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# SECTOR STUDIES

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# Progress with Profits

## The Development of Rural Banking in Indonesia

Richard H. Patten and Jay K. Rosengard

A Copublication of the International Center for Economic Growth
and the Harvard Institute for International Development

ICS Press
San Francisco, California

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Thoughtful men, once escaped from the blinding influences of traditional prejudice, will find in the lowly stock whence man has sprung the best evidence of the splendor of his capacities; and will discern in his long progress through the past a reasonable ground of faith in his attainment of the future.

—T. H. Huxley
*Evidence as to Man's Place in Nature*, 1863

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# PREFACE

*Progress with Profits* is the fourth in ICEG's series of Sector Studies. A Sector Study analyzes one country's response to a specific policy problem or compares the policies of several countries. In this study, Richard H. Patten and Jay K. Rosengard of the Harvard Institute for International Development (HIID) mission in Indonesia look at two successful rural banking systems in Indonesia, comparing their approaches to rural lending and pinpointing the factors that have contributed to their effectiveness.

In many developing countries, the poorest segment of the population lives in the rural areas. During past decades, economists and policy makers have emphasized that one way to stimulate rural economies is to offer credit to the poor. Even modest loans allow farmers, tradesmen, and vendors to raise their income levels by buying improved seed varieties, investing in new equipment, and expanding their inventory. Rural banks offering credit to the poor have taken hold with great success in several countries, most notably perhaps in Bangladesh. In many other countries, however, rural banks have been short-lived.

The two rural banking systems considered in this Sector Study—Badan Kredit Kecamatan and Bank Rakyat Indonesia—have not only made millions of loans, but have also offered many of their clients a safe, convenient place to hold their savings. Equally important, the banks have been profitable, and therefore sustainable.

Patten and Rosengard look at the evolution of these institutions to determine why they work so well. The credit they provide is accessible, has low transaction costs, is expeditious and reliable, and charges market interest rates. Some of the strengths of the two banks are based on their specific geographic, political, and economic circumstances.

Others, such as their adherence to traditional banking principles and their high understanding of and responsiveness to their clientele, can be transferred to rural banks elsewhere.

After years of struggling with the problem of rural poverty, development economists and bankers have much to learn from the experiences of these two banks. We hope that the lessons presented here can be fruitfully applied in other developing countries. We are pleased to publish this study as a joint effort of HIID and ICEG for the benefit of policy makers everywhere.

Nicolás Ardito-Barletta
General Director
International Center for Economic Growth

Panama City, Panama
July 1991

# COPUBLISHER'S PREFACE

The rural landscape of the developing world is strewn with examples of rural credit systems that failed. Over the past three decades, developing country governments and international aid agencies, working separately and together, have poured billions of dollars into rural credit schemes. Most of these experiments have been failures in the sense that loan default rates have been high, and the large financial losses entailed ensured that these efforts were not sustainable once the large subsidies involved were removed.

This study of the rural credit experience of the Bank Rakyat Indonesia (BRI) and the smaller Badan Kredit Kecamatan (BKK), therefore, is more than just another case study of two rural credit programs. It is a study of two successful rural banking systems. In the developing world there are few others, and perhaps none that have had the quantitative impact of the BRI credit and savings initiatives. Indonesian rural households today (1990) receive hundreds of millions of dollars of credit more each year than was previously available to them. And rural savings in the organized banking sector have risen by an even greater amount.

Are there lessons in this experience for others? The answer is almost certainly yes. Some of the features that made the BRI and BKK experiences so positive may have been unique to Indonesia. But a banking system that gives its local managers incentives to respond to the real financial needs of the rural population is not inherently Javanese, Balinese, or Sumatran.

For whom are the lessons relevant? Other nations with low per capita incomes trying to create a viable rural banking system can obviously learn from the Indonesian experience. Many Indonesians can themselves benefit from a better understanding of what the BRI has accomplished and how it has done so. In developing countries there is always a danger that promising new institutions can be undermined by uninformed government interventions. Telling the BRI story is, therefore, a part of the process of sustaining what has been achieved.

But the lessons of the Indonesian experience with rural banking reach beyond issues of rural credit and savings. BRI reforms have been part of a more general effort to convert Indonesia's financial system from one governed by bureaucratic procedures and central commands to a market-oriented system of competitive commercial banks. Furthermore the BRI remains state owned, not a private enterprise, and hence is a test case for whether state-owned enterprises can be made responsive to market forces. Much of the literature on market-oriented reforms assumes that all one need do is get the government out and market forces will naturally take over. The Indonesian experience with rural banking shows that at least one part of a large state enterprise can be made responsive to market forces. The restructuring of BRI's rural programs also illustrates that there is much more to the process than just reducing the role of government intervention. One must also transform the incentive systems within the bank itself.

It is hoped that this study by Richard H. Patten and Jay K. Rosengard will be the first of many monographs written about the Indonesian rural banking experience. This study covers the salient features of how the BRI and BKK programs were structured. As data now being collected become available, other studies will look at issues such as the impact of BRI lending on the rural economy.

For the past three years Richard Patten has been the leader of the Harvard Institute for International Development (HIID) technical assistance team within the BRI. Earlier, he spent five years leading the technical assistance effort to rehabilitate the BKK program. Subsequently, Patten, and others, worked with the BRI under the auspices of Indonesia's Center for Policy and Implementation Studies. Jay Rosengard worked on the BKK programs through Development Alternatives, Inc. (DAI) before joining another of HIID's projects in Indonesia.

It has been HIID's privilege to work on these rural banking issues with an extraordinary group of senior Indonesian leaders within both BRI and the Ministry of Finance. It was they who made the decisions that brought about the reforms described in this book, and it is they who bear most of the responsibility for their success.

Dwight H. Perkins
Director
Harvard Institute for International Development

Cambridge, Mass.
December 1990

# A C K N O W L E D G M E N T S

First and foremost, we would like to thank the management and staff of Bank Rakyat Indonesia and Bank Pembangunan Daerah Jawa Tengah, as well as the local managers, field employees, and customers of the unit desas and Badan Kredit Kecamatans throughout Indonesia for their gracious assistance and considerable patience during our work together over the past decade. We would also like to express our gratitude to our colleagues at the Harvard Institute for International Development and the Center for Policy and Implementation Studies for their many contributions to the development of the institutions described in this study. We are especially indebted to Glenn Jenkins for his initiative in launching this project and his perseverance in seeing it through to completion, as well as to Dwight Perkins for his timely sponsorship and consistent support of our work. We also appreciate the guidance provided by government of Indonesia officials at the Ministry of Finance and other ministries during the entire period it has been our privilege to work in Indonesia.

# ABOUT THE AUTHORS

RICHARD H. PATTEN has worked on rural development, rural credit, employment, and transmigration issues in Indonesia since 1970. He is currently a Harvard Institute for International Development (HIID) consultant to Bank Rakyat Indonesia, helping to develop a full rural banking system. He has also been an HIID consultant to Indonesia's Ministry of Finance, a U.S. Agency for International Development (USAID) consultant on rural development and rural credit to the government of Indonesia, and an adviser on rural development to a number of developing country governments. Mr. Patten received a B.A. from the University of Oklahoma and an M.S. in economics from the University of Wisconsin, where he has also done additional study in public finance.

JAY K. ROSENGARD has spent the past fifteen years designing, implementing, and assessing international development projects, programs, and policies. He has worked as a consultant to developing country governments, multilateral development banks, United Nations agencies, and bilateral assistance institutions in Asia, Africa, the Middle East, and the Caribbean. Most recently, Mr. Rosengard was HIID project coordinator for the World Bank–assisted Property Tax Project in Indonesia. He previously served as team leader for the USAID–assisted Financial Institutions Development Project in Indonesia. Mr. Rosengard received an A.B. from Princeton University and a master's degree in public administration from the John F. Kennedy School of Government at Harvard University. He is now a teaching fellow and candidate for a doctor of design degree in public finance and urban economics at Harvard University's Graduate School of Design. His current research is on the implementation of fiscal policy reform in developing countries.

# 1
# Introduction: Rural Banking in Print and Practice

*Experience joined with common sense*
*To mortals is a providence.*

—Matthew Green, *The Spleen,* 1737

Much has been written on how one should design and implement rural credit and savings schemes. Likewise, many studies have been undertaken regarding the results of specific rural banking projects and programs. Rarely, however, has the theoretical been examined in light of the actual; seldom have field experiences been utilized in the reassessment of general principles. Furthermore, when such comparisons have been made, the traditional programmatic focus on relative success or failure of a particular credit or savings activity has usually overshadowed concern for the overall development of rural financial institutions and rural banking services.

Thus, proselytizers of different schools of rural financial market development have not been able to prove or disprove their theories convincingly nor to offer much of value to those working in the field to develop rural banking organizations, systems, and products.

This study has been prepared in a context in which there is, first of all, a plethora of theory and an abundance of field experience on the promotion of rural banking in developing countries, with links between the two that are tenuous at best, and, second, a widespread emphasis on the implementation of transitory projects and programs instead of the promotion of self-sustaining institutions and services.

A rural credit program should be evaluated on the basis of whether it increases the capacity of a rural financial institution to provide a continuing flow of financial services to the people of the rural areas, rather than whether it succeeds in disbursing a certain amount of credit to a particular target group. This study looks at two programs in Indonesia specifically designed to develop institutions to provide a long-term flow of financial services to people in rural areas.

The Badan Kredit Kecamatan (BKK) program was set up by the government of Central Java in the early 1970s to provide credit for villagers who were short of capital for their enterprises. At the end of 1989, the BKK program had more than five hundred thousand loans outstanding. It is covering all costs, including losses, and is a financially viable credit institution.

When the BKK program was set up, founders did not perceive the need for an institution that would provide savings services for rural people. Rural people were considered too poor to save without previous help in the form of capital. The "savings" in the BKK are forced from the borrowers to "educate them to the value of saving." BKK pilot projects with voluntary savings facilities have found a strong response, but the BKKs have not followed up these results. Outside capital plus retained earnings were adequate to support growth; there was no compelling need for voluntary savings as a source of loanable funds. This appears to be a case of ready availability of capital from government and aid donors stunting an institution's development into a full financial intermediary.

The *unit desas* (village units) of the Bank Rakyat Indonesia (BRI) were established in the early 1970s to provide credit for agricultural inputs as part of an extension program, BIMAS, encouraging the use of fertilizer-intensive rice cultivation. They were not intended to be financial intermediaries. The country had to increase rice production quickly and authorities thought that the required sudden increase in cash inputs could only be met by credit to the farmers and that the government was the only possible source of such credit. The agricultural extension program succeeded. The rural credit network, however, was marked by increasing arrears and operating deficits, which were covered by BIMAS subsidies.

The BRI unit desas were in effect reborn in 1983–1984, when it was clear that BIMAS credit and operating subsidies were going to be stopped. The human infrastructure for a huge financial institution had been developed. The unit desas were providing the only formal banking

services in more than 75 percent of all the locations in the country that had any such services. The ending of BIMAS could have meant abandoning this banking infrastructure. Instead, the decision was taken to turn the more than three thousand unit desas into full banking units that would be financially viable without further subsidy from government.

In revamping the unit desa network, planners decided that savings would be the major source of loanable funds and would carry a positive real interest rate. Interest rates on loans were set at levels high enough to cover all costs, including expected loan losses, and to earn a net profit. The goal was to build a stable and financially viable institution that would earn the trust of the people as a place to borrow and to keep savings. The credit operations of the unit desas have grown at an impressive rate since 1983, with more than 1.5 million loans on the books in mid-1990. Loan losses are well controlled, and the unit desas are now consistently profitable. The savings response has been even more impressive. In mid-1990 there are more than 7 million savings accounts in the unit desas. The value of savings exceeds credit outstanding, so there is no need for injections of outside funds. The unit desas now provide a steady flow of the financial services needed by the people in the rural areas.

The four primary objectives of this study are to provide a critical assessment of the development of rural banking in Indonesia; synthesize lessons learned from field experiences regarding the design, implementation, and modification of rural banking policies and practices; offer suggestions for the growth of rural banking in Indonesia; and assess the transferability of the Indonesian experience to locations outside of Indonesia.

This study will compare what seems to be working in practice with common theoretical tenets presented in literature on rural banking and offer observations on lessons learned in the field regarding the development of rural financial facilities in Indonesia and elsewhere.

We begin by reviewing key principles in the development of rural financial institutions and services in chapter 2. Chapter 3 summarizes the Indonesian macroeconomic policy context in which the rural financial institutions described in the remainder of the text were developed. Chapters 4 and 5 describe and analyze two of the most successful rural banking efforts anywhere in the developing world: the Badan Kredit Kecamatan, or BKKs in Central Java, Indonesia, and the Bank Rakyat Indonesia (BRI) unit desas throughout Indonesia. Chapter 6 synthesizes lessons learned from the BKKs and BRI unit desas and

discusses implications for the transferability of these lessons to other rural financial institutions both within and outside of Indonesia.

In keeping with the objectives outlined above, this study is *not* a comprehensive review of the hundreds of rural credit and savings programs that have been implemented and institutions that have been created in Indonesia over the past two decades. Little is to be gained from such a review. Not only has much of this experience been discussed at length elsewhere (see bibliography), but most of these rural banking efforts have been spectacularly unsuccessful.

Instead, this study briefly summarizes these initiatives, emphasizing the reasons for failure, and explores Indonesia's two notable successes at length. Rather than dwell on the negative, we stress lessons from these two positive experiences in the hope that they will assist in the development of other rural financial institutions both in Indonesia and abroad. Moreover, nonformal financial systems are beyond the scope of our discussion. Rather, this study focuses on the development of self-sustaining formal financial institutions and the strengthening of rural financial services offered by these institutions.

Finally, because of differences in accounting and reporting systems, raw data from different programs or institutions in Indonesia are often not directly comparable, even if similar terminology is employed. Thus, we have occasionally made minor adjustments (noted in accompanying footnotes) to allow for a more detailed analysis and discussion.

# 2
# Principles in the Development of Rural Financial Institutions and Rural Banking Services

*What we have to learn to do, we learn by doing.*

—Aristotle, *The Nicomachean Ethics*, c. 340 B.C.

## Market Demand

The conventional portrait of the target beneficiary of rural financial institutions and their rural banking services is the peasant farmer in a subsistence economy struggling to feed his family by cultivating a marginal crop.

The common belief is that if only this farmer had access to cheap funds for agricultural production, he could increase his yield and thus raise his income and improve his quality of life. A corollary of this belief is the assumption that the target beneficiary has neither the ability nor the need to save from his subsistence income.

Therefore, the traditional program to develop rural financial markets and institutions is usually built primarily or entirely around the provision of credit to farmers at below-market interest rates and is normally tied to specific agricultural packets or technologies.

However, the actual profile of rural communities in developing countries tends to be much more complex, with the rural populace typified by the following attributes:

- mixed economic activities, with significant seasonal and geographic variations
- fungibility of rural household budgets, in response to changing needs and opportunities
- wealth held in primarily nonliquid assets
- short-term cash needs met by local nonformal credit sources
- a complex set of interrelationships among economic activities, financial transactions, community structures, cultural values, and social controls

Given this client profile, the demand for rural banking services is clearly at odds with those services usually offered by traditional rural financial institutions. The rural populace needs flexibility and discretion to respond to continually changing and highly localized circumstances, and requires permanent access to stable institutions capable of executing essential banking functions. Instead, it is offered temporary programs of tightly structured, highly standardized, severely restricted, and closely supervised lines of credit. That is, despite the heterogeneous and fluid nature of market demand, project designers and implementers assume they are dealing with a homogeneous clientele. Furthermore, they assume they can identify and meet the precise needs of this clientele through the formulation of standard loan packages, regardless of season, location, physical environment, and socioeconomic conditions. Finally, they assume they have the capability and resources to assure that their clientele uses loans in the manner they prescribe.

At the same time, legal requirements such as the pledging of nonmovable assets as collateral, rather than reliance on traditional community relationships and social restraints, frequently limit access to credit facilities of those who can make best use of these resources. Moreover, legal, bureaucratic, and social constraints often make the seizure of such collateral extremely unlikely.

In addition, subsidized interest rates distort the natural project feasibility screening mechanisms used by nonformal lenders to eliminate support for enterprises that can not generate a sufficient return to pay for the cost of capital at market rates. At the same time,

subsidized interest rates doom the local bank to either bankruptcy or perpetual dependence on external financing.

The provision of savings services is traditionally either omitted, included primarily as an educational device, or added as an afterthought. The legitimate need of people in rural areas for a safe, convenient savings institution is not addressed.

Finally, such rural credit and savings programs tend to ignore questions asked most often by prospective rural borrowers and savers. These questions focus on client financial incentives and transaction costs regarding banking services, and confidence in financial institutions performing these banking functions:

- How do loan terms, conditions, and services compare with local nonformal alternatives?
- Is the interest paid on savings competitive with the return on traditional forms of savings?
- How far, how often, and at what cost must I travel to deal with this institution?
- Is there a "toll road" of hidden administrative expenses?
- If I repay my loan in good faith, will this institution survive to make me another loan?
- If I put my savings in this institution, will they be paid out on demand, regardless of the health of this institution?

## Market Supply

Just as the nature of rural market demand is usually misconstrued, so is the character of rural market supply. The cause is often the same: the perception of homogeneity instead of diversity.

If the rural populace is commonly caricatured as having a narrow set of needs, so are most rural credit and savings programs remarkably similar variations on a severely restricted common theme. Moreover, rural financial institutions are alike in their tendency to rely on the most expedient funnel for these prefabricated programs. Consequently,

although there are numerous rural credit and savings programs and many channeling agents for these funds, most programs look quite similar, and their positive influence on the institutional development of rural banking is usually minimal.

In fact, just as in any market, the most successful development of rural banking takes place where (1) rural financial institutions segment the market in which they operate and establish market niches based on comparative advantages over competitors, and (2) banking services are initially tailored to an institution's relative market strengths and subsequently modified as needed to accommodate changes in market conditions.

Identification of market position is closely tied to the operational effectiveness and financial viability of a rural financial institution: it enables the institution to offer appropriate services at a reasonable cost, with the level of both services and cost rising the smaller and shorter term the transaction and the more remote the client.

Effective and profitable rural financial institutions in turn ensure the self-sustaining supply of rural financial services in response to market demand.

## Financial Intermediation

The most important economic function of a banking system is financial intermediation between savers and borrowers: the banks receive savings for capital accumulation, on which they pay interest to the saver, and make loans for investment or consumption, on which they receive interest from the borrower.

The function of the savings interest rate is to induce saving by those whose alternative use of funds would produce a lower return than the interest they earn from the bank, while the function of the loan interest rate is to ration the available funds to the uses of capital that have the highest return.

Rural financial institutions, however, are often seen not as intermediaries between savers and borrowers but rather as one-way funnels for government funds. The main function of these institutions is then to serve as government cashiers and accountants, disbursing external resources locally and reporting on the results thereof.

Consequently, rural financial institutions focus little attention on either mobilizing funds or allocating resources, the two principal func-

tions of financial intermediation. Rather than using a credit or savings program to develop the institutional capacity to act as a financial intermediary in rural areas on a long-term basis, energy is instead devoted to the short-term task of resource distribution.

## Integration of Financial Markets

If financial intermediation is extended to savers and borrowers in different locations successfully, the result is integration of financial markets: a bank with a single office achieves financial market integration through the interbank money market, while a bank that has many branches integrates financial markets both within the bank and through the interbank money market.

During initial efforts to develop rural financial institutions, the promotion of financial market integration should be secondary to achievement of viable lending operations and provision of appropriate savings instruments. However, as rural financial institutions grow and liquidity imbalances arise at specific points within a given system, the integration of financial markets increases the financial stability of these institutions, without which client confidence is easily eroded.

The principal type of financial market integration in developing countries is between rural and urban financial markets. It is uncertain whether integration of these markets will result in the flow of funds from urban savers to rural borrowers, or from rural savers to urban borrowers. Nonetheless, funds in undistorted integrated markets undoubtedly will flow *from* savers whose alternative use of these funds offers a relatively low return compared with interest paid on savings *to* borrowers whose alternative use of the funds offers a relatively high return when compared with interest due on funds borrowed.

Even if rural investments offer a relatively high return when compared with urban alternatives, however, achievement of a flow of funds from urban savers to rural borrowers still faces a major obstacle: in rural areas, individual loans are likely to be both very small and highly dispersed, while loans in urban areas tend to be quite large and geographically concentrated. Consequently, the cost of delivering credit to rural borrowers is high compared with the cost of lending in urban areas. Such a transaction cost differential increases the interest rate spread necessary to induce a flow of funds from urban to rural areas, rather than the reverse. Nevertheless, government intervention

to lower rural interest rates is the rule rather than the exception in rural credit programs. This is a well-intentioned but self-defeating policy, given the economics of keeping a financial institution solvent.

## Institutional Performance

The performance of a financial institution is determined by its efficiency, effectiveness, adaptability, personnel, autonomy, and accountability.

**Efficiency.** A financial institution tends to function efficiently only if it sets its interest spreads correctly, is instilled with a profit motive, is allowed to retain at least a portion of the profits it generates, and is faced with serious competition.

The spread between savings and loan interest rates must cover the costs of intermediation, namely, the costs of operations and loan losses. If a financial institution holds down costs and sets interest rates correctly, it will make a profit. If it sets savings and loan interest rates, either by choice or by government mandate, with insufficient spread, or if operating costs or loan losses get too high, the financial institution will suffer a loss.

Thus, the profit motive should perform a dual function: it should encourage both the setting of interest rates with sufficient spread to cover intermediation costs and the optimization of efficiency to limit these costs.

Nothing else to date has been as effective in promoting efficiency as the profit motive. This explains the disastrous record of public enterprises worldwide except where government has directed the managers to run them like private enterprises and judged performance on the basis of profits earned. Efforts to substitute other criteria for judging, and therefore for motivating managers of public enterprises, have usually ended either in bankruptcy or in survival through the perpetual injection of external subsidies.

The use of profit as a motivation for managers to be efficient will not work, however, if there is no competition or if at least a portion of these profits cannot be retained. Lack of competition will allow a financial enterprise to increase the spread enough to cover the high costs of inefficient operations. This will result in mobilization of a smaller amount of savings and transfer of a smaller amount of resources to high return investment. The earning of profits that cannot be retained relegates

a primary performance incentive to that of a tax, which tends to promote "creative bookkeeping" rather than operational efficiency.

**Effectiveness.** Although a financial institution might be very efficient, policy makers would probably consider it a failure if it did not reach the clientele it was established to serve. Thus, client coverage is an essential factor in determining institutional performance, whether in terms of the number of people serviced, the geographic location of savers and borrowers, a clientele's socioeconomic profile, or the uses to which borrowed funds are applied.

**Adaptability.** Although a financial institution might initially experience short-term prosperity, continued survival is dependent on its capacity to adapt to its environment: responsiveness to market conditions is a prerequisite for a financial institution's long-term success. Prices change. Laws change. Government policies change. Seasons change. People change. If a financial institution cannot adapt to the transformation of circumstances that determine its survival, then it will also change—it will die.

**Personnel.** If a financial institution is to achieve its objectives, the incentives both to the institution and to the individuals who manage it must be set correctly. Concomitantly, personnel must be trained so they are able to respond to these incentives.

For incentives to be effective, the following must be clearly understood and equitably implemented at each level of the institution:

- the objectives of the institution
- the conditions within which each organizational unit and each manager is expected to perform
- the basis for judgment of success or failure
- the financial and career rewards for good individual and organizational performance and the penalties for failure

A strong staff training program is also needed to complement a clearly articulated and fairly applied system of incentives to good individual and organizational performance. This training program

should be an ongoing effort, with an emphasis on continual refresher courses that recycle staff through a layered curriculum of formal training and field exercises.

**Autonomy.** Responsibility without authority provides a powerful personal and organizational disincentive to good performance, just as anonymity through aggregation greatly impedes an effective management response to poor performance. Thus, the primary unit of field activity, whether it is a bank branch or financial institution subdistrict office, should be granted a significant degree of autonomy to allow it to fulfill its responsibilities effectively. This autonomy also facilitates collection of the data senior managers need to make informed assessments of staff performance.

For example, each local unit should have its own balance sheet and income statement, so that performance is judged on the basis of its own financial position. It is difficult for a regional office to assess, and if necessary assist, unprofitable branch offices if disaggregated raw data are fed directly into a computer and outputs consist only of consolidated financial statements.

This local autonomy should be balanced by uniform standards, systems, and procedures across similar functional units of an organization to promote professionalism; ensure adherence to laws, regulations, and policy directives; facilitate training; and expedite inspection and audit activities.

**Accountability.** It is one thing to promote excellence; it is quite another thing to assess performance. Without an effective management information system, it is difficult to recognize and reward achievements and to detect and punish failures.

A financial institution's management information system comprises two principal subsystems: bookkeeping and reporting. To be effective, bookkeeping must be accurate, functional, transparent, and nondiscretionary; reporting must entail a timely exchange of credible, accessible, and practical data. Both subsystems must also contain internal controls, together with mechanisms for external supervision, inspection, and audit. Thus, the management information system becomes an organization's primary tool for ensuring accountability, by allowing the institution to evaluate performance and to respond to the results accordingly.

# 3
# The Indonesian Macroeconomic Policy Context

*Annual income twenty pounds, annual expenditure nineteen nineteen six, result happiness. Annual income twenty pounds, annual expenditure twenty pounds ought and six, result misery.*

—Charles Dickens, *David Copperfield*, 1849

The results of the case studies presented in the following two chapters would probably have been much less encouraging had the government of Indonesia not been able to control the hyperinflation of the mid-1960s, even if it had strictly adhered to the principles in the development of rural financial institutions and rural banking services described in chapter 2. This chapter briefly summarizes the policy context in which the Indonesian rural financial institutions described in chapters 4 and 5 were established.

## Inflation

In the mid-1960s, inflation in Indonesia was running at more than 600 percent per year. This effectively wiped out most existing small rural savings and credit institutions, including the cooperatives. After

the mid-1960s, the government of Indonesia followed the monetary, fiscal, and foreign exchange policies described below.

**Monetary policy.** The key features of the government's monetary policy have been:

1. high interest rates on savings and credit in the first few years after 1966 to restrict the money supply and bring inflation down to a manageable level

2. direct credit controls to dampen the inflationary effect of devaluations in the 1970s

3. abandonment of direct quantitative controls on credit and interest rates, and institution of more indirect controls of money supply to control inflation after 1983

4. liberalization of bank licensing requirements and deliberate promotion of competition among banks

**Fiscal policy.** The primary features of the government's fiscal policies since 1966 have been:

1. strict adherence to a balanced budget, except for adjustments to run a temporary surplus when the large increase in oil prices in the mid-1970s would have increased the budget too rapidly

2. no internal government debt; budgeting of foreign grants and loans along with planned expenditures on projects aided by foreign agencies

3. subsidies, such as those for fertilizer and fuel, shown in the budget as expenditures so that their continuation would be weighed against other uses of resources

4. rapid imposition of budgetary austerity, including rescheduling of large capital-intensive projects and three years of no increase of civil service salaries, when oil prices and therefore government revenues declined sharply in the 1980s

**Foreign exchange policy.** The key attributes of the government's foreign exchange policy have been:

1. strict adherence to a completely open capital account, no restrictions on exchange of rupiah and foreign currencies in Indonesia, and no restrictions on company export of profits

2. unification of the exchange rate

3. devaluation of the rupiah when necessary to keep rates competitive and avoid balance of payments difficulties; exchange rate floated against a trade-weighted basket of currencies.

## Rural-Urban Terms of Trade

In addition to controlling inflation, the government of Indonesia has maintained favorable terms of trade for rural areas compared with urban centers. The government has not distorted prices against farmers in favor of the urban population. Instead, it has set a floor price on rice and purchased rice to maintain this floor price, maintained a fertilizer-rice price ratio that has made it profitable to grow rice, and kept rice prices in line with general inflation, although this is hard to do since rice is the main component of the price index.

One might also see the government's decisions to provide savings services close to people residing in rural areas and to pay positive real interest rates for rural savings as a continuation of the policies summarized above. In the long run, the movement from an agriculture-based economy to an urban, industrial, and trading economy has to be financed, at least in part, from rural savings, although it may be financed temporarily from foreign aid and urban savings. The government's policy, whether or not consciously conceived as such, could be viewed as a way of mobilizing rural savings for development that is fair to the rural populace. The government has accomplished this by providing savings services at market interest rates, rather than by distorting the agriculture-industry terms of trade against the farmers.

# 4
# Case Study One: Badan Kredit Kecamatan (BKK)

*It is common sense to take a method and try it.*
*If it fails, admit it frankly and try another.*
*But above all, try something.*

—Franklin D. Roosevelt
Speech at Oglethorpe University, 1932

## BKK Boja, Kendal District, Central Java

It is 10 A.M. The central market in the Boja Subdistrict (Kecamatan Boja) is bustling with activity.[1] The road leading to the market is jammed with minibuses, trucks, pedicabs, motorcycles, bicycles, and pedestrians. Hawkers have set up small kiosks at their usual places in the open-air market, while petty traders are peddling their wares in the pathways between these booths. *Dangdut* pop songs are blaring from a stall well stocked with music cassettes. A vendor is beseeching all to try his *jamu* as a cure for any number of ailments.

Everyone seems to be in a hurry, rushing from vendor to vendor trying to strike the best deal for the purchase of a wide assortment of daily family needs: rice, sugar, cooking oil, fruit, vegetables, medicine, clothes, toiletries, sundries, and miscellaneous household knickknacks.

1. For full explanations of all Indonesian terms, please see the Glossary at the end of this book.

In the middle of this cacophony of Javanese capitalism is a small wooden shack that looks like it won't withstand the next strong wind or major rainstorm. The floor is bare earth, the roof a zinc sheet. Air conditioning is a cross-breeze.

On closer inspection, this appears to be a makeshift office: three young men in starched white shirts and dark blue trousers sit behind wooden tables, busily filling out forms, making bookkeeping entries, and handling cash transactions. Local vendors are seated on a few benches around the walls of this shack or are huddled at the front table. These petty traders, dressed in a mixture of traditional village garb and simple Western-style city clothes, carry on animated conversations in Javanese, the local language, while awaiting their turn. Javanese, rather than Indonesian, is also the preferred language for conducting formalities at the front table.

This is Pos Pasar Boja (Boja Market Post), one of sixteen *pos desas* (village posts) of the Boja Badan Kredit Kecamatan (BKK Boja). Every Thursday, two or three employees from the BKK head office come to the market to conduct all normal BKK credit and savings operations: extend loans, accept loan payments, disburse savings, and receive savings deposits.

They arrive early in the morning on BKK motorcycles, with a set of client records for this post and cash to cover the day's activities. In the afternoon, they head back to the BKK office to consolidate Pos Pasar Boja accounts with those of other pos desas. On Thursday, two other pos desas are open: one at the head office, the other at Puguh village.

The BKK employees are themselves residents of the Boja Subdistrict. Most are in their twenties and are graduates of senior technical high school. Two employees are female; the remaining nine are male. Their salaries are paid from BKK Boja earnings according to provincewide standards. They also receive an incentive payment totaling 10 percent of BKK Boja pretax profits; there is no nominal ceiling on this bonus.

The head of BKK Boja, Mr. Muljani, started as a cashier in 1972 and has been manager since 1983. A few years ago, Mr. Muljani had the opportunity to become a government civil servant, but chose to remain at BKK Boja instead.

Most of the other BKK employees have been with BKK Boja for several years. Senior employees hold the positions of head cashier, head bookkeeper, and credit supervisor. The junior staff are designated as pos desa staff and go from village to village on market day in teams of two: one serves as a bookkeeper, the other as a cashier.

At present, fourteen of Boja Subdistrict's eighteen villages are serviced in this manner through a system of sixteen pos desas—two villages have two separate posts each, while residents of four other villages must travel to a neighboring village to receive BKK services. BKK Boja's manager would like to open pos desas in two of the four villages not yet covered directly by BKK Boja, but he feels the remaining two villages are more efficiently served by existing posts.

The schedule is complicated, and organizing BKK Boja's eleven employees to cover sixteen pos desas, some as far as an hour away by motorcycle, is no easy task. Some pos desas are open once a week on a Western calendar day. Other posts are open once a week only when this calendar day coincides with a Javanese market day. Still others are open on specified dates, rather than days.

For example, Pos Desa Purwogondo and Pos Desa Campurejo are open every Monday; Pos Desa Puguh is open every Monday that coincides with the Javanese day Pahing; and Pos Desa Meteseh is open on the twenty-eighth of every month. Pos desas are usually temporary quarters at the village chief's office complex.

These pos desa schedules are designed to match the different loan payment systems offered by BKK Boja. About half of BKK Boja's borrowers repay their loans in weekly installments; about half prefer monthly installments; and a small percentage use the *lapanan* system (every thirty-five days, or seven Javanese weeks).

Average loan amounts also correspond to these payment systems: in December 1988, the average weekly loan was Rp. 67,000; the average monthly loan, Rp. 180,000; and the average lapanan loan, Rp. 23,000.[2]

BKK Boja is one of the largest and most successful BKK units in Central Java. It is located in Kendal District (Kabupaten Kendal), roughly a half-hour's drive through rice fields, teak forests, and rubber tree plantations from the provincial capital of Semarang.

BKK Boja's main office is convenient, secure, and inviting. Strategically located in the Boja Subdistrict government office complex, the office is fifty yards from the main road and two-thirds of a mile from Boja's central market. The Boja Subdistrict government owns the land, while BKK Boja owns its office. The office is thirty feet by sixty feet, simply decorated with inexpensive wood desks, chairs,

2. All monetary values in this study are given in Indonesian rupiah. U.S. dollar values can be determined by converting rupiah values using the exchange rates provided in Appendix Table A1.

and benches. It is also equipped with filing cabinets, a safe, and a fire extinguisher. It is clean and tidy, with BKK Boja statistics and general information posted on the walls. BKK Boja's manager recently decided to spruce up the appearance of his staff by providing them with shirts boasting a BKK Boja patch on the front pocket.

Established in 1972 with a Rp. 1 million provincial government loan, BKK Boja has grown into a large and highly profitable financial institution. As of December 31, 1988, total loans outstanding were Rp. 357 million, held by 5,222 borrowers. This amounts to roughly 10 percent of Boja Subdistrict's 51,000 residents and approximately half of its 11,000 households. About half of these loans were extended through Boja's pos desas, 10 percent were extended through BKK Boja's pos desa at the subdistrict's central market, and the remaining loans were extended through BKK Boja's main office at subdistrict headquarters.

During the month of December 1988, 1,048 loans totaling Rp. 83 million were made, for an average loan of Rp. 80,000 per borrower. These loans were extended through the network of sixteen pos desas, dispersed throughout the 15.8 million acre subdistrict.

The quality of BKK Boja's loan portfolio has remained high: although BKK Boja has not written off a loan since it was established in 1972, cumulative arrears were only 5 percent of total loans outstanding in December 1988, and 90 percent of loan payments due that month were paid on time.

These loans have been used for a variety of primarily off-farm enterprises: mixed petty trading; roof-tile production; brick making; bamboo weaving; soybean snack preparation; food stalls; vehicle repair shops; horse-drawn carriages and motorcycle transport services; chicken raising; and fruit, vegetable, and medicinal gardening.

At the end of December 1988, 5,160 clients had mandatory savings accounts totaling Rp. 49 million, and 380 clients had opened voluntary savings accounts (through the Tabungan Masyaraleat Desa, or TAMADES program) totaling Rp. 28 million since the initiation of the TAMADES pilot project in November 1987. Average mandatory savings totaled Rp. 9,400, and the average TAMADES account was Rp. 74,000.

In 1988 pretax profits for BKK Boja were Rp. 91 million, and net worth (primarily retained earnings) totaled Rp. 238 million. BKK Boja expected to pay approximately Rp. 21 million in taxes for 1988.

The winner of a grand prize offered by the TAMADES pilot project, a Honda motorcycle, was a Boja junior high school girl who bought seventeen Rp. 1,000 TAMADES certificates. When she received the

Honda, she sold the motorcycle and deposited the money she received in her TAMADES account. This account now totals almost Rp. 2 million.

BKK Boja's relationship with the Central Java Regional Development Bank (BDP Jawa Tengah) has been a key factor in its rapid growth. The BPD supervisor based at the BPD's Kendal branch office visits BKK Boja at least once a month to provide technical support and operational supervision for BKK Boja. Moreover, BKK Boja staff have attended several BPD-sponsored training courses in Semarang, regarding BKK history and objectives, BKK policies, BKK bookkeeping and reporting systems, and BKK management.

The Central Java BPD has also been a constant source of loan capital for BKK Boja, having funneled the following funds to BKK Boja since 1972:

- first provincial government loan—Rp. 1.0 million (repaid)
- second provincial government loan—Rp. 1.0 million (repaid)
- Ministry of Finance loan: general lending—Rp. 12.0 million (partially repaid)
- Ministry of Finance loan: rural electrification—Rp. 27.5 million (partially repaid)
- BPD short-term liquidity credit—Rp. 15.0 million (repaid)
- provincial government loan for motorcycle purchase—Rp. 2.0 million (partially repaid)
- Financial Institutions Development (FID) project loan for office equipment purchase—Rp. 1.5 million (partially repaid)

Most of these funds are on-lending of the Ministry of Finance Rp. 3 billion loan for the BKK system, and have been provided in the form of twenty-year loans at 1 percent per month, with a three-year grace period on principal payments.

The rural electrification loan has similar terms, only the repayment period is five years, including a two-year grace period. This loan, when matched with BKK Boja capital of Rp. 5 million, has been used to provide one-year, Rp. 100,000 loans to 3,250 Boja residents for

connecting their homes and businesses to recently installed National Electric Company (PLN) facilities.

The BPD short-term liquidity credit was provided at the BPD's regular commercial rate of 1.8 percent per month to cover the seasonal surge in savings withdrawals during the Lebaran holidays, which follow the month of fasting (Ramadan).

Both of the project loans are for three years; the motorcycle is at 1 percent per month, the office equipment at 0.5 percent per month. Although there are provincial government credit facilities, again through the BPD, for the construction of BKK offices, BKK Boja built its current office with its own funds in 1978. BKK Boja also purchased four other motorcycles with its own funds.

In addition to providing loan capital, the BPD has served as a depository for excess BKK funds. As of December 31, 1988, BKK Boja had Rp. 27 million on deposit in 16 percent, three-month BPD time deposits, and Rp. 8.4 million in BPD *giros* (demand deposits) at 0.25 percent per month.

Spirits at BKK Boja are quite high, and BKK Boja staff are optimistic about future prospects for expansion of their credit and savings facilities. Judging from the crowds swarming BKK Boja village posts, this enthusiasm is well founded.

## Background

In 1965, twenty years after declaring independence from the Dutch and then defeating its former colonialists in a bitterly fought struggle for national sovereignty, the republic of Indonesia was threatened with disintegration from within: the nation was rocked by a series of political, religious, and regional revolts throughout the 1960s, culminating in the attempted communist coup of 1965.

Although ultimately unsuccessful, these rebellions and the widespread fears of national fragmentation and political, economic, and social chaos left in their wake prompted the government of Indonesia to promote national stability by combating what was perceived as a primary cause of this national unrest: rural poverty.

The government mobilized the banking system as the principal fiscal mechanism to diversify the economy, redistribute wealth, and promote rural development. It established dozens of credit programs to channel resources to rural entrepreneurs and thus to lessen the

**BKK Snapshot: Ibu Gima**

Ibu Gima's appearance is deceptive. At sixty years of age, she has no teeth, and her mouth is red from chewing on betel nut. She is illiterate and dressed in simple village garb. Ibu Gima, however, is a valued client of BKK Boja. Two years ago, she borrowed Rp. 50,000 for use in her itinerant trading activities: Ibu Gima buys and sells basic daily needs in Boja Subdistrict. She repaid this initial loan in the agreed-upon twelve weeks, in equal weekly installments of Rp. 5,000 each. She has borrowed regularly from BKK Boja since then and is currently paying off a similar type of loan for similar trading activities, but now for Rp. 250,000. Although this is market day and Ibu Gima is in a hurry, she spoke briefly about herself during the few minutes it took to make her loan payment. As she stamped the necessary documents with her thumb, she explained that she is from the area, and although she has had no formal schooling, her husband is a retired elementary schoolteacher. Children? Oh yes, she has two sons and one daughter. They are all grown now and are all elementary schoolteachers, like their father. Ibu Gima is now fidgeting nervously, a clear signal she is anxious to get back to her trading activities.

economy's dependence on agriculture by promoting small industry, to shift economic resources to targeted ethnic groups, and to promote economic activities of the poor.

Central Java was a key target for such rural credit programs: not only was this province considered the cultural center of Indonesia by the nation's predominantly Javanese leaders, but it was also one of the most bitterly contested political battlegrounds of the Indonesian Communist party (Partai Komunis Indonesia, or PKI) in the 1960s.

As Major General H. Moenadi, the former governor of Central Java (1966–1974), noted recently, his primary objective in establishing the BKK program in Central Java in 1970 was to complement the prevalent "security approach" to national stability with a "prosperity

approach." He attributed much of the unrest in his province to lack of economic opportunity for low-income groups, a grievance upon which rival political factions were able to build a base of popular support.

The BKKs were conceived before the first major oil price increase, so limited resources compelled provincial government officials to create a system of rural financial institutions that would not be a long-term drain on the provincial treasury, but in fact would be able to pay back their initial loan capital in three years.

Furthermore, in designing the BKKs, government planners wanted to avoid the shortcomings characteristic of similar credit schemes by combining the speed, ease, convenience, and reliability of traditional moneylenders with the efficiency, profitability, and lower interest rates of commercial banks.

Most rural credit programs that had been attempted previously in Central Java, elsewhere in Indonesia, and abroad either failed or were mixed successes at best, for several reasons. Fixed, subsidized interest rates, coupled with inflation, led to credit portfolio decapitalization. Cumbersome but ineffective screening and oversight procedures resulted in expensive, inefficient loan processing and supervision. Credit disbursed in single, large loans rather than in progressively larger repeat loans raised the lender's financial risk considerably. Because of the first two deficiencies, the lending institution had little financial viability. Borrowers, having no assurance they would be able to borrow again when they needed additional capital, had a disincentive to repay their loans. Finally, centralized operations made effective financial and administrative supervision infeasible.

Thus, when the governor of Central Java launched the BKK program in 1970, it was in the context of severe fiscal constraints, a prevailing desire to learn from past mistakes, and a commitment to alleviate the poverty of Central Java's rural populace. These circumstances allowed the BKKs to develop, through a long and difficult period of trial and error rather than according to a detailed blueprint for success, into a self-sustaining system of rural financial institutions.

Over time, the BKKs found that they could provide services to their rural clientele effectively and profitably if they:

- charged interest rates high enough to cover operating expenses, including the cost of funds

- relied on character references from local officials for loan eligibility, rather than on the availability of collateral or lengthy staff analyses of a proposed enterprise's feasibility

- reduced risk by making small initial loans to a new borrower and then gradually raised that client's credit ceiling as his or her repayment record warranted

- used repeat loans as the borrower's primary incentive for full and timely repayment

- blended local autonomy with overall program quality control, by stressing a highly decentralized organizational structure with villages as the focus of operations, together with central program technical supervision by the Central Java Regional Development Bank

From its inception, the BKKs' objective has been to provide small, short-term loans to rural families, primarily for off-farm productive purposes. Hence its motto, "Fast, Cheap, and Productive Credit."

Until 1987, the single savings instrument of the BKKs was a mandatory savings component of borrower loan payments, with the dual purpose of providing BKKs with inexpensive loan capital and educating BKK clients regarding the virtues of saving. The need for safe, convenient, and competitive savings instruments in rural areas was not directly addressed. In fact, as nonbank financial institutions, BKKs were prohibited by law from collecting voluntary savings; it was chiefly this characteristic that distinguished BKKs from secondary banks until 1984, when the Ministry of Finance granted the BKKs permission to receive public funds.

The BKK program is designed to serve Central Java's rural poor, for whom credit is both limited and expensive. However, it is based on the assumption that although the province's primary economic base is agricultural, most rural Javanese do not spend the majority of their time on agriculture, nor do they derive the bulk of their income from farming. Instead, the rural poor support themselves through a diverse set of economic activities that complement and supplement agriculture, such as food processing and preparation, petty trading, and handicrafts.

The primary goal of the BKK program is therefore to supply capital through a convenient mechanism that charges a reasonable interest rate but still earns a profit. This goal is based on the belief that a viable, self-sustaining financial institution provides good long-term assurance that the rural poor in Central Java will continue to have access to its services to develop off-farm income-generating activities and thus promotes the economic, political, and social stability of the province. A secondary BKK goal is now to provide a safe, convenient, and competitive savings instrument for its clientele.

## BKK Development

BKK development falls into five overlapping but distinct phases: creation of BKK units (1970–1975), survival of the fittest (1975–1979), rehabilitation (1979–1981), growth and institutionalization (1981–1986), and consolidation and diversification (1986–1989).

**Phase I: Creation of BKK units (1970–1975).** Phase I of BKK development was devoted to planning and establishing BKK units at the subdistrict level throughout Central Java. By 1975 the BKK system had almost achieved its goal of universal coverage of the province, with 486 units, one in all but 6 of Central Java's 492 subdistricts.

The BKKs were capitalized in 1972 with a Rp. 200 million loan from the Central Java provincial government, through the Central Java BPD, to the BKKs. The three-year disbursement of these funds began with 200 BKKs and grew to 486 BKKs. Each BKK received a three-year, Rp. 1 million loan at 1 percent per month, with a one-year grace period on principal repayment. This 1 percent interest charge was to be used to cover BPD administrative and supervisory expenses, while the principal was to revert to the provincial development budget. Thus, after the three-year provincial government loans were repaid, the BPD would collect no further interest income to cover its technical supervision costs.

Each BKK could in turn lend the money to individual clients according to one of six repayment plans (see Table 1), at a nominal monthly rate of 2.0 to 4.8 percent (see Table 2). The loans would be for twenty-two days to six months, with interest due and "forced savings" repaid before any principal installments. All payments would be in equal amounts, both to simplify bookkeeping and to minimize borrower confusion.

TABLE 1 Types of BKK Loans (Original System)

| Loan type | Payback period | Total loan interest (%) | Total mandatory savings (%) | Total interest + savings (%) |
|---|---|---|---|---|
| *Harian* (daily) | 22 days | 3.5 | 6.5 | 10.0 |
| *Pasaran* (every 5 days) | 12 *pasar* (60 days) | 8.0 | 12.0 | 20.0 |
| *Mingguan* (weekly) | 12 weeks | 10.0 | 10.0 | 20.0 |
| *Bulanan* (monthly) | 3 months | 10.0 | 10.0 | 20.0 |
| *Lapanan* (every 35 days) | 5 *lapan* (175 days) | 20.0 | 20.0 | 40.0 |
| *Musiman* (seasonal) | 6 months | 12.0 | 10.0 | 22.0 |

SOURCE. Central Java Regional Development Bank.

TABLE 2 Nominal and Effective BKK Monthly Interest Rates (Original System)

| Loan type | Payback period | Nominal monthly interest rate (%) | Effective monthly interest rate[a] (%) |
|---|---|---|---|
| *Harian*[b] | 22 days | 4.8 | 10.8 |
| *Pasaran* | 60 days | 4.0 | 6.9 |
| *Mingguan* | 12 weeks | 3.6 | 6.9 |
| *Bulanan* | 3 months | 3.3 | 5.3 |
| *Lapanan* | 175 days | 3.4 | 5.6 |
| *Musiman*[b] | 6 months | 2.0 | 2.2 |

a. Effective interest rates were calculated by assuming that interest and commitment fee were repaid before savings and principal according to the formula:

$$\frac{(P+I)\left(\frac{I}{0.99P}\right)30}{\frac{[(n_1 \times 1) + (n_2 \times 2) + \ldots + (n_z \times z)]d}{w}}$$

where

$P$ = loan principal

$I$ = amount of interest plus 1% fee

$n_1$ = amount of first loan payment (interest, fee, principal)

$n_z$ = amount of last loan payment (principal)

$d$ = number of days for loan repayment

$w$ = number of payments made (only for loan interest, fee, principal; not including any payments solely for savings)

b. *Harian* and *musiman* loans are rarely disbursed by BKK units.

SOURCE: Susan Goldmark and Jay Rosengard, *Credit to Indonesian Entrepreneurs: An Assessment of the Badan Kredit Kecamatan Program* (Washington, D.C.: Development Alternatives, Inc., May 1983). 51.

As noted earlier, the mandatory savings component of the BKK system was introduced not only to mobilize loan capital and thereby expand and diversify BKK working capital resources, but also to serve as a rural education campaign regarding commercial banking. In theory, clients would have access to their savings after full loan repayment. In practice, however, many of the BKKs did not allow or encourage such withdrawals because of acute loan capital shortages.

The initial 200 BKKs lent Rp. 442 million in 1972. By 1975 486 BKK units had lent a cumulative total of Rp. 8.8 billion.

It is important to note that, since its inception, the BKK system has had several unique organizational features compared with similar rural credit institutions elsewhere.

First, the BKKs have functioned as a single system only in that they are owned by and operate under the auspices of the Central Java provincial government, and receive technical supervision and support from the Central Java BPD. The system is composed of nearly five hundred BKKs, however, each of which is an independent subdistrict institution that is locally administered and financially autonomous. This has ensured consistency of overall system policies, standards, and procedures, and at the same time maintained local accountability and incentives based on local performance.

Second, these independent BKK units in turn provide banking services for their rural clientele through a provincewide system of more than three thousand pos desas, manned by traveling BKK staff once a week on average, usually on a village's local market day. This has allowed the BKKs to justify relatively high interest rates by maximizing borrower convenience while minimizing borrower transaction costs.

Third, as noted above, BKK lending procedures balance speed and simplicity for the client with cost and risk containment for the lender. The loan application is a single page and is either approved or rejected within one week; a repeat borrower can often receive his or her new loan on the same day the application is submitted.

Fourth, the BKK program is composed of three channels of provincially based, locally executed administration: operations, supervision, and coordination. The balanced mixture primarily of the first two administrative components has been critical to the success of the BKK because it has coupled political accountability with financial competence. The BKK system has built-in political accountability because it is incorporated into the structure of local government in Central Java. The governor of the province presides over the system, administrative

authority is delegated to the district and subdistrict levels, and most BKK transactions are conducted at the village level. At the same time, the system's financial integrity has been maintained through close supervision of BKK operations by the Central Java BPD. The BPD designed a unified system of BKK bookkeeping formats and procedures when the BKKs were first established and, assisted by the provincial government, has held primary responsibility for all BKK staff training.

Effective technical supervision by the Central Java BPD is the cornerstone upon which the professionalism and financial resiliency of the BKK system have been built. The BPD, being a development bank, has brought its expertise in using money both productively and profitably to the BKK.

The BKK system evolved consistent with the concepts outlined above during Phase I, except for the introduction of a *khusus* (special) loan window in 1974. Pleased with the development of the BKK program, the governor of Central Java decided that all of the credit programs from the province's *dinas*es (technical service agencies) should be transferred to the BKKs as well. Thus the BKKs lent approximately Rp. 245 million in khusus funds for activities such as upland crop production, animal husbandry, fish fingerling production, fish marketing, kapok processing, rural industries, rubberization of bullock cart tires, rural electrification, and women's social and economic development.

This was not a fruitful realignment of responsibility, for the BKK units were placed in the position of acting as collection agencies, rather than performing the banking functions for which they were designed. Khusus clients were selected by their respective dinases instead of by the BKK character reference system, so BKK units could not screen out potentially high-risk clients.

Moreover, dinases were interested primarily in the one-time disbursement of previously allocated funds, whereas BKKs were equally concerned with loan repayment so that these funds would stay in circulation as part of the system's capital base, and clients would be encouraged to repay their loans in the hope of receiving future loans.

Finally, BKKs were allowed to charge only 1 percent per month on khusus loans, although these loans were often for much higher-risk activities than were the standard loans.

As a result of this confusion over khusus objectives and procedures, BKK performance on the khusus portfolio was extremely poor.

Repayment was lower than the *umum* (general) BKK loans, although comingling of khusus and general loan funds made it difficult to determine precise repayment rates.

**Phase II: Survival of the fittest (1975–1979).** Phase II was devoted to improving the effectiveness and efficiency of BKK operations with little injection of new working capital into the program.

Phase II overlapped with Phase I, as those BKK units created early in the system's evolution gradually were forced to finance themselves with funds generated from their ongoing operations to repay their provincial government loans; the only exceptions were ten BKK units that each received an additional loan of Rp. 1 million in recognition of especially good performance.

Phase II ended in 1979 for the sixty-five BKKs that received technical assistance and additional capital under the auspices of the government of Indonesia/U.S.Agency for International Development (USAID) Provincial Area Development Project (PDP) (see "Phase III" below), but it continued until 1982 for the rest of the BKKs in Central Java.

During Phase II, BKK units tried both to stabilize and to expand their operations, and thus demonstrate that they were financially viable, developmentally sound rural credit institutions. However, the cost of trying to foster sustainability in this manner was high: 33 percent of the BKK units either closed or continued at very low operating levels.

Each unit had to "sink or swim" on its own—the price of independence was a lack of funds flowing among the BKKs from surplus to deficit units, and provincial government resource constraints precluded external assistance on an individual unit basis.

**Phase III: Rehabilitation (1979–1981).** Phase III was primarily a period of rehabilitation for BKKs that had collapsed, as well as rapid expansion for relatively healthy BKKs. This phase was characterized by a combination of significant injections of capital and the application of lessons learned during the initial decade of BKK operations. Phase III began in five of Central Java's thirty-five districts and *kotamadyas* (municipalities) with the introduction of PDP in 1979 and spread to the remainder of Central Java by the end of 1981.

The objective of PDP was to improve government capacity to reach Indonesia's rural poor by increasing the capability of provincial, district, and subdistrict planning units to identify, design, and imple-

**BKK Snapshot: Bp. Djokro**

Fifty-seven-year-old Bp. Djokro is another valued client of BKK Boja. He has borrowed and repaid loans of Rp. 300,000 regularly for twelve-week periods for several years. He is a petty trader of daily necessities in the local market, while his wife runs a small food stall at the same location. Bp. Djokro's BKK loans have enabled him to buy his wares at lower prices through bulk purchases, to expand and diversify his inventory, and to avoid forced sales at reduced prices to generate cash. To raise additional income for the support of his eight children, Bp. Djokro also owns and cultivates a 500-square-foot garden of mangoes, rose apples, oranges, and cloves. Like many BKK Boja customers, he is dressed in local village attire, and his appearance belies the success of his various businesses. But Bp. Djokro's broad grin of shining silver expresses the air of confidence born of entrepreneurial achievements.

ment rural-based income-generating projects through the provision of a combination of rural development advisory services and rural credit.

PDP, whose final year of implementation was Indonesian fiscal year 1988–89, operated in subgroupings of relatively poor districts in eight provinces throughout Indonesia: Aceh, Bengkulu, West Java, Central Java, East Java, West Nusa Tenggara, East Nusa Tenggara, and South Kalimantan. In Central Java, initial PDP efforts focused on five of the province's poorest districts, namely, Demak, Kudus, Jepara, Rembang, and Pati. Although Blora and Grobogan districts were added during the final stages of project implementation, PDP assistance to the twenty-eight remaining districts and municipalities in Central Java was limited to indirect program support.

The PDP area in Central Java served as a valuable testing ground for new BKK procedures and initiatives, the most successful of which were later transferred to non-PDP areas. Moreover, PDP technical assistance was both a catalyst for change and a facilitator among BKK units, the Central Java BPD, and the government of Indonesia in experimenting with these changes.

For example, PDP granted approximately Rp. 327 million to establish a revolving fund within the Central Java BPD for the sixty-five BKK units in the original PDP area. As in the case of the loan that established the BKK system, BKK units paid a 1 percent monthly interest charge to support BPD technical supervision and program development activities. Unlike the initial provincial government loan, however, the PDP grant enabled the Central Java BPD to relend BKK principal repayments, thereby allowing BKKs to grow faster and provide a continuous source of income to cover BPD costs. This innovation was introduced when the BPD could no longer cover its BKK technical supervision costs with the interest income it received on the provincial government loan. Thus, the PDP grant helped to sustain and revitalize the Central Java BPD technical supervision of the system, which has been critical to BKK success. Other financing subsequently made available to the BKK system has used this revolving-fund model.

In addition, PDP technical assistance helped to develop a system to classify BKKs by the overall magnitude and viability of their lending operations, based on the following six factors and relative weights (see Table 3 and Figure 1):

- total equity (50%)
- ratio of villages to village posts (10%)
- number of new borrowers (10%)
- portfolio quality (10%)
- total savings (10%)
- capital circulation (10%)

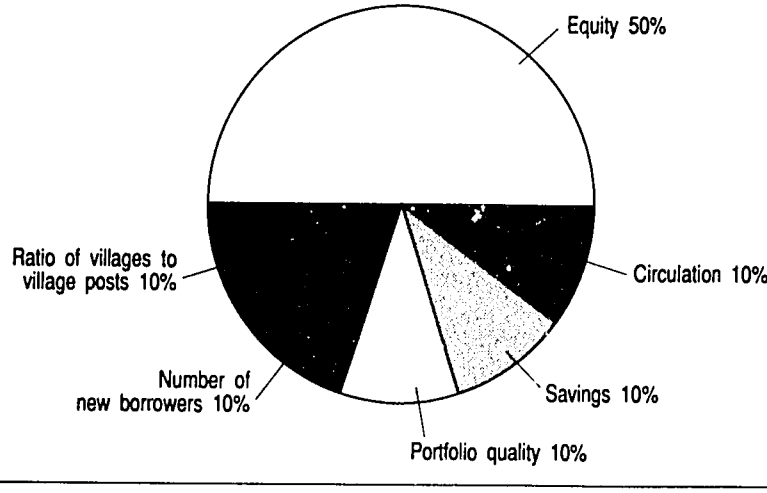
All BKKs are now classified semiannually (see Table 4). This classification allows the Central Java BPD to assign credit ceilings and add capital based on a BKK's financial soundness. It also serves as a convenient series of time-lapse snapshots of overall BKK status and development, as well as an early warning system regarding troubled BKK units. Finally, it provides an effective mechanism for conveying operational priorities to BKK units, who in turn have worked to improve their performance in the six classification areas.

TABLE 3 BKK Classification Criteria

| Criterion | Class I | II | III | IV | V |
|---|---|---|---|---|---|
| Equity[a] (millions of rupiah) | ≥ 10,000 | 5,000–9,999 | 1,000–4,999 | 1–999 | 0 |
| Ratio of villages to village posts | ≤ 2 | 3–2.1 | 4–3.1 | 8–4.1 | > 8 |
| Number of new borrowers (monthly average) | ≥20 | 15–19 | 10–14 | 5–9 | < 5 |
| Portfolio quality[b] (percentage) | ≥90 | 80–89 | 70–79 | 50–69 | < 50 |
| Savings (millions of rupiah) | ≥2,000 | 1,000–1,999 | 500–999 | 200–499 | < 200 |
| Circulation[c] (millions of rupiah) | ≥5,000 | 2,000–4,999 | 1,000–1,999 | 100–999 | < 100 |
| Overall classification | 1.0–1.5 | 1.6–2.5 | 2.6–3.5 | 3.6–4.5 | > 4.5 |

a. Equity = cash on hand/in bank + (total loans outstanding – loans overdue > six months) – loans to BKK – client savings.
b. Portfolio quality = number of loan payments received ÷ number of loan payments due.
c. Circulation = monthly average lent during six-month classification period.
SOURCE: Central Java Regional Development Bank.

FIGURE 1 BKK Classification Weights




SOURCE: Prepared by authors.

TABLE 4 BKK Distribution by Class, 1981–1989

| Class | August 1981 | December 1983 | December 1985 | December 1987 | December 1989 |
|---|---|---|---|---|---|
| I | 18 | 64 | 113 | 137 | 157 |
| II | 49 | 98 | 129 | 144 | 156 |
| III | 113 | 129 | 134 | 118 | 139 |
| IV | 122 | 67 | 40 | 40 | 41 |
| V | 184 | 135 | 80 | 58 | 6 |
| All classes | 486 | 493 | 496 | 497 | 499 |

SOURCE: Central Java Regional Development Bank.

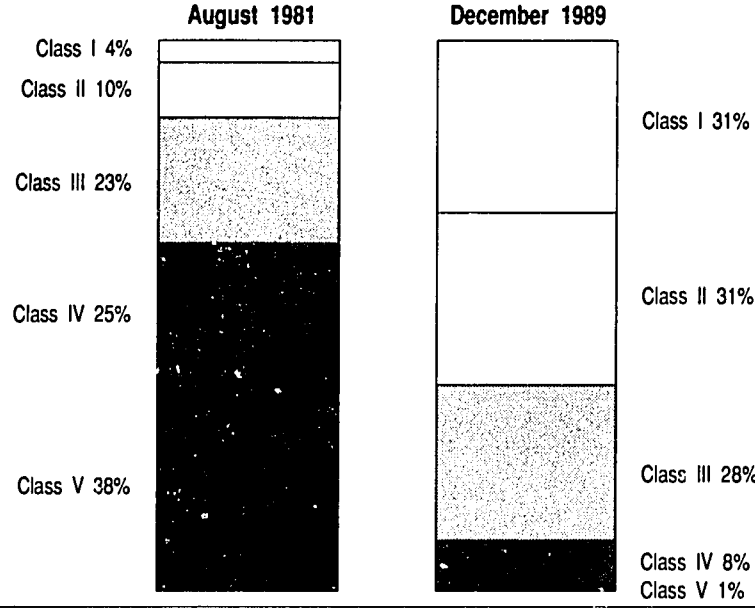
PDP also provided technical and financial assistance for the rehabilitation of failed or weak BKKs and for the expansion and diversification of successful BKKs. This process has taught the Central Java BPD the steps by which to rehabilitate those BKKs that are barely functioning or have ceased to operate (Class V BKKs). Such technical assistance and capital infusions were responsible for decreasing the number of Class V BKKs in the PDP area from twenty-six to seven within three years, and the same techniques have reduced the total number of Class V BKKs in Central Java from 184 units when the first provincewide classification survey was conducted in August 1981 to 6 units in December 1989 (see Table 4 and Figure 2).

**Phase IV: Growth and institutionalization (1981–1986).** The year 1981 was a watershed period for the BKK system: the provincial government upgraded the BKK system from an experimental project to a permanent government-owned enterprise *(badan usaha milik daerah)*, while the central government demonstrated its strong support by means of a Ministry of Finance Rp. 3 billion loan to the provincial government, through the Central Java BPD, to assist in BKK rehabilitation and expansion.

As the BKK system grew dramatically during this period, the Central Java provincial government and BPD officials took the following initiatives to institutionalize the BKK system:

- They used the increased interest income to the BPD for the support of one full-time BKK field supervisor in each district in the province.

FIGURE 2 BKK Classification Results, 1981 and 1989




SOURCE: Prepared by authors.

- They purchased vehicles to increase the mobility of these BKK field supervisors.
- They started to replace BKK field staff who were government civil servants with direct BKK employees or to convert the status of the former to the latter.
- They began an intensive training program for BKK field staff.
- They instituted credit facilities for healthy BKK units to construct permanent offices and procure office equipment and motorcycles.
- They commenced the filing of national income tax returns.
- They automated the BPD's BKK management information system by revising field reporting forms and procedures and

installing a multiuser microcomputer system in its Semarang headquarters.

**Phase V: Consolidation and diversification (1986–1989).** Whereas Phase IV was characterized by growth and institutionalization, Phase V was a period of consolidation and diversification, as BKK program implementers attempted to adapt to both a maturing BKK clientele and an increasingly competitive operating environment.

Phase V coincided with and was assisted by the USAID-supported Financial Institutions Development (FID) project, a seven-year, US$30 million undertaking comprising technical, capital, commodity, and training assistance designed to promote economic development through the expansion, improvement, and diversification of rural banking services in Central Java, West Java, East Java, and West Sumatra.

The BKKs began to consolidate their position by determining that the BKK credit system had to be updated to keep the oldest, largest, and best BKK customers from defecting to BKK competitors.

Realizing that loan terms had not been altered during the eighteen years the BKKs had been in existence, despite inflation and BKK client development, the BKKs modified their lending program early in 1988 to allow loans of up to one year (see Table 5) and as large as Rp. 1 million, depending on the quality of the borrower and the class of the BKK unit. Individual loan ceilings remained Rp. 200,000 for the weakest BKKs, Class IV and Class V units, while this ceiling was raised to Rp. 500,000 for Class III BKKs and Rp. 1 million for Class I and Class II units.

However, to promote a healthy balance between established, relatively large borrowers and new, typically small borrowers, loans of more than Rp. 200,000 were limited to half of a BKK unit's total loan portfolio for Class I, II, and III BKKs. Moreover, to reinforce the BKK stepwise system of lending whereby a client's repayment history was the best hedge against risk of default, a borrower's new loan ceiling was restricted to an increase of 50 percent or less of the client's previous credit limit.

The BKKs also began to work more closely with Central Java BPD branches not only in identifying local enterprises with high economic potential, but also in cofinancing these endeavors with BPD branches where appropriate. High-potential ventures include home industries like agroprocessing and village development activities such as rural electrification, with working capital provided by the BKKs and investment funds by the BPD.

TABLE 5 Types of BKK Loans (Revised System)

| Loan type | Payback period | Total loan interest (%) | Total mandatory savings (%) | Nominal monthly interest rate (%) | Rebate (%) | Net monthly interest rate (%) |
|---|---|---|---|---|---|---|
| *Harian* | 22 days | 3.5 | 6.5 | 4.80 | 1.0 | 3.43 |
| *Pasaran* | | | | | | |
| System A | 12 *pasar* (60 days) | 8.0 | 12.0 | 4.00 | 1.0 | 3.50 |
| System B | 34 *pasar* (170 days) | 20.0 | 16.0 | 3.53 | 2.5 | 3.09 |
| System C | 60 *pasar* (300 days) | 30.0 | 20.0 | 3.00 | 5.0 | 2.50 |
| *Mingguan* | | | | | | |
| System A | 12 weeks | 10.0 | 10.0 | 3.57 | 1.0 | 3.21 |
| System B | 26 weeks | 20.0 | 10.0 | 3.33 | 2.5 | 2.92 |
| System C | 52 weeks | 36.0 | 20.0 | 3.00 | 5.0 | 2.58 |
| *Bulanan* | | | | | | |
| System A | 3 months | 10.0 | 10.0 | 3.33 | 1.0 | 3.00 |
| System B | 6 months | 20.0 | 12.0 | 3.33 | 2.5 | 2.92 |
| System C | 12 months | 36.0 | 20.0 | 3.00 | 5.0 | 2.58 |
| *Lapanan* | 5 *lapan* (175 days) | 20.0 | 20.0 | 3.43 | 2.5 | 3.00 |
| *Musiman* | 6 months | 12.0 | 10.0 | 2.00 | | 2.00 |

NOTE: Blank cell = not applicable.
SOURCE: Central Java Regional Development Bank and authors' calculations.

Finally, to lower the BKK interest rate slightly while also reducing loan arrears, the BKKs began to offer a modest rebate for the timely repayment of a loan (*hadiah angsuran tepat waktu*) when the revised credit system was introduced.

The BKKs also made significant changes regarding funds mobilization. Mandatory savings had been an integral part of the BKK system since its inception, and BKKs had accumulated Rp. 2.4 billion in borrower savings by June 1987. Yet, even though the Ministry of Finance had granted the BKKs permission to collect voluntary savings as a nonbank financial institution in 1984, the Central Java provincial government and Central Java BPD felt the time was not ripe to implement a voluntary savings campaign until the BKK bookkeeping system had been updated to include transactions entailed in maintaining voluntary savings accounts, all BKK managers and staff had been trained in this new system, external sources of loan capital had been almost

**BKK Snapshot: Ibu Pasiyem**

Several years ago, Ibu Pasiyem borrowed Rp. 25,000 from BKK Boja as a twelve-week working capital loan for her fruit-trading business. She has repaid this loan, and several subsequent loans, in full and on time. She now has a loan of Rp. 250,000 from BKK Boja. Although this is a relatively small amount of money, it is ten times the amount of her first loan. Ibu Pasiyem expresses this sense of accomplishment as she talks of a growing clientele for her fresh fruit: she boasts that there is no doubt her fruit is the best in the market. Her family lives in Boja city and has no land for farming or gardening, but the fruit-trading business, which employs both Ibu Pasiyem and her husband, is enough to support their two young daughters. At thirty years of age, Ibu Pasiyem is optimistic about the future. Although she graduated from elementary school, Ibu Pasiyem hopes that if her business continues to grow, her children will be able to graduate from secondary school and thus have even greater opportunities than either she or her husband.

completely disbursed, and market competition warranted a more aggressive policy to attract new BKK clients.

These conditions were met by mid-1987. The villager savings program, TAMADES, was therefore introduced to nine BKK units throughout Central Java (three each from Class I, II, and III BKKs) in November 1987 on a trial basis.

The results of the TAMADES pilot project through June 1988 were promising: more than Rp. 50 million was raised in seven months by the nine participating BKK units, or more than Rp. 5 million per unit. If compared to the main alternative external source of funds for BKK units, their line of credit with the Central Java BPD, this amounts to more than ten tranches of loan capital drawdowns (BPD loans are usually received in installments of Rp. 500,000 at a time, so that the BPD can assess BKK performance before releasing more funds).

Even more encouraging has been the capacity of BKK units to continue to implement TAMADES during the Lebaran holidays and the commencement of the school year, both of which traditionally

place tremendous demands on BKK cash resources as clients withdraw savings to pay for holiday festivities and school fees.

In addition, preliminary analysis of TAMADES savers indicated that approximately 75 percent were not BKK borrowers, although they fit the profile of potential BKK clients: the average TAMADES account was roughly Rp. 15,000, or about 25 percent of the average BKK loan and more than twice the 10 percent mandatory savings requirement, which indicates the potential of TAMADES as a significant BKK marketing tool.

The design of TAMADES is sound: market interest rates (1.25 percent per month compounded quarterly), unlimited access (funds may be withdrawn anytime on demand), security (guaranteed by the provincial government), and a promotional incentive (an annual lottery). Furthermore, it seems to serve a market niche not yet filled by other formal savings programs, namely, the small-scale saver at the village level. Thus, the Central Java provincial government and BPD are planning to expand TAMADES to all Class I, II, and III BKK units (approximately 450 BKKs, or 90 percent of all units) in phases over the next few years. As of December 1989, there were almost 61,000 TAMADES accounts totaling approximately Rp. 1.1 billion.

Other activities undertaken by Central Java provincial government and BPD officials since 1986 to consolidate the position of BKK units and diversify BKK field operations include:

- updating, streamlining, and revising the BKK bookkeeping system to incorporate noncash transactions
- training all BKK managers and staff in this upgraded administrative system
- compiling a comprehensive inventory of bad and doubtful BKK loans in preparation for the eventual write-off of uncollectible loans
- offering intensive instruction for BPD field supervisors in data analysis and technical oversight
- assisting these supervisors to prepare a field manual regarding BKK inspection and audit guidelines and procedures

- reorganizing and expanding the Central Java BPD department responsible for technical supervision of and support to BKK units

- offering credit to BKK units for procurement of additional office equipment and completing the first two phases of BKK training center construction

- commencing province-level discussions regarding the future growth and competitiveness of the BKK system and how the BKK system might adapt to both the maturation of BKK units and developments in the market environment in which these BKK units operate

## Current Performance

As of December 1989, the BKKs had made more than 6.6 million loans, totaling more than Rp. 255 billion, and had accumulated more than Rp. 4.7 billion in client savings. The speed and magnitude of BKK growth are vividly demonstrated by the fact that the 1989 average monthly BKK circulation of more than Rp. 3.6 billion is more than the BKKs lent in an entire year a decade ago (see Table 6 and Figure 3).

The quality of this loan portfolio is remarkably good, especially for rural credit. The BKKs' long-term loss ratio (the total amount overdue compared to the total amount due) is 2.1 percent, despite limited BKK loan write-offs to date. If the BKKs wrote off all of their uncollectible loans, the BKK portfolio status (arrears as a percentage of loans outstanding) would be 7.4 percent as of December 1989 (see Table 7).

Key features of overall BKK performance for the period 1985–1989 are as follows (see Tables 8, 9, and 10 and Figure 4):

- Lending activities were highly seasonal. They stagnated during the first half of each year, which spans the dry season and the fasting month (Ramadan) and subsequent holiday festivities (Lebaran), as BKKs continue to collect cash to cover withdrawals, and they expanded rapidly during the second half of each year.

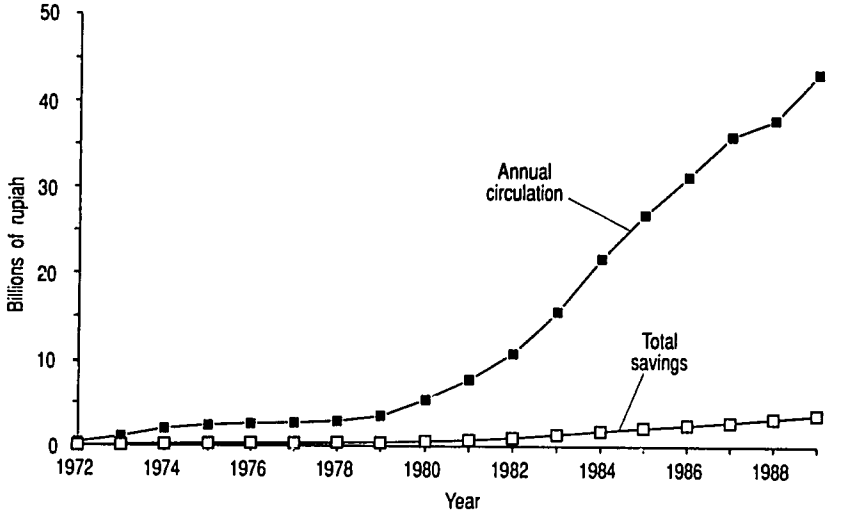
- Arrears rose at an alarmingly fast rate in 1988, and then dropped dramatically in 1989. This fluctuation is believed to

TABLE 6 Growth of the BKKs, 1972–1989

| Year | Number of BKK units | Amount loaned during year (thousands of Rp.) | Number of loans during year | Cumulative amount loaned (thousands of Rp.) | Cumulative number of loans | Total savings at end of year | |
|---|---|---|---|---|---|---|---|
| | | | | | | Thousands of Rp. | Persons |
| 1972 | 200 | 442,576 | 119,870 | 442,576 | 119,870 | 38,389 | 73,456 |
| 1973 | 350 | 1,178,534 | 277,860 | 1,621,110 | 397,730 | 110,700 | 160,011 |
| 1974 | 432 | 2,032,465 | 377,059 | 3,653,575 | 774,789 | 220,102 | 240,248 |
| 1975 | 465 | 2,479,702 | 360,352 | 6,133,277 | 1,135,141 | 285,392 | 260,456 |
| 1976 | 486 | 2,632,008 | 304,909 | 8,765,285 | 1,440,050 | 338,359 | 262,558 |
| 1977 | 486 | 2,726,110 | 232,044 | 11,491,395 | 1,672,094 | 356,273 | 244,469 |
| 1978 | 486 | 2,994,337 | 212,988 | 14,485,732 | 1,885,082 | 385,467 | 232,16[illegible] |
| 1979 | 485 | 3,597,076 | 213,746 | 18,082,808 | 2,098,828 | 435,743 | 234,263 |
| 1980 | 485 | 5,436,751 | 212,391 | 23,519,559 | 2,311,219 | 565,943 | 224,625 |
| 1981 | 486 | 7,705,187 | 267,933 | 31,224,746 | 2,579,152 | 733,838 | 243,917 |
| 1982 | 486 | 10,892,636 | 311,484 | 42,117,382 | 2,890,636 | 1,002,394 | 283,841 |
| 1983 | 493 | 15,629,593 | 385,196 | 57,746,975 | 3,275,832 | 1,372,404 | 306,385 |
| 1984 | 496 | 21,818,510 | 468,994 | 79,565,485 | 3,744,826 | 1,794,063 | 343,928 |
| 1985 | 496 | 26,996,344 | 533,623 | 106,561,829 | 4,278,449 | 2,156,832 | 372,625 |
| 1986 | 497 | 31,371,330 | 551,148 | 137,933,159 | 4,829,597 | 2,477,449 | 393,076 |
| 1987 | 497 | 36,003,078 | 591,546 | 173,936,237 | 5,421,143 | 2,845,274 | 419,181 |
| 1988 | 497 | 37,993,606 | 587,331 | 211,929,843 | 6,008,474 | 3,241,987 | 451,621 |
| 1989 | 499 | 43,386,931 | 609,668 | 255,316,774 | 6,618,142 | 3,683,973[a] | 439,964[a] |
| | | | | | | 1,050,687[b] | 60,599[b] |

a. Mandatory savings.
b. Voluntary savings (TAMADES).
SOURCE: Central Java Regional Development Bank.

FIGURE 3 Growth of the BKKs, 1972–1989




SOURCE: Prepared by authors.

be the result of efforts to inventory and age BKK loan portfolios to reflect better each unit's real financial position and the subsequent first phase write-off of uncollectible loans.

- The average BKK loan remained relatively small, hovering at about Rp. 75,000, with approximately 90 percent of all loans still less than Rp. 100,000.
- The BKK program continued to expand at a healthy rate, in terms of both people (new clients) and area (new village posts).
- A new emphasis was placed on mobilizing funds through the introduction of TAMADES.
- The BKK program continued to generate substantial profits, totaling Rp. 1.7 billion in 1989, of which the BKKs effectively retained 90 percent (see Figure 4).
- Assets were used productively, with approximately 85 percent held in outstanding loans.

TABLE 7 BKK Loan Portfolio Quality, 1972–1989

| Year | Total loans outstanding | | Total loans delinquent less than 6 months | | Loans delinquent < 6 months ÷ total loans outstanding | | Cumulative overdue ÷ cumulative loaned | |
|---|---|---|---|---|---|---|---|---|
| | Thousands of Rp. | # of loans | Thousands of Rp. | # of loans | % of Rp. | % of loans | % of Rp. | % of loans |
| 1972 | 213,429 | n.a. | n.a. | n.a. | n.a. | n.a. | 7.11 | 16.03 |
| 1973 | 401,967 | n.a. | n.a. | n.a. | n.a. | n.a. | 5.54 | 11.52 |
| 1974 | 701,135 | n.a. | n.a. | n.a. | n.a. | n.a. | 4.96 | 10.19 |
| 1975 | 894,372 | n.a. | n.a. | n.a. | n.a. | n.a. | 4.00 | 8.65 |
| 1976 | 1,180,223 | n.a. | n.a. | n.a. | n.a. | n.a. | 3.73 | 8.15 |
| 1977 | 1,400,382 | 260,253 | n.a. | n.a. | n.a. | n.a. | 3.15 | 7.03 |
| 1978 | 1,597,652 | 256,755 | n.a. | n.a. | n.a. | n.a. | 2.59 | 5.49 |
| 1979 | 1,886,176 | 280,551 | n.a. | n.a. | n.a. | n.a. | 2.51 | 5.43 |
| 1980 | 2,507,736 | 270,269 | n.a. | n.a. | n.a. | n.a. | 2.39 | 5.08 |
| 1981 | 3,319,535 | 275,763 | n.a. | n.a. | n.a. | n.a. | 2.16 | 4.68 |
| 1982 | 4,817,823 | 310,167 | n.a. | n.a. | n.a. | n.a. | 1.92 | 4.36 |
| 1983 | 6,598,389 | 349,691 | n.a. | n.a. | n.a. | n.a. | 1.73 | 4.07 |
| 1984 | 9,421,244 | 407,531 | 409,220 | 26,326 | 4.34 | 6.46 | 1.71 | 3.77 |
| 1985 | 11,943,055 | 448,960 | 688,370 | 36,897 | 5.76 | 8.22 | 1.79 | 3.52 |
| 1986 | 15,055,624 | 488,626 | 867,308 | 40,387 | 5.76 | 8.27 | 1.86 | 3.29 |
| 1987 | 18,223,750 | 516,065 | 1,095,692 | 45,283 | 6.01 | 8.77 | 1.98 | 3.26 |
| 1988 | 20,887,882 | 540,338 | 1,713,684 | 55,978 | 8.20 | 10.36 | 2.40 | 3.41 |
| 1989 | 23,496,588 | 509,584 | 1,744,724 | 52,613 | 7.43 | 10.32 | 2.14 | 2.81 |

n.a. = not available.
SOURCE: Central Java Regional Development Bank.

TABLE 8 BKK Performance Indicators, 1985–1989 (thousands of rupiah)

| Performance indicator | 1985 December | 1986 June | % change | 1986 December | % change | 1987 June | % change | 1987 December | % change |
|---|---|---|---|---|---|---|---|---|---|
| Loan circulation[a] | 2,353,408 | 2,381,475 | 1.2 | 2,847,080 | 19.6 | 2,865,598 | 0.7 | 3,134,915 | 9.4 |
| Loans outstanding | 11,943,055 | 13,312,212 | 11.5 | 15,055,624 | 13.1 | 16,651,132 | 10.6 | 18,223,750 | 9.4 |
| Collectability[b] | | | | | | | | | |
| Current/delinquent | 10,038,612 | 11,106,300 | 10.6 | 12,484,238 | 12.4 | 13,683,965 | 9.6 | 14,779,348 | 8.0 |
| Doubtful/bad debts | 1,904,443 | 2,205,912 | 15.8 | 2,571,388 | 16.6 | 2,967,167 | 15.4 | 3,444,402 | 16.1 |
| Ratio of interest income to loans outstanding | 0.16 | 0.13 | –18.8 | 0.14 | 7.7 | 0.13 | –7.1 | 0.12 | –7.7 |
| Average loan per borrower[c] | 52.4 | 57.1 | 9.0 | 56.8 | –0.5 | 59.8 | 5.3 | 61.9 | 3.5 |
| Loan size (# of loans) | | | | | | | | | |
| < or = Rp. 100,000 | 420,709 | 428,130 | 1.8 | 449,344 | 5.0 | 459,465 | 2.3 | 468,045 | 1.9 |
| > Rp. 100,000 | 28,251 | 30,686 | 8.6 | 39,282 | 28.0 | 41,398 | 5.4 | 48,020 | 16.0 |
| New clients[d] | | | | | | | | | |
| Borrowers | 54,156 | 41,130 | –24.1 | 49,755 | 21.0 | 42,215 | –15.2 | 51,570 | 22.2 |
| Savers | 54,156 | 41,130 | –24.1 | 49,755 | 21.0 | 42,215 | –15.2 | 51,570 | 22.2 |
| Percentage of villages serviced | 29.3 | 31.6 | 7.8 | 33.0 | 4.4 | 33.9 | 2.7 | 35.8 | 5.6 |
| Total savings | 2,156,832 | 2,043,899 | –5.2 | 2,477,449 | 21.2 | 2,389,226 | –3.6 | 2,865,724 | 19.9 |
| Total time deposits | 0 | 0 | 0.0 | 0 | 0.0 | 0 | 0.0 | 29,550 | 0.0 |
| Net profits[d] | 1,000,282 | 1,059,693 | 5.9 | 1,191,237 | 12.4 | 1,225,208 | 2.9 | 1,132,598 | –7.6 |
| Net worth[e] | 6,246,329 | 8,053,805 | 28.9 | 8,018,847 | –0.4 | 10,086,982 | 25.8 | 10,081,982 | 0.0 |
| Operational expenses per loan | 2.9 | 3.3 | 13.8 | 3.7 | 12.1 | 3.9 | 5.4 | 4.3 | 10.3 |
| BPD profit (loss) on BKK operations[f] | (53,750) | (50,975) | –5.2 | (50,975) | 0.0 | (48,200) | –5.4 | (48,200) | 0.0 |
| Total BKK units | 496 | 496 | 0.0 | 497 | 0.2 | 497 | 0.0 | 497 | 0.0 |
| Total village posts | 2,466 | 2,609 | 5.8 | 2,770 | 6.2 | 2,860 | 3.2 | 3,015 | 5.4 |
| Total BKK staff | 1,709 | 1,705 | –0.2 | 1,740 | 2.1 | 1,808 | 3.9 | 1,897 | 4.9 |

(continued)

TABLE 3 (continued)

| Performance indicator | 1988 June | 1988 % change | 1988 December | 1988 % change | 1989 June | 1989 % change | 1989 December | 1989 % change |
|---|---|---|---|---|---|---|---|---|
| Loan circulation[a] | 3,251,492 | 3.7 | 3,453,666 | 6.2 | 3,620,927 | 4.8 | 3,956,977 | 9.3 |
| Loans outstanding | 19,448,911 | 6.7 | 21,020,596 | 8.1 | 22,695,507 | 8.0 | 23,496,588 | 3.5 |
| Collectability[b] | | | | | | | | |
| Current/delinquent | 15,016,848 | 1.6 | 16,108,646 | 7.3 | 17,123,327 | 6.3 | 18,863,894 | 10.2 |
| Doubtful/bad debts | 4,432,063 | 28.7 | 4,911,950 | 10.8 | 5,572,180 | 13.4 | 4,632,694 | −16.9 |
| Ratio of interest income to loans outstanding | 0.12 | 0.0 | 0.12 | 0.0 | 0.12 | 0.0 | 0.14 | 16.7 |
| Average loan per borrower[c] | 64.3 | 3.9 | 65.5 | 1.9 | 64.4 | −1.7 | 75.0 | 16.5 |
| Loan size (# of loans) | | | | | | | | |
| < or = Rp. 100,000 | 477,416 | 2.0 | 482,745 | 1.1 | 500,105 | 3.6 | 462,150 | −7.6 |
| > Rp. 100,000 | 49,901 | 3.9 | 57,593 | 15.4 | 47,925 | −16.8 | 47,434 | −1.0 |
| New clients[d] | | | | | | | | |
| Borrowers | 44,424 | −13.9 | 47,533 | 7.0 | 42,215 | −11.2 | 45,511 | 7.8 |
| Savers | 44,424 | −13.9 | 47,533 | 7.0 | 80,741 | 69.9 | 65,051 | −19.4 |
| Percentage of villages serviced[d] | 36.2 | 1.1 | 38.3 | 5.8 | 39.3 | 2.6 | 41.0 | 4.3 |
| Total savings | 2,722,625 | −5.0 | 3,190,590 | 17.2 | 3,092,136 | −3.1 | 3,683,973 | 19.1 |
| Total time deposits | 51,744 | 75.1 | 93,501 | 80.7 | 573,189 | 513.0 | 1,050,687 | 83.3 |
| Net profits[d] | 1,239,471 | 9.4 | 121,310 | −90.2 | 741,243 | 511.0 | 957,080 | 29.1 |
| Net worth[e] | 12,159,021 | 20.6 | 12,187,328 | 0.2 | 10,929,063 | −10.3 | 10,736,806 | −1.8 |
| Operational expenses per loan | 2.5 | −41.9 | 5.3 | 112.0 | 4.3 | −18.9 | 5.7 | 32.6 |
| BPD profit (loss) on BKK operations[f] | (42,600) | −11.6 | (22,290) | −47.7 | (18,450) | −17.2 | 17,750 | −196.2 |
| Total BKK units | 497 | 0.0 | 497 | 0.0 | 499 | 0.4 | 499 | 0.0 |
| Total village posts | 3,063 | 1.6 | 3,221 | 5.2 | 3,333 | 3.5 | 3,440 | 3.2 |
| Total BKK staff | 1,925 | 1.5 | 1,964 | 2.0 | 2,056 | 4.7 | 2,048 | −0.4 |

a. Monthly average for six-month classification period.
b. Current = all payments made on time; delinquent = one or more payments not made on time but repayment period not yet expired; doubtful = one or more payments not made on time and repayment period expired; bad debt = same as doubtful except loan deemed uncollectable.
c. Based on loan circulation.
d. Total for six-month classification period.
e. Comprised primarily of retained earnings, and thus only changes appreciably when net annual earnings are posted at end of year.
f. Total BPD BKK operational income less total BPD BKK operational expenses; parentheses indicate a negative number.
SOURCE: Central Java Regional Development Bank.

TABLE 9 BKK Comparative Profit and Loss Statements, 1985–1989 (thousands of rupiah)

| Income and expenses | December 1985 | December 1987 | December 1989 |
|---|---|---|---|
| Income | | | |
| Loan interest | 3,154,684 | 4,487,945 | 5,810,879 |
| Bank interest | 10,666 | 23,220 | 79,731 |
| Loan fee (1%) | 269,262 | 362,422 | 431,637 |
| Administrative fees | 745 | 3,081 | 6,192 |
| Penalty payments | 13,200 | 32,705 | 61,002 |
| Residual | 176 | 103 | 0 |
| Other | 2,879 | 19,825 | 440,797 |
| Total income | 3,451,612 | 4,929,301 | 6,830,238 |
| Expenses | | | |
| Interest paid to BPD | 220,804 | 408,415 | 568,950 |
| Interest on savings | 7,046 | 9,991 | 115,222 |
| Salaries and wages | 664,782 | 1,109,663 | 1,471,226 |
| Administration | 171,030 | 297,804 | 441,621 |
| Transport | 157,777 | 224,951 | 319,694 |
| Other | 169,748 | 366,119 | 428,265 |
| Depreciation | 80,281 | 154,551 | 356,101 |
| Write-off of bad debts | 0 | 0 | 843,433 |
| Accrued expenses | 0 | 0 | 587,404 |
| Total expenses | 1,471,468 | 2,571,494 | 5,131,916 |
| Profit (loss) | 1,980,144 | 2,357,807 | 1,698,322 |

SOURCE: Central Java Regional Development Bank.

- Net profits and net worth showed a relative decline in 1989, owing to the introduction of revised accounting procedures, including the writing off of bad debts and the declaration of accrued expenses, to indicate more accurately the financial position of BKK units.

- The Central Java BPD covered all of its supervision costs with income generated by BKK interest payments for loan capital.

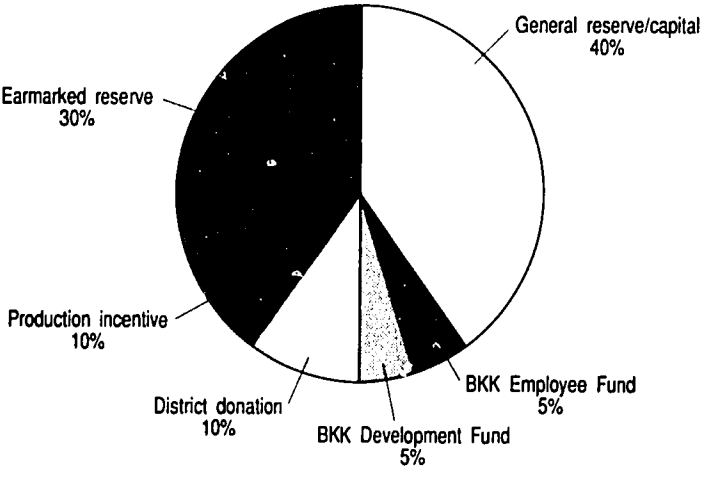
The characteristics of BKK clients in 1989 were still accurately described by the key findings of a two-stage, purposive sample survey

TABLE 10 BKK Comparative Balance Sheets, 1985–1989 (thousands of rupiah)

| Assets and liabilities | December 1985 | December 1987 | December 1989 |
|---|---|---|---|
| Assets | | | |
| Cash | 347,557 | 329,747 | 510,966 |
| Savings accounts | 316,448 | 614,518 | 1,456,823 |
| Loans outstanding | 11,943,055 | 18,223,750 | 23,496,587 |
| Equipment/buildings | 643,902 | 1,417,413 | 2,031,623 |
| Duty stamps | 7,325 | 18,996 | 2,665 |
| Accounts receivable | 0 | 0 | 289,998 |
| Total assets | 13,258,287 | 20,604,424 | 27,788,662 |
| Liabilities | | | |
| Local government/BPD loans | 2,642,024 | 4,896,205 | 6,801,116 |
| Village deposits | 28,574 | 34,449 | 158,135 |
| Technical services deposits | 204,383 | 383,708 | 311,803 |
| Mandatory client savings | 2,156,832 | 2,845,274 | 3,683,973 |
| Voluntary client savings | 0 | 0 | 1,050,687 |
| Accounts payable | 0 | 0 | 1,678,858 |
| Other current liabilities | 0 | 0 | 638,964 |
| Prizes | 0 | 0 | 26,719 |
| Provision for bad debts | 0 | 0 | 1,003,278 |
| Retained earnings | 6,246,329 | 10,086,982 | 10,736,806 |
| Current profits | 1,980,145 | 2,357,806 | 1,698,323 |
| Total liabilities | 13,258,287 | 20,604,424 | 27,788,662 |

SOURCE: Central Java Regional Development Bank.

FIGURE 4 BKK Division of Profits




SOURCE: Prepared by authors.

of 662 BKK clients at twenty BKK units throughout Central Java conducted at the end of 1982:

- Petty trading was the primary economic activity for more than half of BKK borrowers, and farming the secondary activity for more than half.
- Sixty percent of borrowers were women.
- The average age of borrowers was forty, with most in their prime earning period between twenty-five and forty-nine years.
- The average loan recipient family had five members living at home, and each family member earning an income supported an additional 2.6 people.
- About half of BKK borrowers owned land, averaging 0.8 hectare (above the average for Central Java).
- More than 60 percent of rural clients and about 45 percent of urban borrowers either had received no schooling or had not completed primary school.
- Most borrowers lived in the village where their BKK transactions took place.
- More than one-third of BKK borrowers had received credit from other sources.
- Average borrowers quadrupled their loan size (in real terms) within four years and received over thirteen loans.
- More than 40 percent of BKK borrowers had savings accounts outside their BKK, in addition to their BKK savings.

Survey results also showed that BKK loans had promoted the expansion of most borrowers' businesses. In addition to improving ongoing activities, about one-fourth of BKK clients had begun new economic activities since receiving their first BKK loan. Almost all BKK clients used their loans as working capital to buy raw materials

for production or goods for resale. Client responses were confirmed by high BKK loan repayment rates, which indicated that most borrowers were using their loans for productive purposes that generated a cash flow sufficient to cover the high interest charges. Most BKK borrowers reinvested their profits into their business, and withdrew their mandatory savings for family needs and holiday celebrations.

BKK loans had a positive, although modest effect on employment. Underemployment was reduced, as more than 60 percent of BKK borrowers spent more time on their business after receiving their first BKK loan. Moreover, 17 percent of BKK borrowers hired new full- or part-time workers. The average sampled BKK client created 0.3 new full-time jobs and 0.4 new part-time jobs.

Finally, the survey indicated that the BKKs had contributed significantly to village and area development in Central Java, but was still a long way from fully meeting the province's demand for rural off-farm credit. BKK client success had rippled through local economies through backward linkages and income multipliers, whereas the effects of forward linkages and consumer surplus were minimal.

The primary BKK backward linkage had been through suppliers: about 90 percent of surveyed BKK borrowers had increased the volume of materials they purchased after receiving BKK credit, and almost half had also increased the number of suppliers from whom they bought.

In contrast to backward linkages, forward linkages had not been important contributors to the BKK program's community impact. Most BKK clients were petty traders and handicraft workers, so they produced or marketed end products rather than served as intermediate suppliers for other businesses. Moreover, survey results indicated that BKK traders' cost-savings derived from new buying patterns usually had not been passed on to consumers.

BKK credit for strictly agricultural activities was minimal, because of a combination of the relatively low interest rate of BKK seasonal loans (2 percent per month) and the high risk of these loans; many of the BKKs that went bankrupt in the mid-1970s attributed their failure to predominantly agricultural loan portfolios.

BKK clients had, however, contributed to the economic growth of their communities by spending more on personal consumption through their increased purchasing power. About one-third had used business profits, and roughly 40 percent had used accumulated savings for family needs and housing improvements. An additional 18 percent had used their savings for the Lebaran and Selamatan holiday celebrations.

## Future Issues and Priorities

The BKK agenda of key issues and major priorities for the next few years comprise the items noted below.

**Growth and diversification of lending activities.** Although BKK lending activities are continuing to grow at a healthy pace, BKK staff will be reminded not to become complacent: the BKK system's primary comparative advantage over its competitors has been its network of more than 3,400 pos desas, and this network must be expanded if the BKKs are to maintain their competitive edge.

While direct coverage of 41 percent of the villages in Central Java is impressive, this is still far short of the system's intermediate goal of one pos desa for every two villages in the province. Furthermore, given the finding of the above-noted survey that most BKK clients did not travel from neighboring villages but instead resided in a village served directly by a BKK, this must remain only an interim goal.

Another method for increasing BKK geographic coverage will be to continue efforts to revive failed BKK units. The strategy for rehabilitation of BKK units is sound: the BPD staff analyzes the reasons for failure and puts together a detailed program for ensuring that these obstacles are redressed before commencing BKK operations. When the reasons for BKK failure are beyond the control of the Central Java BPD and these problems are not addressed, the BPD quite rightly does not restart the failed BKK's operations.

To deal with the special problems of borrower anonymity and mobility, and thus poor loan repayment rates in urban areas, BKK will experiment with requiring recommendations of *rukun tetangga* and *rukun warga* chiefs (chiefs of neighborhood groups) in addition to village chiefs, to increase the likelihood that the person providing character references actually knows the potential BKK clients.

Furthermore, as the BKK system continues to mature, BKKs will look to new markets within their current geographic domain, such as small industry and agroprocessing activities.

In addition, BKKs will increase their participation in BPD cofinancing to retain their best clients, with the former continuing to provide working capital and the latter complementing this financing with investment credit.

In expanding and diversifying their lending portfolios, BKKs will try to build on their strengths and experience, and evaluate new oppor-

tunities based on a proposed activity's financial viability: they will continue to resist the numerous requests by the government and donor organizations to participate in subsidized, targeted special programs that simply divert resources from income-generating activities to resource-depleting endeavors.

That is, prime BKK considerations in evaluating new lending activities will continue to be both internal institutional capacity and external market conditions. Thus, BKKs will try to reject activities such as the Bank Indonesia–sponsored assistance to *kelompok swadaya masyarakat* (self-help groups), for the proposed activities are simply unnecessary (there is no demand) and unbankable (no net income stream is generated).

Furthermore, all efforts to fragment the BKK system by establishing BKK units dedicated to specialized lending, such as the recently resurrected Fish Market BKK (BKK Tempat Pelelangan Ikan) will be resisted: in most cases, the market in one subdistrict is not resilient enough to support more than one BKK, so if a new BKK is eventually successful, it is usually at the expense of another BKK. Instead, specialized markets will be serviced by pos desas, which can respond to market demand quickly and flexibly, while at the same time minimizing cost and risk to BKKs.

**Write-off of uncollectible loans.** The incorporation of twenty years' accumulation of bad and doubtful debts in BKK financial statements had made it difficult to assess the precise financial condition of BKK units. Thus, the Central Java BPD, together with the local government authorities, has conducted a comprehensive field survey of all BKK loans in arrears, and has classified and aged these loans in preparation for the eventual write-off of all BKK loans deemed uncollectible. This activity is scheduled to be implemented in stages over several years. BKKs began to write off their bad debts for the first time in 1989.

**Expansion of TAMADES.** As noted earlier, the positive results of TAMADES to date have encouraged Central Java provincial government and BPD officials to expand the pilot project to 90 percent of all BKK units in Central Java (Class I, II, and III BKKs) over the next few years. This expansion will allow the BKKs not only to decrease their dependency on scarce central government resources, but also to serve more fully as rural financial intermediaries.

However, in expanding TAMADES, BKK units will try to follow the example of BKK Jepon (Blora District), which has sought the

support of the *bupati* (district chief), the *camat* (subdistrict chief), and the *kepala desa* (village chief) in attracting institutional accounts to complement individual savers, thus reducing administrative costs per rupiah raised and facilitating BKK cash management.

Moreover, the Central Java BPD will consider equalizing the cost of loan capital for BKKs by raising the interest rate on BPD capital loans to BKKs from 12 percent to 15 percent per year for all Class I, II, and III BKKs, thus providing BKKs participating in TAMADES a greater incentive to mobilize voluntary savings.

**Continuation of training activities.** Future activities will include the training of BKK managers in financial, personnel, and operations management, along with refresher training of BKK staff in bookkeeping and administration. BPD supervisors will be trained in field supervision, auditing, and technical assistance, with an emphasis on practical exercises and field applications, especially regarding data scanning and data analysis. A BKK training center in Semarang will be completed so the BPD can implement these training activities in a self-sustaining manner once the Financial Institutions Development project is over.

**Institutionalization of the BPD's BKK oversight system.** The BKK Supervision Department of the Central Java BPD has slowly moved from highly personalized crisis management to a more systematic and rational allocation of tasks and responsibilities. For example, the BPD recently split the BKK Supervision Department into three sections (Administration, Reports, and Field Supervision), established a mobile troubleshooting team, recruited and trained several new staff, and reassigned many experienced staff members. The BPD plans to continue such efforts to improve the efficiency and effectiveness of BPD personnel, thereby strengthening long-term institutionalization of the BPD's BKK oversight system.

**Transfer of BKK personnel decisions to the Central Java BPD.** Finally, a major difficulty in increasing the integrity and professionalism of BKK staff has been the lack of BPD authority to enforce personnel recommendations based on BKK performance. Instead, BKK staffing decisions have sometimes been made by local government officials based largely on political or personal considerations.

Thus, Central Java provincial government and BPD officials are currently assessing the long-term possibility of eventually incorporating the BKKs into the BPD. As an interim measure, they will try to

transfer all final decisions regarding BKK staffing, such as the hiring, transferring, promoting, demoting, and firing of BKK managers and employees from the local government apparatus to the BPD. This change would allow the BPD, by exercising direct control over the career paths of BKK staff, to ensure greater accountability for the banking ethics and practices that the BPD has been trying to instill in BKK personnel over the past two decades.

# 5
# Case Study Two: Bank Rakyat Indonesia (BRI) Unit Desas

*Experience teacheth many things, and all men are his scholars: Yet is he a strange tutor, unteaching that which he hath taught.*

—Martin F. Tupper, *Proverbial Philosophy*, I, 1838

## BRI Unit Desa Ambulu, Jember District, East Java

Approximately one hour's drive south of the city Jember in Indonesia's province of East Java lies BRI Unit Desa Ambulu. Located in Ambulu Subdistrict's capital city and encircled by lowland rice paddies, Unit Desa Ambulu is housed in a simple but functional office. Its staff of seven has developed a highly profitable financial institution, generating net profits in 1988 totaling Rp. 88 million.

Most of BRI Unit Desa Ambulu's loans go to small-scale traders: a quarter of all lending supports mixed petty trading, while approximately half of lending is for the trading of agricultural products such as rice, corn, and soybeans. The remaining loans support agricultural production, small industry, local services, and consumer loans for civil servants.

As of December 31, 1988, total loans outstanding at BRI Unit Desa Ambulu were Rp. 550 million, held by 1,261 borrowers. On average, Unit Desa Ambulu made loans to 135 borrowers totaling Rp. 78 million monthly during 1988, for an average loan in 1988 of Rp. 580,000. Also as of December 31, 1988, savings stood at Rp. 377 million, composed

primarily of SIMPEDES accounts totaling Rp. 305 million. Both Unit Desa Ambulu's long-term loss ratio and portfolio status were less than 1 percent (0.2 percent and 0.5 percent, respectively).

The atmosphere in BRI Unit Desa Ambulu is a cross between that of a bank and a local market. Unit desa employees are immaculately dressed, with a highly professional deportment—they exude confidence. Clients are simply dressed and quite informal, anxious to complete their banking activities and return to their homes and businesses.

The head of BRI Unit Desa Ambulu, Mr. A. Dimyati, has an undergraduate law degree and ten years' experience with various unit desas; he has been at Unit Desa Ambulu for the past two and a half years. He manages a staff of six and supervises operations covering six local villages. His unit desa also serves as a monthly payment point for more than four thousand National Electric Company account holders.

BRI Unit Desa Ambulu is located in a productive farming area and supports the region's economy by lending money for agricultural activities and for enterprises linked to agriculture production, processing, and trading. Unit Desa Ambulu employees feel that despite their progress to date, Ambulu Subdistrict has much untapped potential, and they plan to begin more aggressive recruitment of borrowers and savers, especially outside of the subdistrict capital.

## BRI Unit Desa Tentena, Poso District, Central Sulawesi

The journey from BRI's Manado Regional Office in the province of North Sulawesi to BRI Unit Desa Tentena in Central Sulawesi is long and arduous. The trip begins with a two-hour flight from Manado to Palu, the capital of Central Sulawesi, followed by either a twenty-minute flight or a seven-hour drive to Poso. The road is circuitous, narrow, and steep, with a tendency to slide down the mountains through which it weaves. The drive from Poso, the district capital, to Tentena Subdistrict, takes another three hours, also along narrow, winding, and well-worn roads.

Tentena is a small town on the shore of Lake Tentena. Its high elevation and lake breezes make it an ideal clove-growing area. The air is fresh, and rainfall is plentiful. The region is also sprinkled with rice fields and small family gardens. Tentena Subdistrict comprises twenty-eight villages, some of which are accessible only by boat or by foot. The area is vast, with a small and widely dispersed population.

This is the market in which BRI Unit Desa Tentena is thriving. In 1988, Unit Desa Tentena generated net profits of more than Rp. 15 million. As of December 31, 1988, Unit Desa Tentena had 383 borrowers with loans outstanding totaling Rp. 131 million and 1,536 savings accounts, for a total of Rp. 262 million. Its long-term loss ratio was 0.2 percent, and its portfolio status was 0.5 percent.

About half of Unit Desa Tentena's loans have gone to small-scale traders, either for mixed petty trading of daily household necessities or for the trading of agricultural goods. Most of the remaining loans have been for agricultural production, primarily for the preparation, maintenance, and harvesting of clove groves and rice fields. A small number of loans have also been made for home industries such as wood and rattan furniture production, and for civil servants to make home improvements, pay the school fees of their children, and meet similar household needs.

The head of BRI Unit Desa Tentena, Mr. Vidsen Tobias, is a native of NTT province, and the *mantri* (field agent), Mr. Kaferius Kompudu, is from Central Sulawesi. Mr. Tobias has led Unit Desa Tentena for one and a half years, while Mr. Kompudu has been with the unit for six years. Their operations are run with the same degree of confidence and professionalism found in unit desas much closer to provincial capitals.

The main constraint to further expansion of credit and savings activities is the slow rate of regional economic growth. However, the World Bank is now assisting in the construction of a ring road around Lake Tentena, which the Unit Desa Tentena staff believes will dramatically increase the potential for growth. The staff is also considering expansion of its operations into neighboring subdistricts such as Lore Selatan, which are not yet covered by any BRI Unit Desa.

## Background

Bank Raykat Indonesia (BRI) is one of five state-owned commercial foreign exchange banks in Indonesia, with primary responsibility for providing rural banking services in general and for promoting the development of the agriculture sector in particular.

Although the BRI was established in 1968 under National Law Number 21/1968, its origins date from considerably earlier: the BRI is the succ ssor to a series of banks in Indonesia spanning almost one hundred years, beginning with De Poerwokertosche Hulp-en Spaarbank

der Inlandsche Hoofden, founded in 1895. The BRI has grown to become one of Indonesia's largest banks, in terms of both level of resources and coverage. As of December 1987, the BRI's total assets were Rp. 7.6 trillion, including a net loan portfolio of Rp. 5.5 trillion, and 1987 pretax profits totaled Rp. 70.4 billion.

In terms of outreach, the BRI's branch network is the most extensive of any bank in Indonesia: as of December 1987, there were 299 BRI *cabangs* (branches), most of which are located at the district or municipal level, as compared with a total of 296 districts and municipalities in Indonesia. Thus, the BRI's branch system effectively covers the entire nation. The BRI has also established an office in New York. The BRI's total workforce comprised 31,627 employees as of December 1987.

The BRI unit desas were first conceived in 1969 as a pilot project in Yogyakarta to channel BIMAS (Bimbingan Massal, or Mass Guidance) credit to farmers. The BIMAS program's primary objective was to promote national rice self-sufficiency by bringing the green revolution to Indonesia: it was initiated to encourage farmers to use the new fertilizer-responsive rice varieties, along with complementary increased fertilizer dosages and insecticides. The agricultural extension service was expanded dramatically to transmit newly available rice production technology, while farmers were provided credit for a package of inputs comprising new rice seed, fertilizer, insecticides, and a cost-of-living allowance.

Based on the success of the Yogyakarta pilot project (pilot projects in Yogyakarta are almost always successful, mainly for cultural reasons), the government expanded the BRI unit desa system into a national program in 1973, through Presidential Instruction No. 4/1973. Since the primary function of unit desas continued to be servicing BIMAS borrowers, units were established on the basis of how many rice fields they could cover from a given location. On Java, one unit desa was established per 600 to 1,000 hectares (1,500 to 2,500 acres) of rice fields, while off Java, the standard was one unit desa per 1,200 to 2,000 hectares (3,000 to 5,000 acres) of rice fields.

Each BRI unit desa had four employees: a *kaudes* (*kepala unit desa*, or unit chief), responsible for managing all activities of the unit desa; a mantri, responsible for undertaking the field work necessary to verify information in loan applications and to pursue delinquent borrowers; a bookkeeper; and a cashier.

A BRI unit desa was operated as a window of a BRI cabang, not as a separate financial entity. For example, all unit desa transactions were

**BRI Unit Desa Snapshot: Bp. Satiran and Ibu Kaminten**

Bp. Satiran and Ibu Kaminten recently received a seven-month KUPEDES loan for Rp. 1 million at Unit Desa Kabuh, Jombang, East Java. This was their third KUPEDES loan in three years. As with the family's first two loans, the unit desa considered this an agriculture loan, for the family's primary occupation was lowland rice and tobacco cultivation.

Indeed, part of the loan was used to purchase agricultural inputs and hire extra workers during the busiest few weeks in the planting and harvesting cycle. However, this family also ran a small store stocked with a variety of daily household goods, they dried tobacco leaves, and they peddled agricultural products.

Agricultural technology, the amount of land worked, and the size of harvests remained relatively constant, but the store grew significantly—working capital from the store was no longer siphoned out to pay for agricultural inputs and agricultural labor.

All of these activities employed the father, the mother, their children, and several cousins on a regular basis, as well as transient agricultural laborers as needed during peak planting and harvest seasons. Although it is unlikely that any net new jobs were created directly by this KUPEDES injection of capital, without a growth in the family enterprises, some of the children and cousins would probably have gone to the provincial capital, Surabaya, in search of employment opportunities.

re-posted into the cabang books. Cash was returned to the cabang daily or weekly, depending on the distance between the unit desa and the cabang. The authority of the kaudes to approve loans without prior agreement from cabang officers was either small or nonexistent. Profit and loss statements and balance sheets, although prepared for each unit desa, were partial statements whose main purpose was to indicate to the government of Indonesia the amount of operating losses in the BIMAS program, not to depict unit desa overall financial performance. Figures from these statements were later incorporated into consolidated cabang statements.

In addition to lack of financial autonomy and operational accountability, BRI unit desas had limited discretion in the selection and approval of BIMAS borrowers. In effect, the Ministry of Agriculture's extension workers chose the borrowers, since these were the farmers who were certified as agreeing to participate in all aspects of the BIMAS program.

In theory, unit desa staff had the final authority to approve or reject the borrowers selected by extension workers; in practice, the pressure of the local government, which was attempting to achieve area targets for BIMAS, was so strong that few loan applicants sponsored by the Ministry of Agriculture were refused, except for failure to pay previous loans. While the ministry's extension workers were good at finding potential borrowers, they were of little help in collecting loans from the borrowers they had recommended.

In addition, the concentration solely on agricultural lending meant that the staff of the BRI unit desas was extremely busy before and during planting and harvesting seasons, but relatively idle at other times. This increased the operating costs per rupiah loaned and resulted in an uneven and inefficient application of unit desa resources.

The BIMAS program, along with the BRI unit desas, was subsidized in a number of ways. Fertilizer, seed, and insecticide prices were all maintained at below market levels. The interest rate on BIMAS credit was kept below market rates for both the lender and the borrower—Bank Indonesia provided the BRI with liquidity credit at 3 percent per year for BIMAS on-lending, while farmers paid 12 percent per year, which was below both the annual inflation rate and the interest rate paid on small savings. The national government and Bank Indonesia shared the risk on BIMAS lending, covering 75 percent of BIMAS loan losses. The national government also paid the BRI a BIMAS administrative subsidy, initially covering 40 percent of all unit desa administrative costs, and later covering all unit desa operating losses after the unit desas were asked to administer additional credit programs. Finally, the price of rice was supported at a high enough level to ensure that farmers who participated in the BIMAS program would make a profit.

Although the criterion for the establishment and siting of BRI unit desas remained maximum coverage of rice farmers, Presidential Instruction No. 4/1973 also gave unit desas the general mandate to extend non-BIMAS credit and to mobilize rural savings as future development warranted.

Thus, in addition to extending and collecting BIMAS credit, the unit desas expanded and diversified their activities over the next seven years.

In 1974, Kredit Mini was introduced as a unit desa loan window primarily for off-farm economic activities, at an annual interest rate of 12 percent. In 1976, the unit desas were asked to mobilize rural funds through TABANAS (Tabungan Nasional, or National Savings), a nationwide savings program, initially at an annual interest rate of 12 percent and later at 15 percent. In 1980, Kredit Midi was introduced along the lines of the Kredit Mini program to allow the unit desas to extend larger nonagricultural loans, also at an annual interest rate of 12 percent.

Elements of these three programs make up the origins of most current BRI unit desa operations: present credit facilities are essentially Kredit Mini and Kredit Midi with a different source of seed money and higher interest rates, while the most popular savings instrument at present is a refined version of TABANAS, with slightly lower interest rates.

The primary difference between Kredit Mini/Kredit Midi and their successor, KUPEDES (described below), is that the former programs were created with grant funds while the latter was financed by loans at interest rates comparable to market savings rates. Kredit Mini/Kredit Midi grant dependency deterred the BRI unit desas from mobilizing savings and introduced bureaucratic interference in program management by the Ministry of Finance, while loan-based KUPEDES created a built-in unit desa incentive to raise public funds, and obviated non-BRI involvement in the details of program implementation.

Furthermore, there is a clear but unintentional link between Kredit Mini and the BKKs: after studying the BKK design in 1972 and 1973, the national government allocated Rp. 5 billion in grant funds to support "BKK type" initiatives, but in the course of the budgeting process this grant was inadvertently assigned to the BRI rather than the provinces. Thus, quite by accident, the BRI was designated implementer of a rural credit program based on the BKK model of general lending, which it later dubbed Kredit Mini.

## BRI Unit Desa Development

BRI unit desa development falls into two somewhat overlapping but distinct phases: the rise and fall of the BIMAS empire (1973–1983) and metamorphosis and rebirth (1984–1989).

**Phase I: The rise and fall of the BIMAS empire (1973–1983).** Phase I of BRI unit desa development began with dramatic expansion fueled

primarily by rapid growth of BIMAS lending and ended with relative decline as BIMAS lending was phased out.

Given the responsibility of administering the BIMAS, Kredit Mini, Kredit Midi, TABANAS, and miscellaneous smaller programs, the BRI unit desas expanded rapidly: there were only 470 unit desas in 1970, but that number roughly doubled the following year and almost doubled again over the next two years. By 1984 there were 3,626 unit desas.

Concurrent with this rapid expansion in number of BRI unit desas was a drastic increase in unit desa personnel: the 1,871 unit desa employees in 1970 had more than tripled by 1973, more than doubled again over the next five years, and by 1984 totaled almost 14,000 employees, or approximately 4 employees per unit desa (see Table 11).

As BRI unit desas began to grow in terms of both number and personnel, so did their lending activities. However, there was a lag between increase in lending volume and increase in unit desa locations

TABLE 11 Growth of the Number of BRI Unit Desa Offices and Staff, 1970–1989

| Year | Number of unit desas | Number of PPDs[a] | Number of staff |
|---|---|---|---|
| 1970 | 470 | 0 | 1,871 |
| 1971 | 932 | 0 | 3,035 |
| 1972 | 1,194 | 0 | 3,789 |
| 1973 | 1,557 | 0 | 6,079 |
| 1974 | 2,247 | 0 | 8,203 |
| 1975 | 2,981 | 0 | 9,630 |
| 1976 | 3,072 | 0 | 9,703 |
| 1977 | 3,270 | 0 | 11,567 |
| 1978 | 3,288 | 0 | 12,359 |
| 1979 | 3,330 | 0 | 12,675 |
| 1980 | 3,432 | 0 | 13,074 |
| 1981 | 3,524 | 0 | 13,846 |
| 1982 | 3,569 | 0 | 14,310 |
| 1983 | 3,617 | 0 | 14,334 |
| 1984 | 3,626 | 0 | 13,668 |
| 1985 | 2,469 | 1,135 | 12,954 |
| 1986 | 2,273 | 1,226 | 12,954 |
| 1987 | 2,358 | 1,070 | 11,967 |
| 1988 | 2,592 | 878 | 13,099 |
| 1989 | 2,843 | 835 | 14,341 |

a. Pos pelayanan desas, or village service posts.
SOURCE: Bank Rakyat Indonesia Head Office.

and staff, so that as overall lending activities actually decreased in the late 1970s, the unit desas continued to expand.

For example, BIMAS lending peaked in the 1975/76 planting season at Rp. 55 billion, and then began a steady decline, so that by the 1983/84 planting season, BIMAS lending was one quarter the amount lent eight years earlier (see Table 12). By 1989, BIMAS credit through the unit desas had been phased out completely. Meanwhile, although

TABLE 12 BIMAS Credit Statistics by Planting Season for Rice, 1970/71–1983/84

| Planting season | Number of borrowers | Amount lent (thousands of Rp.) | Amount overdue (thousands of Rp.) | Default rate (%) |
|---|---|---|---|---|
| 1970/71 | 1,326,714 | 8,454,655 | 283,918 | 3.36 |
| 1971 | 356,607 | 2,508,981 | 140,936 | 5.62 |
| 1971/72 | 1,181,770 | 7,306,117 | 215,123 | 2.94 |
| 1972 | 356,654 | 2,558,494 | 148,866 | 5.82 |
| 1972/73 | 1,714,733 | 12,772,340 | 624,828 | 4.89 |
| 1973 | 540,684 | 4,942,043 | 319,512 | 6.47 |
| 1973/74 | 2,550,242 | 31,550,210 | 2,586,425 | 8.20 |
| 1974 | 987,764 | 12,537,608 | 1,311,011 | 10.46 |
| 1974/75 | 2,615,451 | 40,558,848 | 3,483,830 | 8.59 |
| 1975 | 1,104,904 | 17,214,042 | 2,472,542 | 14.36 |
| 1975/76 | 2,476,963 | 55,074,430 | 5,242,564 | 9.52 |
| 1976 | 914,105 | 22,442,485 | 3,605,253 | 16.06 |
| 1976/77 | 2,089,933 | 48,871,790 | 7,026,623 | 14.38 |
| 1977 | 635,349 | 17,534,636 | 5,028,980 | 28.68 |
| 1977/78 | 1,799,120 | 44,550,076 | 6,176,217 | 13.86 |
| 1978 | 643,299 | 17,744,210 | 3,876,982 | 21.85 |
| 1978/79 | 1,403,017 | 42,235,323 | 6,740,321 | 15.96 |
| 1979 | 412,837 | 12,983,968 | 2,178,760 | 16.78 |
| 1979/80 | 1,161,317 | 36,313,088 | 5,389,251 | 14.84 |
| 1980 | 432,512 | 14,221,010 | 2,605,034 | 18.32 |
| 1980/81 | 1,087,330 | 35,094,157 | 7,876,394 | 22.44 |
| 1981 | 555,893 | 18,892,722 | 4,393,003 | 23.25 |
| 1981/82 | 1,104,280 | 43,609,046 | 15,314,124 | 35.12 |
| 1982 | 303,306 | 13,755,901 | 7,714,392 | 56.08 |
| 1982/83 | 900,600 | 45,597,802 | 22,285,583 | 48.87 |
| 1983 | 199,468 | 9,411,605 | 4,801,750 | 51.02 |
| 1983/84 | 363,555 | 14,081,566 | 7,679,457 | 54.54 |

SOURCE: Ministry of Agriculture Head Office.

Kredit Mini and Kredit Midi lending continued to rise through 1983 (see Table 13), the volume of these transactions only partially compensated for the decline in BIMAS lending volume. That is, unit desa staff were only servicing one-tenth of the hectarage in 1983 that they were servicing in the mid-1970s—32 hectares (79 acres) per staff person compared with roughly 300 hectares (738 acres)—and the nearly 50 percent average compounded growth rate of outstanding Mini and Midi credit per unit desa employee was not enough to compensate for this BIMAS decline (see Table 14).

The financial consequence of these trends was dramatic: not only were the BRI unit desas net losers every year after their creation except for 1977, but annual operational losses tripled from 1978 to 1979, and then quadrupled from 1980 to 1984 (see Table 15).

These losses were sustainable as long as the unit desas continued to receive administrative subsidies from the Ministry of Finance, but with the BIMAS phase-out and concomitant cessation of these subsidies at the end of 1983, the BRI was faced with a difficult choice: the BRI either introduced drastic measures to increase the profitability of the unit desas or it closed them down.

**Phase II: Metamorphosis and rebirth (1984–1989).** Phase II in BRI unit desa development began as a time of painful adjustment and slow adaptation, which laid the foundation for a subsequent period of dramatic growth and rapid expansion.

TABLE 13 Growth of Kredit Mini and Kredit Midi, 1974–1984 (thousands of rupiah)

| Year | Kredit Mini loans outstanding | Kredit Midi loans outstanding | Kredit Mini + Kredit Midi loans outstanding |
|---|---|---|---|
| 1974 | 1,617,845 | 0 | 1,617,845 |
| 1975 | 4,499,414 | 0 | 4,499,414 |
| 1976 | 7,216,615 | 0 | 7,216,615 |
| 1977 | 9,700,469 | 0 | 9,700,469 |
| 1978 | 14,293,259 | 0 | 14,293,259 |
| 1979 | 18,434,385 | 0 | 18,434,385 |
| 1980 | 32,845,692 | 2,277,335 | 35,123,027 |
| 1981 | 54,414,150 | 24,592,269 | 79,006,419 |
| 1982 | 59,640,981 | 36,904,674 | 96,545,655 |
| 1983 | 57,911,310 | 43,262,729 | 101,174,039 |
| 1984 | 10,410,270 | 15,899,869 | 26,310,139 |

SOURCE: Bank Rakyat Indonesia Head Office.

TABLE 14 Ratio of BRI Unit Desa Staff to Outstanding Credit, 1970–1984

| Year | Ratio of staff to total BIMAS credit realized (hectares) | Ratio of staff to total Mini + Midi outstanding credit (rupiah) |
|---|---|---|
| 1970 | 1 : 667 | |
| 1971 | 1 : 459 | |
| 1972 | 1 : 317 | |
| 1973 | 1 : 301 | |
| 1974 | 1 : 326 | 1 : 197,000 |
| 1975 | 1 : 278 | 1 : 467,000 |
| 1976 | 1 : 249 | 1 : 622,000 |
| 1977 | 1 : 178 | 1 : 839,000 |
| 1978 | 1 : 159 | 1 : 1,157,000 |
| 1979 | 1 : 123 | 1 : 1,457,000 |
| 1980 | 1 : 114 | 1 : 2,697,000 |
| 1981 | 1 : 116 | 1 : 5,706,000 |
| 1982 | 1 : 82 | 1 : 6,747,000 |
| 1983 | 1 : 32 | 1 : 7,058,000 |
| 1984 | 1 : 0.6 | 1 : 1,925,000 |

NOTE: Blank cell = not applicable.
SOURCE: Bank Rakyat Indonesia Head Office.

TABLE 15 BRI Unit Desa Losses over Time, 1970–1989 (millions of rupiah)

| Year | Income | Expenses | Profit (loss) | Total yearly administrative subsidy |
|---|---|---|---|---|
| 1970 | 5 | 77 | (72) | 0 |
| 1971 | 691 | 1,078 | (387) | 655 |
| 1972 | 804 | 852 | (48) | 261 |
| 1973 | 1,232 | 1,419 | (187) | 1,012 |
| 1974 | 2,870 | 2,914 | (44) | 773 |
| 1975 | 4,720 | 6,717 | (1,997) | 1,126 |
| 1976 | 6,820 | 8,092 | (1,272) | 1,672 |
| 1977 | 10,265 | 9,923 | 342 | 1,378 |
| 1978 | 9,794 | 11,915 | (2,121) | 2,518 |
| 1979 | 11,083 | 17,361 | (6,278) | 4,376 |
| 1980 | 13,303 | 20,140 | (6,837) | 8,096 |
| 1981 | 22,822 | 33,114 | (10,292) | 7,068 |
| 1982 | 22,255 | 30,394 | (8,139) | 13,595 |
| 1983 | 21,069 | 33,719 | (12,650) | 21,980 |
| 1984 | 25,853 | 50,976 | (25,123) | 21,444 |
| 1985 | 72,565 | 73,501 | (936) | 1,243 |
| 1986 | 126,932 | 117,086 | 9,846 | 0 |
| 1987 | 177,873 | 155,394 | 22,479 | 0 |
| 1988 | 229,613 | 198,973 | 30,640 | 0 |
| 1989 | 330,629 | 293,715 | 36,914 | 0 |

SOURCE: Bank Rakyat Indonesia Head Office.

Phase II is characterized by the BRI's introduction of three principal policy changes to revitalize its unit desa system:

- transformation of unit desas from BIMAS conduits to full-service rural banks
- internal treatment of unit desas as semiautonomous units of account rather than simply as postings in the BRI's overall accounts, that is, as discrete profit or loss centers instead of disaggregated items subsumed in the BRI cabang financial statements
- evaluation of unit desas based primarily on their profitability, rather than on hectares covered or money lent

The objective of these policy changes was to turn BRI unit desas from marginally useful, extremely costly entities that had outlived their initial reason for being into profitable rural banks that provided the rural populace with vital financial services.

*Becoming a full-service rural bank: Introduction of KUPEDES and SIMPEDES.* As noted above, Ministry of Finance analysis indicated that the BIMAS credit program had outlived its usefulness by 1982 and that its continuation could only be at a cost in excess of any possible benefits. However, discontinuation of the BIMAS program would leave the BRI with more than 3,600 unit desas staffed by nearly 14,000 employees, and at the same time remove the basis for the government's subsidy of unit desa administrative costs. Without a drastic change of direction, the BRI would be faced with a choice of abandoning the unit desa system, or absorbing a loss of Rp. 30 billion to Rp. 40 billion per year. Furthermore, as oil prices began to fall, it was clear that the national government would not be able to subsidize the BRI on this scale.

The Kredit Mini and Kredit Midi programs had shown that there was a large unmet demand for working capital and a smaller but constant demand for investment capital for a wide variety of village enterprises. Moreover, BRI unit desa staff had learned how to administer such credit successfully, for example, limiting the Kredit Mini long-term loss ratio (amount overdue to amount due) to slightly more than 2 percent.

Abandonment of this enormous investment in human resources would be extremely wasteful, and it would take many years to develop

a comparable rural banking network and cadre of trained rural banking staff. Moreover, closing down the BRI unit desas would destroy a considerable amount of goodwill among the unit desa clientele that developed as these customers grew accustomed to banking at relatively convenient locations.

The basic problem was that the 12 percent interest rates that had been set for Kredit Mini and Kredit Midi, and 15 percent rate for TABANAS, created a negative interest spread between savings and lending interest rates of the BRI unit desas. With no prospect for the continuation of large operating subsidies or large amounts of grant funds for on-lending, the interest rate on loans would have to provide a sufficient positive spread over savings rates to cover unit desa operating costs.

In June 1983 the government introduced measures that significantly deregulated Indonesia's banking sector: in a notable departure from its previous monetary policies, the government freed banks from quantitative controls on general, nondirected lending (known as non-program lending) and allowed banks to set their own interest rates on commercial loans and on savings (except TABANAS).

The BRI, with encouragement from the Ministry of Finance and technical assistance from the ministry's Center for Policy and Implementation Studies (CPIS), responded to these measures by initiating a new credit program, KUPEDES (Kredit Umum Pedesaan, or General Rural Credit), as the principal credit program of the BRI unit desas. The primary objective of KUPEDES was to allow unit desas to meet a wide range of rural credit requirements in a flexible and financially viable manner, rather than to continue channeling specialized credits to limited clientele of the government technical departments at a loss.

At the end of 1983, all outstanding BIMAS credit, now mainly arrears, was transferred to the books of the BRI cabangs, although the unit desas continued to act as agents of the cabangs in BIMAS collections. New BIMAS lending, whether directly by the BRI or through cooperatives, ceased altogether in mid-1984. Lending under Kredit Mini and Kredit Midi was discontinued at the end of 1983, and the first KUPEDES loans were made in mid-February 1984.

The most important difference between the BRI-sponsored KUPEDES and the preceding credit programs sponsored by the government and Bank Indonesia (the central bank) was the approach to setting interest rates. Of necessity, the BRI had to concentrate first on the financial viability of the unit desa system. Only a healthy financial institution could provide the continuous, stable, convenient access to

savings and credit services needed by Indonesia's rural populace. In short, access to credit was given priority over cheapness of credit.

Because more people in the rural areas tend to be savers than borrowers at any one time, providing better savings services was seen as more effective in achieving an equitable distribution of banking services than providing cheap credit. The BRI therefore concentrated first on the interest rate to be paid on savings. Since the savings instrument provided by unit desas was TABANAS, the BRI used the TABANAS interest rate of 15 percent per year as the unit desa cost of funds.

The nominal interest rate to borrowers was then set high enough to provide a spread sufficient to cover operating costs plus risk of the intermediary, the unit desa. To make this calculation, BRI planners assumed that:

- operating costs of the unit desas would consist primarily of the unit desa payroll, and that they would rise by approximately 15 percent per year, using the end of 1983 as a base

- Rp. 200 billion in total loans outstanding was a reasonable target for KUPEDES to attain within three years of its creation

- the rapid expansion from Rp. 100 billion of Kredit Mini/Kredit Midi loans outstanding to Rp. 200 billion of KUPEDES loans outstanding would push up loan losses to 4.5 percent, approximately twice the level of losses in the Kredit Mini program

Based on these three assumptions, the KUPEDES nominal interest rate for working capital was set at 1.5 percent per month on the borrower's original balance. The interest rate on investment credit was set at 1 percent per month on the borrower's original balance, because of Bank Indonesia's insistence on providing 3 percent liquidity credits in support of the investment credit portfolio.

Both KUPEDES working capital and investment capital loans are paid in equal installments, each installment divided in the same proportion between principal and interest. Thus, the 1.5 percent flat interest rate for a KUPEDES working capital loan and the 1 percent flat interest rate for a KUPEDES investment capital loan work out to effective interest rates of 2.6 percent and 1.7 percent per month respectively for twelve-month loans, if all installments are paid on time.

**BRI Unit Desa Snapshot: Bp. Bahar and Ibu Satria**

Bp. Bahar and Ibu Satria received a loan for Rp. 1.2 million in January 1988 from Unit Desa Tawaeli, Palu, Central Sulawesi. This was their third and largest KUPEDES loan, and was to be repaid in eighteen monthly installments. As with the first two loans, this was recorded by the unit desa as a trading sector loan, for one of the family's many economic activities was trading.

However, in addition to mixed petty trading, Bp. Bahar and Ibu Satria were engaged in a number of other small businesses: they ran a service to grind coffee, mill rice and corn, and process coconut and sugar; they roasted, ground, and marketed coffee they bought themselves; and they produced metal rat traps. The family's first KUPEDES loan was used to buy a small milling/grinding machine; the second KUPEDES loan was used to buy raw coffee; and their third KUPEDES loan was for the purchase of a large milling/grinding machine.

Before receiving their first KUPEDES loan in 1985, the only business of Bp. Bahar and Ibu Satria was mixed petty trading, with no workers outside the immediate family; in 1988 they had three formal full-time employees.

Despite the rapid growth of their businesses, Bp. Bahar and Ibu Satria believe there is still considerable scope for expansion. They plan to process a greater variety of agricultural commodities, as well as to increase the volume of their current activities.

These effective interest rates are conditional on timely loan repayment, because KUPEDES borrowers of working capital and investment capital are actually charged a 2 percent and a 1.5 percent flat interest rate respectively to incorporate a 0.5 percent per month penalty for failure to pay on time. This amount is refunded to those who pay all installments on time, through the IPTW (Insentif Pembayaran Tepat Waktu, Incentive to Pay on Time) system. Both the KUPEDES interest rates and the 0.5 percent penalty for failure to pay on time were specified by the Ministry of Finance.

The KUPEDES interest rate is not strictly a market interest rate, but rather a rate that would allow the BRI unit desas to break even at a

certain volume of credit if the system had the capacity to lend this amount without adding staff and if loan losses remained within the projected range of risk. The market rate for credit in the villages would be considerably higher than the KUPEDES rate.

Other features of KUPEDES are as follows:

- The minimum loan is Rp. 25,000; the maximum loan was Rp. 1 million and has gradually been raised to a ceiling of Rp. 3 million.

- There are relatively few restrictions for eligible KUPEDES enterprises; borrowing may be for any productive purpose. Borrowing for consumption is permitted, but not encouraged, when the borrower's salary can be pledged as collateral, and the BRI has pledged that not more than 5 percent of total KUPEDES lending will be for consumption.

- Repayment schedules for working capital loans range from three to twenty-four months without a grace period or from three to nine months with a grace period. Single payment schedules for working capital loans range from three to twelve months.

- Repayment schedules for investment capital loans are for a similar range of time and grace period up to thirty-six months.

- The KUPEDES borrower must provide collateral sufficient to cover the value of the loan. The requirement is usually met by land, although occasionally it is met by the pledging of buildings, motorcycles, or other property.

- A borrower classification system based on a client's loan repayment record is used to set a borrower's personal loan limit.

By the end of 1985, the results from the first two years of KUPEDES operation had established that the BRI unit desa system could be financially viable. The BRI therefore turned toward the development of other elements of a sound, comprehensive rural banking system, especially more rapid mobilization of savings and provision of facilities for transfer of funds.

TABANAS was the only savings instrument available at the BRI unit desas through the end of 1983. Although the creation of a positive spread between lending and savings rates had led to a rapid increase in TABANAS accounts, a CPIS survey indicated that people in rural areas could be motivated to save more at unit desas if the terms and conditions of savings instruments were designed to meet their needs more closely. The result was the introduction of *simpanan pedesaan* (village savings, or SIMPEDES), *deposito berjangkas* (time deposits), and *giros* (demand deposits) to complement TABANAS.

As mentioned earlier, TABANAS is a national savings program sponsored by Bank Indonesia and available to depositors in all banks in Indonesia, including state, local government, and private banks. In addition to the general TABANAS program, there are special TABANAS programs for school children, boy scouts, and government employees. The terms and conditions are the same on all these types of TABANAS, namely a 1.25 percent uncompounded monthly interest rate computed on the lowest monthly balance and paid annually, and withdrawals restricted to twice a month. The difference is mainly promotional.

SIMPEDES, in contrast to TABANAS, was introduced to rural savers throughout Indonesia exclusively by the BRI and only through the unit desas in mid-1986. This nationwide exposure was preceded by two pilot projects, first in the unit desas in one cabang, followed by the unit desas in twelve additional cabangs. The SIMPEDES instrument as replicated throughout Indonesia was the product of significant modifications resulting from the pilot project findings.

The terms and conditions of SIMPEDES are as follows:

- monthly compounded interest rates of 0 percent below Rp. 25,000, 0.75 percent from Rp. 25,000 to Rp. 200,000, and 1.125 percent (1 percent until mid-1987) above Rp. 200,000

- unlimited withdrawals

- provision of saver coupons for participation in a semiannual lottery

- BRI guarantee of the safety of deposits (this is automatic, as the unit desas are part of the BRI)

**BRI Unit Desa Snapshot: Bp. Salam and Ibu Alfiyah**

Bp. Salam and Ibu Alfiyah recently received a twelve-month KUPEDES loan for Rp. 500,000 at Unit Desa Mojoagung, Jombang, East Java. It was their second and largest KUPEDES loan. Although both loans were recorded by the unit desa as trading sector loans, the goods traded were in fact the product of the family's primary economic activity, furniture making, and the KUPEDES loans were used to buy teak wood for this purpose.

Bp. Salam and Ibu Alfiyah had been in business three years, during which time their full-time staff had grown from fourteen to twenty employees. However, they were still trying to keep their product simple and their market well defined: they made seats and beds for six shops scattered throughout East Java. Bp. Salam, a technical high school graduate, plans to add both staff and local retail outlets in the near future.

Although SIMPEDES interest rates are in fact lower than those of TABANAS, total SIMPEDES savings have grown rapidly since its nationwide introduction in mid-1986 primarily because of the unlimited access provision and the SIMPEDES lottery. Although very few TABANAS savers actually withdraw funds twice a month, this limitation is an important psychological barrier to the people in rural areas, who seem to fear that they will not have access to their TABANAS savings when they need them. Moreover, the lottery generates considerable excitement among SIMPEDES savers.

BRI unit desas are allowed to accept time deposits of one, three, and six months, with interest rates rising and falling according to market conditions, the same as the rest of the BRI.

Giro accounts are available at the BRI unit desas for individuals, companies, and organizations. Since SIMPEDES pays 1.125 percent per month on accounts over Rp. 200,000 while giro accounts pay 0.25 percent per month, the use of giro facilities by individuals is not likely to expand rapidly. At present, giro accounts therefore are used mainly for the transfer of Village Presidential Instructions (Instruksi Presiden Desa, or INPRES Desa) funds, a central government subsidy for

development projects designed and implemented by village governments, from Jakarta to the approximately 60,000 villages throughout Indonesia.

*Instilling accountability: Financial realignment.* A corollary of the decision to turn BRI unit desas into full-service rural banks was the decision to make each unit desa a separate accounting unit whose financial condition could be analyzed and acted upon in a manner that would ensure staff accountability for unit desa results, and thus tie incentives to performance.

This required the separation of the BRI unit desas and BRI cabangs into discrete accounting units, so one could determine whether each unit desa was making a profit or a loss. Such a change entailed four major accounting modifications: reconstruction of each unit desa's balance sheet, supply of additional liquidity from the cabang as a loan on which the unit desa would pay interest, deposit of excess unit desa funds in an interest-bearing account at the cabang, and payment of the cabang's unit desa supervision costs by the unit desa.

At the end of 1983, each unit desa's balance sheet was reconstructed to:

- transfer all BIMAS assets and liabilities to the cabang, and at least in theory if not yet in practice, place all unit desa BIMAS collections on a fee basis, paid by the cabang

- maintain Kredit Mini and Kredit Midi assets and liabilities with the unit desas, and distribute the Rp. 66.7 billion government Kredit Mini grant as Rp. 19 million in "equity" for each unit desa

- redesignate that portion of a unit desa's total outstanding Kredit Mini and Kredit Midi greater than Rp. 19 million in equity and savings as liquidity credit from the cabang, and that portion less than Rp. 19 million as a positive balance in a unit desa account at the cabang

- constitute a reserve for bad debts at each unit desa equal to the sum of all loan payments more than three months overdue from the final payment date, later changed to a percentage of loans outstanding (currently 6 percent)

Any additional liquidity required by the BRI unit desas beyond the Rp. 19 million in equity noted above and savings raised from the public can be borrowed from the cabangs. The interest rate for such liquidity credit was initially set at 15 percent if the funds were to be used for KUPEDES working capital loans and 3 percent to support KUPEDES investment loans. This was the same rate at which the BRI received liquidity credit from Bank Indonesia for the KUPEDES program.

In March 1986 the rates for liquidity credit from BRI cabangs to unit desas were changed to 17 percent for working capital loans and 5 percent for investment capital loans, to encourage the unit desas to mobilize savings by making it a cheaper option than borrowing from the cabang. The extra 2 percent is placed in a Unit Desa Development Fund, from which the cabang and BRI head office will pay for advertising, training, and other items that are more efficiently funded centrally.

Moreover, if a unit desa mobilizes more savings than required for its lending operations, these funds may now be deposited at the cabang. The cabangs were initially instructed to pay 15 percent to the unit desas on these funds, but the rate was later changed to 17 percent, with the extra 2 percent coming from the Unit Desa Development Fund. This gives the unit desas an added incentive to raise savings, while avoiding a negative incentive to the cabangs, for whom the unit desa funds deposited with them might otherwise be an expensive source of funds.

The cabang's costs of supervising unit desas are charged to the unit desas. During 1984 and 1985, these costs included the salaries of the personnel in the unit desa section of the cabang, but not the salaries of the unit desa officer and other "organic" cabang staff. In 1986 the system was altered so that all cabang costs of supervising unit desas are charged to the unit desa.

*Promoting profitability: Physical reallocation.* The pattern of a standard four-person BRI unit desa located according to the availability of rice-growing land to be converted to high-yielding rice varieties does not always fit the needs of a rural banking system lending for all types of rural enterprise. After the unit desas initiated the KUPEDES program in early 1984, it quickly became apparent that the demand for credit for other types of rural enterprise greatly exceeded that for agricultural production credit. Thus, in late 1984, the BRI began to relocate unit desas and reallocate unit desa staff to meet the demand for KUPEDES credit.

**BRI Unit Desa Snapshot: Bp. Mustakin and Ibu Sulastri**

Bp. Mustakin and Ibu Sulastri received a KUPEDES loan for Rp. 3 million in June 1988 from Unit Desa Kodya, Blitar, East Java. It was their first unit desa loan and was to be repaid in thirty-six monthly installments. The purpose of the loan was to buy a steam furnace for a *tahu* (beancurd) processing factory.

Five years ago, Ibu Sulastri began making tahu in an area at the back of her house. One year ago, shortly before applying for a KUPEDES loan, she moved the operations to an area devoted exclusively to tahu processing, in a simple factory next to her house.

The factory is a bumping, grinding, clanking, steaming, bandaged beast, lumbering along with the maximum output for the minimum investment: pipes are not repaired, but wrapped in cloth to stop leaks; small tools and utensils are used until they decompose; the earth is just fine for the factory floor.

It feels as if one has walked into a cross between an interpretative dance and a local bazaar: local peddlers and full-time factory staff are in perpetual motion, incessantly lifting, hauling, sifting, stirring, straining, pressing, and cutting, while carrying on animated repartee. What one has really stumbled upon though is a well-orchestrated but somewhat free-style human assembly line. Production is continuous, and timing meticulous. However, there are some concessions to automation: a water pump, a soybean masher, and the KUPEDES-financed steam furnace have been installed.

The tahu factory is well integrated into the local economy. In addition to employing eight full-time neighborhood youths, thirty tahu street peddlers come to the factory every day both to supply locally purchased soybeans for tahu processing and to collect the tahu itself for distribution throughout the city of Blitar. The factory's steam furnace is heated by firewood delivered by local wood traders on a regular basis. Tahu discard is sold for cattle and pig feed.

Each BRI cabang in the more densely populated areas of Indonesia, such as Java, Bali, North and South Sulawesi, and North and West Sumatra, prepared a plan that divided existing unit desas into two groups: those that appeared to have the potential to develop sufficient loan activity to cover the cost of a four-person staff, and those that did not appear to have this potential. After these plans were vetted by the *kantor wilayah* (regional office), each low-potential unit desa was combined with the nearest unit desa that was thought to have more potential.

However, a low-potential former unit desa was not closed. Instead, it was designated a *pos pelayanan desa* (village service post, or PPD) and kept open for one to six days a week for all types of cash transactions and for receiving loan applications. It was manned by a *team pelayanan desa* (village service team, or TPD) from the high-potential unit desa, now designated a *unit desa induk* (main unit desa). The excess staff from the low-potential unit desa was made available for work at the unit desa induk or for manning additional TPD and opening new PPD.

The first phase of BRI unit desa reallocation reduced the number of unit desas from 3,626 to 2,469 and created 1,135 PPDs. The total staff employed by the unit desa system dropped from 14,334 in 1983 to 12,954 by the end of 1986. This drop was the result of a combination of natural attrition and the firing of some staff for misappropriation of funds. The reallocation itself did not reduce staff—it only shifted them according to the anticipated demand for their services.

## Current Performance

**National overview.** As of December 1989, BRI unit desa operations had grown dramatically (see Table 16 and Figure 5):

- Unit desas had made more than 6.4 million loans under KUPEDES, totaling almost Rp. 3.4 trillion.

- Total KUPEDES outstanding stood at 1.6 million borrowers for a total of Rp. 846 billion.

- KUPEDES monthly circulation averaged 120,000 borrowers and Rp. 98 billion.

TABLE 16 Growth of BRI Unit Desa Operations, 1984–1989

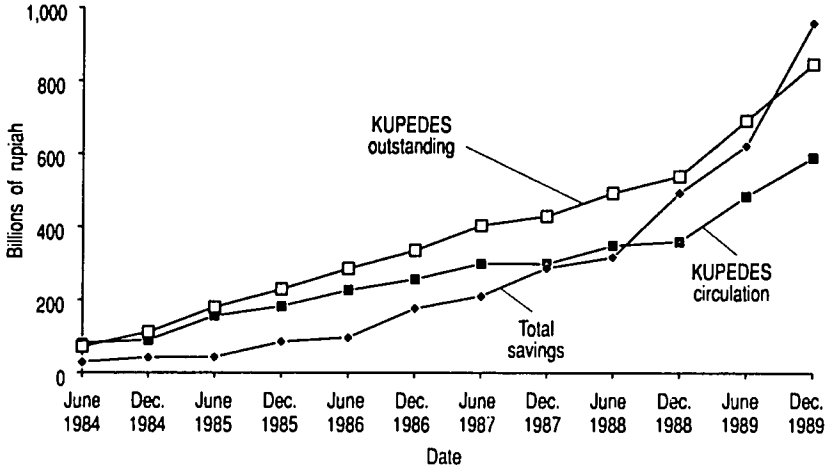
| Date | Total KUPEDES lending during semester | | Total KUPEDES outstanding at end of semester | | Cumulative KUPEDES lending | | Total savings at end of semester (billions of Rp.) | | | | | | Ratio of total savings to KUPEDES loans outstanding (%) |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | | | | | | | Total | | |
| | Billions of Rp. | Thousands of loans | Billions of Rp. | Thousands of loans | Billions of Rp. | Thousands of loans | TABANAS | SIMPEDES | Giro | Deposito berjangka | Billions of Rp. | Thousands of savers | |
| June 1984 | 81.1 | 302 | 71.6 | 360 | 81.1 | 302 | 26.9 | 0.0 | 2.6 | 0.0 | 29.5 | n.a. | 41.2 |
| Dec. 1984 | 90.2 | 337 | 111.1 | 641 | 171.3 | 639 | 39.1 | 0.3 | 2.0 | 0.8 | 42.2 | n.a. | 38.0 |
| June 1985 | 156.1 | 474 | 180.1 | 854 | 327.4 | 1,114 | 39.5 | 0.5 | 1.9 | 1.1 | 43.0 | n.a. | 23.9 |
| Dec. 1985 | 182.7 | 518 | 229.0 | 1,035 | 510.1 | 1,631 | 63.8 | 5.1 | 13.8 | 2.2 | 84.9 | n.a. | 37.1 |
| June 1986 | 225.7 | 572 | 284.9 | 1,164 | 735.8 | 2,203 | 66.5 | 15.5 | 11.8 | 3.0 | [illegible] | n.a. | 34.0 |
| Dec. 1986 | 256.3 | 578 | 334.4 | 1,232 | 992.1 | 2,782 | 78.4 | 82.6 | 10.9 | 3.9 | 175.8 | 3,544 | 52.6 |
| June 1987 | 299.1 | 599 | 403.2 | 1,301 | 1,291.2 | 3,381 | 66.7 | 121.8 | 16.6 | 5.3 | 210.4 | 3,854 | 52.2 |
| Dec. 1987 | 298.7 | 538 | 429.2 | 1,315 | 1,589.9 | 3,918 | 79.5 | 182.6 | 12.5 | 12.7 | 287.3 | 4,184 | 66.9 |
| June 1988 | 348.1 | 568 | 492.6 | 1,379 | 1,938.0 | 4,486 | 70.3 | 214.7 | 9.8 | 21.8 | 316.6 | 4,251 | 64.3 |
| Dec. 1988 | 359.6 | 546 | 538.7 | 1,386 | 2,297.6 | 5,033 | 89.5 | 342.0 | 16.6 | 44.4 | 492.5 | 4,998 | 91.4 |
| June 1989 | 483.0 | 658 | 690.6 | 1,490 | 2,780.6 | 5,690 | 86.4 | 454.9 | 8.4 | 71.6 | 621.3 | 5,365 | 90.0 |
| Dec. 1989 | 589.7 | 722 | 845.6 | 1,644 | 3,370.3 | 6,412 | 113.6 | 699.8 | 26.3 | 117.3 | 957.0 | 6,262 | 113.2 |

n.a. = not available.

NOTE: Slight discrepancies between figures presented in Tables 16 and 17 are due to the difference in data sources (indicated at bottom of each table).

SOURCE: Bank Rakyat Indonesia Head Office ("Laporan Bulanan UDES").

FIGURE 5 BRI Unit Desa Growth, 1984–1989




NOTE: Loan circulation figures are cumulative for six-month reporting period.
SOURCE: Bank Rakyat Indonesia Head office.

- Unit desas had attracted nearly 6.3 million savers and accumulated Rp. 957 billion in client savings, or 113 percent of KUPEDES loans outstanding.

- SIMPEDES comprised 2.7 million savers and total savings of Rp. 700 billion, 83 percent of KUPEDES loans outstanding.

At the same time, the quality of the KUPEDES loan portfolio remained good, with the KUPEDES long-term loss ratio (cumulative arrears plus cumulative write-offs as a percentage of all loans that have fallen due) at 3.3 percent and portfolio status (arrears as a percentage of loans outstanding) at 5.4 percent (see Table 17).

The high volume of BRI unit desa operations after 1984, coupled with a healthy loan portfolio and expenses well within the projected range, helped the BRI achieve one of its primary objectives in reshaping the unit desa system: the transformation of an expensive drain on revenue to a net income generator.

In 1984 the unit desas lost more than Rp. 25.1 billion; in 1989 the unit desas made Rp. 36.9 billion (see Figure 6 and Table 18). Meanwhile,

TABLE 17 KUPEDES Loss Ratios, 1985–1989 (millions of rupiah)

| Regional office | Amount lent during month (1) | Cumulative amount lent (2) | Cumulative arrears (3) | Cumulative write-offs (4) | Cumulative arrears plus cumulative write-offs [3+4] (5) | Total loans outstanding (6) | Change in total loans outsanding (7) | Cumulative amount paid [2–(6+4)] (8) | Cumulative amount due [8+5] (9) | Long-term loss ratio (%) [5/9] (10) | Portfolio status (%) [3/6] (11) |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Java/Bali | | | | | | | | | | | |
| Bandung | | | | | | | | | | | |
| Dec. 1985 | 5,508 | 109,526 | 1,013 | 0 | 1,013 | 49,403 | 510 | 60,123 | 61,136 | 1.66 | 2.05 |
| Dec. 1987 | 9,443 | 325,348 | 5,137 | 2,410 | 7,547 | 81,482 | 303 | 241,456 | 249,003 | 3.03 | 6.30 |
| Dec. 1989 | 18,705 | 691,725 | 9,968 | 8,513 | 18,481 | 162,954 | 2,743 | 520,258 | 538,739 | 3.43 | 6.12 |
| Denpasar | | | | | | | | | | | |
| Dec. 1985 | 1,078 | 19,833 | 177 | 0 | 177 | 9,297 | 211 | 10,536 | 10,713 | 1.65 | 1.90 |
| Dec. 1987 | 1,616 | 62,566 | 732 | 90 | 822 | 19,544 | (151) | 42,932 | 43,754 | 1.88 | 3.75 |
| Dec. 1989 | 3,881 | 130,872 | 2,216 | 914 | 3,130 | 38,566 | 920 | 91,392 | 94,522 | 3.31 | 5.75 |
| Jakarta | | | | | | | | | | | |
| Dec. 1985 | 794 | 7,332 | 14 | 0 | 14 | 4,013 | 450 | 3,319 | 3,333 | 0.42 | 0.35 |
| Dec. 1987 | 1,368 | 39,133 | 821 | 16 | 837 | 11,876 | (15) | 27,241 | 28,078 | 2.98 | 6.91 |
| Dec. 1989 | 3,983 | 89,458 | 2,646 | 1,310 | 3,956 | 29,892 | 1,895 | 58,256 | 62,212 | 6.36 | 8.85 |
| Semarang | | | | | | | | | | | |
| Dec. 1985 | 6,141 | 88,686 | 214 | 0 | 214 | 38,578 | 2,010 | 50,108 | 50,322 | 0.43 | 0.55 |
| Dec. 1987 | 8,892 | 301,884 | 2,784 | 103 | 2,887 | 80,413 | 213 | 221,368 | 224,255 | 1.29 | 3.46 |
| Dec. 1989 | 14,166 | 571,703 | 5,638 | 5,417 | 11,055 | 124,772 | 3,081 | 441,514 | 452,569 | 2.44 | 4.52 |
| Surabaya | | | | | | | | | | | |
| Dec. 1985 | 7,457 | 109,449 | 1,077 | 0 | 1,077 | 46,975 | 2,183 | 62,474 | 63,551 | 1.69 | 2.29 |
| Dec. 1987 | 10,508 | 314,325 | 3,195 | 614 | 3,809 | 75,929 | 1,821 | 237,782 | 241,591 | 1.58 | 4.21 |
| Dec. 1989 | 23,778 | 703,479 | 4,943 | 3,209 | 8,152 | 177,395 | 7,786 | 522,875 | 531,027 | 1.54 | 2.79 |
| Yogyakarta | | | | | | | | | | | |
| Dec. 1985 | 5,390 | 74,051 | 696 | 0 | 696 | 31,222 | 1,324 | 42,829 | 43,525 | 1.60 | 2.23 |
| Dec. 1987 | 5,814 | 212,753 | 1,974 | 263 | 2,237 | 55,639 | 284 | 156,851 | 159,088 | 1.41 | 3.59 |
| Dec. 1989 | 10,119 | 404,306 | 4,469 | 1,537 | 6,006 | 90,830 | 1,765 | 311,939 | 317,945 | 1.89 | 4.92 |
| Subtotal | | | | | | | | | | | |
| Dec. 1985 | 26,368 | 408,877 | 3,191 | 0 | 3,191 | 179,488 | 6,688 | 229,389 | 232,580 | 1.37 | 1.78 |
| Dec. 1987 | 37,641 | 1,256,009 | 14,643 | 3,496 | 18,139 | 324,883 | 2,455 | 927,630 | 945,769 | 1.92 | 4.51 |
| Dec. 1989 | 74,632 | 2,591,543 | 29,880 | 20,900 | 50,780 | 624,409 | 18,190 | 1,946,234 | 1,997,014 | 2.54 | 4.79 |
| Outer Islands | | | | | | | | | | | |
| Banda Aceh | | | | | | | | | | | |
| Dec. 1985 | 430 | 4,780 | 113 | 0 | 113 | 3,171 | 234 | 1,609 | 1,722 | 6.56 | 3.56 |
| Dec. 1987 | 599 | 17,136 | 1,052 | 118 | 1,170 | 7,002 | 160 | 10,016 | 11,186 | 10.46 | 15.02 |
| Dec. 1989 | 1,435 | 44,998 | 1,394 | 1,837 | 3,231 | 15,352 | (47) | 27,809 | 31,040 | 10.41 | 9.08 |

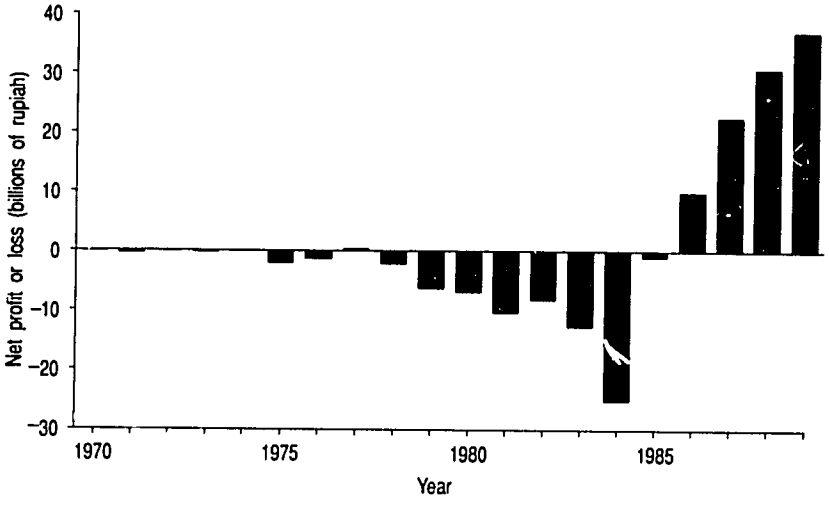
(continued on following page)

TABLE 17 (continued)

| Regional office | (1) | (2) | (3) | (4) | (5) | (6) | (7) | (8) | (9) | (10) | (11) |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Banjarmasin | | | | | | | | | | | |
| Dec. 1985 | 359 | 5,710 | 61 | 0 | 61 | 2,745 | 64 | 2,965 | 3,026 | 2.02 | 2.22 |
| Dec. 1987 | 895 | 20,397 | 296 | 223 | 519 | 6,305 | 123 | 13,869 | 14,388 | 3.61 | 4.69 |
| Dec. 1989 | 2,031 | 58,115 | 1,329 | 696 | 2,025 | 19,002 | 255 | 38,417 | 40,442 | 5.01 | 6.99 |
| Jayapura | | | | | | | | | | | |
| Dec. 1985 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0.0 | 0.0 |
| Dec. 1987 | 13 | 23 | 0 | 0 | 0 | 22 | 13 | 1 | 1 | 0.0 | 0.0 |
| Dec. 1989 | 274 | 3,393 | 28 | 17 | 45 | 2,158 | 115 | 1,218 | 1,263 | 3.56 | 1.30 |
| Kupang | | | | | | | | | | | |
| Dec. 1985 | 97 | 1,604 | 25 | 0 | 25 | 744 | 31 | 860 | 885 | 2.82 | 3.36 |
| Dec. 1987 | 273 | 6,022 | 85 | 18 | 103 | 2,213 | 40 | 3,791 | 3,894 | 2.65 | 3.84 |
| Dec. 1989 | 1,053 | 25,566 | 222 | 109 | 331 | 11,059 | 227 | 14,398 | 14,729 | 2.25 | 2.01 |
| Manado | | | | | | | | | | | |
| Dec. 1985 | 510 | 6,659 | 85 | 0 | 85 | 3,398 | 255 | 3,261 | 3,346 | 2.54 | 2.50 |
| Dec. 1987 | 1,415 | 24,793 | 410 | 25 | 435 | 9,324 | 672 | 15,444 | 15,879 | 2.74 | 4.40 |
| Dec. 1989 | 2,529 | 71,561 | 1,873 | 636 | 2,509 | 26,319 | 1,078 | 44,606 | 47,115 | 5.33 | 7.12 |
| Medan | | | | | | | | | | | |
| Dec. 1985 | 405 | 4,062 | 47 | 0 | 47 | 2,597 | 209 | 1,465 | 1,512 | 3.11 | 1.81 |
| Dec. 1987 | 1,412 | 27,326 | 431 | 25 | 456 | 11,649 | 437 | 15,652 | 16,108 | 2.83 | 3.70 |
| Dec. 1989 | 3,231 | 78,646 | 1,412 | 616 | 2,028 | 26,653 | 1,115 | 51,377 | 53,405 | 3.80 | 5.30 |
| Padang | | | | | | | | | | | |
| Dec. 1985 | 1,538 | 38,800 | 586 | 0 | 586 | 15,901 | (170) | 22,899 | 23,485 | 2.50 | 3.69 |
| Dec. 1987 | 1,947 | 85,238 | 3,700 | 1,108 | 4,808 | 20,600 | (364) | 63,530 | 68,338 | 7.04 | 17.96 |
| Dec. 1989 | 3,651 | 151,267 | 3,009 | 6,043 | 9,052 | 34,362 | 34 | 110,862 | 119,914 | 7.55 | 8.76 |
| Palembang | | | | | | | | | | | |
| Dec. 1985 | 1,546 | 17,067 | 449 | 0 | 449 | 8,786 | 583 | 8,281 | 8,730 | 5.14 | 5.11 |
| Dec. 1987 | 2,868 | 78,979 | 2,153 | 230 | 2,383 | 24,219 | 122 | 54,530 | 56,913 | 4.19 | 8.89 |
| Dec. 1989 | 5,823 | 188,919 | 3,279 | 5,073 | 8,352 | 45,550 | (1,172) | 138,296 | 146,648 | 5.70 | 7.20 |
| Ujung Pandang | | | | | | | | | | | |
| Dec. 1985 | 1,523 | 24,088 | 208 | 0 | 208 | 12,129 | 417 | 11,959 | 12,167 | 1.71 | 1.71 |
| Dec. 1987 | 1,873 | 76,987 | 2,183 | 174 | 2,357 | 23,136 | (303) | 53,677 | 56,034 | 4.21 | 9.44 |
| Dec. 1989 | 2,906 | 153,117 | 3,273 | 1,973 | 5,246 | 40,750 | (427) | 110,394 | 115,640 | 4.54 | 8.03 |
| Subtotal | | | | | | | | | | | |
| Dec. 1985 | 6,408 | 102,770 | 1,574 | 0 | 1,574 | 49,471 | 1,623 | 53,299 | 54,873 | 2.87 | 3.18 |
| Dec. 1987 | 11,295 | 336,901 | 10,310 | 1,921 | 12,231 | 104,470 | 900 | 230,510 | 242,741 | 5.04 | 9.87 |
| Dec. 1989 | 22,933 | 775,582 | 15,819 | 17,000 | 32,819 | 221,205 | 1,178 | 537,377 | 570,196 | 5.76 | 7.15 |
| Total | | | | | | | | | | | |
| Dec. 1985 | 32,776 | 511,647 | 4,765 | 0 | 4,765 | 228,959 | 8,311 | 282,688 | 287,453 | 1.66 | 2.08 |
| Dec. 1987 | 48,936 | 1,592,910 | 24,953 | 5,417 | 30,370 | 429,353 | 3,355 | 1,158,140 | 1,188,510 | 2.56 | 5.81 |
| Dec. 1989 | 97,565 | 3,367,125 | 45,699 | 37,900 | 83,599 | 845,614 | 19,368 | 2,483,611 | 2,567,210 | 3.26 | 5.40 |

SOURCE: Bank Rakyat Indonesia Head Office ("Laporan STP").

FIGURE 6 BRI Unit Desa Profitability, 1970–1989




SOURCE: Prepared by authors.

TABLE 18 BRI Unit Desa Comparative Profit and Loss Statements, 1985–1989 (millions of rupiah)

| Income and expenses | December 1985 | December 1987 | December 1989 |
|---|---|---|---|
| Income | | | |
| Loan interest | 63,627 | 154,640 | 262,992 |
| Bank interest | 7,639 | 12,675 | 41,445 |
| Fees/commissions | 91 | 67 | 61 |
| Other operating income | 801 | 10,392 | 25,912 |
| Nonoperating income | 407 | 99 | 219 |
| Total income | 72,565 | 177,873 | 330,629 |
| Expenses | | | |
| Interest paid on liquidity credits | 13,761 | 25,970 | 23,184 |
| Savings interest | 5,942 | 22,024 | 73,085 |
| Personnel | 33,120 | 39,529 | 68,048 |
| Supervision | 50 | 5,720 | 11,565 |
| Depreciation | 525 | 881 | 3,557 |
| Other | 3,764 | 5,690 | 23,327 |
| Transfer to IPTW reserve | 13,971 | 38,865 | 66,484 |
| Transfer to bad debt reserve | 2,368 | 16,715 | 24,465 |
| Total expenses | 73,501 | 155,394 | 293,715 |
| Profit (loss) | (936) | 22,479 | 36,914 |

SOURCE: Bank Rakyat Indonesia Head Office.

total unit desa assets grew from Rp. 300 billion in 1985 to Rp. 1.3 trillion in December 1989 (see Table 19).

**Regional disaggregation.** As of December 1989, three-fourths of total KUPEDES loans outstanding and two-thirds of total BRI unit desa savings were on the islands of Java and Bali. These figures parallel Indonesian demographics; approximately two-thirds of Indonesia's population lives on Java and Bali. Indonesia's most sophisticated trading networks are also found on Java and Bali.

When BRI regional offices are ranked according to KUPEDES loans outstanding per BRI unit desa rather than by total volume of lending operations per region, also as of December 1989, the results are similar: five of the six top regional offices are on Java or Bali. However, when the same type of ranking is done for total savings per BRI unit desa, five of the six top regional offices are off Java and Bali: Kupang, Jayapura, Banjarmasin, Manado, and Ujung Pandang (see Table 20).

TABLE 19 BRI Unit Desa Comparative Balance Sheets, 1985–1989 (millions of rupiah)

| Assets and liabilities | December 1985 | December 1987 | December 1989 |
|---|---|---|---|
| Assets | | | |
| Cash | 62,807 | 97,214 | 452,559 |
| Loans outstanding | 245,827 | 431,268 | 846,794 |
| (less reserve for bad debts) | (10,524) | (21,301) | (39,663) |
| Net loans outstanding | 235,303 | 409,967 | 807,131 |
| Other receivables | 928 | 1,526 | 2,275 |
| Fixed assets and inventory (depreciated) | 1,139 | 2,293 | 23,190 |
| Other assets | 294 | 952 | 6,010 |
| Total assets | 300,471 | 511,952 | 1,291,165 |
| Liabilities | | | |
| Current accounts | 13,830 | 12,458 | 26,831 |
| Savings | 71,043 | 275,073 | 926,606 |
| Funds held for customers | 8,567 | 19,304 | 34,462 |
| Loans from BRI cabangs | 142,454 | 125,019 | 198,459 |
| Capital | 65,244 | 57,541 | 65,732 |
| Other liabilities | 269 | 78 | 2,162 |
| Undivided profit | (936) | 22,479 | 36,913 |
| Total liabilities | 300,471 | 511,952 | 1,291,165 |

SOURCE: Bank Rakyat Indonesia Head Office.

TABLE 20 BRI Unit Desa Lending and Savings per BRI Regional Office, 1985–1989 (millions of rupiah)

| Rank in 1989 | BRI regional office | KUPEDES loans outstanding per unit desa | | |
|---|---|---|---|---|
| | | December 1985 | December 1987 | December 1989 |
| 1 | **Denpasar** | 95.8 | 214.8 | 393.5 |
| 2 | **Surabaya** | 104.9 | 172.2 | 342.5 |
| 3 | **Bandung**[a] | 148.6 | 216.3 | 338.8 |
| 4 | Manado | 44.7 | 127.5 | 329.0 |
| 5 | **Yogyakarta**[a] | 473.1 | 237.8 | 299.8 |
| | ALL OF INDONESIA[b] | 94.0 | 183.3 | 297.4 |
| 6 | **Semarang**[a] | 81.2 | 244.4 | 292.2 |
| 7 | Ujung Pandang | 87.3 | 168.9 | 277.2 |
| 8 | Palembang | 35.6 | 142.8 | 272.8 |
| 9 | Jayapura | 0.0 | 7.3 | 269.8 |
| 10 | Padang | 118.7 | 159.5 | 250.8 |
| 11 | Kupang | 9.9 | 56.7 | 245.8 |
| 12 | Banda Aceh | 43.4 | 132.2 | 239.9 |
| 13 | Medan | 14.2 | 101.3 | 235.9 |
| 14 | Banjarmasin | 39.2 | 90.2 | 215.9 |
| 15 | **Jakarta**[a] | 121.6 | 143.9 | 177.9 |

| | | Total savings per unit desa | | |
|---|---|---|---|---|
| | | December 1985 | December 1987 | December 1989 |
| 1 | Kupang | 26.6 | 194.3 | 626.0 |
| 2 | Jayapura | 0.0 | 87.0 | 551.6 |
| 3 | Banjarmasin | 38.7 | 158.6 | 548.6 |
| 4 | Manado | 34.7 | 183.5 | 471.7 |
| 5 | **Surabaya** | 40.8 | 130.0 | 412.3 |
| 6 | Ujung Pandang | 40.0 | 145.1 | 387.2 |
| 7 | **Denpasar** | 36.4 | 109.2 | 358.4 |
| 8 | Banda Aceh | 22.4 | 150.4 | 342.3 |
| | ALL OF INDONESIA[b] | 34.3 | 122.8 | 337.3 |
| 9 | **Jakarta**[a] | 21.2 | 127.4 | 324.5 |
| 10 | **Semarang**[a] | 46.4 | 152.9 | 323.8 |
| 11 | **Yogyakarta**[a] | 84.4 | 142.8 | 307.0 |
| 12 | Medan | 11.2 | 77.2 | 297.2 |
| 13 | Padang | 28.3 | 85.4 | 286.3 |
| 14 | Palembang | 13.2 | 73.8 | 267.7 |
| 15 | **Bandung**[a] | 31.0 | 89.1 | 228.1 |

NOTE: Regional offices in bold are on Java or Bali.

a. Comparisons between 1985 and later years are not possible because of revision of office boundaries.

b. Per unit desa average for the entire country.

SOURCE: Bank Rakyat Indonesia Head Office.

The quality of BRI unit desa operations also differs by region. Although the outer islands hold only 26 percent of total KUPEDES loans outstanding, they have 39 percent of all KUPEDES cumulative arrears and write-offs. Outer island KUPEDES loss ratios are also considerably higher than the Java/Bali levels: 5.8 percent compared with 2.5 percent for the long-term loss ratio, and 7.2 percent compared with 4.8 percent for overall portfolio status (see Table 17).

Finally, as of June 1988, 85 percent of all BRI unit desa profits were being generated on Java and Bali. Moreover, the five most profitable unit desa regions were all on Java/Bali, and four of the top six BRI regions in terms of average profits generated per unit desa were on the islands of Java and Bali (see Table 21 and Figures 7 and 8).

## Future Issues and Priorities

The BRI's agenda of major priorities for the next few years comprise the items noted below.

**Growth of operations and expansion of services.** The importance of the revitalized unit desa system to the BRI's overall health is clear: at the end of 1987, more than half of all BRI loan and savings accounts were at the unit desas, and in 1987 the unit desas earned almost one-third of the total profits of the BRI. Furthermore, approximately half of all BRI employees worked at unit desas during this period.

Thus, although the development of the BRI unit desa system has been quite dramatic to date, the BRI believes it must continue to promote growth of current operations aggressively and to pursue the expansion of existing services persistently in order both to maintain the BRI's overall health and to fulfill the BRI's ultimate objective of creating a full-service rural banking network in Indonesia.

In addition to fine tuning and occasionally updating KUPEDES lending terms and conditions, and refining the SIMPEDES savings program, the BRI will emphasize the establishment of more TPDs to expand unit desa coverage, and the improvement of facilities for funds transfers to further integrate the unit desa system (unit desa automation is discussed further below).

The reorganization and reallocation of BRI unit desa resources, especially personnel, are not tasks that can be completed once and for

TABLE 21 BRI Unit Desa Profitability per BRI Regional Office, 1985–1988 (millions of rupiah)

| Rank in 1988 | BRI regional office | Unit desa profitability per regional office: December 1985 | December 1987 | June 1988 |
|---|---|---|---|---|
| 1 | **Semarang**[a] | 407 | 6,614 | 4,272 |
| 2 | **Surabaya** | 252 | 4,356 | 2,356 |
| 3 | **Yogyakarta**[a] | 1,083 | 5,457 | 2,349 |
| 4 | **Bandung**[a] | 615 | 2,775 | 2,174 |
| 5 | **Denpasar** | (131) | 1,395 | 922 |
| 6 | Ujung Pandang | (499) | 990 | 768 |
| 7 | Palembang | (1,112) | 457 | 511 |
| 8 | Manado | (308) | 423 | 289 |
| 9 | Banjarmasin | (93) | 306 | 266 |
| 10 | **Jakarta**[a] | (121) | 352 | 168 |
| 11 | Medan | (1,191) | (137) | 156 |
| 12 | Banda Aceh | (685) | 176 | 167 |
| 13 | Kupang | (213) | (3) | 117 |
| 14 | Jayapura | 0 | (1) | (11) |
| 15 | Padang | 1,060 | (679) | (52) |
| | ALL OF INDONESIA[b] | (936) | 22,479 | 14,452 |

| | | Average profits per unit desa: December 1985 | December 1987 | June 1988 |
|---|---|---|---|---|
| 1 | **Semarang**[a] | 0.9 | 20.1 | 11.4 |
| 2 | **Denpasar** | (1.4) | 15.3 | 9.7 |
| 3 | **Yogyakarta**[c] | 16.4 | 23.3 | 8.8 |
| | ALL OF INDONESIA[c] | (0.4) | 9.6 | 5.8 |
| 4 | Ujung Pandang | (3.6) | 7.2 | 5.5 |
| 5 | **Surabaya** | 0.6 | 9.9 | 5.2 |
| 6 | **Bandung**[a] | 1.7 | 7.4 | 4.9 |
| 7 | Manado | (4.1) | 5.8 | 3.9 |
| 8 | Banjarmasin | (1.3) | 4.4 | 3.4 |
| 9 | Palembang | (4.5) | 2.7 | 3.2 |
| 10 | Kupang | (2.8) | (0.1) | 3.0 |
| 11 | Banda Aceh | (9.4) | 3.3 | 3.0 |
| 12 | **Jakarta**[a] | (3.7) | 4.3 | 2.0 |
| 13 | Medan | (6.5) | (1.2) | 1.4 |
| 14 | Padang | 7.9 | (5.2) | (0.4) |
| 15 | Jayapura | 0.0 | (0.3) | (3.5) |

NOTE: Regional offices in bold are on Java or Bali.

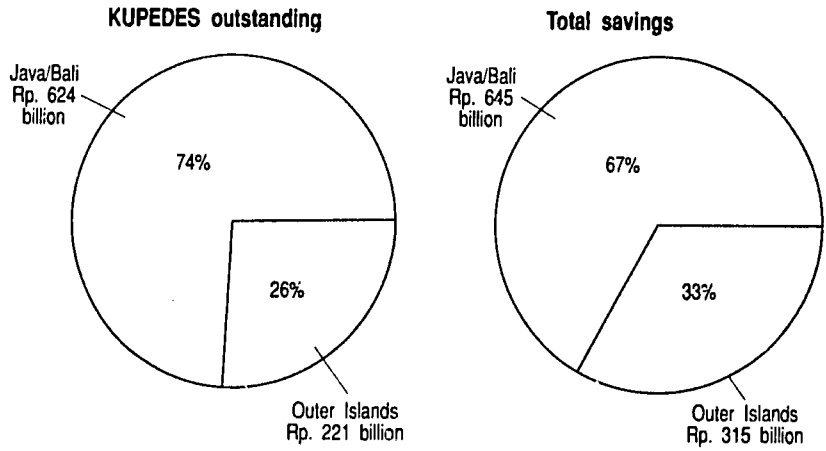
a. Comparisons between 1985 and later years are not possible because of a revision of office boundaries.

b. Total for entire country.

c. Per unit desa average for the entire country.

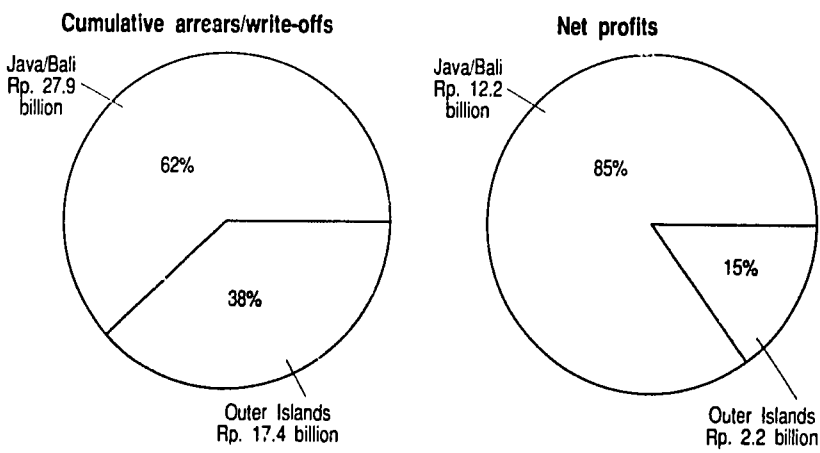
SOURCE: Bank Rakyat Indonesia Head Office.

FIGURE 7 Unit Desa Operations by Region, December 1989




SOURCE: Prepared by authors.

FIGURE 8 Unit Desa Profitability by Region, June 1988




SOURCE: Prepared by authors.

all. It is imperative to continue this adjustment as the demand for banking services expands and the nature of this demand changes.

For example, some unit desas that were thought to have little potential for future growth were reduced to PPDs but have since developed sufficient business under KUPEDES to justify upgrading them to full

unit desas again. Moreover, unit desas have hardly begun to open new PPDs in locations where there was not a unit desa previously.

The expansion into previously unserviced non-rice-growing subdistricts has been retarded by a severe staff shortage due to the rapid expansion of activity at existing unit desas. Although instructions setting forth the basic principles of the next stages in reallocation, staff recruitment, and further delegation of authority to kantor wilayah and cabang office managers were sent out by the BRI head office in May 1986, BRI staff have not yet acknowledged uniformly that unit desas have moved from a stage of consolidation to one of expansion. This means that, at present, some unit desas are presently understaffed; some PPDs with well more than Rp. 100 million of KUPEDES outstanding have not yet been upgraded to full unit desas; and the opening of new PPDs has been undertaken in an organized fashion only in Bali. Thus, the BRI is now planning to undertake a vigorous unit desa staff recruitment and training program, upon which future growth will depend.

In short, the BRI will try to continue exploiting the market niche unit desas have established for themselves and build on the comparative strength unit desas possess over their competitors: a nationwide system comprising thousands of units at the subdistrict level or lower staffed by professional bank personnel and offering programs perceived by unit desa clients as competitive and secure.

The BRI is convinced that there is ample unmet demand for rural banking services to support the development of several existing rural credit and savings programs and institutions that primarily complement one another, although competition at the margins will of course encourage increased efficiency and effectiveness for all parties concerned.

**Increased efficiency and cost effectiveness.** The rapid growth in credit and savings transactions has severely strained the capacity of present BRI unit desa staff and operating systems. The BRI is therefore considering several options to improve current unit desa efficiency and effectiveness, as well as to allow the unit desas to develop into a nationwide system for funds transfers in the future. In pursuit of these objectives, the BRI has given high priority to the testing of electronic verification and posting machines, as well as microcomputers, on a pilot basis.

Some at the BRI believe that unit desa automation will be economic only if there is a shift to a teller system in place of the present division of responsibilities between bookkeeper and cashier in the handling of cash transactions; to be cost-effective, such automation

might also necessitate the abandonment of ledger cards, a move regarded with great caution by BRI staff.

There are also some at the BRI who believe that the unit desa bookkeeping and reporting systems can be greatly streamlined and sharpened, and that these systems should be upgraded before any attempt is made to automate them. This group also believes not only that the above-noted equipment is probably unnecessary, but that it could also be counterproductive, being both impossible to ignore and impossible to maintain.

**Improved supervision and audit.** In addition to the attempt by several individual BRI cabangs to improve unit desa supervision and audit techniques, several steps have been taken programwide by the BRI Head Office to achieve the same objectives, including:

- revision of staffing patterns and work methods for branch-level supervisory sections
- increase in the number of *peniliks*, the BRI branch officers who perform field supervision and audit of the unit desas, from one per six unit desas to one per four unit desas
- issuance and ongoing revision of an audit manual for the peniliks
- preparation of training materials and ongoing implementation of a three-year training program for all peniliks and unit desa managers and staff

The BRI hopes that these activities, if carried out rigorously and updated continuously, will both improve and standardize unit desa operations across the country, as well as enhance BRI efforts to supervise and audit these operations.

**Improved management information system.** The current BRI unit desa management information system, although mostly automated and dramatically improved compared with the system five years ago, is now being further revamped. The primary objective of these revisions to the management information system is to reduce system fragmentation and data redundancies, reconcile data inconsistencies, and increase

timely access to critical information. The BRI is also planning to introduce a unit desa classification system, as both a quick way to assess unit desa progress and a mechanism for motivating unit desas to respond to BRI policy and program priorities.

# 6
# Conclusion: Lessons Learned and Learning Lessons

*Yet is one good forewit worth two afterwits.*

—John Heywood, *Proverbs*, 1546

## Synthesis

The BKKs and BRI unit desas are rare examples of successful rural financial institutions amid the thousands of rural banking disasters around the world. The BKKs and unit desas have flourished where others have failed because they have adhered to the fundamentals of banking and finance regularly enough to become operationally effective and financially viable institutions.

In other words, the BKK and BRI unit desa case studies presented in chapters 4 and 5 illustrate the successful application of the general principles for developing rural financial institutions presented in chapter 2, given the macroeconomic policy context summarized in chapter 3. Both the BKKs and BRI unit desas have responded to market demand based on client characteristics, needs, and priorities. They have established a clear market supply niche among competitors. They have engaged in active financial intermediation between savers and borrowers, and established interest spreads accordingly. They have furthered the integration of local, regional, and national financial markets. Finally, they have excelled at common measures of overall

institutional performance, including efficiency, effectiveness, adaptability, personnel quality, autonomy, and accountability.

**The learning process.** Despite their successes, the BKKs and the BRI unit desas have made many mistakes in the course of their development, and both institutions are still evolving. Their current forms are only partially the result of design; several elements of the BKKs and the BRI unit desas are products of many years of trial and error. The BKKs and the BRI unit desas as they exist today are the result of astute forethought made better through the wisdom of hindsight.

Thus, perhaps the most important lesson the BKK and BRI unit desa experiences offer is the significance of recognizing that institutional development is an evolutionary process that takes place in a dynamic environment. Consequently, continual self-assessment and adaptation are crucial: one must determine regularly what works and what does not work, so the former can be reinforced and the latter corrected.

**Similarities and differences between the BKKs and the BRI unit desas.** A comparison of the development and current operations of the BKKs and the BRI unit desas offers some interesting lessons.

*Origins and evolution.* Although both the BKKs and the BRI unit desas have usually adhered to the general principles noted above, the ways in which these tenets have been followed contrast sharply in both form and timing.

One difference between the BKKs and the BRI unit desas that has had a significant effect on their development is their original organizational structure: each BKK was created as an autonomous unit, while each unit desa was established as a section of a BRI cabang. One model offers more independence while the other offers greater external control over resources and performance.

For example, the BKKs are owned by the provincial government, and the person ultimately responsible for a BKK's performance is the *camat* (subdistrict chief), but unit desas are a part of the BRI, and thus accountable directly to BRI management. BKK institutional autonomy precludes the Central Java BPD from directly removing, transferring, or disciplining BKK staff for reasons such as corruption or incompetence. With the BRI unit desas, however, the shifting or removal of staff is in the hands of the same people who receive the audit reports and are responsible for daily supervision of the unit desas: the BRI.

BKK autonomy imposes discipline in BKK operations not evident in early BRI unit desa activities. The financial position of a BKK has always been clear, especially whether a BKK was making a profit or a loss; with the unit desas, this information has only been readily available after major changes in the BRI accounting system were implemented to separate unit desa accounts from those of the BRI cabang.

If a BKK goes bankrupt, it must cease operations: in the early 1970s, 40 percent of the BKKs actually did so. BKKs have been forced to break even from the beginning, so mistakes have often been fatal. These difficulties have been compounded by potentially productive but idle resources at failed BKKs: if a BKK closes because of bankruptcy, its personnel usually cannot be employed in another BKK where business is large or growing. However, the collapse of a BKK does not have any direct effect on other BKK units.

In contrast, a BRI unit desa can make a loss for several years without necessarily being closed. Furthermore, personnel from a unit desa losing money can be shifted to useful work in another unit desa if the reasons for the loss seem to be beyond their control. However, as with the BKKs, the bankruptcy of one unit desa does not directly affect another unit desa, except perhaps if the weak unit is downgraded to serving as a PPD for a strong unit desa.

For the past two decades the BKK and unit desa models have slowly gravitated toward each other, drawing on their respective strengths. A hybrid third model that balances autonomy with accountability is gradually emerging: the BKKs are moving toward some form of eventual incorporation into the Central Java BPD to increase BKK accountability to the BPD, while the BRI has separated unit desa financial statements from cabang figures to create additional autonomy for the unit desa.

Another difference between the BKKs and the BRI unit desas that has had a major effect on their development is their original source of funds: the BKKs were founded through loans from the provincial government during a period of financial austerity, while the BRI unit desas were established as a channel for an agricultural credit program with virtually unlimited liquidity.

The source of BKK seed money accelerated the development of a financially viable institution by necessity: the BKKs had to pay their own way, including repayment of seed capital in three years, because the provincial government could not afford to do otherwise. Thus, the early years of BKK development were characterized by very restricted

liquidity. This gave the BKKs more time to learn how to run a viable credit program, but the cost, in terms of units lost, was high. This limited liquidity was, however, the primary reason provincial government and BPD officials set interest rates high enough to cover both BKK operational costs and BPD supervision costs.

The BRI unit desas did not face these liquidity constraints until 1984. Consequently, unit desa development as a financially self-sustaining institution was retarded: unit desas would continue to function as long as BIMAS was a top government priority, regardless of unit desa efficiency.

Today, both the BKKs and the BRI unit desas have become financially viable institutions, via different paths but for the same reason: survival. Restricted liquidity required the BKKs to be profitable from the beginning, while the phase-out of BIMAS provided the same set of conditions for the unit desas.

Another difference between the BKKs and the BRI unit desas that has affected their development is their attitude toward savings mobilization: savings were not a major component of either system originally, but mobilizing public funds became critical for the unit desas as part of the package of changes introduced in 1984, while it is only now becoming a priority of the BKKs.

Although a financially viable institution should be able to secure funds from other financial institutions that have a surplus to lend through the interbank market, savings must be a major long-term source of funds for lending if a financial institution is to function effectively as an intermediary between savers and borrowers.

Designers of the BKK system believed that savings were good for development and that people should be educated about the virtues of saving through a mandatory savings program. This attitude, prevalent among sponsors of cooperatives all over the world, is quite different from the belief that people have a need for savings instruments that are safe, convenient, and offer a positive real interest rate.

BKK sponsors did not look at savings as a major source of funding for credit activities. Their view was confirmed by central government regulators when they banned nonbank financial institutions from accepting savings in 1973. This regulation was the result of experience with the mushrooming of banks in Indonesia, followed by a wave of bank collapses and lost savings.

The central government changed its attitude after the provision of technical assistance and capital infusions revitalized the BKKs. In

1984 the Ministry of Finance determined that the BKKs were financially viable and could therefore safely accept savings. The BKKs, however, were slow to react to the permission, indicating that the initiative to create a voluntary savings instrument came from outside the BKK system.

In short, initial lack of liquidity caused the BKKs to institute forced retention of savings, hardly the way to educate people to save; later, excess liquidity insulated the BKKs from mobilizing savings as a major source of funds.

The BRI unit desas were not originally expected to raise savings, given their minimal cost of funds (3 percent liquidity credit for BIMAS and Kredit Mini and grant liquidity for Kredit Midi), together with a negative spread between on-lending rates (12 percent to the final borrower for BIMAS, Kredit Mini, and Kredit Midi) and interest rates on TABANAS savings accounts (12 percent initially, later raised to 15 percent). One of the changes introduced in 1984, however, was consideration of savings as an important source of funds. Interest rates on credit were therefore set high enough to allow a 15 percent cost of funds, and liquidity credit for most loan funds was set at 15 percent, the same as TABANAS interest rates. The formula worked, as described in chapter 5.

Both the BKKs and the BRI unit desas are now implementing voluntary savings programs aggressively, again via a different sequence of events but for the same reasons: to raise loan capital and to serve as a marketing tool in attracting new clients. Equally important, both institutions also charge high enough interest rates on their loans to allow them to pay competitive interest rates on savings.

*Current operations: An overview.* A brief comparison of the BKK and the BRI unit desa operations in Central Java will illustrate similarities and differences in current operations of the two institutions.

The BRI unit desas and the BKKs appear to have segmented the rural banking market in Central Java, with each system servicing a slightly overlapping but nonetheless distinct clientele. While the two systems are of similar magnitude at the subdistrict level (roughly 500 units) and serve a similar total number of clients (about half a million), each offers different services to a different group of people (see Table 22).

The average BRI unit desa borrower is wealthier than the typical BKK client: the BRI unit desa borrower can pledge land or comparable assets as collateral, while BKK loans are unsecured. Most unit desa

TABLE 22 Comparison of BRI Unit Desas in Central Java and BKKs, December 1987 (monetary figures in thousands of rupiah)

| Item | BRI unit desas | BKKs |
|---|---|---|
| Total units | | |
| Subdistrict level | 538 | 497 |
| Village level | 152 | 3,015 |
| Total staff | 2,637 | 1,897 |
| Total loans outstanding | | |
| Rupiah | 117,233,151 | 18,223,750 |
| Persons | 411,877 | 516,065 |
| Monthly loan circulation | | |
| Rupiah | 12,382,968 | 3,134,915 |
| Persons | 25,964 | 50,676 |
| Average loan per borrower | 477 | 62 |
| Total loans per staff member | | |
| Number of loans | 10 | 27 |
| Rupiah | 4,696 | 1,653 |
| Long-term loss ratio (%) | 1.35 | 1.98 |
| Total savings/time deposits | | |
| Rupiah | 72,828,000 | 2,845,274 |
| Persons | 1,126,760 | 419,181 |
| Average savings/time deposits per client | 65 | 7 |
| Net profits (pretax) | 9,805,000 | 2,357,806 |

SOURCE: Compiled by the authors.

clients live close to the subdistrict or district capital, while most BKK clients live in more remote villages: the BKKs operate through more than 3,000 posts at the village level, but unit desas rely on offices at the subdistrict level.

Although both programs have low long-term loan loss ratios and are extremely profitable in Central Java, the dynamics are considerably different: BRI unit desas rely on volume of rupiah mobilized and lent per staff member, while BKKs depend on number of clients served per staff member.

For example, the average unit desa loan in Central Java is almost eight times as large as the average BKK loan, while the average savings account of a unit desa client is almost ten times as large as that of a BKK savings account. Thus, unit desas in Central Java lent four times the amount BKKs lent in December 1987, but the BKKs lent to twice

as many borrowers; likewise, unit desa staff lent almost three times as much as BKK staff per employee, but BKK staff processed almost three times as many loans per employee.

These contrasts are ultimately minimized when assessing the overall profitability that each institution has achieved through interest rate spreads. Since the transaction costs of BKK clients are virtually nil, the BKKs trade better service for higher interest rates.

Finally, both the BKKs and the BRI unit desas in Central Java have been relatively free from intrusive or devastating government interference or arbitrarily imposed market distortions, and thus have been allowed to pursue rational responses to local, regional, and national market conditions.

*Current operations: A case study.* Pati District is a two-hour drive from Semarang, the capital of Central Java. It extends from the Java Sea in the north to hilly forests and limestone mountains in the south, with the central region covered by lowland rice paddies. There are 27 BRI unit desas and 9 BRI unit desa PPDs as well as 20 BKKs and 169 BKK pos desas in the district.

Tambakromo is one of the Pati District's twenty subdistricts. Located in the southern part of the district, the Tambakromo Subdistrict is composed primarily of rice, corn, sugarcane, and peanut fields in the north, and limestone mountains in the south. These two regions are divided by a swath of uninhabited forests running through the lower third of the subdistrict. There are 9,911 households in the eighteen villages of Tambakromo Subdistrict.

BKK Tambakromo was established in 1972 with a Rp. 1 million loan from the Central Java provincial government, channeled through the Central Java BPD. The unit started with a staff of three—a manager, a cashier, and a bookkeeper—in a makeshift office using space borrowed from the subdistrict headquarters office complex.

By the end of 1988, BKK Tambakromo had expanded to a staff of seven. It had built its own office building, measuring about nine square yards, and had equipped this office with a safe, filing cabinets, calculators, and simple but functional furniture. BKK Tambakromo had also acquired four motorcycles and had established thirteen pos desas in addition to its subdistrict head office.

The head of BKK Tambakromo, Ibu Sri Sularni, has been with BKK Tambakromo since it was established in 1972. She started as a cashier and became BKK manager in 1985. In addition to graduating from junior

high school, Ibu Sri has attended several courses in Semarang sponsored by the Central Java BPD regarding BKK policies, procedures, bookkeeping and reporting systems, and management. She has three children, and her husband is the principal of a local elementary school. The remaining staff members, two women and four men, are in their twenties, and have graduated either from junior or senior high school. They have also attended several courses sponsored by the Central Java BPD.

In addition to providing elementary and advanced training for BKK staff, the Central Java BPD has been an important source of capital for BKK Tambakromo. The BPD has on-lent loan capital of Rp. 12 million from Ministry of Finance funds, Rp. 10 million from provincial government funds for BKK office construction, and Rp. 2 million from provincial government funds for the purchase of a motorcycle. In addition, the BPD has also served as a depository for excess BKK funds; at the end of December 1988, BKK Tambakromo had approximately Rp. 2 million in savings at the BPD's Pati cabang office. Finally, a full-time BPD staff member based in the Pati cabang visits BKK Tambakromo at least once a month to provide technical support and supervision.

As of December 31, 1988, BKK Tambakromo had 1,790 borrowers with loans outstanding totaling Rp. 92 million. Only 16 percent of these loans were held at BKK Tambakromo Subdistrict headquarters, while the remaining 84 percent were extended in BKK Tambakromo's pos desas located outside of the subdistrict capital. In terms of rupiah, however, the value of BKK Tambakromo's loan portfolio was rather evenly split between its main office and its pos desas.

During the month of December 1988, BKK Tambakromo made 165 loans totaling Rp. 17 million, for an average loan of roughly Rp. 100,000. As of December 31, 1988, 1,662 people had mandatory savings accounts at BKK Tambakromo, totaling Rp. 16 million. Total assets at the end of 1988 were Rp. 108 million, of which approximately half were retained earnings; net pretax profits for 1988 were Rp. 5 million.

BKK Tambakromo loans fall into three categories, all with three-month repayment periods: approximately 40 percent are repaid in weekly installments (*mingguan*), another 40 percent are repaid in monthly installments (*bulanan*), and the remaining 20 percent are repaid in a single installment at the end of the three-month period (*musiman*).

Most mingguan loans are for petty traders who operate in the local markets. Bulanan loans support small kiosks engaged in mixed trading, freshwater fish production, and a number of home industries: mattress

and pillow stuffing, roof tiles, traditional ceramics, agricultural hand implements, and soybean products (tahu and tempeh). Musiman loans are for agricultural production, primarily rice, corn, and peanuts.

BKK Tambakromo has yet to open pos desas in four of the subdistrict's eighteen villages. One village, Mojomolyo, is easily covered from the BKK's main office. The other three villages, Wukirsari, Maitan, and Pakis, are all at the southernmost section of the subdistrict and are only accessible by a small road that winds through an uninhabited forest. BKK Tambakromo staff believe this area has considerable unexploited potential, and they plan to open pos desas when the level of local economic activity warrants such expansion.

BRI Unit Desa Tambakromo is located twenty-five yards down the road from BKK Tambakromo. The offices are similar in style and size, although the BRI unit desa rents its office space. The staffs also have a similar profile, except that on average, the eight BRI unit desa employees are a bit older, have slightly more formal education, and are all male. Like BKK Tambakromo, BRI Unit Desa Tambakromo also relies on motorcycles for field transport and has an inventory of two such vehicles.

Like BKK Tambakromo, BRI Unit Desa Tambakromo was also established in 1972. BRI Unit Desa Angkatan Lor was established at the same time in the same subdistrict. The purpose of these two unit desas was to channel BIMAS agricultural credit, and on Java, one unit desa was established for every 600 to 1,000 hectares of rice fields.

These two unit desas in the Tambakromo Subdistrict were consolidated into Unit Desa Tambakromo and PPD Angkatan Lor during the 1984 BRI unit desa reallocation, because the volume of business at Unit Desa Angkatan Lor was not sufficient to justify maintaining a full unit desa at that location. In January 1989 PPD Angkatan Lor had grown enough to warrant upgrading to its previous status as a full BRI unit desa. BKK Tambakromo also operates a pos desa at Angkatan Lor every five days, on the Javanese calendar day Pahing.

As of December 31, 1988, before the split off of Angkatan Lor, BRI Unit Desa Tambakromo had 1,104 borrowers with Rp. 274 million in loans outstanding. It made loans to 69 people for a total of Rp. 28 million during the month of December, for an average loan of Rp. 406,000.

The quality of BRI Unit Desa Tambakromo's loan portfolio was relatively high: its long-term loss ratio was 1.7 percent, and its portfolio status was 6.8 percent. All of these loans were for working capital either for agricultural production or for the trading of agricultural products; most loans were for one year, repaid in monthly installments.

Also as of December 31, 1988, BRI Unit Desa Tambakromo had collected Rp. 116 million in savings; three-fourths of these savings were held in SIMPEDES accounts. Profits for 1988 totaled Rp. 11.6 million.

Although both BRI Unit Desa Tambakromo and BKK Tambakromo are doing quite well, there are significant differences in their operations:

- Unit Desa Tambakromo requires collateral for its loans, while BKK Tambakromo loans are unsecured.
- Unit Desa Tambakromo's average loan is four times the average BKK Tambakromo loan.
- Most Unit Desa Tambakromo loans are for one year, and most BKK Tambakromo loans are for three months.
- Unit Desa Tambakromo operates from two sites only, the subdistrict capital and Angkatan Lor, while BKK Tambakromo operates from thirteen pos desas in addition to its office at the subdistrict capital.
- Unit Desa Tambakromo provides several voluntary savings instruments, whereas BKK Tambakromo only collects mandatory savings as part of loan repayments.

BRI Unit Desa Tambakromo and BKK Tambakromo compete for borrowers at the subdistrict capital and Angkatan Lor, but the rivalry is friendly. Their markets only overlap at the margins: the largest BKK borrowers might qualify as relatively small unit desa clients. In any case, the staff of these institutions know each other and provide information for each other on the credit history of prospective clients upon request. Moreover, both managers are quite optimistic regarding prospects for future expansion of current activities, primarily in the southern region of the Tambakromo Subdistrict.

## Transferability

When an activity is successful, planners have a tendency to try and replicate it in other regions of the same country, or even on other continents. Yet specific characteristics of the political, administrative,

economic, and social environment in which the BKKs and BRI unit desas operate have contributed to their success. Lack of any of these ingredients could doom a similar effort elsewhere before it is ever launched.

Factors that have contributed to the success of the BKK and BRI unit desa systems beyond the general principles of rural banking discussed earlier, and that in fact might be location-specific, include:

- clear and continuous government support without government interference
- social sensitivity and cohesion
- a conducive economic environment

**Government support.** The BKKs were first conceived by the Central Java provincial government, and they have received the strong personal support of all governors of Central Java since their founding. This advocacy from the top invariably has filtered down through the local government structure in Central Java all the way to the province's more than eight thousand village chiefs.

Furthermore, the Central Java provincial legislature has continually allocated considerable resources in support of the BKKs, ranging from initial capital loans to term loans for BKK office construction and grants to implement annual BKK provincewide competitions.

The Central Java BPD has also played a critical role in providing high-level professional supervision of, and technical support to, the BKKs.

Finally, the central government, through the Ministry of Finance, provided a Rp. 3 billion loan for the BKKs at a critical time in their development, a clear signal of strong support from Jakarta.

The BRI unit desas have also received strong and consistent Indonesian government support, from initial efforts to establish the unit desas through recent activities to revitalize the entire unit desa system. This government support has included liquidity credits from Bank Indonesia, political and policy encouragement from the Ministry of Finance, and technical and administrative support from the BRI's board of directors and senior managers.

Most government support has been at the policy level and usually has not resulted in bureaucratic interference in daily field operations. In the few cases where government interest led to an active role in

program implementation, good intentions had unintentional negative consequences.

Although both the BKKs and BRI unit desas have received outside support from donors, especially the World Bank (unit desas) and USAID (both programs), this assistance was offered well after each institution had been established and had been running without external assistance for several years. Moreover, in each case, the donor has been able to provide continuity in technical assistance, in terms both of personnel and philosophy.

This situation contrasts with that of many other rural banking projects in which the order is reversed: their inception is stimulated by the lure of outside donor funding, and then project implementers try to establish a local constituency. In these cases, the government usually has a smaller stake in project implementation, and elaborate designs conceived by donor experts tend to be forgotten soon after funding begins.

**Social setting.** The BKKs and the bulk of the BRI unit desas have been established on the islands of Java and Bali. The social setting on these two islands is not typical of many developing countries.

Java and Bali are two of the most densely populated areas in the world. Unlike most of Africa, for instance, almost every subdistrict has a critical mass of clients capable of supporting the costs of staffing a BKK or unit desa office.

Moreover, strong social cohesion and homogeneity allow the client reference system, whether formal (BKK) or informal (unit desa) to ensure high loan repayment rates. The BKK experience in urban areas indicates that this is a critical factor behind BKK success.

Finally, a large pool of talented, educated, and unemployed youth makes it possible to staff the BKKs and unit desas with qualified but relatively low-cost local personnel.

**Economic environment.** The Indonesian economy, particularly on Java and Bali, is also unusual for a developing country: high population density and judicious investment of oil revenues in economic infrastructure, such as roads and communications, have stimulated an extremely high level of economic activity in a small geographic area.

Therefore, although the experiences of the BKKs and BRI unit desas offer important lessons for rural banking institutions, we must issue a word of caution to all readers from the cookie-cutter school of economic development—the BKK and BRI unit desa approach may

not work in areas characterized by one or more of the following attributes:

- sparsely populated
- economically stagnant
- supported by a weak physical and human infrastructure
- ethnically diverse
- lacking a social ethic to ensure that repayments are made on unsecured loans
- without strong and visible government policy support for decentralization amid standardization and market-based savings and lending philosophies

Some elements or principles from the BKK and BRI unit desa systems might be usefully applied in other areas if adopted selectively and executed with prudence and flexibility, but there are few settings that would warrant the unaltered replication of BKKs or unit desas. The key is discerning what is appropriate and what is not, and exploiting the former while discarding or adapting the latter.

# APPENDIX

Indonesian Consumer Price Index and Rupiah/Dollar Exchange Rates, 1967–1989

| Year | Consumer price index (CPI) (base year = 1980) | Exchange rate (rupiah per US$) |
|---|---|---|
| 1967 | 6.7 | 149.6 |
| 1968 | 15.1 | 296.3 |
| 1969 | 17.8 | 326.0 |
| 1970 | 20.0 | 362.8 |
| 1971 | 20.6 | 396.5 |
| 1972 | 21.9 | 415.0 |
| 1973 | 28.8 | 415.0 |
| 1974 | 40.4 | 415.0 |
| 1975 | 48.1 | 415.0 |
| 1976 | 57.7 | 415.0 |
| 1977 | 64.0 | 415.0 |
| 1978 | 69.3 | 442.1 |
| 1979 | 84.4 | 623.1 |
| 1980 | 100.0 | 627.0 |
| 1981 | 112.3 | 631.8 |
| 1982 | 122.9 | 661.4 |
| 1983 | 137.4 | 909.3 |
| 1984 | 151.8 | 1,026.0 |
| 1985 | 158.9 | 1,110.6 |
| 1986 | 168.2 | 1,282.6 |
| 1987 | 183.8 | 1,643.9 |
| 1988 | 202.5 | 1,685.7 |
| 1989 | 215.5 | 1,770.1 |

SOURCE: International Monetary Fund.

# GLOSSARY

## Banking Terminology

Badan Kredit Kecamatan (BKK): Subdistrict credit body.

Badan usaha milik daerah (BUMD): Provincial-owned government enterprise (the legal status of the BPD Jawa Tengah).

Bank Pembangunan Daerah Jawa Tengah (BPD Jawa Tengah): Central Java Regional Development Bank.

Bank Rakyat Indonesia unit desa (BRI unit desa): BRI village unit.

Bimbingan Massal (BIMAS): Mass Guidance program (Indonesia's former nationwide agricultural credit program).

BKK Tempat Pelelangan Ikan (BKK/TPI): Fish Market BKK.

Cabang: BRI branch.

Deposito berjangka: Time deposit (available at a variety of banks throughout Indonesia).

Giro: Demand deposit (available at a variety of banks throughout Indonesia).

Hadiah Angsuran Tepat Waktu (HAT): Rebate for timely BKK loan repayment.

Insentif Pembayaran Tepat Waktu (IPTW): Incentive for Timely Repayment (for KUPEDES loans).

Kantor cabang (BRI kanca): BRI branch office, the level below a BRI kanwil.

Kantor wilayah (BRI kanwil): BRI regional office.

Kepala unit desa (kaudes): BRI unit desa chief.

Kredit Umum Pedesaan (KUPEDES): General Rural Credit program (available exclusively through BRI unit desas).

Mantri: BRI unit desa field agent.

Penilik: Cabang (see above) officer responsible for BRI unit desa field supervision and audit.

Pos desa: Village post (a BKK subunit).

Pos pelayanan desa (PPD): Village service post (a BRI unit desa subunit).

Simpanan Pedesaan (SIMPEDES): Rural Savings program (available exclusively through BRI unit desas).

Tabungan Masyarakat Pedesaan (TAMADES): Village Savings program (available exclusively through BKKs).

Tabungan Nasional (TABANAS): National Savings program (available at a variety of banks throughout Indonesia).

Team pelayanan desa (TPD): Village service team (PPD staff).

Unit desa induk: BRI unit desa main office.

## Local Government Terminology

These terms are arranged from the largest local governmental body to the smallest.

Propinsi: Province ("level one" local government in Indonesia).

Gubernur: Governor (head of a propinsi).

Kabupaten/kotamadya: District/municipality, or alternatively, regency ("level two" local government in Indonesia). Kabupaten and kotamadya vary significantly between Java/Bali and the outer islands in terms of both size and population density, but throughout

Indonesia, they are characterized by a strong executive and a strict hierarchical structure, in contrast to common connotations of the terms "district" and "municipality."

Bupati/walikota: District chief (or regent, head of a kabupaten)/mayor (head of a kotamadya).

Kecamatan: The level of government below a kabupaten or kotamadya, loosely translated as either a subdistrict or a district, depending on the translation used for kabupaten/kotamadya (see above).

Camat: Subdistrict chief (head of a kecamatan).

Desa/kelurahan: Village/neighborhood (the former in rural areas and the latter in urban areas).

Kepala desa/lurah: Village/neighborhood chief (head of a desa/kelurahan).

Rukun tetangga/rukun warga (RT/RW): Neighborhood subdivisions of kelurahan, similar to precincts and wards.

Kepala RT/kepala RW: Precinct/ward chief (head of a rukun tetangga/rukun warga).

**General Terminology**

Dangdut: Music that combines Indonesian and Middle Eastern pop styles.

Dinas: Technical service agency, usually a local office of a national ministry.

Ibu/Bapak (Bp.): Literally, ibu means "mother" and bapak means "father," and these terms are commonly translated as "Mrs." and "Mr." There is, however, no precise English translation for these terms. Ibu/bapak are usually used as female and male honorifics, and connote traditional Indonesian respect for age, family position, or socioeconomic status.

Jamu: Traditional medicine.

Kelompok swadaya masyarakat (KSM): Local self-help group.

Khusus/umum: Special/general.

Lapanan: Javanese month, consisting of thirty-five days (seven five-day Javanese weeks).

Lebaran: Feast at the end of Ramadan.

Partai Komunis Indonesia (PKI): Indonesian Communist Party.

Perusahaan Listrik Negara (PLN): National Electric Company.

Ramadan: Moslem fasting month.

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