The Role of Micro Finance Institutions in Supporting Small Businesses in Village: Evidence from West Java Indonesia

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Abstract. This study aims to produce a model of the development and implementation of Micro Financial Institutions (MFIs) in the rural areas as an alternative source of financing for rural MSEs that is estimated to have a role in creating jobs and reducing poverty once they are empowered. The study uses a Descriptive Comparative Method and a Survey Method. The results of this study indicate that the development of Micro Finance Institutions should be supported by equipping them with the ability to access the capital from certain sources provided by the government through the designated banks. Besides the financial aspect, the development of micro and small enterprises also requires other aspects such as sustainable development, mentoring, and technical assistances.

Keyword : Micro and Small Enterprises, Micro Finance Institutions, Credit Distribution System

1. Introduction

Micro and small enterprises (MSEs) have a strategic role in tackling poverty and unemployment, but they are still facing various problems that become obstacles to their development. The main obstacles faced by MSEs are less conducive business environment in addition to internal problems associated with low access to capital, access to markets, and lack of entrepreneurial competence. One measure that can be done to empower MSEs is the provision of a guarantee of access to financing sources, i.e. through Microfinance Institutions (MFIs). Micro Finance Institution is an institution that conducts the activity of providing financial services to MSEs as well as to low income people who are not served by formal financial institutions. However, the majority of MSEs are concentrated in rural areas. Therefore, it is the time for the financial institutions to change their orientation, from being urban financial institutions to being rural financial institutions. This orientation shift is necessary in order to support the development of rural areas to be competitive in the current global economic order. Microfinance institutions in the rural areas can be an alternative to solving the problems faced by small and micro enterprises in the rural areas. This institution will function as the center for the capital mobilization in the rural areas. With the availability of adequate capital and easy access, the micro scale enterprises will develop, thus not only improving their business scale and productivity but also increasing their revenue, purchasing power, and absorption level of employment. In addition, this will reduce urbanization, poverty, and tackle unemployment level (Sri, 2004; Ashari, 2006; Kementerian Koperasi, 2002)

2. Literature Review

SMEs in Indonesia have a very strategic role, but their development is relatively limited due to various constraints they face. One of the constraints is capital issues, such as accessibility to capital. This constraint proves to be a major problem, compared to other problems based on BPS, 2009. They are assumed to be not bankable because they have no collateral, have a low ability to repay their loans, have low saving habits, and have a high transaction cost. Due to these assumptions, their accessibility to formal financial resources is low, causing most of them to rely only on their own capital. BPS Data, 2009, revealed that over 90 per cent of fund for small and micro businesses were obtained from their own capital sources. In relation with the data, it is therefore neccessary that the government, educational institutions, and public agencies find ways to make these small and micro businesses get access to the available funds that have been allocated for them by the government and find ways to overcome their weakness in capital. Although there have been many financing programs for rural areas, these programs are criticized for not being effective in financing the rural

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economy. To respond to the failure, several financing programs that are associated with poverty reduction programs in rural areas, such as Infrastucture Development for Under Development (P3DT) and KDP program has been introduced. However, to date, these programs has not yet shown its success. Some of the conventional lending institutions such as BRI, Village-based cooperatives (KUD), state-owned enterprises (BUMN), and some programs such as P2KP, Subdistric Development Program PPK, Small Business Credit (KUK), Permanent Working Capital Credit (KMPK), Farm Credit (KUT), and many others, have not yet been able to empower the SME actors in the rural areas. Some conventional lending institutions such as BRI service, cooperatives, state enterprises, and several programs implemented including P2KP program, KDP, Small Business Loan (KUK), Permanent Working Capital Loan (KMPK), Farm Credit (KUT), and so on, are not capable of capable of lifting MSME entrepreneurs from helplessness. In fact, government-subsidized venture funds to SMEs through some of these institutions, with a pattern-interest loans, leave the credit crunch problem everywhere because of their reluctance or inability to return the principal and interest on loans with a variety of reasons (Budi et all,2006; Rahmat et all, 2007)

3. Research Method

Descriptive Comparative Method was used in this study. The techniques used in this study were (1) literature studies and (2) Survey (interviews and observations). The data sources and types consist of secondary and primary data. The study sites are located in Tanjungsari, Tanjung Medar, Ujung Jaya, and Jatinggal District of Sumedang regency. The study was conducted from April to November 2009. The analytical methods used in this study were descriptive analysis, potential analysis, and SWOT analysis. This research can be used as reference material further research for the local MFIs and SMEs in rural communities and local government as well as evaluation and improvements materials for the program in issuing the policy for the development of local MFIs in the rural areas.

4. Results and Discussion

4.1. Characteristics of Micro and Small Enterprises in Rural Areas

Most of the knowledge level of rural MSE actors is relatively limited, causing difficulties for them to meet the requirements set by the financial institutions. From the legal aspect, 89% SMEs merely have the certificate of incorporation. As for company licenses, most MSE companies have the company registration proof (TDP), while those with a licensed business are still in the category of CV with either group or individual ownership status. The number of companies with the individual ownership is as much as 72 percent. Most MSEs' turnover per month is less than Rp. 50 million, which is about 88%. However, there is about 1% of them whose turnover is more than Rp. 200 million per month. Most SMEs with the amount of venture capital of less than Rp. 50 million is about 89 percent, while those with the amount of venture capital more than Rp. 200 million is only 1%. Regarding the procedures/requirements, most companies finding it difficult to obtain a financial credit from a financial institution is as much as 76%.

4.2. Characteristics of Microfinance Institutions (MFIs) in Rural

The average age of most MFI owners is still in the category of productive age. From their educational background, approximately 50% of MFI owners are undergraduates, and as much as 32.14% are of high school graduates. Only a small percentage of them are elementary and junior high school graduates. The MFIs with legal status are 78.57%, with a cooperative status is 57.14%, and with PT and/or group ownership status is as many as 10.71%. Furthermore, MFIs run by other people are as many as 60.71%, and the rest is administered by an individual or by a group. Therefore, the management of MFIs is varied. The amount of funds channeled to the MFIs is of Rp. 300 million, or as many as 32.14%, while the number of loans channeled to communities ranges from Rp. 100 million to Rp. 300 million, which is as many as 25%. One of the ways that MFIs channel their funds is through a loan basis, which is as many as 37.86%. Another way of channeling their funds is through a credit basis, which accounts for 32.14%. As many as 67.86% of MFIs have granted credits to their customers within the range of between Rp. 1 million and Rp. 9 million. The amount of credit ranging from Rp. 10 million to 25 million granted to their customers is 21.43%. The decision on the amount of credit granted to the customers on the basis of their business feasibility is by 75%, while decision on the amount of credit granted to the customers on the basis of the value of their collateral is as many as 25%. The monthly based payback of the credit to MFIs is 60.71%, on daily based is as much as

3.57%. The procedure to obtain credit from MFIs by making a letter of agreement is 28.57 percent and the procedure to get credit from MFIs by filling out insurance papers is 17.86 percent. The percentage of the credits granted to customers range from Rp. 1.000.000,- up to Rp. 9.000.000,- is 67.86 per cent, and the amount of credits granted to customers ranging from Rp. 10.000.000,- to Rp. 25.000.000,- is 21.43 percent. Considerations the amount of credit provided to customers that depend on the feasibility of the business is 75 percent, while the consideration of the amount of credit provided to customers by the amount of guarantee is 25 percent. The maturity date to MFIs is on monthly basis is 60.71 percent, while daily is 3.57 percent, the maturity time on yearly basis is 17.86 percent yearly, while the maturity time on seasonal/harvest time basis is 10, 71 percent and the maturity on a weekly basis is 7.14 percent.

4.3. Analysis of Business Potential of SMEs in Rural Areas

In this study, there are 27 types of businesses run by the rural people that can be categorized as micro and small enterprises. To identify which types of business are favored or potential, they are analyzed by using six indicators, namely: (a) condition and prospect for marketing, (b) entrepreneurial potential, (c) production inputs, (d) infrastructure, (e) growth potential, (f) and perceptions of SMEs owners on the implementation of government policies in the promotion and development of small commodities. Based on the *potential analysis*, the types of businesses that are (1) very potential, (2) potential, (3) less potential, and (4) not potential can be identified. The results of the *potential business analysis* of MSEs are presented in Table 1

Table 1 The results of the potential business analysis of MSEs in Sumedang Regency

No.	Category	Type of Business
1	Very Potential	The kite, Dairy Cattle, Sweet Potato of Cilembu, Catfish, Organic Fertilizer
2	Potential	Fattening Beef Cattle, Fishery, Brown Sugar, Rice, Tobacco, Deblo, Know, Opak Ketan, Sale Bananas, Palette,
3	Less Potential	Opak Red, Powder, Bowl, Embroidery, Selling grocery, Matting,
4	Not Potential	Rangginang, Salted Eggs, furniture, chips, Extract, Turmeric, Sweet Dodol,

The results of the analysis in Table1 show that there are several things to be considered. The first is the lack of entrepreneurship potentials among the owners of SMEs. The entrepreneurial potentials concern the individual factors, such as expertise, knowledge, motivation, and work behavior of individual entrepreneurs. They play a role in the success of a business activity. The second is the weakness in the marketing aspect. There are many shortcomings in developing their business products, such as lack of network development, knowledge in the market search, and receiving information from the government. The third is that the products that are considered less potential and not potential can actually be developed even further by fixing some of their weaknesses as mentioned in the indicators of business potential assessment.

4.4. Analysis of Environmental Enterprises in Rural SMEs and MFIs

These identified positions can then be used as inputs for applying a financing model for SMEs in rural areas. The results in Figure 1.
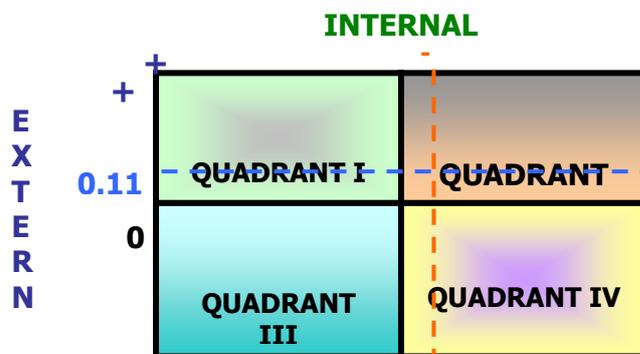

Fig 1. Matrix of SWOT Analysis of MSEs

Figure 1 shows that the position of Micro and Small Enterprises is in quadrant II. This position indicates that even though they lie in the opportunity position, they still have some flaws. The strategy that can be applied for this position is Strategy of Self Improvement. When applying this strategy, they should minimize their weaknesses and use their strengths to seize the opportunities. As for the position of MFI's businesses, it can be seen in Figure 2.
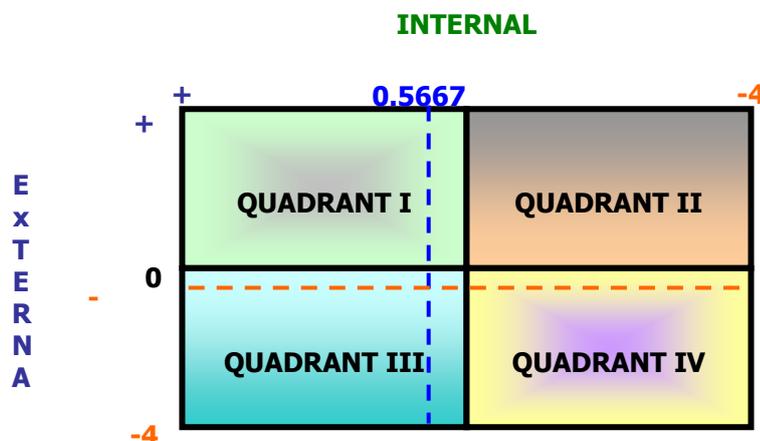
INTERNAL

Fig 2. Matrix of SWOT Analysis of MFIs

Figure 2 shows that the position of the MFI's businesses is in quadrant III. This position indicates that they have both limited opportunities and weaknesses. The strategy that should be employed is Diversification Strategy. When applying this strategy, they should use their strengths to cope with the threats and seize opportunities. (Hunger

4.5. The concept of empowerment of Micro and Small enterprises (MSEs)

To empower SMEs, improving their ability to do business and providing them with financial support should be done. All measures and policies should be focused on encouriging banks to finance their. Therefore, eforts that should be made as far as the empowerment of SMEs are as follows: (1) issuing conducive bank credit policy (2) providing technical assistance, and (3) developing and strengthening their institution. One form of independence of MSEs in carrying out their businesses is their ability in accessing the capitals from certain sources. Besides the financial aspect, other aspects such as coaching, mentoring, and technical assistance that support their development should also be provided. Accordingly, the empowerment and development of MSEs require a commitment, real involvement, and good coordination among all actors -- both banks and related institutions. Through this commitment, both in the provision of funds, technical assistance, and institutional strengthening, it is hoped that MSEs' access to bank credit facilities can be realized. (Chamber, 1995)

4.6. The concept of Developing MFIs in Rural Areas

The noble vision and mission of microfinance institution cannot be realized by ordinary way. The institution must be built with passion, perseverance, spirit of co-operation between the community and the institution as well as equipped with the institution officers that have a high motivation. The above-mentioned development efforts are not only economically financial but also sociological, which is loaded with religious content. In relation with developing MSEs, the MFIs must have the characteristics of humanity. These are an initiative, give opportunities, promote, and be in favor of SMEs. The principles that must be considered in developing MFIs in rural areas as follows: (1).The procedure of obtaining credit application for SMEs should be relatively simple and easy. (2) The schedule for Credit Return should be adjusted to the production process of SMEs. (3) The rates charged by MFIs should be relatively lower than other financial institutions. (4) MFIs should be able to collect funds from the people in the rural areas. (5) MFIs should be located nearby the business premises of MSEs. (Chaston et all, 2001).

5. Conclusions and Recommendations

5.1. Conclusions

Based on the findings of the study and the discussion of them, it can be concluded that:

The source of capital for SMEs to run their business comes from their own capital, their own family, an individual money lender, Cooperatives, Government's Credit Program, and banks. The characteristics of MSEs are (a) run mostly by old aged employers, (b) run by primary school graduate employers, (c) most of the profit they earn is used for their daily consumption, and (d) their products are still marketed the vicinity where the MSEs are located. Funds provided by the MFIs for MSEs Credit is still relatively low. MSEs find that the procedure to obtain the credit is still difficult. The interest that is charged is still high. The MFIs is still managed by relatively low qualified human resources.

5.2. Recommendations

Based on the conclusions, it is recommended that the following should be followed up:

(1). To the managers of MFIs, they should lend SMEs credits which is in accordance with the feasibility of and cost required for running the business. (2) The supportive and mutual benefit of performance and cooperation between MFIs and MSEs are required. (3) In giving a loan, the type of business and the duration of the production process need to considered.(4) To implement the concept of empowering MSEs, its empowerment patterns should be made in such a way that the concept can be applied. (5). The concept of developing MFIs in rural areas includes the principles such as the loan application procedure should be relatively simple and straightforward, the credit return schedules must be adjusted to the MSEs' production period, the interest rates should relatively be lower than that of other financial Institutions.

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