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Access To Microfinance Effect And Economic Welfare

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A B S T R A C T

Regional approach for financial inclusion has been identified as one important factor for national development in many ASEAN countries. The deepening of the financial sector is one of the main objectives in the AEC. It mainly affects the capital and capacity constraints on the financial system in several ASEAN countries, including Indonesia. Lembaga Perkreditan Desa or LPD is a traditional micro finance institution in Bali. It is called traditional because they operate based on local government regulation which roots from traditional village rules (namely awig-awig). Microfinance institutions, including the LPD, became the foundation to achieve the main goals of financial inclusion in Indonesia. This study tries to look beyond the influence of access to the LPD, through public perception point of views about distance, interest rate, and service to improve Balinese people welfare. Tests carried out using cross section OLS to retrieve data from interviews of 107 respondents who become LPD customers. The results of this study are expected to provide further description whether access to the LPD affect the increase in the welfare of society, especially access to microfinance institutions.

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INTRODUCTION

Village credit institution (*Lembaga Perkreditan Desa*/LPD) is one of traditional microfinance institution (MFI) in Bali. The existence and the ability to survive of the MFI (in this case, LPD Bali) is being questioned ahead of the enactment of financial inclusion in ASEAN area in 2020. The free entry for foreign financial institutions as accessible financial source for the society becomes a challenge to maintain the existence.

The existence and the spirit of the LPD in Bali is basically for the development of indigenous village as a fortress to guard Balinese culture and a new step in increasing financial access for the poor society in particular. The effort is wrapped with a term of financial inclusion. The purpose is to have all parties can be covered by the financial sector. Ito (2003) stated that microfinance institutions are in an area where social capital role receive more attention. Social capital itself is defined as a norm and social relation attached to a social structure of society that allow the people to coordinate in order to achieve the expected goals. The establishment of LPD is based on a cultural heritage of *pakraman* village, which is a form or an umbrella of a village government system consisted of a family bond.

In its development, LPD has proven to be able to contribute to the development and welfare of the community of local *pakraman* village. The relatively high growth of the LPD overtime is an indication that it is needed by the rural communities, including UMK (small and medium enterprises) that has been in their service. The specification of LPD that has cultural and psychological closeness to its customers as well as close location factor allows it to reach its customers. In addition, the supple business character of the LPD is the strength of the institution to survive and to have competitiveness to other similar institutions, especially in this current economic condition. The progress of the LPD that is expected to be an effective financial institution for rural communities will have positive impact on rural area development since the communities will be assisted in terms of funding to develop business potential in their area that will make the rural area to be a competitive area in global economic order.

Since its initiation in 1984, the LPD has functioned to drive economic development of the community through directed savings and the distribution of effective capital. It is also expected that it could eradicate bonding system and dark mortgage that often occurred in the community. Another function of the LPD is to create equal distribution of employment opportunities to work directly at the LPD or to be employed in productive businesses funded by the LPD in the community. Creating purchasing power and accelerating payment and exchange traffics in the village are the main duties of the LPD.

LPD has strategic position in rural development level to accelerate economic growth and development of the *pakraman* village in order to improve the standard of living of rural communities. As the umbrella of rural economic wealth, the LPD is expected to play role in increasing rural economic efficiency, encouraging productivity of the community as well as giving contribution to the development.

This paper is aimed to find out to which extent the community feels being helped by the existence of LPD in their area. Since its establishment, the LPD has developed rapidly. Various indicators, from financial indicators to service and outreach indicators, have been chosen to be used to explain its performance that shows a significant improvement. According to Arsyad (September 2005), there were two important things should be noted. First, the data has indicated that the LPD has succeeded in stimulating and encouraging the increase in saving behaviour of the rural communities. It means that they are able to achieve one of their establishment goals as well as increase the degree of monetation in their area. Second, the LPD has succeeded in offering a mechanism in mobilizing the available fund. Customers feel that the mechanism is in accordance with their need. The condition could also mean as the high trust of the customers in the LPD, which is the basic of the reason for them for savings in a financial institution.

Financial institution is the core of development process. An efficient and well-functioned financial system is very crucial in bridging the flow of fund to various productive financing sectors including risk allocation. This, in turn, could drive economic growth, increase income opportunities and distribution, and reduce poverty. On the contrary, if access to financial institution and its various related services is limited, the benefit of financial system development cannot be felt by many people or companies and as consequence, the increasing number of poor population. Therefore, access to financial institution is important. The access allows households to invest in activities that tend to have more contribution to the increase in their future income and certainly to the economic growth (Ellis et al., 2010).

Microfinance institution has evolved since 1990s as a tool of economic development aimed for the low but potential income society. Ledgerwood emphasized the main goals of the institution as a developer organization, which is providing service that help the financial need of society that is unreached or unreachable by the bank, particularly, those societies within the poor category or low income (Arsyad, Sept. 2005). Specifically, World Bank stated that the existence of microfinance institution is expected to be able to reduce poverty as one of the most important development goals. However, the positive impact of microfinance institution to the socio-economic welfare of the poor society could only be reached and maintained if the institution has good financial condition and operational outreach performance.

Microfinance institution is often used as the best example of the effectiveness of social capital mobilization to reduce poverty when market and government fail to do so. A concept proposed by Coleman (1988) defined social capital as a variation of various different entities with two general elements, which are having the aspect of social structure and facilitating certain actions of its players, in person or group, in the structure. The social structure included, either vertical or horizontal, is part of the social capital. A group-based financial scheme for the poor society group. By opening the door of information widely, the group will know each other. Therefore, according to Seralgeldin and Grootaert, the scheme rests on the social capital that able to overcome the lack of information and a group of risk faced by the funders (Ito, 2003). They clearly stated that started from the *tontines* (informal saving cycle) in West Africa to *Grameen Bank* in Bangladesh, they can function well since their member have better information about their group compare to those owned by the bank. The pattern is known as a success in overcoming information issue and to reach more poor people in rural financial market in the developing countries.

Just like other financial institutions, LKM has intermediation function in financial sector. The function is aimed to give better access to the society within the low income category. The institution is expected to be financially independent. The consequence is that the measurement of the performance of LKM is based on their financial performance referring to their ability to cover their operational cost with their revenue (Arsyad, Sept. 2005). The performance of LKM is not merely measured by their financial independence but also by their operational outreach. Both indicators are the standard in performance measurement of LKM.

In the assessment technique, however, some contextual factors should be taken into account. Those factors are, for example, geographical context (benchmark to Latin America is not necessarily suitable to Asia and Africa), the age of the institution (new institution might bear expansion cost without adequate revenue, thus it cannot be compared to institution that has long been established), and various lending approaches used (Arsyad, Sept. 2005).

According to the explanation of Regional Regulation (*Perda*) No. 8/2002, that was later being changed into *Perda* No. 3/2007, the establishment of LPD and its business forms should be directed to the increase in the standard of living of *Krama Desa* and its activities should support the village development. LPD's businesses are conducted to drive the economy of the rural communities by increasing saving behaviour of the communities and providing credit for small business, eliminating various forms of credit relationship exploitation (such as *ijon* (bondage), dark mortgage, and other forms similar to them), creating equal business opportunity for *Krama Desa*, and increasing monetization level (purchasing power and facilitate payment traffic and money circulation) in rural areas. The value of LDR (credit to saving ratio) is one indicator of the ability of financial institutions in implementing their intermediation role. The high value of LDR indicates that LPDs have succeeded in achieving their role as financial intermediation institution and increase their outreach area, which is the proxy of their positive impact to the development of rural economy. Regulation from the central bank (BI) requires LKM to maintain their LDR in the level of 95 percent. The establishment of LPD, targeted to be existed in all customary villages, is not necessarily forced by the government. Based on Article 5 *Perda* No. 8/2002, LPDs could only be established in *pekraman* villages (customary village) that have written '*awig-awig*' and have potential to be developed based on their socio-economic aspect.

In the practice, as required by explanation of *Perda* No. 8/2002, the LPDs should implement prudential aspect as the commercial financial institution so that they could achieve health indicator required. Other regulations include capital sufficiency, limit of loan given or legal lending limit, loan classification system, the availability of sufficient provision for bad debts, liquidity management, assessment system for LPD, reporting regulations for LPD, and sanctions for violations and their implementation including restructuration, closure and liquidity of LPD. Basically, the regulations set are similar to the health analysis of rural bank (*Bank Perkreditan Rakyat*/BPR), which is capital, adequacy ratio, management quality, earning and liquidity (CAMEL). However, in the practice, the health assessment of LPD by the village consultative body (*Badan Permusyawaratan Desa*/BPD) is not as strict as those implemented by BI to banking sector; therefore, sanction given to the LPD within the category of unhealthy is unclear. The category itself is classified as healthy, fairly healthy, less healthy and unhealthy. According to the note of BPD (GTZ, 2010), the development of LPDs within the category of less healthy and unhealthy is decreasing.

In the measurement of portfolio quality, the ability of repayment is the most important performance indicator of a financial institution. The indicator is also prevailed for LKM due to the urge for the LKM to be independent and survive in a long term. Yaron stated that the achievement of high profit cannot be an indicator of independence and existence since profit can be achieved in short term (Arsyad, Sept. 2005). Therefore, the achievement of the provision of current credit by customers is the important condition for the LKMs to be self-sufficient in the long run. The indicator is also used by the Bank of Indonesia, as a central bank, to measure the health of the banking (in CAMEL), by giving maximum limit of 30 percent to be stated as healthy (Arsyad, April 2005).

The BPD classifies credit repayment of LPD in four categories: performing loans, doubtful loans, substandard loans, and nonperforming credit. The level of credit repayment in the LPDs is within the category of very good since the NPL value is decreasing. According to Arsyad (Sept. 2005), there are four reasons for the good portfolio performance. First, according to the rule, the LPDs will give loans only for customers who have their own business (UMK, farmers, and small traders) and use the loan productively. For the LPDs' management, it is relatively easy for them to identify qualified prospective borrowers due to their limited operational area, which is in one customary village where people tend to know each other. In addition, the screening technique for potential borrowers (with the agreement of the *Bendesa Adat*) and credit billing could help the LPDs to minimize problems that often faced by the LKM in giving credit to small business. Also, the use of rule enforcement mechanism through customary village, such as social sanction, could reduce problems occurred during credit payment. Second, most of the borrowers come from a customary village where the LPD is located. The LPD is rooted from culture and should follow the local customary. The attachment of LPDs to the local institution brings a sense of belonging and the growth of moral responsibility to support the development of their LPDs. Moreover, from the screening process to the enforcement of rules, the management works together with the supervisory board who knows better about the reputation and character of the prospective borrowers, thus it is very efficient to avoid error during the assessment of credit payment ability of the borrowers. Third, social sanction set in the *awig-awig* has a power to force the borrowers to pay their credit on time. It is due to the heavy sanction, which is up to an exile from the community, implemented for those who violate the customary rules. Fourth, the technique for the credit repayment, such as savings, is conducted from house to house so that it forces them to pay on time. Therefore, it can be concluded that the portfolio quality performance of LPDs is influenced by the management practice of LPD that utilize the customary and culture of the community.

In many cases, this practice becomes perfect information and reduces transaction cost for both the customers and the LKMs (Arsyad, April, 2005). It is also a reason why the prospective borrowers who are not from the local customary village are not allowed to apply for credit in the LPD since they do not bound by the *awig-awig* thus social sanction is no longer effective. Moreover, it justifies the argument of World Bank that informal institutions could become less effective if there are more exchange partners thus the socio-cultural is more diversified. The written regulation in the awig-awig is also prevailed for the management and staffs of the LPDs who break the rule or implement the wrong management in the daily operational, such as collusion, corruption, and manipulation. Social sanction can be imposed to them as those for the delinquent debtors. Furthermore, *Perda* No. 3/2007 emphasized that the criminal sanction that might threaten the staff and management is in maximum of six months in prison or maximum fine of IDR 50 million (previously was IDR5 million in *Perda* No. 8/2002). It indicates that informal and formal institutions are used simultaneously in the management practice of LPDs.

RESEARCH METHODOLOGY

The research would focus on sampling of LPDs in Denpasar. Due to the large number of LPDs (total 1,433 LPDs in Bali) but with homogenous characteristics and regulation used, sampling of LPDs in Bali was expected to represent the expected result. Data used was secondary data of financial data of the LPDs in the BPD as well as in the LPDs and primary data in form of interview (questionnaire).

The research used two techniques, interview with respondents and a quantitative analysis. Interview would involve all elements who were responsible for and had direct interaction with the LPDs, which were management of LPDs, Bendesa (*Prajuru Banjar*), and the surrounding communities. Quantitative analysis was used to find out whether there was a significant influence of the outreach and access to LPDs on the economy of the community and the sustainability of the LPDs.

The impact of LPDs on the economy was seen from the perception of the community on the role of LPDs in their economic life. The emphasis here was on how the influence of the access to LPDs determined their perception on the role of LPDs on their economic welfare. The term of access used here is defined as the easiness for someone to use the financial services when they want it. This terminology is different to the utilization. An individual might have access to a financial service but he/she chooses not to use it. It is also possible that someone faces obstacle in access although they use a financial service. For example, someone might have an account but have difficulty to use it actively since the nearest branch or the ATM is far from his/her home.

The term of utilization is often used as a proxy of an access since it is easier to measure. In this research, however, information gained was considered as sufficient to look for the reason of each respondent in using the financial service of LPDs. Whether someone does not use the financial service due to obstacle in the supply side of access (such as the distance to the bank, the cost of service, eligibility requirements, etc.) or it is related to the demand side (such as, there are not enough money for savings or have no reason to apply for credit), which means that they might have the access to a financial service but prefer not to use it.

The econometric model used here was aimed to find out the probability of someone states that whether or not the LPD is beneficial for his/her economy. The model used was as follow:

$$P_{id} = \alpha_d + \beta_1 access_{id} + \beta_k X_{id}^k + \varepsilon_{id} \qquad (1)$$

Using sample of all respondents, borrowers and depositor, Pid is a discrete variable equal to 1 if the respondents answer is that the LPDs help to improve the economy and equal to 0 if the respondent answer is no. The variable was regressed with accessid variable indicating access of respondents to the LPDs. The access was proxied by some variables, which were the distance of the house from the LPDs, a dummy variable indicating the satisfaction of respondents to the service of the LPDs, and a dummy variable to catch the perception of respondents of the interest rate given by the LPDs. X_{id}^k variable was a control variable, which was the characteristic of respondents consisted of age, gender, last education, status in the household (head of family or not), job (civil servant or non-civil servant), the number of dependents in the household, and income.

RESULT DISCUSSION

The research targeted all components of LPDs, starting from customers of depositors to borrowers. Almost all LPDs required the customers who borrow at the LPDs (debtor) to have deposits in the LPDs. Almost 64.77% of the creditor in the LPDs were also a debtor and only 17.47% who were creditors only or depositors who had no loans in the LPDs. It indicates that most of the society of LPDs' user used the

LPDs as their financing source in form of credit and only small part of them used the savings service of the LPDs. It can be understood due to the limitation of LPDs in providing other facilities, such as ATM or debit card, which were the advantage of commercial bank in raising fund. On the other hand, the LPDs, with their characteristic that differ from commercial bank, could provide more flexible credit service in terms of the requirements and the disbursement time. These characteristics had made the community preferred to use their access to the LPDs if they needed funds.

Based on the gender, 71.96% of the respondents were male and 28.04% were female with ages ranged from 21 to 75 years. The education of respondents was varied from elementary school (SD) to graduate school (S2). The users of LPD were not only dominated by the economically weak (poor) communities but also from the medium to high income communities who trust them with all their limitation as the elected financial institutions for various financial transactions.

The establishment of LPD was basically aimed as an information centre of strategic and productive business of the community that was directed to increase and empower local economic potential and in turn could increase the competitiveness and welfare of the community of *pekraman village*. The LPDs were expected to have a very strategic role in serving micro and small enterprises (UMK) and local communities. It can be indicated by the intended use of the loan from the LPDs where credit for working capital had the biggest portion (59.02%) compared to consumption (31.15%). Credit was also used for education. It indicates that the financing from the LPDs had been used for productive purposes. The credit score of the customers was relatively small and it was in accordance with the purpose of the establishment of LPD. Most of the customers had credit below 5 million and 30.51% of the customers had credit above 5 million. The reasons for using the LPDs, which were the close distance and satisfying services, were the indication that they had full access to the LPDs in their neighbourhood.

The econometric regression model is presented in Table 1. The dependent variable was the perception of respondents of the benefit of LPDs for their economic welfare. The result shows that the access to LPDs had a significant effect to the economic welfare of the local community. Although distance had no significant effect, the satisfaction with the LPDs services had a significant impact on the economy of the society. Distance indicated a negative relationship. It is in accordance with the hypothesis that if the access (in this case, the distance between the society and their financial institution) is hard, the impact of the existence of micro financial institution is lower. However, since the LPDs were in the local community neighbourhood, distance was considered as not a variable with significant influence. This is different with services given by the LPDs.

Service in the research was a dummy variable indicating the satisfaction perception of the society with the services of the LPDs based on the transaction cost imposes by the LPDs. An analysis using primary data, which was the result of survey to LPDs' respondents, indicates that almost 64.58% of the respondents stated that the services of the LPDs was satisfactory, whereas 15.63% stated that the services were very satisfactory, and only 19.79% of the respondents stated that it was unsatisfactory. Result of analysis indicates that the more satisfied the respondent with the services of the LPDs, the more useful the LPDs in their economy. It is explainable since the transaction cost of the LPDs was relatively cheap (easy requirements, the existence of a proactive system, and faster processing time).

Table 1
Result of Regression Model

Variables	Coefficient
The distance of the home to the LPDs	-1,511
The services of the LPDs	2,840**
The interest rate of savings	-1,085
The interest rate of credit	-48,927
Age	0,096
Gender	-3,542
Education	-3,150*
Status in the household	7,233**
The number of ART	-0,573
Job	-1,443*
Income	1,900**
The purpose of credit	12,144

Note: *** $p_{val} < 0.01$, ** $p_{val} < 0.05$, * $p_{val} < 0.1$

Another variable describing the access to LPD was the perception of the community of the interest rate imposed by the LPDs. The interest rate can be used as an indicator since the choice of whether or not to use the services of a financial institution is depended on its interest rate. If the public considers the interest rate is “low”, they could choose to access the LPDs instead of the commercial bank. The result shows that either savings or credit interest rate had no significant impact on the economy of the community. It indicates that interest rate was not the main consideration for the society to access the LPDs. Referring to the various reasons given by the respondents it was the easy requirement in lending that became the main strength factor. In addition, the efforts of the LPDs by conducting service from house to house showed the closeness of the LPDs with their surrounding communities so that awareness emerges from the communities to use the LPDs as an effort to improve their environmental economies.

From various variables of respondent characteristics, last education, status in the household, income, and job, had a significant influence in the formation of respondents’ perception of the role of the LPDs in their economy. Education gave negative relationship signal with the role of the LPDs. It can be explained by the increasing insight of the respondents on the various existing financial institutions with various facilities given. It gave them more choices of institutions they can access based on their need.

Job variable, which was a dummy variable of civil servant or non-civil servant, gave signal that respondent who worked as non-civil servant felt the benefit of the existence of LPD more than those of respondent who worked as a civil servant although the influence was not so strong. It can be understood since civil servant had easier access to formal financial institutions, especially bank due to the cooperation system between the bank and the government. It is different to those respondents who worked as non-civil servant since they had to try to pledge “themselves” in order to access formal financial institutions.

Education also had negative influence indicating that someone with low education could feel the benefit of the LPDs more in helping their economy. It shows that the LPDs had a very strategic role in helping the poor society to increase their economic welfare as is the role of the LPDs. Some empirical studies showed that the weak do feel the benefit.

Income, however, had positive influence on the perception. The phenomenon was related to the strong role of the LPDs in the community, thus they were not only utilized by the low economic (poor) society but also those who are quite capable in terms of economy. The bigger their income, the more is the benefit of the LPDs that they perceived for their economy. The role of the LPDs here was to generate economic potential in their area. If credit from the LPDs was used to expand the business or its variations, the role of the LPDs had succeeded. Those communities who gained increase in income would continue to use the services of the LPDs as their funding source. It can be related to the relationship between the intended uses of the credit (consumption or business capital) that had positive values. Credit from the LPDs was indeed to direct and increase the productivity of the society to empower local economic potential and in turn, it could increase their own welfare.

Status in the household indicated positive influence. It means that if the respondents who accessed the credit were the head of household they were more capable in utilizing the fund for the family welfare. It was different if the one who accessed the credit was the household members.

Another interesting phenomenon was the gender of the respondents, although the influence was not significant. This negative relationship indicates that if women accessed the credit, the family's economic welfare was more perceived than if man accessed the credit. Some studies indicated the differences in the way woman and man managing the assets (in this case, access to credit). If women were given access to credit, their bargaining power in the decision making in their household would be stronger. Credit received would be distributed to increase the family welfare, for example, to give better education and increase the nutrition and health of the children as well as the family (Quisumbing & Maluccio, 2003; Smith et al, 2003). Therefore, for the last 10 years, international development institutions, such as World Bank and the United Nations, gave priority to women for access to financial institutions, especially informal, microcredit distribution-based institutions (Norwood, 2005).

CONCLUSION

The research was an empirical study to find out the role of LPD as traditional microfinance institution in Bali in local community welfare. Efforts in strengthening the existence of LPD are very important in supporting the government's effort to increase financial inclusion to encourage development and reduce poverty. The financial inclusion process will protect the poor society groups that unable to gain access to financial institutions due to limitation in access, guarantee, and connection.

LPD becomes an informal microfinance institution that closes to the people of Bali due to the historic reason and the supporting regulations. Under the regulation of local government, instead of Banking Laws, LPD becomes more flexible in giving access to the local communities to use its services, especially micro credit. Result of analysis indicates that the easiness in access, especially transactional cost given by the LPD, had a significant influence on the perception of society of the role of the LPD in helping their economy and welfare. Transactional cost tended to lead to the easiness and quickness of the LPD in serving the public. Therefore, the existence of LPD as a microfinance institution could direct and increase the productivity of the community to empower local economic potential that in turn could increase their welfare. What can be underlined from the research was the establishment of a financial institution will meet the expectation of the society if it has easy access. This easy access can drive local economic potential, thus able to increase the economic productivity of the community.

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