

## **Unlocking the Small, Medium Enterprises' Potential to Promote Financial Inclusion and Sustainable Economic Growth**

Chairman of Indonesia Financial Services Authority

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***Excellencies, Distinguished Colleagues, Speakers, Ladies and Gentlemen***

***Good Afternoon.***

1. First of all, I would like to thank The Financial Services Agency of Japan, ADB Institute and International Monetary Fund for inviting me to this international conference. I would also like to express my gratitude to the organizers who have organized this conference excellently.
2. I am very enthusiastic to join all of you in this important event to share, discuss and gather valuable perspectives from all of you on how to accelerate the development of SMEs. We, as the regulator, certainly need some feed backs that will help us to have a comprehensive understanding in constructing essential to support SMEs development. I believe this panel discussion may provide brilliant ideas that might be of use not only to authorities but also to anybody who has interest on this subject.
3. Before I share my view, let me take some time to share with you about Indonesia FSA's journey in the first year of its establishment. Then I will proceed with my views on how to unlock the Micro, Small and Medium Enterprises' potential to promote better financial inclusion and sustainable economic growth.

***Distinguished panelist and participants,***

4. It has been a year that the Indonesia FSA, or as we call it “OJK”, --with its two mandate of supervising financial sector and providing financial literacy and customer protection-- came into operation. Dec 31, 2012 will be marked as the new era of Indonesian financial system with the handover of capital market and non-bank financial institutions supervision to OJK. It was a smooth transition, without any unexpected reaction from the market.
5. From then on we gather ourselves on building foundation for conducting an integrated supervision. It is not easy, undoubtedly. First step we need to harmonize regulations between sectors in financial industry and set a common standard, based on risk assessment. OJK will enhance the implementation of risk based supervision on all sectors in the industry. The concept of integrated supervision will be implemented gradually in line with the aspirations and preparedness of the industry.
6. Meanwhile, we keep on augmenting the supervisory function on each sector in the industry. In the the capital market, we focus on providing regulatory environment which supports the strengthening and development of capital market that meets international standards. As an emerging market, it is really important to have a strong and sound capital market that can work as an alternative to bank finance, especially for long term investment and infrastructure project.
7. We need to speed up the development of our capital market, both equity and debt markets, including the possibility of small investor and medium enterprises to utilize the market. Major initiatives have been taken in developing our capital market; among others are simplifying public offering procedures, deepening the stock market, providing investor protection fund and developing bonds market. We also have just published the roadmap

entitled "Governance Roadmap for Companies in Indonesia: Towards Better Governance of Securities Issuers and Public Companies" which will serve as role model of governance practice for all companies in Indonesia.

8. Other than capital market, we also put priority on developing the non-bank financial industry in order to lessen the burden of financing bear by banks. Not only that, increasing financial-literate middle income people is in line with higher demand for more financial services such as insurance and pension fund. We cannot be behind the curve. Our young and productive people will turn into ageing societies that might pose social problems in the future. The financial industry would be foolhardy to ignore this fact.
9. Some major initiatives, among others, are creating the Grand Strategy for Micro Insurance, optimizing insurance and reinsurance capacity, establishing the Agency for insurance rating and statistics, and increasing the number of actuaries in the insurance and pension fund sectors. OJK have also started the preparation on regulating and supervising Microfinance Institutions that we will commence in 2015. In this regards, we have built a good cooperation with local government throughout the country.
10. For expanding the contribution of financial service will not be optimal without greater consumer inclusion, amidst imbalance bargaining position between customer and financial institution, the role of consumer education and protection is justified to resolve the problem of asymmetric information. The goal is not only to increase the financial literacy, but to enhance their financial capability. In this context, OJK has provided a Financial Customer Care, as a medium of access to information and dispute resolution between customer and financial institution. This is done comprehensively under the Blueprint of the National Financial Literacy Strategy that we have just launched in November 2013.

11. While keeping everything intact, at the same time we also prepared the transition of bank supervision, the dominance sector in Indonesia financial system. It is our goal that the transition process takes place smoothly without causing any undesirable impact to the system stability. In doing so, we did exhaustive and thorough preparations in conjunction with Bank Indonesia.
12. It was a busy year indeed. So many things to do. We were swamped with works and hardly had time for ourselves. However, this hard work pays its price. The handover of banking regulation and supervision from the central bank by the end of 2013 runs smoothly. Banks' business runs unaffected and customers continue to enjoy banking services. To keep orderly functioning banking system, at initial phase, we will maintain the same regulatory regime as before unless new facts or certain financial market development drives the need for adjustment.
13. Accordingly, approximately 1,200 supervisors from the central bank have been assigned to work with the Indonesia FSA, and simultaneously, 35 offices throughout Indonesia have started to operate that will play vital role as front line for financial literacy and access to finance programs. Most of these offices are still located in the central bank's premises. The Indonesia FSA and the central bank established excellent cooperation regarding the transfer of human resources, documents, data, and information systems.
14. I am glad that the establishment of IFSA got so many supports. Not only from domestic, but also from international community. JFSA is one among others. Therefore, I would like to thank Commissioner Hatanaka and JFSA for their kind assistance we have received along the year.
15. Another good news is, just last week the Indonesia FSA became the 100th signatory to the IOSCO Multilateral Memorandum of Understanding on cooperation and exchange information to combat cross-border financial

services misconduct. So much has been done. Now let me move to my second topic.

***Distinguished panelist and participants,***

16. Let me start by quoting Altijana Dzombic, a small business owner in Sarajevo, benefiter of the World Bank's Enhancing SME Access to Financing Project.

*"Production is the future for any country. We need a balance between imports and exports. For 15 years we imported everything...now people have started making [their own goods]"*

17. I could not disagree with her testimony. I personally believe that enhancing Small and Medium Enterprises (SMEs) is far beyond poverty alleviation as lots of people might think so. For most developing countries, SMEs are the backbone of the development and quiet often acted as a shock absorber as proven through many crises we have been dealing. Even G-20 leaders pay their attention on the critical importance of job creation in the recovery cycle following the recent financial crisis through the promotion of SME development. Clearly, SMEs is not only a developing countries phenomenon.
18. I would like to highlight the important role of SMEs in economic development. SMEs contribute up to 45 percent of employment and up to 33 percent of GDP in developing economies; these numbers are significantly higher when taking into account the estimated contributions of SMEs operating in the informal sector.<sup>1</sup> In Indonesia, this number is even higher.
19. Taking a closer look at the SMEs, no one argues that access to finance is a key determinant for business start-up, development and growth for small and

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<sup>1</sup> Scaling-Up SME Access to Financial Services in the Developing World, Financial Inclusion Experts Group, SME Finance Sub-Group –IFC, October 2010

medium sized enterprises (SMEs). However, SMEs have very different needs and face different challenges with regard to financing compared to the larger businesses. The large businesses have an option to utilize capital markets, which is unfortunately not the case for the vast majority of small businesses. Thus SMEs has to rely merely on bank lending and other types of financial products.

20. The current economic environment has brought SME needs into particular focus. Given the significantly tightened credit supply conditions arising from the reduced ability and willingness of banks to provide the financing on which this sector is particularly reliant, SMEs certainly needs alternative source of financing.
21. Despite the fact that promoting SME development is an important priority, most of countries face almost the same challenges. Yet, with different magnitude depends on the size of the business. According to IFC report, the likelihood of a small firm having access to a bank loan is about a third of what it is for a medium-sized firm, and less than half of what it is for a larger firm. Meanwhile, other sources of finance are still lacking.
22. Many measures are taken to open access to finance for small and medium-sized enterprises, however, many of these measures are unsuccessful at addressing market failures. Margaret Hodge, who chairs The Commons Public Accounts Committee in UK once said “Small and medium-sized enterprises have a vital role to play in driving the UK’s economic recovery, but despite government attempts to encourage lending to SMEs many still struggle to access the finance they need”.
23. It is important to keep in mind that SME development projects are not a charity. It is true that that it will help to alleviate poverty. But, it does not mean when they have been taken out from poverty, then it is the end of SMEs.

SMEs will always be there. When the small business grows and becomes medium or even large enterprises, there will always be a new small business entering the market.

24. With that chain of thought, we cannot just provide these SMEs with a one-time-aid project. We need to construct a generic business model that can be used to provide SMEs an everlasting access to finance. It is well known that access to finance is the key. Then, we just simply need to focus on how to tackle this issue. It is sound familiar. But, it is really easier said than done.

***Distinguished panelist and participants, ladies and gentleman,***

25. So, what are we going to do to boost up the development of SMEs? Let me echo what IFC has proposed. There are 3 other important aspect beside access to finance that will determine SMEs development.
26. First, a conducive business environment as the foundation to support SMEs. It needs regulation to provide favorable investment climate, i.e., simplify start up procedures and provision of tax incentives. Solving the regulatory problem is the entry point of SME development.
27. Second, limited management and operational capacity. We need to focus on capacity building of SMEs through some training programs, including financial and marketing aspects and also easy access to information. We have to collaborate with other stakeholders such us government, the central bank and educational institutions to roll-out capacity building initiatives to enhance SME competitiveness.
28. Third, creating linkages between SMEs and large businesses, that can secure the sustainability of SMEs line of production. This linkage program proved to be very substantial in building managerial and operational capacity

29. The final building block, which is the paramount of importance, is access to finance. This is a serious challenge for many SMEs that need affordable and tailored credit and investment. We need to think out of the box. We need a breakthrough.
30. The problem of access for SMEs comes from both demand and supply. From demand side, most of SMEs do not have proper financial report. This lacking has consequences. It is hard for financial institution to make assessment on their financial conditions. It is even more so for weighing their business prospect or their future cash flow. In this context, financial education finds its ground to step in. Relevant authorities in Indonesia are working hand-in-hand to tackle these issues, and most often also involving financial industries. We launch a counselling program in making simple financial report to SMEs. To financial institution, we have to make them perceptive not to count it as liabilities. In fact, when SMEs become bankable, it means more business opportunities. The business of SMEs is very prospective. They even dare to lend from loan-shark, not just because they do not have access to formal lending but mostly because they are able to pay the interest.
31. Education can also help SMEs to get acquaintance with financial services. Yes, they may have known what bank is. But, they do not know how it works, how to get credit, what are the requirements needed etc. Our survey found that even 57% respondent use banking services, only 22% understand about the products. For other than bank, less than 20% understand the product and the utilization is far smaller. For example, only 2.3% knows capital markets products and services, and the usage only 0.1%.
32. But survey says that quite significant proportion of SMEs or people do not understand what services are to offer by banks or financial institutions.

33. From supply side, financial institutions are bounded by strict regulation that they have to follow. While formal paperwork issues can be diluted by education program as I mentioned before, the problem of collateral still exist. I can share with you an interesting experience in Indonesia. To tackle the issue of lacking collateral, some of the provincial/local administrations certified people's assets, or more accurately, people's belonging. They certified bicycles, home appliances, or even livestock. Then, they can use it as collateral to get credit. In other places, the local governments provide a guarantee scheme by establishing Regional Credit Guarantee Institutions, so the risk premium can be brought down.
34. Furthermore, we have done a pilot project of extending the traditional APEX bank in East Java Province. In addition to guarantee scheme, we include the inclusion of payment system, namely for making transfer for rural bank customer possible through APEX bank. This pilot project is going quite well and now we are ready to expand the program to other regions.

### **Distinguished participants, Ladies and Gentlemen**

35. I am not suggesting relaxation of regulation nor direct incentives without hard justification. The development of SMEs must have business rationale. We need not create any moral hazard. Incentives must be given through market mechanism. Most importantly, even there is a generic business model; every country has to find a specific way that matches their social/cultural surroundings.
36. In Indonesia, several banks have pioneered in financing SMEs. I notice that these businesses are going very well as now more and more banks are keen to enter SMEs financing. This is the proof that SMEs business is promising.

37. Before I conclude my speech, I would like convey my greatest believe that East Asia should be the leader in finding sustainable SMEs programs since almost half of SMEs in the world are in East Asia. We need to create more and more initiatives to make them grow. It is not for their sake only. We all are in the need of sound and functioning SMEs to provide job, to preserve financial system, and macroeconomic stability, and to guarantee a balance and sustainable growth. Thank you.

**Muliaman D. Hadad**

Chairman

The Indonesia Financial Services Authority