

Why Women-Owned Businesses in Indonesia Stay Small

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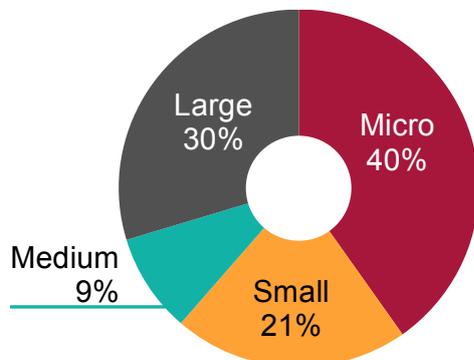
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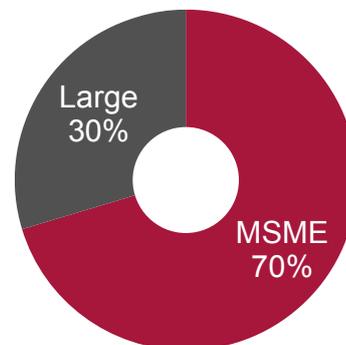
From complex regulations to inflexible loans, the incentives need to be aligned to encourage women entrepreneurs to expand their businesses.

Micro, small and medium-sized enterprises (MSMEs) are the economic engine of Indonesia. In 2013, MSMEs accounted for up to 70 percent of Indonesia's total gross domestic product, and more than 95 percent of the country's workforce works in an MSME.¹ And women owned nearly four in ten of those MSMEs in 2015.²

GDP Contribution per Business Scale in 2013



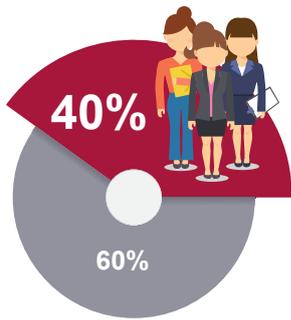
MSME - GDP Contribution 2013



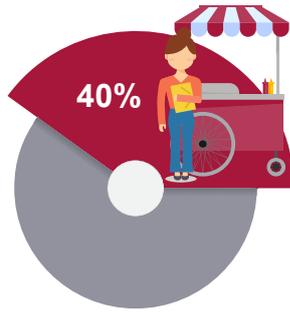
Source: Website of Ministry of Cooperative and MSME, MSME Data: The Growth of Large, Middle, Small and Micro Enterprises 2012-2013

¹ Website of Ministry of Cooperative and MSME, MSME Data: The Growth of Large, Middle, Small and Micro Enterprises 2012-2013

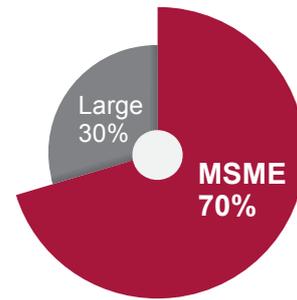
² The Development of Women Businesses for Family Welfare through Entrepreneurship, Ruslan MR, Assistant to Deputy Review and Research on MSME, Ministry of Cooperation and MSME, Presentation Material on November 3, 2016



Women make up about 40% of the world's workforce*



Women ownership represent nearly 40% of all MSMEs **



MSMEs accounted for 70% of Indonesian GDP in 2013; large corporations accounted for 30% ***

Source: *data.worldbank.org, **The Development of Women Businesses for Family Welfare through Entrepreneurship, Ruslan MR, Assistant to Deputy Review and Research on MSME, Ministry of Cooperation and MSME, Presentation Material on November 3rd, 2016, ***www.dekop.go.id - Website of Ministry of Cooperative and MSME : The Growth of Large, Middle, Small and Micro Enterprises 2012-2013

Although women are contributing substantially to the country's economic growth, they could contribute even more if they were to expand and build their businesses. Yet many if not most women business owners are opting to remain small and informal. Remaining in the informal economy makes it difficult for businesses to enter commercial contracts and access government subsidies and incentives. Operating in the informal economy places small businesses at a competitive disadvantage vis-à-vis their competitors.

Understanding why women business owners choose not to expand is important if countries are to design better policies and supports to encourage these businesses to grow and become formal enterprises. Knowing more about which sectors the informal businesses belong to, what prevents them from formalizing their enterprise and growing their client base, and how they think about growth will be critical to expand employment and ensure inclusive economic growth.

Toward that end, Centennial Asia Advisors and Independent Research & Advisory Indonesia identified key factors that influence entrepreneurs', and in particular women entrepreneurs', decision to remain in the informal economy in Indonesia. The research included: (1) a review of third-party statistics and analyses, including data from government and other sources on the state

of MSMEs in Indonesia; (2) empirical surveys with industry experts, and (3) focus groups of business owners across the archipelago. We summarize a sample of key findings here.

As this paper shows, women-owned micro and small businesses in Indonesia face several push and pull factors in deciding whether to remain small or expand their businesses. Time constraints and the demands of household domestic duties are a major reason for their decision to remain small and informal. Women's access to capital is also constrained, and even if available, the loan products do not fit their needs for faster access to cash at more flexible terms. This in turn drives them to informal lenders, even when the cost of that cash is considerably higher than capital from a bank.

As this white paper shows, helping women entrepreneurs move beyond the informal economy will be integral to ensuring that future economic growth fully taps women's potential and results in shared and equitable prosperity.³

Snapshot of MSMEs in Indonesia

Indonesia is the largest economy in Southeast Asia.⁴ With a gross domestic product at \$1.0 trillion in 2018 (or \$4,052 per capita), it ranks among the top 20 economies in the world, and the economy has grown steadily in the last decade.⁵ It is a nation of 26.7 million businesses and a workforce of 70.3 million. Nearly 90 percent (23.8 million) of these businesses are micro businesses (see box for definitions of micro, small, and medium businesses) and nine percent are small businesses.⁶ In other words, 99 percent of businesses in Indonesia are micro, small or medium enterprises.

³ The Mastercard Center for Inclusive Growth financially supported the study conducted by Centennial Asia Advisors. As an independent think tank, based in Singapore, Centennial is responsible for all findings, analysis, and conclusions. Neither Centennial Asia Advisors nor Independent Research & Advisory Indonesia have been provided access to any of Mastercard's data-driven insights.

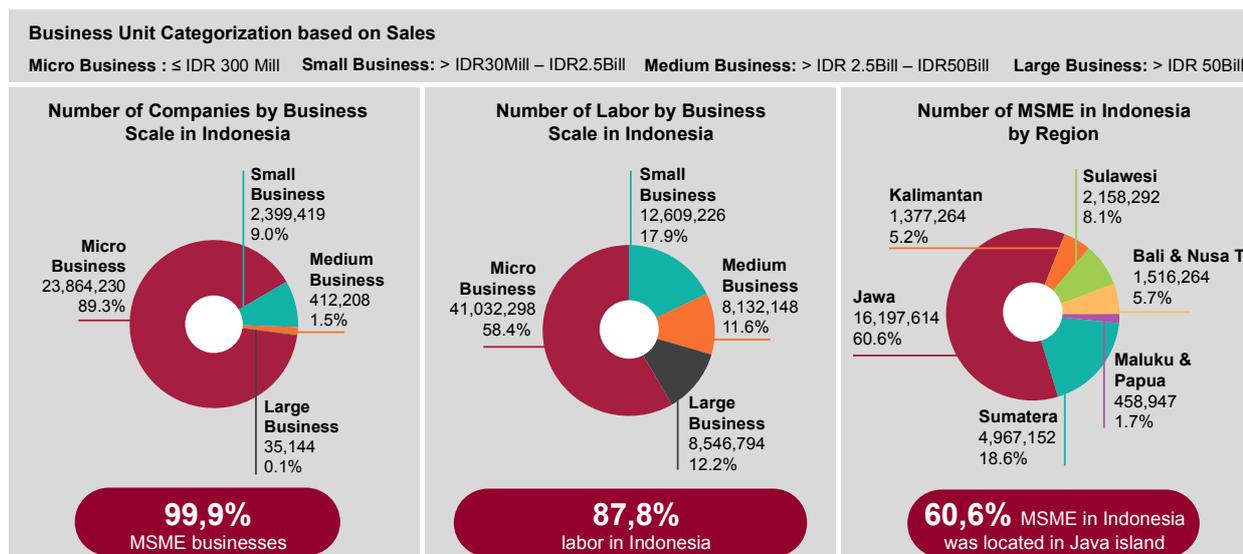
⁴ Unless otherwise noted, all data in this section are from the World Bank, <http://www.worldbank.org/en/country/indonesia/overview>

⁵ International Monetary Fund, "World Economic Outlook Database," April 2018. <https://bit.ly/2sPqmJG>

⁶ Economic Census 2016 for Micro Small Enterprises and Middle to Large Enterprises, Central Bureau of Statistics in 2017. <http://se2016.bps.go.id>

On average, micro enterprises absorb 58 percent of the workforce (or approximately 41 million people) and small businesses absorb 20 percent of the workforce (or 14 million people).⁷ In contrast, medium-sized businesses employ 8.1 million workers.

The majority of micro businesses are on Java Island (14.4 million businesses employing 24.8 million people), followed by Sumatra (4.6 million businesses employing nearly 8 million).



Source: Economic Census 2016 for Micro Small Enterprises and Middle to Large Enterprises, Central Bureau of Statistics in 2017. <http://se2016.bps.go.id>

Most micro businesses are started using fund from family money. The Indonesian government considers a micro business as those with less than 300 million IDR in revenue annually (or approximately US\$20,500). Micro businesses in Indonesia tend to remain small and informal.

⁷ Economic Census 2016 for Micro Small Enterprises and Middle to Large Enterprises, Central Bureau of Statistics in 2017. <http://se2016.bps.go.id>

Definition of MSMEs

All MSMEs in Indonesia are categorized as such by revenue and assets, as well as other criteria as described in Law 20/2008. To be considered an MSME, the business must be owned by individual or entity that is not subsidiary or branch of a medium or large corporation.

	Assets (in IDR)	Revenue (in IDR)
Micro business	<50 million	Up to 300 million
Small business	50 – 500 million	300 million – 2.5 billion
Medium business	500 million – 1 billion	2.5 – 50 billion

Source: Indonesian Law No. 20/2008 on Micro, Small and Medium Enterprises chapter IV article 6 on Criteria

The MSME sector in Indonesia is dominated by wholesale and retail trade, manufacturing, accommodation and food service. Seventy-nine percent of MSMEs are in these three sectors.⁸ Many entrepreneurs, both men and women, choose these sectors because they are “recession-proof” and income is stable. The three sectors are also easier to enter than more established sectors like financial services, real estate and construction.

Micro businesses are dominated by women entrepreneurs and are concentrated in food and accommodation and retail trade. Forty percent of micro businesses in 2016, for example, were in wholesale and retail trade, which includes clothes and textiles, accessories, handicrafts and fireworks for Eid al-Fitr celebrations at the close of Ramadan.⁹ Approximately 16 percent were in food service and accommodation and another 16 percent were in manufacturing. Most of the micro businesses are in the informal economy.

⁸ Economic Census 2016 for Micro Small Enterprises and Middle to Large Enterprises, Central Bureau of Statistics in 2017. <http://se2016.bps.go.id> - Table Number of Business/Enterprises Based on Business Field, 2016

⁹ Economic Census 2016 for Micro Small Enterprises and Middle to Large Enterprises, Central Bureau of Statistics in 2017. <http://se2016.bps.go.id> - Table Number of Business/Enterprises Based on Business Field, 2016

The following chart provides an overview of the characteristics unique to micro, small, and medium-sized businesses in Indonesia.

Aspect	Micro Business	Small Business	Medium Business
 Formality	<ul style="list-style-type: none"> Operates in informal structure. Unregistered business. Rarely or not paying tax. 	<ul style="list-style-type: none"> Some operate in the formal sector. Some are unregistered or no business licenses. Only few that pay tax 	<ul style="list-style-type: none"> Mostly in the formal sector. Mostly registered and pay taxes.
 Economic Relations	Most of them do not have a business relationship with larger business.	Many of them may have access to government programs (such as credit program) and have business relationship with large business (including foreign investment or PMA).	Most of them may have access to government programs (credit program) and many have business ties with large businesses (including PMA).
 Market Orientation	Generally sell to local markets for low income groups.	<ul style="list-style-type: none"> Many are selling to the domestic and export markets. Serving the lower middle class. 	<ul style="list-style-type: none"> All of them sell to the domestic market and most of them are also to export market. Serving upper middle class.
 Women Entrepreneurs	The ratio of women who work as entrepreneurs is estimated very high than men.	The ratio of women who work as entrepreneurs is estimated quite high than men.	The ratio of women who work as entrepreneurs is estimated relatively very low than men.

Source: IRAI analysis, 2018

Reasons Why Women Entrepreneurs Stay Small

To women entrepreneurs in Indonesia, it is often a perfectly rational decision to stay small. Time commitments are a frequent consideration. Women in Indonesia are expected to handle all the domestic and caregiving demands while running their business, which makes balancing an expanding business difficult. In addition, from IRAI's survey in selected cities, many women (42 percent) have started a small business to simply supplement their husband's earnings and are content to remain small if they are achieving that goal. Women also hold little economic decision-making power in the family. They typically defer to their husband on matters of business and they often need their spouse's approval for any business-related actions.

Still others are hesitant to expand because it would mean hiring staff other than family members or expanding into new markets. Instead they may reject new orders rather than hiring more staff to help fulfill them. Others are not sure where to start the process of becoming a formal entity. In our

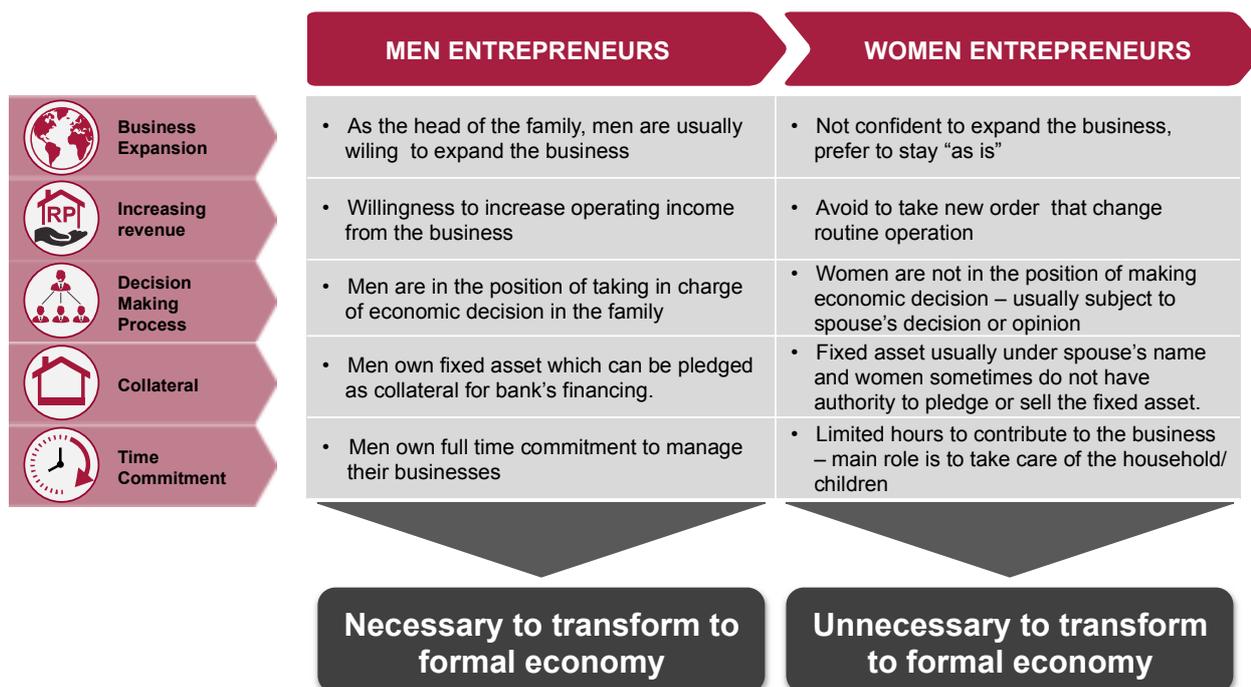
one-on-one conversations with approximately 30 small business owners, women said they had little information on how to begin the process of registering their businesses.

In short, there are both push and pull factors which influence women entrepreneurs' decisions about whether to grow and transition into the formal economy.



Source: IRAI analysis, 2018

Men, on the other hand, are more motivated to expand their small businesses, though they, too, face hurdles. The business is more often a full-time endeavor for men, whose profits support the family. As such, expanding is often a goal, and they have the time to do so instead of having to care for children and other domestic duties. As head of household and with more rights conferred to them, men are also in a better position than women to make decisions. Importantly, they have some fixed assets which can be used as collateral when seeking a loan to expand. Men, however, face hurdles in expanding such as the high costs of production and imported materials, tight competition and difficulty breaking into new markets.



Source: IRAI analysis, 2018

Access to Credit: a Tool for Growth and a Motivator to Transition to the Formal Economy

To grow, a business must have access to capital. Yet women are often precluded from financial access. Often in Indonesia, women must first get approval from their husbands to approach a bank. Many also lack the collateral to secure a loan, though the Indonesian government is working to accelerate the land registration and land certification process through Systematic and Completed Land Registration approach.

Many women business owners are hesitant or uncertain how to take these steps to gain access to financial capital. More commonly, however, women entrepreneurs see banks as too slow to process a loan even if they could get one. Micro businesses tend to operate with a daily inventory. A micro-merchant might buy just enough chicken for the day's food orders or just enough raw material for a handiwork order, and then pay back the lender when the order is delivered. When they need cash, they prefer the informal money lenders, who can produce cash instantly and on flexible terms, even if the cost is high. Interest rates can be double or more than formal banks, but the flexibility and

speed is, in their minds, worth it. In other words, women business owners are not price sensitive to the cost of money, and therefore see no reason to join the formal economy to access a bank loan. Perhaps this is one reason why 69 percent of Indonesian MSME owners have no bank account, and 65 percent believe they do not need one.¹⁰



Source: Digital Financial Services in Indonesia. An overview of the USAID e-Mitra project and efforts to advance digital financial services in Indonesia, 2015

Our personal interviews with approximately 30 small business owners reveal that the complexity of the application process for a loan was the key dissuader from applying for a loan. Needing collateral was also an issue, and many would appreciate higher credit ceilings as well as coaching clinics on how to apply for and manage capital loans.

¹⁰ USAID. Digital Financial Services in Indonesia. An overview of the USAID e-Mitra project and efforts to advance digital financial services in Indonesia, 2015

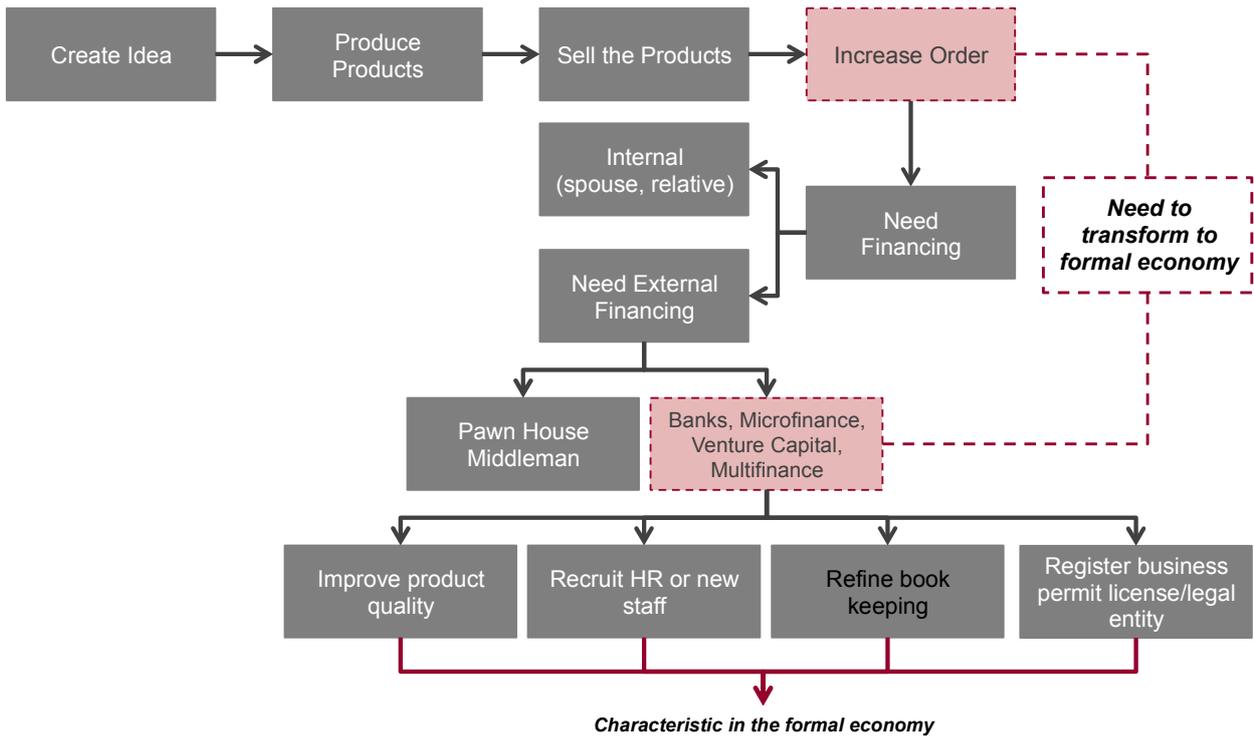
Based on our expert interviews, we summarize the differences and similarities between men and women entrepreneurs as follows:

	MEN ENTREPRENEURS	WOMEN ENTREPRENEURS
 Reason to start the business	<ul style="list-style-type: none"> Start the business as main sources of income for the family or household 	<ul style="list-style-type: none"> Assist their spouses in generating additional income whilst still have time to take care of the child.
 Repayment Commitment	<ul style="list-style-type: none"> Make priority for repayment commitment to maintain their businesses* 	<ul style="list-style-type: none"> Make priority for repayment commitment to continue support additional household income and to support their children education.
 Access to bank financing	<ul style="list-style-type: none"> Most of them have registered fixed assets as collateral under their name therefore easier to get bank financing if needed. 	<ul style="list-style-type: none"> Avoid to access bank financing due to high dependence on spouses approval, limited ownership on collateral as well as long approval process in the bank, unbanked (no permit licenses).
 Willingness to expand the business	<ul style="list-style-type: none"> Willing to expand the business 	<ul style="list-style-type: none"> Sometimes avoid to expand the business and quit satisfied with current condition
 Interest rate sensitivity	<ul style="list-style-type: none"> Not price sensitive (willing to pay between 1.8-2.2% per month) 	<ul style="list-style-type: none"> Not price sensitive (willing to pay between 1.8-2.2% per month)
 Purpose to get financing	<ul style="list-style-type: none"> Need additional financing to expand the business both for working capital (to buy raw material) or for investment loan (buy fixed asset) 	<ul style="list-style-type: none"> Mostly for working capital (instant funding is needed), quick financing required with limited administration requirement.
 Capacity improvement	<ul style="list-style-type: none"> Lab for capacity building combined with regular coaching from expert/third party to answer all related business's issues/questions. 	<ul style="list-style-type: none"> Lab for capacity building combined with regular coaching from someone to answer all related business's issues/questions.

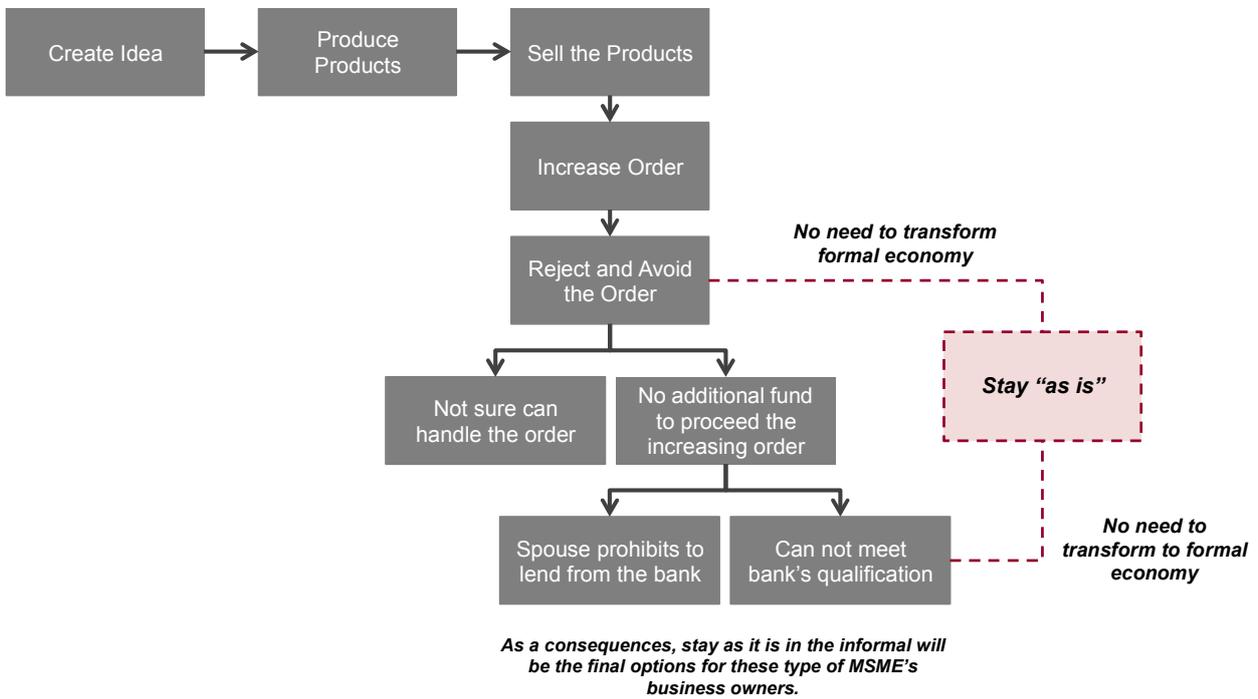
*Note : No difference on default rate between men or women entrepreneurs.

Source: IRAI analysis, 2018

Our research identifies an untapped lever, which can empower more women entrepreneurs to transition into the formal economy. We believe that better suited credit products from formal financial institutions can influence the decision of women business owners to grow. The following two flow charts illustrate the decision process that women entrepreneurs make when managing their businesses. While simplified, greater access to tailored financing could attract more women-led businesses into the formal economy and in turn lead to more robust growth.



Push Factors that Catalyze the Transition from Informal to Formal Economy



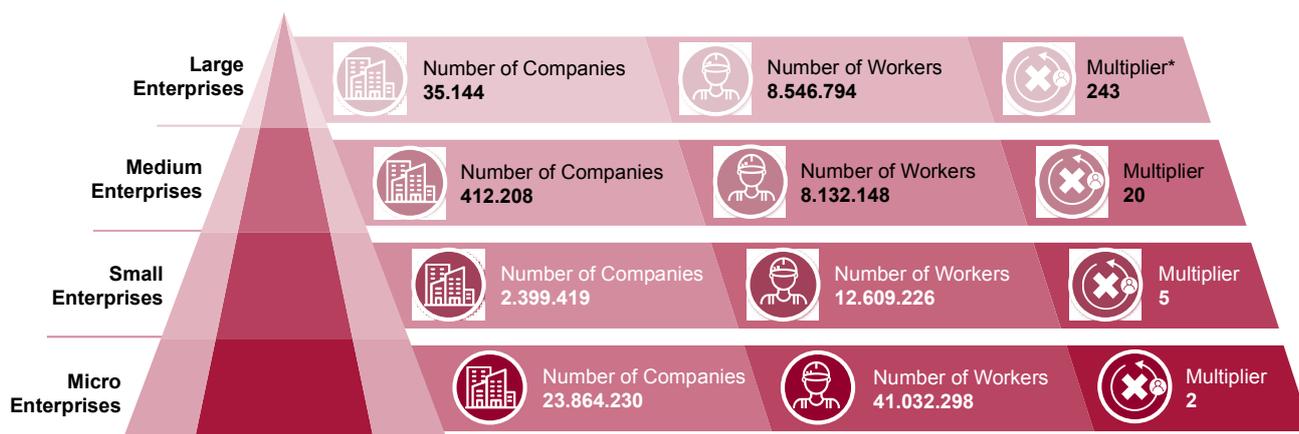
Pull Factors that Catalyze the Transition from Informal to Formal Economy

Source: IRAI analysis 2018

Advantages of Growing and Becoming Part of the Formal Economy

Though many women-owned businesses remain small and informal, there are numerous benefits to joining the formal sector, both for the entrepreneurs and the country.

A key reason for encouraging expansion is the employment multiplier effect. Every business provides jobs to people, whether one job for a sole proprietor to hundreds of jobs in large corporations. Microenterprises employ approximately two people in every business, often family members. The larger the business, however, the “labor absorption rates” are proportionally greater. For every medium-sized enterprise, 20 Indonesians are employed. For every large enterprise, 243 are employed.¹¹ Therefore, it behooves the country to see companies expand and grow, which necessitates transitioning into the formal economy as a legally registered company.



Total companies/business unit=26.711.001 and total workforce = 70.320.466

Source: Economic Census 2016 for Micro Small Enterprises and Middle to Large Enterprises, Central Bureau of Statistics in 2017. <http://se2016.bps.go.id>

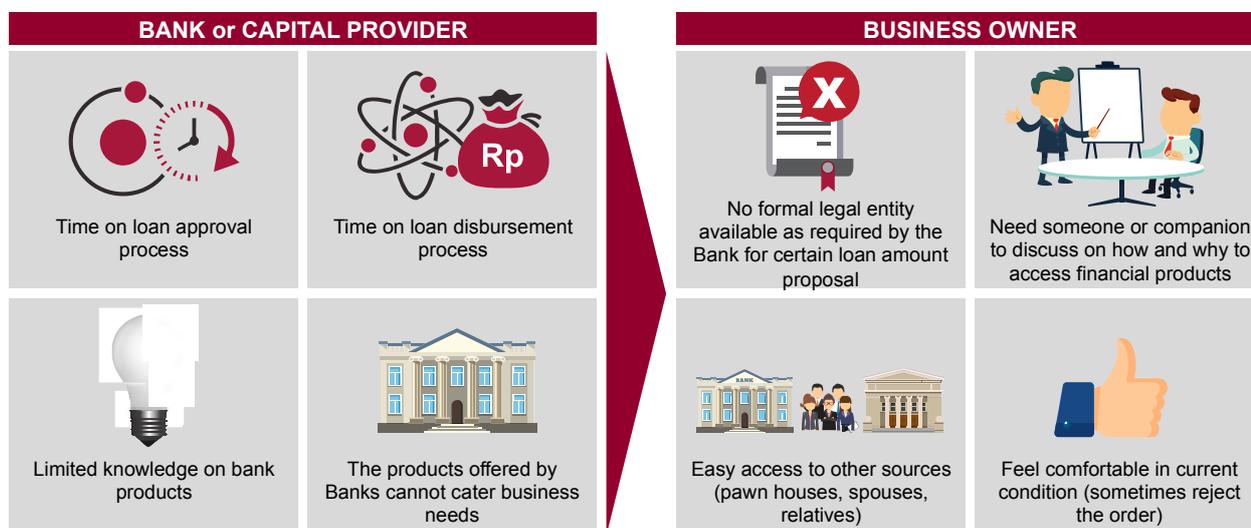
Unregistered businesses are also unable to access formal financial services and government support programs—valuable tools that can help small businesses grow.

¹¹ Economic Census 2016 for Micro Small Enterprises and Middle to Large Enterprises, Central Bureau of Statistics in 2017. <http://se2016.bps.go.id>

Connecting more women business owners to the networks that drive the modern economy, such as e-commerce, financial services, and technology, can help also boost their productivity. Expanded productivity will lead to greater business success, job creation, and ultimately, shared prosperity across Indonesia.

Recommendations

This research reveals that most women-owned micro and small businesses prefer to remain small. They perceive few incentives to expand their business and are unfamiliar with or intimidated by the regulatory steps to do so. They are also dissuaded from expanding because of the demands on their time from juggling a business and domestic chores. The women owners are also either unfamiliar with the process of applying for capital loans from formal financial institutions or find that the available products do not fit their needs. They prefer faster access to cash at more flexible terms, even if the cost of that cash is considerably higher than if they secured working capital from a bank.



Source: IRAI analysis, 2018

To overcome these barriers and perceptions, policymakers and the private sector should consider the following recommendations.

By 2018, the Central Bank of Indonesia has required that all Indonesian banks must channel at least 20 percent of their total loans to MSMEs.¹² To achieve that and still maintain strong portfolios, banks could:

- Tailor loan products to the unique needs of MSMEs. A key comparative advantage of micro and small businesses is operational nimbleness. To be opportunistic, MSMEs need access to financing that matches their business cadence. Key loan features that MSMEs identify as critical are: faster application process, speedier loan disbursement, and more flexible loan repayment schedules.
- Expand the types of collateral or guarantee required to secure financing. By broadening acceptable collateral – beyond immovable property such as land – women-led businesses would be empowered to grow their companies. Female entrepreneurs would no longer have to seek their spouses' approvals to pledge fixed assets. Encouraging women entrepreneurs to access the government MSME guarantee program, KUR¹³ could also unlock more women-led business growth.
- Offer product innovations tied to micro and small business accounts. Structuring overdraft or lines of credit could encourage entrepreneurs to separate personal from business expenses and move toward legal business registration.
- Provide coaching and monitoring for MSMEs. There is an opportunity for banks to become one-stop partners for MSMEs. Banks could appoint and train a bank officer as a coach for MSMEs to monitor cash flow, offer advice on suitable bank products, and provide insights on market access. This would help business owners to grow. It also would help banks mitigate loan portfolio risk, improve visibility into a business' operations, and engender greater customer loyalty.

¹² Central Bank of Indonesia' Regulation No. 17/12/PBI/2015 (Amendment of Central Bank of Indonesia Regulation No. 14/22/PBI/2012) on Bank's credit or financing and technical assistance to the development of MSME sector – article 2 (3) f

¹³ CMEA Regulation No. 11/2017 on Credit for Business Program



Source: IRAI analysis, 2018

Public and private sectors could:

- Leverage banks' obligation to provide training for MSMEs when they fail to meet the mandatory MSME lending requirement, as defined in Bank Indonesia Regulation No. 17/12/PBI/2015 on Bank's credit or financing and technical assistance for the development of MSME sector. Through coordinated and strategic partnership, the public and private sectors could develop coaching clinics to help MSMEs build their capacity, share knowledge, and more effectively to assist and provide consultancy/advisory service on how to manage their business. Key business issues that MSMEs need assistance with are: market access, including how to go digital; packaging; human resource management; operational efficiencies; and business permitting and legal registration. Coaching clinics could help with early stage development as well as coaching for businesses ready to expand.

- Communicate the importance and benefits of formalizing a business. Organizations could design information campaigns on registering a business and the benefits of operating in the formal economy. They could also organize events and get-togethers among business owners to share information and insights.

Women entrepreneurs are the future of Indonesia's continued prosperity. Addressing the factors that prevent or discourage women from expanding their small businesses will be critical to the country's continued prosperity and inclusive growth. Factors such as greater access to capital, more flexible loans, more training in the advantages of the formal sector, clearer pathways to formalizing a business, and other steps can help women expand and grow. Equally important will be helping women manage their time commitments to both business and family demands.

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