



# Report and Recommendation of the President to the Board of Directors

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Project Number: 42905  
July 2008

## Proposed Loan Bank Mandiri (Persero) (Indonesia)

In accordance with ADB's public communications policy (PCP, 2005), this abbreviated version of the RRP excludes confidential information and ADB's assessment of project or transaction risk as well as other information referred to in paragraph 126 of the PCP.

**Asian Development Bank**

## CURRENCY EQUIVALENTS

(as of 18 June 2008)

Currency Unit	–	rupiah (Rp)
Rp1.00	–	\$0.00011
\$1.00	–	Rp9,281

## ABBREVIATIONS

ADB	–	Asian Development Bank
ALM	–	assets and liabilities management
CAR	–	capital adequacy ratio
ESMS	–	environmental and social management system
GDP	–	gross domestic product
LOS	–	loan origination system
Mandiri		Bank Mandiri (Persero)
NPL	–	nonperforming loan
S&P	–	Standard & Poor's
SBU	–	strategic business unit
SOE	–	state-owned enterprise

## NOTE

In this report, "\$" refers to US dollars

<b>Vice Presidents</b>	L. Jin, Vice President, Operations 1 C. Lawrence Greenwood, Jr., Operations 2
<b>Deputy Director General</b>	S. Chander, Private Sector Operations Department (PSOD)
<b>Team leader</b>	S. Hruschka, Senior Investment Specialist, PSOD
<b>Team members</b>	P. Flegler, Investment Specialist, PSOD L. Hauck, Guarantees and Syndications Specialist, Office of Cofinancing Operations A. Idris, Head, Private Sector Group, PSOD N. Moller, Counsel, Office of the General Counsel

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## THE PROPOSAL

1. I submit for your approval the following report and recommendation on a proposed loan to Bank Mandiri (Persero) (Mandiri) of up to \$300 million of which (i) up to \$75 million (the A loan) is funded by the Asian Development Bank (ADB), and (ii) up to \$225 million (the B loan) is funded by commercial banks under participation agreements between ADB and such banks. The design and monitoring framework for the proposed investment is in Appendix 1.

### I. RATIONALE: CHALLENGES AND OPPORTUNITIES

#### A. Indonesian Economy

2. **Economic Assessment.**<sup>1</sup> Indonesia, one of the world's most important countries in terms of biodiversity, has experienced extraordinary changes in the past 15 years. Following rapid economic growth and declining poverty in the early 1990s, the country witnessed a sudden deterioration of its gross domestic product (GDP) and heightened poverty in 1997–2000 due to the Asian financial crisis. The crisis exposed key issues related to the lack of coordination between levels of government, as well as endemic corruption. Subsequently, a strong focus on maintaining macroeconomic stability and a conservative fiscal policy helped the country gradually overcome some of the economic, political, and social shocks. Growth has been moderate and poverty incidence has declined.

3. Indonesia is now at a critical stage as recovery efforts must also aim to achieve annual growth rates of about 7% in order to create jobs needed to mitigate the unemployment rate of 10.4%. To meet this target, much-needed reforms must continue to encourage greater private sector participation by improving the investment climate and developing a more responsive and supportive finance sector. Moreover, the country needs to boost its development spending in a manner that would support attainment of the Millennium Development Goals; progress has been mixed with many regions lagging.

4. **Economic Outlook and Challenges.** Indonesia's economic growth accelerated to 6.3% in 2007, above its 5-year average of 5.5%—the best growth rate since 1996. The main drivers of growth were private consumption, supported by private investment and an expansion of net exports. Year-on-year inflation declined from a peak of 18.4% in late 2005 to 6.6% at the end of 2007, as the impact of a 126% rise in fuel prices in October 2005 faded. Amid some volatility, inflation averaged 6.4%—within Bank Indonesia's target range of 5%–7%. While movements in food prices and seasonal factors contributed much to the volatility, a combination of factors ranging from higher global nonfood commodity prices, the depreciating rupiah, and a steady increase in domestic demand kept inflation from declining further.

5. Private sector credit growth quickened, reflecting a reduction in interest rates. With the easing of inflationary pressures, Bank Indonesia cut its policy rate from 12.75% in April 2006 to 8.0% in December 2007. This led to a corresponding reduction in commercial bank rates and a recovery in bank credit, which increased by 25.5% year-on-year in December 2007. The stronger growth in lending helped lift bank profits. Although GDP<sup>2</sup> growth is forecast at 6.1% in

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<sup>1</sup> ADB. 2006. *Country Strategy and Program: Indonesia 2006–2009*. Manila.

<sup>2</sup> Indonesia's nominal GDP in 2006 was approximately \$364 billion.

2008, down slightly from 2007, cheaper borrowing costs, a new investment law,<sup>3</sup> efforts to encourage infrastructure investment, and various new guidelines introduced by Bank Indonesia to stimulate bank lending continue to create opportunities for growth. The main drivers in recent growth are private consumption, a recovery in private investment, and solid expansion of exports. The forecast slowdown is essentially the result of weakness in the global economy.

6. The strengthened economic fundamentals and yield differentials attracted significant foreign portfolio inflows during the first half of 2007, before international investors turned more risk averse after the subprime credit problems in the United States. After experienced a sharp downturn during July–August, the Jakarta Stock Exchange rebounded, and more than regained lost ground during the rest of the year. By the end of 2007, the exchange’s composite index was 52% higher than a year earlier. The rupiah depreciated by 4.4% against the dollar in 2007, despite strong growth in international reserves. This growth is partly attributed to reserve management arrangements, whereby inflows of foreign exchange from oil revenues and royalties automatically accumulate as Bank Indonesia reserves, while Pertamina (the state-owned oil company) buys dollars in the market to purchase oil imports.

7. The relatively moderate impact of the United States subprime crisis on domestic financial markets, together with an improved policy environment, led to Standard and Poor’s (S&P) raising the country’s sovereign foreign currency debt rating to BB– and Moody’s rating it Ba3 in 2007.

8. Indonesia’s concerns are no longer dominated by economic stabilization and recovery, but rather of achieving and sustaining higher growth rates to reduce unemployment, poverty, and overall vulnerability. Complemented by a relatively young population, the country displays immense economic potential that could lead to higher demand for consumer spending and banking services. The Government of Indonesia is pursuing a progrowth agenda while pushing forward broad, structural, and institutional reforms.

9. Economic growth-related constraints include a narrow and shallow finance sector, poor infrastructure, and an adverse investment climate. Deepening of the finance sector is a prerequisite for long-term development of the infrastructure sector and sustained growth. The reliance of most businesses on direct bank lending limits investment possibilities and does not encourage good governance. The Government recognizes that expansion of infrastructure is required to increase service coverage, remove bottlenecks, and attract investments that would help achieve and sustain projected economic growth.

## **B. Indonesian Banking Subsector**

10. **Banking Subsector Composition.** The finance sector continues to be dominated by banks, which in 2007 accounted for about 80% of the sector’s assets. The country has 129 banks: 5 state-owned banks, 82 private commercial banks, 26 regional development banks, and 16 joint venture banks. Despite a reduction in the number of banks from 222 banks in 1997, the banking subsector is still overcrowded and fragmented. Many small banks are undercapitalized and have very limited businesses, with several others having ceased operation. Twenty-four banks have a capital base of less than Rp100 billion, 100 banks have from Rp100 billion to

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<sup>3</sup> The new investment law released in March 2007—UU Penanaman Modal 2007—aims to reinvigorate investment in the Indonesian economy, create jobs, and reduce poverty. In the Indonesian Global Investment Forum in New York, the President argued that the country needed to attract investors in order to create jobs and halve the poverty rate by 2009. He said Indonesia needed \$426 billion of investments to make the 6.6% growth target possible each year until 2009.

Rp10 trillion in capital, and only 5 banks have capital greater than Rp10 trillion. Indonesia's largest bank is only the eighth largest in Southeast Asia. To create a sound and efficient banking structure, the regulators plan to reduce the number of banks by imposing a higher minimum capital requirement.

11. **Policies, Regulations, and Strengthening of the System.** Finance sector regulation and supervision are under the authority of two main supervisory authorities. Bank Indonesia regulates and supervises banks. In the aftermath of the Asian financial crisis, it received significant strengthening and was given financial autonomy. The 1999 Central Bank Law has transformed Bank Indonesia into an independent central bank free from government intervention or any other parties. The law, amended in 2005, proposes to establish a consolidated supervisory authority for financial services in 2010. The Capital Markets Supervisory Agency (BAPEPAM) regulates and supervises the capital markets. It has limited powers and reports to the Ministry of Finance, which is responsible for high-level policy matters.

12. Bank Indonesia is seeking to promote consolidation and strengthen capitalization through a policy framework—the Indonesian Banking Architecture. The framework includes new capital tiers for banks that wish to operate internationally, nationally, or regionally. The new rule that imposes a minimum capital requirement of Rp100 billion will significantly reduce the number of banks. Several banks have already merged or were acquired by larger institutions this year. The framework also aims to improve regulatory standards based on international best practices by phasing in Basel core principles of effective banking supervision. The strict enforcement of prudential rules, the need for internal control systems, and Bank Indonesia's policies are likely to strengthen banking.

13. In addition, Bank Indonesia's single presence policy, which will be effective in 2010, limits the controlling majority (25% ownership or indirect control) from having a controlling stake in more than one bank. Those with multiple stakes will need to divest, establish a banking holding company, or merge their bank interests in Indonesia. Under the Indonesian Banking Architecture, the regulators aim to ultimately reduce the number of banks to 50–60 from the current base of 129.<sup>4</sup>

14. **Banking Performance.** The overall performance of banks in 2007 was positive, supported by favorable economic conditions. Bank Indonesia's key interest rate dropped from 12.75 % at the end of 2005 to 8.25% by the end of October 2007, but was raised in May 2008 to 8.5% to ease inflationary pressure from the 27% average increase in fuel price. In May 2008, year-on-year inflation was 10.3%. Although this rate is hoped to recede to approximately 7% by the end of 2008, the impact of increasing fuel and food prices will prove challenging in curbing inflationary pressures.<sup>5</sup> The lowering of the Bank Indonesia rate has led to a recovery in credit growth. However, as a reaction to the Asian financial crisis in 1997, banks are more risk adverse in lending to corporate customers and more inclined to keep funding in Government bonds or consumer lending. Consumer loans account for 50% of all loans, while working capital accounts for 40% and term loans 10%.

15. At the end of July 2007, net nonperforming loans (NPLs) made up 3.0% of the banks' loan portfolio down from a peak of 48% in 1998. The asset quality of commercial banks has recovered. The Government recently introduced regulations providing more flexibility for state

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<sup>4</sup> Fitch. 2007. *Indonesian Banks*. Jakarta.

<sup>5</sup> Prices of rice, Indonesia's staple food, are reported to have increased approximately 26% from the first quarter of 2007 to the first quarter of 2008.

banks to write off their bad debts, so the NPLs of state banks are expected to decline. Banks remain well capitalized, with a capital adequacy ratio of 20.5%, well above the prescribed norm of 8%. With respect to foreign currency, access for private enterprises was drastically reduced during the Asian financial crisis. In particular, long-term funds in foreign exchange available for lending decreased and have not yet recovered. Foreign exchange to local banks from the international market has gradually become more available at lower and more competitive interest rates; however, these funds are only suitable for short-term lending.

16. **Privatization.** After recapitalizing and restructuring the ailing major banks, the Government began to privatize them to create a more competitive banking landscape and to raise state revenues. The privatization aims to improve the performance and value of the banks; and to widen the investor base targeting institutional investors, portfolio managers, and existing owners seeking to raise their stakes. The sale of the Government's stake in the major banks was successful with international investors indicating strong interest. Fifteen banks representing more than 70% of the country's bank assets have been privatized. The Government divested its stake in nine private banks to foreign investors as controlling shareholders. Total assets of these foreign-owned banks have reached 42% of the total industry assets.

17. The Government has also started to partially privatize state-owned banks as part of an effort to sell off its holdings in selected state-owned enterprises (SOEs). The Government partially sold its stake in Mandiri to the public in 2003 and 2004. As a listed company, the regulations of the Capital Market Supervisory Agency require greater supervision, transparent reporting, nomination of independent accountants, and establishment of an audit committee. This enhanced supervision combined with greater assertiveness of public shareholders in exercising their rights have proven to be quite effective in making Mandiri more transparent, accountable, and commercially operated.

18. **Long-Term Financing.** Despite recent improvements, the Indonesian banking subsector is not a source of long-term funding. As of December 2005, Indonesian banks controlled Rp1.47 trillion in assets (more than 50% of GDP). However, similar to the banks in many countries in the region, Indonesian banks obtain most of their funding from short-term deposits.<sup>6</sup> Accordingly, Indonesian banks have difficulty offering loans that match the life of a borrower's investment and expenditure requirements without taking a significant asset–liability maturity mismatch.

19. In the Indonesian market, demand for long-tenor dollar borrowing to finance infrastructure-related projects is substantial as many such projects generate dollar revenues. In the mid-1990s, private investment commitments in any given year averaged 30%–40% of the Government's development spending on infrastructure, or nearly 2% of GDP. In 2003 and 2004, private investment fell to less than 25% of Government spending, or just 0.4% of GDP. The World Bank estimates that Indonesia needs to increase its lending to infrastructure by about 2% of GDP, or \$5 billion per year, if the Government is to reach its 6% per year targeted medium-term economic growth. The most significant bottleneck to meeting the investment in infrastructure required for sustainable economic growth is the inability of the Indonesian finance sector to access long-term financing.

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<sup>6</sup> More than 80% of Mandiri's funding is by way of deposits of 1 month or less.

### **C. Loan Rationale**

20. Given the significant long-term financing requirement in Indonesia for infrastructure development and other capital expenditure, and the severe limitations of the local financial market, Mandiri's role as the country's largest financial institution continues to be of critical importance. Mandiri has undergone significant reform of its finances and operations since its establishment as a result of the Asian financial crisis. However, the ability of Mandiri to provide much needed long-term funding is severely constrained by Mandiri's maturity mismatch in its assets and liabilities, and the unavailability of long-term financing to address this mismatch. The longer-tenor funding required is not available in the market without ADB support, and will greatly assist in improving the maturity profile of Mandiri's balance sheet. Further, the B loan will establish Mandiri's relationship with international commercial banks, thereby fulfilling the vital role of facilitating avenues for future fund raising.

## **II. THE BORROWER**

21. Mandiri is the largest bank in Indonesia in terms of total assets, loans, and deposits (based on financial statistics reported by Bank Indonesia as of 31 December 2007) and one of the leading banking and financial services providers in Indonesia. Mandiri is majority-owned by the Government. As of 31 December 2007, Mandiri had Rp319.1 trillion in total assets, Rp125.5 trillion in total consolidated loans, and Rp253.8 trillion in consolidated total deposits.

22. Mandiri was established in October 1998, and following the merger in July 1999 with four state-owned banks—Bank Bumi Daya (Persero), Bank Dagang Negara (Persero), Bank Ekspor Impor Indonesia (Persero), and Bank Pembangunan Indonesia (Persero)—it commenced operations in August 1999.

23. Mandiri completed its initial public offering in July 2003. The Government followed this by divesting 20% of its shares in Mandiri. Mandiri is currently listed on the Jakarta Stock Exchange and Surabaya Stock Exchange. In March 2004, the Government divested an additional 10% of its shares in Mandiri through a secondary offering.

24. Mandiri has 14 subsidiaries. The Mandiri Group's principal activities include providing general banking services including activities based on sharia principles. The group carries out commercial banking, corporate banking, consumer banking, and treasury activities. One of its subsidiaries, Mandiri Sekuritas, is the largest and best-capitalized investment bank and securities firm in Indonesia. The subsidiaries are an amalgamation of companies originally owned by the four merged banks. Mandiri continues to evaluate subsidiaries' activities with the intention of divesting those that do not fit with its main business lines in corporate, retail, sharia, and investment banking.

## **III. THE PROPOSED ASSISTANCE**

### **A. Proposed Investment**

25. The proposed loan to Mandiri is for up to \$75,000,000 without a government guarantee from ADB's ordinary capital resources. It will have a term of up to 7 years and other such terms and conditions set forth in this report.

26. The proposed long-term dollar financing will assist Mandiri in two core areas. It will assist in improving the funding structure problems currently stemming from the large asset–liability maturity mismatch. In addition, it will enable Mandiri to support and expand its long-term dollar loan portfolio, which consists primarily of customers seeking financing to invest in long-term projects, such as infrastructure-related activities.

## **B. Social and Environmental Safeguard Issues**

27. The investment is classified FI under ADB's *Environment Policy* (2002). ADB has advised Mandiri on its safeguard policies, and discussed their relevance and importance. Mandiri will be required to comply with ADB's *Environment Policy* as applicable to FI and nonsovereign operations. Mandiri will be required to adopt an appropriate environmental and social management system (ESMS) and build capacity in environmental and social impact assessment and management where appropriate.

28. As a corporate loan, the investment does not involve any identified projects requiring involuntary resettlement and is not expected to adversely affect indigenous peoples. It is therefore assigned category C with regard to *The Bank's Policy on Indigenous Peoples* (1998) and the policy relating to *Involuntary Resettlement* (1995).

## **C. Anticorruption Policy and Policy Relating to the Combating of Money Laundering and the Financing of Terrorism**

29. Mandiri was advised of ADB's *Anticorruption Policy* (1998, as amended to date) and policy relating to the *Combating of Money Laundering and the Financing of Terrorism* (2003). Consistent with its commitment to good governance, accountability, and transparency, ADB will require Mandiri to institute, maintain, and comply with internal procedures and controls following international best practice standards for the purpose of preventing corruption or money laundering activities or the financing of terrorism, and covenant with ADB to refrain from engaging in such activities. The investment documentation between ADB and Mandiri will further allow ADB to investigate any violation or potential violation of these undertakings.

# **IV. PROJECT BENEFITS, IMPACTS AND ASSUMPTIONS**

## **1. Objectives and Outcome**

30. The loan merits ADB support for the following reasons:

- (i) The loan provides support to Mandiri as it continues to strengthen its financial position and undertake further financial reform. The loan will assist Mandiri to address the severe asset–liability mismatch that dominates Mandiri's balance sheet and exposes Mandiri to significant liquidity risk. Financial institutions such as Mandiri will play a critical role in strengthening Indonesia's finance sector and in providing much needed long-term funding in Indonesia.
- (ii) The loan will improve Mandiri's ability to lend long-term foreign currency to borrowers involved in various long-term projects across Indonesia and enable better matching of cash flows, thus stabilizing economics for the end borrower. Long-tenor funding is required to help Indonesia meet infrastructure development requirements essential for sustained economic growth.

- (iii) The loan supports the Government's strategy of encouraging private sector participation in capital investment, given the large financial outlays required and limited public sector financing available.
- (iv) Through the loan, ADB will guide the development and institutionalization of Mandiri's ESMS to ensure consistency with ADB's environmental and social safeguard policies in its transactions.
- (v) The loan is likely to catalyze commercial bank participation. Long-term debt has already been verbally committed by reputable international banks under ADB's B loan program. This is likely to facilitate Mandiri's access to longer-term funding from similar institutions.
- (vi) ADB assistance to Mandiri will be the first from a multilateral development agency without sovereign guarantee, and will be viewed by the market as supporting Mandiri as it undertakes reform measures. These reforms are in line with the Government's ongoing efforts to restructure state-owned banks and with Bank Indonesia's program to strengthen banking in Indonesia.

## **2. Development Impact and Effectiveness**

31. The development impact assessment of a financial intermediary, including Mandiri, begins by acknowledging the well-established thesis that a healthy finance sector, populated by healthy financial institutions, promotes sustainable economic growth, helps generate employment, and ultimately reduces poverty. Therefore, the ability of a financial intermediary, in this case Mandiri, to positively impact development depends on various indicators of its strength, through both qualitative and quantitative measures, as well as broader impact beyond Mandiri itself.

32. Development indicators can be categorized along two key parameters within the project's impact on private sector development via (i) project (direct) company impact that the project delivers to and/or by Mandiri; and (ii) beyond (indirect) company impact to the wider sector and/or economy outside the specific activities of Mandiri.

## **3. Fit to Sector and Country Strategy**

33. Due to budgetary constraints, the Government has had difficulty providing the required infrastructure investment from its own funds. It has therefore launched an infrastructure reform program supported by ADB and other development partners to regain the confidence of private sector investors, and to mobilize their resources to fill the gap resulting from the sharp decline in infrastructure investment. The assistance to Mandiri will help provide the funding needed to support the Government's efforts. The Government continues to undertake regulatory, structural, and policy changes in an effort to prepare sector ministries, local governments, and SOEs for greater private sector involvement in infrastructure.

34. ADB will engage the Government in five areas of operations derived from the analysis of constraints on development. The expected outcomes include

- (i) improved infrastructure and infrastructure services, including rural infrastructure, with increased public and private sector investment and improved sector regulation as indicators;
- (ii) deepened finance sector with improved domestic resource mobilization to meet long-term financing needs as the indicator;

- (iii) improved decentralization with increased regional spending and enhanced financial reporting as indicators;
- (iv) accelerated Millennium Development Goal achievement with better water supply and sanitation, health, and education indicators; and
- (v) strengthened environment and natural resource management with enhanced water and marine resource management and reduced pollution as indicators.

35. Areas (i) and (ii) are expected to help leverage much greater private sector participation. Engagement will be selective, and reflect the priorities of ADB's recently approved long-term strategic framework 2008–2020 (Strategy 2020)<sup>7</sup> as well as those of the Government.

36. To support the Government's goal and drawing on lessons, ADB intends to focus on (i) development of infrastructure, (ii) promotion of decentralization, (iii) reduction of regional disparities, (iv) enhancement of natural resource management, and (v) reform of the finance sector.<sup>8</sup> Given the core objectives to develop infrastructure, promote decentralization, and reform the finance sector, the proposed investment in Mandiri is directly in line with ADB's country partnership strategy for Indonesia and Strategy 2020.

37. The proposal supports the Capital Market Development Program Cluster<sup>9</sup> aimed at increasing the contribution of the finance sector to economic growth and development. It also supplements the loans and grants under the Infrastructure Reform Sector Development Program<sup>10</sup> to help improve Indonesia's investment climate and tap the power of the private sector in meeting the country's huge infrastructure needs.

#### 4. SOE Lending under the Innovation and Efficiency Initiative

38. As outlined in ADB's Innovation and Efficiency Initiative: Pilot Financing Instruments and Modalities,<sup>11</sup> many SOEs are creditworthy and have the long-term financial viability to borrow without government guarantees. They constitute a third generation<sup>12</sup> of potential borrowers, and are increasingly important as they operate rather independently from the sovereign. These entities play an important role in creating employment, and providing infrastructure and basic services. Giving them access to affordable long-term credit is critical to promoting economic growth. In addition to providing Mandiri with a much-needed source of long-term funding, ADB's objective in this transaction is to lend and facilitate cofinancing, in each case without government guarantee, to ensure that Mandiri's asset–liability gap and corresponding liquidity risk can be reduced, while enabling longer-tenor financing to be available to borrowers in the Indonesian market.

<sup>7</sup> ADB. 2008. *Strategy 2020: The Long-Term Strategic Framework of the Asian Development Bank 2008–2020*. Manila.

<sup>8</sup> ADB. 2006. *Country Strategy and Program: Indonesia 2006–2009*. Manila.

<sup>9</sup> ADB. 2007. *Report and Recommendation of the President to the Board of Directors on a Proposed Loan and Technical Assistance Grant Capital Market Development Cluster (Subprogram 1) (Indonesia)*. Manila.

<sup>10</sup> ADB. 2006. *Report and Recommendation of the President to the Board of Directors on a Proposed Program Cluster, Loans, Technical Assistance Grant, and Administration of Grant from the Government of the Netherlands; Republic of Indonesia: Infrastructure Reform Sector Development Program*. Manila.

<sup>11</sup> ADB. 2005. *Innovation and Efficiency Initiative: Pilot Financing Instruments and Modalities*. Manila

<sup>12</sup> The first generation of clients comprises sovereign states; the second generation comprises private sector companies. SOEs lie somewhere between the two, forming a distinct group or third generation.

## 5. Supporting Mandiri's Reform Program

39. The Innovation and Efficiency Initiative provides that ADB lending to an SOE should be accompanied by corporate and/or sector reforms. Examples of such reforms are the creation of a sound financial base and specific undertakings for financial management, environmental and social safeguards, matters regarding operations, and ownership. Mandiri has already implemented various financial reform measures to strengthen its financial position, including resolving NPLs, reducing operating costs, and improving its business strategy. As part of this reform process, it is seeking to strengthen its balance sheet, thereby improving its financial risk profile. The ADB assistance would assist in addressing Mandiri's current maturity mismatch, and consequently strengthen its financial base. This will greatly contribute to Mandiri's financial reform.

40. Mandiri has undertaken numerous corporate governance reforms to improve performance, transparency, and efficiency. These reforms are in line with Government efforts to improve the management and operations of SOEs, which have been supported by ADB.<sup>13</sup> Its work in this area has been publicly noted, and in light of the numerous governance awards won in recent years, is currently seen as a governance model for other financial institutions and SOEs in Indonesia. Mandiri has made clear progress in the area of operations reform, and on the basis of its financial standing and the nature and depth of specific undertakings, merits access to financing in accordance with the Innovation and Efficiency Initiative.

## V. ASSURANCES

41. Consistent with the Agreement Establishing the Asian Development Bank, the Indonesian Government will be requested to confirm that it has no objection to the proposed financial assistance to Mandiri. No funding will be disbursed until ADB receives such confirmation.

42. ADB will enter into suitable loan documentation and other required legal documents, following approval of the proposed financing by ADB's Board of Directors.

## VI. RECOMMENDATIONS

43. I am satisfied that the proposed loan would comply with the Articles of Agreement of the Asian Development Bank (ADB) and, acting in the absence of the President, under the provisions of Article 35.1 of the Articles of Agreement of ADB, I recommend that the Board approve:

- (i) the loan of up to \$75,000,000 to Bank Mandiri (Persero) from ADB's ordinary capital resources, with interest to be determined in accordance with procedures applicable to ADB's nonsovereign operations and as approved by ADB's Pricing and Credit Enhancement Committee, a term of up to 7 years, and such other terms and conditions as are substantially in accordance with those set forth in this report, and as may be reported to the Board; and

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<sup>13</sup> ADB. 2001. *Report and Recommendation of the President to the Board of Directors on a Proposed Loan to the Republic of Indonesia for the State-Owned Enterprise Governance and Privatization Program*. Manila.

- (ii) to the extent cofinancing is made available under ADB's B loan program, a B loan of up to \$225,000,000 to Bank Mandiri (Persero) on terms agreed between ADB, Bank Mandiri (Persero), and the B loan participating banks; and such other terms and conditions as are substantially in accordance with those set forth in this report, and as may be reported to the Board.

Liqun Jin  
Vice President

07 July 2008

## DESIGN AND MONITORING FRAMEWORK

Design Summary	Performance Targets and/or Indicators	Data Sources and/or Reporting Mechanisms	Assumptions and Risks
<p><b>Impact</b></p> <ul style="list-style-type: none"> <li>• Mandiri is able to address part of its asset liability and foreign currency mismatch concerns</li> <li>• Efficient allocation of finance to end borrowers</li> <li>• The Indonesian economy experiences increased broad-based economic growth (i.e., more capital expenditure leads to enhanced private investment and economic expansion)</li> <li>• Other domestic and international financial institutions are encouraged to provide long-tenor dollar funding to Indonesian financial institutions demonstrating commercial viability</li> <li>• Environmental and management capacity is enhanced</li> </ul>	<ul style="list-style-type: none"> <li>• Amount of the mismatch decreases</li> <li>• Enhanced future long-term private-sector funding by Indonesian and international financial institutions</li> <li>• Project meets ADB's environmental and social requirements</li> </ul>	<ul style="list-style-type: none"> <li>• Balance sheet data</li> <li>• Government statistics</li> <li>• Other reports specifically requested by ADB</li> <li>• Trade publications and market commentary</li> <li>• Data from Mandiri indicating its loan processing and monitoring process are compatible with ADB's standards (and associated compliance)</li> </ul>	<p><b>Risk</b></p> <ul style="list-style-type: none"> <li>• Stability of the Indonesian economic and political landscape</li> </ul> <p><b>Assumption</b></p> <ul style="list-style-type: none"> <li>• Mandiri will be able to lend ADB loan proceeds to suitable borrowers</li> </ul>
<p><b>Outcome</b></p> <ul style="list-style-type: none"> <li>• Within a reasonable time frame, Mandiri is able to identify, process, sign, and ultimately disburse loans to borrowers</li> <li>• Mandiri builds up its long-tenor loan book following ADB's investment</li> </ul>	<ul style="list-style-type: none"> <li>• Mandiri's long-tenor loan book is commercially viable</li> <li>• Mandiri's credit quality is high</li> <li>• Mandiri meets return on equity and return on assets targets</li> <li>• Mandiri's capital adequacy ratio remains above Bank Indonesia requirements</li> </ul>	<ul style="list-style-type: none"> <li>• Mandiri's quarterly and annual financial statements</li> <li>• Reports specifically requested by ADB</li> </ul>	<p><b>Risk</b></p> <ul style="list-style-type: none"> <li>• Stability of the Indonesian economic and political landscape</li> </ul> <p><b>Assumptions</b></p> <ul style="list-style-type: none"> <li>• Mandiri does not breach domestic prudential norms</li> <li>• No regulatory changes for banking</li> <li>• No other exogenous factors have a negative impact on development of banking</li> </ul>

<b>Design Summary</b>	<b>Performance Targets and/or Indicators</b>	<b>Data Sources and/or Reporting Mechanisms</b>	<b>Assumptions and Risks</b>
<b>Outputs</b> <ul style="list-style-type: none"> <li>• ADB provides dollar debt funding to Mandiri</li> <li>• Mandiri operationalizes use of proceeds</li> </ul>	<ul style="list-style-type: none"> <li>• Mandiri receives funding</li> <li>• Financing requests are received by Mandiri from its borrowers</li> </ul>	<ul style="list-style-type: none"> <li>• Mandiri's quarterly and annual financial statements</li> <li>• Reports specifically requested by ADB</li> <li>• Trade publications</li> </ul>	<b>Assumptions</b> <ul style="list-style-type: none"> <li>• All regulatory approvals in place for ADB</li> <li>• No adverse changes in market conditions</li> </ul>
<b>Activities with Milestones</b> <p>1.1 Provide Mandiri with a direct loan of \$75 million and B loan of \$225 million by August 2008</p> <p>1.2 Operationalize funding proceeds by Mandiri (ongoing)</p> <ul style="list-style-type: none"> <li>• Strengthen the maturity profile of its balance sheet</li> <li>• Origination of new client opportunities</li> <li>• Due diligence on clients</li> <li>• Completion of financing arrangements with clients</li> </ul>			<b>Inputs</b> <p>ADB:</p> <ul style="list-style-type: none"> <li>• \$75 million direct loan</li> <li>• \$225 million B loan</li> </ul>

ADB = Asian Development Bank.