POLICY BRIEF

MICROFINANCE IN INDONESIA

I. Background

The year 2005 was designated by the United Nations as the Year of Microfinance. Microfinance is considered an important strategy in poverty reduction and various microfinance services have been opened by government, donor institutions, NGOs and public banks. While there has been significant growth in microfinance activities, a number of issues of concern have arisen.

Microfinance has a long history in Indonesia since the establishment of The People's Credit Bank (Bank Kredit Rakyat) and Lumbung Desa (an institution that provided loans and collected savings in the form of rice) in the late 19th Century. After independence, the Indonesian Government supported the establishment of bank pasar as well as microfinance institutions (MFIs) formed by local governments.

The implementation of Law No. 7 of 1992 on banking established two types of banks in Indonesia: public banks and People's Credit Banks (BPR). Other financial institutions are considered to be MFIs. Today MFIs can be grouped as: 1) formal MFIs consisting of bank and non-bank units (cooperatives, pawnshops); 2) non-formal MFIs, both those which are already legal entities (foundations) and those which are not; 3) MFIs established under government programs, as well as 4) informal MFIs, like arisan and moneylenders.

II. Findings

- Attitudes towards the Poor

  During the period when the government provided subsidized agricultural credit (1950s – 1970s), the poor were considered to be marginalized farmers, usually males, who needed to increase their productivity through the provision of credit. In the 1980s poor communities were viewed more as micro-entrepreneurs, generally women, who have no assets to use as collateral despite their businesses prospering. For that reason there were many attempts by non-government institutions to provide microcredit. In the 1990s microfinance services made innovations in the means of channeling credit in the form of groups patterned on the Grameen Bank, and groups of poor women became the main target.

  At the end of the 1990s, several studies highlighted the growing exclusion of the poorest groups from microfinance services due to the excessive emphasis on payment continuity, the 'institutional viability' of microfinance service providers and microfinance service programs that are not compatible with the living patterns of the poorest whose economic activities are carried out on a small-scale with a very high level of vulnerability to fluctuations in economic conditions.

- The Problem of Microfinance in Indonesia

  Institutional deficiencies:

  Microfinance services face many obstacles. The problems, inter alia, are connected with capitalization or the source of funding, institutional affairs, management, and the quality of human resources. There is inadequate capacity building and funding support from the government (BI) particularly for nonbank formal MFIs, nonformal MFIs and the microfinance units of government programs so their development is languishing.

  Legal status:

  There is a lack of clarity on the legal status of MFIs, especially on their ability to mobilize funds or undertake law enforcement against their clients. Most stakeholders consider that legislation will inhibit community initiative to form microfinance services while supporters believe legislation is necessary for the effective development of MFIs.

Accessibility/livelihood compatibility:

Not all microfinance institutions are easily accessible by the poor, especially those who live in rural areas who find it difficult to obtain access to banking services because it is difficult to fulfill the necessary requirements. In addition, their needs and conditions in general are not compatible with the prevailing policies of the banking world.

Inadequate funding capacity:

Outside the banking system, the poor can obtain finance services from nonbanking institutions, nonformal institutions and the microfinance enterprise units of government development programs. The main service that is provided by these institutions is credit but the funding capacity of these microfinance institutions is, in general, small.

Community group sustainability:

The majority of microfinance services from government programs are channeled via community groups. Community groups can survive and prosper if adequate technical facilities are available. Community groups usually develop savings activities to support the sustainability of credit services but due to the nature of the revolving system, there is a scarcity of available enterprise capital for the poor.

III. Conclusions and Recommendations

Conclusions

Microfinance services in Indonesia are still faced with many obstacles, including the absence of legislation on MFIs, capitalization problems, lack of funding, institutional affairs, management, and the quality of human resources. MFIs cannot mobilize funds due to the lack of clarity concerning their legal status. Technical support for microfinance activities as well as capacity building efforts by government (BI) are also still limited.

Recommendations

1. Legal Status:

   Enact legislation on MFIs in order to provide a legal basis for MFIs to develop, assist the commercialization of financial services, to support the community initiative to form MFIs as well as to support weak MFIs.

   Re-examine and re-formulate the draft legislation for MFIs that was compiled by Gema PKM Indonesia and the Bank of Indonesia in 2001.

2. Accessibility/livelihood compatibility:

   Examine and change the format of MFIs microfinance services so they are more compatible with the needs of poor communities.

   Improve the accessibility of enterprise credit for farmers in order to enhance the compatibility of available credit schemes with the pattern of activities of agricultural enterprises.

   Recognize microfinance services as a basic need, as is the case with education and health, to remove the need to subsidize service providers.

3. Community group sustainability:

   Assist the capacity building of community groups by providing adequate technical facilities to assist in the group's management and the members' businesses.

The SMERU Research Institute: Jl. Pandeglang No. 30 Menteng, Jakarta 10310 Phone: 6221-3193 6336; Fax: 6221-3193 0850, e-mail: smeru@smeru.or.id, Website: www.smeru.or.id