of small and cottage establishments (SCE) in Indonesia. Special attention is given to major characteristics and problems of SCE. The rapid growth of Large and Medium Establishments (LME) since the 1970s has overshadowed the sluggish growth of SCE. Nevertheless, SCE have played a considerable role in generating employment and supporting household income. Indeed various programs have been offered by various institutions (i.e. government, NGOs, universities) to empower SCE, but the results is likely to be marginal either in boosting the growth of SCE or changing the Indonesia's industrial structure.

Why the Small scale businesses need to be developed?

Since 1983, the government has been conducting various de-regulation efforts as means to make a structural adjustment and an economic restructuring. Nevertheless, many people point out that the deregulation in trading and investment will not provide lots of benefits for small and medium enterprises; in facts, the big companies and conglomerates will get the benefits. Empirical studies proved that the increase of added value is not enjoyed by small, medium, and big-scale companies, but conglomerate-scale companies which have workforce more than 1,000 people just enjoy the increase of both absolute and in average added value per companies (Kuncoro & Abimanyu, 1995)

In such constellation, the attention to improve and develop the small and cottage establishments (SCE) in case is based on three reasons. Firstly, SCE industry absorbs a lot of work forces. The tendency in absorbing abundant workforces generally makes many SCE industries also use intensively local natural resources. Above all, since the location of many SCE are lying in a village area, the SCE industry growth would impact positively on the increase of workforce, the poverty dropping off, even distribution in income spreading, and the rural economic development (Simatupang, et al., 1994; Kuncoro, 1996). In the view of the policy aspect, SCE clearly needs more attention because SCE not only provides income for

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a large part of Indonesia workforce, but also stands in forefront in all efforts to eradicate poverty. In village area, the important roles of SCE in offering some additional income (Santee et al., 1994) are a seedbed for industry development and as a complement of farming production for needy people (Weijland, 1999). In other words, SCE also has a function of survival strategy amidst monetary crisis.

Secondly, SCE takes an important role in non-oil and gas export which was in 1990 reached US\$1.031 million or occupied the second rank just below the export of various industry groups. SME (Small & Medium Business) also contributes to export income, even though the SME contribution is far less than a large business contribution (see Table 1). In SME sector, the prime contributors of non-oil and gas export are also manufacturing sector in particular garment, textile and textile products, and shoes.

**Table 1. The development of Non-oil & gas export
According to the business scale in 2002-2006**

Year	Amount (RP billion)					Proportion (%)				
	SB	MB	SME	LB	Total	SB	MB	SME	LB	Total
2002	20.469	66.821	87.290	311.916	399.206	5,13	16,74	21,87	78,13	100,00
2003	20.464	55.394	75.859	305.997	381.856	5,36	14,51	19,87	80,13	100,00
2004	24.408	71.140	95.548	375.242	470.790	5,18	15,11	20,30	79,70	100,00
2005	28.048	82.290	110.338	433.864	544.202	5,15	15,12	20,28	79,72	100,00
2006	30.304	91.896	122.200	485.198	607.398	4,99	15,13	20,12	79,88	100,00

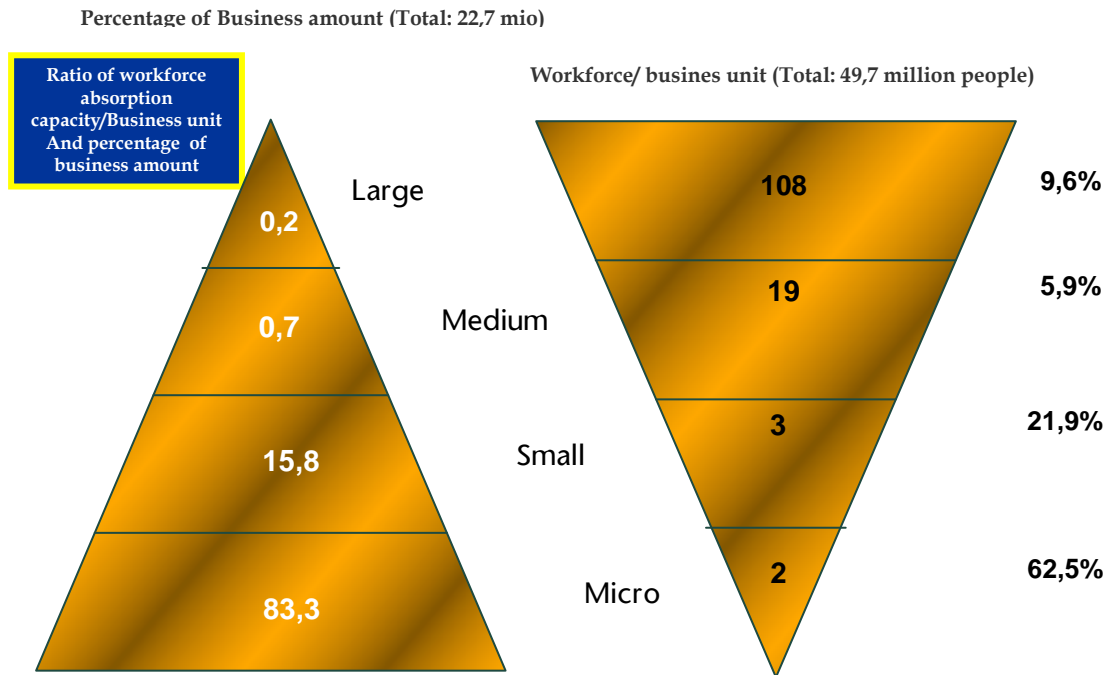
Remark: SB=Small Business; MB=Medium Business; SME=Small & Medium Business;
LB=Large Business

Source: SME Statistics 2005 - 2006

Thirdly, the Indonesia's economic structure that possesses a pyramid shape has popped up an issue of industry dualism. According to the Economic census in 2006 conducted by Central Agency of Statistics, showed from total 22.7 million companies in Indonesia found that the small and micro business dominated both in terms of business unit side (99.1%) and workforce absorption (84.4%), with the proportion for micro business and small business were 2 workforces per business unit and 3 work forces per business unit respectively. On the contrary, large and medium scale industry that their amount of business unit only attained 0.9%, absorbs 15.5% of workforce with the ratio of 19 workforces per business unit for medium business and 108 workforce per business unit for large scale business (see exhibit 1). The pyramid base is dominated by small and medium scale business operating in very competitive climate, low entry barrier, low profit margin, and

high drop-out level. The pyramid-shaped economic structure proven has popped up a concentration and conglomeration issue and being accused of preserving dualism in the national economy.

Exhibit 1. The Indonesia's Economy Pyramid



Source: processed from BPS, *Economic census 2006*

Thee (1993:109) stated that the development of small scale industry is the method that considered has a huge role in the development of manufacturing sector. The development of small scale industry would help in solving unemployment problem as regard technology used is a labour intensive technology, therefore could expand the job demand and business opportunities that in turn could propel the development of village region and area.

Profile and the distribution of Small Business

There are two definition of small business known in Indonesia. First, Small Business definition according to the Law no. 9 year 1995 regarding Small Business explained that small business is the activities of people economy that have a maximum of Rp. 1 billion yearly selling result and posses a net wealth, exclusive of land and building treated as a workplace, a maximum of Rp. 200 million (Sudisman & Sari, 1996;5). Second, as stated by Central Agency of Statistics, small business is identical with small industry and home industry. BPS classifies industry based on the

number of its employees, that are: (1) home industry consists of 1-4 people; (2) small industry comprises of 5-19 people; (3) medium industry works with 20-99 people and (4) big industry consists of 100 people or more (BPS, 1999; 250).

Even so, there are several definitions of Small Business, it seems that small business retains rather a uniform characteristic. First, there is no clear segregation of duty between administration and operation aspect. Most of the small industry is managed by individual who also served concurrently as the owner and company's management, and then uses workers from family and their close relatives.

Second, because small industry has a low access to formal lending institutions so that they tend to depend the business financing on their own capital or other sources such as family, relative, trader, agent, even usurers. Third, most of the small business is characterised by not already having a body corporate.

Forth, in terms of industry group it is seen that almost one third of whole small industry is active in a food industry, beverage and tobacco business group (ISIC31), followed by non-metal quarrying industry group (ISIC36), textile industry (ISIC32), and wood, bamboo, rattan, grass, etc include household furniture (ISIC33). The percentage of each group is approximately between 21% and 22% of all existing small industries. Whilst, small industries which play on paper business industry group (ISIC34) and chemistry (ISIC35) are only in little proportion which is less than 1%.

Whereas, table 2 shows that SCE has a quite important role in manufacturing sector in terms of the number of business unit and workforce absorption capacity, but it is still weedy in contributing an output value. In 2006, 99.3% of total manufacture business unit in Indonesia which is accounted for 3.2 million was SCE business unit. SCE that has workers less than 20 people are able to provide job demand of 60.3% of total work opportunity. However, the contribution of SCE output value to manufacturing industry is only 10.3%. This pattern slightly increases from year to year (2002-2006). Many people work in SCE prove how important the role of IKR in helping to solve an unemployment problem and even distribution of income allotment.

On the other side, in terms of output value, a large medium scale industry provides a dominant contribution. In 2002, large medium scale industry contributed 91.6% of total value output absorbing around 39.9% of total work opportunity, while the business unit aspect only bestowed 0.8% of total existing business unit. In 2006, it contributed 89.7% of total work opportunity, provided job demand about 39.7% of total work opportunity, but only supplied 0.7% of total existing business unit.

According to the latest several studies pertaining to industrial organisation, the modern industry has to face a change either in terms of demand or technological aspects reducing economic scale due to standardisation and mass production (Weijland, 1994: 97-110). This argument was strengthened by Porter (1998: 77-91) stated that currently, the economic map is dominated by cluster which has a definition as a geographical concentration of companies and institutions that interrelated in a certain region. Basically, the industrial cluster is a production group that is highly spatial concentrated on and generally specialised in only one or two main industries.

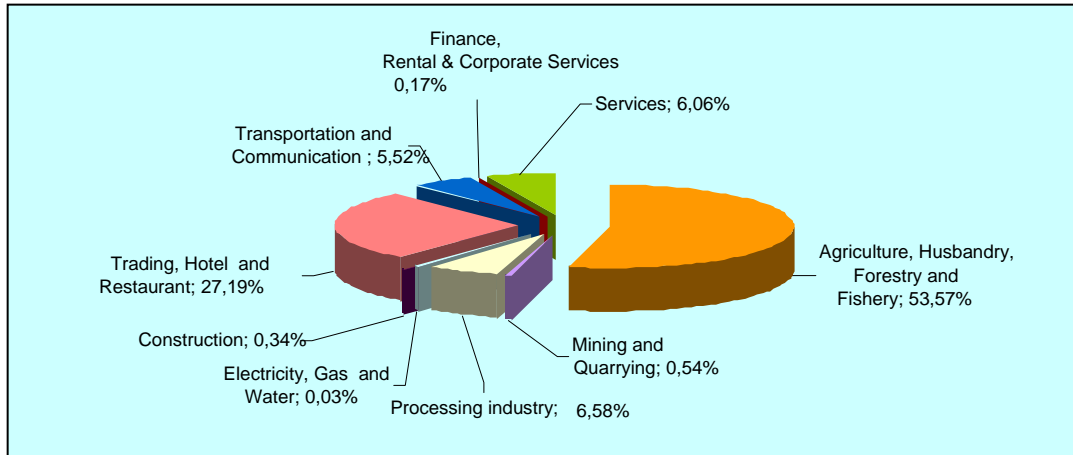
Table 2. The contribution of each type of industry in Indonesia Manufacturing sector, 2002-2006

Type of Industry	Business Unit									
	2002	%	2003	%	2004	%	2005	%	2006	%
Large and Medium Industry	21,146	0.77	20,324	0.76	20,685	0.77	20,729	0.71	23,244	0.72
Small and home industry	2,728,700	99.23	2,641,909	99.24	2,671,660	99.23	2,916,025	99.29	3,184,909	99.28
Total	2,749,846	100.00	2,662,233	100.00	2,692,345	100.00	2,936,754	100.00	3,208,133	100.00
Type of industry	Workforce									
	2002	%	2003	%	2004	%	2005	%	2006	%
Large and Medium Industry	4,364,869	39.93	4,273,880	40.18	4,324,979	39.78	4,226,572	38.14	4,730,125	39.72
Small and home industry	6,566,232	60.07	6,363,565	59.82	6,547,855	60.22	6,856,043	61.86	7,178,990	60.28
Total	10,931,101	100.00	10,637,445	100.00	10,872,834	100.00	11,082,615	100.00	11,909,115	100.00
Type of industry	Output value (billion RP)									
	2002	%	2003	%	2004	%	2005	%	2006	%
Large and Medium Industry	882,476	91.58	838,826	90.68	985,946	90.66	1,088,684	89.36	1,368,638	89.70
Small and home industry	81,160	8.42	86,200	9.32	101,627	9.34	129,613	10.64	157,219	10.30
Total	963,636	100.00	925,026	100	1,087,573	100.00	1,218,297	100.00	1,525,857	100.00

Source: BPS, <http://www.bps.go.id>, various years

SME economic sector that has the biggest proportion of business unit are (1) Agriculture, Husbandry, Forestry and Fishery; (2) trading, hotels, and restaurants; (3) Processing industry; (4) Services; and (5) Transportation and Communications, the growth of each sector recorded 53.57%, 27.19%, 6.58%, 6.06% and 5.52% respectively (see exhibit 2).

Exhibit 2. The proportion of SME economic sectors based on number of Business unit in 2006



Source : State Minister for Cooperatives and SME (2008)

Financing Strategy of Small Business

In 2007, the growth of Small, Medium and Micro Enterprises (UMKM) showed the increase of 23%. Private National Banks recorded as the biggest creditor for UMKM which have proportion of 47% of total UMKM loan. Whilst, the usage of those loans were more allocated for consumption which was accounted for 50% of total lending, followed by working capital usage about 42%, then for investment around 9% (see table 3).

Table 3. The growth of UMKM Loan (Billions of Rp.)

Group of banks	2005	2006	2007	Jan 2008	Growth (06-07)	Share 07
States Banks	122,189	144,935	176,740	172,797	22%	35%
Regional Development Banks	42,462	52,859	67,774	67,508	28%	13%
Private National Banks	176,421	195,326	238,211	235,961	22%	47%
Foreign Banks and Joint Banks	13,836	17,322	20,073	20,658	16%	4%
Total UMKM Loan	354,908	410,442	502,798	496,924	23%	100%
Type of usage						
Working capital	142,633	171,118	204,765	197,067	20%	41%
Investment	33,049	37,147	44,578	43,898	20%	9%
Consumption	179,225	202,177	253,453	255,959	25%	50%

Source: Central bank, *Indonesian banking Statistic* (2008), analysed

In order to optimally grant a small business loan (KUK) to small business enterprises, Central Bank of Indonesia (BI) along with the banking sector have been implementing three basic strategies as follows : First, the application of Minimum Limit loan distribution which is 20% of total loan for all banks, with regards to the January Policy Package 1990 and also providing a liquidity credit facility for financing of some priority sectors namely cooperatives development, procurement of food and small modestly house ownership. Those are conducted in providing Bank Indonesia Liquidity Credit (KLBI) for a Farmer Credit Program (KUT), *KKUD* (a cooperative credit program), and *KKPA* (Agricultural Food Tenacity Loan) and State Logistic Agency (BULOG).

Second, to develop institutionally by expanding banking network, encouraging inter banks cooperation in Small Enterprise Credit (KUK) distribution and building up financial institutions that suit for the need of low income people such as the establishment of Rural Banks (BPR) and Sharia Rural Banks (Sharia BPR)

Third, provide a technical assistance through Small Business Development Project (PPKU), Linking Banks and Self-Help Groups Project (PHBK) and Micro Finance Development Project (PKM). By means of PPUK is expected to be able to change attitude, approach and skill of banks credit officers in handling small business loan. The assistance to the banking is in the form of identification investment opportunities that reasonably financed by KUK or through partnership project between big business and small business. The objective of PHBK is to exert an availability of financial services for Self-Help Community Group (KSM) that has saving and loan activities and its members of small farmers, and small business entrepreneurs in informal sectors. PHBK activities lie on self-supporting principles such as promote savings and then peg those savings to a credit disbursement. Therefore, loan will be given to a certain group if they capable to make some mobilisation of the members savings. PKM objective is to encourage government programmes in increasing income and work opportunities in villages, eradicating poverty, and improving the capability of village institutions. The target of this project is to provide a financing provision to 300,000 micro entrepreneurs in five provinces.

In addition, the government also promulgates a distribution programme of People's Enterprise Credit (KUR). KUR was launched for the first time on 5 November 2007, then for the next three months total KUR which has been disbursed reached Rp.1.7 trillion. The credit amount for this programme is settled exactly Rp. 500 million per debtor with the maximum interest rate was 16% per annum. What's the difference between KUR and the others? Firstly, credit programs which are directed for micro, small, and medium enterprise and

cooperatives are provided along with the pattern of government insurance. The guarantor of KUR credit is the State Business Development Facility Company (Perum Sarana Pengembangan Usaha= SPU), and the Indonesian Credit Insurance (Askrindo). The collateral for KUR which is 70% can be covered by government through Askrindo and SPU and 30% is borne by executing bank.

KUR is clearly designed for handling collateral problems that generally become an obstacle for UMKM to grant a loan from commercial banks. The impediment is whether SPU and Askrindo have coverage capacity to all areas in Indonesia. Are they still willing to guarantee UMKM credit in earthquake region (i.e. Bantul and Klaten) and calamity area (e.g. Sidoarjo, Aceh) as regard the asset values decrease 25-50%?

Secondly, KUR is distributed for productive economy sector with the maximum interest rate of 16% and the amount of the maximum outstanding credit is Rp. 500 million per debtor. The intended productive sectors include agriculture, fishery, marine, cooperatives, forestry, industry, and trading. It seems that this program is commenced to support government program in order to eradicate the poverty and lessen unemployment. KUR Program only engages three state banks, without involving regional government banks (BPD).

However, the critical things that should be taken into account are the business assistance program for UMKM which has being granted the loan. Creditors, especially banks, must possess a business assistance program for UMKM. It is proceeded in order to make UMKM is able to manage a given loan. The assistance program could be performed via cooperation with government, universities, and other related parties.

Conclusion and implication

The article has attempted to analyse the development of SCE (UMKM) in Indonesia. Some proven facts demonstrate that the fantastic and rapid growth of large business since the decade of 1970 had ignored the relatively sluggish development of SCE. Nevertheless, in fact SCE has taken a considerably significant role in absorption of a workforce, exports and supporting a household family income both in cities and villages.

Admittedly, various programs have been offered by many institutions: government, banks, NGOs or universities. However, the benefits from those programs have not been experienced by most of the SCE. This can be seen in any case their problems are not yet completely solved. Partnership programmes and

linkage between large business and small business actually are still in embryonic phase.

In the future UMKM Financing must still be improved considering many UMKM are not able to get loan due to have still not bankable yet. The implication, it is seemingly time to conduct reorientation of UMKM financing by using partnership principle. Intertwined partnership should be based on synergy principle that is mutual need and help each other. Mutual need principle will assure the sustainability of partnership because of the “natural” characteristic and merely not based on “have pity”. Derived from this principle, large business would always invite small business as a partner in progress. Many “Adopted child-parents” pattern are not based on mutual need principle. This is proven by the facts that the business sector of “adopted father” is often totally difference and no upstream-downstream or downstream-upstream linkage with a business sector of small business that treated as an adopted child. The adopted father system in fact is obliged to State-owned companies by separating out 1-5% of their profit, while for big private companies are persuasively to do the same. What happened in real life are : (1) the assistance given by adopted-father business sector is considered in effective because the adopted-father acts like Santa Claus that distributes the assistance funds without caring with a dynamic business of the adopted child (2) The adopted-father also feels that the involved partnership is merely just to fulfil a social mission.

“The Help each other” principle will emerge if large businesses need the existence of small business. Sub contract programme that have been running by Astra Group and Bukaka are examples that intertwined partnership could improve efficiency. Astra conducts a sub-contract of vehicle’s spare parts to small business entrepreneurs in Java. Bukaka also entrusts a making of certain parts of “garbarata” to several small business entrepreneurs. Similarly, national batik tycoons get supply of batik from small scale batik entrepreneur in Jogya and Surakarta.

If both those partnership principles are well-implemented, the partnership would not only “luxurious stuff” in Indonesia, but would become an “essential stuff” as a common relationship similar to the other business relationships. The partnership is not a charity program anymore. As a partner, both sides are standing on the equal position. In turn, by means of partnership is expected there will no more jealousy and social imbalance.

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