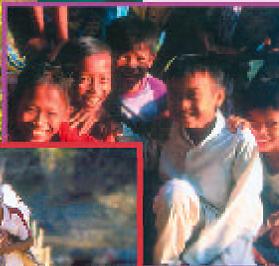




International  
Labour  
Organization  
Jakarta

Indonesia:  
Working out  
of Poverty



**Job creation and  
enterprise development  
(SMEs and  
local economic development)**

**3**

In Preparation for the ILO's submission to the Poverty Alleviation Committee in Indonesia, a series of 12 (twelve) Technical Briefing Notes (TBNs) have been prepared which serve two purposes; first, as background documents, on issues and policy choices critical to poverty reduction and secondly, as building blocks towards a comprehensive report: "*Working Out of Poverty: an ILO submission for the Indonesia PRSP*".

This briefing note address ***Job creation and enterprise development (SMEs and Local Economic Development)***. Other themes in series include the following:

- Employment dimensions of macro and sectoral policies;
- Decentralization and decent work: making the connection to the MDGs;
- Youth employment: pathways from school to work;
- Rural development: access, employment and income opportunities;
- Skills development for economic growth and sustainable livelihoods;
- Promoting the declaration on fundamental principles and rights at work;
- Eliminating the worst forms of child labour;
- Social protection for all;
- Promoting good governance in the labour market by strengthening tripartism and social dialogue;
- Migration: opportunities and challenges for poverty reduction;
- Gender and poverty.

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# JOB CREATION AND ENTERPRISE DEVELOPMENT (SMEs AND LOCAL ECONOMIC DEVELOPMENT)

*We know only too well that it is precisely the world of work that holds the key for solid, progressive and long-lasting eradication of poverty. It is through work that people can expand their choices to a better quality of life. It is through work that wealth is created, distributed and accumulated. It is through work that people find a dignified way out of poverty..... Employment, and the promotion of enterprise that creates it, remains the most effective route to poverty eradication.<sup>1</sup>*

Access to employment is the surest way out of poverty. Consequently, employment creation policies and programmes continue to play an important role in combating poverty. Cooperatives and small and medium-sized enterprises (SMEs) are recognised worldwide as critical factors in economic growth and increasingly responsible for the creation of the majority of jobs. Cooperatives alone created 100 million jobs. In response to these trends, the International Labour Conference adopted Recommendation 189 (1998) on *General conditions for the promotion of job creation through small and medium-sized enterprises*<sup>2</sup> and Recommendation 193 (2002) on the *Promotion of Cooperatives*<sup>3</sup>. Recommendation 189 recognizes the importance of setting an environment that is conducive to SME

## Introduction

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1 ILO: Working Out of Poverty, Report of the Director-General, International Labour Conference, 91st Session, Geneva, 2003.

2 International Labour Office (1998). Recommendation 189: Recommendation concerning General Conditions to stimulate Job Creation in Small and Medium-Sized Enterprises. Geneva.

3 Promotion of Cooperatives, ILO Recommendation No. 193 (2002)

development and notes the need for decentralizing the delivery of services and involving a wide range of stakeholders in the planning and implementation of these services. Recommendation 193 has advanced the thinking even further by advocating the need for governments to recognize the global importance of cooperatives in both economic and social development, encourage international cooperation, while at the same time reaffirming the cooperative identity based on values and principles. It underscores the equal treatment of cooperatives vis-à-vis other types of enterprise and social organizations, and defines the government's role in creating a supportive policy and legal framework, and in facilitating access to support services and finance, without undue interference.

In Indonesia, it is widely acknowledged that the vast majority of women and men derive their livelihood and incomes from SMEs. However, measuring the contribution of SMEs has for many years, been frustrated by the absence of a uniform definition that is accepted by all government departments and agencies, as well as by the private sector. Presently, only the Central Bureau of Statistics makes a systematic distinction between household (cottage), small, medium and large-scale enterprises on the basis of the number of workers. This classification makes it possible to analyse changes in the size structure of employment over time. In contrast, most definitions that are used by government departments and agencies are not based on size of the workforce but refer to either value of assets or turnover (sales). For example, the State Ministry for Co-operatives and SMEs defines small enterprises as firms with annual sales between Rp.1 to 50 billion. Subsequently, the State Ministry found that more than 99 percent of all enterprises in Indonesia could be defined as small enterprises that together employ more than 99 percent of the total workforce. Other departments use slightly different definitions that also indicate the enormous size of the SMEs sector in Indonesia. Notwithstanding these measurement difficulties, SMEs are recognised as already being important and have an even greater role in the economic and social development of Indonesia. Thus, SMEs development is one of platforms for the Government's economic and social development agenda.

Another platform is the development of cooperatives. In Indonesia, co-operatives are poised to break free from dependencies on subsidies from the central government as the impact of the dimensional monetary crisis and the move towards regional autonomies has weakened central control over co-operatives. Independent institutions such as the Institute for Co-operative Studies (LSP2-I) initiated a process to pass a new co-operative law that was aimed at breaking the ground for such a change. It concluded a year long participatory exercise - beginning with primary members at the grass roots - to arrive at various amendments to the existing co-operative law. Meanwhile, DEKOPIN, the apex cooperative union of Indonesia, has also undertaken an internal review of the changes to be made in the existing cooperative legislation and have placed their recommendations before the appropriate body in Parliament.

A third draft version was finally launched by the government in late October 2003 and duly tabled for discussions in the Indonesian Parliament. Although there is nothing fundamentally deficient with Co-operative Law 25/1992, the participatory process initiated by LSP2-I has created greater awareness among stakeholders from all over Indonesia on the need of incorporating the ICA Co-operative Identity Statement, as well as the substance contained in ILO Recommendation (193), in the draft legislation.

Understanding the relationship between enterprise development and poverty reduction calls for recognition of Indonesia's large urban informal economy and agricultural sector, as this is where the vast majority of small-scale enterprises and primarily where poor workers and poor entrepreneurs exist.

The informal economy in Indonesia could be more correctly called the *urban informal economy* as the Central Board of Statistics, (*Badan Pusat Statistik*, *BPS*) usually separates it from the other traditional element in the informal economy, the agricultural sector. According to the BPS, the urban informal economy comprises those individuals and employers that have not been accorded legal status and have

### **Urban informal economy**

commenced their operations, sometimes without the sanction or knowledge of the local authorities. Yet, many of the enterprises in the informal economy may have been registered with local authorities and finance regulators, such as the Ministry of Finance or the taxation office, but have not been accorded legal status under this definition of 'legal entity'.

In Indonesia, the formal economy comprises about 2 million employers (including the self-employed) and a workforce of about 29.5 million, representing 33 per cent of the total national workforce of 90 million. The informal economy holds over 60 million of the work force or 67 per cent of the total. The formal economy contains almost 22 million (or 44 per cent) of the 49 million non-agricultural work force, while the informal economy holds almost 28 million (56 per cent). The formal economy dominates such sectors as the mining, construction and utilities sectors (85 per cent) as well as the financial sector (74 per cent). On the other hand, the informal economy dominates the sector of trade (85 per cent) and has the majority share of employment in manufacturing (54 per cent). Employment in the sector of transport, storage and communication is split almost equally between the formal and informal parts of the economy. Trade dominates the informal non-agricultural economy with 57 per cent of the total, followed by manufacturing (23 per cent), finance and services (10 per cent) and transport (8 per cent).

Not all workers or employers in the informal economy are poor; but many are, or live with the constant risk that some event may push them into poverty. Work in the informal economy is too often characterized by low levels of skill and productivity, low or irregular incomes, long working hours, small or undefined workplaces, unsafe and unhealthy working conditions, and lack of access to information, markets, finance, training and technology. Workers in the informal economy are not recognized, registered, regulated or protected under labour legislation and social protection, often because their employment status is ambiguous. A large proportion of those who suffer these conditions are women and children.

The ILO has developed a participatory approach to improving working and living conditions of informal

economy workers in partnership with trade unions and cooperatives in three African countries, Rwanda, Tanzania and Uganda. This SYNDICOOP approach could be looked at to develop suitable programmes for the informal economy workers in Indonesia and to incorporate the informal economy into the PRSP process with the support of trade unions and cooperatives.

In Indonesia, agriculture dominates the national employment scene with 41 million workers, of whom 80 per cent are attached to the informal economy. Furthermore, poverty is very much a rural phenomena, as about 75 per cent of the total poor households reside in the rural areas and depend on agricultural sector for their main livelihood.

## **Rural poverty and cooperatives**

The rural poor are often confronted with disadvantages stemming from remoteness, lack of education and health care, insecure and unproductive jobs, high fertility and discrimination for women or ethnic minorities. Thus, poverty reduction policies and programmes must give strategic focus on rural development and must create more opportunities for women and men to find work in the rural areas. Such policies not only promote economic growth but also help alleviate urban poverty through reducing out migration from rural areas to densely populated urban centres. In rural Indonesia, like in many other Asian countries, the nearest organizations to the poorest are primary cooperatives, and through cooperative channel, most of the poor people living in isolated areas can be reached to help them create sustainable livelihoods and provide basic social services.

Discriminatory treatment of women in the labour market and the disparate impact of workplace structures and practices on women and men produce both short and long-term disadvantages for women relative to men. Women are commonly over-represented in low-paying jobs in the informal sector and in non-standard work arrangements. This results in less job security, lower income, inadequate social protection, and higher under-employment for women relative to men.

## **Gender considerations**

Women entrepreneurs represent a potentially powerful economic force, but currently face many constraints. They lack adequate access to training in marketing, book-keeping and management skills, and they lack the networks and business information that would equip them to better compete and to meet changes in consumer demand, and technology. They face difficulties obtaining credit, particularly when their requirements exceed what cooperatives and other micro credit sources can offer women.

**Mainstreaming  
of poverty  
reduction in  
enterprise  
development  
policies and  
programmes**

Commonly, the institutions and their policies that designed to support enterprises development are geared towards serving the formal economy to the exclusion of actors in the informal economy. Their procedures, technologies, delivery mechanisms and product contents are more suited to the requirements of larger enterprises. This needs to change – urban informal economy and rural enterprises need to be recognized and included in official statistics, licensing and registration in local and national government agencies needs to be appropriate, and these enterprises need to have access to productive resources such as credit, training, marketing and business advice. The needs of these sectors needs to be mainstreamed in enterprise development policies and programmes.

Opportunities for the start-up and growth of enterprises are not created by external interventions – they arise from markets and entrepreneurial capabilities of women and men. Key aspects that impact on the start-up and growth of enterprises include the following:

**Enabling environment** - A favourable policy environment is crucial for the promotion of enterprises. Thus, economic policies, both macro and micro policies, have important roles to play in facilitating an enabling environment for the evolutionary growth of enterprises in the economy. In Indonesia as decentralization has evolved, concern has been expressed that there is confusion in the regulatory regime that is being established in different districts.

Access to skills and technology – technical and management skills are essential to improve productivity, incomes and access to employment

opportunities. Yet, a striking feature of most poverty reduction strategies is the absence of vocational education and training – even though the vast majority of working people living in poverty cannot afford and have no access to training opportunities. Programmes that link skills and technology acquisition with entrepreneurship support are an important part of any poverty reduction strategy. Such community based training programmes systematically identifying employment- and income-generating opportunities at the local level, designing and delivering appropriate training programmes, and providing necessary post-training support services, including credit, technical assistance and market information.<sup>4</sup>

Access to finance — It is impossible to build an enterprise without access to capital. Poor people all over the world have little access to formal financial services. Microfinance activities go hand in hand with entrepreneurship, enabling the poor to borrow for productive purposes, save and build their assets. There is evidence in Indonesia that the existing demand for micro-finance is only partially met by current institutional providers and the opportunity presents itself either to expand the outreach of existing institutions or to establish new institutions.<sup>5</sup> For instance, with 36,000 primary credit and savings cooperatives and about 11 million members, the cooperative sector responds to the micro credit needs up to the volume of 30 per cent, which makes it the second largest after Bank Rakyat. Furthermore, encouraging the adoption of new technologies and new methodologies can help build capacity to serve this market in a sustainable manner.

Access to business development services – Business Development Services (BDS) include training, consultancy and advisory services, marketing assistance, information, technology development and transfer, and business linkage promotion. The BDS provider commonly exists in most of the big cities and universities. There are also institutions and organizations offering BDS for

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4 For further discussion, see the ILO's Technical Briefing Note on Skills and Training.

5 Evidence for the existence of the prevailing gap between the demand and supply of micro-finance comes from recent evaluations of BRI's (Kupedes) micro-banking services (BRI,2003)

cooperatives, and the Institute for Cooperative Studies (LSP2-1) and National Cooperative Business Network (JUK) are among these BDS service providers.

Access to markets – Providing skills training, entrepreneurship development, micro-credit, business development services and capacity building, helps improve earnings. However, without access to viable markets, these entrepreneurs may still not be able to get out of poverty. In many developed and developing countries, marketing cooperatives play an important role to create access to markets for their members. Provision of rural infrastructure, participation in trade fairs and meet the buyers programmes, and linkages programmes between small and large enterprises can be used to improve small enterprises access to markets.

### **Cooperatives as a model for local development**

A sound poverty reduction strategy must place great emphasis on the participatory approaches and particularly on the participation of working women and men living in poverty in particularly rural areas to improve their lives. Cooperatives and other types of self-help groups, including, member-driven community organizations are frequently advocated as effective means of organizing to meet the needs of workers and entrepreneurs in the rural and urban informal economies. Capacity building, improvements in literacy and health, opportunities for income generation, access to public services, representation and voice – for all these services, poor people depend on some kind of cooperative organization.

In the past, the term “cooperative” has been misused in Indonesia, like in many other countries. State-promoted “cooperatives” failed to mobilize members, who perceived them as being controlled by government-appointed managers. The cooperative vision of enlarging the economic power of individual members through membership-driven entrepreneurship was either devalued or ignored. Today, many of the registered cooperatives in Indonesia are trying to overcome the problems they inherited from the past. Cooperatives are member-owned and community-based models of sustainable development and their role in local development should not be discarded. Financially strong and self-reliant cooperatives can play an important role in

increasing their members' welfare and thereby contribute to a more equitable income distribution. Cooperatives are very important for employment creation in Indonesia's large rural and urban sectors, as well as informal economy.

Young women and men in Indonesia face a daunting array of social and economic problems including continuing high levels of unemployment and underemployment. Youth unemployment and underemployment are not only an enormous waste of the talents and skills of the new generation but are linked to a range of social problems. It results in the loss of the creative talents of young people who otherwise would be making innovative contributions to the workforce and society.

## **Promoting youth entrepreneurship<sup>6</sup>**

In Indonesia, about 60 percent of working poor youth earn their living in the informal economy. Most self-employed youth run tiny businesses and the main problem they face are the lack of training and capital, competition and corruption, and fluctuating income due to seasonal variations in business activity. Not surprisingly, most are ill prepared to transform their business into mature small firms that thrive and create sufficient incomes and future jobs.

There is a growing awareness of the need to address the problem of youth employment in Indonesia— both to provide decent work opportunities for young people and to allow Indonesia to get the full benefit in its economic and social development of their contribution. This is also a crucial part of an effective poverty reduction strategy for Indonesia and is needed in order to avoid the problems of social exclusion, hopelessness and frustration. Such a strategy should involve participation from private sector and community organizations, including cooperatives, to provide training, mentoring and access to credit for young entrepreneurs. Cooperatives can organize the youth to train them on certain occupations and create decent employment. The strategy could also involve the promotion of entrepreneurship in schools and vocational training institutions.<sup>7</sup>

6 For further discussion, see the ILO's Technical Briefing Note on Youth Employment.

7 As part of the ILO's and Government of Indonesia project on Youth Employment, efforts are being made to integrate the ILO's Start Your Business programme in selected vocational training institutions as part of their entrepreneurship programmes.

**Decentralization  
and enterprise  
development**

Decentralization continues to be one of Indonesia's most significant reform initiatives. In SME and cooperative promotion, at the national government level, the Office of State Minister of Cooperative and SME have the authority to coordinate efforts concerning SMEs development (UU No. 9/1995 and Presidential Decree No. 101/2001). However, the decentralization process is leading to transfer of responsibilities in SME development programming and implementation from the central to the regional government.

Already across Indonesia, some provinces and districts/cities are increasingly taking up the challenge of formulating local economic and employment policies and programmes. Thus highlighting the importance of the convening power of the national Government to ensure local programmes and policies are both economically sound and friendly to SMEs. Such initiatives should systematically draw on international best practices and on the expertise of local businesses and business associations.

**Local Economic  
Development as  
a framework for  
decentralized  
enterprise  
development**

The internationally recognized Local Economic Development (LED) approach provides a framework for this type of local action. LED approach is a participatory development process that encourages partnership between the main stakeholders within a defined territory with the objective of stimulating economic activity and creating employment. Stakeholders are individuals, firms and/or organizations in the public, private and not-for-profit sectors that have an interest in and ability to contribute to supporting the development of the community. They include NGOs, universities with a strong interest in SME development, employers and business associations, workers organisations, and other representatives of the SME sector.

The process enables the joint design and implementation of an economic development strategy, by making use of the local resources and competitive advantages. Typically in the LED approach, local government takes the lead in facilitating and encouraging local participation of stakeholders and consensus building in determining economic and social welfare initiatives for their community.

## **Building on existing industries and clustering**

In many provinces and districts/cities, specific industries play an important role in the local economy and the provision of jobs for the poor. Often these industries have been in existence for decades. Today, globalisation is altering and placing competitive pressures of many of these industries. For too many of these enterprises, continuing to compete with other international producers based on low-cost, low-value added and high volume production is unsustainable and will lead to poor quality jobs and enterprises. Supporting local industry stakeholders to understand the dimensions of these competitive pressures and their potential impacts upon employment and to identify and implement responses to these changes often becomes an important part of a LED strategy.

One approach that is used by small enterprises in responding to these competitive pressures is the clustering of small enterprises operating in the same or in related industrial sectors. The approach is common practice in Indonesia and there are sound economic reasons for this phenomenon. Enterprises operating in such clusters derive a clear competitive advantage from:

- The proximity to sources of raw inputs;
- The availability of suitably customized business development services;
- The abundance of clients attracted by the cluster tradition in that industry; and
- The presence of a skilled labour force.

However, experience in Indonesia suggests that government direct efforts to promote cluster development through technical assistance have frequently failed because they did not succeed in activating the clusters' self-organization and entrepreneurial potential. Government needs to establish the right policy environment and work in partnership with industry stakeholders to have them develop and implement their strategies and clusters.

## **Capacity building of local stakeholders**

The LED approach provides a framework in which a wide range of public and private stakeholders can work together to tackle local social and economic concerns such as income generation, employment creation and poverty reduction. The LED approach could become an important strategy in

Indonesia's fight against poverty. However, the approach requires new skills and competencies. A rigorous capacity-building programme for local governments in SME policy making and programme development is required. The capacity building efforts are not only required for the public sector but for all stakeholders.

## **Policy recommendations**

In the context of the PRSP, the ILO urges the Government to:

### **1. Strengthen the policy coordination framework.**

In order to take advantage of the opportunities to promote SME development initiatives, it is imperative that there be stronger coordination of policies and programmes among the national players, as well as among local governments and the private sector. Furthermore, it is important that national Government uses its convening powers to ensure local programmes and policies are both economically sound and friendly to SMEs. Such initiatives should systematically draw on international best practices and on the expertise of local businesses and their associations.

### **2. Mainstreaming of poverty reduction in enterprise development policies and programmes.**

Unfortunately, many past enterprise development policy prescriptions did not view job creation or its enhancement as an explicit objective. Consequently, inequitable development has occurred that now needs to be redressed. Therefore, there is a need to integrate or mainstream poverty and employment concerns in social and economic policy debates. Such mainstreaming will automatically calls for recognition of Indonesia's large urban informal economy and agricultural sector, as this is where the vast majority of small-scale enterprises and where most of the poor workers and poor entrepreneurs live.

An important target group in these entrepreneurship development programmes should be young women and men. In this way, young people will contribute to the creation of their own jobs and Indonesia will receive the benefit of the creative talents of young people. Such a strategy should involve participation from

private sector and community organizations to provide training, mentoring and access to credit for young entrepreneurs. The strategy could also involve the promotion of entrepreneurship in schools and vocational training institutions.

### **3. Support Cooperatives to take part in Poverty Reduction.**

It is known all over the world that cooperatives are one of the most suitable organizations to fight against poverty. In Indonesia, due to past State-sponsored cooperative experience, in order to reinstate the value and advantage of cooperative organizations in development, the inherited problems should be solved, including the finalization of the process of creating a favourable policy framework, taking into account the provisions of Recommendation 193. Cooperatives should therefore become member-owned, democratic and autonomous organizations, and remain free from government interference. In addition, cooperatives need to have access to support services, including management training, member education, auditing and credit, so that they can shoulder greater role in poverty reduction in rural and urban areas and in the informal economy. The trade union – cooperative collaboration should be encouraged to improve working conditions and reduce poverty in the informal economy.

### **4. Build capacity for Local Economic Development.**

Most SME programmes in the future will be decentralized, thus highlighting the importance of strengthening the capacity of institutions at all levels of government, to enable them to fully realize the potential benefits decentralization and regional autonomy can yield for the local population and the nation as a whole. A rigorous capacity-building programme for local governments and other stakeholders in Local Economic Development (LED) policy making and programme development is required.