

Roos Kities Andadari¹, Meine Pieter van Dijk²
**CAN INDONESIAN SMES COMPETE WITH THEIR PARTNERS
 IN THE ASEAN ECONOMIC COMMUNITY? ***

This paper examines whether Indonesian SMEs are ready to benefit from the implementation of AEC. Research conducted in Central Java found that Indonesian SMEs are not ready for AEC due to internal and external disadvantages. Therefore, there is a need to develop a systemic strategy to address these disadvantages.

Keywords: trade liberalization; AEC; SME; readiness; competitiveness; Central Java.

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Рус Китієз Андадарі, Майне Пітер ван Дійк
**ЧИ ЗМОЖЕ МАЛИЙ ТА СЕРЕДНІЙ БІЗНЕС ІНДОНЕЗІЇ
 КОНКУРУВАТИ В МЕЖАХ ЕКОНОМІЧНОГО
 СПІВТОВАРИСТВА АСЕАН?**

У статті досліджено готовність малого та середнього бізнесу Індонезії використовувати переваги від створення Економічного співтовариства АСЕАН. Дослідження, проведене в регіоні Центральна Ява, доводить, що МСБ Індонезії в цілому не є готовим до нової спільноти через низку внутрішніх та зовнішніх недоліків. Продемонстровано необхідність розробки системної стратегії, яка б врахувала всі описані слабкі місця.

Ключові слова: лібералізація торгівлі; Економічне співтовариство АСЕАН; малий та середній бізнес; готовність; конкурентоздатність; Центральна Ява.

Табл. 2. Літ. 11.

Рус Китієз Андадарі, Майне Пітер ван Дійк
**СМОЖЕТ ЛИ МАЛЫЙ И СРЕДНИЙ БИЗНЕС ИНДОНЕЗИИ
 КОНКУРИРОВАТЬ В РАМКАХ ЭКОНОМИЧЕСКОГО
 СООБЩЕСТВА АСЕАН?**

В статье исследована готовность малого и среднего бизнеса Индонезии использовать преимущества от создания Экономического сообщества АСЕАН. Исследование, проведенное в регионе Центральная Ява, доказывает, что МСБ Индонезии в целом не готов к новому сообществу в силу ряда внутренних и внешних недостатков. Показана необходимость разработки системной стратегии, которая бы учла все описанные слабые места.

Ключевые слова: либерализация торговли; Экономическое сообщество АСЕАН; малый и средний бизнес; готовность; конкурентоспособность; Центральная Ява.

Background. Trade liberalization is believed to improve welfare for the countries involved, but it also causes inequality among member countries. This imbalance occurs because not all countries have a comparative advantage against others. The main objective of trade liberalization is to eliminate trade barriers for goods, services, production factors, and investments. Indonesia has implemented an opening up policy since 1967, but its implementation was slow and partial. Indonesia became member of the World Trade Organization (WTO) in 1995, and has reached free trade agreements with countries through the establishment of Regional Comprehensive Economic Partnerships (RCEP), such as ASEAN and China (ACFTA), ASEAN and

¹ Satya Wacana Christian University, Salatiga., Indonesia

² Institute of Social Studies of Erasmus University, Rotterdam, Netherlands.

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South Korea (AKFTA), ASEAN and India (AIFTA), ASEAN and Australia-New Zealand (AANZFTA), and ASEAN with Japan (the Comprehensive Economic Partnership, or AJCEP) besides a bilateral relation with Japan (Japan Economic Partnership). The free trade agreement now is the ASEAN Economic Community (AEC). This requires eliminating restrictions on the flows of goods and services, and all ASEAN countries should liberalize investments, skilled labor and capital flows.

AEC provides opportunities through an increasingly broad market, increased investments, and access to resources in other ASEAN countries. However, there will be increased competition due to the absence of tariffs and non-tariff barriers, a more open service sectors, and increased mobility for workers. In flow of goods and services from abroad increases consumer choices. AEC is also expected to encourage bureaucratic reform due to the demand to create conducive business environment. Indonesia will also face tough competition with other ASEAN countries due to its high inflation, high interest rates, unstable capital, low competitiveness of human resources, as well as issues related to national sovereignty. One of economic actors that will be affected by the enactment of the AEC are micro-, small, and medium enterprises (MSMEs). Several studies have emphasized the benefits of trade liberalization for SMEs in developing countries, but many developed countries have complained about the negative impact. This paper examines whether Indonesian SMEs are ready to benefit from the AEC.

Theoretical framework: liberalization of trade and competitiveness of SMEs. Not all countries are ready to face free trade in the multilateral system as arranged by the WTO. Several countries have formed regional agreements or trade blocs to advance regional economic growth. Among the trade agreements that have been formed are AFTA (ASEAN Free Trade Area), NAFTA (North American Free Trade Agreement), EU (Europe Union), Mercosur (the Southern Part of South America), CARICOM (Central America). F. Jovanovich (2006) argues that economic integration is a process in which a group of countries work to improve the level of prosperity. P. Krugman (2012) emphasizes that economic integration may impact on people's welfare when a strong economic country that applies a high tariff then decides to release this tariff. Economic integration has trade creation and trade diversion effects. Trade creation means increased trade among member countries, while trade diversion is shifting imports from non-member to member countries. This will occur if each country has different products. The problem is if countries in the region have relatively similar products, then the expected impact is not happening.

Public perception of the implementation of the ASEAN-China Free Trade Agreement (ACFTA) is essentially not very positive because it hurts many parties in Indonesia. A survey conducted by the Indonesian Survey Circle in May 2010, 4 months after the enforcement of this agreement, shows that only a small fraction (26.7%) of Indonesian public knows or has heard about this agreement. This situation illustrates that the Indonesians are not ready to face ACFTA (Sri Susilo, 2010).

In Indonesia MSMEs have become the backbone of the economy. The number of MSMEs covers more than 99% of all business units, employing 97% of all labor force and contributing about 60% to GDP. In the aftermath of the financial crisis, MSMEs were considered to be the savior of Indonesian economy because when a great number of firms went bankrupt, MSMEs remained strong. According to

(Pratomo, 2004), there are at least 4 reasons why SMEs in Indonesia can survive in times of an economic crisis: 1) most MSMEs produce consumer goods; 2) the majority of MSMEs rely on non-banking financing in their funding; 3) MSMEs have strict product specialization; 4) new MSMEs are established as a result of a number of job losses in the formal sector. The largest number of MSMEs can be found in agriculture, followed by trade, hotels and restaurants, while the number in manufacturing is approximately equal to those engaged in transportation and communications.

Competitiveness is defined as the ability to compete (Ambastha and Momaya, 2004) and determines firm's success in our hyper-competitive era. It is argued that SMEs cannot compete at global markets as these firms face the disadvantage of having limited resources. However, studies have found that competitiveness can be derived from many sources. Small firms need to overcome these limited resources through exploiting other sources of competitiveness (Andadari, 2008: 25).

N. Rafinaldy (2006) relates limited competitiveness of Indonesian SMEs to the problems faced by small businesses: 1) low productivity associated with low quality of human resources and low entrepreneurial competencies; 2) limited access to productive resources, especially capital, technology, information, and markets; 3) low quality institutions; 4) low performance and negative image of cooperatives; 5) less conducive business climate. He divides the problems faced by MSMEs into internal and external ones. Internal problems include: 1) lack of capital and limited access to financing; 2) low quality of human resources; 3) weak networking and little abilities for market penetration; 4) problems with business mentality (the SME working atmosphere is relaxed and less active, often causing less opportunities; 5) there is lack of transparency, especially between the older generation and the next generation, due to lots of information and links that are hidden and not disclosed.

External problems include: 1) non-conducive business climate; 2) limited facilities and infrastructures owned by SMEs; 3) there are illegal charges; 4) implications of decentralization; 5) implications of free trade for SMEs; 6) products have short durability; 7) there is limited access to markets; 8) there is limited access to information, which makes it difficult to enter export markets.

Readiness is the overall condition that makes a person or an institution ready to respond or answer in a certain way to a particular situation. M.R. Hamidizadeh and M. Zagaranyazd (2014) define internationalization readiness as firm's preparedness and propensity to commence export activities. They propose a framework to evaluate SMEs international readiness that consists of 3 dimensions: 1) marketing/operational; 2) functional; 3) managerial commitment.

SMEs are considered to be ready to face AEC when they are able to take advantage of opportunities arising from AEC implementation. These capabilities are related to SMEs competitiveness. As known, trade liberalization in the ASEAN region will increase trade volumes. The issue is whether SMEs can take advantage of these opportunities. In addition, SMEs are ready to face AEC when they are able to survive after the influx of foreign products.

The ability to take advantage of export markets or to survive the flow of products from other ASEAN countries is highly dependent on the competitiveness of products. Competitiveness of Indonesian products is considered to be low. The WEF (2015) ranks Indonesia's competitiveness at 34 of 144 countries. At the level of ASEAN,

Indonesia is ranked fifth after Singapore, Malaysia, Brunei, and Thailand. Indonesian firms have so far been unable to take advantage of the achievements of the ASEAN market in exports and imports inside ASEAN. Microconditions for readiness are related to the availability of supporting activities for SMEs. Macroconditions are associated with various aspects of the environment such as dependency on importing raw materials, semi-finished and finished goods, energy supply constraints, and poor infrastructure. Readiness of SMEs to face AEC is closely related to their current competitiveness. T. Tambunan (2011) stated that competitiveness is determined by the competitiveness of company, which depends on worker skills, entrepreneurial skills, good organization and management, capital availability, accessibility of technologies, the availability of information, and accessibility of other inputs.

Research methods. Are SMEs in Central Java ready to compete with their ASEAN partners when AEC is implemented? The study takes a sample of SMEs in Central Java. According to government regulation No. 20 as of 2008, a firm is considered a small one when sales turnover per year is between 300 mln Rp and 4 bln Rp. A firm is considered to be medium when sales turnover per year is between 4 bln Rp and 50 bln Rp. This research does not include microfirms as most microfirms have an insignificant impact on economy.

We studied SMEs operating in various sectors. The data is collected through a survey in which business owners or managers were interviewed with a semi-open questionnaire in March-April 2014. The respondents are drawn from most districts of Central Java, but the respondents' selection is conducted through purposive sampling. To describe the conditions of SMEs survey, SWOT-analysis was used exploring strengths and weaknesses of SMEs and identifying opportunities and threats faced by SMEs in Central Java dealing with AEC.

Analysis and findings. The total number of small and medium scale businesses interviewed was 310. Most respondents are from the manufacturing sector (32.6%); followed by trade and HoReCa sector (25.8%); and agriculture (20.6%). Meanwhile, other sectors of the sample take less than 10%. Based on sales turnover classifications, about 79% of firms are considered to be small enterprises (Table 1).

Table 1. Number of respondents by sectors and size, authors' (Andadari et. al., 2015)

SECTOR	Size				Total	
	Small		Medium			
	Abs	%	Abs	%	Number	%
1. Agriculture	57	89.1	7	10.9	64	20.6
2. Manufacturing	82	81.2	19	18.8	101	32.6
3. Construction	6	46.2	7	53.8	13	4.2
4. Trade and HoReCa	57	71.3	23	28.8	80	25.8
5. Transportation and communications	11	68.8	5	31.3	16	5.2
6. Finance, renting, other services	8	80.0	2	20.0	10	3.2
7. Services	24	92.3	2	7.7	26	8.4
Total	245	79.0	65	21.0	310	100

The most dominant small-scale firms in terms of sales turnovers belong to services sector, followed by agriculture and processing industry. Most respondents (70%)

already have business licenses (in Indonesia the term is SIUP); the lowest number of firms with SIUP (only 35.9%) are in agriculture. In agriculture, nearly one-third of firms do not have SIUP, primarily medium-sized enterprises. Moreover, most of SMEs (67%) already have a tax number (NPWP). When viewed by the sectors the majority of firms that do not have NPWP are from agriculture (68.8%). As with SIUP, among those which do not have NPWP, most are classified as medium size firms.

Although AEC was launched at the end of 2015, still quite a lot of business persons (41.6%) do not know about the plans to implement this agreement. Of those who already know about AEC, they received information from mass media such as TV, newspapers, and the Internet (77%). However, socialization program by the government is not widely regarded as a source of information, perhaps because the frequency of this socialization is not so intense, so that it receives less attention from businesses. News about AEC, however, in mass media has been much more aggressive in the last 2 years.

According to business representatives, most of them are quite optimistic about AEC implementation bringing business opportunities (82%). Most believe it will allow them sell more products (41.9%). Enforcement of AEC rules is also expected to encourage entrepreneurs to provide higher quality of goods (21.9%). However, only a few businessmen plan to take advantage of opportunities selling their products to other ASEAN countries (17.7%). Apparently, orientation of most entrepreneurs in Central Java is rather domestic. Despite new opportunities for exports, not many SMEs will export to other ASEAN countries. Of these business persons, there are those who assume that AEC does not provide any business opportunities (18.5%).

Majority of entrepreneurs (79%) think that AEC will pose a threat to their businesses, and only a small number of them consider AEC as being not threatening (21.2%). Many businessmen emphasize that AEC allows for the entry of cheaper products (35%), an inflow of good-quality products (32.5%), and of more attractive products (10.8%).

It can be concluded that many entrepreneurs are unaware of the plan to implement AEC. There are even some entrepreneurs who tend to ignore this plan. Some of them are still busy with internal problems, so they are not concerned about what will happen in the future. The enforcement of AEC provides opportunities for SMEs to sell more products, encourage entrepreneurs to provide higher quality products, and sell products to other ASEAN countries. There are still people who believe that this agreement does not bring business opportunities. AEC enactment threatens businessmen and women through the entry of cheaper products, better quality products, and more attractive products.

Readiness of SMEs to face AEC is not only seen from how SMEs can take advantage of the opportunity to enter other ASEAN markets and gain access to inputs, but also how SMEs will be able to withstand the entry of new products from other ASEAN countries. With the opening of the ASEAN market, all SMEs in Central Java face increased competition. Based on the three scores of competitiveness (strong, moderate, and weak), competitiveness of SMEs in Central Java is considered to be moderate. Most entrepreneurs (58%) have experienced an increase in sales turnover in the last 5 years, 30% have experienced steady sales, and 12% have had a turnover decline. The same trend is observed when viewed as the spread of the mar-

ket in the last 5 years. 53% of the entrepreneurs have had an increase in and broadened their market activities, 43% have maintained steady sales, and 3.5% experienced a decline in sales. However, if viewed from their real product value in the last 5 years, only 37% have undergone an increase in real product value, 53% have experienced a steady product value, and 9% have had a decline in product value. This is due to the impact of inflation that occurred in the last few years, directly or indirectly affecting real product value.

Entrepreneurs perceive that their competitiveness is predicted to weaken due to enforcement of AEC rules, where only 38% of firms are estimated to have an increase in sales turnover, while 49% will be steady, and 13% will experience a decline. For medium-sized enterprises, the number of firms that perceive an increase in turnover will be higher than those in small business. Meanwhile, the extent to which opportunities can be exploited and threats hindered depends on market orientation of most firms.

Most of them sell their products locally, in Central Java, almost one-third sell to other domestic markets, outside Central Java, and only 7.8% export their products. Trade, hotels and restaurants sector is a natural locally market. This shows that the market orientation of most Indonesian SMEs is domestic one. This infers that only a limited number of firms are ready to exploit new opportunities at foreign markets when AEC is implemented, whereas the majority have to be ready for the inflow of foreign products from other ASEAN countries, while only a few firms intend to benefit from potential markets in the ASEAN countries. Larger firms that already benefit from foreign markets are mostly from the manufacturing sector.

Innovation is an important factor for businesses to maintain competitiveness. SMEs in Central Java take efforts to innovate, but not all firms actually have innovations. Periodic innovation is only done on part of these firms (59%). The share of medium-sized businesses that do periodic innovation is far more than that of small businesses. Most innovations (33.4%) concern production processes, followed by product innovation (27%) and innovation in technology (16%). Innovations in packaging are done by about 8% of these firms. SMEs are relatively low in innovation because they face some barriers. Most barriers are related to costs (35%), followed by other barriers (25%), time constraints (20%), and lack of knowledge (or "have no idea") about how to conduct innovation (19.5%).

Another factor that may contribute to innovation performance is quality of human resource. This refers to the presence of skilled labor because education of labor in SMEs is generally low. In Central Java, 39% of firms have mostly laborers with high school education; 35% have mostly laborers with a junior high school education; and 3% of the firms have primarily uneducated laborers. It seems that there is no clear pattern related to education of workforce considered by sectors. Labor problems for SMEs are getting worse because most firms (71%) do not provide regular training for their workforce. Training plays an important role in enhancing competences and productivity of laborers.

The majority (70%) of firms obtain their raw materials from surrounding areas in Central Java province. Other firms (about 20%) also rely on raw material sources from outside Central Java, while only 4.2% of firms rely on imported raw materials. The majority of enterprises (74%) have no difficulty in obtaining raw materials, but

this picture does not provide clear information on whether SMEs have actual dependence on raw materials from abroad. In some cases, SMEs may use materials purchased where they are located, but they have been actually imported by other institutions.

Financing used by SMEs in Central Java is still very traditional because most of the firms (64%) rely on equity capital and many others – on individual loans. Only 32% of the firms receive loans from banks/financial institutions. In general, most firms (87%) would have no trouble obtaining capital. Although firms do not have problems in gaining access to financial sources, their reliance on equity capital and individual financial support limits their access to larger volumes of finances they need.

Most entrepreneurs (93%) feel they have no difficulty in obtaining information for their businesses. The question is to what extent information is used in making business decisions. Concerning record keeping in a company, a firm's recording system is applied mostly manually (almost 60%); only 30% of them use computers to record data. Of these, only 10% implement an integrated recording system and only 38.7% of SMEs regularly use the Internet.

Concerning management, SMEs in Central Java have characteristics of SMEs in general. Most of the respondents run their businesses under family management, where the owner who manages business is assisted by family members. Some entrepreneurs (24%) have begun to involve professionals in their businesses, but it is still limited to outsourcing some jobs to professionals outside the company. Only 10% of business owners rely on professionals to run their businesses.

74.5% of SMEs have the capacity to serve current consumer demands; there is no difference between small and medium businesses. However, in anticipating AEC, most firms (77.7%) plan to increase their production capacities. This is consistent with the possibility of increasing the number of sales that will evolve with the implementation of AEC.

Supervision over products on the spot is not easy, as market inspectors cannot easily distinguish between domestic and imported products. Implementation of Indonesian National Standard (SNI) certification is expected to be a filter for bad products to enter Indonesian market, but application of SNI may impact Indonesian SMEs when they are not ready. Similarly, concerning certification, Indonesian SMEs do not seem to be ready to face AEC given that only 17% of them have SNIs. Meanwhile, obtaining certification for SMEs cannot be done quickly. This is because infrastructure available for certification process is inadequate. On the other hand, entrepreneurs are also constrained with the costs of their products certification. Applying for certification is not cheap.

One of the problems faced by many Indonesian products produced by SMEs is many SMEs do not have certification from the Indonesian National Standard (SNI). Another problem that may occur is a flood of illegal products from other ASEAN countries due to lack of supervision at the entrance and at the markets. Weak supervision may lead to the risk that domestic markets would be flooded with illegally imported products. The price of imported products is very cheap, though some are of poor quality, so the government needs to strengthen standardization and certification. Standardization and certification is applied as a two-edged sword, because it will be a

filter for products from abroad to enter Indonesia, but it also will sieve domestic products that cannot meet the corresponding benchmark.

To be able to compete in the AEC era, products sold are expected to meet consumer demands in terms of environmentally friendly process. In general, 80% of SME entrepreneurs know how to take advantage of export markets by producing environmentally friendly products. The problem is that only a few entrepreneurs plan to take advantage of export opportunities to other ASEAN countries under AEC.

One of the determinants of competitiveness is that produced are unique. The majority of business owners (60%) feel their products are unique. For SMEs, a small market segment, usually around the production location, allows them focus more. However, 40% of the firms still do not have a unique product.

Furthermore, customer satisfaction is an important factor to retain customers. About 84% of the firm owners think their consumers are satisfied with their products, only 11% of firms consider their consumers are very satisfied. The factors considered important in order to increase customer satisfaction are improving the product quality (49%) and providing good service (24%). Network marketing is still considered sufficient to support SMEs (market shares are still available). About 72.6% of the entrepreneurs stated that the current market is sufficient to meet company needs (what is produced can still be well-absorbed by the market). Only 27.4% of business owners said that the current market with its available networks is insufficient to meet company needs. Based on these explanations, competitiveness of SMEs in Central Java is assessed through SWOT-analysis.

Table 2. Central Java's SMEs SWOT-analysis, authors'

Strengths	Weaknesses
<ul style="list-style-type: none"> - Most firms are able to develop uniqueness in their products to satisfy consumers with their products. - SMEs have enough networks for their marketing needs. - They do not have barriers to market their products. - They are capable to meet consumer demand, and they plan to increase their capacity. - They do not have difficulties in obtaining raw materials, as they rely mostly on domestic raw materials. 	<ul style="list-style-type: none"> - Many businesses do not perform periodic innovations. - Majority of workers at most firms have relatively poor education. - Lack of regular training. - Few SMEs have SNI. - Entrepreneurs are oriented on domestic markets, especially Central Java one. - A family system management is often implemented. - Most firms do not have foreign market information. - Use of IT is still limited.
Opportunities	Threats
<ul style="list-style-type: none"> - Despite the large domestic market, opportunities in the other ASEAN markets are now to be explored. - Access to raw materials and other inputs from other ASEAN countries should be easier. 	<ul style="list-style-type: none"> - Large domestic market could be a target for other ASEAN entrepreneurs. - Various macrofactors weaken the competitiveness of Indonesian products produced by SMEs (including underdeveloped infrastructure, which causes high operating costs; weak control over domestic markets etc.).

With their capabilities, SMEs in Central Java have been able to dominate the local market since they have been able to create unique products, satisfy consumers,

use networking marketing, and do not face obstacles in marketing. Besides that, raw materials to support production can be easily obtained. As known, competitiveness of enterprises is very dynamic in nature. Therefore, employers need to continue to overcome the weaknesses, take benefits from the available opportunities, and avoid threats. Associated with weaknesses, SMEs still do not innovate on a regular basis, do not utilize technological advantages, have low quality of human resources that are not trained on a regular basis, have a traditional management system, and are only domestically oriented.

For SMEs, business opportunities in other ASEAN countries as well as in Indonesia are still to be exploited further given the tastes of population in other regions are not much different. If Indonesian entrepreneurs want to focus on Indonesian market, it is still possible given the magnitude of Indonesia's population. It encompasses nearly half of the population of the ASEAN overall. To face the threats, government intervention is needed to create a conducive climate for entrepreneurs as the lack of infrastructure leads to high costs of product monitoring at the domestic market.

Discussion. The firms' responses to AEC launch depend on the awareness of the companies related to the consequences of implementing this agreement. A number of entrepreneurs are not aware of the impact of this plan. Some of them can be even considered ignorant in this regard. One of the reasons SMEs do not care about AEC is because they are shortsighted, as their mindset is preoccupied with internal problems of their businesses, so they do not pay attention to what is going to happen in the near future for their businesses. Most firms are oriented towards local markets, because that majority sells their products locally. There is much optimism concerning AEC, but only a small number of firms plans to sell their products to other ASEAN countries.

Previous studies show that many new small firms from developed and developing countries gradually enter international markets. Exporting is the most popular mode of entry to foreign markets. There are many reasons for small firms from developing countries to enter foreign markets, for example, because the local market may be too small, access to raw materials may be difficult etc. However, for small firms the decision to internationalize is a difficult choice, as it brings along risks while they are already constrained by limited resources. Experience also shows that many small firms successful at their domestic market may fail when they go international. Studies show that many small firms from developing countries enter export business unintentionally after receiving an order from a foreign buyer. Therefore, not all small firms need to go to foreign markets but they have to be competitive domestically.

AEC provides opportunities for SMEs to sell more products, encourage them sell higher quality products, and also sell to other ASEAN countries, although there are still people who believe that this agreement does not bring business opportunities.

Conclusions and recommendations. Although many SMEs already know about AEC, there are still some business owners who do not know and even tend to be ignorant about the implementation of this plan. Most SMEs are not ready for AEC, as shown by the level of competitiveness, considered to be medium. Although Indonesian SMEs are ready to increase their production capacities, able to create unique products, to satisfy current customers, and do not have problems with access

to raw materials, the firms do not have periodic innovations due to low quality of human resources and the use of traditional methods in managing their enterprises. Competition from other ASEAN products concern quantity, quality, and price. Businessmen and women perception about AEC needs to be influenced externally because problems arising from the AEC enforcement are only relevant for those who intend to export. All firms, even those who focus on domestic markets, face the threat of competition due to the inflow of products from other ASEAN countries.

Quality is one of the key aspects of competition that SMEs will face. To protect the domestic market, the government should set up product certification using SNI. Regarding product certification, the government should find a creative way to overcome certification problems faced by SMEs. To improve the readiness of SMEs in Central Java, a systematic strategy needs to be designed to address various aspects that are not competitive today. This strategy needs to involve various government agencies and other stakeholders competent in the related fields.

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