

**Joint GTZ-KfW  
Fact-Finding Mission  
in Nanggroe Aceh Darussalam Province (NAD)**

**February 21 – March 8, 2005**

***‘Designing a Microfinance Development Strategy  
as Part of Economic Recovery And Employment Promotion  
in Post-Tsunami Aceh’***

Consolidated Report

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## 1. EXECUTIVE SUMMARY

- A joint GTZ-KfW fact-finding mission was assigned to assess the situation in NAD after the tsunami with the objective to design a micro-finance development strategy as part of economic recovery and employment promotion.
- Before the disaster, 70% of the working population, were self employed or engaged in the informal economy. The open unemployment rate was higher than the national rate and poverty levels were alarmingly high with 488,282 households or roughly 2 Million people (53%) living below poverty line and 90% of the monthly per capita population's expenditure being less than Rp 300,000. 10 out of 21 districts have poverty levels higher than 50%. All except one of these districts were affected by the disaster, thus making the economic situation of the poor even worse.
- The financial sector in NAD before Tsunami was not well developed, somehow reflecting the depressed state of the real economy. The sector is dominated by the (mainly state-owned) commercial banks, which cater to the financing needs of a few large enterprises, government infrastructure programs and SMEs. As their lending generally requires "hard" collateral and minimum loan amounts majority of micro finance demand is excluded.
- The BPR/BPRS and credit cooperatives are targeting more the microfinance market. Most of them are facing serious institutional and organizational problems and outreach is limited due to small client base, lack of capital and funding. NGO-MFIs and various government initiated MFIs have very limited outreach and their sustainability is questionable.
- BI estimates the total damage and losses in the banking sector in the range of Rp 1 trillion. The nation-wide operating CBs have incurred the major losses in absolute terms. But as their Aceh portfolio accounts for only a very small fraction of their respective total portfolios any losses can be covered by provisions. Taking into account the dominance of the CBs there seems to be no systemic risk to the financial system.
- BPD Aceh incurred heavy losses and it is estimated that almost 50% of its loan portfolio is affected, thus increasing its already existing liquidity problems. Besides TA for necessary institutional and organizational restructuring the BPD is in urgent need of fresh funds in order to avoid bankruptcy.
- Both the BPR/BPRS and the BMT systems are seriously threatened by the losses and damages caused by Tsunami. Several BPR and BMT are facing bankruptcy due to acute liquidity shortages.
- The assessment shows clear demand for TA but at the same time difficulties to identify feasible FC approaches: CBs don't need outside financial assistance to handle the Tsunami effects on their respective portfolios. On the other hand, microfinance oriented institutions are lacking outreach and absorptive capacity for FC funds, and need heavy up-front TA in the areas of institutional and human resource development.
- Other planned donor activities indicate sufficient funds for rehabilitating the microfinance system in NAD.
- BMT - locally known as *Baitul Qiradh* - MFIs that practice Syariah principles, community owned village finance institutions (LKD) and the revitalization of the income generating groups under the Family Welfare Program constitute potential components of a microfinance program. German development assistance could be complemented by a twinning program of the SBFIC with BPD, wholesale finance mechanism for BPR/BPRS and support to BAV venture capital scheme based on the guiding principles: following a systemic and realistic approach, market-based, building on existing institutions for sustainability, increasing outreach, and empowering of women, covering the region and respecting the socio-cultural context.

## 2. INTRODUCTION

A joint GTZ/KfW fact-finding mission was assigned to assess the situation in Aceh Province after the tsunami with the objective to provide recommendations for the design of a financial system reconstruction strategy with special reference to the microfinance and rural financial system. The mission was scheduled from February 21 to March 8, 2005 with a field visit to Aceh from February 21 to 26.

The mission was designed as a team approach with only one set of ToR. The main objectives of the fact-finding mission were:

- a) To briefly estimate the demand for recovery grants, micro-credit and other services from micro-enterprises in Aceh province.
- b) To give a general overview on the microfinance industry in Aceh province estimating refinancing and institutional building needs.
- c) To identify appropriate approaches for the support of the microfinance industry in Aceh.
- d) To identify areas for a possible cooperation with other donors.

Based on an agreed division of labor between the mission members prior to the start of the mission,<sup>1</sup> the following consolidated report has been prepared.

Discussions were held in Aceh with representatives of BAPPEDA, BI, BRI, Bank Mandiri, selected BPR and BMT, BAZNAS, BPS, BKKBN, Dinas Sosial, ILO, World Bank, Mercy Corps, SDC, ARF and YADESA. Moreover, first hand information was acquired via interviews with tsunami affected and less affected populations (using a random sampling technique). Despite several attempts the mission failed to schedule a meeting with BDP Aceh. In Jakarta the mission met with BI, BAPPENAS, BRI, Bank Danamon, BNI, ADB, World Bank, USAID, PNM, BKKBN and Bahana Artha Ventura (BAV).

On March 4, a debriefing with the German Embassy, GTZ and KfW Jakarta took place and on March 8, the major findings of the mission were presented to BAPPENAS in Jakarta.

The mission had to face two major problems. Firstly, there is a lack of detailed data on the semi-formal and informal financial system in Aceh province and, secondly, data on tsunami damage are still preliminary and in particular for smaller rural financial institutions still incomplete.

## 3. TARGET GROUP & FINANCIAL NEEDS ANALYSIS

The earthquake and tsunami on December 26<sup>th</sup>, 2004 have seriously affected large parts of Nanggroe Aceh Darussalam, namely Banda Aceh, the coastal areas of Aceh Besar, Aceh Jaya, Aceh Barat, Nagan Raya, Aceh Barat Daya, Aceh Selatan, Aceh Singkil (along the west

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<sup>1</sup> Overall responsibility, coordination and communication with Bappenas: Dr. Alfred Hannig.

The mission members and their respective responsibilities were: Dr. M. Hamp (mission leader, donor relationship), Prof. Dr. Peter Hartig (overall financial sector aspects, formal financial institutions and capacities, relevance as cooperation partners), Ursula Hammerich (target group, community development aspects, financial needs assessment), Riza Primahendra (non-regulated MFI, MFI financial and technical assistance requirements, donor programs and NGO activities).

coast) and the coastal areas of Aceh Besar, Pidie, Bireuen, Aceh Utara and Aceh Timur (along the east coast, see map).



Source: [www.bps.go.id/news/tsunami/nad2.htm](http://www.bps.go.id/news/tsunami/nad2.htm)

Overall, the destruction was more devastating on the west coast than on the east coast. 25% of the tsunami-affected areas are urban and the remaining 75% are rural areas. As a result of the disaster 122,232 people died, 113,937 are still missing and 406,156 people have been displaced (300,000 are in host families and 106,156 live in tents/camps/barracks).<sup>2</sup> ILO estimates that about 600,000 people or the equivalent of 36% of the working population lost their jobs, mainly in the agricultural sector (300,000 people), the fishery sector (130,000) and unregistered small businesses (170,000).<sup>3</sup>

Before the disaster, 1,645,244 (70%) of the working population, were self employed or engaged in the informal economy,<sup>4</sup> indicating a substantial lack of job opportunities in the province. The open unemployment rate was higher than the national rate with 11.2% (184,267) versus 9.5%, with unemployment being a special concern for women and youth.<sup>5</sup>

The most prominent economic sectors are agriculture (62.05%, mainly subsistence farming), trade/commerce (14.84%) and the service sector (10.51%).<sup>6</sup> More women than men engaged in the agricultural sector (differential 4.69%), in the industrial sector (differential 5.16%) and the service sector (differential 4.23%), while more men are working in the trading sector (differential 3.89%).<sup>7</sup>

<sup>2</sup> Figures provided by BAKORNAS on 21<sup>st</sup> of February 2005.

<sup>3</sup> The Consultative Group on Indonesia (BAPPENAS & The International Donor Community), Indonesia: Notes on Reconstruction. The December 26, 2004 Natural Disaster, January 2005: 17

<sup>4</sup> Badan Pusat Statistik Propinsi Nanggroe Aceh Darussalam, Welfare Statistics, National Social Economic Survey, Banda Aceh 2003: 95

<sup>4</sup> According to SDC host families have accommodated 8-11 IDPs on average per family in Banda Aceh, thus indicating that a social support system is very much functional.

<sup>5</sup> The Consultative Group on Indonesia (BAPPENAS & The International Donor Community), Indonesia: Notes on Reconstruction. The December 26, 2004 Natural Disaster, January 2005: 17

<sup>6</sup> Badan Pusat Statistik Propinsi Nanggroe Aceh Darussalam, Welfare Statistics, National Social Economic Survey, Banda Aceh 2003: 94 - 95

<sup>7</sup> Ibid.: 94 - 99

Poverty levels were alarmingly high with 488,282 households or roughly 2 Million people<sup>8</sup> (53.53%) living below poverty line and 90.59% of the monthly per capita population's expenditure being less than Rp 299,999. 10 out of 21 districts have poverty levels higher than 50%. All of them, except Aceh Tenggara, were affected by the disaster, thus making the economic situation of the poor even worse (continuation of poverty spiral).

In comparison, only 23,163 of households had access to credit and revolving funds before the tsunami and many of these still have outstanding loan amounts, which they are not able to reimburse under the given economic circumstances.

On the other hand, the majority of 237,757 households which had savings either in deposit or savings accounts have presently been refused access to their savings because of lack of documentation and identification (i.e. savings book, death certificate, KTP).

The above figures highlight the overall high unmet demand for credit in a province, which needed access to capital already urgently *before the tsunami* and whose demand for credit has been even further increased *by tsunami* (demand supply gap).

Demand for credit products after tsunami varies according to the degree that people have been affected by tsunami. They can be divided into 3 broad categories:

- a) Those **people mostly affected by tsunami** (406,156 IDP), who presently live in tents/barracks or host families and lost all or most of their assets. They are totally depending on direct assistance provided by the government and donors. They need technical assistance and conditional *grants in the short term* and *soft loans in the medium term* to start livelihood activities. The majority of them want to engage in economic activities related to the agricultural and fishery sector, which constitute the most important economic sectors in the province.
- b) Those **people partly affected by tsunami** (circa 200,000 people), who have lost only parts of their assets and are ready to restart income generating activities, but presently lack access to financial micro-finance services. Many representatives of this group are traders and SME. They also need access to business development services.
- c) Those **people not directly but indirectly affected by tsunami** include for example host families, who need access to capital to expand economic activities to meet higher living costs<sup>9</sup> and those traditional clients of formal financial institutions. They might need loans to expand businesses due to gaps caused by lack of economic players and to address higher demand for certain goods, products and services after tsunami, (while at the same time there might be no market for other products).

Those who need immediate financial assistance are those target groups represented in a) and b). They include 300,000 farmers who need either access to new land or support to clean contaminated farmland wherever possible in order to start agricultural activities as soon as possible (2 harvests are already lost). They need access to soft loans to buy seeds, fertilizer, tools/material, etc. Moreover, action has to be taken to provide 130,000 fishermen and prawn farmers with soft loans to buy boats and fishing equipment and 100,000 small businesses

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<sup>8</sup> Out of a total population of 4.213.821. Source: Badan Pusat Statistik Propinsi Nanggroe Aceh Darussalam, Welfare Statistics, National Social Economic Survey, Banda Aceh 2003: 13

<sup>9</sup> Host families have accommodated 8-11 IDPs on average per family, thus indicating that a social support system is very much in place.

employing over 170,000 people need access to loans to restart business activities (working capital, provision of equipment, goods, etc.) as soon as possible.

However, it has to be emphasized that financing needs will be higher on the west coast than on the east coast due to a higher degree of devastation caused by the disaster.

While economic recovery efforts will clearly focus on the most affected areas first, people living in unaffected areas are indirectly hit by the disaster as well and financial services should cater for their credit needs as well, especially with regards to the generally high prevalence of poverty *throughout* the province and the high level of female-headed households (19%) already before tsunami.

## **4. OVERVIEW OF THE MICRO-FINANCE INDUSTRY IN NAD**

### **4.1. FORMAL FINANCIAL SYSTEM**

BI estimates the total damage and losses in the banking sector due to tsunami in the range of Rp 1 trillion, including loan losses (900 billion), infrastructure damage (110 billion) and reconstruction cost of loan and savings records (20 billion).

#### **4.1.1 Commercial Banks**

The financial sector in Aceh before tsunami was not well developed and not very active, somehow reflecting the depressed state of the real economy after two decades of continuing political and military conflict. The sector is dominated by the (mainly state-owned), eleven commercial banks (CBs),<sup>10</sup> operating on national scale and one regional development bank (BPD Aceh), with more than 98% of assets, outstanding loans and savings at the end of 2004. CB cater for the financing needs of a few large enterprises, government infrastructure programs and small & medium enterprises (SMEs). The total of CB branches is over 200<sup>11</sup> and main clients are employees and traders.

Weaknesses of CBs are that outreach is limited due to the concentration of their branch network in Banda Aceh and some bigger cities and lending generally requires 'hard' collateral, thus excluding the majority of microfinance clients with smaller loan demands. Their credit technologies are not tailored to the special needs and requirements of micro enterprises and poor households.

Overall, the commercial banking system seems to be sound,<sup>12</sup> with the exception of the provincial Government owned BPD Aceh (see BPD Aceh below).

The nation-wide operating CBs have incurred the major losses due to tsunami in absolute terms. But as their Aceh portfolio accounts for only a very small fraction of their respective total portfolios any losses can be easily covered by general or special provisions. Taking into account the dominance of the national CBs there seems to be no systemic risk to the financial system.

##### **4.1.1.1 BPD Aceh**

BPD Aceh, which is the single most important CB in Aceh in terms of savings and loans, faces chronic liquidity and governance problems as well as political interference.

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<sup>10</sup> Major players are Bank Negara Indonesia (BNI, market share: 62% assets, 15% savings, 31% loans), Bank Rakyat Indonesia (BRI, market share: 17%, 19%, 31%), Bank Mandiri (market share: 5%, 12%, 3%).

<sup>11</sup> BRI alone has 13 branches and 114 BRI units.

<sup>12</sup> With a comfortable liquidity position: Loan to asset ratio: 10%, loan to deposit ratio: 43%, NPL ratio: 5%.

It incurred heavy losses due to tsunami and it is estimated that almost 50% of its loan portfolio is affected, thus increasing its already existing liquidity problems. Besides technical assistance (TA) for necessary institutional and organizational restructuring to improve governance structure and institutional efficiency, the BPD Aceh is in urgent need of fresh funds in order to avoid bankruptcy.

#### **4.1.1.2 Bank Danamon**

Bank Danamon, a privately owned CB,<sup>13</sup> is one of the most innovative CBs in Indonesia in the field of microfinance. In 2003 the bank reevaluated its strategy for microfinance and as a result a special organization for micro and small scale businesses in Indonesia, Danamon Simpan Pinjam (DSP), was established.<sup>14</sup>

DSP policies, regulations, products and services are specially designed to cater for the needs and demand of the micro and small scale businesses as well as the employees and blue collar workers. Innovations introduced are biometric technology for thumb print verification, simple credit approval procedures leading to a loan approval within two working-days, less paper work for payment, withdrawal and credit application. Substitutes for traditional collateral are savings first, graduation and group approach. Individual lending is based on the character of the borrower and the cash flow of the project. DSP provides micro loans as low as 2 million Rp. So far, the NPL ratio of the total DSP outstanding loan portfolio is less than 1%.

As a reaction to tsunami, Bank Danamon is increasing its presence in Aceh. In March 2005, one DSP unit will be opened in Banda Aceh, another unit is still in the planning stage. Target groups are self-employed micro and small entrepreneurs and fixed income earners, with priority in the short term on market traders.

#### **4.1.2 BPR/BPRS**

The rural banking system, comprising of 18 rural banks (14 BPR, 4 BPRS) before tsunami, had a market share of less than 1%, but importance of some BPR/BPRS might be higher in areas not served by CBs. The BPR/BPRS or People's Credit Banks are organized as unit banks without branches or sub-branches. 4 BPRS are applying the Islamic principles of interest free loans on a profit sharing basis (Syariah).

BPR/S are mainly owned by the provincial government and are under the supervision of the BI. They cater more for the MF market, but still demand tangible collateral. With an average client base of less than 200 borrowers per bank and located mainly in Banda Aceh and the west coast, their outreach is quite limited.<sup>15</sup> Other constraints are low operational efficiency with 100 borrowers or less/loan officer, a high NPL ratio of 20% before tsunami (September 2004) and quite limited institutional and managerial capacities.

7 out of 18 BPR/S were affected by tsunami and one BPR had to completely stop operations. One BPR in Banda Aceh reported that 70% of clients have been affected by tsunami (borrower missing or dead, assets destroyed). The BPR/S system is seriously threatened by the losses and damages caused by tsunami. Several are facing bankruptcy due to acute

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<sup>13</sup> 62% is owned by a consortium of Singapore-based Temasek Holdings and Deutsche Bank

<sup>14</sup> The first DSP branch opened in March 2004 and by the end of December 2004 a total of 264 DSP branches in Java, Bali, Sumatra and Sulawesi had opened to serve 147,000 customers, with a total loan amount of Rp 655 billion.

<sup>15</sup> Even if you assume an average of 200 borrowers per bank the total number of 18 BPR/BPRS was accounting for just 3,600 borrowers.



liquidity shortages. BI estimates that the majority of the loan portfolio of the affected BPR/S has to be restructured, but no special regulation (as in the case of CBs) has been issued yet.

## **4.2. NON-BANK FINANCIAL INSTITUTIONS**

### **4.2.1 Bahana Artha Ventura Aceh**

PT. Sarana Aceh Ventura is a venture capital fund owned by the Bahana Artha Ventura group (BAV). BAV belongs to Bahana Pembinaan Usaha Indonesia (BPUI), which is owned by the BI and the Ministry of Finance (MoF). BAV owns and supervises provincial venture capital companies (PVCC) such as the Saranah Aceh Ventura.

The institution provides only loans to SME in Aceh, because equity financing is restricted to listed companies by law (collateral based lending only). The outstanding loan portfolio before tsunami was Rp 10 billion to 147 SME. The venture capital company incurred a loss in 2003 and the NPL ratio end of 2004 was high with 23% compared to commercial banks (5%). With a total staff of 15 the company has one office in Banda Aceh and business is concentrated in Banda Aceh and Aceh Besar (low outreach).

## **4.3. SEMI-FORMAL & INFORMAL FINANCIAL SYSTEM**

### **4.3.1 BMT**

The BMT system had about 76 credit, savings and multipurpose cooperatives in the mid 90ties. The number decreased to 20 institutions until end of 2004, due to lack of capital, weak management capacity and insufficient support from PINBUK (small business incubation center) as their promoting institution.

Supervised by the Ministry of Cooperatives, the BMT are generally considered as institutionally and organizationally weak, with very limited outreach, small client base of less than 100 active members and low loan portfolio quality. Tsunami wiped out 8 BMT and out of the 12 remaining, only 6 are considered profitable based on indicators used by PINBUK. BMT demand tangible collateral, thus excluding a majority of potential MF clients.

The BMT system is seriously threatened by the losses and damages caused by tsunami. Several BMT are facing bankruptcy due to acute liquidity shortages (see also BPR/S).

### **4.3.2 MF-NGOs**

Only 4 NGOs (YADESA, CCDI in Banda Aceh and Citra Desa, Malin Daging in Sigli) could be identified in NAD involved in economic and microfinance activities before the tsunami. CCDI was entirely wiped out by tsunami.

Of the remaining 3, only YADESA is a member of the association of self-help promotion institutions *ALTRABAKU*. YADESA is targeting the poorest in both urban and rural areas. Before tsunami the NGO was providing micro loans to 150 micro enterprises in Banda Aceh with an outstanding loan portfolio of Rp 40 million (4,000 USD). While NGO-MFI are targeting the poorer strata of the population their number and outreach is very limited.<sup>16</sup> Other constraints are lack of regulatory and supervisory framework, limited organizational and management capacities, lack of capital and sustainability.

In general, there are no MFI with adequate financial technologies and their institutional capacity to act as intermediary for financial cooperation funds is quite limited.

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<sup>16</sup> For example: YADESA currently works with a target group of 200 and wants to expand to 400.

### 4.3.3 Government Programs

There are several government sponsored microfinance programs initiated and supported by the government and implemented by for example Dinas Sosial or the National Family Planning Board (BKKBN). The strengths of these programs are that they focus on the poorest of the poor, women, the destitute and disabled and, if functional, they have considerable outreach.<sup>17</sup> They dispose of a substantial amount of field workers, cooperate with other government service departments to provide the needed technical training and use local banks (BRI, BNI) or post offices for fund channeling.

Weaknesses are that these programs often have limited management capacities, poor loan portfolio quality and heavy dependence on financial support from the government. Generally, their sustainability has to be thoroughly assessed.

Apart from the above mentioned programs, a pilot test was launched before tsunami based on a decree of the head of Bireuen district (*surat keputusan bupati*), establishing member-based institutions locally called *Lembaga Keuangan Desa* (LKD). 10 of these LKD have been successfully formed so far and could represent an interesting example of developing rural MFIs.

### 4.3.4 Moneylenders, Relatives & Friends

The only access to 'fast cash' for those households, fishermen, farmers and micro enterprises, which lack collateral, are moneylenders, relatives and friends.

However, many people are afraid that they will become even more indebted if they use moneylenders' services. They express fear of not being able to repay the high interest rates under the given economic situation (20 – 50%/month) and therefore rather refuse their services. Moreover, charging interest is culturally not everywhere accepted because of the prevalence of Syariah in Aceh province.

Generally, family, relatives or friends are preferred sources of finance (given that they are able to provide sufficient capital amounts themselves), as they usually provide loans free of interest and with flexible repayment periods, which is very much in demand after tsunami.

## 4.4 SUMMARY ASSESSMENT

**Table 1: Summary Assessment of the Financial Sector in NAD**

<b>Financial Institutions</b>	<b>Institutional Soundness</b>	<b>MFI / SME Orientation</b>	<b>MFI /SME Outreach</b>	<b>Tsunami Impact</b>	<b>Need for TA</b>	<b>Need for FC</b>
<b>National state-owned CB</b>	High	Medium	Low	Medium	No	No
<b>BRI</b>	High	High	Medium	Medium	No	No
<b>Bank Danamon</b>	High	High	Low	Low	No	Low
<b>Sarana Aceh Ventura</b>	Medium	High (SME)	Low	High	Medium	Medium
<b>BPD Aceh</b>	Low-medium	High	Medium	High	High	Medium

<sup>17</sup> The UPPKS' program of BKKBN had 2000 groups in 21 districts of NAD and Dinas Sosial formed 1,250 groups, all of which got access to revolving funds.

<b>BPR/BPRS</b>	Low	High	Low	High	High	Low
<b>BMT</b>	Low	High	Low	High	High	Low

## 5. REHABILITATION, RECONSTRUCTION & DEVELOPMENT STRATEGY FOR THE FINANCIAL SECTOR IN NAD

The overall goal of the rehabilitation, reconstruction and development strategy for the financial sector in Aceh province is to establish

*“an efficient financial system that contributes to restoration and development of the people’s livelihood in the NAD province.”*

The main objectives of the strategy are to rehabilitate and reconstruct the existing financial system and to improve the financial system.

The major strategic components comprise of 1. the legal and regulatory environment (assessment of deregulation of BPRs and BPD, apex institution, legal framework for establishing new non-bank micro-finance institutions and supervision), 2. recapitalization (of BPR/BPRS, BPD and non-bank financial institutions and MFIs) and 3. capacity building (strengthening of institutions, mainly BPR/S, BPD and non-bank MFIs as well as human resource development).

The action plan will be divided into three phases:

1. Rehabilitation phase (3 – 12 months)
2. Reconstruction phase (12 – 36 months)
3. Further development (> 36 months)

The implementation of the strategy for the entire financial sector (including new organizations) will focus on the following aspects (see table 2):

**Table 2: Implementation Matrix for the Entire Financial Sector in NAD**

	<b>Rehabilitation</b>	<b>Reconstruction</b>	<b>Further Development</b>
<b>Legal &amp; regulatory environment</b>	NPL, loan classification, claiming the insurance, loss of assets, access to savings	Assessing deregulations for BPR/BPRS, BPD  Apex mechanisms	Legal framework for establishing new MFIs, e.g. LKD, incl. supervision
<b>Recapitalization</b>	Mapping & assessment of non-bank MFIs & BPR/S; Quantifying demand of FIs	Design & implement recapitalization programs	Sustaining mechanism by institutional investor strategy
<b>Capacity building</b>	Mapping & assessment of non-bank MFIs & BPR/S; Qualifying & quantifying demand	Design & implement capacity building programs & institutionalization	Non-financial service provider industry, tertiary education on MF/SME finance - HRD

An Aceh Finance Sector Task Force (AFS-TF) should be established, chaired by BAPPENAS, or the regional development and planning body Bappeda respectively, including line ministries, as a steering and coordination, facilitating and monitoring capacity between the implementation level (financial intermediaries, i.e. BI, CB/BPD/BAV, BPR/BPRS and MFIs) and the support level (donors, private sector and government). It would act as a permanent clearing house.

The guiding principles of the strategy are to pursue a systemic and realistic approach, which covers the entire region. It has to be market oriented and improves the competitiveness of the MF & SME finance service providers. It builds on existing institutions and focuses on sustainability and increasing outreach. Empowerment of women as well as respect for the socio-cultural context is crucial.

## **6. COOPERATION WITH OTHER DONORS**

### **6.1. ADB**

ADB plans to provide 25-50 million USD for a comprehensive restructuring program for BPD Aceh including TA and a liquidity facility. In addition, a possible assistance (TA, liquidity) for the BPR system in the range of 5 million USD is discussed. Assistance to BMT might also be considered but seems less likely.

### **6.2 AFD**

According to information from BRI, AFD is currently negotiating a 20 million USD refinancing facility with BRI for Aceh. Terms are: 20 years with 10 years grace period, 2% p.a., no other charges. BRI shall receive the facility in foreign exchange and should lend the equivalent amount in Rp to micro enterprises in Aceh.

### **6.3. Savings Bank Foundation for International Cooperation (SBFIC)**

The German Savings Bank Foundation has scheduled a fact-finding mission for mid March to Aceh to identify possible projects in the microfinance sector. A savings bank reconstruction fund in the range of 8 million USD for refinancing MFIs and up to 5 banking experts are offered as assistance to the microfinance sector in Aceh. The reconstruction fund will be sourced from donations by the German Savings Banks Finance Group.

The integration of SBFIC's project idea into the official development cooperation program is vital in order to harmonize German development contributions.

### **6.4 USAID**

USAID considers the tsunami effect on the financial system in Aceh as not system-threatening. In addition, USAID sees currently more a need for grant funds for the immediate replacement of lost assets. Thus, it is questionable whether in the short run a commercially oriented microfinance approach will be viable. Nevertheless, USAID is scheduling a microfinance mission for March/April this year to further explore possible microfinance schemes in Aceh.

### **6.5. CGAP**

According to ADB information a CGAP mission to Aceh is scheduled for March 17-24, with a wrap-up meeting in Jakarta on March 23.

## **6.6 World Bank**

World Bank is planning to expand its Sub-District Poverty Alleviation Program ‘*Program Pengembangan Kecamatan*’ (PPK) into all 21 regencies of NAD as a consequence of tsunami. The MF component (provision of revolving funds) of this program will be launched in the medium term, once groups have been formed and are effectively running.

Moreover, World Bank is launching a new MF national program with a particular focus on NAD named ‘*Support for the Poor and Disabled*’ (SPADA) as well as a smaller, but popular program ‘*Koperasi Unit Desa*’ (KUD)<sup>18</sup>, which it started implementing in NAD on a small scale before the tsunami together with the Fishery and Agriculture Ministry.

Aceh province will be part of the WB microfinance program on national scale, which will include the establishment of a policy and regulatory environment for MFIs and an institutional support program for PNM.

Major reasons for World Bank not to engage in micro-finance activities on a large scale right now are the perceived risk of market distortion through the influx of grant money and the conflict with principles of a commercial and market oriented and private sector-led microfinance development strategy.

## **6.7 OTHER DONORS**

UNDP indicated that microfinance might be one component in its program “Rehabilitation of Income Generating Activities.”

Other international donors and NGOs (e.g. SDC, Mercy Corps, FAO, Care, Save the Children and Cord Aid) are presently using grant funds to assist in income generating activities in Aceh and want to switch to a (soft) loan methodology (MF) in the medium term.

## **6.8. SUMMARY ASSESSMENT**

Other planned donor activities indicate sufficient funds for rehabilitating the microfinance system in Aceh. ADB alone is planning to assist BPD Aceh and the BPR system in the range of 30-55 million USD. The German Savings Bank Foundation is preparing a savings bank reconstruction fund in the range of 8 million USD for refinancing MFIs and up to 5 banking experts are offered as assistance to the microfinance sector in Aceh. AFD is currently negotiating a 20 million USD refinancing facility with BRI for micro loans to micro enterprises in Aceh. In addition, both USAID and CGAP are planning microfinance missions to Aceh in March/April 2005.

Any FC-TA project has to consider these already on-going or planned activities from other donors. In particular, FC has to communicate and coordinate with ADB and the German Savings Bank Foundation before finally deciding on a possible microfinance project in Aceh.

# **7. POSSIBLE FINANCIAL & TECHNICAL COOPERATION APPROACHES**

## **7.1 GENERAL FRAMEWORK & CONSTRAINTS FOR ASSISTANCE**

Any assistance for the microfinance sector in Aceh has to consider two distinct issues:

- The various problems and constraints of MFIs already existing *before* the Tsunami

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<sup>18</sup> KUD are multi-purpose cooperatives at sub district level and presently only cover 2 villages (1300 creditors) in NAD because of budget constraints.

- The additional problems created *through* Tsunami.

While the additional problems created by tsunami for the MFIs are mainly financial, that is lack of capital and liquidity, the already existing weaknesses of MFIs before tsunami are mainly institutional and organizational and thus more complex.

The challenge for any assistance is then to avoid providing liquidity (without a major TA input) to MFIs that were already poor performers before tsunami. Successful assistance needs a good blend of TA and FC and in particular a proper phasing of the two components. For a majority of BPR and BMT institution building might even take quite some time before even small amounts of new funds could be absorbed properly. This challenge seems to be quite real as political pressure on the Indonesian side and the serious liquidity situation of some MFI are calling for some fast actions, not necessarily conducive for the longer term efficiency and sustainability of the microfinance sector.

The assessment of the microfinance system in Aceh before and after tsunami clearly shows the difficulties to identify feasible FC approaches: Well functioning national CB don't need outside financial assistance to handle the Tsunami effects on their respective portfolios. On the other hand, microfinance oriented institutions are lacking outreach and absorptive capacity for FC funds, and need heavy up-front TA in the areas of institutional and organizational development. Both will lead to quite limited options for FC.

The expected heavy influx of foreign grant funds might create for some time conditions not necessarily conducive for the development of a sound and sustainable microfinance sector in Aceh. World Bank's and USAID's current reluctance to provide assistance for the microfinance sector in Aceh are mainly based on the perceived risk of market distortions through grant money.

Before tsunami the Aceh economy was in a state of depression and so was the financial sector. Therefore, future economic development and demand for microfinance and financial services in general in Aceh will primarily depend on a peaceful solution of the long lasting political and military conflict.

A post-disaster economic take-off, as predicted by many observers, will sooner or later lead to a consolidation of the institutional landscape of the financial sector in Aceh. Increasing demand for more and new financial services will bring in new players and thus increase competition. Nation wide operating CBs in general, and in particular innovative CBs like Bank Danamon or BRI with its comparatively large branch network will have a competitive edge over rural unit banks or banks with regional business focus. The lack of economies of scale will most likely reduce the number of these banks making their survival subject to identifying and successfully occupying market niches not attractive for larger banks.

## **7.2 FORMAL FINANCIAL SYSTEM**

### **7.2.1 Bank Danamon**

Bank Danamon Simpan Pinjam (DSP)'s micro-loan scheme is looking for technical assistance in setting up a linkage banking approach, and in developing savings and credit self-help groups.

Moreover, German assistance could focus on financial support for Bank Danamon's newly introduced micro insurance scheme (pilot project) in Aceh. Insurance products will include

health, life and fire insurance. The bank expressed principal interest in a FC project in the range of 2-3 million EUR for a period of 3-5 Years. The project concept would be a risk-sharing arrangement (re-insurance or guarantee) between Bank Danamon and KfW for a micro insurance scheme in Aceh.

Open questions and issues are:

- The project concept is still very general and has to be further specified;
- As Bank Danamon is a private CB, the Ministry of Finance might be reluctant to channel ODA funds to a private entity;
- As the CB belongs to the most profitable banks in Indonesia the question arises whether the bank really needs FC funds;
- An FC project with Bank Danamon would not address the immediate affects of tsunami but would aim at increasing sustainable access of microfinance target groups; thus the project might not be considered as (politically) feasible in the context of tsunami assistance.

### **7.2.2. Regional Development Bank (BPD Aceh)**

BPD Aceh requires a comprehensive restructuring and institutional support, e.g. via twinning program and recapitalization.

An additional strategic option for further financial sector development is to provide capital to BPD as a wholesale finance mechanism / apex bank to refinance retail institutions, i.e. BPR/BPRS and non-bank MFIs. PT Permodalan Nasional Madani (PNM) may assist with technical support for facilitation and institutional capacity building (also see 7.4.1). Different entry levels for donor funding and technical assistance (TA) are given. Since most of the BPR are government-owned, a “package-solution” with BPD would form a strong component of this strategy. A special TA window within BI branch office Banda Aceh, comparable with the GTZ-ProFI office in Jakarta, may constitute a management structure for funding and other support from investors, corporate social responsibility contributions and donor programs for reconstruction of the financial system.

### **7.2.3. BPR/BPRS**

Deepening of financial services in rural areas is vital and BPRS need a fully fledged technical assistance package and refinancing for business recovery and facilitation of linkages with commercial banks, apex institution and non-bank MFIs.

## **7.3. NON-BANK FINANCIAL INSTITUTIONS**

### **7.3.1 Bahana Artha Ventura Aceh (BAV)**

German assistance would focus on broadening venture capital (FC) and to support the provision of the necessary legal framework (TA) for a non-bank financial institution.

PT. Sarana Aceh estimated a recapitalization need due to tsunami in the range of around Rp 10 billion (0.8 million EUR). The institution expects a rising need for SME financing in the near future due to the economic recovery of Aceh and estimates a future refinancing requirement in the range of Rp 65 billion (5.5 million EUR) for the next 3 years. BAV has already submitted a respective proposal to the Ministry of Cooperatives and SME. Financing will first focus on the trading sector and later expand to the fishery and agricultural sector.

The management of both PT. Sarana Aceh and BAV expressed strong interest in a possible FC project in Aceh. However, BAV is already the likely executing agency in an upcoming FC

SME project nationwide, thus a separate project in Aceh might not be advisable. Other open questions and issues are:

- BAV needs further institutional assessment; in particular, the high NPL ratio of 23% before tsunami compared to 5% NPL of the CB-system needs further clarification;
- The company is only providing loans thus duplicating SME finance of CB; with a strong emphasis on collateral based lending and only one branch in Banda Aceh, the “value added” of the financial institution is questionable;
- Why does the company not provide leasing finance which would complement loan financing from the CB and increase the range of financial products available for SME?
- FC need for portfolio expansion might be too high taking into account the portfolio of less than Rp 10 billion in 2004.

## **7.4 SEMI-FORMAL & INFORMAL FINANCIAL SYSTEM**

### **7.4.1 The PNM-BAZNAS Program for Rural Financial Institutions (BPR/BPRS, BMT)**

PT Permodalan Nasional Madani (PNM) is a government financial institution that was established in 1999 to provide financial and technical support to micro, small, medium enterprises and cooperatives (MSMEC). In accordance with the MoF, the PNM was appointed as a credit program financing coordinator. In addition, PNM acts as an apex bank for donor funded credit programs and manages special credit facilities of BI which were transferred to PNM in accordance with the new BI law. PNM acts basically as a wholesale lending institution that provides credit through accredited retail banks to the target groups of MSMEC. In addition, PNM is also involved in activities such as management, training, and TA support to rural MFI.

As a response to the tsunami disaster PNM together with BAZNAS, an Islamic oriented NGO, has developed a program for the recovery of the Aceh microfinance sector. The program will provide finance and TA for the rehabilitation of already existent and establishment of new Syariah based BPR (BPRS) and BMT. The total capital need for the program is tentatively estimated at Rp 40-50 billion (3-4 million EUR) for a total of 30-45 BPRS and BMT within a period of 3-5 years. Financing for the start-up of the program (6 BPRS/BMT) will be provided by BAZNAS.

Main open questions and issues are:

- As only 12 BMT and 17 BPR/BPRS are still existing after tsunami, the total number of viable MFI (old and new ones) is still unclear;
- The absorptive capacity of the BPR/BPRS/BMT system for FC seems to be quite limited;
- In general, sustainability and viability of rehabilitated and newly established BPR/BPRS/BMT might be questionable;

### **7.4.2 MFI-NGOs**

Existing MFIs need an entire package of TA to ensure provision of quality MF (development of a range of suitable MF products, HRD) and business development services. The same services have to be provided to newly created MFIs (capacity building/institution building) in order to achieve substantial deepening of the MF sector in NAD province.



Moreover, TA should focus on creating the needed regulatory framework to ensure legality (including supervision) of MFIs.

#### **7.4.3 Government Programs**

The most important MF program addressing the particular needs of (poor) women with a significant outreach, is the BKKBN supported UPPKS program. Both, financial as well as technical assistance is needed to re-vitalize activities of the program. TA should focus on developing a sustainable MF program (HRD, development of viable MF products, etc.), which would address the identified weaknesses and build on the strengths of the previous program through making maximum use of the already existing infrastructure of UPPKS (see 4.3.3). Also, sufficient vocational training and business development services have to be identified and provided to cater for those economic activities that women are engaged in (namely in the agricultural sector (65.22%), trade/commerce (12.22%), service sector (13.36%) and industry (8.29%).<sup>19</sup>)

### **7.5 SUMMARY ASSESSMENT**

The assessment of the microfinance system in Aceh before and after tsunami clearly shows the difficulties to identify feasible FC approaches: Well functioning national CB don't need outside financial assistance to handle the tsunami effects on their respective portfolios. On the other hand, microfinance oriented institutions are lacking outreach and absorptive capacity for FC funds, and need heavy up-front TA in the areas of institutional development and capacity building of management and staff. Both will lead to quite limited options for FC, but several opportunities for TA.

The total need for FC funds would be in the range of 10-13 million EUR, distributed between three different projects. However, FC fund requirements for Sarana Aceh Ventura and the BPR/BPRS/BMT might be actually lower than indicated by the project executing agencies. A significant need for up-front TA for BPR/BPRS/BMT might limit the absorptive capacities of these MFI and delay disbursement of FC funds.

The major findings of the assessment can be summarized as follows (see table 3):

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<sup>19</sup> Badan Pusat Statistik Propinsi Nanggroe Aceh Darussalam, Welfare Statistics, National Social Economic Survey, Banda Aceh 2003: 94 - 95

**Table 3: Comparative Assessment of FC & TA Project Proposals**

<b>Financial Institutions and Possible FC Approaches</b>	<b>Bank Danamon/DSP Micro Insurance Scheme</b>	<b>Sarana Aceh Ventura Recovery and Expansion project</b>	<b>PNM/BAZNAS BPR/BPRS/ BMT Rehabilitation Program<sup>20</sup></b>
<b>Institutional Soundness</b>	High	Medium	Low
<b>Microfinance / SME Orientation</b>	High (microfinance)	High (SME)	High (microfinance)
<b>Outreach</b>	Medium	Low	Low
<b>Absorptive Capacity for FC Funds</b>	High	Medium	Low
<b>Need for TA</b>	No	Medium	High
<b>Need for FC</b>	Low (2-3 million EUR)	Medium (5-6 million EUR)	Low (3-4 million EUR)
<b>Major Issues</b>	<ul style="list-style-type: none"> <li>- Not directly Tsunami related</li> <li>- Private CB and ODA funds</li> <li>- Additionality of FC funds</li> </ul>	<ul style="list-style-type: none"> <li>- High NPL ratio</li> <li>- “Value added” of credit finance to SME</li> <li>- FC needs might be too high</li> </ul>	<ul style="list-style-type: none"> <li>- Absorptive capacity for FC</li> <li>- High up-front TA need</li> <li>- Sustainability of MFI</li> </ul>

<sup>20</sup> Assessment refers to BPR/BPRS/BMT only.

## ABBREVIATIONS & ACRONYMS

ADB	Asian Development Bank
AFD	Agence Française Développement
ALTRABAKU	Association of Self-Help Promotion Institutions – Partner for Micro-Finance Institutions and Micro-Enterprise Development
ARF	Aceh Recovery Forum
BAPPEDA	Regional Development Planning Agency
BAPPENAS	National Development Planning Agency
BAKORNAS	Badan Koordinasi Nasional Penanggulangan Bencana Dan Penanganan Pengungsi: National Coordinating Agency for National Disaster & Refugees Relief
BAV	Bahana Artha Ventura: Venture Capital Company
BAZNAS	Islamic Oriented NGO
BI	Bank Indonesia: Central Bank
BKKBN	Badan Koordinasi Keluarga Berencana Nasional: National Family Planning Board
BMT	Bank Maal wat Tamwil, Non-Bank Micro-Finance Institution
BNI	Bank Negara Indonesia: Commercial
BPR	Bank Perkreditan Rakyat: People’s Credit Bank
BPRS	Bank Perkreditan Rakyat Syariah: People’s Credit Bank following Islamic Principles
BPS	Badan Pusat Statistik: Central Bureau of Statistics
BRI	Bank Rakyat Indonesia
CB	Commercial Bank
CGAP	Consultative Group to Assist the Poor
DSP	Danamon Simpan Pinjam: Microfinance Product
FAO	Food & Agriculture Organization
FC	Financial Cooperation
GTZ	Gesellschaft für Technische Zusammenarbeit: German Technical Cooperation
HRD	Human Resource Development
IDP	Internally Displaced People
ILO	International Labor Organization
KfW	Kreditanstalt für Wiederaufbau: German Development Bank
KUD	Kooperasi Unit Desa: Multi-Purpose Cooperative at Sub-District Level
KTP	Identification Card
LKD	Lembaga Keuangan Desa: Village Finance Institution
MF	Micro-Finance
MFI	Micro-Finance Institution
MoF	Ministry of Finance
MSMEC	Micro, Small, Medium Enterprises and Cooperatives
NAD	Nanggroe Aceh Darussalam
NGO	Non Government Organization
NPL	Non-Performing Loan
ODA	Official Development Assistance
PINBUK	Small Business Incubation Centre
PNM	Permodalan Nasional Madani: state-owned financial institution
PVCC	Provincial Venture Capital Companies
PPK	Program Pengembangan Kecamatan: Sub-District Development Program

SDC	Swiss Agency for Development & Cooperation
SPADA	Support for the Poor & Disabled (Worldbank Project)
SME	Small & Medium Enterprise
TA	Technical Assistance
ToR	Terms of Reference
UNDP	United Nations Development Program
UPPKS	Usaha Peningkatan Pendapatan Keluarga Sejahtera
USAID	United States Agency for International Development
YADESA	Economic Empowerment and MF-NGO