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SessionⅣ: Financing SMEs: Issues and Options from the Ecotech Perspective

Financing Challenges of SME's

from the Policy Perspective

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Financing Challenges of SMEs From The Policy Perspective

The Experience of Bank Rakyat Indonesia in SMEs Financing

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1. Introduction

Many international organizations and scholars have put poverty issue as a focal point in shaping the better world. Working forward with poverty combating program, the UN Summit 1990 has promoted a campaign "The Millennium Development Goals" which call for reducing the proportion of people living on less than $1 a day to half the 1990 level by 2015, if achieved, this would reduce the number of people living in extreme poverty to 890 million or to 750 million[1]. Indonesia is among the developing countries, which face a huge poverty problem, particularly when the country hit by multi-dimension crisis in 1997.

This multi-dimension crisis has changed the government policy in economic growth strategies. Most of corporations especially in South East Asia region collapsed during the crisis while many of micro, small and medium businesses were remain stable and grow. This contradictive situation has leads the government to put more attention in enforcing the role of micro, small and medium enterprises (SMEs) in national development program. The growth of micro, small and medium businesses was strongly proven in supporting the sustainable growth of some banks.

Three years after economic crisis in 1998, the Indonesian economic growth has not yet completely recovered to the pre crisis level. Indonesian economic growth, which was about 7-8 percent before the crisis, hit its bottom of negative 13.1 percent in 1998, and has rebounded to 3-4 percent since the last two years. Currently, the expected economic growth remains modest because of the global economic slowdown and unfavorable business environment, especially for foreign direct investment. The economic growth is driven by domestic consumption and enhanced by micro, small and medium enterprises (SMEs) activities, which much focus on local resources.

The World Bank report notes that there is significant progress on democratization issue, macroeconomic stability and fiscal sustainability but no substantial progress in poverty alleviation.

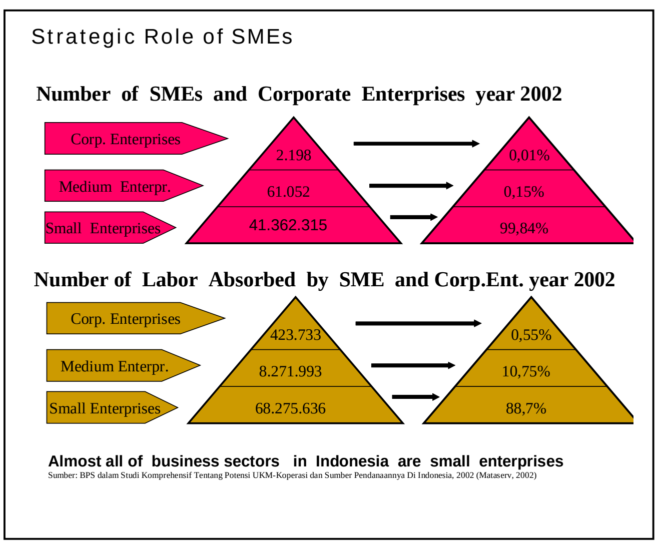
[1] http://developmentgoals.org/poverty.html

In their annual report The World Bank Group reported that of today's population of approximately 6 billion, 3 billion live on US$ 2 a day or less. The billion or so that is fortunate enough to live in the wealthy industrialized nations account for 80 percents of the US$ 35 trillion global economy. The other 5 billion living in developing and transition economies must compete for the remaining 20 percent. In an era of constrained public budgets, their best hope for income, lies with locally owned small businesses.

Such is the world's income distribution today- imbalanced any standard. But think ahead to year 2025. By then population will likely have climbed to approximately 8 billion, with most of the increase coming in the developing world, where economic opportunity are already far too scarce. Job creation is very essential, and it must come from the local SMEs that dominate the developing world's private sector. Well designed assistance programs to support private sector development in the country will be critical, especially those targeting Micro, Small and Medium enterprises. To grow, they need stronger business environments and access to the right kinds of financial and nonfinancial support. This is why the development of SMEs is very critical, and The World Bank Group provided almost US$ 1.5 billion in SMEs support in the year 2002

Indonesia is one of developing countries facing a severe poverty problem, particularly when the country hit by multi-dimension crisis in 1998. In order to alleviate poverty, the Indonesian government established a Committee for Poverty Alleviation in 2001. The members were from several ministries with the job was to create integrated policies for poverty alleviation program.

Although the government has done significant efforts to combat poverty, the number of people living below the poverty line in the last five years has remained steadily high. In 2001, the number of Indonesian living below the line of poverty was approximately 37.1 million, or 18.4 percent of the total population, most of them lives in rural areas[2]. Flexibility and lower start-up and operating costs have enabled SMEs to spring up, and reposition and adjust themselves quickly in response to market and economic changes. Moreover, they can easily expand or contract within a short period of time, to embrace new business opportunities or pull out where there is an over-supply. SMEs have not only survived the impact of big enterprises and the law of economies of scale, but have carved out niches for themselves which enable them to co-exist with big enterprises.



[2] Indonesia Bureau of Statistic,2002

The contributions of SMEs in promoting the growth of Indonesia economy are very important. It would provide job opportunities, enhance the quality of human resources, nurture a culture of entrepreneurship, foster creativity, and open up new business opportunities. Beside that, SMEs will play an increasingly important role in the new economy.

2. The SMEs terminology

Discussing micro, small and medium enterprises (SMEs), it is necessary to have a common understanding the terminology of SMEs. Classifying enterprises into micro, small, or medium enterprises can be based on a firm's assets, firm's characteristic, the number of employees and annual sales. The definition may vary across countries, it depends on the domestic condition.

The member of World Bank Group, International Finance Corporation (IFC) is currently has concise classification of SMEs based on total assets, total annual sales and number of employees.

a. Micro enterprises are defined as :
   - a.1. Individual/firms with total assets of up to US$ 100,000
   - a.2. Total annual sales of up to US$100,000
   - a.3. Employ up to 10 people

b. Small enterprises are defined as :
   - b.1. Individuals/firms with total assets of up to US$ 3 million
   - b.2. Total annual sales of up to US$ 3 million
   - b.3. Employ up to 50 people.

c. Medium enterprises are defined as :
   - c.1. Individuals/firms with total assets up to US$15 million
   - c.2. Total annual sales of up to US$ 15 million
   - c.3. Employ up to 300 people

Swiss Contact Foundation has classification that SMEs businesses are define as individual/firms with total asset excluding land and building up to US$ 112,000, total annual sales up to US$ 1,680,000.

However each country has their own criteria on Micro, Small, and Medium enterprise and usually below IFC's criteria.

The government of Indonesia has several policies in defining SMEs, there are as follows :

Institution/law	Size of business	Criteria
Law no.9/1995 about Small Business	Small business	• Asset ≤ IDR. 200 million excl . land & building (+/- US$ 22,000) • Annual sales up to IDR. 1 billion (+/- US$ 112,000) • Owned by Indonesian citizen, not affiliated with middle or corporate. • With or without having legal entity

Central Bureau of Statistics (BPS)	Micro business	Employee up to 5 people, including family workers.
	Small business	Employee up to 19 people
	Middle business	Employee up to 99 people
Law No. 10/1999	Medium business	Asset IDR. 200 million – IDR. 10 billion (eq. US$ 22,000 – US$ 1,100,000)
Bank Indonesia (Central Bank)	Micro business	- Very small scale business that run by family members. - Local resources and simple technology - Easy to exit and entry.
	Small business (Law no.5/ 1995)	- Asset $\le$ IDR. 200 million (US$ 22,000) excl. land & building. - Annual sales $\le$ IDR. 1 billion (US$ 112,000)
	Medium business	- Asset $\le$ IDR 5 billion (US$ 561,000) for industrial sector. - Asset $\le$ IDR.600 million (US$ 67,000) exc. Land & building and excluding non-industrial sector manufacturing. - Annual sales < IDR. 3 billion (US$ 336,000).

3. SMEs Role in Developing Economic Growth

SMEs according their characteristic and unique have dominated economic activities in many developing countries. Job creation and equally distributed incomes among people are the most significant contribution of SME. In Indonesia, SMEs have played a significant role in the economy of this fifth largest population country in the world. Of more than 40 million enterprises, 99.99% is small and medium enterprises and only 0.01% is large corporation. Millions of people engage in this productive business and SMEs employ 99.45 % of people working in the private sector. They significantly contribute to the country development as 54.74% of Gross Domestic Product comes from these enterprises. These are some aspects that should be considered by the bank. SMEs business has the ability in facing multidimensional economic crisis, almost all of SMEs businesses are loyal in paying the loan even in economic crisis condition.

Table 1. Number SME Businesses and Labor Absorbed in Indonesia in 2002

Enterprises	Number	%	Labor	%	% of export	GDP (in IDR)	%
Small	41,362,315	99,8	68,275,636	88,70	3.37	578,359,165	39.40
Medium	61,052	0,14	8,271,993	10,74	10.93	225,223,692	15.34
Sub total	41,423,367	99,99	76,547,629	99,49	15.30	803,582,857	54.74
Corporate	2,198	0,00	423,733	0,55	85.70	664,517,170	45.26
Total	41,425,565	100	76,971,362	100	100	1,468,100,025	100

Sources: Ministry of Cooperatives & SME

Looking at the statistics in table 1 above, in pursuing proper method of developing business and creating job opportunities, the government takes into consideration in improving SME particularly in reducing the negative impact of economic crisis.

4. Financing SMEs : Problems, Challenges and Policies

Flexibility and lower start-up and operating costs have enabled SMEs to spring up, and reposition and adjust themselves quickly in response to market and economic changes. Moreover, they can easily expand or contract within a short period of time, to embrace new business opportunities or pull out where there is an over-supply. SMEs have not only survived the impact of big enterprises and the law of economies of scale, but have carved out niches for themselves which enable them to co-exist with big enterprises.

The contributions of SMEs in promoting the growth of Indonesia economy is very important. It would provide job opportunities, enhance the quality of human resources, nurture a culture of entrepreneurship, foster creativity, and open up new business opportunities. Beside that, SMEs will play an increasingly important role in the new economy

Despite the fact that SMEs are very potential for building a stable economic growth, developing SMEs is not an easy problem. Myriad problems need to be addressed. The most common problems for SMEs are the lack of access to market information, technology, low quality of human resources and lack of access to capital. Most SMEs do not understand what kind of products needed by market, how big the market and when the products needed and how to deliver the products. SMEs also have weakness in bargaining power especially in dealing with big buyers. Even if they understand the market, they sometimes find difficulties in raw material supply, both in the availability and price.

Access to capital is not the only constraint for SMEs to grow, but it is considered an important problem in developing SMEs. There is a common misunderstanding that banks are reluctant to lend money to SMEs as the banks never believe that lending to SMEs are commercially viable for them. SMEs that are essential to sustainable growth and poverty reduction will never get enough of the capital they need to build and expand the business.

For some banks, financing SMEs may be very difficult. This is not surprising as some problems arise beyond the capability of the banks to handle such as business environment which is not conducive or a systematic ill in the financial sector. There is also legal issue in enforcing contract or business issue to obtain and enforce loan collateral. Furthermore, banks usually regard lending to SMEs is a high risk and unprofitable business due to:

- Unavailability of accurate, reliable information on enterprises financial condition and performance
- Unconvinced and weak business plan

- Weakness in SMEs management, market links, governance, and information technology.
- Weakness in banks staff including loan officers are not sufficiently trained in lending to SMEs
- Bank's weaknesses in identifying the characteristics of SMEs
- Weaknesses of the banks in adopting appropriate lending technologies and operation system that will enable them to realize this market potential and to lend profitably to small business
- The availability of other investing tools which give opportunity to the banks to have lower risk investment such as holding government paper
- Higher overhead cost due to a high number of customers with smaller loan size.

With so many constraints to grow, SMEs will have to face greater challenges in free trade era in the next couple years. Strengthening SMEs must be a priority in order to prepare the facing the challenges. The clients' limitation and the banks' interest must be formulated such that the loans delivery mechanism can provide access for SMEs without eliminating commercial principles and prudential banking.

Aiming at promoting the SMEs, the government made policy to encourage the banks to have at least 20% of its portfolio in SMEs. This policy requires a lot of commitment from banks as lending to this sector requires specific treatment. There are several ways to provide financial assistance for SMEs, including:

- Developing lending programs appropriate for the enterprises
- Simplifying administrative procedures and collateral system
- Providing technical assistance
- Providing loan guarantee and micro credit insurance

In general financial services for SMEs can be classified into:

- Micro lending for micro entrepreneurs served by micro banking such as the BRI-Units, rural banks (BPR), village banks (BKD), state owned pawnshop (Perum Pegadaian), and other micro finance institutions
- Loan for small entrepreneurs supplied by commercial banks and other financial institutions, i.e. the state owned venture capital (Permodalan Nasional Madani). In addition, the government runs the small business and cooperative development program that financed through state owned companies profit.

Medium size lending mostly provided by commercial banks and other financial service provider. Indonesia is the world's largest archipelago country, lies between Asia and Australia, and alongside two major oceans, from the Indian Ocean to the Pacific Ocean. The country comprises more than 17,000 islands, covering 1.8 million square kilometers, and divided into 32 provinces. According to the Indonesian Bureau of Statistic, total population of the country in 2000 was approximately 206 million. In terms of population, Indonesia ranks the fourth, and its population colored by diversity of cultures, linguistic and ethnic groups. The country also rich in natural resources such as oil, natural gas, minerals, timber and other energy resources. In general, there are four sectors dominate the Indonesian economy; manufacturing contributes the highest value on GDP (US$ 36.2 billion), and then followed by agriculture, forestry and fishery (US$ 24.5 billion), trade, hotel and tourism (US$ 23.1 billion), and services (US$ 12.5).

5. An Overview of the Policies of the Indonesia Banking Industry in Developing SMEs

Since Independence Day of August 17, 1945, Indonesia had change or adjusted policy from time to time depend on Government policy. The first commercial state own bank is Bank Negara Indonesia (BNI) that was established in 1946. However Bank Rakyat Indonesia (as the stated own bank too), originally was founded on December 16, 1895 (more than 107 years ago) by Mr. Aria Wiraatmadja an indigenous person who care to help the poors. Before 1983, all Indonesian banks business regulated and directed by Government.

The Indonesian banking system has evolved in line with the country's structural developments. Since 1983 Indonesian banking system implement a new deregulation. This condition and development until today if we use a similarity as the Four Season transition in Indonesia's banking industry.

First, The deregulation period (1983-1992) characterized by banking deregulation of June 1983 and follows up by second deregulation in 1988 then enabled of the new banking law in 1992. The deregulation consist of removal of the interest rate ceilings which had set up in 1974-1983, and easy to open banks and branches. In this season the number of bank growth rapidly. This economic acceleration followed the impact of extensive bank reform and capital market in October 1988, Indonesian economic grew very rapidly and became overheated in 1991. Until 1996 was a golden moment for Indonesian economic.

Second, The Fall Season (1997-1998) known as economic or monetary crisis, as a result of the growing number of the banks, Indonesian economic become overheated and then followed by the liquidation of many banks.

Third, The Winter Season (1999–2000), this period characterized by Recapitalization, Restructuring and Consolidation of banking institution. Therefore most of banks facing with consolidation, less expansion.

Fourth, The Spring Season (2002), this period characterized by business expansion like the flower glooming. In this season banking industry starting expansion through intermediary function and became more prudent and stable.

Since 1983, the banking industry grew rapidly in terms of number of banks and business volume when the government implemented a liberal bank reform in October 1988. In a very short period of time, the Indonesian Central Bank (Bank Indonesia) granted licenses to 73 new commercial banks and 301 commercial banks' branches. However, such an effective supervision framework did not follow the policy that it led to imprudent banking practices. As a result, Bank Indonesia needs to impose prudential banking principles, including implementation of the BIS's capital adequacy ratio, legal lending limit (LLL), and a policy to encourage consolidation through merger and acquisition. Prior to the financial turbulence, the state-owned banks dominated the Indonesian banking industry with a total market share of nearly 50 percent.

After the re-capitalization program conducted during the recovery period, the Indonesian banking landscape has changed considerably, in which most banks owned by the government through the re-capitalization program. While the banking performance has slightly improved, it is still vulnerable to the risk of non-performing loans and slow growth in lending. The performance of Indonesian banking industry since the crisis of 1997 is described in the following table.

Table 1. Banking Indicators 1997 – 2002

(In trillion IDR)

Indicators	**Industry Performance**						**BRI**	**Share**
	1997	**1998**	**1999**	**2000**	**2001**	**2002**	**2002**	**(%)**
Total Assets	715	895	1,006	1,030	1,099	1,112	86	7.7%
Loan	378	487	277	320	358	410	38	9.5%
Gov. Bonds	52	64	432	430	421	395	29	7.3%
Saving	400	625	618	699	797	835	70	8.3%
NPL	7.2%	46.6%	32.8%	18.8%	12.1%	8.3%	6.7%	-
Profits	Na	na	(75.4)	11	13	21.9	1.5	6.8%
LDR	94.5%	78%	45%	46%	45%	49%	57%	-
No. Bank	222	145	145	145	145	141	-	-
Networks	Na	na	na	na	6,979	7,001	4,510	64.4%

- *Source: Bank Indonesia Annual Report 2002, Exchange rate: ± 9,000 IDR/USD*

6. The Role of Bank Rakyat Indonesia (BRI) in Strengthening and Developing SMEs

As the oldest bank in Indonesia, Bank Rakyat Indonesia (BRI) was founded on December 16, 1895 in Purwokerto, Central Java by Raden Bei Aria Wiraatmadja. Its initial name is *De Poerwokertosche Hulp en Spaarbank der Inlandsche Hoofdeen.* The bank began its business by lending money belonged to a mosque to indigenous people who had businesses in the community. Along with the Indonesian political development, the bank's name has undergone several changes; Hulp-en Spaarbank der Inlandsche Bestuur Ambtenare, De Poerwokertosche Hulp Spaaren Landbouw Crediet (Volksbank), Centrale Kas Voor Het Volkscredietwezen in 1992, Algemene Volkscredietbank (AVB) in 1934, Syomin Ginko in 1942. In 1946 the name was again changed to Bank Rakyat Indonesia. In 1956, its name was Bank Koperasi Tani dan Nelayan (Farmer and Fisherman Cooperative Bank), in 1965 was BNI Unit II, and finally in 1968 the bank's name was changed again to Bank Rakyat Indonesia.

In the period of 1970-1983 along with the implementation of long range plan of economic development, BRI took as length arms of Government programs of self supporting rice for the country. Among those developments, a significant change in banking sector begun in June 1983 when the government released the interest rate ceilings on credit and savings and allowed banks to develop their products and services, particularly in mobilizing public funds. The policy was set in order to overcome the impact of decreased revenues from oil and gas, which heavily supported the Indonesian development programs and provided subsidized credit for rice self-sufficiency (BIMAS).

The Government appointed BRI as the legal banking institution to support the program by establishing BRI-Units to channel subsidized credit to farmers involved in the BIMAS program. To accomplish this program, BRI established about 3,600 BRI-Units nationwide at the sub district level. These rural bank outlets functioned primarily as channeling agents for BIMAS and other subsidized rural lending programs. This program made BRI has the experience in financing SME businesses.

As a full-service commercial bank, BRI provides a wide range of banking services such as commercial loans, particularly to micro, small, and medium enterprises, saving products, trade finance and other financial services. In addition, the bank also plays a significant role in assisting the government in agribusiness development and cooperatives. Uniquely, BRI has a microfinance window, the BRI-Unit Desa that provides financial services to economically active poor and micro-enterprises, particularly in rural areas. BRI network consists of 12 Regional Offices, 323 Branches, 64 Sub-branches, 3,916 BRI-Units and 238 Village Service Post. This network covers the country up to the level of sub-district and village. Needless to say that BRI is the bank with the largest network in Indonesia. BRI also operates overseas offices, in the Cayman Island and New York. The other two offices in Hong Kong and Singapore were closed during the crisis of 1997.

At BRI's branches, the bank provides a full range of banking services, such as loans to small and medium enterprises, loans to fixed income earners and pensions, trade finance, and food security programmed-loans, and loans to cooperatives. Lending to medium enterprises and corporate are managed by the Regional Office and Head Office. The branches also provide savings (BRITAMA), saving for pilgrimage (Tabungan Haji), current account and time deposit. Since its establishment BRI is well known as the only bank in Indonesia that has an extensive experience in supporting rural development. The bank consistently prioritizes its business focus to Micro and Small enterprises development, which is stated in the vision and mission of the bank

Vision

To be a leading commercial bank placing utmost priority on customer satisfaction

Mission

- To perform the best banking activities by delivering services mainly to Micro, Small, and Medium enterprises in order to support the economic development.

- To provide excellent services to its customers through widely distributed network supported by professional human resources, and to conduct good corporate governance practices.
- To provide optimal profit and benefit to its stakeholders.

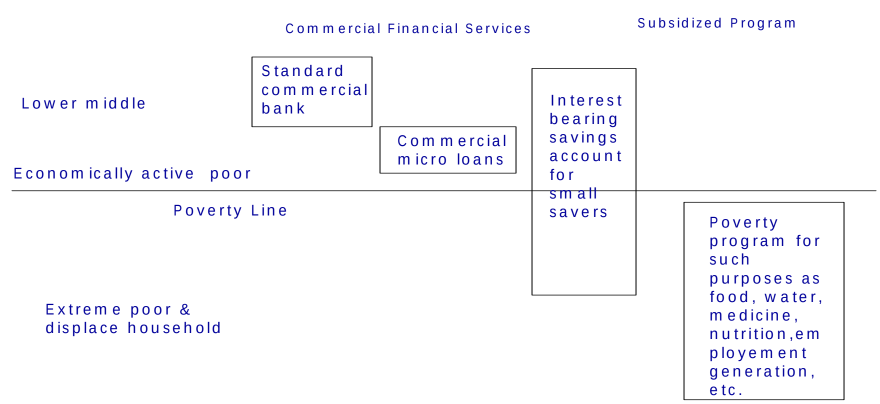
In doing so, BRI approach is to develop a strategy that suits to the characteristics and the preference of each segment. Beside that, BRI also develops a broad range of products, distribution channel and business models that fit the needs of each its market segments.

In her inspiring book, *The Microfinance Revolution: Lesson from Indonesia*, Robinson (2002) draws a schematic diagram of a poverty alleviation toolbox, with an emphasis on its financial component. The diagram shows relationship between financial services and the characteristic of poor based on income level. From broaden perspective, micro-finance is not only directly involves in financing activities but, in indirect ways, it also play a multiple role as a social safety valve.

Furthermore, Diagne et al (2000) suggest access to credit affects borrower welfare outcomes through at least two channels. First, it alleviates the financial constraints on low-income households and micro enterprises. Expenditures on agricultural inputs and mostly off-farm activities usually incurs seasonally. The expenditures incur during the planting and growth periods of crops, while returns are received only after the harvest several months later. Therefore, to finance the purchase of inputs, the farm household must either dip into savings or obtain credit. Hence, access to credit can significantly increase the ability of borrowers with no or little savings to acquire needed agricultural inputs or other related inputs that associated with off-farm activities.

In general, BRI's approach to support rural development is described by Marguerite Robinson in her Poverty Alleviation Toolbox, as follows [3]) :

Figure 1. Poverty Alleviation Tool Box



[3]) Marguerite S. Robinson, The Micro finance Revolution, Volume 1, p. 58

There are three different credit schemes for different groups or business sizes :

a. Level 1 (below the poverty line). At this level BRI provides loan schemes to communities below the poverty line, e.g. P4K program (the rural income generating project for farmer and the landless) and programmed loans for agriculture and cooperative development, and programmed loans for self-help groups (PHBK).

b. Level 2 (above the poverty line). Loans provided at this level are for micro and small entrepreneurs living above the over poverty line. These can be program loans, which the interest rates set up by the government, i.e. for supporting agricultural development or commercial loans at market interest rates such as KUPEDES (the general rural credit). The loan size ranges from IDR 25,000 to 50 million.

c. Level 3 (small businesses up to IDR 350 million). The loan scheme at this level is designed for small enterprises that need additional capital greater than the levels 1 and 2, that generally have better management practices. The loan size ranges from IDR 50 million to 5 billion.

BRI's commitment in strengthening SME is reflected in the loan portfolio. Since 2000, BRI has set up a policy that at least 80% of its loans portfolio of SME.

Table 2. BRI's Loans Portfolio

Segment	2000		2001		2002	
	IDR billion	%	IDR billion	%	IDR billion	%
Micro	**7,827**	**30**	**9,841**	**30**	**11,990**	**31**
Small	**10,742**	**41**	**13,881**	**43**	**18,927**	**48**
Medium	**3,262**	**12**	**3,572**	**11**	**2,479**	**7**
Sub total	21,831	83	27,294	84	33,396	86
Corporate	**4,536**	**17**	**5,064**	**16**	**5,631**	**14**
Total	26,367	100	32,358	100	39,027	100

Note ; 1 US $ = IDR 8,870

7. BRI's Microfinance Policies

BRI involved in micro finance in 1970, when government of Indonesia wanted to achieve rice self-sufficiency production by applying modern technology in rice cultivication by introducing BIMAS. BRI-Units formed in order to support this government program In early 1984 the BRI-Units were transformed into micro finance units. The role of BRI-Units at this time in channeling the credits for the *BIMAS* was just as an agent of the government. The management of BRI-Units did not remotely follow sound financial institution principles since the credit disbursement only for meeting the target, fund mobilization was limited, it was non-profit oriented, the BRI Units were not located in centers of economic activity, no business incentive, and the product and services were not market oriented.

In the early 1980's, despite the success of BIMAS in helping Indonesia achieve national rice self-sufficiency, losses on the program credit, caused by distortions in their extension, made the BRI-Units unsustainable. Recognizing the failure of the BIMAS program, the government adopted a policy of transforming 3,600 BRI-Units from highly bureaucratized, heavily subsidized conduits for agricultural credit into self-sustaining and profitable financial intermediary units. The transformation of BRI-Units took place within the context of overall financial sector deregulation. In June 1983, the government suspended ceilings on credits, removed controls on interest rates for both deposits and loans, and prioritized savings mobilization. These changes provided an opportunity for BRI to explore new services and products.

In the beginning of 1984, BRI's management redesigned the BRI-Unit into a micro banking unit, including an operational system, products and organization that were suitable to the characteristics of the market and adopted profit oriented policy. This is several characteristic of the BRI-Units :

- Structurally BRI-Units were separated from the branch offices as autonomous financial entities. Each BRI-Unit prepared its own financial statement and allowed management to identify clearly the financial health of the unit. Each BRI-Unit became a separate profit center and reconfigured its bookkeeping and accounting system to reflect the change.

- BRI-Unit offices were relocated from agricultural production areas to business centers which relatively close to the customers. In addition, numerous of BRI-Units were downgraded to be Village Service Post in order to achieve low operational cost.

- Staff accountability became closely associated with the performance of the BRI-Unit. Direct responsibility for loan approvals and repayment rested with unit staff, particularly credit officers.

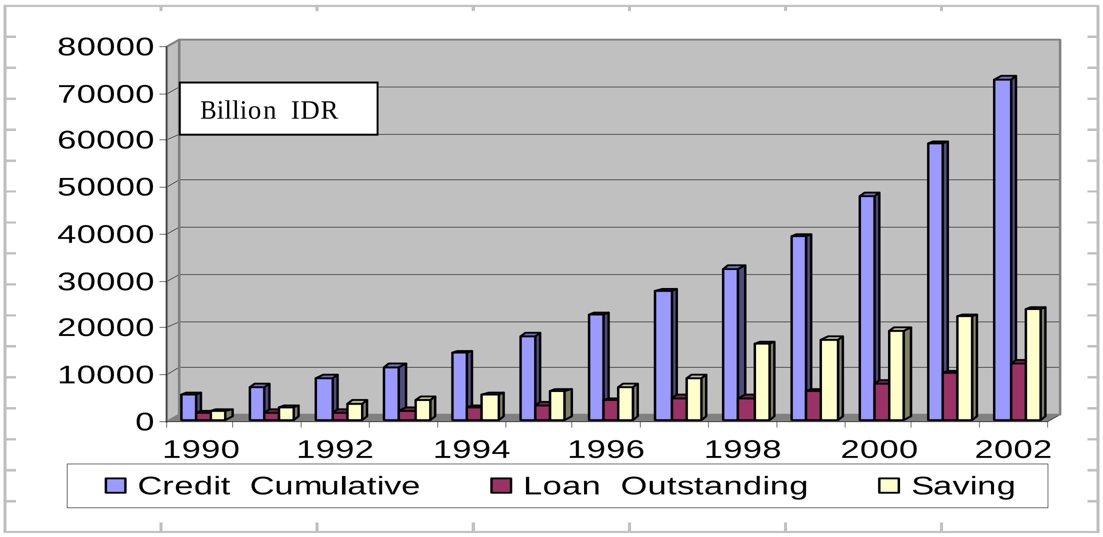
- Branch offices supervised the BRI-Units and managed liquidity between each unit under its jurisdiction. The BRI-Units' income statements recorded transactions, such as interest paid on excess funds borrowed from the branch office and interest received on any excess liquidity.

- Internal supervision and audit capacities were also strengthened. The number of internal supervisors increased from one per six BRI-Units to one per four.

- A new lending product (KUPEDES or General Rural Credit)) and savings product (SIMPEDES or Rural Saving) were launched to meet the needs of the clients. Profit, which previously had not been a target for BRI, then had to be an important consideration for the bank in providing its services and products. Corporate culture had been changed and incorporated with the promotion an incentive system to motivate employees to perform better.

Since 1986 BRI-Units have been a profitable and sustainable entity and internationally recognized as one of the leading micro finance institutions. Up to December 2001, the number of BRI-Units in the network was approximately 3,823 through the country both in urban and rural areas. Since its development, BRI Units have disbursed nearly IDR. 58.8 trillion (US$ 5.6 billion) KUPEDES to 28 million low-income people and micro business. At the end of 2001 there was about US$ 949 million in KUPEDES credit outstanding to about 2.8 million borrowers. On average, KUPEDES borrowers have continued to pay back more than 97%.

Figure-2
BRI-Unit Performance 1990 - 2002



Equally important BRI-Units have significantly contributed to the development of rural areas in Indonesia. Research shows that BRI-Units allow micro enterprises and poor people to access financial support that is relatively rare in rural areas, and which indirectly generates economic growth, rural development, employment and people's incomes, as well as playing a part in enhancing micro entrepreneurial skills and knowledge, particularly in the area of finance. BRI-Units have also been involved in transforming rural economic activities from the agriculture sector to other sectors, such as trade and industry, and contribute to national income through its profits and income taxes.

8. The Micro finance's Key Success Factors

As a state owned bank, the development of BRI was strongly influenced by the government policy, BRI management successfully develop BRI-Units to become a commercial and profitable unit. The success of BRI-Units is a result of BRI's commitment, consistency and the capacity of management to combine a development finance approach with a business approach that is inherent in the BRI-Unit's system and products. There are several key success factors in the BRI-Unit system:

- Simplicity. The BRI-Unit system, such as products, procedures, accounting system and supervision are designed to be very simple in order to keep the system efficient and effective.
- Accessibility. BRI-Units are easily accessible to poor people and micro enterprises, which mostly live in remote areas.
- Demand driven. Loan and saving products are designed to fit the customers' needs and preferences.
- Transparency. In order to ensure that the simplicity concept works properly, the BRI-Unit works transparently.
- Cost recovery. All costs must be recovered by income with a sufficient margin. Lending rate covers all cost, including the high overhead cost, commercial cost of fund and loan risk, and returns a profit to the bank for sustainable growth.
- Sustainability. BRI-Units are profitable and self-sufficient entities, which allow the bank to achieve sustainable growth.
- Continuous Training. BRI-Unit training programs have successfully enhanced the capacity of staff to deliver the appropriate services to the clients.
- Supervision. The BRI-Unit supervision system ensures that managers and officers comply with sound banking practices.
- Incentives. BRI-Unit has incentive system to the employees who perform well, and interest rate incentive to customers who pay the loan on time.
- Independency. BRI-Unit manager works independently in approving the loans and managing the unit. Intervention from outside parties is not allowed.

9. BRI's SMEs Center

To provide micro, small and medium enterprises with access to information technology, BRI actively involves in developing the SME-Centers by working together with TELKOM (a state-owned telecommunication company) and CD SMEs (Center of Development of Small and Medium Enterprises), an affiliation of Indonesian Chamber and Commerce. The SME-Center, which is a virtual center, is a node of network and point of transit of local business to access global market via Internet. SME-Center facilitates SMEs for accessing market information, transaction and business assistances. BRI has established nine SME-Centers located at BRI Branch Offices. Those centers have received positive responses from the entrepreneurs since they can use the SME-Centers to explore business opportunities. In the next year, BRI will establish another 40 SME-Centers.

There are myriad problems in developing Micro and SMEs. The problems may rise from market access, management skill, human resources and technology. SMEs, especially micro scale, do not have bargaining power, have limited production capacity, simple technology and limited capability to market the products. Even if those problems have been eliminated, there is still a critical issue that SMEs do not have access for information.

SMEs Center, which is a virtual center, is a node network and point of transit of local business toward regional alliances as SMEs Center is directly connected to global internet network links each SMEs node to global market. SMEs Center facilitates SME for accessing market information, transaction and business assistance for all SME. SME Center is directly connected to global internet network which links each SMEs node to global market.

SMEs Center main objectives are :

- To provide an interactive global market information system which is simple, easy and inexpensive for SMEs in Indonesia
- To assist SMEs in increasing the business skill through IT
- To assist the members in promotion, business consultancy, transactions, etc
- To facilitate SMEs development program

SMEs Center serves as an online service center providing facilities as below :

1. Business Center, provide location as a navigation point to access SMEs business activities, consisting of :
    - Business Site for SMEs to place their company profile and products catalogue
    - Trade Show Center which provide list of prospective partner
    - Business Meeting as a facility to obtain order from products including supply chain management for supply order planning involving supplier, distributor and customers.
    - Info Center to spread information regarding business opportunity
2. Business Service, provide service for improving the SMEs both from the HRD size or business capability. These services include : Business and IT Advocacy, Business document template (business proposal, export import etc), tele education and on line consultation

10. Closing Remark

The development of micro, small, and medium enterprises has been proven that it gives a lot positive impact to the country development as well. The development of these enterprises is not only bank responsibility, but all parties involved. It requires commitment from financial institution, large scale company, central and regional Government and all other institutes, such as The Chamber of Commerce, SMEs association, NGO, guarantee institution and financial support institution. Combining all of parties involved in SMEs development creating synergy. The government should have an integrated and comprehensive policy in order to achieve this goal.

The success of micro, small and medium entrepreneurs in developing their business will benefit the state's economics conditions. Many stories of the clients have been revealed in numerous books and publications which illustrate how the institutional credit and saving services have helped the poor to expand and diversify their enterprises, to increase their incomes, to improve the quality of live for themselves and their dependents, and to create employment for others.

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