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Enterprise Surveys
Country Note Series

Indonesia

Running a Business in Indonesia

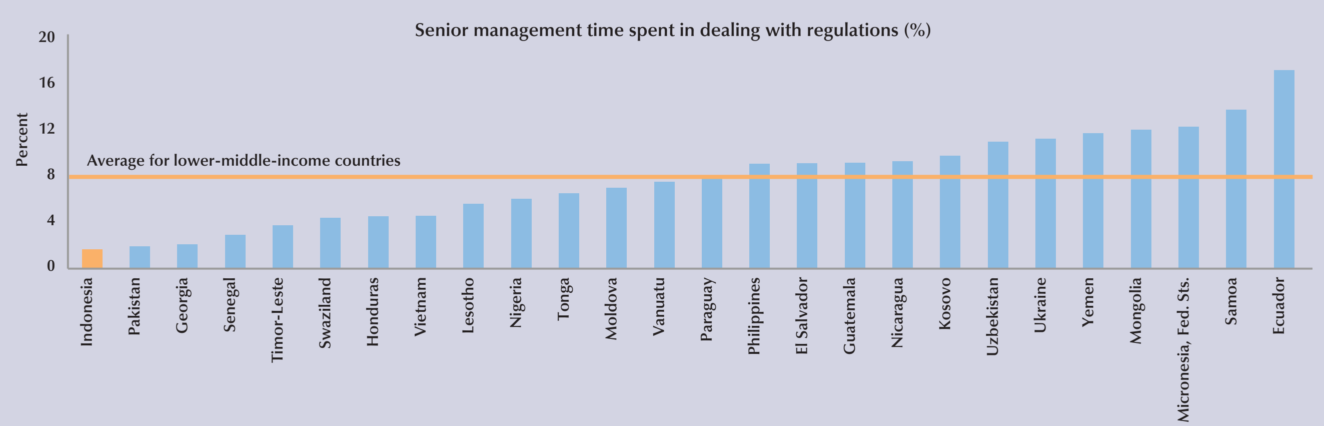
Recently obtained Enterprise Surveys data indicate that senior managers in Indonesia spend the least amount of time dealing with the requirements of government regulations when compared to countries in the same income and size groups (figure 1). However, Indonesian firms perform poorly in international trade and in the use of technology. Only 4 percent of firms are exporters. This is lower than the average in countries with similar income levels—11 percent—and population sizes—17 percent. Similarly, Indonesian firms report a lower share of sales exported and fewer firms use imported materials and goods. This finding could be the result of firm composition in the country – 77% of firms have less than 10 employees and these firms are much less likely to engage in foreign trade. Indonesian firms are also much less likely than their international peers to use their own Web site or to use e-mail. Across the firms in Indonesia, exporting and foreign-owned firms have more visits or meetings with tax officials, and the managers of these firms spend a larger share of their time dealing with government regulations.

The Enterprise Surveys use standard survey instruments to collect firm-level data on the business environment in a country from business owners and top managers. The surveys cover a broad range of topics including access to finance, corruption, infrastructure, crime, competition, labor, obstacles to growth and performance measures. The survey is designed to be representative of a country's private non-agricultural economy, and firms sampled are stratified by size, location[1] and sector (figure 2)[2] to ensure that most major types of firms are covered. Only firms with five employees or more are included in the sample. In Indonesia, 1,444 firms were surveyed from August 2009 to January 2010. The information collected refers to the characteristics of the firm at the moment of the survey or to fiscal year 2008.

What is the average firm in Indonesia?

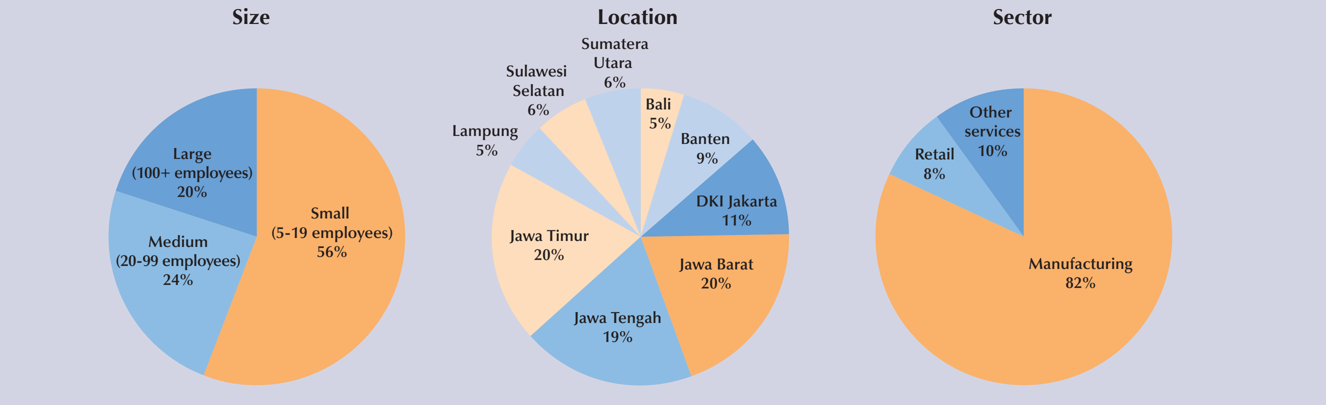
Indonesian firms have a female participation rate in ownership and management of 43 percent and 31 percent, respectively. The ownership rate is close to the average for countries of the same size and income level (table 1), while the female manager rate is above average. Small firms are roughly one and a half times as likely as medium firms, and nearly three times as likely as large firms—33 percent versus 20 percent and 13 percent—to have a female top manager. Unsurprisingly, firms with a female top manager are more than four times as likely to have female participation in ownership (90 percent) than male-managed firms (21 percent). Firms with female participation in ownership, or

Figure 1 **Indonesian firms spend less time dealing with regulatory burden**



Source: Enterprise Surveys.

Figure 2 Characteristics of the firms interviewed



Source: Enterprise Surveys.

female top managers, are also more likely to employ women than their counterparts. Firms with female top managers employ twice as many females (52 percent of their full-time permanent workforce), on average, than male managers (26 percent female). Similarly, firms with female participation in ownership employ females at twice the rate of firms without female ownership—48 percent versus 23 percent. This finding extends to female non-production workers where firms with female participation in ownership or female top managers employ females in non-production jobs at about twice the rate of their male counterparts.

The average firm[3] in Indonesia is 15 years old (table 2). At 20.2 years on average, large firms are older than medium firms and small firms that average 16.6 years and 14.7 years, respectively. Small firms are the most common in Indonesia—the average firm has only 18 full-time permanent workers—and only 10 percent of firms have more than 20 permanent employees, while 77 percent of

Table 1 How does Indonesia 2009 compare with other countries in the same income or population group?

Ranking 1 assigned to the largest value	**Lower-middle-income economies (26 countries†)**	**Similarly populated countries (13 countries ‡)**
Percent of firms formally registered when started operations in the country	23	11
Private domestic ownership (%)*	16	12
Private foreign ownership (%)*	22	11
Government/state ownership (%)*	17	10
Percent of firms with female participation in ownership	12	7
Bank finance for investment (%)	22	12
Percent of exporter firms	22	12
Domestic sales (percent of sales)	6	3
Percent of firms with internationally recognized quality certification	24	13
Percent of firms with annual financial statement reviewed by external auditor	26	13
Capacity utilization (%)	1	1
Percent of firms using their own Web site	26	13
Percent of firms using e-mail to communicate with clients/suppliers	26	13
Ranking 1 assigned to the smallest value	**Lower-middle-income economies (26 countries†)**	**Similarly populated countries (13 countries ‡)**
Value of collateral needed for a loan (percent of the loan amount)	2	9
Number of power outages in a typical month	5	2
Senior management time spent in dealing with requirements of government regulation (%)	1	10
Average number of visits or required meetings with tax officials	1	4
Incidence of graft index**	21	10
Losses due to theft, robbery, vandalism, and arson against the firm (percent of sales)	3	4

Source: Enterprise Surveys.

Note: This table presents a ranking out of different groups of economies for each of the listed indicators. The lower-middle-income group includes 26 countries and the similarly populated group consists of 13 countries. The numbers are ranks as opposed to the actual value of the indicator.

Table 2	The average firm in Indonesia 2009		
	Indonesia	**Lower-middle-income economies (26 countries †)**	**Similarly populated countries (13 countries ‡)**
Age (years)	15.0	14.6	16.7
Percent of firms formally registered when started operations in the country	29.1	88.0	87.9
Most common legal form	Sole Proprietorship	Sole Proprietorship	Closed Shareholding Co.
Private domestic ownership (%)*	89.4	87.9	93.4
Private foreign ownership (%)*	1.5	9.8	4.6
Government/state ownership (%)*	0.1	0.5	0.6
Percent of firms with female participation in ownership	42.8	41.3	41.6
Percent of firms with female in top management position	31.2	20.8	24.2
Experience of the top manager (years)	13.2	16.0	17.7
Average number of temporary workers	1.8	7.8	9.0
Average number of permanent, full-time workers	17.9	31.9	58.1
Percent of full-time female workers	33.9	31.0	32.9

Source: Enterprise Surveys.

firms have 10 or fewer permanent employees. This high percentage of small firms might be related to the small percentage of firms formally registered when they started operations in the country.

Both the size and the composition of the workforce differ across firm types. For instance, exporter firms and firms with foreign ownership[4] are, on average, much larger employers of permanent workers—at 197 and 154 respectively—than firms that do not export or are fully domestically owned—at 14 and 16 permanent employees respectively.

Eighty-four percent of the firms in Indonesia that have five or more employees are sole proprietorships, while limited partnerships are the second most common legal form at 8 percent. Private domestic ownership, as a percentage of total ownership, in firms with female participation in ownership is 85 percent. This is significantly lower than the 93 percent exhibited in male-owned firms. Female-managed firms have a similarly lower share of private domestic ownership. Although less than 2 percent of firms have any foreign ownership participation, 1.2 percent of firms are wholly foreign-owned. The average firm has only 1.5 percent foreign-owned equity. Government participation in the ownership of private sector firms is very low in Indonesia at 0.1 percent. Overall, 89 percent of private sector firms are fully private domestic firms.

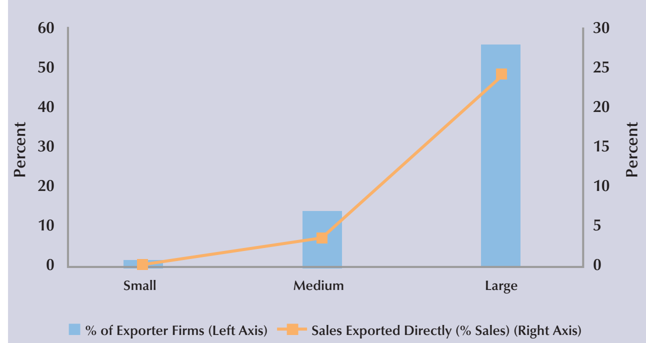
How do businesses operate in Indonesia?

Use of internal finance is high when compared to other countries of similar size or income level. At 88 percent, Indonesia has one of the highest levels of internal financing for investments and, at 6 percent, one of the lowest levels of bank financing relative to its peers in size and income. Only 12 percent of firms use bank financing for investments; less than a fifth of firms have a line of credit or bank loan and only 51 percent of firms have a checking or savings account—well below the average in both comparator cohorts. Firm-size is associated with the likelihood of having a bank loan or line of credit—47 percent of large firms have a bank loan or line of credit, while 28 percent of medium and just 17 percent of small firms do.

Firms with female participation in ownership or a female top manager use bank loans less often and are 10 percent to 15 percent less likely to have a checking or savings account than their counterparts. Only 13 percent of female-managed firms have a bank loan or line of credit compared to 21 percent of male-managed firms.

Firms in Indonesia trade relatively little with the rest of the world (table 3). Only 4 percent of Indonesian firms are exporters compared to 11 percent of firms in lower-middle-income economies and 17 percent in countries with similar populations. This low participation rate in the export market is mostly seen in small and medium-sized firms. Fifty-five percent of large firms participate in export markets but only 2 percent of small and 14 percent of medium-sized

Figure 3 **Small and medium-sized firms have low export performance**



Source: Enterprise Surveys.

Table 3	Choices by the average firm in Indonesia 2009		
	Indonesia	Lower-middle-income economies (26 countries †)	Similarly populated countries (13 countries ‡)
Internal finance for investment (%)	88.3	71.1	67.1
Bank finance for investment (%)	6.4	15.2	18.1
Value of collateral needed for a loan (percent of the loan amount)	52.7	151.6	126.8
Loans requiring collateral (%)	83.6	79.5	68.8
Percent of firms with a checking or savings account	51.5	85.2	85.4
Percent of exporter firms	4.1	11.1	16.8
Domestic sales (percent of sales)	97.8	94.9	93.7
Sales exported directly (% sales)	1.1	3.5	4.4
Sales exported indirectly (% sales)	1.0	1.6	1.9
Sales that are pre-paid (%)	21.7	20.4	15.5
Sales sold on credit (%)	45.6	37.4	52.7
Percent of firms with internationally recognized quality certification	2.9	12.6	15.8
Percent of firms with annual financial statement reviewed by external auditor	4.0	41.1	38.9
Capacity utilization (%)	85.9	70.2	75.3
Percent of firms using their own Web site	5.7	25.8	43.1
Percent of firms using e-mail to communicate with clients/suppliers	13.2	54.6	67.2

Source: Enterprise Surveys.

firms participate (figure 3). The number of exporter firms, the share of sales exported, as well as the percentage of firms using imported inputs are all well below the averages demonstrated in countries with similar income levels or populations. Export market participation is low among firms that have a female top manager compared to firms with a male top manager (1 percent vs. 6 percent). Exporting small and medium-sized firms do not trade intensively. Small firms gain 0.3 percent of their total sales from direct exports (figure 3). The values for medium-sized and large firms are 4 percent and 24 percent respectively. About half of the exporting large firms export more than 40 percent of their output.

Senior managers in Indonesia spend the least amount of time dealing with the requirements of government regulations

Likewise, 98 percent of inputs in Indonesia are of domestic origin. Even compared to other countries with few importing firms—such as Nigeria, Pakistan, Uzbekistan, Ukraine and Timor-Leste—Indonesian firms utilize fewer foreign inputs. Only 2.5 percent of small firms use foreign inputs and these inputs correspond to just 1.1 percent of the value of their total inputs. Firm-size is associated with the intensity of firms' usage of foreign inputs—12 percent of medium-sized firms use foreign inputs for 6 percent of total inputs, while 56 percent of large firms import 31 percent of theirs.

Indonesia ranks well below average on international quality certification. Out of 26 countries in the lower-middle-income group, Indonesia ranks above only two countries on this indicator—Uzbekistan and Timor-Leste. Having internationally recognized quality certification is more common among firms with global engagement—40 percent of exporting firms and 46 percent of foreign-owned firms own a certificate, but only 2 percent of non-exporting and 2 percent of domestic firms own these certificates. Similarly, Indonesian firms are the least likely group compared to other countries in this cohort to have their financial statements reviewed by an external auditor. Large firms are most likely to have their financial statements reviewed by an external auditor at 51 percent, while 10 percent of medium firms and only 2 percent of small firms have their financial statements reviewed by an external auditor.

Indonesian firms are much less likely than their peers to use their own Web site or to use e-mail. Some firms make better use of the internet than others—over 30 percent of both exporters and foreign-owned firms use their own Web site compared to just 5 percent of their counterparts. These patterns also hold for using e-mail to communicate with clients and suppliers—75 percent of exporter firms report using e-mail for business compared to just 12 percent of non-exporters. Firms in the retail and other services sectors use Web sites and e-mail more frequently than the firms in the manufacturing sector. In the retail sector, 22 percent of firms use e-mail and 15 percent use a Web site. In the other services sector, 46 percent use e-mail and 21 percent have a Web site. However, in the manufacturing sector these values are quite low—8 percent for e-mail and 3 percent for Web site usage.

Table 4 Constraints on the average firm in Indonesia 2009	Indonesia	Lower-middle-income economies (26 countries †)	Similarly populated countries (13 countries ‡)
Number of power outages in a typical month	2.1	9.8	4.8
Senior management time spent in dealing with requirements of government regulation (%)	1.6	7.8	12.4
Average number of visits or required meetings with tax officials	0.2	1.7	1.6
Percent of firms expected to pay informal payment to public officials (to get things done)	14.9	29.5	29.5
Incidence of graft index**	27.0	17.1	15.7
Losses due to theft, robbery, vandalism, and arson against the firm (% of sales)	0.4	1.4	1.0
Percent of firms paying for security	23.5	56.9	57.3

Source: Enterprise Surveys.

What constrains firms in Indonesia?

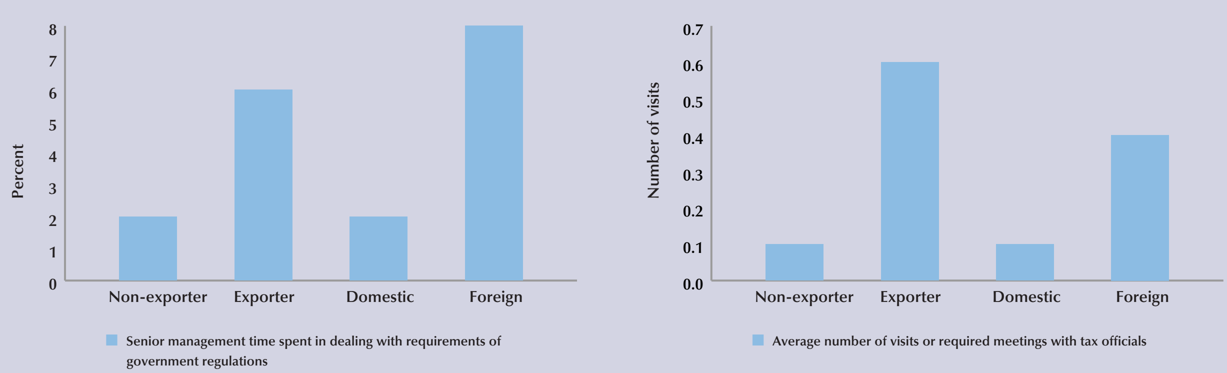
Senior managers in Indonesia spend the least amount of time dealing with the requirements of government regulations compared to the other 25 countries in the same income group. Indonesia (at 1.6 percent) is followed by Pakistan and Georgia with values of 1.9 percent and 2.1 percent. The top ranking position of Indonesia also holds when comparing countries that have similar population sizes (table 4).

The activities of globally-engaged firms (either through exporting or having foreign ownership) are affected more by regulations and visits of government officials when compared to non-exporting and domestic firms in respective order (figure 4). The data show that both groups of firms have more visits or meetings with tax officials and the managers of these firms spend a larger share of their time dealing with government regulations. The managers of exporting firms spend almost four times more time relative to non-exporting firms (5.7 percent vs. 1.5 percent) and managers at foreign-owned firms spend five times more time than domestic firms (7.6 percent vs. 1.5 percent) dealing with regulations. Around 20 percent of exporting and foreign-owned firms spend more than 10 percent of their time on this task. In addition to global engagement, time spent in dealing with regulations also varies across firm-size. Managers in large firms spend 6.9 percent of their time on this task— five times more than small firms and twice as much as medium-sized firms.

Large firms are more severely affected by corruption in Indonesia. Thirty-five percent of large firms are expected to pay informal payments to get things done, while 13 percent of small and 28 percent of medium-sized firms are expected to make these payments. Large firms face the same difficulties when getting an electrical connection or a construction permit. Moreover, the share of large firms that believe the court system is fair and uncorrupted is lower than the share of small firms (52 percent vs. 71 percent).

Firms in Indonesia have few power outages in a typical month when compared to countries in the same income group. Indonesia ranks fifth after Philippines, Moldova, Vietnam and Tonga in this indicator. Close to 60 percent of large manufacturing firms own or share a generator and almost 8 percent of their electricity is produced by generators. These values are higher than the values for small manufacturing firms (3.7 percent of generator usage and 1.3 percent of electricity production). Among all firms in Indonesia, large firms suffer fewer power outages in a typical month (1.4 outages) compared to small and medium

Figure 4 Globally-engaged firms are visited more often by government officials and spend more time dealing with regulations



Source: Enterprise Surveys.

firms (1.95 and 2.91, respectively). However these outages last longer for large firms than small firms (4.4 hours vs. 2.1 hours). For a quarter of large firms that had an outage, it lasted more than 6 hours. The duration of power outages is also more severe for foreign-owned businesses compared to domestic firms (4.4 hours vs. 2.2 hours).

In Indonesia the cost of securing firms' premises is low. Indonesia has the second lowest percentage of firms paying for security and third lowest losses due to theft, robbery and vandalism among the countries in the same income group. It ranks at the top and in second place in those indicators among countries with similar populations. Almost half of foreign-owned firms pay for security—slightly more than twice the share of domestic firms. Similarly, exporting firms are more likely to pay for security than non-exporting firms (57 percent vs. 23 percent). Paying for security is more common among both the retail (44 percent) and other services (49 percent) sectors than the manufacturing sector (19 percent). However, among the firms that pay for security, manufacturing firms pay a higher share of their sales (2.1 percent) relative to firms in the retail sector (0.6 percent).

The analysis performed in this note reveals several important areas of improvement for policy makers. The use of external finance for investment purposes, which is crucial for firm growth, is quite low in Indonesia when compared to its peer countries in size and income. Moreover, Indonesia has a low share of trading firms, and the firms that export generate only a small share of their revenues from exporting. Finally, the use of an international quality certification, which has a positive impact on the quality of production and productivity, is low in Indonesia. Developing an improved business environment starting with these areas should lead to more job creation, faster growth, and sustained economic development in Indonesia.

Notes

1. The following are the nine Indonesian regions sampled: Lampung, Sumatera Utara, Banten, DKI Jakarta, Jawa Barat, Jawa Tengah, Jawa Timur, Bali, Sulawesi Selatan.
2. This figure presents the unweighted distributions by size, sector and location of the firms interviewed without any inferences to the whole economy.
3. The term "average firm" is used to convey the average firm characteristics from the Indonesia 2009 Enterprise Survey. The sample of firms interviewed is representative of the manufacturing and services sectors of the economy. For more information on the survey methodology please consult http://www.enterprisesurveys.org/Methodology/
4. Firms with ≥ 10 percent of foreign ownership are defined as foreign-owned.

* The ownership variables represent the average ownership composition within a firm. These variables do not represent the ownership composition across firms.

** The Incidence of Graft Index is the percentage of instances in which a firm was either expected or requested to provide a gift or informal payment during solicitations for public services, licenses or permits. This Index uses data from 6 survey questions for each firm. For purposes of Index computation, a refusal to answer a particular survey question is considered an affirmative answer. This Index is a modified version of the Graft Index defined in A. Gonzalez et al. 2007. World Bank Policy Research Working Paper #4394.

† Comparator countries in lower-middle-income group: Ecuador2006, El Salvador2006, Georgia2008, Guatemala2006, Honduras2006, Indonesia2009, Kosovo2009, Lesotho2009, Micronesia, Fed Sts. 2009, Moldova2009, Mongolia2009, Nicaragua2006, Nigeria2007, Pakistan2007, Paraguay2006, Philippines2009, Samoa2009, Senegal2007, Swaziland2006, Timor-Leste2009, Tonga2009, Ukraine2008, Uzbekistan2008, Vanuatu2009, Vietnam2009, Yemen2010.

‡ Comparator countries with similar population size: Argentina2006, Brazil2009, Colombia2006, Indonesia2009, Kenya2007, Mexico2006, Pakistan2007, Philippines2009, Poland2009, Russian Federation2009, Turkey2008, Vietnam2009, Ukraine2008.

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