



# Strengthening Local Green Markets by Linking Procurement with Sustainable Enterprises

**Policy Landscape Paper | Indonesia**  
SEED Practitioner Labs Policy Prototyping



**SEED**  
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for sustainable development

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## EXECUTIVE SUMMARY

Over the past year and a half, the Covid-19 pandemic and related social and economic shocks have underlined the importance of strong local economies. Where global and regional value chains were disrupted, local businesses and their value chains emerged as important providers of essential goods and services, especially for marginalised populations who were disproportionately affected by the effects of the pandemic. As a result, support for local businesses has gained traction, with an acknowledgement that they are and will be key players in the road to economic recovery and resilience.

The Indonesian government has placed a strong emphasis on the development of local economies across the country, and have put into place important steps to align government spending on procurement with this priority. Alongside the #BanggaBuatanIndonesia campaign to drive interest and demand for locally produced goods and services, Presidential Regulation No. 12 of 2021 on Government Procurement of Goods and Services ("Regulation 12/2021") requires Ministries, Institutions and Local Government to use at least 40% of its budget to obtain domestic products from micro-level businesses and cooperatives. This priority on supporting micro, small and medium enterprises (MSMEs) to access markets through government spending has the potential to drive economic recovery efforts at a local and national level.

Guided by national sustainability targets of Indonesia, including the Sustainable Development Goals (SDGs), Low Carbon Development Indonesia (LCDI) and Nationally Determined Contributions towards emission reductions (NDC), local government is embracing sustainability commitments across the country ("National Sustainability Targets"). Local economic resilience is strongly linked to the ability to reduce the negative effects of, and adapt to, a changing climate. It is thus not surprising that data also shows that the number of MSMEs aiming for sustainability at the local level has been growing consistently in Indonesia for the past few years. These MSMEs - "eco-inclusive enterprises" - have the potential to contribute towards this journey by offering triple bottom line impacts - developing their local economies, providing jobs and social impacts to marginalised communities along their value chain, and contributing to positive environmental effects through sustainable resource use, circular economy efforts, and protecting biodiversity.

A significant opportunity lies in further linking procurement from local enterprises to policy priorities to mitigate and adapt to climate change, while providing support to the MSMEs. As guidance, Indonesia has issued a specific definition on sustainable products and services under the Ministry of Environment & Forestry Regulation No. P.5/MENLHK/SETJEN/KUM.1/2/2019 on sustainable procurement labelling ("MOEF Regulation 5/2019"). Under this regulation, sustainable products and services must be legally sound and uphold sustainability principles in utilising natural resources throughout the entire life cycle. By prioritising eco-inclusive enterprises in national and local procurement efforts, we can boost support for #BanggaBuatanIndonesia and MSMEs, and accelerate Indonesia's effort to achieve National Sustainability Targets and build back better post pandemic.

The SEED Policy Labs for Sustainable Procurement in Indonesia look to make this link, bringing together key public, private, and civil society stakeholders to explore the challenges facing eco-inclusive enterprises and co-creating solutions to align national and local procurement with enterprises that deliver impacts on people, profit and the planet. Hosted by the Ministry of National Development Planning of Indonesia (Bappenas), the National Association for District Government (APKASI), and the Sustainable Districts Association (Lingkar Temu Kabupaten Lestari - LKTL), and integrating the voices of SEED-supported eco-inclusive enterprises, the labs aim to ensure that the potential of sustainable MSMEs is unlocked to drive sustainable economic growth.



# INTRODUCTION

As we prepare at a global level to transition to green and inclusive economies, and build back better from the effects of the Covid-19 pandemic, a key question arises. How do we ensure that commitments at a global and national level translate to sustainable development at a local level? Micro, small and medium enterprises (MSMEs) - core actors in the private sector - play a significant role in ensuring that the transition to a green and inclusive economy is driven by bottom-up and localised solutions that leverage the specific opportunities available to communities to mitigate and adapt to climate change.

An important policy instrument for focusing climate action on local opportunities and needs is finance. Finance can direct where attention is given, which innovations are scaled, and which sectors and businesses are supported to deliver green jobs and impacts. Procurement practices of the government can be a significant factor in directing where financing is committed, as public procurement can make up 15-30% of GDP. Particularly in the wake of the Covid-19 pandemic, governments have been delivering additional relief packages. Looking at procurement practices and how they link to MSME activities at the local level is therefore an opportunity to advance global commitments and develop green and inclusive economies as we build back better.

In Indonesia, public procurement accounts for just under half of all ministerial, institutional and local government spending; in 2019, procurement spending in Indonesia amounted to over 80 billion USD.<sup>1</sup> The opportunity for directing this finance to locally produced, climate-smart products and services is therefore notable, and points to an important role for local governments to link with MSMEs operating in their area.

Hosted by the Ministry of National Development Planning of Indonesia (Bappenas), the National Association for District Government (APKASI), and Sustainable Districts Association (Lingkar Temu Kabupaten Lestari - LKTL), an association of district governments dedicated to sustainable development through multi-stakeholder mutual cooperation, the 2021 SEED Practitioner Labs for Policy Prototyping will look at sustainable procurement at a national and district level, and how to strengthen links and MSME access to procurement processes.

## What is an eco-inclusive enterprise

The term “eco-inclusive enterprise” refers to enterprises with business models that are at the core 1) ecological i.e. contributing to the mitigation of and/or adaptation to climate change, or implementing broader environmental and social sustainability measures such as using sustainable production methods, contributing to the efficient use of resources, managing waste, or conserving biodiversity; and 2) inclusive i.e. creating local jobs, in particular for often marginalised populations such as youth, women and low-income households, and through integrating these communities into local and global value chains as suppliers, distributors or customers. Eco-inclusive enterprises are major contributors to poverty reduction and inclusive growth, supporting the achievement of the Sustainable Development Goals (SDGs).

## SEED Practitioner Labs for Policy Prototyping

The SEED Practitioner Labs for Policy Prototyping offer an opportunity for key ecosystem stakeholders to contribute to policy agenda setting, improve policy implementation, and make recommendations to improve targeting of policies. By collaborating across stakeholder groups (policy practitioners, MSME support organisations and MSMEs) to develop policy solutions, Lab participants play an important role in shaping the policy landscape of Indonesia and creating a supportive environment for MSMEs.

<sup>1</sup> UNODC. (2020). Public Procurement Reform in Indonesia. <https://www.unodc.org/southeastasiaandpacific/en/what-we-do/anti-corruption/topics/2020/public-procurement-reform-indonesia.html>

# 1. ALIGNING GLOBAL COMMITMENTS WITH LOCAL IMPACT

Over the last decade, Indonesia has enjoyed steady economic growth, transforming the country into one of Asia's major economies. Indonesia is currently Southeast Asia's largest economy (and sixteenth biggest in the world), having grown steadily for the previous decade.<sup>2</sup> Indonesia further enjoys an abundance of natural resources, ranging from forest lands, peat lands, coastal areas, the world's third largest rainforest, and significant biodiversity. Significant progress has been made in recent years to reduce poverty, which halved from 24% in 1999 to 9.78% in 2020 as a result of rapid economic growth.

As made evident by the economic and social shocks of the Covid-19 pandemic globally, further shocks - such as the effects of climate change - may threaten the gains made in poverty reduction, and introduce new challenges and opportunities for sustainable development. As an economy that has significant population density and is dependent on natural resources, the effects of climate change will play an important role at both the economic and social level in Indonesia. Changing rainfall patterns, a rise in the sea level, and other climatic events such as floods and droughts could cost Indonesia, as estimated by the Asian Development Bank, around 2.5-7% of GDP by 2100.<sup>3</sup>

In an effort to address climate change, Indonesia joined 195 other countries to sign the Paris Agreement in 2015, intending to limit global average temperatures to „well below“ 2 degrees Celsius (ideally 1.5 degrees Celsius) above pre-industrial levels. 127 countries (including Indonesia) have committed to achieving net-zero emissions by 2050. In the Nationally Determined Contribution, Indonesia committed to reducing emissions by 26% (41% with international assistance) compared to a business-as-usual scenario by 2030.<sup>4</sup> Most recently, Indonesia has completed its Second Biennial Update Report in 2018 to monitor progress along emissions reduction activities outlined in its NDC.<sup>5</sup>

The Indonesian government is making headway in integrating sustainability policies and activities into its

national plans and priorities.<sup>6</sup> This plays an important role in key government development plans, such as the five-year National Medium-Term Development Plan, which specifies the executive branch's development goals.<sup>7</sup> The National Medium Term Development Plan 2020-2024 aims to strengthen economic resilience for quality and equitable growth, develop regions to reduce inequality and to ensure equity, increase the quality and competitiveness of human resources, mental revolution and cultural development, strengthen infrastructure to support economic and basic services development, strengthen the environment and improve resilience against natural disaster and climate change, also to strengthen the stability of political, legal and security affairs and transformation of public services. As part of the implementation strategy, BAPPENAS is also hosting both National Secretariat of Sustainable Development Goals (SDGs)<sup>8</sup> as well as Low-Carbon Development Initiatives.<sup>9</sup>

## a. Mainstreaming sustainable policy priorities in procurement

An important tool for governments to mainstream global and national level commitments at a local level is through public procurement. Accounting for between 13-20% of GDP in many countries<sup>10</sup>, this represents a significant market through which policy priorities can be communicated. This is even more relevant in the context of the Covid-19 pandemic, during which governments have increased expenditure to provide emergency relief. In Indonesia, the State budget increased by 1 billion USD between 2020-2021, commensurate with an increase in procurement expenditure in the same period.<sup>11</sup>

COVID-19 has, however, a negative impact on the size of the budget for implementation of mitigation actions and low carbon development programs and activities. As a result of decreased socio-economic activities in response to the spread of Covid-19, low carbon development such as reforestation, avoided deforestation, increased

2 OECD. (2018). *SME and Entrepreneurship Policy in Indonesia 2018*. <https://doi.org/https://doi.org/https://doi.org/10.1787/9789264306264-en>

3 Asian Development Bank (2021). *Climate Risk Country Profile Indonesia*. <https://www.adb.org/sites/default/files/publication/700411/climate-risk-country-profile-indonesia.pdf>

4 UNFCCC. (2016). *First Nationally Determined Contribution Indonesia*. [https://www4.unfccc.int/sites/ndcstaging/PublishedDocuments/Indonesia%20First/First%20NDC%20Indonesia\\_submitted%20to%20UNFCCC%20Set\\_November%20%202016.pdf](https://www4.unfccc.int/sites/ndcstaging/PublishedDocuments/Indonesia%20First/First%20NDC%20Indonesia_submitted%20to%20UNFCCC%20Set_November%20%202016.pdf)

5 UNFCCC. (2020). *Indonesia Second Biennial Update Report*. [https://unfccc.int/sites/default/files/resource/FSV\\_Climate%20Dialogues%202020\\_Indonesia.pdf](https://unfccc.int/sites/default/files/resource/FSV_Climate%20Dialogues%202020_Indonesia.pdf)

6 PAGE. (2018). *Indonesia PAGE Partner Country*. <https://www.un-page.org/Indonesia%20country>

7 OECD (2018).

8 <http://sdgs.bappenas.go.id/tentang/>

9 <https://lcdi-indonesia.id/sekretariat/>

10 World Bank. (2020). *Global Public Procurement Database: Share, Compare, Improve!* <https://www.worldbank.org/en/news/feature/2020/03/23/global-public-procurement-database-share-compare-improve>. Other sources indicate that public procurement spending could range between 15-30%; see *The Economist Intelligence Unit*. (2020). *The future of public spending*. [https://content.unops.org/publications/Thefutureofpublicspending\\_EN.pdf?mtime=20200623084321&focal=none](https://content.unops.org/publications/Thefutureofpublicspending_EN.pdf?mtime=20200623084321&focal=none)

11 UNODC (2021).



Renewable Energy capacity and energy efficiency will be negatively impacted, hindering efforts to reduce emissions. The Presidential Decree 112/2020 was issued to strengthen the National Annual Planning 2021 on Economic Recovery and Social Reforms post-Covid and stimulate the industry, tourism and investment climate.<sup>12</sup> This Decree establishes the urgency to impose the sustainability criteria into the economic recovery efforts.

At the same time, the government of Indonesia has attempted to boost support systems and market access for local products and services offered by Indonesian Micro, Small and Medium Enterprises (MSMEs) through the #BanggaBuatanIndonesia (Proud of Indonesian Local Products) campaign from 2020. The campaign has managed to insert a minimum quota for local goods and services in the public procurement system. Strengthening Indonesia's national procurement process has been one of the focus areas to empower local markets to accelerate economic recovery post-COVID-19 pandemic. This has been addressed through the Presidential Regulation No. 12 of 2021 on Public Procurement and the Minister of State-Owned Enterprises PER-08 / MBU / 12/2019 on Public Procurement which prioritises the purchase of local goods and services. By integrating sustainability considerations into these procurement decisions, local governments can leverage this opportunity to build green and inclusive economies at a local level through tangible market access for their MSMEs.

## **b. Setting regulations for sustainable and local procurement**

The issue of promoting procurement of sustainable products has been addressed both by the Ministry of Environment and Forestry, as well as from regulations related to procurement of goods and services.

Through the Ministry of Environment & Forestry Regulation No. P.5/MENLHK/SETJEN/KUM.1/2/2019 on sustainable procurement labelling, Indonesia has set several core indicators to define sustainable products and services. The labelling is applicable for all products and services which are (i) energy-utilisation based, (ii) nature-based and (iii) recycling-based. The regulation also highlights that labelling will be done in the form of certification, provided by the existing system under government and/or another mutually recognized certification body. Process-wise, sustainable products and services according to the regulation must be (i) legally sound - including having a Chain of Custody system, (ii) uphold environmentally friendly principles throughout its entire life cycle, (iii) responsible in its production process and (iv) sustainable in utilizing natural resources.

Issued on the 2nd February, 2021, Presidential Regulation No. 12 of 2021 on Government Procurement of Goods and Services ("Regulation 12/2021") provides more opportunities for micro-level businesses and cooperatives to be involved in the public procurement of goods and services. It amends Presidential Regulation No. 16 of 2018 ("Previous Regulation"). Regulation 12/2021 is one of the implementing regulations of Law No. 11 of 2020 on Job Creation or the Omnibus Law that was enacted in October 2020. Regulation 12/2021 now requires the Ministry/institution/local Government to use at least 40% of its budget to obtain domestic products from micro-level businesses and cooperatives, whereas no specific percentage was required under the Previous Regulation. Regulation 12/2021 also makes amendments to provisions on other matters (e.g. procurement contracts, methods and dispute settlement) to ease doing business related to public procurement. Furthermore under Regulation 12/2021, a Toko Daring (Online Store) is now described as a source of e-purchasing for choosing a provider of goods/construction works/other services. Procurement using a Toko Daring will be regulated further under a regulation of the head of the National Public Procurement Agency.

Another Circular of the Minister of SOEs Number SE-10 / MBU / 08/2020 dated August 26, 2020 concerns increasing the Role of Micro, Small and Medium Enterprises in the Procurement of Goods and Services in State-Owned Enterprises, which also in line with the Regulation of the Minister of State Owned Enterprises of the Republic of Indonesia Number PER-08 / MBU / 12/2019 concerning General Guidelines for the Implementation of Procurement of Goods and Services for State-Owned Enterprises. The issuance stipulates that State Owned Enterprises are required to prioritise the use of domestic production, design and national engineering, as well as expansion of opportunities for small businesses, as long as the quality, price, and objectives could be accounted for.

This foundation presents an opportunity to promote social criteria in procurement practices by training government procurement specialists to lead the cultural change and development of the public procurement policy and toolkits. Public procurement practices alone can be a significant factor in directing where financing is committed, as it makes up 15-30% of GDP.<sup>13</sup> (The Economist Intelligence Unit Limited, 2020). Unfortunately, sustainable procurement guidelines have not yet been integrated into existing policy formulation. Thus, there is still a gap to transform #BanggaBuatanIndonesia into sustainable #BanggaBuatanIndonesia - tapping into the full potential for MSMEs to support green and inclusive economies transition in Indonesia.

<sup>12</sup> Nugraheni, Ninis, Hening Prabawa Arifanda, Alifihan Astahtyan. (2020). *Public Procurement Contract for Goods and Services Following the Presidential Decree Number 12 of 2020 on the Stipulation of the Coronavirus Disease (Covid-19) Pandemic as a National Disaster*. <https://doi.org/10.22304/pjih.v7n2.a5>

<sup>13</sup> The Economist Intelligence Unit Limited. (2020). *The Future of Public Spending*.

## 2. THE ROLE OF INDONESIAN MSMEs IN SUSTAINABLE DEVELOPMENT AT A LOCAL LEVEL

MSMEs are well-positioned to drive economic recovery and sustainable development at a local level by delivering climate-smart products and services to marginalised communities, thereby addressing both poverty reduction and promoting low carbon development. The Policy Labs for Sustainable Procurement process in Indonesia, hosted by Bappenas and LTKL with SEED, will explore paths forward for integrating sustainable procurement

practices at the district level and linking sustainable enterprises to these market opportunities.

The Ministry of Cooperatives and Small and Medium-Sized Firms defines SMEs under National Law 20/2008 (Article 6) according to their maximum net worth excluding land and structures on which the firm operates, and the annual revenues.

	Micro enterprises	Small enterprises	Medium-sized enterprises
<b>NET WORTH</b> (excluding land and structures)	Maximum IDR 50 million	Greater than IDR 50 million but less than IDR 500 million	More than IDR 500 million but less than IDR 10 billion
<b>ANNUAL REVENUES</b>	Maximum IDR 300 million	Greater than IDR 300 million but less than IDR 2.5 billion	More than IDR 2.5 billion but less than IDR 50 billion

### a. MSMEs hold potential to generate significant economic impact

Globally, SMEs play a significant role in promoting more inclusive and shared growth. They account for 99 percent of all enterprises, generating approximately 60% of employment.<sup>14</sup> SMEs have a critical role in ensuring that economies and society adjust not only to environmental concerns but to other significant upheavals such as digitisation and globalisation. They generate jobs in various geographic areas and industries, employing a diverse range of labour segments.

According to the Ministry of Cooperatives and SMEs of the Republic of Indonesia, MSMEs account for around 99.99 percent (62.9 million units) of all business players in Indonesia (Purwanto, 2020). When combined, MSME economic activity accounts for around 60% of Indonesia's overall Gross Domestic Product (around IDR 8160 trillion of GDP IDR 13600 trillion in 2017).<sup>15</sup>

### ESTIMATED ANNUAL GDP CONTRIBUTION

**MICRO**

**IDR 5000 trillion**

**SMALL**

**IDR 1300 trillion**

**MEDIUM**

**IDR 1800 trillion**

**LARGE**

**IDR 5400 trillion**

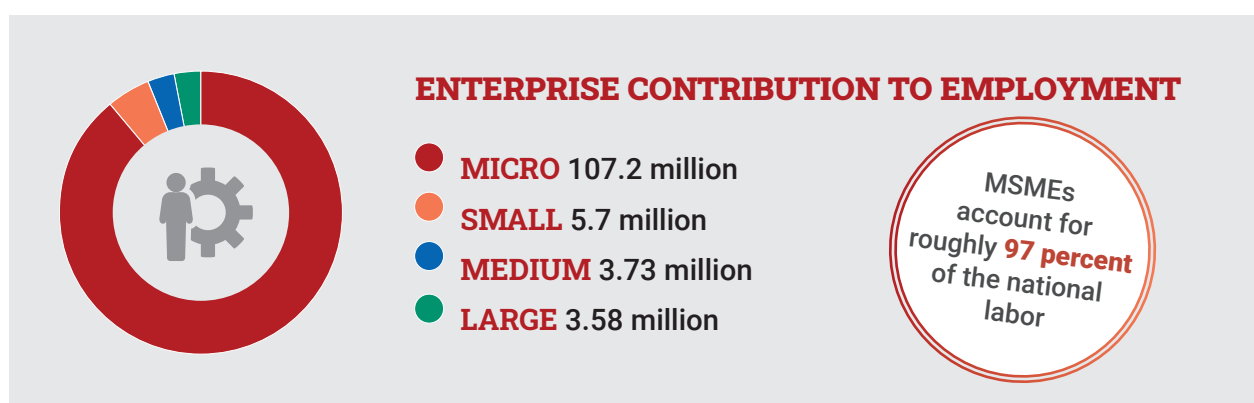
<sup>14</sup> OECD. (2019). *Strengthening SMEs and Entrepreneurship for Productivity and Inclusive Growth*. <https://doi.org/10.1787/c19b6f97-en>

<sup>15</sup> Data from the Ministry of SMES (2017). Taken from Haryanti, D., & Hidayat, I. (2018). *Portrait of Indonesian MSMEs: Little Ones Who Play a Big Role | Indonesian SMEs*. <https://www.ukmindonesia.id/baca-artikel/62>



	Units	% business units	Total income (trillion IDR/yr)	% contribution to GDP	Average income per business unit (IDR/yr)
<b>MICRO</b>	62,106,900	98.70	4,272.99	34.12	76,126,646.15
<b>SMALL</b>	757,090	1.20	1,234.21	8.91	1,630,202,485.83
<b>MEDIUM</b>	58,627	0.11	1,742.44	12.57	29,720,777,116.35
<b>LARGE</b>	5,460	0.01	5,136.22	37.07	940,699,633,699.63
<b>TOTAL</b>	62,928,077	100	12,841	93	

Beyond contributions to GDP, MSMEs are important contributors of employment in Indonesia. In total, MSMEs account for about 97% of the national labour force.<sup>16</sup>



## b. MSMEs are active in key sectors for green growth

The Indonesian Ministry of Cooperatives and SMEs classifies SMEs into agricultural and non-agricultural SMEs. Agriculture firms are estimated using the 2013 Agricultural Census, and non-agricultural firms using the 2016 Economic Census. Haryanti and Hidayah (2018) estimate that there are 26,135,469 Agricultural Businesses; of these, 0.016 percent, or approximately 4200, are legal companies. The 2016 BPS Economic Census estimates the total number of non-agricultural micro, small, and medium-sized firms at 26,263,649 units. Where half of MSMEs are engaged in the agriculture, forestry and fisheries sector, the other half of micro and small enterprises are operating in wholesale and retail trade (63.5%), manufacturing (16.7%), other services (10.7%) and transportation and communications (7.3%).<sup>17</sup>

The current trade and investment landscape of Indonesia highlights opportunities for the regional government to play a more significant role in boosting potential trade and investment of the country. Agriculture as a sector

still provides income for the majority of Indonesia households - with approximately 41 percent of the total Indonesian labor force are employed by the sector. There is a growing global, regional, and domestic demand in the sector to produce sustainable commodities that balance economic, social, and environmental impacts. Producing sustainable commodities would require key stakeholders to invest on a long term supply-chain transformation. Investment in a broad sense can include capital or equity, network, capacity development, and exposure through media and/or events. To date, sustainable commodities transformation has become a significant agenda for many local governments in Indonesia.<sup>18</sup> Lingkar Temu Kabupaten Lestari (LTKL) has several district members in Indonesia such as Siak, Riau and Sintang, and West Kalimantan, and has focused on empowering eco-inclusive MSMEs to create sustainable value-added products contributing towards climate change mitigation and adaptation through a rural economic area approach.

<sup>16</sup> Ibid

<sup>17</sup> Haryanti & Hidayah. (2018)

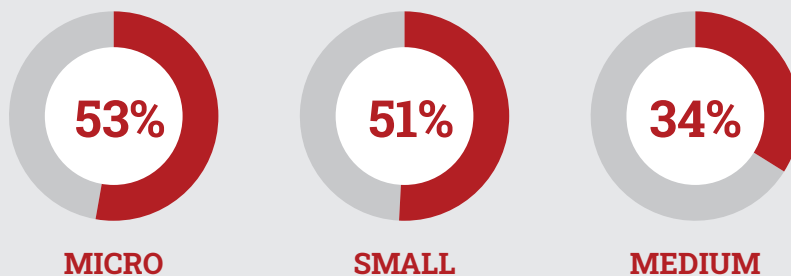
<sup>18</sup> LTKL. (2020). Mapping Commitment of Subnational Government to Sustainable Land Use in Southeast Asia. [https://jaresourcehub.org/wp-content/uploads/2021/02/Buku\\_LTKL-TFA-Report\\_Final.pdf](https://jaresourcehub.org/wp-content/uploads/2021/02/Buku_LTKL-TFA-Report_Final.pdf)

### c. MSMEs address inequalities through social impact

MSMEs also deliver social impact by integrating marginalised communities along their value chains, as employers, suppliers, employees and buyers. According to a 2016 survey, 52.9% of Indonesia's microenterprises were owned by women; 50.6% of small enterprises, and 34% of medium sized enterprises.<sup>19</sup> Growing opportunities for MSMEs can therefore translate into increased income for women, reductions in inequalities, and inclusive economic development by involving rural areas. Considering the geographical spreads of Indonesia, there is a significant role for local regulators to enable local MSMEs by putting into place relevant policies, plans, and programmes in their designated area.

The social MSME sector is dominated by young leaders aged 25-34 years old, with a nearly equal number of men (41%) and women (40%) leading social enterprises.<sup>20</sup> In 2018, an estimated 342,000 social enterprises contributed a potential 1.7% to Indonesian GDP. In the last five years, the ecosystem has demonstrated significant growth (70% from 2015), mainly focused in creative industries (22%), agriculture (16%) and education (15%). The majority of social enterprises operated at either local level (37%) or national level (35%), rather than at regional scale (2-3 provinces).<sup>21</sup>

### FEMALE-OWNED ENTERPRISES IN INDONESIA



### d. Untapped potential in the MSME sector in Indonesia

Despite representing a large proportion of the private sector, MSMEs in Indonesia generally stay small due to barriers in growing and scaling their enterprise. Much of the sector remains informal: over 70% of national employment and over 90% of total commercial companies are estimated to be informal. Widespread informality has

a detrimental effect on Indonesian MSME performance as informal firms must operate under the radar of state authorities and are thus hesitant to make long-term investments.<sup>22</sup> This leads to areas of untapped potential within the sector, for example in:

#### Labour productivity



According to the Asian Labour Productivity Organization (APO), Indonesia's average labor productivity (GDP per worker) was higher in 2016 than the ASEAN average. This conceals, however, significant variance within the Indonesian MSME sector. According to data from the Ministry of Cooperatives and Small and Medium-Sized Enterprises, the GDP per worker in microenterprises was only 3% of the GDP per worker in large enterprises. In comparison, the GDP per worker in small and medium-sized enterprises was 16% and 31% of the GDP per worker in large enterprises respectively. Between 2006 and 2013, productivity growth was low across all firm size classes, with average annual rates of 1.1 percent for micro-enterprises, 0.3 percent for small businesses, and 0.6 percent for medium-sized companies.<sup>23</sup>

<sup>19</sup> [https://www.ifc.org/wps/wcm/connect/260f2097-e440-4599-91ec-e42d45cf3913/SME+Indonesia+Final\\_Eng.pdf?MOD=AJPERES&CVID=1j8qhPY](https://www.ifc.org/wps/wcm/connect/260f2097-e440-4599-91ec-e42d45cf3913/SME+Indonesia+Final_Eng.pdf?MOD=AJPERES&CVID=1j8qhPY)

<sup>20</sup> British Council (2018). The State of Social Enterprise in Indonesia. [https://www.britishcouncil.org/sites/default/files/the\\_state\\_of\\_social\\_enterprise\\_in\\_indonesia\\_british\\_council\\_web\\_final\\_0.pdf](https://www.britishcouncil.org/sites/default/files/the_state_of_social_enterprise_in_indonesia_british_council_web_final_0.pdf)

<sup>21</sup> Ibid

<sup>22</sup> OECD, 2018.

<sup>23</sup> World Bank (2015). Enterprise Survey Data Indonesia. <https://microdata.worldbank.org/index.php/catalog/2665>



## Low integration into global markets

Large enterprises primarily drive Indonesia's export activity. This has become more prevalent in recent years. Between 2006 and 2013, the proportion of total exports in medium-sized enterprises (excluding oil and gas) decreased from 12.2 percent to 11.5 percent. The proportion of small enterprises exports decreased from 4% to 2.8 percent, and the proportion of micro-enterprises exports decreased from 1.7 percent to 1.4 percent. MSMEs are often engaged in export sectors such as food, beverages, textiles, shoes, handicrafts and furniture.<sup>24</sup>



## Research and Development, Innovation

SMEs make for a sizable portion of aggregate investment in Indonesia, accounting for 56.2% of overall investment in 2013.<sup>25</sup> Between 2006 and 2013, the percentage of overall investment by medium-sized firms increased from 22.4 percent to 30.9 percent. According to the World Bank, just 2% of Indonesian enterprises invest in research and development (R&D); this figure jumps to 10% for enterprises with more than 100 employees. Low R&D expenditure is also reflected in innovation outcomes: in the previous three years, just 5% of small businesses and 9.7% of medium-sized businesses in Indonesia launched a new product or service.

<sup>24</sup> Asian Development Bank. (2020). Asia SME Monitor Volume 1. <https://www.adb.org/sites/default/files/publication/646146/asia-sme-monitor-2020-volume-1.pdf>  
<sup>25</sup> Ministry of Co-operatives and SMEs

# ECO-INCLUSIVE ENTERPRISE SPOTLIGHT



## MYCOTECH

2019 SEED Low Carbon Award Winner

Waste Management | Bandung, Indonesia

Mylea is mushroom vegan leather created by Mycotech. Mycotech works with designers to turn Mylea into final goods through co-investment strategies. They hope to generate greater environmental consciousness in the fashion business and manufacture this revolutionary material as a substitute for livestock-based leather.

## IMPACTS

<b>Social</b>	<ul style="list-style-type: none"> <li>Enhancing skills and providing good work for 270 (64% women) mushroom farmers, with the potential to grow to 53,000 mushroom growers across the archipelago.</li> <li>Increasing farmer revenue through agri-waste sales</li> </ul>
<b>Environmental</b>	<ul style="list-style-type: none"> <li>Reduce 10.6 billion kilograms of CO2 per year with the manufacturing of 1 million square feet of Mylea</li> <li>Reduced resource use due to a shorter leather harvesting time when compared to cow leather (5 days vs 2 years and 45L vs 80,000L of water used)</li> </ul>
<b>Economical</b>	<ul style="list-style-type: none"> <li>Developing a new economy in the synthetic leather industry and promoting sustainable fashion (total market worth USD1.3T)</li> <li>Contributing to the fashion industry's movement toward a green economy, as Mylea draws a large number of high-end fashion businesses</li> </ul>





## RAHSA NUSANTARA

2019 SEED Low Carbon Award Finalist

Biodiversity | Bandung, Indonesia

Rahsa Nusantara began with knowledge drawn from Java Island and items meant to aid healthy living, including ready-to-drink teas, drippers, and supplements. They make their products from substances found nearby, and recycle organic waste. Appreciating that each location possesses a particular type of wisdom that can be applied to solving local issues, the business seeks to uncover and utilise the finest of that wisdom in providing new lifestyles and legacies for the future.

### IMPACTS

<b>Social</b>	<ul style="list-style-type: none"> <li>• Empowering women - especially mothers (80% of our workers) - who have low education in urban areas through employment</li> <li>• Improving health of marginalised people by selling the product at low prices</li> </ul>
<b>Environmental</b>	<ul style="list-style-type: none"> <li>• Applying circular economy into every step of production process from sourcing organic material, responsible packaging to processing organic waste to fertilizers and fodders</li> </ul>
<b>Economical</b>	<ul style="list-style-type: none"> <li>• Increasing family income of the women employees by 60%, improving incomes of farmers who supply raw materials</li> <li>• Offering lower priced health supplement products to prevent illness, saving marginalized people expensive medical costs</li> </ul>



Rahsa Nusantara

### 3. CHALLENGES FACING MSMEs IN INDONESIA TO REACH SCALE

Developing the potential in the MSME sector in Indonesia to create productive green jobs, export sustainable products and services and develop climate-smart innovations rests on the development of markets in which these enterprises can scale their products and services, drive down their costs, increase productivity and generate profits that can be reinvested for R&D.

A common challenge facing local sustainable MSMEs is accessing markets for their product and service. In some cases, this relates to export markets; in others to local markets. Often, access to markets is hindered by informality or lack of business registration, low business management and capacity, and limited access to industrial clusters.<sup>26</sup> Access to market challenges are further exacerbated by lack of business model validation, publicity and marketing instruments that enable them to communicate product-market fit to their target market.

Another commonly cited challenge to growth of MSMEs is access to finance. MSME loans account for just 7% of GDP. Enterprises lack access to credit and other forms of finance in part due to low levels of financial inclusion and management, collateral requirements, and burdensome regulations.<sup>27</sup> These findings are corroborated with a comprehensive report from Angel Investor Network on the topic of Social Finance in Indonesia, which reported 70% of social enterprises in Indonesia are in the pre-seed and seed stages, which will require funding ranging between USD 10,000-150,000. Social enterprises in Indonesia therefore face a small- ticket size funding gap, when the seed stage enterprises may not be ready to absorb capital injection beyond the range provided by current impact investors in the ecosystem.<sup>28</sup>

Many of these challenges have been exacerbated by the impact of the Covid-19 pandemic in Indonesia. 90% of MSMEs surveyed by UNDP and the University of Indonesia – Institute for Economic and Social Research (LPEM FEB UI) indicated that they faced lower demand from the market. Over 45% faced issues obtaining raw materials, and more than 80% had lower profit margins. The pandemic also had impacts in the assets held by enterprises, with over 53% reporting a decrease in assets.<sup>29</sup>

For enterprises based outside of urban centres and clusters of MSME support in Java and Bali, accessing support to overcome these barriers can be difficult. Many SME programmes are based in urban areas, and therefore do not reach recipients in other geographies. While there has been growth of sustainable MSMEs such as social enterprises in Indonesia in the past five years, these enterprises are often operating outside the capital. According to a BCG report (2015), most social enterprises, along with most of Indonesia's economic resources, are located in Java (46%).<sup>30</sup> Encouraging social entrepreneurs to use local potential and create more opportunity in the rural areas can be a pull factor in the attempt to slow down the urbanisation rate, therefore reducing unequal wealth distributions and degraded social living conditions in the city as well as addressing social development and economic improvement at the national level.

Addressing the challenges faced by MSMEs is therefore both an integral aspect in both short-term economic recovery from the Covid-19 pandemic as well as long-term sustainable development. Strengthening the support through local government could be the key to nurture the enabling environment for local SMEs in peripheral areas such as those relevant to LTKL member districts.



<sup>26</sup> Asian Development Bank. (2020).

<sup>27</sup> International Labour Organization. (2019). *Financing Small Business in Indonesia*. [https://www.ilo.org/wcmsp5/groups/public/---asia/---ro-bangkok/---ilo-jakarta/documents/publication/wcms\\_695134.pdf](https://www.ilo.org/wcmsp5/groups/public/---asia/---ro-bangkok/---ilo-jakarta/documents/publication/wcms_695134.pdf)

<sup>28</sup> Angel Investor Network. (2016). *Social Finance and Social Enterprises*. <https://www1.undp.org/content/dam/indonesia/2017/doc/INS-SF%20Report2%20ANGIN.PDF>

<sup>29</sup> UNDP and University of Indonesia. (2020). *Impact of Covid-19 Pandemic on MSMEs in Indonesia*. <https://www.id.undp.org/content/dam/indonesia/2021/docs/INS-Report%20Impact%20of%20COVID-19%20Pandemic%20on%20MSMEs%20in%20Indonesia.pdf>

<sup>30</sup> Boston Consulting Group (2015). *The Art of Sustainable Giving: Priorities to Accelerate Social Enterprise Growth in Indonesia*. [https://image-src.bcg.com/The-Art-of-Sustainable-Giving-May-2015\\_tcm93-40480.pdf](https://image-src.bcg.com/The-Art-of-Sustainable-Giving-May-2015_tcm93-40480.pdf)



## 4. POLICY FRAMEWORKS FOR PROMOTING MSMEs IN INDONESIA

Sustainable public procurement means government agencies must consider long-term economic viability, minimising environmental impact and being socially responsible when procuring goods, services or works in support of their activities. Public procurement has the potential to offer regular and longer term transactions which provide the stability needed to eco-inclusive enterprises, as most small businesses rely on weekly projections in order to maintain their market share and relevancy. Especially during the Covid-19 pandemic, most businesses are financially vulnerable: more than ever, systematic initiatives and government interventions are needed to revitalize the entrepreneurial ecosystem.<sup>31</sup> The opportunity for directing this opportunity to locally produced, sustainable products and services is therefore notable, and points to an important role for local governments to link with MSMEs operating in their area.

The Indonesian government acknowledges MSMEs as essential drivers of social inclusion and economic wealth, and has made them a policy priority by enacting a national Micro, Small, and Medium-Sized Enterprise (MSME) Law (Law 20/2008) and establishing a Ministry for SMEs (Ministry of Co-operatives and SMEs). This is supplemented by a National Entrepreneurship Draft Bill which has included the definition of social entrepreneurship as part of the recognised typology of entrepreneurship in Indonesia. Although the Social Entrepreneurship Proposed Bills has been replaced by the National Entrepreneurship Bills, the government has shown urgency in nurturing the entrepreneurial ecosystem in Indonesia as one of the National Development Plan agenda.

In addition to the MSME Law and the Ministry of Cooperatives and SMEs, multiple programmes have been launched to support the development of (sustainable) MSMEs. Many of these centre on digitisation and the digital economy, including but not limited to the MSMEs GO Online Programme, the One Million .id Domain Programme, and the 1000 Digital Startups programme. The Creating Healthy, Strong, Resilient and Independent Cooperatives and SMEs to Contribute to the National Economy (2015–2019 vision and mission) of the Ministry for Cooperatives and SMEs, for example, looks to improve access to finance, increase productivity, strengthen business capacity, among other objectives.

Further programmes have looked specifically at the role of MSMEs in industry and in developing local products across the country, such as the Master Plan of National Industry Development 2015-2035 and the Masterplan for Acceleration and Expansion of Indonesia Economic Development 2011-2025 (MP3EI). These plans also look regionally, for example across 6 economic corridors: Sumatra Economic Corridor, Java Economic Corridor, Kalimantan Economic Corridor, Sulawesi Economic Corridor, Bali Nusa Tenggara Economic Corridor, and Papua Kepulauan Maluku Economic Corridor. There are also efforts to develop Rural Economic Areas (Kawasan Ekonomi Perdesaan), focusing on empowering eco-inclusive community business to create nature based value added products is carried out in several districts in Indonesia such as Siak, Riau and Sintang, West Kalimantan.

A significant opportunity exists to accelerate the inclusion of sustainability criteria in procurement policies and link to enterprise support policies and frameworks. Leading by example, sustainable procurement policies direction can offer short-term economic recovery effort to the MSMEs from the Covid-19 Pandemic to support long-term sustainable development.



<sup>31</sup> Maritz, Alex, Aron Perenyi, Gerrit de Waal and Christoph Buck. (2020). Sustainability 12(11). Entrepreneurship as the Unsung Hero during the Covid-19 Economic Crisis. <https://doi.org/10.3390/su12114612>



# ECOSYSTEM ACTORS



**National Government** is a critical stakeholder in the design of procurement strategies that would encourage local sustainable products and services, as core policy maker and facilitators. Initially, there are three specific clusters of national government actors, namely a) the procurement ecosystem, b) the MSME ecosystem, and c) the sustainability ecosystem. The National Goods & Services Procurement Policy Agency (Lembaga Kebijakan Pengadaan Barang Jasa – LKPP) and Ministry of Domestic Affairs are the core actors for the procurement ecosystem. The Ministry of Cooperatives and SMEs, the Ministry of Tourism and the Creative Economy, the National Development Planning Agency (Bappenas), the Ministry of Trade, and the Ministry of Domestic Affairs are core actors of the MSMEs ecosystem. The Ministry of Environment and Forestry, and the National Development Planning Agency (Bappenas) are core actors for the sustainability ecosystem. As a member of the **Partnership for Action on the Green Economy**, Bappenas provides a framework for green growth policies at a national level.



**Local government** is also a critical stakeholder of the design and implementation of procurement strategies that encourage sustainable local products and services. The majority of MSMEs will also operate under local government jurisdictions. Both provincial government and district/city government are key to a successful sustainable procurement implementation. At a district level, the National Association of District Government (APKASI) have appointed LTKL as a caucus to work cross-programs and mainstream sustainability into local development models particularly at district level. LTKL district founders and members are committed to implement sustainable land-use models which protect the environment and improve community welfare through partnership and collaboration. Currently, the association has 9 active member districts in 6 provinces in Indonesia including districts Musi Banyuasin, Aceh Tamiang, Siak, Labuhanbatu Utara, Rokan Hulu, Batanghari, Sanggau, Sintang, Kapuas Hulu, Sigi, Gorontalo, Bone Bolango.



**Business support programmes** include the PLUT-KUMKM Centres for non-financial business support, the Iptekda LIPI programme, which supports research and development within SMEs. It also includes incubation and acceleration centres such as Instellar.



**MSMEs** are core to the implementation of sustainable procurement practices at a local level, as the majority operate under local government. MSMEs that deliver triple bottom line impacts - social, environmental and economic - operate across a wide range of sectors. These includes actors such as FAM Organic, Komodo Water, Mycotech, Neurafarm, Perfect Fit, PT Seaweed Tama Biopac Indonesia, Rahsa Nusantara, Sampangan, Sefactor Deos Maks, and SukkhaCitta, among others.



**Civil society and movements** such as the #BanggaBuatanIndonesia campaign, which promotes the consumption of locally made products. Civil society actively promoting sustainable procurements and empowerment of MSMEs as key actors of sustainable economy includes KEHATI and AMAN, among others.



**International actors** involved in supporting the development of green policies and programmes can also play an advisory role in policy pathways for promoting green growth at the local level. They also play an important role in linking across the three major ecosystems - procurement, MSME, and sustainability. These include actors such as GIZ, Switch Asia Green (EU), the PAGE programme, the British Council, among others.



Photo: unsplash.com

## **NEXT STEPS: THE POLICY LABS FOR SUSTAINABLE PROCUREMENT**

The Policy Labs for Sustainable Procurement process is hosted in Indonesia by Bappenas, LTKL, SEED and Instellar. The programme will look to link discussions on sustainable development, challenges facing MSMEs in accessing procurement markets, and district government procurement activities, in an effort to leverage the opportunity to buy locally made and climate smart products and services. Following a workshop on identifying priority areas for action and barriers facing MSMEs, the programme will present challenge statements as part of the Indonesia Development Forum to spur action in this area. The programme will conclude with a hackathon designed to bring together cross-sector collaboration to design pathways forward in ensuring procurement markets are accessible and leveraged by locally based sustainable MSMEs.

The PLSP targets district governments with strong commitment on sustainable commodities production such as the members of Lingkaran Temu Kabupaten Lestari (LTKL/Sustainable Districts Association). District government is seen as a key actor to encourage collaborative processes between agencies responsible to plan, manage, and implement commodities production and key stakeholders in the district. Through a participatory approach that will involve MSMEs in the process of integrating policies and programs, this can also be the direction to accelerate the Entrepreneurship Law enactment to provide a regulatory basis for social entrepreneurship activities in Indonesia. Involvement of the national government will support identification of existing and potential regulatory enablers and roadblocks, and facilitate discussions and exchanges of information between all stakeholders to come up with the proposed regulatory changes. This direction would strengthen the role of MSMEs in reducing inequalities, supporting local economic development, and protecting the environment.

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