AGENCY FOR INTERNATIONAL DEVELOPMENT
PPC/CDIE/DI REPORT PROCESSING FORM

ENTER INFORMATION ONLY IF NOT INCLUDED ON COVER OR TITLE PAGE OF DOCUMENT

1. Project/Subproject Number	**2. Contract/Grant Number**	**3. Publication Date**
497-0357	497-C-00-98-00045-00	November 2000

4. Document Title/Translated Title

Why Isn't There More Small and Medium Enterprise (SME) Credit from Commercial Banks in Indonesia?

5. Author (s)

1. Thomas A. Timberg
2.
3.

6. Contributing Organization (s)

Nathan/Checchi Joint Venture/PEG Project

7. Pagination	**8. Report Number**	**9. Sponsoring A.I.D. Office**
3	PEG 26	ECG, USAID/Jakarta

10. Abstract (optional - 250 word limit)

The paper outlines the factors that are likely to constrain its volume in Indonesia, and make some recommendations about how to affect them. For legal purposes, SME credit is defined by directives of Bank Indonesia and reported on a monthly basis by the commercial banks to Bank Indonesia. There is a lack of parallelism between the definitions used in banking regulations and by policymakers for SME lending in Indonesia, and that used in the field by Banks. Commercial Banks typically define a retail banking segment as including all enterprises with credit accounts of under 1-3 billion rps. Retail lending and official SME lending as well is constrained by four successive factors as follows:

1. The demand for loans at the going terms and conditions.
2. The incentive structures for the retail bank loan officers empowered to grant SME credit to do so.
3. The limits set by bank management on SME credit.
4. The regulatory and legal restrictions on loan sanction.

11. Subject Keywords (optional)

1. Indonesia
2. Small & Medium Enterprises
3. Credit
4. Commercial Banks
5.
6.

12. Supplementary Notes

13. Submitting Official	**14. Telephone Number**	**15. Today's Date**
C. Stuart Callison, Chief of Party	011-62-21-520-1047	4 September 2001

…...…………………………….…………DO NOT write below this line……………………………….………

16. DOCID

17. Document Disposition

DOCRD [ ] INV [ ] DUPLICATE [ ]

AID 590-7 (10/88)

Why Isn't There More Small and Medium Enterprise (SME) Credit from Commercial Banks in Indonesia?

Thomas A. Timberg, Ph.D.[1]
Delivered at the USAID Indonesia Retreat, November 2000

In what follows I first define SME credit, outline the factors that are likely to constrain its volume in Indonesia, and make some recommendations about how to affect them. For legal purposes, SME credit is defined by directives of Bank Indonesia and reported on a monthly basis by the commercial banks to Bank Indonesia, which then publishes the total figures. This legal category includes a large amount of consumer and housing credit, but also includes loans to small businesses of up to 350 million rps. The figures also include the funds that commercial banks on-lend to smaller borrowers through rural banks, Bank Perkreditan Rakyat (BPR). The small businesses must meet the requirements of the Small Business Law of 1995: they must have a capital worth exclusive of land and building of less than 350 million rps, be owned by Indonesian citizens, and have a turnover of less than 1 billion rps. Medium size enterprises are defined as having a capital exclusive of land and buildings of 2 billion rps. There is no separate legal category for medium sized loans. IBRA and JITF have defined all outstanding loan balances of less than 5 billion rps as "retail." Those with balances of 5 to 50 billion rps. are classified as "commercial." It has been proposed to adjust some of these figures upwards, to take account of the rapid inflation connected with the Monetary Crisis, but no such adjustment has occurred.

The Central Statistical Agency defines small enterprises as those with less than 19 employees, and medium enterprises as those with 20-99 employees. This is in accordance with standard international statistical practice. As will be shown these probably do roughly align with the categories of enterprises covered by the other definitions.

Retail and Small and Medium Business -- As Target Markets

There is a lack of parallelism between the definitions used in banking regulations and by policymakers for SME lending in Indonesia, and that used in the field by Banks. Commercial Banks typically define a retail banking segment as including all enterprises with credit accounts of under 1-3 billion rps. These loans include, as do the officially defined ones, a fair amount of consumer and housing credit. In fact, the overwhelming bulk of retail credit is not business credit. But retail credit also includes most credit to the enterprises that might be defined as small, and often even medium enterprises in Indonesia.

Retail credit certainly includes almost all credit to any enterprise whose capital size puts it in the present SME category -- those with under 350 million Rps exclusive of plant and buildings for small, and 2 billion for medium. They probably include as

---

well most of the credit to those enterprises with less than 19 employees (small) and even 99 employees (medium). The matter is less conclusive, since an enterprise may have few employees but extensive business and capital.[2] Think of an enterprise with an average value of capital equipment per employee of one billion rps. (only US$125,000). Obviously that enterprise might have a capitalization of 190 billion for 19 employees, or close to a trillion for 99. However, to the extent that the Economic Census is valid it would seem to show that enterprises in Indonesia are rarely so heavily capitalized. Since the small enterprises total capital worth is under 15 billion rps., it seems likely that their maximum bank credit will generally be under 5 billion.

Banks generally treat retail business as a separate line of business. This is clearest in the case of BRI, a major lender in this category, which has an entirely separate set of branches under its Unit Retail to deal with "retail" business, in its case until recently loans of up to 3 billion. In many banks, retail business is simply a category defined by the fact that loan sanctioning and administration is decentralized to or near the branch level.

For this reason, any approach to promoting SME business as a constituent part of commercial bank, is in fact an attempt to promote retail business -- and needs to be monitored and promoted as such.

The Constraints on Retail Lending

Retail lending and official SME lending as well is constrained by four successive factors as follows:

1. The demand for loans at the going terms and conditions.
2. The incentive structures for the retail bank loan officers empowered to grant SME credit to do so.
3. The limits set by bank management on SME credit.
4. The regulatory and legal restrictions on loan sanction.

These constraints are sequential. If there is no demand, the most willing lender cannot make loans. If the lending officers have weak incentives they will not lend despite wide authority and demand, and so forth. Which constraint is binding at a given point is an empirical question and precisely for that reason t may make sense to work on all four constraints at once, even though they are not all binding at the moment.

In Indonesia today, it is not clear which constraint binds, though there is some evidence for all four being relevant. Bankers do not report heavy excess demand for

---

[2] There are roughly 40 million enterprises with less than 20 employees according to the Economic Census, roughly 17 million of these are non-agricultural. Sixty three thousand had over 20 employees. About 35000 enterprises had over 500 million in production, and 28,000 more between 200 and 500 million. Badan Pusat Statistik, *Profile of Establishment with Legal Entity, 1996 Economic Census* and *Profil Usaha Kecil dan Menengah Tidak Berbadan Hukum Indonesia, Survey Usaha Terintegrasi 1998*, passim.

small credits at existing terms and conditions, nor do many enterprises with adequate security report that they cannot secure loans at all. Rather, they report that the terms and conditions for such loans are unattractive. In fact, there seems to be vigorous competition for the good customers of closed banks.

On the other hand, in most cases, lending officers do not come closer to using their lending authority, suggesting that the internal systems of banks do not generally encourage retail lending. In some banks where retail banking is a focus of their strategy, retail credit has expanded, suggesting that their incentive systems are adapted to promoting small credit. Undoubtedly, there are also problems with authority to lend and certainly some limitations from the regulatory side, such as narrow definitions of collateral and requirements for licensing.[3]

What Is To Be Done?

This background suggests the following actions to increase SME credit:

1. Improvements in the general business climate and capital and money markets so that money is cheaper and more business people want to borrow. The primary constraint on SME growth in Indonesia today is not a shortage of normal bank credit.
2. Some banks need to be encouraged to focus their efforts on retail finance to adapt their incentives and systems (including training their personnel) for serving the retail market.
3. As a distinctly lower priority, regulatory reform should remove several unjustified obstacles to small scale lending. It has been suggested in a survey conducted by Bank Indonesia that these include especially a requirement for various government registrations and about the appropriate subjects for collateral.

---

[3] Thomas A. Timberg, "Strategy of Financing Small and Medium Enterprises in a New Economic Environment," delivered at the 50th Anniversary Seminar of the Faculty of Economics, University of Indonesia, 2000.