

**Growth and Resilience of Savings-based Microfinance Institutions:
The Case of the Microbanking Units of Bank Rakyat Indonesia**

**By
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Abstract

The microbanking units of BRI, with a savings portfolio of \$5.9 billion and a loan portfolio of \$3.9 billion (2008), are a heavyweight in microfinance. Crisis has played a crucial role in their evolution. Just as BRI, the bank of which they are a part, owes its origin to globalization and the resulting crises during the second half of the 19th century, so do the microbanking units. They were created in 1969, under conditions of abundant oil revenues, as a policy instrument for channeling subsidized credit to agricultural priority sector, following the dominant paradigm at the time. When the global tide turned and the oil price fell in 1982, the Government was no longer able to maintain the drain on its resources from the losses of the units. Confronted with the options of closing or reforming the village units as they were called, the new management opted for the latter. Autonomy, self-reliance, profitability and national outreach were the core principles on which the new units were founded. Within a few years they started generating ever-increasing profits and surplus liquidity.

When the Asian financial crisis hit and the Indonesian banking sector collapsed, the units proved resilient. Safe deposits with positive real returns throughout the years and easy access to repeat loans for any purpose at market rates of interest combined with powerful incentives to clients and staff had made the units the most trusted local financial institutions in a large country with numerous competitors. When other institutions folded up under bank runs and mounting default rates, the units collected vast amounts of additional deposits, and their customers continued to repay their loans. Profitability remained high. BRI was one of the insolvent banks, pulled down by the dead weight of its corporate portfolio. The Government's decision to restructure, rather than merging it with other defunct state banks, was to a considerable extent due to the outstanding performance of the unit system throughout the crisis as well as its international reputation. Nowhere else than during that crisis, aggravated by drought and the downfall of the political regime, have the strength and resilience of savings-, profit- and outreach-driven microfinance institutions been more apparent.

Given the historical record of the units, it is not surprising that the ongoing global crisis has not affected them. What is surprising, however, is that not only the units, but all of the bank's five business segments have either stood up well or even improved their performance. Risk management in microbanking over the past 25 years, and mesobanking all the way up to corporate banking over the past decade, is an art that the various management and governance teams of BRI have learned and effectively applied.

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Microfinance and the global meltdown

For three decades microfinance has rapidly expanded around the globe. By the end of 2008 microfinance investment vehicles (MIVs) had invested US\$6.6 billion in microfinance institutions (MFIs), and almost as much had been provided by donors (CGAP 2009b). It is now feared that this process of growth might have been reversed, or at least come to a standstill, as stated by the American Banker: “The \$32-billion microfinance sector has been pounded by the worst economic slowdown since the Great Depression... growth has pulled back significantly, with MFIs hampered by the capital constraints endemic to the financial market meltdown.” (Rosta 2009) On the basis of a survey among over 400 MFIs in 82 countries, CGAP (2009a), the microfinance sector’s think tank and global advocate, reports that over the past eighteen months, “many MFIs are finding it harder to access funding, and their microcredit portfolios are stagnant or shrinking—a significant shift after years of remarkable growth.” Of the top ten risks now facing the microfinance sector, nine are reportedly related, directly or indirectly, to the economic meltdown, with credit risk and liquidity the two biggest.

As CGAP realizes, its findings are not based on a random sample. In fact, many of the microfinance institutions (MFIs) which make headlines and are found on the *Microfinance Information eXchange (MIX)* have enjoyed disproportionate support from international donors and investors. MFIs which rely on their own resources, particularly deposits, and do not have a donor paying for their participation at international gatherings are less conspicuous. Paradoxically, least conspicuous are those savings-driven MFIs which occur in numbers too large to be individually listed, such as 4,300 Microbanking Units of Bank Rakyat Indonesia (Seibel 2009a), 1,350 village financial institutions (LPD) in Bali (Seibel 2008) and 1,015 rural credit cooperatives (PCF) in Vietnam (Seibel 2009b), to mention just three subsets in Southeast Asia, comprising almost 6,700 MFIs with a total savings balance of \$7.1 billion as of 31 December 2008 – more than the total investments by MIVs worldwide. Have these MFIs been equally affected by the global meltdown? Does it make a difference whether MFIs rely on their own resources rather than on those of donors and international investors?

This paper deals with the Microbanking Units (MBUs) of Bank Rakyat Indonesia (BRI), restructured in 1984, savings-driven and self-reliant long before the restructuring of BRI as a bank after the Asian financial crisis. How have they weathered the Asian Financial Crisis, the meltdown of BRI in 1998 and the ongoing global financial crisis?

A century of crisis and reform in Bank Rakyat Indonesia

The popular (*rakyat*) credit system in Indonesia, rather than having been *pounded* by crisis, owes its very origins to crisis, poverty and the unpredictable impact of globalization. In the last decades of the 19th century, a number of factors pounded the rural population and led to its impoverishment: coercive recruitment of plantation labor until 1870; the opening up of the rural sector to European and Chinese capital after the Agrarian Law of 1870 which exposed

¹ We gratefully acknowledge that this paper has benefited from comments by Michael Marx and Jacob Yaron.

the sector to the fluctuations of global markets; increasing land shortage caused by an expanding plantation economy; a global commodity crisis in 1884 which led to the collapse of the agricultural investment banks; and a growing indebtedness to Chinese and Arab moneylenders. As in various European countries at the time, usury and the resulting indebtedness were considered a major cause of impoverishment – a social as well as a political concern threatening the stability of the colonial system. A popular credit system – in today's terminology: *inclusive finance* – appeared as a panacea. In the following decades policy issues of how best to achieve this objective were hotly debated, focusing on such issues such as social vs commercial banking, centralized vs decentralized institutions, subsidized vs commercial credit, and government dependence vs self-reliance based on savings mobilization and retained earnings.

This is the historical background for the emergence of Bank Rakyat Indonesia (BRI), which occupied a central place in these discussions. BRI dates its origins to the *Hulp en Spaarbank der Inlandsche Bestuurs Ambtenaren* in Purwokerto Regency on Java, established in 1895. Since 1897 it was popularly known as *Volksbank (bank rakyat, people's bank)*. It provided savings and credit in cash or kind to Indonesians of any occupation and European civil servants. It underwent many transformations and changes of name, until it was finally reestablished, in 1968: as a commercial bank and, at the same time, the government's main policy instrument in the rural sector, with the task of financing rural development and the green revolution. In the tradition of the *dual economy* of the colonial period, BRI was given a dual function: commercial *general* lending to the middle class including small and medium enterprises according to banking criteria, and concessionary *special* loan programs for small farmers and microentrepreneurs.

Heavily subsidized credit programs designed by government and donor agencies increasingly dominated BRI's agenda. In 1969 BRI was appointed as the only bank for Bimas, a program of credit to farmer groups with the main objective of rice self-sufficiency. Liquidity was provided by Bank Indonesia, the central bank, insurance by Ascrindo, a state insurance company. As an institutional channel BRI established a network of village units (*unit desa*), predecessors of the microbanking units. Their number grew rapidly: from 18 in 1969 to 537 in 1970 and, after a surge in the oil price in 1973, to 2131. In 1974 the units were authorized to collect savings; but this remained an insignificant source of funds.

In 1971, Bimas loans accounted for 15% of the total amount, and 80% of the number, of BRI loans outstanding. One third of the Bimas clients were in arrears, resulting in a loss ratio of 17.5%, with a deteriorating trend. To the borrowers, the benefits of subsidized credit were drastically reduced by several factors: a shift of transaction costs from lender to borrower, onerous procedures, frequent delays beyond the agricultural input time, restriction of loan purposes to production-oriented agricultural targets, and illegal extra charges by loan officers. In the absence of incentives for small farmers to repay and for the staff (numbering 14,000) at the units to enforce repayment, default rates had surged by 1982 to above 50%, resulting in heavy losses.

The decline of the oil price in 1982, another global event, marked a turn-around in rural finance policy. The loss of income from oil exports initiated an era of deregulation and a shift from a supply-driven to a demand-oriented approach. In the process market forces increasingly replaced the government as prime mover of development. Policy measures in 1983 comprised full interest rate deregulation, the elimination of credit ceilings and a reduction of central bank liquidity credit. This terminated the disbursement of program credit by the BRI units, putting the future of the whole network at risk. At the time BRI comprised 292 branches and 3617 village units, with a total of 31,777 employees, 45% of them in the units – the largest delivery network of any bank in Indonesia. BRI was given two options: closing or reforming the units. BRI opted for the latter. This marked the beginning of a process which eventually made BRI one of the largest and perhaps most successful provider of commercial microfinance in the developing world.

In August 1983 BRI was placed under new management. Encouraged by the Ministry of Finance, BRI decided on a massive restructuring of the units. With technical assistance from the Harvard Institute for International Development (HIID), a new system was designed, turning the village units into microbanking units, implemented as of February 1984. (BRI 1995; Robinson 2001; Schmit 1991; Seibel 1989, 1998, 2003, 2009a)

The microbanking units: from subsidy to self-reliance

Under the new organizational system the units were separated from the branches and placed under their own administrative structure. Designed to remain micro, the standard staff size of a unit was set at four, which might expand up to a maximum of eleven beyond which a unit is split into two. The units were turned into self-sustaining profit centres with substantial profit-sharing incentives for their staff. If arrears exceeded 5%, unit managers would lose their lending authority as well as career prospects. Units were moved from rice planting areas to business centers; unprofitable units would be closed or downgraded to service posts. Training and retraining were organized in regional centers. All government- and donor-supported programs were kept away from the units and handled at the branches.

At the market segment level the units moved away from the previous commodity approach with its emphasis on farmers, crop agriculture and seasonal loans. Credit was provided to any credit-worthy person and for any income-generating activity, such as petty-trading, agricultural input trade, industry, services, agriculture, horticulture, small plantations and livestock as well as consumer credit. Anyone is a potential customer who is able to save and repay his loans; there is no targeted credit.

At the product level, the credit-only approach was replaced by an equal emphasis on product innovations in savings and credit; later money transfer, cheque clearing and bill payment were added. On the basis of calculations of microsavings and microcredit transaction costs, two new commercial products were crafted with commercial rates of interest. One is a rural savings product, *Simpanan Pedesaan* (Simpedes), with unlimited withdrawals and a lottery component with prizes in well publicized public events, complementing demand and time deposits and other savings products. Of the gross interest rate of 13%, savers received 11.5%, while 1.5% was put into the prize fund. (Until 1996 inflation rates were single digit.) This turned out to be immensely attractive and at the same time has served as a very effective instrument of resource mobilization.

The other product is a non-targeted general credit product, *Kredit Umum Pedesaan* (Kupedes), open to all and for any purpose. Portfolio diversification is thus ingrained in Kupedes. Loan sizes started as low as \$3 up to a maximum of \$5,000, now increased to \$10,000.² Its features include simple procedures, short maturities, regular monthly instalments mainly from non-agricultural income, flexible collateral requirements (none for small loans up to \$500), incentives for timely repayment, repeat loans contingent upon successful repayment of previous loans, and market rates of interest. Loan interest rates were calculated as a monthly flat rate with constant monthly payments, which is easy to comprehend for staff and borrowers. Interest rates amounted to 2% flat per month on working capital loans and 1.5% on investment loans, equal to gross effective rates of respectively 44% and 33% per annum, minus 11% for timely repayment, leaving net effective interest rates of respectively 33% and 22% per annum, covering all costs and risks.³ The

² The average outstanding loan size was \$875 in 2008.

³ The interest rate has given cause to some debate. Yaron (2006) has calculated the Subsidy Dependence Index (SDI) for 1985 at 32.2, for 1990 at -13.7 and for 1995 at -44.5%. That means that, without subsidies, the interest rate would have to have been risen in 1985 by 32.2% to break even, while in 1995 there was room for lowering the interest rate to around 18% and still staying profitable. Instead, BRI opted for a transfer of profits to other business segments, resulting in a regressive

gross flat rate in 2008 stood at 1.0% to 1.5% per month depending on loan size – deducting the rebate, the effective annual interest rate stands at 16.5%-24.75% or approximately 7% to 15% in real terms. The rebate for timely repayment turned out to be a powerful incentive to repay on time, resulting in a 95% on-time repayment rate. The arrears ratio (≥ 1 day overdue) was 5.4% in 1984, fluctuated over time but on the whole has shown a declining trend, reaching 1.1% in 2008; the 12-month loss ratio stood at 1.0% in 2008.

Three sources of funds were available to the BRI units: (i) an injection of Rp210 billion (\$196 million) of seed capital in 1984 by the Government as start-up liquidity, fully used by 1986; (ii) a World Bank loan of \$102 million (\$5 million for technical assistance in 1987 and \$97 million for onlending in 1989, but reallocated); (iii) savings deposits remunerated at positive real returns. As of 1986 the units turned a profit; and in 1988 and 1989 they accounted for 30% of BRI's total net income. At the same time BRI was able to show in an impact study that the units have a significant impact on women's access to credit and on poverty alleviation. (Yaron 1992: 99) – despite high interest rates that might have been substantially lowered in subsequent year given the units' high profitability (Yaron et al. 1997).

During 1989, the units broke even in terms of savings mobilization and loans outstanding and began generating surplus liquidity. Ever since, the unit network has been self-reliant and viable by mobilizing its own resources and generating profits. Disbursement of the World Bank loan in 1989 came thus at a time when the units had outgrown the need for it; the credit line was thus reallocated to the branches. Surplus liquidity continued to grow reaching \$2.0 billion in 2008. The total sum mobilized and transferred to the branches from 1989 to 2008 amounted to \$24.7 billion⁴ - an indicator of successful savings mobilization as much as of limitations in lending outreach (Seibel 2005).

The number of savings accounts has increased continually since 1984. As of 2005, the BRI units served 32 million savings accounts. During 2006 to 2008 BRI closed dormant accounts, resulting in a reduction to 20 million accounts as of 2008. Savings balances crossed the \$1 billion mark in 1991 and the \$2 billion mark in 1993, fell briefly below that mark in 1997, exceeded \$3.5 billion in 2003 and reached \$5.9 billion in 2008, averaging \$300 per account. Net profit in 2008 amounted to \$564 million. The units' self-reliance in terms of fund mobilization and profitability has created the material base for their autonomy and freedom from political interference which so severely afflicted the rest of the banking system up to the crisis of 1997/98. (BRI 1990-2008; Robinson 2001; Seibel 2009a; Yaron 1992, 2000)

The microbanking units during Asian financial crisis

During the crisis of 1997/98 the currency collapsed, and so did the Indonesian commercial banking sector: as a result of external factors and internal weaknesses. BRI was one of the insolvent banks, pulled down most of all by the failure of its corporate portfolio. From Dec 1996 to Dec 1998 total assets in US\$ terms (after a drastic devaluation) fell from \$14.44 billion to \$4.25 billion, gross loans outstanding from \$11.23 billion to \$5.41 billion, deposits from \$8.10 billion to \$5.34 billion, and total equity from \$0.76 billion to -\$3.08 billion. Income (before tax) dropped from \$0.14 billion to -\$3.31 billion.

At the eve of the crisis, December 2006, the 4,000 units held 2.5 million loan accounts and a loan portfolio of \$1.7 billion, financed through 16 million deposit accounts with a total balance of \$3.0 billion, leaving \$1.3 billion in surplus liquidity. This amounted to 15% of the Bank's loan portfolio and 37% of its deposit balance. More importantly, return on assets (ROA) of

income redistribution (Yaron) and cross-subsidization in reverse (Seibel 2005). However, note should be taken that this enabled BRI to keep the interest rate stable through most of the hyperinflation phase during the Asian financial crisis.

⁴ Calculated at the respective year-end exchange rates.

the units was 5.7%, compared with 0.7% of the Bank as a whole. This combination of outreach and financial performance of the units had earned the Bank a worldwide reputation of excellence; in fact, its fame was such that many believed that the Bank *was its microbanking network*. It appears that this was perhaps the decisive factor motivating the Government to rescue the bank, bringing it back to its original mission as expressed in its name: the People's Bank of Indonesia.

The monetary crisis did affect the units, but in a positive way compared with BRI as a whole and other banks. In terms of number of deposit accounts, growth continued from 16.1 million accounts in 1996 to 18.1 million in 1997, 21.7 million in 1998, and 24.2 million in 1999, with the rate of growth in number of deposit accounts surging to 19.6% in 1998 from 12.4% in 1997 and 11.5% in 1996. During the three-month peak crisis period, June-August 1998, when Indonesia had been most badly hit by both a drought and the financial crisis, 1.3 million new deposit accounts were opened in the units and an additional Rp2.84 trillion (\$354 million) deposited. In nominal terms, during the initial 12-month crisis period from September 1997 to August 1998, total savings deposits in the units almost doubled: from Rp7.98 trillion to Rp15.13 trillion, an increase by 89.6%; and in all of BRI from Rp17.86 trillion to Rp35.17 trillion, a growth of 96.9% (above the inflation rate of 56%). On a year-to-year basis, deposits in the units surged by 83.8% in nominal terms from Rp8.8 trillion in 1997 to Rp16.2 trillion in 1998. In US dollar terms, due to the massive devaluation of the rupiah, deposits in the units fell from \$3.0 billion in 1996 to \$1.9 billion in 1997; it took until 2003 to reach, and surpass, the pre-crisis level.

Figure 1 shows the precipitous fall in the dollar value of deposits in 1998.

In contrast to what many donors expected, willing to provide extra funds for the poor, the number of borrowers with loans outstanding from the units fell from 2.6 million in 1997 to 2.5 million in 1998 and 1999 – not because of a shortage of funds, but because of uncertainty felt by clients over the future. The amount of loans outstanding remained almost constant in nominal terms, In US dollar there was a substantial decline: from \$1.7 billion in 1996 to \$1.0 billion in 1997 and a low of \$0.6 billion in 1998; recovery to the pre-crisis level was only reached at the turn of 2003/04. (Figure 1)

The crisis had only a moderate effect on repayment, testifying to the effectiveness of incentives as well as the resilience of the borrowers. There were delays in repayment, indicated by an increase of the non-performing loan ratio (≥ 1 day) from 3.7% in 1996 to 5.7% in 1998. The contrast to BRI as a whole is striking, with the NPL ratio surging from 10.6% in 1996 to 53.0% in 1998. (Table 1) The 12-month loss ratio increased from 1.6% in 1996 to 2.2% in 1997 and then started declining to an all-time low of 0.5% as of 2001. Interesting from a viewpoint of microborrower psychology, there was a rush to repay in August 1998, right after the peak of the crisis, leading to an unprecedented one-month loss-ratio of -0.21% – more than the due amount having been repaid.

Table 1: NPL and ROA of BRI and the BRI MBUs, net profit of MBUs in million US\$, 1996-2008

Year	NPL ratio		ROA		Net profit of MBUs
	BRI	MBUs	MBUs	BRI	
1996	10.6	3.7	5.7	0.7	177.5
1997	11.4	4.7	4.7	0.1	89.7
1998	53.0	5.7	4.9	-77.8	88.9
1999	19.9	3.1	6.1	-4.8	167.7
2000	5.0	2.5	5.7	0.7	120.9
2001	4.9	2.2	5.8	1.6	128.9
2002	6.7	1.6	6.4	1.8	186.1
2003	6.0	2.5	5.7	4.0	195.3
2004	4.2	1.9	6.8	5.8	233.5
2005	4.7	1.4	7.0	5.0	250.2
2006	4.8	1.3	8.5	4.4	323.4
2007	3.4	1.2	9.4	4.6	524.3

2008	2.8	1.0	9.8	4.2	563.8
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Source: BRI financial reports

Who saved BRI?

When the Indonesian banking system collapsed, BRI's microbanking division remained profitable. In US\$ terms, due to the devaluation, profits were cut in half in 1997; they stayed at that level in 1998 and doubled in 1999 (Table 1). Return on assets hardly budged, declining from 5.7% in 1996 to 4.7% in 1997 and, at the height of the crisis, recovering to 4.9% in 1998. This is in sharp contrast to BRI as a whole. The bank's ROA declined from 0.7% in 1996 to 0.1% in 1997 and then, in 1998, turned sharply negative at -77.8% (Table 1), resulting in a negative capital of -\$3.08 billion in 1998 and -\$3.70 billion in 1999. BRI was technically bankrupt. Like many other banks, BRI could have been closed or merged. BRI would probably not have survived had it not been for the units or had the government decided to spin off the units into a separate new microfinance bank, one of the options discussed. In a more technical sense, the units have cross-subsidized the bank in two ways – before, during and after the crisis: through the continual transfer of profits from the units to the bank, including the crisis period; and by transferring savings mobilized at village and sub-district level to the branches and head office.

Over the 14-year period from 1990 to 2003, the year when BRI went public, cumulative net profits of the units amounted to \$1.6 billion (and added up to a grand total of \$3.5 billion as of 2008). Cumulative surplus liquidity since 1989 amounted to \$15.9 billion as of 2003 (and 24.7 billion as of December 2008). Thus, it was the units which ultimately saved BRI; they provided the ground for its reform in 2000 and its entry into the stock market in 2003. Their success presumably played a key role in the decision to recapitalize BRI: their continually excellent performance since 1984, their vast outreach, the large number of well trained staff and last but not least, their international reputation – lauded as “the most advanced example of the microfinance revolution” (Robinson 2001) and “a flagship of rural microfinance” (Seibel 2005).

The microbanking units during the global crisis

2008 marks the 25th year of the reformed units. 2008 is also the year when the global crisis hit. Have they been affected? We proceed in three steps. First, we examine the long-term annual trend of growth and performance of the units, with particular emphasis on the last four years, 2005-08 (Table 2); next we use monthly data for the period January 2008 to June 2009; finally we compare the performance of the units with the other business segments of BRI.

As of December 2008, the BRI unit business segment held 19.6 million deposit accounts, down from 32.2 million in 2005 due to the cleaning of dormant accounts. During the four-year period the deposit balance grew from \$3.7 billion to \$ 5.9 billion, with a slow-down in 2008, mainly due to a temporary change in the exchange rate.⁵ The number of credit accounts grew from 3.3 million to 4.5 million and the amount of loans outstanding from \$2.3 billion to \$3.9 billion, both without any change in the direction of the trend. The arrears ratio fell steadily from 1.4% to 1.0%. ROA continued to increase every year, from 7.0% in 2005 to an all-time high of 9.8%, albeit at a lower pace, in 2008. Net profit, which had surged to \$524.3 million in 2007 from \$250.2 million in 2005, continued to grow and reached \$563.8 million in 2008 (moderated by a temporary decline in the value of the Rupiah by 16%). (Table 1, Table 2; BRI 2009)

⁵ The value of the Rupiah to the US\$ fell from 9,419 at the end of 2007 to 10,950 at the end of 2008. At the time of writing (8 Oct 2009) it had fallen to 9,368, below its previous level.

Table 2: Performance of BRI microbanking units, 1984 – 2008 (amounts in million US\$)

Year	Savings deposits		Loans outstanding		Surplus	12-month loss ratio	Arrears ratio*	ROA	US\$ exch. rate**
	Accounts	Amount	Accounts	Amount					
1984	2,655	39.3	640,746	103.4	-64.1	1.0	5.4	n.a.	1,074
1985	36,563	75.5	1,034,532	203.6	-128.1	1.8	2.1	n.a.	1,125
1986	418,945	107.1	1,231,723	203.7	-96.6	2.7	4.5	n.a.	1,641
1987	4,183,983	174.2	1,314,780	260.4	-86.2	3.0	5.8	n.a.	1,650
1988	4,998,038	284.8	1,386,035	313.3	-28.5	4.6	7.4	n.a.	1,731
1989	6,261,988	534.9	1,643,980	472.1	62.8	2.3	5.4	n.a.	1,793
1990	7,262,509	902.9	1,893,138	736.2	166.7	2.0	4.1	3.0	1,877
1991	8,587,872	1,275.4	1,837,549	730.8	544.6	4.9	8.6	2.7	1,992
1992	9,953,294	1,648.4	1,831,732	799.5	848.9	3.4	9.1	2.6	2,062
1993	11,431,078	2,049.9	1,895,965	927.7	1,122.2	2.2	6.5	3.3	2,110
1994	13,066,854	2,378.2	2,053,919	1,117.3	1,260.9	0.7	4.5	5.1	2,200
1995	14,482,763	2,606.4	2,263,767	1,382.7	1,223.7	1.1	3.5	6.5	2,308
1996	16,147,260	2,975.9	2,488,135	1,710.5	1,265.4	1.6	3.7	5.7	2,383
1997	18,143,316	1,900.4	2,615,679	1,007.6	892.8	2.2	4.7	4.7	4,650
1998	21,698,594	2,011.9	2,457,652	585.3	1,426.6	1.9	5.7	4.9	8,025
1999	24,235,889	2,403.1	2,473,923	839.0	1,564.1	1.7	3.1	6.1	7,100
2000	25,823,228	1,992.2	2,715,609	815.7	1,176.5	1.1	2.5	5.7	9,595
2001	27,045,184	2,114.5	2,790,192	949.4	1,165.1	0.5	2.2	5.8	10,400
2002	28,262,073	2,626.4	3,056,103	1,343.4	1,283.0	1.7	1.6	6.4	8,940
2003	29,869,197	3,538.2	3,100,358	1,683.4	1,854.8	1.9	2.5	5.7	8,425
2004	31,271,553	3,541.4	3,210,678	2,067.0	1,474.4	1.3	1.9	6.8	9,285
2005	32,252,741	3,742.7	3,313,532	2,317.9	1,424.8	1.3	1.4	7.0	9,830
2006	30,907,566	4,659.7	3,455,528	2,904.8	1,754.9	1.2	1.3	8.5	9,393
2007	21,229,085	5,646.4	3,515,812	3,461.3	2,185.1	0.9	1.2	9.4	9,419
2008	19,575,496	5,881.3	4,460,580	3,904.7	1,976.6	1.1	1.0	9.8	10,950

Source: BRI, Laporan Statistik BRI Unit

* Total payments overdue one day or more in % of total loans outstanding, excluding loans written off.

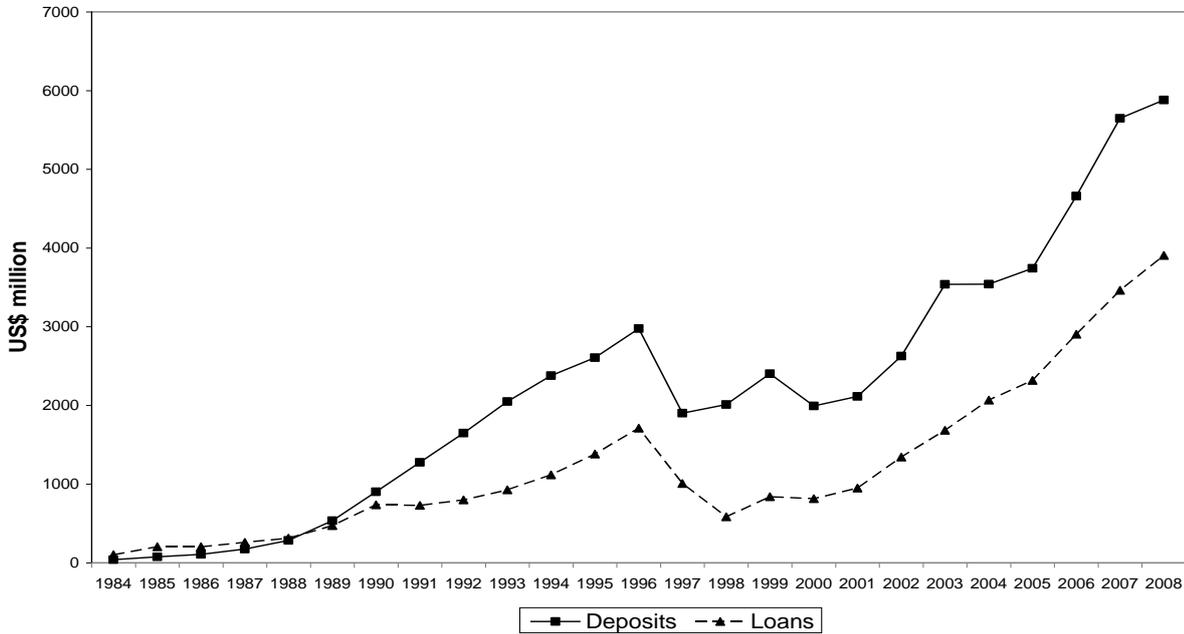
** End-of-year exchange rates.

1997-98: Asian financial crisis (hyperinflation).

2006-08: Cleaning of inactive savings accounts.

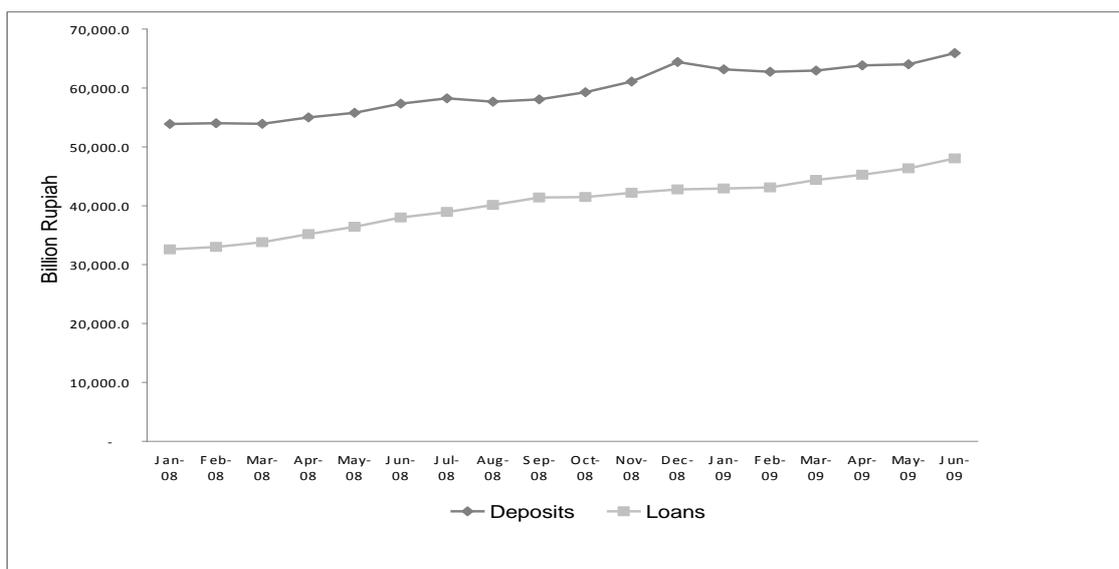
Figure 1 shows how the value of deposits and loans outstanding continued to grow in 2008, with a dip in the curve of deposits, which was due to a temporary decline of the Rupiah.

Figure 1: Deposits and loans outstanding of BRI microbanning units, 1984-2008 (in million US\$)



Monthly data for the period January 2008 to June 2009, reported in billion Rupiah to eliminate the fluctuations of the exchange rate, show a steady growth of deposits and loans outstanding, unimpeded by any external crisis. (Figure 2) Similarly, there is no detectable effect of the crisis on monthly loss, arrears and return-on-assets ratios of the microbanning units over the same time period. (BRI 2009b)

Figure 2: Deposits and loans outstanding of BRI MBUs, Jan. 2008 to June 2009 (in billion Rupiah)



During the financial crisis of 1997/98 BRI virtually collapsed, while its microbanking units continued to thrive. Meanwhile, BRI has been recapitalized (in 2000) and partially privatized (in 2003)⁶ and has since grown into the most profitable bank in Indonesia with the biggest outreach and the largest loan portfolio – an outstanding example of successful restructuring of a government-owned bank (Seibel 2009a). We will now examine whether the excellent performance of the MBUs during the global crisis still sets them apart from the rest of the bank. (Table 3)

Table 3: BRI portfolio composition and NPL ratios, 2005-2008

Business segment	Loan size in US\$ (2007)	Non-performing loan ratio				Portfolio 2008 in %
		2005	2006	2007	2008	
Microbanking	Up to 5,000*	1.55	1.36	1.19	1.02	26.6
Small consumer	Up to 20,000	1.62	1.91	1.67	1.08	19.0
Small commercial	Up to 500,000	4.06	6.32	5.71	3.52	27.6
Medium	>0.5-5 million	7.48	5.87	5.67	6.33	7.7
Corporate	>5 million	16.93	13.55	4.62	4.53	19.1
Total		4.68	4.81	3.44	2.80	100.0
<i>Total in billion US\$</i>		<i>7.68</i>	<i>9.61</i>	<i>12.09</i>	<i>14.71</i>	

*Raised to US\$10,000 toward the end of 2008.

Source: BRI 2009

During the four-year period from 2005 to 2008 portfolio size almost doubled from \$7.7 billion to \$14.7 billion. In response to the crisis of 1997/98 it was decided that the bank should focus on MSME lending. As of 2008 almost half the portfolio has been in microloans up to \$5,000 (27%) and salary-based consumer loans up to \$20,000 (19%). These two business segments with relatively small loans have by far the best performance, with NPL ratios of 1.0% and 1.1%, respectively. Small commercial loans up to \$500,000 account for 28% of the portfolio, at a considerably higher NPL ratio of 3.5%. Medium-scale loans up to \$5 million account for 7.7% of the portfolio, at a yet higher NPL ratio of 6.3%. Corporate loans, kept below 20% of the portfolio as per decision of the Government as the bank's (majority) owner have an NPL ratio of 4.5%.

Overall there is no visible effect of the global crisis on the performance of BRI's portfolio as a whole. Since its recapitalization in 2000 BRI has made serious efforts to keep its NPL ratio below 5% as required by the central bank. In 2005 and 2006 NPL ratios were just below that level. Since then BRI succeeded to lower the ratio substantially: to 3.4% in 2007 and 2.8% in 2008. ROA, however, fell slightly, from 5.4% in 2005 to 4.6% in 2007 and 4.2% in 2008, while equity fell from 37.9% in 2005 to 31.6% in 2007, but rose to 34.5% in 2008.

The two small-scale business segments, micro and consumer lending, despite an already excellent performance in 2005, succeeded in bringing down their NPL ratios by about one-third, notably unimpeded by the crisis when comparing 2007 with 2008. Small and medium commercial loans improved their performance slightly, the latter however with a higher ratio in 2008 compared with 2007. It is not clear whether this might have been due to the crisis. The most impressive result has been achieved in corporate lending, much of it agricultural, with innovative approaches in supply chain finance and in agribusiness public-private partnerships, its NPL ratio cut down to about a quarter of its 2005 level,

Conclusion

The microbanking units of BRI, with a savings portfolio of \$5.9 billion and a loan portfolio of \$3.9 billion (2008), are a heavyweight in microfinance. Crisis has played a crucial role in their evolution. Just as BRI, the bank of which they are a part, owes its origin to globalization and

⁶ The Government's share of ownership has declined from 59.5% in Nov 2003, the IPO date, to 56.8% as of Dec 2008.

the resulting crises during the second half of the 19th century, so do the microbanking units. They were created in 1969, under conditions of abundant oil revenues, as a policy instrument for channeling subsidized credit to agricultural priority sector, following the dominant paradigm at the time. When the global tide turned and the oil price fell in 1982, the Government was no longer able to maintain the drain on its resources from the losses of the units. Confronted with the options of closing or reforming the village units as they were called, the new management opted for the latter. Autonomy, self-reliance, profitability and national outreach were the core principles on which the new units were founded. Within a few years they started generating ever-increasing profits and surplus liquidity.

When the Asian financial crisis hit and the Indonesian banking sector collapsed, the units proved resilient. Safe deposits with positive real returns throughout the years and easy access to repeat loans for any purpose at market rates of interest combined with powerful incentives to clients and staff had made the units the most trusted local financial institutions in a large country with numerous competitors. When other institutions folded up under bank runs and mounting default rates, the units collected vast amounts of additional deposits, and their customers continued to repay their loans. Profitability remained high. BRI was one of the insolvent banks, pulled down by the dead weight of its corporate portfolio. The Government's decision to restructure, rather than merging it with other defunct state banks, was to a considerable extent due to the outstanding performance of the unit system throughout the crisis as well as its international reputation. Nowhere else than during that crisis, aggravated by drought and the downfall of the political regime, have the strength and resilience of savings-, profit- and outreach-driven microfinance institutions been more apparent.

We can only speculate whether the experience of the units has served as a model and driving force in the reform of BRI after 1998, which is now the most profitable bank with the widest delivery network and largest loan portfolio in Indonesia. Given the historical record of the units, it is not surprising that the ongoing global crisis has not affected them. What is surprising, however, is that not only the units, but all of the bank's five business segments have either stood up well or even improved their performance. Risk management in microbanking over the past 25 years, and mesobanking all the way up to corporate banking over the past decade, is an art that the various management and governance teams of BRI have learned and effectively applied. Through its International Visitors' Program⁷ BRI is prepared to share this art with other countries in the South – and of course with those in the North if anyone cares to listen.

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