

**Sharing of  
International Best Practice  
for the  
Establishment of  
BPR APEX Institution  
in Indonesia**

**Desk Study**

By  
Wolfgang Heupel  
GTZ Rural Finance  
Ghana

Jakarta / Accra  
January 2005



# Table of Contents

|  |    |
|--|----|
| Table of Contents.....   | 3  |
| Introduction to the Terms of Reference (ToR) .....   | 6  |
| Part I.....  | 8  |
| The Case of Rural Banking and of the.....  | 8  |
| ARB APEX Bank Ltd. in Ghana.....   | 8  |
| 1. Background of Rural Banking in Ghana.....   | 9  |
| 2. Weakness of the Rural Banking Industry in Ghana.....  | 10 |
| 2.1 Internal Control Lapses .....  | 10 |
| 2.2 Poor Liquidity Management .....  | 10 |
| 2.3 Poor Credit Administration Practices .....   | 11 |
| 2.4 Management and Staff.....  | 11 |
| 2.5 Low Capitalisation.....  | 12 |
| 2.6 Lack of Product Innovation.....  | 13 |
| 3. Steps towards the Establishment of the ARB APEX Bank Ltd.....   | 14 |
| 3.1 Mission and Ownership of the ARB APEX Bank Ltd.....  | 15 |
| 3.2 Functions of the ARB APEX Bank Ltd. ....   | 15 |
| 3.3 Start up Finance and Scope of Operations of the ARB APEX Bank Ltd.   | 16 |
| 4. Functions of the ARB Apex Bank Ltd .....  | 17 |
| 4.1 The ARB APEX Bank Ltd. as Mini Central Banker for Rural Banks.....   | 17 |
| 4.2 The ARB APEX Bank Ltd. as Promoter and Service Provider.....   | 17 |
| 4.3 Short Term Liquidity Management and Stand By - loans.....  | 19 |
| 4.3.1 Brokerage Services for the Purchase of Bills / Bonds .....   | 19 |
| 4.3.2 Clearing Account Credit Balances .....   | 19 |
| 4.3.3 APEX Short Term Certificate of Deposit (ACOD) .....  | 19 |
| 4.3.4 Rediscounting of Treasury Bills .....  | 19 |
| 4.3.5 Overdraft Account.....   | 20 |
| 4.4 Wholesale Financing .....  | 21 |
| 4.4.1 Wholesale Financing / Linkages with Commercial Banks and other Non<br>Bank Financial Institutions (NBFIs)..... | 21 |
| 4.4.2 Loan Syndication / Pooling of Funds.....   | 21 |
| 4.5 The ARB APEX Bank Ltd - Gateway for Government and Development<br>Partner Programmes .....                       | 21 |
| 4.5.1 Micro Insurance Pilot Scheme .....   | 23 |
| 4.5.2 Women Development Fund / Japanese Grant .....  | 23 |
| 4.5.3 Village Infrastructure Programme (VIP).....  | 23 |
| 4.5.4 Social Investment Fund (SIF) .....   | 24 |
| 4.5.5 Credit with Education (CwE) .....  | 24 |
| 4.6 Payment System and Clearing House Mechanism .....  | 26 |
| 4.6.1 Cheque Clearing .....  | 26 |
| 4.6.2 APEX Link.....   | 27 |
| 4.6.3 APEX Link International (Int'l Money Transfer / Remittances) .....   | 28 |
| 4.6.4 Specie (Cash) Supply of Rural Banks .....  | 29 |

|                 |  |           |
|-----------------|--|-----------|
| 4.6.5           | Salary and Pension Payments to Civil Servants.....   | 29        |
| <b>5.</b>       | <b>Institutional Profile of Qualifying Rural Banks and Eligible Criteria (Soundness, Demand, etc.) .....</b>     | <b>31</b> |
| <b>7.</b>       | <b>Regulatory Requirements and Preconditions .....</b>   | <b>33</b> |
| <b>8.</b>       | <b>Governance and Operations Issues .....</b>  | <b>33</b> |
| <b>9.</b>       | <b>Introduction and Operation of ICT Based Rural Banking.....</b>  | <b>35</b> |
| <b>Part II</b>  | <b>.....</b>   | <b>40</b> |
|                 | <b>International Best Practice of APEX .....</b>   | <b>40</b> |
|                 | <b>Institutions for the Micro Finance Industry.....</b>  | <b>40</b> |
| <b>1.</b>       | <b>International Best Practice .....</b>   | <b>41</b> |
| <b>Part III</b> | <b>.....</b>   | <b>48</b> |
|                 | <b>The Case of Rural Banking in Indonesia .....</b>  | <b>48</b> |
| <b>1.</b>       | <b>Challenges for the Banking Sector in Indonesia .....</b>  | <b>49</b> |
| <b>2.</b>       | <b>Rural Financial Services in Indonesia.....</b>  | <b>52</b> |
| <b>3.</b>       | <b>BRI - Bank Rakyat Indonesia .....</b>   | <b>55</b> |
| <b>4.</b>       | <b>Characteristics of People’s Credit Banks (BPRs) .....</b>   | <b>57</b> |
| <b>5.</b>       | <b>The Competitive Environment of BPRs.....</b>  | <b>61</b> |
| <b>6.</b>       | <b>Funds Mobilisation and Co-operation of Microfinance Institutions.....</b>                                     | <b>61</b> |
| <b>7.</b>       | <b>Market Outreach of BPRs .....</b>   | <b>63</b> |
| <b>Part IV</b>  | <b>.....</b>   | <b>65</b> |
|                 | <b>Recommendations and Critical Issues for the Way Forward towards a BPR APEX Institution in Indonesia .....</b> | <b>65</b> |
| <b>1.</b>       | <b>Introductory Remarks .....</b>  | <b>66</b> |
| <b>2.</b>       | <b>Review of Recent Background Work on Concepts for the Establishment of a BPR APEX Institution .....</b>        | <b>67</b> |
| <b>3.</b>       | <b>Recommendations and Critical Issues Identified.....</b>   | <b>68</b> |
| 3.1.            | The Political Issue.....   | 68        |
| 3.2.            | The Legal Issue: .....   | 70        |
| 3.3.            | The Regulatory Issue: .....  | 72        |
| 3.4.            | The Equity Capital and Shareholder Issue: .....  | 73        |
| 3.5.            | The Ownership and Governance Issue:.....   | 74        |
| 3.6.            | The Pooling of Funds and the Linkages Issues .....   | 75        |
| 3.7.            | The Clearing House Issue .....   | 76        |
| 3.8.            | The Market, Competition and related Product Development Issue:.....  | 76        |
| 3.9.            | The Sustainability Issue.....  | 78        |
| <b>Part V</b>   | <b>.....</b>   | <b>80</b> |
| <b>1.</b>       | <b>Summary of Conclusions and Recommendations.....</b>   | <b>81</b> |
| <b>2.</b>       | <b>The Next Steps .....</b>  | <b>81</b> |
| 2.1.            | The Need for a Detailed Feasibility Study and a Business Plan .....  | 82        |

|                |   |           |
|----------------|---|-----------|
| 2.2            | Full Feasibility Study Needed .....   | 83        |
| 2.3            | BPRs as Majority Shareholders over Time .....   | 84        |
| 2.4            | The Supervision Function Needs External Support .....   | 84        |
| 2.5            | Rating Function should not be Undertaken by the APEX Bank itself. ....                            | 84        |
| 2.6            | Training and Consultancy is Key to Improvement of Soundness and<br>Efficiency of BPR-Sector. .... | 84        |
| <b>ANNEX 1</b> | .....   | <b>86</b> |
|                | BPR Market Enquiry (February 2004): .....   | 86        |
| <b>ANNEX 2</b> | .....   | <b>88</b> |
|                | Bibliography .....  | 88        |

## Introduction to the Terms of Reference (ToR)

The ToR of Dec 22, 2004, describe the tasks of the Consultant as follows:

Comparison of the present development in Indonesia with best practices derived from the international discussions and publications as well as lessons learnt in Ghana.

In order to fulfil the task, the Consultant has

- compiled all relevant information of the present set up of the ARB APEX Bank Ltd. in Ghana
- met with the Indonesian research teams to mutually exchange knowledge in Indonesia
- consulted with local stakeholders for better understanding of the Indonesian context and demand
- given indications for further business planning by the Indonesian APEX structure itself
- drafted the concept study with some financial projections in terms of the APEX institution' s business viability and sustainability
- presented the concept study and the financial assessment within a seminar organized by Bank Indonesia

Before the short visit of the Consultant to Indonesia, he accompanied a delegation from Bank Indonesia during a visit to Ghana for the purpose of a comparative study of the rural banking industry in Ghana and Indonesia, including the ARB APEX Bank Ltd. as well as the regulatory and supervisory institutions.

During this study visit and in compiling relevant information for the desk study, special attention was given to the following aspects :

- Short term liquidity management and stand by loans
- Wholesale financing and inter bank call money
- Clearing house mechanism
- Payment system
- Institutional profile of qualifying rural banks and eligible criteria (soundness, demand, etc.)
- Rating system
- Regulatory requirements / preconditions
- Governance and operations

After the mission to Indonesia, the Consultant shall finalise the study including recommendations for the way forward.



## **Part I**

### **The Case of Rural Banking and of the ARB APEX Bank Ltd. in Ghana**



# 1. Background of Rural Banking in Ghana

The rural banking concept started in Ghana in 1976 with support of the Bank of Ghana (BoG), the Central Bank.

Rural banks are privately owned by (usually a large number of) individuals within the community. They are all incorporated under the Ghana Companies' Code as Limited Liability Companies. They are licensed under the Banking Act by BoG.

The number of rural banks rapidly increased from 20 (1980) through 122 (1990) to 133 (1999). In 1999 however Bank of Ghana closed 23 distressed banks bringing the number to 115 in 2002. In 2004 four (4) new rural banks were licensed and started business.

In the 80' and 90', a number of rural banks was closed and others were opened. Up to 1994 BoG gave technical support, like cheque clearing, funds management and training. In 1994 BoG withdrew its technical support and asked rural banks to bank with banks of their choice.

This situation brought in its wake problems as being competitors, the commercial banks frustrated the rural banks in several ways: delays in clearing of cheques, low denomination of currency supplies, mutilated notes and even off-loading of coins.

Altogether the sector was rather weak and had a poor image among the population. Farmers who were forced to wait for many days to cash their so important cocoa cheques, would not return to the rural banks again. Delays in placing funds for investment purposes also led to income losses of the rural banks.

This was the state at which the Association of Rural Banks (formed in 1981) began to explore the possibilities of having their own APEX bank to support the rural banks.

Their proposals were placed before the Ghana Government and the World Bank. The Government of Ghana embraced the idea and with the World Bank, the IFAD and the African Development Bank and the GTZ put together the Rural Financial Services Project (RFSP).

## **2. Weakness of the Rural Banking Industry in Ghana**

Since the late 90' the quality and performance of the banks has improved altogether. However as of 2004, 22 banks are still considered mediocre with varying degrees of manpower, operational and management problems.

The weaknesses of the rural banking industry as a whole and of those mediocre banks in particular can be described as follows:

### **2.1 Internal Control Lapses**

Rural Banks have not yet systematically put in place adequate internal control measures to ensure the validity of banking and accounting transactions. This has led to discrepancies and imbalances in the records of such banks. Lack of proper control has led to a number of improprieties in the sector. A GTZ / ARB APEX survey of 2004 revealed that altogether 76 rural banks (out of 115) confirmed balancing problems. According to BoG inspection reports, most banks face fraudulent losses of one or the other kind.

In 2004 GTZ has finalised the development of an operational manual on internal control and audit for rural banks, which has been sanctioned by the BoG. With GTZ support, the ARB APEX Bank Ltd. has been entrusted to implement it and conduct the necessary follow up training and onsite application support programme. All rural banks are pushed to recruit an internal control officer. Recruitment requires prior approval by the ARB APEX bank Ltd. This is deemed of particular importance as the once a year on-site inspection by the Central Bank is considered woefully inadequate to identify all loopholes at the level of management, accounting and operations. This is also considered one of the major areas of improvement as it is a prerequisite for the ongoing growth in operations and outreach.

### **2.2 Poor Liquidity Management**

Funds mobilised from largely poor rural households have either been misapplied or misallocated. Due to very high treasury bill interest rates, most deposits have not been invested into local MSME activities, but have rather been used to support economic activities in the urban centres where at instances sophisticated borrowers have deprived such banks by not paying back loans, thus plunging rural banks into serious liquidity problems regarding reserve requirements and withdrawal demands. On the other hand, substantial proportions of cash or near

- cash funds are “parked” as liquid funds with commercial banks, without any earnings and beyond the prevailing prudential reserve requirements.

## **2.3 Poor Credit Administration Practices**

A combination of poor lending practices and ineffective monitoring of the loan portfolio have contributed to high loan delinquency rates. As a result of unethical practices, it has become difficult to pursue those loans as the management and personnel lack the courage and competencies to do so.

Together with GTZ, the ARB APEX Bank Ltd. has launched a systematic multi level training concept for credit operations in rural banks. However, many rural banks still lack proper credit administration manuals and policies. Furthermore the ARB APEX Bank Ltd. (with support from GTZ) strongly promotes knowledge and skills in micro lending methodologies and schemes which have proven to generate very high repayment rates. This becomes increasingly important in Ghana due to the drastically fallen interest rates on treasury bills, thus forcing the rural banks to strengthen the credit operations.

## **2.4 Management and Staff**

The mediocre status of about 20 % of the rural banks and the inadequate performance of the remaining rural banks (despite their satisfactory rating) is a direct result of the capability, calibre and experience of management and staff.

The absence of effective staff recruitment and placement policies, as well as poor remuneration have negative repercussions on the operations of many of the rural banks, including mismanagement of resources. Among the many operational and manpower problems are :

- Weak management information systems
- Fraud and dishonesty
- Lack of capabilities in financial planning and budgeting
- Lack of skills in financial decision making
- Weakness in internal control systems
- Unhealthy involvement of board members in operational issues
- Organisational and procedural weaknesses
- Government interventions

Since 2003, the ARB APEX Bank Ltd. has not only set up a data bank on rural bank personnel trained but also on dismissed staff. For certain senior functions

(management, project officers, internal auditors, program coordinators, etc.), the ARB APEX Bank runs collective recruitment campaigns for its member banks at very advantageous costs, thus ensuring appropriate checks, vetting and effectiveness.

In 2004, the ARB APEX Bank Ltd. launched a systematic approach to training and capacity building and for this purpose developed a training architecture based on a modular approach and providing for distinctive career paths within the industry. It is envisaged that in the coming years internships and rotation of staff among the rural banks will see further promotion.

## **2.5 Low Capitalisation**

Most of the rural banks currently in operation have very low capital. According to a recent investigation of BoG and GTZ, only about 15 % of the rural banks comply with the prudential requirement of GHC 500 mio paid - in capital. A large number of rural banks have an equity of between GHC 100 – 200 mio. As a result, many rural banks are unable to meet the minimum capital adequacy requirement of 10 % and have very limited possibilities for their lending operations.

This has also to do with a poor share register management and lack of dividend payments in the past at the level of the individual rural banks. Therefore the ARB APEX Bank Ltd. envisages in 2005 to set up a central share register and management for all (interested) rural banks with the objective to make provision of the following:

- Point of purchase and payment for shares
- Issuance of share certificates
- Issuance of dividend warrants
- Bonus issue of shares
- Rights offer
- Share transfer procedures
- Basic principles in valuing and selling of shares

In addition due to the very good performance of most rural banks since 2002, dividend payment were used to issue additional shares and by doing so gradually increase the share basis. Some rural banks have also developed share based savings products. A nationwide training scheme is under preparation to educate community based shareholders to take appropriate decisions affecting the governance of the rural banks. This particularly refers to the election of a more adequate and qualified board composition.

## **2.6 Lack of Product Innovation**

Most rural banks have been very conservative in their product portfolio and customer services. It appears that individual rural banks lack capacities and competencies to enter into innovative concepts, which include market research, product design, costing and pricing, launching and marketing, as well as ongoing adjustment. With support from GTZ and the RFSP, the ARB APEX Bank Ltd. has launched a campaign for product innovation. Pilot schemes are being supported in order to seek further replication and application throughout the industry. This concerns both savings and lending products, with a major emphasis on micro finance products and practices in order to truly benefit the rural banking system.

Such innovation push cannot be expected to be initiated and implemented effectively and efficiently from within the rural banks themselves. Therefore the ARB APEX Bank Ltd. has identified product development as one of its core functions and has recruited a manager for this purpose.

### **3. Steps towards the Establishment of the ARB APEX Bank Ltd.**

As a result of those structural deficiencies within the rural banking system which was considered the backbone of financial services provision in the rural areas of Ghana, the Association of Rural Banks (bottom –up) and the Bank of Ghana (top down) came to the conclusion that it was worthwhile investigating further into the creation of an APEX Bank for the rural banks in Ghana.

A pre - feasibility study was commissioned in 1996 to explore the legal viability and the banking dimensions of an apex body for the rural banking sector. The study favourably recommended an apex structure similar to the Rabo Bank model of the Netherlands.

In 1998 the Association of Rural Banks and the Bank of Ghana commissioned a consultant to examine the feasibility of establishing the APEX Bank. The conclusion of the feasibility study was that if established the APEX Bank's activities would remove both the operational bottlenecks and institutional constraints on the operations of the rural banks and facilitate their transformation into profitable and effective rural finance intermediaries.

From 1991 to 2001, the World Bank, in association with IFAD, AfDB (African Development Bank) and GTZ conducted several project fact finding and appraisal missions which resulted in a joint project appraisal document (PAD) for the launch of the Rural Financial Services Project (RFSP).

The RFSP seeks to broaden and deepen outreach of financial services to the rural population through the capacity building of the rural banks and other micro finance institutions, the establishment of the APEX Bank to support rural banks to be able to perform more effectively and the strengthening of the oversight of the Central Bank (BoG) and the Ministry of Finance.

In order to prepare for the establishment of the ARB APEX Bank a transition technical steering Committee (TASC) was set up in 1999 by BoG and chaired by the Deputy Governor of the BoG. TASC members included council members of the regional chapters of the Association of Rural Banks. TASC established a technical secretariat in 1999 to take action steps to establish the bank. An executive manager was employed to implement the everyday start up activities.

The ARB APEX Bank Ltd. was incorporated in January 4 2000 (certificate of Incorporation), the banking licence was granted in June 2001, and the Certificate of Commencement of Business was awarded in July 2002. The ARB APEX Bank Ltd. commenced operations on 2<sup>nd</sup> July 2002.

The Board of Directors was appointed at the first AGM in November 2003. At that meeting the TASC was dissolved. After new Banking Act 673 became effective late in 2004, the ARB APEX BANK regulation, a legislative instrument is about to be signed by the Governor of the BoG early 2005 in order to give legal effect to the establishment of the bank.

### **3.1 Mission and Ownership of the ARB APEX Bank Ltd.**

The mission of the Bank is to provide banking and non banking support services to the Rural/Community Banks with the aim of improving their operational efficiency, thereby transforming them into efficient financial institutions, which can effectively address the banking needs of the communities in which they operate.

The APEX Bank is wholly owned by the rural banks (present and future). It was recognised that the rural banks could not meet the initial equity requirement and therefore the Government of Ghana made a grant provision in the frame of the RFSP for the procurement of capital goods e.g. vehicles, computers, establishment and refurbishment of premises etc.) for the Bank.

### **3.2 Functions of the ARB APEX Bank Ltd.**

The functions of the ARB APEX Bank Ltd. are summarized as follows:

- Cheque clearing and guarantee support for cheques of rural banks
- Computerisation of rural banks (industry wide WAN ICT solution (hard and software procurement, installation, maintenance and servicing, incl. training)
- Cash movement (in and out) for rural banks
- Full integration of rural banks into the national payment system, including gateway for international remittances
- Training of directors, management and staff of rural banks (development of a nationwide rural banking training architecture incl. set up of a certification scheme, establishment of an ARB APEX Training school)
- Treasury operations (liquidity management, overnight facilities, money market operations)
- Product development (Agro lending, Credit with Education, susu savings mobilisation, etc.)
- Inspection of the rural banks (on site and off site, transferred from BoG)
- Enforcement and implementing of internal control and audit of the rural banks

- Provision of (whole selling) credit delivery and management services (arranging refinancing facilities, pooling funds, discounted procurement of goods and services, etc.)
- Provision of financial and technical support for the weaker rural banks
- Industry marketing and confidence building for all rural banks
- Arranging (syndicated) loan consortia for financing larger projects

### **3.3 Start up Finance and Scope of Operations of the ARB APEX Bank Ltd.**

The start up was financed with support from BOG (GHC 500 million) and IFAD (USD \$10,000). The grants were used to finance the feasibility study and the business plan and other consultancy services for the HR and ICT departments, as well as legal issues.

Start up funds were also needed and made available for the TASC secretariat and the TASC operations, and the renting of the premises, incl. furniture and office equipment of the head office. Initial recruitment and training of 39 staff was also pre - financed. Government has given the required land for building a new head office worth about GHC 20 bn, out of which the ARB APEX Bank Ltd. will contribute GHC 7,8 bn from own (earned) funds. The building shall be completed in 2005.

Until December 2004, 82 RCBs (out of 117) had paid in their respective share subscriptions of GHC 20 mio each for the establishment of the ARB APEX Bank Ltd., in total GHC 1,64 bn, the balance of 35 RCBs had partly been subscribed – altogether GHC 169 mio. The balance due is being pre - financed by BoG according to an agreed subscription schedule.

Until end 2004 the ARB APEX Bank Ltd has opened six (6) out of eight (8) branches with the main objective of cheque clearing, specie movement (cash supply and collection) and, as from 2005, the inspection of the rural banks. They also function as regional training support units.

All expenditures relating to the establishment, the setting up of a new head office, the purchase and refurbishment of eight (8) zonal offices, the provision of vehicles (about 17, including bullion vans, etc) as well as the cost of the ITC solution and capacity building (training) were made by the Rural Financial Services Project (RFSP), with increasing contributions of the ARB APEX Bank Ltd and the rural banks respectively.

After about 2,5 years of operations, the ARB APEX Bank has now about 110 staff, which are to double by end 2005, in particular after all eight (8) zonal



offices are fully operational and the inspection function will be transferred from BoG to the ARB APEX Bank. The latter would require an additional staff of about 50 alone.

## **4. Functions of the ARB Apex Bank Ltd**

### **4.1 The ARB APEX Bank Ltd. as Mini Central Banker for Rural Banks**

The transfer of the inspection function from BoG to the ARB APEX Bank Ltd. is so crucial for the improvement of the whole system and the full deployment of the M & E function of the ARB APEX Bank Ltd. The early warning system envisaged to be implemented shall be much better placed at the ARB APEX Bank Ltd. than at the BoG. The transfer of the inspection has been waiting for the new Banking Law and until signing of the ARB APEX Bank Ltd regulation, full implementation will be during 2005.

Thus the APEX Bank has an insight into their share holder performance and the impact of products and services (IT, training etc.) on their shareholding rural bank members. The APEX is much closer to the day-to-day business of rural banks than in the case of the BoG.

The RFSP Project as well as BoG are to fund the operational cost of the inspection function for the first five (5) years (salaries, overnight allowances, training, vehicle purchase and maintenance, etc.)

### **4.2 The ARB APEX Bank Ltd. as Promoter and Service Provider**

Product development, innovation, training, IT, all such essential business support components are being channelled through the "central service provider", which is the ARB APEX Bank Ltd. This makes it highly cost efficient and attractive for the individual rural bank to be within the network. Here in Ghana we do not fear any rural bank to become over influential on the ARB APEX Bank Ltd.

The cohesion building role of the ARB APEX Bank Ltd. across the industry can be clearly detected from the installation of an annual meeting of rural bank

managers since 2002 with the objective to create a platform of information, motivation and exchange of views and experiences.

The main functions of the ARB APEX Bank and some important pillars of its promotional role for change within the industry are exemplified in the working group agenda of the 2<sup>nd</sup> annual rural banks managers meeting held in 2003:

- Improving the image of RCBs
- Training organisation and programmes for all categories of RCB staff
- Development of innovative banking products for the RCBs
- Computerisation of the RCBs
- Syndication by RCBs for worthwhile and economically viable projects
- Establishment of a training school / college for ARB APEX Bank Ltd. and the RCBs

## **4.3 Short Term Liquidity Management and Stand By - loans**

### **4.3.1 Brokerage Services for the Purchase of Bills / Bonds**

BoG has accepted the ARB APEX Bank Ltd. as a primary dealer in Government securities and its own (BoG) securities. Rural Banks submit their applications and those of their customers to the ARB APEX Bank Ltd. through the regional clearing centres close of business every Monday. In case of purchase, the respective clearing account of the rural banks is debited. The rural bank earns 25 % of the brokerage fees on their customer applications. Rural banks are requested to submit their certificates for renewal stamp when any roll-over is effected. Currently the total average monthly treasury bills purchase stands at about GHC 30 bn, earning substantial commissions for the ARB APEX Bank and the participating rural banks.

### **4.3.2 Clearing Account Credit Balances**

As an incentive to rural banks, the ARB APEX Banks presently pays interest on the clearing account credit balance. This was implemented in January 2003 to attract idle funds with other commercial banks to the ARB APEX Bank Ltd. The interest is graded according to the volume of the credit balance.

### **4.3.3 APEX Short Term Certificate of Deposit (ACOD)**

This product was introduced in February 2003 and offers maturities of 7 days, 15 days, 30 days and 60 days. There is the flexibility of premature redemption if a bank requires liquidity to meet cash shortfalls. Interest rates on the product are announced weekly through the regional clearing centres. Minimum deposit is GHC 500,000. Since inception, virtually all rural banks are patronising the product. During the period of the first six (6) months after launching of the product, the respective investments amounted to about GHC 95 bn and earned an interest of about GHC 500 mio.

### **4.3.4 Rediscounting of Treasury Bills**

This service is intended to assist rural banks to have access to their T-Bill investments before maturity. Such investment must have reached 2/3 of their term. Rediscount rates are given at the time of the transaction. The ARB APEX Bank Ltd. provides substantial added value compared to other commercial banks

which very often provide insufficient information on the discounts and the reconciliation.

#### **4.3.5 Overdraft Account**

On the basis of the clearing accounts of the rural banks with the ARB APEX bank Ltd., the rural banks are being offered an overdraft. The interest is only .10 points above BoG base rate.

#### **4.3.6 Overnight Money Market Operations**

The ARB APEX Bank Ltd. does participate in the overnight money market and earns interest on behalf of the rural banks, primarily on the basis of their 5 % clearing reserve and other additional liquid funds transferred by individual rural banks to the ARB APEX Bank Ltd. for its respective management.

Altogether the biggest earnings of the ARB APEX Bank Ltd. are of course with treasury operations (liquidity management).

## **4.4 Wholesale Financing**

### **4.4.1 Wholesale Financing / Linkages with Commercial Banks and other Non Bank Financial Institutions (NBFIs)**

The ARB APEX Bank Ltd. in Ghana has not resumed this function yet due to an obvious lack of business opportunities. In fact virtually all rural banks face a heavy over - liquidity while the same applies to commercial banks. Until recently both institutional groups have almost exclusively invested excess funds in government papers. However the ARB APEX Bank Ltd. has already attracted third party funds and acts as their fund manager.

### **4.4.2 Loan Syndication / Pooling of Funds**

In order to allow rural banks to enter into financing of larger SME projects, the ARB APEX Bank Ltd. is currently preparing an educational campaign on loan syndication. This is the first and an innovative step for rural banks to operate in partnership and beyond its local boundaries. It raises awareness of risks and promotes a more sophisticated costing approach. The concept development and training is on the agenda for 2005.

## **4.5 The ARB APEX Bank Ltd - Gateway for Government and Development Partner Programmes**

As many other developing countries Ghana is severely challenged by the number of programmes of Government and international development partners with the objective of poverty alleviation, rural development and support of specific groups in need of support. Various Government ministries and agencies, both on the national and the district level, implement a variety of so called micro finance schemes with as many approaches to conceptual design and delivery mode as there are programmes.

In the past many of these programmes have been channelled through the rural banks with a highly detrimental and devastating effect on the banks themselves and very poor target group orientation, impact and efficiency.

Most of these programmes have been interest rate subsidised, with no fee or commission payment for the rural banks for disbursement, monitoring and collection.

The ARB APEX Bank has successfully convinced Government to stop disbursement / distribution of (politically minded, interest rate subsidised) funds on the basis of district list without taking into consideration the mandatory requirement should exclusively target at economically active poor who have inculcated a certain savings habit and are prepared to repay the (revolving) funds.

Since the existence of the ARB APEX Bank Ltd., the political pressure on the individual rural banks exercised by regional or district administrations is being reduced while the visibility of such partnerships of the APEX Bank (and the RCBs behind) with Government programmes gains a much higher visibility on the national scale than if such programmes were individually negotiated and then implemented.

While Government is about to finalise the adoption of a national strategic framework for micro finance due early 2005, number of Government and development partners have detected the ARB APEX Bank Ltd. as a very appropriate gateway and fund manager for those programmes. This puts the ARB APEX Bank Ltd. into a very interesting position to negotiate more adequate terms and conditions for those micro finance programmes from a conceptual point of view and also as a one stop negotiation and monitoring partner acting on behalf of all participating rural banks.

The existence of the ARB APEX Bank Ltd. is being perceived by Government as well as development partners as an ideal gateway for micro finance oriented development programmes with the final delivery by rural banks. The ARB APEX Bank Ltd. assures

- very efficient one face to the customer / donor negotiations
- simple disbursement and whole selling functions to all rural banks
- effective training and implementation support at the rural bank level
- quality monitoring and reporting according to donor requirements
- 100 % repayment rates if required
- implementation support through membership in programme steering committees
- representation of rural bank interests
- acquisition of further programmes

In the framework of the linkage model drafted under the GTZ project, the ARB APEX Bank Ltd. may play a role as a gateway for channelling commercial or int'l funds into micro finance products on standard terms for all RCBs.

Equally the ARB APEX Bank Ltd. shall enter into strategic alliances with other APEXES such as the Credit Union Association (CUA) and the Ghana Cooperative

Susu Collectors Association (GCSCA) in order to promote that their (non regulated or non bank) members do business with the rural banks and by doing so upgrade their level of formality in financial services delivery and integration into the financial sector.

Since inception of the ARB APEX Bank Ltd in Ghana, the following programmes have been taken into the ARB APEX Bank portfolio (excerpt) :

#### **4.5.1 Micro Insurance Pilot Scheme**

In collaboration with a private sector insurance company and support from DFID, the project aims at increasing the availability and the purchase of appropriate micro insurance products by low income households in urban and rural areas of Ghana. With support from ARB APEX Bank Ltd., about 10 rural banks have been selected to participate in the programme. ARB APEX Bank Ltd. has assisted this process, coordinates training and monitoring and serves on the advisory committee of the scheme.

#### **4.5.2 Women Development Fund / Japanese Grant**

This project is undertaken by the Ministry of Women and Children Affairs, funded under a Japanese grant of GHC 235 bn, and aims at extending micro credit to women with the objective of poverty alleviation. Funds are channelled through the ARB APEX Bank Ltd. to participating rural banks. The ARB APEX Bank ensures adequate and equal disbursement and repayment modalities for the customers of all participating rural banks, ensures that all rural banks provide a 50 % matching loan fund, and ensures expected repayments under this revolving fund mechanism.

#### **4.5.3 Village Infrastructure Programme (VIP)**

The programme aims at poverty alleviation in the rural areas of Ghana. It makes provision of micro credits to finance acquisition of agro - processing facilities, rural transport and small irrigation equipment. Funds disbursement and collection is carried out through the ARB APEX Bank Ltd. In case of default, the ARB APEX Bank Ltd. will debit the respective rural bank account. More than 50 % of all rural banks participate in this big programme.

#### **4.5.4 Social Investment Fund (SIF)**

The project is a poverty alleviation intervention of the Government with funding from the AfrDevBank and the OPEC Fund. It is primarily a revolving micro credit programme. The project operates in almost all rural districts of the country with the ARB APEX Bank Ltd. as the (paid) fund manager (fund volume of phase 1: USD 1 mio, phase 2: additional USD 2 mio) and the rural banks as the implementing financial institutions. The ARB APEX Bank Ltd. management fee amounts to 5 % of the interest earned by the SIF (spread between cost of funds and interest charged to the rural banks.)

As in similar cases, the ARB APEX Bank Ltd. signed a participatory agreement with the SIF, while subsidiary agreements have been signed between the ARB APEX Bank Ltd. and the participating rural banks. The refinancing maximum per each rural bank amounts to GHC 500 mio. Each bank must provide information on specific (new) products or projects which they intend to finance under the scheme.

#### **4.5.5 Credit with Education (CwE)**

The ARB APEX Bank Ltd has entered into a strategic partnership agreement with GTZ and Freedom from Hunger Ghana (FFHG) in order to develop and implement the Credit with Education micro finance methodology to a brand product of rural banking in Ghana. After a long testing phase on individual bank basis with support from selected development partners, GTZ and ARB APEX Bank Ltd. have taken the bold decision to simultaneously roll the product out in up to 40 more rural banks.

Together with its partners, the role of the ARB APEX Bank Ltd. Consists in the coordination of respective activities on the rural bank level of adequate planning and budgeting, recruitment and training of staff, customer awareness campaigns, as well as monitoring & evaluation. The existence of the ARB APEX Bank Ltd. makes this coordinated approach possible which comes at about 1/10 of costs compared to previous individual solutions. The outreach and impact on the final beneficiaries after 3 years is estimated at about 80,000 new rural savings and loans customers of the rural banks.

#### **4.5.6 Food Security Budget Support (FSBS)**

The Canadian Government has provided funds worth CND \$ 80 mio to the Government of Ghana, i.e. the Ministry of Food and Agriculture, for implementing a long term food security policy scheme. Among others, the loan fund is



accessible by individuals, groups, NGOs and private companies with projects that contribute to agricultural development, notably processing, packaging, and marketing, as well as to land conservation development (construction of dams, establishment of agro chemical shops, storage equipment, etc.) The fund provides substantial grant components according to the nature and size of the projects.

The ARB APEX Bank Ltd. has signed a MoU with the Ministry to act as the fund manager. Fund disbursement, monitoring and collection are carried out by the rural banks through applications addressed to and supported by the respective MoFA district offices. This huge programme has a multi annual dimension. It appears that the ARB APEX Bank Ltd. has agreed not to charge a fund management fee because FSBS is a government programme.

## 4.6 Payment System and Clearing House Mechanism

### 4.6.1 Cheque Clearing

As said before, in the 90' the rural banks in Ghana were not integrated into the financial system and notably not into the national payment system. BoG even withdrew the cheque clearing function for the rural banks. Thus the rural banks were forced to accept inadequately delaying clearing processes of selected commercial banks. Cheques of rural banks were not commonly accepted payment instruments. Payment transfers often took several weeks within the rural banking system as well as with other financial institutions.

Since the establishment of the ARB APEX Bank Ltd and the launching of its cheque clearing function, rural bank cheques have gained wide recognition within the rural banking industry and beyond. Each rural bank has a clearing account with the ARB APEX Bank Ltd., and the ARB APEX Bank is of course member of the association of clearing houses.

Since the introduction of the ARB APEX Bank clearing function, the clearing cycle has been reduced from over 21 days to average  $t + 3$  days, the maximum is 8 days in remote areas. i.e. rural bank cheques are widely accepted and used payment instruments, with a very cost effective and correct clearing and settlement. Some rural banks still use correspondent banks to clear cheques, however the opening of the remaining regional centres will address this issue.

Within the first 13 months after opening of the ARB APEX Bank Ltd and the inception of cheque clearing operations, the operational figures were as follows :

About 66,000 cheques received (debit about GHC 365 bn)  
About 100,000 cheques cleared (credit about GHC 750 bn)

Net result amounted to about GHC 370 bn.

The figures have dramatically increased since, as is indicated in the following :

Dec 2002 –Dec 2004:        423,000 cleared cheques  
                                      236,107 cheques received  
                                      187,109 cheques sent

The net result amounted to about GHC 6279 trillion.

All rural banks participate in this operation and clear almost all cheques with the ARB APEX Bank Ltd. now instead with other commercial banks. This has

tremendously contributed to the rapid recognition of the ARB APEX Bank Ltd. by the whole banking community. The introduction of the so - called MICR cheques with all the modern security features among the rural banks has greatly raised the image and confidence of rural bank customers.

#### 4.6.2 APEX Link

Since the concept formulation of the ARB APEX Bank Ltd., it was evident that the rural banks had to play a crucial role in the national payment system. Until then very many overland travels were carried out with the main purpose of carrying cash funds from A to B. Payments through the rural banks often took more than 25 days. Therefore the first main product innovation promoted by the ARB APEX Bank Ltd. was the introduction of the APEX Link product, a domestic payment transfer system, based upon the clearing function of the ARB APEX Bank Ltd.

As a matter of fact, among the main sources of revenues of the ARB APEX Bank Ltd. are commissions and fees on the APEX link domestic money transfers, on int'l remittances, on cheque clearing, on treasury functions, and on overnight facilities. Some services alike training come with a price tag as well, however this function is not self sufficient yet because it is still (RFSP) donor driven / funded.

To give an example of transaction related sources of income : On the ground floor of the BoG Annex Building, the ARB APEX Bank Ltd. operates an APEX Link office. The end of June 2004 (monthly) report (including Jan – June 2004) provides the following figures:

|            | No. transactions | Outward Value | Commission 50 % |
|------------|------------------|---------------|-----------------|
| Current    | 220              | 1.273.645.000 | 4.229.750       |
| Previous   | 923              | 3.388.625.000 | 11.184.146      |
| Cumulative | 1143             | 4.662.270.000 | 15.413.898      |

|            | No. transactions | Inward Value  | Commission 30 % |
|------------|------------------|---------------|-----------------|
| Current    | 127              | 1.287.832.348 | 1.203.594       |
| Previous   | 494              | 2.159.966.498 | 6.006.025       |
| Cumulative | 621              | 3.447.798.846 | 7.209.619       |

The Commission on domestic fund transfers is shared between the sending and the receiving bank(s) according to an agreed formula.

Figures for June – December 2004 are as follows :

Altogether 35,031 transactions have been registered with a turnover of GHC 138,3 bn. The total commission earned amounted to GHC 125 mio during the reporting period only.

The APEX Link product has been in operation since July 2003. The figures above represent only a sketch of the performance of one of many hundred offices (POS') throughout the rural banking industry as well as only an excerpt of the overall performance of this product in order to illustrate the strong and growing earning position of the ARB APEX Bank and their related rural bank members with "APEX Link" alone.

#### **4.6.3 APEX Link International (Int'l Money Transfer / Remittances)**

Ghana is of the top ten countries in the world in terms of gains from overseas remittances as a large community of Ghanaians live and work overseas. The volume of about USD 3 bn exceeds the income from cocoa sales, which is the No. 1 export product of the country. A BoG report of 2003 confirmed that virtually all banks had ventured into new int'l money transfer products during that period.

Three months after inception, the ARB APEX Bank launched a pilot collaboration with other commercial banks in order to disburse international funds transfers directly to the rural beneficiary at the rural bank level, without any delay. In the meantime several other commercial banks have approached the ARB APEX Bank Ltd. in order to enter into collaboration for the benefit of their rural customers.

The international remittances product is in operation since April 2004 only. In 2005 the ARB APEX Bank Ltd. will deploy the international money transfer to all rural banks, which is a unique and highly interesting commission earning business for the rural bank. Although rural banks are not allowed to do int'l operations, the 2<sup>nd</sup> tier ARB APEX Bank Ltd. allows them to tap into this high net profit business, which greatly contributes to their image and attractiveness.

The use of other commercial banks of the ARB APEX Bank Ltd. as a gateway to channel funds through to rural banks and their final rural customers is remarkable.

In terms of conditions of this business, the commission on int'l transfers for the ARB APEX Bank Ltd. is 20 % of 0.75 % of turnover, the remaining 80 % being

credited to the respective account of the RCB, which does the final disbursement to the customer.

Between June - December 2004, an average GHC 19.5 bn have been transferred / remitted every month, while the growth trend is impressive. An ARB APEX Bank Ltd. business projection presented in August 2004 of GHC 100 bn as a target for 2005 has already been out dated and doubled by real figures as of the end of the year 2004.

#### **4.6.4 Specie (Cash) Supply of Rural Banks**

The delivery of specie to the doorsteps of rural banks is seen as one of the core functions of the ARB APEX Bank Ltd. It was inadequately and unsatisfactorily assured by nearby commercial banks before. In collaboration with the regional offices of the BoG, specie movement is carried out by the bullion vans located at the eight (8) regional branches of the ARB APEX Bank Ltd. The specie movement system was enhanced by decentralising the cheque encashment to the regional APEX clearing centres. Since inception most rural banks have patronised this service while maintaining specie supply from nearby commercial banks as a stand - by solution. The acquisition of smaller bullion vans subsequent to the opening of the remaining regional centres will then service virtually all rural banks for this service which is also expected to positively contribute to its cost effectiveness

Cash supplies during the first 12 months (start was three (3) months after opening of the ARB APEX Bank Ltd.) amounted to about GHC 960 bn.

The service operates on a 24 h advance notice base. Rural banks bear 50 % of the cost of services debited to their clearing account. Avg. current charge per delivery amounts to GHC 100,000.

As of end of 2004, the ARB APEX Bank Ltd. operates ten (10) bullion vans and escort vehicles. The bank has also recruited specie officers and chief cashiers for deployment at the regional centres.

#### **4.6.5 Salary and Pension Payments to Civil Servants**

Since the inception of the ARB APEX Bank Ltd., all payments of salaries and pensions of civil servants are channelled through the ARB APEX Bank Ltd., which in turn credits the respective accounts of the rural banks on same day basis. Thus the rural banks are able to promptly make payment to their customers.

During the first 12 months of operations (July 2003 – June 2004) the amount transferred amounted to GHC 650 bn.

It is assumed that the proportional business increase exceeds the nominal increase of individual pension and salary payments by 10 % per quarter due to additional / new customer payment transactions within three years from inception.

This has greatly erased the frustrations the rural banks went through when the salaries were routed through other commercial banks. Rural banks now have a competitive edge over the commercial banks because in many cases their salary and pension payments are made faster than those of commercial banks, which has even attracted more customers to the rural banks, also for the often more convenient location of the rural bank.

## **5. Institutional Profile of Qualifying Rural Banks and Eligible Criteria (Soundness, Demand, etc.)**

In order to improve the standing and the performance of the rural banking industry as well as to achieve economies of scale in the service delivery, it has been the interest and intention from day one of the establishment of the ARB APEX Bank Ltd. in Ghana that all rural banks are shareholders of the ARB APEX Bank Ltd. and participate in and benefit from the operations. It appears as a principle of network economy that the cost benefit ratios increase with the number of active participants in a given network.

All rural banks in Ghana are unit banks with their individual ownership and governance structures. Therefore since its inception, the ARB APEX Bank Ltd. ran a heavy awareness and marketing campaign among all rural banks in order to explain and promote the benefits of products and services of the ARB APEX Bank Ltd.

Those benefits were equally important for all rural banks, the strong and the weak ones, as in the past virtually all RCBs had experienced set backs in cooperating with commercial banks as well as the Central Bank as their facilitators. Therefore despite about 25 % of the rural banks having been in a mediocre state of soundness, the adherence to the APEX model was promoted as a must for rural banks in order to stay in business and improve and expand it.

## **6. The Rating Issue**

A few years ago the Association of Rural Banks (Ghana) had initiated a rating system for benchmarking purposes among the rural banking industry. Its parenthood was associated to the Micro Banking Bulletin. However the activity under this scope became dormant a like the overall activities of the ARB.

Today the BoG provides a (non published) classification of rural banks with a major, almost exclusive focus on CAR. A valuation a like the one of BI according to CAMEL is not in place. The BoG classification is used to define the 3 categories of satisfactory, mediocre and unsatisfactory, which directly reflect in the secondary reserve requirements of the rural banks concerned.

As described above one of the core deliverables under the RFSP is the establishment of a wide area (VPN) network of all RCBs including a standard banking software (TEMENOS – emerge (UK/RSA) for all RCBs which would then allow standard (online) MIS, reporting, electronic clearing, etc., as the basis for transparency and future rating.

Along the progress of the full implementation of the systems expected for 2006, the ARB APEX Bank shall also fully contribute to the performance monitoring and benchmarking set up under the MIX (CGAP) mechanism by the Ghana Micro Finance Institutions Network (GHAMFIN) as an umbrella body for all micro finance APEXes and their respective member institutions.



## **7. Regulatory Requirements and Preconditions**

The Banking Law (2004) as well as the Bank of Ghana Law (2002) require that all rural banks are licensed by the Central Bank. The capital equity requirements are comparable to the situation in Indonesia. A new rural bank requires GHC 500 mio for starting business. For rural banks operating agencies in an urban environment, BoG may require a capital base substantially above this level. Rural banks may operate savings and lending operations. However they are restricted from forex and int'l operations. They are also not in securities operations.

The ARB APEX Bank Ltd. has been awarded a full banking license. The Bank of Ghana Law provides for transfer of certain central banking functions to the ARB APEX Bank Ltd, notably the inspection of rural banks.

## **8. Governance and Operations Issues**

The ARB APEX Bank was created as a fully licensed (commercial) bank which is now also member of the Ghana Association of Banks (GAB) and of course of the Association of Clearing Houses. A like other APEXes in Ghana, the ARB APEX Bank Ltd is member of the Council of the Ghana Micro Finance Institutions Network (GHAMFIN).

It has the potential to become one of the largest banks in the country (a like Rabo Bank in the NL, Credit Agricole in France, and the DZ Bank in Germany).

The bulk equity came as a grant under the RFSP (mainly capital goods, worth about USD 5 mio, plus TA worth about another USD 5 mio); however every rural bank has been obliged to purchase shares worth GHC 20 mio each (about USD 2000). Thus the ARB APEX Bank Ltd. is exclusively owned by the rural banks themselves.

The provisional board, which was called TASC (Technical Advisory Steering Committee), was chaired by the Deputy Governor of the Central Bank. Since the ARB APEX Bank was formally founded and became operational, a proper board is in place where BoG does not hold the chair any more. However two (2) senior officials of the Ministry of Finance and Economic Planning (MoFEP) as well as of BoG respectively are members of the Board. The Annual Reports of 2001 / 02 and then of 2003 were approved by the Annual General Meeting (AGM) of the ARB APEX Bank Ltd.

As for the legal framework, there have been quite some changes recently. There is a new Banking Law of 2004, which regulates the whole financial industry

including the rural banks. There is also the Bank of Ghana Law (2002), which permits that certain functions, including the inspection of the rural banks, may be outsourced.

Since the new Banking Law has very recently become effective, it is expected that a legal instrument, the ARB APEX Bank Ltd. regulation, shall soon be signed by the Governor of BoG, as it has been developed by the central bank and already had the no objection of the board of the ARB APEX Bank Ltd. In particular it provides for the transfer of the inspection function to the ARB APEX Bank Ltd. and considers the ARB APEX Bank Ltd. as the mini central bank of all rural banks.

Government influence on the ARB APEX Bank Ltd. is fairly low if not inexistent. This is part of the move towards private sector promotion and the divestiture of Government from some of their core stakes in the utility business (water, electricity, telcom) and the banking industry. Secondly it is a reflection of professional (commercial and micro finance) management attitude of the ARB APEX Bank Ltd.

In terms of Government support of the rural banking industry, the RFSP project is a WB / IFAD / AfrDevBank long - term soft loan. Training is being decreasingly subsidised. For any procurement (IT etc.) under the project, sub loans are being signed between each beneficiary rural bank and the BoG acting on behalf of Government. The RFSP also decreasingly subsidises ARB APEX bank staff salaries during years 1 – 4. Some mistakes have been made in not being strict enough as to the target orientation and focus of (decreasing) subsidies and may compromise the smooth transition into full self sufficiency.

According to the Banking Law and a respective BoG circular regulation, rural banks in Ghana have to hold the following:

- Primary Reserve (mandatory 8 % held in cash or in a current account with another (commercial) bank)
- Secondary Reserve (20 %, 25 %, 30 % , according to portfolio quality, held in T-Bills or other cash or near - cash positions)
- Clearing Reserve (mandatory 5 % deposited with respective clearing account at the ARB APEX Bank)

Most RCBs hold more cash or liquidity at the ARB APEX Bank Ltd. and, to a lesser extent, with other commercial banks in order to allow intra – rural bank liquidity management, money market and other treasury operations by the ARB APEX Bank Ltd. on behalf of the respective rural banks and / or its customers.

The minimum paid – in capital of rural banks in Ghana amounts to GHC 500 mio for new banks, however existing banks enjoy a certain tolerance of BoG, which tries to balance the roles of promoter and regulator. Thus more than 85 % of rural banks are still under capitalised and therefore very much constraint in their active business. Those rural banks with the intention to open branches (agencies) in urban environment would have to increase to up to 2GHC 2 bn.

Rural banks in Ghana may hold equity investment in other corporations up to a maximum of 20 % of their own paid-in capital (thus the APEX share holding size of GHC 20 mio per rural bank).

## **9. Introduction and Operation of ICT Based Rural Banking**

Another main function of the ARB APEX Bank Ltd. is to set up an integrated wide area network of information and communication technology for itself and all rural banks. The broader objective is that the computerisation can support fundamental change in the vision, structure and public perception of rural banks.

The direct objective of the ARB APEX Bank Ltd. IT department is to define, design, develop, implement and support an appropriate ICT solution in order to obtain timely delivery of information for decision making.

Apart from full computerisation and data migration at head office, the bank has set up a remote access link from the clearing centres to the head office. This link would facilitate clearing transaction data to the head office on same day basis fro updates. It is important that data (account balances) relayed to RCBS is current to facilitate effective planning. The ARB APEX Bank has also set up an electronic mailing system and intranet and has a registered domain @arbapexbank.com. This allows overnight circulars to all rural banks. The ARB APEX Bank Ltd. has also established a direct connectivity to SWIFTnet.

The ARB APEX Bank Ltd. is currently in the process to computerise 40 rural banks. This is the first stage of an industry wide migration towards information technology based on one and the same banking software (TEMEMOS Globus / eMerge, Oracle/BSsystems database). The process is about to be completed in 2007.

This very eminent step into a new era of rural banking in Ghana has required number of preconditions, such as:

- Acceptable to all various interest groups
- Cost effective and affordable to run

- Easy to implement and operate
- Logistics secured for delivering the solution
- Plans for implementation of over 500 installation sites realistic
- Rural bank management aware of organisational and budget implications
- IT training resources available and rural bank staff released

As part of this process, the ARB APEX Bank Ltd. has sensitised all rural banks on

- Changes in the business operational procedures
- Changes in the duties and functions of staff
- Items to be delivered to the banks under the project
- Responsibilities of the banks
- Programme for the computerisation project
- Site preparation
- Additional resources required outside the project

As the ARB APEX Bank Ltd. has set up a core IT implementation and support team, dependence on external providers can be minimised and thus be very cost effective for rural banks. The same applies to training. The ARB APEX Bank Ltd. is about to recruit a team of full time IT trainers who cater for all ongoing software application training.

The central procurement of IT solutions by the ARB APEX Bank Ltd. has multiple benefits:

- industry wide standard configuration (make and model)
- one and the same compatible software
- Better negotiated prices
- Single vendor
- Ease of maintenance, support and training
- Easy cross industry migration of staff

The ARB APEX Bank Ltd. could also bring in its knowledge in standard procurement procedures to order hardware and software for rural banks which themselves would have faced serious problems in this regard. By doing so, quality standards and best warranty support arrangements could be achieved. In the meantime many rural banks have expressed readiness to procure additional services and goods in the future through the advantageous bidding method of the ARB APEX Bank Ltd. so that they can benefit from the above.

As anywhere else, but particularly relevant for the further development and integration of the rural banking industry is the establishment of this wide area network (WAN), as it allows for

- Resource sharing
- Information sharing
- Liquidity and fund management
- Reliability
- Up to the minute information
- Distributed processing

In this particular case of the rural banks in Ghana, the business goals were described as follows:

- Improve corporate communications
- Shorten transaction cycle and increase the bank's productivity
- Build partnerships with other banks
- Reduce telecom cost, especially for long distance calls
- Expand data available to management and field officers for better decisions
- Offer better customer support
- Offer new customer services

The computerisation would enable the individual rural bank to

- Extend working hours for customer services
- Better market existing products and services
- Launch new products and services
- Devote mre time for business planning and development
- Put in more efforts on recovery of loans

Altogether the ARB APEX WAN will generate the following benefits for the sector:

- Improve efficiency and streamline working with rural banks
- Automate day to day banking activities
- Speed up business transactions
- Enhance management's decision making capability
- Higher productivity

In the future a lot more central services are provided or purchased by the ARB APEX Bank Ltd. for and on be behalf of the rural banks on the basis of discounted procurement rates which are then shared and directly debited to the respective RCB account held at the APEX Bank. Ltd.)

## 10. Industry Development since the Establishment of the ARB APEX Bank Ltd.

### FINANCIAL PERFORMANCE OF RCBS

|                                     | 2000   | 2001   | 2002   | 2003     | June,2004 |
|-------------------------------------|--------|--------|--------|----------|-----------|
| Total Assets                        | 316.62 | 518.19 | 863.79 | 1,275.37 | 1,517.63  |
| Total Deposits                      | 236.49 | 381.27 | 667.04 | 949.19   | 1,146.11  |
| Total Loans                         | 98.01  | 144.88 | 225.59 | 348.43   | 458.54    |
| Investment in Government Securities | 144.1  | 247.31 | 383.22 | 524.66   | 640.65    |
| Net worth                           | 45.19  | 73.33  | 107.71 | 120.36   | 138.98    |
| Stated Capital                      | 6.84   | 9.58   | 14.06  | 22.26    | 25.95     |

### PERCENTAGE INCREASE/IMPROVEMENT BETWEEN 2000 & 2004 (JUNE)

|                                |         |
|--------------------------------|---------|
| Total Assets                   | 479.12% |
| Total Deposits                 | 484.59% |
| Total Loans                    | 355.5%  |
| Investment in Gov't Securities | 444.86% |
| Net Worth                      | 307.55% |
| Stated Capital                 | 379.3%  |

### OUTREACH

| Narration         | 2001      | 2002      | 2003      | 2004      |
|-------------------|-----------|-----------|-----------|-----------|
| No. of Depositors | 1,129,316 | 1,187,366 | 1,456,987 | 1,715,741 |
| No. of Borrowers  | 139,325   | 148,271   | 194,804   | 212,872   |

### CAPITAL ADEQUACY

| Narration                   | 2002       | March, 2003 | June, 2003 | End of June, 2004 |            |
|-----------------------------|------------|-------------|------------|-------------------|------------|
| Satisfactory CAR 6% & above | 90         | 90          | 94         | Satisfactory      | 97         |
| Mediocre                    | 25         | 25          | 21         | Mediocre          | 4          |
| Newly Licensed              |            |             |            | Unsatisfactory    | 14         |
| <b>Total</b>                | <b>115</b> | <b>115</b>  | <b>115</b> |                   | <b>115</b> |



## **Part II**

### **International Best Practice of APEX Institutions for the Micro Finance Industry**



# 1. International Best Practice

In addition to the case of the establishment of the ARB APEX Bank Ltd. in Ghana, the Consultant has reviewed international best practice and the experiences of national micro finance apexes as wholesale mechanisms with a diversity of functions, including the channelling of funds, the provision of technical support to micro finance institutions, the integration into the national payment system as well as the raising of donor funds and guarantees to downscaling refinancing linkages with the commercial banking sector.

Global experiences can be summarised as follows:

- APEXes probably expand the supply of resources available for unlicensed micro finance institutions, at least in the short term.
- However micro finance development in most countries is held back by a shortage of strong micro finance institutions at the retail level than by a shortage of wholesale funding
- Planning documents for APEXes typically over estimate the number of retail MFIs that will be strong enough to channel APEX funds effectively.
- APEXes that fund licensed institutions such as banks have seldom been successful in encouraging these institutions to continue micro lending when the APEX money runs out. The only exceptions to this pattern seem to be where the APEX's funds are linked to day to day technical assistance from a group that has a track record of running sustainable MF itself, and was able to provide the retail institution with a fairly complete package of information and management systems.
- APEXes have not been successful in building bridges between MFIs and commercial funding sources.
- It may not be reasonable to require that APEXes be financially sustainable themselves.
- Little evidence was found that APEXes play a useful role in coordinating among donors and harmonising their requirements.
- Management is key to an APEX's effectiveness. The actual availability of managers with the necessary technical and personal qualifications should not be assumed, but rather should be investigated carefully at the planning stage.
- One of the most important functions of the APEX management is the selection of MFIs to be funded. Because the number of qualified MFIs is usually limited, managers have trouble applying proper selection criteria when they are faced with political pressure or pressure to disburse large amounts quickly.
- Political interference is a common problem in APEXes despite assurances to the contrary at the planning stage. The best protection will usually be to keep

state participation in the governance of the APEX to the minimum level possible.

- Donors and governments tend to create unrealistic disbursement pressure for APEXes. It would usually be preferable for initial funding of an APEX to be modest, with larger amounts added later in response to demonstrated demand and capability.

According to an international comparison, the typical functions of an APEX institution can be summarised as follows:

- Expand MFIs access to a greater volume of financial resources on better terms
- Build a micro finance industry by bringing financial and technical assistance resources to a larger number of MFIs
- Select viable and potentially viable MFIs
- Improve donor coordination
- Support institution building of client / member
- Establish a bridge between MFIs and financial / capital markets
- Provide monitoring and supervision / inspection of MFIs
- Reduce costs of technical assistance, training and back office activities

Of course there are pros and cons and good and not so good experiences. The good thing however is that those specific experiences are available and documented, thus allowing to better set the barriers along the road towards achieving predetermined objectives of the proposed BPR APEX institution in Indonesia.

The creation of APEX institutions does facilitate amassing MF funds from governments, bilateral donors, and int'l financial institutions that probably would not be available in the same amounts if those sources had to transfer them directly to retail level institutions instead. The amount of money involved, however, must be put in the perspective of the total demand for financial services and the administrative capacity on an APEX institution. Thus in the development prospective, one must come back to the issue of sustainability.

The shared objective of greater outreach of BPRs will only be reached in a sustainable manner if and when the needed resources are being generated by the micro finance system, in this case the BPR industry, itself. The proposed APEX institution might inject additional resources to give a development or growth push to this process, additional funds raised along the creation of the APEX Bank may be useful for achieving some of the necessary institutional changes, but money itself is not the main factor for the development of a healthy BPR system.

A critical constraint evident in almost all country studies, and the cases of Ghana and Indonesia confirm this picture, is the lack of effective retailing capacity and an unachieved financial sustainability. Thus in many cases, despite a large number of clients / members, lending of the APEXes tends to be concentrated among only a few big MFIs which ultimately would not even need the intermediation of an APEX.

In terms of sustainability, the aspect of additionality discussed in the review of int'l APEX setups, should also be considered for the case of Indonesia. Is the APEX generating additional funds, which otherwise might have directly been made available to individual MFIs ? Is the APEX channelling MF funds to its clients /members which then invest own funds into other less riskier, thus more profitable business?

Also many cases prove that funds channelled through the APEX structure, particularly when offered at below market interest rates, tend to undercut the resource mobilisation incentives of the retailing institutions. On the other hand, examples (such as the Ghana case) show that retailing member institutions have refrained from drawing on APEX (channelled) funds, preferring to rely on their own (cheaper) resource mobilisation.

The only (internationally repeated) case where substantial external funding has tremendously contributed to a sustainable growth in MF outreach is associated to an intensive, hands - on and long term nature of technical assistance provided to the APEX and / or individual retail MFIs (the case of IPC in Latin America, Central and Eastern Europe and also in Ghana).

As mentioned before development of soundness and sustainability of the industry is or should be the main driver for setting up an APEX structure. The provision of a comprehensive package of technical assistance and services should therefore be in the centre of the APEX support activities and the raison d' etre of the APEX institution. The case of Ghana has shown that this has been reflected in the formulation of the mission of the ARB APEX Bank Ltd.

Financing of such functions of institution building of its members may be in the form of external (matching) grants or other supports or by cross - subsidies from within the different APEX business lines / profit centres.

As far as eligibility criteria of membership or client base of an APEX are concerned, there are int'l differences due to the nature of the respective national markets and the institutional setup. Institutional and financial soundness is of course a key criterion when it comes to develop the APEX as a gateway for external funding. Membership or client base may also be defined as a result of

the legal and / or political mandate of the APEX body. There are also cases of ownership of the APEX institution by its clients / members (the Ghana case).

In addition there may be specific selection criteria of donors (or the APEX itself) for disbursement of funds and / or accessibility to specific subsidised technical assistance.

For example the ARB APEX Bank Ltd. in Ghana implements a special capacity building programme for the lowest performing quintile of its shareholding member banks in order to improve their operational and financial sustainability and soundness towards a better rating of the Central Bank. There are other awareness and training programmes for directors (board members) on issues like governance, legal aspects of banking and the requirements for share register management, which equally come at virtually no cost for the beneficiary MFIs as a promotion campaign of the ARB APEX Bank Ltd. whilst most other APEX training programmes are implemented on an increasingly cost covering basis.

For almost all specific MF programmes (product innovation, MF outreach schemes, agricultural finance, etc.) implemented in rural banks in Ghana together with the ARB APEX Bank Ltd. and GTZ and other donor support, the minimum institutional eligibility criteria include adequate governance, management and staff structures and resources, good loan collection and high recovery rate, solid internal audit and accounting, and MIS and reporting capacities in place.

Solid financial performance cannot be a valid eligibility criterion for adhering to the APEX or having access to specifically designed support programmes as this would in most cases not reflect the mission, vision and development goals of the APEX institution and / or its programmes.

However performance over time in institutionalising accounting and auditing standards, implementing adequate reporting modes and providing a satisfactory level of information and transparency, should be compensated / rewarded by increased or expanded access to financial and non financial services of the APEX institution.

In order to assure "ownership" of a process, the respective own contribution of the MFI in kind or funds must be documented and formally approved by the respective board of the MFI before any subsidised or granted technical assistance is made available. On a larger scale, this principle should be applicable to an APEX institution as a whole.

By all means, eligibility of membership of the APEX institution or access to its services and funds should be exempted from any political or donor pressure. IN this regard governance and management of the APEX institution play a key role.

Global examples show another risk to be avoided by APEX institutions. In many cases, and Ghana is one of them, Government agencies and donors tend to overload the APEX institution with programme implementation tasks and responsibilities which it cannot fulfil due to lack of resources and, in case, its mandates.

In addition to funding, most APEX institutions offer technical assistance and training to their client MFIs. In some cases MFIs must take the technical support package in order to qualify for financial support. Almost all donor financed programmes include technical assistance and training, usually grant funded to both the APEX and the retailing MFIs (and sometimes to retailing borrowers as well). However the level of subsidies must be in decline, and the cost contribution of the MFI must be sensible in order to appreciate the value of the services.

There is a great danger that donors as well as APEX institutions oversee that TA and training are activities ongoing over a long time and cannot be limited to the implementation period of a project or programme. Sustainability of those TA and training concepts is therefore often underestimated which is a critical factor for the development of a sustainable industry, an objective which used to lye beyond the timeline of an initial support.

In the case of Indonesia, the CERTIF model appears to be a positive approach towards a cost covering institution building concept. Experiences in Ghana and elsewhere also tell that a sustainable training function for the industry should not be hosted by an APEX bank. An industry association or a specialised training provider or institute are a better and more adequate institutional set up.

APEX institutions have seldom been able to connect with financial markets. Such bridges become increasingly feasible as the MFIs themselves achieve or approach financial sustainability.

The same scarcity of coordination success is reported internationally as regards the aid coordination by APEX institutions. However there have been positive attempts here and there and the ARB APEX Bank Ltd. in Ghana is disposed to play such a role in an increasing manner regarding government interventions in MF. In this regard one major breakthrough is that the ARB APEX Bank Ltd. has convinced Government to abandon any sort of interest rate subsidy at the level of the final borrower and to involve the ARB APEX Bank as a coordinator, promoter and guarantor of a strict loan repayment policy approach.

This is so important as without retail interest rates at least covering the operational and financial costs of providing the services, the financial sustainability of MFIs is impossible by definition.

The subsidisation of credit for poverty alleviation purposes is a legitimate decision for governments and donors to make, but the considerable costs of doing so must be taken into account. However so long as MFIs are unable to cover their costs, their continued operations and any extension thereof remain dependent on an ongoing generosity of taxpayers and donors to pay the bill.

Generally speaking, international discussions of micro finance issues are very nervous about interest rate subsidies. There are overwhelmingly more reasons not to go for them. Interest rates are always an expression of risks involved in a business. If risks are transferred outside the financial institution and even removed from the final beneficiary of a loan, then sustainability and poverty alleviation are at stake. Subsidies in micro finance should not go into the financing business itself, but rather into underlying structural deficiencies and at decreasing rates.

Micro finance is a business, with definitely more risks and certainly also more profits than many other businesses do offer and can generate, not only in banking and finance. The issue is to do it well. If it is not done well, then this comes at a cost. Any micro finance strategy formulation or attempt of institutions building or regulation of the industry must clearly detect the inherent industry weaknesses and the related costs over time. As some institution whatsoever has to bear this cost, there is the subsequent need to develop concepts as to how to reduce these costs, i.e. the level of subsidies over time, in order to determine the point in time of harvesting on a macro and institution level.



## **Part III**

### **The Case of Rural Banking in Indonesia**



# 1. Challenges for the Banking Sector in Indonesia

The present level of capital in the banking system, and in particular in the BPR system indicates that high rates of credit expansion will be difficult to achieve if the national banking system does not strengthen the capital base.

Loan disbursement is not only constrained by bank capital, but in many ways also by the reluctance of some banks to extend credit because of weak risk management capacity and lack of core banking skills as well as relatively high operating costs.

The structural weaknesses in the Indonesian banking system are marked by concentration of the banking structure to only 11 large banks controlling 75 % of all banking assets. However the situation of smaller banks, in particular in rural areas calls for attention.

Other distinctive marks of the Indonesian banking system can be summarised as follows:

- Banking services fail to satisfy public needs.
- Bank supervision is in need of various improvements.
- Capabilities in the banking industry are weak.
- Profitability and operating efficiency are unsustainable.
- Customer protection needs improvement.
- Information technology requires advancement.

In addition to these challenges which have been reflected in a 2004 – 2010 action plan for the financial sector, the programme for reinforcing the structure of the national banking system foresees to strengthen linkages between commercial banks and rural banks.

As many other developing countries and a like Ghana, Indonesia is severely challenged by the number of programmes of Government and international development partners with the objective of poverty alleviation, rural development and support of specific groups in need of support. Various Government ministries and agencies, both on the national and the district level, implement a variety of about seventy (70) so called micro finance schemes with as many approaches to conceptual design and delivery mode as there are programmes. The volume reported for 2002 amounted to Rp16.5 tn (USD 1,8 bn).

Many of these programmes have been channelled through the financial system with a highly detrimental and devastating effect on the banks themselves and very poor target group orientation, impact and efficiency. The most common

interventions have been grants, revolving funds, heavily subsidised credits and semi - commercial credits. They also do not clearly separate financial and social interventions, and they frequently apply subsidised interest rates.

Commercialisation of micro finance requires a shift of Government resources from interest subsidised credit programmes to capacity building for expanded sustainable outreach by micro finance providers including banks and operators of micro enterprises.

Generally speaking and when considering commercialisation and professionalisation of micro finance there is a continuum from increased cost recovery, achievement of operational and financial self sustainability towards the utilisation of market based sources of funds. The ultimate step would be to operate as a for profit micro finance institution with full integration into and part of the formal financial system.

However there are number of requirements:

- Policy environment (Government, donors)
- Legal framework (licensing criteria, etc.)
- Regulation and supervision (capacities, risk / activity based, degree of deposit mobilisation, etc.)
- Money markets and capital markets (non subsidised loans from APEXes and CBs, deposit mobilisation, private MF investment funds (domestic and overseas)s, pension funds and insurance
- Support institution (credit reference bureau, MF Training, Rating, Networks, technical assistance providers, IT, BDS)

From recent studies (ADB 2003) it appears that demand for micro savings is high, while demand for micro credit is considerably lower. Simple evidence has shown that low income households primarily need savings instruments that enable them to manage their liquidity effectively.

| Participants of the Microfinance Sector in Indonesia   |   |   |
|--|---|---|
| Institutional Microfinance   | Program Microfinance  | Individual Microcredit  |
| <b>Commercial Banks (mainly BRI units)</b><br>R&S: Bank Indonesia<br>Level: District and sub-district          | <b>Microfinance System Building</b><br>- Linkage project (PHBK)<br>- Microcredit project (PKM)<br>Commercial relations between banks, LDKP, NGOs, self-help groups, and individual customers. Strengthening small financial institutions. | Moneylenders<br>Traders<br>Shopkeepers<br>Neighbors<br>Family members |
| <b>People's Credit Banks (BPR)</b><br>R&S: Bank Indonesia<br>Level: Sub-district                               |   |   |
| <b>Rural Credit Fund Institutions (LDKP)</b><br>R&S: Provincial governments<br>Level: Sub-district and village | <b>Poverty Alleviation Programs</b><br>- Rural Income Generation Project (RIGP/P4K) : Commercial relations  |   |

|   |  |  |
|---|--|--|
| <b>Village Credit Institutions (BKD)</b><br>R&S: BRI on behalf of Bank Indonesia *<br>Level: Village  | between BRI and small farmer groups<br>- Family Welfare Income Generation Project (UPPKS) : Subsidized credit to family welfare groups<br>- Sub-district Development Project (PKK): grant-based revolving fund for sub-district financial management units<br>- Urban Poverty Alleviation Project (P2KP): grant-based revolving fund for village-level financial management units<br>- similar regional projects |  |
| <b>Village Savings &amp; Credit Units (UED-SP)</b><br>R&S: Ministry of Home Affairs<br>Level: Village   |  |  |
| <b>State-owned Pawnshops</b><br>R&S: Ministry of Finance<br>Level: District and sub-district  |  |  |
| <b>Microfinance Cooperatives</b><br>- Savings & credit cooperatives (KSP) **<br>- Savings & credit units (USP) of coop.<br>R&S: Ministry of Cooperatives<br>Level: District and sub-district<br>- Savings & credit service points (TPSP)<br>R&S: MoC and BRI (TPSP)<br>Level: Village | <b>Crisis-related channelling of funds</b><br>- Social Safety Net, i.e., PDM-DKE: grants to villages and community groups<br>- Community Recovery Program : grants channelled through NGOs<br>- Fuel subsidies converted to funds channelled through cooperatives and microfinancial institutions  |  |
| <b>Savings &amp; Credit Associations ***</b><br>R&S: Non-regulated, apex organizations<br>Level: Village  | <b>NGO microcredit programs</b>  |  |

R&S = Regulation and Supervision.

Level = Location and predominant area of operation.

\* Note : BKD are recognized but not regulated as banks.

\*\* Includes institutions such as Credit Unions, BMT that obtained the legal status of cooperative.

\*\*\* Includes Credit Unions, BMT and other cooperative-like associations, which do not have a clear legal status and operate as financial intermediaries; does not include credit channelling groups.

## 2. Rural Financial Services in Indonesia

**Commercial banks** are involved in microfinance sector activities by acting as channelling institutions for governmental credit programs and by cooperating with small financial institutions and cooperatives. Only a few commercial banks, however, have their own microfinance windows or were established especially for providing microfinance services.

Two recognised local examples are *Bank Purba Danarta*, which were established by a non-governmental organization in Central Java, and *Bank Dagang Bali*, a private bank in Bali that started as a small secondary bank with strong touch with the microfinance sector. Recently *Bank Mandiri* has made a remarkable push and opened about 150 rural branches or outlets.

The only microfinance window of the commercial banking sector with national significance is the sub-district level unit system of *Bank Rakyat Indonesia* (BRI).

The **BRI unit system** is the backbone of the rural financial system, which has gained international recognition for its outreach, profitability and soundness.

**People's Credit Banks** or *Bank Perkreditan Rakyat* (BPR) are secondary banks, which are also subject to the banking law and are regulated and supervised by the central bank. The vast majority of these institutions were established after the banking reform in 1988 that introduced the new classification of primary and secondary banks. BPR usually operate at the sub-district level. Note that this category does not include non-bank financial institutions that are often subsumed under the generic term 'BPR'.

**Rural Credit Fund Institutions** or *Lembaga Dana Kredit Pedesaan* (LDKP) are different types of non-bank microfinance institutions operating either at the sub-district or village level. They were established on initiative of provincial governments since the 1970s and are licensed, regulated and supervised by the provincial governments. Technical assistance and supervision is usually delegated to the Regional Development Banks (BPD), which are owned by the provincial governments.

**Village Credit Institutions** or *Badan Kredit Desa* (BKD) operate in Java and are village-level financial institutions with historical roots dating back to colonial times. The evolution of banking laws and regulations has resulted in a strange and contradictory situation that BKD were acknowledged as BPR in word, but are neither regulated nor supervised as secondary banks. In reality, BKD are tiny institutions and lack all features characterizing BPR. BKD are supervised by BRI on behalf of Bank Indonesia.

**Village Economic Unit – Savings and Credit** or *Unit Ekonomi Desa – Simpan Pinjam* (UED-SP) are tiny village institutions that have been promoted by the Ministry of Home Affairs since 1995 for providing credit to low-income groups. The ministry is also responsible for their regulation and supervision. Actually, these institutions highly depend on government subsidies and have been used for channelling funds rather than being developed into viable financial institutions.

| Institutional Microfinance in Indonesia |                       |                  |                          |                    |                          |                   |
|---|-----------------------|------------------|--------------------------|--------------------|--------------------------|-------------------|
| Institution                             | Units                 | Deposits         |                          | Loans Outstanding  |                          | Members<br>(,000) |
|   |                       | Accounts<br>,000 | Amount<br>Rp.<br>billion | Accounts<br>,000   | Amount<br>Rp.<br>billion |                   |
| BRI units ( June 2000)                  | 3,694                 | 24,883           | 18,055                   | 2,627              | 6,713                    | -                 |
| BPR (March 2000)                        | 2,427                 | 4,837            | 2,252                    | 2,197              | 2,632                    | -                 |
| LDKP (June 2000)                        | 1,603                 | 871              | 342                      | 500 <sup>5</sup>   | 337                      | -                 |
| BKD (June 2000)                         | 4,566                 | 600              | 24                       | 726                | 148                      | -                 |
| UED-SP (March 1999)                     | 52,222 ? <sup>1</sup> | ?                | ?                        | ?                  | 116 <sup>7</sup>         | 345               |
| Pawnshops (Dec. 1999)                   | 645                   | -                | -                        | 4,000 <sup>6</sup> | 705                      | -                 |
| Microfinance cooperatives               | 15,000 ? <sup>2</sup> | ?                | ?                        | ?                  | ?                        | ?                 |
| Credit Unions (Dec. 1999)               | 1,105                 | 252              | 117                      | ?                  | 134                      | 252 <sup>8</sup>  |
| TPSP (April 2000)                       | 1,582                 | 254              | 16                       | 240                | 37                       | 254 <sup>8</sup>  |
| BMT (Nov. 2000)                         | 879 <sup>3</sup>      | 175              | 46                       | 73                 | 51                       | 175 <sup>8</sup>  |
| Savings & Credit Associations           | 10,000 ? <sup>4</sup> | ?                | ?                        | ?                  | ?                        | ?                 |

1 This number reported by the Ministry of Home Affairs is not reliable (see chapter 5).

2 Reliable and new statistics differentiating between cooperatives with and without microfinance activities were not available (see chapter 6).

3 PINBUK reports a number of 2,914 established BMT, though financial statistics include only 879 (see chapter 7).

4 The linkage project involved some 6,500 savings and credit groups. The estimate takes into account Credit Unions and other savings and credit associations without a legal status. This estimate includes only institutions that build up own loan funds and intermediate between savers and borrowers independently of access to outside funds. Does not include pure credit channelling groups and rotating savings and credit associations (*arisan*).

**Microfinance cooperatives** are defined as cooperatives that provide financial services and are licensed, regulated and supervised by the Ministry of Home Affairs. Cooperatives specialised in financial services are known as *Koperasi Simpan Pinjam* (KSP) or savings and credit cooperatives. Multi-purpose cooperatives are allowed to provide financial services, if they operate an

organisationally differentiated savings and credit unit or *Unit Simpan Pinjam* (USP). *Tempat Pelayanan Simpan Pinjam* (TPSP) or savings and credit service posts operate at the village level under the umbrella KSP or USP, but they are independent organisations supervised by BRI.

**Credit unions** or *Koperasi Kredit* are organised by the non-governmental Credit Union Coordination Board, and have been increasingly converted from non-regulated savings and credit associations to licensed cooperatives since the liberalization of the cooperative law. Another type of microfinance institution that partly operates as licensed cooperatives and partly as unregulated savings and credit associations is the *Baitul Maal wat Tamwil* (BMT). This institution operates based on Syariah principles and has been promoted by the non-governmental Foundation for the Incubation of Small Businesses or *Yayasan Inkubasi Bisnis Usaha Kecil* (YINBUK).

**Non-government organisations (NGOs)** in Indonesia are usually not microfinance institutions in the sense that they act as bank-like intermediaries. Few have established small banks and most of them are either involved in or carry out their own microfinance programs. Their traditional field of intervention has been the promotion of savings and credit associations. The Credit Union Coordination Board and YINBUK are two examples of these NGOs. Savings and credit associations that build up their own loan funds have also been supported by other NGOs such as *Bina Swadaya* and other self-help promotion Institutions that participated in the linkage program.

### ***Perum Pegadaian* – the state-owned pawnshop company**

Pawnshops are an important part of institutional microfinance. The first pawnshops in Indonesia were established in the beginning of the 20<sup>th</sup> century. The pawning business has been a monopoly of the government and is organized in form of a profit-oriented state enterprise (*Perum Pegadaian*) since 1990. Since then the company has been professionalized and developed into a service-oriented institution that provides low-income households who hold their savings in movable assets with an important source of liquidity. The Ministry of Finance is responsible for regulating and supervising the company.

Between 1990 and 2000 the number of the company's offices increased from 505 to 645. Pawnshops can be found in every district capital and increasingly in sub-district capitals. Pawnshops are usually staffed with two managers and six other employees, and open six days a week from 7.00 hours to 15.00 hours. They provide simple and fast (transactions usually take 15 minutes) services, and have the comparative advantage that customers can turn their valuables easily into cash without having to sell them, particularly in cases of emergency.

Pawnshops accept collateral in the form of gold, jewelry, household items, electronic goods, motor vehicles, and even valuable fabrics and hand-woven cloth. They have five credit schemes depending on loan size, with the loan size ranging from a minimum of Rp. 5,000 to more than Rp. 20 million. Repeated loans using the same collateral are very usual.

The monetary crisis contributed to the growth of the pawning business. Between the end of 1996 and the end of 1999, the company's assets increased from Rp. 647 billion to Rp. 1,151 billion, its loan amount outstanding from Rp. 414 billion to Rp. 705 billion, and its net profit from Rp. 34 billion to Rp. 61 billion. In 1999, the company served 12.4 million customers with a total loan amount of Rp. 3.2 trillion and an average loan size of about Rp. 260,000.

### 3. BRI - Bank Rakyat Indonesia

| <i>Perum Pegadaian – State-owned Pawnshop Company</i><br>(in Billion Rupiah) |       |       |       |        |
|--|-------|-------|-------|--------|
| Indicator  | 1996  | 1997  | 1998  | 1999   |
| Number of offices *  | 598   | 622   | 635   | 645    |
| Total assets *   | 674   | 798   | 1,221 | 1,151  |
| Loans outstanding *  | 414   | 526   | 793   | 705    |
| Equity *   | 308   | 333   | 371   | 407    |
| Net profits *  | 34    | 35    | 53    | 61     |
| Loan amount disbursed **   | 1,724 | 2,088 | 3,131 | 3,229  |
| Number of customers (,000) **  | 5,030 | 5,305 | 9,822 | 12,428 |

Source : Perum Pegadaian, Annual Report 1999

\* End of year; \*\* During year.

**(People's Bank)** is stated owned and runs about 4000 units around the country. With a strong regional representation, it has about 70 -80 % of the deposit market share. The population perceives BRI as the preferred sound and state guaranteed deposit collector in the country.

BRI units also offer other financial services, such as money transfers and serving as payment points for utility bills. The wide range of micro finance products and services was the result of a commercial approach which in turn improved the quality of outreach.

BPRs have found it hard to compete with government owned BRI units in deposit mobilisation and the implicit government guaranteed safety of deposits. Hence

BPRs are forced to offer higher returns on deposits and better service, e.g. doorstep collection of savings.

Furthermore most BPRs are independent unit banks with no access to liquidity like BRI, exposing them to much higher risks and costs. This situation has placed BPRs at a competitive disadvantage vis a vis the BRI units.



## 4. Characteristics of People's Credit Banks (BPRs)

The industry of BPRs is characterised by the large number of about 2150 and a very heterogenous ownership. Roughly 40 % of BPRs are in public ownership, while 60 % are privately owned, with a wide range of ownership. The industry also includes large holdings with over several 50 or so BPRs.

This diversity is a reflection of the Banking Act : Art 21 (Form of legal entity), Para. 2, which defines the following legal entities to operate as licensed rural banks:

- Regional development enterprise
- Cooperative
- Limited liability company
- Other from of legal entity stipulated in a Government regulation

This heterogeneity has direct implications on other legal / regulatory issues, which are worth a review, such as:

- Art. 23 (Ownership)
- Art. 25 (Share register, increase of capital, M & A)

This diversity invites for number of questions regarding equity, liability, ownership and governance issues.

It is also problematic and not international standard that a formally licensed financial institution like a rural bank (BPR) in Indonesia may not hold shares in other companies / banks. This may be a major challenge to overcome in time for a BPR based ownership structure of the proposed APEX institution.

The BPR outreach is concentrated in urban areas of Java and Bali provinces (comprising some 82 % of the total number of BPRs. Outreach into outlying provinces and their rural areas is very limited. The main constraint for expanding the BPR industry relates to the high minimum capital requirements. Lack of a national branch network also poses constraint to BPR expansion in terms of being able to distribute credit risk geographically, to manage bank liquidity needs, and to provide customers with possibilities to withdraw savings or otherwise access their accounts in other areas.

Access to support services is another challenge because of the unit structure of the BPRs. The development of new micro finance products and services, training of staff, and enforcement of effective auditing and control mechanisms are expensive for to expensive for an individual BPR.

Generally the BPR deficiencies can be described as follows:

- **Restricted management autonomy.** The management autonomy of BPR is often restricted by the involvement of owners and commissioners in operational decision-making. BPR with strong owner involvement do not perform better and often worse than those enjoying high management autonomy. Higher degrees of functional differentiation, clearly distinguishing between the roles of owners, commissioners and directors, and making directors fully responsible for BPR operations may contribute to improving soundness.
- **Bureaucratic governance.** Restricted management autonomy is a special issue for BPR-LDKP. Owned by local governments they tend to be governed by bureaucratic command. Dependence on centralised decisions undermines market-oriented banking necessary to react flexibly to local conditions.
- **Ineffective internal control.** Effective internal control is a major factor relevant for improving BPR soundness. Its lacking effectiveness is a striking feature of poorly performing BPR. Effective internal control requires functionally differentiated authorities for special internal control staff.
- **Low functional and organizational differentiation.** Low levels of functional and organizational differentiation characterize the institutional setup and practice of many BPR. The effectiveness and efficiency of these institutions suffer from an unclear division of labor and understanding of specialized functions. Institution building requires improving this differentiation in accordance with financial and human resources.
- **Lacking compliance with loan loss provision requirements.** The serious under-provisioning reveals unsound management practice and is a major problem to be solved in the field of financial management. Loan loss provision costs have to be fully accounted for in the financial statements. Creating a sound BPR industry requires enforcing full loan loss provisioning.

The ProFI baseline survey pointed to the need for reviewing the current rating system, because it gives too much tolerance to short-term loans being in arrears, gives too little weight to assets quality and loan loss provisioning, and tends to over-state profitability when full loan loss costs are not accounted for in income statements. Bank Indonesia has also realised the weaknesses of the current regulatory and supervisory framework and its practical implementation for BPR and non-bank microfinance institutions.

Currently, Bank Indonesia with technical assistance from GTZ-ProFI project is reviewing the existing frameworks with the aim to improve BPR regulation and supervision. Only about half of the BPR are being inspected. Also the frequency for on-site supervision is not risk or activity based and does not correlate with BPR performance. BPR managers are found to be highly interested in improving Bank Indonesia's supervision capacity. They asked for increasing the frequency of on-site inspections, combining supervision with technical assistance, more effectively enforcing the owners' compliance with supervision recommendations, and focusing on supervision of unsound institutions.

- **Unsound credit management.** Loan loss was incurred through business failures, moral hazard, inadequate credit analysis, and deviation from prudential credit procedures. 1/3 of BPRs still lack lending policies and experience a high concentration of their loan portfolio. Neglect of lending limits is also a major issue in this respect. Loan portfolio quality worsened with large parts of the loan portfolio concentrated in few hands. Considering that prudential credit analysis and loan approval procedures would have prevented also much of the loss managers ascribe to business failures and the borrower's character, improvement of credit management has to be regarded as a priority field of action.

In 2000, the overall loan portfolio at risk ratio was 21%. Bank Indonesia classified 4% of the industry's total loan portfolio as sub-standard, 6% as doubtful and 11% as loss.

The loan portfolio at risk ratio ranged from only 3% in Lampung to an outstanding high 48% in the greater Jakarta area. Extremely high ratios of more than 30% were also faced by the BPR in East Kalimantan and Bali. Loans classified as loss made up more than one quarter of the total loan portfolio in these regions. Apart from Lampung, only the BPR in Central Sulawesi, Jambi and Bengkulu had less than 10% for their loan portfolio value at risk.

Supervision of the sector by BI has resulted in a rating of financial sustainability. The development of this indicator appears impressive.

| Status of solidity | „sound“ | „fair“ | Total  |
|--------------------|---------|--------|--------|
| 31.12.2002         | 64,5 %  | 15,6 % | 80,0 % |
| 30.06.2003         | 63,9 %  | 16,5 % | 80,4%  |
| 31.12.2003         | 66,7 %  | 17,0 % | 83,7 % |

However it is noteworthy that BPRs generally consider loans in arrears less than 3 months as standard, thus writing off bad loans only after 27 months. This fact is not reflected in their returns to BI and subsequent ratings. After stricter implementation of the regulations, in particular the required loan loss provisions, the picture will look rather different with about 40 % of non performing loans across the industry. About 50 % of the rural banks would then fall into the category of unsound (2004).

This has a tremendous impact on number of issues falling under the wider concept of an APEX bank, i.e. ownership, pooling of funds, linkages, etc.) and being part of the short and medium term agenda of BI, e.g. enforcement of regulation.

- **Low operating efficiency.** The average operating costs to operating income ratio was unsound for the small BPR. The margin between income and costs is often too small to generate returns sustaining the real value of capital. Operating efficiency has to be improved by reducing personnel costs and/or increasing outreach.

- **Lack of capital versus over-liquidity.** Lack of capital and over-liquidity are two opposite financial situations faced by BPR. Over-liquidity, mainly experienced by large BPR for which time deposits are the major source of funds, reflects difficulties in creating new credit markets. Lack of capital reflects low degrees of deposit mobilization of mainly small BPR and BPR-LDKP. Both situations require active market-orientation and entrepreneurship.
- **Weak market-orientation and entrepreneurship.** Innovative product, marketing and entrepreneurship are crucial for tackling both problems. Time deposit services of small BPR are considerably under-developed. Opening new credit markets requires diversifying loan products, convenient and fast credit procedures. Lack of market-orientation and entrepreneurship is a major weakness of BPR-LDKP.
- **Low quality of human resources and lack of training impact.** Low quality of human resources is the keyword most often used to define the core problem of BPR. The analysis of management aspects and the BPR directors' own problem analysis pointed to lacking skills covering the entire range of banking operations. Training is often considered the key to solving these problems. However data do not provide evidence that training has positively impacted on performance. Training contents are often not tailored to the needs of a specific institution, and trainees are often not able or authorized to transform training contents into practice. It is expected that these issues will be addressed under the CERTIF scheme.

## 5. The Competitive Environment of BPRs

**PNM Permodalan Nasional Madani** is a state owned non bank financial institution. The fund has the Ministry of Finance (2/30 and Bank Indonesia (1/3). as shareholders. Its operations are centred around

*Add content here*

PNM has been active in promoting the concept of an APEX structure for the BPR industry, in particular in view of the proposed pooling of funds. It perceives its role as follows :

*Add input from MH / SJ*

*Question mark for the following !!!*

Earlier studies considered PNM as a possible shareholder of an APEX structure. The existing structure of PNM could also be a possible gateway for equity participation of strategic investors a like DEG / KfW or IFC.

## 6. Funds Mobilisation and Co-operation of Microfinance Institutions

Successful microfinance institutions such as BRI units, LPD and Credit Unions rely on savings mobilisation. These institutions have proved that satisfying the demand of low-income groups for savings instruments is as important as satisfying their demand for credit. They have also proved that savings mobilisation is crucial for the sound and sustainable growth of their loan portfolios.

As in most other countries, government and donor funding in Indonesia is not large and permanent enough or bluntly not available to assure the continuing delivery of micro finance / micro loan services to the millions of economically active poor who need them. BPRs can achieve massive outreach over the time only if they are able to increase their deposit basis and eventually tap commercial sources of funding, in combination with specific non financial government support aiming at distinctive development goals.

A great number of BPRs however has not further developed the necessary focus on savings mobilisation, in particular term deposits. This limits their growth and outreach, and deprives them of an important means of screening their

borrowers' creditworthiness. Many of the BPRs do neither meet the demand for flexible savings instruments nor an increasing credit demand.

Success in savings mobilisation also depends on savings capacities varying depending on local economic conditions and the clientele of microfinance institutions. ProFI studies on BPRs and LPDs have shown that these industries experience both the lack of loanable funds and over-liquidity.

An important issue in this context is that most microfinance institutions lack institutionalised forms of financial co-operation through which they are able to access refinance at reasonable costs or to place excess funds to uses with returns higher than yielded on current bank accounts.

For cost reasons, such collaboration should first and foremost be promoted within the BPR industry itself and then be expanded to systematic linkages with other financial intermediaries.

It is evident that with about 86 % share, own deposits held with their customers form the major and cheapest source of funding. However about 1/3 of all BPRs have already established a borrower relationship with individual commercial banks. Refinancing linkages predominantly exist with selected bigger BPRs but not as a strategic decision to invest or expand into MF, but rather on a one to one basis. Particularly after the financial crisis a couple of years ago, commercial banks are still very cautious about their loan portfolio. The creation of an APEX for the BPRs would not change their mind over night.

The BPR system as a whole has substantial liquidity but much of it is needed

- to offset the high 2 :1 ratio of term to savings deposits
- to provide a cushion for increased lending
- to offset the lack of an effective inter - BPR funds transfer mechanism.

BPRs generally have fairly high risk operations with relatively poor portfolio quality.

## 7. Market Outreach of BPRs

| Status              | BPR   | Savings Accounts | Term Deposits | Loan Accounts |
|---------------------|-------|------------------|---------------|---------------|
| 31.12.2002          | 2141  | 4.890.535        | 438.093       | 1.824.736     |
| 31.03.2003          | 2133  | 4.688.775        | 415.643       | 1.903.936     |
| 30.06.2003          | 2130  | 4.890.626        | 453.053       | 1.984.726     |
| 30.09.2003          | 2134  | 5.086.514        | 475.325       | 2.063.935     |
| 31.12.2003          | 2141  | 5.045.552        | 489.359       | 1.993.128     |
| Differenz 2002/2003 | 0,0 % | +3,2 %           | +11,6 %       | +9,2 %        |

Across the regions the BPR business of savings, term deposits and loans shows a great variance : for the loan accounts (savings accounts) from -35,1 % (-32,7 %) in the Aceh province to +68,2 % (50,2 %) in North Sumatra; for term deposits there are very impressive increases of up to 101 % (South Sulawesi) but also declines of for example -9,2 % (Western Java).

It is recommended that BI further investigates the BPR market and its development over time in terms of number of customers and volumes of transactions for the main savings, deposits and loan products, according to geographical / regional clusters as well as ownership structures and institutional clusters of paid - in capital / equity and size of their balance sheet.

This will lead to a clearer picture of the frequently cited over liquidity and at the same time the growth potentials (and weaknesses) of their lending operations. Such a combination with available data on the quality of the respective loan portfolio will generate a risk classification required for assessing the business opportunities of pooling funds within the BPR industry.

The desk study revealed two apparently contradictory statements:

- Smaller BPRs appear to have shortage of liquidity
- Smaller BPRs and particularly those in truly rural areas have a comparably small size of time deposits.
- Larger BPRs have over liquidity.
- Larger BPRs operating mainly in densely populated provinces have a comparably higher volume of term deposits.

However other sources reveal that mainly the larger BPRs undertake borrowing from commercial banks in order to satisfy their need of loanable funds.

A number of questions arise from this assessment: Does this mean that commercial banks consider the weaker and “more rural” BPRs as not creditworthy? Does this mean that larger BPR underutilise their own liquidity and rather buy additional funds at certainly higher costs? Is there a potential market for inter - BPR lending at more convenient rates? What is the net transfer rate between the BPRs and the commercial banks? Can such existing linkages be classified according to BPR sizes, their locations, the prevailing maturity rates etc? It is recommended that data available at BI be assessed and interpreted in more detail in order to better understand the prevailing market dynamics.



## **Part IV**

### **Recommendations and Critical Issues for the Way Forward towards a BPR APEX Institution in Indonesia**

## **Recommendations and Critical Issues for the Way Forward towards a BPR APEX Institution in Indonesia**

*The greatest difficulty in the world is not for people to accept new ideas, but to make them forget about old ideas.*

(John Maynard Keynes)

### **1. Introductory Remarks**

In the late 1980s and early 1990s the old idea of supporting rural development and alleviating poverty by channelling subsidized targeted credit appeared to be replaced by the new idea of financial systems development as an approach to microfinance. The new idea was increasingly accepted, but the last decade has shown that the old idea is not only forgotten but has regained its predominant role in microfinance policy and practice.

The findings presented in this study suggest that new efforts have to be undertaken to make us forget about old ideas, to formulate a realistic microfinance sector policy and strategy, to identify the appropriate prudential and institutional interventions for strengthening the microfinance sector, and to learn from success studies and failures around the world in approaches to reinforcement of rural banking by designing the desired functionalities for the establishment of a second tier APEX institution.

As in other countries, consideration of reinforcing the BPR industry should be guided by a microfinance sector and rural development strategy, therefore it has to be a financial systems inclusive of development strategy that does not only contribute to poverty alleviation but also to strengthening and integrating the total financial system.

To be able to contribute to sustaining and increasing access of the rural population to financial services of BPRs, the policy and institutional framework must promote a demand-driven approach, has to refrain from replacing savings mobilization by subsidized credit or expensive commercial sources of funding, and should apply indirect approaches through appropriate institution and capacity building of the BPR industry in order to respond to all or most of the identified weaknesses in a systematic and planned manner.

Sustainable financial services provided to a growing number of low-income customers require viable and strong BPRs and an enabling regulatory and

supervisory framework that supports increased soundness, higher transparency as the main underlying criteria for growth of the institutions and of the real sector in their markets.

BPRs will only be able to sustain and expand their outreach to low-income groups if they are demand-driven, savings-driven and adhere to the principles of prudential banking, if their regulatory frameworks give them adequate room to move, and if their supervisory frameworks succeed to enforce their compliance with prudential practice standards.

Besides facilitating the microfinance policy dialogue and the formulation of a microfinance sector policy, there are four broad components of a microfinance sector strategy which are equally relevant in Indonesia :

- improving legal, regulatory and supervisory frameworks for different sorts of microfinance institutions
- institutional strengthening of microfinance institutions
- institutional innovations or establishment of new microfinance institutions
- re - orienting poverty lending and strengthening microfinance programmes.

## **2. Review of Recent Background Work on Concepts for the Establishment of a BPR APEX Institution**

There have been several initiatives aiming at strengthening institutional microfinance, mainly through small financial institutions such as the People's Credit Banks (BPR). These initiatives intend to improve access to microfinance services indirectly rather than directly.

Initiatives such as the ProFI programme of Bank Indonesia/GTZ, and UKABIMA, a private non-bank finance company sponsored by USAID and executed by CRS, focus on improving framework conditions and technical capacities of small financial institutions.

In the past the two major microfinance programmes aiming at developing sustainable microfinance systems in cooperation with banks, non-government organisations and self-help groups were carried out by Bank Indonesia (BI) in cooperation with GTZ (Project Linking Banks and Self - Help Groups Project) and ADB (Micro Credit Project).

Recently BI has decided that institutional strengthening of the BPR industry requires the establishment of an APEX bank with the main objective to develop

instruments and methods to overcome the identified weaknesses of the industry and to promote micro finance saving and loan products delivery in an efficient and sustainable manner so that rural financial services become an integral part of the financial system of Indonesia.

### **3. Recommendations and Critical Issues Identified**

From the analysis of the weaknesses of the BPR industry and the study of other cases of attempts to the development and strengthening of rural banking as a core component to poverty alleviation and economic growth, it is clear that an APEX structure is an appropriate instrument for achieving these objectives which require

- a broad stakeholder acceptance and participation
- a thorough market research
- a determination of the central bank to take the lead
- a detailed feasibility study

It is also clear that an APEX structure for the BPR industry cannot be erected over night, requires a much more in depth research and planning, a strong commitment by both the regulator and the industry and an enduring effort of funding or fund raising while pursuing a commercial approach.

Besides some general recommendations, this study would wish to rather point at some critical issues which can help designing a medium term roadmap with clearly identifiable achievements in 2005. Earlier market research has been taken into consideration.

#### **3.1. The Political Issue**

For the Indonesian economy, BPRs are the sole regulated and supervised source of finance for the in- or non-formal sector of the economy, be it individual traders, non-bankable SMEs or small agriculture, all areas that employ and/or provide a livelihood for a large segment of the Indonesian population and are therefore politically of great socio-economic importance.

The informal moneylenders and probably also pawnshops are much more expensive sources of finance for this group of borrowers. So a sound and profitable BPR-sector is politically and socio-economically highly desirable. The positive socio-economic effects of a more effective BPR-sector, to be achieved by

the creation of an APEX Institution, that can further develop and support the BPRs, can easily be assessed when traveling through Indonesia and witnessing the importance of the informal SME and agricultural sector, for primary and secondary sector production, services and foremostly employment.

From previous market enquiries it has become evident that the need for an APEX Institution is widely accepted (cf Annex 1), but in all probability and for different reasons the conceptual ideas vary widely in regard of the range of size, ownership, soundness, quality of staff and management, public image as well as activities of the BPRs. But in one point there seems to be an unified interest: More and cheaper funds for the BPRs and need for an uplifting of skills on all levels of the BPR-sector. So these two areas plus the clearinghouse function should deserve more in – depth analysis before finally setting the focus of the BPR APEX institution.

It is also very clear that a possible APEX would have to serve a rather segmented market. This is in fact a very critical issue. Can the APEX generate critical masses for its diverse services?

From the point of view of Bank Indonesia and the state-owned corporation for small and medium enterprise financing *Permodalan Nasional Madani (PNM)*, it is politically desirable to foster the BPR sector and to strengthen the supporting structures in such a way that the BPR sector is sounder and in a better position to grow whilst continuing to serve the small businesses and small agricultural entities. Here the role of consultancy and supervision, potentially leading to a better rating, are seen as a central role as to achieve the funding requirements, especially the lowering of the cost of funds to the BPR-sector as such.

All major stakeholders have a common interest in an APEX Institution as a liquidity manager and funds provider, as well as a consultant to uplift skill-levels.

But there are varying views on other services, the legal form, the structure of the APEX Institution and especially where the funds should come from to finance the creation of an APEX Institution.

It is therefore advisable to get a more unified commitment from the BPRs themselves, to support the APEX Institution and use its services, not only opportunistically, but exclusively, subject of course to the APEX Institution being competitive in quality of service and pricing.

Only with a strong APEX Institution can the BPR sector achieve its goals and thereby serve a sector of the community that the commercial banks will and can not serve sufficiently for its further development.

### **3.2. The Legal Issue:**

It is recommended that to fulfill services such as clearing of payments and cheques, selected central banker functions, and liquidity management (pooling of and channeling of funds, the concept of the preferred banker) and the co - financing linkage concept), a banking license will be required for the establishment of the BPR APEX institution.

Earlier in 2004, workshop reports mentioned that one could buy existing banks at lower costs than the present minimum capital requirement (as their license was issued when the minimum capital requirements were lower) and, that there are even some small but sound banks to be sold, that one should look into, as a vehicle for the APEX Institution.

At first, this idea is appealing as it leaves room for the APEX Institution to expand its scope of activities in the future, to complementary banking products for the BPRs, which they do not want for the time being. In addition to that, the costs seem to be considerably lower than applying for a new banking license.

However it is recommended to very carefully revisit this idea as the functionality of the bank will be totally changed from a (small) commercial bank to a kind of Central Bank for the BPR sector, with a very different range of products and services and a much broader outreach. Even the minimum capital of such a bank may not be sufficient for the scope of business of the proposed APEX Bank servicing more than 2000 PBRs throughout Indonesia.

As mentioned for the case of Ghana and equally valid for Indonesia, the BPRs are individual unit banks with the majority privately owned. Of course it is very desirable for the APEX institution to achieve critical masses that the BPRs

- become shareholder of the APEX Institution,
- pool all excess liquidity with the APEX Institution,
- maintain a clearing account with the APEX Institution and
- channel all clearing transactions through the APEX Institution.

However this may be difficult to be enforced. The APEX Institution, in turn, must offer quality services at market rates.

The current legislation of Indonesia provides the following restrictions within the Banking Law:

Art. 1, Para 4: Rural banks shall not provide payment transactions.

Art 14, letter c: Rural banks are prohibited from conducting equity participation.

An APEX institution as proposed in this study would certainly require an amendment of the Banking Law in these regards. Furthermore

Art. 30, Para 3: Information shall not be made public and shall be confidential.

contradicts any attempt of benchmarking, rating, share flotation, M & E, and linkages as those issues are built on transparency and should form areas of the future APEX institution.

In line with a general review of the Banking Law regarding the BPRs, we would also recommend to review

Art. 31 – 33, (examination, types, procedures, scopes, period of time, results of examination, follow up)

if examination (inspection on site and off site) be transferred to an APEX body and external audit becomes a mandatory requirement for all BPRs.

We have noted with satisfaction that Art 44 of the Banking Law opens the door for the establishment of a credit reference bureau. International experience shows that the establishment of a credit bureau mechanism significantly contributes to the reduction of the inherent risks and costs of lending operations and the over indebtedness of borrowers. Generally transparency is a major tool for achieving better performance within an industry.

In regard of the intended scope of operations of the BPR APEX institution, the following rural banking regulations require thorough reconsiderations:

1.1.06 rural banks shall not provide clearing payment services

2.1.01. ff further explanations on the legal form of a rural bank

3.2.01 same capital requirements as in Ghana

Rp. 2 bn for urban areas

Rp. 1 bn for peri urban areas

Rp. 500 mio for rural areas

Paid - in capital for cooperatives may be composed of principal savings, mandatory savings, and endowments

4.1.03 would require amendments

7.3 It remains unclear who would be doing it.

Chapter 8 deals with the Government Blanket Guarantee

Is it still in place and / or shall it be supplemented / replaced by the envisaged deposit insurance institution?

In conclusion it is recommended that the APEX Institution shall be a bank institution with branches and a banking license to enable the banking functions needed. A legal framework for BPR sector and APEX bank has to be developed. It is recommended that the legal aspects of the establishment of a new BPR APEX Institution be revisited as soon as possible as amendments of the legal framework usually need time. It has been understood that a draft amendment of the Law should be sent to Parliament in June 2005.

### **3.3. The Regulatory Issue:**

As the performance of BPRs is extremely differentiated, perhaps the first priority should be to make efforts to improve their transparency in terms of internal financial monitoring and public disclosure of financial performance. This process is likely to bring to the surface the most pressing institution specific concerns regarding what areas of BPR operations or infrastructure require improvement to enhance financial performance and to improve efficiency.

It is recommended to establish a work plan for stricter implementation of regulatory requirements, including an awareness and support scheme for the rural banks. It has been understood that before even the closing of this study work, a separate APEX working group and a draft work plan for Q 1 – Q 2 / 2005 have been set up with the objective to identify the preconditions and possible obstacles as well as to link up with another BI / ProFi working group on regulations and include contacts with the API and Legal Departments of BI as well as with outside stakeholders such as PNM, Perbarindo and BPD. The provisional time frame for implementing the draft work plan is June 2005.



### **3.4. The Equity Capital and Shareholder Issue:**

Recently a number of options have been discussed and defended in view of the adequate set up of a BPR APEX institution regarding the regulatory environment and preconditions as well as the operational requirements of such an institution.

- The pooling fund model of Central Java, Surabaya and Bali: it consists of a voluntary model whereby members place a prescribed contribution (based on asset size) with another bank, and that bank lends to those members that have a liquidity mismatch.
- LDA BPR Pt Permodalan Nasional Madani
- Fund Manager Institution / APEX Investment Manager
- BPR Leader
- APEX Unit in Commercial Bank / APEX Commercial Bank
- APEX as bank services unit

Discussions as to outreach range from national to regional to local.

Various options have also been thrown into the discussion arena in terms of a gradual or step by step approaches, either from a pooling fund solution to an APEX Unit in Commercial bank, or from Apex Unit to MSME Centre.

The multiple options discussed over time reflect the diversity of the focus of a possible APEX institution. It has been made clear that if the focus is only and exclusively on pooling of funds, this may be done by a fund manager of whatsoever kind on contract / commission base. It need not be a bank. It would rather operate like an exchange platform. However more detailed research and proof needs to be made available regarding the volumes and demand and supply side as well as the commercial environment for such business. Also the issue of attractiveness for larger and stronger BPRs to participate in such a scheme, as well as questions relating to collaterals are still open ends.

If the focus is on capacity building only, an adequate (CERTIF) structure is currently being put in place. If the focus is on MSME promotion, BPRs need further support in developing adequate products and market oriented services including linkages to business development service providers.

It is believed that further concepts should reconsider the principle of form following functions. Based upon research for this study, experiences in Ghana and good international practice, it is strongly recommended to stratify further feasibility studies towards setting up the BPR APEX institution as a national (commercial) bank, i.e. NOT as a unit within a commercial bank and NOT as an entity which opts for converting into an MSME finance centre and NOT as fund manager which might commute into another operational form at a later stage.

Any approach which includes the transition through different institutional set - ups is promising to be very difficult and costly, in terms of legal and constitutional aspects, management and staffing, as well as regarding ownership and business focus. Transitional models include the danger that changes in focus are built in from the beginning. A gradual approach is not considered an adequate basis and design as part of a strategic banking architecture development approach.

In our view anything but a formal (commercially run APEX) bank is also not adequately placed within the whole financial sector to promote rural banking and interlink BPRs with all other players. Only a bank can offer a fully fledged range of products such as payment systems, treasury operations and others.

It is also recommended that the BPR APEX Institution should be owned by the BPRs themselves. If a full ownership / share investment is not possible for all BPRs from day 1, a gradual buy in – concept could be developed and promoted by BI.

As for the equity capital requirements, the Banking Law provides for the required indicators. However further market investigation would be required in terms of a proper definition of the overall capitalization needs, the expected volume of operations and inherent risks involved. BI blanket guarantees maintained for BPR APEX shareholders (on exclusive basis?) could represent a very important promotional step and incentive for the establishment of the APEX institution.

### **3.5. The Ownership and Governance Issue:**

It is recommended that the BPR APEX body should be a fully licensed bank so that it can proficiently play the role of a mini central bank, including access to the capital market, to become full member of the national payment (and clearing) system, to issue cheques and other modes of payments, etc.

It is not recommendable to opt for a divestiture in stages.

Of course another option could be to get IFC / KfW or alike buy into the model and gradually (5- 10 years) sell their shares to the BPRs. I also suggest that the full capital equity should be sought for from day 1 in order to generate an excellent standing towards and recognition by the established banking community in the country.

### **3.6 The Pooling of Funds and the Linkages Issues**

Much has been said before on the issue of liquidity management and pooling of funds within the BPR sector as well as linkages between commercial financial institutions and the BPR sector.

It appears that there are severe underlying problems in terms of portfolio quality and loan delinquency and liquidity management capacities in the BPRs.

If less than 40 % BPR sector placements with commercial banks (2002: projected RP 1.6 trillions) are recycled back to BPRs in the form of loans or overdraft facilities (RP 600 bn), then this severely constrains BPR sector growth and profitability and the sector to provide funding to the real MSME sector. Discussions with stakeholders revealed that there is currently a net transfer from BPRs to CBs.

A pure liquidity facility provided on a secured basis (collaterals) may not always be a sufficient answer to problems relating to capitalization, training needs, even the need to improve governance structures.

The fact that about 1/3 of BPRs appear to have found their own solutions to liquidity problems may be an indicator that the problem is not liquidity alone but merely consists of structural gaps or strengths within the institutions.

It is believed that a thorough and reinforced inspection and adequate follow up and a systematic industry wide evaluation can identify the major problems or needs.

However it is also believed that a strait promotion of a linkage programme fostering intra - bank (subsidized?) funds transfers to BPRs can create additional problems to an already high NPL portfolio situation in many BPRs. On the other hand existing linkages focus on the stronger BPRs – upon their own initiatives. A linkage programme therefore appears to have a wider political, MSME promotion character which does not necessarily follow commercial implementation patterns.

Indonesia does have a functioning institutional set up for MSME promotion. Therefore and for the time being, linkages could be thought of in terms of coordination between these bodies, BPRs and regional development institutions.

Altogether it goes without any doubt that there do exist and persist liquidity problems among BPRs due to asset and liability mismatch, short time gaps, non - performance of loans, undercapitalization, etc.

Liquidity management in the form of emergency support, credit lines or any other form can be provided by a BPR APEX institution for its member clients at remarkably lower cost than any commercial bank could do it which would always

price the full risk factor. Therefore unlike in Ghana, a proposed BPR APEX institution may consider liquidity management and intra BPR pooling of funds as one of its first and core product, including issues as credit guarantee facilities, collateral substitutes, factoring etc.

It has therefore been noted with satisfaction that during the course of this study, BI has installed a competent working group to further investigate and clarify the discussion and the scope of business about pooling of funds.

### **3.7. The Clearing House Issue**

The clearing house function has earning potential in commissions charged per transaction and the float that is created.

Of course there are no figures on hand yet as to the volumes and number of transactions that can be expected to be channeled through the APEX Institution. However examples such as the case of Ghana as well as the number of customers in the system can form a base for a rough target group assessment. This needs to be quantified, as to come to any meaningful figures.

A detailed cost benefit analysis of an APEX Institution needs to be done once conclusions have been drawn and decisions taken on legal form and set-up of the APEX Institution as to get a clearer picture of the length of period the APEX Institution will need to reach break even. This will determine the time frame and scope of support the APEX Institution will need in terms of financial as well as technical support.

### **3.8. The Market, Competition and related Product Development Issue:**

BPRs throughout the country operate in a competitive environment of financial services with a very high density of providers in the densest populated parts of Java.

The larger BPRs are associated in regional networks respectively have cross ownership. They have established links with commercial banks.

Generally over - liquidity of a financial institution can be perceived as an indicator for inefficient or ineffective lending operations and / or inadequate products or a lack of sufficient market outreach. In the rarest cases it indicates lack of markets. Rather it hints to a capacity gap within the institution in terms of market development, product development and competent risk assessment.

The point was made during this field study that should the BPRs reduce their deposits with commercial banks by 60 %, the cost of their external funding would reduce from 13,4 % to 10,7 %.

A stress test of BPRs has clarified that about 50 % of them are in distress and that the rate of non performing loans (NPL) is up to 40 %.

Across the regions the BPR business of savings, term deposits and loans shows a great variance : for the loan accounts (savings accounts) from -35,1 % (-32,7 %) in the Aceh province to +68,2 % (50,2 %) in North Sumatra; for term deposits there are very impressive increases of up to 101 % (South Sulawesi) but also declines of for example -9,2 % (Western Java).

It is recommended that BI further investigates the BPR market development in terms of number of customers and volumes of transactions for the main savings, deposits and loan products, according to geographical / regional clusters and ownership structures. This will lead to a clearer picture of the frequently cited over liquidity and at the same time the potentials and deficiencies of their lending operations. A combination with available data on the quality of the respective loan portfolio will generate a risk classification required for assessing the business opportunities of pooling funds within the BPR industry.

This will lead to a clearer picture of the frequently cited over liquidity and at the same time the growth potentials (and weaknesses) of their lending operations. Such a combination with available data on the quality of the respective loan portfolio will generate a risk classification required for assessing the business opportunities of pooling funds within the BPR industry.

It is also recommended that prior to any (politically motivated and centrally initiated) concept for expansion of the BPR lending operations to the real sector, a strong industry sanitation exercise should be initiated by the regulator (BI) and implemented by the industry support agencies (Perbarindo, CERTIF, etc.). As soon as the APEX institution is in place, this role falls under its core functions.

Linkage banking if perceived as an instated mechanism of scaling down funds from (state owned?) commercial banks to BPRs for onlending to the real sector may overwhelm the individual BPR and the attempt to improve the soundness of the industry.

Pooling of funds, considered as another liquidity management tool, can of course only be run efficiently on the basis of a function market place, which is supposed to be the APEX institution, which by economies of scale, can gain a much higher bargaining power and reduce costs per transaction in terms of time and money.

Earlier considerations that the APEX bank may become a competitor of the BPRs, should be taken seriously in order to avoid this situation. The lines must be drawn clearly as to prevent the APEX bank of interfering into the retail market of the BPRs.

It is recommended that a product development and marketing team be set up for the APEX institution in order to clearly define and document the various lines of business, their competitive environment and their respective comparative advantage for all categories of BPRs.

Research carried out by this precursor of the future product development and marketing team of the APEX institution should also look into the issue of payment systems as this is not yet part of the BPR portfolio at all. However both domestic payment transaction as well as international remittances should form an increasing source of fee and commission income of the BPRs in the future.

### **3.9 The Sustainability Issue**

A cost benefit analysis for the creation of an APEX Institution for the BPR sector is another task / activity to be included into the work plan 2005. It should consider (among others) the following analysis and documentations:

- Equity per BPR
- Locations / Premises
- Organizational set-up

It is recommended that for the time being, the supervision and rating functions as such will have to be performed by Bank Indonesia, where it is performed today, with a gradually growing involvement of the APEX Institution over time (3 – 4 years after establishment) in the area of inspection, given the magnitude and novelty of approach to this task.

The APEX Institution's supporting inspection function, feeding into Bank Indonesia's primary supervision responsibility, should soon get a go ahead for developing guidelines and rules for the improvement and reinforcement of the following up on recommendations and instructions given by the respective BPR

inspection teams for the improvement of the individual BPR business in terms of the BPRs asset quality, bad-loan portfolio and its provisioning and the handling of short term loan arrears, as these are problem areas leading to the current bad ratings of the BPRs.

## Part V



## 1. Summary of Conclusions and Recommendations

- The creation of a BPR APEX Institution is feasible and necessary.
- The APEX institution must be a bank with branches.
- Initial Governmental and donor technical and financial support is needed (provision of capital, restructuring and start-up costs for the APEX bank as well as a reviewed deposit / credit insurance scheme)
- Not all BPRs may be able to pay the full costs of APEX services needed. Therefore external technical assistance and a thorough fading out scenario planning will be crucial for the success of the BPR APEX bank.

Financial support through a long-term concessional loan (without foreign exchange risk) is needed as to enhance the process of capitalization, growth and stability of the APEX bank and is therefore a vital contribution to the success of the APEX bank.

The amount must be determined by the assessment of the growth and development potential of the BPR-sector in the next few years, but should not be too large as this may encourage unhealthy growth given the concessional level of the cost of funds of such loans.

## 2. The Next Steps

As a result of an enquiry conducted in early 2004, a quantitative and qualitative majority of the BPRs appeared to support the creation of a BPR APEX institution and were in principle prepared to:

- Initially subscribe to at least one share (or, if the law has not been changed, grant a subordinated loan) of / to the APEX Institution and agree to the goal that the APEX Institution should eventually be majority owned by the BPRs.
- Channel their excess liquidity to the APEX Institution
- Pay in full for all training, consultancy and IT-support etc. received from the APEX Institution
- Maintain a clearing account with the APEX Institution and channel all clearing payments through this account
- Agree that 1/3 to 1/2 of all cost of fund reductions offered by the APEX institution - in comparison to the established baseline of the respective BPR - be paid into their equity / subordinated loan account with the APEX Institution.

The study suggested that after carrying out an industry wide awareness and promotion campaign, such a consensus may be laid down in a "Letter of Intent" or "Letter of Understanding" offered to be signed by all BPRs as a sign of their support.

The agreement of at least 75% - 80% of all BPRs representing 80% - 90% of the paid - in capital of the whole BPR sector should be targeted, as the "buy-in" of the BPRs into the APEX concept is of utmost importance for the success of the APEX institution in terms of achieving maximum economies of scale and outreach as well as benefit for the individual BPRs.

Generally speaking, those next steps may be agreeable although it may be reiterated here that it is perceived as a conflictual approach to impose a defined "Must Do" subscription methodology. However there appear to good chances that a joint effort of Bi together with Perbarindo may achieve a high BPR APEX concept penetration rate among industry members.

## **2.1. The Need for a Detailed Feasibility Study and a Business Plan**

The preparatory stage:

Bank of Indonesia should carry out a comprehensive quantitative and qualitative assessment of all relevant data on the industry. Sufficient data from various sources are available on hand, as to get a picture of the volumes and quantities involved with respect to the aforementioned functions of the APEX Institution. Plausibility checks and occasional random reality checks should be included as a matter of validation of current prudential inspection and supervision practice.

- Look into the legal framework needed for the BPR-sector as to weld and consolidate the BPR-sector together and set the framework of co-operation with the APEX Institution. A legal consultation should provide responses to the following issues:
- Project the growth potential of the BPR-sector under the assumption of more and cheaper funds made available and the positive effects, constraints and possible negative effects this may have on the BPR-sector, thus identifying the limits of growth for the BPR-sector as per now.
- Establish a cost benefit analysis on the basis of a business plan for the first five years of operation and make a projection on the time frame needed for the APEX Institution to break even.

- Make suggestions for the legal form,
- location and initial organizational set-up of the APEX Institution and make projections as to the creation of the branch network, outlining principles for the assessment of priorities.
- Make suggestions as to the supervision function and the role of the APEX Institution in co-operation with Bank Indonesia.
- Make suggestions on a fair and transparent process to assess the reductions of the cost of funds charged by the APEX Institution to the individual BPR, based on progress of soundness and efficiency of the respective BPR.
- Make suggestions on how to outsource training, consultancy and IT-support appropriately, whereby the APEX Institution is responsible for the quality, price and timely delivery of these services to its members/shareholders.
- Evaluate the efficiency potential of a unified IT-supported, improved accounting system and an IT-based information system for the BPR- Sector, thus enhancing the transparency and improving the level of market and client information available to the BPRs.
- Make suggestions on the initial ownership structure of the APEX Institution including the question of voting rights and seats on the Board of the APEX Institution, and set a time framework for the gradual increase of the equity/shareholding of the BPRs from minority shareholder to majority shareholder of the APEX Institution. Models as to the development over time, of the voting rights and the representation of the BPRs on the Board should be developed in line with the increased share of the BPRs in the equity of the APEX Institution.
- Make suggestions on how to take the growing Syariah banking market of the BPRs into account and cater for their needs.
- 
- Make suggestions for a professional project management for the implementation phase of the APEX Institution, should the study come to the definite conclusion that the creation of an APEX Institution is feasible.

## **2.2 Full Feasibility Study Needed**

A Feasibility Study must be undertaken to come to final conclusions, but it is advised to get the moral buy-in of the BPR-sector through a "Letter of

Intent/Understanding", as to be sure of the total support of the BPRs for this project.

### **2.3 BPRs as Majority Shareholders over Time**

Build up of capital by apportioning 1/3/ to 1/2 of the interest rate reductions enjoyed by a BPR to its capital/equity account with the APEX bank, thus increasing the capital base of the APEX bank and at the same time increasing the relative equity share of the BPRs in the APEX bank.

### **2.4 The Supervision Function Needs External Support**

The supervision and rating function has to be "outsourced" given the magnitude of the task, its importance and the limited resources available. But the APEX bank must get involved in the supervision function by developing tools and early warning signs to monitor the soundness of the BPRs more intensively. At the same time the APEX bank gets a better insight into their members/shareholders. Once the APEX bank is fully established with a branch network etc., the inspection function may be gradually "in-sourced" into the APEX Bank. It must be mandatory for all BPRs to be submitted to supervision inspection and rating.

### **2.5 Rating Function should not be Undertaken by the APEX Bank itself.**

The actual rating of the BPRs and the APEX bank itself has to be done by an independent and credible institution. The rating has great influence on the reduction of the rates of interest offered to the individual BPR of course and must therefore be kept at arms length as to be accepted by the market.

### **2.6 Training and Consultancy is Key to Improvement of Soundness and Efficiency of BPR-Sector.**

Quick build up of a network of consultants that can deliver the Training and Consultancy in terms of quality and quantity needed to uplift the skills level of staff and management of the BPRs, whereby the BPR APEX bank must take an active role by acquiring the training and consultancy needed, by advising the BPRs accordingly and by being accountable for the quality of the Training and Consultancy outsourced. Success in this area will contribute to an increase in

soundness and efficiency of the BPRs thus leading to reduced cost of funds for the respective BPR and therefore motivating them to embrace the training and consultancy needed.

# ANNEX 1

## BPR Market Enquiry (February 2004)<sup>1</sup>:

### Question 1:

Describe your largest bottlenecks for a sound and profitable development of your institution. Please first name the most important bottlenecks.

### Answer abstract:

- Getting funds from third parties at reasonable rates
  - Training/Consulting to improve staff quality as well as management skills
- 

### Question 2:

Can an APEX Institution be of help to solve the above bottleneck through:

- Services :
  - Supervision
  - Training/Consulting
  - Liquidity management/ Pooling of funds
  - Clearing Bank function for the Group
  - Center of Information
  - Increase bargaining power of the Group
  - IT support
  - Rating of Member banks (to be outsourced to an independent and credible institution)
- Business Partner of BPRs:
  - Product provider: international business, leasing, factoring etc.
  - Risk sharing/ Consortium loans
  - Wholesale banking activities

### Answer abstract:

- Services only, as listed above, for the time being
- 

---

<sup>1</sup> Wend land, (2004)

**Question 3:**

What would you be prepared to pay for the services?

- 
- as % of your paid-in capital
- full costs
- partial cost coverage only

**Answer abstract:**

- Membership fee
  - Pay full costs for services used/needed
- 

**Question 4:**

What legal form should the APEX Institution take and shall it have branches?

- Can the BPRs subscribe to the capital of APEX (change of law needed) and how would they finance their subscription?
- Are there other forms of giving the BPRs a substantial share in the equity of the APEX Institution?

**Answer abstract:**

- Legal form remained open and needs to be further studied from a legal point of view (non-banking financial institution, fully licensed bank and PT, were mentioned as examples).
  - National Institution with branches, where needed
- 

**Question 5:**

Who should own the APEX Institution?

**Answer abstract:**

Ultimately the APEX Institution must be owned by **all** BPRs but for the time being (because i.e. legal restrictions), PNM should be the joint venture partner.

## ANNEX 2

### Bibliography

**Addo, Richard M.**, Report on Training Activities, Paper presented at the 3<sup>rd</sup> Managers' Conference of the ARB APEX Bank and the Rural and Community Banks, Kumasi / Ghana, April 2004

**Addo, Richard M.**, Innovative approaches to rural financial services provision with emphasis on small holders, Paper presented at the 2<sup>nd</sup> Sub regional AFRACA workshop, Freetown/Sierra Leone, November 2003

**ARB APEX Bank Ltd.**, Annual Reports 2001 – 02, 2003,

**ARB APEX Bank Ltd.**, Training Programme 2004

**ARB APEX Bank Ltd.**, Business Plan 2002 – 2005

**Bank Indonesia**, Short Summary Paper on Research Study carried out by LPPM and INDEF, January 2005

Bank Indonesia, The Indonesian Banking Architecture – Vision for the Indonesian banking System, 2004

**Bank Indonesia, Directorate of Legal Affairs**, Act No. 7 of 1992 concerning Banking as amended by Act No. 10 of 1998

**Bank Indonesia, Legal Department**, Act No. 23 of 1999 concerning Bank Indonesia

**Bank Indonesia, Directorate of Rural Bank Supervision**, The Indonesian Rural Banks, 2004

**Bank of Ghana Law**, 2002

**Charitonenko, Stephanie, and Afwan, Ismah**, Commercialisation of Micro Finance, The Case of Indonesia, Asian Development Bank, November 2003

**Duffu, Sam**, Keynote address to the 3<sup>rd</sup> Managers' Conference of the ARB APEX Bank and the Rural and Community Banks, Kumasi / Ghana, April 2004

**Government of Ghana, Banking Act**, No. xx, 2004



**GTZ ProFi**, Project Progress Report, 1994

**Holloh, Detlev, Dr.**, ProFI Microfinance Institutions Study, 2001

**INDEF**, Pengkajian Lembaga APEX bagi BPR, Presentation for BI Focus Group Discussion, January 2005

**Kwapong, Emmanuel K.**, Roles and function of the ARB APEX Bank Ltd. as change agent for the rural banking industry, Paper presented at the 2<sup>nd</sup> Managers' Conference of the ARB APEX Bank and the Rural and Community Banks, Sunyani / Ghana, August 2003

**Levy, Fred D.**, APEX institutions in Micro Finance, CGAP Occasional Paper No. 6 (no year)

**LPPM**, Penelitian Lembaga APEX Bagi BPR, Presentation for BI Focus Group Discussion, January 2005

**Pinkrah, Charles**, Update on the activities of the Information and Communications technology for the ARB APEX Bank and the Rural Banks in Ghana, Paper presented at the 3<sup>rd</sup> Managers' Conference of the ARB APEX Bank and the Rural and Community Banks, Kumasi / Ghana, April 2004

**Prins, H.**, First draft concept for an APEX bank for the NPRs in Indonesia, GTZ ProFI, November 2001

**Prins, H.**, Comment on BPR Pooling Funds, GTZ ProFI, July 2001

**Prins, H.**, Notes for a meeting with PNM on the issue of the establishment of a BPR APEX institution, GTZ ProFI, November 2003

**Prins, H.**, BPR Blueprint –from a mainly regulatory perspective, GTZ ProFI Discussion Paper, November 2003  
between M

**Sarpong, Yaw E.**, Operational activities of the Banking and Treasury Department of the ARB APEX Bank Ltd., Paper presented at the 2<sup>nd</sup> Managers' Conference of the ARB APEX Bank and the Rural and Community Banks, Sunyani / Ghana, August 2003

**Steinwand, Dirk**, The alchemy of micro finance – the evolution o the Indonesian people's credit banks (BPR) from 19895 to 1999 and a contemporary analysis, 2001

**Wendland, Clemens B.**, Pre Feasibility Study for the establishment of a micro finance APEX institution in Indonesia, Report on findings of a short mission to Indonesia, 2004

**World Bank**, Rural Financial Services Project (RFSP), Project Appraisal Document (PAD), 2001