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Bank Rakyat Indonesia: Twenty Years of Large-Scale Microfinance

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Executive Summary

Established 20 years ago, the Unit system of Bank Rakyat Indonesia (BRI) today is the largest and one of the most successful microfinance institutions in the world. The 3,855 Units—small outlets mostly in rural areas with around six staff members each—are scattered all over Indonesia and provide services to almost 30 million small savers (the average account is US $108) and 3.1 million small borrowers (average loan outstanding is US $540). The BRI Units have followed a profitable, sustainable approach to microfinance on a large scale, based on locally-mobilized savings without subsidies and funds from government or donors. The commercially-based provision of credit and savings services has had a powerful positive impact on the lives of millions of poor and low-income households.

Several factors have driven the reform and implementation of the BRI Unit system. Effective leadership, strong commitment, and political support were crucial at the initial reform stage but also throughout the development process. The institutional design of the BRI Unit as the nucleus of the entire system combined standardization and flexibility in a unique way. The BRI experience drew extensively on the lessons and experimentation of other initiatives and from BRI's own trials and pilots.

External factors gave the impetus for the initial reform. Later on, stable macroeconomic conditions and a series of financial sector reforms provided a conducive environment within which the new Unit system could develop and prosper. When the Indonesian banking system collapsed in 1998, BRI's Unit system remained profitable, loan repayment rate stayed high, and the deposit volume more than doubled. The BRI Units emerged from the crisis stronger and even more robust than before.

Implementation Process

Origins of the BRI Units

Bank Rakyat Indonesia (BRI) is a state-owned commercial bank that has historically concentrated on providing banking services to the agricultural sector and rural areas of Indonesia. BRI established 3,600 village units in the early 1970s as conduits for channeling subsidized credit to farmers under the BIMAS program. When the government decided to terminate the BIMAS program, and with it the massive subsidies to unit operations, BRI was faced with a difficult choice: either introduce drastic measures to make the village units viable, or close them down. With the encouragement of the Ministry of Finance, BRI decided to convert the units into a rural banking network that would meet a wide range of financial needs of rural households in a sustainable manner.

The timing and conditions for a "big-bang reform" of the BRI Unit system were favorable as the collapse of BIMAS coincided with important events: the collapse of oil prices and the sharp decline in oil revenues which put heavy strains on the government budget, a new cabinet and key personnel changes in the government (finance minister), and the launching of fundamental economic reforms. A major financial sector deregulation package was announced in June 1983 allowing banks to set their own interest rates; this created opportunities and the enabling environment for a viable rural banking operation.[1]

Establishment of the New Unit System (1984–86)

Viability guided the transformation of the Units from conduits for BIMAS (which was not profitable) to full-service rural banking units. A massive restructuring took place. One of the first steps taken was reorganizing the Units into profit centers and creating separate balance sheets and profit and loss statements for each Unit. Almost one-third of the Units was identified as having low potential and were downsized to village service posts. Many Units were physically relocated from out-of-town field sites to central locations close to the markets.

New products were introduced. A pair of products, KUPEDES (for credit) and SIMPEDES (for savings), have become the backbone and trademark of the new Unit system. KUPEDES is a single loan product for general rural credit. It is non-targeted and is available to any creditworthy customer for any kind of productive enterprise. KUPEDES interest rates were set at 1.5 percent flat per month (an annual effective rate of 33 percent). KUPEDES borrowers must provide sufficient collateral to cover the value of the loan, usually in the form of land titles, but also can pledge buildings, motorcycles, or other property. KUPEDES also has a timely repayment incentive, equivalent to a refund of 25 percent of the interest paid on the loan.

SIMPEDES is a simple passbook savings product that was introduced after pilot-testing and experimentation. Savings have been an integral part of the Unit banking philosophy and strategy from the outset. Because more people in rural areas tend to be savers than borrowers at any one time, providing better savings services was seen to be more effective in achieving an equitable distribution of banking services than providing cheap credit. In addition to SIMPEDES, the main product, the BRI Units offer demand and time deposits, as well as another savings product called TABANAS, which is mainly targeted at school children and students.

KUPEDES and SIMPEDES had a successful start, and after three years it became clear that the BRI Unit system could be financially viable. In 1984, only 14 percent of the Units were profitable. Two years later, this had increased to 72 percent. The BRI Unit system as a whole achieved profitability in 1986, the third year of operations.

Expansion and Scaling Up (1987–97)

The initial phase of transformation and establishment of the new BRI Unit system was followed by a decade of rapid expansion and scaling up. The expansion was fueled by continued deregulation and reforms of the financial sector and by macroeconomic growth and

Table 1: Deposits and Loans in BRI Units, 1984-2003						
	Deposits			Loans Outstanding		
Year End	Number (in thousands)	Amount (Rupiah billion)	Amount (US$ million)	Number (in thousands)	Amount (Rupiah billion)	Amount (US$ million)
1984	0.003	42	39	641	111	103
1985	0.04	85	76	1,035	229	204
1986	419	176	107	1,232	334	204
1987	4,184	288	174	1,315	430	260
1988	4,998	493	285	1,386	542	313
1989	6,262	959	533	1,644	847	471
1990	7,263	1,695	892	1,893	1,382	727
1991	8,588	2,541	1,276	1,838	1,456	731
1992	9,953	3,399	1,644	1,832	1,649	798
1993	11,431	4,325	2,058	1,896	1,957	931
1994	13,067	5,232	2,379	2,054	2,458	1,118
1995	14,483	6,016	2,631	2,264	3,191	1,395
1996	16,147	7,092	3,026	2,488	4,076	1,739
1997	18,143	8,837	2,424	2,616	4,685	1,285
1998	21,699	16,146	2,044	2,458	4,697	595
1999	24,236	17,061	2,419	2,474	5,957	845
2000	25,823	19,115	1,986	2,716	7,827	813
2001	27,045	21,991	2,105	2,790	9,873	945
2002	28,262	23,480	2,627	3,056	12,011	1,344
2003	29,869	27,429	3,240	3,100	14,183	1,675

stability. Every year, the BRI Unit system added an average of 100,000 borrowers and 1.5 million depositors.

In the sixth year of operation in 1989, the BRI Unit system achieved self-sufficiency in funding when the volume of deposits was equal to the loan amount outstanding. Since then, deposits continued to outstrip loans both in terms of number of accounts and volume. In terms of volume, the deposit-to-loan ratio has been about 2:1, with the result that only half of the funds mobilized by the Units were recycled as KUPEDES loans, and the other half were transferred to the branch system. For the Units, the fund transfer was attractive because they were paid an interest rate—the so-called transfer price—which was normally set slightly above the interest rate paid on time deposits. The branches easily absorbed the Units' excess liquidity and channeled the funds into large corporate loans that were rapidly expanded during the 1990s.

In 1997, the Unit Banking System recorded more than 18 million savers and 2.6 million borrowers (see Table 1). This dimension of outreach clearly established the BRI Unit system as the major institution in rural finance in Indonesia.

Financial and Economic Crisis (1998–99)

In late 1997, Indonesia was hit by a severe financial and economic crisis. Within a few months, the country's currency—the *rupiah*—experienced a dramatic 80 percent plunge in its value against the US dollar, followed by sharp increases in inflation (77 percent in 1998) and interest rates. The ensuing political crisis mounted in May 1998 with the downfall of President Suharto. The banking system was on the brink of collapse, forcing the government to step in and provide a blanket guarantee for all bank deposits. Many private banks were closed down, major state banks merged, and non-performing assets transferred to the newly-created Indonesian Bank Restructuring Agency (IBRA).

The BRI Units weathered the crisis period remarkably well. On the one hand, the BRI Unit system experienced an enormous influx of deposits because it benefited from its status as a state-owned bank and safe haven for depositors. In 1998 alone, more than three million new deposit accounts were opened, and the volume of deposits in rupiah doubled. On the other hand, the number of KUPEDES loans stagnated during the two years of crisis, and the portfolio level declined in real terms.

Most surprisingly, however, loan repayment suffered only marginally. Contrary to the massive defaults of large and corporate customers in the Indonesian banking sector, the KUPEDES borrowers maintained a strong repayment discipline and continued to honor their obligations despite the economic hardships they faced. Microenterprises primarily employed family labor and their own capital, and were able to adjust more flexibly to the external shock. Furthermore, the impact of the crisis on the poor was generally more severe in urban areas than in the countryside.[2] A key factor was also the long-term banking relationship that had developed between the Units and their customers.[3] Amid a general credit crunch in the banking sector, KUPEDES loans were continuously available to existing customers during the crisis years, although Unit managers did not seek out new clients during that period. Borrowers were particularly anxious to continue having access to BRI's credit facilities because such credit availability represented a form of insurance for dealing with external shocks. Hence, they strived to keep their borrowing history good and placed a high priority on repaying their loans to BRI.

The impact of the crisis on the viability of BRI Unit operations was thus only marginal. The BRI Units were able to maintain their profitability, albeit at slightly lower levels. The

BRI Units came out of the crisis stable and robust, contrary to the rest of BRI. Due to heavy loan losses in the corporate business unit, BRI almost collapsed and was recapitalized by the government.

Post-crisis Period (2000–Present)

In the four years since the crisis, the BRI Unit system continued to expand in scale. At the end of 2003, the Units recorded 30 million deposits and a volume of US $3.1 billion. The number of borrowers increased to 3.1 million, with a total loan amount outstanding of close to US $1.7 billion. With less than five percent of the portfolio at risk, the quality of loans remained excellent.

The crisis had brought a considerable rise in poverty. In 1998, over 24 percent of Indonesia's population, or almost 50 million people, had fallen below the poverty line, from around 15 percent before the crisis. The Poverty Alleviation Committee, established in 2001, has launched a ten-year program of poverty alleviation until 2010 and has set an intermediate target to reduce poverty to 14 percent of the population, or 26.8 million people, by the end of 2004. The Committee has realized the important role of the banking sector and has obtained the commitment of major banks, including BRI, to expand their lending to micro and small enterprises.

In an attempt to provide access to commercial credit for the enterprising poor in Indonesia on a massive scale, in January 2000 BRI introduced a small-scale KUPEDES product with simplified administrative procedures and flexible collateral requirements for loans under Rp 1 million (US $120). Although BRI has developed a significant portfolio of small-scale loans, it has not expanded to full capacity in the small-scale credit market, and there remains considerable scope for financing a significant portion of micro-entrepreneurs below the poverty line. But there are also limits to the provision of very small loans in a financially sustainable way. Despite the simplified administrative requirements, the break-even point for small-scale lending is Rp 1.2 million (US $143) when accounting for the full cost of lending.[4]

The latest development has been the privatization of BRI. The sale of 41 percent of BRI shares to the public through an IPO was completed in November 2003. The IPO was successful and drew strong interest from investors—its shares were oversubscribed by 16 times. The IPO was the largest equity deal since the financial crisis. Total proceeds from the IPO amounted to Rp 4.1 trillion (US $486 million), of which around Rp 2.5 trillion (US $297 million) is to be transferred to the state budget and the remaining is to increase BRI's capital.[5] What impact this partial privatization will have on the microbanking business and the Unit system is yet to be seen. However, with the BRI IPO, microfinance has made a successful entry into private equity markets, and this will send a powerful message to policy makers and bankers in Asia and the developing world.

Impact Analysis

Looking back on 20 years of implementation, the BRI Unit system has had a strong impact on rural microfinance in Indonesia and beyond. The immediate impact was felt by millions of microenterprises and poor households who benefited as savers and/or borrowers from the financial services offered by the BRI Units. Moreover, the BRI experience was a powerful demonstration to policy makers and other financial institutions in Indonesia and in many other countries. Its impact can be measured in terms of efficiency, effectiveness, and poverty outreach.

Efficiency in the Use of Resources

Efficiency and productivity have been key operating principles in the BRI Unit system. The Unit system functions as an independent profit center within BRI, and each small BRI Unit is a profit center within the system. This has formed the basis for transparency, accountability, and efficiency in the use of resources. BRI has set clear benchmarks for staff productivity: one credit officer for every 400 borrowers, one teller for every 200 daily cash transactions, and one bookkeeper for 150 daily transactions. Nowadays, a credit officer is responsible for more than 500 borrowers and a teller handles an average of 6,000 deposit accounts. The computerization of the BRI Units in the course of the 1990s has significantly contributed to the gains in staff productivity. As a result, cost efficiency of the Unit system has increased considerably over the years. In 2000, administrative costs as a percentage of the average loan portfolio came down to about 8 percent, which is very efficient by microfinance standards.

Effectiveness

Judging from the BRI Units' success in building and maintaining a large, stable, and growing customer base, it is clear that BRI has been highly effective in meeting the rural population's demand for savings and credit services at a reasonable cost. Beyond these direct effects, the performance of the BRI Units had a significant impact on financial sector policy in Indonesia. The design of the 1988 decree (so-called PAKTO) for setting up private rural banks was strongly influenced by the initial success of BRI's commercial approach to rural microfinance. The BRI Unit system has emerged as the leading institution in rural areas and has set the benchmark for rural microfinance in Indonesia. Moreover, BRI has gained international recognition as the most prominent showcase of large-scale microfinance and has become a learning ground for policy makers and practitioners from many countries. The BRI experience served as a model for institutional design in Cambodia, for savings product development in Thailand, and as input for microfinance legislation in Tanzania, to name a few examples.

Poverty Outreach

Over the past 20 years, the BRI Units have provided financial services to millions of microenterprises and rural households, most low-income in the general population and many among the poorer of the rural population. BRI's KUPEDES lending program does not specifically target the very poor below the poverty line but rather the *working poor* who have viable economic activities and sufficient repayment capacity. Poverty data for BRI Unit borrowers are not available, but proxy indicators (such as the number of small KUPEDES loans) provide an indication of depth of outreach.

Presently, the average outstanding loans are US $540, which is about half of the per-capita income in Indonesia. In 2001, 60 percent of KUPEDES loans were below US $300.[6] However, KUPEDES lending has not reached much of the population below the poverty line or the very poor, but rather those near the poverty line. A recent impact evaluation found that regular BRI Unit borrowers are relatively better off than other respondents, including BRI savers only and non-customers, whether measured in terms of income or wealth.[7] It remains to be seen whether the small-scale KUPEDES product introduced in 2000 can address these issues and successfully expand lending to poorer segments of the population.

Much of the debate on poverty outreach of the BRI Unit system (and of other microfinance institutions) has focused on *loans* and on the poor as potential *borrowers.* One may argue, however, that poor people are more likely to be found among the BRI Units' 30 million *savers* (average deposit US $108) than among the three million borrowers.

Savings are a cushion against emergencies for poor households. They help reduce their vulnerability and provide them with a tool for managing uncertainty and risks. For many poor people, credit may not be appropriate as it may not lower but rather increase their risk. Findings of the recent impact evaluation seem to confirm this hypothesis for rural Indonesia. When potential borrowers with viable enterprises were asked why they did not borrow from formal financial institutions, two-thirds said they did not want to be indebted.[8] It would be worthwhile to study the characteristics of BRI Units' small savers in more detail, as well as the importance of savings services for the poor, and the impact of savings services in terms of poverty reduction.

Driving Factors

Commitment and Political Economy for Change

Effective leadership, strong commitment, and political support were crucial factors not only at the initial reform stage but also throughout the development process of the BRI Unit system. In 1983, several events converged to create the political economy and climate for change. The government launched overall economic and financial reforms, which prepared the groundwork for a radical reform of the BRI Units. The blueprint for the new BRI Unit system was perfectly in line with the financial sector reforms announced in June 1983, thuswinning the support of the architects of the reform in the Ministry of Finance and the Central Bank.

Commitment and leadership within BRI have been essential. BRI's president director from 1983 to 1992 took personal initiative and responsibility for the development of the Unit banking system. Jointly with the other members of the Board, he protected the Units from interference and led the development of what they called BRI's new institutional culture and Indonesia's new rural banking system.[9] The change in culture was associated with the shift from subsidized farm credit to commercial microbanking. Starting from the top management, it triggered a major transformation of the entire institution by changing the mindset of its 14,000 employees.

Despite being part of a government-owned bank, the BRI Units were able to maintain their operational autonomy and to stay free from interventions, such as credit targeting, interest rate restrictions, provision of cheap funds, or from interference in lending decisions. However, as the designated bank for the rural and agricultural sectors, BRI continued to implement subsidized credit programs for priority sectors and specific target groups. These programs were shifted to the BRI branches at the district level, and kept strictly separate from Unit operations. This way, BRI was able to accommodate specific requests and special programs from the government and from donors, without disturbing the development of the Unit system.

Institutional Innovation

The BRI Unit—as the nucleus of the entire system—is itself an institutional innovation. Much of its success may be attributed to the organizational set-up of the single BRI Unit as a highly decentralized and semi-autonomous financial entity. The BRI Unit is commonly found in a central location of the sub-district town, often near the market place. It typically rents a one-room office in order to keep overhead costs low. A Unit covers about 16–18 villages at the sub-district, and currently serves an average of 10,000 savers and a little over 1,000 borrowers. The individual Unit was purposely kept small, by limiting the number of staff and focusing its operations. The four staff member—a manager, a loan officer, a teller, and a desk officer—have clear job descriptions and division of responsibilities. Personnel responsibilities and performance-based standards are harmonized across the Unit system. As volume of operations increase, up to 11 additional staff are posted to a Unit. If the business of a Unit expands beyond the maximum staff limit, the Unit is split to keep the operation small and focused.

The accounting system allows each Unit's performance to be evaluated as profit center. Unit managers and staff are accountable, which has instilled a high degree of responsibility among them. A standardized management information system (MIS), centered on a few key performance indicators, provided timely information to managers and supervisors at all levels. On this foundation the staff incentive system was built.

Overall, the Unit as the institutional nucleus combines standardization and flexibility; it can be easily replicated and easily adapted to the scale of operations in a particular area, providing an ideal institutional solution for expansion and scaling up.

Learning and Experimentation

The BRI experience is based on extensive learning and experimentation. Learning from others dominated the period *before* implementation while learning by doing (including pilot testing) was the main feature *during* implementation.

BRI did not invent all the features that characterize the Unit system. It pointedly studied the experiences of others before setting up its own system, such as Bank Dagang Bali, a private bank founded in 1969; the Badan Kredit Kecamatan (BKK), a community-based institution in Central Java; and informal moneylenders, specifically that they collected valuable insider information on prospective borrowers from input suppliers and buyers. BRI had experimented with the Kredit Mini and Kredit Midi products for several years and learned how to analyze the viability of informal microenterprises. The design of the KUPEDES product, the analysis of borrowers' repayment capacity, and the system of monitoring and collection were all built on this early experience.

Pilot testing became standard for BRI. Until 1983, BRI had virtually no experience with rural savings mobilization. Following an initial demand study, a first version of SIMPEDES was introduced as a pilot project in November 1984, and quickly showed evidence of massive demand for a liquid, convenient, and safe deposit facility. After some modifications and refinements, the facility was expanded to all Units by September 1986.

The BRI Units also learned from mistakes. For example, continuous access to credit is an important incentive for borrowers to repay their loans. When tight monetary policy caused a liquidity shortage in BRI and the management imposed a halt in lending in 1991–92, loan repayment deteriorated because borrowers perceived the availability of future loans to be at stake. During the recent financial and economic crisis, the KUPEDES lending window remained open to credit-worthy borrowers.

External Catalysts

External factors played an important role for the initial reform. The oil price collapse in 1983 and the decline in oil revenues forced the government to impose austerity on budgetary expenses and subsidies. Economic pressures made politicians adopt a commercial approach to rural microfinance. During the scaling-up period, stable macro-economic conditions and a series of financial sector reforms provided a conducive environment in which the new Unit system could develop and prosper. A decade later, the BRI Unit system was stable and robust enough to weather the severe economic crisis.

External assistance was crucial, especially in the early years. Technical assistance was provided by the Harvard Advisory Group, partially funded by the World Bank and USAID. Together with local bankers, the experts developed the initial design and principles of the new BRI Unit system. Financial resources were only required in the very beginning. With the know-how and the systems in place, the BRI Units were soon able to generate their own resources locally. A World Bank loan of US $97 million for KUPEDES onlending was disbursed in 1990, at a time when, strictly speaking, the BRI Unit system no longer needed outside funds.

Lessons Learned

Many lessons can be learned from the BRI experience. Some of its key principles have been replicated and adopted by the international microfinance industry as best practices. Some of the features are unique to the specific context of rural Indonesia and/or to BRI as an institution, but others can be generalized and applied in other countries. The BRI experience has become a learning ground for policy makers and microfinance practitioners from all over the world. BRI has established an international visitors program to facilitate international exchange and learning, and every year, about 20 international delegations visit and study the BRI Unit system.

Reforming a state-owned bank and utilizing existing infrastructure is possible within a short period of time. For scaling up poverty reduction, the major lesson to be learned is perhaps that reforming a state-owned bank, and utilizing the existing infrastructure and human resources to implement a sustainable approach of large-scale microfinance, is possible within a short period of time. Commercially-based provision of credit and savings services has had a powerful positive impact on the lives of millions of poor and low-income households, based on locally-mobilized savings without subsidies and funds from government or donors. This required a change of culture: treating the poor no longer as *beneficiaries* but as *customers* who can save, who are able and willing to pay market prices for good services, and who honor their obligations and repay their loans despite economic hardships.

Expand microbanking services to ensure sustainability. Some challenges remain and actions should be taken to ensure the sustainability of present achievements. First, lending should be further expanded. Even though the BRI Units have done a remarkable job in extending savings and credit services throughout Indonesia, there is considerable scope for expanding these microbanking services, especially to poorer segments of the rural population. Most Indonesians still do not make use of formal banking services, so the challenge for BRI is to address the needs of this “unbanked majority.”[10] However, an expansion of borrower outreach can only be achieved with additional staff, especially loan officers who serve more than 500 borrowers on average. Management must ensure that the increase in staff—and thus cost—is balanced by an increase in income from lending to additional borrowers, in order to maintain the profitability and sustainability of Unit operations.

Re-invest profits to ensure sustainability. BRI should not use the Units’ profits to cross-subsidize the non-profitable parts of BRI as has been done. Profits should rather be re-invested in the Unit infrastructure in order to improve the services to those who enabled the profits, Unit borrowers and savers.

Microfinance providers need competition. BRI Units need competition, which they have not had, and they hold a quasi-monopolistic position in the rural areas of Indonesia with market shares of 74 percent (deposits) and 39 percent (loans). Policy makers should create a conducive policy environment, and donors should provide support to other microfinance operators (for example, private rural banks) to encourage healthy competition. Competition is the driving force behind innovations, expanded outreach, and improved services to the poor. All these efforts are necessary to maximize the impact of large-scale microfinance on the reduction of poverty and on the achievement of the Millennium Development Goals.

End Notes

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