

STRATEGIES FOR DEVELOPING MICRO, SMALL AND MEDIUM ENTERPRISES (MSMEs)

Presented by

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on

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1. Introduction

The economic crisis in 1997 has changed the government policy in economic growth strategies. Most of corporations collapsed during the crisis while many of micro, small and medium business remain stable and grow. This contradictive situation leads the government to put much attention on the endeavor to foster the role of micro, small and medium enterprises (MSMEs) in national development program.

When discussing the micro, small and medium enterprises, it is necessary to have a common understanding of the terminology of MSMEs. Classifying enterprises into micro, small, or medium enterprises can be based on a firm's assets, sales or the number of employees working for the firm. The definition may vary among countries or institutions along with the differences in economic level or wealth of the countries.

The government of Indonesia defines micro and small enterprises as firms with total assets up to Rp. 200 million (US \$ 22,500) excluding land and building or the total annual sales are not more than Rp. 1 billion (US \$ 112,700). While the medium enterprises are firms with total assets more than Rp. 200 million but not exceed Rp. 10 billion (US \$ 1.127 million) excluding land and buildings.

The World Bank has more concise classification of MSMEs based on number of employees, total assets and annual sales. Micro enterprises are define as individual/firms with total assets less than \$ 100,000, total sales less than

\$100,000 and employ less than 10 persons. Small enterprises are individuals/firms with total assets or annual sales between US \$100,000 up to US \$ 3 million and employ 10–50 persons. Medium enterprises are individuals/firms with total assets or annual sales more than US \$3 million up to US \$ 15 million and employ more than 50 up to 300 persons.

Undoubtedly, MSMEs have dominated economic activities in many developing countries. Job creation and equally distributed incomes are the most significant contribution of MSMEs. In Indonesia MSMEs have played a significant role in the economy of the fifth largest population in the world. Of more than 40 million enterprises, 99.99% is small and medium enterprises and only 0.01% is corporation. Millions of people engage in this productive activity and MSMEs employ 99.45 % of people working in the private sector. They contribute significantly to the development as 54.74% of Gross Domestic Product comes from these enterprises.

Table 1. Number of enterprises in Indonesia in 2001

Enterprises	Number	%	Labor	%	% of export	GDP (in Rp)	%
Small	40,137,773	99.85	65,246,294	88.6	3.37	578,359,165	39.40
Medium	57,743	0.14	7,993,449	10.85	10.93	225,223,692	15.34
Sub total	40,195,516	99.99	73,239,793	99.45	15.30	803,582,857	54.74
Corporate	2,095	0.01	406,215	0.55	85.70	664,517,170	45.26
Total	40,197,611	100	73,646,008	100	100	1,468,100,025	100

Sources: Ministry of Cooperatives & SMEs

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

2. Financing MSMEs: Problems & Challenges

Despite the fact that MSMEs are very potential for building a stable economic growth, developing MSMEs is a difficult issue. Myriad problems need to be addressed.

The most common problems for MSMEs are lack of access to market information, technology, low quality of human resources and lack of access to capital. Most MSMEs do not understand what kind of products needed by market, how big the market and when the products needed and how to deliver the products. MSMEs also have weakness in bargaining power especially in dealing with big buyers. Even if they understand the market, they sometimes find difficulties in raw material supply, both in the availability and price.

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

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

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

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

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

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

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

In general financial services for MSMEs can be classified into:

- Micro lending for micro entrepreneurs served by microbanking such as the BRI-Units, rural banks (BPRs), village banks (BKDs), state owned pawnshop (Perum Pegadaian), and other microfinance institutions
- Loan for small entrepreneurs supplied by commercial banks and other financial institutions, i.e. the state owned venture capital (Permodalan Nasional Madani). In addition, the government runs the small business and cooperative development program that financed through state owned companies' profit.
- Medium size lending mostly provided by commercial banks and other financial service provider.

3. The Role of BRI in Strengthen MSMEs

The root history of Bank Rakyat Indonesia is back to the 19th century when Raden Bei Aria Wiraatmadja established *De Poerwokertosche Hulp en Spaarbank der Inlandsche Hoofdeen* on December 16, 1895. Formally, BRI was established in 1968 under National Law No. 21, 1968, its primary mission being the provision of rural and urban community banking services by mobilizing family savings and deliver credit products to micro, small and medium enterprises. Furthermore, the promulgation of the Banking Law No. 7, 1992 BRI was transformed the bank into a limited liability company (PT. Persero), which wholly owned by the government.

As a commercial bank, BRI provides a wide range of banking products and services such as commercial loans particularly to MSMEs, saving products and other financial services. In addition, the bank also plays a significant role in assisting the government in agribusiness development and cooperatives. Uniquely, BRI has a microfinance window, which provides financial services to

low income people (economically working poor) and microenterprises particularly in rural areas.

From its establishment, BRI is designed and consistently focus on MSMEs development, which depicted in the bank's mission:

- To perform the best banking services focusing on micro, small, retail and medium scale enterprises to enhance the economic activity at large.
- To provide prime services to customers through its widespread business network supported by professional staff and implement good corporate governance.
- To deliver value and optimal benefits to stakeholders

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

Table 3. BRI's Loans Portfolio

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

Note ; 1 US \$ = Rp 8,870

3.1. BRI's Strategies for Financing and Developing MSMEs

Lending methodology

To accommodate the different level of MSMEs, BRI has been developing several loan schemes based on the business scale such as loans for micro

entrepreneurs, loans for small scale business and loans for Medium scale business.

Moreover, there are two main approaches in serving the micro and small enterprises. For the micro entrepreneurs who are still below poverty line, BRI provides subsidized loans since their conditions and level of capabilities are not sufficient enough to accommodate the commercial approach. Meanwhile, for micro enterprise above poverty line, BRI provides fully commercial basis loans since they have the capabilities to do so.

In providing the subsidized loans for micro entrepreneur below poverty line, BRI collaborate with the government agency. The interest is in subsidized rate as the funds come from government or other international institution, such as IFAD, ADB. The example of this loan is Rural Income Generating Project (RIGP). This loan is a group loan and the government provides assistance.

BRI provides commercial loans called Kupedes for micro entrepreneur who are above poverty line. The source of funds comes from market. The loan size is up to Rp 50 million (US \$ 5,600). As the target market is the micro entrepreneurs, the approach is slightly different from conventional banking approach. BRI keeps the procedure as simple as possible and avoiding much paper work. Creditworthiness of the prospective borrowers is based on prospective clients' character as there is no reliable information about the business performance. Even, on very small loans (below 2 millions rupiah or US \$ 225), BRI waives the collateral requirements.

Loans products for small entrepreneurs are Investment Loans, Working Capital Loans, Export Loans, with maximum loan, up to 5 billions rupiah (US \$ 56,300). Even though the loan procedures are not as simple as the Kupedes, but they are not as complicated as the loans procedures for medium entrepreneurs or corporations.

For medium enterprises, BRI provides loan with loan size up to Rp 50 billion (US \$ 5.7 million). As the loan size is quite significant, BRI use conventional banking approach in evaluating the prospective borrowers.

Extending the outreach

To be more accessible for the clients, BRI is developing distribution strategies through networking. Nowadays, BRI is a bank with the widest network in Indonesia with 13 regional offices, 324 branches, 3,916 BRI Unit offices, 68 sub branches and 220 service posts. This wide network enables BRI to serve rural areas, the location of micro and small enterprises. For extending the outreach, BRI has a policy to establish 100 BRI-Unit outlets per year up to 2005.

Collaboration with relevant institutions

Realizing that many MSMEs still require facilitator for business growth, BRI collaborate with some relevant institutions to develop MSMEs business. BRI has a collaboration with some universities in providing technical assistance or research in developing MSMEs. Some problems may arise from MSMEs ignorance of marketing product overseas. BRI tried to encounter the problems by having a collaboration with Export Development Agency. This collaboration provides MSMEs the opportunity to expose their product abroad through trade show.

Establishing SME-Center

BRI actively involves in developing SME-Center, together with TELKOM(a state owned telecommunication company) and CD SMEs (an affiliation of Indonesian Chamber and Commerce)

SME-Center, which is a virtual center, is a node of network and point of transit of local business to connect with the internet in order to access the global market. SME-Center facilitates SMEs for accessing market information, transaction and business assistances. BRI has established 9 SME-Centers located in 9 BRI Branch Offices. The establishment of these centers received positive responses from the entrepreneurs as they can utilize the facilities in SME-Center to explore the business opportunities. In the next coming year, BRI will establish another 40 SME-Centers.

Linkages with big corporation

BRI also facilitates a partnership between corporations and MSMEs. In this partnership, the corporations act as a credit guarantor for MSMEs loans. The corporations also guarantee to buy MSMEs' products so that there will be marketing problems. Recently BRI signed an Memorandum of understanding with Agritani Ltd from Malaysia to develop SMEs in agribusiness.

BRI as a technical advisor

The relationship between a bank and the MSMEs must be a mutual symbiotic. A bank always has a concern in the business performance of its borrowers. If the borrower can improve the business capabilities, they can develop their business, gain higher profit and create more job opportunities. They can repay the loans or even ask higher loan as they need more capital to support the business. This means that the bank will grow as the borrowers' businesses grow. On the other hand, some MSMEs lack of knowledge in some business aspects that may prevent their business growth. Realizing the need of the clients, BRI also provide technical assistance for them. The credit officers play important role in giving direct technical assistance to the clients. While they are visiting the clients for monitoring they also give assistance to the clients regarding administration, market information, financial management etc.

Developing MSMEs through IT

In order to anticipate the development in information technology and realizing the importance of information technology for business expansion, BRI is developing a site for MSMEs called **SME Online** at the BRI website. In the future, this project will provide information system network and e-business for MSMEs:

International Visitor Program

As a leading microbanking institution, BRI has a commitment to share its wealth of experience with other countries interested in microfinance. In 1996, BRI established the International Visitor Program (BRI-IVP) under a partnership agreement between BRI and USAID. Furthermore, BRI has signed a partnership with the Consultative Groups to Assist the Poorest (CGAP), a World Bank affiliate organization, to develop the capacity building of BRI-IVP programs. BRI-IVP provides Study Visit Programs and training programs, which have been attended by 1,700 visitors from 37 countries. Recently, BRI-IVP has collaborated with NAM-CSSTC in conducting training on microcredit scheme for Asia Pacific region and Southern Africa region.