

## RECENT DEVELOPMENT OF MICRO, SMALL AND MEDIUM ENTERPRISES IN INDONESIA

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### ABSTRACT

This paper examines the development of micro, small and medium enterprises (MSMEs) in Indonesia. It aims to answer the following research questions. First, how important are MSMEs? Second, what are their main constraints? Third, how was the impact of the COVID-19 pandemic on them? This study adopted descriptive analysis using secondary data. It shows that MSMEs are dominated by micro and small enterprises (MSEs), and accounted for almost 100% of all firms but only contributed an average per year of around 58 % of the GDP. Their main constraints are a lack of capital, and difficulties in marketing and in the procurement of raw materials. During the pandemic, many MSEs were severely affected although it varied by industry. This study has, however, one limitation. Although the study aims to examine MSMEs, the focus is however on MSEs in the manufacturing industry due to a lack of national data.

**Keywords:** MSMEs, MSEs, COVID-19, Manufacturing Industry, Constraints.

**JEL codes:** D22, I25, I26, I60

### 1.0 INTRODUCTION

It is widely stated in the literature that micro, small and medium enterprises (MSMEs) in developing countries are important socially and economically for several reasons, which include: (i) their wide dispersion across rural areas and therefore they are very important for rural economic development; (ii) their ability to absorb a significantly large number of workers; (iii) their role as a place for entrepreneurship and business skill development, especially in rural areas; and (iv) as a source of business opportunities for women. However, their development is hampered by several constraints, and most significant being the lack of access to bank loans and difficulties in marketing (e.g. Tambunan, 2009a,b; Yuhua, 2013; Das & Mohiuddin, 2015; Santos & Moustafa, 2016; Thapa, 2016; Raghuvanshi et al., 2017; Blancher, et al., 2019; Muhammad et al., 2020; Ogundana et al., 2021; Eton, et al., 2021; Eton & Nkamusiima, 2022).

In Indonesia, the definition of MSMEs is set in Law Number 20, 2008. In this law, the criteria used to define an MSME as outlined in Article 6 are net asset value excluding land and building of business premises or annual sales. Under these criteria, a microenterprise (MIE) is a business unit with an asset value of at most 50 million Indonesian rupiahs (Rp) or annual sales of a maximum of Rp300 million; a small enterprise (SE) is a business unit with an asset value of more than Rp50 million up to a maximum of Rp500 million or annual sales of more than Rp.300 million up to a maximum of Rp2.5 billion; medium enterprise (ME) is a company with a net worth value of more than Rp500 million up to a maximum of Rp10 billion, or annual

sales of over Rp2.5 billion to a maximum of Rp50 billion; and a company with beyond that threshold in net worth value and annual sales is defined as large enterprise (LEs). Alternatively, Indonesian National Statistics Agency (BPS) adopts the number of workers as the criteria: MIE: 0–4 persons; SE: 5–19 persons; ME: 20–99 persons; and LE: > 99 persons.

Based on this background, the main objective of this study is to examine the development of MSMEs in Indonesia with the emphasis on the following four issues: (1) the role of MSMEs; (2) their main constraints; and (3) the impact of the COVID-19 pandemic on them. More specifically, this study aims to answer the following four research questions. First, how important are MSMEs in Indonesia? Second, what are their main constraints? Third, how was the effect of the pandemic on their performance?

Methodologically, this study adopted descriptive analysis, using secondary data on MSMEs in Indonesia with the aim to describe recent development of MSMEs in Indonesia and the impact of the COVID-19 pandemic on these enterprises; it is not to identify main determinants of the development by using certain statistic method. The data were obtained from two sources, namely: (i) most recent national data on the development of MSMEs for 2019 from the Ministry of Cooperative and SME (online data); and (ii) data on MSEs in the manufacturing industry for 2020 (National Survey on Micro and Small Industry).

This study is important because it is the first study in examining the development of MSMEs, particularly MSEs, in Indonesia based on the latest available secondary/national data, including examining the impact of the pandemic on MSEs.

## 2.0 LITERATURE REVIEW

The literature used for this study consists of two parts. The first part is literature on the development of MSMEs and their constraints in developing countries. The second part is literature on the impact of the COVID-19 pandemic on MSMEs in developing countries, including available micro-level empirical studies based on primary data in Indonesia.

### 2.1 Development of MSME and Their Constraints

A lot of evidence throughout the world, and especially in low-income/poor countries, shows that MSMEs play a crucial role in addressing the impediments of poverty, inequality, and job creation, particularly in rural areas. They are also an important source of employment or business opportunities for low-skilled women and the youth. Even, in many countries, these enterprises are an important growth engine for GDP and the export of manufactured goods. However, many (if not all) MSMEs, especially MSEs struggle to sustain or expand due to many constraints they face, especially lack of access to bank loans, difficulties in marketing, and limited access to advanced technologies and skilled workers. The majority of MSEs, particularly MIEs in developing countries are operating in the informal sector (e.g. Orlando & Pollack, 2000; Midgley, 2008; Tambunan, 2009a,b, 2018; Yuhua, 2013; Das & Mohiuddin, 2015; Santos & Moustafa, 2016; Thapa, 2016; Raghuvanshi et al., 2017; Blancher, et al., 2019; Maurya & Mohanty, 2019; Athaide & Pradhan, 2020; Eton, et al., 2021).

In the literature on entrepreneurship, it is often stated that the existence or growth of MSMEs in a region reflects the development of the entrepreneurial spirit in that region. Many people

choose to run their businesses for various reasons, e.g. flexibility, freedom, independence, achieving dreams, or earning more money (Orlando & Pollack, 2000). Entrepreneurship is seen as a process leading to the creation of MSMEs (e.g. Akande & Ojukuku, 2008; Lucky & Olusegun, 2012).

But, since the publication of a paper written by Dennis Anderson in 1982 that became famous in the literature on MSMEs in developing countries, the question arises: whether a large number of MSMEs, particularly MSEs, in poor countries reflects the high entrepreneurial spirit or more as a sign of poverty (e.g. Oyelana & Adu, 2015; Thapa, 2016; Rambe & Mosweunyane, 2017; Bortamuly et al., 2015; Hazarika et al., 2016). Even, evidence in several low-income countries suggests that MSEs function more as the 'last resort' rather than as profitable businesses opportunities for the poor: because they are poor or unemployed, they are forced to conduct any kind of activities that can generate some income for them to survive (e.g. Midgley, 2008; Oyelana & Adu, 2015; Lateh, Hussain & Halim (2017).

Unfortunately, this reviewed literature does not provide a theoretical framework that explains why the presence or growth in the number of MSEs in developing countries in general (if not all) is due to poverty, not market opportunities. It also does not explain the relationship between the characteristics of MSEs and poverty. This research tries to fill this gap.

## 2.2 Impact of COVID-19 Pandemic on MSMEs

Economic crises can be defined as unexpected and uncontrollable large fluctuations beyond the acceptable limits of price changes, currency exchange rates, or supplies of commodities that occur within a certain period. A country hit by an economic crisis usually shows sluggish economic growth or even negative growth in its gross domestic product (GDP) (Gallegati et al, 2017; Hadziahmetovic, et al., 2018). Long experience with economic crises in many countries and regions since the 1970s has shown that there can be many primary causes or first triggers for an economic crisis, such as an increase in energy prices happened in the mid-1970s with the sudden and significant increase in international oil prices as a result of the conflict in the Middle East, known as the first oil crisis; or a huge depreciation of a currency against the US dollar (USD) due to a large capital flight, as happened in Thailand, and was immediately followed by Indonesia, the Philippines, and South Korea which eventually triggered a major regional crisis, i.e. the Asian financial crisis in 1997-98 (Bello, 1999; Griffith-Jones and Ocampo, 2009; Claessens, 2011; Hartono, 2011).

In many countries hit by the COVID-19 pandemic in 2020 and 2021, including Indonesia, the economic crisis that followed was generally considered a domestic supply and demand crisis due to the declined consumption and production as a direct result of government regulations on social/physical distance, work, and schools from home, and the necessity for companies in non-strategic sectors to stop their activities. In Indonesia, according to Indonesia's Central Bureau of Statistics (BPS), GDP growth in the first quarter of 2020 was only 2.97 percent compared to the same quarter in 2019 or slowed down by 2.41 percent every quarter when compared to quarters IV-2019.

OECD (2020a,b), in its reports on SME policy responses to the crisis due to the COVID-19 pandemic, explains that the crisis affected many businesses including MSMEs both from the

supply side and the demand side. On the supply side, MSMEs experienced labor shortages because many workers were infected with the virus or had to look after their children because schools were closed, and the movement of people was restricted. The implementation of health protocols as recommended by the World Health Organization (WHO) to stem the spread of the virus by closing schools and universities, cessation of all business activities except sectors considered vital such as energy, finance, transportation, health care, and prohibition of social activities (e.g. weddings, seminars/congresses, and entertainment events), as well as quarantine, have led to an even greater decline in the use of installed production capacities which had a more severe impact mainly because regional or global supply chains were also severely disrupted. As a result, many domestic businesses, including MSMEs, experienced a shortage of spare parts, semi-finished goods, or processed raw materials. On the demand side, MSMEs also experienced a lack of funds due to a drastic drop in demand and income. All these effects were exacerbated because workers were laid off and businesses were unable to pay salaries. The virus's impact could spread to financial markets, which would make MSMEs that relied heavily on bank loans suffer more. According to this report, in general, MSMEs tend to be more vulnerable to this crisis than their larger counterparts mainly due to their higher level of vulnerability and lower resilience associated with their size.

Shafi et al. (2020) surveyed 184 Pakistani MSMEs and the collected data were analyzed with descriptive statistics. It revealed that most of the respondents were seriously affected by the reduction in domestic market demand which led their sales and profit to drop significantly. Apart from slumping demand, many of them were found to be facing other two issues namely financial problems and supply chain disruption. Another important finding from their study is that almost 70 percent of the surveyed businesses said that they were nearing a critical threshold and would not be able to sustain their business if the lockdown lasted more than two months.

In Indonesia, many micro-level studies and case-based reports on the impact of COVID-19 on MSMEs in various regions and sectors were conducted. MSMEs in the tourism sector was the hardest hit, followed by the business lines, such as small shops, restaurants, cafes, and transportation, which were heavily affected by the 'anti-COVID-19 impact' policies which led to drops significantly in market demand and production (Table 1).

**Table 1 Findings from studies and reports on the Impact of COVID-19 on MSMEs**

Source	Impact
Rahman (2020), Santoso (2020),	Since mid-March 2020, 163,713 MSMEs have been seriously affected. As many as 56% due to a decrease in sales, 22% difficulty in capital, 15% difficulty in the distribution of products, and 4% difficulty finding raw materials
Hermansah (2020)	Based on a survey of MSMEs, 96% claimed to have been negatively impacted. As many as 75% experienced a significant decrease in sales; 51 % believe that it is very likely that their business will only last one month to the next three months
Anwar (2020)	Of the 14,238 MSMEs in Serang City, 10,238 were affected. Only 4,000 MSMEs have survived this epidemic
Kompas (2020a)	The decrease in demand for MSME products is expected to decrease by around 60% to 80%. This decrease was caused by a decrease in the number of buyers visiting shops

Sundari (2020)	Many MSMEs in Cimahi City have experienced a decline in sales of up to 80%. Even a large number of MSMEs are forced to lay off their employees. Especially those whose businesses rely heavily on daily production activities are severely affected. Also, export-oriented MSMEs are affected
Nurzaman (2020)	Ms. TarliSutarli is the manager of the Bueuk stamp coffee plant located in Golempang Hamlet, Ciliang Village, Parigi District, Pangandaran Regency. According to her, at normal times her turnover can reach 7 to 12 million IDR per month. Recently, hit by the corona pandemic crisis, she has almost closed her business because her turnover has dropped dramatically from day to day
Burhan (2020).	MSME revenues in the culinary, fashion retail, and beauty services sectors fell during the corona pandemic. The culinary sector experienced a decline in daily income of up to 37%, fashion retail by 35%, and beauty services by 43% percent. Also, food orders at restaurants decreased very significantly by up to 60%. The negative impact of the pandemic was felt most significantly by MSMEs that still ran their businesses offline
Kompas (2020b, c)	By April 2020, there were 212,394 laid-off workers and 1,205,191 workers who were sent home but still paid (not full) from 74430 companies. From the informal sector, the number of workers affected and losing their jobs reached 282,000 people from 34453 enterprises, mostly from the micro and small enterprise category

Finally, Tambunan and Himachalam (2022) in their edited book show research findings in several developing countries including Indonesia, India, Sri Lanka, and Viet Nam which show that the economic crisis due to the COVID-19 pandemic was mainly due to a drastic fall in public demand which has forced many businesses, including MSMEs, close or go bankrupt.

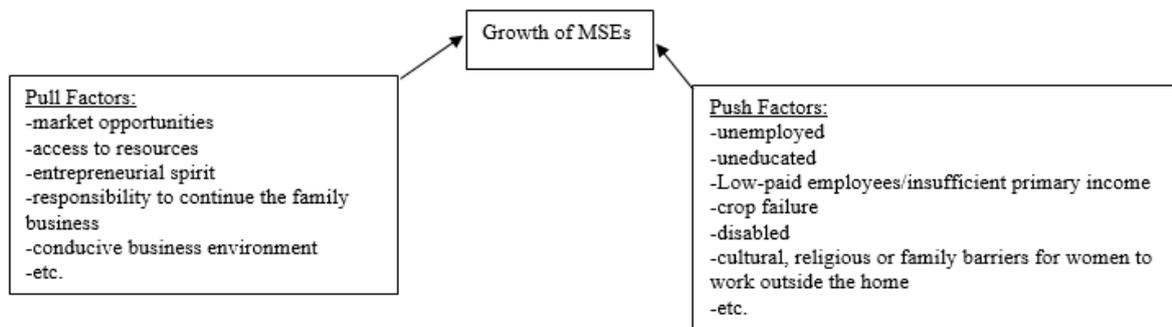
In overall, there is quite a lot of research on the impact of the COVID-19 pandemic on MSMEs. The general conclusion is that due to declining market demand, many MSMEs have stopped their activities. However, from these studies, there is no detailed explanation of how the impact happened, especially regarding the pathways through which the pandemic negatively affected many MSMEs. This study tries to explain this.

### 3.0 THEORETICAL FRAMEWORK

#### 3.1 "Push" versus "Pull" Determinant Factors of the Growth of MSEs

Based on the literature review and direct observations, MSEs in developing or poor countries are very different from MSEs in developed or high-income countries. In poor countries. Most MSEs are low-income or seasonal activities with low productivity and produce very simple and low-quality goods at low prices which are mostly only sold in the local market. The owners or entrepreneurs of MSEs as well as their hired workers mostly are low-educated and come from poor families. Because they could not find better jobs elsewhere, they have no other choice than to do MSE activities (either as a primary or a secondary or a temporary/seasonal source of income) as a means for them to survive. Thus, they are “pushed”, not “pulled” to do MSE activities (Figure 1).

**Figure 1 “Pull” and “Push” Determinant Factors of the Growth of MSEs in Developing Countries**



The theoretical assumption that most (if not all) of MSEs in developing countries like Indonesia are driven by poverty rather than market opportunities (entrepreneurship spirit) is based on the fact that MSEs are very different (especially MIEs) from MEs in many ways as can be seen in Table 2.

**Table 2. Main characteristics of MIEs, SEs, and MEs in Indonesia**

Aspects	MIEs	SEs	MEs
Formality	operate in informal sector, and unregistered	some operate in formal sector, registered and pay taxes	all operate in formal sector, registered and pay taxes
Location	Majority in rural areas	Many in urban areas	Mostly in urban areas
Organization and management	- run by theowner - no internal labordivision -no formal management and accounting system	- In some, run by theowner - labor division in some -formal management and accounting system in some	-many hire professional managers, -many have labor division, formal organizational structure and formal accounting system
Nature of employment	majority use unpaid family members	some hired wage laborers	all hire wage laborers and have formal recruitment system
Nature of production process	degree of mechanization very low/mostly manual - low level of technology	some use advanced machines	many have high degree of mechanization and have access to modern technology
Market orientation	majority sell to local market and for low-income consumers	-many sell to national market and export -many serve also middle to high-income group	-all sell to national market and many also export - all serve middle and high-income consumers
Owner’s profiles	low or uneducated and from poor households	some have good education, and from non-poor households	majority have good education and are from wealthy families
Sources of inputs	majority use local raw materials and use own money	some use imported raw materials, and have access to bank	majority use imported raw materials and have access to formal credit sources
External networks	majority have no access to government programs and no business linkages with LEs	many have good relations with government and have business linkages (e.g. subcontracting) with LEs	majority have good access to government programs and have business linkages with LEs.
Motivation of the owners	to survive	some are looking for profit	all are looking for profit

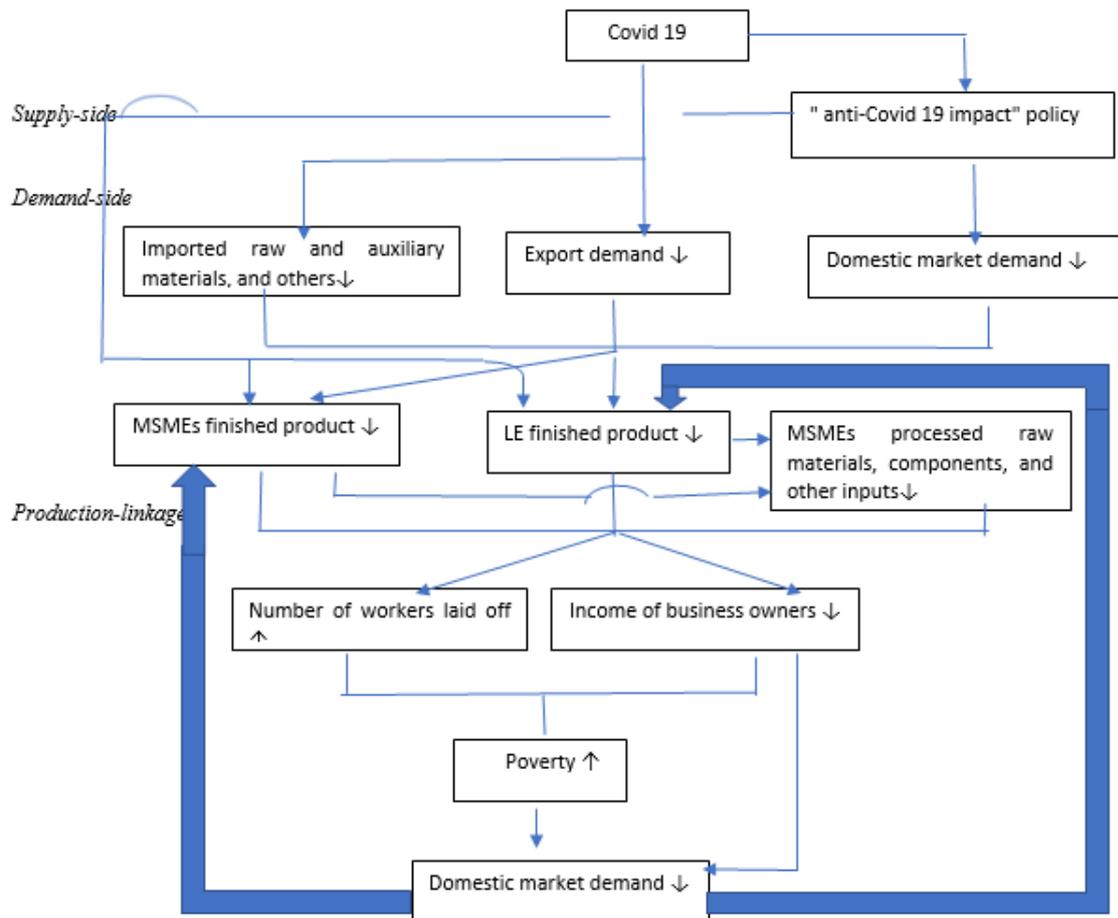
Level of entrepreneurship of the owners	Low	medium	High
Female owner	majority	many	Few

**Source:** Tambunan (2022)

### 3.2 Impacts of the COVID-19 Pandemic on MSMEs: Main Transmission Channels

So far in the past few months, the Covid-19 pandemic has severely affected many MSMEs as well as LEs in Indonesia through four main channels (Figure 2). The first channel was the result of the "anti-Covid 19 impacts" policy which consisted of three main elements: (i) social/physical distancing' (ii) learning and working from home; and (iii) the temporary suspension of business activities in non-strategic sectors. The second element has caused the number of buyers in the local market to decrease dramatically (↓). Thus, this policy element has affected MSME activities on the demand side ('demand effect'). Whereas the third element of the policy has affected MSMEs on the supply-side ('supply effect'). These demand-side and supply-side effects did not happen only in MSMEs manufacturing finished products but also in those that supply processed raw materials, components, spare parts, auxiliary goods, semi-finished goods, and other inputs. The second channel was the decrease in world demand, especially from China, for Indonesian products which caused Indonesia's exports to decrease (ADB, 2020). The third channel was the decline in imports of processed raw materials and auxiliary materials, especially from China, which forced many companies, including MSMEs, in Indonesia which were highly dependent on imports from China to reduce/stop their productions (Kompas, 2020a, b). The fourth channel was the increase in the number of poor people as many employees have been laid off, or their wages were cut, which further led local market demand to decline that hit the MSME business.

**Figure 2 Impact of the Covid-19 Pandemic on MSMEs in Indonesia**



**Multiplier Effect**

**4.0 METHODOLOGY**

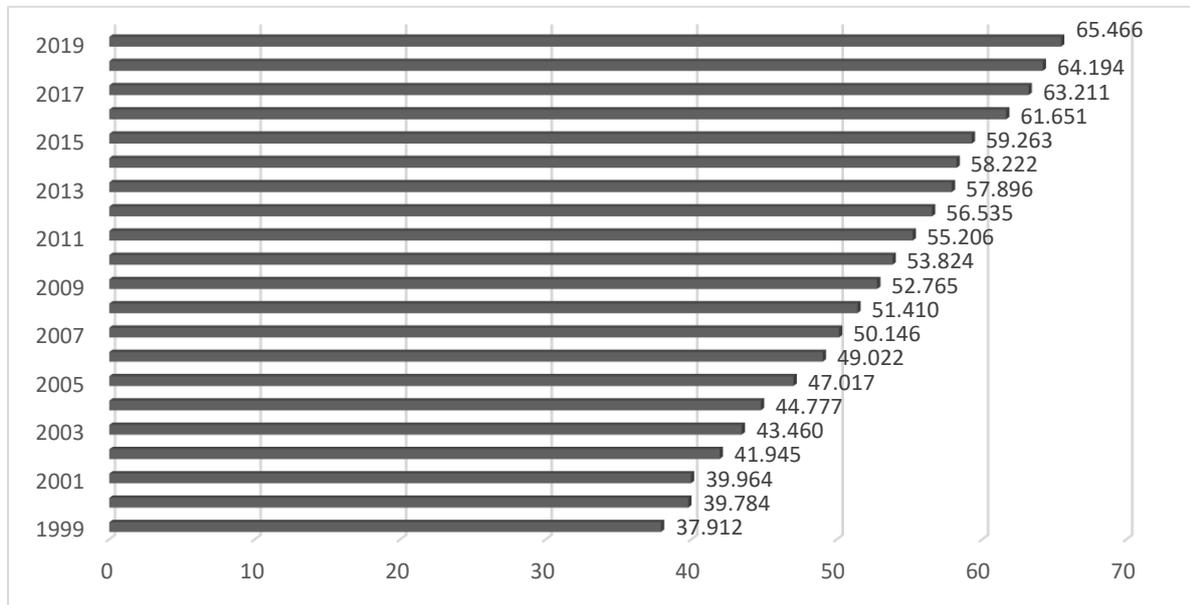
This is a descriptive study that analyzes secondary data from a number of government agencies including data on MSMEs in Indonesia from the Ministry of Cooperatives and Small and Medium Enterprises, and the Central Bureau of Statistics. Meanwhile, data for MSMEs in other countries in the Asia Pacific region was obtained from the APEC Secretariat in Singapore.

**5.0 RESULTS AND DISCUSSION**

**5.1 Development of MSMEs**

One characteristic of the Indonesian economy is that domestic economic activities are dominated by MSMEs; although the ratio of MSMEs to LEs (medium and large enterprises) varies across different economic sectors. For example, in the mining sector, particularly in oil, gas, and coal, where there are mainly LEs, including foreign companies, the ratio is lower than in other sectors such as trade, manufacturing industry, and agriculture. As shown in Figure 3, the total number of MSMEs in Indonesia increased every year from 37.912 million units in 1999 to more than 65 million units by 2019.

**Figure 3 Total number of MSMEs in all sectors, 1999–2019 (million units).**



Source: the Ministry of Cooperative and SME (<http://www.depkop.go.id/berita-informasi/data-informasi/data-umkm/>)

As previously explained, MSMEs in developing countries are dominated by MSEs or more precisely MIEs; and Indonesia is no exception (Table 3). This means that when we talk about Indonesian MSMEs, we are talking about MIEs. Or if it is said that Indonesian MSMEs face various kinds of obstacles such as limited access to funding from formal sources such as commercial banks and difficulties in marketing, what is meant is constraints experienced by MIEs. If Indonesian MSMEs are dominated by MEs, the types of constraints will likely be very different. Another important point is that all MIEs operate in the informal sector and most are carried out by poor households or individuals with low formal education levels who have no access to formal employment with a reasonable income. Thus, as in the theory discussed earlier, the existence or growth of most (if not all) of MIEs is driven by poverty: they are forced to do so simply to earn some money to survive. In other words, the existence of MIEs or the annual increase in number in Indonesia to a larger extent does not reflect the increasing entrepreneurial spirit of the community.

**Table 3 Total MSMEs and Employees by Sub-categories, 2016-2019**

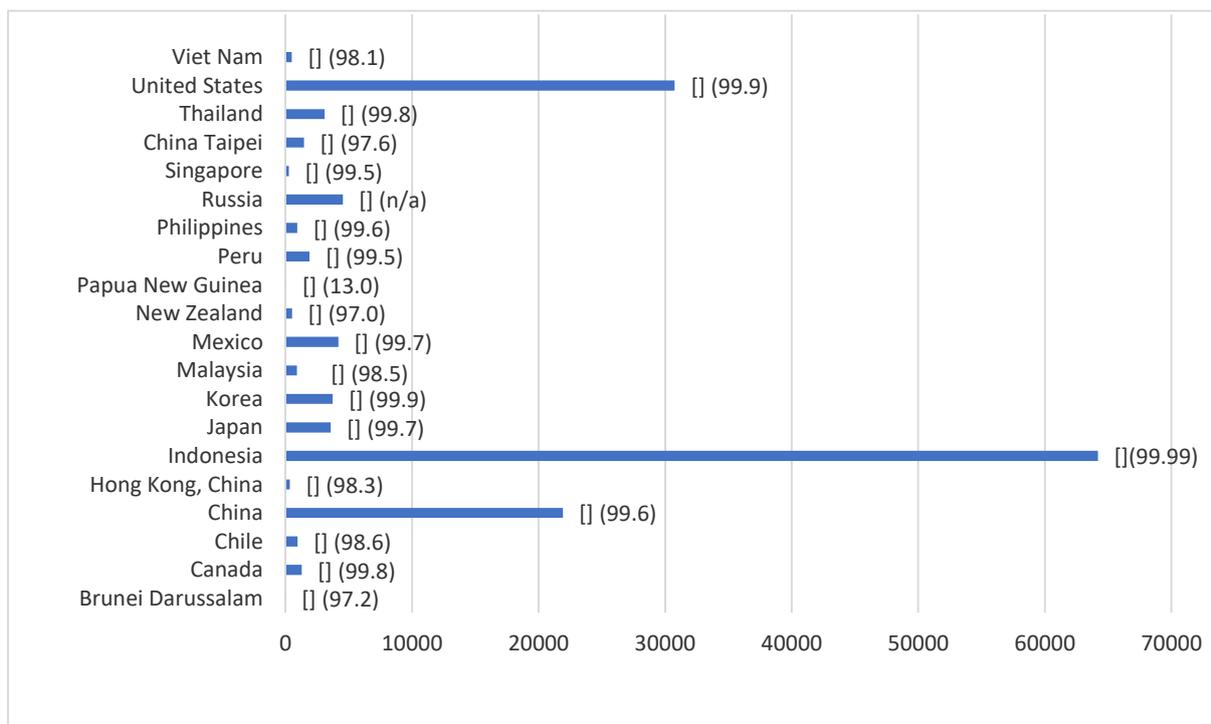
Description	Unit	2016		2018		2019	
		Number	Share (%)	Number	Share (%)	Number	Share (%)
MSMEs	Unit	61,651,177	99.99	64,194,057	99.99	65,465,497	99.99
-MIEs		60,863,578	98.71	63,350,222	98.68	64,601,352	98.67
-SEs		731,047	1.19	783,132	1.22	798,679	1.22
-MEs		56,551	0.09	60,702	0.09	65,465	0.10
LEs		5,370	0.01	5,550	0.01	5,637	0.01
MSMEs + LEs		61,656,547	100.00	64,199,607	100.00	65,471,134	100.00

MSMEs	People	112,828,610	97.04	116,978,631	97.00	119,562,843	96.92
-MIEs		103,839,015	89.31	107,376,540	89.04	109,842,384	89.04
-SEs		5,402,073	4.65	5,831,256	4.84	5,930,317	4.81
-MEs		3,587,522	3.09	3,770,835	3.13	3,790,142	3.07
LEs		3,444,746	2.96	3,619,507	3.00	3,805,829	3.08
MSMEs + LEs		116,273,356	100.00	120,598,138	100.00	123,368,672	100.00

**Source:** Menekop& UKM (<http://www.depkop.go.id/>)

A comparison with other economies in the Asia and Pacific (AP) region, based on the most recent data available at that time in the period 2015-2018 from the APEC Secretariat, showed that more than 98 percent of companies are considered MSMEs with more than half of the economies, including Indonesia, holding a share of more than 99 percent as indicated in Figure 4. This share has remained constant over the past decade for all economies. This means nearly 150 million businesses in the region are considered MSMEs based on how each economy defined its MSMEs and the availability of most recent data and this represents approximately 99.8 percent of all businesses in the region. It is important to note that what is considered MSME in one economy may not be considered MSME in other economies due to the difference in their definitions of the concept.

**Figure 4. Number of MSMEs in the AP Region by Economy**

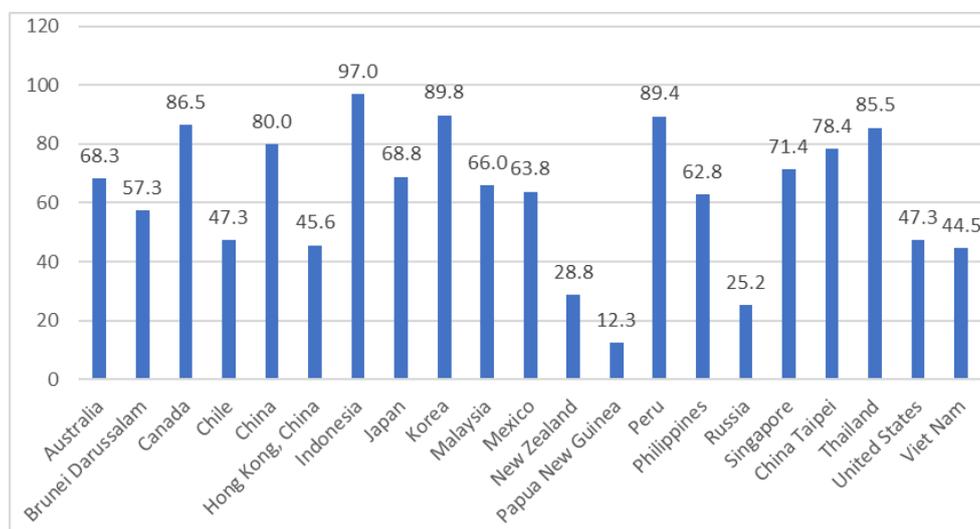


Note: the number of MSMEs is rounded up to a thousand. The numbers in brackets are percentages of total enterprises,

**Source:** APEC (2020).

The share of the total workforce in MSMEs also varies widely between economies in the region. For example, Russia has only approximately 25.2 percent as indicated in Figure 5 against the higher percentage recorded in Indonesia. Moreover, the number of workers in MSMEs comprises more than 60 percent of total workers in most economies with some recorded to have more than 80 percent. It was also discovered that there are more than 950 million people employed by MSMEs across the region depending on how each economy defines MSMEs and most recent data and this value accounts for nearly two-thirds of the total employment in the region. This proportion has also remained constant for the past 5 to 10 years across the economies in the AP region with only Malaysia and Thailand observed to have experienced a substantial change over the reference period as indicated by an increase of 13.3 and 7.3 percentage points, respectively.

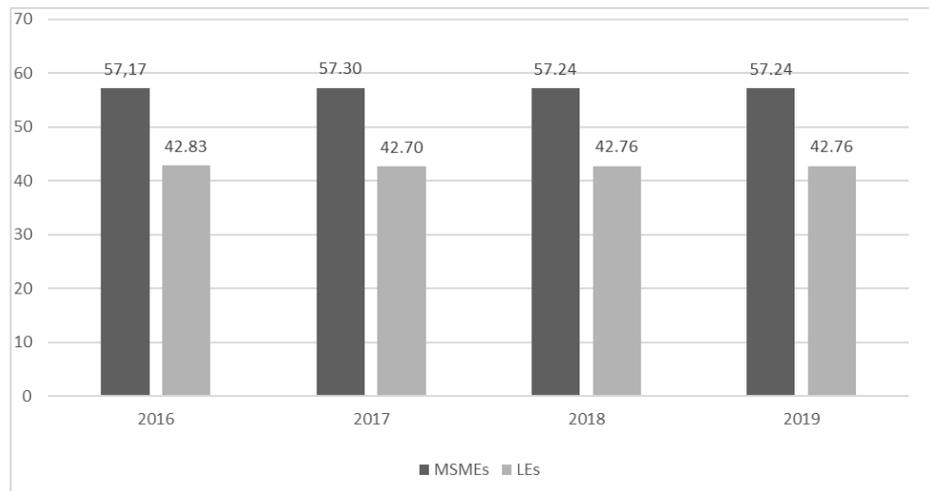
**Figure 5 Share of Employment in MSMEs in the AP Region by Economy**



**Source:** APEC (2020)

The contribution of MSMEs to gross domestic product (GDP) is always smaller than their role as job creators in all economies in the AP region. This is observed from their absorption of more than 90 percent of the total workforce as well as their contribution of lesser than 90 percent to the GDP with the economies having different ratios. Figure 6 shows that MSMEs collectively contributed more than 50 percent to Indonesia's GDP and even though this is greater than the value for LEs, their actual contribution is much smaller because they have a significantly higher number compared to the LEs. Moreover, there are also differences within the MSME group such that the total contribution of MIEs and SEs is lesser than those for MEs which is also smaller than the ones provided by the LE.

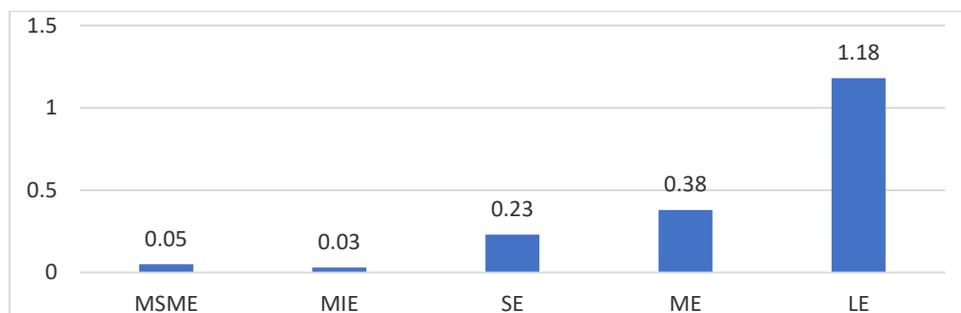
**Figure 6 Share of GDP by Business Size in Indonesia, 2016-2019 (constant 2000 prices; %)**



Source: Menegkop & UKM and BPS

But, the higher GDP share of MSMEs than that of LEs is not because labor productivity in MSMEs is higher than that in LEs. It is mainly because the number of MSMEs is very large, far exceeding the number of LEs. As shown in Figure 7, the ratio of the value added to the number of workers in the first group is much lower than in the last group. Within the MSMEs group, the lowest ratio was in MIEs. This is understandable because MIEs are more difficult than SEs and MEs in gaining access to capital, technology, and skills.

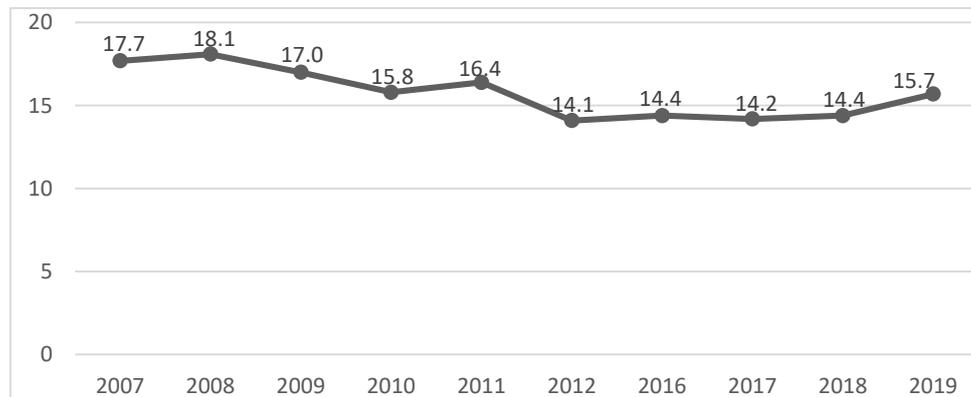
Figure7 Labor Productivity by Business Size in Indonesia, 2018 (IDR billion)



Source: Menegkop& UKM/BPS

MSMEs in Indonesia are also expected to contribute to export growth in addition to their contributions to employment generation and gross domestic product (GDP). However, available provided by the Minister of Cooperatives & UKM showed that the share of MSME exports in the country’s total exports is always very small with the 17.7% recorded in 2007 observed to have dropped to 15.7% in 2019 as indicated in Figure 8.

Figure 8 Export development of Indonesian MSMEs, 2007-2019 (% of Total Exports)



Source: Menegkop& UKM (online)

As a regional comparison, the contribution of MSMEs as part of total exporters in the AP region varied from 55.3 percent in Chile to 97.5 percent in the United States as indicated in Table 4. The share remained stable over the reference period of 5 to 10 years with only Thailand showing a large increase from 59.6 percent in 2010 to 71.0 percent in 2018. Moreover, it was discovered that the involvement of MSMEs in the export of goods was very low in all economies with an average of less than 2 percent. It is important to note that this data is focused only on goods without services.

Table 4 Share of MSME Exporters in the AP Region by Economy

Economy	Share of total exporters (%)	Share of total MSMEs (%)	Year
Australia	87.2	2.0	2017-18
Canada	96.6	2.7	2018
Chile	55.3	0.5	2017
Mexico	83.1	3.6	2017
New Zealand	67.9	1.4	2018
Peru	70.5	0.3	2017
Thailand	71.0	0.9	2018
United States	97.5	0.9	2017

Source: APEC (2020).

### 5.2 MSEs in the Manufacturing Industry during the COVID-19 Pandemic

Based on the results of a survey of MSEs in the manufacturing industry (called micro and small industries or MSIs) conducted by BPS (2021), the production growth of MSIs during 2020 experienced a deep contraction when compared to the growth rates in 2018 and 2019 (Figure 9). The beverage industry (KBLI11) was the industry group with a percentage of MSIs that were closed or temporarily not in production, i.e. around 11.95 percent, during the fourth quarter of 2020. At the end of 2020 (fourth quarter), 7.06 percent of MSIs were closed or temporarily not producing (11.25%). Banten was the province with the minimum percentage of MSI closed/temporarily not in producing (11.22%) during the fourth quarter of 2020.

Figure 9. Growth Rates of Production in MSIs, 2020



Source: BPS (2021)

Almost a quarter of the total number of MS could not continue in production during the 2020 pandemic. In percentage terms, the number of MSIs that were still in production, both those that remained with the same industrial activities (permanent KBLI) or those that changed the type of industrial activity (KBLI 2-digits changed) the lowest occurred in Quarter II-2020, which was 76.70 percent (Table 5). Most of the MSI production was still in the same type of business activity. Changes in the number of MSIs fluctuate between quarters. This shows that MSIs’ efforts were very dependent on the state of the pandemic.

Table 5. Percentage of MSIs by Business Status, 2020

	Production, Fixed KBLI	Production, Different KBLI 2-Digit	Temporarily Not in Production	Closed	Others
Q1-2020	76,6	0,53	13	4,28	5,6
Q2-2020	76,7	0,29	15,35	5,43	2,23
Q3-2020	80,11	0,22	11,55	6,03	2,1
Q4-2020	79,39	0,18	11,25	7,06	2,12

Source: BPS (2021)

### 5.3 Main constraints

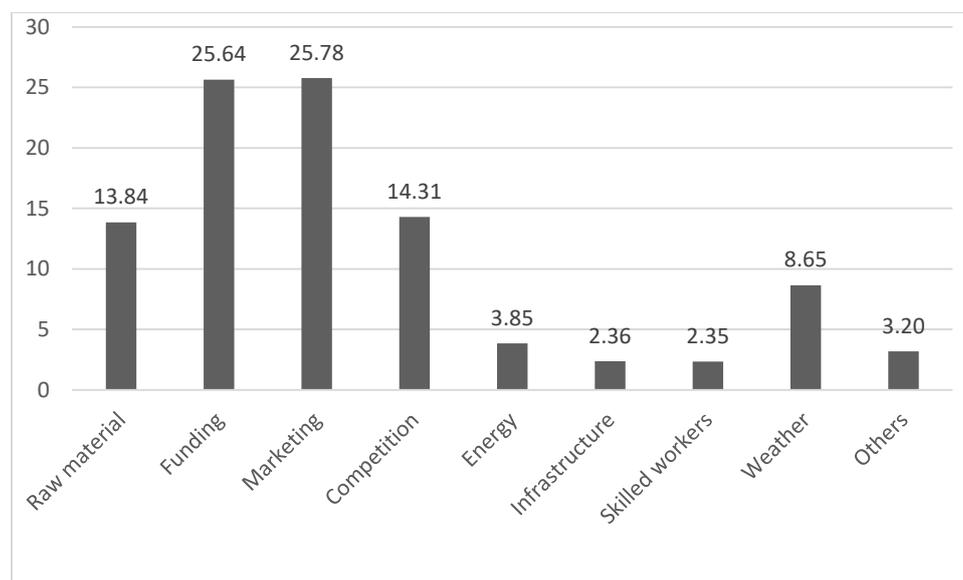
Like in other developing countries, the development or growth of MSMEs in Indonesia is hindered by many obstacles which differ in intensity based on regions, rural and urban areas, sectors, and even between companies in the same sector. However, there are some problems considered to be common to all MSMEs in any country, especially developing countries and these include limited working capital and investment; difficulties in marketing, distribution, and procurement of raw materials and other inputs; limited access to information about market opportunities and others; limited skilled personnel or low quality of human resources; low technological capabilities; high transportation and energy costs; limited communication; high costs due to complicated administrative and bureaucratic procedures, especially in business licensing; and uncertainty due to unclear or uncertain economic regulations and policies.

Data from the 2020 National Survey on MSEs in the manufacturing industry show that around 64.88 percent of them or as many as 2.73 million enterprises said that they have difficulties in

running their businesses. It varies however by groups of industry. For instance, MSEs in the base metal industry experienced the biggest obstacle/difficulty, which reached 91.68 percent. Likewise for those in the computer, electronic, and optical goods industry, as many as 90.18 percent of IMK experienced business problems. Meanwhile, in other types of industry, less than 80 percent of MSEs experience business constraints. There are three most common types of obstacles/difficulties experienced by MSEs in this sector, namely marketing, capital, and raw materials.

Concerning marketing, around 25.78 percent of the total number of MSEs have difficulties in conducting their businesses (Figure 10). This is because of their efforts other than producing goods as well as marketing them. Also, MSEs (also as a matter of fact in other sectors) generally do not have the resources to seek, develop or expand their markets. Instead, many (if not all) of them relied heavily on their trading partners such as mobile traders, collectors, or trading houses to market their products. Often they also depend on consumers visiting their production sites, or through production linkages in the form of subcontracting arrangements with larger enterprises which contribute a small percentage to the marketing efforts.

**Figure 10. Percentage of Main Difficulties Experienced by Manufacturing MSEs, 2020 (%)**



**Source:** BPS (2020)

The second most constraint is lack of capital. In fact, in Indonesia, there are several special credit schemes for MSEs, but most of the respondents, especially those in rural areas, said they have never received credit from banks or other financial institutions. This means they depended entirely on their own money or savings, financial assistance from relatives, and loans from informal money lenders to finance their business activities. Some of the reasons provided for not dealing with banks include not having information on the existence of such special credit schemes, some tried to apply but were rejected because their business was deemed unfit for funding, some resigned due to complicated administrative procedures or inability to fulfill

requirements including the provision of guarantees or collateral such as house or land certificates. Others did not wish to borrow from formal financial institutions because they felt uncomfortable or afraid of defaulting (BPS, 2018).

The third most important constraint/difficulty is lack of capital. capital. There is 25.64 percent of MSEs in the sector experienced this constraint. The next type of constraint is heavy competition not only among them but also with domestic LEs producing similar goods and imported goods, especially from China with lower prices. The next most common type of obstacle/difficulty is difficulties in the procurement of raw materials. Raw materials are the heart of industrial enterprises. Without raw materials, there will be no production. This constraint was felt by as much as 13.84 percent of MSEs, but in the rubber industry, rubber and plastic goods the difficulty of raw materials is above 30 percent. The difficulty of raw materials is mainly because of the high price of raw materials. In addition to the high price, the problem of material availability.

## 6.0 CONCLUSION

This study reveals several key facts which add new important information to the existing literature on MSMEs. First, MSMEs accounted for almost 100% of all firms, and they are dominated by MSEs. Second, MSMEs are the largest contribution to employment generation but they contributed not more than 58 percent of GDP on average per year because their labor productivity is very low due to a lack of advanced technologies, capital, and human resource. Lack of capital makes their investment very low, especially in MSEs, and without investment especially in advanced machines, new production tools, and research and development, these enterprises can't improve their productivity. Third, MSMEs are also relatively weak in export because of these constraints. Fourth, the growth or sustainability of MSMEs is very dependent on market demand, which is why during the economic crisis caused by the COVID-19 pandemic many MSMEs, including MSEs in manufacturing had to stop their operations or many went bankrupt. Fifth, given in the literature and based on own direct observations that most MSEs (if not all) are conducted by poor households and low-educated and unemployed individuals, the existence or annual growth in the number of MSEs in Indonesia reflects mainly the economic hardship, not the increase in the spirit of entrepreneurship of the community.

Finally, the findings from this study are also important for policymakers, not only in Indonesia but also in other developing countries, for two main reasons. First, with their huge number, MSMEs are indeed very important not only as a source of employment but, potentially, as a growth engine for the economy. But they need government support, especially in capital and human resource development. Second, especially MSEs are very close to poverty, therefore, their existence or growth are among the important targets of the sustainable development goals (SDGs).

Therefore, capacity building in these enterprises especially MSEs should be given a high priority by the policymakers in their economic development policies. Governments, especially at the regional level, should (i) conduct training programs routinely and in all MSME centers that focus on online marketing, entrepreneurship, management, and improvement of product

quality and business efficiency; (ii) provide alternative funding facilities with low-interest rates and non-burdensome requirements; (iii) provide technical assistance (e.g. production, maintenance of machines) and non-technical assistance (e.g. marketing, promotion, distribution) directly in the production site for new entrepreneurs in their first one to two years of running businesses; and (iv) to secure the availability of MSMEs most needed raw materials with stable prices are. In addition, all gender discrimination treatments that have been burdensome for women to run their businesses must be eliminated, and all existing government-initiated programs to support MSMEs must be fully socialized so that all MSMEs are fully aware of such programs/facilities.

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## Availability of data and materials

The (secondary/national) datasets used by this study are available from the following three sources.

1) Ministry of Cooperative and Small Medium Enterprise (online data):

<http://www.depkop.go.id/berita-informasi/data-informasi/data-umkm/>.

2) BPS (<https://www.bps.go.id>):

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