

Beyond Emergency Responses: Ensuring the Legacy of Market-Based Microfinance Expansion

By Mariano A. Cordero, Rizal Matondang, and Pieter Smidt

- **The creation of a Microfinance Innovation Fund was a prominent feature of the Earthquake and Tsunami Emergency Support Project in Indonesia.**
- **To coopt success, before establishing the Fund, the project provided technical assistance to build the capacity of partner banks, created a Board for the Fund, setup guidelines for operations, extended loans and deposits at near-market rates, and partnered with PT. Permodalan Nasional Madani that assumed the role of Fund custodian.**
- **The Microfinance Innovation Fund is set to continue successful fund operations long after project completion.**

Background

The ADB-assisted Earthquake and Tsunami Emergency Support Project aimed to develop sustainable and responsive financial services to micro and small enterprises in Aceh and the island of Nias in Sumatra, Indonesia.

The Grant Agreement for the project included the creation of a Microfinance Innovation Fund to provide commercial funding to partner banks willing to expand financing for micro and small enterprises.

The Microfinance Innovation Fund was designed to be a revolving fund to serve microfinance-oriented banks beyond the life of the project.

Challenges

A main challenge was the proliferation of massive grant funds for “microfinance” provided by development partners, international nongovernment organizations, and government entities even beyond the emergency or aid-driven phase of disaster responses.

Another challenge was an emerging culture of grant-dependence among potential partner banks and the flawed perception that microfinance is synonymous with aid assistance for the poor.

Within the short time frame of the project, an ad hoc but transparent and efficient system to manage and operate the Microfinance Innovation Fund had to be set up, while ensuring its seamless transfer to a more permanent scheme after project completion.



Eriek Nurhikmat

Result of effective microfinance services: thriving microbusiness

Innovative Management and Operations of the Microfinance Innovation Fund

The project extended and completed technical assistance for capacity building of partner banks before they were allowed to avail of Microfinance Innovation Fund financing to ensure proper usage of monies; this also afforded sufficient time for “microfinance” grant funds from development partners to be used up, making the market-based Microfinance Innovation Fund attractive to those in real need of it.

To ensure transparency, a three-member board was created for the Microfinance Innovation Fund, composed of representatives from ADB, Badan Rehabilitasi dan Rekonstruksi (BRR, the government entity that oversaw rehabilitation and reconstruction efforts in Aceh and Nias), and an independent member from the leading local university in Aceh.

The board set up guidelines for operations and was the sole approving authority for financing partner banks in accordance with the fund’s objectives. In the early stages, it received assistance from project consultants to guide its operations.

The Microfinance Innovation Fund was made available to all banks needing funds to expand lending to micro and small enterprises in Aceh and Nias; funding was provided to partner banks in the form of loans and/or deposits priced at near-market rates.

PT. Permodalan Nasional Madani (PNM), a government-owned, non-bank institution with the mandate to provide wholesale funds to financial institutions to expand lending to micro and small enterprises, was selected as the fund’s custodian to conduct due diligence of banks applying for funding; process applications for board approval, monitor and collect

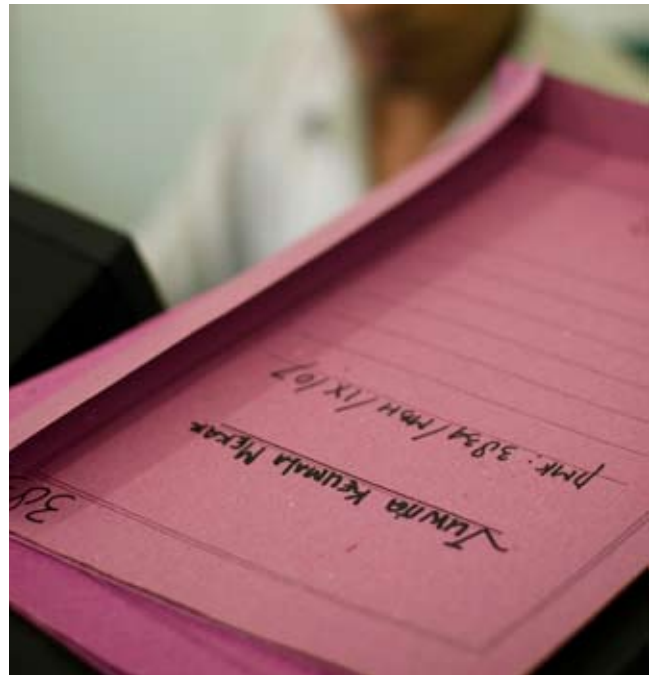
loans or deposits from partner banks, and manage or temporarily invest idle funds. The use of PNM avoided “reinvention of the wheel” within the short life of the project since it already had the organization, systems, procedures, and presence in the project areas needed to perform effectively as custodian.

Operating Beyond the Project

As of late 2009, all \$8.5 million of project grant funds allocated to the Microfinance Innovation Fund had been fully disbursed to partner banks in Aceh.

At the same time, all collections, earnings, and other revenues have been reverted to the revolving fund operated by the Microfinance Innovation Fund and were being recycled, making these continually available for microfinance expansion of partner banks in Aceh and Nias.

Before end-2009, the exit strategy is to hand over the Microfinance Innovation Fund to the proper pre-existing entity (e.g., PNM) to continue fund operations for the same purposes long after project completion. The selection of PNM as custodian anticipated its potential role as manager of the Microfinance Innovation Fund beyond the project.



Eriek Nurhikmat

Beyond the emergency response: strengthening the banking system to mainstream microfinance services (above and below)



Eriek Nurhikmat

Banking with the poor: door-to-door microfinance delivery



Eriek Nurhikmat

For further information

Contact Pieter Smidt, Lead Professional (Water Resources), Indonesia Resident Mission (psmidt@adb.org); Mariano A. Cordero, Team Leader, ETESP consultants (SMEC International Pty Ltd) (mariano.cords@gmail.com); Binh T. Nguyen, Finance Specialist (Rural and Microfinance) (bnguyen@adb.org); and Rizal Matondang, Advisor, ETESP Project Management Office (rhmatondang@gmail.com).

Earthquake and Tsunami Emergency Sector Project (ETESP) - Indonesia www.adb.org/Projects/ETESP/default.asp

Asian Development Bank is dedicated to reducing poverty in the Asia and Pacific region.

www.adb.org/knowledgeshowcase

The Knowledge Showcase highlights innovative ideas from ADB technical assistance and other knowledge products to promote further discussion and research.

The views expressed in this publication are those of the author(s) and do not necessarily reflect the views and policies of ADB or its Board of Governors or the governments they represent.