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THE SUCCESSFUL OF MICROFINANCE FOR THE SUSTAINABILITY OF INDONESIAN ECONOMICS

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ABSTRACT:

The success of Grameen Bank in improving the economic conditions of the poor in Bangladesh propelled the role of microcredit into the limelight. Based on that condition Indonesia inspired to do the same program for increasing the welfare and poverty alleviation in the country. One of the Bank is Bank Rakyat Indonesia that success to help the society to increase their welfare. This paper is will discuss about microfinance in Indonesia. The paper goes on to provide a brief history of microfinance in Indonesia. We have also chosen to highlight one important success of microfinance in Indonesia: how the microfinance industry maintained its stability during the Asian financial crisis. Finally, we take a critical look at some of the issues facing microfinance in Indonesia, and then end with some recommendations on how Indonesia might overcome these outstanding issues.

Key words: *microfinance, sustainability economics.*

ABSTRAK:

Keberhasilan Bank Grameen dalam meningkatkan kondisi ekonomi masyarakat miskin di Bangladesh mendorong peranan kredit mikro menjadi pusat perhatian. Berdasarkan kondisi tersebut menginspirasi Indonesia untuk melakukan program yang sama dalam meningkatkan kesejahteraan dan pengentasan kemiskinan di negara ini. Bank Rakyat Indonesia sebagai salah satu Bank di Indonesia yang sukses membantu masyarakat untuk meningkatkan kesejahteraan mereka. Paper ini membahas tentang keuangan mikro di Indonesia, dimulai dengan sejarah singkat dari keuangan mikro di Indonesia. Kemudian menyoroti satu keberhasilan penting dari keuangan mikro di Indonesia mengenai bagaimana industri keuangan mikro dapat mempertahankan stabilitas selama krisis keuangan di Asia. Akhirnya, secara kritis melihat beberapa masalah yang dihadapi keuangan mikro di Indonesia, dan kemudian berakhir dengan beberapa rekomendasi tentang bagaimana Indonesia bisa mengatasi isu yang beredar.

Kata kunci: *keuangan mikro, ekonomi keberlanjutan.*

INTRODUCTION

Microcredit involves the loaning of small amounts (typically USD 10) of money to the poor. It is characterized by group lending, rigorous monitoring and progressive lendings to lower the risks of default, and to lower the costs of monitoring and administration.

Group lending lowers the risks of default for two reasons: the peer selection process by group members ensure that trustworthy and creditworthy individuals are admitted into the group. After all, the group members know their fellow villagers best, and would not want a "bad apple" to jeopardize their chances of obtaining loans.

Loan repayments are also due fairly quickly and frequently (e.g. every week or once every two weeks). This kind of meticulous monitoring enables the lender to establish the creditworthiness of their clients very quickly.

Progressive lending means that borrowers are given increased borrowing limits after they establish a good credit record of prompt repayments. Hence, progressive lending provides an incentive for borrowers to repay their loans on time, so that they would be eligible for increased loan amounts.

Microfinance is a wider definition as compared to microcredit. In addition to microcredit, microfinance also includes other value-adding activities like the provision of business and financial advice, and also the provision of savings and insurance services. The inclusion of savings is important, as it allows the microfinance institutions to recycle the savings from the community into loans, thereby creating a more sustainable form of banking.

Indonesia is one of the developing countries that successfully run sustainable microfinance in a relatively large scale. For example, Bank Rakyat Indonesia (BRI) unit network is now the largest and one of the most profitable rural micro banking networks in the developing world. Therefore, this makes microfinance in Indonesia an interesting research subject from which we hope to learn some best practices in this area.

OVERVIEW OF MICROFINANCE IN INDONESIA

Microcredit is defined by Bank Indonesia, the central bank, as a loan below Rp0.50 million (US$5,373), a financial product provided by formal and semi-formal financial providers in Indonesia.

As of 2003, 31.2 million poor people were living in Indonesia, and represented 17.4% of the population. Approximately 20% of Indonesia's 214 million people depend on micro- and small-scale businesses to earn a living, but only 10 million out of 42 million microenterprises have access to credit from formal financial institutions.

After the financial crisis of 1997-98, poverty alleviation became one of the first priorities of the government engaged in wide-range financial reforms, which also sought to reduce growing income disparities between people, and between regions. Several studies have demonstrated that there is still an unmet demand for microfinance services, as a majority of rural households still do not have access to a source of funds from a semi-formal or formal institution. The regulated microfinance providers, BRI Units and BPRs, tends to cover mostly the upper levels of the microenterprise market, in district and sub-district towns, with loans of more than Rp 3 million (US$320), while NGOs, cooperatives, and village-based institutions village-based institutions – Badan Kredit Desa (BKDs), Badan Kredit Kecamatan (BKKs) – reach a lower end of the market but still have a limited outreach in rural areas.

HISTORY OF MICROFINANCE IN INDONESIA

Indonesia has a long history of commercial microfinance, starting a century ago with the Badan Kredit Desa (BKD or Village Credit Organisation), Bank Kredit Kecamatan (BKK's) village-owed banks offering microcredit on commercial terms. Approximately 7,000 BKDs operate in Indonesia nowadays. Sustainable microfinance in the banking sector began in 1970 with the opening of Bank Dagang Bali (BDB), a private bank in Bali specialised in commercial microfinance, which built it success on the knowledge of microfinance clients and on state-of-the art savings products. BDB was closed by Bank Indonesia in 2004 due to governance and liquidity problems.

The generic term for small financial institutions in Indonesia is Bank Perkreditan Rakyat (People's Credit Bank, or BPR), which were introduced by Bank Indonesia in 1978. After the 1988 financial reforms of PAKTO 88, new secondary banks were established, also called BPRs. Specific requirements for the licensing of pre-existing BPRs (capital, size of deposits) were set but never fully respected. Today, BPRs includes licensed financial institutions, mostly privately-owned, that meet the criteria specified in the 1992 Banking law, and number 2,148 in 2004 (accounting for 15% of the microfinance market), and almost 9,000 public rural financial institutions that are not licensed, and can be categorized as generic BPRs, which include village-owned BKDs of Java and Madura, and the Lembaga Dana dan Kredit Pedesaan (LDKPs) or Rural Fund and Credit Institution, owned mostly by provincial governments (or in some cases by villages).

In 1984, in the wake of new financial reforms undertaken by the government, Bank Rakyat Indonesia transformed its sub-branches ('Unit Desa') network operating at subdistrict level. The outlets were transformed from loss-making channelling agent for the government subsidised credit program for rice cultivation (BIMAS) into commercial microfinance intermediaries. The unit network is now the largest and one of the most profitable rural microbanking networks in the developing world.

During the 1997-98 financial crisis, most of BRI microfinance clients kept their trust in the financial services offered by BRI units; clients maintained and even increased their savings levels. The BRI Unit Desas unaffected success during the crisis were in sharp contrast with BRI heavy losses on its corporate portfolio, which meant that BRI became technically bankrupt, and had to be rescued by a public restructuring and refinancing program, as for the rest of the banking industry.

Another significant player in the formal microfinance market is the state-owned pawning company, Perum Pegadaian, serving million of low-income people. With these three main players (BRI, BPRs, and Pegadaian), the formal financial sector is the dominant force in microfinance, and outperforms the semiformal and informal sectors by a large margin.

The semi-formal financial sector has had a much smaller role in the provision of microfinance in Indonesia. Traditionally in Indonesia NGOs have not play a significant role in financial intermediation, but focused on social mobilisation, at times partnering with government poverty reduction programs. In recent years, a few NGOs have ventured into commercial microfinance, with the establishment of their own BPRs, or in two specific cases: a commercial bank in Central Java and a cooperative in Lombok. During the Suharto regime, the cooperative system was highly politicised and used as vehicle to disburse cheap credit to targeted groups. The cooperative sector still suffers from political interference and also from weak regulations.

In addition, government programs have provided subsidised credit financing to targeted populations, using the commercial banking system to channel the funds. To assist poor farmers, the Income Generating Program for Small Farmers and Fishermen (Pembinaan Peningkatan Pendapatan Petani-Nelayan Kecil, or P4K), provides soft loans through self-help groups. To reach women, the Prosperous Family Program implemented by the National Family Planning Coordinating Board (Badan Koordinasi Keluarga Berencana Nasional, or BKKBN) has a network of village outlets and operates through women's groups, by encouraging savings mobilisation and disbursing subsidised credit.

Finally, Indonesia has also a long history of informal credit and savings schemes, comprising Rotating Savings and Credit Associations (RoSCAs) or Arisan in Indonesian, and other forms of traditional finance. However, most of these schemes have limited outreach and sustainability prospects.

The fact that BRI village units began operating profitably was a major achievement of the reorganization. The network's transformation was largely completed within only four years (1984-1987), and the cost to the Government in terms of subsidies was relatively low. By 1985, most of the units were turning a profit. In 1991 the unit network accounted for 25 percent of BRI's deposits, 10 percent of outstanding loans and over 70 percent of its profits (Robinson, 1992).

The factors contributing to this success were the wide mobilization of savings with government guarantees, increased staff productivity (the result of motivation and training), and the support which the village unit network received from BRI's entire structure (whereby *Cabang* provided technical follow-up and monitoring services and ensured a balance between profitable and unprofitable units). In December 1996, the village units had 16.2 million depositors, 2.5 million borrowers, and a surplus of $1,260,000 in savings over outstanding loans ($1,705,000). BRI's outreach places it among the world's largest institutions offering services to rural areas. A comparison of unit performance of BRI and KUD – two networks which were created to support the green revolution – suggests that the Government has established two very different entities. One is a commercial enterprise free of cumbersome operations and constraints which might undermine its efficiency (although it is still vulnerable to the pressures of corruption) and possessing the financial and human resources enabling it to operate profitably. The other is a policy-oriented channel for government support for specific agricultural development programs and a player in defining the structure of rural areas. Older institutions thus were affected differently by the liberalization process. The study will now examine its impact on new institutions seeking a place in the financial landscape.

RESULTS AND DISCUSSION

1. Characteristics of Successful Microfinance Associations

   The following characteristics contribute to the ability of a network or an association of small banks or Microfinance Institutions to contribute to the development of its respective sector: an efficient management, a transparent governance structure, increasing sustainability, a big and committed membership, a demand for services and the capacity to satisfy this demand.

2. Management Capacity and Governance Structure

   An efficient management helps to divide labor and coordinate tasks. Sound financial management is a precondition for efficient work and building of trust. A business plan is a powerful management instrument: it outlines the vision and development goals for the next years. It should be revised according to the objectives and reacts to external signals, opportunities and threats. Vision and objectives should serve members' interests. As Brüntrup points out, business plans give the association a common direction and can be used to plan for self sufficiency, "by making the distinction between vital key activities, services, and resources necessary for the survival of the MFA, and supplementary elements that are important but not indispensable."

   The governance structure is closely related to the management capacity. An efficient governance structure demands transparency, impartiality and a strong executive. It should be free of political interference. Due to the voluntary membership, an unequal distribution of resources by the association can lead to abandonment by the members, unless their commitment and ties are very strong. Thus, commitment and representation of members should be insured.

3. Sustainability

Whether or not MFAs should be financially sustainable depends largely on the type of services they offer. Lobbying, information exchange, coordination of sector-wide activities are services that cannot be provided in a cost covering way, as the industry as a whole benefits from them it would be difficult to identify individual entities that could be charged for the services. Other services, such as training, have to be sold at market prices.

Thus, MFAs should be considered sustainable when core services are provided based on membership fees. It is crucial to distinguish between an association, which offers goods that benefit the whole sector and are hard to value or sell at a fixed price to customers, and training providers, offering specific courses for a specific price. For the latter, the sustainability should be increasing. Growing cost coverage in income statements gives a realistic perspective on the institution's future sustainability. The role of donors can be crucial: the maintenance of the logic of an artificial economy introduced by donor funds has to be avoided by all means. Incentives for the MFA to become sustainable and a gradual exit strategy need to be developed. Furthermore, MFAs, like all member-based institutions, should not be dominated by donors and have enough space to develop from within.

4. Membership

A big membership and the ownership and commitment of members are helpful to build up a client base and ensure membership fees. A big membership increases political power and influence in the microfinance industry. On the other hand, keeping the membership small facilitates decision-making processes. The more heterogeneous the membership base, the more internal problems arise. More common goals and a better political standing are achieved with a homogenous membership base. However, maximising the membership in order to broaden the financial basis is not the right strategy. Membership fees are low and do not justify lowering the entrance criteria if the result is a weaker association. The quality of the membership, a common commitment and common goals are more important. Thus, it is crucial to find the right balance between depth and outreach.

5. Demand for Services

MFAs are generally looked at as service providers for the Microfinance industry. Their services range from networking and information exchange to the facilitation of trainings. Some of these services can be sold at market prices, others cannot. Ideally, services would benefit the whole sector. A successful service provider should know the market for its products and its potential, and offers services on the basis of a realistic estimate of the demand. It should further have the capacity to satisfy this demand.

MFAs should look at their activities and find out which services they can offer to their members and non-members and analyse their needs, and the capacity and willingness to pay for them.

6. External Factors

Several external factors contributed to this miraculous success of microfinance institutions during the crisis. First of all, the unconventional nature of clients helped: Most micro finance clients operate in the domestic economy and were not directly affected by the currency crisis.

Second factor was the efforts of the Indonesian government to quickly institute emergency antipoverty programs. With help from the IMF and other donors, government programs supplied food, created employment, and kept children in school. These programs, along with the stabilization measures, ensured that most of the economically active poor could stay economically active and therefore were able to make use of commercial microfinance services during the crisis.

7. Internal Factors

However, more unique success factors can be found in the institutions:

First, borrowers greatly valued the option to re-borrow in times of difficulty and thus made loan repayment a high priority. Savers also tried to save more and consume less. Thus, the behavior of the clients was the driving force behind the stability, and this behavior was the result of the education that the institutions had provided, directly and indirectly. The institutions provided trainings and education on the basic economic concepts and skills (direct), but the learning also came from the experience of using microfinance institutions (indirect).

Also, savers valued the security, convenience, liquidity, confidentiality, products, and services offered by these institutions, and some savers moved their accounts from failing banks to the unit desa or other microfinance institutions.

Finally, the institutions had built a record of trust. They had good, committed management, friendly and motivated staff, and products appropriate for microfinance clients. As they had successfully provided what clients could not find or afford elsewhere in a professional and friendly way, clients remained loyal during the difficult time.

As mentioned earlier, Indonesia has created some successful and sustainable projects such as the BRI Unit Desa, BDB and BKD. But there still remain some outstanding issues and challenges that microfinance programs need to address.

8. Inadequate outreach to the rural community

Most of the programs that have been relatively successful have been located in the Java and Sumatra islands. Furthermore, the bulk of the microfinance institutions and programs in Indonesia are located in the urban area. The reasons for such limited scope are as follows:

a. The successful program, BRI Unit Desa, was initially evolved from BIMAS (Government Mass Guidance) which was a subsidized program targeting the rural rice farming industry; the majority of the rice farming industry in Indonesia are located in Java island

b. The majority of the Indonesian population is actually located in these two islands: 60% in Java and 20% in Sumatra. It made sense that most of the programs will be initiated in the most populous regions.

c. In order to remain sustainable, the successful program, such as the BRI Unit Desa, needed to cover its operations costs. One way to achieve this is by making sure that there is a large base of customers to spread its expenditures and makes sure that it is located closer to the consumer's home and workplace. Therefore, during the restructuring of BIMAS to BRI Unit Desa in 1984, many of these units relocated from rural rice productions centers to the urban commercial centers or district capitals

d. Government created new laws to improve overall banking regulation and supervision due to a large proliferation of privately owned banks in Indonesia. The law's reach encompasses BPRs operation. The effect is increased minimum paid-up capital requirements to set up new BPRs and minimum capital assets for existing ones. This caused many BPRs to move up from village/desa levels to district/kecamatan levels which reduce service for rural areas (e.g. BKDs)

Greater efforts are still needed to expand the reach of the microfinance programs. One way to address this is to let BRI Unit Desa to continue serving the district levels and return the BKDs to the village levels and the more rural areas. Concerns such as set up costs for rural areas perhaps can be addressed by creating a mobile microfinance outlet. Some experiments have been made to have a staff from a more populated village area to have a weekly trips to the surrounding more rural villages to offer microfinance services, and this had indicated some promise. Government coordination will be required to incentivize BKDs to be more active in rural areas (e.g. provide infrastructure, initial subsidies). Government also need to revisit the 1992 laws and made a distinction between larger BPRs operating in a more economically active urban areas and the smaller ones in rural areas; adjust the law to protect microfinance initiatives in the rural areas.

NGOs on the other hand can play a role in pushing for a wider outreach of the microfinance program to rural area. NGOs can provide initial efforts and grants to start a program that specifically target the rural poor and then push the government to aid in providing the right environment to grow and sustain these initiatives. Without government support, it will still be difficult for NGO programs to morph into a more sustainable form of microfinance because they have limited resources for proper supervision and regulation.

9. Impact of Politics on Microfinance Efforts

Most of the microfinance programs in Indonesia are still operated or funded by the government. Although BRI Unit Desa is run by a commercial bank, BRI itself is still owned by the government. The positive impact of this is that with the support of the government, the projects can receive initial funding. Initially private commercial banks do not see the profitability of microfinance and thus steered away from it. Successful government led programs had created interest in the public sector to develop such services for the poor, such as the BDB (Bank Dagang Bali). But there are negative impacts also that can threaten the future of microfinance, whether it is the sustainable ones or not:

a. Since most are government owned or operated, there are many political pressures that can jeopardize the various microfinance programs. One example is that during the election periods, these microfinance institutions faced pressures to reduce their underwriting and collections efforts which undermine its sustainability. Another is that in order to satisfy local government demand, certain programs were overstaffed and became inefficient.

b. The government has many programs rolled out from different ministries, and due to political and communication issue, there are conflicting programs. One example is the efforts from the Ministry of Cooperatives to discontinue plans too expand the BKD system which was quite successful. The reason was that the Ministry was worried that the BKDs will compete with the microfinance activities of its own program called KUD (Village Cooperative Units). Yet since the cooperative is outside of the banking regulations, it has not always adhere to prudent banking standards in its operations, therefore became less sustainable than the BKDs.

Since the government resources is strained and many times decision to pursue poverty alleviation measures is politicized, NGOs need to come and put more pressure and awareness to the plight of the poorest of the poor. Better communications between the different ministry departments will also help to assure that one project does not jeopardize the others.

10. Lack of Awareness of Microfinance Policies

There is still lack of awareness of sound principles of microfinance within the organizations that developed and provided microfinance initiatives in Indonesia, whether it is the government officials, NGOs or privately owned institutions (formal or semi-formal). As of yet, there is no centralized training centers where the different players in microfinance can go and get additional training and support.

This lack of understanding and training produced the following problems in order to satisfy public concerns or to address political pressures, the government developed directed and subsidized microfinance programs. The intention is well, but some programs were created within the space of the sustainable microfinance initiatives. This created an unfair competition for the sustainable microfinance institutes such as the BRI Unit Desa and can jeopardize its operation

11. Effects on Poorest of the Poor

Finally, there are concerns that the impact of microfinance in Indonesia is only benefiting the better-off of the poor. What about the poorest of the poor? They are people who are living below the extreme poverty line, people who has no means of income, whether it is skill or asset.

Microfinance works by allowing people who are already economically active to take advantage of greater economic opportunities. It helps people with microenterprise to borrow money to purchase assets that can help improve its operations and profits. It helps people with a working income source to weather financial shocks or shortages by giving them a more flexible and smoothed finance, give loans or provide means for savings to tie them up till the next stream of revenue comes along. It helps people with the skills and knowledge to create a business to start one by providing loans to acquire the necessary assets and equipments.

What microfinance does not do is to create new opportunities. The poorest of the poor typically have limited skills and assets to create stable income source. Their immediate and main concern is to fulfilling basic needs such as food, shelter and clothing. Many live in remote rural areas where there is no viable market for them to become economically active. For them microfinance is not the answer to get them over the poverty line.

CONCLUSION

Microfinance activities in Indonesia has shown that with proper incentives and good operating principles that adhere to market economy principles, providing financial services can not only become sustainable, but even profitable. The sustainable microfinance program, BRI Unit Desa, was so well executed that it ended up performing better than the large commercial banks during the 1997 Asian economic crisis. This is not just because the economic activities of the BRI Unit Desa's consumers is in domestic market, but also because the system has taught the poor people the advantages of having proper credit history, due to the progressive loan system, and good savings, to weather them through shocks and slow time.

As an institution, microfinance has been successful in help improve the economically active poor to maintain and grow their source of income and increase their living standard. Unfortunately in order to be sustainable, there are certain conditions that need to be met that made expansion to rural and less populated area difficult. To address this, government and NGOs need to start by initializing subsidized programs, then nurture and grow it until it can become sustainable. Innovations will also be needed to assure that rural regions will be served, such as mobile microfinance outlet.

From studying Indonesian microfinance initiatives, in such a disperse and expansive country, government involvement is crucial in making sure that the programs can be successful. Only the government has enough power and resources to provide the needed infrastructure, supervision and regulation. Better communications amongst the various players and better understanding of the microfinance principle will also aid the government to regulate and supervise the various programs.

Finally, care should be taken in addressing the poorest of the poor. Microfinance works well for the economically active poor that have access to market. For others in the lowest strata of economy, where there is limited or no economic opportunity available, a program that includes aid, training and infrastructure development might be the better choice. Microfinance is not a cure all; its strength is in allowing the poor to take advantage of economic opportunities, not in creating them.

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APPENDIX

Tabel 1. Data of Poor Population 1996-2006

Year	Total (million)			Percentage		
	Kota	Desa	Kota+Desa	Kota	Desa	Kota+Desa
(1)	(2)	(3)	(4)	(5)	(6)	(7)
1996	9,42	24,59	34,01	13,39	19,78	17,47
1998	17,60	31,90	49,50	21,92	25,72	24,23
1999	15,64	32,33	47,97	19,41	26,03	23,43
2000	12,30	26,40	38,70	14,60	22,38	19,14
2001	8,60	29,30	37,90	9,76	24,84	18,41
2002	13,30	25,10	38,40	14,46	21,10	18,20
2003	12,20	25,10	37,30	13,57	20,23	17,42
2004	11,40	24,80	36,10	12,13	20,11	16,66
2005	12,40	22,70	35,10	11,68	19,98	15,97
2006	14,49	24,81	39,30	13,47	21,81	17,75

Source: Survei Sosial Ekonomi Nasional (Susenas)

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GENERAL COMMENTS

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