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## Digitalization in supporting the development of Small and Medium Enterprises (SME) evidence in Indonesia

Wahid Wachyu Adi WINARTO , Islamic State Institute of Pekalongan, Indonesia

### Abstract

The problems that arise in increasing the productivity of SMEs are limited access to formal financial institutions, production technology, human resource capacity, raw materials, and marketing. In addition, SMEs that dominate business units in Indonesia are generally managed informally, with a low level of management education, and labor skills that are not yet optimal. This affects the ability of SMEs to increase business productivity. In general, actors with lower business scales are less likely to innovate, and some of them are even unable to innovate independently. Strengthening innovation for SMEs will support the achievement of inclusive growth by reducing the productivity gap between SMEs and other larger-scale businesses. Increased innovation in SMEs can be optimized by taking advantage of the increasingly accelerated development of the digital economy and finance during the new normal. By utilizing digitalization on SMEs, it will improve performance and result in an increase in the country's economy.

*Keywords: Financial Technology, Digitalization, Small and Medium Enterprises*

### Introduction

Various policies continue to be strengthened for the development of Micro, Small and Medium Enterprises (SME) which have a strategic role in the economy through the pillars of corporatization, capacity, and financing so as to support strong economic growth (Lastauskaite and Krusinskas 2021). SME have a strategic role in the domestic economy, reflected in the large number of business units, high employment, and large contribution to GDP. SME also have high resilience in the face of previous crises, even though the current Covid-19 crisis is placing enormous pressure. So far, the high resilience of SME has played a role as a cushion for the economy because of its ability to withstand periods of stress and be able to re-grow faster and post-stress. With this strategic role, SME certainly play an important role in supporting Bank Indonesia's policy mix to maintain macroeconomic and financial sector stability, as well as national efforts to support economic transformation towards Advanced Indonesia. Various efforts to strengthen SME continue to be carried out end-to-end, including by Bank Indonesia. After the Covid-19 pandemic, the transformation of SME needs to continue to be strengthened through optimizing the use of digital technology so that they can benefit from one of the main lessons of the health crisis, namely the use of digital technology for daily activities.

The rapid development of the digital economy and finance has spawned various digital platforms that offer innovation in production, consumption, collaboration and sharing activities (Abor 2010). This digitalization provides opportunities for SME to adapt and transform in order to survive and rise and grow higher, accompanied by increased corporatization, capacity, and financing (Antill 2022). One of the important lessons in the Covid-19 pandemic is the acceleration of digital use in meeting consumption needs, production activities, and investment transactions. Thus, the use of digital platforms can encourage stronger SME through capacity building that is more productive and

innovative as well as facilitating the expansion of MSME access to both the marketplace, industry and financial institutions (Durst 2012).

The focus of end-to-end MSME development is aimed at strengthening institutions and increasing business scale, increasing productivity through innovation, and expanding MSME access to markets, industry, and financial institutions (van der Crujisen, de Haan, and Roerink 2021). Meanwhile, the MSME development roadmap is aimed at encouraging the establishment of Digital SME and Export SME, with strengthening directed at priority sectors that support export potential and tourism development, as well as strengthening the supply and distribution of strategic food commodities (Ciliberti 2008). The digitization process in every step of MSME development will open opportunities for strengthening the MSME activity chain, starting from production, product processing, marketing, and financing, to produce new digital-based business models that are more efficient and competitive. As a result of the strengthening measures, SME will continue to advance in class and have higher added value both to the domestic economy and in increasing exports.

The use of digitalization for SME needs to be strengthened to support the acceleration of SME development.

The trend of using digitalization in SME has continued to show improvement in the last few years, although there is still room for acceleration and optimization of digitization, especially in the aspect of SME capabilities and supporting infrastructure (Rivza et al. 2019). The SME capability aspect is needed to increase SME access to the digital ecosystem and its utilization for business activities (Tien 2022). This is because SME actors who already have access to the digital ecosystem do not necessarily have a strong understanding of using digitalization to develop business activities. Meanwhile, the infrastructure aspect can be directed at incentives to facilitate ownership of digital technology facilities and infrastructure for individual SME actors as well as infrastructure to support information technology and internet connectivity. The space to accelerate the use of digitization is also reflected in the Index.

Digitalization provides SME opportunities to become stronger and more advanced.

The adaptation and transformation of SME in the use of digitalization will encourage the formation of SME that are not only more resilient, but also more advanced and strong. The rapid development of the digital economy and finance has spawned various digital platforms that offer innovation in production, consumption, collaboration and sharing activities (Rivza et al. 2019). Utilization of digital platforms, including the use of digitizing production processes with product and service innovation, can encourage stronger, more productive and innovative SME. Adoption of new, more efficient business models can be done more cheaply due to lower investment and operational costs. The use of digital platforms also allows SME to be more advanced in line with business expansion opportunities supported by the expansion of SME access to the market (marketplace), industry, and financial institutions. In addition, digital platforms are able to facilitate a better understanding of SME about consumer needs and the overall business environment. The quality of SME services can also improve due to faster, easier and more efficient interactions with consumers and business partners along the value chain.

Digitalization is the entry point for SME to increase market access, not only the national market but also the global market.

SME products that were originally marketed were only limited to local areas, with technology support they can be marketed in a wider market, both nationally and globally (Bejarano and Rey 2021). The SME development space is wide open so that the capabilities of Indonesian SME can be more aligned with international SME, through increasing the export contribution of SME nationally and their role in the global supply chain. Digitalization facilitates the development of SME to not only capture the potential of the large domestic market with a population of 269 million, but also the global export market with a world population of 7.4 billion, or 28 times the population of Indonesia. The use

of digital technology in marketing SME products reduces barriers to entry into a wider market and can be more efficient in reaching the market, especially the segmented target market on digital platforms. Digital devices also have the potential to reduce export costs and the time required to export by up to 40% and 10% for manufacturing companies, and 82% and 29% for service providers, respectively.

SME have room for further development through expanding access to financial institutions, including digital payment system services and financing.

SME have the potential to develop further by considering the characteristics of SME, most of which are still unbanked with limited access to financial products and services (Kharlamov and Aref'ev 2022). The development of information technology and digitalization in the financial sector has fostered various alternative financial products and services offered by banks and non-banks, thereby potentially increasing SME financial access (Darmansyah et al. 2020). The provision of SME access to financial institutions through digitalization is the entry point for SME to advance to class, through the use of products and services in payments, financial management, and financing. Access to digital payment services will increase SME efficiency and simplify financial management. Meanwhile, access to financial institutions will encourage healthier SME financing to support business expansion.

Expanding access to digital payment system services not only improves SME efficiency, but is also an important step in expanding access to financing for SME through financial technology.

The use of digital payment system services will accelerate and facilitate SME transactions, so that not only lower operational costs but also have the potential to increase revenue (Wachyu and Winarto 2020). QRIS as a digital payment tool solution that is fast, easy, cheap, and safe can encourage more efficient SME with better financial management. In addition, digital payment system transaction data by SME can be a source of information for the formation of digital data related to business feasibility. SME that can be used in assessing the financial feasibility of SME in credit/financing evaluations. Evaluation of the SME risk profile through digital payment transaction data is a new business model to open access to financing for SME. In this case, access to digital payment services, including QRIS, can build SME credit profiles, thereby opening access to wider financial institution services, including credit/financing.

Digitization supports the expansion of SME access to industry, thereby encouraging supply chain strengthening.

Digitization provides an additional boost in efforts to strengthen inter-SME connectivity as well as between SME and industry along the value chain (Wachyu and Winarto 2020). This step is in line with efforts to strengthen SME institutions through corporatization which strengthens interactions and synergies, both between similar SME and in value chain integration. In this case, the corporatization carried out by expanding SME access to the industry facilitates the transfer of knowledge including the adaptation of innovation and technology to increase SME productivity and competitiveness in a comprehensive and inclusive manner. Expanding SME access to these industries will encourage productive and innovative collaboration, thereby strengthening domestic supply chains.

QRIS expansion efforts support the accelerated expansion of SME access to digital payment system services.

As of December 2021, there are more than 5.5 million SME that have been facilitated to use QRIS in all regions. QRIS provides various conveniences, namely fast and recorded transactions, efficient, and safe because it is supervised by Bank Indonesia, and more hygienic because it does not involve physical contact. Currently, the use of QRIS has connected around 5.8 million retail merchants nationwide. Most of these merchants are SME, in particular the more than 3.6 million Micro Business (UMI) merchants and around 1.2 million Small Business (UKE) merchants. Through QRIS, the digitization of SME can be accelerated so as to support economic and financial inclusion nationally, including the availability of SME data which has been one of the obstacles in its development. In the

future, the QRIS feature will be developed not only for transactions within the country, but also for cross-border or abroad, so that it is hoped that it can facilitate SME users of QRIS who carry out export transactions.

Expanding access to financial institution financing services through the use of digitalization will encourage SME to more easily expand their business.

The expansion of SME access to financing services is directed at efforts to overcome the asymmetric information aspect, where financial institutions find it difficult to assess business feasibility so that SME are often perceived as high-risk business units. In addition, the expansion of SME access is also focused on aspects of the operational costs of SME lending, which have the characteristics of a nominal amount that is not large but with a large number of transactions (Pînzaru et al. 2022). Digitalization also supports the expansion of SME financing access by utilizing digital SME transaction data as an indicator of SME creditworthiness.

Digitalization also encourages operational cost efficiency in the distribution of SME loans so as to support the expansion of SME access.

With the support of digitalization, it is easier for SME to expand their business with broad access to financing services from financial institutions. After strengthening institutions and production, the development of SME is emphasized on efforts to expand access to marketing, including by encouraging marketing partnerships and product innovation. Improvements in product quality and innovation include product facilitation to improve product quality according to the target market. The increase in product added value is carried out through assistance in collaborating with designers and curators. In line with efforts to encourage the recovery of SME and increase the digitization of SME in the pandemic era, Bank Indonesia also facilitates education and onboarding of fostered SME and SME partners to connect with the digital ecosystem. Education is carried out through the preparation of materials that are more structured and systematic so that they are easy to understand, including general digital literacy, digital marketing through various social media platforms, onboarding processes in marketplaces and digital payments, as well as introduction to the concept of online aggregators.

In the pandemic era, Bank Indonesia also implemented digitalization in the promotion of SME products and facilitating business meetings (business matching).

For example, Bank Indonesia facilitated the promotion of curated SME products and partner SME through e-catalogue in the virtual exhibition of Karya Kreatif Indonesia 2020 (KKI). In addition to promotions, KKI also facilitates virtual SME business meetings, both with financial institutions, fintech players, as well as with exporters who are able to generate financing commitments and expand export market access. Bank Indonesia is also active in involving fostered SME and SME with potential export partners in various virtual trade promotion activities, both national and international levels, including Trade Expo Indonesia, Singapore Specialty Coffee (Online) Auction and Cupping Session, New York Now Digital Market 2020, Future Tea and Coffee Summit and Expo 2020, and China ASEAN Expo 2020.

Digitalization provides opportunities for SME to grow higher.

The Covid-19 pandemic as an extraordinary event prompted the Government to provide extraordinary support to help rescue and recover SME through a stimulus program. Meanwhile, SME are also increasingly implementing digitalization and continue to explore opportunities from digitization and adopt digital-based business models in order to grow higher. The development of the digital ecosystem has provided various digital business models from upstream to downstream that can be adopted by SME. Digitalization provides opportunities for SME to adapt and transform to survive, rise, and grow even higher, accompanied by increased corporatization, capacity, and financing. For example, Bank Indonesia facilitates the use of Internet of Things-based technology in both production and marketing in a number of fostered agricultural clusters in Java, Sumatra,

Kalimantan and Nusa Tenggara, in collaboration with digital farming platforms. Digitization of business processes in the agricultural sector is implemented starting from the on-farm side (upstream) through the use of weather sensors, to the off-farm side (downstream), by facilitating access to agricultural e-commerce.

Going forward, optimizing the role of SME as the backbone of the economy will continue to be directed at efforts to increase productivity, inclusive economic growth, and adapt to digital changes.

The role of SME as the new power of the national economy is increasingly relevant today, with many countries starting to rely on sources of domestic economic growth, including through SME. The development of SME is directed at maintaining resilience and supporting national economic recovery in the short term, as well as encouraging increased contributions to the national economy in the medium term. The priority of strengthening SME can be directed at priority sectors that have export potential and encourage tourism, as well as support the supply and distribution of strategic food commodities so as to support economic growth and reduce the current account deficit. This prioritization step is intended to support inter-sectoral and inter-regional integration, through synergizing policies and programs that are harmonious with the Government and Regional Governments to produce superior SME at the national and regional levels.

## Conclusion

Facing global economic challenges, efforts to strengthen the role and resilience of SMEs are increasingly relevant to support strong and sustainable economic growth. In the medium to long term, gradually increasing the capacity of SMEs will also support the process of transforming Indonesia into a developed country. Strengthening SMEs will also indirectly support the realization of an inclusive economy and finance, because of their wider accessibility to formal financial institutions. In addition, the rapid development of information technology demands a policy response to changes in the behavior of economic agents, including SMEs, along with the rapid penetration of the digital economy and finance in Indonesia. Fundamental changes in the economic landscape as above, require a policy response that is carried out holistically leading to the same goal, namely to support the improvement of people's welfare and Indonesia's transition to a developed country.

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