

The Role of Microfinance Institutions in Supporting the Development of Micro, Small And Medium Enterprises

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ABSTRACT

Microfinance Institutions (MFIs), created based on Law No 1 of the Year 2013 concerning Microfinance Institutions, aim to provide legal certainty and fulfill financial service needs for the poor and/or low-income people. Meeting the needs of financial services by increasing access to micro-scale funding, contributing to the increase in economic empowerment and community productivity, as well as increasing the income and welfare of the community. Thus, MFIs can be one of the effective solutions to support the development of Micro, Small and Medium Enterprises (MSMEs) due to their financial service procedures being more flexible and more affordable in rural areas. MSMEs are basically part of the poor who have the willingness and productive ability to improve people's lives in the regions. MSMEs must be provided the widest access to obtain funding from MFIs. Hence, it is important to know the role of MFIs in supporting the development of MSMEs. associated with improving regional economies.

Keywords: *microfinance institutions, medium enterprises, regional economy*

1. INTRODUCTION

MSMEs can sustain the economic growth, both in the regions and in the capital. With the growth of MSMEs in the regions, the regional economy can also run well. MSMEs currently face the problem related to the capital structure. Conventional banks or Islamic banks, both government and private, both apply strict requirements for their customers to obtain credit facilities that can be used as capital for MSMEs. Conversely, MSME customers who will or are currently establishing their businesses always have to pay high interest and fulfil complicated requirements. The presence of MFIs in the regions is expected to overcome this crucial problem.

According to Bank Indonesia, the Rural Credit Bank (RCB) is a microfinance institution (MFI) in the form of a bank. RCB as an intermediary institution in microfinance aims to serve MSMEs in the regions. RCB has flexible financial services that are in line with the needs of MSME units, which will open access to capital for MSMEs to finance production activities and expand production capacity to grow and develop [1]. This indicates a positive relationship between MFIs, in this case, RCBs and the development of MSMEs.

According to the Directorate of Finance of the Ministry of Agriculture in 2004, the development of MFIs was carried out on the basis of a passion to help and facilitate the poor, both for consumptive and productive activities. The financial services aim to assist the poor in increasing their financial security so that it will provide

opportunities for them to take advantage of business opportunities and facilitate their business growth. The more MFIs available, the easier the community can get access to it, especially the weak economy community to improve their welfare. In the end, the regional economy will move in a better direction.

One way to grow the regional economy is by moving the economy that involves a lot of low-income people (rural communities), such as empowering MSMEs. Prasetyo argued that one of the most prominent roles of MSMEs in the economy is its ability to absorb a sizable amount of labors, compared to the types of other businesses. The absorption of labor through MSMEs will increase incomes especially, the poor's, so that they can meet the minimum needs, meaning free them from their current conditions [2].

This research used normative juridical research, which was studied systematically based on the obedience to the legal structure hierarchically to provide a legal opinion as the justification (prescriptive) of a legal event.

This research is based on the previous descriptions. This study addressed the following research problem: how are the roles of the Micro Finance Institution (MFI) in supporting the development of MSMEs in relation to improving the regional economy. In other words, how MFIs can support the development of MSMEs to improve the regional economy. In the case of an MFI as a Rural Bank (RCB) that can provide venture capital to MSMEs in the regions, it is uncertain whether the MSME can prioritize the use of credit as business capital if the guidance or assistance is not provided by the RCB.

2. Relationship of MSMEs with Micro Finance Institutions (MFI's)

Based on the research of Atik M. Suhartini, et al., it was found that MSMEs will increasingly develop along with the development of Rural Credit Banks (RCB). The increasing number of RCBs will open more access for MSMEs, concerning funding, in particular, obtaining the capital which in turn will stimulate MSMEs to develop their current businesses or form new businesses. According to Landiyono, RCB is a MFI that has the ability to provide financial services in the context of developing micro-businesses sustainably. The position of the BPR as the second tier bank is directly under the supervision and guidance of Bank Indonesia (BI), the existence of the Indonesia Deposit Insurance Corporation (IDIC) and a clear legal basis to further guarantee RCBs to be able to provide microfinance services continuously [3].

Wiyono and Harsono [4] argued that the aspect of capital is one of the fundamental problems faced by the SMEs, especially the sources of financing from banking financial institutions. The main reason for this limitation is due to the strict bank requirements, so that MSMEs depend on their limited self-financing ability, and/or on the finance from loan sharks, which usually requires higher costs than the formal financial institutions. Harsono argued that proving the role of MFIs as the main actors in the development of microfinance that have more flexible services in terms of capital can be a solution to these MSME problems.

Furthermore, Karay also argued that proving that greater financial services from MFIs as a source of funding for MSMEs also provide greater opportunities for MSMEs to better develop [5]. Herri et.al also found that the role of rural banks in West Sumatra went well as an intermediary for the economic activity, with an increase in funds collected and channeled, as well as an increasing number of MSME customers. In fact, Hendayana and Bustaman found that MFIs have a strategic role as an intermediary for the economic activities that have so far been unreachable by conventional banking, indicated by the growing development of MSMEs which receive funding services from MFIs.

Based on the foregoing, the relationship between MSMEs and MFIs is as follows. MSMEs need MFIs for to meet the capital structure needed by MSMEs so that MSMEs get their funding and be free from loan sharks who usually charge high loan interest.

3. Microfinance Institutions (MFIs) in Indonesia

Looking at the long history of microfinance, it is not surprising that there are many types of microfinance institutions in Indonesia. Microfinance services are not only dominated by institutions but also other types of services and assistance in the form of subsidies disbursed by the

government. Precisely, new government always launches different programs for the poor and low-income people. This change causes overlapping programs, rules and also the authority of institutions engaged in microfinance, and ultimately leads to the difficulty of measuring and evaluating the success of existing programs. This situation also negatively influences MFIs both village-based and those in urban areas in running their businesses on an ongoing basis, meaning that the survival rate of the MFI is low [6].

Tight competition and overlapping policies lead to many MFIs unable to compete, so they have to stop their businesses. For example, in a village in Bali, there are around five to seven types of MFIs and banks targeting the micro-segment, including Village Credit Institutions (LPD), Village Unit Cooperative (KUD), Multipurpose Cooperative (KSU) or Savings and Loan Cooperatives (KSP) established by the community, RCB, Teras BRI (BRI micro-unit), and *Danamon Simpan Pinjam* (DSP). The limited market segment makes each MFI have to compete, which is certainly challenging for conventional MFIs as they have to face modern institutions, such as commercial banks and RCB.

Microfinance participants in Indonesia can be divided into three groups, the first group is formal and non-formal institutions or institutions, the second group is a microfinance program, both organized by the government and donor agencies at home and abroad. The third is individual participants who are usually informal, have no legal power and run their business illegally, such as moneylenders, bonded labor, illegal pawns, artisan groups, etc.

The difficulty of classifying microfinance institutions and types of microfinance services makes mapping, monitoring, and evaluation of financial services difficult. The overlapping rules, authority and broad scope of services of microfinance institutions also contribute to the difficulty of implementing appropriate development strategies for MFIs. This situation causes the level of business or sustainability of MFIs and microfinance programs to drop. Only a few MFIs can survive and compete with fellow MFIs and more modern types of banking services.

The absence of definitive data related to the number and condition of these institutions makes it difficult to present the accuracy regarding the number of these institutions. Many institutions are under the guidance of the provincial government, but there is no exact data from each local government related to the number of MFIs in their regions. Only MFIs, such as LPD in Bali already have data and financial conditions recorded properly [7].

Ironically, research and projects from foreign institutions are used as a reference in predicting the number and existence of MFIs in Indonesia. This research project is seasonal or does not periodically monitor the number of MFIs in Indonesia so that the sustainability of data and information is hard to find.

In addition, the history of BMT (*Baitul Maal wat Tamwil*) in Indonesia is inseparable from the establishment of the Small Business Business Incubation Foundation

(YINBUK). This foundation was formed around March 1995 through the initiative of the Indonesian Ulema Council (MUI), the Indonesian Muslim Intellectual Association (ICMI) and Bank Muamalat, that is the first sharia bank in Indonesia with B.J. Habibie, former president of Indonesia, being one of the founding fathers. YINBUK then formed the Small Business Incubation Center (PINBUK) [8].

The establishment of PINBUK was intended as an operational means to channel funds raised by YINBUK. This institution then initiated the formation of BMT in Indonesia, by also providing guidance, monitoring, evaluation, and protection in term of legal status, because the status of BMT was not yet clear. In December 1995, President Suharto declared BMT as a national movement to empower small businesses, and in the same year Bank of Indonesia (BI) also established BMT as an institution that could provide funding assistance and was included in the linkage program with commercial banks.

BMT is operationally run with organizations, such as cooperatives. The initial membership of at least 20 members. Baitul Maal has the principle as a collector and distributor of *zakat*, *infaq*, and *shadaqah* funds (Islamic charity), in the sense that Baitul Maal is only "waiting" for the awareness of the people to channel their *zakat*, *infaq* and *shadaqah* funds without any power to collect them directly. In addition to these funding sources, BMT also receives funds in the form of donations, grants, or endowments and any of charity funds. The distribution of funds sourced from Baitul Maal funds must be specific, especially funds sourced from *zakat*, because the funds from this *zakat* have been explicitly stipulated in the Al-Qur'an, namely to eight groups (*ashnaf*), i.e: the poor, *the needy*, *zakat collectors*, *mu'alaf (muslim revert)*, those in bondage, the debt-ridden, those in the cause of Allah, and wayfarer. While funds outside of *zakat* can be used to develop the business of the poor, the construction of educational institutions, mosques and other operational costs of social activities. BMT can implement three principles (in its function as Baitul Tamwil), namely: (1) the principle of profit-sharing, (2) the principle of buying and selling with profits, (3) the principle of non-profit.

To date, BMT covers all regions of Indonesia, with the largest number in Java. In addition to Java, there are sizable concentrations of BMT populations in South Sulawesi and West Nusa Tenggara. Data from the RENDEV Project reported that 2,025 BMT-YINBUK were found in Indonesia. Of these, approximately 72% (1,456) is in Java [9]. Since the ratification of Law No. 1 of 2013, BMTs are classified as MFIs, and must follow the rules in the law. This gives the legal status that BMT has long waited for.

All businessmen must face problems both from within and from outside the SME. Internal problems usually include the difficulties or the lack of capital, employee strikes, etc, while external problems may be the economic conditions and government regulations and the pressure from the competitors. Murwanti and Sholahuddin's research revealed that the problems that are commonly faced by small traders or MSMEs are the lack of capital, being less

educated, poor administration, family management, the lack of discipline, and the lack of planning [10]

After identifying the relationship between MSMEs and MFIs, the problem in this study can then be addressed, namely how MFIs can support the development of MSMEs to improve the regional economy. Based on Law No 1 of the Year 2013, concerning MFIs, MFIs are defined as financial institutions specifically established to provide business development services and community empowerment, either through loans or financing in micro-scale businesses to the members and the community, savings management, or providing business development consulting services, which are not solely for the profit.

This definition implies that MFI is a profit-oriented institution that is also social-oriented, whose activities focus more on community development without ignoring its role as a financial intermediary institution. As a financial institution that functions as an intermediary institution, MFIs also conduct savings and loan activities, whose activities not only lending but also increasing the awareness of saving in the community, especially the low-income people.

Microfinance itself is a financial sector activity that raise funds and provide loans or finance in a micro-scale with a simple procedure for the poor and/or low-income people. Internationally, the term microfinance refers to financial services provided to the small entrepreneurs or small businesses, who usually do not have banking access, related to the high transaction costs imposed by banking institutions.

Microfinance is financing that can cover many types of financial services, including microcredit, which is a type of loan given to customers who have a medium-scale business and tend to have never been connected with the banking world.

4. CONCLUSION

This study concludes that the MFIs that can support MSMEs in improving the local economy are those providing or channeling funds as capital that can be used by MSMEs to develop their businesses with easy conditions. In addition, MFIs are also required to play a role in providing and teaching MSMEs skills related to administration, management, discipline, and planning.

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