MICROFINANCE INNOVATION CENTER
FOR RESOURCES AND ALTERNATIVES

Rapid Evaluation Report

On
Government Community Development Operations:
Microfinance and Microcredit Projects

Presented to the BAPPENAS and World Bank – Decentralization Support Facility

Prepared by Yayasan "MICRA"
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ABOUT MICRA

The Microfinance Innovation Center for Resources and Alternatives (MICRA) is an Indonesian foundation focused solely on the development of the microfinance industry. MICRA was founded in early 2006 by Mercy Corps, in order to institutionalize and expand its work over the past six years in microfinance throughout Indonesia. Its mission is to build the institutional strength and outreach of the Indonesian microfinance sector, by providing a full range of high-quality, best-practice technical inputs and support to all industry stakeholders, in a sustainable and demand-driven manner. As an independent support center, MICRA is committed to promoting innovations, transparency, increased outreach to the poor and ever-improving performance in the microfinance industry.

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ADB	*Bank Pembangunan Asia*	Asian Development Bank
APBN	*Anggaran Pendapatan dan Belanja Negara*	National Budget
Balai	*Balai Pengembangan Sumber Daya Manusia Pertanian*	Institute for the Agricultural Human Resources Development
BLM-KIP	*Bantuan Langsung Masyarakat Keringanan Investasi Pertanian*	Direct Community Financial Assistance for Agricultural Investments
BDSP		Business Development Service Providers (including vocational and entrepreneur training)
BI	*Bank Indonesia*	Bank of Indonesia
BMT	*Baitul Mal dan Tanwil*	Islamic Banking Cooperative
BPD	*Bank Pembangunan Daerah*	Provincial Development Bank
BPKP	*Badan Pemeriksa Keuangan Pusat*	National Audit Body
BPR	*Bank Perkreditan Rakyat*	second-tier community banks, also known as rural banks
BPRS	*Bank Perkreditan Rakyat Syariah*	Sharia-based People's Credit Bank
BPS	*Badan Pusat Statistik*	State Statistics Agency
BRI	*Bank Rakyat Indonesia*	Indonesian People's Bank (name of a commercial bank)
BRR	*Badan Rehabilitasi dan Rekonstruksi*	Rehabilitation and Reconstruction Agency (Aceh Government Reconstruction Agency, involved in MFI funding)
BQ	*Baitul Qiradh*	Aceh Islamic-based Cooperatives
CSO	*Organisasi Masyarakat Sipil*	Civil Society Organization
DEP	*Dana Ekonomi Produktif*	Productive Economic Fund
FEA	*Agen Penyuluh/Pendamping*	Field Extension Agent
FGD	*Diskusi Kelompok Terfokus*	Focus Group Discussions
GoI	*Pemerintah Indonesia*	Government of Indonesia
IFAD	*Dana Internasional untuk Pembangunan Sektor Pertanian*	International Fund for Agricultural Development
IFC PENSA		International Finance Corporation, Program for Eastern Indonesia SME Assistance Indonesia
ILO	*Organisasi Buruh Internasional*	International Labor Organization
JBIC		Japan Overseas Investment Corporation
KUBE	*Kelompok Usaha Bersama / Program Pemberdayaan Masyarakat*	Joint Enterprise Group/Community Empowerment Program
MFI	*Lembaga Keuangan Mikro*	Microfinance Institution
MICRA		Microfinance Innovation Center for Resources and Alternatives

MIS	*Manajemen Sistem Informasi*	Management Information System
MoA	*Departemen Pertanian*	Ministry of Agriculture
MoCS	*Departemen Koperasi dan Usaha Kecil dan Menengah*	Ministry of Cooperatives and Small and Medium Enterprises
MoF	*Departemen Keuangan*	Ministry of Finance
MoMF	*Departemen Kelautan dan Perikanan*	Ministry of Marine Affairs and Fisheries
MoSA	*Departemen Sosial*	Ministry for Social Affairs
NGO	*Lembaga Swadaya Masyarakat*	Non-Governmental Organization
NPL	*Hutang tak terbayar tepat pada waktunya*	Non-Performing Loans, typically measured as a portion of loans which are overdue past 90 days
P3-KUM	*Program Pembinaan dan Pengembangan melalui Kredit Usaha Mikro*	Revolving Fund Facility for Conventional/ Sharia-based Microenterprise Productive Activities
P4K	*Proyek Peningkatan Pendapatan Petani dan Nelayan Kecil*	Rural Income Generating Project for Small Farmers and Fishermen
PEMP	*Pemberdayaan Ekonomi Masyarakat Pesisir*	Economic Empowerment for Coastal Communities Program
PINBUK	*Pusat Inkubasi Usaha Kecil*	Development Center for Small Enterprise
PNM	*Permodalan Nasional Madani*	State-owned MFI apex bank, supervisor and technical service provider)
PNPM	*Program Nasional Pemberdayaan Masyarakat*	National Community Empowerment Program
PRA		Participatory Rural Appraisals
SHG	*Kelompok Swadaya Masyarakat*	Self-Help Group
SMEs	*Usaha Kecil dan Menengah*	Small and Medium Enterprises
TA	*Bantuan Teknis*	Technical Assistance (includes training, consulting and other technical support)
UNDP	*Program Pembangunan Perserikatan Bangsa-bangsa*	United Nations Development Program
WB	*Bank Dunia*	World Bank
WB-DSF	*Lembaga dari Bank Dunia khusus untuk menangani Proses Desentralisasi*	World Bank - Decentralization Support Facility

PROJECT DATA SHEETS

P4K Project Data Sheet

1	**Title of Program:** "P4K – Proyek Peningkatan Pendapatan Petani dan Nelayan Kecil" (Rural Income Generating Project for Small Farmers and Fishermen)
2	**Implementing Ministry:** Ministry of Agriculture (MoA)
3	**Contact persons:** Name : Ms. Widayanti Address : Kantor Pusat Departemen Pertanian, Gedung D Lt. VI, Jl. Harsono Rm. No.3, Jakarta Selatan – 12550 Telephone: 021 – 7815380 ext 5623 E-mail : widayanti@deptan.go.id
4	**Program Implementation Period** Beginning year: 1979 – 1988 (Phase I) 1989 – 1998 (Phase II) 1998 – 2005 (Phase III) End year : 2005
5	**Sector/Theme:** Agriculture / Microfinance and Microenterprise
6	**Budget by Source of Funding:** Total Budget for Phase III only: US$ 118 million (Rp.1.1 trillion) ADB (48%), IFAD (12%) and Bank BRI (40%)
7	**Project Locations** Number of Provinces : 12 Provinces Number of Districts : 126 Districts Number of Kecamatan/Villages : 1,973 Kecamatan (sub-districts)/10,720 Villages
8	**Objective of the Program:** The development of a sustainable and participatory system to help poor rural households improve their livelihoods and standard of living through the creation of

	community-based-self-help groups (SHGs).
9	**Brief Description of the Program and each Component:** P4K is a program managed by Ministry of Agriculture in co-operation with Bank Rakyat Indonesia. The project is directed at poverty reduction within rural areas through the development of human resources and microfinance services for micro enterprise development. The aim of this program is to reach beneficiaries who live below the poverty line. They might be small scale farmers, share croppers, farm laborers, small scale fishermen, small home industry operators and other poor villagers who do not have any permanent job. Directly the program focuses on building micro-enterprise skills, providing microcredit, and promoting savings. In addition, the program attempts to link groups of borrowers with community activities and other social service agencies. Program Components: 1) <u>Self-Help Group Development</u> The project identified rural poor families through poverty targeting surveys and encouraged representatives of these families to form self-help groups for the purpose of pooling resources, providing group support and for acceptance and use of credit. The poverty targeting surveys used to form SHGs were based on the Participatory Rural Appraisal (PRA) approach. To facilitate its implementation in the target locations the project hired around 4,000 field extension agents (FEAs). The project design also incorporated a graduation program for those SHGs that reached a self-sustained development stage to gain access to higher level formal credit programs and other government services. Sustainable SHGs were also expected to form associations of SHGs and/or cooperatives to scale up their businesses and ensure their sustainability; 2) <u>Microfinance Services</u> Microfinance Services were offered by the project to help SHGs mobilize savings and access non-collateralized solidarity group loans to finance their micro-business activities. BRI managed the credit process and provided a mechanism for establishing group savings. The SHGs were responsible for their own loan repayment; and 3) <u>Institutionalization and Capacity Building</u> The management systems and the staff quality were keys to the success of the project implementation. Thus, the third component aimed at assisting different government's agencies at different level of project implementation to enhance their institutional capacity and systems in line with the principles of decentralization and transparency.

PEMP Project Data Sheet

1	**Title of Program:** "PEMP – Program Pemberdayaan Ekonomi Masyarakat Pesisir" (Economic Empowerment for Coastal Communities Program)
2	**Implementing Ministry:** Ministry of Marine Affairs and Fisheries (MoMF)
3	**Contact persons:** Name : M. Zaki Mahasin, MPi Address : Direktorat General Pesisir dan Pulau-pulau Kecil, Direktorat Pemberdayaan Masyarakat Pesisir, Jl. Medan Merdeka Timur No.16, Gedung Mina Bahari II, Lt. 8, Jakarta Pusat - 10110 Telephone: 021 - 3520768 E-mail : n.a.
4	**Program Implementation Period:** Beginning year: 2001 End year : 2009
5	**Sector/Theme:** Fisheries / Microfinance and Micro-businesses at coastal areas
6	**Budget by Source of Funding:** State Budget (APBN) and Fuel Subsidy (BBM compensation) Total Budget: Rp.1.2 trillion
7	**Project Locations** Number of Provinces : 33 Provinces Number of Districts : 291 Coastal Districts Number of Kecamatan/Villages: 8,090 Villages
8	**Objective of the Program:** To improve the welfare of coastal communities by strengthening MFIs, encouraging entrepreneurship, stimulating peoples' participation in community-based capacity building and diversifying local resource-based micro-enterprises in a sustainable way.
9	**Brief Description of the Program and each Component:**

	This program targets people who have micro-businesses that are directly or indirectly related to fishery and located along coastal areas in fisheries sector, including fishermen. Initially, the project was designed to reduce the impacts of rising fuel price on the socioeconomic conditions of coastal communities through the provision of business capital using revolving fund facilities for productive micro-businesses. At the district level, the revolving fund facilities were managed by privately-owned Mitra Mina micro-coastal development economic agency (Lembaga Ekonomi Pengembangan Pesisir Mikro Mitra Mina, LEPP-M3). LEPP-M3 was established initially as an embryo of a 'holding' company owned and managed by the coastal communities. The initial project design included the start up of large numbers of new cooperatives to provide financial and other services to coastal communities. However, based on the failure of a number of cooperative start-ups, the revolving funds have now been placed in over 250 pre-existing coastal-based cooperatives, with improved results. Project implementation is divided into two periods: (i) from 2001 to 2003 during which time a revolving fund mechanism was applied through LEPP-M3; and (ii) from 2004 to 2007 the project has used micro-credit scheme provided through MFIs in cooperation with banks. Program Components: 1. Working with MFIs/Cooperatives; 2. Linking cooperatives with banks, with government guarantee/cash collateral; and 3. Technical Assistance provision to MFIs and beneficiaries.

KUBE Project Data Sheet

1	**Title of Program:** "KUBE - Kelompok Usaha Bersama / Program Pemberdayaan Masyarakat Miskin" (Joint Enterprise Group/Community Empowerment Program)
2	**Implementing Ministry:** Ministry for Social Affairs (MoSA)
3	**Contact persons:** Name : Drs. Manggara Simanjuntak Address : Departemen Sosial, Direktorat Fakir Miskin, Jl. Salemba Raya, Jakarta Telephone: 314-4323 ext. 2303 E-mail : n.a.
4	**Program Implementation Period:** Beginning year: 1997 End year : 2010
5	**Sector/Theme:** Social / Microfinance and micro-businesses or productive economic activities of the poor people
6	**Budget by Source of Funding:** State Budget, Bank BRI Total Budget: Rp.300 billion
7	**Project Locations** Number of Provinces: 33 Provinces Number of Districts : 143 Districts
8	**Objective of the Program:** To provide business loans to poor households both in rural and urban areas and to empower them through community-based joint enterprise groups and MFIs. The project is integrated into the financial management improvement of MFIs in order to strengthen their organizations.
9	**Brief Description of the Program and each Component:** KUBE project – implemented by the Ministry of Social Affairs – was created to

	address the wide spectrum of issues in fighting poverty in Indonesia. Target beneficiaries of this project are poor households living in rural, sub-urban, urban, forest, coastal, conflict, border, disaster areas as well as small and remote islands. The main activity of the project is to provide a grant-based government match to KUBE group member savings, which can reach up to 200% of total group savings. The savings then form the basis for MFI lending to these groups, while at the same time building KUBE member assets, savings habits and relationship with a local financial institution. The program includes the following components: 1) Ministry of Finance approves funding allocation proposal from the MoSA; 2) The MoSA then appoints the Director General (DG) for Social Assistance and Security as the national coordinator of the KUBE program; 3) The government appoints Bank BRI to channel these funds to KUBE groups and the DG for Social Assistance and Security opened an account in Bank BRI's headquarter; 4) DG district offices assist communities to form groups (KUBE) with Pusat Inkubasi Bisnis Usaha Kecil (PINBUK) and appoints MFIs to channel funds to members of KUBE groups; 5) Each appointed MFI is required to open an account in Bank BRI's branch offices. MFIs generally receive funds from BRI within 30 days of written request from the government to transfer funds to the MFIs' account in their respective Bank BRI branch offices; and 6) MFIs disburse funds to beneficiaries (KUBE) in accordance with their own standard operating procedures on credit assessment. Funds are considered as loans that must be repaid to the government through MFIs.

P3KUM Project Data Sheet

1	**Title of Program:** "P3KUM – Program Pembinaan dan Pengembangan melalui Kredit Usaha Mikro" (Revolving Fund Project for Conventional/Sharia-based Microenterprise Productive Activities)
2	**Implementing Ministry:** Ministry of Cooperatives and Small and Medium Enterprises (MoCS)
3	**Contact persons:** Name : Ms. Niniek Agustini Address : Department Koperasi, Jl. HR Rasuna Said, Jakarta Selatan. Telephone: 021-52992833 E-mail : n.a.
4	**Program Implementation Period:** Beginning year: 2006 End year : 2008
5	**Sector/Theme:** Cooperatives / Microfinance and Micro-enterprises
6	**Budget by Source of Funding:** State Budget Total Budget for 2007: Rp.200 billion
7	**Project Locations** Number of Provinces: All Provinces nationwide
8	**Objective of the Program:** 1) To improve access of small and micro enterprises to finance by strengthening the capital structure of Savings and Loans Cooperatives and Units (Koperasi/Unit Simpan Pinjam, KSP/USP) and other women cooperatives; and 2) To support the government's poverty alleviation program and increase new employment opportunities. P3-KUM funding objectives for both conventional and sharia-based scheme are the same.

9	**Brief Description of the Program and each Component:** The P3-KUM is managed by the Ministry of Cooperatives and SMEs (MoCS). The project implementation was divided into two phases: Phase 1 from 2000-2005 and Phase 2 from 2005-2008. The project provides revolving funds in the form of a ten year loan to cooperatives to finance member micro-businesses. Funds repaid by MFIs to the project are then provided to new cooperatives. There is also a specific program focus on cooperatives run by and for woman micro-entrepreneurs. The project is targeted to reach around 8,484 KSP and USP by 2005 and cover additional 6,103 by 2008. To be eligible, cooperatives must meet the following requirements: (i) primary cooperatives at district level that have legal license for a minimum of one year and a savings and loans unit separate from other business activities, (ii) at least has 25 members who own micro-business and never received loans from previous MoCS' projects, and (iii) has an internal rules and regulations, including regular members meeting. During Phase 2, MoCS plans to establish a network of 6,103 MFIs in all districts throughout Indonesia and to include revolving loan provision to cooperatives, capacity building for MFIs and their borrowers and on-going project monitoring. Program Components: 1. Selection of partner cooperative in each district using scoring model; 2. Ten years loans to MFIs channeled through banks; 3. Subsidized interest covers technical assistance costs and bank fees; and 4. Fund revolves to other MFIs.

BLM-KIP Project Data Sheet

1	**Title of Program:** "BLM-KIP – Bantuan Langsung Masyarakat Keringanan Investasi Pertanian" (Direct Community Financial Assistance for Agricultural Investments)
2	**Implementing Ministry:** Ministry of Agriculture (MoA)
3	**Contact persons:** Name : DR. Mohammad Dani Address : Departemen Pertanian, Gedung Arsip Lt. 3, Jl. Harsono No.3, Pasar Minggu, Jakarta Selatan - 12550 Telephone: 021 – 788395205 E-mail : n.a.
4	**Program Implementation Period:** Beginning year: 2007 (newly approved project, but not yet implemented) End year : 2008
5	**Sector/Theme:** Agriculture / Non-microfinance and grant to invest in agricultural-related activities
6	**Budget by Source of Funding:** State Budget Total Budget: Rp.400 billion for FY 2007 and Rp.300 billion for FY 2008
7	**Project Locations** Number of Provinces: 10 Provinces
8	**Objective of the Program:** To improve access of small farmers to various agricultural-based financial services to facilitate increased productivity.
9	**Brief Description of the Program and each Component:** BLM-KIP is a new program which has not yet begun operations, but is planned for significant funding over the next two years (700 billion IDR). The project is expected to complement other Government agricultural-related financing facilities, including the Agricultural Financing Facility Scheme (Skim Pelayanan Pembiayaan

	Pertanian, SP3) that provides credit guarantee for farmers for commercial loans from Bank Mandiri, Bank Bukopin and Regional Development Banks (Bank Pembangunan Daerah, BPD). Government funding through the project provides matching grants for farmers and farmers' groups with established credit histories from bank or other non-banking financial institutions upon their renewed application for working capital loans for agricultural-related investments. Grants will be made for up to 10% of the new loan value, through participating network of banks on loans up to 500 million IDR. Priority will be given to small farmers of basic agricultural commodities and existing farmers' groups. Target beneficiaries include farmers, groups of farmers, association of farmers' groups, agricultural-based cooperatives and small and micro agro-enterprises. Poultry, plantations and agricultural products processing businesses are also qualified. Loans provided through BLM-KIP project is specifically for targeted farmers' groups that have previously received credit facilities from banking or other non-banking financial institutions. Program Components: 1) Supplemental 10% grant on top of existing loans to agro-borrowers through partner banks; 2) Beneficiaries must be pre-existing borrowers; and 3) Beneficiaries must apply for grant to Dinas.

1. EXECUTIVE SUMMARY

1. The Government of Indonesia (GoI) through Badan Perencanaan Pembangunan Nasional (Bappenas) has commissioned a series of independent evaluations to examine the effectiveness of ongoing government poverty reduction programs, focusing on the community level. Bappenas has identified 14 large community development programs implemented by ten different ministries to be evaluated in 2007. From these programs, five are categorized as microfinance/ microcredit programs. These programs are:

Name of Program	Implementing Ministry
Microfinance/Microcredit	
KUBE (Kelompok Usaha Bersama/Program Pemberdayaan Masyarakat Miskin)	Ministry for Social Affairs
PEMP (Program Pemberdayaan Ekonomi Masyarakat Pesisir)	Ministry of Marine Affairs and Fisheries
P4K (Proyek Peningkatan Pendapatan Petani dan Nelayan Kecil)	Ministry of Agriculture
BLM-KIP (Bantuan Langsung Masyarakat—Keringanan Investasi Pertanian)	Ministry of Agriculture
P3-KUM (Penyediaan Dana Bergulir untuk Kegiatan Produktif Skala Usaha Mikro dengan Pola Bagi Hasil/Syariah dan Konvensional)	Ministry of Cooperatives and SMEs

Source: Terms of Reference (ToR)

2. These programs were chosen because they: (a) relate to community development; (b) target primarily the kecamatan and village levels (as opposed to national, provincial, or district levels); and (c) are significant in terms of government funding levels.

3. ***Objectives of the Rapid Evaluation***. Bapennas – with technical assistance from the World Bank and financial support from the Decentralization Support Facilities (DSF) – asked MICRA, an Indonesian microfinance research group, to conduct a rapid assessment of these five programs in order to provide the GoI with useful and timely information to manage and guide public resources and interventions. The overall objectives of the rapid evaluation are to provide independent assessments of the five microfinance projects in order to: (a) understand the effectiveness of the programs at meeting their stated objectives; (b) pinpoint possible areas for program improvement; and (c) draw on lessons and best practices from other governmental community development and poverty reduction programs, especially in the preparation of the National Community Empowerment Program (PNPM).

4. The rapid assessment was conducted from May 21st – June 29th, 2007 and covered project implementation in Jakarta and three provinces: East Java, South Sulawesi and South Sumatera. Due to the widespread location, scope of the microfinance projects and time

constraints, methodologies have been kept simple, but sufficient to meet the assessment objectives. The rapid evaluation focused on four key areas: 1) assessment of project documentation; 2) assessment of project objectives and design; 3) assessment of project implementation, efficiency and management; and 4) assessment of results and effectiveness. Research techniques included desk reviews, structured interviews, individual field surveys and focus group discussions with program senior managers, strategic partners, field implementers, monitors and end beneficiaries.

5. Program assessments were limited in scope due to the restricted timeframe; limited document available to be review and/or lack of access to complete project documentation and some project leadership among the wide range of government ministries at the national, provincial and local levels.

6. ***Summary of Key Findings***. The five projects reviewed had significant differences in terms of objectives, design, scale, target groups, quality of implementation and overall sustainability. Detailed findings on each project are to be found in the main body of this report. Also, a summary matrix which presents findings on each of the five programs based on all major evaluation criteria can be also found in Appendix 1. The P4K and PEMP projects were assessed with good overall performance due to their clear objectives, good fund flow and overall effectiveness, while KUBE and P3-KUM were assessed with average performance. While BLM-KIP has yet to be implemented, comments related to project design are included in the relevant section and matrix. Key project findings are presented below:

- ***Achieving Objectives***. *Performances of all four projects in meeting their objectives are highly varied*. PEMP seems to be the best performer in achieving its objective. Review on PEMP project documentation reveals that the project objectives and implementation strategies are the clearest, relatively realistic, and the most simple compared to other government microfinance projects evaluated, but with no implicit direct targeting of the poor. Based on the field survey, majority of beneficiaries (60%) are also satisfied with PEMP project and beneficiary fishermen report significant increases in income. Decentralization seems to have impacted some projects' performance (i.e., P4K and P3-KUM) in achieving results and ensuring project sustainability.

- ***Poverty Targeting / Site Selection***. *Performance on poverty targeting or site selection is strong among projects which actively aim to serve the poor*. P4K and KUBE are projects that directly aim to serve poor households, and both performed well in poverty targeting – reaching low-income people in relatively poor areas. The use of the comprehensive BPS data on poverty by KUBE in identifying poor areas and the use of Participatory Rural Appraisal (PRA) model at the village level by P4K project to select individual beneficiaries is very effective in poverty targeting. It will be best to complement both methods to better target the poor.

- ***Monitoring and Evaluation***. *There has been very limited monitoring and evaluation of government microfinance projects, particularly related to impact evaluation*. Almost no

monitoring and evaluation report were found during the field review, which indicate poor project monitoring and evaluation. This is supported by the fact that, based on interviews and field visits, key stakeholders and beneficiaries confirm that very few monitoring and evaluation have been done. Also, the Government oftentimes focuses more on directing resources toward reaching as many poor people as possible within the project duration and not gives enough attention and allocates enough resources in the design and implementation of effective monitoring and evaluation. Any evaluation efforts appear to take place in the initial stages of beneficiary and partner targeting, but is not repeated later in programming to assess impact.

- ***Cost effectiveness and Budget Structure***. *Cost effectiveness/budget structure was difficult to measure due to lack of both information and key reports and general transparency in budgets and performance*. Field assessment shows that *flow of funds appears generally good for all projects evaluated*, but with some bottlenecks due to unclear project procedures. Based on findings from the field evaluation, PEMP is the strongest project with a clear budget structure and most efficient flow of funding, drawing on the online management information system (MIS) of Bank Bukopin with its partner cooperatives. Field evaluation also reveals some irregularities among programs in funding at the local level. Also, some programs rely on local funds and resources for implementation, which are not fully available.

- ***Collection Performance and Rate of Repayment***. *Interview with project staffs and field survey show that collection performance are mixed, with rate of repayment is just average for all projects*. Evaluation on collection performance and rate of repayment is difficult to do due to the difficulties of getting the data. However, the limited field survey and interviews with project staff shows that rate of repayment is average for all projects. The projects that indicate good collection performance and rate of repayment (i.e., PEMP and KUBE) appear to be projects that: (i) have a strong incentive element for partner banks/MFIs to collect; (ii) employ dedicated and well-trained Field Extension Agents (FEAs); (iii) lend through well-formed self-help groups (SHGs); and (iv) target economically productive poor women.

- ***Capacity Building***. *Capacity building varies depending on project design, budget allocation and capacity of FEAs and other local service providers*. Technical assistance provided through the government's microfinance projects is still limited, and typically focuses on the individual beneficiary level. Based on the field evaluation, all projects evaluated have technical assistance for capacity building component in project implementation. However, the human, technical and financial capacity of participating MFIs to serve poor people is generally very low and capacity building at this level is often lacking, due to lack of funding, focus or qualified providers (i.e., PEMP and P3KUM).

- ***Beneficiary Satisfaction***. *Most beneficiaries (53-83% of respondents) in each village visited reported that they are satisfied with the government microfinance projects*. Factors driving satisfaction levels are: (i) improved access to finance; (ii) ease of loan terms; (iii) mostly no collateral requirements and long-term loan tenor; and (iv) affordable interest rates. KUBE projects recorded the highest level of client satisfaction. Clients are typically poor women with

no prior access to finance. There is evidence of improved standards of living associated with the program and strong community bonds through KUBE group formation.

▪ ***Project Sustainability***. *Most projects evaluated have weak financial sustainability*. Microfinance differs from most forms of government intervention because of the potential for long-term financial viability and therefore impact on poverty alleviation. Financial viability of these programs is often weak because it does not: (i) include a viable "exit strategy" that transfers vital government functions; (ii) does not build sustainable institutions to promote long term growth; (iii) does not place sufficient focus on quality of repayment, in order to demonstrate overall viability of lending to the poor. The PEMP project has the strongest financial sustainability due to active participation of Bank Bukopin and option for long term post-program financing.

▪ ***Community Organization through Self-Help Groups***. *Development of community organizations varies depending on overall program objectives, the extent and design of TA provision, budget allocation and capacity of local FEAs*. KUBE and P4K projects have the strongest performance in community organization through the formation of self-help groups (SHGs) with adequate technical assistance from FEAs. Many projects, including KUBE, attempt to create new cooperatives to meet project objectives, without sufficient investment in building strong or sustainable institutions. Working through existing community organizations, such as in P3-KUM, promotes longer-term viability.

7. ***Summary of Recommendations*:**

In order to increase project impact and sustainability:

▪ *Government funding for microfinance should always be used as a catalyst for sustainable development and incorporate a long-term "exit strategy"* that gradually builds commercial partners to assume all government necessary program activities and supports the development of a sustainable source of financing for both micro and small-businesses and MFIs. Components to build effective, sustainable linkages with the formal financial system to support growth and leverage government funds should always be included.

▪ The microfinance industry is already fractured and inefficient. *To the full extent possible, government agencies should work with and strengthen existing MFIs*, rather than building new ones, and support industry consolidation and strengthening. Whenever possible, Government must support MFIs (and banks) to deliver their own products tailored to local market, rather than creating temporary "project" products.

▪ *Government projects that target and build the bankability of poor borrowers appear to be a successful intervention for building financial access for the poor*. However, MFIs should always be allowed to lend based on demonstrated client bankability, in order to build the long

term viability of the MFI, and therefore its sustainable service for the community. Grant programs for the poor should be administered separately from credit programs.

▪ *Portfolio quality appears to be higher in areas where executing banks played a more active role* (i.e., Bank Bukopin). The government should take special care in aligning incentives for meaningful bank participation, as well as selecting banks with genuine institutional interest in serving the target group. As much as possible *identification and participation of executing (or channeling) banks and MFIs* in the projects must not be by appointment, but through a fair and transparent bidding process.

▪ *Components to build effective, sustainable linkages between microfinance project and the formal financial system to support growth and leverage government funds should always be included*. Most of the microfinance projects rely only on government and/or donors funding. Thus, an increased participation of large private commercial players is absolutely necessary to sustain the projects, as well as leading the industry towards a wider range of products, broader distributions systems, greater access for the poor to various microfinance services, and putting microfinance in the economic mainstream.

▪ *Loans for non-business purposes need to be incorporated into government's microfinance projects*. The poor also need loans for non-business purposes, in order to protect and build their assets and businesses. Thus, limiting loan purposes only for business could limit the benefit of, and access to, credit by the poor.

▪ *To achieve long-term success, Self-Help Groups (SHGs) need to be fully incorporated into MFI or bank activities over the life of the program, rather than supported and subsidized by government field staff.* In practice, SHGs formed over the course of government programming appear dependant on continued external support and many cease to exist when projects end.

<u>In order to increase project quality and outreach</u>:

▪ *To complement BPS poverty data, Participatory Rural Appraisal (PRA) approach is a very effective methodology to identify target beneficiaries and to encourage the SHGs at the community level*. Best-practice rules in SHG formation should be respected and implemented to ensure success of joint-liability group guarantees and performance.

▪ *Internal controls should be clearly structured into project design and linked to monitoring and evaluation, with sufficient budgeting.* Field assessments clearly demonstrate a high degree of variation in implementation and performance quality by region. The lack of project controls can lead to fraud.

▪ *Increased transparency in project funding, budgets and performance reporting could drive quality improvement and greater outreach to the poor*. An IT model applied by Bank Bukopin that shares data with MFIs on-line is an ideal technology application to facilitate greater

outreach to the poor and ensure transparency in funding provision. This type of shared MIS can form the basis of a credit bureau for low-income borrowers, helping to build their financial track records and ultimately to include them more actively in the formal financial system.

▪ Selection of MFIs to participate in government microfinance projects should *be standardized, objective and performance-based* to promote healthy sector development and growth in outreach. Moreover, technical assistance to participating MFIs is an important element in increasing project outreach, performance and viability.

In order to improve project design and implementation:

▪ *A standardized approach to monitoring and evaluating program performance based on microfinance best practice would help create clear guides and support for the overall development of the sector*. Monitoring and evaluation of government microfinance projects has so far been limited, particularly related to impact evaluation. There is very little information, therefore, to drive improved program design.

▪ *Financial feasibility studies should be conducted and extended to the bank branch level to ensure that the operational cost of implementation does not exceed interest and fee earnings*. The role of executing and channeling banks in all government microfinance programming is vital. If banks are not actively interested in promoting and sustaining the project, loan disbursals will be low and its terms and conditions uncompetitive.

▪ *If funding through government microfinance projects is to directly reach out to the segment of bankable poor people, then participating banks must establish adequate measures to assess credit risk of lending to poor population*. Credit application processes in banks sometimes are based on traditional credit assessment methodology which involves extensive documentation and paper work and is costly; thus, making it unsuitable for smaller loan sizes borrowers who demand shorter loan processing time and lower processing costs.

In order to focus and improve the role of Government:

▪ *The Government should play an important role as an enabler*, not a direct provider, of financial services, by ensuring sound legal and supervisory systems, as well as capacity building mechanism for MFIs.

▪ At the provincial and district level, *the Government should build the capacity of key staff of ministries in best-practice microfinance standards*, to allow them to provide competent oversight.

▪ *A centralized body that specifically oversees and supports these tasks would be very useful to serve as a one-door policy-making body* to guide government microfinance programming, helping to align, coordinate, support and more effectively leverage government

resources. This body should also be tasked to set standards and coordinate microfinance programming between ministries and to support development, monitoring and evaluation of microfinance programming at the provincial and district level.

2. INTRODUCTION

2.1 Background

8. The Government of Indonesia (GoI) through Badan Perencanaan Pembangunan Nasional (Bappenas) has commissioned a series of independent evaluations to examine the effectiveness of ongoing government poverty reduction programs, focusing on the community level. Bappenas has identified approximately 14 large community development programs implemented by ten different ministries to be evaluated in 2007. From these programs, five are categorized as microfinance/ microcredit programs. These programs are:

Table 1: Government's Micro-finance/Micro-credit Programs

Name of Program	Implementing Ministry	Total Value of Project (in Rp.)
Microfinance/Microcredit		
KUBE (Kelompok Usaha Bersama/Program Pemberdayaan Masyarakat Miskin)	Ministry for Social Affairs	Rp.300 billion
PEMP (Program Pemberdayaan Ekonomi Masyarakat Pesisir)	Ministry of Marine Affairs and Fisheries	Rp.1.2 trillion
P4K (Proyek Peningkatan Pendapatan Petani dan Nelayan Kecil)	Ministry of Agriculture	Rp.1.1 trillion
BLM-KIP (Bantuan Langsung Masyarakat – Keringanan Investasi Pertanian)[1]	Ministry of Agriculture	Rp.400 billion
P3KUM (Penyediaan Dana Bergulir untuk Kegiatan Produktif Skala Usaha Mikro dengan Pola Bagi Hasil/Syariah dan Konvensional)	Ministry of Cooperatives and SMEs	Rp.200 billion

Source: Various Project Documents

9. These programs were chosen because they: (a) relate to community development; (b) target primarily the kecamatan and village levels (as opposed to national, provincial, or district levels); and (c) are significant programs in terms of government funding levels.

10. The GoI, through Bappenas – with technical assistance from the World Bank and financial support from the Decentralization Support Facilities (DSF) – has asked Microfinance Innovation Center for Resources and Alternatives (MICRA) to complete a rapid evaluation of the five microfinance programs during the period from May to June 2007 *(*see *Appendix 2)*.

[1] BLM-KIP is a new program which has not yet begun operations during the evaluation. The project is not a microfinance project, but provides grant to invest in agricultural-related activities. Thus, outcomes of the rapid evaluation on this project are based mainly on desk review (no field assessment is carried out to evaluate the project).

2.2 Description of the Research

2.2.1 Objectives

11. The overall objectives of the rapid evaluation are to provide independent assessments of the five microfinance projects in order to: (a) understand the effectiveness of the programs at meeting their stated objectives; (b) pinpoint possible areas for program improvement; and (c) draw on lessons and best practices from other governmental community development and poverty reduction programs. The evaluation studies will provide the GoI with useful and timely information to manage and guide public resources and interventions.

2.2.2 Methodology and Data Collection Techniques

12. The rapid evaluation included the following key activities: (a) to conduct an initial desk review regarding design and implementation of the five programs at the ministry level (see *Appendix 6.1*), (b) to review program operations and implementation in three locations, on and off-Java, including clients and outreach of microfinance institutions (MFIs) to target population (see *Appendix 6.2 and 6.3*); (c) to analyze preliminary impacts of program on current beneficiaries and their satisfaction; and (d) to prepare detailed assessment of models/implementations and present recommendations on the possibility to continue the model.

13. The assessment was conducted between May 21st to June 29th, 2007, by a 13 members evaluation team of MICRA in four locations. Due to the very limited evaluation timeframe, the rapid evaluation will focus on a range of monitoring and short-term performance indicators, rather than longer-term impact of the programs.

Table 2: Methodology and Respondents

NO	METHODOLOGY	CLASSIFICATION	Program					TOTAL
			P4K	PEMP	KUBE	P3KUM	BLM-KIP	
1	In depth Interview	National level	3	4	7	2	1	17
		Municipal/City level	9	15	12	28	0	64
	TOTAL INTERVIEW		12	19	19	28	1	81
2	FGD	Beneficiaries	3 FGDs	2 FGDs	3 FGDs	3 FGDs	0 FGD	
		FGD Respondents	25	11	30	42	0	108
		Non Beneficiaries	3 FGDs					
		FGD Respondents	23					23
	TOTAL FGD		14 FGDs					
	TOTAL RESPONDENTS FOR FGD							131
3	Individual Questionnaire	Beneficiaries	19	11	17	20	0	67
		Non Beneficiaries	16					16
	TOTAL RESPONDENTS FOR QUESTIONNAIRE		35	11	17	20	0	83

Source: Author's Summary

14. Due to the widespread location and scope of the microfinance projects and time constraints to conduct the rapid evaluations, methodologies have been kept simple, but sufficient to meet the assessment objectives. The rapid evaluation focuses on four key areas: 1) assessment of project documentation; 2) assessment of project objectives and design; 3) assessment of project implementation, efficiency and management; and 4) assessment of results and effectiveness.

15. To collect the required data and information, a range of research methodologies and data collection tools were used, including: 1) meta evaluations of project documentation; 2) structured in-depth interviews; and 3) focus group discussions. Details on these methodologies and copies of all survey instrumentation, documents reviewed and profiles of survey respondents can be found in Appendix 5 to 10.

2.2.3 Locations and General Implementation

16. Field work was conducted in Jakarta and three areas for the four microfinance projects where the government has already delivered significant levels of services, despite the early stage of rollout. The evaluation team did not conduct a field review for the BLM-KIP project since it is not yet implemented. Field research included assessment on beneficiaries and non-beneficiaries, project review and evaluation was conducted simultaneously in the same areas using the same interview tools, to ensure consistency of data and information. The selection of target sub-district was made in consultation with the WB following an initial desk review period.

17. Three provinces were chosen for field evaluations: East Java, South Sumatera and South Sulawesi, based on the following criteria: (i) provinces where at least four projects were being implemented, (ii) mix of Java and non-Java, (iii) provinces with high population density, and (iv) provinces with high poverty levels, as measured by the Gini ratio. Selection of villages and groups was based on data and information provided by the local government offices during the field evaluation (see *Appendix 7*).

18. The evaluation was carried out by four teams, including a total of 13 MICRA analysts. One team focused on working on the ministerial level in Jakarta, while the other three teams conducted simultaneous field evaluation. The field assessment began in June 4 and completed in June 20, 2007. The overall rapid assessment was to a certain extent limited by the ability to gather complete data on all projects within the short assessment timeframe.

3. PROGRAM REVIEW AND FINDINGS

3.1 RURAL INCOME GENERATING PROJECT FOR SMALL FARMERS AND FISHERMEN (P4K)

3.1.1 Program Summary

19. ***Background***. P4K is a completed government project that was managed by the Ministry of Agriculture (MoA) in cooperation with Bank Rakyat Indonesia (BRI), which served as the channeling bank. The project is a group-based micro-enterprise promotion and lending program targeting the rural poor. P4K was implemented in three phases and initially funded by the Government and a grant from the United Nations Development Program (UNDP). Phase I of the project ran from 1979 to 1988 was known as an "*Action Research Phase*", aimed at facilitating the empowerment of rural poor communities and ensuring its effectiveness (see *Appendix 11.1*).

20. Phase II of the project ran from 1989 through 1998 and received significant financial and management support from the International Fund for Agricultural Development (IFAD), UNDP, and the Dutch government. Phase II was known as a "*Formulation of Small Farmers Empowerment Methodology Phase*." During this phase the project focused on building micro-enterprise skills, providing credit, and promoting savings. In addition, the program attempted to link borrower groups with community activities and social service agencies. The role of BRI also changed from a channeling bank to an executing bank, wherein BRI effectively took all risks related to credit provision. BRI's responsibility also expanded to include appraising business plans proposed by the Self-Help Groups (SHGs) under the project and determining whether they were eligible for the credit.

21. P4K's potential for larger scale poverty alleviation programming was recognized by the GoI, International Fund for Agricultural Development (IFAD) and Asian Development Bank (ADB), which agreed to expand the project to Phase III. Phase III ran from 1999 through 2005 with a total budget of US$118 Million provided as a loan to BRI. Of this, 5% came from BRI, 55% from ADB and 40% from IFAD. Phase III was intended to facilitate the development of a more participatory and sustainable system and mechanism for poverty alleviation.

22. ***Objectives***. P4K vision, mission and objectives are clearly stated in the project documents. The vision is to help poor rural households free themselves from the cycle of poverty. Its mission was: (i) to improve the skills of small farmers so that they will be able to improve their livelihoods, (ii) to empower small farmers so that they can increase their income and improve their welfare, (iii) to create conditions and develop services conducive to support the productive activities of poor farmers, and (iv) to institutionalize poor farmers' groups so as to increase their capacity to work together, improve their bargaining power and improve their productivity. The project's objectives were directed toward the development of a sustainable and

participatory system to help poor rural households improve their livelihoods and standards of living through the creation of community-based self-help groups (SHGs).

23. ***Design and Characteristics***. The project consisted of three interrelated components:

(1) SHG Development – the project identified rural poor families through poverty targeting surveys and encouraged representatives of these families to form self-help groups for the purpose of pooling resources, providing group support and for acceptance and use of credit. The poverty targeting surveys used to form SHGs were based on the Participatory Rural Appraisal (PRA) approach. To facilitate its implementation in the target locations the project hired around 4,000 field extension agents (FEAs). The project design also incorporated a graduation program for those SHGs that reached a self-sustained development stage to gain access to higher level formal credit programs and other government services. Sustainable SHGs were also expected to form associations of SHGs and/or cooperatives to scale up their businesses and ensure their sustainability;

(2) Microfinance Services were offered by the project to help SHGs mobilize savings and access non-collateralized solidarity group loans to finance their micro-business activities. BRI managed the credit process and provided a mechanism for establishing group savings. The SHGs were responsible for their own loan repayment; and

(3) Institutionalization and Capacity Building – the management systems and the staff quality were keys to the success of the project implementation. Thus, the third component aimed at assisting different government's agencies at different level of project implementation to enhance their institutional capacity and systems in line with the principles of decentralization and transparency.

24. ***Program Locations and Outreach.*** Phase I covered six provinces, including all provinces in Java (except DKI Jakarta) Bali and West Nusa Tenggara. Phase II expanded to 12 other provinces, i.e., Banda Aceh, North Sumatera, West Sumatera, Riau, Bengkulu, South Sumatera, Lampung, West Kalimantan, South Kalimantan, South Sulawesi, Central Sulawesi and East Timor. The total number of SHG beneficiaries increased from 2,150 in phase I to 50,038 in phase II. By the end of Phase III in 2005, it was expected that the project would reach at least 74,000 SHG beneficiaries (approximately 740,000 families).

25. ***Implementation Mechanism*.** The MoA's FEAs were the principle implementers of the project. They identified communities with the potential to participate in the program based on the community's income level and opportunity for micro-enterprise development. The agent, in conjunction with the community, identified promising areas for small business development. Within the targeted communities, the agent identified poor households interested in participating in the program. Only households with annual per capita incomes below the monetary equivalent of the price of 320 kilograms of rice (approximately Rp.320,000) were accepted. Household

income was determined via a detailed questionnaire that extension agents filled out based on information supplied by the household.

26. Households qualifying for participation were encouraged to form groups of 8 to 16 families. The average group size was 10.8 households. To receive its first loan, a group must save a minimum of 10% of the credit ceiling received. In addition, they must participate in two training sessions provided by their agriculture extension agent. During the second session, the agent helped the group completed their business plan, which was then approved by the district office of the MoA and sent to the appropriate BRI branch. The BRI branch must also approve the business plan. In theory BRI's approval process included a field visit to the group.

27. The average length of time from household completion of qualifying questionnaires until loan receipt was six months. P4K loans were made only through BRI branches, not through BRI's Unit Desa network. Groups must make their last payment directly to a BRI branch. All other payments can be made at a BRI branch, a village post, a mobile service unit, or a Unit Desa. Each group received one loan which was divided among group members as they chose – usually evenly. The group assumed joint liability for repayment of the loan. Table 6 below provides a summary of the scheme from Ministry of Finance (MOF) to BRI and from BRI to SHGs.

Table 3: Summary P4K Credit Scheme

SCHEME OF CREDIT:	
TO BRI FROM MOF	**TO SHGs FROM BRI**
Term of loan: 20 years (1998 to 2018) with 5 years grace period	Term of loan: 12 months to 18 months
Cost of fund not including BRI op-ex: ▪ Interest rate on loan to MOF 5.89% ▪ Insurance to Askrindo 3.4% ▪ Incentives on on-time payment 2.25% ▪ Commitment charge 0.75% ▪ Or in total, maximum of 12.29% not including BRI op-ex	Interest rate charged per annum is 22.15% effectively
Availability of funds until 2018	Availability of fund until December 15, 2007
Losses covered by Askrindo up to 75% of total loss; BRI also collected SHGs compulsory saving 5% of loan through the credit period for first loan and 10% for any loan after.	Will receive incentive 1.25% from loan for on time payment (approx 5.6% from interest per installment)

Source: P4K Project Guideline

28. ***Incentives for FEAs***. Agriculture extension agents received a number of incentives to identify groups and assist them in obtaining credits, including travel allowances, fees for repeated group course deliveries and promotions and salary increases based on a point system,

whereby for every group they formed and was able to access loan extension agents received one point. BRI as the executing bank recognized the importance of providing field extension agents with additional incentives to provide continued support to groups. While overall non-performing loan (NPL) for the project was high, some areas with strong FEAs reported negligible NPL.

3.1.2 Program Review and Findings

29. In general, P4K is a good project with excellent outreach to the poor and good results in poverty alleviation due to long delivery period and the use of Participatory Rural Appraisal (PRA) model for poverty targeting, but mixed results in overall sustainability. In addition, P4K has performed strong in community organization through the forming of SHGs with adequate technical assistance from FEAs. It is recommended for further investment with modifications. Detailed program review and findings are described below (see also *Appendix 11.2 and 17*).

30. ***Project Documentation.*** *The P4K project documentation is comprehensive and informative*. Bank BRI and MoA issued a circular letter that serves as a guideline for the credit extension and procedure of the project implementation. The project guideline document clearly describes the background, objectives, design and characteristics, target beneficiaries and implementation mechanism of the project. MoA and BRI issued many publications designed to publicize project progress. However, few key stakeholders (i.e., donors, related government agencies in the national and provincial level) appear to be aware of the publications.

31. Two formal impact assessments of the P4K project were jointly conducted by MoA with different partners which are Institute of Bogor Agriculture and the Central Bureau of Statistics (Biro Pusat Statistik, BPS), as well as a number of smaller evaluations. The first study was conducted in 2002 conducted by MoA and Institute of Bogor Agriculture, to learn on the partnership between cooperative and Kelompok Petani dan Nelayan Kecil (KPK). Finding from the study shows that there are three different partnership approach between cooperative and KPK. In general, this partnership was able to increase the efficiency of operational activities; to realize a collective-based economic synergism resulting from jointly structured institutions; to face common enemy such as money lender or rural loan shark which widely operates in the region.

32. The other report was an impact study P4K to the improvement of small farmers and fisherman welfare conducted in year 2005 in collaboration with the BPS. One of the finding from the study is the increase of P4K members' awareness on savings where 57.6% of the respondent have saved in the group, and 37% in Bank. The study found that based on BPS poverty line, the number of poor family of SHG members decreased on 10 provinces.

33. Project evaluation documents were easily accessible to the evaluation team. However, no project documents related to the project agreement, budget and realization, detailed workplan and project progress reports were made available to the evaluation team, impairing the

ability to evaluate project effectiveness, implementation progress and impact. The project audit report is considered classified and therefore was not accessible to the evaluation team.

34. Interviews with MoA and BRI indicate that information and data gathering on the P4K project is often problematic mainly because of the long duration of the project and turnover of key staff. No written information and data was provided by BRI's headquarter to the evaluation team. BRI was only willing to share data on the amount of loan disbursed, including arrears/NPL information, to the evaluation team verbally.

35. ***Project Implementation, Efficiency and Management***. *P4K project management performance is average*. The management of the project was the responsibility of MoA through the head office of the Institute for the Agricultural Human Resources Development (Balai Pengembangan SDM Pertanian, Balai) in Jakarta. Prior to decentralization, it appears that management of the project by MoA was effective and well-coordinated. However, post-decentralization, project management assumed by local governments and the structure of implementation varied by local government. The responsibility of the central government on the project was over when Phase II ended. Effectiveness in project implementation became dependant on the effectiveness and focus of the local government in implementing the project.

36. Based on the field review, the actual handover to local government is still an ongoing process. In East Java, the Balai has already handed over the project responsibility to the local government. In South Sumatera, the hand-over has not been done yet and up to now the Balai still monitors the loan repayment in Bank BRI's branch office in South Sumatera.

37. The Balai's provincial offices were responsible for managing the project at the district and sub-district level, with FEAs at the forefront of its implementation. However, in practice the number of FEAs was often times not sufficient and needed the support from the local government. While FEAs were key to the success of the project implementation, typically serving 20 groups, reaching between 200 and 250 group members, they were required also to work on other projects, compromising their service to SHG.

38. On the other hand, the structure of credit line provision under BRI management was relatively clear. Every BRI branch manager was authorized and instructed to implement the project, and there has been little variation since project inception. BRI was required to provide loans to communities in certain locations as determined by the Government. However, the total loan disbursement for the project was considered too low to make it economically viable for the bank. High operational costs relative to low loan disbursement were a key reason why BRI was reluctant to continue the project. That said, government funding for FEA activities (including their salary) could in a way be considered as a strong subsidy for BRI, which did not employ loan or collection officers to work on the project, relying rather on the FEAs and providing them with additional incentive payments to ensure both growth and repayment.

39. ***Achieving Objectives***. *P4K project objectives are clear, but too broad. It has clear indicators of success in poverty alleviation, but is lacking specific and clear steps to meet the objectives. In addition, the project also has some failings in sustainability*. The project focus is on empowering poor farmers and fishermen. To meet its objective, the project applied a holistic approach to lift people out of the vicious cycle of poverty through a government intervention. Intervention came in two different services: capacity building and loans provision. The loan provision is optional, especially for a target community group that is already self-reliant and does not need a credit line. Capacity building is an important project component. In practice, rural poor need both services, regardless of who provides it (government or private sector), in order to be self-sustained and self-reliant. They need services or tools necessary to make them more economically active and independent.

40. Up to the end of the project, 250 cooperatives and 58,000 SHGs have been formed by the project. However, the project seems to focus too much on outreach, but not to give enough attention to the quality of SHGs (i.e., SHGs dropout is high). There are two reasons that make SHGs dropout high: (i) they were formed externally (i.e., the initiative did not necessarily come from communities); and (ii) FEAs capacity to help improve SHGs quality is weak.

41. The study included direct interviews with a limited sample of P4K beneficiaries, using individual interviews and FGD. While P4K project beneficiaries in all areas report positive program impacts, due to the limited timeframe and scope of the study, reported impacts could not be verified by field analysts. Beneficiaries report that loans have helped improve their standard of living and the program should be continued. Over 75% of individuals surveyed evaluated the project as successful or very successful. Beneficiaries link growth of their micro-businesses to improvements in housing conditions and education levels of their children. Detailed results can be seen in Table 4.

Table 4: P4K Project Impact and Satisfaction

Impact and Satisfaction		All	East Java	South Sumatera	South Sulawesi
		19*	5	9	5
Loan impact *(In scale 1: deteriorated substantially to 5: Improved Substantially)*	Business income	4.1	4.0	3.6	4.6
	Employment	3.4	3.8	3.2	3.2
	Skills	3.5	4.2	3.3	3.0
	Housing	3.2	3.2	3.1	3.4
	Assets base	3.4	3.6	3.1	3.6
	Child education	3.3	3.4	3.2	3.4
	Health	3.5	3.6	3.2	3.6
Level of program success	Unsuccessful	10.4%	0.0%	11.1%	20.0%
	Average	14.1%	20.0%	22.2%	0.0%
	Successful	58.5%	40.0%	55.6%	80.0%
	Very Successful	17.0%	40.0%	11.1%	0.0%
Level of satisfaction	Unsatisfed	6.7%	0.0%	0.0%	20.0%
	Average	20.7%	40.0%	22.2%	0.0%
	Satisfied	42.2%	0.0%	66.7%	60.0%
	Very Satisfied	30.4%	60.0%	11.1%	20.0%

Source: Author's Field Survey Summary

** Number of beneficiaries interviewed*

42. Field Surveys and focus group discussions with beneficiaries indicate a wide range of perceived program benefits, including access to finance, training, markets and risk-sharing opportunities. In general, access to finance was considered more important than access to technical assistance. Average loan sizes to project beneficiaries vary slightly by region (with the highest levels loans in South Sumatra), as well as average loan term (highest in South Sulawesi). Loan processing time also seems to vary significantly by region, ranging from one to two weeks up to six months. Beneficiaries from South Sumatera used the loan entirely (100%) for micro-business purposes, while those from East Java and South Sulawesi used on average 41% and 19% of the loan received, respectively, for household purposes. Detailed tables covering these statistics are available in Appendix 11.2.

43. ***Poverty Targeting***. *P4K performs well in terms of poverty targeting – serving mostly the poor people in relatively poor areas*. This is due to the use of BPS data on poverty to select the project area and application of Participatory Rural Appraisal (PRA) model. Poverty targeting indicators were clearly stated in project guidelines. At the beginning of Phase III, the identification for poverty level for each location used Bappenas' poverty indicator of annual per capita incomes below the monetary equivalent of the price of 320 kilograms of rice (approximately Rp.320,000). In 2001, a Participatory Rural Appraisal (PRA) approach was introduced. PRA is a community-based rural appraisal method to determine the local poverty level and select the target beneficiaries of the project. However, PRA approach usually requires highly skilled human resources (i.e., FEAs), who ideally are members of the target communities of the target locations and act solely as facilitators (not beneficiaries).

44. To complement the PRA method, the identification of target locations was also based on: (i) the availability of supporting documents at the sub-district level; (ii) high poor population; (iii) proximity of the location from the district (max. of 60 km.); and (iv) good and adequate response from sub-district leaders to participate in the project. Details on characteristics of P4K project beneficiaries can be found in Appendix 10.

45. ***Monitoring and Evaluation***. *P4K project monitoring and evaluations appear to positively impact future programming*. All beneficiaries said that prior to any loan disbursement an assessment was conducted, generally by government, but also by banks and outside contractors. Also, the majority of beneficiaries (93.3%) said that follow-up assessments were conducted after loan disbursement either by the government or community organizations. However, only 43.7% of beneficiaries were actually asked to submit their business financial report to FEAs or MFIs, most of them were beneficiaries from South Sulawesi.

46. Related to the project, 39.3% of beneficiaries interviewed knew where to file a complaint. In South Sumatera the percentage of beneficiaries who knew where to file a complaint was high, while in East Java and South Sulawesi was low. This shows that effort to properly disseminate details about the project was not uniform among provinces. As many as

14.1% of beneficiaries, mostly from South Sumatera, had sent a complaint with a response received within at least one or three days. Detailed results of assessment on P4K project monitoring and evaluation performance can be found in Appendix 11.2.

47. ***Cost-Effectiveness and Budget Structure***. *Project cost effectiveness and budget structure is difficult to measure either due to lack of information on outreach or detailed data on budget are not available from the executing bank*. Project budget evaluation focused only on Phase III (1999-2005) of the project implementation. Total budget for East Java for Phase III was Rp.900 million, in which 45% of the total budget was allocated for capacity building and technical assistance activities. On top of this, BRI also contributed to the project cost by providing financial incentives for FEAs in the form of transportation allowances for the agents every time they visited or gave technical assistances to the SHGs. BRI also provided commissions to the agents whose SHGs were able to achieve the best repayment rate.

48. The overall budget for Phase III of the project is Rp.1.138 billion, serving 58,118 SHGs. There were 10 to 15 members per SHG, with women constituting the majority. Programmatic capacity building accounts for 65% of the overall budget makes microfinance extremely expensive. The average loan size per client was Rp.300,000. At the onset of the project, the average loan size has increased to IDR 2 million. However, in practice, loan size for each beneficiary was not the same, depending on the recommendation of the FEA and community group where he/she belonged. Loan size was gradually increased in accordance with the growth of the business and the increased ability of the beneficiary to pay.

49. The project offered loans for poor farmer and fishermen with low interest rates and long repayment period. Since the project has stopped two years ago, some BRI's branches visited were not open to discuss about the project, especially about the project financial performance. Detailed results of assessment on P4K project cash loan characteristics can be found in Appendix 11.2.

50. ***Collection Performance and Rate of Repayment***. *Based on interview with project staffs from MoA and with BRI, P4K project collection performance is just average and varies widely by region, with rate of repayment approximately 29% (measured after 90 days) at the national level (BRI)*. Collection performance depended a lot on FEAs capacity to follow on loan repayment. Even though FEAs also received cash incentives from Bank BRI for repayment, the project still had increasing problems with NPL.

Table 5: P4K Project Loan Perception

Perception Regarding The Loan from The Program		All	East Java	South Sumatera	South Sulawesi
		19*	5	9	5
Eligible fo the loan	Business men/women	54.1%	100.0%	22.2%	40.0%
	Have run business	0.0%	0.0%	0.0%	0.0%
	Never have access to loan	0.0%	0.0%	0.0%	0.0%
	Have collateral	0.0%	0.0%	0.0%	0.0%
	Poor People	0.0%	0.0%	0.0%	0.0%
	Small business scale	3.7%	0.0%	11.1%	0.0%
	MFI member	3.7%	0.0%	11.1%	0.0%
	Group member	38.5%	0.0%	55.6%	60.0%
	Its not clear	0.0%	0.0%	0.0%	0.0%
Perception in repaying the loan	Mandatory	81.5%	100.0%	44.4%	100.0%
	Optional	18.5%	0.0%	55.6%	0.0%
	It's a Grant	0.0%	0.0%	0.0%	0.0%
	Don't know	0.0%	0.0%	0.0%	0.0%
Constraints for the loan	High interest rate	13.3%	0.0%	0.0%	40.0%
	Loan procedure is too complicated	0.0%	0.0%	0.0%	0.0%
	Loan size is too small	0.0%	0.0%	0.0%	0.0%
	Loan term is too short	13.3%	40.0%	0.0%	0.0%
	Loan term is too long	0.0%	0.0%	0.0%	0.0%
	Does not have collateral	6.7%	0.0%	0.0%	20.0%
	Does not have grace period	6.7%	20.0%	0.0%	0.0%
	Doesn't need a loan in the future	0.0%	0.0%	0.0%	0.0%
	Don't have any constraint	60.0%	40.0%	100.0%	40.0%

Source: Author's Field Survey Summary
** Number of beneficiaries interviewed*

51. Beneficiaries' perception regarding loan repayment was also a factor for the project success in rate of repayment and should be addressed in future programming. Many beneficiaries – 55.6% of those interviewed from South Sumatera – thought that loan repayment is not mandatory. Around 40% of respondents from South Sulawesi felt that interest rates were the main constraint in applying loans and those from East Java (40%) thought that the loan repayment schedule was too short and should be extended in accordance with the nature of their micro-businesses. This shows the necessity of adjusting the loan terms and conditions to the local conditions of the areas where beneficiaries live.

52. As many as 51.1% of respondents reported no difficulty in repaying the loan. Meanwhile, 55.6% of beneficiaries who had difficulty in repaying the loan said that unprofitable business activities was the main reason of not repaying the loan on time. This would seem to indicate that the internal function of SHG and the external function of FEAs and BRI to complete proper risk analysis were not fully completed (see *Table 5*).

53. ***Capacity Building***. *P4K project has a strong performance on community organization through the forming of SHGs with adequate technical assistance from FEAs*. However, quality of its implementation varies by location and depends on FEAs capacity.

54. To improve entrepreneurial capacity, SHGs received technical assistance such as business plan formulation and financial planning. In theory, the government was responsible for providing the capacity building and technical assistance to SHGs through FEAs. However, in practice, the Balai oftentimes had neither enough human resources, nor adequate capacity to provide the services. Capacity building provision was generally secondary to the focus on loan repayment. Oftentimes the capacity building and technical assistance were provided by outside providers, such as Civil Society Organizations (CSOs), local NGOs and educational institutions.

55. BRI was responsible for providing basic training on banking and financial services to SHGs. The trainings were conducted jointly by the bank's officers and FEAs. Beneficiaries are usually very hesitant to apply for a formal loan with the bank, except loans under the government's P4K project. In this regard, this training was successful in bringing low income people into the formal financial sector. Detailed results of assessment on P4K project capacity building can be found in Appendix 11.2.

56. ***Beneficiaries Satisfaction***. *P4K clients have the lowest satisfaction levels compared to other government microfinance projects evaluated because of small loan size and lack of follow-up on credit and TA provision after the project closed*. However, in South Sulawesi P4K clients were mostly satisfied with the project success in helping many SHGs to become formal cooperatives. The newly established cooperatives can in turn help other communities to get access to loans. Project beneficiaries interviewed were mostly (42.2%) satisfied about the project and 58.5% of beneficiaries said the project was successful in reducing poverty in their area (see *Table 4*).

57. ***Project Sustainability***. *P4K project has weak financial sustainability, mainly because of lack of Bank BRI interest in continuing the project that is due to insufficient revenue flow to cover project costs*. Government's "exit strategies" that gradually build commercial partners to assume all necessary program activities was not clearly defined. The government exit strategy was that by the end of the project lifetime, the management and implementation of the project was handed over to the local governments. The local government will be responsible for identifying the source of funds to continue the project and appointing the field project officers. The preparatory work for the hand-over process was initiated by inviting the heads of participating municipal and city governments to a series of coordination meetings organized by the Balai. The challenge during the hand-over process was to build the same perception among the different government's agencies on the project so as to ensure its continuity. In Malang municipality for example, the hand over process has already been started since 2005, but not yet completed until now due to the on-going rotation or change of the head of the local office of MoA.

58. P4K project was able to form 250 cooperatives and 58,000 SHGs. Many of its beneficiaries have moved into bankability. But because of weak FEAs capacity to help improve SHGs quality, a significant number of SHGs dropout (at least 17%).

59. ***Major Factors Affecting the Project Results***. *The role of FEAs was crucial to the success of the program*. The FEA was the focal person in an SHG, wherein he/she continuously assisted the group through the steps needed to access the loan. There was a significant drop in the number of SHG formed (at least 17%) over phase III, which may be linked to a weakened FEA function and also potentially the effects of group formation that was influenced by external factors (i.e., the initiative to form an SHG did not come from within the communities). Best practice in solidarity group formation clearly shows that groups should be self-formed, rather than appointed by an outside party (in this case, the FEAs).

60. *SHG sustainability is tied to group cohesiveness and ability to self-form*. It also depended on the availability of funds or loans from the government project. As soon as the project stopped, many SHGs ceased to exist because they no longer saw the importance of the group except only for accessing the loan. The bond among members of an SHG usually was not as strong as those formed under an MFI. This is particularly due to the non-application of the principle of joint liability or risk-sharing (*tanggung-renteng*) to cover any late loan repayment or delinquency from its members. The non-collateralized loans were also seen as high risk and vulnerable for the continuity of the project by the bank.

61. Another factor affecting the project results was the lack of sufficient management training and assistance to SHGs. Beneficiaries usually did not have proper accounting and other financial reporting skills. This weakened internal loan due diligence capacity.

62. The strength of this project hinged on the gradual process of group formation and supervision, which ensured that the group was ready to receive a loan. However, this gradual process required intensive and active assistance from the FEAs.

63. Based on project design, SHGs were responsible for sending their own loan repayment to the bank directly. However, in practice FEAs collected loan repayments and delivered them to the bank. This practice was not accordance with the project guideline and certainly increased costs of implementation, although it did improve the repayment rates.

64. The decentralization process appears to have weakened overall project implementation. This is most likely due to three factors: (i) lack of clear guidance from the central government for the project hand-over and supervision, (ii) low capacity – technical and financial – to carry on the project at the local level, and (iii) other competing priority programs of the local governments which are not necessarily in line with those of the central government.

65. The lack of a clear and well-designed sustainability plan has affected the success of the project. Subsidized FEA performed critical functions, including loan origination, analysis and collections, free of charge for BRI. In the absence of this subsidy, BRI is unlikely to assume full activities necessary to support its continuation. Also, guidelines for project hand-over from the central to the provincial government did not exist and local government ownership of the program is weak.

3.2 ECONOMIC EMPOWERMENT FOR COASTAL COMMUNITIES PROGRAM (PEMP)

3.2.1 Program Summary

66. ***Background***. There are approximately 8,090 villages located in the coastal areas nationwide, with a total population of about 16.4 million peoples in which about 5.3 million (32%) are living below poverty line, much higher than the average national poverty level of 17.75% in 2006. Government policies in developing coastal areas have generally been characterized by a top-down approach which often did not reflect the needs and interests of the community. Increased decentralization, growing community roles in decision making process and greater attention to the potential of rural poor areas were the main drivers behind the design of the PEMP project. The project is managed by the Ministry of Marines Affairs and Fishery (MoMF) in cooperation with selected channeling banks (see *Appendix 12.1*).

67. ***Objectives***. The project aims to improve the welfare of coastal communities by strengthening microfinance institutions (MFIs), encouraging entrepreneurship, and stimulating peoples' participation in community-based capacity building and diversifying local resource-based micro-enterprises in a sustainable way. By the end of the project in 2009, it is expected that income of poor coastal communities that participate in the project will increase by 10%.

68. ***Design and Characteristics***. Initially, the project was designed to reduce the impacts of rising fuel price on the socioeconomic conditions of coastal communities through the provision of business capital using revolving fund facilities for productive micro-businesses. At the district level, the revolving fund facilities were managed by privately-owned Mitra Mina micro-coastal development economic agency (Lembaga Ekonomi Pengembangan Pesisir Mikro Mitra Mina, LEPP-M3). LEPP-M3 was established initially as an embryo of a 'holding' company owned and managed by the coastal communities. The initial project design included the start up of large numbers of new cooperatives to provide financial and other services to coastal communities. However, based on the failure of a number of cooperative start-ups, the revolving funds have now been placed in over 250 pre-existing coastal-based cooperatives, with improved results.

69. PEMP project implementation involves many agencies at different levels (see *Figure 1*):

- At the national level, MoMF through its Director General of Maritime, Coastal Areas and Small Islands (Dirjen KP3K) has the overall responsibility of the project implementation, including the formulation of project guidelines, project awareness campaign, training, monitoring and evaluation and reporting;

- At the provincial level, the local office of the MoMF is responsible for coordinating, disseminating, monitoring and evaluating and reporting the project implementation. The local MoMF office also targets district recipients, to select and hire district management consultants, to select cooperatives, to conduct public awareness campaigns, to form MFIs in areas where there is no local provider, to hire the FEAs, as well as to train, monitor and evaluate and report on the project implementation;

- *Management Consultants*. Management consultants are responsible for all technical aspects and management of the project implementation, as well as technical assistance provision to MFIs and other institutions;

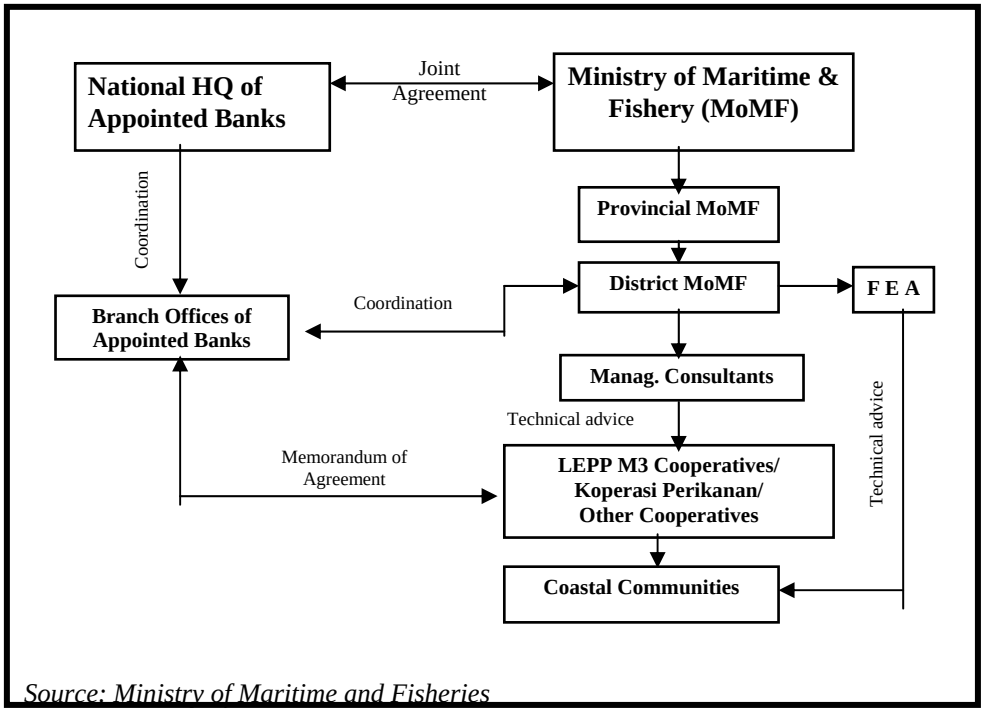
- *Field Extension Agents (FEAs)*. Extension agents are local experts who stay with and provide technical expertise to individual businesses within the target coastal communities to train them in how to access credit from MFIs, to write a business proposal, to run and develop the business and to provide regular reports to local MoMF;

- *Cooperatives*. Cooperatives are the key component in the PEMP project implementation at the district level, by receiving government funding (in the form of collateralized loans from participating banks) and on-lending these funds to coastal community members and micro and small enterprises;

- *Banks*. Revolving funds are placed on deposit with participating commercial banks as a 100% guarantee for loans made to program cooperatives for on-lending to their members. Banks have the following responsibilities: (i) to provide credit to cooperatives; (ii) to channel the loans through the cooperatives' saving account to the coastal MFIs and other intended economic activities; and (iii) to provide technical and administrative assistance to MFIs. The participating banks include Bank Syariah Mandiri, Bank Maluku, Bank Papua, Bank Bukopin and Bank BRI which are all stated-owned banks.

70. ***Target Beneficiaries***. Target beneficiaries are persons with micro and small businesses directly or indirectly related to fisheries and located along coastal areas. Considering that from 16.4 million peoples in which about 5.3 million (32%) in coastal area are living below poverty line, there is no poverty criteria required in the selection of beneficiaries. However, the coastal communities are targeted using an overall poverty level for the areas, based on BPS data.

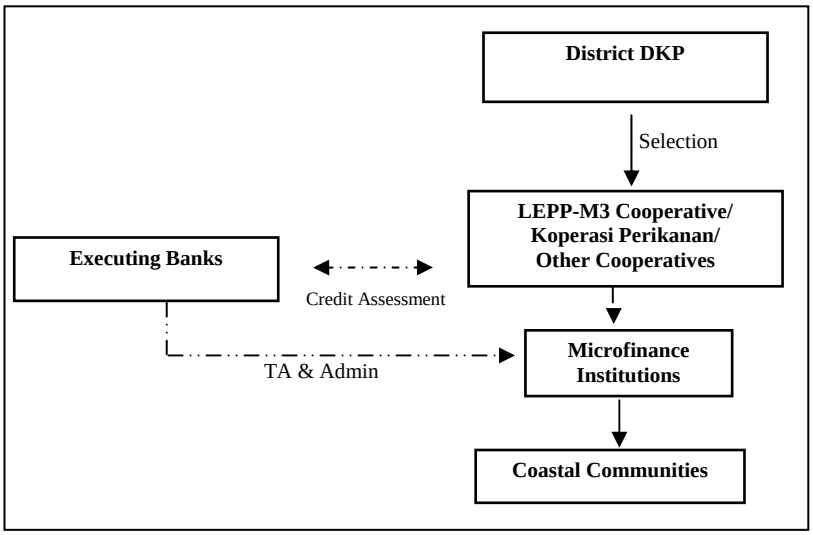
Figure 1: Organizational Chart of PEMP Implementing Agencies



71. ***Implementation Mechanism***. Project implementation is divided into two periods: (i) from 2001 to 2003 during which time a revolving fund mechanism was applied through LEPP-M3; and (ii) from 2004 to 2007 the project has used micro-credit scheme provided through MFIs in cooperation with banks.

72. The PEMP project is funded from state budget formerly used for fuel subsidies as seed capital to support business activities of the coastal communities selected through a community consensus mechanism. The type of business activities and the amount of capital needed are determined by the community through a consensus mechanism overseen by staff from the local office of the MoMF. MoMF is responsible for conducting awareness campaigns, project monitoring and reporting. The provincial offices of MoMF propose districts that can join the project based on individual criteria of each province. The district offices then appoint MFIs/cooperatives that will join the project. Training and capacity building are provided for MFIs and direct beneficiaries by the MoMF district offices. Participating MFIs are required to establish an agreement with the executing banks, open an account to deposit the revolving fund as collateral and are responsible for providing direct credit to the targeted poor coastal communities. Verification and study of eligibility of the target activities is completed by local communities with the assistance of MFIs/cooperatives.

Figure 2: PEMP Funding Mechanism at the District Level



Source: Ministry of Maritime and Fisheries

3.2.2 Program Review and Findings

73. Overall, PEMP is a good project with strong sustainability component due to option for long term post-program financing, but limited specific poverty outreach. PEMP also has a clear budget structure (20-40% for TA; 60-80% for capital) and the most efficient flow of funding among all projects mainly due to Bank Bukopin's online MIS with participating cooperatives. It is recommended for further investment. Detailed program review and findings are described below (see *Appendix 12.2 and 17*).

74. ***Project Documentation***. *The PEMP project has an outstanding information system available at the participating bank because reports are made on-line (i.e., 52 MFIs have on-line system with Bank Bukopin).* Written project guidelines and other supporting documents are also available and easily accessible to the public. MoMF issued a general project guideline and implemented a Memorandum of Understanding (MOU) with the executing banks which appears clear and complete, with the exception of a lack of current guideline on the eventual distribution of project funds, which are intended to be given to participating MFIs as grants.

75. ***Project Implementation, Efficiency and Management***. *PEMP project implementation and management performance is average*. Government staff turnover appears to have impacted PEMP project implementation, as new staffs were not aware of program guidelines. Little attention was given to coordination and hand-over processes. These problems were compounded by weak coordination among government agencies at different level. From

2000 through 2007 the PEMP project covered 289 districts with coastal areas, out of 450 districts in Indonesia (based on data from Project General Guideline provided by MoMF). It is expected that by the end of 2009 the project will reach all districts nationwide.

76. However, the management structure of the project is relatively clear and appropriate, including the provincial and district offices of the MoMF, management consultants, cooperatives and participating banks. The involvement of LEPP-M3/Cooperatives and some executing banks is an important factor to ensure wide outreach of the project, ultimate sustainability and that project objectives are achieved.

77. During the initiation stage (2001-2003), credit extension was handled by community-based institutions called Mitra Desa whose official and non-official members come from the targeted coastal communities. However, Mitra Desa was ineffective and subsequently replaced by a new institution called LEPP-M3. In theory, it is expected that LEPP-M3 will in its development become a local holding micro-enterprise owned by the coastal community in each target location. In practice, this implementation strategy was not successful and difficult to achieve due to two factors: (i) limited reliable long-term financial sources; and (ii) weak technical capacity of the institution in providing necessary trainings for other micro-enterprises. To address these issues, the implementation strategy on the following stage was changed and done with the active participation of Bank Bukopin and through existing cooperatives.

78. In some cases, the provincial branch office of the participating banks, such as Bank Bukopin, had to channel funds to other nearby provinces since in some selected areas none of the partner banks had branch operations. This raised overall administrative cost for banks and MFIs.

79. The level of support from the government varies by location. In East Java, the local government was more active than in other provinces in term of providing capacity building activities to cooperatives and beneficiaries. As consequence, the overhead cost allocation for capacity building provision in East Java is higher (6%) than two other provinces (0.5%). Elsewhere, evaluations conducted in South Sumatera indicate that the provincial office of the MoMF did not provide any substantial support in the implementation of PEMP project.

80. ***Achieving Objectives***. *PEMP has strongest performance in meeting its objectives, due to clear objectives and relatively simple implementation strategy, but with no implicit directive to target poor*. The project was also successful in responding to early failure and adapting new approach. This means that it has learnt that working with and through existing cooperatives is more effective than forming new cooperatives.

81. The project in partnership with Bank Bukopin has been successful in facilitating the establishment of 144 Swamitra Mina cooperatives, 52 of which implement an on-line management information system (MIS) with Bank Bukopin. Data from this system is easily accessible and gives a clear and up to date picture of MFI and beneficiary profiles and

performance. The formation of Swamitra Mina has proven effective in reducing beneficiary dependence on loan sharks, which in the past have been the main source of funding.

82. A key indicator of success has been Bank Bukopin's deployment of its own additional financing for MFIs in the project, demonstrating clear leverage of government funding and a sustainable development path for the project. This result is facilitated by Bank Bukopin's institutional expertise and systems that markedly improve the nature of their service to MFIs.

Table 6: PEMP Project Implementation Highlights[2]

Community Profile		All	East Java	South Sumatera	South Sulawesi
		11*	5	0	6
Member of Community Organization		75.0%	100.0%	-	50.0%
		8	5	-	3
Average years as member of community organization		2.7	3.1	-	2.3
Initiate the community organization	Government	16.7%	0.0%	-	33.3%
	Community leader	50.0%	100.0%	-	0.0%
	Community itself	33.9%	0.0%	-	67.7%
	Partner- MFI/Bank	0.0%	0.0%	-	0.0%
Set the requirement	Government	16.7%	0.0%	-	33.3%
	Community leader	40.0%	80.0%	-	0.0%
	Community itself	43.4%	20.0%	-	66.7%
	Partner- MFI/Bank	0.0%	0.0%	-	0.0%
Initiate activities	Government	0.0%	0.0%	-	0.0%
	Community leader	50.0%	100.0%	-	0.0%
	Community itself	50.0%	0.0%	-	100.0%
	Community together with group	0.0%	0.0%	-	0.0%
	Partner- MFI/Bank	0.0%	0.0%	-	0.0%
Manage the program	Government	0.0%	0.0%	-	0.0%
	Community leader	66.7%	100.0%	-	33.3%
	Community itself	33.4%	0.0%	-	66.7%
	Community together with group	0.0%	0.0%	-	0.0%
	Partner- MFI/Bank	0.0%	0.0%	-	0.0%
Knowledge of long term objectives of the group		70.0%	40.0%	-	100.0%
Benefit as the community member	Training	41.7%	0.0%	-	83.3%
	Consulting	8.4%	0.0%	-	16.7%
	Access to market	0.0%	0.0%	-	0.0%
	Access loan from the program	40.0%	80.0%	-	0.0%
	Access to financial services oher than government program	10.0%	20.0%	-	0.0%
	Risk sharing	0.0%	0.0%	-	0.0%
	Study	0.0%	0.0%	-	0.0%

Source: Author's Field Survey Summary
** Number of beneficiaries interviewed*

83. In practice, however, loan disbursement mechanisms and the degree of bank involvement varied by province. In East Java, for instance, all loan disbursements must be approved by Bank Bukopin, while in South Sulawesi, only loans of more than 5 million required approval of Bank Bukopin. Portfolio quality is higher in areas where executing banks played a more active role and tends to be weak without active participation from the bank, such as the case of South Sulawesi where monitoring and evaluation was conducted only by the MFI.

[2] Rapid evaluation was not conducted in South Sumatera since it was found out that the project is not yet implemented in Palembang and the other location where the project has been implemented is too far away to visit given the very short field review timeframe.

84. During the project implementation, the community and community leaders formed and actively managed the SHG. Beneficiaries had highly varied opinions as to what aspect of the project they thought was most beneficial, with the highest values being placed on access to finance and training (see *Table 6*).

85. Based on the small sample size from this rapid appraisal, average loan sizes and terms varied by province, typically between Rp.4 million and Rp.7 million. Loans were provided to individuals with loan repayment period of 20 to 24 months. Beneficiaries used mostly (95% of) the loans for micro-business purposes and the rest for household purposes. Loan approval processes appear to also vary significantly between regions. Details on project loan parameters can be found in Appendix 12.2.

86. ***Poverty Targeting***. *PEMP does not explicitly target the poor, but takes a more holistic approach to supporting fishing communities in poor coastal area*. The project lending activities focus mainly on micro- and small-entrepreneurs within the coastal areas who are not necessarily poor. Areas are selected based on BPS poverty information, but criteria for beneficiaries are not fully clear. This resulted on some non-beneficiaries expressed their complaint that local targeting was based on relationships. Details on characteristics of PEMP project beneficiaries can be found in Appendix 10.

87. ***Monitoring and Evaluation***. *Monitoring and evaluation for the PEMP project was generally effective, but varied significantly by location*. Monitoring and evaluation is excellent on the side of the commercial bank, but very poor on government side. In theory, the community – those who have received funding and those who are still waiting for funding – itself is responsible to monitor and oversee the effective utilization of the funding. In practice, this is usually done through community-based groups with relevant expertise. At the district level, monitoring and evaluation is supposed to be completed by the district offices of MoMF, although in practice this is rarely being done.

88. In South Sulawesi, most of the beneficiaries underwent an assessment before and after the loan disbursement, while in East Java, only 20% of beneficiaries were assessed before and none after the loan disbursement. Beneficiaries were typically not aware of any formal channels for project feedback. Detailed results of assessment on PEMP project monitoring and evaluation performance can be found in Appendix 12.2.

89. ***Cost-Effectiveness and Budget Structure***. *Project cost effectiveness and budget structure in general is difficult due to lack of information on outreach or detailed data on budget are not available from the executing bank.* In spite of this and based on available information, PEMP appears to be the best project with a clear budget structure (20-40% for TA; 60-80% for capital) and have the most efficient flow of funding among all projects evaluated. Online MIS implemented by Bank Bukopin is very useful to ensure project cost effectiveness and greater transparency.

90. The project budget at the national level was decided and managed directly by the MoMF, whereas the provincial and district offices of the MoMF were responsible only for supervising the participating cooperatives. The fund was channelled through Bank Bukopin who charged government a partnership fee of Rp.25 million for five years.

91. Each targeted district is entitled to register one cooperative only to this project. One cooperative will receive Rp.1 billion. Up to 2007, there are 278 cooperatives nationwide joining the project. Total budget funds disbursed during 2001-2007 is Rp.1.2 trillion, of which 60%-80% was disbursed to finance micro-business capital and the rest (20%-40%) for capacity building. Detailed results of assessment on PEMP project cash loan characteristics can be found in Appendix 12.2.

92. ***Collection Performance and Rate of Repayment***. *According to project staffs at the MoMF and the Swamitra Mina cooperatives surveyed in this assessment, loan repayment rates and collection performance of MFIs to banks were reportedly high, but some evidence of high NPL at cooperative level may become a long-term problem*. There are two level of collection, one collection performance at the MFI level (client to MFI); and the second is collection performance at the bank level (MFI-Bank). At the MFI level, majority of beneficiaries were aware that it was mandatory to repay the loan, however 20% of beneficiaries did not know if the loan had to be repaid or not. Beneficiaries generally reported that the loan size was too small and the interest rates too high, a possible indicator that this project did not reach poor borrowers. Nearly all indicated a need for future access to credit (see *Appendix 12.2*). No quantitative data on collection performance and rate of repayment has been made available for the evaluation team.

93. The majority of beneficiaries (56.7%) surveyed under this rapid appraisal reported difficulties in repaying their loan. Key reasons cited were family problems, crop failure and lack of profitable business activities. As many as 51.7% of beneficiaries thought that failure to repay the loan did not carry any consequences (see *Appendix 12.2*). This is part of the reason for the high NPL at MFI level as beneficiaries' commitment to repay the loan is weak.

94. There appear to be cases of over-borrowing. Clients sometimes received more than one loan from different government's projects at the same time without undergoing proper credit and business assessment. This jeopardized repayment capacity and increased risk of nonpayment, affecting overall financial sustainability of the MFIs and ultimately the future bankability of the client. These risks could actually be mitigated through proper identification of beneficiaries and program coordination.

95. ***Capacity Building.*** *Capacity building does not appear vital to project success and PEMP project is generally good in the provision of capacity building to participating MFIs (provided by Bank Bukopin and MoMF), but weak to end-beneficiaries*. This is partly due to limited or insufficient budget allocation. Capacity building for beneficiaries was mainly provided by outside contractors, such as CSOs, local NGOs and local universities that have no

relation with the project. Field evaluations indicate that direct capacity building for beneficiaries has been very limited. Trainings focused mainly on project implementation, rather than MFI capacity building.

96. Capacity building provided to MFIs was one of the major factors affecting the project outcomes. Bank Bukopin has effectively carried out its responsibility in providing these services, such as setting up the legal framework, developing management information system (MIS), and formulating standard operating procedures (SOP) of participating cooperatives. However, there is a need also to provide other trainings, such as financial analysis and business planning, to enhance the capacity and improve the management of the cooperatives.

97. FEAs played an important role to ensure that beneficiaries improved their capability in running their micro-businesses. However, FEA capacity to deliver micro-business related trainings was very low and there was a high level of FEA turnover. The associated local government budget to cover FEA salary was very limited. In addition, there are no incentives to compensate FEA good performance. Detailed results of assessment on PEMP project capacity building can be found in Appendix 12.2.

98. ***Beneficiaries Satisfaction***. *Most beneficiaries are generally satisfied with PEMP project.* No formal impact studies have been undertaken for this project. Based on the small survey size of this rapid assessment, beneficiary fishermen report significant increases in income. The project also clearly promotes local savings, which help build beneficiary assets. Project beneficiaries generally assessed the project as "average" in meeting its objective, while 53.3% of beneficiaries were satisfied and a small number (6.7%) not satisfied due to the lack of technical assistance (see *Appendix 12.2*).

99. ***Project Sustainability***. *PEMP project has a strong financial sustainability component due to active participation of Bank Bukopin and option for long term post-program financing*. Bank Bukopin also appears to be ready to take some risk on lending and has good systems and experiences to handle MFIs in remote areas. The project is essentially designed to build financial linkages between Bank Bukopin and sustainable MFIs (with 100% cash collateral from the Government) in order to expand MFIs access to finance.

100. ***Major Factors Affecting the Project Results***. The community-based or bottom-up approach and efforts to tailor project outputs to the needs of the community appears effective in producing positive impacts in a large number of coastal community members as possible, but outreach to poor beneficiaries may be limited.

101. MFI and Bank Bukopin are the key components for successful implementation of the project. Support from Bank Bukopin such as MIS, monitoring and evaluation, and reviewing loans proposed by clients has helped MFIs improve their loan processing capacity and portfolio quality. Evaluation findings indicate, however, that MFI capacity at the local level remains weak.

3.3 JOINT ENTERPRISE GROUP/COMMUNITY EMPOWERMENT PROGRAM (KUBE)

3.3.1 Program Summary

102. ***Background***. The problem of poverty is very complex since factors causing it are multi-dimensional, ranging from illiteracy, unemployment, inequality in income distribution up to lack of adequate public service provision. Oftentimes, poverty does not only involve a lack of material possession, but also the lack of access, capacity and opportunities to develop one's human capability to do economically productive activities. The KUBE project – implemented by the Ministry of Social Affairs (MoSA) – was created to address this wide spectrum of issues in fighting poverty (see *Appendix 13.1*).

103. ***Objectives***. The KUBE project in general aims to provide business loans to poor households both in rural and urban areas and to empower them through community-based joint enterprise groups and MFIs. The project is integrated into the financial management improvement of MFIs in order to strengthen their organizations so that the MFIs can, in turn, help create revolving funds and attract local investors to participate in developing MFIs as embryos of self-reliant cooperatives and as the center of community-based social safety system.

104. ***Design and Characteristics***. The project implementation involves many agencies at different levels:

- At the national level, the MoSA has the overall responsibility of the project implementation, including designing the technical guideline, standardization, accreditation and program controlling and facilitating the funding support.

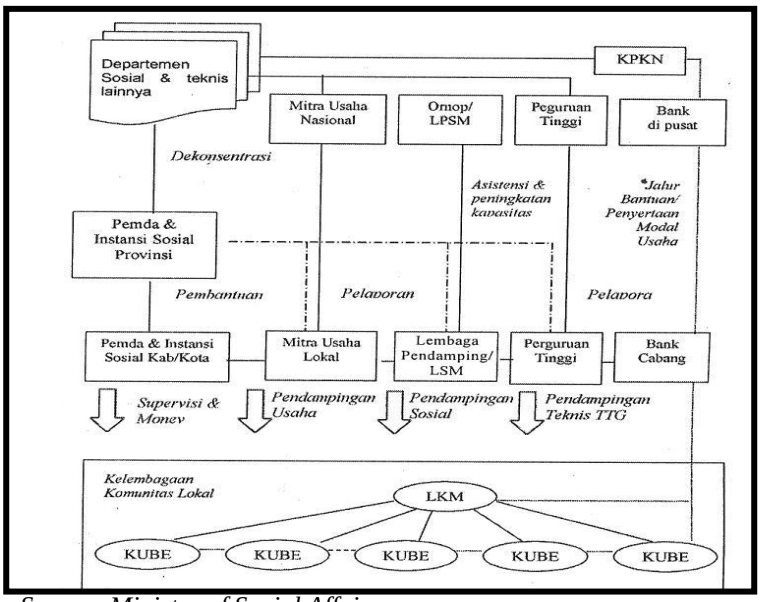
- At the provincial level, the Governor is responsible for designing the project operational and conducting the project monitoring and evaluation up to the district level.

- At the district level, the city mayor or head of the district must be responsible for the fund allocation for each targeted area and for supporting project implementation. The support can be in the form of providing matching fund for FEAs through local government budget or fundraising from local communities and businesses in the target area.

- *Partner Agencies*. Partner agencies are responsible for ensuring that the project is implemented as planned and loans are received by the poor. Various interested civil society organizations and NGOs are expected to provide social assistance, ranging from group identification, needs analysis, group support and the establishment of MFIs. Local community organizations facilitate planning, field assistance, monitoring, and managing project implementation at the community level.

- Participating poor households are organized into "KUBE" groups and formed by the community based loosely on the Grameen Bank methodology which is a solidarity group-based lending to women micro-entrepreneurs, with an average of 10 members. The KUBE groups are expected to communicate with other groups to improve social relationship, to help solve socioeconomic problems and to be a venue for developing the community's business.

Figure 3: KUBE Project Organizational Scheme



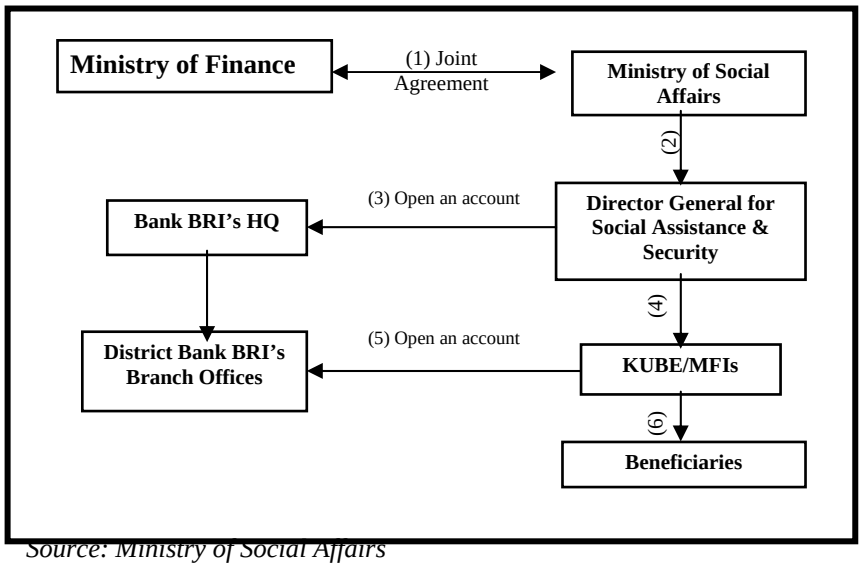
Source: Ministry of Social Affairs

105. ***Implementation Mechanism***. The main activity of the project is to provide a grant-based government match to KUBE group member savings, which can reach up to 200% of total group savings. The savings then form the basis for MFI lending to these groups, while at the same time building KUBE member assets, savings habits and relationship with a local financial institution.

106. Project implementation has been in a constant state of flux since program inception, with yearly changes in partnership arrangements and project mechanisms. Typically the program has included the following steps: (1) Ministry of Finance approves funding allocation proposal from the MoSA; (2) The MoSA then appoints the Director General (DG) for Social Assistance and Security as the national coordinator of the KUBE program; (3) The government appoints Bank BRI to channel these funds to KUBE groups and the DG for Social Assistance and Security opened an account in Bank BRI's headquarter; (4) DG district offices assist communities to form groups (KUBE) with PINBUK and appoints MFIs to channel funds to members of KUBE groups; (5) each appointed MFI is required to open an account in Bank BRI's branch offices. MFIs generally receive funds from BRI within 30 days of written request from the government to transfer funds to the MFIs' account in their respective Bank BRI branch

offices; and (6) MFIs disburse funds to beneficiaries (KUBE) in accordance with their own standard operating procedures on credit assessment. Funds are considered as loans that must be repaid to the government through MFIs.

Figure 4: KUBE Funding Mechanism



Source: Ministry of Social Affairs

3.3.2 Program Review and Findings

107. Overall, KUBE project's performance is average with strong outreach to the poor. The project has excellent poverty targeting due to the use of comprehensive BPS poverty data to select priority areas and the consultation process with the community (through meeting and consensus) to select individual target group that is defined as poor. KUBE has good potential for sustainable development and poverty alleviation – due to its savings-led funding mechanism. However, KUBE project is weak in field implementation through start-up MFIs. MFIs capacity in collections, however, is better than other projects due partly to well-functioning joint-liability groups. KUBE project performs very strong in community organization through the forming of SHGs with adequate technical assistance from FEAs. It is recommended for possible investment only with modifications. Detailed program review and findings are described below (see *Appendix 13.2 and 17*).

108. ***Project Documentation***. *KUBE project documentation appears complete. However, budget and project report documents are hardly made available during the evaluation.* The project has developed many project manuals. The latest and most important is the project strategic plan for 2006-2010 which lays out the details of the project implementation, including its background, objectives, project indicators, implementation strategy, program and policy, operational guidelines, medium-term plan and monitoring and evaluation system and mechanism. In addition, several technical guidelines and operational manuals outlining the

project implementation mechanism have also been published. However, project progress reports and financial information were not made available to the evaluation team.

109. Even though criteria for identifying the beneficiaries of the KUBE project have not been clearly established in any of its project documents reviewed, KUBE appears to be very successful in serving mostly the poor people in relatively poor areas. This is partly due to the use of comprehensive BPS data to select priority areas and beneficiaries. In practice, the social groups actually reached by the program vary widely by location.

110. ***Project Implementation, Efficiency and Management***. *KUBE project management performance is average*. The provincial office of the MoSA is responsible for the management of the project, including assisting the FEAs in supervising KUBE groups. The project works in cooperation with PINBUK to establish new Sharia-based MFIs to serve KUBE groups. In each of the participating MFIs, the organizational structure consists of two people responsible for the management, i.e., a manager and an accounting staff, and three people, including an FEA, responsible to oversee the MFI's business activities. In practice, support for the newly formed MFIs has been inadequate to fully support their sustainable development.

111. The KUBE community-based groups are the focal point in ensuring the project meets its objective, since they are in the forefront of the project implementation (see *Figure 4*). On the other hand, MFIs are the key strategic partners for serving KUBE groups by mobilizing savings and disbursing loans. The success of MFIs is one of the key indicators for the project achievement and its sustainability.

112. The project has experimented with both cash and in-kind provision of assets to KUBE groups. While experience still varies, in general KUBE has found cash transfers to be more effective and less administratively burdensome.

113. The MoSA was responsible for disseminating the project to the local governments through various coordination meetings and conferences held in Jakarta and in the provinces during the project preparatory work. Government also provided support for the project by covering the operational cost, including salary of the FEAs, as well as facilitating a capacity building forum on microfinance management for all participating MFIs' managers in Jakarta. However, the capacity building event was only conducted once during the forming of MFIs.

114. A critical weakness of this project has been insufficient resource provision for start-up MFIs, including human, technical and system resources. The quality of operational/ administrative and technical skills and knowledge of the staff are still far from adequate to run the MFI in an effective and sustainable way. In consequence, regular monitoring and visit to KUBE members' businesses were rarely done aside from group weekly meeting. This oftentimes resulted in poor loan repayment analysis.

115. ***Achieving Objectives***. *KUBE project appears to meet its community empowerment goals in providing business loans to the poor and building community based groups, but not very successful on MFI support and development*. The provincial office of MoSA is in charged with socializing the program to the selected member of KUBE, in areas approved by Dinas. There have been concerns that the limited scope of these activities in some areas has caused limited participation. In South Sumatera, for example, there was very little awareness campaign activities on the program compared to the other two provinces evaluated, with FEAs as the only agents to help introduce the program to potential beneficiaries. As a result, in South Sumatera, participation is not evenly distributed throughout the province.

116. Most loans are based on the solidarity group lending methodology. The average loan size is Rp. 1.36 million, with a tenor of 24 months, mostly weekly loan repayment schedule and installment basis. The average loan processing period reaches about one week, which can be considered highly efficient. Typically, most of the loans were used for business purposes (see *Appendix 13.2*).

117. A small sample of KUBE group members was surveyed under this rapid assessment in three provinces. Members had been in KUBE groups on average for three years. The majority cited access to finance as the most valued service offered by the program (see *Appendix 13.2*).

Table 7: KUBE Project Impact and Satisfaction

Impact and Satisfaction		All	East Java	South Sumatera	South Sulawesi
		17*	5	6	6
Loan impact *(In scale 1: deteriorated substantially to 5: Improved Substantially)*	Business income	4.2	3.8	4.2	4.5
	Employment	3.2	3.0	3.3	3.2
	Skills	3.4	3.4	3.7	3.0
	Housing	3.2	3.6	3.0	3.0
	Assets base	3.1	3.0	3.2	3.2
	Child education	3.2	3.2	3.3	3.0
	Health	3.5	3.8	3.2	3.5
Level of program success	Unsuccessful	11.1%	0.0%	16.7%	16.7%
	Average	17.8%	20.0%	0.0%	33.3%
	Successful	65.6%	80.0%	66.7%	50.0%
	Very Successful	5.6%	0.0%	16.7%	0.0%
Level of satisfaction	Unsatisfed	11.1%	0.0%	16.7%	16.7%
	Average	5.6%	0.0%	0.0%	16.7%
	Satisfied	83.3%	100.0%	83.3%	66.7%
	Very Satisfied	0.0%	0.0%	0.0%	0.0%

Source: Author's Field Survey Summary
** Number of beneficiaries interviewed*

118. The project appears to have good impact on the beneficiaries. They report using loans to grow their business and, therefore, increasing their income. The project reportedly helped reduce their dependency on high cost loan sharks for emergency financing needs. Table 7

shows that in addition to increases in business income, there were also reported improvements in child education and skills. The level of satisfaction of this program was also relatively high.

119. Project beneficiaries also report improvements in skills and knowledge related to financial services, including both savings and determining borrowing needs. Beneficiaries acquired all these skills and knowledge mainly through the mandatory trainings and intensive assistance provided by the FEAs and also, in theory, by the participating MFIs.

120. ***Poverty Targeting***. *KUBE project performance in poverty targeting is excellent partly due to the use of comprehensive BPS data to select priority areas and followed by community meeting to get consensus on defining poor people as project beneficiaries*. In addition to that, KUBE project clearly identifies poverty levels among beneficiaries by classifications, such as red group for the poorest, yellow group for the poor and green group for the not-very poor group, and tracks their progress in moving up the poverty chain.

121. The project identification of poor household beneficiaries relies on the following criteria: (i) individual expenses per month based on BPS poverty indicators per province and/or per district, dependency on food donations for poor people (such as Zakat/rice for poor people/social charity); (ii) limited availability of proper clothing for individual family members in a year (only able to have one set of clothing per individual per year); (iii) inability to cover medical expenses if a family member is sick; (iv) inability to send children to attend nine-year compulsory education; (v) lack of productive assets to cover daily needs for three months; (vi) sub-standard housing; and (vii) lack of access to clean water. Details on characteristics of KUBE project beneficiaries can be found in Appendix 10.

122. ***Monitoring and Evaluation***. *Project evaluation and reports were not made available to the evaluation team. Based on regional samples from the evaluation, the project has highly varied experience with client monitoring and assessment*. Work plan for appropriate project monitoring and evaluation does not exist. KUBE groups are in theory required to self-monitor. Monitoring and evaluation of beneficiaries typically consists of weekly group meeting focused on attendance and loan repayment performance.

123. At the implementing agency level, sub-district office of MoSA together with participating MFIs are supposed to be responsible for project monitoring and supervision, but has insufficient budget and skills in microfinance. Monitoring and evaluation of beneficiary business activities and performance is also rarely carried out by the MFI due to weak capacity which, in turn, weakens overall project quality control. Detailed results of assessment on KUBE project monitoring and evaluation performance can be found in Appendix 13.2.

124. ***Cost-Effectiveness and Budget Structure***. *KUBE project cost effectiveness and budget structure is the most difficult to evaluate among other government microfinance projects evaluated, because project budget, design and implementation changes yearly and related documents are hardly available*. The entire budget for KUBE project amounting to Rp.300

billion came from the state budget, but budget allocation for capacity building is not very clear. The evaluation done in Sidoarjo – East Java for KUBE project reveals that there was a gradual increase in the project budget, starting from Rp.187.5 million in 2004, Rp.220 million in 2005 and Rp.960 million in 2006.

125. Beneficiaries generally preferred to receive loans in-cash to finance their micro-businesses or open a new one. However, the loan provision for KUBE groups was not always given in-cash. In South Sumatera, for instance, the loans were provided to all groups in the same area in the form of a production tool. This can cause unfairness since the in-kind loan would simply be impossible to be equally distributed to all members of the group. There was even no clear guidance for the group on how to make use of the production tool equally among its members.

126. MFIs are usually charged an interest of 1.5 % per month (equivalent to 18 % per annum). MFIs' income from these interest charges was partly used to cover environmental development cost (5%) and technical assistance (10%).

127. Profit sharing from MFI to beneficiaries was equivalent to 1.4% to 1.6% per month. The income from profit sharing was sufficient enough to cover MFI operational cost. An incentive was awarded annually by the MFI to the best group performer. And at the end of the year, if there was enough profit, MFIs gave souvenirs to their clients. Detailed results of assessment on KUBE project cash loan characteristics can be found in Appendix 13.2.

128. ***Collection Performance and Rate of Repayment***. *Based on interview with MoSA and field survey results with some KUBE groups, KUBE project performance in collections is good due partly to well-functioning joint-liability groups*. Loan repayment performance varied by regions and usually was affected by individual illnesses or health conditions of beneficiaries (vulnerable population). No quantitative data on collection performance and rate of repayment has been made available for the evaluation team. Based on the small survey (questionnaire and group discussion) completed for this rapid evaluation, the respondents have generally clear perception that loan repayment is mandatory. However, as many as 83.3% of respondents in South Sumatera perceived the loan as a grant, significantly affecting loan repayment.

129. Collections are the responsibility of participating MFIs and the quality varies by institutional quality and capacity of MFIs. Typically, Sharia-based MFIs have higher levels of delinquency due to the risk-sharing approach and lack of clarity around obligations for lending to the poor and repayment. Repayment rates are clearly tied directly to the public perception of government funding. Detailed results of assessment on KUBE project delinquency can be found in Appendix 13.2.

130. ***Capacity Building.*** *KUBE project has the strongest performance in community organization through the forming of KUBE groups with technical assistance provided by FEAs*. The capacity building provided to the beneficiaries was mainly in the form of technical

assistance and sharing experiences during the weekly meetings. This method is good enough for local conditions and culture in many of the target locations characterized by communal values. Through these meetings, beneficiaries can meet and share their experiences and problems with other members of the group and ask for guidance/assistance from the FEA to address their concerns.

131. However, few business-related trainings were provided and the amount of TA provided varies widely by region. As cited earlier in the report, capacity building for MFIs started under the project has been insufficient to ensure sustainable development, although PINBUK provides additional support to some MFIs outside of the parameters of this project. Detailed results of assessment on KUBE project capacity building can be found in Appendix 13.2.

132. ***Beneficiaries Satisfaction***. *The level of success and clients satisfaction of KUBE project is relatively high, mainly due to: (i) beneficiaries previously lacked access to finance, (ii) strong evidence of improvement in standard of living, and (iii) strong community bond/group formation*. Table 7 shows that there are improvements on beneficiaries' income from their micro-businesses. Improvements on child education and skills are also reported. However, KUBE project does not have a client complaint handling mechanism.

133. ***Project Sustainability***. *Overall sustainability of this project is weak for a number of reasons*. The project has no clear exit strategy for the central government and mechanism to hand over the project to the local government. Therefore, continuity and sustainability of the project were not assured yet until the time of the evaluation. Local governments currently appear to be very reluctant to include the KUBE project in their budget plan.

134. However, KUBE savings-led funding mechanism and the available revolving funds from the previous project activities have enabled participating MFIs that are already self-sustained to continue the project. The savings-led funding mechanism is also an important step toward sustainable development and poverty alleviation. The demand for financing facilities through this kind of project is high, not only because the loan was easily accessed through MFIs, but also the opportunity to build and develop their micro-businesses together with other beneficiaries. The key question is the real level of sustainability of participating MFIs which were established under the project.

135. ***Major Factors Affecting the Project Results***. The project is fully funded by the state budget, with no contribution or leverage from the banks or private sectors. However, in all locations surveyed local governments were reluctant to include the project in their budget. Nonetheless, government investment in matching KUBE member savings does motivate KUBE members to build their savings base, thereby mobilizing funds among the poor in targeted areas.

136. FEAs play a key role in group formation and project continuation. Their activities complement that of the MFIs. It is unclear whether MFIs will be able to deliver the same level and quality of service when FEA supporting positions are ended.

137. The capacity enhancement program for members of the KUBE groups was a fundamental factor for the success of the project, because almost all important decisions, such as loans approval, determining repayment schedules and group rules and regulations are made by the members of the group themselves. The joint-liability or risk-sharing principle applied in the project also serves as an internal control and ensures the on-time loan repayments by all members of the group.

138. The mandatory orientation program for potential beneficiaries prior to forming a KUBE group is critical to the creation of a strong and solid group. Initially, it took about seven months to form a group, and as time went by, the time required to form a new group became shorter, which could lead to quality issues in future implementation.

139. MFI capacity or lack of capacity to build, support and finance KUBE groups will be the ultimate determining factor of the sustainability of this model. To date, MFI capacity is still weak.

3.4 REVOLVING FUND PROJECT FOR CONVENTIONAL/SHARIA-BASED MICROENTERPRISE PRODUCTIVE ACTIVITIES (P3-KUM)

3.4.1 Program Summary

140. ***Background***. The P3-KUM is managed by the Ministry of Cooperatives and SMEs (MoCS). The project implementation was divided into two phases: Phase 1 from 2000-2005 and Phase 2 from 2005-2008. The project provides revolving funds in the form of a ten year loan to cooperatives to finance member micro-businesses. Funds repaid by MFIs to the project are then provided to new cooperatives. The P3-KUM has a specific program focus on cooperatives run by and for woman micro-entrepreneurs (see *Appendix 14.1*).

141. ***Objectives***. The objectives of the project are twofold: (i) to improve access of small and micro enterprises to finance by strengthening the capital structure of Savings and Loans Cooperatives and Units (Koperasi/Unit Simpan Pinjam, KSP/USP) and other women cooperatives; and (ii) to support the government's poverty alleviation program and increase new employment opportunities. P3-KUM funding objectives for both conventional and sharia-based scheme are the same.

142. ***Design and Characteristics***. The project implementation was designed based on the previous similar projects of the MoCS and involves many agencies from different level:

- At the national level, the Ministry of Cooperatives and SMEs has the overall responsibility of the program implementation and acts as the steering committee of the project. Tasks include designing and formulating the project concepts, designing technical guidelines, coordinating with other relevant government's agencies, monitoring and evaluation and supervising the overall project implementation.

- At the provincial level, the Head of the MoCS provincial office is responsible for coordinating the project implementation and activities in province, verifying and approving the list and applications of cooperatives, overseeing the funds disbursement process and conducting the project monitoring and evaluation up to the district level.

- At the district level, the city major or head of the district supported by the district office of the MoCS is responsible for disseminating and supervising the project implementation, identifying potential cooperatives, reviewing proposals and approving the applications at the district level.

- *Executing Banks*. There are basically two types of executing banks, i.e., Regional Development Banks (Bank Pembangunan Daerah, BPD) and sharia-based Bank Mandiri and Bank Muamalat. Executing banks were appointed by the MoCS and have the responsibility as stipulated in the MoU between the MoCS and the banks. Operationally, the executing banks' branch offices must fulfill the terms and conditions related to the loan assessment, disbursement, repayment schedules, capacity building and monitoring and evaluation of the use of loans.

143. ***Target Beneficiaries***. The project is targeted to reach around 8,484 KSP and USP by 2005 and cover additional 6,103 by 2008. To be eligible, cooperatives must meet the following requirements: (i) primary cooperatives at district level that have legal license for a minimum of one year and a savings and loans unit separate from other business activities, (ii) at least 25 members who own micro-business, (iii) never received loans from previous MoCS' projects, and (iv) has an internal rules and regulations, including regular members meeting.

144. Meanwhile, the requirements for micro-business to receive the loans are the following: (i) member of the cooperative for at least three months, and (ii) no outstanding loans to the cooperative.

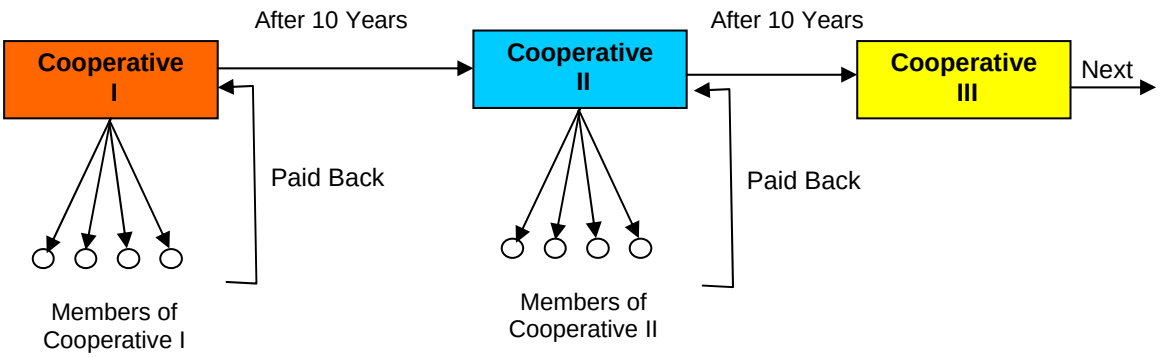
145. ***Implementation Mechanism***. The key activity in this project involves the selection of appropriate MFIs in each district. The steps of selection consist of:

- The district office of MoCS (Dinas) sets the criteria for selection and advertises the opportunity openly;
- Dinas receives formal applications from cooperatives;

- Dinas verifies cooperative performance using a formal scoring system and forward recommended applications to provincial level. If accepted, Head of Provincial Office of MoCS recommends a loan of Rp.50 million to Rp.100 million to MoCS in Jakarta; and
- MoCS makes approvals and releases the approval letter to the accepted cooperative.

146. During Phase 2, MoCS plans to establish a network of 6,103 MFIs in all districts throughout Indonesia and to include revolving loan provision to cooperatives, capacity building for MFIs and their borrowers and on-going project monitoring. The project implementation mechanism for the Phase 2 is illustrated in the Figure 5 below.

Figure 5: P3-KUM Implementation Mechanism



Source: Ministry of Cooperatives and Small & Medium Enterprises

147. Cooperatives participating in P3-KUM project are required to repay 10% of the total loan principle annually (in quarterly installments) and are charged an annual interest rate of 6% flat per year by the participating banks, 4% for bank's fee and 2% to cover training and audit services cost to target cooperatives. There is no clear incentive to the banks to complete their functions in a timeline manner, since the 4% fee is received regardless of performance. The 2% training fee is intended to be used by the partner banks and other institutions to provide technical assistance to participating cooperatives. In practice, this has yet to be realized, due to lack of clarity on TA provider selection, duties and payment.

3.4.2 Program Review and Findings

148. P3 KUM project still at early stage of its implementation. Overall, the project's performance is average with good selection of MFI partners for sustainability using the scoring system, but limited poverty targeting or outreach. The scoring system is looking at various indicators especially at the institutional level includes institutional factors; organizational aspects; business and services diversity; business ownership; and business plan on the use of the proposed budget; but not specifically looking at whether the cooperative serve the poor community or not.

149. The project's proactive and strong outreach to women's as stated in the government regulation (Decree of State Ministry on Cooperative; Small and Medium Enterprise no.9 and 10/Per/M.KUKM/VI/2006). Based on the field visits, the only government microfinance project that mainly focuses on women group is P3-KUM and thus it helps increase women access to financial services. We recommend for possible investment only with modifications. Detailed program review and findings are described below (see *Appendix 14.2 and 17*).

150. ***Project Documentation***. *P3-KUM project preparatory and original guidelines are generally sound, but weak in the areas of monitoring and evaluation*. Project documentation is generally comprehensive and provides clear guidelines in most areas, with the exception of ultimate use of project funds after they have revolved for the second time and the clear use of interest income intended for capacity building. The project documents also do not include a clear workplan or project milestones to give inputs for monitoring the progress of the project implementation.

151. ***Project Implementation, Efficiency and Management***. *At this early stage of its implementation P3-KUM project management performance is still weak, but will hopefully improve over time*. In theory, the Provincial Development Banks (BPD) (i.e., BPD of South Sumatera) should provide active support to P3-KUM project implementation and act as an executing bank. However, in practice they give neither serious attention to the project, nor clear and active guidance to its district branch offices. BPD regional staffs do not appear well acquainted with the project parameters.

152. Control on project management is also weak that sometimes results in cooperatives receiving revolving funds from different government programs at the same time. Moreover, there is inconsistency in project implementation in terms of opening bank accounts for loan repayment. In theory, a participating cooperative must open three bank accounts (i.e., for principal loan repayment, interest payment and technical assistance). In practice, however, a cooperative can either open just one bank account or uses one of the accounts for other purposes.

153. ***Achieving Objectives***. *P3-KUM project does explicitly target the poor, but has limited success and does not provide sustainable support to cooperatives*. The project has a clear ability to meet objectives by financing existing MFIs, rather than creating new MFIs.

154. Coordination on MFI selection is sometimes problematic. On an annual basis, local government selects qualifying cooperatives in their areas and recommends them to Dinas for approval. However, at the provincial level new cooperative candidates are sometimes chosen. Both the local and provincial levels complete scoring of MFIs independently.

Table 8: Summary of P3-KUM Cash Loan Characteristics

Loan Description		All	East Java	South Sumatera	South Sulawesi
		20*	5	10	5
Loan Disbursement	Through MFI/Bank	86.7%	60.0%	100.0%	100.0%
	Through group	13.3%	40.0%	0.0%	0.0%
Type of loan	Cash loan	100.0%	100.0%	100.0%	100.0%
Collateral	None	50.0%	40.0%	70.0%	40.0%
	Building/property	13.3%	40.0%	0.0%	0.0%
	Vehicle	13.3%	20.0%	0.0%	20.0%
	Household item	10.0%	0.0%	30.0%	0.0%
	Saving block	13.3%	0.0%	0.0%	40.0%

Source: Author's Field Survey Summary
** Number of beneficiaries interviewed*

155. A survey of existing project beneficiaries indicates that most clients are already clients in long-standing with their cooperatives (ranging from 3 to 8 years) and that their primary benefit derived is continued access to finance. Detailed results of assessment on P3-KUM project implementation highlights can be found in Appendix 14.2.

156. All loan disbursements to program beneficiaries are made through cooperatives and participating banks based on their existing loan products, which include solidarity and group lending products and both secured and unsecured lending (see *Table 8*). The rapid evaluation reveals that small size of funding by P3-KUM project generally does not have high impact on MFI development.

157. ***Poverty Targeting***. *Poverty targeting is not a strong stated criterion for the project, and therefore beneficiary poverty levels vary significantly depending on the natural outreach of the participating cooperatives*. P3-KUM project appears to focus only on empowering MFIs, not the poor. Meanwhile, proactive outreach to women's cooperatives does effectively impact service to this group. Details on characteristics of P3-KUM project beneficiaries can be found in Appendix 10.

158. ***Monitoring and Evaluation***. *P3-KUM project documentation regarding monitoring and evaluation is incomplete*. Moreover, the project has a very limited budget from government for monitoring and evaluation, which has hampered the project's ability to deal with implementation difficulties.

159. On monitoring and evaluation, 76.7% of respondents were assessed prior the loan disbursement and 70% reassessed post-loan. The assessment was conducted by MFI/Bank (83.3%) and the rest by community organizations. Levels of monitoring and evaluation varied significantly by region. The type of monitoring conducted was mainly through observation (67.5%), followed by general discussion (20%) and financial review (12.5%) which was only applied in South Sulawesi. Detailed results of assessment on P3-KUM project monitoring and evaluation performance can be found in Appendix 14.2.

160. ***Cost-Effectiveness and Budget Structure***. *The pressure on government at different levels to spend all funds for P3-KUM project by year-end leads to ineffective use of funds*. The budget for P3-KUM project amounting to Rp.200 billion for fiscal year 2007 came from the state budget, while budget allocation for capacity building and monitoring and evaluation is provided by the provincial government but reported to be insufficient. The requirement for participating MFIs to open and maintain three bank accounts each appears to be costly for MFIs.

161. The decision on budget for the whole project was decided by the MoCS, whereas district and sub-district government acted only as a party who gave suggestion for the nominee of cooperatives. The fund of project was delivered directly to the nominee through BPD. In 2007, the MoCS allocated funds for two main revolving fund projects, i.e., (i) conventional and sharia-based revolving fund facility for cooperatives and micro-businesses with a total budget of Rp.200 billion for 2,000 cooperatives and/or micro-businesses, and (ii) conventional and sharia-based revolving fund facility for women cooperatives called PERKASSA, with a total budget of Rp.25 billion for 250 women cooperatives.

162. There have been problems with mishandled funds and instances of fraud with seven cooperatives which have been identified and referred for legal action.

163. ***Collection Performance and Rate of Repayment***. *P3-KUM project is still at early stage of its implementation and no data available yet on collection performance and rate of repayment. However, field survey showed indication of some problems related to MFI loan repayment*. Loan repayment for this project is conducted at two levels. Cooperatives must make quarterly principal and interest payments to the banks from money borrowed from the project and ultimately beneficiaries must repay cooperatives. Reports on loan repayment of cooperatives to the project are not generally available from the participating banks, which do not appear to honor reporting timetables. Reports on MFI repayment rates were not made available to the evaluation team, however, it is known that in some cases MFIs have not repaid because of fraud and other MFIs report difficulty in repayment due to interest rate (6% flat is the equivalent of 12% effective annual interest, near market rates).

164. At the participant level, the majority of clients interviewed during this study reported that loan repayment is mandatory (68.1%), but 25.2% still feel it is optional. Difficulty with repayment was linked to inappropriate loan terms. Most of the respondents perceived that

there will be collateral execution if they cannot repay the loan, while the other 30 % perceived that the government will only give them warning (see *Table 9* and *Appendix 14.2*).

Table 9: P3-KUM Project Delinquency

Delinquency		All	East Java	South Sumatera	South Sulawesi
		20*	5	10	5
Difficulty in repaying the loan	Sometimes	20.0%	0.0%	0.0%	60.0%
	Yes	13.3%	0.0%	0.0%	40.0%
	No	66.7%	100.0%	100.0%	0.0%
		5.0	5	10	0
Reason for difficult	Profitable activity	70.0%	60.0%	80.0%	-
	Repayment schedule is suitable	10.0%	20.0%	0.0%	-
	It is a responsibility	20.0%	20.0%	20.0%	-
		1.7	0	0	5
Reason for difficult	Loan not used for business purpose	0.0%	-	-	0.0%
	Not profitable business	14.3%	-	-	14.3%
	Sickness	28.6%	-	-	28.6%
	Major force/disaster	14.3%	-	-	14.3%
	Loan period is not suitable	28.6%	-	-	28.6%
	Loan collection is not suitable	14.3%	-	-	14.3%
If beneficiaries cant repay the loan	Collateral execution	33.3%	60.0%	0.0%	40.0%
	No more loan in the future	6.7%	20.0%	0.0%	0.0%
	Penalty	10.0%	0.0%	10.0%	20.0%
	Warning	30.0%	0.0%	90.0%	0.0%
	Nothing	13.3%	0.0%	0.0%	40.0%
	Don't know	6.7%	20.0%	0.0%	0.0%

Source: Author's Field Survey Summary
** Number of beneficiaries interviewed*

165. ***Capacity Building***. *P3-KUM project is generally weak in the provision of capacity building either to MFIs or end-beneficiaries*. This is due to: (i) limited or insufficient budget allocation for capacity building, and (ii) lack of clarity on TA provider (participating banks or the district office of MoCS). In practice, no capacity building has been provided for the cooperatives and/or clients as planned. Interest income earmarked to pay for technical assistance has accrued, but not yet been spent due to lack of clear guidelines. Cooperatives appear to have weak understanding of project guidelines and requirements.

166. MoCS does not have a comprehensive plan and schedule or sufficient budget for capacity building. However, of the 26.7% of survey respondents did receive some form of capacity building through the project, including of industry-related technical assistance, entrepreneurship, and training about cooperatives, either from government or from the cooperatives themselves. Delivery is highly tied to specific regions. Detailed results of assessment on P3-KUM project capacity building can be found in Appendix 14.2.

167. ***Beneficiaries Satisfaction***. *More than half of beneficiaries interviewed are generally satisfied with P3-KUM project*. However, formal impact assessments have not been carried out for this project. Based on the limited study conducted during this rapid evaluation, beneficiaries report limited impact in business income, most likely because they are already clients in longstanding with these cooperatives. However, about 56.7% of total sample state that

this program is successful, and then followed by average (36.7%) and only 6.7% state that this project is very successful. In practice, individual beneficiaries have no real interaction with the project, since there are no inputs at the beneficiary level, other than ongoing access to credit (see *Appendix 14.2*).

168. ***Project Sustainability***. *The financial sustainability element of this project is relatively weak, due to the low funding levels coming from the Government and the fact that they must be repaid over the course of 10 years with no possibility of repeat financing for the MFI.* There are few incentives in the project to improve MFI performance; furthermore, there is a clear disincentive to repay the funds since no punitive measures are in place to handle defaulters.

169. The project also does not actively encourage the participation of local banks to assume its place as sponsors for MFI expansion, missing an important opportunity to build sustainable linkages between MFIs and the formal financial sector. That said, through sound MFI targeting practices, the fund does serve relatively sound cooperatives and therefore builds (temporarily) outreach to their target population, but only whilst project funds are still available.

170. ***Major Factors Affecting the Project Results***. The capacity of the cooperative is a main factor that ensures the successful of the program. The use of the cooperative scoring system in choosing participating cooperatives has greatly assisted in the process of targeting stronger cooperatives for this massive rollout of cooperative financing.

171. The lack of sufficient budget for monitoring and evaluation seem to leave the project open to fraud and misuse of funds for simple technical reasons.

172. The lack of clear performance-related incentives for banks and MFIs leads to inadequate reporting and thus influence the project management and quality. There is a missed opportunity to leverage government funding with commercial bank funding and to build sustainable commercial linkages for bankable cooperatives that demonstrate a good track record with this program.

173. There are no clear and measurable indicators related to the outreach of this project that can help direct and build its social impact.

3.5 DIRECT COMMUNITY FINANCIAL ASSISTANCE FOR AGRICULTURAL INVESTMENTS (BLM-KIP)

3.5.1 Program Summary

174. ***Background***. BLM-KIP is a new program which has not yet begun operations, but is planned for significant funding over the next two years (700 billion IDR). In the last three years (2004-2006), investments in the agricultural sector, both local and foreign, approved by the GoI have increased significantly. This trend is expected to continue over the short term.

However, efforts to enhance the capacity of farmers to increase their productivity are still far from sufficient and access to financial services particularly by small farmers remains problematic. This is caused not by the many administrative obstacles or the inability of the bank to reach million of farmers, but mainly by the unaffordable interest rates and the high perceived risk involved in rural agricultural lending (see *Appendix 15*).

175. At the same time, GoI has continuously increased the production targets of the four basic agricultural commodities, i.e., rice, corn, soybean and sugarcane, in order to ensure adequate supply. Based on these targets, the MoA issued a Ministerial Decree no.: 98/Kpts/OT.160/2/ 2007 to formally launch a new related project called BLM-KIP, in 2007. The newly launched project is designed to promote credit extension to small farmers and group of farmers for agricultural-related investments and productive activities.

176. ***Objectives***. The BLM-KIP project in general aims to improve access of small farmers to various agricultural-based financial services to facilitate increased productivity. In addition, the project's objective is geared towards creating a conducive environment for agricultural investment and growth, gradually providing technical assistance to farmers' groups, reducing and mitigating risks in agricultural-related investments and micro-businesses, increasing competitiveness and productivity of micro and small scale farming sector, encouraging farmers' groups to utilize various banking financial services available to them and attracting commercial banks into agricultural lending. The project is expected to complement other Government agricultural-related financing facilities, including the Agricultural Financing Facility Scheme (Skim Pelayanan Pembiayaan Pertanian, SP3) that provides credit guarantee for farmers for commercial loans from Bank Mandiri, Bank Bukopin and BPD.

177. ***Design and Characteristics***. Even though BLM-KIP project is created to complement another microfinance project of the MoA, the characteristic of its funding as a grant technically means that *it is not a microfinance project*. Essentially, Government funding through the project provides matching grants for farmers and farmers' groups with established credit histories from bank or other non-banking financial institutions upon their renewed application for working capital loans for agricultural-related investments. Grants will be made for up to 10% of the new loan value, through participating network of banks on loans up to Rp.500 million. Priority will be given to small farmers of basic agricultural commodities and existing farmers' groups. As the project has yet to be implemented, evaluation on BLM-KIP project will focus on project design qualities and documentation.

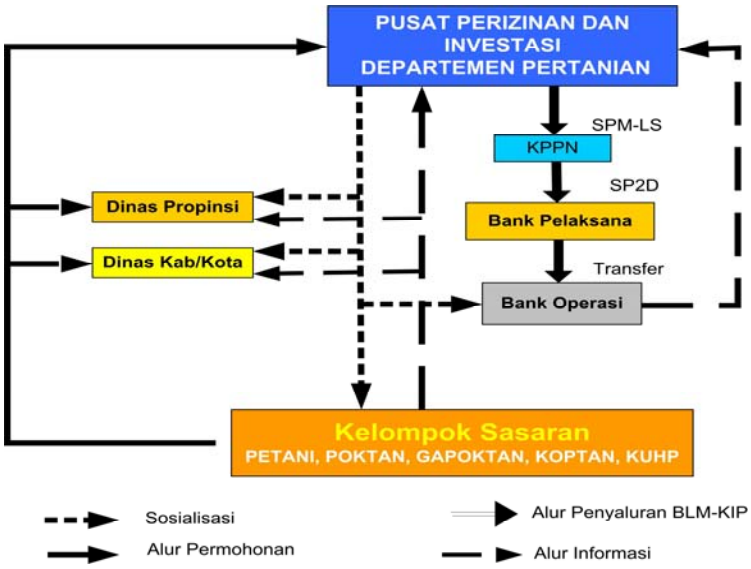
178. ***Target Beneficiaries***. Target beneficiaries include farmers, groups of farmers, association of farmers' groups, agricultural-based cooperatives and small and micro agro-enterprises. Poultry, plantations and agricultural products processing businesses are also qualified to receive the grants through BLM-KIP project as long as they have already received a loan from commercial banks. Details of the requirements to be the beneficiaries of the loans are provided in the newly published project guideline.

179. The project will operate in 10 provinces, i.e., North Sumatera, South Sumatera, West Java, East Java, Bali, Central Kalimantan, West Kalimantan, South Sulawesi, North Sulawesi, and Irian Jaya.

180. ***Implementation Mechanism***. The funding mechanism of BLM-KIP is fairly straightforward. The farmer (or group of farmers) submits his/her application for credit to a participating bank (i.e., Bank Mandiri, Bank Bukopin and Bank BPD). After receiving the bank's approval, the applicant must complete a second application for a grant at the district and municipality where he/she belongs.

181. All approved applications, both by bank and by the local MoA, are sent by the provincial office to the Investment and Permits Division (IPD) at MoA headquarter. IPD verifies the completeness and accuracy of applications. The Head of IPD issues an authorization letter for verified applications to the MoF (or KPPN) to disburse the loan to applicant's saving account in the participating bank. The amount of grant received by the client (or group of clients) may not be more than 10% of the total loan approved by the bank.

Figure 6: BLM-KIP Implementation Mechanism



Source: Ministry of Agriculture

3.5.2 Program Review and Findings

182. Overall, BLM-KIP is not a microfinance project, but more of cash grant provided only to those already have access to loans to encourage more investments in agricultural-related activities. There are concerns about lack of project sustainability and poverty targeting. It is not

recommended for investment. Detailed program review and findings are described below (see *Appendix 15* and *17*).

183. ***Project Documentation***. BLM-KIP is a newly launched project in which project documentation is not yet completed. The only project document available to the evaluation team is the project general guideline. At the time of the rapid evaluation, MoA explained that other required project documents, such as detailed project guidelines, project agreement, budget and workplan are still being finalized.

184. ***Key Factors that May Affect Project Results***. The BLM-KIP project objective is essentially to help bankable farmers and agricultural-based businesses financially. The evaluation team has the following key concerns regarding project design:

- "Topping up" loans which are already being made to established, bankable farmers (or groups of farmers) may not form a significant incentive to banks to expand outreach to this group;
- This type of activity will not support low-income or poor farmers who typically do not have access to formal banking finance;
- Because target clients are already bankable, government funds may simply displace/replace commercial funding which would have gone to the clients, representing a minimal benefit to the borrower, at high cost to the government;
- Project strategy to help poor households (farmers, in particular) financially through the provision of both commercial loans and grants at the same time is counter-productive. In the long-term, this kind of strategy would even make the poor very dependent on more loans and grants; and
- Bureaucratic delays in grant approvals and disbursement may have negative effect on agribusinesses expecting these funds to complete necessary productive investments.

4. LESSONS LEARNED AND RECOMMENDATIONS

4.1 Key Lessons Learned

185. ***Project Documentation*.** In general, project documentation of the five Government microfinance projects evaluated is comprehensive and provides clear guidelines. However, degree of transparency and full disclosure on some project documents varies, such as:

- At P4K project, project evaluation documents were easily accessible, but project documents related to the project agreement, budget and realization, detailed workplan, project progress reports and audit report were not made available to the evaluation team. Moreover, the participating bank was not willing to share any written reports related to loan disbursement and repayment.
- At PEMP project, written project guidelines and other supporting documents are available and easily accessible to the evaluation team. Moreover, the project has an outstanding information system available at the participating bank because reports are made on-line.
- At KUBE project, the project strategic plan, technical guidelines and operational manuals outlining the project implementation mechanism were made public and accessible, but project progress reports and financial information were not made available to the evaluation team.
- At P3-KUM project, the project preparatory and original guidelines are available and generally sound, but weak in the areas of monitoring and evaluation. Project documentation is generally comprehensive and provides clear guidelines in most areas, with the exception of ultimate use of project funds after they have revolved for the second time and the clear use of interest income intended for capacity building.
- At BLM-KIP project, the project documentation is not yet completed and the only project document available to the evaluation team is the project general guideline. The project is not yet implemented at the time of the rapid evaluation.

186. ***Project Implementation, Efficiency and Management*.** Management performance of all Government microfinance projects evaluated (except BLM-KIP) is generally average. Design of project implementation and management varies which in turn affects the project sustainability performance, such as:

- At P4K project, management of the project was effective and well-coordinated prior to decentralization, but varied by local government after decentralization. Effectiveness and sustainability in project implementation became dependant on the effectiveness and focus of the local government in implementing the project. However, participating bank appears to be reluctant to continue the project.
- At PEMP project, the management structure of the project is relatively clear and appropriate, including the provincial and district offices of the MoMF. Proactive involvement of participating banks is an important factor to ensure ultimate sustainability of the project.

- At KUBE project, the project achievement and sustainability of its implementation hinge on: (i) the success of SHGs to fully transform into new MFIs, and (ii) the level of support given by the Government to MFIs and FEAs.
- At P3-KUM project, control on project management is weak and there are inconsistencies in project implementation which is partly due to lack of attention and support from participating banks.

187. ***Achieving Objectives***. *In general, the performances of all four projects evaluated in meeting their objectives are highly varied.* Review on PEMP project documentation reveals that the project objectives and implementation strategies are the clearest, relatively realistic, and the most simple compared to other government microfinance projects evaluated, but with no implicit direct targeting of the poor. Based on the field survey, most beneficiaries are satisfied with PEMP project and beneficiary fishermen report significant increases in income. Performance of other projects are as follows: (i) P3 KUM does explicitly target the poor, but has limited success and does not provide sustainable support to cooperatives; (ii) P4K project objectives are clear, but too broad. It has clear indicators of success in poverty alleviation, but is lacking specific and clear steps to meet the objectives. In addition, the project also has some failings in sustainability; (iii) KUBE meets its community empowerment goals, while missing its microfinance institution (MFI) development goals; and (iv) BLM-KIP that has not been implemented yet may not increase access to finance, since grant provided only to those already have loan access. Decentralization seems to have impacted some projects' performance (i.e., P4K and P3-KUM) in achieving results and ensuring project sustainability.

188. Previous experiences show that strategy to help poor households (farmers, in particular) financially through the provision of both commercial loans and grants at the same time is counter-productive, such as in the case of BLM-KIP project. In the long-term, this kind of strategy would even make the poor very dependent on more loans and grants. In areas that experienced natural disaster and often received grants from either the Government or international communities, people tend to be reluctant to repay their loans, because they were used to receive grants through the same financial institution (commercial banks or MFIs) and consider the loans provided by these financial institutions as also grants not to be repaid.

189. ***Poverty Targeting / Site Selection***. *Generally, performance on poverty targeting or site selection is strong among projects which actively aim to serve the poor.* P4K and KUBE were the best projects in terms of poverty targeting – serving mostly the poor people in relatively poor areas. Both the comprehensive BPS data on poverty used in KUBE project to identify poor area and the Participatory Rural Appraisal (PRA) model at the village level used in P4K project to select individual beneficiaries are very effective in poverty targeting. On the other hand, PEMP project does not explicitly target the poor, but takes a more holistic approach to supporting fishing communities and fisher-related micro-enterprises. P3-KUM objectives do specifically include poverty alleviation, but cooperative performance in this area is limited. However, proactive outreach to women's cooperatives has impacts for the service to poor

women. BLM-KIP does not specifically target the poor, but focuses on agro-businesses of varying size.

190. The financial services provided through these projects cover almost all levels of poverty, from the very poor to the vulnerable non-poor and beyond. However, there are still many poor people who were not aware or excluded from the project. Exclusion of some rural poor households to the projects (i.e., non-beneficiaries) was, in general, due to three factors: (i) the ineffectiveness of the poverty identification approach and project awareness campaign by the government (i.e., PEMP and P3-KUM); (ii) the selection process of beneficiaries that was based on personal relationship (i.e., PEMP); and (iii) insufficient information and resources (i.e., PEMP and P3-KUM).

191. Often government loans are mandated for productive, entrepreneurial purposes only. However, limiting loan purposes only for business could limit the benefit of, and access to, credit by the poor. The poor also need loans for non-business purposes, such as education and housing, in order to protect and build their assets and businesses. Government programs that build savings accumulation among the poor (i.e., KUBE) seem to provide as much value as those that provide loans.

192. ***Monitoring and Evaluation***. To determine the effectiveness of microfinance programs in alleviating poverty and to establish a clear causality between microfinance and higher socio-economic welfare, *continuous project monitoring and evaluation on data and results is an important prerequisite*. *However, there has been surprisingly little monitoring and evaluation works on government microfinance projects, particularly related to impact evaluation*. This may be explained by the fact that government – and donors who finance the projects – oftentimes focuses more on directing resources toward reaching as many poor people as possible. It is very important to know which project concepts work best and which ones are less effective. Careful experimentation with sound control groups may provide such insights.

193. ***Cost effectiveness / Budget Structure and Funds Flow***. *In general, cost effectiveness/budget structure for all projects is difficult to measure either due to lack of information and general transparency in budgets and performance*. Based on findings from the field evaluation, PEMP is the best project with a clear budget structure (20-40% for TA; 60-80% for capital). It has also the most efficient flow of funding among all projects due to the application of online management information system (MIS) of Bank Bukopin with its partner cooperatives. On the other hand, KUBE project's budget structure is the most difficult to evaluate, because project budget, design and implementation changes yearly. Field evaluation also reveals some irregularities in funding at the local level and some projects rely mainly on local funding which is not sufficient for full implementation.

194. ***Collection Performance and Rate of Repayment***. *Collection performance are generally mixed, with rate of repayment is just average for all projects*. Evaluation on collection performance and rate of repayment is difficult to do due to the difficulties of getting the data.

However, based on the limited field survey it seems that rate of repayment is average for all projects. The best performers in collection and rate of repayment (i.e., PEMP and KUBE) appear to be projects that: (i) have a strong incentive element for partner banks/MFIs to collect; (ii) employ dedicated and well-trained FEAs; (iii) lend through well-formed self-help groups (SHGs); and (iv) target economically productive poor women. P4K project included BRI cash incentives to field extension agents (FEAs) for repayment, but had increasing problems with non-performing loans (NPL). The quality and availability of FEAs directly affects the collection performance and rate of repayments of P4K and KUBE projects. Sometimes FEAs are not readily available due to insufficient numbers of FEAs employed. At KUBE, MFIs capacity in collections is better than other projects due partly to well-functioning joint-liability groups. At PEMP, MFIs repayment to the bank is high, although clients' repayment to MFIs is often weak. While for P3 KUM, the project is still at the early stage of its implementation, but some problems with MFIs repayment has been encountered.

195. Some findings from the field quick assessment reveal that microcredit helps the poor to increase their income through entrepreneurial activities. The effects are often larger for women than for men. This finding, supported by much research in the field of microfinance, suggests that women should remain an important target group.

196. Portfolio quality appears to be higher in areas where executing banks played a more active role (i.e., Bank Bukopin). The government should take special care in aligning incentives for meaningful bank participation, as well as selecting banks with genuine institutional interest in serving the target group.

197. ***Capacity Building***. *Capacity building varies depending on budget allocation and capacity of FEAs*. Technical assistance provided through the government's microfinance projects is still limited, and typically focuses on the individual beneficiary level. Based on the field evaluation, all projects evaluated have technical assistance for capacity building component in project implementation. However, the human, technical and financial capacity of participating MFIs is generally very low. PEMP and P3 KUM project are generally weak in the provision of capacity building either to MFIs or end-beneficiaries. This is due to: (i) limited or insufficient budget allocation for TA; and (ii) lack of clarity on TA provider.

198. ***Beneficiary Satisfaction***. *Most beneficiaries (53-83% of respondents) are generally satisfied with the government microfinance projects*. Factors behind good satisfaction level are: (i) financial access of the poor is improving; (ii) ease of loan terms; (iii) mostly no collateral requirements and long-term loan tenor; and (iv) affordable interest rates. KUBE projects recorded the highest level of clients' satisfaction, mainly due to: (i) beneficiaries previously lacked access to finance; (ii) strong evidence of improvement in standard of living; and (iii) strong community bond/group formation. On the other hand, clients of P4K project have the lowest satisfaction levels because of small loan size and no follow-up – in terms of other lending opportunities and TA provision – after the project closed.

199. ***Project Sustainability***. *In general, most projects evaluated have weak financial sustainability*, mainly because of: (i) lack of planned "exit strategies" that gradually build commercial partners to assume all government necessary program activities; and (ii) components to build effective, sustainable linkages between program and the formal financial system to support growth and leverage government funds are not very clearly defined. PEMP project has a strong financial sustainability component due to active participation of Bank Bukopin and option for long term financing, post-program. KUBE savings-led funding mechanism is also an important step toward sustainable development and poverty alleviation. Evidence with P4K project shows that BRI lacks interest in continuing the project due to insufficient revenue flow to cover operational costs.

200. All the Government's microfinance projects evaluated were implemented either before or during the decentralization process. Meanwhile, the project guidelines were designed based on the centralized government approach. The lack of coordination and local ownership of project is one of the critical issues for successful implementation. The hand-over of the project from the central to the provincial governments during the transition period often faces many obstacles and should be carefully addressed so as to ensure project sustainability.

201. Government programming related to microfinance should always incorporate a long-term "exit strategy" which supports the development of a sustainable source of financing for both micro and small businesses and MFIs. Microfinance services provided through the government institutions were often given as one-time microcredits for micro and small business. Loans are largely given to community groups, individuals or cooperatives in the form of funds or credits to be revolved to other groups. This system does not effectively support the need of the business or MFI, which both need long-term access to repeated sources of finance and other services to be successful. Development of a sustainable source of funding would also provide much stronger leverage of government funding.

202. ***Community Organization through Self-Help Groups***. *Project success in community organization varies depending on budget allocation and capacity of FEAs to help form and develop SHGs*. KUBE and P4K projects have the strongest performance in community organization through the forming of SHGs with adequate technical assistance from FEAs.

203. Self Help Groups (SHGs) have become a well-known model in the microfinance industry to promote empowerment and access to information, financial services, and livelihood promotion for the poor, especially women. In all the government-sponsored microfinance projects evaluated, it is clear that the rural poor households participated still require both greater access to basic financial services and loan with affordable interest rates and terms and conditions. Thus, the formation of SHGs is very crucial precisely to meet this requirement and has the following benefits: (i) it enables beneficiaries to have a collective bargaining mechanism at the district/village level; (ii) it facilitates them to go out of their household and build relationships with various stakeholders; (iii) more than the loan received, the self-management

that it has fostered through capacity building provision has led to people/community empowerment.

204. However, in practice SHGs seem to depend very much on government initiative and support (i.e., support from field extension agents). That is why many SHGs ceased to exist when the project finished; the technical assistance provision stopped, leaving the SHGs that are not yet self-reliant and self-sustained alone on their feet. To achieve long-term success, SHGs need to be fully incorporated into MFI or bank activities over the life of the program, rather than supported and complemented by government field staff.

4.2 Recommendations

In order to increase project impact and sustainability:

205. *All government programming which creates new groups or new microfinance institutions and approaches must include a sustainable exit plan*, which clearly and realistically hands over the subsidized role of government to an institution which will continue to fulfil that role on commercial terms that are appropriate to the target client.

206. *More existing MFIs, both conventional and sharia-based, need to be involved in the projects design and implementation and receive adequate capacity building assistance*. The Indonesian microfinance sector is already highly fragmented, with over 50,000 MFIs in existence. The sector needs consolidation, not the continuing creation of small and weak institutions to serve specific government project needs. To the full extent possible, government agencies should work with and strengthen, existing institutions.

207. *Provided that capacity building provision to MFIs is adequate, MFIs must be given a chance to implement the government projects and determine the target beneficiaries independently based on its individual organization standard and operating procedures*. This way, MFIs can learn lessons from the process and improve the way it manages the project in a commercially sustainable and viable way. All government funding to MFIs should be performance based, to ensure that lessons are learned and MFIs move in a positive direction.

208. *Participation of executing (or channeling) banks and MFIs in the projects must not be by appointment, but through a fair and transparent bidding process overseen by a joint donors and government committee*. Involvement of banks in bidding process must not only be limited at their headquarters, but also be extended to their district branch offices where the projects are implemented. This will help ensure more affordable funding terms and conditions, such as lower interest rates, longer loan repayment periods and non-collateralized loans that are suitable to the local microfinance market. Competition is always good to better serve the financial needs of micro-entrepreneurs.

209. Most of the microfinance projects evaluated rely only on government and/or donors funding and with minimum capacity building assistance from commercial banks. This makes it difficult to ensure sustainability of the projects if the funding is stopped. An increased participation of large private commercial players is absolutely necessary to sustain the projects. *More commercial banks active in microfinance and social investors must be encouraged also to provide loans, equity or technical assistance to microfinance institutions to complement government funding*. These linkages and partnerships will lead the industry to a wider range of products, broader distributions systems, greater access for the poor to various microfinance services, and finally put microfinance in the economic mainstream.

210. Often, "subsidized" interest to MFIs through executing banks is actually quite high, when all cost computations are taken into effect. There are several options to bring down the interest rates to a more affordable level for microfinance market: (i) streamlining the credit processing mechanism to reduce operational cost; (ii) competitive bidding process for banks and MFIs wanting to participate in the project; and (iii) cross subsidized interest rates in which interest income of banks or MFIs with beneficiaries from relatively not-so-poor areas with higher interest charges can be used to subsidize interest rates for beneficiaries from other poorer areas.

211. *Loans for non-business purposes need to be incorporated into government's microfinance projects*. Often government loans are mandated for productive, entrepreneurial purposes only. However, limiting loan purposes only for business could limit the benefit of, and access to, credit by the poor. The poor also need loans for non-business purposes, such as education and housing, in order to protect and build their assets and businesses.

212. *To achieve long-term success, Self-Help Groups (SHGs) need to be fully incorporated into MFI or bank activities over the life of the program, rather than supported and subsidized by government field staff*. Although SHGs have become a well-known model in the microfinance industry to promote empowerment and access to information, financial services, and livelihood promotion for the poor, especially women; in practice SHGs formed over the course of government programming appear dependant on continued external support. That is why many SHGs cease to exist when projects end (i.e., P4K project).

<u>In order to increase project quality and outreach</u>:

213. *The use of Participatory Rural Appraisal (PRA) in complement with BPS poverty data is a very effective approach to identify target beneficiaries and to encourage the SHGs forming*. PRA is a community-based rural appraisal method to determine the local poverty level and select the target beneficiaries of the project. However, PRA approach usually requires longer time and highly skilled human resources to implement the project. In addition, best-practice rules in SHG formation should be respected and implemented to ensure success of joint-liability group guarantees and performance.

214. *Inaccurate poverty identification methodology can lead to some poor people being excluded from the project beneficiaries, or alternatively, inappropriate groups being forced into borrowing that they cannot afford*. Poverty indicators set by Bappenas are good for poverty identification at the very beginning of the project. This would help ensure that the project objectives were met. However, this was not sufficient enough if the identification does not also consider other poverty indicators commonly used, such as illiteracy rate, life expectancy and mortality, and done with the active participation of the target communities.

215. *Internal controls should be clearly structured into project design and linked to monitoring and evaluation*. It is clear that nearly every project had high fluctuations in implementation procedures and quality by region. The lack of project controls often leads to fraud.

216. *In the future, approved budget of the project should be made public, especially through the websites of relevant Ministries*. In addition, up-to-date outreach and other performance information from the projects should be easily available. The flow of funds for government microfinance projects is less bureaucratic than in the past, but still lacks transparency. This is supported by the fact that it was very difficult to get information on budgets and actual expenditures, both at the national and local level. Monitoring and evaluation on the actual flow and use of funds must be conducted regularly and compared with the plan. Any differences in the budget data must be analyzed accurately to find the real cause, and actions must be taken to solve any budget-related problems.

217. *To increase project transparency, a comprehensive client information management and sharing system need to be established*. An MIS model applied by Bank Bukopin, i.e., Mitramina on-line, is an ideal technology application model for microfinance to facilitate greater outreach to the poor and ensure transparency in funding provision. The large amount of data and information being generated at the district level by an increasing number of beneficiaries requires a mechanism that would capture, analyze, process and present the data to various stakeholders of the microfinance sector. A key feature of the MIS should be a microfinance client database with built-in statistical features that can: (i) provide a robust mechanism to capture information at every level to ensure records tracking of individual clients; (ii) analyze and present data and information in an easily accessible manner; (iii) create a technology linked platform that can reduce the cost of data gathering and lead to quick information transfer; and (iv) be developed as a sustainable business model. Ultimately, such a database could form the basis of a credit bureau for low-income borrowers, helping to build their financial track records and ultimately to include them more actively in the formal financial system.

218. *Disbursement pressure can promote fraud and should be countered with strong monitoring and evaluation roles for Government*. As much as possible avoid disbursing huge amount of funding to ill-defined target group covering the entire country in a short period of time, since this may lead to fraud (i.e., BLM-KIP project).

219. A micro-insurance product could be incorporated into overall project design to protect borrowers and MFIs.

<u>In order to improve project design and implementation</u>:

220. *A well-structure performance monitoring and assessment mechanism with clear and measurable performance indicators is a priority to be established in future government microfinance projects*. Microfinance projects are complex and long-running. There is often a lack of capacity and commitment to implement and maintain long-term oversight by local government agencies. This is mainly because clear oversight mechanisms to monitor and assess their performance are not well-established. This lack of performance evaluation affects also commitment of people at the village level and, therefore, the success of project implementation. It must be done periodically and corrective actions to improve it must be followed. A standardized approach to monitoring and evaluating program performance based on microfinance best practice would also help create clear guides and support for the overall development of the sector in a more sustainable direction, increasing its outreach and impact.

221. *Regular monitoring and evaluation of the projects implementation at different level of government agencies must be done, both internally and through an independence evaluator*. This is very important to determine the effectiveness of microfinance programs in alleviating poverty and to establish a clear causality between microfinance and higher socio-economic welfare. Moreover, at the groups of beneficiaries level, a simple and strict internal control mechanism within the group must also be encouraged and enforced, not only in ensuring the loan repayment but also in making sure that each and every members of the group follows a set of process in accessing and using the loan for the intended purposes.

222. *Financial feasibility studies should be conducted and extended to the bank branch level to ensure that the operational cost of implementation does not exceed interest and fee earnings*. The role of executing and channeling banks in all government microfinance programming is vital. If banks are not actively interested in promoting and sustaining the project, loan disbursals will be low and its terms and conditions uncompetitive. Commercial banks cannot be expected to engage in loss-making government projects effectively. Thus, a mutually beneficial partnership between government and commercial banks must be formulated.

223. *A careful and thorough project feasibility study to determine the financial viability of each microfinance project must be conducted at district and village level by each bank branches which specifically includes realistic positive and negative incentives for all implementing partners*. This is to ensure that the most cost effective operation is implemented and that operational cost will not absorb most of the interest income from the project.

224. *If funding through government microfinance projects is to directly reach out to the segment of bankable poor people, then participating banks must establish adequate measures*

to assess credit risk of lending to poor population. Credit application processes in banks sometimes are based on traditional credit assessment methodology which involves extensive documentation and paper work; thus, making it costly and time intensive and suitable only for large size loans. Such application processes are not suitable for smaller loan sizes borrowers who demand shorter loan processing time and lower processing costs.

225. *Following decentralization, projects need to be developed in cooperation with local government to increase local ownership and capacity to implement*. The effects of decentralization and the *lack of coordination and local ownership* of project is one of the critical issues for successful implementation. The hand-over of the project from the central to the provincial governments during the transition period often faces many obstacles and should be carefully addressed.

In order to focus and improve the role of Government:

226. *The Government should play an important role as an enabler, not direct provider, of financial services, by ensuring sound legal and supervisory systems, as well as capacity building mechanism for MFIs*. In most of the microfinance projects evaluated, the Government agencies (at the national, provincial and district level) put too much emphasize on disbursing (or providing fund) rather than improving the legal, supervisory systems and capacity building mechanism of the project which are necessary for the development of the industry. This might lead to a possible conflict of interest and discourage active participation from the private sector. When needed, Government funds should be used more as an incentive to encourage greater private sector participation in microfinance provision, and at the same time Government must improve regulatory environment and supervisory system.

227. At the provincial and district level, *the Government should build the capacity of key staff of ministries in best-practice microfinance standards*, to allow them to provide competent oversight. Good working knowledge of Government staff on best–practice microfinance standards is a key factor for the success of the project. Most of the Government microfinance projects evaluated relies mainly on its field staffs in building the capacity of community-based groups and MFIs and monitoring and evaluating their development and performance. The lesser their knowledge about the sector and the weaker their capacity to provide these tasks effectively are, the greater the likelihood of failure for community-based groups and MFIs to develop and perform is.

228. *To simplify the implementation mechanism of and to better coordinate the different microfinance-related projects of the Government, a centralized body to set standards and coordinate microfinance programming among Ministries and support development of microfinance programming at the provincial and district level could play a positive role in sector development and poverty alleviation*. The Government microfinance projects are managed separately by different ministries and regulated based on individual government department's policy. Coordination among them and within the various local government agencies is complex

and project design encompasses a wide range of often-conflicting field implementation. The body must be independent and set up jointly by different Ministries responsible for the government microfinance programs. It can serve as a one-door policy making body to guide all government microfinance programs, helping to align, coordinate, support and more effectively leverage government resources.

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