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Financing Small Businesses in Indonesia

Challenges and Opportunities

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The research was commissioned by the ILO Jakarta Office under the PROMISE IMPACT Project which is funded by the Swiss Secretariat for Economic Affairs (SECO). An external consultant prepared the final draft which was further revised after an expert group discussion in Jakarta which was hosted by the Financial Services Authority or Otoritas Jasa Keungan (OJK). ILO would like to offer its gratitude to OJK in the preparation of this report and continued support.

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EXECUTIVE SUMMARY

This research paper seeks to assess the demand and challenges faced by small and medium enterprises (SMEs) to obtain credit in Indonesia. An attempt was made to understand issues affecting SMEs engaged in different sectors of the economy with a focus on local manufacturing. The exercise is based on a synthesis of existing literature and interviews with relevant stakeholders including regulators and selected institutions. The latest figures suggest that there are 816,000 SMEs in Indonesia, employing 7.9 million people and contributing 27% to GDP. Out of the total bank lending of IDR 4,136 trillion, SMEs represent approximately 16%. This figure has remained relatively consistent in recent years.

In terms of suppliers, Bank Rakyat Indonesia (BRI) still dominates the microlending market, but it also provides sizeable lending to SMEs, followed by other banks, such as Bank Negara Indonesia (BNI), Bank Mandiri and Bank Central Asia (BCA). Several smaller banks focus on the SMEs, but are facing greater competition from larger banks that offer the subsidized *Kredit Usaha Rakyat* (KUR) loans to micro and small enterprises. As for the products offered, there are generally just two standard products for SMEs, namely working capital and investment loans, with the former making up approximately three-quarters of the portfolio.

The potential role of financial technology firms (Fintechs) is considerable, but they are not a major play in the industry yet, other than in niche products such as short-term invoice discounting. There are also doubts about their capacity (both financial and analytical) to provide larger loans needed by SMEs. Nonetheless, the emergence of Fintech could push the banks to be more creative, some of whom are already recognizing that there are alternatives to direct lending by partnering with digital companies, thereby combining the capital and knowledge of the financial institutions with the technology and outreach of the Fintechs.

According to the World Bank's 2017 Findex study, the number of Indonesians with an account with a formal financial institution has been growing rapidly since 2011, rising from 20% to 49% of the adult population in the last six years. However, the figure for borrowing to start a farm or business was extremely low: only 6% of all respondents, surprisingly down from 12% in 2014. Another survey indicated that the access to loans for SMEs was limited, with only 39% of small and 50% of medium-sized enterprises using bank services for financing.

In seeking to assess the potential demand for finance from SMEs, the banks do very little formal quantitative research. An International Finance Corporation (IFC) survey showed that 57% of small and 67% of medium-sized enterprises would be interested in borrowing an average of IDR 308 million and IDR 1,057 million, respectively. This translates into a potential market demand of IDR 114 trillion for small enterprise lending and IDR 41 trillion for the medium-sized enterprises, making a total for SMEs of IDR 155 trillion or $10.4 billion.

In the various studies conducted to assess the needs of SMEs in Indonesia, a major issue has been, and remains, access to finance, although the ranking of finance among other factors varies. Many SMEs are not yet bankable, either due to the absence of transparent financial management or a lack of managerial and financial capability. However, the shortfall of supply can also be attributed to the financial institutions themselves, such as their internal systems, staff capacity and insistence on fixed collateral.

Below are key findings from the research along with recommendations grouped by regulatory and macro environment, supply, and demand for SMEs.

REGULATORY AND MACRO ENVIRONMENT

1. **The requirement for banks to lend 20% of their portfolio to small businesses is not entirely clear**. There is no doubt the requirement has helped, especially with banks lacking a culture of lending to small businesses, as has been the case in other countries. However, a large proportion of SMEs loans are for trading purposes. Some of the loans made to SMEs have been used for consumption or wholesale lending to rural banks or *Bank Perkreditan Rakyat* (BPRs), as not all the financial institutions have the capacity to lend for production purposes. ***Recommendation to Otoritas Jasa Keunagan (OJK)***: It may be worth considering setting targets for loans to be made for production sectors. Also, the regulation should further clarify the implications of non-compliance.

2. **The focus on non-performing loans (NPL) from OJK, and a perceived limited flexibility, is making some banks reluctant to lend to SMEs.** The result is that the client may be referred to a different financial institution with lower liquidity, or the funds redirected by the bank to another bank product or existing client. The classification of loans in arrears is also now more demanding for the banks, with issues such as business prospects, repayment capacity and payment history being difficult to ascertain for many SMEs. ***Recommendation to OJK:*** To encourage more lending to SMEs, there may be some value in loosening the NPL requirements for banks making such loans, and the current data does not suggest that the NPL rates are appreciably higher for SMEs than for other classes of borrower. It would also help if OJK could signal the possibility of FSPs not moving straight to enforcement but sometimes allowing SMEs time to restructure.

3. **The Financial Information Service System (SLIK) credit data registry needs improvement.** Currently, access to the system requires contacting the OJK call centre or visiting one of its offices. Whilst it may go online at some time, the need to make a request and then wait for a response is inefficient. The other challenge is that the number of SMEs with credit data in SLIK is fairly limited. ***Recommendation to OJK***: Firstly, the move to online processing should continue and other changes should be considered to make the SLIK system more accessible and useful. Secondly, measures should be explored to rapidly increase SME credit data in SLIK.

4. **There are weaknesses in Insolvency and Creditor Rights (ICR).** Such weaknesses, particularly regarding the costs of using formal insolvency procedures, impede banking efficiency and inclusion through higher intermediation costs and inhibit capital market development through diminished investor demand for private instruments. ***Recommendation to Government:*** ICR laws and practices need enhancement to improve their effectiveness, and hence increase the willingness of FSPs to lend to the sector.

5. **Lack of credit information is a factor that contributes to the constraints faced by SMEs.** Assessing the creditworthiness of SMEs represents a unique challenge, as they have less access to traditional sources of finance such as banks and other financial institutions whose data is typically used in the production of credit reports. However, such ratings can be expensive for SMEs and, therefore, are often funded by a donor agency.

Recommendation to Government: In order to address this issue, Bank Indonesia (BI) has introduced an MSME Credit Rating Agency and two of the credit rating agencies operating in Indonesia are also looking to expand into the SME finance market. The Government should further support this as progress has been slow to date.

6. **The regulatory arrangements for smaller financial institutions are not ideal and do not match with best practice in other countries**. One major issue is that financial institutions other than commercial banks cannot be foreign owned and, therefore, the larger ones are licensed as Ventura Companies (VCs). Some of these companies are now actively considering SME lending but may be constrained by their licence in doing so. ***Recommendation to Government:*** Rather than forcing these companies to look for a 2nd best option, such as to transform into a multi-finance company (MFC), it would be preferable to amend the regulations to allow for at least a degree of foreign ownership.

7. **The Kredit Usaha Rakyat (KUR) product is now less focussed on new clients such as unbanked SMEs.** Whilst its volume and wide dissemination alone has made it a success, the current KUR program has been criticised for focussing more on an interest rate subsidy than a credit guarantee, which would be of assistance to first-time borrowers. There are also some uncertainties regarding the way that KUR is implemented, especially whether there is a need to take collateral for the smaller KUR "Mikro" loans. It is important to note here that the Ministry of Cooperatives and SMEs (MoCSMEs) is implementing a programme for SMEs to obtain land certificates for free. The objective is to help SMEs to use registered assets as collateral. During the expert FGD it was mentioned that the responsible agency (BPN) faced challenges and as a result the programme is not being executed optimally. ***Recommendation to Government***: In designing KUR for future, the Government should consider re-introducing the idea of additionality, i.e. at least a percentage of the loans goes to businesses that have not been able to access formal finance to date. Although most KUR loans still have the benefit of a guarantee for the financial institutions, the government needs to be more targeted, for example, to directly guarantee loans up to a certain (higher) limit to small businesses to purchase land, buildings or equipment.

8. **There is no 'one stop shop' for SMEs.** There is no shortage of projects and stakeholders supporting SMEs, both generally for business development services and specifically for access to finance. However, there is no single source of information on the various services or funds available. It is intended that the MoCSMEs should provide such a central facility but this has not occurred to date. ***Recommendation to Government and Donors:*** It would be very helpful for SMEs, FSPs, NGOs and all the other stakeholders working in the sector for such a facility to be established as soon as possible. There is also a role for the development community to build platforms to bring together all stakeholders to foster the exchange of good practices on SME growth and finance.

9. **There may also be a need for a more specifically focussed organisation to help SME develop their business capacity.** In some countries, an institution has been set up specifically to provide advice to SMEs. The GoI established the Small and Medium Enterprises and Cooperatives Indonesia Company (SMESCO) in 2007 but its objective is mainly to promote the products of Indonesian SMEs. ***Recommendation to Government:*** It would be worthwhile considering whether Indonesia needs a specific SME focussed body to provide advice on all matters relating to SME and entrepreneur capacity building.

10 **Some Fintech and tax regulations are burdensome.** Whilst OJK has been praised for the decision to establish a regulatory sandbox, there are issues with other regulations, for example affecting eMoney licences and P2P transactions. In addition, leasing is discouraged by VAT being payable at both the beginning and end of the contract. ***Recommendation to OJK and Government:*** Whilst OJK generally does a good job with its ongoing regulation of a very vibrant sector, there is still a need to facilitate the Fintech advances in a way that both encourages the new technologies whilst ensuring that consumers are protected. Similarly, the GoI should consider the tax regime for leasing to determine if some relaxation of the VAT can be justified by the resulting increase in finance to SMEs.

SUPPLY SIDE

1. **There is a general lack of loan products that SMEs need.** Whilst all the banks and other FSPs offer working capital and investment loans, there is literally very little else and virtually no cashflow-based lending. Whilst there are many reasons, one of the key ones is the inability of FSPs to assess SME credit risk, due to their lack of records and cash accounting. ***Recommendation to FSPs:*** New product development involves both SME friendly terms, instead of pure asset-based financing, as well as appropriate pricing, based on a proper risk assessment by the lender. FSPs should look for alternatives to traditional collateral-based lending or, at least, use movable collateral registries to cover their perceived risks of lending. There are also opportunities in supply chain finance, where small businesses are financed through the relationships they have with their major suppliers or customers.

2. **Many banks do not possess the necessary systems, data and infrastructure to expand their SME lending.** Especially the smaller banks engage in time consuming credit procedures, use inefficient and expensive core banking systems and lack an appropriate branch network. Some FSPs are seeking to overcome these issues, by working through agents and other intermediaries including Fintech companies, and using new forms of business information such as digital data. ***Recommendation to FSPs and Donors:*** There is more that the FSPs can do in this area, supported by donors, to capture market opportunity. Some financial institutions are beginning to emphasize relationship lending technologies, which are based on "soft" information such as payment histories and social media interaction, more attuned to the characteristics of SMEs compared to banking norms and procedures. One possibility already happening is for the traditional FSPs with the capital to partner with the Fintech companies who own the technology and data. In addition, banks should move to decentralise operations, with additional branches or other ways to reach clients, such as digital banking.

3. **Many FSPs also lack an understanding of the sectors in which the SMEs operate.** Even with the current products, many bank field staff require training in SME lending and how to assess loan applications against the background of the sectors in which the SMEs operate. There is a general need to improve the skills of loan/account officers for marketing to SMEs and analysing their business. Detailed market research on the SME sector is also missing, not just on the numbers of SMEs in existence but their activities and financing needs. ***Recommendation to FSPs and Provincial Governments:*** The focus in this area should be on equipping the SME relationship managers, as they are

the interface between the clients and the bank, with the capacity to serve SMEs. In some provinces, there is a specialist SME bank, for example Bank (BPR) UMKM owned by the government in East Java, which can be helpful. A better strategy would be for FSPs in general to target SMEs as a separate and strategic customer segment, as they differ substantially from microenterprises and corporate sector in its financial and operational needs and require more alternative services.

4. **Alternate credit scoring and loan monitoring methods are needed.** Given the "ticket size" of SME loans versus the loan administration costs, banks need more efficient loan assessment processes for SMEs. ***Recommendation to FSPs:*** Some innovative approaches already exist, such as psychometric testing. However, the best prospects will be using 'big data' from online sources such as digital payment platforms and social media, which should be examined by the FSPs more actively. The loan monitoring approach also needs to change for SMEs, in areas such as portfolio quality and delinquency management.

5. **The presence of both commercial and subsidised lending can create confusion.** Despite some reservations on the targeting of KUR, the terms of the product are clear enough. There are also loan schemes at provincial level with subsidies. These may create confusion in the market. If this is unchecked, it can lead to higher NPL rates and discourage other lenders from entering the SME market. ***Recommendation to FSPs and Government:*** There should be greater clarity in the product disclosures to avoid this confusion. At the sector wide level, the funders or providers of the subsidised products, whether KUR or provincial government products, should assess the products regularly, to ensure they are having the desired impact and not 'crowding out' commercial, and hence more sustainable, alternatives for SME finance.

DEMAND OR CUSTOMER SIDE

1. **SMEs need to take steps to become more 'bankable' in order to access financial services.** Many SMEs need to adopt a more business-like mindset, rather than seeing their enterprise as an extension of family activities. Key to this is usually a business plan, with details on its operations, products, employees, marketing and processes. ***Recommendation to SMEs and Donors***: SMEs should take a more entrepreneurial approach to their businesses and build their own technical capacity, overall operational quality and enterprise information transparency. Moreover, SMEs should offer effective financial reports with high authenticity to help commercial banks make judgments on their credit worthiness. Donors can play a role, for example to provide proper business bookkeeping with cash flows and the capacity to plan for expansion, as well as workshops on topics such as financial literacy and use of Fintech.

2. **SMEs also need to be better informed on the potential finance and other services available to them.** Once the SME has a full understanding of its future financing needs based on some sort of a business plan, it is then a matter of determining what type of product and what quantum of funding best meets the SME's financing needs. ***Recommendation to SMEs***: As part of any financing decision, the SME should make detailed enquiries with the FSPs based on their situation and needs. In addition, the associations representing SMEs and entrepreneurs can do more, ideally operating in a coordinated manner to save costs and avoid duplication in serving their members, by

bringing to their attention some of the appropriate financial products, training and other business development services.

3. **The lack of required collateral hinders access to finance.** Whilst it can be argued that the lenders need to be more flexible in this regard, in most cases SMEs need to have some form of collateral in order to obtain finance. ***Recommendation to SMEs***: Management needs to take steps to clarify their title to land and other assets and obtain documentation that can be pledged for loans. If collateral cannot be provided, the SME should examine its capacity to provide alternatives, such as security over other assets, liens, guarantees and post-dated cheques.

4. **Many SMEs operate in remote areas where it is difficult to connect with banks and other services.** The banks are beginning to use networks other than physical bank branches, such as online processes or local agents, to reach potential clients. As for the supporting services, this is an issue for the regulators and FSPs, but it may also be the fault of SMEs themselves in not reaching out for the banks and the information. ***Recommendation to SMEs, Government and Stakeholders:*** Management should adopt a similar approach, particularly using the technologies being employed by the FSPs, such as the internet and digital payment platforms. Understanding and accessing these avenues for finance can be obtained from the FSPs themselves and other stakeholders, such as government ministries, donors, NGOs and business associations.

5. **There is a general lack of assessments of the impact of SME finance and other services.** The range of financial products, training and other business development services available to SMEs is extensive. However, there is very little detailed assessment done of what products and services work well and the impact on the SMEs and their owners and employees. ***Recommendation to Government, Donors and Stakeholders:*** More information on the SME sector, the finance available and support services would be of interest to those operating on the macro and supply sides and the SMEs themselves. The size and cost of impact assessments means that it is more likely to be government and donors that undertake such studies - like this one - but some of the analysis could be done on the demand side, perhaps again by the business associations working in tandem.

LIST OF ABBREVIATED TERMS

ASBANDA	Association of Bank Pambangunan Daerah (BPDs)
BAPPENAS	Kantor Menteri Negara Perencanaan Pembangunan Nasional (Ministry of National Development Planning)
BI	Bank Indonesia
BPR	Bank Prekreditan Rakyat (People's Credit or Rural Bank)
BPD	Bank Pembagunan Daerah (Regional Development Bank)
CMEA	Coordinating Ministry of Economic Affairs
CSR	Corporate Social Responsibility
DFS	Digital Financial Services
DoCSMEs	Department of Cooperatives & Small Medium Enterprise
F&B	Food & Beverages
FSP	Financial Service Provider
G2P	Government to person
GoI	Government of Indonesia
ILO	International Labour Organization
KSP	Koperasi Simpan Pinjam (Saving & Credit Cooperatives)
KUR	Kredit Usaha Rakyat
LPDB-KUMKM	Institute for Managing Revolving Funds of Cooperatives and MSMEs
LMK /MFI	Lembaga Keuangan Mikro/Microfinance Institution
MoCSMEs	Ministry of Cooperatives and Small Medium Enterprises
MSEs	Micro Small and Medium Enterprises
NBFC	Non-banking financial company
NPL	Nonperforming loan
MFC	Multi-finance company
OJK	Otoritas Jasa Keuangan (Financial Services Authority)

P2P	Peer to peer
Perbarindo	Perhimpunan Bank Perkreditan Rakyat
PROMISE IMPACT	Promoting Micro and Small Enterprises through Entrepreneur's Access to Financial Services
SECO	Swiss State Secretariat for Economic Affairs
SMEs	Small and Medium Enterprises
SNKI	*Strategis Nasional Keunagan Inklusi* (National Strategy for Inclusive Finance)
UKM/SMEs	Usaha Kecil Menengah/Small and Medium Enterprises
UMKM/MSMEs	Usaha Mikro Kecil Menengah/Micro Small and Medium Enterprises
UNPAD	University of Padjadajaran

1. INTRODUCTION AND BACKGROUND

1.1 OBJECTIVES AND SCOPE OF THE STUDY

The Government of Indonesia (GoI) has clearly defined objective to gradually increase financing for small and medium enterprises (SMEs), which are considered as the backbone of the economy. Around 99% of businesses in Indonesia are categorized as micro, small, and medium enterprises (MSME). Around 700,000 from a total of over 57 million are small and medium sized enterprises[1].

These enterprises provide jobs to over 93% of the labour force engaged in wage employment. However, in terms of value added, micro and small enterprise contribute relatively less (43%) to gross domestic product (GDP) compared to medium and large businesses (57%). One of the major constraints faced by small enterprises which affects their growth is lack of or limited access to financial services.

A majority of enterprises in Indonesia use their own funds for working capital and investment. In general bank lending for small businesses is relatively low. The government has directed banks to allocate 20% of credit to SMEs, a target that the banking industry is required to reach by 2019. While the number of SMEs accessing financial services is quite low, the type of loan products and economic sectors covered by banks is fairly limited. More than half of the SME loans are for trade. On the other hand manufacturing and agriculture loans amount to only 10.2% and 9.1% respectively of the total[2].

Against the above backdrop, the present research aims to understand the real and latent demand for SME financing across different economic sectors. Past studies on access to finance have generally focussed on SMEs as a homogenous group. This paper tries to delve into issues affecting SMEs engaged in different sectors of the economy with a focus on manufacturing or local production. The distinction between production and trade does not imply productive and consumptive credit. It is possible that loans for consumption may be used for productive purposes. By referring to production, the report only implies an economic sector which in this report mainly refers to manufacturing

One of the objectives of this research was to focus on sectors other than trade and services which banks normally consider as low-risk for lending. These two sectors undoubtedly play a key role in the economy and in fact taken together provide employment to over 46% workers in Indonesia. Historically though growth of manufacturing has enabled countries in industrialization and structural transformation leading to greater employment creation and decent work.

The research was undertaken as part of an initiative under the *Promoting Micro and Small Enterprises through Entrepreneurs Access to Finance Project* (PROMISE IMPACT). The project is implemented by the International Labour Organization (ILO) with funding from the Swiss State Secretariat for Economic Affairs (SECO). PROMISE IMPACT aims to promote growth, productivity, and jobs in small businesses through value-added services provided by financial institutions.

1 Based on data from Ministry of Cooperatives & SMEs

2 Data from OJK, July 2018

Through an innovative approach, the project assists financial institutions to create greater social and economic impact by developing replicable models which can be scaled up and help in shaping the policy landscape in Indonesia.

The research will complement a survey which was also commissioned under the project to understand internal bank policies and practices for financing SMEs. The survey looks at the issue mainly from the supply-side whereas this research is focusing on demand and policy environment underpinning the supply of credit and financial service providers (FSPs). Recent attempts to measure the demand for financial services have mainly focussed at the household level. There are some enterprise level surveys which include queries about borrowing, but usually these surveys are not able to fully capture demand and importantly latent demand for borrowing among SMEs. The research is, therefore, trying to broaden the knowledge base on SME financing with a focus on production sectors of the economy.

1.2 METHODOLOGY AND ANALYTICAL FRAMEWORK

Specifically, the study aims to:

1. *discuss and analyse demand, including latent demand, for finance among SMEs;*

2. *shed light on constraints faced by SMEs to access finance including the lack of financial products and services which better meets their needs; and*

3. *what measures can be taken to address constraints and stimulate demand for SMEs in production sectors, explored from the demand side (SMEs) as well as the supply side (financial institutions and policy environment).*

The scope of work included literature review including academic studies on SME financing in Indonesia and elsewhere. The desk research also included an analysis of credit allocations across different sectors and time periods. These were reviewed in the context of various policies and national schemes to promote SMEs.

Besides desk research, several key national stakeholders and industry experts were interviewed. Besides interviews in Jakarta, stakeholders were consulted in West Java where the PROMISE IMPACT conducted a supply-side survey with over 50 banks. The stakeholders interviewed for this research fall into three broad groups:

- Regulators and other development partners, such as OJK, Bappenas, Ministry of Industry, Coordinating Ministry of Economic Affairs, ILO, IFC/World Bank, IFAD and UN; and the University of Padjadjaran
- Supply-side actors including banks and associations of banks such as ASBANDA (Association for Regional Development Banks in Indonesia), PERBARINDO (Association of Rural Banks in Indonesia); and
- Demand-side actors, such as representatives of industry, entrepreneur associations, business development service providers.

A complete list of respondents and the interview guides are included as annexes. Following the field work, debriefings were organized to share preliminary findings and seek further input and validation.

1.3 STRUCTURE OF THE REPORT

The report is structured into three main chapters. Besides chapter one which provides an introduction and background, chapter two contains a situational analysis of the country, including: a review of the regulatory and policy landscape of the financial system; the key institutions, regulators and service providers, processes, the nature and scope of the financial system; and product innovations to improve SMEs' access to, and use of, financial services.

Chapter three sets out results of the literature review and field study, starting with an analysis of the access, usage and quality of the financial services made available to SMEs. Lastly, chapter four comprises a summary of findings of gaps in the access to finance for SMEs and recommendations to improve SME financial inclusion, at the three levels of regulatory, supply side and demand side. There is also an analysis of the opportunities for product innovations and technology that can help in improving financial services for SMEs.

2. SITUATIONAL ANALYSIS

2.1 OVERVIEW OF THE ROLE OF SMES AND STATE OF FINANCIAL INCLUSION

2.1.1 LEGAL AND POLICY FRAMEWORK

Since 2004, the GoI has strategically promoted small businesses as the engines of sustainable and pro-poor growth. In consultation with all the relevant ministries and agencies, the government launched comprehensive economic policy reforms called the New Economic Policy Package in 2007 and 2008. This package included policies to improve the investment environment, finance and infrastructure sector. One deliberate aim was to strengthen small enterprises in the country.[3] The government also passed the SME Law (Law No.20/2008) providing a single national definition for the benefit of all government authorities and the Bank of Indonesia (BI): see section 2.1.2. More initiatives impacting SMEs were announced in 2012, which included the Microfinance Law (Law No.1/2013).

The National Medium Term Development Plan places 2nd on its list of priorities to "improve access to finance, through developing special financial institutions for small enterprises and cooperatives with financial stakeholders in providing various financial schemes that matches with the needs of, and improving capacity of small businesses in managing finance".[4] The National Strategy for Financial Inclusion (NSFI) for Indonesia also aims to improve both coordination among various government agencies and access to finance for small businesses: see section 2.1.6 for more detail.

In this section, the aim is not to list all the regulations and laws relevant to the financial sector, as these can be found elsewhere, including in an International Fund for Agriculture Development (IFAD) authored report[5]. However, some recent initiatives are worth highlighting. Firstly, the government has reduced the tax rate for SMEs, under Government Regulation (GR) No.23/2018 (GR-23), with effect from 1 July 2018[6]. The new "final tax" rate of 0.5% (down from 1%) applies for SMEs with annual gross turnover of not more than IDR 4.8 billion (approximately $323,000[7]). One of the aims of the regulation is to encourage SMEs to register with the government and adopt a more formal operating status, thereby taking advantage of other facilities, such as training and using better bookkeeping.

Secondly, the government launched the online single submission (OSS) licensing system on 9 July 2018[8]. The system is designed to cut lengthy bureaucratic procedures, thus attracting more direct investment. Several key business permits – such as the location permit, environmental permit and building permit – can be obtained in one step. The 'one stop shop' will be operated by the Coordinating Ministry for Economic Affairs (CMEA) until the Investment Coordinating

3 IFC (2016), Women-owned SMEs in Indonesia: A Golden Opportunity for Local Financial Institutions, IFC March 2016, page 9

4 MCSME (2018), National Development Policy on MSMEs and Cooperatives, Presentation by Director of SMEs and Cooperatives

5 Hamp, Michael (2015), Republic of Indonesia: Integrated Participatory Development and Management of Irrigation Project (IPDMIP) Project Administration Manual Appendix 3: Working Paper – Rural Finance, 30 September 2015, Jakarta: IFAD

6 https://www.pwc.com/id/en/taxflash/assets/english/2018/taxflash-2018-07.pdf

7 Using exchange rate of $1 = IDR 14,868

8 Based on (1) Presidential Regulation No. 91/2017 on the Acceleration of Business Implementation and (2) Government Regulation No. 24/2018 on the Electronically Integrated Business Licensing Service

Board can take it on. Cutting of 'red tape' has allowed Indonesia to rise in the ranks of the World Bank's Ease of Doing Business Index from 109th in 2016 to 72nd in 2018. However, it still lags behind some of its peers such as Singapore, Malaysia, Thailand and Vietnam.

According to the World Bank[9], the authorities have improved the use of movable collateral by transitioning to an online collateral registry in 2013. The transformation from manual to online resulted in a huge increase in the number of total registrations. In the first three years since its launch, the registry has facilitated over US$30 billion in financing for more than 200,000 small-scale businesses. In total, there were 19.3 million registrations of corporations, enterprises and consumers, compared to only three million registrations in total during the ten years of operation of the manual registration system that preceded it.

On the regulatory side, suffice to say here that the two main bodies are: the central bank of Indonesia, Bank Indonesia (BI); and the Financial Services Authority or *Otoritas Jasa Keuangan* (OJK). Their roles will be referred to throughout this report.

The main categories of FSPs are discussed here briefly from the regulatory side; their contributions to SME finance are dealt with in section 2.1.3. The Law 7/1992 on Banking, as amended, differentiates between two bank types, Commercial Banks (CBs) and rural banks, *Bank Perkreditan Rakyat* (BPRs). There are currently 115 CBs with 31,966 branches. BPRs, who are limited to operating in one province and cannot take demand deposits, number some 1,609 with 6,225 branches.

There are also regional development banks, *Bank Pembangunan Daerah* (BPDs), and *Lembaga Dana dan Kredit Pedesaan* (LDKPs), which is the generic name for independent regional government owned microfinance institutions (MFIs). Since 2014, OJK is responsible for regulating and supervising the financial market, banks and licenced financial institutions or *Lembaga Keuangan Mikro* (LMK).

Finally, there are a number of different types of non-banking financial institutions which are registered as co-operatives including: *Koperasi Simpan Pinjam* (KSP), *Unit Simpan Pinjam* (USP), *Koperasi Kredit* (Kopdit) or Credit Unions (CUs) and Syariah Co-operatives (BMT). The data on exact number of credit and savings co-operatives is not available but one estimate is that there are a total of 80,000 credit and savings co-operatives in Indonesia while another suggests there are more than 3,624 KSPs and 36,000 USPs. Inkopdit, the credit union network of Indonesia, estimates there are 917 CUs in Indonesia, only 274 of which have more than 1,000 membership.

There is also one nationwide operating financial institution which collaborates with BPRs, MFIs and cooperatives. The state owned PT Permodalan Nasional Madani (PNM) mainly focuses on financing micro, small and medium enterprises as well as cooperatives. PNM makes loans of Rp1 million to Rp200 million, which means it focuses at the smaller end of the market; it also provides indirect financing services through BPRs and other financial institutions.

9 World Bank (2017), Financial Sector Assessment: Republic of Indonesia, June 2017, Washington: World Bank

2.1.2 ENTERPRISES IN DIFFERENT SECTORS

Using the most recent government source, there are approximately 63 million MSMEs in Indonesia[10]. As shown in Table 1, MSMEs employ approximately 97% of the Indonesian workforce and contribute to 57% of GDP. The same source indicates that there are 816,000 SMEs employing 7.9 million people and contributing 27% to GDP[11]. The number and contribution to GDP of SMEs has increased from 2013 when there were around 700,000 and contributing 22% to the GDP.

Table 1: MSMEs in Indonesia

Type	Number		GDP		Employment	
	Unit	Share (%)	IDR (billion	Share (%)	Person	Share (%)
Micro	62,106,900	98.7	2,856,608	30.06	107,232,992	89.17
Small	757,090	1.20	1,191,871	12.54	5,704,321	4.74
Medium	58,627	0.09	1,376,936	14.49	3,763,103	3.11
MSME	62,922,617	99.99	5,425,415	57.08	116,673,416	97.02
Large	5,460	0.01	4,078,743	42.92	3,586,769	2.98
Total	62,928,077	100.00	9,504,149	100.00	120,260,185	100.00

Source: Bappenas (2018)

According to the figures (Table 2) compiled by the SME Finance Forum, there are over 50 million MSMEs in Indonesia. More than half of these are involved in primary agricultural production. These make up 52% of micro enterprises and 0.5% of SMEs. A larger proportion of SMEs (71.8%) are engaged in trade while manufacturing SMEs account for a little over 11% of the total.

10 In this report, we adopt the MSMEs definition from Government Regulation No. 20 /2008 on MSMES:

Type of Enterprise	Asset Value (Million IDR)	Annual Sales (Million IDR)
Micro	Less than 50	Less than 300
Small	50 up to 500	300 up to 2,500
Medium	500 up to 10,000	2,500 up to 50,000
Large	More than 10,000	More than 50,000

11 Bappenas (2018), National Development Policy on MSMEs and Cooperatives, Presentation by Director of SMEs and Cooperatives

Table 2: MSMEs by Sectors

	Micro	SMEs	%Micro	%SMEs
Manufacturing and Processing	**3,176,471**	**61,640**	**6.27%**	**11.01%**
Services	**2,309,311**	**43,797**	**4.56%**	**7.82%**
Construction and Real estate	159,883	14,476	0.32%	2.59%
Other services	2,149,428	29,321	4.24%	5.24%
Trade and Hotels/Restaurants	**14,387,690**	**402,260**	**28.38%**	**71.85%**
Extractive Industries	**258,974**	**2,367**	**0.51%**	**0.42%**
Infrastructure	**3,196,937**	**19,710**	**6.31%**	**3.52%**
Electricity, Gas and Clean Water	10,756	866	0.02%	0.15%
Transportation and Communication	3,186,181	18,844	6.28%	3.37%
Financial services	**970,163**	**27,348**	**1.91%**	**4.88%**
Primary Agriculture, Livestock, Forestry and Fisheries	**26,398,113**	**2,756**	**52.07%**	**0.49%**
Total	**50,697,659**	**559,878**	**100%**	**100%**

Source: http://www.smefinanceforum.org/data-sites/msme-country-indicators

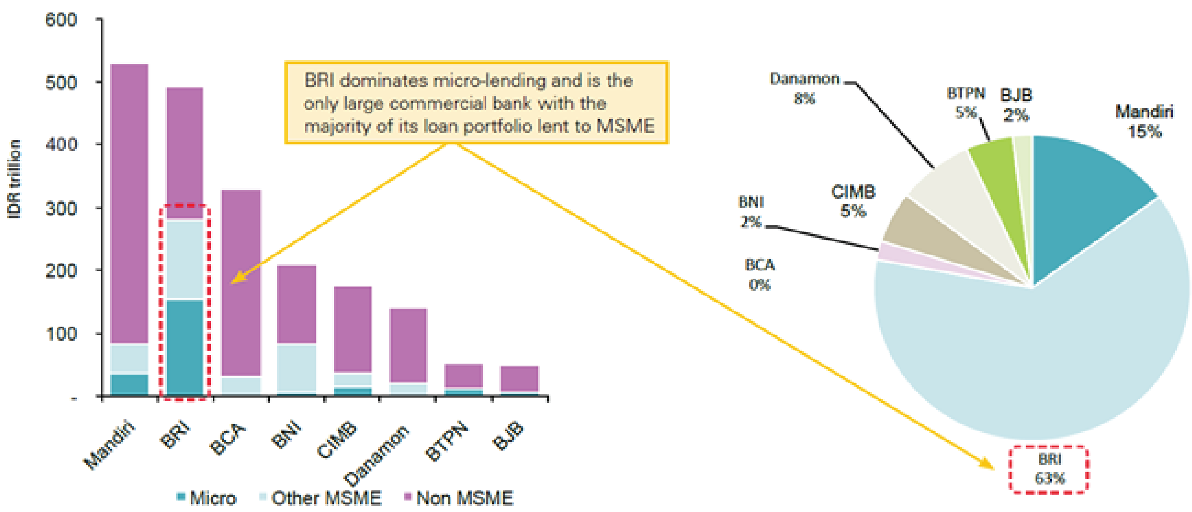
2.1.3 FINANCIAL SERVICE PROVIDERS (FSPs)

By international standards, Indonesia's financial sector as a whole has been growing but is still small in terms of total financial assets as a percentage of GDP and the amount of credit to the private sector, at 103% and 25% respectively. By way of comparison, the nearby countries of Malaysia, Thailand and China boast financial assets as a percentage of GDP equivalent to 383%, 210% and 542% respectively, while credit to the private sector in Malaysia, Thailand and China amounts to 108%, 84% and 114% of GDP respectively.

Banks

As for the amount allocated to small enterprises, the figure below shows, on the left, the split of the banks' portfolios between micro, other MSME (i.e. SMEs) and larger enterprises. As has been the case for decades, BRI dominates the microlending market, but it also provides sizeable lending to SMEs, followed by other banks, led by BNI, Bank Mandiri and BCA.

Figure 1: Lending to MSMEs



Source: KPMG (2015)

After the 'Big 4', other larger CBs that focus on SMEs are Bank CIMB-Niaga and Bank BTPN. In terms of BPDs, as shown in the figure, Bank BJB is particularly strong in West Java. In addition, there are private and foreign banks with a strong focus on SMEs, such as OCBC NISP, Bank Permata, Bank Panin, Commonwealth Bank and KB Hana. There are also smaller banks with an SME focus, including two that were interviewed during the field work, namely JTrust (focuses on "productive SMEs and the commercial sector") and Sampoerna ("emerging SMEs in trading and manufacturing, as well as plantations and agriculture").

Some of this strategic focus may have been driven by the impact of the subsidised KUR product, which means that the banks allowed to offer KUR loans (up to IDR 500 million) can do so with a subsidised interest rate. Other banks lending to the micro and SME sector cannot offer this and are also unable to compete on costs of funds with BRI and the other government-owned banks, who get the bulk of the KUR allocation (see section 2.1.4 for more detail).

Rural Banks (BPRs)

The footprint of BPRs shows a strong presence on Java, which accounts for over half of their assets. BPRs focus on SMEs but nearly 50% of their portfolio is for consumption loans and the businesses they focus on are mainly microenterprises, self-employed, and individuals with fixed income. Many of the BPRs suffer from issues such as portfolio quality, governance and low capitalisation, meaning that all but the larger ones have human and financial resources for large scale SME lending. Also, the existing regulations limit the services that BPRs can provide. The World Bank is currently preparing a study for OJK on the state of BPRs.

Figure 2: Geographic Spread of BPRs

	Sumatra	Lampung	Java	Bali	Kalimantan	Sulawesi	Others
Population	18%	3%	57%	2%	6%	7%	6%
Outlets	10%	1%	75%	6%	2%	3%	3%
Asses	12%	9%	58%	10%	3%	5%	4%
USD mio.	771	556	3.757	643	161	298	261

Source: Hiemann (2014)

A World Bank report in 2017[12] noted that bank credit is focused on large corporates and state-owned companies, while MSMEs remain largely underserved. Indonesian MSMEs face significant challenges in accessing financing, mainly due to the stringent operational, reporting and collateral requirements of commercial banks. Notwithstanding various government initiatives discussed earlier, the share of MSME loans to total bank loans stands at around 16%.

Cooperatives

There are two types of cooperatives, namely primary cooperatives and secondary cooperatives. Primary cooperatives require at least 20 members, who contribute the primary cooperative's authorized capital. On the other hand, secondary cooperatives can be established by at least 3 primary cooperatives. The focus of this report is on the primary cooperatives which are restricted in their operations, based on their legal type, as mentioned in section 2.1.1. For example, savings and loans services can be offered by single purpose cooperatives (KSP) and specialised units (USP) within multipurpose cooperatives (Koperasi Serba Usaha or KSU).

CUs are generally known to be the healthiest segment of the cooperative sector. They operate under the umbrella of a regional and national association (Inkopdit) following international credit union rules. Most CUs may not have the financial or institutional capacity to analyse or lend to SMEs but a few are very big, such as Kospin Jasa and CU Lantang Tipo in West Kalimantan, the latter with 190,000 members[13].

12 World Bank (2017), Financial Sector Assessment: Republic Of Indonesia, June 2017, Washington: World Bank

13 http://www.culantangtipo.com/

Volume of Lending to SMEs

As for lending by the various classes of banks to SMEs generally, at the end of 2017 there was IDR 883 trillion outstanding in loans to MSMEs. It is broken down as shown in the Table below, indicating that the state-owned banks dominate the overall category (56%), with 73% of the total loans to SMEs.

Table 3: Lending to MSMEs in Indonesia

Category of Lender (IDR trillion)	Microenterprises	Small enterprises	Medium enterprises	Total
State owned banks	175.3	195.6	124.3	495.2
BPRs	15.5	27.9	27.0	70.4
Foreign Exchange Commercial	15.9	44.9	249.5	310.3
JV and Foreign	1.0	0.8	5.5	7.3
Total	207.7	269.2	406.3	883.2

Source: OJK (2018)

Of the total, IDR 114.7 trillion (13%) was in West Java and IDR 132.5 trillion (15%) in Jakarta. For SMEs, the total was IDR 675.5 trillion. Out of a total bank lending of IDR 4,136 trillion, this represented approximately 16%. This proportion has been reasonably consistent: the figure for 2014 was 15%.[14] As for non-performing loans (NPL), state-owned banks had much lower NPL rates (December 2017) in micro (1.8%) than in small enterprise (3.4%) and medium enterprises (6.6%), with NPLs for all lending of 2.5%. For the private commercial banks, the ratios are much closer at 3.6%, 4.4% and 3.2%, respectively, compared to a total NPL of 2.6%.

Other Lenders

In addition to the above, some of the Multi Finance Companies (MFCs) such as Indosurya and Radana, who can now provide more than vehicle leasing, are targeting SMEs. MFCs have had two years since the law was changed but still lack capacity to make loans based on the ability to analyse standalone businesses. However, MFCs offer promise as they expand products and install better systems, although the fact that they cannot take deposits will affect their cost of funds.

The role of Fintechs will be considered in sections 2.1.4 and 2.1.7; in summary, whilst their potential is considerable, the Fintechs are not a major competitor yet, other than in niche products. One example is invoice discounting, being conducted by companies such as Investree, but the finance is only 1 to 3 months.

14 KPMG (2015), New Indonesian 'Branchless Banking' and Microfinance Laws, 2015, Jakarta: KPMG, page 9

Crowdfunding or (peer-to-peer) P2P lending is also taking off, and it occupies the space between MFIs and bank loans. Amartha is an example of a P2P lender with a Fintech licence, partnering with banks for savings. Whilst it claims to be doing working capital lending, it is mainly consumer lending or payday loans. At the moment it appears that P2P loans are incurring high NPLs, estimated by one interviewee at 13-15%. This can be attributed to a lack of real capacity in these 'start ups' to analyse credit risk in the same way as the banks.

2.1.4 INVENTORY OF CURRENT PRODUCTS

The total outstanding amount of loans to MSMEs in Indonesia at the end of 2017 (IDR 883 trillion; see Table 3) was divided into working capital (WC) loans (IDR 659 trillion or 74.6%) and investment loans (IDR 224 trillion)[15]. The leading sectors to which the SME loans were made at the end of 2017 were: Wholesale and Retail (IDR 462.7 tr); Manufacturing (IDR 93.2 tr); Agriculture, Hunting, and Forestry (IDR 78.7 tr); Construction (IDR 55.8 tr); Real estate, Business Services (IDR 42.9 tr); and Community, Sociocultural, Entertainment and Others (IDR 42.5 tr).

The FSPs interviewed during the field work also indicated that they generally offered just two standard products for SMEs: WC and investment loans with WC larger (60-75% of portfolio); the only other product was a foreign currency facility for large overseas trading companies.

Table 4: SME Loans Offered by Banks Interviewed

Bank	Loan Range (IDR bn)	Interest Rate (pa)	Criteria	Collateral
BRI	0.2-50	13-15%	Not start up	Immovables
J Trust	1-15	10.5-13.5%	Not start-up, 2 years' experience	Land and buildings
Sampoerna	0.5-3	NA	2-3 years' history	Fixed assets
btpn	1-50	10.5-12.5%	NA	Immovables
Mandiri	0.5-5	12-15%	NA	Immovables

Source: Bank interviews

The above banks did not identify particular sectors for lending although some stated their focus as being on "all productive sectors". The sectors identified by banks interviewed included: "Mainly trading followed by small manufacturers/producers e.g. large home industry or small factory in sectors such as garment/textile, FMCB, food and beverages, fashion, crafts; and then retail and services e.g. restaurants, garages, mobile phones and tourism". Many operate entirely or mostly in urban areas but have some activities in agriculture or fisheries.

15 OJK (2018), Indonesian Banking Statistics, May 2018, Jakarta: OJK.

As for the small banks, they compete by offering speedy credit assessments, with more flexible requirements. The quick turnaround allows them to compete, as they will otherwise lose on price due to higher costs of funds. In addition, they try to build loyalty by adding non-financial services, such as business advice. Some also offer specialised products for particular industry sectors.

Many banks use agents to approach SMEs or offer existing clients new customer introduction fees. Social media is also being used for marketing. Thirdly, some banks collaborate with other parties to reach SMEs e.g. through cooperatives (by channelling to those who lack finance) or using their corporate network to reach suppliers and clients. Some work with a range of partners, such as Google, IT providers or tax consultants. However, the personal approach to SMEs in the field via loan officers remains important, with some accessing data from government departments or chambers of commerce to suggest clients, for example, construction companies doing work for government.

Many of the medium or smaller banks are focused on SMEs, sometimes because it has become too competitive in the microenterprise segment owing to KUR which is discussed below.

Kredit Usaha Rakyat (KUR)

The Government established the KUR program in 2007 in order to enhance MSMEs' access to bank loans through the provision of partial credit guarantees. KUR guarantees were provided through Askrindo and Jamkrindo – the two dominant state-owned Credit Guarantee Companies (CGCs) – to participating banks for their eligible MSME loans. The government paid the guarantee premiums and provided capital to the two CGCs annually, and set the policies and requirements applied under the KUR program. The CGCs covered 70 to 80% of the risk of loan loss for banks' MSME loan portfolios.

The new KUR program featured prominently in the Government's economic reform packages was announced in late 2015. Under the new KUR program, the Government provides interest subsidies to participating banks allowing them to lend to MSMEs at capped interest rates. The interest rate subsidy also covered the guarantee fees paid by banks to the CGCs but the capital at risk and loan liquidity comes from the banks themselves. The government sets the annual targets for the lending and the banks are then allocated a proportion for which they can make loans with the government subsidised interest rate.

The total amount disbursed through the KUR program has increased each year, from IDR 94.4 trillion in 2016 and IDR 96.7 trillion in 2017 to a target of IDR 120 trillion for 2018. In 2018, IDR 79.7 trillion in loans was expected to be channelled through BRI, retaining its dominance of around two-thirds from previous years. In June 2018, there were 2.4 million KUR clients with IDR 64.6 trillion of loans outstanding. When compared to the total outstanding stock of loans to micro (IDR 207.7 trillion by end 2017) and small (IDR 269.2 trillion) businesses, it is clear that the KUR program is of central importance for the entire market segment.[16]

As to the loan size and terms, there are two products: KUR Mikro is for loans up to a maximum outstanding amount of IDR 25 million and KUR Kecil (formerly Retail) is up to IDR 500 million. However, some banks cap their KUR loans at IDR 200 million. The interest rate was reduced to

16 World Bank. 2017. Indonesia Economic Quarterly: Staying the Course. March 2017. Jakarta: World Bank, page 39

7% (down from 12% in 2015 and 9% in 2016 and 2017), with a subsidy of 9% for loans of less than IDR 25million and 5% above. Despite the government suggesting that no collateral is needed for SMEs to access KUR, in practice though many banks still require collateral from the clients since KUR is purely financed by banks and they have to follow standard banking procedures that require collateral. It is important to note here that the MoCSMEs is implementing a programme for SMEs to obtain land certificates for free. The objective is to help SMEs to use registered assets as collateral. During the expert FGD it was mentioned that the responsible agency (BPN) faced challenges and as a result the programme is not being executed optimally.

Importantly for many SMEs, the KUR program has shifted from a partial credit guarantee program intended to create credit records for first-time borrowers, and thus make them more bankable, towards a program with a predominant focus on interest-rate subsidies intended to create better loan conditions for borrowers, including repeat borrowers. Non-first time borrowers, and even former KUR borrowers and former commercial borrowers, can now also apply.

Another issue is that the geographical coverage for KUR lending is not particularly flexible, with SMEs in remote areas complaining they were rejected by the bank because of their distance from the relevant bank branch. Finally, the number of eligible sectors for KUR was increased, such that the new KUR program is available to almost all sectors where MSMEs operate. The regulations for KUR in 2018 focus more on "productive" sectors, which is defined to include "agriculture, fisheries, industry processing, construction and production services", although there are no specific targets for such lending. It can be said that KUR has become more focussed on expanding finance for SMEs in productive sectors.

However, for the above reasons, there is a risk that banks will direct subsidized KUR loans to those MSMEs that can provide the most information on their creditworthiness (generally those that have already received a bank loan), while the financial institutions without access to KUR attend to higher risk MSMEs with less information. In the long run, commercial offerings will find it hard to compete in the micro- and small loan market (commercial market interest rates are usually 20 to 26%), and probably abandon the market.

The CMEA issued a regulation in 2016 entitled "Guidelines of KUR Disbursement" to prevent crowding out credit at the downstream level, but its impact remains to be seen. For the MSMEs themselves, sustainable access to loans is usually more important than lower interest rates. One report concluded that subsidized KUR loans have the potential to increase MSMEs' income by only 3% or less, whereas the increase in income from the mere access to loans and the resulting investment is often more than 20%.[17]

A very recent study[18] suggests that the KUR program, despite its limited coverage, has been quite effective throughout the country due to: wide dissemination of the program; simplicity of the application procedure; full participation and support from banks; and strong coordination between all stakeholders. On the other hand, to improve efficiency and fiscal sustainability[19], the World Bank has recommended that the authorities should consider targeting more first-time borrowers and MSMEs in remote areas and underserved priority sectors. More broadly,

17 World Bank. 2017. Indonesia Economic Quarterly: Staying the Course. March 2017. Jakarta: World Bank, page 42

18 Tambunan, Tulus T.H, The Performance of Indonesia's Public Credit Guarantee Scheme for MSMEs: A Regional Comparative Perspective, Journal of Southeast Asian Economies (JSEAE), vol. 35 no. 2, 2018, pp. 319-332. Project MUSE, muse.jhu.edu/article/702088.

19 The redesign of the KUR program has led to an estimated ten-fold increase in fiscal costs in terms of both direct and indirect subsidies, which sum up to roughly IDR 12.3 trillion per year over 2016-2017.

strengthening the financial infrastructure (e.g., ICR regimes, credit information, and collateral registries) and pure partial credit guarantees are likely to be more effective and sustainable interventions.

Other Soft Loans

The corporate social responsibility (CSR) program of state-owned companies is known as the *Program Kemitraan dan Bina Lingkungan* (PKBL) and low-interest loans for MSMEs are a part of the program. Under PKBL, state-owned companies can provide credit of up to IDR 200 million[20] to MSMEs with less than IDR 200 million in assets (excluding land and business premises), with no collateral on loans up to IDR 30 million. The maximum term is 3 years and the interest rate can be as low as 3% per annum flat, although the actual terms can be set by the company itself.

Another example of a subsidized loan program is the *Kredit Cinta Rakyat* (KCR) product distributed by Bank BJB with funding from the West Java government. It focuses on MSMEs with a maximum of IDR 20 million for Micro and IDR 50 million for small enterprises. Investment loans are for a maximum of 5 years and WC loans for up to 3 years. The interest rate is 8.3% pa. Whilst from 2011 to 2018 a total of 16,576 loans were disbursed, only 2,085 of them were for small enterprises, according to the BJB executive interviewed.

Leasing

Beyond traditional lending, leasing is an important way for SMEs in many countries to expand their access to short- and medium-term financing. Under a finance lease, a firm makes a small down payment and a series of subsequent payments for the use of production assets and equipment. At the end of the lease term, the firm can purchase the assets from the lessor by making a minimal buyout payment. Leasing enables SMEs to preserve cash for profit-generating activities. The advantage for the lessors is that, because they retain ownership of the leased assets throughout the life of the contract, these assets become a form of collateral, as control of the leased asset facilitates a simple recovery procedure, even in weak legal and institutional environments.

However, as the IFC has determined[21], leasing of machinery or other equipment is more common for corporates and individuals than for SMEs: only 2 % of the SMEs use leasing. As some of the MFCs, such as Indosurya, move away from vehicle leasing under their expanded licensing mandate, they could expand into leasing of equipment. However, only a few MFCs are doing so, and one reason may be tax issue. The problem is that VAT of 10% is payable when the lessor acquires the asset at the beginning of the lease and then again when it is purchased by the lessee at the end of the lease term.

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20 http://infopkbl.bumn.go.id/

21 IFC (2016), Women-owned SMEs in Indonesia: A Golden Opportunity for Local Financial Institutions, IFC March 2016, page 29

Fintech

Based on data from OJK[22], disbursement of credit through Fintech in Indonesia reached IDR 7.8 trillion ($534 million) in the 7 months through July 2018, over three times the IDR 2.56 trillion ($175 million) that was disbursed in full-year 2017. These funds originate from 66 local Fintech companies that have obtained permits from OJK to engage in P2P lending. There are also more than 100 unlicensed P2P lending providers active in Indonesia. According to the Indonesian Fintech Association[23], there are now a total of 235 Fintech companies operating in Indonesia, with over half of those founded in the last two years. As of August 2018, another 62 local Fintech companies were seeking to obtain permits from OJK.

Examples of the Fintech products already available to MSMEs in Indonesia are those offered by Investree, namely discounting invoices (for a 1-3 month period) and some WC lending for up to a year, but its total clients (a mixture of microentrepreneurs and SMEs) is just 2,600. There are also P2P lenders such as Amartha, which has made 130,000 loans since 2010, and Gandeng Tangan, but they are mainly focussed on rural micro entrepreneurs.

Apart from a lack of focus on SMEs, some are concerned that the model is too risky and that most Fintech operators are missing a strong banking background, which will mean the Fintech companies do not move into the SME market. However, during the expert discussion organized by OJK to discuss the draft findings in this report, it was underlined that P2P lending will play a critical role in improving access to finance for SMEs.

The potential 'elephant in the room' is Gopay (see section 2.1.7) but it is not currently providing loan products to SMEs, as digital payments is still its core feature. At present, Gopay is focused on recruiting more micro merchants, with its main competitor being Tcash. A report by PwC Indonesia[24] in July says a majority of Indonesian bankers surveyed (43 banks participated) felt threatened by Go-Pay/Go-Jek (72%) and Alibaba's Alipay (62%), with Grab (42%) and Tokopedia (38%) also ranking ahead of global players such as Amazon (28%), Google (18%) and Facebook (12%).

2.1.5 CURRENT LEVELS OF FINANCIAL INCLUSION

According to the 2017 Global Findex, half of Indonesia's population is still excluded from formal financial services. Whilst 55% borrowed in the last year, only 17% borrowed from a formal bank or microfinance institution and 36% borrowed from informal sources such as neighbourhood schemes, friends and family[25]. As an indication of the extent of Fintech, only 7% of the total sample (1,000 respondents) used a mobile phone or the internet to access a financial institution.

However, the number of Indonesians with some form of account with a formal financial institution has been growing rapidly since 2011, rising from 20% to 49% of the adult population in six years. Indonesia's 29 percentage point gain over the six years is far above the global average and has outstripped some Southeast Asian countries, as shown in the figure below.

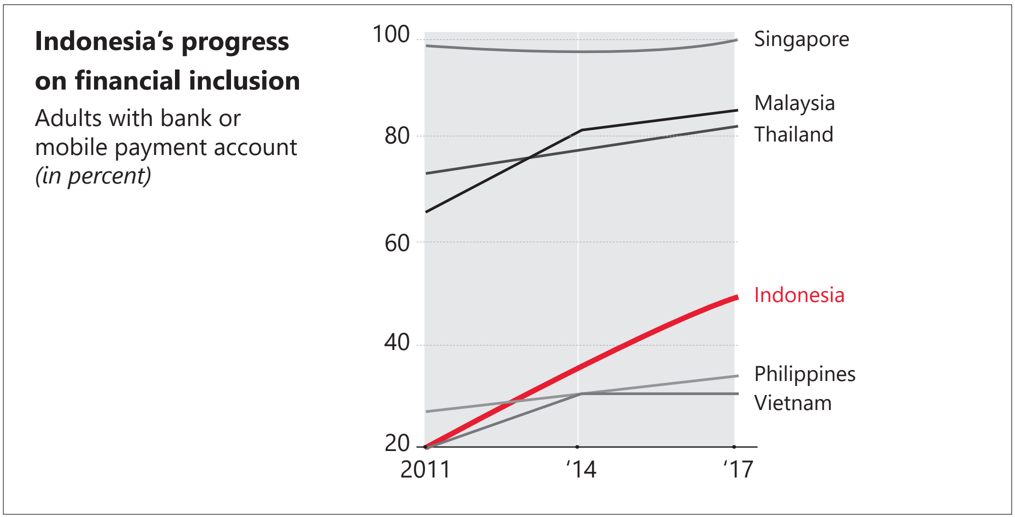
22 https://www.indonesia-investments.com/finance/financial-columns/rapid-development-of-Fintech-industry-in-indonesia/item8949

23 https://en.antaranews.com/news/116999/indonesia-makes-great-progress-in-financial-inclusion-ifc

24 PWC (2018), PWC Survey: Digital Banking in Indonesia 2018, July 2018, Jakarta: PWC

25 Demirgüç-Kunt, Asli, Leora Klapper, Dorothe Singer, Saniya Ansar, and Jake Hess (2018), The Global Findex Database 2017: Measuring Financial Inclusion and the Fintech Revolution, World Bank: Washington, DC.

Figure 4: Growth in Financial Inclusion in Southeast Asia



Source: World Bank

Another study[26] focussing on Eastern Indonesia (East Java, NTB, NTT and South Sulawesi) arrived at a similar figure for those accessing credit through banks: only 13% of borrowers in the four provinces. The majority of adults who had accessed loans (71%) did so either informally or outside the financial system entirely. A third study by the IMF[27] came up with a similar figure for borrowing from commercial banks: 22% of all adults. The Global Findex does not survey enterprises. However, the figure for borrowings to start a farm or business was extremely low: only 6% of all respondents, surprisingly down from 12% in 2014[28].

In an earlier IFC study[29], 76% of the surveyed urban SMEs confirmed using some type of banking service. Nonetheless, access to loans is limited with 39% of small and 50% of medium-sized enterprises using banks services for obtaining financing. In the survey, 46% of the SMEs said they had a loan with a bank at some point in their existence, with 29% having a loan outstanding in the past two years. Using the national SME definition, 20% of urban micro enterprises, 33% of urban small enterprises and 41% of urban medium enterprises had a bank loan.[30]

26 SOFIA (2017), Understanding people's use of financial services in Indonesia, May 2017, Jakarta: AIP-PRISMA

27 IMF (2017), IMF Financial Access Survey (FAS) available at www.imf.org

28 Demirgüç-Kunt, Asli, Leora Klapper, Dorothe Singer, Saniya Ansar and Jake Hess (2018), The Global Findex Database 2017: Measuring Financial Inclusion and the Fintech Revolution, World Bank: Washington, DC.

29 IFC (2016), Women-owned SMEs in Indonesia: A Golden Opportunity for Local Financial Institutions, IFC March 2016

30 IFC (2016), Women-owned SMEs in Indonesia: A Golden Opportunity for Local Financial Institutions, IFC March 2016, page 21

2.1.6 PROGRAMS SUPPORTING SMES

The Indonesian National Financial Inclusion Strategy (SNKI) has raised the profile of the financial inclusion agenda. The SNKI has an ambitious goal to reach 75% of adults with a transaction account by the end of 2019. President Joko Widodo launched the SNKI, when Queen Maxima (the UN Secretary-General's Special Advocate for Inclusive Finance for Development) was in Indonesia in 2016. The President chairs the national steering committee, assisted by a Secretariat and 7 Working Groups made up of various key ministries and regulatory bodies. The SNKI does not focus on SME finance specifically but does so indirectly through various avenues, such as KUR and improvements in the availability of land certificates.

The National Medium Term Development Plan identifies three initiatives to promote access to finance: SME credit rating body; SME credit guarantees; and various credit schemes including KUR.[31] The latter was dealt with in section 2.1.4 while the other two are covered below. The role of OJK in the financial sector has already been discussed above. This section considers the support provided by other government bodies.

Bank Indonesia

The key initiatives pursued by Bank Indonesia (BI) include: (i) a financial identity project to assist individuals who are currently barred from accessing financial services due to lack of formal identification; (ii) further developing and implementing nationwide comprehensive financial education programmes; (iii) substantially increasing access to, and the culture of, savings; and (iv) creating an enabling environment to encourage sustainable growth of branchless banking in Indonesia through the formulation of smart regulatory framework.

Some of the programs implemented by Bank Indonesia with particular relevance to SMEs are:

- Regulation to increase lending to MSME: In order to encourage banks' lending to MSMEs, BI issued a regulation (Nomor 14/ 22 /PBI/2012) in 2012 that mandates banks to increase the share of their lending to the sector in stages to 20% of the total loan portfolio by 2018 (later extended to 2019). The regulation imposes administrative sanctions on banks that do not meet their yearly target. The disciplinary actions can be in the form of a warning, a fine or recommending that further measures be taken by the OJK as the banking supervisory body, such as not being able to climb to the next bank-tier or "buku" until the target is achieved.
- MSME Rating Agency: One of the problems banks face in lending to MSMEs is the staff's lack of knowledge when it comes to assessing MSME businesses. In order to address this issue, BI has introduced an MSME Credit Rating Agency, supported by a Japanese donor, and advocated its wide use. The MSME Credit Rating Agency specializes in assessing the soundness and creditworthiness of these enterprises. However, whilst such agencies have been successful in some countries, such as India and Bangladesh, the agency for Indonesia has not progressed much beyond the pilot stage. The general response in interviews was that a SME Rating Agency was not a high priority in expanding access to finance for SMEs, at least for all those other than the larger ones.

31 MCSME (2018), National Development Policy on MSMEs and Cooperatives, Presentation by Director of SMEs and Cooperatives

- Regional Credit Guarantee Corporation: The credit guarantee system of Indonesia operates at two levels: national level and provincial level. At the former are Askrindo and Jamkrindo, which focus on the implementation of government policies and programs, in particular to promote the development of MSMEs. Section 2.1.4 described the operation of the two CGCs with respect to KUR. Secondly, BI encourages the establishment of Regional Credit Guarantee Corporations in all the provinces of Indonesia. However, the decision to establish these corporations falls under the jurisdiction of provincial governments. Presidential Regulation number 2/2008 regulates the establishment of credit guarantee institutions, of which there were only eight at the end of 2017.

Ministry of Cooperative and SMEs (MoCSME)

The main support given to the sector by MoCSME is the Pusat Layanan Usaha Terpadu (PLUT KUMKM) or MSME Support Centres. MoCSME's objective was to create 258 PLUTs (or approximately one in every district across Indonesia) by 2020, of which 51 have been established so far in 16 provinces. Services provided to enterprises under the program are:

- Business consultation: Human resource development, product quality improvement, intellectual property rights, business management, among others;
- Mentoring: providing a business mentor;
- Assisting MSME in obtaining financing: connecting with banks, assisting in preparing loan proposal etc;
- Marketing and promotion: product exhibitions, connecting with supermarkets, better packaging, among other things;
- Business training: technical training, accounting and bookkeeping, taxation, and other–business related activities; and
- Networking (facilitating networking with larger companies and other institutions).

The MSME Support Centres are among the most active support providers to MSMEs, offering the widest range of services. However, as with many such initiatives, awareness of the programs among MSMEs is rather low. Usage might be further limited by the small number of centres and their low capacity for servicing MSMEs with quality training or mentoring.

The second support activity from MoCSME is revolving funds that are channelled through the Institute for Managing Revolving Funds of Cooperatives and Micro, Small and Medium Enterprises (LPDB-KUMKM). The LPDB-KUMKM's main tasks are managing the revolving fund for SME financing, among others, in the form of loans and other forms of financing that meets the needs of small businesses. In 2017 the target for the LPDB-KUMKM revolving funds was IDR 1.5 trillion channelled to 120,000 MSMEs through 586 partners consisting of cooperatives and non-cooperatives. Since it started in 2008, LPDB-KUMKM has distributed revolving funds amounting to IDR 8.1 trillion to nearly one million MSMEs. In 2018, LPDB-KUMKM involved the guarantee agencies (Jamkrindo and Jamkrida) as the first party to analyze the feasibility of proposals brought to it.

Ministry of State Enterprises (SoEs)

Both private companies and state-owned companies implement CSR programs in Indonesia. CSR programs are mandatory for SoEs and they have to set aside 2% of their net income for such activities. As mentioned, the CSR program of state-owned companies is known as the PKBL. The programs usually focus on education (scholarships), environment, relief assistance, training and capacity building, production equipment and donations. With regards to economic empowerment and improvement of the MSMEs, PKBL provides both working capital and investment loan for MSMEs, as well as partnerships with SoEs providing assistance in the form of business coaching, management training and marketing assistance.

Ministry of Industry & Trade

The Ministry of Industry & Trade focuses mainly on medium enterprises[32] with support more at the industry i.e. manufacturer level and not the seller. There is a program (E-smart IKM) to promote products on line. The Ministry also conducts training programs, to which small enterprises are also invited, on issues such as financial literacy, documents, marketing, product certification and credit.

Other Government Programs

The CMEA holds one day workshops for SMEs, in which banks participate. A total of 350 companies have attended these sessions. Some other national Ministries, such as Agriculture and Fisheries, also provide lists of potential borrowers to the banks.

The Provincial Government of West Java has set a target to support 100,000 new enterprises in 5 years under the *Wirausaha Baru* program. It provides technical assistance to businesses operating in agriculture but also crafts, manufacturing and F&B. It facilitates introductions to banks, for KUR and other loans, but data was not available on the number of businesses that were able to secure finance under this program.

In 2007, the national government established the Small and Medium Enterprises and Cooperatives Indonesia Company (SMESCO). Its objective is to promote the products of Indonesian SMEs, with a gallery where enterprises can display their products. By 2015, the SME Galley in Jakarta had served 560 SMEs from 19 provinces offering 124 different products.

Every local government also regularly conducts MSME exhibitions in their province or district. Some of the samples of those local government exhibitions are Jawa Barat Expo, NTB Expo and Bogor Expo. Among the more thematic exhibitions are Indonesia Fashion Week and the Indonesia Fashion, Accessories and Craft (IFAC) Expo.

Despite the many programs, an IFC survey[33] indicates that only 24% of SMEs are aware of government support services.[34] Moreover, the results did not vary much between the different sizes of enterprise: both small enterprises (78%) and medium enterprises (71%) scarcely

32 Defined by the Ministry as companies with 20 plus employees and IDR 1-15 billion of investment value of assets (not land)

33 In August and September 2015, 600 SMEs – of which 360 were owned by women and 240 by men – were interviewed in 12 cities across Indonesia and 9 Focus Group Discussions with 72 participants were conducted in Jakarta, Padang and Denpasar

34 IFC (2016), Women-owned SMEs in Indonesia: A Golden Opportunity for Local Financial Institutions, IFC March 2016

benefited from government services in the prior two years. While small enterprises did feel more strongly than medium enterprises that the services are not relevant for them, the main reason generally for not participating is the lack of information about such programs. One of the issues may be that there is no single source of information on the various support services available to SMEs.

Industry Associations

There are many such bodies in Indonesia, such as the Indonesia Micro and Small Business Association (HIPMIKIMDO) with 500 members and Womens Muslim Entrepreneurs Association (IPEMI) with 5000 members. Several members have well established businesses but many are still struggling to access finance: one such association indicated that 20% or less of members had formal finance; other than family and friends, the balance are funded from grants or subsidised loans.

Some of these associations try to increase banks' trust in members by setting up meetings between them. One association, GUMKIMINDO, has its own saving & credit cooperative which members can join and get loans from funds raised from the savings of the members. There is also collaboration with banks such as BJB and BRI, by inviting them to workshops to improve the commercial mindset of members and encourage banks to be more sympathetic to the financing needs of SMEs. The associations also provide training on key topics such as financial reporting, marketing, and branding.

However, there is a lack of research on the impact of these activities. Although some do follow up with SMEs on training via WhatsApp etc, no specific evidence exists to what extent training is helping. After inviting banks to trainings, one association claimed that "1 or 2 SMEs got a loan". IPEMI did conduct an informal monitoring of its activities and the results showed that more of its women members were at least focussed on bank requirements.

International Donors/ Development Partners

The main multilateral agencies in Indonesia that are focussing on finance for SMEs include the World Bank, IFC, UN agencies such as ILO and IFAD. Among the bilateral institutions, the Australian Department of Foreign Affairs and Trade (DFAT) and the SECO are the two main donors. There are also some international NGOs active in the sector, such as MicroSave, Savings Banks Foundation for International Cooperation (SBFIC), Opportunity International, Mercy Corps, and Swiss Contact.

2.1.7 INNOVATIONS

As already indicated (and considered again in section 3.1.1), access to finance remains a serious constraint for MSME growth. For many experts and commentators, the solution is the piloting and up-scaling of innovative financing solutions[35].

There is a paucity of innovative products from the mainstream banks, with the same two loan products (Working Capital and Investment) being ubiquitous and very similar as to their terms. A few banks are showing signs of innovation, for example, Bank Btpn has introduced non-financial services such as training, networking and information for free, to attract and retain clients. Other banks have tried to be innovative but failed, for example Bank Permata introduced a non-collateralised SME loan but it was discontinued (due mainly to problems elsewhere in the bank).

The banks are mainly looking at innovation generally, like cardless cash withdrawals for clients without bank accounts, but this would not be of great benefit to SMEs. Furthermore, the banks appear to be more focussed on processes, such as using a chatbot to ask some early questions over WhatsApp to prospective clients, but not so much in the products themselves. The most important issue is that SMEs lack the fixed assets needed to obtain finance.

Fintech

Naturally, everyone points to Fintech as the solution for this problem. For example, Robert Dunn, Opportunity International's Global Executive Director, recently said: "*the concept of Fintech is very exciting, particularly with respect to credit scoring and figuring out what products are needed by different people. But it is at an early stage. The exciting development, I believe, will be the use of credit scoring algorithms based on social media footprints for lending to small- and medium-size businesses … it is about approaching the "missing middle" — people who are employing other people but can't get access to finance.*"[36]

As shown above, banks are not very innovative when it comes to lending to SMEs, and certainly not as experimental as elsewhere. For example, in Bangladesh some banks offer as many as eight products for SMEs.[37] Even though the amount of Fintech lending is still small (see section 2.1.4: less than 1% of the total outstanding amount of loans to MSMEs in Indonesia), and in many cases not suitable for SME finance, the emergence of Fintech could push the banks to be more creative.

Go-Jek recently announced[38] joint ventures with three P2P lending firms: Findaya, Dana Cita and Aktivaku. Findaya specializes in providing lending services to Go-Jek Partners. Dana Cita and Aktivaku, on the other hand, are lending platforms specializing in academics/education and housing/property respectively. The initiatives will be run separately from Go-Jek's current payment vertical Go-Pay.

Already half of Go-Jek's 100 million monthly transactions are processed through Go-Pay. As a whole, the value of e-money transactions in Indonesia has been growing exponentially.

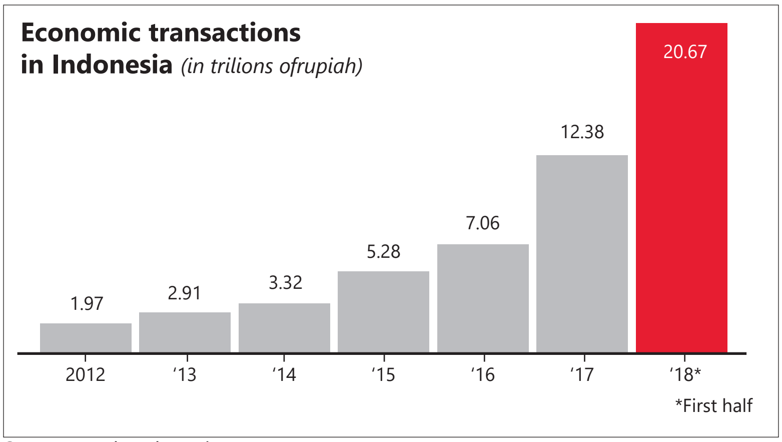
35 ICSB (2017), Report on MSMEs, page 99

36 http://knowledge.wharton.upenn.edu/article/how-is-Fintech-transforming-microfinance/

37 O'Brien, Barclay (2012), Access to Finance for Inclusive Businesses in Bangladesh, July 2012, London: Challenges Capital

38 https://techwireasia.com/2018/09/go-jek-partners-Fintech-in-indonesia-to-provide-easier-access-to-loans/

Table 5: Growth in E-money Transactions



Source: Bank Indonesia

Nonetheless, Morgan Stanley noted recently that only 2.1% of transactions in Indonesia in 2017 used e-money, as cash remains dominant. But the share is expected to rise to 24% by 2027.

Partnerships

Probably recognizing this, Alibaba and its local partner, Elang Mahkota Teknologi, launched Dana, a mobile wallet running on Blackberry Messenger, in March. Telkomsel, Singapore-based ride-hailing service Grab and a popular Indonesian eCommerce site Tokopedia -- all of which have their own e-payment platforms -- are also perceived as emerging banking competitors.

The eCommerce platforms, like Tokopedia and Bukalapak, are also a key part of the innovation taking place. First, eCommerce allows MSMEs to expand their business and attract finance. Tokopedia alone serves two million merchants with some 80 million transactions per month. As a result, some FSPs, such as Bina Artha, are conducting pilots by using the platform, plus others such as Facebook, to identify clients. Other banks, such as Bank Mandiri, are also working with the eCommerce sites. An additional benefit to SMEs is that, by putting their transactions on line, their activities become more transparent, and for the banks to understand the business and assess credit risk.

The banks are also recognising that there are alternatives to direct lending by partnering with digital companies. For example, J Trust Bank lent IDR 40 billion to two Fintechs (Investee and Modalku) for SME lending and the MFC Indosurya is also channelling through Fintechs such as Modalku and Amartha. Secondly, Bank CIMB Niaga has acquired 940,000 new customers by opening up new accounts for Go-Jek and Grab drivers, most of whom were previously unbanked. So even without having a loan product, Fintechs can potentially act as a bridge for the unbanked to reach the formal financial sector.

A third example, and harbinger of future activities, comes with Go-Jek assisting a state-backed lender, BNI, to find potential borrowers -- and provide data on creditworthiness. Go-Jek mines the transaction data of the 125,000 restaurants that partner with its food delivery service, Go-Food, to determine which may be eligible for KUR. BNI was unable to grant enough of the microloans to meet its target last year, but this has changed since the partnership with Go-Jek.

Prospects

Certainly, the infrastructure is there for innovations to boost SME finance. Mobile subscriptions reached 385 million in 2016 -- by far exceeding Indonesia's 260 million population, since many people own multiple numbers. Unique users are estimated to be 178 million and the number of smartphone users reached an estimated 67 million last year. By 2017, there were 132 million internet users and 106 million active mobile social media users. These and other figures for Indonesia are compared to other Southeast Asian countries below, indicating that Indonesia does not lag behind by a large margin in terms of these enablers for innovation.

Nonetheless, Indonesia has been placed very low (80th) in terms of technological readiness, much lower than its overall global ranking of 36th on the Global Competitiveness Index[39].

Table 6: Internet and Mobile Users in Southeast Asia

Indonesia

Population	262.0 M
Internet users	132.7 M
Social media users	106.0 M
Mobile connections	371.4 M
Mobile social users	92.0 M

Thailand

Population	69.22 M
Internet users	45.00 M
Social media users	45.00 M
Mobile connections	90.94 M
Mobile social users	42.00M

Malaysia

Population	30.96 M
Internet users	22.00 M
Social media users	22.00 M
Mobile connections	42.93 M
Mobile social users	20.00 M

Singapore

Population	5.74 M
Internet users	4.71 M
Social media users	4.40 M
Mobile connections	8.44 M
Mobile social users	4.00 M

Philippines

Population	103.0 M
Internet users	60.00 M
Social media users	60.00 M
Mobile connections	129.4 M
Mobile social users	54.00 M

Vietnam

Population	94.93 M
Internet users	50.05 M
Social media users	45.00 M
Mobile connections	124.7 M
Mobile social users	41.00 M

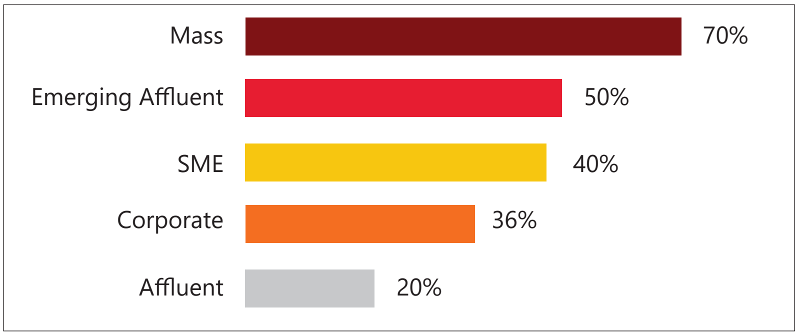
Source: WeAreSocial, Hootsuite (2107)

In summary, Fintech will be an important part of the innovation needed for greater financial inclusion in Indonesia but, at least in the short term, this will be mainly for payments, increasing individual accounts, rather than in SME lending. In the longer term, the recent PWC survey[40] on banks' digital strategy suggests that SMEs will also be a focus, with nearly half the banks saying that it will be part of their use of digital finance (Figure 5). However, there are considerable capacity issues, at all three levels (regulatory, supply side and demand side), that need to be resolved (see Chapter 4) before the unmet demand for SME finance can be addressed.

39 Global Competitiveness Report 2016-2017, World Economic Forum.

40 PWC (2018), PWC Survey: Digital Banking in Indonesia 2018, July 2018, Jakarta: PWC

Figure 5: Banks' Focus Areas for Digital Strategy



Source: PWC (2018)

2.2 DEMAND, INCLUDING LATENT DEMAND, FOR FINANCE AMONG SMES

There is no doubt that many SMEs lack finance for their business and the general perception is that the need will increase. This is a global issue. IFC`s CEO Philippe Le Hou'rou recently stated[41] that almost 70% of SMEs do not use external financing from financial institutions, and another 15% are underfinanced. The total credit required to finance these SMEs fully is over $2 trillion, equivalent to 14% of total GDP of developing economies[42].

As for the demand in Indonesia, the monthly and annual reports for current lending produced by OJK[43] are helpful; the figures for 2017 were summarised in Table 3 (Small enterprises: IDR 269.2 trillion; and Medium: IDR 406.3 trillion). The level of debt was analysed a different way in another paper: on the basis of debt as a percentage of "value added" by the enterprise, it is 21.0% for small enterprises and 24.5% for medium, compared to 46.3% for corporates[44]. However, there is a lack of formal data quantifying demand for the whole market.

Somewhat surprisingly, it seems the banks do very little quantitative research. Their internal market research confirms that there are still "millions of people" without finance and many SMEs are unbanked. However, most of this information comes from informal surveys by account and marketing officers speaking to entrepreneurs rather than any actual market surveys. One bank even said that "SMEs are well served by all banks". However, most reflect the view that "the market potential is huge".

The best source is the IFC[45] which estimated that 54 % of SMEs in Indonesia were interested in obtaining a bank loan. In another IFC survey, 46% of the SMEs said they had a loan with a bank at some point in their existence with 29% having a loan outstanding in the prior two years.[46]

41 https://en.antaranews.com/news/116999/indonesia-makes-great-progress-in-financial-inclusion-ifc

42 World Bank (2018), Improving Access to Finance for SMEs: Opportunities through Credit Reporting, Secured Lending and Insolvency Practices, page 4

43 OJK (2018), Indonesian Banking Statistics, May 2018, Jakarta: OJK.

44 IFC (2016), Women-owned SMEs in Indonesia: A Golden Opportunity for Local Financial Institutions, IFC March 2016

45 SME Finance Forum (2017), MSME Finance Gap Report, Washington: IFC

46 IFC (2016), Women-owned SMEs in Indonesia: A Golden Opportunity for Local Financial Institutions, March 2016, Washington: IFC, page 21

Using the national SME definition, the survey suggested that 51% of micro, 57% of small and 67% of medium-sized enterprises would be interested in borrowing. Small enterprises would wish to borrow an average of IDR 308 million and medium-sized enterprises IDR 1,057 million. Using the latest numbers for SMEs, this translates into a potential market demand of IDR 114 trillion for small enterprise lending. Added to that the market of IDR 41 trillion for the medium-sized enterprises, the total derived from this analysis is IDR 155 trillion or $10.4 billion[47].

The SME Finance Forum report shows the demand for finance among SMEs in Indonesia to be much higher. The report indicates that finance provided to MSMEs in Indonesia is $56.6 billion out of potential demand of $222.4 billion, leaving a MSME financing gap of $165.8 billion[48], equivalent to 19% of GDP. The Forum also considers how many of the SMEs are constrained and to what extent, with 113,948 (17.6%) fully constrained and another 198,228 (30.7%) partially constrained in their access to finance.

The FSPs that were interviewed for our research believe that the demand for finance from SMEs is increasing, with targets of around 15-20% growth. There is some concern about the economy, in regard to both recent slower growth and the impact of next year's elections. However, there is an expectation that SMEs should grow faster than the overall economy, with certain sectors growing even faster, e.g. trade, services and tourism, which is where a vast majority of SMEs are engaged.

47 Using exchange rate of $1 = IDR 14,868

48 http://www.smefinanceforum.org/data-sites/msme-finance-gap

III. ASSESSMENT OF ACCESS TO FINANCE AMONG SMEs

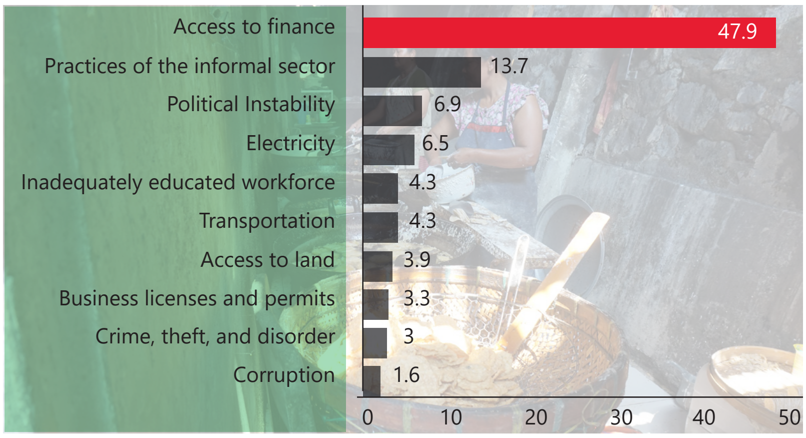
3.1 CONSTRAINTS FOR SMEs

A major issue confronting SMEs in Indonesia is and remains access to finance. The importance of finance varies from study to study but is always a feature. In one survey[49], 15% of SMEs mentioned lack of finance as one of the top three business challenges. Informal SMEs (19%) are obviously more affected but semi-formal (10%) and formal SMEs (11%) also face this obstacle. Obstacles that SMEs consider more severe than access to finance were stated to be competition (66%), high costs of materials or labour (37%) and rents/lack of space (22%), in addition to the lack of skilled staff or difficulties in retaining skilled staff (23%).

This was lower than other surveys, such as the one conducted by the CMEA, where 45 out of 269 SMEs said that access to finance was a problem. A 2012 survey of 200 SMEs in six areas in Java concluded that access to finance was the second most important barrier for SMEs[50]. In order of priority, the ten major barriers faced by SMEs were identified as: competition barriers; financial access; price of energy; technology; inefficient production cost; economic factors; management skill; process; limitation of sales; and raw material.

Another study by the IFC ranked access to finance far ahead of the other issues for SMEs.

Table 7: Issues Confronting SMEs



Source: IFC (2013)

SMEs must confront other management, organizational and non-financial issue, such as the following:

- Lack of knowledge of production and packaging technology;
- Poor product quality control caused by the lack of opportunity to keep abreast of latest techniques;

49 IFC (2016), Women-owned SMEs in Indonesia: A Golden Opportunity for Local Financial Institutions, IFC March 2016

50 Irjayanti, Maya and Anton Mulyono Azis (2012), Barrier Factors and Potential Solutions for Indonesian SMEs, Science Direct

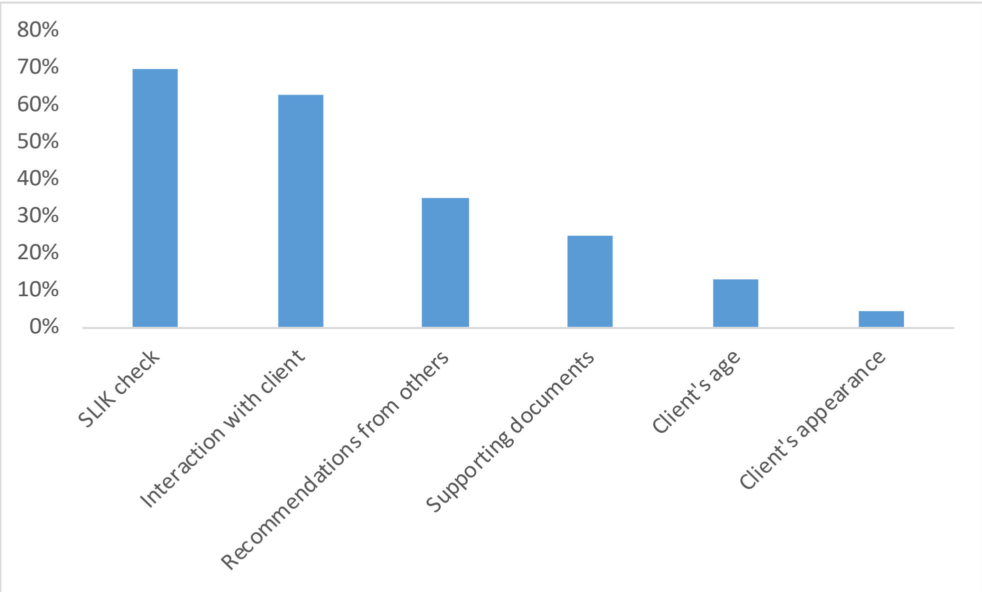
- Lack of education, financial literacy and training;
- Poor knowledge of marketing by SMEs;
- Limited ability of SMEs to provide products and services in accordance with market demand;
- Inability to develop human resources; and
- Lack of understanding of finance and accounting.

Much of this stems from one general characteristic cited by one report[51]: most SMEs are still influenced by the traditional family-own management mode. For example, many SMEs do not separate the accounting for the business from that of the owner(s).

Related to this issue is their legal status, as many SMEs are not registered. Most banks and other FSPs will not lend to unregistered businesses. In addition, exhibiting the attributes of formal enterprises is also important. Business planning, proper bookkeeping and money management are all keys to growing beyond micro enterprises to SMEs.

Many SMEs have problems with poor performance regarding previous finance. The use of OJK's credit check (Financial Information Services System or SLIK) is the most important criteria for assessing loan applications. According to a survey in West Java close to 70% of loan officers rely on SLIK to assess the merits of loan applications.

Figure 7



Source: ILO & UNPAD (2019)

51 Han, Ping (2017). Analysis on Financing Difficulties of Small and Medium Sized Enterprises in China and Corresponding Countermeasures. International Journal of Humanities and Social Science, 3(15)

52. ILO & UNPAD (forthcoming), State of Credit to SMEs: Findings from a survey of banks in West Java

The implication is that, while FSPs do rely on intangible criteria like recommendations, at the end of the day the credit decision will be based on hard financial data, which is not always favourable to SMEs.

Two of the credit rating agencies operating in Indonesia, PT Pefindo and Kredit Biro Indonesia Jaya (part of the international Equifax group), receive the SLIK data. Both are looking to expand into the SME finance market, which may provide a broader picture for banks and other FSPs looking to assess SME's credit worthiness.

3.2 ACCESS AND QUALITY OF PRODUCTS

Many SMEs are not yet bankable, either due to the absence of transparent financial management or a lack of managerial and financial capability. However, the shortfall of supply can also be attributed to the attitude and conduct of the FSPs themselves. One report[53] analyses the reasons for SMEs having financial problems from the supply side as follows:

- Mismatch between available funds that can be accessed by SMEs and the supply stems from a lack of systematic approach to the funding of SMEs;
- High transaction costs exist, caused by complicated and time-consuming credit procedures, whilst the number of loans disbursed is small;
- Inefficient and expensive core banking systems;
- Absence of bank branches in remote areas;
- Lack of adequate information for SMEs to locate potential lenders; and
- High interest rates on standard loans for investment and working capital.

Many FSPs also suffer from poor risk mitigation strategies beyond taking fixed asset collateral. An IFC survey indicates that 65% of loans to SMEs are backed by immovable assets, with others secured by vehicles or movable assets, but only 1% are unsecured.[54] Some banks believe that it is an OJK requirement and, even for KUR Mikro where collateral is not required for loans of less than IDR 20 million, many banks insist on it. However, many SMEs lack the required collateral or the certificates to prove ownership.

Many SMEs are discouraged from even requesting loans, given issues such as the interest rates and concerns about their ability to repay. There is generally too much focus on collateral, especially fixed assets, from banks and virtually no cashflow-based lending. Bringing in such products, in countries like India, took time. A key was the growth of the banking market generally, and hence competition, led by non-banking financial companies (NBFCs) such as Vistaar.

Other better tailored products are also missing, such as value chain finance and factoring/trade discounting, although some of the latter is beginning via invoice discounting. In other Muslim countries e.g. Malaysia, Syariah lending makes up a higher proportion of lending, although most of it is focussed on microentrepreneurs.

53 Ibrahima, Niko and Verliyantina (2012), The Model of Crowdfunding to Support Small and Micro Businesses in Indonesia Through a Web-based platform, Science Direct

As a result of the issues relating to the current products, many SMEs are turning to Fintech. They often prefer it because it is less formal and introduced by trusted peers or via agents/ intermediaries. SMEs, especially those run by younger people, are also familiar with the technology that Fintechs use. Interest rates are often higher, but the informal and unregulated nature reflects many of the SMEs' own operations. And, at the end of the day, the major issue for many SMEs is access to finance rather than the marginal interest rate.

3.3 OPPORTUNITIES IN THE MARKETPLACE

A number of opportunities, both evident and latent, became manifest through this study. Some of these opportunities for players in the financial industry are discussed below:

1. **There is an opportunity to expand the product offering for SMEs beyond the standard working capital and investment loans.** New research[55] shows that banks can position themselves to treat SMEs as a core and strategic business. In terms of products to increase SMEs' access to finance, it may be that leasing, factoring and venture capital offer the best prospects.[56]

2. **Among the new products, leasing may be especially appropriate.** At present, leasing of machinery or other equipment is more common for corporates and individuals than for SMEs. A finance lease can provide a natural form of collateral in the ownership of the asset remains with the lessor/bank until the end of the contract, thereby simplifying any necessary enforcement process. However, VAT of 10% is payable both when the lessor acquires the asset at the beginning of the lease and again when it is purchased by the lessee at the end of the term.

3. **The business potential for SME lending applies across the banking spectrum.** The increasingly saturated microenterprise market, particularly with the expansion of KUR, and the risky corporate segment could compel banks to establish a clear mandate for the 'missing middle' of SMEs. Small and niche banks can overcome the perceived 'opaque' nature of SMEs through relationship lending and the larger multiple-service banks can offer a wide range of products and services on a large scale through the use of new technologies, business models and risk-management systems.

4. **Other forms of collateral are now available.** IFC suggests[57] that a higher share of SMEs (10%) said they could provide machinery or equipment, accounts receivables (6%) or stock of merchandise (7%) as collateral than they are doing now. Greater use of movable collateral would help increase the pool of potential borrowers and this has been facilitated by the online movable asset register established by the government in 2013. During the expert FGD the case of group solidarity or *tanggung renteng* was highlighted also an alternative to collateral. This form of "collateral" has been very successfully used by the Grameen Bank in Bangladesh to reach micro and small businesses. There are also

54 IFC (2016), Women-owned SMEs in Indonesia: A Golden Opportunity for Local Financial Institutions, IFC March 2016

55 Rodano and others 2015, "Bankruptcy Law and Bank Financing". Oxford University Centre for Business Taxation Working Paper series

56 Bappenas (2018), National Development Policy on MSMEs and Cooperatives, Presentation by Director of SMEs and Cooperatives

57 IFC (2016), Women-owned SMEs in Indonesia: A Golden Opportunity for Local Financial Institutions, IFC March 2016, page 26

several successful replications of the Grameen group lending in Indonesia. The rate of NPLs is quite low.

5. **There is also an opportunity for Fintechs to expand into the SME space.** The best example is Investree with its invoice financing, although its volume of lending remains small as yet. However, most of the Fintechs are currently focussed on products such as individual P2P lending and many lack the knowledge of banking to offer more sophisticated products of use to SMEs.

6. **The banking sector has the opportunity to compete with these developments by offering SMEs services intrinsic to it,** such as longer term loans and saving facilities. In order to make the latter available, banks need to set up Agency Banking facilities. The best approach may be partnerships between the formal financial providers and Fintech, combining the capital and knowledge of the FSPs with the technology and outreach of the Fintechs, and this is beginning to happen in Indonesia.

IV. FINDINGS ON GAPS FOR INDUSTRY AND RECOMMEN-DATIONS

The purpose of this chapter is to set out the gaps in the regulatory, supply and demand side of the country's financial services landscape, as well as lessons and good practices that have been identified. These are discussed drawing on the detailed analysis in the preceding sections of the report. The chapter also includes recommendations for regulators, policy-makers, FSPs, business associations, and other stakeholders who wish to improve the financing for SMEs in the country.

4.1 REGULATORY AND MACRO ENVIRONMENT

The study has identified a number of barriers to increasing access to finance for SMEs that exist from a policy and regulatory perspective:

1. **The requirement for banks to lend 20% of their portfolio to MSMEs is not entirely clear.** Although the requirement is spelt out in a regulation, including the resulting sanctions, some banks seem unsure of the consequences of non-compliance. There is no doubt that the requirement has helped, especially with banks lacking a culture of lending to MSMEs. Such a requirement by regulators in not uncommon. In China[58] and the United States local commercial banks must put at least 25% of their total financing into SMEs. However, some banks in Indonesia have struggled with it, due to the short period of time to transform when not used to such lending. In March 2017 OJK reported that around one-fifth of commercial banks in Indonesia had fallen short of the 10% interim target for 2016[59]. Furthermore, many of the loans made to MSMEs have been indirectly used for consumption as not all the FSPs have the capacity to lend for productive purposes. Finally, some of the banks have satisfied the requirement through wholesale lending to BPRs. ***Recommendation to OJK***: It may be helpful to include the need for the loans to be made for production in the regulation covering the requirement, and to reiterate the implications of non-compliance, which may not have been imposed to date due to the large numbers of banks failing to meet the interim targets and with the 20% required target being deferred to 2019 in any event. ***(Medium Priority.)***

2. **There is limited flexibility regarding NPLs for SMEs.** Whilst the role of OJK is to ensure a stable banking sector, the focus on NPL levels is making some banks reluctant to lend to SMEs. The result is that the client may be referred to a different FSP, e.g. an MFI with lower liquidity, or the available funds redirected by the bank to another bank product or existing client. The classification of loans in arrears is also now more demanding for the banks, with issues such as business prospects, repayment capacity and payment history being difficult to ascertain for many MSEs. The banks must also obtain this information in advance of making the loans in case it is needed to decide if the loan has become non-current. ***Recommendation to OJK:*** To encourage more lending to SMEs, there may be some value in loosening the NPL requirements for banks

58 Han (2017), op cit

59 https://keuangan.kontan.co.id/news/ojk-20-bank-belum-penuhi-porsi-kredit-umkm

making such loans in case. The current data (see section 2.1.3) does not suggest that the NPL rates are appreciably higher for SMEs than for other class of borrowers and yet the banks adhere strongly to the collection process. It would help if OJK could signal the possibility of FSPs not moving straight to enforcement but sometimes allowing SMEs time to restructure. ***(Medium Priority.)***

3. **The SLIK credit data registry needs improvement.** OJK started operating the SLIK from January 2017, as the replacement for the Debtor Information System (SID) run by Bank Indonesia, but access to the system requires contacting the OJK call centre or visiting one of its offices. Whilst it may go online at some time, the need to make a request and then wait for a response is inefficient. ***Recommendation to OJK:*** Firstly, the move to online processing should continue and other changes should be considered to make the SLIK system more accessible and useful. Secondly, measures should be explored to rapidly increase SME credit data in SLIK. ***(Medium Priority.)***

4. **There are weaknesses in Insolvency and Creditor Rights (ICR).** Enforcement of loans is still difficult in Indonesia. Insolvency practices also play a crucial role in the SME lending process because the default recovery rules that are part of insolvency regulation influence creditors. Such weaknesses impede banking efficiency and inclusion through higher intermediation costs and inhibit capital market development through diminished investor demand for private instruments. Last year, the World Bank noted that laws and practices need significant enhancement, particularly regarding the costs of using formal insolvency procedures, and that insolvency practitioners are perceived as regularly failing to perform their duties.[60] ***Recommendation to Government:*** ICR laws and practices need enhancement to improve their effectiveness, and hence increase the willingness of FSPs to lend to the sector and to avoid the over-use of informal procedures. Studies show that, in economies with adequate creditor protections, the bank credit financing gap between large and small firms decreases. ***(High Priority.)***

5. **Lack of credit information is a factor that contributes to the constraints faced by SMEs** as assessing their creditworthiness represents a unique challenge. Compared to larger firms, it can be more difficult for an SME to develop a credit history as they have less access to traditional sources of finance such as banks and other financial institutions whose data is typically used in the production of credit reports. However, such ratings can be expensive for SMEs and, therefore, are often funded by an agency, for example in India, the SME Rating Agency (SMERA) has been adjudged a key component to SME development. ***Recommendation to Government:*** In order to address this issue, BI has introduced an MSME Credit Rating Agency, supported by a Japanese donor, and advocated its wide use. Two of the credit rating agencies operating in Indonesia are also looking to expand into the SME finance market. The Government should further support this as the credit rating agency for Indonesia has still not progressed much beyond the pilot stage. ***(Medium Priority, as much of this is in train)***

6. **The regulatory arrangements for microfinance institutions are not ideal.** The regulations for MFIs do not match with best practice in other countries, such as Cambodia and Myanmar. The term "MFI" is used in the legislation but it applies mainly

60 World Bank (2017), Financial Sector Assessment: Republic of Indonesia, June 2017, Washington: World Bank

to rural banks and cooperatives. One issue is that MFIs cannot be foreign owned[61] and, therefore, the larger ones, such as Bina Artha, are licensed as Ventura Companies (VCs). OJK is now requiring such companies to invest at least 15% of their portfolio in private companies by December 2020. Whilst this makes sense for a 'venture capital' company, and the government is pushing the VCs to finance SMEs as part of the 15% requirement, it is not appropriate for an MFI. Therefore, some of the MFIs will transform into an MFC, as there is no other suitable NBFC licence. ***Recommendation to Government:*** Rather than forcing these companies to look for a 2nd best option, such as to transform into an MFC, it would be preferable to amend the MFI laws to allow for at least a degree of foreign ownership. ***(Medium Priority.)***

7. **Despite increases in volume of lending, the KUR product is now less focussed on new clients.** On one hand, given its volume and wide dissemination of the programme, KUR has been a success. On the other hand, it has been criticised for focussing more on the interest rate subsidy issue rather than being a credit guarantee, thereby not reaching first-time borrowers and MSMEs in remote areas and underserved priority sectors. For the latter, whose numbers remain very large, access to finance is more valuable than any interest rate saving. There are also some uncertainties regarding the way that KUR is implemented, especially whether there is a need to take collateral for smaller KUR Mikro loans. ***Recommendation to Government***: In designing KUR for subsequent years, the Government should consider re-introducing the idea of additionality, i.e. that at least a percentage of the loans goes to businesses that have not been able to access formal finance to date. Secondly, guarantee schemes are common in many countries as a way to increase access to finance for SMEs, but KUR has moved away from this approach. Although most KUR loans still have the benefit of a guarantee built into the pricing, it would be possible for the government to be more targeted, for example to directly guarantee loans up to a certain (higher) limit to small businesses to purchase land, buildings or equipment. Thirdly, any such re-design of KUR would also be an opportunity to clarify some of the other criteria. ***(High Priority.)***

8. **There is no 'one stop shop' for SMEs.** Whilst there is no shortage of projects and stakeholders supporting SMEs, both generally and specifically for access to finance, there is no single source of information on the various services or funds available. Coherent efforts are needed to create incentives for SME entrepreneurship, enabling their knowledge and skills to improve and adopt innovations and increasing their access to knowledge and networks, such as business associations and chambers of commerce. It is also hard to find data on the SMEs themselves. It is intended that the MoCSMEs should provide such a central facility but this has not occurred to date. Furthermore, with the establishment of Tim Percepatan Akses Keuangan Daerah (TPAKD), support for SMEs can be further harmonized. TPAKD is an inter-departmental team in the regions to promote financial inclusion. ***Recommendation to Government and Donors:*** It would be very helpful for SMEs, FSPs, NGOs and all the other stakeholders working in the sector for such a facility to be established as soon as possible. MoCSMEs is working on providing a reliable data base for SMEs by developing an online and real time source through the SME registration and report process but this is not yet publicly available.

61 A minimum 60 percent of shares must be owned by regional/regency/city government or village/rural enterprise, while the rest of the shares can be owned by Indonesian citizens and/or citizen-owned cooperative with maximum ownership of 20 percent: see https://www.ojk.go.id/en/kanal/iknb/Pages/Microfinance-Institutions.aspx

There is also a role for the development community, including the UN, to build platforms to bring together all stakeholders to foster the exchange of good practices on SME growth and finance. The role of TPKADs can be further strengthened as it provides an interface for integrated support to the SMEs. As noted below, it may also be appropriate to conduct a detailed assessment of the effectiveness of the existing programs and revise their content and delivery, if necessary, with the support of external advisors. ***(Medium Priority, as much of this is in train.)***

9. **There may also be a need for a more specifically focussed organisation to help SMEs develop their business capacity.** In some countries, an institution has been set up specifically to provide advice to SMEs. For example, in Bangladesh the SME Foundation was established with an endowment from the central bank and is credited with having played a major role in modifying the sector via extensive research and fundamental support. The GoI established SMESCO in 2007 but its objective is mainly to promote the products of Indonesian SMEs. ***Recommendation to Government:*** It would be worthwhile considering whether Indonesia needs a specific SME focussed body to provide advice on all matters relating to SMEs and entrepreneur capacity building, in areas such as promotion and market expansion of SME products, but also: linkages between buyers and sellers; advice and guidelines with information support for new business development; SME business manuals; SME product fairs; and access to finance. ***(Medium Priority.)***

10. **The Government has taken steps to encourage SMEs to register and to enter the formal sector.** For example, the government has launched an online licensing system and a new lower tax rate for SMEs to encourage them to register with the government, in order to take advantage of other facilities, such as training. ***Recommendation to Government:*** Whilst the regulations to increase formality and ease registration procedures are constructive and timely initiatives, the take-up to date is low. Therefore, more could be done to increase their effectiveness and impact, potentially by making them easier and more transparent for SMEs. One suggestion is that "Facts and Frequently Asked Questions" about finance, costs, grants, loans, taxes and incentives should be actively disseminated as part of financial literacy or SME development schemes. ***(Low Priority, as this is in train.)***

11. **Some Fintech and tax regulations are burdensome**. Whilst OJK has been praised for the decision to establish a regulatory sandbox similar to that made by Bank Indonesia for Fintech companies in payment gateways, there are issues with other regulations. For example, eMoney licences require the licensee to obtain BI permission for any partnership, a common activity in the space, with a wait of 40 days for approval. Second, P2P transactions require two separate agreements to be entered into between the parties (an agreement between the lender and the P2P Company; and an agreement between the P2P Company and the debtor), with both agreements in a stipulated form. In addition, leasing is discouraged by VAT being payable at both the beginning and end of the contract. ***Recommendation to OJK and Government:*** Whilst OJK generally does a good job with its ongoing regulation of a very vibrant sector, there is still a need to facilitate the Fintech advances in a way that both encourages the new technologies whilst ensuring that consumers are protected. Similarly, the GoI should consider the tax regime for leasing to determine if some relaxation of the VAT can be justified by the resulting increase in finance to SMEs. ***(Medium Priority.)***

12. **The existing 'Microfinance' sector should be rationalised.** As indicated in section 2.1.3, most of the BPRs and cooperatives are badly organised, suffer from low portfolio quality and are under-capitalised, meaning that all but the larger ones have the human and financial resources for SME lending. ***Recommendation to OJK and Government:*** The existing regulations should be enforced, so that the worst performers can be de-licensed, and for others to merge, to produce a smaller number of more capable lenders. There is also a need to revisit the regulations concerning BPRs. At the moment BPRs are allowed to carry out limited banking functions which should be reconsidered as BPRs are facing greater competition not only from commercial banks but also from Fintech. ***(Medium Priority.)***

4.2 SUPPLY SIDE

Barriers to greater SME finance on the supply side include:

1. **There is a general lack of loan products that SMEs need.** Whilst all the banks and other FSPs offer working capital and investment loans, there is literally very little else. Whilst there are many reasons, one of the key ones is the inability of FSPs to assess SME credit risk, due to their lack of records and cash accounting. The government has been trying to get SMEs to link their records to tax records but the take-up has not been dramatic so far. From the supply side, banks generally focus too much on collateral, especially fixed assets, and virtually there is no cashflow-based lending. During the expert FGD, it was pointed out that it is mainly the lack of collateral that makes it risky for the banks and even if SMEs are able to show cashflow it will not be sufficient for the banks. Moreover, the periodic income of SMEs can vary considerably which again increases the chances of credit default and higher NPL for banks. ***Recommendation to FSPs:*** New product development involves both SME friendly terms, instead of pure asset-based financing, as well as appropriate pricing, based on a proper risk assessment by the lender. Even where collateral is required, SMEs do not generally have access to fixed assets, such as land or buildings, but instead mainly rely on movable assets to access finance. Therefore, FSPs should look for alternatives to traditional collateral-based lending or, at least, use movable collateral registries to cover their perceived risks of lending. It can take time to bring on such products, and in countries such as India, this often came from growth of the banking market generally, and hence competition. There are also opportunities in supply chain finance, where small businesses are financed through the relationships they have with their major suppliers or customers. ***(High Priority***.)

2. **Many banks do not possess the necessary systems, data and infrastructure to expand their SME lending.** Especially among the smaller banks, it is the case that many engage in time consuming credit procedures, use inefficient and expensive core banking systems and lack an appropriate branch network. Some FSPs are seeking to overcome these issues, by working through agents and other intermediaries including Fintech companies, and using new forms of business information such as digital data, but much more needs to be done. ***Recommendation to FSPs and Donors:*** There is more that the FSPs can do in this area, again to capture the market opportunity. Some financial institutions are beginning to emphasize relationship lending technologies, which are based on "soft" information such as payment histories and social media interaction, more attuned to the characteristics of SMEs compared to banking norms and procedures.

The key requirement is access to the systems and technology solutions to track the transactions and obtain the data. One possibility already occurring is for traditional FSPs with capital to partner with the Fintech companies who own the technology and data. In addition, banks should move to decentralise operations, with additional branches or other ways to reach clients, such as digital banking. There is also a role for donors here to make the FSPs aware of the opportunities and possibly support their required investments. ***(Medium Priority.)***

3. **Many FSPs also lack an understanding of the many productive sectors in which the SMEs operate.** Even with the current products, many bank field staff require training in SME lending and how to assess loan applications against the background of the sectors in which the SMEs operate. Cooperatives know the needs of members better than banks know their clients but most lack the necessary liquidity to meet the demand. Across the board, there is a general need to improve the skills of account officers for marketing to SMEs and analysing their business. Detailed market research on the SME sector is also missing, not just on the numbers of MSMEs in existence but their activities and financing needs. ***Recommendation to FSPs and Provincial Governments:*** The focus in this area should be on equipping the SME relationship managers, as they are the interface between the clients and the bank. FSPs could do more to take advantage of this market opportunity by training their loan officers for SME lending and to be better able to analyse small business accounts and cashflows. In some provinces, there is a specialist SME bank, for example Bank (BPR) UMKM owned by the Government in East Java. It may make sense for other provincial governments to set up a specialized FSP for MSMEs, although this raises funding and issues of 'crowding out' of the private sector. A better strategy would be for FSPs to target SMEs as a separate and strategic customer segment, as they differ substantially from microenterprises and corporate sector in its financial and operational needs and require more alternative services. At the same time, the segment is growing more strongly than the microenterprise segment and is less served than the corporate sector. In some countries, having an SME department is mandated for all banks but this does not always ensure banks are fully committed to the sector. Most important is the requirement to build knowledge and the capacity to serve SMEs in general. ***(High Priority.)***

4. **Alternate credit scoring methods are needed.** Given the "ticket size" of SME loans versus the loan administration costs, banks need more efficient loan assessment processes. As already mentioned, the capacity of banks to assess SMEs is rather inadequate. ***Recommendation to FSPs:*** FSPs should consider new approaches to SME credit assessment. Some such approaches already exist, such as psychometric testing (by groups such as ELF and new ones by Fintechs e.g. Amartha). However, the best prospects will be using 'big data' from online sources such as digital payment platforms and social media, which should be examined by the FSPs more actively. The loan monitoring approach also needs to change for SMEs, in areas such as portfolio quality and delinquency management. ***(High Priority.)***

5. **The presence of both commercial and subsidised lending can create confusion.** Despite some reservations on the targeting of KUR, the terms of the product are clear enough. There are also loan schemes at provincial level with subsidies. These may create confusion in the market. If this is unchecked, it can lead to higher NPL rates and discourage other lenders from entering the SME market. ***Recommendation to FSPs and***

Government: There should be greater clarity in the product disclosures made to avoid this confusion. At the sector wide level, the funders or providers of the subsidised products, whether KUR or provincial government products, should assess the products regularly, to ensure they are having the desired impact and not 'crowding out' commercial, and hence more sustainable alternatives for SME finance. ***(Medium Priority.)***

4.3 DEMAND SIDE

The keys to success for SMEs accessing finance revolve around three main initiatives: seeking the best financing product; the SME putting "its best foot forward" in the application process; and changing the business operation for the better:

1. **SMEs need to take steps to become more 'bankable' in order to access financial services.** The blame for the lack of SME finance cannot be attributed only to the regulators and the suppliers. Many SMEs need to adopt a more business-like mindset, rather than seeing their enterprise as an extension of family activities. Key to this is usually a business plan, with details on its operations, products, employees, marketing and processes. To take a more entrepreneurial approach, many SMEs also need proper business bookkeeping, with cash flows tracked and the capacity to plan for expansion. ***Recommendation to SMEs and Donors***: SMEs should take a more entrepreneurial approach to their businesses and build their own technical capacity, overall operational quality and enterprise information transparency. Moreover, SMEs should offer effective financial reports with high authenticity to help commercial banks make judgments on their credit image. Of course, not all SMEs have the financial capacity to achieve these lofty goals, and this is where other stakeholders can play a role, for example to provide proper business bookkeeping. Also of assistance would be more workshops on topics such as financial literacy and the use of Fintech. (***High Priority.)***

2. **SMEs also need to be better informed on the potential finance and other services available to them.** This is an issue for the regulators and FSPs, but it may also be the fault of SMEs themselves in reaching out for the information. Once the SME has a full understanding of its future financing needs based on some sort of a business plan, it is then a matter of determining what type of product and what quantum of funding best meets the SME's financing needs. **Recommendation to SMEs and their associations:** As part of any financing decision, the SME should ask certain questions: Can it provide collateral, or must it seek a cash flow based not asset backed loan? When will the funds be needed and, if not the full amount on Day 1, can a facility with tranches be arranged? Is it possible that equity funding would be more appropriate than debt? Would other products also be important, such as insurance coverage? In particular, the associations representing SMEs and entrepreneurs could do more to assist their members. For example, there are at least half a dozen such associations in Bandung alone and yet there appears to be a lack of coordination among them. If they operated together, they could save costs and avoid duplication in serving their members and bringing to their attention some of the appropriate financial products, training and other business development services. ***(Medium Priority.)***

3. **The lack of required collateral hinders access to finance.** Whilst it can be argued (see section 4.2) that the lenders need to be more flexible in this regard, for the moment

SMEs need to have collateral in order to obtain finance from banks. ***Recommendation to SMEs***: The owners and management of SMEs needs to take steps to clarify their title to land and other assets and obtain documentation that can be pledged for loans. If collateral cannot be provided, SMEs should examine its capacity to provide alternatives, such as security over other assets, liens, guarantees and post-dated cheques. (***Medium Priority***.)

4. **Many SMEs operate in remote areas where it is difficult to connect with banks and other services.** The banks are beginning to use networks other than physical bank branches, such as online processes or local agents, to reach potential clients. As for the supporting services, this is an issue for the regulators and FSPs, but it may also be the fault of SMEs themselves in not reaching out for the banks and the information. ***Recommendation to SMEs, Government and Stakeholders:*** SMEs should adopt a similar approach, particularly using the technologies being employed by the FSPs, such as the internet and digital payment platforms. An understanding of, and access to, these avenues for finance can be obtained from the FSPs themselves and other stakeholders, such as government ministries, donors, NGOs and business associations mentioned already. ***(Medium Priority.)***

5. **There is a general lack of assessments of the impact of SME finance and other services.** The range of financial products, training and other business development services available to SMEs is extensive. The same can be said for all the other services provided to SMEs. As mentioned under "Supply" (section 4.2), there is very little detailed assessment of what works well and those that have the biggest impact on the enterprises and their owners and employees. The finding is also relevant for those operating at the macro and supply sides. ***Recommendation to Government, Donors and Stakeholders:*** More information on the SME sector, the finance available and support services would be of interest to those operating on the macro and supply sides and the SMEs themselves. The size and cost of doing impact assessments means that it is more likely to be government and donors that undertake such studies - like this one. Nonetheless, some of the analysis could be done on the demand side, perhaps by the associations (see above) working in tandem. ***(High Priority.)***

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ANNEX A: LIST OF INTERVIEWEES

Organisation	Person (Role)	Email Address
ASBANDA (Association for Regional Development Banks in Indonesia)	Mr. Valentino Gola (Project Management Officer)	tvalen223@gmail.com
National Planning Agency (Bappenas)	Mariska Suwardi	mariska.suwardi@bappenas.go.id
Bappeda West Java Province	Dr Iendra Sofyan	iendra@hotmail.com
Bina Artha	Christian Banno (CEO)	chrbanno@gmail.com Christian.banno@bina-artha.net
Bank BJB	Arief Setyahadi (Head UMKM)	asetyahadi@bankbjb.co.id
	Foura D Trisnasih (Group Head Sentra)	fdeviyanti@gmail.com
BMU	Edwar Fitri	edwarfit@yahoo.com
	Yudi Utomo	yudie911@yahoo.com
Bank BRI	Mrs. Fita Arisanti (Senior Manager of Strategic Small Business)	fitaarisanti@gmail.com
Bank Btpn	Toni H Wirja (Asset Business Planning Head)	Toni.hwirja@btpn.com
Dinas Cooperatives of West Java	Rudi Billah (Head of Small Enterprise Division)	rrudibillah652@gmail.com
Go-pay	Brigitta Ratih E. Aryanti (Head of Government Relations and Policy)	brigitta.aryanti@go-pay.co.id
GUMKEMINDO	Yusi Syamsuddin	Yusi.syamsudin@gmail.com
	Neneng Nurlaela	
HIPMIKIMDO (Indonesia Micro and Small Business Assoc)	Liseu Purnamasari	Hipmikimdo_jabar@gmail.com

Organisation	Person (Role)	Email Address
International Fund for Agricultural Development (IFAD)	Ms Sarah Hessel via Heike Hakim	h.hakim@ifad.org
International Finance Corporation (IFC)	Nyoman Yogi (Operations Officer, Financial Institutions Group)	nyogi@ifc.org
International Labour Organization (ILO)	Owais Parray (Chief Technical Advisor)	parray@ilo.org
	Muce Mochtar (National Programme Coordinator)	muce@ilo.org
	Yanis Saputra (Provincial Coordinator)	yanis@ilo.org
Indosurya Finance	Mulyadi Tjung (CEO)	Mulyadi.tjung@indosuryafinance.com
Investree	Adrian Gunadi (CEO)	adrian@investree.id
IPEMI (Womens Muslim Entrepreneurs Assoc)	Etsa Rahma Devi	Magentia.alete@gmail.com
	Ir. Diah Ivoniarty	Diah.ivoniarty@ymail.com
J Trust Bank	Tomas Sugiono (Head of Consumer & Credit)	Tomas.sugiono@jtrustbank.co.id
Bank Mandiri	Pak Sumedi (VP, Microbanking)	Sumedi@bankmandiri.co.id eddi.arrafi@bankmandiri.co.id
	Edii Arrafi (Assistant Manager, Micro Banking)	
MicroSave	TVS Ravi Kumar (Senior Manager Inclusive Finance and Banking	ravi@microsave.net
Coordinating Ministry of Economic Affairs (CMEA)	Mr. Iwan Faidi (Assistant Deputy for Improving Cooperative and SME Competitiveness)	iwanfaidi@cbn.net.id
	Mr. Edi Prio Pambudi (Assistant to Deputy Minister Monetary & Balance Payment)	epambudi@ekon.go.id
	Ms. Eni Widiyanti (Head of Banking, Capital Market and Financial Institution Principles)	enimaera@gmail.com enimaera@yahoo.com

Organisation	Person (Role)	Email Address
Ministry of Industry & Trade	Ms. Gati Wibawaningsih (Director General of Small and Medium Industries)	Gati-w@kemenperin.go.id
Otoritas Jasa Keuangan (OJK)	Mr. Roberto Akyuwen	roberto.akyuwen@ojk.go.id
OJK Regional II West Java	Mr. Miftah Budiman	ext.miftah@ojk.go.id
PERBARINDO (Association of Rural Banks in Indonesia)	Ms. Riwandari Juniasti (Secretary General)	riwandari.perbarindo@gmail.com dpp_perbarindo@yahoo.com
PUPUK (Small Business Assoc)	Cecep Kodir Jaelani	cecep_kj@pupuk.or.id
Sampoerna Bank	Ong Tek Tjan (Director, SMEs)	Ong.tjan@banksampoerna.com
	Rudy Mahasin (Director, Micro Business)/Pak Ceppy (Micro)	rudy.mahasin@banksampoerna.com
SECO	Remy Duiven	remy.duiven@eda.admin.ch
	Melisa Go	melisa.go@eda.admin.ch
UN Pulse	Maesy Angelina (Social System Lead)	maesy.angelina@un.or.id
UNPAD	Reza Zulkarnaen	reza.zulkarnaen@unpad.ac.id
	Teguh Santoso	teguh.santoso@fe.unpad.ac.id
	Adhi Hartadi	adhi.hartadi@unpad.ac.id
World Bank	Michael Steidl (Lead Finance Specialist)	msteidl@worldbank.org

ANNEX B: QUESTIONNAIRE FOR GOVERNMENT/ REGULATOR/OTHER

A: BACKGROUND OF THE ORGANISATION:

1. Name of Organisation:____

2. Type of Institution: Regulator ( ) Government department or agency ( ) NGO ( ) MLB ( ) Investor/donor ( ) Other (please specify (_________________________)

3. Year of entry into country: ( )

4. Name of Personnel (answering the questionnaire) -------------------------------------- Position-------------

5. Does your Organisation have a person focussed on access to finance for SMEs? YES ( ) NO ( ).

   If your answer is YES, could that person participate in this interview?

6. Contacts: Email: _____________________ Phone: ___________________________

B: OPERATIONS OF THE INSTITUTION:

1. What Role does your Organisation play in the Financial Sector and, specifically, access to finance for SMEs[62]?

2. Are you aware of FSPs that target SMEs? YES ( ) NO ( ).

   If your answer is YES, what are the names?

3. What types of Products (loans, savings etc) are offered to the target market by these FSPs? *Please specify this is the table below, to the extent you are aware.*

62 Where possible, this will focus on SMEs in the productive sectors, being manufacturing including agro-processing and high value-added services such as technology-based industries which are likely to have an impact on future jobs

Type of Product/ Service	Number of Clients Served (Dec 2017)	Amount Outstanding (Dec 2017)	Region(s) in which the Product/ Service is offered

4. Are there any issues related to SMEs (eg access, usage, quality etc) with these products, to your knowledge? Are they adapted to the clients' needs?

5. Compared to last year, has there been any increment in demand for products by SMEs? YES ( ) NO ( ).

   If YES, please give an estimate of this increase or decrease in demand.

   Reasons for increase or decrease in demand

   Estimated increase or decrease in volume as compared to the previous year's figures.

6. Do you have any SME focused programs. YES ( ) NO ( )

   If yes, please provide:

   - Description of program and program rationale
   - Program life cycle, timeframe and implementation capacity
   - Source of funding
   - No. of active participants (if any)
   - No. of targeted participants
   - Results – expected result of initiative

7. Do you know if other government bodies, donors or private sector actors are attempting to address the same problem? YES ( ) NO ( )

   If yes, please provide:

   - Description of program and program rationale
   - Program life cycle, timeframe and implementation capacity

- Source of funding
- No. of active participants (if any)
- No. of targeted participants
- Results – expected result of initiative

8. What are the major challenges that you think are hampering SMEs from accessing financing or other financial services?

9. Are there any rules and regulations that you think are hampering the delivery of finance to SMEs?

   YES ( ) NO ( ).

   If YES, what are these rules and regulations and what would you recommend about them?

10. Are there any new products you are aware of being developed by a FSP for SMEs? YES ( ) NO ( ).

    If YES, please provide details?

11. Given your experience, what do you expect to happen in the next 3-5 years as regards financing for SMEs?

12. What recommendations would you give to enhance the delivery of finance to SMEs in Indonesia?

Thank you for your time! We would greatly appreciate your sharing any reports or documents than can support the information you have supplied above. This will be treated as confidential and used solely for this exercise.

ANNEX C: QUESTIONNAIRE FOR FINANCIAL SERVICE PROVIDERS

A: BACKGROUND OF THE FINANCIAL INSTITUTION

1: Name of Institution:____

2: Type of Institution: Bank ( ) MFI ( ) FSP Association ( ) Other (please specify (________________________)

3: Legal Entity of the Institution

a. Company Limited by Guarantee ( )
b. Limited Liability Company ( )
c. Member Owned ( )
d. Others (please specify): ______________________________________

4: Year of Institution Establishment in country: ( )

5: Name of Personnel (answering the questionnaire) --------------------------------------- Position-------------

6: Does your Organisation have a person focussed on access to finance for SMEs[63]? YES ( ) NO ( )

If your answer is YES, could that person participate in this interview?

7: Contacts: Email: ____________________ Phone: _________________________

63 Where possible, this will focus on SMEs in the productive sectors, being manufacturing including agro-processing and high value-added services such as technology-based industries which are likely to have an impact on future jobs

B: OPERATIONS OF THE INSTITUTION:

1. What Target Market does your institution[64] serve?

2. What is your total portfolio as at end of December 2017?

3. What is the number of clients served as at end of December 2017?

4. In how many outlets (branches) are these clients/members served?

5. If more than one outlet, please identify these outlets in the table below

Region in which outlet is located	Year in which Outlet was establishment	Total Number of Clients (December 2017)	Portfolio Outstanding (December 2017)

6. What types of Products (loans, savings etc) are offered to the target market in all these outlets? *Please specify this is the table below, highlighted any targeting SMEs.*

Type of Product/ Service	Number of Clients Served (Dec 2017)	Amount Outstanding (Dec 2017)	Region(s) in which the Product/ Service is offered

64 Where the interview is with an FSP association, the questions will be asked about members as a whole.

7. What category of clients access the products identified under (6) above. Tick all that apply:

a. SMEs at the urban level ( )

b. Rural SMEs ( )

c. SMEs in productive sectors ( )

d. Others (*please specify*) ____

8. Are you aware of how many of your clients are SMEs? YES ( ) NO ( ).

If your answer is YES, please help fill in the table below:

Type of Product/ Service	Number of SME Clients	Outstanding Portfolio for SMEs

9. Compared to last year, has there been any increment in the demand for your products by SMEs? *Please give an estimate of this increase or decrease in demand.*

a. *Reasons for increase or decrease in demand*

b. *Estimated increase or decrease in volume as compared to the previous year's figures.*

10. What strategies do you have in place to target SME clients and therefore increase supply?

If favourable costing of finance (Interest, fees and commissions) is one of the strategies you use to attract client, please summarise the past and present costs in the table below.

11. What are the major challenges that you think are hampering SMEs from accessing

Cost Item	Previous Cost of Finance	Present Cost of Finance
Annual Interest Rate		
Types of fees and commission: a. b.		
Others *(Specify)*		

financing or other financial services?

12. What major challenges and risk factors do you face in offering services to SMEs and therefore likely to hamper growth of the portfolio?

    a. *Challenges and risk factors*

    b. *Possible remedies to these*

13. Are there any rules and regulations that you think are hampering the delivery of finance to SMEs?

    YES (   ) NO (   ).

    If YES, what are these rules and regulations and what would you recommend about them?

14. If 7 (c) was ticked, did you get support of any kind in starting and rolling out your product for SMEs?

    YES (   ) NO ( ).

    If YES, please specify the kind of support, what it is (was) for and when it is likely to end.

15. In the event that this support stops do you think your institution will continue offering the product?

YES ( ) NO ( ).

If YES, how do you intend to fund this continuation?

16. If you are a member of any financial association or member-based organisation, how has this membership helped you in propagating the SME product?

    Are you aware of any other organisations supporting access to finance for SMEs?

17. Are there any new products you are developing? YES ( ) NO ( ).

    If YES, which category of clients are you targeting?

18. Have you experienced any competition in the delivery of the SME product?

    YES ( ) NO ( ).

    If YES who are these competitors and in what way are they competing with you?

19. Given your experience, what do you expect to happen in the next 3-5 years as regards financing for SMEs?

20. What recommendations would you give to enhance the delivery of finance to SMEs?

Thank you for your time! We would greatly appreciate your sharing any reports or documents than can support the information you have supplied above. This will be treated as confidential and used solely for this exercise.

ANNEX D: QUESTIONNAIRE FOR DEMAND SIDE STAKEHOLDERS

A: BACKGROUND OF THE GROUP:

1: Name of Institution:____

2: Type of Institution: Industry Association ( ) University ( ) Think Tank ( ) Other (please specify (__________________________)

3: What type of business are your members or stakeholders engaged in? (*Record numbers for each)*

a) Distributive and Retail Trade

b) Agriculture

c) Manufacturing

d) Production (give type)

d) Other

e) No business

4: How long have your members or stakeholders been in their current business? (*Record numbers for each)*

a) 0 -1 yr.

b) 1 -3 yrs

c) 3-5 yrs

d) above 5 yrs (please specify)

5: How did they get the money to start their business? (*Record numbers for each)*

a) Loan from friend/relative

b) investor

c) loan from financial institution

d) personal savings

e) inheritance

f) other

6: Have your members or stakeholders ever applied for credit at bank, MFI or other FSP and was unsuccessful?

YES ( ) NO ( ) *(Record numbers for each)*

If Yes, what were the reasons given for no loan?

____

7: Have they ever received any type of business training or support?

YES ( ) NO ( ) *(Record numbers for each)*

If yes, from whom? ____

8: What are the top challenges or issues your members or stakeholders face in running their businesses?

(Record numbers for each)

____ ( )

____ ( )

____ ( )

____ ( )

B: ACCESS TO FINANCE FOR SMES[65]:

1. What types of Products (loans, savings etc) are offered to SMEs? *Please specify this is the table below.*

Type of Product/ Service	Who Offers It	Region(s) in which the Product/ Service is offered

65 Where possible, this will focus on SMEs in the productive sectors, being manufacturing including agro-processing and high value-added services such as technology-based industries which are likely to have an impact on future jobs

2. Are you aware of any other programs targeting SMEs?

   (Record numbers for each)

   ____ ( )

   ____ ( )

   ____ ( )

3. What are the major challenges that you think are hampering SMEs from accessing financing or other financial services?

   (Record numbers for each)

   ____ ( )

   ____ ( )

   ____ ( )

4. Are there any rules and regulations that you think are hampering the delivery of finance to SMEs?

   YES ( ) NO ( ).

   If YES, what are these rules and regulations and what would you recommend about them?

   (Record numbers for each)

   ____ ( )

   ____ ( )

   ____ ( )

5. If you are an association or member-based organisation, how has membership helped your members in accessing financial services?

   (Record numbers for each)

   ____ ( )

____ (   )

____ (   )

6. Are you aware of any other organisations supporting access to finance for SMEs?

   (Record numbers for each)

   ____ (   )

   ____ (   )

   ____ (   )

7. What recommendations would you give to enhance the delivery of finance to SMEs in Indonesia?

   (Record numbers for each)

   ____ (   )

   ____ (   )

   ____ (   )

Thank you for your time! We would greatly appreciate your sharing any reports or documents than can support the information you have supplied above. This will be treated as confidential and used solely for this exercise.

PROMISE

IMPACT

Decent jobs through financial inclusion

Promoting Micro and Small Enterprises through Entrepreneur's Access to Financial Services (PROMISE IMPACT) project was developed in partnership between the Government of Indonesia, the Swiss State Secretariat for Economic Affairs (SECO), and the International Labour Organization (ILO). The project supports financial service providers to operationalize development mission into specific metrics, craft strategies, and design services to help small businesses achieve greater productivity, growth, and jobs