

# CHAPTER I

## INTRODUCTION

### 2.1. Background

Globalization brings significant changes in how the international world interacts; Jim et al., in 2013, said that globalization is marked by changes in the international world, where all the people of the world are connected (Sheffield, Korotayev, & Grinin, 2013). Therefore, globalization could be defined as a worldwide process accelerating economic, cultural, and political interdependence and integration with deep historical roots. This process itself is fostered by liberalized international trade and innovations in information technology and communication, which have been promoted and managed to a greater or lesser degree by international institutions, multinational corporations, national governments, international non-governmental organizations, and even individuals with access to the online (Bamigboye, Effects of Globalization on International Relations, 2020). Globalization from an economic perspective is indicated by the increasing dependence of the economy between one country and another, which is supported by technological developments; therefore, it can be said that economic actors in the international world can develop their abilities in the face of globalization (Devi, 2019).

The acceleration of globalization over the last few decades is inseparable from the rapid development of technology that facilitates communication and interaction between actors in carrying out their activities (Gilpin, 2001). However,

in some cases, technological advances raise some new problems. This generally occurs when the ability of actors to adopt technology is still relatively low, so implementation tends to be slower (Devi, 2019). This is in line with the report released by the KOF Swiss Economic Institute report, where the growth of globalization can be measured by using the *Konjunkturforschungesstelle* (KOF) Globalization Index, which uses the benchmark of economic, social, and political dimensions of globalization and is used to monitor changes in the level of globalization on a country scale (ETH Zurich, 2018), where if the value is close to 100, that means the group of globalization in that respective country is considered high. Indonesia itself, based on the 2019 report, shows that we are in the position of 60.74, which is higher compared to ASEAN countries (50), but still behind the global average (63.87) (OECD-UNIDO, 2019). According to the research conducted by Suci, Asmara, and Mulatsih in 2015, the effect of globalization in Indonesia is not exponentially increasing income and economic growth and is not necessarily equally distributed; one of which is marked by the low GDP growth of a country. For example, Indonesian GDP Growth in 2015 from 4.88% just to 5.02% in 2019, which means it experienced a slight increase then a sharp decline in 2020 to -2.07% due to the COVID-19 pandemic (Macrotrends, 2022).

The inequality and low GDP growth are closely related to how the backbone of Indonesia's economy is supported. The Ministry of Cooperatives and SMEs noted that the number of Micro, Small, and Medium Enterprises (MSMEs) reached 65.47 million in 2019. This number increased by 1.98% compared to 64.19 million units in the previous year. Moreover, this amount covered 99.99% of the

total business in Indonesia. Meanwhile, large-scale enterprises only amounted to 5,637 units, equivalent to 0.01% (Data Indonesia, 2022). Therefore, optimizing MSMEs is crucial for Indonesia's economic resilience amid global challenges. One of the learning examples is how the COVID-19 pandemic, which has lasted for the last two years, has had a significant impact on the growth and resilience of MSMEs, especially in the aspect of Impact on revenue and Profit margin (Sonobe, Takeda, Yoshida, & Truong, 2021). At least 63,9% of Indonesia's MSMEs are experiencing declining revenue of more than 30% (Bachtiar, 2021). However, despite the sluggish economic growth, the MSMEs have continued to be a powerful growth engine during the pandemic; the trend is expected to accelerate the economic engine. One of the main factors driving the survival of MSMEs lies in the extent to which industry players can transform their businesses by entering the digital platforms.

Digitalization is the phenomenon that encompasses a variety of digital technologies, concepts, and trends, such as artificial intelligence, the "Internet of Things" (IoT), and the "Fourth Industrial Revolution," that can improve business relationships between customers and companies, thereby contributing to the economy, state, and society as a whole (Reis, Amorim, Melão, Cohen, & Rodrigues, 2020). Through digitalization, global commerce, communication, and business connections have never been more vital than today. However, the pattern of globalization is shifting . Historically, trade was dominated by tangible goods and primarily restricted to advanced economies and their multinational corporations. Today, global data flows are exploding, and digital platforms enable

participation by more nations and smaller businesses (McKinsey Global Institute, 2016).

In the context of this research, MSMEs digitalization can be defined as a process of technology adoption carried out by MSMEs in transforming their business into a digital platform, whether in the transaction, marketing, sales media, or others. Digitalization is critical for MSMEs, reaching markets with a wider geographic area, increasing revenue, and bringing a domino effect to the supporting industries in the vicinity; McKinsey report in 2016 also illustrates that many businesses, particularly in the MSMEs becoming “micro-multinationals” by using a digital platform, such as Amazon, E-Bay, Alibaba, and Facebook with customers and suppliers in other countries. Even the smallest businesses can become international: 86% of technology-based startups report international activity. The ability of small businesses to enter new markets promotes global economic growth (McKinsey Global Institute, 2016).

Therefore, the government of Indonesia has done various programs to transform MSMEs so that currently, it is becoming Asia's largest digital economy by 2020 with its MSMEs (BKPM, 2022). As part of Indonesia’s pandemic recovery efforts, accelerating the digitalization of MSMEs has been identified as essential to making businesses more resilient. At the end of 2020, Indonesia surpassed its goal of digitalizing its MSMEs and had more than 10 million small businesses using online business platforms (Parlemen, 2021). While this number represents just 16% of all Indonesian MSMEs, the rate of digitalization is on a clear upward trend that will continue from 2022 onward. To aid MSME digitalization during the pandemic,

the Indonesian government has partnered with large enterprises like Grab, Tokopedia, Bukalapak, and Gojek to develop and promote the adoption of digital tools for entrepreneurs (Gloria, 2020).

Furthermore, various government programs were carried out to digitalize MSMEs, such as at the Ministry of Communication and Information (Kominfo) by launching MSMEs “Go Digital”; by encouraging the implementation of the use of technology 4.0 such as Big Data, Quick Response (QR) Code Payment, and Augmented or Virtual Reality. This program reached 26,000 MSMEs in 2021 and is targeting 30,000 MSMEs in 2022. In addition, Kominfo also launched the MSME Digital Technology 4.0 Adoption program. The program will reach up to 70,000 MSMEs in Indonesia by 2024. Improving the digital entrepreneurship skills of MSME actors is also a concern of Kominfo, one of which is through the Digital Entrepreneurship Academy (DEA) training under the Digital Talent Scholarship (DTS) Program (Kominfo, 2022). In the financing aspect of MSME Go Digital, Bank Indonesia also launched various programs, including e-Farming which utilizes digital technology in agriculture to increase production capacity and cost efficiency. e-Commerce includes capacity building in digital marketing and marketing of MSMEs to the global market through digital platforms. They support e-Financing through digital applications for MSMEs (SI APIK). Also, digital payment facilities facilitate MSME transactions (QRIS MSMEs) (Bank Indonesia, 2022).

One of the reasons for the rapid digital transformation of MSMEs in Indonesia is the connectivity that has been evenly distributed throughout Indonesia,

and the pandemic itself has become an accelerator of internet usage penetration in Indonesia, mainly done via mobile internet. Approximately 77% of Indonesia's population is already using the internet. This growth is fantastic; before the pandemic, internet users were only 175 million. According to the latest data from the Association of Indonesian Internet Service Users (APJII), in 2022, internet users in Indonesia will reach around 210 million. This means there are an additional 35 million internet users in Indonesia. If we go into further detail, of the internet users in Indonesia, 43% are on the island of Java, followed by Sumatra (16.63%), Sulawesi (5.53%), Kalimantan (4.88%), and Nusa Tenggara (2.71%) with the largest portion. The most prominent user profile is in the age range of 13-18 years for educational and entertainment needs, as well as the range of 19-34 years with a wider variety of uses, such as e-commerce, work, and others (Antara News, 2022) (Dewi I. R., 2022).

The Indonesian government's policy of accelerating the development of the MSMEs digitalization ecosystem is critical. It is at the right momentum, considering it is the largest business type population in Indonesia, with a total contribution of 61.97% of the total national GDP or equivalent to Rp. 8,500 trillion by 2020 (BKPM, 2022); therefore, it does not only significantly impact economic growth in Indonesia. But also expediting regional economic integration in Southeast Asia (SEA) is defined as a process in which two or more countries agree to remove financial barriers to increase productivity and economic dependence. In the context of this research, regional economic integration emphasizes how the digitalization of MSMEs can accelerate the integration process so that the main goal

can be achieved (Rillo & dela Cruz, 2016). This perspective is essential, considering that traditional economic integration tends to use views based on public policies, trade flows, foreign direct investment, etc. While the process of economic integration due to the digitalization of MSMEs occurs because of the role of non-state actors, that is, the business owner who wants to increase profits by utilizing technology.

Regional economic integration in SEA is critical, as this region is considered the world's fifth-largest economy after Japan and Germany Field (ASEAN, 2020); hence, SEA is a vital trading partner for many countries and other regions of the world. According to the report given by Hootsuite, We Are Social, in 2021, SEA will have a 679 million population where the size of an internet user is 104,5% of the total population, which means that some groups of people have more than one internet device per person. In the other hand, it is also indicating that digitalization enables MSMEs to tap a larger market (We are Social Hootsuite, 2021).

The report released by the Asian Development Bank (ADB) in 2020 shows that SEA has at least 71 million MSMEs, employs 67% of the region's working population, and accounts for 97% of all businesses (Tan, 2022). Hence, as non-state actors, these enterprises play an indispensable role in the area, especially in job creation, gross domestic product (GDP), and economic integration (Vineles, 2017) (Wellington Capital Advisory, 2021).

Furthermore, the ASEAN SME Index Policy report in 2018 clearly stated that development is an essential pillar in supporting regional economic integration

efforts (OECD/ERIA, 2018). MSMEs could be considered non-state actors to support economic prosperity and independence. Therefore, in January 2016, ASEAN, as the group of nations that are located in SEA, also agreed to launch the ASEAN Coordinating Committee on Micro, Small, and Medium Enterprises (ACCMSME), responsible for strengthening MSMEs' participation in ASEAN integration and deepening and broadening their contribution to ASEAN's economic growth (ASEAN, 2015).

Ensuring the well-being of MSMEs is part of ASEAN's commitment to achieving "Equitable Economic Development," bringing about inclusive, equitable, and sustainable development. The importance of SME development to ASEAN economic integration was enshrined in the ASEAN Economic Community (AEC) Blueprint of 2007-2015, and the AEC Blueprint 2016-2025 also incorporates SME development. Thus, the ASEAN Strategic Action Plan for SME Development (SAPSMED 2016-2025) laid out five strategies on how to accelerate the MSMEs in the region, where one of the critical priorities located on technology enablement, such as how to increase access to finance, innovation and increase productivity through technology (Vineles, 2017). And specific, in this research, we will limit ASEAN countries to Brunei, Indonesia, Malaysia, Philippines, Singapore, Thailand, and Vietnam, considering these countries have rapidly growing Digital economy enablement and provide significant contributions to the ASEAN member.

Digitalization, infiltrating the system of international relations, changes the principles of global communications and its tools (Rusakova, Grobovod, & Vakhrusheva, 2020). Hence, at the G20 itself, digitalization of MSMEs is one of



the main topics under the Digital Economy Working Group (DEWG), which specifically addresses how to steer Indonesia's digital transformation to be inclusive, empowering, and sustainable (G20, 2022). And understanding that the importance of digitalization of MSMEs in Indonesia is not only for Indonesia but also for the region. Therefore, this research will emphasize how non-state actors play an essential role in the process of digitalization of MSMEs and economic integration in SEA. Gilpin, in 2001 also illustrates how globalization and technological adoption shift economic development into more market domination, which is considered a prominent feature of liberal economics, as by nature, the non-state actor will evolve their business to increase gain more revenue, increase the efficiency, expand the market, and by default we can't control the technology development that is rapidly growing.

However, even though digitalization is ultimately economic liberalization, as it is associated with free markets and private ownership of capital assets, a balance is formed where you get the maximum benefit based on the market value; the role of government is vital, as the government and individuals can strengthen trade relations with other groups by reducing barriers and risks, especially those involving interaction, lobbying, and negotiation in changing interests for development and economic improvement goals based on positive, sum-game principles promoting the element of rationality. This research will also examine why the role of the Indonesian government is critical to support the digitalization of MSMEs as in liberalism, as state-society relations in the liberalism assumption represent some segment of domestic society whose interest is reflected

in state policy and how the nature of international system formed (Moravcsik, 1992).

## **2.2. Research Questions**

1. How does the digitalization of MSMEs in Indonesia contribute to regional economic integration in SEA?
2. Why is the role of the Indonesian government in the digitalization of MSMEs in Indonesia critical to accelerating SEA economic integration?

## **2.3. Research Objective**

The topic of SMEs is a very strategic issue in various contexts, not only because it is the backbone of the economy in Indonesia and SEA but also because of its social, political, and cultural influence. History also proves that during the 1998 monetary crisis and the COVID-19 pandemic, SMEs were able to survive and become an accelerator of economic revival in Indonesia. Furthermore, as Indonesia is leading the G20 presidency, this topic has become more prominent, and digital economic transformation is considered one of the three priority agendas.

Therefore, this study examines further how the digitalization of MSMEs in Indonesia contributes to the regional economic integration in SEA, such as how these factors play a role, what factors influence it, and why it has a role. Moreover, as the MSME digitalization process on economic integration cannot be performed without state actors, this research will also explain why the Indonesian government

has a substantial contribution. Hence, it is hoped that this research will make a real impact in various fields, which will be described in more detail in the research significance.

#### **2.4. Research Significance**

Studying these two objectives further is critical for scholars, the government, professionals, and local people:

1. Academic. Essential reference as a form of evaluation of the digitization of MSMEs in Indonesia and its impact on the SEA region
2. Professional. As a market research and insight to prioritize the investment, product roadmap, and business model, particularly in technology industries
3. Comprehensive insight on how to incubate and educate the best talents in the MSME ecosystem from an international relations view. Furthermore, this could also be a strategic reference for public policy making.
4. Local People. Provide ideas and strategies related to the development of MSMEs so that they can enter the international market through business digitalization.
5. G20 and ASEAN. It targeted this thesis as part of a research fellow in the G20 Studies Centre; hence it could give another perspective inside the Digital Economy Working Group (DEWG) and as an input for the Indonesian Government on how to lead the ASEAN chairman in 2023.