Small medium enterprises (SMEs) play a significant role in Indonesia by having a high contribution to employment growth, GDP and also to net exports, which makes them potentially important for the economic development of Indonesia. However, despite their importance to national economic growth, SMEs’ growth is having a problem with lack of strong foundation and also growth cycle. The analysis shows that limitation to financial access and SMEs’ lack of innovation and business knowledge are the major constraints for the SMEs. This paper will analyze the impact and also limitation of one Indonesian government initiative to support the financial access to SMEs that is called Kredit Usaha Rakyat (KUR). After that, this paper will also analyze the possibility of implementing Hometown Investment Trust Fund in Indonesia as an alternative source of funds to overcome the SMEs’ issue of limitation to finance. And then in order to tackle the issue of lack of innovation, this paper will discuss the possibility of integrating Hometown Investment Trust Fund with the university and cooperative as its business operator to enhance the growth of SMEs both in urban and rural areas.

One of the most important factors that makes small medium enterprises (SMEs) sustainable is government support, which is in the form of policies that can become a catalyst for entrepreneurial growth. Some policies that have already been implemented in many countries aim to reduce the financial constraint that entrepreneurs face, such as preferential loans with low-interest rate and also preferential tax treatment for SMEs.¹

In Indonesia, the government has already implemented some policies to ease SMEs’ financial constraint. The first one is a low tax rate for SMEs that have a gross profit below 4.8 billion rupiah, which about 12% from gross profit per annum. This tax rate is considered very low compared to the tax rate in many developed countries, which revolve around 15% per annum. Beside a low tax rate, the Indonesian government also provides a low-interest loan for low risk SMEs through the national banks, hoping that by this loan the SME can achieve significant growth.

Nevertheless, with these policies, the government has not achieved a significant growth in the number of entrepreneurs in Indonesia. The data that has been provided by the Ministry of Cooperative and Small Medium Enterprises states that the number of entrepreneurs in Indonesia was only 1.56% of the population in 2012. It was considered low compared to Singapore and Malaysia, where about 7% and 3% of their population were entrepreneurs.

There are two main reasons these policies are ineffective, which are the lack of entrepreneurial knowledge transfer from the government to the potential entrepreneurs and also limited access to the formal sources of finance (banks). Only 18% of the SMEs have the access to formal sector finance and the remaining 82% still rely on internal savings, retained earnings and borrowing from family, friends and informal money lenders. The problems occur for both the SMEs and the banks, where from the SMEs that had been surveyed, around 65% stated that the collateral requirement and also high lending rates became their biggest barriers to accessing finance from the bank. While from the banks side, the information asymmetry became the biggest issue for them since they still consider many of the SMEs as risky, hence they put a high interest rate and tighter requirement for getting a loan.

There are four issues that will be discussed in this paper; the first one is

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2 PricewaterhouseCoopers, *Indonesian Pocket Tax Book 2014* (Jakarta, 2014), PwC.
3 Ibid., 1.
7 Ibid., 4.
8 Ibid., 4.
to analyze the impact of the government of Indonesia’s Kredit Usaha Rakyat (KUR) and also its limitations. The second issue is to analyze the needs of implementing the Hometown Investment Trust Fund (HIT) as an alternative financing scheme for SMEs to grow their business in Indonesia. Third is to analyze the possibility of utilizing universities as a business incubation center and also as the main channel for executing the HIT, which can enhance the regional development that has become an inconclusive issue in Indonesia. And lastly is to incorporate the cooperatives as an alternative channel for implementing HIT in rural areas.

The author hopes that with the implementation of the Hometown Investment Trust Fund, the SMEs in Indonesia can get better access to finance and capital so that they can grow their business, and can bring a positive impact to the economic growth of Indonesia.

An Overview of SMEs in Indonesia

SMEs play a significant role in creating employment in Indonesia, which in turn fosters Indonesia’s economic development (Figure 1). In the past, because of its role in creating job opportunities, SMEs played a major role in sustaining the household income and, at the same time, steadily decreasing the poverty rate during the financial crisis. The main reason for this phenomenon is because in Indonesia SMEs are less dependent on any formal source of capital (e.g. bank loan), which makes them more resistant to sudden financial shocks compared to a large firm.

The numbers in Figure 1 are also supported by the statement from the Indonesian Ministry of Cooperative and SMEs, which identified that in 2011 the SMEs created job opportunities for 101,722,548 people in Indonesia (97.24% of the total employment in Indonesia) and in 2012 the number even grew to become 107,657,509 people (about 9.16% higher than in 2011). The SMEs’ contribution to GDP is also substantial, with 57.94% (equal to 4,303,571.5 trillion rupiah) in 2011, which increased to 59.08% of the GDP (4,869,568.1 trillion rupiah) in 2012.

12 Ibid., 5.
13 Indonesian Ministry of Cooperative and SMEs, “SMEs Development in Indonesia” (paper presented at the 1st Meeting of the COMCEC Trade Working Group, Ankara, Turkey, June 20, 2013).
Furthermore, SMEs in Indonesia have a significant impact on the net export rates of Indonesia. In 2010, SMEs’ export contributed approximately 175,894.9 billion rupiah (15.81% of the total net export), with the leading export commodities being handicraft (30%), fashion and accessories (29%), furniture (27%), food and beverages (10%), and health and beauty products (4%). Due to their availability ranging from urban to rural areas, the SMEs play an important role in regional development, especially in rural areas.

With all of the aspects that have been mentioned above and also considering the fact that SMEs in Indonesia play a significant role in Indonesian economic development, the SMEs will become one of the key factors enhancing the development of the Indonesian economy.

The SMEs’ Growth in Indonesia

SMEs in Indonesia grew rapidly from the period of 2007 until 2013. In 2007 the number of SMEs was counted as 47,840,600 enterprises and there was a big difference between the number of SMEs and large firms, which totaled around 450,000 firms (see table 1). Then in 2013 there was a 28.5% growth rate for the numbers of SMEs in Indonesia amounting to 61,496,080 firms, while the growth rate of large firms was smaller than the SMEs’ growth rate.

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14 Ibid., 5.
16 Ibid.
17 Ibid.
(15.7%) from 450,000 firms in 2007 to 521,000 firms in 2013.

**Table 1. Number of SMEs and Large Enterprises in Indonesia (in 000 units)**

<table>
<thead>
<tr>
<th></th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Small and Medium Enterprises</td>
<td>47,840</td>
<td>52,367</td>
<td>52,764</td>
<td>55,914</td>
<td>57,229</td>
<td>59,768</td>
<td>61,490</td>
</tr>
<tr>
<td>Large Enterprises</td>
<td>4.5</td>
<td>4.4</td>
<td>4.7</td>
<td>4.73</td>
<td>4.94</td>
<td>5.04</td>
<td>5.21</td>
</tr>
<tr>
<td>Total</td>
<td>47,845</td>
<td>52,372</td>
<td>52,769</td>
<td>55,919</td>
<td>57,234</td>
<td>59,773</td>
<td>61,496</td>
</tr>
</tbody>
</table>

Source: Badan Pusat Statistik

The growth structure of the SMEs in Indonesia can be divided into four different findings, such as:

1. The flexibility of SMEs to specialize either to become a subcontractor to a larger firm, if they already have already got their own economies of scale, or to develop their own niche market when they do no yet have economies of scale. This flexibility allows the SMEs to survive and grow even in a difficult conditions (e.g. financial crisis).

2. The growth stage of SMEs varies depending on their level of maturity, where in the early stages of development they are usually start as household industries, and then become manufacturers in later stages.

3. The increasing level of customers’ incomes can enable new market development, since customers’ demand are going to shift to a more sophisticated products. This condition will encourage the growth of SMEs and also increase the competition among SMEs that can lead to more innovation and improvements.

4. The growth of SMEs in urban areas is faster compared to rural areas. This happens because urban areas have a higher population density that leads to a higher demand than the demand in the rural areas. Besides that SMEs in urban areas can get some benefits due to better business conditions within those areas.

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Constraints toward Nurturing SMEs’ Growth

Indonesia’s economy is considered to be the 10th largest by nominal Gross Domestic Product (GDP) at Purchasing Power Parity (PPP). Referring to World Bank data, the annual GDP growth rate of Indonesia in 2012 was 6.2% slightly decreased from 6.5% in 2011. However, despite its high GDP growth rate, Indonesia’s unemployment rate is still considered quite high. Shinozaki argued that economic growth in Indonesia does not necessarily mean there is growth in the employment rate as well (see figure 2). From figure 2, it is clear that when the GDP growth of Indonesia increased from 2% to 5%, the unemployment rate hiked from 2% to 7.8%. This indicates that there is a problem with the quality of economic growth in Indonesia, which might be caused by a lack of the establishment and also growth cycle of SMEs.

Figure 2. Economic Growth and Unemployment Rate in Indonesia and the Philippines

PHI = the Philippines; INO = Indonesia
Source: (Shinozaki 2012)

According to World Bank Group, the lack of the establishment and also

20 Ibid., 4.
21 Ibid., 4.
growth cycle of SMEs in Indonesia happened due to several constraints faced by SMEs in Indonesia. Those two major constraints are limitation to formal financial access and SME’s lack of knowledge and innovation.\textsuperscript{22}

**Financial Access to the SMEs in Indonesia**

*The Importance of Financial Access to the SMEs’ Growth*

Access to finance is very important for enhancing the growth of SMEs in order to support economic development. SMEs use the funding that they have for growing their business by purchasing fixed assets or expanding their business to another market. In order to comprehend the relationship (whether it will be a positive or negative) between access to finance and SMEs’ growth, a correlation analysis will be used.

Then, simple nonlinear regression analysis will be used to assess the impact of funding from formal finance to the SMEs’ growth. The data were obtained from World Bank Group’s enterprise survey,\textsuperscript{23} where the dependent variable will be the SMEs’ growth and access to formal finance will be the independent variable. The method that will be used to conduct this regression analysis is Ordinary Least Square Method (OLS), with the following equation:

\[
\log\text{growth} = \beta_0 + \beta_1 \log\text{credit} + U
\]

Where

- \(\log\text{growth}\): The SMEs’ growth function that is indicated by the percent of SMEs buying fixed assets (buildings, equipment, land, machinery, etc.) in order to grow their business.
- \(\beta_0\): The predicted percentage of growth if percentage growth of formal finance is equal to zero (\(\log\text{credit} = 0\)).
- \(\beta_1\): Change in percentage of growth, when \(\log\text{credit}\) is increased by one percentage point.
- \(\log\text{credit}\): The percentage of loans or credit that have been approved by financial institutions.
- \(U\): Residual.

From the analysis, it can be estimated that the capital raised from financial

\textsuperscript{22} Ibid., 20.
\textsuperscript{23} Ibid., 20.
institutions correlates positively (correlation = 0.642) with the SMEs’ growth, which is denoted by the percentage of SMEs that acquire fixed assets (see figure 3). This analysis shows that with better access to finance, the SMEs will prefer to invest for their growth by purchasing fixed assets.

The regression analysis shows that the increase in access to finance (credit) drives up the SMEs’ growth with the significance level at 1% (see table 2). From the result it can be seen that if the percentage of credit growth increases by 1 percentage point, the SMEs’ growth increases by 0.6166 percentage points. Therefore, the resulting equation is:

$$\text{log\_growth} = 6.4132 + 0.6166 \text{log\_credit} + U$$

Figure 3. Correlation Analysis between Access to Finance and SMEs’ Growth

Considering the result of this analysis, there is a high probability that providing better access to finance will be one of the government’s policy concerns in order to enhance the growth of SMEs, which can lead to more sustainable economic development.
Table 2. SMEs’ Growth and Access to Finance (Credit) Regression Analysis (with OLS)

Dependent Variable: log\_\text{growth}

Included Observations: 255

<table>
<thead>
<tr>
<th></th>
<th>Coefficients</th>
<th>Prob.</th>
</tr>
</thead>
<tbody>
<tr>
<td>$\beta_0$</td>
<td>6.4132***</td>
<td>0.0000</td>
</tr>
<tr>
<td>$\beta_1$</td>
<td>0.6166***</td>
<td>0.0048</td>
</tr>
</tbody>
</table>

R-squared: 0.4331

*p<0.1, **p<0.05, ***p<0.01

Source: Author’s Calculation based on World Bank Group Enterprise Survey and Badan Pusat Statistik

SMEs’ Constraints to Access a Formal Source of Funds

However, despite its importance for enhancing the growth of SMEs, there is clear evidence that the SMEs in Indonesia still have a lot of difficulties getting financial access to formal institutions. Figure 4 shows that both the percentage of small enterprises and medium enterprises that can get access to bank loans are low (small enterprises = 16.5% and medium enterprises = 27.6%) compared with the percentage of large companies that can get loans or a credit line from the banks (47.1%).24

Figure 4. Firms with Bank Loans or a Credit Line (in %)

![](image)

Source: World Bank Group Enterprise Survey

Having limited access to sources of finance from formal institutions, SMEs still rely on their internal finance as a source of funding for their business activities, where the percentage for both small enterprises and medium
enterprises are quite high at 88.9% and 87.4% respectively. The percentage of SMEs that use bank loans as their source of funding to operate their businesses is quite low at 6.1% for small enterprises and 6.8% for medium enterprises.

**Figure 5. SMEs’ Source of Finance (in %)**

![Chart showing SMEs' source of finance](chart)

Note: Other Financing: Venture Capital, Cooperative, and Microcredit

*Source: World Bank Group Enterprise Survey*

Based on the analysis on figure 4 and 5, it can be seen that although there are some small and medium enterprises that have credit line from the banks to get loans for operating their business, however only 6.1% of the small enterprises and 6.8% of the medium enterprises that utilize the credit line that they have to run their business. It happens because the SMEs are reluctant to use the bank loans and they prefer to use their internal source of fund to run their business.

According to the survey that had been done by Indonesian Ministry of Cooperatives and SMEs, there are some factors that become the trigger of this issue (see figure 6). The biggest concern is about strict requirement of collateral from the banks, which in most cases the SMEs fail to achieve it because of their insufficient collateral value to fulfill the banks' requirement. The second major trigger is the high lending rate from the bank to the SMEs due to the higher risk of non-performing loan as the result of the

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25 Ibid.
26 Ibid.
27 Ibid., 5.
information asymmetry between the banks and the SMEs. Furthermore, the implementation of Basel Capital Accords (Basel II and Basel III) will accelerate the limitation of access to the bank loans for the SMEs, because this those regulations will require banks to raise their capital requirement, which means that they will be less tolerance for riskier businesses like SMEs.²⁸

Figure 6. Obstacles to Access Bank Loan (in %)

![Chart showing obstacles to access bank loan](chart)

Note: The survey was conducted by asking whether each of these issues become the SMEs’ barrier to bank loan or not

Source: Indonesian Ministry of Cooperatives and SMEs

From all of the analysis above, the result is clear that there are some limitations that are confronted by the formal institutions (in this case is banks) to give financial access to SMEs. This also means that the SMEs will have some difficulties to raise secure and sustainable funds to grow their business. Thus, to overcome this problem, a new alternative source of funds is needed to complement the limit of bank financing to the SMEs.

The Issue Regarding Business Knowledge and Innovation

Innovation is inarguably one of the key aspects for SMEs to grow their business because by focusing on innovation, the SMEs can improve their productivity and also expanding their market base. In order to innovate

themselves, the SMEs need business knowledge and also guidance either from government, incubator or other SMEs.\(^{29}\) However in Indonesia these business knowledge and guidance seems not to be taken seriously. World Bank Group indicated that the innovation amongst the SMEs was very low comparing to the large companies, and only 9.31% of the SMEs are engaging in innovation-related activities, while the percentage of the large companies is 50.83% (see table 3).\(^{30}\)

**Table 3. Indicator of Innovation**

<table>
<thead>
<tr>
<th>Categories</th>
<th>SMEs</th>
<th>Large corporations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Percentage of firms with an internationally recognized quality certification</td>
<td>3.95</td>
<td>40.8</td>
</tr>
<tr>
<td>Percentage of firms using technology licensed from foreign companies</td>
<td>6.35</td>
<td>35.4</td>
</tr>
<tr>
<td>Percentage of firms with their own website</td>
<td>6.7</td>
<td>45.3</td>
</tr>
<tr>
<td>Percentage of firms using email to manage supplier and client relations</td>
<td>20.25</td>
<td>81.8</td>
</tr>
<tr>
<td>Average percentage of engagement in innovation related activities</td>
<td>9.31</td>
<td>50.83</td>
</tr>
</tbody>
</table>


Based on the analysis on innovation aspects, it can be identified clearly that the level of innovation among the SMEs is quite low. It happens because of several knowledge-related factors, such as: lack of professional institutions to educate and train entrepreneurs, limited amount of experienced entrepreneurs that can educate and train people to start their entrepreneurial career, and lack of good entrepreneurship development program.\(^{31}\)

**Government Initiative to Provide Financial Access through Kredit Usaha Rakyat (KUR) / Credit for the People**

Kredit Usaha Rakyat (KUR) or Credit for the people is one of the most notable

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29 Ibid., 10.
30 Ibid., 20.
initiatives from the government of Indonesia to encourage financial inclusion to SMEs in Indonesia. As it has been analyzed in the previous chapter, SMEs in Indonesia are facing some constraints in order to access financing from the banks, which are related to strict requirement of collateral and also high lending rate from the banks. Therefore, the government has developed KUR that tackle the issues of insufficient collateral from the SMEs to the bank as well as to provide the SMEs with a reasonable lending rate.\textsuperscript{32}

Within this program’s framework (see figure 7), the Ministry of Finance provides insurance for 70% of the loans that are given to the SMEs, while the banks bear 30% of the risk.\textsuperscript{33} Under this scheme, there are six national banks and also 26 regional banks that have already joined in order to provide loans to the SMEs.

While in terms of interest rate, because the government guarantee 70% of the loans’ risk, hence the banks become more risk-tolerance and can provide interest rate at the level of 13% for the retail businesses and 22% for the microenterprises.\textsuperscript{34} This interest rate is considered low, comparing with the interest rate from the informal financial sources. Besides that, in order to manage the risk and potential issue of the government regarding this loan to SMEs, the government of Indonesia has already set a ceiling of 20 million rupiah that can be borrowed by the microenterprises.

Impact of KUR and Its Limitation

The KUR program has created a positive impact on SMEs by supporting them with a source of finance that can be accessed easily. In 2012, approximately 29 billion rupiah ($3.1 million) had been circulated to 1,909,914 SMEs by the banks as part of the KUR loan program.\textsuperscript{35} Stimulated by the success in 2012, the government increased the amount of funds that were distributed to the SMEs through the KUR program, which was estimated as 37 trillion rupiah ($2.9 billion) in 2013.\textsuperscript{36} In 2014, the six national banks partaking in the KUR program had provided 11,309,283 SMEs with funds of 146.33

\textsuperscript{34} Ibid., 33.
\textsuperscript{35} Ibid., 36.
\textsuperscript{36} Ibid., 35.
trillion rupiah.\textsuperscript{37}

\textit{Figure 7. Framework of Kredit Usaha Rakyat (KUR)}

An analysis has been done to assess whether the government initiative through KUR has created a positive impact on SMEs. This analysis has been established following the credit supply function of the disequilibrium model,\textsuperscript{38} and also based on the regression model that has been developed by the Central Bank of Indonesia in their empirical investigation on the credit crunch in Indonesia.\textsuperscript{39}

According to the model, the loan or credit supply function is defined by the banks lending capacity and the factors that affect the eagerness of the banks to supply the loan, such as: lending rates, real output (GDP), and the non-performing loan (NPL) of the SMEs.\textsuperscript{40} Hence, the loan or credit supply function can be described as follows:

\[
CS = \beta_0 + \beta_1 \text{len\_capacity} + \beta_2 r + \beta_3 y + \beta_4 \text{sme\_npl} + U
\]

\text{CS: Credit supply}

\textsuperscript{37} Ibid., 35.
\textsuperscript{39} \textit{Credit Crunch In Indonesia In the Aftermath of the Crisis}. Directorate of Economic Research and Monetary Policy, Bank Indonesia, Jakarta, 2001.
\textsuperscript{40} Ibid.
len_capacity: The lending capacity, which can be described as: total liabilities minus capital of the bank minus required reserves minus cash in vault.

r: Lending rates.

y: Real output, which is measured by the real value of GDP.

sme_npl: The non-performing loans of the SMEs.

U: Residual

The data that will be used for this regression analysis are the data from 2005 until 2013. From the regression analysis that has been done, the credit supply for SMEs increases when the lending capacity, lending rates, production output (real GDP) increase (see table 4). Besides that, the credit supply also increases even when SMEs’ NPL increases, which indicate that the banks are more risk-tolerant of SMEs’ risky loan because of the government’s support through the KUR program (see table 4). Hence, the result shows that Kredit Usaha Rakyat (KUR) has a positive impact towards credit supply, since the banks are willing to give credits to SMEs (even though they are riskier than large enterprises) under this program.

Table 4. Analysis of KUR’s Impact to the Credit Supply (2005 – 2013)

<table>
<thead>
<tr>
<th>Dependent Variable: CS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Included Observations: 60</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>Coefficients</th>
<th>Prob.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Constant</td>
<td>-24.8248***</td>
<td>0.0000</td>
</tr>
<tr>
<td>len_capacity</td>
<td>0.4273***</td>
<td>0.0048</td>
</tr>
<tr>
<td>r</td>
<td>0.3768***</td>
<td>0.0005</td>
</tr>
<tr>
<td>y</td>
<td>2.4468***</td>
<td>0.0029</td>
</tr>
<tr>
<td>sme_npl</td>
<td>0.015***</td>
<td>0.0000</td>
</tr>
<tr>
<td>Adjusted R-squared</td>
<td>0.5786</td>
<td></td>
</tr>
</tbody>
</table>

*p<0.1, **p<0.05, ***p<0.01

Source: Author’s Calculation based on Badan Pusat Statistik (2012) and Bank Indonesia (2013)

However, there is a big hesitation towards the KUR program regarding whether it will be sustainable during a crisis. In order to analyze its sustainability, the
same regression model will be used, however this time the analysis will be divided into two. The first one is the analysis before the global financial crisis (GFC) that will use 2005-2007 data. The second one is the analysis after the GFC, which will use 2008–2013 data.

Table 5. Analysis of KUR’s Sustainability Towards the Credit Supply

**Before the Global Financial Crisis (2005 - 2007)**
Dependent Variable: CS  
Included Observations: 60

<table>
<thead>
<tr>
<th>Coefficients</th>
<th>Prob.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Constant</td>
<td>-23.1225***</td>
</tr>
<tr>
<td>len_capacity</td>
<td>0.4928***</td>
</tr>
<tr>
<td>r</td>
<td>0.2748***</td>
</tr>
<tr>
<td>y</td>
<td>2.1641***</td>
</tr>
<tr>
<td>sme_npl</td>
<td>0.1206***</td>
</tr>
</tbody>
</table>

Adjusted R-squared 0.6557

**After the Global Financial Crisis (2008 - 2013)**
Dependent Variable: CS  
Included Observations: 60

<table>
<thead>
<tr>
<th>Coefficients</th>
<th>Prob.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Constant</td>
<td>-25.0756***</td>
</tr>
<tr>
<td>len_capacity</td>
<td>0.2652***</td>
</tr>
<tr>
<td>r</td>
<td>-0.0203***</td>
</tr>
<tr>
<td>y</td>
<td>2.6804***</td>
</tr>
<tr>
<td>sme_npl</td>
<td>-0.0391***</td>
</tr>
</tbody>
</table>

Adjusted R-squared 0.5488

*p<0.1, **p<0.05, ***p<0.01

Source: Author’s Calculation based on Badan Pusat Statistik (2012) and Bank Indonesia (2013)

After the analysis both on the impact and also the sustainability of (KUR), the result is that Kredit Usaha Rakyat indeed has a positive impact on the credit supply for SMEs. However, the analysis also shows that the KUR program is more risk-sensitive after the global financial crisis, since this KUR loan program is distributed through banks which are sensitive to financial
crisis. Besides that, the incoming implementation of the Basel III capital requirement in 2019 makes the banks more risk-averse and limit loans to the SMEs even with the support of the KUR. Hence, it can be assumed that the KUR program is not really sustainable, since it is sensitive towards financial crisis; therefore, an alternative source of finance for the SMEs is needed.

**Hometown Investment Trust Fund (HIT): An Alternative Source of Finance for the SMEs**

Hometown Investment Trust Fund (HIT) is a small investment that focuses on regional development. The uniqueness of HIT is its model, which aims to develop an innovative financial intermediary channel outside of the indirect funding and market sectors in one country’s financial system.\(^1\) HIT creates a new flow of funds that can accommodate riskier businesses like SMEs and it also focuses on enhancing the financial system to support SMEs as a form to promote real economic development.\(^2\)

In the HIT framework, the business operator acts as an asset management company to manage the funds that have been generated from the investors (see Figure 7). This business operator’s roles consist of doing a valuation of the SMEs that will be invested in using the funds, channeling the investment to the chosen SMEs and monitoring the SMEs by doing a business audit.\(^3\)

The investors of HIT can invest directly in the project that will be executed by the SMEs through the website (like the model of Crowd funding) that has been developed by the business operator or through other HIT sales channels, such as banks, cooperatives, post offices, etc. (see Figure 7). This concept of using the website as an investment platform can allow the investors to choose the projects that they are interested in, while also reducing the transaction cost of direct investment to the project. By implementing this direct investment model to the SMEs from household financial assets, HIT can provide other sources of funding to the SMEs with better risk tolerance compared to the banks are bound to the Basel capital requirement.\(^4\)

HIT uses the approach of silent partnership in order to ensure the management independence of the SMEs to run their business (see figure 8). Silent partnership allows people to invest directly in individual projects;

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\(^1\) Ibid., 9.
\(^2\) Ibid., 9.
\(^3\) Ibid., 9.
\(^4\) Ibid., 9.
however, they will not be allowed to participate in the management of SMEs and/or the SMEs project. This approach is different from traditional investment in the partnerships and common stock where the investors in a publicly traded company are involved in the shareholder meeting to decide the direction of the company.  

Figure 8. HIT Framework Diagram

Hometown Investment Trust Fund has three major advantages. First, it can reduce information asymmetry, because the investors have direct access to the SMEs’ projects in which they will invest their money. Second, HIT is a stable source of risk capital, since it is a project-driven fund where the investors decide to invest in the SMEs and projects that they are familiar with (e.g. the investors can choose to invest to the SMEs that are located in the same region or hometown as they are), thus the investors can trust the

SMEs and do voluntary monitoring. Third, HIT can connect households (both investor and consumers) to the SMEs so that they can grow and provide more job opportunities, as well as regional development, which can contribute to the economic development of Indonesia.46

**HIT Implementation Approach in Indonesia**

Besides the issue of access to finance, Indonesia’s SMEs also face another major constraint, which is lack of innovation and business knowledge. Therefore, it will be desirable to develop an HIT implementation approach that can overcome this problem. There are two implementation models that will be discussed in this paper: the first one is to incorporate universities as the business operator of the HIT and the second is to utilize the role of cooperative for developing HIT to reach the SMEs in rural area.

*Incorporating Universities as the Business Operator of HIT*

The basic argument for this approach is that universities will provide knowledge and guidance to the SMEs through their business incubation center to the SMEs. Business knowledge is crucial because it will determine the successful execution and the growth of their business. By acquiring an adequate level of knowledge, SMEs can obtain a strategic advantage in enhancing their business productivity, understanding the market, differentiating their products, and expanding their market base. Without this strategic advantage, potential investors would not be eager to invest in the SMEs because they are unsure that the SMEs can survive in the market even after receiving their investment.

The initiative to enhance the growth of SMEs has become one of the universities’ focuses towards becoming entrepreneurial universities. One of the common strategies to achieve that is through developing business incubation centers to assist SMEs in developing their business. Up until now, there are 82 major universities in Indonesia that have a center for SMEs development, or a business incubation centers.47

The framework of this model starts with the investor’s access to the list

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of SMEs project database on the website (see figure 9). On this website the investor can check all of the information about the SMEs and their projects, such as the company profile, details of the project and potential yield of the project. The website also acts as the investment platform where the investors can invest their money directly through the website to the projects that suit their interest, just like in a crowd funding online platform (e.g. kickstarter.com). In this model, the main sales channel for HIT will be through the website, however there will be further sales channel development through banks, post offices and cooperatives.

Figure 9. Universities – HIT Framework Diagram

The universities play a big role in this model because they will be the business operators of HIT. The main activities of the universities in this model are building an online investment platform for the HIT, promoting HIT to potential investors, evaluating the SMEs project to minimize the risk as well
as to foresee the potential of each SMEs’ projects, providing a development packages (knowledge, guidance and consultancy) to the SMEs, and doing the monitoring and auditing of the SMEs.

There will be various advantages when implementing HIT through the universities’ business incubations, such as:

1. The universities have a lot of experts (e.g. professors and researchers) that are capable of developing and also guiding the SMEs to grow their business. These experts from the universities will become the SMEs’ mentors and consultants, and it will be a great benefit for the SMEs.

2. Many potential students can become consultants for the SMEs (either as a pro-bono scheme project consultant or as an intern).

3. This model also allows the students to learn directly from the SMEs’ key players, so that they will be motivated to become entrepreneurs, hence it can increase the growth of SMEs in Indonesia.

4. Gaining better trust from the investor since the universities have already gained credibility through public exposure as well as because of the experts inside the universities.

*Rural Development Strategy through the Integration of HIT and Cooperatives*

Cooperatives have played an important role in the development of rural areas in Indonesia. There is a government organization that manages all of the cooperatives in Indonesia and it is called Induk KUD. Induk KUD is the national federation of rural cooperatives in Indonesia, and it was founded on November 12, 1979.

The Induk KUD mission is to help the cooperative movement expand joint business relationships, ensure creation and implementation of a business climate that supports cooperative survival and development, education and training, develop cooperative business, and improve the welfare of its members and as a result the community. Induk KUD currently has members in 27 provinces with three overseas representative offices.

The cooperative has a savings and loan business unit for members of staff, their members (individual and SMEs), and potential members. They also procure and distribute goods such as raw materials and production facilities to increase production for members and staff. The organization also assists in helping members and open up markets in domestic and foreign countries in the various sectors that there are in – agriculture, fisheries,
livestock, plantation, mining, forest and crafts.

The basic argument for this approach is that the cooperative has a business model that is relatively similar to a business incubator. From the explanation above, it is clearly stated that the cooperative supports the development of its SMEs’ members and provides them with necessary access to low interest loans. However, the cooperative’s source of funds is limited to the internal contribution of its members, which is one of the reasons for the integration of HIT to expand its external source of funds (public investors).

*Figure 10. Cooperatives – HIT Framework Diagram*

In this approach, the investors can invest directly in the SMEs and their projects either through an online investment platform (just like in the university approach) or by going directly to the cooperative or the over the counter (see figure 10). Over the counter selling channel will be important for the cooperatives that are located and have portfolios of SMEs’ projects in
rural areas, since internet access will be quite limited in this area.

As for the development of the SMEs and also monitoring and auditing, this can be done directly by the cooperative or by partnership with the university. Partnership with a university will be quite useful when the cooperative has fewer experts to develop the SMEs, so in order to fulfill the gap, the cooperative can collaborate with the university to get the necessary resources.

The advantages of implementing HIT through cooperatives are:

1. The vast network of cooperatives in both urban and rural areas can create a wider positive effect of HIT implementation.
2. The HIT model can be easier to be implemented within cooperatives than universities, since cooperatives have a quite a similar business model to HIT.
3. Cooperation with universities will allow the cooperatives to acquire the necessary expertise to develop SMEs and execute a more effective fundraising method.
4. Better support from the government through the Ministry of Cooperatives and SMEs.

**Conclusion**

SMEs in Indonesia play a significant role in the economy by making a high contribution to employment growth, the GDP and also to net exports. Besides that, the number of SMEs in Indonesia is bigger than the number of large companies, which makes them potentially important for the economic development of Indonesia.

Despite their importance to national economic growth, SMEs’ growth is having a problem with its foundation and growth cycle. The problem is due to two major constraints, which are limited access to finance and SMEs’ lack of innovation and business knowledge.

The analysis that has been done regarding financial access, shows that access to finance is important for enhancing the growth of SMEs, however, from the analysis it can be observed that the percentage of SMEs that have already received credit lines or bank loans is quite low. Furthermore, the SMEs are reluctant to get loans from the banks because of two major problems: such as the binding collateral requirement and high lending rate from the banks. These two major problems appear because there is an information asymmetry between the banks and the SMEs.
Regarding the issue with innovation and business knowledge, the research indicates that the innovation amongst SMEs is very low compared to the innovation of large enterprises. This occurs because the SMEs could not get an adequate level of business knowledge or guidance to improve their business.

So, in order to overcome issues with limitations to financial access, the implementation of the Hometown Investment Trust Fund (HIT) is needed. According to the analysis, HIT will be suitable to be implemented as an alternative source of funds for SMEs because of several features: its ability to reduce information asymmetry, its nature as a stable source of risk capital, and its capability to connect households with SMEs. The integration approach of HIT will be very important, since SMEs also face some challenges that are related to innovation and business knowledge. This paper suggests two types of HIT integration: the first is integration with universities and the second is integration with cooperatives. Conducting further research is necessary to validate whether these two types of HIT integration can be implemented since they are still concepts that have not been tested in reality yet.