Financing SMEs: Sharing Ideas for Effective Policies

Capacity Building and Training Workshop

Jakarta, Indonesia, 15-16 October 2014

BANK INDONESIA

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The Workshop Organizer

Bank Indonesia, located in Jakarta, is the central bank of Indonesia. It was founded on 1 July 1953 from the nationalization of ***De Javasche Bank*** (Bank of Java). In its capacity as central bank, Bank Indonesia has one single objective of achieving and maintaining stability of the Rupiah value. In the pursuit of the objective, Bank Indonesia is supported by three pillars, representing its three sectors of task, which are formulating and implementing monetary policy, regulating and ensuring a smooth payment system, and financial system stability. Bank Indonesia's policy in developing SME financing is carried out to support the task of maintaining financial system stability. For more detail, visit **www.bi.go.id**.

Asian Development Bank Institute (ADBI), located in Tokyo, is a subsidiary of the Asian Development Bank. It was established in December 1997 to respond to two needs of developing member economies: identification of effective development strategies and improvement of the capacity for sound development management of agencies and organizations in developing member economies. As a provider of knowledge for development and a training centre, ADBI serves a region stretching from the Caucasus to the Pacific island. For more details, visit **www.adbi.org**.

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Preface

Considering the significant role of Micro, Small, and Medium Enterprises (MSMEs) in the economy, they are then becoming a very strategic global issue, especially for countries in the ASEAN region who are preparing toward the implementation of ASEAN Economic Community (AEC) by the end of 2015. It is an urgency to enhance MSMEs' competitiveness and resilience in order to be the world-class enterprises, capable of integration into the regional as well as global supply chains, able to take advantage of the benefits of AEC, and operate in an environment that is conducive to MSMEs development, exports and innovation.

However, MSMEs have not yet fully developed because of the limitation especially in their access to finance. One of the key factors hindering the MSMEs' financing access is the asymmetric information between financial institutions and MSMEs. This condition has led to a situation where most of MSMEs rely on their own capital, including loans from their families and friends. Bank Indonesia survey on MSMEs profile in 2005 revealed that most MSMEs in Indonesia sees interest rate and collateral as obstacles in accessing finance from formal financial institutions, while from the bank side, the limited information on MSMEs is considered as the main problem.

The MSMEs financing has been a subject of great interest to policy-makers. This is because MSMEs are an engine for economic growth and job creation. Moreover, MSMEs are now recognized world-wide for being a key source of dynamism, innovation and flexibility in advanced industrialized countries, as well as in emerging and developing economies.

In order to acquire a substantive discussion on MSMEs financing among policy makers and key stakeholders to gain a shared understanding of best practices to support MSMEs growth with their limitation to access financing, Bank Indonesia in cooperation with The Asian Development Bank Institute organized the workshop with related topic. It covered the issue and challenges on SMEs financing in Asia, financial policy, credit rating, secured transaction and moveable assets financing, state banks and SME-oriented commercial banks, guarantees, and capital market. All of those topics have already included in this proceeding prepared by the drafting team from the organizer. I hope that the proceeding cas serve as a record for the issues regarding MSMEs access to financing as well as a reference for preparing policy recommendation.

Halim Alamsyah

Deputy Governor of Bank Indonesia

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Welcoming Remarks

Mr. Jae-Ha Park (Deputy Dean, Asian Development Bank Institute, Japan)

Deputy Governor Dr. Halim Alamsyah, Distinguished Guests, Ladies and Gentlemen,

Good morning.

On behalf of the Asian Development Bank Institute (ADBI), I am honored to welcome you to the Workshop on Financing SMEs: Sharing Ideas for Effective Policies, jointly organized by ADBI and Bank Indonesia.

I would like to sincerely thank all of you for joining the workshop in spite of your busy schedules. In particular, I would like to express my deep appreciation to the staff of Bank Indonesia for their excellent arrangements and preparations for this workshop.

As all of you are well aware, small and medium-sized enterprises (SMEs) constitute an integral part of developing Asian economies. Latest data show that SMEs account for 98% of all enterprises and employ around 66% of national labor forces in Asia. In addition, a vibrant and dynamic SME sector is the birthplace of innovation, economic growth, and poverty reduction through empowerment and opportunity.

Unfortunately, however, the economic potential of SMEs remains underutilized in Asia. For example, despite the huge numbers of SMEs, they contribute only 38% of gross domestic product (GDP) or manufacturing value added in Asia. It is no wonder that the SME sector in the region is underdeveloped. In almost all developing countries, SMEs face many problems, including limited market access, low labor skills, and limited access to finance, among others.

In particular, limited access to finance for investment, operations, and trade can be a key constraint. The high proportionate cost of loan administration, along with the difficulty of overcoming information asymmetries and securing collateral, limit the outreach of banks.

Against such a background, this workshop has been organized to enhance the capacity of policy makers in designing and implementing effective policies for SME financing. It will focus on policy options to increase the flow of private and public finance to the sector as a means to foster a dynamic SME sector.

Diverse and imperative areas which will be discussed in this workshop include SME development and finance in Asia, financing needs, credibility and collateral, public sector banking and credit guarantees, and informative case studies from across Asia.

In closing, let me emphasize that the success of any SME finance policy reforms requires collective efforts. While the government formulates and implements the policies, other stakeholders such as the private sector, academic institutions, international organizations and nongovernment organizations (NGOs) should also play equally important roles.

That is why I am very glad that we have many high-ranking policy makers across Asia participating today and also many financial market practitioners attending to support this workshop. We recognize that it is through building the capacity of countries to implement policies that policies can become meaningful and relevant.

I hope this workshop will provide you with broad and up-to-date knowledge on SME policies and SME financing, and thus establish a foundation for collaboration that is indispensable for sustainable growth in Asia. The workshop is expected to be a blended learning course consisting not only of lectures, but also of discussion and active exchange of views among all the participants to develop the knowledge into policy actions.

Ladies and gentlemen, on that note, I look forward to very fruitful, productive, and free-flowing discussions during this workshop.

Thank you for your kind attention.

Opening Remarks

Mrs. Eni V. Panggabean (Executive Director of Financial Access and SME Development Department, Bank Indonesia)

On behalf of Mr. Halim Alamsyah (Deputy Governor, Bank Indonesia)

Excellencies,

- *Mr. Jae Ha Park, Deputy Dean, Asian Development Bank Institute (ADBI).*
- *Mr. Paul Vandenberg, Senior CBT Economist, ADBI.*
- *Mr. Choirul Djamhari, Deputy Minister for Business Finance, Ministry of Cooperatives and SMEs.*

Distinguished Speakers, Moderators, Guests, Ladies and Gentlemen

Assalamu 'Alaikum Warahmatullahi Wabarakatuh
Good Morning

1. On behalf of Bank Indonesia, it is my greatest pleasure to welcome all of you to the Capacity Building and Training Workshop on Financing SMEs: Sharing Ideas for Effective Policies, joint cooperation between ADBI and Bank Indonesia. We are indeed honored to have you here, and look forward to two full days of presentations, insightful discussions, and also networking, with the main aim of formulating policy effectively and sharing ideas on SME Financing among Asian countries. I am glad that so many of you have been able to take the time out of your busy schedule and join this important meeting.
2. The SMEs financing has been a subject of great interest to policy-makers both in developed and developing countries and also to international organizations due to a number of reasons. Some argue that improving access to finance may reduce poverty in developing economies due to the fact that in most developing countries SMEs are concentrated in rural areas in which high levels of poverty persist. In addition, better access to financial sources for SMEs indicates that the role of financial institutions in bridging finance to real sector is working. Stiglitz in the recent seminar in Bali, just last week, said that increasing SMEs access to finance is one of the aspects that should be considered in monetary policy formulation. Thus, central bankers should pay more attention on this issue.

3. However, continuous development of the SMEs could be hindered by the difficultyin getting loans from financial services providers. Most of the SME's have limited access to financial services and as the result they could not optimize their contribution to the economic growth, competitiveness on the world stage, andsupport to create jobs, thus their contribution to the prosperity of the society as a whole would not be optimal.

4. Therefore we should consider this meeting as a very important one that will help raise the issues that are blocking SME's access to finance in order to boost their businesses.It is not only very important for SMEs, but also for financial institutions, the government and other stakeholders in the SME sector. Hence, all participants are invited to actively participate in identifying the problems of SMEs, in particular the SMEs access to finance from formal sources. In addition, this meeting should identify roles and responsibilities, make concrete proposals and develop a strategy on how to overcome the obstacles that SMEs face in accessing finance.

5. Furthermore, I do believe that economy in Asian countries will evolve towards higher value added activities, so that the financial support services that is being provided by the financial institutions also needs to evolve. Financial institutions have to recognize that SMEs will increasingly become specialized and diversified, and will require a much more customized and differentiated financial services.

Distinguished Guests, Ladies and Gentleman,

6. Now let me brief you about SMEs financing in Indonesia. As in many other countries, SMEs form a significant part of the Indonesian economy, accounting for 99.9 percent of established businesses and employing 97.2 percent of the nation's workforce. The Indonesian SME contribution to GDP is now 57.48 percent.

7. The significant roleof the SME sector in Indonesia remains constrained by a number of factors including marketing, lack of supporting infrastructure, skills shortage, scarcity of capital goods, and poor management, with the biggest problem facing the sector is the unavailability of adequate financing facilities. I believe, the problem of limited access to finance for the SMEs is not exclusive to Indonesia, but also in most Asian countries.The common characteristic of SMEs is information asymmetries, in which banks could not immediately get information of SMEs as prospective debtors. Moreover, lend to SMEs perceives as high risk and high cost. Thus, it impedes banks to extend credit to SMEs.

8. The problem of financial access lies both to financial institutions and SMEs. Limited branch network, limited range of financial instruments and lending conditions, banks' inadequate

capacity to appraise the creditworthiness of SMEs are some banks' challenges in financing SMEs. While from SMEs side, poor financial information, unrealiable and inadequate book keeping and lack of collateral make SMEs difficult to have financial access.

Distinguished Guests, Ladies and Gentleman,

9. Recognizing the importance of SMEs in contributing to the socioeconomic development and the engine of economic growth of the country, at the end of 2012, Bank Indonesia has issued regulation that mandates 20 percent of banks loan portfolios should be lent to SMEs segment by 2018.This regulation will be effective next year, 2015 where the banks have to allocate 5percent of banks loan portfolio to SMEs, and 10 percent, 15percent and 20percent in the following years. Currently the SMEs loan ratio is 19.6 percent of the total outstanding loans with a growth rate of 12 percent, year on year.

10. In addition to regulation, Bank Indonesia has developed some initiatives to enhance the access to finance for SMEs.

    First, Promoting the establishment offinancial infrastructures for SMEs in term of institutions and instruments. These initiatives among others are the establishment of SMEs Credit Rating Agency and Regional Credit Guarantee Corporation and also cattle insurance as risk mitigation for financing the cattle farm sector.

    Second, Promoting and supporting the Financial Inclusion programs among others through Digital Financial Services (DFS). Currently, the DFS is developed for transfer only, but in the future it will cover both saving and credit especially for micro scale enterprises.

    Third, Increasing the capacity of SMEs, in particular for providing the adequate financial transactions through National Movement of Financial Transactions Recording for SMEs.

    Fourth, Disseminating information related to SMEs development through website of Bank Indonesia, such as researches and data on potential SMEs borrowers.

11. As I conclude, allow me to thank the speakers, moderators and all participants, especially to ADBI, who have consistently supported the development of SMEs in the region and collaborated for this workshop. Hopefully there is another collaboration in the future. I urge all delegates to engage fully in these discussions so that we can collectively develop pragmatic solutions to the SMEs financing challenges facing our country and institutions. Given the quality of participants in the meeting, I am convinced that useful policy recommendations will emerge at the end of this meeting.

12. On that note, and with this prayer, **BISMILLAHIRAHMAN NIRRAHIM**, I hereby officially declare the Capacity Building and Training Workshop Financing SMEs: Sharing Ideas for Effective Policies open.

Wabillahi Taufik Walhidayah, WassalamualaikumWarahmahtullahiWabarakatuh.

Thank you.

Session 1: SMEs and Financing in Asia and Financing vs Other Constraints to SME Development

Speakers:

1. Mr. Charles Harvie, Associate Professor,The University of Wollongong, Australia
2. Mr. Paul Vandenberg, Senior Economist, ADBI

Moderator:

Mrs. Yunita Resmi Sari, Director of Financial Access and SME Development Department, Bank Indonesia

Access to Finance and SMEs in East Asia: key issues and policy implications

Mr. Charles Harvie

It is long been believed that when it comes to lending to firm, SMEs tend to be at the disadvantage. They are subject to what we call "Credit Rationing", which makes it very difficult for them to get an access to finance. They have a lot of potential, but access to finance is the critical issue. Also when we look at the issue of SMEs, we have to emphasize that SMEs are very heterogeneous cohort of enterprises.

We tend to think that SMEs are a block of enterprises that are all essentially the same. They look so homogeneous but in reality they are very heterogeneous. We cannot assume the one size fits all when we come to the policy recommendation. There are different types of SMEs on the financing requirements. And also when we look at countries and different stages of development of a country, the requirements of the SMEs are different one another. The financing requirements for those countries with more elementary stages of economic development are so much different from those who have more advance stages of development.

SMEs are very important from the number of perspectives. 98% to 99% of all enterprises in all economy basically are SMEs. They vary in size from micro, small, and medium size so their financing requirements may also vary.

In fact, if we look at business number of that cohort, about 99% of that numbers evolved from SMEs, approximately 60% to 70% of those are micro enterprises. In some places, the enterprises only employ less than five people. Their size is very small and they are very fragile enterprises that will bring to a consequence that their financial requirements are significantly different compare to medium size enterprises.

Approximately 35% to 50% original outputs are generated from SMEs, depending on the country's condition. Their employment generation potential is very high. In OECD countries for example, about 70% of net employment generation comes from SMEs. Those factors above become the reasons why Governments are very interested in SMEs on their development especially for access to finance. Employment generation of SMEs in ASEAN becomes very important, especially due to the establishment of the ASEAN Economic Community (AEC) by the end of 2015.

Around 35% of original (direct) export in Asia comes from SMEs, if we include their involvement in production networks which is the very core of East Asian economy. The reason why ASEAN member states (AMS) are moving to AEC is to build a production network in the region. So clearly, the success of AEC will bring exclusive economic integration, and SMEs are going to play a critical role in that context.

Innovation is very important when it comes to product innovation in particular. Many countries heavily depend on the SMEs sector as a basis of putting effective poverty alleviation strategies. Small or very tiny micro enterprises can play very important role in alleviating poverty and economic empowerment, especially in competing toward globalization.

Globalization presents many challenges, and we are in the global role in terms of trade flows, flows of labour, capital, innovation, and ideas. Globalization exist in order to create challenges and opportunities to businesses including that of small businesses, but one of the biggest issues are lack of resources, finance, technology, access to skilled labour, access to market, access to information about market and business opportunities.

In terms of generating competitiveness, it is not come from the generation of large volume of production. They lack of the economic skill and school. The key aspect or key potential for competitiveness is the ability to produce customize product, niche product for the niche of the costumers. They also face high transaction cost, lack of information/knowledge, network and experience of international market. Those are also important factors if we want to encourage the growth of SMEs so they can play a substantive role and develop economy.

Globalization market will become more concentrated so it would be difficult for SMEs to compete and participate in the global economy. The lack of resources faced by SMEs will cause their inability to engage in research, development and more substantive innovative activities. One major problem

when it comes to economic development is the high turnover faced by SMEs. Only few of them will survive after it is being set up. Establishing a solid foundation will develop new markets and generate more employment in the future.

SMEs focus on niche market to customization, they do not produce a lot of outputs but they produce to meet the specific requirement of the customers, where large firms cannot do that. We have seen an interesting development in technology that is called discontinuities in production. The production process can be broken down into various parts. In past, we use to have large multinational enterprises producing output in a large integrity plans. These days we find another production process has been broken down into numerous parts and this can provide opportunity for subcontracting activities which can fit very nicely the model of the multinational enterprises by engaging and subcontracting to enable them to be flexible and adaptable to changing global demands which is a risk for them. SMEs can participate in so-called production network.

This day product life cycle are significantly reduced. It is very risky for large firms to invest in substantial plants and machineries to produce large volumes of output. For smaller firms, they are flexible, adaptable, and rapidly changing their development within global market place that give them key advantage. Multinational enterprises outsource the parts and components for the final products they produced. SMEs are going to play important roles in that part of process.

We also see the growth of service sector, which is dominated by SMEs, become critically important as a generator of jobs in economic growth. Knowledge creativity and innovation become important source of international competitiveness. SMEs are officially less bureaucratic and greater flexibility to adapt to global changing market circumstances. In the past, there is a perception that SMEs were not particularly innovative because they do not have resources to be innovative.

Electronic commerce also expands the outreach of SMEs. The development of clustering in networking is very interesting. The competitiveness can be created by clustering with other firms at the similar or different stages of production. Networking has become a critical factor to become competitive that can help them to become more productive. SMEs that operate in a very much individually tend to operate in not a long period of time because an enterprise can only survive if they have knowledge and networking.

Basically there are three sources of finance, which are formal sources of finance predominantly from commercial banks; informal from gray market and informal money lender; and internal sources of finance (such as entrepreneur's own saving, relatives' saving or borrowing from friends). If the SMEs continue to remain predominantly on internal sources of finance it will prohibit their potential to grow and develop. In order to overcome the problem, alternative sources of finance are needed.

According to Stiglitz and Weiss, because of asymmetric information, the information obtained by lending institutions and firms are very different. It is very difficult for banks to distinguish between good and bad loans. SMEs, especially small firms, are lack of transparency so that banks are difficult to assess them. This condition leads to adverse selection and moral hazard problems, resulting to what we called “financial gap”. The demand for funds by SMEs is not much by the supply fund by financial institutions. The condition, called “credit rationing”, is largely aroused because of lack of transparency in the operation of SMEs, lack of collateral, the lack of business plan, the fact that they are seen as more risky businesses, and lending to SMEs are relatively more costly related to lending to large firms.

The critical factors in financial gap are size of the firms (the smaller the firms are, the more they face difficulties in obtaining credit facilities), age of the firm (start-up and young enterprises find it more difficult to acquire access to finance), lack of collateral, profitability assessment (the less transparent they are, the more difficult for them to get access to finance), legal system, property rights and bankruptcy law, bank-line relationship (small firms do not tend to have bank-line relationship so they do not have credit history), and absence of business plan. All those conditions make SMEs become the subject of credit rationing. Furthermore, smaller firms have to pay higher interest rates because it is related to the default risk.

Credit rationing is a potential problem for SMEs because it makes SMEs do not obtain the amount of loan they wish to have and tend to pay higher interest rate. Those elements can impact the growth and development of the SMEs sector, which can also impact the SMEs’ performance from a number of perspectives, such as their ability to grow (in terms of output of production), their ability to generate employment, to be profitable, to be able to participate in exporting, to be able to produce capital equipment, to improve their efficiency in productivity, low return in their assets, and reduce the potential for innovation.

Macroeconomic policy is also very important factor. If the Government is running a lot of budget deficit, for example, then it means that they are drawing quite heavy for domestic saving. The consequence applied is that there may be an imbalance between national savings and investment.

In the past, the Government recognize the problems dealing with SMEs access to finance. They require financial institutions to lend proportionally to SMEs, and they have to give interest rate subsidy, to give tax concession, to give guarantee loan, to develop financial institution, to specialize

in lending to SMEs, to develop business development services, to encourage the stock exchange to list the firms to get funding through stock market as the alternative source of finance, and to establish venture capital market for knowledge and innovative SMEs.

Stage of economic development is very important. For advance economy, if there is any credit rationing, lack of finance is merely for the innovative or knowledge intensive enterprises in the developed world. However, in the emerging market and developing economy, the financial gap is getting wider. Credit rationing is particularly prevalent in emerging and developing economy because asymmetric information is more intense in the stage of economy.

The factors caused SMEs to be disadvantage from the external finance are their size, their country of location, the characteristics of the firm itself, its age, its profitability, and the characteristic of the owner of SMEs.

The factors influence SMEs desire to obtain external finance or aspects enhance the ability to get finance from multiple sources of finance is business cycle (start-up, high growth, immature, or decline firm), the involvement of the found-owners to get access to finance from multiple institutions, characteristics of the owners (managerial experience, net worth, and ownership in the multiple businesses), sales growth of the firm, profit margin of the firm, firm’s expansion plan, access to internal funds, and also the age, their size, the country which firms are based (developed or less-developed country), and sectors which firms operate in.

The two critical sources of finance for business start-up are loans from friends and retained earnings. In conclusion, internal sources are very important for business start-up. Seeking external sources from banking institutions is relatively more important when it comes to seeking finance for ongoing business operation.

The terms, size, and duration of the loan contributes to the discrimination of small firms in getting access to finance. Regarding the duration factor, smaller firms find it harder to get longer period of loan. Smaller firms also have to pay higher interest rate. There are two factors to measure small firms’ performance, which are their innovation and export capacity.

In general, SMEs who are actively seeking finance from multiple institutions and multiple sources are firms with the following characteristics: they tend to be domestically owned and the found-owner of SMEs is not interested in getting external sources of finance. The cohort of SMEs who are interested in getting access to finance is quite diverse in categorizations, which are high growth, mature, and larger SMEs; SMEs making low profits; and also SMEs who tend to expand their businesses.

Pecking order hypothesis related to SMEs who are seeking loans: they tend to identify/generate loan internally and then seek for external funds. When they use the internal funds, it tends to be the lower cost for them compare to external funds.

The greater the involvement of the found-owners of SMEs, the easier they get access to finance. No involvement at all from the found-owners makes it more difficult to obtain loan with longer period of time. If the found-owners have multiple businesses, they will get relatively small size of loan because they increasingly depend on the resource of entrepreneurs themselves rather than seeking for a large loan from outside.

In order to prepare SMEs facing the globalization, we need to encourage formalization because SMEs cannot get access to finance unless they are formally registered. If we want to encourage growth in employment and output, we need to encourage firms to be formally registered. We also need to reduce bureaucratic regulation and taxes that encourage the firms to remain informal.

Many countries usually have a lot of micro firms and less large firms. We need to put attention to the medium firms because they are who generally generate jobs and exports.

Finance vs. Other Constraints Facing SMEs in Asia

Mr. Paul Vandenberg

The most important thing we have to do that makes it our primary goal is to develop a strong and vibrant SMEs sector. There are 4 major areas of economy that need to be developed: farm sector, SMEs sector, large enterprises sector, and public sector.

In developing strong SMEs sector, they are two specific aspects: (1) specifically ask the enterprises' owners about their major constraints (finance or not finance) and (2) look at the owners' access to finance.

We tend to have a tendency to say finance is the answer. Sometimes we also think that putting more money and having more money can solve the problem.

The World Bank HMC enterprise surveyor usually do survey for categorizing the enterprises sector. They do arrange the survey from small to the medium and also to the large enterprises. There were 30 countries ranging from the survey done in India on 2006 up to the one done in Myanmar in 2014.

30 countries surveyed consist of East Asia, South East Asia, South Asia, Pacific, and Central Asia countries. From 30 countries surveyed, there are 15 possible constraints the SMEs think that could affect their growth and development. Those constraints are finance, transportation, electricity, access to land, workers (along with workers' regulations), and practice of the informed economy. The other constraints missing related to regulatory and environmental variables consist of access to technology and macro stability. When conducted the survey, the enterprises are divided into small medium and large enterprises.

In South Asia and East Asia, access to finance becomes the main constraint for small enterprises while in Central Asia and Pacific is political instability. Political instability relates to macro instability because it will slow down the economic activity. The slowdown in economic activity will affect demand and in the end will affect the enterprises. Some of the countries find that electricity is the constraint. If we were the policy maker and we want to promote the SME sector, we have to have finance and non-finance programs that support SMEs. We have to provide electrical supply to our SMEs so that they can operate in a more continuous basis. Skilled workers is also become the important factor. Other factor that also affects SMEs is corruption.

The similar condition happens for medium enterprises. Electricity and skilled workers also become constraints. Furthermore, electricity is more important for medium enterprises compare to small enterprises.

The interesting thing is, for small enterprises, transportation is not included as a constraint. On the other hand, the court becomes the constraint. Labor is important but labor regulation is not important. Crime and theft and access to land are also not important. Small enterprises feel that trade regulation is not important but it is probably because they do not trade to cross border very often. However, for medium enterprises, trade regulation, custom regulation, and tax rate do become more important.

We know from many studies that internal fund becomes important, especially for enterprises at a lower level of development and less-developed financial system. More than 80% of small enterprises finance themselves internally. Some countries such as Thailand and Malaysia have a low rate of internal financing. It relates with the fact that they are more developed countries with more developed financial sectors. Similar situation happens in medium enterprises.

We often think that finance is needed for enterprises to grow their businesses, but we also have to realize that working capital is very important to keep the business/operation going. We found that working capital tends to be financed more by banks than by credits supplier. It also happens in medium enterprises.

We also deal with "not-wanting finance". In order to grow, enterprises need to be financed. But it is not true in all cases because for various reasons, enterprises may not be seeking access to finance. There are some reasons; one of them is that they are not "growth-oriented". In Japan, there is a situation where there are some enterprises who want to grow and to develop but there are some others that are just happy with what they are now.

Over 60% of small enterprises in Lao PDR, Philippine, Pakistan, and Fiji are reluctant to use source of financing from bank loan. It is important for policy makers that the programs which the government sets up should not target the SME sector overall but they should target the portion of SME sectors that does want to grow and does need access to finance. There are viewers of medium enterprises that do not look for a loan because more medium enterprises have already obtained access to finance.

Although SMEs access to finance becomes the main constraint in Asian countries but there are some other constraints such as infrastructure issues that hinder the SMEs to grow.

The critical issue about SME funding is to identify the SMEs that potential to grow, because they are the ones that we really need for the economic growth and employment generation. Their financing needs are totally different. This situation tends to cause difficulties among policy makers because one size-fit all strategy is not going to work. Some tends to use the policy because they do want to grow but some other will just waste it. We need to look at the particular problems that they have and trying to create the level of playing field to ensure that they are not discriminate each other, such as rules of government, good macro-economic (fundamental), stable inflation, low budget deficit, interest rate goes down, stable exchange rate, and good legal regulatory institution environment.

Great varieties in SMEs sectors means that we should have different policies to tackle the different parts of this sector because the things that are needed to help get financed to medium-sized enterprises are different from the way it is to get to micro enterprises.

We need a similar type of revolution for micro enterprises because it is known that a lot of banks just do not want to go to reach them, they have specific characteristics, and they often do not have collateral they need to put up to get the bank financing. More government focus and support is needed to tackle problems faced by micro enterprises. To handle problems in small and medium enterprises, we need more private sector solution on how to adapt in the environment of the private

sector, private banks, and private financing. Banks and financial institutions need to have screening mechanism to find the potential SME to be financed.

In Thailand, there are 8 Specialized Financial Institutions (SFI), which are government-owned institutions, which specifically channeling funding to specific part of economy. Thailand is one example where there is a combination between having specialized institutions and the cost of delivering to SMEs are being underwritten by the government through those institutions, as well as the private sectors.

Based on Bank Indonesia's experience in North Sumatera, the successful entrepreneurs are reluctant to go to banks for financing. On the other side, some of banks in the area are successful to finance the SMEs because they act more as advisors for the SMEs instead of lenders. In Indonesia, collateral is not a must in bank financing as long as the banks confident about the repayment capacity of their debtors.

Related to the issue of collateral, banks as institutions which are very conservative by nature tend to ask micro enterprises, with very risky characteristics, to provide collateral if they want to get financing from banks.

Some of the research results demonstrated that one of the very important aspects is business plan. In a lot of micro and small firms, one of successful way to get financed from banks is the ability to clearly put the objective of their firms in the future market to produce profitability. In the case of small firms, the cost of lending is relatively high because the compliance cost to meet the banks requirement is also high. Government role is much needed to facilitate these firms in producing credible business plans. In developing countries such as Indonesia, government provides access to such support business development program to increase transparency and reducing the moral hazard problem.

Formal enterprises have to obey regulations while informal enterprises which operate under the radar of regulations do not have to register, pay the tax/fee, and so on. The formal small enterprises sector thinks that informal small enterprises sector has advantages because they do not have to comply with the regulations. In most countries, once an enterprise became formal then it became the subject to various required standards, such as health standards, safety standards, environmental standards, and labor standards.

The financial planning expertise will need to put altogether the solid and bankable business plan which will be very useful for the SMEs because most of the expertise is provided by the private sector. If that such of special expertise are not developed well, that would be an example of market failure.

Key Points

1. Financial gaps or credit rationing is more pervasive in emerging market and developing economies. The overall legal, institutional and regulatory environment is a critical determinant of SME access to finance. In emerging market and developing economies access to finance for startup and young enterprises is critical. In advanced economies there is less evidence of financial gaps or credit rationing. But there appear to be financial gaps specifically for innovation oriented SMEs.
2. SMEs face difficulties that can impact start-ups and the performance of existing small businesses such as terms of loan size (less), duration of the loan (shorter), and cost of the loan (higher).
    a. The SMEs key characteristics that have <u>positive correlation</u> for them to obtain:
        1) More loan size: foreign ownership, size of SMEs, owner's net worth, financial statements, business plan, and cash flow
        2) Longer duration of the loan: business life cycle, owner's multiple businesses, sales growth, size of SME, less developed economy, owner's net worth, collateral, financial statement, and business plan.
        3) Lower cost of the loan: less developed economy
    b. The SMEs key characteristics that have <u>negative correlation</u> for them to obtain:
        1) More loan size: owner's multiple businesses, profit margin, less developed economy, garment sector, and auto parts.
        2) Longer duration of the loan: foreign ownership and profit margin.
        3) Lower cost of the loan: sales growth, size of SME, owner's net worth, and business plan.
3. Small enterprises and medium enterprises tend to rank access to finance as a major constraint in approximately the same number of countries in ADBI sample of 30 countries. Finance considered a constraint for large enterprises (100+ workers) but less likely to be the main constraint.
4. Finance is a major constraint in East and Southeast Asia (and to some extent for small enterprises in South Asia), middling constraint in South Asia, and not considered a main constraint in most of Central and West Asia and the Pacific Region. Other constraints dominate other regions (Central Asia and the Pacific where finance not among the top five constraints are political instability in Central Asia and the Pacific; electricity and lack of skilled workers in South Asia; and corruption, licensing, and tax administration). The factors considered as not so important are transport, courts, labor regulations, crime and theft, access to land. For small enterprises, customs/trade regulations and tax rates not such a concern while they are more important for medium enterprises.

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Session 2: Financial Policy's Role in Expanding Access to Finance for SMEs

Speakers:

Mrs. Eni V. Panggabean, Executive Director of Financial Access and SME Development Department, Bank Indonesia

Moderator:

Ms. Elaine MacEachern, Secured Transactions Specialist, Finance and Markets Global Practice, World Bank Group

Bank Indonesia Policy Role to Accelerate Access to Finance for MSMEs

Mrs. Eni V. Panggabean

The strong resilience of Indonesia's economy is due to the strong domestic demand which is supported by the MSMEs. The contribution of 55 million business units comes from SMEs. They also absorb about 97.2% of labor force and the contribution is more than half of the GDP, which is 57.5%. The contribution of MSMEs to export is 14.1%. The share of MSMEs loans to total loans in August 2014 reaches 19.5%. Most of the loan contributes by wholesale and retail trading sector while agriculture and fisheries sector only contributes for 8.5%.

From the survey of ADB, we acknowledge that collateral becomes the most obstacle factor in accessing finance, followed by high lending rate, complicated procedures, short-term loan period, exclusive lending attitude, and financial access and lending policy. The survey of Bank Indonesia in 2010 stated similar results, where the major obstacle for banking industry to disburse loan to MSMEs is the absence of credit guarantee. The other two major results are the collateral and lack of knowledge.

Bank Indonesia issued a regulation in 2012 to oblige banks to disburse loan to MSMEs for 20% of their total loans in 2018. It will be applied gradually, which is 5% of each bank total loan in 2015, 10% of it in 2016, 15% of it in 2017, and 20% of it in 2018. Banks are allowed to disburse loan directly to debtors or through linkage program. In order to fulfil the regulation, foreign banks are forced to help SME exporters. Bank Indonesia provides technical assistance to increase SMEs capacity, in the form of training, research, provision of information, and facilitation. The failure to achieve the target makes banks have to allocate certain amount as a provision of training to SMEs. The implementation of the regulation so far is on the right track and banks follow this regulation.

The leniency for banks who disburse loan to MSMEs is the lower risk-weighted assets for micro and small loans which are only 75%. The asset quality assessment for MSMEs loan is only based on one pillar, which is the timely payment of the loan principal and interest, compare to corporate loan which has to comply with 3 pillar of assessment. The other leniency is the legal lending limit for plasma nucleus partnership and special treatment for MSMEs financing in certain regions that are affected by natural disaster.

For MSMEs that are not feasible and not bankable, the financing is given in the form of soft loan like Corporate Social Responsibility (CSR). For not feasible but bankable MSMEs, called productive-poor, the Government offers the interest rate-subsidized credit program. For feasible but not bankable MSMEs, the Government offers guaranteed credit program for maximum of 80% while the rest of 20% will be borne by banks. The example of this program in Indonesia is called Business Credit for People (Kredit Usaha Rakyat – KUR), which has 2 (two) schemes. First scheme is loan for very small enterprises which does not need collateral in obtaining bank financing while the situation is the other way around for the other scheme dedicated for medium enterprises. Furthermore, credit scheme for feasible and bankable MSMEs is commercial loans.

Bank Indonesia's initiative to promote MSMEs financing has the final objective which is the growth of MSMEs and real sector and inflation control by supporting food security and creation of new economic centers in the regions. The initiative has four strategies, which are capacity building for MSMEs, increasing access to finance, minimize the asymmetric information, and coordination and strategic partnership. In order to implement the strategy, Bank Indonesia sets some programs which consist of cluster (value chain) development, entrepreneurship development, financial transaction recording movement, strengthening financial infrastructure, facilitation of Government credit program, provision of study/research, dissemination of information, development of MSMEs microsite in the website of Bank Indonesia, and coordination with local government, central government and international institutions. The overall programs are implemented through coordination between Bank Indonesia head office and 43 representative offices all over Indonesia.

Cluster (value chain) development and entrepreneurship development are executed in order to increase MSMEs capacity building. Related to cluster development, Bank Indonesia provides technical assistance to improve MSMEs competitiveness in following aspects: marketing, production, finance, and human resources/social capital. Bank Indonesia does not have a special scheme for

cluster development. The MSMEs in clusters are encouraged to obtain loan from financial institutions to improve their business. Bank Indonesia tries to control the inflation which is affected by the volatile food through the development of clusters in all regions. In addition, entrepreneurship development is dedicated to create new entrepreneur by providing technical assistance and business coaching. Bank Indonesia deals with entrepreneurship because in order to develop good MSMEs, the development of entrepreneurs is much needed.

To increase MSMEs access to finance, Bank Indonesia contributes in developing financial infrastructure institutions and financial structure instruments. The development financial infrastructure institutions includes regional credit guarantee, which objective is to address lack of collateral faced by MSMEs in the region and is initiated by joint cooperation among government ministries and Bank Indonesia. The other financial infrastructure institution is SMEs credit rating which objective is to overcome asymmetric information between SMEs and banks and is a pilot project as the cooperation between Bank Indonesia, OJK, banks and rating agencies. The financial structure instruments consist of the utilization of land certificate and cattle insurance. The utilization of land certificate program is aimed to encourage the use of land certificates to improve access to finance for MSMEs. The program is a joint cooperation among related Ministries, National Land Agency, and Bank Indonesia. The other instrument, which is cattle insurance, is intended to address the risks inherent in the cattle farm business. It is a joint cooperation among Bank Indonesia, Ministries of Agriculture and insurance companies.

The other programs implemented by Bank Indonesia is financial transaction recording movement which is intended to help MSMEs deals with financial transaction records because they usually do not have it.

Bank Indonesia's implementation of those programs faces some challenges, opportunities, and strategies. The challenges encounters are coordination among institutions, changing Banks' paradigm to treat MSMEs as a partner, and the implementation of ASEAN Economic Community 2015 while the opportunities are the widespread of Information, Communication, and Technology (ICT) implementation, such as: online business and utilization of mobile phones. To deal with those challenges and opportunities, there are some strategies to be performed, which are applying innovation, such as financial transaction recording through ICT devices (personal computers, laptops and smart phones), and widening financing sources (Value Chain Financing, Angel Investors).

Key Points

1. The strong resilience of the Indonesia economy among other is due to the strong domestic demand, which is supported by the pivotal role of MSME.
2. Based on National Economic Census in 2006, financing and marketing aspects are the main challenges of the MSME.
3. In order to support MSMEs financing, Bank Indonesia issued Bank Indonesia Regulation No. 14/22/PBI of 2012 which mandates that 20% of banks portfolios should be lent to MSME segment by 2018 (gradually for 5% in 2015, 10% in 2016, 15% in 2017, and 20% in 2018). To meet this requirement, Banks are allowed to directly lend to MSME or through linkage and on-lending programs. The penalty for the failure to achieve target of MSME lending is Bank has to allocate certain budget for provision of training to MSMEs.
4. Bank Indonesia's initiatives to promote MSMEs financing are through the implementation of strategies as follows: capacity building for MSMEs, increasing access to finance, minimize the asymmetric information, and coordination & strategic partnership. The methods applied to implement those strategies are research, training, provision of information, and facilitation.
5. The challenges in promoting MSMEs financing are coordination among institutions, changing banks' paradigm to treat MSMEs as partners, and the implementation of ASEAN Economic Community in 2015.

Session 3: Rating Agencies

Speakers:

Mr. Parag Patki, former CEO, SMERA (SME Rating Agency), India

Moderator:

Mr. Choirul Djamhari, Deputy Minister for Business Finance, Ministry of Cooperatives and SME

Financing SMEs: Sharing Ideas for Effective Policies

Mr. Parag Patki

Credit rating is an evaluation report of how well or bad a company is performing in absolute terms in a particular market industry. Such report makes it possible for the stakeholder to compare a company's creditworthiness against the company that operating in similar market or industry internationally (Peter Larus).

Credit rating for SME, in particular, has undergone evolution as SMEs are never rated before. Rating has always been given to a corporation, not SME. SME Credit Rating in India also faces this issue.

Access to finance condition in India is characterized by low access to formal finance (Only 11% have financial access from formal sources), high interest rates (17-22% per annum), low loan size (average US$ 2,000), and lack of supportive ecosystem. Commercial bank credit to SMEs, as a percentage of net bank credit, has declined sharply in India since the late 1990s. Access to adequate and timely financing has been a major deterrent to growth and competitiveness of SME. Moreover, India has poor infrastructure and information availability.

There are some challenges faced by lending institution in India, such as: information asymmetry, lack of disclosure/dependence on consultants, financial/commercial illiteracy, high audit/regulatory scrutiny when decisions gone wrong, limited skill to assess SME loan application, high mortality rates, etc.

Simple example solution in India to address the lack of information availability is the concept called "know your costumer". Know your costumer concept is to have a basic demographic of a company or a person. If you had that basic demographic, you can get the information about the person or company to be given credit.

There is gap between bank's perception of SME and SME expectation. Lenders perception of SMEs is typical in India. This is due to the absence of reliable information, weak accounting and unreliable financial statements, lack of sufficient market credibility, poor historical performance and high transaction cost (preference to give credit to corporation rather than to SMEs) and high risk perception. On the other hand, SME expects that lenders are able to provide credit which is delivered timely, reasonably priced, in adequate amount and require less collateral.

To encourage funding to SMEs in India, since 1995 The Government of India has done a lot of things such as development of SME credit rating, SME stock exchange, Credit Bureau (already have 4) and provided many development programs such as subsidy for SME credit rating (75%), and preparing collateral registry program. In particular, SME Credit rating can encourage funding to SME by providing a bridge to close the gap between lenders and borrowers, and also facilitate decisions making to lenders by providing information on SME creditworthiness.

In India, the credit rating services for SME is provided by SME Rating Agency (SMERA). SMERA is owned by different type of shareholders from Government/Public/Private/MNC Lenders and Banks that committed to SME Sector, such as Small Industries Development Bank of India (SIDBI), Dun & Bradstreet Information Services India, Citigroup, and Standard Chartered Bank.

SMERA has built a Proprietary Models and expertise in accessing the SMEs application. SMERA also possesses information across sectors, clusters, geographies and rating categories. SMERA rating, started in September 2005, is a pioneer in SME credit rating. SMERA has completed 40.000 SME Ratings by September 2014. That number is not enough, because India has 30 million SME, among them only 1 million are registered and just around 200.000 accounts get loans from formal funding institutions.

Credit rating agency will evaluate SMEs on various risks such as sector risks, dependency risks, cluster risk, management risks, and financial risks. The assessment on SME will be based on 3 C's criteria which are Character (can be assess from various sources, character will share the outcome of company's journey into next few years), Capacity (whether the company has the capacity to use the loan and capacity to networking) and Capital (capability of capital).

SME rating process is varied. It's a combination between expert- and statistical-based models. The methodology of rating consists of 2 factors: financial factor (based on statistical modelling) and qualitative factor (based on due diligence and site visit). There are 2 parameters in Rating Factor Scheme: Financial parameters such as solvency ratio, liquidity ratio, profitability ratio, and activity ratio and trend analysis and Non-financial parameters such as management quality, location

advantage, marketing network, legal issues, industry and macro-economic assessment. Rating process flow should minimalize conflict of interest and moral hazards because the data will be collected by various people.

There are a lot of challenges in SMEs Ratings, such as: Inconsistency in supply of information, Mismatch of non-financial information with financial information and site visit details, data disconnection between those submitted in the questionnaire and those provided in the management interview, lack of appropriate disclosure of financial Information & its quality, frequent changes in management and its constitution, lack of appreciation of the changes in the regulatory environment, etc.

SMERA Rating is different from Banks Bank's internal rating, as follows:

1. Ratings by Banks: Mostly use financial parameters, Industry benchmarking is nil or limited, mostly is a generalization of MSMEs across geographic boundaries, banks are involved as financiers, backward looking.
2. Ratings by SMERA: Rating beyond financials, using robust industry benchmarking and linked to size, consideration to parameters specific to a geographic location, ratings are neutral, unprejudiced & credible, forward looking.

Key Success Factor of developing SME Rating:

1. Government & Central Bank supports to frame basic regulations for acceptance of SME Ratings by banking sector.
2. Enabling legislation to bring clarity on SME definition/priority lending norms/ information sharing by Credit Bureau/ collateral registry/ banking/Government with SME Rating agencies.
3. Government/SME/Finance Ministry supports budget allocation for SME rating subsidy.
4. Identifying efficient Nodal agency to manage disbursement of the rating subsidy.
5. Identify diversified shareholding such as Development Financial Institution/Leading lenders/ Technical collaborators or private body.
6. Finding 8-10 year technical & financial support from multilateral institutions in creation of a SME Rating Agency.
7. Set up a professional Credit Rating Agency for SMEs on Public/Private Partnership model for building trust/efficiency & profitable growth.
8. Hire professional personnel to manage the rating agency & provide complete autonomy in day to day management.
9. Setup a professional board representing various stakeholders and experts to ensure orderly growth of the Agency.

10. Register the Rating Agency with the local regulators to gain credibility and acceptability.

Banking industry in India is going on certain changes as corporation in India is able to get funding from external commercial borrowers through equity and foreign convertible bonds. So their revenue to raise money from corporation has changes dramatically in the last 2 years. Because of that, the Indian Banks are forced to look at any source of lending.

Indian Banking Association, which is APEX body of various banks, the Ministry of Finance, the Ministry of SME, and existing credit rating agency have assisted SMERA to improve the penetration of SME credit rating in the market. The industry association has also helped SMERA to connect to millions of SME units. The banks also support SMERA by giving 1%-2% interest rate subsidy for SME that rated 6 by credit rating agency.

There is no country that does not look at other countries to have benchmark but innovation ability is the important thing as far as information technology, biotechnology, and genetic are concerned. Many companies in India come from these particular sectors. India hires the expert from these sectors to sit in the rating committee and ask them whether SMERA has been looking for the right parameters to assess the innovation ability or not.

There is a bias in the credit rating system for micro enterprises toward the medium and large enterprises because SMERA used to have a structure of information from medium scale enterprises and sometime small enterprises but the micro was so unorganized, they did not even have balance sheet. In this case, SMERA hires a consultant to create a balance sheet for the micro enterprises and after that the micro enterprises can come to SMERA. Bias will always exist but SMERA will constantly tries to minimize the bias. There is a strong micro association in India that will push credit rating agency to ensure that the bias is not built.

There are 2 (two) major questions usually raised regarding the credit rating: (1) What is the potential benefit for SMEs and (2) How to regulate the credit rating, including industrial risk, financial risk and the risks that potentially will be experienced by executing bank. The answer is that it is just a matter of spreading the credit rating culture because many countries in this forum already have experience with credit rating.

SME Ratings are beneficial among others because ratings could help Increasing credit sanctions, Enhancing credit limit, Consistent, and Efficient. In India, Due to rating SME in India receive benefits such as 21% of units received interest rate benefit, 17% of units received enhancement in credit limits, processing time of application for credit can be reduced in 12% of cases, 7 to 8% of units

received reduction of collateral/security. The overall benefit in money terms is estimated to reach USD 200 million.

In India, the subsidy for credit rating fee is provided by the Government. The Ministry of Finance allocate budget to the Ministry of SMEs to create an agency called National Small Industry Corporation. This agency is a complete autonomy body and part of the Government who disbursed the subsidy for government programs, including the subsidy for credit rating. SMEs applicants only pay 25% of the rating fee and the National Small Industry Corporation pay the rest (75%) to credit rating agency.

Credit Rating Agency should register to District Government for Industrial Centre and obtain the registration certificate to be eligible for subsidy. The rating fee is determined by the credit rating agency, but the government determined the maximum fee, so the rating agency should be able to manage the cost. In India, the rating fee is about 1.000 dollar.

The biggest issue is subsidized from the government of India. Subsidy-based rating is a challenge for SMERA because it completely depends on subsidy from the Government for its sustainability. SMERA is registered to central banks and SEC to diversify its source of income. Now SMERA also regulate the rating for capital adequacy of the banks. It gives SMERA good source of income (20-30% of revenue). We also do green-field rating, brown-field rating and technical evaluation of the proposal for the banks.

SMERA has an issue about the limited subsidy and deficit financing is a challenge for every government. The government has changed. The earlier government has given SMERA a liberal subsidy but the new government say if it helps government then the government does not mind to give more and more subsidy. This is the reason for the government to limit the subsidy in the future.

India has 6 rating agencies. Banks treat credit rating agency differently based on consistency of SMEs performance that have been rated by credit rating agency. If credit rating agency giving a lot of rating which are not representative, bank will not deal with that credit rating agency.

The subprime crisis in the US is a classic example for credit rating agency that does not do the job. But as long as you have credible institutions working with each other, have a strong regulatory overview from the local regulators based on the default criteria; you will be able to manage it. You should create good institutions as a good economy is always about good institutions. The most important thing is the process itself including the financial literacy.

Based on India's experience, they feel really pessimistic when they started to develop the credit rating agency for the first time. But the entire global situation, the financial situation, the financial literacy and financial inclusion situation started to change in the last 8-10 years. Globally if we want to support our employment rate, we have to create institutions and SMEs rating agency is one of them.

Key Points

1. The challenges of SMEs rating system are inconsistency in supply of information, mismatch of non-financial information with financial information and site visit details, disconnection between data submitted in the questionnaire and data provided in the management interview, resistance to share sensitive information, lack of appropriate disclosure of financial Information & its quality, un-signed Balance Sheet, Profit & Loss statements, and audit report, un-authenticated schedule and annexure of Balance Sheet and Profit & Loss statements, frequent changes in management and its constitution, frequent changes in business plan, including line of business, un-satisfactory explanation of certain financial treatments, unrealistic future plans for growth, in-ability to understand the information requirement, lack of seriousness in complying with rigor of rating procedure, one point contact and flow of information within the enterprise, lack of appreciation of the changes in the regulatory environment, excessive dependence on the consultant/ audit firms, ambiguity in the financial data provided, lack of proper documentation, and in-ability to understand the information requirement.
2. The benefits of SMEs rating system are reduced bad debts, reduced exposure to high risk accounts, quick approvals/declines of loan, less efforts in data collection, in depth analysis for borderline SMEs credit accounts, increased volume of accounts evaluated with the same staff, ensure unbiased and objective treatment of each applicant, apply consistent, objective decisions across the organization based on ratings, target creditworthy SMEs and other customers for future promotions, and increase approval rates.
3. Key success factors to implement SMEs rating system are to seek for the government and the central bank's support to frame basic regulations for acceptance of SMEs ratings by banking sector, to enable legislation to bring clarity on SMEs definition/priority lending norms, the availability of information sharing by credit bureau/collateral registry/banking/government data on sectors with SMEs rating agencies, the supports from government/SMEs/finance ministry in creating rating subsidy budget for SMEs, to identify efficient nodal agency to manage disbursement of the rating subsidy, to identify diversified shareholding, such as development

financial institution/leading lenders/ technical collaborators-private body, for becoming part of the dedicated rating agency, to seek 8-10 year technical and financial support from multilateral institutions in creation of SMEs rating agency, to set up a professional credit rating agency for SMEs on public/private partnership model for building trust/efficiency and profitable growth, to hire professional personnel to manage the rating agency and to provide complete autonomy in day to day management, to setup a professional board representing various stakeholders and experts to ensure orderly growth of the agency, and to register the rating agency with the local regulators to gain credibility and acceptability.

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Session 4: Secured Transactions and Moveable Assets Financing

Speakers:

1. Ms. Elaine MacEachern, Secured Transactions Specialist, Finance and Markets Global Practice, World Bank Group
2. Mr. Aria Suyudi, Consultant, Finance & Markets, World Bank Group

Moderator:

Mr. Paul Vandenberg, Senior CBT Economist, ADBI

Secured Transactions and Collateral Registries: A Global Perspective

Ms. Elaine MacEachern

Particularly in Asia, the collateral taken by the financial institution is around 27% on the moveable collateral (other than land and buildings) but the primary assets the financial institution will be looking for is the immovable property (land and fixed assets). On the other hand, the capital stock of firms consists of 22% of land and real estate, 34% of account receivables, and 44% of vehicles, equipment, and inventories.

If we look at the more developed economy, the North America for example, 67%-72% of a bank portfolio is lending on movable property, it is not on land and buildings. The reasons why the financial institutions prefer moveable property are they perceive that it is easier to get access to moveable property (they can sell it in a considerable length of time) and they can diversify the risk across their portfolio so they do not only rely on immovable property.

Finance is a major constraint for many countries all over the world. This is an issue faced by 13% of firms in the OECD countries and 17.1% in East Asia Pacific countries. The percentage of firms with bank loan or line of credit in OECD countries is around 51% while in East Asia Pacific is around 35%. The value of collateral needed for loan or the percentage of loan value versus the assets that will be put up as collateral is 151% in OECD countries but it is much higher in East Asia Pacific.

The getting credit indicator has 10 sub indicators which most of them point out at the regulatory and institutional aspects of access to finance.

There are reasons that cause some financial institutions are reluctant to require movable collateral. Those are lack of an adequate legal framework to protect the security in that particular collateral, lack of clear priority, lack proper enforcement mechanism, lack of information about the restrictions to the assets they are able to take. In some countries, account receivable cannot be taken as collateral because it cannot be recognized as an asset. The other cause of reluctance is the lack of registry of security interest in some of movable properties. Another reason is because some countries do not know how to deal with movable properties. In some cases, the lack of bank's interest in moveable properties is because it is not their core business.

Benefits of a solid secured transactions system are:

1. Increases access to credit and reducing the risk of credit
   Essentially, we are targeting the underserved market, and in particular women entrepreneurs. The background of this targeting is because they often are left-out or are required to fulfil additional requirements when they want to obtain bank loans. A secured transaction system also promotes good risk management and prudent lending practices within the bank itself.
2. Reduces the cost of credit
   Interest rate is related to risk so if we can manage the risk better, the interest rate will going down. People are moving from informal to formal economy. They become financially literate. As they start to establish themselves with the banking system, they become the known-commodity to the financial institutions.
3. Promotes credit diversification
   There is a credit risk diversification between immovable and movable properties and sector diversification in the portfolio.
4. Increases market competition.
   There is a development in other industries such as factoring, leasing and non-banking financial institutions (NBFIs) as ways to address the access to finance for SMEs in particular. In the case of leasing, the whole leasing industries in Middle East North Africa (MANA) was created on the backed of secured transaction legal framework. The condition brings the new method of financing such as the acceptance of equipment and machinery for SMEs in particular, new jobs, and new industries.

The World Bank has conducted a survey and the results showed that access to finance was increasing by 8% as a result of the movable collateral registry implementation. They also found out that 7% of SMEs got access to a loan. The working capital financed by the banks increased by 10%.

The interest rate was going down about 3% while the loan maturity term was extended for 6 months.

SMEs, particularly micro and small industry, become the police for themselves. When relates to banks, they already knew that they probably are not going to meet banks' criteria so they did not even bother to go to ask. In order to get them into the system, one of the ways is that we have to create the proper legal framework which is going to recognize the assets SMEs have.

When we are talking about secured transaction system, we also talk about the legal and institutional framework that facilitates the use of movable property (anything other than land and buildings) as collateral for both business and consumer credit. If the property has a value, small and medium size companies could use it as collaterals. And the value of movable properties will become a way for legal framework to allow them to be recognized as valuable assets.

The agricultural products such as foods, live stocks, and fish can include products that will be harvested in 6 months such as cattle and offspring of the cattle or minerals in the ground that are going to be mined.

Based on Holistic Approach, the business and delivery model consists of legal and regulatory framework, creation of electronic registry, building the capacity of stakeholders, and monitoring impact and communication. For the legal and regulatory framework, in Indonesia particularly, there is a legal framework called fiducia security act, of which about 80% is in-line with international best practice. Besides strengthening the fiducia security, Indonesia has also created 157 decentralized registries spread across the islands and centralizing all of them in one place with web-based system where financial institution can go online to search individually on enterprise's name to find out whether the particular assets have been pledged to someone else. We can have the most pristine legal and regulatory framework and wonderful state of the art registry system but if the financial institutions do not have confident in it, due to data integrity issue, the usefulness or benefit of the data will have no value to anyone. The capacity building is more than just making people aware of the legal and regulatory framework. It aims to support them to give transparency and ease of access to financing.

In order to develop good policy, we have to know how it works in another jurisdiction and also the impact of the policy there. Furthermore, we also have to implement 5 key principles to build an effective secured transaction system, which are (1) to broad the scope of assets, (2) to be able to create security interest (the mechanism of financing statement that borrower and lender get into), (3) to be able to publish that we have the security interest in that particular assets, (4) to set a priority rule to set embedded rules (e.g. to determine who is going to receive the claim at the first place if two parties are claiming on the particular assets if it falls to court), and (5) to implement the whole enforcement.

In an ideal situation, at first we deal with stand-alone transaction law then we take the functional approach and lastly, we will build a register regulation along with it which ultimately becomes the operating guidelines.

The key legal principles in a collateral registry need to be a single source of data for all collaterals that are being pledged by all debtors in one centralized place. The data in the database should be very simple (debtor and creditor's information, the type of collateral, and also the value and the term of the loan).

The registration fees and any other fees that are associated with the use of the registry should be a flat fee and set at the cost recovery basis to operate the registry. In some countries, they map the registration or transaction fee against the value of the loan, as the percentage of the loan. But that condition just does not work because generally people will not pay the fees and financial institutions will pass it on to borrowers and this will increase the cost of credit. The registration fee ranges from USD 1 until USD 10, depending on the size of economy, transaction volume, and the cost of overall operation.

In a collateral registry, the registry staffs will process every document by scrutinizing the document to make sure that everything is ok. If they found something that they do not like, they will send them back and reject them. If we want to move to a more modernized environment and to put in one of the secured moveable transaction registry, the role of the registry takes on a different form. The registry staffs are no longer scrutinizing documents; it is being pushed back to the financial institutions. It is the financial institution's best interest to make sure that the data they put in the database are correct according to the legal framework. Sometimes it becomes a bit challenging to get particularly registry people to start changing the way they think.

If we would like to see the impact of a secured transaction and collateral registry program, we must have a strong committed partner to do the reform with us. If there is no political will, the program will not succeed. The reform is based on an international base standard and it can be done with any legal system. Whoever is going to be responsible entity for managing the registry, they need to be on board at the very beginning. We cannot just do the program and then hand over it and expect other parties to handle it. We also need to have a solid legal regime, a modern well- designed

registry and extensive training. The Government role to step up and to facilitate SMEs access to finance is much needed.

Optimizing Access to Finance in Indonesia through Improvement of the Movable Collateral Framework & Registration System

Mr. Aria Suyudi

Legal framework supporting movable collateral registration in Indonesia is 80% in-line with international best practice. Besides fiducia law, Indonesia also has Government regulation (No.86/2000) and Presidential regulation (No.139/2000). However, those implementing regulations are not really in-line with international best practice.

Indonesia's fiducia law broadly defines objects of security as the following:

1. The objects of security is one or more types of goods, including receivables, either present when the security was established or equipped in the future. Basically, it covers any types of movables. The law also stated that security is also extend to proceed of the objects of fiducia security, means that it also accommodate the inventories.
2. The law also mandated that encumbrance of fiducia must made by virtue of serial deeds.

With regards to the fiducia registration, Indonesia's laws cover almost all moveable assets, excluding very limited types of objects which are mortgage ships with gross tonnage of 20 cubic or more, mortgage on aircraft, and pledges. With regards to other moveable assets, the law can accommodate a wide range of moveable assets such as account receivables, inventories, equipment, machineries, crops and fertilizer commodities, live stocks, negotiable instruments, etc. In Indonesia, registration must be made on the basis of notarial deeds while other countries allow direct registration for the movable security registry.

Indonesia has the first fiducia law and establishes the first Fiducia Registry at the Ministry level in 1999. During the past 10 years, Indonesia has 30 decentralized registration office; one in each provinces and more than 150 offices where creditors can file their registration. The bad things about the pre-reformed practice was those offices were not connected to each other. It means that if creditors would like to search information about the registration, they had to know where the objects are registered so they need to check the information in the 30 registration offices.

In terms of the registration operation itself, it was conducted in the manual basis so the applicants had to wait for months to obtain the certificate of fiducia. Due to the length of time in obtaining the certificate, people were trying to expedite their registration process in order to get priority by paying an additional registration fee. The condition made registration process very costly and business parties did not like it. They did not do the fiducia registration process until they saw a problem in their loan. It led to a very low level of compliance with regards to the number of notarial deeds produced by notary to establish fiducia security and the number of actual notarial deeds registered to the fiducia registration offices. It means that the Government lost its potential income because each registration should be a subject to official fee. It also became the problem to SMEs because the registration process was time consumed and costly.

The first registration process reformation was occurred in the year of 2000, initiated by the Ministry of Finance. In October 2012, the Ministry of Finance established a regulation which stated that it is a mandatory for Non-Bank Financial Institutions (NBFIs) who disbursed vehicle loan to register their security to the fiducia registration office no later than 30 days after the establishment of notarial deed. If the NBFIs failed to comply with the regulation then the consequences is the revocation of the NFBIs licence.

The Ministry of Law and Human Rights in cooperation with the International Finance Corporation (IFC) established 3 working groups which deal with the improvement of regulatory frameworks, the modernization of the registry, and the outreach of reform achievement. In March 2013, the working groups launched the first fiducia online registration. The reformation process is still ongoing because a lot of things need to be improved. The first online registration is very simple because it only contains of two fields, which are creditors' name and identity of notarial deed as the base of fiducia registration.

In 2014, the updated version of fiducia online registration was launched. The Ministry of Law and Human Rights start to look at the old data which scattered all over Indonesia. They currently deliberate the idea to amend the Government regulation No.86/2000. At present, the fiducia online registration form consists of 16 columns to be fulfilled. The additional fields are needed to capture more information about market behaviour to create more favourable policies.

Although the regulation stated that creditors or their representatives are responsible to enter the data in the fiducia online registration, in practice it is only conducted by the notary. In the future, the Ministry of Law and Human Rights will open the online registration so it will not only be limited to the notary but also to creditors as mandated by the law.

In the fiducia online registration, we can have information such as the identity of the security provider, the identity of beneficiaries, the key information on the deed of fiducia security, the deed number and date, the name of the notary, and other information such as information about the principal of agreement. In the current fiducia online registration, Indonesia classifies the objects between the ones with serial numbers and without serial numbers. The objects without serial numbers consist of sub-criteria such as cattle, company assets and others while the objects with serial numbers has more comprehensive list of sub criteria such as two-wheel vehicles, four-wheel vehicles, farms equipment, heavy equipment, shares, and obligations.

One of the reformations in fiducia registration process can be seen through the issuance of fiducia certificate. In the past, the fiducia certificate takes time to be issued while nowadays debtors can print out the certificate through the online system after they completed all data needed. At present, the system has provided the facility for creditors and any other interested parties to search the content of the database such as financial identity number and vehicle engine number. The information that has not been implemented in the new version of fiducia online registration is the search engine based on the debtors' name but it will be implemented in the upcoming version. The upcoming search module implemented in the fiducia online registration may provide better access to finance by enabling creditors to have better information about priorities, prior making decision, and improve legal certainty in creditors' priority.

The monthly fiducia registration is consistently high during the period of March 2013 to September 2014, with the average of 655,826 applications. The fiducia registration reached 966,883 applications in April 2014 (the highest application during that period) after the Government announced that they will increase the registration fee by 100% so everyone was in a rush to register before the regulation was implemented.

The pre-reform fiducia online registry also received complaints from its users because fiducia security is not flexible since it cannot be used to secure objects such as stock and company's assets. In reality, based on data, stock, company assets, and cattle have been registered effectively. More than 90% of the registration are vehicles (two and four-wheel).

Indonesia fiducia online registry is operated based on cost recovery. The Ministry of Law and Human Rights has the right to retain 70% of the income made from registration fees which makes it one of their additional incomes.

Intellectual property (IP) is more challenging than moveable collateral because there is very few of people who know how to value IP. India is good in valuing IP. They have made a great start and gone to the right direction. The Ministry of Finance of India has just recently agreed to amend the act to facilitate the implementation of IP as collateral. The amendment had been drafted, endorsed by the Ministry of Finance and have gone through a public consultation, and everyone seems to be very pleased with it. It means that along with the amendment, they will be able to expand other type of movable property to be registered in The Central Registry of Securitisation Asset Reconstruction and Security Interest of India (CERSAI).

CERSAI is 51% owned by the Government and 49% owned by Indian bankers association. The business model developed in India is interesting and it seems to be relatively well from operational perspective. India runs the registry at the arm-length of the Government and keeps a proportion of the revenue, of which a large proportion will go back to central treasury within the India government. That is the arrangement in India. It is a little bit different from business models in most other countries which are being outsourced. The challenge in India is that there are extremely small team, which consists of 5-7 people, and they handle about 100 transactions a month with a limited scope of assets that can be registered. So when the amendment increases the scope of asset that could be registered, they will have a capacity issue from the manpower perspective as well as IT infrastructure as it was not built to be robust enough to accommodate a future increase in volume of transactions.

Key Points

1. Financial institutions are reluctant to take movable property as collateral due to lack adequate legal framework, lack of security in movables, lack know how on movable asset lending, and lack interest.
2. A solid secured transactions system offers some benefits such as increases access to credit, reduces the risk of credit, reduces the cost of credit, promotes credit diversification, and increases market competition.
3. Partner with a strong institution with strong political clout is highly needed because public and private commitment is critical.
4. Reform based on international accepted standards can be done in any legal system but more difficult in civil law countries.
5. Local ownership is the key factor where client, monetary or in-kind contributions, local lawyers, local software solutions, and IT supports will strengthen client ownership and sustainability.
6. Solid legal regime is important but so is a modern well designed registry and extensive training.

7. The reform of fiducia occurs in a quick period of time where a lot of aspects need to be catched up at least the legal framework. The fiducia online registration needs to be improved to so that it is more responsive and effective in practice. Furthermore, it also needs to be encouraged to improve data segregation based on classification, e.g. company or individual debtor, SMEs or non SMEs, and commercial or consumer loan. One of the problems in implementing the moveable secure transaction is lack of understanding among stakeholders, users, and policy makers so the public outreach is also very important.

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Session 5: State Bank & SME-Oriented Commercial Banks

Speakers:

1. Mr. Masahiko Furuya, Director, Japan Ministry of Finance
2. Mr. Johanes Saragih, Senior Vice President, Bank Rakyat Indonesia

Moderator:

Mr. Paul Vandenberg, Senior CBT Economist, ADBI

Public SME Financing and Financial Investment Long Program (FILP) System in Japan

Mr. Masahiko Furuya

The definition of SMEs in Japan is based on the SME Basic Act which differentiates between small enterprises and medium enterprises. In example, based on the law, a medium enterprise in manufacturing industry has its capital up to JPY 300 million with the number of employees is up to 300 people, while for the retail industry; its capital is up to JPY 50 million with the number of employees is up to 50 people. In the small enterprise, the number of employees is fewer than the medium enterprise. The number of employees in a small enterprise in manufacturing industry is up to 20 people while in retail industry is up to 5 people.

There are some aspects of SMEs in Japan; the first aspect is number of enterprises where SMEs reaches 99.7% (3.85 million) from all the enterprises in Japan. The next aspect is the number of employees where SMEs employs more than 66% of labour force. Then, the value added of SMEs, which in manufacturing industry is 50.6% from the total added value (JPY 80.3 trillion).

Besides that, there are differences between the need of financing in small, medium, and large enterprises. Each of the enterprises has their own financial needs. The share of SMEs loan to total loan in Japan is much higher than the US and is almost the same with European area. In the US people can generate money by issuing share and equity, but Japan heavily relies on loans.

Japan has its own financial Institutions systems. In banking industries, there are several types of banks such as city banks (3 major bank: Tokyo-Mitsubishi UFJ Bank, Sumitomo Mitsui Bank, and Mizuho Bank), regional banks or second-tier regional banks, foreign banks, and trust and banking. Beside banks, Japan also has cooperative financial institutions like shinkin banks and credit union. The cooperative financial institutions are much smaller than banks. shinkin bank customers are small and medium enterprises whilst the city banks' consist of large and medium corporation in the city area such as Tokyo.

The number of banks in Japan is 140 (including 3 major banks), 105 regional banks and 270 shinkin banks. The average outstanding loan in banks is 84.62 JPY million while in shinkin banks is JPY 35.76 million.

There are some issues about SMEs financing in Japan such as increasing credit risk, lower reliability of financial statements, fewer collateral by SMEs, and higher cost of monitoring due to the asymmetric information. Furthermore, in the situation of the shortage of saving, banks in Japan still prioritize in giving lending to large corporations.

In Japan, the reforms of public or government institutions were started in 2008. Previously, public institution that Japan has are National Life Finance Corporation; Agriculture, Forestry and Fisheries Finance Corporation; Japan Finance Corporation for Small and Medium Enterprise; The Okinawa Development Finance Corporation; Japan Bank for International Cooperation (that consists of International Financial Operation and The Overseas Economic Cooperation Operation); Development Bank of Japan, The Shoko Chukin Bank, and Japan Finance Corporation for Municipal Enterprise. Lending outstanding of 8 government financial institutions is JPY 90.2 trillion. After the reform, Development Bank of Japan and Shoko Chukin Bank decided to be privatized and some others were merged to be a Japan Finance Corporation (JFC). In average, the share of public financial institutions loan is nearly 20% in 2000 and decreasing to around 14% in 2012 from the entire outstanding loan.

JFC is a policy-based public financial institution, wholly owned by the Japanese government, and aimed to complement financial activities carried out by private financial institutions. Privatization in Japan is a complement from the government because the number of public institutions should be reduced to maximize the market mechanism. Development banks in Japan help large enterprises by giving long term and low rate investment. In the year of 2000, companies can issue bonds into financial market so they did not have to get loan from public institutions. The condition makes economists said that the development banks in Japan should be privatized, but on the contrary they

said that Japan Government should support the public finance institutions to fulfil the small businesses' needs.

JFC is divided into 3 units: Micro Business and Individual Unit (MBIU); Agriculture, Forestry, Fisheries and Food Business Unit; and SMEs unit. The Ministry of Finance is in charge of the Micro Business and Individual Unit focusing in giving loans to small enterprises; the Ministry of Agriculture, Forestry, and Fisheries is in charge of the Agriculture, Forestry, Fisheries and Food Business Unit and The Ministry of Economy and Trade is in charge of the SMEs Unit focusing on giving loan to medium enterprises. Even though the JFC helps to develop the SMEs, it is also subsidized by the government if It got loss in the business. There are several of reasons of the net losses of JFC. One of them is the implementation of low interest rate applied to the SMEs even though the risk of them is high. The interest rate in private institution is 3%-5% while in JFC is 1%-2%.

The JFC MBIU disbursed small loans to a large number of micro businesses. Their loans have reached to 0.95 million units of businesses. 90% of total borrowers in this unit are an enterprise with 9 or fewer employees and 74.1% of those loans are without collateral.

It is not easy for small enterprises to get loans from banks, because their business size are so small, even for getting loans from the shinkin banks. The average outstanding loan of JFC MBIU is JPY 6.66 million, which is too small to be a loan facility in private finance institutions/banks (the average outstanding loan in a banks JPY 84.62 million while in a shinkin bank is JPY 35.76 million). The difference between JFC MBIU institution and a bank is in MBIU, it does not provide checking account process while in banks, it provides checking account process because the absence to do the process will increase the risk of the bank. From the number of borrower perspective, an MBIU can give loans to 0.95 million borrowers while 270 shinkin banks can only give it to 1.14 million borrowers and 140 banks can give it to 2.03 million borrowers.

Small business is a very risky business, but it needs loans without collateral requirement. The Japanese government accommodate the condition by changing the policy for financial institution to disbursed loans without collateral. The government uses the subsidies for public financial institutions to provide loans without collateral. There are 52 Credit Guarantee Corporations (CGC) in Japan providing guarantee for SMEs. If borrowers want to get loans from the private banks, the banks will ask CGC to give the guarantee. At the same time, the corporations need insurance from JFC who provides it. JFC pays huge amount of money to them which funded by the government.

The flow of fund in JFC SME Unit is almost the same with the one in MBIU. The differences could be seen in the use of the loans because it is only exercised for special purposes or based on policy decided by the government while in MBIU it can be used for every purposes like daily needs. In 2012, the total loans provided by the JFC SME Unit are JPY 2.095,7 billion and most of the loans are used for the safety-net loans program (55.1%), loans for enhancing corporate vitality (16.9%), and Great East Japan earthquake recovery special loans program (14.1%).

Growth rate of loans from public financial institutions show inverse correlation with the growth rate of loans from private financial institutions, example during the Lehman shock in 2009, the interest rate for SMEs loans and small enterprise for the JFC is increasing, while the rate from private banks is decreasing. The financing by public financial institutions works as a safety net during economic contractions and tighten lending from private financial institutions.

JFC obtains its fund from the financial market by the assistance from the government. There are some ways for JFC to obtain fund from the financial markets, which are FILP, Government-guaranteed Bonds, FILP Agency Bonds that are issued by the JFC itself, and capital contributions. Japan government gives grants-in-aid and subsidy for JFC in almost every year (around JPY 17.6 billion in 2013).

FILP consists of three elements, namely fiscal loans, industrial investments, and government guarantees. FILP supports policy targets by financing FILP agencies. They provide long-term, fixed, and low-interest (loan interest = government bonds interest) loans, which are difficult for the private sectors to provide.

The difference in the flow of fund between the subsidies of general account and FILP is unlike the general account's subsidies which lack tracking functions for awarded funds, FILP provides loans which accompanies the redemption process of the transferred funds in the future. The redemption process includes a long-term checking function to the beneficiaries. This function facilitates the beneficiaries to use fund in a discipline manner. As FILP plays the role as a national lender (or investor), the FILP's financing scheme could be used when the strong policy needs to generate a certain degree of profitability.

Based on the overall economic policy target of ending deflation and revitalizing the Japanese economy, for the year 2014 FILP is planned to provide capital instruments (e.g. long risk money) as a catalyst to the economy in order to appropriately address the challenges that it faces, such as (1) to active private investments, (2) to support small and medium enterprises facilitating required efforts to improve their performances, (3) to support expanding the activities of Japanese enterprises in overseas market, and (4) to export infrastructures and secure natural resources.

There was an FILP reform in 2001, with the main points as follows: (1) the elimination of mandatory deposit of all postal savings and pension reserves, and introduction of market-based fund raising and (2) the introduction of policy cost analysis and rigorous expansion of information disclosure. In the previous FILP, postal savings and pension reserves deposit their money to become the FILP fund while in the current FILP, the fund comes from the financial markets which buy the FILP bonds.

Financing MSME: Accessibilities are The Key

Mr. Johanes Saragih

We will have a big picture about Bank Rakyat Indonesia (BRI) as one of the commercial banks in Indonesia which has a significant participation in financing MSMEs. In June 2014, BRI made a profit for IDR 11.72 trillion while banking industry obtained IDR 58.43 trillion. Until June 2014, BRI has served 8.2 million debtors with IDR 459 trillion outstanding and 43.4 million saving accounts customers. That is why in the upcoming years BRI plans to buy satellite because the local provider cannot support its operation anymore. In order to run its business, BRI hires 123,000 employees and the number will continuously increase.

BRI divides types of loan to MSMEs into four kinds of loan: loan program which is subsidized by the government, micro loans, retail loans, and medium loans. BRI's policy stated that at least 70% of its portfolio should be disbursed to MSMEs.

MSMEs have their own business behaviour that is why we should develop certain business model to serve every single business segment. BRI has four business models to serve this segment. There are many types of BRI's costumers~~:~~ namely micro loan costumers, corporate loan costumers, medium loan customers, small/retail loan customers, and program loan customers.

BRI has already experienced how to perceive and to serve MSMEs. Accessibility is the key point, which consists of the physical access and the access to finance. We have to put physical access in the first rank because MSMEs cannot spread out to other countries, they will only stay in a particular place. This is the reason why BRI tries to come closer and build outlets to reach those MSMEs. Those outlets consist of conventional outlets, e-channel outlets, and "human outlets".

The conventional outlets that BRI has until June 2014 are almost 10.000 outlets; 1 head offices, 19 regional offices, 18 regional audit offices and 453 branches offices. The branch~~es~~ offices coordinate the E-buzz-Cash office for retail segment, around 600 sub branches for retail segment, more than 5.000 BRI units that specialized for micro banking segments and also control the cash office for the retail segments. Under the BRI units, there are 504 TERAS mobile-cash offices for micro segments, around 2.454TERAS units-cash office for micro segments, and 2 floating TERAS because Indonesia is an archipelago. BRI also has around 19.200 ATMs, 192 Cash Deposit Machines (CDMs), and around 93.000 EDCs. Besides that, BRI has "Human Outlets" which consists of mobile banking and internet banking. The transaction of "Human Outlets" is growing rapidly shown by the data that there 28.4 million debit cardholders and it is part of the potential "Human Outlets" in 2014.

Access to finance means the way MSMEs can afford loans from financial institutions. Low interest rate loan is obtained by giving an easy term and low cost of loan but still in-line with the prudential banking principles. It is shown in the NPL ratio of BRI which is 1.97% while the industry's is 2.16%.

There are four functions in loan management; which are legal, collecting, marketing, and financial analyst. In banking standards, those four functions have to be performed by four people, but in BRI they are handled by one person.

MSMEs are high risk businesses because there is very limited information and mostly lack of financial reports. BRI's loan officers will help the MSMEs to produce the financial reports if the MSMEs (costumers) do not understand accounting. If we want to deal with MSMEs financing, please use their perspective instead of corporate management or corporate banking perspective, because it is totally inaccurate.

There are three important things run by BRI to serve MSMEs; which are Human Resource Development Policy, Business Process, and Outlet. BRI's recruitment system for micro business officers is different from small, medium, and corporate's. Micro business officers has its own training method since the accounting terms such as account receivables, inventory or sales will not be understood by the micro business customers. BRI's loan officers produced the financial report for the customers so both the loan officer and the costumer will be well-informed about the profit.

Loan Approval System (LAS) mobile is a loan approval system which operates with laptop and wireless connection in order to enable the loan officers of micro and retail businesses input the data while they are in the field. After they fill in the data then their superior will approve and send it back to them. The satellite is surely needed to make the process faster.

BRI is very successful in serving SMEs by implementing the same "formula" that has been used for 20 years ago, which is a very old formula to calculate the lending rate. BRI cost of fund in June 2014 is 4.2%. It can reach the base lending rate by executing three key strategies. The first one, it controls its funding so it can get the lowest cost of fund as possible. The second one, it controls overhead cost

(operating activity), because dealing with MSMEs is quite costly. Lastly, it always sounds its credit policy.

The main different of BRI business model compares to other Micro Finance Institutions (MFI) determinant factor is the quality of loan officer. That is why BRI puts integrity in the highest level. BRI does not chose its employees based on of their intelligence only, but the most important aspects are honesty and diligently.

Key Points

1. It is not easy for small enterprises to get loans from banks, because their business size are so small, even for getting loans from the shinkin banks. This is due to small business is a very risky business. It needs loans without collateral requirement. The Japanese government accommodate the condition by changing the policy for financial institution to disburse loans without collateral. The government uses the subsidies for public financial institutions to provide loans without collateral.
2. Accessibility is the key point in serving MSMEs, both the physical access and the access to finance. The physical access is put in the first rank because MSMEs cannot spread out to other countries, they will only stay in a particular place. This is the reason why BRI tries to come closer and build outlets to reach those MSMEs.

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Session 6: Guarantees – Republic of South Korea's and Indonesia's Experience

Speakers:

1. Mr. Yong Pyung Park, Korea Credit Guarantee Fund
2. Mr. Bobby Hamzar Rafinus, Deputy Minister for Fiscal and Monetary Coordination, Coordinating Ministry for Economic Affairs

Moderator:

1. Mr. Shigehiro Shinozaki, Senior SME Finance Specialist, ADB
2. Mr. Jae Ha Park, Deputy Dean, ADBI

Introduction to Credit Guarantees in Korea – KODIT and Korea's Experience

Mr. Yong Pyung Park

The definition of SMEs in Korea is quite the same as the one in the Japan. Korea uses two criteria to define them, number of employees + capital and number of employees +sales.

Like any countries in the world, the proportions of SMEs are quite large compared to total institutions. There are more than 3 million companies in total where only about 3.000 companies are large enterprises. There are 15 million employees in total and only about 2 million employees of them are employed by the large enterprises.

The credit guarantee institution is like a bypass or a small tower between SMEs and the banks. It will guarantee the repayment of credit risk of debtors so that the banks are willing to lend some money to SMEs. Many academics criticize that credit guarantee is the second best option or solution to solve the financial problem of SMEs.

In Korea's case, using the credit guarantee in direct way to solve the SMEs financing problem has many positive things. The blockage was removed by this bypass solution. Credit guarantee, especially in market economy, aims to change the attitude of participants: banks and SMEs.

In the past, SMEs tried to have collateral so they invested in land and properties. After credit guarantee existed, they started to change their attitude. They rather moved into the situation which more focuses on loan timely payment, loan interest, and loan principle. They focus more into the business itself rather than the collateral or other necessary things.

Korea's credit guarantee system started in 1961 when the Korean government established an Industrial Bank of Korea, which is called IBK that specializes in SMEs lending. In that era, Korea was under authoritarian government and it orders banks to setup a reserve. Banks collect extra 3% from the borrowers and they will accumulate it as fund. When SMEs loan are risky enough, they use it as a reserve. In 1972, when Korean economy was hit by the oil shock (the first oil shock), the bank has tendency to "lend umbrella in the shiny days and take it back in the rainy days". After the oil shock, the banks were not only reluctant to lend money to SMEs; but they also tried to reimburse those loans. Many SMEs rely on the private financial institutions, which charged around 20% or even 50% or 100% of interest rate.

Related to the condition above, the Government enacted a presidential emergency decree to order all commercial banks to have their own credit guarantee funds. Now the entire banks have their own credit guarantee funds. At that time, Korean economy was growing so fast like more than 10% even 20%.

In 1976, Korea Credit Guarantee Fund (KODIT) was established and in 1989 the government setup a Credit Technology Guarantee Funds called KIBO for the venture capital or technology oriented companies. In 1999, there was a self-autonomy movement among the region and that became the reason for the government to setup The Regional Credit Guarantee Foundation Act. Korea has three credit guarantee institutions, which are KODIT, KIBO, and other 14 credit guarantee corporations in the regional governments.

Before KODIT was established, the guarantee funds have low liability because the banks just accumulated 3% of their specific loans which size is too small. It is hard to change their attitudes towards SMEs loan. So, after KODIT was established, it had higher reliability in the article of credit guarantee act which stated that if KODIT loses a lot of money, the final responsibility goes to the government. The government is always ready to contribute to KODIT financial performance.

In 1976, the total guarantee result was KRW 29 billion, which is very small amount of money, and it grew to become KRW 135 billion in 1980. The guarantee outstanding in 1976 was KRW 102 billion, as the result of 15 years of credit guarantee system. In 1980, after like four and half years later, the guarantee outstanding grows to KRW 1.255 trillion. So, it can be said as a successful result.

The credit guarantee institutions in Korea consist of KODIT as the leading institution, KIBO and 16 guarantee foundations or corporations. The government separates the target business area so that

the credit guarantee institutions will not compete to each other for the same SMEs. The target business for KODIT is general SMEs, which are exporting and start-up companies. KIBO has a target market in technology oriented and venture companies. Others credit guarantee institutions' target business is micro companies. The market share is 55% for KODIT, around 26% for KIBO, and around 19% for the others.

Korean government tries to control the guarantee total amount of the SMEs loan because if guarantee were applied too much in the market, there will be a possibility of moral hazard so it is reluctant to expense too much on the guarantee in the financial market.

The most important thing in operating credit guarantee organization is the funding. There are three main sources of funding in Korea:

1. Government

   The funds come from the government annual budget and very irregular. When government think that a party needs to expand some kind of SMEs lending, then government gives it money. After the global financial crisis, government worried about bankruptcy among SMEs so it wants to fuel the money into the economy. It put a lot of money for about USD 2 billion into KODIT to extend so many credit guarantees to the SMEs at that time.
2. Banks

   The most important source of funding is the bank. Under the Korea credit guarantee fund act, bank should donate in proportion to monthly balance of outstanding commercial loans.
3. Others

   Occasionally KODIT receives some contribution from the large enterprises but in a very small amount of money.

Government contributions tend to increase during the crises and decrease during the stable economic conditions

The cost of guarantee ceiling is divided into two categories: cost for general ceiling is around KRW 3 billion per enterprise and cost for special ceiling is around KRW 7 billion. There is also coverage ratio, which can be used as an instrument to prevent moral hazard of a financial institution, because with this risky sharing the banks will rely more to the guarantee fund. In the past, when KODIT guaranteed 100% of the loan, the banks did not care about the guarantee loans.

The rating classification is ranged between K1 until K15. K1 is the best credit rating; the company with this rating result will receive the 70% of coverage ratio while K 15, the lowest or the worst rating, will get 85%. So, it looks unusual because better enterprise should get more coverage ratio while worst rated company should get less coverage ratio. KODIT implemented the policy because it wants to intervene so much in the financial market. K1 companies have already obtained an easy access to get loan from the banks, but on the contrary, the K15 companies need more credit guarantee. Besides that, if a company uses credit guarantee for more than 10 years, KODIT will lower the coverage ratio by 5%.

Supervisions and appraisal is the key success factors for a good credit guarantee system. There are so many governmental bodies that put their eyes on us. The Ministry of Strategy and Finance, The Finance Services Commission, The Small and Medium Business Administration, The National Assembly, and The Board of Audit and Inspection are supervising KODIT. As a government sponsored organization, KODIT is monitored and assessed by related authorities.

In Korea, the credit guarantee is used as a counter-cyclical policy. The total amount of guarantee loan is not related to the SMEs loan; it is tied to GDP of Korea. Korea Government tries to maintain the total credit guarantee loan around 5% from the GDP. By doing that, the proportion to the total SMEs loan is controlled because SMEs loan tends to increase, according to GDP growth rate. If we look at the year of 1998, 2001, and 2008, if the GDP decreased, the credit guarantee outstanding increased and vice versa. In 2011, the contributions from the bank increased a lot because KODIT came up with a program with a special guarantee. If one bank participated, then the other banks started to contribute more on the credit guarantee program.

Through this credit guarantee system, the SMEs lending increases a lot. We cannot say that credit guarantee system is the only factor that caused the increasing numbers, but the government who takes a big part is also an important one. The government encourage the banks to lend to SMEs, create another credit guarantee system, and have other non-financial supporting organization.

So, credit guarantee is powerful policy tools for government because it can be used as an efficient way to distribute financial resources. Furthermore, the credit guarantee changes the attitudes of participants (banks, SMEs, or even other participant such as tax services agency).

KODIT tries to maintain its default rate at around 5% and pays out for about 3% of the total guarantee amount. By doing that, according to KODIT's cash flow, from the 3% paid-out, around 1.2% is covered by guarantee fee from the enterprises and about 2% is covered by contribution from the banks. Any other administration expenses are covered by the return on KODIT's investment. So, KODIT is well-prepared in term of cash flow.

The main purpose credit guarantee is that the SME can get access to formal financing with lower interest rate through credit guarantee. Furthermore, the sustainability of guarantee system is

crucial, although KODIT pays more attention to SMEs access to finance, it also maintain its financial performance by determining the default rate for 5% at the maximum.

Public credit guarantee in Korea is not only develop the SME but also develop the infrastructure of some companies. KODIT not only guarantees the SMEs loan but also becomes the credit guarantee infrastructure and provides insurance and consultation.

"Kredit Usaha Rakyat" – SME Financing Through Credit Guarantee Scheme: Indonesia Experience

Mr. Bobby Hamzar Rafinus

The amount of SMEs in Indonesia is more than 99% from all the entities in Indonesia. SMEs have an important role in employment creation as well as contribution to Indonesia's GDP. In financial sector structure in Indonesia, banks have a dominant role because almost 80% of Indonesia's financial system is dominated by banking sector. The SMEs definition in Indonesia is divided between micro, small, and medium enterprises. A micro enterprise is a company with assets bellow IDR 50 million or equivalent to USD 4,167, a small enterprise is a company with assets ranged from more than IDR 50 million to IDR 500 million or equivalent to USD 41,667 and a medium enterprise is a company with assets ranged from IDR 500 million to IDR 10 billion or equivalent to USD 833,340.

"People Business Credit" or in Bahasa called as "Kredit Usaha Rakyat (KUR)", is a public program. This credit scheme is established by the Presidential Instruction No.6 in 2007. The instruction has a mission to accelerate the development of real sector and empowering the MSMEC (Micro, Small and Medium Enterprises and Cooperatives). The goal of this instruction is to enhance economic growth, to provide job opportunity, and to reduce poverty. There are four sections under the Presidential Instruction are as follows:

1. Improvement in financing access.
2. Entrepreneurship development.
3. Market improvement for SMEs and Cooperative products.
4. Reform on SMEs and Cooperative regulation.

There are some constraints in dealing with the SMEs because they have limitation such as capability of human resources, market coverage and networking, technology capability, financing access from banks, and the ability of SMEs to provide collateral.

If we look at those five limitations above, at least there are two constrains that we need to address, which are financing access from banks and the ability of SMEs to provide collateral. According to Bank Indonesia's data, the financial inclusion index in Indonesia, especially credit, is relatively low, for around 20% to 25%. It is important for the government to improve the accessibility of the SMEs. As we know, we have global financial crisis in 2008 until 2009 and it impacts Indonesian economic because Indonesia's economic growth in 2008 decreased to 4.8%.

The other target related to the poverty alleviation is the reduction of poverty rate from around 13% to 10% from the period 2010 until 2014. Additionally, the unemployment rate also is also targeted to decrease from around 8% to 6%. This Presidential Instruction is a part of government's effort to achieve the target. Indonesia has huge amount of micro enterprises for about 45 million units, but we have only few small enterprises for just 600.000 units and fewer in medium enterprises for only 44.000 units while for large enterprises is 4.000 units.

In the beginning, the People Business Credit or KUR is developed to finance working capital and also investment for productive, flexible, and non-bankable micro and small enterprises. Initially, the credit limits was IDR 500 million or equivalent to USD 42,000 which partially guaranteed by the government through the credit guarantee company.

KUR program is targeted to the productive businesses which are businesses that produce goods and services, provide added value and increase business revenue; the feasible businesses which are businesses that makes profit so they have ability to pay their loan and to develop their business; and also the non-bankable businesses, which are businesses that cannot meet the banks' requirement especially in the provision of collateral.

Indonesia government in dealing with poverty alleviation implements three-cluster approach, such as:

1. Dealing with chronic poor people

   The government has social assistance on dealing with chronic poor people's problem such as social assistant in education and health.
2. Dealing with empowering the society

   The government provides credit programs with low interest rate.
3. Dealing with productivity improvement

   The objective of the cluster is an effort to push people escape from the poverty level through productivity improvement.

In KUR scheme, the government has a KUR policy committee that assigned Guarantee Company by providing guarantee fee and also capital. The guarantee company will set a contract with the executing banks which will give loan to SMEs.

The stakeholders of KUR program consist of government, executing banks, guarantee company, and supervisors or oversight institution. In the government side there were 10 ministries and in the executing there were 33 banks which 4 of them were the biggest bank in Indonesia and others is regional development banks, There are also 2 national credit guarantee companies and 2 regional credit guarantee companies. The supervisor for this program is Bank Indonesia (the central bank of Indonesia), the Financial Supervisory Agency (OJK) and the Government Audit Agency (BPKP).

In KUR Scheme, the funding for loans comes from the banks, while the loans are guaranteed by the government. Micro credit is not required to provide collateral to push the access of micro enterprises to the banks. Until August 2014, the credit disbursed is around USD 13.75 billion while the government support for this program is around USD 1.4 billion. It is closed to Korean experience where government budget had already generated ten times of credit from the banks.

There are two schemes of credit for KUR program:

1. Micro KUR (KUR Mikro)

   The amount of credit is up to IDR 20 million (equivalent to USD 1,700) with the maximum interest rate is 22% p.a. In providing more access to Indonesia's micro enterprises, the Debtors Information System checking is not necessary, so is collateral. On the contrary, in practice, some banks still ask for additional collaterals. The government still in discussion with the central bank and the executing banks to develop an instrument of micro credit insurance. As we know, 70% risk sharing come from the government, but the bank still burden around 30%. That is why some banks still ask for additional collaterals. Actually, the understanding of no collateral is the business itself as the collateral.
2. Retail KUR (KUR Ritel)

   The amount of credit is above IDR 20 million until IDR 500 million (equivalent to USD 42,500) with the maximum interest rate is 13% p.a. The Debtors Information System is required and additional collateral should be provided.

There are other regulations related to KUR program, which are KUR working capital program that could be extended from 3 to 6 years, while KUR investment program could be extended from 5 to 10 years. Indonesia also develops the linkage credit program with maximum amount of IDR 2 billion. Beside the regular sector, Indonesia defines the priority sectors which consist of agriculture, fisheries, marines, small industry, forestry and also Indonesia Migrant Worker. Government's risk sharing for the priority sectors is 80% while for the others is 70%. The guarantee fee for this credit guarantee is 3.25%, so when the default exists, the government will pay 70% of the fee, means around 2.4%. For the plantation sector, the tenure of the credit can be extended until 13 years. Indonesia also pushes the bank for having channelling and also executing linkage with micro finance institutions.

Government has a big role in KUR program; it is shown in the evolution of KUR regulation. Government, through the policy committee, designed regulations for this program, e.g. regulation for types of credit. In the beginning, KUR program only offers one type of credit, which maximum amount is IDR 500 million but started in 2008, there were 2 type of KUR program: micro KUR and retail KUR. There was also change regarding the interest rate, where government tries to negotiate with the bank in reducing the interest rate. For the micro KUR, the original interest rate was 24% but since 2010 it was reduced to 22% while retail KUR interest rate decreased from 16% in 2007 to 13% in 2012.

On the other hand, the government increases the guarantee fee. The original guarantee fee was 1.5% and at the beginning of 2010 it increased to 3.25%. This guarantee fee increasing was a part of government effort to improve the credit volume to the SMEs. The other change is related to KUR coverage. Originally, there was only 1 scheme of coverage (70%) but started in 2010, the coverage for mainstream or priority sectors increased to 80%.

In 2007, there were only 6 banks who involved in this program; then in 2010 the regional development banks were included in this program so there were 33 banks in total who involve in KUR program since 2012. There were only 2 companies who involved in this program but nowadays there are 4 credit guarantee companies who joint it. The biggest two credit guarantee companies are state-owned enterprises. The capital injection from government is part of its effort to strengthen the credit guarantee companies and to maintain their sustainability. The government will only give capital injection for 5 years (2010 until 2014). Indonesia has only one private credit guarantee company with a small size that caused the government for not involving the private credit guarantee company on this scheme. The government policy so far is to support the development of regional credit guarantee companies which two of them have become part of the member of this KUR program.

The development of KUR stakeholders is also shown by the involvement of ministries. At first, only 7 ministries involved but now there are 10 ministries who support it. The same condition goes to the

number of regional governments involved. In 2010, there only 3 provinces that joined this program but recently, 33 provinces have already became KUR program partners.

There are four rules to ensure that the credit comes to the right target, as follows:

1. Preparation steps

   Technical ministry is in charge in preparing productive, feasible, but non-bankable SMEs to be finance by the banks.
2. Policies and priorities of the business

   Establishing policies and priorities of the business that will receive credit guarantee or financing.
3. Providing guidance and assistance during the credit or financing period.
4. Facilitating coordination between SMEs and cooperative with other parties such as the company's core/off taker who contributes and supports business.

The Government supports the guarantee company from the budget side. There are two kinds of budget support; the first one is by paying the guarantee fee and the second one is by giving capital injection, especially for credit guarantee company. Related to the Presidential Instruction, one of the goals is to strengthen the credit guarantee scheme. Credit guarantee scheme in Indonesia was started in 1960s but the development of the guarantee was very slow because it just covered small limitation businesses, especially cooperatives.

From the period of 2007 until August 2014, the credit disbursed to 11 million debtors and the volume of credit was around IDR 164 trillion. There were an increasing in guarantee fees in 2007 that caused the volume of the credit started to increase from IDR 17 trillion in 2010 to IDR 29 trillion in 2011, IDR 34 trillion in 2012, and IDR 41 trillion in 2013.

The problem Indonesia facing now is the high NPL ratio which comes from the regional banks. Indonesia~~n~~ is in the process of improving its regional bank performance, especially in dealing with the micro enterprises. Bank Indonesia will gradually require banks to disburse their credit proportion to SMEs for 20% of their total credit in 2018. This credit scheme is also part of the effort to strengthen the capacity of banking system in delivering financing or credit to SMEs.

Related to KUR distribution in Indonesia, most of it was distributed in Java Island (more than 45% of total loan). The concentration happened because the population and the business activities were concentrated in Java, especially Central Java while the distribution in North Sumatera and South Sulawesi reach around 4.5% each province. This distribution reflected the potential economy of the region in Indonesia.

The distribution by sector in August 2014 is still dominant by trade, restaurant and hotel sector for 38.6% and this is also reflecting the credit distribution in the banking system. The distribution to agriculture and fisheries sector is 16.6%, and to small industry sector is 3.4%. Actually the priority sector (agriculture and small industry) have higher coverage ratio but so far the KUR performances in that sector only reach 20% of the KUR distribution.

The National Socio-Economic Survey (SUSENAS) made a KUR evaluation in 2011 which data shows that about a third of households of KUR recipients are in the 40% bottom group. Although there are many KUR recipients from households in the non-poor, KUR is still good enough to reach the poor and near-poor groups. As a safety net, KUR need improvements in targeting and defining efforts to reach the poor consumer.

Another study was comparing KUR program with National Program for Community Empowerment (PNPM Program). Data shows that the KUR recipients come from lower socio-economic households compared to the commercial credit recipients. It means that KUR can fill the void of access to credit for poorer groups than the average bank customers. On the expenditure per capita side, the debtors of KUR program are in the middle economic position between the debtors of PNPM program and commercial bank.

The other indicator that we evaluate is the KUR performance by looking at the growth of micro KUR (in which the recipients are mostly come from small and micro enterprises) and retail KUR (the majority recipients are medium size enterprises). The number of micro KUR which is higher than retail KUR shows that KUR already achieve its mission to promote the access for micro, small medium enterprises and to minimize the gap between micro and small enterprises with medium size enterprises.

Credit guarantee companies' data shows that the impact of KUR on employment is more on the maintenance current employees in the micro and small enterprises. The other impact of KUR called as migration. As we know that KUR is targeted for non-bankable SMEs. After few years those SMEs become part of KUR debtors, they become commercial debtors. According to BRI experience, there are around 10% of their KUR debtors who become commercial debtors.

Key Points

1. Credit guarantee is powerful policy tools for government, an efficient way of distributing financial resources, and tools to change the attitudes of participants.

2. In designing a credit guarantee scheme, we have to consider moral hazards (guaranteed companies, banks, and guarantee institutions), funding, and market distortion.
3. The limitation of MSMEs and Cooperatives are capability of human resources, market coverage and networking, technology capability, financing access from banks, and the ability of SMEs to provide collateral.
4. Although there are many KUR recipients from households in the non-poor, KUR is still good enough to reach the poor and near-poor groups. Improvements in targeting and efforts to reach the poor consumers can make KUR serves more as a safety net.
5. The banks need to be encouraged in giving credit in the priority sectors, such as agriculture, fisheries, marines, small industry, forestry and also Indonesia Migrant Worker to increase access to finance of them.

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Session 7: Capital Markets

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Is There Potential in SME Capital Markets in Asia?

Mr. Shigehiro Shinozaki

Asia has been growing continuously and the growth of Asia has been alleviating poverty and increasing the number of major income country in developing Asia. The small and medium size enterprise has a key role of promoting Asia's sustainable economic growth. Economic expansion in Asia has created a foundation of growth oriented in SMEs, with a need for access to long-term growth capital. The barriers of national efforts in developing SMEs capital market in Asia also related to the demands on SMEs for capital market financing. In fact, the development of capital market for SMEs has become a new challenge in SMEs finance.

The SMEs as the backbone of the Asia Pacific economies, counting for more than 90% of total enterprises, and contributes to around 70% of national labour forces during the 2007 until 2012. On other hand, SMEs only contributed for 30% to 40% of GDP. The number shows that SMEs contribution to the regional economies can be expanded further. The SMEs also influence the trade; in China, SMEs contribute for 41.5% of total export in 2012 (6.8% yoy). In Thailand, they participate for 28.8% of total export (3.7% yoy). The number will continuously grow since SMEs have a big potential to be developed. SMEs become part of global change that has potential to promote the international trade and to mobilize domestic demand.

As recognized, poor access to finance is one of the critical factors inhibiting the growth cycle of SMEs. The International Finance Corporation (IFC) and McKinsey estimate that the gap in formal SMEs credit is USD 700 billion to USD 850 billion which is equivalent to 21% to 26% of total formal SMEs credit outstanding in the developing world. If informal SMEs, especially micro enterprises, are included, the gap or amid financing demand were USD 2 trillion in the developing countries, and the gap is getting wider with the newest data.

Many countries in Asia Pacific thought SMEs as key for inclusive economy, and as source of job creation. They have established a comprehensive midterm action plans to promote the SMEs growth. National development of SMEs in general includes encouraging the market access, enhancing productivity, creating the compatible environment, formalising the informal SMEs, and helping the SMEs to adapt with the technology to innovate their business.

At the national level, many factors have been developed to improve SMEs access to finance, including the public credit guarantee scheme like people business credit or Kredit Usaha Rakyat (KUR) in Indonesia, the guarantee scheme in Thailand, and direct lending in Philippines. There are also transaction reforms to establish collateral registries in promoting movable assets financing in Pacific region, financing scheme in Bangladesh and Malaysia and establishment of centralize credit bureau in Vietnam. However the main policy focus is on enhancing bankability in Asia and Pacific.

From the findings of The Asian Development Bank (ADB) stated in the working paper on regional economic integration, it is known that most of the SMEs in China, India, Korea and Malaysia still seek for access to formal financing such as bank loan and diminish the informal finance dependency. In the loan term issue, most of the credits in those countries were diversified as long-term funding with tenor for more than 5 years. Even though, they have demands on the formal financing and long term funding, and the SMEs in these countries still have difficulty in accessing the financing instrument they desire.

There is also awareness of issues about the limit of bank financing for SMEs under the continuing global financial uncertainty. Related to that issue, a diversification of financing scheme is necessary because no one-size-fits-all financing solution. The SMEs' needs for long term funding will increase as they grow further; that becomes the reason to provide a comprehensive menu of policy options for SME financing.

By looking at the current SMEs capital markets in Asia where central bank's financial system has been established, the SMEs capital markets are still in the early stage of the industry development. Equity markets for SMEs in emerging Asia are typically small in scale; with market capitalization is equal to less than 10% of GDP and market performances that significantly vary by country. For example in China, the SMEs have sharply expanded in terms of size and number. On the other hand, the SMEs market capitalization in Korean Securities Dealers Automated Quotations (KOSDAQ),a largest organized market for SMEs and venture businesses in the Republic of Korea, and Growth Enterprise Market (GEM), an alternative stock market for high-growth enterprises in Hong Kong recover from the global financial crisis in 2008 but the growth of these markets tends to be slow. The market size of Catalyst in Singapore, ACE Malaysia, and Market for Alternative Investment (MAI) in

Thailand, in the long term has not expanded well like similar markets in the People's Republic of China (PRC) and the Republic of Korea, since their listed companies are not increasing at a sufficient pace. From those condition mentioned, it seems that the equity markets in Asia, except for those in the PRC and the Republic of Korea, have not yet become a financing venue for SMEs. Extensive national policies and strategies for improved SMEs access to capital markets are needed.

We can get further information about the development of capital market in Asia by looking at MAI in Thailand which was established under the Stock Exchange of Thailand (SET) in 1998. Its main mission is to provide opportunities for entrepreneurs and SMEs to tap long-term growth capital. Since the first listed company appeared in 2001, MAI market has been growing. As of 19 September 2013, MAI holds 89 listed companies with total market capitalization of THB 180 billion and total turnover value of THB 448 billion. So far, 14 companies have successfully moved from MAI to the main board of SET since the establishment. The Thai government initially introduced a tax incentive scheme for newly listed companies in MAI, i.e. corporate tax reduction from 30% to 20% for five accounting periods, which boosted the number of listed companies in 2004 and 2005, but this tax privilege is no longer available as the government has uniformly reduced corporate tax for all firms.

Actually the Securities and Exchange Commission (SEC) of Thailand is taking several initiatives to develop SMEs capital markets in Thailand, which mainly comprises three programs. First is the program to promote SMEs bonds issuance through educating SMEs and creating incentive schemes for them to tap bond market. Second is the program named "IPO, Pride of the Province" to facilitate potential growth of local firms to raise funds from capital markets through the provision of free training courses, consultations, and listing fee exemption. Third is the program to allow accredited investors to invest in riskier products such as unrated bonds. So, enhancing capital market literacy for the traditionally underserved SMEs is a common approach across these programs. This initiative by the government and SEC is a very good practice to develop SMEs capital market.

There is a new movement for creating SMEs bond markets in countries such as China and Korea. In Korea, a Qualified Institutional Buyer (QIB) system was established for SMEs bond trading in May 2012. However, SMEs bond transactions under the QIB system are quite limited and are not attractive to individual and institutional investors because of the existence of low investment grade bonds, in example the BB or below. China has developed three types of SMEs bond instruments: (i) SMEs Collective Note, (ii) SMEs Joint Bond, and (iii) SMEs Private Placement Bond. The SMEs Collective Note market is an inter-bank market regulated by the People's Bank of China (PBOC) and the National Association of Financial Market Institutional Investors (NAFMII). It grows rapidly, with annual issuance of CNY 10.6 billion in 2012.

About the regulatory structure for capital markets that SMEs can tap in selected Asian countries, the data shown that as a whole, the baseline laws and regulations (capital market law) show no differences between the general and SMEs markets in the observed countries. Under the control of uniform capital market laws and regulations, the responsible regulator (e.g., Securities Commission), stock exchange, or the operating Self-Regulatory Organization (SRO) generally provides special rules, guidelines, and regulations on SMEs markets. The listing criteria and the disclosure requirements for SMEs markets are widely lightened as compared with the main board of the stock exchange. However, there are some limitations to reduce the requirements for listing and maintaining stocks in such concessional markets. SME markets have mainly been created under a stock exchange or regulated SRO. Given the no stand-alone and specialized legislation that is separated from the general set of capital market laws, direct financing venues may be inflexible to SMEs funding needs, particularly in size matters. For instance, the minimum number of shareholders in a stock offering and the maintenance of stocks stipulated under the baseline laws may not fit the funding needs of those who want to raise small funds from limited investors. The regulatory framework for SMEs capital markets should be flexibly examined upon necessity.

In 2013, ADB assessed the potential of capital market financing for SMEs by a survey for the supply- and demand-sides of capital growth, study meetings and interviews. The survey was held in selected countries: China, India, Korea, and Malaysia. The supply-side survey was aimed to review regulatory and policy stance, business and investment needs, and critical factors for developing SMEs capital markets. Meanwhile, the demand-side survey was aimed to investigate funding needs of SMEs, barriers to accessing finance, and critical factors for establishing an SME-friendly market.

There is a finding from ADB survey in 2013, about whether a special equity financing and bond issuance venue for SMEs is needed for creating the base of high quality SMEs that drives sustainable economic growth and pro-poor growth at the national level. The survey assessed their willingness to access SMEs capital market. SMEs respondents in study countries are likely to utilize such a specialized market venue for their future funding if established, with positive answers of 77% in China, 83% in India, 82% in Korea, and 54% in Malaysia. In India, Korea and Malaysia, they relatively preferred to access an equity market rather than a bond market. The major reasons of their preference are to increase easiness of funding overall, funding alternative besides banks, and to increase social credibility of the company expected. Meanwhile, Malaysia indicated that the major constraints to access SMEs markets are procedure to issue stocks complicated and cost to issue stocks such as listing fees and maintenance of their listed stocks. It suggests that simple procedures and low cost structures are keys for designing a functional SMEs capital market, given the potential demands on SMEs.

The ADB survey also shown that from the financial institution and regulators side, more than 80% of the respondents in respective study countries have recognized that developing SMEs capital markets is a policy priority at the national level. In line with that, around 80% of the respondents in each country answered that potential demands on SMEs for long-term financing increase as Asia's growth is continuously driving the global economy and that SMEs growth is accelerated further through direct provision of capital growth for SMEs. Moreover, they identified that the limitations of bank financing for SMEs require diverse financing modalities for them, which is SMEs capital markets.

According to survey result, all study countries considered a comprehensive policy framework for SMEs access to capital markets is needed; especially policy measures to develop investor base for SMEs markets and to promote market literacy for SMEs and investors. The establishment of SMEs database and policy measures to build the base of professionals that support SMEs in capital markets are ranked top as a necessary policy support area for SME markets.

There were two-split opinions among country respondents about the type of markets that would be appropriate for SMEs. In China, India, and Korea, around 70% of the respondents preferred the development of a domestic exchange market as an appropriate capital market venue for SMEs, while in Malaysia around 65% indicated non-exchange market represented by a non-SRO operated market as an appropriate capital market venue for SMEs. Additionally, China, India, and Korea generally evaluated that the exchange market has a cost-efficient structure because they already established trading platforms to be utilized for SMEs under stock exchange and a relatively well-organized risk conscious mechanism with transparency backed by laws and regulations. Meanwhile, Malaysia expected that non-SRO operated SMEs markets for unlisted SMEs are appropriate as preparatory markets for SMEs before tapping regular markets.

On the other hand, the ADB survey also asked about types of markets that would not be appropriate for SMEs. In China, India and Korea, around 30%–40% indicated that non-exchange market represented by a non-SRO operated market and a specialized market for socially-oriented firms, as an inappropriate market venue for SMEs. On the contrary, the respondents in Malaysia indicated the domestic exchange market as inappropriate for them. In particular, the respondents in Malaysia considered that even if the exchange market provides preferential measures for SMEs such as lowering listing criteria and fees, the lack of SMEs' ability to tap capital markets, especially in complying with disclosure requirements, is still a critical hurdle for establishing an SME market. They considered that a private-led preparatory market is needed to foster the base of potential SMEs that eventually move to the exchange market. This different point of view in the thought of about the type of market which appropriate for SMEs shown that there were different strategy among the government and different types and characteristics of the SMEs.

The comparison of critical factors to create SMEs supply-and demand-sides is also become one of the topics that being analysed in the survey. In every study country, there was gap between both sides in priority actions to establish a functional SMEs market. In China, the supply-side, indicated that top three priorities to be taken are (i) a well-established regulatory and supervisory framework, (ii) a mechanism that supports SMEs in preparing disclosure documents, and (iii) a simplified listing procedures. On the other hand, these actions ranked eighth, sixth and third in the demand-side and shown a gap. Meanwhile, SMEs pointed out that (i) raising funds speedily, (ii) small amount funding available, and (iii) simplified listing procedures as top three priorities in the demand-side, while these ranked eighth, fifth, and third in the supply-side.

In India, top three priorities in the supply-side were (i) raising funds speedily for SMEs, (ii) simplified listing procedures, and (iii) information dissemination of SME capital markets, while these ranked fourth, third, and tenth in the demand-side. The top three in the demand-side were (i) simplified disclosure requirements, (ii) low cost for listing and maintenance, and (iii) simplified listing procedures, while these ranked tenth, fifth, and second in the supply-side.

In Korea, top three priorities in the supply-side were (i) simplified listing procedures, (ii) low cost for listing and maintenance for SMEs, and (iii) low cost for establishing and operating an SME market, while these top two issues ranked sixth and fifth in the demand-side. The top three in the demand-side were (i) a well-established regulatory and supervisory framework, (ii) tax incentive schemes for issuers and investors, and (iii) simplified disclosure requirements, while these ranked sixth, seventh, and ninth in the supply-side.

In Malaysia, top three priorities in the supply-side were (i) tax incentive schemes for issuers and investors, (ii) low cost for establishing and operating an SME market, and (iii) raising funds speedily for SMEs, while such the first and the third issues ranked fifth and fourth in the demand-side. The top three in the demand-side were (i) simplified listing procedures, (ii) simplified disclosure requirements, and (iii) low cost for listing and maintenance, while these ranked ninth, eleventh, and seventh in the supply-side.

The critical factors to create SMEs markets vary among countries due to different circumstances of SMEs financing and capital markets. However, these findings suggest a common issue in priority actions between the supply-and-demand-sides: i.e., actions to reduce cost burden for SMEs to tap capital markets. The cost issue is often touched upon when establishing SMEs markets because the market size is anticipated to be typically small in scale. On the whole, country respondents tended not to see the establishment cost as a critical barrier for a new market if it is needed. However, the cost issue is yet crucial for creating a sustainable market venue for SMEs, considering that low cost

structure of SMEs market for both SMEs and market organizers is indispensable for a sustainable long term financing venue for SMEs.

There were 2 brainstorming that being discussed in the ADB working paper, the first one is about the creation of an exercise equity market for SMEs, especially in lower middle income Asian countries. The concept is to create a preparatory market for “smaller but growing” firms that will eventually tap the regular market of stock exchange. Previously, the concept was discussed in Indonesia as part of the JICA Capital Market Project (2008–10). The exercise market is (i) an equity market for unlisted SMEs that are willing to raise growth capital, (ii) independent from the regular market stock exchange, (iii) learning venue for SMEs to learn more market rules and obligations such as disclosure before tapping the organized market, (iv) a mechanism supporting SMEs in equity finance from various angles, (v) channel investment capital into “smaller but growing” firms, and (vi) lead high-end SMEs to business growth cycle.

The exercise market has a comprehensive mechanism for supporting SMEs in equity finance from various angles, which is combined with (i) fostering the venture capital industry as an initial risk capital provider for SMEs; (ii) developing the base of professionals supporting the SMEs disclosure process, such as CPA networks; and (iii) designing government policy support measures such as tax incentives scheme for SME issuers and investors. There were so many external parties that should coordinate to support the exercise equity market, and the market is just a mechanism not an infrastructure. By developing the exercise equity market, both the SMEs and the market side will get benefits such as the SMEs can take a funding alternative besides borrowing and the market can increase the depth of capital market. In other hand, the developing SME capital markets presents a two-fold challenge; from the demand creation and the market sustainability.

The second brainstorming is a social capital market. The social capital market is a place where social enterprises can link up with impact investors. Social enterprises are defined as business oriented not-for-profits, or mission-oriented for-profits, having a social and/or environmental mission at the core of their work but seeking to operate in a financially sustainable manner, this definition was provided by ADB studies conducting in 2011. This category includes microfinance institutions and innovative SMEs in the education, energy, health, and agro-business sectors. Impact investors are defined as investors seeking to make investments that create a positive social and environmental impact beyond financial return, this definition supported by JP Morgan studies in 2010. The impact investors includes social venture capital funds, microfinance investment vehicles, pension funds, mutual fund managers, institutional fund managers, sovereign wealth funds, endowments, and family foundations.

JP Morgan (2010) estimated that the impact investment market has the potential to absorb between US$400 billion–US$1 trillion over the next decade, especially in the areas of housing, rural water delivery, maternal health, primary education, and financial services. A social stock exchange has similar functions as the regular market of stock exchange, where social enterprises can raise capital through offerings of shares, bonds, or other financial instruments. There are two social stock exchanges operating in the world: (i) the Impact Exchange and (ii) the UK Social Stock Exchange. Both platforms were established in June 2013. The Impact Exchange, located in Mauritius, is operated by the Stock Exchange of Mauritius and supervised by the Singapore-based Impact Investment Exchange Asia (IIX), targeting Asian and African social enterprises. The UK Social Stock Exchange, with 11 listed social enterprises at present, was launched by the London Stock Exchange Group as part of the national strategies for fostering social impact businesses in the United Kingdom. An ADB survey in 2011 indicated that 74% of investors in the sample who were not currently impact investing would consider transacting on a social stock exchange. So, a positive demand on the social stock exchanges is exist.

To move forward to the capital market development of SMEs in Asia, a new external environment should be billed as a solution. The liberalization of economic integration brought by ASEAN Economic Community (AEC) in 2015 and a kind of globalization economy will promote structure changes of SMEs business model from the traditionally domestic to globally competitive. A new financing solution such as internationalizing SMEs, increasing the importance of SMEs supply chain finance and trade finance, and also a long term financing is needed for developing the SMEs.

In summary, Asia's large bank-centred financial systems require the reduced supply-demand gap in lending as a core policy pillar to improve SMEs access to finance. Meanwhile, the diversification of financing is another core policy pillar to provide better financing for SMEs, which includes the development of capital market financing for SMEs as a venue for providing long-term growth capital.

Referring to the existing market structures, capital markets that SMEs can tap are classified into four modalities under two categories: (i) exchange market comprising which is include domestic market and professional market; and (ii) non-exchange market comprising which include SRO-operated and non-SRO-operated OTC market. The market type which is appropriate for supporting SMEs growth at the national level depends on the country context. Two-split opinions were extracted from the supply-side survey. The country that supports the development of domestic exchange market for SMEs stressed the cost efficient structure of existing market due to trading platforms that have already established to be utilized for SMEs market and the risk conscious mechanism backed by existing regulations, while having a concern about the lack of potential investors in non-exchange market. On the other hand, the country that supports the development of non-exchange market for

SMEs indicated the necessity of a preparatory market before their tapping the regular exchange market in order to create the base of high-quality potential issuers for higher segment of the market.

Comprehensive policy to create investor base and enhance market literacy for SMEs is need to develop new market. Critical factors to create SMEs markets will address simple, low cost, fast transaction, liquidity, supporting professionals, and policy framework and market literacy.

The combination of SMEs funding sources and risk capital providers in the growth cycle of enterprises also becomes one of the solutions to make the SMEs move forward. The financing needs of firms depend on their stage of growth. For instance, growing SMEs tend to seek access to long-term funding instruments for further growth of their business, which creates increased demands on SMEs for capital market financing. However, most SMEs have little ability to tap the regular stock exchange market because of relatively strict listing requirements and, more importantly, a lack of basic knowledge of capital market financing. Therefore, the creation of a venue for learning market rules, obligations, and benefits through the experience of issuing and trading stocks within the established system, yet separate from the regular market, is potentially useful for growth-oriented SMEs. The creation of investor and professional bases that support SMEs in equity financing is needed to implement this concept. In this regard, extensive national policies and strategies for SMEs access to capital markets, with appropriate regulatory backing, are keys to realize the preparatory market concept.

At the end, five core elements recommended to develop SMEs capital markets are as follows: (i) demand creation focusing on target segments such as social enterprises and women-led SMEs, with designing a low cost structure for SME access to capital markets; (ii) establishment of investor base that provides initial risk capital for potential growth-oriented SMEs, with fostering the venture capital industry; (iii) strengthening market literacy for potential SME issuers and investors; (iv) investor protection mechanisms backed by proper laws and regulations; and (v) facilitation measures for access to an SME market backed by a comprehensive policy support framework with well-organized policy coordination among regulators and line Ministries responsible for SME sector development and access to finance.

Widening and Diversifying SME Financing through Capital Market

Mr. Jae Ha Park

In 2013, Asian Development Bank (ADB) and Organization for Economic Cooperation and Development (OECD) made studies related on SMEs and one of them shows a result about trends in

SMEs financing and challenges. SMEs account for more than 90% of total enterprises in number and employ more than half of national labour forces on average in both of ADB and OECD countries. In OECD countries, access to finance represents one of the most significant challenges for entrepreneurs and innovative small business. Meanwhile in Asia, the issue of how to enhance the lending accessibility for SMEs has become the core of the SMEs access to finance agenda.

Some issues have become the priority of policy agenda in Asia, such as enhancing the bankability for SMEs, raising more bank lending efficiency for SMEs, and filling the supply demand gap in SMEs financing. Interrelated with that, the government has developed a variety of measures to support SME access to banks, for example public credit guarantee schemes. Additionally, there were also a policy measures supplementing the promotion of bank lending to SMEs, consist of concessional direct lending, refinancing scheme for banks, and government interest rate subsidies.

Since the sources for SMEs financing is limited, it caused a financing gap. Financing gap defined as the difference between the demand for funds by SMEs and the supply of funds. This gap occurs because of various reasons and particularly prevalent in developed countries. Based on past financial crises in Asia, growing access to SMEs finance to reduce the supply-demand gap has become a priority for sustainable and inclusive growth. From OECD studies, it is known that the OECD countries do not report any generalized SMEs financing gap. They reported that the financing gap primarily in equity financing, which is concentrated in certain sector such as start-ups and high tech firms.

In most countries, commercial banks are the main source of SMEs financing. In Asia, the lending scale to SMEs in 2012-2013 is relative well-developed, double digit to GDP; such as Korea (38.9%), Thailand (33.7%), and Malaysia (20.1%). Since SMEs rely on banks loans, there is a big possibility of failure in roll-over for the loans maturity when banks face liquidity problems. Due to that issue, a diversification of source of funding is needed and one of the best solutions for a source of long-term funding for SMEs is by approaching the capital markets. However, most countries have problem in SMEs financing through the capital markets, for example the SMEs' illiquid financial instruments caused a hard way to find investors.

An example of source of SMEs financing is based on Korea's experience. Most Korean SMEs heavily depend on bank loans for more than 70% of their total funding. While bank loans have steadily increased, financing from the capital market has decreased because SMEs can hardly acquire investment-grade credit ratings that satisfy investors' demands. SMEs use policy funding and credit guarantee programs as their major financing sources, usually with the share of credit guarantee

programs at around 20% of total funding. Meanwhile, the SMEs financing from capital market is mere 0.7% of total.

With regard to SMEs financing, a movement from bank intermediation towards funding in the capital markets has long been considered a long-term objective of many countries in the region. However, this movement has many hurdles until its full implementation. The first hurdle to overcome is having an adequately developed capital market in terms of depth and liquidity. Secondly, there is information asymmetry in this segment of enterprises. SMEs' corporate information is often nonexistent, or comes with very high costs in many economies in the region. Third, SMEs, in essence, have relatively high credit risk. While SMEs have high potential growth, they are also more vulnerable to sudden changes in the economic and competitive environment. Fourth, SMEs financing is inherently associated with a higher unit cost compared to large corporations. The relatively smaller size of funding, as well as higher information and monitoring costs, leads to higher implementation costs per deal when processing finance in capital markets.

The government's role is crucial in alleviating SMEs financing gaps in the capital market. Thus, government and policy makers not only have to focus on the development and growth of capital market itself but also focus to overcome the obstacles inherent to SMEs. In order to facilitate active SMEs financing capital market, the government can provide access to credible corporate information on SMEs and alleviate higher credit risk and higher transaction cost.

According to Korean experience, there was an example of SMEs financing in bond market. In accordance with the tightening money and capital markets, the Korean government introduced the Primary Collateralized Bond Obligation (P-CBO) program in order to smooth out liquidity constraints and support SMEs.

A P-CBO is a type of asset-backed security (ABS) with newly-issued corporate bonds as the underlying asset. These P-CBOs can be a useful instrument that can resolve the credit mismatch problem that exists between investors and SMEs, thus filling the financing gap of SMEs. The P-CBO offer more fundraising opportunities to SMEs that have low credit ratings. In fact, the distinguishing feature of the P-CBO program lies in facilitating the issuance of corporate bonds to help finance SMEs. Because P-CBO pools bonds with different levels of risk, the overall risk of default decreases. Because P-CBOs are issued through strict surveillance by credit rating agencies, they are a relatively safe and fairly attractive investment. Furthermore, P-CBOs can offer higher yields than general corporate bonds to mezzanine tranche investors.

There were many variation of P-CBO. The first one is first P-CBO program by small business cooperation (SBC). The example of this program is the one implemented in Korea where the credit enhancement was provided by the Korea Housing Bank in the form of liquidity facilities. SBC provided additional enhancement by repurchasing the subordinate junior tranche and the senior tranche was sold to investors in the market. After the first P-CBO program, the Korean government introduced a special guarantee program applicable to P-CBO issuance and started to use credit guarantee funds, namely Korea Credit Guarantee Fund (KODIT) and KIBO. With credit enhancement in the form of credit guarantees provided by KODIT or KIBO, the percentage of total value in the senior tranche of the P-CBO went up to 93%-97%, thus maximizing funding efficiency of the program.

In 2004, SBC led an issuance of cross-border P-CBO. 46 Korean SMEs participated in the P-CBO issuance in Japan in the amount of JPY 10 billion.Credit guarantees were provided by the Industrial Bank of Korea (IBK) and the Japan Bank for International Cooperation (JBIC). A dual SPC structure was used and the subordinate tranche of the CBO issued by the domestic SPC was purchased by SBC, providing additional credit enhancement. The senior tranche of the CBO was acquired by the foreign SPC established in Japan and then distributed to investors in the Japanese market.

Besides developing the bond market, the Korean government also develop an equity market or a venture capital for their SMEs. Most investors invest in SMEs directly or indirectly through investment funds made by venture capital companies. In the case of indirect investment, a venture capital company makes a venture investment fund, and then operates the fund as a general partner (GP). Other investors can participate in the venture investment fund as limited partners (LPs). When a venture investment accomplishes its purpose, an initial public offering (IPO) in the stock market and mergers and acquisitions (M&A) are most widely used exit methods.

Overall, there were 3 stages consisted in a venture investment; fundraising, investment, and exit. In the fundraising stage the central and local governments provide the capital for the small and medium enterprise start-up financing companies and became the largest investors for it. In theory, if institutional investors, such as banks and insurance companies, were able to actively provide capital to venture funds, then soundness in the venture capital market would be enhanced, because institutional investors will also be monitoring the fund's management. This provides an extra layer of supervision and protection to the market. The situation is mutually beneficial; the venture capital market gains another reliable source of investment, and institutional investors have a high-risk, high-return investment instrument. Fortunately, the Korean government recently announced the removal of the afore mentioned restrictions, thus opening the market to increase investment from banks and insurance companies. Mutual savings banks are also now allowed to invest to a limited extent.

The second stage is the investment stage. The venture capital industry is in recovery due to the government effort to rehabilitate venture capital market since 2004. Because the venture capital market is in recovery in Korea, investment in early-stage companies is not likely to be large due to the high credit risk associated with these companies. Nevertheless, the share of investment is increasing as well as the average size of fund.

The last stage is the exit stage which in Korea, 90% of venture capital investment depends on IPO while the rest of 10% depends on M&A as the exit method. Besides that, the venture firm's IPOs with venture capital investment is increasing, shown by the continuously increased of the ratio from 50.5% in 2002 to 81% in 2007. The venture capital also gave a positive impact to a startup company, because a firm without venture capital investment takes approximately 11.5 years until their IPOs but the average time span for a venture firm with venture capital investment is 7.9 years.

In 2005, Korea Fund of Funds (KFoF) was established as a stable and unified source of venture investment. Since the introduction of KFoF, Korean government is not directly involved in investment procedure and the fund was operated by KFoF in more efficiently and for public interest. The government hopes that the fund may protect the venture capital market when the economy is in recession.

Other advantages from the fund of funds structures is the venture capital market will become more transparent because there are high standards for the selection and management of sub-funds. Since the fund will select sub-funds with good track records, sub-funds have an incentive to efficiently manage their assets. Fourth, the KFoF will be a stable investment source to venture firms, by raising KRW 1 trillion over five years. It is expected that the KFoF will create new venture capital ranging from KRW 500 to 600 billion each year.

Implication from the Korean experience, there is a need to set specific targets within SME sector in which financing gap is most serious. If a government does not set a specific target sector, then government's funds may direct to a sector which does not need financing support. Moreover, early-stage innovative SMEs are most likely to have a financing gap; it is kind of matching to the kind of need of the society and the economy. P-CBO was attractive to investors because the overall default risk decreased that is why an innovative effort with various financing tools is crucial, innovative tools to final user must be provided. The last implication is even in venture capital market, government role was important in rehabilitating the market and KFoF will significantly controlling in the future.

Final policy recommendation can be described as follows: first of all, the government must build credible SMEs information sharing system, because it was the most difficult so many times. Secondly, we have to facilitate SMEs financing through bond market because they need such long term financing source. Third, fostering venture capital market and the last one is the government need a cooperation and coordination between public and private sectors. Actually, the role of government and private sector is crucial to develop this kind of market.

Key Points

1. There is a potential of capital market financing for SMEs because SME seek to access formal finance and diversified long-term funding instruments for stable growth of business.
2. Thailand government became a good example by make 3 program for developing SME capital market. From their experience, enhancing capital market literacy for the traditional underserved or SME is the best way to facing the challenges in the development of capital market.
3. Most of SMEs depend upon bank loans and generally experience a financing gap. This financing gap for SMEs is most prominent in capital market financing and most countries, including developed ones, have problems in SME financing through capital markets.
4. Major Obstacles for capital market financing:
   a. Having an adequately developed capital market in terms of depth and liquidity.
   b. SMEs, in essence, have relatively high credit risk.
   c. There exists severe information asymmetry in this segment of enterprises.
   d. SME financing is inherently associated with a higher unit cost when compared with that of large corporations.
5. By looking to the Korean experience, The Korean government introduced the primary collateralized bond obligation (P-CBO) program and developed a venture capital in order to smooth out liquidity constraints and support SMEs.
6. Government and policymakers not only have to focus on the development and growth of the capital market itself, but also search for a means to overcome the obstacles inherent in SMEs in order to facilitate active SME financing through capital markets.

Conclusions and Recommendations

1. The formalisation of SMEs needs to be encouraged because SMEs cannot get access to finance unless they are formally registered. Furthermore, if we want to encourage growth in employment and output, we also need to encourage firms to be formally registered. We also need to reduce bureaucratic regulation and taxes.
2. The bureaucratic regulations and taxes should be reduced because it caused informal firms to remain informal.
3. SME governance and entrepreneurial skills must be improved in order to increase their eligibility and capability to access finance from financial institutions.
4. Encourage foreign owned enterprises to establish in the country, or establish majority foreign owned joint ventures with local SMEs.
5. Improve book-keeping requirements of SMEs to improve transparency.
6. Provide advice/assistance in the preparation of business plans.
7. Tackle legal, institutional and regulatory distortions that discourage commercial bank-SME loans.
8. Governments needs to tackle macroeconomic imbalances (national savings and investment), limited depth and breadth of financial markets and implement microeconomic reform measures that encourage competition (in financial markets)
9. Establish venture capital markets, in collaboration with the private sector, for high tech SMEs, as well as access to equity markets.
10. Establish a credit rating agency for businesses, where possible, to make the task of banks' lending to SMEs much easier.
11. Government and Central Bank have to support to frame basic regulations for acceptance of SME Ratings by banking sector while Government and the Ministry of Finance have to support in creating rating subsidy budget for SMEs.
12. A professional Credit Rating Agency for SMEs on Public/Private Partnership model needs to be set up to build trust, efficiency and profitable growth.
13. Financial institutions need to be willing to lend. If they reluctant to disburse the loan, we can have the best system in the world but the impact will be insignificant.
14. Five core elements to develop SMEs capital markets are (i) demand creation focusing on target segments such as social enterprises and women-led SMEs, with designing a low cost structure for SME access to capital markets; (ii) establishment of investor base that provides initial risk capital for potential growth-oriented SMEs, with fostering the venture capital industry; (iii) strengthening market literacy for potential SME issuers and investors; (iv) investor protection

mechanisms backed by proper laws and regulations; and (v) facilitation measures for access to an SME market backed by a comprehensive policy support framework with well-organized policy coordination among regulators and line Ministries responsible for SME sector development and access to finance.

15. In order to widen and diversify SMEs financing through capital market, the government must build credible SMEs information sharing system, because it was the most difficult so many times. We also have to facilitate SMEs financing through bond market because they need such long term financing source. Then, we need to foster venture capital market. Lastly, the government needs a cooperation and coordination between public and private sectors. Actually, the role of government and private sector is crucial to develop this kind of market.

Appendix: Forum Program

DAY ONE: 15 October 2014	
8:00 – 8:30	**Registration**
8:30 – 9:15	Welcoming Remarks ***Jae Ha Park, Deputy Dean, ADBI*** Opening remarks ***H.E. Dr. Halim Alamsyah, Deputy Governor, Bank Indonesia*** *Photo session*
9:15 – 11:15	**SESSION 1: SMEs and Finance in Asia & Financing vs Other Constraints to SME Development**
	Moderator: Yunita Resmi Sari, Bank Indonesia **Access to Finance and SMEs in East Asia: Key Issues and Policy Implications** *Charles Harvie, University of Wollongong, Australia* **Access to Bank Finance as a Constraint Across Asia** *Paul Vandenberg, Senior CBT Economist, ADBI* Open Discussion
11:15 – 11:30	**Coffee Break**
11:30 – 12:30	**SESSION 2: Financial policy**
	Moderator: Elaine MacEachern, Secured Transactions Specialist, Finance and Markets Global Practice, World Bank Group **Financial Policy's Role in Expanding Access to Finance for SMEs** *Eni V. Panggabean, Bank Indonesia* Open Discussion

12:30 – 13:45	**Lunch**
13:45 – 14:45	**SESSION 3: Rating Agencies**
	Moderator: Choirul Djamhari, Deputy Minister for Business Finance, Ministry of Cooperatives and SME **The Role of a Credit Rating Agencies: The India Case** *Mr. Parag Patki, former CEO, SMERA (SME Rating Agency), India* Open Discussion
14:45 – 15:15	**Coffee Break**
15:15 – 16:45	**SESSION 4: Secured Transactions and Moveable Assets Financing**
	Moderator: Paul Vandenberg, Senior CBT Economist, ADBI **Role of Moveable Collateral Registries in Expanding SME Finance: The Case of Indonesia Fiducia Online** *Elaine MacEachern, Secured Transactions Specialist, Finance and Markets Global Practice, World Bank Group* *Aria Suyudi, Consultant, Finance & Markets, World Bank Group* Open discussion
18:30 – 19:30	**Dinner Reception**

DAY TWO: 16 October 2014	
8:00 – 8:30	**Registration**
8:30 – 10:30	**Session 5: State Banks & SME-Oriented Commercial Banks**

	Moderator: Paul Vandenberg, Senior CBT Economist, ADBI **Role of Public Sector Banks in Japan** *Masahiko Furuya, Director, Ministry of Finance* Open Discussion **Dedicated SME Banks** *Johanes Saragih, Senior Vice President, Bank Rakyat Indonesia* Open Discussion
10:30 – 10:45	**Coffee Break**
10:45 – 11:45	**SESSION 6: Guarantees – Republic of South Korea's Experience**
	Moderator: Shigehiro Shinozaki, Senior SME Finance Specialist, ADB **Korean Experience: Structuring the Guarantee and Financing** *Yong Pyung Park, Korea Credit Guarantee Fund* Open Discussion
12:00 – 13:15	**Lunch**
13:15 – 14:15	**SESSION 6 Cont: Guarantees – Indonesia's experience**
	Moderator: Jae Ha Park, Deputy Dean, ADBI **Managing Credit Guarantee Programs for SMEs** *Bobby Hamzar Rafinus, Deputy Minister for Fiscal and Monetary Coordination, Coordinating Ministry for Economic Affairs* Open Discussion
14:15 – 14:45	**Coffee Break**
14:45 – 16:45	**SESSION 7: Capital Markets**

	Moderator: Paul Vandenberg, Senior CBT Economist, ADBI **Is There Potential in an SME Equities Market?** *Shigehiro Shinozaki, Senior SME Finance Specialist, ADB* Open Discussion **Widening and Diversifying SME Financing Through Capital Markets** *Jae Ha Park, Deputy Dean, ADBI* Open Discussion
16:45 – 17:15	**Closing**
	Summary and Closing Remarks *Eni V. Panggabean, Bank Indonesia* *Paul Vandenberg, Senior CBT Economist, ADBI*

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