

REPORT AND RECOMMENDATIONS
ON THE DEVELOPMENT OF
SMALL- AND MEDIUM-SCALE ENTERPRISES
IN LHOKSEUMAWA, INDONESIA

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EXECUTIVE SUMMARY

Lhokseumawe is industrializing rapidly, but the benefits of its growth are not reaching the people of the area. Government officials, business people, and others are concerned about the dangers of building a prosperous enclave surrounded by poverty, and about what will happen to the economy of the area when the current building boom subsides. There is a real danger that the people of Lhokseumawe will in future years have even fewer job opportunities and commercial development prospects than they have now.

There is a pressing need in Lhokseumawe for technical information, expert assistance, credit, and other resources to help local people develop and expand their own businesses. A sustained program with close ties to the local population could do a great deal to make the current growth more equitable and long-lasting for all.

This report is a result of my three-week trip to Indonesia in November 1982. The first section summarizes why the trip took place and what occurred. The second section analyzes briefly the current situation in Lhokseumawe. The third and final section makes a series of recommendations on developing small- and medium-scale enterprises in the area.

My recommendations can be summarized here as follows:

1. Establish a small business technical and management resource center.

2. Provide a highly skilled expatriate staff with Indonesian counterparts.
3. Assist local agri-business development.
4. Set up a revolving fund for loans to small businesses and enterprises.
5. Publish a small business manual that is specifically tailored to the Indonesian context.
6. Explore licensing arrangements with small American firms.

SECTION ONE: SUMMARY OF TRIP ACTIVITIES

My visit to Indonesia resulted from a letter written in May 1982 to the Minister of Industry, Mr. A. R. Soehoed, by the former U.S. Ambassador to Indonesia, the Hon. Frank Galbraith, who is now a member of the Board of Directors of Volunteers in Technical Assistance (VITA). Ambassador Galbraith's letter described VITA's resources and its 23-year record of helping to transfer technologies to private and public enterprises throughout the world. VITA is a private, nonprofit organization that provides technical assistance to people and groups in developing countries. It implements major overseas programs, answers technical inquiries, publishes numerous "how-to" books, does technical training, conducts R&D studies, helps develop new businesses, and offers a number of other services. Ambassador Galbraith suggested that VITA might be of assistance in helping develop small- and medium-scale enterprises in Indonesia.

Minister Soehoed responded in August with an invitation to VITA to send a person to Indonesia "to study the methodology and possibilities for developing industrial linkages in the Lhokseumawe area in Aceh where a number of basic industries are under construction." The Minister assigned the state-owned fertilizer company, PT. Pupuk Iskandar Muda, to sponsor the study.

Ambassador Galbraith requested funding for my trip from the Mobil Oil Company, contractor of Pertamina. The company generously agreed to provide funds for my international travel and stay in Jakarta. PT. Pupuk Iskandar Muda provided

transportation from Jakarta to Lhokseumawe, as well as local transportation and lodging in Lhokseumawe. I am grateful to both companies for their cooperation in making the trip possible.

I arrived in Jakarta on November 6, 1982, and spent a week interviewing the appropriate persons in the Indonesian Government, as well as expatriate and domestic consultants, and oil company executives. I spent my second week in Lhokseumawe, where I spoke with:

- . Officials in the PT. Pupuk Iskandar Muda.
- . The provincial and district representatives of the Ministry of Industry.
- . The proprietors or managers of eight small industries.
- . Representatives of the Ceramics Research Institute.
- . The District Director of the Young Indonesian Businessmen's Association.
- . Expatriate technicians.
- . The Public and Community Relations Office of PT. Arun.
- . The Director of the Lhokseumawe branch of the Bank of Indonesia.
- . The Secretary of the Kadin.
- . The Bupati.
- . The Director and Secretary of the Pesatren Pertanian Peusangan.

I spent the third week of my trip discussing my findings with some of the same people that I had met earlier, and wrote this report.

All of the people I talked to in Lhokseumawe were cooperative and helpful, and I want to acknowledge their generous commitment of time and the information I received, which helped me to learn about the situation in Lhokseumawe. I am particularly indebted to Mr. Mustafa Ali of the Public Relations Offices of PT. Pupuk Iskandar Muda, who patiently worked with me to plan and carry out my program for the visit. A word of special thanks should go to Mr. Ridwan Zakih of the Jakarta office of P.I.M., who accompanied me during the entire trip and translated when necessary.

I was helped enormously in preparing for my trip by reading several very good studies and reports. Among them were:

Dr. Joost de la Rive Boy and Dr. Ing. Arend Eisenloeffel,
"Report on a Reconnaissance Mission on Industrial Linkages to Large Scale Industries (Based on Arun Gas) in Aceh Planning Area III." Rotterdam: Netherlands Economic Institute, September 1980.

Dr. Alan Strout, Dr. Donald Emmerson, and Joseph Bergquist,
"Aceh Planning Assessment Team Preliminary Report." Washington, D.C.: New TransCentury Foundation, April 1982.

Craig Thorburn and Dr. Amin Aziz, "Report on the Study of Community Development and Technical Skills Training Assistance Opportunities in Aceh." Undated.

Robert J. McSwain, Walter Tappan, and David W. Devin, "Trip Report." Washington, D.C.: USAID, February 1982.

I saw and heard nothing during my visit to Lhokseumawe to contradict the accuracy of the observations and analysis in these reports. My own mission is in many ways a logical

outgrowth of these earlier studies, and proposes concrete steps for quick, flexible action to help remedy many of the problems they describe.

SECTION TWO: THE SITUATION IN LHOKSEUMAWE

Lhokseumawe is a small provincial city in the Province of Aceh in North Sumatra that has suddenly become the site of a vast industrial development effort to use natural gas deposits in the area. Billions of dollars are being invested; five major industrial complexes are planned, under construction, or already built.

It would be an understatement to say that Lhokseumawe was not prepared to cope with this rapid industrialization. As a result, the local population has not benefitted to the degree anticipated from the influx of industry. Large, capital-intensive industries provide few jobs for the unskilled local populations once their construction is completed. For example, I was told by a person at the PT. Arun plant that 11,000 people had been employed in its construction, but only 1,200 were required when it became operational, and few local people had the managerial or industrial skills to qualify for those positions.

This actually should come as no surprise: the area has no training facilities, information resources, or technical assistance programs except for occasional training programs carried out by the Ministry of Industry. A proposed technical high school is being discussed, but it will be years before the first class graduates even if the school is finally approved and established.

As growth continues and the population increases--already an incredible 60% between 1974 and 1980--the local people become

further and further removed from the benefits of industrialization.

Sincere concern has been expressed by responsible government and private company officials about the danger that a prosperous enclave surrounded by poverty is developing. The fear is well founded, but the reality appears even more serious. The local population is excluded from the best jobs in the large industries because of its lack of industrial and management skills. Even the small service industries, such as automobile and appliance repair shops, are increasingly being started by newcomers to Lhokseumawe. Unless something is done soon, the local population might find this alternative closed to them when the building boom ends. The result will be not only the original island of prosperity surrounded by poverty, but the intrusion of a middle layer of newcomers that isolates the local poor even more. And it is obvious that, as we have seen in the case of PT. Arun, when the construction boom subsides, as it surely will someday, there will be massive unemployment among the unskilled local population and others who flocked to Lhokseumawe.

The government does require that all construction contracts below a certain sum be awarded to local contractors. This, together with the large volume of construction taking place, has resulted in a concentration in that industry by the local population. It would appear that if viable alternatives were available for starting enterprises, some of the initiative demonstrated by the proliferation of construction companies might be channeled into other commercial ventures. It would be essential for such a redirection of effort to take place that the local population have access to technical information and assistance as well as training and credit.

The situation in Lhokseumawe is by no means a hopeless one. There are many positive elements that can contribute substantially to the alleviation of some of the problems.

Among them is the sincere desire on the part of national, provincial, and local governments, as well as the companies, to do whatever is reasonable to see to it that the local population shares in the benefits of the industrial development going on. They are prepared to commit a substantial effort and considerable resources to that end. They are sensitive to the social consequences if they are not successful.

A second positive element is the many resources in the area, which could become the basis for new industries. For example, entrepreneurs could use available wood resources to make and sell charcoal, particle board, and other products. Farmers could develop a number of new agri-business opportunities. There also are possibilities for more technologically sophisticated downstream industries built around plastics, fertilizer, and paper.

A third positive element is the growing population of professionals with high incomes, who provide a ready market for agricultural goods and services. Similarly, an excellent harbor will improve access to export markets in nearby countries, as well as to other parts of Indonesia.

Finally, the most important resource is the people of Lhokseumawe themselves. I have heard that many newcomers to the area express little respect for the initiative, skills, or energy of the local population. I saw no basis for this attitude during the few days I spent there. On the contrary, I was impressed by the entrepreneurial initiative demonstrated at the eight small local industries that I visited. While

much could be done to improve their management practices or product quality, these people were genuine entrepreneurs. They knew their business and what they need to improve it.

A study done by the Netherlands Economic Institute (see page 5) contains an excellent analysis of downstream small- and medium-scale industry possibilities, and lists some 50 support industries that could be made commercially viable in the Lhokseumawe area. The report, which was submitted in 1980, also suggests much that could be done immediately, and recommends concrete steps that should be taken to begin the effort. I agree.

The following recommendations are designed to respond quickly to needs that have been recognized by all those who have studied the situation, and would be welcomed by all those with whom I spoke in Lhokseumawe. Implementation of the recommendations would provide easy access by the local population to the resources necessary for local initiative to create jobs.

RECOMMENDATIONS

My purpose in visiting Indonesia was not to make a political, economic, or social analysis of Lhokseumawe. Competent professionals already have prepared several such studies (see page 5), and I saw and heard nothing to contradict the accuracy of their observations. Rather, my goal was to prepare the way for some action to begin immediately. The following recommendations would establish a modest three-year program that would respond to many of the needs cited above. Everyone with whom I spoke in Lhokseumawe was very positive about these proposals, which can be implemented quickly and have a real impact in helping the people of Lhokseumawe to share more equitably in the industrialization of their area.

1. Establish a Small Business Technical and Management Resource Center.

A Small Business Technical and Management Resource center should be established as early as possible in Lhokseumawe. Its purpose would be to encourage small- and medium-scale businesses that are labor-intensive and require minimum capital investment. These businesses might include manufacturing industries, the transportation of people and goods, service enterprises, agri-business, fishing, or other activities.

The center would offer the local population extensive technical information on small- and medium-scale technologies. Its staff would provide practical assistance in making prototypes of new technologies, improving the quality of products and industrial processes, introducing new designs, demonstrating

marketing techniques, managing enterprises, encouraging the formation of cooperatives, etc. The local population and district political leaders would be encouraged to feel that the center is part of their community. For example, the Bupati would play a key role in recommending business activities or loan recipients. Personnel at the center would live among the people instead of in expatriate compounds, and would identify themselves with the community. They would make every effort to inform the local population about the services the center offers, using demonstrations in marketplaces, meetings, technology fairs, advertising, and other extension services. The center also would work closely with the district representative of the Ministry of Industry, the district Kadin, regional authorities, and large industries.

The center would administratively be part of the PT. Pupuk Iskandar Muda, but should be located physically in the city of Lhokseuwame so the local population has easy access to its resources. After the three years of the program, the center could become part of the proposed Technical Training Institute in Lhokseumawe or might instead be continued as part of the PT. Pupuk Iskandar Muda with its Indonesian staff.

An integral part of the center's services will be a well-stocked technical library. VITA has assisted in setting up technical documentation centers in Africa, Latin America, and Asia. Its semi-annual course has trained 30 people in 18 countries to organize and operate such centers. Three people from institutions in Indonesia already have taken the program at VITA's headquarters; they came from Dian Desa in Jogjakarta, the Irian Jaya Development Information Service Center, and the U. S. Agency for International Development.

VITA's own documentation center is one of the world's finest collections of information on small- and medium-scale technologies. The materials are now being microfilmed and the card files computerized at considerable cost. In addition, Dian-Desa already has translated some of VITA's technical manuals. VITA would make available all these materials to the Lhokseumawe center, including copies of the microfilm and catalog computer discs. In addition, VITA's home office in suburban Washington, D.C., would play a supporting role to the center, providing it with updated technical information and reporting on the experience of people in other countries with specific technologies. VITA would help the center develop exchange agreements with similar organizations throughout the world, as well as useful relationships with companies in the United States and elsewhere. It also would recruit competent consultants and help design and carry out training programs as needed for center activities.

2. Create a highly skilled expatriate staff with Indonesian counterparts and part-time consultants to provide training and other services.

The staff of the center should include expatriates who are experienced in developing labor-intensive small businesses for developing countries. Specifically, it should include: (1) an industrial engineer, (2) a management/marketing specialist, and, (3) an agricultural engineer. I recognize that the cost of all three expatriate experts might be a problem. In such a case, the industrial engineer would appear to be the most essential.

A counterpart staff of Indonesians with similar skills should work closely with the expatriates. It is important for the continuity of the program that young Indonesian technicians

work with the program from the beginning so that it will continue after expatriates leave.

The program also should include up to 12 person-months per year for outside consultants, and a like amount for Indonesian consultants. These people would provide training programs on a regular basis in fields identified as priorities by local requesters and officials. Well designed training programs are critical for the success of this program. The small businesses that I visited in Lhokseumawe needed training in management, quality control, marketing, and design. VITA has long experience in developing countries providing training in both technical and business subjects. Its 4,000 volunteer experts in more than 100 countries have expertise in 800 technical subjects, and could provide needed short-term consultancies. In addition, I was very impressed by the high quality of the Indonesian technicians whom I met during my trip, and have no doubt that many of them could provide much of the training and technical assistance required.

3. Assist local agri-business.

Assistance should be provided to help develop various agri-businesses, including those that deal with the production, storage, packaging, processing, transportation, and marketing of farm produce. In addition, existing agricultural technologies can be improved in the fields of resource management, non-traditional food and industrial crops, animal husbandry, agriculture and aquaculture, fish farming, and irrigation. VITA has developed a modular agricultural program for developing countries in which technology and expertise are available in a wide variety of agricultural areas.

4. Set up a revolving fund for loans to small businesses and enterprises.

A fund of perhaps \$100,000 a year for each of three years should be established to provide small loans at prevailing rates of interest. Every single business person with whom I spoke listed the availability of credit as a problem. Each insisted that access to credit would help increase production, expand the product line, and hire more people. It is important that loans be made at the prevailing rate of interest and not be subsidized. Experience has shown that artificially low interest rates defeat the purpose of job creation because entrepreneurs will usually invest the money instead in labor-saving machinery.

The program would provide small loans (usually less than \$10,000) to small farmers, business people, local cooperatives, and others for specific projects or activities. The loans would be targeted for projects that seem especially likely to create new jobs and sustainable enterprises among the local population. While necessary financial safeguards would be established, the loan officers would identify promising local efforts and award loans with a minimum of red tape. VITA has had considerable success running a small grants program for renewable energy projects in developing countries, and has learned from experience that comparatively small amounts of money awarded quickly and effectively can be the crucial factor in getting small businesses off the ground.

5. Publish a small business manual that is specifically tailored to the Indonesian context.

A manual on small business development in Indonesia should be written to ensure that the knowledge gained on technologies,

business ideas, dissemination, and other areas during the program is shared with people both in Indonesia and other countries.

VITA has throughout its 23-year history sought to develop and collect the best information possible on specific technologies and their successful application in developing countries. This information, in turn, is made available to other individuals and agencies working in developing countries, and is used by VITA in programs that it implements in many countries of the world.

6. Explore licensing arrangements with small American firms.

Licensing arrangements, co-production agreements, and possible joint ventures with small American companies should be explored as ways to help local people in Lhokseumawe to develop new enterprises. VITA has wide contacts among such firms, and could help ensure that any arrangements protected the rights and interests of the Lhokseumawe parties involved.

CONCLUSION

This report is an effort to be responsive to the needs identified by Indonesians, and to the priorities they have expressed. In the three weeks I spent there, I talked to dozens of people in government and in the private sector. My respect for their judgment and sincerity grew stronger day by day. As the Executive Director of VITA, I would be very happy to see my organization play a modest role in the exciting things happening in Indonesia. I believe VITA can make a contribution.

If the Ministry of Industry decides that the above recommendations should be implemented to help the people of Lhokseumawe share more equitably in the industrialization of their area, VITA is prepared to submit a formal proposal without delay.

Once again, I want to express my appreciation for this opportunity and the courtesies extended to me by the Director and employees of PT. Pupuk Iskandar Muda.