



## **The Role of Accounting in Managing Micro, Small and Medium Enterprises (MSMEs): The Case of Indonesia**

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### **Abstract**

The Covid-19 pandemic affects the economy of a country as well as its Micro, Small, and Medium Enterprises (MSMEs). The MSMEs contribute to the economy of a country's GDP and can engross the workforce. In the case of Indonesia, 99% of MSMEs are micro- and small- businesses that need an intervention program from the Government. Having Accounting skills is important to manage MSMEs, as indicated by the OECD report (2017) regarding financial education. Unfortunately, the level of education that the owners of micro to small businesses have is relatively low and therefore, the program should be developed carefully considering the educational background of the sector. Training these business owners on simple accounting skills, which are critically important such as cash in and out records, may be suitable for micro and small businesses. In addition, recognition of their existence is also important by providing them with a business certificate from the city council. The certificate can also be used as a basis to allocate temporary space for the business that does the trading in the street market. Having the certificate recorded and maintained by the city council, as well as the simple financial record, can be used by the Government to base intervention programs such as financial and skill training as well as access to financial support or loan.<sup>3</sup>

**Keywords:** SME, MSME, ASEAN, Accounting skills for SME, Indonesia.

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## Introduction

Micro, Small, and Medium Enterprises (MSMEs) play essential roles in the economies of many countries. Various studies found that the numbers of MSMEs enterprises are the majority of the business institution in many countries. According to Asian Development Bank statistics in 2015, MSMEs in the Asian region occupied 96% of the total enterprises, absorbed 62% of the workforce, and contributed 42% of GDP on average (OECD, 2017, p.8). Similarly, ASEAN Strategic Plan for SMEs Development 2016-2021 indicated the important role of SMEs in ASEAN countries (ASEAN, 2016-2025). The ASEAN working group (2014) has addressed the need of the Government of the country to carry out an intervention by issuing a policy to help its SMEs sector to deal with competitive markets. One of the challenges dealt with by MSMEs in ASEAN countries is the lack of access to finance. A study by Bellefleur et al. (2012) found that the MSMEs 'access to finance in Indonesia was facilitated by a state-owned commercial bank. Alternative financial access can be through Angel investors, Business incubators, and Venture capital. Unfortunately, all these resources need the MSMEs to provide a basic financial report, cash flow, and collateral requirements. Therefore, the role of accounting skills becomes important in this matter. This has been suggested by the OECD (2017) report on the need for financial education for MSMEs in Indonesia.

Some studies may classify this group as SMEs, but others, especially in Indonesia, are classified as MSMEs (Micro, Small and Medium Enterprises). Therefore, in some parts of the discussion, it uses SMEs, while in the discussion on the case of Indonesia, the OECD (2017) study uses MSMEs. Studies on the role of accounting for SMEs have also been done by some authors. Ganapaiah (2017) conducted a study on the use of strategic cost management in SMEs in India, and Catto (2016) studied the nature of management accounting information and how 43 SMEs use them in Melbourne, Australia. Ahmad (2017) investigated the implementation of MAP (Management Accounting Practices) within the SME context using 160 respondents in Malaysia. The study categorised MAPs into five broad types; costing system, budgeting system, performance management system, decision support system (DSS) and Strategic Management Accounting (SMA) and investigated its utilisation in SMEs. Amir et al. (2016) examined the relationship between cost management practices and competitiveness of strategic priorities among 96 respondents from Malaysian SMEs.

Regrettably, Covid-19 has hit the world's economy. Many business sectors are affected by this pandemic, particularly small and medium businesses. Lai et al. (2020, p13) cited a study by Mah, who indicated that the Covid-19 pandemic severely affected small to mid-scale SMEs which operate in the restaurant industry in Malaysia. Regarding the impact of Covid 19 pandemic, Luis Felipe Lopez-Calva, who is a UNDP regional director for Latin America and the Caribbean, also reported a similar situation. He mentioned that the tourism sector in Latin America and the Caribbean was hit hard by the Covid-19 pandemic (UNDP, May 2021). The impact hit even harder for smaller businesses. Luis cited the result of a World Bank's Enterprise Survey that indicated the impact on two main aspects; firstly, sustained larger drops in sales and secondly, higher rates of permanent closure. Since Indonesia has a similar sector of tourism and hospitality, it is interesting, therefore, to look at this issue in the case of Indonesia. intervention

This study will use three important aspects into consideration that have been brought forward by previous studies. Firstly, understanding the characteristics of MSMEs; second, the important role of the Government's actions to help the SMMEs; thirdly, the level of financial education, including accounting skills and knowledge to enable the MSMEs to access financial resources as well as manage their business well. The contribution of the study is to bring those three aspects together to the discussion, so it can bring an idea of what level of basic accounting skills need to be deployed to train MSMEs. It will encourage the academic to deliver these skills to help MSMEs. Another contribution from this article is that it may give a direction for the related government unit to develop and implement suitable policies and regulations as well as an intervention to help the MSMEs in Indonesia.

The intervention may be related to financial support, which requires the management of the MSMEs should be able to display its financial performance in a simple way. Therefore, there is a need to comprehensively understand the case of MSMEs so the intervention can be expected to be effective. The study discusses various attributes of MSMEs in several sections starting with the definition of MSMEs, characteristics, roles and challenges, the need for accounting skills, and ending with discussion and recommendations.

### **The Definition of MSMEs**

There is another type of business that is smaller than SMEs, and they are called Microbusinesses. Pfitzner and McLaren (2018) mentioned that microbusinesses form an important basis for future entrepreneurial and economic development in Australia. It is characterised by the following.

"... normally have close ties to the community within which they operate, typically providing economic and social benefits such as employment opportunities and as places of social interaction" (Pfitzner & McLaren, 2018, p.5).

Other than the number of employees and level of turnover, Pfitzner & McLaren (2018, p.6) pointed out significant differences between Micro and Small businesses as follows,

"the small business that is turning over AUD50 million is likely to have considerable infrastructure, monitoring and control systems, staff with specific skills, knowledge and experience, a formal management structure and tailored financial and accounting systems... a microbusiness is likely to be cash based, lack any formal systems, be self-financed with limited resources and capital, lack any formal structure and have minimal if no financial or accounting systems".

Considering this study is using the case of Indonesia, which may have Micro business as a significant sector, the study will combine micro business into the SMEs into one in this study and so-called Micro, Small and Medium Enterprises (MSMEs).

The definition of Micro, Small, and Medium Enterprises (MSMEs) may be different among countries and sectors. OECD (2017, p.10) conducted a survey in Asia regarding this matter and found that approaches to defining enterprise size and sectors differ among countries. The study found the attributes used to define the size of the firm are as follows:

<b>Table 1: Basis of Classification of MSMEs</b>		
Country	Definition based on	Sector
Bangladesh	Income	Varies by sector
China	Number of employees and sales	Varies by sector
Hong Kong	Number of employees	Not provided
India	Not provided	Vary in sectors
Indonesia	Number of employees, net assets, or annual sales	A variety of sectors are identified
Japan	Number of employees and capital	Variations by sector

Source: OECD (2017, p.10)

According to Bellefleur et al. (2012), the Government of Indonesia classified MSMEs based on Net Assets and Annual Revenues. These two classifications are presented in the table below:

Attributes	Micro	Small	Medium
Assets up to	IDR 50 million	IDR 500 million	IDR 10 billion
Annual Sales Revenue up to	IDR 300 million	IDR 2.5 billion	IDR 50 billion

Source: Bellefleur et al (2012, p.6)

### Characteristics of MSMEs in Indonesia

In Indonesia, 99% of enterprises are micro to small-scale. They absorb 89% of the workforce in the private sector (OECD, 2017, p8), and the majority are self-employed (Bellefleur et al., 2012). The report from the Government of Indonesia (OECD, 2017, p.9) provides the profile of Indonesian MSMEs in 2015 in relation to the size and absorption of the workforce as follows:

Business size	Number of enterprises	%	Number of employees
Micro enterprises	3,220,563	91.2	6,039,855
Small enterprises	284,501	8.1	232,281
Medium enterprises	23,744	0.7	5,132,150
Total	3,528,808	100	11,404,286

Source: OECD (2017, p.9)

The study by Bellefleur et al. (2012) found that 69% of the head of MSMEs are the owners, 11.5% are supervisors, 8.5% are managers, 5% are directors, and 6% are in other positions. In relation to the level of education, the owners of MSMEs are as follows:

Level of education	Percentage
No Formal education	4.4
Primary school	16.7
Junior High School	16.6
Senior High School	42
Academy/Diploma	5
Bachelor from University	14
Master's degree	1
Doctorate	0.3

Source: Bellefleur et al (2012, p.6)

From the above data, the level of education indicates the owners of MSMEs who sit in no formal education to senior high school occupy 79.7%. Knowing this characteristic may guide the state leader in being able to launch an intervention to increase the level of education or increase technical skills through training or formal education.

### **Roles and Challenges Faced by MSMEs**

Consider the contribution of MSMEs to the economy of a country; it is not only happening in Indonesia. ASEAN report on Strategic Plan for SMEs Development 2016-2025 also indicated the important role of MSMEs in ASEAN countries (ASEAN, 2016-2025, p.1). A similar situation was also dealt with by other countries such as India (Ganapaiah, 2017), Australia (Catto, 2016 and Nandan, 2010), Malaysia (Amir et al., 2016), and Indonesia (Tambunan, 2008). In this situation, the terms MSMEs and SMEs can be used interchangeably as the situation dealt with by both are not much different.

MSMEs play an important role in a country and its society. Therefore, every state should be able to help, maintain, and let these ventures grow, develop and be sustainable. However, the degree of competition among MSMEs may increase, especially in the era of the post-ASEAN Economic Community, 2015.

The ASEAN SME Working Group (2014) conducted a study on the competitiveness dealt with by SMEs in ASEAN countries after the onset of the ASEAN Economic Community (AEC). The study indicates that SMEs in ASEAN face at least three challenges: Regulatory barriers that inhibit growth, Lack of Access to Finance, and Lack of Access to Technology. Furthermore, the report suggests that competitiveness will increase and, therefore, suggests ASEAN and its Member States should play important roles in defining the policy and regulatory landscape in which the SMEs operate (ASEAN SME Working Group, 2014, p.9). Regarding the report setting, the ASEAN SME Working Group (2014, pp.9-10) recommended policy priorities to enable SMEs to increase their competitiveness as follows:

1. **Supporting international market expansion, integration into global supply chains and finding new customers:** Support modern manufacturing and supply-chain patterns to facilitate SME participation in global supply chains, including policies supporting ethical business practices and corporate governance that will open up opportunities to work with US companies and other multinationals. In addition, to leverage the new growth in Business-to-Consumer (B2C) transactions, it is critical to pursue a conducive environment for cross-border e-commerce in the Asia Pacific Region.
2. **Regulatory simplification, standardisation, and mutual recognition:** The AEC 2015 Blueprint articulates a robust vision of regional integration that is grounded in the understanding that eliminating regulatory barriers to trade will provide the most opportunities for ASEAN SMEs to expand through the region, thereby realising the potential of AEC. Today, in too many instances, SMEs with strong products and value propositions are unable to grow their business due to artificial constraints imposed by differential and complex regulatory requirements between ASEAN countries. ASEAN should continue to deepen this critical aspect of its reform agenda to ensure the complete implementation of regulatory reforms, broader standardisation across sectors, and expanded mutual recognition of standards and conformance.
3. **Sustainability of business from start-up to SME development via enhanced access to finance:** There is a substantial unmet demand for credit among ASEAN SMEs who cite the lack of financing as a major growth inhibitor. To support the sustainability and growth of SMEs, we recommend that ASEAN establish policies to promote product innovation in the financial market, considering alternative finances and diversified financial markets, ranging from microfinance, leasing, factoring, venture capital, equity funds, and business angels, to

stock markets. Policies supporting retail financing and e-payment systems such as debit and credit cards, mobile phone payments and online banking by individuals also support SMEs as a means to expand reliable and verifiable financial transactions.

- 4. Facilitating and incentivising the use of technology to enable SMEs to access markets and innovate:** Adopt policies supporting creativity, entrepreneurship, and the flourishing of technology, including the protection of intellectual property rights, and the free-flow of data across borders, needed by companies from all sectors including manufacturing, agriculture, retail, and banking who leverage technologies such as cloud computing to store and share data in an increasingly collaborative business world.

Regarding financial accessibility for MSMEs, the Indonesian Government responded to the need by setting up various financing programs for MSMEs, such as People Based Small Business Loans (Kredit Usaha Rakyat) deployed by Bank Rakyat Indonesia (BRI), a state-owned entity. Other financing alternatives for MSMEs are *Angel investors*, *Business incubators*, and *Venture capital* (Bellefleur et al., 2012). However, there are still problems with the interest rate, the requirement to have two years of experience in operating the business, reported cash flows and collateral requirements (Bellefleur et al., 2012).

Bellefleur et al. (2012) described those financing alternatives as follows: *Angel investors* refer to external individuals or groups who provide start-up funding without collateral or other formal bank requirements to entrepreneurs. The *Business incubator* is an entity that can be Government based or sponsored by a university that provides business development facilities through management, mentoring or technology. *Venture capital (VC)* is the investment from a venture capitalist into a prospective business for partial ownership of the entity. However, in financing MSMEs, bank credit facilities in Indonesia remain assessing the loan applications on 5C; Character, Capacity, Capital, Collateral, and Condition (Bellefleur et al., 2012).

### **The Contribution of Technical Accounting Skills to Managing MSMEs**

Considering the level of education of the owners of MSMEs, there is a need to increase their knowledge and skills, particularly in accounting. This will give them more understanding of the importance of financial records and how to present financial achievements. More importantly, it can be used as financial history to give a direction to guide the business to improve its financial performance and to support the application for a loan from available financial institutions when needed.

The OECD (2017) has addressed this need in its report on financial education for micro, small and medium-sized enterprises in Asia. The report provides various aspects needed to educate MSMEs on financial matters that include guidance on policymaking and the practice of financial education for MSMEs, particularly in Indonesia. The study of Nandan (2010) also indicated the need for accounting by SMEs not only limited to financial but also management accounting.

Financial education initiatives put MSMEs as a target group in 2013. The Government of Indonesia aims to increase employment and tax revenue from MSMEs (OECD, 2017, p.15). However, a survey indicated that "...increasing tax revenues is not a commonly stated policy aim elsewhere" (OECD, 2017, p.15). Nevertheless, to be able to prepare financial statements from which the financial assessments will be based, the MSMEs must have a certain degree or certificate in accounting technicality.

The content of financial education in Indonesia covers financial literacy and business literacy categories, and the providers of this education are public sector/government units, the financial sector, and international not-for-profit entities (Bellefleur et al. 2012, p.17). The delivery channels vary widely from face-to-face, printed materials, and online materials to social and traditional media. An

example of a formal face-to-face channel is at universities or colleges, and an informal face-to-face example is through seminars (Bellefleur et al. 2012, p.19).

There are various studies have been conducted on the use of accounting information by MSMEs, such as Catto, 2016; Ganapaiah, 2017; Ahmad, 2017; Amir et al. Catto (2016) investigated the role of strategic planning, accounting information and advisors in the growth of SMEs. The study took place in Australia between the years 2012-2014. One of the workshops investigated by the study is on the understanding of financial statements, considering cash flow drives and forecasting cash flow for business planning. The study found that 43% of the samples update their financial accounts annually; however, 63% of the samples do not have a clear idea of the gross margin or breakeven position of their company (Catto,2016, pp.70-71).

Ganapaiah (2017) investigated strategic cost management and business performance of SMEs in India. The study investigated strategic cost management areas covering product costing, the make-or-buy decision model, marketing channel decisions, and the identification and elimination of non-value-added activities (Ganapaiah, 2017, p.27). They found that the implementation of strategic cost management by SMEs in India was minimal (Ganapaiah, 2017, p.27).

Ahmad (2017) investigated the implementation of management accounting in SMEs and its relationship with performance. The study was undertaken on SMEs in the manufacturing sector in Malaysia. The areas of management accounting investigated by the study cover five broad areas: costing systems, budgeting systems, performance management systems, decision support systems and strategic management accounting. The study by Ahmad (2017, p.350) found that most of these management accounting areas were used by SMEs, but utilisation was higher in the medium size business. The basics of management accounting practices were found in small enterprises, and the more sophisticated management accounting practices were found in medium businesses. The study also found that the practice of management accounting in SMEs increases the efficiency and performance of SMEs. In terms of competitiveness, Amir et al. (2016, p.89) found that the practice of management accounting contributes to the ability of SMEs to compete.

## **Discussion and Recommendations**

The above data indicates that the most crucial part among the MSMEs categories is the micro size of the business. Street markets may be easily seen in Jakarta, and they are part of the micro size businesses segment. This group may not have legal or official business licenses, and they may not have a secure and constant place for trading their products or services. Table 3 presents that 99% of the MSMEs are micro and small businesses, containing 91% of micro businesses. Therefore, the accounting skill that should be offered varies among sizes. Accounting skills may cover two major areas of financial and management accounting. From the studies on management accounting practice in SMEs, it looks like management accounting would not be suitable for micro size businesses. This may be caused by undeveloped levels of education. Table 4 indicated that about 80% of the owners' level of education ranges from no-education to senior high school. However, for some of the small to medium enterprises, the simple to sophisticated management accounting practice may be relevant. To achieve a good result, the implementation of financial education should be executed with due care considering the characteristics of the owners of the MSMEs. For micro and small businesses, it may need precise training, such as in financial accounting or cash flow, as well as accounting technicality for how to record the transaction and how they are presented in the financial statements. In addition, they should be given a clear understanding of the need for this knowledge to develop their business and to facilitate access to financial support. This indicates the need for accounting academics to participate in building the knowledge and skill of the MSMEs' personnel.

It is recommended that the Indonesian local Government needs to encourage the MSMEs to maintain financial records and use this information for managing a sustainable business. The use of accounting information in terms of simple cash inflow and outflow would be required more by the micro

businesses. The local Government can also support the micro businesses owners by issuing a business certificate; then the records should be maintained by the local Government. By having the micro business registered and certified, it will be easier to control and put the intervention programs such as financial or technical education. In addition, the certificate of registration can also be used as a basis to temporarily be allocated space in the street market for at least one year. This can be renewed annually if they comply with the regulations and are able to provide and maintain their cash-in and cash-out records. Other than that, the financial record may also be used for small loan applications when available.

Since the study of micro and small businesses is limited, there is a need for further investigation of MSMEs to better understand the importance of financial records and the use of simple accounting records to manage their business. By doing this, the study may be done on the type or level of financial and business training that is needed by each different business size, how the training should proceed, and who should execute the program.

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