

AID-FOR-TRADE CASE STORY

GERMANY

Value Chain Promotion in the Rattan Furniture Sub-Sector in Indonesia

Date of submission: January 2011

Region: South-East Asia

Country: Indonesia, Solo Region in Central Java

Type: Programme component, AfT category 2 (CRS code 25010)

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On behalf of
Federal Ministry
for Economic Cooperation
and Development

CASE STORY III

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Executive summary

This case story describes a minor intervention with direct relevance for *Aid for Trade* within the comprehensive programme of “Local and Regional Economic Development” (RED) in Indonesia, which is being implemented in partnership between the Indonesian National Planning and Development Agency (BAPPENAS) and German Development Cooperation for a total duration of nine years (2004-2013).

The intervention comprises an integrated value chain approach in the rattan furniture cluster of the Solo Region in Central Java/Indonesia. The target group of the intervention consists of owners and managers of rattan furniture companies as well as their employees. From the outset, the program involved and supported all relevant stakeholders (manufacturers, traders, local government) and cooperation partners (furniture association ASMINDO and Bank Indonesia) in identifying the strengths and weaknesses of the value chain. Activities to overcome existing bottlenecks were jointly developed and implemented. This approach proved to be successful as all outcome objectives and indicators were achieved. The programme also encouraged stakeholders to continue monitoring indicators, such as export and employment figures, in order to be able to measure the indirect impact.

It is important to note that the rattan furniture cluster was severely affected by the global economic and financial crisis which began in 2008, resulting in decreasing export and employment figures for the sub-sector. However, the intervention is a showcase for achieving a high degree of “structural sustainability” which ultimately contributes to long-term positive and sustainable development, even without further external support. As such, the lessons learnt are considered valuable also for other programmes as well.

1. Issues addressed

Indonesia has the world's largest rattan stocks. Approximately 80% of the rattan traded originates in Indonesia. Whereas rattan furniture manufacturing in Indonesia is mainly concentrated on the islands of Java and Bali, raw materials mostly come from the islands of Kalimantan and Sulawesi. Since the late 1990s, the rattan cluster in the Sukoharjo District in the Province of Central Java has grown significantly, while international competition has intensified, particularly from China, Thailand and Vietnam. With no rattan resources of its own, China imports increasing quantities of rattan from Indonesia. Consequently, local manufacturers have had to cope increasingly with shortages in domestic supply of rattan resources.

Support for the rattan furniture cluster in the Solo Region in line with the "Local and Regional Economic Development (RED) programme started in 2005. In a general economic baseline study, RED identified several focal sectors in the Solo Region. It was agreed that, since the rattan furniture sub-sector was an important export sector and major provider of employment in the region, it should be one of the three sub-sectors (aside from milk and tourism, both aiming at domestic markets) to receive support through the programme. In 2005, approximately 8,000 people were employed by the rattan furniture cluster, with 23 rattan furniture exporters were working together within a network of 410 home or "cottage" industries. At the time, the export value amounted to 31 million US dollars per year. The entry point for RED was Trangsan Village in the Sukoharjo District in the Province of Central Java/Indonesia with a population of around 6,500.

In focus group discussions, organised by RED at the beginning of 2005, the following challenges became apparent:

- **Supply of raw material:** In 2005, the government lifted the export ban for natural rattan introduced in 2004. As a consequence, shortages in supply occurred and prices grew by 10% in 2006. Furthermore, the transportation of rattan from Kalimantan and Sulawesi to the Solo Region was taken too long and involved too many middlemen, resulting in high costs and a lack of reliability in the supply chain.
- **Human Resources:** There was a lack of capacities to handle rattan material, and buyers complained that companies were not consistently delivering the same quality.
- **Productivity:** As the production process was dominated by the home industry, productivity of the rattan cluster was noticeably lower than in competing countries.
- **Access to international markets:** Manufacturers lacked an understanding of market needs and trends as well as of the procedures of international marketing and selling, necessary language skills and direct marketing contacts needed to compete internationally.
- **Innovation and design:** Many manufacturers only produced furniture based on designs provided by clients but were hardly able to create their own innovative designs, which would enable them to access the higher-segment markets in the USA and EU.

- **Capital:** In order to finance raw material and salaries, small sub-contractors and craftsmen needed access to sufficient working capital. They depended heavily on informal money lenders who claimed high interest rates.

RED addressed these challenges, working closely with its main local implementing partners, the furniture association ASMINDO and the regional branch of Bank Indonesia. In Indonesia, the central bank, Bank Indonesia, has the mandate for SME promotion.

The overall programme is marked with the CRS Code 25010 and is thus an example of AfT category 2 “Trade Development”.

2. Objectives pursued

The support given to the rattan furniture sub-sector constitutes one of several interventions within one of altogether three components in a wider programme of German development cooperation, which aims at large at improving regional competitiveness, among others through strengthening related institutions and supported services. This includes (but is not exclusively restricted to) export and trade promotion. This case story does not discuss the overall programme objective, its indicators or all interventions, but concentrates on the support to the rattan sub-sector as the only explicit export-related sub-component of the program. As a matter of fact, the RED programme was not explicitly designed to facilitate exports. Rather the link to trade and export only became a focus during the implementation.

In order to measure improvements in the rattan furniture cluster as a result of the RED support, a new “case” objective was thus integrated into the monitoring system: small and medium-sized enterprises (SMEs) in the rattan furniture sub-sector have increased their competitiveness.

This objective is measured by the following indicators:

1. At least 10 companies offer new or improved products to the market.
2. At least 1 Public-Private Partnership (PPP) contract has been signed and implemented.
3. At least 3 new services have been established and are being applied (e.g. a warehouse for raw material, training on design management, training on productivity and quality).
4. According to a members’ survey of ASMINDO, the degree of satisfaction with their services has increased.
5. Customer satisfaction has increased.

It is intended that these achievements at the outcome level shall enable SMEs in the rattan furniture cluster to compete better in international markets, particularly in the USA, Europe and Australia. Therefore, export and employment figures as well as indirect impacts of the programme were also monitored, albeit without defining a baseline or target values because there was too much of an attribution gap between RED interventions and the achievements of these indicators. As the rattan value chain is comparatively labour-intensive, it is evident that progress in developing the rattan value chain could contribute significantly to productive employment creation, decent work and poverty reduction.

3. Design and implementation

The support given to the rattan furniture sub-sector in Indonesia is one of several interventions by the “Local and Regional Economic Development” (RED) programme in cooperation with the National Planning and Development Agency (BAPPENAS). The programme is being implemented by GIZ (formerly GTZ)¹ on behalf of the German Federal Ministry for Economic Cooperation and Development (BMZ). RED actively supports the nationwide implementation of a comprehensive and integrated strategy for regional economic development in Indonesia. The overall programme was started in 2004 and applies an integrated approach to regional economic development by combining various strategies, such as regional marketing and image-building, inter-district cooperation, private-sector and SME promotion as well as activities to create a conducive business climate (amongst others through business climate surveys, regulatory impact assessments and one-stop services). The programme is currently in its second phase, which is scheduled to run until the end of 2013. The total costs of the entire programme (2004-2013) are expected to reach up to 12.7 million euros. As the first region in which to implement this approach, RED selected the Solo Region in the province of Central Java, which comprises seven districts with an overall population of 6.2 million people.

Support for the rattan furniture cluster started at the end of 2005 with a multi-stakeholder dialogue and an analysis of the value chain, including the identification of strengths and weaknesses, bottlenecks and success factors for future development. From the beginning, the role of RED was to provide basic studies, advice and training, as well as to initiate and moderate stakeholder discussions. The approach was to get local companies and their association, ASMINDO, into the driver’s seat in order to facilitate a sustainable dialogue and strategy development among the stakeholders.

In an integrated value chain approach (see also annex), a number of activities have been facilitated by RED to assist the manufacturers with the highest growth potential (i.e. “champions” in the industry), the furniture association ASMINDO and other relevant stakeholders in ensuring sufficient supply of raw material, increasing the productivity of companies and improving product design, international marketing skills and business contracting. In a participatory process, a value chain mapping and upgrading strategy was developed mainly by the stakeholders. The strategy was based on studies (e.g. of productivity and design capacity), surveys (e.g. concerning the supply chain of raw material and the regulations and policies affecting the rattan furniture industry), and focus group discussions.

Supporting activities by RED included facilitating the development of a business plan for a warehouse for the raw material, as well as organising business gatherings between suppliers of raw material and rattan furniture manufacturers in the Solo Raya region.

The cooperation with ASMINDO on rattan value chain promotion was formalised in agreed minutes in late 2006, and focused on strengthening the service delivery and lobbying role of the association. Joining forces with the regional branch office of Bank Indonesia in

¹ The Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) GmbH was formed on 1 January 2011. It brings together the long-standing expertise of the Deutscher Entwicklungsdienst (DED) gGmbH (German development service), the Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ) GmbH (German technical cooperation) and InWEnt – Capacity Building International, Germany.

Semarang, RED has been providing training on several issues, such as design management, production plans and inventory control, marketing and business contracting.

In order to foster the collaboration between actors in the rattan furniture cluster, RED and its cooperation partners helped improve the access to markets and financial institutions. Bank Indonesia also co-financed various value chain interventions and facilitated relations between entrepreneurs in the cluster and commercial banks, with a view towards reducing barriers to bank lending. Furthermore, with assistance from the programme, local designers from the Sukoharjo District were able to present their new designs at international trade fairs.

4. Problems encountered

The initial problem at the beginning in late 2005 was the skepticism of local entrepreneurs. In focus group discussions and business gatherings with all relevant stakeholders, it was possible to gradually convince entrepreneurs of the usefulness of the programme approach. After a slow start, dynamism has been growing significantly since the end of 2006. At times, stakeholders have even elaborated innovative and unexpected solutions.

Another anticipated challenge concerned the attitude of some stakeholders. In the early stages of cooperation, rattan manufacturers asked for more export restrictions on raw rattan, and ASMINDO as well as other associations actively lobbied for a new ban on exporting raw rattan (an export ban of 2004 was lifted by the government in 2005). The initial risk was that ASMINDO might be too focused on complaining about lost privileges and would be hardly interested in setting up better services for its members. After being convinced about the usefulness of the value chain approach, ASMINDO eventually turned into a highly cooperative partner.

A major problem, very much affecting the success of the programme, was the global economic and financial crisis which started in 2008, and led to a decline in exports and employment in the entire furniture sector in Indonesia. Furniture exports from Indonesia decreased by almost 15%, from 1,995 million US dollars in 2007 to 1,711 million US dollars in 2009. Whereas large manufacturers possessed sufficient resources and experience to survive the crisis, small companies often did not have the financial resources necessary to cover longer periods of low demand. Even some of the “champions” in the Sukoharjo rattan cluster were forced to give up their businesses due to the crisis. Further challenges came from the increasing competition of countries such as China and Vietnam, where furniture exports continued to grow during the crisis.

Despite these threats, the crisis also had a positive effect on the “willingness to change” of various actors: ASMINDO and most of the companies realised that periods of low demand increase the pressure to further improve quality and introduce new designs.

5. Factors for success and failure

In the light of the negative impact of the global economic and financial crisis on the economic performance of the rattan furniture cluster, it is too early to assess the success of the case at stake based solely on the current economic performance indicators (see section 6). So far, the success of the intervention can be seen in better framework conditions in the rattan cluster, improved business networks and services to increase the probability of greater

exports and employment. In other words, it was possible to fully achieve the objective of the programme, but more time is needed to assess the impact on trade and employment.

The above-mentioned achievements were supported by several factors:

- RED initiated a multi-stakeholder approach (involving manufacturers, traders, local government, ASMINDO, commercial banks etc.) right from the beginning of the intervention. Following initial skepticism from local entrepreneurs, stakeholders showed a high level of commitment to participate in and contribute to activities supported by the programme. ASMINDO seemed to be even more open to change during the global economic crisis. Its Solo Raya branch started to become more active and service-oriented instead of complaining about lost privileges.
- Private companies and ASMINDO have always been in the driver's seat. This is remarkable in Indonesia where government institutions are often too dominant in implementing strategies for private-sector development.
- RED also worked on increasing the institutional sustainability of important stakeholders, for example through capacity development for ASMINDO, so that the association could provide better and more innovative export services for its members.
- There are some qualified vocational and academic institutions in the Solo Raya region, which proved to be valuable cooperation partners for the programme. For example, the graduates of an academic school (PIKA) which focuses on wood processing and technologies for furniture-making, are in high demand by furniture companies.
- In addition to the RED support, ASMINDO and Bank Indonesia provided financial and in-kind contributions of around 24,000 euros, exemplifying the high sense of ownership of both institutions and their willingness to support the rattan value chain. Bank Indonesia even considers the value chain approach as one of their most successful pilot cluster development programmes, and is interested in expanding this model to other districts and clusters in Central Java.

The impact of the global economic crisis on Indonesia showed that sectoral support can be quite risky. Even if the sector is carefully selected based on an economic analysis and extensive stakeholder discussions, the dynamics of international markets can always unexpectedly affect local clusters, such as the rattan furniture sub-sector.

6. Results achieved

All in all, the programme so far has achieved its set targets. The specific results and impacts according to the case objective and the corresponding indicators described in section 2 include:

1. All 10 companies offer new or improved products to the market. Some companies established their own R&D units and employed designers. Also, e-marketing was introduced and is being successfully applied by some companies. Design and production trainings resulted in the establishment of design departments in some companies.

2. RED concluded a Public-Private Partnership Agreement with Biochemicals Indonesia in order to jointly carry out a training programme on applying environmentally-friendly finishing products for the furniture industry in the Solo Raya region.
3. ASMINDO introduced seven new services in 2009 and 2010, including certification of wood products, verification of legal origin, export consultation, and marketing support. These services are highly appreciated by its members (see the results of the members' survey below). Furthermore, it was possible to improve the supply of raw material to the rattan cluster. New supply links were established, and stakeholders are now implementing their own solutions for raw material storage and financing. A member of ASMINDO reported that the costs for raw material had been cut by 15 to 20% following the RED intervention.
4. A customer satisfaction survey was carried out at the beginning of 2008. It showed that in general, buyers were quite satisfied with the rattan furniture products. Some buyers recognised efforts to increase quality and invest in new designs. However, complaints remained concerning inconsistent quality, in particular in the case of products from small manufacturers.
5. In 2010, a members' survey revealed that the degree of satisfaction with ASMINDO's services amounted to 75%, which is a significant improvement compared with only 33% in the 2009 survey. This increase is a positive and obvious result of the introduction of new services by ASMINDO.

Whereas all outcome objectives and indicators were fulfilled, the indicators at the impact level showed noticeably lower figures due to the economic and financial crisis. Between 2007 and 2009, the export volume of rattan furniture from the Solo Raya Region decreased by almost one third, and the export value fell by approximately 25%. As a consequence, the number of employees in the rattan cluster decreased by 15% to 1,923 workers. The decrease is lower than the export decline because the three biggest "champion" companies decided not to lay off workers. Although exports in 2010 grew significantly in volume and value, pre-crisis levels were not achieved. Employment declined in 2010 as some of the smaller companies were forced to close down their businesses.

Table 1: Development of exports of and employment levels in rattan furniture, Solo Region

	2007	2008	2009	2010
Export volume (no. of containers)	3,946	2,829	2,684	2,891
Annual change in %		-28.3	-5.1	7.7
Export value (in million US\$)	25.20	20.53	18.98	22.02
Annual change in %		-18.5	-7.6	16.0
Number of Employees	2,272	2,192	1,923	1,895
Annual change in %		-3.5	-12.3	-1.5

Source: ASMINDO survey among 10 "champions" of rattan furniture companies in the Solo Region, Central Java, Indonesia

As the programme is ongoing in other pilot regions until the end of 2013, the future development in the cluster will be continuously monitored and systematically assessed.

Furthermore, relevant partner institutions have also undertaken to continue the monitoring of impact indicators.

As stakeholders in the rattan furniture cluster as well as in other intervention areas of the RED programme in the Solo Region are already capable of applying the value chain approach by using their own resources, RED has decided to end the direct support to the region. During the closing workshop at the end of 2010, almost all stakeholders participated and showed great appreciation of the support received, and committed themselves to maintaining the dialogue on how to overcome existing bottlenecks in the rattan furniture cluster.

7. Lessons learned

A number of lessons can be drawn from this case story, concerning the implementation of the intervention itself as well as related to methodological matters, such as the selection of suitable indicators.

The decision to involve all relevant stakeholders from the outset in the development of the selected value chain can be considered a suitable approach to identifying opportunities and bottlenecks as well as to ensuring a high degree of ownership and willingness for active participation. At present, important (export) services are being offered by ASMINDO without any further RED support. Moreover, companies are in a better position to develop innovative products and access new markets. As such, the structure of the value chain cluster has been improved. This “structural sustainability” is vital as it contributes to long-term positive and sustainable development, even without further external support.

Even though a sector with considerable export potential was selected for the value chain approach, export figures do not yet show a positive trend. However, with RED support, stakeholders in the cluster have been quite successful at overcoming several challenges and bottlenecks in the value chain as well as in increasing their capacities for innovation. If this process continues after the phasing-out of the programme, a positive trend for exports and employment is very likely.

Some manufacturers stated during the closing workshop in Solo Raya that without the programme support, export and employment figures would have looked much worse. However, this constitutes only soft evidence for this success. In order to generate hard evidence, it is necessary to apply sophisticated tools for analysis (e.g. regression analysis and control group analysis), which would allow for a clear distinction between programme interventions and other factors beyond the control of the programme (e.g. business cycle). As these tools require data that are very often not available or accurate in developing countries, their application in the case of small intervention, such as described in the rattan case story, would be too elaborate and expensive.

An intervention, such as the one described in this case story, can be considered successful if it achieves a high degree of ownership, innovation, and networking among local stakeholders. This raises the likelihood of realising a sustainable increase in exports and employment, and contributing to poverty reduction. Outcome indicators, therefore, should not solely concentrate on export success, but also measure “structural changes” and other framework conditions that enable relevant stakeholders to improve their competitiveness without further programme assistance. In other words: short-term outcome indicators to

measure progress in (trade) capacity are as important as medium- and long-term outcome indicators (or impact indicators) related to trade or economic performance. However, this case story shows that formulating these capacity indicators is not an easy task: the selected indicators do not measure all relevant dimensions of “structural sustainability”.

Furthermore, the negative impact of the global economic crisis on rattan furniture exports clearly demonstrates that an increase of international competitiveness (defined as a combination of supply and demand as well as influenced by the position of competitors) at the SME level cannot directly be influenced by the programme and therefore lies beyond the attribution gap (impact level). The same is true for increased export, turnover and employment figures. However, the programme is able to improve the supply-side (e.g. by improving services, productivity etc.).

Still, it is highly important to continuously observe changes in trade and economic performance and identify indicators beyond the attribution gap, during and even after the implementation of the program. It is also vital to consider external risks and factors in the overall logic and design of such a sectoral intervention. This serves to detect long-term trends that are less affected by short-term fluctuations. Therefore, it is highly important for *Aid for Trade* programmes to encourage partner institutions to regularly monitor these indicators beyond the conclusion of the programme support. This could then render cost-intensive ex-post evaluations unnecessary.

8. Conclusion (applicability to other programmes)

The case story at hand is an excellent example of an integrated AfT intervention within a broader program on private-sector development programme. It clearly shows how trade or export-related aspects can be identified only in the course of programme implementation. Owing to the flexibility of instruments and modalities of German development cooperation, RED was able to accommodate these aspects in its overall approach and thus to react to needs and demands on the partners' side.

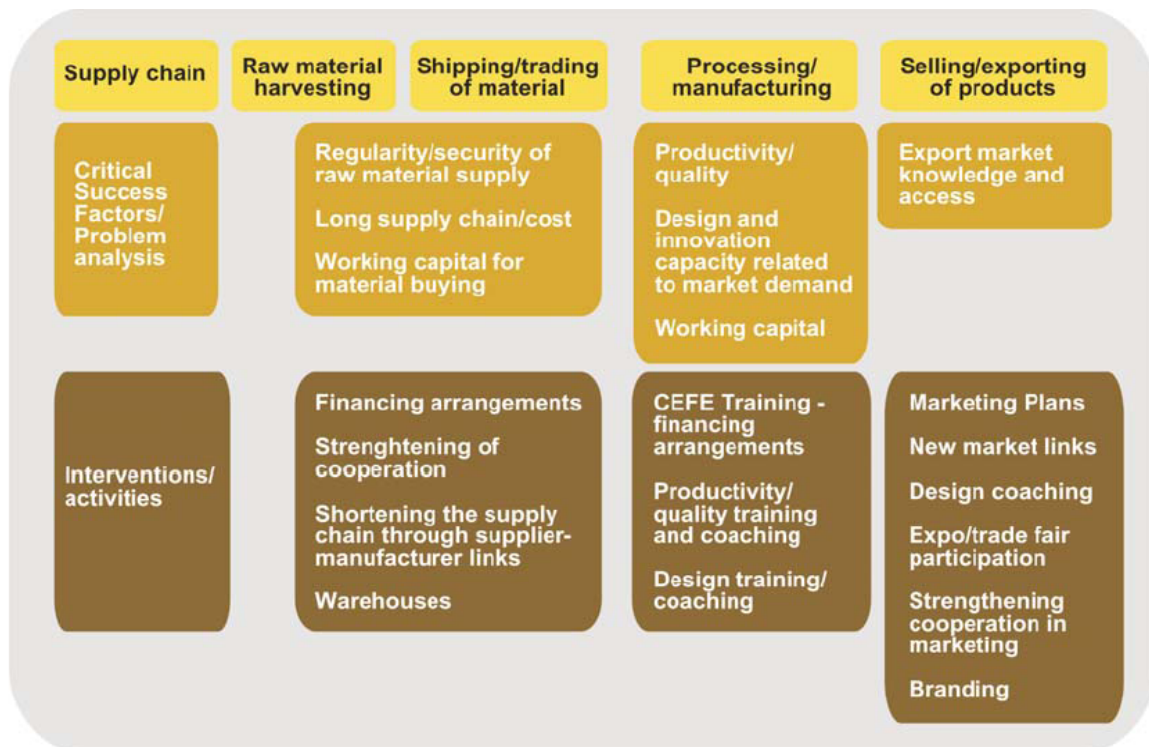
Although there will be no further direct assistance to the rattan furniture cluster in the Solo Region, the program will continue until the end of 2013. It is envisaged that continuous contact will be kept with local partner institutions in order to further monitor the longer-term trade impact. Moreover, RED plans to provide support for an exchange of experience with furniture clusters in other regions in and outside Central Java in order to scale up the intervention.

If it is decided to implement a value chain promotion approach, it is recommended that the value chain approach is applied simultaneously to several clusters, rather than concentrate the support on only one product. This reduces the risk of being affected by unforeseen negative developments that lie beyond the scope of action and influence of the programme. In the Solo Region, for example, the programme also supported tourism development, resulting in a growing number of visitors to the region - even during the crisis. Furthermore, sectoral instruments can complement other instruments to improve the overall business climate.

In general, the value chain approach described in this case story is applicable to other programmes and sectors. However, it requires a considerable commitment and a sense of

ownership, as well as sufficient resources from partner institutions for capacity development, and must go hand in hand with a willingness to create new (export) products and services. If, for instance, business associations lack service orientation (as it is the case in many former socialist countries), this capacity-oriented approach may be less successful.

Annex 1: Overview of Integrated Value Chain Development Approach



Source: RED 2007/8: Rattan Furniture Value Chain Promotion in the Solo Region, Central Java, Indonesia