

Research Article**Policy Strategy in Developing the Capacity of Cooperatives and MSMEs: A Case Study of Indonesia-Timor Leste****Aura Nabila Putri S:** Muhammadiyah University of Sukabumi, **Indonesia**; auranabilaps@gmail.com**Casmirio Soares:** Universidade Oriental Timor Lorosa'e, **Timor Leste**; casimirosoares31@gmail.com***Corresponding Author:** auranabilaps@gmail.com

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Abstract: *Capacity development of cooperatives and Micro, Small, and Medium Enterprises (MSMEs) is a strategic agenda in promoting inclusive and sustainable economic development in developing countries. However, various cooperative and MSME development policies still face limited effectiveness due to weak policy design and mismatches between objectives, instruments, and implementation context. This study aims to analyze policy strategies in developing the capacity of cooperatives and MSMEs through a case study of bilateral cooperation between Indonesia and Timor Leste using Public Policy and Policy Design Theory as an analytical framework. This study uses a qualitative approach with a policy case study design. Data were collected through analysis of policy documents, memorandums of understanding (MoUs) on bilateral cooperation, international organization reports, and relevant scientific literature published since 2020. Data analysis was conducted using qualitative content analysis with a focus on policy objectives, policy instruments, policy actors, and implementation context. The results show that the policy strategy has adopted a capacity-building approach through training, mentoring, and strengthening cooperative institutions. However, policy design still faces challenges in the form of normative policy objectives, weak policy mix coherence, and gaps between policy design and the capacity of implementing actors. This study concludes that developing the capacity of cooperatives and MSMEs requires a coherent, adaptive, and contextual policy strategy to have a sustainable impact.*

Keywords: *Public Policy, Capacity Development, Cooperatives, MSMEs, Bilateral Cooperation.*

1. INTRODUCTION

Cooperatives and Micro, Small, and Medium Enterprises (MSMEs) are widely recognized as key pillars of economic development in developing countries due to their role in creating jobs, reducing poverty, and strengthening local, community based economies (OECD, 2021; World Bank, 2022). However, despite their significant contributions, many cooperatives and MSMEs still face structural challenges that hinder their growth and sustainability, such as weak institutional capacity, low quality human resources, limited governance, and limited ability to adapt to global economic dynamics (ILO, 2022; UNIDO, 2021).

Empirical evidence in various developing countries indicates that most cooperatives and MSMEs operate with low productivity and fragile business sustainability. Village cooperatives, in particular, often rely on government support without a long-term capacity-building strategy, thus failing to develop into independent and competitive economic entities (Birchall & Ketilson, 2021; Dana et al., 2022). Furthermore, fragmented public policy and weak inter-agency coordination mean that cooperative and MSME development programs tend to be fragmented, short-term, and unintegrated (Meyer & Peng, 2020; Battilana et al., 2021).

From a public policy perspective, these issues indicate that the primary challenge facing cooperatives and MSMEs is not simply limited capital, but rather weak policy strategies for building internal and institutional capacity. Policy approaches that overemphasize financial assistance without balancing it with strengthening human and organizational capacity have proven ineffective in fostering business independence (OECD, 2021; Williams et al., 2023). This situation calls for a more comprehensive, systemic, and sustainable development-oriented policy approach.

In recent years, international cooperation – particularly bilateral cooperation – has begun to be viewed as an alternative strategy for developing the capacity of cooperatives and MSMEs. Bilateral cooperation allows for knowledge transfer, the exchange of best practices, and the strengthening of institutional capacity across countries with relatively similar economic and social characteristics (Saguin & Howlett, 2022; UNDESA, 2023). The Indonesia–Timor Leste cooperation in developing village cooperatives and improving cooperative human resources reflects the developing country's strategic efforts to utilize economic diplomacy as an instrument for strengthening community-based economies.

To systematically analyze this phenomenon, this study utilizes relevant theoretical analysis tools. First, the Theory of Capacity Building emphasizes that the success of cooperatives and MSMEs is largely determined by the organization's ability to sustainably develop human, institutional, and support system capacity (Eade, 2021; UNDP, 2022). From this perspective, capacity building is understood as a long-term process that goes beyond mere technical or financial interventions. Second, Institutional Theory is used to explain how public policies, regulations, and institutional norms shape the organizational behavior of cooperatives and MSMEs. Bilateral cooperation is seen as an institutional mechanism that can strengthen legitimacy, governance, and organizational practices through a process of cross-border institutional isomorphism (North, 2020; Scott, 2021). Third, Public Policy and Development Theory is used to analyze how policy strategies are designed and implemented in the context of economic development. This theory emphasizes the importance of alignment between policy design, program implementation, and the local context for cooperative and MSME development policies to produce sustainable impacts (Howlett et al., 2020; Peters, 2021).

Although the literature on cooperatives, MSMEs, and economic development continues to grow, most previous research still focuses on the domestic context and micro-organizational aspects. Studies that explicitly integrate capacity development, institutionalization, and public policy approaches within the context of bilateral cooperation, particularly in developing countries, are still relatively limited (Saguin & Howlett, 2022; Williams et al., 2023). This gap highlights the need for research that can explain the strategic role of international policy and cooperation in developing the capacity of cooperatives and MSMEs.

Based on this background, this study aims to analyze policy strategies for developing the capacity of cooperatives and MSMEs through a case study of Indonesia–Timor Leste cooperation. This research is expected to provide theoretical contributions through the integration of capacity building, institutional theory, and public policy perspectives, as well as practical contributions in the form of evidence-based policy recommendations for the sustainable strengthening of cooperatives and MSMEs.

2. LITERATURE REVIEW

Public Policy Strategy in Organizational Capacity Development

In public policy literature, a policy strategy is understood as a set of objectives, instruments, and implementation mechanisms designed by the government to address public

problems systematically and sustainably. Public Policy Theory emphasizes that public policy is not merely the result of political decisions but also a process involving the formulation, implementation, and evaluation of policies within a specific institutional context (Howlett et al., 2020; Peters, 2021).

In the context of organizational capacity development, public policy acts as a catalyst, enabling organizations to enhance their internal capabilities, including human resources, governance, and operational systems. Recent studies have shown that the success of organizational capacity development is significantly influenced by the quality of policy design and its alignment with the needs and capacities of the target actors (Capano & Howlett, 2020; Mukherjee & Howlett, 2021).

Policy Design Theory and Policy Instruments

Policy Design Theory emphasizes the importance of policy fit, namely the alignment between policy objectives, policy instruments, implementing actors, and the socio-economic context. Policies designed without considering the context and capacity of implementers tend to result in policy failure or unsustainable impacts (Howlett, 2021; Peters, 2021).

The literature divides policy instruments into several main categories, including regulatory, economic, informational, and collaborative instruments. In developing the capacity of cooperatives and MSMEs, informational and collaborative instruments such as training, mentoring, knowledge transfer, and cross-institutional and cross-national collaboration are considered more effective than solely financial assistance (OECD, 2021; UNDP, 2022).

Empirical research shows that policies that are too oriented towards subsidies and financial incentives often fail to improve the long-term capacity of organizations, because they do not address the root of structural problems such as weak governance and low managerial competence (Williams et al., 2023; Meyer et al., 2020).

Capacity Development of Cooperatives and MSMEs from a Policy Perspective

Cooperatives and MSMEs have different organizational characteristics than large companies, necessitating a more adaptive and contextual policy approach. Several international studies have shown that cooperatives and MSMEs often face limitations in access to knowledge, technology, and market networks, which cannot be addressed through market intervention alone (Battilana et al., 2021; Dana et al., 2022).

From a public policy perspective, capacity development for cooperatives and MSMEs is viewed as a multidimensional process encompassing strengthening human resources, institutions, and support systems. The OECD (2021) emphasizes that effective MSME development policies must integrate organizational learning, innovation, and cross-sector collaboration. A similar point is emphasized by the ILO (2022), which states that cooperatives require a policy framework that not only promotes economic growth but also strengthens democratic governance and institutional sustainability.

International Cooperation and Policy Learning

In modern public policy literature, international cooperation is seen as a means of policy learning and policy transfer, where countries can learn from each other in designing and implementing development policies (Dolowitz & Marsh, 2021; Saguin & Howlett, 2022). Bilateral cooperation allows developing countries to adopt more effective policy practices without the need for lengthy trial and error.

Several studies have shown that international cooperation in the development of cooperatives and MSMEs can enhance institutional capacity through knowledge exchange, enhanced staff competency, and harmonization of policy frameworks (UNDESA, 2023; UNIDO, 2021). However, the effectiveness of such cooperation depends heavily on how policies are designed and adapted to the local context of each country.

3. METHOD

Research Design

This research uses a qualitative approach with a policy case study design. This approach was chosen because the research aims to deeply understand policy strategies in developing the capacity of cooperatives and MSMEs, particularly in the context of bilateral cooperation between Indonesia and Timor Leste. Policy case studies allow researchers to comprehensively explore the process of policy formulation, design, and implementation within a specific institutional and social context, which cannot be adequately explained through quantitative approaches.

The qualitative approach is considered relevant because the focus of the research does not lie in measuring the causal relationship between variables, but rather in analyzing the substance of policies, policy instruments, and the dynamics of actors and contexts in developing the capacity of cooperatives and MSMEs.

Theoretical Framework and Analytical Lens

This research uses Public Policy and Policy Design Theory as its theoretical framework and primary analytical tool. This theory is used to analyze policy strategies based on several key dimensions, namely:

- a) Policy goals in developing the capacity of cooperatives and MSMEs,
- b) The policy instruments used, such as regulations, training, mentoring, and bilateral cooperation,
- c) Policy actors involved in the formulation and implementation of policies,
- d) Policy context includes institutional, social and economic conditions.
- e) This framework allows for a systematic analysis of the fit between policy design and the capacity development needs of cooperatives and MSMEs.

Data Sources

The research data comes from secondary data collected through document analysis. Data sources include:

- a) Official policy documents of the Indonesian and Timor Leste governments regarding cooperatives and MSMEs.

- b) Memorandum of Understanding and statement of bilateral cooperation in the field of cooperatives,
- c) Official reports from international organizations (e.g. OECD, ILO, UNDP, UNIDO) that are relevant to the development of cooperatives and MSMEs,
- d) Reputable international journal articles discussing public policy, organizational capacity development, and international cooperation,
- e) Credible economic and policy media publications as supporting sources of empirical context.
- f) The use of secondary data was chosen because this research focuses on policy analysis and institutional frameworks, not on individual perceptions or measurement of business actor behavior.

Data Collection Technique

The data collection technique was carried out through a systematic document review, with the following steps:

- a) Identify policy documents and literature relevant to the theme of developing the capacity of cooperatives and MSMEs.
- b) Document selection based on criteria of relevance, source credibility, and publication period (≥ 2020).
- c) Classification of documents based on policy type, actors, and policy instruments.
- d) Extraction of key information related to policy strategy and organizational capacity development.

Data Analysis Technique

Data analysis was conducted using qualitative content analysis combined with a policy analysis framework. The analysis process included:

- a) Thematic coding, to identify key themes related to policy strategies, policy instruments, and capacity development.
- b) Comparative analysis, to compare the policy approaches of Indonesia and Timor Leste in the context of bilateral cooperation.
- c) Theoretical interpretation, by mapping empirical findings into the Public Policy and Policy Design Theory framework.

This analysis aims to assess the extent to which the policy design is aligned with the objectives of developing the capacity of cooperatives and MSMEs, as well as identifying the strengths and weaknesses of the policy strategies implemented.

Ethical Considerations

This research used secondary data sourced from public documents and scientific literature, thus not directly involving human subjects. Therefore, no specific ethical approval was required. However, the principle of academic integrity was maintained by transparently and accurately citing all sources in accordance with ethical standards for scientific publications.

4. RESULTS AND DISCUSSION

Policy Strategy in Indonesia-Timor Leste Cooperation

The analysis of policy documents indicates that the capacity development strategy for cooperatives and MSMEs in the Indonesia-Timor Leste partnership was designed as part of a community based and inclusive economic development agenda. The policy focuses on strengthening village cooperatives, enhancing human resource capacity, and fostering cross-border institutional learning. This approach aligns with public policy literature that emphasizes a shift from aid-based policies to capacity-oriented policies to achieve long-term sustainability (OECD, 2021; UNDP, 2022).

From the perspective of Public Policy and Policy Design Theory, these findings demonstrate clear policy goals, namely increasing the independence and resilience of cooperatives and MSMEs. However, these policy goals remain normative and have not been fully translated into measurable performance indicators, a weakness often found in policy design in developing countries (Howlett, 2021; Peters, 2021).

Policy Instruments and Design Suitability (Policy Fit)

The dominant policy instruments used are informational and capacity-building instruments, such as managerial training, institutional mentoring, and knowledge exchange. These instruments are considered most relevant for addressing the internal capacity limitations of cooperatives and MSMEs, as recommended by the literature on MSME policy and institutional development (ILO, 2022; OECD, 2021).

The analysis also shows that these instruments are not fully integrated with regulatory and economic instruments. This lack of integration has the potential to reduce policy effectiveness because capacity building is not always accompanied by adequate regulatory support and access to financing. This situation reflects weak policy mix coherence, which, according to Policy Design Theory, is a crucial factor in the success of public policies (Capano & Howlett, 2020; Mukherjee & Howlett, 2021).

Policy Actors and Implementation Governance

Key actors in policy implementation include relevant ministries, cooperative institutions, and institutional partners from both countries. Bilateral cooperation creates a network governance model, where capacity development is the result of collaboration between actors across institutions and countries. This model aligns with network governance literature that emphasizes the importance of collaboration in development policy (Provan & Kenis, 2020; Klijn & Koppenjan, 2021).

However, research also reveals coordination challenges and differences in institutional capacity between actors. This disparity creates an implementation gap, a mismatch between policy design and the capacity of implementing actors, which is often a major cause of public policy failure in developing countries (Peters, 2021; Saguin & Howlett, 2022).

Policy Context and Design Adaptability

The differences in social, economic, and institutional contexts between Indonesia and Timor-Leste demand adaptive policy design. Research shows that uniform policy strategies

are less effective when applied to different contexts. Adaptive policy design literature emphasizes that policies must be able to learn and adapt to the implementation context to achieve sustainable impact (Capano & Howlett, 2020; Howlett, 2021).

Although bilateral cooperation opens up opportunities for policy learning, policy feedback and evaluation mechanisms remain limited. This suggests that the policy learning process has not been fully institutionalized, as recommended in contemporary public policy literature (Dolowitz & Marsh, 2021; Mukherjee & Howlett, 2021).

Impact of Policy Strategy on Capacity Development

The policy strategy had a positive impact on increasing awareness and basic knowledge of cooperatives and MSMEs regarding their governance and economic role. This finding is consistent with previous research that suggests capacity-based policy instruments are effective in improving initial organizational competencies (Battilana et al., 2021; Dana et al., 2022).

The impact on long-term capacity building remains limited and incremental. Lack of policy integration and weak performance evaluation result in suboptimal policy outcomes. Within the framework of Policy Design Theory, these findings emphasize that policy success is determined not only by the type of instrument but also by the coherence of the overall policy design (Howlett, 2021; Peters, 2021).

DISCUSSION

This discussion aims to interpret the research findings within the framework of Public Policy and Policy Design Theory, and to place the results of the case study of Indonesia-Timor Leste cooperation into a broader academic discourse on the development of cooperative and MSME capacity in developing countries.

Policy Strategy as an Instrument for Capacity Development

Research findings indicate that the policy strategy in Indonesia-Timor Leste cooperation has normatively adopted a capacity-oriented policy approach, emphasizing human resource development, institutional governance, and organizational learning. This aligns with Public Policy Theory, which positions public policy as a tool for state intervention to address structural failures in community-based economic development (Howlett et al., 2020; Peters, 2021).

This discussion emphasizes that policy success is determined not only by policy orientation but also by the quality of policy design. Policy Design Theory emphasizes that policy objectives must be translated into clear operational indicators for objective evaluation (Howlett, 2021). In the context of this research, the findings indicate that capacity development objectives remain general, potentially weakening policy accountability and effectiveness.

Coherence of Policy Instruments and Policy Mix

The research findings demonstrate the dominance of information-based policy instruments and capacity development, such as training and mentoring. The MSME and cooperative policy literature acknowledges the effectiveness of these instruments in

improving initial organizational competencies (OECD, 2021; ILO, 2022). However, this discussion emphasizes that a single instrument is insufficient to generate sustainable capacity development.

According to Policy Design Theory, effective public policy requires a coherent policy mix, namely a combination of complementary regulatory, economic, and informational instruments (Capano & Howlett, 2020; Mukherjee & Howlett, 2021). Research findings indicate that weak integration between policy instruments is one reason why policy impacts remain incremental. In other words, organizational capacity building will not be optimal without clear regulatory support and adequate economic access.

Policy Actors and Implementation

This discussion also highlights the role of policy actors in determining the success of capacity development strategies. The Indonesia–Timor Leste partnership reflects a network governance approach, where multiple actors are involved in policy implementation. This approach aligns with public governance literature that emphasizes the importance of cross-actor collaboration in development policy (Provan & Kenis, 2020; Klijn & Koppenjan, 2021).

Research findings indicate an implementation gap caused by differences in institutional capacity and resources between actors. From a Public Policy Theory perspective, this gap is a classic problem in policy implementation in developing countries, where policy design often does not fully consider the capacity of implementing actors (Peters, 2021; Saguin & Howlett, 2022). This discussion emphasizes that strengthening the capacity of cooperatives and MSMEs must be accompanied by strengthening the institutional capacity of the policy actors themselves.

Policy Context and the Need for Adaptive Design

Further discussion shows that the differences in social, economic, and institutional contexts between Indonesia and Timor-Leste require adaptive policy design. Adaptive policy design literature emphasizes that policies must be able to learn from implementation practices and adapt to changing contexts (Capano & Howlett, 2020; Howlett, 2021).

This study demonstrates that bilateral cooperation has created opportunities for policy learning, but the policy learning mechanisms have not been systematically structured. This indicates that international cooperation has not been fully utilized as a means of strengthening learning-based policy design. This discussion reinforces the argument that bilateral cooperation serves not only as a diplomatic forum but also as a strategic instrument for enhancing the policy capacity of developing countries (UNDESA, 2023).

5. CONCLUSION

This study aims to analyze policy strategies in developing the capacity of cooperatives and MSMEs through a case study of bilateral cooperation between Indonesia and Timor Leste, using Public Policy and Policy Design Theory as the primary analytical tool. Based on the analysis and discussion, this study concludes that the implemented policy strategies have demonstrated a paradigm shift from an aid-based approach to a capacity-building approach,

particularly through strengthening human resources, institutional governance, and organizational learning.

This study also found that the effectiveness of these policy strategies still faces several limitations. The objectives of cooperative and MSME capacity development policies tend to be normative and have not been fully translated into measurable performance indicators. Furthermore, the policy design does not demonstrate strong coherence between policy objectives, policy instruments, and the capacity of implementing actors. This situation results in the policy's impact on increasing the capacity of cooperatives and MSMEs remaining incremental and suboptimal in the long term.

From a Policy Design Theory perspective, this study's findings confirm that the success of organizational capacity development is determined not only by the existence of policies, but primarily by the quality of the policy design itself. An effective policy strategy requires a policy fit between the issues faced by cooperatives and MSMEs, the policy instruments used, and the institutional and social context in which the policies are implemented. Without an integrated and adaptive policy design, capacity development programs risk losing their leverage for sustainable economic development.

This research also highlights the importance of bilateral cooperation as a public policy instrument, serving not only as a means of economic diplomacy but also as a mechanism for policy learning and strengthening policy capacity in developing countries. However, for bilateral cooperation to have a more significant impact, strengthening evaluation mechanisms, policy learning, and continuous adjustment of policy designs is necessary.

This research contributes by expanding the application of Public Policy and Policy Design Theory in the context of developing the capacity of cooperatives and MSMEs, particularly through a bilateral case study approach. Practically, the findings of this study confirm that the development of cooperatives and MSMEs must be positioned as a strategic, systemic, and coherent public policy agenda. Thus, strengthening the capacity of cooperatives and MSMEs can provide a stronger foundation for inclusive and sustainable economic development in developing countries.

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