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**Informal Finance and Poverty Alleviation:  
A Grassroots Study of Small Farmers' Credit  
In West Sumatra, Indonesia**

A thesis presented in fulfilment of the requirements  
for the degree of Doctor of Philosophy in  
Development Studies at Massey University,  
Palmerston North, New Zealand

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***“If you disclose your charitable expenditures, they are good; but if you conceal them and give them to the poor, it is better for you and He will remove you some of your misdeeds (thereby). And God, with what you do is (fully) acquainted” (Al-Qur’an 2:271).***

**\*\*\*I dedicate this work to my parents,  
who passed away during the process of this study\*\*\***

## ABSTRACT

The main objective of this study is to explore the credit and savings behaviour of small farmers in rural areas of Indonesia, with particular reference to informal systems of credit. It examines the relationship between credit and rural poverty and on identifying small farmers' credit and savings behaviour as well as problems they encounter in accessing credit programmes at the grassroots level. In this study, the extent of informal credit programmes in rural areas is identified and an assessment is made of how important these schemes are to rural people, especially small farmers, from economic, social and cultural points of view. The influence of local culture and values on informal rural credit systems is also examined. Fieldwork was conducted in three villages of Solok district, West Sumatra, Indonesia.

This study reveals that credit programmes, whether from the formal or informal sectors, have not had a positive impact on poverty alleviation. The majority of formal credit programmes in the three case study villages failed to give service to the rural poor, especially small farmers. It is likely that the reason for the failure was the unmet demand between the formal financial institutions as the credit providers and the small farmers as the credit recipients. The informal credit programmes were also unsuccessful in helping the poor to increase their income because the loans were small in size and were mainly used for fulfilling basic and emergency needs. Credit from informal sources is used for survival rather than for development.

However, informal credit schemes were favoured by the majority of the rural population due to their flexibility and adaptation to local cultures and values. This study finds that informal credit schemes in these three case study villages have potential to empower local people and to strengthen traditional rural credit systems in the era of decentralisation. *Arisan Suku*, *Julo-julo* and 'friendly moneylenders' are examples of these informal credit schemes, and they figured significantly in the credit and savings activities of the poor in the study area. Therefore, this study rejects the conventional assumptions that informal finance is exploitative, insignificant and unorganised.

The positive impact of local culture and values on the informal credit systems in the study area mainly focuses on the influence of local culture of Minangkabau and the value of Islamic religion in shaping rural informal credit systems. In this case Minangkabau people have been practicing credit and savings activities for a long time, and this reinforces the informal credit system in the area. Regarding the influence of Islamic values, this is in line with the current growing attention paid to the Islamic finance system, both at national and international levels. The positive impacts of local culture and values are important for developing a more participatory rural financial system. This study recommends that the future rural financial systems can be developed by combining positive features of both formal and informal credit systems.

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## GLOSSARY

<i>Adat</i>	Custom
ADB	Asian Development Bank
<i>alim-ulama</i>	Religious chiefs
<i>Arisan</i>	Rotating Savings and Credit Association (ROSCA)
<i>Arisan Barang</i>	Goods ROSCA
<i>Arisan Kelompok Tani</i>	Farmer's Group's ROSCA
<i>Arisan Kenduri</i>	Feast ROSCA
<i>Arisan Suku</i>	Clan ROSCA
<i>Arisan Tenaga</i>	Alternate Working Together
AVB	<i>Algemeene Volkscredietbank</i> (AVB-Bank)
<i>Balita</i>	Children under five years old
<i>Bank Umum</i>	General bank
BAPPEDA	<i>Badan Perencanaan Pembangunan Daerah/</i> Regional Planning Board
BAPPENAS	<i>Badan Perencanaan Pembangunan Nasional/</i> The National Planning Board
BDB	<i>Bank Dagang Bali</i>
<i>Bidan Desa</i>	Rural midwife
BIMAS	<i>Bimbingan Massal/</i> Mass Guidance Credit Programme
BKD	<i>Badan Kredit Desa/</i> Village Credit Organisation
BKK	<i>Badan Kredit Kecamatan/</i> Sub-district Credit Organisation
BKKBN	<i>Badan Koordinasi Keluarga Berencana Nasional/</i> National Family Planning Coordination Agency Board
BLM	<i>Bantuan Langsung Masyarakat/</i> Community Direct Assistance
BMI	<i>Bank Muamalat Indonesia</i>

BPD	<i>Badan Perwakilan Desa/</i> Village Representative Board
BPD	<i>Bank Pembangunan Daerah/</i> Local Development Bank at the provincial level
BPR	<i>Bank Perkreditan Rakyat/</i> People's Credit Bank
BRI	<i>Bank Rakyat Indonesia</i>
BRI Unit Desa	BRI Village Unit
BUMN	<i>Badan Usaha Milik Nagari/</i> Village-owned Corporation
<i>Bupati</i>	District Head
BUUD	<i>Badan Usaha Unit Desa/</i> Village Unit Corporation
<i>Cabe-rawit</i>	Fine-chilli
<i>Camat</i>	Sub-district Head
CARE	One of International NGOs which deals with microfinance programme in Indonesia
<i>Cerdik-pandai</i>	Educated people in Minangkabau customs
CVPD	One of orange's disease
<i>Datuk</i>	The clan's chief in Minangkabau customs
DAUN	<i>Dana Alokasi Untuk Nagari/</i> Allocated fund for a <i>Nagari</i>
<i>Desa</i>	Village in Indonesia's centralised system
<i>Dukun</i>	Traditional healer
<i>Gabah</i>	Husked rice
GDP	Gross Domestic Products
<i>Golkar</i>	<i>Golongan Karya/</i> One of political parties in Indonesia
<i>Gotong-royong</i>	Practices of mutual cooperation
GTZ	<i>Deutsche Gesellschaft fur Technische Zusammenarbeit/</i> German International Cooperation
HYV	High Yielding Varieties
IDT	<i>Inpres Desa Tertinggal/</i> Presidential Instruction on Development of Backward Village

<i>Idul Fitri</i>	Islamic celebration day after fasting month ( <i>Ramadhan</i> )
<i>Idul Qurban</i>	Islamic celebration day during the pilgrimage time ( <i>Haji</i> )
<i>Imam</i>	Islamic religious group leader
IMF	International Monetary Fund
INPRES	<i>Instruksi Presiden/</i> Presidential Instruction
<i>Iyuran</i>	Group member's contribution, usually in the form of money
<i>Jaring</i>	Small fishing net
<i>Jeruk-peras</i>	Crush orange
<i>Jorong</i>	Wards in West Sumatra Province
<i>Julo-julo</i>	Rotating and Saving Credit Association (ROSCA) scheme in West Sumatra
<i>Julo-julo Alat-alat Dapur</i>	Crockery/kitchen appliances' ROSCA
<i>Julo-julo Beras</i>	Rice ROSCA (the contribution is in the form of rice)
<i>Julo-julo Padi</i>	Paddy ROSCA (the contribution is in the form of paddy)
<i>Julo-Julo Panen</i>	Harvesting's ROSCA (ROSCA that is done every harvesting time)
<i>Julo-julo Piring</i>	Plate ROSCA (the lottery received is in the form of plates)
<i>julo-julo Pupuk</i>	Fertiliser ROSCA (the lottery received is in the form of fertiliser)
<i>Julo-julo sekali panen</i>	Harvesting's ROSCA (ROSCA that is done every harvesting time)
<i>Julo-julo Tenaga</i>	ROSCA in which the contribution is in the form of energy
<i>Julo-julo Tikar</i>	Carpets ROSCA (the lottery received in the form of carpet)
<i>Kampung</i>	Small village



<i>Kedai</i>	Small shop
<i>Kelompok Pengusaha Mikro</i>	Microentrepreneur groups
<i>Kelompok Tani</i>	Farmers' group
<i>Kepala Desa</i>	Village head
<i>Keramba</i>	Big bamboo basket for catching fish in the river or the sea
KIK	<i>Kredit Usaha Kecil</i> / Small Investment Credit
KKN	<i>Kuliah Kerja Nyata</i> / Obligatory social action internship for university students
KKP	<i>Kredit Ketahanan Pangan</i> / Credit for food security
KMKP	<i>Kredit Modal Kerja Permanent</i> / Permanent Working Capital Loan
<i>Kongsi</i>	<i>Julo-julo tenaga</i> / <i>Lambaihari</i> / Alternate working together
<i>Kongsi Biasa</i>	Regular Alternate working together
<i>Kongsi Kas</i>	Alternate working together aims for group savings
<i>Koperasi</i>	Cooperative
<i>Koperasi Nagari</i>	Village Cooperative
<i>Koperasi Simpan Pinjam</i>	Credit and Saving Cooperative
<i>Koperasi Suku</i>	Clan Cooperative
KOPERTA	<i>Koperasi Pertanian</i> / Agricultural Production Cooperative
KSP	<i>Koperasi Simpan Pinjam</i> / Savings and Credit Cooperative
KUD	<i>Koperasi Unit Desa</i> / Rural Unit Cooperatives
KUK	<i>Kredit Usaha Kecil</i> / Credit for small businesses
KUK-DAS	<i>Kredit Usaha Kecil- Daerah Aliran Sungai</i> / Credit for small business in one catchment's area
KUPEDES	<i>Kredit Umum Pedesaan</i> / General Rural Credit
KUT	<i>Kredit Usaha Tani</i> / Credit Programme for Farmers
<i>Lambaihari</i>	<i>Julo-julo tenaga</i> / Alternate working together

<i>Lapau</i>	Small coffee shops
LDKP	<i>Lembaga Dana Kredit Pedesaan</i> / Rural Credit Fund Foundation
LDP	<i>Lembaga Dana Pedesaan</i> / Rural Fund Foundation
LMD	<i>Lembaga Musyawarah Desa</i> / Village Consultative Assembly
LPN	<i>Lumbung Pitih Nagari</i> / Traditional informal credit system in West Sumatra, Indonesia
<i>Lubuak</i>	Public wells
LUEP	Local Government's Credit Scheme for rice mills' owner
<i>Lumbung Beras</i>	Rice barns
<i>Lumbung Padi</i>	Paddy barns
<i>Madrasah</i>	Islamic religious school
<i>Malu</i>	Shy
<i>Mamak</i>	Mother's brother
MDGs	Millennium Development Goals
<i>Merantau</i>	Wandering/ specific culture of Minangkabau People who move from their home village to another place to earn income, or to study
MFIs	Microfinance Institutions
<i>Nagari</i>	Village in a decentralised system in West Sumatra Province
NGOs	Non Governmental Organisations
<i>Ninik mamak</i>	Cultural chiefs in Minangkabau custom
NPF	Non-Performing Financing
P4K	<i>Proyek Peningkatan Pendapatan Petani Kecil</i> / Income Generating Project for Small Farmers
<i>Paceklik</i>	Time of scarcity before harvest
PAKJAN	<i>Paket Januari</i> / Financial deregulation that Occurred on January 1999

PAKMAR	<i>Paket Maret/</i> Financial deregulation that occurred on March 1989
PAKTO 1988	<i>Paket Oktober/</i> Financial deregulation that Occurred on October 1988
<i>Palawija</i>	Secondary crops
<i>Panca Sila</i>	The basic philosophy of Indonesian state
<i>Pedagang kaki lima</i>	Street traders
<i>Pedagang kecil</i>	Petty traders
<i>Pematang sawah</i>	Dikes between rice fields
<i>Perantau</i>	The wanderer/ people who do <i>merantau</i>
<i>Perantauan</i>	The destination of the wanderer ( <i>perantau</i> )
<i>Perum Pegadaian</i>	State-owned pawning company
PMA-PMUK	<i>Pemberdayaan Masyarakat Agribisnis Melalui Penguatan Modal Usaha Kelompok/</i> Agribusiness Community Empowerment Programme through Strengthening Group Capital
PMI	Credit for Food Security
<i>Pos Yandu</i>	<i>Pos Pelayanan Terpadu/</i> Integrated medical services point
<i>Pos Yandu julo-julo</i>	ROSCA <i>Pos Yandu</i>
PPL	<i>Penyuluh Pertanian Lapangan/</i> Agricultural Extension workers
PRA	Participatory Rural Appraisal
<i>Priayi</i>	Civil servants
<i>Pukat</i>	Large and long fishing net
<i>Ramadhan</i>	One of months in the Islamic calendar when Muslims do fasting
<i>Rankiang</i>	The small houses which are located in front of the Minangkabau traditional house
RDKK	<i>Rencana Dasar Kebutuhan Kelompok/</i> Basic Group Plan

RFIs	Rural Financial Institutions
<i>Riba</i>	Money interest in Islam
ROSCAs	Rotating and Saving Credit Associations
Rp	<i>Rupiah</i> / The Indonesia's currency
<i>Rumah adat</i>	Traditional house
<i>Rumah Gadang</i>	Minangkabau's traditional house
SACI	Specialised agricultural credit institutions
<i>Sawah</i>	Ricefields
<i>Sedekah</i>	Charity in Islam
<i>Simpan pinjam</i>	Saving and credit scheme/ Cooperatives
<i>Simpan Pinjam Kelompok Tani</i>	Farmers' Groups' Cooperatives
<i>Simpan Pinjam Suku</i>	Clan cooperatives
<i>Simpanan Pokok</i>	Voluntary savings
<i>Simpanan Wajib</i>	Compulsory (basic) saving
SIMPEDES	<i>Simpanan Pedesaan</i> / Rural Savings
Suku	<i>Clan</i>
<i>Syarak</i>	Religion
<i>Syari'ah</i>	Religious regulations
<i>Tanah ulayat</i>	Clan land
<i>Tapian</i>	Public toilets and bathrooms
<i>tegalan/pekarangan</i>	Unirrigated land
<i>Tukang Urut</i>	Traditional massager
<i>Tungku Tigo Sajarangan</i>	Three hearths in one place (the structure of village council in Minangkabau custom)
TV	Television
UEDSP	<i>Unit Ekonomi Desa Simpan Pinjam</i> / Village Economic Savings and Credit Unit
BUKOPIN	<i>Bank Usaha Koperasi Indonesia</i> / One of Indonesia's state-own banks
<i>Urang Sumando</i>	Brother in law
USP	<i>Usaha Simpan Pinjam</i> / Saving and credit

	enterprise
<i>Wali Nagari</i>	Village Head
<i>Warung</i>	Small shops
WILUD	<i>Wilayah Unit Desa/</i> Agro-economic unit
<i>Zakat</i>	Compulsory contributions in Islamic religion

## **CHAPTER ONE**

### **INTRODUCTION**

#### **Background to the Research Programme**

In recent decades, there has been an increasing attention paid to microfinance as a tool to alleviate poverty in developing countries. Microfinance provides financial services for the poor, in small loans and usually without collateral, which the commercial banking sector cannot afford. Furthermore, microfinance not only provides credit for the poor, but also can involve a range of services from savings mobilisation to insurance services and financial advisory services. Also, microfinance provides social intermediation services which aim to enable the poor to become self-reliant through group formation, developing self-confidence, and training in financial management (Ledgerwood, 1999: 1). Thus microfinance functions not only as a financial intermediation but also as a means of social intermediation. In short, microfinance is a tool for development.

However, most attention in microfinance has been paid to the formal credit systems, which are carried out by either government institutions or non-government organisations. These institutions are usually organised, regulated and apply standard formal banking systems, as well as link to wider financial markets. On the other hand, there is not much attention given in discussion on microfinance to the informal sector. Knowledge about informal lenders such as moneylenders and local customary credit systems, which are not linked with the formal banking sector, is very limited. There is also insufficient research about how microfinance is adapted to the credit and savings needs and behaviour of the poor at the grassroots level.

Focusing on the poor is the main strategy of the microfinance movement. Considering that the majority of the poor in developing countries reside in rural areas (IFAD, 2001: 1), development of a favourable rural financial system becomes significant. The rural poor have many disadvantages in accessing financial services. Their remoteness and lack of formal education leads to hesitancy on the part of urban formal financial institutions to provide financial services for them. Further, small farmers, who represent

the majority of the rural population in developing countries (Yaron, Benjamin, & Piprek, 1997: 18), encounter many problems in accessing credit from formal credit systems. Their incomes are irregular due to the seasonal feature of farming activities, and are highly dependent upon uncontrollable factors such as pest attack and natural disasters.

This study focuses on the dynamics of small farmers' informal credit and savings activities in rural areas of the West Sumatra province, Indonesia. The reason for choosing this topic is the high poverty level of small farmers in Indonesia's rural areas, which is exacerbated by insufficient government policy intervention, especially regarding the rural credit programme to increase farmers' income and quality of life. The earlier government policy of decentralisation in rural financial development has overlooked the small farmers' credit needs and behaviour, as well as the dynamics of their credit and savings activities at the grassroots level. In this era of decentralisation, it is timely to pay more attention to them. As a matter of fact, poor farmers represent the majority of Indonesia's population (ADB, 2001b: 1) and their role as food producers cannot be ignored.

The main objective of this study is to explore the credit and savings behaviour of small farmers in rural areas. This will take the debate on rural financial development beyond the concept of microfinance. Credit and savings activities of small farmers in rural areas do not deal only with financial activities. This is because the life of the poor in rural areas, especially that of small farmers, takes place not in a vacuum, but amidst processes which are dynamic and full of interaction. Their daily life is highly influenced by local conditions such as the culture and social norms present in an area. Thus, credit and savings activities of rural people attach to their local culture and values. In West Sumatra in particular, credit and savings have been habits of rural people for a long time, and therefore, they still retain traditional systems in credit and savings.

### ***The theory of farmer-centred development***

Theories of development have evolved rapidly over recent decades. Development theories have been proposed, modified, rediscovered, and adopted, mainly due to

dissatisfaction with previous development strategies. Brohman (1996: 202), for example, elaborates on the dissatisfaction with mainstream development strategies. He argues that the fulfilling of development objectives, such as employment generation and poverty reduction, does not always follow economic growth. In some countries, despite economic growth being attained, mal-development problems still occur, such as unemployment and unequal income distribution. Ironically, growth has been accompanied by the deterioration of living standards, and the decreasing access to productive resources for large numbers of people, including the landless, farm-workers, peasant cultivators, and informal-sector workers. Brohman (1996) therefore suggests that:

Successful development should be measured not in abstract, aggregate growth indices, but according to other people-oriented criteria, such as the universal provision of basic needs, the promotion of social equity, the enhancement of human productive and creative capabilities, and the capacity of communities to set and meet their own development goals (Brohman, 1996: 203).

This view is similar to the declaration made by the scientists at the Cocoyoc Seminar on 'Patterns of Resource Use, Environment and Development' in 1974 which is seen as the origin of alternative development (Friedmann, 1992: 2). The seminar concluded with two major strands of alternative development: first, priority attention should be given to the fulfilling of the basic needs of people, rather than maximising growth, and second, consideration of the 'outer limits' of the earth's resources to sustain the growth. This is also in line with Dudley Seers's opinion on theory of development that development deals not only with increasing per capita output, but also with eliminating poverty, unemployment and inequality (Seers, 1969). People-centred development, in harmony with the environment in this case, would require a more self-reliant effort than in the past (Friedmann, 1992:2).

The concept of alternative development, which includes people-centred development, according to Pieterse (1998:58) is essentially 'development from below'. In this context, 'below' refers to 'community'. It tends to be based on practices at the field level rather than theories at the policy level. It also counts on local knowledge rather than abstracts of expert knowledge, with local – rather than regional or global- orientation.



This explanations about alternative development that puts people at the centre of development (people-centred development) and concern for the rural poor, have led to the notion of the importance of small farmer development. Robert Chambers' works (Chambers, 1983, 1997) are concerned with this, and attempt to put the rural poor and the small farmers as the first priority in rural development.

Concern for improving small-farmer development has existed for the past two decades, when scientists from around the world met and discussed strategies for improving small farmer development in the tropics, at the University of Hawaii, USA, 23-26 May 1977. It was argued that basic issues in reaching the small farmers are: lack of governments' political will; structural deficiencies that are caused by small farmers' dependency on the dominant groups; lack of formal and informal education systems in rural areas; and ineffectiveness of agricultural development programmes. To solve these problems it was proposed to apply an approach of involving small-farmers in development, by creating positive links between service agencies and small farmers, and giving motivation to the people to take an active part in the action programme (Higgs, 1977: 43).

Bottomley (1989) highlights the concept of farmer-centred development. He states that the concept is based on a simple, but significant, proposition that true development is not only about economic development and increasing production, but also about development of people through the improvement of their economic condition and quality of life. Thus any strategies to achieve these objectives should be focused on the development of skills and confidence, or to empower them to become self-determined (Bottomley, 1989: 3).

Bottomley (1989) further argues that farmer-centred development is about making the farmer, and his family and community, the focus of rural development strategy. He stresses the importance of cooperative organisations to provide services for small farmers such as credit, supply and marketing, since cooperative organisation in agriculture is directly involved in the process of decision-making of the individual farmers, and provides facilities according to each farmer's particular needs. Development strategy for small farmers covers four ideological backgrounds:

1) growth, particularly in life improvement, confidence, skills, and abilities, other than growth in economic resources and production; 2) creation of wealth which provides adequate reward and motivation to the rural producer; 3) self-help, self-reliance, and collective action, which are very important for personal and community development. The people should identify their own needs, determine their own development institutions, and decide the programmes that affect them; and 4) change is necessary, in terms of working process, procedures and tools, and production system (Bottomley, 1989: 6-8).

In achieving the objectives of small farmers' development, the research programme is exceptionally important. Edwards (1993) focuses on the importance of participatory research. He states that the conventional approach of development research is irrelevant and based on the outsider expert's views, which are not sensitive towards the complexity of the real-life problems in a particular time and place. The purpose of research in development studies is therefore to promote development of poor and powerless people; and for it to be relevant, poor people should participate in the process in order to construct our understanding of how their world operates.

### ***The importance of small farmers' credit development in developing countries***

After the failure of agricultural credit programmes in many developing countries during the period of 1970-1980, attention towards providing credit for the agricultural sector, especially small farmers, has declined. It is obvious that there is a decreasing number of donor-supported agricultural credit programmes, and many government institutions in developing countries have reduced their support to the agricultural sector (FAO & GTZ, 1998: iii). The microcredit programmes are also still insufficient to help the small farmers in rural areas. These programmes focus more on rural poor in general, and tend to help off-farm activities, especially in facilitating self-employment (Khandker, 1998: 47). A study of three microcredit institutions in Bangladesh revealed that the Grameen Bank had successfully increased in self-employment in off-farm activities rather than farm activities, while in the Bangladesh Rural Agricultural Committee (BRAC) and Rural Development Project-12 (RD-12) villages, the farm employment reduced

(Khandker, 1998: 54). On the other hand there is an increasing food demand among densely populated countries due to the increase of population and economic development, while the improvement of national and international terms of trade in agriculture causes an increasing demand for agricultural products.

The need to revisit agricultural finance focusing on small farmers' credit is therefore imperative nowadays. The reason for focusing on the small farmers for future development strategies of developing countries is because small farmers are the largest body of producers and small farmers represent most of the underemployed labour resources to be mobilised. FAO (1993: 1) estimates that about 60% of all farmers are small farmers who account for less than 40% of agricultural output. Also, small farmers are more productive than large farmers when land becomes scarce and labour becomes more plentiful, since the small farmers are more likely to get yield per hectare than large farmers (Donald, 1976: 13). Then, credit assistance is considered as a pertinent means for small farmers development because financial credit is the most universal and transferable form of economic resource, while it gives also much greater freedom of choice and efficiency.

However, providing credit for small farmers is a difficult task for the formal financial institutions. Apart from the tendency – among some groups of people - to be unwilling to repay the credit, ability to repay is influenced by many unpredictable factors such as climatic conditions, pests, market price fluctuations, poor farming and improvidence of human beings (Bottomley, 1989: 57-58). The seasonal character of agricultural business and the susceptibility of farming activities to covariant risks such as pest outbreak and natural disaster cause irregularity of farmers' income, and this affects the difficulty of formal financial providers to extend credit to small farmers. Furthermore, the rural clientele are often unable to provide a collateral that is required by commercial credit institutions, and this limits the access of the rural poor to financial services (FAO & GTZ, 1998: 34). Thus, despite the remarkable expansion of microcredit programmes in developing countries over the last decades, only a small fraction of farmers received or benefited from such credit programmes. It is estimated that only 5% of farmers in Africa, and about 15% in Asia and Latin America have had access to formal credit (Braverman & Guasch, 1986: 1255). Furthermore, the cheap credit policy with low interest rate that was applied by many government agencies in developing countries,

which aimed to equalise income disparity, benefited large farmers rather than small farmers. This is because larger farmers required larger loans, which are favoured by formal banking institutions. The bias of formal financial institutions towards large farmers caused the small farmers in developing countries to become poorer and poorer.

Many authors have realised the disadvantages of rural people in accessing financial services in developing countries (Basu, 1997; FAO & GTZ, 1998; Germidis, Kessler, & Meghir, 1991; Yaron et al., 1997). Low and scattered population density in rural areas together with the small size of loans and low household savings caused an increase of transaction costs. Also, poor communication and lack of infrastructure caused lack of integration with other markets which creates information barriers and limits risk diversification (Yaron et al., 1997: 18). Thus, it is recognised that normal flows of credit through formal banking institutions favour productive development and this excludes small farmers who have been far more limited in access to these opportunities than other sectors.

### ***The urgency of conducting grassroots research on small farmers' credit in Indonesia***

In Indonesia, the agricultural sector has been the main source of income of the majority of the population for a long time. Agriculture is an important sector in Indonesia's economy because this sector produces food, particularly rice, for the large population, while this sector contributes a large share of the GDP, as well as providing large employment opportunities, especially for the rural population (ADB, 2005).

Focusing on the welfare of small farmers is one of the current strategies of Indonesia's agricultural development. Agricultural development means not only increasing farm production, but also – importantly - improving the income of agricultural workers. This strategy reflects that developing the future agricultural sector should be focused on increasing the quality of life of small farmers (Apriyantono, 2004: 3). In Indonesia, small farmers represent the majority of the poor in rural areas (75%) (ADB, 2001b: 1).

Many factors have constrained the small farmers' development in Indonesia. Lack of - and inappropriate - technology transfer, lack of access to capital and information, and low skills and education levels are the main problems that are hampering small farmers' development. There are also problems of long and unfair marketing systems toward small farmers as well as weak farmers' institutions and bargaining position (MOA, 2005: 18-21). With regard to the limited access of small farmers to capital from formal institutions, MOA (2005: 18) argues that this is due to the limited number of formal financial institutions available for the rural population. Also, the procedure and requirements needed by formal financial institutions are difficult for the rural community to fulfil, while most farmers are unable to access credit because formal credit institutions usually apply a commercial approach in setting up interest and other regulations. These factors cause the exclusion of small farmers from formal financial activities.

Rural financial systems in Indonesia have been available for a long time, but formal credit programmes for the agricultural sector, especially for small farmers, is still problematic. Many rural credit programmes such as BIMAS, KUT, and KKP have failed to give their services to the small farmers. In recent years, many agricultural programmes and projects such as BLM and PMA-PMUK that were designed to provide financial services for farmers in rural areas also suffer from mismanagement and poor implementation (World-Bank, 2005a: 2). Although many projects and programmes have been set up by the government to solve the problem of lack of capital for the small farmers, most of these programmes and projects are not sustainable because of lack of coordination and poor management (Sukarno, 2000: 13). These problems have affected rural credit programmes, and therefore, it is urgent to find their causes.

Despite the fact that policies concerning farmers' credit have been formulated and implemented based on some research, farmers' needs and behaviour towards credit are still under-researched. The existing research has mainly focused on analysing the impacts of specific credit programmes, and lacks information on what the actual credit needs of the poor are, especially those of small farmers at the grassroots level. Therefore, filling this gap is important in order to improve small farmers' access to rural credit and thus their quality of life.

Another aspect of rural credit in Indonesia is culture. Small farmers in Indonesia usually live in a specific geographical area and ethnic group. Although they live in isolated or remote areas, their living environments are dynamic and are influenced by specific local cultures, norms and values present in the respective areas. They usually have specific customs or ways in farming, as well as in credit and savings activities. Often they have specific credit and savings schemes that adapt to their local culture and values. For example, rural people in Bogor and Tasikmalaya of the West Java Province continue to use informal finance in their credit and saving activities, although there are formal credit institutions that have operated in the area (World-Bank, 2001: 24).

The tendency of Indonesian farmers to rely on traditional informal credit schemes is supported by the fact that Indonesia is a large and diverse country consisting of many ethnic groups and cultures, and many groups have their own specific savings and rural credit scheme. Many of these schemes have been identified, such as *Lumbung Pitih Nagari* (LPN) in West Sumatra province and *Badan Kredit Kecamatan* (BKK) in Central Java province (Chaves & Gonzalez-Vega, 1996: 67). However, a greater part of traditional informal rural financial institutions in Indonesia are poorly studied if at all. In addition, it is difficult to identify and regulate rural informal financial institutions, due to their informal and nonlegal nature (Robinson, 2001; Sukarno, 2000).

Furthermore, small farmers in rural areas may have specific reasons whether to participate or not in any rural credit programmes. These might be including economic, social and cultural reasons. As an example, a rural household survey conducted by BRI and Harvard University in 2000 concluded that about 68% of households did not have credit from any formal credit institutions (Charitonenko & Afwan, 2003: 11). In this case, there might be some reasons behind this, considering that large proportions of rural people do not have access to a formal credit programme.

In considering these reasons, it is important to conduct a grassroots study on small farmers' credit in Indonesia. The current approach of rural financial development is still insufficient to respond to the real needs and aspirations of small farmers towards credit. There is a lack of knowledge on what are the actual attitudes and behaviour of small farmers in rural areas regarding credit. Getting to know about small farmers' credit cannot be done by just evaluating the impacts of existing credit programmes or by

assessing economic benefits and institutional changes of rural credit programmes. Conducting a grassroots study of small farmers' credit through participatory research is important, so that the credit and savings behaviour of small farmers in rural areas can be recognised.

Considering these contextual issues, the central research question of this study is: "How can microfinance fulfil the needs for development of the rural poor, especially small farmers in Indonesia?" Based on this central research question, many specific research questions emerged, among others:

- What are the small farmers' perceptions and aspirations regarding rural credit, and what forms of credit are chosen by small farmers and why? Also, what types of intermediaries do the small farmers prefer?
- How do the rural poor perceive the current formal credit programmes, and how do these schemes affect the poverty level in rural areas?
- How do local culture and values influence the credit and savings behaviour of poor farmers in rural areas?
- What is the availability of informal credit programmes, and how important are these schemes in terms of economic, social and cultural aspects?
- How can an appropriate and more responsive rural financial development strategy be achieved in order to increase the quality of life of poor people, especially small farmers in rural areas?

## **Structure of the Thesis**

The structure of the thesis is as follows:

In Chapter One the background to the research programme is introduced. In this case, the provision of credit for small farmers in developing countries seems to be important, and therefore needs to be highlighted. Also, the urgency of conducting grassroots study on small farmers' credit in Indonesia in this era of decentralisation is presented. In order to have a clear understanding about the importance of small farmer development in developing countries, the development theory of farmer-centred development is also briefly discussed early in this chapter.

Chapters Two and Three consist of theoretical frameworks which are important for discussion on small farmers' credit at the grassroots level. In Chapter Two, the important role of microfinance for poverty alleviation and empowerment is examined. This chapter is a basis for further discussion on informal finance in Chapter Three, since microfinance actually consists of formal, semi-formal, and informal systems (Ledgerwood, 1999: 97). In order to have a clear understanding of the concept of microfinance, it is important to explore this concept by assessing its evolution from the colonial credit system to microcredit and microfinance systems. Then, to understand the important role of microfinance in poverty alleviation, a discussion on the theory of poverty in the development context, and the financial needs of the poor are presented. The latter is important particularly in designing appropriate financial policy interventions for the poor. The empowerment feature of microfinance is specifically examined in relation to its role in financial and social intermediations. In this regard, the Grameen Bank experience in poverty alleviation and empowerment is discussed along with the role of microfinance programmes in the empowerment of women. At the end of this chapter, the limitations of microfinance programmes, especially in providing services for the rural poor are described.

Chapter Three provides the theory of informal finance in developing countries. The concept of informal finance is explored, including its characteristics, size, and types, as well as its importance and its interactions at local level. In this case the negative old view of informal finance has been changed. Informal finance is defined as "all financial transactions, loans and deposits, occurring outside the regulation of a central monetary or financial market authority – the regulated activities being labelled as formal" (Adams & Fitchett, 1992: 2). There is now growing attention paid to the concept of informal finance, especially regarding its positive role to provide alternative financial services for the poor in developing countries. Exploring the concept of informal finance becomes meaningful and central in this study, especially considering the localised character of this sector, and therefore the fact that it is preferred by poor and marginalised people such as small farmers.

In Chapter Four, a discussion on Indonesia's rural financial development is presented. In this chapter the development of rural financial policy and practice in Indonesia is



explored, starting from colonial era until the liberalisation of financial development and the recent time of commercial micro finance. By tracing its history, we will be able to understand how Indonesia's rural finance system has been shaped and how it impacts upon farmers' credit systems. The existence and role of informal finance are also examined, considering its large market and its importance in providing financial services for the rural poor.

Chapter Five focuses on research methodology and experiences of the researcher in conducting research in the field. In this chapter the philosophy of conducting research on small farmers is presented together with the methods and techniques employed in this study. The elaboration of actual experiences of the researcher in doing research in the field is specifically important because it informs about the unique features of conducting the study, such as how to cope with data collection problems, adapting methodology, and obtaining trust from the participants.

Chapters Six, Seven and Eight are a unit of chapters consisting of analysis of case studies in the three villages of Solok District, namely Dilam, Saniangbaka, and Tikalak. In each chapter discussion on the economic and social conditions of each respective village is provided, including its geographic and demographical and conditions. These are important for discussion of the rural credit systems in each area. The specific characteristics of rural financial systems in each village are also examined in order to have an understanding of how small farmers cope with their credit problems. This is also important to identify the magnitude of informal credit system present in each village.

Chapter Nine provides a discussion on small farmers and rural credit in the Indonesian context. This chapter brings together the discussions on small farmers' credit from the previous three case study chapters. In this case the characteristics of small farmers in the study area based on their socioeconomic conditions are identified, which leads to finding indicators of poverty. Then the credit and savings behaviour of small farmers in the case study villages is discussed, which leads to the findings about the problems they encounter and their preference in rural credit systems, whether formal or informal. This is followed by discussions on the role of local government in rural financial development, as well as on the strength of traditional informal credit schemes at the

village level. At the end of this chapter, arguments about the new dimensions of rural financial development in Indonesia are presented.

Chapter Ten is the conclusion chapter. In this chapter, the findings of this study and lessons learned in order to design future credit programmes for small farmers in Indonesia are summarised. Then, major themes are discussed, which reflect the findings of this study but which are more applicable at the global or international level. These major themes focus on the relationship between credit and poverty, the extent of conventional credit programmes to help the poor, and the potential of traditional informal finance, which is influenced by local cultures and values, in providing credit for the rural poor. Finally, there are recommendations for designing future rural financial strategy for small farmers in developing countries and in Indonesia in particular, which emphasise how formal credit systems can be strengthened by using the strategies of informal credit systems which have been proven - as illustrated in this study – to be successful.

## **CHAPTER TWO**

### **MICROFINANCE, POVERTY ALLEVIATION AND EMPOWERMENT**

#### **Introduction**

The aim in this chapter is to explore the concept of microfinance and its role in poverty alleviation, empowerment, and development. Discussion of poverty and credit systems is crucial in order to understand the issue of microfinance at the grassroots level, especially the way poor people adopt the concept of microfinance – through both formal and informal sectors – based on their needs and aspirations. The concept of microfinance cannot be separated from poverty, because one of the solutions for poverty is providing financial assistance for the poor. In this case there is an empowerment role of microfinance, yet poverty cannot be solved by only financial assistance through credit programmes, as there must be also a range of complementary services (Ledgerwood, 1999: 6).

In exploring the concept of microfinance, it is essential to discuss the evolution of this concept from agricultural credit to rural finance, microcredit and microfinance. Debates about these concepts are still going on, and academics, policy makers and development practitioners are still searching for best practice for delivering credit programmes for the poor (Morduch, 2000: 617).

Thus in this chapter I will elaborate on the evolution of the concept of microfinance, followed by a discussion on the role of microfinance in poverty alleviation, which covers discussions on the definition of poverty in the context of development and the financial needs of the poor. A discussion on the empowerment role of microfinance is presented, focused on the Grameen Bank model of empowerment, and women's empowerment in microfinance. The limitations of microfinance revolution are discussed, which cover the criticism addressed to the microfinance programmes, and the constraints imposed upon formal credit programmes to give services to the rural poor. Finally, a conclusion will be drawn.

## **The Evolution of the Concept of Microfinance**

The concept of development from below has also been applied in some respects to the strategies employed by banking institutions worldwide. International financial institutions such as the World Bank, IMF, ADB, and other donor agencies have been focused in their financial assistance to help the poor, most of whom reside in rural areas. The World Bank, for example, has made efforts to help meet the credit needs of small farmers since 1975. The World Bank encourages governments to develop a system of lending through cooperatives and/or groups of small farmers (World-Bank, 1975: 6). This approach seems to be the most appropriate way for reaching large numbers of poor people in developing countries at low cost. The attempts of banking institutions to help the poor have encouraged policymakers to initiate the concept of microfinance, which is a financial scheme especially designed for lower income people.

### ***The origin of the concept***

The concept of microfinance originates from the concept of rural credit, which is traced back to the seventeenth century when peasants in China used the rural credit market to raise money necessary to invest in production. By using rural credit for petty commodity production, peasant households were helped in generating cash incomes, and in turn to improve their standard of living. It was argued that the traditional rural credit market was crucial for increasing agricultural production (Ming-te, 1994: vii).

In Western countries, the concept of microfinance was initiated with the establishment of *Landschaften* in Germany in 1729 by introducing collective security which in modern times became the cooperative (Belshaw, 1959). This concept has been replicated with modification in other parts of Europe and the United States, in which the Federal Loan System in the United States includes some of the *Landschaften* principle (Belshaw, 1959).

The other two types of credit institutions were introduced after the establishment of *Landschaften*, namely the Raiffeisen Agricultural Bank which specifically focused on the rural sector, and the Schulze-Delitzsch People's Bank, which operated in rural and

urban areas. These banks also used cooperative systems, which are believed to be the most significant credit systems that later influenced the establishment of cooperative institutions world-wide (Agricultural-Credit-Commission, 1913; Belshaw, 1959).

The origin of the concept of credit, according to Belshaw (1959: 43) stems from the necessity for a large amount of capital to provide the equipment, stocks of raw materials and semi-finished goods that must be accumulated in order to ensure the continuity of production. It is important for the manufacturers to have materials on hand before they require them. Whilst the process of capital accumulation involves saving, this can be taught to the users or manufacturers who need them. Hence, modern economic organisations can function effectively through the transfer of capital from those who accumulate and own it, to those who use it in production, or, in short, “credit” is necessary to ensure the functioning of modern economic society.

The modern economic society of developed countries, which is characterised by commercialisation in agriculture, requires a phenomenal increase in the value of investment and operating capital. The increase in investment capital, according to Lee (1930), is due to:

the increase in the price of farm lands, building materials, machinery, and livestock; the improved quality and the increased quantity of machinery, livestock, and improvements which are necessary in the more intensive stage of agricultural development which we are entering (Lee, 1930: 5).

He further argues that the commercialisation of agricultural production has been greatly influenced by the use of credit, particularly operating credit (Lee, 1930: 6).

In the developing countries, the emergence of the concept of credit is based on the necessity to have additional resources for the target group, namely poor or small farmers. Donald (1976: 17) argues that financial credit is the most universal and flexible source of economic resources. Goods and services can be easily transferred through credit, with much greater freedom of choice and more efficiently. The use of credit in developing countries is more to achieve social efficiency rather than economic efficiency, so that credit can fulfil the basic needs of the poor and improve their quality of life.

As the target population for credit programmes in developing countries is mainly the poor, Heidhues and Schreider (1999: 11) argue that the origin of the credit concept comes from the necessity to break the vicious circle of low capital formation of the poor, as presented in Figure 2.1:

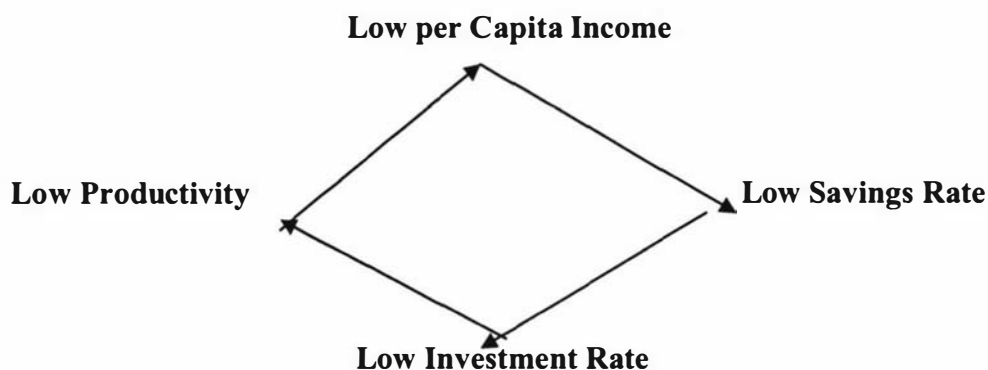


Figure 2.1. The vicious circle of low capital formation.  
Source: Heidhues & Schreider (1999:11)

Figure 2.1 shows that the formation of capital is influenced by per capita income, savings rate, investment rate, and productivity. The low level of each of these factors will impact on the vicious circle of low capital formation. It is argued that the role of credit programmes is to break this cycle; that per capita income could be increased, and this will increase the savings rate, investment rate and productivity (Heidhues & Schreider, 1999: 11). If there is no credit intervention created for this cycle, or whenever the credit programme does not significantly increase income, then the poor will stay in poverty.

### ***The evolution of the credit concept***

The concept of credit for the poor in developing countries has evolved over time. This evolution predominantly was due to dissatisfaction with the earlier concepts, or the inability of the concept to adapt to new policy environments.

## **Colonial credit policies**

The colonial credit policies, which operated from 1900 to 1943, aimed at transplanting credit policies from Western countries to their colonies in the Third World. The characteristics of colonial credit systems were - according to the FAO (1975: 17) - firstly, the dualism of credit markets between organised and unorganised (the former refers to credit transactions for higher-level economies such as export-import companies, while the latter refers to poorly developed credit markets such as shopkeepers in the developed countries), and secondly, the organised credit markets in colonial countries, which are similar to the mother countries, but with limited scale of operations, poor development, and a lack of competitiveness.

The colonial credit market was influenced by the credit policy in the respective coloniser countries. For example, the British credit system was more focused on trade and extractive industries such as copper mining and export-oriented agriculture, especially in Asia and Africa, while the French government tended to establish agricultural banks in the colonial countries such as in many countries in Africa. The US experience in agricultural credit strongly influenced the credit market in Latin America, which focused on establishing agricultural banks for export crops such as coffee, and later shifted into a cooperative farm credit system (Donald, 1976: 6). In this period, the era of 'development' that was launched by President Truman in 1949, and the US Government started to assist the poor in developing countries (Adams, 1995: 110).

## **Agricultural credit policy**

The colonial credit system changed and was replaced by the concept of credit for small farmers in developing countries. The emergence of this new concept was due to consideration of the state of poverty in developing countries, and the necessity to help the poor to increase agricultural production. This initiative was led by the US Agency for International Development (USAID) which instigated support for agricultural credit in developing countries, beginning in 1943. The USAID experience, in supporting small farmers in developing countries through credit programmes was not only a supervisory method but also to provide credit with low interest (Donald, 1976: 97).

Donald (1976) highlights conditions for the success of small farmer credit, that credit alone is not sufficient for the successful programme. He stated that:

there must be a new technology for increasing production, markets that can supply additional inputs and absorb additional output, institutions that are willing to lend to small farmers with attractive terms and conditions, and most importantly, farmers who are willing to borrow, to invest and to repay loans (Donald, 1976: 27).

He also argued that new technology is an essential condition for a successful repayment record. Farmers would intend to repay on time if technologies were available and profitable and could increase incomes. The Indonesian BIMAS Programme, for example, experienced success initially, but as the programme expanded the single technology package became less appropriate, as the credit, fertilisers, and other inputs often were not available in time, and technical assistance efforts no longer reached the farmers, which caused the failure and termination of the programme (Donald, 1976: 40).

The concept of agricultural credit for small farmers in developing countries in the period 1970-1980, and especially its low interest policy, heavily criticised by many authors (Adams, 1980, 1984; Adams, Graham, & von Pischke, 1984; Bourne & Graham, 1984; Gonzalez-Vega, 1982, 1984). It was argued that low and fixed interest rates had caused the impediment of savings and capital formation, which in turn caused the fragmentation of financial markets, inefficient resource allocation, and distortions in income distribution and asset ownership (Adams, 1980: 17). Cheap credit actually reduced the total volume channelled to small farmers because the credit favoured the non-rationed borrowers who were large and influential producers such as large farmers or investors in agricultural production (Donald, 1976; Gonzalez-Vega, 1984; Vogel, 1984a). Subsidised low interest credit also caused the disturbance of formal credit institutions, because they could not operate properly due to limitations of services they had. The government restricted the operations of formal credit institutions, and funding for these institutions was highly dependent on support from government and donor agencies (Adams et al., 1984: 65). Thus despite the large amounts of credit disbursed for small farmers in developing countries, loan default problems persisted because the borrowers tended to use this cheap credit for other purposes.



The criticisms also focused on the establishment of specialised agricultural credit institutions (SACI), in which the credit is directed specifically to farmers to purchase inputs and to pay other costs in farming. Bourne and Graham (1984: 37) argue that SACI suffers from limited outreach because it focuses on farming activities only, and also tends to be unsustainable because it is highly dependent on official funds from the government or donors. These institutions also have high transaction costs of administering a high number of small loans and their emphasis on providing loans for agricultural activities (Seibel, 2000: 2). This has resulted in many problems in agricultural lending such as low repayment performance which leads to high loan default, poor design and the administrative failure of agricultural credit institutions (Adams, 1995: 111).

Considering the negative views about agricultural credit systems in developing countries, the policymakers, academics, and practitioners agreed to shift the credit system in developing countries from agricultural credit to rural finance. It was agreed that the credit system in developing countries should not be focused on specific activities or a specific segment of the community, but cover the wider aspects of activities and population in rural areas (Adams et al., 1984; Bottrall & Howell, 1980).

### **The concept of rural finance**

The concept of rural finance, according to Yaron, Benjamin and Piprek (1997: 32-33), can be divided into the traditional or old approach and the new approach to rural finance. The traditional approach to rural finance, which is essentially the agricultural credit system as has been elaborated above, usually implies a high level of government intervention (Adams, 1984; Howell & Adams, 1980; Yaron et al., 1997). Governments use a 'supply-led' strategy to force the pace of economic development; that is, rapid expansion in the supply of financial services combined with concessionary interest rates (Adams, 1980)

This form of intervention was often based on a serious misconception of the real challenges facing rural communities (Adams, 1980; Yaron et al., 1997). For example, rural communities have been perceived as too poor to save, that they need cheap credit and careful supervision in order to use loans wisely (Adams, 1980). As a result, efforts

have concentrated on providing only credit for farmers, and ignoring rural saving facilities. Also, rural financial institutions are often perceived as government political disbursement windows, with cheap credit, and have often been utilised by well-off or influential farmers, rather than poor farmers. These adverse factors are then heightened by government's urban biased policies, such as "overvalued exchange rates; low, controlled, and seasonally invariant prices for agricultural products; usury laws that rule out the loans typical in rural areas: small, risky, and high cost loans; and excessive taxes on agricultural exports" (Yaron et al., 1997:2).

High-level government intervention in rural finance in developing countries reflects the centralised planning of the rural financial market with more political sense. Adams et al. (1984) have viewed this phenomenon as a political development policy that intrusion into financial markets is irresistible, and any efforts for reforms often blocked by political obstacles. Attacks on cheap credit, for example, are often regarded as criticism of the government's financial development policy.

Many authors then proposed a new perspective on rural financial markets, which are more localised rather than centralised (Yaron et al., 1997), recommending that priority should be given to small farmers (Donald 1976). Development practitioners should view the rural community as an asset to develop their programmes to be effective and efficient (Soetrisno, 1986: 71). Donald (1976) further argues about the important role of social and cultural factors in small farmer credit:

traditional sectors may not offer the same growth opportunities, or they may be inequitable, but they have the clear advantage of being coordinated, on-going systems; of being adapted to local conditions; and of providing reasonably predictable incomes (Donald, 1976: 53).

The new approach, which is gradually becoming mainstream thinking, focuses on the primary goals of rural development: income expansion and poverty reduction. It recognises that this approach should be complemented by other government actions such as increased investment in rural infrastructure and human development, while an active role for government in establishing a favourable policy environment is required (Yaron et al 1997). Yaron et al. (1997: 32) made a comparison between old and new approaches to rural finance, as shown in Table 2.1 below.

Table 2.1. Characteristics of old and new approaches to rural finance

OLD	NEW
<b>Primary goals:</b> <ul style="list-style-type: none"> <li>• Growth and income expansion (frequently pursued by introducing modern technologies with concessional credit)</li> <li>• Poverty reduction</li> </ul>	<ul style="list-style-type: none"> <li>• Growth and income expansion</li> <li>• Poverty reduction</li> </ul>
<b>Working assumptions:</b> <ul style="list-style-type: none"> <li>• Accelerated economic development requires controlled commodity and financial markets (such as control of food prices and interest rates)</li> <li>• Small farmers and rural entrepreneurs cannot pay commercial interest rates</li> <li>• Small farmers and rural entrepreneurs cannot save</li> <li>• Access to concessional credit is essential to growth and poverty reduction</li> </ul>	<ul style="list-style-type: none"> <li>• Accelerated economic development requires enhanced competition in goods and financial markets (through flexible prices, for example)</li> <li>• Small farmers and rural entrepreneurs can pay commercial market rates of interest</li> <li>• Small farmers and rural entrepreneurs can, and want to, save</li> <li>• Access to non-subsidised financial services is essential to growth and poverty reduction</li> </ul>
<ul style="list-style-type: none"> <li>• To directly intervene in and control the agricultural sector and agricultural credit</li> </ul>	<ul style="list-style-type: none"> <li>• To create a favourable policy environment, while minimising direct intervention in, and control, of the agricultural sector and agricultural credit</li> </ul>

Source: Adapted from Yaron et al. (1997: 32)

Table 2.1 clearly depicts that the rural financial development strategy has been shifted from a centralised or top-down approach to a decentralised or bottom-up approach. While the old approach neglects the rural community's capacity, the new approach to rural finance enhances the capacity of rural communities – mainly small farmers and rural entrepreneurs - by assuming that they can pay commercial market interest rates, and can and want to save, under a competitive financial market environment.

This new concept of rural finance agrees with the concepts of microfinance, which follow the bottom-up approach where the targets are poor households and small entrepreneurs. In this case the views and needs of the poor are being heard and brought to the attention of policymakers, regulators and those with the authority to influence the environment in which poor households and informal sector institutions have to operate (Remenyi, 1997: 1).

## **The microfinance revolution**

The beginning of the microfinance revolution, according to Meyer and Nagarajan (1999: 40) was in the early 1970s, when policymakers or academics and practitioners started thinking about an appropriate strategy for developing the rural financial market. This was mostly by granting small loans to the poor or to microenterprises, in order to increase income, to create employment, provide emergency relief after natural disasters and conflicts, and to improve rural health, education and nutrition (Meyer & Nagarajan, 1999: 40). In this case, the experiences of delivering credit for the rural poor by rural banks in Bangladesh and Indonesia have made important contributions to the emergence of the microfinance concept. The Bank Dagang Bali (BDB) of Indonesia is believed to be where microfinance began, since it was the first financial institution to provide microcredit profitably (Robinson, 2002:144).

## **Defining Microfinance**

In defining microfinance, it is important to distinguish between the meaning of microcredit and microfinance, since these terms are often used interchangeably in the literature.

### ***Microcredit or microfinance?***

There is an increasing popularity of the terms of *microcredit* and *microfinance* nowadays. In fact, there are differences between these terms, especially in relation to the concept of rural finance and poverty alleviation (Armendariz de Aghion & Morduch, 2005; Khandker, 1998). It is important to make a clear distinction between these terms, so that the discussion on this topic becomes fruitful and the policy design based on the results of discussion becomes effective.

Many authors have provided varying definitions of microcredit and microfinance. With regard to microcredit, many definitions have been developed which can be divided into two groups. First, the authors who view microcredit as part of microfinance systems, and see that microcredit programmes are still incomplete systems for poverty alleviation and development (Goronja, 2005; Hossain, 1988; Ledgerwood, 1999; Navajas,

Schreiner, Meyer, Gonzalez-Vega, & Rodriguez-Meza, 2002; Robinson, 2001). Microcredit is one element in microfinance systems and is aimed at helping the poor to escape from poverty and to improve their quality of life. In this case, a complete and popular definition is given by The United Nations (2004:2) as “a small amount of money loaned to a client by a bank or other institutions”. Microcredit can be offered, often without collateral, to an individual or through group lending. Microcredit is also viewed as “part of financial intermediation which allocates resources over time and transfers resources from one individual, household, or firm to another”(Berger, 1989:1018). The majority of authors who work for discussion on microfinance have defined microcredit based on this notion.

Second are the writers who view microcredit as an independent system within the broad systems of development. The proponents of this opinion think that microcredit is an important aspect in development as a tool to combat poverty, and thus to increase economic development of a country and region. In this case, microcredit is perceived as a grassroots approach that provides loan for the poor, and offers an alternative to a top-down macro-economic approach (Woller & Woodworth, 2001:265). In this regard, microcredit has two important roles in economic development: raising income and generating self-employment. Ahlin & Jiang (2005:2) stated that the aim of the microcredit programme is “to extend small amounts of capital to poor borrowers throughout the world, most commonly intended for use in income-generating self-employment activities”. Thus, the basic meaning of microcredit is to extend small loans to the poor, so that the poor could increase their incomes and also would be able to create self-employment. These two objectives of microcredit are influential in macroeconomic development, as a stable and high people’s income level and low unemployment rate are the goals of macroeconomic development. Based on this opinion, many authors insist that microcredit is the primary programme that should be developed in a poverty alleviation programme, and should be included in every macroeconomic development policy, whether at national or international levels (Bamfo, 2001; Bhatta, 2001; Snow & Buss, 2001; Woller & Woodworth, 2001, 2001a).

Microfinance, on the other hand, has been viewed as an integrated system of small-scale financial service, which aims at reducing poverty and generating the prosperity of the poor. This system basically consists of savings and credit elements (Ledgerwood, 1999;

Robinson, 2001). However, some microfinance institutions provide other financial services such as insurance, financial advisory services, and other financial services targeted at low-income people (Goronja, 2005; Johnson & Rogaly, 1997; Ledgerwood, 1999; Remenyi, 1997; United-Nations, 2004). Further, Ledgerwood (1999:1) asserts that microfinance institutions provide not only financial intermediation, but also social intermediation, which covers “group formation, self-confident development, and training in financial literacy and management capabilities”. Therefore, microfinance is defined as the combination of financial and social intermediation, and it is not only covers banking activities but is also a development tool (Ledgerwood, 1999: 1). Microfinance goes beyond the business loan, meaning that the poor use financial services not only for business investment, but also for improving their health and education, to manage their household emergencies, and to fulfil a variety of cash needs (Littlefield, Morduch, & Hashemi, 2003: 1).

The concept of microfinance has become increasingly popular around the world nowadays. The concept has been successfully implemented in many parts of the world, and billions of dollars have been quickly pledged by donors and aid agencies to support the expansion of programmes (Morduch, 2000:617). It was reported that in 2002, about 67.6 million microfinance clients, of whom 41.6 million were living below the poverty line, had been served worldwide by over 2500 microfinance institutions (Daley-Harris, 2003: 3). Therefore, many government and non-government organisations, donors and academics, at national and international levels have used microfinance as a tool to achieve the goal of improving the welfare of the world’s poor people, as one of the Millennium Development Goals (MDGs) (Littlefield et al., 2003; United-Nations, 2004).

This explanation suggests that, although there are similarities between microcredit and microfinance in terms of providing small-scale loans to the borrowers, there is nevertheless a distinction between these two terms. This difference relates primarily to the services included in each system, in which the microcredit system has basic services for poverty alleviation (namely financial or credit assistance), while microfinance systems cover broader services in financial systems. There is also an interpretation that microfinance is the advanced or developed concept of microcredit, or microcredit is a narrower concept of microfinance (Khawari, 2004: 3-4). Here, microfinance refers to

microfinancial services that are essentially helping the poor to convert their savings into a lump sum for satisfying a wide range of needs such as personal or business, consumption, and social and asset building (Matin, Hulme, & Rutherford, 2002: 273). Considering its broad definition, and for the purpose of this study, the term 'microfinance' is used more frequently than 'microcredit' in this thesis.

Regarding the institutions in microfinance, Ledgerwood (1999: 97) classifies three types of financial institutions, namely: formal institutions, which are those not only subject to general laws and regulations, but are also subject to specific banking regulations and supervision; semiformal institutions, which are formal because they are subject to general laws and regulations, but are informal because they do not come under banking regulation and supervision; and informal providers, who are under neither general laws nor specific bank regulations. In this case, institutional microfinance includes microfinancial services provided by both formal and semiformal institutions (Khawari, 2004: 4), while the informal providers are excluded because their operations are so informal that any disagreements arising from contact with them cannot be solved by recourse to the legal system (Ledgerwood, 1999: 104).

The broader area of services covered by microfinance programmes, such as saving mobilisations, insurance, financial advisory, and other financial services, is important in relating to its role as a tool for poverty alleviation and empowerment, considering that the meaning of poverty is beyond the concept of limited income. The role of microfinance in poverty alleviation and empowerment based on this concept of poverty is discussed in the next sections.

## **Microfinance and Poverty Alleviation**

The important role of microfinance in poverty alleviation is clear and has been acknowledged by practitioners, academics and policymakers around the globe. Some argue about its important role in increasing income, others have focused on the significant role of microfinance for food security. There is also concern, however, about the role of microfinance outside of poverty alleviation, such as for fulfilling consumption needs, or for survival. Thus, it is necessary to identify the financial needs

of the poor, and then the role of microfinance in poverty alleviation. Nevertheless, first, it is important to review the meaning of poverty in the context of development, especially the Third World context, so that the role of microfinance in poverty alleviation becomes clear.

### ***Definition of poverty in the development context***

Defining poverty is a contested issue since many kinds of definitions have been given by many authors (Greeley, 1994; Holcombe, 1995; Hulme & Mosley, 1996; Pradhan, Suryahadi, Pritchett, & Sumarto, 2000; Sen, 1999). However, although the authors name them differently, discussion about the definition of poverty usually falls into two categories: reductionist and holistic.

The reductionist approach relates to the meaning of poverty “as material needs... which concentrates on the measurement of consumption, and uses income as surrogate” (Hulme & Mosley, 1996:105). This definition therefore correlates with the measurement of poverty based on a poverty line, which assesses poverty based on calorie intake (Pradhan et al., 2000). This reductionist approach, which is in line with the ‘income or asset dimension’ of poverty as stated by Holcombe (1995: 13), is more concrete and easier to measure. This approach has been heavily criticised, especially by Chambers (1981), because of its reductionism and because it ignores a broader approach of poverty alleviation. This income or asset dimension of poverty is also unable to detect the degree of poverty and the distribution of poverty among classes and ethnic groups, or within households (Holcombe, 1995: 13). However, Greeley (1994: 57) maintained that the use of a poverty line as the measurement of poverty can empower the poverty reduction agenda and encourage appropriate resource allocations. This is also supported by the fact that the majority of government and development agencies use this concept in designing poverty and anti-poverty policies (Hulme & Mosley, 1996: 105).

The holistic approach, however, refers to the broad meaning of poverty, which is not only concerned with the lack of consumption and income, but covers other shortages in the life of the poor such as social inferiority, powerlessness, humiliation, isolation, physical weakness and ill-health (Hulme & Mosley, 1996:106). This participation and



empowerment dimension as proposed by Holcombe (1995) seems difficult to measure, but it reflects the wide range of efforts to capture the full impact of poverty. Streeten (1990, cited in Holcombe, 1995:14) suggests making the link between the asset and the empowerment dimensions of poverty if talking about non-material benefits such as good working conditions, the freedom to choose jobs and livelihood, self-determination, the assertion of traditional and religious values, and empowerment or access to power.

A more fundamental definition of poverty within the context of the holistic approach is given by Amartya Sen (1999) who defines poverty as the capability of deprivation. He sees poverty from the capability perspective because capability deprivation has impacted on real poverty. He further suggests linking the two perspectives of poverty: the lowness of income and/or consumption and the capability of inadequacy, because income is an important means to achieve capability (Sen, 1999:91). In the case of poverty alleviation initiatives, which aim to remove income poverty, the connection between these two perspectives should begin by enhancing capability, which could, typically, expand a person's ability to be more productive and thus earn higher income. However, to achieve a more holistic impact of poverty alleviation, a more inclusive strategy should be adopted such as improvement of basic education and health care, which in turn would affect on the increase in income. Sen (1999: 91) warns of the danger of seeing poverty in the narrow terms of income deprivation. Poverty and deprivation are understood in terms of many aspects of life which affect the level of freedom that people actually have.

The holistic approach of defining poverty, which embraces both income and consumption and capability poverty, is important in development. As Korten (1980, cited in Holcombe, 1995:15) stated, poverty is "not only the size of the world's poor, but also the likelihood that the poorest did not benefit from, and may even have suffered loss as a result of, development". In this case the solution of poverty is by inclusion of the poor in any decision, implementation, and benefit of development.

### ***Financial needs of the poor***

Discussion about the definition of poverty, as mentioned above, has turned our attention to identifying the financial needs of the poor. This information is important in order to make effective the credit interventions that are given to the poor.

Demand for financial services from poor households is basically influenced by two economic environments (Matin et al., 2002: 275). First is the condition of the poor with a lack of assets, and operating a mini economy, which causes the need for credit to expand their income and improve their quality of life. Second, poor households are characterised by their high level of insecurity and risk, and their vulnerability to crises and shocks. These factors affecting the poor need short -and long- term credit lines for financing inputs and investment, both for physical and human capital. In this case Matin et al.(2002: 275) argue that financial services to cope with risks and shocks are more important than credit for increasing production, because the covariant nature of risks such as war, flood, cyclone, and fires, and the idiosyncratic emergencies such as injury, the death of the household head, and loss of employment have weakened the capacity of the community-based security network, and the household capacity to support the process of production. Therefore, to recover from such emergency situations, poor households tend to use credit and savings as an insurance substitute (Matin et al., 2002; Manfred Zeller, Schreider, Braun, & Heidhues, 1997).

The financial needs of the poor can be seen based on the poor livelihood. As 'livelihood' refers to the many activities which make up a living (Chambers, 1995: 23), the poor can choose financial assistance based on their livelihood capabilities. It is a fact that the poor have limited choice regarding their livelihood capabilities due to their powerless, exploited, and isolated condition, but they tend to diversify their livelihood whenever they have to struggle for survival in order to maintain their standard of living (Ellis, 1998: 5).

According to Dreze and Sen (1989, cited in Goodland, Onumah, Amadi, & Griffith, 1999: 6-8), the financial needs of the poor can be categorised as livelihood promotion and livelihood protection. The livelihood promotion refers to activities that aim at

improving the standard of living, usually through increasing productivity and income. The types of activity usually include on-farm and off-farm activities. Thus, the type of financial assistance for the poor in this case aims to help them to increase their productivity and income, and is named production credit, in order to take them out of the poverty condition. The livelihood protection of the poor, on the other hand, concerns the activities that aim at maintaining living standards at a certain level, and protecting livelihoods against unexpected crises or shocks. The financial needs of the poor in this case include consumption credit, saving scheme, and insurance system.

### **Consumption credit**

With regard to the consumption credit, Goodland et al. (1999: 8) argue that because of the vulnerability of the poor, they experience periods of shortfall in their consumption. The poor in developing countries, especially in rural areas, are typically highly dependent on renewable natural resources directly or indirectly, and these resources are greatly influenced by external factors, which in turn affect the fluctuation in flow of income. The shortfall in consumption usually occurs seasonally (such as before harvesting), long term (due to, for instance, environmental degradation and soil erosion), and the unforeseen or sudden (such as drought, flood, economic crisis, and so on) (Goodland et al., 1999: 8). During these situations, consumption credit is needed to recover from the shortfall, and to survive and maintain their living. Thus, credit for consumption is temporary in nature, and cannot be used for increasing income and improving quality of life.

Another opinion about credit for consumption is related to the role of credit for food security (Manfred Zeller et al., 1997). In this case consumption is differentiated into various types of uses such as food, spending on health care, social obligations, and leisure. When crises in food and other non-food items occur, the demands on credit increase - in this case the consumption credit - at the expense of future consumption. Thus, credit for consumption is temporary, and should be prioritised, because this kind of credit is used for maintaining and enhancing human capital, which in turn is important for the continuation of the production process. In this regard, consumption credit and production credit complement each other, both for maintaining food security, and for sustaining productivity (Manfred Zeller et al., 1997: 20).

## Savings scheme

Regarding the need for a savings scheme for the poor, many authors have contributed their opinions about the important role of savings mobilisation in microfinance (Goodland et al., 1999; Robinson, 2001; Vogel, 1984b; Manfred Zeller et al., 1997). Robert Vogel (1984b: 249-253) argues about the importance of savings mobilisation in rural finance, and states that this is the forgotten half of rural finance. He asserts that there are four arguments why savings mobilisation is important. First, savings mobilisation can redistribute income, so that more equitable income distribution would be achieved. Policies that promote savings opportunities can help to redistribute income toward the rural poor better than can projects based on low-interest lending. Second, savings mobilisation can improve resource allocation, because by enhancing savings, resources will be protected from unproductive investments, especially inflation hedges, as this opportunity is provided to make deposits earn a positive real rate of interest. These resources can then be lent by financial intermediaries for other activities to help the poor. Third, savings mobilisation has a positive effect on financial institutions because it makes the institutions more viable, and likely to have a continual flow of resources available for lending. Fourth, savings mobilisation provides appropriate incentives and discipline, not only for the rural financial market and financial institutions, but also for the government and international donors. The volume of resources obtained from effective savings mobilisation is far greater than amounts of subsidised loans and grants from government and international donors.

The saving behaviour of the poor usually relates to the condition of lack of assets, and their necessity to substitute future expenses. Rural poor people usually prefer to accumulate savings rather than invest in productive activities, because the poor tend to hold liquid deposits so that they could use them when prompted by risks and shocks in their daily activities (Goodland et al., 1999: 10). The poor also use savings for consumption and income smoothing. This is especially applicable to poor farmers in rural areas who usually save part of their harvest after harvesting, in order to smooth their consumption at the time of deficit (Robinson, 2001: 225). The saving behaviour of rural people in the Minangkabau tribe of West Sumatra, who save their harvests in small huts in front of their houses (named *Rangkiang*), is one example of this phenomenon, and has been practised for a long time (Sanday, 2002).

Based on a food security point of view, Zeller et al. (1997: 52) argue that savings are related to human capital formation such as investment in education, and improvement of the nutritional and health status of family members. This has impacted on the increase of number of family labourers and therefore increases the household income. Savings are also important for an insurance substitute, known as precautionary savings. This topic will be elaborated further in the next section.

The credit and saving behaviour of poor people is especially seen in informal finance in the form of mutual finance. In ROSCA, for example, the member puts the money in the lottery and waits for his or her turn, which is a kind of savings activity. Then the members give an opportunity to a member to take his/her turn in the lottery, which is a credit kind of activity. Detailed discussion on informal finance and ROSCA will be presented in the next chapter.

### **Insurance systems**

The high risk and vulnerable characteristics of poor household income require insurance and an insurance substitute. Churchill (2002) argues that poor households should be given multiple financial services in order to be able to manage risks. These risk-managing services include: first, voluntary savings which enhance customer retention; second, varied loan products which can increase an MFI's market and diversify its credit risk, and third, the provision of insurance, which has a potential to improve profitability by reducing loan losses and replacing the need to draw down savings for emergencies (Churchill, 2002: 383).

The provision of an insurance system for poor households in a formal financial system, however, is difficult to sustain. This is because of the fact that administrative costs are high, and the governments is unable – for political reasons - to charge fair premiums and enforce impartial loss adjustments on the poor. Therefore, the government's insurance scheme is represented in the form of a subsidy with limited value to the poor (Goodland et al., 1999: 9). In this case, a formal insurance scheme is thus very rarely available for the poor.

Nevertheless, to protect themselves from risks, poor households employ a number of activities as insurance substitutes, which usually occur in informal finance (Goodland et al., 1999; Matin et al., 2002; Manfred Zeller et al., 1997). These strategies include: first, savings in the form of money or assets which can be accessed at times of need. Second, investment in social capital in the form of a reciprocal self-help credit system and developing ties with peers and relatives to increase access to potential assistance at times of need. This is an important means to stabilise consumption need in the event of shock (Manfred Zeller et al., 1997: 21). Third, risk-reducing behaviour of the poor, which relates to the tendency of the poor to diversify their livelihood at the time of emergency (Goodland et al., 1999: 9). Therefore, although there is difficulty in accessing an insurance system for the poor in the formal sector, they have their own way to insure their living through informal finance. In this respect, the informal sector is more adapted and favoured by the poor in their daily life rather than the formal sector.

### ***Role of microfinance in poverty alleviation***

By identifying the definitions of poverty and the financial needs of the poor, as mentioned above, discussions on the role of microfinance in poverty alleviation becomes clear. The dual approach to define poverty: reductionist and holistic, has led to the divergence of the role of microfinance in poverty alleviation. With regard to the former, which refers to income/consumption poverty, the role of microfinance in poverty alleviation is to increase income and then to provide self-employment. This role is the primary process by which financial services are viewed as reducing poverty (Hulme & Mosley, 1996: 108). Also, if a particular level of income per capita is based on the poverty line, poverty reduction can be measured by counting poor people who can pass the line. However it is sometimes difficult to identify the precise level of income of the poor, because of its fluctuation during any given year. Poverty in this case can be understood by vulnerability to downward fluctuations in income, and this can be relatively predictable (Johnson & Rogaly, 1997: 10).

The latter is associated with the role of microfinance in increasing the quality of life of the poor, which affects not merely the economic aspect, but also the social and cultural

aspects of the lives of the poor. In this regard, Johnson and Rogaly (1997: 10) argue that poverty is seen as powerlessness which correlates with economic inequality either within or between households, and stems from the concentration of political and social power. Inequality can increase whenever better-off people can increase income more quickly than others, the better-off can be more powerful than the worse-off, namely the poorer. If poverty is defined as the level of powerlessness, the microfinance interventions should be focused on the social relations and specific circumstances such as gender and age (within the household) and caste, ethnicity, and wealth (within the community)(Johnson & Rogaly, 1997: 11).

The role of microfinance in poverty reduction especially relates to the fact that the poor are excluded from accessing credit from conventional banking institutions because of, among other reasons, their inability to provide physical collateral or to pay high interest. Thus the microloans that are offered by the microfinance institutions are usually without physical collateral, and attract low interest. In this case the noble role of the microfinance movement is to “exploit new contractual structures and organisational forms to reduce risks and high costs for small, un-collateralised and cheap loans” (Khawari, 2004:1).

However, many authors are still doubtful regarding the role of microfinance in poverty reduction. Hulme and Mosley (1996: 16) assert that, based on their study of 13 MFIs in seven countries, microfinance programmes have positive impact for people above the poverty line, who are willing to take a bigger loan for working capital and investment, while the very poor would take only the small and subsistence protecting loans. This suggests that microfinance may not be effective in reducing poverty among the very poor.

There is also a view that microfinance is likely to be more effective in some circumstances than in others. According to McGuire and Conroy (2000: 9), the impact of microfinance programmes on poverty reduction will be significant if there are opportunities for income-generating activities, such as a market for marketing goods and services that are produced by the microenterprise. It is likely that countries or areas with a high population density would be successful in implementing a microfinance programme and *vice versa* (McGuire & Conroy, 2000:9). Thus, this explanation reflects

that the microfinance revolution has contributed to the progress of reducing poverty in many parts of the world, but microfinance is not a panacea for poverty (Khawari, 2004; Remenyi, 1997). Millions of people in the world, especially in Africa and South Asia, are still living in very poor conditions. This means there is still a huge challenge to achieve the goal of the microfinance revolution, which was launched through the Microcredit Summit in 1997.

With regard to the effectiveness of microfinance programmes in alleviating poverty, it is also related to the condition of the target population. Debate about this issue is still ongoing among the microfinance experts. Robinson (2001:21) argues that the microfinance programme is effective only if the target population are people whose income level is categorised as lower-middle income and they are economically active poor. These people usually have some form of employment and are not severely food-deficit or destitute. They have marketable skills to be used to earn income, are in good health, and thus could become creditworthy borrowers and potential savers in commercial institutions (Robinson, 2001:18-19). On the other hand the very poor or the extremely poor that are living below the poverty line are not eligible to receive a microfinance programme, because they lack skills and investment capital and assets for increasing income, meaning that they are not creditworthy. The most appropriate financial intervention for these people, according to Robinson (2001: 21) is a poverty reduction programme in the form of a grant or subsidy credit programme.

The opponents of this opinion, however, assert that the microfinance programmes should reach the very poor (Cohen, 2002; Dunn, 2002; Woller, 2002a; Wright, 2000). They argue that the exclusion of the very poor from microfinance programmes contradicts the image of microfinance as a tool of poverty alleviation. Therefore, it is proposed that microfinance should be customer-centred rather than product-centred, and should put the customers as the centre of decision-making. Thus, in this case, it is possible to offer a set of financial services to the very poor that meet their livelihood needs (Matin et al., 2002: 29).

This view of customer-centred microfinance has led to a discussion on the importance of the market-orientated microfinance system. The market-led microfinance system relates to how the products become attractive to the customers (Woller, 2002a: 307).



Thus, in this case, it is important to know the customers well, their preference for - and attitude to - microfinance, and their financial capacity, rather than to focus on the products. Dunn (2002: 326) asserts that to achieve the sustainability of microfinance institutions, it is not enough to know only the products and how to use the products efficiently. It is a must to have information about customers which basically includes three aspects: who are the customers?; how do customers use products?; and how do the products affect the clients? By knowing detailed information about the customers, the MFIs can respond appropriately to what the customer needs. Hence the MFIs can manage risks, they can develop financial innovations and can create new value for their clients (Dunn, 2002: 334)

Regarding the importance of customer-centred microfinance, Richard Meyer (2002: 366) suggests that there is an urgent need to create a more flexible microfinance product, because based on the experiences of many MFIs in Bangladesh, it is concluded that the standardised products of microfinance may not be satisfying customer needs very well. Typical poor customers' characteristics are: insufficient resources, ill health or vulnerability to crisis, being a female head of the household, and lack of education (Evans et al 1999 cited from Meyer, 2002: 354). This has caused the reluctance of the poor toward MFIs, which is reflected by the large number of dropouts, loan delinquencies, multiple membership, and preference to use informal finance (Meyer, 2002: 353-357).

Discussion on the role of microfinance in poverty alleviation, especially relating to customer-centred microfinance as stated above, has brought our attention to the empowerment role of microfinance. This topic is discussed in the next section.

## **Microfinance and Empowerment**

The concept of empowerment emerged to extend the theory of participation in development. While participation might be quite passive in practice and under the control of authority or powerful parties, empowerment implies an active involvement of people, by giving them the ability to devise their own development strategies. Narayan

(2002) adopted an institutional definition of empowerment in the context of poverty reduction:

Empowerment is the expansion of assets and capabilities of poor people to participate in, negotiate with, influence, control, and hold accountable institutions that affect their lives (Narayan, 2002: 14).

In this case assets refers to “material assets, both physical and financial”, while capabilities are “inherent in people and enable them to use their assets in different ways to increase their well-being” (Narayan, 2002: 14). Assets and capabilities can be individual and collective, and the capacity of the poor people to organise and mobilise to solve problems are important collective. Social capital, such as norms and networks are important factors for collective actions, and could help the poor to access resources and economic opportunities.

The concepts of participation and empowerment in microfinance are very relevant. In this case, assets and capabilities of the poor are strengthened to help them to identify their needs in order to overcome problems of limited resources (Narayan, 2002: 15). Thus, the provision of credit for the poor as beneficiaries should be based on their demand, as the beneficiaries should also be well informed about the products before these are delivered to them. In rural finance, the concept of empowerment relates with the ability to put customers at the centre of decision-making. The customer-centred nature of microfinance attempts to empower customers (i.e. the poor or small farmers), by designing rural finance products based on customers’ needs and preferences (Cohen, 2002: 335). A study in Bangladesh on ‘The Demand for Flexible Microfinance Products’, reported that people were no longer interested in a microfinance industry characterised by a high level of dropouts, delinquencies, and multiple membership due to inflexible and product-centred microfinance (Meyer, 2002: 352-356).

The concept of empowerment is also the process of social and political movement. Friedmann (1992: 30-31) argues that the recent successful economic growth has caused the exclusion of the poor or disadvantaged people from economic and political power, a process he named systematic disempowerment. Empowerment in this case is a process to break the barriers of the status quo of political power, and provide the poor with ability and skill that make them powerful.

As has been discussed earlier in this chapter, the definition of microfinance relates not only to delivering financial assistance to the poor, but also to the wide range of services that can be offered. This includes savings mobilisation, insurance, and other financial services which impact not only on the economic condition of the poor but also on their social, cultural, and political conditions. This phenomenon reflects that microfinance has a significant empowerment role. The empirical evidence can be seen from the success of many MFIs in the world in bringing out the poor from poverty, and enabling some of them to become small entrepreneurs within households or in the community. As the Grameen Bank of Bangladesh is viewed as one of the most successful microfinance institutions, in this section I would like to elaborate on the success story of the Grameen bank in poverty alleviation and empowerment. Then, women's empowerment in microfinance will be discussed, considering that the majority of microfinance's customers are women and women are represented among the poorest of the poor (Armendariz de Aghion & Morduch, 2005; Mayoux, 1999, 2001).

### ***The Grameen Bank model of poverty alleviation and empowerment***

The Grameen Bank in Bangladesh is one of the microcredit programmes which is considered successful in delivering credit for the poor in developing countries (Bornstein, 1996; Holcombe, 1995; Hossain, 1988; Jain, 1996; Meyer, 2002; Morduch, 1999). From the beginning, the vision of this bank has been focused on helping the poor to be able to get out from poverty. The Grameen Bank's commitment to poverty alleviation is reflected in its specific vision to achieve the dual purpose of poverty alleviation: increasing income/assets and empowerment and participation (Holcombe, 1995:59). To implement this vision, the Grameen Bank committed to targeting clients who are the landless and rural poor, men and women. Despite the remarkable growth and expansion of the Grameen Bank to date, the basic objectives of the Bank remain the same, as stated in a document prepared in 1988:

1. to extend banking facilities to poor men and women;
2. to eliminate exploitation by moneylenders;
3. to create small enterprise opportunities for unemployed and underemployed;

4. to bring disadvantaged people within the fold of some organisational format which they can understand and operate and can find some socio-political and economic strength through mutual support;
5. to reverse the age-old vicious circle of 'low income, low savings, low investment, low income' into an expanding system of 'low income, credit, investment, more income, more credit, more investment, more credit (Holcombe, 1995:61).

Based on these objectives it is clear that the Grameen Bank is not only concerned to transfer the customers from low incomes to higher incomes, but also to design and provide facilities that could enable the borrowers to control the resources and thus make them powerful. The objectives numbered 1, 3 and 4 clearly respond to this principle of empowerment.

The Grameen Bank model of poverty alleviation and empowerment was formerly best known as an operating model of targeted and small-scale rural credit, which will allow the poor to increase their income. Based on this view, poverty alleviation is measured mainly in terms of income changes. However, the Grameen Bank model has an integrated package of interventions that may include training, extension, physical inputs, and credit as well.

Basically, the Grameen Bank model for poverty alleviation is characterised by four elements: group-based collateral, reliance on existing skills, village based, and development of group solidarity, leadership, and social programmes (Holcombe, 1995: 39). The Grameen Bank ensures a low default rate by organising the borrowers into groups of five, in which each member is responsible for the repayment of other group members, and arranging repayment weekly rather than monthly (Jain, 1996: 79). The reliance on existing skills means that the assumption is that the poor have the skills, but they require viable productive activities. Thus sooner or later the borrowers can be empowered to manage their own enterprise either at household or community levels. The village-based element reflects that the Grameen Bank activities are focused on the poor at the grassroots level, which ensures the bottom-up or participatory approach of the Grameen Bank's management. This also ensures the empowerment of grassroots institutions such as borrowers' groups and the centre (a merger of groups). Finally, the development of group solidarity, leadership and social programmes has built awareness and consciousness among the poor towards leadership and has developed social capital

among them. The weekly meeting at the centre is the time for group members to pay weekly repayments, to a deposit or to a savings account, and to discuss new loan requests or other matters of interest to the members (Holcombe, 1995: 40).

The Grameen Bank's approach to poverty alleviation is different from those of other credit institutions. It is believed that credit intervention is not enough for alleviating poverty. Social development inputs are required to help the poor become more productive. In this regard, the most immediate need of the poor is credit to create self-employment opportunities. Unlike the other NGOs or credit institutions which provide skill training and production inputs before distributing the credit, the Grameen Bank distributes credit before providing these inputs. Thus the credit can be used to create productive activity to increase their income (Khandker, Khalily, & Khan, 1995: 15).

The social development programme of the poor, which is also one of the distinctive features of the Grameen Bank, is outlined in the "sixteen decisions", in order to promote social and financial discipline among the rural poor (Holcombe, 1995; Khandker et al., 1995). The "sixteen decisions" reflect that the Grameen Bank is not only concerned with increasing the economic condition of the poor borrowers, but is also focused on improving the social conditions of the borrowers, which cover health, nutrition and child care, education, sanitation, and the environment. The improvement of social conditions of the borrowers means that they have a favourable environment for carrying out productive activities, and therefore can improve their income and quality of life.

The empowerment feature of the Grameen Bank, according to Holcombe (1995: 64), is centred on a view that credit is a pivotal tool for relieving inequalities which create and maintain poverty. In this regard, the group formation – which is the distinct feature of the Grameen Bank – is central to the effectiveness of the credit tool. Group formation is a common mechanism to encourage participation. This reflects the capacity of the group members to build group solidarity, to encourage on time regular repayment and peer monitoring within the group. Group solidarity enables the borrowers to demand extension service, health service, and even a voice in local decision making. Furthermore, the discipline to meet weekly repayments has built a new habit for the poor borrowers, in which they could create their income flows, and change their lives. The discipline of regular weekly repayment also confirms that the poor can repay, and

also have potential for producing. Thus, discipline is a fundamental element of empowerment, and access to credit is meant to provide benefits which extend beyond enabling small business to operate (Holcombe, 1995: 64) . Thus access to credit in the Grameen Bank is a social power.

In the Grameen Bank, credit is empowering not only the poor, but also the Grameen Bank's institutions, through two strategies (Holcombe, 1995: 65). First, delivering commercially viable credit programmes for the poor means that, over time, the Grameen Bank reduces its dependency on donors' assistance. Credit and savings activities could become cost covering and generating capital, and therefore, outside assistance becomes less important. Second, the continued efforts of the Bank's management to be self-sustained has fostered an attitude of independence and an ability to counter interference from outside donors. Despite many criticisms addressed to the Grameen Bank regarding the ability to be sustained without donors' subsidy (Armendariz de Aghion & Morduch, 2005; Jain & Moore, 2003), the senior managers of the Grameen Bank are still looking forward to the time when the Bank's banking operations will need no more funding from donors (Holcombe, 1995: 66).

Another distinguishing feature of the Grameen Bank model of poverty alleviation and empowerment is the fact that it is deliberately targeting women (Holcombe, 1995; Jain, 1996; Khandker et al., 1995). Historically, women are neglected by development projects, and are removed from the growth and development process. In Bangladesh in particular, women are prevented from accessing credit due to the patriarchal family system where women are subordinate to their husbands (Hasyemi, Schuler, & Riley, 1996: 636). Discussion on women's empowerment by microfinance programmes will be presented in the next section.

### ***Women's empowerment in microfinance***

Although it is not always clearly stated, the microfinance movement has been primarily targeted at women (Armendariz de Aghion & Morduch, 2005: 179; Khawari, 2004: 6). Despite the fact that not all microfinance institutions focus specifically on women, many data and much information support this argument. The Microcredit Summit

Campaign Report for the year 2000 reported that 75% of the microfinance clients were women (Microcredit-Summit-Campaign, 2000: 1). The Grameen Bank of Bangladesh serves over two million borrowers, 95% of whom are women with repayment rates as high as 99% (Hashemi & Morshed 1997, cited in Khawari, 2004: 6). Also, in Africa and Latin America, the statistics show that the greater percentage of the MFIs are women (Khawari, 2004: 6).

With regard to the empowerment role of microfinance programmes toward women, Mayoux (2001:246) argues that there are three underlying paradigms that can be understood from the current views of women's empowerment in microfinance. First is the financial self-sustainability paradigm. This economic empowerment stems from the consideration arising from the high female repayment rate in microcredit programmes. This is evidenced by the Grameen Bank, which shows that only 1.4% of women were struggling and 3.7% were irregular in repaying the loans, while 3.7% of the male borrowers were struggling, and 9.7% were irregular with repayments in 1994 (Khandker et al., 1995: 76). Similarly, the field experience of Grameen Bank's replications in southern Mexico shows that women are better about repaying loans than are men (Armendariz de Aghion & Morduch, 2005: 183). This financial self-sustainability paradigm in microfinance means that if women's access to microfinance programmes is increased, it will enable them to increase incomes through microenterprise, and thus would increase their control over income and resources.

The second paradigm is the poverty alleviation paradigm. This paradigm is inspired by the view of the integrated meaning of poverty as has been mentioned above. The reason for targeting women is the higher level of female poverty than male, and the household responsibility. Women are over-represented among the poorest of the poor, and are too often oppressed by their husbands (Armendariz de Aghion & Morduch, 2005: 183). Women also tend to spend more of their increased income on their households, children's education and family welfare. Hence, improving women's income means improving the welfare of their families (UNCDF, 2002: 1). Thus the focus is not only for increasing the income of female borrowers, but also for improving well-being and to enable women to initiate the broader social and political changes they desire. Further, increasing women's access to microfinance programmes is seen as increasing their status in the household and community, giving them greater confidence, and freedom in

household decision making. Thus, the main focus is on the integrated approach to alleviation of poverty and to vulnerability, as well as increasing the well-being of the poorest households. This means that the empowerment role of microfinance is to increase welfare, community development, and self-sufficiency (Mayoux, 2001: 247).

The third paradigm is feminist empowerment, which is inspired by the international women's movement regarding the gender impact of microfinance. In this case, women are seen as the objects of mistreatment towards gender equity and human rights and the focus of policy intervention is towards the economic, social and political empowerment of women (Mayoux, 2001: 247). The gender inequality views come from such areas as the job market, in which poor women tend to work longer hours for less pay. Women are lagging behind in many key indicators of economic development, and many obstacles hamper their accessing of social, legal and economic development (World-Bank, 1990). In this regard, women's empowerment is seen as more than economic empowerment, improvement of well-being and addressing gender inequality. It is more about a process of change in achieving individual internal capacity and mobilising efforts to change gender subordination by both women and men. Thus, in this case, microfinance is seen as an entry point into this process (Armendariz de Aghion & Morduch, 2005; Mayoux, 2001).

However, criticisms are also addressed to the success of microfinance in empowering women. Hulme and Mosley (1996: 128) argue that there is a naivety of belief that every credit given to a woman contributes to the strengthening of the economic and social position of women. In many cases, loans that are initially targeted to women are either fully or significantly controlled by men. For example, research conducted by Goetz and Gupta (1996: 47) in Bangladesh revealed that only 37% of the loans provided by four credit institutions (Grameen Bank, BRAC, PROSHIKA, and BRDB) are controlled by women, a further 24% are partially controlled by women, while the rest are fully controlled by men. Men, in this case, are responsible for - or have control over - the productive process, while women are responsible for providing labour inputs. (Goetz & Gupta, 1996: 47). These findings have led to a conclusion that credit programmes have relatively little effect on women's empowerment.



Hulme and Mosley (1996: 129) further argue that the female participation rate in any credit programmes cannot be assumed as an indicator of women's empowerment. This is evidenced by the study conducted by Schuler and Hasyemi (1994 cited in Hulme & Mosley, 1996: 129) regarding measuring women's empowerment through the use of contraceptives. It reveals that although the empowerment score is high, contraceptive use by women is not significant. Therefore, it is suggested that thorough research should be done regarding the usage of loans before deciding whether or not a credit programme has significantly empowered women.

## **The Limitations of the Microfinance Revolution**

Despite the rapid growth of the microfinance industry, it suffers from many limitations, especially in providing services for the poor in rural areas. There are many criticisms addressed to the microfinance programmes either at policy or at implementation levels.

### ***Criticisms of the microfinance revolution***

The majority of criticisms of the microfinance revolution are at the implementation level. The first criticisms is related to the outreach of microfinance programmes (McGuire & Conroy, 2000; Woller, 2002a). It was reported that worldwide, only 2% of Microfinance Institutions (MFIs) reach microentrepreneurs (CGAP, 1998). The BancoSol in Bolivia, and the BRI *Unit Desa* system in Indonesia, which are financially self-sufficient, lend predominantly to non-poor households, and estimated that only 29% and 7% of the borrowers were below the poverty line respectively (McGuire & Conroy, 2000: 10). Furthermore many programmes offer only limited products and do not meet all the financial service needs of the clients. The microfinance programmes viewed have not reached the clients down at the poverty end of the spectrum; rather they just clustered around and/or a bit above the poverty line (Woller, 2002a). For these reasons, many commentators are doubtful about the ability of microfinance programmes, as declared in the Microcredit Summit in 1997, to reach 100 million poorest families within nine years of operation, and in which, to date, the expectation is still far from the achievement (McGuire & Conroy, 2000:7).

Another criticism of the microfinance system is related to the model, which is believed by the government and non-governmental organisations, donors, and academics to be 'best practices' (Bhatt & Tang, 2001; Morduch, 2000). The criticism is centred on the mismatch between the rhetorical expectation of 'best practices' by the financially-minded donors and action by socially-minded programmes (Morduch, 2000:618). This means that the microfinance model viewed as 'best practices' by donors or governments has not been fully implemented at the field level. For example, the 'best practices' claim that financially sustainable microfinance programmes have greater scale than subsidised programmes, so that it could have greater impact on poverty alleviation. However, in reality, subsidised programmes which are usually targeted to destitute and poorer clients are successful in reaching millions of borrowers in Bangladesh, such as the Grameen Bank and Bangladesh Rural Advancement Committee (BRAC) (Morduch, 2000: 623). In terms of scale and outreach, subsidised credit programmes cater widely to the poverty spectrum, in which the clients tend to be poorer than those in sustainable programmes. Regarding the impacts, raising the poorer borrower's income by one dollar has 1.8 times greater impact than doing the same for the less poor borrower (Morduch, 2000: 622). Thus, the 'best practices' of microfinance programmes which promotes un-subsidised and a commercial approach of microfinance programmes are still inadequate.

There is another criticism which relates to the effectiveness of microfinance programmes, which in rhetoric aims to create an equitable and sustainable development. But in practice, in some cases, microfinance is unfair toward the poor, especially poor women. In Bangladesh for example, where women are subordinated men, men usually take the women's loans and use them for fulfilling their secondary needs (Rahman, 1999: 71). In this case, there is also a misuse of credit, in which instead of using credit for increasing income and for poverty alleviation, it was used for secondary needs, which more relates to cultural and political rather than economical.

***The constraints on formal microfinance programmes which serve the poor in rural areas.***

As has been mentioned earlier, financial institutions can be divided into three: formal, semiformal and informal, and microfinance institutions refer to both formal and semiformal. These institutions go beyond the NGOs and include commercial banks, state-owned development banks, financial cooperatives and a variety of other licensed and unlicensed non-bank institutions (Christen, Lyman, & Rosenberg, 2003: 6), and usually have a specific programme in microfinance such as KUPEDES of the BRI *Unit Desa* in Indonesia.

The constraints encountered by the rural poor when attempting to access formal microfinance services centred on imperfect information from both the lenders and the borrowers. On the part of the lenders, the lack of information can cause difficulties in defining the creditworthiness of the borrowers, and to collect this information is costly (Manfred Zeller et al., 1997: 3). The characteristic of the rural financial market having scattered clients (Manfred Zeller & Sharma, 1998: 15) has made the collection of information about the borrowers more difficult. On the part of borrowers, the lack of information about the lenders, aggravated by the poor borrowers' low education level and illiteracy, can cause the loss of time and money. This is because the lenders insist on taking long bureaucratic procedures, resulting in decision-making delays likely to render a loan request obsolete, especially for time-sensitive activities such as rain-fed agriculture (Goodland et al., 1999: 14).

The commercial characteristic of formal microfinance institutions, which have business orientation and prefer credit for productive activities (Robinson, 2001: 46), has limited their operations in rural areas. The characteristics of the rural poor, whose incomes are highly controlled by risks, cause the loans to be used for any purpose. A study in eight countries revealed that the rural poor use loans more for consumption activities than for production or investment activities (Manfred Zeller & Sharma, 1998: 11). The logic for prioritising consumption activities is because they need food and nutrition in order to be strong and healthy to work productively. Hence, in this case, provision of consumption credit for the rural poor should be seen as productive loans because the loans are used to

strengthen the ability of household members to earn income. Nevertheless, many formal microfinance institutions, or bankers in particular, frequently argue against consumption loans on the grounds that loans should be used to finance activities to generate income for repaying loans.

The commercial and business orientation of formal microfinance institutions also constrains the rural poor in their attempts to access credit. This especially applies to rural borrowers, who mostly engage in agricultural activities. Farming activities have many limitations and high risks, such as the fact that the harvests are highly dependent on the weather or climatic conditions, and covariant risks such as pest outbreak, floods or drought can come any time (FAO & GTZ, 1998: 34). Thus, in short, there is irregularity of farmers' income. This irregularity is not matched with the aim of commercial lenders who require on-time repayment.

## **Conclusion**

In this chapter it is argued that the concept of microfinance is shaped from theories of credit formulated during the colonial era, which have evolved since to the concept of agricultural credit, and rural finance. The concept of agricultural credit, which focuses on helping small farmers in developing countries to raise their agricultural production, was a strategic policy after World War II, considering that the level of famine and poverty was so high. The constraints, however, came from the implementation level, when each country tried to adopt the policy with limited management and human resources. The idea of rural finance, which replaces the agricultural credit system, is considered more appropriate to cover a wide section of the rural community.

Many policies and various development models and philosophies that have been employed from the colonial era until recently have led to the emergence of the concept of microfinance. However, the concept of microfinance, which stems from the idea of providing microfinancial services for the poor, is still a contested issue nowadays, as there is hardly any agreement on a universally accepted definition of microfinance (Khawari, 2004: 3). Nevertheless, although many authors in microfinance are still searching for the best practice of delivering microfinance programmes, the holistic notion of microfinance seems more appropriate to tackle the problems of poverty and

powerlessness. This is, in fact, matched with the theory of poverty based on a development context, in which poverty is seen as the capability of deprivation (Sen, 1999), and embraces the concept of poverty based on the lowness of income, and the capability of inadequacy. In other words, poverty means not only the shortage of income or consumption, but also the condition of incapability socially and culturally.

By adopting the above-mentioned concept of microfinance, its role in empowerment of the poor becomes clear. As illustrated by the practice of credit delivery of the Grameen Bank in Bangladesh, the poor benefit not only from the increase in their income, but also from the increase in their capacity to control resources, and receive improvement in their freedom both socially and politically. This especially happens to poor women, where microfinance programmes have significantly empowered the poor women around the world.

The formal approach of the microfinance system has been successful in delivering credit for the rural poor as exemplified by the Grameen Bank in Bangladesh and other microfinance institutions around the world. These programmes are carried out either by government's agencies or NGOs. The operations of these programmes are regulated and controlled, and the process of lending and repayments is based on standardised banking systems. Some of them still need subsidies from donors to sustain their operations, and most of them have links with wider financial markets. Also, some of microfinance programmes have adopted a participatory approach in formation and implementation.

The above explanations suggest that there is significant attention paid to the formal financial system in microfinance. Governments, donor agencies and NGOs are sharing their ideas as well as funding to develop more effective formal credit systems. However, there is still a gap in the literature especially regarding the informal financial system. The microfinance movement often still overlooks the needs and credit behaviour of the rural poor who prefer to use informal finance, while knowledge about informal and customary credit systems at the grassroots level is still lacking. There is even less research about link between formal and informal credit at the local level.

The common view regarding informal financial system is negative, meaning that these systems are exploitative, illegal, insignificant and unorganised. It is now important to

have a closer look at this system, considering that the majority of rural poor in many areas use this system to fulfil their credit needs. It is to this issue of informal finance that we now turn to in the next chapter.

## **CHAPTER THREE**

### **INFORMAL FINANCE IN DEVELOPING COUNTRIES**

#### **Introduction**

In Chapter 2, the important role of the formal financial sector through microfinance programmes has been discussed, especially in poverty alleviation and empowerment of poor people. Also, many microfinance programmes such as the Grameen Bank in Bangladesh have applied the participatory approach in delivering credit for the poor. However, there are many aspects that the microfinance programmes still overlooked, and these are available in the informal financial sector.

The microfinance programmes are characterised by being highly controlled and legalised by official authorities, especially the financial authorities. These institutions also have special regulations with which with ordinary banking systems must comply. They usually operate in low-income communities, and relate to the financial market either in urban or rural areas. The informal finance institutions, on the other hand, are positioned outside official control and regulations. They usually adapt to specific local conditions, and attach to the culture and values available in the specific area.

The role of informal finance in developing countries has become increasingly important nowadays, as millions of lower-income people in developing countries around the world now count on informal finance as a means of dealing with their credit and savings activities. These informal credit sources are available in many forms depending upon the needs and conditions of people in the respective areas.

The importance of informal finance in developing countries is related to its localised feature and its attachment to the economic, social and cultural conditions of a certain area. Since it is away from government's regulation and supervision, informal finance can freely operate based on the desires and aspirations of each local community. In many societies, informal finance - especially group finance - is nicely adapted to the local culture and values.

In this chapter I explore the concept of informal finance, which include its characteristics, size, and divisions. I would like also to examine the mechanics of informal finance at local level, especially regarding its interaction with local culture and values, its importance in strengthening social capital, and its role in supporting decentralisation. Thus, this chapter begins with an elaboration of the concept of informal finance, followed by a discussion on the mechanics and the importance of informal finance at local level. An elaboration of ROSCA and moneylenders as important examples of informal finance will be presented, as well as lessons from informal finance that can be learnt by microfinance providers. Finally, a conclusion is presented.

## **The Concept of Informal Finance**

The concept of informal finance has been available for a long time, when people saw informal lenders negatively as monopolists, usurers, loan sharks, and exploiters. A study by Darling in India (1925, cited in Adams, 1992: 7) reported that in the early 1990s, informal lenders were mostly found in rural areas, and set interest rates higher than those charged by formal banks. The negative conventional wisdom about informal finance did not improve until the early 1980s when research increasingly showed that informal finance played an important role in development, especially for poor people.

The shortcomings of - and dissatisfaction with - the practices of many formal credit programmes had caused researchers and policymakers to re-evaluate old views about informal finance. Most of the researchers in the seminar on “Informal Financial Markets in Development” held in Washington D.C. on October 18-20, 1989 concluded that informal finance makes an important contribution to development, partly because formal financial systems often perform poorly (Adams & Fitchett, 1992: 1).

### ***Defining informal finance***

In defining informal finance, many authors have various opinions about this term. Chandravarkar (1985, cited in Ghate, 1992: 8) argues that it is difficult to make a rigid definition of informal finance because to differentiate between formal and informal



finance is not easy. The two sectors form, rather, a continuum, which ranges from casual loans from relatives or friends, to loans and deposits handled by various types of informal credit and savings groups, pawnshops that maybe operate with government licence, finance companies that have a corporate charter but are not regulated, credit unions that in some countries are regulated and in others are not, to formal banks that are closely regulated by the central bank. Furthermore, the differentiation between formal and informal should be based on country-specific decisions, meaning that in one country one credit scheme is informal, while in other countries it is formal (e.g. pawnshops). This formal-informal continuum is also supported by Adams and Fitchett (1992: 2) who assert that at the middle of the continuum there is a grey area, in which the activities of the schemes may be partially regulated by a government agency through licensing and supervision. These schemes are usually named as semi-formal finance (Ledgerwood, 1999: 101). Thus there is a possibility that informal finance could become formal at some time, or *vice versa*.

The difficulty in making a clear-cut difference between formal and informal finance is also asserted by Germidis, Kessler, and Meghir (1991). They stated that there is no distinct boundary between these two sectors, as the reality is much more complex. Informal savings and credit systems are not exclusively rural area phenomena, and sometimes they are quite 'organised'. Conversely the modern sector - which refers to the formal sector - frequently practises the barter trade of the informal sector (Germidis et al., 1991: 40).

However in the past few years, the term informal finance has replaced the old negative view of informal lenders. Many authors are of the same opinion, which mainly leads to the view of informal finance as economic activities which lie outside the officially regulated or monitored realm (Adams & Fitchett, 1992; Germidis et al., 1991; Ledgerwood, 1999; Montiel, Agenor, & Ul Haque, 1993: 40; Schreiner, 2000).

A comprehensive definition is given by Adams and Fitchett (1992) as:

all financial transactions, loans and deposits, occurring outside the regulation of a central monetary or financial market authority – the regulated activities being labelled as formal (Adams & Fitchett, 1992: 2).

According to Montiel et al. (1993: 8), informal activity is basically a market response of economic agents to their economic environment. Such a market frequently exists alongside similar activity in the formal sector, or develops rapidly where no formal markets exist, or where formal markets are legally prevented from existing. An informal sector is thus created as a response to the shortcomings and excessive regulation of the formal financial sector, and can be reduced by removing the constraints imposed upon the formal sector (Germidis et al., 1991). Schreiner (2000: 2) gives a definition of informal finance as: “contracts or agreements conducted without reference or recourse to the legal system to exchange cash in the present for promises of cash in the future”. In this regard, Schreiner (2000) made a comparison between informal finance and microfinance, and argues that informal finance derives from the grassroots, bottom-up demand of the poor, whereas microfinance obtains from donor-driven and top-down supply.

The informal sector has long been considered as the survival activity for poor households (Ledgerwood, 1999; Montiel et al., 1993). The growing migrant population in urban areas and the poor households in rural areas of developing countries are usually the participants in informal financial sectors. Thus the informal financial sector comprises the poor such as casual labourers, street hawkers, small farmers, the landless, and so on. As such, this sector has been seen as a transitory and transitional phenomenon, which would disappear with economic development and growth (Montiel et al., 1993: 9). By this definition, informal finance is considered as undesirable, and receives little attention in the macroeconomic literature.

The lack of official acceptance of the informal sector has led to the image that this sector is unproductive or undesirable, and unorganised. However, this notion is not wholly true and is sometimes misleading. The size and growth of this market is at least as large as the formal sector and may even be larger (Montiel et al., 1993: 17), and in many cases the informal sector is highly organised with regulatory control not from the official financial authorities but from social pressure and the borrowers' desire to uphold good repayment records which will ensure access to future loans (Germidis et al., 1991: 48).

Unfortunately, because of the very nature of this sector, it is not easy to obtain information on the activity of the informal sector. The informal lenders tend to operate out of office, and they maintain few records. Because their loans tend to be relatively small and to finance working capital rather than the formation of fixed assets, informal finance is much less visible than formal finance. The participants in such a market, because of the need to avoid regulatory action, often prefer to remain anonymous and are reluctant to disclose information on their transactions to official agencies. Furthermore, informal lenders tend to be shy in talking about their credit operations due to the sensitivity that is attached to the credit, on the part of borrowers or lenders (Ghate, 1992: 3). In some countries, such as in Indonesia, such services are still illegal (Matin et al., 2002: 278).

### ***Characteristics of informal finance***

Among the important characteristics of informal finance are diversity, informality, flexibility, and adaptability. The diversity character of informal finance is identified because it encompasses the huge short-term flows in the inter-business market and the curb market in developing countries. It also includes lending and borrowing among friends and relatives, the activities of finance companies, some of them large institutions which collect deposits, as well as local pawnshops and village moneylenders. Also, there are wholesale traders who finance trade in food-grain and raw materials for industry, to village level crop buyers, input suppliers, petty traders, and itinerant sellers. Above all, there is a variation of ROSCA and other group finance available both in rural and in urban areas (Ghate, 1992: 40).

The informality of informal finance stems from its functioning outside the purview of official regulations (Germidis et al., 1991: 48). Informality is also characterised by its highly personalised loan transactions entailing face-to-face transactions between borrower and lender. The scale of personalised loan transaction is relatively small primarily because informal lending is usually based on personal knowledge of the lender. Specialisation in this case is important, in which an individual lender has knowledge of, and is operating in, a bounded area or in a specific niche of the market. The small-scale transactions of informal lenders are advantageous because they do not

suffer from problems of intra-agency as do those of the formal institutions (Ghate, 1992: 6).

The flexible nature of informal finance is correlated with interest rates and collateral requirements. With regard to the interest rates, there is a popular view that informal lenders usually set high interest rates. However, this view is understandable when considering the high opportunity costs and lending risks of the moneylenders (Adams, 1992). The high interest rates in informal markets may largely indicate that the funds are scarce and that some people expect a high rate of return from using borrowed funds. In some cases, however, the lenders charge a low interest rate or even none at all. This usually occurs in Islamic countries because interest is prohibited in the Islamic religion (Ghate, 1992: 47).

The collateral requirement is one factor that differentiates between informal and formal finance. In formal finance, collateral is a must, while in the informal one, provision of collateral is relative, depending on the terms and conditions set up by the lenders. In intermittent lenders such as friends and relatives, collateral is not required, while for pawnshops or pawnbrokers, collateral is required (Ghate, 1992: 25-27).

Informal finance is also characterised by its adaptability. This fact is related to its localised feature, in which informal finance is easy to adapt to the local conditions, and therefore is responsive to the specific needs of a particular group of people. This especially applies to moneylenders and group finance such as ROSCA and credit cooperatives. Individual moneylenders in rural areas usually are landlords, large-farmers, and traders or shopkeepers, who are often local residents. Being local residents means that they are localised and attentive to the needs and aspirations of the respective local people (Germidis et al., 1991: 151).

### ***Size of informal credit markets***

The difficulty in obtaining information on informal finance means that it is not easy to have a distinct picture with regard to the size of the informal credit market. Moreover, the heterogeneity of activity in the sector increases the costs of information gathering

(Montiel et al., 1993). Therefore, a picture of the informal credit market can be obtained only by estimation.

Nevertheless, the size of the informal finance market remains large, and most loans in developing countries are provided by the informal sector (Robinson, 2001). A study on rural credit in Thailand found that almost 75% of those active in the credit market still used the informal sector (Siamwalla et al., 1993, cited in Robinson, 2001: 175), and Braverman and Guasch (1986: 1255) predict that about 95% of farmers in Africa, and 85% in Asia and Latin America have had no access to formal credit. This suggests that farmers use other forms of credit through informal way.

In estimating the relative size and share of informal credit, Ghate (1992) estimates the overall household credit, rural credit, and urban credit. Rural informal credit in Asian countries remains high. In the rural areas of the Philippines, informal credit constituted 70% of the total household borrowings in 1987, while in Thailand it accounted for 55% of all loans in 1978. In Bangladesh, the Rural Credit Survey in 1987 estimated that the proportion of people accessing informal credit was 64%, and in India, about 75% of total debt outstanding was in the informal sector (Ghate, 1992: 61-63).

The figures as stated above reflect the fact that the majority of informal finance is located in rural areas; as stated by Von Pischke (1991, cited in Robinson, 2001: 175) it is estimated that less than 20% of formal agricultural credit reaches farming households in developing countries, and the rest is informal credit. This relates to the argument of the localism of the informal financial sector, while the formal sector has an 'urban bias' (Germidis et al., 1991: 150). It is further argued that the 'local bias' of the informal financial sector is one of the strengths of this sector, as the schemes are set up in response to the specific needs of a particular group of people.

### ***Major types of informal finance***

Major types of informal finance, according to Ghate (1992: 24) and Montiel et al. (1993: 11), consist of four categories: occasional lending, regular moneylending, tied credit, and group finance. Occasional lending, or intermittent lending, usually occurs

among friends, relatives and acquaintances, in environments where consumer credit and small business loans are unavailable. Such loans are often extended without interest and collateral, and the terms depend on the nature of the relationship between the borrower and the lender; sometimes the loan may evolve into a grant. The relationship between the borrower and the lender could minimise moral hazards, and therefore reduce monitoring costs. These continuing social and economic ties can be developed over the years, even over generations, and could enforce the terms of loan. In a credit-constrained environment of developing countries, especially in agrarian societies where income tends to be uncertain and quite variable, such loans are used to smooth consumption over time (Montiel et al., 1993: 12). One dominant feature of these loans is that they frequently involve unwritten reciprocity obligations, in which the borrower implicitly assumes the responsibility to help the lender sometime in the future should their fortune be reversed (Ghate, 1992: 25). Intermittent and sometimes reciprocal lending takes place also between firms, which works to smooth out the short-term cash flow problems of firms, and also to ease longer term credit constraints (Ghate, 1992: 26).

Regular moneylending or untied credit refers to specialist moneylenders who do their activity for profit, using their own or borrowed funds, and operate regularly as a pure moneylending business without tying in their moneylending transactions to transactions in other markets. Examples of this group are regular moneylenders, pawnbrokers, indigenous bankers, and finance companies (Ghate, 1992; Montiel et al., 1993: 13). The topic of moneylenders will be discussed further in a specific section in this chapter.

Included in this group are pawnbrokers, who lend against collateral. Pawning usually involves the surrender of the asset being pawned to the lender until the loan plus interest is repaid. If the loan, or at least the interest, is not repaid during a specific time, the pawned item is forfeited to the lender (Bouman & Houtman, 1988).

Tied credit is another type of informal finance, in which the credit transactions that take place between borrowers and lenders are continued with other transactions in other markets. The continuing business relationship serves as substitute for collateral in the credit transaction. This is one of the important mechanisms in informal finance, which reduce transaction costs and risk premium. For example, landlords may extend credit to

their tenants, a supplier to a purchaser, or an employer to an employee, and the good relationship between both parties is needed to guarantee the continuing of credit transactions (Montiel et al., 1993: 14-15). In some countries, there is evidence that tied credit is more important than untied credit (Ghate, 1992: 30).

The last type of informal finance is group finance. This is a traditional form of finance that continues to be used frequently in both urban and rural areas. In this case, all members in a group together voluntarily pool their savings on a regular basis to generate loanable funds for the membership (Montiel et al., 1993: 15). The group may be established around a geographic unit such as a village, in a place of business, or within some small social grouping or organisation. It is common that some of the funds are lent to group or non-group members who ask for loans. Also, in a few cases, the funds collected are used to invest in a group enterprise. Rotating savings and credit associations (ROSCAs) are a famous example of group finance. This topic will be elaborated on further, later in this chapter.

Another division of informal finance is introduced by Johnson and Rogaly (1997), who divide informal finance into two categories: user's own informal financial services and informal financial services for profit. The former refers to the system which facilitates financial transactions and is owned by their users. Types of this group range from simple reciprocal arrangements between neighbours, saving clubs, and ROSCAs, to forms of insurance and building societies (Johnson & Rogaly, 1997: 17). The latter relates to the system which extends informal credit to gain profit. This consists of two groups: deposit takers (money guard) and lenders.

Johnson and Rogaly (1997: 20) argue that lending money can be exploitative as well as enabling for poor people. In tied credit for example, poor people who face seasonal shortages may have only one source of credit, such as an employer. The employer may agree to provide a loan, but only if the borrower agrees to work for a salary under the standard wage-rate. In Indonesia, for instance, crop traders may provide farmers with seasonal credit on the understanding that the harvest is sold to the traders at a lower price. This kind of credit, whether in cash or in kind, may be the only means of survival for poor people. However, these arrangements can maintain or even aggravate inequalities of power between the rich and the poor. By contrast, the user-owned

informal financial services such as ROSCAs, are more likely to be supportive and enabling, because the profits are pooled and shared among the members, and ownership and control of the funds are on the hands of the users (Johnson & Rogaly, 1997: 17).

## **The Important Roles of Informal Finance at the Local Level**

The adaptability character of informal finance, as mentioned above, reflects that this informal sector can be operated in any circumstances and environment. As the participants of informal finance usually are poor people, women, operators of small business, small farmers and the landless, this means that informal finance attaches to the grassroots people. And the localism feature of informal finance suggests that the operation of informal finance is best in a specific geographical area. These phenomena allow informal finance to interact and are influenced by local specific values and culture, and therefore enhance local culture and values, to strengthen social capital in the respective areas, and then in turn to support the process of decentralisation.

### ***Influence of local cultures and values***

The operation of informal finance at the local level impacts on the dynamics of livelihood of the local community. As people engage in informal finance at the local level, this means that the culture and values of the community influence the mechanics and operations of informal finance.

To understand the relationship between culture and values and informal finance, it is important to know the meaning of culture and values. Hofstede (1984: 18) differentiates between culture and values, in which “values are an attribute of individuals as well as collectivists, while culture presumes a collectivity”.

Culture has been defined in many ways. The anthropological definition of culture has been given by Kluckhohn (Kluckhohn, 1951: 86, 5):

Culture consists in patterned ways of thinking, feeling and reacting, acquired and transmitted mainly by symbols, constituting the distinctive achievements of human groups, including their embodiments in artefacts; the essential core of



culture consists of traditional (i.e. historically derived and selected) ideas and especially their attached values.

Many authors have seen culture as the behaviour of human beings in relation to how they interact with the environment. Hofstede (1984: 21) asserts that culture could also be defined as “the interactive aggregate of common characteristics that influence a human’s group response to its environment, and it determines the identity of a human group in the same way as personality determines the identity of an individual”. The term ‘culture’ is usually reserved for societies, ethnic or regional groups, but it can be applied equally into other human collectivities or groups such as an organisation, a profession, or a family (Hofstede, 1984: 21).

Some economists have seen the importance of culture in economic development. Lal (1998: 6) argues that the gradual evolution of culture affects the rise of cultural and political aspects of Western market economics which include democracy and respect for human rights. He further asserts that the definition of culture based on ecologists’ views matched with the economists’ views on equilibrium, in which human beings learn to be survived in the new environment and be able to fix them by social custom.

The view that culture is an important determinant of economic growth has been known for a long time. Weber (1930, cited in Stulz & Williamson, 2003: 314) argues that culture has an important role in the history of economic development such as during Calvinist Reformation. However, despite this long tradition that demonstrates that culture matters, the impact of culture on finance has not been investigated directly. Stulz and Williamson (2003: 314) called for a more direct investigation to determine “whether there is evidence that culture matters for finance beyond its relation with legal origins”.

In examining the relationship between culture and organisation of society, Greif (1994: 913) argues that cultural variations are dependent on the difference in societal organisation. In the ‘collectivist’ society of developing countries, social structure is segregated, meaning that each individual interacts socially and economically mainly with members of a specific ethnic, religious, or familial group through informal economic and social institutions. Members of a collectivist society are usually involved

in the lives of other members of their group. Thus, in developing countries the unity of each cultural group is very tight. This is different from developed countries, in which the social structure is 'integrated' in the sense that economic transactions are conducted among people from different groups, and individuals shift frequently from one group to another. Therefore the unity of the members in a group is not so strong, and the people in developed world are usually individualistic.

Greif (1994) further argues that cultural belief is an integral part of institutions affecting the evolution and persistence of diverse societal organisation. He divides the cultural beliefs in the world into two: the Muslim world, which originates from the Maghribi traders in the eleventh century, and the Latin world, which stems from the Genoese traders of the twelfth century. The Muslim world represents modern collectivist society, while the Latin world represents individualist societies (Greif, 1994: 914).

The influence of cultural beliefs on social and economic interactions is clear in the developing world. In informal finance, one aspect that is influenced by local culture and values is the concept of interest. In Islamic countries in particular, interest is prohibited. Thus a credit transaction in this case is interest free. In Bangladesh for example, the prohibition of interest rates has influenced the practice of informal finance; among others the relatively high proportion of the *dadon* system or forward sales of crops as a means of financing crop production, in which the price discount on the forward sale substitutes for interest. There is also high frequency of a profit-sharing system in lieu of interest and the high share of interest-free credit (Ghate, 1992: 47).

The prohibition of interest in Islam is an exclusive feature of Islamic finance. The rationale for prohibition of interest in Islamic finance by the *Sharia* principle, according to Ariff (1988: 2), is because interest is a pre-determined cost of production, and tends to prevent full employment. A common thread of discussion about interest is the exploitative character of the institution of interest.

Mills and Presley (1999) give comprehensive critiques of interest including legal, ethical, and economic points of view. With regard to legality, they argue that the most fundamental Islamic critique of interest centres on the definition of legal exchange, in which for an exchange of money or goods to be legitimate, no party should receive any

advantage without giving an appropriate counter-value. The exchange of money for money is legal in Islam when no increase (*riba*) occurs in the transaction. In Islamic law, money is a valid claim on property if it is obtained from work, gift, or inheritance (Mills & Presley, 1999: 9).

The ethical criticism on interest stems from unjust allocation of profit and risk between borrower and lender. In the case of production loans for example, there is unfair allocation of risk between borrower and lender, because no real investment project under competitive conditions can be guaranteed to make a gross profit, let alone automatically cover interest costs. Interest gives the lender immunity from the potential for loss that the borrower faces. Losses in business have a social impact in productive activities, and the costs of such impact should be shared between borrower and lender through a profit-and-loss sharing arrangement (Mills & Presley, 1999: 10). The interest rate mechanism of the conventional banking system, therefore, is replaced by the profit-loss-sharing arrangement (Ariff, 1988: 3).

From an economic point of view, Islamic economists define money and capital as facilitators of exchange, while in the conventional banking system money acts as a measure and store of value (Mills & Presley, 1999: 12). Islamic writers argue that if money is to act as a measure of value, it is paradoxical for it to command a price in terms of itself. Interest acts as the price of money and so makes the measure of value itself an object of exchange, which is believed to impede the effectiveness of money in its role as a means of exchange (Ballantyre, 1988: 5). Furthermore, Islamic writers are suspicious of money acting as a stable store of value, because of the Holy Qur'an's condemnation of the practice of hoarding (9:34, 35), and the hoarding of cash interrupts the exchange of goods and service, and thus possibly causes the deficiency of effective demand (Saud 1967, cited in Mills & Presley, 1999: 12).

Another aspect of informal finance that is affected by local culture and values is the credit mechanism. Since informal finance is adapted to the local conditions and environment, the mechanism of credit delivery or transactions follows the norms, culture and values available in the respective areas. Donald (1976: 54) argues that the complex interactions, including social ties and ritual responsibilities at the village level will shape economic transactions. The norms and values in the respective cultures are

usually applied in designing informal credit schemes. Within the hierarchical structures in the community, characteristics such as holding a higher position in the kin group or being a ritual leader are also influential in shaping the design of credit transactions. The local culture and values also act as the screener, in which any negative practice of informal finance will be rejected, such as the exploitative interest rates in moneylending.

The important role of local culture and values is significant in informal finance, especially in the practice of group finance such as ROSCA and other self-help groups. In ROSCA, its design usually follows the culture and norms that have been practised in the area for a long time. Therefore, ROSCAs are evident in many countries in the world with a different name and design, but having the same principles.

### ***Strengthening social capital***

The localism and adaptability features of informal finance contribute to strengthening the social capital of each respective community. Germidis et al (1991: 152) argue that the common bond in mutual finance instigates a close relationship among the members. This is because group or mutual finance, which requires regular meeting, permits its members to know one another. In rural areas this common bond is supported by the membership of a certain clan or ethnic group, while in urban areas the common bond is usually found in the working place (occupational bond), where the urban-based mutual finance may have an employer in common (Germidis et al., 1991: 152). The common bond then forms a tight relationship among the members and, hence, strengthens social capital.

The definition of social capital is still contestable and the debate about this issue is still ongoing (Bebington, Guggeinheim, Olson, & Woolcock, 2004; Uphoff & Wijayarathna, 2000). However, Narayan and Pritchett (1999: 872) try to define this term as “the quantity and quality of associational life and related social norms”. In this case the focus is how to achieve better outcomes, and they argue that greater social capital is potential to produce better outcomes by facilitating greater cooperation. The general definition of social capital comes from the term of “society” that is defined as a series of nodes (e.g.

individuals or households), and a set of connections between those nodes. The connections between nodes can be any kind of relationship, whether a social relationship, shared beliefs, group identification, or voluntary associations (Narayan & Pritchett, 1999: 874).

Another understanding of social capital is given by Uphoff and Wijayaratna (2000: 1876), who see social capital as an asset that produces definite flows of income, and argue that the benefit achieved from social capital is named as mutually beneficial collective action (MBCA). They divide social capital into two forms: structural and cognitive. The structural forms of social capital are relatively external and objectified. This category derives from various aspects of social capital which can be explicitly described and modified, such as procedures, roles, rules, and social networks. The cognitive forms of social capital are more internal and subjective, such as norms, values, attitude and beliefs. Both structural and cognitive forms are interactive and connected in practice. For example, if a natural disaster such as an earthquake happened in a village, the cognitive social capital of attitude and values to help each other would emerge, and the structural form of social capital such as social networks and procedure of evacuation would be performed by the village headman or key persons in the village.

In informal finance, intermittent lending and group or mutual finance contribute to strengthening social capital. Lending among friends and relatives requires trust and a close social network, and thus includes the cognitive form of social capital. The mutual or group informal finance, such as ROSCA, self-help groups, cooperatives and credit unions are important to strengthen social cohesion kinship and brotherhood, which are important for the formation of social capital.

### ***Supporting decentralisation***

The fact that informal finance is mostly attached to people who are marginalised at the grassroots level reflects that the process of formation of informal finance follows the bottom-up approach. The bottom-up design of informal finance in this case is in line with, and supports, the concept of decentralisation.

The participatory concept in informal finance is particularly observed in group finance, or user-owned finance (Johnson & Rogaly, 1997). In this case the users of the informal finance own the scheme and participate in the planning and design process. The main function of the scheme is to facilitate financial transactions. ROSCA is an extreme example of user-owned informal finance, in which a number of people agree to set up a ROSCA scheme, and they run the scheme based on terms and conditions agreed by the members. The attractiveness of ROSCA in this case is its voluntary participation, its organisational autonomy, and self-sufficiency (von Pischke, 1992: 333).

The participatory approach of group finance or user-owned finance significantly affects the development of the credit and savings scheme, and in turn leads to the people's empowerment. The members of Rickshaw ROSCA in Bangladesh, for example, are able to own a rickshaw when they take their turn in the lottery, and thus could increase their income and quality of life. By setting up a ROSCA, the rickshaw drivers learn how to manage an organisation as well as a financial institution, and as a result, the financial institution becomes bigger and more progressive (Johnson & Rogaly, 1997: 18). The successful management of a bottom-up or grassroots organisation would be helpful for the progressiveness of the community, and also an important factor for a successful decentralisation process.

### **Important Schemes in Informal Finance**

Among the diversity of informal finance in developing countries, ROSCA and moneylenders are dominant, and more often to be found in one country than other types of informal finance. Thus, it is important to further discuss these schemes such as follows.

#### ***Rotating, savings and credit association (ROSCA): The roots of microfinance***

The Rotating, savings and credit association (ROSCA) is one of the informal finance schemes that is mostly favoured by people in developing countries. This scheme has been known for a long time and has been seen as the roots of microfinance (Armendariz

de Aghion & Morduch, 2005; Kimuyu, 1999). While borrowing from the moneylenders is constrained by high costs, and from relatives and friends is hampered by social costs, ROSCA is viewed as one alternative solution for borrowers in low-income countries for their credit problems. The features of ROSCA that make this scheme more favourable than other schemes of informal finance are: its ubiquity, in that the scheme is available in many ethnicities and countries with a variety of local names, and signifies its viability and applicability in most parts of the developing world; its function as a good intermediary, and its collective activity, reflecting its capacity to adapt to the norms and cultures in which it operates (von Pischke, 1992: 326-327).

The mechanism of ROSCA is very simple. A number of people agree to save a fixed amount of money or in kind, at regular intervals, such as weekly or monthly. Each member contributes an agreed amount, resulting in a single lump sum becoming available, which is then allocated to one of the members. When each member has received his/her turn, the cycle is completed, and the ROSCA is reorganised (von Pischke, 1992: 327).

There are three different types of ROSCA based on the allocation of a lump sum (Armendariz de Aghion & Morduch, 2005; Johnson & Rogaly, 1997). First, the allocation is based on strict rotation among members of the group. In this case the order of rotation is predetermined based on agreement reached among the members. Second, the allocation is based on lottery, or named as random ROSCA. This type is more prevalent in developing countries, and more favoured because it is fairer (Armendariz de Aghion & Morduch, 2005: 65). Third, the allocation is based on auction, or named as bidding ROSCA. In this regard, the members are invited to bid, rather than simply wait for their turn. There are, of course, numerous varieties of ROSCA owing to its flexibility to accommodate the special needs of each community. The savings and credit functions of this scheme are implicit, since within a ROSCA cycle, the members can at one time be a saver and at another time a creditor, depending on when they take their turn to collect the fund (Kimuyu, 1999: 1299).

Many authors have given their opinions regarding the favourable characteristics of ROSCA (Armendariz de Aghion & Morduch, 2005; Handa & Kirton, 1999; Kimuyu, 1999; von Pischke, 1992). One feature is that it economises the transaction costs. The

simplistic character of ROSCA is that on the same day the funds are collected, they are distributed again, so that the transaction does not need a physical place or office and administrative fees. This also makes the ROSCA perfectly matched, in which the inflows and outflows of funds are precisely synchronised which permits ROSCA to operate without any permanent capital. The transaction is conducted in full view of the members so that written records are unnecessary (von Pischke, 1992: 328). ROSCA is also useful in mediating funds. Its intermediary functions are transforming future payments into an immediate turn, and accumulating small payments into a larger pool (Kimuyu, 1999: 1300). It also serves as a device to foster discipline and encourage savings, which in other schemes might be impossible. Participating in ROSCA thus provides a secure and structured way to save (Armendariz de Aghion & Morduch, 2005: 66).

The positive characteristics of ROSCA, especially its role to provide useful financial services for the poor, reflect that this scheme has potential to be developed. Significant advantages of ROSCA, then, could become lessons learnt by the policymakers in designing effective and efficient future microfinance programmes.

### ***Moneylenders: The oldest type of informal finance***

The practice of moneylending with high interest has been a controversial issue for a long time. The conventional view of moneylenders has been negative since nearly 3,000 years ago, by which the lending of money aims for profit with high interest, and all credit has come under this definition for many centuries (Rowlingson, 1994: 9). In a more extreme view, moneylenders are stereotyped as being evil in many cultures, which reflects the natural tendency to fear and dislike the moneylenders' activity (Adams, 1992).

Rowlingson (1994: 11-12) outlines the reasons why there are negative connotations associated with the practice of moneylending. First, as has been mentioned previously, the moneylenders usually charge extortionate interest rates. They set high interest rates because their customers have very limited access to other forms of credit and there is little competition between moneylending companies. Secondly, the moneylenders may



pressurise customers to borrow more money than they really want to, or, they may use intimidation, threats or violence to enforce payment. This often applies to doorstep moneylenders who collect payment directly from their customers at their doorstep. Thirdly, people borrowing money from moneylenders could end up in a cycle of debt because they are usually in a desperate financial situation. Moneylenders are therefore exploiting people in vulnerable situations. Fourth, moneylenders usually do not check sufficiently on the ability of the borrowers to repay loans, so that there is a high risk that the borrowers will default. If the borrowers default on loan repayment, extra interest or charges are added which lead to even greater debt problems. It is further argued that these negative connotations are usually associated with illegal moneylenders (Rowlingson, 1994: 11).

However, many authors argue that the high interest charged by the moneylenders is explainable due to many kinds of costs incurred in the process of moneylending. The costs that will be borne by the lenders in delivering informal loans consist of: transaction costs, opportunity costs, risk premium, and monopoly profits (Ghate, 1992: 139-52). The main reasons for the high interest rates according to Aleem (1990: 331) are because the lenders have high costs in obtaining loanable funds that sometimes come from the informal markets; the relatively large costs of monitoring and administering the loans; and the costs associated with credit delinquency. It is further argued that moneylenders sometimes find it difficult to cover their fixed costs adequately due to the small amount of loans that they are contracting (Montiel et al., 1993: 22).

The professional moneylenders who depend on moneylending as the main source of their income represent a small proportion of informal finance. The more common type is a part-time moneylender, who supplements his/her income through moneylending, such as large farmers, salaried employees, shopkeepers and businessmen and women. As the moneylenders lend primarily on the basis of good information on borrowers, they therefore tend to have a limited clientele and relatively long-standing relationships with borrowers (Ghate, 1992: 26). The clients of moneylenders are usually people who cannot borrow from other sources such as from friends and relatives, or from a collateral-based source of formal finance or from a collateral substitute of tied credit

since they cannot provide collateral. Moneylenders tend to take advantage from the rigid demand schedules of credit of such borrowers (Ghate, 1992: 26).

The borrowing and lending process of moneylending is simple and usually aims to make a convenient way for the borrowers, as a compensation for its high costs. For example, the procedure is short and flexible, and the amount of money borrowed is not restricted, depending on the need and capacity of the borrowers to repay. These features, which are absent from formal finance, could become lessons learnt by the formal financial providers to improve their services for their customers. Furthermore, the main advantage moneylenders have over formal lenders is the comprehensive information they accumulate about their clients through intensive day-to-day contact, which limits the number of clients that they can collect (Adams, 1992: 9).

### **Informal Finance and Microfinance: What Can Be Learnt From Informal Finance?**

The many positive aspects of informal finance in providing services for the poor could become lessons to be learned by microfinance providers in order to improve their performance and services for their poor clients. The advantages of informal finance that can be copied by formal financial providers, according to Johnson and Rogaly (1997: 24-25) include, firstly, its range of financial services such as saving facilities, credit for consumption, and funding for predictable but expensive events such as marriages and funerals; secondly, its lower transaction costs than the formal lenders, since the informal lenders are usually localised, who do not need travel costs and are sometimes without administrative procedure; thirdly, informal finance imposes discipline on the borrowers. The local flow of information among relatives and friends and the small number of lenders or credit schemes result in social pressure for the borrowers to repay on time.

Ghate (1992: 163) focuses on the flexibility feature of informal finance that makes the schemes match with the need and capacity of the poor. Interest rate flexibility has allowed informal finance providers to cover a large range of clients. In addition, the flexibility of the repayment schedule contributes to the higher repayment rates and therefore reduces risks premium, as well as allowing less chance for foreclosure of an

account. Also, the greater flexibility regarding the duration of loans and charging of interest only for the duration of a loan is more convenient for small and medium borrowers. It is argued that daily repayment loans are not only convenient for the borrowers, but also they greatly reduce risks, and keep the lenders supplied with up-to-date information about the borrowers (Lava et al 1988 cited in Ghate, 1992: 163).

However there are also many negative aspects of informal finance that the microfinance providers should avoid. Germidis et al. (1991: 49) argue that the high interest rates charged by informal lenders such as merchants, middlemen and landlords are socially unacceptable, especially among poor borrowers in rural areas, where the borrowers often may not realise the true rate of interest they are paying and either do not know, or do not have access to, an alternative source of finance. It is also reflected that the high interest rates indicate high costs of financial intermediation in informal finance. Another criticism is that since informal loans are mostly used for consumption purposes, it is often argued that the flow of funds are more from savers to consumers rather than into productive investment for development, and therefore informal loans discourage economic development. Also, since the informal finance is usually positioned outside the control of public authorities, its existence and expansion could cause ineffective financial and monetary policies in developing countries.

## **Conclusion**

In this chapter the concept of informal finance has been discussed. The concept of informal finance, has now become an important tool for the savings and credit activities of the lower income people in developing countries. There is a wide range of credit and savings facilities in informal finance from intermittent lenders to friends and relatives, professional lenders and tied lenders, to group or mutual finance. The widespread nature of ROSCA and other group finances in most developing countries supports the accumulation of capital, and therefore strengthens economic development of the respective communities.

The important mechanisms of informal finance at the local level are sometimes overlooked by researchers or practitioners, especially regarding its interactions with local cultures and values and its role in enhancing social capital and decentralisation. In

fact, the influence of local culture and values upon social and economic organisation is important in the collectivist society of developing countries. People tend to be grouped based on their ethnicity, religion, and familial group. The setting of interest for example, which is one aspect in informal finance, is highly criticised by Islamic society. The rationale for banning interest in the banking system has resulted in the increasing popularity of the concept of Islamic banking, which is now widely used by banking companies in both Islamic and non-Islamic countries. Similarly, the close interaction between members in informal finance, especially in group or mutual finance, has resulted in tight relationship among the members, which in turn strengthens the community's social capital. In the same way, the bottom-up approach of the establishment of informal finance is supportive of the successful implementation of decentralisation.

Despite the above positive features, there is still a largely negative view towards informal finance especially regarding moneylenders. Poor people usually use moneylenders as the last resort, when other options of credit sources are unavailable. It is often suggested that moneylenders take advantage of uneducated people and lack of knowledge of credit.

The positive and negative features of informal finance as mentioned above are important for the development of local financial systems in developing countries. These could become lessons to be learnt by researchers and policymakers to design future rural financial systems.

## **CHAPTER FOUR**

### **RURAL FINANCIAL DEVELOPMENT IN INDONESIA**

#### **Introduction**

Provision of credit for small farmers in Indonesia has been a continual challenge for government, illustrated by many changes in policy. Since the colonial era until the liberalisation of financial systems during Soeharto's government, farmers enjoyed the provision of credit for their agricultural activities, because the government's development policies were focused on the expansion of agricultural outputs. Most rural credit programmes during this period were subsidised, and farmers experienced ease in accessing loans. However, after the liberalisation of the financial systems, the direction of rural financial development was shifted, and not only focused on broader agricultural development, but also covered wider aspects of rural activities. The attention given to farmers was reduced, yet the focus was moved to the poor, who represent the rural population with a variety of occupations but with limited income. Although many criticisms have been addressed to the targeted and specialised credit programme for agriculture (Adams, 1984: 36; Gonzalez-Vega, 1984; Vogel, 1984a), small farmers in Indonesia still need specific forms of credit which are adapted to their conditions.

The purpose of this chapter is to explore the development of rural financial policy and practice in Indonesia, according to their roles to serve the farmers with credit and savings facilities. After briefly reviewing the economic, geographic, demographic and social background of Indonesia, an overview of agricultural and rural development and farmers' credit will be presented. This is followed by an historical review of rural financial policy, which focuses on how it has been shaped from the colonial period until the liberalisation of the financial system in the late 1990s and up to the current time. Then, the performance of rural financial institutions will be elaborated on, including the structure of rural finance institutions, and a review of major rural financial institutions since the financial liberalisation era. Considering the growing importance of informal finance in delivering credit for small farmers, a discussion on the structure and performance of informal finance will be provided.



Figure 4.1. Map of Indonesia.

Source: <http://www.asean-disease-surveillance.net/images/map/indonesia>

## **Indonesia's Agricultural and Rural Development, and Farmers' Credit**

### ***Country background***

Indonesia is part of the world's largest archipelago consisting of more than 13,000 islands, scattered along the equator over 40 degrees of longitude. The total area covers 1.905 million square kilometres (Sukarno, 2000: 4), and it is home to some 216 million people of great ethnic and linguistic diversity (ADB, 2005: 244). Based on these figures, Indonesia has a deceptively low population density ratio of about 114 people per square kilometre. However, the three most populous islands of Java, Bali, and Madura support more than 60% of the country's population on less than 10% of the land mass, on average some 800 people per square kilometre, which means that they are among the most densely populated islands in the world (Charitonenko & Afwan, 2003:4). This difference in population density contributes to distinction between 'the three inner larger islands' and all 'the other smaller outer islands' in terms of socio-economic and physical infrastructure conditions. This distinction also impacts on the uneven demand of rural finance facilities and institutions between the regions, so that the inner islands have more institutions and facilities than the outer islands.

Indonesia has been experiencing sustained and remarkable economic growth for many years. The per capita growth rate was 4.8% between 1970 and 1991 (Paul Mosley, 1996:32), and the government managed to decrease the proportion of population living in poverty from 40.1% in 1976 to around 17.6% or about 34 million people in 1996 (Charitonenko & Afwan, 2003:5).

The Asian Economic crisis had a severe impact on the economy and the social conditions of people (David C Cole & Slade, 1998; Djiwandono, 2000; Patten, Rosengard, & Johnston-JR, 2001). The economic deterioration has been extreme. The GDP growth rate jumped into negative figures (-14%) in 1998, the income per capita was cut 50% in dollar terms, and the inflation rate increased from single digits to 80% (Djiwandono, 2000:50). In addition, the exchange rate plunged from Rp 2,450 to the US dollar in mid-1997 into Rp 14,900 by mid-1998 (Patten et al., 2001:1058). An additional five million people became unemployed, and the number of people living below the poverty line increased from 11% to 25% of the total population in 1998,

causing an increase in the rate of school drop-outs, crime, and prostitution and other social problems (ADB, 2001a; Djiwandono, 2000:51).

The government prioritised economic recovery after the crisis. However there was still slow economic growth. The growth rate of real gross domestic product (GDP) fell from 4.9% in 2000 to 3.3% in 2001, and the unemployment rate increased from 6.1% in 2000 to 6.7-7.0% in 2001 (Charitonenko & Afwan, 2003:6).

The government has devised several approaches to combat rural poverty in Indonesia since 1960 and again since the crisis, but progress is still insufficient to end poverty. Nowadays, about 110 million people are still living on less than \$2 a day and close to 60% of the population are below the national poverty line (World-Bank, 2005d: 1). Almost half of the Indonesian rural population lack access to either water or sanitation (ADB, 2001b: 1). Most Indonesians are vulnerable to poverty, and small changes of prices, incomes and health conditions can throw them into poverty. For example, the current increase in fuel prices has caused the escalation of the number of poor households, from 15.5 million before the fuel price increase to 16.5 million after the implementation of this government policy (Tim-Kompas, 2005).

Rural poverty in Indonesia has been a serious problem for several decades. The poverty incidence in rural areas increased by 11.7% from 1990 to 1999, while at the same time, the urban poverty increased by only 2.6% (ADB, 2001b: 1). During the Asian economic crisis alone, the proportion of the rural population below the poverty line increased by 9.7% within two years, from 1996 to 1998 (World Bank 2001).

The majority of the poor in rural areas are small farmers, who are the most affected by the crisis, and represent 75% of the total poor in Indonesia (Charitonenko & Afwan, 2003: 5). There are many reasons why poverty occurs mostly in rural areas. One important reason is the lack of diversity of source of income. Most rural people are dependent on farming as their main occupation. Although there are alternative sources of earnings such as handicrafts and petty trading, these occupations are small-scale and have no significant impact on people's income. Another reason is that because farming activity is not profitable due to the low value of agricultural commodities, especially



rice, so that farmers' incomes remain low. This has caused farming in rural areas to be unpopular, especially among the young generation.

### ***The performance of Indonesia's agricultural development***

The agricultural sector plays an important role in the Indonesian economy for many reasons. First, this sector produces food, especially rice, to feed Indonesia's large population. The achievement of rice self-sufficiency in 1985 evidenced the critical role of this sector in economic development. Secondly, this sector is one of the largest contributors to the Gross Domestic Product (GDP), which reached 354,435 billion Rupiah in 2004, or 15.4% of the total GDP, after manufacturing and trade sectors (28% and 16% respectively) (ADB, 2005: 244). Thirdly, the agricultural sector is the largest employer of labour. In 2003, about 43,042,000 people, or 41.9% of the total labour force were engaged in this sector (ADB, 2005: 244). Fourth, agriculture and natural resources are the basis for manufacturing, especially for the export market. Fifth, the agricultural sector has an important role in poverty alleviation, because the majority of the poor (60%) engage in agricultural sector which provides the main source of income, whether from labour or land (Charitonenko & Afwan, 2003: 5). Thus the agricultural and rural sectors are prioritised in Indonesian economic development.

However, agricultural development has been challenged by many problems. As has been mentioned above, small-scale farming activities are not attractive. The rural economy is still handicapped by low technology and serious deficiency in capital and human skills, which cause the lack of employment opportunities through which to achieve a better quality of life. This has led to the increase in rural-urban prosperity gaps and pressure for urban migration. Other problems are the decline of farm size, inadequate resources, and deficient infrastructure (ADB, 2001a). The decrease of landholdings by farmers, especially in Java, was due to the increase in population and the escalating conversion of arable land to other purposes such as industry and tourism. The expansion of industry and tourism especially in Java had also caused the deterioration of the quality of natural resources such as soil and water, and in turn impacted on the decrease of farmers' outputs.

The negative growth of the agricultural sector was heightened during the Asian economic crisis. The labour productivity and income gap between agriculture and non-agriculture sectors widened over that period (Charitonenko & Afwan, 2003: 5). This slow growth is suspected to be due to the limited diversification of agricultural products, although there has been a shift towards high value agriculture. The share of rice in total agricultural production is still very high (38%), but industrial crops, horticulture, fisheries and livestock will most likely make up to 80% of the growth of agricultural output in the future (World-Bank, 2005b: 1).

***Rural development and village governance in the decentralisation era:  
From top-down to bottom-up***

The formulation of a rural development strategy is a difficult task within a country as large and diverse as Indonesia. Before the decentralisation era, rural development planning was carried out through a top-down development approach. Central policy making and development planning occurred at the National Planning Board (BAPPENAS), which is complemented by a regional planning board (BAPPEDA) in each province. Funding of development projects comes from three main sources: from the national development budget, which is channelled through central lines agencies; from the provincial development budget; and from presidential grants (INPRES) that go directly to various beneficiaries, especially the poor (Thorbecke & van der Pluijm, 1993: 21). In this regard, despite the stated intention to decentralise authority, such as establishing provincial planning boards and provision of development funds from provincial budgets, the central government continues to exercise control over lower-level administrations. Almost all regional or sub-regional as well as rural development programmes and projects are designed and selected by the central authority.

This centralised decision-making is also reflected by several agricultural policy interventions. The BIMAS intensification programme that includes the use of high yielding varieties (HYV) of seeds, using agricultural inputs, extension and credit services, and expansion and rehabilitation of irrigation systems, is a good example of top-down government intervention in the agricultural sector. However, the top-down

BIMAS credit system also caused high default and high loan delinquency, which in turn effected the termination of this programme in 1983 (Meyer & Nagarajan, 1999).

With regard to village governance, the centralised government system under the Soeharto administration decreed Law 5 of 1979 concerning Village Governance (Antlov, 2003: 195). In this case, village government was under the firm control of higher authorities, and village structure was designed homogeneously, which did not allow either traditional governance structure or room for innovation from below. The power of the village leaders (*Kepala Desa*) was dominant because they are the 'extension hands' of the central government, which means that the structure of local politics was based on patronage. Although it is stated that the village government consists of two parts: the head (and his/her staff) and the Village Consultative Assembly (LMD/*Lembaga Musyawarah Desa*) (paragraph 3 of Law 5/1979), there is no separation of power between these two, meaning that the village head could become the chair of the LMD. Thus, there was no mechanism for village people to have an accountable village head due to his/her paradoxical role: very weak and co-opted (seen from above), and very powerful (seen from below) (Antlov, 2003: 197).

After the launch of the decentralisation era through Law 22 of 1999 on Regional Governance, and Law 25 of 1999 on the Fiscal Balance between the Centre and the Regions, the responsibility of planning and implementation of rural development and poverty alleviation schemes was moved down to the provinces' and districts' government. Through these two laws, the districts and municipalities' government have freedom to decide local policies, to raise their own revenue, and to deliver the services to the community without any interference from the higher authorities.

With regard to village governance, Law 22/1999 replaced the previous Law 5/1979, which is specifically outlined in paragraph No.93 to No.111. It is stated that the regulations in the village government are 'diversity, participation, genuine autonomy, democratisation, and people's empowerment' (section 9.1 of Law 22/1999 cited from Antlov, 2003: 197) This means that a big change has been made from the previous Law, that the village government was homogenous with the principle of 'singular loyalty', to support a certain political party, lack of people participation, and the dominant power of the village leader. The new village government is an autonomous government, and

provides a space of diversity and responsiveness to local aspirations. For example, the village can be called by any traditional name such as *Nagari* in West Sumatra, and *Lembang* in Central Sulawesi (Antlov, 2003: 199).

Importantly, there is a clear separation of power between the village head and Village Representative Board (BPD/*Badan Perwakilan Desa*), in which the village head is responsible to the village population through the BPD, and is required only to submit an administrative report to the sub-district head once a year (Bennet, 2002: 63). The BPD is a democratic organisation, and the village parliament, which drafts village legislation, approves the village budget and monitors village government. The village government also has the right to establish independent organisations according to the village people's needs, including the right to create self-help groups and their activities to raise village revenue.

With regard to the implications of this village government autonomy for rural development programmes, it is likely that it will be more difficult for local government to implement programmes in the future, because, under the Law 25/1999, the central government has a diminishing capacity to provide funding for local government. However, this could have both positive and negative impacts. It is positive because it signals the end of central government's dominant authority, and allows for local creativity and innovations. It is negative when local government cannot find an alternative source of revenue, and poverty would thus be on the rise at the village level. Furthermore, to date, local government has not been successful in addressing issues of rural development (Antlov, 2003: 208).

### ***Farmers and rural credit: Searching for the most appropriate scheme***

To discuss the condition of small farmers' credit in Indonesia, it is important to examine the characteristics of small farmers and farmers' credit itself, as presented below.

## **Characteristics of small farmers in Indonesia**

Discussion on small farmers in Indonesia can be divided based on the economic and socio-ecological contexts. In the economic context, the term small farmers is linked with agricultural or rural households, or small-scale rural enterprises, while in respect of social context, the small farmer is correlated to the peasant, who represents subsistence agricultural workers in rural areas.

In the economic context, agricultural households can be divided into two: first, those who claim that their primary income is from agriculture, and second, those who claim that agricultural activities are not the main source of household income. Based on this division, it is found that the percentage of households which have agricultural-based income has declined slightly from 81.7% in 1984 to 78.5% in 1993 (Booth, 2004: 23). Thus economically, the current characteristic of Indonesian farmers is that there is a tendency to have off-farm activities rather than an on-farm source of income only (Hansen & Birowo, 1981: 2)

With regard to the socio-ecological context, Indonesian farmers can be divided into two: swidden farmers and wet-rice farmers. The swidden farmers are those who cultivate dry land, and tend to move from one site to another site based on the ecological conditions of the area. It involves the clearing of forested areas, with the land being allowed to lie fallow for a specific time and be cultivated again with a variety of crops such as dry rice, cassava, maize, yams and so on (1974 cited in Hansen & Birowo, 1981: 2-3). Although swidden farmers have been seen as subsistence farmers, due to their activities in agriculture being mostly aimed at fulfilling their daily consumption needs, Hudson (Hansen & Birowo, 1981: 3) asserts that the swidden agriculture could be expanded into commercial agriculture. This is because of the integrated feature of swidden agriculture, which includes cash commodities such as rattan, timber, and rubber. This type of farmer is found particularly in the outer islands, where most of the agricultural land is unirrigated or rainfed, such as Sumatra, Kalimantan, Sulawesi and Irian Jaya (Hansen & Birowo, 1981: 3).

By contrast to the swidden farmers, there are wet-rice farmers who deal with irrigated agriculture, which is mostly found in Java and Bali. The typical Javanese farmers have

access to small-size plots which are continuously cultivated with a cropping pattern, whether the land is irrigated (*sawah*) or unirrigated (*tegalan/pekarangan*) (Geertz, 1966: 29).

The socio-ecological characteristic of Indonesian farmers is elaborated further by Clifford Geertz (1966) in his well-known book *Agricultural Involution* where he describes the ecological approach of Indonesian agriculture. He states that the socio-cultural changes in the community are attributable to ecological process. The swidden farmers tend to be integrated to the land, adaptive, and maintain the general structure of the pre-existing natural ecosystem. The *sawah* farmers, on the other hand, are cultivating lands with artificial and continuous cultivation, with technical and experimental efforts to raise production, and with massive interactions between living organisms and non-living organisms (Apriyantono, 2004; World-Bank, 2005d). In the case of subsistence farmers who follow non-developmental attitudes, Geertz argues that this pattern is the production process of peasant farmers to the existence of what he calls the ethic of “shared poverty”.

### **Credit for small farmers**

Focusing on farmers’ income and prosperity is one strategy for future agricultural development (Apriyantono, 2004: 2). The government has stated that agricultural development should be ‘people-centred’ which focuses on human resources, i.e, the farmers, while the commodity is only a tool to achieve the goal of a higher income and prosperity of the farmers. Therefore farmers should select the commodities which are marketable and profitable in order to be able to compete in the international markets, and therefore raise their income (World-Bank, 2005a: 2).

To achieve these goals, farmers need funds for financing their farming activities. This could come from the government budget to meet farmer credit needs, or from the private sectors and NGOs. The government has committed to achieving this objective by providing credit for small farmers through many programmes and projects such as the BIMAS credit programme, KUT, P4K, KKP, and the most recent one is PMA-PMUK, which focuses on empowerment of the agribusiness community through group lending (Mayrowani, Syukur, Sunarsih, Marisa, & Sutopo, 2000: IV-1).

Nevertheless, small farmers often encounter many problems in accessing rural credit. Farming activities are highly dependent on uncontrolled factors such as natural disaster and climatic conditions. Small farmers therefore are confronted by high risks when performing farming activities or agribusiness. In many cases they cannot repay a loan promptly due to the irregularity of their earnings, or they cannot provide collateral because of their limited income. Therefore, small farmers need a more flexible credit system, which is easily accessed, regardless of time and place. But this type of credit is very limited, while the demand is increasing (Mayrowani et al., 2000: R 4, 6). The difficulty of providing collateral, and high transaction costs are the main problems faced by small farmers in attempting to access credit from the formal sector. Research conducted in the three provinces: West Sumatra, West Java, and South Sulawesi, in 2000 reported that collateral is the main requirement that should be fulfilled by the farmer to access credit, and the credit given will be only 60% of the value of the collateral. Furthermore, small farmers are burdened by high transaction costs, on which illegal costs are usually bigger than the legal or official costs (Soentoro, Supriyati, & Erizal, 1992: 6).

## **Historical Overview of Rural Financial Systems**

Indonesia's rural finance system is famous for its richness and long history. It has experienced frequent changes and deregulations over time. It can be traced back to the colonial period and evolved during Sukarno's period, Soeharto's regime, and the reformation era. An historical overview of the rural finance system in Indonesia can be divided into two big parts: First, the period from the colonial era until the liberalisation era of the Soeharto regime, and second, from the liberalisation of the financial system to the present. As has been mentioned in the introduction, this division is important because it divides the focus of credit interventions, in which before the liberalisation of the financial system, the rural credit system remained centralised and was mainly focused on strengthening agricultural development. Therefore, agricultural credit programmes were dominant, while after the liberalisation of the financial system, the focus has been concentrated on microfinance for poverty alleviation.

## ***Rural credit systems before the financial liberalisation era***

Indonesia's rural credit systems before financial liberalisation experienced many changes starting from colonial period, the Sukarno government and part of the Soeharto regime.

### **The colonial period**

Indonesia's rural credit system has been formed since the time when the Dutch still occupied Indonesia in the nineteenth century. The dawn of the rural credit system in Indonesia is believed to have started when Patih Wiryaatmadja from Central Java officially established the first credit bank in Indonesia in 1895, called the *Hulp En Sparrbank Der Inlandsche Bestuurs Ambtenaren*, or named as *Bank Priayi*. The main purpose of this credit bank was to prevent the upper class (*Priayi* or civil servants) from being serviced by the moneylenders who set up high interest rates (BRI, 1995). Although this bank no longer operates, its role is very important in laying down the foundation of the rural financial system in Indonesia. *Bank Priayi* is believed to have been the starting point of the establishment of state banks later such as *Bank Rakyat Indonesia* (BRI) and *Bank Perkreditan Rakyat* (People's Credit Bank/ BPR) (Soentoro et al., 1992: 6).

After the establishment of *Bank Priayi*, the Popular Bank, Village Bank and *Lumbung Desa* (or rice barns, banks that allowed villagers to secure a rice advance until the following harvest) were established. The main purpose of these banks was to help rural people to fulfil their credit needs, and to secure them from the practice of money lenders who set high interest rates and rigid regulations (Sukarno, 2000:9). The progress of these banks was remarkable. Within a six-year period (from 1906 to 1912) the number of popular banks increased from 33 to 75, the number village banks rose from 300 to 1,336, and the *Lumbung Desa* augmented from 7,424 to 12,424 (Chaves & Gonzalez-Vega, 1996). This success is related to the capability of colonial government in granting subsidies in a centralised system, and close supervision of these credit institutions. The *Badan Kredit Desa* (BKD) in Central Java and the *Lumbung Pitih Nagari* (LPN) in West Sumatra were also established during the colonial period. These rural credit



programmes are still operating and are considered as being among the successful rural financial intermediaries in Indonesia (Sukarno, 2000: 13).

The main characteristics of the rural finance system during the colonial period, therefore, are that it was highly centralised with supervisory and regulatory issues (Schmit 1994 cited in Sukarno, 2000: 9). This has impacted on the performance of the rural financial system and the shaping of the establishment of new rural credit institutions even until now. For example, the designing of the current KUPEDDES and SIMPEDES of BRI *Unit Desa* was done by consulting the AVB or the *Priayi Bank* (Charitononko & Afwan, 2003: 37-38). On the other hand, these main characteristics also had negative impacts on the performance of the current microfinance programmes. For example, the *Bank Perkreditan Rakyat* (BPR) is now suffering from a lack of legal and regulatory framework. Also, the challenge faced by the proponent of the current commercialisation of Indonesia's microfinance system, among others, is the lack of legal and regulatory frameworks, and the tendency to form subsidised and directed microcredit programmes that inhibit the initiative of private sectors in microfinance (World-Bank, 2001: 3). The highly centralised nature of the rural finance system in Indonesia has also had an impact on the character of the current microfinance industry in Indonesia, which is mainly state-owned with a minor role being played by NGOs and the private sector (Paul Mosley, 1996:33; Soentoro et al., 1992).

### **The Sukarno regime**

During Sukarno's regime (1945-1966) the banking system was almost completely nationalised and centralised, but it did not function smoothly. The rest of Sukarno's regime was characterized by economic and social turmoil coupled with political crisis. The inflation rate reached 600%, and in the political arena, the communist party attempted a coup against the government. Agricultural development was slowing down, and the peasant economy, especially in Java, reached a stagnant level of subsistence output. This period is believed to be the background of the later emergence of several rural finance institution, in which the agricultural credit programmes were implemented to support agricultural development (Soentoro et al., 1992: 18). Agricultural credit programmes were focused on increasing rice production to combat poverty in rural areas. The *Padi Sentra* credit programme was the first agricultural credit programme

with clear, dynamic and simple procedures which gave help in the form of both 'in kind' (fertilisers, chemicals and seeds) and money. However this credit programme does not exist any longer. The simple procedure and other facilities produced the problem of farmers becoming spoilt and their rate of repayment was sluggish (World-Bank, 2001: 5).

### **The Soeharto Government**

The Soeharto era is a critical time both for economic development and rural financial development in Indonesia. In the economic sense, the Soeharto Government was crucial in restoring Indonesia to financial and monetary health focused primarily on combating inflation (Paul Mosley, 1996: 33). The transition between Sukarno's and Soeharto's Government was also important for improving fiscal, financial systems, and agricultural development as well. In the agricultural sector, the Government kept the terms of trade favourable by setting the floor price of rice and controlling fertilizer's price in order to make growing rice profitable, and thus maintained the farmers' income (BRI, 1995: 21).

In the case of rural financial development, the early Soeharto regime is particularly important for the establishment of the agricultural credit system. The famous BIMAS programme was set up as a response to the need to increase agricultural outputs through Indonesia's Green Revolution of agricultural intensification programme. The primary purpose of this programme was to achieve rice self-sufficiency, which is the ambitious political objective of the Green Revolution. Thus, it is clear from this programme that the government's political objective was prioritised, and to achieve the goals, the government had heavily subsidised the rural credit programme with 3% interests rates from Bank Indonesia (Soentoro et al., 1992: 22).

In order to improve performance, the BIMAS programme had experienced many times of changing and deregulations. The BIMAS National credit programme was implemented in the 1965/1966 planting season, with the objective of helping the farmers to increase agricultural outputs. Credit was channelled to the farmers through the Agricultural Production Cooperative (KOPERTA) from the state Bank (BRI) in the form of agricultural inputs such as seeds, fertilizers, and pesticides, as well as money for land tillage. The government designed this credit programme to be simple and

convenient for the farmers, so that the farmers can adopt it easily, and the government goals to boost agricultural production, especially rice, would be realised. For example, credit can be repaid in the form of paddy after harvesting, with an agreement that this repayment should cover the debt with interest, savings, and administrative costs. Farmers also received concession credit with 3% interest rates per month, and credit to be repaid after seven months (Agricultural Department, 1968 cited in Soentoro et al., 1992: 23). The government's effort seemed successful, and the farmers' response was positive. This was evidenced by the increase of the area being farmed from 9,985 hectares in 1964/1965 to 462,520 hectares in the 1966/1967 planting season (Hadisapoetro, 1970, cited in Soentoro et al., 1992: 23). However, the problems of low repayment and high arrears occurred, and arrears reached 94.6% during the 1968/1969 planting season (Timmer, 1981: 37). This undermined the expansion of the planting area, and therefore the agricultural outputs. Another problem was the shortage of funds to provide inputs supplies and domestic credit for the farmers due to the government's budget deficit (Timmer, 1981: 37).

The problems faced in implementing the credit programme through the BIMAS National programme had inspired the policy makers to design a new credit programme in order to increase agricultural production. Because of the lack of capital, the government needed to cooperate with the private sector such as fertiliser and pesticide companies to run the credit programme (Kasryno 1969, cited in Soentoro et al., 1992: 26). This credit programme is named the BIMAS *Gotong Royong*, which was launched in the 1968/1969 planting season, and the clients consist of groups of farmers who cultivate around 50 hectares of land per group. Thus the clients of the BIMAS *Gotong Royong* are specifically selected and are different from the clients of the BIMAS National credit programme. Learning from the failure of previous BIMAS National credit programmes, the government tried to be more liberal to the farmers in order to encourage them to increase production by making it easier for them to access credit. In this case no interest was charged, and the repayment was based on profit sharing. To avoid long and complicated procedures, the credit was not channelled through cooperatives and state banks, but it was delivered directly to the *Kepala Desa* or village head. Nevertheless, problems were still encountered, and these centred on the unmet demand between the farmers at the field level and the government's policy at the office level. For example, the delivery of agricultural inputs such as fertilisers and seeds, and

money for land cultivation and spraying was late. Also, the types, dosage and quantity of inputs given by the government were not compatible with local conditions, or were not matched with the farmers' expectations (Soentoro et al., 1992: 30).

Despite the problems found in the BIMAS National and BIMAS *Gotong Royong* credit programmes, the programmes have successfully expanded the planting area and production as a result of introducing new farming technology to the farmers. The numbers of BRI *Unit Desa* branch also increased sharply from 18 in 1969 to 3,563 in 1985 (Soentoro et al., 1992: 28).

The shortcomings found in this farmers' credit programme have become lessons learnt by the policy makers to design the most appropriate credit programme for the farmers. It was considered that there is an urgent need to provide support institutions at the village level, in order to assist the farmers in performing farming activities. The concept of "*Unit Desa*" was created, which is a composition of support institutions available at the village level such as extension services, credit or banking institutions, and farming supplies kiosks. This agro-economic unit, or *Wilayah Unit Desa* (WILUD), is expected to fulfil the farmer's needs on extension services, credit, and agricultural inputs (BRI 1986 cited in Moll, 1989: 37)

The BIMAS *Gotong Royong* was replaced by the BIMAS *yang disempurnakan* (Completed BIMAS) programme, which incorporates the concept of WILUD and started to be implemented in 1970/1971 planting season. This Completed BIMAS programme is expected to improve the services given to the farmers. The private sectors, such as state-owned companies and cooperatives, handled the credit component and inputs delivery of this programme. The credit component, in particular, was provided by the BRI *Unit Desa* with safe and simple procedure, while the inputs delivery and marketing of farmers' harvests was done by the *Badan Usaha Unit Desa* (BUUD) and *Koperasi Unit Desa* (KUD). Thus, the BRI *Unit Desa* has begun to be involved in the rural credit programme in Indonesia, which was initiated by delivering direct credit to the farmers in 1969. In this case, the credit was not only available for rice farmers, but also for the secondary crops (*Palawija*) farmers.

During the period of 1972-1976, the government enjoyed the smooth implementation of BIMAS credit programme through BRI *Unit Desa*, which channelled Rp 48.87 billion to the farmers, and about Rp 30.07 billion of the repayment (Moll, 1989: 36). However, starting with the 1977/1978 planting season, the annual flow of BIMAS credit declined with the increasing number of farmers who had defaulted on previous loans. The high loan defaults continued and the number of farmers who received the loans reduced sharply, reaching only less than half a million farmers in 1984, which caused the termination of this programme in 1985 (Gonzalez-Vega, 1982; Moll, 1989; Robinson, 2002; Soentoro et al., 1992).

The analysts have provided many reasons for the failure of the BIMAS credit programme (Gonzalez-Vega, 1982). One reason is the periodic debt forgiveness given to the defaulting farmers, which developed the attitude among the farmers that sooner or later their debt will be pardoned (Soentoro et al., 1992: 35). This caused the farmers to view the credit programme as a grant from the government. Another reason is lack of coordination and conflicting roles among the stakeholders, wherein each of them wanted to achieve their goals as soon as possible. For example, the BRI *Unit Desa* had the goal to channel the credit and receive the repayment soon, which frequently conflicted with the Ministry of Agriculture, who aimed to reach the target of planting area, production and productivity as soon as possible also (Moll, 1989: 36). In this case the centralised system of rural financial development required that the lower level (such as BRI *Unit Desa*) should follow the policy of higher institutions (such as the Ministry of Agriculture), and caused the paralysing of the function of the BRI *Unit Desa* as the credit provider. There was also the problem of misuse, in which the credit fund was used for other than farming purposes by bank employees and others who were involved in the provision of loans (Soentoro et al., 1992: 36). In addition, there was also the widespread practice of *fictitious loan*, that is the loan was applied for by farmers but the money was used by the third party (Moll, 1989: 36). This reality suggests that although the BIMAS credit programme has successfully introduced new technology and increased rice production by achieving self-sufficiency in 1984, the programme has not contributed to the establishment of a regular and sustainable financial system for the farmers (Moll, 1989: 39).

The failure of the BIMAS credit programme in delivering credit to farmers has been a valuable lesson for the government officials or policy makers in designing the future rural finance system. The government, in this case, has used the financial sector to channel funds to the priority sector to promote growth, with high subsidy and facilitating the disbursement so that it meets the target in terms of amount disbursed. However, it limits the effective use of resource, in that every place has different input requirements, while the capability of farmers in different places is also different. On one hand, the BIMAS programme has been successful in increasing national rice production. However, whether the BIMAS programme has raised farmers' income is questionable (Adams et al., 1984), while the repayment discipline of the farmers and the accountability of bank staff and officers are clearly negative. In fact, these circumstances are important for the efficiency and effectiveness of future rural credit systems. Many authors have acknowledged many criticisms about the limitations of cheap credit and special credit institutions in developing countries (Moll, 1989: 37), and the BIMAS credit programme in Indonesia has confirmed these criticisms.

Considering the increase of commodity diversification in the agricultural sector, and also the limited economic capacity of small entrepreneurs in rural areas, the government expanded the credit programme into commodities other than rice and secondary crops, such as for livestock, fisheries, and cash-crops, and to other activities such as cooperatives, rice milling, petty-trading, and so on. These credit programmes started in 1974, named as KIK (Small Investment Credit) and KMKP (Permanent Working Capital Loan), and were attractive and greatly demanded by the customers. By December 1974 the requests for KIK and KMKP loans were 16,988 and 18,690 respectively. These credit systems follow the system of the BIMAS credit programme which was also channelled by the BRI *Unit Desa*. The maximum loan permitted per borrower is Rp15 million for both programmes and the interest rate is 12% per year. To avoid the risks of loan default, the government established an insurance company named P.T. Askrindo, which guarantees the repayment of the loans. The successful implementation of the credit programmes caused the KIK and KMKP to become the largest small-scale cheap credit programmes in 1982 with a total amount outstanding of Rp 1,196 billion (equal to US\$1.8 billion) (BRI, 1995; Soentoro et al., 1992).

There are also other important rural credit programmes which were established before the financial sector liberalisation, namely, Mini Credit, Midi Credit, and BKK. Mini and Midi Credit programmes were created in 1974 by the BRI *Unit Desa*, to respond to the demand of poor farmers in rural areas, who could not access the BIMAS credit programme because they were located outside the BIMAS credit's zone (BRI, 1995: 43). Mini credit was given to the small entrepreneur in rural areas with a loan between Rp 10,000 to Rp 100,000, and with very soft terms and simple procedures (Soentoro et al., 1992: 42). The main purpose of this Mini credit, therefore, was to help the rural community to transform potential resources they have into real ones. Farmers were encouraged not only to focus on rice and secondary crops, but also to expand to non-farm activities, so that they could rise above poverty and increase income (BRI, 1995: 45). The Midi credit was also channelled to the rural community but the target population were the middle-income people, with the loan size between Rp 200,000 to Rp 500,000. This credit is usually given to the rural people who have already proved that they can run their business successfully, and the fund is used to improve their business activity (Chaves & Gonzalez-Vega, 1996; Paul Mosley, 1996; Patten & Rosengard, 1991; Riedinger, 1994).

The *Badan Kredit Kecamatan* (BKK) credit programme is one rural credit programme that was established in 1972 during Soeharto's government, or before the liberalisation of the financial system, but it was initiated by the provincial government. This credit programme has been considered very successful by many authors in delivering credit for the rural community (Soentoro et al., 1992:48 ).

Besides the many rural credit programmes, which have been established out of the BIMAS credit programme, which focus on increasing income and combating poverty, the government also realised the need to direct a credit programme for the poor. The Presidential Instruction No. 4/1973 gave tasks to the BRI *Unit Desa* to extend non-BIMAS credit programmes and to mobilise savings. The government's attempt to diversify the types of rural credit systems appropriate for the rural population has become a signpost for the future liberalisation of Indonesia's financial system.

### *The rural financial system after the liberalisation of Indonesia's financial system*

Parallel with the period of Soeharto's government, gradual liberalisation of Indonesia's financial system came into effect. The first monetary and banking deregulation was launched on 1st June 1983, which was followed by a sequence of government regulations to complement the first deregulation. The main purpose of these deregulations was to accumulate public funds in order to ensure economic growth and the smooth implementation of development. Other objectives were to reduce government dependence on oil export, to increase the efficiency of the banking sector, and to manage the development of the capital market (Soentoro et al., 1992: 45).

The background to introducing this deregulation package is related to the world economic crisis that particularly occurred in North America and Western Europe. This impacted on Indonesia's economy in terms of the drop in oil price, reduction of exports, limitations being placed on imports, and the decline of financial assistance from these developed countries, which caused the decrease of the country's foreign exchange (D. C. Cole & Slade, 1996; Martokoesoemo, 1994a; Soentoro et al., 1992; World-Bank, 2001). To solve these problems, the government launched the deregulation in order to mobilise domestic funds, and to reduce state involvement in the banking sector, so that the private sector and public sector would have a healthy competition in the capital market. The June 1983 deregulation was focused on banking deregulation in which the control of the interest rate and credit ceiling was withdrawn, so the ceiling on rates, loan volume, and volume of most deposits were raised (D. C. Cole & Slade, 1996; World-Bank, 2001).

The next deregulation to complement the 1983 deregulation was in October 1988 (PAKTO 1988) when the licensing of the new private, domestic and foreign bank was eased, the regulations on bank branching was relaxed, while the creation of new banking products such as savings and deposits was permitted (Soentoro et al., 1992: 49). By launching this deregulation measure, the number of banks increased sharply by about 35 banks from 1985 to 1995 (Conroy, 2000: 7). Also, after this deregulation the *Bank Perkreditan Rakyat* (People's Credit Bank/BPR) was created with special



incentives granted to indigenous entrepreneurs to enter the banking system. This banking policy measure limits the time of operations of the old BPRs (the BPRs that were established before October 1988) to adjust to the new regulations of BPRs. The main requirement to establish a BPR was the availability of capital of at least Rp 50 million (D. C. Cole & Slade, 1996: 128-30).

The 1988 deregulation was followed by another one, which occurred in March 1989 (PAKMAR 1989). This measure aims specifically to improve the implementation of the BPR, in which the time limit allowed to the BPR to adjust to the new regulation was eliminated. Thus, the number of BPRs increased sharply from 5,783 in 1988 to 8,717 in 1993 (World-Bank, 2001: 7).

In January 1990, the government continued to launch deregulatory reforms to further reduce the subsidising of credit programmes. However, the central bank still subsidised credit to certain target priority sectors, primarily food production and small farmers. Also, under the KUK programme (credit for small businesses), all national banks, whether state-owned or private are required to allocate 20% of their portfolios for small credit; similarly, state-owned enterprises are required to earmark 5% of their annual profits to the KUK programme (Charitonenko & Afwan, 2003: 17).

All of the changes made since the 1983 deregulation are summarised and expanded upon in the 1992 Banking Act. Through this Banking Act, the banking system in Indonesia is divided into two: the commercial or general banks (*Bank Umum*) and the people's credit bank (*Bank Perkreditan Rakyat/BPR*). The commercial banks provide general banking services as well as foreign exchange services, while the BPRs are generally smaller, locally based and privately owned institutions, and do not provide foreign exchange services (Charitonenko & Afwan, 2003: 26). A detailed explanation about BPR will be provided in a later section in this chapter.

Long after the launch of the 1992 Banking Act, the government decreed the Banking Act No. 10/1998, which mandated and gave a legal basis for the central bank (BI) to develop an Islamic Banking System (Republika, 2005b). Indonesia is the largest Islamic country in the world, and there is growing popularity of the principle of Islamic finance both at national and international levels (Charitonenko & Afwan, 2003: 26). The

concept of Islamic banking is the renewing of Islamic Law (*Sharia*) based on modern economic and financial transactions (Venardos, 2005: 47-52). The development of a legal and regulatory framework of *Sharia* principles could help the shift of focus from traditional collateral requirements to the Islamic Banking principles, which are based on profit-sharing and are interest-free (Sukarno, 2000: 10). This change of emphasis may also improve microcredit access of the poor in rural areas, who have cultural and religious reservations about conventional credit programmes.

The last financial regulation measure identified, which relates to rural financial development, was the announcement of Banking Act No. 23/1999 concerning the supervision of the financial sector. According to this mandate, the bank supervision function is transferred from BI to a new independent institution, which supervises all financial institutions and emphasises its activity by effectively enforcing banks' prudential regulations and Non-banks' regulation and supervision. This breakthrough is crucial, considering the overlapping function of the central bank (Bank Indonesia) so far. Also, there are many types of MFIs, such as BKDs, LDKPs and other Non-bank Institutions, which are operating without licences as banks and are registered as cooperatives. These institutions need to be regulated since they could violate the Banking Act when they mobilise public funds.

## **The Performance of Rural Financial Institutions (RFIs)**

Indonesia's rural financial institution is characterised by its high diversity. It covers formal, semi-formal and informal finance at central, provincial, district and sub-district, and village level. This section highlights the performance of rural financial institutions in Indonesia including the structure of RFIs, and the profile of major rural financial institutions which were established after the liberalisation of the financial system.

### ***The structure of Indonesia's rural financial institutions***

Indonesia's rural financial institution can be divided into formal, semi-formal, and informal. The formal sector comprises the institutions which are chartered by and subject to be regulation and supervision by the government. On the other hand, the

informal sector, usually in the form of intermediaries, is operated outside the government's interventions and regulations. Between these, there are semiformal sectors which are not regulated by the central banking authorities, but are registered and/or licensed by other government authorities such as the local government (Paul Mosley, 1996: 36).

Differently from other countries, where semiformal and informal sectors play an important role in building rural financial institutions, Indonesia's rural financial institution is highly dominated by the formal sector. Under the leadership of the central bank (Bank Indonesia-BI), rural financial institutions are managed through several banking acts and financial regulations. This domination proceeds further even to the village level, in which the Bank Rakyat Indonesia (BRI) with its *BRI Unit Desa* networks plays an important role in developing and managing the rural credit system for the rural people. Despite many state banks having credit programmes in their activities, in fact, there is only the BRI that has responsibility for rural development (1973, cited in Paul Mosley, 1996: 36).

Despite the domination of the government's credit programme in rural areas, the rural financial institutions are also much influenced by the practice of informal lenders such as moneylenders and self-help groups, for example *Arisan* (ROSCAs), *Koperasi Simpan Pinjam* (Credit and Saving Cooperative), and other community groups' credit programmes. Before the liberalisation of the financial system in 1983, the role of these institutions was dominant in rural areas, and there was also healthy competition to attract the customers among them, but they could not be enumerated with accuracy. Prabowo and Sayogyo (2003) reported from their research that about 46% of the total respondents who use credit facilities accessed formal credit institutions and cooperatives and about 30% borrowed from informal sources such as moneylenders and ROSCAs. The rest, who are difficult to count, could use community groups, or rural banks which are set up by the rural community.

After the liberalisation of the financial system, the barriers to credit institutions wishing to enter the rural credit market were lowered. In this case the semi-formal and informal credit providers were regulated, and the focus of the credit programme was not solely on the agricultural sector but more on rural development and poverty alleviation.

Therefore, since then, the rural financial institutions have been transformed into microfinance institutions, which deal with helping the poor in rural areas and urban areas. In recent times the supply-side of microfinance institutions is shown in Table 4.1 below:

Table 4.1 Supply of microfinance institutions by formality of provider type

Formal Institutions	Semi-formal Institutions	Informal credit providers
Primary commercial banks (district and sub-district): <ul style="list-style-type: none"> <li>• State-owned BRI Units</li> <li>• BDB (<i>Bank Dagang Bali</i>)</li> </ul> Secondary Banks (sub-district): <ul style="list-style-type: none"> <li>• BPR (Bank Perkreditan Rakyat)</li> </ul> State-owned Pawnshop (district and sub-district)	LDKP (Rural Credit Fund Institutions)  BKDs (Village credit institutions)  Microfinance Cooperatives (district and sub-district): <ul style="list-style-type: none"> <li>• Savings and credit cooperatives (KSP)</li> <li>• Savings and credit units of cooperatives (USP)</li> <li>• Savings and credit service points (TPSP) (village)</li> </ul>	Microfinance NGOs (village)  Moneylenders (village)  Traders (village)  Savings and credit associations (village)  Self-help groups  Friends and family.

Source: Adapted from Charitonenko & Afwan (2000) and Sukarno (Charitonenko & Afwan, 2003: 11)

Based on Table 4.1, the degree of formality of microfinance institutions follows the continuum from formal to informal. In this case, there is a possibility of informal institutions to become formal according to their capability to adopt requirements and regulations stated by the government. For example, a KSP could become a BPR if it can demonstrate banking expertise and put initial capital as requested.

The informal sector as seen in Table 4.1 consists of microfinance NGOs, traders, saving and credit associations, moneylenders, friends and family. While the first three informal lenders can be identified, since they can be found physically, the last three lenders, namely moneylenders, friends and family are difficult to detect. In fact, rural people easily access these 'invisible lenders', since they do not require administrative procedure, ceremony, and so on.

It is important to notice from Table 4.1 that although the BRI *Unit Desa* deals with the poor in rural areas, its location is usually at the District and Sub-district level. On the other hand, some of the semiformal lenders and all of the informal lenders have their centres at the village level. This reality suggests that the BRI *Unit Desa* is not close enough to the rural people compared to the semiformal and informal lenders, which are often located just next door to the rural poor. This fact could be the reason why the majority of rural people are reluctant to access formal credit institutions (Fieldwork, 2004). A study conducted by BRI jointly with Harvard University in late 2000 also concluded that 62% of respondents did not have saving accounts, and 68% did not have credit from any formal financial institutions (Charitonenko & Afwan, 2003: 19).

Looking at the size of microfinance institutions, the formal sector is still dominant. The BRI *Unit Desas* and BPRs are the major state banks which engage with the poor in rural and urban areas. To get the picture of microfinance institutions, the size of current microfinance institutions can be seen in Table 4.2.

Table 4.2 The size of microfinance supply

MFI Name/ Type	Units No.	Outstanding loans		Outstanding loans		Total Deposits		Total Deposits	
		No. x1000	%	Rp billion	%	No. x1000	%	Rp billion	%
<b>Formal MFIs:</b>									
•• BDB	31	9	0.1	57	0.3	242	0.7	190	0.6
•• BRI Units	4,063	2,790	23.2	9,841	43.5	27,040	77.5	21,991	74.2
• BPRs	2,143	1,900	15.8	6,420	28.4	5,200	14.9	5,597	18.9
• <i>Perum Pegadaian</i>	714	5,230	43.4	1,355	6.0	-	0.0	-	0.0
<b>Semiformal MFIs:</b>									
•• LDKPs	1,603	500	4.2	337	1.5	871	2.5	342	1.2
• BKDs	4,518	658.871	5.5	198	0.9	571	1.6	38	0.1
•• Cooperatives									
○ KSPs	1,097	655	5.4	531	2.3	655	1.9	85	0.3
○ USPs	35,218	-	0.0	3,629	16.0	-	0.0	1,157	3.9
• Credit Union	1,071	296	2.5	272	1.2	296	0.8	249	0.8
<b>Total</b>	<b>50,458</b>	<b>12,039</b>	<b>100.0</b>	<b>22,640</b>	<b>100.0</b>	<b>34,875</b>	<b>100.0</b>	<b>29,648</b>	<b>100.0</b>

Source: Adapted from Charitonenko & Afwan (2003:13).

Table 4.2 shows that the BRI *Unit Desa* is dominant in microfinance activities among the formal sector in Indonesia. It has the highest number of units, and reached the

highest share of deposits of 74% in 2001. However, in terms of the number of outstanding loans, the *Perum Pegadaian* (state-owned pawning company) has the highest number of outstanding loans, although in terms of value, the *BRI Unit Desa* was still leading. Because of the reluctance of poor people to access banking institutions, more people borrow from the *Perum Pegadaian* because of its simplicity. This microfinance institution which targets low-income households provides simple and fast transactions, and allows the customers to turn their valuables as collateral into cash without any responsibility to sell them. Furthermore, the interest rate is low, 12.5% per month for loans up to Rp 150,000 (US\$17) and 1.75% per month for loans more than Rp 500,000 (US\$56) (Sukarno, 2000: 35).

Regarding the semiformal sector, the cooperatives and credit unions operate at the sub-district or village level, and are regulated by the Ministry of Cooperatives. The LDKPs and BKDs are established based on the initiative of provincial government, and therefore are licensed and regulated by the provincial government. Based on Table 4.2, *Usaha Simpan Pinjam* (USPs) has the largest number of units in Indonesia, and shared the highest percentage of total deposits in 1999. This reflects the fact that the rural people are still relying on the cooperative system in borrowing money. The second largest share of deposits was the LDKP. LDKP is a general term representing a variety of non-bank institutions established by provincial and district governments. Currently, there are two main regional non-bank credit institutions under the LDKP system, namely the Balinese LDP, and the *Badan Kredit Kecamatan* (BKK) in Central Java (Charitonenko & Afwan, 2003: 20). The LDKP is considered as the most successful and the only viable system of village-level institutions in Indonesia (Sukarno, 2000: 12-14).

The informal sector, which is not included in Table 4.2, remains undetectable. However, it is estimated that there are 400 NGOs, more than 50,000 self-help groups, and 250,000 ROSCAs or *Arisan* available in Indonesia (Sukarno, 2000: 13). This topic will be discussed further in this chapter.

## ***Government's projects and programmes in the microfinance and agricultural sector***

After the Asian economic crisis hit Indonesia in 1997/1998, an increasing number of government projects and programmes in microfinance were created, which aimed at helping the poor both in rural and urban areas to cope with poverty problems. For the purpose of this study, I would like to elaborate specifically on the government projects and programmes in the agriculture sector, along with the general government projects and programmes for poverty alleviation.

### **Government's projects and programme for poverty alleviation**

In addition to the various types of microfinance institutions as mentioned above, there are several large microfinance programmes funded by the government and donor agencies. Major government agencies include: the Ministry of Agriculture, National Planning Agency Board (Bappenas), and National Family Planning Coordination Agency Board (BKKBN). Despite the increasing effort to achieve the commercialisation of microfinance programmes in Indonesia, these government institutions still continue to subsidise the credit programme to the poor.

This condition has been the subject of criticism by many authors. The first criticism relates to the coordination of the programmes among the agencies. Each agency has a particular philosophy and procedure based on its policy priority, and in many cases there are contradictions in promoting formal microfinance policy from the central government (ADB 2003, cited in Charitonenco & Afwan, 2003: xv). Another criticism relates to the subsidised and directed microcredit programme. A recent survey found that there are 70 programmes and projects for poverty alleviation available in various ministries and other government institutions, each of which has a microcredit component, with high government subsidy (Charitonenco & Afwan, 2003: 37). For example, the Family Welfare Income Generating Project (*Usaha Peningkatan Pendapatan Keluarga Sejahtera*) under the BKKBN charged very low annual interest rate (only 6%), while the Village Economic Savings and Credit project or UEDSP

promoted by Ministry of Home Affairs had allocated substantial subsidies to local government (Sukarno, 2000: 14).

Another example is the *Inpres Desa Tertinggal* (IDT) programme or presidential instruction relating to least developed villages. IDT is the largest government programme for poverty alleviation, which has developed about 20,000 self-help groups in target villages (Conroy, 2000: 107). This poverty alleviation programme, which is coordinated by the National Planning Agency (BAPPENAS), is an inter-departmental programme aimed at reducing regional income inequality. The programme consists of providing capital grants for each least developed village for income-generating activities of the poor, along with a package of infrastructure development, training programmes, and so on (Perdana & Maxwell, 2004: 15). A block grant of Rp 20 million was given to each participating village, and this fund is used as the basis for small-scale revolving credit for groups of people in the village (Perdana & Maxwell, 2004: 15-18).

Although the IDT cannot be classified as a microfinance programme, because of its capital grants to the poor, this programme has developed an image among the poor who receive grants that the government is very generous, and any government's programme is considered cheap, and the repayment of any credit advanced under a formal programme is sometimes unnecessary. This impression is widespread among the rural community and is affecting credit programmes designed by the government such as the KUT and credit for food security (KKP).

The main problem in channelling the IDT fund was in selecting the participating villages. This problem is very common in Indonesia, considering the fact that the number of villages categorised as under-developed is high, and to select them as the recipients of the IDT funds needs specific standards or criteria. Similarly, it was also difficult to identify the population who are the poor, not poor or semi-poor, and sometimes the poor are not residing in the respective village at the time of identification, and they are therefore missed from the identification (MOA, 2002; Perdana & Maxwell, 2004). Considering the ineffectiveness of this programme, and coinciding with the fall of the Soeharto regime, the IDT programme did not receive further funding after 1997. The increasing number of credit projects and programmes



provided by the government agencies could hamper the process of commercialisation of microfinance in Indonesia.

The background as to why the government is still continuing to implement subsidised credit programmes is in order to help the poor who suffered greatly from the last Asian economic crisis, while the government no longer gives liquidity credit from the central bank (Bank Indonesia) (MOA, 2002). In the agricultural sector, the reason for extending the subsidised credit programme is to strengthen the food security of the poor, especially after the crisis. It is also to support the small farmers with capital for their farming activities, considering that credit for the agricultural sector has been limited after the elimination of liquidity credit from the central bank (Hermanto, 1992: 65).

### **Government's credit programmes and projects in the agricultural sector**

The government's credit programme and projects in the agricultural sector are usually named as '*Kredit Program*', which are characterised by high subsidy level, and the procedure of delivery is usually through state banks or cooperatives direct to the farmers' groups. The previous BIMAS and KUT credit programmes are examples of this kind of government credit programme. The '*Kredit Non-Program*', on the other hand, is a credit programme for the agricultural sector, which comes from private banks or non-bank institutions (World-Bank, 2005a: 2).

In recent years the government, through the Ministry of Agriculture, has designed many credit programmes which are aimed at helping farmers to fulfil their capital needs for their farming activities. However, most of these credit programmes are not successfully implemented due to many shortcomings, such as slow distribution of credit funds, low repayment, and problems in design and management, while the government has to continue to replenish their capital in order to enable them to survive. In fact, these programmes absorb a large part of the government budget, of which about Rp 3 trillion is used for subsidising interest rates and topping up revolving funds (MOA, 2002:3).

The KKP (*Kredit Ketahanan Pangan* or credit for food security) credit programme was launched in 2000, to replace the KUT credit programme, which was terminated in the 1998/1999 planting season. The objective of the KKP is to strengthen the national food

security, and also to increase farmers' income through provision of investment credit with affordable interest rates of 6-10% (SMERU, 2002: iii-iv). However, this programme was constrained by the slow distribution of credit funds. Until March 2001, the distribution of credit in South Sulawesi reached only 2.17% of the total funds available, while in East Java was only 0.5% of the total funds (World-Bank, 2005a: 2).

Other programmes are *Bantuan Langsung Masyarakat* (BLM) and *Pemberdayaan Masyarakat Agribisnis Melalui Penguatan Modal Usaha Kelompok* (PMA-PMUK). The BLM is a revolving credit mechanism, which absorbs 40% of the Ministry of Agriculture's public funds, while the PMA-PMUK spent Rp 1.8 trillion of the government budget. This is the highest among the government's recent targeted credit programme (Soentoro et al., 1992: 51). Because the BLM suffered from poor implementation, the government replaced it by the PMA-PMUK in 2003, which has been more a change in name rather than substance. Looking at the previous credit programmes of KUT and KKP, the pattern is similar, and the problems of poor design and implementation are reiterated.

### *A review of major rural financial institutions*

#### **Farmers' Credit Programme (*Kredit Usaha Tani/ KUT*)**

The deregulation of the banking and monetary sectors in 1983 affected the development of Indonesia's rural financial system. The direct effect was the closing down of the BIMAS credit programme and its replacement by the Farmers' Credit Programme (KUT), which started to be implemented in 1985. The significant change introduced in this KUT credit programme that credit for farmers was not only used for increasing production of rice and secondary crops, but also to assist farmers with capital to engage in producing other commodities such as inland-fishery, cash-crops, sugar-cane, and livestock (Soentoro et al., 1992: 52). Thus, the provision of credit for small farmers was no longer based on the government's political objective of increasing rice production, but it was based on the needs and demands of the farmers.

The KUT is one of the prominent credit programmes in Indonesia to help the farmers in rural areas to fulfil their needs of necessary inputs and equipment for farming. This credit programme was handled by the BRI Branches and channelled through the Village Cooperative Unit (KUD) to the farmers. However, the government made strict regulations for the KUD who channelled the credit, by which the KUD should be self-sufficient, and its default rate should not be more than 20% (Soentoro et al., 1992: 52). Despite the liberalisation of Indonesia's financial system, this KUT credit programme still received fully subsidy (only 3% interest rate per year) from the Liquidity Credit of Bank Indonesia (KLBI). However, because of the further reduction of credit subsidy through a deregulation package in January 1990 (PAKJAN 1990), the interest rate from BRI was increased from 12% to 16% (Soentoro et al., 1992: 52).

Another difference between the KUT credit programme and the BIMAS credit programme is that the credit is delivered through the farmers' groups, and the chief of group has responsibility to manage the instalments and repayment. Many agents were involved in the credit activities such as the agricultural extension workers (PPL), KUD manager, and village head (*Kepala Desa*). However, some agents involved in the KUT credit programme had brought moral problems such the misusing of the fund, fictitious loans, and other forms of corruption (Soentoro et al., 1992: 52).

The indication of the low performance of the KUT credit programme was seen in the early 1990s. The amount of credit channelled to the farmers reduced sharply, and reached only 25% in 1990. There are many reasons for these problems. The first reason was the low educational level of the farmers, and the fact that most of them were not familiar with the banking system. Therefore, most farmers were not able to formulate the Group's Basic Plan (RDKK), and they asked the Village Head, agricultural extension workers, or a KUD staff member to create it. These agents, then, used this opportunity to apply to the government for a fictitious credit (1990, cited in Waluyo & Djauhari, 1992: 117). The second reason was the declining number of KUD eligible to channel the credit, because of the low performance of the KUD. Based on research conducted by Nasution (Soentoro et al., 1992: 53), these KUDs have not been recognised, and were not able to optimise their resources. This had caused the process of channelling credit to be less than optimal, and often the credit received was delayed until the planting season had finished. This rendered the credit useless, and further, the

farmers' harvests were unsatisfactory. The third reason was the transfer of many farmers to apply credit from the KUT to the KUPEDDES credit programme because the interest rate which KUPEDDES used was relatively the same, while the procedure was quite easy compared with that necessary for obtaining credit from the KUT (Chaves & Gonzalez-Vega, 1996; Paul Mosley, 1996; Patten & Rosengard, 1991; Patten et al., 2001; Robinson, 2002).

### **The transformation of the BRI Unit Desa system**

By the reduction of state involvement in the banking sector, the private or commercial banks could freely regulate their banking activities, based on their own regulation. However, banking institutions should also be capable of managing resources properly, due to the reduction of liquidity credit from the central bank (Bank Indonesia), and in order to survive in the liberalisation era. The BRI, through its *Unit Desa* network, is one of the state-owned bank, which transformed its function after the financial liberalisation.

The transformation of BRI *Unit Desa* system is one step which has caused Indonesia, especially Bank Rakyat Indonesia (BRI) to become one of the most successful rural banks in the world (Robinson, 2001; Rudjito, 2003). This tremendous shift centred on the establishment of BRI networks and the setting up of BRI branches at the sub-district level, namely BRI *Unit Desa*. Thus, the system was transformed from their previous practices, channelling government-subsidised BIMAS credit for rice farmers to being the world's largest, most profitable banking system. Therefore, the function of BRI shifted from being administrative to being commercial.

The 'privatisation' of BRI *Unit Desa* has many positive meanings. The decentralisation of decision-making has made the employees fully responsible for their work, and therefore improved the professionalism of its staff. This also had improved the gap between central and local government, and also between the lenders and the borrowers in rural areas. The flexible procedures, and targeting of all rural people's activities rather than focusing purely on agricultural undertakings was another positive side of the BRI *Unit Desa* System.

The transformation of BRI *Unit Desa* into a profitable commercial banking system, however, means that it has adopted the strategy of being business oriented. Therefore the regulations include market interest rates, and the requirement of providing collateral by the customers, which means the very poor, cannot access this credit programme. The clients of the BRI *Unit Desa* therefore are those who are the poor living at, or slightly above, the poverty line, sometimes known as 'working poor' (Soentoro et al., 1992: 55). To accomplish the objective of becoming a profitable commercial banking system, in 1984, the BRI *Unit Desa* introduced two new products, namely KUPEDDES (General Rural Credit) and SIMPEDES (Rural Savings).

The KUPEDDES is a credit programme for rural people, aimed at simplifying a variety of credit programmes which had been available in the 1980s such as KIK, KMKP, *Kredit Mini*, *Kredit Midi*, and *Kredit Program*. By the introduction of KUPEDDES, rural people were able to access only one credit programme. The government has made this programme simple and flexible, to ease the customer access (Maurer & Seibel, 2001: 3). The KUPEDDES is a non-targeted and non-subsidised credit programme, meaning that credit is available for any creditworthy customer, with annual interest rates 33% for working capital loans and 22% for investment loans, if the borrower repays on time. This credit programme also requires collateral, usually in the form of land titles, but buildings, motor-cycles, or other possessions could become a guarantee (Charitonenko & Afwan, 2003: 16).

It is interesting to note that since KUPEDDES loans are provided for working capital and investment purposes, and the customers are individuals who have a productive enterprise or regular income, such as civil servants and employees of enterprises, the customers of BRI *Unit Desa* are the better-off poor and non-poor households (Robinson, 2002).

Regarding the success of KUPEDDES in extending loans to the rural people, Robinson (Charitonenko & Afwan, 2003: 16) argues that the reason for high repayment rates is because of close supervision by bank staff in selecting the borrowers based on their ability to use the loan productively, and their willingness to repay. Another reason is because the bank gives incentives to the borrowers to increase the amount of loan based on the repayment record and the creditworthiness of the enterprise, so that the borrowers

are keen to repay promptly. A refund of 25% of interest paid is made when instalments are not delayed for consecutive months. By applying this incentive, KUPEDES borrowers have paid back more than 97% of all loans (Robinson, 2002: 266).

The SIMPEDES and other savings products of the BRI *Unit Desa* are aimed at mobilising and accumulating capital in rural areas. This point is important, considering that the government experienced budget deficit due to the dropping oil prices, and the reduction of assistance from donor countries. The accumulated capital is also important to finance the demand for credit and to ensure the institution's sustainability. In this case the saving mobilisation in BRI *Unit Desa* is useful for financing the KUPEDES (Charitonenko & Afwan, 2003: 16). The introduction of SIMPEDES also had worth for rural people, because based on surveys since 1982 it was found that there is extensive rural demand for reliable and liquid deposit facilities (Danusaputro, M. et al, 1990 cited in Soentoro et al., 1992: 55).

Considering the successful implementation of KUPEDES and SIMPEDES, it was reported that there was a sharp increase of savings up to 57% for one year only, with an increase of SIMPEDES savings alone at 64%, while the KUPEDES funds increased up to 52% (Charitonenko & Afwan, 2003: xvi). These figures reflect that rural people very much welcomed these two programmes.

### **People's Credit Bank (*Bank Perkreditan Rakyat* /BPR)**

The term of *Bank Perkreditan Rakyat* (BPR) emerged after the launch of a Banking Reform in 1988, which removed most banking industry barriers and allowed the commercial banks to extend their branch network throughout Indonesia, and the announcement of the 1992 Banking Act, which permits the establishment of secondary banks at the sub-district level. This term refers to a variety of small-scale MFIs with different historical background and different systems. Some are deposit taking, and some are credit only systems, which are not properly differentiated in the literature.

Two major MFIs that transformed into BPR are BKD and LDKP. The BKD refers to the MFIs that were formed since the Dutch colonial so-called "village banks" and "paddy banks" (*Bank Desa* and *Lumbung Desa*). The LDKP is a generic term referring

to various regional MFIs, which were mostly established between 1970-1990. This type of MFI is a post-colonial revival of the village bank, and suffered a severe setback in 1960s due to political instability and high inflation. The *Lumbung Pitih Nagari* (LPN) in West Sumatra is an example of this type of MFI.

The present status of BPR, therefore, is the banking institution as the product of the deregulation package of 1988, under the regulation and supervision of BI. Other MFIs such as BKD and LDKP were given the opportunity to upgrade themselves into BPR by fulfilling several requirements such as a minimum capital requirement of Rp 50 million. This regulation was renewed in May 1999 by increasing the minimum capital requirement into Rp 2 billion for the national capital area (Jakarta and surroundings), Rp 1 billion for a provincial capital, and Rp 500 million in other areas (Sukarno, 2000: 28).

The establishment of the BPR confirms that the government has seriously attempted to decentralise the rural financial system. This is because the main characteristic of BPR is that it is localised and involves mostly privately owned institutions. The BPR is closer to the community than other commercial banks. However, by the introduction of new regulation of BPR, such as the increasing minimum capital requirement (ten times higher than the previous minimum paid-up), it would be impossible to establish new BPRs in rural areas. This also contradicts the spirit of financial liberalisation in the early 1980s, which eased banking entry barriers in order to expand banking institutions in rural areas.

The strict regulation the BPR coupled with the suffering caused by the Asian economic crisis, weak management, and insufficient supervision has led to insufficient growth of the BPR. Several BPRs have become less sound, and even unsound, which forced the BI to freeze the operations of 72 BPRs in 1999, and more will follow in coming years (Karim, 2005: 2).

### **The emergence of an Islamic Banking system**

As has been stated earlier, the government launched the Banking Act No.10/1999 regarding the establishment of an Islamic Banking system in Indonesia. Owing to the favourable environment of Indonesia's population, which has the largest Muslim

community in the world, there is an impressive growth of Islamic banking in Indonesia. Various banking institutions in Indonesia have opened their *Sharia* services, which has caused Indonesia to become a country which has the highest number of Islamic Banks, and Islamic Insurance as well (Djaafara, 2004: 1). It was reported that up to November 2004, the network of *Sharia* banking has been added 69 offices more than the previous year, the bank assets increased up to 80.56%, and financing reached 101.08% (Tim-Republika, 2005: 1).

The reason for the establishment of Islamic Banking system in Indonesia is because of the economic crisis that severely hit Indonesia since July 1997, followed by political instability, causing the slow growth of economic development and the banking system, especially the conventional banking system. Thus, the government attempted to find an alternative way, which could solve the problems faced by Indonesia's banking systems.

The Bank Muamalat Indonesia (BMI) pioneered the establishment of Islamic Banking in Indonesia that commenced in May 1992. The BMI has proven that the excellence of the Islamic concept caused the BMI to remain solid, and it did not incur high losses during the economic crisis. Up to October 2005, after thirteen years of operation, the total assets of the BMI reached Rp6.890 trillion, with Rp145.460 billion profits and Rp67.15 billion Non-Performing Financing (NPF) (Arndt, 1987).

The establishment of the concept of Islamic Banking in Indonesia and its impressive growth reflects that the community has accepted this type of banking system. As stated previously, cultural and religious factors could become the reason for the successful implementation of the Islamic *Sharia* banking system in Indonesia. With regard to the development of a rural financial system, therefore, the Islamic Banking System has become one alternative for achieving success in Indonesia's rural financial development in the future.

### **Informal Finance in Indonesia**

Discussion on informal finance in Indonesia is hampered by the lack of data and official information. It remains a little-studied sector. Nevertheless, despite the insufficient information available, there is a large capital market involving informal finance in



Indonesia (Robinson, 2002; Soentoro et al., 1992; Sukarno, 2000). As informal finance in Indonesia is positioned outside the government's interventions and regulations, the establishment and the operations of informal finance are difficult to identify and a specific study on this topic needs to be carried out.

Other than the above 'invisible' feature, its long history and diversity also characterise Indonesia's informal finance sector. The old character of informal finance is reflected by the fact that the practice of moneylenders has been available since long before the Dutch colonial period. The establishment of the *Badan Kredit Desa* (BKD/ village credit organization) and *Lumbung Desa* (village barns) during the colonial period was also to protect the borrowers from the extreme practice of moneylenders (World-Bank, 2001: 24). These measures reflected colonial perceptions that informal finance was exploitative and inefficient.

The diverse character of informal finance in Indonesia can be explained by the fact that Indonesia has a diversity of cultural, social or ethnic groups, and each group has its own way of accumulating fund and credit activities. The traditional and long-standing features of informal finance have ensured that this financial system remains firmly anchored in the practices of the rural population; thus rural people are more likely to join their own ethnic and social group in credit and savings activities than another programme. A study in Bogor, West Java, reveals that more than 80% of rural households were linked with the informal sector, although the formal sector has been developed and practises in the area (Conroy, 2000:106).

As shown in Table 4.1, informal finance consists of the microfinance NGO, moneylenders, traders and shopkeepers, saving and credit association, and family and friends. Among these, Rotating and Savings Credit Associations (ROSCAs, or *Arisan*), individual moneylenders, and self-help-groups, such as *Kelompok Simpan Pinjam* (Savings and credit groups/ KSP), and *Kelompok Pengusaha Mikro* (microentrepreneur groups), are dominant in rural Indonesia. It is estimated that 100,000 self-help groups exist in Indonesia with a total of a million members and which have at least one credit component (Sukarno, 2000:14). Regarding the KSP, the group could be formed from any group available in the community with varying functions, including ones based on neighbourhood, religion, ethnicity, gender group, occupation group, and so on.

The *Arisan* or ROSCA in particular, is the major and most popular informal finance scheme in Indonesia. There is a wide variety of *Arisan*, and they are spread all over the country. In the absence of statistics, it is predicted that one tenth of Indonesian adults participate in the *Arisan*, and therefore about 5 million people are involved in this savings and credit association. Further assuming that if 20 people participate in one *Arisan*, there are therefore about 250,000 *Arisans* available in Indonesia (Hospes, 1992:231).

The well-established *Arisan* in the Indonesian community both in urban and rural areas suggests that the indigenous and traditional framework of the financial system is successful in responding to the savings and credit demand of the community. A study conducted by Otto Hospes in 1989 in Maluku, Indonesia, reveals that there was an increasing popularity of *Arisan* among the inhabitants and a variety of people from different professions and background were involved. For example, he encountered several dozen *Arisans* available, and the grouping is usually based on profession, ethnicity, gender, the primary purpose of *Arisan*, the period of rotation, the mechanism that determines rotation of funds, and the existence of voluntary emergency funds (Hospes, 1992; Moll, 1989).

With regard to the division of *Arisan* based on the primary purpose, some *Arisans* are created in order to strengthen social ties among the group members, while other *Arisans* had mainly economic functions. The case of *julo-julo* in this study (Chapter Six) for example, appears more related to the former, since the group members were interested in joining this credit and saving because they are in one clan (*suku*), although they expected to have advantage economically from money they received when they got their turn. However the grouping of *Arisan* based on gender is dominant in Indonesia, because *Arisan* is frequently found among women's groups (1991, cited in Robinson, 2001).

The moneylender, as has been mentioned above, is seen by Indonesian people as a credit intermediary, who sets up high interest rates, usually as a private person rather than a group. According to Schmit (1989: 18) the moneylending practice has existed since the Dutch colonial period, in which the Chinese and Arab moneylenders set up

very high interest rates, and therefore caused the instability of colonial society. Moll (2001) classifies this personal lender as a professional operator, together with traders, indigenous bankers, landlords, pawnbrokers, and larger farmers. These informal finance operators provide financial services on commercial terms, either as their main occupation, as part of their business enterprise, or as a part-time occupation.

It is estimated that there is a large credit market for moneylenders, both in rural and urban areas. Because of its invisibility, there are no precise data regarding the number, the area covered, and type of customers. However, according to Robinson (Robinson, 2001) their customers mostly are low-income households, because these poor people usually have limited bargaining power, and even no, or less, choice to find credit sources. The moneylenders usually charge monthly interest rates from about 10% to 60%, while daily or weekly loans, when calculated as effective monthly rates, range from 10% to more than 1500% (Germidis et al., 1991: 49).

In rural areas, the practice of moneylenders is usually done in a professional way, in which the lenders have close knowledge of the borrowers, and a good relationship is established between the lenders and borrowers. These professional moneylenders usually cover only limited population with a small value of transactions, in order to avoid capture by the legal authority, considering that moneylenders are still illegal in Indonesia. Moreover, in some cases, the moneylenders may not be welcomed, because their practice is sometimes detrimental to rural people (Moll, 1989: 21).

Family, friends and relatives are other sources of loans available in rural areas. It is also difficult to identify the size of this scheme in the community because the transaction is based on mutual trust, and usually undocumented. This kind of lending is also characterised by its simplicity and is economical, as credit transaction cost is very minimal because no collateral or interest is required. This scheme of credit is mainly found in rural areas of Indonesia, where people are living in subsistence and formal credit institutions are unavailable. The simple procedure of this scheme has caused poor farmers in rural areas to still depend on family, neighbours, and relatives as the first stop for their emergency credit needs. Although the loans are generally interest-free and uncollateralised, the repayment procedure between friends and relatives is usually based on reciprocation, in which in the future the loan could be repaid in the form of, for

example, support during an emergency, gifts, or other kinds of assistance (Moll, 1989; Robinson, 2002) .

Notwithstanding the positive characteristics of the informal financial system in Indonesia, the small size of loans and lack of regulation and supervision have led to a view that the informal finance in Indonesia is incapable of increasing incomes and alleviating poverty (ADB, 2001b).

## **Conclusion**

Rural financial development in Indonesia has been shaped from the colonial period, New Order, Reformation era, and until the current time. The foundation of the rural finance system was laid down during the colonial period, and it has weathered Sukarno's regime, but it was strengthened during the Soeharto government and after the liberalisation of the financial system. This has continued until now with the remarkable growth of microfinance industry. This process is crucial, considering that Indonesia has a dominant rural population, while the rural poverty incidence is still high, and the introduction of microfinance programmes in rural areas is an appropriate strategy to combat rural poverty.

However, there are many challenges facing the development of the rural finance sector in Indonesia. The challenge faced by the formal credit sector to give their service in rural areas is the fact that the majority of the rural population are poor farmers who are living below the poverty line (Charitonenko & Afwan, 2003:11). Formal financial institutions are encountering a dilemma in which, on one hand they have commercial and business-oriented institutions, whereas on the other hand their clients are poor people with unstable and irregular income. Hence, it will be difficult for the commercial formal credit institutions to extend their outreach in rural areas. There is also a challenge by recognizing the fact that, based on a survey, the majority of rural people are not willing to access formal banking facilities, either savings or credit, and prefer to use informal finance as means of credit and savings activities (Chambers, 1983; Holland & Blackburn, 1998). This could lead to the decline of rural people's trust in the formal financial sector.

The attempts of the government's institutions and donors to set up several credit programmes and projects could be seen both as positive and negative points of view. Positively, these targeted credit programmes are crucial to help the rural poor, especially after the economic crisis severely hit Indonesia in 1997/1998. In the agricultural sector, these efforts are important, considering the fact that the share of government budget for this sector has been reduced, thus affecting the service given to the farmers. Moreover, the poor farmers in Indonesia are always confronted by the lack of capital to fund their farming activities. On the negative side, these direct and subsidised credit programmes and projects could undermine the process of commercialisation of the microfinance industry in Indonesia. The high level of funds channelled to these programmes and projects could also create an unhealthy environment, which could be open for misusing or corrupting by opportunist agents. Looking at the implementation of these programmes, there is a lack of coordination and proper management, which has thus caused their unsustainability.

Despite the fact that there are limited data and information about the practice of the informal finance sector, there is a good prospect of development of this sector in the future. In the era of decentralisation, when the local values and cultures are reinforced and appreciated, many self-help and local specific credit programmes are expected to become widespread.

## **CHAPTER FIVE**

### **METHODOLOGY AND RESEARCH EXPERIENCES**

#### **Introduction**

This chapter describes the research design and methods of data collection as well as the researcher's experiences in doing fieldwork. This research targeted the small farmers in rural areas, exploring their credit and savings behaviour. Whilst the qualitative approach is dominant in this research, the method used was a combination of quantitative and qualitative research, namely the triangulation method.

This chapter consists of two main parts. In the first part, the philosophy of choosing participatory research for the small farmers is presented, followed by the logic of using the triangulation method. Then the research design is discussed, which focuses on elaboration of the quantitative and qualitative methods including the techniques used in each method. The second part is the experience of the researcher doing fieldwork staying out in the villages, and this consists of the preparation stage, entering the village, ethical considerations, adapting methodology and data collection practices, doing research with one's spouse, and maintaining a relationship with the participants. Finally, a summary is presented.

#### **The Philosophy of Conducting Participatory Research Among Poor Farmers**

My intention to conduct a participatory research among poor farmers firstly emerges from my personal as well as my professional background. I grew up in rural areas where I spent my childhood and teenage years, and my educational background is in agriculture. The struggle of poor farmers to manage their life under uncertain and unpredictable conditions attracted me and I wanted to help them by investigating their needs and aspirations through field research. Rather than just obtaining information from the rural poor, I preferred to conduct research that could empower them in a way that the poor would have opportunity to speak out about what they wanted, their

problems and how to solve them. This empowerment-oriented approach of participatory research ensures that the participants are able to identify their problems, to plan programmes and activities, to solve the problems, and to monitor and evaluate them in order to have a better future (IDS-Workshop, 1998: 176).

I considered that PRA (Participatory Rural Appraisal) was suited to my intention to conduct participatory research about small farmers. PRA is one method of participatory research which is now used increasingly by researchers and practitioners who work for community development around the world. PRA is different from conventional research that is highly dependent on rigid and structured techniques and procedures. In PRA, the tool is the researcher, the setting is natural and flexible, and “the process is open ended in which the participants are given an opportunity to design questionnaires, to develop the criteria, and indicators, discussing the issues which need to be explored and collecting and analysing data” (IDS-Workshop, 1998: 176). Since PRA is an empowering experience, every stakeholder should be empowered by the participatory policy process in different ways.

The PRA also applies the pluralistic-use research method or triangulation process in which multiple strategies are employed to influence policymakers. It is argued that participatory methodologies and methods for policy-focused research should not be adopted in isolation, but should be seen as powerful research instruments when combined with other methodologies and traditions. The triangulation process allows the researcher to use different methods and approaches to cross-check results and to use secondary sources as baseline or comparisons (Okali, Sumberg, & Farrington, 1994: 13-15). The topic of triangulation method will be elaborated on further in the next section.

Participatory research with farmers as targets cannot be separated from farmer participatory research. Farmer participatory research can have many meanings, and the most common sense one is described as carrying out a project or research in close collaboration with farmers. However, it is argued that the discussion of farmer participatory research is intertwined with wider debates about empowerment, social justice and community development (Cromwell & Wiggins 1993, cited in Okali et al., 1994: 15). The empowerment feature of farmer participatory research relates to the creation of an environment which is responsive to their poverty through learning and

action (Okali et al., 1994: 15). In this respect, there are dual focuses of farmer participatory research which are interrelated: first on political, social and institutional process, and second, on the development and testing of agricultural technology (Jick, 1979: 604).

## **The Logic of the Triangulation Method**

The triangulation method is being increasingly used by social researchers today. The logic behind the application of the triangulation method is that any bias inherent in individual data sources, investigators, and method, would be neutralised in conjunction with other data sources, investigators, and methods (Denzin, 1989: 234). A combination of methods is also means of examining the same research problems by different approaches, and crosschecking the same problems would results in consistent and integrated data (Greene, Caraceli, & Graham, 1989). There are many other additional reasons for combining methods in a single study as stated by Greene, Caraceli, and Graham (1989):

triangulation is seeking convergence of results, complementary between one method and another; developmentally, wherein the first method can help the subsequent second method; initiation, in which each method has specific characteristics and any contradictions or fresh perspective could emerge; and expansion, on which the mixed methods could add scope and breadth of the study (Greene et al., 1989: 175).

The issue surrounding whether to choose qualitative methods or quantitative methods or the combination of both has been debated among researchers. Many social researchers have now moved towards supporting qualitative methods of data collection. The great strength of qualitative research is the validity of the data obtained. Participants are interviewed, and they may give responses which are true, correct and complete, and believable based on their views and experiences. The techniques of qualitative methods such as observations and in-depth interviewing provide researchers with insights from the participants' attitudes and behaviour (Goldman & McDonald, 1987:7). Therefore, qualitative methods require greater interaction between the researcher and research participants.



This does not mean, however, that the quantitative methods are rejected. Quantitative techniques can provide quick and clear results since they can be analysed using statistical procedures. Quantitative methods are also appropriate where variables can be measured quantitatively and hypotheses can be tested while qualitative methods are invaluable where researchers wish to address the structure and nature of attitudes and motivations, and aim to explore in depth the feelings and beliefs of people, and to learn how these feelings shape their behaviour (Brannen, 1992; Brewer, 1989; Creswell, 1994).

The most efficient use of both quantitative and qualitative paradigms is to combine them in a single study (Brewer, 1989: 28). Multi-method research requires more and different kinds of information to solve research problems than any single method, and therefore is likely provide better solutions and have a firmer base since they are based on observations in different ways of social reality (Greene et al., 1989: 264). The implementation of the combined methods can be interactively, independently, concurrently or sequentially (Greene et al., 1989: 256). But J. W. Creswell (1994: 177) outlines three models of combined designs: two-phase design, dominant-less dominant design, and mixed-methodology design. For the purpose of this study I used the dominant-less dominant model, wherein the research design was essentially qualitative in nature, but a small aspect was drawn from the quantitative paradigm to complement the overall data. Whilst before conducting fieldwork my intention was to carry out a two-phase or sequential study, in implementation I decided to perform qualitative and quantitative methods concurrently, for reasons of efficiency and effectiveness. The aim was to see the validation, corroboration and cross-checking of findings within a single study (Robson, 1993: 42), and as a means to compensate the weaknesses of one method with the strength of another method. Although this strategy has limitations, I found it was very efficient in that it saved time, money, and energy, and was effective for gathering more information in greater depth from the participants.

## **Research Design, Data Collection Methods, and Data Analysis**

This section describes the research design and how the researcher employs the methods in data collections and data analysis. This begins by the nature of designing the research, the conducting of quantitative and qualitative methods of data collection, gaining data from other sources, and the process of data analysis.

### ***Research design***

As stated in the introductory chapter, the objective of the study was to explore the credit and savings behaviour of poor farmers in rural areas. This exploratory research reflects the intention to find out ‘what is happening’ (Stebbins, 2001: 6), and at the end, inductive generalisations will result. Next, these generalisations will be woven into a grounded theory explaining the object and the construction of the study (Mason, 1996: 93). Exploratory research therefore requires me to use a variety of methods, which provides scope for a range of new information. In this study, which focuses on empowerment and participation-oriented research, exploratory research requires the adoption of more pragmatic and unconventional methods, which is the combination of quantitative and qualitative methods, namely triangulation or mixing research methods. Table 5.1 shows the mechanics of my research design.

Table 5.1. Summary of research methodology

<b>Research Approach</b>	<b>Qualitative Research Method</b>	<b>Quantitative Research Method</b>
Focus of Inquiry	<ul style="list-style-type: none"> <li>-Farmers' perception on rural credit programme</li> <li>-Farmer's choice on: forms of credit, intermediaries, time/when they need credit</li> <li>-problems encountered by farmers in accessing credit programme</li> <li>-the magnitude of informal credit institutions</li> <li>-role of culture and social norms in rural credit</li> <li>-pattern of relationship between farmers, rural financial institutions, local government</li> </ul>	-Farmers' economic & social conditions
Selection of respondent	Purposive sampling	Random sampling
Data collection techniques	<ul style="list-style-type: none"> <li>-PRA</li> <li>- focus group discussion;</li> <li>-in-depth interview;</li> <li>-direct observation</li> <li>-documents analysis</li> <li>-key interviews</li> <li>-field notes</li> <li>-research diary</li> </ul>	<ul style="list-style-type: none"> <li>-self-administered questionnaire</li> <li>-semi-structured interview</li> </ul>
Data analysis methods	Thematic and categorisation analysis	Descriptive analysis (frequency distribution)

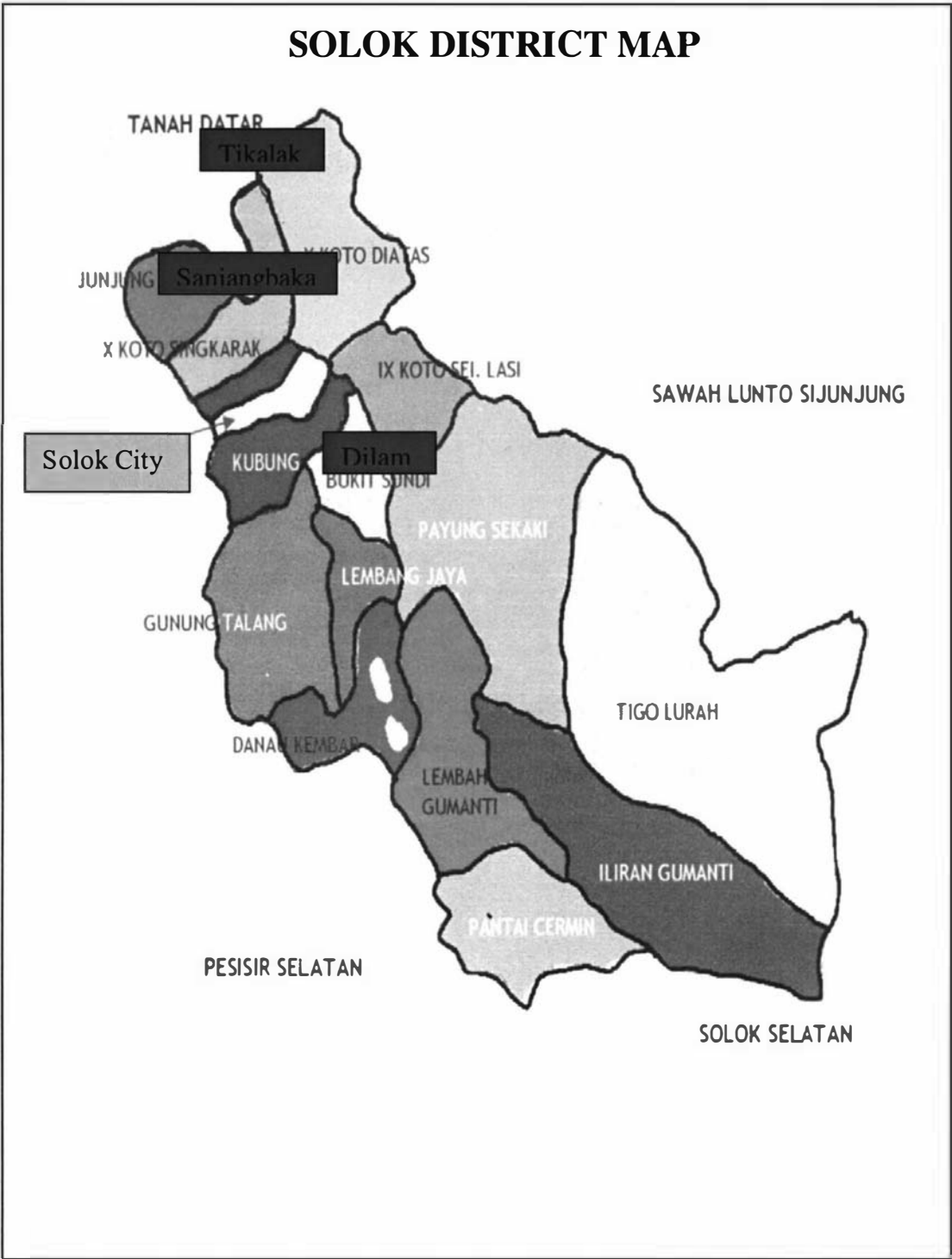


Figure 5.1. Map of Solok District and research sites

### ***Site selection and sampling procedure***

The study was conducted in the three villages of the Solok district, West Sumatra province, Indonesia. There are many reasons why West Sumatra province is selected the study area. First, in West Sumatra people's income is mostly from agriculture. Its natural resources are poor and industrialisation has not been developed properly due to a lack of raw materials and human resources. Its topography is dominated by highlands; its irrigation systems are undeveloped and constrain the expansion of agricultural production. The second reason is that the poverty level is high and people's income is limited by infertile soil especially in rural areas. Many remote areas in rural West Sumatra lack rural infrastructure such as roads, electricity, markets, banks, and educational institutions. The third reason is that this province is well known for its ethnic group of Minangkabau, whose savings and credit has been part of their culture for centuries. Thus, many traditional and informal savings and credit institutions can be found in rural areas of West Sumatra province. This study becomes significant especially to enhance the savings and credit behaviour of the Minangkabau people, and to gather more information and data to improve self-help informal credit institutions in the study area. Also much research about microfinance in Indonesia has been concentrated mainly located on Java and Bali islands, and little research has been conducted in the outer islands such as Sumatra.

Drawing from the secondary data and information that was obtained before entering the field, three villages were selected purposively, which were suited to my research objectives and could answer my research questions. Thus each of the villages represents one or more of the characteristics of my research questions such as poor farmers in remote areas, informal and formal credit schemes, credit default problems, availability of farmers' and women farmers' groups, and traditional or strong cultural influences. The case study villages were selected to be located in the same district in order to avoid wasting time moving from one village to another, thus allowing me to do my research thoroughly and deeply.

Selection of participants for quantitative survey research was conducted through a randomised sampling procedure, considering that the information that needed to be achieved was general and applied to the entire community. So, the participants were

randomly selected in each village to complete the questionnaires, as well as to answer questions in a semi-structured interview.

In qualitative case study research, the selection of participants is based on 'purposively sampling', in which the participants are selected based on the study purpose and relevant to the research questions and theoretical framework (Babbie, 2001: 285). To obtain maximum variations of population, the participants were subdivided by many variables such as types of crops planted, type of land ownership and prosperity, education levels, and credit access. Owing to the flexible nature of qualitative research, the design can be modified at any time (Neuman, 1997: 253), the use of these variables was different between one village and another, while the number of participants was also adjusted based on local specific conditions. However, to obtain optimum results, there was a minimum 10 participants involved in the case study research in each village.

### ***The quantitative method: obtaining a general picture of the population***

This section deals with the quantitative method of data collection which consists of a standardised questionnaire, and semi-structured interview.

In the standardised questionnaire, the questions focused on the general picture of participants, such as demographic profile, economic and social conditions, and general information on the participants' rural credit activities. To improve the quality of the questionnaires, in order to be focused and suited to the conditions in the study area, I made some adjustments and amendments when moving from one village to another. Lessons and experiences that I learnt from the previous village were used to improve my questionnaires and research plan for the next village. This strategy, as suggested by my supervisors, could save time, in that I did not have to conduct a pilot study, and allowed me to be focused and deeply concentrated to do research in each village. A copy of the questionnaire, both in Bahasa Indonesia and English is presented in Appendix 1.

I decided to use a standardised home delivery questionnaire in this study with the view that the participants were poor farmers, who usually have low education levels and

sometimes are illiterate. The home delivery method is considered more efficient than other methods because the researcher can deliver the questionnaires directly, talk face-to-face to the participants, and explain the contents to the participants whenever they were unclear on the questions. Very often, I took over the role of filling in the questionnaires, while the participants just talked and answered the questions. This type of survey have the highest response rates, and the researcher can observe the surroundings and can use nonverbal communications and visual aids (Babbie, 2001). Also, response rates are expected to be higher than for mailed questionnaires, since the researcher has the opportunity to meet the participants and wait for their responses (Robson, 1993: 237). Another advantage of this type of survey is that I had opportunity to talk further to the participants, when the situation permitted, and invited them to be involved in my case study research. So, it happened during my fieldwork that I conducted quantitative and qualitative research concurrently, in such a way that I did the filling in of the questionnaire and conducted semi-structured interview and in-depth interview at the same time.

The semi-structured interview was carried out directly after filling in the questionnaire form. Whilst the purpose of this technique was to gain further supplementary information that could not be obtained in the questionnaires, the topic of the interview was focused on economic conditions and farmers' rural credit activity, such as their additional income and property, average monthly expenditure, their chosen rural credit programmes, and so on. Although I had prepared a set of questions in advance, in reality I made some adjustments and modifications, based on my perceptions as to what seemed most appropriate in the context of conversations (Mason, 1996: 60).

### ***The qualitative method: maximising participation***

This section focuses on the implementation of the qualitative method in this study. This consists of several techniques such as direct observations, research diary, in-depth interview, focus group discussions, and several PRA methods such as problems identification, matrix scoring and ranking, seasonal calendar, and Venn diagram.

### **Direct observations**

The direct observation method of this study was conducted through being involved and immersed in the daily life of the rural poor, and observing the dimensions of that setting, interactions, relationships, actions, and events throughout my stay in the villages (Robson, 1993: 191). The major advantage of observation is its directness, that the researcher can just listen and watch, and does not necessarily ask the participant's views, feelings or attitudes (Neuman, 1997: 361). So, I have had the opportunity to involve myself in casual conversations, meetings, and any activities that allowed me to capture information related to my topic. By involving myself and participating in their activities, such as planting, harvesting, or cultural events, I was able to record important information, even that which they usually hide, such as information on their own or somebody's credit default and their difficulties with repayment. Also, my strategy was to be close to the rural people such as having respect for their culture and beliefs, speaking their language, adjusting to their daily habits, and allowing them to speak freely without any pressure. This was very important both for myself and the participants as well. For my part, I could gain more and more data and information that I transferred to my research diary, while on the participants' side, they had an opportunity to communicate their feelings, problems, ideas, and aspirations without pressure, with the hope that sometimes I could help to solve their problems. In this case, I used all my senses to absorb all sources of information, and researched in detail any aspects that could be overlooked by others, since these could signpost messages that affect people's attitudes and behaviour (Robson, 1993: 191). Data and information that I obtained from direct observation were very useful to validate or corroborate the messages obtained from other techniques such as in-depth interviews, focus group discussion and PRA (Neuman, 1997: 372).

### **In-depth interviews**

In-depth interviews were carried out with the selected farmers and their households that had been chosen when I conducted the survey. In contrast to the survey interviews that were more structured and adhered to the interview plan, in-depth interviews were more flexible and adjusted to the social context as well as the participants' norms and



language usage. The researcher can also randomly interrupts, encourages, comments, and responds, in a friendly and relaxed environment, but take control of the pace and direction of conversations. The questions started with the general and non-sensitive issues, and reached the inner feelings when intimacy was established (Krueger, 1994: 77). Hence, in this study, I conducted in-depth interviews mainly in the farmers' houses during their spare time to avoid interrupting their daily activities. These open-ended interviews were focused on the participants' knowledge, views, understandings, interpretations and experiences of rural credit. In this case, I have had opportunity to listen to the participants elaborating their views and insights on the current rural credit programme in the area, their understanding and interpretation of rural credit, as well as their visions and aspirations concerning what form rural credit should take in the future. Visiting farmers' houses brought two advantages. First, I could observe the physical situation of each farmer's household that could be interpreted and transformed into my research diary. Second, I had opportunity to talk to other family members. This could help to obtain more information than could be provided by one family member. In this study, I conducted 32 in-depth interviews, in which 10 interviews were conducted each in Dilam and in Saniangbaka, and 12 interviews were conducted in Tikalak. The in-depth interview guide as well as dates and number of interviews are presented in Appendix 2 and Appendix 3 respectively.

### **Focus group discussions**

The focus group discussions were conducted mainly among farmers' groups in the three villages. I did not differentiate between women and men in focus group discussions since the gap between men and women was not so significant in this area. The matrilineal feature of the Minangkabau tribe in West Sumatra supported this condition, that women's role was quite substantial in the community. However, I tended to select the poor and less progressive farmers to ensure homogeneity in the group, which allowed the participants to express their opinions freely (Denscombe, 1998: 115). As other methods have many limitations, the focus group method in this study functioned basically to supplement, to validate and corroborate the data. In this study, the role of the focus group method was particularly to gain information from the farmers in a group, where the PRA method could not be carried out.



Figure 5.2. Focus group discussion in Tikalak

The topics of discussion in focus groups were mainly general and not on sensitive subjects (Krueger, 1994: 83) and included subjects such as the types of credit scheme available in the area, climatic and crop disease problems, and suitable time to deliver credit to farmers. The groups' members, which usually had six to twelve, had an opportunity to convey their concerns and aspirations. The focus group discussions were mostly conducted in the field when farmers had spare time during lunch breaks. I deliberately chose this timing to achieve natural, real-life situations and a relaxed environment (Chambers, 1994, 1997), so that participants were enthusiastic and freely expressed their ideas and interests, and sometimes proposed a programme and requested my help to convey their proposal to the government. So, in this case, I had a chance to probe and to explore information deeply.

In this study I conducted a total of 14 focus group discussions (FGD), in which 7 FGDs were conducted in Dilam, 4 FGDs in Saniangbaka and 3 FGDs in Tikalak. Information on the Focus Group Discussions is presented in Appendix 3.

## **The PRA method**

The PRA method was intended as the core technique of qualitative data collection in this study, other than in-depth interviews, direct observations, and focus group discussions. The nature of the PRA method is essentially to allow and facilitate local people to express their views, to analyse their knowledge, and to plan their activities based on their capabilities and resources. The outsider acts as a facilitator, who listens to, and learns from, the local people and encourages them to have an awareness and confidence to initiate their own actions (Holland & Blackburn, 1998: 5). Thus the ultimate goal of PRA is empowerment in the sense that the beneficiaries have opportunity to control and manage their resources, and are confident to do that (Chambers, 1994). The PRA method is also basically a development process, which is concerned to find or improve ways that people in general, or the marginalised, can determine or have a voice, and the process should be comprehensive from the first stage up to the final stage of the people empowerment process (Cancian, 1993). The academic researchers who employ PRA techniques in collecting qualitative data may not consider applying the PRA methods because they may not be able to reach the ultimate goal of the empowerment of the entire community, due to their limited research requirements (Chambers, 1997: 117). This limitation applies also to this study, due to time constraints. Nevertheless, for the purposes of this study, I used several PRA techniques for collecting qualitative data to answer my research questions for example: problems identification, matrix scoring and ranking, seasonal calendars, and Venn diagram.

To facilitate the implementation of collecting data through the PRA method, and to make my research more grounded and locally specific, I tried to find the PRA method that has been familiar to the participants. Fortunately, an NGO that has been working on an empowerment project using a participatory approach has introduced several PRA techniques that are specifically adapted to this community. So, it was easier for me to carry out this PRA technique by adjusting these locally specific PRA techniques into my research plan.



Figure 5.3. PRA in Dilam

Considering my intention to maximise rural people's participation in this study, I allowed the participants to make a plan to carry out these PRA methods, such as to set the place and time that suited them, and to invite other participants. As the PRA method is typically a 'handing over the stick' method that allowed the participants to initiate and express their ideas (Babbie, 2001:295), my role was only as a facilitator, who prepared resources such as pens and stationery, and guided the process that was suited to my research topic.

Consequently, in the 'problems identification' technique, wherein the topic concerned the farmers' problems accessing credit from each of the formal and informal financial institutions, the participants discussed the problems, how to solve them, and recommended programmes and activities for the future. In 'matrix scoring and ranking', participants were able to list types of credit scheme, as well as credit intermediaries available in the village, and discussed the advantages and disadvantages of each scheme. They scored each credit scheme and credit intermediary based on its advantages and disadvantages, and ranked them. The first rank means that it is most preferred by the participants. The 'Venn diagram' technique was conducted to identify the relationship between individuals and institutions within a community. So, the

participants identified their position, and showed the relationship and the extent of each institution's role such as rural banks, cooperatives, NGOs, and local government in providing credit for poor farmers, which was reflected by the distance and size of circles in the diagram. The last technique was 'seasonal calendar' which aimed to identify the seasonal changes of income and expenditure and therefore reflected their credit needs. This technique is very important to discover the appropriate time to deliver credit to poor farmers.

### **Field notes and research diary**

Field notes and research diary were the important tools to record all of the data, information, events, my impressions, thoughts, and feelings during the fieldwork. Field notes were necessary since the researcher tended to forget occurrences or information received from participants. The field notes were taken mainly during the process of data collection. But in some cases, due to limited time, I wrote down the notes right after the events. At these times I recorded what I "knew" and what I "thought" had happened (Neuman, 1997: 366). This was important in order to achieve breadth of information, so that any data or information received was accompanied by their interpretations.

The research diary recorded my personal feelings, impressions, insights, and ideas relevant to any issues or events that happened during my fieldwork. This diary was written up usually at night, when all other research activities had been finished. Compared with the field notes, the research diary is longer and more detailed. This diary was also important to review what had been recorded in the field notes, wherein the researcher attempted to give meanings the events and the link between ideas, hypotheses, and developing new concepts (Robson, 1993: 318).

### **Other sources of information**

Other than the methods of data collection described above, there were two sources that I used to gain data and information. They are document study and key interviews.

Before starting my fieldwork in the three villages of Solok District, West Sumatra, I was able to review the documents from the central or local government, NGOs, banks,

research centre, and university. These documents were more related to the government's policy and regulations on credit and decentralisation system. Data and information on the local government's policy of credit delivery for small farmers in the study area were obtained from Solok District office, while research reports on performance of farmer credit were procured from the Agricultural Socio-economic Research Centre in Bogor. I also had an opportunity to review the NGO's empowerment programme in Solok district, which covered the rural credit programme for small farmers, while academic findings on rural credit were obtained from Bogor Agricultural University. I also had an opportunity to review articles in the newspapers, magazines and journals which were related to the issue of rural credit programmes in Indonesia. These gave me important insights and background which were very useful in selecting sites and participants, as well as in choosing methods that would be employed during my fieldwork.

Key interviews were conducted with many government officials both at the central and local government levels, with bank officers at the district levels, and with NGO staff. This kind of data collection method was very important particularly in searching officials' opinions on the existing rural credit policy, and also in crosschecking information and data that I received from the field. Thus, the key interviews were conducted both before and after fieldwork. Before conducting the fieldwork I had opportunity to visit several officials at the central government level who are responsible for designing rural credit policies and programmes. After the fieldwork I had meetings with officials at the district and sub-district levels, such as Head Cooperative Office, Head of Agricultural Office, Director of Community Empowerment Office, and Sub-district Bank Directors.

### ***Data analysis***

The data analysis was carried out after finishing the fieldwork. All the data analyses were conducted when I returned to New Zealand. After completing data collection in the three villages, all data were sorted out and divided into two groups: quantitative and qualitative.

Since quantitative research is less dominant in this study, the quantitative data are analysed through a very simple method of descriptive statistical analysis using the

frequency distribution technique. Frequency distribution is a simple means of exploring many data sets in a way which counts the frequency (the number of times) that certain things happen (Overton & van Diermen, 2003: 45). It is also used to illustrate the distribution of a single variable across categories. This is one of the excellent and simple ways to introduce data, such as to give an overview of a village before coming into more specific issues (Ezzy, 2002: 88). Thus, frequency distribution is used to give a picture of the economic and social conditions of participants in each village. The economic conditions of rural people in this study include level of income, rice production and size of land holding, while social conditions of participants include educational attainment, access to drinking water, toilet and bathroom facilities, and visits to the health centre.

Thematic analysis was used to analyse the qualitative data. Thematic analysis aims to identify themes within the data, and the categories into which the themes will be sorted are not decided prior to coding the data. In this case, the general issues were determined before the analysis, while the specific nature of categories and themes to be explored are not predetermined (Neuman, 1997: 352). Thus there is a possibility that this form of research will reveal problems or issues which were not anticipated. The themes and categories in this study were obtained through reading the whole data and affixing labels and themes to them. Various themes and ideas that were found in the data eventually constructed the findings which are presented in the following case study chapters. In this regard, the qualitative and quantitative data are jointly presented in each chapter.

## **Research Experiences**

This section focuses on my actual research experience and records my various impressions during my stay in the field. It starts from the preparation stage, entering the villages, ethical considerations and practices, adapting methodologies and data collection, research with my spouse, and establishing and maintaining relationships with the participants.

### *The preparation stage*

I departed for Indonesia to do my fieldwork at the end of September 2003. Since I was heading to my home country, I was already familiar with its culture and the environment, so that the problems of 'cultural shock' and 'pre-departure anxiety' were minimised. My concerns were more related to whether the methodology that I had designed would be suited to the situation and conditions in the field. Also, I had to be aware of any unexpected conditions, such as an unwelcoming attitude of village people or arrogant and unfriendly local officers who could prevent me from doing the research smoothly.

After making the necessary preparations and adjusting to the new environment, I started the fieldwork in the middle of October 2003. I preferred to do part of my fieldwork (such as key interviews with officials at the central government level in Jakarta and collecting secondary data in Jakarta and Bogor) in the first place, and then enter the field in *Solok* district, West Sumatra, later. My point was to avoid entering the field during the fasting month (*Ramadhan*), which ran from early November to early December 2003, when farmers in rural areas were not performing much farming activity. However, I intended to obtain a research permit in West Sumatra earlier in order to be ready for any problems that might be encountered, and that could delay my fieldwork.

Obtaining a research permit is one of the important requirements for conducting fieldwork in Indonesia. Since my fieldwork involved gathering data and information in the agricultural sector, I needed to obtain a research permit from the Ministry of Agriculture, whose authority covers the institutions within its structure, as well as local government offices. In my case, I was able to secure this permit almost without any significant problems, perhaps due to my position as a staff member at this Ministry. After I contacted the Ministry to make an appointment, the Secretary General invited me to come to his office. On that occasion, I had an opportunity to explain to him my research proposal, and to request a research permit, as well as to interview him as one of my key interviewees. Because of the urgent need for participatory research on small farmers' credit in Indonesia, the response from the Secretary General was positive and



he was ready to give any administrative assistance relating to my research. He assisted me to obtain a research permit from the local government by sending a letter of recommendation to the head of Solok district (*Bupati*) in West Sumatra, as well as to other institutions such as banks, research centres and the Agricultural University.

I went to Solok district, West Sumatra, soon after I received the letters of recommendation. The process of obtaining a research permit in this district was simple, and the officers were very helpful and friendly. They then gave me three recommendation letters that were to be given to the heads of the sub-districts where my fieldwork was located. These recommendation letters were given to the Sub-district Head (*Camat*), who also gave a similar letter to the Village Head (*Wali Nagari*) before I entered the villages. The procedure of giving a recommendation letter to the institutions within the structure is very common in Indonesia, especially in the public sector. The long-established centralised Indonesian government system, I supposed, influenced this practice.

Before entering the villages, I had a chance to look around and evaluate many potential villages that I considered suited to my research topic. By so doing, I met key informants in each village that could give me preliminary information about the village and the community as well.

After making careful consideration, I selected three villages (*nagari*) in three different sub-districts as my fieldwork locations. However, one village that was located on the mountain slope was very difficult to reach, and farmers' locations were scattered. I decided to drop this village and replaced it with a village close to the lake, but in the same sub-district as the second village, where the people were very poor due to infertile soil and unproductive fishing activities. Thus, overall the three villages selected were: Dilam in the Bukit Sundi Sub-district, and Saniangbaka and Tikalak, both in the X Koto Singkarak Sub-district.

### *Entering the villages*

Before entering each village, I decided to make a preliminary visit in order to gain access and to meet key persons in the village. This strategy was useful, especially to establish social relations with the leaders and key persons in the area, since these people often require special negotiations for gaining access (Devereux & Hoddinot, 1992). This visit was very useful in that it could reduce my anxiety and uncertainty before entering the village. It could help me to solve the methodological and logistics problems, and streamline the obtaining of permission (Siahaan, 2004). This strategy was also worthwhile for me in order to make necessary preparations before entering the village such as to get to know the house in which I will to stay, my hosts, village physical environment, and so on.

My experiences upon entering the villages were varying. Since I conducted this research together with my spouse, he accompanied me from the beginning of the fieldwork. In Dilam village, on the first day we arrived, we went directly to a farmer's house where we stayed for the next four weeks. We met the homeowners, who were father, mother and two children. While they had agreed and said that they were happy to receive us in their home, it was seen that they were very cautious and introverted, and talked carefully, especially the host mother. At first, it seemed that she did not welcome us very eagerly. She said that their house was very simple and lacked furniture, and was not suited to us as urban people. However, after I explained that I also was born and grew up in the rural area, she was convinced, and allowed us to stay in their home. The reserved and cautious attitudes of the homeowners, perhaps, were influenced by the traditional introverted nature of the rural community who live in the remote areas.

During the first couple of days of our stay in the village, we tried to adjust our life to the new environment, such as using bathroom and toilet facilities located outside the house and attached to the fishpond, and using firewood for cooking. We took showers very early in the morning or late afternoon, when it was getting dark, to avoid being seen. However, we enjoyed the fact that we slept well at night in cool weather, accompanied by the splatter of water from the fishpond.

Obtaining the trust of the research participants is extremely important in social research, especially when the topic is quite sensitive (Creswell, 1994: 177). To gain trust and acceptance from the villagers, I attempted to follow the daily activities of small farmers by visiting them in the field, talking to them, asking questions related to their farming activities, and listening to their problems and constraints encountered in farming. In Dilam village, I had an opportunity to do paddy planting with other women at my host-mother's rice field. It was an enjoyable experience for me, since it reminded me of my childhood and living in my village. Furthermore the women and men farmers who met me in the field became pleased and happy and became close to me, since they felt that I could adapt to the rural situation and the lives of small farmers.

Another opportunity to gain trust and acceptance from the village people was by practising our Islamic religion properly. The Minangkabau tribe is famous for its strong Islamic faith, especially in rural areas. Fortunately my spouse and I have sufficient knowledge of Islam, and this fieldwork was a good opportunity for us to share our knowledge with village people as well as to learn from them. The religious activity of my spouse at the mosque and the fact that we dressed according to the Islamic way attracted the attention of the villagers, causing them to trust and accept us in their village.

In the second village, Saniangbaka, the first two days staying in the village were spent dealing with the difficulties of meeting people/farmers, since they usually worked in the field during the daytime, returning home before dark. Considering this situation, we spent these days for fieldwork orientation going around the village getting to know the village physically and being seen by people. We also went to the mosque especially during prayer time, to meet people and talk to them. I also changed the strategy to meet farmers or hold a meeting at night, usually after 8 p.m.

In the third village, Tikalak, the process of entering the village was not so smooth. Although I had made a preliminary visit to gain access, the village headman seemed not so open and hesitated to give me help. To solve this problem, I tried to get access and gain trust from other key people, such as the cultural group leader (*datuk*), religious group leader (*Imam*), farmers' group leader, elementary school teacher, by getting close to them. I visited each of these people, and explained my purpose to them. This strategy

was quite successful, since these leaders were the senior people for whom rural people, including the village headman, had respected and whom they trusted.

### ***Ethical considerations and practices***

I carried out the research following the participatory rules and respecting the rights and privacy of the rural poor. I practised ethical conduct that is imperative when doing a research involving humans. For example, I visited the village headman (*Wali nagari*) to report my arrival in the village and to ask his permission, and to inform them of my research objectives as well. I also requested him to hold a meeting with the farmers and other rural people. Then, during a village meeting, I informed the participants of my purpose for being in the village, my research objectives, and invited them to participate in the research. I also informed them of their rights as participants, and assured them that no negative effects would be affecting their life or business.

Obtaining participants' consent was the first task that I undertook when I first entered the village. I was aware of the right of participants to be informed and have full understanding about the research project, when agreeing to be part of the project. The process of my fieldwork was guided by the major principles of ethical conduct of research as stated in the Code of Ethical Conduct for Research and Teaching Involving Human Subjects of Massey University.

After I reported my arrival to the village headman (*Wali Nagari*) and gave him the recommendation letter from his superior, the sub-district head (*Camat*), I introduced myself and explained the research objectives. Then, I immediately requested the village headman to conduct a meeting, to be attended by influential and key persons, farmers' groups and women farmers' groups. On this occasion, I had a chance to explain my research objectives to the participants and read their rights as stated in the information sheet. In view of the illiterate and low-educated nature of the majority of rural people, I preferred to invite participants during the meeting to be involved in my research programme, rather than to send them an information sheet and a consent form. I also allowed the participants to give their consent verbally, since they seemed reluctant to give a written signature. This strategy was efficient, effective and had moral benefit. I

did not have to spend money and time to type and send the information sheet and wait for their responses. I found that meeting the rural people face-to-face, and addressing them, were appropriate approaches to gain people's respect.

### ***Adapting methodologies and practising data collection techniques***

My basic intention in conducting the research was to apply a combination of quantitative and qualitative research methods. The "two-phase design", whereby the qualitative method is dominant and the quantitative method acted is complementary (Hakim, 1987: 144), meant that the results from the first phase were used to plan the next phase. This can provide a rich sampling framework for selecting particular types of participant (Denzin, 1989: 243).

However, in reality, it was difficult to conduct each method in separate and isolated study. The traditional and indigenous nature of participants, and the physically dangerous locations, as well as the limited time that I had, required me to practise the triangulation method with flexibility, conformity and creativeness. Thus, I conducted the research by mixing several data collection techniques according to my research priorities and the time available. In this case Denzin (1989) suggests applying as many methodological perspectives as possible in sociological enquiries, in order to achieve diverse sources and in-depth interpretations.

Generally, the process of collecting data in the villages ran well. In Dilam village, I had a unique experience in inviting participants. Almost every day, people came to our house to have a massage with my host-mother, who is a traditional massager, especially for children. She cured her patients by massaging with coconut oil, and gave them herb medicines that she found in the garden or field. I took advantage of this situation by talking with these patients, and asking them if I could visit them at home or in the field. This was to facilitate my data collecting process, thus obviating the difficulties of finding people, especially men, during the daytime. In adapting methods of data collection, I have also had to be creative in using any opportunity. For example, after the village meeting, I requested the participants to gather and to discuss rural credit in

the village. If the situation permitted, I then visited them one by one to complete the questionnaires.

Dilam is the only village in my research where I could conduct the PRA method. This is because the NGO, which previously worked for this village had introduced the concept of PRA to the rural people. Thus, I could apply several PRA techniques such as matrix scoring and ranking, Venn diagram, problems identification, and seasonal calendar. I conducted these PRA techniques in the second week of my stay in the village when trust had been established and more people were interested in participating in this study. As a result, people were enthusiastic about doing the PRA, which was reflected by their voluntary initiative to set up the place and time for conducting the PRA.

In Saniangbaka, my experience in data collection was challenged by the difficulties in getting information on formal credit from the farmers. When I tried to ask about their involvement in formal credit programmes such as KUT, they tended to change the subject, they declined to answer questions, or they said that they did not access any formal credit programme. In fact, based on district records, I realised that this village had a recorded a high rate of credit default in a KUT credit programme. Similarly, I also had difficulty in collecting data about the rural bank in the village. The bank officers seemed to hide the faults of the bank in channelling the credit to the farmers, and disclosed only information other than the credit default.

In Tikalak, the data collection process was not as smooth as in the previous two villages. The scattered locations of farmers' houses, steep slopes, and the unwelcoming attitude of the village head were the reasons why I was not able to conduct PRA techniques in this village. To complement my data collection techniques, I interviewed key persons in the village such as the elementary school teachers, religious leaders, and the farmers' group leaders. This strategy was useful to validate and corroborate information received from the farmers.

Because of the difficult physical condition of Tikalak village, where people's residential areas are scattered and the road is steep, I preferred to do my interviews and fill in the questionnaires in the field when farmers or groups of farmers were doing their daily activities rather than at their homes. Thus in this way I could perform many techniques

of data collection at the same time such as filling in questionnaires, doing semi-interviews, and facilitating focus group discussions. This strategy saved time, money and energy for me as a researcher, and was also more convenient for the farmers, because they did not have to allocate special time to receive us at home. In this way, they and their friends could also discuss their problems in farming and their difficulty in accessing credit in the village. As happened in Dilam and Saniangbaka, my spouse and I were also actively involved in the religious activities in the mosque, which could attract the respect and trust of the local people. This aspect contributed to the smooth implementation of my research process.

### ***Doing research with a spouse***

From the beginning I had an intention not to hire research assistants to help me in doing my fieldwork. I preferred to do this research myself. As my research is more qualitative in nature than quantitative, I thought that doing the research myself would be more beneficial to me especially when writing up my thesis, rather than to ask somebody else to do my research. By doing the research myself, such as an interview or filling in the questionnaires I could observe the situation of the participants, as well as feel what they are feeling based on their expressions or attitude. The results would have been different if an assistant had done it for me, because he/she would have been the one who was directly in face-to-face contact with the participants, not myself.

With the above consideration in my mind, I decided to ask my spouse to help me during my fieldwork. His role was that of a companion, not a research assistant. The presence of a partner or spouse in the field could have some advantages and disadvantages (Scheyvens & Nowak, 2003: 109) but my experience of doing research with my spouse has brought more advantages than disadvantages. First, as the Minangkabau people have been known for their strong Islamic belief, a woman who is accompanied by her husband is more welcomed than a single woman (Dt-Indomo-Marajo, 2000: 39). Hence, this point helped me to be accepted by the rural people. My spouse's better understanding and knowledge of Islam was shared with local people, and this was very helpful to my data collection process. As happened in Saniangbaka village, I could conduct a focus group discussion smoothly after my spouse gave a talk about Islam.

Being of the same beliefs and visions in religion instigated their respect and cooperation to respond to my questions, and sometimes they told their story fluently, relating to their hardship and expectations. Secondly, my spouse's involvement in my fieldwork was also helpful in the data collection process, such as probing in in-depth interviews, taking photographs, setting up the audio recorder, and assisting with taking notes.

Being accompanied by my spouse during my fieldwork was also very helpful since many meetings with participants were frequently conducted at night, and occasionally in remote areas. This would not have been possible if I had done my research alone. One such example was when we conducted a PRA at one ward of Dilam village. The farmers' group chief had set the time for after eleven o'clock at night, because it was the only time they had, and it is a common practice for them to have a group meeting late at night. The meeting place was located far up a hill with steep slopes. We had to attend the meeting, however, because this was one of the *Arisan Suku* meetings that I wanted to observe, while I also wanted to apply PRA techniques. The meeting finished around 1.30 a.m., and we went home by a motorcycle that we borrowed from a friend in Solok city. The farmers' group chief in this case didn't worry about my safety because my spouse accompanied me.

### ***Maintaining relationships with participants***

Conducting fieldwork in the three villages of Solok district, West Sumatra, has given me some valuable personal experiences. Staying in the villages and being immersed in the daily life of rural poor has given me deep understanding of the real life of the poor. My relationship with the rural people was very close, especially with my hosts who came to see my spouse and me as their stepchildren. At the end of our stay in each village we had a farewell meeting with research participants and key persons in the village. At this meeting, I had the opportunity to extend my thanks and appreciation to the participants and village headman as well as to say good-bye and to give presents.

In May 2005, I had the opportunity to visit the three study villages to maintain relationships and to report the results of the study to the participants. On this occasion I had a chance to interview the village headman and some of the *Nagari* officials to get



feedback regarding the research, and the progress of their rural credit programmes after the research. I found that the participants were satisfied with the research and expect that the results could be implemented as soon as I complete my study in these three villages. They also hope that our personal relationship could be maintained indefinitely.

## **Summary**

In this chapter I have elaborated on my research methodology and my actual experiences doing research in the field. While the qualitative method is dominant in this study, the triangulation method of data collection is employed, which is a combination of quantitative and qualitative methods. The triangulation method means that each method used is complementary to the other, as in this study the quantitative method complements the qualitative. The quantitative techniques that were used in this study include self-administered questionnaires and semi-structured interviews, while the qualitative techniques involve: PRA techniques, direct observations, focus group discussions, in-depth interviews, field notes, a research diary, key interviews, and document analysis. My actual experiences doing research in the village include the preparation stage, how I entered the village, my ethical considerations, data collection experiences, and maintaining relationship with research participants. One of my findings in this research that is doing fieldwork with one's spouse has more advantages than disadvantages.

## CHAPTER SIX

### DILAM VILLAGE

#### Introduction

Chapters 6, 7 and 8 are a unit of chapters comprising of analysis of case studies in the three villages of Solok District, namely Dilam, Saniangbaka and Tikalak. Based on the literature review in Chapters 2 and 3, it is clear that poor people in rural areas have many constraints in accessing financial services from the formal sector, while the informal sectors are usually readily available for the poor in rural areas. This chapter focuses on Dilam, a village which is located in a remote area of Solok District. The village's remote location causes poverty is still prevalent, while the community maintains its traditional values, and is selective towards any outside interventions. Therefore, it is necessary in this chapter to enquire the state of poverty in this village and how the rural people manage their needs for capital. Also, in relation to the previous research questions, I would like to find out about the development of formal and informal credit programmes in this area, and how the rural population view these credit programmes based on their needs economically and culturally.

I start this chapter by presenting a brief description of Dilam village, including its social and economic conditions. This section is complemented mainly by quantitative data gathered during the fieldwork, as well as by secondary data from the local government. It is followed by an overview of rural credit systems available in this village, including a discussion of the functions and availability of formal and informal credit systems. The advantages and disadvantages of both types of rural credit system are elaborated. The next two sections provide a description of *Arisan Suku*, a local-specific rural credit programme, and *Julo-julo*, a saving and credit behaviour of rural women. I follow this with an examination of the roles of local government and NGOs, which have contributed to shaping the development of the bottom-up rural credit systems development in Dilam. Finally, a conclusion is presented.

## The Setting: *Nagari Dilam*

*Nagari Dilam* is a village in Bukit Sundi Sub-District under the administration of the Solok District government. It is located in the Plateau of Talang Mountain, about 40 minutes' drive from Solok City, the Solok District capital. The landscape of this village is hilly, which is reflected by a steep and twisting road leading to the village. This might be the reason for the infrequent public transport, which comes to this village. The road is asphalt, but in many places there is gravel covered by soil, which becomes muddy during the rainy season. Access roads to the hill or rice-fields are only small paths. In some places there is no road to access the remote *kampungs* beyond the rice fields, thereby requiring people to use *pematang sawah* (dikes between rice fields) to reach their homes.

Rice-fields or *sawah* with terracing is the main feature of the landscape of Dilam Village. Terracing, which is naturally established, has benefited farmers because of its dual functions in soil erosion prevention and acting as irrigation channels. The latter especially function during the rainy seasons since this area is rainfed and unirrigated, and water flows through *sawah* from upper levels down to lower levels. The rain fed character of this village limits the farmers to planting paddy only twice per year. Farmers grow chilli and other secondary crops during the rest of the year.

Village infrastructure is very minimal, consisting of schools, mosques, and bridges, but no rural market, health centre, or banks. There are small shops (*warungs*), which provide only limited goods for rural people, and also *lapaus* (coffee shops), where men usually spend their spare time after finishing their work in the fields, drinking coffee or playing cards. *Lapaus* also function as places for informal meetings of men to discuss current issues in their *Nagari*. Most houses are made of wood with the roof made of corrugated iron, and carved like the horn of buffalo, the symbol of the Minangkabau tribe. Electricity has been available for the last three years, but it has not yet reached the remote areas in the village. Telephone connections are not available, however the well-off residents use pre-pay mobile phones.

*Nagari* Dilam is divided into three *Jorongs* (wards): Dilam, Batusangkar, and Batukarak. This division was started when the government launched the decentralisation of local government in early 1999, and the villages that previously formed the *Desa* (village in a centralised system) were transferred into *Nagari* (village in a decentralised system), which is specific to the Minangkabau culture. The *Nagari* government, which is the lowest structure of local government in West Sumatra, is formed by three elements, named as *Tungku Tigo Sajarangan*, which consists of *ninik mamak* (cultural chiefs), *alim-ulama* (religious chiefs), and *cerdik-pandai* (educated people). A *Wali Nagari* or the 'Village Head', who has the executive roles of the *Nagari*, directs the *Nagari* government. He is responsible to the *Camat* (Sub-district Head) of Bukit Sundi, and then to the *Bupati* (District Head) of the Solok district.

The total population of Dilam is 3,153 people, consisting of 1,624 females, and 1,529 males. Households number 800, of which 751 households are engaged in the agricultural sector (BPS-Solok, 2002). Thus, about 93 % of the population are in farming households. However, most farmers are engaged in more than just farming activities. It is common in Dilam that household members are involved in many activities such as farming, crafting, civil service, labouring, and petty trading, in order to have more income.

Paddy is the main crop planted every year, but the production is at subsistence level. This subsistence farming is limited by the small size of landholdings, unirrigated rice fields, pest outbreaks, low level farming technology, and low education levels of farmers. The high price of fertilisers and pesticides also restricts paddy production. Farmers frequently complain about this issue and request the government to subsidise the cost of fertiliser. Farmers are frequently experiencing big losses when their harvests fail, since their expenditures to buy fertilisers and pesticides can't be recouped. Other expenditure such as land preparation, planting and weeding can be controlled since they can manage them by themselves or ask their family or relatives for help. When their harvest is going well, they receive only small profits, since fertiliser prices keep increasing, especially over the last five years. I received complaints from the farmers many times regarding this issue during my stay in the village, especially during focus group discussions.

*The high price of fertiliser is the main constraint for us to increase our income from farming. These prices keep increasing and have never gone down, especially over the last five years, while our rice production remains flat. Sometimes we borrow money to buy fertiliser from moneylenders or relatives. When our harvests fail we can't repay the credit on time.*

*I prefer to use a small amount of fertiliser rather than to borrow money from moneylenders or relatives. I could use organic fertilisers such as compost or cow's dung to substitute chemical fertilisers, if I want, so that the expenditure can be reduced. In this case, when the harvest failed, I would not have a burden to repay the loan.*

*We do not understand why the government has the heart to treat us like this. We are already poor, and will become poorer if the fertiliser's price keeps increasing. If the rice price is good, the situation would be better, but in fact, our rice is priced lower than the traders'. We hope that the situation will be changed in the next regime, and the government will be on our side (Focus Group Discussion, 17 January, 2004).*

The poor and unprogressive conditions of the Dilam people, and the diverse sources of income, create difficulty in detecting the exact level of income for the population. Also, people hesitate to disclose information on their real earnings. The proxy measure of participants' gross incomes, however, can be calculated by counting total earnings from crops and livestock, and off-farm incomes. Thus, the estimated monthly earnings of participants can be seen in Table 6.1.

Table 6.1. Estimated monthly earnings of participants

Range of Earnings (Rp)	No of Participants	Percentages
0 – 250,000	13	46.4
250,000 – 500,000	6	21.4
500,000 – 750,000	5	17.8
750,000 – 1,000,000	1	3.5
1,000,000 +	3	10.7

Note: n=28; US\$1=Rp 8,500 as at January 2004.

Source: Fieldwork (2004).

The largest group of participants (46.4%) earn less than Rp 250,000 per month or less than Rp 8,333 per day. If the global poverty line is US\$ 1 per day (World-Bank, 2005c), and US\$ 1 equals Rp 8,500, then almost half the participants are living below the poverty line.

Based on my direct observations, the size of landholdings, variety of crops planted, and amount of off-farm income, all contribute to an increase of household incomes. About 60% of the participants occupy less than 0.5ha land, and only 14% have 1.5ha or more. This landholding refers to the land that is being currently cultivated by each household. Rural people usually have a larger land, named as *tanah ulayat* or clan land, which they use jointly, and the harvests are used solely for the benefit of their clan (*suku*). This clan land is usually used for social purposes such as for developing mosques, schools, cemeteries, and other public purposes buildings.

Rural people tend to grow a variety of crops or livestock in order to enhance their earnings. As farming activities have many uncontrolled constraints, depending upon incomes from only one or two crops is too risky. The varieties of commodities that are usually produced by people in Dilam include: paddy, chillies, bananas, coffee, cloves, cinnamon, cows, buffalo, chickens, and ducks. Based on my fieldwork survey, the majority of people in Dilam (53.57%) have four to six types of commodities, typically paddy, chillies, bananas, coffee, cows and chickens. Owing to the fluctuation of some commodity prices, people select the crops that will give them higher returns, which have stable and good prices and which are consumed by most of people regularly.

Chillies, bananas, and cows are the most favoured commodities. Chillies are usually planted after paddy, especially in August or September, and are harvested when the price is good before *Idul Fitri* holiday. By contrast, coffee, cloves, and cinnamon are not preferred since their prices are lower and they incur high cost for harvesting and transporting. Farmers tend not to harvest these crops although they have planted them and the crops have matured.

Off-farm activities are also influential in supporting household incomes. Craftsmen and petty traders are the well-off people, while the poor who have only small areas of land and having less variety of crops/livestock prefer to be farm labourers, working on other people's farms once or twice a week, and receiving Rp 8,000 per day. These jobs usually include weeding, planting, or hoeing. The majority of types of off-farm activities of participants are crafting and petty-trading. The data on landholdings, types of crops/livestock, and off-farm activities are presented in Table 6.2.

Table 6.2. Economic condition indicators

Indicators	Number of Participants	Percent
<b>Landholdings:</b>		
0 - 0.5 ha	17	60.71
0.5 - 1 ha	4	14.28
1 - 1.5 ha	3	10.71
1.5 +	4	14.28
<b>Number of commodities:</b>		
1 - 3	6	21.42
4 - 6	15	53.57
7 - 10	7	25.00
<b>Off-farm activities</b>		
None	8	28.57
Farm Labourers	8	28.57
Craftsman & Petty traders	12	42.85

Note: n=28. Source: Fieldwork (2004).

The social conditions of the Dilam people are reflected in their level of educational attainment, their accessibility to a health centre or hospital, and sanitation. The education level of rural people is low. This is reflected in the fact that only about 40%

of the participants have finished high school and university, and the majority of participants (60.7%) have finished elementary school only.

Access of rural people to modern health centres such as hospitals and clinics is limited. People prefer to go to a *dukun* (traditional healer) or *Bidan Desa* (rural midwife) to check or cure their health problems rather than to a hospital, because of their low cost and accessibility. *Bidan Desa* is very popular since the method is half modern, but the costs are reasonable and the method of payment is flexible. Rural people who do not have enough money to pay can postpone the payment until they have money.

Access to drinking water and the availability of toilet and bathroom facilities at home are some indicators for good sanitation in Dilam village. The majority of participants do not have access to drinking water (60.7%), and do not have a toilet and a bathroom at home (75%). People must go far from their houses to collect water for cooking and washing. Sometimes they have to go to the valley or river with steep slopes, and back home with water and laundry carried in their hands. Apart from their poverty reasons, Dilam people hesitate to build toilet and bathroom facilities at home because they are accustomed to using the public toilets and bathrooms (*Tapian*), which are usually located next to the fishpond. This gave them some advantages such as the chance to meet friends or relatives in the public bathrooms to chat or exchange information, or to inspect their rice-fields or fishponds. A summary of data on these social indicators is presented in Table 6.3.





Figure 6.1. Public toilets and bathroom (*Tapián*) in Dilam

Table 6.3. Social conditions indicators

Social Indicator	Number of Participants	Percentage
<b>Education Attainment</b>		
No school	0	0
Elementary School	17	60.7
High School		
Junior	5	17.8
Senior	5	17.8
University	1	3.5
<b>Having visited Health Centre:</b>		
Traditional healer/Rural midwife	22	78.5
Hospital	6	21.4
<b>Access to Toilet and Bathroom:</b>		
Inside	7	25
Outside	21	75
<b>Access to Drinking Water:</b>		
Access	11	39.2
No access	17	60.7

Note: n=28. Source: Fieldwork (2004)

## Overview of Rural Credit Systems

Dilam Village, with its traditional nature, is characterised by its diversity of rural credit systems. These can be divided into two main categories: formal and informal. The formal credit systems refer to the credit systems that are provided, administered, and licensed by the government, while the informal credit systems are all financial systems that occurred outside government's regulations.

The formal credit systems consist of credit schemes administered by the central government such as Bimas, KUT (*Kredit Usaha Tani*/ Credit Programme for Farmers), PMI (Credit for Food Security), and credit schemes managed by the local government such as revolving credit (usually in the form of cows), and credit for rice-mill owners (LUEP). Bimas, KUT, and PMI credit schemes, which were managed by the central government, are usually intended for the food-crop and vegetable farmers in the form of farm supplies such as fertilisers, pesticides and seeds. Other credit schemes that have been operated in Dilam were KUK-DAS and *Kupedes*, which were managed by *Bank Rakyat Indonesia* (BRI) *Unit Desa*. The KUK-DAS credit scheme was especially used for conservation purposes and delivered by the Ministry of Forestry. In Dilam, this credit aimed to help farmers prevent hill erosion. Thus, farmers who received this credit were mainly those who grew annual crops such as coffee, rubber, clove, and cinnamon in the hills. The *Kupedes* of BRI was usually accessed by well-off rural people, who needed cash to start a small business or trading.

These formal credit programmes have not operated in Dilam, except those that are managed by the local government such as the LUEP, and the revolving credit programmes to raise cows. This is because of the unsuccessful nature of previous formal credit programmes, and the government hesitates to continue. Many of the KUT 's customers, who can't repay the loans, are still there, but their number can't be detected owing to their hesitancy to inform anyone about their credit defaults.

The number of participants, as stated in Table 6.4, shows the numbers, who have had previous experience with the formal credit schemes. Table 4 also shows that the KUT covered more participants than other schemes covered. This was due to its simplicity

and its accessibility features that allowed farmers easily to participate in this credit programme. The formal credit programmes from local government have fewer participants since they are particularly designed to specific customers who have a rice-mill (for LUEP credit scheme) or are successful in farming (for the revolving credit scheme to raise cows).

Informal rural credit systems in Dilam consist of a variety of Rotating Savings and Credit Associations (ROSCA) or *Julo-julo*, moneylenders, and *Simpan Pinjam* (rural/traditional cooperatives). Except for moneylenders, informal credit systems in Dilam are arranged for a group of people. For example, farmers in one watershed or farming area are grouped into one farmers' group, and their credit programme is named *Arisan Kelompok Tani*. This usually consists of a variety of *Julo-julos* and *Simpan Pinjams*. Farmers or rural people in one clan also formed a group credit system named *Arisan Suku*, which also consists of *Julo-julos* and *Simpan Pinjams*. Other than these groups, there are neighbourhood groups, women's groups, and groups of other constituents who have formed *Julo-julo* and *Simpan pinjam* credit schemes appropriate to themselves.

Based on my survey research in Dilam, Table 6.4 shows that most of the participants are involved in *Arisan Suku*, while fewer participants are engaged with moneylenders.

Table 6.4. Rural credit programmes in Dilam

Types of Credit Programmes	Sponsored by	Number of Participants	Percentage
<b>Formal Credit:</b>			
- KUT (Credit Programme for Farmers)	Central govt	9	64.2
- <i>Kupedes</i> BRI (Rural Credit from BRI Bank)	Central govt	1	7.1
-LUEP (Local Government's Credit Scheme for Rice Mills' owner)	Local govt	2	14.2
-PMI (Credit for Food Security)	Central govt	1	7.1
-Cow's Revolving Credit Scheme	Local govt	1	7.1
<b>Total</b>		<b>14</b>	<b>100</b>
<b>Informal Credit:</b>			
- <i>Arisan Suku</i> (Clan ROSCA), consists of <i>Julo-julo</i> and <i>Simpan Pinjam</i>		18	56.2
- <i>Arisan Kelompok Tani</i> (Farmer's Group's ROSCA), consists of <i>Julo-julo</i> and <i>Simpan Pinjam</i>		7	21.8
-Moneylenders		1	3.1
- <i>Julo-Julo Panen</i> (Harvesting's ROSCA)		6	18.7
<b>Total</b>		<b>32</b>	<b>100</b>

Source: Fieldwork (2004).

People in Dilam perceive formal and informal credit systems differently. Formal credit systems, which are designed and managed by the government, are usually difficult to be accessed, require long procedures, and have high costs. By contrast, informal credit systems are characterised by simple procedures, are easy to be accessed and have low costs, but provide small amounts of funding only. A Participatory Rural Appraisal (PRA) technique, namely Matrix Scoring and Ranking, that was conducted in one farmers' group in Dilam, shows the comparison between formal and informal credit systems available in Dilam, and how farmers scored and ranked them based on criteria created by them. These are presented in Table 6.5.

Table 6.5. Matrix scoring and ranking of rural credit systems available in Dilam

Types of Credit/Financial Institutions.	Criteria						Scores	Ranks
	Simple and easy to access	Many benefits	Access when emergency	Low interest rates	Large co-verage			
<b>Formal Credit Systems:</b>								
- KUT	****	*****	****	***	****	19	III	
- KUD	**	*	*	*	*	6	VI	
<b>Informal Credit Systems:</b>								
- <i>Simpan Pinjam Kelompok Tani</i> (Farmers' Groups' Cooperatives)	****	****	****	****	****	20	II	
- <i>Arisan Kelompok Tani</i> (Farmers' Groups' ROSCA)	***	***	***	***	***	15	IV	
- <i>Arisan Suku</i> (Clan ROSCA)	*****	*****	*****	*****	*****	25	I	
- <i>Arisan Barang</i> (Goods ROSCA)	****	****	****	****	****	20	II	
- <i>Arisan Kenduri</i> (Feast ROSCA)	****	****	****	****	****	20	II	
-Money lenders	**	*	**	*	**	8	V	

Source: Fieldwork (PRA, 14 January 2004)

Notes: \* = very bad      \*\*\*\* = good  
 \*\* = bad                \*\*\*\*\* = very good  
 \*\*\* = quite good

According to Table 6.5, *Arisan Suku* or Clan ROSCA is the most preferred rural credit programme in Dilam, while the formal credit programme that is channelled by Rural Unit Cooperatives (KUD) is the least preferred. The unpopularity of formal credit programmes will be discussed in the next sub-section.

### ***Formal credit programmes in Dilam: Unpopular rural credit systems***

The formal rural credit system in Dilam village is not so preferred by rural people, because of its unpopular characteristics. This type of rural credit system is characterised by high interest rates, long administrative procedures, and required one to have collateral to access the credit. Another reason is that information about how the formal credit systems work is not available in Dilam. Dilam people, most of whom are poor farmers, perceived the formal credit schemes as unreachable. They thought that borrowing money with high interest is impossible considering their incomes from crops and livestock are unstable and highly dependent upon natural and climatic conditions.

Providing collateral, which is usually in the form of proof of property such as land, buildings and vehicles is difficult for the poor. As one farmer stated:

*To participate in a credit programme from the government with a high interest rate is difficult for us since we do not have a regular income. We can't rely on our crops or livestock, since the harvests sometimes increase or decrease, and diseases threaten the livestock growing. We can't provide collateral because we don't have that kind of property. If the government really wants to help us, the credit scheme should be flexible and adapted to our conditions, such as the repayment should be made at harvesting time, the collateral should be based on trust or moral guarantee, and the interest rates should be lowered and, if possible, with zero interest (In-depth Interview, 20 January, 2004).*

The long bureaucratic procedure is another problem encountered by poor farmers trying to access formal credit programmes from banks. This procedure is usually done through the *Wali Nagari* office, where the farmers register their names. The *Wali Nagari* then submits the names of candidates to the banks who verify these candidates according to their income, daily activities, and personal records. The candidates are invited to attend the interview process. Some candidates may not pass this verifying process because of their unstable incomes or their previous bad personal records. The accepted candidates should then submit a proposal. The bank staffs then examines the proposal, and if passed, the bank will give credit. Sometimes the proposal does not pass the examination, even though farmers have spent a lot of money to develop a proposal and to pay officials to process submitting the proposal, as happened to one farmer in Dilam:

*I have developed two proposals in order to have credit in the form of revolving credit to raise cows. I have prepared the feed for the cows, since it is easy to find here. The first proposal was addressed to the rural bank (BRI). I have spent Rp 250,000 for developing this proposal, and it has been accepted at the sub-district level. But it was failed at the bank level because I could not provide collateral, either vehicle documents or a land certificate. The second proposal was addressed to the local government. In this case no collateral was needed, and I have spent Rp 300,000 to process it. It has*

*been two years since, but I have no progress or information regarding this proposal so far (In-depth interview, 14 January 2004).*

The pessimism of Dilam people toward formal credit systems is also influenced by their bad experience when they were previously participants of the KUT credit programme. The KUT is a government credit programme and is specifically designed for poor farmers. At the policy level, this KUT scheme is adapted to the poor farmers' conditions in terms of low interest rates, simple procedures and practically no collateral. Interest rates for KUT credit scheme were less than 6% per three months, or about 2% per month. The requirements for accessing credit are simple; farmers need to associate in one group and make a group plan named *Rencana Dasar Kebutuhan Kelompok* (RDKK). This plan and name of group members are submitted to the *Wali Nagari* office, and the *Wali Nagari* then pass on them to the rural bank (usually BRI *Unit Desa* or BUKOPIN). This proposal will be accepted after a short examination. The repayment procedure was also based on groups. In this case, it was the task of farmers' group chief to collect the repayment from the group's members.

In reality, however, the implementation was not as simple as outlined above. Often, the time of credit delivery was not matched with the farmer's needs. This affected the low quality of crops and therefore, caused the loss of harvests. Farmers usually need cash to buy fertilisers, and to pay labourers for land preparation and planting early in the rainy seasons. At that time, the seedlings are ready to be transferred to the field. However the credit is often received when the rainy season has passed, or in the middle of rainy seasons, when the seedlings are too mature, and the land has already hardened. One farmer complained about this situation:

*Our problem in accessing formal credit such as KUT was that the credit frequently arrived late when we have finished preparing the land and planting, and the seedlings have overgrown. Thus, to fulfil our cash needs for purchasing fertilisers and paying labour, we borrowed money from relatives or moneylenders, who set up high interest rates. But we have no choice. When the credit is received later, we used it for other purposes such as buying a TV or motorcycle, or for costs of children's education. (Focus Group Discussion, 12 January, 2004).*

This situation is very common in Dilam, where the farmers do not always use the credit for farming activities. Often, they can't repay the credit on time or can't repay at all because they used the credit for non-renewable purposes, while the harvests have been used to repay their debt to the moneylenders or relatives. The situation becomes worst if the harvests have failed. The farmers are not only unable to repay the credit, but also are incapable of meeting their daily needs.

Lack of information on credit and banking systems, and farmers' experiences with previous rural credit programmes also caused the lack of success of formal credit programmes in Dilam. Many farmers view formal credit programme as a grant from the government to the poor, so that they do not have to repay the credit. This perception emerged from their previous experience with the *Bimas* Credit Programme, in which the government forgave them and wrote off their credit defaults. Also, there was the IDT programme (Presidential Instruction on Development of Backward Village), a large-scale poverty reduction programme created in 1993, which delivered revolving funds to poor people in more than 20,000 under-developed villages in Indonesia. This IDT programme intended to give soft loans to the poor, but on implementation, the poor could not repay them, and the government also forgave them. During the Suharto regime, the government frequently gave grants to the poor farmers, usually in the form of farm supplies such as fertilisers, pesticides and seeds. This was the reason why most Dilam people preferred to choose *Golkar*, the Suharto party, in the legislative general election, hoping that this regime would return after the election. This perception was widely found among farmers I interviewed, as one farmer said:

*During Suharto's regime, the government spoiled farmers in Dilam with much assistance such as in the forms of farm supplies or extension services. We did not have to repay since the government granted them. I hope that the current or future regime would apply what President Suharto did, to be close to and to help the poor farmers like us. We do not need to repay the credit because we do not have enough money for that. Our money is only sufficient for fulfilling our daily consumptions (In-depth interview, 15 January, 2004).*



The lack of success of formal credit programmes in Dilam village was also apparently due to a lack of commitment by the local government to provide appropriate financial services or credit systems - especially for poor farmers. This is reflected by the absence of rural banks in the village, lack of training or extension programmes to educate rural people on rural credit, and the unavailability of extension workers. The remote location of Dilam village, and scarce public transportation, mean that financial institutions hesitate to establish an office branch in Dilam. Another potential reason is that the majority of people's income is low and unstable since they are poor farmers and they depend for their livelihood only on agriculture. It is too risky for rural banks which have business oriented enterprises to count on the small farmers as their customers. I had an opportunity to validate this assumption by interviewing the director of a sub-district rural bank at the end of my fieldwork:

*It is true that our rural credit policy could not reach the poor farmers, whose incomes come mainly from agriculture. Farming activities are highly dependent upon uncontrollable factors such as climate, pest outbreaks, and natural disaster. Poor farmers are also unable to provide collateral, and could not repay the credit with high interest rates. As we operate a bank as a profit oriented organisation, we can't base our business on customers whose incomes are not regular. Thus, we prefer to channel the credit to petty traders or civil servants who have regular incomes. If the petty traders could not afford to repay the credit, their business capital could be used as a guarantee. We experimented by delivering the KUT credit to the farmers but it failed and many farmers could not repay (Key Interview, 21 April, 2004).*

This finding refutes the current widely held assumption that rural banks in Indonesia are helping poor farmers and are working closely with them. Although many farmers in other areas in Indonesia may have benefited from credit programmes channelled by the rural banks, the situation in Dilam shows that the rural bank has not assisted the poor farmer in all cases.

### ***Informal credit schemes in Dilam: Creating the most appropriate rural credit programmes for poor farmers***

Because of the unpopularity of formal credit programmes in Dilam, farmers are inclined to accumulate capital through informal finance. Poor farmers tend to create credit systems that are most appropriate and adapted to their conditions to fulfil their credit needs. This is very common in Dilam where a group of farmers (both men and women farmer groups) have many kinds of credit systems. These informal credit programmes are mainly in the forms of ROSCA (Rotating and Savings Credit Associations) or *Julo-julo*, moneylenders, and simple cooperatives (*Simpan Pinjam*).

The *julo-julo* scheme, which will be elaborated further in this chapter, is the most popular informal source finance in Dilam. People tend to create *Julo-julo* schemes based on their needs. There are hundreds of *julo-julo* scheme available in Dilam, but they could not be wholly detected because of the time constraints, which is a limitation of this study.

The *Simpan-pinjam*, as has been stated above, is different from *Julo-julo*, since it is specifically created to provide loans for group members. It has a compulsory (basic) saving named as *Simpanan Wajib*, and is usually paid yearly or monthly. There are also *Simpanan Pokok*, or voluntary savings, which are contributed by each member in *Simpan Pinjam*. The amount varies, depending on the capacity of each member to save. Every member in the *Simpan Pinjam* has the privilege of borrowing, with a maximum loan, and interest rates, and other terms and conditions created and agreed by members.

The moneylender is another source of credit available in Dilam. This kind of credit is useful especially in an emergency. Moneylenders usually set up high interest to the borrowers. Moneylenders in Dilam do not solely give loans in cash. Often, the loan is in the form of fertilisers, pesticides, or seeds. Loans in the form of fertilisers are common in Dilam, and the moneylenders usually are the shop-owners or fertiliser retailers. The repayment is usually in the form of harvests (paddy), and the moneylenders usually take profits through this scheme by taking the difference in value between paddy and

fertiliser, since the price of paddy was far higher than the price of fertilisers. One farmer complained about this:

*I actually do not want to borrow money or in-kind from moneylenders, since they set up high interest rates, and the repayment is usually in the form of paddy (husked rice). But I need to borrow money for fertilisers, otherwise I'll miss the rainy season and I could not plant on time. The value of this repayment is sometimes very high and does not balance with the price of fertiliser that I borrowed. This is how moneylenders take interest from the farmers (In-depth Interview, 21 January, 2004).*

The PRA techniques of data collection that were used several times in Dilam were very useful to identify the diversity and advantages of informal credit systems. One PRA technique, which identified the advantages of informal rural credit programmes in terms of economic, social, and cultural points of view was conducted in one farmer's group in Dilam, as presented in Table 6.6.

Table 6.6. Economic, social, and cultural advantages of informal credit systems in Dilam

Types of credit/Financial institutions	Economic Advantages	Social Advantages	Cultural Advantages
<b>Arisan Kelompok Tani (Farmers' Group's ROSCA):</b> -Julo-julo Rp 10,000/2 weeks - Julo-julo Rp 5,000/2 weeks - Julo-julo Rp 2,000/week - Julo-julo Tikar (carpets)/harvesting time - Julo-julo Piring (dish) Rp 2,000/week - Julo-julo Beras (Rice) 1 litre/week - Julo-julo Alat-alat Dapur (Crockery/kitchen appliances)/harvesting time -Simpan pinjam (Cooperatives) Compulsory savings Rp 1,000/week Basic savings Rp 5,000/year	Support DC Support DC Support DC Support SN Support SN Support DC Support SN Support DC	Enhance SR Enhance SR Enhance SR Enhance SR Enhance SR Enhance SR Enhance SR Enhance SR	
<b>Arisan Suku (Clan ROSCA):</b> -Compulsory savings Rp 3000/month -Julo-julo Rp 2000/month -incidental contribution Rp 5000	Support DC Support DC	Enhance SR Enhance SR Support SC	Enhance Minang- kabau Custom
<b>Arisan Tenaga (Alternate Working Together)</b>	Support FA/reduce expenditures		

Notes: DC=Daily Consumptions; SN=Secondary Needs; SR=Social Relationship; SC=Social Capital; FA=Farming Activities. US\$ 1=Rp 8,500.

Source: Fieldwork (PRA, 24 January, 2004)

Table 6.6 illustrates the diversity of informal finance created by poor farmers in Dilam. It shows that one farmers' group has many kinds of credit schemes or *Julo-julo*. Despite the small amount of money being used, these activities significantly supported farmers' daily consumptions and secondary needs as well. Sometimes they also used this money for supporting their children's education, or to pay the costs of medicines and health treatments.

In the case of *Simpan Pinjam* or Simple Rural Cooperatives, according to this group, it was especially useful to support expenditures during *Idul Fitri* Holiday, when every household prepared more foods and purchased new clothes and household furniture to celebrate this holiday. Thus, farmers do not have to borrow money from moneylenders or relatives to fulfil their needs. The 10% interest rates of these simple cooperatives were equally shared among members.

The *Arisan Tenaga* or Alternate Working Together is significant in helping the farmers to reduce the costs for farming activities, especially land preparation, planting, and weeding. This refers to the spirit of *gotong-royong* or working together that has become the tradition of the Minangkabau people. In this *Arisan Tenaga*, farmers work in turn in one of a member's field. Thus the wages of one farmer to work in every member's fields will be compensated when other members work in his field. With regard to *Arisan Suku* or Clan ROSCA, it has economic, social and cultural advantages. As has been shown in Table 6.4 and Table 6.5, *Arisan Suku* is mostly preferred by Dilam people. This type of *Arisan* will be discussed further in the next section.

### **“*Arisan Suku*”: Cultural Influence of Rural Credit Programme**

*Arisan Suku* or Clan ROSCA is one of the informal rural credit programmes in Dilam. The unique feature of this rural credit programme is that it is influenced by the well-known Minangkabau customs of the matrilineal system<sup>1</sup>. The procedure of *Arisan Suku*

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<sup>1</sup> ) A global definition of the matrilineal system is: "relating to, based on, or tracing ancestral descent through the maternal line"(Sanday, 2002:237). However, referring to the *Minangkabau's* situation, matrilineal or matriarchy is defined as "cultural symbols and practices

known Minangkabau customs of the matrilineal system<sup>1</sup>. The procedure of *Arisan Suku* is similar to other types of *Arisans* in Dilam. The members meet regularly, usually monthly, and make contributions of the amount, which the members have agreed. The difference is that the members of this *Arisan Suku* are limited only to *Suku* (Clan) members. Since it follows the matrilineal systems, the members consist of only the females in the family and the sister's bothers. Fathers, grandfathers, and husbands are ineligible to be members, because they belong to other clans. These people are called “*Urang Sumando*” in Minangkabau customs. Thus, in one family, husband and wife are involved in different *Arisan Suku*, and it is common in Dilam that husband and wife go to different destinations to attend their *Arisan Suku's* meetings.



Figure 6.2. *Arisan Suku* meeting in Dilam

The function of *Arisan Suku*, as stated by one senior person in Dilam is: to strengthen the unity of clan or village members, and to encourage the young generation (*anak dan kemenakan*) to be more active to improve their household economy (In-depth Interview, 14 January, 2004).

<sup>1</sup> ) A global definition of the matrilineal system is: “relating to, based on, or tracing ancestral descent through the maternal line”(Sanday, 2002:237). However, referring to the *Minangkabau's* situation, matrilineal or matriarchy is defined as “cultural symbols and practices associating the maternal with the origin and centre of the growth processes necessary for social and individual life”(ITB, 2004).

In line with the above functions, based on my direct observation, the *Arisan Suku* meeting has at least three purposes. The first is to discuss current issues in Nagari and Clan, chaired by the *Datuk* (the clan's chief) or other key persons in the *Suku*. The *Suku* members ask questions related to the economic, social and cultural problems they encounter in everyday life. This discussion is usually preceded by a speech by the *Datuk* or other key persons. In some cases, the *Datuk* or other *Suku* leaders put forward current issues that they try to resolve in the meeting, such as conflict between families, misconduct of *suku* members, and so on. Second, the meeting is a good opportunity for *Suku* members to meet each other, to share and exchange stories, and also to get to know the members, since actually they are in one big family since they have the same ancestor. To get to know the *Suku* members is very important in Minangkabau customs, to avoid unethical conduct such as calling their *Datuks* or seniors inappropriately, or to avoid their children getting married to each other since it is forbidden to find a partner within the same *Suku* in Minangkabau custom. Third, the meeting is an appropriate occasion to conduct an *Arisan*, the tool to accumulate funds, and to help each other. The *Arisan Suku*, therefore has economic, social, and cultural meanings.

The economic advantages of *Arisan Suku*, as shown in Table 6.6, are mainly to support the daily consumption of the family. For better-off households, the money is used for continuing their children's education, to build new houses, or to conduct a ceremony or party. These activities demand high costs, and therefore the members need to borrow from the *Simpan Pinjam* scheme. There is a limited amount of money that can be borrowed by a member, depending on how much money has been accumulated in each group (*suku*). Based on my observation, one member can borrow up to Rp 2 million (Field Notes, January 2004).

The social function of *Arisan Suku* relates to its function to unite the *Suku* members in order to become solid and strong. This is important in order to strengthen the spirit of rural people, especially for the young generations to develop their village. This meeting is also significant for rural people to help each other, especially when one of the members has experienced misfortune or sadness. In each *Arisan Suku* meeting, there is a charity fund that is collected instantly, which will be used when one of members experiencing such misfortune.

Culturally, *Arisan Suku* is significant especially to improve the members' understanding and behaviour with regard to Minangkabau custom, especially for the young generation. The speech of *Datuk* or the key persons in the meeting includes ensuring *Suku* members observe Minangkabau customs appropriately, and follow the values and norms that have been applied since long time ago. The place and situation are created according to Minangkabau custom so as the members can enjoy the meeting and are interested in joining and attending the meetings regularly.

Considering the above advantages, most Dilam people are enthusiastic about attending the *Arisan Suku* meeting. One farmer, who was a member of a *Suku*, expressed his opinion why he is interested in attending *Arisan Suku* meetings.

*I always attend the Arisan Suku meeting every month. If I miss it, I lose on opportunity to meet other relatives to exchange information, to borrow money, or to learn current issues in our clan and nagari. Sometimes this meeting gives a chance for us to exchange information about new technology in farming, or off-farm activities. If I did not attend this meeting, I would also lose the opportunity to receive "Julo-julo", whenever the lottery gives me a turn. (Focus Group Discussion, 18 January, 2004).*

When I had the opportunity to attend this *Arisan Suku* meeting on 25 January 2004 at one *Suku*'s group meeting, I could see the spirit and joyfulness of the *Arisan* members. They could spend hours even until midnight to chat, discuss, and do the lottery. This is a good opportunity for them to escape from their hard and routine works in the fields.

With regard to the *Arisan Suku* itself, rural people favour this credit programme because of its flexibility and the fact that it is gender friendly, as reflected by its matrilineal character. In one *Arisan Suku*, such as in *Suku Panay*, every member contributed Rp 5,000 per month for males and Rp 2,000 per month for females. However, only female members can borrow, since in the matrilineal system, a wife is the *Suku* member, while a husband belongs to other *Suku*. This money is strictly used for non-farm activities such as for children's education, to renovate or build houses, and for traditional ceremonies such as weddings, births, and deaths. The maximum loan is Rp 300,000, and the minimum one is Rp 100,000. The interest rate of this *Simpan Pinjam* credit

scheme is 2.5% per month with six-monthly repayment. Other than the regular contribution, the members are also required to contribute Rp 5,000 per person to be used in the case of an emergency, such as the death of a member. This fund should be used up for this purpose.

One reason for the success of this credit scheme is that the pressure (spoken or unspoken) from members ensures loans are repaid. If a member can't repay on time, she will receive a warning from their *Datuk* or clan's chief. If she can't repay after the third warning, the *Datuk* will try to find the solution. But these warnings have become a punishment to her and her family, since she has embarrassed her family to be unable to repay the loan. To avoid this condition, therefore, the members try to repay on time. A women farmer said that:

*I prefer to become involved in Arisan Suku rather than in other Arisans in Dilam since it helps me to support my family needs, especially for my children's education and other needs. The repayment can be done after harvesting. If our harvests fail, our Datuk takes over the problems and finds the solutions. I also like this Arisan because the money can only be lent to women, and not to men. This meant that the money is only circulated in our Suku. This could make our Suku become stronger and prosperous if the members are disciplined to repay and use the loan appropriately (Focus Group Discussion, 20 January, 2004).*

This comment from a rural woman describes the unique characteristic of *Arisan Suku*, in which, according to its matrilineal *Minangkabau* custom, the active participants are only the women, while the men are only the contributors. The logic of this procedure is that if the men received a loan or *Julo-julo*, the money would be received by his family (wife and children), who belong to another *Suku*, and therefore, the money will be given to another *Suku*. In fact, the main objective of *Arisan Suku* was to support and to increase the prosperity of the *Suku* members.

The unique culture of *Arisan Suku* has created a healthy competition among *Sukus* in Dilam. Based on my observation, every *Arisan Suku* in Dilam has tried to be more progressive and better than the others. They improved the systems and services for the



members in order to make the *Arisan Suku* become attractive and thus attract more members to join. Some of the *Arisan Sukus* were willing to establish legal and registered rural cooperatives or rural banks in the future.

Other perceptions of rural people of *Arisan Suku* are related to its function of enhancing their *adat* (custom) especially to young generations. It has been realised that young people or teenagers are not sufficiently knowledgeable about Minangkabau customs. This is reflected by a lack of solidarity and lack of spirit of young people to develop their *Nagari* or their family. A senior person in Dilam said:

*I like Arisan Suku because it is attached to our Minangkabau adat (custom). However, nowadays people tend to ignore our adat, especially young people since they think that adat is something traditional, unprogressive and not modern. In fact, they have to have knowledge about adat, since they will be the ones who hand it on and sustain it in the future. (In-depth Interview, 21 January, 2004).*

The cultural influence of *Arisan Suku* in Dilam is in line with local government's policy to elevate local culture in the era of decentralisation. West Sumatra's provincial government has been intensively promoting the custom of Minangkabau in every layer of the community. This effort was started by changing the village government's system from *Desa* to *Nagari*, since the *Nagari* government is considered to be effective to sustain Minangkabau *adat*. The Minangkabau *adat* itself is greatly influenced by the Islamic faith, as stated in a *Minangkabau* famous principle: "*Adat basandi syarak, syarak basandi kitabullah, syarak mangato adat memakai, alam takambang jadi guru*" (Dt-Putiah, 2000: 25). The meaning of this principle is: the custom (*adat*) is based on the Islamic religion and the religion is based on the Holy Qur'an. The Islamic religion has been used as a reference to make regulations and this has been implemented through custom (*adat*). The community is also advised to learn about life from nature or the environment. At the end, this effort aims to create a democratic and an independent community while respecting the creativity and aspirations of rural people, who have been marginalised and ignored for a long time.

## **“Julo-julo”: Saving and Credit Behaviour of Rural Women**

Rural people in Dilam have long been practising saving and credit systems through the *Julo-julo* scheme. It also has been part of Minangkabau *adat*, whereby people contribute in the form of *gabah* (husked rice), placed in the small houses (*rankiang*) in front of the traditional house (*Rumah Gadang*). This collected *gabah* is used usually during a time of scarcity before harvest (*paceklik*), or before *Idul Fitri* festival day.

The *Julo-julo* system in Dilam is similar to the ROSCA (Rotating and Saving Credit Association), or *Arisan*. The participants periodically contribute certain amount of money and use lotteries to allocate the fund. This process is repeated during subsequent meetings until every member has had an opportunity to collect the fund once. The saving and credit functions of this system are implicit within the ROSCA's cycle. The savings function applies when a participant contribute cash or in-kind and wait until his/her turn, while the credit function takes place when he/she lets other participants take their turns.

The *Julo-julo* scheme is significantly attractive and meaningful for rural people, especially for women, although its savings and credit functions are implicit, and the small size of money to be contributed. It is common in Dilam that every group, whether farmers, women farmers, or neighbourhood groups, has their own *Julo-julo* scheme. It can help participants, not only for primary or daily consumption but also for secondary needs, such as to support children's education, to build a house, or for conducting a ceremony or party. In an emergency situation, *julo-julo* is also of great assistance. When a participant has misfortune such as the death of a family member, or lack of money, another participant who had a current turn would voluntarily gave his/her turn to the member who had suffered misfortune. A woman farmer stated her experiences of participating in this informal credit scheme:

*Julo-julo has significantly helped us to fulfil our daily needs. Despite the small amount of money contributed, it helps us to buy rice, sugar or coffee, especially when our harvest is failed. In particular, the money could be available when we were in emergency, since another member voluntarily gave his/her turn to us. If we have a group we always want to make “julo-*

*julo*” as much as possible, since it has many advantages. We can buy expensive items such as carpets, or kitchen appliances easily through “*julo-julo*”, which we could not afford if we had to buy by our own money (In-depth Interview, 13 January, 2004).

*Julo-julo* in Dilam has many forms, which are not solely in the form of money. Rural women, who have a more active role than men, are very creative in devising many forms of *julo-julo*, according to their needs. To fulfil their needs for fertilisers, for example, they create *Julo-julo Pupuk* or Fertiliser's *Julo-julo*. In this case, they contributed money weekly or monthly, and then they purchased fertilisers. This *Julo-julo Pupuk* is usually done during the planting season. When they need sand, or cement to build their houses, they create a *Julo-julo* to buy cement or sand. Usually they repay them after harvesting. Also, there is *julo-julo* for purchasing kitchen appliances, dinner sets, or carpets that are very important when one conducts a party. The most popular *julo-julo* is “*julo-julo sekali panen*”, or harvesting *julo-julo*, of which the cycle is between harvesting times. Thus the contribution is made when harvesting, and ended when the next harvesting came. The contributions are usually in the form of paddy (husked rice) so that the value of takings depends upon the price of paddy at that time.

In the *Arisan Kelompok Tani* and *Arisan Suku* as stated above, *julo-julo* plays an important role. Each group has specific *julo-julo* schemes. All *Arisan Suku* participants could become members of farmers' group, but not all *Kelompok Tani* members can become the participants of *Arisan Suku*. Thus, *Arisan Suku* has a more limited membership than *Arisan Kelompok Tani*.

The higher level of activity of rural women in *Julo-julo* than men is explained by many things. The matrilineal system of Minangkabau custom greatly influences this. Women expect to actively manage their households since they live in their own environment (clan). As husbands are viewed as outsiders in their wives' clans, men, in some cases, hesitate to involve themselves in activities beyond their capacity as a husband. Men usually focus only on their main job such as farming or craftwork, and ignore household responsibilities such as cooking, washing, and taking care of children. The latter is not only under the responsibility of the father but also of the uncle (mother's brother/*mamak*). During difficult times or emergency situations, such as when harvests

fail or there is lack of money, women are able to look for help from their relatives or friends or moneylenders. Similarly, when they want to conduct a party or a ceremony, women need to discuss it with their brothers or relatives in their clan, and find a solution about funding. These reasons, therefore, encourage the women in Dilam to actively create or participate in *Julo-julo* credit schemes.

Another reason is that women are always in the position to control the daily activities and consumption, especially for cooking. The small amount of money to be contributed and the short period of each cycle make the *julo-julo* scheme appropriate to be managed by women and the money is spent for household needs. Therefore, it is common that women create *julo-julo* for purchasing kitchen appliances, carpets, dishes, and so on. Another reason is the attitude of men in Dilam who are apathetic about social and public activities. This was shown when I visited many farmer groups in Dilam, in which about 85% of the members are women. A women farmer commented:

*We are the women who are always responsible for any daily activities at home. Men focus only on their job in the field or in crafting, and they do not want to be disturbed. They are also too lazy to become involved in any social activities. They said that it is the task of women. When we are experiencing being broke and have no money to buy rice or sugar, I have to borrow money from relatives or moneylenders. The "julo-julo", therefore significantly can help us especially during an emergency, even though it is only a small amount of money. (Focus Group Discussion, 15 January, 2004).*

However, despite the above positive meanings of *julo-julo*, the small size of capital, and lack of administrative and managerial capability cause these credit schemes to be non-progressive. The accumulated capital is considered useful only for subsistence and emergency situations, and could not achieve the larger impacts to increase the prosperity of rural people.

## **Role of Local Government and NGOs in Rural Credit System**

### **Development**

Local government and NGOs are two institutions, which have the potential to assist the process of bottom-up rural credit system development in Dilam. Each of these institutions has a different processes and activities and is perceived differently by rural people.

### ***Role of local government in Dilam***

Local government's role in assisting rural credit system development in Dilam is mainly through the work of agricultural extension services. Agricultural extension workers in Dilam are responsible for guiding farmers' groups, and each farmers' group has its own rural credit and saving schemes both formal and informal. In an informal scheme, each farmer's group has *Julo-julo* and *Simpan-pinjam* credit schemes as has been described above. The role of extension workers in this case is to monitor the progress of these informal credit schemes, and give guidance on administrative procedures such as bookkeeping and management. In the formal schemes, such as the KUT credit scheme, extension workers assist farmers' groups in developing the Basic Group Plan (RDKK), which is required to apply for KUT credit, and also to monitor the progress of the credit programmes.

However, the role of local government, especially the agricultural extension worker, was the subject of criticism by Dilam villagers. People considered that local government was not providing serious attention to development in Dilam. During my stay in Dilam, no particular extension worker was assigned specifically for Dilam. The extension worker who was assigned for Dilam village has a working area, which covers three *Nagaris* (villages) including Dilam. This affects his working performance, so that farmers were not receiving the extension services they expected. For example, farmers did not get sufficient information about new farming technology, credit facilities from the government, and the procedure to access credit from the bank. The non-availability

of an extension worker to stay in the village also caused his relationship with farmers to be uncomfortable. Farmers frequently complained about this issue, as one farmer said:

*The lower farm productivity and lack of progressiveness of farmers in Dilam is also caused by the lack of attention given from the local government. For example, the extension worker is reluctant to stay in our village, and he comes to this village only once or twice a week, since he has other responsibilities in other villages. This limits us conveying our concerns and discussing our farming problems with him. Sometimes farmers in Dilam prefer to use their own way of farming and ignore new technology, since traditional farming has been used since long time ago and has been adapted by them. We also prefer to accumulate capital by ourselves such as through Julo-julo and Simpan Pinjam (Focus Group Discussion, 16 January, 2004).*

Farmers in Dilam prefer to use their own way of farming and accumulating capital because they receive less attention from local government, especially from agricultural extension workers. As has been mentioned previously, farmers in Dilam creatively formed savings and credit schemes appropriate to them such as *Julo-julo* and *Simpan Pinjam*.

The formal rural credit programmes, which are administered by local government such, as LUEP and revolving credit for raising cows also cause dissatisfactions in rural people. The LUEP, which was given to the rice-mill owners, was not successfully implemented since the credit could not be repaid on time. Whilst this credit programme aimed at helping poor farmers to sell their harvests at a reasonable price by giving credit to the rice-mill owners in order to be able to buy farmers' harvests at reasonable prices. However, the results have not yet been significant because the rice-mill owners did not pass the benefit to farmers through higher prices. Similarly, the revolving credit scheme for raising cows, were available to selected people only, since the amount of credit was limited, while the procedure to apply was quite long. Farmers in Dilam frequently complain about this situation, as stated by one farmer:

*Credit schemes from local government are very rare, especially for small farmers like us. The local government said that they want to help small farmers through the LUEP, but actually they helped the rice-mill owners, who are already well off. The revolving credit is also difficult to secure since the competition is quite high among farmers, while the credit itself is very limited, and there is a long procedure to obtain it (In-depth Interview, 18 January, 2004)*

The lack of local government success in assisting the development of Dilam is also felt by the elites. According to a staff member in the *Wali Nagari* office, many programmes and projects have been implemented in Dilam, including a rural credit programme, but most of them were unsuccessful. He complains that the government was not given full authority to administer the programmes for local people. There were always representatives from the central or local government who monitored and controlled the projects, as he said:

*Actually, the government has allocated many programmes and projects for Dilam, but these projects have no significant impacts on rural people. The government still places its representatives in the projects to monitor and to control them. Despite the fact that a decentralisation era has been launched, it seems that the government is not yet fully in earnest about applying that. Like allowing the horses to run in the field, but they still hold the rope ends (Key interview, 7 January, 2004).*

During my stay in Dilam, there was a programme from local government to temporarily locate several extension workers in Dilam in their internship programme to attain a higher level in their careers. They were required to make a proposal with a topic related to a development programme for Dilam. These proposals were presented in front of rural people and government officers as well as their supervisors. I had the opportunity to attend the seminar, participate in discussions, and interview presenters and audiences. The farmers, mostly women, participated enthusiastically in the discussions. They asked questions, particularly those related to their problems in farming, as they thought the seminar was a good opportunity for them to get a response from the extension officers.

There was also a proposal about a rural credit programme, which was responded to positively by the audience.

Based on my observation, the seminar was a good step to empower and to educate rural people. The spirit of the participants to ask and answer questions in discussions reflected the high level of motivation by rural people to be progressive and independent. The proposals were also promising, despite several shortcomings. The point is, how to implement them and get real and effective improvements for Dilam people, especially in view of the pessimistic views about the practice of the decentralisation process by local government, as stated by a *Nagari* officer earlier in this chapter.

### ***The NGO's roles in Dilam***

The difficulty of implementing several government programmes in Dilam has attracted one local NGO to conduct several empowerment programmes in Dilam. This NGO has had experiences with empowerment programmes in several villages in West Sumatra. This non-profit organisation got sponsorship from an international donor. This NGO starts its empowerment programme by introducing a PRA programme to the rural leaders and key people such as religious leaders (*alim-ulama*), cultural or clan leaders (*Datuk or ninik mamak*), and executives (*Nagari* officers). Since it is a local NGO, the empowerment programmes were in line with the West Sumatra Minangkabau *adat*, especially in designing self-help groups which incorporating the principles of Minangkabau customs. For example, the meeting or discussion follows the regulations in *adat* and the design of the group based on matrilineal Minangkabau custom. The process also follows the bottom-up system of development, and respected the norms and values available in a *Nagari*. Thus, Dilam people quickly accepted this NGO empowerment programme, which was started in 2001.

Through several PRA activities, which are facilitated by this NGO, these key people are able to create proposals for many activities to be implemented in Dilam, including a programme of how to accumulate capital to strengthen the economy of rural people. This capital accumulation programme designed by people, which has resulted in the



*Arisan Suku* credit scheme, that is favoured by most of people in Dilam, as has been described above.

To complement its involvement in the process of development in Dilam, the NGO continues its empowerment programme, through supporting a group of women, who have hobbies such as sewing and embroidering, with small loans for purchasing sewing machines and sewing materials. The NGO also helps women to market their products. There is also a *Simpan Pinjam* credit facility provided for farmers in the form of cash, named “Koperasi Lumbung Parawitan”. This soft loan has flexible repayment procedures and low interest rates.

Farmers’ perceptions of NGO’s role in Dilam are positive. This is reflected in their enthusiasm to participate in *Simpan Pinjam*. Based on my observation using the PRA technique (Venn Diagram) in a women farmers’ group, it was shown that the “Koperasi Lumbung Parawitan” is the most preferred among other financial institutions available in Dilam. The problem was that this cooperative could not cover many people because of its limited budget. One participant asserts that:

*The NGO that has worked well to develop our Nagari, and its cooperative (Simpan Pinjam) has proven to be effective to help us despite only numbers of Dilam people received it. I hope that the NGO can continue to give assistance to Dilam, especially to improve and increase the coverage of its Simpan Pinjam recipients. (Focus Group Discussion, 13 January 2004).*

The positive responses of Dilam people towards the NGO’s involvement in the process of development in Dilam reflects the fact that Dilam people are open for any interventions from outside as long as they are in line with norms or values held by them. This means that Dilam people are eager for any transformation that is appropriate to them. The NGO, which applied a bottom-up planning system in development and respected the *adat* and religion held by rural people, is accepted and preferred by Dilam people.

## Conclusion

This chapter shows that, economically, Dilam people are still in poor condition. This is reflected by the low level of income of the majority of the population. The social conditions of people are still unsatisfactory because the greater numbers of participant have only an elementary school education level. Sanitation and drinking water facilities are also insufficient. Culturally, however, Dilam people still strongly held the norms and values of their traditional Minangkabau customs. The rural credit system, especially the formal one, is not developed properly. Formal credit programmes, which consist of credit programmes that are delivered by the government through banks and cooperatives, mostly have been terminated because of the hesitant of the formal credit providers to give service to the rural people, especially the farmers. The credit programmes from local government still exist but are directed towards selected people only, and suffered by high default. The remote location of Dilam village contributes for the low economic and social condition, in a sense that modernisation process is slowly proceed to this village, while formal credit programmes are also fail to give service to the rural poor.

The informal rural credit systems, on the other hand, which consist a range of informal credit schemes such as *Julo-julo*, *Simpan pinjam*, and moneylenders, are significant in assisting rural people. The traditional informal credit schemes such as *Julo-julo* and *Simpan Pinjam* are successful to help rural people with credit needs. The success of these credit schemes is mainly because the design of these credit schemes follows the culture of Minangkabau, and therefore, rural people respect and prefer to use these informal credit programmes. The *Arisan Suku*, in particular, which is a combination of *Julo-julo* and *Simpan Pinjam*, follows Minangkabau matrilineal system. Despite the small amount of money to be contributed, they can help the participants for daily consumption and in emergency situations. The *Arisan Suku* is not only advantageous for rural people economically, but also socially and culturally. Socially, it can unite people in one *suku* (clan) and they help each other, especially in unfortunate situation. Culturally, the *Arisan Suku* meeting can strengthen rural people's knowledge about Minangkabau *adat*, especially for the young generation.

The success implementation of traditional informal credit programmes in Dilam can't be happened without assistance of a local NGO, which assists the rural people to design development programmes in the village through a participatory approach. The NGO's assistance is in line with the concept of empowerment and follows the local culture of Minangkabau's matrilineal system.

However, it is also important to notice that the fund received from these traditional informal credit programmes is sufficient for fulfilling consumption needs only, and is inadequate to be invested for increasing people's income. For this purpose, rural people usually go to the moneylenders, who can provide larger loans, but with high interests and strict repayment procedure.

## CHAPTER SEVEN

### SANIANGBAKA VILLAGE

#### Introduction

In the previous chapter we saw farmers in Dilam village experienced high levels of poverty, perhaps because of its isolation. People primarily retained and utilised traditional informal credit systems. In this chapter we turn to Saniangbaka village. This village is located close to the Solok District capital, and statistics point to this village being economically better off than Dilam village (BPP-Sepuluh-Koto-Singkarak, 2003). On the other hand, Saniangbaka has been known as one of villages in Solok District, which has high credit default from the previous government's credit programme. This means rural credit is a sensitive issue in this village.

In this chapter I will examine the economic and social conditions of people in Saniangbaka, and the development rural credit systems in this village, both formal and informal sectors, as well as the preference of rural people regarding credit for agriculture and poverty alleviation. Further, I will observe factors that influence rural people to choose and reject specific credit systems. Similarities and differences with Dilam will also be identified and examined. Findings presented in this chapter based on my research fieldwork in Saniangbaka.

This chapter begins with the setting of Saniangbaka village, describing its geographic, economic and social conditions. This section is complemented by data gathered from quantitative surveys and the secondary data from local government. The next section is an overview of rural credit systems in this village and discusses the availability of formal and informal credit systems as well as their ability to support poor farmers to fulfill their credit needs. Next, credit default and low repayment in the formal credit program is discussed, since this is an outstanding issue relating to rural credit systems in Saniangbaka. Then, the significant role of *Perantau* to support rural people with credit needs is elaborated, followed by the unusual role of moneylenders who are friendly and very flexible in giving loans to the rural people. The role of the *Wali Nagari* office in

developing rural financial systems in the era of decentralization will be discussed, and a conclusion will be presented at the end.

## **The Setting**

Saniangbaka is located within the Sepuluh Koto Singkarak Sub-district of Solok District, West Sumatra. It is situated near the Singkarak Lake, about 25 minutes' drive from Solok, the district capital city. The landscape of this village is flat in the northern and eastern parts, where the ricefields and residential areas are located, and hilly in the southern part, where farmers are planting cash crops such as rubber, coffee, cardamon, clove, and teak wood. This is different from Dilam village, whose residential area is clustered in one area and is located separately with ricefields or gardens. Thus the population density in Saniangbaka is quite high compared to other surrounding villages (*Nagaris*) and the distance between wards (*lorongs*) is quite close.

The flat area of Saniangbaka and the availability of a river across the village permit the development of good irrigation channels. Thus, the ricefields (*sawah*) in this village receive irrigation water throughout the year. This allows the farmers to plant rice any time of the year and this means farmers are not dependent on rainy seasons to start planting rice. It is common in Saniangbaka that farmers plant rice at different times. However, farmers who plant rice in the hilly areas have problems of water scarcity, and therefore depend on rainfall to water their fields.

Rice is the main crop planted throughout the year. Thus it can be seen that the flat area of Saniangbaka is dominated by ricefields. Farmers have been planting shallots, as a favourite commodity in this village, for many years. However, since the outbreak of shallot diseases in the 1999/2000 planting season that caused the farmers' big loss in income, they have hesitated to continue planting this crop. Several farmers still attempt to plant shallots, but the production is reduced sharply, and is no longer profitable. Other secondary crops which are planted include chilli, banana, and vegetables such as beans, eggplants, potatoes, tomatoes and so on.

Rice production in Saniangbaka has decreased since the outbreak of pest diseases such as 'wereng' (*nilaparvata lugens*) and mice in the 1999/2000 planting season. Since then,

rice production has never fully recovered, and the level of production remains flat (BPP-Sepuluh-Koto-Singkarak, 2003: 2). In fact, this *Nagari* is famous as a *Lumbung Beras* or a rice granary in Solok district, as an effect of its good irrigation facilities and its fertile soil. The sharp reduction of rice production is a reason why many farmers in Saniangbaka prefer to migrate or do *merantau*<sup>2</sup> to achieve a better standard of living.

The problems encountered by farmers who planted annual crops are the low price of the products and the high price for harvesting and weeding. Many farmers complain regarding the imbalance between low returns achieved from selling the products and high costs for harvesting and weeding, as one farmer stated:

*I am now having problems in cultivating annual crops such as clove, coffee, and cinnamon, which I planted up on the hill. Most of them are not so productive, since I do not really take care of them. The price of the products is too low, while the costs for weeding and harvesting are high. Often, I do not receive any profit from this activity, and I even suffered losses, because the returns that I achieve from selling the products are used up for paying the costs of weeding and harvesting. Thus, I prefer to cut-off the plants before they mature, and replace them with other crops, such as teakwood, which is popular today. I would like, therefore, to request the local government to help us in marketing our products, in order to be profitable for us (In depth Interview, 6 February 2004).*

Based on my interviews with other farmers, the above situation is used by the traders to enjoy profit, since they can play around and set the price that is profitable for them. They usually come directly to the field, select the crops that they want to buy, and help the farmers to deliver the products to the town.

At the time of my fieldwork, the farmers also suffered from problems of plant diseases which hit chillies during the rainy season. Chilli is a popular crop in West Sumatra

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<sup>2</sup>In Minangkabau culture, *merantau* involves people leaving their land, but the system is quite different from that of general transmigration. With the intention of continuing their studies, practicing a trade or seeking jobs, they usually go back to their homeland after they have succeeded. The Minangkabau people are by nature entrepreneurs and travelling or *merantau* is considered a mark of success (Salim, 1993).

because Minangkabau people love to consume spicy food. Its price is very competitive and usually increases before and during religious festival days, such as *Idul Fitri* and *Idul Adha*. The problem of chilli disease has caused big losses for farmers, since usually they made a good preparation for planting chilli by using good seeds and good fertilisers at a high cost, in order to gain good harvests. Poor farmers, since they have limited resources, can not expect to have high profits, and if the disease strikes their crops, they would suffer. When I visited a group of women farmers in their chilli garden, one of them stated that :

*The harvest of our chilli crop is not so plentiful now, because during the rainy season, the disease is very likely to attack the crops. Within four months we have only 10 kilograms of chilli, instead of the usual harvest of up to 40 kilograms. Other than because of the disease, the preparation for planting was not so complete, since we didn't use the polybag in planting. The price of polybag is very high. Also, the fertilizer is inadequate, because we cannot afford to buy high quality fertilizers. Instead, we used green manure or cow's dung as a complement (Focus group discussion, 9 February, 2004).*

The village infrastructure is better than Dilam. There is a good asphalt road leading to both the residential area and ricefield, except the foot-path up the hill, which is only made of clay. The main road has several shops, which sells items from shoes and cosmetics to rice and vegetables. There is also a rural health centre, a rural bank, a high school, a religious school (*madrasah*), many mosques, rice-milling units, and farm supplies kiosks. Electricity has been available for many years, and reaches every house in the village. Telephone connection is also available, but it has not yet covered all residences. Uniquely, in each intersection or at the border of the village or *Nagari*, there is a public TV and benches, where men spend their spare time after working in the fields. This is very common in Saniangbaka, and people use it as a place for informal meetings, and as a place for a security guard.

The *Nagari* Saniangbaka consists of four *lorongs* (wards): Saniangbaka Timur, Saniangbaka Barat, Saniangbaka Selatan, and Air Angek. Each *lorong* covers residential areas, ricefields, gardens, plantation, fishponds, and land used for other

activities. Each *orong* is formed by several *sukus* (clans), and each *suku* consists of several households. Frequently, a *orong* is dominated by one clan, and the *Orong* will carry the name of the dominant clan. For example, *orong* Saniangbaka Timur is dominated by *suku Koto*, so it is called as *Orong Koto*. The division of these *orong*s follows the government's regulations in the era of decentralisation, where the *Desa* government system (in the centralised system) has been transferred into the *Nagari* government system (in the decentralised system).

The total population of Saniangbaka in 2003-2004 was 6,988 people, consisting of 2,705 males and 3,283 females. The number of households was 1,141, of which 1,105 or 96.8% of total households were had members who were farmers. Among these, 408 or 36.9% were farm laborers (Solok-District, 2001).

Farm labourers in Saniangbaka are very common. They usually come from other *Nagaris* around Saniangbaka or from other districts in West Sumatra. They stay and cultivate land in Saniangbaka which has been left by the owners, planting food and cash crops. The harvests are shared with the land owners based on arrangements that they established. Most farmers plant cash crops such as coffee, clove, *cassia vera*, and rubber, since they (the farmers) usually live in the hills, where water is scarce. They build small huts and stay there with their families, with very limited facilities. Some of them live in the foothills where irrigation channels are available, so they can plant rice two or three times a year.





Figure 7.1. Farm labourers in their small hut in Saniangbaka

The land owners prefer to do *merantau*. Usually they do street trading or work for government and private sectors. They assume that to do *merantau* would give them access to more income than staying in the village and doing farming. The low farming income is intensified by low soil fertility, increased price of fertilizers, and low harvest prices. Frequently the harvests fail due to pest outbreaks such as mice and 'wereng'. Therefore, rather than do farming with many shortcomings, farmers in Saniangbaka prefer to rent their land to be cultivated by the farm laborers, and do *merantau* in order to have a better life. Most of them are successful at earning their living in other areas (*perantauan*), and go back home once or twice a year to visit their relatives or to see their farm. The significant role of these *perantau* (people who earn their living in other areas) in rural credit development will be elaborated further later in this chapter.

Similar to Dilam, it is also difficult to identify the level of income of each household in Saniangbaka. The variety of sources of income and the hesitancy of participants to reveal their real earnings are the reasons. It is also difficult for me as a researcher even to presume the participants' level of income since often the majority of their income is from remittances received from their relatives or family members who do *merantau*, and they are reluctant to reveal the precise amount of funding they receive. The

diversity of commodities is not significant to income levels, as crop and livestock productions in Saniangbaka during the research period were depressed for many crops for many reasons such as the low price of several commodities (e.g. coffee, cinnamon, and clove); high expenditure for planting rice due to high fertilizer prices; and disease or pest outbreaks. These are also the reasons why many people in Saniangbaka prefer to do *merantau* rather than stay and do farming in their home village.

However, to illustrate the economic conditions of farmers in Saniangbaka, we can use rice production, land ownership, and land size as indicators, since rice is the major crop planted by most farmers, as shown in Table 7.1 below.

Table 7.1. Illustration of economic conditions of farmers in Saniangbaka

Indicators	Number of participants	Percentage
<b>Rice Production (kg)</b>		
0	5	22.7
1 – 750	7	31.8
751 - 1,500	4	18.1
1,501 - 3,000	2	09.0
3,001 - 6,000	6	27.2
<b>Land ownership</b>		
0	5	22.7
Owner	12	54.5
Share-holder	5	22.7
<b>Size of landholdings (hectare)</b>		
0	5	22.7
0 – 0.5	7	31.8
0.51 – 1.00	5	22.7
1.01 – 2.00	6	27.2
2.01 +	1	04.5

Note: n=22; 0 means the participants did not grow rice (Fieldwork, 2004).

Table 7.1 shows that rice production in Saniangbaka is quite high, with more than 50% of the participants' rice production is over 750 kg, and the majority of farmers (54.5%) own their ricefield. At the time of my fieldwork, the price of one kilogram of rice was Rp 1,750. Thus, the majority of farmers in Saniangbaka received more than Rp 1,312,500 per harvesting time (every four months), or about Rp 10,937 per day. At the

time of my fieldwork US \$1 was equal to Rp 8,900. If the poverty line equals US \$1 per day, the majority of farmers in Saniangbaka, therefore are living just above the poverty line.

However the area of landholdings of farmers in Saniangbaka is still low, with the majority of farmers having less than one hectare (54.5%). The farmers' decision not to grow rice is because of the high costs of fertilizer and the low harvest price. Instead, they replace rice with secondary crops such as chilli and tomatoes, which have a better price. Thus, (refer to Table 7.1) farmers who do not grow rice should be ignored when determining farmers' economic conditions based on rice production.

Regarding the shareholders, as has been stated previously, many of the farmers in Saniangbaka are farm labourers who come from other villages and work on other people's land. Their harvests are shared based on their agreement, usually fifty-fifty, while farm supplies such as fertilisers, seeds and pesticides are provided by the land owners. Usually, these people are poor and landless in their home villages. Thus, based on my direct observation, these people are part of the population who have the lowest income in Saniangbaka. Despite the fact that their farm production is sometimes quite good, due to good management, nevertheless their level of earnings remains low since they have to share them with the land owners.

The social conditions of Saniangbaka people are also better compared to Dilam people. Since Saniangbaka has a better rural infrastructure, many people can access the health centre, and have toilet, bathroom, and drinking water at home. This is shown in Table 7.2 which also shows educational achievement in Saniangbaka. However, farmers who stay in the fields still have these facilities, but they are located outside their houses. Also, as in Dilam, despite the fact that they have sanitation facilities at home, people are still willing to go to the public bathroom to do washing, bathing, or taking water, because they want to meet and chat with friends and relatives, and exchange information regarding farming or daily activities. These are important for them to enhance solidarity and relationship.

Table 7.2. Social condition indicators in Saniangbaka

Indicators	Number of participants	Percentage
<b>Educational attainment</b>		
• Not finished Elementary School	3	13.6
• Elementary School	8	36.3
• Junior High School	7	31.8
• Senior High School	2	09.0
• University	2	09.0
<b>Having visited Health Center</b>	16	72.0
<b>Having inside toilet &amp; bathroom</b>	13	59.0
<b>Access to drinking water at home</b>	14	63.6

Note: n=22, Source: Fieldwork (2004).

**Rural Credit Systems in Saniangbaka**

As in Dilam, the rural credit system in Saniangbaka is characterized by its diversity consisting of formal and informal credit systems. The formal credit systems consist of credit schemes administered by the central government such as Kupedes of BRI *Unit Desa*, and BPR (People’s Credit Bank). There is also Rural Cooperative Unit (KUD) under the supervision of the Ministry of Cooperatives, but it is no longer operated due to its bankruptcy. Compared to Dilam village, the formal rural credit system in Saniangbaka is more advanced and progressive. This is reflected by the availability of a rural bank and a rural cooperative in the village. However, these institutions are not operating properly due to management problems and high levels of credit default, which further causes lack of trust by the people. Therefore, the majority of rural people in Saniangbaka are not involved in credit programmes from the state bank or cooperatives. One farmer expressed his opinion about this issue:

*We are now no longer involved in savings and credit programmes in the BPR and KUD in Saniangbaka, because we do not trust them. The management of these institutions is now in trouble, and many borrowers do not repay their debts, preferring to run away to do 'merantau'. This had put them in financial deficit. Many 'perantaus' were interested in helping by lending money as a bridging fund, but it is still unsuccessful because the problem of mismanagement and lack of trust by people has not been resolved. At the moment we use only this bank (BPR) as a place to pay our electricity and drinking water bills ( In depth Interview 8 February, 2004).*

### ***Formal credit systems***

Formal rural credit systems in Saniangbaka, as mentioned above, consist of credit from the central government, which are channelled through the state banks such as BRI Unit Desa, and BPR, and also through KUD (*Koperasi Unit Desa/ Rural Cooperative Unit*). During my fieldwork in Saniangbaka, I did not find any rural credit schemes which are operated by the local government.

### **The history of formal rural credit systems in Saniangbaka**

Based on my direct observation and interviews with key people in Saniangbaka, it was found that formal credit programmes are available for a long term, and are characterized by the more developed of formal rural credit systems. A Rural Cooperative was established in 1971. This cooperative was completely initiated by rural people without any intervention from the government, and which focuses only on helping farmers. But, in 1972 this cooperative was transformed into KUD (Rural Cooperative Unit) which was supported and supervised by the Ministry of Cooperatives. This formal rural credit programme has many activities in areas such as livestock, in-land fisheries, and food crops. During this time, farming activities were run well, and the majority of commodities had high production, which in turn increased farmer prosperity. When I came to this village twenty years ago to conduct a KKN<sup>3</sup>, I observed high production of crops such as rice, shallots, and chilli, and also an abundance of fish produced from the

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<sup>3</sup> KKN or *Kuliah Kerja Nyata* is an obligatory social action internship for advanced university students.

Singkarak Lake. At this time, not many rural people were interested in doing *merantau* due to their success in farming.

In 1979, a semi-formal rural credit programme, named *Lumbung Pitih Nagari* (LPN) was established. The LPN is a kind of rural bank, which is established based on an instruction from the central government to set up a rural financial institution at the village level. This rural finance institution was managed by local people but the initial capital was coming from the government. This LPN was supervised by BPD (Local Development Bank at the provincial level) and local government at provincial, district and sub-district levels. At the time of establishment it had 20 members, and in 1988 increased to 120 members. The incredible increase of members was due to the good performance of LPN in giving services to its members. At that time, the Saniangbaka LPN was among the best of LPNs in West Sumatra, in that it achieved an award from the government as the best LPN in 1979 (Key Interview, 19 February 2004).

After the Government Banking Act was released in October 1988 (*Pakto-88*), all financial insitutions were shifted into banking systems. Among the 511 LPNs in West Sumatra, 59 of them were selected as a rural bank, which is now popular as the *Bank Perkreditan Rakyat* (BPR). The BPR is supervised by the central bank (Bank Indonesia) and the Ministry of Finance.



Figure 7.2. *Bank Perkreditan Rakyat* (BPR) in Saniangbaka

However, after the Asian economic crisis occurred in 1998 followed by the long drought in 1999 there was a sharp reduction of agricultural production in the country. In Saniangbaka, the disaster was followed by pests and disease outbreaks which attacked rice, shallots, and chilli during 1999/2000 and 2000/2001 planting seasons. The harvests of these primary commodities failed totally. As a result, the farmers were not able to repay the KUT (*Kredit Usaha Tani*/ Farmers' Credit Programme), and this affected the repayment performance of this credit programme, which was channelled through the BPR and the KUD. Therefore, the BPR and KUD in Saniangbaka were experiencing high levels of credit default starting in 2001, and the problems persisted until the time of my fieldwork. Whilst the BPR got support from the *perantau*, by borrowing money as a bridging fund to keep this bank operating, the KUD was not operating at all, and left many customers with high outstanding debt. When I interviewed the *Wali Nagari* (Village Head), he elaborated the problems that occurred in the KUD:

*the KUD is not operating any longer or it has collapsed. The main reason is high loan default. The majority of these customers escape from their responsibility to repay the loan and do merantau. We cannot find them because they didn't give any information about their addresses, even to*

*their relatives in the village. Another reason is the high competition to supply services to the farmers with the private sector such as farm supply retailers or moneylenders. Although the main function of KUD is to give credit to the farmers in the form of farm supplies, this function has been taken over by the farm supplies kiosks since they set interest rates lower, and give other services such as the flexibility to repay and to deliver the goods. The KUD cannot compete with these kiosks since it has limited capital and human resources as well (Key Interview, 18 February 2004).*

The failure of Rural Cooperative Unit (KUD) to compete with informal lenders such as farm inputs retailers indicates that the informal credit providers in this village have given better services to the farmers than the KUD. This suggests lessons could be learnt by the formal sector such as KUD to give better services to their clients.

### **The current situation of formal rural credit systems**

The characteristics of formal rural credit systems in Saniangbaka are highly influenced by the experience of past unsuccessful formal credit systems such as KUT and BIMAS (*Bimbingan Massal* Credit Programme). This lack of success has caused both the government and the rural people to implement formal credit programmes in this village with a lack of spirit. However, there are still many farmers who want to borrow money from the state bank either to continue their activities on the farm after big harvest losses or to start planting cash crops which need substantial amounts of money. Notwithstanding, the poor farmers are eager to have credit from the government, but they still have difficulty to accessing formal credit from the bank. One farmer recounts his experience in accessing credit support from the government:

*I am really fed up and have no connection with the government banks since they have made me really disappointed. When I applied to a state bank for a credit amounting to one million rupiah last year, they required me to provide a collateral, either the certificate of a motor vehicle or certificate of land. Fortunately I had a motor-cycle, and I used the certificate as a collateral. But it seems that they were not satisfied, even though the value of my motor-cycle is higher than the money that I wanted to borrow. They said*



*that they have made a decision, and I am still not eligible to borrow money from the bank. I tried to apply again after a while, but their answer was still "no". (In depth Interview, 17 February 2004).*

Experiences such as this have resulted in the hesitancy of poor farmers to apply for credit from the government's bank, and they prefer to borrow from moneylenders or participate in *Arisan* or *Julo-julo*, although the amount of money they can borrow is not as much as they can borrow from the government's banks. Whilst the farmers actually need a substantial amount of money to recover from failed harvests or to start planting cash crops, they would remain in poor conditions if there is no opportunity for them to access formal credit programmes. The small farmers that I visited in their small huts in the foothills expressed their wishes to be able to borrow money from the state banks, which would be very important for them to start planting cash crops, and also to support their daily life. One of these farmers stated that:

*Despite the fact that we live in poor conditions with low income and low education levels, we still want to have a better life, and give our children good food and education. As a farm labourer in this village I do not have access to any information about credit from the government. But, we still want to borrow money from the government in order to start planting coffee, cloves, teak, or rubber. It is better for us to borrow a big amount of money rather than a small amount since to plant cash crops we need a lot of money. And if the price of these commodities is good, we would gain high profits, and we could repay the credit on time. But we don't know whether they would be so kind as to lend money to us (In depth Interview, 11 February, 2004).*

The doubt of many poor farmers to gain access to credit from the government's bank is reasonable since they know that the government would not want to suffer another big loss of the KUT credit programme. In this case, many farmers could not repay the credit during the 2000/2001 planting season. During the time of my fieldwork, many poor farmers, who depend on farming for their income, failed to be selected as customers of rural credit programmes. Once they tried to apply for credit, the process was very long, and there was no guarantee they would be given credit. Considering this situation, and

also because of the lack of success in planting crops, many poor farmers tried to start selling food or snacks at schools, offices, or at any public areas. This strategy is important to provoke the government to give them credit, since, as stated above, traders or civil servants are more eligible to receive credit than farmers. The traders for example, have financial capital to start their business, and it can be used as a guarantee whenever they cannot repay the loan. When I visited a group of women farmers who could not start their farming activities due to lack of capital, they informed me that they were starting to sell snacks at schools, and they received credit from the government in the form of UEDSP<sup>4</sup> (*Unit Ekonomi Desa Simpan Pinjam*). One woman stated:

*We are now starting to sell simple snacks at schools or 'madrasah', for which we got credit from the UEDSP credit programme. Although the profit is very small, we at least have activities and the government is willing to help us. It is different if we apply for the credit as a farmer. They will not give us the credit because credit from the UEDSP is only for small-scale traders. They do not believe that farmers can repay the credit, since farmers' business is very susceptible to plant diseases and pest outbreak, and farmers tend to escape from their responsibility to repay (Focus group discussion, 10 February, 2004).*

The UEDSP credit programme in Saniangbaka has about 36 members. This credit programme is managed by the rural community, while the government provides the capital which is given directly to the borrowers. The interest rate is 10% and the repayment should be within three months. There is Rp 10,000 Compulsory Saving (*Simpanan Wajib*) plus Rp 2,000 administrative fee. For example, if one member borrows Rp 100,000, he/she can pay six times. The first payment is to pay Rp 10,000 interest, and the other five payments aim to repay the loan of Rp 20,000 each. Late repayment will cause the delay of the next loan. In this UEDSP credit programme, there is no different treatment between men and women, although the majority of members are women.

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<sup>4</sup> Group and saving activity for capital assistance to small industries, a program of the Ministry of Cooperatives.

Based on my direct observation, it seems that people enjoyed participating in this credit programme, as an option to escape from the difficulties in farming and to get through the time of scarcity due to failed harvests. Although they complain about the low profit that is achieved from selling small cakes, at least they have some security to run their daily life.

Another category of borrowers are 'a bit progressive' farmers, who have a regular and better income, and they, in contrast to village farmers, are much more able to access credit from the state banks. This group usually are the pensioners who do farming after retiring from work as civil servants, or the government employees who do their farming activities after office hours. These people have a regular income via their monthly pensions or salaries. Sometimes the banks do not ask them to provide collateral since the banks trust that they will be able to repay the credit. These types of farmers, therefore, have had the opportunity to get credit from many state banks in the area, such as BRI, Bank Bukopin, Bank Mandiri, and BPR. These banks offer good services in such a way that the customers are interested in participating in their credit programmes. A farmer who has retired from the army and is engaged in cash crop plantations such as clove, teakwood, rubber, and *cassia vera*, stated his experience of accessing credit from the state bank, and also his experience as a chairperson of the cash crop farmers' group:

*To start planting these cash crops I need a lot of money. I would not be able to afford this without credit from the banks. So, I applied to a state bank for credit, and they approved my application without any complications or long procedure. For repayment, they just debited directly from my salary, so I don't have to regularly come to the bank to repay. I am now chairing a group of farmers who engage in cash crop commodities. Most of them are small farmers who could not access a formal credit programme. To solve our capital needs, we have a 'Julo-julo' informal credit scheme, on which we could help each other to finance our farm activities (In depth Interview, 9 February 2004).*

### *Informal credit systems*

Informal credit systems in Saniangbaka also consist of a variety of rural credit systems: *julo-julo*, *simpan pinjam*, and moneylenders. Similar to the situation in Dilam village, each group in this *Nagari* has its own *julo-julo* and *Simpan Pinjam*. There are also *Arisan suku*, but the situation is not as glorious as in Dilam. For example, the monthly meeting is intended only for *Simpan Pinjam* purposes, and there are no discussions regarding current issues in their clan. Also, there is no speech from the cultural leader (*datuk*) about their *adat*. This meeting is mostly attended by women.

However, rural women in *Arisan Suku* are more creative in establishing small businesses that are profitable for their Suku. For example, in one *Arisan Suku*, women created a business of renting kitchen appliances, or cockery, for catering purposes. This business is profitable, because many people in Saniangbaka frequently conduct wedding and birthday parties, and other traditional ceremonies. The profits from this activity are collected to buy other items such as tents, chairs, sound systems, and so on. They wish that they could collect more money, so that they would be able to buy a building that could be rented to people who want to have parties, ceremonies, or other performances and functions.



Figure 7.3. Women are participating in *Simpan Pinjam* credit scheme in Saniangbaka

In Saniangbaka, people, especially women, are more interested in participating in *Simpan Pinjam* than *julo-julo* credit schemes. Thus, we can find more *Simpan Pinjam* credit scheme than *julo-julo* in Saniangbaka. The greater interest of people in *Simpan Pinjam* than *Julo-julo* credit schemes suggests Saniangbaka people are more progressive in rural credit systems, in regard to both management and capital. The *Simpan Pinjam* is not as simple as the *julo-julo*, since its procedure is similar to a simple cooperative, and the amount of money that they contribute is higher than other credit schemes. It also has clear and firm regulations. For example, a *Simpan Pinjam* credit scheme of one women-farmer's group has about 40 members and has been established for 30 years ago. It has about Rp15 million accumulated capital, and the members can borrow up to one million rupiah or more depending on the financial situation with interest of 0.25 percent per four months (harvesting period). It also has a *Simpanan Wajib* (Compulsory Savings) Rp 500, that should be paid by the members fortnightly. The members should pay the credit on time, otherwise it will affect their next lending. So, sometimes members must borrow money from their relatives or friends in order to meet the due date of the

repayment. One woman-farmer who is a member of this group narrated her experience in participating in this credit programme:

*I have been participating in this women farmers' group for a long time, when we participated in a BIMAS credit programme from the government. At that time our farm production was good and we could repay the credit on time, and the Simpan Pinjam was only as a complement. But now, our harvests frequently fail due to pests, diseases or drought problems, and the government also now hesitates to give credit to us because of the failure of KUT. Now, we are highly dependent on this Simpan Pinjam, because it helps us to buy fertilizers and pesticides, to hire labourers for ploughing, planting and weeding, and also for supporting our children's education. However, sometimes it is difficult for us to repay the credit on time. So, we have to borrow money from relatives or friends to fulfill it. We just move from one debt to another debt (In depth interview, 11 February, 2004).*

The strict regulations to repay *Simpan Pinjam* credit programme in Saniangbaka had developed an impression in the community that the members of *Simpan Pinjam* credit programme are more well-off, similar to those people who have a regular or stable income such as civil servants, pensioners, or traders. This opinion was highlighted when I had a discussion with several farmers, as they asserted:

*The strict regulations of Simpan Pinjam to repay the credit on time is hard for us as farmers. As you might know, our income is on and off based on our harvests. If the harvests fail, we do not have money. So, the Simpan Pinjam does not suit our conditions, and is only adapted to civil servants, teachers, pensioners or traders who have a more stable and higher income (Focus Group Discussions, 6 February 2004).*

Considering this situation, farmers in Saniangbaka rely on relatives, friends, or moneylenders to solve their financial problems. The significant role of relatives in particular in Saniangbaka, as a place for asking for financial assistance, is closely related to the strong kinship of Minangkabau people. They think that since a long time ago they were united in one family, so the family members should come together and

help each other. The role of moneylenders, who do not charge interest to the borrowers, and sometimes are not expecting repayment if the borrower is very poor and cannot repay, is also related to this phenomenon. These 'friendly' moneylenders are very common in Saniangbaka. They are usually the well-off people, farm supply retailers, shop owners, or *perantau*. This topic will be discussed further later in this chapter.

In summary, when we analyse the informal credit situation in Saniangbaka, and also based on my findings, the progressive development of informal finance in this village is the result of the unsuccessful implementation of formal credit systems. People try to find alternative financial institutions to fulfill their credit needs because of their inability to access formal credit programmes from the banks. The desire of the Saniangbaka people to receive formal credit programmes since the establishment of LPN and KUD about two decades ago was cut off due to the KUT tragedy in the 1999/2000 planting season. The failure of the KUT credit programme is elaborated further in the next section.

### **Credit Default and Low Repayment: The Results of Unsuccessful Formal Rural Credit Programmes**

The unsuccessful implementation of the KUT rural credit programme because of the failure of harvests during 1999/2000 and 2000/2001 planting seasons, is a big issue among the people in Saniangbaka. Actually, the KUT is a well organised rural credit programme, which is especially designed to help poor farmers in rural areas. Loan procedures are simple and the interest rate is very low. Farmers just need to form a group, and prepare their workplan in the form of *Rencana Dasar Kebutuhan Kelompok* (RDKK); then it is submitted to the Village Head (*Wali Nagari*), and the *Wali Nagari* send it to the Bank.

In the case of Saniangbaka, the KUT credit programme was given to a group of farmers instead of an individual. This credit programme particularly aimed to help farmers to increase production of foodcrops, especially shallots and rice. Although the group might not be established properly and the RDKK was not ready, farmers still received credit. This is because the government seriously wanted to help them, due to their poor

condition. Also, the government wanted to develop shallot production in Saniangbaka, since historically this *Nagari* has had successful experience in the production of this commodity.

However, disaster in the form of disease attacked shallot plantations in the 1999/2000 planting season, not long after the farmers received KUT credit. This disease severely attacked the tubers and damaged about 90% of shallots in this area. The remaining 10% that could be salvaged survived until the next (2000/2001) planting season.

In the case of rice, this foodcrop commodity was also attacked by a pest *wereng* (*Nilaparvata lugens*) during the 1999/2000 and 2000/2001 planting seasons. This also caused a big deficit due to the failure of the rice harvests, and thus affected the KUT repayment performance. The outstanding debt of farmers in Saniangbaka reached the total amount of Rp 500 million in the year 2001 (Key Interview, 10 February, 2004).

The KUT credit program is a sensitive issue in this *Nagari*. Therefore I have been unable to do many interviews about this issue, especially with the farmers. Some farmers pretend that their KUT credit is going well, but when I check with the *Wali Nagari*, the majority of them have not repaid their credit. I gained information about this issue from the key persons such as officers in the *Wali Nagari* office, local government officers and bank officers. One community leader in Saniangbaka explained his opinion about this issue:

*The case of KUT is a big issue in Saniangbaka. Since this tragedy occurred in 2000/2001, the government is no longer willing to give a loan to the farmers. On the other side, the farmers also hesitate to have contact with the bank due to their traumatic experience with the KUT. I suggest that the government should be cautious before granting a credit to the poor farmers since their farming activities are highly dependent on uncontrolled factors such as disease and pest outbreak. As an option, the government could give insurance to the farmers, in case of pest and disease outbreak or other natural disasters occurring suddenly (Key Interview, 10 February 2004).*



The farmers who have been black-listed by the bank officers and cannot access formal credit programmes have no choice except to borrow money from relatives or moneylenders, or do *merantau* to escape being chased by the banks or tax officers, and to earn money to repay the credit. Another key farmer informed me that:

*Farmers who had high arrears in the KUT requested the government to wipe-out or to reschedule their debt, as happened with the BIMAS credit programme twenty five years ago. They argued that they haven't had opportunity to enjoy the outputs of the credit programme, so they were should be forgiven* (Focus Group Discussion, 6 February 2004).

The inability of the farmers to repay the KUT credit caused financial loss to the banks such as BRI and BUKOPIN, which were channelling the credit to the farmers. Therefore, farmers are often chased by bank officers or tax officers to ask them to repay their credit. Some of them escape and do *merantau*, in order to earn money to repay the credit or to avoid responsibility for it.

The meaning of *merantau* for Saniangbaka people is not just to escape from the responsibility to repay the credit, but it is more related to the social and economic development of Saniangbaka village, as will be elaborated on in the next section.

### **The Significant Role of *Merantau* and *Perantau***

In the Minangkabau culture, to do *merantau* is very common and has been practised for a very long time. There are many factors that push the Minangkabau people to do *merantau*. First was the need to develop new settlements when the existing compounds, situated between three mountains (Merapi, Singgalang, and Sago, named as Darek), were considered to be too crowded, both for settlements and agriculture, because of rapid population growth. Another factor is the motivation to have a better education, especially in Islamic religion. The Minangkabau people used to go to Aceh or Saudi Arabia to learn about Islam. After the country's independence and the PRRI civil war in 1958, economic and political factors encouraged the Minangkabau people to do

*merantau*. However, the psychological and sociological effects of matrilineal kinship systems are considered as the most evident causes of *merantau*.

In Saniangbaka, there are many reasons for people to do *merantau*. The most popular reason is to earn money in order to have a better living. In the past, *merantau* was closely related to the matrilineal system of Minangkabau, in which it was only men who did *merantau* because they felt embarrassed in the wife's clan environment if they didn't have any job. Nowadays, women also do *merantau* for economic and social reasons. Lower level income people usually become small traders such as street vendors (*pedagang kaki lima*) or petty traders (*pedagang kecil*).

Generally, people who do *merantau* have somebody to visit when they first come in the *perantauan*<sup>5</sup>. This person, either relative or friend, will help them to start their small business, sometimes by apprenticing them in their already established business. This person can also provide them with food and accommodation, often free of charge, since these newcomers usually have limited resources. When these new *perantaus* become independent and can run their own business, they would also become the helpers of the new *perantaus*. This process is repeated when new *perantau* come and the independent (senior) *perantau* helped their 'junior' to be an independent small businessman. The strong relationship among these *perantaus* has helped them to be successful rather than suffer failure in business, since any problems encountered can be solved together.

The well-off people usually do *merantau* to continue their education or to find a job in the public or private sectors. However, this type of *perantau* represents a small percentage of the population, yet they are very influential because as educated people, they receive a better income than the small traders. However, in many cases, there are many traders who had low education levels, but have also become rich people in the *perantauan*.

These successful *perantaus* are now becoming the supporters of the development of Saniangbaka village. These *perantaus*, either in groups or individually, collect funds to be given to individuals or institutions in the village. Usually, they go to the village a few

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<sup>5</sup> *Perantauan* is the place where people do *merantau*.

weeks before *Idul Fitri* day, to make an observation and evaluation, and then select individuals or institutions that will become the recipients. Often they select schools, or *madrasah* (religious schools), or mosques as the recipients, or poor people. When they come back in *Idul Fitri* day, they pass on the fund to the recipients, usually without any intermediaries. In order to educate people, they lend the fund to the individual in the form of a soft loan without interest, but if the recipient is very poor and cannot repay, they just grant the money to them. This kind of ‘friendly’ moneylender is very common in Saniangbaka. This topic will be elaborated further in the next section.

The activity of the rich *perantau*, who spend their money to help the poor or religious institutions in Saniangbaka, is closely related to the religious value of Islam, in the form of *zakat* or *sedekah*. If their wealth has reached a certain amount, it is compulsory for each person to give away a certain percentage of their money as a *zakat* to the needy, while the *sedekah* can be given any time, as a voluntary gift to the needy. These activities have been regulated in the Holy Qur’an. This phenomenon has been practiced for a long time, and has increased in the last five years, as a result of the improvement of economic conditions of Saniangbaka’s *perantau*. One key person in Saniangbaka explained this positive development to me:

*The role of perantau is very positive in Saniangbaka, in terms of speeding up the development process of this Nagari. It can be said that the progressive growth of Saniangbaka today is because of the active role of perantau. They helped the Nagari council or leaders to build village infrastructures such as schools, madrasahs, mosques, roads and bridges, which could not be done if the Nagari depended only on local government’s assistance. The perantau also give significant help to the poor, by giving soft loans or grants if the poor are not be able to repay. They insist that the number of poor people who live below the poverty line in our Nagari could be reduced or could be removed altogether (Key Interview, 6 February, 2004).*

The role of *perantau* in Saniangbaka is not only in the form of granting funds to the institutions or individuals, but also to contribute thoughts, ideas and insight, for the development of Saniangbaka. Usually, during the *Idul Fitri* day, they come together to Saniangbaka, called *Pulang Basamo*, and conduct a meeting with the villagers, and

make a plan for activities that will be implemented to develop the village. If these activities require funding, they would without hesitation contribute their money. For example, during the *Idul Fitri* holiday a couple of years ago, they made a plan to establish a BUMN or *Badan Usaha Milik Nagari*, which is a rural enterprise that is run by the village people and for the benefit of the *Nagari*. This kind of BUMN is administered by the *Wali Nagari* office, which also provides assistance to the rural people in order to increase their income. The significant role of the *Wali Nagari* office in the era of decentralisation, will be described further in this chapter.

In regard to the low income level of *perantaus*, their roles are also significant especially in regard to helping their relatives who stay in the village. Often, when I interviewed the farmers at their fields or at home, the majority of them confirmed that they regularly received money (remittances) from their relatives - usually children or niece/nephew - in the *perantauan*. Thus, despite the difficulties to access a formal credit programme in their village, they still have relatives in *perantauan*, who are always ready to give help, whether in difficult or in amenable conditions. This also becomes the reason for Saniangbaka people to encourage their children to do *merantau*, either for trading, for continuing their education, or for looking for a job. Concerning the habit of *merantau* of Saniangbaka people, a *Wali Nagari* office staff member informed me that the number of Saniangbaka people who do *merantau* is higher than the number of people who live in Saniangbaka. It is estimated that the number of people who live in *perantauan* is twice as high as those who live in Saniangbaka (Key Interview, 6 February, 2004).

Older rural people also do *merantau* to join their children or family who have been successful in the *perantauan*. Most of them spend the rest of their life in the *perantauan* with all of their families, and usually never come back to their home village until they die. Therefore, it is common in Saniangbaka that many houses are unoccupied, or they hire somebody to take care of the house. Nevertheless, as Minangkabau people always have a desire to come back and develop their home village, the *perantau* in Saniangbaka are always willing to visit their village, especially when they have gained success in the *perantauan*.

Another reason for Saniangbaka people to do *merantau*, is to escape from the responsibility to repay credit arrears, such as KUT. As has been stated earlier, the

continued harvest failures have caused the inability of farmers to repay the credit, and to do *merantau* is one option, in order to earn money for repaying the credit.

The diversity of purpose of *merantau* and the significant role of *perantau* in developing their home village, has shown *merantau* in Saniangbaka in particular, as an asset to be developed for future rural development.

### **‘Friendly’ Moneylenders: Alternative Sources of Credit for Poor Farmers**

To fulfill their needs of cash to finance their farming activities as well as their daily life, poor farmers in Saniangbaka tend to borrow money from relatives and moneylenders. These moneylenders are very tolerant, as they do not charge interest, while the repayment schedule is flexible.

These ‘friendly’ moneylenders are usually the well-off people, the shop-owners, the farm-supplies retailers, or the *perantau*. The well-off people frequently lend money to their relatives who need money in an emergency situation, or to poor people who request a loan from them. They usually do not charge interest, and for poor people they sometimes do not expect the repayment when the borrowers are not be able to repay. To reciprocate the kindness of the lenders, the borrowers sometimes sell their harvests to the lenders in the form of husked rice (*paddy*), and then the lenders sell again in the form of rice (*beras*), so that they could gain profits since the rice’s price is higher than the paddy’s price.

The shop-owners usually give credit to rural people in the form of goods for daily consumption, such as rice, sugar, cooking oil, and so on. These shop-owners also do not charge interest, but they need to verify the customers by identifying their personal record in the community, especially in credit activities. As Saniangbaka is a small village, it is easy to identify the track record of each person. One poor farmer, who is a farm labourer and lives with his family in a hut in the rice field, tells his experience in accessing credit from the shop-owners:

*I have never received any rural credit assistance from the government, since we live here in the rice field, far from people, and have never received information about credit from the banks. Fortunately, the landowner provides farm supplies such as fertilisers, seeds, and pesticides, so I don't have to spend money to buy these things. However, we still haven't enough money to meet our daily consumptions since our harvests often fail, and at the same time we have to share it with the landowner. To support our daily life, I borrow rice from a shop owner, and I repay it after harvesting. This scheme is all right for me since they do not charge interest (In-depth Interview, 11 February, 2004).*

Credit from farm-supply retailers is also common in Saniangbaka. This kind of moneylender usually gives credit 'in-kind', such as fertilisers and pesticides. However, they do not give credit to everyone who requests it. They need to make a selection based strictly on the previous personal records of the person, since many of them have had negative experiences with the borrowers. I had an opportunity to interview one farm-supply retailer, who has had many experiences with borrowers who could not repay the credit.

*I can't give credit to everybody who requests credit from me. I need to verify their ability to repay based on their personal records. I have to be careful on this, since I have experienced lost money up to seven million rupiah, since the borrowers could not repay the credit. This borrower told me that he cannot repay because his harvest has failed, and now he does not have money. He promised to pay in full as soon as possible, but there is no action until now. I cannot force him to repay because, as well as being our village inhabitant (meaning that he also is our relative), it is also the fact that he is very poor (In-depth Interview, 13 February 2004).*

In contrast to from previous 'friendly' moneylenders in Saniangbaka who do not charge interest, these farm-supply retailers charge an additional amount of money if farmers buy farm supplies by credit, despite the fact that they say they didn't charge interest. For example, when farmers buy fertilisers at Rp 55,000 per bag at the time of land preparation, they have to repay the money at Rp 60,000 per bag at harvesting time.

The different attitude of farm-supply retailers in extending credit to the farmers is closely related to their business-oriented activities. As this kind of trader earns money only from profits of reselling the products, they also expect profits when on-selling fertilizers or other farm supplies to the farmers. They are also very cautious in giving credit to the borrowers, since the loss of money from credit default means that they have lost their money forever. They have no recourse to stringent actions such as reporting the borrowers to the police or tax officers, since they don't dare to do that because of a tight kinship in the village. These kinds of moneylenders can't be categorised as well-off people because their income is still vulnerable, especially when the borrowers do not repay the loan.

The last type of moneylender is the *perantau*, who have successfully earned their living in the *perantauan*. These moneylenders generally extend credit to the rural people, both in groups and individually. When they give a loan to a group of people, they usually predetermine the usage of the money, such as for purchasing farm supplies, for continuing children's study, and so on. This is important to avoid using the loan for unimportant purposes. Also, this is correlated with the role of the *perantau* to support the development of Saniangbaka. Thus, the allocation of credit for rural people is based on priority plans that are designed during the village's annual meeting. The *perantaus* assign someone in the village to distribute the loans to the poor, and to select the candidate borrowers based on their real needs and situations. The procedure is made as simple as possible by only requiring a receipt as a proof of lending.

Many *perantaus* also give loans to the individuals. As has been stated before, *perantau* do the selection by making observations and evaluations by themselves during their visit to Saniangbaka, and extend credit during the next visit, usually during *Idul Fitri*. In this case, the *perantau* don't determine the use of credit, since they really want to help the poor. They also do not expect the repayment if the borrowers cannot repay, by which they intend the grant as an Islamic charity (*zakat* or *sedekah*).

## **The Role of the *Wali Nagari* Office: Enhancing Village Enterprise**

In the current era of decentralisation, the *Nagari* in West Sumatra is an autonomous government at the village level. The government has given an authority to the *Nagari* government to regulate and manage their village, based on the aspirations of the rural people, by incorporating values and culture that have been adopted by the community (Antlov, 2003). This authority includes the capacity to manage financial resources available in the respective *Nagaris* (BPP-Sepuluh-Koto-Singkarak, 2003: 2).

In Saniangbaka, financial resources available in the *Nagari* include funds as a grant from the government in the form of the Allocation Funds for *Nagari* Government (DAUN Fund). Whilst the resources from the government are often limited, the *Nagari*'s residents are also willing to contribute funds. Again, the role of *perantau*, many of whom have become educated and wealthy, is significant in sharing their thinking and ideas, as well as funds, for the prosperity of rural people.

The village-owned corporation or BUMN (*Badan Usaha Milik Nagari*), which is the first enterprise developed by rural people, was established two years ago. The primary fund of this enterprise comes from the DAUN Fund and the rest comes from the contributions of *perantau*. During its early establishment, this BUMN has implemented three programmes, all of which aim to help rural people to increase their income.

The first program is a revolving fund programme for cow fattening. This programme is targeted at poor farmers who have a capability to grow cows, but they do not have capital. The BUMN then lends a cow's offspring to the farmers, who care for it until it breeds, and then the offspring is returned to the BUMN, who in turn lend this offspring to another farmer. This activity seems to be successful, in that about 21 farmers are benefiting from this revolving fund.

The second programme is giving credit to rural women, to do stitching and embroidering. There is a good prospect of selling gold-string embroidery in Indonesia, as well as in West Sumatra, since it is commonly used to embellish the traditional



clothes used during cultural parties or ceremonies. In fact, women in Saniangbaka have been practising embroidery for a long time, but this valuable talent had become lifeless, due to lack of supervision and training. The BUMN have been encouraging the women to start doing embroidery since two years ago, and at the time of my fieldwork, several women's groups had been established. The procedure of credit is flexible, in which the BUMN give them capital in the form of materials and gold string. The women's groups sell the products themselves, and the profits are shared among the members. As this kind of credit is also without interest, and the repayment is in the form of cash, therefore the women can repay the credit anytime, based on how many products they have sold.

The third program is credit assistance for fishermen who live at the edge of Singkarak Lake. Poverty is the reason for extending credit to these fishermen. They are usually the landless, who come from other villages or areas in West Sumatra to earn a living in Saniangbaka. They came to Saniangbaka to catch the fish around two decades ago, because Singkarak Lake was famous for its high production of fish, especially 'Bilis' fish which is available only in this lake. The BUMN of Saniangbaka *Nagari* government were interested in exploring again the natural resource potential of Singkarak Lake, by giving credit assistance to the fishermen. However, this program has failed, and the fishermen cannot repay the credit at all due to the sharp reduction of fish production in the lake during the last five years. When I had an interview with the *Wali Nagari* about this situation, he confirmed the lack of success of this credit programme, as he said:

*It is unfortunate that this programme is unsuccessful, because we really wanted to help the fishermen, who represent the poorest segment of our community. Now we are trying to look for another option to help them to increase their income. We also want to explore the main reason for the decrease of lake fish production. I suspect that the main reason is due to the decreasing of the surface of Singkarak Lake water. This decrease is supposedly because of the establishment of PLTA (Electrical resources from water power) near to the Singkarak Lake, and this impacts on the drifting of fish into the rivers (Key Interview, 20 February 2004).*

Despite its early implementation, the Saniangbaka *Nagari* government, through its BUMN, has successfully implemented the first and the second credit programmes, although the third programme has lacked success. The success of the first and second programmes is related to the strategy of BUMN to give credit in the form of in-kind or tools. This is also an important lesson for the people, in order not to be spoilt by being granted cheap credit, and also to avoid the misuse of the funds. Thus, the poor are expected to do the activity satisfactorily in order to achieve their goals and improve their income.

## Conclusion

This chapter identifies many factors that influence the development of rural credit systems in Saniangbaka village, and therefore also people's decisions in selecting an appropriate credit scheme for them. One factor is people's previous experience with formal credit programmes. Farmers were very cautious in selecting a credit programme, and were very sensitive, particularly because of their previous experiences in participating with credit programmes from the government. The bad experience of harvest failures in the past were followed by severe economic crisis which in turn affected farmer's repayment performance. Therefore, as a result of high levels of default, most credit programmes from the government were withdrawn and are no longer available in the village, and people hesitate to have any relationship with formal credit providers such as banks and cooperatives. This is one of the reasons why rural people, especially the farmers, prefer to use informal lenders as their credit provider rather than the formal institutions.

Another factor is the fluctuating nature of farmers' income and its vulnerability towards uncontrolled risks such as natural disasters and pests' outbreak. This requires flexibility on the part of rural credit systems. Thus the design of rural credit system should follow the trend of farmers' income. In this regard, the trend of farmers' income is highly influenced by the season, on which, the harvesting time occurred after the rainy season or at the beginning of dry season. The repayment procedure thus follow this tendency. However, the harvests are not always successful due to the uncontrolled risks as mentioned above. The question is that whether the government be willing to share some

of these risks, in which the failure of the harvests are not only under the responsibility of the farmers.

One interesting finding of this study is that the factor of tight kinship, close family ties and togetherness among people in the village, and between people in the village and in the *perantau* had strongly affected people's preference in credit. In this case, the role of friendly moneylenders is very significant, especially to help the very poor in the village with no interest loans. The role of the *perantau*, who provide these cheap loans, are also important in fulfilling the need of capital for rural people who have family or relatives in *perantau*. The *perantau* in Saniangbaka is not only influential economically, but also socially and culturally, as they always pay attention to the development process of Saniangbaka, although they stay away from their home village. The strong social capital of people in Saniangbaka has become a good component for the successful development of Saniangbaka in the future.

As in Dilam village, the cultural values of the Minangkabau tribe heavily influence the design of informal rural credit systems in Saniangbaka, and affect the people's preference in choosing credit programmes appropriate for them. People in Saniangbaka were enjoy their *Arisan Suku* and *Koperasi Simpan Pinjam*, because as they receive funds from the *arisan's* lottery and the loans from their *Koperasi*, they can exchange information or discuss their *suku*, which then unites them and strengthens their view and knowledge about Minangkabau culture.

When comparing Saniangbaka and Dilam, the similarities between these two villages include the strong influence of Minangkabau culture on the rural credit system. The *Arisan Suku* credit systems are available in both villages, and the membership is dominated by women. Another similarity is the unsuccessful of formal credit programme implementation in these two villages, despite the cause is different. In Dilam, the failure of formal credit programme was due to the hesitant of formal credit providers to give service to rural people due to their remoteness, while in Saniangbaka the lack of success of formal credit programme was due to past experience of high credit default, in which the formal credit institutions reluctant to give service to the rural people, especially the farmers. The difference between these two villages, regarding rural credit systems is the role of moneylenders. In Dilam, the role of moneylenders is is

the same as usual moneylenders who set up high interest rate, and the loan is not merely in cash but also in kind such as fertilisers and seeds. In Saniangbaka, the role of moneylenders are significant and are favoured by the majority of population. These moneylenders are friendly, in which they do not charge interest, and sometime they do not expect repayment if the borrowers cannot do so.

Regarding the factor of isolation, different from Dilam, this factor is not influential toward formal rural credit system in Saningbaka. It is evidenced that formal credit system is still problematic despite the location of Saniangbaka is close to the District's capital city. However, regarding informal/ traditional rural credit system, the isolation factor is not a matter, in which in both villages informal/ traditional rural credit systems are successful.

Based on the above explanation, it is concluded that rural credit scheme must be designed by taking into account the factors as mentioned above. Rural credit schemes are not operating in a blank space, but in a complex and fluid context in which people are doing their best to improve their lives in many ways.

## CHAPTER EIGHT

### TIKALAK VILLAGE

#### Introduction

Tikalak village is the third village of the three case studies, examining factors affecting rural credit systems in rural Indonesia. The previous two case study villages in Chapter 6 and Chapter 7 drew our thinking to the state of poverty, and development of rural credit systems in these areas. Tikalak village is located close to the provincial road and near to the Singkarak Lake, but with poor natural resources. The state of poverty and the development of rural credit systems might be different in comparison with the previous two villages.

Thus, in this chapter I will elaborate on the economic, social and cultural conditions of Tikalak, and to discuss rural credit systems available in this village. I also will investigate how rural people manage their needs on credit, and the government's response to provide appropriate credit for the rural poor. The comparison between Tikalak and the previous two villages: Dilam and Saniangbaka, will also be examined.

In this chapter, the setting of Tikalak Village, which covers its geographical, economic, and social conditions, is outlined first. Data from quantitative survey and local government offices are used to explain this village's setting. This is followed by an overview of rural credit systems covering explanations on formal and informal rural credit systems available in the village. Next, by contrast with Saniangbaka village, the role of 'unfriendly' moneylenders is elaborated, followed by the explanation of '*Lambaihari*', another kind of *arisan*, which focuses on the contribution of energy rather than money in credit systems. This scheme is closely related to the spirit of '*gotong royong*', which is an important part of Indonesian culture. Finally, a conclusion is presented.

#### The Setting

Tikalak is situated in the northern part of Solok district, under the Sepuluh Koto Singkarak Sub-district government. Its location is at the edge of Singkarak Lake, where

the provincial road of Solok to Bukit Tinggi crosses this village. The distance from Solok district capital city is about 30 kilometres. The landscape of the village is divided into two: the flat area that is spread out along the edge of Singkarak Lake, close to the provincial road, and the hilly area in the eastern part, which is isolated with a scarce population. The road to the hilly areas is steep and winding. Part of the road is asphalted, but the paths to the isolated *kampungs*<sup>6</sup> are still made of clay and gravel, and become muddy and slippery during the rainy season. Some of the paths to access *kampungs* are very small through the forest or bush, with ever-present wild animals such as tigers, wild-pigs or snakes. These cause difficulty for a newcomer, like myself. This hilly area is dominated by bush and forest, without any irrigation channels. Thus, the area is rainfed, dry, and infertile, which is characterized by the domination of *alang-alang* (coarse grass) growing wild in this area.

Tikalak village consists of three *lorongs* (wards), namely: “Pasir”, “Tengah”, and “Batu Api”. *Lorong* Pasir is situated along the edge of Singkarak Lake. The inhabitants of this *lorong* are primarily poor fish-farmers who catch the fish from the Singkarak Lake, and petty-traders who sell food in the small shops along the provincial road. The rest are civil servants who work for government offices in the sub-district and district capital. The remainders of people are unemployed. Compared to the other two *lorongs*, “Pasir” is a bit more progressive since it is located in the flat area near the lake, and close to the provincial road, which permits good communication and transportation with surrounding cities or villages. This *lorong* also has many tourist spots alongside the lake, such as jetties and parks, but they have not been developed properly, and therefore have not yet raised people’s income. Conversely the other two *lorongs*, “Tengah” and “Batu Api”, are isolated being located in the hilly area, with steep roads, and few inhabitants. Thus these *lorongs* are still unprogressive, especially “Batu Api” which is located near the top of the hill. The majority of the populations are poor farmers, who plant annual crops and only a few who plant dry-land paddy, chilli, and other kinds of vegetables.

Public facilities in Tikalak are lacking, especially in *lorong* “Tengah” and “Batu Api”. In these *lorongs*, the only public facilities are elementary schools and mosques. The

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<sup>6</sup> *Kampung* is a group of houses as part of village or town .

roads are not completely sealed, and sometimes there are only small paths made of clay. Small shops (*kedai*) are available, but they sell a very limited range of goods. In *orong* "Pasir", however, the public infrastructure is better. There are big shops and restaurants alongside the provincial road. These facilities aim mainly at servicing travellers who drop by to have lunch or dinner at the restaurants, and for local tourists who want to ride boats on the lake, or just sitting at the lakeside.

The total population of Tikalak is 1,547 people, consisting of 749 males and 798 females, or 378 households. This is the lowest village population in the Sepuluh Koto Singkarak sub-district. Among these the majority (313 households or 82.8% of the population) are farmers and fish-farmers (BPP-Sepuluh-Koto-Singkarak, 2003).

Rural institutions in Tikalak have not yet been developed. The *Wali Nagari* (Village Head) office is the highest government institution level in Tikalak. As happened in other *Nagaris* in West Sumatra in the era of decentralisation, *Nagari* government has an autonomous authority to manage the village based on the people's needs and aspirations. However, the *Wali Nagari* office in Tikalak has not yet made use of this opportunity properly. This is evidenced by the fact that few programmes have been successfully implemented in Tikalak. Lack of motivation and accountability of the *Nagari* government is suspected as the prime reason (Field Notes, 7 March 2004).

The farmers' groups and fish-farmers' groups are important institutions in Tikalak. These groups have become the medium for interaction and communication among farmers and fish farmers. Usually, they set up a group based on clan (*suku*) or neighbourhood. These groups become the basis for creating *Julo-julo* or *Koperasi* credit schemes. However, the number of these groups is still low compared to other villages surrounding Tikalak. There were four farmers' groups and one fish-farmers' group in Tikalak, in which three of them were established just one year before the time of this fieldwork.

The economic condition of people in Tikalak is still at the subsistence level. This is due, among other reasons, to poor natural resource conditions and low education levels. The dry and rain-fed conditions of hilly areas mean that the majority of farmers can plant perennial crops only, such as *kapok* trees, clove, cinnamon, rubber, and coffee. Teak

wood is also planted, but it is still in the preliminary stage. However, most of these crops are not productive, especially clove, cinnamon, and coffee. *Kapok* is a specific commodity available in this *Nagari*, and has been the core crop to support people's income for a long time. However, its production has been decreased over the last five years due to the reduction of soil fertility and lack of farm technology. Due to the high cost of maintenance and harvesting of rubber only a few people planted it. It is usually grown on the top of the hill.

It is interesting to note that, unlike the previous two *Nagaris*, rice is not the main crop planted in Tikalak. The unavailability of irrigation channels, the dry and rainfed conditions, and the infertile soil had caused the resistance of farmers to plant rice. Only a few farmers who live near the public wells (*lubuak*) plant rice, but their farming activities are often constrained by pest and disease outbreaks, and thus they can plant only one crop a year during the rainy season.

The scarcity of water is the main constraint for farmers in the hilly areas to increase their income from farming. This problem not only affects rice planting but also other crops, such as oranges, chilli, and other vegetable crops. Sometimes people in the hilly areas have to go far to collect water for their domestic needs and for watering plants and livestock. One farmer states his irritation:

*We are suffering from the scarcity of water, and it restricts our ability to increase our income in farming. Therefore, we are not planting rice as the main source of income since it does not give us much return. When we tried to plant dry-land paddy, it was hampered by pests such as mice and "wereng", so we can plant only one crop a year every rainy season. Nonetheless, whether rainy or dry seasons, the situation here is the same. The scarcity of water is the main problem, even for our domestic needs. We hope that the government can help us to solve this problem (In-depth Interview, 7 March 2004).*

Other food crops planted include oranges, avocado, *sawo*, chilli, and fine-chilli (*cabe-rawit*), but the production is still low. Oranges, for example, have been planted by farmers in Tikalak for the past decade, since the government granted the villagers seeds



and also provided farm extension workers (PPL) to give guidance on how to plant them. At first, the production and quality of oranges were high and the price was good. Farmers enjoyed planting oranges, and these were famous as '*Limau Kacang*', the labelled name of the product. Farmers therefore received good returns from this crop. However, the CVPD disease attacked orange trees about five years before the time of this fieldwork, causing a decrease in the production and quality of oranges. This hardship was intensified by the reduction of soil fertility and a lack of guidance from extension workers and local government officers as well. One farmer states his complaint:

*The disease of CVPD viciously hit our orange plantation about five years ago, and since then the quality of our oranges decreased sharply. Thus, we do not take care of this plantation properly, while the extension workers who previously came and visited us regularly to give guidance, rarely come now. Subsequently, we still have many orange trees, but the harvests are not as expected. So, we replace them with 'cabe rawit' (fine-chilli), which has a better price in the market (Focus Group Discussion, 4 March 2004).*

Another farmer lamented especially about the sharp reduction in the oranges' quality, which affects the price of the products:

*Now, we are not so enthusiastic about planting oranges since the price is very low, due to their low quality. Despite the production being maintained in quantity, our products are valued only as 'jeruk-peras' (crush orange), with very low price (around Rp400 or Rp 500 per kilogram). The traders came here to buy our oranges directly from the field, and brought them by trucks to other provinces such as Riau and North Sumatra. We suffered losses because of a very low turnover, but we thought that to sell these products is better than nothing being achieved (Focus Group Discussion, 4 March 2004).*

The infertile soil conditions and plant diseases in Tikalak village have depressed the people's spirit to better their livelihood and have caused the Tikalak people to remain poor and underdeveloped. Farmers expect to have good returns from planting *cabe*

*rawit* only. They learned about this crop from farmers of surroundings villages, who successfully planted and received good returns from it. *Cabe rawit* is usually exported to other provinces or overseas and used as raw materials for making chilli sauce. However, the good prospect of *cabe rawit* in Tikalak is threatened by the rainy season, which causes the spreading of plant diseases.

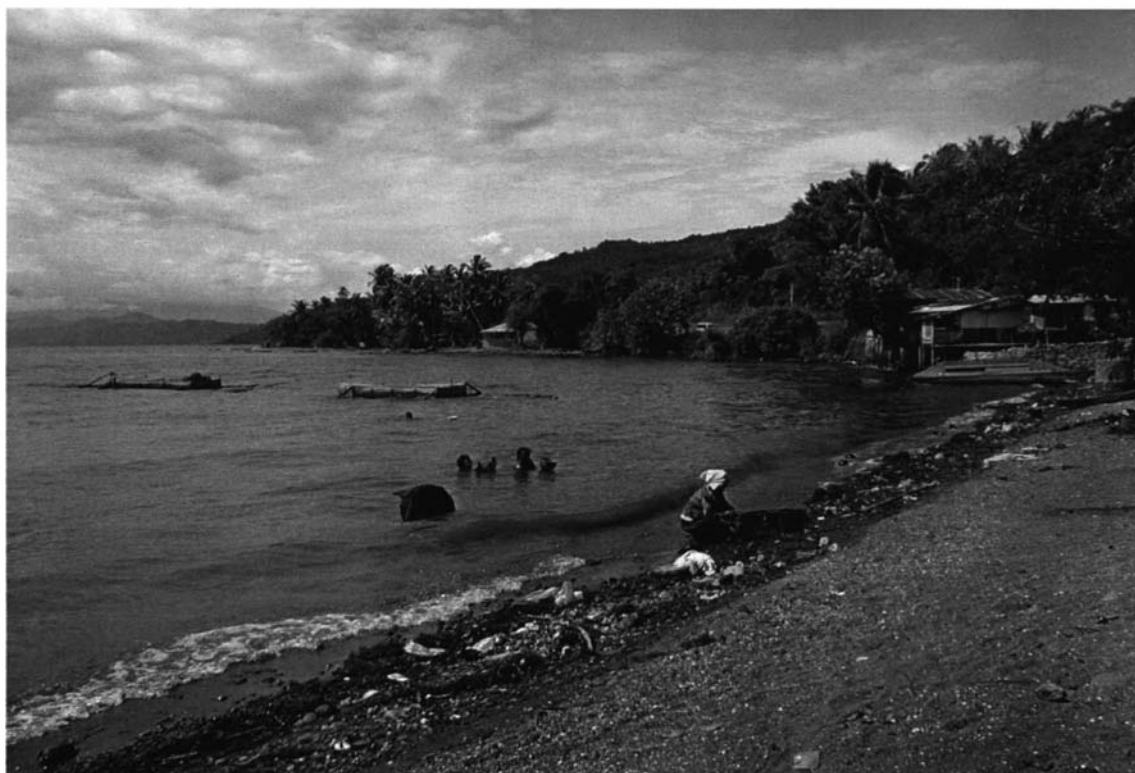


Figure 8.1. Women are catching small fish in Singkarak Lake, Tikalak

With regard to fish-farmers, the situation is comparable. Fish production in the Singkarak Lake has reduced sharply, especially in the three years before the time of this fieldwork, and resulted in a severe drop of the fish-farmers' income. Many of them are frustrated about this situation, as one fish-farmer says:

*We are now experiencing big losses, due to the sharp decrease in fish production in the lake, especially since three years ago. Before, we could have five to ten buckets of fish per day, but now we can have only one or two buckets only per day. Sometimes I hesitate to go to the lake because of very low fish production, but I need to feed my children. Thus, we catch fish only for our daily consumption, not for sale (Focus Group Discussion, 7 March 2004).*

Another fish-farmer who owns three types of tools for catching fish also complains that the tools are useless because they are not much use to them much given the reduced quantity of fish in the lake. These tools are: *jaring* (small fishing net), *pukat* (large and long fishing net), and *keramba* (big bamboo basket for catching fish). He says:

*Now I can use only 'jaring' for catching fish; the other two are not in use since only a small number of fish can be caught. In fact, for maintenance of keramba I need Rp 700,000 per month. This is out of proportion to the returns from catching fish. If I could catch two litres of fish per day, I could have Rp 30,000. But this does not happen very often; sometimes I could have only less than one litre or none at all (Focus Group Discussion, 7 March 2004).*

The good news for fish-farmers of Singkarak Lake is that the price of fish increases when the fish is scarce, due to the high demand on fish, especially “Bilis” fish, which is a specific kind of fish available only in the Singkarak Lake. The size of this fish is about 7 cm long, so that fish-farmers sell it by the litre or bucket. One fish-farmer explains that:

*When fish production was stable about three years ago, the price of one litre of fish was Rp 5,000. At that time we sold fish in a bucket equal to about two litres of fish. Now when this price increases three-fold, it becomes Rp 15,000 per litre. However, although the price is good, the quantity of fish is very small, so our income is still low (Focus group discussion, 7 March 2004).*

As with *Nagari* Dilam and Saniangbaka, it is difficult to identify the level of household income in Tikalak. The main reasons are the level of poverty and the lack of sources of income. At the time of this fieldwork people's incomes both from catching fish in the Singkarak Lake, and from farming were decreased sharply. People are hesitant to tell the real income received from their activities, since they consider that it is very small, and it is shameful to disclose it to others. Despite farmers planting many kinds of crops, they do not receive good returns from these farming activities. Furthermore, paddy,

which is usually used to measure levels of income, is not being planted by the majority of people, while fish-farmers are struck by the sharp reduction in the quantity of fish in the lake.

However, to illustrate economic conditions of the Tikalak people, we can make estimation. Based on my direct observation, people who have incomes from off-farm activities and have planted various kinds of crops have a better livelihood. Off-farm activities become preferable options for farmers in Tikalak due to bad returns from farming. This can be seen in Table 8.1 below.

Table 8.1. Economic conditions of farmers in Tikalak

Indicators	Number of Participants	Percentage
<b>Number of crops planted/on-farm activities:</b>		
0 – 3 crops/ on-farm activities	5	17.85
3 – 6 crops/ on-farm activities	15	53.57
> 6 crops/ on-farm activities	8	28.57
<b>Total</b>	<b>28</b>	<b>100.00</b>
<b>Types of off-farm activities:</b>		
Trader (average income > Rp 1 million/month)	4	14.28
Carpenter (average income Rp 750,000/month)	4	14.28
Civil servant (average income Rp 500,000/month)	1	03.57
Small trader (average income Rp 300,000/month)	8	28.57
Labourer (average income Rp 150,000/month)	4	14.28
None	7	25.00
<b>Total</b>	<b>28</b>	<b>100.00</b>

Note: n=28

Source: Fieldwork (2004)

In Table 8.1, crops planted mean all of the crops planted by farmers, despite not all of them being productive. This consists of annual crops such as rubber, coffee, cinnamon, clove, *kapok*, nutmeg, candlenut, and teakwood; fruit crops such as oranges, sapodilla, avocado, *duku*, durian, *rambutan*, mango, mangosteen, and rose-apple; and vegetable crops such as chilli, *cabe rawit*, and cardamom. On-farm activities consist of growing cattle, chicken, and catching fish in the lake.

Based on Table 8.1, it can be seen that the highest numbers of off-farm activity participants are small traders (28.57%). At the time of this fieldwork, US\$1 equals Rp 8,500, thus the small traders receive around US\$ 35.29 per month. In this case, it is difficult to identify the fixed figures of daily income of Tikalak people, to determine

whether they are living below or above the poverty line. However, the bad harvests in farming and fishing, and the very low selling price of several commodities are the reasons for the very poor condition of Tikalak people.

Social conditions of Tikalak villagers are not better than Saniangbaka, but about similar with Dilam villagers. Indicators used in this research to illustrate the social conditions of Tikalak village consist of educational attainment, having visited the health centre, having an inside toilet and bathroom, and access to drinking water at home, as presented in Table 8.2 below.

Table 8.2. Social conditions of participants in Tikalak Village

Indicators	Number of Participants	Percentage
<b>Educational attainment:</b>		
• Not finished elementary school	5	17.85
• Elementary school	12	42.85
• Junior high school	5	17.85
• Senior high school	5	17.85
• University	1	03.57
<b>Having Visited Health Centre</b>	23	82.14
<b>Having inside toilet and bathroom</b>	6	21.42
<b>Access to drinking water at home</b>	8	28.57

Note: n=28. Source: Fieldwork (2004).

Table 8.2 shows that the majority of participants have education up to Elementary school level only (60.70%), of which 17.85% have not finished elementary school. This condition limits the ability of Tikalak people to develop their *Nagari*, and to improve their quality of life.

The low percentage of participants having an inside toilet and bathroom relates to the availability of the lake in their village, as they usually use the lake as a toilet, especially for those who live near the lake. They have been used to this practice for a long time. Even if they have an opportunity to build a toilet and bathroom inside the house, they

still feel more comfortable going to the lake (In-depth interview, 7 March 2004). In the case of people who live on the hill, it is common that they have to go far from the house to go to the toilet or to collect water, due to the dry area and scarcity of water.

## **Overview of Rural Credit System**

The rural credit system in Tikalak is also characterized by the diversity of formal and informal credit systems. Formal credit systems consist of credit schemes from the state banks such as BRI and BPR, in which people mainly access the *Kupedes* credit scheme of BRI *Unit Desa* rather than other state banks. Informal credit systems consist of a variety of *Julo-julo*, *Koperasi Suku*, *Koperasi Nagari*, and moneylenders.

### ***Formal credit system***

Formal credit systems in Saniangbaka have been available for the past two decades, when the government established the BIMAS credit programme to help farmers boost food-crops and horticultural production. Since Tikalak is a rainfed area, and only a few farmers planted rice, the BIMAS credit programme was focused on horticulture, especially fruit production. The credit programme operated in the form of in-kind supplies such as seeds, fertilisers, and pesticides, and the majority of this credit aimed to support orange production. As stated previously, Tikalak village was famous for its specific variety of oranges “*Limau Kacang*”, and the production was remarkable during the 1980s and early 1990s.

However, orange production decreased during the last five years, especially in terms of its quality. Farmers blamed the reduction of the oranges’ quality on many causes. The delay of credit received by farmers, which meant the delay of fertilising the crops, was one factor for this failure, as one farmer said:

*One problem of accessing credit from the government was the delay of credit received by farmers. As we received credit in the form of seeds and fertilisers, we expected that the seeds would arrive before or early in the rainy season, so that we could transplant the seed to the field during the rainy season, to ensure the plants have enough water during the early*

*planting time. In reality, however, often this in-kind type of credit arrived at the end of or after the rainy season, and when we transplanted them into the field, the soil had already dried, and thus affected the quality of the oranges. This was heightened by the attack of CVPD disease, which hit our oranges many times (In-depth Interview, 15 March 2004).*

With regard to a second source of formal credit, state banks, as in Saniangbaka village, farmers in Tikalak rarely receive credit from the state banks, except those who have off-farm activities, or are civil servants or petty traders. Farmers and also fish-farmers are excluded from the formal credit programme. Some farmers in Tikalak are not bothered by this situation, either because of lack of information on credit and banking services, or because they thought that they will not be able to provide collateral and repay the loan. One farmer commented on this issue, as he said:

*We realise that we will not be able to access credit from the government bank because the interest is high and also we have to provide collateral, while the procedure to access credit is very long. Our income from farming is very fragile since it is easily attacked by pests and diseases, while the price of our farm products is not so good right now. So, we will not be able to repay credit or to provide collateral. Also, we are not used to dealing with banks. Thus, we prefer to stay away from the banks (In-depth Interview, 17 March 2004).*

However, the more progressive farmers who have been associated with a farmers' group aspire to have a soft loan from local government. They want to have in-kind credit such as fertilisers and pesticides because the price of these farm supplies has increased over the last few years. They don't want to have credit of fruit seeds anymore due to their bad experience with oranges. Instead, they prefer to have high-quality rubber seeds, which is more resilient to attack from diseases and pests. One farmer commented in a focus group discussion:

*We, the farmers in Tikalak, are now finding difficulties in farming. The crops are not growing properly due to lack of water, and lack of fertilisers as well. The harvests are depleted because the quality is low. We cannot*

*afford to buy fertilisers due to the high price. So, we would like to request credit from local government in the form of fertilisers and pesticides. And if possible, we also want credit of annual crop seeds such as rubber rather than orange, because rubber is more immune from diseases and pests than fruits (Focus Group Discussion, 4 March 2004).*

Another farmer said that this in-kind credit can be channelled directly to farmers' groups, and the group chief will distribute it to the group members. The reason for channelling credit directly to farmers' groups is to simplify the long procedure if credit is channelled through government offices.

Thus most poor farmers and fish-farmers in Tikalak do not have access to the formal credit system. These poor people are not interested in being involved in the formal credit programme because, beside the long procedure, they realise that they would not be able to afford the high cost of participating in the programme from the government bank.

### ***Informal credit systems***

In a similar way to the previous two villages, Tikalak's informal credit system is characterized by its diversity, consisting of *Julo-julo*, *Koperasi Suku*, *Koperasi Nagari*, and moneylenders. In addition, however, the *Julo-julo* in Tikalak is not only focused on cash or goods, but also takes the form of energy (*tenaga*). This kind of *Julo-julo tenaga*, also known as *Lambaihari*, is significant in helping farmers to solve the problem of credit needs. This topic will be elaborated on further in this chapter. Moneylenders, as will be shown, also play a different role in Tikalak compared to the other two villages.

One famous *Julo-julo* scheme in Tikalak is named "Ikatika". The members of this *Julo-julo* scheme not only come from Tikalak village, but also from its neighbour village: Kacang. The "Ikatika" itself stands for: *Ikatan Keluarga Tikalak dan Kacang* (the association of Tikalak and Kacang neighbourhood). The *perantau* of these two villages who live in the Solok City are also members of this credit scheme. This *Julo-julo* was established a decade ago, and has about 40 members. Uniquely, the monthly



contributions for this *Julo-julo* scheme are divided into three categories: Rp 5,000; Rp 10,000 and Rp 25,000. Members can select the category, based on their capability to pay, and one member can choose more than one category. One group is limited to ten members, to ensure that the rotation is short enough, so that each member does not wait too long for his/her turn. Since the members of this *Julo-julo* scheme are located in the dispersed area, the monthly meetings are conducted in these three places: Tikalak, Kacang, and Solok City, and each member pays Rp 1500 per monthly meeting for consumption costs.

People felt that this “Ikatika” *Julo-julo* scheme has been useful to support their needs of capital either for daily consumption or for farming, fishing, and small business activities. However, the performance of this *Julo-julo* scheme has decreased, especially in the last three years, due to managerial problems. One *Julo-julo* member said that:

*The “Ikatika” Julo-julo credit programme has helped people significantly in Tikalak and Kacang for many years, especially to support our farming and fishing activities, and our daily needs as well. However, the operation of this Julo-julo is not so effective, especially during the last three years, which is characterised by high arrears. The reason is that the management is not firm, so the members are easily undisciplined to repay their loans. Thus, the management is now handled by people from “Kacang” village, due to the failure of “Tikalak” people to manage this Julo-julo scheme (In-depth interview, 19 March 2004).*

Beside *Julo-julo*, there is also *Koperasi Ikatika*, which was established recently. This cooperative was established to respond to the demands of several members who want to borrow bigger amounts of money. The compulsory savings (*simpanan wajib*), which is the obligatory savings for each member, is Rp 2,000 per month while the basic savings (*simpanan pokok*), which is the obligatory savings only for members who want to borrow money from the cooperative, is Rp 10,000 per month. The interest rate of this *Koperasi* is quite high (7% per month). This is the reason why this *Koperasi* is not so favoured by people in Tikalak.

People who cannot afford to contribute higher amounts of money chose *Julo-julo Pos Yandu* as their credit programme. The members of this *Julo-julo* scheme are usually women who periodically come to the *Pos Yandu* (integrated medical services point) to check the health conditions of their infants or *Balita* (children under five years old). However, due to the popularity of this *Julo-julo* scheme, women from outside this group are also interested in joining. The monthly contribution of this *Julo-julo* scheme is only around Rp 1,000 to Rp 2,000 per month, and it is available in each *Pos Yandu* point in Tikalak. Despite only small amounts of money being received, lower income people gain help from this *Julo-julo* scheme to fulfil their daily basic needs, as a woman states:

*I choose the 'Julo-julo Pos Yandu' because the contribution (iyuran) is not so high, compared to iyuran for "Ikatika". I don't like to join "Ikatika", because other than the high level of contribution paid, the management is currently not good. In Pos Yandu, although only a small amount of money is received, it can help us to manage our daily needs (In-depth Interview, 20 March 2004).*

The *Koperasi Suku* is another kind of informal credit scheme and is favoured by the majority of people. The *Koperasi Suku* in Tikalak is similar to *Arisan Suku* in Dilam, and *Simpan Pinjam Suku* in Saniangbaka. The systems of these informal credit programmes imitate the practice of a simple cooperative. There are three *Sukus* in Tikalak: Sumpadang, Jambak, and Sikumbang. Each *suku* has its own *Koperasi*. Many people are interested in being involved in this *Koperasi Suku* because of its many advantages. First the procedure is very simple, without any collateral, and the interest is very low. For example, *Koperasi Suku Sumpadang*, which is the most progressive *Koperasi Suku* in Tikalak, has more than 50 members. The members of *Suku Sumpadang* will automatically become the members of the *Koperasi Suku Sumpadang*. The interest rate is only 1% per month. So, if one member borrows Rp 1 million, he/she should repay within 10 months. Each month she/he pays Rp 116,000,- consisting of Rp 100,000 instalment payment, Rp 10,000 interest, Rp 5,000 compulsory savings, and Rp 1,000 administration fee. The interest collected is used for the benefit of their *suku* such as to build a mosque, public bathroom, or for helping other members who are in misfortune or sadness. The administration fee, in this case, is used to buy snacks, tea, and sugar for consumption during the meeting, and also for purchasing stationery.

Secondly, people can borrow a bigger amount of money than they can get from *Julo-julo*. In the *Koperasi Suku Sumpadang*, for instance, the members can borrow from Rp 500,000 to Rp 1 million. The larger amount of money could be used for improving income levels and also for social purposes. Thus, people can use the money to pay the cost of land preparation for farming or for purchasing fertilizers, to buy fishing gear, to start petty trading, or for paying the children's school-fees. A woman farmer expressed her opinion about this situation:

*We are gaining much help by borrowing money from the Koperasi Suku, since we can use it to start our 'kapok' trading. So, my husband and I can build a simple cleaning room, for cleaning the 'kapok' after harvesting. We can receive a better 'kapok' price if it is sold cleaned. The money is also used for supporting our daily consumption (In-depth Interview, 19 March 2004).*

As also happened in Dilam, another advantage of participating in *Koperasi Suku* is the opportunity to meet and exchange information with friends and relatives in the same *suku*, and to escape from the routine work on the farms or at the lake. Although the quality of *Koperasi Suku* Meeting in Tikalak is not as good as *Arisan Suku* Meeting in Dilam, the members can feel the benefit of being involved in this *Koperasi Suku*.

There is also dissimilarity between *Arisan Suku* in Dilam and *Simpan Pinjam Suku* in Saniangbaka on the one hand, and the *Koperasi Suku* in Tikalak on the other. The *Koperasi Suku* in Tikalak has an open membership policy, meaning that everyone in Tikalak has a right to join with any *Koperasi Suku*, if he/she is interested in doing so. This is different from *Arisan Suku* in Dilam. The spirit of competition among *sukus* in Tikalak is not as intense as in Dilam. For example, the *Koperasi Suku Sumpadang* (also known as *Koperasi Bina Keluarga*) has members from *Suku Jambak* and *Suku Sikumbang*. Based on my direct observation, this *Koperasi Bina Keluarga* is more progressive than other *Koperasi Sukus* in Tikalak. There is a possibility that this *Koperasi Suku* will develop faster, since it does not restrict the membership and the management is held by trusted and accountable people.

The *Koperasi Nagari* is another kind of *Koperasi* that is available in Tikalak. This *Koperasi* is managed by the *Wali Nagari* office, and has been established for approximately ten years. The interest rate is 2% per month, with *Simpanan Pokok* (basic savings) Rp 10,000 and *Simpanan Wajib* (compulsory savings) Rp 5,000 per month. The credit should be repaid within ten months. Any delay in repayment could affect the ability to have credit next time. There is no guarantee for the first-time applicant to receive credit earlier, since there are many things that need to be considered before giving credit to a person. Unlike the *Koperasi Suku*, this *Koperasi Nagari* has only a few members. The reasons behind this are the inflexible regulations, many 'hidden' considerations, and poor management. The latter is related to the lack of trust held by villagers for the people who manage the *Koperasi*. It is common in Tikalak that rural people do not count on people who are associated with the government, due to corruption and nepotism trademarks of Indonesia's governance. I found this perception in Tikalak, when I interviewed a key farmer, as he said:

*People in Tikalak are now selective in choosing a credit scheme appropriate to them. People tend to choose credit schemes which come from the community, and if there is credit assistance from the government, they want the money to be managed by the farmer's group or other community's group, not the Wali Nagari office. Our long experience has shown that programmes that are handled by the Wali Nagari office mostly fail. We do not want to be prejudiced against our current Nagari government, but just to be cautious that people will not lose out (In-depth Interview, 21 March 2004).*

### **Unfriendly Moneylenders: Farmers' and Fish-farmers' Credit Problems**

The moneylenders are another potential source of credit in Tikalak. However, contrary to the situation in Saniangbaka, moneylenders in Tikalak are unfriendly. Moneylenders in Tikalak can be divided into two categories. The first category is the moneylenders who lend cash or goods to the rural people, with the repayment being in the form of standing crops such as kapok trees, rubber trees, or fruit trees when the farmer is unable

to repay cash. Thus, the moneylenders will own these trees forever, in the sense that they can harvest these plants any time they want. Farmers feel that this method is unfair, because the value of repayment received by moneylenders is not balanced with the money they borrowed, and the interest rate can be unlimited. However, the moneylenders argue that the plants were not productive at the time of repayment and the value is comparable with the money borrowed, but the farmers are still irritated because they have lost their source of income from these crops. I received many complaints from farmers relating to this issue, as a farmer states:

*Farmers in Tikalak are now suffering from financial loss because of the practice of moneylenders who have a specific way to charge high interest from the farmers. When we need to borrow money, they can instantly provide it with unlimited amount. But for repayment, they suggest we repay in the form of live plants, if farmers cannot repay the loan on time. Thus, farmers have to surrender their trees to the moneylenders whenever they cannot repay the loan earlier. We feel that this is unfair, because moneylenders can gain profits many times over when the trees become productive (In-depth Interview, 21 March 2004).*

Another farmer, who was the client of this type of moneylender before, expressed his feeling that:

*Whether I liked it or not, I allowed the moneylender to take my kapok and sawo trees, to repay my credit. Actually, these trees would be productive if we managed them properly, such as weeding and fertilizing, but I don't have enough time and money to do that. I am more focused on growing "cabe rawit", which would give good returns due to its good selling price now. So I need cash to start this activity (In-depth Interview, 21 March 2004).*

Farmers in Tikalak actually do not want to borrow money from this kind of moneylender because of this situation. But, when people need a large amount of money instantly, this kind of moneylender is the most suitable choice. When I tried to ask further about this type of moneylender, the farmers said that this is a very sensitive

situation, and they don't want to give more information about these moneylenders because they are influential people in Tikalak. They felt relieved when trying to explain this situation to me, in the hope that the government could help them to solve their credit problems.

The second type of moneylender in Tikalak is the common type of moneylender, who lends money to the borrowers and charges high interests. The repayment period is only one month with 20% interest rate. For example, if one borrows Rp 150,000, he or she should repay Rp 180,000, which is Rp 6,000 per day for one month. The positive feature of this moneylender is that the lender delivers the money directly to the doorstep of the customer and also picks up the repayment directly from the borrower's place. The money can be instantly available, and the amount is based on the request. It does not matter if the borrowers borrow a small or big amount of money, as long as they can repay it in one month with 20% interest. People in Tikalak are not so enthusiastic about borrowing money from this moneylender either. On one hand the borrowers feels that this type of moneylender can help them to solve their sudden money needs, but on the other hand, it is hard for poor people to repay the credit with high interest and a short repayment period.

The customers of this moneylender are usually the fish-farmers and petty traders who sell food along the lakeside or provincial road. This moneylender is not based in Tikalak, but in Solok city. It is a large business and has many customers spread throughout Solok District. One fish-farmer states his experience of being the customer of this moneylender:

*I choose to borrow money from this moneylender because it can provide me cash any time and with an amount based on my request. So, it is no problem if I borrow only a small amount of money, if I can repay it on time with high interest. Also, I didn't have to bother to come to its office to collect or to repay the loan, because they did all of that. However, the interest is so high, that my income per day from catching fish was used up in repaying the loan. Sometimes my income per day is not sufficient to repay the credit. Therefore, I borrow money from relatives to make up the difference. So, I just take a loan to pay another (In-depth Interview, 24 March 2004).*

This situation is economically unhealthy for people in Tikalak, because they don't have an opportunity to improve their income and thus also their quality of life. However, poor people have no option, except to apply for a loan from moneylenders in order to fulfil their daily needs. The difficulties in obtaining capital for financing their farming activities have caused farmers in Tikalak to look for alternative ways to be thrifty with their money by conducting *Julo-julo tenaga* or *Lambaihari*. This topic will be elaborated on further in the next section.

### **“*Lambaihari*”: An Alternative for Rural Credit Needs**

*Lambaihari* is a *Julo-julo* type of credit scheme but it is in the form of energy rather than money. Farmers in Tikalak participate in *Lambaihari* in order to reduce expenditure for farming especially for land preparations such as weeding, hoeing and ploughing. This kind of work usually needs a large amount of money to hire labourers, especially if the land is quite large. Only men do these tasks in Tikalak, while women are only responsible for planting.

The origin of *Lambaihari* comes from the concept of *gotong-royong*, which is the traditional system of working together in Indonesia's culture. In *gotong royong*, people do something together voluntarily without any expectation of gaining individual benefit. People work voluntarily to do big jobs such as building pathways, cleaning parks, building houses or public buildings and so on. With regard to *Lambaihari*, however, people expect to benefit individually from this activity, in terms of reducing farming expenditure.

The procedure of *Lambaihari* is very simple. Like *Julo-julo*, *Lambaihari* should be done in groups, and everybody takes a turn. In Tikalak, grouping is based on *suku* (clan). First, the farmer has a turn to receive help when other members in his group do land preparation on his land. Second, he takes a turn to work on other members' lands either before or after *Lambaihari* is done in his land. In Tikalak, *Lambaihari* is also named as *Kongsi*. This *Kongsi* is divided into two categories: *Kongsi Biasa* (regular), and *Kongsi Kas* (labourer). *Kongsi Biasa* is a normal *Lambaihari*, as described above.

In this case, each group has a plan or a timetable about when and where the members will do the work. In Tikalak, *Lambaihari* is usually done every Thursday. So, on that day every member should not do any other activities except *Lambaihari*. The work usually starts at eight o'clock in the morning and finishes at around four or five o'clock in the afternoon. The landowner usually prepares lunch and morning snacks.



Figure 8.2. Farmers are doing *Lambaihari* in Tikalak

Farmers in Tikalak feel that they receive great help from being involved in *Lambaihari*, as one farmer says:

*I really receive great help from the Lambaihari credit scheme. You can imagine how much money that I have to spend if I have to hire labourers to hoe my land, because it is very large and the soil has already hardened due to a lack of water. With Lambaihari, it can be done in only one day, since it is performed by ten people at one time, free of charge. (In-depth Interview, 5 March 2004).*



If there is no member's land to be done, this group of farmers will look for a job by working in other people's land, where the owner of the land is not a member of the group. This is named *Kongsi Kas* and in Tikalak is performed every Monday. The work of *Kongsi Kas* is similar to working as a labourer, in which people do the job on others' lands and receive wages. In this case they receive money from the landowner, about Rp 20,000 per day. If the landowner cannot prepare lunch or morning snacks, they are paid Rp 25,000 per day. Sometimes farmers prefer not to be provided with lunch or snacks, so that they can have a higher income. As a consequence, they have to bring their own lunch or snacks.

The money received from *Kongsi Kas* is not used directly by farmers, but they save it in a group's account, which is kept by the group's treasurer. This money then is distributed to the members once a year, usually before *Idul Fitri* day. The period before *Idul Fitri* is the most critical time for people in West Sumatra, because they need to buy many things to celebrate this holy day. Farmers in Tikalak know the importance of this *Kongsi Kas*, since it can help them to solve the problems of financial deficit before *Idul Fitri*, as one farmer said:

*Our savings from Kongsi Kas are very helpful to manage our high expenditure before Idul Fitri day. You know that for Idul Fitri day, we need to buy a new dress, shirt, or shoes for the children, to buy food, to buy gifts for my parents and relatives. All of these cannot be covered by only my small income from farming. Thus if we can save money before, we are not so burdened by high expenses in Idul Fitri day (In-depth Interview, 5 March 2004).*

Other than the economic advantage of *Lambaihari*, farmers in Tikalak enjoy doing *Lambaihari*. They always look forward to *Lambaihari* every Monday and Thursday, since it is the time to work together, to exchange information either about farming or other issues, to share happiness or sadness, to make a joke or teasing each other, and to plan their future activities. The time of *Lambaihari* is the right time for farmers to discuss their problems and find the solutions. Since they are grouped based on *suku*, they also discuss current issues in their *suku* and also in the *Nagari*. Sometimes the extension workers visit them and give information and guidance to solve problems they

face in farming. In this way they have an opportunity to ask questions or to convey their concerns or aspirations to these government officers regarding their farming activities.

When I visited a group of farmers during their *Kongsi Kas* work, we had an opportunity to conduct a focus group discussion. Farmers had time to express their opinions and aspirations regarding rural credit, such as how they manage the need for capital in farming, their access to credit from the state banks, and how to improve their income. The record of that discussion is as follows:

Researcher: Why do most of the farmers in Tikalak not access the credit programme from the government banks such as BRI and BPR?

Participants: *The majority of us do not access the bank because our knowledge about banking is very limited. We haven't even tried to do that. Also there is as yet no training programme from the government about this. However, we understand that when we borrow from banks or a cooperative, either money or in kind, we must repay them based on the regulations from the banks or cooperative.*

Researcher: If you do not have access to any credit programme from the government, how can you manage your needs for capital in farming?

Participants: *When we need capital for farming, first we depend on our own money, which is very limited. Then we collect money through this Kongsi Kas or through julo-julo. Even though the results are not so substantial, it does help us to manage our urgent needs such as for buying fertilizers, seeds, and nets for fish-farmers. We also work as labourers, especially during "fruit seasons" to pick fruit such as oranges, sawo, and rambutan, and during "kapok season" to pick and clean kapok.*

Researcher: I heard that farmers in other villages encountered difficulties in accessing credit from the government bank, such as long procedures, high interest rates, and requiring collateral. What is your opinion about this?

Participants: *We do not mind the administrative procedures that are required by the banks, but we expect that collateral should be simple and flexible and should not burden us too much. Now we are in the process of developing a proposal to the Solok District government through the Wali Nagari office to obtain credit for cows. The collateral for this credit is Rp 5 million, and will be provided by the Wali Nagari office.*

Researcher: So, in this case, what is your aspiration regarding credit for farmers in Tikalak, and what is your expectation of the local government?

Participants: *Now we expect that the district government would give us credit for purchasing a tractor, fruit seeds, and fertilizers. We really need a tractor for our Kongsia Biasa and Kongsia Kas, since the land is hard because of the dry area, and sometimes it is too large for us if we use hoes for land preparation. We also hope that the government could help us to solve the problem of low fish quantity in the Singkarak Lake. This situation terribly affects our income (Focus Group Discussion, 19 March 2004).*

This discussion with a farmers' group in Tikalak illustrates that poor farmers in Tikalak are still not serviced by formal financial systems. Nevertheless, they have a positive attitude about formal credit from the government, and expect that the local government could give them loans for purchasing agricultural tools. The *Wali Nagari* office has also been responsive to helping farmers, by managing revolving credit from the local government for cows. According to one key farmer, this is started a couple of months ago, when the *Wali Nagari* was invited to attend a meeting at the *Bupati* (District Head) office (Field Notes, 19 March 2004).

## Conclusion

This chapter has shown that deep poverty occurs in Tikalak. Economically, the source of income of people is very limited due to unfavourable natural resource conditions such as steep slopes, dry and unfertile soil conditions, and lack of water. This is especially so for people who live in the hilly area. In the flat area, which is situated at

the side of Singakarak Lake, fish-farmers encounter the problem of the low quantity of fish in the lake, and has caused a severe drop in their incomes. Tikalak villagers can be categorised as underdeveloped, as reflected by the low educational level of the majority of the population, and due largely to the lack of educational and rural institutions. Beyond this, Tikalak people appear to have had lack of motivation to be involved in official development projects as a result of the indifferent and unaccountable attitude of the village government and the community leaders towards the rural community. Thus, the favourable location of Tikalak, which is close to the provincial road and tourist object, can't guarantee the economic and social progress.

Importantly, the state of underdevelopment and poverty had constrained the development of rural credit systems. The formal credit system is immature, in which the majority of the population do not access formal financial institutions. Besides their inability to provide collateral and to pay high interest, rural people also have minimal knowledge about credit and banking services. The informal credit system, on the other hand, is more favoured by the population because of its simplicity and flexibility. Rural people prefer to borrow money from the *Koperasi Simpan Pinjam*, or participate in *Julo-julo* or *Lambaihari*, to solve their credit problems. These informal credit systems are usually created based on their traditional culture (*clan*). The tendency of rural people to use their traditional culture combined with the spirit of people working together (in *Lambaihari*), reflects the fact that the social capital in this village is still strong. Therefore, although Tikalak people are economically very poor, and the traditional informal credit schemes have not significantly impacted on people's income, their tight kinship and strong social capital would be an important basis for the village's future economic development.

Compared to Dilam and Saniangbaka, the state of poverty and the development of rural credit systems in Tikalak is the worst. Economically, it is mainly because of the village's unfavourable natural resource conditions as well as the low education levels and a lack of knowledge of the banking system of the people. In the case of the undeveloped rural credit system, relative to Saniangbaka, rural people in Tikalak are lacking in motivation and spirit, whether they stay in the village or in *perantauan* to develop their *Nagari*. Another contrast with Saniangbaka is regarding the role of moneylenders. In Tikalak, the moneylenders are not friendly. They attempt to profit as

much as possible from the borrowers, as the case of repayment in standing trees. Also, there is a moneylender who comes from other town and sets high interest rates, but with a flexible and short procedure. The role of moneylenders in Tikalak contributes for the problematic rural credit system in this village. Another difference is the role of the village government, which in Tikalak is not supportive, compared to Dilam and Saniangbaka. Just recently however (at the end of my fieldwork), the *Wali Nagari* office did attempt to help farmers by providing collateral to access credit from the district government.

The main similarity with Dilam and Saniangbaka is the spirit of rural people to create rural credit scheme based on their traditional Minangkabau custom (*suku*). *Lambaihari* for example is favoured by rural people, because it not only functions as a medium for savings and credit, but also for discussion and the exchange of information among *suku* members. *Lambaihari* is one of way rural people in Tikalak to solve their credit needs. To conclude, many challenges are faced by rural people in Tikalak in increasing their standard of living and in accessing rural credit programmes. A flexible and conducive rural credit system is required in order to meet the needs of the rural poor for credit, and therefore the role of local government in this case is important. Tikalak is the third and final case-study village in this research. In Chapter 9 the three villages will be assessed together to draw further conclusions from their similarities and contrasts.

## **CHAPTER NINE**

### **SMALL FARMERS AND RURAL CREDIT IN INDONESIA**

#### **Introduction**

The information from the previous case study chapters reflects the diversity of socio-economic conditions of small farmers and rural credit systems available in the three villages. Each village has its own characteristics, while there are also many similarities among them, especially how small farmers manage to fulfil their credit needs in ways which are suitable and fit their economic, social and cultural conditions.

In this chapter therefore, the conditions of small farmers and rural credit in Indonesia, as exemplified by the evidence from the three case study villages will be discussed. Firstly, the indicators of poverty in the study villages are examined. This is followed by a discussion of the failure of formal rural credit programmes in rural areas, and a discussion about local government's role in rural financial development. Then, the strength of informal rural credit activities is noted. In this section, the significant role of local cultures and values in providing a conducive environment for the development of informal rural credit systems will be discussed. Next, potential new dimensions of rural financial developments are examined. In this section the main findings of this study will be elaborated with regard to Indonesia in particular, covering several issues such as participatory rural financial development, cultural and values influences on rural financial development, and the importance of kinship and social networks in rural finance.

#### **Small Farmers and Rural Credit in Indonesia: The Challenges in Agricultural Development**

About 57% of Indonesia's population reside in rural areas and about 75% of these people are small farmers who are living in poverty (ADB, 2001b: 1). Because these farmers constitute the majority of Indonesia's population, they should receive priority attention by the government in development. In reality, however, small farmers'

conditions in Indonesia have not improved, despite the fact that many programmes and policies have been set up to improve their conditions.

### ***Characteristics of poor farmers in the study area: Indicators of poverty***

The three case studies that have been presented have provided evidence about the real conditions of small farmers in some rural areas of Indonesia. There are several indicators demonstrating the poverty of the three case study villages.

The main indicator is the low level of household income. As depicted in Tables 6.1, 7.1, and 8.1, the estimated household income of the majority of participants is below the poverty line. Many factors contribute to the low level of income including: the small size of land holdings, the limited variety of crops planted, and the low level of off-farm income. This low level of income limits the ability of the rural poor to fulfil their basic needs, such as food, shelter and education for their children. Food shortages are significant in Dilam, and villagers' daily diet is mainly rice. Rice is easy to find since the majority of people plant rice. They eat usually three times a day, but lack a variety of food. Sometimes they eat only rice with chilli, or rice with vegetables. Foods providing proteins such as meat and fish are luxuries and are scarce in the village. If people want to eat beef, chicken, or fish, they have to go far away to buy these foods in Solok City, or to the sub-district capital every Thursday, a market day. The small shops in the village have limited provisions, which are expensive.

There is a lack of adequate shelter in Dilam and Tikalak, and in some parts in Saniangbaka. The majority of rural people's houses are made of wood, and sometimes bamboo. In Saniangbaka, for example, landless farm labourers stay in very modest houses made of bamboo. In Dilam, a lack of income has forced three or four nuclear families to live in one structure. In most cases, families residing together are related, forming extended families of three or four generations. The consequence is that the house becomes crowded, and this overcrowding causes poor conditions for its inhabitants.

The low-income level of the majority of people results in people's limited capacity to purchase farm supplies such as fertilizers, pesticides, and seeds. As mentioned in Chapter Six for example, small farmers in Dilam cannot afford to buy fertilisers. Besides the increasing price of fertiliser, people's incomes are low and flat, inhibiting their capacity to increase farm production. Thus, they try to use organic fertilisers such as cow-dung and tree-leaves to replace chemical fertilisers. This results in small harvests, but they have no choice. In Tikalak, the fish-farmers cannot continue to catch the fish in the lake because they cannot afford to buy new fishing equipment, such as *jaring*, *pukat*, and *keramba*. In addition, as stated in Chapter Eight, the income of fish-farmers in Tikalak has decreased sharply in the last three years due to the decrease of the quantity of fish in the lake. Thus, the low level of people's income in the study area has made them unable to improve their harvests and therefore their quality of life.

Another indicator of poverty in the three study villages is poor social conditions. Tables 6.3, 7.2, and 8.2, explain the social conditions of rural people in the study area. Such conditions include the level of educational attainment, access to a health centre, the presence or absence of inside toilets and bathrooms, and potable drinking water. It is evident from these three tables that people's social conditions in the three villages are insufficient, which has an adverse effect on their living standards.

Regarding educational attainment, the majority of participants finished only elementary school, and in some cases never entered school at all. Their children also sometimes could not continue their study due to a lack of money for school fees. The majority of the children in the study area are enrolled in elementary schools since these schools are inexpensive, due to the new government's policy to provide all the population with basic education. However, not all parents could afford to send their children to the junior or senior high schools, nor to university. The children who cannot continue their study usually help their parents in the rice-fields or gardens. Sometimes they go to *Madrasah*, the Islamic school, since fees are small and sometimes attendance is even free. In Saniangbaka, children who cannot continue their study engage in *merantau*, and do street trading. As stated in Chapter Seven, since *merantau* is the specific habit of Minangkabau people, the dropout school children become petty traders in the beginning, but may become more well-off entrepreneurs later in life.



Poor health care systems and sanitation are other indicators of poverty in the study area. Rural people tend to use traditional healers or traditional medicines in order to reduce expenditure. In Dilam village for example, people usually go to a *Dukun* or *Tukang Urut*, the traditional healers, to receive health care and medicines, especially for the children. These health services are sometimes insufficient, thus resulting in an increase in child mortality rates in this area.

The level of sanitation is poor in the study area, especially in Dilam and Tikalak. In these villages people have to go far away from their homes to collect water for drinking, washing, and also for bathing. People rarely have toilets inside the house. They usually go to the public toilets; otherwise they use the waterways (such as the river and lake) as a toilet. The scarcity of drinking water in these areas and the lack of inside toilets cause poor sanitation, and in turn cause poor health conditions for the rural people.

This explanation suggests that poverty is endemic to the study area. One factor that could contribute to the widespread nature of poverty in this area is the remoteness or the isolated location of the village. This particularly applies to Dilam village and part of Tikalak village (the hilly area). Being isolated means that modernisation proceeds only slowly to these areas, and causes the low educational level of people as well as the lack of access to information and technology.

To manage their requirements for money to fulfil their basic needs, people create informal rural credit schemes appropriate to them, such as *julo-julo*, *simpan pinjam suku*, *koperasi suku*, friendly moneylenders, and *lambaihari*. Thus these informal credit schemes are used for survival and for emergency purposes only, but they are successful in terms of satisfying the needs of the rural poor.

### ***The need for credit for development***

Credit for survival is useful to fulfil basic needs and to manage emergency situations and this kind of credit, therefore, does not have great potential for increasing the quality of life of rural people. Credit for survival is sufficient only for supporting the daily life of the rural people from one harvest to the next. These informal credit schemes cannot

easily be expanded to increase household incomes of the rural poor, because the size of capital is limited and the management system has not developed. Hence, poor farmers in these three case study villages are still living in poverty.

With regard to the lack of implementation of formal credit programmes in these three villages, the main cause is the inability of the farmers to repay the credit on time. This is due to the specific conditions of small farmers. They have irregular income since their harvests are highly dependent on uncontrollable factors such as pest outbreaks, climatic conditions, and natural disasters. Furthermore, they have small land parcels, and the type of crops grown could not be diversified due to the limited amount of water available and lack of modern agricultural technology.

Consequently, small farmers in the study area need credit schemes appropriate to their specific conditions in order to raise income and to combat poverty. This credit can be used to buy high quality seeds and fertilisers, or to buy tools for land cultivation. These specific credit schemes should be suited to the conditions of small farmers. For example, the credit should be available before the planting season, and the repayment made flexible according to the time of harvesting. This is different from the previous credit for survival, which is only useful for fulfilling basic needs and satisfying emergency situations. This kind of credit for development is crucial for investment and to achieve the improvement of quality of life of small farmers.

### ***Small farmers' credit and savings behaviour***

The poor economic condition of farmers shapes their attitudes and behaviours towards savings and credit, as well as banking systems. It also affects the attitude of financial institutions, such as banks and cooperatives, in the way that they treat the poor, especially small farmers.

The primary effect of poor economic conditions of farmers on their credit and saving behaviour is that they think that access to the formal credit programmes and banking transactions is very costly. This is because small farmers use small amounts of money for their daily life, and thus formal banking systems become unattractive to them (Matin

et al., 2002: 275). Therefore, members of the three villages in this study felt that access to the banking facilities is an unaffordable luxury, because they have to spend money to go to the bank, to pay administration fees, and even to provide collateral, while their resources are very limited. Provision of collateral seemed to be the main cause for the difficulty of poor farmers' access to formal rural credit programmes. In Indonesia, the state bank still requires borrowers to put up physical collateral, either in the form of land or vehicle certificates, or other belongings such as a TV or radio. In Dilam village, for example, farmers are required to provide land or vehicle certificates in order to be able to receive credit from the state banks. Because farmers' land is acquired through inheritance from their ancestors, farmers do not have the necessary transaction documents. Farmers must therefore apply for a certificate and it takes time and is costly. In Saniangbaka village also it was found that the rural people must provide a TV, radio, or other electronic appliances as security, in order to be able to borrow money from the bank. Sometimes this is an insufficient financial collateral to guarantee credit from the state bank, since other than physical collateral, banking institutions also consider the personal records of potential borrowers (In-depth Interview, 17 February 2004).

Another effect of this condition is that the farmers tend to be cautious in accepting formal rural credit. This is mainly because of the fragility of income, in which they have high levels of insecurity and risk. Their flows of income commonly do not coincide with expenditure, because of specific household factors such as loss of earnings due to sickness, urgent medical expenses, death, theft, and insecure conditions of employment. Also broader uncontrollable environmental factors such as natural hazards and unfavourable climatic conditions (e.g. drought and flood) cause the failure of farmers' harvests.

The consequences of the situations described above cover a number of issues (Manfred Zeller et al., 1997: 7). First, they limit the interactions between small farmers and the formal sector. This is evidenced by the findings in the three villages of my research, that the majority of small farmers did not access the formal credit institutions. The reasons were not just because of high interest rates and the obligatory collateral, but also because small farmers are not accustomed to, and lack knowledge about, accessing credit from formal financial institutions. Small farmers tend not to be involved in formal

credit programmes, especially a formal credit programme from the state bank (In-depth Interview, 17 March 2004).

A second consequence is that the rural poor tend to diversify their income, based on opportunities they have. Income diversification or crop diversification is one strategy of small farmers to improve their earnings. In Dilam village, for example, farmers planted vegetable crops such as chilli and tomatoes after paddy. Planting chilli was profitable especially before *Ramadhan* because they can harvest it before *Idul Fitri* day, when the chilli price is good. In Saniangbaka and Tikalak, farmers deliberately changed their crops from planting cloves or cinnamon, which are not profitable, into teakwood and fine-chilli. Although teakwood is slow growing, people believe that it will give high returns when harvested, based on other people's experience in other places. Other farmers in these three villages also manage to have off-farm activities such as trading, carpentry, or labouring. In Dilam village, one farmer could gain better income from cow trading. He said that he could achieve at least Rp 400,000 (\$NZ 66.00) net per week during the peak season (usually before *Idul Qurban* festival day), a rate he could not receive if farming only. From this activity, he said that he could buy a motorcycle, and continue to support the study of all of his children to university. In Tikalak village, small farmers tend to diversify their income by working as labourers in the local market, or picking fruits during fruit season. Unlike the farmers in Dilam, small farmers in Tikalak received only a small wage from working as labourers.

The rural poor also attempt to develop economic networks or relationships either with individuals, groups, or agents. This effort is mainly as security against controlled or uncontrolled risks. For small farmers, uncontrolled risks significantly result in a sharp reduction in income, and can easily throw them into chronic food insecurity (Basu, 1997; Germidis et al., 1991; Goodland et al., 1999). Group networks are very common in all three case study villages, with the purpose being to strengthen people's economic and social conditions. Small farmers are inclined to associate in farmers' or neighbourhood groups, and then create a savings or credit scheme appropriate to them. Creating *julo-julo*, *simpan pinjam* and *lambaihari* credit schemes are examples of these attempts. By participating in these savings and credit schemes, small farmers are able to manage the problems of accessing capital, either in emergency situations to fulfil basic needs or in fulfilling secondary needs, such as to continue children's education, to

purchase electronics, or to conduct a ceremony or party. But, in case of *Lambaihari* in Tikalak village (Chapter 8), their needs of capital are substituted by decreasing expenditures in land clearing.

Formal banking system responses towards the specific poor conditions of farmers are distinctive in the three previous case studies. The specific characteristics of small farmers' income, influenced by uncontrollable hazards, such as long droughts and pest outbreaks cause an irregularity of flow in their income. This influences and increases the hesitancy of formal credit institutions to give credit to the small farmers, and therefore causes the failure of formal rural credit institutions to provide credit for them. Considering that the agricultural sector is the main source of income for the majority of Indonesian people, this situation will challenge the future of agricultural development, especially in providing reliable rural credit systems for small farmers.

### **The Lack of Success of Formal Credit Programmes at the Grassroots Level**

One of the findings of this study was that the formal sector failed to deliver rural credit programmes at the grassroots level. The failure of formal rural credit programmes to give service to the poor, especially small farmers, has been acknowledged in various countries in the world (Germidis et al., 1991: 47). Formal financial institutions are characterised by their urban-based nature, and often tend to overlook the rural section in their operations. The ignorance of the formal sector about the rural population is mainly due to high costs which are incurred because of poor communication and infrastructure in rural areas (Lele, 1981; Lipton, 1976). During earlier times, formal rural credit programmes were mainly targeted to boosting agricultural production, and thus there was a need to provide credit for all farmers. This subsidised agricultural credit was viewed as a key strategy for promoting economic growth and poverty reduction.

However, the empirical record suggests that these strategies have seldom benefited small farmers or poor people (Matin et al., 2002: 283). The reasons behind this include urban- biased credit allocation, the inability of the poor to provide collateral, high interest rates and transaction costs for the poor borrowers, and corrupt practices

(Sukarno, 2000). The credit default rate was also high which thus prevented the credit institutions from becoming viable. This led to their being abandoned by public financial support and then collapsing. The reasons for high default rates were the lack of information on how the banking system worked, seeing credit as something that need not be repaid (Lipton, Haan, & Yaqub, 1997: 157), inappropriate design features, and politicisation of rural credit programme that made borrowers view credit as political charity (Donald, 1976; Manfred Zeller & Sharma, 2002: 19).

The difficulty of formal rural credit programmes in reaching the rural poor is one constraint of extending the outreach of microfinance programmes. Many scholars have noted that on average, only 10 to 15% of all rural households in developing countries ever had access to formal credit in the mid-1970s, and this proportion has not changed over time (Matin et al., 2002: 283). Banks' approach to banking and financial service provision has remained largely unaltered. This might be because of scepticism about profitability, a lack of pro-poor values of rural finance systems, or simply because the market niche is inappropriate and better served by the informal lenders, NGOs, or specialised microfinance institutions (Navajas et al., 2002: 155).

These arguments correspond to the situation at the grassroots level, such as at the three villages of this study. In the current modern era of microfinance, rural people are still lacking access to formal financial services. In Dilam Village, for example, the government banks were not available in the village. The state owned banks, which are located at the sub-district capital, were hesitated to give credit to the poor, especially small farmers. This can be proven by the long procedure and strict requirements to become a customer of the bank (In-depth Interview, 14 January 2004). The majority of people had a lack of information on banking systems, and therefore were not reached by formal financial services.

In Saniangbaka village, where rural people's knowledge about banking systems and people's economic conditions is a bit better than that of the people in Dilam, the state banks gave credit only to the small traders, shop owners, pensioners, or civil servants, and ignored the farmers (Key Interview, 21 April 2004). The reason was that the farmers' income is irregular and sometime unpredictable, and is highly influenced by uncontrollable factors such as climatic conditions and pests and diseases. Additionally,

small farmers were also unable to provide physical collateral. The cautious attitude of the state bank to giving credit to the farmers was influenced by the previous difficult experience of high credit default when channelling KUT credit programme to the farmers in the area. The state banks are still experiencing financial loss as a result of outstanding farmers' debts in the area.

The failure of the formal credit programmes in Tikalak village was mainly due to the lack of awareness of rural people about banking systems and also the hesitancy of formal credit providers to reach the poor, especially farmers in rural areas. The low level of education and income of the majority of Tikalak people contributed to their inability to access a formal credit programme. The majority of them realised that to access a bank loan is costly, since they have to provide collateral and pay high interest. Therefore, they preferred to stay away from banking activities (In-depth Interview, 17 March 2004).

This evidence from the village case studies suggests that a formal rural credit system in Indonesia is still problematic, especially regarding outreach and sustainability. In fact outreach of rural financial institutions is very important in order for them to become effective in helping all of the rural community members. The deeper outreach usually increases not only social values, but also social costs if the lenders cannot manage the risk properly. So, from the lenders' point of view, as the income and wealth of the poor decrease, it becomes too costly for the lenders to engage in the small loans with the poor (de Vera & Kim, 2003: 5). For example, if the poor make a transaction in a small amount of money, the costs will be the same if one made a bigger loan, and if the poor make the small loans frequently it will cause a loss to the lenders. This might be one reason why the state banks in Solok district hesitate to give loans to the poor, especially poor farmers.

On the other hand, financial transaction costs of formal credit systems can also be high for rural borrowers. This results from the loss of working time since the borrowers may have to pay several visits to the bank branch office to conclude long loan application procedures, with the location of the bank branch office being far from their village. Also, the borrowers have to spend money to obtain the required documents or in paying an administration fee. This cost will be heightened by the obligation of providing

physical collateral, usually in the form of land or vehicle certificates or electronic appliances.

Given the problematical situation of formal credit systems in Indonesia, rural people - especially small farmers - prefer to use informal finance to solve the problems of credit needs. As a consequence, the formal banking system is not attractive to rural people, and sooner or later, this could affect the sustainability of formal rural financial systems. This is a challenge for the Indonesian government to create formal rural credit programmes which are appealing to, and which can be sustained by, rural people and which are attractive to credit intermediaries as well. In this case, the role of local government is crucial in order to make a favourable environment to develop rural credit systems appropriate for the poor at the grassroots level. This will be elaborated on further in the next section.

### **The Limited Role of Local Government in Rural Financial Development**

The role of local government in rural financial development is imperative because the local government's position as the closest government level to the rural areas means that one of its responsibilities is to manage financial matters in the region. This is in line with the spirit of decentralisation, about which Indonesia has decreed two laws: Law 22 on Local Government Autonomy and Law 25 on the Central-Local Balance Financial Fund. These laws give local governments authority to manage their areas, including regional responsibility for expenditures.

Regarding the rural credit system, the local government's role is also important to encourage an environment conducive to, and giving support for, the smooth implementation of rural credit programmes. In the previous centralised system, central government usually designed formal rural credit programmes, and local government took a lead in managing credit delivery to the borrowers. In the KUT credit programme, for example, the loans were channelled to the district branches of state banks, and then were distributed to the borrowers by the local government. In this case, all regulations



came from the central government, while the local government facilitated the implementation process.

In the current era of decentralisation, local governments in Indonesia are encouraged to actively participate in developing microfinancial systems in the region. In Solok District, the local government has created many credit programmes, which are mainly aimed at helping the poor to manage their credit needs, such as the LUEP credit programme, and revolving credit for cows. At the institutional level the process of planning and designing of rural credit programmes is going well, but the implementation at the field level is not so satisfactory. The district government has set up one division in the district office, namely the Office of Community Empowerment, which is responsible to oversee the activities of empowerment programmes in the district including credit and saving activities. The revolving credit for cows and LUEP are designed and administered through this office. However, as has been stated in Chapter Six, the rural poor, especially farmers, were not very satisfied with the performance of these two credit programmes (In-depth Interview, 18 January 2004). The LUEP credit scheme, which was directed at the rice-mill owners, and aimed to help rice farmers, did not significantly reach its objective. Similarly, the revolving credit for cows did not reach the poor, because the procedure to apply for the credit is quite long.

The unsatisfactory performance of local government's rural credit programmes in Solok District reflects the immaturity of rural financial development at the local government level. There are many reasons behind this. Firstly, Indonesia is still in the early stages of decentralisation and local government is not yet ready to fully implement the decentralisation process. As stated by one key person in Dilam village, local government has not fully trusted local people to manage the programmes or projects by themselves (Key Interview, 7 January 2004). Secondly, there is a lack of professional human resources, which include human resources at the office level and at the field level. This not only covers planning and managerial capacity, but also the morality, accountability and integrity of the persons. Thirdly, there is a lack of extension services and promotion of rural credit programmes to the target groups, whereby the credit programmes are not sufficiently promoted to, and acknowledged by, the rural community. In fact, this is important in order to make the target population aware of,

and therefore easily adopt, the programme. Lastly, the resources are still limited; thereby the credit programme cannot cover a large part of the population.

The lack of success of formal rural credit programmes and the inadequate role of local government in encouraging a favourable rural credit development in the area turns our attention toward the prospect of informal finance. This could become one path for the government to be chosen and strengthened, as this study has proven the successful implementation of informal rural credit systems in the three villages. This will be discussed further in the next section.

### **The Strength of Informal Rural Finance: The Diversity and Capacity in Adopting Local Cultures and Values**

Despite the negative views regarding informal finance in the past, there is now a positive attitude towards these kinds of financial services in some literature at least, which is shown by the greater understanding of the way they operate, and their strengths and weaknesses. Current research on informal finance has highlighted a range of savings, credit, and insurance facilities accessible to poor people (Ghate, 1992: 3), even though the empirical research is still difficult due to the sensitivity that attaches to financial transactions on the part of both borrowers and lenders (Matin et al., 2002: 278).

The increasingly important roles of informal finance in developing countries have been corroborated by the findings of this research as stated in the three case study chapters. The majority of people in the three villages preferred to participate in informal credit schemes rather than formal credit schemes, as they also received many economic, social or cultural advantages.

#### ***The diversity of informal rural credit systems***

Within the broad scope of informal finance, the main characteristics are its diversity and heterogeneity. Even the distinction between informal providers and their users is often

fuzzy, since they are often operating in one group and the same activities (Tsai, 2004: 1487).

In the three villages of the study area, it was found that many types of informal rural credit and savings systems were available. Major types of informal rural credit schemes were: *julo-julo*, *simpan pinjam*, and moneylenders, and each of these types has many kinds of credit schemes. For example, a women farmers' group in Dilam village has many kinds of *julo-julo* such as 'fertilizer julo-julo' (*julo-julo pupuk*), 'rice julo-julo' (*julo-julo beras*), 'dinner set julo-julo' (*julo-julo piring*), and so on. There was also a *julo-julo tenaga*, in which the contribution is in the form of labour rather than money. In Tikalak this is named as *Lambaihari*. The *Simpan Pinjam* or *Koperasi* also has many kinds of schemes, such as *Simpan Pinjam* or *Arisan Suku* in Dilam and Saniangbaka, and *Koperasi Suku* as well as *Koperasi Nagari* in Tikalak. There were two different kinds of moneylenders: friendly moneylenders, and unfriendly moneylenders. The former are usually shop-owners, farm supply retailers, friends and relatives, and *perantau*, who are especially available in Saniangbaka, and usually come from this village. The latter are usual moneylenders who charge high interests, and who are available in every village, but are usually not inhabitants of the village.

The diversity of informal finance available in the study area shows how well developed the rural credit and savings systems are in each village. Each of these informal rural credit schemes has its own regulations, committee and management. Some of the participants wanted their credit and savings schemes to become better than the others', and in the future to advance into bigger and more progressive institutions such as banks or cooperatives.

The diversity of the informal credit schemes also brought many advantages for rural people. Firstly, rural people have many choices in selecting the rural credit scheme appropriate to them. In Tikalak village for example, lower-income people preferred *Pos Yandu julo-julo*, since the amount of contributions is smaller, compared to other schemes such as *Ikatika julo-julo* scheme, in which the amount of contributions is also divided into three levels: Rp 5,000; Rp 10,000, and Rp 25,000. Participants can choose how much money they can afford to contribute. Secondly, the diversity allows them to manage their needs properly, despite the fact that only small amounts of money are

achieved. In Dilam village, the *julo-julo* scheme allows rural women to manage their needs from fulfilling daily rice consumption (weekly rice *julo-julo*) to satisfying their secondary needs (dinner set or carpets *julo-julo*), and the needs of farm inputs (fertiliser *julo-julo*). Thirdly, the diversity encourages the creativity of rural people to design a rural credit system suited to their conditions, and thus empowers them. Rural people, especially women, were very creative in this manner. They made a plan and assessment of their needs, and then designed the regulations and procedures. Despite its simplicity, this reflects the ability of rural people to manage their own credit needs and credit schemes.

### ***Accomplishment in adopting local cultures and values***

The successful implementation of informal rural credit and savings schemes in the three case study villages is viewed as the result of the accomplishment of adopting local cultures and values. As informal finance is more suited to people at the micro level (Johnson & Rogaly, 1997: 25), the variety of forms and functions demonstrates the adaptability of these systems to different situations - either economic, social or cultural conditions (Meyer & Nagarajan, 1999; Moll, 1989; SMERU, 2000; Sukarno, 1999). Local cultures and values, which are embodied within the local political, institutional and market interactions, play an important role in shaping the practice of informal credit and savings activities in the area.

The unique feature of informal credit schemes in each village explains the above phenomenon. For example, there was an *Arisan Suku* in Dilam village, in which the practice follows the matrilineal culture of Minangkabau. People were attracted to join this credit scheme since the procedure was consistent with the local culture and beliefs. In this credit scheme, only women can receive the loan, while men could only participate as contributors or depositors. In this case, since the *suku* system is based on the matrilineal line, they believe that the money could only be received by *suku* members, and could be used for the benefit of their *suku*. Another reason why men cannot receive credit is because the typical Minangkabau man is a wanderer, who usually goes to other areas to earn income (*merantau*), sometimes never returning to his home village, and thus the money will be lost. Also, a man from Minangkabau

frequently has more than one wife. If he receives a loan, it may go to his other wives, who come from a different *suku*.

In Saniangbaka, people seemed happy to become 'friendly moneylenders', lending money to the needy without interest, and they granted the money if the borrower could not repay due to their chronic poverty situation. The basic principle of this activity is to help the poor, and these principles coincide with their religious value of Islam. Therefore, while many well-off people in Saniangbaka were interested in becoming friendly moneylenders, especially the *perantau*, the poor enjoyed receiving credit from these people, and preferred to use this kind of informal finance rather than formal finance.

In Tikalak village, small farmers were enthusiastic to do *Lambaihari* and *Kongsi Kas*. Similar to *Arisan Suku* in Dilam, these activities were also done in a *suku* group. Thus their credit and saving activities were done for the sake of their *suku*. Despite only a small amount loan being achieved, the farmers gained many advantages. They preferred to do this activity because they believe that they can share information, exchange ideas with other *suku* members during works, and they can help each other as well.

The significant role of culture and values in shaping rural credit systems in the three case study villages is evidenced. People engaged actively in savings and credit activities with enjoyment and spirit. They also followed all regulations that have been set up in each scheme, and they even aspired to make their informal credit and savings schemes better in future.

### **Alternative Dimensions of Rural Financial Development in Indonesia**

These explanations suggest that there is an alternative dimension to rural financial development in Indonesia. This dimension covers several aspects: first, the benefits of bottom-up approach of rural financial development to ensure the voices of disadvantaged people are being listened to; second, the influence of cultural values on rural financial development, including the promotion of Islamic finance in Indonesia; and finally, the importance of kinship and social networks, which leads to the

establishment of social capital in the community, which is important for rural financial development. These three aspects will be discussed further in the following sections.

### ***Enhancing bottom-up rural financial development***

Whilst rural financial development in Indonesia is still dominated by the centralised and top-down approach, there is an urgency nowadays to develop a bottom-up or client-centred rural credit programme, considering that the majority of formal or government designed rural credit programmes have failed to give services to the rural poor (Cohen, 2002: 335).

The bottom-up approach of rural financial development takes into account the need to have greater in-depth understanding of clients. To achieve this, it is necessary to have knowledge of who the clients are, and how the clients use financial services. Also, it is important to know what rural financial products match with the needs of the poor, what institutions are required to deliver the products, and what environment would be conducive to running the rural financial services (Cohen, 2002:336). With regard to rural credit programmes aimed at poverty alleviation, the clients should be those who have income levels below the poverty line. This includes the poor who are destitute, extremely poor, and moderately poor (Meyer & Nagarajan, 1999: 277).

The bottom-up approach of rural financial development also endeavours to have information on how the clients use financial services. The three case studies reflect the strategy of the rural poor in using financial services. Based on direct observations and other qualitative techniques in this study, information was gained particularly on how clients use credit. The majority of participants use financial services to fulfil their daily consumption needs, and to solve an emergency situation, while some of them use this fund for secondary needs such as for ceremonies (marriage, birth, death), children's education or house building (In-depth interview, 13 January 2004; Focus Group Discussion, 15 January 2004). The three case studies also show how the rural poor manage risks. In Dilam village for example, rural women tend to use small amounts of money in *julo-julo*, while in Tikalak village, farmers preferred to use energy rather than

money in the *Lambaihari* scheme. These mainly aimed for using money as little as possible, as one strategy to use money efficiently and also to manage risks.

Regarding the appropriateness of the products to the needs of the clients, the rural poor tend to choose specific rural credit systems based on their resources and capacity. The repayment process, and amounts to be contributed were also tailored based on the capacity and culture of the clients, while the size of loans and flow of repayments were matched with the repayment capacity of the customers. The three case studies clearly demonstrate that rural people choose informal credit and savings schemes suited to them (such as *julo-julo*, *simpan pinjam*, friendly moneylenders, and *lambaihari*), and reject formal credit systems, which are inappropriate to them. The *simpan pinjam* scheme of *Arisan Suku* for example, has specific regulations which are adapted to their Minangkabau culture, such as giving sanction through the *Kepala Suku* (Clan Chief), who gives warning to ill-disciplined borrowers. The amount of *Simpanan Wajib* (compulsory savings), and *Simpanan Pokok* (basic savings) are set up based on the capacity of the members. Also sanctions are designed based on agreement reached from the members' meeting.

Concerning the financial institutions, the favourable environment of a bottom-up rural financial system gives the opportunity for the clients to be heard or the clients to participate in institutional decision-making. If the voices of the clients are to be heard, and then further utilised to influence the functions of rural financial institutions, this can significantly improve the effectiveness of the services. In the *Arisan Suku* of Dilam village, there is a monthly meeting, when the participants have opportunity to convey their opinions and aspirations, and also to discuss current issues in their village (*Nagari*), then find the solutions as well.

Learning from the clients is important in order to adopt the system for tracking the personal records of the clients, and this is important in designing new rural credit institutions. The behaviour of clients in many informal rural credit schemes in the three case study villages could become examples. In Saniangbaka village, farmers tend to use friendly moneylenders to solve their credit needs, since this kind of informal credit scheme is cheap or interest-free. In Dilam village, rural women tend to conduct *julo-julo padi* (paddy julo-julo) every harvesting time, because it is easier for them to repay after

harvesting. They also preferred to conduct *julo-julo beras* (rice *julo-julo*) every week, because as a staple food, rice is always available in every household, and the short-term cycle of this *julo-julo* could help them to manage daily rice consumption.

This explanation on bottom-up or client-centred rural finance in the three case study villages reflects the availability of new strategy for rural financial development in Indonesia. There is optimism that the government could use this strategy to develop appropriate rural finance systems in Indonesia for many reasons. First, the failure of several top-down formal rural credit programmes in the past gives enough reason for the government to seek the possibility of applying the bottom-up or participatory approach in rural financial development. The government could learn from the previous unsuccessful experiences, such as the top-down BIMAS credit system which caused high default and high loan delinquency. This in turn effected the termination of this programmes in 1983 (Martokoesoemo, 1994b; Meyer & Nagarajan, 1999). The centralised KUT credit programme suffered from credit delinquencies due to mismanagement at the central and local government levels (Arihadi, 2003: 165). Then, the government could examine the advantages of participatory rural credit programmes. Many NGOs in Indonesia, such as Bina Swadaya, CARE and Mercy Corps, have successfully implemented participatory rural credit programmes, and this also could be used as a consideration in order to develop appropriate rural credit systems in Indonesia (Nasution, 2003: 107).

Secondly, in the recent era of decentralisation, the bottom-up or participatory approach in development is very popular, and thus it is easy to implement participatory rural finance. Despite the decentralisation process not being fully implemented in many places in Indonesia, the spirit of decentralisation has reverberated in the country. Furthermore, the government has updated its micro financial development policy and has focused on strengthening small and medium credit institutions.

### ***Cultural influences on rural credit systems: Considerations of cultural and Islamic rural finance systems***

The previous three case studies chapters give a picture of the important influences of local culture on rural credit systems in the study area. The Minangkabau culture of West



Sumatra has a specific characteristic of matrilineal systems, in which the family descent is based on the mother line. This matrilineal system has a significant role in shaping up rural credit systems in the study area, such as *Arisan Suku* and *Julo-julo* in Dilam, *Simpan Pinjam Suku* in Saniangbaka, and *Lambaihari* in Tikalak. All of these rural credit schemes have successfully attracted rural people to participate and therefore have been implemented smoothly.

The cultural influences on rural credit systems in the three study villages may not be suitable to be implemented in other areas in Indonesia, considering the diversity of Indonesia's cultures. However, this specific rural credit system in West Sumatra could enhance the decentralisation of rural financial development. As Indonesia is now entering the era of decentralisation, the decentralisation of rural financial development is important in order to make it localised rather than nationalised, which would therefore cause it to adopt the values and cultures in each local area.

Other than matrilineal family systems, Minangkabau culture is also characterised by its strong Islamic religious culture. The principles of Minangkabau culture is "*Adat Basandi Syarak, Syarak Basandi Kitabullah*", meaning that the culture is based on Islamic religion (*Syarak*), and the Islamic religion is based on the Holy Qur'an (Ariff, 1988: 3). This Islamic faith has also influenced informal rural credit systems in the study area, especially in Saniangbaka village. In this village, there was a specific kind of moneylenders, named as friendly moneylenders, who charge no interest to the borrowers, and sometimes they did not expect repayment because the borrowers were very poor and unable to repay (In depth Interview, 6 & 13 February 2004).

The Islamic religious influences on rural credit systems coincide with the principles of Islamic finance. The interest-free system of friendly moneylenders in Saniangbaka is similar to profit-sharing principles of Islamic finance. As has been stated in Chapter 2, the rationale behind the banning of taking interest in Islamic finance systems is that the interest is a pre-determined cost of production (Khan, 1986; Mannan, 1970), which is unearned income, and therefore is unfair. It is also exploitative and tends to prevent full employment (Republika, 2005b). The profit-sharing principle is viable in Islam because the owner of capital can legitimately share the profits made by the entrepreneur, and it is not the rate of return itself that is predetermined.

The successful implementation of friendly moneylenders in Saniangbaka gives a view that this kind of rural credit scheme could be used as a strategy for the Indonesian government to develop locally specific rural financial systems. There are many options that could be selected by the government in order to increase the accessibility of rural poor to rural credit programmes. First, the government could imitate the credit delivery system that is currently adopted by the friendly moneylenders in Saniangbaka by giving soft loans to these friendly moneylenders. These loans then are credited to the poor without interest. Secondly, considering that moneylenders are common in Indonesia, and they are available in any ethnic group, the government could give a training programme for these moneylenders about Islamic finance, thereby enabling them to practise as friendly moneylenders. The latter option seems appropriate for the Indonesian government, as nowadays there is growing attention given by the national and global financial institutions to Islamic finance systems.

Cultural values' influence on rural credit systems could be smoothly implemented in Indonesia because Indonesia is a diverse country consisting of many ethnic groups. Each ethnic group has specific norms or characteristics, and may have specific rural informal credit systems. These rural credit systems are difficult to detect due to their invisibility, and also the lack of research in this area. Introduction of culturally influenced rural credit systems could be easier because a similar credit system has been available and adopted by local people.

In addition, human beings are usually interested in joining together to perform activities based on their cultural roots, and to compete with other groups. This argument is in line with the attitude of *suku* members in Dilam, where these people aspire their *Arisan Suku* credit scheme is better than others' *suku* credit scheme (In-depth Interview, 18 January 2004). They also enjoyed gathering together, allowing them to discuss current issues, exchange information, or make friends.

Regarding religious influences on the rural credit system, there is a good prospect of establishing this kind of rural credit systems in Indonesia. There are many reasons for this. First, Indonesia has the largest Moslem population in the world, and an Islamic rural credit system would be easily adopted. Second, it is a common thrust in Indonesia

that rural people usually hold the values and practice of Islamic faith better than urban people. The previous three case studies supported this argument, in which, based on my direct observation, people in the three villages practised their religion properly. People were more honest and sincere in helping each other, and diligently performing religious Islamic ceremonies such as five times a day praying and Friday prayers. Thirdly, as has been stated previously, there is now growing attention being given to the Islamic finance system in Indonesia. Many state or private banks have established their *Syari'ah* banking divisions, or even transformed totally into an Islamic Banking system. People found that the practice of *Syari'ah* banking system favoured honesty and fairness, while the conventional banking system has been blamed as the cause of the monetary crisis in Indonesia (Republika, 19 April 2005).

### ***Kinship and social networks: New insights on social capital in rural finance***

Another feature of the state of rural financial systems in the three case study villages is the characteristic of strong kinship ties and social cohesion. This observable fact is according to *gotong-royong* systems, which have been very popular in Indonesia's traditional culture since a long time ago.

Many informal rural credit systems in the study area such as *Julo-julo*, *Arisan Suku*, *Simpan Pinjam Suku*, friendly moneylenders and *Lambaihari* have strong characteristics of kinship and social cohesion, which are the important elements of social capital (Narayan & Pritchett, 1999; Okten & Osili, 2004; Wydick, 1999). In *julo-julo*, women contribute money or in-kind in this ROSCA system, and give priority to the members who are in mourning due to the death of family members or in high debt, to receive the lottery. In the friendly moneylender scheme, the *perantau* prioritised their poor relatives to receive the credit, and then other poor people in the *Nagari*. The rich people in this *Nagari* work hand-in-hand to help the poor, and people always pay attention to their poor family members and relatives. Despite staying away from their home village, the *perantau* in Saniangbaka always watch out for their *Nagari*, monitoring the administration of *Nagari* government, and observing the villagers' situation, including poverty, education, employment, and security. This reflects that the spirit of kinship and

social cohesion are significantly felt in Saniangbaka, and it seems that this has been available for a long time.

In the case of *Arisan Suku*, *Simpan Pinjam Suku* and *Lambaihari*, the kinship character was dominant. In these informal rural credit schemes, people tended to help each other within a *suku*. In Dilam's *Arisan Suku*, for example, loans are available only for the clan's members, especially women, while in *Simpan Pinjam Suku* of Saniangbaka, loans were also available for the clan's members, but are prioritised for members who have emergency situations, such as death of family members, high debt, or loss of employment or harvests. Similarly, in *Lambaihari* of Tikalak village, the focus was also the clan's members, and priority is given to the unfortunate members. Considering that the members of these informal rural credit schemes are bonded by their clan, the method of giving sanction is based on the culture of embarrassment, in which if one borrower has a credit default, this person will be warned by the *Datuk* (*Suku* chief), and this is enough for her/him to feel shame among their clan group. Regarding friendly moneylenders, the method of giving sanctions also follows the culture of embarrassment, but since the clients are usually the very poor, the lenders usually do not insist on repayment if the borrowers do not repay. Instead, the lenders make it as *sedekah* or *zakat*, which is part of their Islamic responsibility to help the poor.

This explanation suggests that kinship and social networks could become ingredients for successful implementation of rural credit programmes in Indonesia. Many authors have also acknowledged the importance of social capital in microfinance (Okten & Osili, 2004: 1225), and the most recent research, which was conducted in Indonesia stated that community and family networks play an important role to improve credit access (Republika, 2005a). In Indonesia, social capital has been available for generations, as the spirit of *gotong royong*, as has been mentioned above, which is a part of Indonesia's culture. Indonesian people hold the traditional values of helping and respect for each other as stated at the state principle of *Panca Sila*. However, some of these norms have been eroded due to modernisation, especially in urban areas. People tend to live individually and become self-centred, and rely on culture or material from overseas rather than choosing the local (Republika, 19 April 2005a). Relying on domestic culture and products would provide many advantages for the country, such as independence economically, politically and culturally, and also encourage the development of

domestic industries. Therefore, the traditional values of fairness, honesty and harmony should be maintained and sustained, since these are important for developing social capital, which is required for smoothing the process of development.

## Conclusion

Discussion about small farmers and rural credit in Indonesia in this chapter has shown many findings. One fundamental finding is about the relationship between poverty and credit. It is argued that given the poverty conditions of farmers in the study area, which is illustrated by several indicators, credit interventions are useful only for survival. Rural people use credit that they receive – mainly from informal credit programmes – only for fulfilling their basic needs, and are unable to increase their incomes. Therefore, there is an urgent need to design appropriate rural credit systems for them, which could increase their level of income, and therefore their quality of life. This kind of credit for development should be appropriately designed with the specific characteristics of small farmers' income, such as seasonality and dependence upon uncontrollable factors including pest outbreaks and natural disasters.

The specific characteristics of small farmers' economic conditions have shaped small farmers' behaviour towards rural credit systems. These behaviours, on one hand, could be pessimistic because these characteristics such as poor economic conditions, being isolated and underdeveloped have shaped the farmers' poor attitude towards formal credit systems, and have made them stay away from formal credit institutions. On the other hand, these conditions have optimistic aspects, which encourage small farmers to diversify their incomes in order to survive. Farmers tend to do off-farm activities such as crafting, petty trading, or labouring. Also, small farmers tend to create networks among their groups, either cultural groups (*suku*) neighbourhood groups, or farmers' groups, to exchange information, to help each other, and to make friends.

Another important point is related to the failure of formal credit systems to deliver rural credit programmes to rural people. This reflects many shortcomings embodied in Indonesia's formal rural financial sector. Although the success of Indonesia's rural credit system through its rural banking programme has been acknowledged nationally and globally, the situation at the grassroots level, however, is different. The rural

people, who are predominantly small farmers, are not sufficiently reached by formal credit programmes. Formal credit institutions tend to exclude small farmers because of their specific constraints regarding conditions of irregular income, and inability to provide physical collateral. Thus, there is now a critical time for the government to re-examine the current rural financial systems and re-create rural credit systems, which are accessible for all of the rural population.

Behind the failure of the formal sector, however, the informal rural credit systems are growing and being implemented successfully. The informal sector is not just more flexible in procedure, but it is also diverse, and is able to adopt local culture and values. The cultural and religious influence on rural credit systems is one phenomenon in this study that should be encouraged and developed, because it is strongly shaped by local matrilineal culture and Islamic faith. Rural people enjoy participating in this kind of informal credit system because the credit system follows their traditional culture and values. In this regard, small farmers are empowered, because they have their freedom to choose appropriate credit schemes appropriate to them, and have an opportunity to participate in developing their *suku* or *Nagari*. These aspects are important elements for designing a more participatory rural credit system, especially in the current era of decentralisation.

The success of informal rural credit programmes in this study has created the optimism about the development of the new dimension of the rural credit system in Indonesia. The bottom-up design of informal credit programmes gives a chance for the enhancement of participatory rural financial development. The capability to adopt local culture and values leads to the possibility of the establishment of cultural and values' influence on rural credit systems, and this agrees with the current growing attention toward the Islamic finance system both at national and global levels. Finally, the kinship and social networks were implied in the three case studies of this thesis. These are important for the development of social capital, and thus also for the future prospect of rural finance in Indonesia.

However, there are limitations of informal credit schemes identified in these case study villages. These include the limitation of capital and lack of administrative and management skills of human resources. These problems impacted on the incapability of

these credit schemes to increase people's income and thus the prosperity of rural people. These shortcomings can be minimised by integrating the positive features of the formal financial systems which have large capital and skilful human resources into the informal finance system or *vice versa*. This topic will be elaborated on further in the next chapter.

While this chapter deals with the context of the small farmers' credit system in Indonesia, the next chapter focuses on a general discussion of credit and poverty at the global level and other major issues that relate to the objectives of this study. A summary of findings will also be included.

## **CHAPTER TEN**

### **CONCLUSION**

#### **Introduction**

The purpose of this thesis is to explore the credit and savings behaviour of small farmers in rural areas in Indonesia. It particularly focuses on examining the relationship between credit and rural poverty and on identifying small farmers' credit and savings behaviour as well as problems they encounter in accessing credit programmes. In this study the extent of informal credit programmes in rural areas is also identified and an assessment is made of how important these schemes are to the rural people, especially small farmers, from economic, social and cultural point of views. In this case the influence of local culture and values on informal rural credit systems is also examined. Lastly, this study aims to recommend an appropriate rural credit system for small farmers in the era of decentralisation. In this chapter the findings that have been elaborated in the previous chapter are summarised, and there is a discussion on the major themes of this thesis at the global level. Recommendations for designing future rural financial development strategy are also provided.

In this study the triangulation method of data collection, which is a combination of quantitative and qualitative approaches, was employed. The qualitative approach, which is dominant in this study, consists of several participatory techniques while the quantitative method includes questionnaires and semi-structured interviews. The fieldwork was conducted in the three villages of Solok District, West Sumatra Province, Indonesia, with the researcher being immersed in the daily life of small farmers in rural areas. The study also involved interviews with government officials at the central, provincial and district levels.

#### **Summary of Findings and Lessons Learned**

At the beginning of this thesis the objective of this study was identified comprising a central research question and five specific research questions. The central research question was posed as: "How can microfinance fulfill the needs for development of the



rural poor, especially small farmers in Indonesia?” The specific research questions were:

- What are the small farmers’ perceptions and aspirations regarding rural credit, and what forms of credit are chosen by small farmers and why? Also, what types of intermediaries do the small farmers prefer?
- How do the rural poor perceive the current formal credit programmes, and how do these schemes affect the poverty level in rural areas?
- How do local culture and values influence the credit and savings behaviour of poor farmers in rural areas?
- What is the availability of informal credit programmes, and how important are these schemes in terms of economic, social and cultural aspects?
- How can an appropriate and more responsive rural financial development strategy be achieved in order to increase the quality of life of poor people, especially small farmers in rural areas?

The findings are as follows:

This study was conducted in three villages of Solok District, where rural people have been practicing credit and savings activities in their Minangkabau culture for a long time. Thus, rural people in the study area have been familiar with credit and saving activities, and therefore have positive perception regarding rural credit.

However, based on the analysis and explanations from the preceding chapters, it is clear that the current formal credit programmes are not really favoured by the majority of rural people, especially the poor. This was due to many reasons. First, the rural poor have perceived that access to formal credit programme is a luxury and costly activity, since the transaction costs are high, and they were required to provide physical collateral. Second, they think that the formal credit institutions are hesitant to provide credit for the poor, especially small farmers, because of the specific character of the small farmers’ income such as its irregular nature and its high dependence on uncontrollable factors such as climatic conditions and natural disasters. Consequently, the majority of small farmers in the study area did not have access to the formal credit

programmes, and therefore these programmes have not had positive impacts on poverty alleviation in the area.

On the other hand, the informal credit schemes were more favoured by the majority of people in the study villages because they adapted to the local culture and values held by the local people. The local culture of Minangkabau and the Islamic religion specifically influenced the credit and savings activities of informal credit schemes in these three case study villages. The *Arisan Suku* credit scheme for example, which consists of *Julo-julo* and *Simpan Pinjam*, are highly influenced by the matriarchal system of Minangkabau culture, while the 'friendly moneylender' system is influenced by the Islamic finance system of zero interest and profit-sharing.

The availability of informal credit schemes in the study area has had positive impacts on the poor people in the study area, in terms of economic, social and cultural aspects. Economically, although these schemes can not solve the poverty problems in the area, they were being able to fulfill the basic and emergency needs of the rural poor. These informal credit and savings schemes also have the potential to alleviate poverty and to increase people's income in the future because the system is already available and only needs small intervention from outside to make the schemes become more effective. Socially, the informal credit schemes have been able to empower local people through creating their local specific rural credit systems and also to encourage them to help each other which have resulted in social cohesion and an increase in social capital. Culturally, the informal rural credit schemes which are significantly influenced by local culture of Minangkabau and the value of Islamic religion, in turn strengthen these local cultural elements.

Considering these positive aspects of informal rural credit schemes, and the important role of formal rural credit programmes in Indonesia's rural financial development, it is recommended that the positive features of both formal and informal rural credit systems could be combined in order to achieve an appropriate and more responsive future rural financial development strategy for small farmers in Indonesia.

In the sections that follow, these main findings will be elaborated as well as the relationship between microfinance and poverty alleviation.

### ***Microfinance and poverty alleviation in Indonesia***

The three case studies in the villages resulted in several findings on the state of poverty and rural credit systems at the grassroots level. This study confirms that poverty still exists in the three case study villages. As the majority of rural people are engaged in the agricultural sector, the poor in these villages are mainly farmers.

While the determinants of poverty are unemployment and low productivity (Meyer & Nagarajan, 1999; Robinson, 2001; Yaron et al., 1997), the low productivity of small farmers is the main cause of poverty in these study villages. This was characterised by small harvests and lack of income diversification. These have economically impacted the low level of income of the majority of the population and poor social conditions (see Tables 6.2, 6.3, 7.1, 7.2, 8.1, and 8.2).

Many factors contribute to low productivity. Unfavourable natural resource conditions, such as small plot size of farmer-owned land and a lack of water in hilly areas are two factors which limit the farmers' ability to increase their farm productivity. Another factor is farmers' low educational level that affects their low adoption rate of new farming technology. There is also a lack of information or promotion of new farming technology to the rural people.

Low productivity has caused a lack of savings and capital amongst small farmers. This causes difficulty for the poor in the three case study villages if they wish to expand their farming activities. In fact, capital is needed to increase harvests or to diversify their sources of income. For example, they need to purchase high quality fertilisers in order to increase their harvests, and to buy high quality seeds of vegetables or fruits or other cash crops to diversify their income. Alternatively, they need to have capital to start petty trading or other off-farm activities. Also they have to ensure proper soil tillage in order to achieve a good quality fertile soil, and thus need to hire labour or farm machinery to do that, requiring capital to fulfil these tasks.

Providing credit is one way to help the poor to increase their productivity, and thus to alleviate poverty (Khandker 1998, Zeller et al.1997). However, rural credit programmes

in these three villages have not had positive impacts on poverty alleviation. Many reasons contributed to this lack of success. The hesitancy of the formal sector to provide credit for the poor, especially small farmers is one reason. This study found that there was a bias of formal credit providers against small farmers. This was due in part to the irregular nature of their income. Farmers' income is highly constrained by uncontrollable factors such as unfavourable climatic conditions and pest outbreaks, and the formal credit institutions would suffer loss if the farmers could not repay on time. Also, formal credit providers were hesitant to give services to the poor in remote areas since the transaction costs would be high, while the amount of credit is small. The inability of rural poor to provide physical collateral completed the hesitancy of formal financial providers to give credit to these poor people.

These conditions influence the small farmers' behaviour with regard to credit and savings. There was lack of relationship between farmers and formal credit providers in the three villages. As stated in the previous chapter, small farmers viewed a relationship with formal banking institutions as a luxury and a costly activity. This notion at least was caused by two factors. First, there is a lack of information or extension services on banking and credit systems given to the rural people. Therefore rural people's knowledge about this sector is very limited, and causes their unwillingness to have contact with banking institutions. Second, previous bad experiences of the failure of formal rural credit programmes such as KUT and BIMAS, have caused the pessimism of rural people about engaging in formal rural credit programmes. As a result, rural people prefer to become involved in informal rural credit programmes, which are close and appropriate to them.

Despite being favoured by the majority of local people, however, the informal rural credit programmes available in the three villages remained small in size and did not seem able to provide a path to alleviate poverty. All informal rural credit schemes in the study area aimed only at solving pressing survival needs and emergency problems. The limited role of informal rural credit programmes in alleviating poverty corresponds with the incapability of these schemes to generate income. It was found that the informal rural credit schemes in the three case study villages still operate to provide subsistence in a traditional way, and thus do not significantly augment the incomes of rural people. The informal rural credit programmes also have not been able to make their members

become self-employed, due to lack of training or extension services to guide them to become small entrepreneurs, and also because of limited available capital. It is also not apparent that borrowers graduate from using informal mechanisms to seeking credit from formal institutions.

Local government has not been effective in encouraging an environment conducive for rural financial development. Lack of local government capacity is a direct result of the early stages of decentralisation. Local government is still in the learning process, while the central government is not fully confident to delegate part of its responsibility to the local government. Thus, local government is not yet ready with its resources, whether human or capital. Therefore, in implementing local government's rural credit programmes, there were many problems encountered such as lack of capable and professional human resources, lack of facilities and infrastructure, and also lack of capital.

These problems indicate that there is still a long way to go to achieve the goal of poverty alleviation through rural credit programmes in Indonesia, especially in the study area. Although many authors have acknowledged the success of many formal rural credit programmes in Indonesia (Narayan & Pritchett, 1999: 872), there are still problems encountered at the grassroots level.

### ***The benefits of informal rural credit programmes***

Based on the assessment of small farmers' credit and savings behaviour in the three case study villages, it is found that informal rural credit programmes are preferred over these formal credit programmes. Notwithstanding the small size of informal rural credit programmes as stated above, this study found several interesting points, which relate to the positive roles of informal rural credit programmes in empowering local people, and encouraging participatory rural financial systems.

It was found that the majority of informal rural credit programmes in the three study villages adopted a bottom-up approach to rural finance. Each of the informal rural credit programmes had its own strategy to allow the members' voices to be heard. In Dilam's

*Arisan Suku* for example, there was a monthly meeting where the members discussed the current issues to solve problems and improve their *Suku*. There was also time allocated for discussion regarding how to improve their informal credit schemes. In the *Simpan Pinjam Suku* in Saniangbaka, the *suku* members had regular meetings in their *rumah adat* (clan's house), to discuss their *suku* and their credit systems: *julo-julo*, *simpan pinjam*, or friendly moneylenders. Similarly, in Tikalak village, the members of the *Lambaihari* or *Kongsi Kas* credit system have specific ways to meet and discuss their rural credit system.

The empowerment feature of these informal rural credit systems can be seen by the capability of rural people to create their specific credit system appropriate to them, and to make regulations and sanctions, so that the processes of credit and savings were done smoothly. Their respectfulness toward their *suku* leaders, their compliance to follow norms and customs in their *suku*, and their spirit of competition to make their *suku* better than others contribute to the smooth implementation of these informal rural credit programmes. While the role of local government was still minimal, including almost no guidance or intervention, these schemes proceed successfully.

### ***The relationship between culture and credit***

The relationship between culture and credit has emerged as a major theme in this study and this can be categorized into three levels, namely the role of Minangkabau culture at the local level, the Indonesian culture at national level, and the concept of Islamic banking systems at the global level

The important role of Minangkabau culture in rural financial development at the local level can be seen particularly through the development of locally specific and participatory rural credit systems. As reflected in the three case study chapters, informal rural credit schemes become strong because they were created by and were aligned to the culture and traditions held by the local people. The members of such scheme are familiar with their culture, and therefore it is easier for them to follow the regulations of each informal credit scheme. In this case, the traditional informal rural credit systems were an outgrowth of local cultures and communal practices. Many traditional rural

credit schemes examined in this study based on *suku* membership follow the matrilineal system of Minangkabau culture, and this helped encourage and strengthen the participation of women in credit schemes. In the current era of decentralisation, it is important that locally specific initiatives are encouraged and promoted. The positive development of locally specific credit systems means that local government should face fewer problems in developing decentralised rural finance systems in their area.

At the national level, the Indonesian culture of *gotong-royong* also influenced the development of informal rural credit systems. *Gotong royong* means “solidarity or mutual aid” (Kamus-online, 2006: 1). The concept of *gotong-royong* itself is available in the concept of “*Panca Sila*”, which is the basic principle and way of life of Indonesian people. Considering the important role of culture on rural credit system which affects to the creation of social cohesion in this study, was also influenced by the spirit of *gotong royong* of Indonesian people. The activity of working together in *Lambaihari* scheme for example is rooted from the spirit of *gotong-royong*.

At the global level, the important role of culture on credit system is linked to the development of Islamic Banking system. The zero interest and profit-sharing systems in banking is now being used not only by Islamic countries but also by other developed countries in the world. This system is rooted by the culture of Islam which avoids manipulation and *riba* (usury) and promotes sharing of profit (Mills & Presley, 1999: 9). The successful implementation of informal rural credit schemes in this study which follow Islamic principles also opens possibilities for linking Islamic banking at both local and national levels. For example, national and international Islamic banking institutions could provide capital or training assistance to establish and expand local informal credit programmes.

The cultural influences on rural credit systems could become a new phenomenon to be developed by government or non-government organisations in order to make rural credit programmes more effective. Interventions could be made by strengthening local capacity such as human or capital resources, or by replicating the principles to be adopted and implemented in other areas. As one area has its own local specific culture and values, the procedure and regulations might be different among areas, and the replicating process should follow the norms and values available in the respective area,

but the basic principles of a participatory approach could be the same in any region, resulting in maximising the use of local culture in developing rural financial systems. The expansion of cultural influences on rural credit system could enrich the current rural financial development approach available either at global or national levels.

One specific finding in this study is that the credit savings behaviour of rural people in Indonesia is influenced by the religious values of Islam. This dimension agrees with the present popularity of Islamic finance systems either at national or global levels. Developing Islamic values within rural credit systems would not only receive positive responses at the local level, but also at the national and international levels. This dimension should be welcomed in regions where Islam is dominant such as West Sumatra. The positive response from national and international institutions could be beneficial also to provide capital or training assistance to establish and expand rural credit programmes.

Another characteristic of the credit and savings behaviour of small farmers in the study area is its capacity to maintain social capital. Social capital is “referring specifically to social networks and to horizontal/voluntary/local association” (Harris 2001:113), and “the greater social capital potentially leads to better outcomes by facilitating greater cooperation” (Narayan & Pritchett, 1999: 872). This study found that social networks, such as kinship and group cohesion, characterised each of the informal rural credit programmes, and the cooperative features of these social networks have produced positive outcomes for the credit programmes. For example, the *perantau* in Saniangbaka village cooperated in helping their poor relatives by providing cheap loans, while the social norms of *malu* (embarrassing) has been effective to make the *suku* members in *Arisan Suku* of Dilam village repay credit on time.

The importance of maintaining social capital to support a participatory rural finance system is clear in this study by considering that the kinship and group associations heavily contribute to the successful implementation of informal rural credit programmes. This was enhanced by the spirit of *gotong-royong*.



## ***Searching for a more participatory rural financial systems for poverty alleviation***

The main challenge faced by rural credit systems in order to reduce the poverty level nowadays is how rural credit programmes can reach the poor and be sustained over time. This study has confirmed that there is still a long way to go to achieve the goal of poverty alleviation through rural credit programmes in Indonesia. This study found that the formal sector has failed to deliver credit programmes for the rural poor, especially small farmers, meaning that the outreach of formal rural credit programmes is problematic. This also reflects the inappropriateness of the approaches employed by the formal sector to deliver credit for the poor, and therefore they need to be reconsidered.

The problem of limited outreach of rural financial programmes should be sought through defining the problems at the grassroots level. Thus, to understand the living conditions and environments of the poor as the clients is important in order to make rural credit programmes appropriate to their specific needs and conditions. These include economic, social, and political conditions as well as the values, culture, and norms held by the poor.

The argument of this thesis is that there is an urgent need to rethink the current approach of formal rural credit programmes in order to be effective to alleviate poverty. The current approach of formal rural finance is still characterised by the top-down and product-centred model, in which the design of rural credit programmes is still done by the planners or policymakers at the institutional level without participation by the target population, and focuses on promoting products rather than clients. On the other hand, the participatory approach ensures that the voice of the poor will be heard, while their culture, values and norms are respected.

The importance of employing participatory approaches in rural financial development is not only advantageous for the smooth implementation of rural credit programmes, but also would have positive impacts on the empowerment of local communities, which result in the increase in people's self-esteem, independence, and confidence. This would

allow for the growth of self-help organisations at the village level, and thus promote rural development.

## **Major Themes**

Considering these findings of the study, there are several major themes that need to be discussed. These major themes are more applicable at the general or global level rather than at country level.

### ***The relationship between credit and poverty***

The importance of credit for the alleviation of poverty is clear and has been acknowledged and understood by academics, donors and development practitioners. The common thrust is that credit has been used to increase productivity and thus also to increase income (Hulme & Mosley, 1996: 8). In order to effectively raise the incomes of the poor, credit programmes should be well designed and should be implemented in areas with relatively high population densities, and access to active markets. Credit is also used for investment in creating jobs for the poor, to create the linkages to their income-generating activities especially in the informal sector, or as direct lending to support micro-enterprises owned by the poor, allowing them to improve their productivity and therefore incomes.

The more recent view on the relationship between credit and poverty is that credit and financial services have been used to help the poor in order to cover a variety of needs such as business, consumption, personal, social, and asset building (Mosley & Hulme, 1998: 115). In this case, effective financial services for the poor should be able to cater for short, medium, and long-term needs, and must be delivered in convenient, appropriate, safe, and affordable ways, which could help the poor to deal with their vulnerability, and improve their incomes and quality of life.

However, at the grassroots level, such as in the three villages of this study, credit is used mainly for survival. Very poor people, whose incomes are below the poverty line, use credit only for fulfilling their basic needs, to survive from one harvest to the next, and to

satisfy their emergency needs. Appropriate types of credit for this type of poor people usually involve a consumption credit scheme, in which funds are seldom invested in new technology or fixed capital, and are usually used for working capital or, in the majority of cases, to smooth consumption and reducing vulnerability. This phenomenon is especially true with informal finance, in which the transaction is relatively small and is commonly used to fulfil consumption and working capital needs.

Credit for survival from informal finance in many cases is also used as savings and insurance. This is especially adapted to the ROSCAs' credit system which has a savings and credit element. The participants save their money while waiting for their next turn to receive funds from the pool. It also plays an insurance role against uncertainty, especially for event uncertainty, such as flood and drought, or pests' outbreak.

The credit needs of the very poor are still under debate. Many authors argue that people whose income is below the poverty line may not be economically active (Goronja, 2005). These people do not need credit programmes, and delivering credit to these people will not make any sense and even make them worse-off (Robinson, 2001: 21). Instead, they need to receive a specific programme in order to allow them to escape from poverty, such as subsidised poverty alleviation instruments. They are excluded from the commercial microfinance programmes since they are not 'economically active poor' and are unable to engage in any economic activity. However, many authors challenge this opinion, and state that the very poor are also bankable and there is also possibility to offer them financial services. The partial success of the Grameen Bank in Bangladesh in delivering credit to very poor people is one example. In this case, microfinance programmes should be more focused on the poor as the clients rather than the products, and the clients should become the centre of any decision making.

This explanation suggests that there is a gap in the literature regarding what type of credit is really needed by the very poor people. As evidenced in this study, the very poor engage in informal rural credit programmes, but they remain in a poor condition. People's primary aim is to use credit only for fulfilling their basic and emergency needs, while the rural credit programmes have not yet taken them out from the poverty condition. Thus, the use of credit for survival reflects the reality of what is really needed by the very poor at the grassroots level.

This argument challenges the microfinance literature, especially related to the main role of microfinance programmes to alleviate poverty. Extensive research has been conducted around the world, and most was conducted to examine the impacts of microfinance programmes at the institutional levels (Cohen & Sebstad 2002 cited in Woller, 2002a: 306). The evidence demonstrates a positive impact of existing microfinance programmes on poverty alleviation, especially on raising enterprise and household incomes and asset accumulation, household consumption, on enhancing women's empowerment, and also helping the poor to manage risks (Woller, 2002a, 2002b). However, looking at the grassroots level, many microfinance programmes have not reached the very poor (Boume & Graham, 1984: 37), and often, as indicated in this study, the programmes are inappropriate to the real needs and aspirations of the very poor.

### ***The inability of conventional microfinance programmes to meet the needs of the poor***

The attempts of conventional microfinance programmes to focus on the promotion of products rather than the need of clients reflects that the strategy still follows the top-down approach of microfinancial development. This strategy was criticised by many authors and development practitioners decades ago, when subsidised agricultural credit programmes failed to meet the need of poor farmers in developing countries (Adams & Fitchett, 1992: 3), and cheap credit has resulted in the increase in arrears, thus causing the collapse of rural credit institutions. At this time, rural credit programmes were frequently biased towards the small farmers, and were used as political tools to implement government's development programmes. Governments preferred to give loans to the large farmers because they have larger areas of land, and therefore represent appropriate means for increasing the quantity of crop production. The BIMAS credit programme in Indonesia collapsed in 1984 due to high arrears. This programme was a tool for the government to boost agricultural outputs, especially rice, through rice intensification programmes, but the programme failed because there was a mismatch between the needs of small farmers at the field level and the government's policy at the central level (Vogel, 1984a: 138).

In recent times, as stated above, the product-centred commercial microfinance programmes did not reach very far down the poverty spectrum (Woller, 2002a: 306). Instead, the clients of microfinance programmes are clustered around the poverty line, being predominately 'moderately poor' or 'vulnerable non-poor', whose household income was above the poverty line but vulnerable to slipping back into poverty. Commercial microfinance institutions usually prioritise cost recovery and rely on high interest rates in order to gain profit.

In this study, the very poor failed to receive services from the microfinance institutions, since these formal microfinance providers focus on middle-level income farmers, or small traders, who could provide physical collateral and have regular income. These microfinance institutions have business-oriented company systems, and therefore will not take the risks of late repayment or arrears from the borrowers. Therefore, they selected the customers who have regular income or have a certain amount of capital as guarantee. Credit programmes from these microfinance institutions therefore were more focused on raising the income of the microentrepreneurs rather than on fulfilling the daily consumption needs of the very poor people.

The exclusion of the very poor from the commercial microfinance programmes reflects the failure of the microfinance revolution to combat poverty. This has created a dichotomy between 'financial systems' and 'poverty lending' approaches to microfinance service delivery, in which the former is based on the sustainability of microfinance institutions, and the latter on subsidised institutions providing credit for the very poor (Conroy, 2003: 58). In Indonesia, the majority of formal rural financial institutions, such as the BRI *Unit Desa*, employ the former approach since they are a government-owned company and have a business orientation and thus are intended to be sustainable, while the latter is exemplified by the Grameen Bank credit systems in Bangladesh.

The failure of formal rural credit programmes to deliver credit to the very poor people in this study confirmed that there is a problem of targeting rural credit programmes for the very poor. The current formal credit programmes are aimed at increasing the income and quality of life of the poor, or in other words, credit programmes are used for

development, but the real need of the very poor at the village level is credit for survival. In this case credit for smoothing consumption, and for fulfilling emergency needs usually comes from informal lenders. Low-level informal finance usually attaches to the culture and values available in the respective areas, and often influences them. The role of culture in informal credit systems to meet the need of the poor is discussed in the next section.

### ***The role of culture in informal finance to meet the needs of the poor***

The importance of local culture in microfinance programmes has not been sufficiently discussed in the literature. Available discussions on culture in the financial sector are mainly related to its function as a means to achieve vision in an organization, and view culture in organisations as a means to cope with external and internal problems. Also, microcredit is used as an incentive for cultural conservation.

The important role of culture in informal credit programmes is one of the main themes in this study. This study confirms that the practice of informal lending at the grassroots level has been successful, due to its synergy with local cultures and values. Low-level informal credit programmes work very well because the participants understand them and they are closely linked to their local culture and their religion. In this case, the matrilineal culture of Minangkabau and Islamic finance has strongly influenced the implementation of informal credit programmes in the study area. Furthermore, the creation of informal rural credit programmes based on clan (*suku*) has developed strong kinship and social cohesion among the participants.

This view, however, contrasts with the traditional view of informal finance found in the literature. Informal finance has considered as being small, insignificant, and invisible (Adams, 1992; Donald, 1976). Furthermore, the informal finance providers, especially the moneylenders, have been viewed as usurious since they charge high interest rates to the borrowers, and frequently with only short lending periods (Schreider & Cuevas, 1992; Shipton, 1992).

Nevertheless, the ability of informal finance to easily adapt to local social, economic and cultural conditions has been identified as a tool for successful credit programmes for the poor (Holcombe, 1995: 82). This agrees with the bottom-up or participatory rural financial development strategy, which favours and respects local cultures and values. The Grameen Bank credit system, which is one of the most successful rural credit programmes in developing countries, applies this strategy. It is highly influenced by the character of Bangladesh cultures of hierarchy and fatalism. The success of understanding their culture and values influenced the design of the Bank's system by recognising the needs and aspirations of the poor who are affected by their traditional culture. For example the hierarchy culture in Bangladesh has created the perception of women as inferior, and this severely restricted women to participate in activities outside the household, including banking activities (Jain & Moore, 2003: 4). Delivering credit to the doorsteps of the borrowers is one of outstanding features of the Grameen Bank to help the rural poor women to access the credit. Then, the positive character of rural people, who have strong kinship and social cohesion, has been used by the Bank's staff to promote social collateral, in which the repayment of credit was guaranteed by social punishment or peer pressure.

However, there are many criticisms that have been addressed to the Grameen Bank, especially related to the replication of its model to other countries. Despite the fact that the Grameen Bank has been successfully developed and operated through a bottom-up strategy of rural financial development, the replication process of its model remains top-down and is usually done by consultants or donors who only partly comprehend or understand the model and the environment of the specific country where the Grameen Model is replicated. It is clear that no one model is suitable for all situations and no single model is a panacea since the economic and social environments may be greatly different. Therefore, it is suggested that this microfinance model needs to be re-examined before replication (Cohen & Sebstad, 2000). It requires refocusing on the clients, their demands and preferences and their financial strategies.

The use of local culture and values in implementing rural credit programmes, which has been observed in this study, is one phenomenon that could become an option for successful implementation of rural credit programmes in developing countries. As cultures and values are locally specific, they should be adapted easily in the respective

areas. The potential of bottom-up cultural influence on informal rural credit programmes in providing credit for survival and also credit for development is discussed in the next section.

***The potential for an informal bottom-up rural finance strategy to provide credit for the rural poor***

In more recent years, the perception of informal finance has changed. Informal finance has been viewed as dynamic, innovative, and flexible to adapt to local economic and social conditions (Ghate, 1992; Matin et al., 2002). It is also characterised as ubiquitous and rooted from the respective community, and usually follows the respective culture.

The success of bottom-up informal credit systems in delivering credit for the poor is described in this study. This success was mainly related to its positive roles in empowering local people and creating conducive environments for participatory rural financial development. The empowerment features of this bottom-up informal credit system are its capacity to make the voice of the poor to be heard and the ability of the poor to manage and control the resources, so that their rural credit programmes are accessible and profitable for all of the participants. As practised by the Grameen Bank system, this bottom-up informal credit system was started at the village level and at very low-level community organisations such as clan groups (*suku*), women farmers' groups, farmers' groups, and neighbourhood groups. This could ensure that these credit programmes become adapted to the local community and therefore could become sustainable.

The success of this grassroots informal finance to adopt and respect local culture and values is another achievement, so that local cultures and values become promoted in this decentralisation era, and village-level organisations become empowered. This in turn creates an environment conducive for the development of a participatory rural financial system. In this case, this study confirms that cultural and religious-based rural informal credit programmes are developed, and the practices of friendly moneylenders are preferred by most participants. Whilst the moneylenders have been seen in the literature as negative, especially in terms of exploiting the borrowers with high interest, the



religious-based moneylenders in this study were favoured and positive, since they did not charge interest to the borrowers, and were always ready to help the poor, even if they could not repay. In the case of other cultural-based informal credit programmes as mentioned above, they charged interest but they used it for administrative and charity purposes, or they shared the profits with participants. These practices were in line with the principles of Islamic banking, which has profit-sharing principles. The ability of these informal credit schemes to be strong and solid and always ready to help the participants reflects their moral features, resulting in strong kinship and strong group cohesion, which are important for the formation of social capital (Matin et al., 2002: 280).

The potential of a bottom-up informal credit system to provide the rural poor with credit for survival is related to the capacity of informal finance to act as savings and insurance tools. Many informal finance transactions, which on the surface appear as credit, are on a deeper analysis, very closely related to savings and insurance, and therefore a credit transaction of informal finance is also described as an insurance substitute (Rutherford, 1999), or as an advances against future savings (Matin et al., 2002: 280). Getting access to a lump sum through building mutual savings is important to informal group finance systems, in which groups of individuals pool their savings and lend primarily to each other. In *julo-julo* for example, the equal periodic savings of every member are pooled and given to each member in turn. There are therefore as many pooling as there are members and the cycle come automatically to an end when each member takes her 'prize'.

Thus, the participants of informal finance have credit, savings and insurance schemes all together at the same time, because the informal credit scheme, which is extended through intermittent lenders and group finance arrangements are essentially a mixture of financial products incorporating savings mobilisation and insurance functions. While in this study, informal credit programmes were mainly used for fulfilling basic needs and consumption, the saving component was viewed as deferred consumption, and these were done through direct lending usually from friends and relatives. Consequently, the function of bottom-up informal credit programmes for survival in this study was successful. Despite the fact that they own only small amount of lump sum, the

participants were not worried about their future household consumption since sooner or later they would receive the 'prize', which acted as savings and insurance instruments.

The success of the bottom-up informal finance system in this study in functioning as credit for survival meant that it also could perform as credit for development by making several interventions and innovations. As the bottom-up informal credit programmes are constrained by lack of capital and insufficient management and administrative stuff, these interventions should be directed to meet these needs, while its positive characteristics should be maintained and developed.

## **Implications for Designing Future Rural Financial Development Strategies**

Learning from the successes of bottom-up informal rural credit programmes and the failures of conventional top-down rural credit programmes, this study concludes by making several recommendations for designing appropriate credit systems for small farmers at the village level. These recommendations could become an alternative to transform the existing credit for survival of the small farmers into credit for development, which would be able to increase their income and thus their quality of life.

First, the bottom-up approach of informal rural credit programmes in this study has been proven to be effective to implement rural credit programmes at the grassroots level. This strategy puts the client as the focus of interventions and at the centre of any decision made by the rural finance institutions. Thus, future rural financial strategy should adopt this approach and should be maintained and developed based on the specific local environment.

Secondly, learning from the important role of local culture and values in informal rural credit programmes in this study, it is suggested that future rural credit programmes should be designed using local culture and values based on strong kinship ties and social cohesion. To design rural credit programmes based on local culture and values could also create a more locally specific rural credit system, and therefore could result in an

increase of sense of ownership toward their rural credit programmes, which in turn would ensure their sustainability.

Thirdly, by recognising the importance of bottom-up and culturally and value-based informal credit systems, future rural financial systems could be designed by combining formal and informal financial systems. As formal credit systems in this study were found to be ineffective in delivering credit to the rural poor, while the informal credit system was locally successful within limits, the formal sector could use the ways that the informal finance system uses to deliver the credit programmes to poor people in rural areas. These include agents such as Islamic finance, ROSCAs and moneylenders. The mechanisms of current and proposed rural credit system are presented in Figures 10.1 and 10.2 below:

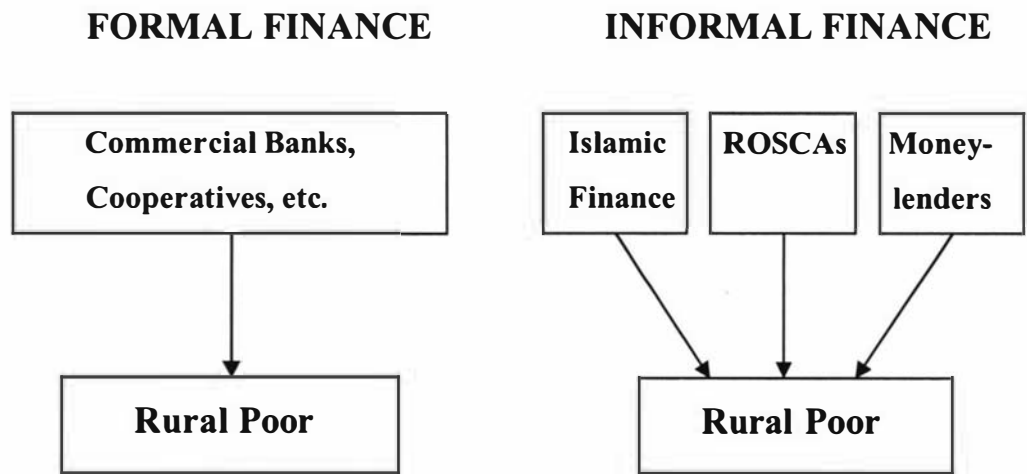


Figure 10.1. Current rural financial system for the rural poor

Figure 10.1 depicts the present dual situation which is not operating effectively to promote development. The current rural formal credit system does not work because of unmet demands and expectations between the rural poor and the formal financial institutions. The current rural informal credit systems are also unable to increase the income of the rural population, and are thus incapable of relieving poverty. This is because their credit system is still traditional with a lack of capital and management services, and credit is used only for survival. However, these informal credit programmes are preferred by the majority of the rural population due to their low costs, flexibility, and their match with local culture and values.

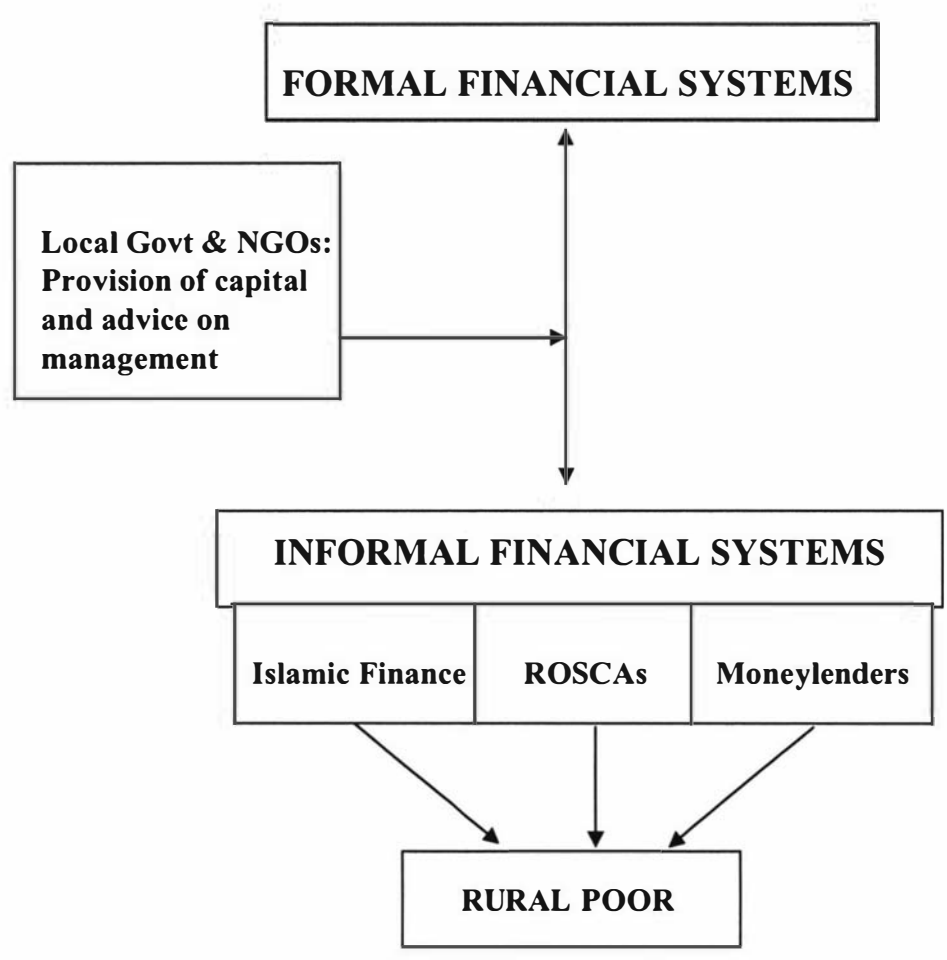


Figure 10.2. Proposed rural financial system for the rural poor

Based on Figure 10.2, the proposed future formal credit system can be designed by integrating the ‘best practices’ of informal credit systems as stated above, and by incorporating support systems including capital and training programmes on financial management and financial administration. Local governments and NGOs can play active roles in this respect. The components of informal financial systems are not limited to only Islamic finance, ROSCAs and moneylenders as mentioned above, but they could cover any informal schemes that are locally adopted and preferred by rural people. With regard to the provision of capital for these informal providers, it can be done by providing credit with low interest rates, and this in turn would be available to the rural poor.

The proposed future formal rural credit system as depicted in Figure 10.2, consists of two-way relationship between formal and informal credit systems that could be

facilitated by local government and local NGOs. These links can work, including through some of the following ways:

- Informal sector credit facilities access formal credit institutions. For example, traditional ROSCAs at the village level, which have been success with small-scale credit provision, can access the formal banking system to obtain further credit. In this case, there is a possibility for these traditional informal credit systems to move from using credit for survival to use credit for development.
- Training and extension provided by the formal sector for the informal sector. In this case the members of informal credit institutions could learn about, for example, bookkeeping, management practices and so on.
- Informal credit schemes access formal credit institutions for savings and security purposes. In this case, the informal credit schemes such as moneylenders or ROSCAs could have their bank accounts in the formal banking institutions in order have savings and to secure their money.
- The formal sector could use informal sector as an intermediary to reach their poorer borrowers at the grassroots level. In this case the formal sector could extend credit with low interest to the informal credit institution such as ROSCAs and 'friendly moneylenders' and then credit is extended further to the poor people. Informal institutions thus become agents for the formal sector.
- Progression from informal to formal sector. In this case, it is hoped that when rural people begin to do well as a result of gaining small-scale credit through the informal sector and establishing a good credit record, they could progress to larger formal sector institutions. This would require recognition by banks of saving records at the lower level.

As a consequence of designing these bottom-up, client-centred, and culturally appropriate credit systems at the policy level, the future strategy of rural financial development at the implementation level should match with the characteristics noted above. Therefore, this study recommends several points that follow these criteria.

First, it has been recognised that small farmers in rural areas have many disadvantages, and their income is highly constrained by uncontrolled factors such as climatic

conditions, natural disasters, pest outbreaks, and crop price fluctuations. As a result, they have irregularity of income. Consequently, an appropriate rural credit system for them should adapt to these conditions, allowing for a repayment schedule which might not be regular. Thus the repayment procedure should be flexible and rely on the economic conditions of small farmers.

However, peer pressure or social punishment is important in making participants disciplined about repayment. Therefore, secondly, it is recommended that the use of social collateral is preferred rather than physical collateral, considering that poor farmers have limited capital or property.

Thirdly, considering that the principle of Islamic finance has proven to be successful for bottom-up informal finance in this study, and this model has been increasingly used by government agencies and private sectors at national, regional and global levels, it is recommended that an appropriate credit system for poor farmers should be based on profit-sharing rather than interest. For the very poor people, it is suggested not to charge interest. However the participants should not be encouraged not to pay interest since this could affect their moral attitude, thinking that credit is something granted from donors or the government.

Finally, with regard to the administrative procedures of future rural credit systems for the poor and the very poor people, it is recommended that the credit transactions be made as simple as possible. Taking into account that the poor have many disadvantages such as living in remote areas, lack of transportation, and low level of income, it is suggested that the credit transaction should be close to the poor. The strategy of the Grameen Bank to deliver credit at the doorstep of the poor, and the policy of Indonesia's BRI *Unit Desa* to use a mobile banking system are good examples of credit delivery system for the poor.

## Concluding Remarks

There are several contributions that can be presented from this thesis. First, it is asserted that grassroots research on rural finance, which focuses on exploring the behaviour of the target groups, has been able to capture real information at the field level, which is usually neglected as research usually focuses only on the institutional or organisational levels. The formal rural credit programmes, which have been acknowledged as moderately successful at national and global levels have failed to deliver services to the rural poor, when seen from the grassroots level. Furthermore, the traditional rural credit programmes, which are often seen as informal, small, and insignificant, have been found to be active, dynamic, and influential.

The second contribution is that the cultural and religious values have been able to encourage local people to perform savings and credit activities more effectively. This could become alternative option to formulate future strategy for rural financial development in developing countries.

The third contribution is that by identifying the importance of development of small farmers' credit systems in developing countries, it is now time for microfinance programmes to pay more attention to farming activities along with non-farm activities. The majority of rural poor in developing countries are undertaking farming as their main occupation, and this activity is highly constrained by uncontrollable factors such as climatic conditions, natural disasters, and pest outbreaks. In this respect, it is important for the microfinance providers to design specific credit systems that are adapted to these conditions.

Finally, it is important to highlight that the replication of microfinance programmes cannot be done by just transferring a model from one area to another. It needs to be re-evaluated, especially with regard to whether the model is adapted to the conditions where it is replicated, and relating, in particular, to cultural and religious values held in the area. This study promotes the importance of local culture and values in developing rural financial systems.

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APPENDICES

Appendix 1: Questionnaire

STANDARDIZED QUESTIONNAIRE  
(Bahasa Indonesia)

A. INFORMASI UMUM

1. Lokasi: Kabupaten Solok, Propinsi Sumatra Barat

Kecamatan:    (    ) Bukit Sundi  
                  (    ) X Koto Singkarak

Nama *Nagari*                    : .....

2. Jenis Usaha Tani (Tick sebanyak yang sesuai):

- (    ) tanaman pangan
- (    ) tanaman tahunan
- (    ) perikanan darat
- (    ) peternakan

3. Jenis Kepemilikan

- (    ) milik sendiri
- (    ) sewa
- (    ) bagi-hasil
- (    ) buruh
- (    ) gadai

B. KEPENDUDUKAN

Nama Peserta	Jenis Kelamin		Umur	Status Perkawinan*			Jumlah Anak	Jenis Famili*	
	Laki-laki	Wanita		Menikah	Tidak Menikah	Janda/Duda		Tunggal	Banyak

Catatan:

\*= tick kolom yang paling sesuai.

## C. KONDISI EKONOMI

### a. Pertanian

1. Luas kepemilikan lahan:
  - (    ) 0.5 hektare
  - (    ) kurang dari 0.5 hektare
  - (    ) lebih dari 0.5 hektare
  - (    ) tidak ada
2. Produksi/ hektare:
  - (    ) 1 kuintal (100kg)/ hectare
  - (    ) kurang dari 1 kuintal/hectare
  - (    ) lebih dari 1 kuintal/ hectare
3. Berapa kali panen per tahun?
  - (    ) satu kali
  - (    ) dua kali
  - (    ) tiga kali
4. Berapa pengeluaran setiap kali panen (dalam *Rupiah*)?
  - Benih: Rp.....
  - Pupuk: Rp.....
  - Pengolahan Tanah: Rp.....
  - Pesticida / insektisida: Rp.....

### b. Perikanan Darat

1. Jumlah kepemilikan kolam ikan:
  - (    ) satu
  - (    ) lebih dari satu
  - (    ) tidak ada
2. Produksi/ bulan:
  - (    ) 100 kg
  - (    ) kurang dari 100 kg
  - (    ) lebih dari 100 kg
3. Jumlah pengeluaran/ bulan (dalam *Rupiah*):
  - Benih: Rp.....
  - Pupuk Rp.....
  - Pakan ikan: Rp.....



**c. Peternakan**

1. Jenis dan jumlah ternak yang dimiliki:
  - (    ) sapi.....ekor
  - (    ) kerbau.....ekor
  - (    ) kambing.....ekor
  - (    ) ayam..... ekor
  - (    ) itik.....ekor
2. Produksi/ bulan: .....
3. Pengeluaran (dalam *Rupiah*):.....

**d. Kegiatan diluar pertanian**

1. Jenis kegiatan diluar pertanian (tick sebanyak yang sesuai):
  - (    ) pedagang/ punya took
  - (    ) tukang
  - (    ) sopir/ ojek
  - (    ) buruh
  - (    ) pegawai negeri/ guru
  - (    ) lainnya (sebutkan)
2. Penghasilan rata-rata/ bulan: Rp.....
3. Pengeluaran rata-rata/ bulan: Rp.....

**D. KONDISI SOSIAL****a. Tingkat Pendidikan:**

- (    ) tidak sekolah
- (    ) Sekolah dasar
- (    ) Sekolah Menengah Pertama
- (    ) Sekolah Menengah Atas
- (    ) Perguruan Tinggi
- (    ) Sekolah Agama

**b. Kesehatan & Sanitasi (tick sebanyak yang sesuai):**

- (    ) Akses ke Puskesmas
- (    ) Ikut Program Keluarga Berencana (KB)
- (    ) Akses terhadap air bersih
- (    ) Akses terhadap jamban didalam rumah

**E. KREDIT PEDESAAN****E1. PROGRAM KREDIT FORMAL****a. Keikutsertaan dam program kredit formal:**

1. Alasan keikutsertaan dalam program kredit formal:
  - (    ) perlu tambahan uang untuk pertanian
  - (    ) perlu uang untuk bayar hutang
  - (    ) perlu uang untuk kebutuhan social (seperti pendidikan, perkawinan, kelahiran, dsb.)
  - (    ) perlu uang untuk memenuhi konsumsi setiap hari.

2. Jenis program kredit formal:

- ☐ Kupedes BRI
- ☐ Koperasi Simpan Pinjam (KSP)
- ☐ Koperasi Unit Desa (KUD)
- ☐ Program Kredit Ketahanan Pangan (KKP)
- ☐ Lainnya (sebutkan)

3. Lama nya ikut ikut serta dalam program kredit formal:

- ☐ kurang dari satu tahun
- ☐ satu tahun
- ☐ lebih dari satu tahun (sebutkan)

**b. Persyaratan dan prosedur untuk menjadi anggota program kredit formal:**

1. Kolateral (jaminan) dalam bentuk:

- ☐ uang/ property
- ☐ tanah
- ☐ rekening bank
- ☐ kepercayaan
- ☐ lainnya (sebutkan)
- ☐ tidak ada

2. Simpanan wajib:

- ☐ diwajibkan (sebutkan jumlahnya)
- ☐ tidak diwajibkan
- ☐ diwajibkan dengan beberapa ketentuan (sebutkan)

3. Biaya pendaftaran:

- ☐ diwajibkan (sebutkan jumlahnya)
- ☐ tidak diwajibkan
- ☐ diwajibkan dengan beberapa ketentuan (sebutkan)

4. Prosedur pengembalian:

- ☐ langsung ke Bank
- ☐ melalui ketua kelompok tani
- ☐ melalui koperasi
- ☐ diambil oleh petugas Bank
- ☐ lainnya (sebutkan)

5. Tingkat bunga:

- ☐ kecil dari 5% per bulan
- ☐ 5% per bulan
- ☐ lebih dari 5% per bulan

6. Sanksi/ hukuman:

- ☐ denda
- ☐ sanksi adapt/ social
- ☐ lainnya (sebutkan)

c. Masalah yang dihadapi dalam mengakses program kredit formal:

1. Masalah institusional (tick sebanyak yang sesuai):
  - ☐ tingkat pendapatan yang rendah/ tidak stabil
  - ☐ tidak punya kolateral (jaminan)
  - ☐ tinggal ditempat terpencil
  - ☐ banyak tunggakan kredit yang lalu
  - ☐ tidak mampu bayar tunggakan
2. Masalah administrative (tick sebanyak yang sesuai):
  - ☐ prosedur yang panjang dan berbelit-belit
  - ☐ banyak biaya yang tak terduga
  - ☐ manajemen kurang baik

## **E2. PROGRAM KREDIT INFORMAL**

1. Alasan keikutsertaan dalam program kredit informal:
  - ☐ butuh uang untuk pertanian
  - ☐ butuh uang untuk bayar hutang
  - ☐ butuh uang untuk keperluan social ( seperti pendidikan, perkawinan, dsb)
  - ☐ tidak bias akses ke program kredit formal
2. Jenis kredit informal:
  - ☐ *Arisan* atau *julo-julo*
  - ☐ Koperasi simpan pinjam (KSP)
  - ☐ Rentenir/ pelepas uang
  - ☐ Kredit tradisional
  - ☐ lainnya (sebutkan)

## **E3. PERAN PEMERINTAH DAERAH DAN LEMBAGA KREDIT PEDESAAN**

1. Peran pemerintah daerah:
  - ☐ training dan penyuluhan tentang kredit pedesaan
  - ☐ pengadaan kredit untuk petani
2. Peran lembaga kredit pedesaan:
  - ☐ keuntungan/ kerugian dalam mengakses program kredit formal
  - ☐ keuntungan/ kerugian dalam mengakses program kredit informal

STANDARDIZED QUESTIONNAIRE  
(English)

A. GENERAL INFORMATION

1. Location: Solok district, West Sumatra Province

Sub-district: ( ) Kecamatan Bukit Sundi  
( ) Kecamatan X Koto Singkarak

Name of *Nagari* :.....

2. Types of Farming (Tick as many as appropriate):

- ( ) food-crops
- ( ) cash-crops
- ( ) in-land fisheries
- ( ) livestock

3. Types of enterprise (Tick as many as appropriate):

- ( ) owner
- ( ) rent
- ( ) share-cropper
- ( ) laborer
- ( ) pawning

B. DEMOGRAPHIC CHARACTERISTICS

Name of Participant	Gender*		Age	Marital Status*			No. of Children	Type of family*	
	Male	Female		Married	Not married	Widow		Nuclear	Extended

Note:  
\*= tick the most appropriate one.

C. ECONOMIC CONDITIONS

a. Farming

1. Land owned:

- ( ) 0.5 hectare
- ( ) less than 0.5 hectare
- ( ) more than 0.5 hectare
- ( ) none

2. Production/ hectare (productivity):

- ( ) 1 kuintal (100 kg)/ hectare
- ( ) less than 1 kuintal/ hectare
- ( ) more than 1 kuintal/ hectare

3. How many harvest(s) per year?
  - ☐ once crop/ year
  - ☐ two crops/year
  - ☐ three crops/ year
4. Farm expenditures per each crop (in *Rupiah*):
  - seeds:
  - fertilizers:
  - land-tillage:
  - insecticides/ pesticides:

**b. Inland Fisheries**

1. Pond owned:
  - ☐ one
  - ☐ more than one
  - ☐ none
2. Production/ month
  - ☐ 100 kg
  - ☐ less than 100 kg
  - ☐ more than 100 kg
3. Expenditures (in *Rupiah*):
  - seeds:
  - fertilizers:
  - feed:

**c. Livestock:**

1. Types and Number of livestock owned:
  - ☐ cattle .....
  - ☐ buffalo .....
  - ☐ goat .....
  - ☐ chicken .....
  - ☐ duck.....
2. Production/ month:
3. Expenditures (total in *Rupiah*):

**d. Off-farm activities:**

1. Types of off-farm activities (tick as many as applied):
  - ☐ trader/ shopkeeper
  - ☐ craftsman
  - ☐ transportation/ driver
  - ☐ laborer (services, industry, etc)
  - ☐ civil servant/ teacher
  - ☐ other

2. Average gross income/ month: Rp.....
3. Average expenditures/ month: Rp.....

#### **D. SOCIAL CONDITIONS**

##### **a. Education levels:**

- ☐ no school
- ☐ elementary school
- ☐ secondary school
- ☐ tertiary school
- ☐ religious school

##### **b. Health and Sanitation (tick as many as applied):**

- ☐ access to the Health Center
- ☐ access to Family Planning Program
- ☐ access to clean/ good drinking water
- ☐ good sanitation (i.e. the availability of toilet and bathroom at home)

#### **E. RURAL CREDIT**

##### **E1. FORMAL RURAL CREDIT PROGRAMME**

##### **a. Involvement in formal rural credit programme:**

###### **1. Reasons for involvement in formal rural credit program:**

- ☐ need additional money for farming
- ☐ need money for debt repayment
- ☐ need money for social needs (education, wedding ceremony, etc.)
- ☐ need money for daily economic consumptions

###### **2. Types of formal rural credit program:**

- ☐ Kuyedes of BRI
- ☐ Borrow & Savings Credit (KSP)
- ☐ Rural Unit Cooperative (KUD)
- ☐ Food Security Credit Program (KKP)
- ☐ Other (please mention)

###### **3. Duration of involvement:**

- ☐ less than one year
- ☐ one year
- ☐ more than one year (please mention)

##### **b. Requirements and procedure to be a member of formal rural credit programme:**

###### **1. Collateral, in the form of:**

- ☐ Money/ property
- ☐ Land
- ☐ Bank account
- ☐ Trust

- ☐ Other (please mention)
  - ☐ None
2. Compulsory savings:
- ☐ Required (please mention how much)
  - ☐ Not required
  - ☐ Required with conditions (please mention)
3. Entrance Fee:
- ☐ Required (please mention how much)
  - ☐ Not required
  - ☐ Required with conditions (please mention)
  - ☐ Not applicable
4. Repayment procedure:
- ☐ Directly to the Bank
  - ☐ Through farmer's group
  - ☐ Through Cooperative
  - ☐ Pick-up by Bank officer
  - ☐ Other
5. Interest rates:
- ☐ less than 5% per month
  - ☐ 5% per month
  - ☐ more than 5% per month
6. Sanction/ punishment
- ☐ fines
  - ☐ cultural/ social sanction
  - ☐ other (please mention)

**c. Problems encountered in accessing formal rural credit programme:**

1. Institutional problems (tick as many as applied):
- ☐ Lack of access due to unstable/ low income
  - ☐ lack of collateral
  - ☐ lack of access due to live in remote areas
  - ☐ lack of access due to high debt of previous loan
  - ☐ lack of access due to unable to repay the loan (high interest rates)
2. Administrative problems (tick as many as possible):
- ☐ long procedure
  - ☐ too many fee
  - ☐ poor management

## **E2. INFORMAL RURAL CREDIT PROGRAMME**

1. Reasons for involvement in informal rural credit program:
  - ( ) need additional money for farming
  - ( ) need money for debt repayment
  - ( ) need money for social needs (education, wedding ceremony, etc.)
  - ( ) need money for daily economic consumptions
  - ( ) can't access to formal credit
2. Types of informal rural credit program:
  - ( ) ROSCA (*Arisan*)
  - ( ) KSP (Borrow & Savings Credit)
  - ( ) Moneylender
  - ( ) Traditional/ cultural credit scheme
  - ( ) Other

## **E3. ROLE OF LOCAL GOVERNMENT AND RURAL CREDIT INSTITUTIONS**

1. Role of local government:
  - ( ) Training & extension on rural credit
  - ( ) Provision of credit program
  - ( ) Provision of credit regulation
2. Role of rural financial institutions:
  - ( ) advantages/ disadvantages of formal rural credit institutions
  - ( ) advantages/ disadvantages of informal credit institutions.



## Appendix 2: Interview Questions

### IN-DEPTH INTERVIEW GUIDE

#### I. Farmer's perceptions on rural credit

1. What is your understanding of rural credit?
2. What is your understanding about rural credit scheme available in your area?
3. Do you know about rural credit intermediaries available in your area?
4. What is the role of local government and central government in facilitating rural credit program in your area?

#### II. Farmer's past experience on rural credit

1. Have you ever been involved in formal rural credit program before?
2. Have you ever been involved in formal rural credit program before?
3. If yes, what type of formal or informal rural credit program?
4. Have rural credit programs helped you?
5. If yes, in what ways?
6. What are advantages of this formal or informal rural credit programs? Please mention.....
7. What is the greatest advantage?
8. What should be done to sustain it?
9. Why there are advantages?
10. What are the disadvantages/ problems to be involved in rural credit program? Please mention.....
11. Which one the biggest problem, and do you know how to solve it?
12. Why there are disadvantages/ problem available?
13. What are farmer's experiences to work with credit intermediaries (Banks, KUD, moneylenders, NGO, etc)?
14. What are farmer's experiences to work with local government when involving in rural credit program?
15. How do you rate and compare your farming and household economic conditions before involved in rural credit program and after involved in rural credit program?
  - a. (    ) worse-off
  - b. (    ) the same
  - c. (    ) better-off

#### III. Farmer's preferences on rural credit

1. What type of rural credit do you prefer?
2. Why do you choose this type of rural credit?
3. Which programs have helped you the most? How?
4. Which ones have helped you the least? Why?
5. What type of credit intermediaries do you prefer?
6. Why do you choose this type of credit intermediaries?
7. When do you prefer to use rural credit? and why do you think this is the most suitable one?
8. What do you think the most suitable interest rate for rural credit? Why?
9. What do you think the most suitable collateral for rural credit? Why?

**IV. Farmer’s aspirations on rural credit:**

1. What is your expectations about rural credit program in the future, in terms of:

- Interest rate
- Collateral
- Repayment procedure
- Membership
- Management/ administration

2. Which of the following is the most or the least important in rural credit in your village today? (1 is the most, 5 is the least).

- local government	1	2	3	4	5
- NGOs	1	2	3	4	5
-cultural leaders (kepala adat)	1	2	3	4	5

3. Which of the following is the most or the least important in rural credit in your village in the future? (1 is the most, 5 is the least).

- local government	1	2	3	4	5
- NGOs	1	2	3	4	5
-cultural leaders (kepala adat)	1	2	3	4	5

### Appendix 3: Summary of interviews and focus group discussions

#### IN-DEPTH INTERVIEWS (Numbers and dates)

No.	Dilam Village	Saniangbaka Village	Tikalak Village
1	13 January 2004	6 February 2004	5 March 2004
2	14 January 2004	8 February 2004	5 March 2004
3	15 January 2004	9 February 2004	7 March 2004
4	18 January 2004	11 February 2004	15 march 2004
5	19 January 2004	11 February 2004	17 March 2004
6	20 January 2004	11 February 2004	19 March 2004
7	21 January 2004	13 February 2004	19 March 2004
8	21 January 2004	17 February 2004	20 March 2004
9	22 January 2004	19 February 2004	21 March 2004
10	23 January 2004	20 February 2004	21 March 2004
11			21 March 2004
12			24 March 2004

**FOCUS GROUP DISCUSSIONS**  
**(Dates and Topics)**

No	Dilam Village		Saniangbaka Village		Tikalak Village	
	Date	Topic	Date	Topic	Date	Topic
1	12 Jan 2004	Formal credit programme	6 Feb 2004	Informal credit programme	4 March 2004	Problems in farming
2.	13 Jan 2004	Role of NGO & Local Government	6 Feb 2006	Issue on KUT in Saniangbaka	7 March 2004	Fish Production in the Singkarak Lake
3.	15 Jan 2004	Informal credit programme ( <i>Julo-julo</i> )	9 Feb 2004	Problems in farming	19 March 2004	Farmers expectations regarding formal and informal credit
4.	16 Jan 2004	Role of extension worker	10 Feb 2004	Formal credit programme		
5.	17 Jan 2004	Problems in farming				
6.	18 Jan 2004	Informal credit programme ( <i>Arisan Suku</i> )				
7.	20 Jan 2004	Informal credit programme				

**KEY INTERVIEWS**  
(Dates, Topics, and Participants)

No.	Date	Topic	Participants
1.	24 October 2003	Small farmers' credit in Indonesia	The Secretary General, Ministry of Agriculture
2.	27 October 2003	Credit programmes in agricultural sector	Director, Agricultural Finance, Ministry of Agriculture
2.	7 January 2004	Decentralisation	Officer at the <i>Wali Nagari</i> office
3.	6 February 2004	Role of <i>Perantau</i> in Saniangbaka	Cultural leader ( <i>Datuk</i> )
4.	10 February 2004	Issue on Farmers' Credit Programme (KUT)	Community leader
5.	18 February 2004	Role of Rural Cooperative Unit (KUD)	The Village Headman ( <i>Wali Nagari</i> )
6.	20 February 2004	The reduction of fish production in the Singkarak Lake	The Village Headman ( <i>Wali Nagari</i> )
7.	17 April 2004	Rural credit programmes in Solok District	Head, Office of Community Empowerment, Solok District
8.	21 April 2004	Small farmers' access to formal credit programmes	Officials of BRI at Sub-district level