

German Technical Cooperation



Deutsche Gesellschaft für  
Technische Zusammenarbeit (GTZ) GmbH

## INDONESIA

Project Appraisal Report  
("Projektprüfungsbericht")

# Reconstruction and Development of the Microfinance System in Nanggroe Aceh Darussalam (NAD)

August 2005

prepared by

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## ABBREVIATIONS AND ACRONYMS

AFD	-	Agence Française de Développement
AGM	-	Annual General Meeting
BAPPENAS	-	National Development and Planning Body
BAZNAS	-	National Agency for Zakat (Religious Alms)
B.I.	-	Bank Indonesia (central bank)
BKKBN	-	National Family Planning and Welfare Program
BMZ	-	Bundesministerium für wirtschaftliche Zusammenarbeit und Entwicklung
BNI	-	Bank Negara Indonesia
BPD	-	Bank Pembangunan Daerah, Regional Devt. Bank
BPR	-	Bank Perkreditan Rakyat (“People’s Credit Bank”)
BPR (PD Mustaqim)	-	BPR owned by local government
BPRS	-	BPR following Islamic Banking (“Syariah”) norms
BQ	-	Baitul Qiradh, thriift and credit coops based on Syariah
BRR	-	Badan Pelaksana Rehabilitasi dan Rekonstruksi, NAD Regional Rehabilitation and Reconstruction Agency
CAR	-	capital adequacy ratio
CBD/CBO	-	Community Based Development / Organizations
CCDE	-	Center for Community Development and Education
DED	-	German Development Services
DSP	-	Danamon Simpan Pinjam, outreach mechanism of Bank Daganon
GAM	-	Gerakan Aceh Merdeka: Aceh Movement for Independence
IDR	-	Indonesian Rupiah (national currency)
ILO	-	International Labour Organisation (of the U.N.)
LDKP	-	Lembaga Dana Kredit Pedesan, village savings & credit inst.
MBDC	-	Micro Banking District Center (of Bank Mandiri)
MFI	-	Microfinance Institution
M.I.S	-	Management Information System
MSME	-	Micro, Small and Medium Enterprise
NAD	-	Nanggroe Aceh Darussalam, Province w. capital Banda Aceh
NPL	-	non-performing loan
PER	-	Pemberdayaan Ekonomi Rakyat People`s Economic Development Programme (Govt. Programme with resources channelled through BPR PD Mustaqim)
PERBARINDO	-	Persatuan Bank Perkreditan Rakyat Indonesia Association of Indonesian BPR
PINBUK	-	Center for the Incubation of Small Businesses
PLKB	-	Petugas Lapangan Keluarga Berencana: Family Planning Field Worker

PNM	-	Permodalan Nasional Madani
ProFI	-	GTZ Program Strengthening of Small Financial Institutions
RoA	-	Return on Assets
RoE	-	Return on Equity
SBFIC	-	Savings Banks Foundation for International Cooperation
SME	-	Small and Medium Enterprise
SOP	-	Standard Operating Procedure
UNHCR	-	United Nations High Commissioner for Refugees
UPPKS	-	Usaha Peningkatan Pendapatan Keluarga Sejahtera, BKKBN Revolving Savings and Loan Fund Program
USD	-	United States Dollar

## CURRENCY EQUIVALENTS

Interbank Rates:

### As of 30 June 2005

1 EURO = 11,694.90 IDR (Ind. Rupiah)

1 US\$ = 9,694.90 IDR

### As of 31 December 2004

1 EURO = 12,692.16 IDR

1 US\$ = 9,305.10 IDR

## FISCAL YEAR

1 January to 31 December

## MAP OF THE PROVINCE NANGGROE ACEH DARUSALAM



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

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Annex 1: Mission Assessment and Update on BPR /BPRS

Annex 2: Mission Assessment and Update on Cooperative Forms of MFIs

Annex 3: Mission Assessment and Update on Govt. MFI Programs and NGOs

Annex 4: Mission Assessment and Update, Commercial Banks and Microfinance

## EXECUTIVE SUMMARY

*The Tsunami flood disaster with its epicentre in North Sumatra caused not only unseen devastation among people, but also led to widespread destruction of financial and other institutions. Compared with the more than 122,000 people that died and almost 114,000 people that are still missing, the financial loss and washing away of buildings and financial records may seem minor, but the damage in the province of Nanggroe Aceh Darussalam (NAD), commonly referred to as Aceh Province, to financial services and institutions was likewise substantial: About half of the credit cooperatives in the province were simply washed away, 6,000 borrowers that stopped repaying because they became victims of the deadly waves or lost their business, and financial losses that amount for the small regional development bank to a massive EUR 85.5 mn equivalent all attest to the immediate and urgent attention required to rebuilding the financial infrastructure in Aceh Province. Even before the Tsunami, political interference, guerrilla warfare in several parts of the province, limits in management know how and technical skills, and the comparatively low population density in most parts of the province severely hampered the productivity of small and microfinance institutions.*

*Against this background, the **main problem** to be addressed by the project consists of the non-existence or low quality of supply of microfinance services after the Tsunami. Destruction of premises, loss of staff, loan documentation and credit collateral all result in a wholly inadequate supply of microfinance services in the Province at present. Precisely when microfinance institutions and their credit resources are required most to rebuild productive assets, both the institutions and the refinancing capital are not at hand to meet the requirements of the Acehnese. The local population does not want to rely on hand outs, but expects the Government and international community to facilitate the reconstruction of institutions and resumption of financial services to help micro and small entrepreneurs make a living again out of their own initiative.*

*The **rationale** is therefore self-evident for a quick, flexible and immediately actionable project to kick-start the process of re-building the financial infrastructure in the Aceh Province for facilitating the recovery of micro and small enterprises. The longer potentially productive villagers live in camps with their families surviving from aid donations, the harder it will be to bring them back into the process of rural economic development.*

*The **main goal** of the proposed project is therefore to increase the number and volume of microfinancial services accessible above all to the lower income segments of the population. This two-pronged approach – rebuilding MFIs where feasible and creating additional branches or units of existing MFIs – would yield tangible results in strengthening financial institutions' capacity in the shortest time without compromising on service quality.*

*To this end, the central bank, the Bank Indonesia and the GTZ plan to carry out a microfinance promotion project that would operate at three levels, and encompass the following **main activities**:*

- 1)The capacities of regional supervision agencies and other institutions involved in the reconstruction and promotion of MFIs would be strengthened and additional capacity for coordination, regulation and supervision be built above all in the regional Bank Indonesia office (macro level);*

2) *The number and service quality of microfinance institutions in the province would be increased. This would target primarily the People's Credit Banks both those operating under Islamic sharia principles (BPRS) and those that are not (BPR). Equally, thrift and credit cooperative societies would be strengthened where they still exist or assistance provided in creating these financial cooperatives again from scratch. Collaboration with commercial banks and the Aceh Development Bank, but also with women groups attached to larger Government support programmes are not excluded at this time, but a detailed in situ assessment of potential and needs should first be conducted in the initial phase of project implementation to make a final decision on project inclusion. (micro level);*

3) *Both the reach and the quality of services to the intended target group in the Aceh Province should be considerably improved. This would enable rural micro and small entrepreneurs including farmers that are integrated in the local cash economy to rebuild their livelihoods and assist in the re-integration of temporarily displaced persons (target group level)*

*The initiative would start at the earliest possible date with (i) the identification and credit appraisal of the three first applicant microfinance institutions through a line of credit made available through a public private partnership fostered by this project; (ii) the compilation of an inventory of locations where thrift and credit co-operatives could be newly established with the help of the project. These would encompass both sites where these cooperatives existed before the Tsunami and then perished, but also completely new locations. Reaching out to more remote locations is possibly easier now after conclusion of peace negotiations with the GAM guerilla group, and (iii) a study primarily in the more remote districts of the province to assess the feasibility of collaborating with the National Family Planning and Welfare Programme (BKKBN) and support their microfinance initiative, the UPPKS.*

*The parallel implementation of the much larger GTZ Programme ProFI for the Promotion of Small Financial Institutions enables a permanent recourse to emerging best practices in microfinance promotion countrywide. In turn, new mechanisms and activities that would be successful in the NAD Province, may later be expanded from Aceh to other areas in the country with the help of the ProFI Programme.*

*This carefully targeted project with a three layered support structure can have a potentially significant impact on the re-emergence of microfinance institutions in the Aceh Province. Total project duration is scheduled to be four years with total costs estimated around EUR 4.000.000 without additional contributions expected to the total financing plan from private corporate financial institutions.*



# **Bank Indonesia / GTZ Reconstruction and Development of the Microfinance System in Nanggroe Aceh Darussalam (NAD)**

## **PROJECT APPRAISAL REPORT**

### **I. BACKGROUND AND INTRODUCTION**

1. Background: Following the immediate fielding after the Tsunami of a German Fact Finding Mission from 21 February to 8 March, 2005 a Bank Indonesia GTZ Appraisal Mission visited the Aceh Province from 10 to 18 June, 2005 and stayed up to 29 June in Jakarta to finalise stakeholder consultations and a Project Concept Document for presentation at a wrap-up meeting in the Bank Indonesia on 28 June, 2005.

2. The appraisal team consisted of Rauno Zander, Numan Rayadi Manaf (PNM) Dani Dityawan (PNM), Dali Sadli Mulia (PNM) and Ir. Al. Krisdiono (Bina Swadaya). The team is exceedingly grateful for the patient lead and guidance provided by the B.I. / ProFI Programme, from the central bank in particular Mr. Mohammad Dakhlan, Dy. Director of the Directorate of Rural Bank Supervision of the central bank, Susum Na Mayawati, Manager of the Rural Bank Licensing, Research and Regulation Division and Mr. Tabrani Hilmi Ibrahim, the Regional Representative of the Bank Indonesia in the Aceh Province.

3. Dr. Michael Hamp, Coordinator from the GTZ ProFI Programme Office in Jakarta, drafted the terms of references, briefed and de-briefed the mission and provided guidance and advice to the mission during the stay in the field. Dr. Alfred Hannig, the Programme Coordinator also met the mission. In Banda Aceh, the team met with Marcus Lange, Governance Advisor and Head of Office of GTZ in the province. In GTZ head office, Dr. Gabriela Braun gave technical feed back. Mr. Weidlich, First Secretary of the German Embassy Liaison Office in Banda Aceh and Mr. Krämer from the same office likewise briefed the mission in the field.

4. Apart from several detailed discussions with the regional central bank office in the Aceh Province, the mission met with representatives from the Regional Rehabilitation and Reconstruction Agency (BRR), BAPPEDA and BAPPENAS, several donor agencies as well as the Aceh Regional Development Bank, most of the People's Credit Banks in the province, cooperative of the Sharia (Islamic Law) and non-shariah type, as well as representatives from BRI and other commercial banks. Particularly useful was the close collaboration with Mr. Alan Boulton, Director, and Juana Rodriguez, microfinance specialist of the International Labour Organisation of the United Nations, the ILO. Various forms of interplay between the ILO activities focussing mostly on business development services and skills training, and the GTZ thrust of re-building financial services in the province were elaborated in detail. The appraisal team was also closely involved in the conduct of a two-day workshop on the status of microfinance in the Province and possible future directions ("Financial Services to Rebuild Livelihoods"), bringing together donor agencies and local and international microfinance practitioners.

5. Socio-economic Profile of Aceh Province: The NAD or Aceh Province generates 43% of its gross domestic product at present out of gas and oil resources, but stocks are declining fast with oil reserves estimated to be depleted by 2011. The unemployment rate has risen to 27% and economic stagnation after the Tsunami is likely to push 600,000 people below the poverty line of earnings of less than one dollar a day. According to World Bank data, supply and distribution constraints, exploding housing, food and transportation prices resulted in a provincial inflation rate of 17% as against 7% nationwide.

6. The Post-Tsunami Scenario: The earthquake and subsequent tidal waves on 26 December, 2004 have destroyed 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 coast) and the coastal areas of Pidie,

Bireuen, Aceh Utara and Aceh Timur (along the east coast)<sup>1</sup>. 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). 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).

7. 70% of the working population were self employed or engaged in the informal economy in the NAD Province before the Tsunami. The open unemployment rate was higher than the national rate and poverty levels were high with 488,282 households or roughly 2 mn. 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 in the province even worse.

8. The Tsunami also had a strong impact on the existence and functioning of microfinance institutions in the province. The existing infrastructure was mostly destroyed with about 6,000 debtors that stopped repaying after Tsunami. About half of the savings and credit cooperatives in the province were simply washed away. Financial losses that amount in the case of small regional development bank to a massive EUR 85.5 mn equivalent all attest to the immediate and urgent attention required to rebuilding the financial infrastructure in Aceh Province. Even before the Tsunami, political interference, guerrilla warfare in several parts of the province, limits in management know how and technical skills, and the comparatively low population density in most parts of the province severely hampered the productivity of small and microfinance institutions.

9. Countrywide, 70% in urban and 54% in rural areas live below the poverty threshold. Even before December 2004, the NAD Province was one of the poorest in the Indonesia: 34% of the population were classified as poor<sup>2</sup>. The micro and small enterprise sector provides livelihoods for 50 mn. people. These micro and small enterprises constitute the backbone of the Indonesian economy. They would benefit substantially from an improved access also to formal, institutional financial services. Likewise, they are indispensable in any strategy of rebuilding livelihoods and the economic sectors in the affected Aceh Province.

10. ProFI- A Countrywide Response to Microfinance Gaps: The German financed advisory Programme ProFI has been implemented for some time in Indonesia. Its four programme components fully encompass the major proposed thrusts of this project. The now appraised localised and much smaller GTZ exposure in the Aceh Province represents therefore a modular application of the main ProFI advisory messages and activities: strengthening of the regulatory and supervisory capacity of the central bank (ProFI component 2), capacity building for training and management development of MFI staff (component 3), and above all component 4 the more determined outreach of MFIs to smaller provinces of the country. Component 1, in turn, with its focus on policy development and subsequent laws and regulations for MFIs would provide useful downstream support to the planned initiative in Aceh.

## II. OVERVIEW OF MICROFINANCE PROVIDERS IN NAD<sup>3</sup>

11. Definition: In the context of Indonesian Poverty Alleviation Policies and Perspectives, micro loans are those defined smaller than or equal to 50 mn. Rupiah (IDR) loans (EUR 4,275,37 equivalent).

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<sup>1</sup> See province map on page iv of this report

<sup>2</sup> Only West Papua has sizeably more poor people as a share of the total population, 39%.

<sup>3</sup> A detailed overview of microfinance providers aggregated for the entire island of Sumatra can be found at the ProFI website under <http://www.profi.or.id/engl/mapping/scripte/detail.sumatra.PDF>

1. Commercial Banks

12. Traditionally, the state owned Bank Rakyat Indonesia (BRI) has been in the forefront of implementing innovative microfinance programmes. Table 1 indicates the dominance of this state owned bank in the micro and small retail segment of the market:

Table 1: Current Coverage of Microfinance in NAD Province (other than BRI indicative only)

INSTITUTION	NUMBER OF UNITS OR BRANCHES	NUMBER OF CLIENTS	OUTSTANDING PORTFOLIO	SAVINGS
BRI	114	49,587	383,960,471,000	684,589,590,000
BPRS Hureucat	1	280	820	181,000,000
BQ Surya Madina	1	192		
BQ Baiturahman	1	130	125,152,975	199,885,174
BQ Indrapuri	1	15		195,047,300
BQ Laot Raya	1			
BQ NBM	1	105	114,000,000	87,728,300
BPRS HikmanWakilah	1	2605	964,398,000	1,356,271,000
BPRS Baiturahman	1	6300		2,240,974,587
CCDE	2	1015	400,000,000	
PNM	2BPR's 3BQ	2000		
Bukopin	10 coops	786?	12,000,000,000	13,500,000,000
<b>Total</b>	<b>139</b>	<b>63,015</b>	<b>397,564,022,795</b>	<b>702,350,496,361</b>
<b>Percentage BRI/total</b>		<b>78.69%</b>	<b>96.58%</b>	<b>97.47%</b>

Source: GTZ Appraisal Team, ILO

13. The table illustrates the dominance of BRI even though not all of the smaller players are even included (some local NGOs and savings and credit co-operatives, see below). However, as a large domestic banking institution, BRI does not find it difficult to cover material losses from their own reserves. According to the regional manager, the only requirement of BRI at this time for NAD Province would be adequately trained bank staff to substitute for the many BRI employees that have perished as a result of the earthquake and tidal waves. It was agreed to collaborate fully on the design and implementation of specific bank staff training measures, but a wider collaboration or partnering to rebuild branches and recapitalise lending operations does not seem to be necessary from BRI's point of view, in particular since French AFD funding may be forthcoming for BRI operations in the Aceh province, see below.

14. Table 2 compares the typical loan terms and conditions of BRI as the market leader with those of selective other MFIs, mainly People's Credit Banks of the Sharia (BPRS) and non-Sharia (BPR) type:

**Table 2: Terms and Conditions of BRI as Compared to Other MFIs in Aceh**

MFI TYPE	MIN / MAX LOAN SIZE	INT. RATE p.a. (Flat or on reducing balance)	MIN AND MAX AMOUNT TIME
BRI	250,000 to 50,000,000	13-24% annum flat	3mnths-3 years
BPRS Hareucat	500,000 to 20,000,000	0-24%	3 bulan-12 bulan
CCDE-NGO	500,000 to 2,000,000	18% p.a. flat	6-10 months
Darul Imarah BPR	2,000,000 to 60,000,000	11.26%-24% Annum flat	1-2 tahun
LBMIJ B. Muamalat	20 to 50 million	Equiv rate: 18 –19%	5/4 4th

Source: GTZ Appraisal Team, ILO

15. Lot sizes of BRI appear quite appropriate both in terms of very small minimum loan sizes, but also as far as maximum loan sizes in their microfinance programmes are concerned. Likewise, interest charges and repayment periods are kept flexible and tailored to the borrower requirements. Rates vary. The NGO example (CCDE) charges flat rates, but even the sharia type BPRS Hareucat and BRI charge 2.0% per month on some of their loans offered.

16. BRI rolled out a special loan type to assist post-Tsunami victims with refinancing needs. Terms and conditions are summarised in table 3 below:

**Table 3: BRI Special Credit Kemitraan for NAD Province**

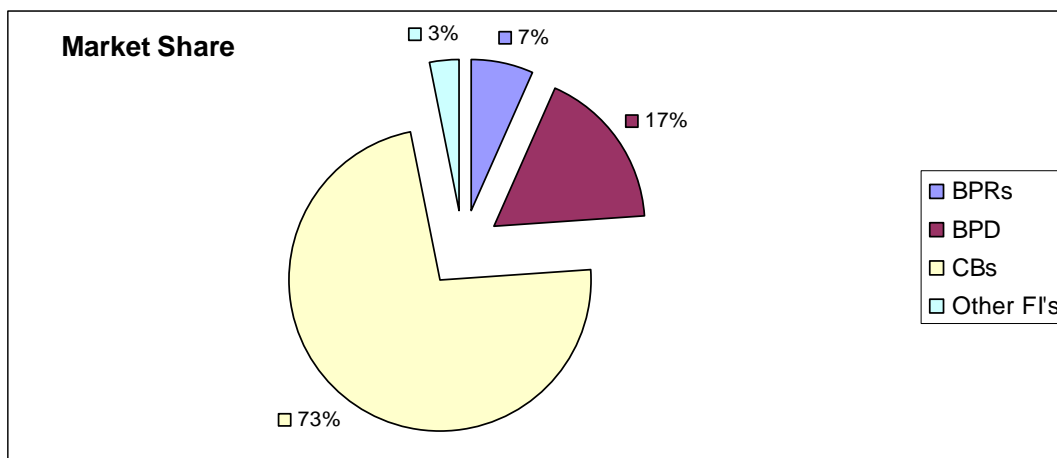
Loan Brackets and Interest Rates:	a) IDR 0.5 - 2.0 million, 4% p.a.
	b) IDR 2.0 – 5.0 million, 6 % pa
	c) IDR 5.0 – 10.0 million, 8 % pa
Target Clientele	clients with existing track record
Collateral	Non-collateralised

17. Bank Danamon: This is a nationwide operating, privately owned commercial bank with some ambitions in microfinance. In 2003 the bank adjusted 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. 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 IDR 655 billion or EUR 56 mn. disbursed as micro loans up to now in other parts of Indonesia. DSP works with systems and procedures that try to reduce red tape and formality, including 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. As a reaction to the Tsunami, Bank Danamon is increasing its presence in Aceh. Since March 2005, a first DSP unit is under preparation to open in Lambaro. Others are planned to follow in Neuseu / Banda Aceh. Target groups are self-employed micro and small entrepreneurs and fixed income earners, with priority on urban based market traders.

18. Other Commercial Banks: Five of the 11 major Indonesian commercial banks are represented in the capital city of the province, Banda Aceh. Bank Mandiri operates so called Micro Banking District Centers (MBDC) in order to get a share of the microfinance market in Indonesia. However, there is no MBDC located in the NAD Province.

19. Finally, the diagram below compares the market share of commercial banks against those of all other formal financial institutions in the Province. The figures relate to December 2004 (pre-Tsunami) and show that institutions smaller than commercial banks have a comparatively higher share of small-scale clients. This becomes obvious above all when comparing the graph to the volume percentages of financial transactions that are contained in table 1:

**Graph 1: Market Shares in NAD Province (Number of Customers)**



Source: GTZ Appraisal Mission

20. In sum, commercial banks present in Aceh are predominantly BRI, with much smaller presence in the capital only of Bank Mandiri, Bank Danamon, BCA and the Industrial Bank of Indonesia. Commercial Banks have a customer base totalling 781,128 in the province, as against 56,000 customers for the Regional Development Bank (BPD) and BPRs with 28,000 customers. The average savings account in BPR per customers varies from IDR 100,000 to IDR 100 mn. Loan sizes range from IDR 500,000 to 10 mn. The average interest rate is around 20%-35% p.a. expressed in the case of commercial banks on the reducing balance.

## 2. People's Credit Banks (BPR / BPRS)

21. Overview: In analysing the People's Credit Banks (also referred to as Rural Banks), two distinctions have to be made: (i) privately owned People's Credit Banks versus those owned by local govt. , and (ii) People's Credit Banks operating according to sharia (Islamic law) principles (referred to as BPRS) as against those not operating under sharia (BPR)<sup>4</sup>.

22. Smaller bazaar or market based banks similar to Rural Banks in the Philippines emerged in Indonesia in the 1960s. A network of Bank Pasar or market banks was developed by the Kosgoro organization, which owns 277 village and market banks. However, the establishment of these banks was stopped by MoF decree in 1970. By 1980, these banks tended to move their business to urban areas. 86% of their assets were concentrated in large urban areas, and many of them faced severe credit collection problems. In 1988, 423 of these banks were operating all over the country. The banking reform of 1988 (PAKTO 1988) had as one objective to expand the outreach of financial services to rural areas. The government permitted the establishment of new secondary banks at the sub-district level with a paid-up capital of only IDR 50 mn. More than 1,000 new BPR were established during the following five years.

23. After the rapid growth of the BPR industry it then faced a crisis caused by low capitalization, weak management and unsound banking practices. This situation was aggravated by the Asian Financial Crisis of 1997/1998. Between 1997-1999 Bank Indonesia withdrew five licenses and was forced to freeze the operation of 72 BPR. As a consequence,

<sup>4</sup> The term Bank Perkreditan Rakyat (BPR) stands for secondary banks that, according to currently valid laws and regulations, must comply to regulations enacted for secondary banks, and are subject to supervision and enforcement of secondary bank regulations as applied by the central bank.

BI decreed that BPR / BPRS were required to increase their paid up capital up to IDR 2 billion for the greater Jakarta region, IDR 1 billion for provincial capitals and IDR 500 million for other areas. Aiming at fewer but financially more robust BPR / BPRS, Bank Indonesia liquidated a further 300 BPR in 2000/2001. as per end 2000 the number of existing BPR / BPRS stood at 2,427. Further increases in minimum capital requirements and capital adequacy ratios are likely in future to continue the process of consolidation of BPR / BPRS that commenced in the late 1990s.

24. To date, there are 2,427 BPR and BPRS operating nationally with high concentrations in Java and Bali (83% of total). 9,8% of all BPR / BPRS are located in Sumatra. In the NAD Province, there were altogether 20 People's Credit Banks. 12 BPR were owned by local government operating in 5 districts (details, see annex 1, pp. 4) and 8 privately owned BPR in 3 districts. Details are contained in tables 4 and 5 below:

**Table 4: Publicly Owned People's Credit Banks in NAD Province**

#	District <sup>5</sup>	Name of People's Credit Bank
1	Banda Aceh	PD BPR Meuraxa
2	Aceh Basar	PD BPR Sukamakmur
3		PD BPR Seulimeum
4		PD BPR Lhoong
5	Aceh Barat	PD BPR Kuala
6		PD BPR Seunagan
7		PD BPR Kaway XVI
8		PD BPR Kuala Batee
9	Aceh Selatan	PD BPR Kluet Utara
10		PD BPR Tangan-tangan
11	Aceh Tenggara	PD BPR Blangkejeren
12		PD BPR Seunagan

Source: GTZ Appraisal Mission

**Table 5: Privately Owned People's Credit Banks in NAD Province**

#	District <sup>6</sup>	Name of People's Credit Bank
1	Aceh Basar	Koperasi BPR Ingin Jaya
2		PT BPR Darul Imarah Jaya
3		PT BPRS Hareukat
4		PT BPRS Hikmah Wakilah
5		PT BPRS Baiturrahman
6	Pidie	PT BPRS Teungku Chik Dipante
7	Aceh Utara	PT BPR Sabee Meusampe
8.		PT BPRS Rahman Hijrah Agung

25. Not surprisingly for the Aceh region known nationally for its Muslim conservative views, all but 5 of the 8 privately owned People's Credit Banks operate according to Shariah principles of Islamic finance.

26. Supervision of BPR / BPRS was up to 1988 delegated to BRI. To date, the central bank applies a rating system based on financial reports and their on inspection visits. The BI rating system for BPR / BPRS follows the CAMEL principles (capital, assets, management, earnings, liquidity) as follows:

<sup>5</sup> Compare with map of NAD Province

<sup>6</sup> Compare with map of NAD Province

**Table 6: BI's Rating System**

	Ratings	Category
1	81 < 100	(S) Sehat / <i>Sound</i>
2	66 < 81	(CS) Cukup Sehat / <i>Fairly Sound</i>
3	51 < 66	(KS) Kurang Sehat / <i>Less Sound</i>
4	0 < 51	(TS) Tidak Sehat / <i>Not Sound</i>

Source: Ikhtisar Ketentuan BPR, published by Direktorat Pengawasan BPR, Bank Indonesia, 2004

27. Status: BPR/BPRS operate as so called secondary banks and are like BPDs exempt from certain commercial bank licensing requirements. They are small, single unit banks normally operating with between 8 to 20 employees (even though post-Tsunami, at least 9 of these banks were still working with less than 8 staff). As pointed out in the Fact Finding Report to this project<sup>7</sup>, this system of small banks ("rural banks") had a market share of less than 1% before the Tsunami, but likely with an importance of some BPR/BPR higher in areas not served by commercial banks. 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. Other constraints are:

- Low operational efficiency with 100 borrowers or less/loan officer;
- Collateral based lending;
- NPL ratio of 20% before Tsunami (September 2004)
- Limited institutional and managerial capacities.

28. Government owned BPR/BPRS are considered bureaucratic with a much lower performance (see table 7 below) due to the involvement of local government as decision makers. The local government place commissioners and in some cases directors are appointed directly by owners. On the other hand, the privately owned BPR/BPRS operate autonomously and market oriented. Surveys in other parts of Indonesia have shown that these small banks more than other formal financial institutions reach lower income clients and may be located in less favourable locations in rural areas and urban poor areas.

29. The Sharia based BPRS have an advantage in that they fit into the social-culture in NAD province and are considered to have strong growth potential on account of this. On offer are mostly *musharaka* and *mudabarah* type of services. *Salaam* type of transactions that would be useful for farmers and other primary producers are not yet widespread.

30. Table 7 contains the data for 17 BPRs and BPRS' surveyed by the appraisal mission in NAD Province in June 2005<sup>8</sup>

**Table 7: Inventory of All BPR in NAD Province**

	BPR/BPRS	Ownership <sup>9</sup>	Years of Operations	# staff	Assets (IDR mn.)	# Savers	# Borrowers	NPL (%)	CAR (%)
1	Seulimeun	Pemda NAD, II	7	8	2,679	914	209	60	47.85
2	Meuraxa	Pemda	n/a	N/a	n/a	n/a	n/a	n/a	n/a

<sup>7</sup> Joint GTZ-KfW Fact Finding Mission in Nanggroe Aceh Darussalam Province February 21 – March 08, 2005, Assessment of the situation in Aceh Province after the Tsunami and Recommendations for the Design of a Financial System Reconstruction Strategy with Special Reference to Micro and SME Finance

<sup>8</sup> see annex 1 by Numan Rayadi Manaf for more details on the survey methodology and implementation details

<sup>9</sup> Ownership : Pemda NAD (Aceh Provincial Government), Pemda II (Regencies government)

		NAD, II							
3	Lhoong	Pemda NAD, II	10	4	1,130	708	406	50	38
4	Sukamakmur	Pemda NAD, II	10	6	n/a	n/a	n/a	n/a	n/a
5	Kluet Utara	Pemda NAD, II	8	6	1,351	1,828	339	19	29
6	Kuala Batee	Pemda NAD, II	7	9	1,889	928	732	n/a	n/a
7	Tangan-tangan	Pemda NAD, II	9	5	1,330	603	902	n/a	n/a
8	Blangkejeren	Pemda NAD, II	10	7	1,222	667	330	n/a	n/a
9	Lawe Alas	Pemda NAD, II	8	7	624	257	n/a	n/a	n/a
10	Kaway XVI	Pemda NAD, II	5	6	1,554	1,040	139	30	52
11	Seunagan	Pemda NAD, II	7	5	2,185	1,460	714	n/a	n/a
12	Kuala	Pemda NAD, II	7	6	789	462	165	n/a	n/a
13	Darul Imarah	Zulkifli Amrin	8	9	3,064	2,097	173	9.3	18
14	Hikmah Wakilah	PT.PNM,B MI ICM	10	10	1,766	2,605	217	57	34
15	Baiturahman	Ibrahim Hasan,Dolog	11	10	4,412	5,525	285	20	11
16	Rahmah Hijrah Agung	PT Arun,BMI,P T PIM	9	24	8,480	8,000	2,000	9	n/a
17	Chiek Dipante	Ibrahim Hasan	10	16	3,942	1,354	992	n/a	n/a

Source: GTZ Appraisal Mission June 2005

31. The table conveys a picture of acute problems in a post disaster scenario. The major problem facing BPRs are liquidity constraints caused by non-repayments of loans. Most of the People's Credit Banks especially the coastal ones affected by Tsunami, have lost large parts of their portfolios. Clients are either dead, moved elsewhere and are untraceable or survived but had lost their business. In most cases, in the coastal districts all documents containing information on the customers were destroyed. BPR / BPRS liquidity ratios also deteriorated because clients with deposits in the bank demanded cash withdrawals to cope with the aftermath of the disaster. In addition, bank employees that died have to be quickly replaced and training and management development courses for new or already existing staff are in high demand. TA is required in these areas and to assist in the rebuilding of destroyed premises and data systems. – With their locations off the beaten track and in the less populated districts and their reach to lower income customers, BPR / BPRS should be fully rebuilt and new ones established as well, if they follow a pattern of private ownership and management and have adequate growth potential in view of the expected B.I. increases in minimum capital requirements (see above).

### 3. Regional Development Bank (BPD Aceh)

32. Regional Development Banks do not have to follow all stipulations contained in the laws governing commercial banks, here above all minimum capital requirements. Some of the



Regional Development Banks have a mixed or private ownership, others – such as the BPD Aceh – are still fully owned by local government. Various governance problems can be observed. On the whole, BPD Aceh suffers from political interference at management level and as far as loan approval decisions are concerned. Consequently, Bank BPD Aceh was already before Tsunami in need of a comprehensive restructuring program including recapitalization and improvement in its governance structure and institutional efficiency. According to information from BI, BPD Aceh had submitted a request for fresh capital to the MoF already before the Tsunami. The three shareholders of BPD Aceh are detailed in table 8:

**Table 8: Ownership Structure of BPD Aceh**

1:	Government of Indonesia	48.31%
2:	Regional Government	31.72%
3:	NAD Provincial Government	19.97%

33. The management team consists of four executives. They are flanked by a board with an equal number of members. The majority of the latter four hold positions in regional or provincial government. The chairperson of the board, Mr. H. Thantawi Ishak holds the position as a Secretary of the Provincial Government. One board member is the head of the Department of Finance at province level, but there is also one independent board member, Professor Raja Masbar, a lecturer at the University of Syah Kuala Banda Aceh.

34. A look back at graph 1 illustrates the comparatively strong market penetration of this secondary bank. BPD is the single most important CB in Aceh in terms of deposits mobilised and the length of the loan book to clients other than salaried borrowers with consumer lending requirements or large enterprises.

**Table 9: BPD Aceh Financial Highlights before Tsunami and as of 12 December 2004 :**

1. Total Assets	:	Euro	359 Million
2. Total Loans Portfolio	:	Euro	110 Million
3. Total Equity	:	Euro	16 Million
4. Revenue	:	Euro	16 Million
5. Earnings Before Tax:	:	Euro	3 Million
6. Loan Deposit Ratio	:		41.82 %
7. ROA	:		1.29 %
8. ROE	:		13.48 %
9. CAR	:		16,35 %
10. NPL	:		1.81 %

35. It is rather doubtful on what basis the low NPLs were calculated. Possibly, they are the result of loan write offs, but the infection of 50% of the total outstanding loan portfolio after the Tsunami has wiped away the equity and the bank seems now de facto decapitalised: Non-performing loans increased to IDR 100 billion. The necessary capital and technical assistance to restructure this bank are expected to come from the German Savings Bank Foundation. BPD Aceh has also approached the Asian Development Bank for technical assistance and is in negotiations with the NGO Mercy Corps concerning the issuance of credit guarantees for micro enterprises.

#### 4. Cooperative Forms: BMT / Baitul Qiradh

36. Overview: Cooperatives in Indonesia have for the past 60 years mostly been introduced in an old fashioned top down approach and as part of wider political initiatives for economic development. They would be best sub-divided into those that focus on thrift and credit on one hand, as against the multi-purpose type on the other. And as in the case of PBR / BPRS rural banks, cooperatives may or may not follow the Islamic finance route.

37. In the NAD Province, there are only less than 200,000 members out of a total of more than 11 million members countrywide. Likewise, the total of registered savings and credit cooperatives is comparatively small in this province. Cooperatives have been particularly affected by the Tsunami: Out of 20 in the two most economically active districts of Banda Aceh and Aceh Basar, more than half vanished and to date, only eight are still functioning. In the more remote parts of the province, this decentralised microfinance model has a clear scope for replication, but security considerations may have limited the operations of these village based MFIs in the recent past.

38. Status: The detailed table in appendix 4 to the main report captures the key information that was collected on savings and credit cooperatives in the province. The table captures 10 coops since the quasi-defunct societies of Nanggroe and Laot Rayah were included into this inventory. The table shows:

- The quick and substantial equity contributions from local Muslim organisations generated the necessary liquidity for these cooperatives to restart lending activities very soon after the December events. Where destructions were not substantial, the profit picture is encouraging (4 coops in surplus as of end June 2005).
- Both the very small absolute number of coops and the fact that more than half of them were destroyed indicates that the potential for these decentralised financial institutions is probably substantial and the setting up of new cooperatives should be a priority option for microfinance development.
- The coops still operate sub-optimally in many procedural respects (AGM, supervisory committee, etc.) indicating the need for capacity building and training of office holders.
- The quick resumption of duties after liquidity infusion through Baznas and ICED shows the relative resilience of thrift and credit cooperatives to external risks and challenges, a fact that has been several times pointed out as a factor in their favour, above all when working in more remote and difficult to access locations.

39. Finally, it is important to note that the domestically offered technical assistance package of PNM that is described in detail on pp. 5 of Annex 2, together with the liquidity support of Baznas and ICED has shown results in terms of robustness of the IT platform and streamlining of systems and procedures. It would be useful to replicate and upscale this approach, and the proposed project would carry this out not just for cooperatives but also for other microfinance institutions BPR / BPRS and if possible, publicly sponsored microsavings and credit programmes.

## 5. NGO Type Microfinance Institutions

40. Prior to the December 2004 events, the NAD province did not receive the same extent of attention from development and microfinance NGOs as other parts of the country. For this reason, the total number of civil society organisations working with credit funds is relatively small. International specialised microfinance NGOs are however planning to start services once their study / reconnaissance work has been completed. It is however understood that these MFIs (World Vision, World Relief) would not start operations prior to 2006, if at all.

41. Local NGOs with Credit Services – CCDE The Center for Community Development and Education (CCDE) was founded in 1993 to foster community empowerment, through income generating activities for Acehnese women. The institution was destroyed by the Tsunami disaster and lost its office, all its data and facilities. One of its business programs relevant for microfinance development was the programme for Income Generation of Farmers, Breeders, Fishermen and Small Enterprise. The total number of groups receiving technical assistance from CCDE is 44, or 1,021 people. Total disbursed loans up to July 2005 reached IDR 400 mn with a repayment level of 99.98%. This activity is handled by 7 staff, 4 field staff, 2 administrative staff and 1 coordinator.

42. Aceh Recycle Foundation /Yayasan Daur Ulang Aceh (YDUA): This NGO started operations in 1998. The NGO finances working capital for group members. Loan amounts

range from IDR 1,000,000 to 3,000,000 with flat rate interest charging of 2% per month. The loan portfolio at the time of the visit in June 2005 reached only IDR 534,000,000 to 178 borrowers. Post Tsunami, the NGO had lost several lives and assets: 6 staff, office premises and documents. In addition, as many as 370 group members had lost their houses. 267 assisted group members had perished. YDUA has cooperation experiences with various partners, such as PKM Jakarta, YAPPIKA Jakarta, KKTGA, WALHI Aceh, Oxfam, SHEEP and Save the Children. There are no information available about its microfinance portfolio. The microfinance programme is handled by 6 staff, including one accounting employee.

43. MiSPI or Mitra Sejati Perempuan Indonesia was founded on August 20, 1998 in Banda Aceh, with the aim of empowering women. Activities are conducted through assisting women prayer groups at village levels. During the prayer meeting, the trainer gives counselling on education characteristics, including business motivation, how to start up business. Both seed capital requirements and request for small asset expansion loans from members are served by MiSPI through its prayer groups<sup>10</sup>.

44. YADESA (Yayasan Pembinaan Masyarakat Desa): This is another MFI NGO with a portfolio so small that the impact on the target group has been rather limited. Founded in 1998, YADESA works with the very poor in the community using participative methods. The total number of beneficiaries before the Tsunami amounted to 457 people, and dropped to 199 as of June 2005. Total loans disbursed amounted to IDR 84.5 mn. or EUR 7,225 only. Outstanding loan portfolio as at the end of May 2005 equalled IDR 26,800,500. Total assets before Tsunami reached IDR 343,500,000, but as of June 2005, total assets had fallen to only IDR 254,000,000 or EUR 21,720.50. YADESA operates its lending facility in 3 districts (of Pidie, Bireun, and Aceh Besar) and 2 cities (Banda Aceh and Sabang). Total YADESA staff amounts to 5 administrative staff and 10 field staff.

45. FLOWER ACEH (Women Activities for Rural Progress): This is the oldest NGO with loan facilities to low income women in the province. Founded in 1989, Flower Aceh conducts (a) management training; (b) training courses for micro entrepreneurs, and (c) granting working capital loans to women groups<sup>11</sup>.

46. In sum, none of these five local NGOs has the size, growth potential or strategic plan for expansion that would make it a suited as a major partner for a microfinance development programme. The forthcoming project should however share major forthcoming training and management development activities with these NGOs, possibly assist in the formation of a Province NGO-MFI apex if indeed foreign international NGO MFIs start to enter the market in 2006.

## 6. Government Programmes with Microfinance Components

47. In Indonesia, several microfinance arrangements with significant outreach and therefore impact on poor people have traditionally been carried out with close collaboration of government ministries, agencies and their staff. The P4K programme with active involvement of thousands of field extension workers is just one and probably the best known international example in this regard. Quite a few ministries have their own schemes and programmes with integrated microcredit or microfinance components

48. UPPKS of BKKBN (Badan Koordinasi Keluarga Berencana Nasional) or National Family Planning Board: This program was initially introduced to NAD in 1994, with the aim to alleviate poverty through women groups. Each participating woman had to manage a business in order to be included in the Programme. Groups ("UPPKS groups") are supported by field staff of National Family Planning Board (BKKBN). After having received technical

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<sup>10</sup> The data and information on microfinance portfolio were promised to this mission but not made available.

<sup>11</sup> Data on microfinance services could not be obtained from the management of this NGO.

assistance from field staff of the National Family Planning Board, UPPKS groups may apply for productive business working capital loans. One single group may have up to 20 women members. There is no definite data on the number and quality of involved field staff and their groups post Tsunami. It is however likely that quite a number of dealing staff and also of group members have perished as a result of the Tsunami.

49. Loan interest is 12% per annum with a 24 months repayment term (including three months grace period). Loan repayment is effected by monthly instalments, from member to group manager, then the manager pays the loan instalments to the field staff. Funds are then deposited to an account of the National Family Planning Board. for payment into the "UPPKS Fund" account held in the name of the BKKBN Head of the local regency/city. The funds are then redirected to BKKBN of NAD Province through a special account in the name of Pengurus Bidang Keluarga Sejahtera with BNI 1946 Banda Aceh branch office. The funds are re-channeled again to regency/city with vetted and approved funding proposals.

50. The total number of groups receiving technical assistance before the disaster was 10,000 UPPKS comprising a group rating from 1 (basic) to 4 (excellent). The total number of highest rated UPPKS groups before the Tsunami stood at only 40 groups, with 511 members and savers.

### III. EMERGING APPROACHES AND EXPECTED DONOR ACTIVITIES

#### 1. Policy Framework

51. Microfinance for poverty alleviation has been a traditional forte of a number of domestic financial institutions and government programmes. Microfinance strategies and policy statements are currently being formulated under the aegis of the recently formed National Committee of International Year of Microcredit 2005, chaired by Deputy Minister for Economy Mr. Dipo Alam<sup>12</sup>.

52. Sequencing of Microfinance Policy Initiatives: The practical policy and strategy work of the Indonesian Government and national decision makers appears to benefit substantially from the German advisory function provided through the ProFI Programme (Component 1 – Programme Advice and Involvement in Formulating Microfinance Strategy and Legal Framework for Indonesian MFIs). The Indonesian Government plans to finalise a first national **Microfinance Policy** and formally enact this through Parliament. Thereafter, decisions would be taken as to the types of institutions that should be regulated within the framework of a **Microfinance Law**.

53. ProFI Process Guidance and Possible Complementarities: Synergies with the ongoing nationwide operating B.I. / GTZ Programme for Promotion of Small Financial Institutions should be sought above all with components three and four of the ProFI Programme.

54. A new emerging approach for microfinance development and capacity building of small financial institution is a new training system promoted by ProFI called CERTIF. As the first professionally managed accreditation and certification system in the area of microfinance worldwide, CERTIF had made substantial progress since it was launched by ProFI. The system has since evolved as an independent domestic training institution (March 2005) and provides services in seven provinces of Indonesia. Through presentation in the supervisory board of this institute, ProFI can influence not just training content, but also wider strategic decisions of CERTIF.

55. Responses of Bank Indonesia: Policy responses in the area of microfinance have in Indonesia traditionally been formed and formulated by domestic decision makers. The central

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<sup>12</sup> This has been flanked by the declaration of 2005 also as a national year for microfinance with the respective 12 months period launched in February 2005

bank<sup>13</sup> issued two regulations concerning treatment of overdue debts and arrears. The first one dates 10 January 2005 and relates to commercial banks (see appendix 2 to this report)<sup>14</sup>. It permits the rescheduling (“roll over”) of loans without however injecting new liquidity for loan write offs.

56. Appendix 3 contains the new regulation on treatment of bad debt as related to BPR / BPRS in the NAD Province<sup>15</sup>. As far as these Peoples’ Credit Banks are concerned, the central bank sets new and more relaxed conditions for re-booking loans in arrears as new loans but again, no additional capital is provided to enable the write off of loans without recovery prospects.

## 2. Specific Microfinance Support Activities Planned in NAD Province

57. The Fact Finding Report of March 2005 contains a list of planned projects from international donors in support of microfinance development in the NAD Province. Out of these, two proposals had reached a more imminent and concrete shape and one will shortly start implementation. First, a USD 20 mn. credit facility for BRI through the Agence Française de Développement (AFD), and second World Bank engagement through a new national microfinance programme with a particular focus on NAD named ‘Support for the Poor and Disabled’ (SPADA) as well as a smaller, but popular World Bank programme ‘Koperasi Unit Desa’ (KUD). This Programme started implementation in NAD as a pilot and on a small scale before the tsunami together with the Fishery and Agriculture Ministry. No further details are known about the World Bank pipeline projects. After hosting a provincial workshop on microfinance in Aceh Province, it appears that the ILO is not pursuing options any further for developing a microfinance support function<sup>16</sup>. On the other hand, the support project of SBFIC, the German Savings Banks Foundation for International Cooperation, to the Aceh Regional Development Bank, has been further prepared and Agreements for Cooperation signed. This project may still start in 2005.

## 3. Outlook and Expected Gap in Development and Rehabilitation of MFIs

58. The supply and demand situation and relevant estimates were presented in the above referenced GTZ Fact Finding Report on microfinance development for NAD Province of March 2005.

59. The gaps between supply and demand above all in areas outside of Banda Aceh and districts adjacent to the provincial capital city are assessed to be major. Even though a forceful contribution to institutional capacity building would change this equation somewhat, the microfinance market in this province in the short to medium term is likely to remain a sellers market. Some of the post disaster capacity building initiatives proposed in this report have however the capacity to add substantially to the quality and quantity of microfinance services in the vast areas away from the capital. These include the strengthening and formation of new thrift and credit cooperatives, assistance in setting up a government

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<sup>13</sup> <http://www.bi.go.id>

<sup>14</sup> Bank Indonesia Regulation No. 7/5/PBI/2005 of 10 January 2005; on the web, see <http://www.bi.go.id/NR/ronlyres/C58559AD-F5D0-46BA-B0F3-6ABD242655F6/2380/PBI7505eng.pdf>

<sup>15</sup> Bank Indonesia Regulation No. 7/17/PBI/2005 of July 2005; on the web, see

<http://www.bi.go.id/NR/ronlyres/0490E533-25C8-44CB-A899-8BC646418977/2575/pbi71705eng.pdf>

<sup>16</sup> However, the ILO had been very fast and effective in setting up training centres and Business Development Centres, mostly newly created after the Tsunami and in different parts of the province. As argued further below in this report, this new service infrastructure offers several ways for collaborating with this proposed project.

supported service initiative with potential to reach far into the Acenehse hinterland, and also through capacity building of small single unit banks, the rural banks or BPR / BPRS. Their selective restructuring and de-politicisation is likely to remove development barriers and may contribute to a large expansion of the service area of these banks.

#### IV. THE PROPOSED PROJECT

##### 1. Rationale and Design Considerations

60. Loans versus Grants – Short and Medium Term Perspective: Quick and flexible access to grants was of the essence immediately after the disaster. As a short term measure, grant inflows for disaster rehabilitation and initial endowment with working tools have been useful as a first response. Grants should be provided cautiously and according to clear, uniform guidelines that puts nobody at a disadvantage and avoids undue rationing of funds or access to specially positioned people only. In the medium term and as an overall general response to capital requirements, access to credit would be more appropriate than grants. The development of a 'grant attitude' of recipients should be avoided. It would have a detrimental effect on the target group as it might undermine active economic engagement and their medium term 'bankability'.

61. Simple Design for Quick Results: Based on the experience of GTZ in other countries affected by Tsunami<sup>17</sup>, the project is kept simple with a few focussed and concrete support activities that would have a direct impact as close as possible to the ultimate target group, the severely affected people of the Province. The target group for this project would be the families directly affected by the Tsunami, but also the remainder of the population that is indirectly affected by the Tsunami impact and in need of rebuilding livelihoods and employments again. This conforms with the GTZ target group definition for its Indonesia operations as *the poor and low-income households* and would apply for the entire NAD province.

62. Anchor for German Microfinance TC Activities in NAD and Select International Public-Private Partnerships: A leading international commercial bank plans to collaborate with GTZ in NAD province for microfinance development and focuses on the establishment of a GTZ managed credit revolving fund plus accompanying technical assistance. Similarly, technical and financial corporation activities of the German Savings Bank Association would be aimed at restructuring and capacity building of the Regional Development Bank (BPD Aceh). Other private sector partners may follow thus increasing the need for an internationally funded credit facility to be managed by GTZ.

63. Project Appraisal Process to Respond to Client Requirements and Stakeholder Preferences: GTZ has been working successfully in the Indonesian microfinance sector for the past two decades. Partnerships with the main stakeholders of a microfinance project in NAD are well developed and national decision makers were kept in the forefront of project development since formal project inception with the Bank Indonesia having requested for this project, and the provincial and national Planning Department, the Regional Rehabilitation and Reconstruction Agency BRR and financial institutions kept briefed and consulted about project progress at every step of project design. A provincial Workshop in Banda Aceh on 21 and 22 June brought local microfinance institutions together with the Bank Indonesia, donors and representatives of international NGOs. The GTZ Appraisal Team could present its initial findings and recommendations and listen and collect the views and recommendations of the audience consisting in large part of local microfinance staff. A second brainstorming meeting in Jakarta on 28 June 2005 in the Bank Indonesia brought together senior staff and decision makers with a view to finalise together with GTZ the main pillars of this project.

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<sup>17</sup> The GTZ sponsored Sri Lankan Website [www.microfinance.lk](http://www.microfinance.lk) contains up to date information on activities of the German Technical Cooperation in the country (see the link on the website "sustainable microfinance for Tsunami affected areas")

64. Project Proposals in Line with National Policy Priorities and Recovery Strategies: The Master Plan for the Rehabilitation and Reconstruction of the Regions and Communities of the Province of NAD, the draft national Microfinance Strategy currently under review<sup>18</sup>, and the GTZ endorsed CGAP Declaration for Post Tsunami Microfinance Assistance at international level guided the formulation, design and activity proposals of this mission.

## 2. Proposed Project Activities in Summary

65. Twofold Project Structure: The basic structure of the project is twofold. First, a menu of Technical Cooperation activities will assist Tsunami affected financial and microfinance institutions to quickly get back to business. Project capacity building measures would include support for the physical reconstruction of small financial institutions, development of staff technical and management skills, above all by linking up with the highly successful national Certif Institute for banker training, and by providing on-site tailor-made TA in areas related to IT development, credit systems and procedures, development of new financial products and diversification and drafting of policies and manuals that are adapted to the specific requirements of the supported institution. While there would be a priority focus on BPRS and BPR, as well as on cooperatives and possibly the UPPKS Programme of the Government's National Family Planning Board, commercial banks and also the regional development bank would also be invited to participate selectively in certain training and capacity building measures.

66. As a second project pillar, the project would manage an externally provided credit fund provided out of private corporate resources and to be hinged to the Provincial Reconstruction Coordination Agency (BRR).

## 3. Support to People's Credit Banks<sup>19</sup>

67. Financial Requirements: The appraisal mission estimates total financial requirements for the People's Credit Banks to be in the range of EUR 500,000. Added to this are TA requirements that would best be provided by the GTZ experts with recourse to local consultants. Financial requirements for cleaning the balance sheet of irrecoverable loans post Tsunami would for all the affected banks amount to between EUR 500,000 and EUR 1,000,000. After recapitalisation, these banks could absorb additional loan funds of up to EUR 5 mn<sup>20</sup>.

68. TA Requirements: Most BPR / BPRS People's Credit Banks would however not be in a position to immediately borrow larger amounts from a GTZ managed credit fund. Rather, technical assistance measures in a number of productivity enhancing areas needs to be implemented in order to increase financial robustness of these small banks and make them fit for taking up external credit funds in a second step.

69. Apex Requirements: Currently, In Aceh there is no BPR association that would provide support to its member banks. In other parts of Indonesia these associations exist and are known as PERBARINDO or "Association of BPR Indonesia". Initially they were formed by member banks. Where they exist, PERBARINDO perform three main tasks: (i) as a lobbying group to Bank Indonesia and to other governmental bodies including the parliament; (ii) as a forum for members to exchange views and find common positions on policy issues, and (iii) as providers of training and management development support (TA) to its member banks,

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<sup>18</sup> National Policy and Strategy for Microfinance Development.

<sup>19</sup> They are also referred to as Rural Banks, even though they are in many cases located in urban areas.

<sup>20</sup> While coops are not expected to borrow significant amounts out of the project credit fund, internationally sponsored NGO MFIs that are not allowed to mobilise deposits under Indonesian legislation, may between them have a take up of about EUR 3 mn. in credit funds, see below.

often by way of linking them up eventually with the services of the GTZ-ProFI established Certif Institute.

70. Specific Proposed Project Activities: After detailed discussions with Bank Indonesia at national and Province level and after a rapid financial and operational appraisal of a number of BPR and BPRS, the following sequencing of project support is proposed:

- **Restructuring TA for Government-owned Peoples' Credit Banks**: The political will to enhance productivity and limit the scope for political interference in the Province is there and if anything, is more pronounced now after the December events and the recognition that quality financial services to small and micro enterprises are a sine qua non for economic recovery. In close collaboration with the B.I. the experienced GTZ banking specialist would perform a programme that would consist of the following steps: (i) due diligence with local and international (GTZ long term) experts in each bank to get the specific problems, weaknesses and threats of the institution (ii) signing of an MoU with proposed institutional strengthening and capacity building measures specifically tailored to this bank covering an 8 to maximum 12 months period, (iii) technical assistance on site in organisation and development, board restructuring and amendments to the articles of association, job audits, rightsizing of the bank, internal controls and M.I.S., product development IT development and streamlining of systems and procedures through standardized policies and procedures manuals for different front and back office functions of the bank.

***For comparatively stronger banks, a focus on strengthening the MSME lending functions in the process of a restructuring exercise could be considered as well and respective benchmarks to be reached included in the MoU.***

- **Technical Assistance through the National CERTIF Institute**: Those Peoples' Credit Banks in private ownership may immediately start with training and capacity building measures of CERTIF and may borrow from the fund if their financial and operating data are in order. Specific requirements would be worked out between the international project TA of GTZ, the CERTIF Institute, and also the ProFI office as far as strategic issues are concerned.
- **Product Development Support for Islamic Finance Systems**: This is the area where demand was expressed most vocally by BPRS (and also by thrift and credit cooperatives following the sharia principles, see below). The team found a pronounced lack of *e/ salaam* services that would be useful for primary producers. New product development initiatives from Bank Pertanian and other Malaysian banks that are in the forefront of experimenting with new Islamic financial products and instruments could be transferred to the small banks<sup>21</sup>. Equally, turn key standard solutions are in demand for IT accounting and investment / loan tracking platforms that operate according to Islamic finance principles. Solutions applied here up to now are piecemeal and of greatly varying quality<sup>22</sup>.

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<sup>21</sup> Dr. Fadlullah Wilmot of MuslimAid UK / Australia is a current director of the MA office in Aceh and is interested to collaborate in practical aspects of product development in Islamic finance for small Fis.

<sup>22</sup> The GTZ / FAO Microbanker package is well adapted to single unit banks without a wide branch infrastructure. GTZ may consider it useful (and it may indeed already have been initiated) to adapt a special version of this widely known software for Islamic finance principles. GTZ international TA may bring this up with the regional microbanker coordinator in FAO Bangkok and the coordinating Financial Systems Development Division in GTZ head office.



- **Market Support and Development by Collaborating with BDS Providers:** The small banks could profit from collaborating with the different BDS providers that have been built up as a consequence of the quick and focused support of ILO in Aceh Province. Different types of collaboration with the newly opened technical training centres could be envisaged.
- **Possible Support for a Provincial Apex:** This activity would be better suited for the subsequent phase since the existing small banks are currently still weak and not in a position to participate in the establishment of a provincial apex. After capacity building and strengthening / restructuring of these banks, the need for apex support should be assessed again at the end of phase 1 (after two years) of this project.

#### 4. Support for Cooperative Development and Rehabilitation

71. Cooperatives have been particularly affected by the Tsunami: Out of 20 in the two most economically active districts of Banda Aceh and Aceh Basar, more than half vanished and to date, only eight are still visible and partly functioning. In the more remote parts of the province, this decentralised microfinance model has a clear scope for replication, but security considerations may limit the operations of these village based MFIs for some time.

72. Requirements: The appraisal mission estimates total financial requirements for the different types of cooperatives not to exceed EUR 50,000 for the first phase of the project. Much more important would be TA requirements that would best be provided by the proven local consultants (PNM TA Programme for NAD Cooperatives) together with GTZ experts. The biggest challenge but also the activity with a significant potential medium to long term development effect is the establishment of new thrift and credit cooperatives in the more remote parts of the province. The recently concluded peace negotiations between the Indonesian government and the Acehese GAM guerrilla movement open the possibility to operate decentralised savings and credit facilities without the permanent danger of looting and robberies. The cooperative model has proven one of the most robust and least-cost models of decentralised financial intermediation and the setting up of new primary societies should therefore also be supported by the project. Whilst the target of no more than 10 coops to be set up may not be overly ambitious, it can provide a demonstration on practical financial self-help based on systems and procedures designed and/or finetuned by the GTZ project.

73. Apex Requirements: It would be useful to initiate work on a functioning province wide apex once the cooperative outreach programme is concluded and the new societies operate successfully next to the ones that continued to exist after the Tsunami. This apex should initially only have limited responsibilities (training and TA, essential member services) and a very small budget to ensure sustainability and financing out of member fees and charges to the largest possible degree. In the structural arrangements for this regional cooperative apex organisation there could however already be arrangements (in the By Law and guidelines and procedures to the By Law) that would permit for involvement in supervision and regulation, and possibly also the running of a apex finance facility to intermediate between cooperative surplus and deficit units. The apex would only serve savings and credit cooperatives.

74. Specific Proposed Project Activities: Together with a small outreach programme that could result in the establishment of up to 10 new cooperatives all over the province, an Action Plan for thrift and credit cooperative apex services should be developed. This should be done in close collaboration with the Ministry of Cooperatives and SMEs. Systems and procedures at the primary and the proposed provinial apex level should be worked out as a priority and put into practice only after two stakeholder meetings discussing these sets at province and national level. Before proceeding with establishing the first cooperatives, a set of criteria for locations that is mutually agreed on between the Ministry of Cooperatives, the BRR and the project, has to be agreed on.

75. The following sequencing and detailed activities are proposed:

- Completion of Inventory of Existing Coops, Identification of Locations for New Coops: As a first step, it would be necessary to update and complete the inventory contained in annex 2 of this report. A team consisting of one local and one international specialist should also recommend up to 25 locations for new savings and credit cooperatives to be set up. The inventory would (i) collect the latest available financial statements and internal performance reports, (ii) importantly, provide a short member by member poverty / income and socio-economic profile to better understand which segments of the population have up to now been attracted to cooperative membership, and (iii) by laws, and systems and procedures at primary coop level should be assessed for membership recruitment, lending procedures and management of defaults. Did the board and management contribute to problems? Are overdues promptly identified? Are collection steps properly recorded, etc.
- Preparations for Cooperative Establishment: A team should then visit the proposed 25 locations and convene village meetings to discuss and explain the proposed savings and credit cooperative. If adequate interest is signalled from the village, then an organizing committee needs to be formed at village level, if the initial meeting indicated enough support. 15 villagers would form an organizing committee and work on preparing a by law and simple business plan for the new cooperative. Finally, the founding AGM can be convened to agree on by laws, procedures and vote office bearers into place. The coop should initially operate out of the premises of office bearers and not have an own office in order to save costs.
- Drafting of Relevant Model By Laws and Administrative Procedures: Drafts of these documents should be agreed on with the Ministry of Coops at regional and national level.
- Upscaling of Existing Savings and Credit Cooperatives: Together with the presentation of updated by laws and operating procedures, managers and members of the supervisory board would undergo training in the classical thrift and credit coop training disciplines. In addition, a special curriculum and training module for new and existing members should be drawn up. This preparatory training would help familiarize interested people from the village community with basic financial concepts and the value of a thrift and credit culture and the TA would thus not exclusively target current office bearers only.
- Evaluation Workshop: At the end of the first project phase, all planned cooperatives to be newly established should be in place, and the major work of upscaling and building capacity among the still existing cooperatives be completed. An evaluation workshop should then be held where progress and achievements at that time will be assessed. This should then also be the venue to discuss the sope and scale of a formal provincial apex to be strengthened through the project. The results and recommendations of this workshop would directly influence the work plan for apex strengthening to be carried out in the latter two years of the project.

76. DED Engagement: Collaboration with the German Development Service (DED) should be sought in implementing this cooperative development initiative. DED specialists could be posted directly into a district. If possible, 2 specialists should be involved. This would increase the number of new cooperatives to be established from 10 to 15 – 20.

##### 5. Support for Decentralised Rural Microfinance Programmes

77. UPPKS: This MF program has many traits that would make it a suitable candidate for inclusion at least into the capacity building part of the project. It operates decentralised, and with the wide network of staff from Family Planning. This offers the potential to reach large numbers of rural women and offer them an alternative income to improve the household food security and purchasing power of the household.

78. Feasibility Check in Project Start-up Phase: On the other hand, the few available data and inconclusive budget proposal submitted by the Family Planning and Welfare Programme, together with the fact that many field staff have in the mean time relocated would make a detailed feasibility check prior to commencement of a project support activity advisable. For this reason, it is recommended to have a detailed feasibility check up in the field, and in different districts of the NAD province where the programme and UPPKS groups are supposed to be still visible. The check should encompass the following three levels and be conducted within a two months period before the end of 2005:

- Group level, Systems and procedures, and factors determining group composition and election of group leader; acceptance of female income generating activities and actual control over credit resources.
- Field Staff: social and educational background, appropriateness and interest dealing with women economic matters and managing financial resources
- BKKBN Level Aceh and District Office: Capacity of handling cash transactions, internal control and financial inspection, book keeping, security of cash in transit, interest and staff capacity related to handling financial resources.

79. This check would be conducted pragmatically, but the above criteria should be seen as safe minimum criteria for entry into a wider project collaboration. Since this programme is potentially large (a first preliminary budget attached as appendix 5 amounts to about EUR 670,000, even though in terms of number of groups to be established or rehabilitated over the entire activity period of three years (511), the approach does not seem to be overly ambitious. Total gross credit requirements could likely be upwards revised from the current EUR 50,000 in view of the extraordinary needs above all in districts far away from Banda Aceh and with large needs but no financial institution to service these requirements.

80. Proposed Activities: Assuming that safe minimum requirements are in place for starting up a larger scale support to UPPKS groups, the following sequencing of project support is proposed<sup>23</sup>:

- **Identification of UPPKS Groups**, new, existing or in the process of starting up; since the perceived forte of this activity is the deep reach into more remote sub-districts and villages, a total of about 38 groups in as many villages are proposed.
- **Programme Marketing and Familiarisation with Procedures**, since experience from other programmes illustrates the importance of a formal group inauguration process, etc.
- **Training to Field Staff**: a batch of initially 20 field employees would be trained intensively during two rounds of training lasting one week each. Trainers would be both from the province and from Jakarta.
- **Training to UPPKS Groups**: the training sessions for the more than 500 group members would be conducted at district level and for training sessions of three days each. During the first training rounds, training material and training reports would be produced in order to facilitate refresher training later on (not budgeted).
- **Reality Check Workshops**: All the 80 groups to be formed during the project support period would be invited to a year end evaluation workshop for the first years of implementation. The purpose of this joint learning and refining exercise is to get an overview of strengths, weaknesses, yet uncovered opportunities and threats emanating from UPPKS groups support. The results and recommendations of these

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<sup>23</sup> These were agreed upon with the provincial head of the Family Planning Department, the head of the UPPKS Coordination for NAD Province and two technical staff in direct contact with field level employees.

workshops would directly influence the work plans and budgets for the following year.

- **Other Costs:** these include minor amounts for administration and incentive payments to field staff.

## 6. Credit Fund and Related Activities

81. The credit fund would initially be managed out of BRR, the Regional Rehabilitation and Reconstruction Agency for the NAD Province. This credit fund would usefully complement the capacity building thrust of this project since:

- Management on site in NAD would permit also smaller wholesale loan sizes (adequate to small financial institutions) and a tailoring of loan sizes and tenors specifically to the needs and absorption capacities of the concerned institution.
- The example of the Baznas liquid fund injection into cooperatives and the TA – credit fund mix illustrates that this quick and pragmatic service mix can yield very quick results in favour of the final target group, while not weakening the MFI in the process.
- The provision of lending funds from sources other than public and government to government sources would set a useful precedent for financial institutions and the wider public in Aceh Province. It would provide incentives to recipient institutions that could strengthen their balance sheet and ratings as a result of having passed loan appraisal exercises /due diligence analyses conducted by GTZ. And it would set a visible example that corporates and people from Europe are forcefully supporting the reconstruction efforts in the province as well.

82. A minimum of EUR 5 mn would be required if this facility is supposed to offer more than quickly recycling working capital loans. Investment loans with a 3 to 5 year duration could be offered in particular by the Peoples' Credit Banks with a robust financial status and without significant upfront technical assistance requirements. Smaller commercial banks and the Regional Development Bank may also benefit from a term lending facility. It is likely that over the next 24 months, international MFI NGOs such as World Vision and World Relief put in place their own MFIs in the NAD Province. These would be endowed with seed capital, but experience from other countries shows, that these microfinance institutions would quickly require external credit funds to upscale their own business. Demand from two internal MFI NGOs alone would amount to between EUR 2 and 3 mn.

83. Both in the case of working capital loans and in the case of investment loans, these should be granted on a pre-financing basis on account of current liquidity constraints. Reporting to the project /BRR would follow standard reporting formats for micro and small enterprise lending and be provided in three monthly intervals.

## V. Project Management

84. The overall coordination of project activities would be done through the offices of an international TA that would be posted as team leader to the province for two years. Responsibilities of this TA would include coordination of technical assistance activities with recourse to selective short term local and international TA, management of a project credit fund foreseen to be plished out of private commercial resources, implementation of the cooperative outreach and UPPKS programme and facilitation of policy dialogue and coordination of project activities with those of other donors and other projects within the German-Indonesian Technical Cooperation. The second long-term TA would be posted directly into the regional BI office in Banda Aceh to manage the restructuring of BPR and BPRS, as well as the Regional Development Bank BPD (if required).

## 1. Proposed Staffing and Process Issues

85. Staffing: 1.5 international long term TA would be required to coordinate and partly execute these measures. Close collaboration with the ProFI Programme office would be critical to ensure a quick start-up, TA impact and assistance in identifying and sifting local consultants to be engaged in the capacity building work of the project.

86. The management of the credit fund mobilised by the GTZ public-private partnership and plished through a leading international commercial bank on a non-repayable basis would require the equivalent of 0.5 international TA without long term local expertise, but assistance in implementing financial institutions credit appraisals and due diligence studies.

87. Implementation – Flexibility and Process Approach: Managing this capacity building and financial cooperation project in a post disaster scenario will pose a number of challenges. In the absence of any binding commitment to support small retail finance or microfinance in the NAD Province up to now by any major donor apart from SBFIC support for BPD, see below, the microfinance landscape will probably change quickly and depending on the type of support provided or independent new international NGO backed microfinance institutions to be established. Flexibility and quick and pragmatic responses to continuously changing circumstances will therefore determine the visibility and medium term impact of this GTZ project.

## 2. Monitoring and Evaluation – Managing the First Mover Advantage

88. At the time of conducting this appraisal in late June 2005, no other microfinance support initiative of another major donor was about to be carried out. Smaller but important domestic support had been initiated from institutions such as BAZNAS and their re-capitalisation support programme for cooperatives plus smaller international organisations such as Muslim Aid Australia or Mercy Corps. The only major initiative with prospects to be started up within the next months is the support project of SBFIC, the German Savings Banks Foundation for International Cooperation, to the Aceh Regional Development Bank.

89. Against this background, a thorough monitoring of supported small and micro financial institutions is essential. Above all in the early phase of reconstruction or new foundation, BPRS, cooperatives and the UPPKS programme will be likely to require technical support in organising for a small but effective M&E function.

## 3. Connectivity to Other Rehabilitation and Development Activities in NAD

90. Support to the Aceh Regional Development Bank can be phased in flexibly and depending on the level of support coming from SBFIC. New MFI operators may be established, World Relief and World Vision are particularly far advanced with their study and reconnaissance work. There are however not yet any firm commitments from these two international MFI NGOs.

91. Domestic Muslim organisations such as BAZNAS provided quick support in re-capitalising cooperatives. The accompanying technical assistance provided by Permodalan Nasional Madani or PNM<sup>24</sup> was well received by interviewed savings and credit cooperative staff and managers and the approach should be upscaled in this project.

## 4. Reality Checks with Local / National Policy & Other Decision Makers

92. Strategy Elements for Development of Strong MFIs: Part of the ProFI Programme approach is the embedding of MFI support into a larger development context that would make sustainability of the supported institution and its services to low income households more likely and would fit a single project or programme activity directly into a larger domestically

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<sup>24</sup> a parastatal organisation that also formed the major part of this appraisal team (not by weight but by number of team members), see annexes 1 to 3 to this report

formulated development context. The five strategy elements are summarised by ProFI as follows<sup>25</sup>:

- 1) A microfinance policy that supports the strengthening of microfinance institutions rather than focusing on channeling program credit;
- 2) Regulations that enable MFI to increase outreach to the village level and provide the basis for controlling their soundness;
- 3) An effective supervision system that is capable of protecting MFI clients and helping MFI to maintain or achieve soundness;
- 4) Capacity building through standardized and high quality training of MFI managers and staff;
- 5) Building up business linkages between banks and non-bank MFIs, or MFIs operating at the national, provincial, district, sub-district and village levels.

93. Microfinance System Approach: The combination of these strategy elements may be termed by ProFI the microfinance system approach. This approach aims at providing MFI with the framework conditions and inputs (policy, regulation, supervision, training, technical assistance) that enable them to provide sustainable access to financial services, especially at the village level and for low-income households. The GTZ ProFI program contributes to improving these framework conditions and inputs (especially for BPR) at the national level. At the level of this proposed Project in the NAD Province, small and microfinance institutions will be rehabilitated again with a quick restoration of services to the targeted clients, but close collaboration will be sought with nationally operating programmes such as ProFI in order to ensure a long term impact on the services provided and the microfinance institutions themselves.

94. National Microfinance Policy: In addition to this purely technical coordination and synergising, the project would also aim to spearhead the current work in the country to provide best practice examples and concrete models for replication in other impoverished regions of Indonesia. The Aceh Province was exceptionally hard hit by the recent disaster, but the entire east, West Papua etc. are largely without any functioning financial infrastructure at all.

95. Provincial and Local Workshops: The ILO initiated workshop for microfinance support in NAD Province constituted a well timed initiative to bring together microfinance practitioners, local policymakers and donors. What was still missing were concrete examples of donor support for microfinance development. After 6 to 12 months of project implementation, GTZ may consider organising a follow up workshop with ILO, this time not focussing on intentions, but on actual results to be delivered in the meantime.

96. In this context, the continuous and close dialogue with the central bank, the Bank Indonesia, as the partner and domestic owner of this project will likewise be crucial. Since ProFI is located in the central bank in Jakarta, the main focus of this project would be to closely coordinate activities with the B.I. Office in Banda Aceh. This would be greatly facilitated by posting one of the two proposed international TA directly into this office. Similarly, close collaboration and continuous exchange of views and policy guidance should be ensured by posting the second international TA within BRR (Badan Pelaksana Rehabilitasi dan Rekonstruksi, NAD), the local Regional Rehabilitation and Reconstruction Agency established by the Government after the December 26 events.

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<sup>25</sup> [www.profi.or.id](http://www.profi.or.id)

## 5. Sunset Clauses and Exit Scenarios

97. The project time frame is strictly limited to four years. With a clear and simple overall objective of accelerating the reconstruction and service provision of microfinance providers in NAD Province, there are two challenges in terms of ensuring the long term impact and integration of the project activities into domestic economic development.- These relate to (i) the mix of capacity building measures offered, and (ii) arrangements for the credit fund.

98. Project Capacity Building – A Regional Modular Extension of the ProFI Service Menu: This mission does not recommend exit scenarios for the capacity building work of this project that are any different from those of the regional outreach programmes undertaken by ProFI. The same transfer arrangements and institutional arrangements that would be envisaged for ProFI at the time, should be applied also to this small project.

99. Project Credit Fund: Negotiations about the launch modalities of this fund are still ongoing. As argued above, this fund would usefully complement the Technical Cooperation activities.

100. Financial arrangements after project closing would depend on the modalities of fund transfer from the European bank. If it is a repayable loan, then a coordinating bank would have to be appointed at the end of the project based on specifications to be agreed upon (length of lending period from European bank, formal recipient of loan, replenishment arrangements into the fund, use of reflows, use of excess income over expenditures). If the funds come as a non repayable grant, then successfully repaying institutions could be capitalised, the loan fund could be auctioned among local banks with the use of the proceeds to be specified in the management agreement between GTZ and the concerned bank.

101. It is recommended to draft a management agreement as a tripartite arrangement between the bank, the recipient in Indonesia (the BRR Regional Recovery and Rehabilitation Agency or a commercial bank that holds these funds in trust) and GTZ as the managing entity, as soon as the framework agreements and wishes of the concerned European commercial bank reach a more final stage.

## VI. Investment and Technical Cooperation Risks

102. The final section of this report summarises the main risks for the two types of main activities planned under the proposed project, technical assistance and the provision of a loan fund.

### 1. Inadequate Infrastructure Rehabilitation in the Province

103. Movements within the province are still badly affected by destruction. This applies above all to coastal districts<sup>26</sup>. Even though large international donors are focussing precisely on this aspect of quick rehabilitation of infrastructure destroyed, movements of specialists, but also cash in transit, etc. will remain exposed to higher than usual risks for the time being. There are no possibilities at hand for this project or the German Technical Cooperation to directly influence the speed of recovery.

### 2. Security Risks

104. Banks and other financial institutions had problems in developing their markets and clients in the NAD province. This is due to the security problems which have lasted for more

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<sup>26</sup> Reuters ("U.S. begins rebuilding major Aceh road after tsunami") informs in August that "...the first (!) post-tsunami infrastructure project...got underway...with the awarding of an initial contract of US\$ 245 mn. Large parts of the 240 km west coast road linking the provincial capital Banda Aceh and the city of Meulaboh were destroyed and are to be reconstructed. One of the challenges will be the (re) construction of 110 bridges in the process.

than 30 years in the province. A recently completed Peace Agreement between the Government and the GAM rebel movement offers hope for a large scale laying down of arms and more security for the province in future. Even though the agreement is promising and required both sides to compromise substantially, it is not sure whether the positive effects of peace on security and economic development in the province will last in the medium to long term.

### 3. Non-sustainable Competing Microfinance Activities

105. As experience in other countries affected by the Tsunami and already awash with different donor activities shows, there is always a risk of undercutting market terms and conditions in order to gain a quick and easy market entry. Mostly, the institutions that on-lend funds below market rates are subsidised by government since they do not generate the margins to operate out of their own earnings. Because of its planned early placement of project staff, GTZ together with the partner BI will however have the possibility to influence the policy dialogue and concrete arrangements with other donors to ensure that microfinance support remains sustainable at all levels and minimises subsidies at the end use level in order to avoid credit rationing and the receipt of funds by more influential upper strata of society rather than those most in need of capacity building and credit support.

### 4. Summary Risk Assessment

106. The summary risk profile for technical and financial cooperation projects in the Province has to be judged substantially higher than in comparable locations that were not affected by a natural disaster, guerrilla warfare and multiple donor presence. As far as the strengthening of sound business practices for microfinance institutions and their clients is concerned, the planned project is likely to have a major impact because of the first mover advantage of GTZ as an international donor agency and in rehabilitating MFIs in the NAD Province, and because of the presence in the province of international staff supported directly by the central bank