Chapter 2
SMALL and MEDIUM ENTERPRISES in INDONESIA

2.1 Introduction

The aim of this chapter is to describe the existence and operations of SMEs in Indonesia. As seen in other countries, there are many views on SMEs; however, there are several points of view with regard to their operations that can be dealt with in spite of the constraints. The objective of the study was to examine how innovations in distribution channel led to improve firm performance of export oriented agriculture based SMEs industries in Indonesia, hence; the location of the sample size of this study was accordingly highlighted.

2.2 A brief review of Indonesian economic development

Indonesia has been through various stages of development in economics, particularly since 1960s. In 1966, only 50.00 USD was earned within a year in average or around 65% of the country's population lived in absolute poverty. In the beginning of the 1970s until the 1980s, the economy grew better after several policies, such as five-year economic development plan, which was effectively implemented. For instance, there were liberalization in investment, capital accounts, banking, and external trade, in which the sectors of industry and agriculture were given the highest priority. Within that period, an import-substitution strategy was further effectively operated and it mainly focused on labour-intensive industries, such as textile and garments, footwear, and wood products, as well as food and beverages. Continuously, further policies regarding automotive assembling industries, reducing import tariff, and exporting boundaries have become a

conducted strategy of export promotion, particularly for the labour intensive industries. Furthermore, green revolution was adopted in order to improve the agricultural productivity to attain rice self-sufficiency, and to enhance real income per capita in the suburban areas to reduce rural and national poverty as a whole. The result of these strategies had successfully created a fast and sustained economic enlargement at an average of 7% per year. These happened throughout the 1980s and all the way until 1997, before the Asian financial crisis which occurred from 1997 until 1998 (Tulus Tambunan, 2006).

After the monetary crisis in 1997, when the price of oil in the world market increased by more than 100%, the Indonesian government eased fuel subsidies that effected the rise of inflation rate in October 2005. Due to the subsidy reduction, it was anticipated that the economy growth rate would have been less than 6% in 2006. As the agriculture sector plays a dominant role in national industries, the Indonesian economy encountered a massive structural transformation. However, in comparison to 1970, the gross value added from the agriculture sector in 2005 contributed up to 45% of the gross domestic product (GDP). GDP contribution from the industrial sector increased from less than 20% in the 1970s to almost 30% in 2005. The industry also joined the big sectors in terms of output growth per year. In 2004, it grew by 6.4% or 4.6% compared to 2.1% or 2.5% in 2005 for agriculture. By 2005, other sectors that had relatively high growth rates were transport and communication (13%), trade (8.6%), construction (7.3%), and finance (7.1%) (Tulus Tambunan, 2006).

2.3 A brief review of Small and Medium Enterprises (SMEs) Development in Indonesia

In regards to the SMEs in Indonesia, from 1990 up to 2002, based on the Asia-Pacific Economic Cooperation (APEC) report, there were around 50% of total non-agriculture SMEs established in Indonesia and China. Whilst within the period, if agriculture was included, this portion would surely be much higher as both countries are known as the largest agrarian economies then. However, from 2003 until 2004, trade, hotel and restaurant of the SME sectors were second after agriculture. Another important sector within that period was the manufacturing industry (with around 6.4% of total SMEs) and its activities were mostly involved in simple traditional lines, such as handicraft and furniture, clothing, footwear, as well as food and beverages. Only a small share of SMEs was involved in machineries, tools, and automotive components production (Tulus, 2007).

However, similar problems were experienced in other parts of the country, where financial access had become important for SMEs to grow, as shown in Table 2.1. It indicates significant participation of SMEs to use loans to support the business in the last two years (2011-2012), whereby the trading (wholesalers and retailers) sectors were of the highest proportion, followed by agriculture and forestry, manufacturing, transportation, warehousing, communication, and others (Bank Indonesia, 2012).

Table 2.1: Loan expansion of SMEs by sectors in Indonesia (billion rupiah)

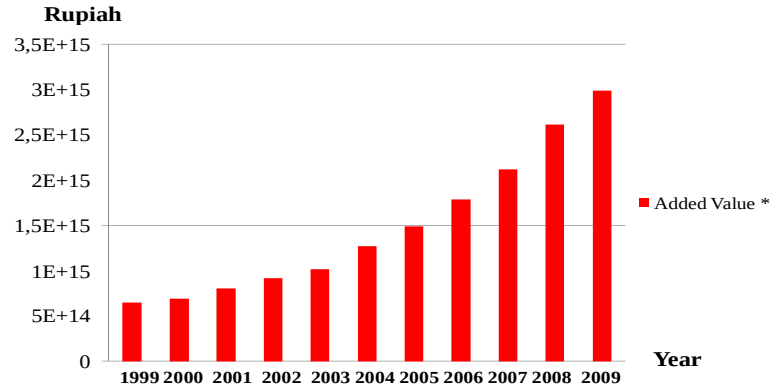
Sectors	**2011**	**2012**
Agriculture and forestry	10,814.6	14,247.6
Fishery	506.2	335.4
Mining	799.5	1,525.8
Manufacturing industries	9,371.0	7,343.9
Construction	4,280.6	6,677.6
Wholesalers and retailers	37,054.2	2,449.8
Food and beverage	2,964.7	3,708.9
Transportation, warehousing, and communication	5,396.6	2,449.8
Financial agency	3,542.0	3,855.1
Real estate and rental services	7,369.9	6,073.5
Education	318.8	470.8
Health services	246.3	594.5
Entertainment	5,337.1	858.8
Other sectors	3,867.3	-1,656

Source: Indonesian Bank (2013)

As Indonesian SMEs are mostly involved in agro-based activities and are located in rural areas, the presence of the sector in the economy and its ability to provide employment and added value are significantly recognized. According to BPS in Mukhamad *et al.*, (2011), in 2009, the number of SMEs totalled up to 52.7 million or 99.9% of all establishments in this highly populous country. In terms of job opportunities, Indonesian SMEs provided about 96.2 million employment or 97.3% of the total employment.

Furthermore, as seen in Figure 2.1, the value added contributions of SMEs in Indonesia from 1999 until 2009 grew (BPS in Mukhamad *et al.,* 2011) and the activities in exports from 2007 until 2011 were significant (as seen in Table 2.2). The annual growth of SMEs engaged in export activities, particularly in non-oil and gas sectors, was also significant, as reflected in Table 2.3.

Figure.2.1 The growth of value added by SMEs in Indonesia 1999-2009



Source: BPS in Mukhamad *et al.*, (2011)

Table 2.2: Export growth in Indonesia

($)	2007	2008	2009	2010	2011
Export of agricultural	3.657.784.654	4.584.576.851	4.352.754.318	5.001.899.002	5.165.793.669
Growth of export in agriculture (%)	--	25	-5	15	3
Industries	76.460.827.880	88.393.495.928	73.435.840.877	98.015.076.416	122.188.727.150
Growth of export in industries (%)	--	16	-17	33	25
Mining	11.884.904.619	14.906.165.178	19.692.338.644	26.712.581.107	34.652.027.382
Growth of export in mining (%)	--	25	32	36	30
Others	8.805.722	9.912.090	10.795.331	9.947.411	13.036.223
Growth of export in others (%)	--	13	9	-8	31

Source: www.kemenperin.go.id

Table 2.3: Annual average growth of SMEs export activities in Indonesia

	Business (%)	Labour (%)	GDP (%)	Export (non oil and gas) (%)
Micro	1.98	3.34	17.14	16.08
Small	4.93	3.01	13.16	3.15
Medium	3.64	3.07	14.51	9.16

Source: Ministry of Cooperatives and SMEs (2011), in Setyorini Christina *et al.*, (2013)

2.4 Small and medium enterprises in Yogyakarta Special District Indonesia

Located within the centre of Java, Yogyakarta Special Province (DIY: Daerah Istimewa Yogyakarta), as in Figure 2.1, has been known as one of the biggest SMEs populated regions in Indonesia. Here the service/other sectors have become dominant industries,

followed by others, such as craft, furniture, food, and clothing industries. However, in spite of the existence of various sectors, referring to Disperindagkop DIY (2013), as seen in Table 2.6, their development in the last four years had shown good growth. It had been indicated that in 2009, there were 77,851 units of SMEs that hired around 291,391 employees with a total production capacity reaching up to 2,325,582,931 million IDR. Furthermore, in 2012, there were 81,523 units of them absorbing 300,549 employees with the total production capacity of more or less 3,199,224,964 million IDR. Regarding their growth, the SMEs that were registered with licence (SIUPP) also increased significantly from 32,415 unit of businesses in 2008 up to 39,724 units in 2012 (Table 2.5). Furthermore, in respect of their financial activity, in accordance with Indonesian Bank-Yogyakarta (2013), SMEs that were involved in the banking services were able to achieve as much as 1,296 billion IDR outstanding loan in 2011, and this was further increased to 1,820 billion IDR in 2012 (Table 2.4).

Figure 2.2 Yogyakarta Special District-Daerah Istimewa Yogyakarta (DIY) Indonesia

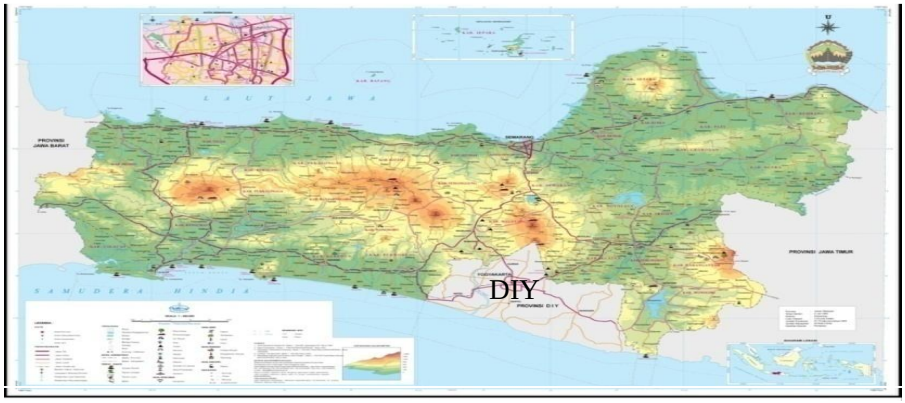


Table 2.4 Loan growth of SMEs in DIY (billion IDR)

Sectors (unit)	Des 2011	Jun 2012	Des 2012
SMEs	1,296	1,548	1,820

Source: Indonesia Bank-DIY (2013)

Table 2.5 The development of licensed SMEs (SIUPP) in DIY

No	Sectors (unit)	2008	2009	2010	2011	2012
1	Medium	1,296	1,548	1,820	1,999	2,142
2	Small	31,119	33,425	35,296	36,607	37,582
	Total	**32,415**	**34,973**	**37,116**	**38,606**	**39,724**

Source: Disperindagkop DIY (2013)

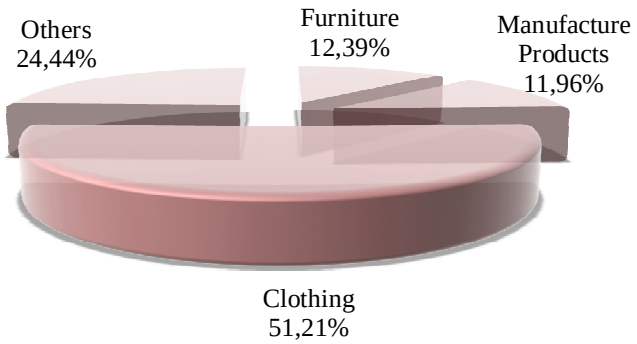
Table 2.6 The development of SMEs in Yogyakarta Special District Indonesia (DIY)

No	Sectors	2009	2010	2011	2012
1	Unit	77,851	78,122	80,056	81,523
2	Employees	291,391	292,625	295,461	300,549
3	Production (Million rupiah)	2,325,582,931	2,821,218,797	3,053,031,164	3,199,224,964

Source: Disperindagkop DIY (2013)

Generally, as seen in Table 2.7, the majority of the manufacturing activities in DIY-Indonesia were dominated by agriculture based industries (food and beverage, clothing, craft-wooden-natural material, and others). However, in other regions, as seen in Figure 2.2, in 2012, some of the SMEs took part in the export activities. Throughout the year, the whole proportion of export volume in DIY, which consists of clothing industries, achieved 51.21%, furniture 12.39%, manufactured products 11.96%, while other industries, 24.44%.

Figure 2.3: Export volume in DIY in June 2012



Source : Indonesian Bank (2013)

Table 2.7 Manufacturing centres of firms in DIY in 2012

No	Industries (unit)	Centres	Unit	Production (unit)
1	Food and beverage	81	3,768	155,894,022
2	Clothing and leather	25	1,513	5,113,615
3	Chemical and construction material	59	5,540	169,056,600
4	Electronics	18	420	1,936,346
5	Craft	70	3,619	3,369,228
	Total	**253**	**14,860**	**335.369.811**

Source: Disperindagkop DIY (2013)

2.5 Roles and problems of SMEs in Indonesia

The past history showed an economic turbulence in Indonesia around 1997, when Indonesia was hit by monetary crisis, as its local currency underwent a large devaluation that dramatically increased from 2,500 rupiah, to a dollar, to above 10,000 rupiah. By 1998, it experienced a GDP decline of 13%. During that period, economists expected the sudden devaluation would increase export activities so that the economy would be able to recover from the crisis. However, it was apparent that the large corporations that dominated the export sector had yet to lead the country out of the crisis (Jan Ter Wengel, & Edgard Rodriguez, 2006). According to Jan Ter Wengel, and Edgard Rodriguez (2006), five years after the crisis, the depressed Indonesian economy did not show any signs of recovery. Furthermore, from 1999 until 2000, the growth of economy in Indonesia was still unsatisfactory. In 1999, Indonesia's GDP grew moderately by less than 1%. In 2000, the growth reached up to 4.8%, and then, slowed down again to 3.3% in 2001. A similar growth pattern also occurred in 2002. Fortunately, the poverty figures dropped from 23.4% of the population to 18.2% in 2002 (World Bank, 2003).

Interestingly, during the period of the crisis, large enterprises (LEs) and SMEs responded differently to the situation. The capability of Indonesian SMEs surviving the crisis proved better than larger firms (Berry *et al.*, 2002). One of the reasons why large exporters could

not perform well in exports was that they mostly depended on massive amount of imported input. Hence, when the Rupiah dropped, they also saw their input prices in dollars increasing dramatically, making recovery difficult to attain (Zhuang *et al.*, 2001). On the contrary, the crisis gave a rather surprising advantage to the SMEs. With a low local market demand and a higher local price for their products, SMEs were forced to find new markets and many of them switched to international markets. Their low import requirements resisted their competitiveness abroad. The export response of SMEs indicated that small firms are important participants in the international trade (Reynolds, 1999). Since then, the roles of SMEs, in some ways, have increased in value and have become one of the sources for the national economy growth.

From above, as in most other developing countries, the existence of in Indonesia has always played a vital role in contributing to the national economic growth. According to the Ministry of Public Welfare (2007), Indonesian SMEs generally dominate the economy. Moreover, the contribution of SMEs to GDP, excluding oil and gas, was around 53.3%. The three sectors that employed the most workforces were: agriculture with 38.8 million workers (43.66%), trading and hotels with 22.2 million workers (24.98%), and services with 9.4 million workers or 10.5% (Ministry of Public Welfare, Indonesia, 2007).

In addition, regarding to Indonesian SMEs growth, their dynamic development had steadily increased in the various economic sectors since the late 1960s all the way up to 1997. This included both labour intensive products whose competitiveness depended on the country's low wages, as well as other products that relied on natural resources and special policy support. Manufacturing in Indonesia remained dynamic in the 1990s up until the crisis,

which began in 1997. The improvement in the macro and regional economic policies, including the development of financial, trade, and physical infrastructures, contributed to the growth of medium and large scale industries. In some industries, this growth had been at the expense of small enterprises, for instance, in the cases of bamboo weaving and palm sugar processing (Standee, & Riveted, 2000).

Besides, many scholars have conducted researches to examine several aspects of the growth of SMEs. The studies of Tulus (2000) and Nurul (2007) indicated that SMEs in Indonesia have a strong linkage with the agriculture sector because of the high potential in this sector. Nevertheless, relating to their development, the Indonesian SMEs are also plagued by various problems, which may usually be multi-dimensional, like capital or finance, raw materials, organization management, technical issues, skilled labour, demand (marketing), distribution, up to date information to access the global market, as well as networking.

Another study conducted by Manginsela (2005) indicated that the SMEs in Indonesia were still faced by difficulties in improving their share on exports, resulting in lower GDP. Hence, there is a great necessity for the immediate involvement of higher education institutions on the development of SMEs. In the short term, SMEs need assistance on human resources due to lack of management and production skills. Dissimilar findings were found by Diana Sari *et al.,* (2008) that indicated many SMEs needed to address their weaknesses related to newness, smallness, and being inexperienced. Many factors should be considered when developing effective and efficient policies and/or programmes for SMEs. Policy makers should have good comprehension on the factors that influence the

internationalization of SMEs and then emphasize on those areas that require more attention. Furthermore, policy makers should support SMEs with 'internationalization' potential.

Another study related to the distribution, conducted by Tulus *et al.,* (2009), indicated several interesting findings. Firstly, in accordance with WTO and ASEAN Free Trade Area (AFTA) agreements, the Indonesian government implemented many actual actions so as to improve trade facilitation (TF), which would increase the flow of goods and services both within and outside the country. However, Indonesia was still faced with problems regarding trade facilitation elements, such as customs procedures, trade regulations, and poor infrastructure that make the process of improvement rather slow. Secondly, the study also indicated that the Indonesian SMEs' involvement in export activities was generally weak, not only in comparison to their larger counterparts, but also to SMEs in well-developed countries. In general, the majority of export-oriented SMEs in Indonesia did not export directly, but they do so via intermediaries, such as private traders, export companies or trading houses. They also export via sub-contracting agreements with LEs, in which SMEs manufacture semi-finished products, which are then finished by the LEs. Thirdly, although empirical evidence was limited, SMEs, especially those located in rural areas had less access to the existing TF as compared to LEs. This is due to their limited capital and knowledge on conducting exports, unlike LEs (Tulus *et al.,* 2009).

2.6 How SMEs in Indonesia adopt capital access

One of the main obstacles for SMEs is facing complicated access for acquiring liquid capital from financial agents; banks, including in Indonesia (Mudrajat, 2003; Manginsela, 2005; Nurul, 2007; Diana, 2008; Tulus, 2009). Additional capital is

required for them (SMEs) to generate tangible and intangible assets to be extra productive and competitive. Financial agents, both private and state, have become effective supporters for them, besides domestic/foreign direct investments. However, in spite of its critical role, the issue of difficulty remains popular for SMEs throughout the globe. The following issues are derived from the observation in SMEs in Indonesia and Indonesian Financial Institutions. However, based on literature review, observations, and interviews made, most policies discussed would remain similar exclusive of the interest rate.

Literatures have found that SMEs still faced difficulties in accessing and adopting financial capital to facilitate their goods' flow and develop their business. Based on the observation involving regional and national financial agents in Indonesia, the notion of financial capital access difficulties are supposed to broaden further, not only in procedural terms, but also in terms of fulfilment. As there are many financial institutions in Indonesia these days that are eager to provide various products in support of SMEs, particularly for the export-oriented, this opportunity should be adopted quickly by Indonesian SMEs. Nonetheless, according to Djoni (2010), many of the potential customers were unfamiliar of the banking products, particularly those who inhabit in rural area.

However, in Indonesia, in general, there are three kinds of loans offered to support SMEs: loans for consumption, investment, and working capital. However, regarding the types of loans mentioned, in order to understand the patterns of the calculation, they are classified into several terms, namely, effective floating, flat, grace period, and R/C (Indonesian conventional Bank, 2011).

Normally, all types of loans may be used for all purposes (consumption, investment, and working capital) as long as the capital flow is suitable for the Indonesian SMEs. It has been found that between flat and effective floating, there is something in common in terms of monthly payment patterns. However, in terms of detailed calculations, they are very much poles apart. In general, a flat loan may, for instance, be calculated based on manual calculations. The following illustration would address how a flat loan is calculated in terms of interest and loan. For example, if customers were to ask for a loan and were granted an amount of $10,000 with an annual interest of 10% within a period of two years (24 months), the payment calculations would be as in the following:

$$= \frac{(\$\ 10{,}000 \times 10\% \times 2\ \text{(years)}) + \$\ 10{,}000 + \text{administration fee}}{24\ \text{months}}$$

$$= \frac{\$\ 2{,}000\text{(interest)} + \$\ 10{,}000\ \text{(loan)} + \text{administration fee}}{24\ \text{months}}$$

$$= \frac{\$12{,}000 + \text{administration fee}}{24\ \text{months}}$$

= $500.00+administration fee/month

Illustration 2.1 Flat monthly payment

Loan	0	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21	22	23	24
Interest	*0*	*1*	*2*	*3*	*4*	*5*	*6*	*7*	*8*	*9*	*10*	*11*	*12*	*13*	*14*	*15*	*16*	*17*	*18*	*19*	*20*	*21*	*22*	*23*	*24*

Most financial agents, however, no longer apply such payment patterns simply because if a customer was able to clear the entire loan before the determined period of 24 months, he/ she would still be required to clear the loan for the entire 24-months period. This form of payment usually becomes a great burden to many customers, particularly for export-oriented SMEs (Indonesian Regional Banking, 2008; Indonesian Central Bank, 2011).

On the other hand, unlike the flat payment pattern, effective floating cannot be calculated through manual means. However, in order to identify the similar result of how much a monthly payment is due, it may be calculated by using **1.73** as a special index. For instance, for customers being offered an effective floating rate of 23% annually, one must first need to find the flat rate for loan payment using the following formula:

$$\text{Interest rate (flat)} = \frac{\text{interest rate (effective floating)}}{\mathbf{1.73}}$$

$$= \frac{23\%}{1.73}$$

$$\text{Interest rate (flat)} = 13.29\% \text{ per year}$$

After finding the flat interest rate, the same calculation was conducted in calculating the flat rate.

$$= \frac{(\$\ 10{,}000 \times 13.29\% \times 2(\text{years})) + \$\ 10{,}000 + \text{administration fee}}{24 \text{ months}}$$

$$= \frac{12{,}658 + \text{administration fee}}{24 \text{ months}}$$

$$= \$\ 527.00 + \text{administration fee}$$

Illustration 2.2: Effective floating monthly payment.

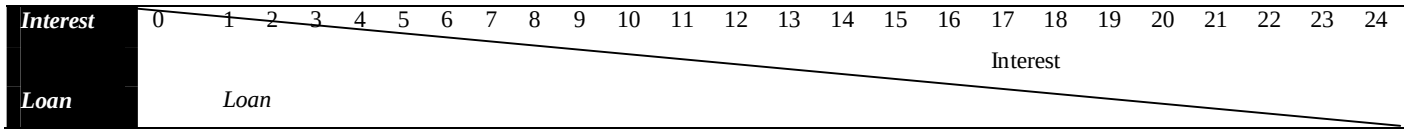


Illustration 2.2 above provides a general picture on how effective floating rate is calculated through computerized programming. The illustration shows that in the beginning of the period, the loan was large, but then, it began to shrink towards the end of the period. The implication of the illustration is that if customers intend to pay off the entire loan on the 13th month ahead of the 24-month schedule, they need not pay the rest of the interest, but they should pay the rest of the loan.

Another type of loan is the grace period loan. Unlike the previous ones, a grace period loan would offer different capital flow patterns and perhaps fit better with export-oriented SMEs. Simple calculations may be seen in the following illustration:

Illustration 2.3: Grace period payment schedule (23%/year)

No.	Months(1)	Loan($)(2)	Interest($)(3)	Payment($)/month(4)	debt balance($)(5)
0	December		-	-	**10,000.00**
1	January		**191.6666667**	**191.6666667**	**10,000.00**
2	February		**191.6666667**	**191.6666667**	**10,000.00**
3	March	**2500**	**191.6666667**	**2691.666667**	**7,500.00**
4	April		**143.75**	**143.75**	**7,500.00**
5	May		**143.75**	**143.75**	**7,500.00**
6	June	**2500**	**143.75**	**2643.75**	**5,000.00**
7	July		**95.83333333**	**95.83333333**	**5,000.00**
8	August		**95.83333333**	**95.83333333**	**5,000.00**
9	September	**2500**	**95.83333333**	**2595.833333**	**2,500.00**
10	October		**47.91666667**	**47.91666667**	**2,500.00**
11	November		**47.91666667**	**47.91666667**	**2,500.00**
12	December	**2500**	**47.91666667**	**2547.916667**	-

Source: Author (2011)

As addressed in Illustration 2.3 (above), if an SME was granted a loan of $10,000 with a grace period of three months for the loan and every month for the interest, the total monthly payment (interest + loan) starting from January up to December would be similar to the result portrayed to the illustration (above). The implication of the illustration is that the

amount of interest would be calculated based on debt balance (5). The lesser the debt balance, the lesser the interest that would be paid. The grace and the year periods are themselves flexible. The grace period may be re-arranged every three, six, or even every one month. It depends on the patterns of SMEs' capital flows from importers.

Another type of loan is working capital loan. Calculations made are similar to those done on credit cards. In R/C, the customers are allowed to withdraw the capital as a plafond, provided while with credit card usage, this cannot be done. For instance, if a customer is granted $10,000 as an R/C loan for a period of one year, this means that the SMEs have the right to a benefit of $ 10,000 throughout the year. A good R/C is an active R/C. An active R/C is one with many withdrawals and credits throughout the year. By being active, the bank usually would extend the loan in the following period and may even increase the plafond. The interest of R/C is calculated based on the loan balance withdrawn and is performed on a daily basis, for instance, SMEs withdraw $6,000 as their capital in 20 days. Putting annual interest at 23%, the interest calculation would be (23%/360 days) x 20 days x $ 6,000 =… The principle calculation of R/C is that firstly, as scheduled, SMEs should repay the entire $6,000 loan, together with the interest. However, if SMEs have trouble in repaying the entire loan as scheduled, it may be restructured into monthly payments (effective floating or grace period) for more than 2 years so that the SMEs can pay all obligations. When SMEs have enough capital, they may repay the entire loan one way or the other. Through loan restructuring, both SMEs and the banks acquire mutual benefit. For SMEs, they may keep the continued flow of goods whilst for the banks, they may still run the business well (Indonesian conventional Banking, 2011).

The types of loans mentioned earlier have a wide set of advantages, particularly for those export-oriented SMEs in enhancing their businesses. At any rate, SMEs should ensure to derive as much benefit from all of the above products and adjust them accordingly so that they may be even more productive. If the capital was only for consumption, there would not be any problem at all to benefit monthly payments, such as that of flat, effective floating or grace period. However, if export-oriented SMEs need investment for their distribution innovation, such as buying more trucks, more containers, more production machinery and so forth, it will be better to benefit grass/grace period in 6 months or a grace period of 6 months in the first year, then after every 3 months in the following year (usually up to 4 years). Besides, for those export-oriented SMEs that would like to purchase raw materials so as to enhance their production capacity and enlarge the flow of exports, it would be appropriate to benefit R/C and be active, meaning, every month, the capital should be debited and credited.

2.6.1 A loan proposal

In terms of arranging a loan proposal, it also needs another innovation so that the proposal would be interesting to be read and examined. Here, the documents should be clean, original, as well as valid. For instance, copies of IDs should not be expired. If what is printed on the ID is not clearly readable, it would be better to attach other supporting documents, such as a driving license or family members' documents. The remainder documents should also fulfil the above outlined requirements. Any proposal made should clearly state what the capital is intended for, whether it is for business or simply consumption. In general, there are three kinds of proposals, namely Investment, working capital, and consumption. Working capital is usually for the purchase of more raw as well

as other production materials. The loan period would be 2 years or less. The following illustration can be used as guidance on the explicit calculation of working capital.

2.6.1.1 How to fulfil a proposal

Normally, working capital is derived from current assets like cash and saving, inventories, gold, short term loans, and many more. Unlike LEs, the element of SMEs' balancing sheet is much simpler than that of the LEs. The period would be, generally, in 2 years or less. From illustration 10 below, it may be concluded that the amount of working capital of export-oriented SMEs is 33,000.00. If SMEs would like to expand to larger market segment and could increase sales up to 200%, this means that the export-oriented SMEs need to buy more inventories, as well as other production factors. However, the ratio of equity to loans should be at least around 60%:40%. It may even be modified as long as the customers can fulfil the repayment.

Illustration 2.4.
Customer balancing 1 sheet, …/…/…

Activa		**Pasiva**	
Current assets :			
- Cash & saving	10,000	- Short terms loan	2,000
- Inventories	20,000	- Long terms loan	1,000
- Etc	5,000		
Fixed assets :	:		
- Lands	1,00,000	- Own equity	80,000
- Buildings	50,000		
- Etc	25,000		
Total activa	**110,000**	**Total passiva**	**110,000**

On the other hand, periods of investment would be much longer and usually, it may range between 4 to 5 years for purchase, for example, renting and equipped warehousing, purchasing trucks, containers, machineries, and so on. When the proposal form has been

filled up, it would then require clean and valid supporting documents. The rest of the required documents would require similar action.

Composing clear, appropriate, and advanced capital flow for investments would be strongly suggested. The following illustration would help show how capital flow should be arranged, particularly for investments. The cash flow below is composed for export-oriented SMEs, which intends to innovate their warehousing systems.

Illustration 2.5: Capital cash flow illustration of one of innovation in distribution channel(s) : SMEs export oriented = Innovation in warehousing industries.

		Capital flow (currency)				
		0(investing year)	**1st year**	**2nd year**	**3rd year**	**4th year**
Initial balance	a.	1,000,000.00	9,726,500.00	14,480,970.00	20,389,850.60	
Sales	b.	5,000,000.00	15,000,000.00	22,500,000.00	33,750,000.00	
Other income	c.	2,000,000.00	2,500,000.00	2,500,000.00	2,500,000.00	
Foreign capital in flow /FDI/Investment	***d.***	***60,000,000.00***	0	0	0	
Total income	**e.**	**68,000,000.00**	**27,226,500.00**	**39,480,970.00**	**56,639,850.60**	
Cost elements :						
Warehousing activities (Inventory & material handling=75% of sales)	f.	3,750,000.00	11,250,000.00	16,875,000.00	25,312,500.00	
Labour	g.	750,000.00	1,125,000.00	1,687,500.00	2,531,250.00	
Administration innovation	h.	2,500,000.00	0	0	0	
Order handling innovation	i.	5,000,000.00	0	0	0	
Assortment innovation	j.	5,000,000.00	0	0	0	
innovation in Information sharing & IT infrastructure	k.	5,000,000.00	0	0	0	
Product & distribution scheduling	l.	5,000,000.00	0	0	0	
Inventory innovation	m.	5,000,000.00	0	0	0	
Transportation innovation & Transport infrastructure	n.	5,000,000.00	0	0	0	
Packaging innovation	o.	5,000,000.00	0	0	0	
Warehousing & product handling innovation	p.	5,000,000.00	0	0	0	
Acquisition innovation	q.	5,000,000.00	0	0	0	
Recruitment & training innovation	r.	5,000,000.00	0	0	0	
others: maintenance & etc	s.	1,075,000.00	75,000.00	112,500.00	168,750.00	
Total cost	**t.**	**58,075,000.00**	**12,450,000.00**	**18,675,000.00**	**28,012,500.00**	
EBIT	u.	9,925,000.00	14,776,500.00	20,805,970.00	28,627,350.60	
tax(2% of EBIT)	v.	198,500.00	295,530.00	416,119.40	572,547.01	
EAT	w.	9,726,500.00	14,480,970.00	20,389,850.60	28,054,803.59	
Final balance	x.	9,726,500.00	14,480,970.00	20,389,850.60	28,054,803.59	
DF=12%	y.	-	0.89	0.80	0.71	

NPV	z.	**0**	**12,929,437.50**	**16,254,664.06**	**19,968,855.05**
Charity/Zakat (2%)	aa.	194,530.00	289,619.40	407,797.01	561,096.07
Net Profit	**zz.**	**9,531,970.00**	**12,639,818.10**	**15,846,867.05**	**19,407,758.98**

Assumption from illustration 2.5: SMEs' warehousing in this context does not have any loan from any financial institution. The innovation, as illustrated above, characterizes the export-oriented SMEs' warehousing. The capital is invested starting from year "0" and then, in the same year, equipping all the innovations would also be conducted. Rows 'a', 'b', and 'c' represent internal income flow from the export-oriented SMEs before being invested. Warehousing activities (f), labour (G), and administrative innovation (h) are the routine costs of SMEs. While letters 'i' up to 'r', represent the innovation investments from 'd'. And the rest of the investment would flow for a final balance. 's' represents other expenses, such as maintenance, security services, and others. Sales are expected to increase significantly after investment. EBIT (Earnings before interest and taxes) would be = (e) – (t). EAT (earning after tax) = (u) – (v). EAT would become the final balance. NPV (Net Present Value) would start from the first year as: X * Y and I = 1/ ((1+i=annual interest rate) ^{n})$^{\cdot}$ The cost of charity/zakat for each year at a minimum of 2% of NPV would also be necessary.

The cash flow portrayed in illustration 2.6. is an example how SMEs prepare investment arrangement for additional capital from financial agents or investors. It is arranged annually and can be assorted into weekly, monthly, semester, annually, and so forth.

2.6.1.2 Loan feasibility

Studies have found that assessing the feasibility of loans is also unique as this would be further explained below. Normally, after proposals were examined, loan officers would

visit the customers, both in the customers' home and business places. There are several factors that should be considered by export-oriented SMEs during the loan feasibility study. Normally, the loan officers would consider the following (World Bank, 2009; Chong, 1992; Djoni, & Rohman, 2007; Shri, & Borbora, 2011) :

Character: In looking at a customer's character, the main point would be as to how well the customers cooperate with their financial agents. Customers' participation and response during an interview may be used as a key identification of suitable customers. Being frank, clear, and respectful to each other would be a positive indication to the loan officers. Another aspect of the customer's character may be examined from the customer's loans history from previous financial agents. Usually, if the SMEs have been running business for a long period of time, they should have taken loans from other financial agents, and they should provide honest information on the loans and payments history from other financial agents. In addition, most loan officers have a sense of distrust when dealing with male customers who would wear gold necklaces. The study, however, was unable to find any solid reason behind this distrust. Cleanliness, however, would be a good indication; a clean business premise, house, warehouse, production process lay out, and so on are all greatly necessary.

Capital: The term 'capital' in this context is also broad. However, tangible and intangible assets were examined more closely as a source of SMEs' survival in the global market place. For instance, tangible assets can be examined in terms of current assets and fixed assets, whilst intangible assets may be measured by things like the entrepreneurs'

knowledge, managerial skills, innovation, experience, marketing skills, market share, and so on. These are among of the things which financial officers may tend to overlook. However, tangible assets are normally pictured by loan officers starting with the most liquid till the least liquid asset. Cash in savings-in banks or deposit-in banks would also be considered (even though gold is more stable and liquid in value than cash). The following illustration explains briefly how records of savings would be read by financial officers:

Furthermore, studies have found that assessing the feasibility of loan is also a different thing. Normally, after the proposals were examined, the loan officers would visit the customers; both at home and business premise. There are several factors that should be considered by entrepreneurs regarding the feasibility of loan:

The implication from illustration 2.6 indicates that the average daily available cash to the customer was (USD/$/RM/Rp/¥/etc) **28,501,477.00**. It can be said that the customer would be eligible enough to obtain a loan, whether a flat loan, effective loan, grace period loan, or R/C loan.

Illustration 2.6. Account of the customer (2011).

Date	Debit	Credit	Balance	Days	Average
0			32,689,205	1	32,689,205
1	848,000		31,841,205	3	95,523,615
4		6,000,000	37,841,205	0	0
4		15,000,000	52,841,205	0	0
4		7,200,000	60,041,205	0	0
4		20,000,000	80,041,205	0	0
4	23,000,000		57,041,205	0	0
4	25,000,000		32,041,205	1	32,041,205
5		10,000,000	42,041,205	0	0
5	100,000		41,941,205	1	41,941,205
6	1,754,000		40,187,205	0	0
6	18,546,800		21,640,405	0	0
6		40,000,000	61,640,405	2	123,280,810
8	3,282,500		58,357,905	3	175,073,715
11	832,000		57,525,905	0	0
11	4,947,500		52,578,405	2	105,156,810
13	10,500,000		42,078,405	0	0
13	38,859,000		3,219,405	1	3,219,405

14		13,700,000	16,919,405	0	0
14	7,106,500		9,812,905	1	9,812,905
15	6,047,500		3,765,405	0	0
15	3,410,000		355,405	3	1,066,215
18		6,595,000	6,950,405	0	0
18	6,595,000		355,405	0	0
18		15,000,000	15,355,405	0	0
18	460,000		14,895,405	0	0
18	9,240,000		5,655,405	0	0
18	5,200,000		455,405	1	455,405
19		20,000,000	20,455,405	2	40,910,810
21	3,000,000		17,455,405	1	17,455,405
22	2,180,000		15,275,405	0	0
22		20,000,000	35,275,405	0	0
22		1,000,000	36,275,405	0	0
22		2,180,000	38,455,405	0	0
22	18,750,000		19,705,405	3	59,116,215
25	1,550,000		18,155,405	0	0
25	5,200,000		12,955,405	0	0
25	100,000		12,855,405	1	12,855,405
26	3,811,000		9,044,405	0	0
26		35,000,000	44,044,405	1	44,044,405
27	23,000,000		21,044,405	0	0
27		12,000,000	33,044,405	0	0
27	17,081,850		15,962,555	1	15,962,555
28	25,000		15,937,555	1	15,937,555
29		25,000,000	40,937,555	0	0
29	22,442,500		18,495,055	0	0
29	1,128,000		17,367,055	0	0
29	30,000		17,337,055	0	0
29		22,164	17,359,219	0	0
29	4,432		17,354,787	0	0
	264,031,582.00	248,697,164.00		**29**	**826,542,845.00**

Capacity: The term ‘capacity’ is equally broad. It is not merely in terms of financial capacity, but in terms of eagerness (intangible asset) to boost the business. However, capacity is usually measured in terms of income, which is EBIT (Earnings before interest and tax). This means the result of capacity can be calculated from the total sales and total expenses. Total expense would include interest expenses from other financial agents.

Illustration 2.7.
Customer balancing sheet 2, …/…/…

Activa		**Pasiva**	
Current assets :			
- Cash & saving	10,000	- Short terms loan	2,000
- Inventories	20,000	- Long terms loan	1,000
- Etc	5,000		
Fixed assets :		:	
- Lands	1,00,000	- Own equity	50,000
- Buildings	50,000	- Shares	30,000
- Etc	25,000		
Total asset activa	**110,000**	**Total asset passiva**	**110,000**

Illustration 2.8.
Customer income statement from 01/01/… up to 31/01/…

Income statements	
Total sales	100,000.00
Total cost	80,000.00
Other cost(tax, interest,& others)	500.00
Earnings after tax(EAT)	19,500.00

As shown in illustration 2.7 above, the total assets in the period where the loan officer collects data are presented. If customers fail to compile such information, the loan officers would usually help them make one. The total assets (tangible) of the customers are normally derived from: Total active assets – total loans (short and long-term loans). The total loans should not be subtracted as that would mean the customer would not be left with any asset.

Cash collateral: Cash collateral is usually the final consideration of financial agents in assessing the plafond or an outstanding loan. The main factors would be character and capacity. But in the end, it all depends on their financial agents and banking policies. Normally, cash collateral may be fixed or current assets. Deposit certificates may also be a better choice. The value of cash collateral is usually 80% of the outstanding loan (plafond). For existing customers, however, things would perhaps be different.

Condition of economy: The performance of SMEs would always be influenced by both internal and external factors. Empirical studies have found that innovation in distribution channels can enhance SMEs' competitiveness, which is relevant to the resource-based view theory. Moreover, from the experience obtained from the 1997 financial crisis, inflation has also become a major factor in the growth of SMEs, especially for foreign direct investment (FDI) to the SMEs. Hence, export performance needs to be enhanced in order to balance the supply of demand between the Rupiah and foreign currencies, especially the U.S. dollar. The empirical studies found that by innovating the distribution channels of export-oriented SMEs, export performance can be enhanced that may lead to overall firm performance, and in turn, boost capital inflow of foreign currency that may control overseas debt growth (World Bank, 2009; Chong, 1992; Djoni, & Rohman, 2007; Shri Viswanathan, & Shri Borbora, 2011).

2.7 Summary

Similar to other countries, the role of SMEs in Indonesia is essential for the economy. With their characteristics (agro-based industries and located in rural areas), the existence of the sector in contributing employment creation and value added are highly recognized.

Nevertheless, various constraints are encountered by Indonesian SMEs in spite of the favourable contributions to the sector, and even though the Indonesian government has taken efforts to ease the problems, internal factors, for instance, marketing and promotion, technology, and human capital, as well as some external factors, namely capital access and legality issues, are still the main concerns.

Besides, globalization has been escorting many benefits to all parties, including the Indonesian SMEs. Literatures show that distribution performance is an essential factor to enhance firm performance, particularly for SMEs that market products to overseas. However, product distribution channel is still a critical issue for local SMEs in Indonesia, particularly those established in suburban areas. However, procedures and trade facilitation are obstacles. Given the available problems, the Indonesian SMEs need to innovate their distribution channels to flow their products in effective and efficient ways.