

1 Introduction

Access to credit has been a major instrument in the promotion of equitable growth and the reduction of poverty in Indonesia. There are two major institutional providers of financial services in rural areas: the government-owned Bank Rakyat Indonesia (BRI) with some 3,500 sub-branches (unit or unit desa) at sub-district level, and some 9,000 formal and semi-formal MFIs. Growth in the number of village banks and rural branches, as a consequence of the deregulation of the banking sector in 1988, helped increase the supply of financial services to the lower segments of the rural population. This deregulation also increased competition and, together, the BRI and the MFIs now have a total of 23.8 million accounts which consist of 4.71 million loan accounts and 19.08 million savings deposit accounts (Table 1). All the same, BRI outperforms the MFIs by a considerable margin: 16.75 million micro-finance accounts in BRI vs. 7.10 million accounts in various MFIs. The micro-finance sector in Indonesia is characterised by an extraordinary variety of institutions. Different types of MFIs are summarised in Box 1. A remarkable feature of the micro-finance sector is its self-financing capacity. Together, BRI and MFIs fully finance their lending operations from internal resources, though BRI more so than the local MFIs.

The article presents a case study of the BPR Bank Shinta Daya, a self-financed private village bank established in 1970 in D.I. Yogyakarta on Java. In the past it dealt mainly with individual clients but, inspired by Bank Indonesia's linkage banking programme, has also adopted the group lending approach. Bank Shinta Daya presents an outstanding example of a private institution that is self-reliant in terms of resource mobilisation, is financially viable having financed its expansion from profits, and has substantially increased its outreach to the poor as a market segment on commercial terms. As it employs both the individual and group technologies of providing financial

¹ This article is drawn from the substantially larger article 'Micro-finance in Indonesia: An Assessment of Micro-finance Institutions Banking With the Poor' published as an *Economics and Sociology Occasional Paper* No. 2365 in January 1998 in the Rural Finance Program of the Department of Agricultural Economics, The Ohio State University, Ohio (USA).

Attaining Outreach with Sustainability

A Case Study of a Private Micro-Finance Institution in Indonesia¹

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Box 1: Rural Micro-Finance Institutions in Indonesia

Rural MFIs in Indonesia are quite heterogeneous. They are classified into: BPR-Non-BKD, BPR-BKD and LDKPs/SFIs (Lembaga Dana dan Kredit Pedesaan/Small Financial Institutions). The banking law of 1992 provides rules for the establishment of a fully licensed Rural Credit Bank (BPR) under Central Bank supervision and the transformation of LDKPs into BPR (BPR Non-BKD). The minimum paid-up capital for a new BPR is Rp 50 million (US\$ 22,500 at 1995 exchange rate). A new BPR cannot operate within the provincial and district capital cities. It is only allowed to operate within the sub-district where it is located (though it appears that this rule is not rigidly enforced). The second type of BPR is BPR-BKD. BKD (Badan Kredit Desa), is a village-based, hitherto semi-formal financial institution, established and owned by local villages and supervised by BRI. The third type of BPR is called LDKP (Lembaga Dana dan Kredit Pedesaan) or rural fund and credit institution, such as BKPD (Bank Karya Produksi Desa), LPK (Lembaga Perkreditan Kecamatan), BKK (Badan Kredit Kecamatan), KURK (Kredit Usaha Rayat Kecil), LPD (Lembaga Perkreditan Desa) and LKP (Lembaga Kredit Pedesaan), LPN (Lumbung Pith Nagari). LDKPs were sponsored by provincial and local governments in the early 1970's as non-licensed rural credit institutions. They were under provincial law and were usually supervised by the provincial development bank (BPD). These LDKPs are now required to receive a BPR license within five years or close down.

Table 1: Formal and Semi-Formal Financial Institutions in Indonesia (December 1995)

Amount (Rp billion)

Type of financial institution	Number	Credit		Funds mobilised		Total financial services	
		Accounts ('000)	Amount (Rp bn.)	Accounts ('000)	Amount (Rp bn.)	Accounts ('000)	Amount (Rp bn.)
BPR (Rural Credit Bank) and Secondary Banks	1,948	1,232	1,566	2,969	1,226	4,252	2,792
LDKPs (Small Financial Institutions)	1,978	261	224	456	118	716	342
BKDs (Village Credit Bodies, including BPR ex-BKD)	5,435	955	93	1,176	63	2,130	156
Sub-total MFIs	9,271	2,448	1,883	4,601	1,447	7,098	3,290
BRI-UDES	3,482	2,264	3,194	14,483	6,016	16,747	9,210
Total	12,743	4,712	5,077	19,084	7,463	23,845	12,500
Commercial Banks	240	91,168	234,611	49,904	214,764	141,072	449,375

Sources: 1. Bank Indonesia: Annual Report 1995/96, May 1996; 2. Indonesian Statistical Report, March 1996; 3. Statistik Kredit Koperasi dan Kredit Kecil (KUK), January 1996; 4. Bank Rakyat Indonesia

services, it also permits a comparative assessment of the effectiveness of the two strategies.

Bank Shinta Daya's performance is evaluated on the basis of four criteria: outreach to the poor (section 2), financial viability and sustainability (section 3), ability to mobilise resources (section 4), and sound micro-finance practices (section 5). Section 6 contains a set of policy conclusions emerging from the

case study, in particular, and the Indonesian micro-finance sector, in general.

2 Outreach

Bank Shinta Daya was established with private money and funded its expansion from profits, not subsidies. During 1970-90, it indistinctively mobilised savings from, and lent to, the non-poor

Table 2: Savings Mobilisation and Credit Delivery through Individual and Group Technologies in Bank Shinta Daya (as at December 1995)

	Technology		Total
	Individual	Group	
Number of depositors	22,940 (75.6)*	7,400 (24.4)	30,340 (100.0)
Number of borrowers	6,456 (51.0)	6,200 (49.0)	12,656 (100.0)
Number of poor depositors	18,352 (71.3)	7,400 (28.7)	25,752 (100.0)
Number of poor borrowers	2,582 (29.4)	6,200 (70.6)	8,782 (100.0)
Amount of deposit (in %)			
– All	96.9	3.1	100.0
– Poor only	89.9	10.1	100.0
Loans outstanding (in %)			
– All	89.3	10.7	100.0
– Poor only	48.4	51.6	100.0

Note: *Figures in parentheses are percentages of the row total.

as well as the poor in its area of operation. Given the relatively high transaction costs of collecting micro-savings and small instalments on micro-loans, the bank made no conscious effort of financial deepening among the poor. This began to change in 1989 when Bank Shinta Daya started to participate in the BI's project 'Linking Banks and Self-Help Groups'. After an expensive and ultimately abortive attempt at working through a local NGO as a financial intermediary, Bank Shinta Daya decided to seek out its own savings and credit groups which are ubiquitous in Indonesia. The bank set up a special group lending department, hired its own field workers, some of them former NGO staff, and trained its own groups of the poor in group management, bookkeeping, savings mobilisation and financial management. By December 1995, the bank was effectively working with 310 self-help groups (SHGs) comprising 7,750 members. Of these, 7,400 were active savers and 6,200 active borrowers of funds lent by the bank wholesale to the SHGs (Table 2). At the same time the bank had 22,940 individual depositors and 6,456 individual borrowers.²

As evident from Table 2, the group technology has enabled the bank to increase the number of savers by about one-third. However, there is a wide differential between individual and group savers in terms of the amount deposited: of the total amount of sav-

ing deposits 96.9 per cent have been mobilised from individuals and only 3.1 per cent through groups. The difference is due to savings techniques: savings from individuals are voluntary; savings through groups are compulsory, regular and standardised at a minimal level that is affordable by each member of a group.

The impact of the newly introduced group approach is most dramatic with regard to access to credit by the poor. By December 1995 the bank lent to 2,582 poor borrowers individually. The group approach increased the number of poor borrowers to 8,782, which is 69 per cent of all the bank's borrowers. Without the group approach, the proportion of poor borrowers would have been only 40 per cent. By comparison, the impact of the group approach on access to deposit facilities among the poor has been less pronounced: without the group approach, the poor make up 80 per cent of the bank's depositors. The group approach has increased the share of the poor savers to 85 per cent. All in all, 80 per cent of the accounts in the bank are held by the poor. Without the group approach, this percentage would have been 71 per cent.

With regard to borrowers, the group technology has enabled the bank to double its outreach: from 6,456 to 12,656 borrowers, but has added relatively little

² Savers and borrowers cannot be added up to arrive at the total number of customers. The practice in many small banks in Indonesia is that opening a savings

account precedes a credit application, with the result that the number of savers equals more or less the total number of customers.

to the volume of loans outstanding. Group members represent 49 per cent of borrowers but only 11 per cent of the volume of loans outstanding. Average loan sizes of individual borrowers are more than twice that of group members, with the result that the volume of loans outstanding from the poor are in the hands of a much smaller number of individual borrowers.

Bank Shinta Daya's experience suggests that:

- private rural banks can and do provide financial services to the poor
- the non-poor are somewhat more likely than the poor to be borrowers while the poor are far more likely to utilise the bank's deposit facilities than the non-poor
- the group approach extends the outreach of the bank to depositors including the poor by a notable margin, but adds little to the overall volume of resources mobilised
- while the bank's individual approach is savings-driven, its group approach is not
- in terms of additionality and financial deepening, the group approach is most successful in providing access to credit for the poor
- there may be an additional impact of bank access on the volume of internal savings and credit operations within the groups
- the individual approach allows for larger average loan sizes to the poor than the group approach – a finding which requires further research. It is not clear whether individual lending allows for more differentiated loan screening while the group approach suffers from an inherent regression to the mean.

There is a notable absence of financial institutions or programmes of any significance specialised on women in Indonesia. To varying degrees, women are part of the market of any financial institution; but most of them have no financial products differentiated by sex, nor do they report sex-specific data. While women have usually been found to be the better savers and more reliable borrowers, they have also tended to be the smaller savers and investors. Few formal institutions, including formal and semi-

formal MFIs, have focused on women only. It would be unthinkable for a national bank like BRI or a private rural bank like BPR Shinta Daya to focus mainly on women. There is usually a scope of widening, but not limiting, their outreach to women. The group approach can be particularly helpful in that respect. Informal financial institutions like ROSCAs are almost a female monopoly in Indonesia; upgrading them would greatly contribute to financial deepening for women participants and indirectly contribute to their outreach – a deepened outreach in this case. Special programmes focusing solely on the poor like P4K³ have established that a strong, though not necessarily exclusive, focus on women will greatly contribute to the viability of the programme and also be more effective in poverty alleviation in terms of donor investment. If this course is further pursued, it might pave the way for transforming project operations into large numbers of autonomous local MFIs owned and run by women.

3 Financial Viability and Sustainability

Only viable financial institutions with sustainable financial services can increase their outreach. The issue of viability is thus not only of relevance to the health and survival of the institutions but also to the poor themselves as clients and owners of such institutions.

Bank Shinta Daya was established with private capital of US\$ 40,000 in 1970, (equivalent to Rp 92.2 million in 1995) and financed its expansion from its profits. Its net worth in December 1995 was Rp. 495.8 million (US\$ 215,000), comprising Rp 179.5 million in capital and Rp 316.3 million in retained earnings. Access to subsidised funds was not of any vital importance to Bank Shinta Daya. In 1990, when Bank Indonesia scrapped most of its subsidised programmes and instead required commercial banks to allocate at least 20 per cent of their loan portfolio to small enterprises either directly or through rural banks, Bank Shinta Daya took advantage of this offer.

³ P4K (Proyek Pembinaan Peningkatan Pendapatan Petani Kecil – Income-generating Project for Small Farmers) was first established in 1980–81 and restarted in 1989–90. It is a large national poverty-lending

project of the Ministry of Agriculture and BRI with substantial financial assistance from IFAD and technical assistance from UNDP.

Table 3: Profitability of the Individual vs. Group Technology in Bank Shinta Daya

Item	Individual	Group	Total
Income (relative % share)	97.6	2.4	100.0
Expenditure (relative % share)	98.0	2.0	100.0
Profit (relative % share)	94.0	6.0	100.0
Profit/loans outstanding	2.6	1.4	2.5
Profit/deposits	2.3	4.5	2.4
Profit/total financial services	1.2	1.1	1.2

The bank employs two technologies: retail financial services to individuals and wholesale services through groups. As indicated in the previous section, by adding the group technology the bank has substantially increased its outreach in terms of number of (end-) customers: group members represent 49 per cent of the bank's direct and indirect borrowers and 24 per cent of the bank's depositors (see Table 2). In assessing financial viability, the crucial issue to the bank is: How much does the group technology add to the bank's business volume? And how profitable are the two technologies to the bank?

In terms of volume, group lending is of minor importance to the bank: 89 per cent of the bank's lending volume goes to individual borrowers and only 11 per cent to group borrowers (Table 2). Group deposits are almost negligible, representing only 3 per cent of total savings deposits in the bank compared to 97 per cent raised from individual clients. For the Bank Shinta Daya both technologies are profitable. But the individual technology is more profitable than the group technology as 94 per cent of the bank's profits are derived from its individual lending and only 6 per cent from group lending. The profit ratio of the individual technology is 2.6 of loans outstanding, the profit ratio of the group technology only 1.4, as shown in Table 3.

The group technology is thus found to be viable as such, but adds little to the bank's overall viability. Why then does the bank engage in business with small groups? The bank's management explains this with future expectations. By providing financial services to group members with micro-enterprise activities, it contributes to their growth. As the members' micro-enterprises grow, so will their business with the bank. Besides providing a service to

the community which covers its costs and even yields a profit, the bank hopes to grasp a larger market share which might pay off substantially in the future.

Thus, the BSD experience shows that viability and sustainability can be attained in banking with the poor and the near-poor. Technical assistance has usually played a key role in the transformation of subsidised programmes into savings-driven viable institutions. Indonesia also shows that institutional viability can be achieved even under repressive policy conditions (before 1983), provided the institutions remain non-formal and apply their own sound practices. Capacity-building through training that may be provided by specialised bank training institutions, and by qualified NGOs, are a key input in the transformation process.

4 Resource Mobilisation

Sustainability of micro-financial services hinges on the mobilisation of internal resources, and the soundness of financial practices in dealing with these resources. Internal resource mobilisation makes micro-finance institutions independent of government and donor funding. It is the heart of self-help. Major resources include share capital, savings deposits and profits. For some micro-financial institutions operating in the micro-economy, high interest rates on loans may be a very effective instrument of internal resource mobilisation, in addition to the collection of voluntary savings; this is a form of self-imposed compulsory savings mobilisation frequently chosen by small institutions in the informal sector. Different types of saving mechanisms that can be promoted for resource mobilisation are summarised in Box 2.

Box 2: Saving Mechanisms for Resource Mobilisation

Savings products and innovations are major instruments in the hands of both formal and non-formal institutions to create their own deposit base. In small local micro-finance institutions, high interest rates on loans may serve as a major mechanism of self-imposed compulsory savings mobilisation. The greatest challenge for MFIs is to develop a range of savings products differentiated according to yield and maturity. Banks, which frequently have access to easy money and cheap rediscounting facilities, need to develop attractive savings products and cost-effective collection services that minimise both the bank's and the savers' transaction costs (for example, daily, or some other form of regular, savings collection at doorsteps, with transaction costs of this service either borne by the saver, as in most informal arrangements, or by the deposit institution, as in most banks which offer this service). For the customers it is important that institutions offer convenient deposit facilities for safeguarding their savings and provide a positive yield in real terms lest their savings are eroded by inflation. Savings products differing in yield and maturity (such as voluntary savings withdrawable at any time, or fixed deposits, or regular compulsory savings that are non-withdrawable) provide incentives to find the right balance between the institutions' concern for long-term deposits (as a basis of long-term loans) and the customers' liquidity preferences (in the form of savings withdrawable at any time): a particularly difficult task in inflationary economies. An additional function of savings lies in the establishment of a track record, providing inexpensive information on the creditworthiness of customers. Particularly in the case of the poor, a savings account provides easy access to a bank, allows familiarisation with the bank and its corporate culture, and creates an opportunity for building up liquid collateral for loans.

Resources can be mobilised under any policy regime; but it is in an environment of deregulated interest rates that resource mobilisation flourishes, providing a source of self-financing to small farmers and entrepreneurs and a basis of self-reliance to financial institutions. By promoting, before deregulation in 1983, autonomous semi-formal financial institutions that did not fall under the banking law, resource mobilisation as their main source of funding was effectively encouraged. As these institutions found it difficult to collect voluntary savings with a negative rate of return, their chief instrument of fund mobilisation was a drastically increased interest rate on credit – ensuring at the same time that very scarce financial resources were allocated to investments with the highest rates of return.

After the deregulation of interest rates in 1983 and even more so after bank deregulation in 1988, resource mobilisation skyrocketed in Indonesia. The former event made it attractive for individuals to save, the latter for institutions to expand their collection network. The effect of deregulation has been more pronounced on savings proper, an instrument of the poorer sections of the population, than on time deposits, an instrument of the non-poor.

All types of financial institutions now mobilise their own resources in Indonesia, from national banks like BRI to village banks, semi-formal MFIs and informal SHGs, and, depending on the investment climate, they do so in aggressive ways. Financial innovations flourish in this climate, with numerous new savings products emerging such as lottery savings and daily deposit collection at doorsteps. There is wide scope for further stepping up resource mobilisation by documenting and disseminating information on such instruments. Institutions that resist innovation and continue to stick to their preferential savings and credit terms, like credit unions until a few years ago, find their growth impeded. It is only sound financial practices which strengthen institutions and provide incentives that motivate their owners and customers.

Convenient and safe savings deposit facilities are of particular importance to the poor who have demonstrated, time and again, a high propensity to save. Savings products successfully used by Bank Shinta Daya include voluntary individual passbook savings and time deposits and compulsory group savings, with interest rates ranging from 12 per cent on passbook savings to 15–21 per cent per annum on time deposits. Its savings deposits amount to 105

per cent of loans outstanding.⁴ But while the poor account for 87 per cent of the bank's depositors, their share of the total amount of deposits is only 38 per cent.

5 Sound Micro-Finance Practices⁵

Sound micro-finance practices are essential for the viability of MFIs and for a sustained increase in their service outreach. This is of particular importance in banking with the poor, hitherto thought of as unbankable. Successful MFIs with sustainable micro-credit services in Indonesia have usually invented a host of instruments and strategies which differ from those used in banking with the urban or rural non-poor. Viable and sustainable micro-credit schemes require:

- prudent adjustment to household savings, investment and repayment capacities
- small loan sizes, with ceilings growing over a cycle of repeat loans up to a level determined by the absorptive capacity of the micro-enterprise and household economy
- dynamically growing savings-to-credit ratios
- market rates of interest autonomously determined by financial institutions and differentiated according to costs and services provided
- loan maturities and repayment modalities according to customer needs and differentiated, in case of wholesaling, according to each level of intermediation
- short maturities, no grace periods and short instalment periods in case of initial loans
- insistence on, and incentives for, timely repayment
- the development and provision of cost-effective monitoring systems.

Micro-credit products⁶ are more appropriately differentiated in terms of maturities, instalments, services and collateral requirements (ranging from joint liability and personal guarantees to tangible collateral and pawning) than in terms of loan use,

which is costly to appraise and, for fungibility reasons, difficult to control. Bank Shinta Daya has two major categories of loan products: retail loans to individual customers and wholesale loans to groups which onlend to their members at terms determined by each group. The bank provides quick and convenient access to small and often short-term loans and bases subsequent lending decisions on repayment performance. It accepts collateral substitutes such as peer guarantees and, in the case of group loans, peer pressure. Bank Shinta Daya employs a fine-tuned loan pricing strategy which takes into account customer category (groups, small entrepreneurs or farmers, wage or salary earners) and size of loan, collateral requirements, loan period and spacing of instalments. Loan products range from 3–6 months small loans up to Rp 5 million – with weekly instalments at 30 per cent interest per annum, directed mainly to the credit demand of small traders, the majority of whom are women – to 12–18 months loans above Rp 20 million – with monthly instalments at 27.5 per cent per annum, directed particularly to small entrepreneurs. For the convenience of the customers, instalments are of a constant size throughout the repayment period and monthly interest is charged at a flat rate ranging from 1.7 per cent for the smallest-size to 1.25 per cent for the largest size loans.

In this context, Bank Shinta Daya's sound micro-finance practices include:

- vigorous savings mobilisation through a range of savings products with positive real returns, including voluntary withdrawable passbook savings and time deposits
- a variety of adequately priced loan products, with different demand-led loan sizes and maturities, as well as regular instalments
- tight monitoring of loans and insistence on timely repayment
- risk management based mostly on adequate lending terms and positive incentives including the expectation of repeat loans of growing size: in conformity with the Javanese culture of face-

⁴ In 1995, the bank had mobilised Rp. 5.05 billion in savings and had Rp. 4.82 billion in outstanding loans.

⁵ The term 'best practices' owes its origin to the World Bank and evokes the notion of optimal practices applicable anywhere. In contrast, experience has shown that sound practices vary by environment and must be

adjusted to a given situation. What is sound in one situation may be unsound in another.

⁶ Credit products and techniques of appropriate credit disbursement have been presented in the form of training modules in Seibel (1992).

- saving positive enforcements
- operations within a confined local area where both the bank and the customers are known to each other
- accountability to private owners who take a personal interest in the profitability of the bank

6 Policy Conclusions

The Indonesian experience shows that the establishment of MFIs and the outreach of existing financial institutions to the poor has been greatly influenced by the deregulation of interest rates in 1983, which led to a surge in national resource mobilisation and a multitude of financial innovations, and bank deregulation in 1988, which led to a rapid increase in the number of village banks and the transformation of small institutions into rural formal sector banks. Both have greatly eased access of the poor to banking services and contributed to the reduction of poverty in Indonesia.

For the further development of micro-finance institutions and micro-financial services for the poorer segments of the population, four policy measures are of particular importance:

- Deregulation of interest rates (a) to permit institutions to pay interest rates with positive real returns to savers and (b) to charge interest rates on loans that cover their costs and permit profits from which their expansion is financed and owners are rewarded. This would allow a given institution to differentiate its interest rates depending upon loan product, loan size, maturity and collection service. Bank Shinta Daya has used the opportunities created by deregulation in various ways, offering an average deposit rate of 14.7 per cent and charging an average lending rate of 27.4 per cent.
- Bank deregulation to ease the establishment of new banks, branching out, taking the bank to the people, and to allow for the establishment of local MFIs with equity capital requirements that substantially differ from those for national banks.
- Provision of adequate forms of governance and legal status for MFIs that may be owned by

members, communities and stockholders, as in the case of Bank Shinta Daya. There is still a need for adequate forms of non-bank status for small and very small MFIs such as financial self-help groups (i.e., the genuine micro-institutions)

- Establishment of second-tier regulatory authorities which guide and supervise large numbers of small financial institutions that cannot be effectively controlled by the central bank. This is still largely a task of the future.

With 43,000 accounts and a clientele of over 30,000, comprising 30,340 savers and 12,656 borrowers, Bank Shinta Daya has shown that privately owned village banks can have a considerable outreach at the local level without being subsidised. Moreover, as it records 69 per cent of its borrowers and 85 per cent of its savers as poor, it has also demonstrated that financial services to the poor by private banks can be profitable and self-sustained. The main emphasis of any further attempt at poverty alleviation must concentrate on institution building: the establishment and upgrading of institutions owned by the poor, and of institutions providing services for a clientele that includes the poor.

It is clear that, on a national scale, no single approach or single type of institution can achieve this end. A systems approach to micro-finance is needed which promotes access of all segments of the population to financial services. In such an endeavour development agencies may assist:

- informal financial institutions to upgrade their financial operations and acquire an appropriate legal status, thus evolving into semi-financial institutions with deepened services and increased outreach
- semi-formal financial institutions to upgrade their financial operations and evolve, where feasible, into village banks (BPR)
- informal, semi-formal and formal MFIs to link up with banks as refinancing institutions, thus strengthening their financial service capacity and deepened outreach⁷
- the poor to organise themselves in self-help groups and to upgrade their activities and gain access to the financial services of banks

⁷ Financial deepening refers to an increase in financial services to a given area or market segment. In discussing outreach, it is proposed to take a wider view

and include both quantitative and qualitative outreach, i.e. numbers and impact.

- MFIs to open a window for targeting the poor through the group approach, linking the MFI to existing self-help groups
- poverty alleviation projects in increasing women's participation and in transforming their local financial operations into autonomous local MFIs owned and run by women
- rural and commercial banks in establishing business relations with MFIs to refinance their activities, thus strengthening their financial deepening and outreach.

The terms and conditions of financial contracts must be sound from both an institution's and its customers' viewpoints. To arrive at balanced loan contracts, an exchange of experience and mutual learning may be required between the various types of non-formal and formal institutions including: (i) informal financial institutions with their wide range of contractual terms concerning interest rates, loan sizes, maturities, grace periods, loan purposes, reciprocities, collateral requirements, services, transaction cost sharing arrangements and unbounded innovations; (ii) semi-formal financial institutions including projects and programmes, which tend to be influenced by governmental or non-governmental donors and may combine comprehensive non-financial services with a lack of commercial orientation; (iii) formal institutions on tightly regulated markets, with a narrow and usually inflexible range of contractual terms (or failing to utilise the freedom granted by deregulation); and (iv) formal institutions on deregulated markets with their much wider range of terms, transaction cost sharing arrangements and innovations. In Indonesia, this learning process has been systematically promoted by Bank Indonesia through its linkage banking project, PHBK.

Ultimately savers and borrowers must be regarded as a market for financial institutions: with the institutions as intermediaries and savers and borrowers as customers rather than beneficiaries. Contractual terms and conditions on that market are the result of negotiation and competition rather than administrative imposition and convenience. With

increasing institutional diversification, there has been mounting competition among institutions at least in the more densely populated parts of Indonesia. This is one of the best guarantees for balanced loan contracts that do not ignore the interests of the poor.

7 Coping with the Financial Crisis – A Postscript

Field research on Bank Shinta Daya was done before the outbreak of the financial crisis in mid-1997. There are no data yet to show how the bank coped with the crisis. However, preliminary information from Indonesia shows that MFIs, including the village operations of BRI, have been least affected. Apparently, politically instigated lending has been a problem for big banks, not for small-scale operations.

The free fall of the rupiah has greatly eroded the value of both the MFI's equity capital and the customers' savings deposits. Only effective supervision of the whole banking system, including rigid enforcement of compliance with sound banking standards, can prevent the reoccurrence of such a disaster in the future. This is of course a political, not a banking, issue as it requires the political will to prevent government interference, and the administrative ability to keep non-interference under control.

Surprisingly, the financial crisis has not discouraged saving behaviour as much as one might have expected. In the case of BRI, the number of savers has further increased, not declined, during the twelve months since the outbreak of the crisis. This might be due to the fact that, to prevent a total collapse of the banking system, the government of Indonesia has guaranteed the deposits in government banks. This has led to an overall shift of deposits from private banks, including MFIs, to government banks, presumably further aggravating the plight of the former. How Bank Shinta Daya has been affected, and how it has coped, is an urgent area for research.

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