Development of Small Businesses During Economic Crises:
Evidence From Indonesia

tulus tambunan
Center for Industry, SME and Business Competition Studies, Universitas Trisakti, Indonesia

EXECUTIVE SUMMARY

This is a descriptive study that aims to estimate the impact of three economic crises (i.e., the 1997/98 Asian financial crisis, the 2008/09 global financial crisis, and the COVID-19 pandemic crisis) on small businesses in Indonesia and to explore their crisis mitigation measures (CMMs). It adopted an exploratory methodology with comprehensively reviewing the available literature (e.g., policy documents, research papers, and reports) on the subject being studied. The data collection technique applied was literature study. It shows that different types of crises have different transmission channels through which such crises affected small businesses. CMMs adopted by affected small businesses also vary by different types of crises and hence different business risks. To the best of author's knowledge, this is the first study that examines transmission channels through which such crises affected small businesses in Indonesia.

INTRODUCTION

The outbreak of coronavirus disease (COVID-19) has had a devastating effect on the Indonesian economy, as on the world economy as well, due to declined consumption and production as a direct consequence of policies on social/physical distance, work and schools from home, and the necessity for companies in non-strategic sectors to stop their activities. Suryahadi et al. (2020) estimated that COVID-19 would reduce Indonesia's economic growth to between 1% and 4%. Whereas the Financial System Stability Committee (KSSK) predicted that the spread of COVID-19 would hit the Indonesian economy in 2020 to reach around 2.3% to - 0.4%.

But this is not the first time that Indonesia faces an economic crisis. The country had experienced two economic crises before, namely the Asian financial crisis that hit several countries in Southeast and East Asia in 1997–1998 and the global financial crisis in 2008–2009. The first crisis was triggered by a sudden capital flight from Indonesia which led the Indonesian rupiah (IDR) to depreciate significantly against the US dollar. The depreciation was soon followed by a national banking crisis and ended up as a national economic crisis. Through the rupiah depreciation and higher interest rate (as the monetary authority's direct response in that time in order to stop capital flight), the crisis hit first middle-and high-income groups such as employees in the financial/banking sector and large-scale industries which heavily dependent on credits from bank or other financial institutions and imports. After several months, domestic inflation started to increase, and this accompanied with the increase in unemployment due to many laid off employees in crisis-affected firms which resulted in a significant increase in poverty in 1998.

The second crisis, which was seen by many as the most serious world financial crisis since the great depression in the 1930s, has impacted many countries through various channels, i.e. exports, investment (including foreign direct investment/FDI), and remittances. However, for Indonesia the most important channel was export. Many exporting firms experienced a decline in their orders from abroad. Retrenchments mounted in many of these firms, while working time fell along with increased downward pressure on wages. Also many employees in these firms were laid off and many of them migrated back to rural areas and shifted to informal and vulnerable employment.

In both crises, many companies in Indonesia were impacted, especially the 1997/98 crisis. The impact of this crisis was so severe that the country's economy slumped into a deep recession. Its gross domestic product (GDP) experienced a negative growth rate at 13 per cent. Many small businesses, represented by micro, small and medium enterprises (MSMEs), were also suffered seriously (although not in all sectors), because they were encumbered by many problems especially financing. (Mustafa and Mansor, 1999; Abdullah, 2002; Griffith-Jones and Ocampo, 2009; Tambunan, 1998, 2010a,b, 2011; Tambunan and Busneti, 2016).

With respect to the initial causes and main transmission channels through which the crises affected local small businesses, these two crises are indeed different than the COVID-19 pandemic crisis in 2020/2021. As explained before, the initial cause of the 1997/98 crisis was capital flight that led to the depreciation of the rupiah. Many local small businesses were impacted through the following transmission channels: i) domestic demand declined, (ii) no credit was available, (iii) imported raw materials and other inputs that became very expensive, and (iv) many local small businesses as suppliers of multinational companies experienced low orders or order cancellations (Mustafa and Mansor, 1999; Abdullah, 2002).

While the initial cause of the second crisis was the decline in world demand which also affected many Indonesian small businesses, particularly in the export sector as well as those acted as subcontractors to large-sized exporting companies in labour-intensive manufacturing (e.g., textile, garment, footwear, seafood processing, and electronic) and small businesses producing items for tourism (Griffith-Jones and Ocampo, 2009; Khor & Sebastian, 2009; Nguanbanchong, 2009; Hartono, 2011).

In contrast to the two crises, the COVID-19 pandemic crisis in Indonesia was generally considered as domestic supply and demand crisis due to declined market demand as a direct consequence of government policy on social/physical distance, work and study from home and regulations requiring all companies in non-strategic and non-basic needs sectors to stop their activities temporary. As in many other countries, this policy has affected domestic economic activities in many sectors. Many small, medium and large companies in some sectors especially tourism, transportation, construction, non-food manufacturing