

The Future of Asia Microfinance Perspective of Indonesia

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MICROFINANCE DEVELOPMENT

Early Stages in 19 Century

- * The corner stone of microfinance in Indonesia was laid by Raden Aria Wirjaatmadja – the founding father of Bank Rakyat Indonesia – when he established *De Poerwokertosche Hulp en Spaarbank der Inlandsche Hoofden* (People Credit Bank) in 1885
- * This institution became popular among the communities particularly in helping indigenous people lifted out from money lender trap
- * Another microfinance institutions were created: Paddy Bank (Lumbung Desa) & Village Bank (Badan Kredit Desa) across Java & Madura islands and Pawnshop (Pegadaian)



MICROFINANCE DEVELOPMENT

The Era of 1970s

- * The next phase of microfinance development started in early 1970s when the government introduced Rice Self Sufficiency Program (BIMAS)
- * Government pointed BRI to establish 3600 BRI Unit Desa offices (the initial name of BRI-Unit) to support the program
- * BRI-Unit majority operated in the rural area of major islands such as Java, Sumatra, Bali etc
- * The main role of BRI-Unit was to channel subsidized loans to peasant farmers who joined the BIMAS
- * The operation of BRI-Unit system was supported and controlled by the government



MICROFINANCE DEVELOPMENT

Attributes of Microfinance in 1970s:

- * Microfinance landscape was dominated by BRI-Unit. Other institutions such as government pawnshop, people credit banks, village banks operated in limited capacity & coverage
- * Financing approach was supply leading. The government provided subsidized loan and controlled the interest rate
- * The program specially designed for rice farmers to conduct on-farm activities & partially non-farm activities. There was also subsidized loans (KIK/KMKP) for native Indonesia entrepreneurs which managed by state-owed banks
- * Source of funding solely provided by the government from oil revenues and assistances from international donors (World Bank & FAO)
- * Indonesia was awarded by FAO as Rice Self Sufficient country



MICROFINANCE DEVELOPMENT

Period of 1980s - 1990s

- * Early decade of 1980, BRI-Unit performance declined significantly which accounted massive losses and very high non performing loans. In general, BRI-Unit operation was unsustainable
- * Moreover, in 1983 government simultaneously transformed the banking system though releasing interest rate ceiling & allowing bank to mobilize public funds. Subsequently, the changes allowed BRI-Unit to operate under commercial practice.
- * Bank Indonesia (the Central Bank) introduced a new system of rural financial system through revitalizing People Credit Bank to become Rural Bank (BPR), and Paddy Bank & Village Bank into Village Credit Body (BKD)



MICROFINANCE DEVELOPMENT

Period of 1980s - 1990s

- * A serial of banking deregulation such as PAKTO 1988 and the new Banking Law 1992 have significantly changed banking industry & microfinance structure. For example rapid development of BPR due to low requirement on capital & banking skill
- * More microfinance programs were developed particularly by local government such as District Credit Body (BKK), Saving & Credit Institution (LPD) etc
- * Those microfinance were designed to alleviate poverty & microenterprise development programs
- * During economic crisis, the presence of microfinance sector was stronger to respond the needs of poor households & microenterprise



MICROFINANCE DEVELOPMENT

Key Issues of Microfinance (1980s- 1990s)

- Demand driven & growing commercial approach. Subsidy-based practices were mostly related to poverty alleviation and agricultural sector
- Loose competition among microfinance providers
- Public saving & deposit increased as the sources of lending
- Economic crisis affected the performance of BRI which many BPR were seized & closed due to very high bad debt. Most of BPR failed to provide provision for loan losses and insufficient capital to cover the losses
- A new government-owned has been created (namely PT. Permodalan Madani/PNM) to support microfinance institutions but its role relatively limited



CURRENT ISSUES ON MICROFINANCE

Microfinance has been an Emerging Industry

- Microfinance has been widely accepted by public and private sector. The industry is viewed as an effective tool to help low income people getting access financial services. Microfinance role is to substitute the presence of banking system where more desire to serve "bankable customers"
- Commercialization of microfinance has progressed in different ways. Based on a study conducted by Asian Development Study (ADB), Indonesia is moving forward in term of scale, outreach and sustainability.
- The sector is heterogeneous but the main players are formal microfinance (commercial banks, BPR & state-owned pawnshop) which their funds sources based on public saving & money market



CURRENT ISSUES ON MICROFINANCE

Microfinance has been an Emerging Industry

- Semiformal microfinance such as BKD, LPD, BKK & LDKP relatively stagnant due to unclear regulation, limited capital, lack of human resources and bad governance
- Informal microfinance such BMT, NGO, ROSCA, money lender etc are still exist in the communities through providing traditional financing mechanism. BMT uses Islamic financing model & in many cases, NGO use integrated approach (microcredit + empowerment)
- Competition in urban area increase sharply involving leading commercial banks such as BRI-Unit, Bank Mandiri (the biggest bank in the country) & Bank Danamon (a foreign owned bank), BPD & BPR. While in sub-urban and sub-district, BRI-Unit remains the market leader



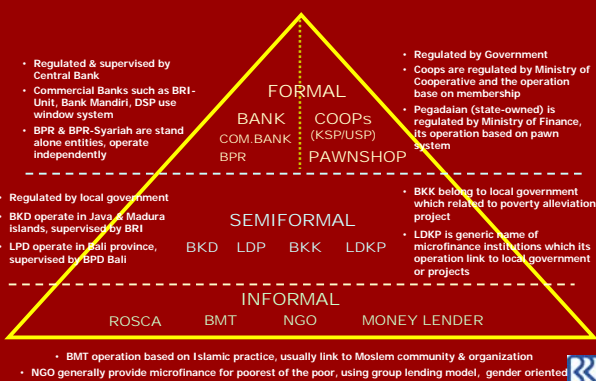
CURRENT ISSUES ON MICROFINANCE

Microfinance has been an Emerging Industry

- BRI-Unit, Bank Mandiri, Danamon Simpan Pinjam (DSP) employ downscaling model by establishing semi-autonomous microbanking units.
- Bank Indonesia have promoted a linkage program between commercial banks and BPR. The initiative is to support funding of BPR. Recently, the program involves 13 banks and 39 BPRs with loan outstanding Rp 1.5 trillion
- Bank Indonesia has initiated the establishment of Apex Institution for BPR. In addition, PNM creates Apex Institution for local microfinance
- There is significant progress in the deployment of information technology (IT) to enhance online system, ATM and MIS. Some products & services have been link to IT, i.e. ATM card



MICROFINANCE STRUCTURE



MICROFINANCE STATISTIC

Institution	Unit No	Loan	Deposit	Client
BRI-Unit	4.328	Rp 22.8 Trillion	Rp 36.7 Trillion	36.5 million
BPR	2.066	Rp 10.4 Trillion	Rp 9.2 Trillion	8.0 million
Pegadaian	797	Rp 7.6 Trillion	-	12 Million
Cooperative	37.386	Rp 4.4 Trillion	Rp 1.5 Trillion	951 Thousand
BKD	5.345	Rp 209 Billion	Rp 33 Billion	640 thousand
LDKP	1.620	Rp 337 Billion	Rp 342 Billion	1.3 million

Note: The figures are collected from various sources and reflected different fiscal years for example BRI-Unit based on 2005, BPR & Pegadaian based on 2004, BKD based on 2005, Cooperative & LDKP based on 2002



CURRENT ISSUES ON MICROFINANCE

Microfinance as an Inclusive Financial System

- The government has been established Deposit Guarantee Institution which insures public deposit including BPR. This initiative will increase public confidence on BPR system, in turn will strengthen their funding structure
- To respond global initiative to bring microfinance as an inclusive financial system which integrate to financial mainstream, there are several efforts to promote & to empower microfinance sector. One of key issues is refocusing the roles of government as a regulator & facilitator
- However, the government supports are needed to strengthen poverty reduction program, i.e. to support the poorest of the poor through non-interest financing & empowerment



THE FUTURE OF MICROFINANCE

Opportunities & Challenges

Iceberg Phenomena



Banking
Horizon

- There are 36.1 million people (16.6%) who are living below the poverty line. In addition, the number of citizens who earn income less than US\$ 2/day approximately 100 million
- Statistic shows more than 40 million Micro & Small Enterprises (MSE) in Indonesia economy system. The statistic shows less than 10% of those are served by formal microfinance (bank & BPR). Majority of microentrepreneurs familiar with semi-formal & informal microfinance
- The major constraints of MSE to access financing are lack of formal licenses, financial statement, business plan, adequate & marketable collateral, sharing of capital etc
- Character of business such as seasonal based production (agriculture sector), geographic condition (remote & scatter), lack of infrastructure weaken the attractiveness of microenterprise sector therefore formal institutions are reluctant to serve the segment
- Those constraints have created Iceberg Phenomena which only bankable clients can access the financing scheme, on the other hand, viable & prospective clients (but unbankable) are unable to access sustainable financing resources. **Microfinance can be a solution**



THE FUTURE OF MICROFINANCE

Opportunities & Challenges

- Microfinance is a critical issue in the National Development Strategy on reducing poverty and economic development.
- The domain of government focus on creating conducive business environment, adequate legal framework, institutional & capacity building in order to provide sustainable financial services to poor households & microentrepreneurs
- Commercialization of microfinance is moving forward since the market mechanism has created positive impacts to the industry financial system and the whole economy.
- However, the government must insure the interest of all stakeholders are properly protected, through setting an equal level of playing field, incentive & punishment system, customer protection etc



THE FUTURE OF MICROFINANCE

Opportunities & Challenges

- In very short time, competition among formal institution will be tight. More new comers will penetrate the bottom of the pyramid market, in turn will create opportunity to poor clients having access to financial services
- There will be explosive growth in new products and in use of technology. Credit cards, smart cards and others will be added to products. Technology will make the administrative work of the loan officers more efficient, lower costs & convenient
- Microfinance network will increase and attach to the financial mainstream such as money market & capital market. Global funds & investors will aggressively look for emerging investment in microfinance



MICROFINANCE SNOWBALL

The progress of microfinance industry can be illustrated like a snowball which will increase in term of business volume, outreach and impact

