

SMALL MEDIUM ENTERPRISE (SME) LENDING EXPANSION STRATEGY (CASE STUDY AT PT BANK BJB TBK)

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Abstract-Data of Bank Indonesia stated that Small Medium Enterprises (SME) loan portfolio by the end of April 2012 amounted to 20.65% of the total national banking loans. Currently the banks, ranging from the state owned banks, private banks, rural banks (BPR), joint venture banks, to foreign banks are competing to grab SME market. The reason is that the SME sector is a profitable and huge market. Bank BJB is one of the commercial banks based in West Java, where in the region, small medium enterprises are growing. It is opportunity of Bank BJB to focus on expanding its SME loans to the region. Existing strategies that adopted by Bank BJB is by opening new branch offices, channeling strategy and acquiring of existing BPR. This study aims to compare the three strategies above in terms of strength, weakness, opportunity and threat that likely occur. Method of analysis to be used is SWOT analysis. Once known Strength, Weakness, Opportunity and Threat for each strategy, then use the TOWS matrix to map out the existing strategy that fits with the use of strength, weakness, opportunity and threat for SME lending expansion of Bank BJB. CAMELS ratio will be used to measure the performance of BPR while Discounted Cash Flow (DCF) is method to valuate the value of BPR. Based on the results, it can be seen that strategy of opening a new branch has strength in terms of management authority which head office can control loans quality of the branch office while the weakness is difficult to find a strategic location for new branch office and it needs big initial investment. Strategy of opening new branches will remain to continue, especially in the district and sub-district area. The channeling strategy has advantage because it does not need big initial investment so the capital can be disbursed as loans effectively. This strategy will be implemented primarily to BPR bank that has broad coverage and low of NPL. The acquisition strategy has advantages in terms of fully authority of head office to control loans quality of the branch offices. This strategy can expand its loans by the existing infrastructure and resources of BPR acquired.

Keywords: SME lending, acquisition, expansion strategy

1. Introduction

Some banks nowadays begin to look small and medium enterprises sector as potential market. It used to be only Bank BRI, regional government bank (BPD), and rural bank (BPR) that interested in financing small and medium businesses. Currently, top banks began to roll in this market. Moreover in UK, a bank which is Nationwide recognize that SME lending would be a good strategic fit to the existing business, given the strong franchise, broad distribution network and current exposure to personal current accounts and commercial lending activities (Goff, 2012).

Bank Indonesia Data (2012) writes that the SME loans portfolio by the end of April 2012 amounted to 20.65% of the total national banking loans. Meanwhile, according to data, cooperatives and SMEs contribution to gross domestic income (GDP) reached 56.5%, and absorbing employment reached 66.74% (Kemenkop, 2011). Unfortunately, SMEs major contribution has not been widely supported by financial sector. SME loans market is still very large, only about 30% of the total 51.3 million units SMEs are financed by banks (Bank Indonesia, 2012). Another interesting thing is the interest margin of SME

loans market, it was above 15% (Bank Indonesia, 2012). Moreover, the People's Business Credit (KUR) now put interest rates up to 20% per year. In addition, the SME sector is the sector most resilient to the turmoil of economic crisis. It was proven by the persistence of SME sector through monetary crisis in Indonesia during 1998.

The above reasons led the banks to compete to grab SME market, ranging from state owned banks, private banks, rural banks (BPR), joined venture banks, to foreign banks. The reason is that SME sector has a profitable market and has huge opportunity. Bank BJB bank is one of commercial bank which its base of operations in West Java, decided to grab SME loans market. It was noticed that West Java has a huge potential for lending credit because of huge number of small and medium businesses.

2. Business Issue Exploration

A. Conceptual Framework

As a guideline for this study, a framework is described as figure below:

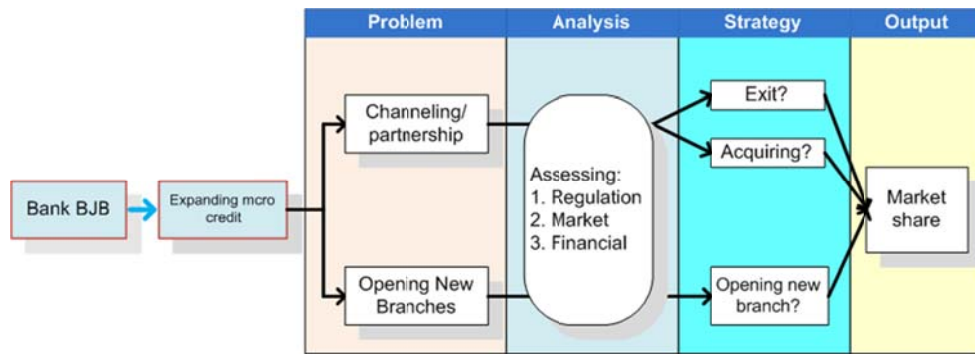


Figure 1. Conceptual Framework

Based on the above figure, shows that PT Bank BJB look to increase market share of its SME lending. One of existing strategy of bank BJB to expand its SME loans is by channeling partnership. Channeling Partnership is strategy of Bank BJB to expand its loans through bank BPR as partner. The obstacle faced is the high level of NPL of the bank BPR. Another problem is the bank's management of BPR has not implemented good corporate government. In some cases, it causes bank fraud. Another strategy is to open a bank BJB branch specifically for SMEs lending. But through this strategy Bank BJB has disadvantages in terms of high initial investment and takes time to penetrate the market. BJB bank plans to acquire the banks BPR, which is already as a partner for its SME lending.

To achieve this strategy, Bank BJB needs to pay attention to related regulations including government regulations, the regulations of Bank Indonesia (Central Bank) and BAPEPAM (Securities and Exchange Commission) because BJB is a public company. Further strategies also need to analyze whether the strategies of banks BPR can be in line with the Bank BJB strategies. The next are indicators that have been set by Bank Indonesia to assess the health of a bank that is CAMEL (Capital, Assets, Management, Earnings and Liquidity). These indicators will be used to assess three of BPR. The last step is to conduct a fair price through valuation of the three BPR. This acquisition strategy is expected PT Bank BJB can increase market share of SME lending in those cities.

B. Method of Data Collection and Analysis

The data are collected from primary and secondary data. Data collected from primary sources are the interviews with bank management and management of BPR to be acquired. Sources of secondary data obtained from various reports which are Bank BJB annual reports, Bank Indonesia Report and several studies and news from various sources.

The below stages are analysis methods to solve the business problems:

1. IFAS/EFAS MATRIX

IFAS MATRIX is used to identify the internal condition of the company and EFAS MATRIX is used to determine the external conditions of the company. By using IFAS MATRIX, we will identify strengths and weaknesses in terms of BJB Bank SME lending. While using EFAS MATRIX, we will identify the opportunity and threat in the SME lending industry.

EFAS and IFAS matrixes are derived from SWOT Analysis. The central purpose of the SWOT analysis is to identify strategy that align, fit or match an organization's resources and capabilities to the demands of environment in which the organization competes (Ritson, 2011, p. 41).

2. General Electric Matrix

After knowing the external and internal scores using the IFAS/EFAS MATRIX, it will be determined appropriate generic strategy in determining SME lending expansion strategy in accordance with General Electric Matrix.

3. TOWS Matrix

Tows matrix used to determine the appropriate strategy in the expansion of SME lending.

4. Corporate Valuation

Corporate valuation is used to determine the value of the company to be acquired. In this case, we will determine how the fair value of the bank BPR to be acquired. This value will be used as the reference price in the bank BPR acquired.

Corporate valuation method to be used in this thesis is the DCF method or Discount cash flow. The two other methods are Relative Valuation and Contingent Claim Valuation.

5. CAMELS Ratio Analysis

Having in mind the appropriate strategy, it will be counted towards their respective risk strategies by measuring the performance of each indicator banks Indonesian banks have been determined by the CAMELS ratio.

C. Analysis of Business Situation

BJB bank has been pursuing a strategy of SME loans expansion through opening new branches and partnering with banks BPR. The following is the last condition of the strategies:

1. Opening New Branch

For this lending strategy, bank BJB has opened a lot of branches. Until 31 December 2011, the bank operated 51 branch offices, 203 sub branch offices, 55 cash offices, 90 payment points, seven mobile cash and 528 ATMs (Bank BJB, 2011).

2. Channeling Partnership

For this lending strategy, BJB Bank currently has cooperated with some banks BPR. Bank BJB has distributed the fund in the form of equity participation. BJB Bank currently has equity investments in 36 banks BPR. The equity amount ranges from 1% to 20%. At each three banks BPR to be acquired, Bank BJB has shareholdings as follows: at Bank BPR Warung Kondang (Cianjur), it has shares of 12.69%, at Bank BPR Jalan Cagak (Subang), has shares of 12.22% while in BPR Garut Kota, Bank BJB owns shares of 8.26%.

Table 1. Comparative Strength of BPR and BJB Branches

No.	Strength	BPR	BJB Branches
1	Growth	√	
2	SME lending experience	√	
3	LDR	√	
4	Coverage	√	
5	ROA		√
6	NPL		√
7	DPK		√
8	CAR		√

Source: Bank BJB (2012)

When will implement the acquisition and channeling strategy, Bank BJB faces some constraints including high on NPL ratio, third party funds are low and low CAR ratio. The advantages of BPR comparing to Bank branch is their high growth rates, a wide range of coverage up to a remote area and have experience in dealing with SMEs loans.

Based on the above, it can summarize some major problems in expanding SME lending of Bank BJB, as follows:

1. How is the evaluation of SME lending expansion strategy that Bank BJB has been doing through branch offices and partnership patterns, is it still worth to be continued?
2. Which strategy is more feasible to expand SME lending of Bank BJB?
3. Is the bank BJB plans to acquire three banks BPR the right step?
4. How about the implications that will result to the banks' risk (CAMELS Ratio) of Bank BJB?

3. Business Solution

A. Alternative Business Solution

1. Chanelling Strategy

Credit distribution by channeling pattern is the pattern of lending by third party institutions/companies and then distributed to the debtor. Bank BJB channeling pattern has been implemented in Bank BPR Jalan Cagak, BPR Garut Kota and BPR Warung Kondang Cianjur.

2. Opening new Branches

The expansion of the bank office network BJB as an effort to expand market penetration, and it has a tremendous opportunity. In addition, the network expansion is intended to expand services for people with ease, speed, comfort and hospitality.

3. Acquiring the existing BPR

PT Bank BJB plans to take over three rural banks (BPR) in West Java, in an effort to expand the scope of business to micro segment. Three BPR banks that will be acquired include BPR Cianjur, BPR Garut Garut Kota, and BPR Jalan Cagak Subang.

B. Analysis of Business Solution

Based on the analysis, it can be conclude that the total score for IFAs matrix is equal to 3.7. This suggests that the Bank BJB has greater strength than weakness to get into SME lending market. Bank BJB has strong advantages, especially in terms of capital. In other cases, the brand, technology and quality resources are also owned by the bank BJB. Based score indicates that the bank BJB worthy to enter the

microfinance market.

In the score matrix EFAs, Bank BPR Warung Kondang has the highest score compared to other banks. Bank BPR Warung Kondang has a score of 3.4 while the Bank BPR Garut Kota and BPR Jalan Cagak respectively have a score of 3.15 and 2.7. Bank BPR Warung Kondang has advantages especially in terms of relatively low in NPL compared with two other BPR. Furthermore, Banks BPR Warung Kondang also has advantages in terms of loan disbursement.

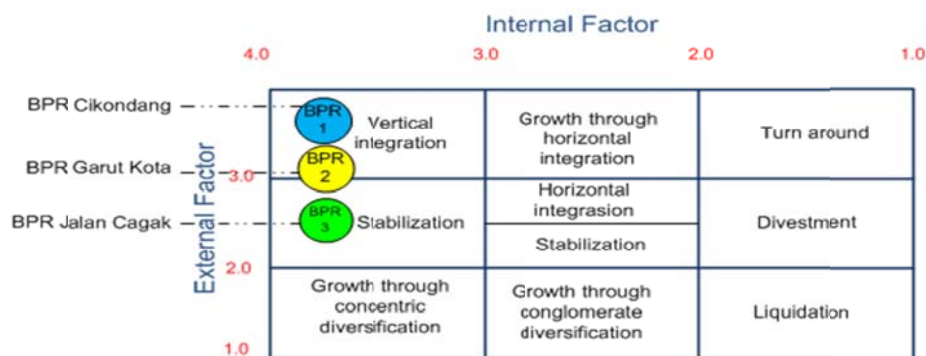


Figure 2. General Electric Matrix

Based on the above, it can be seen that Bank BPR Warung Kondang is in the field of vertical integration, as well as BPR Garut Kota is in column of vertical integration. This suggests that both BPR supports BJB bank strategy to expand SME lending through vertical integration. Column shows that there is opportunity in micro-finance bank while BJB has strengths to enter the market. Vertical integration strategy can be done through the acquisition of both Bank BPR or by opening new branches.

The third BPR Jalan Cagak is located in the column of stabilization. This means that banks Bank BPR Jalan Cagak less support the expansion of SME lending that will be planned by the BJB bank. So the bank BJB has the option whether to acquire the bank BPR Jalan Cagak or open a new branch in Jalan Cagak area.

The following are analysis to some alternative strategies of Bank BJB in disbursing SME lending:

1. Scenario 1- Channeling Strategy

The cooperation is beneficial to both parties. For Bank BJB, this cooperation scheme is part of the acceleration in credit growth, while for Bank BPR, this scheme can overcome limitations of their liquidity to keep lending to the debtor. Other bank that has implemented such the scheme is Bank BNI. This credit is given through channeling or linkage program. Until the end of February 2011, the small business lending of Bank BNI through a linkage program, both for KUR and non-KUR reached Rp3, 36 trillion through 1,633 cooperatives and BPR to 293,292 rural microenterprises.

When Bank BJB implements this channeling strategy, the aspects that will be directly affected by this strategy are the capital and earnings. While Assets, Management, Liquidity and Sensitivity to risk, will not be affected directly. When Bank BJB lends SME lending, then there are funds are distributed, source of these funds is capital of the bank which will affect capital of the bank. Return earned from interest income will go back to the bank and will add to earnings of the bank.

2. Scenario 2 – Opening New Branch

The result of the analysis concludes the impact caused by the strategy of opening new branches to the bank performance indicators outlined by CAMEL ratio. Bank BJB needs to spend capital expenditure to build a branch office so this strategy will affect the capital. Profit earned will be retained earnings and

increase the company's assets as well as the loss suffered by the branch office will reduce the company's assets. To open branch offices, enterprises need to prepare human resources to manage it, it will influence employee performance ratio. Liquidity ratio will be affected by non performing loans of branch offices.

3. Scenario 3- Acquiring Existing BPR

The Company expects, with the acquisition of bank BPR, enhancement of SME lending could be more significant. As of June 2012, total SME lending of Bank BJB has reached Rp2,63 trillion of total loans amounted to Rp32,71 trillion (Bank BJB, 2011). Synergy is defined as the difference between the combined value of the firms and the projected cash flow of the combined firm. The highest synergy of a typically shows the most profitable solution pertaining the solution scenario. Therefore, to determine the most probable solution, we will attempt to compare the total value of three BPR banks with projected cash flow of the scenario.

4. Conclusion and Implementation Plan

In this section, as we have described several matters regarding the implementation in the previous section. These items will include item as described in the following:

- In SME lending expansion strategy, acquisition strategy of BPR is recommended for implementation in the bank BJB. Some weaknesses in the bank BPR include the lack of human resources, low performance and system and technology is still lagging, bank BJB should provide training and set the same standards for the employees off bank BPR. In terms of systems and technology, it should be applied to a system of banking technology, which is already applied in BJB bank to support its performance.
- Banks BPR recommended to be the first priority in the acquisition plan are Bank BPR Warung Kondang and Bank BPR Garut Kota. While Bank BPR Jalan Cagak is not recommended for acquisition, in addition to the acquisition costs are relatively high, Bank BPR has a higher risk, especially in terms of NPLs compared to the other two banks BPR.
- The opening of a new branch office is also one of the lending strategy that should be continued. Branch office has a broader function, as well as lenders but also has a function as a third party collector of funds and office services for customers.
- Channeling strategy can be one alternative in lending. Portion of loans through channeling strategy should be lower than through strategic acquisitions and branch offices.

Road Map

To catch the potential growth of Indonesia, Bank BJB has strategic plans with vision of transforming bank bjb into a bank with full financial services, as stated on its vision to create a strong sustainable growth and profitable national bank which leading in service and performances. Below is the proposed strategy to achieve Bank BJB goals.

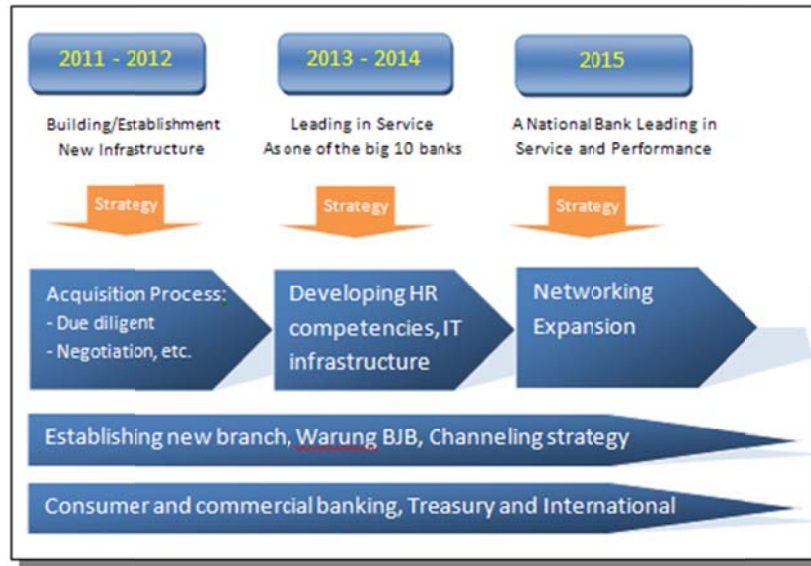


Figure 3. Proposed Road Map of Bank BJB

One of the strategies recommended for the lending bank BJB is through the acquisition of existing BPR bank. Analysis of the strengths and weaknesses are described in previous section. The next step companies need to implement these strategies through various stages. Systematic and comprehensive evaluation is needed to determine whether the target company is a viable candidate for acquisition and to increase corporate value over the long term. In addition, the company must perform due diligence in order to have complete information as possible to determine the strengths and weaknesses of candidates for the target company. Due diligence is conducted on various aspects such as finance, marketing, production and technology, organization and human resources. In terms of legality, juridical firms need to see that the acquisition does not violate or conflict with applicable laws or regulations. The following are the stages of the process of acquisition.

- a) First Identification
At this early stage the bank BJB find and collect as much information as possible BPR potential for acquisition.
- b) Screening
Screening is the process of selecting which of the filter as well as some of the most viable target for acquisition.
- c) Formal Offering
The company formed a team responsible for the execution of mergers and acquisitions. When companies recruit skilled personnel from outside (external advisor) then this party will join to the team and then the team with the target approach. The first approach is carried out formally with official notification in writing addressed to the top management about the purpose of the acquisition of the target company (letter of intent). At this stage, the assessment of mergers and acquisitions between the two sides and talk about the price to be agreed upon.
In this formal offer, the information should not be made open as this will affect the market price of the stock, especially if the target company is a public company.
- d) Due Diligence
Due Diligence or due diligence is a thorough and in-depth investigation of the various aspects of the target company. Due diligence is intended to provide as much detail as possible about the condition of the target company views from all aspects. Due diligence was conducted on aspects of legal, financial, organizational and human resources, marketing, technology and

production.

a process of due diligent need to be done to ensure that the analysis regarding the acquisition is correct. Matter the personnel that need to be included in the due diligent process are as follow:

- a) Regulatory which will involve lawyer as a critical part of the due diligent.
- b) Finance and accounting which will involve the financial and accounting
- c) Human resource
- d) Public relation
- e) Management of each bank
- e) Negotiation/Deal

There are two sides to the target company must approve the acquisition process to run normally the management and shareholders. Once both parties agree to the terms agreed between the acquirer and the target, the next step is to sign a memorandum of agreement (memorandum of understanding) as an extension of their deal.

- f) Closing

If negotiations reach an agreement, means the formal approval of mergers and acquisitions have been completed, while the next is done closing. In the case of the merger, the closing means the end of the legal status of the company in the merger into the company resulting from the merger along with the submission of the merged company's shares to the shareholders of the merged company. While on the acquisition, closing means the deposit paid by the acquirer to the shareholders of the acquired company. At this stage all the submission documents related to mergers and acquisitions have been completed. Besides underwriting and compensation issues are also crucial completed at closing.

- g) Integration Process

Matters that need to be taken care of will be described as follow:

The process of integration planning which will not only include the integration of the value chain as described in the previous chapter but also the integration of following issues:

- People
- Technology
- Product and service
- Operation
- Brand
- Customer
- partner

- a) Regulatory Point of View

In term of the regulatory point of view of this business issue, the most prominent concern is that the acquisition of BPR will result in the monopoly of the current sector of commercial banking. Thus to analysis this, we must to determine the appropriate regulation pertaining monopoly applicable in Indonesia. Such existing regulation, acknowledged as Government Act No. 5 of 1999 regarding the prohibition of the practice of monopoly and unfair business practice. This regulation defines the bounder where a firm is considered to monopolize a business sector or not. The analysis of the business solution proposed in this study and it adhere to the law is described below.

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