

# DEVELOPMENT POLICY AND STRATEGY OF INDONESIAN BANK TO SUPPORT SUSTAINABLE FINANCIAL SERVICES TO MICRO, SMALL AND MEDIUM ENTERPRISES

By: Sri Mulyati Tri Subari

## I. INTRODUCTION

- 1) In terms of accelerating the process of economic recovery, the government has committed itself to improve and develop various economic sectors. As a result, focus will be on various sectors, namely micro, small and medium enterprise or UMKM. From various aspects, these sectors play a highly strategic and significant role in the process of economic recovery in Indonesia. Firstly, these sectors have a large number of industrial branches that are located in each economic sector. According to the Statistic Central Body (BPS), there are 41,36 million units or 99.9% of the total enterprise units (2002 data). Secondly, it has great potential in absorbing human labor. Each investment unit at the UMKM sector can create much more job opportunities in comparison with similar investments at large enterprises. The UMKM sector absorbs 76.55 millions human labor or 99.5 % of the total work force who are in the work force. Thirdly, UMKM contributes significantly to the formation of PDB (approximately 55.3% of the total PDB).
- 2) Bank Indonesia's attempts to promote and extend UMKM in the national economy are done by encouraging the provision of credit banking to UMKM. Other initiatives include having policies, as well as strategies to empower the BPR industry as a micro finance body that possess a strategic role in providing micro finance service to UMKM. The BPR's success in providing services to UMKM mainly accrues to the following factors: (i) The office is located amid the community; (ii). The service procedure to the customer is simple, with priority on a personalised approach, flexible lending model and pattern
- 3) From the banking viewpoint, the credit provision to UMKM is profitable to the concerned bank. Several factors account for this profitability. Firstly, there is a low rate of ***non-performing loans***. This is particularly as a result of the high rate

of small enterprises customers' repayment, which are possibly higher than that of big enterprises. The non performing loans of UMKM recently is as much as 4.4 %, smaller than that of total banking credit (6.2%). Secondly, credit provision to UMKM will encourage risk distribution, since the credit is distributed to small enterprises with small amount of nominal credit. This policy enables banks to multiply its customers to ensure that credit distribution is not just concentrated to a certain group or trade sector. Thirdly, UMKM credit with relatively greater number of customers will add to the credit portfolio diversification as well as spread the risk of credit distribution. Fourthly, a credit interest rate that follows market interest rate is not a main problem for UMKM. By doing so, this enables banks to gain available profits. Recent experiences indicate that the availability of the fund at a right timing, with right number and right target administered by a simple procedure is more important than having low interest and administered through a subsidiary.

- 4) The distribution of new credit to UMKM's customers appears to continue to increase significantly with relatively low non performing loans. The new credit distributed to the UMKM sector through banking enterprises during the first quarter of 2004 amounts to Rp 30.9 trillion or 80.4 % of the banking business plan. This will distribute to the UMKM credit as much as Rp 38.5 trillion. With this growth, the credit outstanding of UMKM in the late June 2004 is as much as Rp 243,8 trillion. This is approximately 49.6 % of the total banking credit that amounts to Rp 491,4 trillion. The growth rate of UMKM sector during the first quarter of 2004 rises by 14,3 % compared with the total credit growth of 11.8%, inclusive of as many as 17.2 million UMKM credit accounts.
- 5) Most of UMKM credit is used in the production sector that amounts to 52.7 % (working capital credit 42.2 % and investment 10.5 %), with consumption purposes taking up 47.3%. Allocation of UMKM credit based on the scale includes micro credit amounting to Rp 101,3 trillion (47,5 %), small enterprises credit amounting to Rp 50,3 trillion (23,6%), and medium enterprises credit amounting to Rp 61,7 trillion (28,9%). Comparing the lower NPLs with the total banking credit, it has been proven that the credit risk distribution to UMKM is relatively small and it remains profitable from business side.

## II. POLICY AND STRATEGY OF THE DEVELOPMENT OF SMALL AND MEDIUM ENTERPRISE BY BANK INDONESIA POST REGULATIONS NO.23/1999

1. With the application of Bank Indonesia Regulations No.23/1999 that is replaced by Regulations No.3/2004, the policy of Bank Indonesia in assisting small enterprise and cooperative has undergone fundamental changes. Bank Indonesia are unable to provide any more the financial aids to UMKM that used to be popular as KLBI\*. Thus, the role of Bank Indonesia in helping small enterprises are now conducted indirectly, mainly in the form of technical assistances and institutional building.
2. In accordance with the Regulations, since 16 November 1999, the task to manage program credit has been redirected to three BUMN (state corporation) designated by the government, namely: PT BRI, PT BTN, and PT PNM. In this case, **PT BRI** serves as the coordinator of the credit scheme distribution for KUT, KAKop, and KKPA-TR; **PT BTN** for KPRS and KPRRS; and **PT PNM** for other credit needs. The redirection includes the management of KLBI with regards to the redirected program credit.
3. The agreement between Bank Indonesia and the three state corporations which was stipulated on 16 November 1999 in relation to the redirection of program credit amounted to Rp 23 trillion. This consists of Rp 18,7 trillion in the form of debt and Rp 4,3 trillion in the *flexible drawing position*.
4. In addition to redirecting program credit. it also stipulates two-step-loans with oversea funds, as well as technical assistance regarding program credit distribution to the designated BUMN. This is done as long as there is a body that can replace the implementation of the technical assistance work. By considering the important role of UMKM in generating various economic aspects and accelerating economic recovery activity, Bank Indonesia remains completely supportive in the growth of the UMKM. This support is required to encourage the recovery of the banking intermediary function and to create a healthy banking condition.

5. In relation to supporting the empowerment and growth of UMKM, particularly to encourage the credit distribution to UMKM, the Bank Indonesia has initiated the following: a) banking credit policy; b) provision of technical assistance to UMKM through Financial Consultant of Bank Partner; c) research pattern/model of financing UMKM; d) provision of information system of financing small trade and technical assistance.

a. Policy of the banking credit

With regards to concerns about creating a healthy banking system as well as encouraging UMKM activities, the Bank Indonesia applies strategies and policies to assist the extension and empowerment of UMKM that encompass:

1. Formulation of Small Enterprise Credit

On 4 January 2001, the Bank Indonesia completed the formation of the Small Enterprise Credit (KUK) through The Regulations of Bank Indonesia PBI No.3/2/PBI/2001 regarding "Provision of Small Enterprise Credit". This means that the Bank Indonesia will not oblige but suggest the banks to distribute KUK in accordance with their business plans. Nonetheless, the banks have an obligation to report their rate of attainment in distributing UMKM credit.

2. Cooperation with the government to cope with poverty

On 22 March 2004, the Bank Indonesia signed the Memorandum of Understanding (MoU) with the government in relation to utilizing the poverty reduction policy via the empowerment and development of UMKM. The aim of this MoU is to empower poor people and families, including women through the extension of micro, small and medium trade related to the poverty reduction policy. According to the business plan 2002, 14 (now 13) banks comprises 80% of the national banking asset (systematically banking asset). BPR also gave the UMKM sector as much as Rp 30.89 trillion that consist of micro trade credit Rp 4.41 trillion, small enterprise credit Rp 12.7 trillion, and medium enterprise credit Rp 13.8 trillion. Through good cooperation of all parties, the banks managed to realize the business plan above the initial target by 116% (which is Rp 35.0 trillion as of 2002 data). In 2003, the target of banking credit distribution to UMKM increased to Rp 42,4 trillion or 50,6%

of the total banking credit expansion at the same period. The new credit distributed through banking enterprises to UMKM during 2003 amounted to Rp 27.0 trillion or 63,8% of the total banking business plan. According to the business plan 2004, the banks will distribute credit to UMKM, consisting of as much as 38.4 trillion. This is splitted specifically as: Rp 13.6 trillion to micro trade, Rp 10.5 trillion to petty trade, and Rp 14.3trillion to medium enterprises' trade. As a result of this business plan, the banks managed to build up credit as much as Rp 30,9 trillion or 80,4%.

3. Adjusting to the banking policy and considering *prudential banking principles*, the prevailing Regulations of the Bank Indonesia issues PBI No.4/6/PBI/2002 regulating that: the *calculation of the collective credit up to Rp 500 millions* is only based on the capability to pay.

4. Facilitating the meeting between the government, banking and business community

The meeting between the banks that consists of the Bank Indonesia, the banking community and business community is purposed to intensify the communication of the two sides having mutual interest. This forum is expected to be able to follow up recommendations steaming from business community's problems so that it can be realized and utilized by Bank Indonesia as well as the banking community to encourage real sector. In addition, the forum also held a bazaar on banking intermediary in the offices of Bank Indonesia, which may unite the banking community and UMKM.

b. Empowerment of Financial Consultant/Assistant of UMKM as Bank Partner

The empowerment of the KKMB consultant is purposed to follow up the joint agreement between Bank Indonesia and the Committee of Poverty Reduction (KPK) on the formation of Task Force for empowerment of Financial Consultant of UMKM Assistant as Bank Partner (KKMB). The formation of this KKMB is intended to empower the consultant/assistant: both the private assistant and the government-formed, who have been involving in developing UMKM recently.

This approach is influenced by some reasons. The reasons include: (i). the encouragement of the realization of the banking business plan to the productive enterprise sector; (ii). the limited human resources and banking network to access UMKM; (iii). the large potential in UMKM that has yet to be identified by banks; (iv). the limited UMKM's access to banks is due to poor experience and lacking collateral as well as the great number of the trade consultants/assistants in the community who need optimal zing to enlarge access to the more productive sector.

The success of this approach will be visible from the increasing number of the bankable UMKM, credit from banks and KKMB operating under business management (mutual profit-sharing), becoming self-supporting groups. Insofar, 26 KKMB's empowerment task forces in 22 provinces have been created, with the involvements of BMPD (deliberation body of the local banking), local KPK or the connected local administration/official.

c. Research Activity

Currently, research activities of the Bank Indonesia related to UMKM are particularly focused on searching for a model or pattern of financing and technical assistance in accord with the needs to assist the growth of UMKM. Moreover, research activities are also proposed to exploit the UMKM sector's potential in each local area of Indonesia. Under these circumstances, research activities conducted by the Bank Indonesia includes baseline economic survey in almost all of provinces, micro credit research, PHBK, KKPA, technical assistance, and lending model. The other research to be undertaken is about the core-plasma relation (INTI PLASMA) and the UMKM's financing model/pattern that is beneficial to the banking community as well as the broad community.

d. Provision of Information System

As an initiative to provide surplus value and greater advantages of the research outcome, the Bank Indonesia has developed an information system on small enterprise development (SIPUK) as a tool to disseminate quickly the

research outcomes and other information. SIPUK encompasses the Baseline Information System of Economic Survey (SIB), Information System of Export-Oriented Agro-industry (SIABE), Information System of Lending Model (SILM), Information System of Decision Supporter for Investment, (SPKUI) and Information System of Procedure to Get Credit (SIPMK).

Currently, SIPUK is accessible to anyone through the internet via the Bank of Indonesia's site ([www.bi.go.id](http://www.bi.go.id)). This can be utilized by the large community, either by UMKM enterprise, banking community, government agencies to nurture UMKM's potential. Since SIPUK's launch on 14 February 2002, it has now been accessed by more than 63,000 people.

- e. Bank Indonesia established the Service Provider Management Center in West Java that provides assistance and consultation to UMKM as the bank's strategic partner. It is possible that this kind of activities can be developed and implemented in other regions as well.
- f. To intensify Bank Indonesia's technical assistance activity, the bank issued regulations PBI No.5/18/PBI/2003 on 9 September 2003, regarding the provision of technical assistance in Developing UMKM. This publication is expected to promote the banking and UMKM perspective in distributing UMKM credit more extensively. The arrangement of technical assistance activity is extended so that it is not only focused on banking, but also on UMKM through the Business Development Service Provider that will hold assistance and construction activity to UMKM. This activity can encourage the program of Financial Consultant of Bank Partner that is also being developed, particularly with regards to the training for UMKM. Alternatively, UMKM's access to banking capital is expected to grow increasingly.

### III. POLICY AND STRATEGY OF DEVELOPMENT OF BPR INDUSTRY

1. During the last three years, the BPR industry indicates a pleasant growth as reflected in some indicators. The business volume increased 94% from Rp 6.5 trillion in 2001 into Rp 12.6 trillion in 2003. At the same period the third party's fund rose

107% from Rp 4.3 trillion into Rp 8.9 trillion and the lent credit increased 89% from Rp 4.9 trillion into Rp 9 trillion. The rise of financial performance is also followed by the drop in non-performance loans rate from 11.8% at the end of 2001 to 7.9% at the end of 2003.

Till the end of March 2004, the indicators above indicates the increasingly consistent growth, with business volume as much as Rp 13.4 trillion, the third party's fund rose to Rp 9.3 trillion and the lent credit rises into Rp 9.4 trillion. At the same period, up to the end of March 2004, BPR encompass 2.148 central offices, among others 85 BPRs operate under **syariah** principles, out of 140 branch offices and 1.018 cash-service-offices.

2. It is understood that many obstacles must be overcome by BPR in order for it to sustain the achievement. We understand that the industrial growing BPR constitutes aggregation of BPR's individual growth that depends on the supporting factors of the inner circle of each BPR itself.

3. Some findings from baseline survey in 2002 indicated that one of the success keys in the BPR growth is the availability of qualified and professional human resources, conducive regulations, effective supervision, standardized information technology, as well as adequate capital.

4. With regards to that matter, the Bank Indonesia has arranged a strategy for the development of BPR to support the sustainable growing BPR industry in order to meet its function to serve UMKM. The applied strategy is also parallel to Bank Indonesia's Vision invested in the Architecture of Bank Indonesia, particularly in promoting BPR's competitive power.

The applied strategy and policy includes:

a) Remedial program of BPR

This aims to encourage the BPR industry to take the initiative to restructure its body. The BPRs overwhelmed with structural obstacles are encouraged to arrange the restructuring program through the exit policy of the Bank Indonesia. Bank Indonesia will lift its business license of BPR either by a restructuring program or acquisition.

The remedial program of this BPR is also endorsed with completing formulation on the collateral program implementation by issuing Regulations PBI no.5/17/PBI/2003 on 3 September 2003 to replace PBI No.3/12/PBI/2001 (issued on 9 July 2001) on Terms and Procedures of implementation of government collateral to the BPR's due debt. PBI, among other things, incorporates the perfection of the terms for government collateral program, implementation of government collateral payment, and the terms of BPR's guaranty.

b) Perfection of Arrangement and Supervision to BPR

Bank Indonesia continually initiates to complete the policy formulation of BPR. In relation to this policy, Bank Indonesia issues some regulations. These regulations include: Regulations No. 6/22/PBI/2004 on BPR (Popular Credit Bank), and Regulations No.6/23/PBI/2004 on 9 August 2004 on Fit and Proper Test to BPR. The new policy formulation on BPR among other things includes enlarging the service network through branch offices by considering prudential aspects/principles. In addition, services can be carried out under the perspective of the availability on the capital support in order for BPR to operate efficiently. Furthermore, in connection with the reconstruction of the structure of BPR industry in the future, the Bank Indonesia considers that capital serves a strategic function in promoting BPR's capability to finance. This is apart from encountering competition with other similar financial bodies. In the policy formulation of BPR, deposited capital can be raised provided there is enough time and with predictable implementation steps. Concerned with achieving the targeted capital condition, Bank Indonesia encourages BPR to take strategic steps either by merger, consolidation, or acquisition. In the mean time, formulation on Fit and Proper Test is an effort to endorse the good governance through BPR's management by BPR's managing board with high integrity and competence. In the future, Bank Indonesia will continue a study to complete the prudential principles of BPR and improve BPR's database as an early warning system to supervise BPR.

c) Capacity Building

With regards to the capacity building of BPR, Bank Indonesia takes steps to enhance the linkage program between BPR and the common banks. It has been largely understood that the linkage program is a strategy to help overcome the limitedness of the common banks in financing UMKM via BPR. Based on the

acceptable information until March 2004, there had been 28 linkages of the common banks (including PT PNM) with 945 BPRs with credit limited to as much as Rp 697 milliard and **BAKI DEBET** as much as Rp 409 milliard. Concurrently, Bank Indonesia was researching on the implementation impact of the linkage program towards credit distribution to UMKM and promotion of BPR's performance. Henceforth, the final objective was to arrange a policy that will encourage the common banks to distribute credit to UMKM via BPR.

d) Institutional Building

In relation to facilitating the formation of the joint service to empower BPR industry institutionally, Bank Indonesia is making a study on the formation of APEX body (particularly the formation rules and its operational application) for BPR, in an attempt to help the organization to overcome its liquidity mismatch.

It is not necessary the case of reaffirming the promotion program of the BPR's competitive power through new formulation in opening branch offices. Instead, the linkage program promotion between BPR and common banks, as invested in the Architecture of Indonesian Bank (API) increasingly assert the BPR's strategic function in keeping its functions sustainable.

5. Another strategic effort in improving BPR's human resource quality systematically through the professional certification program has already legalized by the Governor of Bank Indonesia on 12 July 2004. This program is motivated by the awareness that the whole development strategies of BPR above require special support in the form of availably qualified and professional human resource in the BPR itself, in order for the arranged BPR's development strategy to be implemented well and able to survive.

The certification program above is directed to stipulate standards that may improve BPR's performance, enhance the qualification and competence of BPR's human resource and management, strengthen BPR's competitive power and trust rate as well as endorse Fit and Proper Test of the director and the prospective director of BPR. The final objective of this certification program is the actualized efficient, healthy, and strong BPR.

The certification program is undertaken through a process of studying done by the National Task Force (NTF) that consists of association of BPR (Perbarindo), Training Center of Bank Indonesia (LPPI), Bank Indonesia and international bodies that are concerned with the development of micro finance body, including BPR, namely GTZ-ProFi and Bankakademie.

The program above will be implemented by a **certified body** verified by the **Certification Board**. This is assumed to be competent enough to determine the purpose of the certification policy to guarantee the implemented certification system. The **National Curriculum Committee** functions to carry out research and development in relation to guarding the certification system and the code of conduct as well. On the other hand, the **Managing Board** will manage the daily activities of the certified body.

The professional certification program of BPR will be applied to all directors and prospective directors of BPR across Indonesia. Nevertheless, by considering the number of BPRs and the distributed locations, the entire program implementation will proceed step by step in accordance with the stipulated plan.

To maintain its sustainability, this program will be carried out autonomously by BPR as the beneficiary. Under these circumstances, BPR can utilize the education fund that has been saved, on the condition that they are obliged to provide education and training funds as much as 3% in 2004 and 5% in 2005 (calculated from the labor cost of the previous year). Nonetheless, in the short term (up to 2006), Bank Indonesia will help provide the training cost (maximum 5%) for each BPR's director.

The strategic role of BPR's human resource in achieving a healthy, efficient and strong industry is asserted in the Regulations of Bank Indonesia PBI /No.6/22/PBI/2004 above. Each BPR's director is obliged to possess a certificate issued by Professional Certification Body of BPR (namely a director) at the latest by the end of 2006. The rest of the conditions can be met by the end of 2008. Moreover, the proposed prospective director is obliged to possess this intended certificate at the time as the investor appeals the business permit on BPR foundation.

6. In the future, the Bank Indonesia persists on initiating to develop the arrangement of blue print of BPR that is a part of the national banking blue print (Architecture of Bank Indonesia). BPR's institutional structure that will be arranged in the blue print is directed at the BPR's body based on limited branch banking system, that is limited only one in each province with some reasons, namely:

- BPR as bank community serves the productively micro trade and poor community.
- The service is conducted face to face which needs networks to enlarge the outreach.
- The activity is managed by commercial approach /market oriented to maintain its sustainability, where the BPR can be seen as commercial micro banking.