



*Field Report*

# **Lessons Learned from Microfinance Services in East Nusa Tenggara**

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## ***ABOUT THE SMERU RESEARCH INSTITUTE***

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## SUMMARY

East Nusa Tenggara (NTT) is one of the provinces in Indonesia with a relatively high poverty rate. For this reason, many poverty reduction programs have been implemented in this region, including microfinance services. This study aims to look at the dynamics of the supply of, and demand for, microfinance services in connection with poverty reduction in NTT. A qualitative approach was adopted to understand these dynamics by collecting primary and secondary data on microfinance regulations and services, especially in Kabupaten Kupang and Kabupaten Manggarai. The effectiveness of these regulations and services was determined through interviews with both individuals who use microfinance services and those who do not.

Microfinance services are limited by policies, funding and personnel, whereas the needs of the poor for financial services vary. Their needs vary because of the types of businesses people own, their socioeconomic conditions and the geographical locations of villages. In relation to loans, for example, businesses owned by the poor do not always need additional capital. The poor often need loans to cover various unexpected non-business related expenses. For poor groups, loans for these purposes are required so that these expenses do not disrupt asset ownership and business sustainability.

Banking institutions are one type of financial service provider. These institutions are strictly commercially-oriented. Banks in NTT, for example, do not have special financial service schemes for the poor. Thus, it is difficult for poor groups in NTT to access banking services because their needs and socioeconomic conditions are generally incompatible with the prevailing policies in the banking sector. The access of poor groups who live in rural areas is even more limited because banking services are located far away in urban areas.

Outside of the formal banking sector, poor groups can obtain financial services from non-banking institutions, non-formal institutions and microfinance enterprise units established as a component of government development programs. Small-scale loans are the main services provided by these institutions. The problem is, except for pawnshops, there is a tendency for only poor groups who own non-agricultural enterprises to have easy access to these loans, because non-agricultural enterprises are considered to have better credit ratings.

The majority of services from these institutions are channeled through community groups, both groups established through a community's own initiative as well as those formed to meet program requirements. One problem faced by these community groups is sustainability. Often groups, especially those formed specifically for programs, eventually disband after funds have rotated to other groups or the program finishes. Groups can survive and develop if adequate technical assistance is provided for group management and the members' businesses. Groups like these usually develop savings activities which support the long-term sustainability of finance services.

Apart from that, the poor traditionally met their own needs for financial services through *arisan* (rotating savings) activities or, in urgent situations, by borrowing money from neighbors or moneylenders for daily necessities or business purposes. There are a lot of *arisan* activities in areas where there are a limited number of financial institutions. Various *arisan* groups develop savings activities as a way of providing small-scale loans for their members. There is a real need for savings, loans and insurance in poor communities. Cattle ranching businesses and storing harvest produce in barns, for example, are two means of saving money which simultaneously provide insurance. Food storage barns will provide them with security during famines and the dry season, whereas livestock are a source of funds for pressing needs.

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## LIST OF ABBREVIATIONS AND ACRONYMS

AB	<i>Afdeelingsbank</i>	Former form of People's Credit Bank (BPR)
ADB		Asian Development Bank
APBD	<i>Anggaran Pendapatan dan Belanja Daerah</i>	Regional Budget
APBN	<i>Anggaran Pendapatan dan Belanja Negara</i>	National Budget
ASA		Association for Social Advancement
Asppuk	<i>Asosiasi Pendamping Perempuan Usaha Kecil</i>	(a non-government organization that provides technical assistance and support for women who run small business)
AVB		Algemene Volkscrediet Bank
Bappeda	<i>Badan Perencanaan Pembangunan Daerah</i>	Regional Development Planning Board
Bappenas	<i>Badan Perencanaan Pembangunan Nasional</i>	National Development Planning Board
BBM	<i>Bahan Bakar Minyak</i>	Refined Fuel
BCA		Bank Central Asia
BDS		Business Development Service
BI	<i>Bank Indonesia</i>	Indonesian Central Bank
BK3D	<i>Badan Koordinasi Koperasi Kredit Desa</i>	Village Credit Cooperatives Coordinating Board
BKD	<i>Badan Kredit Desa</i>	Village Credit Board
BKK	<i>Badan Kredit Kecamatan</i>	Kecamatan Credit Board
BKKBN	<i>Badan Koordinasi Keluarga Berencana Nasional</i>	National Family Planning Coordinating Board
BKM	<i>Badan Keswadayaan Masyarakat</i>	Community Self-reliance Board
BKPD	<i>Bank Karya Produksi Desa</i>	(a small private bank)
BLM	<i>Bantuan Langsung Masyarakat</i>	Direct Community Assistance
BMT	<i>Baitul Mal wa Tanwil</i>	(an Islamic-based savings and loans institution)
BNI	<i>Bank Negara Indonesia</i>	National Bank of Indonesia
BPD	<i>Bank Pembangunan Daerah</i>	Regional Development Bank
BPD	<i>Badan Perkreditan Desa</i>	Village Credit Board
BPMD	<i>Badan Pemberdayaan Masyarakat Desa</i>	Village Communities Empowerment Board
BPR	<i>Bank Perkreditan Rakyat</i>	People's Credit Bank
BPS	<i>Badan Pusat Statistik</i>	Statistics Indonesia
BRI	<i>Bank Rakyat Indonesia</i>	Indonesian People's Bank (name of a commercial bank)
BTN	<i>Bank Tabungan Negara</i>	(a commercial bank)
Bukopin	<i>Bank Umum Koperasi Indonesia</i>	(a commercial bank)
BUMN	<i>Badan Usaha Milik Negara</i>	State-Owned Enterprise
CGAP		The Consultative Group to Assist the Poor
CV		Commanditaire Vennootschap
Daperma	<i>Dana Perlindungan Bersama</i>	Collective Insurance Fund (name of a credit and loan insurance company)
Depdagri	<i>Departemen Dalam Negeri</i>	Department of Home (Internal) Affairs
DPR	<i>Dewan Perwakilan Rakyat</i>	Parliament
FA	<i>Firma</i>	Firm
GDP		Gross Domestic Product
Gema PKM	<i>Gerakan Bersama Pengembangan Keuangan Mikro</i>	Join Movement for the Development of Microfinance
GTZ		Gesellschaft für Technische Zusammenarbeit GmbH
IBI		Indonesian Business Institution

IDT	<i>Inpres Desa Tertinggal</i>	Presidential Aid for less-developed Villages
IFAD		International Fund for Agricultural Development
IMS	<i>Inisiatif Masyarakat Setempat</i>	Local Community Initiative
Inkopdit	<i>Induk Koperasi Kredit</i>	Umbrella organizations for credit cooperatives at the national level
JPS	<i>Jaring Pengaman Sosial</i>	Social Safety Net
Kab.	<i>Kabupaten</i>	District
KBI	<i>Kantor Cabang Bank Indonesia</i>	Branch of Indonesian Central Bank
KDP		Kecamatan Development Project
KIK	<i>Kredit Investasi Kecil</i>	Credit for Small Investment
KKop	<i>Kredit Koperasi</i>	Credit for Cooperatives
KKP	<i>Kredit Ketahanan Pangan</i>	Food Security Credit
KKPA	<i>Kredit kepada Koperasi Primer untuk Anggotanya</i>	A program which provides credit to Primary Cooperatives to be lent to its members
KLBI	<i>Kredit Likuiditas Bank Indonesia</i>	Indonesian Central Bank Liquidity Credit
KMKP	<i>Kredit Modal Kerja Permanen</i>	Credit for Capital
Kopdit	<i>Koperasi Kredit</i>	Credit Cooperatives
KPK	<i>Komite Penanggulangan Kemiskinan</i>	National Poverty Reduction Committee
KPKU	<i>Kredit Pengembangan Kemitraan Usaha</i>	Credit for Strengthening Business Partners
KPR	<i>Kredit Pemilikan Rumah</i>	Housing Loan
KPRS	<i>Kredit Pemilikan Rumah Sederhana</i>	Credit for Simple House Ownership
KPRSS	<i>Kredit Pemilikan Rumah Sangat Sederhana</i>	Credit for Very Simple House Ownership
Krasida	<i>Kredit Angsuran Sistem Gadai</i>	Loan with pawn installment system
Kreasi	<i>Kredit Angsuran Sistem Fidusia</i>	Loan with fiduciary instalment system
KS	<i>Keluarga Sejahtera</i>	Prosperous Family
KSM	<i>Kelompok Swadaya Masyarakat</i>	Self-reliant community groups
KSP	<i>Koperasi Simpan Pinjam</i>	Savings and Loans Cooperative
KTP	<i>Kartu Tanda Penduduk</i>	National Identity Card
KUBA	<i>Kegiatan Usaha Bersama Agribisnis</i>	Agribusiness Joint Enterprise Activity
KUBE	<i>Kelompok Usaha Bersama</i>	Joint Enterprise Group
KUD	<i>Koperasi Unit Desa</i>	Village Credit Cooperative
KUK	<i>Kredit Usaha Kecil</i>	Credit for Small Businesses
Kukesra	<i>Kredit Usaha Keluarga Sejahtera</i>	People's Prosperity Business Credit
KUM-LTA	<i>Kredit Usaha Mikro Layak Tanpa Agunan</i>	(a microbusiness credit program that does not require business owners to provide collateral)
Kupedes	<i>Kredit Umum Pedesaan</i>	(a rural credit scheme)
KURK	<i>Kredit Usaha Rakyat Kecil</i>	Credit for Small-scale Businesses
KUT	<i>Kredit Usaha Tani</i>	Credit for Farmers
LDKP	<i>Lembaga Dana dan Kredit Pedesaan</i>	Rural Credit and Funds Institution
LEP-M3	<i>Lembaga Ekonomi Produktif – Mitra Mina Mandiri</i>	(name of an institution)
LKM	<i>Lembaga Keuangan Mikro</i>	Microfinance Institutions
LPD	<i>Lembaga Perkreditan Desa</i>	Village Credit Institution
LPK	<i>Lembaga Perkreditan Kelurahan</i>	Kelurahan Credit Institution
LPN	<i>Lumbung Pitih Nagari</i>	(a saving and loan institution)
LPS	<i>Lembaga Penjamin Simpanan</i>	Institution that insures saving
LPSM	<i>Lembaga Pengembangan Swadaya Masyarakat</i>	(a non-government organization)
LSM	<i>Lembaga Swadaya Masyarakat</i>	Non Governmental Organization
MAI	<i>Maskapai Andil Indonesia</i>	Indonesian-owned Company
MAP	<i>Modal Awal dan Padanan</i>	Matching and Initial Funds
MFI	<i>Lembaga Keuangan Mikro</i>	Microfinance Institution
NCBA		National Cooperative Business Association
NGO	<i>Lembaga Swadaya Masyarakat</i>	Non-Government Organization

NTAADP	<i>Proyek Pengembangan Wilayah Pertanian Nusa Tenggara</i>	Nusa Tenggara Agricultural Area Development Project
NTT	<i>Nusa Tenggara Timur</i>	East Nusa Tenggara
P2KER	<i>Proyek Peningkatan Kemandirian Ekonomi Rakyat</i>	Project for Increasing the Peoples' Economic Independence
P2KP	<i>Proyek Penanggulangan Kemiskinan di Perkotaan</i>	Urban Poverty Reduction Project
P2W	<i>Proyek Peningkatan Peranserta Wanita</i>	Program for Enhancing the Role of Women
P3DT	<i>Program Prasarana Pendukung Desa Tertinggal</i>	Rural Infrastructure Program for Less-developed Villages
P4K	<i>Proyek Peningkatan Pendapatan Petani dan Nelayan Kecil</i>	Rural Income Generation Project for Small-scale farmers and fishermen
PDM-DKE	<i>Pemberdayaan Daerah dalam Mengatasi Dampak Krisis Ekonomi</i>	(a project which aims to reduce the impact of the economic crisis by introducing labor-intensive jobs and community funds)
PEMP	<i>Pemberdayaan Ekonomi Masyarakat Pesisir</i>	Economic Empowerment of Coastal Communities
Perbarindo	<i>Persatuan Bank Perkreditan Rakyat Indonesia</i>	The Assosiation of Indonesian People Credit Banks (BPR)
Perda	<i>Peraturan Daerah</i>	Regional Regulation
PHBK	<i>Pengembangan Hubungan Bank dengan Kelompok Swadaya Masyarakat</i>	(a program which develops relations between banks and community self-reliance groups)
PHBL	<i>Pengembangan Hubungan Bank dengan Lembaga Keuangan Mikro</i>	(a program which develops link between banks and microfinance institutions)
PINBUK	<i>Pusat Inkubasi Bisnis Usaha Kecil</i>	The Center for the Development of Small Businesses
PKK	<i>Pembinaan Kesejahteraan Keluarga</i>	Family Welfare Assistance
PKM	<i>Program Kredit Mikro</i>	Microcredit Program
PKPS-BBM	<i>Program Kompensasi Pengurangan Subsidi Bahan Bakar Minyak</i>	Compensation funds for increases in the price of oil and gas
PNM	<i>Permodalan Nasional Madani</i>	(a financial institution)
Pra-KS	<i>Keluarga Pra Sejahtera</i>	Pre-Prosperous Families
ProFi		Promotion of Small Financial Institutions
PUKK	<i>Pemberdayaan Usaha Kecil dan Koperasi</i>	Small Business and Cooperative Development program
PUKM	<i>Pengembangan Usaha Kecil dan Mikro</i>	Development of Small dan Micro Business
Puskopabri	<i>Pusat Koperasi Angkatan Bersenjata Republik Indonesia</i>	Cooperative with membership consists of Indonesian Army Cooperatives
Puskopdit	<i>Pusat Koperasi Kredit</i>	Cooperative with membership consists of credit cooperatives ( <i>Kopdit</i> )
Puskud	<i>Pusat Koperasi Unit Desa</i>	Cooperative with membership consists of Village Cooperatives (usually at the provincial level)
RDKK	<i>Rencana Definitif Kegiatan Kelompok</i>	Group's Activity Plan
Renstra	<i>Rencana Strategis</i>	Strategic Plan
RUU	<i>Rancangan Undang-undang</i>	Draft Law
SAADP	<i>Proyek Pengembangan Wilayah Pertanian Sulawesi</i>	Sulawesi Agricultural Area Development Project
SDM	<i>Sumber Daya Manusia</i>	Human Resources
Simpedes	<i>Simpanan Pedesaan</i>	(a rural savings scheme)
SIPUK	<i>Sistem Informasi Terpadu Pengembangan Usaha Kecil</i>	Integrated Information System for the Development of Small Businesses
SME	<i>Usaha Kecil dan Menengah</i>	Small and Medium Enterprises
SPUP	<i>Sarana Penunjang Usaha Produktif</i>	Credit which functions as a means of supporting productive businesses
SSN	<i>Jaring Pengaman Sosial</i>	Social Safety Net
TLM	<i>Tanaoba Lais Manekat</i>	(an NGO in NTT which provides microcredit services)

UBSP	<i>Usaha Bersama Simpan Pinjam</i>	Joint Savings and Loans Enterprise
UED-SP	<i>Usaha Ekonomi Desa – Simpan Pinjam</i>	Village Economic Enterprises – Savings and Loans
ULM	<i>Unit Layanan Mikro</i>	Microfinance services unit
UMKM	<i>Usaha Mikro, Kecil dan Menengah</i>	Small, Medium and Micro Enterprise
UP2K	<i>Usaha Peningkatan Pendapatan Keluarga</i>	Effort to Improve Family's Income
UPK	<i>Unit Pelayanan Kecamatan</i>	Kecamatan Service Unit
UPKD	<i>Unit Pelayanan Keuangan Desa</i>	Village Financial Service Unit
USP	<i>Usaha Simpan Pinjam</i>	Savings and Loans Unit
YAO	<i>Yayasan Alfa Omega</i>	(an NGO in NTT which provides microcredit services)
YPPL	<i>Yayasan Pengembangan Pesisir dan Laut</i>	(an NGO in NTT which provides microcredit services)

# I. INTRODUCTION

## 1.1. Background and Objectives

Poverty is still a major problem in East Nusa Tenggara (NTT) because of the high proportion of poor people and the low level of economic development compared with the Indonesian average. There have been various attempts to reduce poverty in this province, including the provision of microfinance. Microfinance is considered an important strategy in poverty alleviation. In Indonesia, several microfinance services have been regarded as successful in reducing poverty, among them the rural branches of the Bank Rakyat Indonesia (BRI) (Robinson, 306-362), microcredit provided through the Rural Income Generation Project (P4K), as well as microfinance services provided by Bank Purba in Semarang and Mitra Karya in East Java (Seibel and Parhusip, 1-28). Although studies in a number of countries have highlighted the success of microfinance in reducing poverty, several analyses have acknowledged that the ability of microfinance to lift the poor, particularly the poorest of the poor, out of poverty has some limits. In addition, local conditions and the design of microfinance services will influence their success in reducing poverty.<sup>1</sup>

### Box 1.1. The Definition of Microfinance

Microfinance is the provision of a variety of financial services – including loans, savings accounts, insurance and money transfers – for poor or low-income earners and families, as well as for their microbusinesses. This definition emphasizes the expansion of the type of financial services that were previously only associated with microcredit, and the target of services, that is the poor and low-income earners. There are two characteristics of microfinance which differentiate it from the products offered by formal financial institutions, these being the small amounts of money saved and/or loaned, and/or the absence of collateral. Microfinance services can be provided by microfinance institutions, that is institutions whose main activity is providing microfinance services, formal financial institutions that have microfinance service unit, development programs or poverty reduction programs that have a microfinance component, and informal organizations created by communities themselves.

This study tries to analyse whether the provision of microfinance services is likely to be an effective tool for poverty alleviation in NTT. In order to do so, it has attempted to:

1. Observe the current microfinance services in NTT and how far these services are capable of reaching, or being reached by, the poor;
2. Identify the types of microfinance services that are not yet available for the poor in NTT;
3. Identify the size of the poor's demand for microfinance services which are not yet available;
4. Identify the factors that cause the unavailability of certain microfinance services in NTT;
5. Observe the technical support in place for microfinance activities in NTT, including regulations and supervision, both that provided by institutions in the province as well as institutions outside NTT;

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<sup>1</sup> The debate on the effectiveness of microfinance as a strategy to reduce poverty, particularly for the poorest of the poor, is discussed in papers written by Fernando "Microfinance Outreach", Morduch and Haley "Analysis of the Effects", Marr "Microfinance and Poverty", Sebstad and Cohen "Microfinance, Risk", Matin et.al. "Financial Services", as well as Kalpana "The Shifting Trajectory".

6. Formulate an appropriate approach to developing microfinance (as an independent program or as a component of a program) based on the findings related to the points above; and
7. Formulate an alternative form of assistance from funding agencies to reduce the gap between the demand for and supply of microfinance in NTT.

## 1.2. Research Methodology

This study adopts a qualitative approach to analysing data and information gathered in Jakarta and NTT. This approach was chosen in order to obtain a deep understanding in a relatively short time period because this study was conducted over three months, between July and September 2004. During this study period the research team collected information from a number of relevant institutions in Jakarta and NTT. The research team visited two *kabupaten* in NTT – Kupang and Manggarai – during the first two weeks of August. During this field trip, the research team collected primary and secondary data at the provincial, *kabupaten*, *kecamatan*, and village levels, and conducted interviews with individuals, particularly poor households who had received microfinance services and those who had not.

Secondary data was collected through a review of relevant documents and interviews with regional government offices which manage programs with microfinance components, microfinance providers including banks as well as formal non-banking and non-formal financial institutions, and microfinance observers in NTT. Interviews were based upon guidelines developed for each type of institution. Primary data was collected through in-depth interviews with communities (respondents). The objective of the interview with respondents was to assess the accessibility and benefits of microfinance services from a community perspective, as well as to identify communities' demand for microfinance. Information about the institutions interviewed, as well as the number and location of respondents interviewed are provided in Appendix 1.1.

The selection of sample regions was based on the distance from an economic center and the numbers of microfinance providers. Kabupaten Kupang was selected because it is relatively close to an economic center and there are many microfinance services. Kabupaten Manggarai, on the other hand, was selected because it is relatively far from economic centers and there are fewer microfinance services. The research team visited two *kecamatan* in each *kabupaten*, one *kecamatan* which is relatively close to an economic center and one which is relatively remote. In each *kecamatan*, the team visited a minimum of one village that is serviced by the selected samples of microfinance services. The sample villages in Kabupaten Kupang were Kelurahan Oesao in Kecamatan Kupang Timur and Desa Ponain in Kecamatan Amarasi. The sample regions in Kabupaten Manggarai were Kelurahan Wae Belang in Kecamatan Ruteng and Desa Golo Kantar in Kecamatan Borong. To observe several microfinance services that are not available in the sample regions, the research team also visited Desa Tarus, Desa Bao Bao and Kelurahan Merdeka in Kecamatan Kupang Timur, as well as Desa Bea Kondo in Kecamatan Satarmese, Kabupaten Manggarai.

In general, microfinance service providers observed in this study could be classified into four groups:

1. Formal institutions, that is institutions that are legal entities formally recognized by the existing law as financial institutions. Formal institutions consist of two groups that are banks and non-banking institutions. The banks visited included BRI, Bank Mandiri, Bank NTT and the People's Credit Bank (BPR), whereas the non-banking institutions included Village Credit Board (BPD), cooperatives, Village Cooperative (KUD), credit unions, Regional Credit Cooperatives Coordinating Board (BK3D) and pawnshops.

2. Non-formal institutions, that is institutions which have a legal base -both legal entities such as foundations, and institutions with other legal bases such as a decree from a governor or *bupati*, but are not authorized to operate, or are not acknowledged, as formal financial institutions under the existing laws and regulations. Non-formal institutions include savings and loans units (USPs) and non-government organizations (NGOs) which provide microfinance services. The non-formal institutions visited during this study included Yayasan Alfa Omega (YAO), Tanaoba Lais Manekat (TLM), Foundation for the Development of Sea and Coastal Regions (YPPL - *Yayasan Pengembang Pesisir dan Laut*), Yayasan Sanlima, Yayasan AYO Indonesia and Yayasan Delsos.
3. Government programs that provide microfinance services or have a microfinance component, generally in the form of microcredit. To find out about these programs, the study team conducted interviews and collected secondary data from various sectoral offices at the provincial and district levels, including the office for cooperatives, office for food crops, office for plantations, office for fisheries, office for industry and trade, and offices that deal with family welfare and family planning.
4. Informal institutions, that is institutions which are non-legal entities, such as community rotating savings (*arisan*) groups, church groups and other informal sources. This study mainly observed informal institutions formed by the community themselves. The activities of these institutions were uncovered through interviews with group members and administrators.

### 1.3. Report Structure

This report consists of six chapters.

- Chapter I is an introduction that provides the background and objectives of the study, the methodology used, and report structure. It also presents a review of literature that focuses on the relationship between microfinance services and poverty reduction, as well as a general illustration of NTT and the two *kabupaten* included in the study.
- Chapter II provides a brief overview of microfinance services in Indonesia as a background for understanding the state of microfinance services at the national level. More specifically, this chapter highlights the development of microfinance institutions, the scope and performance of microfinance institutions at the national level, as well as the existing microfinance infrastructure.
- Chapter III provides a description of several microfinance services in NTT, specifically in the sample regions. It presents the issues regarding the type of services available, scope of services, performance of service and the access of the poor communities to these services.
- Chapter IV illustrates the poor's utilization of, and demand for, microfinance services in the sample regions. In order to provide the context of the poor's demand for microfinance institutions in NTT, this chapter also presents the livelihood of the communities in the sample regions, the microfinance services they can obtain, and their demand for microfinance services.
- Chapter V discusses the field findings in the context of the existing and the potential roles of microfinance services as a tool for poverty alleviation in NTT.
- Chapter VI presents conclusions derived from this study and highlights some recommendations for funding agencies and local governments.

#### 1.4. Microfinance Services and Poverty Reduction: A Literature Review

To date, microfinance is still considered one of the key strategies in poverty reduction. Studies in various countries have highlighted the benefits of microfinance in increasing the poor's standard of living. However, poor communities are not a homogenous entity, and the strategy and design of microfinance services have changed in line with developments in thinking on, and understanding of, the poor (Matin, Hulme and Rutherford, 4). During the period when the government provided subsidized agricultural credit (1950s – 1970s), the poor were considered as marginalized farmers, usually males, who needed to increase their productivity, which could be done through the provision of credit. In the 1980s, the poor were considered as microbusiness owners, generally female, who did not own assets that could be used as collateral despite their businesses having good prospects. As a result, there were many attempts by NGOs to provide microcredit particularly for women. The argument that the poor require greater access to credit rather than credit with subsidized interest rates provided a backdrop for the move from subsidized credit to non-subsidized credit. Microcredit developed further during the 1990s with innovations in ways of channelling credit through groups using the Grameen Bank model, where groups of poor women were the main targets. This model attracted worldwide attention, was adopted in many countries and attracted support from many funding agencies. This development led to the emergence of a microfinance industry that emphasized the financial viability and sustainability of microfinance service providers. This development was accompanied by a large effort to increase the number of clients or the size of loans held by each client (Kalpana, 7-8).

At the end of the 1990s, several studies were critical of the increased tendency to exclude the poorest of the poor from microfinance services. A phenomenon has been observed as a side effect of the excessive emphasis on high repayments rate and the institutional viability of microfinance service providers. In 2003, for example, the Consultative Group to Assist the Poor (CGAP) stated, "most microfinance clients today fall in a band around the poverty line and the extremely poor are rarely reached by microfinance" (Fernando, 1). In this regard, Kalpana identified at least four factors that exclude the poorest of the poor from microfinance services, that are:

1. Inflexible loans with strict weekly repayments and an absence of savings services;
2. The dominance of program staff over clients, so restricting two-way communication;
3. A supervisory system between individuals in a group that, in fact, excludes the poorest people or the unfortunate; and
4. Pressure to make repayments on time that triggers borrowers to become trapped in high-interest loans (8-12).

Matin, Hulme and Rutherford also suggested that the exclusion of the poorest was, in general, due to the design of microfinance services not taking into account the living patterns of this group, whose economic activities (production, consumption, trade, savings, loans and jobs) are conducted on a small scale and are highly vulnerable to economic shock (5).

The debate on the exclusion of the poorest from microfinance services focuses on two different perspectives regarding the solutions.<sup>2</sup> The first perspective believes that the poorest of the poor do not require microfinance services and that it is more appropriate for them to

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<sup>2</sup> This debate is discussed in Fernando's "Microfinance Outreach" and Matin, Hulme and Rutherford's "Financial Services." Fernando distinguishes between three perspectives, the first states that microfinance cannot reach the poorest of the poor in a sustainable way; the second states that there is only a small potential for microfinance to reach the poorest of the poor in a sustainable way and on a large scale; and the third states that services can reach the poorest of the poor in a sustainable way and on a large scale.

receive direct assistance. This perspective is based on the reasoning that the poorest, who generally live in isolated regions and have very limited access to transport and markets, are unable to repay loans. Thus, reducing poverty in this group can only be achieved through health, food, and education assistance and not credit (Robinson, 20). In addition, there is also the argument that reaching the poorest of the poor is expensive and that the costs outweigh the benefits (level of savings and loans), and therefore it is impossible to guarantee the viability and sustainability of microfinance service providers (the Microfinance Gateway).

Meanwhile, the second perspective argues that even the poor should be able to access microfinance services and that these services must be designed to fit their needs. This perspective opposes the argument that microfinance services are unsuitable for the poorest of the poor (Matin, Hulme and Rutherford, 24-26). The second perspective emphasizes the need to move the microfinance paradigm away from the focus on the promotion or support of economic businesses and towards microfinance that provides protection through savings, emergency loans or microinsurance.<sup>3</sup> A lack of demand for microfinance services is usually due to the available services not taking the needs of the poor into account, and as a result services need to be adapted to the needs of the poor in order to increase demand. Regarding the cost of providing services and sustainable institutions, there is an argument that if microfinance services are considered a basic necessity, such as health and education, then there is no reason not to provide subsidies for the provision of microfinance service. In the case of savings programs for the poorest of the poor, experiences of SafeSave in Dhaka, Bangladesh indicate that a highly flexible savings and credit program for the urban poor can actually be managed in a sustainable way (27-28).

### **1.5. General Picture of NTT and the Sample *Kabupaten***

The province of NTT covers 566 small and large islands with a land area of 47,300km<sup>2</sup> (2.5% of Indonesia) and a sea area reaching 200,000km<sup>2</sup> in addition to Indonesia's Exclusive Economic Zone (EEZ) beyond the Indonesian territorial sea. In 2001, there were 42 inhabited islands, including four large islands, that is Flores, Sumba, West Timor and the Alor Islands. All of the islands are mountainous with small pockets of flat land, and the average land gradient is greater than 50°. The topography of this region poses a major challenge for transport and communication in this province.

Transport infrastructure and facilities are still very limited in terms of quantity, quality and frequency. Sea transport has a very strategic role as there are 22 seaports complete with docks and 12 traditional ports. A variety of sea vessels stop off at these ports. In addition, in recent years, there has been an increase in the number of flight paths and the frequency of flights, particularly to the *kabupaten* capitals.

For the capital of Kabupaten Kupang, which is located in the capital of NTT, access to transport heading out of the region is relatively easy because there is a large port and an airport with daily flights to Jakarta and Surabaya. Access to transport within this *kabupaten* is, however, still limited, as many regions are difficult to reach, especially in the wet season. The access to the capital of Kabupaten Manggarai is not as easy as the access to the capital of Kabupaten Kupang. Ruteng, the *kabupaten* capital of Kabupaten Manggarai is located in the mountains, 4-5 hours to the north or west of any large port. There is an airport in Ruteng but the flights to Kupang do not leave everyday. Transport within the *kabupaten* is also still poor, particularly because it is mountainous terrain.

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<sup>3</sup> This argument is also raised in Churchill's "Emergency Loans" and Kalpana's "The Shifting Trajectories."

**Table 1.1. The Area and Population of NTT, Kabupaten Kupang and Kabupaten Manggarai**

	East Nusa Tenggara	Kabupaten Kupang	Kabupaten Manggarai
Area (km <sup>2</sup> )	47,394.9	5,898.2	7,136.4
Population (2001)	3,888,735	323,624	633,316
Population Density (per km <sup>2</sup> )	82	55	89
Number of <i>Kabupaten/Kota</i>	15		
Number of <i>Kecamatan/Kelurahan</i>	175	13	17
Number of Villages	2,526	186	375

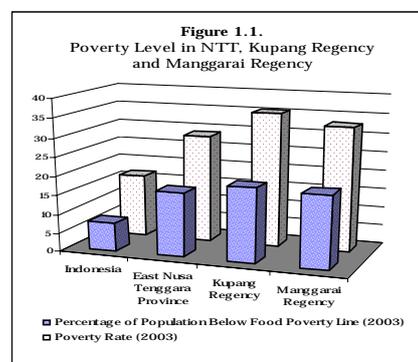
Sources: BPS NTT Province (2001), BPS Kabupaten Manggarai (2002), and BPS Kabupaten Kupang (2002).

In general, NTT has a very dry climate compared with the rest of Indonesia. The dry season lasts for between eight and nine months while the wet season only lasts for around three to four months. The topsoil is relatively thin because of the region's rocky structure and there is little vegetation cover, thus it is vulnerable to erosion. Kabupaten Manggarai is, however, somewhat different because the rainfall in several locations is relatively high and the wet season can last seven to eight months a year. In relation to soil fertility, the regions in Kabupaten Manggarai are more fertile than those in Kabupaten Kupang, as there are active volcanoes in Manggarai.

Although land conditions provide limited support for agricultural activities, the agricultural sector still dominates the economy in NTT. In 2001, the agricultural sector accounted for around 42% of the gross domestic regional product (GDRP), whereas the manufacturing industry accounted for less than 2%. Some of the products farmed by communities include food crops (corn, rice and cassava) and plantation crops (coffee, cashew nuts, coconut, candle nuts, kapok, and vanilla). NTT is also a main livestock producer in Indonesia.

The agricultural sectors in the two sample *kabupaten*, particularly Manggarai, also provide large contributions. The agricultural sector in Kupang accounts for around 49% of the *kabupaten's* GDP, and the population of its main commodities, beef cattle and buffaloes, make up 25% of the total number of livestock in NTT. The agricultural sector contributes around 60% of the GDP in Kabupaten Manggarai through food crops, particularly rice which is a mainstay. Kabupaten Manggarai is the main producer of rice in NTT accounting for almost 27% of the province's rice production. Other than this, plantation crops, particularly coffee and chocolate, are also primary commodities.

The limitations in economic activities in the province are also reflected in the low per capita gross regional product. The per capita gross regional product in 2001 was only around Rp1.9 million in NTT Province, Rp2.1 million in Kabupaten Kupang and Rp1.4 million in Kabupaten Manggarai, all of which are far below the Indonesian average which reaches around Rp6.9 million per capita. The economic status of communities is also relatively low and there is a high level of poverty. As is apparent in Figure 1.1, poverty figures calculated on the basis of consumption indicate that the level of poverty in NTT is higher than the Indonesian average. Meanwhile, it is evident that there is a higher level of poverty in Kabupaten Kupang than Kabupaten Manggarai.



Poverty in NTT is also apparent from the low level of human development as shown in Table 1.2. The health, education and economic conditions of people in NTT and the two sample *kabupaten* are relatively lower than the national averages. Between the two sample *kabupaten*, human development conditions are better in Manggarai, in particular because of higher education levels and better economic conditions. Kabupaten Manggarai, however, actually lags behind Kupang in relation to the provision of health services and clean water.

**Table 1.2. Human Development Conditions in NTT, Kabupaten Kupang and Kabupaten Manggarai, 2003**

	Indonesia	NTT	Kabupaten Kupang	Kabupaten Manggarai
<b>Human Development Index (HDI)</b>	<b>65.8</b>	<b>60.3</b>	<b>56.9</b>	<b>60.3</b>
Life expectancy (years)	66.2	63.8	64.2	64.2
Literacy rate (%)	89.5	84.1	80.7	85.8
Mean years of schooling (years)	7.1	6.0	5.4	5.6
Real per capita expenditure (PPP adjusted) (Rp thousands)	578.8	563.1	531.6	558.2
<b>Human Poverty Index (HPI)</b>	<b>22.7</b>	<b>28.9</b>	<b>27.5</b>	<b>33.0</b>
People not expected to survive to age 40 (%)	15.0	19.2	18.4	18.5
Adult illiteracy rate (%)	10.5	15.9	19.3	14.2
People without access to safe water (%)	44.8	46.8	36.9	44.5
People without access to health services (%)	23.1	32.8	30.8	61.7
Malnutrition in children under five (%)	25.8	38.8	41.8	32.4

Note: National figures (Indonesia) from 2002.

Source: BPS, Bappenas and UNDP "Indonesia Human".

## II. MICROFINANCE IN INDONESIA: A BRIEF OVERVIEW

### 2.1. The History of Microfinance in Indonesia

The first formal microfinance institutions in Indonesia began in the late 19<sup>th</sup> century with the establishment of the People's Credit Bank and *Lumbung Desa*.<sup>4</sup> These two institutions were formed in order to assist farmers, white collar workers and labourers to free themselves from loan sharks. In 1905, the People's Credit Bank was upgraded to become the Village Bank whose services were expanded to include business activities outside the agricultural sector (Bank of Indonesia, 2). In 1929, the East Indies government published Gazette 1929 No. 137 on the establishment of the Village Credit Board (BKD) which aimed to manage rural credit schemes in Java and Bali. In 1930, a regulation was issued on *Algemene Volkskrediet Bank* (AVB) which is now known as BRI, and *Afdeelingsbank* (AB) which then became BPR (Robinson 93-94, Chotim and Handayani, 15-20).

After independence, the Indonesian government encouraged the establishment of banks specializing in small, low-interest loans in order to provide financial services to market traders. These institutions were registered as private and public companies (*perseroan terbatas* – PT), partnerships (*commanditaire vennootschap* – CV), cooperatives, Indonesian-owned companies (MAI), foundations or associations. In 1970, the government created *Bimas* and *Inmas* the funding for which was channelled through the rural branches of BRI.<sup>5</sup> These institutions were also designated as the institutions through which small and medium credit would be channelled. Because a large amount of *Bimas* funds were not repaid however, this credit program (including small and medium-scale credit) ceased in 1984. After this, the rural branches of BRI developed a new commercial savings and credit scheme which was called *Kupedes* (rural credit scheme) and *Simpedes* (rural savings scheme). The *Bimas* credit program was replaced by Credit for Farmers (KUT), which later became the Food Security Credit Program (KKP).

With the ratification of Law No. 14/1967 on Banking Regulations, it became illegal to establish a bank without adhering to the above law, but those which already existed were allowed to continue to operate. At that time, several microfinance institutions had been established by the regional governments, for example, the Rural Credit and Funds Institution (LDKP) in West Java, the *Kecamatan* Credit Board (BKK) in Central Java, Credit for Small-scale Businesses (KURK) in East Java, *Lumbung Pitih Nagari* (LPN)<sup>6</sup> in West Sumatra, and the Village Credit Institution (LPD) in Bali (Bank Indonesia, 2). In October 1988, the government issued a regulation which made it easier to establish BPRs. This was followed by the passing of Law No. 7/1992 on Banking, which established that there would only be two types of banks in Indonesia, that is commercial banks and BPRs. After this law came into effect, banks and microfinance institutions (MFIs) that did not fulfil the requirements to become a BPR were considered as illegal banks or non-formal banks as they are usually known. As a result, the status of around 5,000 BKD branches is currently unknown, with some being considered formal and others considered semi-formal.

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<sup>4</sup> *Lumbung Desa* was an institution that provided loans and collected savings in the form of rice.

<sup>5</sup> *Bimas* (Bimbangan Massal) was a package-deal credit plan, whereas *Inmas* (Intensifikasi Massal) was a mass agricultural intensification program.

<sup>6</sup> *Lumbung Pitih Nagari* is an institution that provides savings and loans services within a *nagari* (an area of land belonging to a traditional community in West Sumatra).

In addition, the government has also implemented a number of microcredit programs in order to reduce poverty. In its implementation, microfinance institutions such as Kecamatan Service Units (UPK) which were a part of the Kecamatan Development Program (KDP), Community Self-reliance Boards (BKM) which were established under the Urban Poverty Reduction Project (P2KP), Economic Productive Unit (LEP-M3) which were established to channel the compensation of BBM subsidy and so forth, were formed. Provincial and *kabupaten/kota* governments also adopted similar projects within their development programs. Meanwhile, several NGOs and funding agencies formed microfinance institutions using approaches that had been successfully developed overseas, such as the Grameen Bank model and the Association for Social Advancement (ASA) in Bangladesh. The application of these approaches in Indonesia by Bina Swadaya, Yayasan Dharma Bhakti Parasahabat, Yayasan Mitra Usaha and Bina Masyarakat Mandiri has been somewhat successful. In an effort to strengthen the position of these institutions, a joint forum for developing microfinance (Gema PKM Indonesia) was established in 2000. This forum provided a platform for communication between stakeholders, including financial institutions, the business community, the mass media, funding agencies and community self-reliance groups (Ismawan, 1). This forum is pushing for the formulation of laws and regulations on microfinance institution, but to date has not been successful.

From the explanation above it can be concluded that, in addition to the microfinance branches of commercial banks such as BRI rural branches and micro services units, the only microfinance institutions legally permitted in Indonesia are BPRs and cooperatives. Pawnshops are another formal financial institution which also provides microfinance services but they are regulated by a separate law. Thus, microfinance institutions (MFIs) in Indonesia can be classified as: 1) formal MFIs, including banks and non-banks, 2) non-formal MFIs, including those that are legal entities and those which are not, 3) MFIs established under government programs, or 4) informal MFIs, including *arisan* groups, moneylenders and so forth.

## 2.2. The Scope and Performance of Microfinance

A profile of MFIs in Indonesia in terms of their number of branches, loans disbursed and savings is provided in Table 2.1. The rural branches of BRI are still the most dominant formal institutions in microfinance services, both in the provision of loans as well as the mobilization of savings. BPRs, which have experienced rapid growth in recent years, also make a significant contribution, both in terms of loans as well as savings. Meanwhile, pawnshops have shown the best performance amongst non-bank formal institutions. In fact, with regard to the number of debtors, pawnshops have the highest ranking with total debtors exceeding the number of debtors of BRI rural branches and BPRs.

Other than non-formal institutions such as *Baitul Mal wa Tanwil* (an Islamic-based savings and loans institution – BMT) and BK3D, a large amount of funding for microfinance is provided by programs run by the central government. The most prominent programs include People's Prosperity Business Credit (Kukesra), P2KP, P4K, Kecamatan Development Program (KDP), and a project to economically empower coastal communities (PEMP). These programs have attracted quite a few debtors. For example, Kukesra has 10.3 million debtors<sup>7</sup>, P2KP has 3.2 million debtors and the Microcredit Program (PKM) has 2.3 million debtors. The relinquishment of several programs to local community initiatives and the

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<sup>7</sup> This number of debtors referred to the situation up to June 2002. The Takesra/Kukesra Program was jointly developed and implemented by BKKBN, BNI Bank and PT Post Indonesia from 1997 to March 2003. As the program had been discontinued, all savings and loans should be settled by the end of August 2004. However, some district governments have provided support to continue this program with minor adjustment of its loan scheme.

implementation of decentralization has, however, made it difficult to obtain the most recent accurate data regarding the progress of these programs. For example, it is now difficult to determine whether a program is still running, progressing or if revolving funds have stopped. In addition, there is no national level data regarding the performance of informal microfinance services, such as *arisan*, loans from neighbours or loans from moneylenders. Although in principle microfinance is provided for the poor and low-income earners, it does not mean that all poor people enjoy this service. Based on existing information, for example, it appears that small-loans or credits provided by banks do not reach poor people, mainly because there is an obligation to provide collateral or prove business feasibility before receiving loans/credits. Meanwhile, the poor cannot enjoy a number of credit programs because the strong emphasis on the performance in terms of the repayment rate has excluded the poorest from becoming program beneficiaries.

**Table 2.1. The Profile of Several Microfinance Institutions in Indonesia**

Type of Institutions	Number of branches	Loans Position			Savings Position	
		Number of Customers	Total in billions of rupiah)	Average (in rupiah)	Number of Customers	Total in billions of rupiah)
<b>I. FORMAL</b>						
<b>1.1 BANKS</b>						
- BRI Unit (July 04)	4,049	3,200,000	17,300	5,000,000	30,000,000	32,000
- BPRs (Mart. 04)	2,148	>2,000,000	9,431	4,700,000	>5,000,000	9,254
- BKD (June 03)	5,345	436,000	190	440,000	507,000	39
<b>1.2 NON BANKS</b>						
- KSP <sup>1</sup> (Apr 00)	1,097	655,000	531	810,000	n.a.	85
- USP (Apr 00)	n.a.	n.a.	3,629	360,000	n.a.	1,157
...- BK3D (Dec 03)	1,139	378,000	577.5	1,530,000	n.a.	199
- Swamitra <sup>2</sup> (2003)	177	32,000	127	3,960,000	55,000	56
- LDKP (Apr 00)	2,272	1,300,000	358	280,000	n.a.	334
- Pawnshops (Dec 03)	774	14,300,000	8,810	620,000	n.a.	n.a.
<b>II. NON FORMAL</b>						
- BMT (Dec 01)	209	1,200,000	157	130,000	n.a.	209
<b>III. PROGRAM</b>						
- Kukesra (Jun 02)	-	10,300,000	754	n.a.	n.a.	n.a.
- KKP (2002)	15,481	300,000	243	n.a.	n.a.	n.a.
- P4K (May 02)	6,542	700,000	394	n.a.	n.a.	n.a.
- P2KP (Sept 03)	2,227	3,200,000	500	n.a.	n.a.	n.a.
- PKM (Jun 03)	1,140	2,300,000	649	n.a.	n.a.	n.a.
- IMS-NTAADP <sup>3</sup> (Jun 02)	214	58,000	42	n.a.	n.a.	n.a.
- IMS-SAADP <sup>4</sup> (Dec 03)	592	94,000	100	n.a.	n.a.	n.a.
- PEMP (2003)	n.a.	n.a.	308	n.a.	n.a.	n.a.
<b>IV. INFORMAL</b>						
- <i>Arisan</i> groups	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
- Moneylenders	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
- Church groups	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

Notes: n.a.: not available, 1) KSP – Savings and Loans Cooperative, 2) Swamitra – a joint operation between Bank Bukopin and cooperatives to provide microcredit and savings services, 3) IMS-NTAADP – Local Community Initiative – Nusa Tenggara Agricultural Area Development Program, and 4) IMS-SAADP – Local Community Initiative – Sulawesi Agricultural Area Development Program.

Source: BI and affiliated institutions.

Furthermore, the performance of MFIs can be seen from the increase in the number of branches, amount of loans disbursed, amount of savings mobilized and the number of account holders. Table 2.2 indicates that the increase in the number of branches was not significant and, in fact, some of them, such as BPRs, have decreased in number due to the Indonesian Central Bank policy to restructure BPRs. There was a somewhat significant increase in the number of pawnshops and BRI branches. Unfortunately, this data does not provide information regarding the performance of MFIs that were formed on the basis of government programs nor informal MFIs.

**Table 2.2. The Increase in the Number of Microfinance Institutions, 2000-2003**

Institution	Number of Branches		
	2000	2003	Increase
<b>Bank</b>			
BRI rural branches	3,817	4,049	6.0%
BPRs	2,149	2,141	- 0.4%
BKDs	4,518	4,518	0.0%
<b>Non Bank</b>			
KSPs	1,097	n.a.	n.a.
USPs	35,218	n.a.	n.a.
BK3D	1,105	1,139	3.1%
LDKPs	2,272	n.a.	n.a.
Pawnshops	659	774	17.5%
<b>Non-Formal</b>			
BMT	3,038	n.a.	n.a.

Notes: n.a.: not available.

Source: BI and affiliated institutions.

Table 2.3 shows the increase in loans, savings and account holders of several MFIs during the period of 2000 – 2003. It can be seen that the institutions with the greatest increase in the amount of loans provided were BPRs, with an increase of 150% during 2000-2003, even though the number of account holders only increased by 19.3%. There was also a large increase in the number of loans offered by pawnshops, which increased by more than 100%, and BRI which increased by around 75%.

**Table 2.3. The Increase in Savings, Loans and Account Holders, 2000 – 2003**

Institution	Loans (in billions of rupiah)			Savings (in billions of rupiah)			Account Holders (in thousands)		
	2000	2003	ncrease	2000	2003	Increase	2000	2003	Increase
<b>Bank</b>									
BRI rural branches*	9,873	17,300	75.2%	21,990	32,000	45.5%	2,784	3,200	15.0%
BPRs	3,619	8,985	148.3%	3,082	8,868	187.7%	1,761	2,100	19.3%
BKDs	179	n.a.	n.a.	16	n.a.	n.a.	665	436	- 34.4%
<b>Non Bank</b>									
KSPs	531	n.a.	n.a.	85	n.a.	n.a.	655	n.a.	n.a.
USPs	3,629	n.a.	n.a.	1,157	n.a.	n.a.	10,141	n.a.	n.a.
BK3D**	n.a.	577	n.a.	118	199	68.6%	252	378	50.0%
LDKPs	358	n.a.	n.a.	334	n.a.	n.a.	1,326	n.a.	n.a.
Pawnshops	4,231	8,810	109.2%	n.a.	n.a.	n.a.	12,982	14,318	10.3%
<b>Non-Formal</b>									
BMT	157	n.a.	n.a.	209	n.a.	n.a.	1,200	n.a.	n.a.

Notes: \* Position as of July 2004; \*\* Position as of 2001; n.a.: not available.

Source: BI and affiliated institutions.

Similar trends can also be observed in the mobilization of savings. The amount of savings mobilized by BPRs increased more than 185%, much greater than the increases at BK3D (68.6%) and BRI (45%). These results were related to the restructuring of MFIs by BI which specifically restructured BPRs as the only formal banks that provide microfinance recognized by BI. From the total amount of savings and loans, however, BRI still obtained the highest ranking.

## **2.3. Microfinance Infrastructure**

### **2.3.1. Microfinance Funding**

In general, the funding for microfinance services could be provided by four types of source, including: 1) central and regional governments, 2) non-government institutions such as banks, private organizations and state-owned enterprises (BUMN), 3) NGOs and funding agencies, and 4) the community through savings. Funding from the central government consists of Bank Indonesia Liquidity Credit (KLBI) and program funds. Since the 1960s, BI has provided liquidity credits that have been channelled to public banks for several subsidized credit programs in the agricultural sector and to assist the lower economic class and cooperatives. These credit programs include Bimas/Inmas, KUT, KKP, and loans for Small Businesses (KUK) and other programs for promoting small and medium enterprises. In addition, some program funds have been directed toward developing microfinance, specifically developed to reduce poverty, such as Presidential Aid for Underdeveloped Villages (IDT), KDP, P2KP, NTAADP, and Direct Community Assistance – Fuel Subsidy (BLM-BBM). Taking these programs as a reference, the provincial and *kabupaten* governments also allocate funds in their regional budgets (APBD) for microfinance programs.

After BI stopped disbursing credit programs, following the restriction put in place by Law No. 23/1999 on the Bank of Indonesia, the management of credit programs (previously KLBI) was transferred to three executing banks. These banks included BRI which operates the programs providing credit for the members of primary cooperatives (KKPA) and credit for cooperatives (KKop); National Savings Bank (BTN) which operates programs providing credit for those wanting to buy simple houses (KPRS) and very simple houses (KPRSS); as well as the national financing institute (Permodalan Nasional Madani – PNM) which operates other program credit schemes. The amount of credit program funds reached Rp9.5 trillion for BRI, Rp3 trillion for BTN and Rp10.4 trillion for PNM. These funds must be returned to BI within five years.

In the 1980s, the government made it compulsory for public banks to set aside around 20% of their loans for the lower economic class but the implementation of this policy failed. BI in collaboration with Bina Swadaya has also sought financial assistance for microfinance activities. In 1989 they began a program to develop links between banks and self-reliance groups (PHBK). Yet, after Law No. 23/1999 on the Bank of Indonesia was passed and as a result of the monetary crisis, this policy was stopped (Susanto, 5). Since then, BI has facilitated inter-bank relations through PHBL (a program which develops links between banks and MFIs). Until March 2004, this program had initiated the cooperation between 998 BPRs, out of 2,123 active BPRs, and 29 public banks and PNM with a funding ceiling of Rp736 billion as well as committed funds of Rp430 billion (Salam, 2 and Bank Indonesia, 147). In addition, through Ministerial Decree No. 316/KMK.016/1994, the government ordered BUMNs to put aside a maximum of 5% of their profits to assist small businesses and cooperatives, which is referred to as the Small Business and Cooperative Development (PUKK) program.

Several funding agencies and NGOs have also supported the development in MFI activities. During 1979-2005, the Ministry of Agriculture, with funding support from the Asian Development Bank (ADB) and the International Fund for Agricultural Development (IFAD) implemented P4K which provided access to credits and savings for the poor, the credit services of which were assigned to BRI. Similarly, between 1995 and 2001, BI conducted a PKM with funding support from the ADB as well as a grant from the Norwegian government. However, in 2001 BI handed over responsibility for this program to Bank Mandiri which had previously been a channelling institution. Meanwhile, Mercy Corps has acted as a wholesale service provider since 2000 by providing technical and financial assistance for local institutions in Indonesia.

In 2002, the National Poverty Reduction Committee (KPK) and BI made an agreement to reduce poverty through developing small, medium and microbusinesses.<sup>8</sup> This agreement was implemented by making it compulsory for public banks to include their microfinance funding plans and funding plans for small and medium businesses in their business plans. Based on this agreement, banks were to channel Rp4.6 trillion in funds into microbusinesses (Ismawan, 3). However, because these activities were fully funded by each public bank, funding priorities were still given to existing account holders. New account holders were not prioritised and they even had to meet business feasibility standards according to banking requirements. As recently as early 2004, the government announced a microbusiness credit program that does not require business owners to provide collateral (KUM-LTA), as the government provides a credit guarantee. However, this program is considered to have political motives and its developments are so far unknown.

Besides funding from the government, private sector, donors and non-government organizations, savings mobilized from the community contribute significantly, particularly for the banks. In addition, poor communities tend to use informal sources funded mostly by the communities themselves. The most popular form of informal microfinance is *arisan* that have been developed into loan and saving groups both in the form of money as well as goods such as rice.

### **2.3.2. Regulations and Supervision**

To date, there are no specific regulations on MFIs in Indonesia. Law No.7/1992 on Banking, which was modified by Law No.10/1998, only applies to one type of MFI, that is BPRs. Supervision of BPRs by BI is done through the Directorate for Supervision of People's Credit Banks. Other MFIs are cooperatives, and Law No.25/1992 on Cooperatives governs the supervision and regulation of these institutions. According to formal regulations, however, the activities of a cooperative only relate to the interests and prosperity of the members, including accumulating and channelling funds through savings and loans activities (section 43 and 44 of Law No. 25/1992). The legal status of many other MFIs is uncertain, both informal institutions and those which are legal entities, such as foundations as well as institutions established through government programs, governor or *bupati* decrees or otherwise.

According to Section 19 of Government Regulation No.71/1992, MFIs should have applied for a business permit to become a BPR within five years of the government regulation on MFIs being enacted. Given this, MFIs which have yet to meet requirements as BPRs or become cooperatives, have thus become illegal banking institutions. In 2002, BI recorded 2,272 LDKPs which were operating without a legal basis, as well as 5,245 BKDs which had not fulfilled the requirements to operate as BPRs (Ibrahim. 90).

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<sup>8</sup> Joint Agreement No. 11/KEP/MENKO/KESRA/IV/2002 or No. 4/2/KEP.GBI/2002, 22 April 2002.

Section 16 of Law No.7/1992 banned MFIs which are not authorized BPRs from mobilizing community funds (See Box 2.1.). This section also states that there is a penalty of up to 15 years in jail and a maximum fine of Rp10 billion for offenders. This means that the funding for MFIs is very much dependent on program assistance or funding agencies, or only occurs within a small environment, such as with cooperatives. This regulation, according to MFI providers, somewhat hinders the development in microfinance service activities.

**Box 2.1. Some Important Stipulations in Law No. 7/1992 on Banking**

Section 1 (1) states that the term 'bank' refers to an institution which collects funds from the community in the form of savings and lends funds to the community in order to improve the standard of living.

Section 3 states that the main function of banks is as a collector and lender of money to and from the community.

Section 8 states that in providing loans, commercial banks are required to be sure of the ability and willingness of debtors to settle their debts as agreed.

Section 16 (1) states that every institution which collects funds from the community in the form of giros, time deposits, certificates of deposit, savings, and/or other similar forms is required to first obtain a business permit from the Minister for Finance which allows them to operate as a public bank or BPR, except where it is intended for these activities to be regulated by their own law.

Section 46 states that anyone who collects funds from the community without a business permit from the Minister can be threatened with up to 15 years in jail and a fine of up to Rp10 billion.

Because of this circumstance, microbusiness owners have pushed for the formulation of laws and regulations which govern MFIs. In 2001, BI and the Ministry of Finance began to formulate a Microfinance bill. To date, this law has not been ratified and remains with the Ministry of Finance, because there are still several principal differences between the department and the microfinance providers. The Ministry of Finance believes that there are no significant differences between microfinance institutions and BPRs contained in the bill, particularly in regards to the mobilization of funds. But, microfinance providers object to Section 10 of the bill which states that there is an obligation for microfinance institutions that have collected savings of more than Rp1 billion to turn into BPRs (Law No. 10/1998 on Banking) or cooperatives (Law No. 25/1992 on Cooperatives). They argued that MFIs have their own special characteristics which are different from BPRs, such as group-operated credit services, shared responsibilities, and financing targets specifically for the poor.

### **2.3.3. Capacity Building**

BI has admitted that the lack of institutional building has hindered the development of MFIs. It is because BI, in general, is responsible mainly for strengthening the capacity of banks which provide microfinance, that is BPRs. BI, through the Directorate for Supervision of People's Credit Banks, has implemented several policies to strengthen BPRs, such as programs to restructure BPRs as well as strengthen BPR infrastructure and capacity, research, and supporting the cooperation between public banks and BPRs. In general BI's policies relating to institutional capacity building cover: 1) empowerment of associations and networks, 2) training and certification, 3) information technology, 4) linkage programs, 5) establishment of savings and loans institutions (LPSs), and 6) pioneering the establishment of Apex (Salam, 105). Nevertheless, these programs have also touched other MFIs, particularly formal MFIs. For example, BI has developed an integrated information system for the development of small businesses (SI-PUK) which covered the Baseline Economic Survey information system, agroindustry, and the financing patterns of small businesses; and then

training activities, linkage programs and so forth. Other MFIs and the public could also access these programs.

International organizations have also carried out similar activities. In 2001 GTZ through the Promotion of Small Financial Institutions (ProFi), and in collaboration with Indonesian Association of BPRs (Perbarindo) in East Java and BI, provided training, management consultation and legal support for BPRs. Similar activities were also carried out in Kabupaten Alor, NTT. In addition, BI in collaboration with USAID and the Indonesian Business Institute (IBI) organized a seminar about the most appropriate information technology for BPRs.

Capacity building for MFIs in the form of cooperatives and non-formal MFIs is generally carried out by the relevant government offices at the central and provincial levels, or more specifically the Office for Cooperatives, Small and Medium Businesses and the Office for Industry and Trade. Several NGOs have also provided assistance for MFIs, such as what has been carried out by the Center for Small Business Development (PINBUK). Some capacity building activities included: funding assistance, training, technical assistance, provision of facilities, information and promotion. For example, in addition to providing loans, the small business and cooperative empowerment program (PUKK) also funds training, promotion, and marketing programs for small businesses. Furthermore, Gema PKM Indonesia, which was founded on 10 March 2000, is attempting to support joint activities to improve MFIs as a means of poverty reduction in Indonesia. Activities have included meetings with stakeholders, formulation of the draft MFI bill, engagement in international movements, capacity building, and the promotion of microfinance.

### III. MICROFINANCE SERVICES IN NTT

Microfinance has become an important policy strategy for poverty reduction in NTT. Both government and non-government organizations have been directly involved in the provision of microfinance services for various community groups, particularly those that are considered to have limited economic capacity such as small traders, household industries, low level employment and labourers, as well as farmers and fishermen. Various types of MFIs such as banks, pawnshops, cooperatives, MFIs managed by NGOs, government programs with microfinance components and informal MFIs developed and managed by the communities themselves, have been identified in NTT and in the sample regions in particular. These MFIs have different characteristics in terms of geographical coverage, institutional capacity, range of services being offered, as well as targets of services. From the providers' point of view, microfinance is not only for poverty reduction effort but also for commercial purposes that is to maintain institutional sustainability of the MFIs, and for increasing production or productivity –particularly for the case of program credit. This chapter describes the profile and the activities of a variety of MFIs found in NTT, specifically in the sample regions in Kabupaten Kupang and Kabupaten Manggarai.

#### 3.1. Services Provided by Formal Institutions

##### 3.1.1. Services Provided by Banking Institutions

As it is the second poorest province in Indonesia, NTT does not attract many banks to open and operate branches. Compared to West Nusa Tenggara (NTB), the number of banks in NTT is much lower. In 2001, there were only 30 branches of commercial banks in NTT, while there were around 100 branches of commercial bank in NTB. In general, these banks were state-owned banks such as BRI, the National Bank of Indonesia (BNI) or the NTT Regional Development Bank (BPD/Bank NTT). Only Kota Kupang which is the provincial capital has a significant number of banks, including BI, Bank Mandiri, Bank Central Asia (BCA) and the Public Bank for Indonesian Cooperatives (Bukopin).

**Table 3.1. Number of Banks and Cooperatives in NTT by Kabupaten**

No	Kabupaten	Banks		Cooperatives <sup>1)</sup>
		2001	2002	2002
1	West Sumba	1	3	53
2	East Sumba	2	3	70
3	Kupang	-	-	122
4	South Central Timor	1	3	72
5	North Central Timor	1	2	50
6	Belu	3	4	79
7	Alor	1	3	64
8	Lembata	1	2	18
9	East Flores	1	5	72
10	Sikka	4	4	73
11	Ende	4	5	43
12	Ngada	1	3	49
13	Manggarai	1	5	47
14	Kota Kupang	9	18	237
	NTT	30	60	1,049

Notes: <sup>1)</sup> =Includes school cooperatives with a legal base.

Source: BPS NTT 2001 and 2002.

In 2002 however, the number of bank branches in NTT increased by 100% in just one year, totalling 60 branches (Table 3.1). The number of banks that, until 2001, averaged only one or two in each *kabupaten* increased to two or three establishments in 2002. It seems that this increase corresponded with the high economic growth in NTT's that reached 4.2% in 2000 and increased to 6% in 2002. This was lower than the national growth rate of 4.99% in 2000 but significantly higher than the rate of 3.8% in 2002 (BPS NTT 2002, 548). On the other hand, two out five BPRs in NTT have recently shut down because they were unable to operate efficiently. The landscape of banking in NTT is therefore dominated by national commercial banks that have opened new branches in NTT. Another formal institution that has a significant number of establishments is the cooperatives movement. As can be seen in Table 3.1, there were more than 1,000 cooperative establishments in 2002 in NTT, although the number has not increased significantly in the last few years.

There are several banks in NTT which provide microfinance services, including BRI, Bank NTT, Bank Mandiri and BPRs. Table 3.2 provides an illustration of the provision of microcredit and mobilization of savings by banks in 2003 in the sample regions and Table 3.3. presents the schemes of microcredits offered by these banks. BRI operates the rural credit program (Kupedes) and rural saving program (Simpedes) managed by BRI rural branches. There are 4 BRI rural branches in Kabupaten Kupang and there are 8 BRI rural branches in Manggarai (some of them now serve the new Kabupaten of West Manggarai). Each BRI rural branch is equipped with 5 staff: a head of the branch, an account officer who manages credit, two book keepers, and a cashier. The account officer is a field officer who has to check and assess the creditworthiness and assets of a borrower, collect instalments, and supervise the borrowers. Each BRI rural branch in NTT serves between 500 to 1.000 borrowers.

**Table 3.2. Position of Microfinance Services Offered by Banks in NTT, 2003**

Type of Institution	Number of Branches	Loans			Savings	
		Customers	Total (in millions of rupiah)	Average (in millions of rupiah)	Customers	Total (in millions of rupiah)
- BRI Kupang	15	15,964	85,960	5.4	192,682	114,463
BRI Unit Oesao	1	972	5,787	6.0	11,600	9,281
- BRI Ruteng	8	4,902	31,835	6.5	58,420	42,972
BRI Unit Wae Belang	1	640	3,323	5.2	8,320	7,959
BRI Unit Borong	1	622	3,569	5.7	n.a	6,449
- Bank Mandiri (PUKK)	1	1,116	14,410	12.9	n.a.	n.a.
- BPD Main Branch Kupang	1	n.a.	20,624	n.a.	n.a.	n.a.
BPD Sub-branch Oesao	1	101	2,100	20.8	232	417
- BPD Branch Ruteng	1	n.a.	20,601	n.a.	n.a.	n.a.
- BPR Lugas Ganda	1	1,277	2,400	2.0	321	1,300

Note: n.a.: not available.

Bank NTT provides loans for consumption purposes, manages the "Pundi Putri" loan program, and the "Bank NTT Peduli" program which provides small loans of less than Rp5 million for poor families. In NTT, this bank has 15 branches and 9 sub-branches. The sub-branches usually serve rural areas. The sub-branch of Oesao Village in Kabupaten Kupang, for example, should cover 9 *kecamatan* but it now effectively covers only 3 *kecamatan*. This

sub-branch has 5 staff: a head of sub-branch, an account officer, a book keeper, and 2 cashiers. In Kabupaten Manggarai, Bank NTT has one branch located in Ruteng, the capital city of Kabupaten Manggarai, and no sub-branch.

In addition, Bank Mandiri also operates the PUKK program.<sup>9</sup> This program obtains funds from BUMNs which are required to set aside a maximum of 5% of their profits for microcredit (see Table 3.3). In Manggarai, a BPR also provides microcredit for agricultural business and working capital. This BPR is located at the capital city of this *Kabupaten*, but its operation covers several *kecamatan*s around the capital city through field officers who actively go out to the surrounding *kecamatan*s.

**Table 3.3. Microcredit Products Offered by Banks in NTT**

No	Bank	Type of Credit	Credit ceiling (Rp)	Timeframe	Interest rate	Approach
1.	BRI	Kupedes (Investment)	<50,000,000	<2 years	18% p.a.	Individuals
		Kupedes (Working Capital)	<50,000,000	<3 years	18% p.a.	Individuals
		Kupedes (K-3) <sup>1</sup>	<3,000,000	<3 years	18% p.a.	Individuals
		Golbertap <sup>2</sup>	<50,000,000	<5 years	1.3% per month	Individuals
2.	Bank NTT	Credit for consumption purposes	5-50,000,000	1-7 years	15% p.a.	Individuals
		"Pundi Putri"	5,000,000 (individuals) 50,000,000 (groups)	1 year	15% p.a.	Individuals and groups
		Bank NTT Peduli	5-25,000,000	1 year	13% p.a.	Individuals
3.	Bank Mandiri	PUKK	<20,000,000	<5 years	6-15% p.a.	Individuals
4.	BPR	Working capital	<20,000,000	<2 years	2,5% per month	Individuals
		Agriculture	<5,000,000	6-12 months	3% per month	Individuals

Notes: 1) Kupedes K-3 is a credit program which provides a maximum of Rp3 million and,  
2) Golbertap is a credit program for individuals with a fixed income.

In principle, the government's political orientation and the internal policies of banks have already attempted to accommodate the need of the poor in accessing banking services. In reality, however, it is difficult to serve the poor as banks still have to take into account the feasibility of the business to which they are lending money as stipulated in Section 8 of Law No. 7/1992 on Banking (see Box 2.1 on page 14). Given this regulation, bank loans are generally only given to businesses that are already operating well and not to the poor who have just started their business so that they can escape poverty. For example, although the BRI rural branches operate the Kupedes K-3 scheme, which provides credit of up to Rp3 million without collateral, the provision of credit still needs to take into account business feasibility. As a result, it is still difficult for this product to reach the poor.

<sup>9</sup> Based on Decree No. 236/2003, issued by the Minister for State-owned Enterprises, the name of this program has been changed to Program Kemitraan, literally the Partnership Program.

Around 80% of the debtors at banks visited were white-collar workers or those with a stable income. Thus, there is only a small opportunity for the majority of the poor in NTT to access loans offered by banks. In addition to not having collateral, the poor are generally unable to meet the terms and conditions stipulated by banks, such as that a business must have been in operation for one year, be of a reasonable size, and be certified, as well as other legal requirements. Furthermore, the location of the bank that is limited to urban areas and the lack of a means of transport and communication in NTT make it even more difficult for the poor to make use of microfinance services provided by the existing chains of banks.

### 3.1.2. Services Provided by Non-bank Institutions

The non-bank formal MFIs which provide microfinance services in NTT include pawnshops and cooperatives. Pawnshops in NTT only carry out their traditional task, i.e. to lend money to individuals who want to pawn valuable items that are later redeemed within a certain timeframe. Loan schemes, which are repaid in instalments, and that have been developed in other regions have not yet been implemented in this province. On the other hand, not all cooperatives operated in this province adopted the cooperative's principles that are based on doing business from, for and by the members. Some cooperatives expand their activities and provide services for, or cooperate with, non-members, and there are some institutions identified as cooperatives focussed merely on commercial businesses rather than emphasizing solidarity between cooperative members.

#### 3.1.2.1. State-owned Pawnshops

State-owned pawnshops also provide microfinance services and thus it is appropriate to include them in the MFI category. The services offered by pawnshops are one source of microfinance that, from the perspective of loan terms and conditions, can be easily accessed by the poor, given that they possess items that can be pawned (see Box 3.1). Up until the end of 2003, there were 774 branches in Indonesia, serving 14.3 million account holders and credit to the value of Rp8.8 billion.<sup>10</sup> However, the limited number of branches and the fact that they are located in urban areas impedes access to these services for the majority of the poor. For example, the pawnshops in Kecamatan Kupang Timur and Kota Ruteng serve six and seven of the surrounding *kecamatan* respectively.

#### Box 3.1. Pawning Procedures in the Pawnshop

Pawnshops do not differentiate between potential customers according to socio-economic status. As long as individuals can meet requirements, these financial institutions are open to anyone who needs them. Conditions for becoming a customer are possessing proof of residency and goods that can be pawned (gold, electronic goods, a motorcycle). Pawnshop staff then appraise the value of an item to determine the amount of money that can be loaned. Customers can borrow a maximum of 80% of the value of gold jewellery, 65% of the value of electronic goods, and 75% of the value of a motorcycle. This process requires around 15 minutes.

In a pawning system, interest rates are calculated per 15 days over a 4-month period. Customers can settle their debts before the due date or just pay the interest after the due date without paying any extra charges. If, after the due date, a customer has only paid the interest, the pawned goods are revalued in accordance with the current price. This makes it fairly easy for customers, and thus there are rarely arrears or auctions. The auction rate for goods pawned is less than 1%.

<sup>10</sup> In addition to conventional pawning, state-owned pawnshops have operated a credit program for small and microbusiness owners called Kreasi since 2002 where repayments are made in instalments. Kreasi uses a fiducial system whereby individuals do not need to hand over collateral. At present, state-owned pawnshops are preparing a new product called Krasida. Krasida will provide credit for individuals who have collateral that will remain at the pawnshop. NTT branches do not have the authority to provide Kreasi credit because of the poor standard of human resources at these branches. Branches operating in NTT only provide conventional pawning services that require collateral in the form of mobile assets, such as gold jewelry and electronic goods.

In 2003, the Kupang Timur branch provided credit of Rp4.4 billion for 26,039 customers. The average pawn value per customer is Rp167,000 and on average this branch serves 2,170 customers per month. The branch has 6 staff including a head of branch, an appraiser, a cashier, a person who is responsible for the warehouse and two guards. In the same year, the Ruteng branch provided credit of Rp8.76 billion to 19,375 customers. This means that the Ruteng branch serves an average of 1,615 customers per month with an average pawn value of Rp448,000 per customer. The Ruteng Branch has 7 staff and one additional staff on contract. The fact that this branch recruited non-permanent staff indicates that this branch needs more staff.

### 3.1.2.2. Cooperatives

Several NGOs, religious organizations (such as churches), and common people in NTT have formed cooperatives to provide microfinance services for the poor. Some of the relatively big cooperatives that provide microfinance services include Credit Cooperatives (*Kopdit*), Talenta Cooperative, *Pusat Koperasi Angkatan Bersenjata Republik Indonesia* (Puskopabri), and *Pusat Koperasi Unit Desa* (Puskud)

#### 3.1.2.2.1. Credit Cooperatives

Among the cooperatives that currently operate in Indonesia, there are 1,039 cooperatives that specifically provide microfinance services in the form of savings and loans; they are referred to as credit cooperatives. Nationally, credit cooperatives have 378,115 members, loans of around Rp577.5 billion and savings of Rp543.9 billion, made up of Rp344.5 billion in compulsory and principal savings and Rp199.4 billion in voluntary savings (Elias, 31). In NTT, there were 253 credit cooperatives with 44,985 members operating as of 31 December 2003. The amount of money loaned by these credit cooperatives reached Rp58.9 billion and the total amount of member savings reached Rp51.4 billion (see Table 3.4).

In Timor and Rote that cover seven *kabupaten/kota*, including Kota Kupang, Kabupaten Kupang, Alor, South Central Timor, North Central Timor, Rote Ndao and Belu, there are 53 credit cooperatives that are united under *Puskopdit Timor* (an umbrella organization for credit cooperatives). The *puskopdit* in Kabupaten Manggarai has 43 credit cooperatives, but only 16 of them are still active. These *puskopdit* are members of the national association of credit cooperatives, *Inkopdit*, which is located in Jakarta.

**Table 3.4. Credit Cooperatives in NTT (as of 31 December 2003)**

<i>Puskopdit</i> /BK3D	Number of credit cooperatives	Number of members	Credit (in billions of rupiah)	Savings (in billions of rupiah)	
				Compulsory	Voluntary
1. Bekatigade Ende, Ngada	62	14,678	28.80	22.30	3.01
2. Swadaya Utama Maumere	95	19,112	19.50	12.50	4.98
3. Bekatigade Timor, Kupang	53	8,412	9.30	5.10	2.68
4. Manggarai Flores	43	2,783	1.30	0.86	0.04
Total	253	44,985	58.90	40.76	10.72

Source: Elias, 31.

Although cooperatives have attempted to be selective in providing loans in addition to requiring collateral (See Box 3.2), the level of non performing loans at credit cooperatives is relatively high. The level of non performing loans at the Samijaya Credit Cooperative in Kupang for example, reaches 15%, whereas at the Bunga Usaha and Hanura credit cooperatives in Kabupaten Manggarai, it reaches 25% and 33% respectively.

### Box 3.2. Membership and Credit Mechanism at *Kopdit*

Both the rich and poor can benefit from credit cooperatives as institutions that provide financial services (only savings and loans services). In order to do so, they first have to become a member by meeting the following requirements: 1) filling out a membership form; 2) depositing a principal contribution and compulsory contribution; 3) providing a photocopy of their identity card; and 4) obtaining a recommendation from the Credit Cooperative Education Section or another member. The membership of credit cooperatives is active, meaning that one has to apply to be members of a cooperative. On one hand, this registration process can be regarded as the implementation of the principle of selectivity that guarantees the sustainability and financial security of a credit cooperative. On the other hand, such a selection process impedes the expansion of a credit cooperative. For example, between 1995 when the Hanura Credit Cooperative in Kecamatan Borong was established and August 2004, the cooperative has only recruited 234 members. The Bunga Usaha Credit Cooperative in Kabupaten Manggarai, which was established three years ago, has 100 members.

All members have the right and responsibility to save and borrow money. In relation to this, they are not permitted to just save or just borrow money. The amount of money the members can borrow or save is restricted by the financial capacity of each credit cooperative. At the Hanura Credit Cooperative, for example, the maximum amount of savings per member is Rp15 million, whereas the maximum loan is two times the amount a member has saved. The annual interest rate is 12%, whereas the monthly interest rate is 3% (see Table 3.5). Credit cooperatives insure their members' savings and loan with *Dana Perlindungan Bersama* (Daperma). Other than members' savings, capital for credit cooperatives generally comes from *puskopdit* cross-regional loans (i.e. loans from a *puskopdit* in another region to a local *puskopdit*) and low-interest credit assistance from the government.

Table 3.5. Credit Schemes at the Hanura Credit Cooperative, Kabupaten Manggarai

Credit	Timeframe	Collateral
Rp300,000-Rp500,000	5 months	Savings
>Rp500,000-Rp1 million	10 months	Savings and household furniture <sup>)</sup>
>Rp1-2 million	15 months	Savings and an official statement indicating that an individual owns land
>Rp2-5 million	24 months	Savings and an official statement indicating that an individual owns land
>Rp5-10 million	36 months	Savings and an official statement indicating that an individual owns land
>Rp10 million	48 months	Savings and a land certificate

Note: <sup>)</sup> = this furniture stays with the borrower.

#### 3.1.2.2.2. Talenta Cooperative

Talenta Cooperative focuses its activities on saving and loans particularly in the form of microcredits. At the present time, there are around 4,000 active members in the Talenta Cooperative in Kabupaten Timor Tengah Selatan, Belu, Alor, Sikka, Ende and Roti Ndao. The outstanding loans were around Rp11 billion as of July 2004. With a start-up capital of Rp4.5 million, this cooperative accumulates capital from operational profits and additional funds from third parties. Nowadays, the third party fund managed by this cooperative accounts for Rp3 billion with an interest rate of 15% per annum, which is higher than bank's interest rates. A few years ago, this cooperative was able to provide an interest rate of 24% per annum for funds from third parties.

The operation of this cooperative is supported by 89 staff; most of whom are field staff responsible for collecting instalments from the borrowers (the members). Each field staff has to manage around 45 members. The key to the success of its credit service is intensive interaction and communication with its members.

### **Box 3.3. Credit Schemes Offered by Talenta Cooperative**

The Talenta Cooperative developed “Talenta Savings and Loans” which provides loans from around Rp100,000 to Rp5 million with the following terms and conditions:

- For daily loans, the maximum amount is Rp15 million, with a loan term of 50 days and an interest rate of 5-7.5% per month.
- For weekly loans, the maximum amount is Rp25 million, with a loan term of 12 weeks and an interest rate of 7.5% per month on the remaining credit.
- For monthly loans, the maximum amount is Rp50 million, with a loan term of 12 months and an interest rate of 6% on the remaining credit.

To borrow from the Talenta Cooperative, prospective borrowers must become a member and save money. In order for a member to open a savings account, the cooperative deducts one-sixth of a member’s loan as initial savings. Furthermore, each time a member makes a repayment, they are required to deposit savings to the value of one-sixth of their instalment. The Talenta Cooperative makes it compulsory for all types of loans to be supported by a personal guarantee and collateral.

### **3.1.2.2.3. Pusat Koperasi Angkatan Bersenjata Republik Indonesia (Puskopabri)**

Another MFI which takes the form of a cooperative and which is widely known to the communities in Kabupaten Kupang and Manggarai is Puskopabri.<sup>11</sup> This cooperative is often referred to as a “daily bank” because loan instalments are generally made on a daily basis. As of June 2004, the East Kupang Puskopabri (Oesao) branch had outstanding loans totalling Rp65 million that had been provided to 200 customers. Puskopabri provides loans of between Rp100,000 and Rp1 million per customer. Loan conditions include owning a business, particularly a stall or kiosk, and possession of a national identity card. Puskopabri does not require the borrower to provide collateral, but it is compulsory for borrowers to save money. Puskopabri deducts 5% from the loan which is converted into savings but after that, borrowers are not allowed to add to their savings.

Determining the feasibility of providing a loan to a potential Puskopabri borrower is the task of field officers. Thus, potential borrowers do not need to visit a branch in order to apply for a loan. They only need to meet a field officer. If an officer agrees to a request for credit, the money is handed over the next day. Borrowers also need not make credit repayments at Puskopabri branches. Field officers will collect repayments from a borrower’s house or place of business. For this service, borrowers must pay a higher interest rate, that is 20% per month. As an example, if a member borrows Rp100,000, he/she must make daily repayments of Rp4,000 for 30 days.

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<sup>11</sup> It is thought that Puskopabri operates like an informal MFI because of the absence of cooperative membership principles and lack of education and guidance for the members, such as member training sessions or meetings involving all cooperative members.

#### 3.1.2.2.4. The Cattle Production Program Managed by *Puskud*

*Puskud*'s cattle production program began in 2002 and is managed directly by staff at *Puskud*'s Kupang branch without involving village cooperatives or the regional government. In managing this program, *Puskud* assigns its staff to publicize the program and develop cooperation with communities, specifically the poor. *Puskud* obtained capital from the National Cooperative Business Association (NCBA)<sup>12</sup> to purchase a supply of cows.

*Puskud* chose the cattle-production business because NTT is renowned as a cattle-breeding and production region, particularly for the purpose of supplying meat to Jakarta and West Java, despite the cattle population having decreased recently. It is hoped that through this program NTT can regain its image as a cattle-breeding region. The potential areas for cattle-production identified are Kabupaten Kupang, South Central Timor, North Central Timor, and Belu.<sup>13</sup> In Kabupaten Kupang, this program is located in Kecamatan Amarasi and the surrounding areas because of the large supply of cattle fodder and residents existing experience in cattle production.

##### **Box 3.4. The Procedures in Implementing Cattle Production Program by *Puskud***

Promotion of this program begins through approaching village officials and prominent community figures. After village officials decide to accept the program, *Puskud* publicizes the program within the community. Program beneficiaries are grouped together on the basis of the proximity of their houses. Each group has around 25 members. The groups make it easier to distribute cows and monitor the program.<sup>1</sup> Village officials select the beneficiaries and determine the number of cows given to each participant as it is thought that they better understand the residents' capabilities. This approach also provides village officials with the opportunity to select staff and more privileged residents who are no longer categorized as poor as program beneficiaries.

The number of cows given to cattle farmers takes into consideration the number of beneficiaries in a group and the area for cultivating fodder they own. Each family receives between two and ten cows, but the majority receive less than five. In order for the cattle production program to operate optimally, the cattle producers must keep the cows in a stall and they are not allowed to let them roam free. If a cow is sick, a cattle producer must report it to the assistant as soon as possible. If a cow dies because of a cattle producer's neglect, the cattle producer is responsible for any losses; but if a cow dies because the assistant is unable to treat it, the cattle producer is not responsible. To date, the cattle death rate has been below 1%. Cows are raised for between eight and twelve months or until they reach 250kg.

The success of *Puskud*'s program in its first year encouraged further activities. There were many requests from cattle producers to join these activities. *Puskud* distributed 500 cows in 2002, around 2,000 in 2003 and 5,000 in 2004. At present, *Puskud* has received requests for around 5,000 cows, but this request could not be fulfilled because of the limited number of cows. To further support this program, *Puskud* hopes that the government will assist with the cultivation and expansion of land to cultivate fodder.

The Agricultural Office has also implemented a similar program, but supervision is not as intensive as that in the *Puskud* program because of the limited number of extension workers. Several cattle traders in Kupang have also implemented a similar program. However, they

<sup>12</sup> NCBA is located in the USA. To date, NCBA has assisted in promoting coffee in Timor Leste.

<sup>13</sup> *Puskud* has funded the planting of vanilla in Kabupaten North Central Timor and Kabupaten South Central Timor since 2003.

completely relinquished the business to the cattle producers and do not provide assistants. As a result, the earnings are lower than that of the *Puskud* program.

This profit sharing arrangement could be considered as a form of credit although the beneficiaries do not own the cows and bear limited responsible for any losses. Given the provision of new production activities involved in this program, the development and expansion of such a program could be considered as one alternative for poverty reduction efforts.

### **3.2. Services Provided by Non-formal Institutions (MFIs Managed by NGOs)**

Various non-government organizations (NGOs) are mushrooming in NTT, and they play significant roles in assisting and empowering poor communities. Some NGOs have activities that directly and indirectly relate to the provision of microfinance for the poor. Some of them that have been visited by the study team in Kabupaten Kupang and Kabupaten Manggarai, are primarily focusing on the provision of microfinance. They are *Tanaoba Lais Manekat* (TLM), Foundation for the Development of Sea-fishing and Coastal Community (YPPL), and UBSP Tunas Jaya. Other NGOs such as Alfa Omega Foundation (YAO), Sanlima Foundation and Delsos Foundation have units or divisions that provide microfinance services. Other NGOs like AYO Indonesia Foundation and many others provided indirect support to microfinance through their technical assistance to community loans and savings groups, both informal organizations as well as cooperatives. The following are some brief profiles of some of the NGOs that provide microfinance.

#### **3.2.1. Tanaoba Lais Manekat (TLM) Foundation – Kabupaten Kupang**

TLM was established by a church to assist with developing the community's economic activities and thus reduce poverty. TLM empowers communities and provides loans that function as a means of supporting productive businesses (SPUP). Both individuals as well as groups who own farming businesses, such as seaweed cultivation, cattle production and small trading businesses, can receive SPUP (see box 3.5.). SPUP groups are restricted to five members and repayments are a joint responsibility. Besides receiving loans, the borrowers also receive training on fund management and business development every three months.

TLM requires prospective borrowers to have a business, permanent address and a savings account with TLM. The requirement for borrowers to own a business is based upon the belief that additional capital for the poor can only be provided to those who own a productive business and initial capital of around Rp500,000. According to TLM staff, the very poor cannot be empowered directly through the provision of capital. The first step that needs to be taken for them is to increase their motivation and improve their insight and skills through education and assistance.

The aim of having a savings account is to educate customers so that they are able to accumulate their own capital and thus not depend on other parties. Because of this, TLM 'forces' customers to make a saving each time they make a credit repayment (minimum 20% of the instalments. Instalments are collected by the TLM field staff who visit the borrowers in their houses or the place where they run their business. To ensure a high level of repayment rates, TLM conducted a small survey to monitor the business performance of its borrowers.

### Box 3.5. Loan Schemes Offered by TLM

The loan schemes offered by TLM can be differentiated into:

- In the group system, the amount of credit is between Rp500,000 and Rp5 million per person. Repayments are made on a weekly basis and the interest rate is 3% per month.<sup>14</sup> Around 70% of TLM's customers are group members.
- Individual loans are between Rp1 million and Rp15 million with an interest rate of 3% per month and monthly repayments. Loan terms for loans less than Rp5 million are between one and 12 months, whereas loan terms are between one and 24 months for loans of more than Rp5 million.
- Cattle-production credit schemes range between Rp1.6 and Rp3.2 million (for purchases of one or two cows) with a loan term of six months. Unlike previous credit schemes, this credit does not attract interest but uses a profit sharing system where profits are divided between the cattle producer (60%), TLM (30%) and the church (10%).
- Credit used for seaweed cultivation ranges between Rp200,000 and Rp2 million with a loan term of 6 months and an interest rate of 3% per month.

At the present time, TLM's operational area covers West Timor, Rote and Alor which are served by 10 branches. It has around 13,000 active customers assisted by 13 field staff. Each field staff is assisting around 275 customers. Outstanding loans as of 30 July 2004 reached Rp7.5 billion with an average annual credit of Rp29 billion. TLM activities have received financial support and technical assistance from various institutions based in Europe, United States and Australia.

#### 3.2.2. Alfa Omega Foundation (YAO) – Kabupaten Kupang

YAO is one of the oldest NGOs in NTT and this foundation has developed many local NGOs in several *kabupaten* in West Timor and in Flores Island. YAO has two main activities that relate to microfinance. The first is strengthening the capacity of other microfinance institutions and the second is providing direct microfinance services to the community. In strengthening the capacity of other microfinance institutions, YAO provides technical assistance to a community based organization and develops it into a multi-purpose cooperative or loans and savings cooperative. Besides providing assistance for business development, seeking market opportunities and human resource management, YAO also provides capital assistance to the groups that are considered to have sufficient management capacity. The amount of a loan depends on the group's proposal and is in the range of Rp75 million to Rp100 million. The loan is to be repaid in 10 months with an interest of 0.75% per month. Nowadays, this activity has been mostly handed over to local NGOs associated with YAO that are located in 6 *kabupaten*: Kabupaten Kupang, Kupang City, Kabupaten Belu, Kabupaten Alor, Kabupaten Rote and Kabupaten South Central Timor. For all of these NGOs, YAO provides Rp 200 million in capital assistance to be directed to the community assisted by each NGO with a scheme that has been adjusted to local conditions.

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<sup>14</sup> According to TLM's staff, the aim of having interest is to ensure the MFI's sustainability.

### **Box 3.6. Loan Schemes Offered by MFI-YAO**

MFI-YAO offers 2 types of loan:

1. Loans with monthly repayment. This loan ranges from Rp1 million-Rp5 million with an interest rate of 2% per month with repayment within 1-2 years. This loan is often used for agricultural business and animal husbandry.
2. Loans with daily repayment (credit union) range from Rp200,000 to Rp1 million, with an interest rate of 12.5% for a period of 50 days.

To get this loan, a prospective customer has to submit a written proposal complemented by a copy of their identity card. Based on this proposal, a field staff from MFI-YAO will assess the feasibility of the proposal in terms of the potential of business to be financed by the loan and the likely capability to repay loan. The amount of the approved loan will be based on the agreement with the borrower. The disbursement takes place at the MFI-YAO office, but the repayment will be collected by the MFI-YAO field staff at the premises of the customer.

The microfinance unit of the YAO (MFI-YAO) manages the direct provision of microfinance services. The target groups of these microfinance services are the low-income classes who do not own collateral, especially women. MFI-YAO has two types of credit scheme; one with monthly repayments and the one with daily repayments (see Box 3.6.). The activity of MFI-YAO covers Kabupaten Kupang, Kabupaten North Central Timor and Kabupaten Belu. The numbers of customers are 300 for loans with monthly repayments and another 300 for loans with daily repayments. The microfinance unit has 9 staff, consisting of 3 administrative staff and 6 field staff (2 in Belu and TTU, and 4 in Kupang). The MFI unit finances the cost of all of these staff, and the profit from loan interest has covered the operational cost of this unit. The MFI activity is quite prospective, as the initial capital has grown from Rp60 million in 2000 to around Rp100 million in early 2004. The proportion of bad debts is also very small and it ranges from 5% to 10%. The bad debts have been handled in a very flexible way, such as by loan rescheduling so that no loan is written off and no penalty system is applied.

The funding for MFI-YAO is mainly from profits that have been separated from YAO accounts, plus grants from NZAID. In addition, MFI-YAO also received funds for training from NZAID and JICA.

#### **3.2.3. Foundation for the Development of Sea-Fishing and Coastal Communities (YPPL) – Kabupaten Kupang**

YPPL started its operation in 1998 as one unit within YAO, and it become independent in 2002. The activities of YPPL include assisting groups, providing capital assistance and raising community awareness for community empowerment, capital strengthening, capacity building and natural resource conservation. The target of this foundation covers coastal communities in Kupang Bay, North Coast of TTU and South Coast of Belu. Capital assistance is given to groups in the form of soft loans under the joint responsibility of all members of the group, and to individuals with monthly repayments (see Box 3.7.). At the time of this study, YPPL has disbursed loans to 26 groups that have businesses in milkfish culture, marine fishing, agriculture, animal husbandry and shops, and 16 individuals who run animal husbandries and cattle trading.

### **Box 3.7. Loan Schemes Offered by YPPL**

YPPL offers two types of loan:

1. Group loans for a group of 10-20 members with joint responsibility. The loan size is around Rp40 million to be repaid in a maximum period of 2 years with an interest rate of 1% per month. The size of a loan will be based on the proposals of all members of a group that is submitted as group proposal to YPPL. For late payments, there is a penalty amounting to one month's interest payment. In addition to the loan, a group also gets assistance from YPPL.
2. Individual loans with a maximum amount of Rp5 million. The loan should be repaid in one year with an interest rate of 2% per month. To get this loan, a prospective borrower should submit a proposal, collateral and sign a formal agreement. The collateral is in the form of a land certificate and it will be kept by YPPL. The target of this program is the middle and low-income classes.

To run its activities, YPPL has received support from various donors and established cooperation with the government. Among others, YPPL received support from COREMAP AusAID in 1998 as well as JICA and NZAID. Since 2001, YPPL has established cooperation with the office for fisheries and marine resources for better management of natural resources through strengthening community based organizations in the coastal areas.

#### **3.2.4. Sanlima Foundation – Kabupaten Kupang**

Sanlima Foundation has three main programs, namely research, democracy and the poor, and people's economy. Within the people's economy program, since 1999, Sanlima have provided loans in the same package as their business assistance. Up to the time of this study, the foundation has assisted 36 groups, 16 of which are located in Kabupaten Kupang and Kupang City. Business assistance has been delivered in the form of training in management and finance. Loans are given to a group of 6-10 members with joint responsibility (see Box 3.8.). Each group makes a deposit of 10% from their loan, compulsory savings of Rp5,000 per person and voluntary savings in the amount decided by the group itself. The repayment rate is quite high. Loans financed from ASPUK funds have no bad debt, while others have bad debts of 5%-10%. The problems in loan repayments are usually caused by the fluctuation in prices that impact on the profitability of the business of the members of the group. Bad debts however, have been minimized through adopting a flexible scheme in accordance with the repayment capacity of the borrower.

### **Box 3.8. Loan Schemes Offered by Sanlima Foundation**

The amount of loan offered by Sanlima Foundation ranges from Rp3 million to Rp5 million per group, or around Rp2 million per person. This loan should usually be repaid in 10-12 months with an arrangement that is flexible, based on the type of business to be financed by the loan and the agreement with the group. The interest rates differ according to the funding source of the loans. There are 4 funding sources for microcredits, namely Yappika, ASPUK, YIS SOLO and CRP. The interest rate on loans financed from Yappika is 2% per month; this includes 1.5% to be paid to Yappika, 0.25% for Sanlima and another 0.25% for group saving. ASPUK provides funding for loans for women with 1% interest rates (0.5% to be paid to ASPUK). YIS Solo provides Rp100 million to be disbursed for rural credits with interest rates the same as Yappika. CRP provides funding for loans for small enterprises in urban areas; these are mainly traders and stall owners.

Five staffs run the microfinance and business assistance activities, but their cost has not been covered by the loans interest. The cost for their activities is financed by assistance funds provided by YIS Solo and ASPUK. Until now, only one staff has been fully financed from the interest collected from the 10 groups under this assistance program.

#### **3.2.4. Delsos Foundation – Kabupaten Manggarai**

Delsos is part of a church organization with a primary objective of community development. In undertaking this task, Delsos performs socio-economic development activities for the community through training and microfinance. Among the training and community development programs are providing seeds and training in crop cultivation (in collaboration with Veko Indonesia), developing drinking water facilities in rural areas (in collaboration with the office for regional settlements and infrastructure development –Kimpraswil), rehabilitation of rural irrigation canals (in collaboration with local government and other NGOs), and reforestation and extension of tree-crops (in collaboration with the office of forestry and the office of plantation).

There are two channels for the provision of microfinance services, firstly via funds from the socio-economic development division of the Indonesian Church Committee (PSE-KWI) located in Jakarta, and secondly be providing microfinance through cooperative networks within church organizations. Funds from PSE-KWI are given to groups of small-businesses that have received training from the church. To get the funds, a group has to submit a proposal to Delsos. For loans in the range of Rp1 million – Rp2 million, a group submits the proposal to Delsos with a recommendation from the priest. For loans ranging from Rp2 million to Rp25 million, a group has to submit the proposal to KWI with recommendations from the priest and Delsos. On the other hand, the network of cooperatives within the church provides savings and loans services for the members, who are staff of the church. The interest rate for the loans is 2% per month with a one-year repayment period. In 2000, Delsos Cooperative received funds from Kerosene Compensation Funds amounting to Rp100 million. This fund has to be paid back in 10 years beginning 2005. This is a revolving fund with an interest rate of 16% annually. This interest is divided into 10% for the cooperative saving (Delsos), 4% for the bank that provides technical assistance (BRI), and 2% for the task force within local government offices. The majority of this fund (90%) is used to increase the amount of loans for the members of the cooperative.

#### **3.2.5. Tunas Jaya Loans and Saving Group – Kabupaten Manggarai**

Tunas Jaya Foundation was established for women's empowerment through life-skills training (weaving, sewing, embroidery, and small-scale agriculture and animal husbandry) and loans-savings groups. The establishment of a loans and savings group is to provide a forum for independent group activities where the members of the group have basic saving, compulsory saving and voluntary saving. The group activities are also used as a medium for empowerment, such as to discuss gender issues and violence against women. The Tunas Jaya Foundation provides technical assistance in bookkeeping and group management in addition to capital assistance in the form of loans with an interest rate of 2% (flat). Not all loans and savings groups can receive the capital assistance. Loans are provided only to the groups that are considered reliable in terms of their own capital, participation of members and the performance of their own loans repayments. The amount of loans is also very much limited by the financial capacity and the loan repayments from the groups that had received loans. Up to the time of this study, there are around 20 groups under Tunas Jaya network receiving assistance. Tunas Jaya activities are managed by 8 staff consisting of 3 administrative staff and 5 field staff. In addition, volunteers from each group carry out the communication between the loans and savings groups and the foundation.

Tunas Jaya activities have been supported by funding from several non-recurrent grants such as KUSO, AusAID, Center for Studies in Regional Development (PSPK), VSO and SPARK. In addition, in 2000, Tunas Jaya received funding of Rp50 million from the Kerosene Compensation Subsidy with an annual interest rate of 16% to be paid monthly to a BRI account. The loan has to be paid back in 10 years beginning 2005. In managing this fund, Tunas Jaya received assistance from BRI and this assistance is considered to be very beneficial in improving the foundation's administration and book keeping systems. So far, the status of Tunas Jaya is as an MFI or a "pra-cooperative".

### **3.3. Services Provided through Government Programs**

The provincial government of NTT as well as the district governments of Kabupaten Kupang and Kabupaten Manggarai have provided microfinance services as part of their regional development programs. The NTT provincial government used the development of rural MFIs as a strategy to push for an increase in medium and small-scale investment.<sup>15</sup> The Kabupaten Kupang government set the provision of microcredit or revolving funds as one program in its community empowerment program<sup>16</sup> by adopting programs similar to those that have already been applied,<sup>17</sup> especially KDP (Kecamatan Development Program). Similarly, the Kabupaten Manggarai government used revolving funds as part of the program to develop the household and village economies.<sup>18</sup> In general, the programs related to microfinance have been carried out through the provision of microcredit programs managed by related sectoral offices and efforts at strengthening institutions that provide microfinance services.

#### **3.3.1. Credit Programs**

##### **3.3.1.1. Credit Objectives and Targets**

Almost all sectoral offices have developed programs or activities that provide revolving funds in accordance with their area of authority. These funds, usually referred to as direct assistance to the communities, are aiming at increasing the business outputs of the recipients, both through business intensification as well as extension. Thus, these programs are not specifically aimed at reducing poverty, although it is hoped that improvements in production in every sector will improve the welfare of the people. This sectoral approach in channelling funds has made it easier for regional governments to divide projects between offices.

Government credit programs target individuals, community groups, financial institutions such as savings and loans cooperatives/groups and other MFIs. The procedures for receiving these credits have been developed by each Kabupaten government (see Box 3.9). Community groups, cooperatives and MFIs then channel funds to their members. Community groups are the targets for a large number of revolving funds activities managed by government offices. A group approach is considered to be the most ideal if it is related to efforts to strengthen the institutional capacity or effectiveness of a business. In practice, however, the group approach is not effective. A large number of program beneficiaries prefer to do business by themselves because they are reluctant to share risks.

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<sup>15</sup> See the NTT Provincial Strategic Plan (2004-2008).

<sup>16</sup> See the Kabupaten Kupang Strategic Plan (2001-2005).

<sup>17</sup> Among them are IDT, a project which aimed to reduce the impact of the economic crisis by introducing labor-intensive jobs and community funds (PDM-DKE), a program providing supporting infrastructure for underdeveloped villages (P3DT), NTAADP and KDP.

<sup>18</sup> See the Kabupaten Manggarai Strategic Plan (2002-2006).

### Box 3.9. The Procedures for Obtaining Credit Programs in Kabupaten Kupang and Kabupaten Manggarai

According to the implementation guidelines for the **community empowerment program in Kabupaten Kupang**, each potential beneficiary, whether it be an institution, community group or individual, must submit a proposal to the executing government office, which outlines the identity of the beneficiary/beneficiaries, amount of the loan and the use to which the loan will be put. Proposals are examined at the *kecamatan* level by the head of a government office branch or technical management unit or the program coordinator. A government office selects program beneficiaries based on these proposals. Funds are transferred through BRI or Bank NTT to the account of an institution, group or individual. A similar process occurs with funds from the provincial and national budgets. Funds sent to the head or treasurer of a group are then divided amongst group members either equally or depending on the needs and capabilities of each member.

The process to obtain **credit in Kabupaten Manggarai** begins with community groups submitting a proposal or definitive plan of the group's activities to the executing government office, with the knowledge of the village head or *lurah*, *camat*, as well as the concerned officials at the *kecamatan* level. If the proposal or definitive plan is accepted, the government department will transfer funds to the group's account through a BRI rural branch or send in-kind assistance directly to a village. Thereafter, a group's management divides the funds between members in accordance with their needs and initial agreement. Kabupaten-level working groups select KSP/USPs and UBSPs. The KSP/USPs and UBSPs selected as beneficiaries are those that are considered financially sound or reasonably sound and those with no debts. At the time when a fund is received, the management of a KSP/USP or UBSP must sign an agreement, a timetable for repaying the loan and provide collateral.

In general, program targets in Kabupaten Kupang are small traders and kiosk owners, cattle producers, small business/industry owners and fishermen, whereas in Kabupaten Manggarai they include rice farmers, small traders and kiosk owners, small business/industry owners, fishermen and cattle producers. The office for cooperatives and small-medium enterprises channels funds to microfinance institutions in rural areas. These include savings and loans cooperatives, savings and loans group and other microfinance institutions. In addition, this office also channels funds directly to individuals, particularly to medium and small-scale enterprises. In Kabupaten Manggarai, the office for cooperatives and small-medium enterprises also provides funds to Village Credits Institution (LPD/LKP) and to savings and loans groups.

#### 3.3.1.2. Funding Sources and Credit Schemes

Funds for microcredit services come from the provincial, *kabupaten/kota* and national budgets (deconcentration funds). Services funded by the national and provincial budgets are usually managed by the provincial governments who appoint high-ranking *kabupaten* project staff as the executors. The *kabupaten* government only has to provide recommendations on the selection of areas and beneficiaries. In addition, there are also national programs funded by the national budget for which the *kabupaten*-level technical offices are fully responsible. These include programs in the fisheries and marine sectors. In this regard, provincial budget allocations only supplement activities funded by the national budget.

At the provincial level, the government offices involved in channelling microcredit are the Cooperatives and SMEs, Fisheries and Marine Affairs, Animal Husbandry as well as the Industry and Trade Offices. The provincial-level BPMD previously managed the channelling of microcredit which was referred to as UED-SP, but the authority has now been transferred to the *kabupaten*-level BPMD. The NTT provincial government also allocates funds to provide initial capital at Bank NTT. The name of the programs, source of funding, target

groups and interest rates of the credit programs managed by the provincial-level technical offices are provided in Appendix 3. 1.

At the *kabupaten* level, the government also channels revolving funds using a model similar to the provincial level. This includes the government offices involved in the rural economy, such as BPMD, the Cooperative and SME Office, Industry and Trade Office, Food Crops Office, Agricultural, Forestry and Plantation Office, Fisheries and Marine Affairs Office as well as the Animal Husbandry Office. A list of program titles, their funding sources, targets and interest rates of microcredit programs managed by the government offices in Kabupaten Kupang and Kabupaten Manggarai are provided in Appendix 3.2 and 3.3.

#### **Box 3.10. Various Schemes of Credit Programs**

The interest rate, timeframe for repayments and revolving funds process differ between one government office and another or from one type of activity to another within the same executing government office. For all types of activities, the interest rate ranges between 0% and 24% per annum. For example, the interest rate for funds channelled by the provincial-level Cooperatives and SME Office to cooperatives, KSP/USPs and MFIs is 16% per annum, whereas there is no interest on funds channelled through community groups and the management of revolving funds is passed to the relevant group. The provincial-level Fisheries Office charges interest of 1-2% per month for the PEMP program and loan terms range from 12 to 36 months, whereas for other programs it does not charge any interest.

In Kabupaten Kupang, the interest rate on repayments for business capital loans channelled through cooperatives, KSPs or USPs is 12% per annum for both individuals as well as groups, and loans are repaid over 12 months, beginning three months after the funds have been received. These business capital loans are funded through the *kabupaten* budgets. For cattle production and shared cattle production programs managed by the Animal Husbandry Office, returns come in the form of profit sharing (the cattle producers gets 70% and the government office gets 30%) and calves (If a cattle producer receives one cow, in five years time he/she must hand over two calves. If a cattle producer receives two cows, he/she must hand over five calves in the same time period).

In Kabupaten Manggarai, only those funds provided for LPD/Ks, are generally granted as additional capital. Other loans from *kabupaten* budgets must be repaid through the executing government office, which has various credit schemes. For example, the Economic Section has set an interest rate of 16% per annum for small industry development funds, whereas the iodine deficiency eradication program only attracts an annual interest rate of 12% and there is a 2-year loan term. For all types of activities and targets, the Cooperatives and SME Office charges an interest rate of 12% per annum with a loan term of 2 years, although only interest is paid for the first three months. Assistance provided by the Food Crops Office in Kabupaten Manggarai comes in the form of input and equipment for rice production, such as seeds/seedlings, fertilizer and pesticide. Repayments are made after harvesting the rice or at the most six months after receiving assistance, and are subject to a 9% interest rate. Meanwhile, cattle production and sharing programs managed by the Animal Husbandry Office, use a profit-sharing system (the cattle producer gets 75% and the government office gets 25%) and repayments are made using calves (calves born on an odd year remain with the cattle producer and calves born on an even year go to the government). A portion of the interest from revolving funds funded by the *kabupaten* budget becomes regional revenue, but this has yet to be formally included in Kabupaten Manggarai's regional regulations.

Some loan repayments are made directly to the executing offices, through bank transfers and others are made in instalments. Group members make repayments through a group's manager/treasurer or through village officials/extension workers. Thereafter, the collected funds are deposited with the treasurer at the relevant government office.

Among the sectoral offices channelling microcredits, the NTT provincial-level Cooperatives and SME Office and the Fisheries and Marine Affairs Office manage the greatest number of microfinance programs. The Cooperatives and SME Office manages the largest funds since almost all programs for developing small and medium enterprises funded by deconcentration funds are channelled through this office. The Marine Affairs Office also channels large amounts of funds for PEMP projects funded by the national budget. The Cooperatives and SME Office in Kabupaten Kupang channels the greatest amount of microcredit. In addition, as a major rice-producing area in NTT, Kabupaten Manggarai has allocated the greatest number of microcredit-channelling activities for improving rice production, particularly those funded by the national budget and managed by the Food Crop Office.

Government offices channel both money and in-kind credit. In-kind credit comes in the form of agricultural tools and products, such as production input packages (seeds/seedlings, fertilizers and pesticides), equipment in the form of processors and sprayers, aquaculture and fishing equipment (fish/fish eggs, fishing boats and other fish farming equipment), as well as calves and cows. These funds come in the form of grants and loans which charge interest as well as no-interest loans (see Box 3.10). However, in principle, all forms of credit must be repaid.

### **3.3.1.3. Program Performance**

The performance of the credit programs in the two sample *kabupatens* is similar, particularly regarding group activities and sustainability, program targets and loan repayments. Groups are only formed to make the channelling and repayment of funds smoother. Groups are often formed unexpectedly and are rarely based on social ties between members, and thus their existence is purely a formality. Groups are not headed by capable leaders because their level of education is generally low and they are usually busy with another job. In addition, the lack of guidance from, and monitoring by, the executing government office and poor assistance also cause group activities to become unsustainable.

Regarding the selection of target groups, the sectoral approach could result in an overlap in targets between one government office and another. In principle, considering that funds are limited, allocations for each area, from the provincial level to the *kabupaten/kota* level or from the *kabupaten/kota* level to the *kecamatan* and village/*kelurahan* level, should be determined on the basis of the existence of other programs, institutional feasibility, regional potential and time rotations. Areas that have already benefited from assistance programs should not be prioritised. Only cooperatives and financial institutions that are financially sound should be given capital assistance. Cattle production programs should be carried out in areas that have high grazing potential, whereas rice field intensification and extension programs should be carried out in regions with widespread fields. Coordination at the village level however, is often problematic because all executing offices would like their programs to have good repayment rates. Thus they tend to select the groups with a good reputation. Consequently, there is a tendency for certain groups to always receive credits, while the others are left out. In addition, the limited access to information often benefited certain groups (the elites) that have better access to the information regarding credit programs.

On the other hand, although business feasibility and the ability of a borrower to make instalment repayments are important considerations in determining a program's targets, the repayment rates are mostly low and vary across business sectors (see Box 3.11). The owners of kiosks or other trading businesses are program targets who have been relatively successful because they are capable of paying instalments on time. Cattle fattening activities in cattle centers also appear to be quite good because of the sufficient knowledge of and experience in cattle production and a guaranteed market. On the other hand, there is a greater likelihood of money loaned to farmers, plantation labourers and fishermen not being returned. The

cultivation of food crops and plantation crops as well as aquaculture and fishing depend upon the natural environment. Unstable production levels and fluctuations in selling prices are reasons why fishermen and farmers are often unable to repay loans.

In some cases, borrowed money is not always used entirely for business capital, but is also used for paying school fees, building a house or carrying out *adat* duties. In addition, the perception that all government assistance comes in the form of grants results in communities failing to make regular repayments. Due to the high level of outstanding loans, there is no continuity in the circulation of funds between groups or individuals and sometimes this comes to a halt.

#### **Box 3.11. Some Repayment Problems in Credit Programs**

- All activities handled by the Fisheries Office at the provincial and *kabupaten* levels in NTT tend to have very low repayment rates. The government channelled a total of Rp1 billion in PEMP funds in Kabupaten Manggarai since 2001. To date, fishermen in this *kabupaten* have only repaid Rp12 million.
- Of the funds channelled by the Economic Section of the Kabupaten Manggarai government to salt farmers in 2001, only 30% have been repaid. Only 33% of the funds channelled by the Cooperatives and SME Office through cooperatives, KSPs or USPs in this *kabupaten* have been repaid. There has not been any repayment of credit by coffee bean processors that was managed by the Cooperatives and SME Office.
- In 2003, the Food Crops Office in Kabupaten Manggarai distributed in-kind assistance in the form of rice production input and equipment for joint agribusiness activities. After the harvest, many farmers were unable to return the money because the price of rice on the local market had fallen sharply. Farmers then made repayments in rice at the government price which was higher than the local market price. The result was that the Manggarai Food Crop Office became a rice warehouse.

In general, it could be said that the involvement of government as a microcredit provider has created a conflict of interest. The function of government offices as a community facilitator conflicts with their function as an agency that ensures credit is repaid. Due to such a conflict, on one hand the function as a facilitator tends to be neglected, while on the other hand, the pressure to meet loan repayments causes communities to avoid meeting government officials.

#### **3.3.2. Efforts to Develop Village Level MFIs**

Besides providing credit programs, local governments are also providing support to strengthen MFIs through funding and technical assistance. It has already been stated in Chapter 3.3.1 that Cooperatives and SME Offices, both at the provincial and *kabupaten* levels, have channelled funds to cooperatives, non-formal MFIs and informal MFIs. In strengthening community institutions, several government technical offices recruit facilitators to facilitate village-level financial institutions, such as cooperatives and community groups, as well as directly servicing the communities themselves. Assistance is generally not continuous considering the technical and financial restrictions, and thus it is ineffective. The existence of a facilitator for cooperatives in Kabupaten Manggarai, for example, is considered ineffectual because the educational background of the facilitator does not correspond with the demands of the position, and some people consider the facilitators to have fewer capabilities than the cooperatives' managers.

In particular, the government of Kabupaten Manggarai has developed MFIs in the form of Village Credit Institutions (LPDs) or *Kelurahan* Credit Institutions (LPKs). The structure and duties of these institutions are similar to the institutions that have existed in other provinces such as East Java and Bali (see Chapter 2). Developing LPDs and LPKs in Kabupaten Manggarai, is the main program of the Village Community Empowerment Board (BPMD) and it is aiming to stop community members borrowing from high-interest moneylenders, to prevent forward selling of crops and to meet the poor's need for capital. The establishment of this village level MFI is to provide an institution to pull together all funds that have been channelled to village communities, such as funds from UED-SP and IDT programs, as well as funds from other sectoral offices including KDP and NTAADP. In principle, LPD/LPK activities are intended to be similar to credit cooperatives with wider coverage to include all households in the respective village.

In establishing LPD/Ks the BPMD Kabupaten Manggarai provides start up funds of Rp25 million to an UBSP selected to be developed as LPD/K and assigns a technical advisor to assist the UBSP managers. UBSPs conduct group activities initiated by communities; these generally begin with *arisan* activities but have developed into savings and loans activities. Up until August 2004, 12 LPD/Ks had been formed in Kabupaten Manggarai and 6 of them received additional capital of Rp10 million each in soft loans from the Cooperatives and SME Office, Kabupaten Manggarai. The plan is that one LPD/K will be formed in each *kecamatan* as a model institution, and it is hoped that one LPD/K will be established in each village/*kelurahan* in the future.

To date, LPD/K services are still limited in scope due to a lack of funds. The Pasir Putih LPK in Kelurahan Wae Belang and the Kotandora LPK in Kecamatan Borong, for example, have only provided credit for 31 and 50 households respectively of 825 households in total. Furthermore, these loans have only been provided to members. To become a member of the Pasir Putih LPD, individuals must deposit principal savings of Rp30,000 and compulsory savings of Rp5,000 as well as make a monthly *arisan* contribution of Rp5,000. In the credit scheme developed by this LPD, loans are between Rp100,000 and Rp1 million with a loan term of 10-15 months and an effective interest rate of 1.5-2% per month.

The future prospect of LPD/K is, however, unknown because the funds that are supposed to be pulled together by this institution as an initial capital, which is IDT and UED-SP funds, are very unlikely to be collected from the communities due to lack of records and the community attitude that they do not have to return the funds. There is also a tendency for sectoral offices to retain their authorities over their programmable funds. The NTAADP executing agency, for example, does not agree to the formation of LPD/K and prefers to increase the capacity of the existing UPKD. In an effort to strengthen the existing UPKDs, Bappeda has hired a financial consultant who works intensively to improve UPKDs administration performance.

### **3.3.3. Microfinance Services Provided by NTAADP and KDP**

Besides microfinance services developed by local governments, there are two big programs with microfinance components supported by donor agencies in NTT. These are Nusa Tenggara Agricultural Area Development Project (NTAADP) and Kecamatan Development Program (KDP). NTAADP was funded by the World Bank between 1999 and 2003. In NTT, this program was conducted in eight *kabupaten*, 28 *kecamatan*, and 263 villages. In 2002, 5,115 community groups, including 48,151 individuals (21% of them were women), received assistance. In Kabupaten Manggarai, NTAADP was conducted in Kecamatan Satarmese that covers 25 villages and utilized funding of Rp3.2 billion. One of these villages, Desa Bea Kondo, received NTAADP funds twice: Rp79 million in 2000 and Rp20 million in 2001.

KDP is a program that is managed by the government through the Directorate General for the Development of Village Communities (Ministry of Home Affairs), in collaboration with the World Bank, several government offices, BRI, universities, regional governments and NGOs. The funds channelled to each *kecamatan* ranges between Rp350 million and Rp1 billion depending upon the number of residents. Most of the funds are used to develop infrastructure in accordance with the community's request, but some of the funds are also used for supporting economically productive activities and revolving funds.

In relation to revolving funds, these two government programs funded by donors have similar objectives, namely to increase the income of poor rural families. NTAADP placed greater emphasis on productive agribusiness activities, whereas KDP provides access to credit for the poor in order to develop their economic enterprises (see Box 3.12.). NTAADP's working area only covered Nusa Tenggara and the program's targets were poor rural families, whereas KDP covers the whole of Indonesia and its targets are the *kecamatan* where a large proportion of residents are poor. Although these programs basically have the same targets, it is apparent that they have had different levels of success in reaching these targets in the field. In the sample regions, it is apparent that NTAADP was able to embrace the poor as beneficiaries, whereas KDP has not been that successful in reaching poor families as communities believed that quite a few rich families had been recipients of KDP funds.

**Box 3.12. Loans Disbursement Procedures in NTAADP and KDP**

The channelling of NTAADP funds used a local community initiative pattern. Through groups, each individual submitted a proposal containing information about the type of business they wanted to establish and their plans for using the credit. The village financial management unit (UPKD) selected proposals. Loans ranged between Rp1.5 million and Rp2 million, but could reach Rp3 million for animal husbandry enterprises. The loan terms were one year and the interest rate was 15% per annum. In practice in Desa Bea Kondo (Kabupaten Manggarai), loans to pig and cocoa farmers ranged between Rp500,000 and Rp700,000 with a loan term of 12 months and an interest rate of 15-18% per annum.

In order to receive KDP funds, groups of prospective borrowers submit credit proposals to a village committee that discusses and approves proposals for village development projects (LKMD) which then creates a UPK. These proposals contain the names of the group members, their planned businesses and the credit repayment schedules. The maximum loan term is 18 months and the interest rate is adjusted to the interest rate at the local BRI branch. The channelling of KDP funds for microfinance services in the sample area indicates that the loan term has been altered from 18 months to only 12 months with an interest rate of either 16% per annum or 1.35% per month.

The performance of loans provided by NTAADP and KDP could be observed from several aspects such as program beneficiaries, credit repayment rate and the sustainability of revolving funds. In relation to the beneficiaries of credit assistance, most of the NTAADP beneficiaries are poor farmers, whereas KDP beneficiaries are mixed, including poor families and rich families. In respect to credit repayments for the NTAADP program, 58% of loans as per May 2004 were outstanding. In fact, in Desa Bea Kondo, of the Rp91 million channelled into the village, 92% was outstanding. These outstanding loans almost caused the local UPKD activities to stop. This also occurred with the KDP program. Outstanding loans in the KDP program vary according to region and business sector. The repayment rate for loans provided to residents who live in areas close to urban areas is higher compared to that for residents who live in the interior. In general, the repayment rate for loans provided to stall owners is higher than that for animal husbandry businesses. In the animal husbandry sector, the repayment rate for loans to cattle producers is higher than that for pig farmers.

The sustainability of revolving funds, both for the NTAADP and KDP programs, depends upon the loan repayment rate. In the areas and sectors where the loan repayment rate is high, funds circulate more quickly between borrowers and from one group to another. Complaints often arise however, because businesses become bankrupt due to a lack of capital after repaying loans. In relation to this, program managers not only need to pay attention to the amount of credit provided, but also to how long a group or individual should continue to receive credit, for example, whether they should receive credit until they are able to sustain their business.

### **3.4. Services Provided by Informal Institutions**

Poor families in NTT also obtain loans from informal institutions such as informal moneylenders (loan shark), *arisan* groups and loan and saving groups. There are more services offered by informal moneylenders in Kabupaten Kupang than in Kabupaten Manggarai. This is, to some extent, related to the level of difficulty of life for the poor in Kabupaten Kupang, which is relatively greater than that of the poor in Kabupaten Manggarai. *Arisan* groups were found in both sample *kabupaten*, but there were more in Kabupaten Manggarai and the type of activities were more varied. The establishment of a large number of *arisan* groups in Kabupaten Manggarai is perhaps due to the lack of microfinance services offered in the region compared to Kabupaten Kupang that is located close to a center for economic and governance activities.

#### **3.4.1. Informal Moneylenders**

With the spread of microfinance services offered by formal and non-formal institutions and particularly government assistance programs, services offered by moneylenders in NTT have decreased significantly. It is however, recognized that the informal moneylenders still exist in many places out of the sample regions (see Box 3.13.). Informal money lending services are still offered here and there, particularly because it is an inexpensive and quick process. If someone needs emergency loans, there are two types of informal money lending services. Firstly, individuals who borrow money from neighbors or relatives; and secondly, lending institutions that are referred to as “daily banks” (as has been discussed in Section 3.1.2.2.3). Borrowing from neighbors and relatives is less common than borrowing from “daily banks,” because rarely are there neighbors or relatives who have excess money that they do not need. In general, individuals referred to as *rentenir* (moneylenders) who provide high-interest loans hardly exist, but their role has been taken over by the “daily banks” which charge interest rate as high as 20% per month.

#### **3.4.2. Arisan and Loan-Saving Groups**

*Arisan* activities have been developed in society because they provide savings and loans for everyone, including the poor. Becoming a member of an *arisan* group means forcing oneself to save money that at some point will be used to meet a variety of productive and consumption needs. In areas where financial services are still limited such as in Kabupaten Manggarai, there are many *arisan* activities that have been developed to fulfil various needs, such as housing, food security, and other household expenses.

Commonly, an *arisan* group is formed by and for the membership of 10-25 people, although some have more than 40 members. Several *arisan* groups developed their activities towards loan and saving group. Besides paying for rotary saving (*arisan*) the members also agree to have compulsory and voluntary savings. The money collected then could be loaned to other members of the group with schemes of saving and lending determined by the consensus between them. This group is usually not permanent and will be wound up after one round of rotary saving or after one completed year. They usually continue with another round

however, after one round is completed, although the membership can change depending on the willingness of the members. Several groups received assistance and motivation from local NGOs and evolved as UBSP or even as loan and saving cooperative. Nevertheless, the development and the sustainability of such groups depends primarily on the leaders of the group and the trust between the members of the group. In one case found during this study, a group that had run quite well was ruined after receiving a loan from one credit program because the members were not confident with the management of this loan.

### **Box 3.13. "Black Money" Flourishing in Public Market Places**

After receiving news that the loan proposal submitted to BRI Unit Kelapa Lima has been rejected, the powerless trader has to continue his/her relationship with a loan shark, just like what has been happened over a long period. This time, *respondent 1* gets a loan of Rp2 million from the loan shark. However, he/she receives Rp100 thousand less or Rp1.9 million instead, and it is in accordance with the rules set by the loan shark. For the Rp2 million loan, *respondent 1* has to make daily payments of Rp32,000 for 100 days. This means that he/she has to pay back Rp3.2 million. Thus, with an initial fund of Rp1.9 millions, the loan shark will get a profit of Rp1.3 millions in 100 days.

Another story concerns *respondent 2* who borrowed Rp100,000 from a loan shark. Out of this loan, *respondent 2* only receives Rp95 thousand and he/she has to pay back Rp4 thousand every day for 30 days. It means that with an initial capital of Rp95,000 (the real amount handed to the borrower), the monthly profit is Rp25,000.

*Respondent 3*, a trader in Oebobo market, describes the strong grip of loan sharks in this market. "Every morning we can see the loan sharks in this market busily collecting repayments or providing new loans to their customers. For me, this market looks like a fertile ground for loan sharks" said this father of one son.

Who owns the money loaned by loan sharks? *Respondent 1*, for example, said that the number of loan sharks in Oebobo Market is teens. They are individuals, shop owners and several cooperatives that act like loan shark. Sadly, citing from the statement of a trader, some of the money lent by these cooperatives are funds from the Kerosene Subsidy Compensation.

This collection of statements from several small traders shows that the life in market places in Kupang City is under the control of loan sharks. The amount of money sold in the public market is not small in size. Some funds from the Kerosene Subsidy Compensation Fund and other sources have been used as the source of capital for this black market.

Source: Summarized from "Uang Gelap Berkembang di Pasar Rakyat", Kompas, 20 September 200.

### **3.5. The Roles of Donor Agencies**

The provision of microfinance services has received direct and indirect support from various donor agencies. Direct support is given in the form of providing funds to be channelled to the community through government, such as NTAADP and KDP that have received funding from the World Bank, or cashew nut intensification program in Manggarai that received funding from IFAD. Other donor agencies provided funding and channelled it through existing MFIs, both cooperatives such as *Puskud* that get funding from NCBA and other non-formal MFI such as TLM, YAO, UBSP Tunas Jaya. Other forms of support are technical assistance and training to strengthening MFIs. Both training and technical assistance could be performed directly by the donor agency or indirectly through other professional organizations or big NGOs. In addition, several donor agencies also assist capacity building through the Central Bank and through facilitating the links between MFIs and banks.

Several activities of donor agencies that are related directly and indirectly with the provision of microfinance services in NTT are as follows:

- The World Bank has funded NTAADP and KDP programs that cover some regions in NTT. NTAADP has been completed in 2003, but there was information within the local government offices that the program is likely to be continued by a program focusing more on strengthening the capacity of existing UPKD. KDP, including the components for supporting economically productive activities and revolving funds are still running in several locations.
- Swiss Contact is in principle focusing on developing the economy of the region through establishing a center for medium and small-scale business development that will link local business to outside markets as well as financial institutions. For NTT in particular, Swiss Contact has not established programs that have been developed in other regions since they considered that the activities of medium and small-scale business in NTT are still limited. Nowadays, Swiss Contact activities in NTT are focusing only on the marketing of cashew nut by facilitating contact between the traders and the farmers, and a pilot project for developing organic cashew nut. At this stage, the assistance is provided in the form of technical assistance and facilitation to increase direct access to exporters, with no additional capital since the farmers do not need special working capital. In the next stage, it is hoped that the farmers can do the processing of the cashew nut and this will be supported by a financial scheme to purchase simple processing machines.
- AusAID has provided support to microfinance in NTT through three programs, which are: 1) Small Activities Scheme (SAS), 2) Program for strengthening MFIs, and 3) Access Program. SAS provides funds for NGOs that had been selected based on proposals submitted by the participating NGOs. Some NGOs channelled the funds to the community through microcredit, both in the forms of revolving funds or cattle. This program had been completed in 2002 and there was no follow up monitoring after the program had ended. The program for strengthening MFIs was done based on AusAID's commitment in the "Microfinance Summit 2001" and it was provided through capacity building program. The program started in 2002 and targeted MFIs that provide microfinance services for the poor. In NTT, this program was carried out by Opportunity International, which assisted the institutional development of TLM so that this MFI could be financially viable and sustainable in the long run and open two new branches. In addition, AusAID also funded Access program with an objective of building the capacity of local NGOs. One of the activities in this program is Community Lead Assessment Processes (CLAP) where NGOs exercise their planning process through the involvement of local communities. Based on CLAP results, there are some requests for microfinance services to be provided by the NGO and local communities.
- NZAID has developed a program called Social Community Development Fund (SCDF) with the objective of empowering communities through NGOs. In its implementation, NZAID collaborated with: 1) Facility NGOs (FNGOs), which are NGOs that channel funds and provide training to local NGOs called Participatory NGOs (PNGOs); 2) PNGOs, which are local NGOs that channel funds and provide direct assistance to community based organizations (CBOs), following a procedures set based on consensus between the PNGOs and the donor agency; 3) CBOs, which are organizations established by the community who received funds from donor agencies through PNGOs. At the community level or CBO, the funds are given as a revolving fund with joint responsibility among CBO members. One of the FNGOs is Yayasan Alfa Omega (YAO) that carried out a daily system of "Credit Union" in Kabupaten Kupang. Besides providing funds, NZAID also provides funds for capacity building and audit facilities for both financial as well as program audits.

- Japan, through Japan International Cooperation Agency (JICA), carried out at least three projects in NTT, namely: 1) Promotion of Improved and Sustainable Community Development Program Method by Multi-sector Approach through Level NGO in East Nusa Tenggara (in collaboration with YAO), 2) Women Empowerment through the development and establishment of Small Industry in East Nusa Tenggara (in collaboration with Womintra), and 3) Community Empowerment Program (CEP). CEP is directly related to the provision of microfinance, and the objective of this project is to improve the welfare level of the communities at the grass root level. Through this program, JICA provides funds and training for NGOs. One of the NGOs that are participating in this project is the Foundation for the Development of Marine and Coastal Communities (YPPL).
- GTZ through its Promis NT program has developed links between banks and community groups (PHBK) in collaboration with local governments. The PHBK program is currently focusing on West Nusa Tenggara (NTB) Province because the activities of banks, BPRs and community groups are more abundant. In NTT, this activity has been initiated only in Kabupaten Alor.

In addition to the donor agencies mentioned above, NGOs in NTT also receive assistance from other donor agencies from Europe, such as AYO Indonesia Foundation in Kabupaten Manggarai that received capital assistance from Fado/Veco Indonesia (Belgium), Misereor (Germany), ICRAF, VSO, Neem, particularly for the Sustainable Agriculture Program. This initiative does not directly relate to the provision of microfinance services but more to the promotion of a sustainable way of agricultural activities through training at the village level. However, the training and technical assistance also includes the use of local resources, strengthening community institutions and economically productive activities.

In general, several program managers based in Jakarta raised some issues of concern regarding the implementation of their programs. These are related to the weaknesses of the NGOs participating in the programs as well as the weaknesses of the communities as program beneficiaries. The weakness of the participating NGOs is usually regarding their limited capability in reporting using good language and presenting clear ideas. For donor agencies, good quality reporting is essential for keeping track of the program and to evaluate the performance of the program's implementers. At the community level, the problem is commonly due to the low level of willingness and awareness of the people (the poor) to participate in group activities, and a lack of discipline in following the necessary steps of a program as well as the poor educational standard of human resources.

## IV. MICROFINANCE IN THE LIVES OF THE POOR IN NTT

The interviews with respondents in the sample villages highlight the diversity in the livelihoods of the poor. These differences influence their access to, choice of, and need for microfinance services. To understand the links between the poor's livelihoods, the services available and the poor's need for microfinance services, this chapter provides an illustration of the lives of the poor in the sample areas, as well as their views of, and experiences with, microfinance services.

### 4.1. A Profile of the Sample Villages

The four villages selected as samples for this study (Kelurahan Oesao and Desa Ponain in Kabupaten Kupang, and Kelurahan Wae Belang and Desa Golo Kantar in Kabupaten Manggarai) have different characteristics. Kelurahan Oesao in Kecamatan Kupang Timur is around 25km to the east of Kota Kupang. This *kelurahan* is semi-urban in nature with highly progressing economic activities as it is the location of the Oesao Market. This market is the gateway and center for the trade in produce, particularly vegetables from the surrounding areas and Kabupaten Timor Tengah Utara. The population of this *kelurahan* was 4,914 in 2002 (BPS Kupang, *Kupang Timur in Figures*). A large proportion of the population makes a living from the agricultural sector, but the Oesao market also provides opportunities for other businesses, particularly trading businesses and home industries such as sewing or baking businesses and working as an ironmonger. A variety of formal and non-formal microfinance services as well as government programs exist in this *kelurahan*. The formal microfinance institutions (MFIs) located in this *kelurahan* include BRI rural branches, pawnshop branches and the Oesao branch of Bank NTT which opened in July 2004. In addition, there are also non-banking and non-formal MFIs which are managed by non-government organizations (NGOs) (see Table 4.1).

Desa Ponain in Kecamatan Amarasi is located around 45km to the northeast of Kota Kupang. The majority of the population earns a living from agricultural and animal husbandry businesses, particularly cattle production. Almost all of the residents, 435 families in total with 1,780 individuals in 2002 (BPS Kupang, *Amarasi in Figures*), own farm land which they use to produce food or plantation crops. Several households run micro-businesses producing coconut oil. This village is a beef-producing village and almost every family plants fodder crops in their yard. There are no formal or non-formal MFI establishments located in this village, and so the community generally accesses the microfinance institutions in Kelurahan Oesao or Kota Kupang. The largest community income-generating program in this village is a profit-sharing cow production program managed by *Puskud*. Other than this, there is also an informal institution in the form of a community group that provides credit to members.<sup>19</sup>

There were 538 families with 2,910 people in 2001 residing in Kelurahan Wae Belung in Kecamatan Ruteng which is around 35km to the east of the capital of Kabupaten Manggarai (BPS Manggarai, *Kecamatan Ruteng in Figures*). Although it is a semi-urban area, businesses are not as busy as those in Kelurahan Oesao. The majority of the population (75%) earns a living in the agricultural sector, particularly rice farming and dry fields or plantations which

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<sup>19</sup> This group is managed by a businessperson from Desa Ponain and has received loans from the *kabupaten*- and provincial-level Cooperatives Offices. This group was created for credit purposes and does not have any routine activities.

are used to plant coffee, cloves and a bit of vanilla, around 15% are civil servants and the remaining 10% work outside the agricultural sector, such as kiosk owners, *batako* producers<sup>20</sup>, sand quarrying laborers and building laborers.

**Table 4.1. Microfinance Institutions in Each of the Sample Villages**

Type of Institution	Kabupaten Kupang			Kabupaten Manggarai
	Kelurahan Oesao – Kupang Timur	Desa Ponain - Amarasi	Kelurahan Wae Belang Ruteng	Desa Golo Kantar - Borong
Formal: Bank	BRI rural branch Bank NTT sub-branch		BRI rural branch	
Formal: Non-Bank	A branch of the state-owned pawnshop Post Office Puskopabri Market cooperatives KUD NHL	Puskud – Cattle raising	Post Office	
Non-formal	TLM YAO YPPL		Pasir Putih LPK	
Government program	KDP – Revolving funds Fisheries and Marine Affairs Office Cooperatives Office Industry and Trade Office	KDP – Revolving funds Provincial-level Cooperatives and SMEs Office Kabupaten-level Cooperatives and SMEs Office PKK funds Kabupaten-level Animal Husbandry Office	KDP – Revolving funds Food Crops Office Cooperatives and SMEs Office	Kabupaten-level Bimas Office PKK funds Kabupaten-level Animal Husbandry Office
Informal	Relatives/ Neighbors Church groups	Church groups Arisan groups Relatives/Neighbors Private – Cattle raising	Arisan groups Joint Savings and Loans Enterprises (UBSP) Forward selling Relatives/Neighbors	Arisan groups UBSP Forward selling Relatives/Neighbors Private – Corn Intensification
Institutions outside the village that are accessed by the community *)	Bank Mandiri (Kupang) NTT Ventura (Kupang) Talenta (Kupang)	BRI rural branch (Oesao) Bank NTT (Kupang) Puskopabri (Oesao) Post Office (Oesao)	Puskopabri (Kota Ruteng) BPR Lugas Ganda (Kota Ruteng) Pawnshop (Kota Ruteng)	BRI rural branch (Kotandora) KUD Borong BPR Lugas Ganda (Kota Ruteng) Bumi Putera Insurance (Kota Ruteng)

Note: \*) Only includes the microfinance institutions accessed by respondents.

In 2001, there were 467 families with 2,397 people in Desa Golo Kantar in Kecamatan Borong (BPS Manggarai, *Kecamatan Borong in Figures*), a rural village that is located around 70 km to the south-east of the *kabupaten* capital. The majority of the residents work in the agricultural sector, mainly in dry fields and plantations that are predominantly used to

<sup>20</sup> *Batako* are bricks made of cement, sand and limestone.

produce cashew nuts, kapok, bananas and cloves. Besides this, there are around 30 hectares of wet rice fields located near flood plains. Widespread planting of cashew nut trees began in 1994/5 with assistance from IFAD. Almost all farmers who owned dry fields received seedlings and pesticides/insecticides on credit during the project period, that is between 1994/5 and 2000.

There are not as many formal and non-formal microfinance institutions in Kelurahan Wae Belang and Desa Golo Kantar as in Kelurahan Oesao. There is only a post office and a BRI rural branch in Kelurahan Wae Belang. For Desa Golo Kantar however, the closest BRI and post office are in the *kecamatan* capital, which is around 7 km from the village. Other banking institutions are in the *kabupaten* capital. There are no non-formal microfinance institutions in Kelurahan Wae Belang or Desa Golo Kantar, but there are a lot of *arisan* groups as well as savings and loans groups that are managed by the communities themselves. In Kelurahan Wae Belang, there are more than ten *arisan*/savings and loans groups, whereas there are around 30 of these groups in Desa Golo Kantar.

#### 4.2. The Community Livelihood in the Sample Villages

The agricultural sector is still the main source of income for the majority of residents in the sample areas, although trading businesses and home industries have developed in several areas, particularly those near urban areas. The growth of agricultural and non-agricultural businesses still faces obstacles because of the dry climate, lack of command of new technology, poor infrastructure and limited access to markets, as well as unfavorable social conditions (see Box 4.1). The availability of water and land fertility very much determines a community's level of prosperity. Desa Oesao, for example, became more prosperous after it received assistance to dig wells in 1974. The water supply allows farmers to plant vegetables in fields that had previously been left untilled or had only been used to plant corn once a year.<sup>21</sup> Most of the farmers in the sample areas own farm land, but not all of it is farmed due to a variety of reasons, including a lack of labor to clear the land,<sup>22</sup> remote and difficult-to-reach locations, lack of capital to purchase seeds and seedlings as well as other production equipment, and lack of water.

Because of the dry climate, farmers generally use intercropping as a means of dealing with the uncertain seasons, for example with corn, dry field rice and cassava. By farming in such a way, it is hoped that if one crop fails, there will still be other productive plants. Farmers only plant rice and vegetables in certain locations where there is enough water. Food crops in dry fields can only be harvested once a year and often fail. Most of the corn and unshelled rice is stored for household consumption, except in wet-rice farming communities that own large amounts of land in rice-producing centers, such as in some locations in Manggarai or in East Kupang. In other areas, the rice harvested is rarely enough to meet the needs of a family until the following harvest, and thus they must purchase staple foods using the profits they earn through selling plantation produce or pigs and chickens.

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<sup>21</sup> Based on an explanation from the former village head in Desa Oesao.

<sup>22</sup> Several respondents revealed that the size of land cultivated is only the area that has been cleared when the rainy season began, while the rest is left uncultivated.

**Table 4.2. The Number of Respondent Households by Livelihood<sup>23)</sup>**

Livelihood	Poor Households <sup>23)</sup>			Non-poor Households		
	Rural	Semi-Urban	Total	Rural	Semi-Urban	Total
Only farming	17	8	25	7	2	9
Farming + other non-agricultural businesses	10	11	21	2	4	6
Only non-agricultural small businesses	-	15	15	1	6	7
Government + non-agricultural small businesses	-	1	1	-	1	1
Government + farming	-	1	1	2	-	2
Retired and widowed	-	1	1	1	-	1
Total	27	37	64	13	13	26

Note: <sup>23)</sup> Respondents were selected purposively and thus the livelihoods of the sample do not reflect the livelihoods of village residents overall.

In a dry land farming system, plantation crops and livestock are an important source of income for families. In addition to purchasing food, earnings from the sale of plantation produce are usually used to pay for other household needs and long-term investments, such as education and houses, as well as *adat* expenses. Cattle, buffalo, and pig farming are a strategic way of saving money. If there is a surplus income from agricultural businesses, it is generally used to purchase cows and pigs. In addition to unexpected needs or education expenses, cows and pigs are also raised for *adat* needs.

#### Box 4.1. Living Life As It Is

Hendrikus and his wife and child live in an old house with a mud floor along with his cousin and her family. He inherited the house from his parents. They earn a living from agricultural activities. Hendrikus owns 0,25 hectare of dry fields and 300m<sup>2</sup> of wet rice fields which he also inherited from his parents. An alternative source of income is working as a laborer.

In 2002, through his farming group, Hendrikus obtained corn seeds, fertilizer and pesticides/insecticides on credit. He planted the corn in his dry field. The produce, 300kg of corn, was sold for Rp210,000. After the harvest, he had to pay the group Rp125,000 for the seeds, fertilizer and pesticides/insecticides he had received. Thus, for three months of work, he earned Rp85,000. This is a very low income and because of this he has never pursued such an activity again.

Hendrikus does not want to borrow money to be used as capital for his agricultural business because he worries he will not be able to repay the money. "I just want to live life as it is," said Hendrikus.

Trading businesses and home industries such as *batako* makers, coconut oil producers, carpenters, ironmongers and bakers, have begun to grow in semi-urban areas. These businesses are generally small or even microbusinesses. Growth of these businesses is generally hampered by limited capabilities and business alternatives as well as limited markets. To add to their income, many families open kiosks at the front of their houses. It is difficult though for these kiosks to grow as an increasing number of households are opening kiosks, whereas consumption is still limited. It is difficult for the majority of small industries

<sup>23)</sup> The division of poor and non-poor was not based upon the poverty line because this study did not take into account household consumption levels. This classification is based upon observations by researchers during interviews, that is by considering the respondents' living conditions, including the condition of their house, asset ownership, consumption and their children's level of education.

to grow because they only serve local markets where there is limited demand, and the skills and capital of business owners are also limited (see box 4.2).

#### **Box 4.2. Uncertain Marketing Opportunities for *Batako* Makers**

Agus has been a *batako* maker since the 1980s. His business usually employs two laborers. Nowadays, Agus uses Rp400,000 in capital for each round of brick making. It takes one week to produce 1,200 *batako* bricks which are sold at Rp600/brick, but he never knows when the bricks will be sold. If there is a commercial building project or a resident building a house close to his business, his *batako* bricks will sell quickly. But, recently building contractors have been making their own *batako* bricks, and thus the market share of small-scale *batako* brick makers, such as Agus, has shrunk even further. It is unclear whether contractors make their own *batako* bricks due to quality or financial reasons. If it is for financial reasons, then *batako* brick makers should consider asking the regional government to prohibit contractors from making their own *batako* bricks.

In the 1980s, Agus once applied for a business loan at BRI, but was rejected because he did not have any collateral. To date he still does not have the collateral required to obtain credit at BRI. Recently, through a group of *batako* brick makers, he tried to obtain a business capital loan funded by KDP. His group's loan proposal though, lost out to other groups.

The communities in the sample villages, as with communities in general in NTT, still adhere to several *adat* customs and systems in their social lives. The *adat* systems relating to the management of family finances are apparent in weddings and funerals. These two affairs are the joint responsibility of the extended family and are usually very expensive.<sup>24</sup> In Kabupaten Manggarai, for example, if a family is stricken by the death of a family member or marries off a son, the nuclear family, daughters and female relatives who are married are obliged to cover the expenses; an obligation which is referred to as *sida*. If a daughter marries, her family, including her brothers, will receive a part of the *belis* (bride price) sent by the groom's family.

There are two different perspectives of this system of paying for *adat* needs. The positive side of the system is that it strengthens kinship ties and social relations. It is also a form of social insurance or savings to cover the rites of one's lifecycle, and thus no family gets stuck in debt in order to pay for wedding celebrations or funerals. The negative side of this system materialized when the amount of a *belis* or size of a contribution is often used to measure a family's prestige, and thus there is a tendency to contribute more than one is capable of contributing and celebrations are also of a large scale. The "obligation" to pay a large *belis* or *sida* tends to result in communities guarding their savings, usually in the form of livestock, and being reluctant to use their savings to increase business capital or make long-term investments. There have also been cases where individuals have used business capital or credit for *adat* needs, and thus their businesses contracted or even went bankrupt (Box 4.3).<sup>25</sup>

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<sup>24</sup> A groom-to-be must pay a *belis* (bride price) to the bride-to-be's family in the form of money, which can reach more than Rp10 million or livestock which can include between two and several dozen cows or buffaloes, depending upon the social position and education level of the bride and groom and their families. The bride's family pays for the wedding reception, a part of which is covered by the *belis* they receive from the groom, and provides gifts for the new couple, such as furniture and household items, including sofas, a bed, cupboards and cooking utensils. Funeral expenses usually include food for relatives or visitors who attend prayer ceremonies held 40 days after someone's death as well as to payback the condolences gifts from relatives.

<sup>25</sup> Several non-formal institutions managed by NGOs reported such cases and that they also need to emphasize from the start that the credit they provide is not to be used for *adat* contributions.

#### **Box 4.3. Problems in Trading Businesses**

Thomas owned a kiosk that sold daily necessities. To open his kiosk, he borrowed money from a BRI rural branch. His first loan in 1999 was for Rp1,750,000, the second was for Rp2,500,000, and the third was for Rp3,000,000. He still has a month of repayments on the third loan to make. BRI provided him with the loan on the basis of his business's feasibility, without collateral, such as a land certificate or letter confirming employment status, as is usually required by BRI.

At the beginning of 2004 however, Thomas' kiosk went bankrupt. Why? He says that the main cause was that large-scale traders took over the market share of small-scale traders. Because of this, he deplores the government policy that allows this to occur and fails to regulate the system resolutely. On the other hand, he also admitted that he did not employ good management skills because there were many unclear or inappropriate expenses. For example, expenses to cover large *adat* ceremonies which were unexpected and unavoidable. "In relation to *adat*, we have to maintain our self respect and that of our family, even though we are forced to borrow money," said Thomas.

### **4.3. Using Microfinance Services**

#### **4.3.1. Formal Microfinance Institutions – Banks**

The banks that were most often accessed by respondents were the BRI rural branches located around *kecamatan* capitals. Besides these banks, people also used other banking services such as Bank NTT, Bank BNI, Bank Mandiri and post offices. In Manggarai, communities also used the services offered by the BPR, that is BPR Lugas Ganda, the only BPR that operates in the sample area. These banks provide credit, savings and transfer services. Of these three forms of services, the type most frequently used by respondents was savings services, although the majority of respondents who had a bank account stated that their balance was low or that their account was not very active. The small amount of money they have to save and the distance between their houses and the closest bank, usually a BRI rural branch, are the main factors impeding the increase in savings. One respondent who worked as a cigarette seller, for example, revealed that he chose to save his money at the post office because he does not save very much money and the notes he banks are dirty and crumpled, thus making him too embarrassed to save at a bank. Those families who do have bank accounts are relatively better off and do not live too far from banks. In addition to individuals, several *arisan* groups or savings and loans groups found in Kabupaten Manggarai also saved their cash at a bank, usually at a BRI rural branch.

Most of the respondents who received credit from banks were civil servants. Several were not civil servants but they had quite large businesses or assets, and thus they were not classified as poor. The poor's access to loans provided by banks is limited by an absence of adequate collateral, which is the main condition of obtaining commercial loans. Despite having collateral, banks often ask poor families to attach a copy of their business permit and a letter from a government official (village head/*lurah*, or *camat*) to certify their identity. It takes a lot of time and money to organize and obtain all of these documents. One respondent, for example, stated that he had to pay Rp50,000 to obtain a letter from the *camat* certifying his identity, or 1.7% of the Rp3 million loans he was requesting. In one of the sample villages, a respondent said that the terms and conditions of obtaining loans from a bank included other irrelevant requirements, such as having paid their land and building tax and made repayments for the corn seeds they received through the Arjuna program as well as having a KUD member card.

Banking institutions generally do not want to provide loans to be used as initial capital, and instead only provide loans for businesses which are already operating. This certainly benefits the individuals who already own businesses and disadvantages those who do not own a business but wish to start one. Banks regard business activities outside the agricultural sector as their main targets. Businesses in the agricultural sector are considered to have very low credit ratings, and thus it is very difficult for farmers to obtain loans for cultivation activities. The loan amount agreed to by a bank is generally lower than the amount requested by the potential borrower. Before applying for a loan however, potential borrowers calculate their real capital needs first. In the end, loan money is not used in accordance with the request.

The loan terms and conditions set by BPRs are somewhat easier than that set by commercial banks.<sup>26</sup> Several respondents who were BPR customers revealed that the BPR only require a letter from the village head certifying that an individual owns land, a photocopy of their identity card and family card, as well as a passport photo of the individual and their spouse. BPR employees go to a borrower's house so that they do not have to apply for credit or make repayments at the BPR branch, which is in the *kabupaten* capital. The interest rate is, however, much higher than the interest rate at BRI. Because of these various impediments, the poor's access to microcredits provided by banks is very limited. Out of the 58 respondents that could be categorized as poor families, only 6 had ever received loans from banks.

The use of money obtained from banks varied amongst respondents. Most of the respondents who were civil servants obtained loans to build or renovate their houses, pay their children's school fees, pay for medical treatment when a family member falls sick, buy motorcycles, and some even saved it for unexpected needs, including paying *belis* or *sida*. Only a few of them use a portion of their loans to buy livestock or increase the capital of their agricultural or trading businesses. Most of the bank customers who were not civil servants use loans to increase business capital, although a number of them also use them for other purposes.

The use of transfers is very limited because families in the sample area rarely need to make inter-regional transfers of money. Most of the respondents who frequently used transfer services provided by banks and the post office were those families whose children went to school in a different region, and in general they were not classified as poor. Other than these families, several families that have relatives who work in other regions or as migrant laborers, occasionally used transfer services. Transfers are usually organized through a bank or post office in the *kecamatan* or *kabupaten* capital. Although banks are a significant distance away, those who use transfer services generally do not complain about the distance they have to travel because they rarely use the service.

#### **4.3.2. Formal Microfinance Institutions – Non-banks**

Pawnshops are one type of non-banking formal MFI that are attractive for borrowers. Pawnshop customers generally feel that the payment system that allows customers to extend the loan term simply by paying the interest on the due date is very helpful, because they rarely have a fixed income. In addition to the flexible payment system, pawnshops do not determine what loans should be used for. Customers can borrow small amounts of money for everyday consumption purposes or larger amounts to increase business capital. Nevertheless, pawnshop services are very limited because there are few branches and transport costs for the poor who live in remote areas to cities are too expensive.

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<sup>26</sup> This case only applies to BPR Lugas Ganda that operates in Kabupaten Manggarai.

Cooperatives are another type of formal MFIs. The study's respondents knew of and used four types of cooperatives, that is: cooperatives established by farmers' groups that only serve members; cooperatives founded by non-government institutions that provide savings and loans services; cooperatives that only provide small-scale loans and cooperatives that work together with farmers through profit-sharing activities.

The Nusa Hijau Lestari Cooperative (NHL) in Kelurahan Oesao, Kecamatan Kupang Timur which was established by the farmers' group of the same name, only assists its 25 members in accessing loans for agricultural businesses from BRI and channels loans from the Cooperatives Office to members. The members feel that the loans are very useful because payments are adapted to the income cycle of their agricultural businesses. Despite this, they still feel that the amount loaned is too small and unreliable, because it depends upon external funding. Although members deposit compulsory and voluntary savings, this cooperative does not emphasize savings services for members. Cooperatives such as this feel it is enough to assist members access additional capital but, unfortunately, not many of these cooperatives are still active. In Kecamatan Kupang Timur, there are only two such cooperatives that are still active and they have a very limited number of members. The KUD which previously channeled KUT to quite a few farmers, is no longer in operation due to bad debts and poor management. In Kecamatan Borong, the KUD is still quite active, but only two or three people in Desa Golo Kantar are members.

Cooperatives that provide savings and loans services, such as Talenta, or those that only provide small-scale loans, such as Puskopabri or Kopabri, are the institutions most commonly used by the lower to middle classes. Although the interest rates set by these cooperatives are quite high (5%-7% per month for Talenta and 20% per month for Puskopabri), many of the poor take these loans because the procedures and the requirements are very easy. Talenta requires borrowers to become members and one-sixth of their loans are deducted to form a savings account. Puskopabri, a well-known "daily bank", also deducted 5% of loans to deposit as savings, although customers are not allowed to add to their savings.<sup>27</sup> Savings at these cooperatives can only be withdrawn after a borrower has settled his/her loan or is no longer a member of the cooperative. Loans are handed over to individuals and cooperative staff go from house to house collecting money for repayments. Respondents stated that most small-scale loans were used for daily necessities or for trading businesses that make a profit on a daily basis. These loan schemes are thought to be disadvantageous and inappropriate for families whose incomes depend upon agricultural businesses.

Although many poor people take the loans provided by this type of cooperatives, the customers complain about the very short loan terms, daily or weekly repayment system, and very high interest rates, particularly for small loans. The respondents who take the loans with very high interest rates (20% per month) stated that this scheme is actually detrimental to their financial condition. They felt obliged however, to take this loan because they need money and they do not have access to other sources.

This phenomenon is ironic. While the number of poor in both urban and rural areas who have the potential to improve their welfare level is limited, they have very limited access to loans provided by banks so that they are prone to be trapped by the very high interest loans provided by other MFIs and loan sharks. According to a poverty expert in NTT, in addition to the scarcity of loans from banks, the poor usually have limited capacity to assess risk. They tend to think of only the short-term consequences and let fortune decide their future. Thus,

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<sup>27</sup> Several respondents who borrowed money from this cooperative did not know that this deduction became savings.

if they have the opportunity to get loans, even with a very high interest rate, they would be likely to take it.

Another cooperative, *Puskud*, has developed cattle production businesses that use a profit-sharing system in Desa Ponain, Kecamatan Amarasi. This initiative adopts a system of cooperation with farmers who are provided with capital in the form of calves to the value of Rp1.5 million. Participants really like how this program is organized. According to a number of respondents however, at least five or six cows are required to meet a family's expenditure, which can reach Rp500,000 per month.

The program beneficiaries generally like this program due to the following reasons:

- Cows<sup>28</sup> are purchased on the basis of an agreement between cattle producers and *Puskud* staff who invite cattle traders into villages. The price of a young cow is around Rp1.5 million per head.
- They sold the cattle openly at a sale attended by cattle farmers, *Puskud* staff and cattle traders. If *Puskud's* bidding price is below that of the cattle trader, the cow is sold to the trader.
- Seventy percent of the profits from the sale, after expenses are deducted (price of the cow, medication, ropes, and village tax<sup>29</sup>), goes to the cattle farmer and 30% go to *Puskud*. Cattle farmers receive a fairly large income from this system.<sup>30</sup> A cattle producer can earn between Rp500,000 and Rp1 million per head of cattle.
- *Puskud* provides a veterinarian on a routine basis to examine the cattle. Besides this, *Puskud* assigns an assistant<sup>31</sup> to live in a village in order to help and supervise the cattle producers. Usually, the assistant checks on every group once a week. For their fieldwork, assistants receive a motorcycle and money to cover operational costs. In addition to receiving a wage, they also receive a bonus if they reach *Puskud's* target.

The program is considered to be highly beneficial because there is intensive assistance, a reliable market and a fairer system that spreads the risk of business failure. The division of cows and determination of selling prices are also considered to be very open. Several respondents stated that the profits they receive from this profit-sharing system are much higher than those from profit-sharing systems usually established with other businesses or individuals.

#### 4.3.3. Non-formal Microfinance Institutions

Of the variety of microfinance services managed by NGOs, respondents were members of two institutions, TLM and YAO. Although they use different systems, the microfinance services offered by these two institutions appear to reach the poor although the majority of borrowers already own businesses. TLM has attempted to reach the poor by providing limited loans for groups of 4-5 people, but it seems that this system is not yet operating as well as it should. TLM customers met in the field revealed that the groups did not operate effectively. Several group members signed the agreement, whereas loans were only used by some of group

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<sup>28</sup> Cows that pass the selection process are those that are 105-110 cm tall, around 150kg, and on average 2-years old.

<sup>29</sup> In one of the sample villages, the tax is Rp25,000/head of cattle. Village revenue from this tax reached Rp10 million (timeframe) and the money was used to build a village office.

<sup>30</sup> The cattle traders are usually responsible for paying for the permit required to transport cattle (*surat mutasi hewan*).

<sup>31</sup> Each assistant handles around 300 head of cattle. *Puskud* currently has 15 assistants, 2 in Kabupaten Belu, 4 in Kabupaten Timor Tengah Selatan, 2 in Kabupaten Timor Tengah Utara and 7 in Kabupaten Kupang.

members. This was due to the fact that the allocations per person (Rp500,000) were too small. As a result, only two or three members from the group would use the loan, although this was done with the agreement of other members.

The loans received are used for a variety of purposes, not just to increase business capital. Most customers obtained small-scale loans on a continual basis. After settling the first loan, customers take out another loan of the same amount or of a larger amount. If they are able to make regular payments, customers are usually offered larger loans when the ceiling has not been reached. Many customers, however, are unwilling to increase the amount of money they receive as they are worried they will not be able to make the repayments. It appears that there is a tendency for the first loan to be used to increase business capital, but further loans are often used for long-term investments such as building a house, paying children's school fees, improving the condition of a kiosk or even for savings, although repayments are still made using business profits. Although loans are somewhat useful, several customers complained about the small amounts of money loaned and weekly instalments that are burdensome because the capital has not yet had time to revolve. It can be said that in general customers feel that the finance schemes they have access to do not actually suit their needs, but that they are forced to take out loans because there are no alternatives. As is the case with Talenta and Puskopabri, the customers of these non-formal MFIs take up this loan primarily because they do not have access to other services that are considered to be more suitable to their needs. Besides this, it appears that there is a lack of business assistance, and thus there have not been any improvements in business management that could result in business owners becoming more capable of accessing capital from banking institutions.

#### **4.3.4. Government Microfinance Programs**

Money channeled by the government through sectoral government offices to communities is generally provided:

- a) directly to individuals or groups in communities in the form of loans or credit from government offices;
- b) through the existing formal or non-formal groups; or
- c) in the form of money to communities along with the establishment of financial management institutions.

One type of credit program was the cashew nut development program in Desa Golo Kantar, which was funded by IFAD and managed by the Plantation Office. Although the profits from this program could only be enjoyed after several years, the program was fairly successful in helping communities increase their incomes. Almost all village residents received seedlings, pesticides and insecticides on credit although not all of them were successful. Several farmers were successful and could even extend their land using the earnings from the cashew nut harvest. In several areas however, the trees died or became stunted because of drought, disease or infertile soil.

Complaints voiced by unsuccessful farmers were the lack of assistance and the absence of assistance if the trees were infected by disease, as they did not understand cultivation methods for cashew nut trees. Repayments by farmers varied. Some repaid the loans despite the trees not yet being productive but others did not make repayments because their plantations were not very productive. Farmers who have repaid their loans generally made payments using the sales profits from other plantations. The *arisan* and savings and loans groups stimulated by this program are still operating and a number of them have indicated that there has been an increase in the groups' assets. Loans originating from IFAD's stimulation funds, member savings and interest rates were determined on the basis of

agreements within each group. Loans could be used for daily necessities, education for children or to increase agricultural business capital.

Purchasing cows or pigs on credit from the Animal Husbandry Office is repaid in the form of calves and piglets. Individuals can also purchase chickens on credit. In general, these programs have very few beneficiaries. As with the cashew program described above, several respondents who have participated in these programs also complained about the lack of business assistance. Another problem faced by beneficiaries was the lack of clarity about the division of risk in the case of natural disasters or disease. In several cases, beneficiaries still had to make repayments despite their livestock or chickens having died<sup>32</sup>, and this meant that they had to pay using money from other businesses.

Finance in the form of loans provided directly to individuals, especially that from the Cooperatives and SMEs Office, is aimed at small businesses. One of the respondents who received a loan was a businessperson who owned a meatball stall and a kiosk which sold everyday items and petrol. Compared with other residents in the village, this respondent was classified as quite well off. Other finance programs that aim at developing small businesses are UP2K and KUKU<sup>33</sup>, and the respondents who received loans from these programs were not classified as poor. Loans received by these respondents are used to increase business capital and are considered to be beneficial because the interest rates are low.

Small-scale loans provided to the poor are generally provided through groups, both existing groups as well as groups formed especially for finance reasons. Respondents were very interested in program credit because of the simple procedures; generally individuals only have to form groups. Besides this, the highest interest rate is equal to interest rates at commercial banks, and many types of programs actually charge lower interest rates or no interest at all. Quite a few communities consider program credit as having few risks as reflected in experiences from the previous programs, e.g. if loans were not repaid, beneficiaries were never clearly or firmly disciplined. The reasons for this behavior could be traced back to the low law enforcement in the past when the creditors received no punishment for not repaying credits or loans.

Although poor families are very interested in loans funded by assistance programs, there are very few beneficiaries. In addition, there is a tendency for groups that have already received assistance and are capable of making repayments to become targets of other programs. Of the respondents met in the field, a number of them who are classified as relatively poor had received loans, but the poorest of the poor had not.

Besides the limited number of beneficiaries, this type of credit is not always available. Sustainability is also a serious obstacle for poor families currently receiving this type of credit. There is no guarantee that they will receive assistance in the future because experience so far has shown that program credit provision patterns are ad hoc. Poverty reduction in NTT needs to be continuous and have clear targets, and thus if the problems described above continue to occur, such program credit provision patterns will be less than effective.

It seems that the government programs that have been accompanied by the establishment of financial management institutions have not yet been able to provide loans on an ongoing basis. Savings and loans programs in the KDP program, for example, have not been able to

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<sup>32</sup> For many of the program recipients, the chickens died because of bird flu.

<sup>33</sup> UP2K are channeled through BPMD and PKK facilitators, whereas KPKU is channeled through BRI rural branches.

provide loans on a continual basis. A respondent in one of the sample villages who had settled his debts was unable to obtain another loan because the other groups had not been able to repay their loans. There were also complaints that the administrative requirements for KDP loans were becoming increasingly complex and the repayments were not established in line with business or agricultural earning patterns. UPKDs formed under the IMS-NTAADP program do not yet function as financial institutions because of management's failure to run the UPKDs well and poor administrative capabilities. It appears the LPDs that are being test-run in Manggarai are still going to experience problems. Stimulation funds provided to the UBSP selected as the initial LPD in the sample villages, for example, were actually only provided to a few managers who were not too poor by the community's standards. Loans from this LPD are preferred over credit from BRI because of the lenient terms and conditions, low interest rate and 0.5% goes to the UBSP. However, if the ways of channeling credit are not improved, those who are better off will only enjoy this type of finance.

#### 4.3.5. Informal Microfinance Institutions

In addition to borrowing from "daily bank", a few individuals also borrow relatively small amounts of money from neighbors or relatives to meet unexpected needs. Individuals can obtain loans as long as they are known to be of a good character. The motivation to assist others is quite apparent in the borrowing process. The loan provider does not charge interest if the borrower can settle the loan in less than a month. In several cases, borrowers who were unable to settle their debt have paid by working as a waged laborer for the person who provided the loan.

It was discovered in Kabupaten Manggarai that individuals borrow from neighbors and relatives to cover rice-farming costs. Loans are repaid using rice after the harvest. The longer the money is borrowed before the harvest, the lower the price of the rice that will be used to repay the loan. For example, if the price of rice at harvest time is Rp1,000/kg, loans obtained during the planting stage are repaid with rice valued at Rp650/kg, loans obtained during the weeding stage are repaid with rice valued at Rp800/kg, and loans obtained towards the harvest are repaid with rice valued at Rp900/kg.

In the villages included in the research sample in Kabupaten Manggarai, the majority of respondents were members of one or more *arisan* groups. They are familiar with a variety of forms of *arisan*, not only those that save money but also those that accumulate goods. Individuals who want to build or renovate a house, for example, form cement, brick or corrugated iron *arisan* groups. In the last five years, houses in one of the sample villages have been built or renovated by their owners with the support of *arisan* groups. The growth of these *arisan* groups indicates that microfinance services provided by formal and non-formal MFIs in the sample regions has not reached the majority of population, particularly the poor. Several *arisan* groups have expanded their activities to include savings and loans activities. Group members are not only required to make *arisan* contributions but also deposit money in the form of savings. Savings of the same amount for each member must be deposited at the same time as *arisan* contributions are made. Members can borrow money that has been collected through deposits. Loans are subject to a monthly interest rate of 5%. Members agree to this high interest rate in order to cover inflation and because ultimately the money collected in interest will be divided equally between group members.

Savings and loans activities through *arisan* groups do not just come in the form of money but also rice. At each harvest, group members hand over an equal amount of rice to the group's manager. Unlike money that is only loaned to group members, rice can be loaned to anybody, such as neighbors. During the dry season, usually towards the planting season, many

residents require rice to meet their food needs. Loaned rice is returned after the harvest with an additional amount, or a type of interest, that is around 5-10% of the amount loaned.

Another variation that has developed in communities is what they refer to as a progressive *arisan*. Considering that the value of the rupiah continually decreases, group members make a larger contribution each month. For example, a contribution of Rp25,000 in the first month would become Rp26,000 in the second month, Rp27,000 in the third month and so forth. This way, those who win the *arisan* later on do not lose out due to a decrease in the value of the rupiah.

#### 4.4. The Poor's Demand for Microfinance

Based on the field findings, it can be concluded that the poor, that is those included in the low income classes in NTT, also require microfinance services in amounts and forms that suit their livelihood patterns. Their need for microfinance services can be grouped into real needs, that are the needs which have already been met, and potential needs. Potential needs include the mismatch between the services provided and the real demand, and the demand that is yet to emerge due to restricting factors, such as infrastructure, technology and markets for produce. Based on this categorization, the poor's need for different forms of microfinance services are as follows:

- **Credit Needs**

Based on the access to, and the demand for, microcredits, the respondents of this study who are considered poor can be grouped into three categories: 1) the poor who express no demand for credits; 2) the poor who have not received any credits or loans but express an interest in obtaining them; 3) the poor who have received credits or loans. Around 25% of the poor respondents have expressed no demand for loans because they do not have fixed incomes and they are afraid that they would not be able to repay the loans. Thus, these respondents prefer to do business just as it is. The majority of the poor, however, articulate their interest in obtaining loans. For those who do not have access to loans, the reasons for not taking up loans are:

- a. the MFIs, particularly banks, that provide loans with low interest rates, require collateral that is impossible for them to fulfill; and
- b. other MFIs that apply simple procedures and requirements, which can be met easily by them, such as Puskopabri and non-formal MFIs charge high interest rates and have short loan periods. In addition to the heavy financial burden of high interest rates, the daily or weekly repayment schedule is incompatible with their income earning cycles.

On the other hand, almost all poor households that have had access to loans, both from formal and non-formal MFIs, stated that the loans that they get do not really fit with their real demand. Nevertheless, they take up the loan because there are no other sources available. This indicates that there is quite a significant gap between the poor's demand for credits and loans that suit their livelihood pattern and the services available.

Another indication of the large gap can be seen from the loans and credits proposals that have not been accepted by various NGOs that provide microfinance services. YAO-MFI receives around 10-20 loans proposals every month of which only 3-7 proposals are approved due to the limited funds to be disbursed. It is a similar situation at TLM where, according to the Executive Director, the proportion of proposals being approved amounts to only around 25% of the proposals being submitted.

Based upon the amount of money borrowed from the existing formal and non-formal institutions as well as the current government programs, the need for finance amongst poor households ranges from Rp100,000 to Rp10 million, with an average of approximately Rp2 million. If differentiated on the basis of type of employment, poor farmers need around Rp1.5 million or the cost of one calf, whereas poor households whose incomes do not just come from farming but also other non-agricultural businesses, need around Rp2.5 million because of their need to develop both agricultural and non-agricultural businesses. On average, the need for finance in rural areas is greater than that in urban areas.

The size of the poor's demand for loans that has not been met is almost the same as the size of the poor's loans that have been met. Unmet demand from agricultural businesses averages around Rp1.5 million, for households in both urban and rural areas. For businesses that combine both agricultural and non-agricultural activities, the size of the demand is around Rp1.5 million in rural areas and Rp1.3 million in urban areas. Meanwhile the size of the demand for small businesses in urban areas is around Rp3.2 million.

On top of this unmet demand, there is actually a lot of potential demand that has yet to materialize. The limited markets and technology, which cause agricultural production costs and produce prices to fluctuate greatly, result in farmers being too afraid to take out credit. As a result, although the majority of farmers in NTT own land that is yet to be cultivated and plantations that are not managed optimally, they tend to be afraid to take risks to develop their businesses. Given these circumstances, the need for credit has the potential to increase given technological and market developments.

From the perspective of what loans are used for, it is apparent that the poor do not just need loans for their businesses. A large number of loans, especially that from informal institutions, are actually used for everyday necessities, such as house renovations, paying school fees and *adat* purposes. Despite this, individuals repay loans using the profits from agricultural and non-agricultural businesses. Although such loans do not directly increase the poor's income, they at least ensure their businesses continue to operate smoothly and protect their assets.

- **Savings Needs**

There is very little money in the savings accounts held by the poor at formal and non-formal microfinance institutions. Only a few families who are not too poor have savings accounts at banks although they tend to be small and inactive, whereas the poorest of the poor do not have bank accounts. Savings accounts with non-formal institutions also have low balances because they are only used to store deductions from repayments which cannot be withdrawn, furthermore these institutions are not licensed to collect funds from communities. Despite this, it does not mean that poor communities do not save to accumulate assets. A large portion of the community in NTT saves money through purchasing livestock (cows, buffaloes, pigs and horses) and storing food, as the majority of unshelled rice and corn is stored for consumption needs until the following harvest.

The need for savings is apparent in the growing number of *arisan* and savings and loans groups. A respondent classified as very poor admitted that he was only able to set aside Rp5,000 per month, whereas those who are better off are able to set aside Rp35,000 for *arisan* as well as savings and loans groups. Setting aside some money to be stored in an *arisan* group becomes the strategy of the poor to fulfill the demand for saving. Besides this, some people also save around 10-20kg of unhulled rice with unhulled rice savings and loans groups. These savings groups are highly beneficial because if individuals have savings in the group, they can borrow money for household needs or to increase their business capital.

- **Insurance Needs**

Formal insurance services do not reach the poor at all. The low level of income, limited knowledge of modern risk management, and the location of insurance agencies that are mainly concentrated in big cities are the factors that impede access of the poor to insurance services. The existing insurance schemes such as health insurance, education insurance and life insurance are simply too expensive for the poor and out of their reach. Those respondents who had insurance were those who were much better off. This does not mean however, that the poor do not need insurance. The use of loans to pay for medical treatment and education expenses indicates that there is a need for health insurance and education savings accounts. The poor's insurance needs are met by informal institutions which they create and traditional savings systems, in the form of livestock and food supplies. Besides this, joint-financing systems such as *sida* or contributions for weddings and funerals, could be seen as a form of traditional insurance for communities in NTT.

- **Money Transfer Needs**

The respondents who have used transfer services, provided both by banks and post offices are very limited. Out of the 91 respondents, only 10 people (2 poor and 8 non-poor respondents) have ever used this service. As has been stated in the previous section, transfer facilities are required if children go to school in another region or if there is a family member who works outside of NTT. The increase in the number of migrant workers however, does not necessarily correlate with the increase in the demand for transfers. Some migrant workers tend to give money to relatives or friends to take home.

## V. MICROFINANCE AND POVERTY ALLEVIATION IN NTT: A DISCUSSION

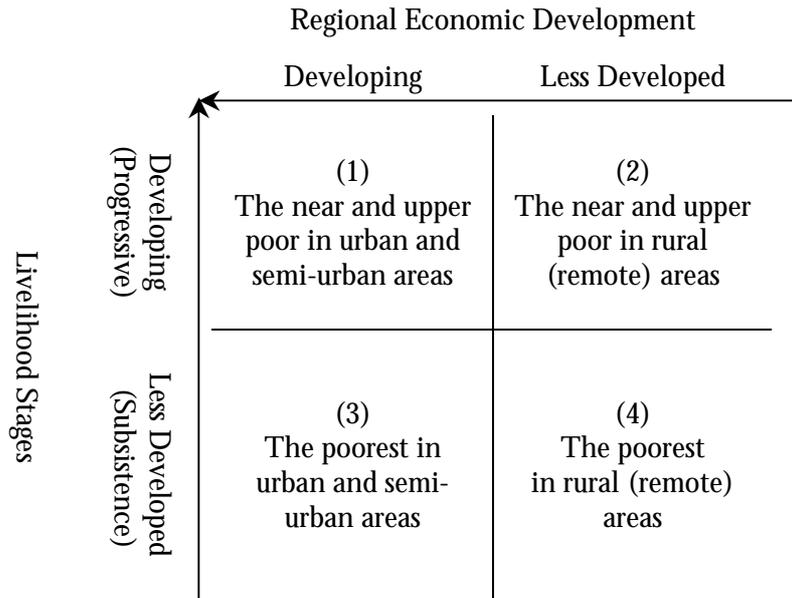
Chapter III and IV of this paper have presented the microfinance services in the sample regions in NTT from the point of view of the providers and clients. This chapter tries to compile the field findings presented in the previous chapters to identify the source of gaps in the provision of microfinance services for the poor in NTT and discuss the potential of microfinance as a tool for reducing poverty.

### 5.1. The Dynamics of Supply and Demand for Microfinance in NTT

The field findings of this study reconfirm the fact that the poor is not a homogenous group. The poor can be categorised on the basis of the severity of poverty into the not so poor (i.e. the near poor), the upper poor, and the poorest of the poor or the lower poor. In addition, the poor's livelihood is influenced by the economic activities of the region where they reside. These activities determine the economic opportunities and risks that they face. To better understand the dynamics of microfinance, this discussion considers the poor within the categories based on the stages in their economic activities that also reflect the severity of poverty, and the stages of regional economic development where they live.

The stages in people's economic activities and the regional economic development are a continuum. In this analysis, however, these processes are made discrete in order to simplify the categorization, so that they can be distinguished into two categories, the developing and the less developed. The low-income class with relatively advanced or progressive economic activities is categorized as "the near and upper poor", while the one with more simple or subsistence economic activities is categorized as "the poorest". It should be noted that this study does not make a clear distinction between the poor and the non-poor, or between the near poor, the upper poor and the lower poor, based on consumption poverty line. The relative severity of poverty referred to in this study is mainly based on the qualitative judgment of the researchers after taking into account various household characteristics including ways to earn income, housing conditions, ownership of assets and daily living conditions. With regard to the economic stages of the regions, the poor can be distinguished into those who live in developing or highly progressing economic regions, i.e. the urban and semi-urban areas, and the ones who live in less developed or rural and remote areas with relatively stagnant economic activities.

Following this framework therefore, the poor and the low-income class could be distinguished into four categories: 1) the near and upper poor who live in urban and semi-urban areas; 2) the near and upper poor who live in rural (remote) areas; 3) the poorest who live in urban and semi-urban areas; and 4) the poorest who live in rural (remote) areas (Figure 5.1.). It is important to note that the proportion of the not so poor and the poorest is not necessarily the same, and so as the proportion of regions that belongs to the developing and less developed categories. In NTT, at the present time, the proportion of regions and people in low-income class that belongs to developing categories are far less than the ones belongs to less developed categories.



**Figure 5.1. The Livelihood Categories of the Poor**

This study has found that the supply of microfinance services varies across regions and is prevalent only in and near urban economic centers (developing regions). The near poor and upper poor who live in urban and semi-urban areas (group 1) receive the bulk of microfinance services provided by formal and non-formal MFIs as well as government programs. This group, that constitutes the smallest fraction of the poor in NTT, is mostly low ranking civil servants, traders and workers in small industries. They have been relatively well serviced by existing MFIs. The loans provided by various providers are predominantly business loans/credits, but the clients do not always utilize the loan to develop their business. Although the loans are repaid from the profits of the client's business, a large proportion of the loans are used for other purposes such as to improve housing conditions, pay school fees and other consumption and emergency purposes. It reflects the limitations of business loans in promoting production and productivity improvement. Despite the generous provision of microfinance for this group, there is a mismatch between the objectives of the loan schemes set by the microfinance providers and the needs of the clients.

The lower poor or the poorest who live in urban and semi-urban areas, however, do not have as much access as the near and upper poor group, despite the availability of microfinance services. This group (group 3) consists mainly of laborers, households with non-permanent income and subsistence farmers who do not own non-agricultural businesses large enough to be considered creditworthy, particularly by banks and by most government microcredit programs. This group is largely ineligible for loan schemes provided by non-formal MFIs because the loan can not be used to start a new business and the high risk due to uncertainty of income earned. Some of the poorest have benefited from government credit programs that were targeted at the poor, but the credit was only received once (ad hoc) and provided no opportunity for the poorest to accumulate assets out of the business financed by the loans. This group is mostly served by cooperatives that practice as a "daily bank" and non-formal MFIs that charge high interest rates as well as by loan sharks. Thus, it can be said that the lack of microfinance services for the poorest in urban and semi-urban areas is caused by unsuitable microfinance design and the limited capacity of the poorest.

Microfinance services, particularly those of banks and non-formal MFIs, in rural and remote areas are limited. Consequently, the access of the near poor and the upper poor who live in these areas is also lacking although some of them have been able to access the services provided by banks and limited number of non-formal MFIs. It seems that government microcredit programs dominate the microfinance services in this area. Interestingly, this study discovered that in the absence of banks and non-formal MFIs, cooperatives and informal MFIs are mushrooming in these areas, and the not so poor make use of these services. The poorest who live in rural and remote areas, however, are mainly using informal MFIs. Since the economic activities are usually stagnant, the “daily bank” and loan sharks are not as abundant as in the developing regions. The poorest mainly obtain their loans from informal MFIs, such as *arisan* and other traditional loan and saving groups, as well as from neighbors/relatives and forward sellers. Although there are a relatively large number of cooperatives, the number of members of each cooperative is limited. For this reason, the limited extent of members’ savings inhibits the financial capacity of the cooperative. Finally, the gap between the supply of, and demand for, microfinance services in rural and remote areas is quite significant.

Microfinance services in NTT are actually expanding, albeit at a rather slow rate, in both the demand for, and supply of, those services. On the demand side, the opening up of the NTT economy by infrastructure and transportation developments has increased the economic activities of the regions as reflected in the high growth of the regions’ gross domestic products (GRDP). The most recent efforts of government and non-government institutions as well as the private sector to improve the marketing of several tree-crops and to develop new commodities are likely to increase the size of the economy that will, in turn, increase the demand for microfinance services.

On the supply side, various institutions acting as both supporters and providers of the services have supported the expansion of microfinance services. Among the institutional supporters that are providing indirect support to the provision of microfinance services, are various donor agencies, large scale NGOs – both national and international NGOs - and the government – at both the national and local level. Donor agencies and large scale NGOs have played important roles in strengthening the institutional and financial capacities of mostly non-formal MFIs, although some also provide assistance to cooperatives and through government programs. This support, however, is rather piece meal and limited in size as it has been provided to only a limited number of institutions and for a short time period. Because the assistance is still very much limited to the existing non-formal MFIs, the MFIs being supported are mostly located in and near urban centers. Although the assistance has been beneficial in increasing the number of clients, the impact on expanding the outreach to rural and remote areas is still very limited.

Both the national as well as provincial and district level governments, provide various support through more diverse channels that include banks, cooperatives, and non-formal institutions, on top of their direct involvement as microfinance providers. Although the support is big in total, it is lacking a coherent approach as the support is mostly provided on a project basis through sectoral agencies. The lack of a long-term vision is reflected in the weak institutional and capacity building support to cooperatives, that are formally under the guidance and supervision of the government through the Cooperative and SME Offices. Many cooperatives have gone bankrupt and inactive, while there is also no clear policy regarding a cooperative that acts as “daily bank”. This has impacted negatively on the image of cooperatives and resulted in a decreased level of public trust in these institutions. The government also provides assistance, mostly financial assistance, to non-formal MFIs, but it is also provided in a piecemeal and ad hoc basis. A local government initiative to create integrated village based MFIs, however, seems to face internal barriers due to a clash of egos between various sectoral

offices and the lack of a comprehensive long-term development plan for MFIs. In summary, the main problem with supporters is the lack of a coherent and long-term vision that would enable the supporters to provide more integrated support to the development of MFIs. There is also a lack of comprehensive assessment on the existing capacity and coverage of MFIs in NTT to back such a long-term development vision and plan.

The providers of microfinance services are also taking some initiatives. In the banking sector, there are some signs of expansion of national private banks through the opening of new branches in the district capital cities and urban centers. This has certainly stimulated local economies although the impact on the provision of microfinance services will likely be limited to the not so poor group. The expansion of BPRs, however, is not happening yet. With regard to cooperatives, despite the large number of establishments, the institutional development and performance in terms of outreach and expanding services to the poor is still unclear. It is quite ironic, given that many savings and loans groups are being enhanced as cooperatives, which is still considered as an ideal type of MFIs instead of BPR.

The non-formal MFIs run by NGOs have also been expanding quite fast recently; supported by various donor agencies and national as well as international NGOs. The coverage of each non-formal MFI is still limited in number and in geographical size. Most of these MFIs also have limited human resource and institutional capacity as well as limited capital, but they have the potential to be improved and strengthened.

The role of governments as microfinance providers presents a dilemma since its current market share is still quite large, but the approach that has been taken is ad hoc and less effective, both in reaching the poor and in supporting long term business development. In addition, there is the moral hazard and crowding out effects that have impacted on the operation and the development of other MFIs. As has already been recommended by various studies internationally, however, it would be better if the involvement of government as microcredit provider be limited or even ended, and the government support shifted to the provision of applied technology and opening up markets for produce as well as creating a conducive environment for the establishment and growth of small businesses.

To sum up, there is much to be done to develop MFIs in NTT in order to increase the geographical coverage and to reach the poorer segments of the community. These include the development of various MFIs with a diversity of services to serve various groups of the poor in various regions, backed up by a long-term vision and plan for MFIs development in the region.

## **5.2. The Potential of Microfinance in Reducing Poverty in NTT**

While the utilization of microfinance services can be easily recognized, the impact of the services on reducing poverty is not straightforward. The potential of microfinance services to reduce poverty will be dependent on various economic and social conditions that drive business development, accumulation of assets, management of risks and vulnerabilities, as well as making long term human investment. In line with the growing knowledge and understanding of the multidimensional characteristics of poverty, the role of microfinance has also departed from a focus on support for the poor's production and productivity. The role of microfinance has been broadened to supporting improvements in the general welfare condition of the poor, including coping with risks and vulnerabilities caused by seasonal and structural shocks (such as drought and economic crisis), events in one's life cycle (such as marriage, funerals, and child birth), and unanticipated crises and emergencies (such as sickness, crime and natural disaster). Microfinance is also seen as a vehicle to increase one's dignity through empowering people to seek better opportunities in developing business as well as in making long-term investments.

Following this multidimensional approach to poverty, the benefits of microfinance services in poverty alleviation should be seen from the point of view of how the services have contributed to overcoming various aspects of the deprivations faced by the poor. These benefits are dependent upon the existing poverty conditions of the poor, which mostly have a locally specific dimension. As has been described in Section 1.5 as well as Section 4.1 and Section 4.2, poverty in NTT has some distinctive characteristics, including low level of economic activities supported by low infrastructure facilities, the predominance of poor farmers dependent on a dry land production base, the low level of human resources both in terms of health as well as education level, high risks and vulnerability due to seasonal drought and natural disasters (earth quake and tsunami) and high cost of *adat* ceremonies. On the other hand, most of the poor in NTT possess some assets in the form of cultivated and uncultivated farmlands, as well as farm animals and cattle.

This study found that the existing microfinance services found in the sample regions, which reflect the majority of services available in NTT, are microcredits focusing on the promotion of production and productivities that are biased towards non-agricultural businesses. Given the existing conditions of the poor in NTT, the benefit of this type of service to the majority of the poor will be limited. There are several limitations. Firstly, as has been discussed in length in the previous section, the majority of poor farmers are not considered eligible to receive the services of microfinance institutions. Secondly, the small size of the economy of the regions limits the expansion in production capacity of small businesses that receive loans. Thirdly, most clients have used the business loans for other purposes. No MFIs have yet responded to the high demand for services other than business loans and are mainly still exploring opportunities to expand their business loans portfolios. The informal MFIs based on community groups have actually served this need with limited financial and management capacities.

The locally specific characteristics of the poor in NTT create major challenges to microfinance services to lift the welfare condition of the poor. Without a successful attempt to improve the economy of the regions and to promote the business development of the poor, microfinance services focusing merely on business loans and credits will have a limited capacity to reduce poverty in the long run. Meanwhile, there has been no attempt to explore the development of microfinance services that are better suited to the poverty condition in NTT, i.e. services that could help the poor in facing risks and vulnerability as well as to facilitate an improvement in human development in health and education. Although these types of microfinance services depart from the traditional business microcredit approach, there have been some innovations in other parts of the world that try to address this demand through product innovation that involves combinations of savings and microinsurance. Such an effort would be crucial for the development of microfinance services if it were to be of benefit to a long-term poverty reduction effort in NTT.

## VI. CONCLUSIONS AND RECOMMENDATIONS

### 6.1. Conclusions

1. The poor's access to microfinance services varies according to the type of provider. Services provided by banks are generally difficult to access by the poor because of the concentration of services in urban economic centers and policies relating to microfinance services not yet accommodating the needs of poor communities. The near poor and the upper poor obtain microfinance services from non-bank microfinance institutions (MFIs), non-formal MFIs, microfinance services provided through government programs and informal institutions. Those who are very poor however, are only able to obtain assistance from some services provided through government programs and informal institutions, as well as "daily banks" and loan sharks.
2. Microfinance services, provided by both the government and non-government institutions, are dominated by microcredits for small business. Credits provided by government are largely given to community groups in the form of funds or credits to be revolved to other groups. This system does not effectively support the business of the recipients and the sustainability of group activities because the speed with which funds revolve between groups does not allow for capital accumulation for business development. Meanwhile, farmers, the majority of whom are classified as poor, also have limited access to the loans for small business provided by banks, cooperatives and non-formal MFIs because the available schemes are incompatible with the patterns of farming business activities.
3. The small scale of the NTT economy limits the expansion of the provision of business loans and credits focusing on promoting business production and productivity. It also impedes opportunities to develop existing businesses and limits the opportunities to open new ones. Conditions like this do not encourage financial institutions to provide to, and develop their services for, the poor, particularly in less developed regions. Thus the provision of microcredits spreads out more only in urban areas and regions that are close to the center of economic development.
4. The poor often utilize loans to ensure food security and make long-term investments in education and housing, although the loan is supposedly for business. This phenomenon indicates that the poor need loans for non-business purposes in order to protect their assets and businesses. Limiting loan purposes only for business could limit the benefit of, and access to, credits by the poor.
5. Because they cannot access the savings services provided by banks, the poor tend to make use of the services offered by informal savings and loans institutions (*arisan* groups) managed by the communities themselves. This certainly indicates the potential for savings activities for the poor that have not yet been provided. The physical distance and the formality of banks' saving facilities limit the poor's access to saving services provided by banks. Formal non-bank MFIs such as cooperatives provide very limited saving facilities, while the non-formal MFIs are not allowed to provide saving services based on the existing laws.
6. The variety of needs and the living conditions of the poor also influence the diversity of needs for microfinance services. Except for transfers, there is a real need for loans, savings and insurance in their daily lives. There are limited saving facilities available for the poor so they

use informal MFIs such as *arisan* and loan and saving groups. Formal insurance services have not touched poor communities because there are no microinsurance services yet. The demand for savings and insurance, for dealing with seasonal cycles, life cycle events (funerals, marriages), and long term investments is fulfilled by traditional means such as animal husbandry activities, storage of harvest produce in barns, joining *arisan* or saving and loan groups, and the system of communal financing based on kinship.

7. Technical support provided for microfinance activities is still limited. The capacity and capability of cooperatives are very low. Despite the rapid expansion of non-formal MFIs, their capacity and capability varies, while their regional coverage and number of customers are limited. To date, laws that could provide clear legal status have not backed up the development of non-formal MFIs. Likewise, efforts by the government (BI) to build the capacity of non-bank formal microfinance institutions, such as cooperatives, non-formal microfinance institutions as well as services provided through government programs, have been inadequate.

## **6.2. Recommendations**

### **A. General Recommendations**

The provision of microfinance services has the potential to support poverty reduction efforts in NTT. Because of the limited economic capacity of the regions and the diversity of poverty conditions in NTT however, policy-makers and microfinance service providers and supporters need to take into account the following issues:

1. Poverty reduction interventions through the provision of microfinance services should be implemented within the framework of market mechanisms, so that they do not interfere with, or overwhelm, the existing microfinance institutions.
2. With the exception of several urban areas, there are only a few regions in NTT where the economic activities provide fertile grounds for the growth of small business, particularly in non-agricultural sectors. Consequently, independent microfinance services focusing only on the provision of business loans with a daily or weekly repayment system and short loan periods are suitable only for a small number of people who already own businesses and are of limited benefit for improving the welfare level of the majority of the poor in NTT. To increase the benefit of microfinance services for the majority of the poor in NTT, therefore, the expansion of the services both in terms of geographical coverage and financial deepening should be done: a) after, or in conjunction with, efforts to increase economic activities that provide new opportunities for the emergence and growth of small business, and b) using more product innovations that are suited to the needs and the capacity of the local poor, and that involve a variety of services on top of business loans.
3. The provision of microcredit services in the form of economic development packages should be carefully designed in order to avoid supply-driven services and moral hazards as has occurred so far with government credit programs. One alternative is to separate microfinance service providers from technical and marketing assistance providers. The programs, however, have to be developed and implemented in an integrated fashion. In this model, a diverse range of microfinance programs can be implemented at the same time as programs designed to strengthen local economies through the provision of technical and marketing assistance in certain regions, although different institutions provide the two programs. Such integrated efforts require comprehensive research into the community livelihoods, the community institutional capacity as well as business opportunities and challenges, so that the

microfinance services can help the poor to improve their business, cope with risks and vulnerability, and make long-term investments.

4. Economic development activities, such as the joint cattle production program complemented with intensive technical and marketing assistance, are one type of activity that is fairly successful. This approach is very useful for the poor because of the low risks involved. The loss of either the technical assistance or the guaranteed market components however, would reduce the program's effectiveness, or perhaps even cause the poor to become even poorer because they would be liable for all business risks. The sustainability of this approach, however, would be at risk without attempts to strengthen the providers of this program.
5. Microfinance institutions that provide a variety of services, or at least savings and loans, would be more beneficial for the poor, particularly the poorest. The combination of savings and loans could function as insurance for the poor because the loans and credit should not only be available for business needs, but also for consumption, emergencies, education and residential building purposes. There is also a need to adapt the loan and credit schemes to the production cycles of agricultural businesses because the majority of the poor earn their living in the agricultural sector.
6. The expansion of diverse and flexible microfinance services to increase the outreach of the services to the poor who are widely dispersed across the interior will be very costly. The development of saving facilities is also impeded by the existing regulations that limit the collection of savings to banking institutions and cooperatives, although such regulations are necessary to protect depositors. Therefore, the alternatives to increase the outreach of saving and loan facilities could be done through linking the non-formal and informal MFIs with banks and through an extensive outreach program of banks such as a mobile banking system. Several models such as linking banks and community groups (PHBK), Swamitra, village service centers and mobile units could be further explored as alternatives for increasing the coverage of microfinance services to rural and remote areas.

## **B. Recommendations for Local Government**

Regional government should not be directly involved as microfinance providers because it could create conflicts of interest and impair the main function of government. Instead, local government could play a strategic role in the development of microfinance services through its role as:

1. a regulator that monitors the implementation of the existing regulations, particularly in controlling and developing favorable relationships between MFIs and their clients, and that spells out the existing laws and develops local regulations that suit local conditions and needs. To support this function, local government should increase its capacity to monitor and assess the provision of microfinance services by various institutions;
2. a facilitator that assists the process of establishing MFIs to increase the access of the poor to microfinance services; and
3. the provider of assistance, both direct assistance to the general public and through existing and newly formed community groups. Direct assistance to the community through extension programs should be maintained and improved to support the poor's business development including agribusiness. In addition, local government could also provide support to increase the management and financial capacities of various MFIs.

### C. Recommendations for Funding Agencies

The form of assistance which could be provided by funding agencies will depend on whether the agency wishes to adopt an approach that puts more emphasis on short-term poverty reduction or long term development of viable and sustainable MFIs.

For the first approach, a program such as the joint cattle production program could be one of the approaches to be adopted. A funding agency could search for an institution to implement such programs and provide necessary assistance that would enable the selected institution to identify business opportunities and formulate an integrated program plan.

For the second approach, a funding agency could provide assistance at various levels, including:

1. Macro: funding agency could assist regional governments to formulate policies that create a conducive environment for the development of MFIs and increase the outreach of MFIs so that they can serve a larger number of clients and reach the poorer segment of the low-income class. This could be done through improving the capacity and capability of local government as regulator and facilitator as well as provider of assistance for the development of MFIs as stated in point B. At the same time, funding agency could assist regional governments to shift its focus of assistance from the direct provision of microcredits to a more systematic and intensive effort aimed at strengthening the economic position of the poor through technical assistance and technological innovations to increase production and productivity, as well as improvements in access to markets for their produce.
2. Meso: funding agency could provide indirect support to improve the capacity and capability of the existing MFIs through technical assistance to, and training for, microfinance providers to develop the types and forms of services that better suit the livelihood and the needs of the poor. Assistance could be provided through large institutions that have implemented a variety of programs to strengthen microfinance institutions. Alternatively, funding agency could assist or facilitate the establishment of links or collaboration between formal MFIs and non-formal MFIs in order to increase the outreach of microfinance services as well as provide a more diversified range of services that would be more beneficial for the poorer groups.
3. Micro: funding agency could provide direct technical and financial assistance to microfinance institutions. This option, however, would be better implemented as a follow-up to the activities in points 1 and 2 above. It is not advisable to provide large-scale funds in a short time frame without sufficient technical assistance, given the limited human resource and management capacities of the existing MFIs. The assistance to microfinance institutions should be provided on a long-term basis that could be 3 to 5 years. There are three types of MFIs that could be assisted: non-formal MFIs managed by NGOs, cooperatives and MFIs formed through government programs such as UPKD (created under NTAADP), and LPD/LPK (created by BPMD Kabupaten Manggarai). This intervention would require the support of a comprehensive research program into the capacity of institutions that would be assisted as well as the opportunities and the risks involved. In providing direct assistance, the following principles should be applied:
  - The formation and development of microfinance institutions, particularly cooperative and village level MFIs, should ensure the full participation of the poor, both men and women, and be driven by demand from the majority of the poor in the respected localities; and
  - The provision of full-time professional assistants should be an inseparable part of the assistance. The professional assistants should cover both institutional consultants for the MFI and business consultants for poor families. In relation to this, all costs associated with assistants must be separated from the operational expenses of microfinance institutions.

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### Appendix 1.1. List of Institutions Visited

Institutions	
NTT Provincial Level	Regional Development Planning Board (Bappeda)
	National Family Planning Coordinating Board (BKKBN)
	Office for Cooperatives
	Office for Industry and Trade
	Office for Fisheries and Marine Resources
	Office for Animal Husbandry
	Branch Office of Bank of Indonesia
	Branch Office of Bank Mandiri
	Branch Office of BRI
	Tanau Balaes Manekat (TLM) Foundation
	Talenta Cooperative
	Center for Community Services, University of Nusa Cendana
	Lecturer at Faculty of Agriculture, University of Nusa Cendana
Kabupaten Kupang	Regional Development Planning Board (Bappeda)
	Economic Section, Kabupaten Secretariat
	Village Community Empowerment Board (BPMD)
	Office for Industry and Trade
	Office for Agriculture and Forestry Affairs
	Office for Fisheries and Marine Resources
	Office for Animal Husbandry
	Office for Cooperatives
	The Management of Puskud
	Puskopdit or BK3D
	Principal Branch of Bank NTT
	Alfa Omega (YAO) Foundation
	Coastal and Marine Development (YPPL) Foundation
	Sanlima Foundation
Kecamatan Kupang Timur	Office of <i>Camat</i> , East Kupang
	PPLKB Kecamatan level
	Office of Lurah, Oesao Village
	PLKB Oesao Village
	Village Unit of Bank BRI, Oesao
	Sub-Branch of Bank NTT in Oesao
	Branch of Tanau Balaes Manekat Foundation in Oesao
	Branch of Pawnshop in Oesao
	Puskopabri, Oesao
	Farmer Cooperatives/ Farmers Group "Nusa Hijau Lestari"
Kecamatan Amarasi	Office of <i>Camat</i> Amarrasi
	Head of PKK Kecamatan Amarasi
	PPLKB Kecamatan Amarasi
	Head of Ponain Village
Kabupaten Manggarai	Regional Development Planning Board (Bappeda)
	Bimas and Food Security Board
	Population, Family Planning and Civic Registration Board (BKKBCS)
	Village Community Empowerment Board (BPMD)
	Statistics Office (BPS)
	Office for Industry and Trade
Office for Food Crops	

<b>Institutions</b>	
	Office for Plantation
	Office for Cooperatives and Small-Medium Enterprises
	Office for Animal Husbandry
	Economic Section, Kabupaten Secretariat
	Office for Agriculture and Forestry Extension Work (KIPP)
	Office for Agriculture and Forestry Information and Assistance (IPPK)
	Office for Bimas
	Branch Office of BRI
	Branch Office of Bank NTT
	BPR Lugas Ganda
	Puskopdit or BK3D
	Ayo Indonesia Foundation
	Delsos Foundation
Kecamatan Ruteng	Office of r Camat Ruteng
	Village Unit of BRI, Ruteng
	Bunga Usaha Credit Cooperatives, Village of Golo Worok
	Office of the Lurah Wae Belang
	Agriculture Extensio Office (BPP)
	Agricultural Extension workers (PPL), Village of Wae Belang
	Managers of Finance Management in Kecamatan Development Program
Kecamatan Borong	Office of Camat Borong
	Office of Golo Kantar Village
	Village Unit of BRI, Kecamatan Borong
	KUD Borong Jaya
	Village Credits Institution (LPK) Kotandora
	Women Farmers Group, Kotandora Village
	Hanura Credit Cooperatives
Kecamatan Satarmesse	Village Head and Secretary of Bea Kondo
	Facilitator for IMS-NTAADP in Manggarai
	Head of UPKD, Bea Kondo Village
	Group Management of IMS-NTAADP Bea Kondo Village

### Appendix 1.2. Profiles of Respondents

Respondents' characteristics	Kabupaten Kupang		Kabupaten Manggarai		Total
	Kecamatan East Kupang	Kecamatan Amarasi	Kecamatan Ruteng	Kecamatan Borong	
Gender:					
• Male	15	15	11	19	60
• Female	15	3	9	4	31
Total	30	18	20	23	91
Welfare Levels:					
• Very Poor	4	3	3	3	13
• Poor	17	8	8	12	45
• Not Poor	9	7	9	8	33
Total	30	18	20	23	91
Clients of MFIs*):					
• Formal Institution					
- Bank **)	9	2	9	9	29
- Non-bank	6	9	2	5	22
• Nonformal Institution	11	4	2	6	23
• Government Programs	7	7	8	15	37
• Informal Institution	4	9	11	15	39
Non-Clients of MFIs	5	2	4	0	11

Notes:

\*) Respondents could be the clients of more than one MFIs, therefore the total number is not equal to the number of respondents.

\*\*\*) Respondents who are the clients of banks could be receiving loans, having saving accounts or using money transfer service.

### Appendix 3.1. Micro-credit Channeling Program/Activity by Provincial Technical Agency

Management Agency	Program/Activity Name	Funding Source	Target	Interest Rate
Cooperatives Agency	PKPS-BBM	APBN	KSP/USP, LKM	16%/year
	Matching funds (MAP)	APBN	KSP	16%/year
	Funding for Women's and Youth Groups	Provincial Budgets	Community groups	0%
	Assistance Package for Coffee Farmers in Manggarai	APBN	Community groups	0%
	Assistance Package for Fisheries Tools in Kota Kupang	APBN	Community groups	0%
Maritime Affairs and Fisheries Agency	PEMP	APBN	Community groups and individuals	1-2% per month
	Intensification of Fisheries Cultivation (saltwater fish)	APBN	Community groups	0%
	Village Fisheries Cultivation (fresh water fish)	APBN	Community groups	0%
Animal Husbandry Agency	Direct Community Assistance (BLM) for Agricultural Development Programs: seedling cultivation, fattening cattle and pigs.	APBN	Community groups	0%
Agency for Industry and Trade	UKM Empowerment Project	Provincial Budgets	Community groups	n.a.
Bank NTT	Capital Participation	Provincial Budgets	Individuals	n.a.

### Appendix 3.2. Micro-credit Channeling Program/Activity in Kabupaten Kupang

Management Agency	Program/Activity Name	Funding Source	Target	Interest Rate
Cooperatives Agency	Revolving Working Capital Assistance	APBN	Cooperatives, Community groups, individuals	16%/year
	Empowerment of KSP/USP Community Groups and Small Entrepreneurs	Kabupaten Budgets	KSP/USP, Community groups, individuals	12%/year
	Development/Strengthening of Cooperatives Capital	Kabupaten Budgets	Cooperatives	12%/year
	Capital Strengthening for UKM	Kabupaten Budgets	Community groups, individuals	12%/year
Agency for Plantations, Forestry and Agriculture	Direct Assistance for Communities	Provincial Budgets	Community groups, individuals	n.a.
	Food: Channeling corn seed	Kabupaten Budgets	Community groups	n.a.
Maritime Affairs and Fisheries Agency	Cultivation of Rural Fisheries (fresh water fish)	APBN	Community groups	n.a.
	Intensification of Fisheries Cultivation (salt water fish)	APBN	Community groups	n.a.
	Procurement of means and infrastructure of fisheries	Kabupaten Budgets	Community groups	12%/year
	Funding for PEMP associates	Kabupaten Budgets	Community groups	12%/year
Animal Husbandry Agency	Productive Cows	Kabupaten Budgets	Community groups, individuals	Interest
	Procurement of stabled cattle (Revolving)	Kabupaten Budgets	Community groups	Interest
	Cattle fattening	Kabupaten Budgets	Community groups	Share of the produce
BPMD	UED	Kabupaten Budgets	Community groups, individuals	12%/year
Agency for Industry and Trade	Development of Small and Medium Enterprises: bricks, beef jerky	Kabupaten Budgets	Individuals	12%/year
	Development of saltwater fishponds	Kabupaten Budgets	Community groups	12%/year
	Channeling Community Empowerment Funds to small traders of stalls and kiosks	Kabupaten Budgets	Community groups, individuals	12%/year
Regional Secretariat for Public and Social Participation	Empowerment of Joint Enterprise Groups (KUBE)	Kabupaten Budgets	Community groups	12%/year
	PKK revolving funding assistance	Kabupaten Budgets	Individuals	12%/year

### Appendix 3.3. Micro-credit Channeling Program/Activity in Kabupaten Manggarai

Management Agency	Program/Activity Name	Funding Source	Target	Interest Rate
BPMD	Communities Economic Development	Provincial Budgets	Community groups	n.a.
	Assistance for Village and Neighborhood (Kelurahan) Credit Institutions (LPD/K)	Kabupaten Budgets	LPD/K	Grants
Cooperatives, Small and Medium Enterprises Agency	Directed BBM subsidy funding and PKPS-BBM	APBN	KSP/USP, UBSP	16%/year
	Working Capital Provision/Targeted towards Cooperatives and UKM	Kabupaten Budgets	Community groups, USP, UBSP	0%, 12%/year and 24%/year
	Revolving funds for Small/Medium Enterprises	Kabupaten Budgets	Community groups, individuals	12%/year
	Development and Empowerment of KSP/USP-UBSP,		KSP/USP, UBSP	12%/year
Food Security Extension Office	Direct Funding Assistance to Communities	Provincial Budgets	Cooperatives	0%
	Development of Food Longevity	APBN, Provincial Budgets	Community groups, cooperatives and schools	Cooperatives: 12%/year Community groups: 0%
Agriculture and Food Crops Office	Increasing the intensification of the quality of wet rice	APBN	Community groups	0%
	Broadening the Area of Padi Production	APBN	Community groups	0%
	Increasing the Wet Rice Planting Index sawah	APBN	Community groups	0%
	Expanding the Area of Corn Production	APBN	Community groups	0%
	Alsintan (Agricultural Machinery) Service Enterprises	APBN	Community groups	0%
	Development of The Mung Bean Agribusiness	Provincial Budgets	Community groups	0%
	Development of the Germination of Wet Rice Fields	Provincial Budgets	Individuals	n.a.
	Development of Wet Rice Agribusiness	Provincial Budgets	Community groups	n.a.
	Demonstration Plot for Water Conservation	Provincial Budgets	Individuals	n.a.
	KUBA	Kabupaten Budgets	Community groups	9%/6 months

Management Agency	Program/Activity Name	Funding Source	Target	Interest Rate
Maritime Affairs and Fisheries Agency	PEMP	APBN, Kabupaten Budgets	Community groups	n.a.
	Rural Fisheries Cultivation (fresh water fish)	APBN	Community groups	n.a.
Animal Husbandry Agency	Direct Assistance to Communities (BLM): seed funding for cattle	APBN	Community groups	n.a.
	Cattle fattening	Kabupaten Budgets	Community groups	Share of Produce
	Cattle seeding	Provincial Budget	Community groups	Seed
Agency for Industry and Trade	Development and Capitalization of Household Industry, Small and Medium	Kabupaten Budgets	Community groups, individuals	10%/year
	Development of Vanilla and Coffee Agro-industry as well as group capitalization	Kabupaten Budgets	Community groups	6%/year
Kabupaten Regional Secretariat (Setda) for Economic Participation	Establishment of Small Industry	Kabupaten Budgets	Community groups, individuals	16%/year
	Iodine Deficiency Eradication Program	Kabupaten Budgets	Community groups	12%/year

**Appendix 3.4. Government Program/Activity on top of Donor Support in The Channeling of Micro-credit in Kabupaten Kupang and Manggarai**

<b>Management Agency</b>	<b>Program/Activity Name</b>	<b>Funding Source</b>	<b>Target</b>	<b>Interest Rate</b>
Director General of Community and Village Empowerment, Department of Home Affairs	Kecamatan Development Program	Central Government Budget, Loans from The World Bank	Community groups, poor kecamatan	16%
Director General of Regional Development, Department of Home Affairs, Bappeda	NTAADP	Provincial Government Budget, Kabupaten Budgets, Loans from The World Bank	Inhabitants/poor farmers, community groups	15%-18%