

Stable outlook for the guarantee industry

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Overview

PEFINDO is of the view that the guarantee industry risk profile as moderate, with a stable outlook. The challenges impacted by the Covid-19 and the inherent risk of the MSME segment to the likelihood of creditors to claim to guarantee companies are appropriately addressed by adopting a stringent underwriting practice, adequate capitalization, strong sponsorship, and supportive regulatory framework.

Since the first quarter of 2020, Covid-19 has adversely impacted the economy world-wide. One significant impact is the weakening repayment capacity of the general debtors, corporations and individuals, due to the slump businesses and workplaces. Such conditions show the pivotal role of the guarantee industry, since it provides cushions for creditors in the event of debtors' default.

Conversely, the exposure to micro, small and medium enterprises (MSME) entails a high potential claim ratio. However, the guarantee companies have limited room to raise guarantee fee to compensate for this high claim ratio since the government related products (such as Kredit Usaha Rakyat or KUR) have certain free structure, while commercial products come across intense competition against insurance companies offering similar services, limiting the pricing flexibility for the guarantee companies.

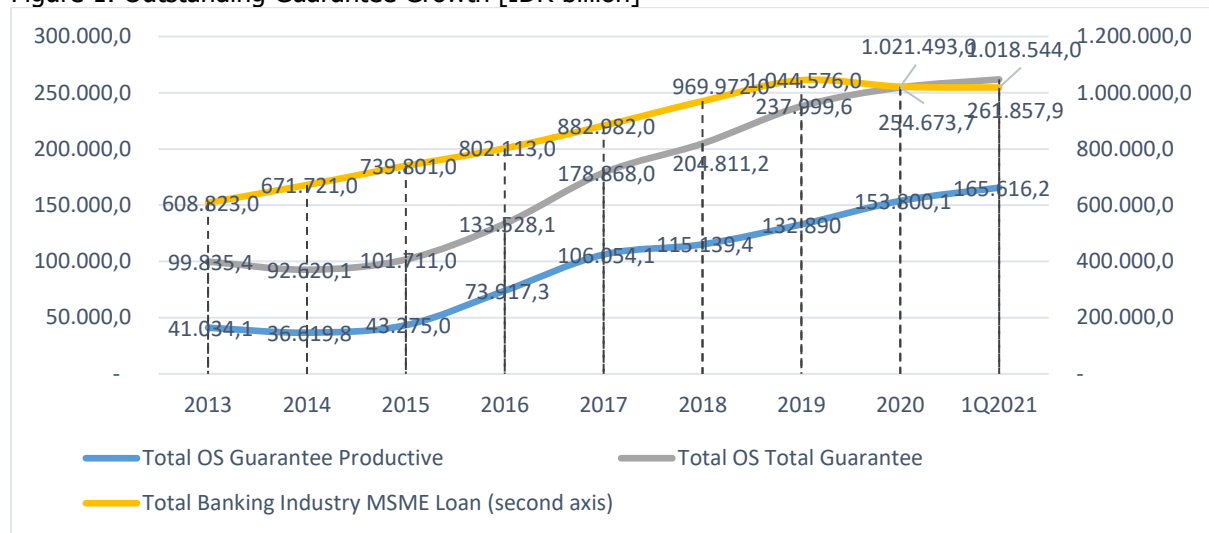
Such characteristics of the guarantee industry result from the fact that most guarantee companies are either owned by regional governments to complement their regional development banks or by the central government to support government programs, particularly channeling loans to micro and productive segments, aimed to promote social-economic regional developments. As of March 2021, this industry consists of 20 guarantee companies, of which 1 is state-owned, 18 owned by regional government, and only 1 privately owned. The state-owned and regional government-owned guarantee companies combined make up 88.9% of the total industry's assets.

This report aims to assess the guarantee industry's performance based on its key success factors, focusing on key points, such as the growth of the guarantee volume, operating performance, as well as other aspects impacting performance in general.

Prospective guarantee volume growth

In terms of volume growth, the industry's prospect has remained promising despite the overall credit contraction in banks, including the MSME segment. A wide gap exists between total credit and the total guarantee volume in the industry, allowing a high probability for the volume to grow in the near to medium term, and we project it to be in the 10% range. The demand by banks, especially for guaranteeing non-bankable MSME loan schemes, has remained adequate.

As of March 2021, the outstanding guarantee reached IDR261.9 trillion, growing by 11.5% (YoY) compared to 7.0% in December 2020, mainly driven by the MSME sector from government credit programs and the national economic recovery program. In the same period, the number of guarantees reached around 16.3 million people, a rise of 5.5% compared to December 2020.

Figure 1. Outstanding Guarantee Growth [IDR billion]


Source: Statistik Lembaga Penjamin Indonesia & Statistik Perbankan Indonesia, processed by PEFINDO, processed by PEFINDO

We view the guarantee from the productive sector will remain dominant with a contribution of more than 55% to the total guarantee volume, in line with the industry’s focus in the MSME segment. As of March 2021, the productive segment contributes around 63% or equivalent to IDR 165.6 trillion. Outstanding guarantees in the non-productive segment contracted by 4.7% YoY to IDR96.2 trillion.

Accelerating the growth of the MSME productive sector is one of the government's focuses in the post-pandemic recovery program, whereby the guarantee industry helps ensure continuous flow of loans to that sector. We view that the guarantee industry will continue its pivotal role for both the national and provincial governments. Given the current ownership structure, the guarantee industry will also benefit from potential and sustainable business synergy with state-owned banks and regional development banks.

Challenges to maintain loss ratio from high-risk profile of guarantee portfolio

Higher claims will continue to weigh on its revenue generation, therefore we view that guarantee industry’s operating performance will remain at a moderate level in the near to medium term.

As of March 2021, the guarantee industry booked a guarantee revenue of IDR 290.5 billion, compared to IDR102.8 billion in March 2020.

We view the pandemic has further exacerbated the high claim nature of the MSME segments, undermining the effort to maintain a prudent underwriting policy. The number of claims paid by guarantee industry players in March 2021 reached IDR804.3 billion, a hike of 119.9% YoY. The soaring claims indicate a high level of non-performance guarantee (NPG), along with the increase in the ratio of non-performing loans (NPLs) to the executing banks. As of March 2021, NPL from the MSME segment stood at 4.1%, higher than the overall NPL ratio of the banking industry of 3.2% in the same period.

A major portion of the guarantee business also comes from banks, allowing banks to leverage bargaining power in striking deals with guarantee companies. Accordingly, it affects the level of stringency the guarantee companies can impose in underwriting the guarantee schemes since guarantee companies need to weigh the trade-off between risk and its business generation. Occasionally, a guarantee company has to accept a less favorable risk profile to secure business sustainability.

We view the guarantee industry’s growth as challenged by its high-risk profile of guarantee portfolio of the government lending program and productive loans, in line with its mission to boost economic activities.

The industry players have launched initiatives to enhance their non-productive business and intensify subrogation efforts, as well as increasing the banks' retained portions. However, such an effort may take time to deliver the intended outcome, while the intense competition from the insurance sector has prevented from simply adjusting the guarantee rates. Hence, we expect significant improvements in operating performance will likely be attained only gradually. Accordingly, PEFINDO is of the view that the guarantee industry's return on average assets (ROAA) will remain low, at less than 1.5% in the near to medium term.

Table 1. Guarantee Industry Financial Summary [IDR billion]

	2015	2016	2017	2018	2019	2020	1Q2020	1Q2021
RGS income	1,590.0	1,948.5	2,141.8	1,740.1	2,575.4	3,447.5	1,069.3	1,879.1
Net RGS revenue	1,302.0	1,651.0	1,861.9	1,411.1	2,205.2	2,891.7	468.6	1,094.9
Total claim expenses	949.0	892.3	1,051.2	1,229.4	1,804.4	2,201.0	365.8	804.3
Guarantee revenue	353.0	758.7	810.7	181.6	400.8	690.8	102.8	290.5
Other revenue	650.0	657.0	707.1	774.2	850.8	1,190.7	142.0	276.2
Operating expense	520.0	734.0	807.2	895.6	1,011.4	788.5	115.1	217.0
Operating profit	483.0	681.7	710.6	60.2	240.1	1,093.0	129.7	349.7
Non operating income	314.0	283.0	324.7	452.8	510.8	(496.0)	9.9	(127.6)
PBT	797.0	964.7	1,035.3	512.9	750.9	597.0	139.7	222.1
Net profit	607.0	835.0	768.6	396.7	603.4	417.4	114.7	149.3
Other comprehensive inc (exp)	34.0	(101.0)	79.5	(203.3)	84.1	152.1	(150.7)	(128.9)
Comprehensive income	641.0	734.0	848.1	193.4	687.4	569.5	(36.0)	20.4

Source: Statistik Lembaga Penjamin Indonesia, processed by PEFINDO

Easing pressure on Return Guarantee Services (RGS)

Usually, the head-to-head competition against insurance companies weakens the guarantee industry's revenue. But the pandemic has also impacted the appetite of the insurance companies, which fundamentally have a more diversified line of business. The launching of the national economic recovery program and the close relationship to state-owned and regional development banks as previously mentioned also led to a higher RGS and an increase in the outstanding guarantee value. The gross RGS amounted to IDR1.9 trillion as of March 2021, a hike from IDR 1.1 trillion as of March 2020.

We view that the guarantee industry's ability to grow its business highly depends on its equity base, given the requirement to maintain the maximum gearing ratio (guarantee outstanding to equity) at below 40x. The industry is dominated by the Indonesian Credit Guarantee Corporation (Jamkrindo, rated idAA+/stable), a state-owned guarantee company. The government guarantee company accounted for the largest contribution of 86.7% of the total equity of the guarantee industry, followed by regional guarantee companies of 12.3%.

The barrier to entry is relatively low with the small equity requirement of IDR 25 billion. However, most of the guarantee industry players, especially Jamkrinda, are not directly competing head-to-head due to its respective captive market in its own region, and the business model may not be attractive enough for the private investors, which typically opt for a more flexible general insurance business.

Supportive regulatory framework

We view the guarantee industry have a supportive regulatory framework, namely UU 1/2016, stipulating guarantee products may no longer be issued by other companies outside the guarantee company, effective from January 15, 2019, hence providing greater market opportunities for the guarantee industry, including sharia guarantee companies. A guarantee company may guarantee debt instrument, purchase of goods in installments, trading, procurement of goods and services (surety bond), counter bank guarantee, letter of credit, customs bond, excise guarantee, and provision of management consulting services. The various scope of coverage should be beneficial for the guarantee players.

However, it seems the competition against insurance companies in providing guarantee services will remain. Article 57 paragraph 4 of Act No 2/2017 regarding construction services stipulates that guarantees may be issued by insurance companies, provided insurance companies have valid entry points to offer guarantee products. Moreover, traditionally the guarantee products have been commonly served by insurance companies, as reflected in the notable contribution and demand for guarantee products by insurance companies, at around 10%.

The issuance of POJK 48/POJK.03/2020 extends the relaxation period, allowing flexibility for banks to restructure loans impacted by the Covid-19, partly easing the pressure on the guarantee industry, as the pandemic-impacted non-repayment for the guaranteed loans will not automatically lead to claims.