

# Indonesia Market Study: Movable Assets-based Financing to Micro, Small, and Medium Enterprises

in partnership with



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# **Indonesia Market Study: Movable Assets-based Financing to Micro, Small, and Medium Enterprises**

This report is the result of a study by the International Financial Corporation (IFC) a member of World Bank Group, in collaboration with the Ministry of Law and Human Rights, Directorate General of General Legal Administration.

The study was conducted in the context of the Fiducia Registry Reform Project, Memorandum of Understanding dated August 17, 2013, between the International Finance Corporation and the Ministry of Law and Human Rights.

## **Acknowledgements**

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We would like to express sincere gratitude for the unconditional support from various key financial regulators such as Bank Indonesia and Otoritas Jasa Keuangan (OJK) and from other government bodies such as Ministry of Law and Human Rights and Ministry of Cooperatives and SMEs. We also thank all the financial institutions, MSMEs and industry experts met during the course of the study for providing relevant information and industry knowledge to support the study objectives and derive valuable recommendations.

## Executive Summary

The report aims to assess the current market for movable assets based lending with respect to micro, small and medium enterprises (MSMEs)<sup>1</sup> in Indonesia. The sections of the report highlight the addressable demand for MSMEs and the current supply provided by various formal sources of financing in Indonesia. Traditionally, financial institutions have preferred lending against fixed asset collateral only. Using that as a starting point, the report seeks to identify the current challenges in lending against movable assets. It further extends the need for a greater financial infrastructure that can facilitate the ability of lenders to evaluate risks in movable assets based lending.

This report delves into the lending challenges faced by MSMEs as well as the challenges that restrict greater supply of credit by financial institutions. It draws on data and insights based on discussions with over 70 financial institutions in Indonesia, and an understanding of the credit requirements of MSMEs – based on over 850 sample cases for quantitative data. These findings were further examined through in-depth qualitative discussions with 34 MSMEs spread across multiple regions in Indonesia.

As the Indonesian economy follows a traditional model of providing credit based on fixed collateral, such as land and buildings, the study focuses on (i) understanding the current credit demand that can be potentially addressed by movable assets to complement the traditional model, and (ii) the challenges that need to be addressed to facilitate the ensuing movable assets based lending.

### **Demand-supply gap in lending to MSMEs**

Demand for credit has been steadily increasing and while the various regulators and government bodies have taken measures to address the increasing demand, the current demand-supply gap is IDR 3,826.5 trillion,<sup>2</sup> which is very significant and presents a clear opportunity to tap the market. The report highlights opportunities that various financial institutions, including commercial banks, can look into to facilitate a better financial ecosystem and create greater supply of credit to boost economic growth. While commercial banks continue to be major contributors to the overall formal supply, they have refrained from adopting innovative lending models. They have also not lent on movable assets, which form more than 50 percent of the MSMEs asset base in Indonesia.

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**1 MSME refers to micro, small and medium enterprises. Indonesian MSME law of 2008 defines MSMEs based on net assets and annual sales, and the same definition has been used for the purpose of the study. The definition has been detailed in section 3 of this report.**

**2 The estimated MSME credit demand-supply gap, from formal financial institutions, have been calculated at IDR 3,826.5 trillion (~USD 383 billion) which has been detailed further in the demand-supply gap section of the report (IDR to USD is taken as 10,000 IDR=1USD)**

## **Market potential for Movable assets based lending**

With respect to the sector level contribution for credit, while Agriculture constitutes almost 50 percent of the enterprises, its supply portfolio is less than 20 percent. With an unmet demand of over IDR 2,661 trillion in Agriculture, the sector needs specific policy changes to address this gap. Additionally, a greater support is required in building robust infrastructure to facilitate the various financial lending models such as warehouse receipts and factoring, among others. Similarly, even at a sector agnostic level, there are clear opportunities with respect to creating a conducive business environment for a variety of assets such as accounts receivable, inventory, livestock, etc. to coexist in the financial lending portfolio.

Fixed asset collateral provides better risk coverage as compared to movable collateral, and such fixed assets enjoy a loan-to-value (LTV) ratio of as high as 80 percent. However, the limited resources that MSMEs have to provide as their collateral are largely movable assets in nature. Considering the scarcity of fixed assets that render MSMEs ineligible to seek financing, even a 25–35 percent LTV on movable assets can significantly address the overall market requirements.

## **Addressing key challenges to facilitate a greater lending against Movable Assets**

For some banks, financing MSMEs is a very risky business proposition indeed. This is not surprising as some of the risks, such as cultural aspects and the business environment in which these businesses thrive, are beyond the capability of the banks to handle. Empirical evidence suggests that there are challenges and legal issues to obtain and enforce loan collateral.

The report seeks to decode these challenges and deliver findings that might serve as triggers for the design of new, more effective methods of providing credit to MSMEs and accelerate development of the largest contributor to the overall GDP.

The challenges discussed in the report have largely been categorized into:

1. technical capacity related challenges,
2. infrastructural challenges and
3. legal constraints.

These challenges are, in detail:

1. The technical capacity challenges from an MSME perspective relate to lack of know-how on the credit process and the relevant documentation required to avail credit. The same from a financial institution's perspective, it is the lack of technical know-how on effective collateral valuation mechanism for movable assets.
2. The infrastructure related challenges refer to the limited availability of historical data on borrowers and their loan pledges, further lack of notaries to address the increasing demand to register a security in the Fiducia and an inadequate capacity of warehouse facilities to support warehouse receipt financing for agriculture produce.
3. The legal constraints refer to key enforcement related challenges and the various reforms that need to be brought about to foster greater movable lending environment.

### **Key Recommendations**

Financial institutions while providing credit to MSMEs press for collateral, especially for land, but do not emphasize on the legal registration of the enterprises with the Ministry of Law and Human Rights. This results in a large number of enterprises not getting registered thereby losing out on the legal status of the enterprise. In order to create a more legalized and formal structure, there is a need to make policy changes regarding the formalization of entities. The formalization should lead to lower risk to financial institutions, and, hence, to borrowers receiving credit at a lower rate than non-formal entities..

Regularization of the land titles and ownership rights can address a significant portion of the problem relating to the real estate ownership. Steps along these lines have been already initiated by the Bank Indonesia (BI), the Central Bank of Indonesia, and would prove very effective in the long run. Recommended steps include acceptance of documents signed by the village head in case of the land title registered in the name of ancestors. While this is an important step to regularize land titles, the larger issue is that the most MSMEs do not have fixed assets to provide as collateral for seeking credit. Therefore, an encouragement of alternate options for credit collateral such as movable assets, e.g. accounts receivable, inventory, livestock, furniture and other movable assets, need a greater focus by financial regulators. While the fixed assets as collateral provide a safe security against risk of default, a significant impetus could be provided to the credit supply if the regulators, for example, can provide credit guidelines that can be designed for lending against movable assets.

It is also important to bring clarity in terms of addressable demand-supply gap and lending models that various financial institutions can adopt, so that there is a shift of focus from capturing the same part of the pie to penetrating an untapped market segment. Creating a space for movable asset based lending models like warehouse receipt financing, factoring, supply chain financing, etc., can also go a long way towards tapping the unmet demand and minimize the demand supply gap to increase supply of productive capital.

Effective credit information sharing, i.e. credit histories collection and consistent dissemination across various financial institutions via credit bureaus, is imperative to ensure that good quality loans are provided with reduced risks of default by MSME-borrowers. The study also covers recommendations on challenges with respect to the collateral registration and enforcement of collections of the movable assets provided as collateral for loans in cases on non-repayment of loan.

The last section of the report addresses best practices of various countries such as Vietnam, Ghana and China that had lending challenges similar to those in Indonesia and successfully implemented secured transactions reforms, resulting in the creation of a greater financial ecosystem for managing movable collateral.

## Acronyms

ADB	Asian Development Bank
Agri	Agriculture, animal husbandry, forestry and fisheries
APPI	Asosiasi Perusahaan Pembiayaan Indonesia or Indonesian Association of Multifinance Companies
Bapepam LK	Badan Pengawas Pasar Modal & Lembaga Keuangan /former Indonesian Securities & Exchange Commission
Bappenas	Badan Perencanaan Pembangunan Nasional or National Development Planning Agency
BAPPEPTI	Badan Pengawas Perdagangan Berjangka Komoditi or Commodity Futures Trading Regulatory Agency (CoFTRA)
BMT	Baitul Mal Wal-Tamwil or Sharia-based Cooperative
BI	Bank Indonesia
BPD	Bank Pembangunan Daerah or Regional Development Bank
BPR	Bank Perkreditan Rakyat or Rural Bank
BPS	Badan Pusat Statistik or Statistics Indonesia
CAGR	Compounded Annual Growth Rate
CERSAI	Central Registry of Securitization Asset Reconstruction and Security Interest of India
CMEA	Coordinating Ministry of Economic Affairs
Con	Construction
CoFTRA	Commodity Futures Trading Regulatory Agency
CU	Credit Unions
EG&WS	Electricity, gas and water supply
FI	Financial institution
Fin	Finance, rent and services
FRO	Fiducia Registration Office
GIZ	Deutsche Gesellschaft für Internationale Zusammenarbeit
GoI	Government of Indonesia
IAI DSAK	Ikatan Akuntan Indonesia (IAI) - Dewan Standar Akuntansi Keuangan or Financial Accounting Standards Board of Indonesian Institute of Accountants
INKOPDIT	Induk Koperasi Kredit or Credit Union Central of Indonesia
JV	Joint Venture
KJKS	Koperasi Jasa Keuangan Syariah or Islamic Financial Services Cooperative
KOPDIT	Koperasi Kredit or Credit Union (CU)
KSP	Koperasi Simpan Pinjam or Savings and Loans Cooperatives
KUR	Kredit Usaha Rakyat or Entrepreneurs Peoples Credit
LDKP	Lembaga Dana Kredit Pedesaan or Rural Credit Association
LPD	Lembaga Perkreditan Desa or Rural Credit Associations of Bali
LPIP	Lembaga Pengelola Informasi Perkreditan or Private Credit Bureau
LTV	Loan to value ratio
M&Q	Mining and quarrying
Man	Manufacturing
MCSME	Ministry of Cooperatives and Small and Medium Enterprises
MFI	Microfinance Institution
MoLHR	Ministry of Law and Human Rights
MSME	Micro, small and medium enterprise
MSOE	Ministry of State-Owned Enterprises
NBFI	Non-bank financial institution
NGO	Non-government organization
NPL	Non-performing loan



OJK	Otoritas Jasa Keuangan or Financial Services Authority
PBI	Peraturan Bank Indonesia or Bank Indonesia Regulation
PINBUK	Pusat Inkubasi Bisnis Usaha Kecil or Small Business Incubation Center
PNBP	Penerimaan Negara Bukan Pajak or Non-tax state revenue
PPA	Penyisihan Penghapusan Aktiva or Provision for asset losses
SAK ETAP	Standar Akuntansi Keuangan untuk Entitas Tanpa Akuntabilitas Publik or Financial Accounting Standards Entities Without Public Accountability
SCF	Supply chain financing
Ser	Services
SHG	Self help groups
SID	Sistem Informasi Debitur or Debtor Information System
SISKOPDIT	Sistim Koperasi Perkreditan or Cooperative Credit Systems
SME	Small and medium enterpris
SOB	State-Owned Bank
SUCOFINDO	PT Superintending Company of Indonesia (Persero)
T&C	Transport and communication
THR	Trade, hotels and restaurants
UJKS	Usaha Jasa Keuangan Syariah or Islamic Financial Services Unit
USAID	US Agency for International Development
USP	Unit Simpan Pinjam or Savings and Loans Units
VC	Venture capital company
WOCCU	World Council of Credit Unions
OJK	Otoritas Jasa Keuangan or Financial Services Authority
PBI	Peraturan Bank Indonesia or Bank Indonesia Regulation
PINBUK	Pusat Inkubasi Bisnis Usaha Kecil or Small Business Incubation Center
PNBP	Penerimaan Negara Bukan Pajak or Non-tax state revenue
PPA	Penyisihan Penghapusan Aktiva or Provision for asset losses
SAK ETAP	Standar Akuntansi Keuangan untuk Entitas Tanpa Akuntabilitas Publik or Financial Accounting Standards Entities Without Public Accountability
SCF	Supply chain financing
Ser	Services
SHG	Self help groups
SID	Sistem Informasi Debitur or Debtor Information System
SISKOPDIT	Sistim Koperasi Perkreditan or Cooperative Credit Systems
SME	Small and medium enterpris
SOB	State-Owned Bank
SUCOFINDO	PT Superintending Company of Indonesia (Persero)
T&C	Transport and communication
THR	Trade, hotels and restaurants
UJKS	Usaha Jasa Keuangan Syariah or Islamic Financial Services Unit
USAID	US Agency for International Development
USP	Unit Simpan Pinjam or Savings and Loans Units
VC	Venture capital company
WOCCU	World Council of Credit Unions

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# **Chapter 1: Introduction and Objectives**

# 1. Introduction and Objectives

## 1.1. Background

Indonesia is one of the fastest growing economies in Asia and a member of G20 major economies. The GDP of Indonesia was USD 878.2 billion<sup>1</sup> in 2012, making it the sixteenth largest economy in the world.

Micro, small and medium Enterprises (MSMEs) are the key contributors to the country's economic resilience during the 2008–09 economic crisis.<sup>2</sup> They employ more than 92 percent of the country's workforce but only contribute to 57.12 percent<sup>3</sup> of the GDP. This low productivity is one of the main problems for the Indonesian MSMEs.

According to the Enterprise Survey conducted for Indonesia by the World Bank in 2009, more than 47 percent of Indonesian micro, small and medium enterprises (MSMEs) believe that lack of financing is the biggest obstacle to their business. Only 51.5 percent (world average is 87.8 percent) of Indonesian MSMEs have a bank account, of which only 18.2 percent have a bank loan or a line of credit. Poor access to financing can be considered as a major reason for the low productivity of Indonesian MSMEs.

Financial institutions (FIs) in Indonesia have traditionally considered fixed assets, particularly land holdings, as a measure of the borrower's credit-worthiness. Indonesian MSMEs<sup>4</sup> have limited fixed assets putting them at a disadvantage in terms of access to financial credit. MSMEs assets are tied up as collateral for obtaining term loans, leaving them in difficulty while obtaining working capital loan from FIs.

While movable assets like vehicles and equipment are accepted by some FIs as collateral, MSMEs do not have significant holding in these non-land assets. Most of their assets are related to sales proceeds, accounts receivable, inventory, etc. Thus, improving the regulatory and institutional framework, allowing FIs to lend against these movable assets would improve credit access for MSMEs. This would play a pivotal role in increasing their productivity, and, in turn, would lead to a greater development of the economy.

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<sup>1</sup> International Financial Statistics, International Monetary Fund, 2012

<sup>2</sup> OECD, Promoting SME Development In Indonesia, Economic Department Working Papers No. 995

<sup>3</sup> Business Process Requirements for Indonesian Small Medium Enterprises (SMEs) in Implementing Enterprise Resource Planning (ERP), P. W. Handayani, A. N. Hidayanto, and I. Budi, paper published in International Journal of Innovation, Management and Technology, Vol. 4, No. 1, February 2013

<sup>4</sup> Based on survey conducted for 34 MSMEs across Jakarta, East Java and Central Java

## 1.2. Objectives of the Study

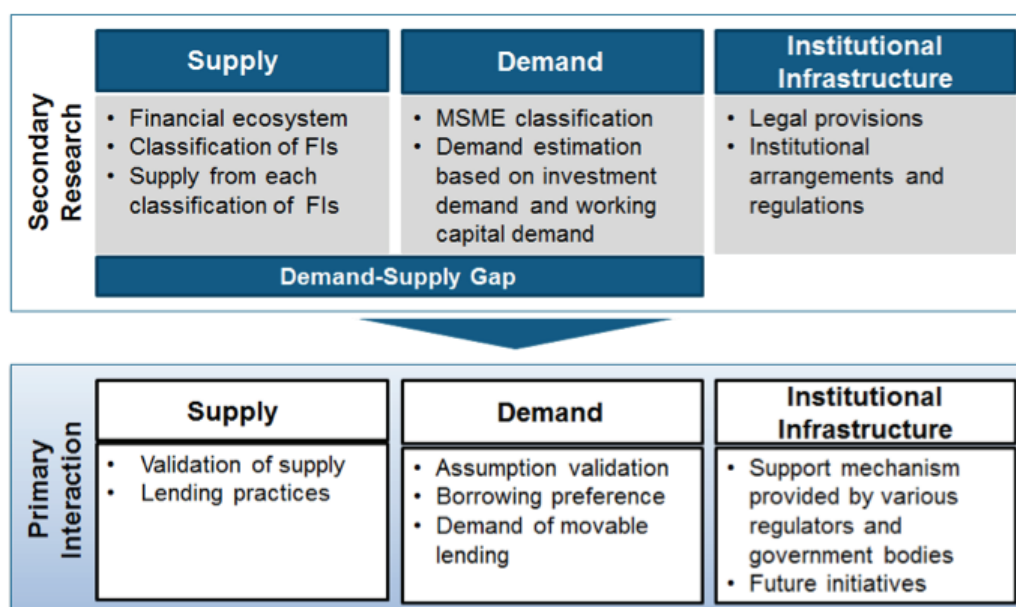
The study was conducted, from September to December 2013, to understand the current level of financing to MSMEs in Indonesia and the current institutional support for lending. The key objectives of the study were to:

- a) Provide an estimate of the current level of financing to MSMEs by FIs in Indonesia, against movable collateral, including:
  - Types of collateral used,
  - Models being used,
  - Main active players, and
  - History of non-performing loans.
- b) Compare the level of credit extended in Indonesia against movable collateral to global benchmarks.
- c) Analyze the size of the market for financing against movable collateral that can be potentially tapped by FIs with suitable products and with the support of enabling infrastructure such as a collateral registry.
- d) Identify the current hurdles for FIs in accessing this market segment.
- e) Identify percentage of loans to MSMEs that are not approved based on collateral requirements and other factors.
- f) Identify the various government institutions and/or administrative agencies where movable collateral is required to be registered/notified if pledged asset is used as collateral.

## 1.3. Approach for the Study

The study adopted a three-pronged approach to understand the supply, demand and institutional infrastructure (Figure 1).

**FIGURE 1 : APPROACH FOR THE STUDY**





### **1.3.1. Determination of Supply**

The financial ecosystem for MSMEs in Indonesia was studied to understand the interaction between different agencies. The FIs were classified based on nature of service provided, and supply from each of these institutions was calculated based on regulatory reporting and other market reports. For the purpose of the study, only formal sources of supply were considered. The formal supply was further validated during the primary research. It has been assumed that any informal source of credit supply to MSMEs is also a potential target market for various FIs to address and bring it within the formalized structure of lending. The lending practices, including types of collateral used and lending models, were comprehended during the primary interaction. The primary interactions also helped determine the challenges faced by FIs in lending.

### **1.3.2. Determination of Demand**

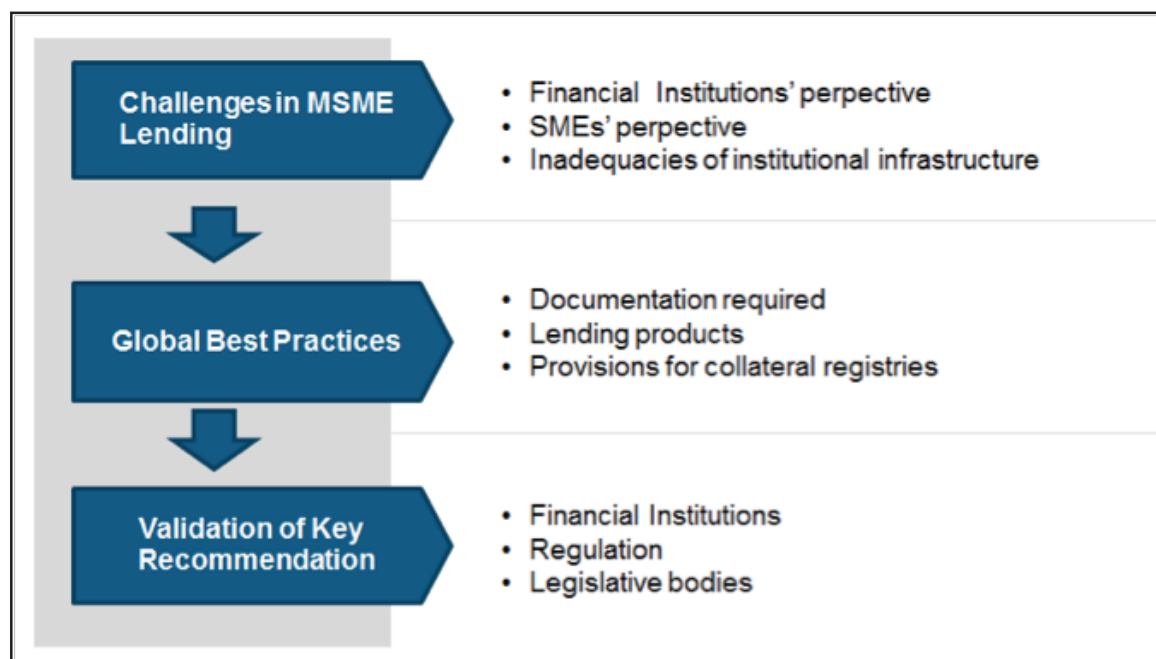
The MSMEs in Indonesia were divided into nine sectors as defined by Statistics Indonesia and Bank Indonesia. Each of these sectors was further divided into micro, small and medium segments to form 27 homogenous sector-segment groups. The investment and working capital debt demand for each of the groups was aggregated to determine the total debt demand for MSMEs in Indonesia. The assumptions for the demand estimation were validated during the primary interactions with MSMEs and industry experts. The borrowing preferences and challenges faced in obtaining finance were also studied during this phase. In addition, the demand supply gap for each sector was identified and analyzed further to estimate the gap addressable by movable assets based lending.

### **1.3.3. Institutional Infrastructure**

The laws and regulations within the financial ecosystem relevant for lending to MSMEs, along with relevant sections pertaining to lending were identified during the secondary research. The primary interactions with regulators and other supporting agencies helped in understanding the genesis of the regulation, the support provided by these agencies and the additional initiatives taken (or those being considered) to facilitate greater lending to MSMEs.

### 1.3.4. Recommendations

**FIGURE 2: APPROACH FOR RECOMMENDATIONS**



Local lending challenges and global best practices were analyzed to arrive at key recommendations. These recommendations were validated through interactions with FIs, regulators and legislative bodies, and further substantiated through a workshop attended by various key stakeholders.<sup>5</sup>

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<sup>5</sup> The workshop was conducted by IFC in Jakarta, Indonesia on December 3, 2013

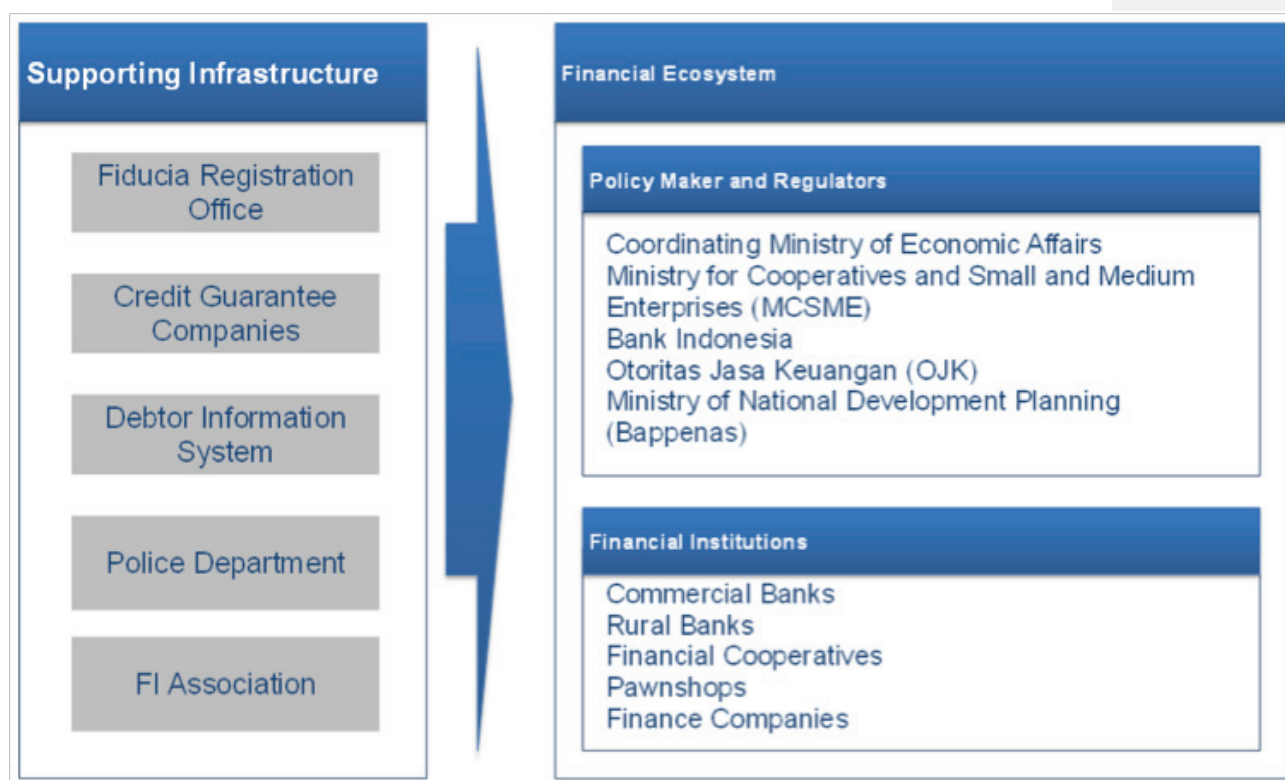
## **Chapter 2: Demand and Supply of Financing to MSMEs**

## 2. MSME Lending Structure

### 2.1. MSME Financial Ecosystem

The Indonesian financial sector comprises of commercial banks, rural banks, savings and loan cooperatives, venture capital firms, pawnshops, multifinance companies, insurance companies, pension funds and money lenders. Table 3 highlights key stakeholders in the financial ecosystem from the micro, small and medium enterprises' (MSMEs') perspective. While there are also other regulators and legislative bodies and supporting infrastructure establishments in the ecosystem, the study viewed the below-mentioned regulators, legislative bodies and infrastructure enablers as having greatest relevance to creating an impact on the situation of lending against movable assets.

**FIGURE 3: FINANCIAL ECOSYSTEM**



### **2.1.1. Policy Makers**

#### **2.1.1.1. Coordinating Ministry of Economic Affairs (Kementerian Koordinator Bidang Perekonomian)**

The Coordinating Ministry of Economic Affairs (CMEA) was formed in 1966 under the name “Home Ministry for the Economy, Finance and Industry” to coordinate with different ministries to improve the macroeconomic indicators for Indonesia. The key functions of the CMEA are:

- a) Synchronization and coordination of planning, preparation and implementation of policies in the field of economy,
- b) Control of implementation of the policies indicated above,
- c) Management of assets/wealth of the country, and
- d) Execution of certain tasks given by the President.

The CMEA introduced the Kredit Usaha Rakyat (hereinafter referred to as the KUR) program to improve financial access for MSME, and is key stakeholder in implementation of the program. The details of KUR are provided in Section 4.3.1.3.

#### **2.1.1.2. Ministry of Cooperatives and Small and Medium Enterprises (Kementerian Koperasi dan Usaha Kecil dan Menengah)**

The main function of the Ministry of Cooperatives and Small and Medium Enterprises (MCSME) is to assist the President of Indonesia in formulating the policy and coordinating policy implementation for cooperatives and MSMEs. The key functions of the ministry are:

- a) Formulation of the government policy in the development of cooperatives and MSMEs,
- b) Coordination and improvement in the coherence of program planning, monitoring, analysis and evaluation of cooperatives and MSMEs’ operations,
- c) Increasing community participation in cooperatives and MSMEs,
- d) Coordination of operational activities of development agencies, economic resources of the country for the development of cooperatives and MSMEs, and
- e) Submission to the President of evaluation reports, suggestions and considerations of tasks and functions related to the development of cooperatives and MSMEs.

The MCSME also regulates cooperatives in Indonesia, defining broad guidelines for them rather than exerting direct control over them. Many cooperatives are also registered with provincial governments.

### **2.1.1.3. State Ministry of National Development Planning (Bappenas)**

The vision of the Ministry of National Development Planning and the National Development Planning Agency (Bappenas) is to be reliable, credible and proactive in supporting the development of Indonesia and the Indonesian provinces.

To achieve this vision, Bappenas takes necessary action in the form of three missions, as indicated below.

1. Preparation of the national development plan that is able to:
  - Integrate, synchronize, and synergize between regions, spaces, different periods of time, and local governments across functions, as well as between centers and regions,
  - Realize the relevance of and consistency between planning, budgeting, implementation and monitoring,
  - Optimize community participation, and
  - Use resources in a manner which is efficient, effective, equitable and sustainable.
2. Monitoring and evaluation of the performance of the implementation of the national development plan, review and evaluation of the quality policy development issues, as input for the next planning process or for policy formulation and development in various fields.
3. Execution of effective coordination in the implementation of the tasks of Bappenas.

## **2.1.2. Regulators**

### **2.1.2.1. Financial Services Authority (Otoritas Jasa Keuangan)**

The former Bapepam-LK was governed by the Ministry of Finance, which developed, managed and oversaw the daily operations of capital markets in Indonesia. It was also entrusted to formulate and implement policies and standards for financial institutions (FIs) in Indonesia. In 2011, in accordance with Law no. 21/2011, Bapepam-LK was transformed into Otoritas Jasa Keuangan (OJK).

OJK is the Government of Indonesia (GoI) agency that regulates and supervises the financial services sector. It is an autonomous agency and its functions, duties and powers include regulation, supervision, inspection and investigation. OJK has the task of regulating and supervising the activities of the financial services sector.

OJK supervises non-bank financial institutions (NBFIs) and includes insurance and guarantee companies, equity and debt market players, venture capital firms, several types of cooperatives, and pension companies. Most of Bank Indonesia's (BI) functions, duties and authorities related to regulation of banks were transferred to OJK effective 31 December 2013. Under this new structure, the OJK as an independent entity reports directly to the Indonesian Parliament.

#### **2.1.2.2. Bank Indonesia**

Bank Indonesia (BI) is the central bank of Indonesia and was the main regulator for the banking sector (both commercial and rural banks) until 31 December 2013. BI had in the past taken various steps including formulating committees to reduce information asymmetries and improve access to finance to MSMEs. For example, in 2012, it mandated that 20 percent of the bank's lending portfolio should be in the MSME sector by 2018. Other initiatives taken by BI are discussed at a greater length in the subsequent sections of this report.

Following the transfer of BI's regulatory and supervisory authorities to OJK, it no longer has direct access to information on the micro prudential banking because the primary function and responsibilities of BI are now related to the macro prudential regulation, establishing and enforcing monetary policy,<sup>6</sup> payment systems and foreign exchange.

#### **2.1.3. Supporting Infrastructure**

##### **2.1.3.1. Fiducia Registration Office – Ministry of Law and Human Rights (Kementerian Hukum dan Hak Asasi Manusia)**

A fiduciary transfer is established in the form of a notarized deed in Bahasa Indonesia between the transferrer (borrower) and the transferee (lender). In accordance with the Fiduciary Transfer Law of 1999, the transferee must register the fiduciary transfer agreement in the fiducia registration book kept by the Fiducia Registration Office (FRO). Registration is also necessary if the transferred assets are outside the country. Although there is no finite time frame defined for the registration, the transfer comes in effect only on the date of registration. If the transferrer fraudulently signs the transfer deed with more than one lender, then the first lender to register the transfer deed will obtain enforceable security interest. The transferee will obtain a fiduciary registration certification post acceptance of registration application.

The FRO initiated an online registration system in February 2013. Currently the online system is available only to notaries for registration, and the legacy data has not yet been digitized. While the registry information contains information on the collateral registered, the registry currently does not capture any specifics of the collateral, which facilitates clear identification of the uniqueness of the collateral.

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<sup>6</sup> 2013 IMN Survey of National Progress in the Implementation of G20/FSB Recommendations, Indonesia

### **2.1.3.2. Indonesian Derivatives Clearing House (PT Kliring Berjangka Indonesia, Persero)**

The clearing house acts as a registry for warehouse receipts under the Warehouse Receipt Law. The security over warehouse receipts can be created by following the steps given below:

- a) Loan agreement between borrower and creditor;
- b) Deed of security agreement between borrower and creditor;
- c) Notification to the clearing house and the warehouse manager that the warehouse receipts have been encumbered,
- d) Recording the security over warehouse receipt in the registry book of security,
- e) Confirmation of security encumbrance and written confirmation to the security grantee.

The security grantee will hold the warehouse security receipt and therefore it cannot be double encumbered.

### **2.1.3.3. Credit Guarantee Companies**

There are two central credit guarantee companies in Indonesia – Perum Jamkrindo and PT (Persero) Asuransi Kredit Indonesia (Askrindo). These companies guarantee (up to 80 percent) the loans provided under KUR. Under KUR, guarantee fees at the rate of 3.25 percent<sup>7</sup> of the credit coverage are paid by the Government annually. The GoI infuses IDR 2 trillion equity annually<sup>8</sup> into these two firms depending on their performance, increasing their ability to guarantee more loans.

In addition to these central companies, two regional companies, PT Jamkrida Bali Mandara and PT Jamkrida Java, also guarantee loans under the KUR program. The GoI also plans to set up four more regional companies – PT Jamkrida Riau, PT Jamkrida NTB Bersaing, PT Jamkrida West Java, and PT Jamkrida West Sumatera to increase MSME financing.

### **2.1.3.4. Credit Bureau**

Currently (as of December 2013) BI maintains a Debtor Information System or Sistem Informasi Debitur (SID) which captures data from 120 commercial banks, 1304 Bank Perkreditan Rakyat (BPR) and 20 NBFIs. Parameters captured in SID are limited to the name of the debtor and creditor and the repayment status of the credit. Any credit information or history of individuals and businesses on account of loans from MFIs is currently not captured by the SID.

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<sup>7</sup> Notes to Financial Statement, JAMINAN KREDIT INDONESIA, For the year ended December 31, 2012 and 2011

<sup>8</sup> Interaction with Deputy Minister for Fiscal and Monetary Coordination



Through regulation 15/1/PBI/2013, BI has opened the credit information sharing practice to private entities. The new credit bureaus (Lembaga Pengelola Informasi Perkreditan – LPIP) are expected to increase the breadth of the data captured (such as utility bills). Microfinance institution (MFI) associations such as Credit Union Central of Indonesia (Induk Koperasi Kredit; INKOPDIT) also started a pilot program in November 2013 called Sistim Koperasi Perkreditan (SISKOPDIT) to capture data of its 930+ members.

#### **2.1.3.5. Police Department**

Motor vehicles are the major collateral for movable assets based lending in Indonesia. FIs retain the possession of the vehicle ownership certificate to safeguard their interest upon lending. Since the owner of the vehicle could get the certificate reissued from the Police Department and sell this vehicle, the transfer of ownership is also processed through the Police Department. To prevent issuance of new ownership certificate and avoid transfer of ownership registration under lien, FIs file a petition with the Police Department to restrict reissuance of the certificate until the debt against the vehicle is paid in full. The Police Department provides this service at a nominal charge of IDR 50,000,<sup>9</sup> and also provides support to the FIs during collateral repossession and execution. In 2011, the Chief of National Police Force issued order no. 08 of 2011 regarding the execution of the fiduciary collateral. The order aimed to ensure peaceful, accountable and orderly execution of fiduciary security while ensuring safety and security of creditor, debtor and/or the public from any action during execution that may inflict loss to property and/or public safety.

#### **2.1.3.6. Credit Rating Agencies**

Credit rating for MSMEs in Indonesia is still in a nascent stage. BI has started a pilot program, in 2013, to develop a common rating matrix for MSMEs. Four rating agencies – ICRA Indonesia, PT Pemeringkat Efek Indonesia (PT PEFINDO), MICRA Indonesia and Dun & Bradstreet – are involved in this initiative. These rating agencies are working with banks in Indonesia including Bank Mandiri to align the credit ratings with FIs' internal credit approval mechanism. The factors considered while designing the credit rating are entrepreneur's profile, review of firm's operational and financial management systems, asset base and past credit history.

Positive credit rating makes it easier for MSMEs to obtain credit at a cheaper rate. Further investigations are required to understand the penetration of these services among MSMEs.

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**9 Based on the primary interaction with various banks during the study**

### **2.1.3.7. Industry Associations**

There are many FI associations in Indonesia including Perbarindo for rural banks, Asosiasi Perusahaan Pembiayaan Indonesia (APPI) for consumer finance companies and INKOPDIT for credit unions (CUs). They assist the FIs in forming lending policies and act as advocates of FIs with the legislative bodies and regulators. APPI's efforts were instrumental in OJK clarifying that the registration of fiducia was not compulsory for consumer finance companies.

Though these associations do not formally perform duties of the regulators, many FIs follow the guidelines and models proposed by the association. They also play an important role in technical capacity improvement of MFIs.

## **2.2. Legal Framework**

A strong legal infrastructure defining borrowers' and creditors' rights and regulations providing guidelines to FIs is pertinent to increase MSME financing in Indonesia.

### **2.2.1. Laws Governing Lending**

In Indonesia, lending and movable assets based lending in particular is not governed by a single law. The Indonesian Civil Code, the Company Law, the Fiduciary Transfer Law and the Warehouse Receipt Law are the key laws governing movable assets based lending in Indonesia (Table 1).

The key implementer of the law is customarily defined as a legislative body or an agency formed under the law. However, in many cases policy makers, especially regulators like BI and OJK, are responsible for implementing/enforcing the lending related laws owing to the nature of their duties and responsibilities.

**TABLE 1:**  
**LAWS GOVERNING MOVABLE ASSETS BASED LENDING IN INDONESIA**

	Indonesian Civil Code	Company Law	Fiduciary Transfer Law	Warehouse Receipt Law
Key Provision	Chapter XX and XXI of Book 2 deal exclusively with pledges, mortgages	Allowed equity shares to be pledged in form of fiduciary security	Allowed transfer of title in trust to creditor for securing debt	Allowed the use of warehouse receipts as collateral
Implementers	Indonesian courts, central government	Ministry of Law and Human Rights	Ministry of Law and Human Rights, public notary, financial regulator	Indonesian Derivatives Clearing House, financial regulator
Key Learnings	Asset can be legally collateralized only once	Fiducia over shares does not fit well with requirements of Fiducia Law	Upon default, creditor only gets title executionary right	New infrastructure is required for success of the law

### 2.2.1.1. The Indonesian Civil Code

Chapters XX and XXI of Book Two (Assets) Indonesian Civil Code deal exclusively with pledges and mortgages.<sup>10</sup> The civil code is implemented by the Indonesian courts and the central and regional governments. One of the key guidelines in the Indonesian Civil Code mentions that an asset once pledged cannot be pledged again until the previous loans are paid in full.

With respect to movable assets based lending, the Indonesian Civil Code defines a pledge as a right of a creditor (pledgee) to movable property or intangible assets (e.g., gold, time deposits, shares and certain marketable securities) that are physically delivered into the possession of the pledgee by a debtor. The pledge gives the pledgee a preferential right to the proceeds from the sale of the goods with regard to other creditors.

### 2.2.1.2. The Company Law (Law no. 40 of 2007)

The new Company Law was passed in 2007 to address gaps in the previous Company Law. Under the new law, the company registry would be maintained by the Ministry of Law and Human Rights (MoLHR), which is also responsible for approving Articles of Association and reduction in paid-up capital. The MoLHR should also be informed within 30 days of change of shareholders and has the right to reject the change if certain requirements are not met.

<sup>10</sup> State Gazette number 23 Year 1847

The Company Law also allows the pledging or encumbering shares with fiduciary security unless mentioned otherwise in the Articles of Association of the company. The pledges and fiduciary security are required to be registered in the shareholders register. The Company Law also keeps the voting rights of these shares with the shareholder. Besides this, the dynamic nature of share pricing and treatment of dividend payment adds complexity from a fiducia perspective.

#### **2.2.1.3. The Fiduciary Transfer Law (Law no. 42 of 1999)**

The Fiduciary Transfer Law of 1999 which became effective in September 1999 requires that the fiduciary transfer agreement is in the form of a notarized deed and needs to be registered with the FRO managed by the MoLHR. A fiduciary transfer is the transfer of title in trust for securing debt to the creditor. Once the debt is paid the title is transferred back to the original owner. In case of default, the transfer is not completely transferred to the creditor, but the creditor has the right to sell the transferred asset to recover the debt. While this law provides the basic framework for movables finance, the process is nevertheless marred with shortcomings such as inadequate infrastructure (shortage of notaries) and high costs.

The key implementing agencies for this law are the MoLHR, notaries, and financial regulators. It should be noted that the law only gives the creditor the executionary right to sell the asset, but no right to ownership of the asset.

#### **2.2.1.4. The Warehouse Receipt Law (Law no. 9 of 2011)**

This law is an amended version of Law no. 9 of 2006. This law was implemented to address business demands regarding warehouse receipts. The significant amendment to this law includes removal of the clause which stated that the value of the warehoused goods would be equal to market price of the goods at the time of storage. This law also calls for formation of a warehouse receipts guarantee institution which would also play a significant role in deciding the damages related to loss or damage of goods during storage. This law also allows the use of warehouse receipts as collateral and gives flexibility to producers to sell their goods when the market prices are right.

The warehouse receipt system is overseen by the Warehouse Receipt System Supervisory Agency (Badan Pengawas Resi Gudang). The Commodity Futures Trading Regulatory Agency (CoFTRA) or BAPPEPTI is currently performing the duties of the Warehouse System Supervisory Agency. The Indonesian Derivate Clearing House (PT Kliring Berjangka Indonesia) under a licence from BAPPEPTI currently serves as the Central Register for the warehouse receipt system and records, stores, transfers ownership, and imposes the rights guarantees of warehouse receipts. Supporting infrastructure including warehouses, warehouse managers and surveyors needs to be developed to achieve the full potential of financing based on this law.

## 2.2.2. Regulations

There are two key BI regulations for promotion of lending to MSMEs. These are discussed below.

### 2.2.2.1. PBI no. 14/22/PBI/2012 for Commercial Banks <sup>11</sup>

This regulation was issued by BI in December 2012. The highlights of the regulation are:

- a) Twenty percent of commercial banks portfolios should be lent to MSMEs:
  - Banks to take their best effort for the years 2013 and 2014,
  - Five percent of total lending portfolio until 2015 and then 5 percent increase every year until 2018.
- b) Realization either through direct lending to MSMEs or indirectly lending through linkage programs with BPRs and cooperatives like channeling, executing or co-financing.
- c) Harmonization of the definition of microenterprise credit, small enterprise credit, and medium enterprise credit with the MSME law of 2008.
- <sup>12</sup>d) Technical assistance for increasing capacities of FIs and MSMEs in the form of research, training, provision of information, and facilitation.
- e) Regulation of MSME credit or financing based on pre-existing BI regulations governing banks business plan, monthly report, quarterly and monthly financial publication report, and certain other reports, debtor information system, transparency of banks product information and utilization of customers personal data.
- f) Regulation of the publication on MSME credit ratio achievement from each commercial bank in BI's website for better coordination with other organizations
- g) Penalty at 2 percent of the non-compliant amount, capped at IDR 10 billion (the exact quantum of penalty was published in mid-2013); based on discussions with BI.

### 2.2.2.2. PBI no. 13/26/PBI/2011 for Rural Banks

This regulation was issued by BI on 28 December, 2011 as an amendment of PBI no. 8/19/PBI/2006 on Earning Assets Quality and Establishment of Allowance for Earning Assets of Rural Banks. The PBI aims to:

- a) Encourage BPR lending to MSMEs while being prudent,
- b) Harmonize the provisions of the asset quality and allowance for productive asset for rural banks.
- c) Ease lending based on gold jewelry, debt securities by GoI, warehouse receipts, business premises/kiosk/stall/right to use, credit guarantee by the state/local enterprises as collateral (details in section 6.2.2.1.1).

In addition to these regulations, the Ministry of Finance issued a regulation<sup>13</sup> for NBFIs in 2012, making it compulsory for NBFIs to register loans on vehicles with the FRO.

<sup>11</sup> The Bank Indonesia's Banking Handbook, 2013.

<sup>12</sup> Law No 20, Year 2008 on UMKM, Indonesia

<sup>13</sup> The Minister of Finance's directive no. 130/PMK.010/2012 for Finance Companies

### **2.2.2.3. The Minister of Finance's directive no. 130/PMK.010/2012 for Finance Companies**

This directive specified that financing companies dealing with consumer finance for motor vehicles shall register the fiducia with the FRO no later than 30 calendar days from the date of consumer financing agreement. The finance companies were also prohibited from executing the collateral in the absence of a fiduciary certificate. The penalties for non-compliance included warning, suspension of business activity, or revocation of business licenses. Later, in response to the complaints raised by the finance companies, the regulator for consumer finance companies, OJK made a clarification of the interpretation of the Ministry of Finance's directive. OJK specified that only the consumer finance companies collecting the fiduciary cost from consumers are obliged to register with the MoLHR. The finance companies which do not wish to use fiducia instruments are not obliged to register, consequently prohibited from collecting fees to establish fiduciary certificate, which has been the case for quite some time.

## 3. Addressable Demand for Financing for MSMEs

This section provides an overview of the MSME demand in Indonesia informed by the primary desk research. The demand of debt finance by Indonesian MSMEs is also estimated in this section.

### 3.1. Definition of Indonesian MSMEs

The Indonesian MSMEs are generally classified based on asset size, number of employees, and revenues. The Indonesian MSME law of 2008<sup>14</sup> defines MSMEs based on net assets and annual sales, whereas the enterprise survey defines MSMEs based on the number of employees (Table 2).

**TABLE 2 DEFINITION OF INDONESIAN MSMEs**

Firm Size	Net Assets* (MSME Law 2008)	Annual Sales (MSME Law 2008)	Number of Employees ** (World Bank Enterprise Survey)
Micro	< 50 million IDR	< 300 million IDR	NA
Small	50-500 million IDR	300-2500 million IDR	5-19
Medium	500-10,000 million IDR	2.5-50 billion IDR	20-99

\* Net Assets do not include land and building assets.

\*\* Enterprise Surveys do not cover enterprises with fewer than five employees.

Unless mentioned otherwise, for the purpose of this study, the definitions as prescribed by the Indonesian MSME law of 2008 have been used. Net assets have been considered to take precedence over annual sales when classifying enterprises across micro, small and medium segments.

### 3.2. Firms and Employment Statistics

The overall MSME landscape has been categorized based on sector specific information and seeks to address how each sector contributes to the growth and penetration of MSMEs. Thus, it would be important to identify key sectors that play a significant role in the overall MSME landscape. These sectors have been identified based on their numbers, employment, GDP contribution, asset base and sales.

**14 Law No 20, Year 2008 on UMKM, Indonesia**

### 3.2.1. Distribution across Micro, Small and Medium Segments

In 2012,<sup>15</sup> there were more than 56.5 million MSMEs in Indonesia employing more than 107 million people, which is about 92 percent of the total working population of 240 million.

**TABLE 3: DISTRIBUTION AMONG MICRO, SMALL AND MEDIUM ENTERPRISES (2012)**

	Number of Entities	% of MSME	Employment	% of MSME
Micro	55,856,176	98.8	99,859,517	92.8
Small	629,418	1.1	4,535,970	4.2
Medium	48,997	0.1	3,262,023	3.0
Total	56,534,591	100.0	107,657,510	100.0

Microenterprises constitute more than 98 percent of the MSME space and provide employment to more than 92 percent of the workforce working in Indonesian MSMEs. These enterprises mostly work in the informal sector and have no legal documentation, making it more difficult for them to access credit through formal channels.

### 3.2.2. Distribution across Industrial Sectors

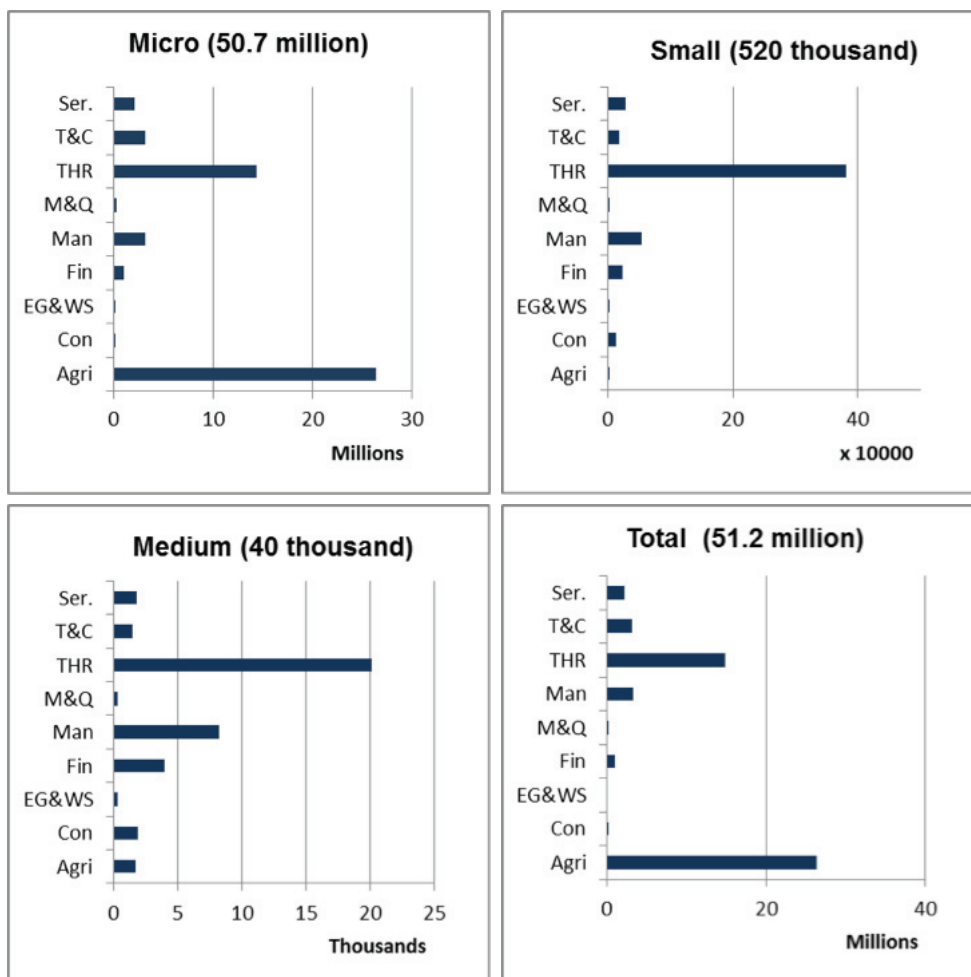
In line with the classification made by Badan Pusat Statistik (Statistic Indonesia or BPS) and BI, for the purpose of this assignment, the MSMEs are distributed among nine broad sectors.

1. Agriculture, animal husbandry, forestry and fisheries (Agri)
2. Construction (Con)
3. Electricity, gas and water supply (EG&WS)
4. Finance, rent and services (Fin)
5. Manufacturing (Man)
6. Mining and quarrying (M&Q)
7. Transport and communication (T&C)
8. Trade, hotels and restaurants (THR)
9. Services (Ser)

<sup>15</sup> Data UMKMB, Ministry of Cooperative and SME, Indonesia updated in 2012.



**FIGURE 4: DISTRIBUTION OF ENTERPRISES ACROSS VARIOUS CATEGORIES (2008)<sup>16</sup>**

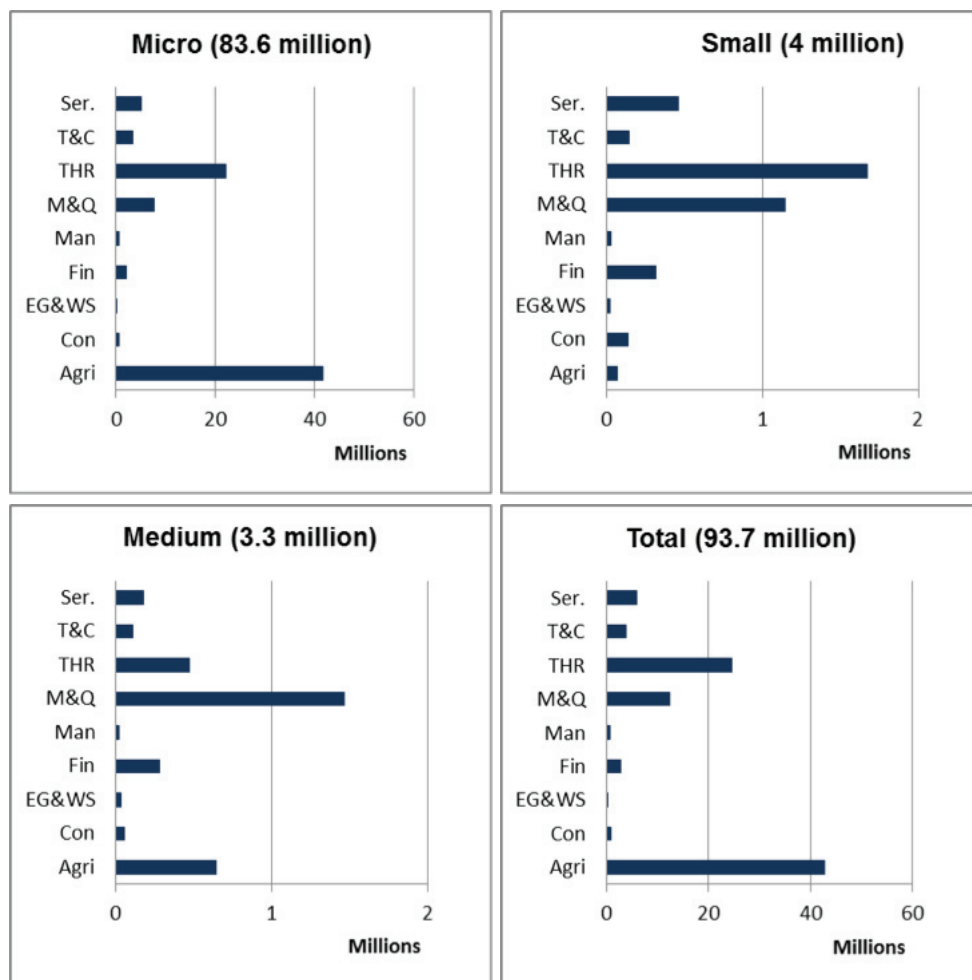


Microenterprises in the agriculture sector constitute 51.5 percent of the overall MSME enterprises and employ more than 45 percent of the total MSME workforce (Figures 5). After the microenterprises in agriculture, those in the trade, hotels and restaurants sector dominate the industrial landscape, with 23.67 percent of the total enterprises' number and 28.07 percent of the total employment.

The sectoral information for micro, small and medium enterprises (MSMEs) provides a different perspective. The trade, hotels and restaurants sector dominates both small and medium sectors in the number of enterprises, followed by the manufacturing sector (Figures 4).

<sup>16</sup> Constraints on Indonesia's Export-oriented Micro, Small, and Medium Enterprises, Secondary Data Analysis and Literature Survey, SEADI Discussion Paper Series, USAID, 2012 and Bank Indonesia survey of MSMEs in 2008 & IFC analysis.

**FIGURE 5: DISTRIBUTION OF EMPLOYEES ACROSS VARIOUS CATEGORIES (2008)<sup>17</sup>**



Agriculture, trade, hotels and restaurants, and the manufacturing sectors are key sectors in the Indonesian MSME landscape and constitute more than 80 percent of the total MSME enterprises.

### 3.2.3. Growth of MSMEs

Since 2006, the number of MSMEs in Indonesia has been growing at an annual rate of 2.4 percent as can be seen in Figure 6.

<sup>17</sup> Constraints on Indonesia's Export-oriented Micro, Small, and Medium Enterprises, Secondary Data Analysis and Literature Survey, SEADI Discussion Paper Series, USAID, 2012 and Bank Indonesia survey of MSMEs in 2008 and IFC analysis.

**FIGURE 6: GROWTH OF MSMEs<sup>18</sup>**

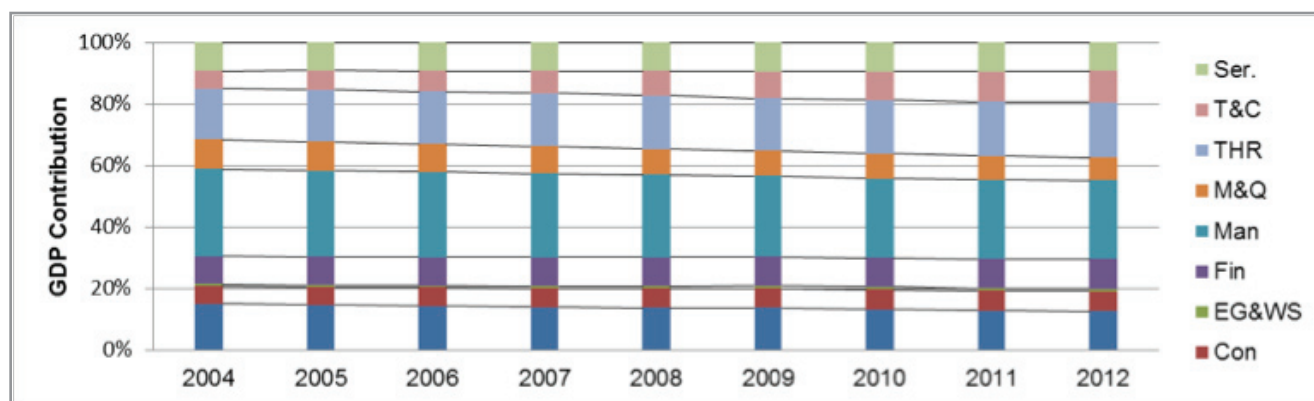


The number of people employed per firm has also grown from 1.79 to 1.95 employees in the last six years.

### 3.3. GDP Contribution of MSMEs

MSMEs contribute to 57.12 percent<sup>19</sup> of Indonesia's GDP. The level of contribution of MSMEs to GDP has remained stable since 2006 (around 58 percent). Sectoral GDP contribution is shown in Figure 7.

**FIGURE 7: SECTORAL GDP CONTRIBUTION<sup>20</sup>**



Since the sectoral GDP contribution has remained fairly constant since 2006,<sup>21</sup> it has been assumed that contribution of MSMEs in individual sectors has also remained constant.

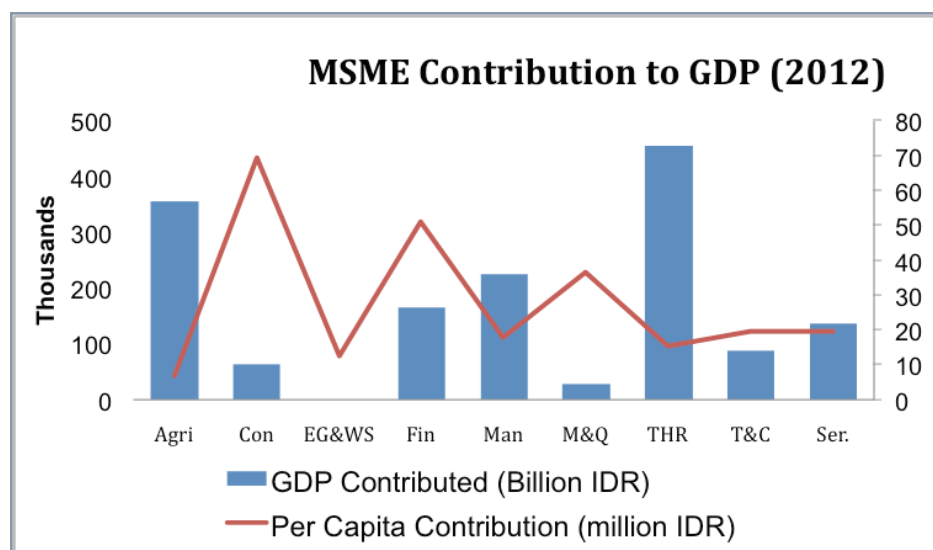
<sup>18</sup> Data UMKMB, Ministry of Cooperative and SME, Indonesia updated in 2012.

<sup>19</sup> Business Process Requirements for Indonesian Small Medium Enterprises (SMEs) in Implementing Enterprise Resource Planning (ERP), P. W. Handayani, A. N. Hidayanto, and I. Budi, paper published in International Journal of Innovation, Management and Technology, Vol. 4, No. 1, February 2013.

<sup>20</sup> Since MSME contribution to the GDP has been fairly constant and sectoral contribution figures has been relatively stable as presented in the graph, it has been assumed that MSME sectoral breakdown for GDP contribution is same as overall sectoral contribution to GDP.

<sup>21</sup> Constraints on Indonesia's Export-oriented Micro, Small, and Medium Enterprises, Secondary Data Analysis and Literature Survey, SEADI Discussion Paper Series, USAID, 2012IFC analysis.

**FIGURE 8: MSMEs' CONTRIBUTION TO GDP IN 2012<sup>22</sup>**



Even though agriculture employs nearly half of Indonesia's work force, the per capita contribution (IDR 6.9 million) to the economy (economy wide average of IDR 13.77 million) is significantly lower than for all the other sectors.

The next biggest sector in Indonesia, trade, hotels and restaurants (employing 40 percent fewer people) contributes 27 percent more to the economy than does agriculture. The key sectors identified like agriculture, trade, hotels and restaurants, and manufacturing are the same as those identified through the analysis of number of enterprises and number of employees.

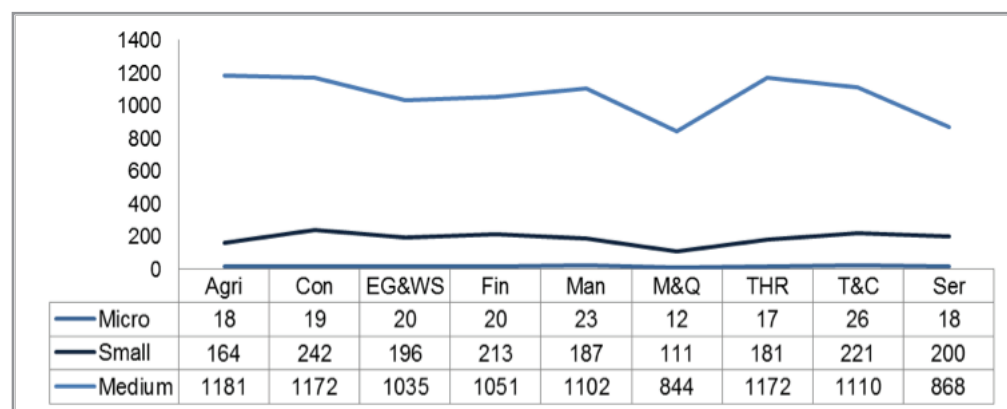
### 3.4. Asset Base of MSMEs in Indonesia

The overall asset base of MSMEs in Indonesia was estimated based on a survey conducted by BI in 2008. Though BI has collected various details including owners, managers, suppliers, customers, balance sheets, income statements and cash flows, only limited information including number of employees, net assets and sales is currently available. In this study, information from 861 enterprises has been captured for the further analysis.

The information available on the asset base of MSMEs was leveraged for estimating the potential addressable investment capital demand for the MSME segment.

<sup>22</sup> Constraints on Indonesia's Export-oriented Micro, Small, and Medium Enterprises, Secondary Data Analysis and Literature Survey, SEADI Discussion Paper Series, USAID, 2012IFC analysis.

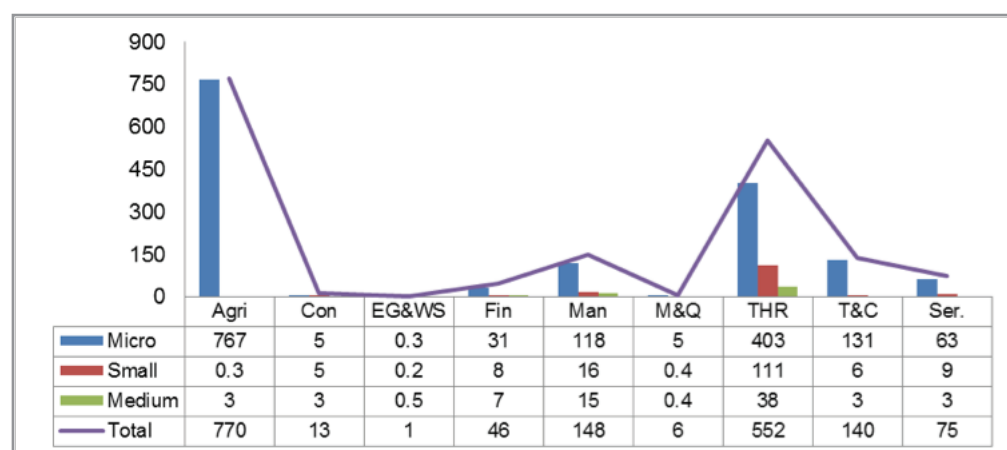
**FIGURE 9: ASSET PER ENTERPRISE ACROSS SECTORS (IDR MILLION) 2008<sup>23</sup>**



The value of the average asset per enterprise across sectors in the same segment, especially the three identified sectors (agriculture, trade, hotels and restaurants, and manufacturing) is nearly constant (Figure 9). Thus the sectoral contribution to the total asset base would depend on the number of enterprises.

The sectoral asset base of MSMEs for 2012 (Figure 10) was projected assuming that the assets per enterprise would increase by 10 percent annually and the number of enterprises would increase by the 2.4 percent.<sup>24</sup>

**FIGURE 10: MSME ASSET BASE, 2012 (IDR TRILLION)<sup>25</sup>**



The overall assets of MSMEs in Indonesia are around IDR 1,751 trillion, of which almost 67 percent are held by microenterprises in the agriculture and trade, hotels and restaurants sectors. It is important to note that micro sized agriculture and trade, hotels and restaurants sectors hold 43.7 and 23 percent of total MSME assets respectively but still contribute only 7.8 and 9.92 percent to GDP respectively.

<sup>23</sup> Based on the survey conducted by Bank Indonesia in 2008 to profile MSMEs, this has been extrapolated to estimate May 2013 figures IFC analysis.

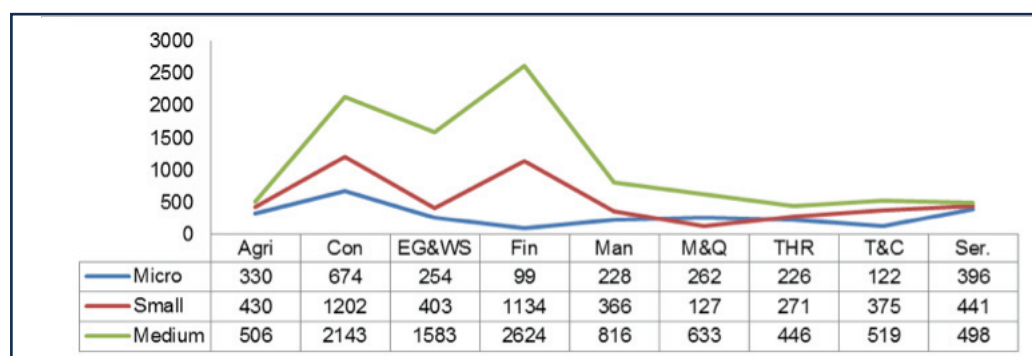
<sup>24</sup> Assuming that MSME growth rates calculated in Section 3.2.3 are consistent across all sectors.

<sup>25</sup> Based on the survey conducted by Bank Indonesia in 2008 to profile MSMEs, this has been extrapolated to estimate May 2013 figures IFC analysis.

### 3.5. Sales by MSMEs

The information available on the sales executed by these segments was leveraged for estimating the potential addressable working capital demand for the MSME segment. The enterprise level sale by each MSME sector across each segment was derived from BI's MSME survey (Figure 11).

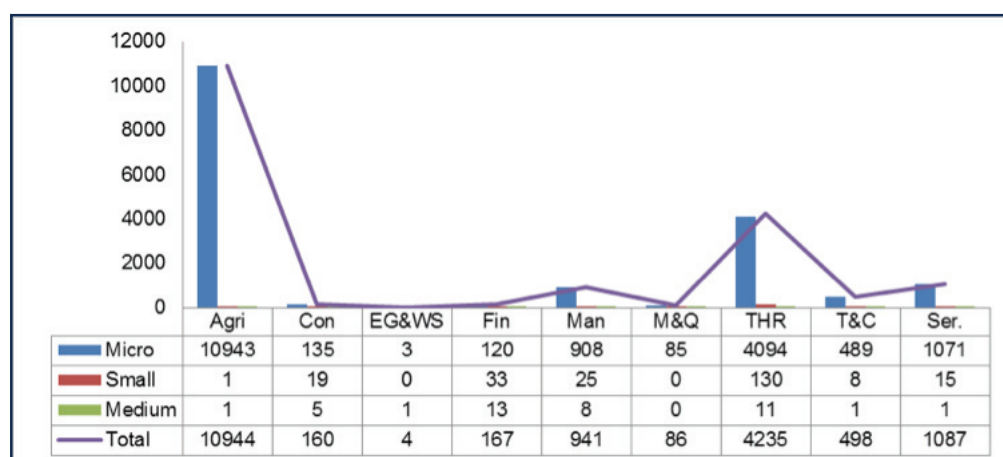
**FIGURE 11: SALES PER ENTERPRISE ACROSS SECTORS AND SEGMENTS, 2012 (IDR MILLION)<sup>26</sup>**



Unlike the assets per enterprise, the average sales per enterprise vary significantly among various sectors and industries.

The overall sales by MSMEs for 2012 are also estimated based on extrapolation of data obtained from surveys conducted by BI (Figure 12).

**FIGURE 12: MSMEs' SALES (IDR TRILLION)<sup>27</sup>**



Total sales by MSMEs amount to IDR 18,122 trillion. The micro segment of agriculture and trade, hotels and restaurants contribute to more than 83 percent of the overall sales. Agriculture, trade, hotels and restaurants, services, and manufacturing are the key sectors as they contribute to more than 95 percent of the total sales by MSMEs.

<sup>26</sup> Based on the survey conducted by Bank Indonesia in 2008 to profile MSMEs, this has been extrapolated to estimate May 2013 figures and IFC analysis.

<sup>27</sup> Based on the survey conducted by Bank Indonesia in 2008 to profile MSMEs, this has been extrapolated to estimate May 2013 figures and IFC analysis.

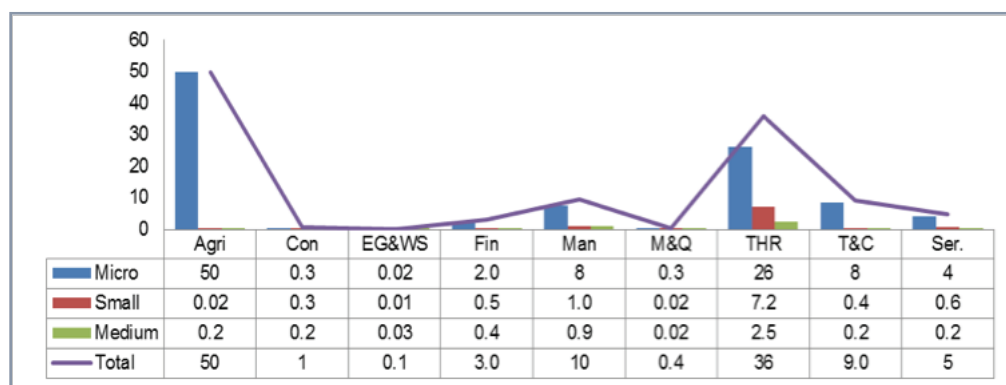
## 3.6. Estimation of Demand Potential

### 3.6.1. Estimation of Investment Capital Debt Demand Potential

It is assumed that the total asset base of MSMEs estimated above are assets created through capital investments. The rate of increase in aggregate assets is assumed to be 10 percent.<sup>28</sup> The total assets are expected to grow from IDR 1,751 trillion in 2012 to IDR 1,973 trillion in 2013. Assuming that 3 percent of the total increase in assets is due to inflation and other factors, the total investment required during 2012–13 is pegged at IDR 162.2 trillion and IDR 127.9 trillion during 2013–14.

Around 70 percent of capital investment is funded through debt, making the total investment capital debt demand potential IDR 113.53 trillion as captured in Figure 13.

**FIGURE 13: INVESTMENT DEBT CAPITAL DEMAND (IDR TRILLION)<sup>29</sup>**



In the small and medium segments, significant debt demand is observed only in the THR sector (trade, hotels and restaurants).

### 3.6.2. Estimation of Working Capital Debt Demand Potential

Assuming the growth rates of sales to be the same as that of GDP i.e. 5.2 percent, the total sales by MSMEs in 2012–13 is computed as IDR 18,122 trillion, while in 2013–2014 is computed as IDR 4,700 trillion.

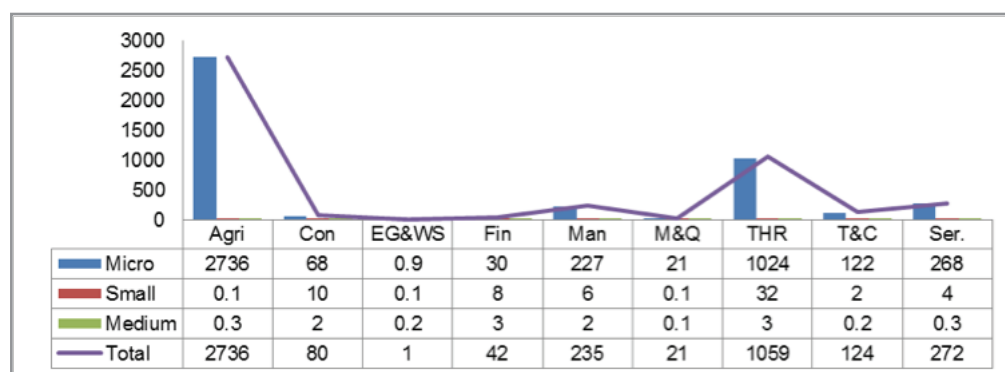
Based on industry information, it is assumed that 25 percent<sup>30</sup> of total sales constitute the total working capital debt demand potential; the total working capital debt demand is calculated as IDR 4,570.5 trillion. The sector level break-up of the working capital debt demand is captured in Figure 14.

<sup>28</sup> A conservative estimate based on the primary survey of this study.

<sup>29</sup> Internal norms as per World Bank PPP document, primary validation through numerous financial institution in Indonesia.

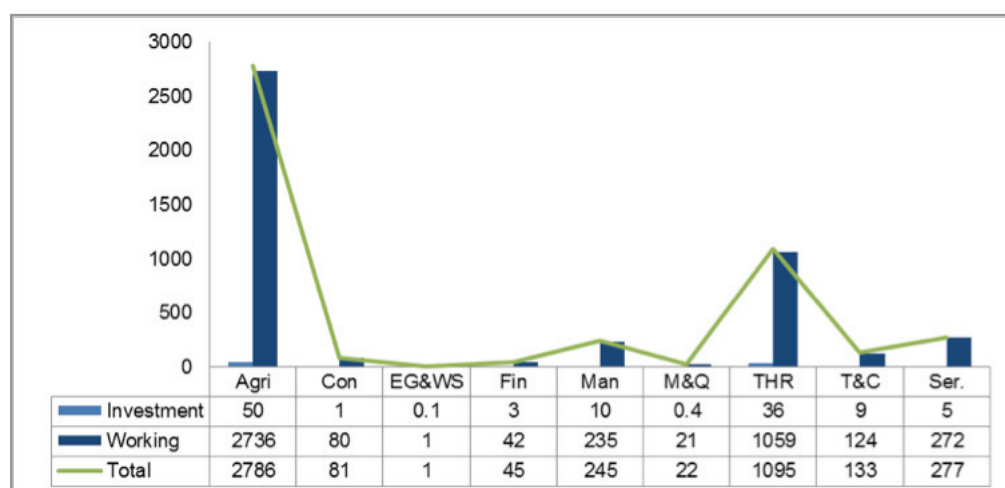
<sup>30</sup> This number has been computed based on methodology written in the report and is first published in this report.

**FIGURE 14: WORKING CAPITAL DEBT DEMAND (IDR TRILLION) <sup>31</sup>**



### 3.6.3. Total Debt Demand

**FIGURE 15: TOTAL LOAN DEMAND (IDR TRILLION) <sup>32</sup>**



The total demand for debt across all MSME segments and sectors in Indonesia is around IDR 4,684 trillion. The agriculture sector contributes to around 60 percent of the demand, followed by trade, hotels and restaurants (23.37 percent), services (5.91 percent) and manufacturing (5.23 percent).

### 3.7. Borrowing Preference

More than 75 percent of the enterprises preferred borrowing from informal sources and MFIs rather than from commercial banks.

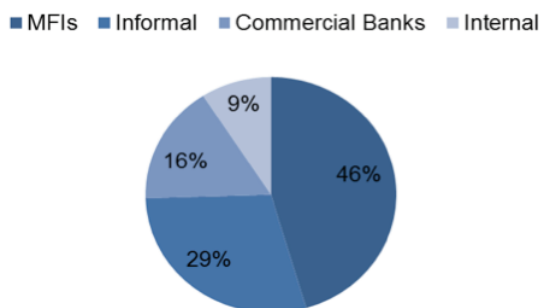
<sup>31</sup> This number has been computed based on methodology written in the report and is first published in this report.

<sup>32</sup> This number has been computed based on methodology written in the report and is first published in this report.



### 3.7.1. Reasons for Borrowing Preference<sup>33</sup>

**FIGURE 16: BORROWING PREFERENCE**



#### 3.7.1.1. Informal Sources

Friends and family are the preferred informal borrowing sources. Ease in obtaining funds, flexible repayment schedules and minimal or zero interest rates are the key reasons for this preference. MSMEs generally approach friends and family for meeting short-term immediate credit requirements. The ticket sizes are usually small, but in certain cases loans as high as IDR 2 billion have been obtained from friends and family. Among informal sources, money lenders, who charge high interest rates, are not desirable.

#### 3.7.1.2. Microfinance Institutions

Many MSMEs especially microenterprises have developed good relationships with MFIs. Easier loan application processes, relationships and availability of funds are the reasons for preferring MFIs. Some stakeholders also confirmed that ease of access (the loan officer from the cooperative visits to collect debt) has influenced their decision to remain with cooperatives.

#### 3.7.1.3. Commercial Banks

While lower rates of interest and larger size of loans are the major factors for MSMEs would like to seek loans from commercial banks as opposed to MFIs, perceived complex documentation, collateral requirements and branch network inaccessibility are the key challenges faced by MSMEs when trying to access funds from banks.

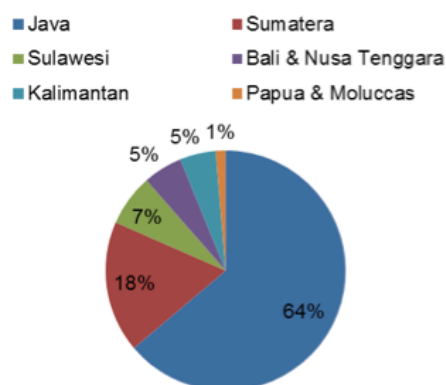
#### 3.7.1.4. Self-Financing Internal Funding

Religious reasons are the key reasons for MSMEs not availing themselves of funds through the financial ecosystem. Lack of awareness of funding programs and unwillingness to increase operations are also understood to be the reasons for preference for internal funding.

<sup>33</sup> Borrowing preferences were calculated based on 34 MSMEs interviewed across Jakarta, East Java and Central Java. These regions cover 40 percent of all MSMEs in Indonesia and receive 40 percent of debt received by MSMEs in Indonesia, as per Bank Indonesia lending data as of May 2013.

### 3.8. Geographical Distribution of MSMEs

**FIGURE 17: MSME GEOGRAPHICAL DISTRIBUTION**



The Economic Survey conducted in 2006 by Statistics Indonesia (Badan Pusat Statistik) divides Indonesia into six key geographies (Figure 17). Java has more than 64 percent of the total MSMEs covered in the economic survey, followed by 18 percent in Sumatera and 7 percent in Sulawesi.

The survey also divides the country in 33 provinces. The top five geographies contribute to 63 percent of the total enterprises. It is important to note that four of the five provinces are situated in Java (Table 4).

**TABLE 4: TOP FIVE PROVINCES IN INDONESIA FOR MSMEs**

Geography	Province	Total MSMEs	% of total enterprises	Key Sectors
Java	West Java	4,192,850	18.6	Agriculture
Java	East Java	4,181,046	18.5	Agriculture
Java	Central Java	3,673,009	16.3	Agriculture and Trade, Hotels and Restaurants
Java	DKI Jakarta	1,122,371	5.0	Manufacturing, Trade, Hotels and Restaurants, and Finance, Rent and Services
Sumatera	North Sumatera	1,049,538	4.7	Agriculture

### 3.9. Identification of Key Sectors

The key sectors in the Indonesian landscape are consistent across various parameters as categorized in the above sections. They are:

- Agriculture (micro),
- Trade, hotels and restaurants (micro, small and medium),
- Services (micro), and
- Manufacturing (small and medium).

The supply of finance to these sectors has been further analyzed in the subsequent supply section 4, which during the course of the study helped in identifying the key sectors for the study.

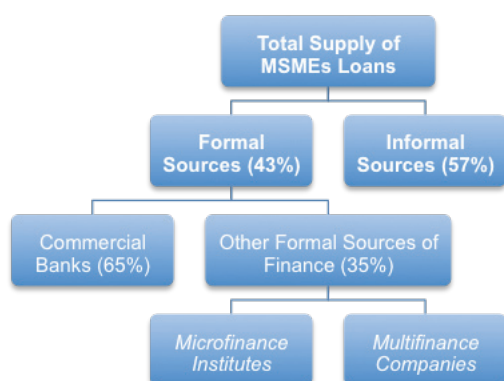
## 4. Current Supply of Financing for MSMEs in Indonesia

This section provides an overview of the credit supply provided to MSMEs in Indonesia informed by primary surveys and secondary desk research. The section includes various sources of supply, different lending models adopted by FIs for MSMEs, and how various FIs are targeting greater penetration on MSMEs considering the BI mandate on minimum 20 percent lending portfolio for MSMEs by 2018.

### 4.1. Supply of Finance to MSMEs

Total flow of financing to MSMEs can be divided into formal and informal sources. Formal flow of financing is provided by banking and other regulated lending institutes, whereas informal financing is provided by friends, family and relatives, unregistered money lenders and informal MFIs.

**FIGURE 18: STRUCTURE OF FINANCING**



Informal sources of financing contribute 57 percent of the overall supply to the MSMEs sector.<sup>34</sup> This report covers only the formal sources of lending since lending through informal sources still represents a gap which can be addressed by the formal sources of financing.

### 4.2. Formal Flow of Financing to the MSMEs\Sector

Formal sources of MSME lending can be classified into lending by commercial banks and other formal sources of finance. Commercial banks form 65 percent of total formal lending to borrowers in Indonesia.<sup>35</sup> Analyses have shown that the loan turnover ratio is

<sup>34</sup> Indonesian's Experiences on Micro Finance Institution and Small Scale Cross Border Transaction, ADBI-AFDC-ABAC "Asia-Pacific Forum on Financial Inclusion, June 2012.

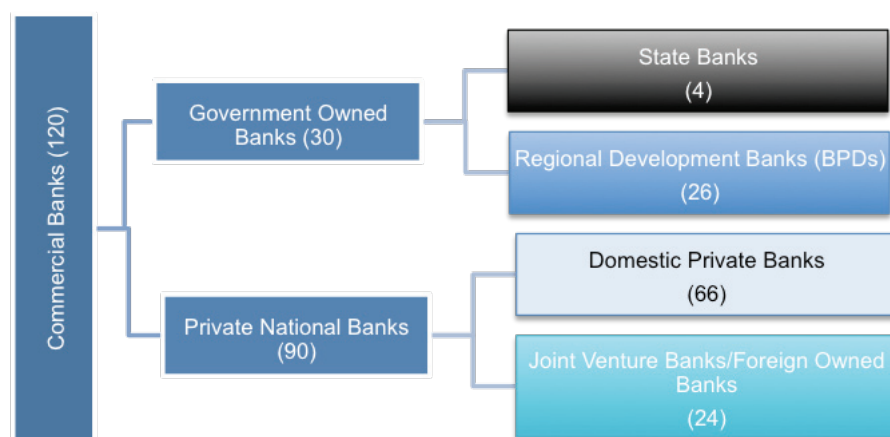
<sup>35</sup> Based on the assumption of Banking Share in the overall funds contributed to MSME lending, provided in Indonesian's Experiences on Micro Finance Institution and Small Scale Cross Border Transaction, ADBI-AFDC-ABAC "Asia-Pacific Forum on Financial Inclusion, June 2012, we have assumed banking sector share in Indonesia as 65% of the overall finance supply.

approximately one<sup>36</sup> (the ratio of the loans disbursed amount to the one of loans outstanding) for the Indonesian FIs. Hence, the total annual supply of financing is considered to be equal to the total outstanding loans at any point in time.<sup>37</sup> Based on the loan turnover being equal to 1, the total loans disbursed to MSMEs' through formal sources is approximately IDR 857 trillion as of 31 May 2013.

#### 4.2.1. Commercial Banks

The commercial bank structure in Indonesia consists of state-owned banks (SOBs), regional development banks (BPDs) and private national banks which can be further classified into foreign exchange banks, foreign-owned banks, joint venture (JV) banks and non-foreign exchange banks.

**FIGURE 19: TYPES OF COMMERCIAL BANKS (NUMBER OF ENTITIES)**



The total estimated supply of MSME financing from 120<sup>38</sup> commercial banks is IDR 559 trillion. These banks can be classified as follows:

**State-Owned Banks** – State-owned banks (SOBs), are wholly/majority owned by the GoI through the Indonesian Ministry of State-Owned Enterprises (MSOE). These banks are set up with the objective to channel resources to “priority” sectors of the economy as well as provide financial services to underserved parts of a widely dispersed country. They have over many years played an instrumental role in the Indonesian economy, given the fact that they control the majority of the country’s banking system. Currently, there are four state-owned banks in Indonesia namely PT Bank Negara Indonesia (PERSERO) TBK, PT Bank Rakyat Indonesia (PERSERO), TBK, PT Bank Tabungan Negara (PERSERO) and PT Bank Mandiri (PERSERO), TBK.

<sup>36</sup> Based on primary interviews MFIs and Banks in Indonesia, we have calculated average loan turnover ratio. A total of 14 large commercial banks in Indonesia and 53 MFI/MFI holding companies were interviewed across Jakarta, East Java and Central Java. Details of the financial institutions have been provided in appendix.

<sup>37</sup> Based on the calculation of average loan-turnover ratio, which is 1 in Indonesian case, loan outstanding figures can be assumed to be loan disbursed to MSMEs as of 31 May 2013.

<sup>38</sup> Indonesian Banking Statistics, May 2013, Bank Indonesia.

**Regional Development Banks (BPDs)** - Regional development banks (26 in total), also known as Bank Pembangunan Daerah (Provincial Development Banks) or BPDs are owned by provincial governments and act as bankers to their governments. BPDs' key objective is to support provincial governments in development and bear the responsibility of supervising certain small formal FIs that operate under provincial regulations.

**Domestic Private Banks** – These include foreign exchange commercial banks (36) and non-foreign exchange commercial banks (30), owned by private domestic investors of the country.

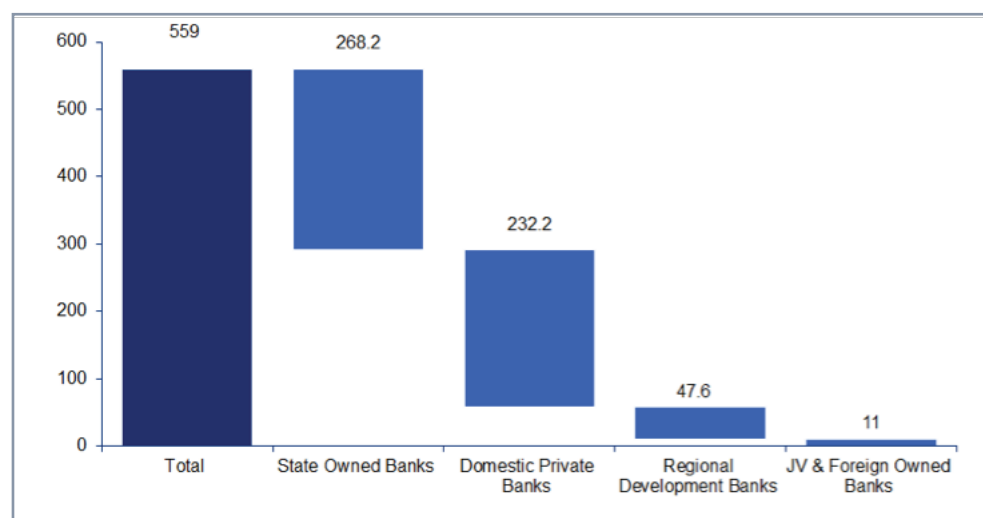
**Joint Venture Banks/Foreign-Owned Banks** –The GoI invited foreign investors to enter the Indonesian banking market during the restructuring period 1998–1999, as part of the privatization program. New foreign banks were allowed to enter the market with low reserve requirements and through joint ventures. As of December 2013, there are 14 joint venture banks and 10 foreign-owned banks operating in Indonesia.

Commercial banks are regulated by BI and under the new architecture would be regulated by OJK with effect from 31 December 2013.

#### 4.2.1.1. Distribution of Supply across Various Bank Categories

The 30 government controlled banks (including SOBs and BPDs) account for almost 56 percent of commercial bank lending to MSMEs. Domestic private banks contribute 42 percent market share and the balance of 2 percent is covered by joint venture banks and foreign banks (Figure 20).

**FIGURE 20: COMMERCIAL BANK LENDING TO MSME SECTOR (IDR TRILLION)<sup>39</sup>**



<sup>39</sup> Indonesian Banking Statistics, May 2013, Bank Indonesia.

#### 4.2.1.1. Sharia-Based Commercial Banks

Commercial banks can also be segregated into conventional banks and Sharia-based commercial banks. Conventional commercial banks also operate Sharia compliant business units, to provide Sharia compliant loans.

**TABLE 5 : SHARIA-BASED COMMERCIAL BANKS AND BUSINESS UNITS<sup>40</sup>**

Sharia Bank/Sharia Units Within Commercial Banks	As of May 2013
State Islamic Bank Unit	2
Regional Development Bank (BPD) Islamic Unit	14
Private Sharia Commercial Banks	11
Private Banks Sharia Unit	8
Total	35

Sharia-based lending constitutes 21 percent (IDR 103.5 trillion) of the overall commercial bank lending to MSMEs. Sharia-based banks focus more on smaller scale financing, given their limited capital base when compared to conventional banks. Thus they lend more to the MSME sector, to address their short-term financing needs with smaller loan sizes.

**TABLE 6 : SHARIA-BASED COMMERCIAL BANKS AND BUSINESS UNITS, OUTSTANDING LOANS TO MSMEs, MAY 2013 (IDR TRILLION)<sup>41</sup>**

Islamic Banks and Business Units	Total Lending Outstanding	MSME Lending	% MSME Lending to Total Lending
	167.3	103.5	62

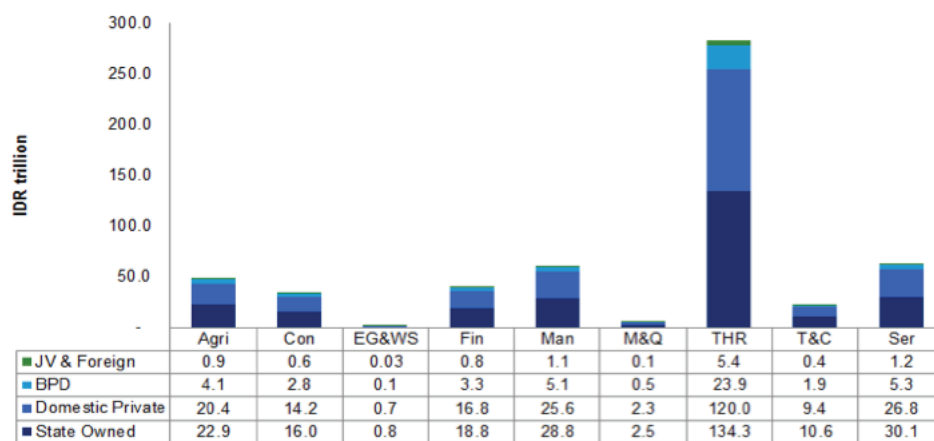
#### 4.2.1.2. Commercial Bank Lending Sectoral Overview

The MSME supply of financing has been mapped on nine sectors described in Section 3.2.2. Further distribution of sectoral supply by bank category shows that all categories of banks follow a similar lending pattern, with THR (trade, hotels, restaurants), manufacturing and agriculture receiving the maximum amount of lending.

<sup>40</sup> Indonesian Banking Statistics, May 2013, Bank Indonesia.

<sup>41</sup> Islamic Banking Statistics, Bank Indonesia, July 2013.

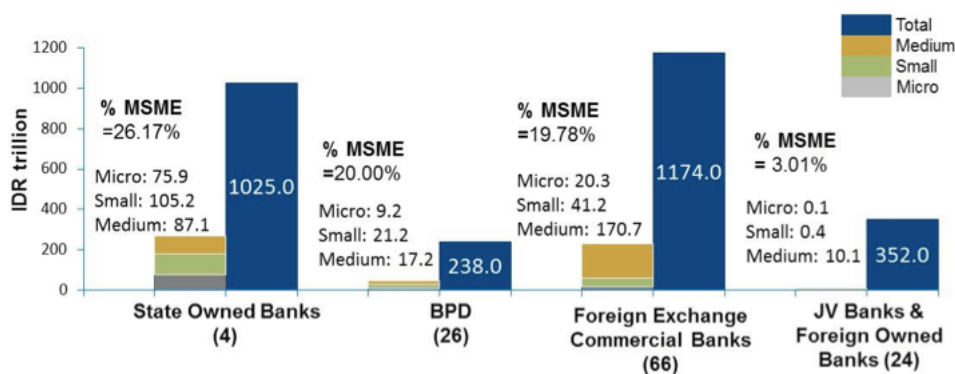
**FIGURE 21: COMMERCIAL BANKS SECTORAL LENDING BREAKDOWN, BANK TYPE (IDR TRILLION)<sup>42</sup>**



The THR sector (trade, hotels, restaurants) dominate the MSME financing space with 51 percent of bank lending to MSMEs in 2013. Commercial banks prefer lending to THR over other sectors, since this has visible cash flows and business cycles are small, ensuring early recovery of loans.

#### 4.2.1.3. Distribution of Loan by Segment

**FIGURE 22: DISTRIBUTION OF LOAN BY SEGMENT**



Currently MSMEs constitute 20 percent of total outstanding loans. This number is skewed by a few banks with substantial lending towards MSMEs. Banks such as Bank Pundi Indonesia and PT Prima Master Bank report the lending contribution to MSMEs constitutes more than 90 percent of their total portfolio, whereas others such as<sup>43</sup> Bank Central Asia, SBI Indonesia, Bank Sinarmas, Bank DKI, etc. lend less than 10 percent to MSMEs. Even for JV and foreign-owned banks, most of the MSME lending is institutional in nature as these banks have limited local reach and are primarily involved in supply chain financing.

<sup>42</sup> Indonesian Banking Statistics, May 2013, Bank Indonesia; IFC analysis of sectoral breakdown, on banking supply side figures for MSME, May 2013.

<sup>43</sup> Condensed Financial Statements of Banks, Bank Indonesia, May 2013.

**TABLE 7: COMMERCIAL BANK LENDING TO MSMEs, PERCENTAGE OF INDIVIDUAL BANK PORTFOLIO, MAY 2013<sup>44</sup>**

Banks	Total Lending Portfolio (IDR Trillion)	MSME Lending (IDR trillion)	MSME Lending (%)
Bank BRI	380.0	163.0	43.0
Bank Mandiri	357.0	58.0	16.3
PT Bank Sumitomo Mitsui Indonesia	26.1	26.1	100.0
BPD Jawa Tengah	19.7	2.1	11.9
BPD Jatim	19.6	4.8	28.4
PT Bank Artha Graha	15.6	1.1	7.3
Bank Andara	1.1	0.2	20.1

Supply of financing by commercial banks is skewed towards medium enterprises (51 percent of overall MSME lending) followed by small enterprises (30 percent) and microenterprises (20 percent).

#### **4.2.1.4. Government Regulation for Commercial Bank Lending to MSME**

In 2012, BI issued a regulation directing all banks to channel a minimum of 20 percent of their total loans to the MSME sector by 2018 through a phased approach, as discussed in Section 2.2.2.1. BI also encourages banks to grow their branch offices in areas with lower population density so that the banking sector can be accessed by customers in remote areas.

Currently, around 55 percent<sup>45</sup> of the current 120 banks in Indonesia do not meet the criteria of lending 20 percent to MSME. If the lending norms are met by banks, in 2018 the overall MSMEs lending would result in an additional supply of credit by around IDR 200 trillion.<sup>46</sup> The net increase of MSME supply of financing is still marginal when compared to the addressable demand.

<sup>44</sup> Condensed Financial Statements of Banks, Bank Indonesia, May 2013.

<sup>45</sup> Condensed Financial Statements of Banks, Bank Indonesia, May 2013.

<sup>46</sup> Condensed Financial Statements of Banks, Bank Indonesia, May 2013.

Assuming a bank loan portfolio's growth rate of 6 percent y-o-y until 2018.



#### 4.2.1.5. Commercial Bank Lending Geographic Overview

**TABLE 8: COMMERCIAL BANK OUTSTANDING LOANS, TOP FIVE REGIONS, MAY 2013 (IDR TRILLION)<sup>47</sup>**

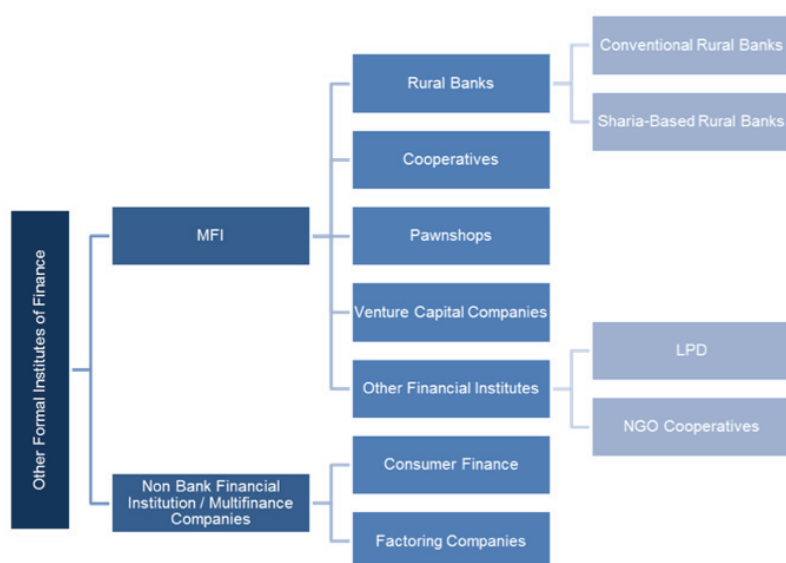
Regions	MSME Lending (IDR Trillion)	% of Total
DKI Jakarta	95.3	17
West Java	71.5	13
East Java	71.2	13
Central Java	56.5	10
North Sumatera	32.6	6
Others	231.4	41
<b>Total</b>	<b>558.5</b>	<b>100</b>

It can be observed that 59 percent of total commercial bank outstanding loans to MSMEs are concentrated around five regions, with other regions individually contributing to 1–2 percent of total MSMEs outstanding loans. Since many enterprises are concentrated around these five regions, bank lending is high for them (Section 3.8.).

#### 4.2.2. Other Formal Sources of Financing

Other formal sources of financing in Indonesia can be broadly classified as MFI and multifinance companies. The total estimated supply of finance to MSMEs from this segment is IDR 298 trillion, with MFI providing IDR 233 trillion and multifinance companies providing IDR 65 trillion.<sup>48</sup>

**FIGURE 23: STRUCTURE OF OTHER FORMAL SOURCES OF FINANCING IN INDONESIA**



<sup>47</sup> Indonesian Banking Statistics, May 2013, Bank Indonesia.

<sup>48</sup> Based on the estimated supply of finance by individual sources such as Rural Banks, Cooperatives, Pawnshops, Venture Capital Firms, Consumer Finance Companies, Factoring Companies and Other Financial Institutes as mentioned in the respective sections below.

#### 4.2.2.1. Rural Banks

Rural banks (BPR) are one of the key constituents of MFIs in Indonesia and are currently (as of 31 December 2013) regulated by BI (and by OJK from 1 January 2014 onwards). These banks differ from commercial banks in their scope of services. For instance, rural banks cannot accept deposits in the form of demand deposit and participate in the payment traffic or conduct foreign exchange business operations other than as foreign exchange traders. Rural bank outstanding loans to the MSME segment amounted to IDR 26.2 trillion as of May 2013.

BPRs lend around 47.6 percent of their total lending portfolio to the MSME sector, key reasons being large network, localized products and ease of accessibility for MSMEs. Unlike commercial banks, rural banks lend more to microenterprises (64 percent of MSME lending) than they do to small enterprises (21 percent), with the balance of 15 percent to medium enterprises.

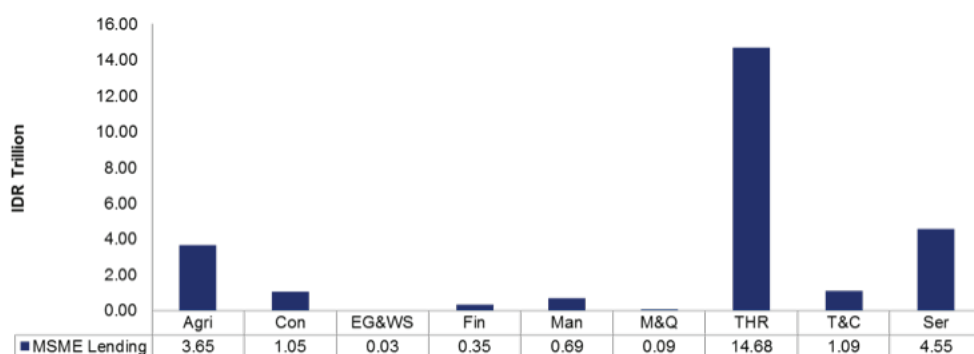
##### 4.2.2.1.1. Sharia-Based Rural Banks

Rural banks can be segregated into conventional rural banks and Sharia-based rural banks. There are 159 Sharia-based rural banks operating under 399 branches across Indonesia. The outstanding loans to MSMEs constitute 60 percent<sup>49</sup> of their portfolio, and as of May 2013 they contribute 9 percent of the total rural bank lending to MSMEs (average lending per Sharia rural bank is IDR 15 billion).

Sharia-based rural banks have increased their lending portfolios towards MSMEs when compared to conventional rural banks. Portfolios of Sharia based BPRs increased at 32 percent compound annual growth rate (CAGR) against 13 percent for conventional rural banks. Rural Sharia banks have similar lending contracts as commercial banks and most lend under a profit sharing agreement with the borrower. This is further discussed in Section 4.3.2.1.

##### 4.2.2.1.2. Rural Bank Lending Sectoral Overview<sup>50</sup>

**FIGURE 24: RURAL BANK BREAKDOWN FOR MSME, BY SECTOR, MAY 2013 (IDR TRILLION)<sup>51</sup>**



It can be observed from the above figure that, from a sector-based lending perspective, rural banks' lending structure is no different from commercial bank lending, with the THR sector (trade, hotels, restaurants) again featuring as the leading sector for receiving finance.

<sup>49</sup> Islamic Banking Statistics, Bank Indonesia, July 2013.

<sup>50</sup> Since the MSME lending constitutes 92.4 percent of the total industrial lending, the sectoral split for the industrial lending and the MSME lending is assumed to be the same. It has been assumed that services include other and unidentified sectors.

<sup>51</sup> Indonesian Banking Statistics, May 2013, Bank Indonesia.

#### 4.2.2.1.3. Rural Bank Lending Geographic Overview

**TABLE 9 : RURAL BANK MSME OUTSTANDING LOANS, TOP FIVE REGIONS, MAY 2013 (IDR TRILLION)<sup>52</sup>**

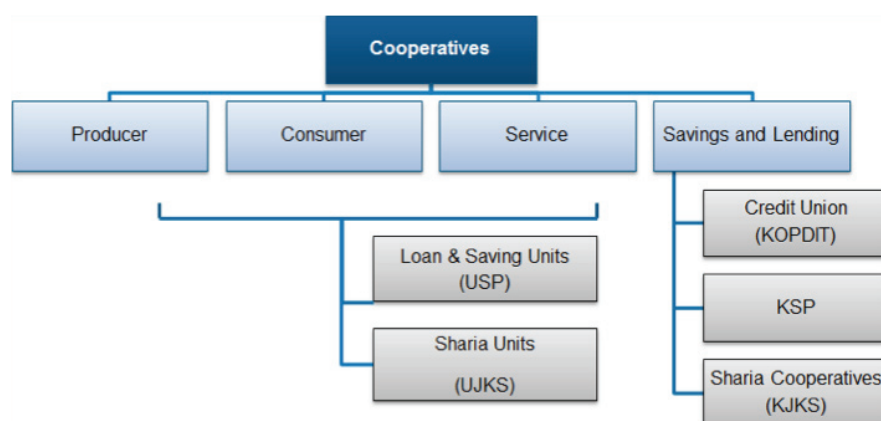
Regions	Micro	Small	Medium	Total	% of Total
Central Java	4.9	1.1	0.7	6.7	25.7
West Java	2.9	1.1	0.5	4.5	17.1
East Java	3.3	0.8	0.1	4.3	16.4
Bali	1.3	0.3	1.2	2.8	10.8
Yogyakarta	0.6	0.4	0.1	1.1	4.0
Others	3.8	1.6	1.2	12.9	26.0
Total	16.8	5.4	4.0	26.2	100.0

It can be observed that around 74 percent of total outstanding loans are from five locations, with all the provinces in Java (including DKI Jakarta) accounting for 61 percent of total outstanding loans. The remaining 26 percent are spread across Indonesia. Geographically, the distribution of MSME lending is in line with the distribution of enterprises in Indonesia (Section 3.8.).

#### 4.2.2.2. Cooperatives

Cooperatives providing savings and loans facilities in Indonesia are structured to provide both conventional lending as well as Sharia-based lending. Cooperatives lend more than 90 percent<sup>53</sup> (IDR 110 trillion) of their portfolio to MSMEs. Cooperatives primarily lend to microenterprises since their loan sizes are small (average IDR 10 million).

**FIGURE 25 : STRUCTURE OF FINANCIAL COOPERATIVES<sup>54</sup>**



Cooperatives that are not registered to provide savings and lending services can lend or provide savings facilities to their members by forming savings and loans units (USP). Some cooperatives also lend to non-members depending on their type of registration.

<sup>52</sup> Indonesian Banking Statistics, May 2013, Bank Indonesia.

<sup>53</sup> Provided by Ministry of Cooperatives and SME during primary interaction. Cooperatives do not distinguish between consumptive and productive loans, but majority of their lending is for business purposes.

<sup>54</sup> Provided by Ministry of Cooperatives and SME during primary interaction.

**TABLE 10: LOAN DISBURSEMENT OF COOPERATIVES AS OF JUNE 2013<sup>55</sup>**

Types of Cooperative	Number of Branches	Number of Members (million)	Assets	Total
(IDR trillion)	Loan Disbursed (IDR trillion)	1.1	0.7	6.7
KSP/KOPDIT	10,464	294.95	14.08	10.05
USP Koperasi	95,066	1,474.33	61.74	41.46
KJKS (Sharia Cooperatives)	1,032	11.99	4.01	3.08
UJKS (Sharia Units)	2,104	27.22	0.68	0.61
<b>Total</b>	108,666	1,808.50	80.51	55.20

*Since the loans disbursed metrics is for half a year as of June 2013, the total lending of cooperatives in Indonesia can be estimated at IDR 110 trillion.*

**Koperasi Simpan Pinjam (KSP)** – KSPs, also known as savings and loans cooperatives, provide lending services to MSMEs, which are their members. Some KSPs are registered to provide lending services to non-members as well. The KSPs are in principle registered with the MCSME and are subject to a regulatory framework which includes minimum capital requirements, a sound rating system, and a loan classification system. The regulations however do not define legal lending limits and requirements for loan-loss provisioning. Also, these cooperatives are inadequately supervised and regulated post registration.

Some KSPs are structured as credit unions (CU)/KOPDIT, enabling them to be a part of the world CU movement under the World Council of Credit Unions (WOCCU). There are more than 1,000 CUs in Indonesia, of which 937 are part of INKOPDIT, a private national apex body, overlooking the functioning of their members. CUs under INKOPDIT had outstanding loans of IDR 13.6 trillion as of September 2013, of which 80–90% is for MSME lending. The loans outstanding for these CUs have been growing at more than 20 percent annually.

**Islamic Cooperatives (KJKS)** – Islamic cooperatives/Koperasi Jasa Keuangan Syariah (KJKS) are registered to provide savings and lending services under Sharia principles. Officially, Sharia cooperatives are referred to as KJKS, but the term BMT (Baitul Mal Wal-Tamwil) is also popularly used. The majority of the BMTs are registered and supported by Pusat Inkubasi Bisnis Usaha Kecil (PINBUK) established in 1995. PINBUK has no formal supervisory power over Islamic cooperatives, but helps them to scale and manage their lending services.

**Unit Simpan Pinjam (USP)** – Producers and consumer cooperatives open USP to provide lending services to their members. USPs operate as separate business units under the existing cooperatives and provide consumptive and productive loans to their members.

<sup>55</sup> Provided by Ministry of Cooperatives and SME during primary interaction.

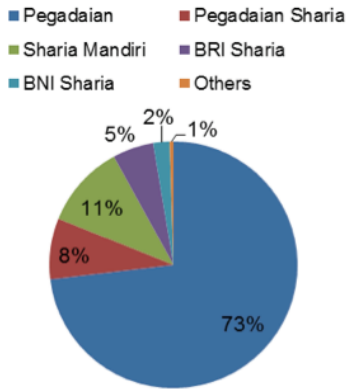
**Sharia Units (UJKS)** – Usaha Jasa Keuangan Syariah (UJKS) are similar to USP, the only difference being that UJKS provides lending and saving services as per Sharia principles.

### 4.2.2.3. Pawnshops

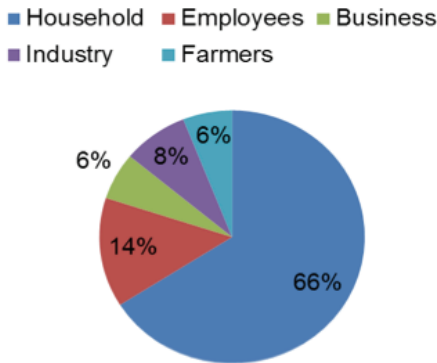
Pawnshops provide secured loans to the borrowers, with items of personal property used as collateral. Pawnshops essentially work on the lending structure based on retaining the physical possession of asset collateralized. In Indonesia, pawnshops provide both conventional lending services as well as Sharia-based lending services. They provide movable finance based on collateral ranging from gold jewelry/precious stones, vehicles (cars/ motorcycles), electronics, fabric and other home appliances (Figure 26).

**PT Pegadaian**, a state-owned pawnshop, is the largest pawning institution in Indonesia, covering more than 80 percent<sup>56</sup> (including Sharia-based lending) of total market of IDR 6 trillion. The company provides pawning and fiduciary services, both conventionally or under Sharia principles, mostly dedicated to middle – low income members of society, and MSMEs. PT Pegadaian has a total portfolio of IDR 446 billion under its fiduciary lending services. Interest charged ranges from 1.5–2.4 percent flat per month for a four-month loan, whereas for a fiduciary loan the interest rate charged is 1 percent flat per month for a one year tenor loan. This business model seems to be finding significant favor amongst the female section of the society and approximately 80 percent of its customers are women. The portfolio distribution for PT Pegadaian is highlighted in Figure 27.

**FIGURE 26: PLAYERS IN PAWNING INDUSTRY**



**FIGURE 27: SECTOR DISTRIBUTION - PEGADAIAN**



<sup>56</sup> An interview with PT Pegadaian during the study.

Pawnshops buy insurance cover from PT Asuransi Jasa Indonesia and PT Askrindo at 2 percent annual premium. This insurance covers up to 80 percent of the net loss in case of default i.e. after collateral execution. Pawnshops have a non-performing loan (NPL) limit of 2 percent of their portfolio. As pawnshops have physical possession of collateral, the enforcement process is problem free. In case of default, the collateral is sold through public auctions.

#### 4.2.2.4. Venture Capital Firms

In 1995 the Ministry of Finance issued a regulation<sup>57</sup> recognizing venture capital as a special field of activity in the financial sector. The estimated financing to MSMEs is IDR 2 trillion<sup>58</sup>. Venture capital firms provide collateral-free lending to MSMEs based on a profit sharing model. In the profit sharing model they provide capital to micro and small business through a pre-agreed profit sharing agreement. There were a total of 86 venture capital companies in Indonesia as of 2011.

#### 4.2.2.5. Other Financial Institutions

Other FIs supplying loans to MSMEs include rural credit association (LDKPs, LPDs in Bali), and non-government organization (NGO) cooperatives financing MSMEs.

- **Rural Credit Associations** – Rural credit associations/Lembaga Dana Kredit Pedesaan (LDKPs) provide savings and lending services to MSMEs (like BPRs, but they are supervised by local government). LDKPs are spread across Central Java, Yogyakarta and Bali. LDKPs in Bali are known as LPDs (Lembaga Perkreditan Desa).
- Despite competition from local formal and informal lending institutes, LPDs are successful under the LDKP system in Indonesia. LPDs receive much technical assistance from the US Agency for International Development (USAID) and Deutsche Gesellschaft fur Internationale Zusammenarbeit (GIZ). Unlike LDKPs, LPDs are not regulated by the Government but owned by local community organizations.

**TABLE 11: LPD MARKET DATA, BALI** <sup>59</sup>

LPD Data (as of August 2013)	Data
Total Number of LPDs	1,421
Outstanding Portfolio (IDR trillion)	7.2
Number of Borrowers	424,203
Number of Active Savers	1,505,574
Micro Loans	90% of outstanding portfolio

<sup>57</sup> Establishment and Development of Venture Capital. Decree of Ministry of Finance of the Republic of Indonesia, Number 469/KMK.017/1995

<sup>58</sup> Based on primary interaction with Bina Artha Ventura; and Figures (2009) provided in "The Capital Market and Non Bank Financial Industry Master Plan 2010-2014", Ministry of Finance, Indonesia which was extrapolated to estimate the number.

<sup>59</sup> Based on estimates provided by LPD Bali, and since most of the LPDs are based out of Bali this has been assumed as industry figures

- **NGO Cooperatives** – Many NGOs in Indonesia, in order to extend microcredit to MSMEs, have taken the form of cooperatives. NGOs conducting microfinance require no permission to extend credit, and there are no reporting requirements or supervisory arrangements for such activities. However, NGOs are forbidden to mobilize the savings of members unless these are deposited directly with a regulated FI.

One such NGO involved in microfinance activities is Yayasan Bina Swadaya. Bina Swadaya helps in the formation and training of self help groups (SHGs) for official and donor-supported microfinance programs. Bina Swadaya has also purchased a number of BPRs to which it links SHGs. It has formed a cooperative which attracts deposits from a middle-class population and lends to the poor.

#### 4.2.2.6. Multifinance Companies

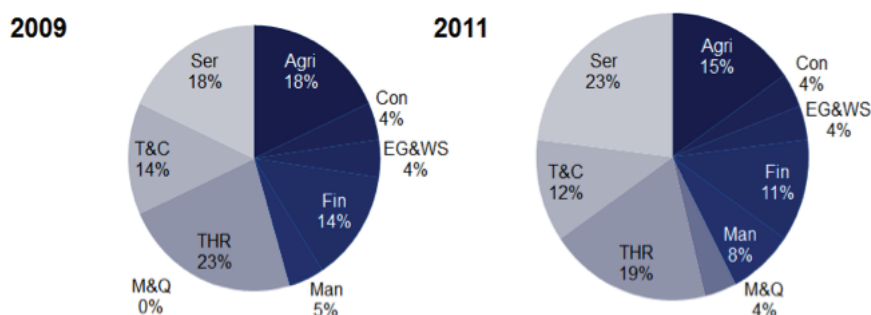
In Indonesia “multifinance” companies engage in a range of “near banking activities”, such as credit card financing, leasing, consumer finance and factoring. There are about 195 multifinance companies, regulated by OJK.

Originally multifinance companies were engaged in leasing but in 2005 nearly 70 percent<sup>60</sup> of their activity was in consumer finance, with leasing accounting for most of the remainder. Leasing activity mainly pertains to large corporations while MSMEs get credit through consumer finance and factoring. With respect to consumer financing, multifinance companies generally provide automobile and motorcycle financing to low-income segments of the population.<sup>61</sup> For the purpose of the study, consumer financing and factoring business have been studied.

##### 4.2.2.6.1. Consumer Financing

Total consumer financing in Indonesia is IDR 205<sup>62</sup> trillion as of May 2013, of which 30 percent<sup>63</sup> (IDR 60 trillion) is estimated to be used by MSMEs and the remaining for consumptive purposes.

**FIGURE 28: SHARE OF CONSUMER FINANCING PER BUSINESS SECTOR (2009–2011)<sup>64</sup>**



60 Non-Bank Finance, Indonesia, USAID, April 2011.

61 Non-Bank Finance, Indonesia, USAID, April 2011.

62 Business Sector of Consumer Finance's Customer, Annual Report Finance Companies, 2011, Bapepam - LK.

63 30% has been assumed considering past break-up of individual and business sector, related client base of consumer finance companies. Business Sector of Consumer Finance's Customer, Annual Report Finance Companies, 2011, Bapepam - LK.

64 Reclassified as per sector mentioned in the report, for the purpose of consistency and analysis. Business Sector of Consumer Finance's Customer, Annual Report Finance Companies, 2011, Bapepam - LK.



Jakarta has the biggest share of consumer goods financing with market share of 23 percent (IDR 13.8 trillion) of total consumer financing, since it is a densely populated region with a high demand for vehicle and car financing. Other areas with significant market share are West Java (16 percent), East Java (9 percent) and Central Java (8 percent).

#### 4.2.2.6.2. Factoring

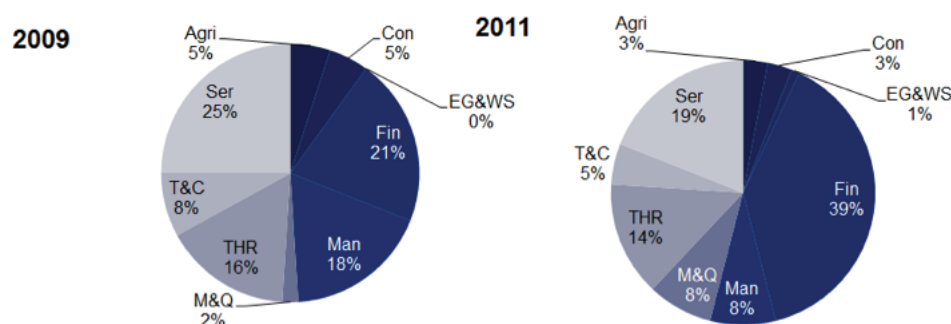
Factoring as part of total lending in Indonesia is at a nascent stage, with only IDR 5.4 trillion (around 0.6 percent of total formal lending) outstanding loans to MSME segment in 2013. Companies/individuals that assign their accounts receivable to financing companies are the clients of the factoring business. The assignment of accounts receivable is conducted to improve their financial liquidity.

Prior to the financial crisis of 1998, around 30 percent<sup>65</sup> of the total receivables were factored. During the crisis a large proportion of the receivable became insolvent and resulted in huge losses for FIs. This resulted in FIs becoming risk averse and reducing their factoring portfolio.

**FIGURE 29: OUTSTANDING LOAN GROWTH OF FACTORING MARKET (IDR TRILLION)** <sup>66</sup>



**FIGURE 30: SHARE OF FACTORING PER BUSINESS SECTOR (2009 – 2011)**<sup>67</sup>



Factoring financing is dominated by non-financial services companies. Finance, rent and services constituted the highest market share sector-wise in 2011 at 39 percent. The factoring market is concentrated in the administrative center, namely DKI Jakarta (76 percent of the market in 2011). This is due to the nature of the factoring financing business in which the decision to assign the client's receivables is still centralized at headquarters/head office. Meanwhile, West Java

<sup>65</sup> During primary interaction with financial institutions in Indonesia.

<sup>66</sup> Indonesian Financial Statistics, Activities of Non-bank Financial Institutions, Bank Indonesia May 2013.

<sup>67</sup> Reclassified as per sector mentioned in the report, for the purpose of consistency and analysis. Business Sector of Factoring's Customer, Annual Report Finance Companies, 2011, Bapepam - LK.

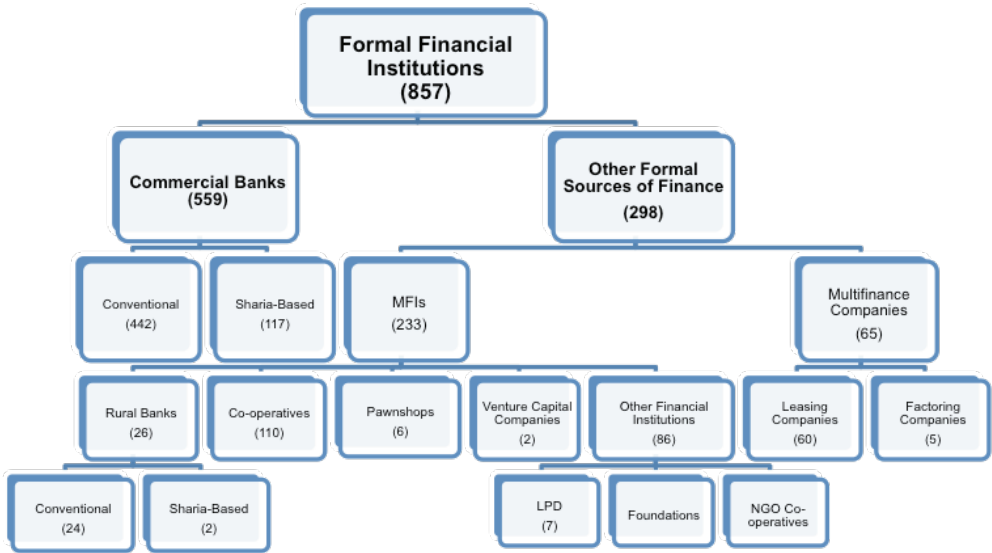


is the only other region that receives a financing share of more than IDR 150 billion; other regions have a factoring business of less than IDR 150 billion.

### 4.2.3. Total Formal Flow of Financing

The estimated formal supply of financing to the MSME sector in Indonesia is IDR 857 trillion, of which commercial banks contribute 65 percent (IDR 559 trillion<sup>68</sup>); the remaining amount is contributed by other formal sources like rural banks, cooperatives, pawnshops, venture capital companies, consumer finance companies, factoring companies and other formal institutions.

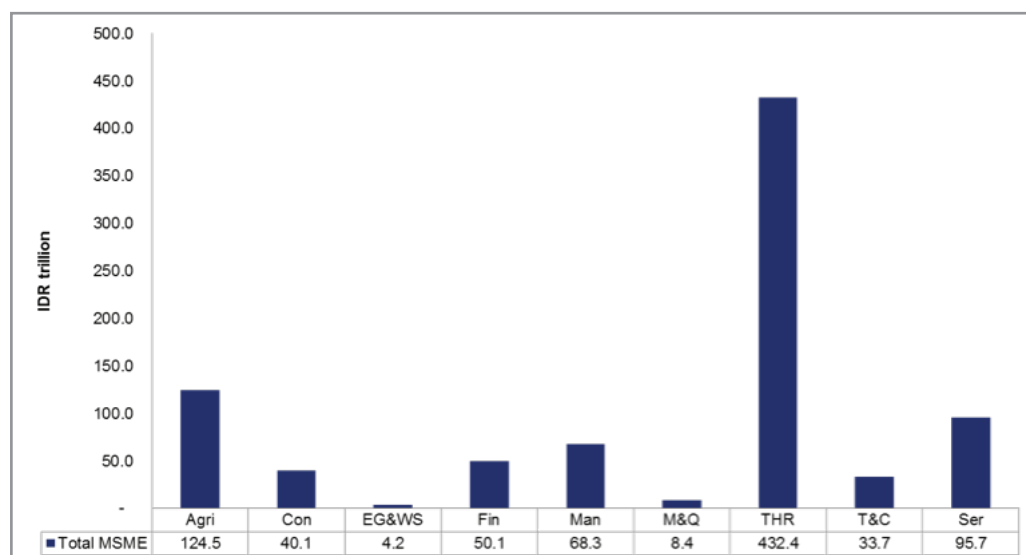
**FIGURE 31: TOTAL FORMAL SUPPLY OF FINANCING TO MSMEs (IDR TRILLION)**



68 As mentioned in Indonesian’s Experiences on Micro Finance Institution and Small Scale Cross Border Transaction, ADBI-AFDC-ABAC “Asia-Pacific Forum on Financial Inclusion, June 2012, banking channel of financing contributes to 65% of total formal sources, hence 35% is assumed to be contributed by other formal sources such as rural banks, cooperatives, pawnshops, venture capital companies, consumer finance companies, factoring companies and other formal institutions.

#### 4.2.3.1. Sectoral Overview of Total Formal Supply

**FIGURE 32: TOTAL FORMAL SUPPLY OF FINANCING SECTORAL OVERVIEW (IDR TRILLION)<sup>69</sup>**



As we have seen in the above sections, FIs prefer lending to the trade, hotels and restaurants sector than to agriculture, due to visible cash flows and faster recovery of loans.

More than 90 percent of respondents are reluctant to lend to the fisheries sector, followed by livestock. To address risks of those businesses, BI has recently started developing a cattle insurance product and guidelines for lending for small boats (less than 20 cubic meters).

Some banks are also reluctant to extend their lending portfolio to upstream forestry and plantation-related businesses. Key reasons for constraints to sectoral lending are:

- a) **Seasonality of business (fisheries)** – The fisheries business is seasonal in nature and so lenders are wary of the long-term cash flow of the business and uncertain business cycles. Furthermore, since most of the borrowers are often at sea to make their catch, the lenders tend to avoid fishermen and this sector.
- b) **Migrant workers (fisheries)** – In fisheries, the majority of the workers are not local residents, hence it is difficult for FIs to assess the credit worthiness of the borrower.
- c) **Higher gestation cycle (upstream plantation and forestry)** – Upstream businesses like forestry have a higher gestation period, adding to the risks and making business cash flows uncertain.

<sup>69</sup> Commercial bank's and rural bank's sectoral break-down was available at, Indonesian Banking Statistics, May 2013, Bank Indonesia. Other formal financial institutions' sectoral break-down has been calculated based on primary survey results and extrapolations.

#### 4.2.3.2. Bank/Non-Bank Non-Performing Loans Analysis for MSME Lending

**TABLE 12: HISTORY OF NON-PERFORMING LOANS** <sup>70</sup>

Source	2008	2009	2010	2011	2012	May 2013
Commercial Banks+	NA	NA	NA	5.0%	3.0%	4.0%
Sharia-Based Commercial Banks	4.0%	5.0%	3.0%	3.0%	2.3%	3.1%
NPL of KUR Scheme of Commercial Banks	NA	NA	NA	NA	NA	4.5%
Rural Banks++	9.9%	6.9%	6.1%	5.2%	4.8%	5.1%
Sharia-Based Rural Banks	10.6%	8.4%	7.9%	7.2%	7.1%	9.5%
Lease Financing*	3.8%	1.5%	0.6%	0.3%	NA	NA
Factoring Financing*	11.5%	5.9%	3.1%	2.8%	NA	NA

+Data of commercial banks and rural banks for MSME lending not available prior to 2011, since MSME loans prior to 2011 also included retail segment loans.

++Since rural bank NPL data for MSME lending is not available, the overall rural banks NPL is assumed to be the same for MSMEs.

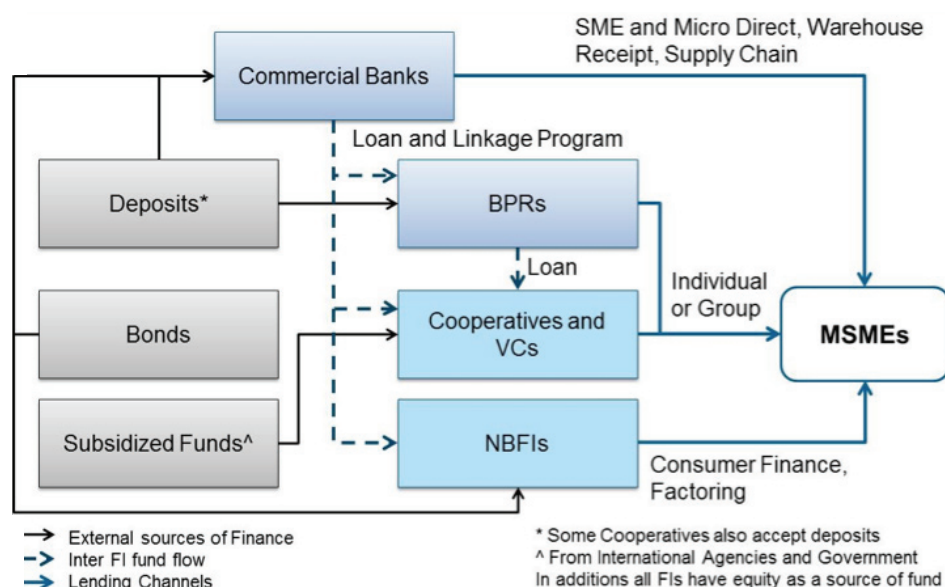
It has been assumed that the total NPL for respective lease financing and factoring financing industry is the same for MSME lending.

It can be observed that the NPL ratios for commercial banks have been relatively constant as compared to those of NBFIs, which show a decreasing trend over the period. Lending by NBFIs is relatively new in the Indonesian context, and NBFIs are still learning to manage their risk effectively.

### 4.3. Lending Models of Supply Stakeholders

MSMEs receive formal financing largely through four key channels - commercial banks, rural banks, cooperatives and venture capital companies (VCs), and NBFIs (consumer financing and factoring).

**FIGURE 33: LENDING MODELS TO MSMEs**

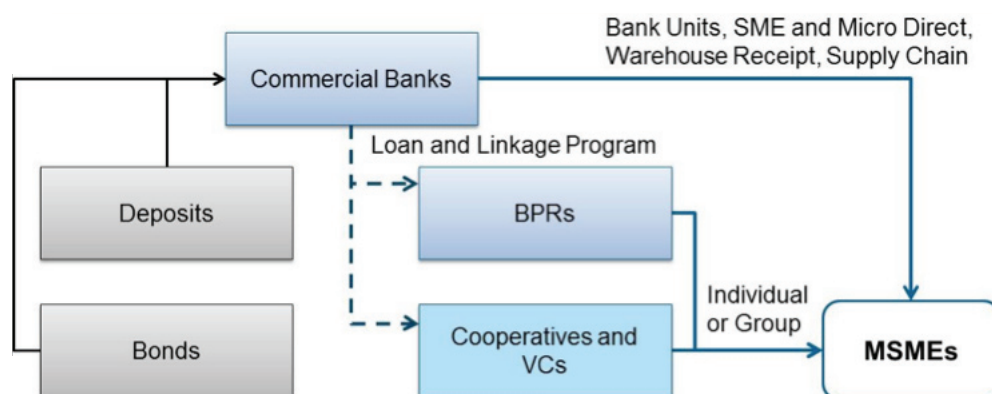


<sup>70</sup> The NPL data for cooperatives, venture capital companies and pawnshops are not available for the period mentioned.

### 4.3.1. Commercial Bank Lending Model

Commercial banks in Indonesia lend to MSMEs either directly or through institutional lending and linkage programs with rural banks, cooperatives and VCs. Direct lending to MSMEs is in the form of MSME and micro direct loans, warehouse receipt financing and supply chain financing.

**FIGURE 34: COMMERCIAL BANK LENDING MODEL**



#### 4.3.1.1. Direct Lending

**Commercial banks lend to MSMEs either through bank branches or through smaller bank units set up in rural areas.**

##### 4.3.1.1.1. MSME Direct Loans

Commercial banks lend to MSMEs through branch banking, by providing working capital and investment capital loans. Various banks have their own internal definitions of loan sizes for MSME loans. The range of lending for micro enterprises is less than IDR 100 million, small enterprises is IDR 100 million–5 billion, and for medium enterprises IDR 5– 50 billion.

Commercial banks provide both conventional loans and Sharia-based loans to MSMEs. According to the conventional lending model, the loans are provided based on interest rates, whereas under Sharia-banking the borrower enters into a contract with the lender either to share profits or for lease purchase.

**TABLE 13: SHARIA/ISLAMIC BANKING CONTRACTS<sup>71</sup>**

Contracts Based on Sharia Principle	Definition/Purpose
<b>Mudharabah Contract (Profit-Sharing Model)</b>	A contract between a capital provider and an entrepreneur or a fund manager, whereby the entrepreneur or the fund manager can mobilize the funds of the former for its business activity within the sharia guidelines. Profits made are shared between the parties according to a mutually agreed ratio.
<b>Musarakah Contract (Profit-Sharing Model)</b>	A contract between two parties whereby both parties provide capital and both may be active in managing the venture. Losses are shared on the basis of how much capital has been contributed. Profits are shared in any way the partners decide.
<b>Murabahah (Buy-Sell Model)</b>	A financing contract on certain goods by confirming the purchase price to the buyer and the buyer pays a higher price as the agreed profit.
<b>Qardh Contract (Interest- Free Loans)</b>	A loan in which the debtor is only required to repay the amount borrowed.

Approximately 27 percent of MSME lending by Sharia commercial banks is on the profit sharing model (Musarakah financing is 20.2 percent and Mudharabah financing is 7.3 percent) whereas the buy-sell model (Murabahah) accounts for around 60 percent of MSME lending<sup>72</sup>, since negotiations of the profit sharing terms is a time-consuming process and more risky as compared to fix margin based business under the buy-sell model.

#### 4.3.1.1.2. Bank Micro Unit

Bank micro units are small bank offices in rural areas that disburse microloans to MSMEs. They operate under the supervision of sub-branch offices of commercial banks and are equipped with account officers with the regional knowledge. Bank micro units are often used to channel KUR loans to MSMEs, which is discussed in subsequent sections of this report.

Bank Rakyat Indonesia (BRI) through its 5,000 micro units called Unit Desa has been successful in providing microfinance to MSMEs. The number of micro loans outstanding in 2012 reached IDR 115.16 trillion, or 33 percent<sup>73</sup> of BRI's total loans. In order to improve lending, BRI has adopted a policy to increase the number of account officers per Unit Desa (from 2.01 in 2011 to 3.09 in 2012).

#### 4.3.1.1.3. Linkage Programs

In order to meet MSME lending targets, commercial banks have two types of linkage programs, channeling and executing, with rural banks and cooperatives. These programs help commercial banks to increase their reach in rural areas and are more cost efficient since they save on administrative, marketing, and credit

<sup>71</sup> Types of Contract in Sharia Banking Business Operation, Indonesian Banking Booklet, 2013

<sup>72</sup> It has been based on primary interaction with Sharia based rural banks and cooperatives, during the research period.

<sup>73</sup> BRI Annual Report, 2012.

collection personnel costs. Under the channeling program the funds for MSME lending are routed through MFIs, whereas under the executing program the MFIs take the loans on their books and further lend to MSMEs.

**TABLE 14: TYPES OF LINKAGE PROGRAMS**

Linkage Programs	Channeling	Executing
Collateral	Collateral paid by the debtor	Collateral paid by the executing MFI
Risk Incidence	Risk of default shared by the bank and the MFI	Risk of default borne by the rural bank

Commercial banks prefer to lend to those BPRs which actually do not need funds for MSME lending (on an average 50 percent<sup>74</sup> of commercial bank loans to these BPRs are unutilized). Further, commercial banks spend considerable time and cost due to lack of comprehensive information on what BPRs to target for this program.

#### 4.3.1.2. Collateral Preference of Banks

Banks prefer their lending to be collateralized, with more than 90 percent of the commercial bank respondents of this study have been doing collateralized lending only. Banks require the value of collateral to be more than 130 percent of the value of the loan. In the case of preferential clients, however, banks do lend if the collateral value is smaller than the loan value. Banks manage their risks by availing credit insurance (up to 70 percent of the loan value) on the loan. The insurance premium (3–5 percent of the loan coverage value) is borne by the debtor.

Commercial banks prefer fixed collateral such as land and buildings with a loan-to-value (LTV) ratio of 80 percent. For collateralizing these assets banks require the property registration and property tax related documents. But in certain cases, banks use their discretion to relax documentation requirements, as explained below:

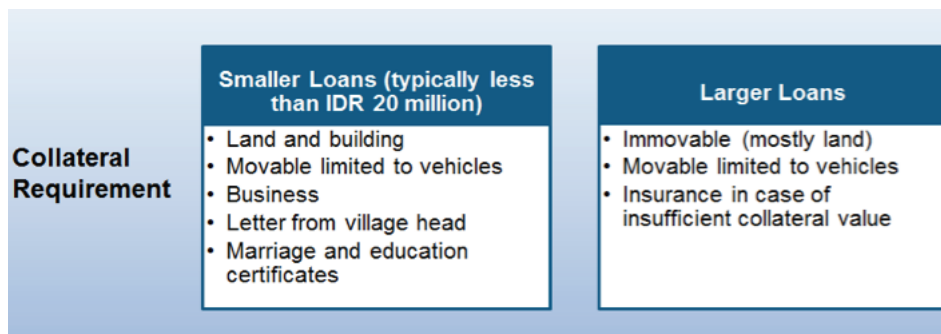
- a) In the case of hereditary land, where the title of the land is still in the name of the family member, a letter from the village head stating the ownership of the land is accepted as collateral by the bank.
- b) If the asset is owned by the spouse, the marriage certificate is also accepted by the bank as collateral.

Though acceptance of a letter from the village head, marriage certificates and education certificates does not attribute to the capacity to pay, it does however have psychological impact on willingness to pay.

Banks also accept movable collateral like motor vehicles, cash, gold and inventory. Movable assets such as motor vehicles are the most preferred collateral with LTV of around 30–80 percent depending on the age of vehicle. Inventory is generally not preferred due to complexities in valuation and management of the collateral.

<sup>74</sup> Mobile Banking in Indonesia, IFC, 2010.

**FIGURE 35: COMMERCIAL BANK COLLATERAL REQUIREMENT**



Banks such as BTPN have identified the unavailability of collateral documents or the collateral itself to be a significant challenge, especially for microenterprises. In such cases, uncollateralized lending is provided for a loan of between IDR 5 and 50 million, but at a higher interest rate of 35–45 percent (effective rate). While the business risks are higher, the perception is that these unsecured lending programs will help develop relationships with microenterprises before they graduate to small or medium enterprises.

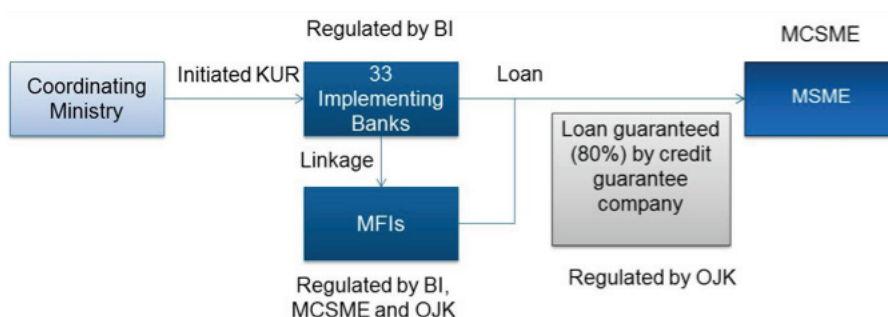
Accounts receivable as collateral is only accepted for institutional lending and linkage programs from banks to MFIs, since this can be conveniently managed by banks. Bank Andara has developed a large part of their business model around lending to MFIs with more than 85 percent of loan secured through accounts receivable.

#### 4.3.1.3. KUR

As a part of the GoI's objectives to promote bank lending to MSMEs, credit guarantee has been provided by the GoI since 2007 for MSME loans under the Kredit Usaha Rakyat (KUR) scheme. Central guarantee companies like Askrindo and Perum Jamkrindo (formerly Perum SPU) and regional guarantee companies in Bali and East Java have been assigned by the GoI to provide the credit guarantee for the scheme.

This scheme is currently managed by 33 commercial banks including 26 BPDs. It is implemented by commercial banks through either lending directly to the MSME or through linkage programs.

**FIGURE 36: KUR LENDING MODEL**



\*Note: Under the new structure with effect from 31st December 2013, commercial banks are no longer regulated by BI. Such institutions are under the direct purview of OJK

The objectives of the KUR program are to accelerate the development of primary sectors and empower small-scale businesses; to improve accessibility to credit and FIs; to reduce poverty levels; and to expand job opportunities. With the GoI providing a guarantee for the loans, the risk to of repayment on such loans is reduced.

KUR is a financing facility that can be accessed by MSMEs, especially those that have good prospects and the ability to repay but are not yet bankable. Currently, there are two schemes which are a part of the KUR program:

- a) **KUR Micro** - Working capital or investment capital loan (productive use) with loan size up to IDR 20 million. An interest rate of maximum 22 percent effective is charged under the scheme by the banks with no collateral requirement.
- b) **KUR Retail** - Working capital or investment capital loan (productive use) with the loan size between IDR 20 million and IDR 500 million. An interest rate of maximum 13 percent effective is charged under the scheme by the banks with a collateral requirement of 30 percent.

As of May 2013, total credit outstanding under KUR from commercial banks was IDR 43.8 trillion. It is important to note that outstanding loan in KUR schemes has been already included as a part of the total commercial bank outstanding.

#### 4.3.1.3.1. KUR Lending by Banks

**TABLE 15: EXECUTING BANKS' KUR PORTFOLIO, MAY 2013<sup>75</sup>**

Banks	Credit Disbursement		NPL
	Disbursed from 2008 to May 2013 (IDR trillion)	Loan Outstanding for 2013 (IDR trillion)	%
BNI	14.1	4.7	4.9
BRI (KUR Retail)	15.4	6.4	3.4
BRI (KUR Micro)	60.6	18.5	1.8
Bank Mandiri	12.3	6.2	3.7
BTN	3.9	2.1	7.9
Bukopin	1.7	0.7	4.2
Bank Syariah Mandiri	3.3	1.6	7.2
BNI Syariah	0.1	0.1	3.5
BPDs	11.8	5.7	7.4
Total	123.3	46.1	3.8

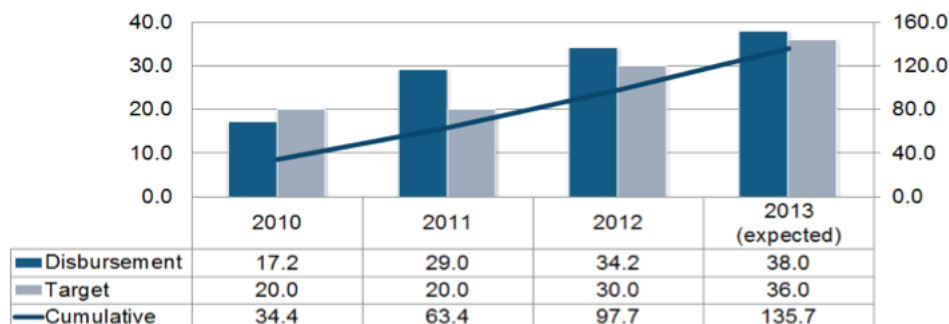
As can be observed in Table 15 above, though the overall NPL under the KUR scheme is 3.8 percent, there is a huge variance of the NPL rate individually amongst banks. The GoI has recently set a NPL target for banks at 5 percent.

<sup>75</sup> Komite-KUR, a policy committee established by Government of Indonesia to coordinate the KUR program.



#### 4.3.1.3.2. KUR Targets

**FIGURE 37: KUR DISBURSEMENT VERSUS TARGET (IDR TRILLION)**



It is important to understand that at current levels KUR-based lending forms only 7.8 percent of total MSME lending by commercial banks. Also, banks have been exceeding the KUR targets set by the GoI consistently for the last three years. Commercial banks have also shown willingness to lend more under the KUR scheme if permitted by the GoI. Government is currently constrained by the financial capacities of participating guarantee companies and is taking steps to improve its KUR targets. The key initiatives taken are:

- a) **Infusion of equity in central guarantee companies** – Government has set aside IDR 2 trillion to infuse as equity in national credit guarantee companies, Jamkrida and Askrindo, depending on their performance. Infusion of equity will help the guarantee companies to increase their total portfolio and to take on additional risks.
- b) **New credit guarantee companies at regional level** – Government has planned to set up regional guarantee companies (PT Jamkrida Riau, PT Jamkrida NTB Bersaing, PT Jamkrida West Java, and PT Jamkrida West Sumatera) to increase MSME financing.

#### 4.3.1.3.3. Collateral Requirement in KUR

The KUR scheme was launched with the intention of providing uncollateralized loans to MSMEs, but in practice, the executing banks ask for collateral while lending. KUR microloans of less than IDR 20 million, even though theoretically collateral-free, are subject to collateral of 30–70 percent of the loan value.

The scheme is further secured by credit guarantee companies providing a loan guarantee of 70 percent (for downstream) to 80 percent (for upstream) of the loan value, for which the premium is paid by the GoI. Thus, on an average, KUR loans are secured for 130–150 percent of the loan value, which in principle is contradictory to the program objective of providing uncollateralized lending under KUR. Additionally, in the case of on-lending to rural banks, commercial banks insist on 100 percent collateral requirement under the scheme.

#### 4.3.1.4. Warehouse Receipt Financing

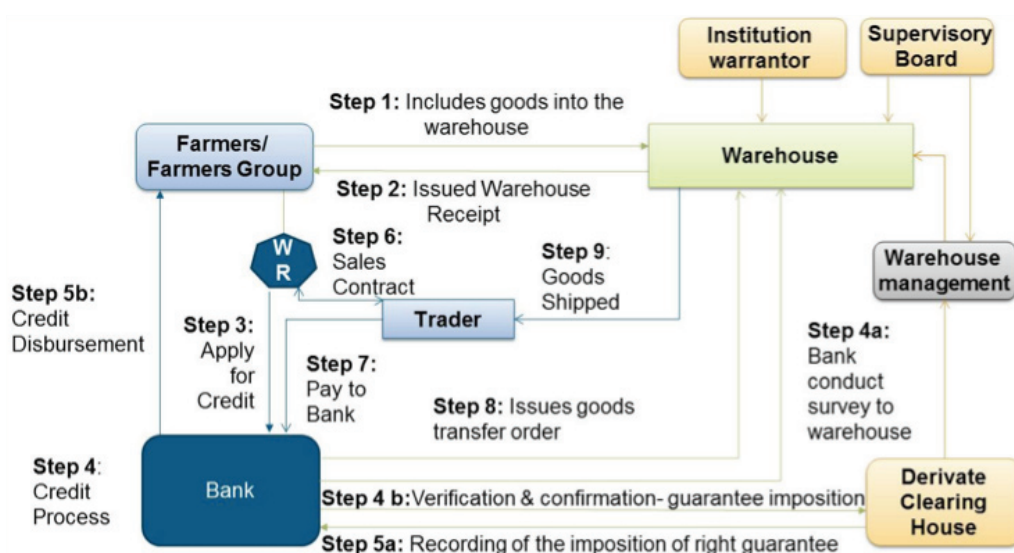
The warehouse receipt is a certificate of title over commodities stored in a warehouse issued by the warehouse manager. Financing is provided against this collateral by commercial banks for a period of 3–6 months.

#### 4.3.1.4.1. The Warehouse Receipt Law

The Warehouse Receipt Law<sup>76</sup> was enacted in 2006 to address demand of warehouse receipt-based financing. This law gave flexibility to producers to sell their goods only when the market prices are right. The law was amended in 2011<sup>77</sup> to bring clarity on the pricing of commodities stored in warehouses and inclusion of new commodities against which warehouse receipts could be issued. The significant amendment in this law included removal of the clause which stated that the value of the goods in the warehouse would be equal to the market price of the goods at the time of storage. This law also calls for formation of a warehouse receipts guarantee institution, which would play a significant role in deciding the damages related to loss or damage of goods during storage. The Warehouse Receipt Law in Indonesia currently allows receipts to be issued against nine crops only, namely rice, paddy, corn, coffee, cocoa, pepper, rubber, seaweed and rattan.

#### 4.3.1.4.2. Process of Warehouse Financing

**FIGURE 38: WAREHOUSE RECEIPTS FINANCING PROCESS**



**Step 1:** The owner of the goods (farmers/farmers' group/farmers group and cooperative) transfers the good to the warehouse. The warehouse manager and/or an external surveyor evaluate(s) the quality of the produce.

**Step 2:** The quality and quantity of the goods define the price of the commodity which is agreed upon by the warehouse manager, the owner and the FI providing financing. The warehouse manager then issues the warehouse receipt after registration in the Indonesian Derivative Clearing House (PT Kliring Berjangka Indonesia)

**Step 3:** Following the issuance of the warehouse receipt, the owner of the goods applies for warehouse receipt credit at the participating FI.

**Step 4:** The FI performs the following credit check operations before approving the loan:

<sup>76</sup> Law no. 9 of 2006

<sup>77</sup> Law no. 9 of 2011

- a) Banks conduct a survey of goods at the warehouse. This operation is either performed independently or with the help of independent surveying agencies such as PT Superintending Company of Indonesia (Persero) (SUCOFINDO).
- b) Post survey, the bank verifies from PT Kliring Berjangka Indonesia if any other FI has imposed a guarantee on the warehouse receipt.

**Step 5:** Credit disbursement procedures are as follows:

- a) The FI proceeds to impose a guarantee (i.e. register) on the warehouse receipt with PT Kliring Berjangka Indonesia.
- b) Post registration, the credit is disbursed to the borrower.

**Step 6:** When commodity prices are favorable, the owner sells the goods by entering into a sale-purchase agreement with the buyer (trader).

**Step 7:** Upon entering into the agreement, the trader pays the FI the value of the goods.

**Step 8:** The bank in turn issues an order to the warehouse manager to release the goods to the trader, following the consent of the owner of the goods.

**Step 9:** The warehouse manager releases the goods to the trader.

#### 4.3.1.4.3. Warehouse Receipt Schemes

In Indonesia, warehouse receipt financing operates under two schemes, subsidized and non-subsidized. The subsidy is provided by the GoI in order to promote credit to farmers.

**TABLE 16: WAREHOUSE RECEIPT PROGRAMS IN INDONESIA**

Parameter	Subsidized	Non-Subsidized
Eligibility	Farmers, farmers' groups, and combined farmers' groups and cooperatives	Individual company, Commanditaire Vennootschap (CV), PT and others
Credit Allowed	Maximum 70% of value of warehouse receipt and maximum IDR 75 million / farmer	Maximum 70% of value of warehouse receipt
Interest Rate	10.50% p.a. (after subsidy of 4.5%, the effective interest rate is 6% p.a.)	12.25% p.a. effective
Time Period	Maximum 6 months of credit, to be paid 1 month before expiry	Expiry time can be extended

#### 4.3.1.4.4. Current Status of Warehouse Receipts

Warehouse receipt financing is less than 1 percent<sup>78</sup> of a commercial bank's portfolio, with only some banks (Bank Jatim and Bank BRI) involved in lending against warehouse receipts. While currently only nine commodities are allowed by GoI to be used under warehouse receipt law, banks also finance other commodities, such as tea, through warehouse financing.

<sup>78</sup> Five percent of the total financial institutions interviewed had some portfolio (less than 1 percent) of finance based on warehouse receipts.

Foreign banks are active in this market, with HSBC and Rabobank providing pre-shipment warehouse financing, for export and import transactions. Basically the goods are sold and warehouse financing is provided for the period the goods are still at the docks. This type of facility is beneficial for an exporter who is unable to provide collateral in the form of fixed assets but has a significant inventory to obtain the working capital financing in order to facilitate business activities.

#### 4.3.1.4.5. Challenges in Warehouse Receipt Financing

- a) **Limited business knowledge:** Limited business knowledge to operate warehouse receipt transactions has been cited as a major reason for banks not entering into this business. This is evident from the fact that very few domestic banks are involved in warehouse receipt financing, and those who are have a very insignificant portfolio.
- b) **Limited warehouse facilities:** Industry and farmer associations have highlighted insufficient limited warehouse facilities as a key challenge in increasing penetration of warehouse receipt based financing. Conversely, the current warehouse operators are battling with the problem of overcapacity in terms of infrastructure readiness. The GoI is taking some steps to increase the number of warehouses in Indonesia.
- c) **High cost of services for small farmers:** Currently, the ancillary cost of availing warehouse receipt based financing is very high. Costs involve warehouse cost and surveyor agency for fixing price of commodities.

#### 4.3.1.5. Supply Chain Financing

Supply chain financing (SCF) refers to a range of financing and business processes that provide short-term credit to optimize working capital throughout the supply chain for both buyers and sellers.

SCF works exactly like reverse factoring and comprises the following main processes:

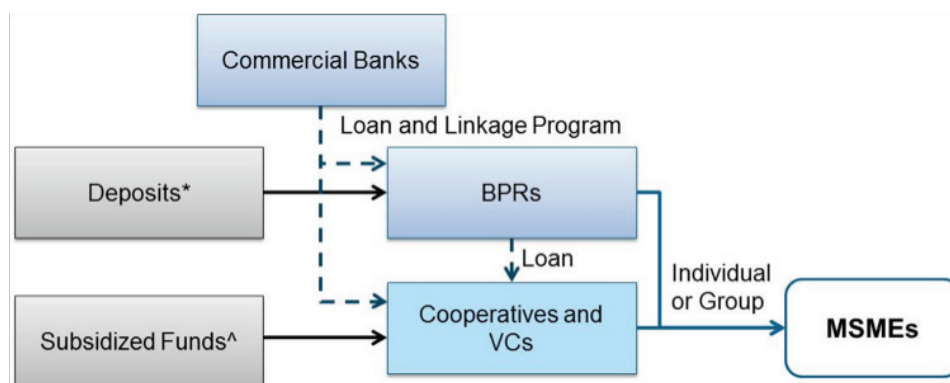
- a) A company purchases goods from a supplier. The supplier submits an invoice to the company.
- b) The purchasing company approves the invoice. This creates an irrevocable payment obligation for the purchasing company.
- c) Through a pre-established relationship between the supplier and the buyer's FI, the supplier may request funding of the approved payable at a date before the receivable's actual payable date.
- d) When the official payment date of the invoice arrives, the FI collects the payment from the purchasing company.

In Indonesia, SCF has recently been introduced with Deutsche Bank and PT Carrefour Indonesia entering into an agreement to finance Carrefour's strategic suppliers. Other banks, such as Bank BTPN, Bank BNI and SBI Indonesia, are contemplating launching similar services.

### 4.3.2. MFI Lending Models

MFIs lending to MSMEs include rural banks (BPRs), cooperatives and VCs. The lending by these MFIs is done through individual lending and group lending models.

**FIGURE 39: MFI LENDING MODEL**



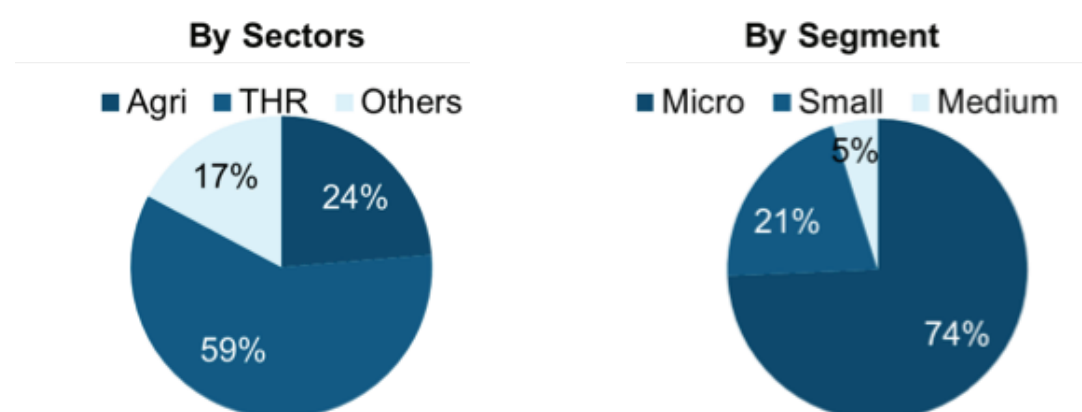
\* Some Cooperatives also accept deposits

^ From international Agencies and Government

#### 4.3.2.1. MFI Lending Sectoral Overview

More than 70 percent of the MFI portfolio is concentrated around microlending. As for commercial banks, MFIs also prefer lending to the THR sector (trade, hotels, restaurants) due to the sector's smaller business cycles and more visible cash flows.

**FIGURE 40: MFI PORTFOLIO BREAKDOWN**



MFIs also lend according to Sharia-based banking practices. Under Sharia-based loans, an MFI usually enter into a buy-sell model (Murabahah), rather than a profit sharing contract (Mudharabah or Musyarakah) since Sharia MFIs prefer short-term financing instead of long-term profit sharing agreements, considering the risk profile of MSMEs. Further framing and execution of such contracts is time consuming. Negotiation of profit sharing terms with the borrowers adds additional time since financial statements of the borrowers are not updated, or are frequently missing.

#### 4.3.2.2.Average Loan Sizes

Cooperatives provide small loans of up to IDR 10 million, whereas MSMEs approach BPRs for a larger ticket size of loans. BPRs also provide small and medium sized loans to MSMEs, where medium sized loans are sometimes arranged through loan syndication with other BPRs in the region (Table 17).

**TABLE 17: AVERAGE LOAN SIZES FOR LENDING**

Average Ticket Size of Loans	Range
Micro Loans by Cooperative	IDR 10 million
Micro Loans by BPRs	IDR 10–50 million
Small Loans by BPRs	IDR 50–150 million
Medium Loans by BPRs	IDR 150– 500 million

#### 4.3.2.3.Individual Lending

Under individual lending, MFIs lend to the borrower based on her/his credit worthiness. Loans are disbursed once the loan officer establishes the borrower's capacity to repay the loan. Loan officers have a good understanding of the client and local lending practices. The individual lending model relies on detailed assessment of the client's financial and economic information gathered and analyzed by the loan officer. Loan decisions are individually tailored based on the specific needs of each applicant and are usually made after the visit of a loan officer to the house and workplace of the client. Loans disbursed are tracked routinely by the loan officer who ensures timely repayments.

Cooperatives, specifically CUs, generally provide training to first time borrowers for three to six months and insist that the borrower regularly attends the training program, failing which the loan may even be rejected. Future loans are processed within a week, once the credit worthiness on past borrowing is established. Cooperatives require members to maintain a savings account with them which acts as cash collateral to cover their risk.

#### 4.3.2.4.Group Lending

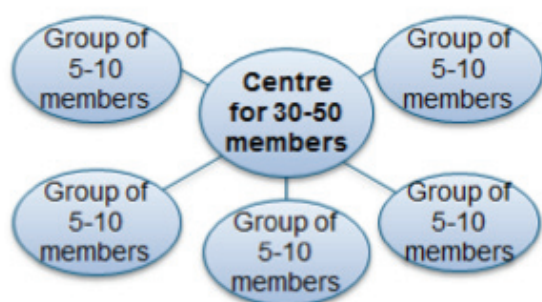
Group lending is the disbursement of loans through groups of customers. The group lending model enables the borrowers to access uncollateralized credit. This model of lending is exercised by cooperatives and VCs (but less than 10 percent<sup>79</sup> of cooperatives and VCs use the group lending model). It has been observed that most of the beneficiaries of group lending models are female business owners.

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<sup>79</sup> Numbers and conclusions are drawn from the primary survey of this study.



**FIGURE 41: GROUP LENDING STRUCTURE**



Group members are chosen by the customers themselves, with the average group size ranging from five to 10 members. The members join a group to share the liability of a loan together. In case a member defaults within a group, the group is legally responsible for her/his payments. In case a group defaults on a large loan, the center which overlooks the functioning of several groups in the region makes up for the default. In this way, the risk of default is spread to a wider range of borrowers and works as an effective control mechanism on the NPL rates.

Group members initially obtain small loans with a duration ranging from one month to one year. The amount disbursed usually follows a staggered lending approach; larger loans are disbursed when previous amounts are repaid. This approach gives an incentive to repay and allows the FI to build a credit history for every group as well as for individual clients. Installments are generally on a weekly or monthly cycle and repayments are guaranteed collectively.

Other important components are regular meetings of the group members, training, and compulsory savings which act as a collateral for the cooperative lending to the member. The members are encouraged to undergo training in order to be a part of the group. These trainings, in which the members are informed about the loan application and loan servicing procedures, range from three to four months. Members are trained to service their loans and keep a check on other members in case of default.

#### **4.3.2.5. Credit Disbursement Mechanism**

- **Branch/Office Banking** – Rural banks prefer to use branches to disburse cash, since this brings borrowers into direct visible contact and also avoids possibility of cash embezzlement.

Rural banks also set up cash offices which have a smaller infrastructure when compared to a branch, and are used solely for the purpose of disbursing loans and collection of monthly installments. As of May 2013, there were 1,527 cash offices belonging to 1,641 rural banks<sup>80</sup> in Indonesia. This shows that on an average every rural bank has one cash office, apart from the main branch and

<sup>80</sup> Indonesian Banking Statistics, May 2013, Bank Indonesia.

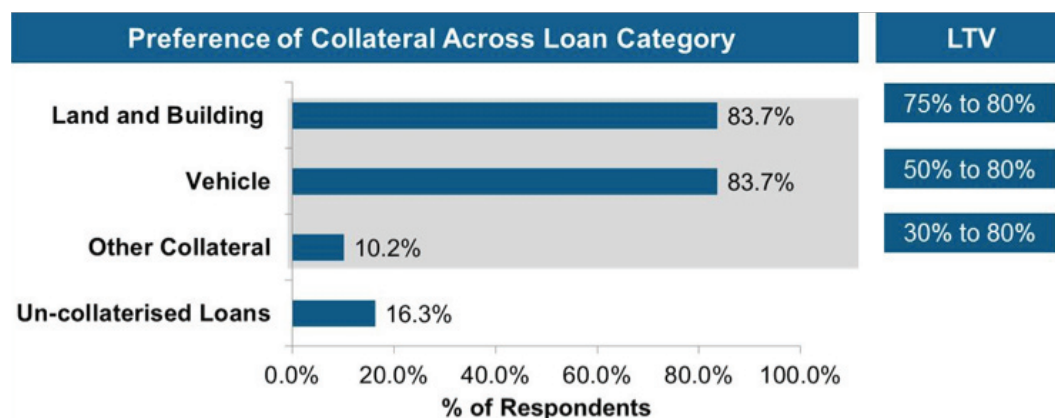
sub-branch office to service loans. Establishment of new cash offices has been cited as one of the major ways to increase MSME lending.

- **Account/Loan Officer** – Account/loan officers are generally used by rural banks and cooperatives to seek new clients and assess the credit worthiness of the borrower by conducting a background check. They disburse loans especially in the case of group lending, where the borrower cannot travel to the office of the cooperative, and the loan amounts are relatively small.

#### 4.3.2.6. Collateral Preference of MFIs

MFIs prefer immovable collateral such as land and buildings and restrict movable asset based lending only to cars and motorcycles (Figure 42).

**Figure 42: MFI PREFERENCE OF COLLATERAL (PERCENTAGE OF RESPONDENTS)**



Other types of movable collateral include accounts receivable, livestock, consumer durables, and inventory

The majority of the respondents (FIs), cited lack of business know-how and complications with on-the-ground management of movable collateral other than vehicles as a major barrier for movable collateral based financing. It was established that:

- BPRs collateralize 100 percent of their loan and prefer fixed assets collateral. Cars and motorcycles are the only movable collateral accepted by BPRs.
- Uncollateralized loans as a part of the BPR portfolio are very insignificant, and are given only to preferential clients who have a successful track record of servicing loans.
- In the case of cooperatives, besides land-based assets, they provide financing on vehicles (cars and motorcycles). Some cooperatives also provide lending on inventory (like livestock, stones, and plants), marriage certificates, education certificates, consumer durables and accounts receivable.
- Cooperatives and VCs, under the group lending model, provide uncollateralized lending but insist on members depositing savings with them. These savings act as cash collateral and are approximately 1/3 the size of the loan. Even CUs use only cash collateral (20–30 percent of the loan value) for smaller loans (less than IDR 50 million).

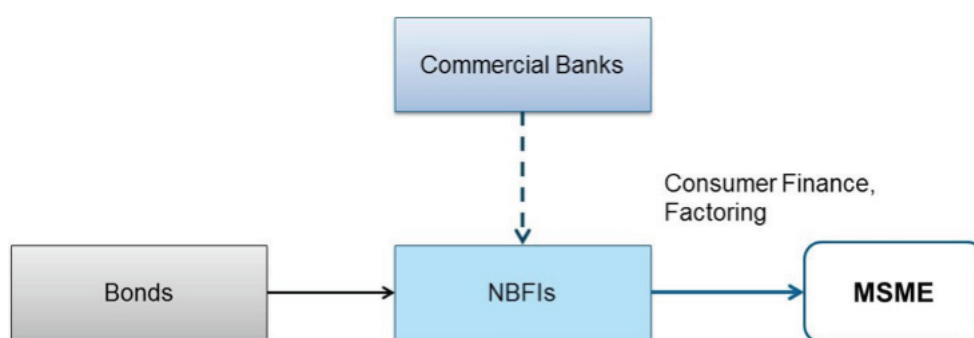


Further, the requirement for collateral varies across provinces, with Bali having a higher proportion of uncollateralized loans and West and East Java having a low risk appetite for uncollateralized lending. Cultural differences were highlighted as one of the important reasons for such a trend.

#### 4.3.3. NBFi Lending Models

NBFI/multifinance companies in Indonesia lend to MSMEs through consumer finance channeling and factoring.

**FIGURE 43: NBFi LENDING MODEL**



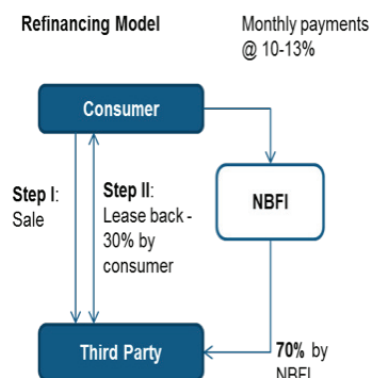
##### 4.3.3.1. Consumer Financing

NBFIs are predominantly involved in consumer financing especially vehicle financing. In Indonesia, NBFIs are restricted from providing financing to MSMEs using their existing asset as collateral, and can only finance purchase of assets.

NBFIs use the refinancing model in order to provide collateral-based financing to MSMEs. The key steps in the model are:

- a) The borrower sells the old vehicle to the third party company, a sister concern of the NBFI, for an agreed value.
- b) Funds received by the borrower through the sale of the vehicle are used to purchase the vehicle back from the third party. Typically 30 percent of the value is given as down payment to purchase back the vehicle. The remaining 70 percent of the loan amount is paid by the NBFI to the third party.
- c) The borrower services the loan to the NBFI through monthly payments and interest on the loan.

**FIGURE 44: REFINANCING MODEL**



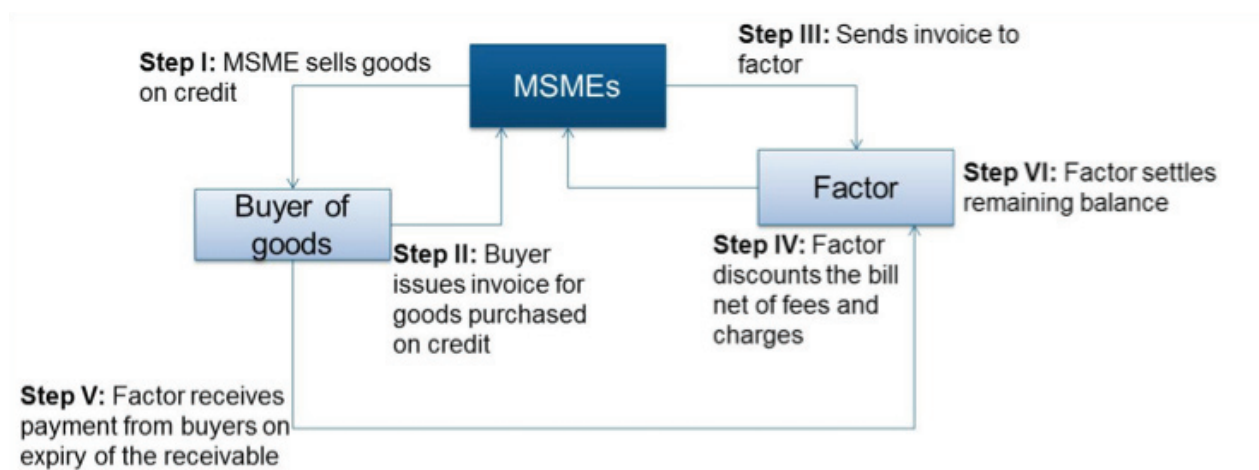
Bank lending constitutes 80 percent of the NBFi sources of fund. Banks allow their funds to be used only for consumer finance of vehicles and at times equipment, but not for warehouse financing or factoring.

NBFIs mostly lend to the trade, hotels and restaurants sector followed by the agriculture sector; and tend to avoid the fisheries and mining sectors. In terms of portfolio contribution, MSMEs constitute 50–70 percent of the NBFi lending portfolio.

#### 4.3.3.2. Factoring

Factoring is a working capital financing method for MSMEs, whereby the accounts receivable are discounted by the NBFi (factor), increasing liquidity for MSMEs.

**FIGURE 45: FACTORING MODEL IN INDONESIA**



- MSMEs sell goods on credit and raises invoice for the same.
- This invoice is discounted by the factor, after deducting certain fees and interest, and money is disbursed to the MSME. The factor releases only 70–90 percent of the invoice amount and retains the balance so as to keep the client obligated towards any future default on the part of the buyer of the goods, return of goods, etc.

- c) The factor in turn recovers the outstanding amount from the buyer of the goods once the due date arrives, settles the remaining balance after deducting the discounted percentage (usually between 3–5 percent of invoice value) with the MSME, and completes the transaction.

In Indonesia before the 1998 financial crisis, around 30 percent of receivables used to be factored, but this became significantly reduced due to risk aversion of the FIs. The factoring industry has grown at CAGR of 50 percent in the last two years (2010–12).

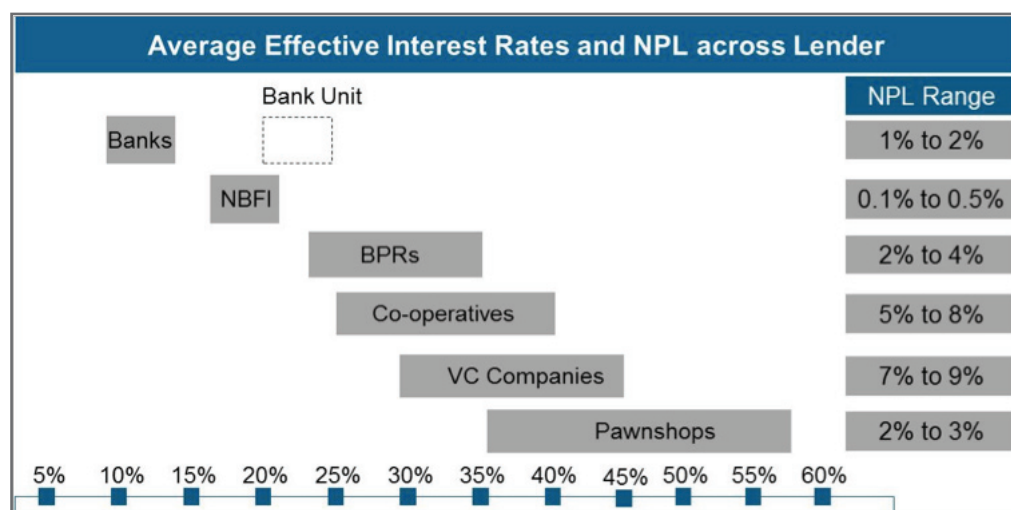
#### 4.4. Interest Rates across Lenders

Typically, commercial banks act as bankers for other FIs which further add their operational charges and risk premium before on-lending to MSMEs. This increases the cost of funds for MSMEs when borrowing from other FIs.

As highlighted in Figure 46, there is a positive correlation between the interest rates charged by various FIs and the NPL rates they carry on their books. Interest rates are also dependent on loan collateralization.

Commercial and rural banks with fixed asset based loans are more effective in managing risk, thereby commanding a lower interest rate. Cooperatives and VCs with a higher proportion of uncollateralized loans charge a higher interest rate to cover their risks. Though pawnshops maintain the physical possession of the collateral, they should be seen as an exception to this phenomenon as they charge a premium for faster disbursement of loans.

**FIGURE 46: INTEREST RATES AND NPL ACROSS LENDERS**

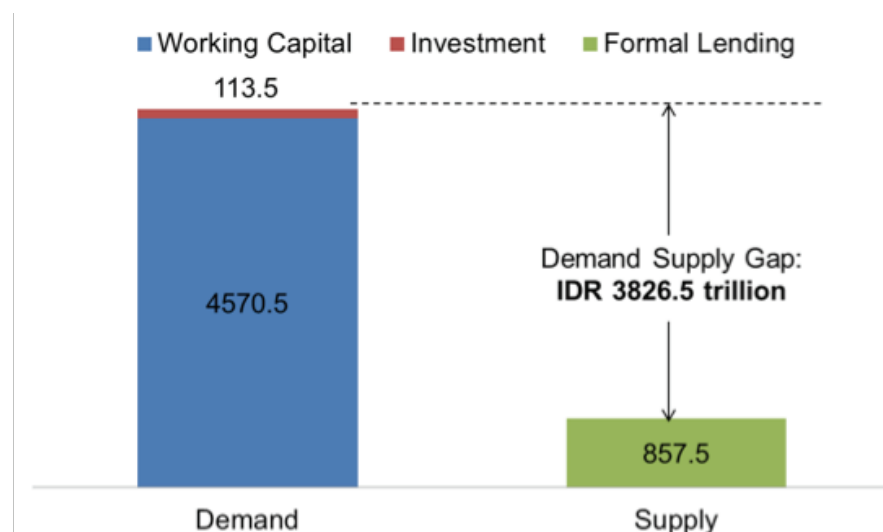


- Bank units of commercial banks provide competitive rates for MSME credit, while maintaining NPL rates in an acceptable range.
- One of the main reasons for bank units providing competitive rates is the loan management services of commercial banks involving the supervision of loans by experienced loan officers. Experienced loan officers are prudent in lending to microenterprises and keep a regular check on loan repayment.
- Pawnshops are able to maintain a low NPL rate since they take the physical possession of the collateral.

## 5. Estimating the Demand Supply Gap

### 5.1. Demand Supply Gap

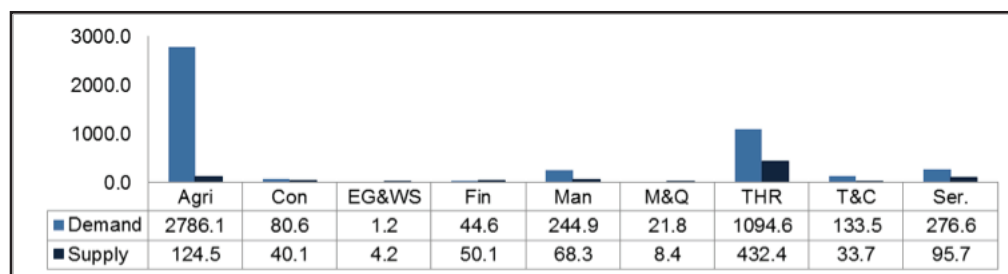
**FIGURE 47: DEMAND SUPPLY GAP (IDR TRILLION)<sup>81</sup>**



As per the current estimates, the demand-supply gap stands at about IDR 3,826.5 trillion. It should however be noted that the demand estimates also include MSMEs who though eligible for debt financing prefer to self-finance (around 10 percent). Additionally, there would be a significant portion of the demand that would be getting addressed through informal sources of financing. For this study, the informal sources of financing and self-financing have not been considered, as they still represent a gap which can be addressed by the formal sources of finance.

For designing appropriate sector specific financing products, it is important to understand the financing gap for each of the financing sectors.

**FIGURE 48: SECTOR SPECIFIC FINANCING GAP (IDR TRILLION)<sup>82</sup>**



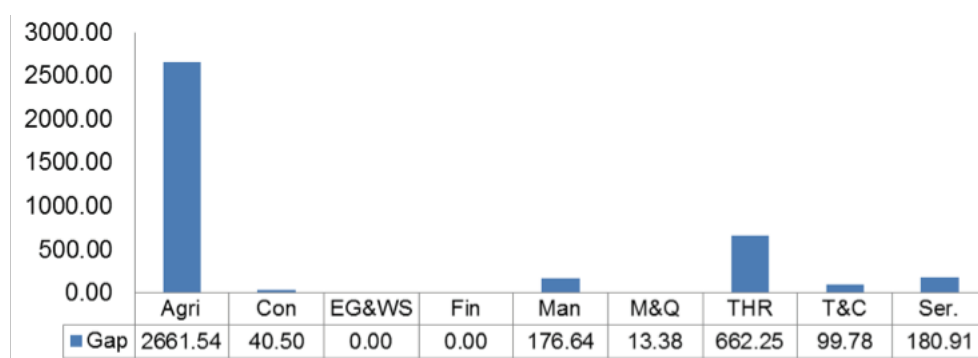
A few sectors including electricity, gas and water supply, and finance, rent and services seem to have a minimal or negative demand supply gap. This may be due to under-estimation of sales and assets for this sector or over-estimation of supply especially from other formal sources. Currently warehouse financing

<sup>81</sup> Calculated based on the estimations provided in demand and supply sections.

<sup>82</sup> Calculated based on the estimations provided in demand and supply sections.

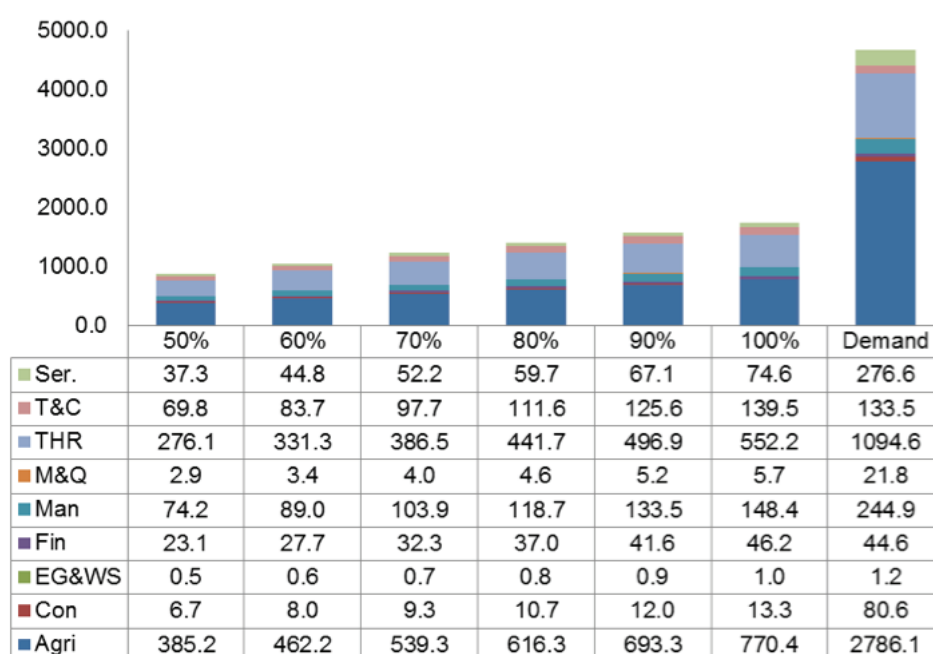
has not been considered in this analysis. The market for warehouse receipt financing is developing, but the lack of business understanding among various FIs and the perceived complexities of receipt financing have kept the portfolio very insignificant.

**FIGURE 49: GAP BETWEEN DEMAND AND FORMAL SUPPLY (IDR TRILLION)** <sup>83</sup>



The amount of loan by sector at different LTVs is presented in Figure 50. This amount is compared with the total demand of financing to give a better understanding of the barrier.

**FIGURE 50: COMPARISON BETWEEN FIXED COLLATERAL BASED LOAN AND TOTAL DEMAND AT DIFFERENT LTVS (IDR TRILLION)** <sup>84</sup>



Even if loans were given at 100 percent LTV, the total demand supply would still be as high as IDR 2,932.7 trillion.

<sup>83</sup> Calculated based on the estimations provided in demand and supply sections.

<sup>84</sup> Calculated based on fixed asset held by MSMEs as provided in the Bank Indonesian survey and calculated the potential to meet the demand supply gaps, of different sectors as calculate above in Figure 49, against different Loan to value ratios for the fixed assets.

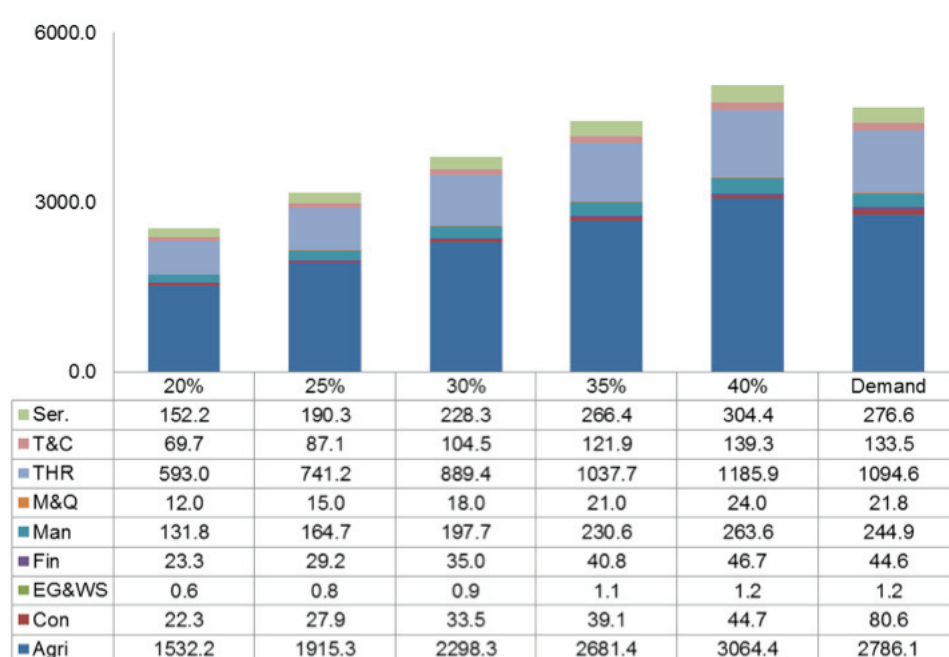
## 5.2. Need for Movable Financing

According to an ADB Working Paper Series on Regional Economic Integration<sup>85</sup>, around 86 percent of the MSMEs surveyed believed that lack of collateral was a barrier to financial access. MSMEs have very limited fixed assets to offer as collateral. The assets are usually offered as collateral for term loans, leaving the MSMEs with limited options to avail of working capital finance.

Most of the financial capital of MSMEs is tied up in inventories, customer receivables and other movable securities. In case of enterprise in the agriculture or animal husbandry sector, the capital is tied up in standing crops and livestock.

Conservatively, around 70 percent<sup>86</sup> of a firm's gross sales are movable assets (such as inventory, accounts receivable, cash collateral) in the firm's balance sheet at any point in time. After estimating the sector level movable assets, movable assets based lending for various LTV ratios was simulated.

**FIGURE 51: COMPARISON BETWEEN MOVABLE COLLATERAL BASED LOAN AND TOTAL DEMAND AT DIFFERENT LTVS (IDR TRILLION)<sup>87</sup>**



Except for the construction sector, the demand of finance for all the other sectors could be met by movable asset based financing even at LTVs as low as 35–40 percent. Therefore, to improve financial access for MSMEs, it is important to accept movable assets as collateral as this would help significantly reduce the demand-supply gap.

<sup>85</sup> A New Regime of SME Finance in Emerging Asia: Empowering Growth-Oriented SMEs to Build Resilient National Economies, ADB, 2012.

<sup>86</sup> It is an assumption validated through primary validation. This is an assumption validated through primary interaction with financial institutions and other industry experts

<sup>87</sup> Calculated based on assumed level of movable asset held by MSMEs, as estimated through the Bank Indonesia survey and calculated the potential to meet the demand supply gaps, of different sectors as calculate above in Figure 49, against different Loan to value ratios for the movable assets.

### **Section 3: Challenges and Recommendations**

## 6. Challenges in Lending

To understand the key reason for the huge gap between demand of debt capital and the formal sources of lending, it is important to understand the process of lending and challenges faced by micro, small and medium enterprises (MSMEs) and financial institutions (FIs) in each stage of the process.

### 6.1. Lending Process

**TABLE 18: LENDING PROCESS FOR MSMEs FROM FINANCIAL INSTITUTIONS**

	Loan Application	Loan Approval*	Loan Disbursement	Collateral Execution
Stakeholders	MSMEs and FIs	MSMEs, SID, FIs	MSMEs, FI, Fiducia, Police	MSMEs, FI, Police, Courts
Steps	Application form	Analyze documents	Collect collateral documents	Try for out of court settlement
	Provide collateral documents	Collateral verification	Register with Fiducia	Intimate Fiducia and SID
	Submission of business details	Collateral checking- Fiducia	Block on collateral with police	Start court proceedings
	Tax registration loans IDR 50 mn	Cross-check with SID	Disbursement	Enforce using police

The overall lending process consists of five steps: loan application, loan approval, loan disbursement, loan management and collateral execution in case of default. The loan management process is not discussed as it is the bank's internal process independent of external agencies.

#### 6.1.1. Loan Application

As a starting point of the value chain in the whole lending cycle, an MSME approaches an FI to meet its financing requirement. Based on discussions with the loan officer, the MSME provides the relevant documentation such as the application form along with the details about its business including legal registration status, business licenses, financial statements, cash flow projections, utilization details of the loan, and information related to its suppliers and customers. In case the loan is more than IDR 50 million, Bank Indonesia (BI) mandates commercial and rural banks to collect tax registration certificates.

Depending on the type of loan and relationship between the FI and the MSME, the type of collateral required and its corresponding loan-to-value (LTV) is derived. The MSME also submits the collateral documents (such as land or motor vehicle certificates, right to use documents) to the FI providing the credit.



### 6.1.2. Loan Approval

The commonly used credit evaluation framework for loan applications is “Six-C” – evaluation of Character (entrepreneur profile), Capacity (financial statement analysis), Capital (availability of equity), Credit (past credit history), Condition (loan term) and Collateral (Table 19).

**TABLE 19: SIX-C CREDIT EVALUATION FRAMEWORK**

<b>Character</b>	This business owner profile is very important to FIs even in case of business loans. The FIs evaluate the business owner in terms of his repayment capacity and willingness. Character is also verified from past lenders and social networks .
<b>Capacity</b>	FIs judge the capacity of the business to repay based on the <b>financial statement analysis</b> . For micro and small businesses, the ability to repay the loan is also verified for the business owner . The competition to the business is also verified.
<b>Capital</b>	The FIs also evaluate the ability of the business to invest the equity required for the implementation of the project financed by the loan.
<b>Credit</b>	The FIs evaluate the credit history of the business and the business owner. This is done by <b>cross checking with the Debtor Information System (SID)</b> . As many MFIs do not access to SID, thus relationships play an important role.
<b>Condition</b>	The duration of the loan, quantum of the loan and the usage of loan amount also play an important role in loan approval process.
<b>Collateral</b>	The collateral documents, the value of the collateral is verified. The Financial institutions also <b>cross check with the Fiducia Registration Office</b> , if loan is already taken against the collateral.

FIs in Indonesia follow different mechanisms to evaluate loan applications. Some FIs use parameters such as house, income, asset and poverty indices to evaluate the credit worthiness of the MSME (Table 20).

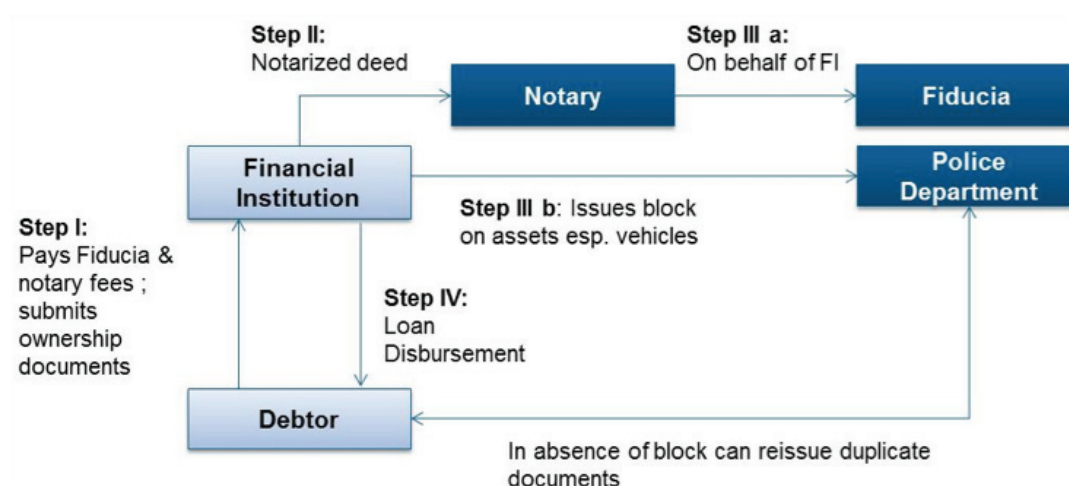
**TABLE 20: METRICS USED TO EVALUATE CREDIT WORTHINESS**

<b>House Index</b>	Assessment of value of the house in which the borrower resides and includes the value of land, building, whether the structure is permanent or made of cement or concrete. For valuation tax registration value is referred by the lenders
<b>Income Index</b>	Assess the income streams for the borrower, revenue stream of the business, expense structure. Analysing the financial of borrower's business and risk related to the industry in which the borrower operates
<b>Asset Index</b>	Assess the value of assets other than the house, which a borrower holds. Value of motorcycle or any pick-up van. For valuation of motorcycle, tax registration value is referred by the lenders. Other non business personal assets are also valued.
<b>Poverty Index</b>	Assess the education level of the borrower, how many members reside in the house.

### 6.1.3. Loan Disbursement

After the loan is approved, the FI registers the collateral security with the Fiducia Registration Office (FRO) and the Police Department (in case of vehicle-based collateral) before disbursement of loan.

**FIGURE 52: INTERACTION BETWEEN VARIOUS AGENCIES FOR VEHICLE BASED FINANCING**



The MSME initially submits the ownership document to the FI along with the fees associated with the fiducia registration, and registers a block<sup>88</sup> with the Police Department in case of motor vehicles based collateral.

A deed is signed between the FI and the debtor with details regarding the loan terms. The signed deed (in Bahasa Indonesia) is notarized by the notary, who further registers the collateral with the FRO. It should be noted that Indonesian FIs currently do not have access to the fiducia system and depend on public notaries

<sup>88</sup> Block refers to the process where in the Police department does not allow creation of a duplicate certificate

registered with the FRO for this. The FI also issues a block<sup>89</sup> against the collateral with the Police Department, in the absence of which the debtor could reissue duplicate ownership certificates through the Police Department. The cost for issuing the block<sup>90</sup> is approximately IDR 50,000 <sup>91</sup>.

#### 6.1.4. Collateral Execution

FIs often collateralize the debts to cover their risks. In case of loan defaults, the FIs recover their capital through sale of assets collateralized. The collateral execution process is the most difficult for FIs, especially when lending on movable collateral. An out-of-court settlement is the first choice for the financial institution. If the settlement discussions do not materialize in a cordial manner, the FI initiates the collateral execution procedures by informing the SID and the Fiducia' Registration Office of the loan default.

The financial institution executes the collateral through a private sale or a public auction.

**TABLE 21: EXECUTING METHODS:**

Parameter	Public Auction	Private Sale
Executing agency	Ministry of Trade	FI or others
Enforcement responsibility	Auction winner	FI
Value realization	Lower than market	Closer to market

The state owned enterprises (banks and PT Pegadaian) are mandated to follow the public auction route. The value realization through this route is lower than market value as the public auctions are widely known to have distressed assets under auction. Financial institutions believe that collateral listing on the state's auction list shows their seriousness in the collateral execution and encourages the MSMEs to accept settlement offers. It should also be noted that Fiducia registration entitles the banks to an executionary right on the collateral but not the right to ownership and hence does not guarantee enforcement. Inadequate understanding of the Fiducia law among law enforcement officials, results in long drawn court cases. In the past, there have been specific cases where local authorities have created obstacles during the collateral repossession process. Therefore, financial institutions take on a police assistance during the collateral execution process.

<sup>89</sup> Block refers to the process where in the Police department does not allow creation of a duplicate certificate

<sup>90</sup> Block refers to the process where in the Police department does not allow creation of a duplicate certificate

<sup>91</sup> Based on primary interactions with MSMEs, rural banks and cooperatives.

## 6.2. Challenges across Stages of Lending

Across various stages of the entire lending process cycle, MSMEs and banks face multiple challenges that act as key impediments which need to be addressed to facilitate a greater lending ecosystem to MSMEs. This section will highlight various key challenges from the MSME perspective as well as the FI perspective that if addressed, can significantly increase the quantum of supply of financing.

**TABLE 22: LENDING CHALLENGES**

	Loan Application	Loan Approval	Loan Disbursement	Collateral Execution
<b>Challenges - MSME</b>	Tedious process	Long lead time	Fiducia Cost	
<b>Challenges - FIs</b>	Non standardized statements	Provision for asset losses	Fiducia time taken	Priority of collateral
	Information asymmetric	Shortcomings in Fiducia and SID	Dynamic collateral -cost & time	Asset degradation and loss
		Current & future asset valuation	Multiple registrations	Lengthy & costly process

### 6.2.1. Loan Application

#### 6.2.1.1. Financial Institution Challenges

##### 6.2.1.1.1. Non-Standardized Statements

Bank Indonesia (BI) prescribes certain documentation norms that need to be adhered to in order to seek a loan. One of the documentation requirements is the submission of audited financial statements, which most of MSMEs do not have. Even un-audited financial statements are not in the format required by FIs. This results in either significant delays in getting loan approvals from FIs or even a complete rejection of a loan application. Banks perceive the availability of financial statements as one of the most important requirements for loan approval besides a fixed asset collateral document submission.

To overcome this barrier, BI has formulated a study regarding minimum standards for financial statements and business plan for MSMEs. This study<sup>92</sup> was conducted in line with the Financial Accounting Standards Entities without Public Accountability (SAK ETAP) which has been issued by the Financial Accounting Standards Board of Indonesian Institute of Accountants (IAI DSAK).

##### 6.2.1.1.2. Information Asymmetric

Information asymmetric refers to inconsistency of data available at MSMEs and the data requirements of an FI to make informed decisions about providing credit. Several instances were observed during the study highlighting the magnitude of the

<sup>92</sup> Based on the primary interaction with Bank Indonesia during the study

information asymmetry that exists in the system. FIs are tackling this information asymmetry as explained below.

- a) Should business owners be unable to produce collateral related documents, especially for hereditary land and building assets, FIs accept a letter from the village head.
- b) In the absence of business licenses, FIs physically inspect the business premises.
- c) Banks also take marriage certificates and education certificates as collateral in the case of female entrepreneurs since these assets have legally always been owned by male members of the family.

### 6.2.1.2. MSME Challenges



Around 75 percent of MSMEs<sup>93</sup> in Indonesia prefer to use microfinance institutions (MFIs) and informal financing sources. Also more than 70 percent of MSMEs do not approach banks after self-evaluation. The key reasons are:

- a) Thirty percent of the MSMEs feel that registration acts as a barrier; however in practice banks do not insist on this.
- b) Thirty-five percent of respondents feel that they do not have sufficient collateral.
- c) Twenty-five percent of respondents perceive the loans process to be time consuming and tedious.

Most of the MSME self-evaluated risks are perceived challenges since FIs have eased the application process and relaxed the loan requirement. For example, a legal registration status, while good to have, is not a mandatory requirement of FIs for loan disbursement.

#### 6.2.1.2.1. Legal Status

The World Bank Enterprise Survey conducted for Indonesia in 2009 highlights that the average number of years for which the MSMEs are not formally registered is 2.4 years as compared with 0.9 years in Cambodia, 0.1 years in Philippines and 0.7 years in Vietnam. None of the MSMEs interviewed during this study were registered with the Ministry of Law and Human Rights (MoLHR) for legal entity registration, and 45 percent of respondents were registered with other government entities. These registrations were with Ministry of Agriculture, Ministry of Trade – for trade licences and with local governments and health departments – for restaurant licences.

For loan requirements in excess of IDR 50 million, a tax registration number is mandatory. This can be obtained at no cost from the Directorate General of Taxation. A domicile certificate is required for obtaining the registration number. Though the domicile certificate can be obtained free of charge, MSMEs have to effectively pay a significant amount to obtain it. In order to avoid the inconvenience

<sup>93</sup> Based on primary interviews with 34 MSMEs based across Jakarta, East Java and Central Java.

and the expensive proposition of obtaining a tax registration number, many MSMEs refrain from approaching FIs such as commercial banks and rural banks for seeking credit.

As mentioned above, MSMEs view this as a major impediment in their ability to obtain loans, but in the current scenario FIs do not insist on submission of these documents.

**6.2.1.2.2. Lack of Collateral**

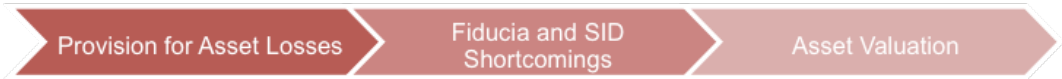
Lack of collateral is both an actual and perceived challenge for the MSMEs. Banks do insist on collateral to safeguard their risks, but they are lenient on documentation. However, it is important to note that movable assets constitute more than 50 percent of MSME assets. Since 2004, commercial banks have been allowed to accept assets other than land or buildings as deductions in determining loan loss reserves when allocating credit to MSMEs (details provided in Section 6.2.2.1.1.). This measure, however, failed to significantly enhance small firms’ access to credit as banks still insist on fixed assets collateral.

The Kredit Usaha Rakyat (Community Business Credit; KUR) launched in 2007 is a Government of Indonesia (GoI) initiative to overcome this barrier. It has the provision for Government-funded guarantee programs to provide comfort to banks for lending to feasible projects which are not bankable. But banks still insist on 100 percent collateral for KUR-based loans. The KUR scheme has been explained in more detail in Section 4.3.1.3.3.

**6.2.1.2.3. Tedious Process**

Sixty percent of the respondents have stated that the tedious loan application process is a key deterrent for approaching commercial banks. The poor understanding of document requirements of FIs, especially those of commercial banks, make the process time consuming and complex. The MFIs, especially cooperatives and VCs, have tackled this challenge by conducting training sessions for its first-time customers. The training focuses on financial prudence in addition to creating awareness about products and associated loan terms.

**6.2.2. Loan Approval**



The loan approval process is primarily concerned with the verification of information submitted to an FI. The process also involves physical verification of the business, asset under collateral, etc. to ensure the genuineness of the loan requirement and also assess the ability or the willingness of the enterprise to repay the loan. Prudence in the loan approval process is the key for FIs in mitigating lending risks.



## 6.2.2.1. Financial Institution Challenges

### 6.2.2.1.1. Provision for Asset Losses

FIs are mandated to maintain a loss reserve to protect bank assets against bad loans. This reserve is a proportion of the FIs' total lending portfolio. In the case of collateralized loans, the proportion of market value of the underlying asset is allowed to be deducted while calculating the provision for asset losses (Penyisihan Penghapusan Aktiva - PPA).

#### *External Barriers*

The banking assets are classified as earning assets or non-earning assets for the purpose of provisioning losses. Loans that are covered by collateral assets that fall under earning assets are required to be provisioned as follows (Table 23):

**TABLE 23: ASSET LOSS PROVISIONING FOR BANKS <sup>94</sup>**

Category	Commercial Bank	Rural Bank
Current	1%*	0.5%**
Special Mention	5% net of deductible collateral	NA
Sub-Standard	15% net of deductible collateral	10% net of deductible collateral
Doubtful	50% net of deductible collateral	50% net of deductible collateral
Loss	100% net of deductible collateral	100% net of deductible collateral

*\* Excluding Sharia Deposit Facility of Bank Indonesia, Bank Indonesia Sharia Certificates and productive assets with cash collateral.*

*\*\*Excluding placement of rural banks on Bank Indonesia Certificates (SBI) and loans guaranteed by liquid collateral of SBI, securities issued by the Government of Indonesia, savings and/or time deposits blocked by the rural bank in question accompanied by power of attorney for disbursement and fiduciary money.*

While traditionally the financial sector has seen lending only against fixed assets such as land and building, there has been a deliberate effort by BI to create a platform for FIs to look at movable assets as collateral for lending and at the same time be covered against the loan loss reserve provisioning requirement. As mentioned above, BI allows many movable assets as deductions in determining loan loss reserves when allocating credit to MSMEs. BI has specific guidelines for the proportion of collateral deductible from the PPA.

<sup>94</sup> Allowance for Assets (PPA), Indonesian Banking Booklet, 2013.

**TABLE 24: PROPORTION OF COLLATERAL DEDUCTIBLE FROM PPA**

Collateral	Commercial Banks	Value	Rural Bank	Value
Land, buildings, residential housing	Yes	0–70%*	Yes	50–80%
Business place/counter/kiosk/ stall/right to use/right to work on	No		Yes	50%
Machinery which is one unit with land	Yes	0–70%*		
Aeroplanes or sea ships/vessels above 20 cubic meter	50% net of deductible collateral	50% net of deductible collateral		
Motor vehicles	Yes	0–70%*	Yes	30–50%
Inventory	Yes	0–70%*		
Actively traded or Investment grade securities and shares	Yes	50% of traded value		
Warehouse receipts	Yes	0–70%*	Yes	0–70%*
Cash collateral in form of demand deposits, savings, marginal deposits	Yes	100%	Yes	100%
Gold	Yes		Yes	85%
Bank Indonesia Certificates (SBI), securities issued by the Government of Indonesia	Yes		Yes	100%
Funds guaranteed by BUMN/BUMD conducting business as credit guarantors			Yes	50% for part of funds guaranteed

\* Depending on the vintage of appraisal of the collateral<sup>95</sup>

As part of the above guidelines, accounts receivable which are the major constituent of MSME assets are not allowed to be deducted while calculating the provision for asset losses. In developed economies like the United States and Canada, more than 40 percent of MSME lending use accounts receivable as collateral. In Indonesia, very few banks actually lend based on accounts receivable. Accounts receivable based financing is considered to be uncollateralized. Proper guidelines for accounts receivable based lending could potentially unlock huge supplies of capital for MSMEs. As mentioned in Section 4.3.1.2., accounts receivable based lending is used exclusively by FIs for institutional lending. No provision for accounts receivable puts these institutions at a disadvantage.

Further, to increase lending to the fisheries sector, BI is contemplating a guideline for small boat based lending.

### **Internal Barriers**

Perceived risks on movable collateral: Banks in Indonesia have historically only lent on fixed collateral. Since 2004, banks have allowed collateralization of movable assets. But the loan officials who perceive movable assets as risky are still sceptical

<sup>95</sup> Bank Indonesia Regulation Number 14/15/ PBI / 2012 concerning assessment of commercial bank asset quality



to lend on movable assets. This trend has been observed particularly in state-owned banks (SOBs) where higher non-performing loan (NPL) rates are equated to corruption. In addition, implementation of guidelines has been ineffective: BI issued PBI no. 13/26/PBI/2011 to encourage lending on movable assets with prudence, but the awareness and adoption of this is still poor among rural banks. Currently, lending is limited to a few categories of assets including land, building, cash and vehicles.

#### **6.2.2.1.2. Shortcomings in Credit Bureaus**

The Debtor Information System (SID) is a credit bureau owned and managed by BI, which maintains the credit history of both individuals and business. Currently 120 commercial banks, 1,304 Bank Perkreditan Rakyat (BPRs) and 20 non-bank financial institutions (NBFIs) are members of SID. The Financial Services Authority (OJK) is contemplating mandating NBFIs to be a part of SID to make it a more robust and comprehensive database for providing credit history of debtors.

One objective of SID is for MSMEs to get access to financing based on their credit records rather than just depend on the availability of collateral. Most of MSMEs avail loans from MFIs who are not members of SID. When MSMEs graduate to the next level (i.e. micro to small) and approach commercial banks to meet their higher demand, banks do not have access to the past credit information of these enterprises. MSMEs then have to re-establish their credentials, thereby defeating one of the key objectives of SID. SID currently captures only the name of the creditor, debtor and the repayment status. Banks have to access other databases like Fiducia to avail complete credit history of the debtor. The data gaps in SID are one of the key challenges for banks while determining the debtor's credit history.

Through regulation 15/1/PBI/2013, BI has opened the credit information sharing practice to private entities (Lembaga Pengelola Informasi Perkreditan – LPIP). The private credit bureaus are expected to capture other information including utility payments, and can be operational by 2016. The new bureaus could also capture information from other FIs including MFIs, NBFIs, etc. As one of the "grass roots" of credit information sharing practice, SISKOPDIT is developed by one of the largest MFI associations, INKOPDIT, to capture information of its 930+ credit unions.

While it may seem logical to integrate the information stored on SISKOPDIT with the information on SID, MFI associations such as INKOPDIT have shown resistance towards this thought as it may reduce their competitive advantage, and may potentially cause loss of their good customers to commercial banks providing credit at lower interest rates.

#### **6.2.2.1.3. Shortcomings in Fiducia**

The Fiduciary Transfer Law was adopted in 1999<sup>96</sup> to regulate fiduciary securities. Fiduciary security is a right, securing the repayment of debt over tangible and intangible movable assets and fixed assets. Unless mentioned otherwise in the agreement between creditor and debtor, the security also covers products resulting from, or insurance claims from, the assets collateralized. The collateralized assets

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<sup>96</sup> Law no. 42 of 1999

are in the possession of the debtor. The FRO was set up as a part of the Ministry of Law and Human Rights (MoLHR) under this law.<sup>97</sup>

The key benefits that the FRO provides are:

- a) Asset execution rights to creditors on payment defaults.
- b) Provision for both current and future debts to be secured by fiduciary transfer;
- c) Creation of transparency by making fiduciary security registry open to public,
- d) Enabling of secondary financing by allowing financing on secured sales contract,
- e) Following the collateral into the hands of transferees,
- f) Definition of scope of collateral to include the profits and proceeds of the original collateral
- g) Definition of priority of the creditor.

The system was originally manual but moved online in February 2013. Till November 12, 2013<sup>98</sup>, for example, more than three million fiducia securities are registered in DKI Jakarta regional office. The manual data has still not been digitized. The system currently does not capture specifics of collateral. Only 20 percent<sup>99</sup> of the collateralized loans are registered with the fiducia system. Many developing countries such as China, Ghana, Vietnam and Cambodia among others have addressed this situation where the assets collateralized are registered with the collateral registry. The registry maintains critical information on the assets, including movable assets, and ensures that each asset registered has a unique identification attached to the collateral. The details on the asset coverage for collateral registry and other details regarding Fiducia are covered in Section 8.3.4.

Data gaps in the Fiducia database and manual nature of old data render the cross-checking process tedious, time-consuming and practically unfeasible.

#### **6.2.2.1.4. Valuation of Assets**

Valuation of collateral is a critical component of the loan approval process. This helps FIs cover their risks efficiently. On valuation of fixed assets, banks usually use internal surveyors. Banks use the property tax certificates and knowledge of the prevalent property rates to value these assets. As per BI, for a loan above IDR 5 billion an external surveyor is required, the additional cost of which is restricted to a maximum of 10 percent of asset value.

As far as movable assets are concerned, with respect to their valuation for deriving their LTV, most banks are sceptical about the quality of movable assets other than vehicles (banks use local newspapers like Poskota for valuation of vehicles) and do not have robust valuation mechanisms for dynamic movable assets such as accounts receivable, livestock, inventory, etc. The proportion of the collateral which can be subtracted as deductible from reserve also depends on the vintage of the survey (see Table 25 for land and buildings, as specified by BI).

<sup>97</sup> In 2000, via Presidential Decree Number 139/2000

<sup>98</sup> Based on primary interaction with Fiducia Registration Office on November 12, 2013

<sup>99</sup> According to Secretary General of the General Administrative Law and Human Rights Ministry, revenue lost by FRO is IDR 300 billion against IDR 90 billion revenues, making total registration rate of around 23%.

**TABLE 25: PROPORTION DEDUCTIBLE FROM PROVISION REQUIREMENT BASED ON VINTAGE OF SURVEY**

Value to be Subtracted	External Surveyor	Internal Surveyor
70%	18 months	12 months
50%	24 months	18 months
30%	30 months	24 months

For example, if the market value of land was found to be IDR 5 billion when surveyed 15 months ago, then IDR 3.5 billion could be subtracted from the loan reserve if the survey was conducted by an external surveyor, or IDR 2.5 billion could be subtracted if the bank conducted an internal survey. Thus, the assets collateral needs to be valued on a continuous basis to draw benefits.

High cost of valuation and limited availability of surveyors is an important barrier in the loan approval process.

#### 6.2.2.2. MSME Challenges

The challenges faced by FIs make the loan approval process lengthy. The loan approval process can take up to four to six100 months for a commercial bank. Generally, cooperatives lending on the group lending model, and CUs, train MSMEs for a period of three to six months before approving the first loan. For the second loan onwards the loan disbursement process takes less than a week. MSMEs require funds immediately to run their operation. This delay impacts their business negatively making it an important challenge for MSMEs.

### 6.2.3. Loan Disbursement

#### 6.2.3.1. Financial Institution Challenges



##### 6.2.3.1.1. Fiducia Time Taken

Registration with FRO is a two-step process. The steps are:

##### *Step I: Notarizing the loan deed*

A loan agreement is first signed between the creditor and debtor in Bahasa Indonesia which is then notarized by the public notary. Any notary registered with the MoLHR can notarize the loan agreement.

While notarizing the deed is a one-day process, the availability of an authorized public notary has been identified by many FIs as a big concern and has often resulted in delayed collateral registration due to non-availability of the public notaries.

100 Based on primary interaction with 34 MSMEs, 14 large commercial banks in Indonesia and 53 MFI/ MFI holding companies which have been interviewed across Jakarta, East Java and Central Java. Details of the financial institutions have been provided in appendix.

## ***Step II: Registration of the notarized assignment with the FRO***

Earlier, registrations were done by the provincial FRO resulting in additional travel costs and time. In the online system which became effective in February 2013, a registered public notary files the collateral registration online. The number of notaries registered with the system to facilitate the process is limited as indicated above. Even in the Jakarta National Capital Region, only around 150 notaries are registered with the online system. FIs have indicated that notaries are not available on some smaller islands, and representatives have to travel to another island for registering with the FRO. After the notary files the registration, it usually takes around a month for the Fiducia certificate to be issued. It is therefore imperative to address the situation of who additionally can be authorized to register the collateral with the FRO, or alternatively to address the limited availability of the public notaries for the Fiducia registration.

To overcome this challenge, the state-owned Pawnshop PT Pegadaian has Fiducia-based lending in their urban centers only where they have connections with notaries. Several NBFIs have also indicated that they only register with the FRO when the loan quality deteriorates.

### **6.2.3.1.2. Dynamic Collateral Management**

FIs have indicated that unavailability of human capital to manage the dynamic collateral acts as an impediment to lend based on dynamic collateral like inventory. A few larger banks like Bank Negara Indonesia (BNI) hire external collateral managers for managing inventory.

There is currently no separate cost structure for registering dynamic collateral. Banks like Bank Andara which predominantly lend on accounts receivable have indicated that they would like to update the changed value of collateral with the FRO but currently the cost and time taken is the same as a new registration. Inadequate human capital and high cost of updating collateral values with the FRO is a challenge for lending against dynamic collateral.

### **6.2.3.1.3. Multiple Registrations**

Vehicles are the dominant collateral for movable assets based lending in Indonesia. For credit provided based on vehicles as collateral, FIs have to register with both the FRO and the Police Department to cover their risks. This step adds to the cost (IDR 50,000) and time taken.

### **6.2.3.2. MSME Challenges**

#### **6.2.3.2.1. Fiducia Cost**

Although the FI is responsible for registering with the FRO, the cost is borne by MSMEs.

**TABLE 26: OFFICIAL FIDUCIA REGISTRATION COSTS** <sup>101</sup>

Asset Value	Fiducia Fees, IDR
Less than IDR 50 million	25,000
IDR 50–100 million	50,000
IDR 100 –250 million	100,000
IDR 250 –500 million	200,000
IDR 500 million– IDR 1 billion	400,000
IDR 1–100 billion	800,000
IDR 100 –500 billion	1,600,000
IDR 500 billion– IDR 1 trillion	3,200,000
More than IDR 1 trillion	6,400,000

Primary interactions with FIs under this study revealed that the actual cost for registration including notary charges and other unofficial costs is much higher. The actual costs provided by FIs (including fiducia registration cost and the notary fees)<sup>102</sup> are:

- a) IDR 1 million for a IDR 1 billion loan
- b) IDR 700,000 for a IDR 500 million loan
- c) IDR 175,000 for a IDR 50 million loan

Global benchmarks suggest that the cost of Fiducia registration range around USD 5 for every asset registration. When compared to the global benchmarks, the current cost structure of Fiducia registration in Indonesia is fairly high and could potentially be lowered in times to come.

#### 6.2.4. Collateral Execution

##### 6.2.4.1. Financial Institution Challenges

###### 6.2.4.1.1. Priority of Collateral

In Indonesia, an asset can be collateralized only once until the debt against the asset is paid off. In case of double collateralization, the Fiducia law prioritizes the creditors based on the date of registration, leaving the second lender unprotected. Currently, the Fiducia registry does not capture the unique identification number of collateral, making it difficult to cross-check against the re-registration of the same asset with a different lender. In the past there have been cases where a motorcycle was pledged as collateral with a cooperative and then pawned with PT Pegadaian. In such cases, FIs have to undergo a lengthy and costly legal case to claim execution rights on the collateral.

<sup>101</sup> Ministry of Law and Human Rights (Government regulation No 19 of 2007).

<sup>102</sup> Based on primary interaction with 53 MFI/MFI Holding Companies across Jakarta, East Java and Central Java and 14 large commercial banks in Indonesia. Details of the interviewees have been mentioned in the appendix.

#### 6.2.4.1.2. Asset Degradation and Loss

Assets pledged under the Fiducia law remain in possession of the debtor. Improper use of pledged assets leads to asset degradation and devaluations. Considering that movable collateral can be stolen and also hidden at the time of enforcement further complicates the possibility of exercising movable collateral for lending. Unavailability of unique identification numbers for collateral makes it easier for debtors to replace it. Anecdotal evidence suggests that there have been cases in which parts of high-end motorcycles were replaced with cheaper parts.

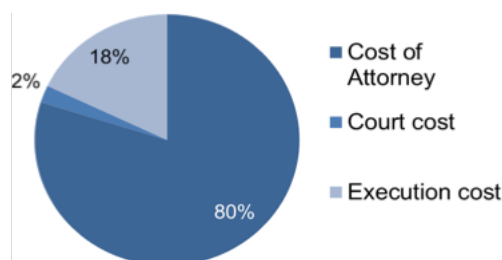
#### 6.2.4.1.3. Lengthy and Costly Process

The Fiducia law gives the creditor executionary right and not the right to ownership over the pledged asset in case of default. FIs have stated that this has caused specific problems especially when Police Departments become involved. While the fiducia law provides the executionary right of the asset, the information on the asset registry is not passed on to the Police Department. Considering that the asset is still legally owned by the debtor, the police officers generally ask for a court document to allow repossession. This leads to a lengthy and costly legal process.

#### Enforcement Cost

As per the World Bank Doing Business Report (2014), the cost of enforcing contracts in Indonesia is 139 percent of the value of contract and among one of the highest in the world. It should be noted that the cost of police involvement is not included in this estimate. Comparison with other geographies has been captured in Section 8.1.

**FIGURE 53: ENFORCEMENT COSTS**



#### 6.2.5. Challenges Related to Technical Capacity of Financial Institutions

Many FIs are facing significant capacity-related challenges especially while lending to MSMEs. Though these challenges are FI specific, the inefficiencies created significantly impact the MSME lending sector.

##### 6.2.5.1. Attrition

Attrition is identified as a significant challenge especially for FIs in microbanking. Movement of professionals is seen across cooperatives, Unit Desa, BPRs and microbanking units of major banks. Relationships and comfort level between loan officers and debtors is key in this sector. Relationships also play an important role when the debtor graduates from micro to the small/commercial category.

### 6.2.5.2. Technical Capability of Human Capital

Understanding and awareness of the risks associated and valuation mechanism of various types of movable collateral is considered to be one of the key challenges for movable assets based lending. Many FIs have also pointed out that skill and lack of technical know-how of human resources required for management of movable collateral of a dynamic nature (such as inventory and accounts receivable), and perceived complexity of the warehouse receipt business model, are the key reasons for minimal lending on such movable assets.

### 6.3. Summarizing Key Challenges

The challenges in the lending process highlighted above can be broadly classified as 1) technical capacity and awareness related challenges, 2) infrastructural challenges and 3) challenges resulting from inadequate regulations and legal provisions. These challenges are further explained below.

Technical Capacity and Awareness Related Challenges
MSME awareness regarding loan process and documentation
FI capacity related to valuating collateral, managing movable collateral and determination of risks in movable assets based lending
Inadequate knowledge among Police about Fiducia laws
Infrastructural Challenges
Data gaps in the credit bureau (SID)
Data gaps in the Fiducia registry, unavailability of cross checking facility and high cost of registration
Limited number of notaries, surveyors and warehouse managers
No information integration to track credit history, assets collateralized and interaction with the law enforcement (police) information
Inadequate warehouse infrastructure
Challenges Resulting From Inadequate Regulations and Legal Provisions
No protection for creditor with second lien
No guidelines for lending on accounts receivable
Lax enforcement laws in case of defaults
Lax enforcement laws in case of defaults



## 7. Key Recommendations

As identified in the challenges section, improvements and initiatives are required:

a) to enhance technical capacities of all stakeholders; b) for integration and upgrading of supporting infrastructure (databases and registries); and c) in current laws and regulations.

Key recommendations for improving movable assets based lending to MSMEs are:

Awareness Creation and Capacity Building
Raising MSME awareness about loan requirements and building technical capacity in loan documentation (financial statement)
Building FI capacity in asset valuation and risk associated with collateral
Raising Notaries and Police awareness about Fiducia laws
Centralized and Accessible Infrastructure
Greater credit bureau penetration among FIs
Cheaper and more accessible Fiducia with specifics on collateral and search capability
Cross-linking information between credit bureaus, Fiducia and police databases
Stronger Laws and Comprehensive Regulation
Creditor priority and stronger enforcement rights post default
Regulation and guidelines to lend on movable collateral, for example accounts receivable

### 7.1. Awareness Creation and Capacity Building

#### 7.1.1. Capacity of MSMEs

##### 7.1.1.1. Awareness and Capacity Building Related to Loan Documentation

It has been observed that most of the challenges faced by MSMEs are perceived in nature; hence it is important to create awareness about lending practices including collateral and documentation for MSMEs. BI has taken many steps to increase awareness. These include:

- Issuance of PBI no. 14/22/PBI/2012 which addresses technical capacity building of MSMEs,
- Development of templates for financial statements of MSMEs and pilot project for their adoption, and
- Development of MSME rating tool.

While BI consistently endeavors to increase technical capacity of MSMEs, additional steps need to be taken to increase awareness and penetration of these programs.



#### **7.1.1.2.Improving Enterprise Registrations**

MSMEs also face significant challenges in the registration process. These include:

- a) Perception by MSMEs that registration with the MoLHR or the Directorate General of Taxation would increase their tax liability, and
- b) Lack of possession of trade licenses by many MSMEs, and the fact that many are not registered with local governments.

The MoLHR, the Ministry of Cooperatives and Small and Medium Enterprises (MCSME) and other relevant central and local governments need to assist MSMEs in getting registered. This can be achieved by registration camps or by setting up one-window services as proposed by the MCSME.

#### **7.1.2. Capacity of Financial Institutions**

Human capital is a key concern for FIs especially in the microbanking space. There is a need to increase the supply of microbanking professionals to keep pace with the increasing demand. Many specific training and awareness programs are required as mentioned below:

- a) Training in understanding of MSME business,
- b) Capacity building for movable assets based lending especially to loan officers, enabling them to make informed decisions,
- c) Awareness about technical guidelines on movable assets based lending,
- d) Valuation of movable assets, and
- e) Movable collateral management especially for dynamic collateral like inventory.

BI has initiated specific programs for increasing capacity of FIs, especially focused on MSME lending. Other regulators including OJK and the MCSME need to undertake similar initiatives.

#### **7.1.3. Capacity of Other Stakeholders**

The lending process involves many stakeholders such as police officials, notaries and lawyers. Specific training needs have been identified for these stakeholders.

- Police officials: The Police Department is involved in the collateral execution process. Limited awareness about the Fiducia law among police officials has been identified as a key challenge.
- Notaries: The notary is the critical link between FIs and the Fiducia registry. The limited number of notaries registered with the online fiducia system is a bottleneck in the registration process. Efforts need to be undertaken to increase the number of notaries registered with the Fiducia system.
- Warehouses and surveyors: Lack of warehouse infrastructure is limiting the penetration of warehouse receipts-based financing. In addition there is a need to increase the supply of surveyors and valuers to increase both conventional and warehouse based lending.

As the capacity building requirements for police officials and notaries are related to the Fiducia law, the MoLHR would be the key in implementing this recommendation.

## 7.2. Centralized and Accessible Infrastructure

### 7.2.1. Credit Bureau

The current operational credit bureau, SID, is managed by BI. Currently only 120 commercial banks, 1304 rural banks and 20 NBFIs are members of SID. Although the members of the credit bureau supply 70 percent<sup>104</sup> of the formal supply to MSMEs, data for most of the microenterprises availing loans from cooperatives and other MFIs is not captured. Thus there is a need to develop a comprehensive credit bureau with complete credit history of MSMEs. This would improve financial access of MSMEs.

It should be understood that the credit bureau is a closed system with proprietary data. Through regulation 15/1/PBI/2013, BI has opened the credit information sharing practice to private entities (LPIP). These new LPIPs should target larger penetration across the financial landscape along with capturing other relevant credit data like utility payments.

### 7.2.2. Fiducia System

- a) **Accessibility:** The Fiducia system moved online in February 2013, but is accessible only to notaries. The unavailability of notaries is a key concern. Therefore, like SID, the Fiducia registry should be directly accessible to FIs.
- b) **Cost rationalization:** The cost of registration (including notarizing cost) is high in Indonesia. Internationally the cost of registration is below USD 5<sup>105</sup>. Cost of updating dynamic collateral and issuance of duplicate certificates needs to be rationalized.
- c) **Specifics on collateral:** The collateral registry could include additional fields to enter specifics of the collateral (such as the chassis number of vehicles).
- d) **Digitization of old data:** As the registry only moved online in February 2013, the old manual data needs to be digitized to facilitate the search facility.
- e) **Increase of penetration:** As per Indonesian Central Auditor reports, the registry is losing revenue of IDR 300 billion as against an income of IDR 70 million. This depicts that the registration on the registry is not exhaustive; efforts need to be taken to increase adoption of the registry among FIs.
- f) **Cross-checking facility:** Data gaps, manual data and inadequate parameters make it difficult to cross-check the asset collateralization status. This allows duplicate registration on the same assets.

As the Fiducia system is currently managed by the MoLHR, it should play an important role in implementing the recommendations.

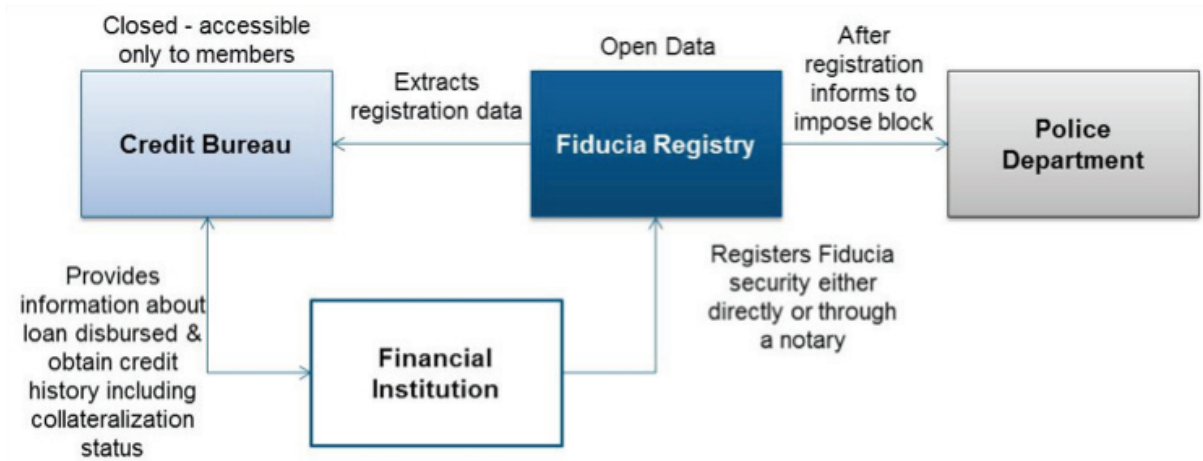
<sup>104</sup> Based on supply side estimation, of credit to MSMEs, from different sources such as banks, MFI, other financial institutions etc. Further accounting for rural banks in the SID system and few NBFIS, 70% has been estimated.

<sup>105</sup> Making security Interests Public: Registration Mechanisms in 35 Jurisdictions, IFC. Further countries shortlisted for Global Best Practices, Vietnam, China and Ghana, are further referred to in the section 8 below.

**7.2.3. Linkages between the Credit Bureau, the Fiducia Registry and the Police Database**

Currently, FIs need to interact with all three agencies to sufficiently manage their risks. An inter-linked database would help FIs as it would reduce time and cost.

**FIGURE 54: PROPOSED INTEGRATED SYSTEM**



Under the proposed system, during the loan approval system an FI obtains all the relevant data from the credit bureau. However, during the loan disbursement process, the FI needs to interact with both the credit bureau and the FRO. The FRO would inform the Police Department after the Fiduciary security is registered.

**7.3. Laws and Regulations**

**7.3.1. Stronger Creditors' Rights**

Indonesian laws have certain provisions defining creditor priority. The current laws give creditors merely executionary right in case of default as against right to ownership, even in cases where the debtor agrees to transferring the security. Limited knowledge of the Fiducia law among police personnel makes it necessary to take a legal recourse. Quick and simple enforcement would help improve creditors' rights and further improve movable assets based lending. Though the law currently provides for a publicly accessible security registry, the creditors lack access to this critical information. The provision of a system to easily access the information of existing securities would significantly help in assuring the rights of the creditors.

The SOBs in Indonesia are required to enforce securities through the public auction route, whereby the value realization is lower than market rate. Designing laws similar to the Indian Securitization Act of 2003 which allow SOBs to enforce security out of court would help improve movable assets based lending from state-owned FIs in Indonesia. In India, the time for execution of collateral has dropped from 10 years to nine months. It should be noted however that though this act has significantly reduced the time for execution, IFC is working with Indian agencies such as Central Registry of Securitization Asset Reconstruction and Security Interest of India (CERSAI) to improve other aspects of regulation related to movable assets based lending,

Currently various types of interest over assets including the Fiducia registry, financial leases, long-term operating leases, secured sales etc., are governed by different laws in Indonesia. A single comprehensive legal framework should be implemented in which all these non-possessionary interests could be considered as equal in defining the priority and rights of the creditors.

### 7.3.2. Improved Regulations

Currently, accounts receivable are not allowed to be deducted while calculating the provision for asset losses. Guidelines to lend against accounts receivable would improve financial access to MSMEs, as they constitute a significant proportion of the MSMEs asset base.

## 7.4. Mapping Recommendations for Lending Process

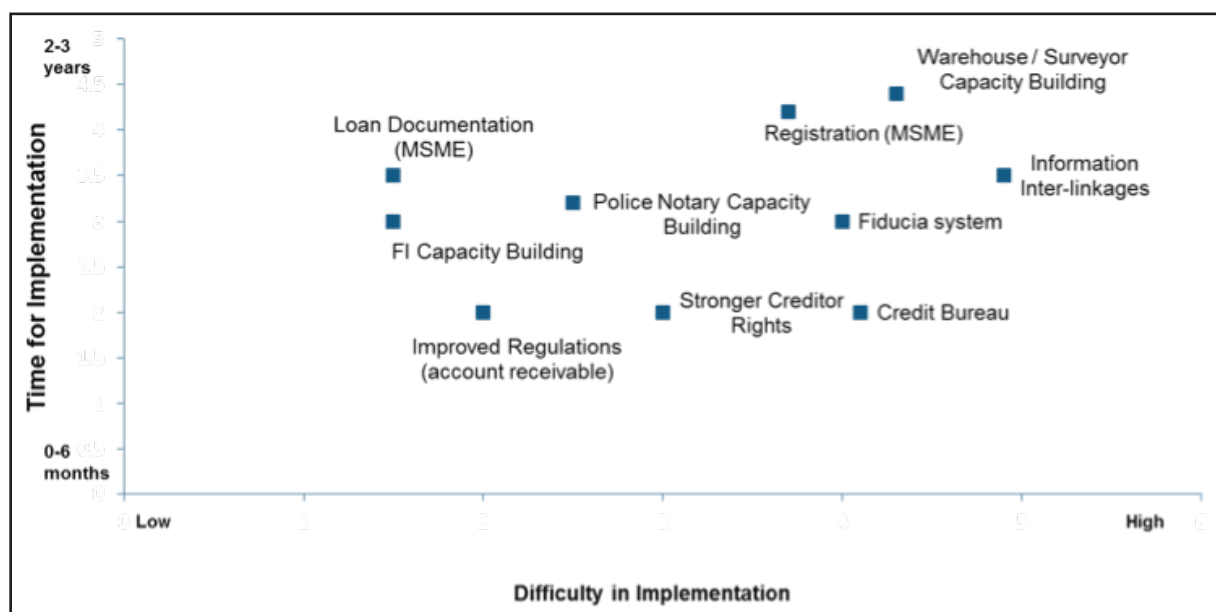
**TABLE 27: RECOMMENDATIONS FOR LENDING PROCESS**

Impact on Lending Process					
Recommendation	Application	Approval	Disbursement	Execution	Implementing Agency
Awareness Creation and Capacity Building					
MSME capacity					
Loan Documentation	Yes				BI & OJK
Registration	Yes	Yes			MOLHR, MCSME
FI Capacity		Yes	Yes		BI & OJK
Police & Notary			Yes	Yes	MOLHR
Warehouse & Surveyor		Yes	Yes		Ministry of Agriculture & others
Centralized and Accessible Infrastructure					
Credit Bureau		Yes			BI & new LPIPs
Fiducia System		Yes	Yes	Yes	MOLHR
Inter linkages		Yes	Yes	Yes	BI & new LPIPs, OJK, MOLHR, Police Department
Laws and Regulations					
Stronger Creditors' Rights		Yes		Yes	Ministry of Finance & MOLHR
Improved Regulations		Yes			BI & OJK

## 7.5. Identifying Low-Hanging, High-Impact Recommendations

### 7.5.1. Analysis of Ease of Implementation vs. Time for Implementing

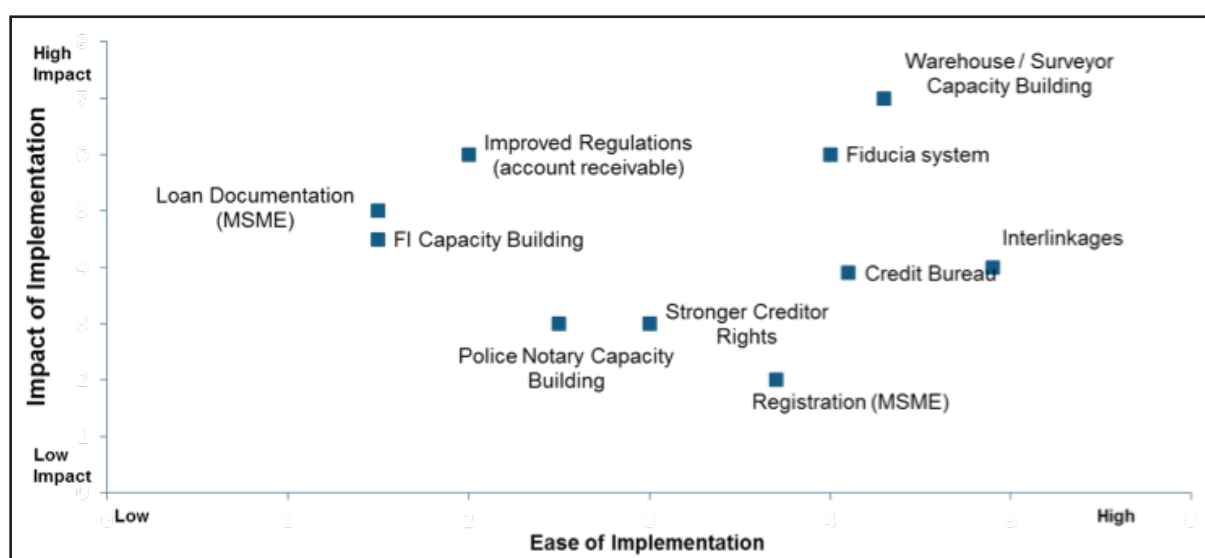
**FIGURE 55: EASE OF IMPLEMENTATION VERSUS TIME FOR IMPLEMENTING**



The categorization of the recommendations has been done based on involvement of multiple stakeholders in and the estimated duration for the implementation. Capacity building of FIs and other stakeholders constitutes a “low-hanging fruit”. Owing to the large number of MSMEs, the overall time taken for implementation of MSMEs’ technical capacity building and awareness raising is fairly long. The success of interlinking the SID, the Fiducia and the police database depends on the improvements made in the Fiducia and the credit bureau system, making it a costly and time-consuming affair.

### 7.5.2. Analysis of Ease of Implementation vs. Impact

**FIGURE 56: EASE OF IMPLEMENTATION VERSUS IMPACT**



In developed countries, accounts receivable based lending forms a significant proportion of movable MSME lending. In Indonesia, the accounts receivable form a significant proportion of the MSMEs' assets. Thus improved regulation for accounts receivable is a high-impact activity. The other high-impact recommendations are improving infrastructure for warehouse receipts and improvements in the Fiducia system. Though time consuming and difficult to implement, these are needed for long-term sustainable development of the MSME financing sector.

## 8. International Best Practices

According to the Enterprise Survey, around 32.5 percent of SMEs internationally identify access to financing as a major constraint to their businesses. One of the key reasons for poor access to financing has been identified as lack of acceptable collateral. In the developing world, 78 percent of the capital stock of businesses is typically in movable assets such as machinery, equipment or receivables, and only 22 percent in immovable property. In economies with a modern secured transactions system, these assets could easily be used as collateral. But in many developing economies movable property might be unacceptable to lenders as collateral – either because the law does not recognize non-possessory interests in movable collateral or because it does not provide sufficient protection for lenders accepting it.

IFC has developed the Secured Lending Program to promote and facilitate the development of efficient secured transactions systems and collateral registries, resulting in expansion of access to finance especially for SMEs.

### 8.1. Indonesia in Comparison with Other Developing Economies

When compared with other developing economies such as Ghana, Vietnam and China, Indonesia performs poorly on broad parameters such as firm registration, getting credit and contract enforcement.

**TABLE 28: COMPARISON OF INDONESIA WITH OTHER DEVELOPING ECONOMIES<sup>106</sup>**

Parameters	Ghana	Vietnam	China	Indonesia
<b>Firm Registration</b>				
Time taken to register a firm (days)	14	34	33	48
Cost to register a firm (% of income per capita)	15.7	7.7	2.0	20.5
<b>Getting Credit</b>				
Doing Business rank to get credit	28	42	73	86
Depth of credit information index (0 indicating worst position – 6 indicating better position)	5	4	5	4
Public registry coverage (% of adults)	0	39.1	30.2	41.2
Private registry coverage (% of adults)	10.4	0	0	0
<b>Strength of Legal Rights</b>				
Strength of legal rights index (0 indicating worst position – 10 indicating best position)	8	8	5	5
Non-possessory use of movable collateral	Yes	Yes	Yes	Yes
Does the law allow parties to agree in a collateral agreement that the creditor may enforce its security right out of court?	Yes	Yes	No	No
<b>Enforcing Contract</b>				
Doing Business rank 2014	43	46	19	147
Time taken for contract enforcement (days)	495	400	406	498
Cost (% of claim)	23	29	11.1	139.4
Enforcement cost (% of claim)	10	3	1.2	25

<sup>106</sup> Doing Business Report 2014, The World Bank.

**Firm Registrations** – Globally, Indonesia ranks at 175 out of 189 economies on ease of starting a business. The average number of days required to start a business is high when compared to other developing economies such as Ghana, Vietnam and China. Though Indonesia made efforts in 2012 to improve the application process by allowing applicants to simultaneously obtain both a general trading license and a business registration certificate, this has not significantly improved its performance vis-à-vis other economies.

A major cost involved for an enterprise to register its business in Indonesia is for notarizing company documents (IDR 4,464,464/USD 450) and fees for legal services (IDR 200,000/USD 20 for name check + IDR 1,580,000/USD 158 non-tax state revenue, PNPB fees for legal service). These costs are exempted for a micro and small sized company in China; are around USD 5 in Ghana for name search and approximately USD 100 for other fees; and under USD 125 in Vietnam (which includes USD 10 for name search as well as business registration and tax registration certificate).

**Getting Credit** – The depth of credit information index measures the coverage, scope and accessibility of credit information available through a public credit registry or a private credit bureau. It also includes strength of legal rights of lender through collateral laws.

As compared to China, Ghana and Vietnam, the credit information bureau in Indonesia does not distribute more than two years of historical credit information. This does not allow the lender to assess the repayment capacity of the borrowers, and acts against making prudent lending decisions. Furthermore, when compared to Ghana and Vietnam, Indonesia needs to improve its legal rights for lenders in regards to collateral registry.

**Strength of Legal Rights** – As a part of credit index, strength of legal rights assess rights of borrowers and lenders through collateral laws and protection of secured creditors' rights through bankruptcy laws.

Indonesia does not have a functional online registry for assets that is unified geographically and by asset type, with an electronic database indexed by debtor's names. This when compared to Ghana and Vietnam acts as a deterrent for the lender to ascertain imposition of guarantee on the collateral, and prevents clear establishment of its rights in case of default. In addition, secured creditors are not paid first in the event of insolvency of the debtor or when the debtor defaults. As compared to other developing economies, laws in Indonesia do not allow the creditors to enter into an agreement at the time of lending that out of court settlement of the collateral may be initiated by the creditor in case the borrower defaults. This increases the enforcement time and cost for the creditor.

**Enforcing Contracts** – Concerning the time taken and cost incurred to enforce a contract in Indonesia, filing a court case in Indonesia takes approximately 100 days, as compared to other economies like Ghana and China in which it takes less than 20 days.



The overall cost of a claim, which is as high as 140 percent of claim value, makes judicial proceedings for enforcement economically nonviable. The cost of attorney is maximum in Indonesia (111 percent of claim), when compared to China (7.6 percent of claim), Ghana (10 percent of claim), and Vietnam (21 percent of claim).

## 8.2. Current State of Secured Transactions in Indonesia

FIs in Indonesia lending to MSMEs prefer immovable collateral such as land and building, and lend only on vehicles as movable collateral. There are some MFIs which lend on other movable collateral such as accounts receivable, consumer durables, etc. but their share in the total MSME lending is very insignificant.

Lack of clarity on regulations for movable assets based lending, high cost and other constraints of collateral registry and inadequate enforcement laws are major challenges for growth of this business. These challenges have been successfully addressed in other developing economies through secured transaction reforms, which improved access to finance for MSMEs. Case studies on countries such as Vietnam, Ghana and China are discussed below.

## 8.3. International Best Practices for Secured Transactions

Globally, implementation of the collateral registry for movable assets has increased firms' access to finance by around 8 percent, with the largest impact on smaller firms. Access to women entrepreneurs has improved, with women-owned businesses accessing credit based on non-land collateral.<sup>107</sup>

### 8.3.1. Vietnam

In Vietnam, regulations to use movable assets as collateral have been in place since 1999, as Decree 165 of the Civil Code of Vietnam, but subsequent amendments to the act have led to restrictive practices to lend against movable collateral. State-owned commercial banks and private banks provided commercial loans secured by movable collateral only as a supplementary collateral. Lending was biased towards real estate which was used as the most preferred collateral by banks, followed by machinery and equipment. Lenders faced enforcement issues on movable assets.

The Civil Code of 2005 introduced reforms for secured transactions. This Code contains provisions on movable property as security that are broadly in line with those in the original Decree 165. The new regulations allowed all types of movable property to be used as collateral, including property that arises in the future. It also confirmed payment priority of the creditors and reduced registration time of the movable assets. The online registry was launched in March 2012, and is managed by the Ministry of Justice.

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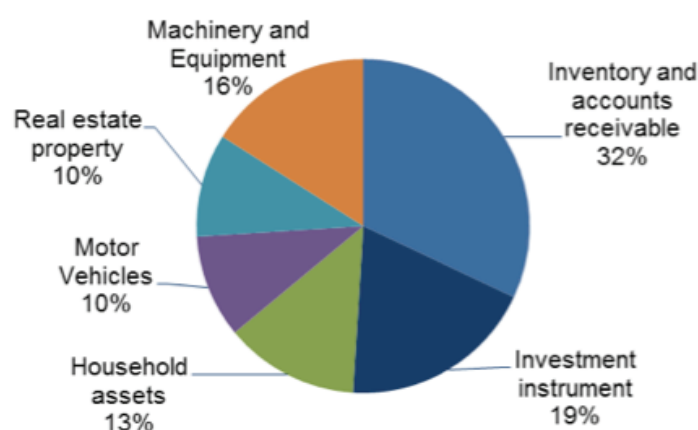
<sup>107</sup> Collateral Registries for Movable Assets: Does Their Introduction Spur Firms' Access to Bank Finance?, Inessa Love, María Soledad Martínez Pería, Sandeep Singh, World Bank, Policy Research Working Paper 6477, June 2013

### 8.3.2. Ghana

Before 2008, 85 percent<sup>108</sup> of the lending activities in Ghana were mainly concentrated around state-owned enterprises and large corporate clients (both local and foreign), due to their low risk profile.

FIs had limited portfolios towards MSME lending due to lack of collateral or the risk that the same collateral would be used for multiple loans. SMEs were given loans only in cases involving immovable assets such as land to offer as collateral. Lending to new clients who did not have past credit records was riskier since there was no credit information bureau to share past credit history of the borrowers. Identifying the need of a strong law defining borrowers and creditors' rights, the Ghanaian Government passed the Borrowers and Lenders Act in 2008 and subsequently (2010) a collateral registry was established in the Bank of Ghana. By June 2013 more than 53,000 security interests had been registered by FIs. These account for more than USD 10 billion in loans secured with movable property – loans that have benefited more than 7,000 SMEs and 30,000 microenterprises. More than 10,000 women entrepreneurs received formal finances<sup>109</sup>.

**FIGURE 57: TYPE OF COLLATERAL REGISTERED**



The collateral registry and law has also increased the confidence of banks and NBFIs taking movable property as collateral: out of 52 FIs, 39 institutions (17 banks, 16 NBFIs, four foreign-based banks and two rural banks) have registered with the collateral registry and granted loans secured with movable property.

### 8.3.3. China

China has a large number of SMEs whose assets are mostly in the form of equipment, inventory and receivables. Lack of credit has been cited as one of the most significant constraints for businesses in China<sup>110</sup>.

Secured transactions laws in China restricted the use of movable collateral. Due to this unfavorable legal framework and lack of knowledge, lenders did not want to take movable assets as collateral. This resulted in Chinese businesses holding more than USD 2 trillion as “dead capital” (their movable assets).

<sup>108</sup> “It Started In Ghana: Implementing Africa’s First Collateral Registry”, Smartlessons, IFC, December 2012.

<sup>109</sup> Getting Credit, Doing Business Report, World Bank, 2014.

<sup>110</sup> China 2005/2006, SME Finance Survey (1,000 SMEs in Five Cities)

China enacted the new Property Law in China in 2007, adopting a number of important principles of a modern secured transactions system and opening up the scope for movables lending (including receivables). The law also sets up a clearer priority rule and provides a better basis for enforcement. Further, registries for accounts receivable and leasing were created in October 2007 and 2009 respectively. These were managed by the Credit Reference Center, People's Bank of China. The online registry, accessible to the public, helped in disseminating creditors' information and defining creditors' priority over movable collateral. As of June 30, 2011, more than 385,000 transactions have been registered, facilitating USD 3.58 trillion accounts receivable financing including USD 1.09 trillion of SME lending in China. In addition, the total number of commercial loans involving movable finance grew by 21 percent per year over 2008–10. These interventions also had a significant effect on leasing and factoring markets. The lease registry has recorded 35,426 leasing transactions cumulatively. The value of factoring grew from 2.6 billion Euros in 2003 to 67.3 billion Euros in 2009, according to data from Factors Chain International. Four of the five big banks have reported an average 25 percent CAGR of their movables lending over 2008–2010 (2 percent over 2006–08).

Similar interventions in Liberia, Malawi, Honduras, and Mexico have improved the access to financing in these countries.

#### 8.3.4. Coverage of Movable Assets in Other Economies

As a part of secured transaction reforms, different movable assets have been allowed by country-specific regulations to be registered for collateralize lending. Except in the case of China, where accounts receivable are the only movable assets to be registered, almost all other types of movable assets have been allowed to be registered to ease lending to MSMEs.

**TABLE 29 : TYPES OF ASSETS WHICH CAN BE REGISTERED WITH THE COLLATERAL REGISTRY<sup>111</sup>**

Types of Assets	Bangladesh	Cambodia	Canada	China	Kenya	Malaysia	US (Texas)
Machinery and equipment	Y	Y	Y	N	Y	Y	Y
Motor vehicles	Y	Y	Y	N	Y	Y	N
Agricultural products	Y	Y	Y	N	Y	Y	Y
Livestock	Y	Y	Y	N	Y	Y	Y
Investment property	Y	Y	Y	N	Y	Y	Y
Financial instruments	Y	Y	Y	N	Y	Y	Y
Intellectual property	Y	Y	Y	N	Y	Y	Y
Accounts receivable	Y	Y	Y	Y	Y	Y	Y
Inventory	Y	Y	Y	N	Y	Y	Y

<sup>111</sup> Making security Interests Public: Registration Mechanisms in 35 Jurisdictions, IFC.

#### 8.4. Key Learnings From Global Secured Transaction Reforms

Implementation of secured transaction globally has improved the status quo of financing for MSMEs. Major highlights of secured transaction programs can be summed up as indicated below,

##### Credit Information

- Secured transaction reforms improving the disclosure standards of borrowers and lenders
- Licensing private credit bureaus with access to government databases
- Basic data on credit, details of lenders and borrowers and linking to the data on collateral used, which in turns is collected in a notice-based filing system
- Allowing borrowers to examine their own credit history

##### Collateral Registry

- Modern centralised registry, managed by financial institutions or a government body having strong influence on the financial system of the country
- Low/flat fees for registration, amendments, searches and certificates (average below USD 5)

##### Enforcement

- Incorporating specific rules about priority of creditors by date of registration, rules on proceeds, buyers of collateral, special priority, etc.
- Allowing lenders to initiate out-of-court settlement in case of defaults, and allowing private sale of collateral at market prices

## **CHAPTER IV: APPENDICES**

# Appendix I

## Rationale for Selecting the Primary Respondents

### Key Sectors

The key sectors for the study are identified based on the total number of enterprises, employment statistics, GDP contribution, asset size, sales, demand for and supply of financing.

**TABLE 30: IDENTIFIED KEY SECTORS**

Sector	Rationale for Selection
Agriculture	<ol style="list-style-type: none"> <li>1. Ranked first in terms of MSME enterprises (51.5% of total MSMEs)</li> <li>2. Largest workforce (46.7% of total MSMEs)</li> <li>3. Second highest GDP contribution ( 23.4 % of the MSME contribution)</li> <li>4. Highest estimated debt demand (IDR 2786 trillion)</li> <li>5. Highest estimated demand supply gap ( IDR 2661 trillion)</li> </ol>
Trade, Hotel and Restaurants	<ol style="list-style-type: none"> <li>1. Ranked first on all parameters in the small enterprise segment</li> <li>2. Highest GDP contribution (29.9% of the MSME contribution)</li> <li>3. Second highest employment count (26.7%) and enterprises count (28.9%) among MSMEs</li> <li>4. Highest estimated supply of debt (50% of the MSME supply)</li> </ol>
Manufacturing	<ol style="list-style-type: none"> <li>1. Consistently rank high in all parameters in MSMEs</li> <li>2. Third highest GDP contribution (14.77 % of the MSME contribution)</li> <li>3. Employs 45% of the MSME workforce in medium segment enterprises</li> </ol>

The three identified sectors contribute to 68 percent of the total MSME GDP contribution and employ 85 percent of the total MSME workforce.

### Key Geographies

The key geographies are identified based on the MSMEs' concentration, geographic distribution of lending to MSMEs and potential to MSME finance. The key industrial sectors have also played an important role in selection of geographies.

**TABLE 31: IDENTIFIED KEY GEOGRAPHIES**

Geography	Rationale for Selection
DKI Jakarta	<ol style="list-style-type: none"> <li>1. Ranks first in the MSME lending (17.1% of the total MSME lending)</li> <li>2. Ranks fourth in the MSME concentration (5% of all MSMEs)</li> <li>3. Key sectors are manufacturing, THR and finance</li> </ol>
East Java	<ol style="list-style-type: none"> <li>1. Ranks second in the MSME concentration (18.5% of all MSMEs)</li> <li>2. Ranks third in the MSME lending (13% of the total MSME lending)</li> <li>3. Ranked second in potential for the MSME finance ranking by BI</li> <li>4. Key sector is Agriculture</li> </ol>
Central Java	<ol style="list-style-type: none"> <li>1. Ranks third in the MSME concentration (16.3% of all MSMEs)</li> <li>2. Ranks fourth in the MSME lending (10% of the total MSME lending)</li> <li>3. Ranked third in potential for the MSME finance ranking by BI</li> <li>4. Key sectors are Agriculture and THR</li> </ol>

Based on the above selection a total of 34 MSMEs were interviewed across Jakarta, East Java and Central Java. These regions cover 40 percent of all MSMEs in Indonesia and receive 40 percent of debt received by MSMEs in Indonesia.

## Identified Commercial Banks

**TABLE 32: LIST OF BANK RESPONDENTS**

Bank Name	
PT Bank DKI	<p><b>Different criteria for selecting banks,</b></p> <ul style="list-style-type: none"> <li>• <b>Bank Type</b> – Bank respondents have been identified from all the bank categories, i.e. state owned banks, domestic private banks, regional development banks and JV &amp; foreign owned banks</li> <li>• <b>MSME lending as a part of the portfolio</b> – Bank respondents have their MSME lending in the following ranges, <ul style="list-style-type: none"> <li>– Below 10% - Low</li> <li>– 10% to 30% - Medium</li> <li>– Above 30% - High</li> </ul> </li> <li>• <b>Overall contribution to MSME lending in Indonesia</b> – Banks have also been selected on the basis of their overall contribution in the MSME lending in Indonesia</li> </ul>
PT. BPD Jawa Timur	
PT Bank Rakyat Indonesia (PERSERO), TBK	
Bank BRI Syariah	
Bank BTPN	
Bank Negara Indonesia	
Bank Panin	
Bank International Indonesia	
Bank Danamon	
PT Bank Maumalat Indonesia	
PT Bank Andara	
Bank Windu Kencana	
Bank ICB Bumiputera	
SBI	

## Identified MFIs

The MFIs surveyed are identified based on specific geographical locations. The other key criteria include the following:

- For BPRs, asset size is in the range of IDR 10–500 billion,
- For BPRs, the minimum number of clients should be 1,000, and
- For Cooperatives, the minimum number of clients should be 500.



**TABLE 33: IDENTIFIED MFIs**

Geography	Name of MFI
Jakarta	<b>MFI Associations</b>
	1. INKOPDIT
	2. Perbarindo
	<b>MFI Holding Companies</b>
	1. ANS Group
	<b>MFIs</b>
	1. BPR Dana Berkah Lestari
	2. BPR Naribi
	3. Koperasi Baytul Ikhtiar/BAIK
	4. KOMIDA (W)
	5. Bina Artha Ventura (W)
	6. Credit Union Bina Mandiri
	7. Prima Cooperative (W)
	8. Amarta Microfinance
	9. Koperasi Mitra Usaha Mandiri
	10. BMT Ibadurrahman
	11. Vision Fund Indonesia
	12. BMT ITQan
	13. BPR NBP 27
	14. BPR Sari Kusuma Surya
	15. BMT Sanama
	16. BMT Mardlotillah
	17. Koperasi Bina Karya
	18. BMT Al Falah
	19. Koperasi Sejahtera
	20. BPR Hisobhan
	21. Kospin Surya Kencana
East Java	<b>MFI Associations</b>
	1. Perbarindo East Java
	<b>MFIs</b>
	1. Credit Union Sawiran
	2. BPR Artha Kencana Madiun
	3. Credit Union Kosayu
	4. BPR Artha Nawa
	5. Pantai Perigi Cooperative
	6. Pancaran Bahagia Cooperative
	7. BPR Porong Idaman
	8. BPR Mulyo Rahardjo/Rachmat
	9. BPR Polatama Kusuma
	10. BPR Kabupaten Madiun
	11. KBPR Takeran
	12. BPR Hamindo Natamakmur
Central Java	<b>MFIs</b>
	1. MDM Cooperative Salatiga
	2. Koperasi Qaryah Thayyibah
	3. Kopeasi Gedong Songo
	4. BPR Dinamika Bangun Artha
	5. KSP Mitra Usaha Mandiri
	6. BPR Mekar Nugraha Klepu
	7. Sarana Bhakti Cooperative
	8. BPR Argo Dana, Semarang
	9. BPR Bank Klaten
	10. BPR Restu Klepu Makmur
	11. BPR Artomoro
	12. BPR Surya Yudha Kencana
	13. Koperasi Setara
	14. KSP Merapi Mulia
	15. Kopdit Anna
	16. BPR Chandra Muktiartha

(W) indicates MFIs lending to female entrepreneurs only.

**Stakeholders**

**TABLE 34: IDENTIFIED STAKEHOLDERS**

Stakeholder	Name
MCSME	Regulator
OJK	Regulator
Bank Indonesia	Regulator
Coordinating Ministry of Economic affairs	Regulator
IWAPI (Women Entrepreneurs Association)	Association
Ministry of Law and Human rights	Fiducia Registrar
Chamber of Commerce and Industry	Organization of business chambers and associations

**Other Financial Institutions**

**TABLE 35: OTHER STAKEHOLDERS**

Stakeholder	Name
PT Pegadaian	Pawnshop
PT Sumber Arthamas Finance	Multifinance company
Koperasi Selaras	Cooperative and warehouse manager for corn
Dr Tulus Tambunan	Industry expert

## Appendix II

### Questionnaire for MSMEs

#### General Information

Name of Company:

Primary Business:

Name of the owner of the enterprise

Gender of the owner of the company:

Telephone/Mobile/Fax Number:

Email address :

Address:

I. Is your company registered with the Ministry of Law and Human Rights?

☐ Yes ☐ No

II. If yes, what are the main challenges faced by your organization in registration?  
(e.g. time consuming process, documentation not available)

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III. If not, what are the reasons for not getting registration?

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IV. What is the nature of Ownership of your organization?

- |                                  |                          |                       |                          |
|----------------------------------|--------------------------|-----------------------|--------------------------|
| 1. Listed Company                | <input type="checkbox"/> | 5. Partnership        | <input type="checkbox"/> |
| 2. Private Company Ltd           | <input type="checkbox"/> | 6. Closed Corporation | <input type="checkbox"/> |
| 3. Sole Proprietor               | <input type="checkbox"/> | 7. Incorporated JV    | <input type="checkbox"/> |
| 4. Other (Please describe below) | <input type="checkbox"/> |                       |                          |
- 

V. Number of employees in your organization?

1. On firms payroll\_\_\_\_\_ 2. Contractual\_\_\_\_\_

VI. Number of female employees in your organization

1. On firms payroll\_\_\_\_\_ 2. Contractual\_\_\_\_\_

VII. Do you have a bank account?

☐ Yes ☐ No

VIII. With whom? \_\_\_\_\_  
(Also mention if it is a Bank – Commercial, BPD, MFI)

### Information on Firm Assets

Please provide information on asset size of the firm in IDR million

IX. Total assets of the firm: \_\_\_\_\_ IDR million

X. Provide distribution of firm's assets across asset categories (IDR million)

- |                              |                                 |
|------------------------------|---------------------------------|
| 1. Land Assets_____          | 5. Equipment and Machinery_____ |
| 2. Building Assets_____      | 6. Inventory_____               |
| 3. Accounts Receivable _____ | 7. Other (Please describe)_____ |
| 4. Vehicles_____             |                                 |

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XI. Growth rates for assets for the organization: \_\_\_\_\_%

### Information on Firm's working capital requirements

XII. Total revenue of the firm: \_\_\_\_\_ IDR million

XIII. Growth rates of revenues: \_\_\_\_\_%

XIV. Total revenue from sales: \_\_\_\_\_ IDR million

XV. Total Working Capital requirement: \_\_\_\_\_ IDR million

XVI. % Working Capital Requirement met by debt: \_\_\_\_\_%

### Information on Firm's sources of finance

XVII. Has your firm taken a loan in the last \_\_\_ years?

☐ Yes ☐ No

XVIII. If yes, for what?

☐ Working capital requirement ☐ Investment / term loan  
☐ Both

XIX. Total loan taken: \_\_\_\_\_ IDR million in the last \_\_\_\_\_ years?

% split among:

Working capital requirement \_\_\_\_\_ % Investment / term loan \_\_\_\_\_ %

XX. For investment/term loan, what was the investment made?

☐ Real Estate ☐ Plant and Machinery  
☐ Other (please specify)

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XXI. Type of loan taken

☐ Collateralized ☐ Uncollateralized  
☐ Both

% split among

Collateralized \_\_\_\_\_ % Uncollateralized \_\_\_\_\_ %

XXII. If uncollateralized, what proportion of uncollateralized loan was KUR: \_\_\_\_\_ %

XXIII. For collateralized loans, please specify:

Collateral used	Value of Collateral (IDR million)	Value of Loan (IDR million)	Notarized deed of the transaction?				Registration with Fiducia Registration Office?			
			<input type="checkbox"/>	Yes	<input type="checkbox"/>	No	<input type="checkbox"/>	Yes	<input type="checkbox"/>	No
			<input type="checkbox"/>	Yes	<input type="checkbox"/>	No	<input type="checkbox"/>	Yes	<input type="checkbox"/>	No
			<input type="checkbox"/>	Yes	<input type="checkbox"/>	No	<input type="checkbox"/>	Yes	<input type="checkbox"/>	No
			<input type="checkbox"/>	Yes	<input type="checkbox"/>	No	<input type="checkbox"/>	Yes	<input type="checkbox"/>	No
			<input type="checkbox"/>	Yes	<input type="checkbox"/>	No	<input type="checkbox"/>	Yes	<input type="checkbox"/>	No
			<input type="checkbox"/>	Yes	<input type="checkbox"/>	No	<input type="checkbox"/>	Yes	<input type="checkbox"/>	No

XXIV. Have you taken loan from the following sources in the last \_\_\_\_ year?

Source	Yes?	Number of times	Source	Yes?	Number of times
Banks	<input type="checkbox"/>		Cooperatives	<input type="checkbox"/>	
NBFI	<input type="checkbox"/>		BPD	<input type="checkbox"/>	
MFIs	<input type="checkbox"/>		LDKP	<input type="checkbox"/>	
Pawn shops	<input type="checkbox"/>		Venture Capital	<input type="checkbox"/>	
Friend / Relative	<input type="checkbox"/>		Money Lender	<input type="checkbox"/>	
_____	<input type="checkbox"/>		_____	<input type="checkbox"/>	

XXV. Have you recently approached a bank for a loan?

☐ Yes ☐ No

XXVI. If no, specific reasons?

- |  |  |
|--|--|
| <input type="checkbox"/> Banks do not provide loans  | <input type="checkbox"/> Bank Process is tedious |
| <input type="checkbox"/> Do not qualify for the loan | <input type="checkbox"/> High interest rates     |
| <input type="checkbox"/> Legal Barriers              | <input type="checkbox"/> Others please specify   |

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XXVII. If you do not qualify for loans, what are the key reasons?

- |  |  |
|--|--|
| <input type="checkbox"/> Lack of adequate collateral       | <input type="checkbox"/> Lack of acceptable collateral |
| <input type="checkbox"/> Bank's do not understand business | <input type="checkbox"/> Registration status           |
| <input type="checkbox"/> Other, please specify.            |  |

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XXVIII. Was your loan rejected in the past year? If so, what are the key reasons?

- |  |  |
|--|--|
| <input type="checkbox"/> Lack of adequate collateral       | <input type="checkbox"/> Lack of acceptable collateral |
| <input type="checkbox"/> Bank's do not understand business | <input type="checkbox"/> Registration status           |
| <input type="checkbox"/> Others please specify.            |  |

### Sources of Financing

(Sources same as those mentioned in question XXII)

XXIX. Give details about the loans you procured in the last year

**Source:** \_\_\_\_\_  
**Type (e.g. Sharia)** \_\_\_\_\_  
**Total Loan Amount** \_\_\_\_\_ IDR million

#### Type of Loans

- ☐ Collateralized      ☐ Uncollateralized

#### Interest Rate

Collateralized \_\_\_\_\_%      Uncollateralized \_\_\_\_\_%

#### Duration of loan

Collateralized \_\_\_\_\_ months      Uncollateralized \_\_\_\_\_ months

**Source:** \_\_\_\_\_  
**Type (e.g. Sharia)** \_\_\_\_\_  
**Total Loan Amount** \_\_\_\_\_ IDR million

#### Type of Loans

- ☐ Collateralized      ☐ Uncollateralized

#### Interest Rate

Collateralized \_\_\_\_\_%      Uncollateralized \_\_\_\_\_%

#### Duration of loan

Collateralized \_\_\_\_\_ months      Uncollateralized \_\_\_\_\_ months



## Appendix III

### Questionnaire for Stakeholders

#### Key objective of the study:

The main objective of the study is to identify the current status of movable asset based collateral for MSMEs and the current legal and regulatory framework that is prevalent in Indonesia to provide access to finance based on movable financing.

#### Purpose of this interview:

The main purpose of this interview is to understand the key initiatives undertaken by the stakeholder regarding MSME finance and their impact, and explore roles the stakeholders could play to improve financial access to MSMEs by exploring barrier management. This interview would also be used to validate our assumption, secondary data and hypothesis.

#### General Information

##### Name of the stakeholder:

<<fill before meeting>>

##### Role of the organization in MSME segment:

<<fill before meeting>>

##### Name of the representative met with designations and contact

Name	Designation	Phone	Email
------	-------------	-------	-------

Address:

I. What are the key initiatives taken by your organization for MSME finance?

<<Write a couple of lines about known initiatives and explore further details, e.g. with BI talk about 20% regulation, DIBI, formats for MSME balance sheets etc. To be filled in by interviewer>>

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II. What are the key impacts if calculated?

<<Quantitative data recommended, if not available, qualitative data>>

III. Are you planning any other interventions for MSME finance? Specifically for movable finance?

☐ Yes ☐ No

IV. If yes, what are the interventions, and what are the reasons and impacts?

Intervention	Reasons	Impacts

### Barrier Identification and Awareness

V. Does the registration status of MSMEs affect their ability to obtain a loan?

☐ Yes ☐ No

VI. If yes, how?

<<Even if the answer is "No" quiz more and get the reasons>>

VII. What steps have been taken to improve the registration status?

<<Specifically for MCSME>>

VIII. Does improper documentation affect ability to obtain loan?

☐ Yes ☐ No

IX. If yes, how?

<<Even if the answer is "No" quiz more and get the reasons>>

X. What steps have been taken to tackle this barrier?

<<Specifically for BI and MCSME>>

XI. Does lack of collateral act as a barrier to financing?

☐ Yes ☐ No

XII. If yes, provide rating for the following reasons.

<<Highlight “high” if the reason is the main reason for lack of collateral being a barrier>>

Key Reason	Rating		
Collateral helps in reducing NPLs	<input type="checkbox"/> High	<input type="checkbox"/> Medium	<input type="checkbox"/> Low
Banks do not accept movable collateral	<input type="checkbox"/> High	<input type="checkbox"/> Medium	<input type="checkbox"/> Low
Fixed collateral is a regulatory necessity	<input type="checkbox"/> High	<input type="checkbox"/> Medium	<input type="checkbox"/> Low
No institutional support for accepting movable collateral	<input type="checkbox"/> High	<input type="checkbox"/> Medium	<input type="checkbox"/> Low
Process of collateral registration very tedious	<input type="checkbox"/> High	<input type="checkbox"/> Medium	<input type="checkbox"/> Low
_____	<input type="checkbox"/> High	<input type="checkbox"/> Medium	<input type="checkbox"/> Low
_____	<input type="checkbox"/> High	<input type="checkbox"/> Medium	<input type="checkbox"/> Low

XIII. Please rank the problems in the current collateral registration process.

<<Highlight “high” if the concerns are of a higher degree >>

Key Reason	Rating		
Registration is not online	<input type="checkbox"/> High	<input type="checkbox"/> Medium	<input type="checkbox"/> Low
Access to registration office	<input type="checkbox"/> High	<input type="checkbox"/> Medium	<input type="checkbox"/> Low
Time taken for the process	<input type="checkbox"/> High	<input type="checkbox"/> Medium	<input type="checkbox"/> Low
Documentation is lengthy	<input type="checkbox"/> High	<input type="checkbox"/> Medium	<input type="checkbox"/> Low
Registration fees and other costs very high	<input type="checkbox"/> High	<input type="checkbox"/> Medium	<input type="checkbox"/> Low
The process is managed by the wrong stakeholder	<input type="checkbox"/> High	<input type="checkbox"/> Medium	<input type="checkbox"/> Low
_____	<input type="checkbox"/> High	<input type="checkbox"/> Medium	<input type="checkbox"/> Low

XIV. What role do you see in removing this barrier?

<<This answer should be a discussion, with the interviewer talking about the current problems in Fiducia registration, the warehouse receipt law>>

## Appendix IV

### Questionnaire for Financial Institutions

#### General Information

Name of Financial Institution:

Type of Lender (Bank/MFI/Pawnshop etc.):

Name and Designation of the respondent:

Telephone/Mobile/Fax Number:

Email address :

Address:

#### Information on Lending

I. What is your total lending in Indonesia?

a. Outstanding Loans (May 2013): \_\_\_\_\_IDR Trillion

b. Loan Disbursed in the last calendar year (Jan 2012 to Dec 2012): \_\_\_\_\_IDR Trillion

II. What are your major sources of funds? (Not applicable for banks)

Source 1. \_\_\_\_\_ Source 2. \_\_\_\_\_

Source 3. \_\_\_\_\_ Source 4. \_\_\_\_\_

III. What is the share of MSME lending in your overall lending portfolio?

- |  |  |
|--|--|
| <input type="checkbox"/> Less than 20%       | <input type="checkbox"/> Between 20% and 50% |
| <input type="checkbox"/> Between 50% and 70% | <input type="checkbox"/> More than 70%       |

IV. For Banks, if it is less than 20%, what are the steps taken by you to meet the regulatory requirement? For FIs other than banks, if it is less than 20%, have there been any significant efforts to increase MSME lending in your total portfolio?

---

V. What is your average loan size per MSME? \_\_\_\_\_(IDR million)

VI. What is the percentage of lending provided by you to MSME, under any government affiliated scheme: \_\_\_\_\_% (e.g. KUR etc.)

---

VII. Is your MSME lending strategy in line with government directives (e.g. 20% minimum lending to MSME) or is your bank comfortable in paying penalty for non-compliance?

VIII. In case of KUR lending, what are major reasons for providing lending through this scheme?

Key Reason	Rating		
Government directive to lend through KUR	<input type="checkbox"/> High	<input type="checkbox"/> Medium	<input type="checkbox"/> Low
There is no high risk in lending through KUR	<input type="checkbox"/> High	<input type="checkbox"/> Medium	<input type="checkbox"/> Low
Increase in Bank Portfolio	<input type="checkbox"/> High	<input type="checkbox"/> Medium	<input type="checkbox"/> Low
Others (please specify)_____	<input type="checkbox"/> High	<input type="checkbox"/> Medium	<input type="checkbox"/> Low

IX. Do you ask for collateral for KUR scheme?

☐ Yes ☐ No

X. In case of yes, mention different collateral required under the scheme

Key Reason	Reasons for collateral requirement
Collateral 1. _____	
Collateral 2. _____	
Collateral 3. _____	

XI. Have you tied up with companies which have provided corporate guarantee to their suppliers/vendors or any other MSME partner, for lending facilities?

☐ Yes ☐ No

XII. If yes, than what type of lending facility have you provided?

XIII. How many times does a corporation come to provide guarantee for the MSME loans?

XIV. What according to you is your market share in total MSME outstanding credit?

☐ Less than 10% ☐ Between 10% and 25%  
☐ Between 25% and 50% ☐ More than 50%

XV. What are the major sectors, for MSME lending in your lending portfolio? (% of total MSME lending)

1. Agriculture: \_\_\_\_\_ 2. Trade, hotel & restaurants: \_\_\_\_\_  
3. Manufacturing: \_\_\_\_\_ 4. Other major sector: \_\_\_\_\_

XVI. What are the sectors in which you do not lend to MSME?

Sector	Reasons for not lending to MSME
Sector 1. _____	
Sector 2. _____	
Sector 3. _____	
Sector 4. _____	

XVII. Further, how much do you lend to Micro, Small and Medium segments, across sectors?

	% of MSME lending		
	Micro	Small	Medium
Aggregate lending			
Sector 3. _____			
Sector 4. _____			

XVIII. What is the percentage of collateral lending across segments?

(Please note that “Collateralize Lending” refers to lending in which secondary collateral is provided. Lending such as leasing in which only primary collateral is present is not considered as collateralize lending)

Segments	% of Individual Segment		
	Collateralize	Collateral Financing Based on Movable collateral	Medium
(% of Collateralize loans)			
Micro Enterprise Lending			
Small Enterprise Lending			
Medium Enterprise Lending			
Aggregate lending to MSME segment			

(If aggregate lending information at MSME level not available, than provide information on Aggregate Bank Lending level)

	Collateralize	Collateral Financing Based on Movable collateral (% of Collateralize loans)
Aggregate Bank lending		

## Product Based Information

XIX. What are the top products for collateral-based financing?

Products		Collateralized category	Types of Collateral Used (Mention the Loan-to-Value ratios in the bracket)
Product 1. ____  Avg. Tenure: __ (mths.)  <b>Int. Charged:</b> ____% (Flat interest) ____% (Effective Interest)  (Mention if different for Sharia-based products) (Check if it changes with regions)  <b>NPL: ____%</b> (as on last published date)  <b>Purpose of Lending:</b> <input type="checkbox"/> Term Loan <input type="checkbox"/> Working Capital Loan  <b>Category of Lending:</b> <input type="checkbox"/> Conventional Lending <input type="checkbox"/> Sharia-based Lending <input type="checkbox"/> Leasing Model____ (% of Sharia-lending) <input type="checkbox"/> Profit Sharing Model____ (% of Sharia-lending)	o/s Loans ____ (IDR Trillion)  Loan Disbursed in the last calendar year ____ (IDR Trillion)	<input type="checkbox"/> Movable Assets <input type="checkbox"/> Immovable Assets	<b>Movable Assets</b> <input type="checkbox"/> Vehicle &Equipment____ <input type="checkbox"/> Accounts Receivable____ <input type="checkbox"/> Durable consumer goods____ <input type="checkbox"/> Inventory____ <input type="checkbox"/> Bank Accounts & financial instruments____ <input type="checkbox"/> Intellectual Property Rights____ <input type="checkbox"/> Mining & Licensing Rights____ <input type="checkbox"/> Others (please specify)____  <b>Immovable Assets</b> <input type="checkbox"/> Land____ <input type="checkbox"/> Building <input type="checkbox"/> Fixed Plant & Machinery ____ <input type="checkbox"/> Others (please specify)____
Product 2. ____  Avg. Tenure: __ (mths.)  <b>Int. Charged:</b> ____% (Flat interest) ____% (Effective Interest)  (Mention if different for Sharia-based products) (Check if it changes with regions)  <b>NPL: ____%</b> (as on last published date)  <b>Purpose of Lending:</b> <input type="checkbox"/> Term Loan <input type="checkbox"/> Working Capital Loan  <b>Category of Lending:</b> <input type="checkbox"/> Conventional Lending <input type="checkbox"/> Sharia-based Lending <input type="checkbox"/> Leasing Model____ (% of Sharia-lending) <input type="checkbox"/> Profit Sharing Model____ (% of Sharia-lending)	o/s Loans ____ (IDR Trillion)  Loan Disbursed in the last calendar year ____ (IDR Trillion)	<input type="checkbox"/> Movable Assets <input type="checkbox"/> Immovable Assets	<b>Movable Assets</b> <input type="checkbox"/> Vehicle &Equipment____ <input type="checkbox"/> Accounts Receivable____ <input type="checkbox"/> Durable consumer goods____ <input type="checkbox"/> Inventory____ <input type="checkbox"/> Bank Accounts & financial instruments____ <input type="checkbox"/> Intellectual Property Rights____ <input type="checkbox"/> Mining & Licensing Rights____ <input type="checkbox"/> Others (please specify)____  <b>Immovable Assets</b> <input type="checkbox"/> Land____ <input type="checkbox"/> Building <input type="checkbox"/> Fixed Plant & Machinery ____ <input type="checkbox"/> Others (please specify)____



Products		Collateralized category	Types of Collateral Used (Mention the Loan-to-Value ratios in the bracket)
Product 3. ____  Avg. Tenure: __ (mths.)  <b>Int. Charged:</b> ____% (Flat interest) ____% (Effective Interest)  (Mention if different for Sharia-based products) (Check if it changes with regions)  <b>NPL: ____%</b> (as on last published date)  <b>Purpose of Lending:</b> <input type="checkbox"/> Term Loan <input type="checkbox"/> Working Capital Loan  <b>Category of Lending:</b> <input type="checkbox"/> Conventional Lending <input type="checkbox"/> Sharia-based Lending <input type="checkbox"/> Leasing Model____ (% of Sharia-lending) <input type="checkbox"/> Profit Sharing Model____ (% of Sharia-lending)	o/s Loans ____ (IDR Trillion)  Loan Disbursed in the last calendar year ____ (IDR Trillion)	<input type="checkbox"/> Movable Assets <input type="checkbox"/> Immovable Assets	<div> <b>Movable Assets</b>  <input type="checkbox"/> Vehicle &amp; Equipment____  <input type="checkbox"/> Accounts Receivable____  <input type="checkbox"/> Durable consumer goods____  <input type="checkbox"/> Inventory____  <input type="checkbox"/> Bank Accounts &amp; financial instruments____  <input type="checkbox"/> Intellectual Property Rights____  <input type="checkbox"/> Mining &amp; Licensing Rights____  <input type="checkbox"/> Others (please specify)____           </div> <div> <b>Immovable Assets</b>  <input type="checkbox"/> Land____  <input type="checkbox"/> Building  <input type="checkbox"/> Fixed Plant &amp; Machinery ____  <input type="checkbox"/> Others (please specify)____           </div>

XX. Do you provide warehouse receipt financing?

☐ Yes

If Yes, what is the proportion of warehouse receipt financing to the total collateralize lending ?

☐ No

If No, then please provide reasons

XXI. What are the major products for uncollateralized lending?

Products	
<p>Product 1. ____</p> <p>Avg. Tenure: ____ (mths.)</p> <p><b>Int. Charged:</b>            ____% (Flat interest)            ____% (Effective Interest)</p> <p>(Mention if different for Sharia-based products)            (Check if it changes with regions)</p> <p><b>NPL: ____%</b>            (as on last published date)</p> <p><b>Purpose of Lending:</b>  <input type="checkbox"/> Term Loan  <input type="checkbox"/> Working Capital Loan</p> <p><b>Category of Lending:</b>  <input type="checkbox"/> Conventional Lending  <input type="checkbox"/> Sharia-based Lending  <input type="checkbox"/> Leasing Model____            (% of Sharia-lending)  <input type="checkbox"/> Profit Sharing Model____(% of Sharia-lending)</p>	<p>o/s Loans ____ (IDR Trillion)            Loan Disbursed in the last calendar            year ____ (IDR Trillion)</p>
<p>Product 2. ____</p> <p>Avg. Tenure: ____ (mths.)</p> <p><b>Int. Charged:</b>            ____% (Flat interest)            ____% (Effective Interest)</p> <p>(Mention if different for Sharia-based products)            (Check if it changes with regions)</p> <p><b>NPL: ____%</b>            (as on last published date)</p> <p><b>Purpose of Lending:</b>  <input type="checkbox"/> Term Loan  <input type="checkbox"/> Working Capital Loan</p> <p><b>Category of Lending:</b>  <input type="checkbox"/> Conventional Lending  <input type="checkbox"/> Sharia-based Lending  <input type="checkbox"/> Leasing Model____            (% of Sharia-lending)  <input type="checkbox"/> Profit Sharing Model____(% of Sharia-lending)</p>	<p>o/s Loans ____ (IDR Trillion)            Loan Disbursed in the last calendar            year ____ (IDR Trillion)</p>

XXII. What is the mechanism to check the credit worthiness of the MSME?  
(For example, Income Index, Asset Index, House Index etc.)

Barriers to MSME lending based on movable collateral

Categorize the major reasons for collateralize lending to MSME

Key Reason	Rating		
MSME business is not financially sound	<input type="checkbox"/> High	<input type="checkbox"/> Medium	<input type="checkbox"/> Low
MSME business is not registered	<input type="checkbox"/> High	<input type="checkbox"/> Medium	<input type="checkbox"/> Low
Lack of acceptable collateral with MSME	<input type="checkbox"/> High	<input type="checkbox"/> Medium	<input type="checkbox"/> Low
Others (please specify)_____	<input type="checkbox"/> High	<input type="checkbox"/> Medium	<input type="checkbox"/> Low

XXIII. Major reasons for lack of movable financing,

Key Reason	Rating		
Internal guidelines on Asset Quality on not financing on movable asset categories	<input type="checkbox"/> High	<input type="checkbox"/> Medium	<input type="checkbox"/> Low
Restrictions on types of assets due to lack of adequate legal framework for e.g. collateral registry	<input type="checkbox"/> High	<input type="checkbox"/> Medium	<input type="checkbox"/> Low
Even if the registry is present, information is not sufficient for movable financing	<input type="checkbox"/> High	<input type="checkbox"/> Medium	<input type="checkbox"/> Low
Priority of creditors unclear for movable assets	<input type="checkbox"/> High	<input type="checkbox"/> Medium	<input type="checkbox"/> Low
No set guidelines on Asset valuation for movable assets	<input type="checkbox"/> High	<input type="checkbox"/> Medium	<input type="checkbox"/> Low
Enforcement Issues	<input type="checkbox"/> High	<input type="checkbox"/> Medium	<input type="checkbox"/> Low
Lack of know-how with respect to managing movable asset based financing process	<input type="checkbox"/> High	<input type="checkbox"/> Medium	<input type="checkbox"/> Low
Not the part of business focus at present	<input type="checkbox"/> High	<input type="checkbox"/> Medium	<input type="checkbox"/> Low
External regulatory constraints to lend against movable collateral	<input type="checkbox"/> High	<input type="checkbox"/> Medium	<input type="checkbox"/> Low
Others (please specify)_____	<input type="checkbox"/> High	<input type="checkbox"/> Medium	<input type="checkbox"/> Low

XXIV.

XXV. What are the important areas the movable asset registry should address for the movable assets based lending (please also comment on any existing registry structure you prefer for movable collateral based lending)

Key Areas	
Legislative Framework	
Institutional Framework	
Service Delivery Areas (customer support, help desk etc.)	
Online registration and movable collateral search capability	
Cost of Service	
Others (please specify)	

XXVI. Do you think existence of Fiducia Registration office has helped you in increasing movable finance to MSME?

☐ Yes                      Reasons \_\_\_\_\_  
☐ No                        \_\_\_\_\_

XXVII. What are the delivery channels for movable collateral based products for your organization?

Model Used	Perceived Challenges
Branch Banking	
Low-cost branches in rural areas	
Branch Correspondents	
Lending to SHGs and village unions	
Others _____	

If "Others", please specify \_\_\_\_\_

XXVIII. How do you think, your organization would improve lending to MSME based on movable collateral?

\_\_\_\_\_

\_\_\_\_\_

XXIX. What kind of government support would help you increase lending to MSME based on movable collateral?

\_\_\_\_\_

\_\_\_\_\_

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