

## **DOES MICRO FINANCE INSTITUTION REDUCE POVERTY WITH ENCOURAGING THE MICRO BUSINESS?**

**Dewi Kusuma Wardani & Sri Hermuningsih**  
[d3wi\\_kusuma@yahoo.co.id](mailto:d3wi_kusuma@yahoo.co.id)  
Universitas Sarjanawiyata Tamansiswa

### **Abstract**

*Microfinance program focuses on expanding economic activity and improve living standards clients by providing the necessary financial services. Microfinance is also facilitating the development of small businesses. The main purpose of the establishment of MFI “Binangun” is helping people overcome poverty. It means that the establishment of MFI “Binangun” must be able to provide the required capital of the poor to increase their revenues, either from agricultural activities and other economic activities outside agriculture, such as trading or handicraft industry.*

*The problem in this research is whether micro finance institution reduces poverty with encouraging the micro business?. This study uses qualitative research approach (qualitative study). The qualitative approach seeks to achieve research objectives by drawing out the primary data in the form view (perception) of the MFI’s stakeholder, like client and government. This approach will analyze and clarify the causes of socio-economic changes that are perceived as the impact of MFIs and the factors affecting the increase in socio performance of MFIs (UNESCAP, 2000).*

*From the MFIs performance evaluation in Kokap, Kulon Progo, Yogyakarta, can we conclude that the social performance of MFIs is still very limited. MFI is to reduce dependence on moneylenders, but because of administrative requirements that are too complicated and the constraints in terms of human resources, there are still many people who use the services of moneylenders. Therefore there needs to be a model to improve the social performance of MFIs.*

**Keywords: Micro Finance Institution, Poverty, Micro Business**

## INTRODUCTION

Microfinance program focuses on expanding economic activity and improve living standards clients by providing the necessary financial services. Microfinance is also facilitating the development of small businesses. Microfinance can be defined as offering financial services such as savings, loans and transfers of funds to lower class economic community that can not access regular banking services (Wilson, 2003). Although the main purpose of Microfinance Institutions (MFIs) is improving the economic status of the poor, most MFIs expand the goal to give effect to the wider community. Because of the targeted households MFI is part of the community and the broader economy, the impact is felt by households also will impact on the community at large. Microfinance is regarded as one of the most logical approach to alleviating poverty by directly touching the bottom of the grassroots community, sustainable, able to involve a broad segment, and build client's economic capacity.

The main purpose of the establishment of MFI “Binangun“ is helping people overcome poverty. It means that the establishment of MFI “Binangun” must be able to provide the required capital of the poor to increase their revenues, either from agricultural activities and other economic activities outside agriculture, such as trading or handicraft industry. However Assessment Study of Potential Establishment of Micro Finance Institutions (MFIs) by Center for Economic Studies Pancasila (PUSTEP) Gadjah Mada University in cooperation with the District Government of Kulonprogo found the opposite conclusion. Kokap MFIs have the most complete program (a national program, region, or village) but has the highest poverty rates in Kulon Progo is 50.58% (BPS Kulon Progo, 2008 and Mubyarto 2004). This raises a question **"Does Micro Finance Institution Reduce Poverty with Encouraging The Micro Business?"**

## PROBLEM

The problem in this research is whether micro finance institution reduces poverty with encouraging the micro business?.

## LITERATURE STUDY

The emerging of micro credit in the late 1970s and early 1980s is increasing concern in rural finance. Indonesia pioneered by BRI, including one of the countries besides Greenen

introduce microfinance in Bangladesh and PRODEM in Bolivia. Although there are some differences among the three countries, microcredit is the main similarity is more emphasis on the principle of partnership and encouragement client character (peer pressure) compared to commercial loans are more concerned with collateral to secure loans, interest rates to cover losses and transaction costs, and incentives for those who repay loans early (Meyer and Nagarajan, 1999).

Most of MFI bring diverse social mission, such as expanding access to financial services, poverty alleviation, women empowerment, building community solidarity or enhance economic development. Social performance indicates the extent to which MFIs are able to achieve the objectives of this set. The concept of social performance does not only focus on the impact end, but also provide a framework for understanding how social goals can be achieved. Social performance appraisal is a process whereby an organization to benchmark the actual social performance with social missions that have been determined previously (Copestake, 2005). The mission and purpose of social performance is not just aimed at the target group but also to the stakeholders concerned. Because the object of social performance assessment is a process, then this measurement can be applied at various stages of social-impact causal chain, ie a model that describes how an impact can be created from a program. Based on this model, the impact of a program initiated from an input which is then transformed through the organization's internal processes and then be output. Output produced outcomes, while outcomes have an impact.

An assessment of social performance is used to evaluate how large the benefits are felt by the recipient of credit to increase the level of welfare. These assessments include analyzing whether the system is built and the instruments used have been fully in accordance with social goals. Social performance appraisal also evaluates the outcomes generated by the program. Social performance assessment can be done only on one particular point in time (one time assessment) or can also be done on an ongoing basis (on-going process). Social performance is a translation of the organization's social mission into practice. Social value of microfinance related to how the financial services improve the lives of the poor, the poor, and their families to access wider opportunities in society. To create these values, the social objective of MFIs including the (Misra, 2006):

1. Increasing the number of services to poor people, not including those who are receiving credit, on an ongoing basis
2. Improving the quality and accuracy of financial services available to clients target through systematic assessment of specific needs
3. Creating benefits for clients of microfinance, including the families and communities associated with the client. These benefits also include social networking client is to expand, reduce uncertainty, increase revenue, and the fulfillment of basic needs.
4. Increasing the social responsibility of MFIs to our employees, clients and community it serves.

Social performance measurement includes not only purposes and outcome but also how the actions and corrective measures taken by the LMM to achieve specified outcomes. Social performance assessment does not only focus on the impact end. The purpose of assessment is to determine whether the MFI provides facilities for him to achieve social goals have been defined, by monitoring the extent to which goals are reached, and evaluate the extent to which the information obtained to improve its operations.

## **RESEARCH METHOD**

This study uses qualitative research approach (qualitative study). The qualitative approach seeks to achieve research objectives by drawing out the primary data in the form view (perception) of the MFI's stakeholder, like client and government. This approach will analyze and clarify the causes of socio-economic changes that are perceived as the impact of MFIs and the factors affecting the increase in socio performance of MFIs (UNESCAP, 2000).

## **RESULTS AND DATA ANALYSIS**

Kokap is the districts in Kulon Progo, Yogyakarta (DIY). Beside Kokap, there are 11 other districts in Kulon Progo district, Temon, Wates, Panjatan, Galur, Lendah, Sentolo, Pengasih, Girimulyo, Nanggulan, Kalibawang, and Samigaluh. Kokap has an area of 7379.95 hectares with Jumah population of 39,793 inhabitants. Currently Kokap districts led by Santosa (<http://www.kulonprogo.kab.go.id>)

Kokap consists of 5 villages, Argowilis, Argomulyo, Argorejo, Kalirejo, and Argotirto. According to Central Bureau of Statistics (BPS Kabupaten Kulon Progo, 2008), Kokap has 33,257 people (8.88% of total population in Kulon Progo) with 9464 households by. The number of poor in Kokap is the highest in Kulon Progo. Those are 4787 households (50.58%). (CBS Kulon Progo, 2008). Various programs have actually implemented the central government to alleviate poverty, one through micro finance institutions targeting the poor and submission requirements, among others, must have a business.

Banks that operate in Kulon Progo are Bank Rakyat Indonesia, Bank Pembangunan Daerah (BPD) Yogyakarta, Bank Perkreditan Rakyat (BPR), Bank Pasar, RB Shinta Putra, and BKD. While non-bank financial institutions is Pegadaian, Badan Usaha Kredit Pedesaan (BUKP), and Koperasi Pasar (Koppas) (Mubyarto, 2004). While microfinance institutions that already exist in the district of Kulon Progo is Binangun MFI, which is located in each district.

### **Microfinance Institutions Hargowilis Village**

Since its founding in 2008, the microfinance institution in Hargowilis already has 520 members with 520 active members. Initial capital of Rp 737.36 million has been playing a loan of USD 1.63715 billion (a total that has been circulated). The female borrowers are 42 people or 8% of the total borrowers. Total nonperforming loans at 4%.

Microfinance institution in Hargowilis, Kokap district, Kulon Progo Regency has not been able to reduce poverty and increase family income. The number of poor people in 2008 by 800 heads of households in the year 2009 remains 800 heads of households. The median income for a permanent resident, which is Rp 500.000, -. These revenues are still below the needs for decent living in Yogyakarta, which is Rp 828,548.

Binangun microfinance institution has not been able to increase access and quality education, reduce unemployment, increase the ownership of assets and factors of production. This can be shown with its fixed number of unemployed amounted to 2350 souls in 2008 and 2009. The number of residents who had assets of production as indicated by the population livelihood as self-employed and farmers / ranchers amounted to 283 souls in 2008 increased slightly (1.06%) to 286 inhabitants. The lack of improvement or life quality declining in Hargowilis after the existence of microfinance institutions indicates its lower social performance.

The microfinance institution social performance in Hargowilis is perceived well by its customers. This can be seen from an average of their assessment of value 7.5 (maximum value 10). From interviews with village officials can be concluded that although the social performance of MFIs in the village Hargowilis still minimal, but has a positive impact on society, that MFIs can increase the venture capital community, to reduce dependence on middlemen and moneylenders, and increasing access to education and health.

In terms of services, the customers gave an average rating of 7.8 which customers trust with MFIs, MFIs good management, supervision and control MFI felt well, fast friendly service and accurate, the loan interest is not burdensome, and access to easy loans . Even 100% of customer respondents said they would ask again if the loan was paid off its debts. Of course, ease of access is because the loan term is very easy, that the borrower must be located and domiciled in Hargowilis. Having a business in the territory Hargowilis, fill out and sign the letter of submission, surrender of collateral or guarantee or collateral in the form of proof of vehicle ownership, no problems with other financial institutions in Hargowilis, and complete other administrative requirements, such as filling of Business Certificate signed by the Head of Village and Hamlet. Interest on loan in the LKM Binangun Hargowilis village is very low, ie 1% per month, which is the average interest rate on bank loans or other institution is 1.5 to 2%. According to the customers, things that need to be improved by micro finance institutions Hargowilis Binangun village is necessary to add the amount of capital so that customers can borrow larger amounts to accelerate the business, officers are expected to dare to act against or collect customer naughty by not paying installments, increased speed loan disbursement, as well as additional service time. Customers also expect that interest rates on MFI loans Hargowilis Binangun village could be decreased demand for more and more and MFIs can progressively expand.

On the other hand, the problems faced by the MFI in the MFI board is the number of customers is delinquent installments, the efforts of community mobility is still limited savings from mandatory savings and loans, and the administration still needs improvement to run in an accountable. MFI board plans to follow up the various errors in previous months, the increase in MFI services, increase efforts to pick up the ball, as well as raising cheap capital from the public. According to administrators, MFI Binangun Hargowilis Village has an opportunity in terms of the loan that uses a system of "sebrakan" so many applicants, but the MFI can not issue a loan with a system of "sebrakan" because of considerations of risk, capital, and there is no rule in the PTO that govern "sebrakan" loan

### **Microfinance Institutions Hargotirto Village**

At present, micro finance institutions in the village of Binangun Hargotirto already have 920 members with 446 active members of the people. Initial capital, USD 753.722 million, has been successfully playing the loan amounting to Rp 2,449,945,000 (total which was circulated). The female borrowers are 10.9% of total borrowers. Total non-performing loans by 10%.

Microfinance institutions in Hargotirto, Kokap, Kulon Progo has not been able to reduce poverty and increase family income. The poor people remain from the 838 family heads in 2008 and 2009. The mean income is increased by 4.76% from Rp 525,000, - to Rp 550.000. However, this income is still below the needs for decent living in Yogyakarta, which is Rp 828,548. microfinance institutions have helped improve access and quality education, reduce unemployment, increase the ownership of assets and factors of production. It can be shown by the decrease in unemployment of 4.63% of the 259 people in 2008 to 247 people in 2009. The number of residents who had assets of production as indicated by the population livelihood as self-employed and farmers / ranchers are for 1642 inhabitants in 2008 rose slightly (0.49%) to 1650 people. The lack of life quality improvement after the of microfinance institutions existence indicates lower of its performance. But, social performance of MFIs in Hargotirto has a better improvement than the other villages.

The Hargotirto microfinance institutions's social performance is well perceived by its customers. This can be seen from an average of their assessment of value 77.5 (maximum value 10). From interviews with village officials can be concluded that although the social performance of MFIs in the village Hargotirto still minimal, but has a positive impact on society, that MFIs

can increase the venture capital community, to reduce dependence on middlemen and moneylenders, and increasing access to education and health.

In terms of services, the customers gave an average rating of 6.8 which customers trust with MFIs, MFIs good management, supervision and control MFI felt well, fast friendly service and accurate, the loan interest is not burdensome, and access to easy loans . even 70% of customer respondents said they would propose another loan if the loan is paid off. Of course, ease of access is because the loan term is very easy, that the borrower must be located and domiciled in Hargotirto. Having a business in the territory Hargotirto, fill out and sign the submission letter, handed over security or collateral in the form of proof of vehicle ownership, no problems with other financial institutions in Hargotirto, and complete other administrative requirements. Interest on loan in the MFI in Hargotirto village is very low, ie 1% per month, which is the average interest rate on bank loans or other institution is 1.5 to 2%. According to the customer, the problem faced by officers MFI is less communicative, MFI officers never asked to the customers on need to borrow again in the MFI, the disbursement of funds that are too long, MFI less careful in selecting clients or borrowers who already have other dependents in Outside, MFI less attention to the utilization of responsibility, perceived lack of good human resources in providing services. According to the customers, things that need to be improved by micro finance institutions are Hargotirto MFIs need to embrace customers who already paid off to keep borrowing at MFI and not run to borrow elsewhere, such as loan sharks. In addition, MFI is expected to increase the capital for more rapid disbursement of funds to MFIs is expected to be able to pay attention to the people who most need loan capital, increasing cooperation among managers of MFIs, MFIs increased accountability report to avoid corrupt practices, giving priority to active customers.

According to management, the problems that happened was a huge bad loans and the large queues that often MFI loan applicant can not meet the credit disbursement. The solution implemented is billing to customers continue to be done. MFIs are still many opportunities for customers who need the funds. Plan for future innovations desired by the board is the MFI into Village Owned Enterprises (BUMDES) that are reliable. Management expects Kulon Progo district governments to provide guidance as in the early establishment of MFIs in 2008.



### **Microfinance Institutions Hargomulyo Village**

By 2010, microfinance institutions in Hargomulyo has 508 members with 210 active members. Initial capital, Rp 778.474 million, have been successfully playing the loan amounting to Rp 2,633,030,000 (total which was circulated). The female borrowers are 20.8% of total borrowers. Total nonperforming loans are 7%.

Microfinance institution in Hargomulyo has not been able to reduce poverty and increase family income. The poor people are 977 households in 2008 and 2009. The mean of income increases by 1.55% from Rp 581,000, - to Rp 590,000. However, this income is still below the needs for decent living in Yogyakarta, which is Rp 828,548.

Microfinance institution has not been able to increase access and quality education, reduce unemployment, increase the ownership of assets and factors of production. This can be shown by the increasing unemployment rate of 3% of 267 inhabitants in 2008 to 259 inhabitants in 2009. The number of residents who had assets of production as indicated by the population livelihood as self-employed and farmers / ranchers are for 1258 inhabitants in 2008 rose slightly (1.27%) to 1274 people. The social performance of microfinance institutions in Hargomulyo is well perceived by its customers. This can be seen from an average of their assessment of value 7.75 (maximum value 10). From interviews with village officials can be concluded that although the social performance of MFIs in Hargomulyo still minimal, but has a positive impact on society, that MFIs can increase the venture capital community, to reduce dependence on middlemen and moneylenders, and increasing access to education and health.

In terms of services, the customers gave an average rating of 7.5 which customers trust with MFIs, MFIs good management, supervision and control MFI felt well, fast friendly service and accurate, the loan interest is not burdensome, and access to easy loans. Although 100% of customer respondents said they would propose another loan if the loan is paid off. Of course, ease of access is because the loan term is very easy, that the borrower must be live in Hargomulyo. Having a business in Hargomulyo, fill out and sign the submission letter, handed over security or collateral in the form of proof of vehicle ownership, no problems with other financial institutions in Hargomulyo, and complete other administrative requirements. Interest on loan in the MFI is very low, ie 1% per month, which is the average interest rate on bank loans or other institution is 1.5 to 2%.

According to the customers, the need to be improved by micro finance institutions Hargomulyo Binangun village is an increase in the percentage of MFI managers who go directly to the field, improving accuracy in credit granting, an increase in working capital, additional hours of work or hours of service MFIs, increasing the amount of credit disbursement. According to administrators, MFIs still have a chance as there are many entrepreneurs who struggle to access micro credit to banks and MFIs location adjacent to the traditional market which has many market traders who caught sharks. In the future, MFIs become strong financial institutions and autonomous. Management expects the district to provide freedom for administrators to determine the size of MFI lending rates in accordance with market conditions and increase the capital by the district.

### **Microfinance Institutions Kalirejo Village**

Microfinance institution in Kalirejo has 815 members with 314 active members of people. Initial capital Rp 635.284 million has been successfully playing the loan amounting to Rp 2,358,370,000 (total which was circulated). The female borrowers are 18% of the total borrowers. Total nonperforming loans is 5%.

Microfinance institution in Kalirejo has been able to reduce poverty and increase family income. The number of poor people fell 0.58% from 1028 households in 2008 to 1034 head of the family in 2009. The mean of income increase 4.17% from Rp 480,000, - to Rp 500,000. However, this income is still below the needs for decent living in Yogyakarta, which is Rp 828,548.

### **Microfinance Institutions Hargorejo Village**

Microfinance institution in Hargorejo has 734 members with 242 active members of people. Initial capital, Rp 831.232 million, has been successfully playing the loan amounting to Rp 3,139,250,000 (total which was circulated). The female borrowers are 30% of the total borrowers. Total non-performing loans amounted to 4.18%.

Microfinance institution in Hargorejo has been able to reduce poverty and increase family income. The number of poor households felt from 1117 in 2008 to 1061. The income mean increase 3.448% from Rp 435,000, - to Rp 450,000. However, this income is still below the needs for decent living (UMR) in Yogyakarta, which is Rp 828,548.

Microfinance institution has not been able to increase access and quality education, reduce unemployment, increase the ownership of assets and factors of production. This can be shown by the increasing unemployment of 4.89% from 1439 people in 2008 to 1509 people in 2009. The number of residents who had assets of production as indicated by the population livelihood as self-employed and farmers/ranchers are for 1312 people in 2008 rose slightly (3.81%) to 1362 people. The social performance of microfinance institutions in Hargorejo is well perceived by its customers. This can be seen from an average of their assessment of value 7.5 (maximum value 10). From interviews with village officials can be concluded that although the social performance of MFIs in Hargorejo still minimal, but has a positive impact on society, that MFIs can increase the venture capital community, to reduce dependence on middlemen and moneylenders, and increasing access to education and health.

In terms of services, the customers gave an average rating of 7.8 which customers trust with MFIs, MFIs good management, supervision and control MFI felt well, fast friendly service and accurate, the loan interest is not burdensome, and access to easy loans . even 100% of customer respondents said they would propose another loan if the loan is paid off. Of course, ease of access is because the loan term is very easy, that the borrower must live in Hargorejo, having a business in the territory Hargorejo, fill out and sign the submission letter, handed over security or collateral in the form of proof of vehicle ownership, no problems with other financial institutions in Hargorejo, and complete other administrative requirements. Interest on loan in the MFI in Hargorejo is very low, ie 1% per month, which is the average interest rate on bank loans or other institution is 1.5 to 2%.

According to the customers, things that need to be improved by micro finance institutions Hargorejo Binangun village is need to increase the speed of disbursement of loans, increased loan amounts allowed, MFIs should not discriminate on its customers, and the socialization of lending programs need to be increased again. On the other hand, the board of MFI plans to innovate with the launch of the group credit, namely credit disbursed to groups of small businesses in the region Hargorejo with joint responsibility and accompanied by MFIs Binangun Hargorejo village.

**Socio Performance Improvement Model of Microfinance Institutions In Kokap District, Kulon Progo Regency, Province Diy**

From the evaluation of social performance of MFIs in Sub Kokap, Kulon Progo Regency, Yogyakarta Province, can we conclude that the social performance of MFIs is still very limited. MFI is to reduce dependence on moneylenders, but because of administrative requirements that are too complicated and the constraints in terms of human resources, there are still many people who use the services of moneylenders. Therefore there needs to be a model to improve the socio-MFI performance.

1. The increase in the field of human resources (HR)
  - a. Giving good customer service training on board
  - b. Improved recruitment standards committee
  - c. Improved welfare board
2. The increase in financial and capital
  - a. Increased capital from local governments
  - b. Increased capital by cooperating with other parties
  - c. Improved financial accountability system
3. Improvement in marketing
  - a. Marketing system pick the ball to the house and into the market
  - b. Marketing system through a business group or association of mothers
  - c. The increase in the operational field
  - d. Improved accuracy in the examination an applicant who is granted
  - e. Increased supervision of the use of credit to improve the local community
  - f. The acceleration time of disbursement of funds

**Conclusion and recommendation**

From the MFIs performance evaluation in Kokap, Kulon Progo, Yogyakarta, can we conclude that the social performance of MFIs is still very limited. MFI is to reduce dependence on moneylenders, but because of administrative requirements that are too complicated and the constraints in terms of human resources, there are still many people who use the services of moneylenders. Therefore there needs to be a model to improve the social performance of MFIs.

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