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Identifying the Biggest Obstacle in Doing Business: What's The Trigger?-An Evidence from an Enterprises Survey

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Abstract

Indonesia is a country with natural resources that requires a lot of manufacturing firms to process raw materials into finished or semi-finished products that are needed both domestically and abroad. Ease of doing business is one of the conditions that support the growth and development of the manufacturing industry.This study aims to provide recommendations related to government policies in creating a conducive business world in Indonesia. Identification and mapping out barriers to doing business in Indonesia is needed in order to provide appropriate policies both nationally and at the local government level. We use the data survey of the Enterprises Survey from the World Bank covers data from 1,444 firms in 9 provinces in Indonesia and processed by using STATA statistical tool to investigate the barriers.The result shows that access to finance is the biggest obstacle identified by firms. It is identify with the firm's reasons did not apply for new credit are the complex credit application procedure, collateral requirements that were too high, unfavorable lending interest rates, and still have sufficient capital.Our findings also confirm that access to finance is being the big barrier to doing business for large firms although most still have sufficient capital.

Keywords
Biggest obstacles, Lending interest rates, Access to finance, Indonesia

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Introduction

The manufacturing industry sector is one of the pillars of the national economy which contributes significantly to Indonesia's economic growth. The manufacturing industry contributes to Indonesia's Gross Domestic Product by 20 (twenty) percent in addition to other sectors such as agriculture, trade, construction, and mining. Most of this achievement was contributed by the five manufacturing sectors, namely the food and beverage industry, textile and clothing industry, automotive industry, chemical industry, and electronics industry (Ministry of Industry, 2019). Indonesia as a country with natural resources that requires a lot of manufacturing firms to process raw materials into finished or semi-finished products that are needed both domestically and abroad. Figure 1 shows that the manufacturing industry provides the largest contribution to GDP among the non-oil and gas industry and the coal & oil and gas refining industry.

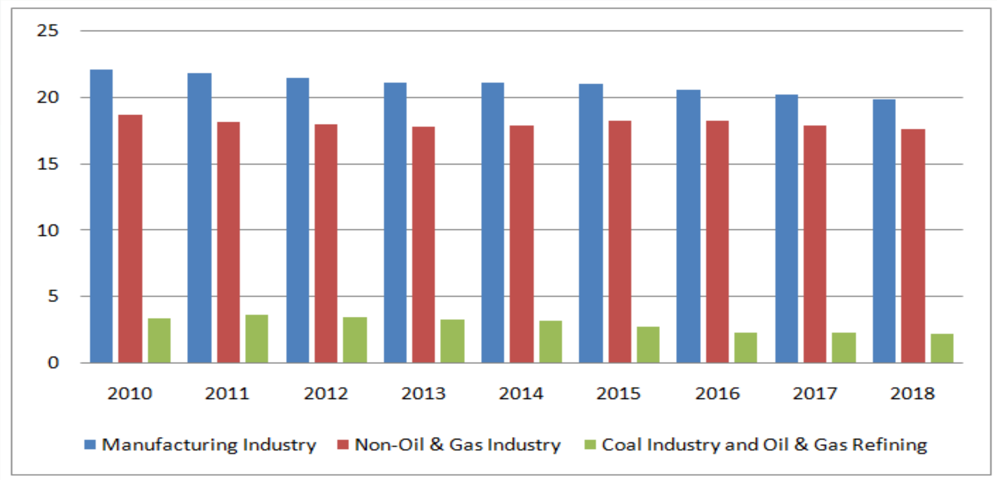

Figure 1. Manufacturing Industry Contribution to GDP(%)
Source : (Ministry of Industry, 2019)

Ease of doing business is one of the conditions that support the growth and development of the manufacturing industry. The ease of doing business in Indonesia according to Easy of Doing Business is ranked 73 in 2018 and 2019. This ranking is far behind those countries and even other Southeast Asian countries such as Malaysia, Thailand, and Vietnam. Big obstacles in doing business will hinder investment. Investors who have invested their capital will even move their business to other countries. Barriers to doing business from the existing literature vary from country to country. Research conducted by Muent et al (2001) found that taxes and the activities of competitors in the informal sector were barriers to doing business in Albania, corruption was the biggest obstacle in Latin America (Gaviria, 2002), and infrastructure was a barrier to doing business in Nigeria (Agboli & Ukaegbu, 2006). Sanfey & Zeh (2012) used data from the BEEPS (Business Environment and Enterprises Performance Survey) obtained the results that the biggest obstacle to doing business was the activity of competitors in the informal sector in Western Balkan countries. Macroeconomic instability, especially exchange rate instability was a barrier to doing business in Georgia (Charaia et al, 2020), and the sustainability of business strategy is a barrier to doing business in Kosovo (Marmullaku, 2018). Previous studies and research on firms' barriers to doing business, with a larger sample of countries in one region such as that conducted by Kounouwewa & Chao (2011), Fowowe (2017), Brixiová et al (2020) and Amos & Zanhouo (2019) in African countries. The study Beck et al (2005) used data covering 54 countries, Wang (2016), and Mertzanis, (2019) used data from developing countries, and Ullah (2020) used data on more than 10,000 firms in countries in Eastern Europe and Central Asia. These studies and research are mostly focused on small and medium enterprises (SME's). This study focuses on the barriers to doing business in Indonesia and the 9 provinces where the sample companies operate, both in terms of the level of barriers, the causes of the main barriers to doing business, and the business sector that identifies these barriers. Indonesia, which consists of 34 provinces with a decentralized government system and regional autonomy, requires acceleration and synchronization between the central government and local governments, thereby ensuring certainty in the business climate in Indonesia. Identification of barriers to doing business in Indonesia is needed in order to provide appropriate policies both nationally and at the local government level. We used firm-level data from the Word Bank Enterprises Survey (WBES) of 1,444 firm in 2009 to map out the main barriers to doing business in Indonesia. This survey covers firms located in 9 provinces in Indonesia, namely Bali, Banten, DKI Jakarta, West Java, Central Java, East Java, Lampung, South Sulawesi, and North Sumatra. This mapping is a contribution to this research. Local governments should synchronize and harmonize regional policies with central government policies. Local governments can make policies that can overcome problems in their respective regions. We compute and rank the barriers to doing business in Indonesia. The Result confirms the biggest obstacles to doing business in Indonesia in 2009 were access to finance, practice of competitors from the informal sector, political instability and electricity were major barriers faced by firms in general. Firms identify access to finance as the biggest obstacle to doing business in Indonesia, citing complicated/complex loan application procedures, unfavorable loan interest rates, and excessively high collateral requirements. This paper is organized as follows. In the second section, a review of the literature is presented to provide a brief summary of the relevant work. The third section describes our methodology and data. The fourth section presents our findings followed by results and discussion in the fifth section, and the last section is the conclusion.

Literature Review

This section discusses the importance of the manufacturing sector in Indonesia and the main results of the literature dealing with barriers to access to finance. Indonesia is a country with natural resources that requires a lot of manufacturing firm to process raw materials into finished or semi-finished products. These products are needed both domestically and abroad.The largest absorption of Indonesian workers occurs in the manufacturing industry by absorbing 18.25 million workers or 14.72 percent of the national workforce. This labor absorption increased by 17.4 percent from 2015. The industrial sectors that absorbed the most labor were the food industry 26.67 percent, the apparel industry 13.69 percent, the wood and cork industry 9.93 percent, the textile industry 7.46 percent, the non-metallic mineral industry by 5.72 percent, and the furniture industry by 4.51 percent (Bps, 2021). There are many previous studies and research on the barriers of firms in doing business, but more samples from countries that are members of one region such as Kounouwewa & Chao (2011), Fowowe (2017), Brixiová et al (2020) and Amos & Zanhouo (2019) look at the barriers to doing business in African countries. The study Beck et al (2005) used data covering 54 countries, Wang (2016), and Mertzanis, (2019) used data from developing countries, and Ullah, (2020) used data on more than 10,000 firms in countries in Eastern Europe and Central Asia. One of the biggest obstacles to doing business is access to finance. The empirical study is more about the effects/impacts of these financial access barriers. Rupeika-Apoga, (2014) found that firms consider the lack of access to finance to be the main factor that hinders innovation activities, while institutional stakeholders consider the lack of access to finance to be the main obstacle for firms to bring innovation to the market. Likewise (Brixiová et al., 2020) states that the effect of access to finance is stronger for manufacturing firms than for service firms, where barriers to access to finance can hinder job creation. Another study found that financial constraints have a significant negative effect on firm's growth. Ullah (2020), obtained the results that financial access barriers have hurt on sales and employment growth. Barriers to access to finance are one of the most important obstacles to firm's growth (Beck et al, (2005), Wang (2016). Every firms that does not experience credit restrictions shows relatively fast growth compared to firms that are restricted (Fowowe, 2017). Financially constrained firms earn a lower income than unrestricted firm.The firm is inefficient and less productive than a firm that is not financially constrained (Amos & Zanhouo, 2019). Research on the analysis of financial barriers is also widely associated with various things other than company performance, such as Kunt & Maksimovic (1998) who examines the relationship of financial barriers to efficiency of the legal system, Kounouwewa & Chao (2011) discusses barriers to financial access with company ownership structure andWellalage, Locke, & Samujh (2020) examines financial access barriers and corporate bribery behavior. Financial barriers related to the gender of the company owner (Asiedu et al, 2013), the company's environmental performance (Tian & Lin, 2019), and research and development investment (Yin, Hai, & Chen, 2019). The general findings in previous studies are the financial problems faced by firms based on firms' size. We will add and explain the causes of this obstacle so that firms identify financial problems as the biggest obstacles to doing business in Indonesia.

Methods

The data used in this paper comes from the World Bank Enterprises Survey (WBES), which is survey data at the company level conducted by the World Bank on companies. The survey respondents are the company's senior business executives or entrepreneurs. The survey conducted by the Enterprises Survey was designed to study the impact of government policies on business activities (Fries, 2003). The WBES is a unique enterprise-level survey data that offers several advantages and provides information about firms' perceptions of the extent to which their business environment is a constraint or not. Unlike previous studies, which assessed financial barriers more from the numbers in the financial statements (Kounouwewa & Chao, 2011). The Enterprises Survey groups Indonesia into countries East Asia and Pasific Region (EAP Region). The survey data used is 2009 data with a sample of 1,444firms in Indonesia. The Enterprises Survey provides a sample of the small, medium, and large companies located in 9 provinces in Indonesia, namely Bali, Banten, DKI Jakarta, West Java, Central Java, East Java, Lampung, South Sulawesi, and North Sumatera. World Bank Enterprises Survey groups the surveyed firms by firm size. Small firms have 5-19 employees, medium firms have 20-99 employees, and large firms have more than 100 employees. Respondents consisted of 821 (56.86%) small firms, 346 (23.96%) medium firms, and 277 (19.18%) large firms. Figure 2 shows the distribution of the sample in each province.Respondents were mostly in West Java, Central Java, and East Java.

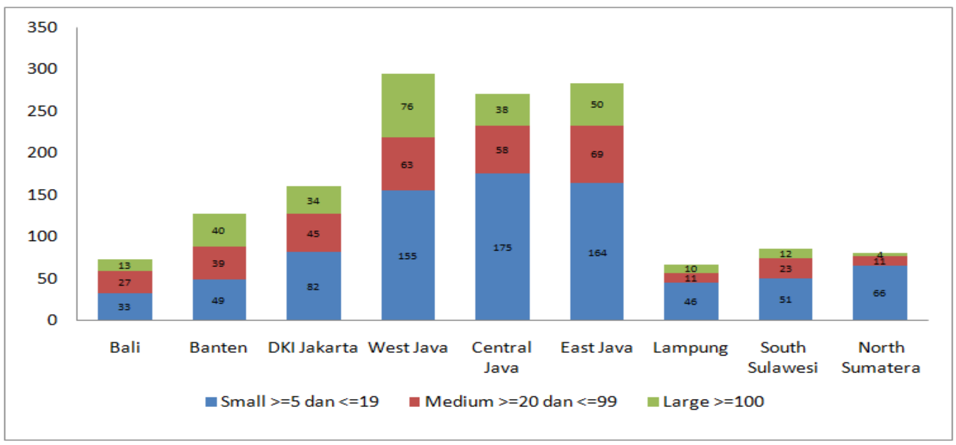

Figure 2. Firm Distribution by Region

Enterprises Survey classifies businesses in Indonesia into 13 business sectors. Figure 3 shows the distribution of firms for each business sector.Most of the respondents came from the non-metallic mineral sector as many as 193 firms (13.37%).

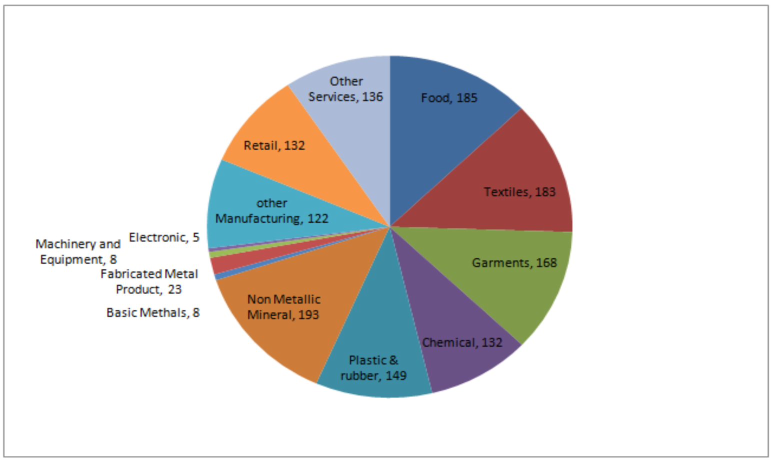

Figure 3. Respondent by Business Sector

Types of obstacle, business sector, average real annual sales growth, and real employment growth are the variables in this study. Answers from respondents are answers to the list of types of barriers to business provided by the survey team. The list is given to answer the question "by looking the list of elements of business environment which one if any, currently represents the biggest obstacle affecting the operation of this establishment". The barrier types available in Enterprises Surveyare access to finance, access to land, business licensing and permits, corruption, courts, crime, theft and disorder, custom and trade regulation, electricity, inadequately educated workforce, labor regulation, political instability, practices of competitor in the informal sector, tax administration, tax rates, and transpor. Data processing is carried out using STATA by grouping these obstacles based on company size, business sector, and the causes of these obstacles.

Finding

This section present our finding of identifying the obstacles. We do not eliminate large companies like many other researchers who focus more on small and medium companies (Wang 2016; Hewa Wellalage et al 2020; Brixiová et al 2020; Tian & Lin 2019). Figure 4 shows the biggest barrier to doing business for firms in Indonesia is access to finance. These barriers were identified by firms as much as 32.13 percent, competing practices in the informal sector as much as 12.81 percent, and political instability obstacles as much as 8.17 percent.

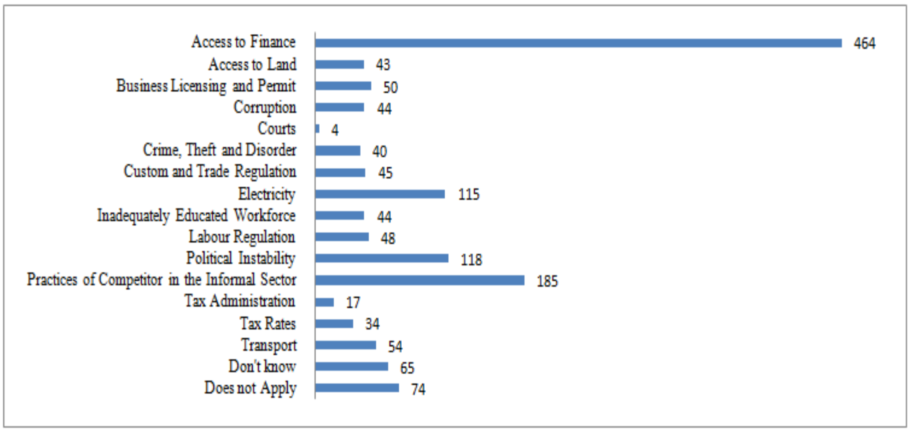

Figure 4. Obstacles of Doing Business in Indonesia

Table 1 shows the selected obstacles that are the biggest problems in running a business by firms' size. The biggest problems in doing business in Indonesia identified by all firms are financial constraints, competitive practices in the informal sector, political instability, and electricity.

Table1.
Proportion of Firms Ranked Based on Obstacles as the Biggest Problem

Small Firms	
Access to Finance	41,29%
Practices of Competitor in the Informal Sector	13,03%
Political Instability	6,21%
Electricity	5,48%
Access to Land	3,77%
Medium Firms	
Access to Finance	25,72%
Practices of Competitor in the Informal Sector	15,32%
Political Instability	12,14%
Electricity	9,25%
Custom and Trade Regulation, Inadequately educated Workforce, dan Transport	3,76%
Large Firms	
Electricity	13,72%
Access to Finance	13%
Labour Regulation	11,55%
Political Instability and Practices of Competitor in the Informal Sector	9,02%
Custom and Trade Regulation	8,30

Firms identify access to finance as the biggest barrier to doing business in Indonesia for a variety of reasons. Answering the question of "why the company did not apply for a new loan?" most of the firms answered because of the complicated/complex credit application procedure, collateral requirements that were too high, unfavorable loan interest rates, and still had sufficient capital. Figure 5 shows the complexity of loan/loan application procedures (20.8%), too high collateral requirements (20%), unfavorable loan interest rates (15.9%), and 20.3% no need for a loan cause still have sufficient capital, which is firm's reason not applying for a new loan. Large firms, apart from still having sufficient capital, not applying because of unfavorable interest rates. Medium-sized firms, in addition to high-interest rates, collateral requirements are too high, and small firms stated loan application procedures are complicated/complex and collateral requirements are too high.

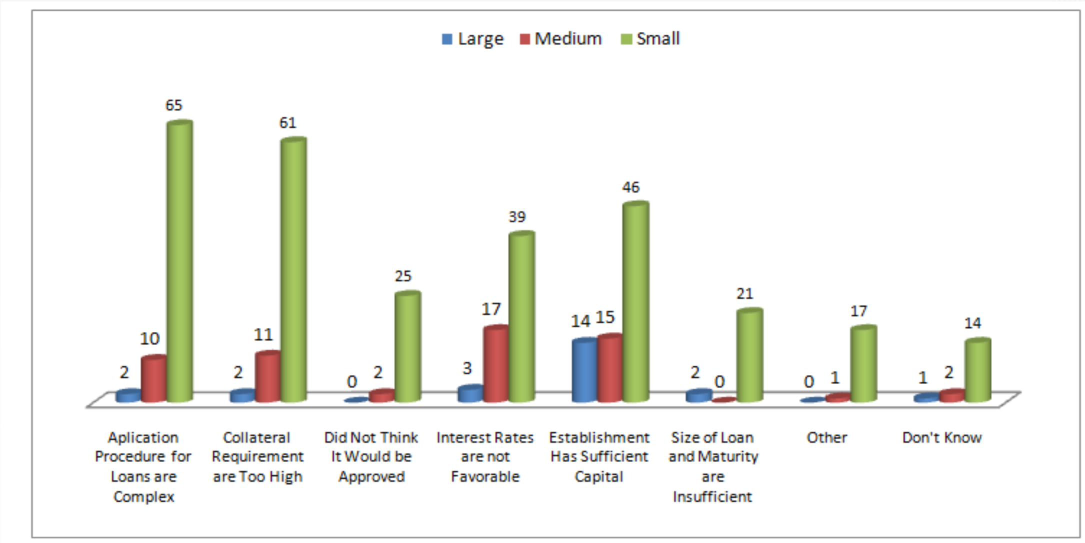

Figure5. Reasons for Not Applying for a New Loan

The business sectors that most identify financial access as a barrier to doing business arefirms operating in the non-metallic mineral product sector with 18.53%, followed by textiles at 15.09%, and food at 13.15%. Figure 6 show the top three barriers are related to the size of the firm, large firms that most identify obstacle access to finance areoperating in the non-metallic mineral products sector, food, and chemical sectors. Medium-sized firms that identify financial access barriers are mostly in the non-metallic mineral product sector, textiles, as well as plastic and rubber. Meanwhile, small firms mostly identified barriers to access to finance from non-metallic mineral products, textiles and food sectors.

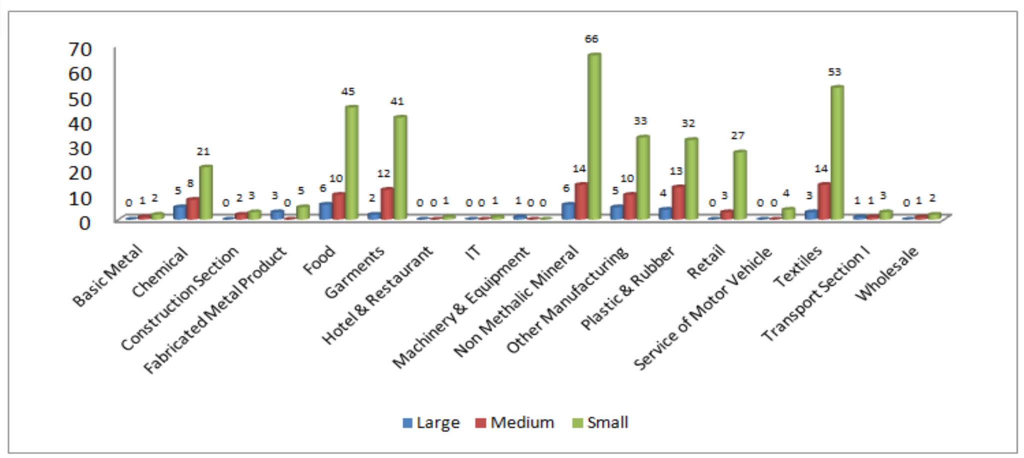

Figure 6. Financial Access Constraint by Business Sector

The table 2 shows the biggest obstacles to doing business in each province in Indonesia are different. Access to finance is the most identified barrier to doing business, except for the provinces of Bali and DKI Jakarta. The obstacle in doing business in Bali is competitive practices from the informal sector, and in Jakarta is political instability. DKI Jakarta is the capital city of the country, where most of the large firms operate, while Bali is the well-known business and tourism center of Indonesia.

Table 2.
Firms Ranked Based on Obstacles as the Big Problem Each Province

Province	1st Biggest Obstacle	%	2nd Biggest Obstacle	%	3rd Biggest Obstacle	%
Bali	Practice of competitor in the informal sector	35.62	Electricity	13.70	Political Instability	12.33
Banten	Access to finance	30.47	Practice of competitor in the informal sector	14.06	Electricity	11.72
DKI Jakarta	Political Instability	20.50	Practice of competitor in the informal sector	18.63	Access to finance	16.77
West Java	Access to finance	34.35	Labour Regulation	9.52	Practice of competitor in the informal sector	9.52
Central Java	Access to finance	40.59	Practice of competitor in the informal sector	12.57	Electicity	7.01
East Java	Access to finance	33.21	Practice of competitor in the informal sector	10.60	Political Instability	9.19
Lampung	Access to finance	55.22	Practice of competitor in the informal sector	7.46	Electicity	7.46
South Sulawesi	Access to finance	29.07	Electicity	15.12	Practice of competitor in the informal sector	12.79
North Sumatera	Access to finance	29.63	Electicity	16.05	Corruption	7.41

Table 3 shows the performance of firms that identify financial access as a barrier to doing business in Indonesia is still growing positively. It also shows the company's growth when grouped by the business sector.

Table 3.
The Biggest Obstacle and Firm's Growth

Biggest Obstacle	Real Annual Sales Growth (%)	Real Employment Growth (%)
Access to Finance	**27,33%**	**17,75%**
Average Growth Non Access to Finance	**21,55%**	**8,12%**
Access to land	2,11%	18,69%
Business licensing and permits	57,56%	1,75%
Corruption	13,25%	3,40%
Courts	5,22%	0,71%
Crime, theft and disorder	15,44%	11,57%
Custom and trade regulation	22,29%	7,03%
Electricity	25,63%	9,64%
Inadequately educated workforce	33,13%	21,55%
Labor regulation	5,73%	-1,42%
Political instability	8,99%	2,25%
Practices of competitor in the informal sector	28,91%	11,43%
Tax administration	0,93%	1,06%
Tax rates	12,09%	-1,95%
Transport	29,44%	15,39%

Real annual sales growth of firms that identify business permits and licenses (57.56%), workforce education inequality (33.13%), competitor practices in the informal sector (28.91%), and transport (29.44%) as the biggest obstacle is greater than the growth of companies that identify access to finance as the biggest obstacle to doing business. Meanwhile, firms that identify access to land and labor education inequality as the biggest obstacles have higher real labor growth than firms that identify access to finance as the biggest obstacles to doing business.

Result and Discussion

The biggest barriers to doing business for large firms are electricity, access to finance, and labor regulations. Small and medium enterprises identified the biggest barriers like access to finance, competitive practices in the informal sector, political instability, and electricity. These results indicate that barriers to access to finance are not only identified by small and medium-sized firms but are also identified by large firms in addition to electricity problems. Financial access referred to here is financing that comes from outside the company. One of the important aspects of ease of doing business set by the World Bank is the ease of obtaining credit. Financial institutions in Indonesia require that every business must be able to fulfill bank requirements to obtain credit. Figure 7 shows the easy of obtain credit in ASEAN countries.

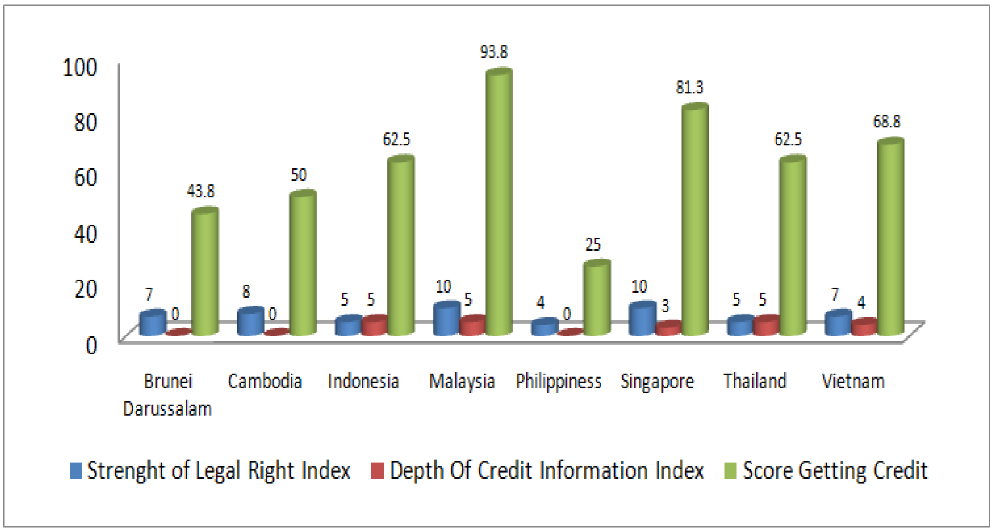

Figure 7. Ease of Getting Credit in ASEAN Countries
Source: EODB (World Bank, 2009)

Wang's research (2016) found that as many as 54.53 percent of small and medium enterprises in developing countries did not need loans. When compared with Indonesia as a developing country, it turns out that only 17.63 percent of small and medium enterprises do not need loans. Difficulties in accessing finance for small and medium-sized companies are mostly due to complicated loan application procedures. Lending interest rates are one of the firm's reasons not to apply for loans because considered unprofitable. Lending interest rates are high in Indonesia compared to other countries of ASEAN. Table 4 shows a comparison of loan interest rates in Indonesia from 2005-2009. The average lending interest rate is above 13% per year, the highest among other neighboring countries.

Table 4. Lending Interest Rate of ASEAN Countries

Countries	2005	2006	2007	2008	2009
Indonesia	14.05%	15.98%	13.86%	13.60%	14.50%
Vietnam	11.03%	11.18%	11.18%	15.78%	10.07%
Philippines	10.19%	9.78%	8.69%	8.75%	8.57%
Malaysia	5.95%	6.49%	6.41%	6.08%	5.08%
Thailand	4.72%	6.27%	6.05%	5.82%	4.78%
Singapore	5.30%	5.31%	5.33%	5.38%	5.38%

Source : World Development Indicators (World Bank, 2021)

The business sectors that most identify financial access as a barrier to doing business arefirms operating in the non-metallic mineral product sector with 18.53 percent, followed by textiles at 15.09 percent, and food at 13.15 percent. These three sectors are industrial sectors that absorb a lot of labor, namely food industry 26.67 percent, the textile industry 7.46 percent, the non-metallic mineral industry by 5.72 percent, and the furniture industry by 4.51 percent (Bps, 2021). These sectors must receive attention in terms of easy access to finance so as not to hinder job creation

(Brixiová et al., 2020) and harming growth and workforce growth like Ullah's research (2020). Average real annual sales growth of firm of 27.33% per year and real employment growth of 17.75% per year. Meanwhile, the average real annual sales growth of firms that do not identify access to finance is 21.55% per year and the growth of the workforce is 8.12% per year. These results indicate that financial access barriers do not hinder the company's growth. This is not in line with research conducted by (Fowowe, 2017) (Amos & Zanhouo, 2019) (Benito, Guillamón, Ríos, & Bastida, 2018) and (Beck et al., 2005) which state that barriers to access to finance are a constraint to firm's growth. A total of 58.33 percent of large firms and 17.63 percent of small and medium-sized firms still have sufficient capital to operate. This shows that the company has sufficient capital that comes from the company's internal. Indonesia's fairly stable economic growth has also influenced the growth of the frirm's performance to the positive side. The global economic crisis in 2008 resulted in a slowdown in the economic growth of developed countries such as the United States, Japan, and the developed countries of Europe. ASEAN countries such as Singapore, Malaysia, and Thailand also experienced negative economic growth. Indonesia is a developing country that can overcome the impact of the global financial crisis. This is indicated by the 2008 economic growth which was at 6.0 percent as shown as figure 8, and the average economic growth in 2005-2008 was 5.9 percent. Economic growth from the demand side was still supported by domestic consumption, particularly household consumption (BPS, 2010).

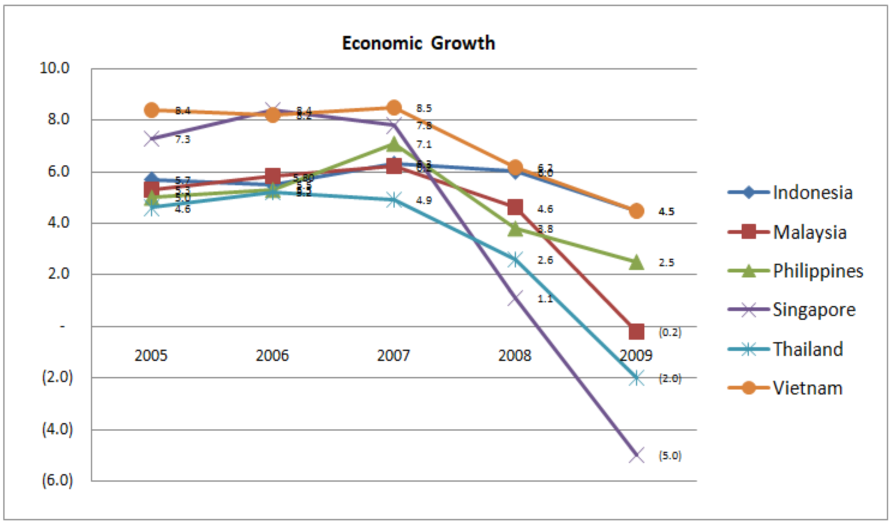

Figure 8. ASEAN Economic Growth
Sumber : (BPS, 2010)

Barriers to access to finance, competitive practices in the informal sector and political instability are common issues that require consideration in determining government policy. These obstacles will cause other problems if policymakers cannot anticipate them properly. The Government of Indonesia anticipated this obstacle to access to finance in doing business, by issuing the Regulation of the Minister of Finance of the Republic of Indonesia Number 135/PMK.05/2008 concerning the People's Business Credit Guarantee Facility. This regulation is the basis for providing easy access to finance for the business world. This Regulation of the Minister of Finance was later amended by Regulation of the Minister of Finance number 10/PMK.05/2009. This regulation limits the number of loans to companies to a maximum of five hundred million rupiahs. Collateral is still needed to get this loan. Interest rates for Indonesian banking loans are still quite high. Indonesia's loan interest rate is still at 9.5 percent in 2020, higher than Vietnam in the amount of 7.6 percent and Thailand 3.3 percent (World Bank, 2021).

Conclusion and Recomendation

Using data from World Bank Enterprises Survey, we found thatthe biggest obstacle to doing business in Indonesia in 2009 was access to finance. These barriers were identified by firms as much as 32.13 percent. Complicated credit/loan application procedures, excessively high collateral requirements and high loan interest rates are the biggest problems in the barriers to access to finance for firms. Complicated credit/loan application procedures more identified by small and medium-sized firms. The firm did not apply for new financing due to complicated/complex loan application procedures as the main reason, unfavorable loan interest rates, collateral requirements that were too high, and large firms still having sufficient capital. The performance of firms that identify financial access as a barrier to doing business in Indonesia is still growing positively. Average real annual sales growth of firm of 27.33% per year and real employment growth of 17.75% per year.Meanwhile, the average real annual sales growth of firms that do not identify access to finance is 21.55% per year and the growth of the workforce is 8.12% per year. Big obstacles in doing business will hinder business development in Indonesia. The policy of lowering interest rates and the ease of requirements for obtaining loans will have an impact on the growth and development of the industrial sector, especially the industrial sector which absorbs a lot of workers such as the food industry, the textile industry, and the non-metallic mineral industry.

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Appendix

Description of Business Sectors and Main Products

Description of Business Sectors	Description of MainProducts
Basic Methal	Steel, steel plate, iron, teralis, golden ring, etc.
Chemical	Aromatherapy oil, paint, pestisida, ink, glue, varnish, mosquito essence, cosmetic, soap, jamu, herbal drink, food flavoring, pharmacie, medicine, compost, HCl, oxygen, hair oil, herbirida, shoe polish, detergent,wig sintetis, crud, candle, brlliantine, ph booster, etc.
Fabricated Methal Product	Stainles pipe, screw, alumunium tin, tank, nail for timber, sleeping bed, mosque dome, kitchen pantry, methalic chair, construction, household equipment, lanseng, brazier, etc.
Food	Jelly, biscuit, bakery, milk, tofu, beverage, ice cube, traditional food, rice mill, wheatflour, noddle, tahu, kerupuk, meatball, red sugar, fermented potato, canned fish, tapioca,cassava, black tea, etc.
Garment	Clothes, pant, hat, sarong, batik, pillow chair, embroydired clothes, songkok, jacket, bag, knitted, bra dan sport wear, etc.
Machinery and Equipment	Machine agriculture
Non Methalic Mineral	Floor cheramic, paving, kinds of brick, red bricks, super rooftile, gypsum, concrete, wall plaster, stove maker, dolomite, pot, mirror, cooking articles of clay, granite, porselen, etc.
Plastic and Rubber	Kinds of plastic bag, household equipment, cosmetic packaging, polybag, sack, stoperred glass, tool box, toys, electricity equipment, waterboard on the roof, motor vehicles part, pipe, rubber, stereform, balloon, sparepart vinyl, gypsum, slippers, shoes, plastic wrapping, button cloth, car seat cover, rubber string, water tank, place medicine, tarpaulin, air filter polycon, cover bottle, plastic laminating, recycling mineral water plastic, polipropelene plastic, etc.
Textile	Sewing fiber, screen printing convection, batik, string, thread, towel, knitted fabrics, duster, mouth mask, clothes, carpet, spinning, pillowcase, curtains, mat, hat, mine belt, table cover, embroidery, calico, weaving of textile, blanket, bandage fabric, sarong, mat, gloves, cuttons, etc.
Electronic	Equipment electricity, stabilizer, etc.
Other Manufacturing	Tobacco, furniture, parguet, cigarette, printing, bag industry, shoes, film poster, cutting wood, wood processing, etc.
Retail	Supermarket, grocery, food, rice, medical, jewelry, handphone, sand, household, fried oil, wood, gold, iron, furniture, material, piano, fruit import, computer, equipment, lamp, interior of house, agriculture, etc.
Other Service	IT, Service of motor vehicle, transpor section I (ekspedisi, mobiler, service shipping goods), etc.