

# THE ROLE OF MICRO FINANCIAL INSTITUTION TO IMPROVE SOCIO-ECONOMIC OF THE RURAL COMMUNITIES

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*Abstract: Micro financial institution had an important role to improve the socio-economic of the rural communities. However, in its effort, the result in improving the socio-economic of the rural communities, particularly among the poor is still low. The access for the rural communities for low interest credit was also limited. The objectives of this research were as follows. First, to analyze the factors that drove the rural communities to borrow money from micro credit institutions. Second, to analyze the role of micro credit institutions and its impacts on the rural communities' socio-economic. Third, to analyze the rural communities' coping strategies. Fourth, to evaluate the rural communities' perceptions on micro credit interest rate. This research used both qualitative and quantitative methods. The results of this research were as follows. First, the factors causing rural communities to borrow money from micro credit institutions were to cover their living cost, provision and addition of capital. The micro credit institution had considerably lower interest rate than rentener, and the procedures were simple and fast. Second, the role of micro credit institutions to improve the rural communities socio-economic was still low. Third, the interest rate of the micro credit institutions was comparably fair and lower than the unlicensed micro bank.*

*Key words: micro credit, rural communities*

Financing through micro credit scheme is seen as one of important strategies in an effort to increase community economic and to prevent poverty. Micro credit distribution is directed to support the productive economic activity of poor community. In this

framework, financing through micro credit is meant to give support to drive productive economic activity owned by community or minor business.

The classical problem that is always found in Indonesia is that government is not able to iso-

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late rent seeker of economic activities. The rent seeker enters in almost every national economic activity. Reality in community shows that the weakness of capital access for poor community/micro business makes more rent seekers apply loan interest which is so high. This situation increases more in community living in either rural areas or urban informal sector. The weakness of access and information to service of micro finance institution makes rent practices grow rapidly.

In a rural area which the existence of the finance institution is limited, there are many "arisan" activities (social gathering whose members contribute to take turns at winning an aggregate money). Many "arisan" groups increase saving money activity as credit service supply for the members. However, the role of "arisan" or borrowing money from interpersonal relationship in supporting economic activity is still limited, especially because of the finance source which is relatively low. The alternative way to borrow money from usurer has a big effect namely making the business stop because the interest is high and it demands daily payment (*bank tithil*). The obstacle of capital access weakness and institution becomes the basic factor for poor community in raising themselves from poverty.

In developing situation, this fact has supported the existence of many micro finance services, either ones given by government through certain program schemes, non governmental organization (ORNOP), and other finance institutions. This micro finance institution service (LKM) is hoped to have a function to give capital access to community with an easy way and lower interest but it still pays attention good management principles so it can support productive economic business for *beneficiaries* as a part of strategy in an effort to increase the economy of community. Through micro credit credit with easy service, the difficulty of capital access for rural community can

be minimized so it can increase the business and help themselves.

As the healthy credit principles, micro credit has an essence which is different from commercial credit, that is the micro credit must be a part of a building process of long term finance, namely capital for the borrowers. This principle is an absolute-ness for loan policy basic which must be increased by every micro finance institution while the ability of long term capital building (*capital formation*) depends on the ability of the service users in managing loan capital for productive business so the result is not only able to return the loan and the interest and other expenses, but the borrower has benefit to add the capital for the business.

There is a conviction that the micro finance is one of the important strategies in increasing community economy and supporting many parties to open micro finance service. Public banks also begin to be interested in giving micro credit service because there is policy incentive by government including by looking how big the micro business potential is and how low the *non-performance loans (NPL)* is or fail credit from this business.

This research is aimed: (1) to analyze the factors causing the rural community to borrow money to the credit micro institution; (2) to analyze the role of credit micro institution in increasing the economy of rural community; (3) to investigate the business done by rural community to fulfill their needs; and (4) to know how far the community evaluates the interest rate which must be paid to credit micro institution.

#### MICRO BUSINESS ACTIVITY AND DEVELOPMENT OF LOCAL ECONOMY

Micro business is a kind of marginal business which is signed with the use of simple tech-

nology, low level of capital and credit access, and it tends to local market orientation. However, a number of investigations in some countries show that micro business has a big role in economy growth, absorbing manpower through creating job field, providing cheap goods and service, and also being able to prevent poverty. Besides, micro business is also one of main components to develop local economy, and it is potential to increase women's *bargaining position* in a family (Research institution of SMERU and the women efficiency ministry of the Republic of Indonesia, 2003).

In the context of cultural sector, basically there are 2 analysis approach models (Mubyarto, 2005). First, The model which is technical-economical analysis. This analysis only pays attention to the problem dealing with result and finance of development activity or investment. Second, the model which is institutional. This analysis pays attention so much on the factor of institutional framework in agricultural development. It means the institutional factor in community becomes an attention in power source allocation which is tried and becomes the orientation of development activity or investment. In the first definition, the activity of agricultural development investment can be seen only by comparing the amount of invested fund and production result gained. In this definition, which community institution given the investment is not a problem and it does not make a matter how the result can be shared or distributed to community so this agricultural political view concentrates more on production problem nationally. For the second understanding, the activity of agricultural development investment must pay attention on community institution which will do the activity. The community institutional aspect becomes a determining variable in the activity. It also happens to investment activity benefit aspect which gives function for community. The investment benefit is

less designed to give bigger function to the community needed more, namely farmers community so the orientation of agricultural development policy managed by government is always oriented to the farmers community widely

Mc Quibria (in Stone, 1992), in *Asian Development Bank* (ADB) explains about the poverty and the people who are poor socially and economically that *It's the lack of ability to employ assets that causes poverty. If your only asset is labour and you are unemployed, you are poor. If you are in a rural area and you don't own land, then you are also poor.* The statement has meanings, first: Why is the available fund not managed well, so it can increase? Many kinds of experiences in the past show that many cheap credits, many subsidies and grant to poor community so far fail. Some examples show that: cows given by government, chicken, grant for KUD, IDT program, electric generator which is not kept and broken soon, and fail credit implicating to the difficulty to get supporting capital, and it does not have a function to the target groups. Second, for a labor, the only productive asset he has is his physical power. He must compete with other labor to get a job, even he faces discrimination and nepotism system. Third, why a villager does not have land. When this problem is sharply opened, it can be found many structural variables which shackle those groups

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## METHOD

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This research will use qualitative and quantitative method. The use of qualitative method is aimed that the researcher gets complete and complex information about phenomenon which is hard to be found by quantitative method. Quantitative method is used to support qualitative analysis.

Population in this research is all families in Blitar regency. The number of families in Blitar regency is 176.500. Choosing sample is using *cluster quota*. Deciding the number of this *cluster quota sample* considers gender and location aspect, namely the distance of cluster and downtown. The cluster location is divided into 3, namely: village cluster which is near downtown (the distance is less than 20 km), village cluster which is 20-30 km from city and the village cluster which is far from downtown or which the distance is more than 30 km.

In qualitative approach, the respondents taken are not used to represent the population, but tending more to the information. The instruments used to get data and gather information from the respondents are *indepth interview* and *Focus Group Discussion* (FGD). The number of respondents in *indepth interview* is 42 people while the number of FGD is 20 people.

The family members who become respondents are a husband or a wife. The number of families in Blitar regency is 176.500. This number is too many if they all become respondents. As the research principle, the researcher may take sample for gathering the data (Sekaran, 2003). Thus, the number of respondents taken in this research is 150 people. Next in this research, the researcher takes 50 respondents from each cluster.

Variable measurement in this research uses quantitative principle by using Likert scale form. The respondents are asked to give response as their perception about the items dealing with the indicators from dimension/variable of social economy and community welfare.

Data analysis in this research uses the Qualitative data principle interactive model. This analysis process consists of three activities happening at the same time namely: data reduction, data pre-

sentation, and conclusion or verification. Quantitative data analysis used is descriptive and inferential. The tests done are reliability, validity and correlation.

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## RESULT FINDINGS

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The number of respondents taken in this research is 240 people. The criteria of respondents chosen in this research are those living in the rural area more than 10 years and getting married already. Questionnaire sending is done in 2 stages. The first stage was sent to the respondents in cluster 1 (rural area which was less than 10 km from downtown). The sending time was done early October 2008 to 80 families and 80 questionnaires. The second stage was sent to the respondents in cluster 2 (rural area which was 10-20 km from downtown) and cluster 3 (rural area which was more than 20 km from downtown). The sending was done in the early November to 160 families and 160 questionnaires. Until early December 2008 the questionnaires sent back were 150. The respondents answering were 150 people. There were 6 respondents answering the questionnaires incompletely. The incomplete questionnaires were sent out from analysis so the number of questionnaires which were analyzed were 144.

### Test to The Level of Answer Deviation

Place difference (cluster) and the time of taking sample can cause different answers. To know whether the respondents answers are different at the different place and time, the researcher uses *sample t test*. It tests whether the mean of respondents answers in the first cluster are different from the respondents answers in the second and third clusters.

Generally respondents answers from each cluster are not different. The different answers from some clusters are because of demography condition and social economy of the community among the clusters. For example, the variable of community income in the rural area cluster which is far from downtown and near a forest is really different from the income of the community from the rural area cluster which is near downtown. Moreover, the rural area community that is near forest, the living depends much on the forest so the answers among the clusters in the research are natural.

**Reability and Validity Tests**

Reability test instrument is done by looking at coefficient a Cronbach, and if a > 0,5 the instrument of the research is reliable. Validity check is done using *Corrected Item-Total Correlation*. If the score of *Corrected Item-Total Correlation* is more than 0.2, the variable is valid from the result table of validity and reability tests. From the test result, it can be known that the research instrument for almost all subdimension and variables are valid. Only 3 subdimensions are less valid. Next the result of reability test also shows that all variables are reliable.

**Description of Community Social Economy in Research Location**

The main job of rural community in Blitar regency until now is agriculture sector. Based on the research result, around 80 % of respondents are farmers. Other 20% work out of agriculture sector like merchants, labors, teachers, civil servants, etc. However they have side job, namely farming. So it cab be said that almost all rural community get involved in agriculture activities.

The average income of rural community from their main income is Rp.1.012.300,00 per month. However, there are still many of rural community having income lower than Rp.500.000,00 per month. The small other parts have income until Rp.6.500.000,00 per month. The families having income until Rp.6.500.000,00 are those having large land or those who work as civil servants. Imbalance in the income appears because there is a difference of the land width and job status owned.

Table 1. Distribution of Land Owning in Rural Area in Blitar Regency

No	Land width	Number (%)	Cumulative (%)
1	Having no land	13.9	13.9
2	Less than 0.25 hectare	55.6	69.4
3	0.25 – 0.5 hectare	21.5	91.0
4	0.5 – 1 hectare	6.9	97.9
5	More than 1 hectare	2.1	100
	Amount	100	

Source: Primary Data, Processed (2009).

The condition of land owning in the future will be worse if the government does not do a policy dealing with land owning distribution. So far, the community get land more because of inheritance, not purchasing transaction. Land will be exhausted because it is shared to heirs. Land getting from purchasing transaction is less because the income of the community is low.

Table 2. Source of Rural Community Land Getting in Blitar Regency

No	Information/explanation	Amount (%)
1	Never getting land	14.6
2	Purchasing	4.9
3	Purchasing, getting inheritance land	27.8
4	Purchasing, getting "tanah bengkok"	1.4
5	getting inheritance land	48.6
6	Rent	2.1
7	Getting grant land	0.7
	Amount	100.0

Source: Primary Data, processed (2009).

Generally the community income from agriculture sector is received at the end of harvest, not early month like income received by labor or civil servant. The way they fulfill their daily need is by finding side job and get saving if they have it. The form of rural community saving is unique because it is not always money. They can have saving in the form of other goods like jewelry (gold), animals (chicken, goats, cows), harvest which can be saved for a long time (rice, corn, soy).

## DISCUSSION

### Factors Causing Rural Community Borrow Money to Micro Credit Institution

Living situation in Blitar regency still shows cooperation so the tradition of helping each other in every business is natural. However, someone cannot rely on all the business continuously to someone else's help. Based on observation, if family A has ever been helped by family B, family A

will help family B at the other time. So it can be said that a help like money, manpower, etc is taking turns.

Together with the reduction of land owning, the real income of rural community generally reduces too. Indeed there are some families that the income increases more, namely those having large land and the people who are successful in looking for and finding job. The people whom the income reduces more and more will fulfill their need in many ways including borrowing money from micro credit institution. Anyway, micro credit institution always asks collateral and another requirement to give credit.

Some other factors causing community borrow money to micro credit institution are: wishing to add business capital, salary which is not definite either the amount or the time, the rate of reachable loan interest (not so high), and the process of easy and fast loan.

### The Role of Micro Credit Institution in Increasing Rural Community Economy

Credit with relative cheap interest (less than 2 %) offered by micro credit institution like Bank Rakyat Indonesia (BRI) has not been fully used by rural community. It is because micro credit institution like BRI always asks collateral. The goods for collateral may be certificate of ownership of motor vehicles (BPKB), land owning certificate like 'petok D', land document and certificate. Most of them get land from parents and ancestor. The condition like this finally hinders the access of rural community to get service from micro credit institution with relative cheap interest.

Table 3. Rural Community Opinion about Functioning Level of Micro Credit Service by Community

No	Rural Community Access to Get Micro Credit Service	Amount (%)
1	Community access to get high credit	11.8
2	Community access to get low credit	23.6
3	Do not know	64.6
	Amount	100.0

Source: Primary Data, processed (2009).

Actually, many of the community having goods to be collateral like motor cycle and land. The problem faced by them is that motor vehicles they own have not been settled or there is no BPKB yet. The land they own rarely has a certificate. People finally have to borrow money to 'bank thitil' with high interest rate (2-4% per month flat) or effective interest per year about 60%. Based on the explanation, it can be said that micro credit institution has not increased rural community economy. In table 17 below, it is explained about rural community view toward micro credit institution role to increase community economy. 27.8% respondents say that micro credit institution can increase rural community village while the rest, 72.2 %, have opinion it cannot and they do not know.

Uncertainty and reduction of income accepted by rural community causes some people cannot pay interest and basic loan (Sulaksono, 2005). Finally it can be guessed, they have to sell land to settle the loan. They have to sell the land to fulfill unavoidable need. It means that community lose their land because they cannot settle their loan to micro credit institution. The case like this often happens in rural area so rural commu-

nity are sometimes doubtful to borrow money to micro credit institution, moreover if the loan is consumptive. Based on the research, people are still pessimistic to the role of micro credit institution in helping them to maintain their land..

Selling land transaction also appears because community cannot get access to borrow money to micro credit institution. They cannot use land as the collateral. It is because the land do not have document, the owner name is not same as written in the land document, the land is because of heritage which the name written in the document is only one person because it is not shared yet to all heirs etc. Most people have land without owning proof. Land owning is only based on the history.

Another part of community has to sell land because the loan amount given by micro credit institution is not as much as what they hope. There is no other way except selling land. So far, credit given is not only based on how big the collateral is, but also the borrower's ability to pay back the loan (Hastuti & Nina, 2004; Fernando, 2004). Micro credit institution will ask what the loan is for. The policy of Micro credit institution like BRI gives a priority at the loan which is for productive activity because the opportunity to get back the loan is higher

Another problem experienced by rural community dealing with micro credit service access is how low the understanding about credit skim offered and the kinds of available Micro credit institution (Soelaksono, 2005). They cannot differentiate which formal or informal Micro credit institution. The important thing for them is getting quick and easy fund. People usually cannot count what the real effective interest that they have to pay. Based on the fact, all Micro credit institutions use flat system as the interest basic counting. The use of flat system eases to count the interest

and administration but in other side it deviates the borrowers. Even there is a borrower who must pay flat interest rate 4% per month or effective interest around 90% per year.

#### Efforts Done by Rural Community to Fulfill Their Needs

Reduction of land owning give direct effect to reduction of community income especially income from agriculture sector so people need to find a strategy or keep trying to be alive (Wijaya, 2005) . Some job strategies done by community and based on their own initiative are: working hard, living safely, farming, getting loan from bank, cooperation, friend, relative, parents, managing finance well, living simply, finding side job (farm labor, building labor), selling farming crop, selling furniture, opening shop, joining *Multi Level Marketing (MLM)*, Working overtime, saving money when having more income, dan being ojek driver (providing service to take someone by motor cycle).

Interest rate given by micro credit institution to community is about 2% – 3% per month. Each micro credit institution has its own interest rate. It means that the interest rate is different. Interest rate of black bank is usually higher, sometimes until 4% per month. Based on the research, 89.9% respondents say that interest rate of micro credit institution is too high. Looking at the fact, government needs to interfere. The forms of interference are (Kalpana, 2004): increasing micro credit service with proper interest rate, facilitating micro credit service, and building community productive businesses especially the business which can create job field and adding income. The other interference form is carrying out application education which can be used in daily life and for the improvement of village infrastructure.

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## CONCLUSION AND SUGGESTION

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### Conclusion

Some factors causing people borrow money to micro credit institution are: income reduction, wishing to add capital, the income received is not certain either the amount or the time, reachable interest rate (not too high), and the easy and quick process. Micro credit service has not been fully used by rural community because micro credit institution like BRI always gives a requirement like collateral and other requirements which are not owned by all people. Micro credit institution has not helped people to maintain the right of their land because the amount of the loan is not enough to fulfill the needs. Besides, in many cases, the borrowers lose their land because they cannot settle the debt to micro credit institution. The interest rate of micro credit is proper but there are still black credit with too high interest. Community have to take the credit with high interest because the process is easy and quick.

### Suggestion

Government needs to facilitate and build community productive businesses especially business which can create job field and adding income. This concept is based on the creativity appearing from low level or referring to *participatory concept*. Based on the experience, the village increase by using *top-down model* often ends with refusing and failure. Government needs to control micro credit institution, especially the interest rate and procedure aspect. The ideal interest rate is the proper one or little higher than market interest. However, the credit procedure should be easier compared with public bank pro-



cedure. It is as the characteristic of village community. Government needs to carry out application education which can be used directly to the daily life and for the improvement of village infrastructure.

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