

PD-ABN-315

PROGRESS REPORT #1

**INSTITUTIONAL TRANSFORMATION FOR SCALE AND SELF-SUFFICIENCY:
A for-profit Approach to Poverty Lending in Indonesia**

For the period:
October 1995 - September 1996

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TABLE OF CONTENTS

	Table of Contents	i
	List of Acronyms	ii
I.	Project Synopsis	1
II.	Summary of Activities During this Reporting Period	1
III.	Status of Project Related Activities	1
	A. Holding Company Structure	2
	B. Investment Committee	2
	C. PT. UKBM staffing	3
	D. PT. UKBM Investment in New BPRs	4
	1. YAPENSKAK - BPR SONBAY	4
	2. YSBS - BPR BMMS	4
	3. ETADEP	5
	4. Training and Apprenticeship Program	5
	E. Investments In Existing BPRs	5
	1. BPR BIAS	5
	2. BPR GERBANG PROSPEK	6
	3. NUSUMA	7
IV.	Technical Supports and Visits	7
	A. Technical Support	7
	1. SEDTU/SIDI Technical Visit - November 29 - December 8, 1995	7
	2. SEDTU/SIDI Technical Visit - March 18 - 17, 1996	8
	3. SEDTU/SIDI Technical Visit - July 27 - August 3, 1996	8
	4. USAID Office of Micro enterprise Development - July 27 - August 3, 1996	8
V.	Constraints and Problem Encountered	8
	A. Staffing Constrains	8
	B. Legal Constrains	9
	C. Delays in Starting the Grant	9
	D. Chnaging Regulatory Environment	9
VI.	Future Plan	9
	A. PT. UKBM Legal Status and Staffing	9
	B. Investments	9
VII.	Budget	10
	Attachment 1. Performance Information	
	Attachment 2. SIDI Technical Visit Report	
	Attachment 3. Projected Investment Pipeline	
	Attachment 4. Proposed Budget for FY 1997	

List of Acronyms

BPR	Bank Perkreditan Rakyat (Small Shareholder Bank)
CRS	Catholic Relief Services
ETADEP	East Timor Agriculture Development Program (an East Timor NGO)
NGO	Non-Governmental Organization
PT	Perseroan Terbatas (limited liability company)
PT UKBM	PT Usaha Karya Bina Mandiri (Self-Reliance Company)
SED TU	Small Enterprise Development Technical Unit
SIDI	Societe D'Investissement et de Developpment International (International Investment and Development Company)
USAID	United States Agency for International Development
YSBS	Yayasan Sosial Bina Sejahtera (Social Foundation for Welfare Development)
YSM	Yayasan Swadaya Membangun (Self-sustain Development Foundation)

PROGRESS REPORT

I. Project Synopsis

Award Number : PCE-0406-A-00-5040-00
CRS Project No. : 838-95-005
Project Title : Institutional Transformation for Scale and Self-Sufficiency: A For-profit Approach to Poverly Lending in Indonesia
Project Holder : Catholic Relief Services (CRS)
Project Period : October 1, 1995 to September 30, 1998
Project Funds
 USAID : USD 1,996,659
 CRS : USD 1,579,614
 Total : USD 3,576,273
Target Beneficiaries : 30,000 women
Organizing Services : 1 Holding Company (Self-Reliance Corporation)
 20 Small-holder Credit Bank (BPR)
Location of Project : Indonesia (Java, NTB, NTT, Southern Sumatra, Kalimantan)
Period of this Report : October 1, 1995 - September 30, 1996
Targets for the period of this Report:
 a. Establish 1 Holding Company
 b. Invest in 4 Small-share holder Banks (BPR)
 c. Serve 6,000 women
Accomplishments during the period of this Report:
 a. Established 1 Holding Company (PT. UKBM)
 b. Invested in 1 BPR (BPR BIAS)
 c. Served 1,500 women

II. Summary of Activities During this Reporting Period

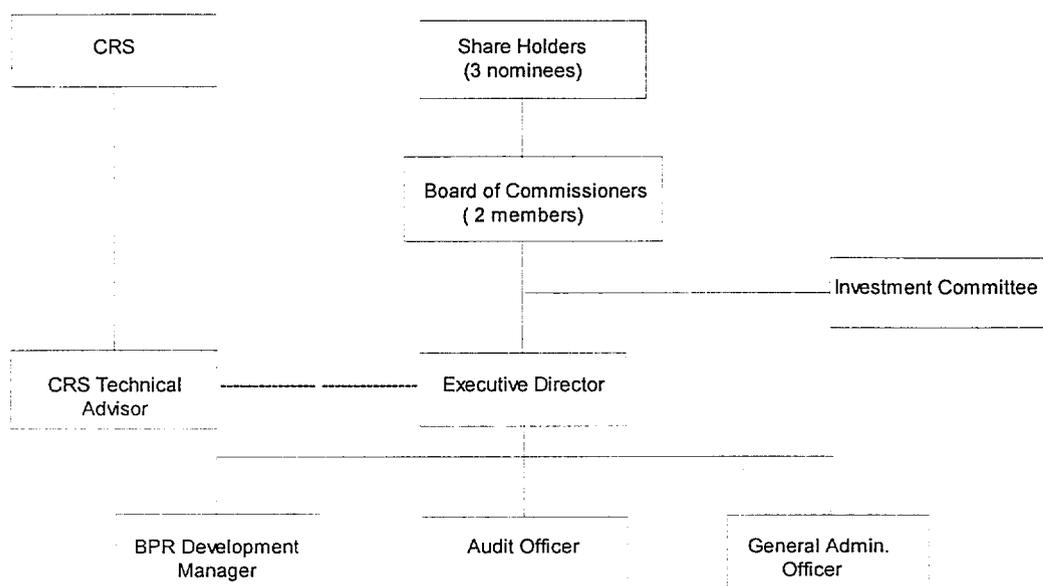
This report represents the first progress report for this grant, covering the period October 1, 1995 - September 30, 1996. During this period significant work has been done to set up the holding company structure, recruit holding company staff, and establish procedures to funnel investments to BPRs. In addition, investments have been made in one existing BPR located on the island of Sumbawa, and through technical visits, potential investments and business partners have been identified for the future. Progress in reaching the grant's first-year targets is slightly behind schedule (see Attachment 1) due mostly to the legal complexities of establishing the company and longer than expected time needed to recruit nominee shareholders for the holding company director.

III. Status of Project Related Activities

The main activity of this grant is to serve the financial needs of 30,000 women by developing a Limited Liability Company which will become the umbrella organization of 20 small shareholder credit banks (BPR). The following highlights specific activities that have occurred during this reporting period.

A. Holding Company Structure

The notary act establishing a general financial company (PT) named PT Usaha Karya Bina Mandiri (PT UKBM -- Indonesian Acronym for the Self-Reliance Company) was signed on April 16, 1996. PT UKBM was established with an issuances of 12,500 shares valued at Rp. 10,000 (\$4.30) per share and an authorized capital of Rp. 500 million (\$214,590). Currently there are three shareholders operating under a nominee share agreement with CRS. In addition, the company was established with two commissioners, who act as the shareholders representatives/watchdogs.



A nominee shareholder system means that CRS has recruited and signed binding agreements with three people who represent its ownership in PT UKBM. A nominee shareholders arrangement

was used because, as a foreign organization, CRS is not allowed to directly own shares in a PT making investments in BPRs. In the future, CRS plans to develop a local non-governmental organization that will eventually take over its shares in PT UKBM, and the nominee shareholder arrangement provides a temporary and legal solution to forming the company.

Moreover, utilizing the nominee shareholder system allowed CRS to involve experienced and trusted people in the development of this program. For nominee shareholders CRS recruited Mr. Kris Sindunatha, a successful local businessman; Fr. Albertus Schreus, a Catholic Priest who currently oversees the Church's finances in Indonesia, and Mr. Yahya Dikan, an eight-year employee of CRS in Indonesia.

B. Investment Committee

To ensure the quality and appropriateness of PT UKBM investments and to capitalize on the expertise of various actors involved in the process, an Investment Committee has been formed for the company. The purpose of the Investment Committee, a mechanism not usually found in company managements, is to quarterly review and approve the investments and loans of PT UKBM. See the organizational chart above for the position of the Investment Committee within PT UKBM's structure.

Because of CRS' relative newness in formal for-profit ventures, an Investment Committee is seen as the best way to insure the overall quality and appropriateness of PT UKBM investments. Comprised of a team of experts in banking, business and micro enterprise, the Investment Committee will ensure the company's investments balance its profit motives with its overall goal of serving the financial needs of the poor. The composition of Investment Committee will be the following:

1. CRS Indonesian Country Representative
2. CRS Micro Enterprise Specialist
3. SIDI Representative - As an organization that has participated in Latin America forums similar to this Investment Committee, SIDI Representation will provide experience as well as technical and business advise to PT UKBM investments.
4. PT UKBM President of Board of Commissioners - The President of the Board of Commission will represent the corporation and the shareholder at this meeting, as well as provide business and technical advice.
5. USAID Indonesia Representative - With a well-respected micro enterprise policy arm, the USAID Indonesia Representative will not be a voting member of the Committee but will provide context and technical assistance to the committee.

The first meeting of the Investment Committee was held on July 27, 1996 and was designed to explain the role and function of this group. The next Investment Committee meeting is scheduled for December 6, 1996.

C. PT UKBM Staffing

During the first year of the grant, a significant amount of time was spent by CRS recruiting the PT UKBM Director. Given the competitive market for financial service personnel in Indonesia coupled with the relatively unique social goals of this program, the ideal candidate was difficult to identify, and consequently, the PT UKBM director position was vacant for most of FY96. After approximately 20 candidates were interviewed, Rudy Prasetya was hired as the PT UKBM director in September, 1996. Mr. Prasetya contains a mix of business, marketing and NGO experience to balance the financial and social goals of this grant.

In the interim, CRS relied upon its in-house micro enterprise expertise, technical visits from SIDI/SED TU, and the appointment of a temporary Managing Director to facilitate project activity.

D. PT UKBM Investments in New BPRs

Although no investments were made in new BPRs during FY96, CRS provided technical assistance to two organizations forming BPRs and made a technical review visit to another group considering developing one. In addition, CRS provided BPR apprenticeship/training to four staff members representing four CRS partners who are considering BPR formation.

1. YAPENSKAK - BPR SONBAY, Kupang, East Nusa Tenggara (NTT)

As one of CRS' older micro enterprise development Counterparts, Yapenskak seeks to formally link , to a BPR, its UBSPs (saving and lending groups) program which currently serves the financial needs of 2,030 women. Proposal for the establishment of their BPR, to be named Sonbay, has been prepared by Yapenskak and reviewed by PT. UKBM. The proposal generally meets the Indonesian regulations for establishing a new BPR. Some minor changes are required, however, to sharpen the proposal before it is submitted to the Department of Finance and Bank of Indonesia (Central Bank) -- the two insitutions in charge of BPR approval and supervision.

BPR Sonbay is expected to obtain a Principal Permit by the end 1996 or in early 1997, and then obtain its Operations Permit by the first quarter of 1997 (March). BPR Sonbay will be located in the village of Oesao, East Kupang, Timor (NTT).

2. YSBS - BPR BINA MASYARAKAT MANDIRI SEJAHTERA (BPR BMMS), Klaten, Central Java

YSBS has been in partnership with CRS since the 1970's with Title II activities such as Food For Work, Food & Nutrition Project and Income Generating Activities (IGA). Currently YSBS continues to run the IGA program in the two southern central Java locations Cilacap and Klaten.

YSBS experiences in UBSP (Saving & Lending Group) development and facilitating linkages between Self-help Groups (UBSP) and Banks (recognised as PHBK program) is a valuable asset. The blend of IGA, UBSP and PHBK illustrates good potential for the formation of a BPR to serve poor women. Currently the YSBS Klaten serves 49 UBSPs with an average member size of 40 women per UBSPs. YSBS Cilacap serves 45 UBSPs.

CRS - YSBS collaboration to establish a new BPR has resulted in the award of a Principle Permit by the Department of Finance at the end of September 1996. The BPR, called BPR Bina Masyarakat Mandiri Sejahtera (BMMS - Community Development for Welfare & Self Reliance), will be located in the village of Jogonalan, Klaten, Central Java. The BPR domicile is now under preparation, and it is expected to start business by January 1997.

3. ETADEP, Dili, East Timor

During July 28-30, 1996, a team from CRS and SIDI was accompanied by a USAID team to conduct a technical assessment of ETADEP, widely acknowledged as the most influential NGO in East Timor. ETADEP was established in 1982 with USAID funds and continues to provide farming, water supply and credit services throughout the East Timor region. Its credit programs use a cooperative scheme that has 20-25 groups with a total membership of 2,500 (30-40% women) in 13 regions of East Timor. They have accumulated savings of Rp. 500 million. Despite its high savings rate, ETADEP provides a subsidized interest rate. In May, 1996 ETADEP contacted CRS about the possibility of forming a BPR. The team found the overall economy of East Timor to be flat and, perhaps not ideal for BPR formation. In addition, ETADEP's subsidized interest rate may make commercial BPR rates unattractive to customers. ETADEP has decided to rethink its BPR strategy at this time.

4. Training and Apprenticeship Programs

A three-month apprenticeship program was conducted in a BPR in Lombok to start developing human resource capacity among NGO staff. The program was attended by four micro enterprise managers from four NGO partners. The apprenticeship covered all aspects of BPR operations including credit, counter operations, accounting and field work to mobilize funds. In addition, topics stressed included business plan development and credit portfolio analysis.

E. Investments In Existing BPRs

1. BPR BIAS

BPR BIAS was created in June 1994, and almost at the point of bankruptcy before it was taken over in September 1995 by YSM. The initial shareholders are local entrepreneurs and local vendors. They had no banking expertise and no ability to supervise. They had political and military backgrounds and were looking for profit and political image. In September 1995, this BPR was running at a Rp 23 million loss. In reality, the stockholder did not pay the Rp 130 million equity, as

shown in the balance sheet, but only Rp 54 million. They then increased the portfolio figure by Rp 76 million to camouflage their trick.

Today, these initial shareholder own an additional Rp 5 million and YSM owns Rp 71 million. Thus capital composition is as follows (in million Rupiahs):

	<u>Initial</u>	<u>Increase</u>	<u>Actual</u>	<u>% ownership</u>
Initial share holders	54	5	59	46 %
YSM	<u>0</u>	<u>71</u>	<u>71</u>	54 %
Total	54	76	130	

In YSM's opinion, BPR BIAS will reach its break-even point by the end of 1996. YSM has proposed a realistic and feasible strategy which consists of restructuring the BPR management team, increasing the interest rate, accelerating savings mobilization, offering attractive remuneration for field workers and aggressively collecting loans in arrears.

In order to minimize investment risk, UKBM will wait for a year before acquiring share in BIAS. Since YSM owns two operational and profitable BPRs, namely BSK 1 and BSK2, UKBM has provided YSM with a Rp 100 million loan to be used to restructure BPR BIAS. This loan is secured by a pledge of collateral in BSK's share.

If, after a year and a half, BIAS proves to be profitable, CRS via UKBM will have the option to change the loan into an equity participation in BIAS at par value (see table below). If BIAS turns out not to be a good investment, UKBM will ask YSM to reimburse the loan or in the alternative, UKBM will take shares in BSK # 1 or 2 (20 % of the 100 % equity of the company).

If UKBM exercises its right to convert its loan into BIAS shares, the ownership of BIAS will be as follows (in million Rupiahs):

<u>Share holders</u>	<u>Equity participation</u>	<u>Percentage of ownership</u>
YSM	71	30.9 %
Initial shareholders	59	25.6 %
PT. UKBM	<u>100</u>	<u>43.5 %</u>
Total	230	100 %

2. BPR. GERBANG PROSPEK

This BPR, created in 1993, showed a relatively fair business performance when it was evaluated by a CRS-UKBM team in July 1996. Based on the financial report as per June 1996, PT. UKBM found that BPR Gerbang Prospek has a quiet high spread (6.6%) compared to General Bank (3%).

On the other hand, we also found that the Loan to Deposit Ratio (LDR) of this bank is over the regulation limited of Bank of Indonesia. The LDR indicates that the BPR's has disbursed loans

above a comparative safe ratio with savings and time deposit mobilization. This means that the BPR could potentially use its capital.

PT. UKBM still has an interest to invest in BPR Gerbang Prospek because of its overall potential and ability to work with poor people. Before investing, UKBM will request that the BPR management increase the savings and time deposit capability and reduce the number of loans in arrears to show improve their perform better.

3. NUSUMA

A series of meetings and discussions have been held with PT. NUSUMA. The PT is an economic development agent of the largest Moslem organization in Indonesia, Nahdlatul Ulama (NU) which owns 44 % of the equity in NUSUAM, while PT. Jawa Post (a news paper) owns 52 %, while the other 4 % equity is owned by Abdurrahman Wahid, the chairman of the NU. Currently this company owns 13 BPR throughout Java.

BPRs, under PT. NUSUMA management, operate with a relatively low operating cost (8-16 % of outstanding loan). The overall performance of the NUSUMA BPR is good. They service mostly women groups and meet the PT. UKBM mission.

At the initial meeting, NUSUMA's management proposed that PT. UKBM acquire shares in two of their BPR's --- one in Surabaya (SWG) and the other in Bogor (TBI). But lately, NUSUMA management has withdrawn this proposal due to the shareholder meeting decision, even though, technically and in principle, NU agree to share minority ownership with PT. UKBM.

Currently NU is negotiating to take over Jawa Post's equity in PT. NUSUMA. PT. UKBM was told that if negotiations go well, NU will welcome UKBM to take minority ownership of NUSUMA BPRs.

IV. Technical Supports and Visits

A. Technical Support

To assist with the implementation of this grant, three technical support visits have been provided during FY96 by the CRS/Baltimore Small Enterprise Development Technical Unit (SED TU), and from SIDI, the for-profit investment company of a French NGO (copies of reports from the first two technical visits are included as Attachment 2). In addition, a team representing the USAID Office of Microenterprise Development conducted an assessment during FY96.

1. SEDTU/SIDI Technical Visit - November 29 - December 8, 1995

The first joint technical visit of both SEDTU (Didier Thys) and SIDI (Edmond de Capele and

Xavier Reille) was between November 29 - December 8, 1995. During this visit the following was achieved: a six-month implementation plan was created; the legal framework and internal consensus on the structure of the P.T. holding company was developed; potential future P.T. investments in existing BPR were reviewed on Sumbawa with YSM and on Java with Nusuma; and, the idea of developing long term technical agreements with Nusuma and YSM were discussed.

2. SEDTU/SIDI Technical Visit - March 18-27, 1996

The second SEDTU (Didier Thys) and SIDI (Edmond de Capele) took place between March 18-27, 1996. During this visit, SIDI facilitated further negotiations with NUSUMA to foster future collaboration; concluded a draft agreement with YSM to invest in BIAS; provided input on the legal and financial set up of PT UKBM; and, reviewed the draft notary act and nominee shareholder agreements establishing PT UKBM.

3. SEDTU/SIDI Technical Visit - July 27 - August 3, 1996

The most recent SEDTU (Didier Thys) and SIDI (Edmond de Capele and Xavier Reille) was conducted during July 27 - August 3, 1996. During this visit a technical assessments was made to ETADep to determine the feasibility of starting a BPR in East Timor; a technical review of PT UKBM's investment in BPR BIAS in Sumbawa was conducted; participation in the first Investment Committee meeting; discussions with the management of NUSUMA and its shareholder NU; and a review of PT UKBM tax and financial issues..

4. USAID Office of Microenterprise Development - July 27 - August 3, 1996

During this period, an assessment was conducted by Heather Clark, a senior technical advisor with the USAID Office of Microenterprise Development, and Dennis Smyth, a USAID contractor from Coopers & Lybrand International Consulting Services. The field assessment was designed to provide the donor agency with an independent assessment of the project's status, specifically, the verification of PT UKBM's capacity for reporting accurate/consistent data, a review financial statements and other relevant documentation, and to assess the appropriateness/reasonableness of annual and end of project targets.

V. Constraints and Problems Encountered

The first year targets are slightly behind schedule due, in part, to the following:

A. Staffing Constraints - New CRS country program management arrived in August, 1995 just before the official start of the program, and they needed time to learn the program and recruit corporate officers. Also, it took more than eight months to find the PT UKBM Director.

B. Legal Constraints - CRS opted to have ownership of PT UKBM through a nominee shareholders agreement. It took three months with extensive legal services to develop the necessary nominee shareholder agreements. Moreover, it took management six months to identify and recruit nominee shareholders.

C. Delays in Starting the Grant - Because of protracted negotiations between CRS and USAID, CRS Indonesia only received the signed Cooperative Agreement in mid-November, 1995. Work on the grant began in earnest during December 1995, essentially delaying the start of the program by two months.

D. Changing Regulatory Environment - In March 1996, the Government of Indonesia made changes to laws needing to establish finance companies, like PT UKBM. The changing regulations forced CRS to develop a new corporate structure with two commissioners. Moreover, there is speculation that Indonesia's Central Bank regulations for establishing BPRs will change in the near future, requiring BPR Directors to have at least two-years of banking experience and raising the initial start-up capital from Rp. 100 million (\$45,000) to Rp. 250 million (\$110,000). If enacted, these changes could further slow or limit the establishment of new BPRs.

VI. Future Plan

A. PT. UKBM Legal Status and staffing.--- To legally operate, PT. UKBM needs additional legal documents that should be obtained during the next reporting period. The documents needed include: tax registration, legal approval from the Departement of Justice to use the name of Usaha Karya Bina Mandiri (approval of Notary Act), legal approval from local Jakarta Government as registered company operating in Jakarta (TDP), and Legal approval for business operation by the Departement of Trade Affairs (SIUP). The process began in the month of October after PT. UKBM obtained its domicile approval. The above process is predicted to be completed during 3 months time.

Completion of the staff including the BPR Development Manager, Audit Officer and General Administration officer will be done during October to November 1996. The team is required to accelerate the process of establishing new BPRs and acquire equity investments in operational BPRs.

B. Investments. --- PT. UKBM has targeted to invest in 7 BPRs, consisting of 4 new BPRs and 3 operational BPRs. With the above target, PT. UKBM will manage 8 BPRs by the end of FY2 (1 BPR - BIAS was establish in the FY1). PT. UKBM also targets to work with another 7 potential BPRs for investment in FY3.

To achieve the above target, PT. UKBM will review 35 investment proposals coming from 10 CRS's counterparts, 10 new business partners/NGOs and another 15 operational BPRs currently being run by NGOs. For the Proposed Pipeline of future investments see Attachment 3.

VII. Budget

For the FY 1996, US \$ 583,292 was budgeted to be spent in US Government funds and US \$ 150,392 in CRS funds. The actual expenses was US \$ 201,410 in US Government funds.

The variance in US Government fund is attributable to the slow start of the grant and resulting slow spending on salaries and in investments. CRS did not spend its funds yet because it was waiting until staff were hired before purchasing a vehicle. In addition, its investment capital will be used in conjunction with existing partners who establish BPRs. This has not occurred yet, but will occur in the next period with UKBM investments in BPR Sonbay.

The following is summary of proposed budget for FY 1997. A detailed budget comparison and the cash flow projection of the PT is found in Attachment 4.

BUDGET SUMMARY FOR FY 2
 INSTITUTIONAL TRANSFORMATION FOR SCALE AND SELF-
 SUFFICIENCY PROJECT

	PROPOSED BUDGET FOR FY 2	
	USAID	CRS
	7	8
I. Program Elements		
A. Salaries	65,954.98	-
B. Administration	29,836.41	6,003.12
C. Travel	17,208.62	-
D. Training Workshops	27,550.00	-
E. Investment Capital	407,025.00	206,550.00
Total Program Elements	547,575.00	212,553.12
II. On-Going monitoring		
A. External consultants	37,575.00	-
B. SEDTU Travel	9,792.00	-
C. External Audits	20,000.00	-
Total On-going Monitoring	88,646.30	-
III. Procurement		
A. Vehicles	-	20,000.00
TOTAL DIRECT COSTS	636,221.30	212,553.12
Indirect Costs (22.5%)	143,658.77	47,994.49
TOTAL COSTS	779,880.08	260,547.62

Attachment 1.

PERFROMANCE INFORMATION

	<u>This period target</u>	<u>This period actual *)</u>	<u>Total acumulated</u>
Number of BPR	4	1 **)	1
Number of loans outstanding	10,000	1,666	1,666
Amount of loans outstanding	\$ 100,000	\$ 89,064	\$ 89,064
Delinquency Rate > 30 days	4 %	20 %	20 %
Long-run Loss Rate	2 %	20 %	20 %
Return on Operations	35 %	(16.9) %	(16.9) %
Number of Savers	n.a	4,763	4,763
Women Savers	n.a.	3,811	3,811
BPR Savings mobilized	\$ 100,000	\$ 82,962	\$ 82,962
Equity investment in PT. UKBM	\$ 50,000	\$54,000	\$ 54,000
Commercial Capital	0	0	0
Women loan-recipients	6,000	1,500	1,500

*) as of September 1996 (BIAS Financial Report to Bank of Indonesia)

***) BPR BIAS, Bima, Western Nusa Tenggara (NTB)

Attachment 2.

SIDI Technical Visit Reports



Origin: Edmond DE CAPELE/SIDI
References: EDC/AS/IND0020.DOC
Distribution: CRS/CS/FLU/XR/MD/PD
Date: Monday, 29 January 1996

**TECHNICAL ASSISTANCE FOR THE LAUNCHING OF PT SRC
FOR CRS INDONESIA**

SIDI'S MISSION TO INDONESIA

29 NOVEMBER - 8 DECEMBER 1995

SUMMARY

Framework

At the request of CRS, SIDI went on a mission of technical assistance to Indonesia from November 29 to December 8, 1995 for the launching of PT SRC. Xavier Reille and Edmond de Capele participated in the mission. The terms of references are annexed to this report.

This mission report is divided into three parts.

I. Relationships with PT Nusuma

At our request, PT Nusuma accepts to sell a portion of its participations in two BPR's in its group; one in the Jakartan suburbs and the other in Sumbaya (East Java).

The BPR in Sumbaya was analyzed; the one in Jakarta will have to be examined in greater detail in the future.

These two BPR's seem interesting as PT SRC's initial investment in order to allow it to learn its trade; however, neither the price nor the level of participation were discussed yet.

II. Relationships with YSM

Unlike PT Nusuma, YSM does not wish to have PT SRC as a partner in their two principal BPR's: BSK # 1 and 2. On the other hand, YSM proposes us to become a shareholder in a BPR in difficulty of which it has just gained control and so we studied this BPR. This operation seems risky today for PT SRC but YSM seems to agree with our counter-proposition which consists of PT SRC lending Rps 100 M (\$50,000) to YSM to be guaranteed by the stocks of BSK # 1 or 2.

At the end of the loan (18 months), PT SRC can either have the loan reimbursed or have it transformed into newly-acquired stocks in the BPR according to the parity exchange agreement settled on at the beginning of the transaction.

III. Legal aspects

- Within the context of Indonesian rules and regulations, all entities with any kind of relationships abroad are barred from participation in a banking activity of the BPR-type. During this mission, an outline of the set-up was drawn with a "DGJ Consultant" lawyer which should allow CRS, like YSRC, to have at the same time control and profits of the operation.
- Within the context of this set-up and taking into account projected relationships with PT Nusuma and YSM, several legal documents must be drawn up in the

following weeks, especially the legal statutes and shareholders' agreement. All these documents are, in general, very classical but sometimes necessitate specific adjustments. This specificity is analyzed in Section III, paragraph "Legal documents to be signed" to give the specific position to the lawyer who should draw up these diverse documents.

I. RELATIONSHIPS WITH PT NUSUMA

A. Characteristics of the PT Nusuma group

PT Nusuma is held by

- Dahlan Iskan Java Post (newspaper) at.. 52%
- Duta Dunie Parintis at.. 44%
- Abdurahman Wahid..... at... 4%.

Since the start of the nineties, it has launched twelve BPR's, all of which are profitable and continue to develop in this sector.

It is an active Muslim group, powerful and very professional.

PT Nusuma's BPR's operate with relatively low operating costs (8-16% of outstanding loans). Its personnel is limited in number. Loan officers work as much as possible with "borrowers groups", spend two hours a day at the office and the rest of the time on the field. Loan reimbursements are generally made on a monthly basis and the use of computers is rather advanced.

The sector's religious leader is appointed as Commissioner Member of the BPR. He gives the bank his moral guarantee which facilitates the collection of funds in the local community. He gives his opinion on the borrower's qualities, which improves the reimbursement rate of loans which is, in general, very good.

The incentive of the BPR's director and its staff is around 5% to 10% of net annual profit.

Loan guarantees are based on a preliminary minimum savings to which are added the group's solidarity guarantee or other classical collaterals (mortgage, security).

PT Nusuma's management proposed that as soon as it is created, PT SRC acquires shares in two BPR's -- one in Surabaya and the other in Bogor in the Jاکartan suburbs.

These shareholdings will allow PT SRC to achieve several goals:

- to concretely learn dynamic and well-organized BPR operations which it may duplicate in the future;
- to have a structure for its future staff's training; and
- to reinforce its relationships with a powerful local Muslim organization.

We then tried to analyze the two BPR's of Surabaya and Bogor.

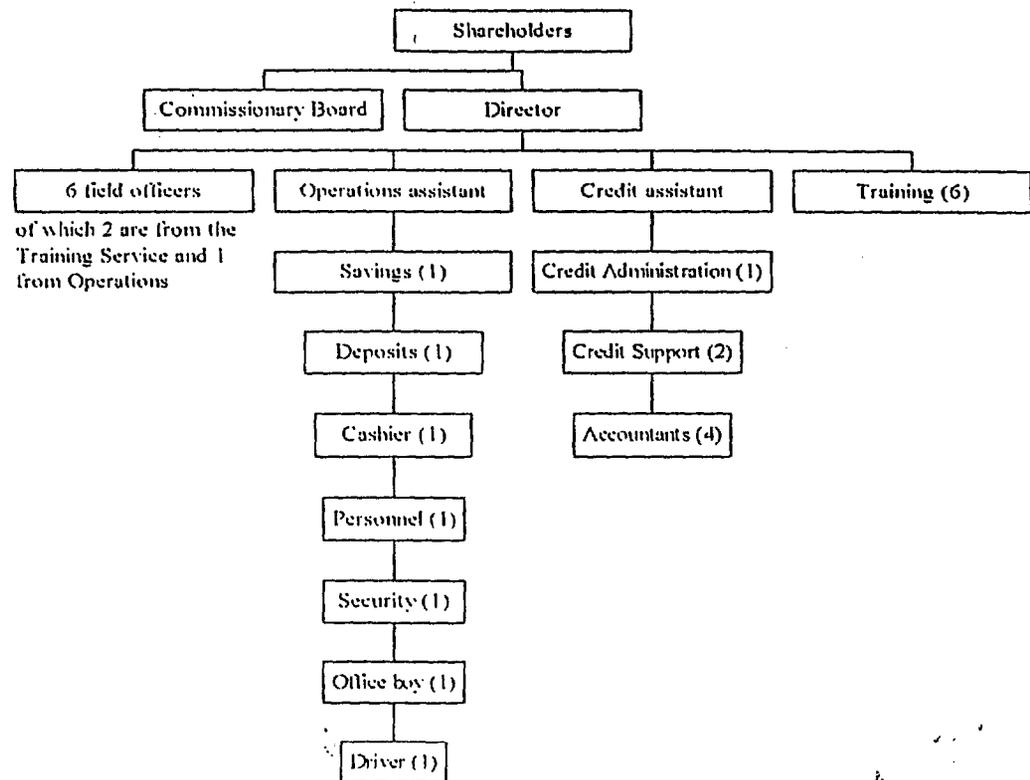
B. Analysis of PT Nusuma Surabaya

This BPR was created at the end of 1990 and operates on the Grameen Bank scheme for 60% of its loans. Loans are made to "groups" at an interest rate of 3% a month and the group lends to its members at 5% a month which allows it to make a profit and build a special reserve fund.

For each loan, the BPR asks that the group deposits 33% of the loan -- 20% of the loan are provided by the loanee and 13% comes from the special reserve fund.

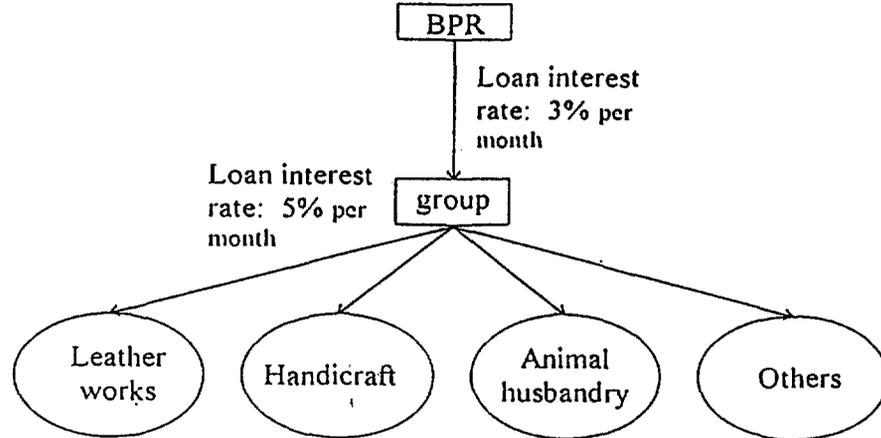
40% of BPR loans are made to individuals and guaranteed in the classical way (collateral, etc.).

1. Organizational chart



2. Organization of the groups

The BPR grants loans to thirty groups composed of fifty to seventy-five members. These groups are formed, at the onset, by NGO's in collaboration with local village leaders.



Each group is composed of a management committee (5 people with token salaries) whose training is provided for by the BPR: one controller, one collector, one secretary, one treasurer, and one head of the group.

3. Training

Two group members should participate in three kinds of regular meetings:

- Monthly: a day's training on organization, management, administration, and reporting.
- Monthly: evaluation on fund sources and uses.
- Weekly: supervision on accounting, finance, loan problems, market potentials.

4. Computerization

Computerization in the BPR is recent and operates with the same program as PT Nusuma.

In practice, time deposit processing seems to operate well while that of savings lends doubt.

Follow up of loans and age balance are not yet computerized. Results on tests done on the manual accounting seem passable.

N.B. Loans are made based on fixed installments and interests on decreasing balance.

5. Financial elements

Balance Sheet (in million Rps)

	1993	1994	Oct 1995 (10 months)		1993	1994	Oct 1995 (10 months)
Assets				Liabilities			
Cash	17	21	23	Savings	560	765	936
Bank deposits	193	343	523	Time deposits	378	434	523
Loan portfolio	877	1 097	1 474	Other liabilities	5	4	41
Provisions	(-9)	(-11)	(-12)	Debts	27	73	325
Fixed assets	33	42	83	Equity	100	100	100
Depreciation	(-21)	(-29)	(-41)	Accumulated profit	28	46	92
Other assets	44	55	60	Yearly profit	36	96	94
	1 134	1 518	2 110		1 134	1 518	2 111

Income Statement (in million Rps)

	1993	1994	Oct 1995 (10 months)		1993	1994	Oct 1995 (10 months)
Expenses				Receipts			
Interests on loans	4	9	19	Bank deposits	29	41	66
Interests on savings	54	89	94	Loan portfolio	248	345	349
Interests on time deposits	84	75	87				
Other interests	2	6	3				
Salaries	43	44	45				
Rent	3	5	4				
Depreciation	8	7	13				
Bad debts provision	4	2	1				
Utilities & others	26	14	20				
Amortisation			5				
Non-operating costs	2	2	2				
Taxes	11	37	28				
Yearly profit	36	96	94				
	277	386	415		277	386	415

Balance per age (in million Rps)

	1993	1994	Oct 1995 (10 months)
Class 1 (no arrears)	857	1 016	1 317
Class 2 (one-month delay)	12	64	82
Class 3 (over 3 months delay)	8	17	75
Class 4 (over 21 months delay)	-	-	-
Total portfolio	877	1 097	1 474

Comments

	1993	1994	1995*
Profit (Rps million)	36	96	113
Return on equity	28%	66%	54%
Savings & time deposits progression	+94%	+28%	+46%
Loan portfolio progression per year	+27%	+25%	+61%

The BPR's activity (savings, time deposits, loans) progresses well.

The return on equity remains high despite the slight decrease of last year.

This decrease seems to be a result of the decrease in interest rates on loans granted while operational costs are low (8% in 1994) and bad debts practically non-existent. (See Table Balance per age above.)

Note that this BPR borrows beyond its needs**, probably to supply cash to its holding/parent company (group Nusuma) to help it finance its growth.

Conclusion

As soon as we receive PT Nusuma Surabaya's 1995 financial statements audited by Coopers***, no obstacle will remain to the acquisition of this BPR by PT SRC.

With this perspective in view, BPR's debt policy must be limited in order to lend to its holding/parent company.

C. Analysis of PT Nusuma Bogor

The time spent at Bogor was very short and the BPR's director was very reserved about the bank's operations so much so that another visit is necessary this coming March 1996 to have a more precise idea of this entity's organization.

Only the financial elements given by Mr. Musthafa Zuhad Mughni allows to make a preliminary judgment on PT Nusuma Bogor which is in the Jakartan suburbs in a sector where several banks are located.

* These figures will be confirmed as soon as we have the audited balance sheet of 1995. They were extrapolated from an account statement at the end of October 1995 of the company.

** The account Bank deposits in Assets represents 35% of portfolio; 20% would have been enough.

*** We understand that Coopers is PT Nusuma's auditor.

Balance Sheet (in million Rps)

	1993	1994	Oct 1995 (10 months)		1993	1994	Oct 1995 (10 months)
Assets				Liabilities			
Cash	12	29	35	Savings	269	359	363
Bank	34	166	224	Time deposits	311	538	836
Loan portfolio	984	1 245	1 519	Other liabilities	5	35	46
Provisions	(7)	(11)	(18)	Debts	305	304	266
Fixed assets	44	91	96	Equity	150	150	150
Depreciation	(23)	(35)	(51)	Accumulated profit	3	26	71
Other net assets	56	48	41	Yearly profit	57	121	114
	1 100	1 533	1 846		1 100	1 533	1 846

Income Statement (in million Rps)

	1993	1994	Oct 1995 (10 months)		1993	1994	Oct 1995 (10 months)
Expenses				Receipts			
Loans	9	70	59	Interest	2	8	45
Savings	31	34	31	Portfolio	250	400	417
Time deposits	64	76	146				
Others	2						
Salaries	37	42	42				
Rent	5	9	6				
Depreciation*	14	13	16				
Bad debts	2	5	9				
Utilities & others	26	30	27				
Non-operating costs	3	1	3				
Taxes	2	7	3				
Yearly profit	57	121	134				
	252	408	476		252	408	462

* Fixed assets - inventory

Comments

	1993	1994	1995
Profit (million Rps)	57	121	137**
Return on equity	37%	69%	62%
Savings & time deposit progression	+21%	+56%	+32%
Loan portfolio progression (yearly)	+68%	+26%	+22%

BPR's activity (savings and time deposits, loans) progresses at a satisfactory rate but is inferior to the one in Surabaya.

** Extrapolated from October 1995 Income Statement.

The return on equity is high. It is approximately equal to the return of PT Nusuma Surabaya. But the BPR in Bogor seems to benefit from a tax exemption which greatly reduces its income taxes and improves significantly its profitability.

In comparison:
(in million Rps)

Surabaya	1993	1994
Profit before taxes	46	133
Taxes	(10)	(37)
Net profit	36	96

Bogor	1993	1994
Profit before taxes	59	128
Taxes	(2)	(7)
Net profit	57	121

It is thus advisable to clarify this tax problem and inquire on the duration of this exemption.

Conclusion

PT Nusuma Bogor seems to be a sound company in which PT SRC can invest. It probably has to face a competition stronger than the one that PT Nusuma Surabaya has to confront.

Its operation costs, all the while being low, are a little bit greater than those at Surabaya. The same thing goes for the payments on arrears even if, for this particular point, it is difficult to know how many loans on arrears have been re-scheduled.

Before participating in this BPR, the policy of re-scheduling and the continuity of the tax exemption must be clarified.

II. RELATIONSHIPS WITH YSM

A. Characteristics of YSM

The YSM group does not have either the financial capacity nor the sophistication of PT Nusuma. However, it was one of the first organizations in Indonesia to create a BPR. Today, it manages three BPR's -- two in Lombok (BSK # 1 and 2) and another recently acquired in Sumbaya (BIAS).

Unlike PT Nusuma, which works mostly with groups in charge of the follow-up of loan reimbursements and the collect of funds, YSM lends mainly to individuals and, to minimize the risk of bad debts, collects loan reimbursements sometimes on a daily basis.

This methodology requires a closer follow up, thus more personnel. Computerization is recent and is not yet entirely set-up. Operating costs are, in general, twice as high as PT Nusuma's. YSM can surely significantly improve its productivity in the following years.

Interests earned on loans are very high -- 25% per 100 days. But if the reimbursement is made without any delay, 10% of interest paid is refunded to the client and 15% to the BPR field officer in the form of a bonus, so much so that:

- the bank collects only 75% of the announced rate, i.e., 18.75% per 100 days;
- operating costs are increased by the difference (25% - 18.75% = 6.25%) and comparison on operating costs can no longer be made with PT Nusuma.

All requests for loans are processed within 15 days. The field officer recommends the loan and he is sanctioned on his bonus if the reimbursement becomes a problem. The central coordinator approves the loan within the limit of a certain amount.

Guarantees are materialized by 20% of previous "savings" to which are added the collaterals (land certificate, house, car, etc.) for all loans greater than Rps 500,000 (\$250). Collateral value should represent 135% of the granted loan.

Given the financial documents of BSK # 1 and 2 presented to us by YSM, we must conclude that these two BPR's are profitable. However, we would like to analyze these two banks more thoroughly using their official balance sheets as of yearend 1995 which we have not yet received.

This analysis will allow us to better understand the management of YSM and to better capture the value of the guarantee of the financial set-up that we propose in Section B below.

Unlike the propositions made by PT Nusuma, YSM did not wish for PT SRC to participate in BSK # 1 or 2. However, it proposed that PT SRC participate instead for Rps 100 M in the third BPR (BIAS) which they just took over in September 1995 in Sumbaya.

B. Study of BPR BIAS (Sumbaya)

This BPR, created in June 1994, was almost at the point of bankruptcy when it was taken over on September 1995 by YSM on the basis of the following balance sheet (before and after the Central Bank audit):

(in million Rps)

	Assets			Liabilities	
	before audit	after audit		before audit	after audit
Cash	4	4	Savings	133	133
Interbank	2	2	Time deposits	28	28
Portfolio	222	146	Bank loans	3	3
Bad debts	(11)	(11)	Equity paid	130	54
Fixed assets	48	48	Loss	(23)	(23)
Depreciation	(17)	(17)			
Other assets	23	23			
	<u>271</u>	<u>195</u>		<u>271</u>	<u>195</u>

1. Current capital composition

The initial shareholders are local entrepreneurs and local vendors. They have no banking expertise and no ability to supervise. They have political and military backgrounds and were looking for profit and a political image. In September 1995, this BPR was running a Rps 23 million loss. In reality, the stockholders did not pay the Rps 130 million equity but only Rps 54 million, as shown in the official balance sheet. They then increased the portfolio figure by Rps 76 million to camouflage their trick.

Today, these initial shareholders just brought in an additional Rps 5 million and YSM, Rps 71 million. Thus capital composition is as follows:

(in million Rps)

	Initial	Increase	Actual	% ownership
Initial shareholders	54	5	59	46%
YSM	0	71	71	54%
Total			<u>130</u>	

2. Financial risk related to the YSM proposal

BIAS' risk essentially lies in the portfolio's economic value and the time needed to make the BPR profitable.

a) Portfolio value

(in million Rps)

Class 1 (no arrears)	59	
Class 2 (over a month's delay)	29	
Class 3 (over 3 months delay)	58	
Class 4 (over 21 months delay)	<u>0</u>	(BIAS set up last June 1994)
	146	

It is difficult to judge the bad debt to be written off from this portfolio. Today 60% of loans are in arrears (40% over 3 months delayed and 20% over a month delayed).

BIAS seems to hold "collaterals" representing 140% of the portfolio's value and the managing director believes that these guarantees may be efficiently operational.

Thus the only solution for PT SRC is to wait for the bad debts to be written off before acquiring shares in BIAS. Any irretrievable amount will only increase BIAS' loss in the months to come. The last payment concerning this portfolio is expected to come in on July 1996. Thus, we will not have an evaluation of the loss' potential risk before 1997. Not to mention the need to control the rescheduling of these old loans.

b) Time needed to make a profit

In YSM's opinion, BIAS will break even at the end of 1996, for several reasons:

i) Economic background
BIAS is in a zone wherein the economy is developing. The population density is high. There are many micro-enterprises and practically no competition from banks.

ii) Restructuring of BPR

In the office: 21 people

- 2 new directors (a man and a woman)
- 4 department heads
 - Credit/Deposit
 - Accounting
 - Funds
 - Administration
- 4 area coordinators
- 1 cashier

- 10 staff members
 - 1 savings
 - 1 loans
 - 1 computers
 - 1 book keeping
 - 4 assistant coordinators
 - 2 drivers/office boys

On the field: 24 people who

- collect savings } + administration
- collect credit installments }
- analyze potential customers

Installment payments are usually collected daily.

iii) Interest rates on loans

Actual rate is 25% per 100 days or 90% per annum.

YSM has a bonus system which grants the following discounts:

- 10% of collected interest to a punctual client
- 15% of collected interest to the field worker if delay in payment is less than 20 days.

However, default interest is increased by 50%.

iv) BPR's new targets

- Target # 1: Increase savings:
 - Each field worker has a savings collection target (Rps 50,000 per day).
 - Rate offered: 12% overnight savings
22% time deposits (1 year)
- Target # 2: Focus on small and micro-enterprises (directed essentially by women) instead of on medium-scale enterprises.

v) 1996 projection

Evolution in million Rps

	end of 1995	end of 1996
Loan portfolio	200	400

	end of 1995	end of 1996
Savings	85	195
Time deposit	45	105
	130	300

1996 Expenses (in million Rps)

Operating costs	170
Salaries	60
Other costs	110*
Interests	50
Bad debts	30
	<u>250</u>

1996 Investments (in million Rps)

Buildings and vehicles -- 100

(in million Rps)

	<u>Use of funds</u>		<u>Need of funds</u>
Portfolio increase	200	Savings increase	170
Investments	100	Loan increase	130
	<u>300</u>		<u>300</u>

What is the accuracy of these 1996 projections?

- Operating costs. Budget: Rps 170 M. (See expenses above.)
BIAS is a labor-intensive operation. (Loan officers collect loan payments daily.) Its ratio operating cost / average portfolio must be at least equivalent to that of BSK # 2, which is highly labor-intensive, too.

$$\text{BIAS: } \frac{\text{operating cost}}{\text{average portfolio}} = \frac{170}{300} = 57\% \quad \left\{ \begin{array}{l} \text{The ratio of BSK \# 2 is} \\ \text{between 50\% and 60\%.} \end{array} \right.$$

Conclusion: Operation costs seem accurate.

- Interests. Budget: Rps 50 M.

A rapid verification can be done as follows:

	M Rps	Rate	Payable interest M.Rps
Average 1996 savings	140	12%	17
Average 1996 time deposits	75	22%	<u>17</u>
			33
Loan to meet funds' needs	130	20%	26*
Total interests			<u>59</u>

* This figure may be reduced if investments (Rps 100 M) are not paid in full at the beginning of 1996.

* Includes supply, transportation, depreciation, bonus, and taxes.

- **Bad debts. Budget -- Rps 30 M.**
This figure is very questionable, knowing that Rps 87 M are already overdue. This budget will depend on collateral efficiency.
- **Income**
To break even, income must be equal to Rps 250 M based on an average 1996 projection of Rps 300 M.
The average interest rate must be equal to 83% per annum.
We know today that the lending rate is around 90% per annum.
Conclusion: Lending rate seems accurate.

General conclusion on the budget

The 1996 Budget does not appear unrealistic but two questions remain to be answered:

- What will be the savers' reaction? After the bank's near bankruptcy, will they trust the bank's new management and will the increase in savings be as fast as foreseen?
- What is the potential loss included on the old portfolio?

c) **CRS proposal**

In order to avoid as much risk as possible, we suggest to wait from a year to a year and a half before CRS acquires shares in BIAS.

To help YSM, CRS will lend to BSK # 1 or 2, both profitable companies. This loan could be secured by a pledge on one or the other company's shares.

After a year, a year and a half, if BIAS proves to be profitable, CRS will have the option to change the loan into an equity participation in BIAS at par value. If BIAS turns out not to be a good investment, CRS will ask YSM to reimburse the loan. If this latter is not in a position to do so, CRS will become a shareholder in BSK # 1 or 2.

III. LEGAL ASPECTS

A. Legal set-up of PT SRC

Legal issues

The letter from DGJ Consultants dated May 28, 1995 brings out the following points:

1. An NGO, not being a legal entity, cannot be a founder in PT SRC. However, once the company is created, an NGO may acquire the shares of another company as long as the subscribers are Indonesians.
2. Any form of nominee arrangement to give a non-Indonesian control of a company is non-enforceable. However, a loan agreement under which the share capital invested by the nominee on behalf of the foreign principal is considered as a loan from the foreigner to the nominee is legal. This loan is then secured by a pledge of shares back to the foreign principal. In its capacity of creditor, the foreign principal may also be given
 - powers of attorney to vote and/or to sell shares in an event of a default,
 - the right to approve/disapprove borrowings, loans, guarantees, changes in the Board of Directors and/or changes in shareholdings,
 - a profit/loss-sharing agreement.

227:4
11/10/95
2/20/96

Conclusions

1. If YSRC can receive the shares only of existing companies, it should look for an intermediary company which will
 - participate in the creation of a PT SRC and
 - transfer its PT SRC shares to YSRC after a pre-defined time.

Since PT SRC should have at least two shareholders, CRS should find two Indonesian legal entities to take on the role of the shareholder.

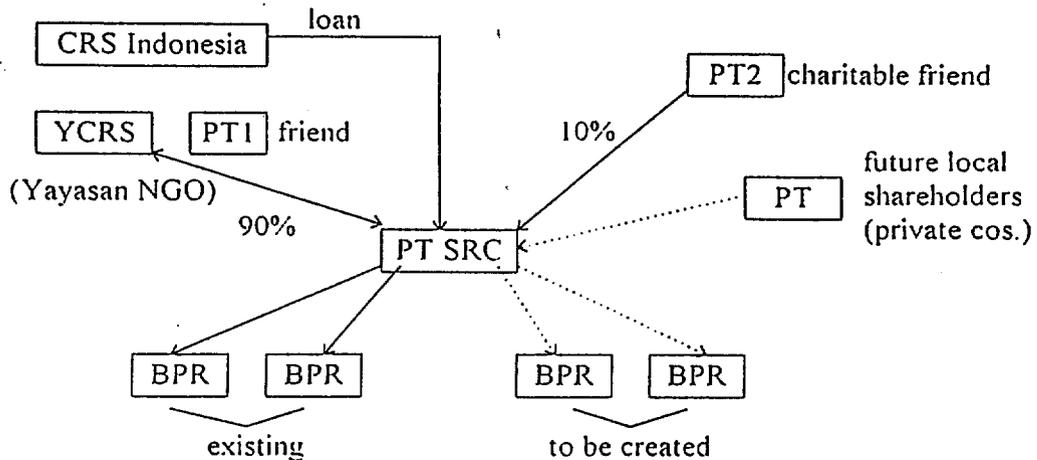
- a) The first legal entity (PT1) will only retain the shares which will be later transferred to YSRC. A loan contract (as described above) should be drawn between CRS and this legal entity which should stipulate that the loan will be reimbursed at a certain date by a simple transfer of ownership of shares to YSRC. (Interest issue to be studied.)
 - b) The second legal entity (PT2) will be the permanent partner of YSRC in PT SRC. To ensure longevity in this set up, this company must be detained by a charity organization which has the same objectives as PT SRC.
2. If CRS Indonesia wants to keep direct income (outside of YSRC), it could directly lend to PT SRC in the context of a profit-sharing agreement. (See Section I.2 above.)

In this case, so as not to generate financial losses in PT SRC, this loan may be equal to the amount invested by PT SRC in the repurchase of participation in existing BPR's owned by friends (PT Nusuma, YSM, etc.). These BPR's, being profitable and capable of distributing dividends to their shareholders, PT SRC could pay the financial charges of the loan granted by CRS Indonesia.*

*With regards to income taxes:

3. Since, we have to wait for one year to eighteen months to receive permission from the Indonesian administration to create a new BPR, PT SRC will start by investing in existing BPR's and then will create new BPR's in one or two years. If we take into account the orientations in Section 2 above, PT SRC could have a relatively minimum amount of capital in the beginning (its initial investment will be financed by loans from CRS). This capital will be increased only at the creation of new BPR's.**

N.B. No debt/equity ratio is imposed by the Central Bank on PT SRC.



B. Legal documents to be signed

Several documents must be prepared by an Indonesian lawyer. Following is an outline and specific points.

1. PT SRC's Articles of Association

Initially, PT SRC will be composed of two Indonesian PT's (See Conclusions above.): PT1 will hold 90% of shares (through a loan granted by CRS Indonesia); PT2 the remaining 10%.

Two points have to be studied with the lawyer:

- Should PT2's pre-emptive right be eliminated when PT1 transfers its shares to YSRC?
- At the request of CRS Baltimore, an "investment committee" can be introduced, composed of PT SRC's managing director and others chosen for their professional experience to make the company's investment decisions. (The guidelines for the organization of such an Investment Committee is exposed in Annex II.)

- CRS may not have to pay taxes on interests if the amount of interest expenses is offset by operating expenses (training).

- PT SRC does not pay taxes on dividends received from BPR's.

** DGJ Consultants has to precise if at each equity increase, once PT SRC is set-up, PT1 has to be involved in any new subscription or if YSRC, as shareholder, may directly subscribe to the new shares.

If so, an article like the following must be included:

Any investment or divestment decision made by the company must be approved by the Investment Committee. The Investment Committee will consist of three to five members appointed by the shareholders at a two-third majority, the General Manager being a "de jure member" of this Committee.

The Committee shall be empowered by the Board to make all investment and divestment decisions by vote of a majority of the total members of the Investment Committee. The General Assembly by a two-third majority may change the size or composition of the Investment Committee.

2. Loan of CRS Indonesia to PT I

To allow PT I to subscribe to its capital at the start up of PT SRC, CRS Indonesia will grant PT I a bridge loan which will be reimbursed when the shares held by the latter will be transferred to YSRC.

The loan contract will be drawn up by a DGJ Consultant lawyer

3. Loan of CRS Indonesia to PT SRC

As specified in the Conclusions above, if CRS decides to keep a part of PT SRC's revenues to finance certain support programs, CRS Indonesia should make a loan to PT SRC to help it take participations in the existing BPR's of PT Nusuma and YSM.

If the lawyer will deem it necessary, it may be decided to give CRS Indonesia, being the creditor, the power to:

- modify the Board of Directors and the members of the Investment Committee and/or
- vote at the General Assembly for principal decisions.

The contract for the loan will be drawn up by a DGJ Consultant lawyer.

a) Shareholders' and Loan Agreements

For the initial investments of PT SRC concerning two direct acquisitions in the BPR's of the PT Nusuma group and an option to acquire shares in the future in a BPR of the YSM group, the following will have to be drawn up:

- a Shareholders' Agreement specifying the bases of the collaboration on the long-term between PT SRC and PT Nusuma, on one hand, and YSM, on the other, within the context of these eventual minority acquisitions.
- a Loan Agreement with YSM, making possible to convert the loan into BIAS shares through a call option.

Following is the outline of these two agreements which must be drawn up by an Indonesian lawyer.

Shareholders Agreement

between PT Nusuma (or YSM) and PT SRC called the partners.

General objectives: Define a cooperative relationship on the long-term to promote the creation or the development of the BPR in Indonesia between the two partners.

Methods: This cooperation will essentially take the form of acquisitions of shares in the BPR or, secondarily, of transfer of know-how. PT SRC may, upon agreement from PT Nusuma (or YSM), take participation in a BPR previously created or in the process of creation by PTN (or YSM).

On the other hand, PTN (or YSM) may acquire equity in a BPR previously created or in the process of creation by PT SRC.

The percentage of equity participation will be negotiated on a case-to-case basis.

Social objectives: The BPR's, being subject to this Cooperation Agreement, should finance groups or micro-sized businesses (as much as possible, women-oriented) through interest-bearing loans.

When a BPR will have reached its break-even point, fixing interest rates should allow it to attain a satisfactory profit level while its borrowers take advantage of a progressive reduction of interest rates to promote their economic development.

Articles of Association: The statutes of all BPR's subject to this participation agreement will be modified in order to integrate in the functioning of the General Assembly the following text:

All decisions will be adopted by a simple majority of votes except the following decisions which will require a qualified vote representing at least two-thirds of the total voting capital of BPR:

- *early liquidation or dissolution*
- *merger*
- *pledge or sale of assets*
- *capital increase*
- *appointment and removal of external auditors*
- *appointment and removal of managing director*
- *loans from commercial banks or other financial companies*
- *fixing of annual budget*
- *approval of annual financial statements*

Dividend policy: The General Assembly will decide each year on the amount of dividends which should be at least equal to 50% of profit after taxes for the fiscal year.

Services: Each partner will be responsible for certain services to the BPR on the condition that the other partner agrees with the costs of these services.

Training: Each partner can send a limited number of interns to a BPR for training. This service will be offered free-of-charge.

Reporting: Each month, the BPR will send each partner a monthly report and will answer all questions asked. It should open its books to all mandated representative of a partner.

Transfer of shares: In case of a transfer of shares to a third party, shareholders will have a pre-emptive right on the price offered by the third-party.

The new owner should accept the principles established by the Shareholders' Agreement.

Governing law: Indonesian law.

Arbitration: Any dispute, controversy or claim arising out of or relating to this agreement shall be settled by arbitration in accordance with UNCITBAL rules.

The Arbitrage Tribunal will consist of three arbitrators. Each partner will appoint one arbitrator and a third will be appointed by the arbitrators of both parties.

b) Convertible loan from PT SRC to YSM

YSM took an equity participation in September 1995 in a BPR named BIAS and situated in Sumbaya.

Following this operation, the capital structure of this BPR may be divided in the following manner:

	M Rps	Percentage of ownership
YSM	71	54%
Initial shareholders	59	46%
	130	100%

After having gained control of BIAS, which, since its creation, has always had profitability problems, YSM is restructuring the BPR.

YSM should propose to PT SRC, within the context of the cooperation agreement signed by the two groups, to give it the option to acquire BIAS shares when this company will have broken even.

In the meantime, and to allow YSM to find the necessary resources for the restructuring of BIAS, PT SRC committed itself to make a loan to YSM under the following conditions:

Amount: Rps 100 M
Interest rate: 18% payable monthly and indexed every three months on the time deposit corresponding to the length of time the loan remains outstanding.
Amortization: bullet after 18 months
Guarantee: shares of BSK # 1 or 2

YSM gives PT SRC the following alternatives:

- Either PT SRC, at any time during the 18 months after the release of the loan, exercises the option to buy BIAS shares and converts its loan into a capital increase of BIAS according to the following outline:

	M Rps	Percentage of ownership
YSM	71	30,9%
Initial shareholders	59	25,7%
PT SRC	100	43,5%
	230	100,0%

Or PT SRC does not exercise its option to buy BIAS shares and asks YSM to reimburse its loan. In this case, if YSM cannot reimburse or can only do so partially, PT SRC will have the right to become the owner of the shares of BSK # 1 or 2 given as the loan guarantee or a percentage of these shares corresponding to the unpaid portion of the loan.

CONCLUSION

Now, it is advisable to progress in the legal set-up of PT SRC and in the realization of our agreements with PT Nusuma and YSM. This additional phase may be realized next March 1996 during our next visit to Jakarta.

To this end, we need to have the following:

- Audited financial statements for yearend 1993, 1994 and 1995 of
 - PT Nusuma -- Bogor and Sumbaya (+ forecasts for the next 5 years)
 - YSM -- BSK # 1 and 2
- Assignment of two Indonesian PT's which would accept
 - for one, to be the "definitive partner" of YSRC in PT SRC and
 - for the other, to be the "relay partner" of YSRC
- Up-to-date on the managing director's recruitment.

ANNEX I

TERMS OF REFERENCE SED TU AND SIDI VISIT TO INDONESIA NOVEMBER-DECEMBER 1995

A. Background

- * The goal of the CRS/Indonesia (CRS/ID) SED program is to improve the income earning potential of poor women and empower them to take greater control of their lives and the welfare of their families.
- * CRS/ID has had a long and extensive experience in managing Small/Micro Enterprise Development Program through savings and lending groups. The program started in 1986 by incorporating Income Generating Activities (IGA) with health activities targeted at mothers participating in community run health (locally known as posyandu) activities. In 1989, due to ineffectiveness and the slow progress of the IGA achievement, a CRS-AID evaluator team recommended separating IGA and Posyandu management. A process of SED and health program separation began among CRS and its counterparts, and it was accomplished in 1992.
- * In 1992, CRS/ID began in earnest income generating activities

through UBSPs or self managed saving and lending group consisting of mostly women). The total project costs was \$195,000. In 1993, CRS/ID was included in a \$5 million CRS sequel grant project, managed by SEDTU-Baltimore. Due to the similarities of its existing SED portfolio, CRS/ID integrated its UBSP and sequel grant activities into one comprehensive Detailed Implementation Plan.

- * To date, CRS/ID through its 8 counterparts has reached 825 UBSPs groups with 19,013 mostly women members, involving accumulated loan valued of \$1.27 million and savings of \$340,000.
- * In the future, CRS/ID will attempt to increase the scope of client participation and related organization's financial and programmatic sustainability. In conjunction with SEDTU-Baltimore and SIDI, CRS/ID was awarded a three-year \$2 million USAID Grant which is entitled: Institutional Transformation for Scale and Self Sufficiency, a Profit Approach to Poverty Lending or MIP. The main activity of this MIP grant is to develop a Limited Liability Company which will become the umbrella organization of 20 small holder credit banks (BPR). These banks will serve at least 30,000 poor people in rural areas.
- * With funding secured, CRS/ID plans to develop a Detailed Implementation Plan which integrates past accomplishments and future development plans. It is expected that SEDTU-Baltimore and SIDI will be involved in this effort during a joint visit to Indonesia during November-December 1995.

B. The Goal and Objectives of the SEDTU-SIDI visit to CRS/ID:

The goal of the visit is to develop a workable Detailed Implementation Plan for the MIP grant which integrates with CRS/ID's long-term and comprehensive SED development plan.

The objectives of the scope of work are :

1. Review revised MIP proposal, specifically outlining the functional and reporting requirements between CRS/Foundation, the Limited Liability Company and the BPRs, policy of shareholders of PT/SRC and BPRs.

2. Discuss the most up to date information concerning Indonesia's banking laws and regulations. These will be reviewed with an eye to making necessary adjustments to the MIP proposal. Specific laws regarding start-up capital and BPR staffing rules will be examined. The discussion will include officers of Bank of Indonesia, Indonesian Banker Institute, PT PPUI, PT BAV and W&L Lawyer Co. (Discussion, topic information attached)
3. Develop strategy to accelerate target achievements and integrate all SED plan. Regulatory changes may delay the establishment of new BPRs and alternative strategies for meeting targets will be reviewed. Review how some counterparts' strategy to develop cooperatives links with the CRS/ID BPR approach.
4. Discuss possible collaboration with SIDI and other investors and expansion plan in the future. During the visit, some options of collaboration strategy will have been identified.
6. Review the recently revised CRS/ID SED criteria and indicators to discern which specifically apply to MIP grant. CRS/ID hopes to achieve a common understanding of performance indicators and a strategy for implementing with counterparts, BPRs, UBSPS, etc.
7. Assess investment possibility in PT Nusuma's BPRs, PT BPR Qirod in Selong-Lombok and PT BPR KAS in Sumbawa. After the policy and regulatory discussion in Jakarta, it is hope Edmond de Capelle will provide technical investment strategy assistance by performing three BPRs field examinations in Selong, Sumbawa and East Jawa.

C. Date/Venue :

Didier and Dona Kerner (SED TU) 26 November-2 December 1995

Xavier Reille (SIDI)

27 November-2 December 1995

Edmond de Capele (SIDI)

29 November-8 December 1995

See Attachment A : tentative Schedule

D. Persons Involve :

All CRS/ID SED staff members and selected staff from other Units are expected to be involved in discussions. CRS/ID management are invited to be involved in all the discussions but particularly those related to policy matters.

E. Budget plan :

It is budgeted in Sequel Grant as well as MIP proposal under line item "consultants". Although not specifically defined who and when will be used, however we can use them for this purpose.

ANNEX II

GUIDELINES FOR THE ORGANIZATION OF THE INVESTMENT COMMITTEE

Guidelines

The Company shall have an Investment Committee, the members of which shall be Principal or Alternate Directors of the Company, and to which the Board of the Company will delegate the authority to make investment and loan decisions. In order to approve an investment or loan, the Investment Committee will require the following:

1. A preliminary review ("Stage 1 Review") must be prepared by the PT SRC General Manager and presented to the Investment Committee. A Stage 1 Review will focus on the fundamental characteristics of the proposed investment or loan opportunity, namely: the sponsors of the Investee Institutions, clients served and the commercial (or potential commercial) viability of the opportunity.

① Use P/L and
Fin Tools
② Prepare
Outline
Agreement

A Stage 1 Review does not result in a recommendation to the Investment Committee, but will indicate whether the PT SRC General Manager intends to pursue the opportunity. A Stage 1 Review may not be required by the Investment Committee if the Company has invested in the subject Investee Institution within the prior year or is represented on the Board of Directors of such Investee Institution.

2. If, as the result of Stage 1 Review, the PT SRC General Manager intends to pursue an opportunity, a further evaluation ("Stage 2 Review") must be prepared and submitted to the Investment Committee with a recommendation by the PT SRC General Manager for financing. The recommendation must be based on a detailed review of a business plan, offering memorandum or financing proposal prepared by the potential Investee Institution. A Stage 2 Review recommending investment by the Company will include a summary of the terms of the proposed loan or equity investment and the proposed exit strategy for such loan or investment.

Use RFA

The Investment Committee will meet to make decisions as opportunities are developed and presented by the PT SRC General Manager. The PT SRC General Manager is responsible for coordinating and arranging the meeting at a time and place convenient to the Investment Committee members. The PT SRC General Manager must provide a Stage 2 Review to Investment Committee members at least one week prior to an agreed meeting date for any investment opportunity that requires their attention.

All approvals of investments or loans will include an authorization to the PT SRC General Manager to negotiate the final terms of the investment or loan on behalf of the Company and to complete the due diligence and legal documentation as required. The Investment Committee will instruct the PT SRC General Manager with respect to the terms of the investment which must be obtained through negotiation and included in the final documentation. For example, in the majority of cases, the PT SRC General Manager will require the Investee Institutions to obtain certification from their clients to the effect that the

* These guidelines were inspired from PROFUND.

business activities of the clients are in compliance with local and national environmental and occupational health and safety regulations.

Members

In our opinion, for the first three or four years, the Investment Committee members should be CRS, USAID, SIDI, a local banker and a representative of the shareholders. All members must have solid financial and banking backgrounds and share the company's philosophy.



Origin: Edmond DE CAPELE/SIDI
References: EDC/AS/IND0667.DOC
Distribution: CRS/CS/FLU/XR/MD/PD
Date: Thursday 30 May 1996

MISSION TO INDONESIA
Edmond DE CAPELE

SUMMARY

The objective of our mission of technical assistance to Indonesia from March 18 to March 27 1995 was to carry on our negotiations with PT Nusuma and VSM to set up the financial and the legal framework of the new company (now called PT UKBM instead of PT SRC).

This mission report is divided into 4 parts

I/ Negotiation with PT Nusuma

PT Nusuma shareholders no longer intend to sell to PT UKBM a minority holding in SWG (Bogor) and TBI (Surabaya), but they agree to set up their future BPR in collaboration with PT UKBM and have no objection on principle regarding our draft MOU.

II/ Negotiation with YSM

YSM still intends to develop their future BPR in collaboration with PT UKBM. They are still willing to get from PT UKBM a 100 MRps loan convertible to BIAS shares at the option of PT UKBM.

They have no objection on principle regarding our draft MOU, our 100 MRps loan project and our evaluation of BSK1 (a percentage of BSK1 shares will guarantee the loan).

III/ Set up of PT UKBM

Due to the evolution of our negotiations with PT Nusuma and YSM, we suggest a scheme to set up PT UKBM in order to get at the same time control and profits of the operation.

The rationale of this scheme is based on financial and legal aspects.

IV/ Legal documentation

This part :

- develops some comments made on several legal documents prepared by CRS' lawyer
- proposes a framework for the 100 MRps loan agreement and Memorandum of Understanding to be drafted by the lawyer.

I/ NEGOTIATIONS WITH PT NUSUMA

During our previous meeting in December 1995, we were told by the Management that PT Nusuma would accept to sell to PT UKBM a minority holding in 2 BPR belonging to their group : SWG (Bogor) and TBI (Surabaya).

These shareholdings would have allowed PT UKBM :

- to concretely learn dynamic and well organised BPR operations which it may duplicate in the future
- to establish a structure for its future staff's training and
- to reinforce its relationships with a powerful local muslim organization.

During our meetings in March 96, we were told that PT Nusuma shareholders

- a) were not willing to sell to PT UKBM a minority holding in SWG and TBI
- b) wanted to set up their new BPR in collaboration with PT UKBM
- c) agreed on principle on our MOU

II/ NEGOCIATION WITH YSM

In December 95 VSM clearly stated it did not wish for PT UKBM to participate in their two fully owned BPR (BSK1 and BSK 2).

However it proposed that PT UKBM participates instead for Rps 100 M in their third BPR (BIAS) which they just took over in September 1995 in Sumbaya

After studying this proposal in December we came to the conclusion (see December report) that BIAS :

- 1) was in a bad situation due to untrustworthy nonprofessional prior management
- 2) should probably recover through YSM management, but as 60% of its loan portfolio was in arrears at that time, this operation appeared to be very risky.

In order to avoid as much risk as possible, we suggest waiting for one year to one year and a half before PT UKBM acquires shares in BIAS.

To help YSM, CRS will lend to BSK 1 or 2 both profitable companies. This loan could be secured by a pledge on one or the other company's shares.

After one year to one year and a half, if BIAS proves to be profitable CRS will have the option to change the loan into an equity participation in BIAS at "par value". If BIAS turns out not to be a good investment, CRS will ask VSM to reimburse the loan. If the latter is not in a position to do so, CRS will become a shareholder in BSK 1 or 2.

During our meetings in March 96, in collaboration with YSM, we investigated various options to establish the operation. We propose YSM to sign :

- 1) a MOU
- 2) a loan agreement backed by 20% of BSK 1 shares.

VSM told us it has no problem on principle with signing these two documents.

1) The MOU
is the same document as the one presented to PT Nusuma (see exhibit 1)

2) Loan agreement between PT UKBM and YSM

Amount : 100 MRps

Purpose : finance the development of BIAS

Monthly interest : 2% above the time deposit rate of the state bank BTPN mentioned in Bisnis Indonesia Newspaper at the first working day in every month, payable every month the last day of the month.

Repayment : balloon 24 months after the withdrawal

Irrevocable right given by the borrower to the lender : to transform the 100 M Rupiah loan into the ownership of 43.5% of BIAS shares so that after exercising this right the ownership of BIAS shall show the following structure :

a) Today

<u>Shareholders</u>	(MRps) <u>Equity participation</u>	<u>Percentage of ownership</u>
YSM	71	54%
Initial Shareholders	59	46%
	130	100%

b) After exercising the right

<u>Shareholders</u>	(MRps) <u>Equity participation</u>	<u>Percentage of ownership</u>
YSM	71	30.9%
Initial Shareholders	59	25.6%
PT UKBM	100	43.5%
	230	100%

Commitment from the lender : to convert its 100 M Rps loan into an equity position in BIAS (according to the scheme above : notice that the conversion is made "at par value") if BIAS before the maturity date of the loan shows a balance sheet (audited by a commonly agreed auditor) with an accumulated profit equal to the accumulated loss generated by BIAS since its start up.

Guarantee : pledge of 20% of its 100% equity participation held by the borrower in BSK I located in Lombok.

EVALUATION OF BSK

Balance sheet (M Rps)							
	<u>1993</u>	<u>1994</u>	<u>1995</u>		<u>1993</u>	<u>1994</u>	<u>1995</u>
Cash	41	56	127	Saving	534	877	1072
Bank	68	69	186	Time deposit	167	287	358
Loan	808	1338	1575	Interbank loan	80	8	1
Provision	(9)	(17)	(40)	Loans	29	201	249
Fixed assets	97	217	259	Liabilities	3	14	28
Depreciation	(25)	(33)	(54)	Equity	100	150	250
Others	<u>21</u>	<u>22</u>	<u>41</u>	Accumulated profit	62	70	40
	1001	1652	2094	Profit /year	<u>26</u>	<u>45</u>	<u>96</u>
					1001	1652	2094

Profit and loss statement (M Rps)								
<u>Expenses</u>	<u>1993</u>	<u>1994</u>	<u>1995</u>	<u>Income</u>	<u>1993</u>	<u>1994</u>	<u>1995</u>	
Interest /saving	29	58	92	Bank interest	6	8	5	
Interest /time deposit	32	70	75	Interest /loans	234	460	667	
Other interests	26	22	8	Commissions	40	87	114	
Salary	104	188	239	Others	1	5	3	
Bonus	35	92	114					
Depreciation	8	10	32					
Bad debt	2	8	21					
Others costs	16	52	84					
Income tax	3	15	28					
<u>Profit (net)</u>	<u>26</u>	<u>45</u>	<u>96</u>					
	281	560	789		281	560	789	

We used 3 different approaches to make the BSK I estimation :

1. Book value
2. Price Earning ratio
3. Good will through return on Equity method

We did not use the discounted cash flow method as it was very difficult to ask YSM to make an accurate projection on the future.

1. Book value

At the end of 1995 BSK I book value was equal to

	M Rps
Equity	250
Accumulated profit	40
Net profit /1995	96
Book value	386

To be on the safe side we have not taken into account an asset reevaluation. However, we do not know if the bad debts are sufficiently provisioned (see NB below)

2. Price earning ratio

This method takes into consideration the market value of several banks listed in the Jakarta stock exchange market compared with their after tax profit. In December 1995 the bank's price earning ratio was around 9 times the net profit.

BPR is a very small financial institution and a BPR shareholder cannot easily sell its shares (BPR is not liquid as it is not listed in the stock market). It is the reason why we have assumed that BSK I value cannot exceed 6 times its net profit.

$$\text{Price Earning value} = \text{profit 95} : 96 \text{ MRps} \times 6 = \underline{576 \text{ MRps}}$$

3. Return on Equity method (good will)

This method takes into account the amount of money invested by the shareholders at the end of 1995

	M Rps
Equity	250
Accumulated profit (previous year)	40
Total Amount invested	290

$$\text{The ratio } \frac{\text{profit /year}}{\text{Amount invested}} = \frac{96}{290} = 33\%$$

Assuming a commercial rate on time deposit equal to 17% we have come to the conclusion that BSK I has a yield equal to $33 / 17 = 1.947$ times the commercial market rate, so that its economic value equals / 1.947 times the total amount invested by the shareholders.

$$\text{Return on Equity value} = 290 \times 1.947 = \underline{564 \text{ MRps}}$$

It is common to make an average of the three methods giving a 33% weight for each method.

	Total	<u>1/3 weighting</u>
1. Book value	386	129
2. Price /Earning	576	192
3. Return on Equity	564	<u>188</u>
BSK I weighted value		<u>509 MRps</u>

Guarantee given by YSM to PT UKBM

Assuming a BSK I value of 500 MRps, 20% of the shares are equivalent to 100 MRps

NB : All financial statements supplied by YSM are unaudited statements. It is necessary before signing this deal to send an auditor to BSK I to check the account, paying particular attention to the bad debt provision.

III/ SET UP OF PT UKBM

A/ FINANCIAL ASPECT

We refer to our last December mission report. This report highlighted the following legal issues and conclusions :

Legal issues

The letter from DGJ Consultants dated May 28, 1995 brings out the following points:

1. An NGO, not being a legal entity, cannot be a founder in PT UKMB. However, once the company is created, an NGO may acquire the shares of another company as long as the subscribers are Indonesians.

2. Any form of nominee arrangement to give a non-Indonesian control of a company is non-enforceable. However, a loan agreement under which the share capital invested by the nominee on behalf of the foreign principal is considered as a loan from the foreigner to the nominee is legal. This loan is then secured by a pledge of shares back to the foreign principal. In its capacity of creditor, the foreign principal may also be given
 - powers of attorney to vote and/or to sell shares in an event of default,
 - the right to approve/disapprove borrowings, loans, guarantees, changes in the Board of Directors and/or changes in shareholdings,
 - a profit/loss-sharing agreement.

Conclusions

1. If YSRC can receive only the shares of existing companies, it should look for an intermediary company which will
 - participate in the creation of a PT UKMB and
 - transfer its PT UKMB shares to YSRC after a pre-defined time.

Since PT UKMB should have at least two shareholders, CRS should find two Indonesian legal entities to take on the role of the shareholder.

a) The first legal entity (PT1) will only retain the shares which will be later transferred to CRS Yayasan called YSRC. A loan contract (as described above) should be drawn between CRS and this legal entity which should stipulate that the loan will be reimbursed at a certain date by a simple transfer of ownership of shares to YSRC. (Interest issue to be studied.)

b) The second legal entity (PT2) will be the permanent partner of YSRC in PT UKMB. To ensure longevity in this set up, this company must be detained by a charity organization which has the same objectives as PT UKMB.

2. If CRS Indonesia wants to keep direct income (outside of YSRC), it could directly lend to PT UKMB in the context of a profit-sharing agreement. (See Section 2 above)

In this case, so as not to generate financial losses in PT UKMB, this loan may be equal to the amount invested by PT UKMB in the repurchase of participation in existing BPR's owned by friends (PT Nusuma, YSM, etc.). These BPR's, being profitable and capable of distributing dividends to their shareholders, PT UKMB could pay the financial charges of the loan granted by CRS Indonesia.*

3. Since, we have to wait for one year to eighteen months to receive permission from the Indonesian administration to create a new BPR, PT UKMB will start by investing in existing BPR's and then will create new BPR's in one or two years. If we take into account the orientations in Section 2 above, PT UKMB could have a relatively minimum amount of capital in the beginning (its initial investment will be financed by loans from CRS). This capital will be increased only at the creation of new BPR's.

N.B. No debt/equity ratio is imposed by the Central Bank on PT UKMB.

* With regards to income taxes:

- CRS may not have to pay taxes on interests if the amount of interest expenses is offset by operating expenses (training).
- PT UKMB does not pay taxes on dividends received from BPR's.

New financial set up

Today the situation has changed and the financial set up of PT UKBM must be adapted to the economic evolution :

PT UKBM will not buy shares in the existing and profitable BPR. Neither PT Nusuma nor VSM are willing to sell a equity participation from their existing BPR subsidiaries so that §2 of "conclusions" above is no longer accurate.

PT UKBM will invest :

- in future BPRs deriving from "UB conversion"
- in future BPRs jointly set up with PT Nusuma or YSM

These new BPRs will be unable to distribute dividends to PT UKBM for approximately two years, so they must be financed through equity and not through loan in order not to generate an operating loss in PT UKBM.

Financially speaking it is not feasible for CRS to make a loan to PT UKBM, as there is no longer participation in the existing BPR to purchase, and consequently no distribution of dividends, allowing PT UKBM to pay the financial charges of the loan granted by CRS.

However a 100 MRps loan from CRS to PT UKBM can be contemplated to help PT UKBM to loan a similar amount to VSM.

This loan will have two repercussions :

On the financial side : CRS Indonesia as a classical lender will cash 24 MRps interest¹ per year to finance a portion of its humanitarian oprations.

On the legal side : CRS Indonesia as lender can keep a legal and enforceable control on PT UKBM through

- powers and rights mentioned in legal issues §2 (above)
- the setting up of an "Investment Committee" composed of the PT UKBM Managing Director and others chosen for their professional experience to make the company's investment decisions.

Conclusion on the financial set up of PT UKBM

PT UKBM will be set up :

- a) with the legal minimum amount of pledged capital : 500 millions Roupies
 - first call : (notary act application) : 12.5% 62.5
 - second call : (Ministry of Justice acceptation) : 12.5% 62.5
135 M Rps

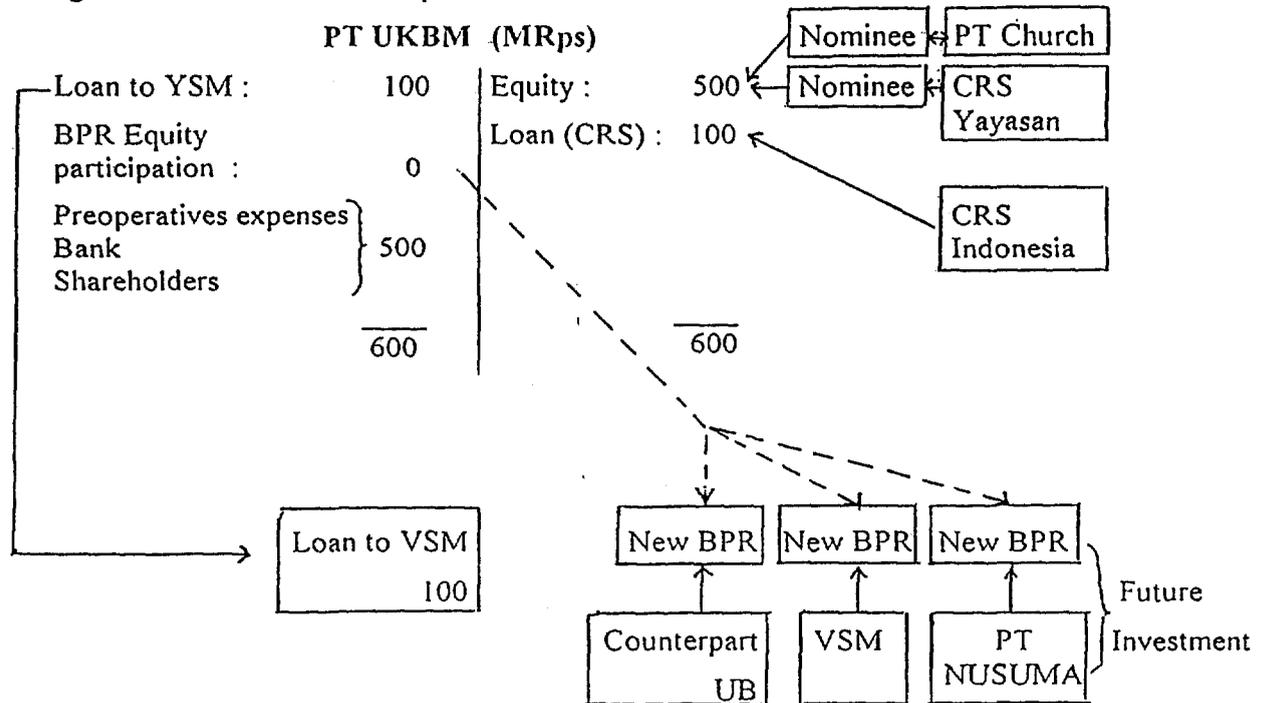
As long as PT UKBM does not invest in a new BPR it does not need additional funds to commence operations as a legal entity.

- b) with a 100 M Rupies loan from CRS Indonesia (see above)

¹ A profit sharing loan could be contemplated (instead of a classical loan bearing interest) but a 30% tax will be charged to CRS Indonesia whereas tax could be offset on "interest" income if CRS grant a classical loan (see B/ b-2).

B/ LEGAL ASPECT

The legal structure can be contemplated as follows :



a) First step

In order to commence operations quickly at PT UKBM, (as it takes several months to obtain a green light from the Indonesian Administration), the company could be set up with nominees, and CRS Indonesia could grant a loan to these nominees.

b) Second step

These nominees will transfer their shares as quickly as possible :

- to CRS Yoyasan (when this one is set up)
- to a PT Indonesian legal entity belonging to the Church or to a charity organization.

We are not in favor of PT UKBM shareholders being nominees for two reasons :

1) Legal issue

Indonesian law is different from English common law : the Indonesian nominees are the legal owners of the property. As mentioned by "DGS Consultants" : whatever rights the foreign principal has derived from the contract, since the arrangement is often entered into to avoid restrictions on foreign participation in the economy, the contracts underpinning a nominees arrangement are often subject to challenge as having an illegal purpose and therefore unenforceable.

Common practice is to try to secure the foreign principal interest through a loan agreement under which the share capital invested by the nominees on behalf of the foreign principal is created as a loan from the foreign principal to the nominee, which is then secured by a pledge of shares back to the foreign principal. These later may also be given powers of attorney to vote on the shares or to sell the shares in the event of default.

This package is valid as long as the nominee never repays the loan. But if the company is very profitable and if the nominee repays the loan, the security arrangement is cancelled.

Apart from this key issue a nominee is a human being and if he passes away, a lot of problems may arise from his heirs as they are not part of the contract and are subject to inheritance taxation.

2) tax issue

PT UKBM must be structured as to transfer its profit to legal entities involved in the humanitarian activities without paying excessive amounts of tax. Such is not the case if nominees are shareholders of this Company. On the contrary if a PT x is shareholder of PT UKBM the income made from PT UKBM dividends can be offset if CRS Indonesia or CRS yoyassan through a "specific contract" invoice "humanitarian services" to PT x. Through such a way PT UKBM profit can be transferred to CRS Indonesia or CRS yoyassan without paying income tax.

Conclusion on the legal aspect

Today CRS Indonesia must :

- 1) Choose two reliable people as nominees to be the first shareholders of PT UKBM
- 2) Set up CRS Yayasan to become in the near future one PT UKBM shareholder.
- 3) Look for an Indonesian PT belonging to the church to become an other PT UKBM shareholder.
- 4) Finalise all the legal documentation with the lawyer.

IV/ LEGAL DOCUMENTATION

During our last visit in Jakarta, we came through several documents prepared by the lawyer and we make some comments on each of them.

A/ ARTICLES OF ASSOCIATION

Article 3.1

Delete "subordinate"

Change "PT BPR" for social institution and other legal entities

Article 4

All PT UKBM shares will be common shares with the same rights.

Article 11.2

Change "preferred stockholder in Article 4.3" for the "shareholders".

Article 15.4

Delete "preferred stockholder per Article 4.3" and change an "unlimited period... at any time" for "a five year term of office".

B/ LOAN AGREEMENT BETWEEN PT UKBM AND A NOMINEE SHAREHOLDER

Article 3

The loan shall carry no interest / Does tax regulations in Indonesia allows one to grant a loan with no interest ?

Article 4.1

Needs to be clarified

Article 5

Seems not to be consistent with Article 3.

Article 8

(a) What is the meaning of the two first lines ?

Article 16.01

How to link "accrued interest" mentioned in this Article 16.01 with the Article 3

C/ PLEDGE OF SHARES AGREEMENT

Linked to the loan agreement between PT UKBM and a nominee shareholder.
No particular comment on this Pledge Agreement.

D/ COOPERATION AGREEMENT (BETWEEN CRS INDONESIA AND A NOMINEE)

This document must be totally amended for specific reasons expressed in our meeting (on March 27th) with CRS and CRS lawyer Gary W. Christian.

E/ LOAN AGREEMENT 100 M RPS BETWEEN PT UKBM AND YSM

The financial terms and conditions have been given to Gary in order to write the Loan Agreement and to include classical covenants and pledge of shares (see chapter II- §2).

F/ LOAN AGREEMENT 100 M RPS BETWEEN CRS AND PT UKBM (TO FINANCE YSM)

This loan must be a long term loan, 10 years duration.

Rate of interest² : 2% above the time deposit rate of the State Bank BTPN, mentioned in Bisnis Indonesia Newspaper at the first working day in every month, payable every month the last day of the month.

This loan Agreement must include as recommended by Gary a fair degree of control over PT UKBM business (right to approve / disapprove borrowings, loans, guarantees, change in the board of directors / change in shareholding / and the so called "Investment committee" composed of PT UKBM Managing Director and other people chosen by CRS Indonesia for their professional experience to make the company's investments decisions).

G / MEMORANDUM OF UNDERSTANDING BETWEEN PT UKBM AND PT NUSUMA / AND YSM

A framework of this MOU (exhibit I) has been accepted on principle by the two groups. The lawyer has to write the document in the legal way.

² For tax purpose, this loan will carry an interest and will not be linked to a profit sharing agreement (see above chapter III- § A.

EXHIBIT I

Memorandum of understanding

General objective : promote the creation or the development of BPR in Indonesia through acquisition of shares and transfer of technology.

Social objective : BPR should finance groups or micro sized business (as much as possible women oriented) through interest bearing loans. BPR must be profit oriented but borrowers should take advantage of a progressive reduction of interest rates.

Article of association

- The status of all BPRs subject to this MOU should be amended as to protect the minority partners : A listing of key decisions must be approved by the General Assembly by unanimous consent.

- A commissioner is appointed by the minority shareholder.

Dividend policy

Dividends declared each year should be equal to at least 50% of profit after tax.

Services

Each partner should be responsible for certain services to the BPR on the condition that the other partner agrees with the cost of these services.

Training

Each partner can send a limited number of interns to a BPR for training. This service will be offered free of charge.

Reporting

On a monthly basis.

Transfer of shares

Preemptive rights given to the old shareholders. If this right is not exercised, the new shareholders should accept the principles established by the "shareholders agreement".

Governing law

Indonesian law

Arbitration

Uncitral rules. The arbitrage tribunal will consist of three arbitrators. Each party will appoint one arbitrator and a third one will be appointed by the arbitrators of both parties.

Duration

Unlimited time (subject to be reviewed annually).

Attachment 3. Projected Investment Pipeline

Attachment 3 Projected Investment Pipeline							
Description of Investment	Oct-96	Nov-96	Dec-96	Jan-97	Feb-97	Mar-97	Apr-97
<i>Business investment</i>	-	80,000.00	-	75,000.00	30,000.00	-	165,000.00
1 Equity investment in new BPR (in USD)	-	30,000.00	-	-	-	-	30,000.00
Business Partner		YSBS			NU/SERULING		YMU/YSBS
# of BPR		1 BPR			1 BPR		1 BPR
2 Equity investment in Operational BPR (in USD)	-	-	-	75,000.00	-	-	75,000.00
Business Partner				YMU/G. Prospek			NU/YIS
# of BPR				1 BPR			
3 Short Term Loan in Operational BPR (in USD)	-	50,000.00	-	-	30,000.00	-	60,000.00
Business Partner		YSBS			NU/SERULING		YMU/Other
# of BPR							YMU/YSBS

Attachment 3						
Projected Investment Pipeline						
Description of Investment	May-97	Jun-97	Jul-97	Aug-97	Sep-97	Total FY2
<i>Business investment</i>	-	60,000.00	105,000.00	30,000.00	30,000.00	575,000.00
1 Equity investment in new BPR (in USD)	-	30,000.00	-	30,000.00	-	120,000.00
Business Partner		YAPENSKAK		Puskowanjati		
# of BPR		1 BPR		1 BPR		
2 Equity investment in Operational BPR (in USD)	-	-	75,000.00	-	-	225,000.00
Business Partner			YMU/Bina Swad.			
# of BPR			Other (1 BPR)			
3 Short Term Loan in Operational BPR (in USD)	-	30,000.00	30,000.00	-	30,000.00	230,000.00
Business Partner		YAPENSKAK		Puskowanjati		
# of BPR						

Attachment 4. Proposed Budget for FY 1997

Attachment 4.

BUDGET SUMMARY FOR FY 2
 INSTITUTIONAL TRANSFORMATION FOR SCALE AND SELF-SUFFICIENCY PROJECT

	BALANCE FROM FY1		BUDGET FOR FY2		AVAILABLE BUDGET FOR FY2		PROPOSED BUDGET FOR FY 2	
	USAID	CRS	USAID	CRS	USAID	CRS	USAID	CRS
	1	2	3	4	5 = (1+3)	6 = (2 + 4)	7	8
I. Program Elements								
A. Salaries	71,587.79	-	93,170.00	-	164,757.79	-	65,954.98	-
B. Administration	17,461.57	4,300.00	23,515.00	4,730.00	40,976.57	9,030.00	29,836.41	6,003.12
C. Travel	12,218.27	-	22,770.00	-	34,988.27	-	17,208.62	-
D. Training Workshops	38,756.65	-	43,010.00	-	81,766.65	-	27,550.00	-
E. Investment Capital	153,101.00	125,000.00	250,000.00	125,000.00	403,101.00	250,000.00	407,025.00	206,550.00
Total Program Elements	293,125.28	129,300.00	432,465.00	129,730.00	725,590.28	259,030.00	547,575.00	212,553.12
II. On-Going monitoring								
A. External consultants	(7,176.09)	-	38,239.00	-	31,062.91	-	37,575.00	-
B. SEDTU Travel	5,791.39	-	9,792.00	-	15,583.39	-	9,792.00	-
C. External Audits	20,000.00	-	22,000.00	-	42,000.00	-	20,000.00	-
Total On-going Monitoring	18,615.30	-	70,031.00	-	88,646.30	-	88,646.30	-
III. Procurement								
A. Vehicles	-	20,000.00	-	-	-	20,000.00	-	20,000.00
TOTAL DIRECT COSTS	311,740.58	129,300.00	502,496.00	129,730.00	814,236.58	259,030.00	636,221.30	212,553.12
Indirect Costs (22.5%)	70,391.02	29,195.94	113,463.60	29,293.03	183,854.62	58,488.97	143,658.77	47,994.49
TOTAL COSTS	382,131.60	158,495.94	615,959.60	159,023.03	998,091.20	317,518.97	779,880.08	260,547.62

BEST AVAILABLE COPY

PT UKBM CASH FLOW PROJECTION																
FY 2 (Oct 96 - sep 97)																
in US \$																
	Ytd Sep-96	Oct-96	Nov-96	Dec-96	Jan-97	Feb-97	Mar-97	Apr-97	May-97	Jun-97	Jul-97	Aug-97	Sep-97	TOTAL (FY2)	TOTAL (YTD)	
OUT FLOW	118,537.40	15,833.48	88,434.88	38,296.84	104,271.46	41,326.44	16,771.46	186,021.46	40,071.46	73,392.46	122,001.46	51,221.46	40,271.46	815,714.32	934,251.72	
1. Legal	5,716.38	1,000.00	-	-	-	-	-	-	-	-	-	-	-	1,000.00	6,716.38	
1.a Notary Act	1,500.00	-	-	-	-	-	-	-	-	-	-	-	-	-	1,500.00	
1.b Domicile	375.00	-	-	-	-	-	-	-	-	-	-	-	-	-	375.00	
1.c SIUP	1,500.00	-	-	-	-	-	-	-	-	-	-	-	-	-	1,500.00	
1.d TDP	125.00	-	-	-	-	-	-	-	-	-	-	-	-	-	125.00	
1.e NPMP	30.00	-	-	-	-	-	-	-	-	-	-	-	-	-	30.00	
1.f Lawyer Fee (6203)	2,186.38	1,000.00	-	-	-	-	-	-	-	-	-	-	-	1,000.00	3,186.38	
2. Operations	16,965.81	7,084.66	7,084.66	11,450.84	7,521.46	7,521.46	7,521.46	7,521.46	7,521.46	7,521.46	7,521.46	7,521.46	7,521.46	93,313.70	110,278.51	
2.1 Salary (6052)	13,091.76	4,365.98	4,365.98	8,731.96	4,802.58	4,802.58	4,802.58	4,802.58	4,802.58	4,802.58	4,802.58	4,802.58	4,802.58	80,887.10	73,778.86	
2.2 Insurance (6061 & 6062)	895.96	438.99	438.99	438.99	438.99	438.99	438.99	438.99	438.99	438.99	438.99	438.99	438.99	5,267.87	6,163.83	
2.3 Office Expense/Supplies (6309)	529.00	276.81	276.81	276.81	276.81	276.81	276.81	276.81	276.81	276.81	276.81	276.81	276.81	3,321.70	3,850.70	
2.4 Utilities (6308 tel) & 6405 (Elec, Wtr)	500.00	650.00	650.00	650.00	650.00	650.00	650.00	650.00	650.00	650.00	650.00	650.00	650.00	7,800.00	8,300.00	
2.5 Occupancy (6401)	1,509.92	875.00	875.00	875.00	875.00	875.00	875.00	875.00	875.00	875.00	875.00	875.00	875.00	10,500.00	12,009.92	
2.6 Correspondence (6302) & 6304	140.26	378.09	378.09	378.09	378.09	378.09	378.09	378.09	378.09	378.09	378.09	378.09	378.09	4,637.02	4,677.28	
2.7 Other incl Intern meeting (6701) Ext Conference (6702) Trg Wkshp, Ort (CRS) - 6705 Severance Payment (6071) & Bank Charge (6943)	298.91	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	1,200.00	1,498.91	
3. Travel	3,496.82	898.62	775.00	775.00	1,550.00	3,455.00	1,550.00	775.00	1,550.00	775.00	2,760.00	775.00	1,550.00	17,208.82	20,705.44	
3.1 Local (6801-oil & gas) & 6802 (tol,parking etc)	75.00	123.62	-	-	-	-	-	-	-	-	-	-	-	123.62	198.62	
3.2 Domestic (6703)	3,364.85	775.00	775.00	775.00	1,550.00	775.00	1,550.00	775.00	1,550.00	775.00	1,550.00	775.00	1,550.00	13,175.00	16,539.85	
3.3 International	-	-	-	-	-	2,880.00	-	-	-	-	1,230.00	-	-	3,910.00	3,910.00	
3.3 Other travel expenses (6709)	56.97	-	-	-	-	-	-	-	-	-	-	-	-	-	56.97	
4. Consultancy (6204 & 6206)	48,009.70	-	-	17,421.00	20,000.00	-	-	12,525.00	-	4,896.00	-	12,525.00	-	87,387.00	115,374.70	
4.1 External Audit	-	-	-	-	20,000.00	-	-	-	-	-	-	-	-	20,000.00	20,000.00	
4.2 SEDTU Travel	3,708.61	-	-	4,896.00	-	-	-	-	-	4,896.00	-	-	-	8,792.00	13,500.61	
4.3 External Consultant	44,301.09	-	-	12,525.00	-	-	-	12,525.00	-	-	-	12,525.00	-	37,576.00	81,876.09	
5. Investment	-	-	16,680.00	20,000.00	-	-	-	-	-	-	-	-	-	36,680.00	36,680.00	
5.1 Vehicle (6803)	-	-	-	20,000.00	-	-	-	-	-	-	-	-	-	20,000.00	20,000.00	
5.2 Office Equipment (Computers, printers etc)	-	-	14,280.00	-	-	-	-	-	-	-	-	-	-	14,280.00	14,280.00	
5.3 Furniture	-	-	2,400.00	-	-	-	-	-	-	-	-	-	-	2,400.00	2,400.00	
6. Human Resource Development	-	-	450.00	-	50.00	200.00	1,050.00	50.00	24,350.00	50.00	50.00	250.00	1,050.00	27,550.00	27,550.00	
6.1 Training	-	-	-	-	-	-	1,000.00	-	-	-	-	-	-	1,000.00	1,000.00	
6.2 Seminar & Workshop	-	-	-	-	-	-	-	-	24,100.00	-	-	-	-	25,100.00	25,100.00	
6.3 Specific Short Term Course	-	-	450.00	-	-	-	-	-	-	-	-	-	1,000.00	450.00	450.00	
6.4 Literature	-	-	-	-	-	150.00	-	-	200.00	-	-	-	200.00	650.00	650.00	
6.5 Subscription	-	-	-	-	50.00	50.00	50.00	50.00	50.00	50.00	50.00	50.00	50.00	450.00	450.00	
7. Business investment	42,863.27	6,500.00	80,000.00	6,500.00	75,000.00	30,000.00	6,500.00	165,000.00	6,500.00	80,000.00	111,500.00	30,000.00	30,000.00	607,500.00	850,343.27	
7.1 Equity investment in new BPR	-	-	30,000.00	-	-	-	-	30,000.00	-	30,000.00	-	30,000.00	-	120,000.00	120,000.00	
7.2 Equity investment in Operational BPR	-	-	-	-	75,000.00	-	-	75,000.00	-	-	75,000.00	-	-	225,000.00	225,000.00	
7.3 Short Term Loan in Operational BPR	42,863.27	-	50,000.00	-	-	30,000.00	-	60,000.00	-	30,000.00	30,000.00	-	30,000.00	250,000.00	272,863.27	
7.4 BPR Pre-operational Expenses	-	6,500.00	-	6,500.00	-	-	6,500.00	-	6,500.00	-	6,500.00	-	-	31,500.00	31,500.00	
8. Miscellaneous	1,485.43	150.00	125.00	150.00	150.00	150.00	150.00	150.00	150.00	150.00	150.00	150.00	150.00	1,778.00	3,260.43	
8.1 Entertainment	54,000.00	75.00	75.00	75.00	75.00	75.00	75.00	75.00	75.00	75.00	75.00	75.00	75.00	800.00	800.00	
8.2 Government Liaison	-	75.00	50.00	75.00	75.00	75.00	75.00	75.00	75.00	75.00	75.00	75.00	75.00	875.00	875.00	
8.3 Advertising	764.81	450.00	-	-	-	-	-	-	-	-	-	-	-	450.00	1,214.81	
8.4 Translate	1,131.25	-	1,000.00	-	-	-	-	1,000.00	-	-	-	-	1,000.00	3,000.00	4,131.25	
INFLOWS	98,219.48	17,035.79	80,639.79	35,081.79	108,160.79	41,160.79	23,035.79	196,060.79	18,785.79	84,181.79	134,160.79	65,540.79	73,035.79	874,798.49	973,018.97	
8. Financing	96,865.00	6,500.00	80,000.00	6,500.00	75,000.00	30,000.00	6,500.00	165,000.00	6,500.00	80,000.00	111,500.00	30,000.00	30,000.00	607,500.00	704,365.00	
8.1 Capital	54,000.00	-	-	-	-	-	-	-	-	-	-	-	-	-	54,000.00	
8.2 Soft Loan for equity investment & temp loan	42,865.00	6,500.00	80,000.00	6,500.00	75,000.00	30,000.00	6,500.00	165,000.00	6,500.00	80,000.00	111,500.00	30,000.00	30,000.00	607,500.00	650,365.00	
9. Revenue	1,354.48	10,535.79	10,535.79	28,581.79	31,160.79	11,160.79	16,535.79	24,060.79	12,285.79	17,181.79	22,660.79	25,560.79	43,035.79	253,298.49	254,650.97	
9.1 Consulting Fee (from MIP Grant) **	-	10,000.00	10,000.00	27,421.00	30,000.00	10,000.00	10,000.00	22,525.00	10,000.00	14,896.00	10,000.00	22,525.00	10,000.00	187,387.00	187,387.00	
9.2 Training fee	-	-	-	-	-	-	6,000.00	-	-	-	10,000.00	-	-	16,000.00	16,000.00	
9.3 Dividend	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	
9.4 Loan/principle repayment from BPR	-	-	-	-	-	-	-	-	-	-	-	-	-	30,000.00	30,000.00	
9.5 Interest repayment from BPR	1,354.48	535.79	535.79	1,160.79	1,160.79	1,160.79	1,535.79	1,535.79	2,285.79	2,285.79	2,660.79	3,035.79	3,035.79	20,928.49	22,283.97	
10. Other Income	-	-	-	-	-	-	-	7,000.00	-	7,000.00	-	-	-	14,000.00	14,000.00	
NET CASH INFLOWS	(20,317.93)	1,402.31	2,100.93	(1,215.05)	1,889.33	(165.67)	6,264.33	10,039.33	(21,285.67)	10,788.33	12,159.33	4,339.33	32,784.33	59,082.17	38,764.25	
Net cash inflows (ytd)	(20,317.93)	(18,915.61)	(16,814.68)	(18,029.73)	(16,140.40)	(16,308.07)	(10,041.74)	(2.41)	(21,288.08)	(10,498.75)	1,860.58	5,999.92	38,784.25	97,846.42	77,528.49	
INDIRECT COST																
New BPR Establishment	-	-	17,794.12	-	-	7,500.00	-	20,294.12	-	12,794.12	7,500.00	5,294.12	7,500.00	78,876.47	78,876.47	
Beneficiaries own Capital	-	-	5,294.12	-	-	-	-	5,294.12	-	5,294.12	-	-	7,500.00	21,178.47	21,178.47	
	-	-	12,500.00	-	-	7,500.00	-	15,000.00	-	7,500.00	7,500.00	-	7,500.00	57,500.00	57,500.00	

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