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The Need and Availability of Micro Finance Service for Micro Enterprise: Bringing Multi-Level Good Practices into Local Context

APEC Small and Medium Enterprise Working Group

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Authors:
Bagus Santoso (Team Leader)
Agung Nur Fajar
A.H. Roslan
Chandra Fajri Ananda
Dhirawit Pinyonatthagarn
Hendri Saparini
Janina V. L. Castillo
M. Soekardi
Rino A. Sa'danoer
Salvador I. Sibayan

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Prepared by:
PT. Arah Cipta Guna
JL. Pengadegan Barat Raya No. 21
Jakarta Selatan
12770

FOR THE ASIA PACIFIC ECONOMIC COOPERATION
SECRETARIAT
35 Heng Mui Keng Terrace Singapore 119616
Tel: (65) 6775-6012 Fax: (65) 6775-6013
Email: info@apec.org
Website: www.apec.org

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Chapter 1

INTRODUCTION AND GENERAL OVERVIEW

The Need and Availability of Micro Finance Service for Micro Enterprise: Bringing Multi-Level Good Practices into Local Context

(Case Study: Indonesia; Malaysia; Mexico; Thailand and the Philippines)

1.1 Background of Study

Micro finance is relatively a new common issue in economic discussion, although micro finance institutions have existed since several years ago. Micro Finance Institutions (MFIs) offer assistance to poor people in finding solution for their financial problems.

In general, the poor are lack of education and skills. It is difficult for them to obtain decent jobs in formal sectors. Moreover, in the age of modern technology, people are required to have a certain level of basic education. Therefore, poor people usually run micro and small-scale business in their search for new breakthrough to improve their lives. However, most of them operate their business without or with minimum external financial assistance, since they do not have adequate access to financial resources. They are lack of access to financial resources due to the absence of assets for collateral. As a result, they cannot obtain financial supports to expand their businesses beyond the minimum level of subsistence.

Economic activities of Micro and Small Enterprises (MSEs), have not been the main concern to some governments and other related parties. Their economic activities are generally classified as informal economic activities, since they do not have formal recognition and grow naturally by themselves. They are considered to have no significant contribution to economy. Consequently, governments excluded them as one key factor in economic development. In many cases, public and government policies have hampered the development of informal economic activities.

Macroeconomic change has direct effect to economic activities of the poor, in this case MSEs, as it could be seen during the crises. Therefore, macroeconomic policies taken by the government will also directly affect their economic performance such as: interest rate rise and inflation generating policies.

MSEs have distinct advantages over big businesses. Although they can easily be affected by negative effects of economic change, but, due to their size they can also be more flexible to cope with the change. As being proved after the East Asia crises in 1997 – 1998, they recovered faster than the bigger businesses. Therefore, it is important to learn more about MSEs and all factors that support them, such as the need of MFIs and efforts to develop them. In learning the position of micro finance institutions (MFIs) for small-scaled businesses, the important issue still lays on how effective micro finance is conducted to assist the poor. Success stories of their operations across the economies are good instances to pose.

It has been acknowledged that, for many years, MSEs have been a significant agent of development in most developing economies. MSEs have helped the developing economies in providing alternative income resource to improve living quality of the poor and improving welfare of the society.

Further discussion on this topic will include at least two institutions, Micro Small Enterprises (MSEs) and Micro Finance Institutions (MFIs). In order to promote MSEs and MFIs development, further study is required to analyze the best practice of MFIs management system and types of MSEs that succeed in using the services of MFIs optimally.
Based on the reason that MSEs and MFIs are important to discuss in relation with national economic development, study of "The Need and Availability of Micro Finance Service for Micro Enterprise: Bringing Multi-level Good Practices into Local Context" is implemented. This study is discussing an assessment on the need of MFIs for micro enterprises (also called "Micro and Small Enterprises/MSEs) in five economies that is in Indonesia; Malaysia; Mexico; Thailand; and the Philippines. Identification of MSEs problems is also included in the study, but this study will focus on micro finances.

Although MFIs services for MSEs are important issues to discuss, until recently, there is no best standard for micro finance practices. However, there are some lessons to learn from some studies about micro finance in several economies. By examining MFIs and MSEs experience in various economies, then this research identifies characteristics of best practices and assesses the possibility of implementing these best practice strategies in the local context.

1.2 Objectives

There are four objectives of this study:

1. To assess the capacity of MFIs and problems faced by the MFIs to deliver micro finance services to the MSEs
2. To collect information about good practices done by some MFIs in delivering services, in term of outreach, collectability and sustainability
3. To assess the need for MFIs services at micro level and to identify problems faced by micro enterprises to access the services
4. To assess the expectation of MSEs to the MFIs (in term of location, delivery system, interest rate, mode of payment and amount of money).

1.3 Research Output

This study will explore the stylized facts about MFIs in the Asia Pacific Cooperation (APEC) region in general, particularly in five APEC member economies, namely Indonesia, Malaysia, Thailand, Mexico and the Philippines. Upon the completion of this study, it is expected that governments in APEC economies will be able to set the sound foundation policies and programs for MFIs and MSEs development. In longer term, it is also expected that MFIs will grow and sustain. Moreover, MSEs will be able to have wider access to financial sources.

In reference to the above objectives, this study should produce workable policy recommendations in each economy. The results of this study are not expected to be identical for all APEC economies, since each economy has its own characteristics.

In the short, medium and long run, the output of this study can be regarded as successful if there are:

1. Improvement in term of quality of policies, particularly the sustainability of MFIs and development of MSEs
2. Steady growth of MFIs that can help the progress of MSEs, some of which are expected to be grow bigger in size and become medium (or even large) enterprises. Otherwise, when micro enterprises stay in the same scale, the policy is deemed to be failed.

The result of this study is expected to benefit both governments and private/business institutions in each APEC member economy. Direct benefits for government institutions are:

1. Better understanding the capacity of MFIs and problems faced by the MFIs to deliver micro finance services to micro enterprises
2. Able to develop appropriate policies and programs in developing MSEs, particularly in broadening access to financial institutions

While for private/business institutions, direct benefits of this study are:

1. To improve outreach, collectability and sustainability of MFIs
2. To improve development of MSEs.

1.4 Literature Study

Definition

Small Medium Enterprises (MSEs)

Micro and small enterprises in this study are defined as enterprises that employ ten or less workers. Normally, these enterprises are family-owned, lack of legal status or recognition and operate in the informal sectors, either in producing goods or services.
In general, MSEs constitute a significant percentage of economic activities in most developing economies. Moreover, MSEs would be very potential economic agents in poverty eradication program.

The development of MSEs has a tremendous macro-economic effect. This effect is simply due to the pure size and diversity of the economic activity. Further, for people living below the poverty line who normally do not have specific education or skills, MSEs are the main – not to said the only – source of employment and income. But working in informal sector is the most possible alternative, since specific educations and skills are less required in MSEs. In many developing economies, economic structure is mainly supported by MSEs. For example, in 1998, MSEs in Latin America and Caribbean have the major employment providers. MSEs contribute 73% of total enterprise operate in Latin America and Caribbean.

The same case can also be found in Indonesia, MSEs provide more than 90% in job creation in Indonesia in 1998. In this case, the micro enterprise is included in the small enterprise classification. Table 1.1 presents the number of enterprises in Indonesia and the labor participation.

Table 1.1
Number of Enterprises in Indonesia, 1998

Enterprises	Number	%	Labor	%
Small	40,137,773	99.85	65,246,294	88.6
Medium	57,743	0.14	7,993,449	10.85
Sub Total	40,195,516	99.9	73,239,793	99.45
Corporate	2,095	0.01	406,215	0.55
Total	40,197,611	100	73,646,008	100

Sources: Ministry of Cooperatives & MSEs, modified.

Beside the potential of MSEs to provide income sources and job opportunity, there is another issue about the existence of MSEs, that is opportunity for women to get involved in economic activities. In poor society, many women are forced to be involved in income generating activities, but only at the level of survival. One of the most familiar cases of women empowerment is found in Bangladesh with Grameen Bank. Gender issues on MSEs will be discussed in particular section in this report.

Each economy has various definitions to describe MSEs' conditions. Each definition in general is based on three factors, assets, sales turn over and employment. In each definition, there may only be found two of the above or all of them. The World Bank classifies enterprises into micro, small and medium scale enterprises as in Table 1.2.

Table 1.2
Characteristic of MSE

Measurement	Micro Enterprises	Small Enterprises	Medium Enterprises
Asset	< U$ 100.000	U$ 100.000 – 3.000.000	U$ 3.000.000– 15.000.000
Sales	< U$ 100.000	U$ 100.000 – 3.000.000	U$ 3.000.000– 15.000.000
Employees	< 10	10 – 50	> 50

Source: Rudjito, 1995.

Other definition proposed by the Inter-American Development Bank (IDB, 1998) defines micro enterprises as:

" *… a productive unit employing 10 workers or less with total assets below*"

Economic Commission for Latin America (ECLA, 1997) has relatively similar definition for micro enterprises is:

" *micro enterprise is a firm with less than 10 workers, including the owner* "

Most micro enterprises operate without legal formal recognition. It means that most MSEs operate in semi-informal or informal manner. The purposes of micro entrepreneurs are not to expand their business, but to subsist. They usually produce home-base industry and focus on labor intensification. Based on the sector, most MSEs operate in retail and services especially in trade sector. Therefore, these MSEs' characteristics can be itemized as follows (Werner, 2001):

1. Non-formal operations
2. Focus on retail and services
3. Labor intensive
4. Home-based industries
5. Most of these enterprises are managed or owned by women owner
6. Subsistence (most of them are not purposed to expand their operation)

When we analyze the type of MSEs, there are different characteristics of MSEs in developed economies and in developing and under-developed economies. Table 1.3 exhibits business model between micro enterprises in different type of economies. Developed economies is called first world, while third world represent developing and under-developed economies.

Table 1.3
Examples of Micro Enterprise Business in First and Third World

First world	Third world
• Caring for children or pets	• Plant crops and fatten livestock
• Cutting hair or polish nails	• Doing odd jobs, especially on farms
• Cooking food and sell drinks at festivals	• Cooking food and sell drinks on the street
• Selling Avon, Amway, or Mary Kay	• Petty trading in food, clothes, or toiletries
• Cleaning homes, cars, or offices	• Taking in laundry
• Trading and/or repair clothes or cars	• Making and/or repair clothes or cars
• Painting or repair houses	• Building or repair houses
• Cutting grass or trim branches	• Collecting and sell wood, charcoal, or water
• Killing pests	• Carrying loads or messages
• Repossess cars	• Driving a bus or truck
• Working with wood	• Working with wood or metal
• Video tapes Rental	• Showing movies from video tapes
• Deejay parties	• Playing a band
• Driving cabs	• Running a rickshaw
• Quilt or knit blankets	• Husking rice or selling peanuts
• Slinging newspapers or brochures	• Selling newspapers or lottery tickets
• Making and sell arts and crafts	• Scavenging for things to recycle
• Making and sell fake-jewelry	• Making and sell baskets or rope
• Buying and sell drugs	• Shining or repair shoes

Source: Screiner, 2001

Besides business sector, the difference between MSEs in developed and developing economies are value added produced and access to supporting resources, such as finance, technology and marketing. Further discussion in this study deals with MSEs in developing economies.

The main problem faced by MSEs in developing economies is to find funding sources. Most of MSEs have limited access to financial services offered by commercial banks. Commercial banks are sometimes reluctant to channel their fund to micro and small enterprises, mostly because of information problems, high credit risk perceptions, lack of acceptable collaterals and high transaction costs of processing small loans. On the other hand, MSEs only need appropriate and small-sized loans, of which the repayment terms coincide with their cash flow.

In details, several factors that hamper MSEs to develop are:

1. Lack of capitals
2. Lack of skills
3. Lack of ability to negotiate with big buyers
4. Legal aspect of MSEs (informal operation)
5. Lack of ability on market identification

Micro and small enterprises usually do not have a credit history with conventional banks, nor the required collateral. These factors contribute to high transaction costs and perceive risks for giving credits to micro-enterprises, which in turn will turn down the credit proposals. Since traditional banking did not serve the demand for financial services by small and micro enterprises, non-traditional and non-conventional approaches emerged in the credit markets. MFIs as well as a variety of micro lending technologies have emerged to meet the demand.

From the macroeconomic perspective, MSEs has limited supporting environment. Asian Development Bank (ADB) identified factors that become major problems for MSEs to develop themselves, are (ADB, 2000):

1. Policy environment
2. Inadequate financial infrastructure
3. Limited retail level institutional capacity
4. Inadequate investment in agriculture and rural development
5. Inadequate investment in social intermediation

As mentioned in the previous sections, among these MSEs' limitations, the most important problems must be solved especially in developing economies is financial aspect. Most of MSEs utilize either self-capital (equity), capital from friends, or relatives. To meet the need for bigger funding, MSEs usually borrow from informal financial institutions. One easy solution to gain some loans is through moneylenders. Moneylenders, also called indigenous bank, aim for high profit earnings by creating continuous dependencies. Besides offering easy procedures, moneylenders can also grant some cash in a short time. Despite the simple procedure offered by moneylenders, interest rates charged is actually very high indeed, especially for the poor. This evidence shows that in fact moneylenders do not help the poor to grow at all, but only help themselves and make MSEs to subsist or keep going on in small scale business.

Based on the above description, the existence of moneylenders has come to the disadvantage the poor and MSEs. Consequently, particular institutions that really concern to micro credit, in addition to informal financial form, are needed. When MFIs have been effectively provided and operated, financial need of MSEs and the poor will be fulfilled at a lower cost or interest rate.

One of the oldest informal financial institutions is known in form of group lending. Normally, a group consists of more than two persons. Collected payment received from group members will be then lent to their group that need the loan, based on exclusive group regulation. This groups system is usually named by Rotation Saving and Credit Associations (ROSCAs), in Indonesia it is known as *arisan*.

In the beginning, government's roles on MSEs development in many economies were limited. Yet, during the last decades there is a paradigm shift that drives MSEs as main actors in economic development, especially in developing economies. Now it becomes common governments help the development of MSEs. Generally, MFIs has significant role on MSEs' development. With such advantages of MFIs for MSEs, this institution can be used as an appropriate agent for providing financial assistance to MSEs. Therefore, it is also common that many governments help the progress of MFIs.

Micro Finance Institutions (MFIs)

Micro finance services have existed since the poor needs for loans and savings has been recognized. It is hard to predict when this recognition has exactly taken place, but as the formal banking institutions established in world history, soon, the demand for financial services for poor people followed.

Table 1.4 exhibits some well-known MFIs that represent good capability and sound practices in worldwide comparison. Although some structure and development process may be quite different, some encouraging patterns are similar one to another. The factors that support these MFIs are key actors, top-down awareness and capability to remain simple in its operations.

Table 1.4
Sound Micro Finance Practices

Economies	Prominent Micro Finance Institutions (MFIs)	Founder
Indonesia	Bank Rakyat Indonesia (BRI)	Raden Aria Wiriamaadya
Bolivia	Banco Solidario (BancoSol)	PRODEM (NGO)
Bangladesh	Grameen Bank	Dr. Muhammad Yunus

Sources: Various readings.

The existence of micro finance in turn will provide financial services to poor households. According to Asian Development Bank (ADB) in ADB Micro finance Development Strategy for Asia-Pacific (2000), micro finance is defined by its target market as:

"*… the provision of a broad range of financial services such as deposits, loans, payments services, money transfers and insurance to poor and low-income households and their micro-enterprises*"

Whereas World Bank in "Microfinance Handbook" defines micro finance as:

"...the provision of financial services to low-income clients, including the self-employed. Financial services generally include savings and credit".

Navajas and Schreiner (1998) present their short definition to explain micro finance:

"*Microfinance is access to financial services by poor households*".

The other definition presented by CGAP (Consultative Group to Assist the Poorest) of ADB (2004) is:

"*Microfinance is the supply of loans, savings and other basic financial services to the poor.*"

Regardless several definitions presented in this study, generally, micro finance is defined as an organization that aim to provide banking or financial services, especially business credits to the poor. On the other hand, micro finance is the term used to refer to dissimilar methods for giving poor people access to financial service. The poor usually ask for credits, when they do not qualify for normal bank loan.

Considering the main purposes of MFIs, the main product offered is micro credit. Generally, micro credit defined as credit provision for middle-low income clients that intend to generate more income from the credit. Micro credits are granted at markets interest rates, but at much lower rate than those offered by informal moneylenders. At least, by the interest rate charged, it can be seen that MFIs are fully support the poor.

In many cases, micro finance practitioners interpret micro finance as micro credit, but also comprise of savings, savings based credit and insurance. Nevertheless, this research point out that there is another purpose of MFIs establishment, that is for poverty alleviation. However, these goals cannot be attained only by saving, credit or insurance activities because of two reasons. First, all these financial micro initiatives are not direct inputs, they have to be transformed into usable direct inputs for income generation activities. Second, another set of non-financial micro initiatives such as education and marketing, are equally a vital direct inputs as that of financial at micro level.

Based on the description above, MFIs need a new breakthrough. A re-conceptualization of micro finance is called "Micro Development Initiative". In addition, this new concept would assist in:

1. Transparency in the process of fighting against poverty
2. Monitoring the real micro credit
3. Evaluating finance support
4. Identifying the various development initiatives at micro level
5. Ensuring an integrated approach by arranging adequate non-financial development

MFIs development shall also be related with government program in poverty alleviation. So the poverty alleviation program can be supported by MFIs to manage financial aids launched by the government. The government funds may be channeled through MFIs as revolving funds in the long run or health insurance and scholarship, in the short run. With such potential of MFI to support government development program, MFI not only be seen merely a usual business entity in financial sector. It also bears social obligation as an agent of development. Therefore, since MFI manages public funds, a clear government regulation must be formulated to guarantee simple, efficient, secure and accountable MFI management.

Micro finance activities are emerging in many economies since there is a massive demand for the service. Poor people are un-bankable, due to their low capabilities, poor capacities and severe inabilities. They do not fit to commercial banking system that requires formal terms, appropriate economic scale and certain collaterals. In legal term, this sort of market is unidentified and un-served. There is a niche for market supply of MFIs' services.
Micro finance is about more than just business loans. It is a bottom-up strategy to finance development by allowing the poor to invest in order to achieve goals that were otherwise unattainable, such as education or health costs. Micro finance is also much more than simply an income generation tool. By empowering the poor, in which women are the most affected in particular, it has become one of key driving mechanisms to reduce poverty and hunger.

In term of MFIs' discussion, there are several other institutions that have become the object of micro finance studies. However, well-known MFIs like BancoSol, BRI and Grameen Bank cannot be left out of the discussion and will be mentioned often in this study.
Many well-known MFIs were founded in 1970s (Principle on Microfinance, 2001), for example, The Grameen Bank established in Bangladesh in 1976 by Professor Muhammad Yunus. The Grameen Bank was developed a highly effective technique for lending to the poor and become benchmark institutions.

In Latin America, the major players are usually NGOs or independent donors. Bolivia is famously known for its *Promocion y Desarrollo de la Microempresa* (PRODEM), a NGO that created BancoSol, while Mexico has been expanding a myriad of micro-enterprise network such as Compartamos and apex organizations.

With over 60,000 clients registered, BancoSol has the broadest outreach compared to other MFIs in Latin America. The rapid growth has made it free from subsidies. The growth was resulted from its ability to keep arrears rate low and generate profits, which in turn has been reinvested to broaden organization's outreach further.

Beside BancoSol, there is another model of MFIs in Latin America named FINCA (Foundation for International Community Banking). FINCA is non-profit organization that operates to meet the financial demand for the poor and was founded in 1992. In order to expand their services, FINCA operates in seven economies in Latin America. One of the largest demands of FINCA's services is in Nicaragua.

As one of micro finance practices' sample, FINCA has its own characteristic that relatively similar with Grameen Bank. FINCA prefers to serve female clients rather than male clients. Moreover, it requires a statement that FINCA's client cannot borrow money from other financial institutions due to avoid over borrowing. Furthermore, FINCA is also put forward group lending. An individual borrowing should have guarantee from their group.

Additionally, there is another new case model of micro finance in Vanuatu. The only significant micro finance program in Vanuatu is Vanuatu Women's Development Scheme (VANWODS). It is relatively similar with FINCA, VANWODS is Grameen Bank replication in Pacific area that supports women's development. This program has been extended since 1997 and was supported by Department of Women's Affairs.

Furthermore, Bank Rakyat Indonesia, BRI in short, is also one of well-known MFI that operates in Indonesia. Like BancoSol, BRI has developed innovative techniques for lending to poor or near-poor clients. Actually, BRI is the modification form of BPR that was merged with AVB (*Algemeene Volkscredietbank*). In serving the poor across the economy, BRI has opened branches (unit-branches) in kecamatan and villages. Nowadays, BRI is the widest network banking system in Indonesia, specializing in micro and small credits.

VANWODS settle a flat interest rate (16%). As 1997, VANWODS has 246 members with US$18,640 loan outstanding. VANWODS presents compulsory and voluntary savings system. VANWODS was able to reach 100% rate of repayment by April 1999. Therefore, one of VANWODS's plans is to attain financial sustainability in 2005 with target of clients about 3000 members. Behind the success of VANWODS, there is special loan characteristic. Demand for micro finance in Vanuatu differs from other developing economies. In rural community, demand for cash money is mainly to gather emergencies, schooling, traditional and religious requirements. Even demands for initial capital for micro enterprise are infrequent.

Another sort of financial institutions found in many Asian economies is cooperatives. Cooperatives play a significant role as financial intermediaries especially in India, Sri Lanka, Thailand and Vietnam. By the year 1998s, cooperatives have tried to explore their market and expand their outreach in micro finance services. Moreover, Mexico's experience shows that cooperatives are responsible to provide initial capital for most micro enterprises (Heiki and Pagan, 2001). One of the most well known cooperatives model has been improved in Germany with their *Raiffeisen*.

Distinction between Micro Finance Services and Conventional Finance Services

As mentioned in the previous paragraph, the main purpose of micro finance services is to serve the poor. Although micro finance is a part of financial services, there are some characteristics that differentiate micro finance from common financial services. Table 1.5 shows the main distinction among micro finance (with micro credit services) and conventional credit offered by commercial banks.

Table 1.5
Distinctive Features of Micro Finance

Category	Conventional Credit	Micro Credit
Ownership and governance	Profit maximizing institutional and individual shareholder	Downscaling bank or upgrade Non-Government Organization (NGO). In the latter case, share holders are mainly nonprofit institutional shareholder
Client characteristic	Diverse formal business and salaried individuals. Geographically dispersed clients	Low income entrepreneurs with rudimentary family business and limited formal documentations. Located in specific geographic area
Product characteristic	Larger amount Longer term Lower interest rate	Smaller amount Shorter term Higher interest rate
Lending Methodologies	Collateral and formal documentation Monthly repayment	Character and cash flow analysis through on-site inspections Weekly or bi-weekly repayment

Source: Jansson, Tor, Micro finance: From Village to Wall Street

In Table 1.5 above, it is mentioned that conventional credit purpose is profit maximization, while most of micro credit services are non-profit organization. Yet, in its development, micro finance services are shifting from non-profit to profit generating. In regards of clients' characteristic, it is shown that most of micro credit's clients are low-income entrepreneurs. In term of lending methodologies, term of repayment is not strict. Clients are allowed to pay back the loan in bi-weekly installment or as agreed by both parties.

Refers to Berger (2000), main distinctions between conventional credit (traditional finance) and credit offered by micro finance can be seen as follows:

Table 1.6
Distinctive Features of Traditional and Micro Finance

Area	Traditional Finance	Micro Finance
Lending Methodology	❑ based on collateral ❑ more documentation ❑ less labor intensive ❑ loans are usually serviced monthly, quarterly, or yearly	❑ based on character ❑ less documentation ❑ more labor intensive ❑ loans are usually serviced/repaid in weekly or bi-monthly installments
Loan Portfolio	❑ fewer loans ❑ loans larger in size ❑ collateralized ❑ longer maturity ❑ more stable delinquency	❑ more loans ❑ loans smaller in size ❑ uncollateralized ❑ shorter maturity ❑ more volatile delinquency

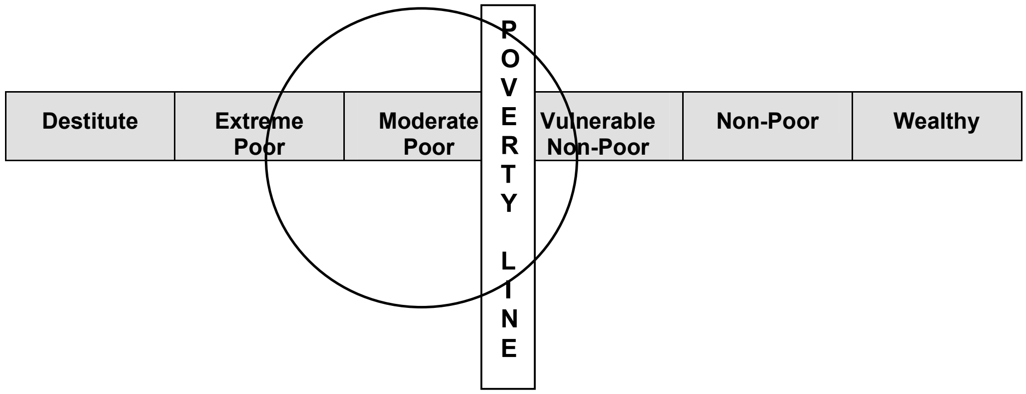
Source: Berger, 2000.

Considering Table 1.6 above, the distinction between conventional credit and credit offered by micro finance can be classified into two main areas. From lending methodology side, MFIs offer more flexible method than the conventional ones. In contrast with conventional finance that have major concern to clients' collaterals, micro finance put forward clients' character to decide the credits disbursed. These factors cause some interest rate difference. Practically, interest rate charged by MFIs is relatively higher than general financial institutions.

Consultative Group to Assist the Poorest (CGAP) identified that interest rate variation was driven by approach-methodology utilized by financial institutions. Most MFIs utilize personal approach to serve their clients. Yet, personal approach methodology was more costly than other approach. Having such a higher cost, it is a logical consequence that MFIs charge higher interest rate to cover their operational cost. Another reason for interest rate variation is smaller value of transaction that affects higher administrative cost. Basically, interest measurement includes administrative cost (identifying and screening the clients, processing credit applications, disbursing credits, collecting repayments, and following up repayments), the cost of risk (credit losses) and the cost of funds for on lending (Occasional Paper, 2004).

Another factor that differentiates micro finance from commercial banking is market targeting. Most MFIs' clients characterized as poor. Robinson classifies the poor into three categories; not-poor, poor but economically active and extremely poor. Little bit different from that statement, CGAP argues that micro finance's clients are surround poverty line. Figure 1.1 below shows the clients demand of service. Circle area that covers extreme poor, moderate poor and vulnerable non-poor are identified as MFIs' market. Whereas the lowest class of poor segmentation cannot be reached by MFIs' services. It needs some government role to interfere.

Figure 1.1
Poor Classification



Source: CGAP Presentation, July, 2003.

Considering the effort to develop micro finance operation, MFIs should have more concern on creating more effective operation. There are several aspects that can be improved to develop MFIs' services. MFIs have to concern on developing effective strategies in delivering its products to the poor. In addition, proper product of financial service can increase its demand. Hence, MFIs' outreach will be expanded.

To reach the main purpose of micro finance operation in the long term, first, MFIs should be sustainable. To be so, MFIs have to avoid high risk operation especially in credit offering. Consequently, institutional standard on loan performance evaluation is required. The last but not least, government involvement in policy, leadership and management are also major factors that affect the micro finance progress.

Types of Financial Institutions

There are a number of distinctive models of micro finance. The variation of micro finance reflects their different environments. Some economies tend to rely on one particular model or method, while others exhibit considerable diversity in the range of models used. In spite of the range of MFIs' types, it is not static.

Discussing the types of financial institutions, there are three kinds of institutions' point of view as follows.

1. Based on operational funding

   Based on operational funding, there are two types of institutions:
   a. Subsidized financial institutions
      In this term, MFIs utilize donor (from government or other institutions) funding to cover operational cost. In subsidized financial institutions, social aspect was put forward compared with other aspects. In the process, non-subsidized financial institution can expand their activities since the operational cost are not fully covered.
   b. Non-subsidized/commercial financial institutions
      On the contrary with subsidized institutions, non-subsidized financial institutions utilize internal funding to meet their operational cost. Usually, non-subsidized financial institutions called by commercial financial institution.

   There is another model, a combination of the above, named "mixed" financial institution. This kind of institution utilizes external funding for fulfilling the financial need. There are advantages when "mixed" type is applied since pilot project MFI uses subsidized fund. Furthermore, when the clients are obedient and potential, they will be provided with commercial or non-subsidized funds.

2. Based on legal aspect of institutions

   Considering the types of financial institutions based on legal aspect, at least there are three kinds of institutions; semi-formal, non-formal institutions and formal institutions. Formal institutions such as commercial banks are regulated by authority and categorized as banking, while semi-formal institutions are classified as non-bank financial institutions, such as cooperatives. In details, MFIs' classification is follows:

   a. Formal financial institutions such as banks and pawnshops, finance companies. Formal financial institutions characterized as high level of regulation and supervision. They will not eager to cover rural area as its small scope economic scale.
   b. Semi-formal financial institutions such as cooperatives or Non-government Organizations (NGOs), credit unions, village banks and cooperatives also enjoy informational advantages over formal lenders but less than informal ones. There are no formal regulations in order to regulate semi-formal financial institutions. Yet, this sort of financial institutions are supervised by government agency.
   c. Informal financial institutions such as Rotation Saving and Credit Association (ROSCA), informal moneylenders, relatives and friends. In term of informal financial institutions, there is no specific form of regulation and supervision to support these institutions.

   Further discussion on informal financial institutions, Group on Indigenous Bankers (1971) put forward moneylender's phenomenon in their study. Based on their study, Group on Indigenous Bankers also state that in general moneylender means person or individual who lends his own funds to the other. In addition, moneylender is also labeled as indigenous banker since they present a best service to their clients, even though they have irrational interest rates.

   Most of moneylenders operate individually. Their practices are found in many economies, like in Asian economies (for example Indonesia and India). The practice may vary between economies depending on local economic condition.
   Moneylenders may or may not require collateral with simple administrative procedures. Moneylenders just come to the clients with a notebook and directly provide some credits upon a mutual agreement of simple terms and requirement. When a client fails to repay the credit, the moneylenders just take the collateral, if any or other assets of the client as agreed before.

3. Based on institutional form

   It has been acknowledged that based on institutional forms, MFIs are divided into two categories: conventional and *sharia* micro finance institutions. Things that differentiate conventional and *sharia* MFIs are the operating principles used. Major MFIs utilize interest rate system in their operational cost analysis. In case of *sharia* MFIs, interest rate system is substituted by profit or loss sharing system. A new micro finance story of MFIs is financial institutions that operate under *sharia* principles. Even *sharia* banking principle is still a new concept, the evidence shows that in some economies, *sharia* banking can compete with other kinds of MFIs in term of servicing micro and small enterprises. *Sharia* principle is originated from Islamic value. Further description on *sharia* financial operation will be examined in a different section.

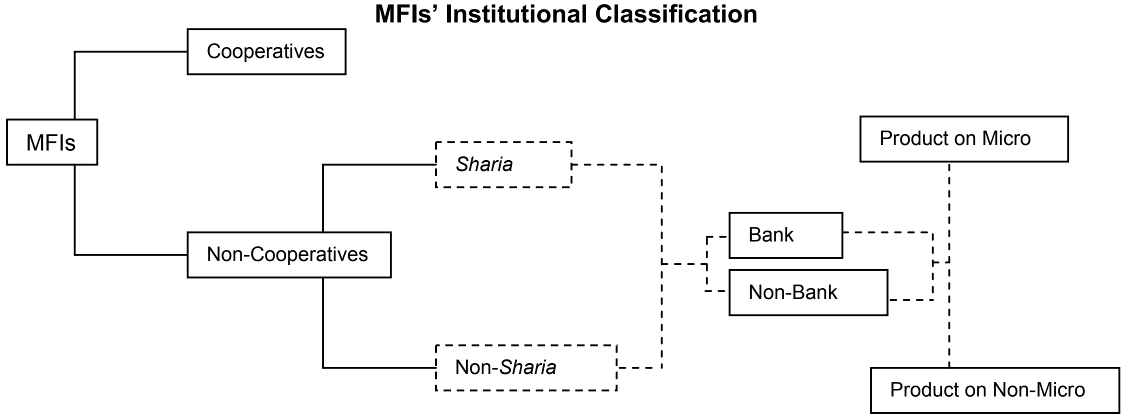
In addition to three classifications above, essentially financial intermediation can be specified into three different levels as follows:

1. Non Government Organizations (NGOs)
   NGOs as well as community based on savings and loans associations, credits unions and cooperatives. NGOs are funded by the existing financial institutions. NGOs have shown their comparative advantage in providing, especially, door to door services.
2. Specialized Financial Institution
   Specialized financial institution has a significant role in providing financial support to NGOs and also other micro credit programs.
3. Regional and Global levels new financial services intermediaries
   The experience shows that donor institution such as Asian Development Bank still supplies MFIs' financial needs. However, private social investor may be attracted by the assured repayment, closeness to market interest rates, potential for rapid scaling up of investment and also social development.

In addition to MFIs' classification elaborated above, there is another sort of MFIs classification as shown in Figure 1.2 below. The figure exhibits that MFIs can be classified into two main institutional forms, cooperatives and non cooperatives. However, non cooperatives institutions can be differentiated into bank and non-bank institutions. Moreover, among bank and non-bank institutions can offer product on micro and product on non-micro.

Figure 1.2

MFIs' Institutional Classification



Source: Various readings, elaborated.

Sharia Banking

As mentioned in the previous section, *sharia* banking is one option of financial services. Originally, *sharia* banking is derived from Moslem financial services practice. Interest rates are unacceptable in Islamic values. Therefore, *sharia* banking is also known as Islamic banking. The existence of Islamic banking and financial corporate has recently being the new economic development paradigm. This system works not only in Islamic economies, but also in the other economies.

Indeed, *sharia* banking principle is a substitution function from interest rates system to profit-and-loss sharing principles. Profit-and-loss sharing is supposed to be more just system. There are three distinctive characteristics between Islamic banking and conventional banking (Ibrahim, Maulana).

1. exclusion of interest rate
2. exclusion of gambling activities
3. morally legitimate investment

In case of *sharia* banking, there are five basic financial activities, trustee financing (*mudharaba*), joint financing (*musharaka*), leasing (*ijara*), purchase with deferred delivery (*bai' al-salam*) and mark up (*murabaha*). Even if basic *sharia* banking's product consists of five points, there are other following products offered by *sharia* banking, such as *wadi'ah* or saving, *qardh* and *rahn* (pawning).

Considering several product offered by *sharia* banking, its system offers comprehensive economic tools. This system includes moral, spiritual and material aspects that meet the Moslem society needs. There are some following objectives of Islamic banking.

1. The philosophical principle
   Islamic banking does not operate solely based on economic objectives. Islamic banking has to integrate moral value in economic activity. The objectives of Islamic banking system have to cover both social and economic benefit.
2. Profit sharing investment
   The basic principle that implemented in Islamic banking is profit (or loss) sharing. With this principle, the return that can be gained is higher in parallel with higher risk, therefore with prudence practice, it may improve standard of living.
3. Positive attitude
   Islamic banking principle presents new strategy in financial services. In this approach, the financial institutions not only wait for the lender to come, but also build an association or joint venture with the customers.
4. Social nature
   As the nature of Islamic norms, Islamic banking must be social system. The use of Islamic banking principle not only deliver higher rate of return, but also gives social benefit.

Institutional forms on *sharia* banking operation are banks and cooperatives. Here, *sharia* cooperatives are also called by *Baitul Maal wa Tamwil* (BMT). Although there are different model of institutions, both of *sharia* banking and *sharia* cooperatives operate under *sharia* (Islamic) norms, which apply loss and profit sharing system. Within the system, lender and borrowers share any loss and profit experienced by the borrowers (customers).

MFIs' Operation across Economies

It has become a common knowledge that micro finance operations cannot be generalized. Different patterns on micro finance operation can be good lessons for micro finance practitioners. MFIs operate among developed, developing and under-developed economies, but each economy has its own characteristic of micro finance operations.

Under-developed economies tend to implement subsidized financial services. Poverty reduction is the reason why under-developed economies present subsidies. By these subsidies, government can help the poor to cover their basic needs. In addition, the existence of subsidized financial credit could motivate the poor to create economic efforts. Bangladesh is good sample to represent this type of MFIs. Until now, Bangladesh government pays special attention on poverty alleviation and women empowerment.

In developed economies, commercial financial services practice has been preferred than subsidized services. The high level of economy poses financial institution to utilize market standards in its operations. Yet, market base of financial operations does not hamper the entrepreneurs to expand their businesses. In such developed economies, subsidized financial institutions have been very limited.

Developing economies have the most various sorts of micro finance operations. Beside subsidized financial services, there are also several commercial financial services. Mapping of financial services' target is needed to ensure that financial services methods are appropriate with the type of clients.

Gender-Oriented MFI

Women Economic Activity

In general, gender refers to recognizing the position and relation of women and men in society. In the field of micro finance, gender refers to examining the obstacle that woman face in these relationships, which prevent them from maximizing the benefits of micro finance services and the society itself.

There are needs and interests that women face nowadays, practical needs and strategic interests. Women's practical needs refer to immediate needs, such as shelter, childcare, health access and access to credit and saving service. While strategic interests refer to unequal aspect of gender roles, such as educational opportunities, access and control to resources (UNCDF, 2001). Making a distinction between practical needs and strategic interests helps MFIs in designing products that conceptualize the intersection between gender and micro finance.

Economic contractions have increased women participation in the labor force, through micro enterprise. In fact, the continued growth on the informal sector in most developing economies has been accompanied by increasing number of working women.

The Inter-American Development Bank (IDB) and Economic Commission for Latin America (ECLA) conducted a household survey in 40 economies during 1998 and found out that in Latin America, 54% of total employment works in micro enterprise sector during mid 1990's. On average, 26% of all micro enterprise workers are poor. Among them, women are the most vulnerable group, with single women being the worst. Women constituted approximately 55% of people living under poverty line.

Considering the fact above, the poor face additional problem when the women work or get involved in economic activity. Women time for child care and health are lessen, which can also affect their welfare.

From UNCDF study, businesses activities owned by woman usually has special characteristic as follows:

1. Informal
   Women led enterprises are more likely to start in the informal sector than man and stay there. This is due to lack of access to formal sector institutions.
2. Home based and sometimes ambulant
   Women are more likely to keep their business close to home to minimize conflict steaming from their multiple roles as wage earners, mothers and home-makers.
3. Concentrated in low-return sectors (commercial and service sectors)
4. Conservative growth orientation
   Women's investment pattern are more survival-oriented and risk adverse than men's. Women's portfolios are more likely to grow via investment into variety of business, whereas men are more likely to plough earnings back into a single business.
5. Small scale
6. Part-time and seasonal
7. Low tech
   Women's owners tend to hire labor as a growth strategy rather then improving their technology.

The Benefit of Giving Credit to Woman

There are findings that MSEs managed by women grow better and more successful than those managed by men entrepreneurs. This is because women are usually more discipline and risk-averse than men, so they are more responsible and trustworthy in repaying the loans. That is one reason why MFIs often targets women as their clients. Sisto's study shows that men potentially tend to be less responsible in managing credit funds rather than women (Sisto at al. 2002).

Many MFIs are increasingly aware of the importance of women concerns in their activities. The service of MFIs must see women as a target market, since women hold a very important role in society. Women that use micro finance services can improve their income and economy security, reduce their family vulnerability and stimulate local economies. However, making financial services available without adapting those services to the special constraints and creating strategies that can suit women's multiple social roles will miss the opportunity to achieve both significant outreach and economic and social empowerment. Therefore, it is important to ensure links between availability, accessibility and impact for women.

Recent Issues: Best Practice for Women

Providing financial services for woman requires some adjustment. To attract more clients and also to better serve women in the need for credit, there are factors to be considered, such as:

a. Matching credit terms, including credit amounts and repayment period, to women's business cycles and capital flow. This will help them maximize benefits of micro credit. Credits are available for every sector (trade, manufacturing and services activities).

b. Simple formalities therefore make credit accessible to semiliterate or illiterate customers. Credit officers are trained to help semiliterate customers completing application. Credit forms are keep simple and have rapid approval process.

c. Allowing nontraditional collateral compensates for women's level of asset ownership. Alternatives to traditional collateral, such us solidarity group or character references, are acceptable

d. Flexibility should govern decisions on whether to lend to groups versus individuals

When MFIs targeted new customers regardless of the gender, it was worried that men would dominate the finance programs. On the other hand, there is also another opinion that interacting men as peers may be more empowering for women. Hence, there is a need of encouragement for men and women to use MFIs mutually for the sake of family welfare.

MFI that Targeted Women

1. Grameen Bank

Grameen Bank model initiated by Muhammad Yunus of Bangladesh in 1976 has been adopted in many economies. Grameen Bank is MFIs that takes women as main target, serves. It provides subsidized loans for customers from all parts of Bangladesh.
Grameen Bank concerns more on potential of clients than other consideration. In addition to that, unlike conventional bank, Grameen pays much attention to the family condition of their customers. It also gives priority to beggar clients, a very specific of Grameen Bank and quite different from other institutions. Grameen also encourages the clients to engage some goals in social, educational and health areas called "Sixteen Decisions" (such as no dowry, education for children, sanitary latrine, planting trees, eating vegetables to combat child's night-blindness and arranging clean drinking water).

With subsidy program, Grameen Bank aimed to reduce poverty in Bangladesh area. Despite the success story of micro finance service, Grameen was very poor in mobilizing saving (Robinson, 2002).

3. Self Employed Women's Association (SEWA) Bank

SEWA Bank started operating in India in December 1971. Initially, SEWA is type of trade association, of which the entire members are women. In 1974 the association changed SEWA Bank as a cooperatives bank that has two main purposes, those are to provide credit for self-employed women and reduce their dependency on moneylenders.
SEWA Bank provided credit for poor women, particularly only for economic activities, not for consuming purpose. There were specific loan purposes as follows:

a. for working capital
b. for buying trading tools
c. for capital investment, like a store, warehouse, workplace, etc

The existence of SEWA Bank has affected the women's life quality, particularly its member and customers/clients. Most of their account holder was urban self-employed women (accounted to 70% of total customers). While the rest were rural self-employed women. SEWA Bank has successfully reduced its clients' indebtedness and dependence on intermediaries and traders. Besides, SEWA Bank has also empowered women that in turn were able to organize themselves. Table 1.7 shows SEWA Bank performance.

Table 1.7
SEWA Bank Performance

As of December 2001	Micro Credit	Micro Savings
Number of active clients	50,000	170,000
Micro account portfolio value (US$)	2,000,000	7,500,000
Minimum amount (US$)	0 to 50	0 to 35
Maximum amount (US$)	500 to 700	-
Micro finance as a percentage of total portfolio	81% to 100%	76% to 100%
Percentage of micro accounts with <US$500	81% to 100%	81% to 100%

Source: Cited from add_gnbi_sewa.html

In 2003, SEWA Bank became one of five participating partners in a $1.4 million grant to Micro finance Opportunities. Micro finance Opportunities is an organization that aims to develop global curriculum of financial education for micro finance's clients. The curriculum consists of cash flow management and budgeting, debt management, saving, financial negotiation and banking service education.

3. *Organizacion de Desarrollo Empresarial Femenino* (ODEF)

ODEF is a women's business development organization in Honduras, founded in 1985. As far, it has almost 10,000 clients registered consisting of urban micro entrepreneurs and small holder farmers (Cohen, 2003). ODEF's core concern is offering a certain range of financial products, ranging from short-term working capital, agricultural and individual loans. It also applied five AIMS tools: the impact survey, client exit study, in-depth interviews (savings), semi-structured interviews (empowerment) and client satisfaction focus group. ODEF set about training staff in information collection skills and integrate staffs at all levels to participate in feedback loop process. As a result, confidence has been increasing for both clients and officers, as they understand each other how to cooperate and create significant value for improvement. This ability has made senior management able to decide policy that meets market needs.

4. *Mata Masu Dubara* (MMD)

Mata Masu Dubara (MMD) means "Women in the Move" in Haussa, Niger, is a self-managed system of financial intermediation. MMD sets the goal to help women handle the numerous and increasing responsibility they faced in unfavorable socio-economic and religious environment. MMD was a modification of from a rotating savings and credit association, which was commonly used by women in Niger. MMD borrowers must repay the loans with interest each month.

MMD program covers about 162,000 rural women in Niger, one of the poorest economies in Africa. MMD is not a single institution, but rather is union of 5,500 stand-alone groups; with each group consist of 29 members. It is estimated that in a village that have MMD program, there are at least one additional group that has formed its own. Total savings are estimated at $3 million. While each group has its own by laws, sets its own interest and keeps the life of group fixed, almost all MMD groups operate in identical ways.

MMD disburse loan to groups of clients. The group is formed for a certain time, usually nine to 12 month, set with specific events in a year. These specific events include religious holidays and the end of the cropping season. These events are chosen because usually the members groups do not have money while all happening events require funds. Once the objective is achieved, the members divide up the portfolio equally among the membership or a certain proportion, depending on the agreement. The groups usually re-form immediately, with members having the right to leave the group if they wish and new members may be inducted.

MMD based its activities on groups of up to 30 women meeting weekly, saving their money in fixed weekly contributions and providing month-long interest bearing loans at every fourth meeting. The women select themselves by excluding women with poor reputations in financial and moral integrity. One of the selection criteria is usually that the women must be carrying out an income generating activity that will allow them to make productive use of the resources. CARE instituted a training program that specified the roles and responsibilities of group officers and the general assembly and helped each group to develop its own set of internal regulation. A group is graduated after eight to nine months.

The women determine the amount of the weekly contribution (between US$5 cents to US$1), according to the capacity of the women to pay. Each woman contributes the same amount, though some women make multiple contributions to the group. Women tend to segment themselves; women with higher financial capacity joining one group while women with lower financial capacity joining another one. Almost all groups have chosen a rate of 10% per month. Since many groups lacked of literate or numerate members who were capable of maintaining record books, CARE develop a methodology that did not rely on written record.

MMD has developed its products and services that fit its client's needs, because it allows the clients to be managers and designers of the product and services. In addition, the institution structure is light and affordable to the clients. While the focus of most government and donors has been on productive credit, the population needs a range of services. These include saving and credit, both for consumption, social and economics activities. MMD starts with saving since from the perspective of the poor savings are usually more important than credit. Credit increase risk while saving reduces it.

Since the poor are risk averse, they have greater demand for saving services than for credit. MMD has managed to find the right mix of savings and credit services that allows the poor to save while making productive use of these resources in the community. Factors that lead to increased costs of providing rural finance in remote rural areas include isolation and poor infrastructure, low productive capacity, smaller loan sizes and high fixes cost, seasonality of cash flow, risk of poor harvest, more barter transaction that make collection more difficult (Grant and Allen). In order to succeed in these markets, a financial service provider must have a very light cost structure to survive. This can be achieved only through a truly decentralized structure.

MMD has been so successful in rural because the very nature of the product makes it highly desirable to the participants. It provides a very high return in savings allowing use of the finds at the same time. Moral hazard is kept to minimum because the members are borrowing their own money and they have strong incentive to stay with the association as a member in good standing until the predetermined end date at which point the distribution will take place.

5. Foundation for International Community Banking (FINCA)

Foundation for International Community Banking (FINCA) in Uganda is a non-profit organization providing micro finance services. FINCA provides micro finance services normally for women. Membership consists of 30-40 women in a group. Every individual borrowing must be guaranteed by each group. Meeting is scheduled weekly. Each group has executive committee of at least six members. Credit is designed to build capital and sustain the growth of the business rather than to establish new business (FINCA, 2001).

Clients are not currently borrowing from other sources (this is intended to reduce indebtedness of borrowers). Each member is required to save at least 10% of any base loan. Compulsory weekly savings of at least USHS[1] 1,250 are required. Voluntary savings also encouraged, of which members have access (FINCA, 2001). Initial loan sizes range from USHS 50-20,000 depending on the economic activity of the area. Borrowing amount is limited to USHS.50,000, USHS 175,000 or USHS 200,000.

6. Vanuatu Women's Development Scheme (VANWODS)

Vanuatu is an economy with low density (177.000 totals of populations). There are two kinds of financial institutions in Vanuatu, namely commercial bank and other institutions and programs. The only significant micro finance program in Vanuatu is Vanuatu Women's Development Scheme (VANWODS). As a note, VANWODS is replication from Grameen Bank. VANWODS presents program to support women's development. This program has extended since 1997 and supported by Department of Women's Affairs.

VANWODS settle a flat interest rate (16%). As 1997, VANWODS has 246 members with US$18,640 loan outstanding. VANWODS presents compulsory and voluntary savings system. Voluntary system is more familiar among clients compared with compulsory savings. The savings then are deposited in commercial banks.

VANWODS can reach 100% rate of repayment by April 1999. Therefore, one of its plans is to attain financial sustainability in 2005 with target of clients is about 3000 members. Behind the success of VANWODS, there is special credit characteristic. Demand for micro finance in Vanuatu differs from other developing economies. In rural community, demand for cash money is mainly to gather emergencies, schooling, traditional and religious requirements. Even as demand for initial capital for micro enterprise are infrequent.

[1] USHS (stands for US Home System Inc.)

According to McGuire (2000), VANWODS has to pass a long way to attain financial sustainability. This is due to Vanuatu condition that restricts micro finance development. Low population and lack of access to financial services in rural area increase cost of operation. While demand for financial services relatively low. These conditions cause micro finance more difficult to reach financial sustainability.

Services

Basically, MFIs serve the poor to improve their quality of life. In this case, some MFIs can conduct two kinds of program, financial and non-financial support. Financial support derived into several products such as lending, saving, pawning and insurance, which can be modified to meet clients' needs. While non-financial support includes assisting program to improve clients' management, knowledge, etc. Both financial and non-financial supports are provided to help the poor in improving their business.

In case of non-financial support, Bina Swadaya, one of the largest NGOs in Indonesia was provided assistant program. The program was adjusted with the character of MSEs. Assistant program consist of four stages. The first stage is for the clients who do not have ability to run the business, while the last stage is for clients who already have been capable in running their business.

The assistant program was made of four stages, starting from the first stage for clients without capability of running business through the fourth for clients with capability of running business. The detailed program is shown in Table 1.8.

Table 1.8
Approaches to MSEs Development Through Self-Help Groups and NGOs Supports

Approach	Micro Enterprises Formation	Poor Micro Enterprises Consolidation	Micro Enterprises Expansion	Micro Enterprises Transformation
Goal	Move clients from survival economy into micro economy	Generate clients from trial and error micro enterprises into consolidated	Improve micro enterprises' performance	Graduate clients from micro enterprises' sector
Characteristic of groups' members	Highly disadvantages groups or poorest of the poor	Micro size of micro enterprises of marginal groups	Small sized micro enterprises	Medium to larger micro enterprises
NGO services	- setting up the groups - start with small savings - highly subsidize - intensive training and technical assistants	- consolidating groups' management - introducing management systems - encouraging saving mobilization - training on management and accountancy	- developing the group capacity - fast saving mobilization - providing market rate credits - training and technical assistance on business management	- developing group capacity to run micro enterprise - saving mobilization served by banks - training and assistance on production processing and marketing
Amount of credit	- US$1,000	- US$2,000	- US$5,000	- US$10,000
Impact	- Poverty alleviation	- Informal sector promoted	- Marginal increase in income and decrease in under-employment across a large number of clients	- Employment and income generation

Source: Haryedi, 1999.

Meanwhile, MFIs serves both of individual and groups' clients. There are different strategies in dealing with individual and groups' clients. Normally, MFIs will provide more services to groups' clients than individual clients. In many cases, groups' client models are purposes to accommodate the poor those do not have any collaterals.

1.5 Role of MFIs

Actually, MFIs serves clients from all class of society, however, the majority of the clients come from those who live under poverty line. Yet, these programs are more effective at reaching a greater proportion of poorer clients. The poor uses credits for a wide range of purposes, such as: home improvements, education fees and health expenses to meet the poor financial aid.

Therefore, the existence of MFIs is significant on economics development. MFIs help MSEs and the poor to meet their financial needs. It is common knowledge, that most banks are reluctant to offer some loans for the poor and MSEs. This evidence based on several reasons such as:

1. Information problems
2. High credit risk perception
3. Lack of acceptable collateral
4. High transaction cost of processing small loans.

Upon the existence of the above constraints, MFIs have sponsored many successful lending programs. Though overhead costs are high relative to loan value, many of the programs have become increasingly efficient and repayment rates are high (Woolcock, 1999; Stallings, 1999 cited on Haynes, 2001).

Although MFIs have many advantages and potency to reduce poverty, there are principles to be concerned when developing MFIs, so as MFIs can give maximum advantages and positive impacts. The principles are (Catholic Relief Services, 2001):

a. Serving the poorest clients
b. Link loans to saving
c. Utilize solidarity guarantee
d. Practice participatory management
e. Invest in scale and self-sufficient
f. Plan to be permanent.

Based on various studies, like ADB's and CGAP's, MFIs' role in reducing poverty is important. According to CGAP, there are at least four impacts of MFIs existence that significantly affect MSEs and the poor those are opportunity, capabilities, vulnerability and empowerment.

Table 1.9
Dimension of Impact Indicators

Items	Dimensions of Poverty	Core Impact Indicators
Opportunity	Income, assets and opportunities through which people can obtain their material requirements	Household income, household and enterprise assets, sources of income, housing tenure, enterprise growth, employment generation
Capabilities	Human capital that enables people to raise their economic living standard	Education of children, nutrition status/food expenditures, skills and knowledge (This dimension relates to gender.)
Vulnerability	Exposure of individuals and households to risks or shocks that cause financial stress	Financial shocks and coping strategies
Empowerment	Ability of people to participate in decisions that affect their lives, especially their economic lives	Participation in borrowing decisions, improved savings behavior, increased self-esteem, enhanced ability to prepare for the future

Source: CGAP Presentation, July 2003.

ADB grouped the positive impact of MFI to the poor based on financial services provided by MFI. However, ADB mentioned that the impacts are potential since there are other factors that affect the effectiveness of MFI products. For instance, loans will potentially increase family income when allocated for productive economic activities.

Table 1.10
Micro Finance Reduction

Financial services	Result	Impact on poverty
Saving facilities	- more financial services - income from savings - greater capacity for self investment - capacity to invest in better technologies - reduce need to borrow from money lenders at higher interest rate - enable purchase of productive assets - improve allocation of resources - increase economic growth	- reduce household vulnerability to risk/ external shocks - less volatility in household consumption - greater income - severity of poverty is reduced - empowerment - reduce social exclusion
Credit facilities	- enable taking advantage of profitable investment opportunities - lead to adoption of better technology - enable expansion of micro enterprises - diversification of economic activities - enable consumption smoothening - promote risk taking - reduce reliance on expensive informal sources - enhance ability to face external shocks - improve profitability of investment - reduce distress selling on assets - increase economic growth	- higher income - more diversified income sources - less volatile income - less volatility in household consumption - increase household consumption - better education for children - severity of poverty is reduced - empowerment - reduce social exclusion
Insurance service	- more savings in financial assets - reduce risk and potential losses - reduce distress selling of assets - reduce impact of external shocks - increase investment	- greater income - less volatility in consumption - greater security
Payments/ money transfer services	- facilitate trade and investment	- greater income - higher consumption

Source: ADB, Finance for the Poor, 2000.

Measurement of MFIs participation to reduce poverty has been done by Afrane (2002). He describes quantitative effects of micro finance that can be examined by analyze economic side, while qualitative aspect includes social, psychological and spiritual side.

Despite of life quality increasing particularly in quantitative measurement, there are negative impacts on spiritual or social aspect. In Afrane’s study, evidences in Ghana and South Africa show that although church’s’ donations increase, while number of attendants decreases. In detail, Table 1.11 demonstrates each indicator taken by Afrane and its impact on qualitative and quantitative aspects.

Table 1.11
Impact Evaluation Indicators

Indicator	Quantitative	Qualitative
Economic	- Number of employees - Increase in revenue - Equipment and tools - Market opportunities - Income and Expenditure	- Quality of business premises - Household/ personal assets - Business diversifications - Business skill and techniques
Access to social services	- Water - Toilet - Health facilities - Children out of school - Number of room occupied	- Housing condition - Health condition - Food and nutrition - Meeting educational needs
Social		- Family bond and relation - Quality time with family - Family acceptance and respect - Social involvements - Public respect and acceptance - Attendance in social meeting - Financial independence of women
Psychological		- Personal dignity - Self worth - Confidence
Spiritual		- Church attendance - Donation in church - Participation in religious activities - Prayer and devotional life

Source: Impact Assessment of Micro finance Interventions in Ghana and South Africa cited on Afrane, 2002.

Support for Micro Finance Development

Despite of several MFIs that have proved successful, in many cases, micro finance operations still need external support. There are several world organizations that have concern to micro finance, such as: World Bank, United Nations Capital Development Fund (UNCDF), ADB, United Nations Development Program (UNDP), *Gesellschaft für Technische Zusammenarbeit* (GTZ) with ProFi program and Inter-American Development Bank (IDB). These organizations conduct study periodically in the field of MFIs development, in order to give support for under-developed MFIs. Moreover, these organizations perform assistance programs to particular economies.

In order to develop, MFIs are required to be self-sufficiency. MicroBanking Bulletin (2000) defines that there are two degrees of self-sufficiency:

a. Operational self-sufficiency. Operational self sufficiency requires MFIs to cover all administrative costs and loan losses from operating income.
b. Financial self sufficiency that requires micro finance programs to cover all administrative costs, loan losses and financing costs from operating income, after adjusting for inflation and subsidies and treating all funding as if it has to cover commercial costs.

Considering the importance of MFIs and their relation with MSEs, as important agent in reducing poverty, it is necessary for international organizations to support micro finance development. ADB, for instance, was in cooperation with some national governments in conducting assistance for micro finance, such as support in innovative programs. Several actions have also been taken by ADB in order to fix the more feasible interest rate in credit offering, determine policy of competitions and price stabilizing. Moreover, ADB also plays as counselor in micro finance development monitoring. In this term, ADB creates

Consultative Group to Assist the Poorest (CGAP) that evaluated its programs every three years.

In particular, ADB has concern to some economies that are integrated in Developing Member Countries (DMCs). ADB plays a significant role in assisting micro finance in DMCs. DMCs consists of developing economies in Asia such as Indonesia, Bangladesh, the Philippines, Nepal, Kyrgyz and Mongolia. In term of efficiency and optimization, local governments have to adopt new strategies. Assistance should be given to micro finance institutions, micro enterprises and poor people, all at once.

Another sample of international organization involvement is UNCDF program called Special Unit for Micro finance (SUM). Through this program, UNCDF provides some grants in order to increase demand for micro finance products. SUM supported project formulations exercise in Bhutan, Haiti, Palestine and Mozambique and re-oriented UNCDF projects in Western Africa, Malawi and Madagascar. Of UNCDF's investment over US$43 million, its micro finance portfolio is distributed in Latin America (10%), Asia (20%) and Africa (70%), covering about 20 economies. SUM is responsible for monitoring the overall programs, including tracking down the growth and performance of those initial MFIs.

In addition to the above-examined programs, UNDP developed a program call MicroStart to support young and promising MFIs. The purpose of MicroStart program is to transfer knowledge and to support financial assistance to MFIs through UNDP branch offices. The MicroStart Programme was established to meet a specific micro finance market niche to support incipient MFIs. MicroStart helps incipient MFIs to incorporate best practices and prepare them to start and scale-up their operations. MicroStart consists of a technical service component and a micro-capital grant component with specific goals like: to increase outreach, to attain sustainability and to develop portfolio quality.

Some technical assistance by MicroStart also shows MFIs how to reduce cost at each level and for each component. The features of cost reduction strategy are: simple record keeping, simple and standardized account, innovative midlevel management, standardize the office setup, reducing waiting time for loan decision and approval and good financial plans.

The most important factor in developing MFI is government's role in making macroeconomic policy. The government has to take macroeconomic policy that encourages the poor to improve their economic condition. The policy taken by the government must be able to stabilize macroeconomic condition, such as: interest rate, inflation, so as to support MFIs development.

Lapenu (2000) states that at least there are three models of government's role to support MFIs development, as follows:

1. Model of integration

   In this case, state totally involve in improving MFIs. India is a good sample to describe this model of integration. Micro finance system took place in public services. Therefore, state has responsibility to regulate and control the development of micro finance.

2. Model of complementary

   In complementary model of government's role on MFIs' development, Indonesia is representative sample on that. Micro finance innovation can be adopted by both public and private sector. Within this model, each MFIs can compete therefore improve the efficiency of financial services in financial market.

3. Alternatives model

   Alternatives model is adopted to response the market or state failure in eradicating poverty. Thus, MFIs are developed to fill the gap between financial services' supply and demand. In this case, NGOs' role is needed as a facilitator to develop MFIs' system.

Recent Issues Concerning Micro Finance

Micro finance is a rapidly growing emerging industry in financial service for middle-low income people and considered as a tool for long term development agenda. Significant efforts have been made in building financially solid and reliable institutions that are capable of reaching large number of middle-low income people, especially women, providing financial services. However, there are recent issues concerning MFIs that are important to discuss.

Among other issues, competition among MFIs has attracted more attention in discussion on MFIs. In order to compete in financial market, it is important to MFIs operating under professional management. MFIs should be more efficient in operating activities.

In general, there are intangible criteria for micro finance as follows:

1. Leadership and vision.
   Vision and commitment cannot be imposed from the outside or reside merely with the founder of the organization.
2. Skills, attitude and market orientation.
   The visionary leader plays a crucial role in setting the targets and defining the mission of the organization, in garnering support for the institution and in maintaining close contact with policy-makers. But this leader must also have the skills and the right attitude to translate this vision into practice. Skills, attitude and market orientation are important to penetrate, listen and respond the market.
3. Institutional culture.
   Ability and willingness to listen to the market and the ability to listen and to learn from within the institution is about more than leadership, skills and a business orientation. Transparency in information and decision-making will ensure a more effective institutional operation internally and will assure technical service providers that a level of trust exists that is necessary for productive technical assistance partnership.
4. A cautionary note.
   It is important to recognize that it will remain difficult to predict which institutions will become breakthroughs. All institutions have varying degrees of positive and negative traits that why identifying breakthroughs has been based on hindsight.

There are two approaches that can be used to develop micro finance, namely institutional and welfare approach (Brau, James C.). In institutional approach, the way financial institution reaches self sufficiency is the key factor. Whereas welfare approach assumes that the significant point in term of MFIs development is the beneficial of MFIs.
In the institutional approach, MFI needs to be financially self-sufficient. In order to be self-sufficient, a MFI should not only supposed to be independent from external aid, whether government aid or as non-government aid, but also be able to generate its own fund. Therefore, MFI will be sustainable. The main issue concerning this approach is commercialization.

In the second approach, MFIs efforts are focused on poverty reduction. Practically, this approach is associated with non-financial or technical assistance, in addition to financial assistance. In this case, MFIs play a role as a channel in distributing funds. Usually, this subsidized fund is delivered to MFIs that in turn have to distribute the fund to the poor. Considering this approach, Remeyi (2002) argues that MFIs will not be sufficient nor grow well by applying welfare approach alone.

Both approaches have strengths and weaknesses. Institutional approach is related with the improvement of MFIs financial system. In this case, financial assistance is reduced gradually. This approach also enforces MFIs and MSEs to be more productive and efficient. However, if an MFI only emphasizes on institutional improvement, it will possibly neglect its mission to improve the welfare of society in reducing property.

On the other hand, many MFIs that apply welfare approach in their operation are relatively not sustainable. In the beginning, they can achieve their goal to reduce poverty. However, it does not last for a long time. Therefore, they cannot achieve their goal to improve society's welfare. It is difficult to determine which approach is the best. It is due to the characteristics of MFIs, which are local and time specific. Each MFI may choose particular approach to apply that is appropriate with local economy.

Robinson (2002) mentions that micro finance has experienced revolution in order to be more efficient. Recently, micro finance becomes one of financial system's components. There are many perceptions regarding the speed of change of micro finance.

For the purpose of supporting MFIs activities in the long term and more efficient, MFI's commercialization has often been the object of discussion. Commercialization is the market based principles implementation in MFIs operation. In the other words, commercialization related to the adoption of market based principles by MFIs in their micro finance activities whether under prudential or non-prudential regulations (Almario, 2002 cited on Charitonenko, 2004).

Yet, in particular economies, commercialization on MFIs have a negative connotation, since they associate term of commercialization with taking advantage of the poor for the profit. Another word that can be allied with commercialization is business orientation approach. With this term, commercialization can reflect positives aspects.

As the idea of commercialization, Seibel states that MFIs have to operate with its own funds. MFIs can utilize savings collected from its clients. Hence saving mobilization can be effective strategy for MFIs to cover the operational costs and as source of lending.

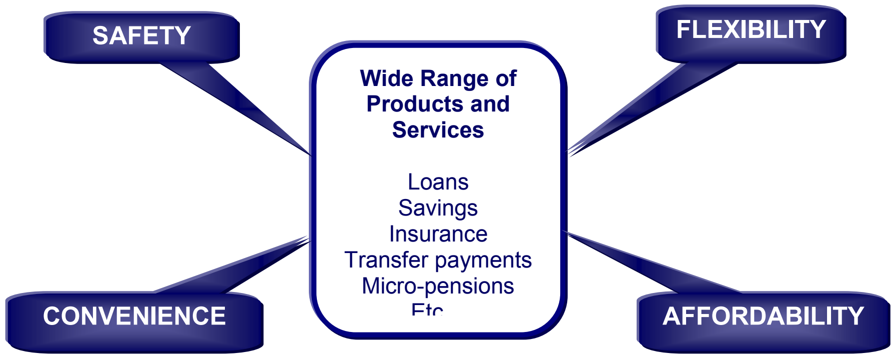
To improve the MFIs' capability in attracting more saving from the clients, MFIs should understand the strategy to increase the number of saving. At least there are four factors to consider by clients (especially the poor) to save to the MFIs (CGAP, 1998):

a. Security of saving
b. Liquidity option of the saving
c. Transaction cost
d. Real interest rate

According to the research conducted by CGAP in 1998 on four MFIs, the poor normally will rely on saving product before they have effective demand for credit. This research takes BAAC (the Bank for Agriculture and Agricultural Cooperatives) in Thailand and BCS (the Banco Caja Social) in Colombia as sample, as well as, BRI in Indonesia and RBP (Rural Bank of Panabo) in the Philippines (CGAP, 1998).

Results of the above study show that there are seven key success factors in saving mobilization. Saving mobilization success is influenced by internal factors, such as type of institution and governance, organizational structure and liquidity management. While from credit perspective, MFIs should concern on clients' needs. There are some aspects required by clients. Figure 1.3 below displays four aspects being considered by clients before they use credit services from MFIs.

Figure 1.3
Clients' Demand of Credit Services



Source: CGAP Presentation, July 2003.

One of MFIs' success indicators is outreach. Outreach is important in MFIs' development. Whereas, outreach also important for clients to ensure that financial service can be afforded effectively. Considering the effort to develop micro finance operation, MFIs should have concern on creating effective operating system.

There are several aspects can be improved in developing MFIs' services. MFIs have to concern on effective strategies to delivering its product to the poor. In addition, proper product of financial service can increase its demand. Hence, MFIs' outreach will be expanded.

To reach the main purposes of micro finance operation, MFIs should be sustainable. When MFIs want to be sustainable, MFIs tend to avoid high risk of operation especially in credit offering. Consequently, institutional standard on loan performance evaluation is needed. Governance performance, leadership and management are also major factors that affect the micro finance progress.

Most of micro finance practitioners assume that to be sustainable, MFIs have to reduce their dependency to donor subsidies. Saving mobilization is the way to cover the financial source need of MFIs.

However, still, there are MFIs unable to be sustainable since it put social mission as main issues. Dual mission is relatively become a common issue in micro finance development. Social versus profit orientations are two things, which cannot be synchronized. Most of micro finance actors state that MFIs that focus on social mission will not sustain, while profit oriented is better.

Robinson (2002) adds that there was shifted paradigm of MFIs' development from supply lending approach to demand driven approach. Supply lending approach characterized as donor dependence to government or donor institutions and delivering subsidies that cause moral hazard. Lately, it has been proved that donor institutions and government were failed to preserve performance standards and MFIs' sustainability. On the other hand, demand driven approach offers market orientation method and initiate sustainable institutions. This approach is relatively difficult to reach the poor since they need sort of subsidies, not commercial funding.

The services of MFIs are market led orientation. This strategy can improve the performance of MFIs and lead MFIs in competing in the financial market. It requires MFIs to be efficient in delivering services to their clients. Recently, market led orientation becomes one of main concerns due to many drops out cases in MFIs. Market led orientation need to develop MFIs' transparency, customer services providing and improve the clients' satisfaction.

Micro Finance Centre (MFC) Spotlight conducts several studies regarding market led orientation. These studies discuss about clients' satisfaction and loyalty. Pawlak (2004) asserts that the services of MFIs should satisfy their clients. In the long run, clients' satisfaction drives to clients' loyalty to MFIs though clients' loyalty does not fully indicate clients' satisfaction towards the services of MFIs (Pawlak, 2004).

MFIs do not have to conduct a complicated study in order to obtain information about clients' satisfaction and loyalty. DEMOS (one of MFIs in Croatia) has proved that the study to obtain information about clients' satisfaction and loyalty is simple and not costly. Moreover, in the long run this study will help MFIs by providing accurate information.

Rising competition forces MFIs to implement best business practices. Actually, a few MFIs have implemented and made the transition to fully regulated financial institutions. In this case, there is a new method utilized to measure MFIs' performance. A strategy that can be implemented is scoring. Scoring (credit scoring) is the derivation of measurement of characteristic of borrowers, loan and lenders affect risk. Usually, credit scoring utilized to predict the loan conditions. Additionally, its probably the next important innovation in MFIs. As we know that most of MFIs have a lack of financial sustainability or have some arrears problems.

Credit scoring utilizes quantitative method. Scoring measure the performance of past credit and forecast the future credit. From experience in Bolivia and Columbia, scoring evidenced can indeed improve the judgment of the risk (Schreiner, 2000). In the long run, credit scoring will be important for MFIs to help in credit analyzing.

Table 1.12
Financial Discipline and Prudential Standards of Commercialized Credit Union

Financial Disciplines	Prudential Standards
1. Delinquency ratio	< 10% of total loan portfolio > 30 days delinquent
2. Loan loss provision	100% of all delinquent loans >12 months 35% of all delinquent loans > 1-12 months
3. Loan charges off	100% of all delinquent loans >12 months
4. Institutional capital reserves ratio	> or + 10% of total assets
5. Liquidity reserves ratio	15-20 % of savings deposits
6. Non-earnings assets ratio	< 10% of total assets
7. Operating expenses ratio	<0% of average total assets
8. Return on assets ratio	> 1% of average total assets (economy specific)

Source: Richardson and Lennon 2001, p.4. Cited on Charitonenko, 2004.

1.6 Characteristic of Best Practices

MFIs is defined as an organization or institution that has dual mission, social mission and profit mission. The existence of MFIs' aim is alleviating poverty through its financial services into micro enterprises or the poor. But recently, MFIs have to change its strategy for its financial sustainability (Rock, 1998).

In most cases, MFIs face difficult task to balance the social and profit mission. In term of MFIs, balancing process of dual mission can be defined with increasing outreach. MFIs have to fit the most appropriate strategy to reach high profitability all at once high client coverage. There is no standard, because each MFI has its own strategies.

By increasing the number of clients, it is more difficult for MFIs to pay close attention to their clients. Another fact shows that MFIs has been experiencing in the high drop-out rates in several target operations (Meyer, 2001). There are five indicators caused by client dissatisfaction and unmeet demands faced by MFIs. The study based on MFIs market in Bangladesh. The result might be applied others MFIs. These factors are:

1. Exclusion and non-participation
   Based on the survey done by The World Bank in Bangladesh, many qualified households choose not to participate in MFIs' operation. The major reason for not joining MFIs' program is because people feel that they would not be able to repay the loan. In this term, exclusion and non-participation are caused by inappropriate design of product for local economic conditions.
2. Drop outs
   Drop out is a client who decides to stop being a client of an MFI. For MFIs, there will be profitable loan if it is third or fourth loan from clients. Starting from small credit is disadvantageous to MFIs since it takes time to adjust with the institutions. There is a principle state that client retention is essential in MFIs' profitability and sustainability.
3. Delinquencies
   Delinquencies arise when clients have no capability to repay and have no value access enough to make long relationship with the institutions. Delinquencies are also can be caused by inappropriate repayment schedule. Yet, delinquency case is relatively difficult to find in Bangladesh since to many donors programs.
4. Overlap
   Multimembership reflects clients' dissatisfaction. Wright (2000) states that multiple membership can be 40 – 50% in areas where MFIs operating. Dissatisfaction may be as a result of amount of credit received by clients.
5. Use of informal finance
   One of MFIs' purposes is to save the poor from informal moneylenders who charge high interest. But yet, sometimes clients need more credit that cannot be fulfilled by formal financial institutions such as MFIs.

Due to this condition, even there is no standard of best practices to come up with the mission, there are some indicators can be used in order to assess whether the institutions categorize as best practices or not. As the basic character of MFIs operations (local specific and time specific), there are several best practices parameters.

In general, the character of best practices includes outreach, availability and impact (Robinson, 2002). First, micro finance has to affect the economy positively. Everything has positive and negative impact, however to be categorized as best practices, positive impact of MFIs should be more than negative impact. Additionally, Gonzales-Vega defines six types of outreach (McGuire and Conroy):

1. Quality; the value of micro finance for particular clients
2. Cost; the cost of micro finance to clients, including interest rate and transaction costs
3. Depth; the social value of extending micro finance to a particular client group
4. Breadth; the number of client reach
5. Length; whether clients will be reached with only one loan, or whether they will receive financial services on a permanent basis
6. Variety; the range of financial services provided to clients.

As the last parameter of best practices according to Robinson' criterion is availability. Availability means the ability of targeted clients to access the micro finance institutions. Term of availability are office hours, strategic location and open days opened. The higher availability, the more effective MFIs can be.

Moreover, Robinsons' has identified several factors as a key success of BDB (Bank Dagang Bali), one of the best MFIs in Indonesia, although this institution was liquidated by Indonesian Government due to other factors (by the year of 2004). Those factors are:

1. Costumer relation
   - Personal approach to costumers. MFIs should have particular approach to understand what clients really need
   - Intimate relation with low-income clients.
   - Respect to the costumers
   - Active communication with the costumers and deep personally relation with costumers
2. Organization
   - There should be a balance components among investors, staff, clients, government and the community to have the same perspective to improve MFIs' performance
   - High staff retention. Staff received incentives for every clients introduced to BDB
   - Effective management structure.
   - Good communication between staff and management
3. Products
   - No group lending, unless each member of the group can monitor each other in term of credit repayments
   - Short term of credits
   - Micro saving offering
   - Providing gifts for certain period of credit and certain amount of saving
4. Services

   In term of servicing clients, there is no discrimination for the poorest of the poor and top level of the poor class. With this kind of services, clients feel respected.

Remeyi (2002) has defined 10 keys success of MFIs. These factors based on assumption that most of MFIs can eliminate poverty. These factors are:

1. Knowing the market

   MFIs must know the market and could adapt the most successful models that support local culture
2. Lead with saving mobilizing

   Credit was believed as good beginning in micro finance activities. But it was changed when successful Rotation Saving and Credits Association (ROSCAS) demonstrated. In this term, the lender should be confident that the amount borrowed can be repaid because it does not exceed the limit set by the capacity to save.
3. Concentrated with the best clients

   This point related with women empowering programs. It based on the fact, which shows that women are more successful in borrowing to micro finance. Women are more reliable in repaying
4. Following subsidiary principles

   Mainstreams bank fails to serve the poor, in part because of the burden of internalizing all the transaction costs associated with financial intermediation. To internalize these function by optimal risk management, quality controls, transparency and losses minimization due to the existence of moral hazard
5. Keep it frequent and small

   Micro finance should be small so that can keep giving frequent services to its clients. Two related issues that critical here are:
   - Micro finance work for the poor. Therefore micro finance must be able to handle very small amount of funds frequently.
   - Clients' needs are predictable and intense contact with the target clients

   MFIs have a better track record in outreach to the poorest of the poor because they are able to offer financial services in small frequent transactions and predictable schedule. The essence of specializing in 'small' transactions refers to the ability to service the need of the poor for small-scale of transaction such as small deposits, small transfers and provide small credits..
6. Honesty and integrity

   Honesty and integrity are the most important principles that must be applied by both the MFIs and the clients. Without honesty and integrity as the foundation, the MFIs' business will not sustainable.

7. Poverty targeting
   Poverty targeting should be included in the MFIs business strategies programs. An argument states that MFIs will get a greater success if it implements open door policy and provide services to everyone.
8. Commercially efficient management
   MFI should implement financial discipline that reflects their financial commitments and responsibilities. Donor subsidies allow management to persist with overstaffing and escape from rigors financial discipline.
9. Participatory risk management
   There are many approaches to risk management. In MFIs, there is no better guide than systems that utilize personal relation to the community being served. Risk management is about designing debt repayment procedures and saving collections that are consistent with money management needed by clients and their efforts to escape poverty.
10. The needs of good products and services
   MFIs honor the poor when MFIs best service not charity. Beside that, sustainability of micro finance cannot be reached unless it performs the business professionally.

Another suggestion concerning best practices principles in micro finance services states that reducing costs is one of the main points to implement. However, as previous principle, market knowledge is the most important factor in providing micro finance services to the poor. In order to motivate clients to repay the credits, MFIs should have special techniques. These techniques will distinguish MFI from the other financial institutions. Furthermore, special techniques in motivating clients to repay credits will be a competitive advantage for MFIs.

Chapter 2
INDONESIA

The Need and Availability of Micro Finance Service for Micro Enterprise: Bringing Multi-Level Good Practices into Local Context

(Case Study: Indonesia; Malaysia; Mexico; Thailand and the Philippines)

2.1 Indonesia's Macroeconomic Condition

It has been generally acknowledged that Micro and Small Enterprises (MSEs) hold a strategic position in the economic structure of Indonesia. The number of MSEs dominates business entities in Indonesia. In regards of employment, MSEs absorb around 90% of Indonesian workforce. They also have shown their persistence to survive during economic crises, however, the role of MSE in the Gross Domestic Product (GDP) growth or value added is still quite low, on the contrary with their number of entity.

Despite the above facts, supports for MSEs in Indonesia have been minimal. Not only in term of government policy, but mostly in the effectiveness of the policy implementation, the government has failed to accelerate the development of MSE. Many programs have been launched by the government either technical, financial or managerial assistance, but the effect is quite small to the development of MSEs in general.

As mentioned in the result of many studies, financial assistance is one of among other factors that are needed by MSE to develop. More specifically, MSEs need micro finance institution (MFI) to improve their performance in the national economic. History has given lessons how MFI played its role in the economic development of MSEs. The lessons must be followed by continuous strategic policy on MFI development.

This chapter will learned about micro finance institutions' (MFIs) share in the development of MSEs, exploring the strategies and programs to reinforce financing access for MSEs, particularly MFIs experience and history in Indonesia. Hence, the result may be used for further development of MFIs and MSEs in Indonesia.

Indonesia's Macroeconomic and Its Impact on MFI

Indonesia is one of APEC economies that has unique characteristic. Moreover, Indonesia is one of the most populous economies in the world. By the end of 2004, Indonesia has approximately 216.4 millions of population. The growth of Indonesia population during 2000 until 2004 is 1.3% (Asian Development Bank-ADB).

Although the percentage has change, compared to about 60% in 1970s, the number of the poor is still huge until recently. Indonesia is still categorized as a developing economy, despite the fact that Indonesia has a rich natural resource such as oil, natural gas, minerals, timber and other primary energy resources.

A substantial share of the 1970s oil wealth was invested in rural infrastructure, agriculture, education and health and family planning. Indonesia was micromanaged through a mixture of top down control, largesse, religious, and ethnic tolerance, military repression and economic development.

The Indonesian crisis erupted shortly after the collapse of Thai Baht in 1997. The primary cause of the crisis in Indonesia was not the underlying economy. It was the closely linked weaknesses in governance and in the financial system (Robinson, 2002). The value of the rupiah plunged from Rp2,450 against US dollar in June 1997 to Rp14,900 in June 1998.

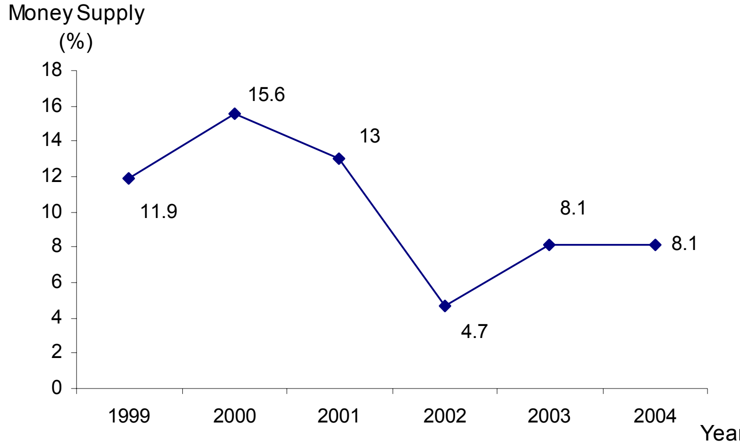
As results of this crisis, 70% of bank's credit was in defaulted loans. The financial system was collapsed. A tight monetary policy, debt rescheduling and IMF support helped the economy improving. However, economic recovery has been slow, mostly caused by political reasons. Unquestionably, macroeconomic condition of Indonesia influenced by political practice.

Political issue was become an essential part in macroeconomic cycle in Indonesia. A conducive macroeconomic condition is an important factor to support development process, especially financial system development. Regardless the governance system, a stable political condition during the "New Order" regime has succeeded in supporting economic development during 1970s – 1990s. During the falling down of the "New Order", national political situation has become unstable. The effect on economy was very bad. Business player would hold the expansion; consumers keep their money; and economic would slow down.

During 1999 – 2004, money supply condition is fluctuated. The lower rate of money supply indicates that people tend to have higher trust to the financial institutions. The highest rate of money supply was on 2000 (15.6%) since the impact of economic crisis in 1998. Money supply rate was decreased from 13% to 4.7% in 2002 (Figure 2.1). However, the people trust to the financial institutions was increased. With the increasing trust, it benefits the development of financial institutions.

By 2003, the rate of money supply was increased by 8.1% and the same value in 2004. This is understandable because during the period, there were several problems that Indonesia' faced include security disturbance, corruption and some natural disasters. The evidence shows that people trust decreasing. Yet, to develop financial institutions, macroeconomic stabilization is needed.

Figure 2.1
Indonesia Growth of Broad Money, 2000 – 2004



Sources: Asian Development Bank (ADB).

The macroeconomic difficulties faced by Indonesia were also affecting the foreign direct investment. Foreign investors would think twice before they invest their fund to Indonesia. Compared to other Southeast Asia economies, Indonesia has the lowest foreign direct investment. Foreign direct investment was dropped from 1999 until 2002. However, by 2003, it was increasing (Table 2.1).

Table 2.1

Foreign Direct Investment (US$, million), 1999 – 2003

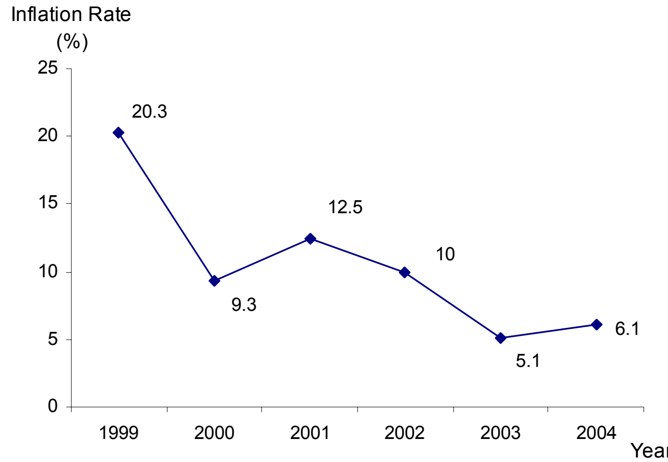
Economies	1999	2000	2001	2002	2003
Southeast Asia	19,722.2	17,087.7	-4,749	7,924	11,460.1
Cambodia	230.3	148.5	149.3	145.1	87
Indonesia	-2,745	-4,550	-3,278	-15,134	-596.9
Laos PDR	–	33.9	23.9	25.4	19.5
Malaysia	3,895.3	3,787.6	553.9	3,203.4	2,473.2
Myanmar	255.6	258.3	210.3	191.1	133.5
Philippines	1,725	1,345	989	1,792	319
Singapore [a]	8,846.3	11,400.4	-8,589.7	1,727	5,625.5
Thailand	6,102.7	3,366	3,892.3	953.4	1,949.3
Viet Nam	1,412	1,298	1,300	1,400	1,450

Note: a Refers to direct investment from the balance of payment section of the country tables
Sources: Asian Development Bank (ADB).

Foreign direct investment is one of factors that significantly influence the business climate. An improving business climate will determine the increasing welfare of Indonesia. With continuous effort to stabilize economic condition, the foreign direct investment will increase. Therefore, business climate will recover.

Another factor that influence business climate is inflation rate. Inflation rate can impede business activities. As 2004, the inflation rate was 6.1%, higher than 2003 (5.1%). However, inflation rate has negative effect on financial institutions. When inflation are increasing, financial institutions will charge higher saving interest. Hence financial institution will be over liquid. Trend of inflation will display in Figure 2.2.

Figure 2.2
Indonesia Trend of Inflation, 1999 – 2004



Sources: Asian Development Bank (ADB).

In Indonesia, industry sector has significantly contributes into Gross Domestic Product (GDP) by 43.7% in 2004 (Shares of Major Sectors in GDP, ADB). While agriculture sector only contributes approximately 15.4% of total GDP by the year 2004. Moreover, share of services sectors in GDP is 40.9%. Based on this fact, it important to develop the industry sector to improve Indonesia's GDP.

Micro, small and medium enterprises have dominated economic activities in many developing economies, give the most significant contribution in job creation and equally distributed incomes. In Indonesia, Micro, small and medium enterprises contribute significantly to the development as 54.74% of Gross Domestic Product comes from these enterprises. From Table 2.2 it can be seen that in pursuing proper method of developing business and creating job opportunities, the government takes into consideration in improving Micro, small and medium enterprises particularly in reducing the negative impact of economic crisis.

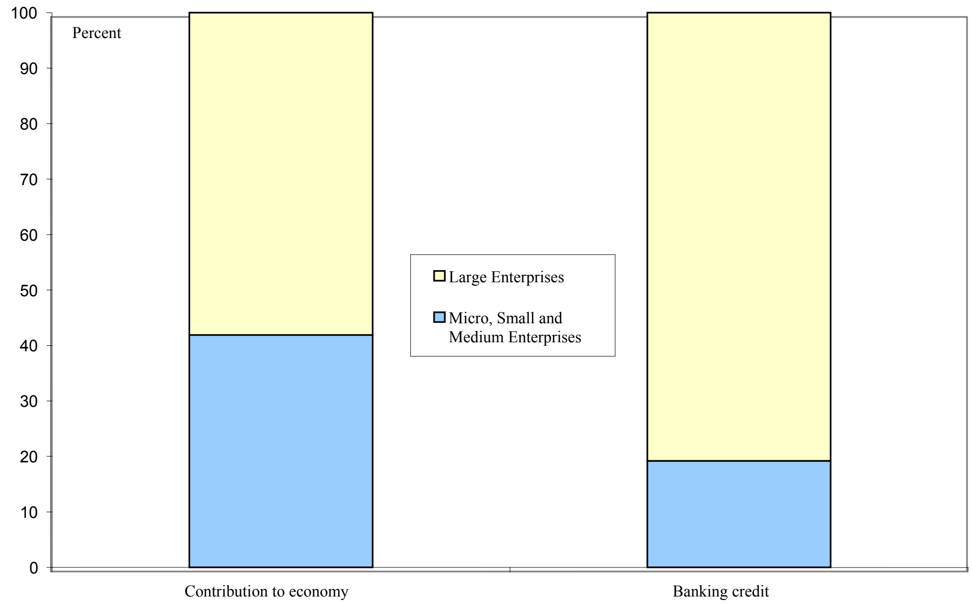
Table 2.2
Number of Enterprises in Indonesia, 2001

Enterprises	Number	%	Labor	%	% of Export	GDP (in Rp)	%
Small	40,137,773	99.85	65,246,294	88.6	3.37	578,359,165	39.40
Medium	57,743	0.14	7,993,449	10.85	10.93	225,223,692	15.34
Sub total	40,195,516	99.99	73,239,793	99.45	15.30	803,582,857	54.74
Corporate	2,095	0.01	406,215	0.55	85.70	664,517,170	45.26
Total	40,197,611	100	73,646,008	100	100	1,468,100,025	100

Sources: Ministry of Cooperatives & SMEs.

Of the industry sector, MSEs contributed significantly to the national economy. Besides absorbing almost 90% of workforce, MSEs value added reached Rp450 trillions or around 41.9% of the GDP in the late 1990s. However, in terms of financing for MSEs, it is not proportional to the contribution of MSE to the economy. So far, the financial industry has tended to have a bias in favour of the large-scale businesses. The position of banking credit in MSE in 1997, for example, was only around Rp67 trillions, or 19% of the total banking credit position. Other financial institutions such as capital market and venture capital have not played much the role in helping MSE financing, either.

Figure 2.3
Contribution of MSE to Economy and Banking Credit for MSE



Source: The Central Bureau of Statistics, State Minister of Cooperatives, Small and Middle Businesses and Bank Indonesia.

Most Indonesia population are 15 – 64 years old or are in productive ages. Based on this fact, it is possible for Indonesia to strengthen business climate, especially through Micro and Small Enterprises (MSEs) development. MSEs business is potential to grow during crisis and economic fluctuation. In addition, MSEs development is also fostered by micro financial system.

Table 2.3 exhibits the labor performance of Indonesia compared with other Southeast Asia economies. From Table 2.3 it shown that women labor participation was increased from 1990 to 2003. However, labor and employment still dominated by male. Related to MSEs development, it was significant role in improving female labor participation.

Table 2.3
Labor and Employment by Gender and Economic Activity, 1990 – 2003

Southeast Asia	Economically Active Population (as % of Working Age Population) [a]			
	1990		2003	
	Female	Male	Female	Male
Cambodia	85.2	86.3	83.9	84.3
Indonesia	52.1	84.4	59.5	84.7
Lao PDR	76.9	91.2	77.9	90.0
Malaysia	46.4	84.0	51.9	81.4
Myanmar	68.5	90.1	68.5	89.3
Philippines	48.1	83.0	52.0	82.6
Singapore	54.4	83.8	54.5	81.7
Thailand	78.5	89.5	77.7	89.7
Viet Nam	81.0	88.1	77.3	83.5

Note: a Data for working age population refer to ages 15-64
Sources: Asian Development Bank (ADB).

Recently, Indonesia business structure is dominated by small-scale business. Moreover, the small-scale business tends to operate without any legal status. Table 2.4 exhibits the structure of business unit in accordance with business scale and legal status.

Table 2.4

Structure of Business Unit in Accordance with Business Scale and Legal Status

Legal / Scale	State Owned Enterprise National and Local	Cooperatives	Private with Legal Status	Private Without Legal Status	Total
Large (Turn over > 50 billions Rupiah)	158	30	2,085	n.a.	2,273
Medium (Turn over 1 - 50 billions Rupiah)	700	3,950	57,336	n.a.	61,986
Small Non-Micro (Turn over 50 millions - 1 billion Rupiah)	n.a.	89,820	111,947	771,743	973,510
Micro (Turn over <50 million Rupiah)	n.a.	KUBE PRAKOP, MFIs	n.a.	n.a.	41,353,5 20
Total	858	93,800	171,368	42,125,263	42,391,2 89

Source: BPS and decomposition by Noer Soetrisno presented in APEC Workshop, Bali, 2005.

From Table 2.4 above, we can see that the number of business entities in Indonesia is dominated by MSE with turn-over below Rp50 million. It is very likely those MSEs are in need of financial assistance to grow. Hence, it is a great opportunity for MFI to take part. MFI, in any form, is regarded as the most eligible institution to provide financial service to the small-scale business. Furthermore, MFIs drive the higher welfare economics. However, this condition is not the only factor that affects the MFIs development. There are also others factors such as government policy and sociocultural aspects also influence the MFIs condition.

Indonesia's Government Policy and Its Impact on MFI

The abundant oil revenues during the oil boom period between 1973 and 1982 enabled the government to realize the development plan. In order to channel the revenues to local industries, state enterprise and cooperatives, the government was strengthened the position of state bank. By 1982, state banks accounted for 80% of total banks assets and 85% of total bank's credit. More than 90% of liquidity credit, which made up almost half of the total loan amount disbursed during the oil boom period, was channeled through state banks.

The rural financial system was virtually closed for the private sector. BRI, one of state bank was instructed to establish an extensive network of village units for the implementation of subsidized credit programs. During the 1980's, the negative consequences of this development model became apparent. The abuse and repression of the financial sector had undermined the mobilization of domestic savings and the institutional viability of state banks. Unsound lending practices, misallocation and misuse of funds, and the consequent high-rates default have happened in most programs involving small-scale, rural and cooperative credit.

There was financial sector reformation aims to improve the competitiveness of domestic industries, reduce reliance on state enterprises and improve domestic resource mobilization. Moreover, government was also removed some restriction that cause high cost economy. Hence, non oil-exports and trade sector improvement can be stimulated. There are two financial reforms in Indonesia:

a. First, reforms in 1983, that removed credit ceilings, interest controls and most of subsidized credit programs.

b. Second, reform in 1988 removed most entry barriers to the still state-dominated banking sector and further reduced more credit programs

Between 1988 and 1994, the number of banks was increased from 112 to 240, and rural banks and credit institutions were increased from 5,783 to 9,196. By 1995, the private sector banks sector exceeded the state banks' share in saving mobilization and credit disbursement.

By the early 1990s the economy and the financial sector faced serious problems. The vast majority of state enterprise and officialized village cooperatives were deemed financially unsound. Financial reforms had reduced existing distortions in financial markets. However, this reform could not answer the problems. Moreover, new seed of problems were added when the government implementing new policies, such as: injecting government money into subsidizes credit programs, obliging banks to allocate 20% of their profits to small enterprises and cooperatives and pressuring private companies to transfer up to 25% of their shares to cooperatives.

By the end of 1992, 15% of state banks loan portfolio was categorized as non performing. High arrears ratio occurred, mainly in credit programs implemented through village cooperatives. Farmers credit program (KUT) incurred arrears (28%) mainly because of the misuse of funds by officials of local government and cooperatives. While *Kredit Investasi Kecil* (KIK) and KMKP (Small-Scale Credit Program) was abandoned in 1990 with a default rate approximately 27%. The subsequent credit program, through which bank was forced to allocate 20% of their portfolio to small business, also become subject to manipulation.

There are two government institutions that supervise financial institution in Indonesia; Central Bank (*Central Bank of Indonesia*-BI) and Ministry of Cooperatives and Small Medium Enterprises. Central Bank is determined to regulate banking operation, while the Ministry of Cooperatives and Small Medium Enterprises controls cooperatives and non-banking financial institutions. However, Central Bank of Indonesia has been long participated in microfinance development. This participation is based on Indonesia's Act No. 13/1968, Central Bank of Indonesia performs, as Indonesia's agent of development with the task is to improve people's standard of living.

Central Bank of Indonesia deregulates the institutional framework by easing the establishment of new banks and the opening of bank branches in 1998. Central Bank of Indonesia allowed the establishment of rural banks (BPRs) with an equity capital of Rp50 million and requiring the existing semiformal financial institutions to be eventually transformed into formal banks/people credit bank (*Bank Perkreditan Rakyat*_BPR). The policy has greatly eased access of the poor to banking services and contributed to the reduction of poverty in Indonesia. Until 1995, there were 1,643 formal rural banks established.

Within 1990 to 1995, the total number of registered small financial institutions grew from 8,003 to 9,271, the number of commercial banks increased from 171 to 240 and the number of their branches increased from 3,563 to 5,191. The number of village banks and rural branches grew rapidly, increasing the outreach of this banking segment to both the non-poor and the poor. To support the small business development, Central Bank of Indonesia was required commercial banks to allocate at least 20% of their portfolio to small-scale enterprises in 1990. These allocations can directly deliver into small credit or through BPR (with little, if any, direct benefit to the poor).

A new banking act deregulates bank ownership was published in 1992. Only two types of banks are recognized: commercial banks with a paid-in capital of Rp10 billion and rural banks (BPR) with a paid-in capital of Rp50 million. This deregulation has also increased competition and requires all registered MFIs in Indonesia to be transformed within five years into formal village banks. Some NGOs, among them *Yayasan Bina Swadaya* as one of the leading institutions, have been inspired by the law on village banks to establish their own banks. Financial services in terms of savings deposit facilities and credit for the lower sections of the population have greatly increased, particularly through government-owned BRI (*People's Bank of Indonesia*), provincial government owned Bank Pembangunan Daerah (BPDs) and a number of private banks and smaller institutions.

However, very few MFIs target exclusively the poor, but many do include the poor among their clientele. Financial institutions have helped to reduce poverty in Indonesia by giving the poor access to savings and credit services. Changes in the policy and regulatory environment have been of crucial importance in that field since Indonesia has a deep experience in the promotion of MFIs, the expansion of micro financial services and the alleviation of poverty.

Deregulation of interest rates to permit institutions to pay interest rates with positive real returns to savers and to charge interest rates on loans that cover their costs and permit profits from which their expansion is financed and owners are rewarded. Establishment of second-tier regulatory authorities, which guide and supervise large numbers of small financial institutions that cannot be effectively controlled by the central bank: still largely a task of the future. Bank deregulation facilitate the establishment of new banks, branching out, *taking the bank to the people and* to allow for the establishment of local MFIs with equity capital requirements that substantially differ from those for national banks.

In 2002, Central Bank of Indonesia cooperates with government (Ministry of Social Welfare and Society) through "Poverty Alleviation through Development and Empowerment of MSEs" program. In this program, the two institutions create MoU (Memorandum of Understanding) which each party should support MSEs development according to the capacity. This program was renewed by 8 June 2005.

The new regulation is Central Bank Act No. 23/1999 and the amendment of Central Bank Act No. 24/2004. This new regulation was limited Central Bank of Indonesia to function as agent of development. However, BI's role was continued by some policies in MSEs development. There are four approaches utilized: banking credit policy, institutional development and capacity building, technical assistance provision and cooperation and coordination between Government of Indonesia (GoI) and Central Bank of Indonesia.

By October 2004, Central Bank of Indonesia state that banking has to publish their annual business plan through minimum quarter of total media in Indonesia. With this regulation, banks require to be transparent. Hence, people can choose the best bank that such their need.

Central Bank of Indonesia coordinates with three state-owned companies (BUMNs). Those are BRI, BTN (*Bank Tabungan Negara*) and PNM (*Permodalan Nasional Madani*). The BUMNs was authorized to channel credit of Bank Indonesia Liquidity Credit (*Kredit Likuiditas Bank Indonesia*-KLBI) for MSEs. In sum, microfinance system development was followed to strengthen the banking industry and accelerate the banking consolidation.

Moreover, Central Bank of Indonesia also enhances the poor access to financial services. Linkage program between commercial bank and rural banks or other MFIs is developed to improve commercial banks loan to MSEs since they are lack of capacity such as expertise, network and culture. Central Bank of Indonesia has following strategies to construct microfinance development; rural bank restructuring, capacity building, infrastructure building, and rural bank regulation and supervision improvement.

Central Bank of Indonesia also has significant role to regulate the financial system including *sharia* banking. As new issues of *sharia* banking operation, Central Bank of Indonesia regulate through Banking Act. No.10 1998. Here, some articles in the Banking act concerning the microfinance, especially on rural banks (*Bank Perkreditan Rakyat*-BPRs), will be presented as follows:

1. The Capitalization of banks

   A minimum paid up capital for the establishment of new rural banks (BPRs):

a. For Jakarta, Bogor, Tangerang and Bekasi area: Rp2 Billion

b. For provincial capital; Rp1 Billion

c. In other areas: Rp500 Million

2. Ownership

   Ownership of BPR by foreign parties is still not permitted

3. The bank management of BPR

   At least two people on the Board of Directors and at least one member of the Board of Commissioners

4. Prerequisites for members of the management of BPRs

   At least 50% of the directors of BPRs must have operational experience in funding and credit-provision sector of at least two years

5. Scope of Work of BPRs

   a. BPRs, which according to the former regulations were forbidden from being established in big cities, are allowed to do so by the new regulations

   b. The opening of BPR branch office in the former regulations was limited to within the same regency (*Kabupaten*). In the new regulations, the area is extended to the same province as the head office.

   c. BPRs are given the chance to extend their services to other cash activities, including payment point, mobile cash, floating cash and cash services outside other offices.

6. Banks based on the *sharia* principle

   The business activities of commercial banks and BPRs based on *sharia* principle can be carried out through:

   a. The establishment of a new bank

   b. The conversion of a conventional bank to a bank based on the *sharia* principle

   c. Opening of a *sharia* branch of a conventional commercial bank

Due to financial regulation above, BPRs as one of MFIs in Indonesia has freedom to expand its financial activities, despite of some limitations. However, simple requirements for BPRs establishment have been enlarged the number of BPRs. The number of BPRs improvement identical with the raising competition among MFIs. Therefore each MFI have to operate efficiently in serving the poor.

In case of credit classification, there are six types of credit based on its amount as follows BPS-KPKM (2001).

Table 2.5
Types of Credit Based on Amount Disbursed

No.	Credit Business Scale	Amount of Credit
1	Large-Scale Business credit	> 50 billions
2	Medium-Scale Business credit	Rp1 billion – Rp50 billion
3	Small-Medium Business credit	Rp50 million – Rp1 billion
4	Small-Small Business credit	Rp1 million – Rp50 million
5	Micro-Small Business credit	< Rp1 million
6	Pre-Welfare Credits	< Rp200.000

Source: Bunga Rampai LKM, Business Innovation Center of Indonesia cooperating with Office of State Ministry for Cooperatives and SMEs, 2003.

Indonesia's Sociocultural and Its Impact on MFI

Indonesia's society has unique features reflecting Indonesian sociocultural situation. Indonesia's society has a strong relationship between individuals and tends to have a particular community. This feature is suitable for the development of *arisan* (Rotation Credit and Saving Associations-RoSCAs), a very well known and widely practice MFIs in Indonesia.

In the beginning, RoSCAs in Indonesia was regarded as for the rich, as a place where they could socialized and with people of the same social level. Participation by the poor was not widespread, not to mentioned did not exist. Rather people with higher income tend to participate in RoSCAs. Understanding why the rich participate in the RoSCA rather than going to a formal institution is important. One reason could be that the social sanctions that are in place to prevent default are very strong. This reason is also explain why the poor are deterred from participating. However, the said pattern has changed, since "*arisan*" has become a method for managing family finance of the poor especially in urban and sub-urban areas. By joining such activity, the poor have been able to meet their need of secondary or tertiary family needs, or even for investment.

Another reason is that RoSCAs can possibly undertake screening and sorting of its members, thus excluding the poor, who may not have adequate disposable income. The richer individuals may participate in the RoSCAs due to the flexibility it offers in terms of selecting the contribution rates and membership. These are possible reasons to explain the upward sloping relationship between RoSCAs participation and income.

In Indonesia, rural population is likely to be poorer than the urban. Another fact is that people in rural areas leave the RoSCAs at a somewhat earlier age than people in urban areas may once again suggest that RoSCAs are not meant for the poor.

Analyzing on the choice to participate in RoSCAs and the reason of people's participation in more than one RoSCAs are important. This would also help us to understand several of the fundamental assumptions of the anthropological and theoretical literature on RoSCA.

First assumption is the general belief that RoSCAs are informal finance mechanism that is predominantly used by the poor. Kurtz (1974) sees poverty as a positive "correlate" of RoSCAs participation. Calomiris and Rajaraman (1998) claim that evidence on participation by the poor is very widespread. Second assumption is that people who generally participate in RoSCAs are credit constrained. The lack of collateral is often given as a reason for why people should choose informal finance mechanism (such as RoSCAs) over a formal financial institution. Third assumption is that women are more likely to participate in RoSCAs than men. RoSCAs are usually practiced by certain community that has one or more similarities. For example, they are office RoSCAs, neighborhood and sub-neighborhoods RoSCAs, religious RoSCAs and market RoSCAs.

In learning the development of RoSCAs in Indonesia, it must be realized that the development of MFI in Indonesia, like in other economies, has not only been affected by economic factors, but also by various socio-cultural factors. These non-economic factors can be grouped into general and specific factors. Such a general factors that promote MFI development is the value of solidarity. In almost all regions of Indonesia, solidarity and helping each other (*gotong royong*) have become an important factor in MFI development. For example, in villages people are helping each other during planting season in the rice-field. One day in a villager rice-field, then the other day in other villager's. The same will also applied when the villagers build houses.

Specific sociocultural factor will be affected by profession, economic level, religion and ethnic. For instance, MFI products and management in farmers and fishermen societies will be different one from another. The same is between people in Java and Sumatra, depending on the local culture.

Another factor that determines the demand for MFI is the nature of business. Theoretically, manufacturing small and micro business is rarely financed by MFI, since the business characteristics will result in higher cost if financed by MFI. This is on the contrary with trading business that only needs short-term financing.

Having access to a formal financial institution in the village (which includes private banks and others such as the Bank Rakyat Indonesia) did not have an important effect on participation. In Indonesia mostly if someone having the credit facility inside the village (rather than outside village) was positively correlated with participation in the RoSCAs. That means formal financial institutions and RoSCAs are complements rather than substitutes. The existence of informal financial programs (such as the KUKESRA which is a government scheme which provides credit to the family) and the presence of moneylenders in the village were also related with participation.

2.2 History of Microfinance Services in Indonesia

World Bank and many others sources state that Indonesia regard success in poverty reduction in recent decades. This is due to the strength and diversity of its microfinance sector as it evolved over the past one hundred years. Indonesia has also provided an outstanding example of the direct impact of financial and economic liberalization policies on microfinance and poverty alleviation, since 1983.

Indonesia has a long history in promoting microfinance services for the poor. Berenbach and Churchill (1997) pointed Indonesia as *"the most developed market for microfinance services in the world".* The need for microfinance services had been recognized since its Dutch colonial period. At the beginning, this effort was organized by some well-educated local indigenous who concerned on their people economic deprivation. Latest history has presented a proof that some legendary MFIs have taken many forms in their development today.

The importance of microfinance to assist the MSEs development in Indonesia is supported by the fact that MSEs absorb significant number of labor force in Indonesia during the last several years. Table 2.6 exhibits some facts of labor absorption in Indonesia based on industrial business scale. In 2002 and 2003, micro and small business sector has absorbed the highest number of labors. It is then obvious, that providing financial services for micro and small sector should have won priority in Indonesian development program. Solving MSEs financial problem will also mean improving the welfare of most Indonesian.

Table 2. 6
Labor Absorption Based on Business Size (People), 2000-2003

Business Scale	2000	2003	Growth (%)
Micro and Small Businesses	62,856,765	70,282,178	11.81
Medium Businesses	7,550,674	8,754,615	15.94
Large Businesses	382,438	438,198	14.58
Number of labors	70,789,877	79,474,991	12.27

Source: Indonesian Ministry of Cooperatives and Small and Medium Enterprise, 2004.

Indonesia has varying form of microfinance service providers, from commercial banks, cooperatives, Islamic banking, to other foundations concerning for micro sector development. Beside the existing institutions, government also participates in many forms of regulations, initiatives and many funding programs correlate to poverty alleviation. Among various types of MFIs, the oldest story can be drawn from cooperatives and BRI.

The cooperative thought was first time introduced by Indonesia in 1896 by Patih R. Aria Wiriatmadja at Purwokerto, Central Java. These activities were then continued by De Wolffvan Westerrode. In 1908, *Budi Utomo*, which was founded by Dr. Sutomo, played the important role for cooperatives movement to improve the life of society. In 1915, *Verordening op de Cooperatieve Vereeniging* was established. In 1927 the other form of cooperatives (*Regeling Inlandschhe Cooperatieve*) was established.

In 1927, Islamic Trader Union (*Serikat Dagang Islam*) was founded to develop bargaining power among local entrepreneur. In 1929, Indonesian National Party (*Partai Nasional Indonesia*) was founded which had activities in promoting cooperative spirit. The Institutional chronology that managed the ideology of cooperatives in the past time are presented in Table 2.7.

Table 2.7
Institutional Chronology of Cooperative

Year	Institutional Chronology
	Before Independence
1930	*Netherlands Indie* Government developed Cooperatives Bureau under the Ministry of Domestic Affairs and had activities of registering and legalizing cooperation
1944	Had founded People Economic Office which Cooperatives Affair became part of it to managing all aspect which dealt only with Cooperatives
	After Independence Period
1945	Cooperatives were in the duty of Cooperatives Bureau and Domestic Trade under The Ministry of Wealth
1964	Cooperatives Department changed into Transmigration and Cooperatives Department
	In 1966 – 2004 Period
1966	Cooperatives Department returns to be self-supporting. Cooperatives Department changed to become Trading and Cooperatives Ministry.
1999	In pursuant to the Decision of President of Republic of Indonesia No.134/1999 date of 10 November 1999 about Position, Duty, Function, Organizational Formation and administration of State's Minister
2000	▪ Pursuant to the Decision of President of Republic of Indonesia No.166/2000 date of 23 November 2000 about Position, Duty, Function Authority, Organizational Formation and Administration of Non Department Government Institutions. Hence was formed the Council of Cooperatives and Small Medium Entrepreneur Resources Development (BPS-KPKM).
2001	▪ Pursuant to the Decision of President of Republic of Indonesia No. 108/2001 date of 10 October 2001 about Organizational Unit and Echelon I Duty of State Minister, hence State's Minister of Cooperatives and Small Medium Enterprises specified directly by State Ministry Secretariat (*Setmeneg*), seven Deputies and five expert staff. These structures go into effect till year 2004 of this time.

Source: Chorological History of Cooperative, Small and Medium Enterprises Affair Institution before Independence Period, 2004.

The Bank Rakyat Indonesia (BRI)

It was Raden Aria Wiriamaadya, who for the first time organized financial institution for local *pribumi* (Indonesian indigenous) that is known as *Bank Rakyat Indonesia* (BRI) today. In 1895, he founded *Hulp-en Spaar Bank der Indlansche Bestuurs Ambtenaaren* (Support and Savings Bank for Domestic Civil Servants) that served indigenous Dutch administration civil officers. However, the mission still based on serving the *priyayi* group, which is a community of traditional Javanese prominent having direct genealogy to subsequent local kings, ministers, or other royal family figures. This therefore made the bank called Bank of *Priyayi*.

In its development, the bank had broadened its missions, from serving only the local prominent, to all considerably local people. This broadening is inspired by Wiriamaadya's self experience of having distressed with Chinese moneylenders loans he made to finance his family's *selamatan* feast (Robinson, 2002). As Dutch colonial government distributed mass credit program known as *Volkscredietwezen*, Wiriamaadya's destination to bring his intention implemented had come true. He was then supported by Dutch administrator of Purwokerto district, Sieburgh.

Later on, the emerging West European cooperative movements in early 20th century had much influenced the young bank. It was De Wolff van Westerrode, Sieburgh's successor, who transforms the bank operation system into cooperative movement. Appointed as director of the bank in 1897, Westerrode applied some German Raiffeisen cooperative practices and rename the bank as *Purwokertosche Hulp, Spaar, en Landbouwcredietbank*. He later won Queen Wilhelmina's attention through implementation of "New Ethical Policy" that had supported strengthening the effort.

Table 2.8
Java Banking Structure in Early 20th Century

Credits Distributed	Institutions	Number (Units)
Volkscredietwezen (popular credit system)	People Credit Bank (BPR)	75
	Lumbung padi (village rice banks)	12,424
Centrale Kas (central fund)	Other emerging village banks	1,336

Source: Schmit, 1994.

The growing performance of Bank of Purwokerto had however attracted other similar institutions to appear in Java. Several instances are *Volksbank* (People's Bank), that later on known as *Bank Perkreditan Rakyat* (People Credit Bank-BPR) which are various in number. In 1912, Dutch administration promoted a credit program destined to improve local indigenous welfare that is *Volkscredietwezen* (credits for people). The loan was worth five million guilders. Subsequently, local credit distributors began to mushroom throughout Java. There are *lumbung padi* agricultural banks, the BPR and some others (Table 2.8).

The welfare package was also designed to restructure banking services providers. Consequently, the program had however required the people's banks to merge less than one institution, making Bank of Purwokerto comply to the rule as well. As a result, the bank was once again renamed, being *Algemeene Volkscredietbank* (AVB).

In 1935, Thomas Anthonij Fruin, the president of AVB, launched his publication titled *The Provisional Manual for the Credit Business of the General Popular Bank*. This manual is a compilation of his writings published in *Volkscredietwezen* monthly journal. Having this publication, AVB is provided with more practical guidelines to operate effectively in daily activities. In 1946, the *Bank Perkreditan Rakyat* (BPR) became BRI, which then merged with AVB in 1950 when it became a state-owned company.

Under Soeharto's administration, rice production had been the main concern of the government. The New Order (as the regime called) was initiated by "Green Revolution", a serious attempt to overcome food crisis by enhancing rice production. To finance the campaign, Soeharto insisted BRI to deliver soft loans programs for traditional farmers, namely BIMAS (1968-1983).

To achieve this strategic goal, BRI initiated developing *unit desas* system as a delivering mean for agricultural loans. As an initial pilot project, first *unit desa* office was opened in Yogyakarta in 1969. BRI cooperated with Food and Agricultural Organization (FAO) in delivering the credit program.

Unpredictably, the cost of delivering BIMAS loans was too high. BRI was not permitted to adjust its interest rates, since it was pegged by government policy. This worsening situation had dampened BRI, as only 54.5% of total disbursed loans was finally repaid.

The *unit desa* system reported loss every year except in 1977. In 1984, arrears were very high and total loss was projected more than US$30 million (Robinson, 2002). As the result, this condition had run BRI into financial instability. BIMAS was ended in 1984.

Analysts argue that the failure of BIMAS was mainly because of its high operational costs (Robinson, 2002). It was due to heavy subsidy contained in the package that drove rent-seeking behavior of delivering agents, combined with high cost of administering such loans for small borrowers and brought the loans to only larger farmers that have more money. Here, Robinson affirmed Gonzalez-Vega (1976), which "Gonzalez-Vega Iron Law of Interest Rates Restrictions" holds.

However, the *Unit Desa* banking system is still running. This unit has been profitable since 1986. Its net income was even doubled during the peak of Asian crisis in 1998. Remarkably, assets and Return on Assets (RoA) increased sharply at the same period (Table 2.9). This had proven that small and micro sector were not affected that much by the crisis.

Table 2.9
Profitability of BRI Units, 1993 - 2000

Indicators	1993	1994	1995	1996	1997	1998	1999	2000
Net income (Rp billion)	140	265	403	423	417	861	1,190	1,160
Average annual assets (Rp billion)	3,344	5,401	6,482	7,680	9,224	14,068	19,487	21,676
Return on Assets (RoA), percent	3.1	4.9	6.2	5.5	4.5	6.1	6.1	5.4

Source: Maurer and Seibel (2001), calculations from BRI Monthly Report February 2001.

In article seven, Law No. 21/1968 about BRI, explains BRI's purposes and duty in Indonesia. Several goals of BRI are:

1. Gives credit to cooperative sector, agriculture and fishery including:
   a. assist cooperative development especially in farmer and fishery sector;
   b. assist farmer and fisherman outside cooperative to develop their businesses in agriculture and fishery sector, an also support them to cooperate with cooperative principle;
2. Assist society outside cooperative to run their business in handicraft sector, household industry and household enterprise and small trade;
3. Supporting government effort in term of apply agrarian politics;
4. Supporting government effort to improve rural society;
5. Assist and monitoring rural bank, *lumbung desa*, *bank pasar* and the other bank based on Central Bank of Indonesia's instruction or direction.

Latest Development

In 1985, BRI started developing KUPEDES (lending) and SIMPEDES (savings) programs. Having learned from BIMAS experience, the government opened wider opportunity for private capital to enter banking sector. Through implementation of 1988 Package (PAKTO '88), government allowed other private entities to participate in banking market. Reducing its intervention, the government also allowed banking sector to set up their own interest rate decision. This policy had led the BRI to perform under more commercial principles. KUPEDES and SIMPEDES were then created under more flexible and market-led interest rate decision.

The development of KUPEDES and SIMPEDES has however led BRI to more profitable environment. In the two products, BRI is allowed to set its own decision on lending and borrowing interest rates, making the bank more flexible to manage and control for the profits. Table 2.10 performs the KUPEDES repayment performance during 1994 to 2000, which proves to be more efficient, compared to BIMAS scheme when it was still subsidized and regulated under pegged-interest rate.

Table 2.10
KUPEDES Repayment Performance, 1994 – 2000

Year	12-month Repayment Rate (percent)	Arrears Ratio
1994	99.3	4.5
1995	98.9	3.5
1996	98.4	3.7
1997	97.8	4.7
1998	98.1	5.7
1999	98.3	3.1
2000	98.9	2.5

Source: Maurer and Seibel, 2001.

The remarkable facts imply that commercialization and flexibility are important keys to achieve sustainability in certain cases. This means that through commercialization, a microfinance institution allowed to be more demand-led, market-based and profitable (Charitonenko and Campion, 2003 and Robinson, 2002). Moreover, BRI has managed to go public in 2003.

Recently, BRI has 4,644 outlets exclude ATM (Automatic Teller Machine). BRI also develop phone banking facility and *sharia* operation. By November 2003, BRI's shareholder is 59.5% owned by state and 40.5% owned by public. The number of savers was increased by 35 millions, while borrowers by 10 millions (Nawawi, 2005).

BRI is the oldest bank in Indonesia and is long perceived as a bank for micro and retail businesses. To support its operation, BRI employs 32,977 people, located at all over of its 4,554 offices. Besides its 682 self-owned ATM, the bank has joined cooperation with ATM *Bersama* and ATM BCA networks. As of June 2004, BRI's shareholders comprised of Government of Indonesia (59.5%) and Public (40.5%). With total assets of IDR99.3 trillion in 2003, BRI is regarded as the fourth largest bank in Indonesia, representing 8.4% market share of the banking industry's total assets.

BRI has very strong franchise in micro and retail business financing

Since its inception, BRI has been committed to provide financing for micro and small-scale businesses. In these two segments, supported by its numerous of banking unit network, BRI has controlled a superior market share. Most of BRI's deposit taking and lending activities for micro financing are delivered through "BRI Unit", which as the end of June 2004 totaling to 4,046 units located at all over Indonesia, which has made it well positioned as one of the largest micro-finance banks in the world. In addition, with 328 branches (including three overseas branches), 163 sub-branches as well as 17 *sharia* branches, BRI is considered as the bank with the strongest and widest network capability in Indonesia.

Given its very strong franchise in micro and retail business financing, BRI has a much diversified business portfolio, as reflected by its large customer base, small average of funding and loan sizes and relatively low concentration risks. Although BRI's products are fairly simple, they have gained satisfactory reception especially in rural areas in which BRI has established its stronghold.

Due to their simple features and requirements, these traditional banking products can be effectively marketed in areas that predominantly consist of less sophisticated customers. As of 30 June 2004, BRI had 8.2 million depositors and 5.7 million debtors. Going forward, with well-established franchise and numerous banking unit networks, that are difficult to be replicated by competitors, it is expected that BRI would be able to maintain its existing superior market position in micro and retail business financing.

BRI has sustainable favorable profitability level

With a strong focus in micro and retail business financing, which represented around 80% of total loan portfolio, BRI has been able to maintain its favorable profitability level. The bank's high proportion of fixed-rate government bonds (74% of its BRI's government bonds) has also positively contributed to the bank's favorable profitability. BRI charged its micro-finance loans with an interest rate of 2% per month or equivalent to an effective yield of 32% per annum (after incentive refund). Incentive refund of 25% of monthly interest rate is granted to borrowers that meet their obligations on time. Therefore, the bank's interest margin as measured by Net interest revenue/Total earning assets was very high at 11.4% in 2004, standing favorably compared to peers' average of 7.5% during the period.

BRI has relatively high non performing loan ratio

The bank's NPL ratio remains relatively high compared to its peers', though improving during the last three years. NPL ratio as measured by NPL (3-5)/Gross loans was standing at 6.5% as of 2004 (6.7% in 2002 and 6.0% in 2003) due to relapsed of some restructured loans. Nevertheless, the bank has provided an adequate reserve to cover its credit losses as evident by the ratio of loan loss provisions (LLR) to total Non Performing Loans (NPLs) category 3-5 ratios of 151.7% in 2004, improved from 150.5% in 2003 and 147.5% in 2002 respectively.

Indonesia become one of the best practice in channeling credit to small industry to its society, relate to "International Year of Microcredit 2005" by United of Nation. United Nation's journalist Statement in New York, mentioned, successful effort of credit micro channeling represent one of millennium development goals which have been signed by the world leaders at *Konferensi Tingkat Tinggi* (KTT) Millennium United Nation year 2000. Since that KTT Millennium clients or small enterprise from Bank Rakyat Indonesia (BRI) succeed to improve their production as 12.9%.

Especially, in Lombok Island, production average from BRI's clients increase about 112% and 90% of family becoming succeeded in poverty reduction. Other nations that also mentioned success enough in micro credit channeling are Bangladesh, Nigeria and Turki. Micro credit has become tool for hundreds of people in world to improve its economics and relieve from poverty.

United Nation mentions that Indonesia becomes one of best practice in channeling credit to its society in the last few years. According to Rudjito, BRI Director, in the last 20 year, credits that channeling to micro and small enterprise is an effective method to overcome poverty. According to World Bank, poor people are they who live under US$1 per day. In Indonesia, August 2004, there are about 38 million people or about 18% of all Indonesia's population, live under poverty line.

Indonesia has many initiatives in micro credit area therefore, through that program Indonesia can decrease poverty number. Based on data from Ministry of cooperative small and medium enterprise and Bureau of Statistic (BPS), amount of micro and small enterprise in Indonesia reach 41 million or 99% the small and micro enterprises.

In August 2004, a total micro institution in Indonesia is 53.044 units, serving more than 57 million clients. That service is conducted through BRI units, Pawnshop, PNM, Cooperative, Non Government Organization and BMT. International Year of Microcredit 2005 representing important thing to reach Millennium Development Goal. MDG signed by world leaders at September 2000 that for agreed on the intention to increase health standard, education opportunity for all people and poverty reduction in the middle of 2015.

BRI services for Micro Small Medium Enterprises (MSMEs)

As a commercial bank, BRI provides a wide range of banking products and services such as commercial loans particularly to MSMEs, saving products and other financial services.

From its establishment, BRI is designed and consistently focus on MSMEs development, which described in the bank's mission:

- To perform the best banking services focusing on micro, small, retail and medium scale enterprises to enhance the economic activity at large
- To provide prime services to customers through its widespread business network supported by professional staff and implement good corporate governance
- To deliver value and optimal benefits to stakeholders BRI's commitment in strengthening MSMEs is reflected in the loan portfolio in Table 2.11.

Table 2.11
BRI's Loans Portfolio (Rp, billions), 2000 – 2002

Segment	2000		2001		2002	
	Rp. Billion	%	Rp. Billion	%	Rp. Billion	%
Micro	7,827	30	9,841	30	11,990	31
Small	10,742	41	13,881	43	18,927	48
Medium	3,262	12	3,572	11	2,479	7
Sub total	21,831	83	27,294	84	33,396	86
Corporate	4,536	17	5,064	16	5,631	14
Total	26,367	100	32,358	100	39,027	100

Note: 1 US $ = Rp8,870
Source: Bank Rakyat Indonesia (BRI)

BRI has been developing several loan schemes based on the business scale such as loans for micro entrepreneurs, loans for small scale business and loans for Medium scale business. There are two main approaches in serving the micro and small enterprises. For the micro entrepreneurs who are still below poverty line, BRI provides subsidized loans since their conditions and levels of capabilities are not sufficient enough to accommodate the commercial approach and BRI collaborate with the government agency. Meanwhile, for micro enterprise above poverty line, BRI provides fully commercial basis loans since they have the capabilities to do so. The interest is in subsidized rate because the funds come from government or other international institution, such as IFAD, ADB.

BRI collaborate with some relevant institutions, for example with some universities in providing technical assistance or research to develop MSMEs business. Some problems may arise from MSMEs ignorance of marketing product overseas. BRI tried to encounter the problems by having collaboration with Export Development Agency to expose the MSMEs product abroad through trade show.

BRI is developing a site for MSMEs called Small Medium Enterprise (SME) Online at the BRI website, in order to anticipate the development in information technology and realizing the importance of information technology for business expansion. The goal is to provide information system network and e-business for MSMEs.

Relationship between a bank and the MSMEs must be a mutual symbiotic. The bank will grow as the borrowers' businesses grow. Hence, a bank always has a concern in the business performance of its borrowers. If the borrower can improve the business capabilities, they can develop their business, gain higher profit and create more job opportunities. On the other hand, some MSMEs lack of knowledge in some business aspects that may prevent their business growth.

Realizing the need of the clients, BRI also provide technical assistance for them. The credit officers play important role in giving direct technical assistance to the clients. While they are visiting the clients for monitoring, they also give assistance to the clients regarding administration, market information and financial management.

The Cooperatives in Indonesia

Cooperatives movement in Indonesia cannot be separated from the role of Dr. Mohammad Hatta, the initial promoter of cooperatives. Having educated in The Netherlands during his youth, Hatta learned much about the growing number of cooperative movements in Western Europe in the beginning of 20th century. At the time, several well-known cooperatives had operated throughout Europe. Some famous ones are by Robert Owen in England and Raiffeisen in Germany.

During Japanese occupation (1941-1945), cooperative movements in Indonesia had been limited in scope. Activities are specified to support Japanese military campaign in Southeast Asia and Pacific during World War II. The one and only formal cooperative institution operating during the period was *Kumiai*, which designed to collect and distribute valuable goods for the *Nippon* (Japanese term for 'Japan'). Under the regime, people hard-living continuously persisted across the economy. The government ban had however hampered cooperative from improving people's collective welfare.

As Indonesia declared its independence in 17 August 1945, the principles of social economy had began to be thought. The Preface of 1945 Constitution states that the mutual purpose of the nation is:

"...to establish a just and equitably prosperous society, based on Pancasila and 1945 Constitution."

The just and equitable ideals for people living had insisted formulation of national economic strategy that benefits as many as possible without creating any gaps. Some founding fathers argued that the nation's typical form of economic life was however designed in the form of cooperative (Article 33 1945 Constitution). In cooperative, people co-work each other, enhancing economic performance to achieve mutual goals, relaxing fierce competition and giving-up individualism above collective needs. Development of cooperative sector in Indonesia up until December 1998 is presented by Table 2.12.

Table 2.12
Cooperative Sector by Type of Cooperative in December 1998 (Rp, trillion)

Type of Cooperative	Number	Members ('000)	Assets	Own Capital	Outside Capital	Business Volume	Profit/ Loss
Civil service, military, police	16,958	3,669	2,854	1,680	974	2,723	200
White collar, professional	8,904	3,144	1,737	786	815	2,246	137
Service, trade, manufacturing	954	362	233	112	112	342	10
KUD	7,324	10,083	3,033	1,302	1,675	4,810	57
Market, multi-purpose coop.	4,237	844	336	153	169	446	14
Pesantren cooperatives	2,164	342	116	57	56	63	3
Women cooperatives	765	255	79	49	24	88	5
Savings and credit cooperatives	942	547	179	86	85	534	7
People's credit banks	26	10	15	6	9	25	1
Other primary cooperatives	3,620	873	629	392	-	1,089	23
Sub-total	45,894	20,129	9,211	4,623	3,919	12,366	456
Secondary cooperatives	508	22	751	500	198	587	54
Total	508	22	751	500	198	587	54

Source: Holloh, 2004.

As a legal basis, the government of Indonesia has provided cooperative sector with Law Number 25 of 1992 on cooperatives. It follows international cooperative principles (voluntarism, transparency, democracy, self-reliance and independence). According to the Law, there are two types of cooperative institutions based on its members: Primary and Secondary Cooperatives. The first represents those whose members are individuals, at least 20 members, while the latter has cooperatives as members which at least three in number.

By its operation purpose, Indonesian cooperatives can be classified as follows:

1. Single purpose cooperatives

   These cooperatives specialize in a certain activity or service. For example; consumption, production, or savings and credits. Included in these criteria are consumption cooperatives such as *koperasi karyawan* (employees-owned cooperatives in any institutions), production cooperatives and savings and credits cooperatives (KSP/USP).

2. Multipurpose cooperatives

   Such cooperatives deliver more than one activities or functions to members. They may deliver loans and savings service provision, consumption facilities, or production channeling. Example of this type of cooperative are *Koperasi Unit Desa* (KUD).

As a matter of fact, either single or multipurpose cooperatives being mentioned above are tailorized further based on its target segment, which can be considered by:

1. Profession; for example *Primkopau, Primkoppol* (cooperatives for air force and police department officers)
2. Geographical cluster; for example KUD Sulahan in Bali, determines their operation for Sulahan residents only
3. Gender orientation; for example Koperasi Setia Bhakti Wanita in Surabaya, East Java, whose members are all women

Each of segmentation above varies their operation by purposes (Figure 2.4). A KUD for instance, may serve its members with many products or services, but limit its scope in a single geographical unit. Others could have been operating in limited scope of service, but open membership as free as possible. This is a very unique feature one may find in Indonesia, proving that the nature of microfinance is however shaped specifically by its member's needs, surrounding environment and sociocultural values. It is time-specific and local-specific. No single design fits all (Robinson, 2002).

Figure 2.4
Cooperative Classification

		By Purpose	
		Single	Multipurpose
By Segments	Profession	*Pesantren* cooperatives, Koperasi mahasiswa (Kopma)	Primkoppad, Primkoppau, Primkoppol
	Geographical	KSP-SPB, Tasikmalaya	KUD Sulahan
	Gender orientation		Setia Bhakti Wanita

Source: Various readings.

Recent issues develop over commercialization of cooperative sector. As Charitonenko and Campion (2003) have been campaigning for profitability from micro segment, some sample cooperatives admit the need for commercialization and application of business principles to be more clients (demand)-led (Robinson, 2002). Hence, success criteria for a cooperative as a microfinance institution are no longer judged upon its members outreach, but rather upon its profitability. In Indonesian term, the word 'profit' has been renamed as spare of business outcome (*Sisa Hasil Usaha*/SHU), which is shared of cooperatives profit to each members at the end of financial period.

Yet, some cooperatives are still reluctant to admit such needs, as being commercial is considered to cease being cooperative. Indonesian core values that cherish familyhood, strong communalities and social-friendly feeling among members, are some sociocultural factors hampering cooperatives from commercialization. Cooperatives must keep themselves far from high cost of borrowing, which is, according to Gonzalez-Vega (1976), caused by heavy subsidy that drives into rent-seeking behaviour.

Moreover, Indonesia's Law Number 25 of 1992 on cooperative states fourth function and role of a cooperative:

"...to establish and develop national economy as a mutual commitment based on familyhood and economic democracy"

Such definition implies that Indonesian cooperative spirit is full of communal togetherness and social concerns. Democratic economy requires equal opportunities for members to absorb and allocate economic resources in non competitive ways. This has led some cooperatives behavior to friendly deal-making for loans, distribution and membership. Some of our surveyed respondents will prove that they have been soft to those who are presumably delinquent in repayment behavior.

Koperasi Unit Desa (KUD)

Koperasi Unit Desa (KUD) is a cooperative entity that is designed to operate at village level. It was introduced and popularized for the first time under New Order administration. During the period 1969-1998, cooperative was valued as strategic mean to promote government welfare program to people, especially those who live in rural areas. They fulfill needs for financial services, crops market channeling and fertilizer distribution.

As a matter of fact, KUD was occasionally used as a campaigning channel for any governmental purposes, either political or economy. Holloh (1998) noted that KUD is obliged to participate in family planning campaign during New Order regime and rewarded monopoly rights in agricultural production and village crops marketing.

In Indonesia, cooperatives are regulated under cooperative law No. 25 of 1992. While savings and credit cooperatives are regulated by government regulation No. 9 of 1995 and ministerial decree No. 351 of 1998.

During New Order era, government policy had favoured the KUD much. The institution was heavily subsidized, making it a 'village conglomerate' (Infobank Magazine, 1991). KUD had been granted dual rights to buy inputs and sell crops to the market at fixed prices. Presidential instruction No. 2 of 1978 even provided KUD with a monopoly status in rural areas, requiring other savings and credits organizations to merge with KUD (Holloh 2004).

Holloh (2004) state enterprises were instructed to allocate 1 – 5% of its profits to small enterprises and cooperatives. Some 160 private enterprises were also urged to sell their 55 million shares to 1,200 cooperatives through interest free loans.

Despite the plenty facilities, KUD faces many problems. Infobank Magazine (1991) reported that about 30% of the subsidized farmer credits channeled through KUD between 1985 and 1991 was classified as loss, which one-third of was appropriated by government officials. Additionally, the Jakarta Post (1992) investigated corruption that looms in West Java cooperatives. These are some problems faced by KUD at the time.
However, for more than 30 years KUD has played as stabilization factor in strategic alliance between top bureaucracy and village communities. Table 2.13 below performs the cooperatives development statistic.

Table 2.13
Cooperative Development Statistics in Indonesia, 2000 – 2001

Indicator	Year 2000	Year 2001
Total number of cooperatives	6,050	109,127
Member of cooperatives	26,303,108	26,309,158
Number of active cooperatives	99,930	96,180
Number of national level cooperatives	231	304
▪ Primary	97	165
▪ Secondary	134	5
Number of business actors	-	40,197,611
Number of small enterprise	-	40,137,773

Source: Indonesian Ministry of Cooperatives and SMEs, 2004.

Baitul Maal wat Tamwil (BMT)

Baitul Maal wat Tamwil[1] (BMT) is an institution that collects savings and distribute funds to its members. Taking a form of cooperative, each BMT members are also its owners. According to cooperative law, founding members should be at least 20 persons.

The institution was initiated from a foundation namely *Pusat Inkubasi Bisnis Usaha Kecil* (PINBUK), which was founded by MUI and former president Habibie in March 1995. This foundation then formulates strategy to develop and expand BMT throughout Indonesia.

Representing its social function, a BMT collect donations according to Islamic principles, which are *zakat, infaq, shodaqah*. Two point 5% of total annual profits must be donated (*zakat*) and minimum 10% (after *zakat* and tax) have to be allocated to managers as compensation fund.

Table 2.14
Number and Outreach of BMT in November 2000

Indicator	Sumatera	Java and Bali	Kalimantan	Sulawesi	Other E. Indonesia	Total
Number of BMT	427	2,061	64	225	137	2,914
Number of reporting BMT	141	466	26	163	83	879
Deposit accounts						
Number of accounts	17,331	79,483	11,814	47,459	18,495	174,582
Average number per BMT	123	171	454	291	223	199
Average amount per account (Rp000)	149	128	438	559		265
Loan accounts						
Number of accounts	8,109	30,883	1,826	14,284	18,239	73,341
Average number per BMT	58		70	88	220	83
Average amount per account (Rp000)	412	384	2,778	1,948	172	698

Source: *Pusat Inkubasi Bisnis Usaha Kecil* (PINBUK), Jakarta.

Java has the largest number of BMTs in recent years, particularly in West Java. During 2000, BMTs have been growing significantly in Java, South Sulawesi and West Nusa Tenggara (Table 2.15).

[1] Arabic for social and business function

Table 2.15
***Baitul Maal wat Tamwil* (BMT) Operation Number of Units, 2000**

Locations	Number of Units
Java	451
- West Java	154
- Jakarta	100
South Sulawesi	115
West Nusa Tenggara	54

Source: Tazkia Institute, 2000.

Meanwhile, in term of performance, the highest loan outstanding of BMT is in Riau Province, by Rp27.5 millions average amount. In addition, the highest deposit is in Central Kalimantan (Table 2.16).

Table 2.16
***Baitul Maal wat Tamwil* (BMT) Performance, 2000**

Regions	Average Amount
Deposits	
Central Kalimantan	Rp1.2 million
Riau	Rp4 million
Loans outstanding (extreme range)	
Central Java	Rp84.000 (lowest)
Riau	Rp27.5 million (highest)

Source: Holloh, 2004.

The Swamitra Program

Bank Umum Koperasi Indonesia (Bukopin) has been a cooperatives-concerning bank institution that founded by eight secondary cooperatives in 1970. In 1998, Bukopin launched Swamitra program. It was designed to assist cooperatives improving their performance through training, education and support facilities. As members signed the memorandum of understanding, they are included in program facilities and tied in cooperation partnership with the Bukopin. Products offered through Swamitra scheme are savings, time deposit and loans (credits).

Gemari (June, 2005) reported that cooperation through Swamitra is built in terms of technological networking, management system and financial services. It also emphasizes socialization of existing governmental regulations, especially Law Number 25 of 1992 and Governmental Decree No. 9 of 1995. Until June 2005, there have been more than 300 Swamitra performed.

Table 2.17
Number and Outreach of *Swamitra* by Region, October 2000

Indicator	Sumatera	Jakarta	Java and Bali	Kalimantan	East Indonesia*	Total
Number of Swamitra	44	24	79	16	14	177
Number of deposit accounts	17,708	7,523	20,933	4,606	4,415	55,185
Average numbers	402	313	265	288	315	312
Average amount	1	0		1	1	1
Number of loan accounts	6,799	7,486	11,413	2,976	3,415	32,089
Average numbers	155	312	144	186	244	181
Average amount (Rp, million)	2	3	2	2	n.a.	2

Note: *South Sulawesi and East Nusa Tenggara
Source: Bank Bukopin

Results are randomly performed. By October 2000, average assets per *Swamitra* varied between Rp423 million in East Java and Rp1.4 billion in the Aceh province. Java and Bali are regions with the highest number of Swamitra commitments (Table 2.17). Either loans or deposits, the two regions perform the highest number of accounts.

The random results indicate uncertain and different effect of Swamitra to cooperatives in different places. This might be caused by different competition intensity and demand for such service in many places.

Table 2.18
Assets and Balance Sheet Structure of *Swamitra* by Region (Rp, million) in October 2000

Balance Sheet Item	Sumatera	Jakarta	Java and Bali	Kalimantan	East Indonesia	Total
Average assets	958	1,120	715	788	709	836
Total assets	42,161	26,870	56,496		9,932	148,060
Loan portfolio	35,858	22,150	48,985	11,145	8,923	127,061
As % of assets	85	82	87		90	86
Total deposits	19,996	3,689	24,146	5,067	3,308	56,206
As % of assets	48	14	43	40	33	38
Equity	346	236	878	346	73	15
Loans	20,762	23,749	30,887	7,518	6,264	89,762
Profit and loans	1,074	-207	1,553	-85	369	2,704

Source: Bank Bukopin in Holloh, 2004.

Up until June 2005, loans outstanding of Swamitra has been Rp290 billions, by which credits from Bukopin is Rp120 billion. The rests are from members (Kompas, 17 June 2005). To accelerate loans delivery, Bukopin expands its operation through development of *Unit Simpan Pinjam Swamitra* (USPS). It is a form of Bukopin's savings and credit post located in many traditional markets. Antara (2005) also reported that Bukopin's Swamitra service has been operating through 387 outlets in 115 cities across the economy.

Koperasi Simpan Pinjam (KSP) and *Unit Simpan Pinjam* (USP)

According to Government Regulation Number 9, credits and savings activities are only allowed to be managed by primary and secondary savings and credit cooperatives (KSP) and savings and credit units (USP) separated from their other business units, if any. KSP/USP may open branches and have their own management by approval of Indonesian Ministry of Cooperatives and SMEs. They are allowed to provide financial services to other cooperatives and their members as well. But loans for other cooperatives' member must be allocated through their institution.

According to Ministerial Decree No. 9 of 1999, supervision priority is be given to KSP/USP that accept deposits from non-members, have assets of at least Rp1 billion and/or were found not comply with valid regulations.

Regarding its capital or equity, Ministerial Decree Number 351 of 1998 stipulates that the establishment of branches requires a paid-up capital of Rp15 million for primary cooperatives and Rp50 million for secondary cooperatives. It has to be deposited in a state bank account. To motivate establishment of new KSP/USP, Presidential Instruction Number 18 of 1998 allows the registration of new rural cooperatives without having to merge with KUD. The performance of KSP and USP in Indonesia can be seen in Table 2.19.

Table 2.19
Development of KSP and USP in Indonesia (by Province), December 2003

Information	Highest	Lowest	Total
Number (units)	5.545 (West Java)	39 (Gorontalo)	36.376
Members	2.398.068 (West Java)	3.061 (Gorontalo)	11.298.529
Savings collected (Rp million)	611.299 (DKI Jakarta)	754,59 (North Maluku)	1.593.427,18
Lendings (Rp, million)*	977,164 (East Java)	5,709.59 (North Maluku)	5.273.646,48
Sisa Hasil Usaha/SHU (Rp million)	204,941.76 (West Java)	310 (Gorontalo)	1.551.134,89
Total Assets (Rp million)	1,309.885 (Central Java)	9,583.24 (North Maluku)	6.197.144,69

Note: *) Lendable loans are from fixed assets, borrowed capital and collected savings.
Source: Financing Deputy, Ministry of Cooperatives and SMEs, 2005 (www.depkop.go.id).

Islamic *Sharia* Banking

Sharia banking is application of Islamic principles in financial institution practice. The idea can not be released from developing of *sharia* economic studies, since the collapse of New Order regime.

In *sharia* banking, cooperation between bank and clients, are based on profit sharing. There are three schemes, which usually offered to the market, *musharaka, mudharaba and murabaha*. Bank is viewed as loans and service provider, while clients should manage the business. Each scheme applies their own features. Yet, avoiding any transactions that indicate speculation is a must. For instance, it is prohibited to trade foreign exchange as it may fluctuate and bear future risks.

In Indonesia, the dominant sharia banking institution is *Bank Muamalat Indonesia* (BMI). Its establishment was initiated by Indonesian Council of *Ulama*s (MUI) in November 1991. After a series of training and preparation assisted by Bank Islam Malaysia, the bank was licensed to operate in 1992. President Soeharto, along with Association of Indonesian Muslim Intellectuals (ICMI) and Muslim business community, had supported the establishment. At first, initial paid up capital was Rp106 billions.

BMI provides return on investment (deposits) as a percentage of its gross income. Time deposits below Rp2 million or USD1,000 are rewarded with an income share of 60%. Seeing this prospective market, other commercial banks have been promoting their own sharia division to serve potential clients. Entering new comers to the market are Bank Syariah Mandiri and Bank Negara Indonesia (BNI) Syariah.

Various Non-Institutional Programs

Holloh (2004) classified microfinance services in Indonesia into two different types:

1. Institutional microfinance

   Institutional microfinance is those who take form as a formal institution to exist and deliver services. Examples for this type are banks, cooperatives and foundations. While the credit programs for microfinance are financial supports distributed to poor people through various channeling programs. This type of support does not need a formal institution to exist formally. Examples are *Inpres Desa Tertinggal* (IDT), P4K and *Kredit Usaha Tani* (KUT), which was delivered through many channels.

2. Credit program microfinance

   Credit programs deliver many values in different sorts of activities. Some programs offer loans, while some other offers both loans and business training. Despite soft loans that they can borrow, mostly poor do not understand how to circulate funds into more profitable value creating activities. This is the reason why training has been important to educate poor families creating value. In practice, training may consist of composing business proposals, experience sharing through group circles and direct learning.

Since 1979, Indonesian government had launched several programs as supports for microfinance activities. Some programs are directed to alleviate poverty in many levels of local administration degrees, while others are crisis-related programs (Table 2.20). The latter was a response to sudden hit of poverty caused by Asian crisis in mid 1997 and 1998.

Table 2.20
Some Non-Institutional Programs for Poverty Alleviation

Year	Programs	Target	Value Delivered	Status
1979	P4K	Farmers, fishermen	Loans, training, business plan, experience (learning process)	Successful. 964 savings and credit association created, becoming 30 legal cooperatives.
1996	UPPKS	Poor families, women	Women empowerment, savings and credits (*Takesra*, *Kukesra*)	Failed. Unsustainable caused by high subsidy
1994-1997	IDT	Poor villages	Capital grants, technical supports	Failed. No proper supervision and skill building
1998-2002	PPK	*Kecamatans* (subdistricts)	Grants, people participation, organization development, public infrastructure building	-
1999-2002	P2KP	*Kelurahans* in urban areas	Grants, business proposals	-
1997-1998	Social Safety Net (SSN)	Villages	Grants	-

Source: Holloh, 2004.

Some factors have however determined the success or failure drivers of programs above. Among the success factors are good training and loans management that enhance people to cooperate effectively. Experience of P4K in 1979 had proven us that skill building would be a meaningful tool to enhance economic recovery for poor households in spite of money being granted. Any types of loans will however, if not managed appropriately, bind the poor to vicious cycle of debt throughout their life rather than help them. Table 2.21 exhibits the scope of programs.

Table 2.21
Scope of Non-Institutional Programs in 1996

Programs	Year Founded	Number of Provinces	Number of Units
BKK (South Kalimantan)	1985	1	110
LKP (Dompu District)	1989	1	4
PHBK	1989	10[a]	323
P4K	1979	6[b]	n.a.
BKD (excludes inactive units)	1898	3	4,806

Note: a/ PHBK is expanding to three more provinces
b/ P4K is expanding to 12 more provinces

Source: Raviez (Searching for Sustainable Microfinance: A Review of Five Indonesia Initiatives)

To understand the impacts of MFIs either institutional or non-institutional program can be seen in Table 2.20. From Table 2.21 we know that by the year 1995 BKD has been reach the highest annual number of loans issues approximately 1,607 thousands. However, compare to other MFIs form, LKP has the highest interest rate was 137 in 1993 and 1995. Often, to reduce the subsidy rate, LKP need to increase its interest rate to 172 by the year 1995.

Table 2.22
Non-Institutional Program Outreach and Sustainability

Indicator	BKK		LKP		PHBK		P4K		BKD	
	1993	1995	1993	1995	1993	1995	1993	1995	1993	1995
Outreach										
Average loan size percent of GDP/capita	9	10	9	7	10- 13	7 - 13	7	7	8	7
Annual number of loans issued (thousands)[a]	18	35	3	4	10	27	113	164	1,713	1,607
Annual loan volume (US$ millions)	1.4	3.4	0.2	0.3	1.6	5.5	6.2	10.9	110.6	113.4
Loan volume real growth rate (percent)	n.a.	42	20	28	7	73	162	-14	8	-8
Women percent of borrowers	n.a.	40	n.a.	62	n.a.	50	n.a.	50	n.a.	40
Sustainability										
Average real interest rate (percent)	49	50	137	137	89	89	16	16	111	111
Real interest rate required to eliminate subsidies (percent)	118	50	288	172	550	244	68	81	n.a.	n.a.
Annual default rate (percent)	23	3	12	6	5	1	n.a.	2 - 3	4.4	2.6
Loan volume in arrears percent of volume outstanding or Number of groups with arrears percent of groups with outstanding loans	27	6	17	20	20	11	6	19	18	18
Voluntary savings percent of loans	16	31	35	18	n.a.	n.a.	n.a.	n.a.	5	5

Note: Information was not available for items labeled "n.a." in the above table.
a/ For PHBK and P4K figures are estimates based on number of loans issued to groups and estimated average number of members in each group. For BKD, the figure is an estimate based on the number of loans issued in December of each year.

Source: Raviez (Searching for Sustainable Microfinance: A Review of Five Indonesia Initiatives)

Until now, BRI Units and BPRs are the leader in microfinance sector. The success factors of BRI Units generated by strong networking and information system. Beside that, saving product development, innovative and flexible loan term are also the key success points in BRI Units development (Ibrahim). Identical to BRI, key success factors of BPRs are strong in capital support, strong networking and technical assistants to borrowers.

2.3 Result of Field Study

Micro and Small Enterprises (MSEs) have survived during crisis in many economies. In Indonesia, the role of MSEs is acknowledged especially since the economic crisis in 1997. Before the crisis, Indonesian economy was dominated by the activities of large businesses. Those large businesses had no sufficient fundamentals to survive during economic crisis. On the contrary, small businesses exhibited astonishing growth. Realizing this fact, The Government of Indonesia (GoI) proclaims year 2005 as Year of Indonesian Micro Finance (*Tahun Keuangan Mikro Indonesia*). This is in accordance with Year of Micro Credit 2005 of the United Nations.

The development of micro, small and medium enterprises (MSMEs) is significantly influenced two main factors, those are conducive economic condition and the availability and accessibility of funds. In order to create conducive economic condition, economic stability and government regulation should facilitate the development of MSMEs. Regarding the availability and accessibility of funds, most of MSMEs utilize their own capitals to run their businesses.

Until now, MSMEs experience difficulties in accessing funds from formal financial institution, fro example from bank. These difficulties are due the high risk of MSMEs businesses and the small amount of credit, which produces high administrative costs for banks. In addition, most of MSMEs possess no assets as collaterals.

There are 12 MFIs as samples in this study. The sample selection took into consideration award received and the institutional form of each sample. Those MFIs are located in Java and Bali. Table 2.9 exhibits the list of samples. There are two MFIs that operate in national level, those are BRI and Pegadaian while the other MFIs operate in local area. Despite operating in local area, those MFIs show good practices in servicing its clients.

The selection process consists of several phases. The first phase was to collect information concerning financial institutions, which received awards for their good performance in financial services. The first phase produced 49 MFIs. The next phase was to contact the corresponding MFIs in order to obtain further information concerning their recent conditions. The selected samples are as follows (Table 2.23).

Table 2.23
Selected MFIs

No	MFI	Achievements	Number of Borrowers	Amount of Loan Outstanding (Rp)
1	BPR Syariah Bhaktimakmur Indah, Sidoarjo	Best BPR according to Central Bank of Indonesia in 1996,1998 and 2001 (East Java)	667	6,789,352,000
2	BPR Duta Gama, Sleman	Man and woman of the year 2005 (FORWIJA) Forum *Wartawan* Independen Central Java and the first BPR set up in a campus	1,585	9,705,662,529
3	KUD Cikajang, Garut*	National patron model for unit desa cooperatives (KUD) year 1996, National Primary-Selected Unit Desa Cooperative (KUD) (dairy farming) in 1997 and Best Cooperative 2003	150	643,050,542
4	BPR Bojonegoro	Award for best services (*Citra Pelayanan Prima* 2004) From President (Megawati)	1,582	7,651,169,072
5	KUD Sulahan, Bangli*	National best village cooperative (KUD), 1997	1,005	8,018,856,391
6	Koperasi Simpan Pinjam SPB, Tasikmalaya	Best cooperative (1982 and 2004)	1,640	4,656,444,150
7	BRI	The largest MFI in the world		
	BRI Unit Turi, Sleman		784	3,467,473,674
	BRI Unit Pakem, Sleman		910	4,901,000,000
8	Pegadaian	The largest pawning institution in Indonesia	14,318 thousands	8,779,662,000,000
	Cabang Ngupasan, Yogyakarta		13,145*	7,792,063,501
	Cabang Bantul		11,911*	2,064,788,700
9	Kopeasi Wanita SBW, Surabaya	Best cooperative for several years, Women of the Year Nominator 2005 and Susilo Bambang Yudhoyono Award	11,099	-
10	LPD Mas, Gianyar	The Healthiest LPT in Gianyar District 2001 and 2005	1,572	9,880,099,330
11	BPR Bhakti Daya Ekonomi, Sleman	The best performance of MFI in Yogyakarta	10,052	54,300,310,000
12	Bank Jabar Syariah, Bandung	Finalist of *"Asian Banking Award 2001"* forum in Bangkok, *"The best financial intermediary" and* the fastest growing asset by December 2004	6,323	175,970,000,000

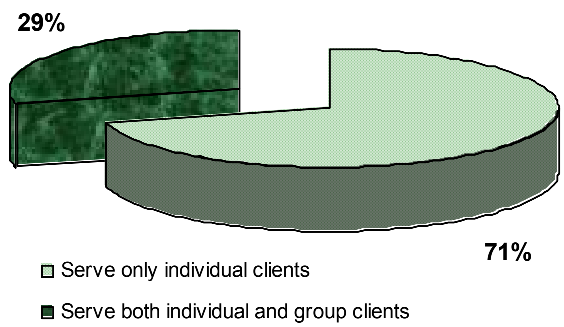
Note: *) only for saving and credit unit
**) estimated
Source: APEC, Survey, 2005.

In addition to awards received by those MFIs, the selection process also considered other factors. For example, BPR Bhakti Daya Ekonomi was selected, as sample due to it was a pilot project in linkage program between bank and Self-Help Group. Bank Rakyat Indonesia (BRI) was selected since it is the largest and most profitable micro lending in the world. In this case, BRI Unit Turi and BRI Unit Pakem were selected as the representatives of BRI.

Koperasi Wanita Setia Bhakti Wanita has a special mechanism in managing non-performing loans (NPLs). This mechanism is called *tanggung renteng*. *Tanggung renteng* is a sort of group responsibility in case there is a group member who is unable to pay their loan instalment. In this case, all members are responsible to pay the instalment. This mechanism is beneficial to manage asset security.

There are two types of MFIs' clients, individual clients and groups. From Figure 2.4 shows that based on survey, 71% of those MFIs serve only individual clients and 29% MFIs serve both individual and group clients.

Figure 2.5
MFI's Client



Source: APEC, Survey, 2005.

MFIs, which serve those two types of clients are Bank Jabar Syariah, KUD Cikajang, BPR Bhakti Daya Ekonomi and Koperasi Wanita Setia Bhakti Wanita, whereas MFIs which serve only individual clients are Pegadaian, BRI, BPR Bojonegoro, Koperasi Simpan Pinjam SPB, BPR Syariah Baktimakmur Indah and BPR Duta Gama. LPD Mas, which is a kind of village banks, delivers credit to individual clients and *banjar*[2]. There is no difference in the types of financial services delivered to individual clients and groups, except the system of credit delivery.

MFIs Provide Trainings and Education for Their Staffs

The selected sample also consider unique characteristic that is applied by MFIs. In order to implement technology optimally, MFIs should possess high quality human resources. Most of MFIs' staff education is Senior High School, but there are also some whose staff education is undergraduate level, those are at BRI and Bank Jabar Syariah.

MFIs utilize computer system in providing services to its clients. This is due to the improvement in management system and banking technology. The use of computer produces more efficient operation. BRI has implemented BRINet, which connect almost all its branch offices in Indonesia. Unit office has also been able to implement this technology, therefore their services has been improved.

Regarding the quality of human resources, the availability of infrastructure and education to enhance the quality of human resources is crucial. In this case, MFIs provide training for their staffs in order to improve the quality of staffs to produce better performance in serving their clients. For example, Koperasi Wanita SBW provides computer course to its staffs and clients in order to optimize its Electronic Data Processing Unit.

MFIs also provide training for their staffs in cooperation with other MFIs or through association. Several MFIs send their staffs to join the trainings organized by PT PNM or Central Bank of Indonesia. Some MFIs allocate their profit for the training. Types of training considered important by MFIs are training in financing analysis, financial management, services, selling skill, accounting and law. *Sharia* MFIs consider that there should be training to improve the understanding of *sharia* principles.

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[2] *Banjar* is the structure of government in Bali which is under the village government.

Staff performance is important to maintain MFIs performance. In order to maintain the performance of their staffs, most MFIs apply the following mechanisms:

1. Motivate the staffs regularly
2. Evaluation and assessment of staffs' performance
3. Provide adequate facilities

Table 2.24 shows the comparison of the number of clients of the selected MFIs, both borrowers and savers. Pegadaian Ngupasan has the largest borrowers, 13,145 borrowers, while KUD Cikajang has the smallest number of borrowers, 150 borrowers. MFI that has the highest number of savers is BRI unit Pakem, 19,128 savers.

Table 2.24 indicates that the number of savers is higher than the number of borrowers, except for BPR Duta Gama and Pegadaian. For Pegadaian, it has higher number of borrowers than savers due to the government regulation. Based on regulation, Pegadaian is prohibited to mobilize savings. It only provides pawning services and credits.

Table 2.24
The Number of Borrowers and Savers of the Selected MFIs, 2004

MFI	Number of Clients	
	Borrowers	Savers
Pegadaian Ngupasan, Yogyakarta	13,145*	0
Pegadaian Bantul	11,911*	0
BPR Bhakti Daya Ekonomi, Sleman	10,052	10,150
Bank Jabar Syari'ah, Bandung	6,323	n.a.
Koperasi Simpan Pinjam SPB, Tasikmalaya	1,640	2,099
BPR Bojonegoro	1,582	4,008
BPR Duta Gama, Sleman	1,585	888
LPD Mas, Gianyar	1,572	5,000
KUD Sulahan, Bangli	1,005**	1,484
BRI Unit Pakem, Sleman	910	19,128
BRI Unit Turi, Sleman	784	9,202
BPR Syari'ah Baktimakmur Indah, Sidoarjo	667	9,000
KUD Cikajang, Garut	150**	150
Koperasi Wanita Setia Bhakti Wanita, Surabaya	n.a.	n.a.

Note: *) estimated. The number of borrowers is calculated as one third of collaterals.
**) only for saving and credit unit
Source: APEC, Survey, 2005

Based on field survey, most MFIs' clients are female. On the other hand, most MFI borrowers are male (Table 2.25), except for BPR Bojonegoro and Koperasi Wanita SBW. For MFIs whose majority clients are women, they also provides special product designed to fulfil women's needs and characteristics. This strategy has been applied in Koperasi Wanita SBW that accepts jewellery as credit collateral due to the fact that women generally possess jewellery.

One interesting fact found from Field study is that men borrowers have larger business scale than women's business scale. However, MFIs states that on average, there is no significant difference between men and woman repayment rate although in general women borrowers are more obedient. Women are more ashamed and worried to be penalized for late instalment payments. On the other hand, men borrowers have higher motivation to revolve funds. This men motivation can leads to late repayment schedule.

Table 2.25
Number of Borrowers of Sample MFIs, 2004

Micro Finance Institutions	Borrowers	
	Man	Woman
BPR Bhakti Daya Ekonomi, Sleman	4,672	2,659
LPD Mas, Gianyar	1,179	388
KUD Sulahan	908	97
Koperasi Simpan Pinjam SPB, Tasikmalaya	902	738
BPR Duta Gama, Yogyakarta	815	770
BPR Bojonegoro	695	887
BPR Baktimakmur Indah, Surabaya	400	267
Pegadaian Ngupasan, Yogyakarta	n.a.	n.a.
Pegadaian Bantul	n.a.	n.a.
KUD Cikajang, Garut	n.a.	n.a.
Koperasi Wanita SBW, Surabaya	n.a.	n.a.
BRI Unit Turi, Sleman	n.a.	n.a.
BRI Unit Pakem, Sleman	n.a.	n.a.
Bank Jabar Syariah, Bandung	n.a.	n.a.

Source: APEC, Survey, 2005.

Most of MFIs Serves Clients Who Work in Trade Sector

The selected MFIs in this study represent the characteristics of MFIs in Indonesia, forms of institutions and market segmentation (sectors of economy served by MFIs). Those MFIs serve almost all economic sectors. The main sectors served by those MFIs are trade, agriculture, industry and services. Most of clients of BRI work in agriculture sector while KUD Cikajang concentrates in serving cattle breeders. Most of clients of LPD Mas work in industry sector since LPD Mas are located in industry area.

Most of MFIs serve clients who work in trade sector, since those who work in trade sector have the following characteristics:

a. high cash turnover
b. high repayment rate/low non - performing loan
c. most profitable sector

Most MFI do not serve extremely poor clients. Target of service of MFIs shifts along with the development of MFIs. Nowadays, only few MFIs serve as subsidy channel despite government effort to deliver credit at subsidized rate (*dana murah*), those are credit from PT. *Permodalan Nasional Madani* (PNM), *Badan Usaha Milik Negara* (BUMN), PT. *Pos Persero* and *Dana Bergulir Bahan Bakar Minyak*.

The result of this study shows that several MFIs serve mainly not poor people, namely BRI unit, LPD Mas, BPR Syariah Baktimakmur Indah and BPR Duta Gama. On the other hand, there are MFIs that still provide financial services to the extremely poor clients, those are Pegadaian, KUD Sulahan, Bank Jabar Syariah and BPR Bhakti Daya Ekonomi although only in a small percentage. Based on MFIs experiences, very poor people usually had problem in repaying their loans and it led to high of NPLs. Therefore, MFIs prefer to deliver financial services to not poor and economically active poor people. This is in line with Marguerite Robinson (2002) who claims that successful MFIs deliver credits to economically active poor or non-poor borrower.

MFIs main products are credit, saving and time deposit. There are also some MFIs offer non-financial products. For example, Koperasi Wanita SBW has a store that provides the needs of its members. It also functions as a means to promote its members' products. Another example is KUD Sulahan. In order to enhance its financial services, KUD Sulahan has cattle food unit that provide credit to its member in the form of cattle food.
Two of the selected MFIs provide pawning services, those are Pegadaian and Bank Jabar Syariah. In addition to pawning, Pegadaian also provides post-harvest credit which is often called *gadai gabah*. The purpose of this product is to help farmers who might experience loss when sell their crops right after harvest when the price of crops is quite low..

MFIs can also facilitate the marketing of its clients' products, such as Bank Jabar Syariah and KUD Cikajang. Bank Jabar Syariah promotes the products of its clients to international market while KUD Cikajang acts as the buyer of its clients products then sell it to the main buyer.

The result of this study shows the pattern of MFIs activities as follows:

1. MFIs in the form of bank and BPR focus their services on financial products
2. MFIs in the forms of cooperatives, pawnshop and village bank have various products since they provide also non-financial products

Each MFIs in this field study has its own method to set the interest rate or profit sharing. Some of them set their interest rate by comparing with other MFIs' interest rates. MFI that is often being used as a benchmark is BRI. MFIs that applied *sharia* principle consider different factors in setting its profit sharing than conventional MFIs.

In order to maintain and increase the number of clients, several MFIs in this study utilize various approaches. Those are as follows:

1. Personal Approach; It is the most effective approach in influencing people to be the clients of an MFI and increase the number of clients. This personal approach is carried out through many ways, through educational mechanism.
2. Advertisements: brochures, pamphlets, sponsorships, radio, newspaper and website
3. Distribution of souvenirs to clients, both borrowers and savers. The examples of souvenirs are umbrella, bag, clock, calendars and mug.
4. Cooperate with government institution and other institutions. For example, LPD Mas cooperates with cultural institution (*lembaga adat*), such as *bandesa adat* and *banjar*'s leader. LPD Mas introduces and promotes their products and services in regular meeting of *Desa Adat Mas*.

Availability of collateral is one of factors considered by MFIs in approving credit application. The amount of credit approved is bades on a certain percentage of the market price of the collateral. The collaterals accepted by MFIs in this study are:

a. Motor vehicle; it is the most common and preferable collateral in this study due to it is a marketable collateral.
b. Land, building and *Letter* C Certificate; *Letter* C is certificate of land ownership but that it is only certified by *kelurahan* office and has not been acknowledged by the state. LPD Mas and KUD Sulahan also accept rice-field land certificate as collateral.
c. Saving and time deposit; they are the safest collateral for MFIs because MFIs are not facing any difficulties in intercepting collateral in the case of non-performing loans. For borrowers who use saving and time deposits as collaterals, they are granted up to 90% of their saving and time deposit balance.
d. Traded goods and crops; Traded goods as collateral basically function as psychological collateral rather than conventional collateral. Crops collaterals are accepted to protect farmers from loss caused by price fluctuations and illegal broker (*tengkulak*)

e. Jewellery; It is accepted as collateral for their pawning activity (Pegadaian and Bank Jabar Syariah) and as credit collateral (Koperasi Wanita SBW).

f. Future income; for employee and retired employee and there is usually mutual agreement between MFIs and related institution.

g. Household utensils; as psychological collateral

MFIs providing credit for group of borrowers, such as KUD Cikajang and Koperasi Wanita SBW, also apply group guarantee as collateral. According to those two MFIs, credits for groups are safer than individual credit due to all group members are responsible for their non-performing loans.

Every MFIs require several document as credit requirement. For every credit application, applicant is also asked to submit required documents, in addition to credit application that provided by each MFI. Every MFI in this study generally has a similar required document, those are identity card, collateral documents (certificate of ownership), saving, spouse/family approval, business document (*Surat Keterangan Usaha*)/employee's cashier approval and approval documents from group leader for group lending application.The special case is LPD Mas which obligates an approval from cultural leader, also known as *Bendesa Adat*, for every credit application.

In processing credit applications, sample MFIs take 5C into account. The MFIs argue that from the 5C, the most important three C are Character, Capacity and Collaterals.

Performance of Selected MFIs

The performance indicators of MFIs are sustainability, outreach, availability, profitability and efficiency. The result of the field study concerning the performance of MFI is discussed in the next section.

Sustainability

Loan to Deposit Ratio (LDR)

A measure of sustainability of an MFI is loan to deposit ratio (LDR). This ratio indicates the ability of a MFI to mobilize funds and deliver credit to its clients. The LDR of an MFI is calculated as the ratio of the amount of credit delivered to its clients towards the amount of mobilized funds as follows:

$$\text{Loan to Deposit Ratio} = \frac{\text{Outstanding Loans}}{\text{Savings + Deposits}}$$

If LDR of an MFI is lower than 100%, then the MFI is over liquidity. The mobilized funds are not managed optimally through credit delivery. On the contrary, if the LDR of an MFI is higher than 100%, it indicates that the MFI has better ability to deliver credit than to mobilize funds.

Table 2.26 shows the comparison of LDRs of the selected MFIs in 2004. MFIs that have LDR above 100% are Bank Jabar Syariah, KUD Sulahan and BPR Bojonegoro. Those three MFIs receive external funds. Bank Jabar Syariah and BPR Bojonegoro receive external funds from the corresponding local government, while KUD Sulahan receives external funds from Ministry of Cooperatives and MSEs.

Table 2.26
Loan to Deposits Ratio (LDR) of the Selected MFIs, 2004

Microfinance Institutions	Loan to Deposits Ratio (%)
Bank Jabar Syari'ah, Bandung	46
KUD Sulahan, Bangli *)	142
BPR Bojonegoro	100.6
BPR Bhakti Daya Ekonomi, Sleman	88.9
LPD Mas, Gianyar	79.5
BPR Syari'ah Baktimakmur Indah, Sidoarjo	75
BPR Duta Gama, Yogyakarta	48
BRI Unit Turi, Sleman	25
Pegadaian Ngupasan , Yogyakarta	n.a
Pegadaian Bantul	n.a
BRI Pakem, Sleman	n.a
Koperasi Simpan Pinjam SPB, Tasikmalaya	n.a
Koperasi Wanita Setia Bhakti Wanita, Surabaya	n.a
KUD Cikajang, Garut	n.a

Note: *) only for saving and credit unit
Source: APEC Survey, 2005.

BRI Unit Turi has the lowest LDR, was 25%. It indicates that BRI Unit Turi is overliquid. The head office of BRI has mechanism to solve this problem. If one of BRI unit experiences overliquid, the surplus must be transfer to the branch office of BRI where the BRI unit is located. The branch office manager transfers those funds to its sub office, named *Kantor Wilayah* and then to its head office.

Other MFIs also have various mechanisms in delivering funds when experience overliquidity. BPR Syariah Baktimakmur Indah and Bank Jabar Syariah deliver those funds to other sharia financial institutions, those are Bank Muamalat Indonesia and Bank Mandiri Syari'ah. BPR Duta Gama delivers its excess funds to other BPRs that face the problem of liquidity while BPR Bhakti Daya Ekonomi saves its excess funds in Bank Niaga and Bank Mandiri.

Availability

Office Hours

The office hours of selected MFIs are quite similar, from Monday to Friday, 08.00-16.00. Several MFIs still operate on Saturday although only until 12 o'clock, those are Pegadaian and LPD Mas while BPR Bhakti Daya Ekonomi and Bank Jabar Syariah still operate on Saturday until 16.00.

Brach Office

Several MFIs increase their outreach by opening branch offices or providing mobile services (*kantor kas keliling*) to potential areas. Some factors an MFI should take into considerations when it plans to open branch office or provide mobile services is the increasing number of officers and whether the opening of new branch office will be profitable or not.

Terms of Instalments

Terms of instalments should be matched by clients' capacity and needs in order to achieve more clients and less NPL. All of our samples MFIs provide monthly terms-of-instalment. However, MFIs also offer other terms of instalments scheme such as daily, bi-weekly and four-monthly or adjusted to clients' cash flow.

Table 2.27
Term of Instalment of Several MFIs, 2004

No	Name of MFIs	Term of Instalments				
		Monthly	Weekly	Daily	Every Four Months	Depends on Cash Flow
1	Bank Jabar Syari'ah, Bandung	√	√*)	√*)		√*)
2	KUD Sulahan, Bangli	√		√	√	√
3	BPR Bojonegoro	√	√	√	√	√
4	BPR Bhakti Daya Ekonomi, Sleman	√	√			
5	LPD Mas, Gianyar	√			√	√
6	BPR Syari'ah Baktimakmur Indah, Sidoarjo	√		√		√
7	BPR Duta Gama, Yogyakarta	√				
8	BRI Unit Turi, Sleman	√	√	√	√	√
9	Pegadaian Ngupasan , Yogyakarta	√				√
10	Pegadaian Bantul	√				√
11	BRI Pakem, Sleman	√	√	√	√	√
12	Koperasi Simpan Pinjam SPB, Tasikmalaya	√				
13	Koperasi Wanita Setia Bhakti Wanita, Surabaya	√				
14	KUD Cikajang, Garut	√		√		

Note: *) For Sharia Micro Finance Institutions (Lembaga Keuangan Mikro Syari'ah, LKMS)
Source: APEC Survey, 2005.

Table 2.27 shows the flexibility of terms of instalment of the surveyed MFIs. The more terms of instalment are offering the more flexible the MFIs in serving their clients' needs. BPR Bojonegoro, BRI Unit Turi and BRI Unit Pakem are the most flexible by offering most instalment schemes.

Outreach

Depth of Outreach

Outreach is one of indicators to assess whether an MFI succeed or not. The outreach can be measured by using depth of outreach. The depth of outreach of an MFI is the ratio of the average amount of credit towards GDP per capita of the region where the MFI is located. The formula is as follows:

$$\text{Depth of Outreach} = \frac{\text{The Average of Credit}}{\text{Gross Regional Domestic Product}} \text{ x } 100\%$$

Table 2.28
***Depth of Outreach* of the Selected MFIs, 2004**

Microfinance Institutions	*Depth of Outreach* (%)
Pegadaian Ngupasan , Yogyakarta	50.41
BRI Turi, Sleman	73.30
Koperasi Simpan Pinjam SPB, Tasikmalaya	74.43
Pegadaian Bantul	82.55
BRI Pakem, Sleman	89.20
LPD Mas, Gianyar	89.35
BPR Bhakti Daya Ekonomi, Sleman	89.51
BPR Syari'ah Baktimakmur Indah, Sidoarjo	101.25
BPR Duta Gama, Sleman	105.52
KUD Sulahan, Bangli *)	156.25
BPR Bojonegoro	171.01
Bank Jabar Syari'ah, Bandung	194.84
KUD Cikajang, Garut	n.a
Koperasi Wanita Setia Bhakti Wanita, Surabaya	n.a

Note: *) only for saving and credit unit.
Source: APEC Survey, 2005, estimated

If the depth of outreach of an MFI is more than 100%, it indicates the MFI delivers the average credit higher than Gross Regional Domestic Product (GRDP) per capita where clients located. It indicates that the main clients of the MFI are relatively not poor people. On the contrary, if the depth of outreach of an MFI is lower than 100%, it means that the MFI delivers the average credit lower than GRDP per capita of its clients and it indicates that the main clients of the MFI are relatively poor people in the region. Table 2.28 shows the depth of outreach of the selected MFIs in 2004. It can be seen that some MFIs serve poorer people and some serve less poor people.

Efficiency

Table 2.29
Loan Officer Productivity of Micro Finance Institutions, 2004

Micro Finance Institutions	Loan Officer Productivity
BPR Bhakti Daya Ekonomi, Sleman	558
BPR Duta Gama, Yogyakarta	528
BPR Bojonegoro	475
BRI Unit Pakem, Sleman	455
Koperasi Wanita SBW, Surabaya	443
BRI Unit Turi, Sleman	392
Bank Jabar Syariah, Bandung	275
Koperasi Simpan Pinjam SPB, Tasikmalaya	234
LPD Mas, Gianyar	143
BPR Syariah Baktimakmur Indah, Surabaya	133
KUD Sulahan	91
KUD Cikajang, Garut	50
Average	**315**

Note: rounded to closest decimal
Source: APEC Survey, 2005, estimated

Common productivity measures for MFIs are loan officer productivity (LOP). This measure illustrates the capacity of MFIs to apply their credit policies. The results confirm that loan officers plays important roles for increasing number of clients and sales turnover (*omzet*). Table 2.29 and 2.30 show the LOP for selected MFIs.

$$LOP = \frac{\text{Number of Borrower}}{\text{Number of Credit Officer}}$$

Table 2.30
Loan Officer Productivity for Pegadaian (Pawnshop) Ngupasan and Pegadaian (Pawnshop) Bantul, 2004

Micro Finance Institutions	Loan Officer Productivity
Pegadaian Bantul	2977*
Pegadaian Ngupasan	1195*

Note: Number of clients are assumed one third of total collateral goods. This means that a client is assumed to pawn three times a year
Source: APEC Survey, 2005, estimated

Profitability

Increasing Pattern of Profit

Microfinance business is profitable. Almost all sample MFIs' profits have been increasing every year. However, profit margin of MFIs is small, less than 5% on average. The sample MFI's profit margins in 2004 are between 1.01 to 6.15%. MFI with the lowest profit margin is Koperasi Simpan Pinjam SPB while MFI with the highest profit margin is BPR Syari'ah Baktimakmur Indah. The results imply that the profits should be increased further.

Non-Performing Loans

One of financial performance indicators of MFIs is non-performing loans (NPLs). The high value of NPLs indicates the inability of an MFI to manage its financial asset and deliver credit. The NPLs of the selected MFIs are in the range of 0 - 8.69%. Koperasi Wanita SBW has the lowest NPLs due to its *tanggung renteng* system. On the other hand, Koperasi Simpan Pinjam SPB has the highest NPLs, 8.69% due to the high tolerance to delinquent clients.

This study finds that the average of credit delivered to MFIs' clients is Rp5.5 millions per borrower. The range of the average credit is Rp635 thousands to Rp12 millions. The lowest average of credit belongs to Pegadaian cabang Bantul, while the highest average of credit belongs to Bank Jabar Syariah. The NPLs and average amount of credit of the selected MFIs are displayed in Table 2.31.

Table 2.31
Non-Performing Loans and the Average Amount of Credit of Selected MFIs, 2004

Micro Finance Institutions	NPL rate	Average Amount Borrowed (millions)
KUD Cikajang, Garut*	0%	0.64
Koperasi Wanita SBW, Surabaya	0% (*tanggung renteng* system), under 1% for micro and small enterprises	6.6
BPR Bojonegoro	0.30%	5
BPR Bhakti Daya Ekonomi, Sleman	0.83%	5.4
BRI Unit Turi, Sleman	1.20%	4.4
LPD Mas, Gianyar	1.70%	5.5
Bank Jabar Syariah	2.50%	12
BRI Unit Pakem, Sleman	3.40%	5.4
KUD Sulahan, Bangli*	4.29%	7.9
BPR Syariah Bhaktimakmur Indah, Surabaya	5.17%	10.2
BPR Duta Gama, Yogyakarta	6.01%	7
Koperasi Simpan Pinjam SPB, Tasikmalaya	8.69	3.3
Pegadaian Ngupasan, Yogyakarta	Pawning= less than 0,1%; credit: n.a.	2
Pegadaian Bantul	Pawning= less than 0,1%; credit: 3% (only two clients)	0.63

Note: *) only for saving and credit unit
Source: APEC Survey, 2005.

The Cause of NPLs

There are various causes of NPLs experienced by MFIs in this study, those are:

a. Economic condition and external factors

The main causes of NPLs are the worsening economic and business condition, which produce difficulties for MSEs in running their business. Inflation, decreasing in sales, fluctuations in product price, decreasing in production capacity and order cancellation can easily disturb micro enterprises' cash flow and decreasing their revenues.

For clients who their product to tourist attraction area, global terrorist attack and uncertain safety condition usually becoming blocked factors for improving business activities and causing difficulties in paying the instalment. LPD Mas, for example, where most of its client has high dependency on tourism is highly affected by this safety condition. Inconducive security situation after Bali Bombing in 2002 cause most of LPD Mas clients experienced a significant decrease in their business and caused an increase inn NPLs.

b. Character

NPLs caused by client's character are difficult to solve. This type of clients does not have intention to repay their obligation and the main cause of unsolved non-performing loan. This is the reason why MFIs consider character as the main consideration in approving credit application.

c. Inability in managing business

Inability in managing business is also one factor causing NPLs. This inability generally related to inability in applying management principle in their business.

d. Misuse of funds

There are many NPLs case due to the fund is used for different purposes and not for productive activity. This misuse of fund could be intentional or unintentional. The misuses of fund that is intentional usually for consumption while unintentional misuses of funds usually for health or calamity.

Table 2.32
Cause of Non Performing Loan

Micro Finance Institutions	Cause of Non Performing Loan				
	Economic Condition	**Character**	**Inability to Manage Fund**	**Misuse of funds**	**Others**
BPR Syariah Bhaktimakmur Indah, Sidoarjo	√		√		
BPR Duta Gama, Sleman	√	√			
KUD Cikajang, Garut	√				Cattle condition
BPR Bojonegoro	√	√			
KUD Sulahan (Credit and Saving Unit), Bangli	√		√		
Koperasi Simpan Pinjam SPB, Tasikmalaya	√	√			
BRI Unit	√	√			
Pegadaian	√				Overestimation of collateral
Koperasi Wanita SBW, Surabaya	√			√	
LPD Mas, Gianyar	√	√			
BPR Bakti Daya Ekonomi, Sleman	√	√			
Bank Jabar Syariah	√				√

Source: APEC Survey, 2005.

There are specific causes of non-performing loan in some MFIs. In KUD Cikajang the highest percentage of non-performing loan is caused by wet season, decreasing milk production in cows dry season, cows health condition and death of cattle that are cause by diseases. For Pegadaian, the NPLs can be as a result of incorrect assessment on collateral from its staffs. Factors caused the NPLs can be seen in Table 2.32.

<u>Methods to resolve NPLs</u>

MFIs have various methods to solve their NPLs problem as follows:

1. Rescheduling, Reconditioning and Restructuring

   Rescheduling is the most common methods used by MFIs to solve non-performing loan problems. Rescheduling is done by changing the instalment period, changing the amount of instalments and lengthened the instalment periods. Reconditioning consists of carrying out rescheduling and the willingness from MFIs to lowering their profit. Restructuring comprises reconditioning, adding new capital and improving the management of micro enterprise.

2. Personal Approach

   Personal approach is the main approach utilized by MFIs to solve their loan problems. Personal approach is done in various ways, for example by visiting the clients non-performing clients more often in order to learn the grounds of their loan problems.

   Personal approach is the main strategy taken by BPR Bate Day Ekonomi in solving its NPLs problems therefore it is able to analyze the client willingness to pay. Clients that have high willingness to pay but are not able to pay the instalment will receive dispensation in form of loan rescheduling or loan reconditioning. However, clients who do not have willingness to pay will be processed through appropriate legal system.

Personal approach that is carried out by BPR Bojonegoro will give BPR Bojonegoro the ability to analyze the solution that should be taken in case of non-performing loan. Basically, BPR Bojonegoro will customize its personal approach and solution in solving problematic loans.

On the other hand, too tolerant personal approach could endanger MFI itself. Koperasi Simpan Pinjam SPB faces high NPLs rate because their personal approach in dealing with non-performing loans is too lenient. This lenient approach is often misused by its irresponsible clients.

3. Auctioning/Selling the Collateral

Auctioning or selling the collateral is the fastest methods in solving non-performing loans. By obligating its credit applicant to submit three receipt that function as *surat kuasa*, Koperasi Wanita SBW can directly sell the collateral. LPD Mas are also selling collaterals in the case of NPLs or when clients are unable to pay the instalments three times, respectively. Clients are asked to complete documents that stated that they have no objection when LPD Mas sells the collateral if their credit is unperformed.

In case of collaterals will be sold, BRI Unit and LPD Mas help their clients to find buyers for the collaterals, especially for land and building collateral. The revenue from the selling then is used to pay the remnant of the credit. The rest money will be returned to the clients.

Pegadaian has a routine auction schedule to sell the collaterals that are not bailed by clients. These auctions are conducted two times in a month, in first and third week. However, not every MFI are willing to seize the collateral of non-performing loans. This unwillingness is cause by the possible negative effect that might cause by a collateral seizure, especially for land and building. It is assumed that hard sanctions for NPLs will cause other clients move to other MFIs.

A unique method to solve non-performing loan problems is practiced by LPD Mas. LPD Mas is working together with cultural leader (*Bendesa Adat*) in dealing with these types of clients. LPD Mas will inform *Bendesa Adat* clients who experience NPLs, especially those are considered as bad borrowers. *Bendesa Adat* will then give advices to these clients to pay their obligations. The hardest sanction for clients experiencing NPLs is the exclusion from being cultural member, but up until now, this sanction is never done by LPD Mas.

BPR Duta Gama applies stricter requirement, increasing the interest rate, lowering the credit platform if a former client experiencing apply for a new credit. A client experiencing NPLs will be notified and be sent a warning letter. BPR Duta Gama will finally execute the collateral if the loan could not be paid.

Control from group leader and group member are a method that applied by MFIs that has provide group lending. In KUD Cikajang the group leader will be responsible if his or her group member is unable to pay the instalments. In Bank Jabar Syariah, control from other group member has significant part in dealing with NPLs. In Koperasi Wanita SBW, through *tanggung renteng system*, all members within a group will pay the instalments for group members that have difficulties in paying theirs.

Based on the field study, several MFIs implement *jemput bola*[*] method by visiting potential clients to promote their products and collecting repayments from clients. This method is more effective than merely wait for clients to repay their loans. This method is feasible if MFIs employ enough field staffs (mainly account officer), feasible geographic condition and their clients are clustered in certain locations, namely markets.

[*] Make effort to "*Take the Ball*"

Some advantages of *jemput bola* method are

1. Expands the outreach
2. Improve MFIs' ability to identify the clients' character
3. Helps to control clients' financial performance
4. Strengthens relationships between MFIs and clients
5. Medium for MFIs' promotion
6. Minimizing Non Performing Loan (NPL)

Some MFIs with limited field staffs intensify *jemput bola* method only when borrowers exhibit NPLs. MFIs that apply *jemput bola* only for less and NPLs are KUD Cikajang, KSP SPB, BPR Duta Gama, LPD Mas and BRI Units.

Institutional Issues

Although all of MFIs in the study are considered as MFIs that experience good practices in providing financial services, they still face a number of institutional issues. Those issues are discussed in this section.

1. Main Competitors of MFIs

Recently, the number of MFIs grows rapidly. As the consequence, MFIs compete each other. MFIs that can deliver the best services can maintain and increase the number of its clients. On the contrary, MFI that delivers poor services will experience the decreasing number of clients. In this case, the efficiency of operational cost also influences the ability of an MFI to survive in the more competitive financial market.
This study identifies four main competitors of selected MFIs. Those are bank, other MFIs that possess similar form of institution, other MFIs with different form of institution and moneylenders.

Based on this study, most of the selected MFIs consider that banks, except BRI Unit, as their competitor. BRI is not considered as the competitors of selected MFIs because BRI has established for a long time and its market segment is relatively different.

The main competitor of the selected MFIs is bank, especially bank that expands its business to micro credit, those are Bank Danamon. Commercial banks, which possess large amount of assets, could possibly delivered funds without facing *Batas Minimum Pemberian Credit* (BMPK). MFIs also complain about the practice of commercial banks in delivering micro credit since commercial banks often ignore the 5C principles.

Table 2.33
The Competitors of Selected MFIs

Micro Finance Institutions	Main Competitors			
	Bank	**Other MFI with the same institutional form**	**Other MFI with different institutional form**	**Money Lender**
BPRS Bhaktimakmur Indah, Surabaya	√			
BPR Duta Gama, Sleman	√			
KUD Cikajang, Garut				
BPR Bojonegoro				√
KUD Sulahan, Bangli			√	
Koperasi Simpan Pinjam SPB Tasikmalaya	√			
BRI Unit	√	√	√	√
Pegadaian			√	
Koperasi Wanita SBW	√			
LPD Mas, Gianyar			√	
BPR Bakti Daya Ekonomi, Sleman	√			
Bank Jabar Syariah, Bandung	√	√		

Note: BRI Unit is considered as bank.
Source: APEC Survey, 2005.

The other competitors of the selected MFIs are other MFIs, either similar or identical institutions. The more MFIs operate in an area, the smaller the opportunity of an MFI in that area to increase the number of its clients.

The last competitors are moneylenders. Moneylenders are informal sources of finance that are very flexible in delivering funds. The requirements are quite easy and the process of delivering funds is fast. In order to compete with moneylenders, MFIs should deliver service in simple and quick way. The competitor's profiles can be seen in Table 2.32.

2. Subsidy

Sustainability is an important indicator in evaluating the performance of an MFI. The lower the subsidy it receives, the more sustainable the MFI. In this case, subsidy refers to financial assistances received by an MFI that do not cause the increasing amount of debt nor the amount of capital ownership in its capital balance sheet. Field study shows that all selected MFIs are independent since they do not receive any subsidy.

3. How an MFI Solve the Problem of Liquidity

The result of this study indicates the pattern of alternative financing of each MFI. Most of the selected MFI use external funds when they lack liquidity. The patterns of the external funds are as follows.

a. External funds obtained through market mechanism

In this pattern, MFIs that lack liquidity can obtain funds from external with interest rates and requirement set by market mechanism. The advantage of using this source of fund is the flexibility of the delivery system of funds. The example of MFI using this source of funds is BPR Bhakti Daya Ekonomi who cooperates with Bank Niaga and Bank Mandiri order to solve its problem of liquidity.

b. External funds with subsidized rate of interest

   Another alternative in solving the liquidity problem is utilizing the external funds with subsidized rate of interest. The interest rate is relatively lower than market interest rate. Institutions that provide these funds are PT PNM, Ministry of Cooperatives and MSEs and foreign institution such as Asian Development Bank (ADB).

   In spite of the low interest rate, this type of funds requires MFIs to fulfil several strict requirements, such as the interest rate of credit delivered by using this source of funds is 20% maximum. The interest charged to MFIs is 9%. Therefore, MFIs obtain 11% spread per year, although MFIs still bear the administrative cost.

   MFIs that utilize this type of funds are KUD Sulahan and Koperasi Simpan Pinjam SPB. Each of them receives Rp1 billion external funds from Ministry of Cooperatives and MSEs to deliver to agricultural sector. The interest rate of these funds is 12% per year.

c. External funds from stakeholders

   Several of the selected MFIs are owned by local government, namely BPR Bojonegoro and Bank Jabar Syariah. BPR Bojonegoro is owned by the Government of Kabupaten Bojonegoro while Bank Jabar Syariah is owned by the Government of West Java Province. As the owner of those MFIs, local governments provide external funds to those MFIs regularly or purposively. The status of this type of external funds is capital share. In 2004, BPR Bojonegoro received Rp1 billion external funds from the Government of Kabupaten Bojonegoro. This amount has increased from Rp500 millions in 2002.

SWOT Analysis

Method that is used to determine MFI efficiency in this study is SWOT analysis. SWOT consists of strength, weakness, opportunity and threat. Strength and weakness are internal factor that effect MFIs, while opportunity and threat are external factors effecting MFI. The result of SWOT analysis is discussed in the following section.

Strength

<u>External Supports</u>

External supports have been very important in MFIs operation. External supports can be in the form of government support, or society and cultural support. Bank Jabar Syariah and BPR Bojonegoro, which are owned by their local governments, receive financial support from the governments when there are liquidity problems. LPD Mas experienced an increase in its business after it manage to receive full support from *Bendesa Adat* (cultural leader) and *Desa Adat* (cultural society). BRI Unit is another example. By applying branch banking, each BRI Unit is a part of big banking system that has full support from BRI Head Office.

Good network with another institution will also have a significant impact on institution development. KUD Cikajang, for example, that does not have difficulties in marketing its member milk production because KUD Cikajang has a good network with milk processing industry.

<u>Outreach</u>

In terms of outreach, BRI is the largest MFI in the world. It has more than 4,000 units all over Indonesia and more than 30 million saving clients in 2004. Moreover, BRI has been operating in micro finance business since 1983 hence BRI has bunch of experiences on micro finance business.

Other MFIs that operates in national level is Pegadaian. Pegadaian is also has branch office in all over Indonesia. In 2003, Pegadaian has 774 branch offices and serving 14 million clients.

In a smaller scale, LPD Mas has more than 5,000 saving clients for its limited coverage area of 1,500 households. It means that in one household there are more than one family members registered as LPD Mas' clients. The number of KUD Sulahan's members reaches 70% of potential members in its coverage area. In providing services to its members, KUD Sulahan has four service points in order to increase its availability to its members.

From examples above, it can be seen that outreach is an important component of strength. By increasing its outreach, an MFI will be able to increase its sales and profit.

Strategic Location

A strategic location will ease an MFI in providing services for its clients and attracting new clients. BRI Unit Pakem, BRI Unit Turi, BPR Bakti Daya Ekonomi and BPR Bojonegoro, for example, are located near traditional markets and business centre, where most of their clients conducting their daily activities. LPD Mas strategic location eases their clients in accessing its financial services. It is suggested that a strategic location must be set up first before establishing a financial institution to avoid loss in the future.

Product Innovation

MFIs must be able to provide product that best fit their clients' needs. One method to meet the client's needs is through product innovation. For example BPR Bhakti Daya Ekonomi introduce new scheme for its saving product, *Simpanan Arisan Ekonomi*-SAE and its credit product *Kelompok Swadaya Masyarakat*-KSM.

Increasing saving interest rate and decreasing credit interest rate can be applied to increase the number of clients. In line with this method, Pegadaian has created a new credit that has lower interest rate compare to private bank interest rate.

Differentiation on collateral is also important in order to accommodate various types of client. For example, Koperasi Wanita SBW accepts jewellery as credit collateral to accommodate its women members' needs. BRI Unit also accepts household utensils as collateral.

A number of MFIs also provide non-financial services for their clients. Koperasi Wanita SBW, KUD Sulahan and KUD Cikajang provide marketing medium for their clients through store and kiosk and canteen facilities to provide their members' daily needs.

Client' saving is guaranteed by Central Bank of Indonesia. However, this security is only for clients of public and private banks and BPR such as BRI Unit and BPR. In order to provide their clients with the same security, non-banking MFIs also innovate and develop their own security method. For example, LPD Mas provides guarantee for its saving clients if in the future LPD Mas could not pay his obligation to its saving clients. Desa Adat Mas, where LPD Mas conduct its operation, provides the guarantee for LPD Mas clients.

A recent product development provided by MFIs is insurance for its credit applicants. This insurance means that if a borrower passed away before he or she settled the credit, her or his heirs do not have the obligation to pay the remaining credit balance. The insurance can be paid by the clients or by MFIs. In the case of Kopwan SBW, BPR Bhakti Daya Ekonomi and BPR Bojonegoro, clients pay the insurance provision. On the other hand, for BRI Unit, the insurance provision is paid by BRI Unit. This insurance can attract senior clients who are afraid to apply for new credits due to the worried to leave burden to their family and descendants in case of something happen during the credit instalment periods.

Simple Procedures

In terms of procedure, clients expect easy, fast and appropriate procedures. Therefore, it is expected that MFIs always innovate and increase the quality of their service procedure in order to win the competition with other financial institutions. For examples, Pegadaian is able to provide its clients with simple and quick procedures.

Good Relationship with Clients and Clients Loyalty

Most of MFIs in this study use personal approach in running their institutions. By using personal approach, MFIs will know the condition of their clients thoroughly. Personal approach is also a common method in handling NPLs. Therefore, there is emotional connection between MFIs and their clients. In the future, this connection will create loyalty of MFIs clients. Loyal clients are important asset of an MFI. Almost all sample of this study confirm this.

For MFI that operate base on *sharia* principles, good relationship can be built with clients who do not practice *sharia* as part of their belief. Bank Jabar Syariah and BPR Syariah Baktimakmur Indah do not differentiate their clients based on their beliefs. This policy is done by maintaining the consistency in practicing a profit sharing principle rather than interest rate system.

Having a routine meeting is also important in building good relationships with clients. Routine meeting, at least once a year are usually conducted by cooperatives (annual meeting). Group meeting or routine meeting between MFIs and their clients could be developed as business channelling media for MFIs clients. Therefore, clients will feel that MFIs give them support in increasing their economic activity. Another method to increase good relationship between MFIs and their clients is conducting productive training for MFIs clients, as has been practiced by Koperasi Wanita SBW.

Good Staff Services

Clients take into consideration good staff service in choosing an MFI. Based on survey on MFIs clients, good staff services is one of their main considerations to become and stay as MFIs clients. Clients expect to receive friendly and sincere services from MFIs staffs. In line with this, dedicated staffs are important assets for MFIs.

In order to improve staff services, there should be regular training to MFIs staffs. All MFIs in this study provide training for their staffs. The methods and types of staff trainings should fit MFIs' needs.

Weakness

High Interest Rate

Most of the selected MFIs charge higher interest rate then BRI. It is possible that this is due to inefficient operational cost, such as experienced by BPR Bojonegoro and BPR Bhakti Daya Ekonomi. Therefore, MFIs optimize their effort to obtain source of fund with lower interest rate in order to cover the high operational cost.

Low Quality of Human Resources

The capability of staffs is essential in improving the quality of services of MFIs. The result of this study shows that some of the selected MFIs have low quality of human resources. There are two main causes of this low quality of human resources, internal and external factors. Internal factors include lack of staff motivations to develop. It is experienced by Koperasi Simpan Pinjam SPB. This hampers the development of ideas and innovations. Internal factor also consists of the low level of education of staffs and the low capacity of staffs in mastering technology. It is experienced by KUD Cikajang and LPD Mas. Other examples of internal factor are the low capability to assess the business prospects and collaterals of clients. BPR Duta Gama mentioned that staffs would have capability to assess the business prospects and collaterals of clients after having working for more than three years experiences.

External factor includes too low competition of financial services in region where an MFI is located. It does not need to work hard to achieve targets, as experienced by BPR Bojonegoro and BRI Unit Turi, where the MFI competitions are low in their areas.

In order to improve the quality of human resources, an MFI should improve the capability of its staffs through trainings. In addition, there should be regeneration of staffs by introducing younger, bright and motivated staffs therefore it is feasible to develop new ideas and innovations.

Limited Outreach

Some MFIs' coverage areas are regulated by government or *Adat*. LPD Mas operation is confined only to its *Desa Adat* area and it cannot expand their service to other *Desa Adats*. It will grow if its economic welfare of *Desa Adat* members also grows. Bali Provincial Government requires any excess liquidity of LPD Mas to be placed in BPD Bali. In this case, LPD Mas could not choose other banks that offer better facilities and services.

Limited number of account officer curbs growth of MFIs. In the case of BRI Unit, limited account officer (*Mantri*) is a drawback in competing with competitors. Most BRI's competitors employ a lot more account officers than BRI.

Insufficient Amount of Credits Disbursed

Often, credit ceiling set by MFIs is too low to meet borrowers' business needs. In this case, clients will probably search for other fund resources.

Lack of Technology

Limited information system, technology and on-line branch offices slow MFIs growth. The limitations hinder clients' data base collection. Technology adaptation is essential point to improve the service quality of MFIs.

Arrears

Good personal relationships with clients can often lead to increase moral hazard of clients. Lenient and inexplicit executions to non performing loans tend to reduce clients' repayment rates. This is the case of Koperasi Simpan Pinjam SPB and BPR Bojonegoro.

Services

Complaints from clients on MFIs mainly concern about services, those are ineffectiveness of suggestion box (*kotak saran*), slow services and unfriendly services. Regarding that service is one of strategies that can attract clients, poor services of MFIs will drive clients to drop out.

High Business Cost

Promotion costs to introduce products and to attract new clients are very high as claimed by Bank Jabar Syariah. For MFIs in cooperative form such as KUD Sulahan, member of KUD is automatically become a member (inactive member) of Credit Saving Unit (*Unit Simpan Pinjam*, USP KUD Sulahan). The inactive members will raise total members of KUD, as a consequence profits to be distributed become less for each member.

More business units also increase costs and lower profits. KUD Sulahan has too many business units and not all units are profitable. Therefore, business units incurring loss become a burden for KUD.

Centralistic Organization

The centralistic cases can be seen in Pegadaian branch and BRI Unit. Targets set-up and human resource planning are determined by the Head Office and Regional Office. Branch or Unit has less leeway to innovate in product creation and services

Opportunity

Optimizing Number of Potential Clients

Good performance and services of an MFI are good advertisement and will attract new clients or members. Good image of Koperasi Simpan Pinjam SPB in local society supports it to be sustained. This cooperative becomes a legend in Tasikmalaya region and the members encourage their descendants to be members of Koperasi Simpan Pinjam SPB. Another example is BRI, which has long experience and good brand image as an MFI. These features lead to attract clients further.

Geographic condition is also an opportunity for some MFIs to raise their clients. BPR Bojonegoro is located in rural environment. This environment is an opportunity to increase good character clients. Civil servants or employees are good potential clients. Since they have certain future salaries, therefore it will have low NPL.

Optimizing Suboptimum Coverage Areas

Potential clients who have not been served and inactive members for cooperatives are potential market for MFIs. Expand coverage areas will increase number clients even further, especially for area with no MFI operations. Sample MFIs that have prospective markets are *Sharia* Micro Financial Institution (SMFI) Bank Jabar Syariah, KUD Cikajang and KUD Sulahan.

Riding the Tide of Improving Economic Condition

In general, results from this study shows that the better security, macroeconomic and political conditions of Indonesia are, the higher the willingness of society to save their money in financial institutions. In addition to increase savers, it will also increase borrowers. If this condition continues, it will have a positive impact on financial service development.

Innovating New Product Development

Product differentiation could increase number of clients since it provide more products for different segments of clients and members. Types of product can also be adjusted to local culture to accommodate local people’s need of financial services. In line with product development, LPD Mas has a plan to provide L/C for its clients.

Pegadaian introduces a new credit scheme called *Kreasi* with competitive interest rate or *sewa modal* (in Pegadaian the interest rate is called *sewa modal*). This product innovation is prospective to acquire more market shares in the future. The traditional business of Pegadaian is pawning, but now it introduces conventional credit services.

In the case of Koperasi Wanita SBW, the cooperative provide financial services for non-member using MSE Credits. The share of credit that has been allocated for these credits are small compares to *tanggung renteng* system. Improvement of this credit is potential to increase business volume of the cooperative.

Sharia Case

People who opposed to interest rate system are the potential clients for sharia micro financial institutions. Potential clients for sharia MFIs are not confined only to Moslem people, but also nonMoslem.

Threat

Competition with Moneylenders, Bank and Non-Banking MFIs

Currently, the main competitors of selected MFIs are banks, people credit banks, other MFIs and moneylenders. The new competitors of existing MFIs are Bank Mandiri, Bank Danamon, Bank Swadesi and Bank Mega, which expand branch banking system similar to BRI. The tight competition often leads to unhealthy competition. Some MFIs even granted credits without proper credit process and requirements such as acceptance of non-bankable collaterals and credit approval without on-site inspections.

Credit officers and account officers “head hunting” by competitors imply stealing of systems and clients since account officers are expert in dealing with MFIs’ coverage areas and clients. Several account officers of BPR Bhakti Daya Ekonomi and BPR Syariah Baktimakmur Indah are taken by Danamon Simpan Pinjam.

Disadvantage Government Policies

Government policies to provide funds with subsidized interest rates will lower market shares of MFIs, which do not access to this fund. For MFIs that receive the funds, they should not rely completely on the funds in attracting clients. They should be aware that the funds create dependency on external sources.

Pegadaian is currently facing short of funds to finance its credit scheme service. Based on government laws, Pegadaian is prohibited to accumulate savings. On the contrary, commercial banks could provide pawning service. This policy is considered will cause lower market shares of Pegadaian since the cost of capital are higher than other commercial banks’ saving and deposit interest rates.

Another example is BRI. A few years ago, local government of Sleman require civil servants’ salaries to be placed/deposited in Bank Pembangunan Daerah (BPD) DIY. This policy significantly reduces total savers of BRI in Sleman.

Arrears

For cooperatives MFIs, non-member clients of Koperasi Wanita SBW who take MSE credits are potential to experience NPLs since lack of sense of belonging of the non member to the cooperative. Therefore, MFIs should improve the monitoring system to avoid non performing loans.

Worst Economic Condition

Worse future economic conditions such as oil-price (BBM) hike recently posed negative impacts to MFIs. Unfortunate economic condition deteriorates clients’ business condition and hence increases credit risks and the probabilities of less and NPLs.

Inferior Image

Some people are reluctant to borrow from MFIs because it may reflect their poor financial condition. In this survey, demand for pawning service from Pegadaian is sometimes associated with ‘desperation and poverty’.

Chapter 3

MALAYSIA

The Need and Availability of Micro Finance Service for Micro Enterprise: Bringing Multi-Level Good Practices into Local Context (Case Study: Indonesia; Malaysia; Mexico; Thailand and the Philippines)

3.1 Malaysia's Macroeconomic Condition

Malaysia's Macroeconomic and Its Impact on MFI

In the last three decades or so, Malaysian economy has experienced a remarkably high economic growth and development. In 1960s, the economy grew at an annual average of 5.2%, 8.3% in the 1970s, 6.0% in the 1980s and 5.2% in the 1990s (Table 3.1). From 1987 until before the financial crisis (in 1997), for the period of about ten years, Malaysian economy has grown at an average rate of more than 8.0% per annum. The rapid economic growth was accompanied by relatively low and stable prices (Table 3.2).

Generally speaking, the average rate of inflation rate was less than 4.0% in the 1980s, as well as in the 1990s. Although unemployment rate was relatively quite high in the 1970s and 1980s, it has declined quite significantly to an average rate of 3.1% in the 1990s (Table 3.3). In fact, in 1990s, the economy could be considered as achieving full employment.

Along with this rapid economic growth, the economy has been transformed from an agricultural-based to an industrial-based economy. Between 1970 and 2003, the contribution of agriculture to GDP declined from 29.0% to 8.2%, while the contribution of the manufacturing sector increased from 13.9% to 30.6% (Table 3.4).

Table 3.1
Annual Growth Rates of Gross Domestic Product (%, at constant prices)

Year	1961-1970	1971-1980	1981-1990	1991-2000	2001-2002
1	1.4	10	6.9	9.5	0.4
2	6.9	9.4	6	8.9	4.1
3	5.5	11.7	6.2	9.9	n.a.
4	5.8	8.3	7.8	9.2	n.a.
5	5.6	0.8	-1.1	9.8	n.a.
6	6.2	11.6	1.2	10	n.a.
7	1	7.8	5.4	7.5	n.a.
8	4.2	6.7	9.9	-7.5	n.a.
9	10.4	9.3	9.1	6.1	n.a.
10	5	7.4	9	8.3	n.a.
Average	5.2	8.3	6	5.2	n.a.

Source: Bank Negara Malaysia (1994, 1999, 2002).

Table 3.2
Annual Growth Rate of Consumer Prices (%)

Year	1961-1970 (1967=100)	1971-1980 (1967=100)	1981-1990 (1980=100)	1991-2000 (1994=100)
1	-1.0	1.6	9.7	4.4
2	1.0	3.2	5.8	4.7
3	4.0	10.5	3.7	3.6
4	0.0	17.4	3.9	3.7
5	-1.0	4.5	0.3	3.4
6	1.0	2.6	0.7	3.5
7	5.8	4.8	0.3	2.7
8	-0.2	4.9	2.5	5.3
9	-0.4	3.6	2.8	2.7
10	1.9	6.7	3.1	1.6
Average	1.1	6.0	3.3	3.6

Source: Bank Negara Malaysia (1994, 1999, 2002).

Table 3.3
Unemployment Rate (%)

Year	1961-1970	1971-1980	1981-1990	1991-2000	2001-2003
1	-	6.8	5.0	4.3	3.6
2	-	6.3	5.1	3.7	3.5
3	-	5.7	6.0	3.0	3.8
4	-	5.2	6.3	2.9	-
5	-	4.9	6.9	2.8	-
6	-	6.1	8.3	2.5	-
7	-	6.1	8.2	2.4	-
8	-	5.4	8.1	3.2	-
9	-	5.2	7.1	3.4	-
10	7.5	5.3	6.0	3.1	-
Average	-	5.7	6.7	3.1	-

Source: (i) Bank Negara Malaysia, 1999
(ii) Economic Report, 2002
(iii) Malaysia Five-Year Plan, Various Issues.

Table 3.4
Composition of Gross Domestic Products (% at constant prices)

Year	Agriculture, Forestry and Fishing	Construction	Manufacturing	Mining and Quarrying	Services
1970	29.0	3.8	13.9	13.7	36.2
1975	27.7	3.8	16.4	4.6	47.5
1980	22.9	4.6	19.6	10.1	42.8
1985	20.8	4.8	19.7	10.5	44.2
1990	18.7	3.5	27.0	9.7	42.3
1995	13.5	4.5	33.1	7.5	41.4
1996	9.6	4.6	28.6	7.5	49.7
1997	8.8	4.7	29.0	7.1	50.4
1998	8.9	3.8	26.6	7.7	53.0
1999	8.7	3.4	28.0	7.6	52.3
2000	8.1	3.2	30.7	7.1	50.9
2001	8.2	3.2	28.4	7.1	53.1
2003	8.2	3.3	30.6	7.2	50.7

Source: (i) Malaysia Five-Year Plan, Various Issues
(ii) Bank Negara Malaysia (1994, 1999, 2002).

The rapid growth of the economy has also been reflected in rising per capita income. It was merely RM721 in 1960, but increased significantly to RM6,099 in 1990 and further to RM9,786 in 1995 (Bank Negara Malaysia, 1994; Malaysia, 1996, p. 36). In 2003, per capita income increased further to RM14,324 or USD3,770 (Malaysia 2003, p. 46). This rising income has been reflected in rising quality of life of Malaysians such as better health and education (Table 3.5).

Table 3.5
Selected Quality of Life Indicators

Indicators	1970	1990	2000
Life expectancy (years)			
Males	61.6	69.0	69.9
Females	65.6	73.5	74.9
Birth rate (per 1000 population)	32.4	27.1	24.4
Infant mortality rate (per 1000 live birth)	39.4	13.5	7.9
Death rate (per 1000 population)	6.7	4.7	4.4
Primary school enrolment ratio (%)	88.2	98.9	
Teacher/Pupil ratio (primary and secondary)	28.9	20.9	
Doctor/Population ratio	1:4302	1:2656	1:1465
Television sets (per 1000 population)	22	100	
Passenger cars (per 1000 population)	26	96	421.9
Telephones (per 1000 population)	1.0	9.7	
Total roads (km)	21182	39113	

Source: Malaysia, 1991 and 2001.

Table 3.6
Malaysia: Poverty Incidence (%), 1970-2002

Year	Poverty Incidence		Incidence of Hardcore Poverty	
	(%)	No. of Households	(%)	No. of Households
1970	52.4	1,000,000	-	-
1976	42.4	975,800	-	-
1984	20.7	649,400	-	-
1987	19.3	-	-	-
1990	17.1	574,500	3.9	137,100
1995	8.7	365,600	2.1	88,400
1997	6.1	274,200	1.4	62,400
1999	7.5	360,100	1.4	66,000
2002	5.1	267,900	0.5	52,900

Source: Malaysia Five-Year Plan, Various Issues.

The remarkable economic growth achieved in the last three decades has enabled Malaysia to significantly reduce the incidence of poverty in the economy from 52.4% in 1970 to 17.1% in 1990 and to reduce poverty further to 6.1% in 1997 (Table 3.6). The number of poor households has declined significantly from 1,000,000 households in 1970 to 274,200 households in 1997.

However, the East Asian financial crisis starting in July 1997 has negatively affected Malaysia's economic growth in 1998. As a result, poverty incidence rose from 6.1% in 1997 to 7.5% in 1999 while the number of poor households rose from 274,200 households to 360,100 households. In 2002, with the recovery of the economy, poverty incidence has declined to 5.1%, while the number of poor households declined to 267,900 households. The incidence of hardcore poverty has also decreased from 3.9% in 1990 to 1.4% in 1997.[1]

During the same period, the number of hardcore poor households has declined more than half, from 137,100 households in 1990 to 62,400 households in 1997. In 1999, the incidence of hardcore poverty remained at 1.4% as in 1997. Nonetheless, the number of hardcore poor households has increased from 62,400 in 1997 to 66,000 in 1999 as a result of the financial crisis.

In 2002, the incidence of hardcore poverty fell to 0.5% with a total of 52,900 hardcore poor households. Thus, it is not an exaggeration to say that Malaysia has achieved a remarkable success in reducing absolute poverty. Indeed, the issue of absolute poverty in Malaysia seems to be almost negligible by the end of the NDP (1996-2000) period. With

[1] In Malaysia, those households who have income half of the defined poverty line income or less is considered as hardcore poor households.

the achievement so far, it has been projected that total poverty incidence could be reduced further to 0.5% by 2005 (Malaysia 2001).[2]

While the overall poverty incidence in Malaysia has been reduced to significantly low level, nonetheless there are still few outstanding issues that need to be highlighted and concerned. First, the incidence of poverty in the rural areas is still relatively high compared to the urban areas. The incidence of poverty in the rural areas has decreased significantly from 60.0% in 1970 to 10.9% in 1997 (Table 3.7). It has however increased to 12.4% in 1999 due to the financial crisis, but it then declined to 11.4 in 2002 after the economy has recovered.

While it is not to deny the fact that poverty in the rural areas has declined impressively, the fact is that the percentage is still considered relatively high, especially when the number of rural poor households is taken into account. In 2002, the number of rural poor households was considerably large. It involved 198,300 households. About one fifth (40,300) of this total rural poor households were categorised as hardcore poor households.[3]

Second, while the question of poverty transcends the question of ethnicity, nonetheless poverty incidence among the Malay/Bumiputera is still critical. Although the incidence of poverty among the Malay/Bumiputera declined significantly throughout the 1970 to 2002 period, nevertheless the incidence of poverty among Malay/Bumiputera was still relatively high compared to the Chinese and Indian.[4] In fact, poverty among Malay/Bumiputera remains the highest. In 2002, poverty incidence among the Bumiputera was 7.3%, while it was only 1.5 and 1.9% for the Chinese and Indian, respectively (Table 3.8). Furthermore, poverty incidence among the Orang Asli is also still high in Peninsular Malaysia. In 1999, the incidence of poverty and hardcore poverty among the Orang Asli were at 50.9 and 15.4, respectively (Malaysia, 2001).

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[2] As incomes have increased and absolute poverty has declined, the focus of government policy has shifted somewhat from broad-based policies to reduce poverty in general to a greater focus on eradicating poverty among the hard-core poor. Under the National Development Policy which commenced in 1991, the government has established a special development program which incorporates economic and social programs to assist the hard-core poor. This package includes a number of elements: (1) Income-generating projects, primarily for cash crop cultivation, livestock rearing, aquaculture, petty trading and cottage industries; (2) Programs to provide and upgrade low-cost housing and to provide basic amenities and facilities such as electricity, safe drinking water and health facilities; (3) Direct welfare assistance and attitudinal change programs; (4) Programs to meet the food and nutritional requirements of undernourished children and to assist school children from hard-core poor families; and (5) The Amanah Saham Bumiputera scheme, a special investment scheme which enables hard-core poor *Bumiputera* households to obtain an interest-free loan of RM5,000 ($2,000) to invest in a unit trust program. The government has also recognized the importance of non-governmental organizations (NGOs) in the overall policy framework to eradicate poverty. In particular, it has supported the micro finance activities of Amanah Ikhtiar Malaysia (AIM) as an integral part of its poverty programs.

[3] Poverty incidence in the rural areas is found relatively high in the agriculture sector and tend to consists of paddy farmers, rubber smallholders, coconut smallholders, fishermen and estate workers. These groups of poor in the rural areas tend to do not have access to resources such as land, capital and technology and produce output and productivity at a very low level, They also appear having no bargaining power in the market. It is also found that most of the rural poor households are headed by the elderly, 65 years old and above. Besides, female-headed households also register high incidence of poverty in the rural areas.

[4] In 1999, for instance, about 75.0% of the total poor households in Malaysia were Malay/Bumiputera.

Table 3.7
Malaysia: Poverty Incidence and Number of Poor Households by Strata

Poverty Incidence	1970	1976	1984	1990	1995	1997	1999	2002
Rural								
Incidence of Poverty (%)	60.0	50.9	27.3	21.1	14.9	10.9	12.4	11.4
No. of Poor Households	-	864,100	556,400	492,500	281,800	221,800	271,000	198,300
Incidence of Hardcore Poverty (%)	-	-	9.3	5.2	3.6	2.5	2.4	2.3
No. of Hardcore-Poor Households	-	-	-	121,600	68,300	51,800	52,100	40,300
Urban								
Incidence of Poverty (%)	22.3	18.7	8.5	7.1	3.6	2.1	3.4	2.0
No. of Poor Households	-	111,800	93,000	82,000	83,800	52,400	89,100	69,600
Incidence of Hardcore Poverty (%)	-	-	2.4	1.3	0.9	0.4	0.5	0.4
No. of Hardcore-Poor Households	-	-	-	15,500	20,100	10,600	13,900	12,600

Source: Malaysia Five-Year Plans, Various Issues.

Table 3.8
Malaysia: Incidence of Poverty by Ethnic Groups, 1970-2002

Ethnic	1970	1976	1984	1987	1990	1999	2002
Bumiputera	64.8	56.4	25.8	23.8	20.4	10.2	7.3
Chinese	26.0	19.2	7.8	7.1	5.4	2.6	1.5
Indian	39.2	28.3	10.1	9.7	7.6	1.9	1.9
Others	44.8	44.6	22.0	24.3	22.8	13.0	13.0
Total	**52.4**	**42.4**	**20.7**	**19.3**	**17.1**	**7.5**	**5.1**

Note: The Bumiputera includes the Malay, the Orang Asli and other Bumiputera in Sabah and Sarawak, while Others include ethnic of Indonesian and Phillipinos.
Source: Malaysia Five-Year Plan, Various Issues.

Third, despite the remarkable economic growth achieved, poverty still remained a critical issue in certain areas and states. The incidence of poverty was still remains considerably significant in the less developed states, especially the states of Kedah, Kelantan, Pahang, Perlis, Terengganu and Sabah. In 2002, Sabah recorded the highest incidence of poverty (16.1%), followed by Kelantan (12.4%), Kedah (10.7%), Terengganu (10.7%), Perlis (10.1%) and Perak (7.9%) (Table 3.9).

Thus, while Malaysia has been successfully reduced the overall poverty to a negligible percentage, nonetheless the problem is quite noticeable among certain groups and in certain areas and states. Under the current Prime Minister, Abdullah Badawi, scaling up income of the poor, particularly those in the agricultural and rural sector, is given a greater emphasis. Indeed, in the Budget 2006 announced recently by the Prime Minister, RM700 million has been allocated for poverty eradication programs. This implies that there are greater opportunities for the MFIs to play a significant role in helping the government to achieve the target of reducing poverty.

Table 3.9
Malaysia: Incidence of Poverty by State

State	1970	1976	1984	1987	1990	1995	1997	1999	2002
More Developed States									
Johor	45.7	29.0	12.2	11.1	10.1	3.1	1.6	2.5	1.8
Melaka	44.9	32.4	15.8	11.7	12.4	5.3	3.5	5.7	2.7
Negeri Sembilan	44.8	33.0	13.0	21.5	9.5	4.9	4.7	2.5	2.2
Perak	48.6	32.4	20.3	19.9	8.9	9.1	4.5	9.5	7.9
Pulau Pinang	43.7	59.8	13.4	12.9	17.2	4.0	1.7	2.7	1.4
Selangor[1]	29.2	22.9	8.6	8.9	7.8	2.2	1.3	2.0	1.1
Wilayah Persekutuan Kuala Lumpur	n.a.	9.0	4.9	5.2	3.8	0.5	0.1	2.3	0.5
Less Developed States									
Kedah	64.5	61.0	36.6	31.3	30.0	12.2	11.5	13.5	10.7
Kelantan	76.1	67.1	39.2	31.6	29.9	22.9	19.2	18.7	12.4
Pahang	43.2	38.9	15.7	12.3	10.3	6.8	4.5	5.5	3.8
Perlis	n.a.	43.0	33.7	29.1	19.3	11.8	10.7	13.3	10.1
Sabah[2]	n.a.	58.3	33.1	35.3	34.3	22.4	16.5	20.1	16.1
Sarawak	n.a.	56.5	31.9	24.7	21.0	10.0	7.3	6.7	5.8
Terengganu	68.9	60.3	28.9	36.1	31.2	23.4	17.3	14.9	10.7
Malaysia	**52.4**	**42.4**	**20.7**	**19.3**	**17.1**	**8.7**	**6.1**	**7.5**	**5.1**

Notes: [1] Includes Wilayah Persekutuan Putrajaya
[2] Includes Wilayah Persekutuan Labuan
*Peninsular Malaysia only
Source: Malaysia Five Year Plan (Various Issues) and EPU.

Malaysian Government Policy and Its Impact on MFI

One of the major problems faced by the lower income groups and micro enterpreneurs is access to finance. Their lack of assets for collateral, financial records and limited credit history have made accessing credit from the conventional banking system almost impossible. Hence, the conventional banking system is not the appropriate mechanism to address their financing needs.

As an alternative, some of the poor households and micro enterpreneurs have opted for illegal money-lenders or "along", where the interest charged is unbelieveably high. Given this, combined with the socio-economic objective of achieving an equitable growth and development, the Government has provided the necessary support to nurture micro finance activity in Malaysia. This is not only to ensure that micro financing is able to fill the gap in the supply of financial services that are not normally covered by the conventional banking institutions, but also to be used as a tool to promote social stability through improved standard of living of the low income groups.

Given that micro finance activity in Malaysia is still relatively less developed compared to some developing economies such as Bangladesh, Philippines and Indonesia, significant support from the Government is therefore important in developing a viable and sustainable micro finance system. The current policy of the government towards micro finance is, therefore, focused on assisting and developing micro finance programme to provide finance for micro enterprises at lower cost. While the aid of Government is required to keep up the micro finance activity at this initial stage, it is realized that a Government-aided micro finance operation would usually lead to overdependence on Government loan funds and subsidies. Such situation is not conducive for the institution to generate sufficient profit margin to sustain its activity.

To ensure the sustainability of micro finance activity, government support would eventually be replaced with a market-oriented micro finance programme, where the micro finance institution is able to be self-sustained in sourcing its own funding; adopting market-based lending rates and generating sufficient profits to finance its activities.[5]

[5] Recently, there is a proposal by the Ministry of Women Affairs for establishing Bank for Women, that will provide micro finance to the poor, especially women.

As part of the efforts to promote micro finance in Malaysia, initial tasks have been undertaken to ensure the sustainability of micro financing activity currently undertaken by the two implementing institutions. In June 2003, Bank Negara Malaysia has embarked on the Micro Finance Project, aiming to strengthen the micro financing framework which would lay the necessary infrastructure for a smooth development of micro finance industry in Malaysia. Areas covered under this framework include developing product specification, policies and procedures for micro finance management, organizational structure of the micro finance institution as well as supervisory and regulatory framework for the regulator to supervise micro finance.

However, this framework would be used as a guide and reference for standard best practices activities among these development financial institutions and other micro finance institutions intending to provide micro financing. In October 2003, a training programme for staff involved in micro financing was conducted for one of the institutions.

Furthermore, another strategic institution in providing micro financing to members is the cooperatives movement. However, due to the relatively weak operational conditions and lack of skills in assessing the business/project viability, the potential of cooperative in this regards has not yet fully capitalised. In view of this, Bank Negara Malaysia with the joint cooperation of the relevant Ministries are currently undertaking efforts to strengthen cooperative movements, with the view of enhancing access for financing micro enterprises through the cooperatives.

Malaysia's Sociocultural and Its Impact on MFIs

In Malaysia, poverty eradication as well as improving income equality is one of the major concerns in Malaysia's development policy and planning.[6] It is not surprising therefore to find that since 1970, the problems of poverty and distribution, particularly enhancing the standard of living of the lower-income group, has been given special attention by the government.

Anti-poverty and pro-active redistribution strategies aimed at improving the quality of life of the poor, the Malays/Bumiputeras in particular, can be found in each of the Malaysia Five-Year Plans. The government has also expressed that the goal of fighting poverty will continue to be one of the major emphasis in the Ninth Malaysia Plan (2006 – 2010). Besides, under the current Prime Minister Abdullah Badawi administration, revitalising agriculture and development of the rural areas has been given special emphasis to reduce poverty in the rural areas as well as a source of employment creation.

Development of efficient and effective micro finance institutions in Malaysia would certainly be important to unlock the potentials of the lower income groups, particularly in the agriculture sector and rural areas. Accessibility of the rural poor to credit that they really need to develop their potentials is therefore important and will continue to be significant issues in Malaysia.

The government appears to acknowledge the importance of the poor to have access to financial services that they really need. Thus, micro finance institutions, particularly NGOs, have generally been supported. Indeed, acknowledging the important role played by the micro finance institution, the government has launched a micro credit scheme in 2003 as part of a comprehensive strategy to stimulate the economy, particularly stimulating agricultural production activities as well as expanding small and medium enterprise

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[6] Generally speaking, the basic philosophy that underlies Malaysia's development policy and planning is that economic growth is not an end in itself but as a means to bring prosperity and better quality of life to all segments of society. In this regards, the principle of "growth with equity" has been central in all Malaysia's development policies and efforts. This philosophy and development approach is initially incorporated in the New Economic Policy (1971-1990) and is continued in the National Development Policy (1991-2000) and the National Vision Policy (2001-2010).

activities.[7] For this purpose, about RM1 billion have been allocated through two financial institutions, those are Bank Pertanian Malaysia (BPM or Malaysian Agricultural Bank – RM500 million) and Bank Simpanan National (National Saving Bank – RM300 million). Besides, another RM200 million was allocated to an NGO, the Amanah Ikhtiar Malaysia (AIM). The scheme was collateral free and borrowers were eligible for a maximum loan of up to RM20,000 (or equivalent to US$5263) with interest rates charged at 4% per annum on reducing balance.[8]

This study examines the four micro finance institutions in Malaysia–Amanah Ikhtiar Malaysia (AIM), Bank Pertanian Malaysia (BPM–Malaysia Agriculture Bank), Tabung Ekonomi Kumpulan Usaha Niaga (TEKUN) and Koperasi Kredit Rakyat (KKR-People Credit Cooperative). The aim of the study is to examine the best practices of these institutions such as in terms of their delivery system, outreach and sustainability.

3.2 History of Micro finance Services in Malaysia

Malaysia experienced a robust economic growth in the last 20 years. According to The Economist daily report, Malaysian income per capita by year 2003 had reached US$6,300 with its economic growth achieved 5.2%. It is no longer plausible to worry about poverty in such advantageous economic boom.

Poverty seems no longer a big problem in Malaysia. But in some critical parts of the economy, poverty is still a matter of hard trouble. A 1986 survey found that 62% of the loans made to farmers were informal (Robinson 2002).

There are some rural areas where poverty can still be found. Among these recent-reported are Kelantan, Trengganu, Kedah, Perlis and some parts of East Malaysia. A survey conducted by World Bank reveals that decreasing inequality in Malaysia has turned reversely since 1990 (Netto, 2003). The fact turned, that among Southeast Asian economies, Malaysia is the one which has got highest rate of income inequality, with Gini coefficient approaching 0.5.

In such high rate economic growth, MFI has achieved less attention from the public (McGuire and Conroy, 1998). This is due to the fact that MFI's purpose is to support and facilitate low-income households, which are no more too large in number. World Bank's 2001 data reveals that number of poor indigenous people constitutes only 7.8% of total population.

The government program is destined to alleviate poverty among poor Malays, bridging the gap separating them from other advantageous ethnic group such as Chinese ethnic. The first appeared was MARA and Bank Pertanian (agriculture bank) as volunteer of MFIs, both were supported by the government. Credits being delivered are mainly focused on agricultural assistance and certain poverty alleviation programs.

Some financial institutions have put a deep attention concerning the growth of small and medium enterprises (SMEs) in Malaysia. Among them are Islamic banking institutions, with Bank Pertanian and Credit Guarantee Corporation (CGC) as the most dominant ones. The

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[7] The micro credit scheme was launched by the Government in May 2003 as part of economic stimulating package, to counter the slow down of the Malaysian economy that was partially due to uncertainties in global political and economic development such as September 11 incidence, the invasion of Iraq, SARS outbreak and the threat of terrorism in Asia after the Bali bombing. The micro credit scheme was introduced to enhance access of micro enterprises to their financial needs, which in turn will support the Government's on-going strategy to promote growth through local private investment, domestic-led growth (See the translation of the Prime Minister's Speech on the "New Strategies towards Stimulating the Nation's Economic Growth", The New Straits Times, 22nd May 2003).

[8] As at end-2003, the total loans disbursed by Bank Simpanan National and Bank Pertanian Malaysia amounted to RM431 million (US$113 million) and RM194 million (US$51 million) respectively (Che Zakiah, 2004).

two institutions deliver soft loans to SMEs. In addition, there also exist commercial and public banks as well as cooperatives that provide programs for small enterprises. But however, cooperatives have no means to develop without assistance from local government (Conroy, 2002).

Table 3.10
Some Active Micro Finance Institutions in Malaysia

Name	Status	Location/Scale
Majlis Amanah Rakyat (MARA)	NGO	National
Credit Guarantee Corporation (CGC)	Governmental	National
Bank Pertanian Malaysia (BPM)	Governmental	National
Farmers Organization Authority (LPP)	Governmental	National
Federal Land Authority (FELDA)	Governmental	National
Yayasan Usaha Maju	NGO	Sabah
Koperasi Kredit Rakyat	NGO	Selangor
Amanah Ikhtiar Malaysia (AIM)	NGO	National
National Savings Bank (BSN)	Governmental	National

Source: Ilias Ahmad (2002)

Some active MFIs in Malaysia, both NGOs MFIs and Governmental ones are displayed in Table 3.10. According to latest report by Ilias Ahmad (2002), on last May 21st 2003 the government of Malaysia had delivered soft loans comprising RM500 to BPM and RM300 million to BSN. Both are used as micro credit for poverty alleviation program.

The Malaysian Financial System

The financial system in Malaysia could be structurally divided into two; the financial institutions and the financial markets (see Table 3.11). The financial institutions could further be divided into two categories; those are the banking system and the non-bank financial intermediaries. The banking system consists of BNM, the banking institutions and other financial institutions, which is the discount houses, the representative office of foreign banks and the offshore banks in the International Offshore Financial Centre in Labuan (Labuan IOFC). BNM, as the central bank, is at the apex of the banking system and is responsible for the regulation and supervision of the banking system.[9] The banking system forms the largest component of the financial system, with assets account about 70.0% of the total assets of the financial system.

The Non-Bank Financial Intermediaries (NBFIs) comprises five groups of institutions; the provident and pension funds, insurance companies (including takaful), the development finance institutions, the savings institutions and other non-bank financial intermediaries. The NBFIs are supervised by the various government departments and agencies. The insurance companies however were brought under the supervision of the BNM, effective May 1, 1988. Furthermore, with the enactment of the Banking and Financial Institutions Act 1989 (BAFIA), companies involved in scheduled businesses such as leasing, factoring, building credit, development finance and credit token businesses are required to register and submit periodic returns to BNM for monitoring process.

[9] The offshore banks operating in the Labuan IOFC however was not under the BNM, but comes under the Labuan Offshore Financial Services Authority (LOFSA).

Table 3.11
Malaysia: Financial System

FINANCIAL INSTITUTIONS	FINANCIAL MARKETS
Banking System	**Money and Foreign Exchange Markets**
Bank Negara Malaysia (Central Bank)	
Banking Institutions	Money Market
Commercial Banks (1)	Foreign Exchange Market
Finance Companies	
Merchant Banks	**Capital Markets**
Others	
Discount Houses	Equity Market
Representative Offices of Foreign Banks	Bond Market
Offshore Banks in Labuan IOFC	Public Debt Securities
	Private Debt Securities
Non-Bank Financial Intermediaries	
	Derivatives Markets
Provident and Pension Funds	
Insurance Companies (2)	Commodity Futures
Development Finance Institutions	KLCE CI Futures
Saving Institutions	KLIBOR Futures
National Savings Bank	
Cooperative Societies	
Other Non-Bank Financial Intermediaries	**Offshore Market**
Unit Trusts	Labuan International Offshore Financial Centre (IOFC)
Pilgrims Fund Board	
Housing Credit Institutions	
Cagamas Berhad	
Credit Guarantee Corporation	
Leasing Companies	
Factoring Companies	
Vanture Capital Companies	

Note:
1. Including Islamic Banks
2. Including Takaful

Since 1987, the financial system has gone through a process of gradual liberalisation, when interest rates on deposits were deregulated. The commercial bank was permitted to establish its own base lending rate according to its cost of funds when interest rates on loans were partially deregulated in 1991. In 1994, a two-tier regulatory system was introduced for commercial banks that allow greater freedom to well-managed banks with strong financial standing. It has now been extended to finance companies and merchant banks, which have also been given greater freedom to accept deposits. Liberalisation of the financial system, nonetheless, has not been accompanied by deregulation of banks.

The BNM still tightly controls the establishment of new banks and only a few NGOs have been granted a special license to provide finance to the poor and lower income groups.[10] In fact, institutions that provide financial services are governed by the Banking and Financial Institutions Act (BAFIA) of 1989, where regulations on deposit taking are tightened up to prevent and penalise unwarranted solicitation of deposit.

There are three categories of institutions covered under BAFIA 1989. These are: (i) scheduled financial institutions – major deposit taking institutions such as finance companies, commercial banks and discount houses; (ii) scheduled non-financial institutions – major non-bank sources of credit and finance such as credit card companies, building societies, factoring and licensing companies and development finance institutions;

[10] NGOs that provide micro finance services operate under a special license granted by the Ministry of Housing and Local Government under the Money-lenders Act, while Co-operatives operate under Co-operative Act of 1993.

and (iii) non-scheduled institutions – statutory bodies and other persons or corporations not subject to the provisions of BAFIA governing scheduled business and representation.[11] Besides, interest rates also remain regulated by Bank Negara. Each bank must establish a base lending rate, based on the Kuala Lumpur inter-bank offer rate (KLIBOR), its cost of funds and its cost structure. The base lending rate for each bank must be approved by Bank Negara and the maximum lending rate for any loan is set at the base lending rate plus 4%. Some specific categories of loans also face lower ceilings (See McGuire, Conroy and Thapa, 1998).

While Malaysia may be credited with maintaining sound financial policies and good supervision, inherent weaknesses do exist within the system. Thus, there are concerns about the health of the banking system in the aftermath of the 1997 financial crisis. Rising NPLs in the banking sector especially during the financial crisis gave rise to the fear of systemic bank failures. The Government has, therefore, taken measures to restructure and consolidate the financial sector with the primary aim of: (i) relieving institutions of their NPLs; (ii) strengthening and recapitalizing banking institutions; (iii) facilitating corporate debt restructuring; and (iv) enhancing efficiency within the system. Thus, it leads to further reform of the financial sector in Malaysia.

Basically, the thrust of Malaysia's banking and financial sector reform measures introduced during the financial crisis was two-folds. They were aimed at immediately stabilizing the banking system and also building a strengthened, more resilient banking sector over the medium to long term. Short-term measures were initiated to ensure the smooth functioning of the intermediation process, while rationalization, consolidation and reform of the financial and banking sector were initiated through the setting up of an asset management company, a bank recapitalization agency, a corporate debt restructuring committee and mergers. These represented part of the long-term strategy to strengthen and consolidate the sector.

The long-term objectives of restructuring the banking sector are: (i) create resilient banking system to withstand future shocks; (ii) develop efficient and competitive banking sector to support economic growth and contribute as sector of growth; and (iii) provide foundation to broaden and deepen financial markets and strengthen financial infrastructure to meet future challenges.

Since the financial crisis in 1997 exposes the vulnerability of small financial institutions, efforts were made to encourage financial institutions to merge and consolidate. BNM has always encouraged banking institutions to merge in order to achieve economies of scale and a higher level of efficiency. The financial crisis in 1997 has given the opportunity for BNM to accelerate the consolidation and rationalization process of the banking sector. With a population of 22 million, Malaysia is considered over-banked with 21 commercial banks, 12 merchant banks and 39 finance companies, not to mention foreign-owned institutions. In order to consolidate and rationalize the banking system to meet the challenges of an increasingly-globalized market, the central bank has encouraged banks and finance institutions to merge.

The central bank in July 1999 announced plans to reduce the number of 58 domestic financial institutions (21 commercial banks, 25 finance companies and 12 merchant banks) to just six banking groups, each of which included a commercial bank, a finance company and a merchant bank, by getting them to merge. This exercise did not involve locally-incorporated foreign banks. The two main objectives of this consolidation process were: (a) to enlarge the capital base of the banking group thereby ensuring a better management of risks and enhancing the resilience of the banking system; and (b) to cut costs and improve the competitiveness of local institutions.

Furthermore, the merger programme for finance companies was one of the measures undertaken by BNM to consolidate the finance company industry which was the most fragmented industry. The program is also part of an overall pre-emptive strategy of BNM to

[11] Thus NGOs that provide micro finance services may be classified under category (iii).

further increase the resilience of the finance companies to withstand any risk from the slowdown in the economy. Although there are 39 finance companies, more than 70% of the finance company business is concentrated in five or six larger finance companies. As a result of the measure, the number of finance companies was reduced to 25. Fourteen finance companies were absorbed by their parent commercial banks while the remaining was acquired by the larger finance companies.

Overview of the Malaysian Micro Finance Services

Like in many other economies, micro finance programmes in Malaysia were aimed at mainly to address the financing needs of the low-income group in rural and urban areas, thus eradicate rural and urban poverty.[12] At present, there are two NGOs that engage actively in micro finance activities in a considerable magnitude - the Amanah Ikhtiar Malaysia (AIM) and Tabung Ekonomi Kumpulan Usaha Niaga (TEKUN). While AIM focuses on providing financing to poor households and micro borrowers mainly for rural poverty eradication, TEKUN is specialised in the provision of small loans to micro enterprises of the native groups (Bumiputera). There are also other NGOs that engage in micro finance activities such as Yayasan Usaha Maju (YUM) in Sabah and the Koperasi Kredit Rakyat (KKR) in Selangor, but their operation is much smaller in scale compared to AIM and TEKUN.

Generally speaking, commercial banks in Malaysia do not significantly engage in micro finance. Their involvement are just limited to extending lines of credit to AIM and as a mediator for schemes such as the loan fund for hawkers and petty traders operated by the Credit Guarantee Corporation (CGC). However, it should be mentioned here that the scheme under CGC does not generally reach poor borrowers. Recently, two financial institutions have also engaged in micro finance activities by the instruction from the government. These two institutions are Bank Pertanian Malaysia (The Malaysian Agriculture Bank), which mainly provide financing and savings services to small farmers; and Bank Simpanan National (The National Savings Bank) which offers savings services and consumer loans to small borrowers.

Amanah Ikhtiar Malaysia (AIM)

In addition to the existing banking institutions, the largest and oldest MFI is Amanah Ikhtiar Malaysia (AIM), which was replicated by the idea of adopting Bangladeshi-born Grameen Bank in local context. The AIM uses *Household Income Survey* as a mean to monitor income improvement among its members. To estimate the lowest income group, they use sample mean test of total population. Having practiced this way, Malay locals poverty rate could be estimated. Up to 1998, AIM owns 40 branches with six regional offices serving 39,000 debtors and 50,000 members. In its development, AIM has grown rapidly due to its wide access and unlimited operational scope which has not only served social purposed programs only.

Moreover, AIM has been developing rapidly since the devastating Asian Crisis in 1998. Many people lost their jobs in this period, following decreasing total productivity. SMEs which put MFIs as secondary source of their income, has then turned their mind to make them the primary one.

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[12] However, it should be mentioned here that the development of micro finance institutions in Malaysia might be considered relatively less developed compared to other developing economies such as Bangladesh, Philippines and Indonesia. The reason might be due to the fact that since 1970s, there are various government agencies that have been established under various ministries that are aimed at improving income and the quality of life of the lower income group, particularly in the rural areas. Thus, to a certain extent, these institutions provide not only technical assistance, but also financial assistance and hence provide the services provided by micro finance institutions. To name a few, these institutions are – Rubber Industry Smallholder Development Authority (RISDA), Federal Land Development Authority (FELDA), Federal Land Consolidation and Rehabilitation Authority (FELCRA), Ministry of Rural and Land Development, etc. In this sense, micro finance is not new in Malaysia.

Table 3.12
Developing Number of Amanah Ikhtiar Malaysia's Membership and Its *Outstanding* Credits
(During Crisis 1997-1998)

***Outstanding* credits**	**Year**	
	1997	**1998**
Amount	31.853	38.251
Volume (RM)	44,4 million (US$10,5 million)	74,3 million (US$17,6 million)
Non Performing Loans	58	197
Recovery rate (percent)	-	99,92
Number of members	21.655	4331

Source: McGuire and Conroy (1998)

As the crisis began, the amount of non performing loans has increased (Table 3.12). By June 1997, approximately 58 loans that had been delivered were unperformed. This amount kept increasing, reaching up to 1997 in the next 1998. Uniquely, repayment rate was still high despite the frequent unperformed loans (approaching 100%). This indicates that repayment magnitude remains high in spite of its steady frequency.

Decreasing number of memberships by 20% in 1998 indicates many old members leaving the AIM or the low rate of new membership applicant's growth. There has been no proof whether the fact was caused by diminishing appeal of AIM to the public or its weakening ability to reach. In fact, AIM has increased its interest rate and loan size even before the crisis stroke.

Due to crisis, Malaysian government had subsidized more to AIM. In March 1998, RM100 million subsidy loan was injected. AIM had also required loan from the bank totaling RM20 million with 1% interest rate. The application was then dismissed since the banks increasing prudence in cash allocation. This proves that Malaysian MFI's vulnerability against shock is still high, while public trust remains steadily low. Only government then, the one who can help them overcoming the trouble.

3.3 Samples of Field Study

In general, the purpose of this study is to get a clear description about micro finance services in Malaysia, one of the APEC economies under investigation. Specifically, the aim of this study is to identify best practices of MFIs in Malaysia. In this regards, the performance of the MFIs in terms of delivery mechanism, outreach and sustainability will be analyzed. The case study approach was chosen for the current investigation as it is appropriate at this stage due to its goals of gaining insights rather than forming conclusions. The case study allows for an understanding of individual cases through a holistic perspective and offers a viable method of generating ideas and insight into future studies (Reinharz, 1992).

Data was abstracted from each MFIs and MEs through questionnaires and interviews. Interviews were conducted with the officers of each MFI as well as with the owner-manager of the MEs. Thus, the analysis presented in this report is based on interviews with four MFIs offering micro finance products and services, as well as clients or members of these MFIs. All four MFIs have their headquarters in Kuala Lumpur (AIM, BPM and TEKUN) or nearby (KKR). The interviews lasted between four to eight hours.

These four MFIs were chosen on the basis of their diversity. AIM is an NGO, while TEKUN is a private company. Both started out as action research projects under the Center for

Policy Research of Universiti Sains Malaysia. AIM and TEKUN have branches all over the economy. In May 2003, BPM, an agricultural bank, was one of two banks selected by the Malaysian Government to distribute RM500 million (US$131.6 million) channelled to the Micro Credit Scheme fund[13]. KKR, on the other hand is a cooperative, offers its products and services limited to its locality in central Malaysia. Recently it established a new community on the east coast of Malaysia.

[13] Both Bank Pertanian Malaysia (BPM) and Bank Simpanan Nasional (BSN) began offering micro credit loans under the Economic Surplus Plan. Under the Micro Credit Scheme fund, entrepreneurs were able to obtain small loans worth up to RM20,000 (USS5,263). BPM is currently developing new products and services to include financial services such as savings and insurance. However, BSN is not covered in the current study. US$1 = RM3.80.

Chapter 4

MEXICO

The Need and Availability of Micro Finance Service for Micro Enterprise: Bringing Multi-Level Good Practices into Local Context (Case Study: Indonesia; Malaysia; Mexico; Thailand and the Philippines)

4.1 Mexico's Macroeconomic Condition

Mexico is the largest and most populous economy in Central America. Its economy has been rapidly grown since devaluation of Peso in 1994. The existence of currency stability and industrial modernization drive Mexico out from poverty. Despite its recovery advantages, some poor Mexicans remain living in particular areas. This condition also indicates income inequality among the nation. According to United Nations Capital Development Fund (UNCDF, 2004), about 40% of the local Mexicans are still living below the poverty line. Most of them are reported being supplied by informal economic sector in the economy. This condition has led a common need for small micro finance institutions (MFIs) to support them with soft and small-scale loans distribution.

Under the Gortari's administration, Mexico had entered NAFTA to gain benefits from trade liberalization. This has ignited frictions within the nation. Despite some benefits garner from liberalization, poor people are living neglected as in Chiapas and Chihuahua. However, this has proved that the nation is still operating dualistic economy.

During 1994 - 1995, Mexico faced economic crisis. There were under-performed loans repayments that caused bankruptcy. As the impact of crisis, several sectors of economy were infected. The industrial sector contracted by 3.5% in real terms, while the agriculture and services sectors grew by 2.5% and 1.1%, respectively, in real terms, in each case as compared with 2000 (APEC Economic Outlook, 2002).

In 1995, Government of Mexico (GoM) took a strategy to reduce the impact of economic crisis. Rage of subsidy programs was offered to debtor. GoM also updated accountancy requirement to meet the international standard and effective supervision. With these regulations, GoM expected that economic condition of Mexico would recover soon.

Mexico's economy slowly recovered. By 2001, the Gross Domestic Product (GDP) was decreasing by 3% compared to previous year (APEC Economic Outlook, 2002). Table 4.1 briefly describes the macroeconomic condition of Mexico. The slowdown economic conditions have direct impact labour market. The number of open unemployment rate was increasing by 0.25% in 2001. The unemployment rate in 1996 was 5.5%. It was decreasing into 2.2% in 2000. Nevertheless, as 2001 the number of unemployment rate was raising into 2.5% (Table 4.1). Table 4.1 also briefly describe Mexico's general macroeconomic performance.

Table 4.1
Mexico's Overall Economic Performance

Economic Performance	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**
GDP and Major Components (percent change, year over year - earlier period, except as noted)						
Nominal GDP (level in billion US$)	332.3	400.9	421.0	480.5	580.1	617.8
Real GDP	5.2	6.8	5.0	3.6	6.6	-0.3
Consumption	1.8	6.0	5.0	4.4	7.5	2.8
Private Consumption	2.2	6.5	5.4	4.3	8.3	3.4
Government Consumption	-0.7	2.9	2.3	4.7	2.0	-1.4
Investment	16.4	21.0	10.3	7.7	11.4	-5.9
Private Investment	26.7	23.5	13.8	7.2	9.2	-5.1
Government Investment	-14.8	10.1	-7.5	10.7	24.5	-9.6
Exports of Goods and Services	18.2	10.7	12.1	12.4	16.4	-5.1
Imports of Goods and Services	22.9	22.7	16.6	14.1	21.5	-2.9
Economic Indicator (percent change, year over year - earlier period, except as noted)						
GDP Deflator	30.7	17.7	15.4	15.3	12.0	5.4
CPI	34.4	20.6	15.9	16.6	9.5	6.4
Unemployment Rate (percent)	5.5	3.7	3.2	2.5	2.2	2.5
Population (millions)	**90.6**	**92.3**	**94.0**	**95.7**	**97.5**	**98.9**

Source: APEC Economic Outlook, 2002.

Financial System

According to CGAP (2005), the Banco de México (Banxico) and the government support for good monetary and relatively stable fiscal policies. Inflation has been on a slow but steady rise, closing 2004 at 5.2%. Interest rates have risen. The peso, free-floating since 2001, has also remained relatively steady at 11.21 pesos per US dollar at the end of 2004. The fiscal deficit has been around 1% of GDP (US$ 638.4 billion as of September 2004). Economic growth has been slow moving; real GDP growth is projected at 3.2% for 2005.

Mexico has a shallow financial system**.** According to the study of CGAP (2005), savings held in banks account for just 9.7% of the gross domestic product (GDP) and bank loans to the private sector account for 11.8% of GDP. The popular finance sector is still small relative to the size of the population. The financial institution branch per million inhabitants is 102. It is also stated that between 15 and 25% of the urban population and as little as 6% of the rural population, has access to accounts in financial institutions.

The number of people in Mexico who have account in the bank is not clear. Some accounts may be inactive or used for limited purposes such as for receiving salaries. As stated in the table 4.2 below, about 20 million people hold accounts in banks, 2.9 million in popular finance institutions and 2.65 million in BANSEFI (*Banco del Ahorro Nacional y Servicios Financieros*), the government savings bank.

As stated by CGAP (2005), in Mexico there is a large market of low income level. Mexico has population of 106 million people. About 43.4 million of the population are considered economically active. A large part of it is employed in the informal sector. The gross national income (GNI) per capita is US$6,230, yet half of Mexico's population is estimated to live in poverty and one-fifth in extreme poverty.

Table 4.2
Key Indicators of Mexican Financial System

General	
Population	106 million
Economically Active Population	43.4 million
Average Exchange Rate for 2004	11.3 US$
Inflation	5.20%
GNI per capita	$6,230
Minimum Wage	US $4.04 per day
% Population on <$2 per day	20%
% Population on <$1 per day	5%
Total Financial Institution Branches	9,948
Population/ Financial Institution Branch	9,799
Financial Institution Branch/Million Inhabitants	102
GDP 2004	US $733 billion
Savings in Banks/GDP	9.70%
Bank Loans to Private Sector/GDP	11.80%

Source: CGAP, 2005.

Table 4.2 (Continued)
Key Indicators of Mexican Financial System

Institutional Comparison	Commercial Banks	Popular Finance Institutions	BANSEFI
Branches	7,793	1,628	527
Population/Branch	12,509	59,879	184,978
Population with account	20-25 million	2.9 million	2.65 million
Number of accounts	36.5 million	NA	2.96 million
Total savings mobilized	US $126 billion	US $2.03 billion	US $330 million
Average savings account	US $3,465	US $782	US $111
Average savings account/GNP per capita	56%	13%	1.80%
Branch/Million inhabitants	80	17	5
Debit cards in circulation	34 million	66,981	None
ATM/Million inhabitants	173	0.6	None
POS terminal/Million inhabitants	1,356	None	None

Source: CGAP, 2005.

Government Regulation and Its Impact on Micro Finance

In Mexico, government has actively been involved in financial market since Mexico Revolution in early 1930s. The first stage conducted by GoM was the establishment of state-owned national banks. One of its purposes was to promote specific sector of economic activity. In less than ten years, there were more than seven state-owned banks in Mexico.

At least there are two reasons why GoM make an intervention to financial market. First, GoM attempts to anticipate the lack of banking sector's role in providing financial services especially to agriculture and industrial sector. Major opinion states that agriculture and industrial sector have no prospect to develop. With GoM intervention, both two sectors are expected to gain more attention, particularly in financial services. The second reason is to facilitate the public funds distribution such as subsidies.

“Stabilizing Development Period” was started in early 1940s. Within this period, GoM strengthened its position to regulate financial system through initiated some regulations on reserve requirement and credit ceiling. In addition, GoM also created board set of credit guarantee funds. In the beginning period, micro enterprises was the second priority due to GoM emphasized medium and large-scale enterprises development to create job opportunity.

Recently, GoM began to accommodate micro enterprise development by conducting two strategies. The first strategy was to create apex organization (such as *Nacional Financiera*-NAFIN). Apex organizations purpose to strengthen Non-Government micro finance organization (Benitez and Vega, 1998). The second strategy was to motivate private banks to open new branches in small town.

Moreover, GoM provided subsidy to assist micro enterprises. However, this program did not succeed due to state-owned banks still prioritized medium and large-scale enterprises. Therefore, micro enterprises could not reach the subsidies provided by GoM.

4.2 History of Micro Finance Services in Mexico

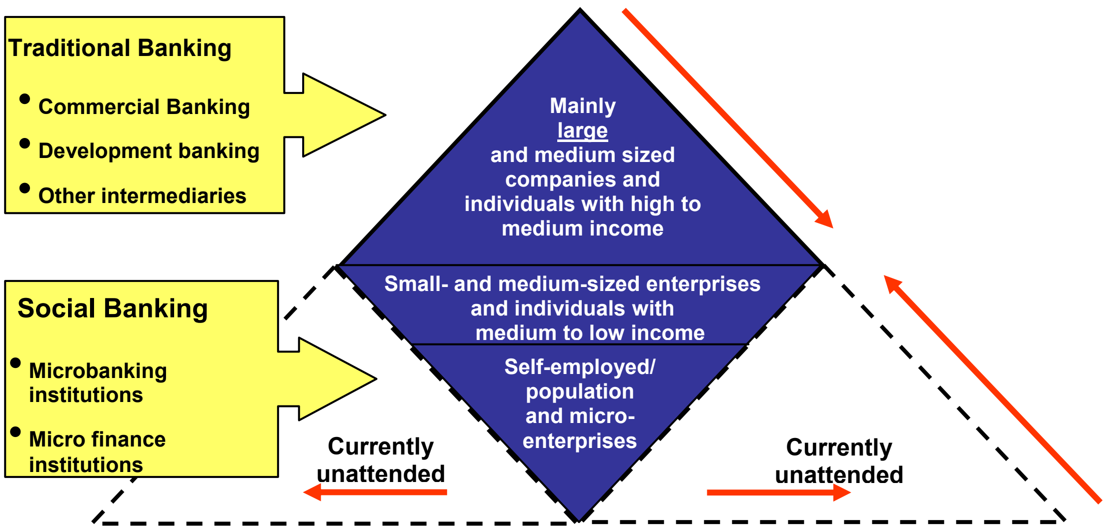
According to CGAP (2001), Mexico had approximately 42 million poor people, or between eight and ten million poor households. About 2.8 million out of 3 million formal enterprises in the economy were small or micro. Only 100,000 of them had access to credit from banking sector. This indicates that the opened or not served potential market for micro finance services was still high. Influencing micro and small sector through improvement, would also improve the economy as a whole.

Mexico’s micro enterprises employ about 20% of total working age population in the economy. The number of micro enterprises also rapidly increases over the last decade. The credit becomes urgent for small business economic development and poverty reduction. Private Banks and cooperatives were responsible for most of micro enterprises’ loans. In addition to these institutions, there are informal lending sources as other substantial source of credit.

Scholars and policymakers have recognized the economic importance of the micro enterprise sectors in Mexico. Given the importance of micro enterprise for job creation in Mexico, the role of credit as start-up capital for micro enterprise development is an important economic and public policy issue. Like any other economies, micro and small enterprises tend to face credit constraint in accessing credit from financial institutions. Therefore, micro finance service is needed to meet the demand for credit Micro and Small Enterprises (MSEs).

Majority of enterprises are operating in medium and large scale. Consequently, most of people are in medium to high income. If we put the condition into a pyramid, we can see that half of the pyramid consists of medium to high-income population. On the contrary, small and medium enterprises are only about one third of the pyramid. The Income Pyramid of the Mexican population can be seen in Figure 4.1.

Figure 4.1
Income Pyramid of the Mexican Population



Source: BANSEFI, 2005.

Mexico has a long story of fighting poverty. In the economy, micro finance refers to popular bank, social finance, cooperatives, *cajas*[1] and other communal organizations that provide loans and saving services for small enterprises. Their number keeps growing each year. Compared to Central America, international donors play only a minor role in Mexico.

Micro finance activities of the Mexican take form as donors, social (or popular) banks, NGOs and practitioner associations. The latter is an affiliation of many small and weak *cajas* or loans distributors. Based on Office of the Secretary of the Economy, micro finance is institutions that provide small loans (micro credits) to the poorest families, in order to support them economically in productive activities (business, self-employment).

In Mexico, micro finance activities are organized under various organization names. There are 29 organizations, most of them are NGOs having regulated into a network called Prodesarrollo. Until 2002, it has reached about 350,000 credit union members (CGAP, 2001). The largest in individual member is Compartamos, which had transformed itself into a regulated financial institution.

Major cases show that micro enterprises have no access to formal financial institutions. Many banks are reluctant to disburse credit to them since they cannot provide collateral. In addition, banking sector also assume that micro enterprises have no capability to repay the credit. Considering Figure 4.1, it is also acknowledged that banking sectors specifies its target.

Banks that serve micro to medium enterprises are characterized as social banking. Whereas, the target of traditional banking are medium to large-scale enterprises. Traditional banking consists of commercial banking, development banking and other intermediaries, while social banking consists of micro banking institutions and micro finance institution.

[1] Spanish for 'fund'.

Commercial banks are seemingly not interested to serve this segment. A survey conducted by CGAP in 2001 had proven that no banker respondents having been interviewed showed excitement about the issue. It was because the downscaling performance of micro and small sectors in Mexico. The set up costs, which might have been very high, were too expensive for commercial banks to cover.

There are several types of financial institutions serving micro and small sectors in Mexico, such as credit cooperatives, saving and loan societies, credit unions, *solidaridad* credit cooperative. However, commercial banking begins to enter the micro financial market recently. Since there is still unmet demand for credit, particularly small credit by micro finance services, commercial banking attempt to serve micro enterprises. Saving and credit institutions profile can be seen in Table 4.3 below.

Table 4.3
Partial Information on Savings and Loan Institutions
As of 30 June 2001

Type of institution	Number of Institutions	Number of Members/Clients (in thousands)	Total Assets (US$000)	Number of Members or Clients Per Institution	Institutions that Compensate Their Directors
Savings and loan cooperatives	186	1,014	853,500	5,452	54
Savings and loan associations	7	640	536,100	91,429	4
Credit unions	24	38	212,800	1,583	11
Solidarity funds	129	142	83,700	1,101	5
Civil associations	18	116	105,900	6,444	6
Civil societies	5	1	1,100	200	1
Social solidarity societies	10	2	400	200	3
Other	9	134	46,100	14,889	2
Total	388	2,087	1,839,600	5,379	86

Source: IDB calculations based on data from the *Diagnóstico de la Situación Financiera, Equipamiento Tecnológico y Censo de las Entidades de Ahorro y Crédito Popular* (EACP), BANSEFI, June 2002 cited on Inter-America Development Bank, 2003.

From Table 4.3 above, it is clear that majority of financial institutions operate in Mexico is saving and loan cooperatives. However, saving and loan associations have the largest number of members per institutions (91,429 members).

Government

Government is the main player that heavily involved in financial activities in Mexico. GoM creates programs that take many forms. Some that have been launched are *Fideicomisos Instituidos Enrelacion con la Agricultura* (FIRA/PROCREA), NAFIN, *Fondos Nacionales de Empresas de Solidaridad* (FONAES), Rural Microfinance Technical Assistance Project (PATMIR) and *Banco National de Credito Rural* (BANRURAL). They usually offer either loans or technical skills for borrowers. Legally, government of Mexico had stipulated new law that regulates micro finance service providers into two types of institutions, those are credit unions and savings and loan companies.

PANHAL

PANHAL is a national savings trust that has 900,000 clients and works through more than 590 branches. PANHAL takes savings only, while no credits services are available. It is also charged to provide technical training for clients but not to help them conducting supervisory function. By November 2001, PANHAL has become *Banco del Ahorro Nacional y Servicios Financieros*-BANSEFI (National Savings and Financial Services Bank), which has been equipped with back-office and treasury services, handling of remittances, Management Information System (MIS), training and other function.

BANSEFI has three main tasks, those are:
1. To promote savings culture and collaborate with other Government agencies in distributing subsidies and other supports
2. To become the Banker of the micro banking Intermediaries that provide financial services to the intermediaries in the micro banking sector and develop complementary products
3. To coordinate temporal supports of the Mexican Government which purpose to integrate the necessary infrastructure in assisting the micro banking Sector to operate in an efficient way and according to the new legal framework

BANSEFI attempts to make the micro banking sectors reduce their cost so that micro banking sector become more efficient. BANSEFI also builds micro banking network and designed the network to support their financial services. In case of BANSEFI, GoM plays role in promoting its operation.

Community Saving Fund (CSF)

CSF was promoted by Ministry of Agriculture of Mexico. CSFs purpose to provide marginalized community groups with simple mechanisms that allow them to save and administer their own funds securely, efficiently and profitably. It can be concluded that CSFs were launched as an option for the very poor to manage their own finance based on their own saving.

Over five years, the program provided funds for rural investment project to groups of farmer. The program promoted an investment recovery mechanism at the end of the productive cycle can gradually reduce farmers' dependency on grants. Under this scheme, participating groups of farmers were expected to recover a previously agreed percentage of the returns from their investment in order to set up a revolving fund.

There were about 420 CSFs formed through the Marginal Areas Program in 12 states with over 11,500 members and 4,090,000 pesos total savings. However, CSFs expected to be financially sustainable in the future.

NGOs

NGOs play major role in micro finance system in Mexico. Initially, NGOs aim to transfer financial resources to micro enterprises (Benitez and Vega, 1998). NGOs start to take a part in this system since 1985. Among them, there are particular NGOs that we will point out in the description below.

Emprendedores

Emprendedores is one of NGO's micro finance that aims to assist the poorest area in Mexico. The borrowers are those who have an income less than 15 yearly minimum wages or around US$1,300, given an exchange rate of 8.30 Pesos per US dollar (Benitez and Vega, 1998). Emprendedores provides individual loans that restrict to those who have settled business. Emprendedores charges the interest rate based on cost of the funds.

Emprendedores is a sample for micro finance NGOs with small coverage of operation. Compare to other micro finance NGOs, Emprendedores have higher Non Performing Loan (NPL), especially in 1996-1997. The number of loans made by Emprendedores was 888 and 809 in 1996 and 1997, respectively. However, the number of clients in 1997 was 448, relatively small number of clients.

Fundacion Habitat y Vivienda, A. C (FUNHAVI)

FUNHAVI is an NGO-supported micro finance service that provides funding for housing and home improvement facilities for poor clients. Cooperative Housing Foundation (CHF) International founded it in 1996, with start up funding from the Ford Foundation. Operating in city of Juarez, Mexico, it targets poor clients that work in *maquiladoras* (foreign-owned company). Concerning earning amount, target clients have between two and eight times the monthly minimum wage ($125 in 2002).

FUNHAVI works through cooperation with building materials suppliers, who support their product at wholesale prices. FUNHAVI then channels materials to clients by selling it in retail-level prices. This will ease poor clients, as they may not get any building materials at low quantity. To manage payments, FUNHAVI cooperate with local S-MART grocery stores that were proven more efficient and easier for clients. To bring additional value for clients, FUNHAVI also supports them with legal right status to occupy new building (houses), even though it was not certified with land title of property.

FUNHAVI loan amounts are based on estimated costs of house improvement and borrowers payment capacity. Amounts range from $500 to $2,500. To be prudent, clients' monthly repayment must not exceed one-third of their monthly income. Interest rates are differentiated, based on net monthly household income. For those who earn two and five times the minimum wage, interest charged is 2.5% per month. While for clients earning between six and eight times a month, they are charged 3% per month. As additional commission, FUNHAVI charges 2% and $20 fee for contracted architect. Average loan terms are usually 20 months, varying from 6 to 36 months. To guarantee loans, FUNHAVI does not require collateral, but rather relies on co-signers (Cities Alliance, 2002).

FUNHAVI repayment rate is historically high. Cities Alliance (2002) reported that repayment approached 97%, with 17% arrears. However, worsening economic condition in Juarez had caused decreasing repayment performance that brought consequences to organisational structure and efficiency. The Cities Alliance analyzes that the main factor leading to high arrearage was FUNHAVI irregularities in managing delinquent loans. At the time, FUNHAVI only writes-off loans in case of borrowers' death. It should have written-off such loans regularly. As of October 31, 2001, FUNHAVI reported 1,300 active clients, with outstanding portfolio over $1 million.

Compartamos

Compartamos is characterized as NGO's micro finance that shows an excellent performance. Nowadays, Compartamos has become one of well-known micro finance institutions in Mexico.

According to Compartamos's mission, "*Compartamos is dedicated to provide financial services to enterprising people who live in disadvantaged conditions and creating opportunities for economic, personal and social growth*". The model of credit disbursed is group lending (*grupos solidarios*). Therefore, each member presents liability to be borrowed by the others. The group members can borrow the funds with 3.7% of interest rates.

In 1990 and 1993, Compartamos was become pilot project for village banking model. Compartamos was expanded its operation into rural states and began with Chiapas and Oaxaca. About two third of its clients are married woman. Majority, the clients of Compartamos live in communities with limited access to education, public services and financial services.

Compartamos recently completed its strategic planning that has resulted in a plan to diversify its portfolio and transform into a bank. Compartamos is expanding its financial services by offering savings products and strengthening its branches. Nowadays, Compartamos have 144 branches across Mexico region. Moreover, Compartamos also plans to invest new technology that appropriate to its goals.

Compartamos has an increasing pattern of clients' growth. Its loan portfolio also shows the increasing pattern. Table 4.4 exhibit the performance growth of Compartamos. The number of active clients was extremely increased in 2001 by 56, 3%.

Table 4.4
Performance Growth of Compartamos, 2000 – 2005

Year	Active Portfolio	Amount Disbursed	Active Clients	Average Loan Balance	Percentage of Women Clients
2000	$10,873,934	$46,083,151	64,141	$170	99%
2001	$25,434,759	$104,147,258	92,773	$274	98%
2002	$43,030,870	$179,124,272	144,991	$297	99%
2003	$64,213,016	$285,256,214	215,267	$298	99%
2004	$102,033,717	$457,529,651	309,637	$330	99%

Source: http://www.accion.org/about_where_we_work_program.asp_Q_T_E_11

As June 2005, Compartamos has approximately 365,710 clients, 97% out of the total are women clients. Selected performance indicator of Compartamos can be seen in Table 4.5 below.

Table 4.5
Selected Performance Indicators of Compartamos, 2005

Performance Indicator	Value
Number of Active Clients	365,710
Active Portfolio	$133,610,695
Average Loan Balance	$365
Average First Loan	$275
Portfolio at Risk	0.59%
Percentage of Women Clients	97%

Source: http://www.accion.org/about_where_we_work_program.asp_Q_T_E_11

Centro de Apoyo al Microempresario (CAME)

CAME is one of the major NGOs providing micro credit services in Mexico. Established in 1990, it serves low-income clients in four municipalities in the State of Mexico, principally in Chalco. It has 33,000 active borrowers and about 80% are women. The lending methodology is primarily village banking. CAME tries to eliminate the internal account but faced opposition from the clients who prefer its greater flexibility and larger loans sizes. CAME recently introduced individual loans to "graduating" clients. Individual loans account for less than 0.5 per cent of their 35,000 clients. (Imp-Act, 2003)

Apex Organizations

An interesting type of MFI assisting agent is apex organization. Apex organization plays important role in financial system in Mexico. It links retailing Micro Finance Institutions (MFIs) with donors and governments. Apex receives supports from government or donors, transform it into valuable resources and distribute it to MFIs. It is up to the Apex how should the resources received be transformed. In some ways, for instance, Apex is allowed to transform supported cash into technical assistance (Navajas and Schreiner, 1998). Apex organization practices in Mexico can be good sample to compare.

Government or private entity may own apex organizations. A very well known apex is FIRA, which is government-owned and operates in rural areas. FIRA focuses in promoting agricultural sector. There is also *Forja Ornamental Mexicana* (FOMEX) that promotes export manufacturing sector and many other organizations.

Service Providers

Two main non-governmental service providers in Mexico are Colcami and Développement International Desjardins. Colcami provides micro finance-training program sponsored by IDB. In addition, there is also Special Unit for Micro Finance- United Nations Development Program (SUM–UNDP). SUM-UNDP is one of micro finance services sponsored by UNDP. In 2001, United Nations Development Program (UNDP) Mexico initiated a Microstart Program to support the development of a robust micro finance industry in rural areas. It consists of three components.

First, Special Unit for Micro Finance (SUM) and UNDP are working with Innova, a technical service provider, to provide technical assistance to three rural financial intermediaries seeking to transform into full-fledged micro finance institutions, namely:

1. GRENSA in the north (Magdalena)
2. *Fundacion Mexicana para el Desarrollo Rural* (FMDR) in the Federal District and
3. ASEA in southern state of Chiapas (Tapachula).

They are supported with training, Management Information System (MIS) and market research. This pilot project was carried out in December 2002.

Second, SUM and UNDP has contracted services of Accion International[2] to work with FIRA, a rural financial institution to support developing micro finance sector in rural areas. Third, SUM and UNDP Mexico will garner experience achieved through the two preceding components to transfer knowledge and technology to other actors. In addition, it is expected that these new actors will enhance wider development of MFIs through traditional banking sector, funding sources expansion and methodologies. Here as we noted, the main role of MFI is being intermediary for rural financial purposes.

Mexican dualistic economy has brought the poor into discussion. However, this remarkable idea has born some conceptual frameworks to assist poor society through many ways. The Funhavi's housing improvement facilities is the one, which is applicable to be noted. Its ability to cope with certain area (Juarez, Chihuahua), focusing on specific purpose (housing) has been the main strength of the features.

Beside the self-sufficiency and clustered management above, government of Mexico has facilitated some efforts to get international institutions involved in the programs. Presence of SUM-UNDP programs has been quite evident. Therefore, government assistance still matters in allowing international co-partners taking joined in poverty alleviation.

As initial capital, MFIs need to borrow start-up funding. This project loan is rarely provided by the public, but rather by government and social foundations. Involving such group like Ford Foundation will enable MFIs projects are done appropriately.

[2] A nonprofit organization that fights against poverty through microlending (www.accion.org).

Chapter

5

THAILAND

The Need and Availability of Micro Finance Service for Micro Enterprise: Bringing Multi-Level Good Practices into Local Context (Case Study: Indonesia; Malaysia; Mexico; Thailand and the Philippines)

5.1 Thailand's Macroeconomic Condition

Thailand's Macroeconomic and Its Impact on MFI

Thailand is one of APEC members that classified into developing economies. The Thai's political system is a Constitutional Monarchy. Initially, Thailand one of major sector of its economy was agriculture. However, within 1980 – 1995, agricultural sector's contribution was declined from about 23% as the share of GDP to 11%. Recently, major sector developed in Thailand is service sector (46% of GDP in 2004). While industrial sector's share reached 45% and agricultural share was 9% of total GDP. Like any other developing economies, Thailand experience in micro enterprise practices. Therefore, micro finance services become common issues to discuss in Thailand.

Among the high-performing East and Southeast Asian economies, Thailand stands out as one of the most outstanding economies in the region in terms of the extent and the rate of economic growth it has generated. From 1961 when Thailand launched its first national development plan, the GNP per capita was only 2,700 baht whereas in 1995, three decades and a half later, its GNP per capita is estimated at 68,405 Baht, an increase of more than 25 times in nominal terms. The rate of growth of GDP averaged about 7.9% during the firs decade of the systematic development (that is after the first plan), and 6.9% during the second decade. Although the growth fell somewhat during the first half of the third decade, the second half of the 1980s saw the Thai economy taking off onto a new height of economic development with double-digit growth rates. After some periods of retrenchment, the Thai economy is now maintaining a slower but still respectable growth rate of about 7-8% per annum during the first half of the 1990s.

Such extraordinary growth and expansion have helped the Thais increase their average household and personal income, and as such has caused the incidence of poverty or the proportion of people having income lower than a given poverty line to fall continuously.

The Thai economy experienced major growth impetus in the latter half of the 1980s. First, the large (14.7%) devaluation of the Thai Baht at the end of 1984 brought about more-than-expected good results in export growth a few years later. The appreciation of the Japanese Yen after the 1985 Plaza Accord lead an influx of Japanese direct investment into low-cost Thailand starting around 1986. The success in the tourism promotion of the Thai authorities in 1987 witnessed the doubling of foreign tourists between 1985 and 1989, and tripling between 1985 and 1995.

Although Thailand experienced sustained current account deficits, its balance of payments is helped by net capital inflows, with adequate foreign exchange reserves for up to 6 months of imports. Until last year, where the economy suffered from severe floods in most parts of the economy causing food prices to rise disproportionately, the inflation was maintained at below 5%. The Thai Government is also in good fiscal conditions, enjoying its eight consecutive years of fiscal surplus since 1987. The export growth, one of the major growth engines of the modern Thai economy, slows down a bit in the first half of 1996, but is expected to pick up during the remainder of the year. The overall picture of Thailand today is that of a newly industrialized economy whose production and exports have now included such manufacturing items as textile products, computer parts and components, electrical appliances, jewellery as well as processed food.

In 1997-1998, Thailand also faced financial crisis as other economies in Asia region. The devaluation of the Baht in July 1997, preceded as it was by a significant slowdown in export growth and a build-up of excess capacity, caused severe problems for borrowers and banks which have been well described in the national press, and thoroughly analyzed by academics and development institutions both nationally and throughout the world. Non-performing loans, now defined as those credits on which interest has not been paid for at least three months, are reported to average between 40% and 50% of total commercial bank credit portfolios.

In order to begin to deal with the problem, the Bank of Thailand has directed the banks to set up reserves for losses on their credit portfolios. All credits are to be classified in one of six categories: pass, special mention, substandard, doubtful, doubtful or loss, and loss. Banks are to deduct a specified percentage from each category and credit the aggregate amount to a reserve for losses account. A deduction of one% is to be applied to credits rated "pass," 2% is to be deducted from credits rated "special mention," 20% from credits rated "substandard," 50% from credits rated "doubtful", and 100% from credits rated either "doubtful or loss" or "loss."

Immediate application of the new rules would have an extremely negative effect on bank earnings and capital. Therefore, the Bank of Thailand is phasing the implementation of the new rules; at the end of 1998 banks were to set aside at least 20% of the full allowance required. The reserve for losses for most commercial banks now exceeds the Bank of Thailand minimum, but the gap between a prudent level of reserves based on what the banks are reporting to the media and actual reserves is understood to be immense. Narrowing the gap depends on a combination of strong earnings and raising new capital share.

Credit growth has slowed dramatically from the double-digit rates which were customary before the financial crisis. Deposits at banks have increased significantly, partly because the closure of 56 non-bank financial institutions caused depositors to move their accounts to relatively safe institutions. In addition, immediate post-crisis interest rates were high to defend the currency, and the absence of safe alternative investments added to the attractiveness of bank deposits.

The combination of lower-to-flat credit growth and the increase in deposits has created surplus liquidity in the banking system. An ancillary effect has been a significant increase in banks' interest margins as deposit rates have dropped further than lending rates. The spread between the fixed deposit rate and the minimum lending rate, for example, is now between 4-5%, which is exceptionally high. What would seem a great benefit to bank profits is not however, since interest is not being collected on a large percentage of the portfolio - that is the non-performing credits.

Banks are totally preoccupied with the bad debt problem. In addition, it would appear that opportunities to invest surplus liquidity are limited. Considering the excess capacity in the industrial and real estate sectors, good lending opportunities are hard to find. The excess capacity directly affects many MSEs to the extent they act as suppliers to many major manufacturers most severely affected by the crisis. In this climate, it may be unrealistic to expect bankers to expand their lending to any sector, least of all to MSEs which are perceived to represent higher risk lending.

However, the crisis recovery process was relatively faster than other economies. Hence, Thailand was become “East Asia’s best-performed” in 2002. Increased investment and consumption was pushed GDP expansion and offer positive impact on Thailand’s macroeconomy.

Since crisis attacks Thailand’s economy in 1997, Thai Government began to pay more attention to the grass-roots economic activities. Grass-roots economic activities are also mentioned as micro and small enterprises. As the consequence, Thai Government concern to the financial intermediaries which serve these segment.

In order to strengthen its economy, Thai Government was promotes “Dual Track Policy”. “Dual Track Policy” emphasizes both of local or domestic economy and promotes the export commodity. In case of strengthening local or domestic economy, Thai Government launched economic stimulating package than drive the Thailand’s economy from grass-roots economic activities (Udyanin, 2004). With this policy, Thai Government can support the grass-roots economic activities to produce export quality products.

Export has an increasing pattern during 1996 – 1999. Moreover, to improve the export quantity, Thai Government initiated One Tambon One Product (OTOP) in 2001. OTOP aims to facilitate the quality improvement of local traditional products. In addition, OTOP also advertise these local products to the domestic, even international market. Therefore, OTOP proved succeed in improving life quality of Thai people, particularly in grass-roots economy.

Thailand’s economic profile can be seen in Table 5.1. In 2003 recorded unemployment rate was equal to 2.2%. While, GDP per head at PPP was 7,370 Bath. In 2004, Thailand’s GDP was equal to $163.2 billion Bath with $2,578 Bath of GDP per capita. Based on Bureau of East Asian and Pacific Affairs (October 2005), Thailand was succeed to reduce the unemployment rate from 2.2% in 2003 to 2.0% in 2004.

Table 5.1
Selected Thailand's Economic Indicators

Indicator	2000	2001	2002	2003
GDP per head ($ at PPP)	6,228	6,460	6,850	7,370
GDP (% real change per annum)	4.76	2.14	5.41	6.74
Government consumption (% of GDP)	11.33	11.35	11.16	10.6
Recorded unemployment (%)	3.6	3.3	2.4	2.2

Source: http://www.economist.com/countries/Thailand/profile.cfm?folder=Profile-Economic%20Data

Thailand is one of economies that attracts investor to invest. Moreover, in order to attract additional foreign investment, the government has modified its investment regulations. With high level of investment, Thai Government can also support the grass-root economy. Within 2001 – 2003 periods, Thailand's economy grew at moderate rate.

In the future stage of Thailand's development, financial system improvement may become main issues. In addition to financial system development, corporate debt restructuring is needed to push economic growth.

Thailand's Government Policy and Its Impact on MFI

Thai Government regulations can be examined in monetary policy and financial reforms, tax policy, public expenditure policy and other government intervention.

Monetary Policy and Financial Reforms

One of the most successful macroeconomic managements in the recent Thai development is how the Thai authorities maintained the monetary and financial stability under high economic growth. The rate of inflation during 1987 to 1990 – at the super high growth period – averaged only 4.5% per annum. During the first four years of the 1990s, this same rate of inflation was maintained. Only towards the end of 1995 the rate of inflation had gone up to more than 7% mainly due to the high food prices brought about by severe floods throughout most of the economy. But overall, annual rate of inflation was only 5.8%.

Although this high rate continued during the first half of 1996, it was brought down to less than 6% during the third quarter and expected to fall below 5% at the end of the year. The credits to this price stability must be largely given to the Bank of Thailand, the Thai central bank whose major responsibility is to conduct the monetary policy. The Bank is well known for its steadfast concern to keep inflation under control, and will do its utmost to achieve this goal. At times, the control on money supply and credit expansion was so stringent that many private firms experience severe liquidity problems bordering on bankruptcy.

Nevertheless, if the effects of inflation on income and consumption of the poor and the less well-off is more negative than the effects on the non-poor and the relatively better-off, then keeping inflation under control must be income equalizing and help alleviate poverty, although there exists no empirical study that specifically measures the impact of inflation on incidence of poverty. But in addition to controlling money supply and credits, monetary policy also includes the management of domestic interest rates and the value of the currency. The effects of these latter aspects of monetary policy upon poverty may be difficult to see, but it is speculated that the liberalization of domestic interest rate setting and the floating of the exchange rate have excused the Bank of Thailand from direct involvement in poverty alleviation.

Financial reforms undertaken by the Bank of Thailand during the last few years may have some repercussions on poverty and income inequality. Until the late 1980s, the Thai financial sector was still considered relatively underdeveloped and overregulated. Exchange transactions were still under strict central bank's control, and so were interest rate ceilings, reserve requirements and new bank and branch banking operations. Assets management of commercial banks were closely monitored and financial instruments were limited. These conditions would certainly inhibit future growth of the economy if they are allowed to remain for quite a long time. Therefore, beginning in 1989 the Bank of Thailand launched it successive plans of financial reforms. What have been accomplished so far are interest rate liberalization, exchange control deregulations, decontrol of assets management of financial institutions, and the setting up of off-shore banking facilities. In the current Plan III of financial reforms, the Bank aims to achieve seven major objectives.

1. To expand the current operations of financial institutions;
2. To further develop financial structure of Thailand;
3. To promote efficiency in competition and liberalization of the Thai financial system;
4. To promote the distribution of economic prosperity from the center to the countryside;
5. To improve the efficiency in the oversight of financial institutions and financial system;
6. To develop financial personnel and their proper financial ethics;
7. To develop Thailand into a regional financial center.

Without a doubt, the above reforms should have promoted efficiency in the commercial bank operations and competition, leading to higher growth in the economy and higher benefits to bank customers in terms of better services and lower prices (service charges). Direct benefits upon poverty may not be so obvious but its alleviation could be traced through greater efficiency and growth in the economic system. Let us take a look at the expected outcomes of recent financial reforms to see how they affect local poverty. Some of these outcomes are:

1) The role of commercial banks in mobilizing and lending in the money market has declined, and their shares have been taken up by other financial institutions such as finance and security companies
2) Most commercial banks have now increased their efforts to improve the efficiency of their banking operations by the use of modern technology and upgrading of their manpower.
3) Foreign liabilities of domestic commercial banks have increased.
4) The structure of domestic interest rates has a tendency to follow foreign interest rates more closely.
5) The off-shore banking activities have increased substantially and could be considered reasonably successful.
6) The importance of the non-resident Baht account is growing.

As mentioned earlier, the above outcomes of financial reforms increase the efficiency of banking operations, which primarily benefit modern industrial, trade and service sectors.

Tax policy

Several tax incidence studies in Thailand have indicated that the overall tax system of Thailand is regressive, and as such contributing to greater income inequality. The study by the present author (Medhi, 1980), for example, found that the post-tax income distribution of the Thai households between 1968/69 and 1975/76 as measured by the Gini coefficient worsened by about 15% compared to the pre-tax situation. The type of taxes that the government collected could also affect poverty in the economy. For example, tax on consumption tends to burden low-income tax payers more than high-income tax payers. Therefore, the tax system which relies more on consumption as the base for tax revenue would tend to hurt the poor relatively more than the nonpoor. This is the case of Thailand where the majority of tax revenue is still collected from consumption sources.

The situation has begun to change recently. The followings are some of the changes in tax policy since the mid-1980s.

a. The share of income taxes in total tax revenue has started to increase. This is partly due to greater efforts on the part of the Department of Revenue to collect more taxes – personal income tax as well as corporate income tax – by setting up several tax offices in various locations throughout Bangkok to facilitate tax payment, streamlining the tax procedures and using modern equipment and technology. The boom in economy in the latter half of the 1980s also gave rise to higher corporate income tax collection.
b. The significance of the taxes on foreign trade has declined, not because of the reduced trade value, but because of the move towards freer trade under regional and international trading arrangements such as the upcoming ASEAN Free Trade Area (AFTA), the general trading direction of the Asia Pacific Economic Cooperation (APEC), and the general tariff reductions under the newly created World Trade Organization (WTO) of which Thailand is a member. The taxes on exports of Thailand, especially rice exports, have been almost completely abolished, which help local producers (rice as well as other upland crop farmers).
c. The basic sales tax of Thailand, the Business Tax, was replaced by the Value-Added Tax (VAT) in 1992. This is considered one of the most important changes in tax policy in Thailand because it took more than 10 years in preparation and in getting through various political hurdles to materialize. The VAT, though a consumption-based tax, is fairer to the former Business Tax because the added value is taxed only once, and the tax avoidance has become more difficult due to the built-in cross-checking mechanism.
d. The excise or selective sales taxes especially taxes on liquors and tobacco have maintained their share of the total tax revenue. This means that these sumptuary taxes continue to burden low income consumers relative to high income consumers.
e. Contributions from government enterprises have increased, and the central government no longer provides net subsidies to these public enterprises. Many of these large enterprises such as electricity generation, telephone and telecommunications have acted like private companies, charging market prices for their services and raise funds from private capital market.
f. Many new local governments have been set up particularly in rural areas. Fiscal autonomy (ability to raise local taxes, especially property taxes) is gradually being given to these local governments.

Direct taxation should improve the existing income distribution. However, one must be careful to distinguish the progressive tax rate on wage-income and the (lower) proportional tax rate on non-wage income in Thailand because this could bring about greater income inequality. On poverty, however, the present tax policy seems to have little impact, except probably the expansion of local governments' fiscal autonomy where the local authorities have more power to collect local taxes for their own use in the local areas.

Public Expenditure Policy

Public expenditure policy might be the most important policy that has direct impact upon poverty in the region. General government spending which aims at fulfilling the three functions of the public sector (efficient resource allocation, fair distribution of income, and stable price and employment) will likely to bring about smoother functioning of the economy, including appropriate welfare level of the whole population. However, when general government spending fails to provide sufficient level of welfare to specific groups of population, the government may supplement general spending with specific spending for specific target groups who need special assistance. This target-group oriented approach of government spending policy has become widely accepted as an addition to general economic growth as major tools to alleviate local poverty.

In contrast to tax policy, the general expenditure policy of the Thai Government was found to be income equalizing, that is to say, the overall effects of government spending benefit the poor relatively more than the non-poor. The post-expenditure income distribution, therefore, is more equal than the pre-expenditure income distribution (see Medhi, 1980). Nevertheless, this income equalizing effects of government expenditure have just offset the income disequalizing effects of the government taxes, making the so-called pre-fisc and post-fisc income distribution practically unchanged. In other words, the role of the Thai Government through its fiscal policy was neutral with respect to income distribution of the Thai people. To affect greater equality of income distribution and the reduction of poverty incidence, the government must change some of its policies.

Recently, the government began to put more emphasis on specific poverty-oriented policies towards specific groups of people. This is generally carried out under the guidance of the national rural development programs. In 1996, more than 200 projects have been selected for nationwide rural development for that year, and out of these projects, about 30 programs were singled out as specific poverty-oriented policies.

Examples of these projects include Programs to Assist Farmers and the Poor of the Prime Minister's Office, the Welfare Programs for the Aged in the village of the Department of Public Welfare, Ministry of Labor and Social Services, the Poverty Credit Programs of the Ministry of Interior, and some other ministries. The total amount of budget for these programs was still small at this juncture.

For instance, the budget for these poverty-oriented programs in 1995 amounted to only 3.7% of total central government budget for that year. But this category of public expenditure has increased rapidly. And it is hoped that with the government now in control of huge treasury reserves accumulated over many years of fiscal surpluses, they can decide to play more active role in the policy of poverty alleviation.

Other Government Interventions

There are several other government interventions in the private economy that are supposed to have impacts upon local poverty. Minimum wage legislation is one, while the social security program is another. Minimum wage legislation may be criticized for encouraging the substitution of machine for labor, but if the substitution is not perfect, then those workers who have received minimum wage and whose services cannot be replaced by machine could stand to gain from this minimum wage law. It may be argued, however, that since the average wage in most firms in the manufacturing sector is already higher than the minimum wage, the impact of this minimum wage law is minimal or negligible.

On social security system, this had just started about six years ago. Thus far, the benefits accrued to industrial workers have been recognized, and more workers have enrolled in the program, resulting in the social security funds accumulating rapidly in the past few years. More and more the 'safety net' provisions will be put in place by the government to help the poor and the needy as the situation arise.

In conclusion here, this section is to trace the changes in poverty and income inequality in Thailand over the past 30 years from 1962/1963 to 1992. It has pooled together various poverty and equity studies by various researchers, using different techniques and tools of analysis. On poverty, most studies used the nutritional adequacy approach as a basis for finding a poverty line, and once the poverty line is established, the head-count ratio or poverty incidence is used as a popular indicator of the extent of poverty in the economy. On income inequality, income share by quintile group is used to show the change in relative income position of the households and population in various regions and locations. The overall Gini coefficient is also used to show the extent of income inequality.

The records over the past 30 years have shown that poverty incidence in Thailand has fallen continuously from about 57% of the population to about 13.7%, using the original (old) poverty lines. However, when a new poverty line which is computed from a new set of population structure, nutritional requirements, and consumption pattern is used, the poverty incidence is still shown to be quite high. Poverty is still highly concentrated in the rural Northeast, with Bangkok having the smallest percentage of the poor among its population. Most farmers are still poor, whereas the laborers have benefited from recent increase in manufacturing activities and have earned a larger income. However, while the incidence of poverty is declining, the distribution of income has become worsened. The Gini coefficient has increased from 0.426 in 1975/1976 to 0.504 in 1990 and 0.543 in 1992, and the rate of increase in this income inequality has become more pronounced in the two years between 1990 and 1992.

On the outcomes of macroeconomic policies, the records of the past 30 years have shown that the Thai Government has emphasized first and foremost economic growth and expansion. When the economy was in difficulty such as external imbalance or domestic inflation, the immediate macroeconomic policies adopted would be to quickly stabilize the economy and continue on the growth path. Poverty and income inequality have never really received top priority in the government macroeconomic policies. However, it must be recognized that growth-oriented macroeconomic policies have brought about poverty reduction through the trickle-down effects, and as such economic growth must still be looked upon as an important pre-condition for sustained poverty alleviation. But growth alone may not be adequate for a sufficient and timely solution to poverty problems, and this calls for targeted approach to poverty alleviation where specific poverty-oriented policies are carried out that aim at redressing the problems of the poor directly.

Finally, although it can be shown that the incidence of poverty has been declining rapidly in the last few years, this level of poverty still translates into several million of poor people. Moreover, if a new poverty line which incorporates changes in population structure, new nutritional requirements, consumption patterns, and prices is used the poverty incidence is still found to be disturbingly high. As the remaining poverty becomes more difficult to remove, perhaps a more targeted approach to helping these poor could be a helpful supplement to the growth effects.

As for the problems of income inequality, it has been mentioned earlier that this is not an immediate problem as long as the economy keeps growing. But the government must be prepared for the situation when the income of the poor and the non-poor could no longer expand. It is a wiser policy to keep monitoring the changes in poverty and income inequality and plan a strategy to cope with it before more serious problems occur.

Principally, Thai Government only supports the potential of each sector of economy. In order to support the regulation, Thai Government assigns Bank for Agriculture and Agricultural Cooperatives (BAAC) and Government Saving Bank (GSB) to support the policies. By 2001, Thai Government was promoting some regulations that relevant to the development of grass-roots economy.

Furthermore, Thai Government, especially Ministry of Finance, has formed a committee purposed to prepare the micro finance master plan in Thailand. In details, the plans are examined as follow (Udyanin, 2004).

1) Providing education and training to low income people in order to foster financial discipline in the micro finance system
2) Strengthening the capacity of self-help organizations in order to improve their management
3) Developing performance indicators for micro finance operation
4) Collecting micro finance data in order to form micro finance credit bureau
5) Preparing operation guidelines for micro finance management

6) Forming the linkage to self-help organizations
7) Linking micro finance to Thailand's financial system

5.2 History of Micro Finance Services in Thailand

About 33% of Thailand total population is living under US$ 2/day (World Development Index-WDI, 2003). The Asian financial crisis in 1997-1998 had led to increasing number of poor families in Thailand. Between February 1997 and February 1998, total employment fell by 800,000 and unemployment rate rose to 4%. It also reduced the contribution of non agricultural sector, which was 60% before the crisis (McGuire and Conroy, 1998).

It was estimated in 1988 that 52% of total credits distributed to agricultural sector was from informal sources (Robinson, 2002). Out of 61.6 millions populations, 48.5% contribute for agricultural sector in 2000. Demand for saving services is quite high, with depth of financial sector (indicated by M2/GDP) reaching 102.9 in 2001. In broader context, gross domestic savings as percent of GDP was 31.1 by March 2004 (WDI, 2003).

In Thailand, micro finance is dominated by small community organizations that are funded by government under certain programs. Its practitioners are commercial banks, Bank for Agriculture and Agricultural Cooperatives (BAAC), cooperatives, and many credit unions. Other types of institutions are various finance companies and credit companies. However, banking institutions may also serve the micro finance market, with BAAC being the largest.

Thai Government classifies micro finance providers into three main categories (Udyanin, 2004).

1) Financial Institutions under supervision of Bank of Thailand (BOT) and Ministry of Finance (MOF)
   There are three MFIs included into this category, The Government Saving Bank (GSB), Bank for Agriculture and Agricultural Cooperatives (BAAC), and Krung Thai Bank (KTB). Among three MFIs mentioned, BAAC is the most well-known MFI in Thailand.
2) Financial Institutions under Supervision of other Government Agencies
   The second category consists of several institutions under the programs conducted by Thai Government agencies. For example, Prime Minister of Thailand provides some funds to allocate for every village across the economy.
3) Self - Regulatory Financial Intermediaries
   However, MFIs that classified into third category is a number of community-based savings groups are supported by NGOs such as village banks, savings cooperatives and self–help savings groups. According to Thailand's experience, community will naturally initiated when people face difficulties in accessing funds from commercial bank. They will gathered and create a community.

Here, we well examine the MFIs' profile in Thailand, based on categories presented above.

Financial Institutions under Supervision of Bank of Thailand (BoT) and Ministry Of Finance (MoF)

The Government Savings Bank (GSB)

The Government Savings Bank (GSB) was founded in 1913. It is owned by Royal Thai Government. The GSB provides credit size up to 10 million Baht for private sector borrowers. Types of credit purposes are for working capital and fixed asset acquisition. Maximum repayment rate is ten years, with interest rates ranging from 0 (zero) to 3.5%. Usual types of collaterals are land, buildings, and equipment.

As of September 1999, credits account for 41.6% of total assets, relatively smaller than commercial banks have. Of the total credits disbursed, private sector including MSEs account for 30-35%. The report records that housing credits account for 18.34% of total loans, while welfare loans for government employees and general public account for 8.51% (Paetkau, 1999).

Krungthep Thurakit, on 3 June 1999 reported GSB's failure in fulfilling the target for MSE lending. Only 50 million Baht had been delivered to target MSEs, less than targeted 1 billion Baht. The causes for this inability were general economic condition, poor public relations, and lack of credit approval proficiency.

Bank for Agriculture and Agricultural Cooperatives (BAAC)

Bank for Agriculture and Agricultural Cooperatives (BAAC) was established in 1966. Its main concern is financial service provision for small agricultural sector. At the time, farmers were in lack of fund supply. But difficulties appear as they do not posses any land certificates as collateral. To guarantee that repayment failure should be minimized, they were asked to form credit groups as a consequence of collateral absence.

BAAC adopted joint-liability credit lending, which required borrowers to form a group consisting of at least five to a maximum of 30 members. The groups should consist of farmers that know and trust each other. They choose partners and define eligibility by themselves, not by the bank. In practice, usually a group consists of 12 to 15 farmers. However, the group is not a legal body. They are not allowed to borrow or enter contracts as groups. It is the group then, who in case of court action on non-repayment, take responsibilities of each member who fails.

There are also some regulations for the lending amount. BAAC may not lend to individual farmers more than 50,000 Baht. It is distributed to individual farmers, not to the group collectively. To observe the use of credits, systematic supervision by field staffs is implemented. They visit borrowers at homes or work fields.

According to BAAC Act Sect. 7, BAAC shares are held by individual farmers, farmers' groups, agricultural cooperatives, and other financial institutions. The Bank of Thailand (BoT), Thai central bank, has introduced a master plan to divide banking sector into two different windows of financial service provision: commercial banks for high capital mobilization, and retail banks for MSEs and other smaller scale requirement.

During the Asian crisis (1997-1998), banking sector was not heavily affected. It was because *Baht*'s depreciation that had increased agricultural crops prices (Lightfoot, 2004). This implies that small and micro sector is not heavily correlated with external economic factors, by which Asian crisis was caused by.

Table 5.2
Commercial Banks, Finance Companies, and BAAC
In comparison

Information	Commercial Banks	Finance Companies	BAAC
Number of institution	31 (according to Bank of Thailand website)	18	1
Total assets	US$ 174.85 billion (31 January 2004)	US$ 8.2 billion (31 January 2004)	US$ 8.29 billion (31 March 2003)
Deposits	US$ 139.34 billion (31 January 2004)	US$ 5.67 billion (31 January 2004)	US$ 6.62 billion (31 March 2003)
Target market	Serves large farms and agroindustries in addition to large urban industry		Provide credits for agricultural purposes to farmers, farmers' groups, and agricultural cooperatives.

Source: CGAP, www.cgap.org (22 June 2005) with official exchange rate as of 30 January 2004.

BAAC is prohibited to practice connected lending. But it is permitted to offer credits, guarantees; buy, sell or pledge moveable and immoveable properties; and taking deposits (BAAC Act, Sect. 10). Its deposit rate is set by the BoT, being 0.75 to 1% for savings as of April 2004. For lending, rates for individual farmers range from 8-14% and 5.5-10.5% for farming institutions.

Considering risk management, total BAAC debts can not exceed 20 times the sum of paid-up capital, reserves, and accumulated profits (BAAC Act, Sect. 34). Insider business is also prohibited. No credit to director, managers, or their spouses (BAAC Act, Sect. 11).

Krung Thai Bank (KTB)

Krung Thai Bank (KTB) began its operation in 1966. KTB was a merged-bank between Agricultural Bank Limited and the Provincial Bank Limited. By 26 June 1989, KTB was introduced into Stock Exchange of Thailand. While in 24 March 1994, KTB was registered as “Krung Thai Bank Public Company Limited”.

KTB is a partly state owned bank. KTB has 511 branches and serves a rather medium-size market segment. The bank has a total credit outstanding of 919.6 billion Baht (nearly US$ 24 billion) as at 31 December 2003 (Udyanin, 2004).

Recently KTB actively involved in the micro-rural finance market as a pilot testing in micro finance with a community bank.[1] The community bank role is not only to lend to the people in the community but also to provide technical assistance and training to improve the community’s capacity.

Recently, KTB does not only the Bank that provide financial assistance to many businesses, large and small, it also renders financial assistance to other state enterprises. As the state-owned commercial bank, KTB pays the benefits reaped from its business transactions to the Thai Government in the form of taxes. Moreover, KTB also pays dividends to the Ministry of Finance.

[1] KTB is supervised by the Bank of Thailand

Financial Institutions under Supervision of other Government Agencies

Urban Community Development Office (UCDO)

One government program that operates under micro finance scheme is Urban Community Development Office (UCDO), which covers many community organizations. UCDO has been experimenting with new development processes to address urban poverty in Thailand. It was established in 1992 under the National Housing Authority to implement poverty alleviation programs for 1.4 million urban poor. The Activities are lending and borrowing, community groups, training, income generating, and developing.

UCDO operates under group model of saving and credit services. UCDO provides credits for housing, emergency needs, and income generation. There are four types of credits for groups.

Table 5.3
Types of Credit for Groups

Credit Type	Purpose	Rate (%)	Term
Revolving	Emergency credits	10	Up to one year
Income generation	Business investment	8	Up to five years
Housing projects	Land and building:	3	Up to 15 years
	- up to 150,000 Baht	8	
	- 150,000 – 300,000 Baht		
Housing renovation	Repair and extension	10	Up to five years

Source: Paetkau, 1999.

During Asian economic crisis in 1997-1998, its number of organization members had almost doubled. Non-recovery rate increased, but outstanding credit decreased at the same time, indicating restrictive behavior to borrow or apply for new credits. However, crisis led to a condition where credits supply was needed. This was proven by number of organizations with credit programs which increased (Table 5.4. In terms of credits outstanding, it did not significantly grow during the crisis.

As of 1999, UCDO reported 822 member communities that represented 41.1% of total 2,000 urban poor communities in Thailand. Its total assets were 1,669.04 million Baht, 67.9% of which was deposited in bank account or invested in cash (Paetkau, 1999).

UCDO is quite different from other similar organizations that operate in rural areas. In urban communities, people are more mobile, competitive, and less relationship awareness. Meanwhile, rural communities are closer in relationship, have strong cooperation, as they produce similar output such as crops. Maintaining groups' performance is more difficult in urban context. Non-repayment rate tends to be high, as people move and out easily and lack of relationship commitment. Therefore, UCDO's most challenging difficulty is managing various diversity in urban borrowers' behavior in groups.

Table 5.4
Performance of UCDO, 1997 - 1998

Indicators	Period	
	June 1997	June 1998
Number of community organizations	165	204
Outstanding credit ($ million)	11.34	11.89
Non-recovery rate on credits from UCDO to community organizations (percent)	0.8	3.0
Number of organizations with credit programs	24	56

Source: McGuire, Conroy, and Thapa. 1998.

In performing its services, UCDO cooperate with several existing organization includes government, NGOs, local authorities and also professionals. In addition, UCDO provides credits for Community Saving Groups (CSGs). However, NGOs become facilitator in supporting the cooperation between UCDO and community saving groups. NGOs also provide some technical assistance for CSGs in setting up savings and credit systems and for developing integrated development plans for drawing credit (Boonyabancha).

People's Bank Program

People's Bank Program, that firstly began the operation in June 2001 is a micro-credit product offered by the GSB. This program targets low-income earners or those are lack access to borrowing funds from financial institutions. Within two years, there was more than 700,000 small borrowers have obtained a credit. In supporting this program, GSB has disbursed approximately more than 17 billion Baht equal to US$ 438 million (Udyanin, 2004).

People's Bank provide initial credit line equal to $US 790 for each borrower. Borrowers are not required to provide some collateral, but they have to presence two guarantors. In term of credit repayment, People's Bank choose monthly repayment scheme, with 1% of interest rate per month.

Debt Suspension and Debt Burden Reduction for Small-Scale Farmers Program

This program aims to provide assistance for small farmers. This program conducted in three years. The small farmers will gain the credits and repay the credit after the program terminated. The credit provided is to help small farmers in earning more income particularly in grace period. This scheme is regarded to aid the Thai's economic system restructuring and sustain economic growth (Udyanin, 2004).

This program supervised by BAAC as an institutions assigned by Ministry of Finance. This program performs credits for less than 100,000 Baht or equal to $US 2,500. Moreover, this program assists small farmers in two categorizes as follow (Udyanin, 2004).

1) *Debt suspension* - The farmers who are authorized for debt suspension have the precise to suspend debt repayment. Farmers also can stop paying interests that have occurred between April 1, 2001 and March 31, 2004. In this scheme, small farmers have an opportunity to join the technical support training and occupation rehabilitation throughout the suspension period.

2) *Debt Burden Reduction* – The farmers who joint the debt burden reduction will receive interest rate compensation at the rate of three% per annum throughout the

entire period of the program and have the right to attend the same training as the farmers authorized for debt suspension.

Gender Mainstreaming

Generally, there is no special gender movement in micro finance system in Thailand. However, some micro finance does take woman as a target to be assisted. One of micro finance that operates in the gender mainstreaming is Credit Union League of Thailand (CULT). CULT is sensitive with the gender issue. CULT attempts to improve the women capacity and enter the decision-maker level. CULT opens for both women and men members.

Credit Union League of Thailand (CULT) was established in 1965 in Bangkok, with support from Father Alfred Bonninque and two Thais. The movement spread gradually and today has established in 48 provinces. As of the end of 1992, total members registered are 94,581. Services provided are savings, credits, and they hold also some reserve (www.gdrc.org).

Unique feature of CULT is its diversity of credit products:

1. Normal credits, intended for purchasing land and cattle, housing, or to create small enterprise
2. Risk-protection for borrowers in case of death or permanent invalidity
3. Life insurance for members who want to save for their old age
4. Provide Risk funds for CULT and its members if fraud or defaults occurred
5. Mutual funds to cover cremation costs
6. Specific programs for women and young people.

However, CULT's revenue has not been sufficient yet to make it released from external aids. It still receives additional funds and supports from any international aid programs. Recent report shows that cost of training activities constitutes 12.8% of total cost being covered. This is all contributed by donations.

Table 5.5
Statistics for Credit Unions in Thailand, 1991

Information	
Credit union cooperatives	816
Members	1,459,879
Savings	19,323,929
Credits	37,621,218
Reserves	1,771,117
Assets	59,241,631
Women in Credit Unions (CULT)	
Women members	37,801
Total members	78,753
Percentage	48

Source: WCCU (www.gdrc.org)

CULT becomes model of cooperatives that run under government supervision. There are also some lessons learned from CULT operation. Motivated by CULT operation, the women participation was increased. The increased of women participation can affect the changes of resources allocation. Women tend to address social infrastructure (for example: schools and water supply) rather than capital construction projects such as roads and buildings. In the other words, women participation enables the faster process in increasing life quality of the poor.

Cooperatives

Cooperatives are regulated by The Cooperative Societies Act B. E. 2511 (1968) and Regulation on the Establishment of Savings and Credit Cooperatives in Communities B. E. 2521 (1978). By law, a cooperative must be comprised of at least 50 members and 500 potential members. No member is allowed more than one-fifth of the total shares (Cooperative Societies Act 11). Compared to BAAC's market, cooperatives serve poorer segments of the rural population.

Credit unions, with a history of 150 years internationally, and plus 30 years in Thailand, were engaged in micro finance before the phrase was commonly used. It could also be argued that credit unions pioneered the concept of combining savings and credit — one must be a share owner and depositor in order to qualify for a credit. Since members' savings and share purchases are usually the only source of funding for credits, credit unions are designed to be self-sustaining, although credit unions sometimes fail due to weak management or adverse economic conditions in the community where the credit union is based.

There are some 1,267 credit unions in Thailand grouped in two organizations: the Credit Union League of Thailand (CULT) with 642 member unions, and the Federation of Savings and Credit Cooperatives of Thailand, Ltd., FSCT, with 625 member unions.

There is no minimum credit size and the maximum credit depends on each credit union's policy. Current interest rates are 12 -15% p.a., and the maximum term is usually three years. Borrowers, who must be members of a credit union for six months before being eligible for a credit, are required to pledge their share capital and provide at least two guarantors. Credits are made to individual members only. Regulations prohibit credits to corporate borrowers.

In each of the past three years "credits for investments" — which represent micro enterprise financing — constituted the largest number and value of the ten categories of new credits made. For example, in 1998 some 1,342 credits totaling approximately 19 million Baht ($514,000) were granted. Credits for investments represented 27% of the number of credits, and 33% of the value. The average credit size in the investment category was 16,925 Baht (or $457). Credits for housing and debt repayment are the next largest categories.

Lending authority is vested in the five-member credit committee. The manager can only approve emergency credits to a maximum of 5,000 Baht, and can lend up to 10,000 Baht provided credits are within 90% of the value of the borrowers' share investment. Current lending rates are 13% for emergency credits and 14% for all other categories. The interest rate on savings deposits and share investments is 5%. The spread is wide because of high "service" costs. This includes life insurance to cover outstanding credits on the death of the borrower, and a further payment of two times the share investment; medical costs for members up to 3,000 Baht each per annum; and death expenses — 10,000 for burial expenses and 3,000 Baht to each immediate family member.

Credit unions are governed by the Cooperative Law administered by the Ministry of Agriculture, with the Cooperative Promotion Department and Cooperative Auditing

Department having direct responsibility. It seems that there are few regulations affecting credit unions - for example the amount of reserves maintained and collateral requirements depend on each Credit Union's policy. There is no effective central bank for members of the Credit Union associations, but there is an "inter-lending" program to enable member unions with excess liquidity to lend to union members elsewhere.

Branch managers have very limited credit approval authority, normally for emergency credits only. Other credits must be approved by the credit committee of each credit union. CULT advised that their credit union members do not report in sufficient detail to enable one to determine how much of the lending is to or for micro enterprises. Credits are classified as "productive", which would include MSEs and credits for self-employment, and "prudential", which would include credits for education, health and general consumption.

Credit unions try and identify the entrepreneurial poor. The process seems to depend on their members building a track record through small initial credits, with the Credit Union providing some training in business planning and management — entrepreneurial enhancement — at an early stage. Credit committees judge the entrepreneurial skills of borrowers, and the committee's judgment determines whether a borrower graduates to the point where her or his needs should only be handled by the formal banking sector.

The credit union movement identified the following issues as most critical for micro-entrepreneurs: lack of marketing skills; no focus on what can be sold; limited ability to build networks; and lack of technical skills, especially in manufacturing which tends to lead to low quality. Finance was not mentioned as the major issue.

As an immediate new source of micro finance, credit unions are likely to have some limitations: growth depends on members building collective deposits, members need to be trained in the credit union principles, and this takes time. Credit unions could be effective in lending for poverty alleviation but less so in lending to smaller businesses. Lack of professional management can be an issue particularly in the assessment of credits for business. A credit committee of peers may not be the best judge of a new business proposition.

The Role of Non-Government Organizations (NGOs) in Micro Finance

NGOs are very active micro finance lenders in a number of economies. NGOs engage in direct lending of funds raised by the organization, and in some cases act as an intermediary for banks. In this case a bank lends to the NGO which on-lends to individual borrowers, and consequently it absorbs the high cost of administering a micro finance portfolio. However, it would appear that NGOs are not active micro finance suppliers in Thailand (see section 4.5 on Banking with the Poor - BWTP - for more information on NGO networks in Thailand).

Thailand has a very significant network of finance institutions, particularly in the rural areas where in other countries NGOs have filled a gap. There may be cultural reasons why there is not the same strong need for NGO finance activities in Thailand. For example, when Grameen Bank was established there was a real need to meet the needs of poverty stricken rural women who were very subjugated by traditional culture. Some suggest that women in Thailand have not been as severely discriminated against and therefore the same need has not been as great.

The important point is that the development of new organizations and institutions is not the main issue in Thailand. It is more a matter of training lenders in existing institutions on how to assess and manage micro finance, and how to address and cater for the needs of the micro enterprise sector.

Guarantee Schemes for Smaller Enterprises

Guarantee schemes represent a well-tested method to assist small enterprises that are unable to meet the usual collateral requirements of commercial banks. The features and principles of successful guarantee program seem to be these: willing and well-run banks; a formula for sharing risks between a guarantee agency and lenders that encourages the latter to participate, but which is also meaningful; clear criteria for credits which qualify for a guarantee, and a straightforward claims process so that there are no undue delays in paying claims.

In Thailand's case, there are differences between the principles commonly applied in other countries and those applied by the Small Industry Credit Guarantee Corporation (SICGC). The formula for risk-sharing as formulated by SICGC - guaranteeing the whole portion of the unsecured credit not exceeding 50% of the total credits with the lender - suggests that borrowers must have at least some conventional collateral. The formula also means that for smaller credits beneficiary banks do not take any risk. In successful schemes elsewhere, some portion of the bank's credit is unsecured and at the bank's own risk.

In successful schemes elsewhere, some portion of the bank's loan is unsecured and at the bank's own risk. This has the affect of building the lending bank's experience in lending to smaller enterprises. Reasonable risk-sharing creates an incentive for the bank to monitor credit servicing and to recognize borrowers who establish a good repayment record. If the bank's risk is fully covered, this incentive may disappear.

Another issue in the case of the SICGC is the potential for conflict of interest. The banks that benefit most from SICGC guarantees are the same banks which own most of the shares in SICGC and which are represented on the Corporation's board. It might be perceived that those who set policy benefit from the policy. With a clear separation between those who own shares and those who benefit from the guarantees, the Corporation could be more pro-active and more forceful in monitoring and expanding its guarantee program.

The approval time – it takes 2 months for a guarantee to be approved – and the claim process – lenders must have a court judgment in order to claim under the guarantee – are other factors that may mean that SICGC is less effective than it might be in encouraging smaller enterprises to pursue this source of support.

5.3 Samples of Field Study

Bangkok Bank

Bangkok Bank is the largest commercial bank in Thailand, and is one of the largest regional banks in South East Asia. Its network of over 600 branches services nearly 10 million customers. The Bank believes that in order to provide outstanding customer service it must make continual improvements in customer service at every level of the organization. To achieve this, the Bank has recently introduced to its management structure four new business units which cater to the needs of key customer segments - Consumer, Business, Commercial and Corporate.

The Bank is supporting these changes with the introduction of new technology to expand its range of products and services and to tailor them to meet the different needs of its diverse customer base. A pioneer in Thai banking, Bangkok Bank has long been synonymous with the progress of the economy. The bank has grown and matured with Thai people and their business interests and today is renowned for its size, stability and partnership approach.

The bank is driving innovation in new products and services and building on its inherent scale advantages to meet the challenges of a changing financial landscape and consolidate its leadership position for the future.

Bangkok Bank has a vision to be the leading financial service provider in Thailand, and to be the leading international bank in South East Asia. We will do this by providing world-class human resources, technology and systems and ensuring that our customers receive superior service for all of their financial needs.

Bangkok Bank recognizes that clients want financial services which are fast, convenient and secure. Even more than that client want the advice and support which will help you to achieve your goals. Our commitment is to become your trusted financial partner and by working closely with clients, we believe as we understand clients more, so we can serve you better.

Bank for Agriculture and Agricultural Cooperative

In 1947 the Bank for Cooperatives was established to serve as a source of funds for the cooperatives that existed in Thailand at that time. The Bank carried out its lending operations until 1966, when it was replaced by a new Bank. The reasons for the change were as follows:

1. The Bank for Cooperatives had no power to provide credit to the majority of farmers who were not members of cooperatives.
2. The Bank did not provide short term credits for crop production.
3. The Bank was not able to consider credit applications.
4. The Bank did not supervise its credits and no government agency carried out this function at that time.

The operations and organization of the Bank for Cooperatives were not internationally known or recognized. As a result the Bank did not have access to foreign sources of funds and suffered from a shortage of capital.

For these reasons, in 1966 the government established the Bank for Agriculture and Agricultural Cooperatives (BAAC) as a state enterprise under the jurisdiction of the Ministry of Finance. The BAAC's mission was to extend credit more widely, directly to individual farmers as well as through farmer institutions.

BAAC has started its operation since 1966. BAAC applied the Corporate Plan, the framework of operational guidelines, for its mission implementing and service offering for the first time in the fiscal year 1985. The Third Corporate Plan (1995 - 1999), the latest one having been use, enabled BAAC to expand its service activities and improve the organization development and technologies to grow at a greater range than in the duration of the second one. A major obstruction was the economic crisis broken out in the late 1996, which hit the Bank financial and operation status. BAAC, then, had to dump its existing resources during such period in order to adjust itself and solve the situation to prepare readiness and strength for its next phase operation.

The operating principle policies and strategies specifies in consistent with the vision, mission and main objectives. The specification is based on the SPAK principle (S = Sustainability, P = Participation, A = Accountability, K = Knowledge) as the mover. Each theme of the plan can be classified as follow:

1. Credit and Services
BAAC applies strategies to expand agricultural credit and increase its role on non-farm credit within the framework of BAAC Act carefully and qualitatively. At the same time, the Bank accelerates to systematically and totally solve the credit-in-arrear problems. In addition, there shall be an improvement and application of effective credit system in servicing and building up close relationship with the customers. There shall be also the increases of credit products and channels of services through allies network or farmer community organizations without negligence to the reservation of natural resources and environment.

2. Banking and Servicing
BAAC shall apply strategies to construct a small-scale individual deposit base in coincidence with the development to technologically modernize the deposit products and service network systems. Furthermore, the Bank shall increase the opportunities and channels for additional income and take a joint venture with the business allies networks.

3. Finance and Investment
BAAC shall carefully apply the strategies of financial policy and increase the business operating opportunities. The Bank shall also increase services and carry out new transactions while maintaining the stability generally accepted and assured.

4. Organization and Technology Development
BAAC shall apply the IT Master Plan as a principal for development to enter the Electronic Banking in coincident with the construction of communication system and good coordination to increase the service efficiency. Besides, the Bank shall develop the modernized system and networks of data center to be able to link with all data bases throughout the internal and external organizations.

5. Human Resource
BAAC shall utilize strategies to manage and develop the human resource to pursue a desirable criterion under transparent and fair circumstances and in consonance with management and changes. This shall be based on the Master Plan of the human resource. Additionally, the Bank shall use strategies to promote teamwork for joint responsibility, to build up working atmosphere that accommodates the use of capability and enhances the potentials of staff including to embed them with the working merits, integrity and ethics.

6. Sociality and Environment
BAAC shall participate in the utilization of natural resources and the sustainable reservation of environment by the following measures: expanding its role to jointly develop the farmer life quality; providing services that reduce but not promote the destruction of environment or the services that promote the substitution of the natural resources consumed; and finally, supporting to strengthen the role of farmer organizations and take more participation in BAAC activities.

Bank of Ayudhya Public Company Limited (BAY)

Bank of Ayudhya Public Company Limited (BAY) was established on 27 January 1945 in Ayudhya Province, once a capital city of the Thai Kingdom, and commenced operations on April 1 in that same year, starting with a capitalization of only one million Baht. The Bank's head office was initially based in Ayudhya but was moved to Bangkok, within a year of the Bank's establishment at the corner of Ratchawong Road and was relocated to Anuwong Road in 1948 and Lamphun-chai Road in 1950.

When the Bank's business prospered, its headquarters was moved to Ploenchit Road in 1970 to accommodate the growing number of customers. The Bank's Ordinary Shares have been publicly listed on the Stock Exchange of Thailand since September 26, 1977 and registered as a public limited company in Thailand under the Public Limited Company Act B.E. 2535 (1992) on 28 September 1993 with an authorized share capital of 8 billion Baht and an issued and paid-up share capital of 4 billion Baht.

In 1996, the Bank moved its new headquarters to the present location at 1222 Rama III Road, Bang Phongphang, Yan Nawa, Bangkok 10120 and commenced its banking services on 30 May 1997. The Bank raised its paid-up capital through rights issues from 4 billion Baht to 5 billion Baht in July 1996 and again from 5 billion Baht to 10 billion Baht in June 1998. On 11 October 2005, the Bank's paid-up capital increased to Baht 28,708,515,860.

Bank of Ayudhya Public Company Limited ("BAY") is the sixth largest domestic commercial bank in terms of asset size in Thailand. As of Year Ended December, 2004 BAY had total assets of 568,390 million Baht, credits outstanding of 415,108 million Baht and deposits of Baht 492,365 million.

BAY had the fifth largest branch network among domestic commercial banks, with 438 branches and its Head Office located throughout Thailand. Of BAY's domestic branch network, 182 branches located in Bangkok and Metropolitan area. In addition to its domestic branch network, the Bank has four overseas branches, Hong Kong, Vientiane, Lao P.D.R. and the Cayman Islands.

BAY provides a full range of retail and corporate banking services to both its corporate and individual customers including:

1. Deposits services : savings , time and current checking accounts
2. Lending services
3. Bills payment services
4. Foreign exchange services and trade financing
5. Investment banking
6. Money transfer
7. Electronic banking

In addition, BAY has always placed importance on the development of products and services so as to provide greater convenience for BAY's customers.

Krung Thai Bank Public Company Limited

Krung Thai Bank Public Company Limited began its operation on 14 March 1966 through the merger of business between the Agricultural Bank Limited and the Provincial Bank Limited with the Ministry of Finance as its major shareholder. The bank was then named Krung Thai Bank Limited and enjoyed the juristic person status of a state enterprise, attached to the Ministry of Finance. "Wayupak Bird", the official seal of the Ministry of Finance was thus adopted as the bank's logo. In the early stage of founding the bank had 4,442.2 million Bath in deposits, 4,582.1 million Bath in worth of assets, Bt 105 million in registered capital, 81 branches and 1,247 personnel.

The headquarter was located on Yawaraj Road in Bangkok Later the bank's operation expanded more and more resulting in its relocation of the head office to No 35, Sukhumvit Road, Bangkok on 26 November 1982. This venue has been used as the Bank's head office until present. In 1982, it was the first to open a foreign branch at New York, in an attempt to expand the international business network in response to customer demands. In March 1987, the bank was entrusted by the Government to administer the "4 April Project" in succession of the Bank of Thailand with the purpose to solve financial problems - experienced by some Thai financial institutions. Later on 17 August 1987, the administration of the assets and liabilities of the Sayam Bank Limited were transferred to Krung Thai Bank Limited in accordance with the policy of the Ministry of Finance as a result of financial problems encountering the Sayam Bank Limited. As of 1988, the bank was the only commercial bank with 288 branches operating in all provinces of Thailand while emphasizing on the opening of new branches in the outer perimeters where the economy expanded. And also in June 1988, the bank was regarded as the first commercial bank that could install the ATMs in all 73 provinces nationwide.

Later on 26 June 1989, the bank's shares were introduced into the Stock Exchange of Thailand. It was thus regarded as the first state enterprise listed on the stock exchange for trading of its shares. Since 2 August 1989, the bank's shares have been traded on the stock exchange.

On 24 March 1994, the bank was registered to become a public limited company, called in English as "Krung Thai Bank Public Company Limited." On 1 October 1995, the bank was granted the status of "Group 1 State Enterprise", aiming for quality services to its customers comparable with other leading commercial banks in Thailand.

At the end of 1996, The Krung Thai Bank PCL.'s largest shareholders were still from the public sector with the Ministry of Finance holding 30.80%, the Financial Institutions Development Fund 29.97%, and the remainder hold by legal entities, individuals and the Crown Property Bureau at 35.70, 3.26 and 0.97% respectively.

Currently the bank is operating 511 domestic and 12 foreign branches and representative offices. It pursues the key policies focusing on valued services to the clients, quality credit extension, efficient budget management, and good quality of life for its employees.

Today, Krung Thai Bank PCL. does not only the Bank provide financial assistance to many businesses, large and small, it also renders financial assistance to other state enterprises, both business oriented and public utility types. As the government's only commercial bank, Krung Thai Bank pays the benefits reaped from its business transactions to the government in the form of taxes, but it also pays dividends to the Ministry of Finance, and engages in many aspects of social, educational and religious life.

Government Saving Bank (GSB)

Later, in 1946, the Government Savings Bank Act B.E. 2489 (1946) was issued on 18 December 1946 to transfer the Savings Office to be under the Ministry of Finance and renamed the Office the Government Savings Bank (GSB), to take effect from 1 April 1947, which was the first year of King Bhumibol Adulyadejs reign. This Act, in fact, brought about a genuine savings bank for Thailand as practiced in other countries. The Banks main objective was to promote social well-being in terms of assets which was to be achieved by offering the service in safeguarding the people money, at the same time, generating reasonable returns on the deposited money for the depositors. The GSB was set up as a juristic person, to be operated independently under the supervision of the Board of Directors appointed by the Finance Minister.

Subsequently, in 1998, the Government issued a Royal Decree on the Modification of the GSB’s Functions (No. 2) B.E. 2541 (1998) to allow the expansion of the GS’s operations to accommodate the development of financial instruments and businesses as well as the emergence of recent financial innovations. The Decree has allowed the GSB to be engaged in such non-traditional services as foreign exchange, financial consulting, issuing of letters of guarantee and avail, with the aim to better serve the growing needs of its customers.

GSB’s vision is to be a leading financial institution that provides quality and impressive services to people from all walks of life, by the year 2007, through the practice of good governance and the employing of cutting edge technology.

The vision of the GSB has been recently modified:
- To be the Bank of the People's Choice
- To be a leading financial institution that provides quality and impressive services to people from all walks of life, by the year 2007, through the practice of good governance and the employing of cutting edge technology.

Its new vision reflects that the GSB recognizes the significance of developing its products and services as well as its service channels with the aim to deliver convenient, speedy and effective services to satisfy the needs of its customers and the general public. This will be achieved by ways of modernizing its information technology system and employing highly qualified and committed staff. This is also in line with the Bank's philosophy, which aims for the prosperity of the Bank, benefits for the society and contentment of the staff.

While gearing towards retail customers to support the Government's economic and social development policy, the GSB has also tried to be responsive to the needs of other groups of its diverse customers. Thus, its financial services, namely deposit, credit and other services, have been constantly developed and diversified to accommodate such varied needs, without compromising the mission that it has committed to from the beginning. The GSB offers a wide range of products and services to its customers as the following.

Savings services
Services of the GSB
The promotion of savings habit can help sustain a solid national savings base, which provides a significant basis for national investment and sustainable economic development as it helps alleviate the economy's dependency on foreign investment. The GSB has constantly developed a variety of attractive savings services in order to satisfy the complex needs of customers from all professions and age groups. Some examples are its wide range of ordinary deposit services as well as the premium savings certificates. All types of the GSB's savings accounts can be put up as collateral on credits or overdraft. In addition, the GSB's fixed deposits accounts and premium savings certificates can be used to secure a bail for a person.

Ordinary deposits
There is no limit on transactions made in each day. Interest is accrued on a daily basis and is tax-exempted. Account holders can make transfer between their savings and current accounts. Payment of public utility bills can also be debited from a savings account. In addition, scholarships are available for children aged under 15.

Endowment and Life Annuity Insurance
This type of insurance guarantees an income which is generated from the deposits over the lifetime of the insured. Two types of endowment and life annuity insurance are offered, with dividends and without dividends.

<u>Islamic Banking Services</u>
Islamic banking services are offered to meet the needs of depositors who wish to save up or make investment in compliance with Islamic principles. On-line Islamic banking services, however, are offered at every GSBûs branch nationwide to any customers regardless of their gender and religion.

The following deposit services are offered:
1) AL Wadiah, to safeguard the depositors' savings.
2) AL Qard and AL Hassan, to promote savings among the Muslim Thais and to encourage them to practice religious rites.
3) AL Mudharabah, to generate return on investment for the account holders.

The GSB will generate income from the deposited money from these accounts by investing only in non-interest businesses to comply with Islamic principles.

Services for the Society and Communities
The GSB is committed to providing extensive services to the people from all walks of life. The community-based organizations are, thus, among the priorities that the GSB intends to help strengthen so that they can become self-reliant. The following social-oriented services and credit programs are offered by the GSB:

The People Bank Project
The People Bank Project offers short-term credits for small entrepreneurs or employees who wish to have supplementary occupation to raise their income. The unemployed who wish to start up a small business are also eligible to apply for a credit from this Project.

Services for the Public Sector
The GSBs role as the Bank for the Public Sector has been its main mission since its establishment. Financial support has been given to the Government and state enterprises in the form of credits and investing in the bonds and promissory notes issued by the Government or state enterprises to finance various development projects at the national scale.

Services for the General Public
The emphasis of the GSB has been on providing services that help improve the quality of life of people and services that are responsive to the needs of people from all walks of life, yet having reasonable requirements.

Phone Banking Services
The 24-hour service Om-sin phone 1115 provides information relating to the GSB's businesses and services. Information provided are, for example, details about deposit services, winning numbers for the premium savings certificate prize draws, interest rates, credit services and other special services. Payment Services various types of payment services are provided, for example, telephone bill payment, insurance premium payment, registration fee payment, third-party insurance premium payment, public utility and communications bill payment. The payment can be made in cash or direct debit from the customers' savings accounts.

Services for Businesses
The GSB offers credit and overdraft services for business organizations as well as co-invest with large, medium- and small-enterprises.

Credit for Businesses in Rural Areas
To promote investment in local communities, credit services are offered through the Credit Project for Industrial and Commercial Production and Service Industry. Real estate and agricultural businesses are, however, not eligible to take out credits from this Project. Borrowers can be individuals or juristic persons.

<u>Credit for MSEs</u>
Long-term credit and overdraft are offered for MSE owners to promote the undertaking of MSEs. Eligible businesses to apply for MSE credits are industrial production business, agricultural business, service business as well as wholesale and retail businesses.

<u>Credit for Shop-house Businesses</u>
Long-term credit is provided for the use as revolving fund or investment in building, machinery, vehicles and other tools or instruments necessary for production.

Credit for Savings Cooperatives
Credit is offered for savings cooperatives and credit unions for the use as revolving fund.

Credit for Educational Institutions
Long-term credit and overdraft services are provided for educational institutions to support them in various educational undertakings.

Wide Ranging Service Channels
Through its branches and other service channels scattered throughout the economy, the GSB offers a wide range of service channels, namely the GSB branch offices, community bank branches, points of sale, school-based banks, e-banking services, electronic cards, phone banking and ATMs installed at its branches, shopping complexes and other public areas. Customers of the GSB can conveniently access its services through such diverse channels, whichever suits their needs and lifestyles.

Advancing through Modern Technology
To be responsive to the modern and fast-pace life style of the new generation customers, modern technology has been employed to build up a network for on-line services with the aim to satisfy the customers with convenient and speedy services. Some of the GSBs on-line services available now with simple procedure are deposit and credit services, services through the internet and e-banking services which do not restrict the time and location in accessing the Bank's services. Additionally, at the branches regularly visited by a large number of customers, a self-service system is installed to offer another alternative to the customers.

Chapter 6

THE PHILIPPINES

The Need and Availability of Micro Finance Service for Micro Enterprise: Bringing Multi-Level Good Practices into Local Context

(Case Study: Indonesia; Malaysia; Mexico; Thailand and the Philippines)

6.1 The Philippines's Macroeconomic Condition

The Philippines' Macroeconomic Conditions and Its Impact on MFI

As of 2002, there were 76.5 million Filipinos, roughly 40% of whom live below the poverty line, which is defined as an income level of PhP[1]100 (less than USD 2.00) a day. With birth rate of 2.36% in a predominantly Roman Catholic economy, the population could easily reach 82 million this year (2005). Poverty is also one of the main causes for high dropout rates at the primary, secondary and tertiary levels. "Out of 100 pupils who enter Grade 1, only 56 reach Grade 6, 23 will finish high school and only 14 will complete a college course. But having a college education does not automatically ensure employment." (Patanne, 1991, p. 4).

To alleviate poverty in the early 90s, Government provided credit directly to the borrowers through specialized banks, including government financial institutions. It used funds from government budgetary appropriations, the Central Bank rediscounting window, and foreign borrowings. Additional financial and non-financial support from foreign donors encouraged more NGOs to go into micro finance. However, Government made funds available at highly concessional rates. The availability of cheap loan funds eventually led to credit rationing, high loan defaults, and neglect in deposit mobilization (DOF, 2005). Moreover, it cost Government an estimated PhP2.00 to monitor each PhP1.00 loan that it released (Jimenez, 2005) compared to PhP0.18 to PhP0.23 reportedly incurred by the private sector for every PhP1.00 in micro finance loans (Chua et al, 2003).

The Philippines' Government Policy and Its Impact on MFI

To correct the situation from being supply-driven to demand driven, Government (DOF, 2005):

1. Adopted market-oriented interest rates
2. Ended subsidized rediscounting programs at the Central Bank

[1] Peso Phillipines

3. Consolidated existing agricultural credit programs into the Comprehensive Agricultural Loan Fund and used this as a loan guarantee fund for agricultural loans granted by banks
4. Stopped direct lending by government agencies implementing agricultural credit

To institute reforms in micro finance, Government passed several measures supportive of MFIs (DOF, 2005, pp. 1-3):

Executive Order No. 138 (10 August 1999) which:
1. Transfers direct credit programs of government line agencies to Government Financial Institutions (GFIs)
2. Discontinues interest rate subsidies that distort the financial market
3. Requires GFIs to provide wholesale credit funds to avoid competing with MFIs
4. Uses sustainable community-based private MFIs in the delivery of micro financial services

Republic Act (RA) 8425 (30 June 1998) [which, by amending certain provisions of the] Social Reform and Poverty Alleviation Act,
a. Rationalizes government directed credit and guarantee programs
b. Emphasizes savings mobilization
c. Provides capacity-building assistance to MFIs but to exclude any and all forms of seed funding, equity infusion and partner funds from government to MFIs

RA 8425 (30 June 1998) [which, by amending certain provisions of the] Agriculture and Fisheries Modernization Act,
1. Consolidates government directed programs in the agriculture sector into the Agro-Industry Modernization Credit and Financing Program (AMCFP)
2. Adopts market-based financial credit policies
3. Uses GFIs as wholesalers of funds
4. Uses private sector MFIs as conduits and retailers of funds

RA 8971 or the General Banking Law of 2000 (GBA):
1. Recognizes the peculiar characteristics of micro finance such as non-collateralized
2. Uses the household's cash flow as basis in the design of micro finance products

Bangko Sentral ng Pilipinas (BSP) Circular 272 (30 January 2001), which provides the guidelines in implementing the micro finance provisions in the GBA, specifying among others that:
1. The maximum principal amount of micro finance loans shall not exceed P150,000.
2. Loan amortization shall consider the projected cash flow of the borrowers and may be done daily, weekly, bi-monthly or monthly.
3. Subject to certain criteria, the MFI may not require from its borrowers the submission of assets and liabilities and income and expenditures
4. Subject again to certain criteria, the BSP exempts the MFI from rules and regulations which may be issued by the Monetary Board on unsecured loans

BSP Circular 273 (30 January 2001), which
1. Partially lifts the general moratorium on the licensing of the new thrift and rural banks to allow the entry of micro finance-oriented banks, preferably in places not fully served by existing rural banks or in areas not fully serviced by micro finance-oriented banks,
2. Provided that at least 50% of the bank's gross loan portfolio at all times shall consist of micro finance loans

BSP Circular 282 (19 April 2001) which provides guidelines for the rediscounting facility for rural banks and cooperative banks in order to give liquidity assistance to support and promote micro finance programs.

BSP Circular 340 (5 August 2002), which lifts the moratorium on bank branching for MFI banks.

BSP Circular 409 (1 January 2004), which

1. Prescribes rules, regulations, and standards governing micro financing operations of banks
2. Adopts portfolio-at-risk as a measurement of delinquency for micro finance loans and for providing allowances for probable loan losses

RA 9178 or Barangay Micro Business Enterprises (BMBE) Law, which requires
1. GFIs to set up a special wholesale credit window for accredited MFIs
2. private sector MFIs will, in turn, directly provide credit support to micro enterprises
3. Small Business Guarantee and Finance Corporation and Quedancor to provide the necessary credit guarantee cover to BMBEs

These reforms resulted in growth on several fronts:
1. From 1996 to January 2003, People's Credit and Finance Corporation's (PCFC) wholesale portfolio grew by 60% per year and stood at PhP1.98 billion as of end January 2003.
2. As of 31 January 2003, PCFC, through its micro finance intermediaries, reported extensive coverage in the Philippines: 100% of the provinces, 99% of the cities and 72% of the towns [although its presence was weak in two regions].
3. PCFC worked through 77 rural banks, 63 cooperatives, 33 non-governmental organizations (NGOs) 37 cooperative banks, two thrift banks and one lending investor. In June 2003, the Bangko Sentral ng Pilipinas (BSP) reported that 119 rural banks were engaged in micro finance, with 363 branches reaching close to 400,000 borrowers who had loans outstanding of PhP2.2 billion. Rural banks now account for over 50% of MFIs, a sector which NGOs initially dominated. The sector's growth was fuelled primarily by the entry of private sector players. (Chua et al, *op. cit.* pp. x-xi)

What has evolved also from the same directives is the structure below.

Wholesale Fund Providers
- Commercial Banks
- Government Financial Institutions
- Foreign Donors

↓ ↑

Microfinance Institutions
- Rural & Thrift Banks
- Credit Cooperatives
- Microfinance NGOs

↓ ↑

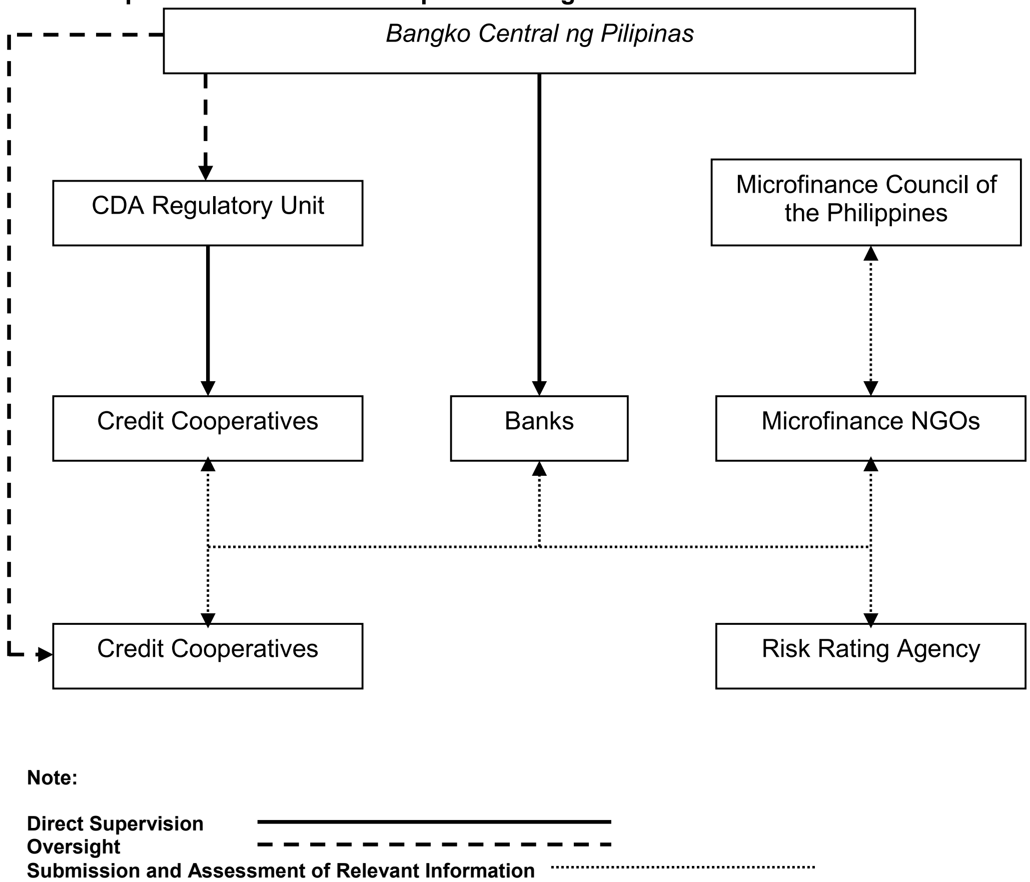
Microfinance Borrowers

Such is the flow of funds, but in terms of regulatory functions, no single government entity covers all the MFIs involved. The BSP regulates all banking institutions. However, the Cooperative Development Authority (CDA) oversees all types of cooperatives, including credit cooperatives. Although mandated by law, the CDA neither supervises nor examines their books. As for Micro Finance NGOs, these are registered with the Securities and Exchange Commission (SEC) but these are neither regulated nor supervised by the SEC.

To regulate micro finance, the following institutional set-up has been proposed, with the CDA establishing a regulatory and supervisory unit (Figure 6.1). In a related move, the CDA has placed on its web page -- www.cda.gov.ph -- the following for all cooperatives to follow: (1) a standard chart of accounts, (2) an accounting manual, (3) performance standards, and (4) accounting and financial tools which was developed by the Technical Working Group (TWG) of the Department of Finance's National Credit Council (NCC) – of which the CDA is a member. Included in this set-up is the Micro Finance Council of the

Philippines functioning as the repository of information of all MFIs and working towards the establishment of a credit bureau and a risk-rating agency for micro finance.

Figure 6.1
Proposed institutional Set-Up for the Regulation of Micro Finance



In addition, the NCC, developed through its TWG, a set of performance standards for all types of micro finance institutions, as follows:

Portfolio Quality. This set of indicators provides specific information on the state of financial health of the micro finance portfolio of the institution. Maintaining good portfolio quality is very important for continued delivery of micro finance services to the MFI's clients. Poor quality of loan portfolio will lead to losses to the institutions, making it difficult to sustain micro finance operations. There are two indicators under this set. These are:

- Portfolio at Risk (PAR) Ratio. The proportion of the micro finance loan portfolio with one day missed payment to the total micro finance loans outstanding at a given point of time and shows the degree of risk of the total micro finance portfolio. Since micro finance loans are usually very small and are paid using very low amortization payments within a short period of time, the likelihood of default of the entire loan balance is great when one amortization payment is missed, with one day missed payment to the total micro finance loans outstanding at a given point of time and shows the degree of risk of the total micro finance portfolio. Since micro finance loans are usually very small and are paid using very low amortization payments within a short period of time, the likelihood of default of the entire loan balance is great when one amortization payment is missed.

Formula:

$$\frac{\text{Balance of Loans with at Least One Day Missed Payment}}{\text{Total Loans Outstanding}}$$

- Loan Loss Reserve Ratio, the degree of protection of the institution against expected losses due to delinquency. An allowance should be provided once the micro finance loan is considered at risk, since the likelihood of default increases as amortization payments are missed. Hence, allowance for probable losses is based on portfolio at risk. Restructured and refinanced loans are considered as non-performing and should be provided the appropriate allowance.

The following shall be the basis in computing for the total required allowance for loan loss reserves:

Time Frame	**Loan Loss Reserve**
Current	1%
Par 1 to 30	2%
Par 31 to 60 and/or loans restructured once	20%
Par 61 to 90	50%
Par 91 and above and/or loans restructured twice	100%

Formula:

$$\frac{\text{Balance of Loans with at Least One Day Missed Payment}}{\text{Total Required Allowance}}$$

Standard: 100%

Efficiency. The indicators under micro finance services at the least cost to the institution. They also indicate this category show whether the MFI is able to deliver he ability of the institution to generate sufficient income to cover expenses related to the micro finance operations.

- Administrative Efficiency, measures the cost of managing the organization's assets.

Formula:

$$\frac{\text{Administrative Costs (direct and indirect costs)}}{\text{Average Gross Loan Portfolio}}$$

Standard: 10% and below

Notes: Administrative costs should include loan loss provision expense.
Average Gross Loan Portfolio = (Beginning Gross Loan Portfolio + Ending Gross Loan Portfolio) / 2

This ratio allocates indirect costs in proportion to the number of personnel directly dedicated to each cost center. The formula for MF indirect costs is:

Formula:

$$\frac{\text{Number of Full-time MF Staff}}{\text{Total Number of Personnel}} \times \text{Total Indirect Costs}$$

Standard: 10% and below

Notes: Full-time MF Staff refers to those working full-time in micro finance operation regardless of employment status.

Total Indirect Costs refer to all personnel and non-personnel costs shared by both micro finance and non-micro finance operations. It includes salaries and benefits, rent, office materials and supplies, publications and publicity, transportation, travel and training for overhead staff, telephone and postage, insurance, utilities, repairs and maintenance, legal, audit and consultant fees, bank charges, taxes and depreciation.

- Operational Self-Sufficiency, which indicates whether or not enough revenues have been earned to cover the organization's costs.
  Formula:

$$\frac{\text{Interest Income from Loans + Service Fees + Fines,Penalties,Surchages}}{\text{Financing Cost +Administrative Costs (direct and indirect costs)}}$$

  Standard: Greater than 120%
  Notes: * Administrative cost should include loan loss provision expense

- Loan Officer Productivity.

  Formula:

$$\frac{\text{Number of Active Borrowers}}{\text{Number of Account Officers}}$$

  Standard: For Group – greater than or equal to 300
  For Individual – greater than or equal to 150

Sustainability. The set of indicators measures the ability of the institution to generate sufficient revenues to cover the costs of its operations in the long run without any subsidy.

- Financial Self-Sufficiency, which indicates whether the organization is earning enough revenue to sufficiently cover in the long-run all operating costs and at the same time maintain the value of its capital and assets, without the need for subsidy.

  Formula:

$$\frac{\text{Operating Revenue}}{\text{Financial Expense + Loan Loss Provision Expense + Adjusted Expenses}}$$

  Standard: Greater than 100%

  Note: Adjusted Expenses = Total Operating Expenses + [(Average Equity – Average Fixed Assets) x Inflation Rate] + [(Market Interest Rate x Average Total Liabilities) – Actual Interest Expense] + Other Implicit Costs. Other Implicit Costs include those costs relevant to the conduct of its business such as grants, rent free building, donor paid technical adviser, or other subsidized expenses.

- Loan Portfolio Profitability, which measures the proportion of net revenues generated from the MF lending operations to the total loan portfolio to determine whether such ratio can sufficiently cover the annual depreciation rate of the peso.

  Formula:

$$\frac{\text{Net Operating Income}}{\text{Average Net MF Loan Portfolio}}$$

  Standard: Greater than the inflation rate during the period

Outreach. These indicators show the extent and depth of reach of the MFI. The extent of outreach is reflected by the growth in the number of the active clients (referring to those with outstanding MF loans with the institutions) and growth of micro finance portfolio. The depth of outreach is indicated by the ratio of the average loan size to the GNP per capita.

- Growth in Number of Active Micro Finance Clients, which measures the ability of the MFI to expand its operations through increases in their active clients.

  Formula:

$$\frac{\text{Ending No. of Active MF clients - Beginning No. of Active MF Clients}}{\text{Beginning No. of Active MF Clients}}$$

  Standard: Increasing

  Note: Active MF clients are those with savings and/or loans

- Growth in Micro Finance Loan Portfolio, which determines the rate of expansion of the MF loan portfolio that may be a result of an increase in the number of clientele or in the loan size amounts granted or a combination of both.

  Formula:

$$\frac{\text{Ending MF Loans Outstanding - Beginning MF Loans Outstanding}}{\text{Beginning MF Loans Outstanding}}$$

  Standard: Increasing

- Depth of Outreach, which indicates whether the MFI has provided the necessary micro financial services to the lower segments of the poor.

  Formula:

$$\frac{\text{Total Loans Outstanding / Total Number of Borrowers}}{\text{GNP per Capita}}$$

  Standard: Not exceeding 20%

RATING SYSTEM

Portfolio Quality (40%)

- Portfolio At Risk

Score	Equivalent Points
5% or less	20
> 5% to 10%	15
> 10% to 15%	10
> 15% to 20%	5
Above 20%	0

- Loan Reserve Ratio

Score	Equivalent Points
100%	20
70% to < 100%	15
50% to < 70%	10
30% to < 50%	5
Below 30%	0

Efficiency (30%)

- Administrative Efficiency

Score	Equivalent Points
5% or less	10
> 5% to 10%	6
> 10% to 15%	4
> 15% to 20%	0

- Operational Self-Sufficiency

Score	Equivalent Points
100%	10
70% to < 100%	8
50% to < 70%	6
30% to < 50%	4
Below 30%	2
	0

- Loan Officer Productivity
  - For Group Loans

Score	Equivalent Points
300 and above	5
250 to 299	3
200 to 249	1
Below 200	0

  - For Individual Loans

Score	Equivalent Points
150 and above	5
100 to 149	3
50 to 99	1
Below 99	0

Sustainability (15%)

- Financial Self-Sufficiency

Score	Equivalent Points
100% and above	10
95% to < 100%	8
90% to < 95%	6
85% to < 90%	4
80% to < 85%	2
Below 80%	0

- Loan Portfolio Profitability

Score	Equivalent Points
Greater than inflation rate	5
Equal to inflation rate	3
Less than inflation rate	0

Outreach (15%)

- Growth in Number of Active Micro Finance Clients

Score	Equivalent Points
5% or higher	5
0 to 5%	3
Below 0	0

- Growth in Micro Finance Loan Portfolio

Score	Equivalent Points
5% or higher	5
0 to 5%	3
Below 0	0

- Depth of Outreach

Score	Equivalent Points
< 20%	5
> 20% to 100%	4
>100% to 150%	3
>150% to 200%	2
> 200% to 300%	1
Above 300%	0

Although compliance is not mandatory, these can be used in various ways; management can use these indicators and standards in identifying weak areas in their micro finance operations and determining the appropriate measures to improve operations. Domestic and international private sector investors can use these standards as guideposts in deciding whether they will invest in a certain MFI or not. Wholesale financial institutions, whether private or government can use these standards in assessing the creditworthiness of MFIs; while donor agencies, in identifying the type of assistance for a specific MFI. (DOF, 2005).

The Philippines' Sociocultural and Its Impact on MFIs

Among the poor, anywhere from 600 thousand to one million have access to micro finance services. (Charitonenko, 2003). A separate research apparently confirms this estimate (Table 6.1)

Table 6.1
Estimated Outreach of Micro Finance Organizations, 1995

Institution	Estimated Number	Average Loan (Pesos)	Average Reach (Number of Individuals)	Total Reach (Number of Individuals)
Development NGOs	150	4,000	150	22,500
Grameen NGOs	40	2,000	500	20,000
Mature Credit NGOs	30	5,000	1,000	30,000
Beginning Credit NGOs	100	4,500	250	25,000
Cooperative Banks	42	21,700	2,000	84,000
Credit Cooperatives	1,500	10,000	300	450,000
People's Organizations	500	3,500	50	25,000
Total	**2,362**			**656,500**

Note: Excluded are rural banks due to lack of information on micro finance
Source: Chua and Llanto (1995) as cited in Llanto (2000)

But whether rich or poor, the Filipino character is rooted in the following: "(1) the family and home environment, (2) social environment, (3) culture and language, (4) history, (5) the educational system, (6) religion, (7) the economic environment, (8) the political environment, (9) mass media, and (10) leadership and role models." (Senate Committees, 1988). What have emerged from these are strengths and weaknesses in the Filipino character. The strengths are: (1) *pakikipagkapwa-tao* (a shared harmonious relationship marked by proper dealings, empathy and the ability to get along with others), (2) family orientation, (3) joy and humor, (4) flexibility, adaptability and creativity, (5) hardwork and industry, (6) faith and religiosity, (7) ability to survive. On the other side of the coin, the negatives are: (1) extreme personalism, (2) extreme family centeredness, (3) lack of discipline, (4) passivity and lack of initiative, (5) colonial mentality, (6) *kanya-kanya* (to each his own) syndrome, (7) lack of self analysis and self reflection.

For the sake of brevity, only a few will be discussed considering their influence on MFI operations. Since the focus is on the enterprising poor, MFIs look favorably on those who show (1) abilities to accept change and to improvise and make use of whatever is available to make and sell, (2) capacity for hard work under proper conditions, and (3) daring and optimism as a result of one's faith. What are MFIs up against? The weaknesses in the Filipino. These are: (1) lack of discipline which is manifested in violation of rules and a casual work ethic, (2) passivity where there is lack of urgency and they expect others, including government authorities, to do things for them, (3) the *kanya-kanya* which is a selfish, self-serving attitude.

By and large, some of the so-called best practices of MFIs covered by this study are culture-based. They communicate in the national language or major dialect with the poor, who in the main have have only had either some elementary or high school education. To address the negatives, values orientation is one of the topics in their initial and required seminar. To instill credit discipline, they adopt zero tolerance for delayed loan repayments. To make savings a habit among their borrowers, they make this mandatory and form part of the weekly loan and inte0rest collections. Since the Filipino tends to be individualistic, one MFI modified its group lending program to allow individual borrowers to be accountable solely for what each one personally borrowed – without removing peer pressure on members who fail to pay their amounts due. Since the enterprising poor, with their family orientation, tend to use their working capital for personal emergencies, such as sickness and school tuition; several MFIs have added hospitalization insurance and educational loans to their financial services.

6.2 History of Microfinance Services in the Philippines

Institutions that offer micro finance fall into three categories: rural banks, cooperatives, and NGOs. Among these, cooperatives have the longest history – having started in the early 1900s, followed by rural banks in the 1952 through the passage of the Republic Act 720, otherwise known as the Rural Banking Act and NGOs which began extending micro credit in the1980s. However, their performance over the years had its ups and downs.

In the case of rural banks, government interference nearly caused their demise. Through incentives and moral persuasion, the Government convinced rural banks to participate in numerous direct credit programs that encouraged risky lending practices. One of the most extensive agricultural extension programs, *Masagana 99*, wrecked havoc on the rural banking system – rural banks served as the major conduit of unsecured loans to small rice farmers during the 1970s. BSP allowed the banks to rediscount 100% of the loan values at 1% per year; the loans already had low interest rates of 10-12% per annum. Furthermore, BSP allowed [them] to exclude arrears under the *Masagana 99* program in their computation of past-due ratios. This allowed [them] to continue to borrow from BSP when their past-due ratios had exceeded the normal 25% limit.

The rural banks complied with the Government's request for their participation partly as a result of the threat that new rural banks would be allowed to open in their geographic territory if they did not participate. In addition, rural banks suffered [from] high inflation, a liquidity crisis, trade imbalances, and large fiscal deficits. These led to tight monetary policies in the early 1980s. In 1984, the rural banks' major source of credit funds, BSP's rediscount window dried up and rural banks' real assets dropped substantially. The highest rate of rural bank failures occurred [during the period] when 182 rural banks closed.

The Countryside Financial Institutions Enhancement Program of 1991 aimed to rehabilitate the rural banks and restore risk asset ratios to at least 10% for these rural banks that could infuse sufficient additional capital. This program, as well as the passage of the revised Rural Bank Act of 1992, reversed the negative trends of the past (Charitonenko, pp. 12-13).

Chronology of Developments In the Cooperative Movement

Cooperatives, on the other had, had its beginnings, as shown by the following chronology of events (CDA, 2004):

First Wave: During the American Regime

1907 - A Rural Credit Cooperative Bill (RCCB) was introduced by Bulacan Governor Teodoro Sandico before the Philippine Assembly.

1908- The RCCB was disapproved by the Philippine Commission.

1915- Rural Credit Act (Act No. 2508) filed by Zambales legislator Rafael Corpuz was enacted in February 5. It was the first cooperative law in the economies and was patterned after German cooperatives based on the Raiffeisen experience. It promoted the organization of rural cooperatives.

1916- Credit Act was amended and cooperative administration was given to the Bureau of Agriculture.

1919- Act No. 2818 was enacted primarily to grant loans to members of rural credit associations. The PhP1 million fund appropriated for rice and corn production under the law spurred the organization at the end of **1926**- of 544 rural credit coops in 42 provinces. The coops failed and the loans were never repaid.

1927- The Cooperative Marketing Law (Act No. 3425) was passed, giving the Bureau of Commerce and Industry the responsibility of organizing farmers into marketing cooperatives.

1938- Five hundred sixty (560) cooperative marketing associations were recorded. The coops turned out to be dismal failures. Church of Christ Missionary Rev. Allen R. Huber organized church members in Vigan, Ilocos sur into the economy's first privately initiated credit union. Inspired by the success of the coop, the Protestant Church in the Ilocos Region organized other coops. Privately organized consumer coops were forged into the Consumers' League of the Philippines under government sponsorship; Commonwealth Act No. 287 was enacted.

1939- Commonwealth Act (CA) No. 565 (Cooperative Act or National Cooperative Law) was enacted, giving rise to the National Cooperative Administration, which was established a year later. It provided for the organization of all types of coops; authorized the National Trading Corporation (NTC) to promote and supervise coops; established the National Cooperative Fund (NCF); gave permission for the organization of a cooperative with no less than 15 members; and, granted coops exemption from government taxes and fees for the first five years of their operation.

1940- The National Cooperative Administration (NCA) was established. The functions of the NTC and the management of the NCF were transferred to the NCA. Cooperatives multiplied under the NCA.

1942 - 45- Coops ceased to function during World War II

Second Wave: The immediate post-war period (1945 - 1972)

1945- CA No. 713 was enacted, amending CA No. 565, this revived the NCA with an appropriation of PhP5 million for its operations. By January 2, 1946, coop societies estimated at 1,500, were organized even without coop education for the purposes of relief and rehabilitation programs.

1947- NCA was abolished and its merchandising function was assumed by the Philippine Relief and Trade Rehabilitation Administration (PRATRA).

1950- Republic Act (RA) 364 created the Cooperative Administration Office (CAO) under the Department of Commerce and Industry and replaced the NCSBC.

1950- RA 583 created the Small Farmers Cooperative Loan Fund

1952- RA 821 (Agricultural Cooperative Law) created the Agricultural Credit Financing Administration (ACCFA). Through ACCFA, the government organized and financed Farmer's Cooperative Marketing Associations (FACOMAs) by providing collateral-free loans funded by the United States Agency for International Development (USAID). These initiatives focused initially in the Central Luzon provinces of Nueva Ecija, Pampanga, Bulacan, Tarlac and Pangasinan, which were the areas most affected by the peasant-based insurgency led by the Communist Huk Movement. The state-initiated FACOMAs failed, as in the past, due to corruption and incompetent management. Non-agricultural coops continued to be under the supervision of CAO.

1953- The Federation of Free Farmers (FFF) was established. FFF would later organize the Federation of Free Farmers Cooperatives in 1966.

1957- RA 2023, or the Philippine Non-Agricultural Credit Act, was passed allowing non-agricultural coops to register with the government.

1957- The Philippine National Cooperative Bank (PNCB) was established for non-agricultural cooperatives.

1960- The Agricultural Credit Cooperative Institute (ACCI) was established at the University of the Philippines, Los Baños.

1960- RA 2717 (Electrification Administration Act) was passed, initiating rural electrification in the Philippines. Congress declared as policy of the Republic of the Philippines "to furnish cheap and dependable electric power and facilities in order to provide for and accelerate the agricultural and industrial development of the economy."

1960- The Philippine Credit Union League (PhilCul), later renamed to PFCCO, was organized. It was the first voluntary cooperative federation in the Philippines. It was affiliated with the Credit Union of North America (CUNA).
Inspired by the Second Vatican Council, the Roman Catholic Church initiated the organization of credit cooperatives in parishes all over the economy as part of their social action projects. This led to the organization of coops in urban areas by lay leaders who were mostly middle class and professionals.

1963- The Agrarian Reform Code (Republic Act 3844) was enacted. The Land Bank of the Philippines was also established.

1966-* MASS-SPECC (Mindanao Alliance of Self-Help Societies Southern Philippines Educational Cooperative Center) was organized at Cagayan De Oro City by leaders of successful coops in Mindanao which were mostly parish-based and institutional coops.

1967-* The Catholic Church sponsored a National Rural Congress which passed a resolution officially recognizing the need to organize coops in the parishes. This became a major plank in the program of action of the diocesan social action centers.

1969- RA 6839 (Agrarian Reform Code) was passed, mandating that coops be utilized as primary conduits for credit, supply and marketing services to agrarian reform beneficiaries.

1969- RA 6038, amending RA 2717 and "declaring a national policy objective for the total electrification of the Philippines" and further providing for the organization of the National Electrification Administration (NEA). The NEA was established also in the same year.

4 August 1969 The Philippine College of Commerce, now Polytechnic University of the Philippines (PUP), was designated as a training center for non-agricultural coops. By 1979, PUP had developed a complete set of coop education materials that could be used by students from kindergarten to college. Later, in March 31, 1989, PUP founded the Institute of Cooperatives, which offered the degree of Bachelor in Cooperatives.

1970-* The Visayas Cooperative Development Center (VICTO) was established by the Scarboro fathers in Hinundayan, Southern Leyte thru a parish social action program called "Saving Souls the Credit Union Way."

1972- Through the leadership of then Senator Emmanuel Pelaez, a proposed cooperative bill, initiated by coop leaders, was approved on second reading. The coop bill was seen as a measure to block the passage of objectional bills that would retain government control over the development of coops.

1972- Martial law was declared by President Ferdinand E. Marcos.

1972- With martial law powers to rule by decree, President Marcos issued Presidential Decree No. 1 reorganizing the executive branch of the government. The decree abolished the CAO and organized the Bureau of Cooperative Development (BCOD) under the Department of Local Government and Community Development (DLGCD) through Letter of Instruction No. 7. BCOD was later transferred to the Ministry of Agriculture.

1972- Presidential Decree (PD) No. 27 (Agrarian Reform Decree) declared the entire economy as an agrarian reform area.

1973- President Marcos issued PD No. 175 and Letter of Instruction 23 to "strengthen the coop movement." The law was tied up with PD 27, the Marcos Land Reform Program, which made it compulsory for a tenant-farmer to join a pre-cooperative organization called Samahang Nayon (SN). Benefits would include the right to borrow funds from government banks through the cooperative rural banks (CRBs) or the local rural banks, the assurance of being supplied with farm inputs such as seeds, fertilizers and pesticides. PD 175 abolished legislations dealing with cooperatives.

1973- Executive Order No. 898 created the Committee on Transport Cooperatives under the Department of Transportation and Communications. The eligible beneficiaries of transport coops are drivers, driver-owners, small operators, mechanics and employees of the transport industry.

1973- The Cooperative Insurance System of the Philippines (CISP) was organized with a capitalization of PhP30 million. Its membership included coops and their federations and unions, SNs, trade unions and their trade unions and their federations and individual policyholders.

1974- PD No. 269 was issued, giving more powers to the NEA and charging it directly with the organization, financing, and regulation of electric cooperatives. (Under PD 40, NEA was given only the power to set the cooperatives) Three years later, President Marcos issued another decree PD 1645 amending PD 269 by granting the NEA "additional authority to take measures that will better safeguard government inputs in electric cooperatives and other entities that are or will be related to the total electrification effort." This broadened and firmed up the lending and regulatory powers of the NEA over electric cooperatives. Under the same decree (PD 1645), President Marcos also directed the development of indigenous and renewable energy resources to supplement conventional power systems, and increased NEA's capitalization to PhP50 billion.

1977-* The National Confederation of Cooperatives, Inc. (NATTCO) was organized as a tertiary-level organization. Among its services were training and education, research, publication, and auditing, and programs such as coop financing for small-scale industries, extension work, women in development, coop insurance promotion, and the inter-coop trading. NATTCO's members included seven regional cooperative training and development centers.

1977-* The Cooperative Foundation of the Philippines, Inc. (CFPI) was organized to conduct in-depth studies of coops in the economy.

1979- BCOD later formed the Cooperative Union of the Philippines (CUP) as the national apex organization of all coops registered under PD No. 175. Its aim was to centralize the coordination of education and training programs of all cooperatives in the economy.

1979- Federation of Electric Cooperatives in the Philippines (FECOPHIL) later renamed Philippine Rural Electric Cooperatives Association, Inc. (PHILRECA), was registered with the NEA as the umbrella organization of the 119 electric coops providing electricity in 73 provinces and 1,417 cities and municipalities.

1979-* National Market Vendors Cooperatives Federation, Inc. (NAMVESCO) was organized by market vendors from Manila, Quezon City, Rizal, Laguna, and Batangas.

Fourth Wave: Under the Restored Democracy

1990- RA 6938 (Cooperative Code of the Philippines) and RA 6939, creating the Cooperative Development Authority (CDA), were signed into law by President Aquino.

The CDA took over the functions of the BCOD of the Department of Agriculture. It was placed under the Office of the President and is headed by a chairman and 6 administrators.

1993- EO Nos. 95 and 96n were issued by President Ramos to enhance the coordination efforts among all government agencies and the establishment of cooperative development councils in national, regional, city or municipal levels.

1993-* The National Cooperative Movement (NCM) was organized.

1994-* The Philippine Cooperative Center (PCC) was organized. It was subsequently registered with the CDA on March 10, 1997.

1994- Various coops launched the Koop-Forum, which covered a series of discussions on issues facing coops under the new Cooperative Code of 1990.

1995- Upon the initiative of Senator Agapito "Butz" Aquino, the Congress allocated PhP40 million for the establishment of a physical center for the use of the cooperative movement.

1996- DECS Order No. 55 was issued, containing guidelines in converting all school canteens in all primary and secondary schools into teachers coops.
The 2nd National Cooperative Summit was held on October 16-18 at Davao City.

1997-* National Organizations conducted a strategic planning workshop that envisioned PCC as a center to promote partnership and unity among cooperatives.
PCC was formally launched on 10 March 1997, Cooperative Day; 3rd National Cooperative Summit, held on November 5-6 in Cebu City.

1998-* The Coop National Confederation of Cooperatives (NATCCO) Network Party formed by members of NATCCO, landed a seat in the House of Representatives after garnering over 2% of the votes cast in the first party elections.

1998- PCC signed the implementation agreement for the project "Effective Local Governance and Support Mechanisms for Sustainable Cooperative Development" with CDA, NEDA and UNDP.

4th National Cooperative Summit (October 16-18, Manila)

1998-* PCC assisted the National Anti-Poverty Commission (NAPC) in organizing the Cooperative Sector Assembly to elect the Cooperative Sector Council.

1999- PCC mounted the National Conference on Local Governance and Cooperative Development, in cooperation with CDA, NEDA and UNDP.

2000- 5th National Cooperative Summit (October 25-26, Tagaytay City)

2001- PCC conducted a planning workshop with CDA that established an action agenda for a central cooperative financial system and common standards in auditing, training and other issues.

2002- 6th National Cooperative Summit (November 28-30, Cagayan De Oro City)

2003-* PCC convened the Philippine Cooperative Forum, a special meeting during the fifth Asia-Pacific Assembly of the International Cooperative Alliance, hosted by the NATCCO.

2003- First National Tri-partite (LGU-CDA-DILG) Conference on Cooperative Development was held in Tagaytay City.

2003-* Strategic Planning Workshop of PCC defined its role as a center for policy, technical and business development cooperation among cooperatives.

Note: All the above activities were initiated by the government except those marked with asterisk (*).

Please note that in the 60s the Catholic Church saw the need to address poverty and social inequity, while some years later the Government saw the need "to prepare tenant farmers for their new role as landowners and to provide them with basic economic and social services." (Charitonenko, p. 16) Both institutions looked at cooperatives as the vehicles that could provide the solution. Viewed as such, cooperatives had a much stronger social orientation than commercial focus. While social values are very important, they are often used as an excuse for poor business management. This lack of commitment to a commercial approach… has resulted in a large percentage of cooperative failure. Of some 42,000 cooperatives registered under the Cooperative Code in 1997, half were inoperative. Lack of prudential standards has resulted in high delinquency, low capital accumulation, and little or no savings mobilization, which in turn, has resulted in very high external dependency.

[However, the well-run cooperatives have shown their] potential for mobilizing deposits and providing financial services to small savers and borrowers, and… to finance… lending from share capital and deposits, quite apart from [their] role as a conduit for government funding. (Charitonenko, p. 16).

Although NGOs offered micro financing in the 1980s, their establishment gained momentum a decade later "under the 1987 Constitution, which requires the State 'to encourage non-governmental and community-based organizations,'" (Chua et al, p. 20) and with financial and nonfinancial support from government, local, and foreign donor agencies. Initially, most MFIs used the Grameen model "due in part to various forms of support available to Grameen replicators." (Charitonenko, p. 19). The use of the Association for Social Advancement (ASA) followed.

As with cooperatives and rural banks, there are a few which are well run and have proven themselves to be self-sustaining and commercially viable.

6.3 Result of Field Study

Because of the need for having received awards over a three-year period, the selection of four MFIs was purposive. Once these MFIs were identified, each interviewer was tasked to obtain a listing of their borrowers in a particular area that the MFI has a presence. If the MFI had only two categories, namely borrowers whose loan payments were current (good) and past due (poor), then borrowers from each of these were selected at random. If the enterprise of the chosen respondent happened to be in services or in manufacturing, the random selection continued until a respondent was engaged in trading, a major sector serviced by Philippine MFIs. The MFIs featured here are:

1. Urban Program for Livelihood, Finance and Training (UPLiFT) Philippines, Inc. (Annex A),
2. ABS-CBN Bayan Foundation, Inc. (Annex B),
3. CARD Bank (Annex C), and
4. Enterprise Bank, Inc. (Annex D)

At the end of 2004, these four MFIs had combined liabilities and equity of PhP770 million and PhP253.3 million, respectively. These are broken down as follows:

Table 6.2
MFIs' Liabilities and Equities Performance

Institutions	In Million Pesos, 2004	
	Liabilities	Equity
UPLiFT	23.6	7.8
CARD Bank	326.2	75.4
Bayan Foundation	85.2	113.9
Enterprise Bank	335.1	56.2
Total	770.1	253.3

For the same year and on the basis of interview responses, these MFIs have outstanding loans of about PhP730 million, broken down as follows:

Table 6.3
MFIs' Loans Outstanding Performance

Institutions	PhP in millions
UPLiFT	15.9
Bayan Foundation	122.0
CARD Bank	278.4
Enterprise Bank	315.4
Total	**731.70**

Combined, they extended these to over 134,000 borrowers (Table 6.4)

Table 6.4
MFIs' Number of Borrowers

Institutions	Number of Borrowers
UPLiFT	8,300
Bayan Foundation	41,000
CARD Bank	46,700
Enterprise Bank	38,700
Total	**134,700**

All four do not lend to small to large enterprises. By type of credit, they lend to the micros and to consumers, as shown below:

Table 6.5
MFIs' Credits Portfolio

Institutions	Percentage, 2004	
	Micro	Consumers
UPLiFT	100	0
CARD Bank	74	26
Bayan Foundation	30	70
Enterprise Bank	27	73

By market segment, the micro businesses serviced are mostly in trade and in services. In terms of gender, most of their borrowers are women – from a low of 60% in the case of Enterprise Bank to a high of 100% for CARD Bank. The reasons given in the Table 6.7 below.

Table 6.6
Gender Perspective

Enterprise Bank	Credit is extended to both men and women, although the latter are better credit risks for micro loans
Bayan Foundation	There is no discrimination, the 90% is a natural development.
UPLiFT	Main targets are unemployed women in the areas where it operates as their husbands are usually employed. Although it has such a bias, it does not discriminate in screening and evaluating loan applications.
CARD Bank	There is a bias in favor of women as these are more responsible in meeting their credit obligations. Men tend to have vices.

Among the methods used, all four MFIs use the personal approach, either through group meetings, house calls, or referrals made by their existing borrowers. As a matter of practice, representatives of UPLiFT, Enterprise Bank, and CARD Bank pay a courtesy call on the local authorities before operating in an area.

Three, namely UPLiFT, ABS-CBN Bayan Foundation, and CARD Bank require some form of mandatory savings or capital build-up (CBU), which is a certain percentage of the loan applied for. Enterprise Bank does not, but it gives its borrowers higher loan amounts if they have existing deposits with the bank

Although they use different approaches in extending loans to the enterprising poor, they do have a number of similarities:

1. The character of the applicants and their capacity to repay the loan are primary considerations. They require their applicants to undergo some social preparation before releasing the initial loan – which is secured either by the following: co-maker, group guarantee, or promissory note.
2. Speed and regularity in terms of loan processing, loan releases, loan collections, and withdrawals from CBUs. Staff meetings are held at the very least weekly to discuss developments of the past week and plan for the following week. In addition, all use computers to keep track of their voluminous transactions.
3. In cases of delayed payments and failure to comply with other requirements, all four MFIs have corresponding sanctions.

UPLiFT	a. Borrowers cannot avail of a subsequent loan if they (a) use their existing loan for purposes other than business or (b) miss paying the amounts on their due dates more than four times b. If the loan has not been fully paid at maturity date, an additional 3% interest is applied on the remaining amount of principal and interest to be paid
CARD Bank	Depending on the number of delinquent payments, there is either a deduction of at least PhP1,000 on the approved loan or a return to the amount of the initial loan.
Bayan Foundation	a. Penalty charges are imposed. b. At the extreme, delinquent borrowers are dropped from their respective "borrowing" groups.
Enterprise Bank	a. Peer sanctions, court action b. No repeat loans

4. If there were any complaints from the small sample of their borrowers, these are few and isolated – even from those who have past due accounts.
5. Continuous improvement of operating procedures, upgrading of staff, and cost reduction.

Chapter 7

CONCLUSION

The Need and Availability of Micro Finance Service for Micro Enterprise: Bringing Multi-Level Good Practices into Local Context (Case Study: Indonesia; Malaysia; Mexico; Thailand and the Philippines)

Micro Finance Institutions and Micro Enterprises in Indonesia; Malaysia; Mexico; Thailand and the Philippines

Within APEC economies, there is no uniform definition on Microfinance Institution (MFI) and micro credit. Each economy has its own definition on MFI and micro credit. However, all economies definitions indicate that an MFI is organization that purpose is to expand outreach of banking services to the poor, and micro and small enterprises (MSEs) by offering micro credit. The credit is usually in the short term and utilized to scaling up income and MSEs development.

In Indonesia, the Ministry of Cooperatives and Small and Micro Enterprises (SMEs) defines MFIs as financial institutions providing financial services to micro enterprises and low-income societies. With relation to the micro credit, an MFI offers micro credit Rp50 million maximum.

Bank Pertanian Malaysia (BPM) defines MFIs, in a narrow definition, as an institution providing small loan to the extreme poor at a subsidized interest rate. The broader definition is the institution that delivers provision of financial services (credit, saving, insurance, and money transfer) to non-bankable populations.

In the Philippines, Department of Finance defines micro finance as the viable and sustainable provision of a broad range of financial services (saving and credit); generally by the private sector to the poor and low-income households engaged in livelihood and micro enterprises activities using non-traditional and innovative methodology and approaches. The maximum individual loan amount provided for micro finance loans is PhP150,000.

The Office of the Secretary of the Economy of Mexico defines an MFI as an institution that provide small loans (micro credits) to the poorest families, in order to support them economically in productive activities (business, self-employment).

There is also no uniform definition on micro and small enterprises (MSEs) in APEC economies. The most commonly used measurements by APEC economies are number of employees and assets. The other measurement criteria are sales, shareholders funds, capital and paid up capital.

Ministry of Cooperatives and Small and Medium Enterprises of the Republic of Indonesia classifies small enterprises as those having assets less than Rp200 million and sales turnover Rp1 billion (Law No. 9/1995 on Small Enterprises). Until nowadays, Government of Indonesia set no formal definition on micro enterprises yet.

In Malaysia, Small and Medium Industries Development Corporation (SMIDEC) defines a micro enterprise as an enterprise that employs less than 5 employees or has sales turnover of less than RM250,000. A small enterprise has sales turnover between RM250,000 and less than RM10 million or has employees between 5 and 19.

Philippines MSEs are categorized based on the value of their assets (excluding land) and number of employees. In January 2003, the Small and Medium Enterprises Development (SMED) Council of Philippines defines micro enterprises as those that have assets P3,000,000 or less and 1-9 employees. Small enterprises have assets between P3,000,001 to P15,000,000 and 10-99 employees.

MSEs have been an engine to economic growth in APEC economies and play role as the backbone of the economy. MSEs have strategic position in poverty alleviation in APEC economies since most of their products are the primary needs of the society. MSEs also have significant contribution to improve health, sanitation, and universal primary and secondary education.

Particularly in Thailand, grass-roots economics activity (also identical with MSEs) is utilized to promote the Thailand’s economy. Furthermore, from these activities, Thailand can produce high quality of export products. With government support, the quality of life of Thai’s people was improved.

MSEs are also taking part in reducing unemployment. This is due to most of businesses in APEC economies are MSEs and those MSEs have displayed success in creating wide job opportunity. MSEs also contribute to Gross Domestic Product (GDP) and export. Moreover, most economies show that MSEs play role on women empowerment since many MSEs are running by women.

This study finds that the main problem faced by MSEs in five economies surveyed is in funding. Most of MSEs frequently are being the victim of moneylenders who charge very high interest rates. This is due to MSEs have limited access to financial services offered by commercial banks.

Commercial banks are sometimes reluctant to channel their fund to MSEs, mostly because of information problems, limited credit history, high credit risk perception, lack acceptable collateral and high transaction cost of processing small loans. They also require quite complex administrative documents, which MSEs often cannot fulfil. Commercial banks prefer to approve credit applications that are fully covered by collateral. On the other hand, MSEs need timely and small-sized loans whose repayment terms coincide with their cash flow.

Regarding the importance of MSEs for economy, this study suggests that it is essential for MSEs to be developed actively. The development of MSEs requires three important aspects. First, conducive economic condition and government support by designing stable economic policies, for example in Thailand. Thai Government promotes “Dual Track Policy” to strengthen the domestic economy and promote export commodity. Besides, Thai Government also initiates some package to stimulus the development of MSEs.

The second aspect is the financial support. Financial support is significant to MSEs development. Due to the limited access of financial support, most of MSEs are unable to expand their business. In Malaysia, the Government has provide the necessary support to ensure that MSEs able to obtain the adequate financial support.

The last is non-financial support/technical assistance. In addition to financial support, MSEs also need some non financial support or technical assistance whether from MFIs or government. The good example for the kind of assistance is Mexico. Government of Mexico provide Rural Microfinance Technical Assistance Project (PATMIR).

MFIs are considered as a practical strategy in reaching the Millennium Development Goals (MDGs) set by the United Nations. They promote social stability by improving standard of living of the low-income groups. It is also acknowledged that the existence of MFIs has enhanced access to financing for MSEs.

With regard to MSEs' need for fund, MFIs can fill the financing gap in fields where commercial banks are reluctant to finance. MFIs play strategic role in empowering MSEs by providing micro credit with simple and fast procedures. In commercial banks, it takes approximately two weeks to one month to process a loan application while it is only three days to two weeks in MFIs. Pegadaian (pawnshop), one of MFIs in Indonesia, only takes fifteen minutes to disburse a credit application. It includes the administrative process and the measurement of the value of collaterals.

The development of MFIs in terms of numbers, types, outreach, value of loans and saving mobilization has been significant. Still, certain issues remain. MFIs face many challenges, both internal and external challenges. Internal challenges faced by MFIs are low quality of human resources, low capital, operational efficiency, and managerial professionalism, while external challenges are competition with other MFIs and commercial banks focused on micro lending, unfavourable regulations, and lack of infrastructure.

This study identifies some problems in delivering financial assistance to MSEs. The credit return often can not cover the cost of processing the credit application. It often drives MFIs to set high credit interest rates. Then, this expensive credit can not be accessed by MSEs and poor people and also reduces the outreach of MFIs.

MFIs aim to reduce the poverty by providing micro credit to poor people and as well as to obtain profit. MFIs face dilemma balancing these two goals. MFIs play role as a tool of development, which often contradict the profit-seeking motive. This is due to MFIs face difficulties in obtaining sufficient profit to cover all of the expenses while serving poor clients. This often reduces the capacity of most MFIs, particularly less-developed MFIs to distribute micro credit.

The result of this study indicates that poor people experience higher non-performing loan compared with not poor people. It is mainly caused by subsidy mentality of poor clients. This drives MFI to allocate more credits for not poor people and economically active poor. It will hamper MFIs from reaching one of their goals, i.e. reduce the poverty.

Most of MSEs also have poor administrative management. It hampers MFIs in assessing the capacity to repay of MSEs, which eventually influence the amount of loan approved by MFIs. It is also difficult for MFIs to identify whether their clients use the loan as working capital or consumption purposes.

Best Practices of Micro Enterprises; Indicator and Characteristics

There are three main indicators in assessing the performance of MFIs in serving MSEs, i.e. sustainability, outreach, and availability. MFIs' **sustainability** shows their capability to survive and face the changes in economic conditions. The good MFIs are those that self-sustained. This study finds that the main problem for MFIs to be self-sustained is how to cover the operational cost. Normally MFIs charge higher interest rate to solve the operational cost problems. Another strategy taken is seeking for subsidies. Yet, subsidy is not an effective way.

The second indicator is **outreach**. The well-performed MFIs are those serving optimal number of clients in their coverage area. Outreach is the important component of MFIs since it can increase the MFIs' sales and profit. In order to improve the outreach, MFIs can implement several strategies, *inter alia*, promote MFIs' product to the clients, provide good services to the clients and increase the number of credit officers.

Availability is the third indicator of MFIs' performance. This indicator includes office hours, branch offices and product innovation. With relation to availability, well-performed MFIs are those that can adjust their activities and product based on clients' need or economic changes.

This study concludes several characteristics of the best-performed MFIs in APEC economies surveyed as follows:

1. **Simplicity**

Considering most of their clients are less bankable MSEs, MFIs provide simple and fast procedures. MFIs set minimum requirements since most of MSEs operate in informal economy. Therefore, the requirements do not hamper MSEs from accessing credits.

2. **Continuous improvement**

MFIs should improve its quality through training programs. In order to support and evaluate the improvement, financial and non-financial, of their institution, MFIs should cooperate with other institutions in order to provide MFIs with unbiased assessments.

3. **Support the clients' business**

MFIs perform better if they can support their clients' business, e.g. by channelling the products of their clients, either to external buyers or to other clients. In addition, best-performed MFIs also play significant role in mobilizing resources among MSEs.

4. **Flexible and market led/demand driven services**

Best-performed MFIs display flexibility in running their businesses. They adjust well to the changes in society. Therefore, they will be able to determine products to be offered, whether products for a specific sector, individual or group.

Involving clients in designing products is essential in order to meet the needs of their clients. Cultural aspects and local organization as well as the characteristics of community, e.g. education, income level, type of business, and cash flow are also consideration in designing products. Those influence the required collateral and the term of instalments. Product designing should also consider the social values and tradition of societies.

5. **Good networking**

External support has been important in MFIs' operation. Good MFIs put proactive effort on creating good networks with other related parties. Some MFIs has showed good performance in channelling fund from government or involving in linkage program with other financial institutions.

6. Saving as credits' collateral

It is essential that MFIs have mandatory saving for the borrowers. Saving can utilize as collateral and to build up internal capital.

7. Personal approach

To assess the clients' character, it is better for MFIs to use personal approach. Personal approach is the most effective way to identify clients' character. Besides, it helps MFIs to measure the clients' capacity to repay the loans.

8. Sanction for delay payment

MFIs have to be more firm towards delinquent clients. There should be sanction mechanism in order to motivate clients to pay their installments on time. Therefore, it will reduce non-performing loans. In addition, MFIs should ensure that MFIs deliver credit for productive purposes.

9. Adoption of technology

Use of management information system by utilizing particular software is necessary in delivering good services to MFIs clients. It allows MFIs for better administration of loan since it facilitate efficient accounting and reporting.

10. Business diversification

Some MFIs diversify their businesses in order to reach their dual objectives as well as cope with competition. The supplementary businesses can offer non-financial products and services that can be other source of profit-generating activities. Therefore, MFIs will be able to serve poor clients but still can make profit. Additionally, it is important if the supplementary businesses support the economic activity of clients.

11. Having Microfinance Unit (MFU)

Some of sustainable MFIs in APEC economies develop MFUs in order to increase their outreach to other potential areas. This method eases poor people and MSEs to access their services.

Issues on MFI

This study finds two important issues concerning the development of MFIs in five economies surveyed. Those are related to the role of MFIs for empowering women and the role of governments to promote the development of MFIs.

1. Gender Empowerments

MFIs in APEC economies are aware to women empowerment. The result of this study indicates that some MFIs economies deliver micro credit to women-owned enterprises or create women-specific products, e.g. Koperasi Wanita Setia Bhakti Wanita in Indonesia and the Negros Women for Tomorrow Foundation, Inc. in the Philippines. Those two MFIs have relatively less non-performing loans.

Regarding the difference between women's performance and men's, the result is mixed across MFIs. Nonetheless, field surveys finding ascertains that women clients have high prudence in managing their loan. However, most women are risk averse due to they are afraid of being unable to repay their loan. It produces women reluctantly to apply for credit. In the future, MFIs, government, and related parties are expected to encourage women to utilize the financial assistance of MFIs.

2. The Role of Government to Develop MFIs

Governments of APEC economies appear to acknowledge the importance of the poor to have access to financial services. Based on this reason, empowerment of MFIs is essential. The supports to MFIs are from either local or central government. Those supports consist of financial assistance and non-financial assistance.
These supports have relation with the types of MFIs. With regard to this, we classify the MFIs into two types, i.e. bank and non-bank institutions. Each type of MFIs needs different strategies to develop. The government supports to MFIs in relation with the types of MFIs are explained hereunder.

a. Financial Assistance

The financial support of government can be in the form of subsidized interest-rate funds. These funds are especially essential for growing MFIs which are not self-sustained yet. These funds should be revolved and allocated mainly to the poor and economically active poor people. This will enable MFIs to provide credit to MSEs at lower cost.

However, government should beware in delivering these funds hence the funds will not be misuses. These funds then should gradually be reduced when those MFIs are able to generate sufficient profit and reach a certain level of sustainability. This is due to MFIs should be self-sustained in the long term and capable to mobilize funds. To ensure the sustainability of microfinance activities, government support should eventually be replaced with a market-oriented microfinance program.

Continuous cheap fund can be harmful for MFIs since it can drive MFIs to neglect deposit mobilization. In addition, it will reduce MFIs incentive to manage non-performing loan that will result in high credit default.

Some mature and sustainable MFIs prove that microfinance business is profitable. The subsidized interest-rate funds are not vital for those MFIs. There are also some MFIs running their businesses with minimum external funds, e.g. Koperasi Kredit Rakyat (KKR) in Malaysia. KKR once received external aid in 1974 and since then has never received any. Despite no more external aid, KKR has exhibit good performance.

b. Non-Financial Assistance

Experiences of the APEC economies surveyed show that economic condition has significant impact on the development of MFIs. The rapid economic growth creates more space for MFIs to deliver their services to poor people and MSEs. Therefore, governments play a great role to develop MFIs through creating conducive business climate and favourable policies.

Government play a great role in MFIs development by designing pro-poor fiscal policies by allocating a portion of their budget that aimed to finance MFI or optimizing MFI involvement in managing programmed funds for the welfare of the poor. With the fiscal incentive given from the regional government, there will be sufficiently numerous banks specializing in one region and able to better identify the potential investments and clients in the region.

Government's role in supporting the MFIs development process is essential. This is due to the development of MFIs in developing economies are government driven. Therefore, governments should regulate financial market institutions in their economies, including MFIs. One crucial supports should be provided by government is to create competitive market for MFIs. Competitive market will drive MFIs to be financially efficient.

It is necessary for MFIs to survive in the more competitive micro financial market. Competition among MFIs can reduce the interest rate that in turns can benefit MSEs.

However, not all MFIs can compete efficiently, especially when they compete with bigger and more established commercial banks. Therefore, government should set market segmentation for MFIs and commercial banks credit in order to protect the sustainability of MFIs.

Market segmentation among MFIs is also essential. No single MFIs form suits different segment of clients hence many types and forms of MFIs are essential to meet the varying needs of MSEs. Therefore, there will be a wide array of financial products available to the MSEs.

Government should also set guidelines regarding ethics or rule of conducts concerning the MFIs activities. This should fit the institutional forms of MFIs. Regarding the different institutional forms of MFIs, government is expected to set standards to rank the performance of the different types of MFIs. Another mechanism to rank the performance of MFIs is to establish a benchmark MFI. The performance of MFIs will be measured in comparison with the benchmark.

Government is also expected to provide consultancy for MFIs. Consultancy will be effective to assist MFIs in running their businesses by helping them to solve the problems they face in their businesses.

Despite the different types and strategies described above, MFIs in general need institutional development and capacity building and technical assistance provision, e.g. the utilization and development of a credit insurance/guarantee agency to overcome issues regarding less-bankable customers of MSMEs. Capacity building also comprises training at all levels of MFIs, therefore MFIs have skills and systems to effectively manage a basic financial institution.

Considering the importance of MFIs for economic empowerment, especially for MSEs and low-income people, there should be continuous improvement of MFIs in term of financial services. This study shows that the development of MFIs is different among economies. Therefore, the further study on the development of MFIs in many different economies will be essential. MFIs can take an applicable lesson from the experiences of other MFIs in other economies in order to improve their services. Government can also design policies conducive for the development of MFIs based on the study.