Chapter 9

SMEs' Access to Finance: An Indonesia Case Study

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CHAPTER 9

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1. Introduction

One of the biggest problems faced by SMEs in most developing countries is lack of access to financial services, particularly from formal institutions (both banks and non-banks). The problem of access to financial sources for SMEs exists when a business activity that would be internally financed if resources were available, does not get supports from external financial institutions. The absence of financial supports for SMEs is perhaps due to high cost in doing business activities which implies SMEs find too costly in accessing external financial sources. Moreover, some argue that high cost of doing business could finally hinder economic competitiveness. ERIA's SMEs research found that access to finance is the most critical factor for SMEs in determining regional competitiveness (Thanh, *et.al.*, 2009).

Theoretically, the presence of financial barriers is due to informational problems (i.e. principal-agent problems) and transactional costs (Stiglitz and Weiss, 1981). *First*, because of lack of collateral/income, formal financial institutions classify SMEs as "non-bankable" firms as well as high-risk borrowers and hence are likely to exclude them. This is because those firms may be unable to repay their debt and may be unwilling to do so. *Second*, the cost of finance may be so high that financial institutions might be unable to reach such firms, particularly the small and medium ones. Baata (2008) found that the main obstacles for Mongolia's SMEs to access financial services included high interest rate, high collateral requirements, limited access to long terms loan, and weak business plan. Generally speaking, despite requesting financial services, SMEs do not have access to, or get external financing from, formal financial institutions even though resources are available.

SMEs' access to finance is a subject of research interest both in developed and developing countries. There are a number of reasons why this is so. Some argue that improving access to finance may reduce poverty in developing economies. Better access to finance for SMEs leads to reducing poverty, perhaps due to the fact that in most developing countries SMEs are concentrated in rural areas in which high levels of poverty persist. In addition, better access to financial sources for SMEs indicates that the role of financial institutions in bridging finance to real sector functions. In conclusion, improving financial access for SMEs will enhance the capacity of SMEs to reduce poverty and advance the role of the financial sector.

To address these issues, this study aims to examine the existing situation of SMEs' access to finance in Indonesia. More specifically, this study investigates the internal characteristics of SMEs in Indonesia such as demographics (firm size, number of employees, year of establishment etc), employment education, cost structure, obstacles facing SMEs and financial sources used either for maintaining or starting businesses. Furthermore, the study analyzes comparisons of those characteristics between SMEs that have access (herein referred to as 'Access firms') to financial institutions and those that don't (herein referred to as 'Non-access firms'). To achieve this objective, Institute for Economic and Social Research (herein referred to as, LPEM-FEUI) organized a field survey to collect firm-level information as well as data from formal financial institutions. The firm survey focused on three specific industries: garments and clothing, automotive parts and components, and electronic parts and components. Moreover, the survey included the financial institutions namely banking and non-banking such as cooperative and rural bank (herein referred to as BPR, *Bank Perkreditan Rakyat*).

The research report will be organized in five sections as follows. Section one is an introduction to the study. Section two highlights SMEs' contribution to the Indonesia economy, while financial policies affecting SMEs will be explored in section three. Section four discusses survey report including survey design and methodology, industry profile, and analyzes of survey results that deal with comparison between access and non-access SMEs to finance. The last section summarizes conclusion and policy recommendation.

2. The Role of SMEs in Indonesia

SMEs are considered to have an important role in economic development in terms of providing employment opportunities, being engines of economic growth, and their contribution to export and trade. Moreover, their flexibility in adapting to changing market situations in terms of demand and supply movement may lead SMEs to be less vulnerable than larger enterprises. According to these positions, SMEs act as a buffer if the economy is in decline.

In Indonesia, SMEs are recognized as a fundamental asset of the economy. They accounted for more than 99 percent of total enterprises in 2009, a slight increase when compared to the previous year of 2008. The definition of SMEs here, however, also included microenterprises so that the ratio of SMEs to total firms looks high. If we exclude microenterprises, they only accounted for less than 1.5 percent of total enterprises in 2008-2009. Moreover, SMEs' contribution to Indonesian economy can be derived from its role in providing employment or job opportunities. Until 2009, SMEs contributed to approximately 97 percent of employment absorption, a slight increase of 2.33 percent compared to the previous year of 2008. (*Ministry of Cooperative and Small and Medium Enterprises*, 2010). In terms of national output, the contribution of SMEs to Gross Domestic Product (GDP) creation was more than 55 percent in 2008/2009, both in current and constant prices.

It is found that SMEs' exports were very small compared to their counterparts, the large enterprises in terms of contribution to non-oil and trade. The SMEs' non-oil exports accounted for approximately 17 percent of total exports in 2009, while exports from the large enterprises comprised 83 percent of the total export in the same year. This percentage decreased slightly from 2005 (20 percent) to 2009 (*Ministry of Cooperative and Small and Medium Enterprises*, 2010). If we split off the value of export by classification of SMEs, the largest contribution of SMEs to export derived from medium enterprises that accounted for 11-15 percent from 2005 to 2009 periods. Tambunan (2007) also found that export-oriented SMEs in Indonesia do indirectly export their products via intermediary parties such as traders, trading houses, and exporting companies.

3. Financial Policies Affecting SMEs

Government policies to address problems of accessing financial support can be divided into two periods: the 'New-Order era' (pre-crisis) and the 'Post-New Order era' (post-crisis). The New Order government's efforts to assist in the development of SMEs, particularly related to financial support, were indicated by various direct special credit programs aimed at bridging SMEs difficulty in accessing financial institutions.

There were at least two types of credit programs initiated by New-Order government, namely the Small Enterprises Development (KIK-*Kredit Investasi Kecil*/ KMKP-*Kredit Modal Kerja Permanen*) Program and the Small Enterprises Credit (KUK-*Kredit Usaha Kecil*) Program. The first program, KIK/ KMKP, was launched in 1973 and ended in 1990. This was a nationwide subsidized credit program directed to small enterprises, namely indigenous[1], including cottage enterprises, and was aimed at providing credit for investment (KIK) and working capital purposes (KMKP) (Thee, 2006). In particular, this program provided interest subsidies to those enterprises. For KIK, the actual provision was managed by five state-owned commercial banks, the Indonesian Development Bank (Bapindo-*Bank Pembangunan Indonesia*), all regional development banks (BPD- *Bank Pembangunan Daerah*) and 14 private banks (Thee, 1994). Because of high a default rate of more than 27 percent, the KIK and KMKP credit programs were stopped in 1990.

To replace the KIK and KMKP programs, in 1990 the government initiated a new credit program, the Small Enterprise Credit (KUK- *Kredit Usaha Kecil*) Program. Under this program, all commercial banks were required to allocate 20 percent of their loans to small enterprises and cooperatives to provide for either investment or working capital. The term 'small' here is attributed to enterprises with net assets of Rp600 million or less, excluding buildings and land. Unlike the previous credit programs (KIK/ KMKP), the KUK was designed to assign interest at market rate rather than at a subsidized rate. Unfortunately, the story of the KUK program was similar to that of the KIK and KMKP

[1] Indigenous is a terms that refers to a business unit operated or owned by local people, so called *pribumi*.

programs. The KUK program did not perform well because the banks either experienced difficulties in meeting the government requirement of 20 percent, or they were simply unwilling to provide 20 percent of their loans to SMEs. It was also found that banks allocated more of their loans to consumption rather than business purposes (Thee, 2006).

After the fall of the New Order regime, the new government implemented a new policy to eliminate problems faced by SMEs by removing barriers to accessing financial support, focused especially on formal financial institutions. Under the Presidential Instruction Number 6 of 2007, the government introduced three policies to accelerate SME development. These were: increasing institutional capacity and access of Micro and SMEs to financing sources, strengthening the loan guarantee system for Micro and SMEs, and optimizing non-banking funds to empower Micro and SMEs. The first policy dealt with strengthening the capacity of SMEs while the last two policies were related to efforts to improve financial access of SMEs. According to attempts to reduce SMEs' financial burden, the government simplified the process of collateral certification in order to facilitate SMEs in accessing external finance from formal institutions such as banks.

By Presidential Instruction Number 6/ 2007, the government introduced a credit scheme for micro and small enterprises, known as micro credit loans (KUR-*Kredit Usaha Rakyat*). These are government-guaranteed loans directed to micro, small, and medium enterprises as well as cooperatives which are productive and feasible businesses, but still un-bankable. The KUR scheme initially requires project or business activity as the principal collateral for the loan. However, since this collateral does not meet with the banks' own requirements, the government initiated a guarantee program for micro, SMEs, and cooperatives so they can access loans from banks. In addition, like the KIK/ KMKP programs in the New Order regime, KUR is intended to provide working capital and investment credit of up to Rp500 million. The credit providers are commercial banks assigned by the government. Yet, the difference between the KIK/KMKP schemes and KUR is that KUR does not provide interest subsidies.

Based on a report from the Coordinating Ministry for Economic Affairs (CMEA), it is claimed that during the period January-December 2010, six banks (BRI, BNI, BTN, Bank

Mandiri, Bank Syariah Mandiri, and Bank Bukopin) and 13 regional development banks (BPD) disbursed approximately Rp17.23 trillion to 1.437.650 debtors. Based on this "success" story, however, some banks are still facing several constraints in distributing the loans under the KUR scheme. For example, they inform that many applicants failed to meet criteria set by the banks in order to make sure that they are able to pay back the loans. Moreover, though KUR loans are aimed at providing business financing to enterprises, many applicants request the loan for consumption purposes. In addition, it is also found commonplace for banks to still demand additional collateral from prospective customers (i.e. 30 percent of total loan). Not unimportantly, there exists some sectoral bias in loan disbursement, with the majority of loans granted to the trade service sector.

4. Survey Report

4.1. Survey Design and Methodology

This study employs small and medium enterprises as our respondents, with Micro, Small, and Medium Enterprises defined according to Law No. 20/ 2008. The criteria for a firm to be classified as a 'small enterprise' are having net assets, excluding land and buildings, of between Rp 50 million and Rp 500 million, or having annual sales of between Rp 300 million and Rp 2.5 billion. The criteria for medium enterprises are having net assets, excluding land and buildings, of between Rp 500 million and Rp 10 billion, or having annual sales between of Rp 2.5 billion and Rp 50 billion.

This survey was focused on three pre-determined industries. Those industries were clothing and garment (CG), parts and components of automotive (PCA), and parts and components of electronics and machineries (PCEM)[2]. The survey was administered by LPEM-FEUI from October to December 2010 using the latest Indonesian Economic

[2] The Clothing and Garment industry (CG) comprises Indonesian Standards of Industrial Classifications (ISIC) code 17 and 18, the Parts and components of automotive industry (PCA) consists of ISIC code 34 and 35, and the Parts and components of machinery and electronics industry (PCEM) contains ISIC code 29-32.

Census (from 2006), published by the National Statistic Office (herein, BPS-*Badan Pusat Statistik*) to construct sampling frames. The census suggests that West Java, Central Java, and East Java together account for 55 percent of total number of manufacturing SMEs in Indonesia. This survey applied a random method of selecting companies as respondents from these three provinces.

Table 1. Distribution of Respondents

Province	Industry			N
	CG	PCA	PCEM	
West Java	24	21	18	63
Central Java	38	19	23	80
East Java	11	4	3	18
N	73	44	44	161

Source: Author's calculations.

Among the selected respondents, LPEM FEUI utilized respondents from the previous survey of SMEs Production Networks. However, not all of the old respondents can be surveyed due to several reasons: some had closed, some had moved, and others were unwilling to participate. Around 70 percent of the previous survey's respondents participated in this new survey.

The survey utilized a structured questionnaire that was applied among country members of the ERIA-SMEs working group. Technically, this questionnaire was translated from English into Indonesian to ensure all respondents are able to answer it. Since this questionnaire asks for extensive information, including sometimes sensitive company financial data, the target respondents were middle managers and above, or the owners of the companies.

4.2. Profile of Respondent

Companies operating in all three industries were mostly established before 1990. This illustrates that the majority of companies in these industries are mature, and the survival rate in these industries is high. During this period (before 1990), companies in the Clothing and Garment Industry (CG) and in Parts and Components of Electronics and Machinery

(PCEM) are concentrated in Central Java, while companies in Parts and Components of Automotive industry (PCA) are distributed evenly in West and Central Java.

Table 2. Companies' Year of Establishment

Province	Industry	Year of Estalishment				N
		<1990	1990-1995	1996-2000	>2000	
West Java	CG	1	7	11	5	24
	PCA	7	5	4	5	21
	PCEM	5	4	4	5	18
Central Java	CG	17	10	6	5	38
	PCA	7	5	5	2	19
	PCEM	9	4	7	3	23
East Java	CG	3	2	4	2	11
	PCA	3	0	0	1	4
	PCEM	2	0	1	0	3
N		54	37	42	28	161

Source: Author's calculations.

On average, the Clothing and Garment Industry (CG) employs the highest number of people, when compared to other industries. On the other hand, the average number of people employed by the Parts and Components of Electronics and Machinery (PCEM) industry is the lowest, at nearly the half of the Clothing and Garment industry's number. These figures show that the technical process of the CG industry to be labor intensive, while the PCEM's technical process depends more on machinery. In terms of education, all of these industries depend heavily on workers with high school education or lower.

Table 3. Employment and Education of Labor

Description	**Degree of education**	**Industry**		
		CG	**PCA**	**PCEM**
Employment[3] (average)		109	103	40
Worker Education (%)	Tertiary or higher	4.2	3.7	6.7
	Vocational	9.5	24.6	33.2
	High School or less	86.2	72	60

Source: Author's calculation.

[3] Total number of employment both full-time and part-time employee.

Table 4. Full-Time Employment by Industry

Industry	Number of Employee					n
	1-5	6-49	50-99	100-1999	>=200	
CG	13	46	6	0	8	73
PCA	16	21	2	1	4	44
PCEM	8	28	3	3	2	44

Source: Author's calculation.

A comparison between Table 3 and 4 above reveals an interesting pattern. On average, only a small number of employees are full-time employees, while the rest work part-time. As clearly shown by Table 4, the majority of SMEs in all industries hire only 6 to 49 full-time employees.

Companies that are owned by domestic owners as account for 93 percent of the total companies surveyed, or 149 out of 161 companies. The rest of the companies are either owned entirely by foreigners or are joint ventures between foreign and local owners. A large proportion of foreign owners are from Japan and South Korea. Other foreign owners identified are from Hongkong and Singapore. Among the companies surveyed, their targets involve the domestic and export markets. However, 147 companies (about 91 percent of these companies) still rely on the domestic market alone.

Table 5. Ownership and Proportion of Production

Industry	N	Status of SME			Proportion of Production		
		Domestic	Foreign	Join-Venture	Domestic	Export	Domestic&Export
CG	73	68	5	0	65	3	5
PCA	44	41	2	1	42	0	2
PCEM	44	40	3	1	40	2	2

Source: Author's calculations.

With further analysis of the ownership status of SMEs, this survey identifies that whether or not the companies are domestically- or foreign-owned, most of them do not participate in production networks. CG companies are in a production network if they sell their products in both domestic and export markets. They usually sell their products to the final consumers directly.

Table 6. Production Network

Status of SME	Production Network?	N	Industry		
			CG	PCA	PCEM
Domestic	Production Network	5	5	0	0
	No-Production Network	144	63	41	40
Foreign	Production Network	2	0	1	1
	No-Production Network	8	5	1	2
Join-Venture	Production Network	1	0	1	0
	No-Production Network	1	0	0	1

Source: Author's calculations.

In terms of profit in 2008 and 2009, companies in the clothing and garment industry (CG) mostly acquired 10-20 percent of total sales. A similar pattern is seen in the parts and components of electronics and machinery industry (PCEM). However, a smaller profit ratio is seen in the parts and components of automotive industry (PCA), at 0-10 percent. There seems that most SMEs in CG and PCEM industries experienced a high profit during 2008 to 2009.

Table 7. Profit

Profit (%)	Industry (n)					
	Garment		Automotive		Electronic	
	2008	2009	2008	2009	2008	2009
Missing	3	3	5	5	2	1
Loss	0	1	0	0	0	0
0-10	20	20	14	17	12	11
>10- 20	34	29	13	10	12	14
>20- 30	11	14	8	8	11	11
>30	5	6	4	4	7	7
N	**73**	**73**	**44**	**44**	**44**	**44**

Source: Author's calculations.

Material costs represent the largest proportion of costs for all of the industries, which is on average about 50-60 percent, followed next by labor costs(around 30 percent on average). Moreover, sales growth from 2008-2009 is, on average, the highest in the parts and components of electronics and machinery industry (PCEM) at 12.3 percent. The second highest is in the Clothing and Garment industry (CG) at 10.7 percent and the lowest is seen in the parts and components of automotive industry (PCA) which, at 2.1 percent, differs significantly from the other two.

Table 8. Cost Structure

Cost of Production as % of total cost (on Average)	Industry					
	Garment		Automotive		Electronic	
	2008	2009	2008	2009	2008	2009
Labor	30,8	32,0	31,4	31,2	30,3	29,2
Raw material/intermediate goods	55,2	57,1	57,0	57,7	56,4	58,6
Electricity,fuel,and water	6,8	6,6	7,2	7,1	7,5	7,2
Interest payment (loan)	3,4	3,3	2,6	2,4	2,8	2,4
Others	0,9	1,0	1,8	1,7	2,9	2,6
Growth of Sales (mean)		**10,1**		**2,1**		**10,7**

Source: Author's calculations.

4.3. Accessibility of Finance

There are various sources of finance for SMEs, but at least three major sources are commonly acknowledged, namely formal external sources (e.g. commercial banks, cooperatives, micro finance institutions (MFI), credit unions, government, suppliers), informal external sources (e.g. loan sharks, friends or relatives) and internal sources (e.g. retained earnings, owners private savings, loans from employees). While these sources vary in their characteristics, features, advantages and disadvantages, this study focuses only on formal external source of finance. Hence, only SMEs that are actually able to acquire finance from external institutions like commercial banks, micro finance institutions (MFI), credit unions, cooperatives, suppliers, government or other formal institutions are defined as firms with access to finance. This distinctness or delineation is very important as it leads to the notion of "*financial gaps*" which serves as the theoretical framework of the study.

By taking this definition into account, more than half of the total 161 (90 firms, or 55.9 percent) SMEs surveyed have access to finance. Table 9 below presents the distribution of SMEs among our three key industries. Across these industries, an interesting distribution pattern appears. Parts and Component of Automotive (PCA) is the only industry in which majority of SME have no access to finance. In contrast, the majority of SMEs in others two industries have access to finance.

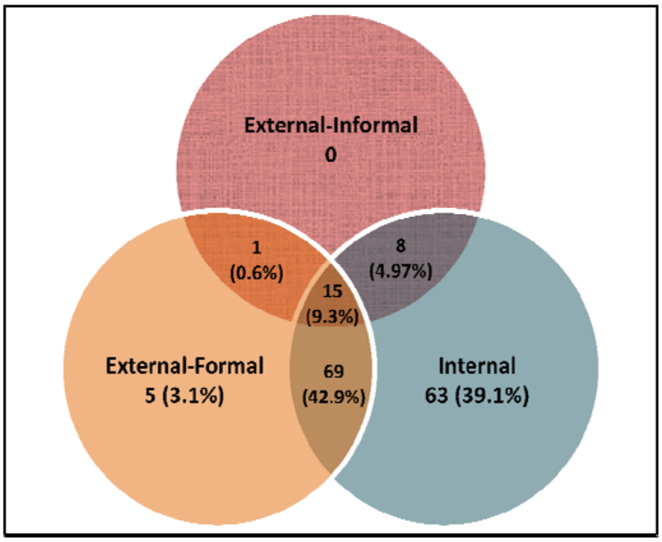
Table 9. Distribution of SMEs by Accessibility of Finance and by Industry

Category of SME	Industry			N
	CG	PCA	PCEM	
No Access	33	23	15	71
Have Access	40	21	29	90
N	73	44	44	161

Source: Author's calculations.

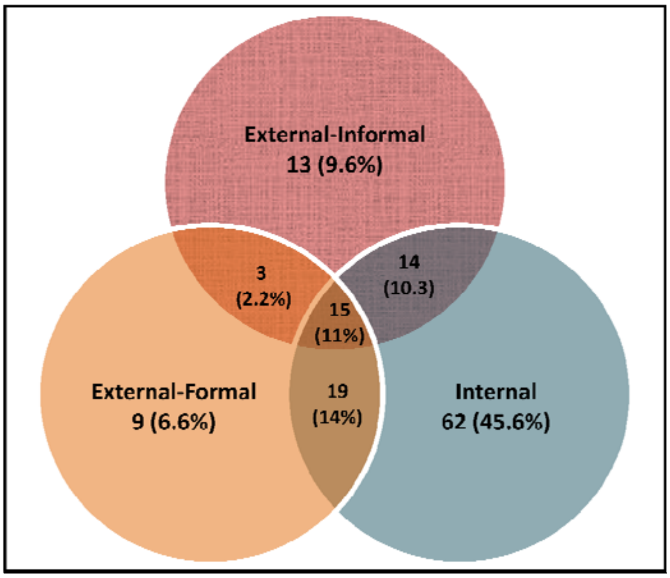
Taking a further look into financial accessibility of these SMEs, some unexpected patterns emerge. Graphs 1 and 2 attempt to portray this pattern.

Graph 1. Sources of Finance for Maintaining the Business



Source: Author's calculations

Graph 2. Source of Finance for Start up Businesses



Source: Author's calculations.

Graphs 1 and 2 provide a diagram of SMEs with their financial sources for both maintaining and starting up a business. It is implied that information from maintaining and starting up businesses (questions in part G) reflects the actual finance obtained from their sources, rather than just a request (questions in part A).

It is clearly shown from graph 1 that even for SMEs with access to finance (able to acquire from external formal sources), reliance on internal sources (e.g. personal/owners savings, retained earnings) and external informal sources (loan from friends or relatives) still prevails. The graph also shows that the number of SMEs that rely only on external formal sources is very small, at 3 percent of total respondents. The dependency on internal and/or informal financial sources along with external-formal sources (i.e. using joint financial sources) for maintaining their businesses may reflect not only the presence of uncertainty but also high opportunity cost of accessing external sources. Overall, this picture may indicate that despite having access to external formal sources of finance, the majority of SME respondents in Indonesia still have traditional mindsets in their way of doing business. This also explains the low share of loan interest payments in the cost structure.

In add, for those with access to finance, the type of formal external sources commonly used include commercial/personal loans from financial institution (e.g. banks, cooperatives), trade credit from suppliers and micro-credit from micro-finance institutions. All of these sources reveal that the majority of SMEs in Indonesia still rely on borrowing, rather than alternative source like leasing and venture capital.

Those with no access to finance mainly rely on internal sources, i.e. personal/owners savings, retained earnings, and loans from employees. Exposure to external sources of finance for these SMEs, if any, is limited only to informal borrowing from friends or individuals unrelated to the business/owners.

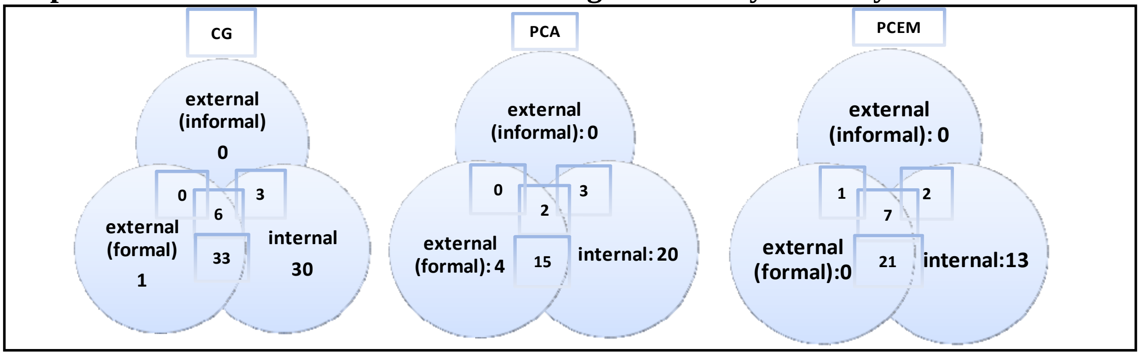
A reasonably similar composition also appears in type of financial sources for business start up as presented in Graph 2. It is natural to heavily rely on internal sources for starting up a business, since they have no experience and credit history yet. Interestingly, there seems to be a gradual shift in financial sources from internal to external-informal and then to external-formal, as shown by the number of SMEs: 45,6 percent of total respondents utilize internal sources only, 9,6 percent use external-informal sources only, and 6,6 percent use external-formal sources only.

Similar to maintaining business, utilizing a combination of financial sources is also common for start up businesses. As shown in graph 2, amongst these hybrid types of financing, dependencies on internal sources is still present. 14 percent of total respondent utilize a combination of external-formal and internal sources, 11 percent utilize a combination of all three, and 10 percent use a mixture of external-informal and internal sources. By contrast, only 2 percent of total respondents use a combination of external-formal and external-informal sources.

Although having access to finance, a pattern of heavy reliance on internal sources is also clearly seen for maintaining businesses across the industries. This type of source, in particular personal/owners saving and retained earnings, are still the two major financial sources for all SMEs across all industries. However, the external sources vary across industries. While both the Clothing and Garment (CG) and Parts and Components of Electronics and Machineries (PCEM) Industries rely on loans from banks and micro credit, the Parts and Components of Automotive (PCA) Industry depends on trade/ supplier credit and loans from banks. Such variation may perhaps reflect the different nature of the industries. Graph 3 below presents this pattern.

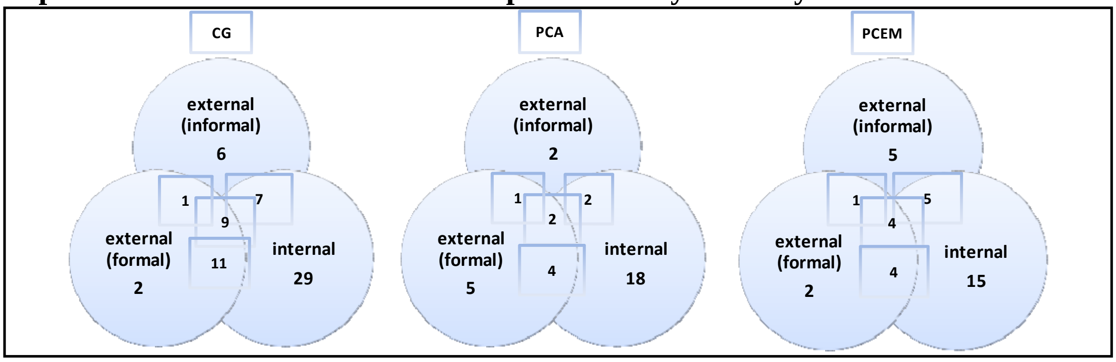
Graph 4 shows a similar pattern for start up businesses. Undisputedly, the major financial source for these companies is personal/owners savings. Some variation across industries appears for the next source. While SMEs in the garment industry rely on loans from friends and relatives (informal external source), those in electronics industries get it from commercial/personal loans from financial institutions (formal external source) as their source of financing.

Graph 3. Sources of Finance for Maintaining Business by Industry



Source: Author's calculations.

Graph 4. Source of Finance for Start up Business by Industry



Source: Author's calculations.

4.3.1. Owner Characteristics

It is a standard practice in the financial sector for at least five important factors to be considered before a decision to approve a commercial loan is made. These factors are commonly known as 5C, and one of these factors is characteristics of the business owners.[4] Tables 10, 11 and 12 below present some elements of owner characteristics, such as age, sex, years of experience, net assets and information on how they run the business.

Table 10. Age Group

Category of SME	Age of Majority Owner					Total
	Don't Know	<=30	31-40	40-50	>50	
No Access	2	4	19	22	24	71
Have Access	5	2	22	29	32	90
Total	7	6	41	51	56	161

Source: Author's calculations.

Table 11. Gender of Owner

Category of SME	Sex of Majority Owner			Total
	Don't Know	Female	Male	
No Access	0	8	63	71
Have Access	3	13	74	90
Total	3	21	137	161

Source: Author's calculations.

Table 12. Years of Experience

Category of SME	Year of Experience of Majority Owner				Total
	Don't Know	0-10	>10-20	>20	
No Access	8	19	28	16	71
Have Access	19	21	35	15	90
Total	27	40	62	32	161

Source: Author's calculations.

For the most part, it is revealed that responding SMEs are owned by males aged 40 years and above with business experience of around 10 to 20 years. The owners' business experience is highly correlated with the fact that most of the SMEs surveyed were

[4] The other factors are: capital, collateral, cash flow and business condition.

established before the 1990s. This pattern holds for both SMEs with access and without access to sources of finance.

Interestingly, although there are far fewer female business, the proportion of them who have access to finance is slightly larger than that of male business owners, 13 of 90 (14.5 percent) as opposed to 8 of 71(11.3 percent) respectively.

Table 13. Net Asset of Owner

Category of SME	Industry	Net Asset of Majority Owner (000,000)						n
		Missing	<250	>=250-1000	>1000-5000	>5000-10000	>10000	
Non-Access	Garment	5	10	13	2	1	2	33
	Automotive	4	10	7	2	0	0	23
	Electronic	3	1	6	3	0	2	15
	N	**12**	**21**	**26**	**7**	**1**	**4**	**71**
Access	Garment	6	15	12	5	0	2	40
	Automotive	7	2	2	3	4	3	21
	Electronic	3	5	7	9	3	2	29
	N	**16**	**22**	**21**	**17**	**7**	**7**	**90**

Source: Author's calculation.

Another important element of 5C is capital which sometime can be replaced by net assets of the owners as a proxy. The higher the capital (the net assets of the owner) is the greater the possibility of securing finance from the credit lender institutions. From the view of credit lenders, higher capital signals greater ability of borrowers to pay back his/ her loan, hence the lenders are more likely to offer loans.

The general pattern from the Table 13 above presents that that majority of both SMEs with and without access to finance are owned by people with net assets of less than Rp. 1 billion, 43 of 90 and 47 of 70 respectively. However, owners with net assets of Rp. 1 billion and above are more prevalent in SMEs with access to finance rather than those without access, 31 of 90 against 12 of 71 respectively. To some extent, the latter pattern seems to support the above hypothesis higher capital results in better prospects of access to finance.

Variations in owners' net assets ownership exist in some industries. Among firms without access to finance, large proportion of SMEs in garment and parts & component of automotive industries are owned by people with net asset less than Rp. 1 billion, while more than one third of SMEs in the parts & component of electronics industry are owned by people with net asset more than Rp 1 billion and about 40 percent have net asset between Rp 250 million and Rp 1 billion. But for those with access, the composition changes, where only SMEs in the garment industry are still mostly owned by people whose net asset are less than Rp. 1 billion. The other two industries have more variation in net asset value of their owners. This may indicate that investment in the parts and component of automotive and electronics industries might require more capital, and hence companies in these industries are more likely to be financed externally.

4.3.2. Owner's Attitude toward their Business

The attitude suggests that SME owners are more focused on their core business and are not very enthusiastic about investing in unrelated business lines (only 39 of 161 respondents answer yes). If any, only a small number of owners are involved in managing these businesses (only 36 of 161 answered yes). Moreover, their involvement is primarily due to the fact that these businesses are owned or operated by friends or relatives (only 34 of 161 answered yes). Owners who actually invest in independent business lines are even smaller in number (only 30 of 161 answered yes). This overall configuration supports that majority of SMEs in Indonesia, regardless of whether they have financial access or not, are still traditional or conventional in their way of doing business.

4.3.3. Firms' Characteristics

Some important characteristics of firms involve their technological and innovation capabilities, which can be shown from their R&D expenditure or patent holdings. Table 14 and 15 below shows these capabilities.

Tabel 14. R&D Expenditure

Category of SME	Expenditure of R&D (in %)					Total
	Missing	0	>0-10	>10-20	>20	
No Access	20	50	0	1	0	71
Have Access	46	35	6	2	1	90
N	66	85	6	3	1	161

Source: Author's calculations.

Tabel 15. Patent Ownership

Category of SME	Missing	No-Patent	Have Patent	Total
No Access	0	65	6	71
Have Access	5	67	18	90
N	5	132	24	161

Source: Author's calculations.

It is surprising that the number of missing values for proportions of R&D expenditure is large (Table 14). This is mainly due to the incapability of respondents to answer the questions because he/she is only a low-level manager, rather than the owner of the firm. Despite this, Table 14 shows that slightly more than half of all SMEs (85 of 161) surveyed spent nothing (0 percent) on R&D, of which a larger proportion is found among SMEs with no access to finance relative to those with access, 50 of 71 as opposed to 35 of 90 respectively. Unlike SMEs with no access to finance, some variations in R&D expenditure appear for those with access to finance. This may suggest that there is a positive correlation between having R&D expenditure and the existence of financial access.

A rather similar composition also emerges with regard to the number of patents held by SMEs. While a large number of SMEs (132 of 161) do not hold patents, patent-holding SMEs are likely to be those with financial access (18 of 90 as opposed to 6 of 71).

It can be inferred that SMEs that spend money on R&D or hold patents are likely to have better chance of securing finance from external sources. Apart from showing the technology and innovation capabilities of the firms, these two aspects may send a signal to the credit lenders that they have good product and good market, and hence, better capability to repay the loan if they borrow money. In this case, the most common type of patent held by SMEs is in the form of trade mark.

The presence of potential business plan is another crucial element in obtaining access to finance from formal institutions. A business plan simply represents the vision and strategy of the owners toward the business and the industry. Table 16 and Graph 5 below try to capture business expansion plans issue.

Table 16. Business Expansion Plans

Category of SME	Business Expansion in the next 2 years?			Total
	Missing	No	Yes	
No Access	5	18	48	71
Have access	4	17	69	90
N	9	35	117	161

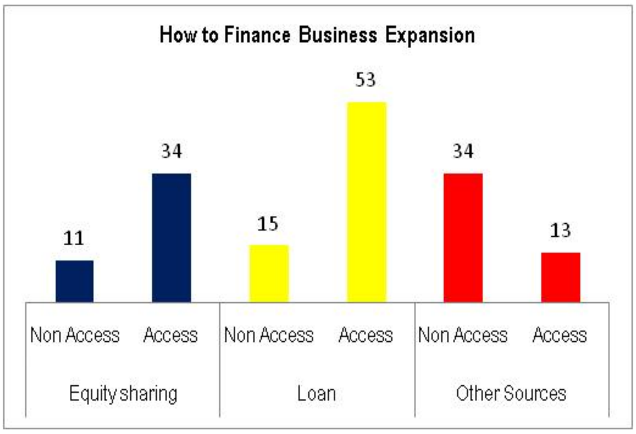
Source: Author's calculations.

Table 17. Sources of Funding

Category of SME	Is internal fund sufficient ?			Total
	Missing	No	Yes	
No Access	10	24	37	71
Have access	15	49	26	90
N	25	73	63	161

Source: Author's calculations.

Graph 5. How to Finance Business Expansion



Source: Author's calculations.

While Table 16 shows that most of the SMEs surveyed (117 of 161) have plans to expand their business in the next two years, of which a greater proportion these SMEs have access to finance. Table 17 illustrates that the majority of them perceive internal sources are insufficient to finance their expansion, hence Graph 5 presents that instead of equity or other sources, borrowing is the likely preference to be used by owners to finance their expansion plan. This is particularly true for SMEs with access to finance.

The firms’ stage of development also affects the likelihood of having financial access, and is highly correlated with the year of establishment. Young firms or start up businesses are likely to be at a disadvantage in having access due to limited credit record, or perhaps higher probability of default. By contrast, an older SME has proven its ability to survive, and hence is more likely to have financial access. Table 17 and 18 portray stages of SME business development both by industry and by financial accessibility.

Table 18. Stage of Business Development by Industry

Industry	Business stage of development						Total
	Missing	Start-up	Fast growth	Slow growth	Maturity	Decline	
CG	2	1	7	30	19	14	73
PCA	2	0	3	17	8	14	44
PCEM	2	0	5	18	10	9	44
N	6	1	15	65	37	37	161

Source: Author’s calculations.

Table 19. Stage of Business Development by Accessibility of Finance

Category of SME	Business’s Stage of Development						
	Missing	Start-up	Fast Growth	Slow Growth	Maturity	Decline	Total
No Access	1	1	3	29	17	20	71
Have Access	5	0	12	36	20	17	90
N	6	1	15	65	37	37	161

Source: Author’s calculation.

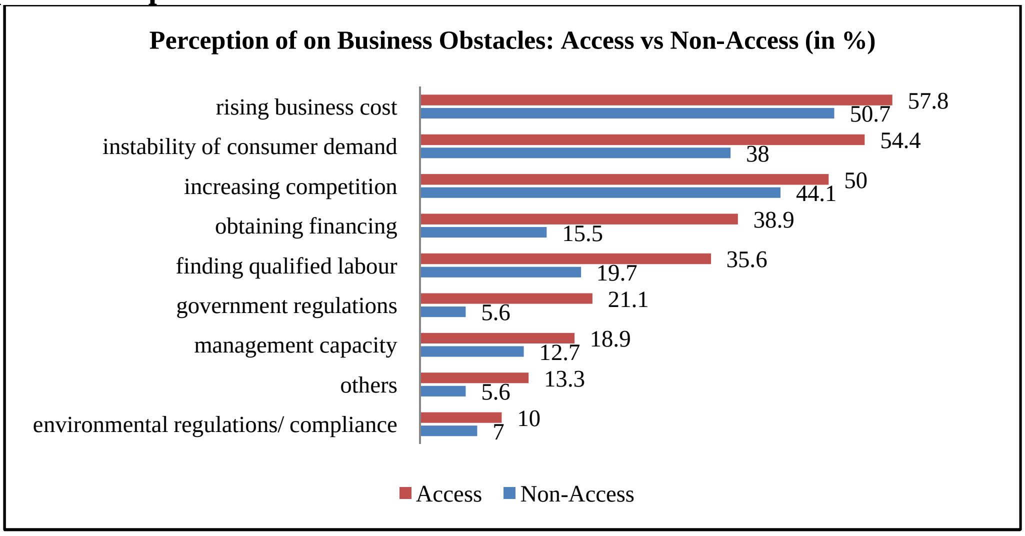
Considering that the majority of SMEs surveyed were established before the 1990s, it is unsurprising to find that a large proportion of these SME are concentrated in the stage of slow growth (sales increase with diminishing rate). This pattern can be found for both tables; business development stage by industry and by accessibility of finance.

Some variation across industries exists. Relative to the garment and parts & components of electronics industries, the parts & component of automotive industry seems to be entering the “sunset” period, as shown by the large proportion of SMEs which are declining, and the smaller proportion of fast-growing SMEs.

With respect to accessibility of finance, SMEs with financial access are more likely to be at the fast-growth stage, and a smaller proportion in the declining stage. However, SMEs in the parts & components of automotive industry with financial access seem to have different characteristics compared to SMEs in two other industries. This implies that SMEs in the parts & components of automotive is less developed than the other industries with regard to financial access. This is confirmed by Table 8.

4.3.4. Perceptions of Obstacles

Graph 6. Perceptions of Business Obstacles



Source: Author's calculations.

A slight variation in perception of obstacles to business growth, between SMEs with and without access to finance exists. Interestingly, both SMEs with and without access to finance perceive rising business costs as their number one obstacle to growth. Meanwhile the rest of the obstacles are similar, varying only in sequence. For SMEs with financial access, the top five perceived obstacles to growth are: 1) rising business costs; 2) instability of consumer demand; 3) increasing competition; 4) obtaining financing; and 5) finding qualified labor. While the top five obstacles to growth perceived by SMEs without financial access are: 1) rising business costs; 2) increasing competition; 3) instability of consumer demand; 4) finding qualified labor; and 5) obtaining financing.

4.4. Financial Institutions

Financial institutions in Indonesia are still largely dominated by the banking industry, although the development of other institutions such as leasing companies and cooperatives has also been quite significant recently. The existence of non-bank financial institutions creates a larger market, and offers a wider variety of products, and terms and conditions, all of which will make the financial industry more flexible for Indonesian customers.

In general, credit supply in Indonesia through banks increases from year to year. The Central Bank (Bank of Indonesia, or BI) records that credit in the banking sector until February 2011 grew by about 24.6 percent or about Rp 1,772.4 trillion relative to the year before. On the other hand, demand for credit is still dominated by large credit (more than Rp 5 billion) which accounts for about 47 percent. However, demand for micro, small and medium credit presents an increasing trend from time to time and in 2010 these represented about 20 percent of total demand for credit. Some commercial banks have entered the SME segment in order to enlarge their business. This recent development in the banking industry illustrates the efforts of commercial banks to improve their function as SME credit suppliers. However, the development of credit demand from non-bank financial institutions in Indonesia is not well recorded and governed.

The survey manages to obtain responses from eleven (11) financial institutions. However, some of the information obtained is incomplete due to a number of reasons, but mainly because of confidentiality restrictions. Even if they do disclose, they only share the total number or percentage rather than detailed information required by the questionnaire. Hence, the information presented in this section is somewhat limited and must be carefully interpreted. The distribution of financial institutions across provinces is presented in Table 20 below.

Table 20. Name of Financial Institution and Provinces

Type of Institutions	Province			Total
	West Java	Central Java	East Java	
Commercial Bank	1	2	2	5
Cooperative	2	0	0	2
Leasing Company	1	0	0	1
Rural Bank	0	3	0	3
Total	4	5	2	11

Source: Author's calculations.

Of eleven institutions, five of them are located at Central Java, four in West Java and the rest are in East Java province. Three of these five institutions in Central Java are the rural credit bank (BPR), while the other two are branches of national commercial banks. Those in West Java are comprised of one branch of a commercial bank, two cooperatives and one multi-finance company. The financial institutions in East Java consist of two commercial banks.

With respect to total assets, these financial institutions present wide variations, ranging from Rp. 260 million (the cooperative); Rp. 13 billion (the rural credit bank) in the middle; to Rp. 2 trillion (one of the national commercial banks), which is the highest. However, it should be carefully noted, especially for the commercial bank, that such a huge amount of assets refers to total assets of the bank, rather than assets of the branch.

Table 21.Type of Institution and Type of Financing Facility

Type of Institutions	Type of Finance				Total
	Loan	Factoring	Leasing	Loan & Factoring	
Commercial Bank	3	1	0	1	5
Cooperative	2	0	0	0	2
Leasing Company	0	0	1	0	1
Rural Bank	2	0	0	1	3
Total	7	1	1	2	11

Source: Author's calculations.

Table 21 above describes type of institution and its type of financing facility. As many of the institutions are in the banking sector, both commercial as well as rural credit banks, the majority offer loan financing facilities. Furthermore, cooperatives also offer similar facilities. There are only few that offer other services like leasing or factoring and both facilities.

Table 22. Reasons for Refusal of Financial Requests by Type of Institution

Reasons for turning down financial requests		Type of Financial Institutions			
		Commercial Bank	Cooperative	Leasing Company	Rural Bank
Insufficient Sales, Income, or Cash Flow		4,8	4	5	4,3
Insufficient Collateral		4,6	3	1	4
Poor Business Plan		4,8	4	4	4,7
Poor Credit History		4,6	4,5	5	4,7
Unstable types of Business		4,2	2	4	4
Age of Business		4	2	4	1,3
Gender of Owner		1,8	1	1	1
Other Reasons	Customer Characters and Recommendation	5	0	0	0
	Legality of Business Ownership	0	0	4	0

Source: Author's calculations.
Note: Figures are average values. The higher the number, the more important the reason is.

Overall, regardless of the type of financial institution, the bottom line is that these institutions are looking for SME that are capable of repaying the loans they offered, as shown by having projected cash flow, credit history, and business plan. Failure to comprehend these aspects is likely to end in a refusal to get financed. However slight variations in reasons appear among these institutions. For instance, for commercial banks, owners' characteristics, availability of a business plan, and projected cash flow are important aspects to be assessed. For cooperatives, slightly different aspects count. The availability of credit history, business plan, and projected cash flow does matter. Leasing companies pay more attention to projected cash flow and credit history, while rural banks are looking for credit history, business plan and projected cash flow.

Of these reasons, the least important aspects which are considered are gender of owner and age of business. This implies that issue of male versus female owner or issue of start up versus mature business is irrelevant in getting financial access as long as they have capability to repay the loan.

5. Conclusion and Policy Recommendations

5.1. Conclusion

It is inevitable that firms need financing to grow and expand their business, including small and medium enterprises (SMEs). However, in order to do so, SMEs often encounter difficulties, in particular limited sources of finance, and hence a financial gap is created.

The survey attempts to shed light on this issue and illustrate the current situation for Indonesian SMEs. It reveals that about 56 percent of SME respondents have access to finance, which is defined as the ability to acquire financial sources from external formal institutions. Such institutions may include banks, cooperatives, micro finance institutions, the government, and suppliers. Interestingly, although having the ability to acquire finance from external sources, reliance on internal financial sources, particularly personal savings and retained earnings, still prevails and plays a crucial role.

In addition, there are only a few firms that just rely on external formal sources, namely only 3.1 percent of SMEs with access use external formal finance. This might be because either non-technical reasons such as cultural aspects or they do not see any need. Some of them might have access, but they choose not to use external financial services. To a large extent such a situation may reflect the fact that the majority of Indonesian SMEs are still considered to be traditional or conventional in doing business. From police makers' view the findings do not really constitute to a problem of asymmetric information because their lack of demand, rather, drives them to not using external financial supports.

Conversely, the survey found that almost half of SMEs have no access to finance even though external financial sources are available. There are possible explanations of why financial problem for such SMEs exists. *First*, SMEs are unable to reach external sources because they perceive that transaction costs in terms of administration and provision costs are too high. *Second,* collaterals to meet financial institution requirements are insufficient mostly because assets provided for loan guarantee are not yet certified. Because they need quick financial support in order to maintain their regular activities, SMEs rather do use external sources with high interest rate particularly from informal institutions. *Finally,* SMEs are lacked of good administration, hence they could not produce good business plan as required by formal institutions.

Having said that, it is not an easy task to identify significant differences between SMEs with access to finance and those without access. Except for a few characteristics, the analysis of patterns for the majority of firm characteristics produces a rather similar result. These characteristics include owners' characteristcs, capital, firms' technological characteristics, stages of development and even their perception of business obstacles. If any, variations are not very significant. As an illustration, there is no significant difference in owner characteristics between SMEs that have access to finance and those without access. A similar result is also found with percepetions of business obstacles. Both SMEs with access and without access perceive rising business costs as the main obstacles to expand their business. The other obstacles are also the same, but only differ in rank. This may indicate there are other factors other than those commonly applied to get credit approval, namely the '5Cs', that enable SMEs to access finance.

The survey also manages to interview eleven (11) financial institutions, which mainly consist of banking-sector companies. There is not much information gathered from this side as they are reluctant to provide detail information due to confidentiality issues. Despite very little information, there is valuable information obtained concerning reasons for rejection of credit application. From the lenders' perspective, the three most important reasons to turn down applications are: (i) poor credit history; (ii) poor business plan; and (iii) insufficient sales, revenue and cashflow.

5.2. Recommendations

Reflecting on the survey's findings, some broad policy recommendations to improve access to finance are as follows:

1. In order to meet the criteria for credit approval, there must be some assistance for SMEs to improve their capacity building, such as preparing simple business plans, and developing simple accounting standard operating procedures and cash flow management systems. This could be conducted by the financial institutions

themselves, or through third parties such as private sector, for instance through business development services (BDS).

2. At he same time, given the nature of SMEs, financial institution must also adjust their standard operating procedures when dealing with SMEs. To this end, some prudential banking regulations must be relaxed to some extent. The role of Central Bank as the main authority of banking supervision is important here.

3. Some incentive for banking institutions to channel the credit to productive sectors, rather than consumer credit, should be provided.

4. The use of alternative institutions as a source of finance for SMEs, particularly in remote areas, should be promoted and socialized. One of the potential candidates is cooperatives that provide deposit and credit services (*koperasi simpan pinjam*) to members. These institution are not only in accordance with our basic law (UUD-*Undang-Undang Dasar*, 1945) but also because they are typically established based on member interest (a 'bottom up' approach) and provide services for members. Thus, the owners of SMEs become cooperative members and hence can borrow money from these institutions.

5. Promoting the establishment of forums or associations for these cooperatives. This in turn may lead to development of secondary markets for these cooperatives.

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