INDONESIA Country Profile

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Indonesia has been one of the first countries to develop commercial microfinance in Asia, with regulated financial institutions providing the bulk of microfinance services throughout the archipelago. Bank Rakyat Indonesia units have been in existence for twenty years, and some forms of 'People's credit banks' or BPRs, have appeared more than a century ago. Microcredit is defined by Bank Indonesia, the central bank, as a loan below Rp.50 million (US$5,373), a financial product provided by formal and semi-formal financial providers in Indonesia. In addition to the success of commercial microfinance providers, Indonesia has also been a favourable ground for the development of numerous subsidised government programs, local and community-based financial institutions, cooperatives and NGOs.

Needs for Microfinance

As of 2003, 31.2 million poor people were living in Indonesia, and represented 17.4% of the population. Approximately 20% of Indonesia's 214 million people depend on micro- and small-scale businesses to earn a living, but only 10 million out of 42 million microenterprises have access to credit from formal financial institutions.

After the financial crisis of 1997-98, poverty alleviation became one of the first priorities of the government engaged in wide-range financial reforms, which also sought to reduce growing income disparities between people, and between regions. The new poverty reduction strategy presented in 2000 was placed under the responsibility of the vice-president and based on three pillars:

1. Promoting economic opportunities for the poor
2. Enhancing social security by supporting community and family-based safety nets
3. Facilitating the empowerment of the poor by:
    - Strengthening community organisations
    - Promoting sustainable rural development
    - Encouraging capital accumulation and self-financing of local communities
    - Revitalizing small-scale and medium enterprises by creating a conducive business environment and improving access to credit and financial services on commercial terms, strengthening community-based financing institutions, and improving the environment for the expansion of micro-credit institutions.

During the financial crisis, commercial microfinance providers such as BRI units and BPRs have shown resilience and growth in savings mobilisation, when the whole banking sector was collapsing. Microsavings have proven to be a valuable safety net for low-income population and microentrepreneurs.

Several studies have demonstrated that there is still an unmet demand for microfinance services, as a majority of rural households still do not have access to a source of funds from a semi-formal or formal institution. The regulated microfinance providers, BRI Units and BPRs, tends to cover mostly the upper levels of the microenterprise market, in district and sub-district towns, with loans of more than Rp. 3 million (US$320), while NGOs, cooperatives, and village-based institutions (BKDs) reach a lower end of the market but still have a limited outreach in rural areas.

Microfinance sector development

Indonesia has a long history of commercial microfinance, starting a century ago with the Badan Kredit Desa (BKD or Village Credit Organisation), village-owed banks offering microcredit on commercial terms. Approximately 5,000 BKDs operate in Indonesia nowadays. Sustainable microfinance in the banking sector began in 1970 with the opening of Bank Dagang Bali (BDB), a private bank in Bali specialised in commercial microfinance, which built it success on the knowledge of microfinance clients and on state-of-the art savings products. BDB was closed by Bank Indonesia in 2004 due to governance and liquidity problems.

The generic term for small financial institutions in Indonesia is Bank Perkreditan Rakyat (People's Credit Bank, or BPR), which were introduced by Bank Indonesia in 1978. After the 1988 financial reforms of PAKTO 88, new secondary banks were established, also called BPRs. Specific requirements for the licensing of pre-existing BPRs (capital, size of deposits) were set but never fully respected. Today, BPRs includes licensed financial institutions, mostly privately-owned, that meet the criteria specified in the 1992 Banking law, and number 2,148 in 2004 (accounting for 15% of the microfinance market), and almost 9,000 public rural financial institutions that are not licensed, and can be categorised as generic BPRs, which include village-owned BKDs of Java and Madura, and the Lembaga Dana dan Kredit Pedesaan (LDKPs) or Rural Fund and Credit Institution, owned mostly by provincial governments (or in some cases by villages).

In 1984, in the wake of new financial reforms undertaken by the government, Bank Rakyat Indonesia transformed its sub-branches ('Unit Desa') network operating at subdistrict level. The outlets were transformed from loss-making channelling agent for the government subsidised credit program for rice cultivation (BIMAS) into commercial microfinance intermediaries. The unit network is now the largest and one of the most profitable rural microbanking networks in the developing world.

During the 1997-98 financial crisis, most of BRI microfinance clients kept their trust in the financial services offered by BRI units; clients maintained and even increased their savings levels. The BRI Unit Desas unaffected success during the crisis were in sharp contrast with BRI heavy losses on its corporate portfolio, which meant that BRI became technically bankrupt, and had to be rescued by a public restructuring and refinancing program, as for the rest of the banking industry.

As a direct consequence of the financial crisis, 82 commercial banks were closed, 13 were nationalised and others recapitalised or merged into a larger financial institution, the newly established Bank Mandiri. The BRI units network saved BRI from being merged into this larger bank. With bank closures, many small depositors lost their savings, sustaining a severe crisis of confidence towards financial institutions.

Another significant player in the formal microfinance market is the state-owned pawning company, Perum Pegadaian, serving million of low-income people. With these three main players (BRI, BPRs, and Pegadaian), the formal financial sector is the dominant force in microfinance, and outperforms the semiformal and informal sectors by a large margin.

The semi-formal financial sector has had a much smaller role in the provision of microfinance in Indonesia. Traditionally in Indonesia NGOs have not play a significant role in financial intermediation, but focused on social mobilisation, at times partnering with government poverty reduction programs. In recent years, a few NGOs have ventured into commercial microfinance, with the establishment of their own BPRs, or in two specific cases: a commercial bank in Central Java and a cooperative in Lombok. During the Suharto regime, the cooperative system was highly politicised and used as vehicle to disburse cheap credit to targeted groups. The cooperative sector still suffers from political interference and also from weak regulations.

In addition, government programs have provided subsidised credit financing to targeted populations, using the commercial banking system to channel the funds. To assist poor farmers, the Income Generating Program for Small Farmers and Fishermen (Pembinaan Peningkatan Pendapatan Petani-Nelayan Kecil, or P4K), provides soft loans through self-help groups. To reach women, the Prosperous Family Program implemented by the National Family Planning Coordinating Board (Badan Koordinasi Keluarga Berencana Nasional, or BKKBN) has a network of village outlets and operates through women's groups, by encouraging savings mobilisation and disbursing subsidised credit.

Finally, Indonesia has also a long history of informal credit and savings schemes, comprising Rotating Savings and Credit Associations (RoSCAs) or Arisan in Indonesian, and other forms of traditional finance. However, most of these schemes have limited outreach and sustainability prospects.

Challenges

- Formal financial providers tend to reach the top end of the microfinance sector, while at the bottom of the financial services pyramid, rural microentrepreneurs operating outside the main towns are still underserved by microfinance.
- Outreach of microfinance services in rural areas remains limited, as most commercial institutions, such as BPRs and BRI Units tend to focus on district capitals and economically active regions. BRI Units expansion seems constrained by the 'cash cow' status it has within the bank. BPRs mostly operate in affluent, urban areas of Java and Bali. Their expansion is limited by the high capital requirements to open new branches or operate outside a specific district.
- The supply-led subsidised microcredit programs initiated by the government do not provide a conducive environment where sustainable microfinance providers can operate.
- There is a lack of awareness and application of basic microfinance principles among government agencies, semi-formal organisations and some commercial banks that have entered the microfinance recently. There is still no central microfinance training provider in Indonesia.
- Technical assistance and capacity building support to microfinance providers have been limited by the diversity and geographical spread, and only a few organisations have benefited from non-financial support. The ProFI project of GTZ and Bank Indonesia has recently tried to address this problem.
- There is no formal credit bureau in Indonesia, which could be used to prevent risks of over-indebtedness in areas of strong competition (cities and main districts towns). Banks involved in microfinance, such as BRI units and BPRs exchange information on their clients on an informal basis.

A survey of 55 microfinance institutions was conducted by Gema-PKM, the Indonesian movement for microfinance, and Mercy Corps, an international NGO active in microfinance in Indonesia. The results showed that all respondents expressed the need for a microfinance wholesaler from whom to borrow funds, one third needed technical assistance, and 8% rating services.

Regulations and government initiatives

Government intervention

The Indonesian financial system has a long history of deregulation but also heavy state intervention, with credit allocation linked to preferential targets (e.g. farmers with the rice cultivation program). Until the 1970s, Bank Indonesia, the central bank set rates and refinancing targets according to the priorities established for the economic sector. During the 1970s, a first wave of major financial deregulations resulted in the opening of capital accounts to foreign flows, however indigenous firms were still highly favoured. Following the oil crisis, the 1980s saw further deregulation with credit ceilings abolished, rates liberalised, preferential refinancing curtailed. In 1988, the deregulation package, called PATKO 88, offered new banking licences, such as BPRs, relaxed regulations on bank branching and deposits. During that time, BRI Unit Desa was restructured.

In the 1990s, the government undertook a further reduction of subsidised loan programmes and made an upward adjustment in refinancing rates. The 1992 new Banking Act removed distinctions between development and savings banks, with new private and foreign banks established, competition with state banks increased, and interest rates fully deregulated. In 1994, after a scandal related to the Indonesian development bank (Bapindo), Bank Indonesia strengthens its control over non-bank financial institutions, and provides a more selective licensing policy. The late 1990s and the financial crisis saw a major restructuring of the financial system, with bank closures, mergers, and heavy public recapitalisation. The government extended a guarantee on bank deposits and certain bank liabilities to prevent a bank run.

Even during the crisis, microfinance providers remained profitable, among them a large number of the BPRs, BRI Unit Desa and the privately-owned Bank Dagang Bali.

Public intervention used to support a variety of rural development strategies coupled with political motives, such as the development of self-help groups and cooperatives to increase political control in the countryside. The result is the current complex set of formal and informal financial institutions in a widespread network of government programs, with limited scope for NGOs.

Many of the government development programs include a microfinance component, and are often managed without considerations of microfinance best practices, creating an unsustainable source of cheap funds, and an unfair competition to commercial microfinance providers. Some of the public resources were also diverted to villages with better political connections and many subsidised projects were set up at enormous transaction costs. However, the government programs contributed to the overall economic growth in rural areas.

Examples of government programs are:

The Income Generating Program for Small Farmers and Fishermen (Pembinaan Peningkatan Pendapatan Petani-Nelayan Kecil, or P4K) is supervised and administered by BRI's branches. It operates in 12 provinces and almost 10,000 villages, reaching 66,000 groups of small farmers. P4K is a subsidised credit and training program for poor rural self-help groups (8-16 members), sponsored by the Ministry of Agriculture, and financed by international donors (IFAD, ADB) and the Indonesian government. In addition to training, P4K provides loans, requiring compulsory savings, and voluntary savings mobilisation, which are managed by BRI through its branch and unit network. The project was designed specifically to assist self-help groups of poor borrowers to graduate from P4K subsidised credit to commercial microfinance. Limits are imposed on the size of the loans and the number of loans (four maximum). A very expensive and highly subsidised program, P4K is managed through BRI branches and not BRI Units, to avoid mixing commercial and subsidised credit programs. It was due to be phased out in 2005.

The Prosperous Family Program implemented by the National Family Planning Coordinating Board (Badan Koordinasi Keluarga Berencana Nasional, or BKKBN) has a network of village outlets and operates through women's groups. The Family Welfare Income Generation Project (UPPKS) provides savings and credit services to the groups, with heavy subsidies applied to run the operations, and to support the very low interest applied on credit. BKKBN uses the commercial bank BNI as financial intermediary in urban areas, and the Post Office in rural areas. The phase three of the project (1998-2004) focuses on self-help groups development, microfinance service and the institutionalisation and capacity building of grassroots partners. The project also involves skills development of group members (marketing, business management, market awareness) and currently put more emphasis on savings mobilisation. It provides credit without collateral at subsidised rates. It reports having formed more than 67,000 self-help groups (SHG), disbursed almost Rp.1,000 billions in credit, for only 5.3% of loans in arrears.

The Inpres Desa Tertinggal (IDT) government program was developed in the 1990s, targeting "backward" villages, especially those on the "outer islands" other than Java, Bali, and Sumatra, and was particularly concerned to reduce regional income inequalities. Through this program self-help groups received grants from the government and then managed the fund created to on-lend to their members. Until its termination in 1997, the IDT program had injected substantial amount of funding into unsustainable microcredit schemes. These unsustainable microfinance programs have provided unfair competition to commercially operated BRI units and BPRs, and other microfinance operators striving to reach sustainability. However these programs managed to provide funds to a high number of low-income people throughout Indonesia.

Bank Indonesia has had an active role in supporting the development of micro-, small- and medium-scale business credit (UMKM) through banking credit policy, institutional development and technical assistance provision. Through banking credit policy, it encourages commercial banks to lend to BPRs. It also encourages capacity building of BPRs, with support from GTZ and Bankakademie in implementing a certified training system, and extends technical assistance and support to information technology. However, under the new central bank legislation of 1999, Bank Indonesia was required to surrender its refinancing functions to a new entity, Permodalan Nasional Madani (PNM). As a second tier institution created specifically for the purpose, PNM took over Bank Indonesia's SME loan portfolio and some of the agricultural loans to cooperatives, with BRI responsible for the balance. Other programs implemented by Bank Indonesia in support to microfinance development are presented in the section "financing and supporting organisations". At the end of 2003 the government had ownership in 36 commercial banks out of a total of 136, including 26 Regional Development Banks (BPDs).

Regulations

The legislation governing the banking system in Indonesia (the Banking Act, 1992 and amending legislation of 1998) provides for two kinds of banks.

General banks are commercial banks (Bank Umum, BU) or primary banks, offering a full range of financial products. They have access to the payment system and provide general banking services, and foreign exchange services. They require a paid-up capital of Rp.10

billion. Bank Dagang Bali was closed by Bank Indonesia because of its low capital adequacy ratio and liquidity problems, related to family ownership of the bank.

People's Credit Banks (BPR) or secondary banks are much smaller, offering basic products only. BPRs are allowed to accept deposits, but are limited in terms of location, function and portfolio composition. They are locally based and mostly privately owned institutions. Initially set up with paid-up capital of 50 million rupiah, this requirement was increased in 1999 to 500 million rupiah, for local areas. Minimum capital requirements were also increased for BPRs operating in the Jakarta region, from Rp.50 million to Rp.2 billion (US$210,000), and for provincial capitals to Rp.1 billion (US$105,000). The regulators have sought to encourage a consolidation of the BPRs, with larger but fewer ones. In result, the creation of new BPRs has slowed down since the new legislation. All commercial banks with microfinance windows are supervised by Bank Indonesia. In addition, Bank Indonesia has special arrangements with other institutions to supervise on its behalf, such as BKDs supervised by BRI branches. To comply with the 1992 Banking law, BKDs were granted a number of collective BPRs licenses, as they were too small to be individually licensed.

To supervise the banks, Bank Indonesia uses a CAMEL (Capital, Assets quality, Management, Earnings, Liquidity) rating system comprising seven ratios and 25 questions. For BPRs the six components of the CAMEL rating system are weighted 30% (Capital), 30% (Assets quality), 20% (Management), 10% (Earnings), 10% (Liquidity). As of March 2004, Bank Indonesia had suspended 194 BPRs from operations. In 2003, with the amendment of the Bank Indonesia Act, the transfer of banking supervision was decided, with the establishment of the Financial Services Supervisory Agency (LPJK).

The legal framework for cooperatives exist but does not seem conducive to an active supervision of cooperatives, partly because of the lack of capacity of the enforcement agency, the Ministry of Cooperatives and Small and Medium Enterprises. The cooperative sector is regulated by a government regulation of 1995 and a ministerial decree of 1998, which restricts credit and savings activities to financial cooperatives (KSP) or specialised units of multipurpose cooperatives (USP). Minimum capital requirements are also imposed.

Lembaga Dana Kredit Pedesaan (LDKP), or 'Rural Fund and Credit Institutions', set up by provincial governments, have been encouraged to convert into BPRs but a majority has not done so. Therefore LDKPs are still licensed and regulated by provincial governments, while technical assistance and supervision is usually delegated to regional development banks (BPDs), also owned by provincial governments. While LDKPs are restricted to mobilise savings, a specific category of LDKP, called Lembaga Perkreditan Desa (LPD) or 'village credit boards' in Bali are allowed by Bank Indonesia to accept deposits from members at village level, with the requirement that they do not use a banking terminology. Semi-formal institutions such as LDKPs, LPDs, but also microfinance cooperatives, credit unions, and NGOs are outside the legal framework of banks, and have an unclear legal status in the financial system. This might represent a risk for small depositors in some cases.

Following a series of abuse of the non-profit organisation status, the government passed in 2001 the first ever law on foundations (the common form of NGOs in Indonesia), which became operational in 2002. According to the law, foundations may only provide social, humanitarian and religious services and are prevented from being involved in income-generating or economic activities, such as microfinance. Existing foundations have five years to conform to the new law, i.e. to cease their microfinance operations or to become BPRs or cooperatives. Some foundations that became specialised microfinance providers face a difficult challenge of converting to a new status, as they lack funds or qualifications to become BPRs, or are reluctant to adopt an unadapted cooperative status.

The government is drafting a microfinance bill, to provide legal support to the development of MFIs, and to coordinate the 50,000 or so non-bank financial providers (cooperatives, LDKPs and similar organisations), the BRI Units, and regional development banks. However, it seems that the bill will not regulate NGOs that use donor funds to operate, but will encourage them to transform into formal institutions, which will be subject to audit and financial regulations. The bill is expected to be passed in 2005.

Practices

Credit products

BRI KUPEDES (Kredit Umum Pedesaan, or general rural credit) is an individual loan to economically active poor and lower-middle class. The interest rate is set to cover all unit costs and risks and to return a profit to the system. A careful screening of loan applicant is made by well-trained, experienced BRI staff, based on considerations of client's character (willingness to repay), viability and cash flow of the supported economic activity (ability to repay). Other features of the KUPEDES are the convenient bank locations, simple loan procedures, quick processes, and flexible terms. Loan maturities and repayment plans are customised to each borrower's needs. Borrowers who repay their loans on time are eligible to have access to larger loans, up to a certain limit. For larger loans, borrowers can access BRI branches.

BRI allows a wide range of collaterals to be presented by borrowers to access loans: land title, fixed and movable assets, savings and payroll deductions.

Despite common assumptions, KUPEDES loans size remain relatively small, ranging from 40-60% of the GDP per capita in the last decade, which indicate their accessibility to lower income clients.

BRI units have been overly conservative in lending, and still haven't reached full potential in terms of outreach in rural areas. By focusing on borrowers with fixed income or collateral, they have excluded a majority of typical microfinance clients.

Before its recent demise, Bank Dagang Bali (BDB) provided individual loans in three categories:

- Retail commercial loans
- Consumer loans (vehicle, housing, personal)
- Loans to larger private and corporate clients

For small loans many forms of security were accepted, and some loans were provided without collateral. Loan appraisal, decision-making and the release of funds were generally accomplished within three to five days for new borrowers, quicker to existing borrowers, as short as one day.

Lending principles of Badan Kredit Kecamatan of Central Java, a BPR following the LDKP system, are worth mentioning: short-term working capital loans, interest rates that cover all costs and risks and unable a profit, character-based lending to individual borrowers, and incentives to management and staff.

The publicly owned pawnshop business, Pegadaian, provides microfinance services, with loans of a maximum maturity date of 3 years, with a size ranging from Rp.5 million (US$537) to Rp.50 million (US$5,370), and movable assets as collateral. It also offers an agriculture credit to farmers at post-harvest period, applying the same pawning process.

Savings products

BRI Units savings products are based on principles of trust, security, convenience, liquidity, privacy, linkages with loans and returns. They have the following characteristics:

- Wide range of savings products available, with different degree of liquidity
- Savings rates increase with the minimum monthly balance, reflecting the higher costs of handling small accounts
- Transfer price set for inter-lending between units, through BRI branches, to allocate funds between cash-poor units and cash-rich units. The transfer price set by BRI is an instrument to encourage more savings or more lending.
- Lotteries organised, with free tickets based on minimum monthly balance
- Savings accounts are used to build credit rating, and credit collateral.
- SIMPEDES, a deposit instrument allows unlimited number of transactions.

A drawback on the savings accessibility is that savers have difficult access to loans from BRI, due to collateral requirements and other restrictions.

It is also worth mentioning the savings products of BDB, even if this institution had to be closed down due to governance problems. BDB built its success on savings mobilisation, with three different types of savings products: time deposits, giro account, and different types of passbook savings accounts. BDB success in savings mobilisation was based on the following characteristics:

- Mobile savings teams. Two staffs undertake daily visits to depositors to collect deposits and pay out withdrawals. One staff manages the cash, the other is responsible for the accounting.
- Quarterly lotteries organised, for which free tickets are given to savers based on their minimum monthly balance.

Other models

Government programs related to family planning and support to poor farmers (see above) facilitate the formation of self-help groups as conduits for microfinance services, usually provided by commercial banks such as BRI. They usually mobilise savings, which are deposited in a BRI account, which will in turn channel subsidised government loans to the groups.

In addition, most formal financial providers (commercial banks and BPRs, Pegadaian) will also operate specific units, branches and products using Islamic bank principles (syariah). Islamic banking is a significant force in the microfinance and financial sectors in Indonesia, in terms of volume of financial services provided and the number of outlets providing them.

Innovations

As a way to encourage more clients to open saving accounts, BRI launched bi-annual lotteries for SIMPEDES accounts' holders. Each saver receives free lottery ticket depending on their minimum monthly account balances. BRI also introduced unlimited withdrawals for savers after field studies showed that the limited number of withdrawals was the main obstacle preventing people to open saving accounts in rural banks.

Bina Swadaya, one of the leading NGOs in Indonesia, is importing some of the successful features of ASA from Bangladesh.

Finally, several NGOs, including Bina Swadaya, have chosen to use BPRs as a way to expand their microfinance programs.

Providers

Formal financial sector

In contrast with other Asian countries, the formal financial sector in Indonesia includes regulated financial institutions with the largest outreach in microfinance. Bank Rakyat Indonesia units, small financial institutions (BPRs) and the state-owned pawning company follow commercial principles in providing savings and credit services. BRI units tend to lend in priority for investment purposes (64% of credit portfolio outstanding as of December 2003), while BPRs finance more working capital (61.5% of their portfolio).

At the end of 2001, supply estimates showed that BRI units were collecting two thirds of the savings mobilised in the formal and semi-formal microfinance sector, and 40% of the loan volume. BPRs had a 15-20% market share of the microfinance sector.

In 2002, 14 commercial banks and BPRs had provided large amount of credit to microenterprises and SMEs sector. Bank Indonesia had also provided refinancing support to PNM, commercial banks and BPRs.

Attracted by the success of BRI Units, a few commercial banks have started their own microfinance program, providing financial services to microentrepreneurs directly or through smaller financial providers, such as BPRs.

Bank Dagang Bali (BDB), a private bank in Bali specialised in commercial microfinance, built its success on the knowledge of microfinance clients and on state-of-the art savings products. The bank was founded by former moneylenders and had been profitable until recently. In recent years, BDB run into problems due to family governance structure, low adequacy ratio and liquidity problems, and had to be closed by Bank Indonesia in 2004.

Bank Rakyat Indonesia (BRI)

The Bank Rakyat Indonesia units (BRI Units), or sub-branches, were first established in the 1970s under a government scheme (BIMAS) to provide agricultural inputs for rice cultivation. Unprofitable until 1983-4, the BIMAS was discontinued and the system was restructured with support from the World Bank and USAID. It transformed into the most successful rural network for microfinance provision managed by a commercial bank.

The BRI units built their success on demand-based financial products and the development of individual profit centres (originally called Unit Desa). The KUDEDES product, an individual loan, requires collateral and can be used for working capital and investment purposes. The SIMPEDES savings product allows unlimited withdrawals, attracts competitive interest rates and is guaranteed by the government. Each BRI unit is treated as a profit centre, financially self-reliant and subsidy independent. At the end of September 2004, BRI was operating 4,049 units, and 325 branches.

BRI partial privatisation was a success, with an IPO and share listing on the 10th November 2003, and shares oversubscribed 15.4 times. The government sold approximately 30% of BRI capital.

At the end of September 2004, BRI had 87% of its loan portfolio in micro, small and medium enterprises, while the corporate lending represented the remaining 13%. 31% of the Rp.58,119 billions (US$6.2 billions) in loan outstanding was related to the microenterprise sector, or Rp. 18,146 billions (US$1.9 billion).

BPRs or People's Credit Banks

After the 1988 financial reforms of PAKTO 88, new secondary banks were established, called Bank Perkreditan Rakyat (BPRs) or People's Credit Banks. BPRs already existed before the new licensing law, and specific requirements for their regulation were set (capital, size of deposits) but never fully respected. Today, BPRs includes rural financial institutions that meet the criteria specified in the 1992 Banking law (2,148 licensed BPRs) and almost 9,000 rural financial institutions that are not licensed (generic BPRs), such as LDKP, BKD and BKKs.

BPRs offer loan, savings and term deposits, but no checking accounts. They serve the middle segment of the microfinance market, generally chosen by clients who cannot provide enough collateral to access BRI loans. They have mixed results and generally low financial performance, weak management and lack internal auditing and supervision.

BPRs do not directly target microentrepreneurs and have been pushed by Bank Indonesia's regulations to do more conservative, collaterised lending.

With the licensing of BPRs, these small financial institutions operating a local level can have a public or private ownership, which entails several differences:

- Public BPRs usually don't compete with one another as they cover different locations. In fact they operate in contexts of quasi monopolies. In contrast, private BPRs compete with one another.
- Public BPR are more efficient in mobilising savings, and provide smaller loans than private BPRs.
- Public BPRs have linkages with commercial banks, in contrast with private ones, which are more recently established, mostly present in urban or peri-urban areas.
- Public BPRs are more profitable than private BPRs, with high returns among BKDs. The public LDKP seems to be the most successful.

As of March 2004, they were 2,148 regulated BPRs reaching 2.4 million borrowers and 5 million depositors, with a 77% loan to deposit ratio, while keeping a low 8% non-performing loan (NPL) ratio. 61% were registered as limited liability companies, 36% as government enterprises, and the rest as cooperatives. As of March 2004, licensed BPRs had Rp.13,430 billion (US$1.4 billion) in assets, from which Rp. 9,431 billion (US$1 billion) was in loans outstanding. They had also mobilised Rp.2,665 billion (US$284 million) in savings, and Rp.3,360 billion (US$360 million) in time deposits. In 2003, they collectively made Rp.429 billion (US$46 million) in profit, posting a 25% return on equity, and 3.4% return on assets.

Perum Pegadaian

Perum Pegadaian (PP) is a large state-owned pawning company providing microfinance services to more than 15 million customers in 2004 through 812 branches. During that year, PP provided Rp.10,450 billion (US$1,1 billion) in loans, and generated a profit of Rp.230 billion (US$24.7 million). Pegadaian offers fast and efficient financial services, allowing clients to turn their valuables temporally into cash without having to sell them. PP provides generally small loans, 88% of PP loans in 2001 were less than Rp.500,000 (US$66).

Semi-formal financial sector

The semi-formal financial sector is composed by thousands of non-bank financial institutions, such as Badan Kredit Desa (BKDs, or village credit organisations), and LKDP, finance and insurance companies, cooperatives and credit unions, and NGOs. These institutions are not directly regulated by Bank Indonesia but registered and licensed by other state authorities and/or regional governments. The semi-formal sector reaches approximately 1 to 2 million clients.

Established more than a century ago, **BKDs** were among the first microcredit institutions in Indonesia. They are village-owned organisations located on Java and in Madura. BKDs are generally small organisations operating at village level, with disparities of performance among them. They generally suffer from poor performance, weak management capacity and are restrained by village bureaucracy.

BKDs are supervised and administered through BRI's branches, on behalf of Bank Indonesia, who reimburse BRI for the expenses related to the supervision. Managed by village leaders, BKDs offer savings and credit products to their clients. Compulsory savings are required in order to borrow. Loans are typically of a small size, without collateral, and are processed quickly. They are not allowed to mobilise voluntary savings. They usually open one day a week, the amount deposited by clients is transferred to the BKD account at BRI. BKDs finance their lending requirements through mobilised earning on deposits, compulsory savings and borrowings from BRI.

LKDP are 'rural credit fund institutions', which takes different forms such as Badan Kredit Kecamatan (BKK), strong in Java, and LPDs in Bali. They are supervised by local provincial governments.

BKK Central Java is one example of a successful 'generic BPR', an LDKP system, owned by the provincial government. It was born as a credit institution to target the poor; and was allowed to accept savings only after 1984. It uses typical microfinance techniques, i.e. loans unsecured and character-based, small initially, then increased gradually according to repayment performance, loans paid in equal instalments, no collateral but mandatory savings. It received technical assistance from USAID

The Lembaga Perkreditan Desa (LPD) of Bali is considered the best LDKP system in Indonesia, despite the strong local competition. It was established in 1988 as village-owned financial institutions, with an economic and a social role in the community. It received technical assistance from USAID and GTZ. LPDs are seen as profitable entities, which rely on savings and deposit as the main source of funding.

LPD differ from the provincial government controlled institutions (LKDPs) by being owned by local community organisations. The glue of customary obligations and relationships is a significant factor in holding these small financial institutions together. In mid-1999, 910 LPD served some 545,000 clients, which meant that more than 80% of the Balinese population was reached by LPDs, a level unrivalled anywhere.
The Balinese LPD and the BKKs account for a substantial part of the LDKPs that have not converted to BPR status.

Cooperatives are seen as highly politicised and used as government funding vehicles. Government-sponsored village unit cooperatives (Koperasi Unit Desa or KUD) were established during the colonial period and seen by the constitution and Pancasila as one of the pillars of the Indonesian state. However, under the Suharto regime, they were mainly used for political purposes, and never seen as real people's institutions but as instruments of government control on rural people, and on pressure to achieve agricultural production targets. Two types of cooperatives involved in microfinance exist, the credit and savings cooperatives, Koperasi Simpan Pinjam (KSP), and savings and credit units (Unit Simpan Pinjam, USP) of multipurpose cooperatives. Most cooperative are highly subsidised and used as government' funds channels. However a few grassroots cooperatives have demonstrated stronger results.

An independent **credit union** movement, supported by the Credit Union Coordination Board of Indonesia (Badan Kordinasi Koperasi Kredit or BK3I), appear more successful. In addition, INKOPDIT (Induk Koperasi Kredit) or the Credit Union Central of Indonesia has started a microfinance program in 2004, which build up the capacity of self-help groups, progressively transformed into cooperatives.

A vast majority of **NGOs** remains unsustainable and dependent on donors' funds to operate. A few NGOs have ventured in commercial microfinance by setting up their own BPRs, as did Bina Swadaya, one of the largest NGOs, or by starting their own commercial bank (Yayasan Purba Danarta in Central Java). Some NGOs use a modified Grameen Bank methodology, such as Yayasan Mitra Usaha (YMU) reaching 12,000 clients, and Yayasan Dharma Bhakti Parasahabat (YDBP) reaching 100,000 members. YDBP uses BPRs to expand its microfinance activities, having acquired four BPRs, it plans to open new BPRs or branches to sustain its expansion. YDBP is the fastest growing and largest NGO-MFI in Indonesia, while serving exclusively women and keeping a relatively high repayment rate (95%).

Bina Swadaya (Self-Reliance Development Foundation) has helped self-help groups to link with banks, especially in many of the most disadvantaged areas of Indonesia. It worked in the poorest villages targeted by the IDT government program developed in the 1990s. Bina Swadaya has also set up its own BPRs and since 2002 has adapted the ASA methodology from Bangladesh in 7 of its 21 branches.

PPSW works exclusively with women on a wide range of issues, such as economic and social development, migrant workers, reproductive health and education. In microfinance, PPSW aims to raise women's income through the development of community-based organisations and cooperatives. PPSW has set up in 2001 and since then financed a secondary cooperative, KOPPERTI, to serve a network of primary cooperatives, which are based on the aggregation of self-help groups.

After a long experience of collaborating with church-based NGOs and cooperatives, Catholic Relief Services decided to focus on BPRs with the establishment of a wholesale fund, PT UKABIMA, also providing technical assistance and equity investment.

The Women Heading Households Empowerment Program, reports that female-headed households represent 13.4% of the 60 million households in Indonesia, with 50% being located in conflict-affected regions. The program, reaching 7,000 women in eight provinces, encourages the development of credit and savings associations, to support business creation by women.

Informal financial sector

The informal financial sector falls outside the framework of public regulation and supervision, and includes thousands of Rotating Savings and Credit Associations (ROSCAs), called Arisan, self-help groups, individual moneylenders, traders and shopkeepers. It reaches approximately 5 million clients.

Funding and Supporting Organisations

ProFI project

The Promotion of small Financial Institutions project is supported by Bank Indonesia, benefiting the association of BPRs (Perbarindo), with technical and management support from GTZ and Bankakademie. The project aims to strengthen two types of microfinance providers, the “People’s Credit Banks” (BPR) and some non-bank microfinance institutions, especially the “village credit boards” (LPDs) in Bali. The project provides support to the development of microfinance policies at national and provincial level, for example by collaborating on the drafting of a new microfinance law for Indonesia and a new legislation to support LPDs in Bali. It also strengthens associations to improve their services to members, especially targeting the associations of BPRs, Perbarindo. Moreover, the project support the development of a training system based on certification for BPRs managers and directors, and also promotes non-bank microfinance institutions in Nusa Tengara Barat and Nusa Tengara Timor

Bank Indonesia has fully supported the certification program for rural banks (BPR), as part of its efforts to strengthen the financial sector serving small and medium size businesses. This component aims to improve the management skills and professionalism of BPR managers and directors. The 2,148 BPRs are one of the leading financial providers for SMEs in Indonesia, and showed some sign of weakness as some were forced to close down due to low capital adequacy ratios.

PNM

PT Permodalan Nasional Madani (PNM) is a state-owned investment firm set up in 1998 after the financial crisis to take over the refinancing role of Bank Indonesia. As a wholesale fund, it is instrumental in serving more SMEs, by mobilizing domestic funding, including some of the idle funds kept by banks (estimated at Rp.300 trillion or US$3.2 billion), and funds coming from state-owned enterprises. Between 1 and 5% of public companies’ profits will be used to finance microentrepreneurs, with a target of Rp.1 trillion (US$111 million) to be collected in 2005. PNM supports linkages programs, between commercial banks and BPRs, and between commercial banks and non-bank microfinance providers. PNM provides loans to non-bank microfinance providers, through regional development banks (BPD), with for unique collateral the amount of savings mobilised by retail microfinance institutions.

There are plans for the development of an apex fund serving non-bank microfinance institutions, which are constrained by limited access to funding, partly due to the commercial banks collateral requirements to access lending facilities. This lack of funding has limited the outreach of semi-formal providers. As an apex body, the apex organisation would also be able to manage interbank lending while establishing a closer network of BPRs, allowing clients to access funds at different locations. The promoter of the scheme, Gema PKM (see below for a presentation), mentions that donors would be approached to guarantee (20%) the loans provided by local financial institutions to the apex. PNM and Bank Mandiri have been contacted to provide the first loans. The wholesaler PKSF operating in Bangladesh has been several times mentioned as a possible model.

Microcredit project

Under this initiative funded by ADB, Bank Indonesia initially disbursed funds to regional development banks (BPD) and BPRs. The latter on-lend directly to microentrepreneurs, while BPDs lend to small financial institutions such as BKDs and LDKPs. The project has been transferred to Bank Mandiri as Bank Indonesia cannot directly finance the banking sector under new regulations.

The project also provided technical assistance to participating financial institutions and NGOs responsible for SHG formation and training. As of June 2000, more than 500,000 borrowers had active loans, out of which only 1.6% was in arrears.

PT UKABIMA

PT UKABIMA (Usaha Karya Bina Mandiri, meaning 'Self-reliance Corporation') is a private non-bank financial company established in 1996 through the support of USAID and Catholic Relief Services – Indonesia program. UKABIMA undertakes sustainable microfinance programming by improving capacities of small rural banks (BPRs), so they in turn provide quality products and services to microentrepreneurs.

PT UKABIMA currently provides wholesale lending to a network of 30 BPRs (as of December 2004). In addition, it also provides technical assistance such as training, due diligence and business consulting services, support to MIS development, to BPRs, local and international NGOs, cooperatives and others. To increase and deepen outreach, UKABIMA has also ventured into equity participation in BPRs and currently owns three BPRs in North Sumatra and Central Java.

GEMA PKM

GEMA PKM (Gerakan Bersama Pengembangan Keuangan Mikro Indonesia), the Indonesian movement for Microfinance Development, was established in 2000, and has since been active in promoting microfinance in Indonesia through a vast forum of diverse stakeholders. It includes more than 50 members, formal financial institutions, NGOs and mass organisations, government programs and agencies, researchers and donor agencies. The forum is also advocating for extending the outreach of microfinance services to ten million of the poorest families in Indonesia, contributing to the Microcredit Summit Campaign objective of providing access to microfinance to 100 million people among the poorest in the word, by 2005. In recent years, it has taken part in the drafting of a new law for microfinance, and advocating for the setting up of a new apex fund serving non-bank microfinance providers.

PERBARINDO

PERBARINDO, the main national association of BPRs has been active in providing technical support to BRPs for a long time, and is currently involved in setting new standards of performance and training development with support from GTZ and Bank Indonesia (see above). It has 1,575 BPRs as members, 80% operating in Java and Bali.

BK3I

The Credit Union Coordination Board of Indonesia (BK3I) is the national apex organisation of the cooperative movement, providing support to its members.

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