

2025 KDI-LPEM 2nd Joint Seminar

Boosting MSMEs competitiveness From subsidizing survival to spurring innovation

Andree Surianta

Center for Indonesian Policy Studies

The Working Paper

Preprint

PDF Available

The effect of regional institutional quality on entrepreneurial flourishing in decentralized Indonesia

March 2025

DOI:[10.13140/RG.2.2.30153.66408](https://doi.org/10.13140/RG.2.2.30153.66408)

License · [CC BY 4.0](#)

Authors:



Andree Surlanta


Australian National University



Krisna Gupta

Politeknik APP Jakarta

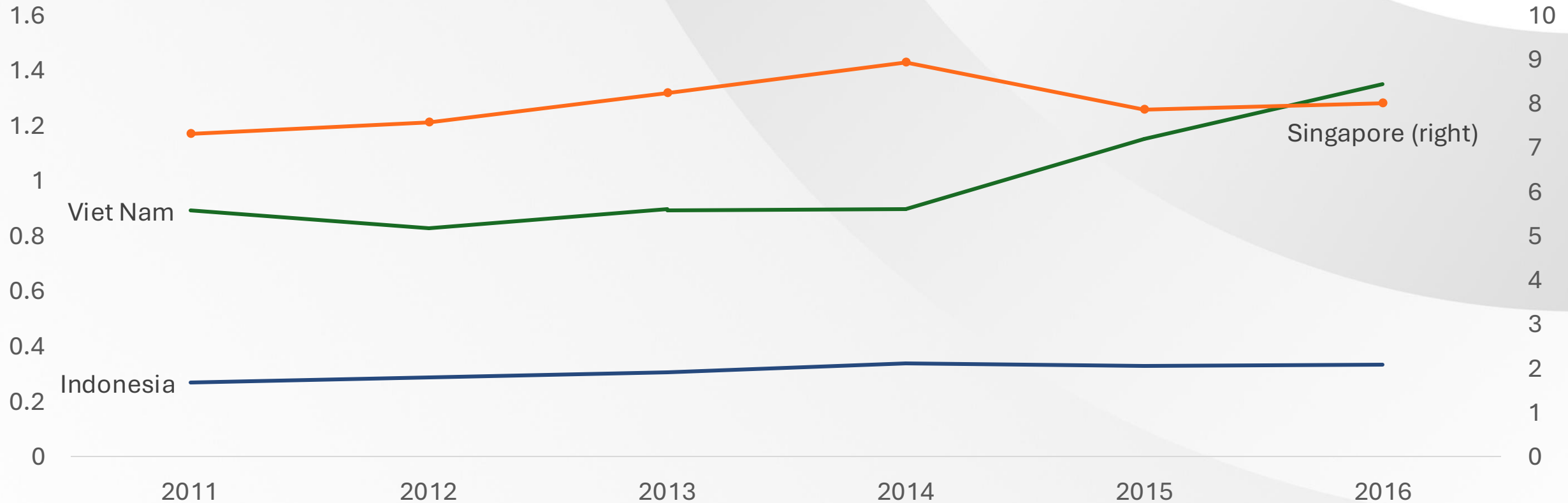


 Download file PDF

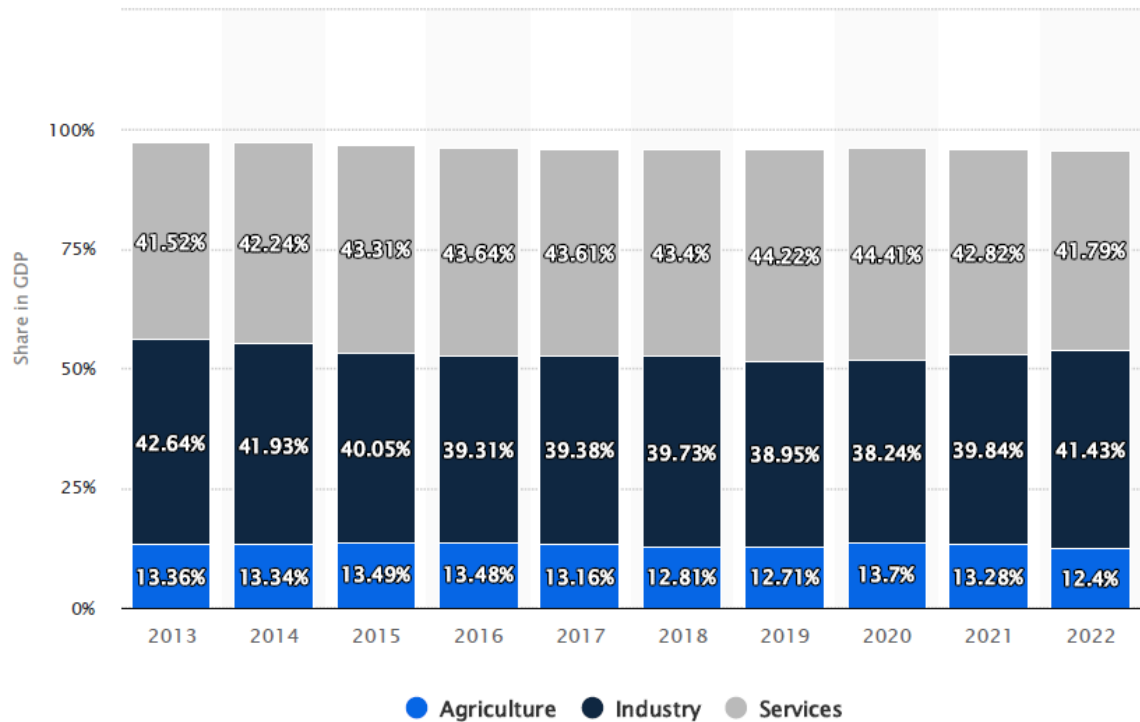
 Read file

Double developmental challenge – weak entrepreneurship

New business density (per 1,000 people ages 15-64)



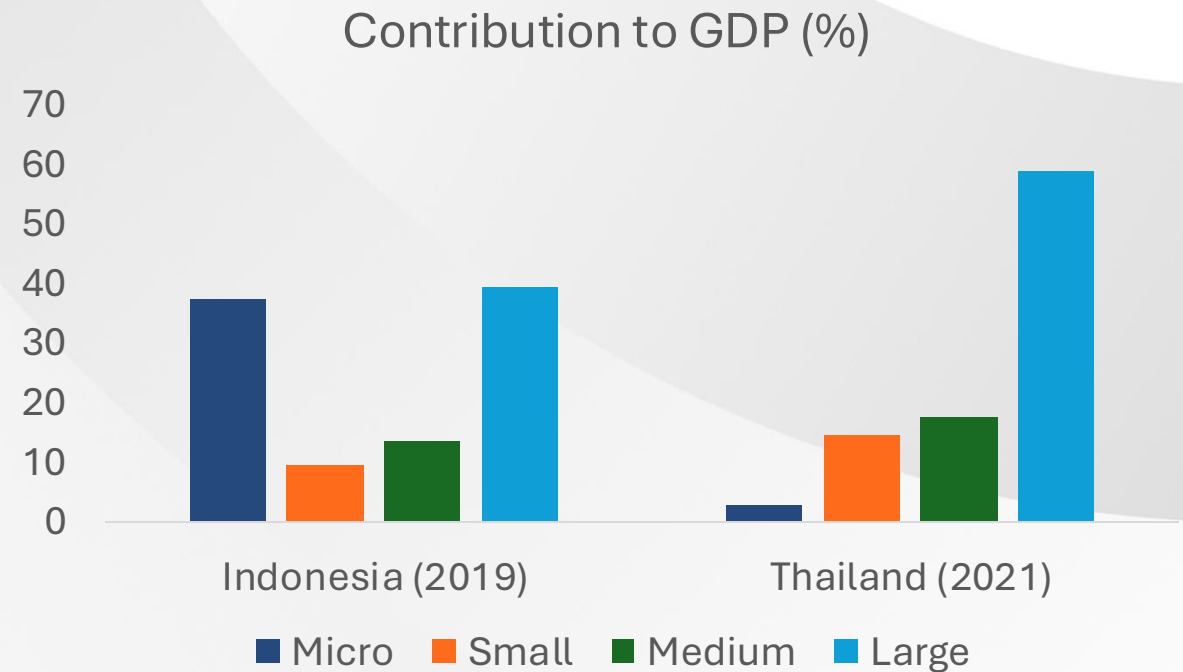
Double developmental challenge – premature deindustrialization



Source: Statista and World Bank

Policy vs problem

- Re-industrialize and boost entrepreneurship
- >95% of businesses (including manufacturing) are micro, small, and medium enterprises (MSMEs)
- Upgrading has been difficult → the “hollow middle” problem



Source: Katadata



Ternyata 95 Persen UMKM Indonesia Belum Kompetitif

Pemerintah akan mendata UMKM untuk menyusun kebijakan dan program pembangunan UMKM yang tepat sasaran dan efektif.

MSMEs: surviving, not competing

Teten Masduki, Cooperative and MSME Minister 2019-2024

- "95 percent of existing MSMEs today are micro-enterprises that are ... more focused on survival, more on a subsistence economy."
- "Unfortunately, the number of MSMEs entering the industrial supply chain is still small, if I'm not mistaken, the figure is 7 percent, which is lower than Vietnam's 24 percent."

Literature on institutional quality and entrepreneurship



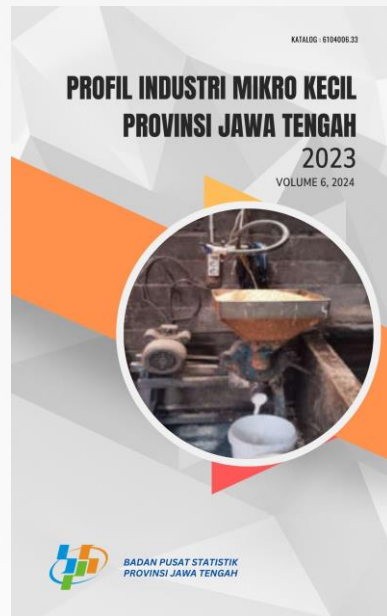
This Photo by Unknown Author is licensed under [CC BY-NC-ND](https://creativecommons.org/licenses/by-nc-nd/4.0/)

- GEM's two entrepreneurship typologies: necessity-driven (NDE) and opportunity-driven (ODE)
- Empirical studies on institutional quality and entrepreneurship usually use GEM cross-country database with institutional indices (WGI, EFI, GCI), controlling for demographic and macroeconomic (WDI, GII)
- **BUT do entrepreneurs really compare countries?**
 - EU (Charron et al. 2012): Governance Quality ↔ SMEs in 172 European regions
 - US (Sobel 2008): Economic Freedom ↔ "unproductive" entrepreneurship (lawsuits and lobby groups) in 48 continental states

Data and method



**Micro and Small Industry
(IndMSE) Statistics**



**Regional
Competitiveness Index**

- 34 provinces, 514 districts, 2 years (2022-2023)
- Pooled OLS and Poisson Maximum Likelihood (PML)
- Province and year fixed effects included

Variables

Dependent variables: Entrepreneurial outcomes

Number of IndMSEs

Informality

Wages

Profitability

Independent Variables: IDSD and Macro Variables

IDSD Institutional Score

IDSD Labour Market Score

IDSD Business Dynamism Score

Gross Regional Product

Population

Government Budget

Provincial level results

	Dependent variables		
	Number of IndMSEs	Informal	Wage-Income gap
Independent var.	FE PML	FE PML	FE PML
LIDSD_INST	-0.993 (1.211)	-1.577 (1.137)	0.373*** (0.099)
LIDSD_LABOUR	0.622 (0.562)	0.377 (0.432)	0.662*** (0.136)
LIDSD_BUSINESS	0.810** (0.271)	0.578+ (0.351)	2.107*** (0.380)
LIndMSE		1.190*** (0.045)	-0.234*** (0.035)
Num.Obs.	40	40	40
R-sq	0.004	0.980	0.200
R-sq Within	0.003	0.866	0.197

Pro-worker institutions pushing entrepreneurs into NDE

- More govt presence and stronger labor market ↔ wider gap between workers' wage and entrepreneurs' income
- Better biz env ↔ more IndMSEs, more informality, wider wage-income gap
- Informal IndMSE grows faster than total, more IndMSE narrows wage-income gap

Caveat: small-N

Significance: + $p < 0.1$, * $p < 0.05$, ** $p < 0.01$, *** $p < 0.001$



District level results

	Dependent variables			
	Number of IndMSEs	Informal	Profit	Wages
Independent var.	FE PML	FE PML	FE PML	FE PML
LIDSD_INST	-1.415+ (0.739)	-1.100*** (0.146)	0.817 (0.573)	0.467 (1.520)
LIDSD_LABOUR	-1.064** (0.330)	-1.137*** (0.167)	0.087 (0.578)	0.014 (0.361)
LIDSD_BUSINESS	0.258 (0.240)	0.267+ (0.144)	0.458*** (0.105)	0.751 (0.509)
LIDSD_MARKET	0.163** (0.062)	0.173*** (0.023)	0.560*** (0.010)	0.610*** (0.069)
Num.Obs.	506	470	479	479
R-sq	0.700	0.694	0.682	0.631
R-sq Within	0.128	0.137	0.197	0.171

Biz environment and market encourage entrepreneurs, institutions and the labor market do not

- Stronger govt presence and labor market ↔ less informality, but also less IndMSEs
- Better biz env ↔ more informality, better profitability
- Market opportunity ↔ positive across all outcomes

Conclusion

- Was Minister Teten right?
 - Are Indonesian MSMEs mostly NDE? YES  → More government presence (protecting workers and subsidizing businesses) increases informality and suppresses both quantity and income.
 - Is supply chain integration important? YES  → Better market access and a more dynamic business environment increase quantity and profitability.
- Protection and subsidy create dependency that holds back entrepreneurs.
- Competition and connection spur innovation (Schumpeter's Creative Destruction).

Some lighter readings

THE CONVERSATION

Disiplin Ilmiah, gaya jurnalistik



Deretan pelaku UMKM yang membuka lapak di sebuah acara UMKM di Depok. murtiwijaya/Shutterstock

Stop banggakan jumlah UMKM: Fokuskan pada peningkatan kualitas dan kemudahan izin

Diterbitkan: Agustus 22, 2025 1.14pm WIB

Andree Surianta

PhD Candidate in Policy and Governance, Australian National University and Senior Research and Policy Specialist, CIPS, Australian National University

Krisna Gupta

Senior fellow at CIPS and a lecturer at International Trade faculty, Politeknik APP Jakarta

DOI: <https://doi.org/10.64628/AAN.y79dtpghw>

EASTASIAFORUM

Peer reviewed analysis from world leading experts

EASTASIAFORUM

[Subscribe](#)

[About](#)

[Contributors](#)

[The Quarterly](#)

[Submissions](#)

[Advertise](#)

SOUTHEAST ASIA

Stemming the rise of destructive entrepreneurship in Indonesia

Published: 16 July 2025

Reading Time: 5 mins

AUTHORS



Andree Surianta

Back Center for Indonesian Policy Studies



DOI: <https://doi.org/10.59425/eabc.1752660000>