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## **STUDY:** **WASH MICROFINANCE AND GRANT BENEFICIARY**

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Cover Page Photo: A community member in Tangerang district benefitted sanitation micro credit from Benteng Mikro Indonesia Sharia Cooperative. From this micro credit, she is now having a toilet and septic tank in her house.

Photo by Pritta Basuki/USAID IUWASH PLUS

USAID INDONESIA URBAN WATER, SANITATION AND HYGIENE  
*PENYEHATAN LINGKUNGAN UNTUK SEMUA (IUWASH PLUS)*

# STUDY: WASH MICROFINANCE AND GRANT BENEFICIARY

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Sanitation and Hygiene *Penyehatan Lingkungan untuk Semua*

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# Acronyms

|                   |   |
|-------------------|---|
| A2F               | Access to Finance   |
| APBN              | <i>Anggaran Pendapatan Belanja Negara</i> /National Government Budget   |
| B20               | Bottom 20 % of the population in terms of wealth  |
| B40               | Bottom 40% of the population in terms of wealth   |
| BABS              | Buang Air Besar Sembarangan/Open Defecation   |
| BPR               | Bank Perkreditan Rakyat/Rural Bank  |
| BPS               | <i>Badan Pusat Statistik</i> /Statistics Indonesia  |
| CAR               | Capital Adequacy Ratio  |
| CSR               | Corporate Social Responsibility   |
| DHS               | Demographic Health Survey   |
| GL                | Group Lending   |
| GOI               | Government of Indonesia   |
| HH                | Household   |
| IDB SANIMAS       | Islamic Development Bank – Sanitasi Berbasis Masyarakat   |
| IPAL              | <i>Instalasi Pengolahan Air Limbah</i> /Wastewater Treatment Plant  |
| JSP               | <i>Jamban Sehat Permanen</i> /Permanent Healthy Latrine   |
| JSSP              | <i>Jamban Sehat Semi Permanen</i> /Semi-Permanent Healthy Latrine   |
| KBMI              | Koperasi Syariah Benteng Mikro Indonesia/Benteng Mikro Indonesia Sharia Cooperative   |
| KOMIDA            | Koperasi Mitra Dhuafa/Mitra Dhuafa Cooperative  |
| Koperasi BAIK     | Koperasi Baytul Ikhtiar/Baytul Ikhtiar Cooperative  |
| LDR               | Loan-to-Deposit Ratio   |
| MCK               | <i>Mandi, Cuci, Kakus</i> /Bathing, Washing, Toilet   |
| MFI               | Microfinance Institutions   |
| NBP               | Nusantara Bona Pasogit  |
| NGO               | Non-Government Organization   |
| NPL               | Non-Performing Loan   |
| OJK               | <i>Otoritas Jasa Keuangan</i> /Indonesia Financial Services Authority   |
| P2KP              | : Program Penanggulangan Kemiskinan di Perkotaan/Urban Poverty Alleviation Program  |
| PDAM              | <i>Perusahaan Daerah Air Minum</i> /Municipal Drinking Water Company  |
| PUPR              | Pekerjaan Umum dan Perumahan Rakyat/Public Works and Housing  |
| ROA               | Return on Asset   |
| ROE               | Return on Equity  |
| RT                | <i>Rukun Tetangga</i> /Smallest Neighborhood Unit   |
| SDG               | Sustainable Development Goals   |
| STBM              | <i>Sanitasi Total Berbasis Masyarakat</i> / Community-Based Total Sanitation  |
| USAID IUWASH PLUS | U.S. Agency for International Development Indonesia Urban Water Sanitation and Hygiene <i>Penyehatan Lingkungan untuk Semua</i> |
| WASH              | Water, Sanitation, and Hygiene  |

# I. Executive Summary

## I.1. Executive Summary

USAID IUWASH PLUS conducted a study to observe the distribution of sanitation financing provided by government in the form of grant and Microfinance Institutions (MFIs) in the form of loan to community members. Analysis on the study of WASH microfinance and grant beneficiaries highlights and suggests a number of important points as follow:

- Public awareness, especially among the financial institutions, on WASH sector is still limited. WASH sector is not known to the financial sector. Even though some donor agencies and programs are beginning to introduce WASH sector as a potential market for financial institution, the effort is still considered limited and at very early stage. There is no official and structured effort in the market to introduce and provide a clear picture of the sector as well as the potential for financial institutions to serve the sector.
- Most financial institutions are not aware of the government's programs to disseminate information on the importance of sanitation. These efforts have minimal impact for the financial institutions, even for MFIs that are day-to-day dealing with customers who are also targeted by the government in the WASH sector. Even when MFIs are informed about the need of proper sanitation for households (HH), they do not have the capacity to understand the best way to serve this need. There are no step-by-step guidelines and business model of approaches that the MFIs can adopt and implement.
- During the in-depth observation, most grant respondents as well as the microfinance respondents in Deli Serdang, North Sumatra were not aware of WASH product loan from MFIs. Furthermore, MFI customers claimed that they were not informed about sanitation loan prior taking it. This finding demonstrates low public awareness on sanitation loan. Therefore, MFIs marketing is critically required because the low-income community does not have good understanding on how microfinance offers the sanitation products. This situation creates a large room to achieve the Sustainable Development Goals (SDG) targets in addition to grant model or approach.
- There is an overlap between the MFIs customers and grant beneficiary targets. Although the government grant programs do not specifically target low income community, most households who practice open defecation are found in the low income population. However, the overlap does not seem interfere the market potential directly.
- Before engaging with MFIs, the MFI customers were not served by any formal financial institutions. Therefore their needs of services go further beyond sanitation loan. Thus, the financial institutions do not serve them because they do not want to have any issue with these MFI clients repayment. The challenge for some MFIs when the loan overlaps with the grant at community level is that the customers often request to postpone taking the loan because they are waiting if they are eligible to receive a grant.
- In the 20% poorest (B20) and the 40% poorest population (B40), microfinance also classified the poor into two levels, i.e. productive poor and non-productive poor. The non-productive poor are mainly the hardest to serve. The MFIs understand their market targets based on local

knowledge of a situation that makes a microfinance business sustainable and able to serve the markets in sustainable manners. Thus, every grant should be strategic so that it will not disturb the MFIs' market sustainability.

- Most B20 and B40 do not have sufficient collateral to guarantee their loan. Thus, the most suitable services for these groups are MSFIs that use group loan model, providing unsecured loan services. This type of loan is different from individual loan that requires collateral. For financial institution that requires collateral, guarantee mechanism can help replace collateral requirement. The guarantee scheme should be provided by companies regulated under Financial Services Authority (OJK).

## **1.2. Study background**

### **Objective**

This study aims to present the WASH microfinance market profile and WASH-related grants or subsidy program target to USAID IUWASH PLUS and its GOI partners so that they have a better picture of the segment that each intervention serves. This study also aims to learn the overlap between the WASH microfinance market and the grant target, if any, as well as to assess its impacts. This study is limited to and specifically looking at MFIs and Government (appointed program) as the provider in the market. Therefore the study will:

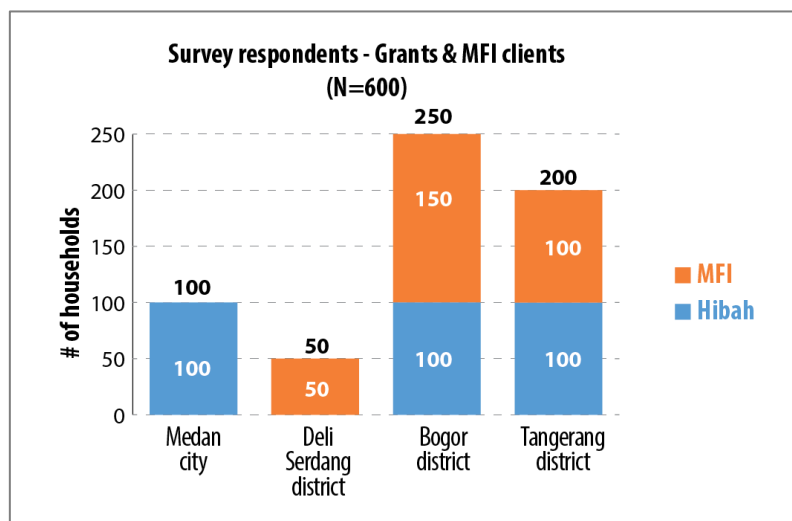
- Identify which segments of the population (by wealth quintile, and/or other criteria) that will become the most appropriate WASH microfinance customers.
- Examine how grant and subsidy programs (from the GOI or private sector sources such as CSR programs) have been targeted in the past and how they have impacted the WASH microfinance market; and in the event that grant programs have had a negative impact on WASH microfinance, propose recommendations for improvement such as through the introduction of more rigorous targeting criteria.



## 2. Demographic Profile of Respondents and Program Profile

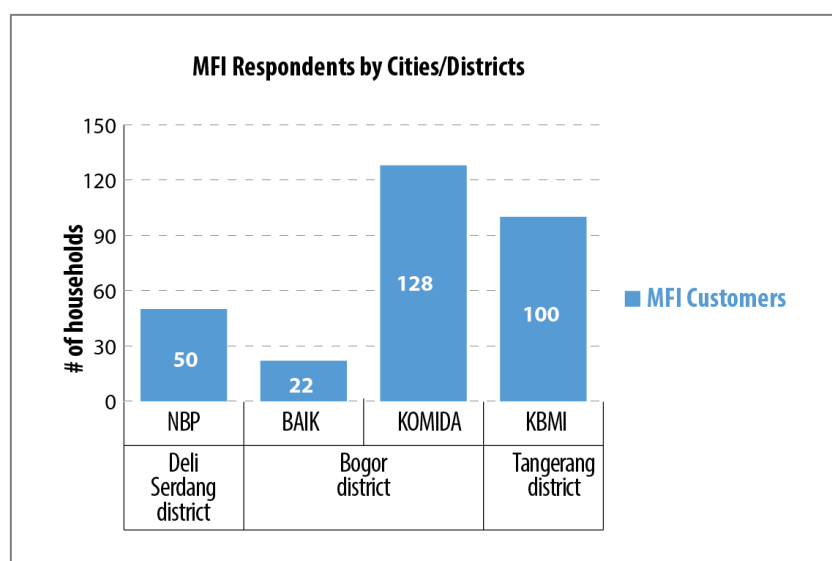
### 2.1. Demographic Profile of MFIs and Grant Respondents

Exhibit 1. Demographic Profile of Both MFIs and Grant Respondents



### 2.2. MFI Respondents By Cities/Districts

Exhibit 2. MFI Respondents by Cities/Districts



## 3. Methodology

The study will provide 2 market analysis, i.e. WASH market profiling and an exercise of market mapping for potential WASH product by MFIs.

### 3.1. WASH Market Profiling.

#### a. Quantitative study

This study will examine areas where both government subsidy program and microfinance present and are currently serving the market. Quantitative survey method was used to collect core information on the current profile of the identified WASH market.

The collected data was further analyzed using Demographic Health Survey (DHS) in which a survey is conducted at representative households to generate data on wide range of monitoring and impact indicators in the area of population, health and nutrition. The DHS wealth index is a composite measure of a household's cumulative living standard. The index is constructed using easy-to-collect information on a household's ownership of selected assets (such as a television, refrigerator, or mobile phone), the type of materials used for housing construction (such as whether the walls are made of brick or wood), and the type of water access and sanitation facilities used by the respective household. The data used in the construction of the current Indonesia Wealth Index comes from the 2012 country-level survey conducted in partnership with Statistics Indonesia (BPS).

A survey of a specific population was conducted using survey tools developed by USAID IUWASH PLUS team to obtain information on the HH wealth levels. Further, this information is used to categorize HH in groups based on their wealth levels. Five categories of HH are presented in the table below:

#### Exhibit 3. Household Categories Based on Wealth Levels

|   |
|---|
| Q1 = Quantile Lower (Wealth Quantile0% – 20%)     |
| Q2 = Quantile Second (Wealth Quantile20% – 40%)   |
| Q3 = Quantile Middle (Wealth Quantile40% – 60%)   |
| Q4 = Quantile Fourth (Wealth Quantile60% – 80%)   |
| Q5 = Quantile Highest (Wealth Quantile80% – 100%) |

The number of HH which fall into Q1+Q2 quintiles can be defined as the number of poor HH (B40) in the area.

## b. Sampling area & criteria definition

Sampling areas for the quantitative study were defined based on an overlapping supplier of sanitation products, i.e. either through Grant program or MFI program/product. Three survey areas are: 1) Medan & surroundings; 2) Bogor; 3) Tangerang.

The sample criteria are defined in the table below:

**Exhibit 4. Criteria of Grant and MFI Samples**

| Grant   | MFI  |
|---|--|
| Previously received grant for WASH facility, the beneficiary has received an average sanitation infrastructure in the amount of Rp 10 million/HH at the most. | <p>MFI's have already implemented sanitation product financing</p> <p>MFI's sample used is the customers who are currently having ongoing loan for more than 6 months (this is also used to identify quality of WASH loan portfolio)</p> <p>The samples in Medan &amp; surroundings are BPR serving the area with micro loan instead of sanitation loan.</p> <p>The loan category for WASH product and microfinance range from Rp1 million – Rp 10 million</p> |

- Bogor and Tangerang were selected as locations to specifically observe sub-district samples where the market overlapping has occurred and to examine the market dynamic.
- North Sumatra was selected as a location to observe microfinance approach, specifically delivered by rural banks that are not familiar with WASH loan, but they have offered micro finance with ticket size of Rp 10 million. This observation aims to assess whether the MFIs also serve micro clients whose wealth levels are similar to that of the grant beneficiaries.

Based on the above criteria, the sampling structure for quantitative survey is presented as follows:

**Exhibit 5. Sampling Structure for Quantitative Survey**

| Areas                  | MFI           |            | Grant      |
|------------------------|---------------|------------|------------|
|                        | MFI's Name    | Population | Population |
| Tangerang              | KBMI          | 5300       | 2071       |
| Bogor                  | KOMIDA        | 10.113     | 609        |
|                        | Koperasi BAIK | 2000       |            |
| Medan and surroundings | BPR NBP       | 1241       | 351        |
| Total                  |               | 18.654     | 3031       |

The MFI dataset is the total loan disbursed from 2014 to 2017. The grant dataset is the number of sanitation grant beneficiaries up to December 2016. The grant dataset were generated from the final report of grant disbursement.

**c. Qualitative study**

Qualitative method also complements the quantitative survey to explore a more in-depth reasoning and background for sanitation product selection. The following is the number of in-depth interviews with respondents conducted during field survey.

**Exhibit 6. Number of In-Depth Interviews with Respondents Conducted during the Field Survey**

| Funding sources | # of respondent | MFI's Officer |
|-----------------|-----------------|---------------|
| Grant           | 20              | -             |
| MFI's           | 20              | 4             |

### 3.2. Market mapping for potential WASH products for Microfinance Institutions

**a. Mapping exercise of MFIs market using secondary data and literature review**

Market mapping exercise on the potential of WASH product introduction to microfinance institution is conducted using secondary data analysis. For this observation, the exercise is extended to West Java and Banten area. This mapping will depict areas that indicate potential for microfinance to enter.

**b. Grant profile and policy.**

Literature review on current WASH grant profile and policy in Indonesia refers to publications entitled 'Skema Pedoman Program Hibah APBN' (Scheme Guidelines for the National Government Budget Grant Program) and 'Buku JukNis Sanimas IDB' (IDB Sanimas Technical Guidelines).

**c. Qualitative study**

Following to the market analysis above, a qualitative survey will be conducted with stakeholders using in-depth interview and desk review. Qualitative study was conducted to explore and examine potential that may exist in each survey area and with MFIs to test and strengthen the result of the exercise. Key objectives of the in-depth interviews with key stakeholders are presented in table 5.

**Exhibit 7. Key objectives of the in-depth interviews with key stakeholders**

| Stakeholder | Key issues  | Institution   |
|-------------|---|---|
| MFI         | <p>Identify and analyze MFIs' perception towards other stakeholders in WASH microfinance sector</p> <p>Examine the extent to which their efforts to promote WASH microfinance were impacted by grant or subsidy programs</p> <p>Identify criteria of WASH customers for successful quality financing.</p> | <p>KOMIDA</p> <p>Koperasi BAIK</p> <p>NBP Group</p> |
| Government  | <p>How grant and subsidy programs (from the GOI and private sector sources such as CSR programs) have been targeted in the past (how criteria were defined) and how they were applied.</p> <p>Identify and analyze challenges and regulation on grant &amp; subsidy program</p>                           | <p>PUPR</p>   |

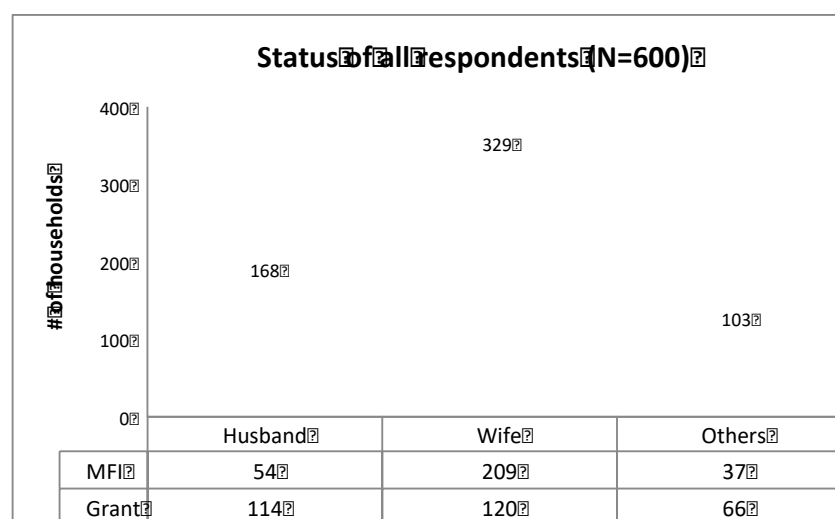
## 4. Finding & Analysis

### 4.1. Respondents characteristics

#### a. Household Status & Economic Activities

Most of the respondents (54%) of the quantitative survey were wives and 28% were husbands. The number of wives and husbands interviewed as the grant beneficiary respondents are equal. Only 20% of the MFI respondents were the head of household, and 38% of the grant beneficiary respondent were the head of household.

**Exhibit 8. Status of All Respondents – Grant Beneficiaries and MFI Customers**



Typical economic activities disclosed during the in-depth interview are:

- In Deli Serdang, majority of the bread winners (husbands) earn daily or weekly income from chauffeuring, running a small stall, petty trading on street, or working as security staff.
- In Bogor area, majority of the respondents work in paddy field (with sharecropping model), some respondents are unemployed but they receive financial supports from their children, and some others are the wives of MFIs customers who have received micro enterprise loan (receiving loan from cooperatives).
- In-depth study with the MFI customers in Deli Serdang and Bogor disclosed information on income and saving capacity based on the respondents' business activities (see table 6).

**Exhibit 9. Income and Saving Capacity Based on Respondents' Business Activities**

| Business activity |                          | Turnover (Sales)/Income | Saving capacity/ net profit |
|-------------------|--------------------------|-------------------------|-----------------------------|
| Trading           | Clothing & cosmetic ;    | Rp2.5 million/month     | Rp200,000/month             |
|                   | Running small stalls     | Rp200,000/day           | Rp50,000/day                |
|                   | Vegetables seller& Kiosk | Rp1.2 million/day       | Rp100,000/day               |

|          | Business activity             | Turnover (Sales)/Income                           | Saving capacity/ net profit |
|----------|-------------------------------|---|-----------------------------|
|          | Vegetable and Spices          | Rp500,000-750,000/week<br>(during harvest season) |                             |
| Services | Becak driver                  | Rp50,000 – 70,000/day                             |                             |
|          | Merchandise Printing          | Rp10 million /month gross                         | Rp3 million/month           |
|          | Outboard sticker for vehicles | Rp200,000 – 300,000/day                           |                             |

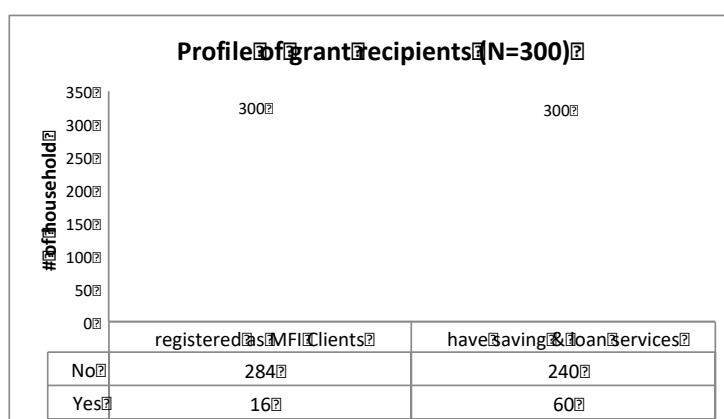
In terms of perception on the needs for proper sanitation, the respondents in Deli Serdang and Bogor have strong perception on the importance of having proper sanitation system in their houses since it is associated with health issues and not having a toilet can be embarrassing. Furthermore, they have urgency to take up sanitation loan because of safety issues.

The respondents on average are keen on receiving grant since they do not have proper sanitation system and they rely on public bathing, washing, and toilet (MCK) facilities, if available. Some respondents are eager to renovate their old damaged or full septic tanks which they received from the previous government grant program. They are reluctant to pay for desludging service because they perceive that the service fee is too high i.e. Rp 1.5 million per service and it has to be repeated every four years. Therefore, the respondents would rather build a new septic tank or an unsealed septic tank than pay the desludging service every one or two years.

### b. Access to Finance (A2F) aspect

In terms of A2F, only 5% of 300 grant beneficiary respondents in the surveyed locations were MFI customers. However, 20% or 60 people have obtained loan services.

**Exhibit 10. Grant Beneficiaries as MFI Customers**



Multi-finance such as Adira Finance, FIF, OTO and WOM are motorbike financing services that provided loans for the grant beneficiary respondents.

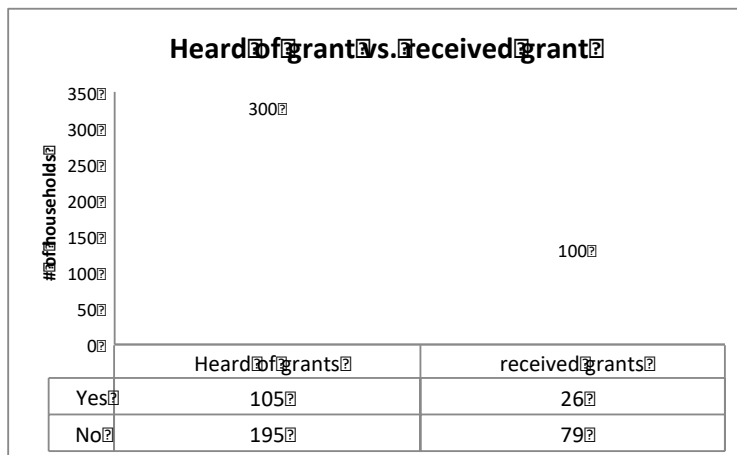
### c. Connection/Involvement to Government Grant

In terms of awareness and connection to the government grant, among 300 respondents of MFI clients, 105 respondents or 35 % have heard about grants, and 26 of them have received it. The

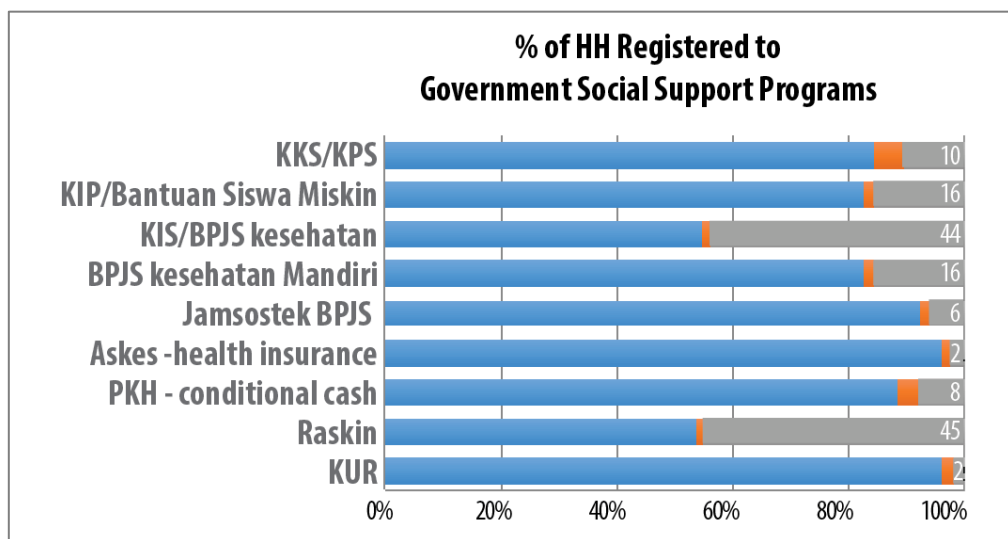
remaining 79 respondents did not receive grant for several reasons, such as the grant was given to their neighbors or they were not considered as eligible recipients.

During the in-depth observation, most grant beneficiary respondents as well as the microfinance respondents in Deli Serdang North Sumatra, were not aware of WASH product loans from MFIs. Furthermore, the MFI customers said they never heard of sanitation loan before taking the loan. This indicates public low awareness on WASH product loans. Therefore, MFI promotion is very important to do because the customers are not familiar with taking loans to build sanitation facilities.

**Exhibit 11. MFI Customers' Awareness and Connection to Government Grant**



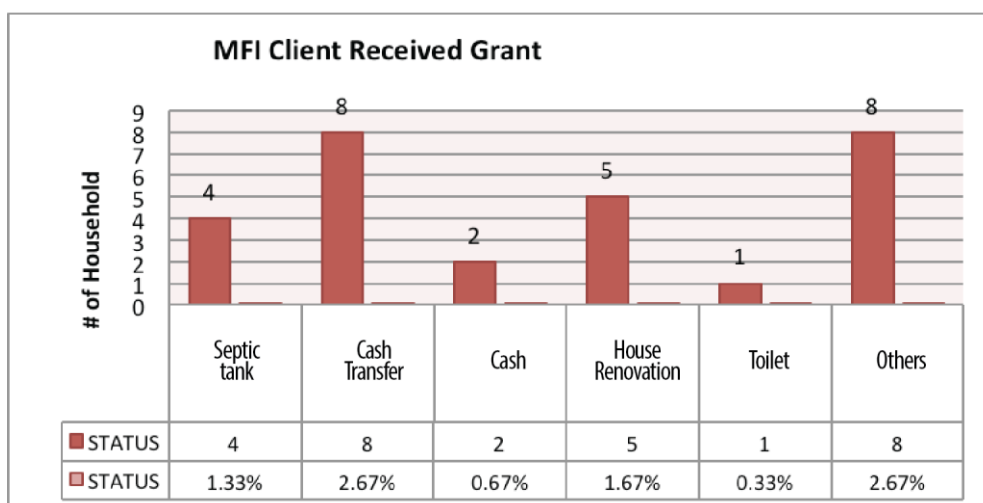
**Exhibit 12. Households Registered to Government Social Support Programs**



Twenty-six of 30 MFI respondents said that they have received the government social supports programs, such as cash grant, house renovation and septic tank construction.



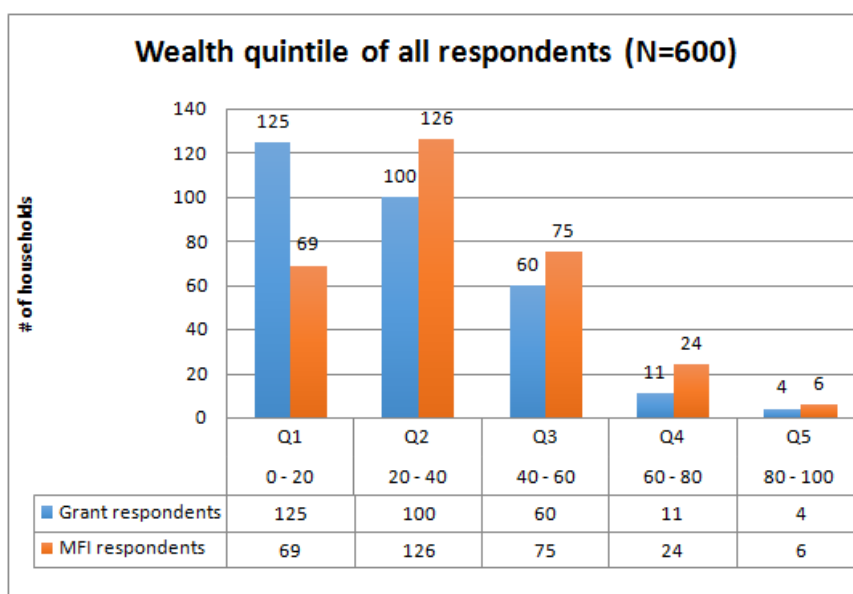
**Exhibit 13. Type of Grants the MFI Customer Respondents Received**



## 4.2. Quintile distribution of MFI and Grant for Urban community

In total, the grant recipients coming from low income community groups (Q1+Q2) is larger (75%) than the MFI customers (65%). This finding suggests that the government grant program reaches the right target.

**Exhibit 14. Wealth Quintile of Grant Beneficiaries and MFI Customers in All Cities/Districts**



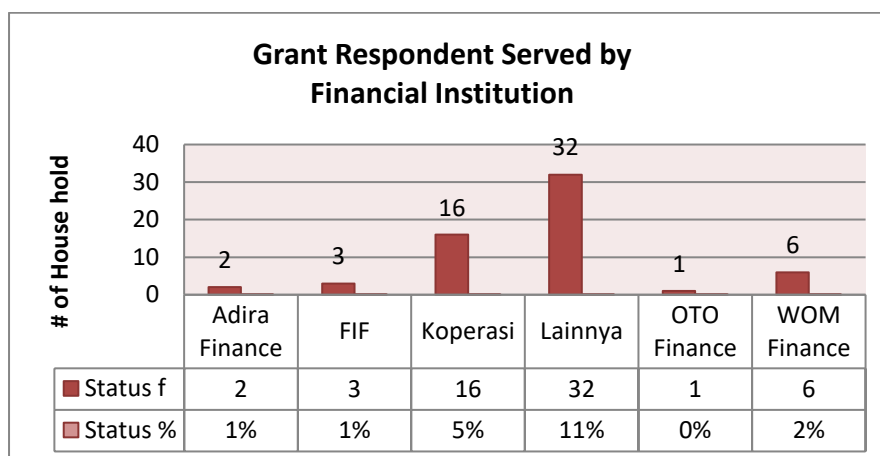
In general, village heads and their staff have disseminated information on the grant program. Some respondents received the information when attending the information dissemination at village halls, and hearing from neighbors or from words of mouth in the village. The respondents were aware that they do not have to spend money to receive the grant, but they do not quite understand the

grant process. They understand that the households that will receive grants should submit copies of identity cards, and family registry record to the RT (smallest neighborhood unit) chief. In some areas, in addition to receiving a septic tank, the household receiving the grant was also provided with fund to support the septic tank construction, in the amount of Rp 200,000.

However, MFI distribution also discloses significant customers targeting among the low income community groups (Q1 +Q2). This finding indicates that these groups can be MFI potential targets, depending on the market targeting strategy of each MFI.

Furthermore, as explained in Figure 3, 20 % of the grant beneficiaries said to get involved with different financial institutions as shown in Figure 9. This number is likely larger than what is reported as the significant number of the grant respondents surveyed are the wives, 40% of whom might not be aware of the husbands' involvement with financial services.

**Exhibit 15. Type of Financial Institutions Serving the Grant Beneficiaries**



About 64% of the grant beneficiaries who do not acquire savings and/or loan said that they are not comfortable dealing with financial institutions, and are not in need of loan (see Figure 10). The low income community members frequently lack education and they are discouraged to engage with formal financial institutions. In Deli Serdang and Bogor, the grant beneficiaries are afraid of not being able to pay the loan installment so that they do not take the loan. The grant beneficiaries are interested in taking the sanitation loan if it can be used to renovate their houses. Therefore, house renovation should be included as part of sanitation development to improve awareness of the grant beneficiaries on sanitation loan.

### Exhibit 16. Reasons for Not Having Loan Services

|                              |    |     |
|------------------------------|----|-----|
| too much hassle              |    | 102 |
| no need                      |    | 90  |
| no officers came             | 16 |     |
| already tried but not served | 6  |     |
| no sharia product            | 2  |     |
| no MFI here                  | 1  |     |
| others                       |    | 60  |

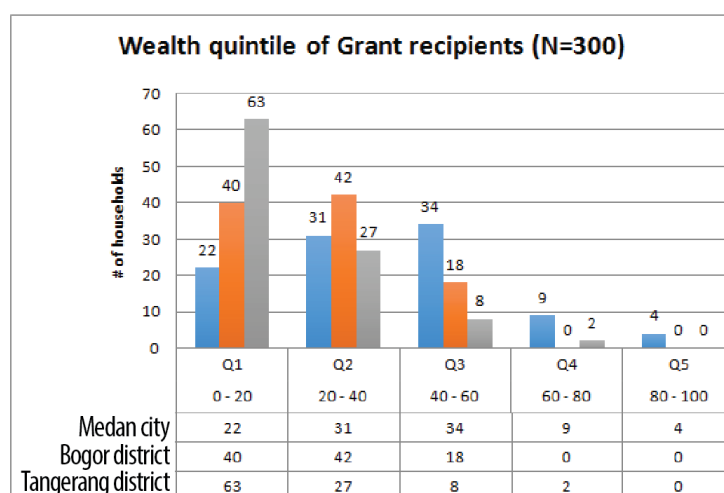
Compared with other cities, the grant beneficiary respondents in Tangerang district make up 90% of the low income community groups (Q1+Q2). The qualitative observation confirms that large number of the grant beneficiaries in Tangerang district, which belong to extremely poor population (Q1), are not feasible for microfinance so that they require comprehensive assistance from government. The sanitation grants in Tangerang were distributed in the form of ‘House Renovation’, which is more suitable and viable for the beneficiaries because some houses are very unfit for living.

In terms of drinking water, households in Deli Serdang and Bogor access water from bore-wells and purchase water from water depots, or getting water from Municipal Drinking Water Company (PDAM) by sharing costs with their neighbors who have had access to the PDAM. The households in Deli Serdang are reluctant to build house connection to PDAM due to its high cost. Some people mentioned that the PDAM house connection construction costs could reach Rp 600,000. This amount is considered unaffordable for the community members. Yet, the installment in the amount of Rp 200,000 with water usage payment capacity of Rp50,000 per 2 weeks as well as installment for PDAM connection fee is considered reasonable. The respondents who actually can afford to pay the PDAM house connection construction fee in cash prefers paying in installment when they are offered loan.

Similarly, the respondents consider sanitation loan facility can be very useful. Yet, they are not aware of any financial institution offering this type of loan. If this sanitation loan is available, the respondents consider Rp 25,000- Rp 50,000 installment per week is reasonable.

During the visit to Bogor district, the MFI respondents said that there is a public MCK facility near their houses. However, their families and other families are reluctant to use the facility. They prefer going to a canal or river before taking sanitation loan from a cooperative.

**Exhibit 17. Quintile of Grant Respondents by Cities/Districts**

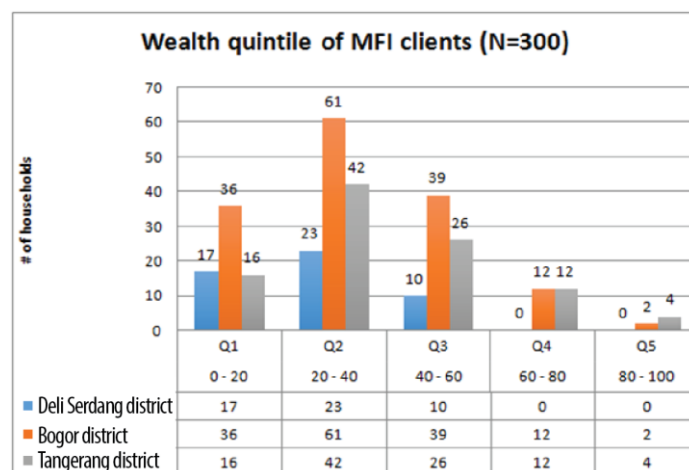


Rural Bank, which is represented by their clients in Deli Serdang, also shows their interest in sanitation loan as well as demonstrates their capacity in accommodating low-income households through micro loan scheme, where 80% of the total portfolio of BPR NBP in Deli Serdang belongs to the low-income community group.

Despite of the overlap and low awareness of the MFI customers on the sanitation grant, some households are reluctant to use communal MCK facility near their houses. This situation gives MFIs opportunities to offer household sanitation financing. The size of sanitation financing loan for building basic household sanitation facilities varies from one MFI to another, ranging from Rp 1.5 million to 5 million. For example, the customers of Baytul Ikhtiar Cooperative in Bogor pay installment in the amount of Rp 72,100,-/week for a 2 year loan period.

The customers accept the MFI products well because they do not have enough cash. As sanitation product is mainly offered to the current cooperative members or outstanding borrowers, their long term relationship with MFIs influences their decision in taking the loan. The MFIs also improve their staff's understanding on the importance of sanitation, and they ultimately encourage the customers to build a toilet. Some MFIs offer sanitation financing top of the customers' working capital loan.

**Exhibit 18. Quintile of MFI Customer Respondents by Cities/Districts**



The figure above shows that 65% of MFI customers belong to low income community. Despite of being classified as the low income community, the MFI customers belong to productive low income community, people with income.

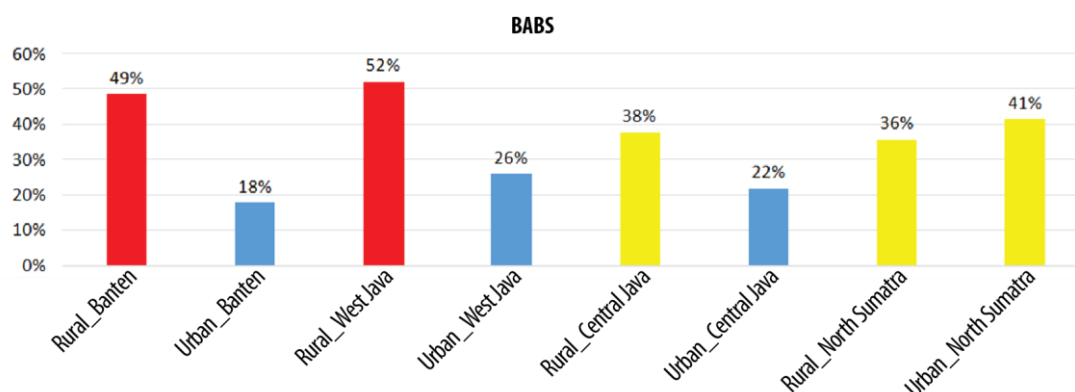
### 4.3. MFI market assessment for potential WASH product financing

To implement sanitation financing, the MFIs need to have good knowledge and understanding on WASH sector, i.e. household situation related to sanitation behavior; sanitation product supplies, and the supply chain situation; relevant stakeholders involved and regulations/policy guiding the government and any public effort. With such basis, the MFI will then further analyze potential demand for sanitation, which will involve the analysis of microfinance market and competition prior to developing the financing product and business process suitable to the MFI's business operation. This process is critical to the success of implementation of WASH financing and or its expansion.

A market assessment exercise was conducted in Banten and West Java provinces to understand the MFI's opportunity to enter the areas. To understand WASH sector characteristics, the MFIs should have baseline data on household situation related to sanitation behavior. Yet, the data available publicly for this purpose is somehow limited. The data on the sanitation condition used in this study and by the MFIs is the STBM profile with criteria of Sharing and Open Defecation (BABS) which is available online on <http://stbm-indonesia.org/>. Pictures 12 and 13 below show the sanitation condition in several provinces selected for this observation.

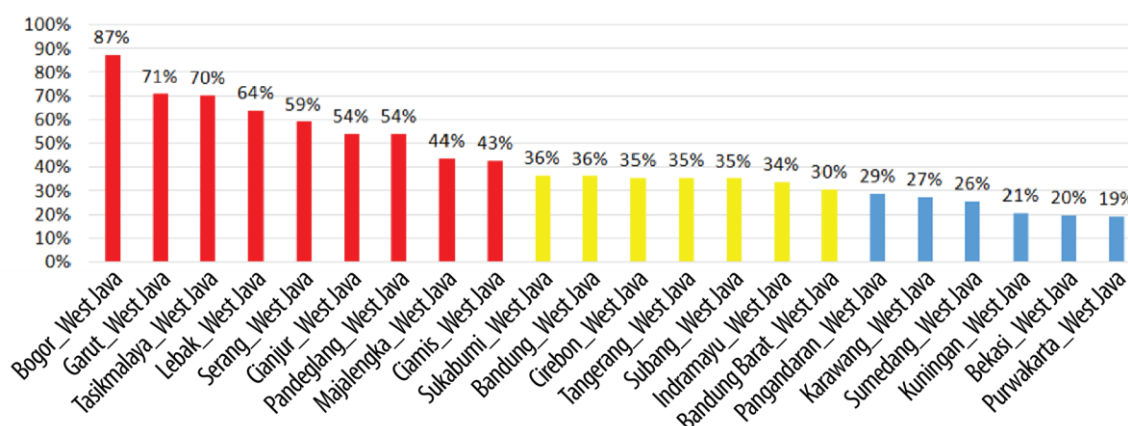
#### a. Comparison of BABS Practices in four (4) Provinces

**Exhibit 19. Situation of BABS Practices in the Selected Provinces**



Based on the explanation above, the MFIs should focus their analysis in the districts with BABS rate is more than 40%, such as Banten and West Java as the priority districts.

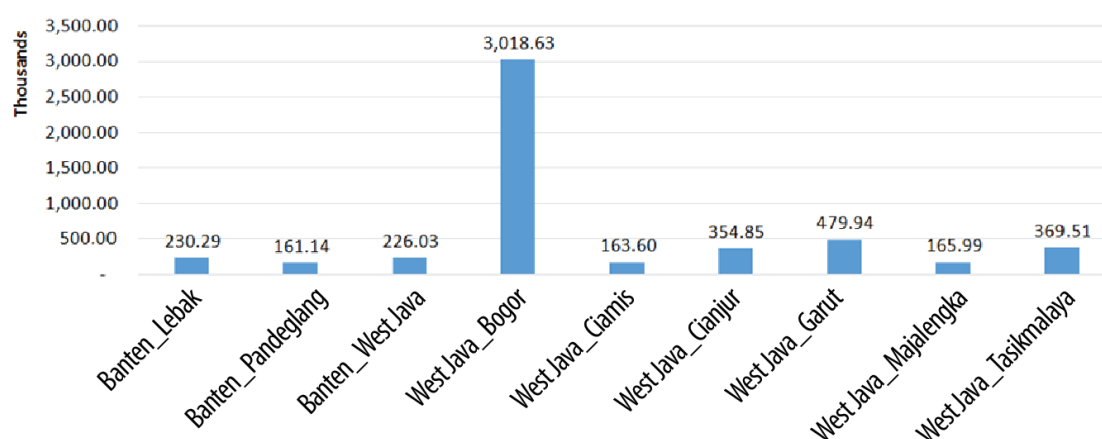
### Exhibit 20. Situation of BABS Practices in Districts and Cities in West Java and Banten



In the selected districts and cities, the MFIs will assess the market potential by looking at number of the highest BABS population in the area. Figure 14 below demonstrate the market potential.

### b. Microfinance Potential in the Selected Districts and Cities

#### Exhibit 21. BABS Population in the Selected Districts and Cities



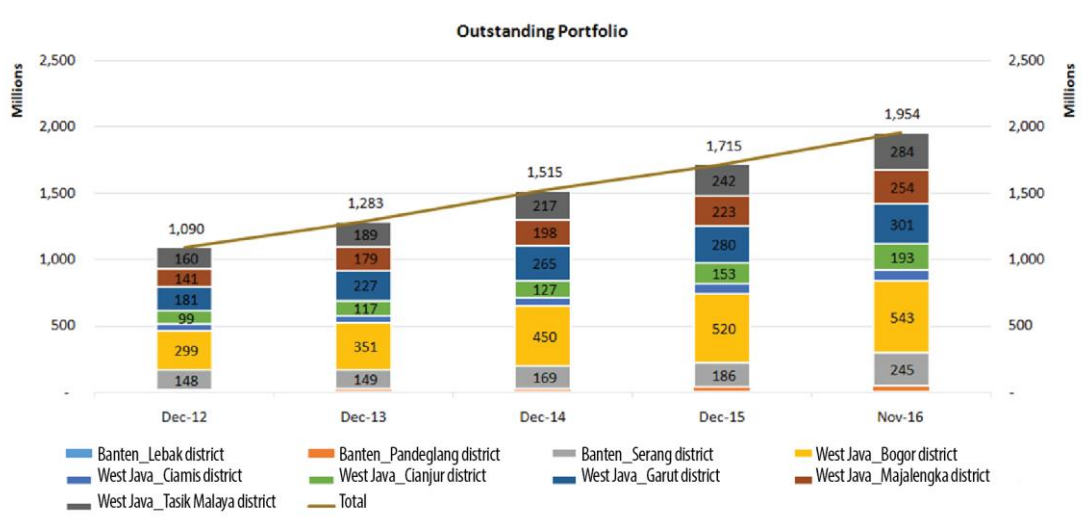
Bogor, West Java has the largest low income population and the highest open defecation rate.

### c. Market Demand in the Selected Districts and Cities

To further understand the market demand, the MFIs conduct profiling competitive landscape in microfinance industry in the selected cities districts using the available secondary data. As reliable information on cooperatives as one of the microfinance service providers is not available, analysis on demand for microfinance commonly used the BPR industry as the benchmark.

In terms of loan portfolio, data on the outstanding portfolio suggest no significant gap for the loan portfolio growth in Banten and West Java Province. During the last five years, the portfolio incremental in West Java reached 80% and 79% in Banten.

### Exhibit 22. Outstanding Microfinance Portfolio in West Java and Banten



#### d. Market Penetration of Microfinance Services

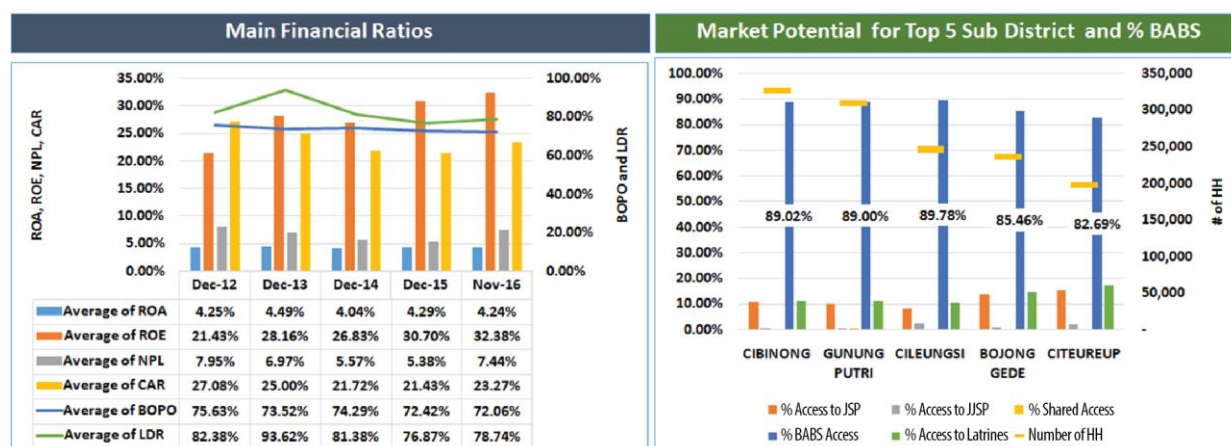
Number of office indicates higher competition landscape in West Java, but the competition in Banten is relatively low.

### Exhibit 23. Expansion of Microfinance Services (Rural Bank)

| Province_District               | Dec-12     | Dec-13     | Dec-14     | Dec-15     | Nov-16     |
|---------------------------------|------------|------------|------------|------------|------------|
| Banten_Lebak district           | 4          | 4          | 4          | 4          | 4          |
| Banten_Pandeglang district      | 3          | 3          | 3          | 3          | 3          |
| Banten_Serang district          | 8          | 8          | 8          | 8          | 8          |
| West Java_Bogor district        | 41         | 41         | 44         | 43         | 43         |
| West Java_Ciamis district       | 9          | 9          | 10         | 10         | 11         |
| West Java_Cianjur district      | 24         | 24         | 25         | 25         | 24         |
| West Java_Garut district        | 22         | 22         | 22         | 22         | 22         |
| West Java_Majalengka district   | 18         | 19         | 19         | 19         | 19         |
| West Java_Tasik Malaya district | 22         | 22         | 23         | 23         | 23         |
| <b>Grand Total</b>              | <b>151</b> | <b>152</b> | <b>158</b> | <b>157</b> | <b>157</b> |

Bogor district in West Java shows high potential for MFIs and it requires further analysis on the microfinance institution performance in the area by looking at 6 main indicators.

## Exhibit 24. Market Potential in the Top 5 Districts and BABS Percentage & Financial Ratios in West Java



### Opportunity:

- High Market Potential
- High Return on Equity (ROE).
- MFIs have good Capital Adequacy Ratio (CAR) to cover loan portfolio growth.
- Good Loan-to-Deposit Ratio (LDR) to increase external funding.
- High Density.

### Challenge:

- Non-Performing Loan (NPL) is high and tend to decrease.
- Relative high competition.
- Return on Asset (ROA) relatively stable, while the ROE increased. Those ratios show the profitability increased due to external funding supporting of the growing of loan portfolio.

From stakeholder perspective, the above exercise suggests opportunity for external program supporting for microfinance combined with impact investment fund such as collaboration with MFIs through placement of term deposit or financing. Prior to investing to MFIs', a full assessment is to be conducted in order to get clear indication of performance and capacity of MFIs. The placement or financing would need to be sufficiently sizeable to affect the MFIs' LDR or CAR.

To further develop a product, following to the above exercise on mapping process which indicates general performances of MFIs servicing the area, MFIs will be required to conduct its institutional market analysis on the selected sub district target as follow:

- Market scanning. Process to examine the external environment in order to identify customer needs, anticipate competitive actions, and identify technical changes which will provide new market opportunities or market disruptions. In particular for WASH sector, it requires the



availability of supplier of the physical or construction of the WASH product, which makes this sector intervention more complex.

- Perception of behaviour and attitudes of potential clients. Discussion with MFI customers and potential customers will capture understanding of popular funding source for them. Specifically for WASH implementation, this activity is critical to develop the best way to conduct effective behavioral change that can be embedded in the marketing tools. This helps to obtain the customers' perspective on ideas for new programs or products and their pattern of behavior in borrowing and saving that is critical to determine the characteristics of the potential WASH product developed.
- Understanding potential client's financial service expectations. This is essential to capture information and learn about a competitor's activities (estimation of rate offered, process, services points, and etc.), customer requirements, and other market changes. This also subject to expectation on the delivery of the infrastructure WASH product i.e. toilet construction
- Understanding typical economic activity and main driver of potential HH source of income, for example the characteristics of agriculture economy in the community, the economic turnover, average cash-flow rate and how society is involved in value-chain of the agribusiness sector in the wider scale.
- MFIs may utilize its internal sales force intelligence (as they are always 'in the market').

Important notes resulted from the discussion with MFIs that implement WASH loan is:

- Opportunity to serve sanitation loan in West Java is getting bigger due to the high competition that pushes MFIs to differentiate their product. Furthermore, the intervention by NGOs initiating this product is quite successful.
- Information of WASH sector and the key stakeholders in this market are available.
- Commitment from shareholder is fundamental to develop WASH products. Aside from dedicating persons to support WASH product development, the commitment is reflected through the management policies, such as providing incentives, additional funds for promotion, etc. Profiles of the MFIs that were observed and interviewed during the study is presented in table 7.

#### Exhibit 25. Profile of the observed and interviewed MFIs

| Institution Name                              | Product Profile   | Operating Area  |
|---|---|---|
| Baytul Ikhtiyar (BAIK)<br>Cooperative Shariah | Group Loan<br>Total Portfolio :<br># of WASH client : 4.052 (as of December 2017)<br>Ticket Size : Rp 2.5 – Rp 3 million<br>Interest Rate: Equal to 24 % flat/annum<br>Term: 50 weeks | Bogor city, Cianjur,<br>Bogor districts,<br>sukabumi city in<br>Southern Bandung ( all<br>located in west java) |

| Institution Name                               | Product Profile   | Operating Area  |
|--|---|---|
| Mitra Dhuafa<br>Cooperative Syariah            | Group Loan<br>Total Portfolio: N/A<br># of WASH Client : 2017 client<br>Ticket Size : Rp 1 million – Rp 5 million<br>Interest Rate: 22 %/ annum<br>Term: 6 months to 2 years  | Operate in 11 provinces in Sumatera Island, Java, Kalimantan, and Sulawesi and NTT (East Nusa Tenggara) in East Indonesia |
| Benteng Mikro Indonesia<br>Cooperative Syariah | Group Loan<br>Total Portfolio (as of December 2018):<br>Rp 42.124 billion (Sanitation and Water);<br># of WASH Client : 7,258 Sanitation & Water)<br>Ticket Size : Rp 10 million at the most<br>Interest Rate: 12 flat/month<br>Term : up to 10 years | Banten Province   |
| Bina Artha<br>Venture Capital                  | Group Loan<br>Total portfolio : Rp 7.389 billion<br># of WASH borrower : 7,389<br>Ticket Size : Rp 1 – Rp 1.5 million (Sanitation component)<br>Interest Rate: 2.5 %/month<br>Term: 15 months   | West Java, Central Java, East Java, Yogyakarta, South Sulawesi  |

#### 4.4. Grant Process From National Level to Implementation

IDB SANIMAS program is implemented by the Ministry of Public Works and Housing (PUPR) targeting the 1) district/city government and 2) low-income communities in residential areas with minimum of 50 households and high-risk sanitation practices. This program is led by national government and implemented gradually in 1,800 target locations in the 13 selected provinces which previously implemented the PNPM Mandiri Urban program (P2KP). The program implementation guidelines are developed by national government and executed structurally from district to village level. At the village level, the program used existing community self-help institutions (MFIs) in the area.

The district/city government required to contribute its funding as their commitment to replicate the program, provide technical assistance and take responsibilities for community preparation, planning and post-construction.

The grant beneficiaries are selected by the community with assistance from provincial or district government. In terms of technology selection, community is provided with education on the design infrastructure to enable community to choose technology that would suit the local conditions. Furthermore, community participation is a critical aspect in the grant beneficiary selection. The SANIMAS program also recognizes the importance of other potential funding to co-finance the implementation and opens for other parties' support including private, business, cooperatives, individuals, and groups.

At the implementation phase, the Head of Village coordinates the community participation and ensures the implementation is successful.

The purpose of the grants is new sanitation infrastructure development with the following options:

1. Construction of communal Wastewater Treatment Plant (IPAL Komunal) with piping system
2. Combination of IPAL Komunal with piping system and MCK.

The amount of grant allocation for each construction project in a target location is maximum Rp 425,000,000 (four hundred twenty five million rupiah).

Mechanism of selection and target location setting are conducted using a selection of participative location point. This method is a rapid and structured assessment used to choose the best location that follows general guidance rules and adopts sustainability principles. The assessment is conducted by a small group of prospective recipients from the targeted village. The variables and weight used in the assessment method are presented below:

1. Community participation rate (50%);
2. Population density (30%);
3. Sanitary-prone conditions (20%);

The assessment indicator applied by the government grant and MFIs confirms that the two services use different approach. The grant implementation requires extensive discussion in the community as a village group, while MFIs assesses each client capacity. Furthermore, the government mainly distributed the grant in communal system, which is different from construction for HH financed by MFIs.

Although government programs do not particularly target the low income community, most of HH that are still practicing BABS are the low income community. Thus, they might overlap with MFIs customer profiles. However, the limited government funds indirectly allow the MFIs to serve the market as well.

When the government grant is distributed in the MFIs' areas, it has minimal impact because the MFIs have large market to serve. The government grant can affect the MFIs' operation if the MFIs have made investment in the area by conducting promotion, and the customers might cancel taking up the loan when they know the grant is disbursed in the areas. However, since most of MFIs' customers, particularly those of MFIs serving group loan, have engaged with the MFIs for a lengthy period of time and sanitation loan is only part of MFI services that they receive. Hence, should the client decide to take sanitation loan from the dedicated MFI, the customer still manage to pay the loan due to group and social pressure. This situation might

be different from MFI who applied individual lending method due to lack of group & social pressure received by the client. One of the challenges that some MFIs face when experiencing an overlap with grant in community level is that the client may request a delay in taking up the loan in case they are made eligible for grant in the near future.

## 5. Conclusion & Recommendation

### 5.1. Conclusion

- Selection and main criteria of MFIs customers and government grant beneficiaries use different indicators, tools and processes. Community involvement is required in the grant process while MFI assessment is based on needs and capacity of HH and potential borrower to engage with MFIs in longer term rather than one time activity.
- However, the WASH sector knowledge is still considered limited and at very early stage and not known to general financial sector.
- Most financial institutions, including MFIs that are day-to-day dealing with customers who are also targeted by the government in the WASH sector, are not aware of the government information dissemination on the importance of sanitation and grant program for sanitation. This implicate the huge market despite the MFIs and grant program overlap.
- MFIs in general are not able to see the opportunity for WASH financing. There is no official and structured effort in the market to introduce and provide a clear picture of the sector as well.
- To accelerate the sanitation program (open defecation eradication), collaboration with MFIs is necessary because there is high demand for sanitation/toilet product. The higher percentage of BABS, the greater is the demand for the sanitation product, which translates to awareness on high importance of sanitation in their daily life.
- Both MFIs and government grant potentially overlap in the market in serving the B20 and B40 and this indicates feasibility of HH in group to be financed by formal financial institution.
- Donor agency efforts and programs to introduce WASH financing to markets are considered very small compared to the market potential and limited support from them on financial sector (here represented by MFI) to improve their capacity in order to have a better understanding the best way to finance WASH sector because currently there are no step by step guidelines and business model for MFI to adopt and implement business model for WASH financing.
- The MFIs have huge opportunities to introduce WASH financing as an effort to differentiate their services in the market particularly for most low level income HH that do not have sufficient collateral as a guarantee to their loan. Microfinance institution particularly with group loan model is most suitable servicing the unsecured loan.
- Some MFIs face challenges when its services overlap with grant in community level. An example of the challenges is the MFIs' customers request to delay taking the loan because they are waiting if they are eligible for a grant.
- USAID IUWASH PLUS suggests the government's current strategy to move forward to include alternative financing through MFIs as part of the solution.
- Complete, reliable and continues of government data on STBM government <http://stbm-indonesia.org/> is crucial.

## 5.2. Recommendation

### a. For government program

1. To improve impact of grant by focusing on QI that may be less priority for MFIs to serve.
2. To focus on infrastructure in the area where HHs are not possible to construct individual septic tank due to limited land availability. In such case, different technology or even more complex technology i.e. IPAL Komunal will be very challenging for MFI to model its financing.
3. Government strategy should also include MFIs as part of its large strategy in achieving the goals of universal access. Since it is operating differently thus enable MFIs to work within its characteristic and rules. Communication and information sharing system and coordination essential to be develop accordingly.
4. To provide financial sector with information on the government grant programs to avoid overlap.

### b. For MFI

1. A stimulus to encourage MFIs to serve sanitation loan products is needed. The observation indicates that other MFIs that are not currently serving, or unable to provide services, lack of information and knowledge and not lack in interest.
2. Group lending (GL) suits to serve sanitation program, since GL is designed to serve unsecured loan. Stakeholders should support enabling environment for MFIs to implement WASH financing.
3. Develop guidelines to provide practical tools for MFIs to map the market so that they can make a strong decision to develop WASH products (at national level)
4. Should microfinance be part of WASH national strategy, it will allow each of the city/district in Indonesia to replicate/implement WASH microfinance. Therefore, an open mechanism for sharing information on government grant program is important. This will allow MFIs gather information that can guide and support them in making strategic decision on priorities area and determine the time to enter. There is a need of having reliable and continuous data of STBM that MFIs can use as the baseline of WASH potential market.
5. Guarantee mechanism to replace collateral requirement. As WASH loan ticket size in average less than Rp 5 Million, this loan is characterized as unsecured loan. Guarantee scheme should be provided by companies regulated under OJK.
6. Introduction of WASH sector should be extended into WASH financing under guidance of OJK. It is important for financial regulator to form strategic work with the ministries managing WASH sector.



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