

Stable Outlook for Credit Guarantee Businesses

Analyst: Adrian Noer

PEFINDO is of the view that the outlook for the credit guarantee industry is stable. A contributing factor for the guarantee industry is the supporting regulatory framework, particularly Law No. 1/2016 on guarantees, which gives a strong advantage to credit guarantee companies over insurance companies who provide similar services. It is also supported by strong demand for guarantee schemes from government and non-government credit programs. However, PEFINDO also notes challenges in the industry in terms of potential higher claims, and a significant dependency on the government's credit program.

The credit guarantee business has showed significant growth over the past five years (2011-2015), as shown by the compound annual growth rate (CAGR) of its assets, net guarantee fees, and total equity, at 25.7%, 13.2%, and 30.1%, respectively. We note that this growth is supported by strong demand from the banking industry that needs guarantee schemes for its loans, especially SME loans. In addition, Bank Indonesia launched regulation No.14/22/PBI/2012 that banks need to increase the proportion of micro, small, and medium sized enterprise (MSME) loans in their portfolios from 5% in 2015 to 20% in 2018. The potential growth of the credit guarantee business is favorable in the near to medium term as many individual business players in the MSME segment are usually not bankable and need to be backed by guarantee schemes. Below are some of the key financial highlights of the industry.

Table 1. Credit guarantee highlights for December 2012-June 2016

as of / for the years ended	Jun-2016 (Audited)	Dec-2015 (Audited)	Dec-2014 (Audited)	Dec-2013 (Audited)	Dec-2012 (Audited)
Total Assets [IDR Bn]	13,839	12,726	11,227	8,828	6,966
Total Equity [IDR Bn]	10,914	10,444	9,554	7,051	5,327
Total Investment [IDR Bn]	9,785	9,770	9,052	6,585	5,577
Net Premium Written [IDR Bn]	747	1,288	1,495	1,355	1,190
Net Claims [IDR Bn]	392	1,018	1,043	897	630
Net Income After Tax [IDR Bn]	326	607	741	514	520
ROAA [%]	4.9%	5.1%	7.4%	6.5%	8.6%
Loss Ratio [%]	59.4%	73.7%	70.2%	69.1%	61.5%
Gearing ratio - total [x]	11	10	14	17	20
Gearing ratio - productive [x]	5	4	6	7	6

Source: OJK, processed by PEFINDO

The guarantee business was initially established in 1970 when the government founded Lembaga Jaminan Kredit Koperasi (LJKK), which focused on providing guarantees to cooperatives. This institution later changed its name and status to Perum Jamkrindo (rated idAA/"stable") and expanded its guarantee coverage to micro, small, and medium sized enterprises and cooperatives (MSMEC). The fundamental reason behind its establishment was to support MSMECs to obtain easier access to the banking sector to enhance their businesses and increase their contribution to the community and overall national economic development. Banks often are reluctant to provide lending to MSMECs due to inadequate assets to be collateralized, lack of financial information, and perception of high-risk business models. With the availability of credit guarantees, MSMEC debtors can have better access to funding from banks and other financial institutions. The guarantee business today has developed and not only gives guarantees to MSMECs, but also to other segments and sectors.

Regulatory environment supportive of potential growth

Before 2016, the guarantee business was only regulated by presidential decree or a ministry of finance regulation. On January 19, 2016 it received its own law, Law No. 1/2016, about guarantees. This law should give guarantee companies better opportunities to tap potential new business that was previously avoided due to conflicts with previous regulations.

Important points added to the new law include:

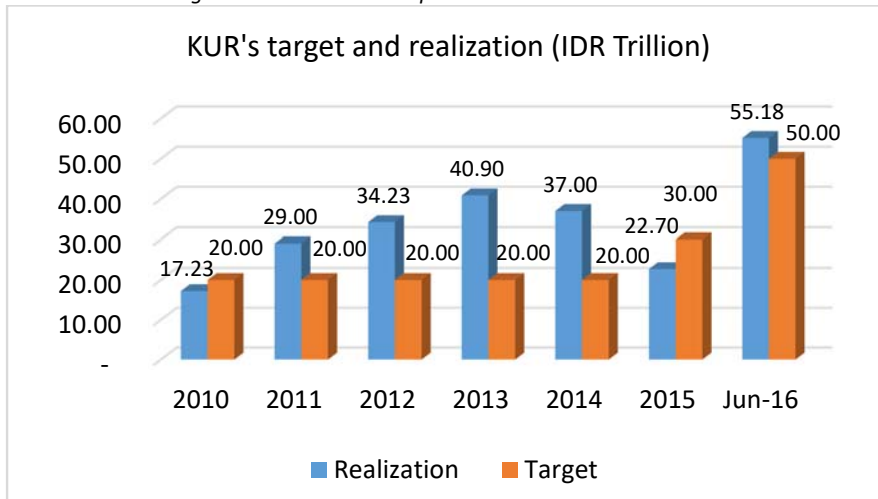
1. Article 61, paragraph 1: any kind of guarantee businesses can only be done by guarantee companies. Insurance companies conducting guarantees (surety bonds) are still allowed as long as it is still in the transitional period (three years) since the law was approved.
2. In Article 4, paragraph 5 says "to support micro, small, medium, cooperatives, and government related programs, the government can assign or delegate directly to the state owned guarantee company". Through this, any new government guarantee programs in the future will become new potential businesses for the state-owned guarantee companies.

The guarantee business includes credit, financing, Islamic finance, cooperative loans, and credit guarantee programs in partnership with the government or state owned enterprises. The guarantee company can also conduct other types of guarantees: debt securities, the purchase of goods in installments, trade, surety bonds, bank guarantees (contra bank guarantee), letters of credit, customs bonds, clearance bonds, guarantee consultation services, and any other types of guarantee schemes that have been approved by the Financial Services Authority (OJK) as the regulator.

Potential business from government and non-government credit programs

With the adoption of the new guarantee law, we are of the view that demand will experience positive growth in the near to medium term. We believe that growth will come from the guarantee requirement for the government’s credit program, and other commercial loans. One of the biggest contributors comes from the government credit program Kredit Usaha Rakyat (KUR). KUR is a type of loan/financing that is distributed to MSMECs that in terms of business is already feasible, but in terms of financial administration is not bankable yet. Feasible here means that the business has good prospects in the future and the ability to repay the debt. SMECs that are expected and encouraged to access KUR are from the productive sectors such as agriculture, fishery, trade, industry, forestry, and financial services. From its launch in 2007 up to June 2016, the KUR program has helped MSMECs increase their participation in the nation’s economic development. KUR growth can be seen in Chart 1.

Chart 1 – KUR’s target and realization comparison in IDR trillion



Source: Ministry of Economic Coordination – processed by PEFINDO

From the chart above, it can be seen that from 2011 until June 2016, the realization of KURs has almost always been above the target set by the government. In 2015, KUR realization fell below the target due to a temporary vacuum of seven months (February to August) related to the transition period from the old KUR program into the new program from the new government. We note that this situation is one of the constraints on the credit guarantee business as it depends heavily on the government’s credit program. Credit guarantee companies need to diversify their businesses and enlarge non-government credit programs to avoid any similar discontinuation program going forward.

Besides the KUR program, which is only assigned to state owned guarantee companies, potential growth comes from other types of commercial loans. One of the sectors that has become a priority in recent years is infrastructure, which needs abundant funds and capital. The banking industry and non-bank financial institutions have been encouraged by the government to boost the portion of credit/financing to the infrastructure sector, which opens up the opportunity for guarantee companies to get involved in providing guarantees for infrastructure loans. Considering the importance of infrastructure guarantees, in 2009 the government set up PT Penjaminan Infrastruktur Indonesia (Persero) (Indonesia Infrastructure Guarantee Fund), a special guarantee institution for the infrastructure sector, which is specifically engaged in guaranteeing infrastructure projects under the public private partnership mechanism.

Many other commercial loans can be a potential source of growth. This is inseparable from the calculation of the bank's risk weighted assets being connected to the presence/absence of loans secured by guarantee schemes. More and more banks are using the credit guarantee mechanism to lower their risk weighted asset calculation to strengthen their capitalization profiles.

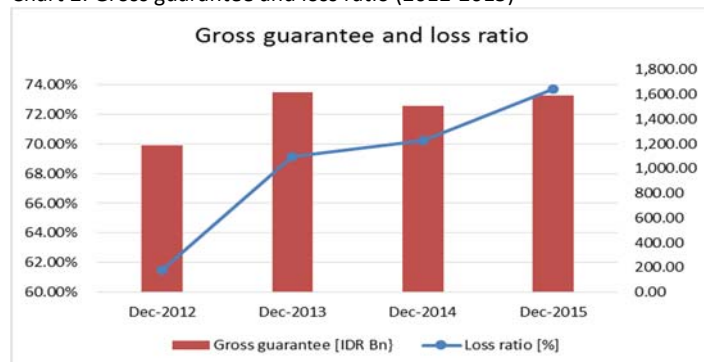
The ample potential business in credit guarantees is supported by OJK regulation No.11/POJK.03/2015 on regulations on national economic stimulus for commercial banks, which, in article 4, states that risk weighted assets calculations for MSME loans backed by guarantees from municipal guarantee companies will be scored at 50% from the previous score of 100%. This has a positive impact as many municipal guarantee companies or Jaminan Kredit Daerah (Jamkrida) have been established to support and cover potential loans that need to be guaranteed in the regionals. To date, there are 14 Jamkrida operating in 14 provinces throughout Indonesia.

Potential challenge from increasing claims

The growth of the credit guarantee business is constrained by several factors. Firstly, potential higher claims as it distributes guarantees mostly to the MSMEC segment, which naturally has a higher risk profile. As a consequence, it is important for the credit guarantee companies to have sizable capital to absorb potential losses. The next constraint comes from competition with the insurance industry. Established insurance companies that have larger capital are a threat to the credit guarantee industry. To strengthen their business penetration, credit guarantee companies need to enlarge their infrastructure such as product varieties, branches, and number of employees. Another factor that can constrain growth is a high dependency on government credit programs. Considering the biggest portion of business is still derived from the government's KUR program, a sudden stop or delay in realization of this program can hamper business expansion. We are of the view that the importance of gradually expanding business outside the government's program is crucial to maintain sustainable growth.

Despite the positive growth from guarantee fees that credit guarantee companies enjoy from debtors, claims have been rising, as shown by the increasing loss ratio for 2012-2015 in the chart below.

Chart 2: Gross guarantee and loss ratio (2012-2015)



Source: OJK – processed by PEFINDO

From the table above, we see that the loss ratio has increased persistently every year, even when guarantee fees declined. We assume that this situation was contributed by the high concentration of business in the MSMEC segment that naturally brings higher risk. The upward trend is mainly caused by increasing non-performing loans (NPL) from the MSME segment in the banking industry, up to 4.4% in 9M2016 from 4.0% in FY2015. We are of the view that guarantee companies need to diversify their business. Expansion to other loan products is needed to reduce their dependence on government credit programs. For the balance of composition of government and non-government credit programs in the medium term, we expect guarantee companies will have lower claims and could increase their revenue through higher and more competitive guarantee fees. We are also of the view that socializing financial literacy to SMEs is essential to ensure future growth and improve their financial health viability in the near to medium term. With so many commercial credit opportunities that have not been touched by the guarantee industry, we note that the infrastructure readiness and prudent underwriting process will also be the keys to support growth in the near to medium term.

Table 2: Comparison of guarantee companies in PEFINDO's portfolio (in IDR billion)

Company	Rating	Outlook	Total Assets	Total Equity	Net Guarantee Fees	Net Claims	ROAA	Loss Ratio	Gearing Ratio
Jamkrindo (FY2016)	idAA	Stable	11,859.9	9,476.2	1,268.0	994.4	5.8%	72.7%	11.0%
Jamkrida Jabar (1Q2016)	idBBB	Stable	185.9	149.1	3.8	1.7	2.0%	59.0%	8.6%

Source: PEFINDO

The above ratios have been computed based on information from the companies and published accounts. Where applicable, some items have been reclassified according to PEFINDO's definitions. Total assets, total equity, and net guarantee fees are in IDR billion.

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