

A series of thin, light-colored wavy lines that flow from the left side of the page towards the right, creating a sense of movement and modern design.

CHAPTER VI

MSME

TRANSFORMATION

FOR INCLUSIVE

ECONOMIC GROWTH

A vertical rectangular inset image on the right side of the page. It shows a close-up of a person's head and shoulders, looking down at a mobile device held in their hand. The person has dark, curly hair and is wearing a dark blue garment. The background of the inset is slightly blurred, focusing attention on the person and the device.



Various policies continue to be strengthened for the development of Micro, Small and Medium Enterprises (MSMEs), which play a strategic role in the economy through the pillars of corporatization, capacity and financing and supporting strong, inclusive economic growth. Efforts to transform MSMEs are being pursued through the use of digitalization to increase resilience and via greater productivity and innovation. MSME development policy is also supported by synergies which continue to be strengthened between Bank Indonesia and the Government, financial institutions and business players.

The transformation of MSMEs is vital to support stability as well as strong and inclusive economic growth.

MSMEs play a strategic role in the domestic economy, as reflected in the great number of business units; the large number of people employed; and their significant contribution to GDP. MSMEs have also been resilient in the face of various crises in the past, even though they are now under great pressure from the Covid-19 crisis. The resilience of MSMEs has acted as a cushion for the economy because of the ability of MSMEs to withstand periods of pressure and then recover and grow at a brisker pace. In light of this strategic role, MSMEs play an important role in supporting Bank Indonesia's policy mix in order to safeguard macroeconomic and financial sector stability, in addition to national efforts to support economic transformation towards making Indonesia a developed nation. Various end-to-end efforts have been made to strengthen MSMEs, including by Bank Indonesia. Post the Covid-19 pandemic, the transformation of MSMEs will need to be continuously strengthened through optimizing the use of digital technology for daily activities to help mitigate the impact of the health crisis.

The end-to-end development of MSMEs is carried out through corporate policy pillars, capacity building and financing, in order to create productive, innovative and adaptive MSMEs.

Corporatization is carried out to strengthen institutional aspects of MSMEs to encourage the creation of an integrated business ecosystem and to increase economies of scale. For its part, capacity building is focused on increasing productivity through innovation and digitalization of business processes in order to make MSMEs more competitive. Capacity building is being carried out in an integrated manner, which includes the strengthening of business management; product quality; market access; financial capacity; and human resource capacity, including the mastery of digital technology. The ability to adapt to the development of digital technology is one of the keys for MSMEs to advance. In the aspect of financing, wider access continues to be encouraged to facilitate business expansion with healthier MSME financing options. MSME development is guided by the productive, innovative and adaptive MSME road map with 4 stages, namely: i) production and institutional activities; ii) increase in market share; iii) digitalization and financing; and iv) access to export markets.

Digital-based transformation will support acceleration of MSME development. The rapid development of the digital economy and finance have given rise to various digital platforms that offer innovative solutions in areas related to production, consumption, collaboration and sharing. This digitalization

"Digital-based transformation will support the acceleration of MSME development"

provides opportunities for MSMEs to survive, adapt, transform and prosper, accompanied by increased corporatization, capacity and financing. One of the important lessons learned from the Covid-19 pandemic is the need to accelerate the use digital technologies to address consumption needs, production activities and investment transactions. As such, the use of digital platforms can help create stronger MSMEs by promoting productivity and innovation and facilitating the expansion of MSMEs' access to marketplaces, industries and financial institutions. Greater MSME access to these various digitizing services will help MSMEs move forward to undertake business expansion and make them more competitive in the post-Covid-19 new normal era.

Efforts to develop MSMEs have shown significant progress.

MSME corporatization has been developed in many regions and has resulted in strong cluster business models that can be replicated, such as the chili cluster in Sleman and the horticulture cluster in Malang. Optimizing the use of digitalization

in strengthening the capacity of MSMEs has also started to be adopted in order to improve innovation and the quality of products and services, business management, human resource capacity, financial management and market access. The digitalization of business processes in the agricultural sector has been applied both on- and off-farm. Technology based upon the Internet of Things (IoT) has been applied for both the production and marketing disciplines in a number of agricultural clusters in the Java, Sumatra, Kalimantan and Nusa Tenggara regions, and these are supported by digital agricultural platforms.⁴⁴ Efforts to expand access to MSME financing are also being encouraged through the provision of technical assistance, including facilitating business meetings between banks and MSMEs, as well as developing a business model for accessing MSME finance as done in the beef cattle cluster in Tuban Regency. Such efforts have been undertaken through synergies that were continuously strengthened among Bank Indonesia, the Government and other related parties.

Going forward, optimizing the role of MSMEs as the backbone of the economy, will continue to be aimed at increasing productivity and achieving inclusive economic growth, by adapting to digital change. The end-to-end MSME development policy

"Efforts to develop MSMEs have shown significant progress "

is undertaken through the three policy pillars (corporatization, capacity and financing; see below) and it is supported by synergies among Bank Indonesia, the Government, financial institutions and business players. Development of MSMEs is expected to support national economic recovery in the short-term and maintain the resilience of the national economy in the medium-term. To ensure these goals are achieved, the strengthening of MSMEs is focused on export potential and tourism development, as well as strengthening the supply and distribution of strategic food commodities. This is achieved through attaining synergy between the policies and programs of the Central and Local Governments with the aim of creating superior MSMEs at the national and regional levels.

⁴⁴ Internet of Things (IoT) refers to a network of physical objects that are embedded with electronic technology (e.g., sensors and software) for the purpose of connecting and exchanging data with other devices and systems over the Internet. It has wide application commercial applications.

MSMEs a Key to Promoting Economic Growth

MSMEs play an important role in the economy, but they can take on a larger role in boosting national economic growth. MSME business units in 2018

reached 99.99% of the total business units absorbing 97.0% of the private sector workforce. MSMEs also play a major role in driving economic growth, as reflected in their 61.1% share of GDP. In 2018, MSME GDP growth stood at 9.6%, which is high, but still less than the growth rates of previous years (Chart 6.1). The labor productivity of MSMEs has also been on an increasing trend, although it remains below that of large enterprises (Chart 6.2). On the side of exports, MSMEs accounted for 14.4% of exports in 2018. On the basis of these and other data, MSMEs clearly play an important role in the national economy and have the potential to be further developed, especially if end-to-end development can be carried out in a sustainable manner.

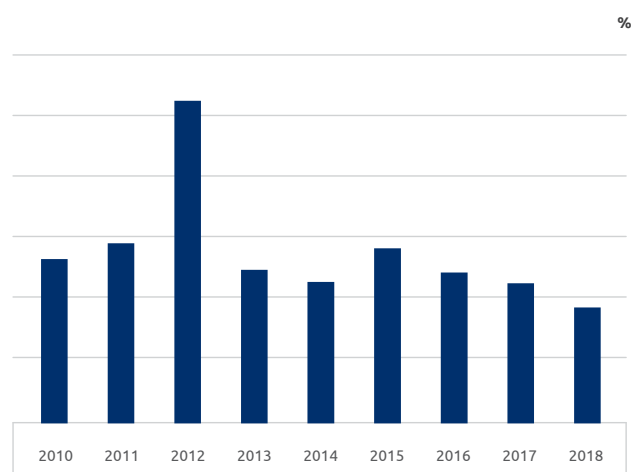
High economic resilience of MSMEs will help to support economic stability. MSMEs are relatively small business units but have the advantage of being flexible and resilient in the face of changes to the strategic environment. This reflects the fact that in many cases MSME products meet the needs of the people; make use of domestic raw materials and resources; and their risk exposure to financial markets

is minimal. Many MSMEs also have flexible business models, for instance, being willing to adopt digital technology, as reflected in the trend of digitizing MSMEs. Given these characteristics, MSMEs can cushion the economy during periods of weakness and help to boost the performance of other sectors while absorbing a lot of additional informal workers, including during economic slowdowns. By way of example, the 2009 Global Financial Crisis (GFC), MSME growth (GDP basis) remained high at 13.6% (yoy), despite a slowdown from 24% (yoy) in 2008.⁴⁵ Looking at the Covid-19 period, MSMEs have still shown resilience and have the potential to recover quickly post-pandemic.

The strategic role of MSMEs continues to be strengthened end-to-end via the road map for developing MSMEs. The focus of end-to-end development of MSMEs is threefold, namely: i) strengthening institutions and increasing business scale; ii) raising productivity through digital innovation; and iii) giving MSMEs greater access to markets, industries and financial institutions. With regard to markets, the roadmap for developing

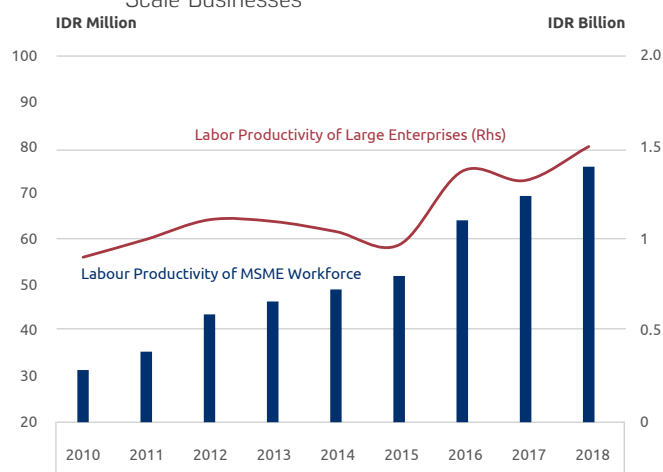
⁴⁵ Post-GFC, MSME GDP growth remained high, even showing stronger performance in 2011 and 2012.

Chart 6.1. GDP Growth for MSMEs



Source: Ministry of Cooperatives and SMEs and BPS, calculated

Chart 6.2. MSME Worker Productivity Compared to Large Scale Businesses



Source: Ministry of Cooperatives and SMEs, calculated

MSMEs emphasizes Digital and Export MSMEs, including tourism as well as the supply and distribution of strategic food products. The process of digitizing each step in the development of MSMEs will create opportunities for strengthening the chain of MSME activities, starting from production, processing, marketing and financing, to producing new digital-based business models that are more efficient and competitive. As a result of strengthening measures, MSMEs will be able to progress to the next level and create greater added value both in the domestic economy and via an increase in exports.

The strengthening of MSMEs is important to increase the effectiveness of policy transmission.

Productive, innovative and efficient MSMEs will support the effectiveness of central bank policy transmission through their role in increasing economic aggregate demand. Strong MSMEs will support a more efficient allocation of resources, so that the central bank's policies to bolster aggregate demand will be transmitted more effectively. MSME's easier access to financial products and to sound financing will also help to increase the effectiveness of monetary policy transmission. The presence of strong MSMEs with easy access to financing will result in a more effective monetary policy transmission channel, whether through the interest rate channel, credit channel or other channels. This condition will also provide positive feedback to MSMEs regarding their ability to adjust to changing interest rates.

The development of MSMEs is also part of efforts to ensure financial system stability. The provision of financial services to MSMEs would also to help protect the health and safety of the financial system by broadening financial institutions' lending base

through economic financing initiatives. This is one of the pillars of macroprudential policy, along with the pillar for safeguarding systemic risk in the financial system. In addition, MSMEs' easier access to digital-based payment products and services will facilitate transactions and strengthen the payment system. There are other, direct benefits to MSMEs, too. For instance, better financial literacy provides MSMEs with better financial management skills that complements their improved access to financing, including from formal financial institutions for business expansion. This stands in sharp contrast to traditional MSME financing whereby MSMEs typically make use of their own funds or obtain external funds from non-formal financial institutions which can be high-cost and high-risk.

MSME development further supports priority sectors. Policies to promote priority sectors, including manufacturing and tourism, are aimed at making Indonesia a country with high value added and diversified, inclusive sources of growth. Many of these sectors could get a higher contribution from MSMEs.⁴⁶ For example, developing MSMEs is specifically aimed at sub-sectors like the creative economy; food and beverages; fashion; handicrafts; tourism; and strategic commodities. As further concern tourism, the strengthening of tourism-supporting MSMEs, including those located near tourism destinations, is intended to help make tourism a source of new economic growth and foreign exchange.

⁴⁶ MSMEs make a fairly large contribution to the manufacturing and tourism sectors, as reflected in their dominance of the wholesale and retail trade sector (including hotels and restaurants) which reached 63.5%, followed by the manufacturing sector at 16.7% and other services sectors at 10.7%.

The MSME Ecosystem Has Been Strengthened

Efforts to increase the productivity of the national economy require better performance by MSMEs.

The experiences of various countries, including China, show that increasing productivity is an important factor in promoting high economic growth.⁴⁷ With the strategic role played by MSMEs in the national economy and their ability to support the economy during times of weak economic growth, policies aimed at increasing the productivity of MSMEs are very useful. Nonetheless, it is not easy to boost the productivity of MSMEs and efforts must be made systematically and sustainably, especially given the differences in the productivity levels of MSMEs as between sectors and between players with different scales of doing business.⁴⁸

Increasing the productivity of MSMEs could be optimized through more innovation. The challenges faced in increasing the productivity of MSMEs relate to the limited access to formal financial institutions; production technology; human resource capacity; raw materials; and marketing.⁴⁹ Besides that, MSMEs are generally managed informally, with modestly educated managers and low skilled workers.⁵⁰ These hinder the ability of MSMEs to increase business productivity. MSMEs operating on a smaller scale of business generally innovate less frequently and some of them are even unable to innovate independently.⁵¹ Making MSMEs more innovative will help to bring about inclusive growth by reducing the productivity gap between MSMEs and other larger scale businesses. Efforts to achieve this goal can be optimized by taking advantage of the economic and digital financial opportunities taking place in this 'new normal' era.

The Covid-19 pandemic has pushed MSMEs to innovate and adapt to developments in digital technology and to the new normal era. The pandemic has given rise to an increasingly contact-free economy and accelerated the transformation of consumer behavior by utilizing digital technology for the purpose of economic and financial interactions and transactions. During the Covid-19 pandemic, consumers in Indonesia have mostly shopped online and made non-cash transactions, a habit that is predicted to continue after the pandemic ends.⁵² Responding to shifting consumer behavior, MSMEs are increasingly utilizing digital platforms, with easier market access being the main incentive.⁵³ The development of digitalization also offers opportunities for MSMEs to innovate their production processes and products and services to better meet the needs of consumers. Digitalization also facilitates productive, innovative interaction and collaboration, whereas literacy and digitalization encourage MSMEs to be more adaptive and proactive in seizing opportunities to grow more briskly.

Greater economies of scale, which increase production and reduce costs, can also have a positive impact on MSME productivity. Greater economies of scale will benefit MSMEs, including in purchasing, production and more efficient management. Purchasing raw materials in larger quantities will provide MSMEs with bulk discounts and a better bargaining position, which can lower raw material prices. Greater economies of scale will also permit the division of labor and greater use of skilled labor; diversification into products with higher added value; and better access to finance. Increasing MSMEs' economies of scale internally can be done

47 Varela, Gonzalo J. (2015), *Openness, Growth, and Productivity in Indonesia's Development Agenda*, World Bank Policy Note 1.

48 OECD, (2017), *Entrepreneurship at a Glance 2017*, OECD Publishing, Paris.

49 Irjayanti, M. and Azis, A.M. (2012), *Barrier Factors and Potential Solutions for Indonesian SMEs*, Procedia Econ. Finance 2012.

50 BPS, (2019), *The Potential for Improving the Performance of Micro and Small Enterprises*, Analysis of the 2016 Economic Census Results.

51 OECD, (2018), *SME Policy Index: ASEAN 2018: Boosting Competitiveness and Inclusive Growth*, OECD Publishing, Paris/Economic Research Institute for ASEAN and East Asia, Jakarta.

52 Google, Temasek, and Bain & Co (2019) noted that internet economic growth in Indonesia has increased rapidly since 2015, with an average annual growth rate of 49%, and the value could reach 130 billion US dollars in 2025. The dominance of e-commerce and ride hailing services in the digital economy landscape in Indonesia provides stark evidence of consumers' preference for online shopping.

53 ERIA (2018) stated that 72% of surveyed MSMEs in ASEAN prioritized business expansion over reducing costs (which was driven by productivity and operational improvements). This behaviour explains the widespread use of social media by MSME as an effective platform to reach consumers.

through business expansion accompanied by greater productivity and efficiency. Increasing economies of scale externally are also possible through closer institutional ties with other MSMEs, so that MSMEs can jointly benefit from higher economies of scale. Further in this regard, clusterization is a common practice that allows MSMEs to benefit jointly from greater economies of scale.

Bank Indonesia formulated the National Strategy (Stranas) for the Development of MSMEs. This strategy is based on three main pillars, namely: strengthening corporatization; increasing capacity; and providing easier access to finance. Success in this regard would make MSMEs more competitive and foster brisker and inclusive economic growth (Figure 6.1). Strengthening corporatization is done in order to increase economies of scale and/or added value by strengthening groups of MSMEs (clustering) that have similar, complementary and/or related businesses, with similar locations and/or interests. It is hoped that more corporatization will encourage the creation of an integrated business ecosystem in support of improved productivity. Increasing the capacity of MSMEs is intended to improve their human resources and business capacity. Meanwhile, improving access to finance is aimed at expanding alternative sources of formal capital for MSMEs in accordance with their needs and prospects for business development. Strengthening corporatization, capacity building and providing easier access to finance are done through synergies with various stakeholders, including Ministries/Institutions, the Local Government, the private sector as well as associations/communities and universities.

Strengthening corporatization will encourage the integration of a series of business value chains, both horizontally and vertically. MSME institutions continue to be strengthened through corporatization, supported by strong social capital. Groups are built on the basis of mutually beneficial cooperation aimed at increasingly formal and modern institutional business forms, including cooperatives, limited liability companies and others. Corporatization is also carried out through cooperation and partnerships, between MSMEs themselves or between MSMEs and partners along the value chain, with horizontal and vertical approaches. The horizontal MSME corporatization model consists of MSMEs in one particular business sector that form an institution to increase aggregate production capacity that collaborate with business support institutions. The vertical MSME corporatization model consists of various types of businesses that are interrelated in a series of business value chains to create value-added products. This integration will help to increase the economies of scale for MSME businesses (Figure 6.2). With larger economies of scale, corporatization will provide other benefits for MSMEs such as increased market access, easier access to financing and greater human resource capacity.

In an effort to increase MSME corporatization in Indonesia, the best cluster business models should be replicated. Replication can be done either horizontally or vertically, by applying technology; innovation; planting methods; institutional aspects; and business management in the best

Figure 6.1. National MSME Development Strategy



Source: Bank Indonesia

cluster business model.⁵⁴ The horizontal approach is demonstrated by the chili cluster in Sleman to maintain the availability of chilies at stable prices (one region, one price). The main activities in this cluster include crop management, the innovation of *mina chili* and drip irrigation, as well as a system of gathering points and auction markets. The benefits obtained from the development of corporatization include: (i) the application of crop management to maintain the supply of chilies throughout the year; (ii) the utilization of an integrated irrigation system to reduce water use; and (iii) the marketing of joint production by implementing an auction market system to improve the bargaining position of farmers. Meanwhile, the vertical approach is applied to the horticultural cluster in Malang, East Java, where partners with industry create value-added processed food products.

Capacity building will encourage improvements in the competitiveness of MSME players. Capacity building for MSMEs will encourage added value through the ability to develop new products. It is also hoped that capacity building will support improvements in the productivity of MSMEs to help raise competitiveness.⁵⁵ The production capacity of MSMEs is not yet optimal in efficiency, partly reflecting their more informal business management.⁵⁶ In the medium- to long-term, improving the competitiveness of MSMEs will increase their role in the local and global production chains,

either through direct or indirect participation with local companies or multinational companies that export.

The strategy for developing the capacity of MSMEs follows the road map for helping MSMEs to move up a class and become Digital MSMEs and/or exporters. Increasing the capacity of MSMEs is carried out to strengthen the quality of their human resources and business potential so that they are more competitive. To support the increase in business scale and competitiveness of MSMEs, Bank Indonesia has established a road map for developing MSMEs based on business capabilities, namely: Potential MSMEs; Successful MSMEs; Digital MSMEs; and Export MSMEs (Figure 6.3). Bank Indonesia will seek to increase the capacity of specific MSMEs as needed and align them with the road map for developing MSMEs. The development of MSMEs in the roadmap for MSMEs will be done over 4 years in 4 stages, namely production and institutional activities; expansion of market share; digitalization and financing; and export market access.⁵⁷ In practice, the roadmap for the stages of developing MSMEs is adjusted to the conditions of individual MSMEs in the field.

Capacity building is carried out in an integrated manner to increase productivity, including through digitizing MSMEs. Increasing MSMEs' capacity includes strengthening business management; improving product quality; expanding market access; increasing financial capacity; and better human resources, including the mastery of digital technology. In its early stages, MSME development

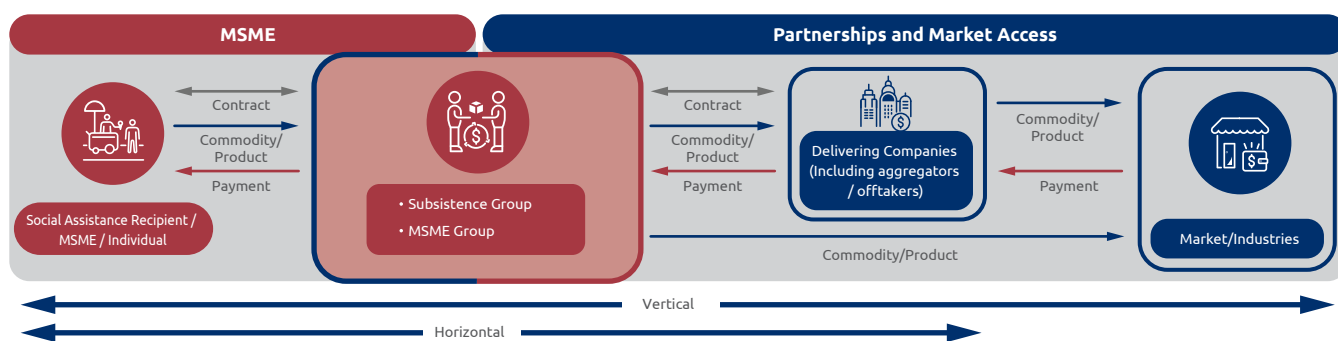
54 The key success factor for the development of corporatization is generally the motivation to achieve the same goals accompanied by strong management, supported by clear standard operating procedures (SOPs), whilst still acknowledging the local wisdom in each unit.

55 Berry, et. al. (1991), Small-Scale Industry in the Asian-Pacific Region Asian Pacific.

56 Perry, et. al. (2007), Informality: Exit and Exclusion, World Bank, Washington DC.

57 Bank Indonesia, (2020), Study of Business Models and Development Strategies for Upgrading MSME.

Figure 6.2. Generic Model for MSME Corporatization



focused on institutional strengthening and increasing the scale of business.⁵⁸ Now, successful MSME development is aimed at improving the quality of product design and packaging as well as expanding market access, including the use of digital technology, such as through the MSME onboarding program for e-commerce. The capacity of MSMEs continues to be strengthened through optimizing their use of digital technology, both in the production and marketing processes, including for payment transactions and expanding access to finance. Furthermore, increasing the export potential of MSMEs to reach the global market is achieved, among other ways, via facilitating the participation of MSMEs in trade promotions and MSME business meetings with potential buyers from inside and outside the country.

Giving MSMEs easier access to finance will promote efforts to achieve inclusive economic growth. There is a positive relationship between the accessibility of MSMEs to financial institutions, their contribution to economic growth and job creation, and between the effectiveness of a country's macroeconomic policy transmission, in this case fiscal and monetary policy.⁵⁹ Nonetheless, compared to large-scale business operators, MSMEs tend to rely on internal funds or on informal financing to start and operate a business, mainly due to the constraints that MSMEs face in accessing formal finance, especially in low-income countries. Various fundamental problems concerning MSME financing pose a challenge regarding the ability of MSMEs to obtain easier access to formal

financing. In Indonesia, most of the initial capital for the establishment of micro and small enterprises in all (non-agricultural) business sectors comes from private capital. In the event that additional financing support is required, individual sources of financing are more of a priority for MSMEs compared to sources of financing from banks or non-bank financial institutions.⁶⁰

Bank Indonesia continues to encourage efforts to improve access to MSME financing, both from the supply and demand sides. From the supply side, Bank Indonesia has established a national MSME Credit Ratio Policy, as stipulated in PBI No.17/12/PBI/2015. This requires commercial banks to allocate a minimum of 20% of total credit for MSMEs, both direct credit and indirect credit through executing, channeling and syndications.^{61, 62} On the demand side, Bank Indonesia provides technical assistance, including facilitating business meetings between banks and MSMEs to increase access to more sources of financing. Besides that, Bank Indonesia's Regional Representative Offices collaborate with local governments to develop business models to assist MSME's access to financing. This has been implemented, for example, in the beef cattle cluster of Tuban Regency, East Java. Implementation of this business model guarantees market access; price certainty for breeders; and easier access to finance. In this business model, a cooperative or business group assumes the role as an off-taker that provides market certainty and avalis (a credit guarantor) to ensure access to bank financing.

58 Institutional strengthening is carried out through technical assistance to facilitate obtaining business legality and permits; certification; the ability to record financial transactions; and the introduction of digital technology. Meanwhile, increasing the business scale is carried out by assisting the production process to achieve standardized production quantity and quality and to fulfil certain certification requirements.

59 IMF, (2019). Financial Inclusion of Small and Medium-Sized Enterprises in the Middle East and Central Asia.

60 BPS, (2019), The Potential for Improving the Performance of Micro and Small Enterprises, Analysis of the 2016 Economic Census Results.

61 Particularly for branch offices of foreign banks and joint venture banks, it can take into account non-MSME credit orientated for non-oil and gas exports.

62 Overall, in the banking industry, this target has been achieved with the realization of MSME credit disbursements of 20.75% in November 2020.

Figure 6.3. Bank Indonesia's MSME Development Road Map



Source: Bank Indonesia

Digitalization Accelerates the Development of MSMEs

The use of digitalization by MSMEs needs to be continuously strengthened to support the acceleration of MSME development. The trend in the use of digitalization by MSMEs has continued to rise in the past few years, although there is still room for acceleration and optimization of digitalization, especially regarding MSME capabilities and supporting infrastructure. MSMEs need to have certain capabilities in order to obtain easier access to the digital ecosystem and to gain benefits from its use in business activities. This is because MSMEs that already have access to the digital ecosystem, do not necessarily have a strong understanding of the use of digitalization to develop business activities.⁶³ Infrastructure aspects focus on providing incentives to make it easier for individual MSMEs to own digital technology facilities and infrastructure to support information technology and internet connectivity. The Indonesian Digitalization Index illustrates the room for greater digitalization; the Index shows considerable inequality, especially in areas off-Java, mainly owing to weaknesses of MSME capabilities and infrastructure (Figure 6.4).

Digitalization gives MSMEs opportunities to advance and become stronger. The adaptation and transformation of MSMEs in the use of digitalization will encourage MSMEs to be more resilient, more advanced and stronger. Rapid development of the digital economy and finance has generated various digital platforms that offer innovation in terms of production, consumption, collaboration and sharing. The use of digital platforms, including the use of digitized production processes with product and service innovation, can encourage stronger, more productive and innovative MSMEs. The adoption of a new, more efficient business model can be done

cheaply because of lower investment and operating costs. The utilization of digital platforms also allows MSMEs to capture business expansion opportunities supported by easier access to markets, industry and financial institutions. In addition, digital platforms are able to give MSMEs a better understanding of consumer needs and the overall business environment. MSME service quality can also improve, thanks to faster, easier and more efficient interactions with consumers and business partners along the value chain.

Digitalization is the entry point for MSMEs to increase market access, nationally and globally. MSME products that were originally sold only in local areas, can be sold more widely to both national and global markets, thanks to technological support. There is wide room for further MSME development, to align better the capabilities of Indonesian MSMEs with their peers, and to increase the contribution of MSME exports nationally and into global supply chains (Chart 6.3). To emphasize this potential, digitalization widens MSMEs' markets from Indonesia's domestic market of 269 million people, to a world market of 7.4 billion people, or 28 times the population of Indonesia.⁶⁴ The use of digital technology in the marketing of MSME products results in lower barriers to entry into an enormous market and allows greater efficiencies in reaching those markets, especially the target market as segmented in digital platforms. Digital devices can reduce cost and time by 40% and 10%, respectively for manufacturing companies, and by 82% and 29%, respectively for service providers.⁶⁵

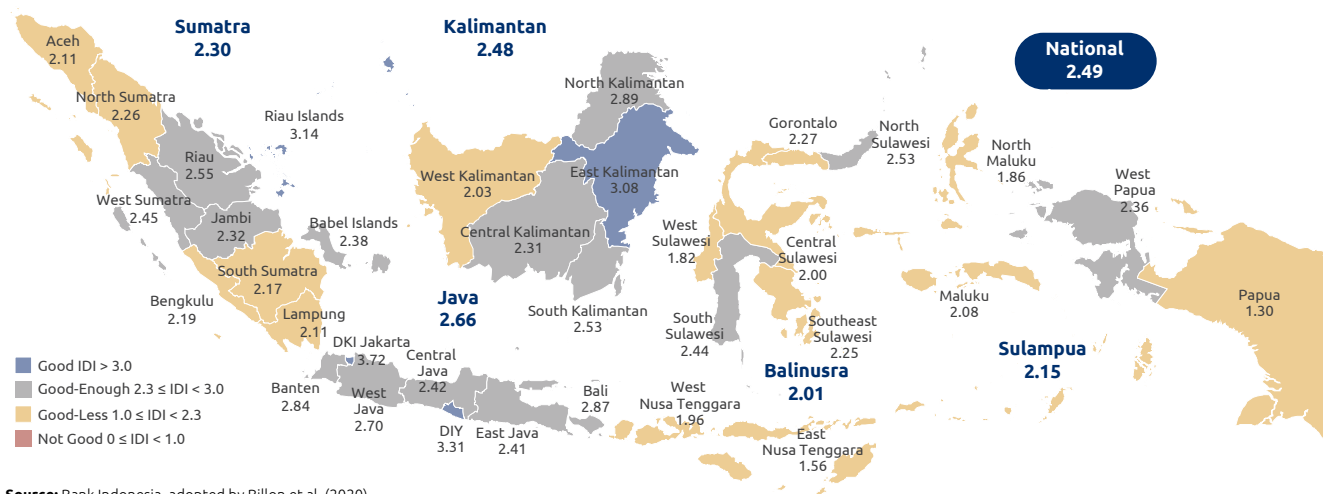
Digitalization gives MSMEs easier access to industry, which in turn strengthens domestic supply chains. Digitalization provides an additional means to strengthen the linkages between

⁶³ Various studies (Deloitte Access Economics, 2015; ERIA, 2018) state that MSMEs that have been online generally only use basic digital devices for communication and business operations; they have not yet utilized digital technology to improve UMKM capabilities.

⁶⁴ Worldmeters 2019.

⁶⁵ Asia Pacific MSME Trade Coalition (2018).

Figure 6.4. Level of Digitalization in Indonesia (ICT Development Index - IDI)



Source: Bank Indonesia, adopted by Billon et al. (2020)

MSMEs, and between MSMEs and other suppliers along the value chain. This step is consistent with efforts to strengthen MSME institutions through corporatization, which solidifies interaction and synergies, either between similar MSMEs or via value-chain integration. In this regard, the corporatization and value-chain integration facilitate knowledge transfer, including technological innovations that boost productivity.

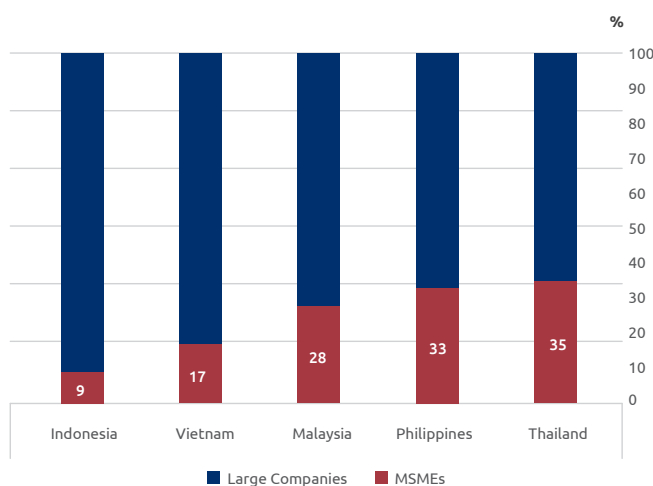
MSMEs have room for further development by obtaining greater access to financial institutions, including digital payment services. MSMEs have the potential to develop further, because they are mostly unbanked and have limited access to

financial products and services.⁶⁶ The development of information technology and digitalization in the financial sector has created a variety of alternative financial products and services offered by banks and non-banks, thereby potentially giving MSMEs easier financial access. Easier access to financial institutions through digitalization allows MSMEs to grow through their use of products and services related to payments, financial management and financing. Meanwhile, access to formal financial institutions should provide MSMEs with higher-quality financing.

Easier access to digital payment system services is also an important step towards better funding through financial technology. The use of digital payment system services will speed up and simplify MSME transactions, thereby reducing operational costs and potentially increasing revenues. QRIS is such a digital payment instrument; it is fast, convenient, cheap and secure can improve MSMEs' financial management. In addition, data in the digital payment system can be a source of information concerning the creditworthiness of MSMEs, which is a useful new business model for establishing a credit profile and assessing creditworthiness.

Expanding QRIS contributes to improved MSMEs' access to digital payment system services. As of December 2020, there were more than 5 million MSMEs that use QRIS across all regions of Indonesia.

Chart 6.3. Proportion of MSME Exports to National Exports by Value



Source: Wignaraja (2012)

⁶⁶ Based on data on the number of MSME credit accounts in October 2020, only a small proportion (25%) of MSMEs are estimated to have access to credit. A lack of comprehensive data on MSME creditworthiness is often an obstacle for MSMEs in accessing credit.

There are various benefits from using QRIS, including fast, efficient, recorded and secure transactions that are supervised by Bank Indonesia, and that involve no physical contact between people. Most QRIS users are MSME merchants, including more than 3.6 million Micro Businesses (UMI) and some 1.2 million Small Businesses (UKE). These examples illustrate how QRIS can support national economic and financial inclusion. This includes making MSME data available, which for a long time has not been possible. In the future, QRIS features will be extended to cover cross-border transactions, which have obvious advantages for MSME exporters.

Easier access to financial services through digitalization helps MSMEs expand. The data available by digitalization provide lenders with better information on MSMEs' creditworthiness, thereby reducing credit risk by overcoming perceptions of high-risk. Besides that, easier access to financing services reduces the operational costs of MSME lending, which are characterized by small nominal amounts and a large number of transactions. This has follow-on benefits insofar as these lower operational costs further improve MSMEs' access to financing.

Bank Indonesia is focusing on MSME digitalization to widen the reach of MSME marketing during the pandemic era. After the stage of institutional and production strengthening, MSME development emphasizes extending the reach of marketing

by, among others, encouraging marketing partnerships and product innovation. One way to undertake more effective innovation and improve product quality is by facilitating on-line product curation, tailored to target markets. Increasing the added value of products is carried out through collaborative assistance with designers and on-line curators. To promote MSME recovery and increase the digitalization of MSME in the pandemic era, Bank Indonesia also facilitates education and onboarding of coached and partner MSMEs to connect with the digital ecosystem. Education is carried out through the preparation of material that is more structured and systematic so that it is easily understood. This includes general digital literacy; digital marketing through various social media platforms; the onboarding process in the marketplace; digital payments; and an introduction to the concept of online aggregators.

During the pandemic era, Bank Indonesia has also implemented digitalization in the promotion of MSME products and the facilitation of business meetings (business matching). As an example, Bank Indonesia facilitated the promotion of curated MSME products and partner MSME products through an e-catalog in the virtual exhibition of Indonesian Creative Works 2020 (KKI). Besides promotions, KKI also facilitates virtual MSME business meetings, with financial institutions, FinTech players and exporters who are able to

generate financing commitments and expand export market access. Bank Indonesia is also active in including coached MSMEs and potential export partner MSMEs in various virtual trade promotions at the national and international levels. This includes Trade Expo Indonesia; Singapore Specialty Coffee (Online) Auction and Cupping Session; New York Now Digital Market 2020; Future Tea and Coffee Summit; Expo 2020; and China ASEAN Expo 2020.

Digitalization gives new opportunities for MSMEs. More and more MSMEs are benefitting from Government programs, by implementing digitalization and exploring new opportunities that arise from adopting digital-based business models. The development of the digital ecosystem has already provided various digital business models (from upstream to downstream) that can be adopted by MSMEs. By way of example, Bank Indonesia facilitates the use of IoT-based technology on the production and marketing sides of a number of coached agricultural clusters in the Java, Sumatra, Kalimantan and Nusa Tenggara regions, in collaboration with digital agricultural platforms. The digitalization of agricultural sector business processes is implemented, starting from the on-farm (upstream) side through to the use of weather sensors, and then to the off-farm (downstream) side, by facilitating access to agricultural e-commerce.

Going forward, optimizing the role of MSMEs as the backbone

of the economy will continue to emphasize higher productivity, inclusive economic growth and adaptation to digital change.

The role of MSMEs as a new national economic power is increasingly relevant today, with many countries starting to rely on sources of domestic economic growth, including through MSMEs. Strengthening MSMEs' role in this regard can be focused on priority sectors, like exports, tourism and the supply and distribution of strategic food commodities. This focus on priority sectors would support inter-sectoral and inter-regional integration, through the synergy of harmonious policies and programs with the National Government and Local Governments to produce superior MSME outcomes.



Strengthening of Synergy to Promote MSME Transformation

MSME transformation requires integrated policy synergies across sectors, centrally and regionally.

In facing global economic challenges, efforts to strengthen the role and resilience of MSMEs are increasingly relevant to support stronger, sustainable economic growth. Over the medium- to long-term, gradual improvements in MSME capacity will support the transformation process of Indonesia into a developed country. Strengthening MSMEs will indirectly support the realization of economic and financial inclusion, because of the wider access to formal financial institutions. Moreover, the rapid development of information technology demands a policy response to changes in the behavior of economic agents, including MSMEs, in line with the rapid penetration of the digital economy and digital finance in Indonesia. These fundamental changes in the economic landscape call for a policy response that is carried out holistically aimed at a common goal, namely improving people's welfare and the transition of Indonesia to a developed country.

Bank Indonesia's MSME development strategy is an integral part of the Government's national development strategy. The efforts to develop MSMEs carried out by Bank Indonesia and its 46 Domestic Bank Indonesia Representative Offices (KPwDN) work in synergy with related Ministries/ Institutions and Local Governments, as well as a number of communities in the regions. These efforts ensure that MSME development is carried out end-to-end, starting from the production, curating, and marketing until the strengthening of capital. Collaboration between Bank Indonesia and several Ministries/Agencies has been carried out, including with the Ministry of Industry; the Ministry of Cooperatives and SMEs; the National Craft Council (Dekranas); and the Regional National Craft Council (Dekranasda). This cooperation has resulted in a

number of concrete programs, such as joint studies; the formulation of policies according to the authority of each institution; exchanging data and information; training and technical guidance; facilitation and mentoring; product promotion and marketing; and policy dissemination.

Through synergy with the Government, Bank Indonesia encourages MSMEs as a force to support economic recovery. The implementation of Indonesian Creative Works (KKI) is a concrete form of Bank Indonesia's support for the "Proud of Made in Indonesian Product" National Movement (Gernas BBI) program. These activities, which are undertaken virtually, are key to prospects of MSMEs, especially through the utilization of digital space as a promotional and sales medium facilitated by the Government and Bank Indonesia. These joint efforts are expected to prompt MSMEs to take the necessary steps to become stronger and more competitive in the future. At the same time, Bank Indonesia also succeeded in facilitating business matching between MSMEs and potential domestic and foreign buyers, including those in Singapore, Italy, South Korea, Japan, China, and Australia. The commitment to this business agreement certainly sends an important message that the entry of MSME products into the digital market will give MSMEs greater market reach, including into overseas markets. These activities are carried out in Jakarta and in a number of other areas.

"Policies will continue to be strengthened to help MSMEs become a source of economic recovery in the digital era"

Going forward, policies will continue to be strengthened to help MSMEs become a source of economic recovery in the digital era. Efforts to encourage economic digitalization will be supported by helping MSMEs take advantage of the opportunities and benefits of the digitalization trend. In this regard, the MSME business process must also be transformed to become more adaptable in the new normal era. Accelerated digitalization is a solution to raise MSME Indonesia to a new level through expanding market access, financing and supply chain networks. To support this, a structured and systematic joint work program between Bank Indonesia and the Government and Local Governments will be directed to give MSMEs easier access to financial institutions; industry and marketplaces; and digital payment channels through the installation of QRIS (QR Code Indonesian Standard).



The opening of the Indonesian Creative Work 2020 Series 2 - 7 October 2020 was attended by the Chairman of Dekranas Hj. Wury Ma'ruf Amin.