

Governance Capacity of Local Government in Empowering Small and Medium Enterprises in Indonesia

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Abstract

Local governments play a strategic role in promoting regional economy. However, case studies on economic empowerment of the people indicate a less optimally stipulated target of the government in terms of financial capacity, human resources and program effectiveness. Such a condition might be due to the lack of governance capacity of the local government in empowering small and medium enterprises (SMEs). This paper discusses the role of local governments in supporting local businesses and their governance capacity required to play such a role. A case study is provided of four local governments in Indonesia. We find that both inside-out and outside-in factors influence local governance capacity. By inside-out factors we mean the governments's self-disclosure in their cooperation with stakeholders to optimize the use of resources and their public accountability. The outside-in factors includes the challenges and barriers to the administrative environment that affects governance capacity.

Keywords: governance capacity, local government, local economic empowerment, small and medium enterprises, Indonesia

INTRODUCTION

Local governments play an increasingly important role through the implementation of decentralization and regional autonomy in Indonesia. In accordance with Law No. 32 of 2004 on Regional Government, local governments, serving as local authorities, have rights, authorities and duties to regulate and administer their local affairs and to serve the interests of local communities. The law regulates the division of power between local government agencies and provides discretion in the implementation of government affairs and public service. One field in which local governments (Pemda) play an increasingly important role, is local and regional economic development.

However, in practice, decentralization and regional autonomy in Indonesia is still regarded, in most cases, as being sub-optimal. This is attributed to the ambiguous authority relations among government agencies, lack of capacity within the local apparatus, lack of a governor role in interregional coordination, creation of new district that runs counter to what was intended, lack of interregional cooperation in the provision of public services and the improvement of people's welfare (Bappenas, 2004). Also, in the field of local economic development, it is questioned if local governments

hold the governance capacity needed to empower small and medium enterprises (SMEs). This paper, therefore, discusses the role of local governments in supporting local business and the governance capacity required to play such a role.

First, we discuss the role of local government in local economic development. Next, we provide a discussion of what constitutes local governance capacity and how such capacity can be assessed. We conclude our theoretical section with a discussion of what factors can be expected to influence local governance capacity. A case study is provided of four local governments in Indonesia. We assess local governance capacity in these four cases and discuss both inside-out and outside-in factors that influence local governance capacity. By inside-out factors, we refer to the local governments's self-disclosure in their cooperation with stakeholders to optimize (the use) of resources and the public accountability. The outside-in factors include the available policy framework and community resources that affects governance capacity.

LITERATURE REVIEW

1. The Role of Local Government in Local Economic Development

In regional economic development, the role of local government (Pemda) is increasingly strategic. Local governments are expected to create a business climate conducive to the growth of local economic activities (Bratakusumah, 2001). The role of government has shifted from being a provider to being a facilitator, motivator and catalyst in all regional economic activities. Bratakusumah (2001) describes how local government should create a conducive atmosphere for nurturing the self-employment and entrepreneurial spirit of its citizens. Equal opportunity should be offered to people who want to engage in economic activities. Incentives that local government should be providing to support the development of local economy include openness and ease of getting information, ease of licensing, appropriate and definite taxation and levy procedures, reasonable land prices, provision of environmental infrastructure and public works, supply of energy resources and provision of telecommunications and information infrastructures.

Blakely (2013) describes four functions of local government in the creation of local economic environment; as entrepreneur/developer, coordinator, facilitator,

stimulator or a combination of these roles. To serve as entrepreneur or developer means to take full responsibility of running a business. Local governments in this role can provide facilities and better opportunities for small businesses, for example by building free internet kiosks. As a coordinator, the government plays a significant role in integrating approaches and resources of various elements to achieve a common goal. Local tourism development, for example, requires coordination between local government, private sector, communities and other interest groups. The role of the facilitator can be carried out by improving the business environment in the region given the available zoning regulation or economic development planning. As a stimulator, the government can play a role in promoting business development and/or maintaining the current progress. For example, the government may implement tax cuts for local business enterprises and cooperatives to optimize their production and to provide rent relief of business premises.

Business is the main driving force of economic development. Local governments, therefore, need to facilitate small businesses to thrive. Small and Medium Enterprises (SMEs) as part of the business sector contribute significantly to the creation of employment, promoting local economic development, income distribution and poverty reduction (Tambunan, 2012). Harvie and Chye Lee (2005: 15) describe the role of local governments in promoting local small business enterprises as follows:

1. Local government needs to establish a level playing field. The fundamental key to a successful SME development strategy is the establishment of a business environment that helps SMEs compete on a more equal basis. For that purpose, it is necessary to evaluate the policies that place disproportionate burden on SMEs, to impose regulations that allow flexibility for SMEs and to put emphasis on competition and procurement policies that grant SMEs access to markets.
2. The government needs to establish public spending projection wisely for the purpose of utilizing scarce public resources on a more effective basis. It is explained that the government needs to design a clear and coordinated strategy for the development of SMEs which can accurately differentiate between equitable distribution and efficiency. In this view, the criteria for determining the performance of this role include monitoring the coverage, cost-effectiveness, financial sustainability and the impact of public spending.

3. Local government needs to encourage the private sector to provide financial and non-financial services for SMEs by building private markets in accordance with SMEs and stimulating market development in terms of supply and demand.

Harvie and Chye Lee (2005) add that the assistance that can be provided by the government for the development of SMEs includes, among others, granting access to finance, provision of infrastructure, training programs, reducing bureaucratic hassle, and creating a pro-business environment. In addition, support for investment in the infrastructure of information, technology and transportation infrastructure will improve efficiency in small business enterprises. Policy makers at the local level may also reduce barriers to trade, because small businesses are often characterized by a weak economy in terms of scope and skill, and, thus, require external practical assistances.

2. Evaluation of Local Government's Governance Capacity

Capacity in Fiszbein's (1997) view represents a tool that enables the government to perform. Government capacity is measured using two main objectives: productive efficiency and distributive efficiency. Capacity for efficient production manifests itself in performance-oriented government. Capacity for efficient distribution is manifested in customer-oriented government. A performance-oriented government will optimize the available resources for the purpose of public service delivery. A public service-oriented government is characterized by the existence of mechanisms through which the general public may express their own views, by efforts to realize public aspirations through activities or government programs, and by government accountability instruments.

For simplicity, capacity can be defined as representing organizational ability to perform works (Yu-Lee, 2002 :1). In the public sector, organizational capacity can be defined as "government's ability to marshal, develop, direct and control its financial, human, physical and information resources" (Ingraham et.al., 2003, p.15). To Ingraham (2005: 392), capacity is a platform for performance or a precondition for performance. Capacity enables both organizations and organizational leaders to utilize and optimize appropriately the resources at their disposal, such as financial, time, and skills.

Definitions of governance capacity itself vary with the perspective and academic arguments promoted by experts. Bhatta (2006: 253) defines governance capacity as the capability of actors, both public (i.e. the government) and private (i.e. companies), to determine and regulate a variety of processes required to produce the goods and services needed by the community. Ideally, the capacity to govern lies in the context of relationship between the government and the governed that allow the public policies and programs to be formulated, implemented and evaluated. Other definitions are developed in the contexts of policy (Brusis, 2003) "*A set of skill and resources that enable reform policies geared to the strategic aim of democracy and market economy.*", regional governance (Foster and Barnes, 2012) "*Regional governance as deliberate efforts by multiple actors to achieve goals in multi-jurisdiction environments .*" (Le Gale's, 1995a)" Governance is the capacity to integrate and give form to local interests, organizations and social groups, on the other hand, the capacity to represent them outside, to develop more or less unified strategies towards the market, the state, other cities and other level of government.", economic development (Frischtak, 2004)" Governance capacity understood as the ability to coordinate the aggregation of diverging interest and thus promote policy that can credibly be taken to represent the public interest.", and state capacity (Migdal, 1988 "*Governance capacity as state capacity defines as the ability of the state to write rules for the game that holds sway throughout society and supersedes any pre-existing rules that are in conflict with its own.*"; Grindle, 1996 "*State capacity as the capacity to set institutional structure conducive to economic growth, to manage economic policy, and to carry out basic public function.*"; Polidano, 2000 "*State capacity as freedom to take decisions, ability to take informed decisions, and ability to have those decisions implemented.*"; Tiihonen, 2004). In this paper, the capacity for governance is defined *as the ability to manage the appropriate way to serve the needs of the community by optimizing resources, building government and community interaction, determine the limits and constraints as well as orienting to the achievement of institutional performance and public accountability.* Thus the notion of governance capacity in this paper is not limited to the capacity of governments that tend to maximize organizational performance, but it also includes the ability and willingness to be accountable for their work to the general public.

Jooste (2008), based on the views of Grindle and Hilderbrand (1995), Grindle (1997), Franks (1999) and Levy (2007), summarizes three elements of government

capacity, namely (1) the institutional level, (2) the organizational level, and (3) the individual level. Government capacity at institutional level focuses on the institutional context and the action environment in which the government works. The institutional context include rules, norms and values (including beliefs) that determine a person's actions and behavior (North, 1990, Scott, 2001). The action environment includes aspects of political stability, fiscal capacity, policy framework and the power of civil society and the private sector (Grindle 1997). Organizational capacity comprises the structure, process, resources, and management style of public sector organizations (Grindle and Hilderbrand, 1995). Included in the organizational capacity are bureaucratic capability, both financial and administrative capabilities (Levy, 2007). As for the individual capacity, Franks (1999) defines it as comprising individual knowledge, skill and attitude and competence to bear responsibility and carry out tasks, separated from or part of a group.

Governance capacity that is necessary for local government in facilitating SMEs should be directed to three elements, namely (1) institution, (2) policy and (3) management. These are crucial elements in regional administration. Concerning the achievement of government performance, public administration literature explains that government performance is determined not only by administrative competence, but also by political choice, political structures and other institutional influences (Donahue, Selden and Ingraham, 2000: O'Toole & Meier, 1999). The question subsequently arises what distinguishes government capacity from governance capacity? The analytical framework in this paper is directed toward local government as one of the actors in governance that plays a critical role in governing and facilitating the development of SMEs. Governance capacity may belong either to government or non-government actors. On the locus of local government, the governing process will lead to how the local government devises the right method and involves the stakeholders of SMEs to manage them. Government capacity is inclined more to the organizations' internal accountability, while governance capacity includes the principles of public accountability.

Bhatta (2006) defines institutional capacity as “the capacity of government institutions to enforce the rules of the game to ensure that there is a level playing field and to regulate economic and administrative activity in its own jurisdictions”. Another definition of institutional capacity within the scope of state capacity is described by

Grindle (1996) as authoritative and effective rules of the game to set the economic and political interaction. The focus of Grindle's conception, therefore, refers to the policy framework and rules of the game in the economic and political domains and the extent to which public officials are accountable for the rules. The concept of institution itself is frequently refers to the institutions involved in the governance. Dwiyanto (2004) noted that in the discussion of studies on governance, public administration institutions are not limited to government agencies, but also involve other institutions, such as market mechanisms and civil society organizations.

The notion of institution mentioned earlier is part of conception of institution itself. In American Heritage Dictionary, we can find three types of institutions: (1) institution as a norm, (2) institution as rules of the game, and (3) institution as institution. In Crawford and Ostrom (1995), institution is defined as rule, norm or strategy that creates incentives for behavior in repetitive situations. Institution can be formally described as the form of law, policy, or procedure, or as something informally as informal norms, standard operation practices or customs. Thus, institutional capacity is the capacity to adopt or generate rules, norms or strategies used as collective rules of the game.

In empirical practice, institutional capacity in Indonesian government administration is regulated by Presidential Decree No. 59 of 2012 as follows:

- a. Structuring of local government organization in the right function and size through evaluation and analysis of departmentation and specialization of the working units of local government organizations.
- b. Improvement of the work mechanism and method as well as working relationships between organizational units of local government and other parties.
- c. To formulate of noble values as organizational culture and to instill organizational culture on each individual.
- d. Strengthening and consolidating of the budget allocation method in accordance with the vision, mission and goals of governance and the development of local revenue sources.
- e. Provision of infrastructures and facilities in accordance with the predetermined standard.

- f. Provision of standard operating procedures (work procedures) and the application of modern working methods based on science and technology in government administration.

Bhatta (2006) defines policy capacity as: (1) the ability to formulate and recommend quality policies to the policy makers; (2) the ability of the government to ensure that the policy-making process is structured and efficient, including making sure the benefit of involvement and of the input from stakeholders. Painter (2002) and Peters (1996) define capacity as the ability to collect necessary resources to make smart collective alternative and to set strategic direction for the allocation of limited resources for public purposes. In his other work, Peters (1996) noted that the government policy capacity focuses on 2 aspects of policy making: (1) capacity to translate public aspiration into public policy and (2) the use of knowledge in the policy making process. Thus, in this article, *policy capacity is referred to as local government's ability to generate policies in accordance with the demands of public aspiration and the ability to invite public participation in the decision-making process.*

In the Presidential Regulation of the Republic of Indonesia No. 59 of 2012, Chapter II Article 5, paragraph 2, it is explained that the capacity building for policy-making in Indonesia is conducted through:

- a. Regional policy-making process in accordance with the demands and conditions of the regional administration
- b. Improvement of policy-making method and mechanism
- c. Public participation in policy making.
- d. Performance assessment of each policy to determine the success and failure of each
- e. Socializing each policy to the regional administration to generate a complete and thorough understanding of every policy.

The third element of governance capacity, that is management capacity, is defined by Selden and Sowa (2004) as *the degree to which the necessary systems and processes are in place to maintain an organization.* Ingraham's (2003) management capacity model describes four management subsystems in management capacity which includes financial management, human resource management, capital management and information technology management. In relation to government, management capacity is defined as the ability embedded in the government to organize, develop, direct, and

control human resources, physical resources, and capital resources to improve the flexibility in policy direction (Ingraham & Donahue, 2000: 294). Boyne (2010) adds to this a fifth element, that is leadership.

Human resource capacity as the element of management capacity of local government is described in Presidential Decree No 59 of 2012 as conducted through formal education, training and course, seminar, apprenticeship, advocacy, personality education and in-service education. Management capacity is also a concept that represents the capacity of two elements: manager quality and management system (Ingraham et.al, 2003). Governments with stronger manager and healthier management system are usually better performed. In this writing, management capacity is directed to the organizational capacity to manage its human resource, financial, and information by public manager in an organizational management system.

4. Factors Affecting Governance Capacity of Local Government

Factors that influence governance capacity of local government in empowering SMEs are analyzed in three aspects: (1) policy framework of central government in developing and empowering SMEs, (2) local government openness to cooperation, and accountability for the implementation of SMEs empowerment and (3) the utilization of community resources in the development and empowerment of SMEs.

The central government's policy framework is often considered to be one of the factors that affect governance capacity of local government (Giguere, 2007). In the context of economic development, Adelman (1999) elucidates the need for sufficient autonomy that is accommodative to economic development. Thus, the framework of central government policies is evaluated to determine the extent to which it is conducive to effective regional development (OECD, 2011). A study by Triastuti (2004) on local financial independence suggests that the regulatory framework for the receipt, management and expenditure of regional finance is inseparable from the policies of the central government. Both the composition and the rules of the central government are among the causes of financial independence and/or dependence at the local level.

The capacity of local governments is often considered inadequate by the central government, whereas in fact the central government is also inadequate in solving regional problems (Litvack et al, 1998). The relationship pattern between central

government and local government often leaves no room for the latter in terms of guidelines, resources, and incentives that will support local capacity. Agreement on the publicly accepted standards for regional public service remains an issue in the relationship between government departments (Ahmad and Searlie, 2005). From the above description we can see a few things related to the central government's policy framework and its influence on governance capacity of local governments, namely a clear direction from the central government in the implementation of regional development, the discretion in the implementation of development and the mismatch between the authority granted and the necessary supporting resources.

The second factor is local government openness to fostering cooperation for development and empowerment of SMEs. A study on governance capacity conducted by Lafortune and Collin (2001) indicates that there are collaborative actors capable of influencing the governance capacity of the government. Collaboration is possible when there are willingness and openness on the part of local governments to foster cooperation in developing and empowering the community. More specifically, Kim (2009) describes the need for local leadership capacity that is able to collaborate with a variety of stakeholders, both internal and external, to strengthen the management capacity of local governments. With the openness to collaborate and share knowledge with internal and external stakeholders, such as business sector, universities, community organizations, international organizations and other local governments, local governments will have more flexibility to adopt multiple frames to improve their management capacity.

In addition to local governments' openness in relation to their management capacity, openness in terms of political and management accountability is indicated as having significant impact on the improvement of their governance capacity. If the government really pays proper attention to its performance accountability, especially in terms of feedback on and evaluation of the performance improvements in the near future, this will pave the way to the improvement of the governance capacity of local governments as a whole.

Accountability in this context is the obligation of public authorities to be answerable before institutions or actors who gave them the mandate for the actions they performed or not performed (Lombaerde, et. al. 2008). Broadbent and Laughlin (2003), in Kluvers (2010), argue that there are two aspects of accountability: public/political

accountability and managerial accountability. In the concept of political accountability, the public is placed as the principal and focuses on issues of democracy and trust. On the other hand, managerial accountability is related to day-to-day activities of an organization, which can be equated with the concepts of processes, performance, and program accountabilities (Stewart's [1984] in Kluvers [2010]).

With such accountability the local governments can manage their capacity to achieve the desired expectations, both expectations of higher levels of government (upward accountability) and of the community (downward accountability). From an understanding of local governments' openness to cooperation and of their performance accountability, we can identify several points about the relationship between the openness of local government and governance capacity; government willingness to open up to cooperation by information and knowledge sharing, the approach to the management of development, and accountability to the central government and the public on the development progress.

The third factor considered as having influence on the governance capacity of local government is the optimization of community resources for the development and empowerment of SMEs. Resources available in the community, according to Wood (1981), consist of people, institutions, industries, and materials. Meanwhile, Brooks (ed.2005) suggests that they can be economic, people, physical and political resources. In a more specific context, resources can be divided into two: those inside the community and those outside the community. The latter can be held by members of the community who have relationships with government, business, or non-profit organizations that can provide resources to the community. In the business context of regional area, community resources for business can be a local chamber of commerce and industry, small and medium enterprise development center, business associations and business service unit of the banks. Optimization of existing community resources may encourage participation of stakeholders of development, which is the base of the formation of local governance capacity.

RESULT AND DISCUSSION

Governance Capacity of Local Government in Empowering SMEs

1. Regional Program for SME Empowerment

Studies conducted in four cities indicated variation in the number of existing SMEs, the number of SMEs served by local government and the scope of empowerment programs.

Table 5.1.1 Scope of SME Empowerment

| City | Bandung | Cimahi | Surakarta | Yogyakarta |
|-----------------------|--|--|--|--|
| Total Area | 167,67 km ² | 40,2 km ² | 44,04 km ² | 32,5 km ² |
| Population | 2.689.267 (2012) | 541.177 (2010) | 545.653 (2012) | 428.282 (2013) |
| Number of SME | 333.000 (2012) | 7.119 (2013) | 10.630 (2011) | 21.536 (2011) |
| Pemda-Assisted SME | 4.512 (2012) | 2000 (2012) | 1.203 SMEs and 60 Cooperatives (2011) | 1.147* (2011) |
| Scope of SME Programs | <ul style="list-style-type: none"> • Fostering a business climate • Business development • Financing • Partnership | <ul style="list-style-type: none"> • Fostering a business climate • Business development • Financing • Partnership | <ul style="list-style-type: none"> • Fostering a business climate • Business development • Financing • Partnership | <ul style="list-style-type: none"> • Fostering a business climate • Business development • Financing • Partnership |
| Related Agencies | Departments of Cooperatives, SMEs, and Industry & Trade | Departments of Cooperatives, MSMEs, Industry and Agriculture | Departments of Cooperatives and MSMEs | Departments of Industry, Trade, Cooperatives and Agriculture |

*from group monitoring and assistance by facilitators.

Source: compiled from studies (2014)

Difference between the actual number of SMEs and the SMEs that receive assistance from local government indicates a less comprehensive scope of services. Local government sets out different activities to empower SMEs. The number of SMEs served in an activity intended for their empowerment and development ranges from 200 to 300. Thus, if 12 activities were allocated in a year within various programs for SME empowerment, there will be only about 3600 SMEs to be facilitated by local governments annually. In a Report on Accountability and Performance of Government Institutions (LAKIP) of SME empowerment-related agencies, it is explained that the constraints impeding local governments' implementation of SME empowerment activities are lack of supporting personnel resources and the limited amount of available budget. Therefore, the scope of this policy for SME empowerment is closely related to the resources available to local governments.

By resources we mean budget, human, and physical resources allocated for the facilitation of small business enterprises in local areas. Based on the indicative ceiling in 2012, budget for the field of cooperatives and SMEs in Cimahi was IDR 3,959,664,000.00. Compared to the total regional spending in 2012, this allocation is not more than 0.5% of the Cimahi expenditures in 2012 (Cimahi expenditure based on budget for 2012 is IDR 905,512,233,341.00). In Bandung, the amount of budget for official program and activities is also considered to be one of the constraints that affect the capacity of agencies in providing services to small businesses. Budget realization for departments of cooperatives, SMEs and Industry and Commerce in Bandung in 2011 was IDR 3,967,160,025.00 or 91.47% of the projected budget plan of IDR 4,339,449,050.00. In Yogyakarta, direct expenditure for the Department of Industry, Trade and Agriculture in 2013 was IDR 3,253,443,825.00. Compared to the total direct expenditures for local governments, such allocation constitutes less than 0.5%. Local government of Surakarta allocated a ceiling of IDR 3,696,142,000.00 in 2012 for cooperatives and SMEs. As for the total direct expenditure ceiling of Surakarta in 2012, it amounted to IDR 450,305,367,000.00.

In addition to the budget allocation of about 0.5% of total regional expenditures, local government financial resources are limited in terms of fiscal capacity. Local governments still rely on revenue from the central government. In Cimahi's budget for 2012, Cimahi balance fund in 2012 was IDR 535,081,845,313.75, and its local revenue was IDR 110,095,908,599 (see local revenue 2012 of Cimahi based on Regional Regulation No. 3 of 2012 dated January 19, 2012). 63.46% of the revenue of this city is derived from the balancing funds. The locally-generated revenue (PAD) of Bandung for 2012 was IDR 933,920,994,572,00, and the balancing fund was IDR 1,794,296,154,447,00. This position puts the city of Bandung on a percentage of 40.70%,

based on the balancing fund allocated by the central government. Meanwhile, based on the regional budget for 2012, 63.93% of total regional revenue of Yogyakarta was supported by the balancing funds from the central government (Based on the budget of Yogyakarta in 2012 (Local Regulation No. 8 of 2011 dated December 29, 2011) it is known that amount of local revenue of Yogyakarta was IDR 241,190,745,004.00, while its balance funds was IDR 575,131,711,129.00). Surakarta, compared to other three cities, remained heavily dependent on the balancing fund in 2012, i.e., 67.96% of total regional revenue.

Public service personnel resources for small businesses in the regional area are indicated as less optimal, both in terms of quantity and competence. It is revealed from field interviews and analysis based on facts on the ground. By focusing on the departments of cooperatives and SMEs as institutions responsible for their role in the affairs of local small businesses, it can be seen that the Cimahi, Bandung and Yogyakarta have the same number of public officials, i.e., 12 persons in the field of cooperatives and SMEs, while Surakarta has only 7. Of course, this number is not proportional to the number of existing small businesses in the regional areas. In fact, the total number of personnel in the department of cooperatives and SMEs is still relatively small compared to the number of local small business enterprises (Department of Kopindagtan of Cimahi has 95 civil servants that serve 7.119 SMEs. Bandung has 125 civil servants and 283.425 SMEs in 2012. Yogyakarta has 131 civil servants at perindagkoptan department serving 22,091 SMEs. Surakarta has 43 civil servants at the departments of cooperatives and SMEs, serving 10,631 SMEs). Indeed, with such a small number of personnel, provided that they are highly competent and capable, they will be able to improve governance capacity of pemda in managing small business enterprises. However, the facts on the ground indicate that the turnovers in the structural positions of government departments in Cimahi are frequent to occur for the reasons of incompatible educational background. The competencies of the executive officers remain the issue in the development of MSMEs of cooperative department and SMEs in Yogyakarta. On the other hand, Bandung and Surakarta put more emphasis on performing the tasks of implementing apparatus than on the services they should be providing.

The responsibility for the procurement of physical resources “By physical resources we mean physical facilities provided by local government for small and medium enterprises, such as technology, capital assistance, and technical training”, for the empowerment of small businesses in regional areas belongs not only to a particular department in local governments, but also to other related departments. In 2012 Cimahi provided facilitation of product packaging to 50 SMEs, e-commerce and websites training to 50 SMEs, technical training of food processing to 100 SME cadres, and the provision of infrastructure and facilities of product promotion in an exhibition. Bandung, in 2009, provided facilitation for organizing exhibition to 100 SMEs, small industry consultation to 400 SMEs, and entrepreneurship training to 210 SMEs.

In the same year (See RKPD Kota Yogyakarta Tahun 2011). Yogyakarta provided area-based economic empowerment (PEW) to 413 groups, constructed griya UMKM (MSME house) and operationalized a Technical Management Unit for Metal Processing (UPT Logam). Moreover, in 2014 the department has provided facilitation for kiosks leasing at XT Square to 14 FORKOMs of subdistrict level and 3 kiosks for members of DEKRANASDA. Surakarta, in 2011, provided generator sets to use in MSME exhibition and additional financial capital to 141 cooperatives, MSMEs, and JVG (Joint Venture Group). In view of the number of physical resources and facilities provided, facilities in the form of physical resources acquired by the local government remain limited. And the number of recipient SMEs was also limited, i.e., 200-300 per year or 50-100 SMEs per program. Such a condition is still far from ideal, as complained by small business in leather industry in Yogyakarta who expected equipment assistance for efficiency and optimization in production, which can not be provided by the government. In an interview, Chairman of FEDEP Surakarta explained that the needs of SMEs are often not in accordance with business needs. Consequently, there is a mismatch between physical aids provided and the actual needs of SMEs.

The programs organized local governments to empower SMEs can be seen in table 5.1.2 below.

Table 5.1.2. Local Government Programs for Small Business Enterprises

| City | Programs intended to develop and empower small business enterprises |
|-------------------|---|
| Bandung (2012) | 1. Programs to create an SME-friendly climate 1.1. Facilitation for Small and Medium Enterprises development 1.2. Policy making on small and medium enterprises 2. Entrepreneurship development and competitive advantage programs 2.1. Entrepreneurship training event 2.2. Training for the Management of Cooperatives/KUD 2.3. Facilitation for the development of product promotion facility 2.4. Introducing Intellectual Property Rights to SMEs 3. Business support systems development program for MSMEs 3.1. Facilitation and Intermediation for SMEs |

| | |
|----------------------|---|
| Cimahi (2012) | <ol style="list-style-type: none"> 1. Programs to create an SME-friendly climate <ol style="list-style-type: none"> 1.1. Network Infrastructure Development for SMEs 1.2. Facilitation for formalization of SMEs 1.3. Facilitation for SME development 2. Support System Development Program for MSMEs <ol style="list-style-type: none"> 2.1. Extending support system for information of capital provision 2.2. Development of marketing facility for MSME products 2.3. Promoting MSME products 3. Entrepreneurship and competitiveness development programs <ol style="list-style-type: none"> 3.1. Entrepreneurial Training Organization 3.2. MSME Product promotion |
| Surakarta (2012) | <ol style="list-style-type: none"> 1. Programs for creating SME-friendly business climate <ol style="list-style-type: none"> 1.1. Facilitation for SME formalization 1.2. Facilitation for SME development 2. Programs for entrepreneurial and SME competitiveness development <ol style="list-style-type: none"> 2.1. Facilitation for technology and business incubator development 2.2. Facilitation for promoting MSME business partnership 2.3. Facilitation for product promotion facility development 2.4. Entrepreneurship training event 2.5. Cooperative/KUD management training 2.6. Familiarizing MSME to Intellectual Property Rights 3. Support system development program for micro, small, and medium enterprises <ol style="list-style-type: none"> 3.1. Introducing supporting information on capital provision 3.2. MSME product promotion |
| Yogyakarta (2012) | <ol style="list-style-type: none"> 1. Entrepreneurship and competitiveness development programs for SMEs <ol style="list-style-type: none"> 1.1. Promoting cooperation networks development for MSMEs and investment promotion 1.2. Facilitation for MSME resource development 1.3. Study of MSME resources 1.4. MSME resource development 1.5. Regionally based economic empowerment 1.6. Human resource development training 1.7. Facilitation for appropriate technology application for MSMEs 1.8. Facilitation for development and innovation of MSME products 1.9. Facilitation for empowering Sharia-compliant financial institution 1.10. Improving the performance of micro financial institution, cooperatives and BUKP 1.11. Development of Unit for Metal Processing (UPT Logam) |

Source: RENJA Tahun 2012 Dinas Perindustrian Perdagangan, Koperasi dan Pertanian Kota Yogyakarta; Penetapan Kinerja 2012 Dinas Koperasi dan UKM Kota Surakarta; LPPD Kota Bandung Tahun 2012; RKPD Kota Cimahi Tahun 2012

The programs organized for small businesses in local areas in 2012 show that there are three important roles of local government, i.e., to grow business-friendly climate for SMEs, to facilitate business development and to build facilities for business development. However, the interpretation of those three roles seems to differ between municipal governments. Facilitations were mostly directed to the programs for SME development or to the issues directly confronting SMEs in local areas, such as lack of capital, product promotion, technological utilization in production and entrepreneurial training. Law No. 20 of 2008 on Micro, Small and Medium Enterprises implies that the role of the central government and local governments can be divided into four: first, the role in fostering the business-friendly climate by establishing laws and policies that govern aspects of funding, infrastructure, business information, partnership, business licensing, business opportunities, trade promotion and institutional support; second, the role in business development through the facilitation in the fields of production and processing, marketing, human resources, design and technology; third, the role in providing financing to SMEs, which may include providing incentives in the form of ease licensing requirements, infrastructure tariff relief and other incentives (See article 21 Law No 20 of 2008); and fourth, the role in facilitating, supporting and stimulating partnership activities. These roles are in line with what was proposed by Hill (2002), who classifies SME development policy instruments in Indonesia into financial assistance, technical assistance, rules and guidelines.

2. Evaluation of Governance Capacity of Local Government in SME Empowerment

The three elements used to analyze the governance capacity of local government in empowering SMEs can be seen from the description in the table 5.2.1. On the whole, governance capacity of local governments in the case studied can be seen from the persistence bureaucratic obedience to superiors, instead of sticking to the vision and mission of the organization (vision and mission of the departments and municipal government). The constraints in managerial capacity aspects such as budget constraints, human resources and weak coordination have become the common issues in the four research sites. SME fundamental issues such as those in marketing, capital, raw materials and human resources have not been optimally addressed in the programs and activities of the city government. In fact, the latter argues that it is a matter of budget constraints and personnel in conducting the assistance. The above-average performance, more than 90%, indicates the internal performance of departments in implementing the planned

programs and activities. Yet, this has not indicate the scope and reach in terms of number of SMEs, and the effectiveness of activities measured forward with additional indicators—benefits and results. Moreover, LAKIP as an agreed-upon accountability norm has been implemented as a part of upward accountability, yet it has not indicated similarity in terms of report structure, especially at department level. The role of SME stakeholders remains untouched either in the accountability report or Information on Regional Government Arrangement Report (ILPPD) (According to Government Regulation No. 3 of 2007, local government accountability mechanisms are categorized into three, namely LPPD or Local Government Administration report to the central government, accountability report of regional head to regional parliament and LPPD to the public.) Minimum standards for SME empowerment are unavailable at the research sites. It is the program implementation and activities according to Law on SME empowerment that is used as an institutional guidance for the provision of services. Therefore, the performance measure for each local administration varies with the interpretation of the programs to be implemented, sufficiency in facilities and resources.

Table 5.2.1. Governance Capacity of Local Governments in Empowering SMEs

| Elements of Governance Capacity of Local Government | Bandung | Cimahi | Surakarta | Yogyakarta |
|--|---|--|---|---|
| <u>Institutional Capacity of Pemda :</u> <ul style="list-style-type: none"> Adoption of Law No 20 of 2008 as a reference to facilitate SMEs Organizational structure of related departments Vision and mission as a reference for related departments | Internal to pemda. Overlapp in the internal assistance of related departments. | Especially in related departments. Differences within departments and pmdas | Internal to related departments. Emphasis on micro concept and facilitation. | Internal to related departments. Micro concept and elements of empowerment emphasized. |
| | 1 head of department, 1 secretariat, 6 fields, UPT and functional position | 1 head of department, 1 secretariat, 3 fields, UPT and functional position. | 1 department head, 1 secretariat, 3 fields, UPT and functional position | 1 department head, 1 secretariat, 5 fields, UPT and functional position. |
| | Vision and mission and related sectoral departments | Latest vision and mission reflect internalization | Vision and mission represent program | Segmentation and differentiation of vision and |

| | | | | |
|---|---|---|---|--|
| <ul style="list-style-type: none"> LAKIP as an accountability norm of pemda Minimum Service Standard (SPM) for SME Development | <p>There is LAKIP of pemda and related departments</p> <p>No special SPM for SME development</p> | <p>and externalization of departments</p> <p>There is LAKIP of pemda and related departments</p> <p>No special SPM for SME development</p> | <p>direction and the activity of related departments</p> <p>There is LAKIP of pemda and related departments</p> <p>No special SPM for SME development</p> | <p>mission within related departments.</p> <p>There is LAKIP of pemda and related departments</p> <p>No special SPM for SME development</p> |
| <p><u>Policy Capacity of Pemda :</u></p> <ul style="list-style-type: none"> Regional Regulation Governing SMEs Mechanism of Public and SME Participation in City Economic Development Planning Policy Implementation | <p>Regional Regulation No 23 of 2009 Involvement in Musrenbang</p> <p>97,67% (2011)</p> | <p>Regional regulation No 12 of 2012 Involvement in Musrenbang. Domination of technocratic and political aspects</p> <p>100% (2011)</p> | <p>No perda in question. Involvement in Musrenbang</p> <p>82,53% (2011)</p> | <p>Regional Regulation No 4 of 2011 Involvement in Musrenbang Accommodation of aspirations set out in the Renja of related departments.</p> <p>99,67% (2011)</p> |
| <p><u>Policy Management Capacity of Pemda:</u></p> <ul style="list-style-type: none"> Human resources of related departments Budget allocation for related departments Komunikasi dan alur informasi dinas terkait | <p>Field of MSME 13 staff</p> <p>IDR 730.729.250,00 (2011)</p> <p>Internal to departments and SKPD External to centers, associations,</p> | <p>Field of Cooperatives and MSME 12 staff</p> <p>IDR 785.000.000,00 (2011)</p> <p>Internal to departments and SKPD External to FK-PEL, forum musrenbang,</p> | <p>Field of MSME 7 staff</p> <p>IDR 1.593.775.000,00 (2011)</p> <p>Internal to departments, sekda, Bappeda, kelurahan External to</p> | <p>Field of MSME resource development 12 staff</p> <p>IDR 1.355.000.000,00 (2012)</p> <p>Internal to departments and SKPD External to FORKOM, universities and</p> |

| | | | | |
|--|----------------------|----------------------|-------------------------|-------------|
| | vertical agencies | vertical agencies | related associations | third party |
|--|----------------------|----------------------|-------------------------|-------------|

Source: compiled from studies (2014)

Thus, we can see from tables 5.2.1 and 5.1.1 that governance capacities of local governments remain less optimal in empowering local SMEs. Local governments have yet to find the most appropriate way in dealing with business affairs. The conventional way to do so is by compiling the programs in accordance with the available budget and organizes them with limited resources. However, this will not alter significantly the development of SMEs. The development of local SMEs requires cooperation with parties to facilitate the promotion and development of SMEs.

External and Internal Factors Affecting the Governance Capacity of Local Government in Empowering SMEs

1. Government Policy Framework for Empowering SMEs

The government policy framework for empowering SMEs can be seen from the Laws that include the implementation of SME empowerment: Law No 32 of 2004 on Regional Government, Law No. 33 of 2004 on Fiscal Balance between Central and Local Governments, and Law No. 20 of 2008 on Small and Medium Enterprises. Law No 32 of 2004 clearly authorizes local government to carry out what is compulsory for them (Chapter III articles 13 and 14), that is to facilitate the development of cooperatives and small and medium enterprises. Law No 33 of 2004 regulates the mechanism for financing decentralization affairs mandated to local administration. The scope of SME empowerment is regulated in details in Law No. 20 of 2008.

Law No. 20 of 2008 authorizes local governments to empower SMEs by creating a SME-friendly climate, business development, finance and SME development cooperation. In terms of fostering the business climate, local governments are authorized to establish laws and policies covering aspects of funding, infrastructure, business information, partnership, business licensing, business opportunities, trade promotion and institutional support. For the purpose of business development, local governments facilitate the production and processing, marketing, human resources, and design and technology. Furthermore, in terms of financing, local governments can provide incentives in the form of ease of licensing procedures, infrastructure tariff relief, and other incentives. In the case of partnerships, local government, business and society facilitate, support and stimulate partnership activities based on mutuality in trust, support, and profitability.

Government regulation for the implementation of Law No. 20 of 2008 which should have been enforced in a period of one year after the law was enacted was only imposed five years later in 2013, i.e., by Government Regulation No. 17 of 2013. In this government regulation, empowering SMEs is meant as efforts directed to the development of business, partnership, licensing, and coordination as well as control.

From the SME development policy framework, we can see that the local governments are authorized to empower SMEs. Such framework has been sufficiently comprehensive to give directions to local governments in the preparation of regional regulatory policy related to the development of SMEs. Incentives for SMEs have been provided through regional policy instruments, for example in Surakarta. Therefore, retributions related to people's economy, such as license of household products (PIRT) and trade business license (SIUP), were exempted from charges, effective from the year 2011. Surakarta municipal government has also set local regulations in favor of micro and small enterprises, namely Surakarta City Regulation No. 5 of 2011 on Management and Development of Modern Shopping Centers and Stores. The law is intended to provide protection and to develop SMEs, cooperatives and traditional markets, in the existence of modern shopping malls and stores.

The supporting program in the establishment of a business-friendly environment in regional areas can take the form of a one-stop service that is expected to facilitate small businesses to seek license for their enterprises. The problem is that the local governments have no guidelines concerning minimum service standard for cooperatives and SMEs that refer to the applicable legislations, i.e., Law No 20 of 2008 concerning Micro, Small and Medium Enterprises, and Law No. 32 of 2004 on Local Government. In article 9 Chapter V of Government Regulation No.65 of 2005, it is stipulated that local government applied SPM in accord with provision stipulated in ministerial regulations. However, fields of cooperatives and SMEs have no new provision governing the Minimum Service Standard (SPM) from the central government (other than the Decree of the Minister of Cooperatives and SMEs No. 20 of 2000 which is no longer relevant to the applicable statutory provisions). This condition made the local government interpret themselves the minimum service in the field of cooperatives and SMEs. This is illustrated in the implemented programs and activities. From an interview also, it is known that local government interpret themselves as having provided minimum service when facilitating local business enterprises through technical and capital assistance programs. In terms of infrastructures that support the creation of business-friendly environment, all four local governments under study have already implemented one-stop services for licensing, including that for small business enterprises. But the fact remains that entrepreneurs are still complaining about the services available to them, the example being those in Cimahi who complained that business licensing requires building permits (IMB) is hard for them to fulfill.

Regulations and guidelines from central government for minimum service standards are stipulated in Government Regulation No. 65 of 2005 concerning Guidelines to the drafting of minimum service standard and the application, Regulation of the Minister of the Interior (Permendagri) No 6 of 2007 on Technical Guidelines for Arrangements and Settings of Minimum Service Standards, and Permendagri No. 79 of 2007 on Minimum Service Standards Achievement Plan. Those regulations tend to be directives in nature, and are intended to set standards for minimum services for the total of compulsory functions at regional level. For minimum service standard specifically designed for SMEs, there are no other regulations from the central government than the Decree of the Minister of Cooperatives and SMEs No. 20 of 2000. As described in the attachments to the ministerial decree, minimum service standards for SMEs include 6 aspects: licensing, business designation, type of business, use of products, procurement of goods and services, and legal consultancy for SMEs.

The Decree of State Minister of Cooperatives and SMEs No. 20 of 2000 provides the guidelines concerning the business environment to create for the development of SMEs in regional areas. Thus, policies, strategies, and programs for small business development at a regional level require cooperation with the Regional Working Unit (SKPD), for example in licensing procedures that fall into the authority of integrated licensing service office (KPPT). From programs implemented for local small businesses in the four study sites, it can be seen that all local governments have already implement these programs, either in an effort to create a climate conducive to business or to overcome the problems of small businesses, especially technical and capital issues. The standard of measurement for minimum service provided to SMEs can be a percentage of solved problems or implemented programs. The standard employed in this study refers to the supply-side analysis of local government, i.e., the percentage of implemented programs and of absorbed program budget. However, from the demand-side, there are no regulations or standards by local governments to provide services that conform to the needs of entrepreneurs.

Local government service standard for SMEs can be divided into three: 1) scope or potential number of SMEs to serve, 2) programs for SMEs, and 3) programs to support business-friendly environment for local SMEs. Standard coverage of small businesses served differs from one site to another. From the Accountability Reports of Government Agencies (LAKIP) of Cimahi for 2012 we can see that the targeted facilitation for 2000 SMEs achieved by 100%, thereby include the 40.72% of the number of SMEs in Cimahi in 2012 (4,911). Bandung, with a large number of SMEs, 283,425 (in 2012) could serve only 4,531 (1.6%) of the total number of SME in this city. Yogyakarta had 22,091 small enterprises in 2011, and projected an increase to 23,341 in 2016, thereby necessitate efforts to create 250 small enterprises each year. Surakarta had 10,630 SMEs back in 2011, which means an increase by 1.519 compared to the number in

2010. From the report on realization of the targeted activities of cooperatives and SMEs department of Surakarta, it can be seen that 1,078 SMEs were involved in facilitation activities held by Surakarta municipal government.

2. Community Resource Potential for the Empowerment of SMEs

Local communities involved in SME empowerment varies considerably. In Cimahi, there are many SME and business associations such as KWACI (Komunitas Wirausahawan Muda Cimahi), FKPEL (Forum Kelompok Pengembangan Ekonomi Lokal), DEKRANASDA (Dewan Kerajinan Nasional Daerah), IWAPI (Ikatan Wanita Pengusaha Indonesia) Kota Cimahi, Agricultural Market Association, Association of Small and Medium Agro Enterprises. In Bandung, there are creative communities other that association and institution that deal with the issues confronting SMEs outside the local administration, such as KADIN (Kamar Dagang dan Industri). Those business communities, associations, and institutions in Bandung consist of, among other, Bandung Creative City Forum, AIKMA (Asosiasi Industri Kecil Menengah Agr), HIPMI (Himpunan Pengusaha Muda Indonesia) Kota Bandung, and APJI (Asosiasi Pengusaha Jasa Boga) Kota Bandung. Yogyakarta has FORKOM (Forum Komunikasi UKM di setiap kecamatan), ASPERAM (Asosiasi Pengrajin dan Pengusaha Kecil Mataram) Kota Yogyakarta, DEKRANASDA Kota Yogyakarta, HIPMIKINDO (Himpunan Pengusaha Mikro dan Kecil Indonesia) Kota Yogyakarta. Surakarta has, among others, FEDEP (Forum for Economic and Development and Employment Promotion), ASMINDO (Asosiasi Permebelan dan Kerajinan Tangan Indonesia) Kota Surakarta, and Forum for Kampung Batik Laweyan Development. In addition to association related to SMEs (either as a subsidiary of the central assosiction or as an independently formed entity), there are also banks that contribute significantly to capital provision for local SMEs. They could be national or local banks such as BRI, bank Mandiri, bank BNI, bank Jabar, bank Jogja. Moreover, state-owned and regional government enterprises (BUMN and BUMD) D and BUMSelain itu badan usaha milik negara maupun daerah (BUMN dan BUMD) were also took part in developing assisted SMEs.

Those local communities, both jointly or independently, have assisted and empowered small and medium enterprises in regional areas. In Cimahi, for example, the local communities organized exhibition at certain events, such as Ramadhan bazaar and Sawala Wirausaha Cimahi that was organized in collaboration between IWAPI, PEL, and KWACI. HIPMI have also organized many activities such as entrepreneurial talk shows by inviting successful entrepreneurs. In addition, Bank Syariah Mandiri provides training on people's economy during folk bazaar event. KADIN Kota Banding has a structure dedicated specifically to provide training and consulting for small business enterprises in this city. Activities conducted at training centers and BPPKU KADIN include franchise management training, intellectual

property rights training, website optimization training and business consulting. In Yogyakarta, activities organized by business communities and banks have contributed to the provision of business training for SMEs. These include participation in exhibitions held abroad and facilitated by ASPERAM Kota Yogyakarta, beside exhibitions for craft SMEs organized by DEKRANASDA Kota Yogyakarta. In Surakarta, facilitations for MSMEs were conducted by Center for Cooperatives and MSMEs Assistance of Sebelas Maret University by constructing a business incubator. Assistance for MSME cluster of Surakarta has been provided by FEDEP Kota Surakarta in collaboration with UNS and BAPPEDA Kota Surakarta.

The activities organized by SME associations and stakeholders indicate high facilitation potential for local SMEs. However, those activities were independently organized, neither integrated into, nor coordinated with, activities and program held by local government, thereby the success of SME assistance can not be precisely measured.

3. Local Government Openness to SME Stakeholders Involvement and Local Government Accountability

Important indicators of the presence or absence of governance capacity in local governments in empowering SMEs capacity include their capacity to involve SME stakeholders in policy making, program planning, implementation and evaluation of empowerment activities and programs. SME stakeholders in the four sites studied are mainly engaged in Development Planning Consultation (Musrembang). However, their engagement in Musrembangs at village administrative and municipal levels and public hearing remain less optimal in improving governance capacity of pemda, especially in SME empowerment. This could be due to the fact that they were not engaged in the implementation of the programs. Stakeholder engagement in regional development planning is more to conveying community feedback for the development of SMEs

In Bandung, both Head of SME affairs and Department Head of Small Business Enterprises of the Departments of Cooperatives, SMEs, Industry and Trade, underlie, in an interview, the need to collaborate with partners and other parties, through provincial and central governments, Chamber of Trade and Industry, business associations as well as universities. This is seen as important to facilitate SMEs, considering the limited budget and human resources at the Department of Cooperatives, Industry, and Trade (Diskopindag). For example, Diskopindag may cooperate with the Central Bureau of Statistics (BPS) for data collection on SME contribution to PDRB (Gross Regional Domestic Product). Diskopindag has also invited a speaker from the Ministry of Law and Human Rights to familiarize SMEs with Intellectual Property Rights (HAKI). Moreover, Diskopindag has facilitated SMEs to have access

to banking finance by inviting related banks such as bank Jabar, bank BRI, bank BNI, and bank Mandiri.

In Surakarta, communication between departments and agencies or associations that houses entrepreneurs such as HIPMI, KADIN, ASEPHI, ASMINDO and FEDEP (HIPMI (Himpunan Pengusaha Muda Indonesia), KADIN (Kamar Dagang dan Industri), ASEPHI (Asosiasi Eksportir dan Produsen Handicraft Indonesia), ASMINDO (Asosiasi Industri Permebelan dan Kerajinan Indonesia). Remains incidental in nature, rather than intensive. From an interview with the Head of the MSME department of Surakarta, it can be seen that the coordination between the departments and associations and organizations was a matter of urgency or institutional needs. For example, when there is an activity from the ministry to familiarize patent, the department will inform the number of entrepreneur needed to organize the activity to related associations.

The effectiveness of small and medium enterprise development programs is rarely evaluated by local governments. The reports presented to the public are more about compiling the percentage of the activities carried out and about the budget absorbed. Reports and public accountability have not addressed the effectiveness of the program for entrepreneurs. Entrepreneurs in Yogyakarta, for example, recommend that local government goes down the field to find out their actual condition so that the programs for SMEs are not the ones implemented once a year. In the same vein, Head of KWACI of Cimahi expected openness of local government in terms of providing information concerning services and programs for SMEs. The leadership of DEKRANASDA Bandung and the owner of enterprises implicitly question local government capability in providing data for product exhibition. All these indicate that the services the local governments have been providing are still limited in scope, and provide little feedback for future programs or on the effectiveness of programs for the entrepreneurs. Those who took part in the programs found that they benefit from the activities organized by local government, as stated by the owner of Sumpia in Cimahi. However, those who took less active part in those programs felt that the local governments play a lesser role, as stated by the owner of a dairy stall in Cimahi.

Nevertheless, local entrepreneurs' expectations that sometimes deemed excessive have become the degrading factors to the governance capacity of local government, as noted by Head of SME department of Surakarta. It is the small entrepreneurs themselves that are frequent to expected more assistance from the local government. The funding initially intended for micro business enterprises turned out to be falling into the hands of small and medium entrepreneurs. It is perceived that the mentality of small entrepreneurs who demand more fund assistance from the government, especially from the department of cooperatives and SMEs, has degraded

the capacity to manage SMEs, and, even worst, frustrated the public officials that serve local small businesses.

The effectiveness of services provided to local business can be assessed quantitatively by looking at the percentage of the program that is implemented. In 2012 (Based on LAKIP Kota Cimahi Tahun 2012) Cimahi reported that all the programs have been 100% implemented. This should, however, be viewed from the benefit of the programs for local entrepreneurs. Did the entrepreneurs who participate in the programs were actually benefit from the programs? One hundred percent achievement in this case was actually achievement in an administrative sense, not in substantive one. It can be seen from the implementation of activities that acquired 100% achievement by including small businesses that could be easily contacted or invited to take part. In turn, small business owners, upon knowing that there will be training or exhibition held with financial subsidy from the government, will be eager to take part, regardless of the irrelevance of the training to their type of business. Moreover, those who took part are mostly the workers, not the owners. In Bandung 2012 LPPD, it was reported that the programs for cooperatives and SMEs were 97.67% implemented. Yogyakarta, in the same year, had implemented 88.18% of its program. Surakarta had implemented 94.86% of its programs. These percentages indicate the effectiveness of administration, rather than of local business. Local government performance and accountability in empowering SMEs tend to represent “one-man show”-ness, rather than explaining and paying attention to the involvement of stakeholders in the development and empowerment of SMEs.

In short, the relevance of empowerment policy framework for SMEs, local government openness to the stakeholders’ inclusion, and accountability and potential community resources for SME development to the governance capacity can be seen from the table below:

**Table 6.3. Relevance of Relationship between the Influencing Factors a
and Governance Capacity of Local Government**

| Factors | Empowerment Policy Framework for SMEs | Openness of Pemda to the Inclusion of Stakeholders and Accountability | Community Resource Potential for SME Empowerment |
|---------|---------------------------------------|---|--|
| | | | |

| Relevance of the factors to governance capacity of pemma | Relevance to program arrangement | Relevance to SPM of SME empowerment | Department Organizational Structure of SME empowerment | Manifestation in Regional Regulation Drafting | Involvement of SME stakeholders | Public Accountability | SME stakeholders in SME empowerment | Communication and information of SME empowerment |
|--|----------------------------------|-------------------------------------|--|---|---------------------------------|-----------------------|-------------------------------------|--|
| Bandung | Relevant | Inadequate | Adequate | Available | Mechanism of musren bang | Available | Highly Potential | Less integrated |
| Cimahi | Relevant | Inadequate | Inadequate | Available | Mekanisme musren bang | Available | Potential | Less integrated |
| Surakarta | Relevant | Inadequate | Fairly Adequate | Unavailable | Musren bang | Available | Potential | Less integrated |
| Yogyakarta | Relevant | Inadequate | Adequate | Available | Musren bang | Available | Potential | Fairly integrated |

Sumber : resume of relevance of relationship (2014)

CONCLUSION AND RECOMMENDATION

From our study, a number of conclusion can be derived :

First, governance capacity of local governments in empowering SMEs remains less optimal and varies with the cities studied. Their capacity indicates differences in institutional, policy, and management capacity. In the institutional capacity, the adoption of Law No. 20 of 2008 in the dynamics of preparation of work programs and regulations at a local level differs in intensity between *pemdas*, especially in their capability to accommodate the demand for SME empowerment in accord with their authority. Moreover, the lack of minimum service standard (SPM) in the empowerment of SMEs in each regional administration constitutes another problem in determining the criteria for the achievement in the provision of services for SMEs. In terms of policy capacity, not all cities have regional regulation concerning SMEs, and the inclusion of SMEs and their stakeholders was conducted in development plan consultation. In view of management capacity, local governments' capacity in managing resources remains

limited to the ones available them, rather than integrating and optimizing resources available to the communities and SME stakeholders.

Second, the development policy framework for SMEs authorizes local governments to do their compulsory empowerment of SMEs, despite the fact that they can not fully exercise their authority. This can be seen from the programs planned and implemented for the empowerment and development of local SMEs. Of the various programs for SMEs, those organized by local governments were focused on business development in the form of direct assistance for SMEs, such as in marketing, capital, training, and so on. The programs intended to create a business-friendly climate tend to be subordinated. In fact, the discretion to foster cooperation with SME stakeholders has been stipulated in policy framework, yet the realization still less optimal.

Third, resources available to the communities and SME stakeholders have not been coordinated and integrated by pemda for the purpose of SME empowerment. Facilitation and training were frequently conducted by SME association or community association, banks and State-Owned Enterprises, yet information on the benefit of facilitation for the development and empowerment of local SMEs is still lacking. Empowerment strategies for local SMEs were still directed to individual, not collective, SMEs, therefore local government budget will continue to be insufficient in comparison to the actual number of SMEs that can be a couple of thousands.

Fouth, local government openness to the inclusion of SME stakeholders in SME empowerment was still limited to normative criteria in regional development planning. Accountability of pemda was also limited to internal affairs through such reports as LAKIP. Accountability report as part of public accountability mechanism, in terms of substance and accessibility, remained ignoring the roles of SMEs, stakeholders, and communities in the programs and activities for SME empowerment.

To conclude, we formulate some recommendation for local government in Indonesia

1. Local government or pemda should arrange a Minimum Standard for Local Service (SMPD) that truly reflects the characteristic of local service tailored to local needs based on the minimum service standard available at a central level. This SMPD can be used as an instrument of public control of local government services. For that purpose, a Minimum Standard Services for Small and Medium Enterprises can be arranged. SMPD arrangement refers to the legality of SME Laws and their implementation procedures and the FGD on minimum service requirement of local business communities.
2. The emphasis on program quality for small business by local government without ignoring the wider scope through collaboration with local SME stakeholders is a necessity. A mere emphasis on quantity will transform SME empowerment programs

into project-oriented ones. Assistance for smaller number of SMEs, yet implemented intensely, will be preferable; from initial facilitation to assistance for product competitiveness both at national and international level. This will strengthen the governance capacity of pemda through the track-record of local SMEs and, at the same time, improve the quality of SME management.

3. Empowerment strategies for business communities may generate efficiency in public spending for SME development programs. Moreover, they will strengthen the institution of local SMEs and promote self-governing among the people and business persons, and local government involvement in business will be more focused on the creating of business-friendly climate and on providing business incentives.

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