

ASIAN DEVELOPMENT BANK

TAR:INO 36546

TECHNICAL ASSISTANCE

(Financed by the Government of the United Kingdom)

TO THE

REPUBLIC OF INDONESIA

FOR PREPARING THE

PROVINCIAL SMALL AND MEDIUM INDUSTRIAL SECTOR DEVELOPMENT

PROGRAM

December 2003

CURRENCY EQUIVALENTS

(as of 9 December 2003)

Currency Unit	–	rupiah (Rp)
Rp1.00	=	\$0.000118
\$1.00	=	Rp8,493

ABBREVIATIONS

ADB	–	Asian Development Bank
BDS	–	business development service
DFID	–	Department of International Development (United Kingdom)
IFC	–	International Finance Corporation
MOIT	–	Ministry of Industry and Trade
OSS	–	one-stop service
R&D	–	research and development
RIA	–	regulatory impact assessment
SME	–	small and medium-sized enterprise
SMOCSME	–	State Ministry of Cooperatives and Small and Medium Enterprise
TA	–	technical assistance

NOTE

In this report, "\$" refers to US dollars.

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I. INTRODUCTION

1. The Government of Indonesia requested technical assistance (TA) from the Asian Development Bank (ADB) to develop a proposal for a sector development program loan for small and medium-sized industrial enterprise development as stated in ADB's 2003 Country Strategy and Program (CSP) and update.¹ The ADB Fact-Finding Mission, which started in late March 2003, reached an understanding with the Government on the TA objectives, scope, terms of reference, cost estimates, and implementation arrangements. The project preparatory TA is based on the policy recommendations of previous advisory TAs that accompanied the Industrial Competitiveness and Small and Medium-sized Enterprise (SME) Development Program (the Program)² and those of an ongoing one.³

II. ISSUES

2. Formulated in the aftermath of the 1997 crisis, the Program aimed to support economic recovery by encouraging a more diversified and competitive industrial structure to provide equal opportunities for all enterprises, in particular SMEs. The Program focused on three main areas: strengthening competition by establishing an appropriate legal and regulatory framework and removing barriers to competition; facilitating investment and trade by strengthening the framework governing domestic and foreign investment and customs procedures; and developing a comprehensive and sustainable SME development policy. Progress in the Program implementation has been significant despite the rapidly changing environment. One of these changes has been decentralization, which started to be implemented in 2001, adding new complexities to the role of governments and opening new and specific areas for reform, in particular, in SME development within a decentralized environment.

3. A complex regulatory environment and lack of financing and business services increase the costs of operating private businesses, especially SMEs in Indonesia, where the cost of starting a new business already stands out as being one of the highest in Asia.⁴ The advent of decentralization has pushed these costs up. Since 2001, following decentralization, regulatory powers have been delegated to the regions. Some local governments now make their own rules and even raise taxes of dubious merit.⁵ Multiple and overlapping regulations on trade, tax, and registration, together with a plethora of business licenses, hinder SMEs' economic contribution. Also, SMEs have limited access to formal credit, which constrains their growth potential compounded by the complexity of the regulatory environment. Finally, SMEs in the regions have limited access to high-quality technical services that are in line with a private sector approach to industrial development. All these constraints explain to a great extent why SMEs—mostly informal businesses—have traditionally exhibited much lower labor productivity than large firms in Indonesia, where the productivity gap between small and large firms is one of the largest by international standards. These constraints need to be carefully addressed under decentralization.

¹ Posted in *ADB Business Opportunities* (Internet edition) on 27 May 2003.

² ADB. 2000. *Technical Assistance to the Republic of Indonesia for Promoting Competition and Deregulation*. Manila (TA 3416, for \$1.5 million); ADB. 2000. *Technical Assistance to the Republic of Indonesia for SME Development*. Manila (TA 3417, for \$2 million), under ADB. 2000. *Report and Recommendation of the President to the Board of Directors on a Proposed Loan to the Republic of Indonesia for Industrial Competitiveness and SME Development*. Manila (Loan 1738, for \$200 million).

³ ADB. 2002. *Technical Assistance to the Republic of Indonesia for Strengthening Business Development Services for SMEs*. Manila (TA 3829, for \$1.5 million).

⁴ World Bank. *Doing Business in 2004: Understanding Regulation*. Washington DC: World Bank, International Finance Corporation, and Oxford University Press, p. 194.

⁵ World Bank. 2003. *Decentralizing Indonesia*. A World Bank Regional Public Expenditure Review Overview Report. Washington DC.

4. Without effective legal, institutional, and regulatory frameworks, markets can malfunction, resulting in great cost, particularly for the poor.⁶ While avoidance of excessive regulations that stifle incentives and discourage investment is necessary, effective regulation remains essential to safeguard the environment; promote financial sector stability; protect consumers; and promote and protect human rights, including core labor standards.⁷ Indonesia's highly regulated environment has, however, enormously increased the cost of conducting business. Official and unofficial levies are estimated to raise the direct operating costs of SMEs by as much as 30%, and the burden has probably increased in the aftermath of decentralization. Across Asia, Indonesia has the highest cost of doing business and, hence, has one of the largest number of informal or unregistered businesses, especially SMEs. For instance, Indonesian SMEs face high transaction costs as a result of the cumbersome registration and licensing, because, in some sectors, SMEs need to secure as many as 11 licenses, some of which have identical purposes but are issued by different agencies. Obtaining licenses takes long and procedures are so complicated that some business owners choose to operate informally. Lack of legal status or informality exposes them to corruption, and makes it difficult for these businesses to access formal services, most notably bank finance. Simplification of these costly licenses and their requirements benefits proportionally more SMEs than large businesses (which can absorb the high cost of conforming with all formalities), as well as the poor.⁸

5. Local governments now have the authority to regulate local businesses but few have taken an effective strategic approach to develop local small businesses (see Appendix 1). The primary source of pro-poor growth will be the private sector, and particularly poor people themselves, but, to achieve this, government regulations must be effective. The conversion of districts into the major units of government authority has carried the risk of increasing taxes, levies, and other fees introduced by local governments. For example, the district of Bulukumba in South Sulawesi has tripled the number of business-related regulations.⁹ This behavior has not been uncommon among the 416 districts, and will hinder, not promote, SME development in the regions. While existing decentralization laws provide for a regulatory monitoring role by the central Government, the sheer volume of new or revised local regulation makes this task unmanageable. Regulatory streamlining and impact monitoring should follow a common, transparent and accountable policy framework for regulatory impact assessments (RIA) across regions with the appropriate institutional setup and capacity building.¹⁰

6. Lack of formal credit for SMEs continues to constrain their development and growth. Provincial banks and venture capital companies have less than 15% of their portfolio in industrial enterprises, and most credit remains short-term consumer credit. After decentralization, provincial and local governments need not keep their funds in provincial banks, which thus need to refocus their portfolio from consumer to productive credit for small businesses. Considering loans to SMEs risky, most banks limit their credit exposure to them. Group or cluster lending remains off-limits for

⁶ GFA Management and Swisscontact Services. 2001. *Improving the Regulatory Framework for SMEs: Streamlining Business Formalization Procedures and Facilitating One-Stop Services*. Policy Paper No. 7. Jakarta, October, under ADB. 2000. *Technical Assistance to the Republic of Indonesia for Small and Medium Enterprise Development* Manila (TA 3417, for \$2 million). Available: www.adbtasme.or.id

⁷ Department for International Development (DFID). 2000. *Eliminating World Poverty: Making Globalisation Work for the Poor*, White Paper. London, United Kingdom.

⁸ See Beck, Thorsten; Demircuc-Kunt, Asli; and Levine, Ross. 2003 *The Impact of SMEs on Growth, Development, and Poverty: Cross Country Evidence*. Washington DC: World Bank.

⁹ Under TA 3829 (footnote 3), four districts show different patterns after decentralization. From December 2000 to August 2002, local regulations in Sragen, Central Java, grew from 23 to 36, while Bulukumba's jumped from 15 to 45. See GFA Management and Swisscontact Services. 2003. *Strengthening BDS for SMEs ¾ Midterm Report*. Jakarta. Available in www.adbtasme.or.id

¹⁰ See Kirkpatrick, Colin. 2001. *Regulatory Impact Assessment in Developing Countries: Research Issues*. Working Paper No. 5. Centre on Regulation and Competition. Manchester: University of Manchester.

banks. Measures to supplement or replace collateral, presently mainly land, remain unworkable. Direct guarantees to SMEs have worked poorly because of poor risk assessment and risk sharing. New banking practices and new financial products for SMEs need to be assessed and adopted within the new banking system emerging after the 1997 financial crisis.

7. To compete, SMEs need to bring their operating costs down by adopting suitable business technologies. Effectively designed business development services (BDSs) by professionals would help SMEs improve their equipment, subcontracting, workplace organization, inventory handling, product design, business planning, etc. Past publicly funded and managed BDS programs have not been successful and do not conform to international best practices in outreach, sustainability, and impact.¹¹ Lessons from ADB support to technological institutes show the need for a shift in approach.¹² In general, subsidized programs through SME incubators, BDS clinics, or technological institutes have been unsustainable, providing services of limited quality and usefulness to few SMEs. These programs have created a culture of “right to free services” among most SMEs. Provision of technical support for industrial SMEs has been devolved to local governments, presenting the opportunity to adopt new industrial management systems around local industrial clusters with a potential competitive edge in tune with the needs of the local private sector.

8. Recognizing that SMEs are instrumental to improve productivity, create jobs, and, hence, reduce poverty, the Government has formulated a comprehensive action plan to be implemented by the State Ministry of Cooperatives and Small and Medium-Sized Enterprises (SMOCSME), Ministry of Industry and Trade (MOIT), and National Planning Agency (BAPPENAS).¹³ ADB's country operational strategy aims at overcoming identified constraints affecting SMEs in the action plan, such as burdensome regulations, lack of access to commercial credit, and ineffective technical services. The strategy emphasizes regional SME development consistent with the Department of International Development (DFID, United Kingdom) country strategy,¹⁴ which states the need to improve governance for sustained growth and poverty reduction.

9. The TA will complement various ongoing SME initiatives of ADB¹⁵ and other aid agencies. The World Bank and International Finance Corporation (IFC) are supporting a private sector TA for BDS—the Program for Eastern Indonesia SME Assistance (PENSA).¹⁶ Japan has an ongoing assessment of industrial clusters and BDS training centers for exporters across Indonesia, while the German Agency for Technical Cooperation (GTZ) is helping the central Government examine decentralized SME policies. The Canadian International Development Agency (CIDA) and Swisscontact have ongoing BDS projects, and The Asia Foundation works on policy advocacy to improve the business climate.

¹¹ See Committee of Donor Agencies for SME Development. 2000. *BDS: A Guide to Donor-Supported Interventions*. Washington, DC.

¹² ADB. 2002. *Project Completion Report on the Industrial Technology and Human Resource Development Project in Indonesia*. Manila (Loan 1433, for \$80 million).

¹³ Supported by TA 3417 (footnote 2), the Midterm Action Plan (MTAP) for SMEs highlights major issues and recommends ways to develop SMEs over 2002-2004.

¹⁴ DFID. 2000. *Country Strategy Paper: Indonesia*. London, United Kingdom.

¹⁵ Footnote 3 for technical assistance. Also, a commercial credit line in foreign exchange was approved for investments in export-oriented SMEs. ADB. 2002. *Report and Recommendation of the President to the Board of Directors on a Proposed Loan to the Republic of Indonesia for SME Export Development*. Manila (Loan 1978, for \$85 million); and ADB. 2002. *Technical Assistance to the Republic of Indonesia for Small and Medium Enterprise Export Development*. Manila (TA 4041, for \$500,000). A partial credit guarantee facility for enhancing SME access to commercial credit is also being considered by the Private Sector Department.

¹⁶ As part of ADB's subregional strategy, ADB and IFC are supporting BDS for BIMP-EAGA's agricultural and marine exports. 2003. ADB. *Technical Assistance for Strengthening Regional Networking for Small and Medium-Sized Enterprises in Brunei-Indonesia-Malaysia-Philippines East ASEAN Growth Area*. Manila (RETA 6146, for \$700,000).

III. THE TECHNICAL ASSISTANCE

A. Purpose and Output

10. The TA aims to prepare a project proposal to promote pro-poor growth and development of SMEs by improving the business climate and increasing access to finance and technology without competing with private sector initiatives. The TA will focus on the relationship between the central Government and four core provinces, building the Government's capacity for strategic policy analysis and coordination, required for a pro-poor policy framework, following a two-step approach to adjust to the changing environment of a young decentralized environment. A final output will be a proposal for a potential sector development program for possible ADB support with a policy and investment components to (i) improve the regulatory environment for SMEs at both central and regional levels (component A); (ii) enhance SME access to formal financing from public and private financial institutions, if appropriate (component B); and (iii) enhance local capacity to provide sustainable technical advice, if appropriate (Component C).

B. Methodology and Key Activities

11. The Government and ADB selected the four core provinces (Central and East Java, and South and North Sulawesi) and two local governments (Sragen in Central Java, and Pare-Pare in South Sulawesi) on the basis of their proven potential for SME development and willingness to work with the Government and ADB. The TA scope has three major components, which will have an assessment phase (phase I, Appendix 2) and a project consultation and preparation phase (phase II) as follows:

- (i) Component A is to improve the central, provincial, and local business climate to reduce the cost of doing business by (a) institutionalizing regulatory impact assessments and (b) streamlining registration and licensing for businesses. Phase I will examine the extent of the preparation required of the central, provincial, and local governments. Phase II will focus on the discussion of findings and preparation of a potential program for policy and capacity building, including central, provincial, and local governments.
- (ii) Component B is to provide improved support to regional public and private financial institutions to enhance their SME portfolio. Phase I will involve the assessment of local small business needs vis-à-vis the financial operations and capacity of institutions such as venture capital companies; provincial development banks; and private banks operating or expanding their operations in core provinces, such as Danamon, Niaga, NISP, Buana, RaboBank, or Hongkong and Shanghai Banking Corporation. Initial assessments will be conducted for sustainable and market-driven collateral-replacement schemes that could benefit SMEs, such as direct guarantee certificates issued by guarantee institutions or warehouse receipts issued by private and public banks. Based on lessons learned, Phase I might lead to preparation of a proposal for potential ADB public or private sector interventions, as required under Phase II.
- (iii) Component C is to improve high-quality and sustainable technical support for SMEs. Phase I will involve the assessment of technological centers,¹⁷ based on ADB experience with these institutes; provinces' economic potential to turn them into providers of sustainable and relevant technical services for SMEs and their

¹⁷ The centers were chosen following a cluster approach. For furniture, Industrial Research and Development (R&D) Institute of Semarang, Central Java (IRDIS); for metal industries, the Industrial R&D Institute of Surabaya, East Java (IRDISB); for agro-based industries, the Industrial R&D Institute of Ujung Pandang-Makassar, South Sulawesi (IRDIUP); and for marine-based industries, the Industrial R&D Institute of Manado, North Sulawesi (IRDIMN).

suppliers; and the role of donor and private institutions operating in the core provinces. Based on Phase I, Phase II might lead to the preparation of a proposal for ADB support for capacity building to serve SME technological needs.

C. Cost and Financing

12. The total cost of the TA is estimated to be \$1 million equivalent. The Government has requested ADB to finance \$800,000 equivalent, to cover the entire foreign exchange cost of \$552,000, and \$248,000 equivalent of local currency costs. The TA will be financed on a grant basis by the Government of the United Kingdom. The Government of Indonesia will finance the balance of the local currency cost, equivalent to \$200,000 through the provision of office accommodation, transport, and staff. See Appendix 3 for cost estimates and financing plan. The Government has been advised that approval of the TA does not commit ADB to financing any ensuing project.

D. Implementation Arrangements

13. The TA Executing Agency will be the MOIT Directorate General for SMEs, which will create and coordinate a working group of implementing agencies: Agency for Research and Development; Directorate General for Domestic Trade, Business Development, and Company Registration Division of MOIT; Directorate General for Financial Institutions of the Ministry of Finance; and Directorate General for Financing of SMOCSME. Phase I will assess needs under Components A, B, and C, and prepare a midterm report for review by ADB, DFID, and the Government. Phase II will consolidate and discuss with stakeholders the findings and recommendations of Phase I and integrate them into a joint final proposal for submission to ADB and the Government.

14. The consultants will be based most of the time at MOIT in Jakarta and are expected to have a full-time consultant in Makassar, South Sulawesi, at the provincial Office for Industry and Trade to serve as contact for North and South Sulawesi.

15. The consultants will submit inception (Phase I), midterm (Phase II), draft final, and final reports to the Government and ADB. The inception report (Phase I) will be submitted 1 month after the TA starts; the midterm report, 5 months after; a draft report, 8 months after; and the final report, 10 months after. All reports will be discussed with the Government, ADB, and DFID during the TA.

16. The TA will require a total of 64 person-months (part- or full-time) of consulting input, including 28 person-months of international and 36 person-months of domestic consultants over 10 months, starting in or about April 2004 and ending in or about January 2005. Consultants will be recruited through a firm (using the simplified technical proposal) in accordance with ADB's *Guidelines on the Use of Consultants* and other arrangements satisfactory to ADB for the engagement of domestic consultants. Their terms of reference are in Appendix 4.

IV. THE PRESIDENT'S DECISION

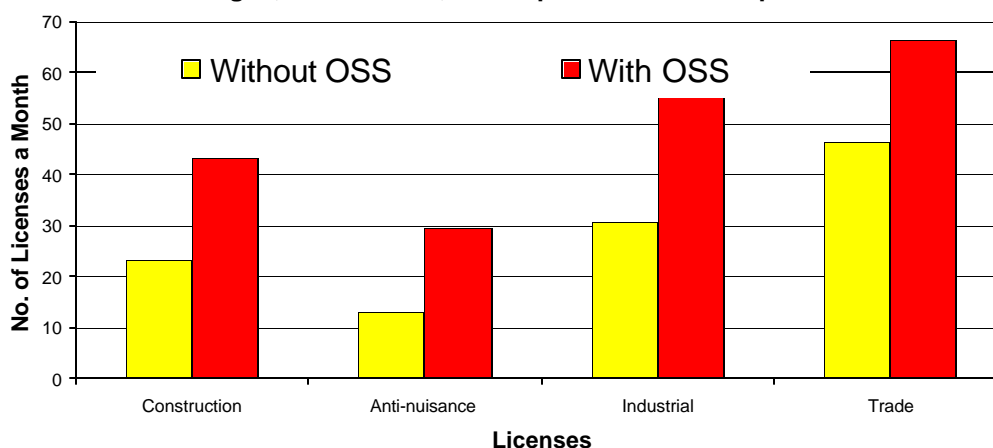
17. The President, acting under the authority delegated by the Board, has approved ADB administering technical assistance not exceeding the equivalent of \$800,000 to the Government of Indonesia to be financed on a grant basis by the Government of the United Kingdom's Department for International Development for preparing the Provincial Small and Medium Industrial Sector Development Program, and hereby reports this action to the Board.

IMPROVING LOCAL GOVERNANCE AND REDUCING SET-UP COSTS: CASE STUDY FROM CENTRAL JAVA

1. Implemented in January 2001, decentralization has seen a marked increase in regulation of local small businesses. The potential for wide and damaging regional variation in regulations needs to be mitigated, and local and provincial governments must ensure that their economic policies are also in the national interest. While the decentralization law provides for a regulatory monitoring role by the central government, the sheer volume of new or revised local regulation makes this task unmanageable. Systematic regulatory streamlining and impact monitoring functions should extend to the local level, providing a uniform framework for business regulations and impact assessment across regions.

Figure A1: Processed Licenses before and after a One-Stop Service Office

Sragen, Central Java, Jan-Sep 2002 and Jan-Sep 2003



Source: Sragen's OSS Office staff estimates.

2. The local government of Sragen¹ in Central Java shows the case of a typical district striving to support better regulations under decentralization. Forty-five minutes away from the city of Solo, Sragen has a population of 850,000 people, of whom 48% are classified as poor. Sragen's labor force earns a living mostly in agriculture, with an annual average income of \$98 a month. The new head of the local government came into office in 2001, and has since counted on the support of the local parliament to improve infrastructure and increase local support to the garment, furniture, and handicraft industries. Pak H. Untung Wiyono, an engineer turned businessman, is aware that agriculture alone cannot support the people of Sragen, and that the local economy requires diversification into labor-intensive industries to create jobs.

3. Promoting easier access to business licenses an incentive he aims to create. The World Bank estimates that registering a business (limited company status) takes 168 days and 11 steps, the longest process in Asia. One third of all businesses in Sragen have no legal status, and only 1% is a limited company.

4. In October 2002, with support from the Asian Development Bank technical assistance, Sragen moved to integrate local government agencies to provide licenses from a centralized

¹ One of the four districts under TA 3829 (footnote 3).

local office known as one-stop service (OSS). The move meant that all the different government agencies represented within the local government would surrender authority to a single office.

5. Efficiency has improved dramatically. The four most common licenses provided by local governments, for example, are permits for construction, anti-nuisance, industrial permit, and trade permit—together providing on average about one third of Sragen's revenues, shared by all government agencies (1% funds the OSS office). With the introduction of the OSS office, run by 27 staff, license processing has increased substantially: from 43% for trade permits to 126% for construction permits. Fewer days are required to obtain a license. The complex construction permit, which once took 15 days to get, now takes just 7. In Karang Anyar, however, next door to Sragen, a construction permit takes up to 35 days. In Sragen an anti-nuisance, industrial, or trade permit takes only an average of 5 days to get, significantly shorter than before OSS.

6. Office manager Pak M. Isnadi emphasized accountability by introducing the use of a tracking time sheet to find out who was processing a specific document at each stage and how long the person took to process it. The result is a faster turnover of documents. Mr. Isnadi takes pride in a team of 27 young and motivated staff who have good academic qualifications to perform their administrative tasks (one third of them have at least three years or more of higher education), and who undergo regular training on new techniques such as monitoring customer satisfaction through feedback. The last survey indicated that 74% of OSS visitors appreciate the services offered. One result of the feedback, but not the only one, was air-conditioning the waiting room and placing magazines in it.

7. An efficient OSS makes the old system easier to manage but does not improve it. Mr. Isnadi said that prospective owners of hair salons in Sragen were required to have an antinuisance license. He brought the issue to the attention of the district's leader ("bupati") and district's parliament. After a discussion in parliament, the bupati signed a new regulation eliminating the license requirement, which represented on average savings of about Rp200,000 (\$25) every 5 years for most of these female-owned businesses.

8. Sragen's OSS now aims to improve its standards of public service and hopes to obtain an ISO9001 certification for service, start working on the electronic handling of files, and soon provide licenses online (e-government). Public administration appears to be determined to erase the common perception of a complex bureaucratic system without solution, and move closer a regime where improvement in public administration eases the initial pains of decentralization, but, more important, have regulations serve the common interest.

TECHNICAL ASSISTANCE FRAMEWORK FOR PHASE I (ASSESSMENT)

Design Summary	Performance Indicators/Targets	Monitoring Mechanisms	Assumptions and Risks
Goal <ul style="list-style-type: none"> Promote competitiveness of small and medium-sized enterprises (SMEs) in the Asian Development Bank's (ADB) core provinces 	<ul style="list-style-type: none"> Projections of SME "competitiveness" indicators in industry and trade in selected provinces 	<ul style="list-style-type: none"> Midterm report at the end of phase I, and proposal for phase II in accordance with to the sector development program agreed on in the 2003 Country and Strategy Program 	<ul style="list-style-type: none"> No major economic policy reversal in SME, industry, and trade reforms as part of the ongoing program (Loan 1738 [footnote 2])
Purpose Business Environment <ul style="list-style-type: none"> Improved governance with adoption of regulatory impact assessments (RIAs) in the planning process of local governments Improved business licensing in provinces and districts increases SME financing SME Financing <ul style="list-style-type: none"> Increased access and increased formal financing for pro-poor investment in SMEs outside Jakarta 	<ul style="list-style-type: none"> Number of provincial officials trained in the use of RIAs Type of regulations to be reviewed Reduction in business licensing procedures Financial viability and good corporate governance of provincial venture capital companies Best practices in SME lending and good corporate governance by provincial banks Expansion of collateral replacements 	<ul style="list-style-type: none"> Midterm report (phase I) with recommendations by the Ministry of Industry and Trade and provincial governments Pilot projects with 1–2 local governments Field visits to selected provinces Midterm report (phase I) with recommendations for a phase-2 proposal of integrated investment project through financial institutions Field visits 	<ul style="list-style-type: none"> Regional governments will continue to support market-friendly policies for SMEs and support central registration and streamlining of licenses Central and regional government support for commercial SME financing
Technology Services for SMEs <ul style="list-style-type: none"> Link technical business development services (BDS) and 	<ul style="list-style-type: none"> Market assessments of technical services by SME sectors Business plans for 	<ul style="list-style-type: none"> Midterm report (phase I) with recommendations to prepare in phase II a 	<ul style="list-style-type: none"> Private sector demand for technical BDS to improve SME operations in selected

Design Summary	Performance Indicators/Targets	Monitoring Mechanisms	Assumptions and Risks
SMEs to improve SME product development	selected technological institutes	project for commercially viable technological institutes	industries
Output (business environment) <ul style="list-style-type: none"> Business regulation monitoring units at MOIT and local governments to reduce cost of doing business Comprehensive review and streamlining of a central business registration in core provinces and districts 	<ul style="list-style-type: none"> Staff assigned and training conducted Rapid assessment of regulations in 10 core provinces Guidelines to streamline RIAs Staff assigned to link with MOIT central registration 	<ul style="list-style-type: none"> Documentation on methodology and training reports Reports on RIAs Recommendation report for an action plan to modify or revoke regulations for each province Recommendation for improved business licensing and formalization 	<ul style="list-style-type: none"> Monitoring units are adequately equipped to identify regulations affecting businesses Concept of business formalization by MOIT accepted
Output (financing) <ul style="list-style-type: none"> Increased use of formal credit by SMEs through better banking services Increased SME operations by provincial financial institutions through investments, use of collateral-replacement schemes, or BDS for SMEs 	<ul style="list-style-type: none"> Up to five financial and governance assessments of SARANAS Up to four financial and governance assessments of BPDs Up to four selected private banks operating in core provinces Two financial and governance assessments of the sustainability of credit guarantee/warehouse receipts in core provinces 	<ul style="list-style-type: none"> Assessment report on credit practices and capacity of financial institutions, including their provision or use of BDS for SME clients Projections for increased SME investment credits Consolidated project proposal for possible ADB financing Workshop to disseminate reports among central government officials 	<ul style="list-style-type: none"> Financial institutions willing to participate
Output (technical BDS) <ul style="list-style-type: none"> Adoption of better management by technical institutions to become viable suppliers of technological services for SMEs Adoption of links 	<ul style="list-style-type: none"> Assessment of clusters' needs for technical services Business plans for technological institutes to provide technical services commercially 	<ul style="list-style-type: none"> Workshop with MOIT, provincial governments, and institutes offering commercial technical services 	<ul style="list-style-type: none"> Technological institutes willing to provide commercially viable BDS to SMEs to support their financing capacity

Design Summary	Performance Indicators/Targets	Monitoring Mechanisms	Assumptions and Risks
between technological institutes and private sector to remain in tune with industry demands for pro-poor growth			
Activities <ul style="list-style-type: none"> For all components: assessment and pilot projects (phase I), and proposal development and dissemination activities (phase II) 	Inputs <ul style="list-style-type: none"> 64 person-months of consulting services (28 international and 36 domestic) 	<ul style="list-style-type: none"> Inception, midterm, draft final, and final reports, including specific project proposals by TA consultants Review missions for tripartite meetings with ADB and Department of International Development (DFID) 	<ul style="list-style-type: none"> Availability of counterpart staff and office space to support consultants

COST ESTIMATES AND FINANCING PLAN
(\$'000)

Item	Foreign Exchange	Local Currency	Total Cost
A. Government of the United Kingdom Financing^a			
1. Consultants			
a. Remuneration and Per Diem			
i. International Consultants	400	0	400
ii. Domestic Consultants	0	80	80
b. International and Local Travel ^b	45	45	90
c. Reports, Communications, and Translation	0	8	8
2. Office Equipment ^c	12	3	15
3. Training, Seminars, and Conferences			0
a. Focus Group Discussions, Training, and Seminars in Core Provinces	0	80	80
b. Regional Study Tours for Local and Central Government Teams on Regulatory, Financial, and/or Technology Services for SMEs	35	0	35
4. Miscellaneous Administration and Support Cost	0	5	5
5. Representative for Contract Negotiations	5	0	5
6. Contingencies	55	27	82
Subtotal (A)	552	248	800
B. Government Financing			
1. Office Accommodation and Transport	0	50	50
2. Remuneration and Per Diem	0	100	100
3. Land Transport and Local Travel	0	40	40
4. Others	0	10	10
Subtotal (B)	0	200	200
Total	552	448	1000

SMEs = small and medium -sized enterprises.

^a Administered by the Asian Development Bank (ADB).

^b Includes rental of vehicles in four core provinces.

^c Equipment includes computers, cellular phones, printers, photocopiers, and air-conditioners to be handed over at the end of the technical assistance in accordance with ADB's disposal procedures.

OUTLINE TERMS OF REFERENCE FOR CONSULTING SERVICES

A. Introduction

1. The technical assistance (TA) has three related components, which will be undertaken by a consulting firm that will provide a team of international and domestic consultants in Jakarta and selected core provinces (Central and East Java, and North and South Sulawesi).

2. This component will build on findings and recommendations from the Asian Development Bank (ADB) TA on small and medium-sized enterprise (SME) development (footnote 2) and strengthening business development services (BDS) for SMEs (footnote 3) for Indonesia. The component will also build on the extensive work of external funding agencies, on SME development, in particular, the International Finance Corporation (IFC) and Japan International Cooperation Agency (JICA) findings and recommendations for Indonesia.

3. The consultants will be based at the Ministry of Industry and Trade (MOIT) office in Jakarta and have a presence in Makassar, South Sulawesi, for 10 months, and pay attention to training needs of proactive local governments in Sragen, Central Java, and Pare-Pare, South Sulawesi, identified under the SME development TA to be used as pilot projects to demonstrate the importance of improved local governance.

1. Team Leader (international, 6 person-months)

4. The team leader should be an experienced SME finance specialist with extensive experience in credit and BDS delivery in Indonesia or other similar developing member countries. The consultant will be based in Jakarta, and manage the teams working in the provinces. The specific tasks will include the following:

- (i) coordinating, managing, and supervising teams A, B, and C under MOIT's Directorate General for Small Industry and Trade;
- (ii) interacting with all implementing agencies such as MOIT (Agency for Research and Development, Directorate General for Domestic Trade and Business Development and Company Registration), Ministry of Finance (Directorate General for Financial Institutions), and State Ministry of Cooperatives and Small and Medium Enterprise (Directorate General of SME Finance) through a working group;
- (iii) preparing and discussing the inception (start of phase I), midterm (start of phase II), draft final, and final reports for discussion with the Government, ADB, and DFID;
- (iv) coordinating proposals of regional study tours to be approved by ADB to learn international best practices under the three major TA themes: regulation and registration, financing, and technological support for SMEs);
- (v) interacting with other ADB projects (especially those on decentralization and SME) and other donor initiatives in SME development, in particular IFC's Program for Eastern Indonesia SME Assistance (PENSA); and
- (vi) monitoring preparation of all reports from all three components and arranging final submission and presentation.

B. Regulatory and Registration Team

1. Legal Senior Advisor (international, 6 person-months)

5. The advisor will have extensive experience of Indonesia's business regulations and licenses. The advisor will work closely with the Agency for Research and Development at MOIT. Specific tasks include the following:

- (i) Identify a list of 4–6 key regulations to be reviewed as a starting point (rapid assessment), based on the finding of the TA 3416 (footnote 2), on promoting competition and deregulation, and other regulations created since decentralization in the core provinces, including trade, infrastructure, tax, or investment regulations affecting businesses.
- (ii) Prepare an action plan to institutionalize regulatory review within the central, regional, and local legislative process to reduce the cost of doing business by recommending streamlining, modification, or elimination of regulations (including MOIT regulations affecting provincial businesses), based on Indonesia's Regulatory Review Manual, prepared under TA 3416.
- (iii) Prepare an action plan to improve national and provincial registration and licensing, including definition of interfaces between central, regional, and local levels to assure appropriate data flow.
- (iv) Prepare participation of central and local government officials in study tours or training, if appropriate, to be approved by ADB, to improve implementation of regulatory assessments or business registration systems in a decentralized environment according to best international practices in Asia and the Pacific.
- (v) The above tasks will involve MOIT's Agency for Research and Development and the Directorate General for Domestic Trade (Business Registration Division) in Jakarta and provincial officials of Central and East Java, and North and South Sulawesi, as well as the relevant local authorities (Pare-Pare, South Sulawesi, Sragen in Central Java).
- (vi) Supervise dissemination and discussion of project proposals within the Government through working groups, including other relevant government agencies such as the Competition Bureau.

2. Legal Advisor (domestic, 12 person-months)

6. The domestic advisor will have extensive experience of Indonesia's business regulations and licenses, and provide support to the senior legal advisor. Specific tasks include the following:

- (i) Help identify 4–6 key regulations to be reviewed as a starting point, based on the finding of TA 3416 and additional regulations created since decentralization in the core provinces.
- (ii) Help prepare an action plan to improve the legal and regulatory environment for SMEs by recommending streamlining and modification of regulations, and possible elimination of unnecessary procedures.
- (iii) Help prepare an action plan to improve regulations on licensing and registration requirements.
- (iv) Help disseminate findings and proposals among central and provincial government officials through working groups and seminars in Jakarta and four provincial capitals (Semarang, Central Java; Surabaya, East Java; Manado, North Sulawesi; and Makassar, South Sulawesi), promoting cooperation for demonstration purposes,

when possible with local governments such as Pare-Pare, South Sulawesi, and Sragen in Central Java.

B. Finance Team

1. Small and Medium Enterprise Banking (international, 8 person-months)

7. The consultant will have extensive experience in Indonesia's SME credit needs. The consultant will work closely with the Directorate General for Financial Institutions, MOF, in Jakarta, and directly with the provincial financial institutions. Specific tasks include the following:

- (i) Prepare a financial and governance assessment and action plan for selected venture capital companies based on current and projected investment needs to meet SME market segment.
- (ii) Prepare a financial and governance assessment and action plan for selected provincial development banks based on current and projected credit needs of the SME market segment.
- (iii) Prepare a financial and governance assessment and action plan for selected private banks operating in core provinces, based on current and projected credit needs of the SME market segment.
- (iv) Recommend and prepare a proposal for participation, if appropriate, of staff from the central or provincial governments, provincial development banks, venture capital companies, and private banks operating in provinces, in study tours to be approved by ADB to improve regional banking or venture capital operations, according to international best practices in Asia and the Pacific.
- (v) Identify and prepare 1–2 successful case studies on financing group clients such as associations or cooperatives of small businesses. The case studies are to be presented as innovative schemes to financial institutions, and should recommend regulatory, lending, and informational requirements for successful implementation.
- (vi) Based on the findings from Phase I, the consultant might integrate into the financial proposal for provincial development banks, venture capital companies, and private banks a plan to link financial institutions with providers of technical services or BDS providers to improve financing of potential SME clients.

2. Collateral Replacement Specialist (international, 3 person-months)

8. The consultant will have extensive experience of Indonesia's banking and guarantee operations for SME credit. In particular, the consultant will have experience in the risk assessment and risk sharing involved in credit guarantees for SMEs in other countries and the use of guarantee-like instruments such as warehouse receipts in trading and banking. The consultant will work closely with the SME banking specialist and the Directorate General for Finance, SMOCSME, to assess the desirability, feasibility, and sustainability of these collateral replacements (credit guarantees and warehouse receipts), based on the extensive experience on credit guarantees and other collateral-replacement schemes, especially the background reports prepared under the TA (footnote 2). Emphasis will be given to market driven guarantee schemes. Specific tasks include the following:

- (i) Review current banking legislation for collateral replacements and requirements for existing or future types of collateral replacement (letters of credit, purchase orders, or commodities), including a review on the status of the registration for moveable assets in Indonesia, based on international comparative work by TA 3829 (footnote 3).

- (ii) Prepare a financial and governance assessment of guarantee companies operating in Central and East Java, and South Sulawesi.
- (iii) Prepare a financial and governance assessment of the warehouse receipt system among local banks in North and South Sulawesi, based on international practices for this type of operation, based on commodities commonly traded in these provinces (mainly cocoa and coffee).
- (iv) Identify and prepare 1–2 successful case studies on innovative guarantees for group clients such as associations or cooperatives of small businesses. The case studies are to be presented as innovative schemes to financial institutions, and should include specific recommendations about the necessary regulatory, lending, and informational requirements for a successful implementation.
- (v) Recommend and prepare a proposal for participation of central or provincial government staff and other relevant agencies, if appropriate, in study tours to be approved by ADB to adopt international best practices for collateral replacement mechanisms in Asia and the Pacific.
- (vi) Based on the above, the consultant will recommend ways to effectively use credit guarantees and a warehouse receipt system in core provinces.

3. Small and Medium Enterprise Finance Specialist (domestic, 18 person-months)

9. The consultant will support the banking and collateral placement specialists. Specific tasks include the following:

- (i) Coordinate field visits to financial institutions, including venture capital companies and provincial development banks in four core provinces, guarantee corporations (Central and East Java), and banks using warehouse receipts in North and South Sulawesi.
- (ii) Coordinate and facilitate the interaction of provincial financial institutions and central government entities such as the Ministry of Finance, Bahana Artha Ventura, Association of Regional Banks, and other relevant agencies.
- (iii) Help prepare individual reports for venture capital companies, provincial development banks, and private banks, as well as case studies on group lending.

4. Specialist on Business Development Services for Finance (domestic, 3 person-months)

10. The domestic consultant will have experience in the delivery of BDS in Indonesia. Specific tasks include the following:

- (i) Coordinate with the banking and collateral replacement specialists in assessing credit needs of SMEs and existing or potential portfolio of provincial financial institutions.
- (ii) Assess BDS needs of banks in core provinces and identify potential BDS providers, suitable to those provincial institutions.
- (iii) Prepare a proposal for financial institutions in core provinces (North and South Sulawesi, and Central and East Java) to promote the use of BDS among their SME clients, based on experiences of the Government and donors.
- (iv) Discuss findings and proposals with the central and relevant provincial governments and other stakeholders for integration in proposed projects under component B (financing).

C. Technology for the Small and Medium Enterprise Team

1. Industrial Cluster Development Specialist (international, 5 person-months)

11. The consultant will have experience in managing technology development for SMEs. Specific tasks include the following:

- (i) Assess current operations of technology institutes (and incubators at universities in four core provinces of the TA, based on the experience of the Bandung Technological Institute and Metal Industry Development Center of West Java, and the work under TA 3417 (footnote 2) and other donor experiences in Indonesia.
- (ii) Recommend business plans to adapt management of technological institutes and incubators at universities to decentralized and commercial service providers for SMEs in key sectors with strong backward linkages to support local economies:
 - (a) background studies from (i) to be used as an example of best practices in Indonesia;
 - (b) management of selected technology institutes and their associated industrial cluster: furniture cluster for the Industrial Research and Development (R&D) Institute of Semarang in Central Java; metal industries for the Industrial R&D Institute of Surabaya in East Java; agro-based industries for the Industrial R&D Institute of Ujung Pandang-Makassar in South Sulawesi; and marine-based industries for the Industrial R&D Institute of Manado in North Sulawesi;
 - (c) management of SME incubators for start-ups at universities, including the Universitas Senelas Maret known as UNS (Central Java), Universitas Brawijaya (East Java), and Universitas Negeri Makassar (South Sulawesi).
- (iii) Review ADB documents¹ and experiences of donors and similar institutes to back up the recommendations.
- (iv) Prepare an industrial strategy to strengthen internal management of institutions, foster their backward linkages within the value-supply chain management of the four types of clusters in each province, and recommend changes to local regulations with a direct impact to the industrial clusters under a local regulatory fast-track (potential link with component A).
- (v) Identify key factors to improve the capacity of clusters and technical institutes/universities in managing the integration of SMEs into regional and global markets, using public and private business facilitation agents such as business associations or private BDS providers or private sector-guided plans for clusters with potential industrial international partners.
- (vi) Discuss proposals with the Government and relevant provincial governments for further integration of proposals under component A (regulation and registration) and/or B (financing).

2. Specialist for BDS for Technology (domestic, 3 person-months)

12. The domestic consultant will have experience in BDS delivery in Indonesia. Specific tasks include the following:

- (i) Help the industrial cluster specialist assess technology needs of SME clusters,
- (ii) Assess technology needs in the four selected clusters, and
- (iii) Discuss findings and proposals with the Government and relevant provincial governments and other stakeholders for integration in proposed projects under component A (regulatory and registration) and B (financing).

¹ ADB. 2002. *Project Completion Report on Industrial Technology and Human Resource Development*. Manila (Loan 1433); TA 3417 (footnote 2); and TA 3829 (footnote 3).