

CHAPTER I

INTRODUCTION

A. Problem Background

Economic integration in Asia region will support the region to become an important player in the global level, not only in economic sectors but also in other sectors. Indonesia has an important role to accelerate that process. Asia contribution toward global economy is growing faster than the other region. Asian economy will grow through cooperation of production, trade, investment and finance. Therefore, the integration will support Asia to become the important player in global economy. Asia will be the important partner to trade, investment, and the global economy development.

ASEAN leaders agreed to propose ASEAN Vision 2020 in ASEAN Summit which was held in Kuala Lumpur, Malaysia in December 1997. ASEAN Vision 2020 is the spirit of ASEAN countries to form ASEAN to become a stable, prosperous, and highly competitive region with equitable economic development and reduced poverty and socio-economic disparities. The spirit was initiated in ASEAN Summit in Bali in October 2003 by Bali Concord II.

There are some triggers in the establishment of ASEAN Economic Community such as the tendencies of global strategic movement which forces the countries in the world in increasing the competitiveness

regional level which is integration effort on economic

integrated single market and production, and the emerge of China and India as new economic power which affect world trade especially in Asia Region.

In January 2007, in the 12th KTT ASEAN, ASEAN leaders agreed the acceleration of AEC implementation from 2020 to 2015. The high level meeting was continued in the 13th KTT ASEAN in November in Singapore which resulted in AEC Blueprint. AEC Blueprint is a strategic schedule consisting of the time limit to ASEAN countries reaching full integration. It is divided into four steps namely 2008-2009, 2010-2011, 2012-2013, and 2014-2015. It is followed by four main characteristics as follows (1) single market and production base, (2) a highly competitive region, (3) equitable economic development, and (4) integrated into the global economy.

So far, Indonesian government has not known yet the commitment of each country to realize Asian economic integration. However, at least by the establishment of ASEAN Economic Community (AEC) 2015, Asian economic integration will be easy to be realized. If the Indonesian government is optimistic, the businessman will be realistic, especially among Small and Medium Enterprises (SMEs).

Indonesian Small and Medium Enterprises have an important role related to the government efforts in order to reduce unemployment, fight against the poverty, and distribute income. On the other hand, the policy of SMEs development is regarded as the policy of work opportunity creation and anti-poverty or income redistribution. The awareness to de

based on two motives. Firstly, SMEs employ many labors. TI

receiving many labors makes SMEs intensive in using local natural resources. Because the location is located in the villages, the development of SMEs will give positive impact toward the increasing labors, reducing poverty, distributing the income, and developing the economy in rural.

In the policy side, SMEs have to gain more attention from the government because SMEs do not only give income to Indonesian work force but also become the main point in order to reduce the poverty. In rural areas, the important roles of SMEs are giving the additional income, as a seedbad to industry development and complement of agriculture production for poor people.

Secondly, SMEs also aim at the survival strategy in monetary crisis. SMEs sector is working hard in facing long term crises. The contribution of this sector in national economy is significant enough. In 2005, the number of SMEs registered 44.6 billion units or 99.99% from the total of economic business unit and received 88.7% labor from the total of Indonesian labors or almost 68.28 billion people.¹ This data indicates that SMEs will become a motivator to the development of national economy, even if the productivity rates are still low.

Small and Medium Enterprises (SMEs) are one of the front promoter of economic development. The movement of SMEs sector is vital to create the economic growth and work opportunity. SMEs can be adapted with the market demand (flexible). They create work opportunity faster than the other

¹ BPS 2008, *Provinsi DIY dalam Angka*.

small enterprise (16.61%), and medium and big enterprises only 1% or 5.06 thousands.⁵

Considering the vital contribution of SMEs sector to economic development in Indonesia, especially in Yogyakarta Special Territory, and the reality that SMEs sector as the economic actor, ASEAN Economic Community will affect to SMEs sector. In this research, the writer will analyze the prospects measured by Strengths, Weaknesses, Opportunities, and Threats of SMEs in facing the implementation of ASEAN Economic Community 2015. The research will take the case study in Yogyakarta Special Territory because SMEs become the promoter of economic development in the region.

B. Research Question

1. What are the prospects of Small and Medium Enterprises of Yogyakarta Special Territory in order to face the implementation of AEC 2015 as regional economic integration, if measured by SWOT analysis?
2. How is the potential success of the integration process of ASEAN Economic Community by learning on European Economic Community Experience?

C. Theoretical Framework

1. Integration Theory

a. The Understanding of Integration Theory

Theories of integration have mainly been developed to

mainly European integration. Europe is one of the

Created with

world, in which its regional integration started in the early 1950s with the European Coal and Steel Community (ECSC) in 1952. Ernest Haas theorized this experience in *The Uniting of Europe* (1958). The main theoretical contribution was the concept of spillover. Later, Lindberg used this concept to study the early years of the European Economic Community (EEC), which started in 1958. These early theories are usually referred to as neo-functional theories. There were some efforts to apply these neo-functional theories to integration in other parts of the world, especially in Latin America (Haas, 1961; Haas and Schmitter, 1964; Haas, 1967). The integration process in Europe experienced a crisis in the mid-1960, when General de Gaulle instructed his ministers not to take a part in the meetings of the EEC Council. In the Luxembourg compromise in January 1966, the six members of the European Communities (EC) decided to disagree.

When early theories of integration were developed, there were many discussions in the literature on how to define the concept. For instance, it discussed whether integration refers to a process or to an end product. Integration is defined as a process that leads to a certain state of affairs.

Karl Deutsch, for instance, defined integration as “the attainment, within a territory, of a ‘sense of community’ of institutions and practices strong enough to assure, for a ‘long’ time, dependence of ‘successful change’ among its population.”

of people or states have been integrated this way they constitute a “security community.” ‘Amalgamation’, on the other hand, was used by Deutsch and his collaborators to refer to “the formal merger of two or more previously independent units into a single larger unit, with some type of common government” (Karl W. Deutsch et al., 1957: 5-6).⁶

Early efforts to study regional integration, as mentioned, mainly concentrated on the European Coal and Steel Community (ECSC) and the European Economic Community (EEC). In Ernst Haas's classical study of the ECSC, *The Uniting of Europe*, integration was defined as

... the process whereby political actors in several distinct national settings are persuaded to shift their loyalties, expectation and political activities to a new center whose institutions possess or demand jurisdiction over the pre-existing national states.⁷

In Leon Lindberg's study of the early EEC, *The Political Dynamics of European Economic Integration*, integration was defined without reference to an end point:

... political integration is (1) the process whereby nations forgo the desire and ability to conduct foreign and key domestic policies independently of each other, seeking instead to make joint decisions or to delegate the decision-making process to new central organs; and (2) the process whereby political actors in several distinct settings are

⁶ Retrieved from <http://www6.miami.edu/eucenter/LaursenLongSympos08R>
April 15, 2009

⁷ James F. Dorschner/Robert J. Delaney, Jr. “Contending Theories of Inter-

persuaded to shift their expectations and political activities to a new center.⁸

Lindberg considered his own concept of integration to be more cautious than that of Haas. Central to it was “the development of devices and processes for arriving at collective decisions by means other than autonomous action by national governments”.

Some concepts of integration applied in studies of the European Communities (EC) may be too specific if we want to conduct comparative studies. Clearly, the process of European integration within the EC has gone further than the integration in other regional settings. A relatively loose definition may be better for comparative studies. However, it seems fair to say that collective decision-making is an important aspect of all regional integration efforts. This collective decision-making can cover a varying number of functional areas (scope). The decision-making process can be more or less efficient and the common institutions established can be more or less adequate (institutional capacity).

Then, what explains changes in the functional scope and institutional capacity of regional integration efforts? This is the central question in integration theory. Ernst Haas developed the concept of *spill-over*, which was also applied by Lindberg

According to Lindberg,

... spill-over" refers to a situation in which a given action, related to a specific goal, creates a situation in which the original goal can be assured only by taking further actions, which in turn create a further condition and a need for more action, and so forth.⁹

Haas saw the EEC as spill-over from the ECSC. He talked about "the expansive logic of sector integration." He predicted that the process would continue in the EEC. Liberalization of trade within the customs union would lead to harmonization of general economic policies and eventually spill-over into political areas and lead to the creation of some kind of political community.

The early theory sees the process as too automatic lead to various efforts to reformulate the integration theory. The effort by Lindberg and Scheingold in the book *Europe's Would-Be Polity* gets a special mentioning. Lindberg and Scheingold study the EC as a political system, where inputs in the form of demands, support and leadership transformed into outputs in the form of policies and decisions. They add three integration mechanisms to that of spill-over already developed by Haas, namely (a) *log-rolling and side-payments*, i.e. bargaining exchanges designed to "gain assent of more political actors to a particular proposal or package of proposals," (b) *actor-socialization*, i.e. the proce

"participants in the policy-making process from ir

bureaucrats and statesmen, begin to develop new perspectives, loyalties, and identifications as a result of their mutual interactions,” and (c) *feedback*, which mainly refers to the impact of outputs on the attitudes and behavior of the public at large. If the public finds the output from the system good and relevant, support for the system is expected to increase.

Integration was seen as a *political* process by Lindberg and Scheingold. On the demand side, various domestic groups have expectations and lobby the governments for certain outcomes. On the supply side, coalition formation and leadership are seen as central aspects of the process. To get decisions through the system, you must have the support of various groups and individual decision-makers. This is where the role of the independent Commission was seen as important in the EC. The Commission can actively try to build coalitions to overcome national resistance to new policies and decisions, i.e. exercise supranational leadership.

b. European States Policy To European SMEs

The process of European Union integration was begun by the establishment of the European Coal and Steel Community in 1951 which began to unite European countries economically and politically in order to secure lasting peace. Then in 1957, the Treaty of Rome created the European Economic Community.

'Common Market' to continue the integration process in achieving European Union.

Micro, small and medium-sized enterprises (SMEs) play a central role in the European economy. They are a major source of entrepreneurial skills, innovation and employment. In the enlarged European Union of 25 countries, some 23 million SMEs provide around 75 million jobs and represent 99% of all enterprises.¹⁰ However, they are often confronted with market imperfections. SMEs frequently have difficulties in obtaining capital or credit, particularly in the early start-up phase. Their restricted resources may also reduce access to new technologies or innovation. Therefore, support for SMEs is one of the European Commission's priorities for economic growth, job creation and economic and social cohesion.

Small and medium-sized enterprises (SMEs) make a major contribution to growth and job creation in the European Union (EU). This is why the new policy on small and medium-sized enterprises (SMEs) creates a more coherent, pragmatic and horizontal framework for these enterprises. Promoting entrepreneurship and developing an environment favorable to SMEs will allow them to become more competitive.

¹⁰ *The New SME Definition* retrieved from http://ec.europa.eu/enterprise/policies/sme_definition/sme_new_guide

SMEs are of major importance to the future European economy because they make a major contribution to the creation and maintenance of employment, and in many regions of Europe they are the predominant providers of jobs and livelihood; they account for a significant share of European GNP, and are the principal sources of wealth creation in many parts of the Union; they occupy unique and strategic positions in the delivery chain, providing highly specialized niche products to large enterprises, for example, as well as ensuring a diversity of supply of goods and services adapted to the needs of final customers.¹¹

The European Union has competences in many policy areas which directly affect SMEs. Moreover, in some of these, competence is shared between the EU, Member States and their regions. Success in making Europe an SME-friendly business environment will therefore require concerted efforts from all relevant authorities to ensure the various policies complement each other.

In 2005, the European Commission adopted its 'Modern SME policy for growth and employment'. This aims to ensure that all aspects of EU policy to help SMEs are coordinated, and that the

¹¹ It is retrieved from http://www.earto.eu/fileadmin/content/03_Publications/1008_11_01_SMEs_in

needs of SMEs are more fully assessed in drawing up such policies.

The policy includes action in five areas:¹²

- Promoting entrepreneurship and skills
- Improving SMEs' access to markets
- Cutting red tape
- Improving SMEs' growth potential
- Strengthening dialogue and consultation with SME stakeholders

Under the modern SME policy, the Commission seeks to highlight examples of successful initiatives and encourage Member States and regions to learn from each other. For example, the European Enterprise Awards highlight and reward regional initiatives with strong results in encouraging small businesses. Furthermore, by encouraging and supporting networking across Europe, the Commission aims to help SMEs gain easier access to new markets outside their own country.

2. SWOT Analysis

a. SWOT Analysis

The SWOT analysis (Strengths, Weaknesses, Threats, and Opportunities) is not the first instrument of analysis which is popular in the strategic management. Basically

¹² A comprehensive policy to support SMEs retrieved from

https://ec.europa.eu/economy_finance/entrepreneurship/emp_policy.htm on August 24th

management is related with the existence of the opportunity and the threats of business from external factor and the strengths and the weaknesses which built by the management. Technically, the SWOT analysis is one of the instrumental assistance of decision making in the strategic management of business. The SWOT analysis is firstly introduced by Heinz Wehrich, the professor of management in the University of San Fransisco in 1982, in his article on Journal of Long Range Fransisco Vol. 5.¹³ Wehrich was introduced the SWOT analysis to the public which can be applied not only in the business organization but also in the organization of states and other organizations.

SWOT analysis can not be separated from the process of strategy formulation. SWOT analysis is expected to facilitate the strategy designers in selecting the suitable strategy for the business. The core of this analysis is the process of doing the evaluation toward the company and its business environment which is done by self-assessment. The result is the critical and selective inventory toward four variables (SWOT) and the implication strategy which is used by the management.

What is the step of SWOT analysis? Firstly, the management and or with consultant identify toward the strengths and weaknesses of the business and then compari

identification to the strengths and weaknesses of the competitors. Make 3 to 10 indicators of each variable. Secondly, the management detects the macro and micro of business environment (the competitor industry) which affect the operational business significantly. Finally, the management formulates the strategy which can be implemented by reflecting the possible combinations of each indicator of SWOT.

Basically, the analysis instrument of SWOT is qualitative. In arranging this analysis, SWOT analysis relies on the strengths, experiences, and intuitions of management. This analysis only demands the management to make a list of the strengths and weaknesses of the business, then faces with the opportunities and threats. By facing the variable of internal (S-W) and variable of external (O-T), the management can consider the possible business strategy which may be more elaborated to implement it.

b. Measured Value and Strategic Position Based on MDTI

1) Determining Measured Value of SMEs

First, the management and or with consultant make the list of indicators from the variables of internal and external. The total of indicators is between three and fifteen. If the variable is too small, it can not reflect the variable, but if there are too many variables, it will not focus. Th

Recent condition	Future condition
1. Identify the variables of internal and external	1. Predict the variables of internal and external
2. Evaluate the internal variable	2. Estimate the internal variable
3. Evaluate the external variable	3. Estimate the tendency of external variable
4. Determine the position of business	4. Estimate the position of business

Sources: Suwarsono Muhammad, 2007

Second, the management gives the weight into each indicator by comparing the role of one indicator to other indicators. Remember the level of influence of one indicator and other indicators in the category of variables of strengths and business opportunities in achieving the aim of the company in arranging the strategic planning. In the other hand, giving the weight is related to the comparison of the role among indicators. The maximum weight for each category, for example the strength is 1 or 100 percent. The maximum weight is distributed to all indicators based on the level of influence of each indicator.

Third, the management gives the evaluation toward the contribution which is given by each indicator in achieving the aim of the company especially for one period of arranging strategic planning. The evaluation is different from the giving of weight, the giving of weight more emphasizes on the comparison of the role among indicators, while the evaluation emphasize on the contribution which is

indicators. The evaluation of each indicator is done through the process of scoring from 1 to 5.

The process of scoring is as follows:

- 1 = very low
- 2 = low
- 3 = medium
- 4 = high
- 5 = very high

Fourth, the management calculates the measured value of each indicator and counts it up. The measured value is the multiplication between weight and score of each indicator. In determining the measured value, the assumption used is as follows:

- The total of measured value between 0 to 3 is low category
- The total of measured value between 3 to 4 is medium category
- The total of measured value more than 4 to 5 is high category

The last stage determines the position of company in one of quadrants from four quadrants and also determining the competition strategy based on the position.

2) Strategic Position of Business Based on MDTI

Matriks Daya Tarik Industry best known as MDTI, is designed to help the management in making the decision for investment on business portfolio. MDTI has t

...vertical and horizontal. Vertical deseri

Created with

strengths which are measured and calculated before, based on the indicator which is chosen by management as approach. Horizontal describes the businesses opportunities and threats from the external business. Both coordinates describe about industry attractiveness which support the business to operate the business continuously.

MDTI has nine cells which are formed after each coordinate is divided into three parts with certain cut off point. The coordinate is categorized as low, medium, and high parts. Each cell is formed by the point of intersection of both coordinate after each coordinate is divided into three parts on market position. Besides that, each cell contains the implication of business strategic.

Figure 1
Matrix of Industry Attractiveness

		Industry Attractiveness		
		High	Medium	Low
Business Strengths	High	Investment and grow	Selective growth	Selective
	Medium	Selective growth	Selective	Divestment
	Low	Selective	Divestment	Divestment

Figure 2
The Strategic Implication of MDTI

		Industry Attractiveness		
		High	Medium	Low
Business Strengths	High	Growth Maximum Investment	Selective Growth Aggressive Investment Keep Other Positions	Keep Other Positions Find Money Supply Investment
	Medium	Lead the Market Based on Segment Improve the Weakness Develop the Strength	Growth based on Market Segment Specialization Selective Investment	Reduction Minimum Investment Ready to Invest
	Low	Specialization Find Space of Market Consider Acquisition	Specialization Find Space of Market Consider Exit from Market	Follow Market Leader Make cash of the competitor disorder Exit from Market

Source: Suwarsono Muhammad, 2007

D. Hypothesis

1. The Small and Medium Enterprises (SMEs) of Yogyakarta Special Territory are able and ready to face the implementation of ASEAN Economic Community 2015 as regional economic integration;
2. ASEAN Economic Community 2015 is potential to succeed the integration process of ASEAN members.

E. Purposes of Research

1. To analyze the Strengths, Weaknesses, Opportunities and Threats of Small and Medium Enterprises (SMEs) of Yogyakarta Special Territory in order to face ASEAN Economic Community 2015 as regional economic integration;
2. To know the prospects and understand the strategy of Small and Medium Enterprises (SMEs) of Yogyakarta Special Territory in

3. To know the potential success of ASEAN Economic Community by learning on European Economic Community Model.

F. Research Method

This thesis is based on a deductive logic. In the science, there are two important elements: logical integrity and empirical verification. In deductive logic, the theoretical expectations were born out by empirical reality.¹⁴

To explain the problems and verify the hypothesis based on the empirical reality, the writer uses the library research method. The writer gets the information from various references in the forms of books, encyclopedia, and SMEs documents. In addition, the writer also uses various data from internet since some information and data dealing with the topic forwarded are only available through the internet. Then, the data collected is analyzed using some theories preferred.

G. Range of Research

In this research, the writer limits the problem by focusing on the factor of Strengths, Weaknesses, Opportunities and Threats of Small and Medium Enterprises (SMEs) in Yogyakarta Special Territory in order to face ASEAN Economic Community 2015 as regional economic integration.

H. System of Writing

The outline of this thesis is described as follows:

Chapter I : Introduction describes problem background, research question, theoretical framework, hypothesis, purpose of research, research method, range of research, and system of writing.

Chapter II : In this chapter, the writer describes Small and Medium Enterprises of Yogyakarta Special Territory.

Chapter III : The chapter describes about the general description of ASEAN Economic Community and the Significance of AEC Blueprint.

Chapter IV : In this chapter, the writer explains the descriptive analysis of the prospects of SMEs of Yogyakarta Special Territory and the potential successful of ASEAN Economic Community.

Chapter V : The last chapter is the closing part of this thesis