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Financial Institutions Development Project in Indonesia:

Developing Financial Institutions to Serve Small Enterprises

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GEMINI

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7250 Woodmont Avenue, Suite 200, Bethesda, Maryland 20814

DEVELOPMENT ALTERNATIVES, INC. • Michigan State University • ACCION International • Management Systems International, Inc. • Opportunity International • Technoserve • World Education

Financial Institutions Development Project in Indonesia: Developing Financial Institutions to Serve Small Enterprises

by

Roland Pearson
Dallas Garland

Development Alternatives, Inc.

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GLOSSARY

General Terms

BAPPENAS	The national planning agency
BI	Bank Indonesia (Indonesia's Central Bank)
BKD	*Bank Kredit Desa* (Small financial institutions similar to the FID village post units)
BPD	*Bank Pengembangun Daerah* (The provincial development banks)
BPR	*Bank Perkreditan Rakyat* (Smallholder Credit Banks or Community development banks recognized and licensed since October 1988)
BRI	*Bank Rakyat Indonesia* (One of five state-owned banks)
Cabang	The corporate banking division of major state and private banks
DIPDA	The provincial development budget for training
FID	Financial Institutions Development Project
KUK	*Kredit Usaha Kecil* (Small business credit)
SFI	Small Financial Institution (Generic term for community level banks)

National Hierarchy

Province	First administrative level below national
Kabupaten	District (One level below a province)
Kecamatan	Subdistrict (One level below a *kabupaten*)
Desa	Village (One level below a *kecamatan*)

FID SFIs and the Provinces in Which They Are located

BKK	*Badan Kredit Kecamatan* (Central Java and South Kalimantan)
BKPD	*Bank Karya Produksi Kecil* (West Java)
KURK	*Kredit Usaha Rakyat Kecil* (East Java)
LKP	*Lembaga Kredit Kecamatan* (West Java)
LPD	*Lembaga Perkreditan Desa* (Bali)
LPK	*Lumbung Kredit Pedesaan* (West Nusa Tenggara)
LPN	*Lumbung Pitih Nagari* (West Sumatra)

Exchange Rate

US$1 = Rp2,070

OVERVIEW

The Financial Institutions Development (FID) Project, funded by the U.S. Agency for International Development and lasting from 1985 to 1993, raised the capacity of small financial institutions (SFIs) to deliver financial services to low-income groups in Indonesia. The first phase of the FID project began in the provinces of Central Java, West Java, and West Sumatra; over the next four years the project expanded to East Java and Bali, and — under the 1989 project extension — to South Kalimantan and West Nusa Tenggara. Most of the SFIs are owned by provincial governments and supervised by Provincial Development Banks (BPDs). SFIs number 1,994, serving 109 *kabupaten* (districts), 1,295 *kecamatan* (subdistricts), and 10,660 *desa* (villages). FID SFIs serve mainly rural, but also many urban and suburban, markets. Many clients are involved in farm-related trade; others are in light industry, general services, transportation, and handicrafts. Other institutions that provide financial services to the poor include the Bank Rakyat Indonesia (BRI) Unit Desa, the Bank Kredit Desa (BKDs), 12 *kabupaten* branches of Bank Sampoernaat in East Java, new and independent Smallholder Credit Institutions (BPRs), and some nascent operations by private commercial banks such as Perbanas and Bali Bank.

Extensive resources were devoted to the project. Two long-term advisors expended 258 person-months and were supported by 98 person-months of local consultant subcontracting and 22 person-months of short-term technical assistance. The overall project budget for February 1985 to May 1993 was $4.6 million, in addition to $5 million in loan capital earmarked for Central Java, West Java, West Sumatra, and East Java. Approximately $4 million was disbursed over the project's first three years. Technical assistance was coordinated through the BPDs. The Ministry of Home Affairs, the central government's overseer of the provincial governments, has been the official, though not wholly appropriate, responsible government ministry. For the last two years, FID's approach, emphasizing self-sufficiency of financial institutions, has been targeted at the Bank of Indonesia (BI), the Ministry of Finance, and local or regional authorities responsible for the BPDs or BPRs.

The project's accomplishments have been documented. As of December 1992, FID SFIs had a loan balance of Rp189.7 billion ($91.6 million) outstanding to 1,067,763 borrowers, and held the deposits of 1,558,319 savers. These figures represent increases of 108 percent, 29 percent, and 48 percent respectively over the last four years. Percentage of savings against outstanding loans is 55 percent. Many SFIs, especially those in Central Java and Bali, began in January 1993 implementing new loan application forms and management information system (MIS) forms and procedures in line with new BI regulations. Other provinces are ready to follow suit. The new forms have introduced a measure of professionalism and sustainability to the SFIs. The project has provided training to 13,365 person-units (some people have been trained more than once) in loan management and recovery, credit analysis, cash management, general branch management skills, savings mobilization, and MIS input and procedures. The FID project also has developed a standard operating manual for accounting and reporting, as well as a supervisory manual and a guide to savings mobilization.

These accomplishments have occurred within a network that operates profitably at each branch. Coverage under the project was excellent and continues to expand under the remaining system of SFIs. Over the life of the project, 10.5 million loans were disbursed to 3.6 million people. As a whole the project served 34 percent of the villages of the provinces in which it operated, covering 1.4 percent of the total Indonesian population and 7 percent of the country's households, based on an average family size of five. Tables 1 and 2 reveal the coverage data for and financial performance of FID SFIs.

TABLE 1
FID SFI COVERAGE DATA AS OF DECEMBER 31, 1992[a]

Province	Loans Outstanding (Rp ,000,000)	Number of Borrowers	Savings (Rp ,000,000)	Number of Savers	Number of SFIs	Percent of Villages Served in Province
Central Java	48,946	498,591	12,500	506,258	510	60%
West Java	92,721	214,379	59,630	488,999	326	42%
West Sumatra	3,865	19,090	2,331	52,510	193	6%
East Java	11,428	157,938	2,858	155,945	222	21%
Bali	28,796	126,861	26,393	320,422	650	100%
South Kalimantan	1,386	15,263	22	697	34	.1%
West Nusa Tenggara	2,515	35,641	981	33,488	59	5%
TOTAL	189,658	1,067,767	104,676	1,558,319	1,994	34%

a Rp2,070 = $1

TABLE 2
FID SFI FINANCIAL PERFORMANCE AS OF DECEMBER 31, 1992

Province	Net Worth (Rp ,000,000)	Net Income (Rp ,000,000)	Capital Adequacy Ratio	Return on Assets	Savings / Loans Ratio	Assets / Staff Ratio (Rp ,000,000)
Central Java	15,394	2,940	34.6%	2.8%	25.5%	34.7
West Java	10,954	3,854	14.8%	3.8%	64.3%	49.2
West Sumatra	1,181	156	30.6%	3.3%	60.3%	6.3
East Java	7,770	1,384	70.7%	10.9%	25.0%	22.3
Bali	5,432	3,144	28.7%	10.8%	91.7%	19.2
South Kalimantan	943	266	85.3%	17.7%	1.6%	16.8
West Nusa Tenggara	1,490	537	75.6%	15.7%	39.4%	11.4
TOTAL	43,164	12,280	27.2%	4.8%	55.2%	30.6

Several other reports have evaluated FID or documented various aspects of the project. The intention of producing this report is threefold: first, to record the status of the project upon its closing; second, to review on-site observations and previous studies of the project to analyze the essential elements of the FID experience; and third, to contribute to the thinking of USAID, the Government of Indonesia, private institutions, other international donors, and the public and private financial communities in Indonesia and in other countries about how best to promote financial services to the poor.

Chapter One of this report, Financial Service Components, discusses the low-income sector's demand for financial services, including savings and credit. It also covers interest rates, institutional safety, the interaction of savings and loan recovery, essential credit and savings policies and procedures, and product mix.

Chapter Two, The Macroeconomic Environment, highlights the role of infrastructure, financial and monetary policies, population density, and externalities such as drought. Chapter Three, Management and Institutional Structure, draws conclusions about appropriate institutional frameworks and staffing patterns, as well as talk about the relationship between management and performance at the SFI and system levels. Chapter Four, Sustainability and MIS, details the actual performance and profitability of the various FID institutions and draws conclusions about their sustainability. This chapter also describes the new monitoring and evaluation criteria recently adopted by BI for the SFIs, and goes on to discuss the appropriateness of these new measures.

Chapters Five and Six, Policy and Regulatory Issues and Nonfinancial System-Level Functions, are related closely. The first of these chronicles the key regulatory, monetary, and economic policies and procedures that have affected FID institutions. Chapter Six then deals with the matters of supervision by policy makers and implementers of the FID institutions, as well as key aspects of training and spawning.

Chapter Seven, on Intervention by Donors and Government, analyzes the role that these bodies have had in the FID project and how their inputs may be enhanced or modified. Chapter Eight, Summary, encapsulates the most important facts and emphasize the key recommendations from the previous seven sections.

Each chapter, with the exception of the last, succinctly states the key findings of this study, analyzes the context and vital dynamics of the issues, and offers recommendations. Although the focus of this report is on FID SFIs, other comparable institutions such as BRI Unit Desa and Bank Sampoerna BPRs are featured to provide additional context and deeper analysis.

CHAPTER ONE
FINANCIAL SERVICE COMPONENTS

CREDIT POLICIES AND PROCEDURES

Key Findings

- FID institutions use not just character-based analysis, but **a web of credit assessment techniques and collateral proxies** that change according to local market conditions (urban or rural, level of involvement of traditional and government leaders, and the like), size of the loan, and type of business.

- Because FID SFIs **do not have a standardized procedure to pursue bad debts**, efforts are often not cost-effective and bear limited rewards.

Analysis

FID SFIs use a measured and incremental approach in their evaluations of client credit risk. They use varying degrees of formal collateral: for small loans, the character of the prospective borrower is considered, whereas for larger loans collateral is legally and officially secured. During the initial interview, lenders assess the perspective borrower's character, judging whether the person is telling the truth about business and personal circumstances. As borrowers establish their creditworthiness, they progress to larger loans.

Signatures obtained from village officials are insufficient in vouching for a person's character. The one major exception to this may have been Bali, where the traditional village *adat* system is still very strong and well respected in the community. Elsewhere village leaders have capitalized on the feeling of indebtedness that comes with approval for a loan. Some leaders have taken payments in cash or in kind for the favor of their approval. Not all village leaders engage in this practice, but it has ironically led to SFIs bringing in borrowers with questionable character.

If the village authorities truly performed character reviews before proclaiming the honesty of individual villagers, SFIs would decline the applications of more than the 1 percent typically denied loans on the basis of character. In other words, it is unlikely that 99 percent of the Indonesian population is so creditworthy. Yet, the process of obtaining clearance from local leaders and using institutions with knowledge and presence in the local market to screen applicants does make the act of borrowing much more public and does create convincing incentives for repayment.

Although procedures and policies vary by location, SFIs' underlying approach to lending is the same. Rural SFIs tend to make more use of the authority of local traditional or government leaders to determine borrower character and enforce repayment. Urban systems, because of the transience of their borrowers and the breakdown of traditional hierarchies, depend more on collectable securities. All FID SFIs have instituted an incremental approach: after faithfully repaying small initial loans (usually between Rp 10,000 and Rp 50,000), borrowers are allowed to receive subsequent loans in increasing increments of Rp 50,000, Rp 100,00, Rp 200,000, and beyond. This process sets a performance record, gives the SFIs time to know new clients, and limits risk from new borrowers.

Other credit analysis and risk-reduction approaches include (1) charging lower effective interest rates by calculating interest on a diminishing balance versus a flat basis, but collecting reimbursable loan origination fees for larger borrowers; (2) restricting loan use to productive purposes; (3) matching loan size to borrower repayment capacity, determined by savings behavior or quick tabulations of household income; (4) matching loan repayment terms to enterprise or household cash flow (most traders are on weekly repayment schedules because turnover in their businesses is rapid); (5) keeping loan applications simple and short (one page), while gleaning vital data; (6) establishing ownership of land or property with title documents, tax receipts, or deeds; (7) limiting loan terms to no more than a year in most cases, where loan amounts were less than Rp 10,000,000; (8) charging interest rates competitive with the local informal and formal market, where, for example, Bali *Lembaga Perkreditan Desa* (LPD) interest rates are subject to negotiation with many applicants, and there are readily available alternatives to the LPDs.

Most village staff, with the exception of East Java, are full-time SFI field staff. This staffing pattern concentrates loan decision-making authority in the hands of those closest to the borrowers. The proximity of authority to clients keeps turnaround for new loans to four working days, and approval for subsequent loans to two days or less. Faster turnaround fosters borrower confidence and loyalty, projects a competitive image to local money lenders, and thereby creates more incentives for good repayment.

Loans for nonproductive purposes, originated by only a few of the SFIs, are limited mainly to salaried people and government workers, for whom debits for repayment can be automatically administered through payroll deductions. This type of loan has been tried predominantly in urban or peri-urban centers, where there is greater competition among financial service providers, clients are more likely to be formally employed, sophisticated banking services are more readily available, and clients have been more sophisticated and diverse in their demands on financial institutions. To limit risk, BRI Unit Desa urban offices have established a limit of 12 times salary as the maximum loan amount that a client can receive for nonproductive purposes. So far, this has proven a reliable measure of borrower repayment capacity.

Other techniques that reduce risk, such as savings mobilization, will be dealt with elsewhere in this report. Table 3 summarizes the key risk-reduction procedures, based on loan size, that are used across Indonesian SFIs. Annex A provides a copy of a typical loan application.

Procedures to trace and chase borrowers are less complex. Unless a delinquent loan amount is greater than Rp5-10 million, depending on branch capital base, it is not cost-effective to initiate formal collateral seizure. SFIs find that making claims on certificates of ownership, which effectively prohibit borrowers from selling the item (most often a motorbike), provides enough incentive for those in arrears to pay. Alternatively, SFIs use modified incremental approaches in pursuing the delinquent borrower, starting with a personal visit from the loan officer, followed by a second visit (sometimes with the loan officer's supervisor or branch manager in tow), moving to dunning notices from local government officials, personal visits by BPD supervisors, and finally a request to meet directly with local traditional and government leaders, at least in rural areas.

TABLE 3
RISK-REDUCTION PROCEDURES BASED ON LOAN SIZE AMONG INDONESIAN SFIs[a]

Loan Size (Rp ,000)	Collateral[b]	Visit Business Before Disbursement	Interest Calculation[c]	Repayment Frequency	Repayment Term	Increment Eligibility[d] (Rp)
10 - 100	No	No	Flat	Weekly	4 - 12 weeks	50,000
101 - 500	No, but seek local character reference	No	Flat	Weekly and seasonally	4 - 12 weeks	100,000
501 - 2,000	Inquire about asset ownership	Occasionally	Flat	Weekly, monthly, and seasonally	3 - 12 months	200,000
2,001 - 10,000	Ask to see and sometimes hold documentation proving asset ownership	Usually	Flat and reducing, depending upon local market competition	Monthly	6 - 24 months	500,000 - 1 million
10,001 - 25,000	Secure and hold asset ownership documentation	Always	Reducing	Monthly	12 - 36 months	1 - 5 million
25,001 +	Legally attach to secured financial and fixed assets, and register a pledge of assets from the client	Always	Reducing	Monthly	24 - 36 months	5 million +

[a] These are general guidelines and should not be construed in any way as mandatory policies.

[b] Steps taken are not mutually exclusive. For example, formal character references also may be sought for loans larger than Rp 10,000,000.

[c] With upgrading of skills and MIS capabilities, more SFIs are moving to reducing balance calculations for all loan clients.

[d] These figures represent the customary maximum amount by which a subsequent loan is approved, assuming perfect borrower repayment performance on the previous loan.

For most customers in arrears, this process leads to an informal rescheduling of debt repayment, with the often underlying assumption that the borrower will pay when and in whatever amount it is feasible. SFI staff felt that most poor repayment behavior was caused by changes in family circumstances and personal or business-related calamities, not poor character. However, observations of the consulting team and technical advisors indicate that there are real and controllable risks directly related to the borrower and the business. The lesson here is that it is clearly more effective to build in incentives and safeguards in the credit review process than to depend on often futile and expensive badgering of poor performers.

Recommendations

(1) Maintain flexible policies and procedures that address varying market conditions and borrower and business sophistication.

(2) Where traditional village bonds are weak or absent, secure title documents and other similar certificates of ownership as a sign of borrower commitment and as a threat of seizure of formal collateral.

(3) Build in incentives through fees, interest rate structures, or changes in nominal interest rates that reward good repayment performance and recognize increasing sophistication of repeat and larger borrowers.

(4) Continue incremental increases in loan amounts for good customers, but do not set rigid minimum and maximum amounts.

SAVINGS ISSUES

Key Findings

- Mobilization of **voluntary savings is an imperative element** of a successful financial institution, for the myriad benefits it yields.
- **Forced savings kills any incentives** for the borrower to voluntarily set aside money or the financial institution to collect voluntary savings.
- **A mixture of term and passbook savings** opens the opportunity to collect savings from a bigger cross section of the market and generates more stable sources of funds, thus easing the burden of obtaining sufficient capital and reducing the need for a high level of cash management sophistication.

Analysis

Voluntary savings mobilization is perhaps the most essential element of successful financial service institutions. Reasons for this include the following:

- Giving clients a sense of community ownership in the institution without incurring the cumbersome and frequently inefficient owner-management found in other institutional structures such as cooperatives;
- Providing a source of local capital that reduces dependence on potentially mercurial donor funds and financial and political shocks that may derive from accepting outside money;
- Offering poorer clients a source of liquidity, which is more important to them than loans;[1]

[1] It makes no intuitive sense nor is it substantiated empirically that poor people want to take on an extra debt burden. Several studies have shown that people at the bottom of the socioeconomic stratum have a higher propensity to defer purchases by saving than to go into debt to acquire something immediately. See Robinson, Marguerite S., "The Role of Savings in Local Financial Markets: The Indonesian Experience," GEMINI Working Paper No. 33, November 1992.

- Supplying locally raised capital that produces a more manageable cash flow size and a velocity that is more consistent with the loan patterns within the same market than do outside funds that may or may not have any relationship to the local timing or size of the need for loan capital;

- Lowering the average financial cost of capital, as compared with commercial rate funds from the money markets or near commercial funds from aid agencies;

- Meshing with historical patterns of saving for traditional events, which inspires creative marketing and savings product ideas, gives the further impression of an institution being part of the community, and provides a predictable base on which cash and portfolio management decisions can be made;

Aside from these benefits that accrue directly to the savings function and the overall management of the SFIs, voluntary savings mobilization also can strengthen an institution's credit function in the following ways:

- Acting as an excellent test of a client's capacity to repay on debt, meaning that SFI managers can confidently conclude that whatever a savings client has stowed away over some period of time is a good approximation of income left after regular monthly expenses — in other words, money that could be used to pay off a new debt commitment;

- Testing the propensity of a client to frequent the SFI, which will help the field officer establish rapport with clients, make vital character assessments, and develop bonds of trust;

- Acting as form of financial collateral to which the SFI could legally attach, in the event of delinquency.

True, an SFI first needs to prove it can lend and recoup money before it can gain the trust of the community to take people's money and pay out principal and interest. Yet savings also encourages better lending and allows for the cultivation of more trustworthy and better-known borrowers.

FID institutions that have begun voluntary savings programs have relied heavily on three major tools to attract community savings: projecting an image of safety; being convenient to the market; and offering competitive interest rates. Security generally is not a problem in most Indonesian villages, but professionalism by SFI staff and use of safes for cash portray acceptable images of safety. The semblance of safety also is achieved by maintaining financial strength and viability of the institutions. Either by locating close to the market or by actively canvassing the market for clients, FID SFIs with voluntary savings programs have lowered the cost to savers of putting funds in their institutions, which leads to higher effective yields for savings clients. In most cases, FID SFIs offer interest rates in line with other banks in the same market. Although BRI Unit Desa are not located at the village level, they have been enormously successful in attracting savings not only through projection of safety and competitive pricing, but by using a lottery system in which a ticket is given for each Rp 10,000 in deposits. As of March 1993 BRI Unit Desa had on deposit Rp 3.427 trillion in voluntary savings, which was 198 percent of total loans.

Most SFIs have released two major savings products to their clients, passbook savings and term deposits. Passbook accounts, with unlimited withdrawals and interest rates about 1 percent to 3 percent above average inflation for the last few years (meaning 11 percent to 13 percent in nominal terms), tend to reach poorer, less sophisticated borrowers who like to put small sums of money away on a regular (usually weekly) basis. Term deposit services reach up in the market and offer interest rates 5 to 8 percent above average inflation (18 to 20 percent nominally). The consulting team did, however, observe an urban SFI that was offering 24 percent on 12-month deposits.

Despite the freedom of unlimited withdrawals, most passbook customers keep money in accounts for six months to a year, taking it out on holidays or special family occasions. Term money's withdrawal restrictions could ease as yet unrealized SFI cash flow problems that might arise with passbook accounts.

The SFIs of East Java, West Sumatra, and South Kalimantan still have forced savings requirements. They usually demand 10 percent of the loan amount, which is collected before the first borrowing. Even with the relatively low opportunity cost of capital among poor clients, this practice represents a clear cost of credit. In fact, forced savings is a misnomer: it is a fee. Because several SFIs have not paid interest on these forced deposits and others have not paid back principal (which had already been assigned to reserves), the cost has been even more explicit to some SFI clients. Furthermore, there is no evidence that taking forced deposits either encourages better repayment or sufficiently covers delinquent loan amounts. Arrears are no better at SFIs that take such deposits (many have experienced worse performance than those who take voluntary deposits), and 10 percent of a loan amount in decapitalizing cash or even an interest equivalent account rarely equals the amount of a delinquent loan.

Recommendations

(1) Assuming adequate loan portfolio performance and management, institute a pilot voluntary savings scheme within six months of SFI start-up.

(2) Start offering 6- to 12-month term deposits and seasonal passbook accounts tied to traditional local events to maintain stability and predictability in cash management, and reach diverse market segments.

(3) Back up deposits at new institutions or institutions with newly implemented savings programs with a repayable, limited-term soft money reserve.

(4) Offer market but not excessive interest rates that yield real positive returns for savers and are competitive with other financial institutions in the same market.

(5) Apply sound and basic financial logic to interest rate setting, giving lower rates for more liquidity and shorter terms.

(6) Do not implement forced savings schemes, because they are unnecessary at best, misrepresentative of their true effects on client costs, and perhaps counterproductive.

FID MARKETS

Key Findings

- FID SFIs have **captured niche markets** and in most instances can still achieve adequate portfolio diversification and size through origination of small loans and collection of sufficient savings to be self-sustaining.

- In provinces such as West Java and Bali, where there are **vibrant industrial economic sectors** (clothing and shoe manufacturing, tourism, and the like), there are greater opportunities to diversify the loan portfolio with larger and more sophisticated borrowers and businesses, and the poorer borrowers not directly involved in these industries have access to wealthier clientele.

Analysis

FID SFIs generally serve individuals from farm-related sectors who are mostly in trade and simple light manufacturing. The SFIs not only have found markets previously ignored by formal financial institutions, but also have provided the service of financial intermediation between buyers and sellers. They have filled a void as a further catalyst to the rural economy of Indonesia by bringing people together in commerce who otherwise might not have found the opportunity to trade or who have found the costs of doing business with others (transportation to another village, high rates of interest for informal supplier credit) prohibitive.

Because they are financial institutions and not targeted credit projects, FID SFIs have been able to satisfy the liquidity needs of the low-income community This has meant providing both credit and savings instruments that respond directly to client needs. It also has led to the provision of credit for a broad range of enterprises that individuals may decide to enter based on their best estimate of the local market in which they live and work. In urban and peri-urban markets, where competition in the financial market is keener and clients are more savvy about formal banking, some SFIs have had the freedom and foresight to diversify their portfolios into consumer or household finance.

Undergirding this ability to concentrate on the lower socioeconomic strata is a series of diverse provincial microeconomies, especially on Java and Bali. With the strong agricultural sector and basically good infrastructure these provinces have, businesses have expanded into adjoining markets in other villages or moved to more lucrative or open markets.

Strong micro- and macroeconomic environments have direct impacts on small and microenterprises and, by association, on the SFIs that serve them. Indonesia has been fortunate to have generated impressive macroeconomic growth during the last 10 years. As a result, small and microenterprises have established linkages to larger industrial sectors, and rural incomes have increased, which in turn means that small business people have had increasingly better-off clients to whom they can sell. SFIs have provided liquidity or finance to clients able to identify new or expanding business opportunities.

Managers of better branches exhibited a deep understanding of the local microeconomy in which their SFIs were located. In Bandung, for example, a branch manager with more than 20 years of experience knew that his best customers and those who had shown the greatest capacity for growth were those attached to the local shoe-making industry. He had created innovative savings products and mobilization strategies to take advantage of the high number of workers who lived outside of the area but were employed by large local shoe factories.

Recommendations

(1) To guide SFI location choice and product mix, adopt a formalized subsector approach to determine the most vibrant microeconomic sectors in a given area and single out those that have the most potential to be integrated into the larger industrial economy.[2]

(2) Promote SFI development in established or growing industrial economies.

(3) Allow enough leeway in financial regulations to promote the design of products and services that serve specific niche markets.

[2] See Boomgard, James J., et. al., "A Subsector Approach to Small Enterprise Promotion and Research," GEMINI Working Paper No. 10, January 1991.

CHAPTER TWO

THE MACROECONOMIC ENVIRONMENT

MACROECONOMIC CONDITIONS

Key Findings

- **Stable and relatively low inflation** is probably the most important macroeconomic element that concerns FID institutions, because nominal interest rates can be held down and because it is easier to maintain a capital base in a low and stable inflationary climate.

Analysis

Indonesia has benefited a great deal from low inflationary pressures over recent years, with national figures for 1991 and 1992 of 9.52 percent and 9.9 percent respectively. Provincial figures vary somewhat, but Bali reported inflation rates approximately 33 percent higher than the national norm for a three-year period. Now inflation in Bali has returned to a stable position commensurate with the national figure.

Relatively low rates of inflation reduce the nominal interest rates being charged on credit and offered on deposits. And because nominally high rates of interest are seen as unfair to poor people, low inflation can help to keep interest rates down and quell discontent. However, the more universal and perhaps more important factor is that low and stable inflation enables balanced portfolio and cash management, lowers the need for financial institutions to keep cash on hand, encourages the holding of financial assets (encourages savings behavior), and limits capital base erosion.

Recommendations

(1) Maintain interest rate liberalization and ensure open foreign exchange; these policies influence inflation most directly.

POPULATION DENSITY

Key Findings

- **Population density is an advantage** to the FID SFIs, but it is not an absolute necessity to operate a cost-effective financial institution.

Analysis

Population densities vary across provinces. Many branches have been established in areas with high population densities. In fact, some SFI sites on Java have densities of 600 to 800 people per square kilometer. Many other branches have been successfully established in areas with much lower population densities.

One criterion developed by the FID technical assistance team for establishment of new SFIs was a minimum population density of 60 people per square kilometer, which works out to approximately 1,200 to 1,400 customers per branch, based on a representation area of a 20-kilometer radius. This density should give sufficient scope for the SFI branches to achieve sustainable status while at the same time limiting the growth potential of the branch to a manageable level. Yet it would be incorrect to concentrate on population density as the key determinant of SFI location and viability. In fact there is a three-way framework that better captures the true dynamics of the density issue: density, infrastructure, and diversity.

Communication and transportation infrastructure are most important. In many of the outer island areas of Indonesia, electricity is not always available and telephone service to branches is rare. The road network is still being developed in several outlying areas, making access by borrowers and savers alike very difficult, particularly in the wet season when torrential rains quickly turn dirt roads into impassable quagmires for motorcycles, which are often the only form of transportation available to the SFI branches or their clients.

The importance of diversity in the local economy was described in Chapter One. Diversity is measured both by linkages to other sectors and by the number of people in a given area devoted to a specific sector. Thus dense populations do not necessarily yield sufficiently vibrant markets. Lack of infrastructure may make cost-effectively reaching even densely populated areas prohibitively expensive. And single-industry economies or ones not linked to other sectors, regardless of density, may be impossible to serve on a financially self-sustaining basis.

Because dense populations are demographic magnets, the greatest proliferation of SFIs, BPRs, and other similar institutions is found on Java and Bali. However, market oversaturation of SFIs can be a problem. In Bali, for example, only 10 of 1,200 customers at one LPD are borrowers at other banks, but at another LPD less than a 15-minute drive away the market saturation point has probably been nearly reached already in three years of operation, loans per family having reached 1.6. Both branches are currently very profitable and have excellent portfolio quality. Yet the second branch already finds itself in a money velocity problem, because there are fewer good clients to whom the LPD can lend. Thus there has been pressure to make larger single loans and to review seriously clients of a higher risk (those residing outside the immediate market radius, engaging in more marginal businesses, seeking loans for nonproductive purposes) than would otherwise be considered. The first LPD serves an area of about 12 square kilometers. Within this area there are about 5,000 people, or 417 people per square kilometer. The second LPD has a smaller potential market size of 3,000 people, but the inhabitants occupy an area of nine square kilometers, yielding a population density of approximately 333 people per square kilometer.

This study did not allow for broader or more in-depth comparative analysis. However, population densities of the two LPDs are both well above the minimum, and both operate amidst excellent infrastructure. Holding all else equal (management capabilities, staff proficiency, and the like), the second branch is apt to face some problems because its market lacks sufficient diversity (gold and silversmithing predominate in the area) and has a limited population size. In addition, the branch cannot expand outside its current geographic area, because other established LPDs and BPRs are at every border.

Those who advocate the establishment of BPR units in every *kecamatan* of a province, for whatever reason, regardless of population density and other criteria, need to seriously consider the long-term economic viability of the SFI branches. A minimum base population is required; the size of the base population needed for economic viability of an SFI branch is directly related to the given capital base of the branch. As the capital base of the branch increases, either through outside capitalization or generation of retained earnings, the population base and market economic diversity needed to sustain economic viability must increase. Table 4 proposes a framework for making decisions about SFI location.

TABLE 4
DECISION-MAKING MATRIX FOR SFI LOCATION

Issue	Illustrative Questions
Density	• What is the geographic size of the area to be covered by the SFI? • How many families, heads of households, and potentially economically active people are there in the designated area? • Are there periodic influxes of people who do not live within the designated area, but who come through for work or market trading?
Infrastructure	• What is the condition of the roads within and surrounding the service area? • Are communication and electrical service to the area reliable? • Is the area particularly mountainous or susceptible to inclement weather?
Diversity	• Is there a factory or other major industrial employer in or near the service area? • Is the local economy diversified beyond agriculture and agriculture-dependent businesses? • Do any linkages exist through subcontracting or other arrangements between small businesses and larger counterparts?

Recommendations

(1) Use the density-infrastructure-diversity matrix to decide on SFI location and viability.

(2) Quantify the costs to the SFI and to the clients of outreach, including transportation and communication and accounting for client costs of travel and time away from the business.

MONETARY POLICIES AND EXTERNALITIES

Key Findings

- **Tight monetary policy, a recession, and drought** in the early 1990s indirectly constricted the rural credit market and also led to poor lending decisions, especially for BRI Unit Desa, which were forced to lend to large customers who had not paid off loans to the larger BRI divisions.

Analysis

In 1990 the Ministry of Finance of the Government of Indonesia authorized two hikes in the prime lending rate. This tight monetary policy did not directly affect the lending operations of the SFIs. Because they did not and do not raise their capital on the open markets, these Government of Indonesia policies, designed principally for the control of the primary banks, did not directly affect the SFIs. However, what happened among the BRI Unit Desa should serve as a lesson and send a clear warning.

BRI Unit Desa were apparently forced into poor lending decisions — lending to large customers of BRI corporate banking branches to cover overdue interest payments on the customers' loans from BRI.[3] These loans for refinancing in turn have become hard-core delinquencies on the books of the Unit Desa and will shortly be written off.

Perhaps part of the blame for the decline in portfolio performance can also be attributed to BRI Unit Desa staff's lack of experience and expertise to handle the more sophisticated lending procedures required for larger loan processing. The staff chose to lend large amounts to new, first-time borrowers who had no proven loan repayment capability, rather than to proven borrowers.

This experience teaches that SFIs should be organizationally shielded from policies, procedures, and operations for which they are not suited. They do not have the staff expertise, the capital base, or the market knowledge to handle bad hand-me-downs (or even good overflow customers) from their large corporate lending colleagues.

Rural areas were hit first by severe drought, which was followed by extensive flooding the next season. Multiple crop failure lowered income and repayment capacity among SFI clients. Dips in 1992 SFI loan disbursement and repayment performance across all provinces, especially Central Java, reflect this reality. In spite of the commendable diversity achieved in the Indonesian macroeconomy, many people in the country and the institutions that serve them remain vulnerable to changes in the agricultural sector, which still directly or indirectly supports so many in the lower socioeconomic strata.

What discrete effect the recession has had on lending operations in the provinces is difficult to determine, although some of the blame for the poorer 1992 performance must be fixed on the recession. Economic activity at the low end of the scale is vulnerable and not self-contained. Rather, shocks that ripple through the national or regional economy affect poorer people, sometimes disproportionately.

Recommendations

(1) Maintain stable financial policies, particularly those directly affecting inflation, such as foreign exchange rates, prime interest rates, and government expenditure.

(2) Separate policies, procedures, and functions of corporate lending from micro- and small enterprise finance.

(3) Look for lag effects of changes in macroeconomic policies and conditions that may manifest themselves only in lower levels of the economy later in the adjustment period.

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[3] The practice of lending to cover interest owed on previous loans is one reason that monetary policy was tightened in the first place.

CHAPTER THREE

MANAGEMENT AND INSTITUTIONAL STRUCTURE

INSTITUTIONAL LOCATION

Key Findings

- **Proximity to the market**, through Unit Desa or *kecamatan* level banks with village posts (*post desa*) is imperative to the outreach, savings mobilization, credit review, disbursement, and collection functions.[4]

Analysis

Several advantages derive from locating an SFI near the market it serves. First, a nearby location enables the SFIs to hire local people and collect information about the local market through them, thereby becoming a part of the community's daily life. Second, locating near the target market lowers the cost of outreach and client monitoring at the SFI and lowers the costs to clients of reaching the branch. Third, having a physical presence in the area served conveys an important sense of community ownership and permanence, not projected by distant or occasional contact.

Branch proximity helps determine staffing levels necessary to cover a given market area and number of people. Branch location also can influence the type of client reached. One Bandung SFI located in a peri-urban and densely populated area maintains a ratio of about 200 clients to 1 field officer. However, in practice, staff see only 100 clients per month, concentrating on new borrowers and those in arrears. Among 19 people on staff in a Bali LPD, 8 do nothing but collect savings from clients within a three-kilometer radius from the branch. As of April 1993, the branch had 3,102 passbook savings accounts and 241 term accounts, necessitating adding 16 people to the number of staff that had served the branch since 1986. FID SFIs maintain a range from 60 to 225 clients per employee, which varies according to population density, geographic coverage, and type of savings mobilization — active canvassing of markets or more dependence on interest- and term-based incentives.

The client-staff mix decision also is influenced by the presence and location of subordinate branches. Many SFIs are located at the *kecamatan* level. However, if the main branch is not situated in the village, as in Bali and West Sumatra, then there are almost always post *desa* set up in a number of villages in the *kecamatan*. The vast majority of the post *desa* are staffed by regular full-time SFI employees. In East Java or where market potential is less evident, they are staffed on an intermittent but regular basis with agents who work under a commission or incentive scheme.

This model of a central branch with satellites seems to be very useful. It limits fixed costs of reaching economically viable but potentially more isolated villages. The approach allows for an element of experimentation at minimal costs in untested markets. Using agents not only limits costs, but also

[4] "*Post desa*" is a composite of English (post) and Bahasa Indonesian (*desa* or village) but is treated here as an Indonesian term for SFI representative offices at the village level.

allows testing of potential new full-time staff, providing full employment to people who would otherwise be underemployed and generating greater zeal for debt collection and savings mobilization through the commissions and incentives. Several FID SFIs use stalls at village markets or underutilized office space as low cost and proximate centers for their post *desa*, whether they are open every day or only on certain days.

Evidence of how variations in market proximity can make a difference in the type of client served can be found in a comparison of FID SFIs with BRI Unit Desa. Even though they are called Unit Desa, the BRI branches are actually situated at the *kecamatan* level. FID SFIs are either located in villages or have established post *desa* really at the village level, as satellites to *kecamatan* central offices. BRI still serves a relatively poor but certainly more affluent client than most of the FID SFIs, based on comparisons of average loan and deposit sizes. FID SFI average loan size is $130 ($92, if West Java is excluded), whereas BRI averages $500. Average savings accounts at FID SFIs are Rp 67,172 ($32). At BRI the average is Rp 335,980 ($162).

Recommendations

(1) To achieve portfolio diversity, limit costs of outreach, limit client transaction costs, and facilitate the servicing of lower socioeconomic strata, establish an SFI at a level subordinate to the district, and set up part-time and permanent village posts, depending on the economic viability of a village area.

(2) Quantify the tradeoff between setting up an operation at various distances from the target market, the radius that needs to be covered for branch financial viability, and client contact design (mobilization, monitoring, rapport building) to establish fieldworker-to-client ratios for savings and credit services.

PROFESSIONALISM

Key Findings

- **Professional and experienced management** of a branch, at whatever level (village, subdistrict, or district), **makes an absolute difference** in branch performance, as seen by comparisons of institutions in the FID project and others, such as BRI and Bank Sampoerna.

- **Management incentives** tied to overall branch profitability and growth have played an important role in distinguishing the good from the bad SFIs.

Analysis

Branch performance correlates positively to experience and management motivation, but not necessarily to higher levels of education. Because underemployment is a national problem, lawyers and college honor graduates frequently end up running SFIs. BRI has recently stipulated that Unit Desa management and staff must have university degrees — a needlessly high standard according to several people in the bank. In fact, the performance of BRI Unit Desa and solid SFIs led by college-educated management was not noticeably better than that of their less-educated counterparts. What emerged as a clear indicator of good performance was the amount of experience a given branch manager had in the particular market and business of small enterprise finance or banking.

It also was clear that performance incentive schemes based on blended rates of loan repayment, loan disbursement, and savings mobilization encouraged management to do a better job. SFI branch managers are urged to participate in setting branch performance targets and to encourage their staff to meet the targets. Yet BRI has gone a step further, regarding Unit Desa managers as on the fast track for promotion to positions in the *cabang* bank or larger Unit Desa, particularly if the managers can achieve their performance targets. In contrast, SFI managers achieve the pinnacle of their career aspirations when they become branch managers. This pattern does not seem to cause undue concern among SFI staff, who have been given no promises regarding promotion prospects, but it does ignore a potentially more powerful incentive for profitable behavior. The differences in the quality of management and drive to succeed were clear by the level of sophistication at which more experienced SFI managers and BRI Unit Desa managers as a whole could discuss cash management techniques, portfolio management, creative financial product design, trend-based forecasting, and other more complex issues.

The other side of this phenomenon is starting to emerge among the new BPRs. New owners of BPRs are often not bankers, and they are required only to hire a manager with no less than one year of banking experience. Exact data were not available, but it seems fairly clear from interviews with several responsible officials that many BPRs are on the brink of failure, in part because of lack of sufficient management expertise.

Recommendations

(1) Develop national employment standards for SFI managers, based on an excellent high school record with good numeracy and literacy, as well as at least five years of relevant banking experience.

(2) Institute performance incentives, succession tracks, and coordinated training for all staff, integrally tied to branch and personal performance for those variables over which the employee has reasonable control — for example, rate of savings mobilization for field staff.

(3) Develop national standards and accredited courses in management, accountancy, financial management, credit analysis, and other relevant disciplines that would reliably measure management potential and capability.

CHAPTER FOUR

SUSTAINABILITY AND MIS

PERFORMANCE AND PROFITABILITY

Key Findings

- Having accumulated 20 years of bad debts in many of the previous systems and having just begun to write these off, some SFIs still have **poor asset quality, and others have set aside paltry and inadequate loan loss provisions.**

- **High effective interest rates, booking of unrealized interest revenues, and under-reporting of true costs** have given a significant cushion even to SFIs with poor repayment performance — meaning that pressure to lower interest rates for either economic or social reasons will jeopardize the viability of the poorly performing branches.

- In many cases **interest rate structures for credit** have yielded misleadingly high profits.

Analysis

Many SFIs have begun a process of cleaning up their balance sheets by writing off uncollectible loans and setting aside financially prudent loan loss ratios. However, they are often dealing with accumulated bad debt from previous programs in the same institutions, which mounted long before the FID project intervened. The project's introduction of financial skills, policies, and systems has provided an incentive for and mode of improving the management reporting function.

Yet, barriers still hinder full reform and compliance. Provincial governments have incentives for profit maximization through their ownership of many SFIs. However, they are similarly motivated to show profits as retained earnings or as community contributions, rather than write down bad debts or set aside adequate loan loss reserves.

Given that branch equity is in the hands of these same owners and not more widely distributed and subject to broader securities regulation, SFI equity is effectively cost-free. Chapter One of this report dealt with the lack of proper accounting and payment of interest on savings, especially forced savings.

Lack of knowledge about accounting principles and inefficient management information systems led to poor aging procedures. SFIs whose loan loss provisions are mere fractions of the percentage of the portfolios in delinquency are common. Branch managers commented to the consulting team that they had decided on the loan loss provision not by sound financial calculation, but by consensus among local leaders about what would probably never be collected. Faith in the community's ability to encourage repayment outweighed the impulse to follow proper accounting procedures.

Among SFIs charging interest on a flat rate, interest is often accrued to the income statement and the balance sheet prematurely. This procedure incorrectly bolsters current income, thus improving the picture of profitability. It also is dangerous because the process may very well count income that is never paid, if the borrower defaults on part of the loan later in the repayment term.

Loans from government agencies, which have been a source of capital for some SFIs, are often rolled over, and only the interest is paid. The Kredit Usaha Kecil (KUK) loans from Indonesia's large banks, about which there will be more later in this report, are particularly susceptible to this practice. The rollover practice allows for single infusions of capital to be counted as a primary bank's yearly contribution, even though they have made only one loan. Outside contributions of capital also frequently have led to overcapitalization of branches, creating incentives to maintain unrealizable assets on the books, especially when branches cannot find enough bona fide clients to lend to. Because of overcapitalization, some branches were not achieving good velocity. Velocity of lending is very important in the early stages of financial institution development, if the institution is to serve the low-income market with the small loans needed and achieve financial self-sustainability.

Effective yearly interest rates ranged from 42 to 80 percent, mainly depending on whether there were forced savings or other fees, interest rate computation on fixed or declining balances, and length of terms. The rates may seem high, but lowering them would be ill-advised for three main reasons. First, although SFIs are profitable individually, these profits tend to be overstated, for the reasons stated above. Thus, mandating lower interest rates could seriously jeopardize the financial health of some branches. Second, despite their knowledge, experience, and presence in the market, most SFI managers still consider the poorest borrowers an extreme risk. Whether these managers would continue to lend to the poorest if interest rate ceilings were imposed is doubtful. Third, servicing many small loans is an expensive undertaking, even for the most efficient SFIs. It would be unrealistic to expect these branches to cover all of their financial, operational, and overhead expenses at much lower interest rates.

Recommendations

(1) Rationalize incentives for BPDs and provincial government owners of SFIs by broadening equity ownership.

(2) Continue to support the upgrading of financial management reporting procedures and policies.

(3) Reduce capital requirements and limit outside capital infusions to encourage more turnover of capital and more prudent financial accounting.

(4) Maintain a liberal interest rate regime in which SFIs can price to the market, so that successful operations spur competition (as in Bali, for example), thereby lowering market interest rates.

PROGRESS IN MIS

Key Findings

- Where the **new FID-developed management information system (MIS)** has been implemented, the capacity to manage effectively has been greatly enhanced and brought in line with changing BI standards.
- An **MIS for monitoring and evaluation** by supervisory bodies has been introduced; however, **forecasting** programs for SFI management have not been effectively implemented.

Analysis

The technical assistance team developed a computerized MIS to assist the BPDs in monitoring individual SFI branches and consolidated provincial performance, but this system was reluctantly abandoned at the end of 1992 when BI introduced new legislation requiring SFIs to file reports in a somewhat different format. No formal legal regulations regarding reporting of SFI branch performance existed previously.

The BI MIS, which is referred to as the CAMEL rating system (for capital adequacy, asset quality, management performance, earnings, and liquidity) has four classifications:

1. Sehat — Sound
2. Cukup Sehat — Fairly Sound
3. Kurang Sehat — Poor
4. Tidak Sehat — Unsound

Classifications 1 and 2 are acceptable under the BI system. This system contrasts with the previous system used by branches in all provinces until the end of 1992, which had five classifications:

Class 1 — Baik (Sehat)
Class 2 — Sehat (1 ratio unsatisfactory)
Class 3 — Cukup Sehat (2 ratios unsatisfactory)
Class 4 — Kurang Sehat (3 ratios unsatisfactory)
Class 5 — Tidak Sehat (4-5 ratios unsatisfactory)

Observations in Central Java by the consulting team revealed that many branches previously classified as 1 or 2 under the old system barely made level 3 or 4 under the BI system. Some of the discrepancy derived from lack of accounting and financial reporting skills and lack of diligence. However, some differences could be blamed on inappropriate BI measures.

Here are some examples of where the CAMEL system designed for large primary banks will require modification for application to the SFIs and BPRs. To achieve the top rating in the current CAMEL for capital adequacy, a bank must achieve 8 percent. However, the system-wide average for FID SFIs is 27.2 percent, with the lowest at 14.8 percent. Given infusions of cheap capital from outside sources and very high reported and actual profits, most SFIs are currently overcapitalized. So the current CAMEL performance rating is not meaningful and hides other problems. BI inspectors ask bank managers 250 questions at each audit. This may be too many for the primary banks; it is extremely excessive for SFIs. In the present CAMEL measure of liquidity, one of the applied ratios includes "call money."[5] SFIs do not use call money.

BI has had time to review the one-yardstick approach for all banks (including BPRs). In discussions with the consulting team, BI head office staff revealed that new regulations are being prepared for a separate CAMEL yardstick especially for the BPRs. Some ratios will be changed, and the 250 questions on management will be reduced to 125. However, determining the most appropriate measures of financial and institutional viability for SFIs will take time. One place policy makers may want to begin

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[5] Call money is debt that can be claimed prior to maturity. It is often used in the Indonesian context as a mode of interbank financing.

to look is the FID technical assistance team's report on this subject, which takes a constructive look at BI's CAMEL and suggests some alternative criteria for the SFIs.[6]

SFIs were to commence reporting under the original CAMEL system in January 1993, but BPDs have experienced a number of problems with computer hardware and supply of incomplete data from the SFIs for the new MIS format. Further confusion is likely because of the introduction of additional regulations for the amended CAMEL system.

By and large, the MIS of most SFIs was a hand-recorded operation, but a number of SFI branches recently progressed to the use of computers, which have been purchased out of the branches' retained profits. This progress is found mainly in the more experienced SFI branches in older FID provinces.

The FID technical assistance team has introduced modified balance sheet and income statement forms, as well as a monthly activity report, which have greatly enhanced SFI branch reporting efficiency, accuracy, and understanding. Copies of these appear in Annex B. The activity report is a particularly useful tool in quickly assessing both trend and static data about portfolio performance, branch profitability, client demographics, and administrative performance. With the exception of the last data, all of this information is extracted from the client application forms and the routine loan and savings transaction records.

Forecasting based on the current MIS has been introduced as a concept, and software has been provided, although few SFIs have used it. The reasons for underutilization of the tool stem from the loop-hole in management incentives and lack of financial management skills, both mentioned earlier in this report. BRI has developed a forecasting model, again based on the information already in the MIS, which is an integral part of management performance measurement. A copy of the model appears in Annex C.

Recommendations

(1) Research and then modify the ratios and management performance questions in the CAMEL, adopting a different set of criteria under the same basic headings.

(2) Rationalize grading systems in the transition from provincial to national ratings.

(3) Introduce a computerized accounting system that is compatible with manual recording at the point where hand-tabulated information is delayed too long for effective reaction by management or data integrity is compromised.

[6] See Development Alternatives, Inc., "The Criteria for Measuring the Soundness and Performance of Small Financial Institutions," Jakarta, Indonesia, January 1993.

CHAPTER FIVE

POLICY AND REGULATORY ISSUES

INFLUENCE AT THE NATIONAL LEVEL

Key Findings

- The Government of Indonesia, in particular BI, has been **notably accommodating and responsive to FID SFIs** and other similar institutions, accepting and strengthening a fait accompli, rather than reinventing or destroying the system.

- Indonesia has effectively allowed the **development of a secondary banking system since 1970** — de facto prior to 1988 and de jure with the enactment of Pakto 27 in 1988.

Analysis

Aside from indigenously generated efforts to promote rural development, early experimentation began under USAID's Provincial Development Project of the early 1980s. The project concentrated on strengthening provincial development and planning capabilities and included provisions for developing new and strengthening existing rural credit institutions. There were few guidelines from the central government on establishment of credit systems, and as a result many systems were tried with mixed results. In general, early attempts on the outer islands failed, mainly because of the absence of a clearly defined system and failure to follow the system that was provided.

Greater success was achieved in Central Java, where an existing *kecamatan* system was already in place and the Badan Kredit Kecamatan (BKK) branches began to flourish. A much-improved system was forged over time that became the model on which systems for the outer islands were based. However, the provincial governments still had the final say on what system they wanted, so the offshoots finally agreed on bore no strong resemblance to the parent system, and each province elected to name and manage its offspring differently from the parent.

The Government of Indonesia made the first major changes in 1983, with legislation freeing deposit and lending rates, eliminating credit ceilings, and reducing the number of programs qualifying for central bank liquidity credits. This did not have any real bearing on the SFIs, which were permitted to proliferate virtually unhindered. Perhaps the reason they were left alone was that they were not regarded as banks, because they were not licensed and therefore not permitted to mobilize voluntary savings. The only exceptions were the Bank Karya Produksi Desa (BKPD) branches in West Java, which were established under previous banking law that recognized them as banks and permitted their mobilization of voluntary savings.

It was not until 1988 when Pakto 27 was introduced that any formal attempt was made to recognize the existence of the SFIs. Under Pakto 27, the SFIs were permitted to mobilize voluntary savings and apply for registration as BPRs. This was the first step to control the proliferation of SFIs. Before Pakto 27 there were 5,345 BKDs under BRI supervision and 383 Bank Pasar (roughly equivalent to BPRs) under BI supervision. Since Pakto 27, BI has recognized 1,963 LDKPs (earlier versions of SFIs), including 217 BKPDs in West Java, 202 BKK BPRs in Central Java, and 77 LPN BPRs in Bali, all under BI supervision. Furthermore, 1,663 SFIs are under provincial BPD supervision, and 896 independent BPRs are supervised by BI.

In 1989 BI introduced a bank rating system to monitor the performance of the BPRs. As a direct result of this legislation, the FID technical assistance team was eventually able to influence all of the FID provinces to convert to a uniform accounting and reporting system.

The Banking Act (Law No. 7) introduced on March 25, 1992, formally required the SFIs to convert to BPR status by October 30, 1997. Under the act, the BPRs are also required to maintain an acceptable level of performance and to operate in a prudent and efficient manner. Annex D is a copy of the Banking Act. A subsequent regulation regarding introduction of a minimal capital base of Rp50 million for new BPRs was introduced on February 26, 1993 (see Annex E). This regulation also restricts the operation of the BPR to within the boundaries of the *kecamatan* in which it is based, which may or may not be appropriate depending upon density, infrastructure, and diversity of the market.

Policy directives have tended to strengthen the market-oriented approach to economic development. The significant exception is perhaps PAKJAN (Decree No. 22/81 KEP/DIR), which requires major banks to place 20 percent of their loans (KUK funds) with small enterprises. This is an ongoing annual commitment, and it is obvious that many banks are having difficulty meeting this condition. However, it is unclear whether this is loan capital base or total capital, which is meant to cover such items as land, buildings, machinery, and equipment, as well as working capital for wages and other start-up operating costs.

Bank Exim has elected to lend KUK funds to SFIs. However, responsibility for repayment of the loan will likely fall to the BPDs as depositories for excess liquidity because in most instances the infusions lead to overcapitalized and overliquid SFIs that cannot turnover the added funds in their portfolios. The solution for BPDs will likely be to roll the debt over each year indefinitely. The end result may be that the SFIs get a substantial one-time injection of KUK funds, which may well discourage the mobilization of voluntary savings. If other banks follow the Bank Exim example, then the SFIs and BPRs could be forced or improperly induced to make larger loans, which they are incapable of handling.

Recommendations

(1) Amend PAKJAN to permit in-kind contributions or seconding of staff to BPRs and SFIs through the BPDs to satisfy the branches' contribution to small enterprise development (this approach would control overcapitalization, provide exciting opportunities for promising junior staff, fill SFI voids in training or management skills, and facilitate an exchange in which major banks could better learn about the low-income market).

(2) Restrict outside capital infusions to 5 percent of current capital up to Rp 200 million to be released in quarterly tranches over a one-year period, subject to satisfactory branch performance over the previous quarters, to encourage branches to mobilize term deposits and savings but restrict lending to their capacity to perform at an acceptable level.

(3) Explore the possibility of having provincial governments establish limited escrow accounts with part of the initial outside capital to motivate the new branches to initiate savings mobilization and protect depositors' money.

INFLUENCE AT THE PROVINCIAL LEVEL

Key Findings

- The provinces that have the best run and most market-responsive institutions are those where local officials, especially from the BPDs, have taken a **keen and supportive interest in the FID institutions**.

- Where government **ownership and supervision have been meddlesome**, FID SFIs have performed below institutions in the private sector and those with more autonomy to establish their own credit and savings policies.

- In some provinces, most notably in East Java, government has issued regulations that, in effect, **micromanage the branches**, limiting their ability to meet changing market and management needs.

Analysis

In Central Java and Bali, in particular, local officials both traditional and governmental have been notably supportive of SFIs. They have encouraged and financed regulation, training, infrastructure development, and communication among SFIs and BPDs. They have included the lending institutions in village development plans, but have not burdened the institutions with tasks outside the institutions' skills or purpose. In short, they have allowed SFIs to meet the financial needs of the market, and provided the environment in which SFIs could flourish.

Some provincial government officials have impinged on technical areas of responsibility in many of the provinces. The heavy involvement is perhaps a holdover from earlier days when provincial governments were very much involved in the establishment of the SFIs. All of the credit systems were established with provincial government funds obtained from Government of Indonesia budget allocations (and with USAID assistance), and provincial government officials were initially responsible for disbursement of budget allocations.

Situations such as the one in West Java — where local government sets interest rate ranges every six months or so, based on the regulations that have always governed the BKPD system — are common. In East Java, there was no central government legislation governing the operation of the KURK system when the initial village branches were introduced. These branches were staffed by part-time workers, and perhaps it was thought that they needed to have rigid instructions to ensure that the guidelines would be followed. The option taken by the provincial government at that time was to produce a credit handbook, issued with an accompanying document signed by the governor, which set all of the credit and management policies of the branches. The booklet was very specific, even including details of maximum and minimum loan amounts. These limits have since become meaningless, and are a hindrance rather than an aid to the SFIs.

As the SFIs are converted to BPRs and more move to self-sustainability, the provincial governments' direct involvement should decrease, leaving the day-to-day supervision of the branches to BPD staff. Provincial government officials should only be involved in policy decisions and in providing an enabling atmosphere. This level and nature of assistance is particularly important for government-owned and -run institutions, where the incentives and responsibilities of ownership, supervision, and support often blur and cause inefficient overlap.

Recommendations

(1) Give the Banking Act (Law No. 7) precedence over provincial law to encourage wider standardization, widen BPR ownership, and upgrade SFI skills and performance.

(2) Amend or repeal intrusive provincial or local government legislation that mandates technical involvement by government or that undermines positive national legislation.

CHAPTER SIX

NONFINANCIAL SYSTEM-LEVEL FUNCTIONS

SUPERVISION

Key Findings

- Except for Central Java and West Sumatra, **the lines of reporting for the SFIs are too centralized** and do not make enough use of the BPD branches to carry out routine daily and monthly supervisory tasks.

- In some cases, Bali and West Java in particular, there are **multiple and overlapping bodies claiming responsibility for supervision**, creating inefficiencies and reverse economies of scale and no better supervisory diligence.

- By its own admission, **BI does not have the human resource capacity, either in terms of numbers or competency, to monitor** even the current number of BPRs adequately , much less the additional ones expected to form over the next 4.5 years.

- **Costs of training and supervision are heavily subsidized** by provincial and district governments, and subsidies do not constitute a stainable solution to an important component of the system.

Analysis

Under the Banking Act (Law No. 7) BI is responsible for the development and supervision of banks, including BPR branches. The act draws a fine distinction between licensed banks and nonbank institutions.[7] Nonbank institutions shall be granted the status of Smallholder Credit Banks (BPRs) by fulfilling the procedures stipulated in the Banking Act.

The BI Head Office has delegated the responsibility of direct supervision of the BPRs to branch offices. Additional BI branches will be established if provincial governments wish to expand the number of licensed BPRs currently under their ownership.

Supervision efficiency has been impaired in many provinces by provincial and district government officials becoming involved in technical areas of responsibility rather than establishing policy guidelines and adopting a supportive role for the BPDs, which have the responsibility for day-to-day technical supervision. Part of the problem centers around BPD's excessively centralized management structure. BPD bears responsibility for hiring and firing of SFI staff and controls the financial purse strings for everything from purchases of equipment and training programs using provincial budget funds down to the level of staff salaries and bad debt provision and write-off approval.

[7] Refer to Article 58 of The Banking System (Law No. 7) found in Annex D.

To avoid any possible overlap of perceived responsibility by provincial and district government officials, clear lines of responsibility need to be drawn as to who is responsible for the provision of day-to-day technical supervision of the SFIs. The provincial systems consist of many individual branches, and the performance of these individual branches varies a great deal. Monitoring aggregate performance gives a global picture, which is useful to an overview, but there is little point in monitoring aggregate performance unless the branches are all well managed and supervised.

The complete supervision process should consist of three components:

- Clinical analysis;
- Treatment; and
- Post mortem analysis.

The clinical analysis should be based on the early warning CAMEL system, which classifies branches under four basic groups mentioned earlier: Sehat (Sound), Cukup Sehat (Fairly Sound), Kurang Sehat (Poor) and Tidak Sehat (Unsound). These data are best collected through an intermittent, but diligent, auditing process. In short, BPD personnel would carefully review financial reports, check compliance with internal cash-handling procedures, determine the timeliness and accuracy of reporting, and question management on any discrepancies or problems.

After analysis of the data, a clear picture should emerge as to which branches need attention to reverse deteriorating trends. The treatment stage should include prescriptions for actions needed to rectify specific problems such as worsening arrears and shrinking ratios for capital adequacy, asset quality, earnings, or liquidity.

The post mortem function comes in to play when the branch has collapsed and a clean-up operation is required. The appropriate BI branch and BPD would carry out valuation and disposition of assets, retrenchment of management, settlement with depositors, and determine takeover or liquidation strategies.

The revised CAMEL system will enable clinical analysis by BI, but this is likely to be passive analysis, given the sheer volume of data to be processed and the limited number of staff available to undertake the task. Unless a way can be found to further delegate responsibility for clinical analysis and treatment, the only service actually provided by BI branches to the BPRs likely will be a post mortem service. BI officials interviewed for this report indicated that ideal ratios for properly covering all three responsibilities are 30:1 for SFIs and 10-15:1 for BPRs. The higher ratio for SFIs recognizes the role and ownership by the BPDs.

To date, the supervisory role has fallen on the BPDs, but there appears to be a reluctance for the supervision facilities to grow at the same rate of growth as the SFIs. This situation can only be expected to worsen as more branches are established and the work load on supervisors increases. In effect, supervision of day-to-day operations of the SFI branches is provided by the BPDs, but the ratio of BPD supervisors to the number of branches supervised, as well as the ratio of supervisors to SFI branch staff numbers, is still too low, particularly in the newer branches where SFI staff and borrowers are relatively inexperienced and deteriorating trends can quickly develop. In addition, BPD branch staff are often not fully committed to the supervision process.

Part of the apparent reluctance to use more supervisors may stem from the substantial additional costs for the BPDs. Details of supervision costs for all provinces were not available, but figures for Central Java, where there are 510 SFIs, were Rp260 million per year.

Similar inadequacies in BI's supervision of the BPRs became apparent during discussions with Bank Indonesia Bali branch staff, and in conversations with BI headquarters officials. At this stage, they are responsible for the supervision of 164 licensed BPRs, and indicated that it takes two people from five to seven days to complete audit functions. With existing staff numbers they can handle only three audit inspections per month. This means that branches could only be audited once every 4.5 years. This calculation does not take into account the 650 existing LPDs that will be converted to BPR status over the next 4.5 years or the additional 655 branches that are likely to be developed in the future to meet the provincial government goal of one branch in each village. Furthermore, LPD branch staff numbers have more than doubled to 2,967 during the past three years.

BRI has effectively decentralized supervision of its BRI Unit Desa by making generous use of its branch network. Unit Desa are supervised three times a week by branch personnel. They review the correctness of reports, suggest improvements based on key indicators, and, for serious arrears problems, go into the field to help collect bad loans. Annex F provides a diagram of the SFI supervision hierarchy.

Recommendations

(1) License the BPDs to supervise and draw the lines of responsibility for supervision of the SFIs so that they lead to direct BPD oversight of organizational and staffing issues, while maintaining the overall responsibility for the soundness of the national banking sector in the hands of BI.

(2) Continue positive responses to SFIs by working to strengthen BI branches and BPDs to facilitate devolution of supervisory and monitoring responsibilities to those best positioned to handle them.

(3) Through a participative approach, involving all levels of government, enact legislation that sets national regulations and standards but places enforcement responsibility closer to the BPD and SFI levels.

(4) Encourage BPDs to consider recruiting seasoned SFI branch managers as BPD branch supervisors to take advantage of their wealth of experience, and their knowledge of the local market, and to offer opportunity for succession where none now exists.

(5) Initiate public and private partnerships in conjunction with accreditation in professional accountancy to bolster BI and BPD staff levels and competency in financial management accounting and auditing.

(6) Second private bank staff to BPRs and SFIs to raise levels of professionalism and ease temporary skill and manpower deficiencies.

(7) Decentralize the MIS for monitoring and evaluation by the BPDs to the BPD branches to speed up data input, evaluation, and reaction.

(8) Considering that SFIs respond better to advice and guidance from experienced officers from large and successful financial institutions, such as the more mature SFIs and BPDs and the BRI system, place senior experienced staff in supervisory positions, increasing the sophistication of their training and remunerating them accordingly.

(9) Charge a percentage of profit rather than merely allocating to the BPDs a proportion of the total cost of supervision, to encourage BPDs to take active roles in provision of effective supervision facilities. If the branches are profitable, then BPD will recoup costs for provision of supervision services and may even make a small profit, depending on the percentage set for the service (10 percent would be appropriate).

TRAINING

Key Findings

- West Sumatra, Central Java, and West Java have built **training facilities with little planning** as to how they may be used cost-effectively, thus leading to their underutilization.
- At some provincial levels, namely in West Java, Central Java, and Bali, there has been a **standardization and level of credibility given to training and skill.** However, there is no national training program for BPRs, although the FID project, BI, the BPDs, and numerous other bodies have offered some training.

Analysis

SFI training centers have been constructed in three FID provinces (West Sumatra, Central Java, and East Java). In the other four FID provinces, facilities are available within the BPD offices or can be rented nearby. It is clear that the three SFI training centers constructed under FID would not stand up to cost-benefit scrutiny.

Two of the training facilities visited (in Central and East Java) were not being used at the time of the visit. This may have been because centrally coordinated DIPDA (Provincial Development Budget) funds for provincial governments are rarely available before July (the financial year for government funding begins on April 1st), which means that as long as the training program is totally dependent on provincial government funding, training will be restricted to a nine-month period. Any provincial government funds remaining unspent at the end of the financial year must be returned to the Government of Indonesia.

BPD Central Java officials indicated that Rp100 million was available for the 1993-1994 training programs from a provincial government allocation. In East Java there was no provision in the provincial budget for the 1993-1994 training program for SFI staff, even though it was stated that 150 SFI staff needed to be trained. It was not clear whether BPD East Java will proceed with the training program for 1993-1994. The uncertainty is exacerbated by the loss of the FID project, which, through its structured training regimen, had acted as the impetus for the dissemination of the DIPDA funds.

In general, the BPDs regard this type of subsidy as their role to assist in provincial development of the SFIs. However, the BPDs are under pressure to act as prudent bankers and at least break even, or make a small profit on their operations. A perpetual subsidy can become an impossible burden for the BPDs, particularly if provincial governments wish to expand the number of BPR units within the province, which will involve greater participation of BPDs in training and supervision.

The extent of the burden in each province is difficult to gauge, but figures for supervision and training obtained from BPD Central Java indicate that these costs are currently Rp520 million per year (this figure does not include motor vehicles, which will have to be replaced at some stage and on an ongoing basis). The cost has been set off against interest earned on Ministry of Finance and USAID loan funds on-lent to the SFI branches. As these loans are gradually repaid, the interest set-off will decrease, and the burden will increase. If there is no specific allocation within the provincial government budget for SFI supervision and training, then the BPDs are left with the choice of accepting the loss or economizing on the cost and extent of services provided to lessen the loss.

The heavy training subsidy problem has been addressed in part by agreement in principle to the allocation of 5 percent of the SFIs' staff salaries and wages to the cost of training SFI staff. However, this proposal has yet to be implemented. A set-aside of this size would cover about 75 percent of training costs.

The long-term technical assistance team, with the help of some short-term consulting, has prepared a wide range of training materials including an operating manual for accounting and reporting; an auditing and supervision procedures manual; instructions on lending procedures; guidelines for the computerized MIS; materials for curriculum development; and pamphlets on cash management, financial management, and savings mobilization. A detailed study also was also undertaken in January 1992.[8] The recommendations in this report have been well addressed by the technical assistance team. The most significant of these were the establishment of job descriptions and qualifications, from which have flowed better designed and directed training. (See Annex G.) West Java, Central Java, and Bali have been particularly successful in implementing the core training agenda.

Within the FID project there has been a marked standardization and improvement in training. However, country-wide and outside of the FID SFIs, there remains too much diffusion of training resources. In addition, what is offered is often inappropriate for SFIs. BI offers only loan management training at a national level for the BKDs. Various private training businesses offer generic management training. LPPI, a national training organization, probably does not have the reach and scope to bring more standardization to SFI training, and its courses are inappropriate for the skill level existing or needed among the SFIs. BPDs routinely offer training in conjunction with technical assistance and supervision that they provide to the SFIs.

The FID advisors have done an excellent job of establishing a core curriculum. The project effectively introduced the concept of including training in a systematic process of human resource development. The wide acceptance of the percentage set aside from branch wage expenses showed that SFIs were willing to put a value on their training, and indicated that they themselves viewed it as worthwhile. The FID-based training was tied closely to factors that determined individual and branch performance, thereby equipping staff to advance on the employment ladder. It was clear that many of the other training schemes throughout the country did not meet these standards.

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[8] McKinnon, E. Edwards, and Yustina Rostawati, "Training and Personnel Needs," DAI consulting report, January 1992.

Recommendations

1) BPDs should project training needs, at least on an annual basis, and include a detailed budget for training courses, a timetable for courses to be implemented, and a detailed list of course participants taken from the provincial human resource database.

(2) The SFI training centers should actively market the use of their facilities by private and government-owned banks in the province as well as by government agencies and private enterprise to cover costs as much as possible and disseminate techniques to other nongovernment sectors.

(3) All BPDs should immediately implement the 5 percent set-aside from wages of SFI branches to cover costs incurred by the BPDs for SFI staff training and branch supervision.

(4) The Government of Indonesia should coordinate training at a national level to achieve standardization of training material over all provinces. It should create an institution that could offer a wide selection of training materials and a distance learning program, and coordinate closely with BI, which could guide the organization on training needs of BPR staff determined by monitoring BPR branch operations.

SPAWNING

Key Findings

- **Ownership** of BKKs in Central Java, LPNs in West Sumatra, KURKs in East Java, and LPDs in Bali has not been addressed but will become more of an issue as more of these register to become BPRs.

- It is unclear how FID SFIs will **achieve licensed and registered BPR status** and what will happen to those that cannot satisfy the minimum requirements at the end of the five-year period (October 1997).

Analysis

Ownership of BKPDs and LPKs in West Java has been split between provincial and district governments, the latter having a majority shareholding. In Central Java 85 percent of each SFI will be owned by the provincial government, and the remaining 15 percent will be held by the BPD. However, clarification of ownership is required by BI prior to conversion to BPR status. BI needs to know who owns the branches — the *desa*, the *kecamatan*, the *kabupaten* government, or the provincial government — and who will be responsible for the branches if serious management problems develop at some later stage.

The informal financial institutions have until October 30, 1997, to become licensed BPRs. This deadline gives ample time for the institutions to demonstrate that they can perform the tasks expected of them in an efficient and professional manner. BPRs will have to comply with BI reporting requirements and standards of performance. Failure to maintain a satisfactory level of performance could result in withdrawal of a unit's license to operate as a BPR. BPRs must perform these tasks:

- Follow policy guidelines in lending procedures;
- Achieve lending and arrears targets;
- Introduce and expand a savings program;
- Introduce and expand term deposit facilities;
- Maintain proper books and accounts; and
- Promptly prepare and submit reports.

Under the new CAMEL system, if a BPR's classification slips to poor or unsound and within nine months cannot be raised to at least Level 2 (Fairly Sound) for three consecutive months, then its operating license can be revoked. The ability of the BPDs to continue to operate on a profitable basis will be the acid test.

Compliance with the reporting requirements should not be any real problem for the FID SFIs because they have already converted to the CAMEL system. However, they will have to adjust to the amended CAMEL regulations introduced in the near future. If history repeats itself, then unlicensed BPRs are likely to be allowed to continue, according to responsible officials within the national planning board (BAPPENAS) and BI. The continued unofficial status of some SFIs will require diligence on the part of BPD supervisors tc monitor them as closely as they do new BPRs.

Recommendations

(1) Require SFIs to accept all of the financial burden for supervision and training costs by October 30, 1997, the deadline set by Bank Indonesia for conversion to BPR status.

(2) Continue technical assistance directed at the SFIs to assist with transition of SFI branches to BPR branches, spawning of new BPRs, and standardization of the accounting and reporting system.

CHAPTER SEVEN

INTERVENTION BY DONORS AND GOVERNMENT

CAPITALIZATION

Key Findings

- Capitalization with **soft loans or grant funds** is not only unnecessary in most cases, but is also counterproductive to SFI institutional development.

- **Financial intermediation, bridging between informal and rural financial systems and large formal financial systems**, meets market needs at both ends and encourages a breadth and depth of financial and institutional development not possible through targeted programs.

Analysis

FID SFIs have received approximately Rp3 billion from the Ministry of Finance and $4 million from USAID over the course of the project. The loan term set by the Ministry of Finance was 20 years with a 3-year grace period. Interest on the USAID funds to Government of Indonesia was 3 percent. The Government of Indonesia in turn lent these same funds to provincial governments at 4 percent, with repayment over 20 years. The provincial governments then lent the money to the SFIs at 12 percent, requiring repayment over a period of two to five years.

KUK funds, however, have far outweighed the others, amounting to about $16 million in the last year alone. The possibly deleterious effects of overcapitalization have been dealt with earlier in this report. Yet, provincial governments may have difficulties finding sufficient funds to cover expansion of the BPR system in the large waves that are being asked for by various constituencies in the country. Perhaps some allowance should be made by BI for in-kind contributions by provincial governments for land and office buildings and other similar start-up costs. Certainly the Bali experience demonstrates that branches can be started with much less capital than the Rp50 million currently projected, if a vigorous savings mobilization program is initiated at the outset.

As shown in the statistics in the beginning of this report, the FID project has been very successful at achieving financial intermediation. Namely, markets have been bridged, low-income people have benefited from the provision of liquidity from formal financial institutions, and all of this has been achieved profitably at the branch level. Many of the FID SFIs have progressed to the third stage of financial viability, one step from commercial viability.[9] Under conservative assumptions, a recent study showed that BPRs could turn a profit within four years and sustain a return on assets well above 6 percent — more than three times the current CAMEL benchmark — with an investment of less than $50,000. (See Annex H.) This model and the lessons of FID have revealed that small amounts of initial capital,

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[9] See Rhyne, Elisabeth, and Maria Otero, "The Financial Systems Approach to Microenterprises," GEMINI Working Paper No. 18, April 1991.

combined with an aggressive savings mobilization scheme, create the right base for building financially self-sustainable SFIs.

Recommendations

(1) Limit soft money or grant funds to seed capital, research and experimentation, and subsidization of low-cost recovery activities such as client training.

(2) Seek formal and informal linkages among net borrowers, net savers, and net investors.

TECHNICAL ASSISTANCE

Key Findings

- **Standardization and rationalization of disparate MISs, credit policies, and operational procedures** across the various provinces may be FID's greatest achievement, and it is a role that needs to continue.

- Indonesia has been a **laboratory for financial services to the poor**, some institutions using the financial systems approach and many programs operating concurrently (FID, BRI, cooperatives, and private banks), allowing for real and sustained comparisons of techniques and institutional structures.

Analysis

The technical assistance provided under FID, especially from long-term advisors, has played a vital catalytic role. By working mainly at the provincial and national levels, the advisors were able to standardize and upgrade numerous skills in many institutions. These institutions in turn have helped millions of low-income people in the country to improve their businesses, increase household income, and meet household liquidity demands. It is fair to say that fewer people would have been served if the intervention had been at a lower level. Intervening at a national level gave legitimacy to the project's work, opened access to influential decision makers, and led to the scale achieved by the project. It would be inaccurate to say that BI's forward thinking about the need to manage SFI proliferation and amend CAMEL resulted from the FID project. However, FID has definitely had some effect on the thought process through example and through direct exchanges.

The high-level institutional mode of technical assistance delivery also ensured that SFIs and BPDs would not become dependent on expatriate staff to perform operational tasks. The FID team concentrated on policies, procedures, and training inputs to enable BPD and SFI staff to absorb and apply the new concepts. The project developed flexible and comprehensive guidelines that have determined product design, mix, and delivery. The guidelines have given SFIs a solid foundation in fundamental management information, both in hardware and software and in processes and procedures to improve collection, storage, use, and appropriateness of the information.

The Government of Indonesia recognizes five models of credit for the poor: FID, BRI, cooperatives, self-help groups, and government direct assistance. BKDs and village posts below the *kecamatan* level are currently the preferred models, because they are perceived as reaching best to the village level. As poverty alleviation moves up on the national agenda, small enterprise finance projects and institutions will have to show that they can effectively serve the society's poor. Although there was respectful recognition within the Government of Indonesia of FID's many accomplishments, there were some reservations expressed by some that it did not seem to reach far enough down to the village level.

The numbers presented earlier and the post *desa* institutional location of most SFIs would support just the opposite view. The successful application of essentially the same systems and procedures in three different institutional settings — namely the provincial and local government-owned FID SFIs, the BRI Unit Desa, and Bank Sampoerna's BPRs — lends legitimacy to the model. Clearly, Indonesia's 183 million people across the archipelago are not homogenous, and FID SFIs have adapted to local conditions under the essential methodologies outlined in this report. In addition, nongovernmental organizations, self-help groups, and cooperatives have not achieved the client reach, financial performance, or sustainability of the FID SFIs, BRI Unit Desa, or Bank Sampoerna BPRs.

Government recognizes that it is important for SFIs to operate on sound business and banking principles. There is also a keen desire that they operate with a sense of (and also tangible) ownership by the community. Furthermore, several officials are very interested in a project that would combine financial and nonfinancial assistance in the same institution.

Recommendations

(1) Coordinate with interested officials at BI and BAPPENAS to confront the regulatory and training problems identified in the SFIs and BPRs by supporting a training and technical assistance project emphasizing appropriate regulation for SFIs and standardized professional development for SFI and BPD staff.

(2) Continue to promote financial systems, not targeted credit projects.

CHAPTER EIGHT

SUMMARY

FID has led to the development of a basic system for SFIs that is responsive to changes in policy, demographics, and other factors in various provinces and branches. The systems main components are these:

- Setting competitive interest rates that cover overhead, operational, and financial costs of the branches;
- Generally limiting loans to productive enterprises;
- Maintaining a portfolio mix of loan size, business type, and loan maturity;
- Determining loan repayment regularity based on expected business and household cash flows (weekly, biweekly, monthly, and seasonal);
- Keeping most loan terms to less than 12 months;
- Maintaining flexibility in loan increment ceilings for initial, second, and subsequent loans;
- Capitalizing on local leadership and knowledge;
- Actively encouraging voluntary savings and deposit products and promotion.

There are other important features of FID SFIs. They motivate staff using controllable variables that affect branch profitability. Having heavily emphasized risk-avoidance policies and procedures, SFIs rarely resort to the expensive and often disappointing route of seizing collateral.

The technical assistance team has played a vital role in bringing greater standardization to SFI procedures and policies, which has strengthened individual SFIs and the BPD systems of which they are a part. Impact has been greatest in MIS development; in provision of comprehensive training materials in management, accounting, supervision, and savings mobilization; and in the regulatory area.

The Government of Indonesia is most interested in achieving two broad objectives: broadening and deepening the delivery of financial services, especially to the poorest in the society, and effectively managing the prudent proliferation of SFIs, BPRs, and other similar institutions. The lessons of the FID project are instructive about how SFIs can reach far down the socioeconomic ladder on a financially self-sustainable basis. This has been recognized by BI, BAPPENAS, and others at the provincial level. The SFIs supported by FID could use some continued assistance as they try to implement many of the changes that have come about in the last year, mainly in the field of MISs and reporting. However, other provinces have yet to benefit from either the basic or advanced system-level technical assistance of FID, and these may be appropriate beneficiaries of future interventions.

BI would like to continue its trend of accommodation, and has recognized the problems it has supervising the SFIs. BI does not have the staff level or experience to monitor the sector effectively. In addition, many of the ratios and premises of the current CAMEL rating system are inappropriate for

SFIs. Explicit requests have been made for assistance in determining how the human capital and rating problems can be solved. The FID experience should contribute tremendously to solving these problems.

There are opportunities to make more use of partnerships among private and government institutions. The length and complexity of the FID experience can provide solid leads to setting correct financial performance measures. Based on SFI experiences with outside capital, effective alternatives can be suggested concerning the size, distribution, and use of commercial rate, soft loan, and grant capital. The FID model has been replicated in other institutional settings and in diverse parts of the country and has proven its strength and resilience.

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ANNEX A

LOAN APPLICATION FORM

Loan Application

[SFI Name:___________]

Borrower No. ______________

A. PERSONAL DATA

1. Name:_______________________________ 2. Status: M C B 3. Age:___ yr
4. Address:_______________________________ 5. No. in household:____ persons.
6. Employment:_______________ 7. Land status: (i) Owned:___ M2 (ii) Used:____ M2

B. LOAN DETAILS

1. No. of loans received:___
2. Loan use code:______
3. Expected use of loan:
   a.________________ Rp.___ __________
   b.________________ Rp.____________
   c.________________ (+) Rp.____________
   Total use: Rp.____________
   Own contribution (-) Rp.____________
   Total loan: Rp.____________

C. BUSINESS ACTIVITY

1. Importance of activity: U S1 S2 other:________
2. Turnover period: H M B other: _____ months.
3. Income estimate per turnover:
   a. Sales Rp. ______________
   b. Expenses (-) Rp. ______________
   c. Profit Rp. ______________
4. Wage expenses per month: Rp. ____________
5. Total workers (i) In family ____persons
   (ii) other ____persons

AGREEMENT

______________________ ____________________ Borrower

Village Head

D. DECISION

1. Rejection with reasons:

2. Agreement:
   a. Loan amount Rp. ________________
   b. Interest rate____% per ________________
   c. Loan term ____________ d. Loan repayment
   Rp. __________ per _________
   e. Collateral _________ Value Rp._____

______________________, __________________ SFI Manager

ARC/SPP/JUNE 1992

ANNEX B

OTHER FORMS

MONTHLY ACTIVITY REPORT

Province/Branch: ______________________ Month: __________ Year: __________

Name of the SFI: ______________________

Loans Disbursed in Current Month (Rp ,000)								Passbook and Term Deposits	
Loans Disbursed								Passbook	Term
Gender	Total Rp	Rp 0-500	Rp 501-1000	Rp > 1000	No. of Borrowers	New Borrowers (Rp)	New Borrowers (No.)	# of Clients	# of Clients
Male									
Female									

Portfolio Classifications	Amount (Rp)	Number of Loans
Current		
In Arrears		
Doubtful		
Bad		
Total Loans Outstanding		
Loans Written Off this Month		

Staff Composition	
Male	
Female	
Village Coverage	
No. of Villages	
No. of Village Posts	

Management Score	Maximum	Rating
1. Overall Management Score according to Bank Indonesia	30	
2. Evaluation of Office Conditions by the SFI Supervisor	.	
a. Appearance	3	
b. Condition	3	
c. Safety	3	
Total	9	

BALANCE SHEET

Province/Branch: ______________________ Month: __________ Year: __________

Name of the SFI: ______________________

ASSETS

No.	Category	Account Code	Rp ,000
1.	Cash	100	
2.	Checks	119	
3.	Bank Indonesia: a. Certificates of Deposit	123	
	b. Other	129	
4.	Inter-bank deposits	130	
5.	Promissory notes	149	
6.	Securities	169	
7.	Loans: a. Loans outstanding	171	
	b. Reserves	172	
8.	Fixed assets and inventories: a. Purchase cost	211	
	b. Accumulated depreciation	212	
9.	Other office assets	221	
10.	Other assets	230	
	Total Assets	290	

LIABILITIES

No.	Category	Account Code	Rp ,000
1.	Current liabilities: a. Government	311	
	b. Other	319	
2.	Savings	320	
3.	Total deposits	330	
4.	Bank Indonesia	349	
5.	Bank borrowings	350	
6.	Loans received (KUK)	369	
7.	Intra-bank liabilities	391	
8.	Miscellaneous liabilities	400	
9.	Capital a: Paid-up capital	421	
	b: Contingent capital	422	
10.	General reserves	430	
11.	a. Profit	441	
	b. Loss	442	
	Total Liabilities	490	

INCOME STATEMENT

Province/Branch: ______________________ Month: __________ Year: __________

Name of the SFI: ______________________

No.	Category	Account Code	Rp ,000
A.	Operating Revenue	100	
	1. Interest		
	a. From Bank Indonesia	119	
	b. From other banks: i. Demand deposits	121	
	ii. Time deposits	122	
	iii. Loans outstanding	123	
	iv. Other	124	
	c. From 3rd parties (non-bank): i. Loans outstanding	126	
	ii. Other	129	
	2. Commissions: a. Loans	151	
	b. Other	159	
	3. Other operating income	170	
B.	Operating Expense	180	
	1. Interest		
	a. To Bank Indonesia	191	
	b. To other banks: i. Time deposits	194	
	ii. Loans outstanding	195	
	iii. Other	199	
	c. To 3rd parties (non-bank): i. Time deposits	203	
	ii. Savings deposits	206	
	iii. Other	209	
	2. Insurance	239	
	3. Salaries	241	
	4. Rent	250	
	5. Honoraria	260	
	6. Taxes	270	
	7. Repairs and Maintenance	280	
	8. Depreciation: a. Fixed assets	291	
	b. Loans	299	
	9. Materials	300	
	10. Other operating expense	310	
C.	1. Operating profit (A-B)	320	
	2. Non-operating loss (B-A)	330	
D.	Non-operating revenue	340	
E.	Non-operating expense	390	
F.	1. Non-operating profit (D-E)	450	
	2. Non-operating loss (E-D)	460	
G.	1. Profit in current year	470	
	2. Loss in current year	480	
H.	1. Profit last year	530	
	2. Loss last year	540	
I.	Income tax	555	
J.	1. Net income	560	
	2. Net loss	570	

ANNEX C

ANALYSIS OF BRI UNIT DESA PERFORMANCE

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BRI UNIT DESA PERFORMANCE ANALYSIS

.ocation of unit:
upervisory BRI Cabang:

Name of unit:
Unit code:
Month / Year:

lo.	Financial Category (Rp ,000)	Performance Last Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
.	Actual Profit	189,154	31,851	53,502	94,260	87,807	0	0	0	0	0	0	0	0
	Target Profit	178,000	17,500	35,000	54,000	72,000	90,000	108,000	126,000	144,000	162,000	180,000	198,000	216,000
	Percentage Change	106.27%	182.01%	152.86%	174.56%	121.95%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
.	Actual Income	2,497,314	215,921	405,575	596,247	803,391	0	0	0	0	0	0	0	0
	Target Income	952,000	218,000	436,000	654,000	872,000	1,090,000	1,308,000	1,526,000	1,744,000	1,962,000	2,180,000	2,398,000	2,616,000
	Percentage Change	262.32%	99.05%	93.02%	91.17%	92.13%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
.	Actual Expenses	2,308,160	184,070	352,073	501,987	715,534	0	0	0	0	0	0	0	0
	Target Expenses	774,000	200,500	401,000	600,000	800,000	1,000,000	1,200,000	1,400,000	1,600,000	1,800,000	2,000,000	2,200,000	2,400,000
	Percentage Change	298.21%	91.81%	87.80%	83.66%	89.45%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
.	Actual Loans Outstanding	1,124,468	1,141,968	1,194,453	1,351,889	1,374,050	0	0	0	0	0	0	0	0
	Target Loans Outstanding	1,321,000	1,343,000	1,365,000	1,387,000	1,409,000	1,431,000	1,453,000	1,475,000	1,497,000	1,519,000	1,541,000	1,563,000	1,585,000
	Percentage Change	85.12%	85.03%	87.51%	97.47%	97.52%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
.	Actual Arrears	162,023	168,030	167,682	171,073	162,467	0	0	0	0	0	0	0	0
	Target Arrears	95,000	159,998	157,973	155,948	153,923	151,898	149,873	147,848	145,823	143,797	141,771	139,745	137,720
	Percentage Change	170.55%	105.02%	106.15%	109.70%	105.55%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
.	Acutal Savings	13,393,913	13,027,202	13,551,492	14,656,312	14,441,665	0	0	0	0	0	0	0	0
	Target Savings	13,000,000	13,555,000	13,716,000	13,876,000	14,037,000	14,198,000	14,359,000	14,520,000	14,680,000	14,841,000	15,002,000	15,163,000	15,324,000
	Percentage Change	103.03%	96.11%	98.80%	105.62%	102.88%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%

Jakarta, Date

BANK RAKYAT INDONESIA
Cabang:
Unit:

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Cabang Supervisor Unit Manager

ANNEX D

THE BANKING ACT
(LAW NO. 7)

THE BANKING SYSTEM
(Law No 7/1992 dated March 25, 1992)

BY THE GRACE OF ALMIGHTY GOD,

THE PRESIDENT OF THE REPUBLIC OF INDONESIA,

Considering

a. that with a view to maintaining the continuity of national development towards the creation of a just and prosperous society on the basis of the Pancasila state philosophy and the Constitution of 1945, the implementation of economic development under the principle of collective effort should pay more attent on to compatibility, harmony, and balance of the elements of the Trilogy of Development;

b. that the banking system, operating under the principle of economic democracy with the main function of mobilising and channelling private funds, has the strategic role of supporting the implementation of national development, within the framework of equitably distributing development efforts and their gains, increasing economic growth and promoting national stability, towards higher living standards of the common people,

c. that national as well as international economic developments, which have always been taking place rapidly along with ever expanding challenges, should be responsively followed all the time by the national banking system in carrying out its function and responsibility to the public,

d that in order to achieve the aims as referred to above, it is necessary to formulate a new law concerning the banking system

In view of

1 Article 5 paragraph (1), Article 20 paragraph (1), and Article 33 of the Constitution of 1945,

2 Law No 5/1962 on regional corporations (Statute Book of 1962 No 10, Supplement to Statute Book No 2387),

3 Law No 12/1967 on the principles of cooperatives (Statute Book of 1967 No 23, Supplement to Statute Book No 2832),

4. Law No 13/1968 on the central bank (Statute Book of 1968 No 63, Supplement to Statute Book No.2865),

5 Law No 9/1969 on the stipulation of overnment Regulation in lieu of Law No.1/1969 on state enterprises (Statute Book of 1969 No.16, Supplement to Statute Book No.2890) to become law (Statute Book of 1969 No.40, Supplement to Statute Book No.2904).

With the approval of

THE HOUSE OF REPRESENTATIVES OF THE REPUBLIC OF INDONESIA,

DECIDES:

To stipulate THE LAW CONCERNING THE BANKING SYSTEM

CHAPTER I

GENERAL PROVISIONS

Article 1.

Hereinafter referred to as :

1. Banks are business units which mobilise funds from society in the form of deposits and channel the funds to society within the framework of uplifting the living s andards of the public at large.
2. Commercial banks are banks which can provide services in payments.
3. Smallholder credit banks are banks which receive deposits only in the form of time deposits, savings, and/or others of similar types
4. Joint banks are commercial banks which are jointly established by one or more commercial banks domiciled in Indonesia and set up by Indonesian citizens and/or Indonesian statutory bodies wholly owned by Indonesian citizens, and one or more banks domiciled abroad.
5. Branch offices are bank offices which are directly responsible to relevant bank headoffices, with permanent business sites at the places where the branch offices undertake their activities
6. Deposits are funds entrusted by society to banks in the form of giro, time deposits, deposit certificates, savings, and/or others of similar types
7. Giro is composed of deposits which can serve as a payment instrument and be drawn any time by using cheques, other payment orders, or book-transfers
8. Time deposits are deposits which can only be drawn within certain periods according to agreements between depositors and relevant banks
9. Deposit certificates are time deposits of which the deposit evidence documents can be transacted.
10. Savings are deposits which can only be drawn under certain conditions already agreed upon, but cannot be drawn by using cheques or instruments of the same type.
11. Securities are debt acknowledgement letters, bills, shares, bonds, credit securities, or derivatives of securities or other interests or certain obligations of issuers, in the form normally transacted on the capital market and money market

12. Credits are the supply of money or claims of the same type, on the basis of loan contracts or agreements between banks and other parties in which borrowers are obligated to settle their debts after certain periods with interest, fees or profit sharing

13 Custody is the keeping of belongings on the basis of contracts between commercial banks and owners of the belongings in which it is stipulated that the commercial banks as custodians have no property right over the things under their custody

14 Trust agents are commercial banks which based on agreements between these banks and issuers of securities, are appointed to represent the interests of all holders of the securities

15 Affiliated parties are

a members of boards of commissioners or supervisors, boards of directors, officials, or employees of banks,

b. members of management boards, auditing boards, boards of directors, officials, or employees of banks, especially for banks with the legal status of cooperatives pursuant to the laws in force,

c parties providing services for the banks concerned, including consultants, legal consultants, public accountants, appraisers,

d. parties which based on the provisions laid down by Bank Indonesia have some influence on bank management

16 Bank secrets cover everything connected with finance and other things concerning bank customers which according to normal banking practice must be confidentially treated

17 Bank Indonesia is the Central Bank of the Republic of Indonesia as meant in the relevant law in force

18. The Monetary Council is the mometary council as meant in the relevant law in force.

19. The Minister is the Minister of Finance of the Republic of Indonesia.

20 The Government is the government of the Republic of Indonesia

CHAPTER II

PRINCIPLE, FUNCTION, AND OBJECTIVE

Article 2.

The Indonesian banking system shall conduct its business operation on the basis of economic democracy by applying the principle of prudence

Article 3.

The Indonesian banking system shall have the main function of mobilising and channelling private funds

Article 4.

The Indonesian banking system shall have the objective of supporting the implementation of national development within the framework of promoting equity, economic growth, and national stability towards uplifting the welfare of the common people

CHAPTER III

KINDS AND BUSINESS OF BANKS

Part One

Kinds of Banks

Article 5

(1) The kinds of banks shall be as the following

a. Commercial banks.

b. Smallholder credit banks.

(2) Commercial banks can specialise themselves in certain business activities or pay greater attention to certain business activities.

Part Two

Business of Commercial Banks

Article 6.

Commercial banks shall cover the following business activities

a. mobilising funds from society in the form of deposits like giro, time deposits, deposit certificates, savings, and/or others of similar types,

b. providing credits,

d. buying, selling or underwriting at their own risk as well as in the interest and at the order of their customers,

1. bills including those with bank acceptances of which the validity periods are not longer than those normally effective in the transaction of such papers,

2. debt acknowledgement letters and other commercial papers of which the validity periods are not longer than those normally effective in the transaction of such documents.

... and government guarantee certificates

4 Bank Indonesia certificates (SBI),

5 bonds,

6 commercial letters with periods of up to 1 (one) year,

7 other securities with periods of up to 1 (one) year.

e transferring money for their own as well as customers' interests,

f placing funds at, borrowing funds from, or lending funds to other banks, both by using letters, telecommunications facilities, and by using order bills, cheques or other means

g receiving payments from claims on securities and making calculations with or between third parties,

h allowing space for keeping goods and securities,

i undertaking custody in the interest of other parties based on contracts,

j making placement of funds from some customers to others in the form of securities not listed at the stock exchange

k buying collateral through tenders, either entirely or partly, in case debtors fail to carry out their obligations to banks, with the provision that the collateral purchased must be immediately disbursed,

l undertaking the business of factoring, credit cards and trust agents

m providing financing for customers on the basis of the principle of profit sharing in line with the provisions stipulated in a government regulation,

n being engaged in other business activities normally conducted by banks as long as they are not contradictory to this law and the relevant laws in force.

Article 7

In addition to the business activities as meant in Article 6, commercial banks shall also be allowed

a to be engaged in foreign currency business activities by observing the provisions laid down by Bank Indonesia,

b to have capital participation in other banks or companies in the field of finance, such as leasing, venture capital, stock companies, insurance, clearing/settlement and depository agencies, by observing the provisions laid down by Bank Indonesia,

c. to have provisional capital participation to overcome the consequences of credit failures, on the condition that such participation must be withdrawn, by observing the provisions laid down by Bank Indonesia, and

d acting as founders of pension funds and management agencies of pension funds pursuant to the provisions in the laws on pension funds in force.

Article 8.

In providing credits, commercial banks shall be convinced of the capacity and capability of debtors to settle their debts as pledged

Article 9

(1) Commercial banks which undertake custody as meant in Article 6 point i shall be responsible for the keeping of belongings and fulfil other obligations in line with contracts

(2) The belongings put under custody shall be separately entered in books and recorded

(3) In case banks go bankrupt, all the belongings under bank custody shall not be included in bangrupt assets and shall be returned to their owners

Article 10

Commercial banks shall be prohibited

a. to have capital participation other than that as meant in Article 7 points b and c,

b. to be engaged in the insurance business,

c. to undertake business activities other than those as meant in Articles 6 and 7.

Article 11.

(1) Bank Indonesia shall stipulate provisions on maximum limits for the issuance of credits, guarantees, the placement of investments in securities, or other similar things banks can provide for borrowers or groups of relevant borrowers, including companies in the same groups of the banks concerned

(2) The maximum limits as meant in paragraph (1) shall not exceed 30% (thirty percent) of the capital of banks as stipulated by Bank Indonesia

(3) Bank Indonesia shall stipulate provisions on maximum limits for the issuance of credits, guarantees, the placement of investments in securities, or other similar things banks can provide for

a shareholders owning 10% (ten percent) or more of the paid-up capital of banks;

b. members of boards of commissioners,

c members of boards of directors,

d family members of the parties as meant in points a, b and c,

e. other bank officials, and

f [illegible]

(4) The maximum limits as meant in paragraph (3) shall not exceed 10% (ten percent) of the capital of banks as stipulated by Bank Indonesia.

(5) The implementation of the provisions as meant in paragraphs (1) and (3) shall be reported according to the procedure laid down by Bank Indonesia

Article 12.

The government can assign commercial banks to carry out government programs for the development of certain economic sectors, or devote greater attention to cooperatives and economically weak business groups/ small scale companies within the framework of uplifting the living standards of the public at large, based on provisions to be further stipulated in a government regulation

Part Three

Business of Smallholder Credit Banks

Article 13.

Smallholder credit banks shall cover the following business activities :

a. mobilising funds from society in the form of deposits like time deposits, savings, and/or others of similar types,

b. providing credits,

c. providing financing for customers based on the principle of profit sharing according to provisions stipulated in a government regulation,

d placing their funds in the form of Bank Indonesia Certificates (SBI), time deposits, deposit certificates, and/or savings at other banks

Article 14.

Smallholder credit banks shall be prohibited .

a. to receive deposits in the form of giro and participate in payments,

b. to be engaged in foreign currency business activities,

c. to have capital participation,

d to be engaged in the insurance business,

e to undertake business activities other than those as meant in Article 13.

Article 15.

The provisions as stipulated in Article 8 and Article 11 shall also apply to smallholder credit banks.

CHAPTER IV

LICENSING, LEGAL STATUS AND OWNERSHIP

Part One

Licensing

Article 16

(1) Any party engaged in the mobilisation of funds from society in the form of deposits like giro, time deposits, deposit certificates, savings, and/or others of similar types, shall obtain prior business licensing as commercial banks or smallholder credit banks from the Minister, unless the private fund mobilisation activities are separately regulated by law.

(2) Business licences for commercial banks and smallholder credit banks shall be granted by the Minister after consultation with Bank Indonesia.

(3) In order to obtain business licences for commercial banks and smallholder credit banks as meant in paragraph (2), requirements shall be fulfilled regarding :

a. organisational composition,

b. capital,

c. ownership,

d. banking expertise,

e. feasibility of working plans, and

f. other matters as stipulated by the Minister after consultation with Bank Indonesia.

(4) To obtain the business licence for smallholder credit banks, besides the requirements as meant in paragraph (3), the condition concerning the domiciles of headoffices of smallholder credit banks in districts shall also be fulfilled

(5) Without reducing the effectiveness of the provision in paragraph (4), by observing provisions to be further stipulated in a government regulation, smallholder credit banks can be set up in capitals of regencies or municipalities, as long as no smallholder credit banks are yet established in the said capitals of regencies or municipalities

(6) The requirements as meant in paragraphs (3), (4), (5) and the procedure for business licensing shall be further stipulated in a government regulation

Article 17.

a. permissible extents of ownership and management of foreign partners,

b. the parties allowed to establish cooperation,

c. other matters which according to the consideration of the Monetary Council should be regulated in the interest of national development

Article 18.

(1) The opening of branch offices of commercial banks can only be realised with the licence of the Minister, after consultation with Bank Indonesia.

(2) The opening of branch offices and representative offices of commercial banks abroad can only be realised with the licence of the Minister, after consultation with Bank Indonesia.

(3) The opening of offices under branch offices of commercial banks shall be reported to Bank Indonesia.

(4) The requirements and procedures for the opening of offices of commercial banks as meant in paragraphs (1), (2) and (3) shall be stipulated by the Minister after consultation with Bank Indonesia.

Article 19.

(1) The opening of branch offices of smallholder credit banks in the capital of the State, capitals of provinces, capitals of regencies and municipalities can only be realised with the licence of the Minister after concultation with Bank Indonesia

(2) The opening of branch offices outside the capital of the State, capitals of provinces, capitals of regencies and municipalities, and the opening of offices under branch offices of smallholder credit banks shall be reported to Bank Indonesia

(3) The requirements and procedures for the opening of offices of smallholder credit banks as meant in paragraphs (1) and (2) shall be stipulated by the Minister after consultation with Bank Indonesia

Article 20.

(1) The opening of branch offices, auxiliary branch offices and representative offices of banks domiciled abroad can only be realised with the licence of the Minister after consultation with Bank Indonesia.

(2) The opening of offices under auxiliary branch offices of the banks as meant in paragraph (1) shall be reported to Bank Indonesia

(3) The requirements and procedures for the opening of offices as meant in paragraphs (1) and (2) shall be further stipulated by a government regulation

Part Two

Legal Status

Article 21.

(1) The legal status of commercial banks can be any of the following

a. State trading/limited liability companies (Persero).

b. Regional administration owned companies.

c. Cooperatives.

d. Limited liability companies

(2) The legal status of smallholder credit banks can be any of the following :

a. Regional administration owned companies

b Cooperatives.

c Limited liability companies.

d. Other companies stipulated in a government regulation.

(3) The legal status of representative offices and branch offices of banks domiciled abroad shall follow the legal status of their headoffices.

Part Three

Ownership

Article 22.

Commercial banks shall only be established by

a Indonesian citizens and/or Indonesian statutory bodies wholly owned by Indonesian citizens and/or Indonesian statutory bodies, or

b. banks which are established according to point a. and banks which are domiciled abroad.

Article 23.

Smallholder credit banks shall only be established and owned by Indonesian citizens, Indonesian statutory bodies wholly owned by Indonesian citizens, regional administrations, or can be jointly owned by the three parties.

Article 24.

Commercial banks and smallholder credit banks with the legal status of cooperatives shall be subject to provisions concerning ownership as stipulated in the cooperatives law in force.

Article 25.

The shares of commercial banks and smallholder credit banks with the legal status of limited liability companies can only be issued as registered shares.

Article 26.

(1) Commercial banks can issue shares through the stock exchange in Indonesia.

(2) Indonesian citizens, foreign citizens, Indonesian statutory boadies and/or foreign statutory bodies can buy the shares of commercial banks sold according to the provision in paragraph (1).

(3) Foreign citizens and/or foreign statutory bodies can buy the shares of commercial banks through the stock exchange on the condition that they shall not become the majority.

(4) Especially for state owned commercial banks, the issue of shares as meant in paragraph (1) can only be done without causing any change in the majority position of share ownership of the State.

(5) The implementation of provisions as meant in paragraphs (2), (3) and (4) shall be further sipulated in a government regulation.

Article 27.

Any change in bank ownership shall

a. fulfil the provisions as stipulated in Article 16 paragraph (6), Articles 17, 22, 23, 24, 25 and 26,

b. be reported to Bank Indonesia

Article 28.

(1) Inter-bank mergers and consolidations as well as bank acquisitions shall be licensed by the Minister after consultation with Bank Indonesia.

(2) Provisions concerning mergers, consolidations, and acquisitions shall be stipulated in a government regulation.

CHAPTER V

DEVELOPMENT AND SUPERVISION

Article 29.

(1) Bank Indonesia shall carry out the development and supervision of banks.

(2) Bank Indonesia shall stipulate provisions concerning the sound condition of banks by taking into account the aspects of capital, quality of assets, quality of management, rentability, liquidity, solvency, and other aspects connected with banking operation.

(3) Banks shall be obligated to maintain their sound condition as stipulated in paragraph (2) and undertake business activities according to the principle of prudence.

(4) In providing credits and conducting other business activities, banks shall adopt methods which do not harm their interests and the interests of customers entrusting funds to banks.

(5) In interest of customers, banks shall provide information on the possible risk of loss to be incurred by customers conducting transactions through banks.

Article 30.

(1) Banks shall be obligated to submit to Bank Indonesia all information and explanations on their business according to the procedure stipulated by Bank Indonesia.

(2) At the request of Bank Indonesia, banks shall allow the opportunity for examination of books and files they maintain, and provide assistance needed for the purpose of finding out the truth of all the information, documents and explanations reported by the banks concerned

(3) The information on banks obtained on the basis of the provision in paragraphs (1) and (2) shall not be announced and shall be treated confidentially.

Article 31.

(1) Bank Indonesia shall conduct auditing on banks, periodically as well as any time considered necessary.

(2) In the case of necessity for the formulation of a macro policy, the monetary council can request Bank Indonesia

a to submit reports on bank auditing results needed,

b to conduct special auditing on banks, and report results of such auditing

Article 32

If considered necessary, the Minister can also request Bank Indonesia to submit reports on bank auditing results or conduct special auditing on banks and report results of such auditing.

Article 33.

(1) The bank auditing reports as meant in Article 31 and 31 shall be confidential in nature

(2) The requirements and procedures for auditing as meant in Article 31 and 32 shall be stipulated by Bank Indonesia.

Article 34.

(1) Banks shall be obligated to submit to Bank Indonesia annual balance sheets and profit/loss statements along with their explanations, as well as other periodical reports within the periods and according to the models stipulated by Bank Indonesia

(2) The annual balance sheets and profit/loss statements as meant in paragraph (1) shall be subject to prior auditing by public accountants.

(3) The book year applied by banks shall be the calendar year

Article 35.

Banks shall be obligated to announce their balance sheets and profit/loss statements within the periods and according to the models stipulated by Bank Indonesia.

Article 36.

Bank Indonesia can stipulate an exception to the provision as meant in Article 34 paragraph (2) for smallholder credit banks

Article 37

(1) If based on the evaluation of Bank Indonesia certain banks are considered in difficulties which endanger the continuity of their business activities, Bank Indonesia shall notify the matter to the Minister

(2) In case certain banks face difficulties which endanger the continuity of their business activities, Bank Indonesia can

a. take measures so that

1. shareholders increase capital,

2. shareholders replace the banks' boards of commissioners and or boards of directors,

3. the banks eliminate bad credits from account books, and calculate their loss with their capital,

4. the banks form mergers or consolidations with other banks,

5. the banks are sold to buyers that are prepared to take over all liabilities,

b. take other measures pursuant to the laws in force.

(3) If based on the evaluation of Bank Indonesia

a. the condition of certain banks endangers the banking system, or

b. the measures as menat in paragraph (2) are not sufficient to overcome the difficulties they face,

Bank Indonesia shall propose that the Minister revoke their business licences.

(4) Based on the proposal of Bank Indonesia as meant in paragraph (3), the Minister shall revoke the business licences of the banks concerned and order their boards of directors to liquidate the banks.

(5) In case the boards of directors fail to liquidate the banks as meant in paragraph (4), the Minister after consultation with Bank Indonesia shall request the Court to liquidate the said banks.

CHAPTER VI

BOARD OF COMMISSIONERS, BOARD OF DIRECTORS AND EXPATRIATES

Article 38.

(1) The appointment of members of the board of commissioners and the board of directors of a bank shall fulfil the requirements as meant in Article 16 paragraph (6) and Article 17.

(2) Any change in the membership of the board of commissioners and the board of directors of a bank as meant in paragraph (1) shall be reported to Bank Indonesia.

Article 39

(1) In carrying out their business activities, banks can use expatriates.

(2) The requirements for the use of expatriates as meant in paragraph (1) shall be stipulated in a government regulation

CHAPTER VII

BANK SECRETS

Article 40.

(1) Banks shall be prohibited to give information on records they keep regarding the financial situation and other matters of their customers which must be treated confidentially by banks according to normal banking practice, except in cases as meant in Articles 41, 42, 43 and 44.

(2) The provision as meant in paragraph (1) shall also apply to affiliated parties.

Article 41.

(1) For the purpose of taxation the Minister shall be authorised to issue written orders to banks to give information and show written pieces of evidence as well as documents regarding the financial condition of certain customers to tax officials

(2) The written orders as meant in paragraph (1) shall mention the names of tax officials and the names of taxpayer-customers whose information is required.

Article 42

(1) For the purpose of legal procedings in criminal cases, the Minister can permit the police, the prosecution or judges to obtain information from banks regarding the financial condition of suspects/defendants at banks

(2) The permits as meant in paragraph (1) shall be granted in writing on the basis of written requests from the Chief of the State Police, the Attorney General, or the Chairman of the Supreme Court.

(3) The requests and meant in paragraph (2) shall mention the names and positions of police officers, prosecutors or judges, the names of suspects/defendants, reasons for requesting the information, and relations between the criminal cases concerned and the required information.

Article 43.

In civil cases between banks and their customers, the boards of directors concerned can give information to the court on the financial condition of the relevant customers and provide other explanations connected with the said cases

Article 44.

(1) Within the framework of exchanges of information between banks, the board of directors of one bank can inform the financial condition of its customers to another

(2) Provisions concerning the exchanges of information as meant in paragraph (1) shall be further stipulated by Bank Indonesia

Article 45.

The parties whose interests are harmed by the information provided by banks as meant in Articles 41, 42, 43 and 44 shall reserve the right to have knowledge of the contents of the said information and demand corrections in case errors are contained therein

Article 46.

(1) Whoever mobilises funds from society in the form of deposits like giro, time deposits, deposit certificates, savings, and/or other of similar types without business licences from the Minister as meant in Article 16 and Article 17, shall be liable to maximum imprisonment of 15 (fifteen) years and a maximum fine of Rp 10,000,000,000 (ten billion rupiahs).

(2) In case the activities as meant in paragraph (1) are carried out by statutory bodies in the form of limited liability companies, partnerships, foundations or cooperatives, the prosecution of these bodies shall be directed at those ordering such activities or those acting as executives in such activities, or at both parties.

Article 47.

(1) Whoever without carrying written orders of the Minister to banks as meant in Article 41 or without the permits of the Minister as meant in Article 42, purposely forces banks or affiliated parties to give information as meant in Article 40, shall be liable to maximum imprisonment of 3 (three) years and a maximum fine of Rp 3,000,000,000 (three billion rupiahs)

(2) Members of boards of commissioners, boards of directors, employees of banks or other affiliated parties who give information that must be treated confidentially pursuant to Article 40, shall be liable to maximum imprisonment of 2 (two) years and a maximum fine of Rp 2,000,000,000 (two billion rupiahs).

Article 48.

(1) Members of boards of commissioners, boards of directors or employees of banks who purposely refuse to give information that must be provided pursuant to Article 30 paragraphs (1) and (2) and Article 34 paragraphs (1) and (2), shall be liable to maximum imprisonment of 2 (two) years and a maximum fine of Rp 2,000,000,000 (two billion rupiahs).

(2) Members of boards of commissioners, boards of directors or employees of banks who neglect to give information that must be provided pursuant to Article 30 paragraphs (1) and (2) and Article 34 paragraphs (1) and (2), shall be liable to maximum imprisonment of 1 (one) year and/or a maximum fine of , Rp, 1,000,000,000 (one billion rupiahs)

Article 49

(1) Members of boards of commissioners, boards of directors or employees of banks who purposely

a. make or cause the presence of false records in account books or reports, and in documents or reports on business activities, reports on transactions or accounts of certain banks,

b. remove or exclude or cause the absence of records in account books or reports, and in documents or reports on business activities, reports on transactions or accounts of certain banks,

c. change, obscure, conceal, erase or eliminate records in account books or reports, and in documents or reports on business activities, reports on transactions or accounts of certain banks, or purposely change, obscure, cause the loss of, hide or disfigure the account book records,

shall be liable to maximum imprisonment of 15 (fifteen) years and a maximum fine of Rp 10,000,000,000 (ten billion rupiahs).

(2) Members of boards of commissioners, boards of directors or employees of banks who purposely

a. ask for or receive, allow or agree to receive certain compensations, commissions, extra fees, service, cash or valuables, for personal benefit or for the benefit of family members, with the aim of obtaining or trying to obtain for other parties, advance payments, bank guarantees, or credit facilities from banks, or within the framework of bank purchase or discounting of bills, promissory notes, cheques, and commercial papers or other evidence on obligations, or with the aim of granting approval to other parties for drawing funds which exceed their credit limits at banks,

b. fail to take necessary measures to ensure bank adherence to the provisions in this law and other effective for banks,

shall be liable to maximum imprisonment of 6 (six) years and a maximum fine of Rp 6,000,000,000 (six billion rupiahs).

Article 50.

Affiliated parties which purposely take no necessary measures to ensure bank adherence to the provisions in this law and other laws effective for banks, shall be liable to maximum imprisonment of 6 (six) years and a maximum fine of Rp 6,000,000,000 (six billion rupiahs)

Article 51.

(1) The acts as meant in Articles 46, 47, Article 48 paragraph (1), Articles 49 and 50 shall be criminal acts.

(2) The act as meant in Article 48 paragraph (2) shall be a violation.

Article 52

Without reducing the effectiveness of criminal provisions as meant in Articles 47, 48 and 49 Bank Indonesia can impose administrative sanctions on banks which fail to carry out their obligations as stipulated in this law or submit proposals to the Minister to revoke the business licences of the banks concerned.

Article 53

Without reducing the effectiveness of the criminal provision as meant in Article 50, Bank Indonesia car impose administrative sanctions on affiliated parties which fail to carry out their obligations as stipulated in this law or submit proposals to authorised agencies to revoke the licences of the parties concerned.

CHAPTER IX

TRANSITIONAL PROVISIONS

Article 54.

(1) With the enforcement of this law :

a. Government Regulation in lieu of Law No.21/1960 on Bank Pembangunan Indonesia (Indonesian development bank) Statute Book of 1960 No 65, Supplement to Statute Book No.1996),

b. Law No.13/1962 on the principles of regional development banks (Statute Book of 1962 No 59, Supplement to Statute Book No.2490);

c. Law No 17/1968 on Bank Negara Indonesia 1946 (Statute Book of 1968 No 70 Supplement to Statute Book No.2870);

d. Law No.18/1968 on Bank Dagang Negara (state commercial bank) (Statute Book of 1968 No.71, Supplement to Statute Book No.2871),

e. Law No.19/1968 on Bank Bumi Daya (Statute Book of 1968 No 72, Supplement to Statute Book No 2872),

f. Law No.20/1968 on Bank Tabungan Negara (state savings bank) (Statute Book of 1968 No 73, Supplement to Statute Book No.2873),

g. Law No.21/1968 on Bank Rakyat Indonesia (smallholder bank) (Statute Book of 1968 No 74, Supplement to Statute Book No.2874),

h. Law No.22/1968 on Bank Ekspor Impor Indonesia (Statute Book of 1968 No 75, Supplement to Statute Book No.2875),

shall remain valid for a maximum period of 1 (one) year starting from the coming into effect of this law.

(2) Within the period as meant in paragraph (1), banks which were established on the basis of the laws as referred to in paragraph (1) shall implement the provisions in this law

(3) In case the banks as meant in paragraph (2) complete their adjustments to the provisions in this law sooner than the time limit as meant in paragraph (1), the relevant laws as referred to in paragraph (1) become no longer effective

Article 55.

(1) Banks which possess business licences from the Minister at the moment of enforcement of this law shall be regarded as already obtaining business licences on this basis of this law

(2) The banks as meant in paragraph (1) shall be obligated to make adjustment to the provisions in this law not later than 1 (one) year starting from the enforcement of this law.

(3) Smallholder credit banks which possess business licences at the moment of enforcement of this law, and are domiciled in the capital of the State, capitals of provinces, capitals of regencies and municipalities, can continue their business activities as smallholder credit banks until their promotion to become commercial banks.

Article 56

The maximum limits for credit issuance as meant in Article 11 paragraphs (2) and (4) shall be fulfilled by banks not later than 5 (five) years starting from the enforcement of this law.

Article 57

Non bank institutes of finance which possess business licences from the Minister at the moment of enforcement of this law can adjust their business activities as banks based on the provisions in this law, not later than 1 (one) year starting from the enforcement of this law

Article 58

Rural banks, village supply units, market banks, employee banks, community supply units (LPN), rural credit institutes (LPD), village credit agencies, (BKD), district credit agencies (BKK), small scale business credit units (KURK), district credit institutes (LPK), rural production banks (BKPD) and/or other similar bodies shall be granted the status of smallholder credit banks on the basis of this law by fulfilling the procedures stipulated in a government regulation

Article 59.

The laws already issued prior to the enforcement of this law shall remain valid as long as they are not contradictory to this law, until their revocation, replacement or renewal.

CHAPTER X

CONCLUSION

Article 60.

With the enforcement of this law :

a. Statute Book of 1929 No.357 dated September 14, 1929 on rural credit agencies in provinces in Java and Madura outside municipal territories;

b. Law No.12/1962 on private development banks (Statute Book of 1962 No.58, Supplement to Statute Book No 2489);

c. Law No.14/1967 on the principles of banking operation (Statute Book of 1967 No.34, Supplement to Statute Book No.2842);

shall be declared null and void.

Article 61.

This law shall come into force as from the date of promulgation

For public cognizance, this law shall be promulgated by publishing it in the Statute Book of the Republic of Indonesia.

Promulgated in Jakarta On March 25, 1992	Stipulated in Jakarta On March 25, 1992
THE MINISTER/STATE SECRETARY	THE PRESIDENT OF THE REPUBLIC OF INDONESIA,
sgd	sgd.
M O E R D I O N O	S O E H A R T O

STATUTE BOOK OF THE REPUBLIC OF INDONESIA 1992 NUMBER 31.

E L U C I D A T I O N

O N

LAW No 7/1992

CONCERNING

THE BANKING SYSTEM

G E N E R A L

Within the framework of creating a just and prosperous society of Indonesia on the basis of the Pancasila state philosophy and the Constitution of 1945, the continuity and enhancement of national development implementation on the basis of collective effort should always be well maintained In order to achieve this objective, the realisation of economic development should pay greater attention to compatibility, harmony, and the balance of elements of development equity, economic growth, and national stability

One of the means having a strategic role in harmonising and balancing the elements of the Trilogy of Development is the banking system The strategic role is particularly due to the main function of banks as a forum which can mobilise and channel private funds in an effective and efficient manner, to support the implementation of national development under the principle of economic democracy, within the framework of promoting equity in development realisation and distribution of its gains, promoting economic growth and national stability, towards uplifting the living standards of the common people.

With such a strategic role of banking institutes in achieving national development aims, effective development and supervision of these institutes should be continuously carried out on strong foundations of operation so that the banking system in Indonesia becomes capable of functioning efficiently, soundly and properly, facing competition of an increasingly global nature, fully protecting deposits of private funds, as well as channelling the private funds to productive fields in order to meet development targets.

In the effort to support the continuity and enhancement of development implementation, banking institutes have shown rapid progress in line with development advancements in Indonesia and international economic growth, as well as in line with the rising public demand for services of reliable and sound banks.

With the increasing demand for banking services, which have been rapidly developing, the operational foundations of the banking system now existing should be adjusted so as to be capable of responding to the need for further developing these services.

For the purpose of boosting the progress of banking institutes in a sustainable manner and in a way that can ensure maximum benefit for national development implementation, as well as guaranteeing the realisation of economic democracy so that all the potential, initiatives and creations of society can be pooled and turned into a real force for the promotion of public welfare, the fostering, supervision and operational foundations of the banking system so far based on the provisions in the Banking Law of 1967 should be developed and improved With this improvement, the banking system can be more prepared and able to play a better role in supporting the process of development, which is is increasingly confronted with challenges of international economic advancements.

The Banking Law of 1967 was formulated at the time when the economic situation and condition were far different from current economic development. The rapidly progressing national and international economies along with ever expanding challenges need to be responsively followed all the time by the national banking system in carrying out its function and responsibility, so that the banking system should

1. be arranged in a more clearcut institutional structure with a broader basis and a better defined scope of operation,
2. be given the opportunity to expand their range of services in all parts of the country, both as commercial banks to reach all layers of society and as smallholder credit banks to serve economically weak/ small scale business groups,
3. be strengthened with the legal basis needed for banking development and supervision, which support the enhancement of banking capability of executing its function in a sound, proper and efficient way, and at the same time enables the Indonesian banking system to make adjustments in line with developments in international banking norms

With view to improving the banking structure in Indonesia, the measures takes are among others

1. Simplification of the types of banks into commercial banks and smallholder credit banks, as well as clarification of the scope and limits of activities allowed
2. Detailed specification of basic requirements for the establishment of banks so that implementation rules connected with banking activities are more clearly stipulated and better directed.
3. Enhancement of protection of private funds entrusted to banking institutes through the principle of prudence and fulfilment of requiremenents for the sound condition of bank.
4. Promotion of professionalism among those engaged in banking activities.
5. Expansion of opportunities for undertaking sound and responsible banking activities, and at the same time prevention of practices which harm the interests of the public at large.

With the improvement efforts the Indonesian banking system is expected to become responsive to the progress of national development so that its role in uplifting the living standards of the common people, creating equity in development realisation and distribution of its gains, as well as increasing economic growth and national stability can be manifested in a more concrete manner within the framework of bringing about just and prosperous society on the basis of Pancasila and the Constitution of 1945.

ARTICLE BY ARTICLE

Article 1 — Point 1 up to point 20 Sufficiently clear.

Article 2 — Hereinafter referred to as "economic democracy" is the economic democracy based on the state ideology Pancasila and the Constitution of 1945

Article 3 and 4 — Sufficiently clear.

Article 5

Paragraph (1) — Sufficiently clear.

Paragraph (2) — Hereinafter referred to as "specializing themselves in certain business activities" is among others financing long-term activities, financing the development of cooperatives, developing economically-weak businessmen/small-scale businessmen, developing non-oil/gas exports and developing the construction of housing complexes.

Article 6 — Commercial banks can carry out business activities as referred to in letter a up to letter h in a part or a whole Each of banks can choose types of business according to expertise and business field it wants to develop. In this way, the banking circles can fulfil the demand of the public for various types of banking services without paying no attention to the principles of health and efficiency

Letters a and b — Sufficiently clear

Letter c — Banks can issue either short-term or long-term debentures The short-term debentures are as referred to in Article 100 up to Article 229 k of the Commercial Law, which in the money market are known as Money Market Securities (SPBU), namely promissory notes, bills and the like to be likely developed in the future.
The long-term debentures can be in the form of bonds or credit securities

Letter d — Business as referred to in this letter covers selling, buying or underwriting securities as referred to in the clarification in letter c and securities that the government and or Bank Indonesia has issued.

Point 1 up to point 6 Sufficiently clear.

Point : This stipulation is aimed at handling the possibility of securities other than those mentioned in point 1 up to point 6.

Letter e and letter f Sufficiently clear.

Letter g — These activities include collection and clearing.

letter h — Hereinafter referred to as "providing space" is the activity of banks solely related to the hiring out of space for keeping goods and securities (safety box) that the banks do not need to know the mutation and content

Letter i — In undertaking custody, banks receive belongings put under custody by recording them separate from the banks' belongings. The mutation in the belongings put under custody is conducted by the banks on the basis of order given by their owners

Letter j — In these activities, banks play a role in connecting the customers requiring funds and those having funds

Letter k — The obligations of banks in this stipulation are aimed at disbursing collateral bought through tenders as fast as possible, so that the banks can immediately make use of the funds arising from the disbursement of the sales of collateral. In case of remainder arising from the tenders after being calculated with the obligations of the customers to the banks, the customers should be allowed to make use of the remainder

Letter l : The business of factoring is the activity relating to the management of short-term receivables arising from foreign domestic trade transactions conducted through the expropriation or purchase of the receivables. Business relating to credit cards is a business activity relating to the granting of credits or the financing of the purchase of goods or services, the withdrawal of which uses cards. Technically, the credits cards function as a means of book-transfer in settling a transaction.

Letter m Sufficiently clear

Letter n Hereinafter referred to as other business activities normally conducted by banks are business activities other than those meant in letter a up to letter m, which are not contradictory to the laws in force, such as giving bank guarantees, acting as a perceptive bank, interest swap, helping customers conduct business administration and the like.

Article 7 Sufficiently clear.

Article 8 The credits provided by banks bear risks, therefore, the banks should pay attention to the principles of sound credits in providing the credits. To reduce the risks, the banks should be convinced of the guarantees given to obtain the credits, such as the capacity and capability of debtors to settle their debts as pledged, which constitute a main factor

To obtain such confidence, the banks should appraise thoroughly the character, capability, capital, collateral and business prospect of the debtors before granting credits in view of the fact that the collateral becomes one of the guarantees to grant credits. If on the basis of other elements the banks are convinced of the capability of the debtors to settle their debts, the collateral can be in the form of goods, projects or right to collect financed with the relevent credits. Land, the ownership status of which is based on the traditional law, namely land of which the evidence of ownership is in the form of 'girik' (land tax assessment paper), 'petuk' (piece of evidence dealing with land tenure), and the like can be used as collateral Banks are not obligated to request collateral in the form of goods not related directly to the projects they finance, normally known as "additional collateral".

Article 9

Paragraph (1) up to paragraph (3) Sufficiently clear

Article 10

Letters a and b Sufficiently clear.

Letter c Other prohibited business activities referred to in letter c include undrtaking business activities as a stock issue underwriter

Article 11 In providing credits, banks may face the risks of failure or stagnation in the repayment of the credits, thereby bringing an adverse effect on the soundness of the banks Since the credits are derived from public funds, the risks the banks face may also bring an effect on the safety of the public funds Therefore, to maintain their soundness and increase their resistance, banks are obligated to share the risks by regulating the channelling of credits, the granting of guarantees or other facilities in such a way so as to avoid the granting of credits to certain debtors or a certain group of debtors only

Paragraph (1) : A group is a group of persons or bodies having mutual relations in case of ownership, management and/or financial relations.

Paragraph (2) : Bank Indonesia can set maximum limits not exceeding 30 % (thirty per cent) of the capital of banks concerned. The definition of bank capital is set forth by Bank Indonesia pursuant to the definition used for assessing the soundness of banks. The said maximum limits are intended for each borrower or a group of borrowers including companies of the same group.

Paragraph (3) :

Letter a up to letter c : Sufficiently clear.

Letter d Hereinafter referred to as "family" includes family relationship up to the second degree pursuant to the vertical and horizontal lines, including parent-in-law, son-or daughter -in-law and brothers or sisters-in-law.

Letters e and f Sufficiently clear

Paragraph (4) : Bank Indonesia can set maximum limits less than 10 % (ten per cent) of the capital of banks. The definition of bank capital is set forth by Bank Indonesia pursuant to the definition used for assessing the soundness of banks.

Paragraph (5) : Sufficiently clear.

Article 12 : Hereinafter referred to as "The government can assign commercial banks" is within the framework of popularizing the provision on the principle, function and aim of banking system as meant in Chapter II, the realization of which is adjusted to the demand of the national development

Hereinafter referred to as "certain economic sectors" includes development programmes in the construction of housing complexes as well as the development of non-oil/gas exports

The government regulation as meant also stipulates the provision on the implementation of certain programmes by one or several commercial banks.

Article 13 :

Letter a Referred to as "others of similar types" is aimed at accommodating the possible type of collecting private funds by smallholder credit banks, which are similar to time deposits and savings but not giros or other deposits which can be withdrawn

Letter b Sufficiently clear.

Letter c Sufficiently clear

Letter d Sufficiently clear

Article 14 This prohibition is intended to adjust to the business activities of smallholder credit banks particularly intended to give services to small-scale undertakings and the public in the rural areas. To that end, the types of service the smallholder credit banks can provide should be adjusted to the purpose

Letter a Sufficiently clear.

Letter b : The prohibition as referred to in this letter excludes the activity of money changers. To run a business as a money changer, the smallholder credit banks must fulfill the provision laid down by Bank Indonesia.

Letter c up to letter e Sufficiently clear

Article 15 Sufficiently clear

Article 16

Paragraph (1) In principle, the mobilization of funds from society by anyone constitutes an activity which needs to be supervised because the activity involves the interest of the society whose funds are deposited at the party collecting the funds In this connection, it is affirmed in this paragraph that a party is only allowed to be engaged in the mobilization of private funds in the form of deposits after the party concerned obtains prior business licensing as a commercial bank or a smallholder credit bank

Though that is the case, in the society there are also other types of institute engaged in the mobilization of funds from society in the form of deposits or the like, such as those managed by post offices, pension funds and insurance companies On the basis of the provision in this paragraph, the activities of the institutes are not included as banking business activities The private fund mobilization activities conducted by the institutes are regulated by separate law and its implementation regulation

Paragraph (2) and (3) : Sufficiently clear.

Paragraph (4) : Hereinafter referred to as "districts" are those located outside the capitals city of regency, municipality, the capitals city of province, or the capital of the state This is intended to enable smallholder credit banks to constantly boost the development and modernization in rural areas

Paragraph (5) Within the framework of further enhancing the equitable distribution of development, smallholder credit banks can be set up by the local administrations, either jointly or in cooperation with cooperatives, state-owned banks and/or regional administration-owned banks especially in the cities as referred to in this paragraph

Paragraph (6) : In the government regulation as the implementation of paragraph (3), (4) and (5), the provisions concerning cooperatives as regulated in the law on cooperatives, such as relating to organizational struture, ownership and management need to the observed,

Article 17

Letter a • The provision concerning the estents of ownership and management of foreign partners also includes the definition of Indonesianization process
With the existence of this provision, it is expected that the nation banking circles would increasingly be able to rely on their own strength

Letter b : Sufficiently clear.

Letter c Other matters required in drawing up the said government regulation are obtained from the Monetary Council because of its functions which are related to the formulation of monetary policies according to the law in force However, the Monetary Council can ask the related state agencies input to formulate the government regulation

Article 18

Paragraph (1) up-to paragraph (4) Sufficiently clear

Article 19

Paragraph (1) To provide services to economically-weak groups/small-scale businessmen in urban areas, the Minister can give licences to smallholder credit banks to open branch offices in the capitals of regencies, municipalities, and/or capitals of provinces concerned after holding consultation with Bank Indonesia. The licences can also be given to small holder credit banks domiciled around the capital of the state to open branch offices in the capital of the state

Paragraph (2) Sufficiently clear.

Paragraph (3) To ensure the survival of smallholder credit banks' business, after holding consultation with Bank Indonesia, the Minister shall stipulate the requirements and procedures for the opening of offices of smallholder credit banks, including the requirement of banks' soundness and banks' preparedness to open offices. Specifically for smallholder credit banks wishing to open offices in the capital of the state, capitals of provinces, capitals of regencies and municipalities, they shall fulfil the requirement of bank soundness and preparedness to open offices, besides other requirements, such as capital, and the availability of professional workers

Article 20

Paragraph (1) Hereinafter referred to as "banks domiciled abroad" are banks which are established on the basis of foreign law and have their headoffice abroad. Therefore, the banks concerned abide by the law of the country where they are set up.

Paragraph (2) and (3) Sufficiently clear.

Article 21

Paragraph (1)

Letter a up to Letter d Sufficiently clear.

Paragraph (2) :

Letter a up to letter c : Sufficiently clear.

Letter d : This provision is intended to provide an umbrella for banking institutes which are smaller than smallholder credit banks, such as village banks, village supply units, village credit boards and other institutes as referred to in Article 58.

Paragraph (3) : Sufficiently clear.

Article 22

Letter a : In case the founders of banks are statutory bodies, the related statutory bodies shall be wholly owned by Indonesian citizens. Included in the definition of Indonesian statutory body shall be state-owned companies, regional administration-owned companies, co-operatives and privately-run companies.

Letter b : Sufficiently clear.

Article 23 : In case smallholder credit banks are owned by Indonesian statutory bodies, the said Indonesian statutory bodies shall be wholly owned by Indonesian citizens.

Article 24 Sufficiently clear.

Article 25 : The shares of banks in the form of named shares are intended to know the change in the ownership of the shares.

Article 26	:
Paragraphs (1) and (2)	: Sufficiently clear
Paragraph (3)	Hereinafter referred to as "majority" is at least 51 % (fifty per cent) of the total shares sold through the stock exchange.
Paragraph (4)	Hereinafter referred to as "the majority position of share ownership of the state" is at least 51 % (fifty per cent) of the paid-up capital.
Paragraph (5)	: Sufficiently clear.
Article 27	:
Letters a and b	: Sufficiently clear.
Article 28	:
Paragraph (1)	: Merger is the merger of two banks or more by constantly maintaining the existence of one of the banks and liquidating other banks. Consolidation is the merger of two banks or more by setting up a new bank and liquidating the existing banks Acquisition is the ownership expropriation of a bank In case of state-owned commercial banks, merger or consolidation can only be conducted among state-owned commercial banks. Therefore, the ownership by private parties of the state-owned commercial banks' shares can only be done through the stock exchange. In conducting mergers, consolidations and acquisitions, it is obligated to prevent the centralization of economic power on one group in the form of monopoly harmful to the public. The mergers, consolidations and acquisitions should not also inflict a loss upon the customers.
Paragraph (2)	Sufficiently clear
Article 29	
Paragraphs (1), (2), (3) and (4)	: In a view of the fact that banks work with private funds deposited in the banks on the basis of trust, each bank needs to maintain its sound condition and entrust to the public. In this connection, Bank Indonesia is authorized and obliged to develop and supervise banks by making preventive efforts in the form of stipulations, directives, advice, and guidance and represive efforts in the form of inspection followed by improvement measures.
Paragraph (5)	: The information made available to the public is the information concerning the risk of the activities which become the target of the use or placement of funds. If the information has already made available, the banks are considered to have implement this provision. The information needs to be provided by banks, in case the banks act as an intermediary in the placement of funds from customers or sell/buy securities for the interest of and at the request of their customers.
Article 30	:
Paragraphs (1) and (2)	: The obligation to submit information and explanations on their business activities to Bank Indonesia is required in a view of the fact that the information is needed to monitor the condition of a bank. Efforts to monitor the condition of a bank should be made to protect private funds and to maintain the existence of banking institutes. The public confidence in the banking institutes can only be promoted if the banking institutes are always in sound condition undertaking their business activities. Therefore, within the framework of the truthfulness of the reports presented by banks, Bank Indonesia is authorized to examine books and documents of banks.
Paragraph (3)	: Sufficiently clear.
Article 31	:
Paragraphs (1) and (2)	: Sufficiently clear.

Article 32 — The request by the Minister to Bank Indonesia to conduct special auditing on banks or to provide reports on bank auditing results is made in case of indication which according to the Minister endanger the soundness and survival of the banks, public interest and the continuation of the national development.

Article 33

Paragraph (1) — Sufficiently clear

Paragraph (2) — Hereinafter referred to as "requirements and procedures for auditing" include types of auditing, auditing procedures, auditing scope, reporting and a follow-up to the auditing result within the framework of development and control.

Article 34

Paragraph (1) up to paragraph (3) — Sufficiently clear

Article 35 — Sufficiently clear

Article 36 — This exception can be provided for by paying attention to the capability of the related smallholder credit banks

Article 37

Paragraph (1) — Sufficiently clear

Paragraph (2) — This paragraph stipulates measures which can be taken by Indonesia against banks which are in difficulties which endanger the survival of their business activities, before revoking their business licence and/or imposing liquidation measures. The said measures are taken within the framework of maintaining/saving banks as public trust institutes.

Paragraph (3) up to paragraph (5) — Sufficiently clear

Article 38

Paragraph (1) — The provision in this Article is also valid in the event of the appointment and mutation of managing officials who are of the same level with members of the boards of directors and commissioners, for banks which in the form of cooperatives.

Paragraph (2) — Sufficiently clear

Article 39

Paragraph (1) : The use of expatriates by banks is justifiable to fulfil the demand of the related banks For smallholder credit banks and commercial banks, the use of expatriates is temporary in nature and limited to experts, counselors and consultants pursuant to the demand of the related banks. For mixed banks and branches of banks domiciled abroad, the use of expatriates is adjusted to the nature of ownership by foreign parties. However, the use of expatriates by the mixed banks and branches of banks domiciled abroad must be adjusted to the Indonesianization program.

Paragraph (2) : Stipulated in the Government Regulation includes requirements as the spelling out of the provision in paragraph (1) such as type of work or expertise which still requires expatriates and the period of using expatriates, pursuant to the effective laws on manpower

Article 40

Paragraph (1) In this connection, what banks must normally keep confidential are all data and information concerning the financial condition and other matters of persons and bodies the banks know because of their business activities

The banks, which require the confidence of the public depositing their money in the banks require the confidentiality for their own interest. The public will entrust their money in banks or make use of banking services only if the banks assure the public that they will not misuse their knowledge about deposits and financial condition of the customers. The provision affirms that banks must keep their secret. However, the banks are allowed to give data or information to other parties pursuant to Articles 41, 42, 43, and 44.

Paragraph (2) Sufficiently clear

Article 41

Paragraph (1) For the judicial interest in criminal cases at the request of the Chief of the Indonesian Police, Attorney General, and the Head of Supreme Court, the Minister can issue written permits to obtain information from banks on the financial condition of the customers who become the suspect/defendant. The word "can" is aimed at giving affirmation that the Minister will issue the permits as long as the parties applying for the permits fulfil administrative requirements/procedures for the issuance of the permits. such as name, position, soldier's registration number (NRP)/civil servant's official registry number (NIP) and police rank, judge or lawyer, the aim of auditing, officials authorized to submit application to the Minister, the name of customers who become the suspect/defended as well as the reasons why the information is required in connection with related criminal cases

paragraphs (2) and (3) Sufficiently clear

Article 43 In case the civil case involving banks and their customers as referred to in this Article, the banks can give information on the financial condition of the customers in the case and other information related to the cases with the permit from the Minister.

Article 44 :

Paragraph (1) The exchange of information among banks is aimed at accelerating and safeguarding the business activities of banks, among others, to prevent double credits as well as know the status of other banks. In this way, banks can appraise the level of risk they will face before conducting transactions with customers of other banks.

Paragraph (2) The provisions to be laid down by Bank Indonesia, among others, concern the procedure for the delivery and request of information and the model and type of certain information which can be exchanged, such as the broad outline indicator of credits banks receive, and information on whether or not the related debtors are included in the list of stagnant credits.

Article 45 If banks fail to make corrections at the request of the parties suffering a loss as the result of the information given by the banks, the parties concerned can submit the matters to the authorized court.

Article 46

Paragraph (1) and (2) Sufficiently clear.

Article 47 :

Paragraph (1) Sufficiently clear.

Paragraph (2) Herein referred to as "employees of banks" are all officials and employees of banks.

Article 48

Paragraph (1) Herein referred to as "employees of banks" are bank officials authorized and entrusted to carry out the operational tasks of banks, and employees having access to information on the condition of banks.

Paragraph (2) Sufficiently clear.

Article 49

Paragraph (1) Herein referred to as "employees of banks" are all officials and employees of banks

Paragraph (2) Letter a : Herein referred to as "employees of banks" are all officials and employees of banks.

Letter b : Herein referred to as "employees of banks" are bank officials who are entitled to and responsible for the matters related to the business of the related banks

Article 50 Sufficiently clear

Article 51 : Paragraph (1) The acts as meant in the paragraphs of this Article shall be classified as criminal acts, meaning that those involved in the said acts will be liable to more severe punishment than if they are merely involved in violation. This reminds us that a bank is an institute in charge of keeping funds the people have entrusted to it, therefore, the acts which cause damage to the public confidence in the bank, and in principle also bring an adverse effect on either the bank or the people, need to be avoided

Since the act is classified as a criminal act, it is expected that there will be strong obedience to the provision in this law. Concerning the criminal acts that members of the boards of commissioners, and directors or smallholder credit bank officials commit, they are in principle subject to the provisions concerning criminal sanctions in Chapter VIII, in view of the fact that the nature of the criminal punishment are valid for the general people With the fixation of the maximum limit of punishment against the acts, the degree of punishment can be mulled over with regard to the losses that may arise

Paragraph (2) Sufficiently clear

Article 52 The administrative sanctions in this article can be in the form of

a fine, namely an obligation to pay certain amount of money for failing to fulfil the provisions in this law

b warrant,

c degration of bank soundness,

d. prohibition of participating in clearing,

e the freezing of either the whole business activities of the bank or the business activities of its several branches,

f the revocation of a business licence

Bank Indonesia shall further regulate the implementation of the administrative sanctions Especially concerning letters e and f, they shall be implemented according to provisions in the prevailing law.

Article 53 Administrative sanctions in this Article can be in the form of

a fine, namely an obligation to pay a certain amount of money for failing to fulfil provisions in this law,

b warrant,

c. the prohibition of serving as a member of the board of directors or the board of commissioners of the bank,

d the prohibition of giving services to banking circles,

e submitting a proposal to the authorized agencies to revoke or cancel a business licence to provide services to banks (among others to consultant, law consultant, public accountant, appraiser).

Article 54 Paragraphs (1) and (2) Sufficiently cldar.

Paragraph (3) The adjustment to the legal status of state-owned banks as referred to in this Article shall be made on the basis of Law No.9/1969 jo. Government Regulation No.12/1969. In this way, after the state-owned banks have already completed the adjustment to their legal status, the law on the establishment of the banks shall be declared no longer effective.

Thereby, Law No 13/1962 shall also be no longer effective 1 (one) year starting from the enforcement of this law.

Article 55 · Paragraphs (1) up to Paragraph (3) Sufficiently clear

Article 56 This provision is intended to enable banks to fulfil provisions on the maximum limit of credits granted on the basis of this law in a stage so as not to cause heavy difficulties for the banks to fulfil the said provisions in view of the present provisions that require banks to provide the maximum limit of credits which is higher than that as referred to in paragraphs (2) and (4) of Article 11

Article 57 : Non bank institutes of finance can adjust their business to become banks on the basis o. this law within a period of 1 (one) year at the earliest starting from the enforcement of this law Non bank institutes of finance can adjust their business to become stock companies on the basis of this provision on the capital marker

Article 58 ' In view of the fact that the institutes as meant in this Article have grown and developed in the community, and the people still need them, the existence of the institutes are acknowledged. Therefore, this law provides the clarification of the status of the said institutes To ensure the unity and uniformity in the development and control of the institutes, the requirement and procedure for the granting of the status of the said institutes as a smallholder credit bank are stipulated by a government regulation.

Article 59 This provision is intended to avoid legal vacuums and deal with problems that arise until the issuance of new regulations

Articles 60 and 61 Sufficiently clear

SUPPLEMENT TO STATUTE BOOK OF THE REPUBLIC OF INDONESIA NO 3472.

14

ANNEX E

MINISTERIAL DECREE ON SMALLHOLDER CREDIT BANKS

GOVERNMENT REGULATIONS

SMALLHOLDER CREDIT BANK
(Decree of the Minister of Finance No. 221/MKM.017/1993 dated February 26, 1993)

THE MINISTER OF FINANCE,

Considering :
a. that within the framework of improving banking services especially for economically-weak people and the rural community, it is necessary to give wider opportunities to the community to develop the business activities of smallholder credit banks,
b. that to ensure their better development, it is necessary to give wider opportunities to smallholder credit banks to grow and develop by taking into consideration principles of prudence,
c that in conjunction with the matters, it is deemed necessary to lay down provisions on smallholder credit banks with a decree of the Minister of Finance.

In view of :
1 Law No 13/1968 on the Central Bank (Statute Book of 1968 No 63, Supplement to Statute Book No 2865);
2. Law No 7/1992 on the Banking system (Statute Book of 1992 No. 31, Supplement to Statute Book No. 3472),
3. Law No 25/1992 on Cooperatives (Statute Book of 1992 No 116, Supplement to Statute Book No. 3502),
4 Government Regulation No 71/1992 on Smallholder Credit Banks (Statute Book of 1992 No 118, Supplement to Statute Book No 3504),
5 Government Regulation No 72/1992 on Banks Operating under Profit-sharing Principles (Statute Book of 1992 No 119, Supplement to Statute Book No. 3505),
6 Presidential Decree No 64/M/1988,

DECIDES:
THE DECREE OF THE MINISTER OF FINANCE CONCERNING
SMALLHOLDER CREDIT BANKS

CHAPTER I
THE LICENCING FOR THE ESTABLISHMENT OF SMALLHOLDER CREDIT BANKS

Article 1

Smallholder credit banks can only be established and run their business activities with permits from the Minister of Finance after holding consultation with the Bank Indonesia.

Article 2

The granting of business licences to smallholder credit banks shall be conducted in 2 stages, :
a. principle approval, i.e. an approval to make preparation for the establishment of a smallholder credit banks;
b. business licence, i.e a licence granted to run a business after the preparations as meant in letter a are already made

Article 3

(1) The application for a principle approval and business licence to establish a smallholder credit banks as meant in Article 2 shall be submitted to the Minister of Finance with a copy addressed to the Bank Indonesia by using the form as attached (see Attachment 1 and 2).

(2) The...

(2) The application to the Minister of Finance as meant in paragraph (1) shall be addressed to the Directorate of Banking and Financial Services, Directorate General of Financial Institute Jl Dr Wahidin No 1, Building A, Jakarta 10710, while the copy of the application shall be addressed to the head office of the Bank Indonesia, Jl M H Thamrin No 2, Jakarta 10010, on the same date

Article 4

(1) The application for the principle approval as meant in Article 3 paragraph (1) shall be submitted at least by one of prospective owners and must enclose :

a. the draft of statute/deed on establishment of the smallholder credit bank contains at least

1) name and domicile,

2) scope of business activities as a smallholder credit bank,

3) capiptalization,

4) ownership,

5) authority, responsibility and term of office of members of the board of directors and the board of commissioners,

b the list of prospective shareholders along with details of their respective participation for the smallholder credit bank which has the form of a regional administration owned company and limited liability company, or the list of prospective members along with details of compulsory deposits and principal deposits as well as the list of parties who will make participation along with the amount of their participation for the smallholder credit bank which have the form of a cooperative,

c. the list of prospective members of the board of directors and the board of commissioners along with

1) identity, i e copy of an identity card (KTP),

2) evidence of the Indonesian citizenship for those of foreign descent and a certificate of the change of name if the party concerned has changed his/her name,

3) curriculum viate,

4) statement of non-involvement in misdeeds in the banking sector and/or statement of unsentenced status in connection with criminal offences in the banking and economic sectors,

5) certificate of operational experience in the banking sector for prospective experienced members of the board of directors,

d the draft of an organisational structure,

e work programs for the first year which contain at least

1) the general view of the economic condities of the related region,

2) the plan for business activities which cover the collection and distribution of funds as well as steps to be taken to realize the said plan,

3) the plan for the need of employees,

4) the projection of monthly cash flow within 12 months starting from the date when the smallholder credit bank carries out its operational activities and the projection of the balance sheet and profit/loss statement;

f the evidence of capital deposit which amounts to at least 30% (thirty per cent) of the minimum paid-up capital, in the form of a copy of deposit ticket under the name of the Minister of Finance q q on of the prospective owners for the establishment of the related smallholder credit bank at a commercial bank in Indonesia by stating that the disbursement of the seposit ticket can be conducted after receiving a written approval from the Minister of Finance and being legalized by the bank receiving the deposit.

(2) The list of prospective sharholders or prospective members as meant in paragraph (1) letter b must enclose

a. in the case of individual

1) condensed curriculum vitae along with a statement of non-involvement in misdeeds in the banking sector and/or a statement of unsentenced status in connection with criminal offences in the banking and economic sectors

2) identity, i e a copy of identity card (KTP),

3) certificate of the Indonesian citizenship for those of foreign descent and a certificate of the change of name if the party concerned has already changed his/her name,

b in the case of legal entity which has the form of a limited liability company, regional administration-owned company or cooperatives

1) statutes/deed on establishment of the related legal entity and amendments thereof the authorized agency already ratifies,

2) identity of all members of the board of commissioners of the related legal entity as meant in letter a,
3) balance sheet of the related legal entity as of the date which is close t to the date on which he application for the principal approval is submitted

(3) For the smallholder credit banks which operate profit sharing principles, the draft of the statute and work programs as meant in paragraph (1) letter a and letter e must clearly enclose the account of bus ss activities which are solely based on profit-sharing principles

Article 5

The principle approval as meant in Article 21 letter a shall be valid for a period of 1 (one) year at the most starting from the issuance date of the principal approval

Article 6

The application for the business licence as meant in Article 3 paragraph (1) shall be submitted by east one member of the board of directors and must enclose

a statutes/deed on establishment the authorized agency already ratifies,
b list of shareholders along with details of their participation for smallholder credit banks which have the form of a regional administration owned company and limited liability company, or list of members ong with details of their principal deposits and compulsory deposits as well as list of the parties who make participation along with the amount of their participation for smallholder credit banks which have the form f a cooperative, by enclosing the dossier as meant in Article 4 paragraph (2),
c composition of the board of directors and the board of commissioners along with
  1) the latest photograph measuring 4 x 6 cm,
  2) exemplary signature and initials
  3) dossier as meant in Article 4 paragraph (1) letter c,
d organizational structure along with working system and procedures, including the composition of personnels,
e evidence of the paying off of the minimum paid-up capital in the form of a photocopy of deposit ticket under the name of "the Minister of Finance q q one of the owner of the related smallholder credit bank" at a commercial Bank in Indonesia, by stating that the disbursement of the deposit ticket can be conducted after receiving a written approval from the Minister of Finance and being legalized by the bank receiving the deposit.
f other evidences of operational preparedness, including
  1) list of fixed assets and stock,
  2) evidence of ownership and control of or a contract for the hiring/leasing of office buildings,
  3) photograph of office buildings and the layout of spaces,
  4) exemplary form/letter to be used for the operational activities of the smallholder credit bank,
  5) Taxpayer Code Number (NPWP)
g statement of non-double position as a member of the boared of directors or an executive official another company for members of the board of directors,

Article 7

(1) The approval or rejection of the application for a principle approval or business licence shall be granted not later than 30 (thirty) work days after the application is received completely
(2) The Bank Indonesia shall give the Minister of Finance consideration to the application for the principal approval or business licence as meant in paragraph (1) not later than 15 (fifteen) work days after copy of the application is received completely

Article 8

(1) The smallholder credit banks which already receive a business licence from the Minister of Finance must carry out operational activities not later than 3 (three) months starting from the issuance date of he business licence

(2) After holding consultations with the Bank Indonesia, the Minister of Finance can revoke the business licence of a smallholder credit bank if after the period of time as meant in paragraph (1) the smallholder credit bank concerned fails to carry out operational activities

Article 9

The smallholder credit bank which alrcady obtain a business licence from the Minister of Finance must clearly add the word "smallholder credit bank or "BPR" to their name whenever they write

CHAPTER II
CHANGE IN BUSINESS ACTIVITIES

Article 10

(1) Smallholder credit banks whose business activities are not based on a Profit-sharing principle can change their business activities to become smallholder credit banks which are solely based on a profit sharing principle with a permit from the Minister of Finance after holding consultations with the Bank Indonesia
(2) The permit as meant in paragraph (1) can be granted if the related smallholder credit banks already
 a change their statutes the authorized agency already ratifies,
 b settle their rights and obligations with all debtors and creditors as a result of business activities which are not based on a profit-sharing principle

Article 11

(1) Smallholder credit banks whose business activities are solely based on a profit-sharing principle can change their business activities to become smallholder credit banks which are not based on a profit sharing principle with a permit from the Minister of Finance after holding consultations with the Bank Indonesia
(2) The permit as meant in paragraph (1) can be granted if the related smallholder credit bank already
 a change their statutes the authorized agency already validates,
 b settle their rights and obligations with all customers as a result of business activities which are solely based on a profit-sharing principle

Article 12

The application for a permit to change the business activities as meant in Article 10 paragraph (1) and Article 11 paragraph (1) shall be submitted by the board of directors of the related smallholder credit bank to the Minister of Finance via the Directorate of Banking and Financial Services , Directorate General of Financial Institute, Jl Dr Wahidin No 1, Building A, Jakarta 10710, while the copy of the application shall be addressed to the head office of the Bank Indonesia, J M H Thamrin No 2, Jakarta 10010, on the same date by using the form as attached (see Attachment 3)

Article 13

The change in business activities as meant In Article 10 and Article 11 can be made one time only

CHAPTER III
THE APPROVAL OF SMALLHOLDER CREDIT BANKS

Article 14

(1) The application from institutes or bodies as meant in Article 19 paragraph (2) of Government Regulation No 71/1992 for a business licence to establish a smallholder credit bank shall be submitted by the executive board of the related institutes or bodies to the Minister of Finance with a copy of the application addressed to the Bank Indonesia by using the form as attached (see Attachment 4)
(2) The application to the Minister of Finance as meant in paragraph (1) shall be addressed to the Directorate of Banking and Financial Service, Directorate General of Financial Institute, Jl Dr Wahidin No 1 Building A, Jakarta 10710, while the copy of the application shall be addressed to the headoffice of the Bank Indonesia, Jl M H Thamrin No 2, Jakarta 10010, on the same date

Article 15

The application for a business licence as meant in Article 14 paragraph (1) must enclose
a basis for the establishment of the related institutes or bodies,
b statutes/deed on establishment the authorizwed agency already ratifies pursuant to the legal form they choose,
c organisational structure,
d balance sheet and profit/loss statement ended before March 25, 1992 and as of the date which is closest to the date on which the application for the business licence is submitted,
e Taxpayer Code Number (NPWP)

Article 16

(1) The application for a business licence as meant in Article 14 paragraph (1) must be submitted not l er than October 30, 1997

(2) The institutes or bodies as meant in Article 14 paragraph (1) which do not submit an application until the time limit as meant in paragraph (1) cannot be approved as a smallholder credit bank and are bann d from collecting private funds in the form deposits

CHAPTER IV
THE OPENING OF OFFICES OF SMALLHOLDER CREDIT BANKS
Article 17

(1) Smallholder credit banks whose headoffice is domiciled in a subdistrict outside the cappital of t state, provincial capital, regencial capital or municpality can open branch offices
   a in subdistricts outside the capital of the state, provincial capital, regencial capital or municipality but still in the same regency where the headoffice of the smallholder credit bank is domiciled,
   b in subdistricts in other regencies as long as the subdistricts still share common borders with th subdistrict where the headoffice of the smallholder credit banks is domiciled, but still outside the capital of the state provincial capital, regencial capital or muncipality
   c in the capital of the state for smallholder credit banks which are domiciled in subdistricts which share common borders with the capital of the state,
   d in a provincial capital or regencial capital of the subdistricts where the headoffice of the relat small-holder credit banks is domiciled or in a municipality which shares common borders with the subdistrict where the headoffice of the smallholder credit banks is domiciled

(2) The smallholder credit banks which will open branch offices as meant in paragraph (1) letter a and letter b must
   a fulfil requirements for the level of soundness and capitalization in the la t 24 (twenty four) mon hs that they are classified as being sound at least in 20 (twenty) months and suff iently sound in the remaining months
   b make a plan and send it to the Bank Indonesia not later than 3 (three) months before the said offi es are opened,
   c repport the opening of the offices to the Bank Indonesia not later than 10 (ten) work days a ter the opening of the offices by using the form as attached (see Attachment 5)

(3) The opening of the branch offices of the smallholder credit banks as meant in paragraphp (1) letter c and letter d can only be conducted with a permit from the Minister of Finance after holding consultations with the Bank Indonesia and must fulfil requirements that
   a the level of soundness and capitalization in the last 24 (months) is classified as being sound at least in 20 (twenty) months and sufficiently sound in the remaining months,
   b equity capital must at least amount to
      1) Rp 10,000,000,000 (ten billion rupiahs) for smallholder credit banks which will open branch offices in the capital of the state,
      2) Rp 3,000,000,000 (three billion rupiahs) for smallholder credit banks which will open branch offices in provincial capitals,
      3) Rp 1,000,000,000 (one billion rupiahs) for smallholder credit banks which will open branch offices in regencial capitals or municipalities outside a provincial capital

(4) The credits channelled by the branch offices of smallholder credit banks as meant in paragraph (1) letter c and letter d must not exceed the amount of creditrs channelled by the smallholder credit banks to customers domiciled outside the cappital of the state, provincial capitals, regencial capital or municipalities

Article 18

(1) To obtain the permit as meant in Article 17 paragraph (3), the board of directors of the smallholder credit bank concerned shall submit an application to the Minister of Finance with a copy addressed to the Bank Indonesia by using the form as attached (see Attachment 6, 6A, 6B and 6C)

(2) Th

(2) The application as meant in paragraph (1) shall be addressed to the Directorate of Banking and Finance Service, Jl Dr Wahidin No 1 Building A, Jakarta 10710, while copies of the application shall be addressed to the headoffice of the Bank Indonesia Jl M H Thamrin No 2, Jakarta 10010 and the local branch office of the Bank Indonesia on the same date, and shall enclose

a consolidated balance sheet in the last 2 (two) months before the date on which the application is submitted,

b appraisala of the soundness of the bank in 2 (two) months which are the same as letter a above

Article 19

(1) The approval or rejection of the application as meant in Article 18 paragraph (1) shall be granted not later than 60 (sixty) work days after the application is received completely

(2) The Bank Indonesia shall give the Minister of Finance consideration to the application as meant in paragraph (1) not later than 45 (forty five) work days after the copy of the application is received completely

Article 20

(1) The opening of the branch offices as meant in Article 17 paragraph (1) letter c and letter d shall be realized not later than 2 (two) months starting from the date on which a permit from the Minister of Finance is issued

(2) The opening of the branch offices as meant in paragraph (1) must be reported to the Minister of Finance with a copy addressed to the Bank Indonesia not later than 10 (ten) work days after the opening date of the branch offices by using the form as attached (see Attachment 7)

(3) If within a period of 2 (two) months, the smallholder credit banks do not open the branch offices as meant in paragraph (12), the Minister of Finance can revoke a permit for the opening of the branch offices after holding consultations with the Bank Indonesia

Article 21

(1) Smallholders credit banks whose headoffice is domiciled outside the capital of the state provincial capital, regencial capital or municipality can only open offices whose status is below branch offices in subdistricts outside the capital of the state provincial capitals, regencial capitals or municipalities which are still the same as the subdistricts where their main office is domiciled

(2) The opening of the offices as meant in paragraph (1) can be realized if the level of soundness and capiptalization in the last 12 (twenty) months is classified as being sound at least in 10 (ten) months and sufficiently sound in the remaining months

(3) Smallholder credit banks which will open offices as meant in paragraph (1) must

a send the plan for the opening of the offices to the Bank Indonesia not later than 3 (three) months before the opening of the said offices,

b report the opening of the said offices to the Bank Indonesia not later than 10 (ten) work days after the opening date of the offices by using the form as attached (see Attachment 7)

Article 22

(1) Smallholder credit banks whose headoffice is domiciled in the capital of the state provincial capital, regencial capital or municipality shall not be allowed to open branch offices or offices whose status is below branch offices

(2) The branch offices of smallholder credit banks and the offices of smallholder credit banks whose statute is below branch offices as meant in paragraph (1) which were established and reported to the Bank Indonesia before December 31, 1989 can continue their business activities

CHAPTER V
THE CHANGE OF ADDRESS OF OFFICES AND THE CHANGE OF NAME OF SMALLHOLDER CREDIT BANKS

Article 23

(1) The change of address of offices of smallholder credit banks can only be made with the provision that

a Smallholder credit banks whose headoffice is domiciled in a subsistrict outside the capital of the state, provincial capital, regencial capital or municipality can only be moved to another subdistrict in the same regency, outside provincial capitals, regencial capitals or municipalities

b smallhold...

b Smallholder credit banks whose headoffice is domiciled in the capital of the state, provincial capital, regencial capital or municipality can only be moved to another area which is still within the same subdistrict or to another subdistrict outside the capital, provincial capital, regencial capital or municipality

(2) The change of address of branch offices of smallholder credit banks can only be made with the provision that

a the branch offices of smallholder credit banks which are domiciled in subdistricts outside the capital of the state, provincial capital, regencial capital or municipality can only be moved to another subdistrict in the same regency as their headoffice, or in a subdistrict in another regency which shares common borders with the subdistrict where their headoffice is domiciled but still outside the capital of the state, provincial capital, regencial capital or municipality

b the branch offices of smallholder credit banks which are domiciled in regeneral capitals or municipalities can only be moved to another area of the same regencies or municipalities or to other subdistricts which share common borders with the subdistricxt where their headoffice is domiciled but still outside the capital of the state, provincial capital, regencial capital or municipality

c the branch offices of smallholder credit banks which are domiciled in the capital of the state provincial capital can only be moved to another area in the capital of the state or provincial capital concerned or to the regency where their headoffice is domiciled

(3) Offices whose status is below the branch offices of smallholder credit banks can only be moved to another area in the subdistrict which is the same as their main office

(4) The change of address of the offices of smallholder credit banks as meant in paragraph (1), paragraph (2) and paragraph (3) must be reported to the local office of the Bank Indonesia with a copy of the report addressed to the Minister of Finance

(5) The report as meant in paragraph (4) must be sent not later than 30 (thirty) work days before the date on which the change of address is made by using the form as attached (see Attachment 8)

Article 24

(1) The change of name of smallholder credit banks can only be made with an approval from the Minister of Finance after holding consultations with the Bank Indonesia

(2) The application for the change of name as meant in paragraph (1) shall be submitted to the Minister of Finance with a copy addressed to the Bank Indonesia by using the form as attached (see Attachment 9)

(3) The application as meant in paragraph (2) must enclose the change of statutes the authorized agency already approves,

(4) The change of name as meant in paragraph (1) must be announced to the local people not later than 10 (ten) work days after the Minister of Finance issues a letter to adjust the name of the banks

Article 25

The reports as meant in Article 23 paragraph (4) and Article 24 paragraph (1) that the board of directors of the bank submits to the Minister of Finance shall be addressed to the Directorate of Banking and Financial Service, Directorate General of Financial Institute, Jl Dr Wahidin No 1 Building A, Jakarta 10710, while a copy of the report shall be addressed to the hadoffice of the Bank Indonesia, Jl M H Thamrin No 2 Jakarta 10010, on the same date

CHAPTER VI
THE CLOSURE OF SMALLHOLDER CREDIT BANKS

Article 26

(1) The closure of the branch offices of smallholder credit banks which have domicile as meant in Article 17 paragraph (1) letter c and letter d can only be realized with an approval from the Minister of Finance after holding consultations with the Bank Indonesia

(2) The application for the closure of the branch offices as meant in paragraph (1) shall be submitted by the board of directors of the related smallholder credit banks not later than 3 (three) months before the closure of the said branch offices is realized, and addressed to the Directorate of Banking and Financial Service, Directorate General of Financial Institute, Jl Dr Wahidin No 1 Building A, Jakarta 10710, while a copy of the application shall be addressed to the headoffice of the Bank Indonesia Jl M H Thamrin No 2 Jakarta 10010 along with the reasons for the closure on the same date

(3) The closure of the offices as meant in paragraph (1) must be reported to the Minister of the finance with a copy of the report addressed to the Bank Indonesia not later than 10 (ten) work days after the date of closure by using the form as attached (see Attachment 10)

Article 27

(1) For the branch offices which have domicile as meant in Article 17 paragraph (1) letter a and letter b as well as the office whose status is below the branch offices of smallholder credit banks, the closure of the branch offices of smallholder credit banks must be reported to the Bank Indonesia not later than 3 (three) months before the closure of the said offices is realized

(2) The closure of the offices as meant in paragraph (1) must be reported to the Bank Indonesia not later than 10 (ten) work days after the date of closure by using the form as attached (see Attachment 11)

CHAPTER VII
OTHER PROVISIONS
Article 28

Smallholders credit banks can be upgraded to become commercial banks on the condition that they meet the procedures and requirements as regulated in Article 34 and Article 35 of Decree of the Minister of Finance No 220/KMK.017/1993 dated February 26, 1993 on commercial banks

CHAPTER VIII
ADMINISTRATIVE SANCTIONS
Article 29

Banks and affiliated parties which fail to meet their obligations as stipulated in this decree shall be subject to administrative sanctions from the Bank Indonesia

CHAPTER IX
CONCLUSION
Article 30

With the enforcement of this decree

a Decree of the Minister of Finance No 1064/KMK.00/1988 dated October 27, 1988 the establishment and business of smallholder credit banks,
b Decree of the Minister of Finance No 279/KMK.01/199 dated March 25, 1989 on the improvement of Decree of the Minister of Finance No 106 /KMK.00/1988 on the establishment and business of smallholder credit banks,
c Decree of the Minister of Finance No 1238/KMK.00/1989 dated November 14, 1989 on the opening of offices of smallholder credit banks which already obtained a permit before October 27, 1988,
d Decree of the Minister of Finance No 228/KMK.01/1991 dated February 28, 1991 on the additional provisions on the establishment and business of smallholder credit banks,

shall be declared null and void

Article 31

This decree shall come into force as from the date of stipulation

For public cognizance, this decree shall be announced by placing it in the State Gazette of the Republic of Indonesia

Stipulated in Jakarta
on February 26, 1993
THE MINISTER OF FINANCE
sgd
J B SUMARLIN

Attachment I

SMALLHOLDER CREDIT BANKS
(Decree of the Minister of Finance No. 221/MKM 017/1993 dated February 26, 1993)

(Continued from Business News No 5386 pages 1A - 8A)

Attachment 1

Decree of the Minister of Finance
No. 221/KMK 017/1993
Dated February 26, 1993

...., 19..

No.
Enclosure :
Subject   Application for a principle approval for the establishment of a smallholder credit bank.

To
The Minister of Finance
attention . The Directorate of Banking and Financing Services, Directorate General of Financial Institutes
Jl. Dr.Wahidin No.1 Building A
Jakarta 10/10

We herewith apply to you for a principle approval to establish a smallholder credit bank with the planned name .. . . . . We enclose the following documents for your consideration :

1 Draft statute
2. List of prospective shareholders'members and list of parties to make participation *)
3. List of prospective members of the board of directors and the board of commissioners/executive board *)
4 Plan for organizational structure;
5. Work programme in the first year.
6. Photocopy of deposit account amounting to Rp .... under the name of the Minister of Finance q.q. .... which accounts for ... ... % of the minimum paid-up capital required and legalized by the bank receiving the deposit.

We greatly appreciate your approval.

Name and signature of the prospective owner.

Copies to

1. Bank Indonesia;
2. The Directorate General of Financial Institute

*) Pick up as required.

Attachment 2 ......

Attachment 2

Decree of the Minister of Finance
No 221/KMK 017/1993
Dated February 26, 1993

...., 19..

No. :
Enclosure :
Subject : Application for a business licence to establish a smallholder credit bank.

To
The Minister of Finance
attention : The Directorate of Banking and Financing Services, Directorate General of Financial Instititutes
Jl.Dr.Wahidin No.1 Building A
Jakarta 10710.

We herewith apply to you for a business licence to establish a smallholder credit bank with the following data :

1. Name of bank
2. Address
3. Number and date of principle approval
4. Taxpayer Code Number (NPWP)
5. Attachments, consisting of
   a. The statute of the bank validated by the authorized agency.
   b. The list of shareholders/members and the list of parties to make participation *)
   c. The composition of the board of directors and the board of commissioners/executive board *)
   d. The organisational structure, working system and procedure.
   e. The evidence of preparedness for operation.
   f. The photocopy of a deposit account amounting to Rp .... under the name of the Minister of Finance q.q. . ... which constitutes the settlement of the payment for the minimum paid-up capital required and legalized by the bank receiving the deposit.
   g. Statement of non-double position as a member of the board directors or another executive official at another company for members of the board of directors.

We greatly appreciate your approval.

Name and signature of the board of directors/ executive board.

Copies to

1. Bank Indonesia
2. The Directorate General of Financial Institutes.

*) Pick up as required

Attachment 3 :

.. ... , 19 .

No
Enclosure
Subject Application for a permit to change a business activity

----

To
The Minister of Finance
attention : The Directorate of Banking and Financing Services, Directorate General of Finan-ial Institutes
Jl Dr.Wahidin No.1 Building A
Jakarta 10710.

We herewith apply to you for a permit to change a business activity from a bank operating under a profit-sharing/non-profit -sharing principle into a bank operating under a non-profit-sharing/profit-sharing principle. *)
We enclose the following data for your consideration :
1 The statute amendment validated by the authorized agency.
2 The evidence of the settlement of rights and obligations with all debtors and creditors as a result of business activities on the basis of a profit-sharing/non-profit-sharing principle.*)
This is for your information

THE BOARD OF DIRECTORS OF
BANK ....

Copies to

-------- -

1. Bank Indonesia;
2. The Directorate General of Financial Institute.

*) Pick up as required.

Attachment 4 .

............, 19..

No :
Enclosure :
Subject : Application for a business licence for anapproval as a smallholder credit banks.

To
The Minister of Finance
attention . The Directorate of Banking and Financing Services, Directorate General of Financial Institutes
Jl Dr.Wahidin No 1 Building A
Jakarta 10710

We herewith apply to you for a business licence for an approval as a smallholder credit bank with the following data :

1 Name of Institute/Body
2 Address
3 Taxpayer Code Number (NPWP)
4 Attachments, including
   a Basis for the establishment of the institute/body in the form . . .. ..
   b. The statute validated by the authorized agency.
   c. The organisational structure.
   d. The financial statement ended on ....x) and ended on .... xx).

We greatly appreciate your approval

Name and signature of the executive board

Copies to :

1 Bank Indonesia;
2 The Directorate General of Financial Institutes.

x) before March 25, 1992.
xx) the date closest to the date on which the application for a business licence is submitted.

Attachment 5 :

Decree of the Minister of Finance
No. 221/KMK.017/1993
Dated February 26, 1993

............., 19..

No. :
Enclosure :
Subject : Report on the opening of office ....

To,
Bank Indonesia
in
....

We herewith inform you that we have already opened our office in .... Jalan .... on .... (date).

This is for your information.

THE BOARD OF DIRECTORS OF
BANK ....

Copies to :
1. The Directorate of Barking and Financing Services;
2. The branch office of Bank Indonesia in ....

Attachment 6. ......
(TO BE CONTINUED)

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SMALLHOLDER CREDIT BANKS

(Decree of the Minister of Finance No. 221/MKM 017/1993 dated February 26, 1993)

(Continued from Business News No 5387/5388 pages 19A-22A)

Attachment 6

Decree of the Minister of Finance
No 221/KMK.017/1993
Dated February 26, 1993

No :
Enclosure ·
Subject Application for the opening of the branch office of a smallholder credit bank

............, 19..

To
The Minister of Finance
attention : The Directorate of Banking and Financing Services, Directorate General of Financial Institutes
Jl. Dr.Wahidin No.1 Building A
Jakarta 10710

We herewith apply to you for a permit to open a branch office ı . . . . with the following data

1 The address of the branch office to-be-opened
2. Attachment
   a consolidated balance sheet in the last 2 months.
   b. appraisal of solvency in the last 2 months

We greatly appreciate your approval.

THE BOARD OF DIRECTORS OF
BANK ....

Copies to

1. Bank Indonesia
2. The Directorate General of Financial Institute

Attachment 6 A

............, 19..

No
Dated

BALANCE SHEET
NAME OF SMALLHOLDER CREDIT BANK ....

(in rupiah thousand)

ASSET ITEMS	MONTH	MONTH	LIABILITY/CAPITAL ITEMS	MONTH	MONTH
1	2	3	4	5	6
1 Cash	..	...	1. Servings	. ..	....,
2. Bank Indonesia	. ..	. ..	2. Time deposits	. ..	.....

3. Claims....

1	2	3	4	5	6
3 Claims on other banks			3 Other liabilities		
a Giro			4 Loans received		
b. Savings			a Bank Indonesia	.	
c. Time deposits			b. Subordination	.	.
d. Granted credits	. .	.	c Others	. .	.
4 Securities and other claims	.	.	5 Miscellaneous liabilities/capital	...	.
5 Granted credits		.	6 Paid up capital		
6 Reserves for classified assets			Reserves	..	.
7 Fixed assets & Inventory (Book Value)	.	.	7 Profit/loss	..	
8 Miscellaneous assets		.			
T O T A L	.	..	T O T A L	..	

ADMINISTRATIVE ACCOUNTS	MONTH	MONTH
1 Credit facilities to customers which are not yet used	.	
2 Other administrative account		
T O T A L		

Attachment 6 B

FROM OF THE APPRAISAL OF SOLVENCY LEVEL

NAME OF SMALLHOLDER CREDIT BANKS .

A D D R E S S :

APPRAISAL MONTH

FACTORS AND COMPONENTS OF APPRAISAL	TOTAL	RATIO	COMPONENT CREDIT VALUE	FACTOR CREDIT VALUE
1	2	3	4	5
I CAPITALIZATION				
A. Capital	....			
B Weighted assets according to ratio (ATMR)	. ..			
C Ratio of capital to ATMR		....	....	
Credit value of capitalization factor				....
II. QUALITY OF PRODUCTIVE ASSETS				
1 A. Classified productive assets	....			
B. Total productive assets	....			
C. Ratio classified productive assets to productive assets		....	....	
2. A. Reserves for classified assets	. ..			
B. Classified productive assets	...			
C. Ratio of reserves for classified assets to classified assets		....	....	
Credit value of factor of the wuality of assets				

1	2	3	4	5
III MANAGEMENT				
1 Capital Management	..			
2 Asset Management	..	. .		
3 General Management	.	.		
4 Rentability Management	...	.. .		
5 Liquidity Management	.. .	.. .		
IV. RENTABILITY				
1 A Profit of the current year (before tax)	. .			
B. Average total assets	....			
C. Ratio of profit to total assets		.. .	...	
2. A. Monthly average operational expenses in the last 12 months	...			
B. Monthly average operational revenues in the last 12 months	....			
C Ratio of operational expepnses to operational revenues		. ..	....	
Credit value of rentability factor				....
V. L I Q U I D I T Y				
1. Credits granted at the end of the appraisal month	....			
2 Second parties' fund at the end of the appraisal month	.. .			
3 Ratio of credit of third parties' fund	....		....	
Credit value of liquidity factor				....
Credit value of Camel Factor				....
VI IMPPLEMENTATION OF CERTAIN PROVISIONS				
1. Maximum limit of the granting of credits (BMPK)				....
2. Small-scale business credits (KUK)				....
VII. FINAL RESULT OF THE APPRAISAL OF SOLVENCY LEVEL				
1 Credit value				. ..
2 Predicate				....

Attachment 6 C

DETAILS OF COLLECTIBLE PRODUCTIVE ASSETS

PRODUCTIVE ASSETS	MONTH	MONTH
1 CREDITS GRANTED IN RUPIAH		
A Smooth		
B Less smooth		
C Doubted		
D B a d		
2 SECURITIES IN RUPIAH		
A Smooth		
B Less smooth		
C b a d		
3 PLACEMENT IN OTHER BANKS IN RUPIAH		
A Smooth		
B Less smooth		
C. Doubted		
D. B a d		

Attachment 7.....

Attachment 7

.. . .., 19

No. .
Enclosure :
Subject : Report on the opening of a branch office . .

To
The Minister of Finance
attention : The Directorate of Banking and Financing Services, Directorate General of Financial Institutes
Jl. Dr Wahidin No.1 Building A
Jakarta 10710

With regard to the permit for the opening of a branch office No . . ... dated .. .., we herewith inform you that our branch office in . ..... was officially opened on . . (date).

This is for your information.

THE BOARD OF DIRECTORS OF
BANK ....

Copies to ·

1. Bank Indonesia
2. The Directorate General of Financial Institutes

Attachment 8

............, 19..

No. :
Enclosure :
Subject : Report on the change of address

To
The Minister of Finance
attention The Directorate of Banking and Financing Services, Directorate General of Financial Institutes
Jl. Dr Wahidin No.1 Building A
Jakarta 10710.

We herewith inform you that our office in .... will move to another place as follows :

Old address : .... Phone No . ... . Telex No . ..
New address : .. . . Phone No . . .. . Telex No ..
The planned date for moving .. . .

This is for your information.

THE BOARD OF DIRECTORS OF
BANK .. ..

Attachment 9....

Attachment 9

............, 19..

No. .
Enclosure
Subject . Report on the change of name of a smallholder credit bank

To
The Minister of Finance
attention : The Directorate of Banking and Financing Services, Directorate General of Financial Institutes
Jl. Dr.Wahidin No 1 Building A
Jakarta 10710.

We herewith inform you that our bank called .... has its name changed into .. . . since .... (date) and has been validated by the Minister of Justice under decree No. ... .. dated . .. .

With regard to the matter above, we request the Minister of Finance to validate the business licence of Bank .... to become Bank .... (the new name of the bank).

This is for your information

THE BOARD OF DIRECTORS OF
BANK ....

Copies to .

1 Bank Indonesia
2. The Directorate General of Financial Institute.

Attachment 10

............, 19..

No. :
Enclosure :
Subject · Report on the closure of the branch office of a smallholder credit bank

To
The Minister of Finance
attention . The Directorate of Banking and Financing Services, Directorate General of Financial Institutes
Jl Dr Wahidin No.1 Building A
Jakarta 10710

We herewith inform you that pursuant to an approval from the Minister of Finance No. .. . dated . . . we close our branch office in the subdistrict of . . . . in the regency of ... . on .. .. (date).

This is for your information

THE BOARD OF DIRECTORS OF
BANK ....

Coppies to :

The branch office of Bank Indonesia in ....

Attachment 11
Decree of the Minister of Finance
No 221/KMK.017/1993
Dated February 26, 1993

. .. ... , 19..

No .
Enclosure .
Subject . Report on the closure of the branch office of a smallholder credit bank

To
Bank Indonesia
in

We herewith inform you that we will close our office in the village of in the subdistrict of in the regency of as from (date)

This is for your information

THE BOARD OF DIRECTORS OF
BANK . .. .

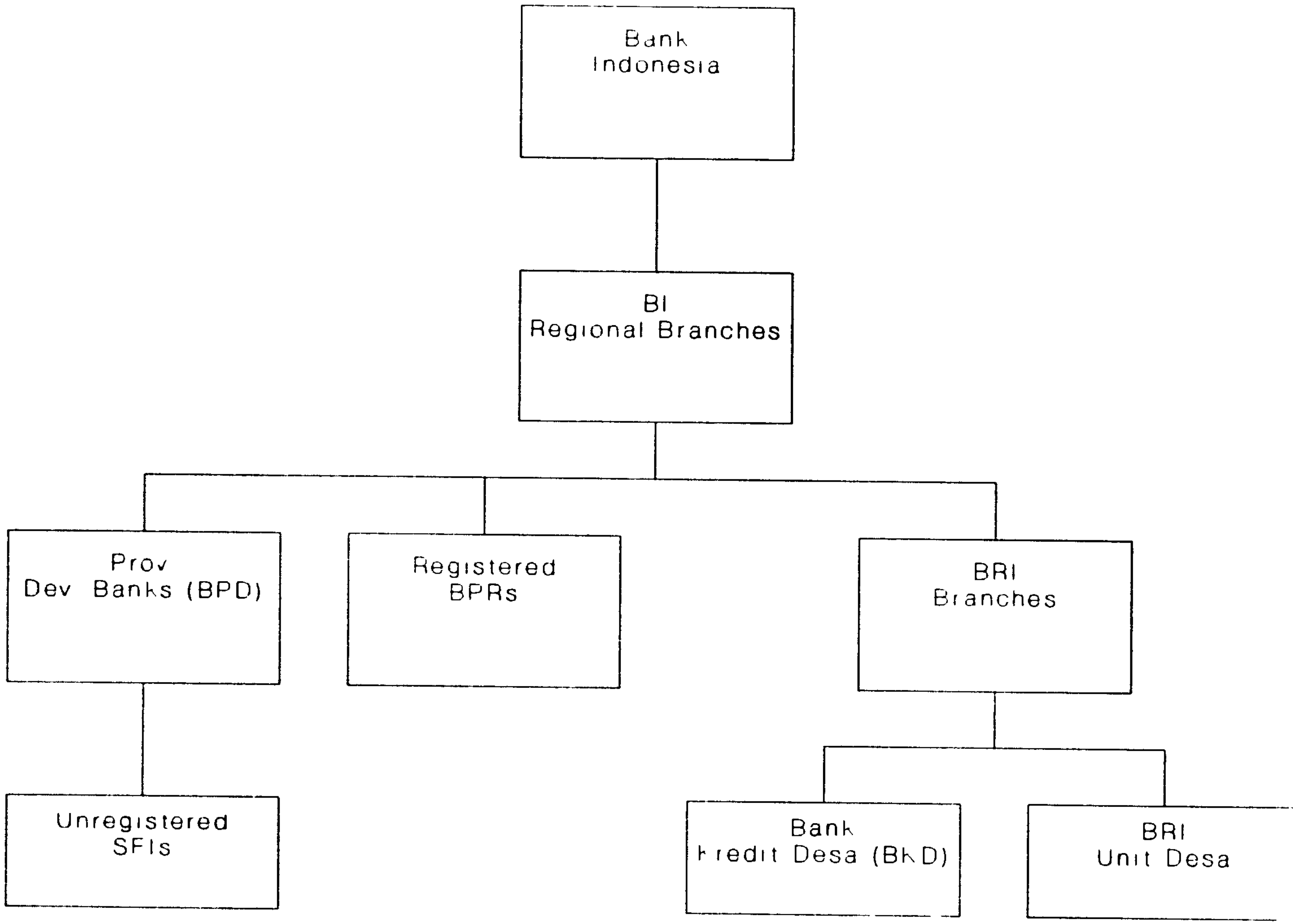
Copies to

1 The Directorate of Banking and Financial Service
2 The branch office of Bank Indonesia in

ANNEX F

SUPERVISION HIERARCHY

Supervision Hierarchy
Indonesian Small Financial Institutions



ANNEX G

JOB DESCRIPTIONS AND QUALIFICATIONS

SUPERVISORS IN BPD HEAD OFFICE

DUTIES	TASKS	TRAINING REQUIRED
Ensure all LFI reports are received on time	List reports based on number of LFIs and type of report Check every incoming report from every LFI	General Management (Office and Personnel Management)
Randomly visit LFI units on spot audits	Identify several LFIs to be visited monthly on basis of performance problems etc Visit each LFI Perform spot audits as required Ensure that approved procedures are followed	Audit Principles and Procedures
Advise the LFI problem units on operational and administrative matters	Explain operational and administrative procedures needed Assist in finding mistakes and identify appropriate solutions	Bookkeeping and Basic Accounting Procedures
Assist in on the job training of BPD branch office supervisors	Discuss monthly schedules for on the job training with field supervisors Ask field supervisors to perform spot audits in LFIs visited Identify mistakes and solutions	Management and Supervision Methods
Carry out analyses of individual reports and results of spot audit	Check every incoming report individually Make analyses of individual reports for all necessary aspects	Lending Saving Mobilization
Prepare necessary reports for management and statistical purposes	Integrate the analyses of all reports	Report writing Spreadsheet and Wordprocessing Utilities

REPORT TO BPD Head Office Department for LFI Supervision

RELATE TO/LIAISE WITH BPD Branch Manager

QUALIFICATIONS
1 Minimum formal educational level SMTA
2 Additional skills in practicing Bon A and B and training (as trainers, preferably attended LPPI training of trainers)
3 Experience as head of a section in BPD branch office
4 Good aptitude such as self motivated character

FIELD SUPERVISORS IN BPD BRANCH OFFICE

DUTIES	TASKS	TRAINING REQUIRED
Ensure that LFI reports are calculated and prepared in a correct and timely manner and delivered to their designated destinations	Compile a list of reports based on number of LFIs and type of reports Check every incoming report from every LFI Check all calculations/balances in each report Cross check with LFI managers whether the reports are delivered to their designated places on time	Office Management Bookkeeping and Basic Accounting Procedures
Regularly visit LFI units to monitor and supervise daily activities	Discuss a visiting schedule among field supervisors on a monthly basis Visit every LFI as in the visiting schedule Check all forms and daily transactions Make sure that all approved procedures are followed	Audit Procedures
Advise LFIs on operational and administrative matters	Identify problems Explain solutions to problems Ask the manager to ensure responsible LFI staff make necessary corrections	Management and Supervision Methods
Carry out internal audits	Check all balance sheets (according to auditing procedures) Indicate necessary corrections	Bookkeeping and Basic Accounting Procedures
Assist LFI managers in the preparation and review of LFI annual plans	Review LFI annual plans together with LFI managers Give advice to prepare the next annual plan based on the previous review	Portfolio Management Savings Mobilization Financial Management
Evaluate the performance of LFI managers and oversee the evaluation of other LFI staff	Compile simple human resource databases for all LFI staff Undertake semiannual evaluation of HRD database to see the previous performance of LFI managers Review previous LFI reports to give recommendations on the performance of LFI managers Make recommendations for follow up actions	Personnel Management Report Writing Spreadsheet and Wordprocessing Utilities

Assist BPD head office in the identification of LFI training needs	List training needs based on the latest human resource database Submit semiannual proposals of training needs consisting of names/positions and the number of LFI staff the training needs, and tentative schedule	Personnel Management
Ensure each LFI has an adequate supply of bookkeeping forms and other materials	Check stock of bookkeeping forms and other materials on a monthly basis Check the supplies of materials when visiting LFIs	Office Management

REPORT TO BPD Branch Manager

RELATE TO/LIAISE WITH Head Office Supervisors and LFI managers

QUALIFICATIONS
1 Minimum formal educational level SMTA
2 Additional courses in Bon A and B
3 Additional training of trainers

MANAGER OF LFI UNITS

DUTIES	TASKS	TRAINING REQUIRED
Ensure the LFI is in compliance with all legal and administrative requirements	Ensure accuracy of all reports prepared and correct distribution in a timely fashion Correct problems identified by audit and supervisory visits	Legal Aspects Indonesian Banking System Office Management
Manage the assets and liabilities of all LFI operations to ensure a satisfactory financial structure and performance	Secure adequate sources and supplies of funds to meet LFI operating and lending needs by promoting savings and borrowing, and by generating profits Undertake new business development activities Liaise with local community leaders Represent the LFI at meetings	Funds Management
Manage and oversee all aspects of the LFI operations	Ensure that correct procedures are followed Prepare implement and regularly review annual and monthly operating plans	Management
Maintain a high standard of loan performance	Approve loans within the limits of delegated authority make recommendations on larger loans Review lending strategies Perform loan appraisal in accordance with the proper procedures Regularly check and control lending documentation Regularly discuss problems related to lending with LFI staff	Lending
Responsible for the supervision, training, personnel performance, evaluation, and motivation of LFI staff	Inform LFI staff of all new aspects of works Deliver sufficient explanation required by LFI staff Make recommendations/evaluations on the performance of LFI staff Introduce cooperative climate among LFI staff Evaluate staff performance on a semiannual basis	General Management

Maintain an adequate supply of office and operational materials	Regularly check the adequacy of supplies of bookkeeping forms and other materials Regularly control the maintenance of all facilities and equipment	Office Management

REPORT TO Bank Indonesia, owners and BPD (as supervisors and/or shareholders)

RELATE TO/LIAISE WITH BPD Branch Office Field Supervisors

QUALIFICATIONS
1 Minimum formal educations level SMTA
2 Additional courses in Bon A and B
3 Age 22 to 35

CASHIER IN LFI UNITS

DUTIES	TASKS	TRAINING REQUIRED
Ensure all cash and valuable documents are kept in a secure manner	Count and reconcile cash on a daily basis Check and lock cash box on a daily basis	Bookkeeping
Keep full written records of cash documents and securities held	Count and reconcile cash delivered and accepted from each *post desa*	Bookkeeping
Maintain full records concerning all transactions involving cash and valuable documents	Record all transactions on a daily basis in appropriate cashier s ledgers and books of account	Responsibilities
Ensure daily cash balances are always in agreement with bookkeeping entries		Records/Bookkeeping related to the position
Provide reports as required by LFI manager		Responsibilities
Customer Relations		Banking Etiquette

REPORT TO LFI Manager

RELATE TO/LIAISE WITH Bookkeeper and Field Officer

QUALIFICATION
1 Minimum formal educational level SMTA
2 Additional courses in Bon A
3 Age 22 to 35

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BOOKKEEPER IN LFI UNITS

DUTIES	TASKS	TRAINING REQUIRED
Ensure all transactions in the LFI are reconciled and properly recorded on a daily basis	Record all transactions on a daily basis Count cash and reconcile all transactions on a daily basis	Bookkeeping Procedures
Prepare financial statements records and such other reports as may be required	Make financial analyses of daily transactions Make all necessary reports as required by LFI manager	Report Writing Basic Financial Analysis
Identify accounts in arrears	Analyze arrears/accounts Prepare necessary reports Alert the manager to any discrepancies and arrears	Loan Supervision Funds Management
Maintain administrative files in a proper manner	Provide files necessary for administrative use	Office Management
Ensure posting to individual ledgers is done properly and accurately on a daily basis	Calculate interest due on savings and deposit accounts Record all calculations to individual ledgers	Savings and deposit accounts mobilization

REPORT TO LFI manager

RELATE TO/LIAISE WITH Cashier and Field Officer

QUALIFICATION
1 Minimum f‹ mal educational level SMTA
2 Additional courses in Bon A
3 Age 22 to 35

ANNEX H

REVISED FINANCIAL MODEL

Rupiah (000) unless specified otherwise

Income Statement	YEAR 00	01	02	03	04	05	06	07	08	09	10
Interest income											
On Loans	0	17 155	65 340	140 361	203 065	109 091	502 025	602 709	709 119	788 598	835 760
On Placements and Term Deposits	0	5 611	1 387	4 849	12 386	19 761	24 855	30 500	36 076	42 009	47 599
Interest Expense											
On Savings Deposits	0	1 212	8 219	20 735	73 397	117 105	117 208	181 216	210 523	218 911	270 110
On Borrowings	0	1 373	23 219	51 290	73 619	84 686	87 592	85 205	76 051	52 664	17 818
Net Interest Income	*0*	*17 151*	*35 289*	*73 106*	*140 135*	*227 061*	*292 001*	*366 789*	*151 121*	*528 990*	*595 1?3*
Non Interest Income											
Fees	0	0	0	0	0	0	0	0	0	0	0
Non Interest Expenses											
Salaries (13.5 months, 5% increase on year)	8 400	18 900	30 611	39 304	51 039	58 083	65 244	72 645	80 510	83 575	86 055
Staff Bonuses	0	2 835	4 592	5 896	7 656	8 712	9 787	10 897	12 077	12 536	12 908
Rental and Insurance (1000 + 1% of fixed assets)	500	1 333	1 369	1 427	1 521	1 562	1 618	1 676	1 738	1 750	1 776
Promotion, surdry, gasoline, etc	0	932	3 052	7 253	14 730	18 419	22 708	27 216	32 187	34 615	37 005
Village Post Service	0	1 440	2 914	4 392	5 870	6 863	7 856	8 842	9 828	9 853	9 857
Training (new people next year trained this year)	2 003	4 101	3 971	5 400	4 661	5 155	5 635	6 194	5 230	5 291	4 710
Supervision	0	1 897	2 637	3 916	6 130	7 826	9 387	11 079	12 940	14 269	15 387
Depreciation	0	6 668	7 370	8 546	10 418	11 238	12 360	13 516	14 768	11 994	15 515
Bad Debt Expenses	0	4 658	8 704	14 358	22 795	12 266	12 840	13 898	15 090	6 623	5 744
Pretax Income	10 983	25 613	29 931	17 306	23 615	96 933	144 565	200 827	267 054	315 492	406 128
Taxes (progressive 15%, 25%, 35%)	0	0	0	0	4 904	27 927	44 598	64 209	87 469	114 922	136 145
Net Income	10 983	25 613	29 931	17 306	18 711	69 006	99 967	136 538	179 585	230 570	269 983
After Tax Distribution											
Dividends	0	0	0	0	6 549	24 152	34 989	47 788	62 855	80 699	91 191
Desa Development	0	0	0	0	936	3 450	4 998	6 827	8 979	11 5?8	13 499
Retained Earnings	10 983	25 613	29 931	17 306	11 227	1 104	59 980	81 923	107 751	138 31?	161 9?0
Ratios											
ROA (on average assets)		n/a	n/a	n/a	2.41%	6.17%	7.30%	8.31%	9.28%	10.70%	11.71%
ROE (on average equity)		n/a	n/a	n/a	85.91%	113.48%	101.19%	80.44%	67.88%	59.48%	50.20%
NII (net interest income/average assets)		16.90%	18.31%	17.87%	19.15%	20.30%	21.32%	22.32%	23.33%	24.56%	25.88%
Non Interest Expense/Average Assets		37.56%	29.33%	18.59%	13.16%	10.51%	9.83%	9.25%	8.75%	8.21%	7.97%
LTR		153.68%	91.62%	85.28%	84.89%	87.75%	90.74%	94.09%	97.83%	101.16%	110.55%
C/R		56.90%	13.00%	3.21%	3.05%	6.23%	9.61%	13.30%	17.23%	?3.?8%	?9.78%
Investment & Dividends	100 000	0	0	0	6 549	24 152	31 989	47 788	62 855	80 699	713 278

IRR	29%

Rupiah (000) unless specified otherwise	YEAR 00	01	02	03	01	05	06	07	08	09	10
Volume Coverage and Staff Projections											
Average loan (35% growth year 1-4 5% thereafter)	0	250	338	456	615	646	678	712	718	785	824
Average loan outstanding	0	144	194	262	354	371	390	409	430	451	471
Village post coverage (direct projections)	0	3	6	9	12	14	16	18	20	20	20
Population coverage (0 2% vill + 12 5% growth)	0 0%	0 5%	1 0%	1 5%	2 0%	2 3%	2 7%	3 0%	3 4%	3 4%	3 4%
Number of borrowers (coverage x population)	0	540	1 148	1 763	2 380	2 818	3 232	3 644	1 056	4 107	1 111
Total loans outstanding (before write offs)	0	77 625	222 687	461 993	811 908	1 046 335	1 260 333	1 491 964	1 713 456	1 853 847	1 949 506
Savings as a percent of net loans outstanding	0%	20%	40%	60%	78%	80%	82%	84%	86%	88%	90%
Number of managers	1	1	1	1	1	1	1	1	1	1	1
Number of staff	6 0	6 0	11 3	15 3	20 9	24 1	27 5	30 9	31 6	36 0	37 1
Balance Sheet											
Assets											
Cash	0	621	3 400	10 879	25 020	32 733	40 911	49 697	59 564	64 908	70 301
Term Deposits (based on % of Savings volume)	0	2 329	13 082	40 796	96 823	122 748	153 416	186 364	223 366	243 405	263 679
Placements	60 018	0	0	0	0	0	0	0	0	0	21 815
Net Loans Outstanding (less write offs)	0	77 625	218 029	453 289	827 549	1 023 540	1 248 067	1 479 124	1 729 559	1 838 757	1 917 963
Net Fixed Assets (base + bikes + 2 5% of loans)	29 000	33 311	36 851	42 732	52 089	56 188	61 802	67 578	73 839	74 969	77 571
Total Assets	*89 018*	*113 915*	*271 450*	*547 697*	*1 002 281*	*1 235 209*	*1 504 196*	*1 782 763*	*2 086 327*	*2 222 039*	*2 376 312*
Liabilities & Equity											
Voluntary Savings/Time Deposits	0	15 525	87 212	271 974	645 489	818 320	1 022 775	1 242 427	1 489 105	1 622 700	1 757 528
Borrowings	0	34 905	150 765	259 555	329 398	348 091	352 642	329 635	278 770	112 511	0
Paid up	100 000	100 000	100 000	100 000	100 000	100 000	100 000	100 000	100 000	100 000	100 000
Retained Earnings	10 983	36 595	66 526	83 832	72 606	31 202	28 779	110 701	218 453	356 791	518 781
Total Liabilities & Equity	*89 018*	*113 915*	*271 150*	*517 697*	*1 002 281*	*1 235 209*	*1 501 196*	*1 782 763*	*2 086 327*	*2 222 039*	*2 376 312*

Assumptions

Minimum Population Base		120 000	
Steady state number of borrowers		3 4%	(reached in year 9)
Steady state number of village posts		20	
Manager/staff annual bonus		15%	
Realized interest income on loans		44 2%	(85% collection on 52% p a)
Annual loan write-offs		6%	
Interest income on placements with banks		18%	
Interest expense on passbook savings		12%	
Interest expense time deposits		20%	
Interest expense on borrowings (takings)		25%	(this would be a working capital loan)
Cash as a percentage of savings deposits		4%	
Percent of savings & time deposits in placements		15%	(for liquidity purposes)
Initial paid up capital (Rp)		100 000 000	
Promotion & sundry expenses as percent of loans and savings		1%	
Multiplier for average loan outstanding		0 58	(approximately 12 monthly equal instalments)
Annual depreciation of fixed assets		20%	
Dividend rate		35%	
Desa Development Contribution (% of Net Income)		5%	
Rental expenses			
Base annual rent		1 000 000	
Incremental increase on loans		1%	
Staffing			
Manager		1	
Borrowers per additional person		250	
Savings deposit balance per additional person (Rp)		120 000 000	
Starting salaries/month (all inclusive)			
Manager		500 000	
Staff		150 000	
Training expenses/year (Rp)			
New staff		595 000	
Manager		203 000	
Staff		122 500	
Village post investment/expenses (Rp)			
Incremental motorcycle investment per post		800 000	
Annual operating expenses per post		390 000	
Additional expenses per borrower		500	
Initial capital investment			
Safe & computer	9 000 000		
Equipment & inventories	1 000,000		
Furniture	2 000 000		
Motorcycles	12,000 000		
Set up costs	5 000 000		
Total initial fixed investment		29 000 000	
Annual supervision expenses			
Fixed component (Rp)		1 200 000	
Percent of pretax income		1 00%	
Percent of loans		0 25%	
Percent of voluntary savings		0 10%	

Borrowings were fixed so that there would be enough funding to support the assets
(This step requires manual key in of borrowings while watching so that placements didn't get too high)

GEMINI PUBLICATION SERIES

GEMINI Working Papers

1 "Growth and Equity through Microenterprise Investments and Institutions Project (GEMINI) Overview of the Project and Implementation Plan, October 1, 1989-September 30, 1990" GEMINI Working Paper No 1 December 1989 [not for general circulation]

*2 'The Dynamics of Small-Scale Industry in Africa and the Role of Policy" Carl Liedholm GEMINI Working Paper No 2 January 1990 $5 50

3 'Prospects for Enhancing the Performance of Micro- and Small-Scale Nonfarm Enterprises in Niger" Donald C Mead Thomas Dichter Yacob Fisseha, and Steven Haggblade GEMINI Working Paper No 3 February 1990 $6 00

4 'Agenda Paper Seminar on the Private Sector in the Sahel, Abidjan, July 1990" William Grant GEMINI Working Paper No 4 August 1990 $3 00

*5 "Gender and the Growth and Dynamics of Microenterprises" Jeanne Downing GEMINI Working Paper No 5 October 1990 $10 50

6 'Banking on the Rural Poor in Malaysia Project Ikhtiar" David Lucock GEMINI Working Paper No 6 October 1990 $3 30

7 'Options for Updating AskARIES" Larry Reed GEMINI Working Paper No 7 October 1990 $3 50

*8 "Technology — The Key to Increasing the Productivity of Microenterprises" Andy Jeans, Eric Hyman and Mike O Donnell GEMINI Working Paper No 8 November 1990 $3 60

9 'Lesotho Small and Microenterprise Strategy — Phase II Subsector Analysis" Bill Grant GEMINI Working Paper No 9 November 1990 $15 50

*10 "A Subsector Approach to Small Enterprise Promotion and Research" James J Boomgard, Stephen P Davies Steven J Haggblade, and Donald C Mead GEMINI Working Paper No 10 January 1991 $3 10

11 "Data Collection Strategies for Small-Scale Industry Surveys" Carl Liedholm GEMINI Working Paper No 11 January 1991 $1 30

12 "Dynamics of Microenterprises Research Issues and Approaches" Carl Liedholm and Donald C Mead GEMINI Working Paper No 12 January 1991 $6 50

13 "Dynamics of Microenterprises Research Priorities and Research Plan" Carl Liedholm and Donald C Mead GEMINI Working Paper No 13 August 1990 [not for general circulation]

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*Publications of general interest

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14 "Review of Year One Activities (October 1 1989 to September 30, 1990) and Year Two Work Plan (October 1 to November 30 1990) " GEMINI Working Paper No 14 January 1991 [not for general circulation]

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