Energizing rural banking in Aceh to support small and micro enterprises was a prominent feature of the Earthquake and Tsunami Emergency Support Project in Indonesia.

The project strengthened rural banking by assessing 12 rural banks, facilitating mergers, setting up standards for banking operations, providing improved supervision and guidance, and advocating partial privatization.

A strengthened provincial rural bank network is now a key player in efforts to reduce poverty and foster economic growth.

Background

The Asian Development Bank-assisted Earthquake and Tsunami Emergency Support Project aimed, among others, to develop sustainable and responsive financial services for micro and small enterprises in Aceh in Sumatra, Indonesia.

Strengthening potential key microfinance players was crucial to achieving the project’s objectives.

Twelve independently-operating rural banks owned by the Aceh Provincial Government were well positioned to provide microfinance services in remote areas of the province.

Challenges

Years of mismanagement, lack of strategic direction, and a former role as conduits for unsustainable, politically-motivated credit programs had weakened the 12 rural banks.

All 12 rural banks had small equity bases with limited expansion prospects; four were proposed to be closed by Bank Indonesia (the Central Bank) on account of unsound banking operations.

Aside from being owned by the Aceh Government, no common bond or standards existed among the 12 rural banks in terms of governance, policies, procedures, business operations, human resource development, etc.

Revitalizing the Rural Bank Network

At the request of the Aceh Government, and with assistance through the project, the rural bank network was redesigned and retooled. Related measures include:

• assessed the 12 rural banks to determine how best they might be strengthened—for example, through a merger;

• obtained approval for the planned merger of the 12 rural banks to include financial consolidation of and an equity increase for the consolidated rural bank; conversion of the other rural banks into branches; and total reorganization;

• designed hiring and rehiring criteria for staff and assisted in the selection of former and new staff; formulated standard operating policies and procedures; designed banking products; installed state-of-the-art information technology systems; assisted in re-equipping and refurbishing all offices; provided intensive training and on-the-job mentoring of management and staff at all levels; and trained two pilot branches as model and training centers from which to source proven technology and plan the expansion of microfinance services in the rural areas of Aceh;

• conducted reorientation training of the relevant Aceh Government office to improve supervision of and guidance to the consolidated rural bank, while granting it autonomy to pursue developmental objectives viably; and

• advocated a partial privatization plan to allow private sector ownership and forge a balance between the pursuit of developmental objectives and entrepreneurial management of the consolidated bank.

The Emergence of a Key Microfinance Player in Aceh

The consolidated rural bank is now, by far, the largest rural bank in Aceh, with total assets and a number of branches larger than all those of the eight privately owned rural banks combined.

The consolidated rural bank is now much better positioned to serve the more remote and “under-banked” areas of Aceh, with good expansion potential given its strengthened institutional and financial capability.
Bank Indonesia treats the merger of the rural banks as a major achievement, consistent with the Indonesian Banking Architecture master plan that envisions the merger of and improvements in the equity base of weak banks as well as expansion of micro and small enterprises financing by the banking sector.

The Aceh Government is now a more responsible owner of a redesigned and retooled rural bank, prepared to take on the challenges of fostering economic growth and reducing poverty in Aceh province.