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DCA LOAN GUARANTEE INDONESIA IMPACT BRIEF

ON THE COVER: Auto Tire Store (one of the borrower under the DCA Guarantee), Other sectors under the DCA Guarantee: Agriculture and Retail. Photos: USAID/Indonesia



BACKGROUND

On December 26, 2004, an earthquake and tsunami struck off the western coast of Sumatra, Indonesia.

This tsunami and another in March 2005 caused massive flooding in the coastal areas of Aceh and North Sumatra Provinces, with an estimated 134,000

deaths and losses of almost \$5 billion, about 97 percent of Aceh's GDP. Thousands of micro- and small enterprises (MSEs) were destroyed or damaged. Prior to the disaster, microfinance institutions were virtually absent in Aceh Province as a result of three decades of civil conflict. After the tsunami, the demand for microfinance was high.

On September 26, 2005, as part of the U.S. Government's "Indian Ocean Tsunami Relief, Rehabilitation and Reconstruction" initiative, and in response to a request from USAID/Indonesia's Economic Growth Office, USAID established a seven-year loan portfolio guarantee with Bank Danamon, aimed primarily at increasing lending to MSEs affected by the tsunami in Aceh and North Sumatra.

USAID/Indonesia also used the guarantee to help mobilize microfinance nationwide to support its Strategic Objective, "Economic Growth Strengthened and Employment Created." Bank Danamon was Indonesia's fifth largest bank, and the first private commercial lender to enter the microfinance arena. The bank's microfinance arm, Danamon Simpan Pinjam (DSP), had been lending to MSE traders and small-scale service providers since March 2004 and had had a modest operation in Aceh and North Sumatra prior to the tsunami. DSP was the first

commercial lender to resume lending in Aceh after the tsunami.

USAID and DSP had three objectives for the guarantee: (1) to resume microfinance lending in Aceh and North Sumatra (USAID's primary objective); (2) to facilitate DSP's entry into new sectors and lending to new types of clients, such as farmers and fishermen; and (3) to facilitate DSP's nationwide expansion in microfinance. A key provision of the guarantee required DSP to provide at least 40 percent of all guaranteed loans in Aceh and North Sumatra (and later Yogyakarta).

EVALUATION OBJECTIVES

In April 2009, USAID's Office of Development Credit (EGAT/DC), commissioned an evaluation of the guarantee to determine its outputs, outcomes, and impacts. Outputs of the guarantee were defined as additionality of loans disbursed, especially in Aceh, North Sumatra, and Yogyakarta. Outcomes are changes in DSP's lending behavior outside, but attributable to, the guarantee. Impact is the demonstration effect of DSP's lending experience under the guarantee on the behavior of other lenders in the MSE market. The evaluation also assessed the influence of exogenous factors. The evaluation focused only on the behavior of lenders in providing loans to SMEs, especially in the target areas. It did not address changes in loan terms, impacts on borrowers, or USAID's management of the guarantee.

EVALUATION METHODOLOGY

The evaluation used a mixture of quantitative and qualitative data collection and analysis methods. The team reviewed background documents and data from USAID, DSP, and other sources; conducted a two-week field visit to Indonesia; and interviewed DSP managers in Jakarta and Banda Aceh, USAID officials, key informants from the banking and microfinance sectors, and a small sample of DSP borrowers.

Starting & Ending Dates	Maximum Cumulative Disbursements	USAID Guarantee Percentage	Guarantee Ceiling	Total Number of Loans	Number of Loans for Aceh, N. Sumatra & Yogyakarta	Total Cumulative Utilization	Cumulative Utilization for Aceh, N. Sumatra & Yogyakarta
9/2005 – 9/2012	\$16,400,000	50%	\$4,100,000	9,348	4,805 (51.4%)	\$16,288,539 (99.3%)	\$8,368,395 (51.4%)



Data limitations, which significantly constrained the team’s ability to create credible findings and conclusions, included: (1) DSP officials did not provide the data needed to answer several key evaluation questions; (2) In 2007, there was a huge exodus of senior DSP managers and staff to a competitor bank and the DSP officials with whom the team met were unable to answer many of our questions about the period during which most of the loans under the guarantee had been made. Former staff was unwilling to speak with the team. (3) Few key informants were aware of the DCA guarantee.

KEY FINDINGS AND CONCLUSIONS OUTPUTS

Conclusions The guarantee achieved USAID’s primary objective for the guarantee—quick resumption and expansion of lending to MSEs in Aceh. DSP exceeded the requirement that at least 40 percent of all guaranteed loans be provided in Aceh, North Sumatra, and Yogyakarta.

The guarantee may have influenced DSP’s recent expansion into a new sector, agriculture. In addition, during the guarantee period, DSP significantly increased MSE lending nationwide; however, aside from the guarantee’s influence on expansion in Aceh and North Sumatra, the role of the guarantee in that expansion was likely modest

DSP did not use the guarantee in the spirit of typical loan portfolio guarantees, i.e., to target borrowers who might not receive loans without the guarantee. DSP did use the guarantee in a positive way, however, by giving underperforming lending units the opportunity to improve performance and therefore continue to lend to MSEs.

Findings in support of these conclusions include:

- During guarantee discussions with USAID in mid-2005, DSP had already reopened its unit in Aceh. Based on the knowledge that a guarantee was forthcoming, DSP opened two more units prior to executing the guarantee agreement. During the guarantee period, it opened another five units in the area in and around Banda Aceh.
- At the time of the evaluation, these eight units had about \$14.5 million in outstanding loan value and 2,500 borrowers, representing 531-fold and 356-fold increases in outstanding loan value and borrowers over pre-guarantee figures.
- Experts said the guarantee played a significant role in these increases. Former and current USAID staff thought the guarantee influenced increased lending in North Sumatra.
- A total of 4,805 loans under the guarantee (51.4 percent of all guaranteed loans) were made in Aceh, North Sumatra, and Yogyakarta. The value of those loans was \$8.4 million, 51.4 percent of the \$16.3 million total value of guaranteed loans.
- In 2009, DSP included 33 loans in “agriculture, hunting and related services activities.” These loans represent only four tenths of one percent of all guaranteed loans, but this was the first time that DSP had reported lending to this sector.
- Between 2005 and 2007, DSP’s nationwide outstanding loan value increased by 231 percent (from \$332 million to \$1.1 billion) and the number of local units more than doubled.
- The overall number and annual volume of loans placed under the guarantee represented small proportions of DSP’s annual increases in total nationwide lending (e.g., four percent for 2006).
- DSP headquarters managers controlled the process of posting loans to the guarantee, after the loans had already been made at the local level. They identified local units with poor repayment performance and chose loans for placement under the guarantee from the lists of unsecured loans already made in those units.
- Local unit loan officers and managers did not know which loans were placed under guarantee.
- During the guarantee period, DSP policy and the local units’ process of choosing to whom and how loans were made was no different from DSP’s pre-loan practice. DSP units neither targeted nor made loans to riskier-than-normal borrowers. However, USAID’s primary objective for the guarantee was to get more loans to borrowers in the disaster-affected target areas.

- DSP used the guarantee to allow underperforming units more time to correct their lending and repayment practices and avoid suspension of lending authority or dismissal of loan officers and/or managers.

OUTCOMES

Conclusions DSP significantly increased nationwide access to credit among MSEs with loans made *outside* the guarantee, but much of this overall increase is likely more attributable to DSP's aggressive growth strategy and profitability than to the guarantee. However, since the guarantee helped DSP expand lending in Aceh, it stands to reason that the guarantee had a positive impact on increased lending in Aceh outside the guarantee.

Findings to support these conclusions include:

- All but four percent of DSP's increase in nationwide lending since the guarantee was established has occurred through loans not placed under the guarantee. Although the influence of the guarantee on nationwide growth is uncertain, the guarantee helped DSP grow in Aceh.
- When USAID and DSP were discussing a possible guarantee in early 2005, DSP had an aggressive expansion and growth strategy. It planned to increase its outstanding loan value from about \$54 million in 2004 to about \$900 million in 2007. By the end of 2007, DSP's actual outstanding loan value had grown to \$859 million, and by April 2009, it had increased to \$1.1 billion.
- Lending to MSEs has been profitable for DSP. According to DSP's cluster manager for the eight units in and around Banda Aceh, all eight units were profitable as of April 2009. At the same time, DSP's microfinance program accounted for 65 percent of Bank Danamon's total profit from all operations.

IMPACTS

Conclusions DSP's approach to MSE lending has served as a model for some competitor banks, both in Aceh and elsewhere. DSP's phenomenal nationwide growth and profitability have both expanded the market and stirred competition. To the extent that the guarantee has helped DSP expand the use of its successful model in Aceh and possibly elsewhere, the guarantee has played a role in the demonstration effect.

Findings to support these conclusions include:

- Experts in Indonesia described DSP as a pioneer in microfinance among private commercial banks, and its model is being adopted by other banks. As an example, Bank Tabungan Pensiunan Nasional (BTPN), to which former DSP managers and staff moved in mid-2007, is using essentially the same model, in direct competition with DSP. It stands to reason that BTPN's managers benefited from their DSP experience under the guarantee.
- At the time of the evaluation, two international commercial banks, CMB-Niaga and Standard Chartered Bank, were considering entering Indonesia's microfinance market. CMB-Niaga stated that a key factor in its final decision would be DSP's experience and profitability.
- According to an official of Bank Indonesia, DSP "opens people's eyes to the potential for commercial banks in microfinance." DSP's "market-friendly" approach includes aggressive pursuit of clients, daily repayment options for borrowers, and use of information technology to record and monitor transactions on-line.
- DSP's lending model is the same as that being used in a loan guarantee partnership between Bank Indonesia and six state-owned partner banks with linkages to microfinance institutions.

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