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The Capital Market as a Viable Alternative Funding Source for Small and Medium-Sized Enterprises in Indonesia

Introduction

Micro, Small, and Medium Enterprises (MSMEs) play a significant role in Indonesia's economy, providing a substantial backbone to total national employment and gross domestic product (GDP). A report by the Ministry of Cooperatives and Small and Medium Enterprises (SMEs) of the Republic of Indonesia (2019) stated that in 2017 MSMEs, which include 62.9 million businesses, contributed 60% of GDP and 99% of total employment. These figures are relatively high compared to the merely 1% of total employment and 40% of GDP contributed by large enterprises. MSMEs also play a significant role in increasing workforce absorption in Indonesia. Notably, workforce absorption increased by 21% from 96 million in 2010 to 116 million in 2017 (Ministry of Cooperatives and SMEs of the Republic of Indonesia, 2010-2017), indicating the strategic role MSMEs play in stimulating national labor demand and, indirectly, in alleviating poverty.

In 2018, 54.9% of Indonesian adults

aged 18 – 64 perceived the opportunity to start a business in the area where they live and 11.8% of that age group also already owned established business. These numbers are generally higher than the average in Southeast Asia (Global Entrepreneurship Monitor, 2018) and indicate that the entrepreneurial climate in Indonesia is slightly better compared to the region as a whole. As entrepreneurial activities invariably create new jobs and stimulate innovation and growth, Indonesian MSMEs undoubtedly are a key driver of the resilient national economy. Therefore, promoting programs to support MSMEs is critical, and in particular programs supporting access to financial services are crucial to encourage more scale-ups.

Startup & SME Financing: Current Landscape & Challenges

Law Number 20 of 2008 concerning Micro, Small, and Medium Enterprises categorizes Indonesian businesses into three categories:

- 1) Micro-enterprises, with net assets*¹ ≤ IDR 50 million, or revenue*² ≤ IDR 300 million.
- 2) Small enterprises, with IDR 50 million < net asset ≤ IDR 500 million, or IDR 300 million < revenue ≤ IDR 2.5 billion.
- 3) Medium-sized enterprises, IDR 500 million < net asset ≤ IDR 10 billion, or IDR 2.5 billion < revenue ≤ IDR 50 billion.

Indonesia has a very high density of micro-enterprise. In 2017, 98.7% of Indonesian MSMEs fell into the micro category, 1.2% fell into the small category and 0.1% fell into the medium-sized category.

As of September 2018, less than 20% of outstanding bank loans in Indonesia were to MSMEs, and the majority of those loans were to medium-sized enterprises which represented 43.5% of total loans to MSMEs (Bank Indonesia, 2019). Indonesia's MSMEs have a total of 16 million credit accounts; assuming each account is owned by one business unit means that less than 30% of all MSMEs in Indonesia have access to bank credit suggests that the majority of MSMEs are unbanked.

In 2019, the Ministry of Cooperatives and SMEs of the Republic of Indonesia issued programs and directives on cooperatives - MSME development for the years 2020 – 2024. The program suggests that the government will encourage more MSME scale-ups, more export-oriented SMEs, and more large scale cooperatives. The ministry projected that, assuming only 10% of MSMEs can scale up their business, national economic growth

would increase by more than 7% (Ministry of Cooperatives and SMEs of the Republic of Indonesia, 2019).

The government has been actively promoting programs to support MSMEs in several ways. In terms of funding, most of the programs are aimed at micro- and small enterprises. One of those programs is Kredit Usaha Rakyat (KUR), a government-backed loan with interest subsidy. KUR is the most extensive funding program for small and microenterprises in Indonesia.

The government also has been actively providing leniency for the MSME sector by lowering the KUR rate from 22% in 2014 to 7% in 2018, lowering the final corporate income tax rate for MSMEs and cooperatives*³ from 1% to 0.5% in 2018, and establishing synergy with Indonesia Eximbank to promote more export-oriented SMEs (Ministry of Cooperatives and SMEs of the Republic of Indonesia, 2019). For those enterprises that do not qualify for KUR, the government also provides a loan-based revolving fund managed by the Revolving Fund Management Agency (LPDB) of the Ministry of Cooperatives and SMEs of the Republic of Indonesia.

Despite government efforts to create a more supportive and business-friendly environment, early-stage startups and SMEs in Indonesia still face several challenges in developing and scaling up their businesses. Indeed, putting startups and SMEs together on the same table is practically like comparing apples to oranges. They are different by nature, especially in their risk profiles and business goals, but they do have similar sets of problems.

The results of an Indonesia Digital Creative Industry Community (MIKTI) survey of 992 Indonesian startups in 2018 identified several main problems for startups including facilities, regulations, human resources, capital, and markets. Importantly, 39% of the total surveyed said that the major challenge is lack of capital and difficulty for raising funds because funding is crucial for running daily operations, improving technology, and launching a comprehensive marketing strategy to increase market awareness about the product (Indonesia Digital Creative Industry Community, 2018).

This finding is also similar to the results of a study conducted by the International Finance Corporation (International Finance Corporation, 2016), which concluded that the lack of financing options during the early stage of business is the major challenge for SMEs. Lack

of financial products beyond standard working capital and investment loans will hamper growth, and this could be a significant barrier for SMEs to get off the ground. Banks also generally focus more on traditional collateral-based financing (immovables), and current KUR products are less focused on new clients. Current KUR products focus on interest rate subsidies rather than credit guarantees, which could be of assistance to first-time borrowers (ILO, 2019).

Alternative loan-based financing

Peer-to-peer (P2P) lending has risen significantly in Indonesia over the past few years. Data from Indonesia's Financial Services Authority (OJK) show that loans distributed by P2P lending services in Indonesia grew 260% from December 2018 to December 2019 (OJK, 2020). This growth is driven by a credit market gap of IDR 800 trillion (Gunadi, 2017) that can be served by P2P lending. This gap is around 15% the size of the IDR 5,295 trillion served by commercial banks in 2018. A survey conducted by the Indonesian Internet Providers Association in 2019 also shows that 64.8% of Indonesia's population of 264 million was already connected to the internet in 2018. OJK in 2016 issued Regulation No. 77/POJK.01/2016 covering information technology-based money lending services. All these factors have created a more friendly ecosystem for P2P lending.

However, as of December 2019, only around IDR 81.5 trillion (OJK, 2020) in loans had been distributed by P2P lending services in Indonesia, a relatively small amount of lending compared to the credit-based financing industry overall. Even so, the rise of P2P lending is playing a significant role in driving the banking industry to issue more innovative products, such as the niche invoice financing market that the P2P lending sector is currently leading.

Equity-based financing

Companies tend to mix debt and equity financing to optimize their capital structure. Even though the cost of issuing equity is relatively higher compared to debt (Myers & Majluf, 1984), equity financing provides distinct advantages for early-stage startups and SMEs. Equity financing requires no repayment and provides extra working capital, which can be used to drive business growth. Most Indonesian entrepreneurs started their business by raising equity from family and friends; other than that entrepre-

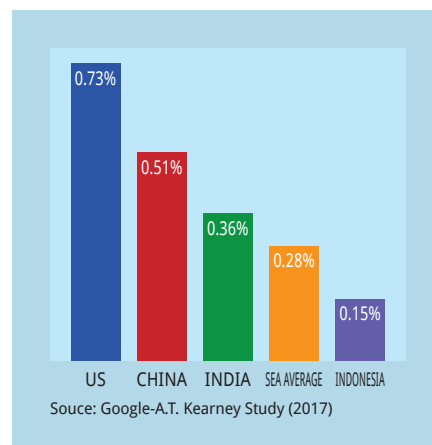
neurs may access private equity financing through Angel Investors, Venture Capital (VC), and Private Equity, or the capital market through Equity Crowdfunding or by conducting Initial Public Offerings to raise capital.

• Private placement financing

Investments in startups in Indonesia have grown 68 times over the past five years. Although meager compared to total investment in Asia, almost 20% of investment in the ASEAN (Association of Southeast Asian Nations) region was invested in Indonesia, reaching nearly USD 3 billion in the first eight months of 2017, or double the previous year's total*⁴ (Google-A.T. Kearney Study, 2017). Research also shows that most of the VC investments in Indonesia are still in the seed or early stages, but late-stage VC investments are generating most of the value. Most VC investors fell into two categories: local investors (54% of total capital) that primarily participate in early-stage deals and foreign investors (46% of total capital) that primarily participate in late-stage rounds. The largest funding rounds are led by e-commerce (42% of total deals) and related transport companies (31% of total deals).

Research also indicates that investors are generally optimistic about the outlook for the Indonesian market, even compared with other Asian markets, including the Southeast Asia (SEA) average*⁵. The reason for the positivity is that Indonesia has favorable demographics and a strong macro-economic foundation. Investors also believe that Indonesia is still under-tracking its peers in VC investment, which indicates much room for growth (Figure 1).

Figure 1: Country Comparison of VC Investments as a Share of GDP (2016)



Looking at the recent local player landscape, as of March 2020, 61 conventional VC firms have been licensed by the OJK. In terms of the operations of these 61 firms, 78% of their investments were made through profit- or revenue-sharing methods, compared to the mere 4% placed through convertible bonds and 18% through equity shares (Financial Services Authority - OJK, 2020). VC activity in Indonesia is not limited to startups as the OJK requires VC investors to allocate at least 5% of their funds to MSMEs.*6

Venture capitalists financed startups and SMEs with interest in generating a return through their eventual exit strategy. The two best ways for a VC to exit are, first, through merger and acquisition and second, if the company does well, by selling their shares through an initial public offering.

• Public equity financing

Initial Public Offering (IPO): Indonesia's capital market is still in an early stage of development. As of 2019, total market capitalization of listed domestic companies in Indonesia was only 46.8% of GDP, compared to 110.8% in Malaysia, 73.1% in the Philippines, 187.4% in Singapore and 104.7% in Thailand.*7 Despite its stage of development, Indonesia's market capitalization of USD 439.38 billion is the third highest in the region, behind Singapore with USD 645.79 billion and Thailand with USD 463.09 billion.*8 Still relatively modest in size compared to the major world exchanges, Indonesia's capital market has considerable room for growth.

The definition of SMEs by the capital market differs from the definition of MSMEs stated in Law Number 20 of 2008 concerning MSMEs under the Ministry of Cooperatives and SMEs of the Republic of Indonesia. In 2017, OJK issued Regulations No. 53/POJK.04/2017 and No. 54/POJK.04/2017 covering the public offering process of SMEs. These regulations also define small and medium-sized issuers as follows:

- 1) The issuer is categorized as small-asset issuer if their asset value *9 is \leq IDR 50 billion
- 2) The issuer is categorized as medium-asset issuer if their asset value is IDR 50 – 250 billion
- 3) Neither category of issuer may be controlled (whether directly or indirectly) by a company that is a controller of an issuer or public company that is not a small or medium-asset issuer or has assets of more than IDR 250 billion.

The regulations also provide for some leniency in public offerings by SMEs.

Equity Crowdfunding (ECF): For startups and SMEs with assets less than IDR 10 billion and aiming to raise under IDR 10 billion, there is another public funding alternative called ECF. The ECF regulation (OJK Regulation No. 37/POJK.04/2018) defines the operational boundaries for ECF platforms, investors, and states the limitation on the amount of money that can be raised from the platform. ECF can be positioned as one step before an IPO. The platform shall help businesses and projects that do not qualify to conduct an IPO to raise funds through the crowdfunding mechanism. Those who participate as investors will receive shares in the company.

As of March 2020, three ECF platforms have obtained a license from OJK: Santara, Bizhare, and CrowdDana. Nevertheless, since the amount of money that can be raised by ECF is limited to under IDR 10 billion, startups and SMEs willing to get more than IDR 10 billion in funding from the public may consider an IPO as a feasible funding option.

Indonesia Stock Exchange (IDX) Initiatives to Support Startups and SMEs

IDX committed to facilitate startups and

SMEs in obtaining funds through public offerings. However, to optimize the public funding that can be raised by Indonesian SMEs, IDX must be able to create a public equity financing ecosystem that will suit their needs. For the one level of funding below IPOs, IDX developed the IDX Incubator. Furthermore, IDX launched the Acceleration Board for IPO Initiatives.

IDX Incubator

IDX launched the IDX incubator in 2017 to support digital-based startups in scaling up their businesses. In addition, since 2019, IDX Incubator has a new incubation program focused on helping startups and SMEs in all sectors, not only digital-based startups, in preparing for the IPO process. The curriculum of the new program, called the "Road-to-IPO" Program, is shown in Table 1.

IDX Incubator also offers other facilities for startups and SMEs that become members, such as cloud services, meeting rooms, multipurpose training rooms, and co-working spaces with high-speed internet access.

IDX Incubator has offices in Jakarta, Bandung, and Surabaya, with 110 members. Nevertheless, only 41 startups and SMEs have joined Road-to-IPO Program. In 2018, 2019, and 2020, 3 IDX Incubator members successfully became listed companies on IDX. They are: PT Yelooo Integra Datanet Tbk. (YELO), PT Tourindo Guide Indonesia Tbk. (PGJO) and PT Cashlez Worldwide Indonesia Tbk. (CASH).

Table 1: Road-to-IPO Program IDX Incubator

Topics	Sub Topics	Trainer
OJK regulations	OJK regulations related to IPOs	OJK
IDX regulations	IDX listing regulations	IDX
Public offerings structure	Valuation	Investment bank
	Financial statement projection	Investment bank
	Roadshow process and IPO timeline	Investment bank
Preparation for meeting with anchor investor	Creating a company profile	Investment bank
	- Milestone	
	- Business model	
	- Business plan	
Legal aspects of the company	- Competitor and competitive advantage	Law firm
	VC funding term-sheet	
Accounting matters	Preparation for legal audit	Law firm
	Accounting bookkeeping services	Accounting firm

Source: IDX

Acceleration Board

Following the issuance of OJK regulations on the public offering by startups and SMEs (no.53/POJK.04/2017 and No. 54/POJK.04/2017)*¹⁰, in 2019, IDX issued Rule number I-V Concerning Specific Provisions for the Listing of Shares (Stock) and Equity-Type Securities Other Than Stock on The

Acceleration Board Issued by The Listed Company. The new board has introduced lower listing requirements than the general listing requirements on the Main Board and Development Board under Rule I-A Concerning The Listing Of Shares (Stock) And Equity-Type Securities Other Than Stock Issued By The Listed Company (Table 2).

As of the end of April 2020, two companies had listed on the Acceleration Board. Both were members of the IDX Incubator, PGJO and CASH.

A company listed on the Acceleration Board is expected to grow rapidly and soon be promoted to the Development Board or the Main Board. The Acceleration Board is designed for a company with a future

Table 2: IDX Equity Listing Requirements

Criterion	Listing Board		
	Main Board	Development Board	Acceleration Board
Independent commissioner	Required	Required	<ul style="list-style-type: none"> •Six-month grace period for medium-asset issuers •One-year grace period for small-asset issuers
Corporate secretary	Required	Required	<ul style="list-style-type: none"> •Six-month grace period for medium asset issuers •One-year grace period for small asset issuers
Audit Committee and unit of internal audit	Required	Required	<ul style="list-style-type: none"> •Six-month grace period for medium asset issuers •One-year grace period for small asset issuers
Operating period	36 months	12 months	Since booked operating revenue
Operating profit	Minimum 1 year	May experience loss, but should have operating and net profit in 2 years based on projection	May experience loss, but should have operating profit by 6th year, based on projection
Audited financial report	Minimum 3 years, unqualified opinion	Minimum 12 months with an unqualified opinion	<ul style="list-style-type: none"> •Minimum 1 year or since establishment if established less than one year •Unqualified opinion
Capital requirement	Net tangible assets*: minimum IDR 100 billion	a) Net tangible asset minimum Rp5 billion; or b) Net profit minimum IDR 1 billion and market capitalization minimum IDR 100 billion; or c) Revenue minimum of IDR 40 billion and market capitalization minimum IDR 200 billion	N/A
Number of shares owned by non-controlling and non-majority shareholders	Minimum 300 million shares and: <ul style="list-style-type: none"> •20% of total shares, for equity <IDR 500 •5% of total shares, for equity IDR 500 billion – IDR 2 trillion •10% of total shares, for equity >IDR 2 trillion 	Minimum 150 million shares and: <ul style="list-style-type: none"> •20% of total shares, for equity <IDR 500 billion •15% of total shares, for equity IDR 500 billion – IDR 2 trillion •10% of total shares, for equity >IDR 2 trillion 	Minimum 20% of total shares
Minimum offering price	IDR 100	IDR 100	IDR 50
Number of shareholders	≥1000 parties	≥500 parties	≥300 parties
Underwriting scheme	Full commitment	Full commitment	Best effort
Lock-up for controlling shareholders	N/A	N/A	6 months

Note: *Net tangible assets (total assets – intangible assets – deferred tax assets – total liabilities – non-controlling interest).

Source: IDX

potential of robust growth, so the most suitable investor type for this board is a growth-focused investor.

Even though the IDX has just launched the Acceleration Board on 2019, 90^{*11} small and medium-asset companies were listed on IDX in the period 2006–June 2020 (Figure 2), based on the definition of small and medium-asset companies in OJK Regulation No. 53. The data indicate that even before the inception of the Acceleration Bboard, IDX was open to small and medium-asset companies.

IDX's data indicates that beside their large counterparts, SMEs also have been increasingly active in utilizing public offerings as one of their financing alternatives. The compound annual growth rate (CAGR) of SME IPO activity was higher than that of all IPOs in general, especially since 2016. IPO activity on IDX has been increasing significantly, with 36% CAGR for total IPOs and 48% CAGR for small-medium IPOs. As a matter of fact, in 2019, IDX ranked 7th highest in the world for the number of IPOs, accounting for 7.7% of global IPO activity (EY, 2020).

In addition to the business incubation program and the Acceleration Board, since 2016 the IDX also has assigned a special task force commissioned to give advisory assistance to potential listed companies. This task force also bridges companies with underwriters and any other capital market supporting institutions/professionals and conducts marketing and branding strategy to familiarize them with the IPO process in Indonesia.

Conclusion

Startup and SME financing through the capital market is not entirely new in Indonesia, as SME IPO activity has been going for the last couple of years. However, to keep up with the development of the industry that continues to transform rapidly, it is evident that more product innovation and leniency on regulations are needed to increase capital market inclusivity in Indonesia. So far, Indonesia's capital market has been focused more on SME equity financing compared to debt financing, but now efforts to foster more equity financing must continue alongside attempts to explore debt financing products for SMEs. To enhance collaboration within the ecosystem is also essential, as platforms or products that can serve as a bridge to the IPO level are still crucial to be offered to the public.

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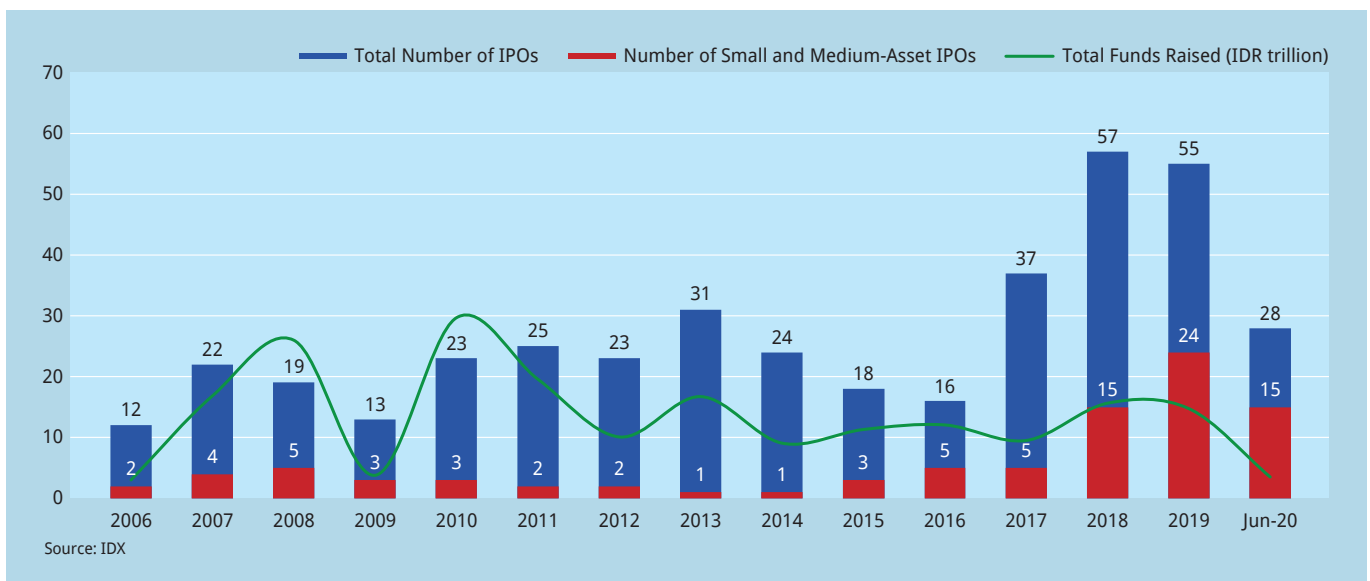
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The views expressed in this article do not necessarily reflect those of the authors' affiliation. Responsibility for any errors lies with the authors.

Note

- *1 Total assets (excluding land and property) – total liabilities
- *2 Annual revenue (net)
- *3 This policy is applicable to any MSME or cooperative which booked operating revenue less than IDR 4.8 billion per year.
- *4 From 2012 to 2017, 244 companies completed 381 VC investment deals.
- *5 SEA consists of Singapore, Malaysia, Indonesia, Vietnam, Philippines, Thailand, Cambodia, Laos, Myanmar, and Brunei.
- *6 OJK Regulation Number 35/POJK 05/2015
- *7 World Federation of Exchanges database (2019)
- *8 IDX (2020)
- *9 Asset value is based on the financial statements used in the submission of the registration statement to the OJK.

Figure 2: Total Number of IPOs and Small and Medium-Asset IPOs



- *10 Regular public offering can also be conducted by following OJK regulation No. 7/POJK.04/2017 and No. 8/POJK.04/2017 for non-startup/SME companies.
- *11 88 companies initially listed on the Development Board and 2 on the Acceleration Board

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Ms. Ramadhani currently serves as an Analyst on the Listing Services and Development Division of Indonesia Stock Exchange. She advises C-level management of potential listed companies on their IPO preparation process, as well links them with capital market professionals and supporting institutions. She covers several capital market products, predominantly equity IPOs. Aside from the capital market, she also has been involved as an advisor to environmental technology projects and to startup/SME/NGO development.