

**MINISTRY OF AGRICULTURE
THE REPUBLIC OF INDONESIA**

**THE STUDY
ON
THE IMPROVEMENT OF FARMERS' INCOME:
AGRICULTURAL PROCESSING AND
RURAL MICROFINANCE
IN
INDONESIA**

**FINAL REPORT
VOLUME-III: APPENDICES**

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Rural MicroFinance

THE STUDY
ON
THE IMPROVEMENT OF FARMERS' INCOME:
AGRICULTURAL PROCESSING AND RURAL MICROFINANCE
IN
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Measurement Unit

US\$ = United State Dollars, ¥ = Japanese Yen, Rp. = Indonesian Rupiah

Exchange Rate

As of April, 2007, US\$1.00 = ¥ 117.38 = Rp.9,128, Rp.1.00= ¥0.01286

List of Terms & Abbreviations

| | |
|----------|--|
| A/C | Account |
| ADB | Asian Development Bank |
| APBN | National Government Budget (Anggaran Belanja Pendapatan Nasional) |
| APBD | Local Government Budget (Anggaran Belanja Pendapatan Daerah) |
| API | Indonesian Banking Architecture |
| BAPPEDA | Provincial Development Planning Agency (Badan Perencanaan Pembangunan Daerah) |
| BAPPENAS | National Development Planning Agency (Badan Perencanaan Pembangunan Nasional) |
| BBDA | Agribusiness Training Center (Balai Besar Diklat Agribisnis) |
| BBM | Increased Price of Fuel (Bahan Bakar Minyak) |
| BCA | Bank Central Asia |
| BDA | Agribusiness Training Center (Balai Diklat Agribisnis) |
| BDS | Business Development Services |
| BDSP | Business Development Service Provider |
| BI | Bank Indonesia |
| BIMAS | Mass Guidance Program (Bimbingan Massal) |
| BIPP | Agricultural Extension Information Centre (Balai Informasi dan Penyuluhan Pertanian) |
| BKD | Village Credit Institutions (Badan Kredit Desa) |
| BPKB | Ownership Certificate of Vehicle (Bukti Pemilikan Kendaraan Bermotor) |
| BKM | Community organisations developed under UPP (Badan Keswadayaan Masyarakat) |
| BLM | Community Direct Assistance under Ministry of Agriculture (Bantuan Langsung Masyarakat) |
| BM2 | BPR Mitra Mandiri |
| BMT | Microfinance institutions operate under syariah and cooperative principles (Baitul Maal wat Tamwil in Arabic, Balai-usaha Mandiri Terpadu in Indonesian, people's economic institution which develop productive business and investment in improving economic activities of small entrepreneurs) |
| BNI | Bank Negara Indonesia |
| BoC | Board of Commissioners |
| BOPO | Operating Expenses to Operating Revenue |
| BPD | Regional Development Bank (Bank Pembangunan Daerah) |
| BPLM | Community Direct Loan Assistance (Bantuan Pinjaman Langsung Masyarakat) |
| BPP | Extension Office (Balai Penyuluhan Pertanian) |
| BPR | People's Credit Bank (Bank Perkreditan Rakyat) |
| BPS | Statistics Indonesia: Central Bureau of Statistics (Badan Pusat Statistik) |
| BPTP | Agricultural Technology Extension Agency (Balai Pengkajian Teknologi Pertanian) |
| BRI | Bank Rakyat Indonesia |
| BRI Unit | Village Unit of Bank Rakyat Indonesia |
| BSM | Bank Syariah Mandiri |
| BULOG | National Logistics Agency (Badan Urusan Logistik) |
| BUMDes | Village Owned Enterprises (Badan Usaha Milik Desa) |
| CAMEL | Capital, Assets, Management, Earnings, Liquidity |
| CAR | Capital Adequacy Ratio |
| CF-SKR | Counterpart Fund Second Kennedy Round |
| CPI | Consumer Price Index |
| CRIFI | Central Research Institute of Fisheries |
| CU | Credit Union |

| | |
|--------------|---|
| DEPTAN | Ministry of Agriculture: MOA (Departemen Pertanian) |
| Df/R | Draft Final Report |
| DG | Directorate General (Director General) |
| DINAS | Service Office for Agriculture and Industry & Trade, Kabupaten / Kotamadya / Kota level |
| DOD | Day Old Duck |
| DOLOG | Regional Logistic Agency (Depot Logistik) |
| DPD | Regional Representative Council under MPR (Dewan Perwakilan Daerah) |
| DPK | Under Special Surveillance (Dalam Pengawasan Khusus) |
| DPR | People's Representative Council under MPR (Dewan Perwakilan Rakyat) |
| DPM-LUEP | Capital Strengthen Fund for Rural Economic Business Institution under Ministry of Agriculture (Dana Penguatan Modal Lembaga Usaha Ekonomi Pedesaan) |
| EKUIIN | The Coordinating Ministry of Economic Affairs (Kementerian Koordinator Bidang Perekonomian Republik Indonesia) |
| FAO | Food and Agriculture Organization of the United Nations |
| FDR | Financing Deposit Ratio |
| FEW | Field Extension Worker |
| F/R | Final Report |
| FY | Fiscal Year |
| GDP | Gross Domestic Product |
| GERDU-TASKIN | Integrated Movement on Poverty Alleviation (Gerakan Terpadu Pemberantasan Kemiskinan) |
| GMoS | General Meeting of Shareholders |
| GNI | Gross National Income |
| GOI | Government of Indonesia |
| GOJ | Government of Japan |
| GPKPMP | Program of Increasing Food Security in Village Communities |
| GRDP | Gross Regional Domestic Product |
| GTZ | German Agency for Technical Cooperation |
| HRD | Human Resources Development |
| IBRA | Indonesian Banking Restructuring Agency |
| Ic/R | Inception Report |
| IFAD | International Fund for Agricultural Development |
| IMF | International Monetary Fund |
| IPB | Bogor Agricultural University (Institut Pertanian Bogor) |
| IPM | Integrated Past Management |
| ISP | International Standby Practices |
| It/R | Interim Report |
| Jabar | West Java (Java Barat) |
| Jatim | East Java (Java Timur) |
| JBIC | Japan Bank for International Cooperation |
| JCIF | Japan Center for International Finance |
| JICA | Japan International Cooperation Agency |
| Kab. | District (Kabupaten) |
| Kec. | Sub-District (Kecamatan) |
| KDP | Kecamatan Development Project (Proyek Pembangunan Kecamatan: PPK) |
| KJKS | Syariah Financial Service Cooperative (Koperasi Jasa Keuangan Syariah) |
| KKMB | Banking Partner Financial Consultant |

| | |
|-----------|---|
| KKP | Food Security Credit (Kredit Ketahanan Pangan) |
| Koptan | Farmer's Own Cooperative (Koperasi Tani) |
| KPK | Self-Help Group (Kelompok Petani Kecil) |
| KPP-PK | West Java Province Food Security Credit (Kredit Ketahanan Pangan Pola Kemitraan) |
| KSM | Community Self-Help Group (Kelompok Swadaya Masyarakat) |
| KSP | Saving & Loan Cooperative (Koperasi Simpan Pinjam) |
| KSU | Multipurpose Cooperative (Koperasi Serba Usaha) |
| KT | Farmers' Groups organized under Agricultural Extension Workers (Kelompok Tani) |
| KTNA | Farmers and Fishermen's Groups (Kontak Tani dan Nelayan Andalan) |
| KUB | Kelompok Usaha Bersana |
| KUBE | Business Groups (Kelompok Usaha Bersama) |
| KUD | Village Cooperative Unit (Koperasi Unit Desa) |
| KUF | Kalimantan Upland Farming System Development Project |
| KUK | Small Business Credit (Kredit Usaha Kecil) |
| KUMKM | Cooperatives, Micro, Small and Medium Enterprise (Koperasi dan Usaha Mikro Kecil Menengah) |
| KUT | Farm Credit Scheme (Kredit Usaha Tani) |
| KWT | Women's Group (Kelompok Wanita Tani) |
| LDKP | Rural Credit Fund Institution (Lembaga Dana Kredit Pedesaan) |
| LDR | Loan to Deposit Ratio |
| LJKK | Credit Guarantee Institution for Cooperatives (Lembaga Jaminan Kredit Koperasi) |
| LKM | Micro-Finance Institution (Lembaga Keuangan Mikro) |
| LKM-A | Micro-Finance Institution-Agribusiness (Lembaga Keuangan Mikro Agribisnis) |
| LKM-B3K | Non-Bank / Non Cooperative Micro-Finance Institution (Lembaga Keuangan Micro Bukan Bank dan Bukan Koperasi) |
| LKS | Syariah Financial Institution (Lembaga Keuangan Syariah) |
| LMDH | Village Community and Forestry Institute (Lembaga Masyarakat Desa Hutan) |
| L-MFI | Large Microfinance Institutions |
| LPD | Regional Guarantee Institution (Lembaga Penjamin Daerah) |
| LPS | Deposit Insurance Agency (Lembaga Penjamin Simpanan) |
| LPSM | Self-Reliance Development Agency (Lembaga Pengembangan Swadaya Masyarakat) |
| LUED | Village Economy Institution (Lembaga Usaha Ekonomi Desa) |
| MAP | Capital and Financial Institution Strengthening through Provision of Initial Capital and Funding (Modal Awal Padanan) |
| MFI | Micro Finance Institution |
| MOA | Ministry of Agriculture (Departemen Pertanian: DEPTAN) |
| MOF | Ministry of Finance |
| MOHA | Ministry of Home Affairs |
| MOU | Memorandum of Understanding |
| MPR | People's Representative House or Parliament (Majelis Permusyawaratan Rakyat) |
| MSME | Micro, Small and Medium Enterprises |
| NAD | Nanggroe Aceh Darussalam |
| NBNC MFIs | Non-Bank Non-Cooperative Micro-Finance Institutions (LKM-B3K) |
| NGO | Non Governmental Organization |
| NIM | Net Interest Margin |
| NPFS | National Program for Food Security |
| NPF | Non-Performing Finance |
| NPL | Non-Performing Loan |

| | |
|-----------|--|
| NRS | National Regulator & Supervisor (proposed under draft Law of MFI, ProFi) |
| NTB | West Nusa Tenggara (Nusa Tenggara Barat) |
| ODA | Official Development Assistance |
| OECD | Organization for Economic Cooperation and Development |
| p.a. | per annum |
| PARAS | Housing Loan (Pembiayaan Anggota Rumah Sehat) |
| P2KP | Urban Poverty Project (UPP) (Proyek Penanggulangan Kemiskinan di Perkotaan) |
| P3EL | Women Empowerment through Local Economic Development (Pemberdayaan Perempuan melalui Pengembangan Ekonomi Lokal) |
| P3KUM | |
| P4K | Rural Income Generation Project (RIGP) (Proyek Peningkatan Pendapatan Petani-Nelayan Kecil) |
| P4S | Centre of Participatory Agricultural Training in Rural Area (Pusat Pelatihan Pertanian Pedesaan Swadaya) |
| p.a. | per annum |
| PEMP | Empowerment of Coastal and Small Island Population (Pengembangan Ekonomi Masyarakat Pesisir) |
| PINBUK | Small Business Incubation Center (Pusat Inkubasi Bisnis Usaha Kecil) |
| PKK | Family Welfare Empowerment (Pemberdayaan dan Kesejahteraan Keluarga) |
| PKBL | Environment Partnership Creation Program (Program Kemitraan Bina Lingkungan) |
| PKP | Food Crop Development Program (Program Padat Karya Pangan) |
| PKPP | Rural Food Crops Institution Development Fund (Pengembangan Ketahanan Pangan Pedesaan) |
| P/L | Profit and Loss Statement |
| PMAM-PMUK | Strengthening Group Business Capital (Pemberdayaan Masyarakat Agribisnis Melalui Penguatan Modal Usaha Kelompok) |
| PNM | (Permodalan Nasional Madani) |
| POKUSMA | Muamalat Enterprise Groups (Kelompok Usaha Muamalat) |
| PPABK | Commodity-based Agribusiness Development Project |
| PPD | Regional Empowerment Project (Proyek Pemberdayaan Daerah) |
| PPK | Kecamatan Development Program (Program Pengembangan Kecamatan) |
| PPL | Agricultural Extension Worker (Petugas Penyuluh Lapangan) |
| PPP | Agricultural Training Center (Pusat Pelatihan Pertanian) |
| P3B | BMT Founding Preparation Committee (Panitia Penyiapan Pendirian BMT) |
| PRA | Participatory Rural Appraisal |
| PT | Limited Company (Perseroan Terbatas) |
| ProFi | Promotion of Small Financial Institutions under BI & MOF supported by GTZ |
| PROPENAS | National Development Plan (2000 – 2004) (Program Pembangunan Nasional) |
| Pr/R1 | Progress Report 1 |
| Pr/R2 | Progress Report 2 |
| PUEM | Community Economic Activity Empowerment (Pemberdayaan Usaha Ekonomi Masyarakat) |
| REI | Resource Exchange International |
| Renstra | Strategic Plan (Rencana Strategi) RIGK Rural Income Generation Project under Ministry of Agriculture, P4K |
| RIGP | Rural Income Generation Project (Proyek Peningkatan Pendapatan Petani-Nelayan Kecil: P4K) |
| ROA | Return on Asset Ratio |
| RPJM | Mid Term Development Plan (Rencana Pembangunan Jangka Menengah) |

| | |
|-----------|---|
| RT | Neighborhood Association, smallest unit under Desa/Kelurahan (Rukun Tetangga) |
| RUB | Group Business Plan (Rencana Usaha Bersama) |
| RW | Citizens Association, smallest unit under Desa/Kelurahan (Rukun Warga) |
| SARAS | Housing Savings (Simpanan Rumah Sehat) |
| SATGASDA | Regional Working Unit (Satuan Tugas Daerah) |
| S&L | Savings and Loan |
| SBI | Bank Indonesia Certificate (Sertifikat Bank Indonesia) |
| SHG | Self-Help Group |
| SHGB | Right to Build Certificate (Sertifikat Hak Guna Bangunan) |
| SHM | Right of Ownership Certificate (Sertifikat Hak Milik) |
| SL-PHT | Field School Approach for Integrated Pest Control |
| SLT | Direct Cash Transfer (Subsidi Langsung Tunai) |
| SME | Small and Medium Enterprise |
| SMERU | Independent institution for research and policy studies |
| SM-MFIs | Small and Medium Micro-Finance Institutions |
| SOEs | State Owned Enterprises |
| SP-3 | Agricultural Financing Services Scheme (Skim Pelayanan Pembiayaan Pertanian) |
| SPPT | Tax Due Notification Letter (Surat Pemberitahuan Pajak Terutang) |
| SSN | Social Safety Net |
| SUB-DOLOG | DOLOG for a District (refer to DOLOG) |
| S/W | Scope of Work |
| TA | Technical Assistance |
| TAMARA | Saving account (Tabungan Masyarakat Sejahtera) |
| TASKA | Time deposit (Tabungan Masyarakat Berjangka) |
| TASYAQUR | <i>Idul Adha</i> Savings (Tabungan Masyarakat Qurban) |
| TSL | Two Step Loan |
| UED | Village Economy Enterprise (Usaha Ekonomi Desa) |
| UEP | Productive Economic Enterprise (Unit Ekonomi Produktif) |
| UKS | Social Welfare Efforts (Usaha Kesejahteraan Sosial) |
| UN | United Nations |
| UNDP | United Nations Development Program |
| UPK | financial management unit (Unit Pengelolaan Keuangan) |
| UPP | Urban Poverty Project (Proyek Penanggulangan Kemiskinan di Perkotaan: P2KP) |
| UPP-KS | Family Welfare Income Generation Project (Usaha Peningkatan Pendapatan Keluarga Sejahtera) |
| UPTD | Regional Technical Implementation Unit / Functional Position Group (Unit Pelaksana Teknis Daerah) |
| USAID | United States Agency for International Development |
| USP | Uniform Customs Practice for Documentary Credit |
| USP | Saving and Credit Unit of Multi-Purpose Cooperative (Unit Simpan Pinjam) |
| YINBUK | Foundation for the Incubation of Small Businesses (Yayasan Inkubasi Bisnis Usaha Kecil) |

CHAPTER 1 INTRODUCTION

1.1 Background

This report compiled the rural microfinance part of “the Study on the Improvement of Farmers’ Income: Agricultural Processing and Rural Micro-Finance in the Republic of Indonesia” (the Study) agreed between the Japan International Cooperation Agency (JICA) and the Ministry of Agriculture (MOA) of the Republic of Indonesia (Indonesia).

The Study was adopted against the following background. After the currency crisis, the Indonesian economy has been recovering through various efforts and GDP per capita of Indonesia reached US\$1,280 in 2005. However, population under the poverty line in Indonesia is around 35.3 million people and of which around 65 % lives in rural area. Therefore, it was important to improve farmers’ income in rural area in order to alleviate the poverty in Indonesia. For the improvement of farmers’ income, Government of Indonesia (GOI) promoted the value addition to the agricultural products by processing, however it was still difficult to add values through processing at the farmers’ level. On the other hand, rural micro-finance was deemed to be effective in financing agricultural processing and activation of economic activities by poor farmers. However, facing various difficulties, sustainable rural micro finance scheme had not been established yet.

The Study was carried out over one and half years from December 2005 to June 2007 as outlined in the schedule below.

| Study Period | 2005 | | 2006 | | | | | | | | 2007 | | | | |
|--------------------|-----------------------|---------------|--------------------|------|------|------|------|------|-------------|---------------|--------------------|-------|---------------|---------------|------|
| | 1st Year (JFY2005) | | 2nd Year (JFY2006) | | | | | | | | 3rd Year (JFY2007) | | | | |
| | Nov | Dec | July | Aug. | Sep. | Oct. | Nov. | Dec. | Jan. | Feb. | Mar. | April | May | June | July |
| Work in Indonesia | | ■ 1st Work | ■ 2nd Work | | | | | | | | ■ 3rd Work | | ■ 4th Work | | |
| Home work in Japan | ☐ Preparatory Work | | | | | | | | | ☐ 1st Work | | | ☐ 2nd Work | ☐ 3rd Work | |
| Report | | △ Ic/R | | | | | | | △ Pr/R 1 | △ It/R | △ Pr/R 2 | | △ Dt/R | △ F/R | |

Figure 1-1 Work Schedule

1.2 Objectives and Scope

The objectives of the Study are:

- (i) To prepare policy recommendations for the GOI in its formulating/ implementing possible future policies for the promotion of agricultural processing and rural micro-finance to improve farmers’ income.
- (ii) To transfer relevant technical skills/knowledge to the Indonesian counterpart personnel through on-the-job training during the course of the Study.

The scope of the Study is stipulated in the Scope of Work (S/W) as follows:

- (i) Review of existing information/data on agricultural processing and rural micro-finance
- (ii) Collection of basic information of the sample sites

- (iii) Promotion of agricultural processing
- (iv) Development of new rural micro-finance scheme
- (v) Linkage between agricultural processing and rural micro-finance
- (vi) Policy recommendations

1.3 Study Area

To facilitate the Study related to agricultural processing, sample commodities (Sweet potatoes, Duck, and Mango) were selected by GOI. Based on the production area of the sample commodities, the following sample sites were selected as the Study Area extending over about 4,300 km² of 5 Kabupatens (Districts).

Table 1-1 Sample Site and Sample Commodity

| Province | Sample Site (District) | Sample Commodity | Area |
|------------|------------------------|------------------|-----------------------|
| West Java | Kuningan | Sweet Potatoes | 220 km ² |
| | Majalengka | Sweet Potatoes | 1,070 km ² |
| | Cirebon | Duck | 960 km ² |
| East Java | Kediri | Mango | 1,390 km ² |
| | Mojokerto | Duck | 690 km ² |
| 2 Province | 5 Kabupatens | 3 Commodities | 4,330 km ² |

In terms of rural microfinance, the Study made the analysis based on the information mainly collected from the Sample Commodity Farmers Groups (*Kelompok Tani*) in the Sample Sites, but also the additional information from inside and outside the Sample Sites.

1.4 Definition of Rural Microfinance

In this Study, the definition of rural microfinance basically follows what is set in ADB (2003) TA No. 3810-INO Rural Microfinance Final Report Vol. 1 as follows:

Rural areas are all areas outside the municipalities (*Kotamadya*) and the capital towns of the districts (*Kabupaten*). Hence, small towns at the sub-district level (*Kecamatan*) are still defined as “rural”. The term rural comprises the whole range of economic activities of villagers such as farm, off-farm and non-farm activities. The rural sector integrates all economic sectors, including agriculture, agribusiness, home industry, services and trade.

Microfinance denotes the very small scale and volume of financial services. Microcredit is commonly defined as loan size up to 150 percent of average per capita income. In Indonesia, for example, with a per capita GDP of Rp. 5.7 million (US\$705) in 2000, loans up to Rp.8.6 million (US\$1,056) would be regarded as micro loans. Accounting for inflation, loans up to Rp 10 million may be classified as microcredit. Under the current banking regulation, micro-lending is the lending not more than Rp. 50 million. Within this range, the Ministry of Agriculture classifies the micro-enterprise lending to type I: not more than Rp. 10 million, and type II: more than Rp. 10 million but not more than Rp.50 million.

Microsavings are defined as savings accounts with a balance of less than Rp. 500,000, i.e. less than 10 percent of the average annual per capital income. Microfinance Institutions (MFIs) are financial institutions with a majority (more than 50%) of their clients being micro-savers and/or micro-borrowers.

CHAPTER 2 CURRENT SITUATION OF RURAL MICROFINANCE

2.1 Economic Situation Related to Microfinance

2.1.1 Post Currency Crisis (1998-2000)

After the Currency Crisis in 1997¹, IMF played a vital role in recovering the economy, guiding the economic and fiscal policy. As a result, the economy bottomed in the fourth quarter of 1998, and it turned to be growing again. The rise of oil price and domestic consumption contributed to the recovery of economy, and the period of 2002 to 2005, recorded 4.9% growth rate. The restructuring efforts of corporate and banking sector progressed along the way, and the NPL ratio of overall banking sector decreased as described in the next section. The comparison of the economy before and after the Crisis is shown in Table 2-1 below:

Table 2-1 Indonesia's Economy: Before and After Crisis Comparison

| Items | Pre-crisis (1993-96) | Crisis (1998) | Post-crisis | |
|--|-------------------------|------------------|-------------|-------|
| | | | (2002-05) | 2005 |
| GDP growth rate (%) | 7.7 | -13.1 | 4.9 | 5.6 |
| Exchange rates (annual average per US\$) | 2,210 | 10,013 | 9,133 | 9,705 |
| Exports (US\$ billion) | 43.0 | 48.8 | 68.8 | 85.6 |
| Imports (US\$ billion) | 36.0 | 27.3 | 42.0 | 57.5 |
| Trade balance (US\$ billion) | 7.0 | 21.5 | 26.8 | 28.0 |
| International reserves (US\$ billion, eop) | 13.8 | 23.6 | 26.8 | 34.7 |
| Inflation rates (CPI) | 8.7 | 58.5 | 8.8 | 17.1 |
| Fiscal balance (% of GDP) | 1.2 | -2.0 | -1.0 | -0.5 |
| Unemployment rate (%) | - | - | 9.7 | 10.3 |

Source) World Bank (2006) Snapshot of Indonesia's Economy

2.1.2 Restructuring of banks

The banking sector in Indonesia went through restructuring process after the Currency Crisis in 1997. From 1998 to 2004, various measures were taken to address the banking sector reform. In 1998, the Government made public its plan to stabilize the financial system, which included restructuring program of banks through capital infusion by the government. As the implementing agency of reform, IBRA (Indonesian Banking Restructuring Agency) was established. The NPL was transferred to IBRA, and many banks were closed or merged. As a result, 239 commercial banks counted in 1996 were reduced to 131 banks at the end of 2005. With this restructuring effort, the NPL ratio of commercial banks once rose significantly in 1999 up to 58.7%, also decreased to less than 10% in 2002 and thereafter, as shown in Table 2-2.

¹ Indonesian economy was heavily affected by the currency crisis which took place in Thailand in July 1997. The Rupiah was weakened drastically. The exchange rate of Rupiah against US dollar fell down from Rp.2,383 at the end of 1996 to Rp.4,650 at the end of 1997. The decline of domestic currency value damaged especially the enterprises that were heavily dependent upon imported materials and goods. Corporations which was borrowing in foreign currency and earning income in Rupiah were severely hit by the depreciation of Rupiah, since the repayment amount increased rapidly. The government raised interest to protect its own currency. Accordingly, the financial burden increased for both individuals and enterprises, causing increased non-performing loans (NPLs). This situation affected banking sector. The banks were suffering from two major problems; (a) increase of their own debt burden due to foreign currency borrowings they have been made, and (b) increase of NPLs. (Kashiwagi, Keiko, 2006, Basic Report on Indonesian Economy, Chapter 2, Japan Center for International Finance).

Table 2-2 Non Performing Loan (NPL) of Commercial Banks

(Unit:%)

| | 98/3 | 99/3 | 99/12 | 00/12 | 01/12 | 02/12 | 03/12 | 04/12 | 05/12 |
|-------------------------|------|------|-------|-------|-------|-------|-------|-------|-------|
| NPL of Commercial Banks | 19.8 | 58.7 | 32.8 | 18.8 | 12.1 | 8.1 | 8.2 | 5.8 | 8.3 |

Source: JCIF (2006), Basic Report on Indonesian Economy, Chapter 2,

IBRA was established as an asset management company by law, which would exist only until 2004. It was actually dissolved in February 2004 completing its mission. As for the function of deposit protection which IBRA had been assuming, Deposit Insurance Institution established in September 2005 succeeded this function.³ For these reasons, it can be concluded that restructuring of banking sector was completed around the period from 2004 to 2005.

2.1.3 After 2000 to Present

The economy of Indonesia gained its stability after 2000, achieving the growth rate between 3.8% and 5.6% as shown in Figure 2-1.

The stable economic growth has been achieved due to several factors such as recovered investment activities after the crisis, increase of domestic private consumption backed by low interest rate and expansion of consumer finance. Construction activities recovered its momentum. On corporate activities, investment in facilities and equipment became active again during this period. In 2004 and 2005, both consumption and investment lead the economic growth.

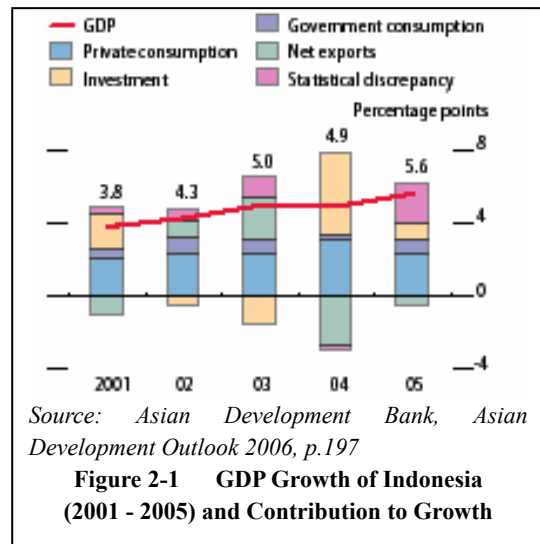


Figure 2-1 GDP Growth of Indonesia (2001 - 2005) and Contribution to Growth

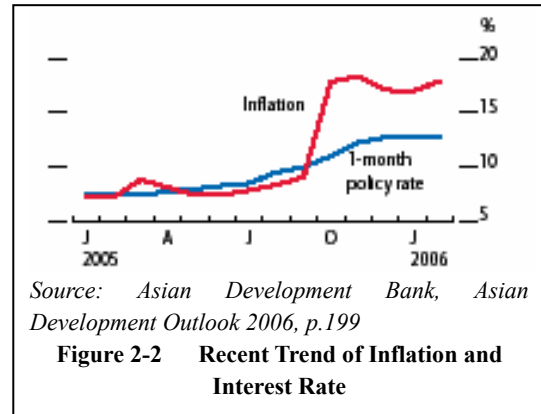
However, toward the end of 2005, the economic growth has been slowed down due to higher inflation and interest rates triggered by GOI's policy to cut down fuel subsidies and to raise administered price of petroleum products by an average of more than 120%⁴. This policy was taken, among other reasons, in order to safeguard the national budget. The government tried to mitigate the shock of poor households through Direct Cash Transfer Program, and during the first distribution phase which was launched on 1 October 2005, the government provided funding of Rp4.6 trillion for approximately 15.5 million households⁵. The disbursement of funds was undertaken by PT Pos Indonesia via its network of branches.

³ Kashiwagi, *Basic Report on Indonesian Economy, March 29, 2006, Chapter 5, pp.9-16*

⁴ *Ibid*, p.4, and ADB's *Asian Development Outlook 2006, p.198*

⁵ According to SMERU Newsletter No. 17, Jan-Mar. 2006, to ease the burden on the poor as the result of the increased price of fuel (BBM), the government in 2005 introduced the Direct Cash Transfer (*Subsidi Langsung Tunai*: SLT) Program for poor households, and each household receives Rp100,000 per month, paid quarterly for a period of one year.

Figure 2-2 shows the recent trend of rising inflation and interest rate in 2005 and 2006. Although the year 2005 recorded the highest GDP growth of 5.6%, toward 2006, the economic growth has been slowed down. Bank Indonesia points out that instability of oil prices still remains as one of the risk factors of the country's economic situation in 2006.⁶



Interest rate in Indonesia (represented by one-month SBI rate⁷) has been in the range of around 10 to 15% till the mid 1990s. After the currency crisis, it rose up to maximum of 70.6% in September 1998. After this peak, the rate has been falling down, and in 2005, the range was between 7.42% and 12.75%.

2.2 Banking Sector

2.2.1 Overview of Banking Sector

Banking Law No. 7/1992 categorizes the banks into two categories: General Commercial Banks and People's Credit Banks (BPR). Both Commercial Banks and BPRs carry out business activities conventionally and/or on the basis of the Syariah principle in their operations. Meanwhile, BPRs are not allowed to provide money transfer transactions. From an operational point of view, Commercial Banks in Indonesia are further classified into four categories, as shown in Table 2-3 below:

Table 2-3 Number of Banks

| | Description | 2001 | 2002 | 2003 | 2004 | 2005* |
|------------------------|----------------------------------|-------|-------|-------|-------|-------|
| 1. | State Owned Banks | 5 | 5 | 5 | 5 | 5 |
| 2. | Private National Banks | 80 | 77 | 76 | 72 | 71 |
| 3. | Foreign & JV Banks | 34 | 34 | 31 | 30 | 30 |
| 4. | Regional Development Banks (BPD) | 26 | 26 | 26 | 26 | 26 |
| Commercial Banks Total | | 145 | 142 | 138 | 133 | 132 |
| 5 | BPR Total | 2,432 | 2,747 | 3,299 | 3,507 | 3,081 |
| Banks Total | | 2,577 | 2,889 | 3,437 | 3,640 | 3,213 |

Source: BI -2005 Economic Report on Indonesia

* September 2005

Rural Credit Banks (BPR) originate from Non Village Credit Board (BPR non BKD), Village Credit Board (BPR BKD) and Rural Fund & Credit Institution (LDKP). BPR non BKD consists of new BPR established since 1988, petty trader/village bank, BKPD, and LDKP that were converted to BPR. BPR BKD consists of Village Bank and Paddy Bank which only exist in Java and Madura and established since 1929.

The outstanding loans by commercial banks before the currency crisis were growing steadily.

⁶ Bank Indonesia, *Economic Report on Indonesia 2005*, p.242

⁷ Sertifikat Bank Indonesia. SBI rate means "Discount Rate on Bank Indonesia Certificate". SBI can be issued with the maturity of 1 to 12 months. They are sold to banks and non-bank financial institutions as means of monetary policy.

After the crisis, however, these loan assets changed into non-performing loans and they were mostly transferred to IBRA as bad debts. Since this transfer, there had been over-liquidity situation where the amount of deposit well exceeded outstanding loan amount, and the abundant cash coming from deposits was not used as much in the form of loan, which led to the decrease of financial intermediary function of banks. Commercial banks tended to push the money collected through deposits to SBI, especially when the deposit rate is lower than SBI rate. Table 2-4 shows the long-term trend of interest rates:

Table 2-4 Trends of Interest Rates in Indonesia

| | 97 | 98 | 99 | 00 | 01 | 02 | 03 | 04 | 05 |
|---------------------|------|------|------|------|------|------|------|------|------|
| SBI Rate (1-months) | 20.0 | 38.4 | 12.5 | 14.5 | 17.6 | 12.9 | 8.3 | 7.4 | 12.3 |
| Deposit rate | 20.0 | 39.1 | 25.7 | 12.5 | 15.5 | 15.5 | 10.6 | 6.4 | 10.7 |
| Lending rate | 21.8 | 32.2 | 27.7 | 18.5 | 18.6 | 19.0 | 16.9 | 14.1 | 15.9 |

(Unit:%)

Note: (1) Deposit interest rate: Yearly average of 3-month time deposits at commercial banks
(2) Lending interest rate: Working capital loan to private enterprises

Source: JCIF, 2006

The recent performance of the commercial banks is indicated in Table 2-5 below. Both deposits and lending has been growing. Of late, the loan to deposit ratio (LDR) has improved and that more money is going into lending.

Table 2-5 Commercial Banks Performance Indicators

| Key Indicator | 2001 | 2002 | 2003 | 2004 | 2005 |
|--------------------------------|---------|---------|---------|---------|---------|
| Total Assets (Rp trillions) | 1,099.7 | 1,112.2 | 1,196.2 | 1,272.3 | 1,469.8 |
| Depositor Funds (Rp trillions) | 797.4 | 835.8 | 888.6 | 963.1 | 1,127.9 |
| Credit (Rp trillions) | 358.6 | 410.29 | 477.19 | 595.1 | 730.2 |
| LDR (Credit/Funds) | 45.0 | 49.1 | 53.7 | 61.8 | 64.7 |
| NII (Rp trillions) | 3.1 | 4.01 | 3.2 | 6.3 | 6.2 |
| ROA (%) | 1.37 | 1.9 | 2.5 | 3.5 | 2.6 |
| NPLs Gross (%) | 12.1 | 8.1 | 8.2 | 5.8 | 8.3 |
| NPLs net (%) | 3.6 | 2.1 | 3.0 | 1.7 | 4.8 |
| CAR (%) | 20.5 | 22.5 | 19.4 | 19.4 | 19.5 |

Source: Bank Indonesia, Economic Report on Indonesia 2005, p.145, Table 8.2

2.2.2 Growth of Micro, Small, and Medium Enterprise (MSME) Lending

Based on BI Regulation No. 3/2/PBI/2001 concerning Lending of Small-Scale Business Credit, banks are set moral obligation to lend to MSMEs and they are required to commit MSME loan in their business plan.

BI has also worked for empowering MSMEs, through the formation of loan insurance schemes that have involved Askrindo (Asuransi Kredit Indonesia) and the Regional Governments. Steps have been taken to relax regulations through reduction of Risk Weighted Assets for small business loans, housing loans and loans to civil servants/retirees.

The years since 2001 have seen a steady expansion in the share of MSMEs credit. This shows that the banking system sees lending to the MSMEs sector as viable and commercially profitable activity. According to Bank Indonesia 2005 Economic Report, in line with the overall expansion in credit, loan disbursements to MSMEs increased sharply during 2005

(See Table 2-6).⁸ The total loans outstanding to MSMEs reached Rp354.9 trillion, up 30.9% over the same period in the previous year and representing 51.0% of total bank lending.

The fact that 2005 was the International Year of Microcredit set by the UN and the launching of Indonesian Microfinance Year seemed to contribute to the growth of MSME lending, and banks disbursed more than what they planned in their business plans.

Table 2-6 Micro, Small, Medium Enterprise Credit

| Description | Position (Rp. Trillion) | | | | | Growth (%) | | | | Share (%) | | | | |
|---------------------------|----------------------------|--------------|--------------|--------------|--------------|---------------|-------------|-------------|-------------|--------------|--------------|--------------|--------------|--------------|
| | 2001 | 2002 | 2003 | 2004 | 2005 | 2002 | 2003 | 2004 | 2005 | 2001 | 2002 | 2003 | 2004 | 2005 |
| Use | | | | | | | | | | | | | | |
| Working Capital Credit | 54.4 | 73.7 | 91.1 | 111.6 | 142.6 | 35.6 | 23.7 | 22.5 | 27.8 | 44.8 | 45.8 | 44.0 | 41.2 | 40.8 |
| Investment Credit | 15.8 | 17.4 | 22.8 | 28.5 | 33.1 | 9.7 | 31.1 | 25.0 | 16.1 | 13.0 | 10.8 | 11.0 | 10.5 | 9.3 |
| Consumption Credit | 51.2 | 69.9 | 93.2 | 131.0 | 179.2 | 36.7 | 33.3 | 40.6 | 36.8 | 42.2 | 43.4 | 45.0 | 48.3 | 50.5 |
| Total | 121.4 | 161.0 | 207.1 | 271.1 | 354.9 | 32.7 | 28.6 | 30.9 | 30.9 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| Economic Sector | | | | | | | | | | | | | | |
| Agriculture | 6.6 | 8.6 | 8.6 | 12.1 | 12.6 | 29.7 | 0.2 | 40.0 | 4.5 | 5.5 | 5.4 | 4.2 | 4.5 | 3.6 |
| Mining | 0.3 | 0.5 | 0.6 | 0.9 | 1.0 | 76.7 | 10.8 | 51.6 | 6.6 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 |
| Industry | 17.6 | 22.0 | 24.4 | 26.5 | 32.5 | 25.2 | 10.8 | 8.8 | 22.3 | 14.5 | 13.7 | 11.8 | 9.8 | 9.2 |
| Electricity Water & Gas | 0.1 | 0.1 | 0.1 | 0.1 | 0.2 | 6.7 | 29.5 | 5.8 | 92.5 | 0.1 | 0.1 | 0.1 | 0.0 | 0.1 |
| Construction | 3.1 | 3.6 | 4.6 | 5.9 | 7.7 | 19.1 | 26.1 | 29.0 | 30.2 | 2.5 | 2.3 | 2.2 | 2.2 | 2.2 |
| Trade | 26.6 | 38.6 | 52.8 | 67.2 | 87.5 | 45.1 | 36.7 | 27.4 | 30.2 | 21.9 | 24.0 | 25.5 | 24.8 | 24.7 |
| Transportation | 2.8 | 3.7 | 5.1 | 6.0 | 6.5 | 33.3 | 37.0 | 19.4 | 7.6 | 2.3 | 2.3 | 2.4 | 2.2 | 1.8 |
| Business Services | 6.0 | 8.0 | 13.3 | 15.5 | 20.7 | 33.8 | 66.5 | 17.3 | 32.8 | 4.9 | 4.9 | 6.4 | 5.7 | 5.8 |
| Social Services | 1.7 | 2.2 | 3.0 | 4.3 | 5.3 | 35.0 | 35.0 | 41.1 | 24.0 | 1.4 | 1.4 | 1.2 | 1.6 | 1.5 |
| Others | 56.7 | 73.6 | 94.6 | 132.4 | 180.9 | 29.8 | 28.6 | 39.9 | 36.6 | 46.7 | 45.7 | 45.7 | 48.8 | 51.0 |
| Total | 121.4 | 161.0 | 207.1 | 271.1 | 354.9 | 32.7 | 28.6 | 30.9 | 30.9 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| Ration-MSMEs/Total | | | | | | | | | | | | | | |
| Bank Lending | 38.4 | 39.2 | 47.1 | 48.5 | 51.0 | | | | | | | | | |

Source) Bank Indonesia 2005 Economic Report

Agriculture sector MSME lending has also grown from Rp. 6.6 trillion in 2001 to Rp. 12.6 trillion in 2005. However, its share among MSME lending is not high. It was 5.5% in 2001, and it is on the declining trend and in 2005 it was 3.6%. MSME Lending is dominated by industry and trade sectors.

2.2.3 Efforts to Link MSMEs and Banks

Bank Indonesia (BI) has been making efforts to link micro, small and medium enterprises (MSMEs) and banks not only through regulations, but through both theoretical (research) and practical (training) aspect responsibility of its Credit Bureau Division.

As for the training, it conducts various training programs not only to banking staffs but also BDS Provider (BDSP) in order to promote more financial access by MSMEs. In 2005, BI provided trainings for 1,605 individual Bank Partner Financial Consultants (KKMBs) coming from 780 BDSPs⁹, and also for 2,530 banking staff. BDSPs are expected to function as an intermediary (facilitator) between micro enterprise and banks. The participants from banks are mainly Account Officers in charge of MSMEs belonging to both commercial banks and BPRs. The courses are not separated for each category of banks, namely, Account

⁸ MSME Lending in Indonesia is categorized according to the size of the loan which is up to Rp. 500 million per customer.

⁹ According to BI, so far loans disbursed through the KKMBs totaled Rp. 164.3 billion from 303 bank offices to a total of 3,522 MSMEs.

Officers from commercial banks and BPRs receive the same courses together. Training conducted by BI requires 20 participants. BI bears maximum 50% of the cost for training addressed to banks and maximum 30% for training to BDSP.

The training subjects for BDSPs are: (i) the empowerment of MSME and BDSP, (ii) introduction to banking, (iii) introduction to accounting, (iv) financial report analysis, (v) guidance of making business feasibility study and credit proposa, (vi) questionnaire preparation, (vii) legal aspect of business, (viii) financial aspect of business, (ix) application of computer in business feasibility study, (x) case study, and (xi) establishment of BDSP communication forum. Meanwhile, Training subjects conducted by BI to banks include: (i) Rapid Rural Appraisal (PRA), (ii) MSME analysis, and (iii) how to handle non-performing loan.

BI has signed MOU with the Ministry of Marine and Fishery, the State Ministry of Cooperative and SME, and the Coordinating Ministry of People's Welfare in initiating the establishment of KKMB (Banking Partner Financial Consultant). BI facilitates this KKMB by forming Komite SATGASDA KKMB in province, whose tasks include providing training to BDS Provider. The selected BDSP can participate to have internship in some Banks, such as in BRI, Bukopin and Mandiri. But, this internship is carried out only in certain area.

In addition, BI has conducted training for duck and sweet potato farmers, aiming to increase farmers' saving.

From theoretical point of view, the Division has been conducting research of lending models for 76 kinds of commodities. Lending models in mango and duck have already been studied and the results are published. The Division is also conducting a study on cluster to understand what type of loan is needed by the cluster. There are two types of clusters: (i) Underdeveloped Cluster and (ii) Developed Cluster. The Division so far concluded that for the Underdeveloped Cluster, financing should be subsidized by the Government to realize low interest rates and no collateral lending, and be facilitated by the Universitas and BDSP in marketing, production and technology. Lending should be offered to the groups, instead of individuals.

2.2.4 Onset of Syariah Financing

Based on the Banking Law No. 10/1998 concerning Banking System, banks were enabled to carry out banking activities based on the Islamic Principle. In 1999, Government established a team to develop several instruments and regulation for Syariah Banking¹¹. At that time, Bank Muamalat Indonesia was the only Syariah Bank in Indonesia. Currently, there are two more Syariah Banks in Indonesia, which are Bank Syariah Mandiri, and Bank Syariah Mega Indonesia. Besides, there are 19 divisions of Syariah banking in National Banks (commercial banks which are able to operate syariah banking offices) and 104 Shariah-based

¹¹ The establishment of Bank Syariah was initiated by the former President Suharto. This establishment was conducted after carrying out a research to about 5000 respondents in Central, West and East Java. More than 40% of those respondents believe that interest rate is against the Islam principle. Many of them do not want to put their idle money in the Bank to avoid sin. They prefer to put their money on the roof. Islamic bank is very potential, especially in East Java, South Sulawesi and North Sumatera.

BPRs (BPR Syariah).

There are two considerations in understanding and developing Syariah Bank: (a) legal issue, where the idea of interest is prohibited, and (b) economic issue, where justice in economy is emphasized. In conventional banking, depositors obtain interests whether the bank gets profit or not. while in Syariah banking, there is profit and loss sharing. Syariah Banks invest the funds to the real sector, and they are not allowed to invest in speculation, which is not stable.

Bank Indonesia has Shariah Banking Division which has a socialization program concerning Syariah Banking addressed to academic people and Islamic schools.

2.2.5 Safety Net for Natural Disasters

In order to support the recovery of economic condition in the area hit by natural disaster, the Government of Indonesia through the Ministry of Finance issued Decree No. 31/PMK.07/2005 and Government Policy No. 14/2005. These regulations let the State Owned Banks, namely: BRI, BPD, Bank Mandiri and BNI, to write off some of its loans in Aceh after tsunami. In this case, the Government does not inject any liquidity for the write offs, but it must follow the regulation that the write off is off set by the capital reserve.

Simultaneously, BI that has the authority in the banking system in deems it necessary to provide special treatment for credit in the form of relaxation in assessment of credit quality and the requirements for regular reporting to Bank Indonesia. Then, Bank Indonesia issued several regulations to support the recovery of banking activities in the area hit by natural disaster. The details of these regulations are found in Appendix a: Report on Major Laws and Regulations related to Microfinance.

2.3 Overview of the Microfinance Sector

2.3.1 Microfinance Landscape

The microfinance sector in Indonesia comprises government programs, institutional finance, and informal finance.

(1) Government Programs

Indonesia has many microfinance targeted programs and poverty alleviation programs with microfinance component. According to the GTZ ProFI Report as of 2005, the numbers reach up to seventy, and they compiled the information on 16 programs shown in Table 2-7:

Table 2-7 Examples of Central Government Poverty Alleviation Program

| Ministry / Institution | Program | Budget (2002) (million Rp.) |
|---|--|--------------------------------|
| National Family Planning Coordination Board | Family Welfare Income Generation Project (Usaha Penengkatan Pendapatan Keluarga Sejahtera: UPPKS) | 1,370,833 |
| Ministry of Agriculture | Rural Income Generation Project (RIGP or P4K) | 19,855 |
| Ministry of Public Works | Urban Poverty Project (Program Penanggulangan Kemiskinan di Perkotaan: P2KP) | 438,910 |
| Ministry of Industry and Trade | 1) Partnership Program (Program kemitraan), 2) Establishment of New Entrepreneurship, 3) Business Clinic Development | 3,483 |
| Ministry of Cooperatives and Small and Medium Enterprises | Revolving Fund Provision for USP / KSP / LKM Program | 90,000 |
| | Capital and Financial Institution Strengthening through Provision of Initial Capital and Funding (MAP) | 8,225 |

| Ministry / Institution | Program | Budget (2002) (million Rp.) |
|--|--|--------------------------------|
| Ministry of Marine and Fishery | Empowerment of Coastal and Small Islands Population (PEMP) | 1,028,000 |
| | Management and Exploitation of Small Islands | 8,225 |
| Ministry of Home Affairs and Regional Autonomy | 1) Kecamatan Development Project (Proyek Pembangunan) and Regional Autonomy Kecamatan (PPK), 2) Regional Empowerment Project (Proyek Pemberdayaan Daerah: PPD) | 1,028,000 |
| Ministry of Women Empowerment | Women Empowerment through Local Economic Development (Pemberdayaan Perempuan melalui Pengembangan Ekonomi Lokal: P3EL) | 4,000 |
| Central Bureau of Statistics | Evaluation of Poverty Indicator Methodology, Regional Calculation of Poor Population in Social Economic Survey 2002 | 206 |
| National Land Use Agency | Land Use Management (land redistribution) for Sharecroppers | 944 |
| | TOTAL | 2,964,456 |

Source) ProFI (2005) Indonesia: Background Paper on Microfinance Policy and Strategy

The detailed financial support programs under the Ministry of Agriculture will be explained in the next chapter.

At local government level, there are many poverty alleviation programs. The programs related to the Sample Kabupaten and Province are described in the later section. Most of the programs are microfinance to the group in micro business, and there seem to be blurred objectives of poverty alleviation and micro business promotion.

(2) Institutional Microfinance

Institutions which offer microfinance services include (i) Commercial Banks (mainly BRI Units), and People's Credit Bank (*Bank Perkreditan Rakyat* : BPR), (ii) savings and loan cooperatives (*Koperasi Simpan Pinjam*: KSP) and units of savings and loan (*Unit Simpan Pinjam*: USP) of multipurpose cooperatives, (iii) village credit institutions (*Badan Kredit Desa*: BKD), and rural credit fund institutions (*Lembaga Dana Kredit Pedesaan*: LDKP), and (vi) pawnshops. Other than BRI Units, other commercial banks attempt to enter in the microfinance sector by channeling funding through above MFIs and/or setting up units.

The outline of microfinance institutions are summarized in Table 2-8 below:

Table 2-8 Microfinance Institutions

| Institution Name | Units | Loan Amount (in Rp.000) | Client | Savings (in Rp.000) |
|---------------------------|--------|-------------------------|------------|---------------------|
| BRI Unit (BRI, Dec. 2003) | 3,916 | 14,182,000 | 29,870,000 | 27,429,000 |
| BPR (BI, Dec. 2004) | 2,158 | 12,150,000 | 5,760,000 | 11,160,000 |
| KSP (MENKOP, Apr. 2000) | 1,097 | 531,000 | N/A | 85,000 |
| USP (MENKOP, Apr. 2000) | 35,218 | 3,629,000 | N/A | 1,157,000 |
| BKD (BRI, Mar. 2004) | 5,345 | 200,000 | 460,000 | 28,500 |
| LDKP (BI, June 2000) | 2,272 | 358,000 | N/A | 334,000 |
| Pawnshop ^{*1} | 42 | 21,000 | No savings | No savings |
| BMT ^{*2} | 3,038 | 157,000 | N/A | 209,000 |
| CU ^{*3} | 1,022 | 395,721 | 207,147 | 272,124 |
| NGO ^{*4} | 124 | 110,008 | 81,931 | 11,969 |
| Total | 54,232 | 31,733,729 | 36,379,078 | 40,686,593 |

1*: Pawnbroker Institute July 2004, 2*: PINBUK December 2001, Some 30% of BMT are not registered as savings and loan cooperatives. 3*: CU Headquarter December 2002. Some 70% of CUs are not registered as savings and loan cooperatives, 4*: 16 NGOs (out of 500) December 2003.

Source: ProFI (2005) Indonesia: Background Paper on Microfinance Policy and Strategy.

(3) Microfinance in Informal Sector

Informal sector is consisted of thousands of self-help groups (SHGs) both voluntary formed and formed under government programs, informal savings and loan cooperatives, *Baitul Maal wat Tamwil* (BMT) and Credit Unions (CUs)¹², NGOs, *arisan*, money lenders, and traders.

2.3.2 Legal Framework for Microfinance Institutions

(1) Current Legal Set-Up

Banks including BPRs are regulated under the Law No.7/1992 which allows to take deposits from the public. It was amended in the Law No.10/1998, to accommodate the growing Islamic banking industry and to regulate banking operations based on Syariah principles, under the supervision of BI. According to the Article 16 of the Banking Law, non-bank non-cooperative microfinance institutions are not allowed to take deposits.

Among non-bank financial institutions, only cooperatives (supervised by the Ministry of Cooperative and SMEs) are allowed to take deposit (savings), but from members and not from the public, under the Law No. 25/1992. Some cooperatives take deposit from non-members, calling them “potential members”, which is not legally allowed.

Another type of non-banking financial institution, pawnshops are the state-owned enterprise (SOEs) operating under the Law No.103/2000, supervised by the Ministry of Finance. (MOF).

BKD operation is legally recognized by the Government Gazette of 1929 of Java Island Finance Department under Dutch Colonial time. They were supposed to convert to BPR under the Banking Law/1992, but none did, because they do not fulfill the level of required capital. LDKPs were established by various provincial governments under provincial regulations. They were also required to convert to BPR under the Banking Law/1992, but only 630 out of 2,244 did so. Both BKD and LDKP are deemed to be in gray zone in the sense that they are not allowed to take deposits if they are not converted to BPR.

NGOs operate under the 2001 Law of NGO. They implement a variety of donor funded projects or formation of groups and linking them to formal banking institutions, but some of the groups take deposits (savings) from the public. They are not supervised by any authorities.

More than two persons can form an association on profit or non-profit purpose, under the Association Law of Year 1848, to be registered under the Ministry of Justice, and get the legal status. But it is not used for microfinance institutions according to the ADB (2003) Final Report of Rural Microfinance Project.

The detailed report on the major laws and regulations related to microfinance is found in Appendix a.

(2) Movement towards the Legalization of Non-Bank Non-Cooperative MFI

There are many non-bank non-cooperative Microfinance Institutions (NBNC MFIs: LKM

¹² Some are not registered under cooperative law.

B3K), not registered as cooperatives, and very small institutions such as groups, associations, and arisan, which are officially not allowed to take deposits, but in reality they grew from the needs of the community and they exist as deposit (savings) taking institutions. On the other hand, there are cooperatives taking deposits (savings) from non-members, which are not allowed under the current legal system. This legal framework does not reflect such reality of the microfinance on the ground. Based on the evidence from literature research and our field survey, micro business and poor people really need financial services of NBNC MFIs due its service flexibility. Therefore these NBNC MFIs need a legal base to enable them to operate their business sustainable. Without legal status, these institutions are hampered to grow healthy and cannot serve to the needs of the community properly.

It is against this background that GTZ's microfinance support program: Promotion of Small Financial Institutions (ProFI) has coordinated an exercise to assist stakeholders to develop a microfinance policy and strategy, in order to have a Government Regulation authorized by an Act of Parliament through an amendment of the Banking Law. ProFI initiated the National Microfinance Policy Discussion Forum (FOMFI) for this purpose.

In 2001, the Initiative Team consisted of BI, the State Ministry of Cooperative & SME, the Ministry of Finance, and State Secretary proposed a Draft Law of Microfinance Institution (MFI=LKM). Until 2006, the status of this draft was still under discussion among the stakeholders. Now, the preparation of finishing this draft involves the Regional Representatives Council (DPD), in order to accommodate the need of MFI in the region. DPD would like to reopen the discussion of this Draft Law through some socialization. DPD through its Ad Hoc Team has prepared *the Academic Script for the Draft MFI Law*. The essence of the Academic Script are summarized in Box 2-1 below:

BOX 2-1: Essence of the Academic Script for the Draft MFI Law

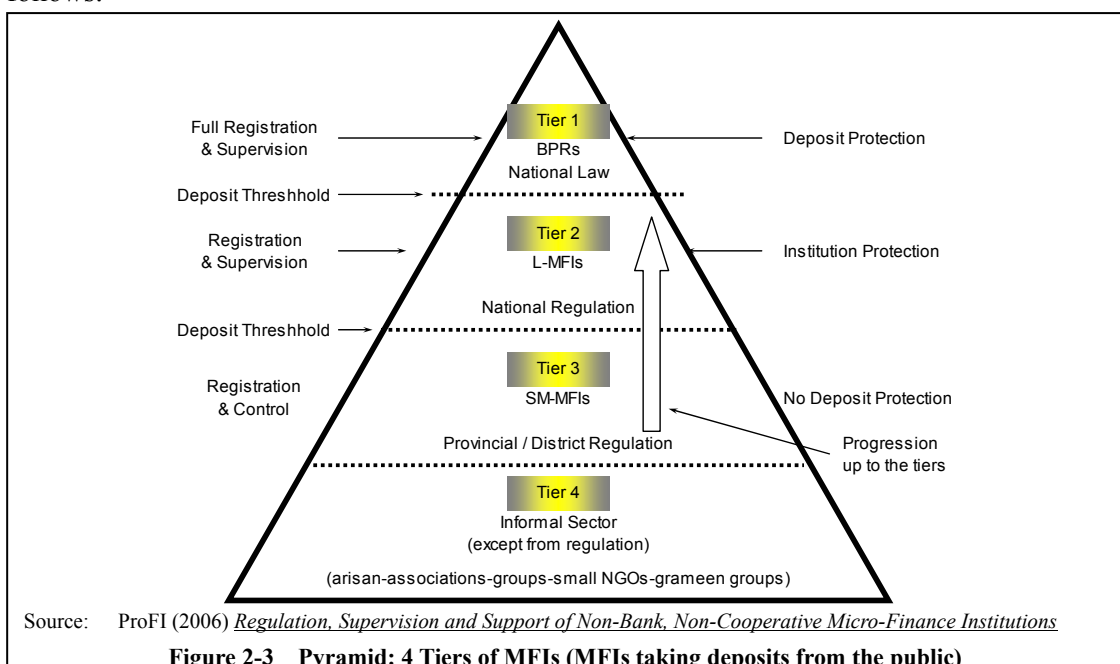
1. The main objectives of the Draft MFI Law are:
 - (i) To reveal the inconsistency of the existing regulation with the need of Micro Finance Institution Non Bank Non Cooperative.
 - (ii) To provide general description of Micro Finance Institution Non Bank Non Cooperative completely.
 - (iii) To provide some inputs of the legal certainty for Micro Finance Institution Non Bank Non Cooperative.
2. The main topics of the Draft MFI (LKM) Law are as follows:
 - (i) The LKM regulated on the Law is only in the form of LKM B3K (Micro Finance Institution Non Bank Non Cooperative).
 - (ii) Business coverage of LKM are as follow: 1) Credit Extension or Financing to micro individual or group; 2) Saving; 3) Other financial services that is not against the existing regulations.
 - (iii) Business operational principle can be in the form of Syariah or Conventional.
 - (iv) LKM can operate only within a village/kelurahan, kecamatan (sub-district), kabupaten/kota (district/municipal) based on the given permit.
 - (v) LKM can be in the form of: a) Group of minimum 20 people (Indonesia citizens) without any family relationship and descent to the second degree; b) Indonesia legal entity wholly owned by Indonesian citizens, such as: PT, PD or Village Owned Enterprise.

- (vi) The amount of minimum paid up capital is determined by the Ministry of Finance based on business coverage area.
- (vii) Fund mobilization will be based on strata of LKM which is regulated by the Ministry of Finance.
- (viii) The supervision of LKM is conducted by the Ministry of Finance. In implementing this task, the Ministry of Finance can delegate its authority to another party.
- (ix) The LKM that violates the provision of the Law shall be subject to sanctions (fines or criminal sanction).
- (x) LKM obliges to protect its clients (depositors and debtors)
- (xi) LKM supervision and development efforts conducted by the Ministry, Government Institution and others still can be continued in order to support the work program of those institutions.
- (xii) Coordinating Committee of Micro Finance Development will be established by the Government Regulation
- (xiii) LKM B3K, including BKD and LDKP that are not fulfilling the requirement as a Bank, should comply to this law within 12 months at the latest.

Source) Draft Law of Micro Finance Institution – Academic Script, prepared by AD HOC II Committee, Regional Representative Council of RI.

In addition, to fill the urgent need of MFI Law, currently, the State Ministry of Cooperative and SME initiated the draft of President Regulation concerning ***National Policy and Strategy for Micro Finance Development***, which is coordinated by the Coordinating Ministry of Economy. This draft was submitted to the Ministry of Finance, still being in the process of analyzing the definition, scope, articles of association and legal aspect of MFIs, before being proposed to the President to be issued as President Regulation. This President Regulation will be considered as the umbrella for the rapid growth of existing MFIs and also, to fill the inexistence of MFI regulation, since ***the draft Law of MFIs*** is still in the process and will be scheduled to be put in the National Legislation Program in 2007.

The recommended legal framework constitutes the strata of MFIs as shown in Figure 2-3 as follows:



In Figure 2-3 above, LDKP, BKD or cooperatives to deal with the public shall in principle, fall under SM-MFIs (Small and Medium MFIs) under Tier 3, being separated from the very small savings and loan groups, associations, and arisans which shall remain in Tier 4. From Tier 3, institutions having a big volume of deposits shall move up to become Large MFIs (L-MFIs) in Tier 2. The possible minimum capital entry point range (deposit threshold) for L-MFI is suggested to range from Rp. 200 million to Rp. 1,500 million.

The legal framework to enable this is at national level, the amended Banking Act (MFI legal window 1) allowing to issue Government Regulation or Presidential Decree to create the legal framework for MFIs, and Cooperative Act (MFI legal window 2) to govern savings and loan activity of cooperatives and shall be amended to require very large KSP/USP to comply with directives of the National Regulator and Supervisor (NRS). And there shall be the MFI Regulation which sets out parameters for deposit mobilization from the public by NBNC MFIs (to create MFI legal window 3). At regional level, the provincial laws / regulations and district regulations /decrees are required to create legal framework for SM-MFIs.

For the village level set-up, recently the Law on Regional Administration was launched, where the Village Owned Enterprises (*Badan Usaha Milik Desa*: BUMDes) will be legal entities. This would be able to administer the microfinance activities, based on the related draft regulation by the Ministry of Home Affairs²⁷.

2.3.3 Financial Intermediary (Re-lending) to Microfinance Institutions

While some commercial banks attempt to enter into microfinance market directly, such as BRI Units and Danamon Simpan Pinjam Units, others take indirect way of entering the market, by strategically lending (re-lending) to MFIs. Some of the latter even play the role of building the capacity of MFIs by themselves, or by working with capacity building partners. These financial institutions are mostly banks such as Bank Bukopin, Bank Mandiri, Bank Syariah Mandiri, Bank Rakyat Indonesia (BRI), Regional Development Bank (BPD), and a state-owned enterprise, Permodalan Nasional Madani (PNM). The detailed report on the commercial banks mentioned here is found in Appendix b: Report on Major Commercial Banks in Microfinance Sector.

(1) Bank Bukopin

Bank Bukopin was established in 1970 to focus on cooperatives, micro, small and medium enterprises. The Bank established “Swamitra” as a form of five-year partnership between Bank Bukopin and Cooperatives. The “Swamitra” program was initiated in 1998 in response to Government regulations which is requiring commercial banks to allocate 22.5% of their portfolio to small businesses and to the deteriorated public image of government-led cooperatives. “Swamitra” are cooperatives or other micro-financial institutions that have entered into a business relationship with Bank Bukopin. Swamitra, empowers functions and roles of Cooperatives as MFIs, through modernization of savings and loan business based on technology network and support from professional management system. Bukopin

²⁷ ProFI (2006) Regulation, Supervision and Support of Non-Bank, Non-Cooperative Micro-Finance Institutions

prepares Swamitra Business Guidelines (Credit Guidelines, Operational Guidelines, Human Resource Guidelines) so that it will be beneficial to cooperatives and its members. Through “Swamitra”, the members of cooperatives are able to access to capital, effective liquidity management and efficient financial transaction through the bank’s on-line system. Cooperatives are expected to develop Unit Simpan Pinjam / USP (saving and loan unit), to improve service to members in accessing capital, and to manage liquidity of USP more efficiently. The entry conditions for cooperatives are that they should have a minimum capital of Rp. 500 million, out of which, Rp. 50 million should be their own capital. The partnership fee payable is Rp. 25 million for five years, and technology fee is minimum Rp. 0.5 million, and the management fee which is calculated case by case.

In order to improve the economic level of the people in the coastal area, Bank Bukopin has also initiated cooperation with fishermen cooperatives/fishery cooperatives, called “Swamitra Mina”.

(2) Bank Mandiri

Bank Mandiri was established in 1999 as a result of the merger of four state owned banks – Bank Bumi Daya, Bank Dagang Negara, Bank Exim, and Bapindo. Bank Mandiri offers a comprehensive range of financial solutions to both private and state owned corporate entities, commercial, small and micro businesses as well as retail customer.

Bank Mandiri has strong commitments in developing Micro, Small and Medium Enterprises (MSMEs). Bank Mandiri also sets up Micro Banking Sales Group to strengthen its linkages with BPR. Until the end of 2005, its BPR linkage was about 1,100 BPR. Loan channeling from Bank Mandiri to BPR is in the form of BPR Mitra Mandiri (BM2) with the patterns of executing, sharing and channeling, which is extended to MSMEs. The role of Bank Mandiri in BPR is not limited to support BPR in financial matters only, it also provides technical training to BPR staffs, improves BPR’s information technology, and also conducts comparative study with other BPR.

(3) Bank Syariah Mandiri

Bank Syariah Mandiri (BSM) was established in 1999, originated from the conventional Bank Susila Bakti which changed its status from a conventional bank to a commercial bank under Islamic Syariah principle. Then, the Bank changed its name to Bank Syariah Mandiri.

In reaching Micro and Small Medium Enterprises (MSMEs) in rural area, BSM has cooperation with BMT (Baitul Maal Wat Tamwil) and BPR Syariah, since their coverage is wider. BSM Financing Activities includes Two Step Loan (TSL), to BMT, BPR, KSP/USP, KUD. This TSL financing contributes more than 60% of its credit portfolio. Most of TSL financing is through BMT. Until today, BSM has financed more than 200 BMT. The criteria of BMT required by BSM, among others are: (i) capital capacity, NPL, and others based on its financial record, (ii) minimum 2 years operation, (iii) it doesn’t have to be licensed or not licensed BPR.

Currently, loan extended to MSME is about 47% of BSM total credit portfolio. BSM has target to increase the portion to be 75%.

BSM has cooperation with BMT Association, such as: PINBUK, Microfin and BMT Center (NGO). Those NGOs provides TA to BMT and give recommendation to BSM concerning the performance of BMT. They act as intermediary if there is problem occurred between BSM and BMT.

(4) Permodalan National Madani (PNM)

Permodalan National Madani (PNM) is a state owned company set up in 1999. Its mandate is to provide financing to MSMEs and cooperatives. Its financing schemes seek to minimize collateral approaches and profiteering. It also provides management assistance packages with finance. It works with venture capital firms, syariah banks, savings and loans co-operatives and rural banks. It aims to cover the business of food crop agribusiness, estates, fisheries, livestock farming, forestry and export-oriented, labour-intensive cottage industries, in addition to service industries.

It manages 12 government credit schemes, which are subject to re-lending through banking institutions, BPR, cooperatives, and BMTs. It fosters, empowers, finances to strengthen the capital structure of the institution. It renders technical assistance such as training, management consultancy, and management services to create value for MFIs.

(5) Bank Rakyat Indonesia (BRI)

BRI was established on 16 December 1895 as a small financial institution, and later it became a commercial bank²⁸. It has been involved in fostering and supervision of Badan Kredit Desa (BKD), as entrusted by Bank Indonesia.

(6) Bank Pembangunan Daerah (BPD, Regional Development Bank)

Bank Jabar and Bank Jatim extend the credit to cooperatives as investment capital or working capital from the fund entrusted by the donors, and central and local governments.

2.3.4 Capacity Building Programs of MFIs

Other than commercial banks which lend to MFIs, there are government programs which have a component of building up the financial institution: Rural Income Generation Project (RIGP or P4K) and Development of MFIs in Agrobusiness (LKM-A) under MOA, Urban Poverty Project (UPP or P2KP) under the Ministry of Public Works, Revolving Fund for USP/KSP/LKM under the State Ministry of Cooperatives, Empowerment of Coastal and Small Island Population (PEMP) under the Ministry of Marine and Fisheries, and Kecamatan Development Project under the Ministry of Home Affairs and Regional Autonomy. Another institution which has MFI capacity building facility is PINBUK, which also works under LKM-A.

RIGP started in 1979 as a savings and loan facility for the Self Help Group (SHG) of poor

²⁸ Bank Rakyat Indonesia (BRI) was established on 16 December 1895 as a small financial institution in Purwokerto, Central Java. Based on Government Regulation No. 1/1946, BRI was considered as the first state owned bank in Indonesia. In 1960, BRI was changed into Bank Koperasi, Tani dan Nelayan (Bank for Cooperative, Farmers and Fishermen). Based on Law No. 21/1968, the function of BRI was changed as a commercial bank. In 1992, based on Law No. 7/1992, the status of BRI was changed into PT. Bank Rakyat Indonesia (Persero) and the Government of Indonesia still owned 100% of its shares. Then, in 2003, BRI conducted the Initial Public Offering which divested 30% of its shares to the public.

people in business. But when it was realized that beneficiaries cannot have access to financial institutions when they graduate the project, they introduced the idea of encouraging SHGs to form Associations (Gabungan), and later transform it to an MFI. But the program did not incorporate additional capital base strengthening for Gabungan nor MFI.

The Program of **MFIs in Agribusiness (Lembaga Keuangan Mikro Agribusiness: LKM-A)** started in 2004 to promote utilizing the funds managed by the community, which could finance farmers and agribusiness, and to facilitate the community to become self-reliant and autonomous. The program is, in principle, a capacity building (training and working capital injection) of LKM-A. And these LKMs are expected to operate under the Law No. 25/1992, as agriculture cooperatives (Koperasi Tani: Koptan). LKM-A includes not only farmers' groups (Kelompok Tani) but also other existing self-help groups in the community (Kelompok Swadaya Masyarakat: KSM), and the existing LKM (transforming existing LKM in the community to serve farmers and agribusiness). MOA supported 368 LKM-As in 12 provinces, in the period of 2004 to 2006. MOA works in partnership with PINBUK. **PINBUK (Micro Enterprise Incubation Center)**, an organisation which has a program of institutional development of BMT, based on syariah principle, professionalism, self-support and independence and sustainability. It developed the Regulations of BMT and it does train, monitor, and guide BMTs. Other such organizations are Microfin and BMT Center.

Empowerment of Coastal and Small Island Population (Pengembangan Ekonomi Masyarakat Pesisir: PEMP) under the Ministry of Marine Affairs and Fishery provides the cash collateral for the cooperatives in coastal areas, and Bank BUKOPIN is involved in cooperative selection and capacity building of cooperatives by offering guidance and monitoring on how to run the financial institution (including savings and loan business and human resource), modifying Swamitra system (capacity building partnership package of cooperatives, see below) to Swamitra Mina. Swamitra Mina is aimed at assisting fishermen's community, processing of sea products and related businesses.

Revolving Fund for USP/KSP/LKM of the State Ministry of Cooperatives are meant to strengthen the capital base of cooperatives and to render loan to MSMEs. The Productive Empowerment Project for Medium Business Loans (P3KUM) is the modified version which started in 2006. It systematically gives Rp. 100 million of soft loan to one cooperative in each Kecamatan, through BPD for conventional finance and through Bank Muamalat and Bank Syariah Mandiri for syariah finance. The loan is payable in 10-years time, with the interest rate of 16% p.a.

Urban Poverty Project (UPP), which is sponsored by the World Bank started in 1999, following the currency crisis of 1997, aiming to get financial resources quickly to the poor. It was designed to organize the poor into groups which would receive microcredit loans for income generation and or grants for tertiary level infrastructure; and (ii) promote the development of community organizations (Badan Keswadayan Masyarakat: BKM) at Kelurahan level, that would receive block grants that they would manage as a revolving fund. BKM is established through election as legitimate representative institution trusted by the community, channeling fund for social program (health, education, and food), environment

program (infrastructure such as housing and water supply), and economic program (microfinance to and training of MSMEs). Currently UPK (financial management unit) of BKM is trained by BRI and BFI Finance for accounting training, on-the-job training, and guidance²⁹.

Another World Bank Project is **Kecamatan Development Project (KDP)**, which aims at alleviating poverty, improving local governance and strengthening local government and community institutions, started in 1998. KDP allocates block grants to poorer sub-districts for financing village infrastructure and economic activities through participative local planning and decision-making mechanisms. A Financial Management Unit (UPK) at the sub-district level provides either grants for infrastructure projects to villages or loans to community groups. UPK is formed by and responsible to the UDKP (Sub-district Development Forum) which allocates KDP funds. It has been operated according to the Implementation Manual. UPKs in NTB, which were developed between 2000 to 2003 is currently under GTZ ProFI Program where they will build a strong system of sustainable village MFIs.

2.3.5 Donor Programs in Microfinance Sector

GTZ implements **ProFI** since 1999 together with Bank Indonesia and the Ministry of Finance, setting up a comprehensive microfinance program to cover from micro level MFI strengthening in Bali and West Nusa Tenggara, meso level capacity building of MFI staff certification, and to macro level policy environment as described earlier. It has also started the intervention in the earthquake area of Yogyakarta and Central Java to reconstruct the microfinance system.

World Bank (WB) implements two major poverty reduction projects with microfinance components, **Kecamatan Development Project (KDP)** since 1998, and **Urban Poverty Project (UPP)**, which started in 1999.

Asian Development Bank (ADB) funds **Community Empowerment for Rural Development Project (CERDP)** from 2001 to 2007 in eleven districts in six provinces of Kalimantan and Sulawesi, which has a component of finance institution development and village economy. ADB also started the **Earthquake and Tsunami Emergency Support Project (ETESP)** in 2005, which is providing rehabilitation and reconstruction assistance to mitigate damage caused by the devastating earthquake and tsunami happened in 2004. ETESP has a component of livelihood restoration which includes microfinance.

Japan Bank for International Cooperation (JBIC) signed the FY 2006 ODA Loan Package for Indonesia in March 2007, which includes **Regional Infrastructure for Social and Economic Development Project** in order to increase employment for the poor and improve their access to social services by developing basic infrastructure based on community needs and by piloting microfinance in communities where poverty is prevalent.

²⁹ According to “the Terms of Reference to the Partnership Cooperation to Advise UPK of BKM under the Ministry of Public Works with BRI”, BRI developed the BPO (Book of Operational Directives), hired advisors from BKD (Village Loan Bank), and trained them. In turn, the advisors train UPK of BKM. BPO includes not only savings and loan and bookkeeping, but organizational issues, TORs for staff, and inspection as well.

CHAPTER 3 AGRICULTURE AND RURAL MICROFINANCE POLICY AND PROGRAM

3.1 Ministry of Agriculture Policy and Program

3.1.1 Policy

The finance policy of the Ministry of Agriculture (MOA) is described in the Strategic Plan (2005-2009) of MOA, and in that of the Center for Agriculture Financial Services under MOA.

The government had been providing liquidity credit through Bank Indonesia (BI) up to the year of 1999, when it was stopped. Now in principle, the main avenue to assist farmers is through commercial finance, and the government's role is to facilitate, regulate, motivate, and promote the access to financial services by the farmers.

In order to achieve the targets set in the Strategic Plan, it is stated that the funds required for agriculture development is Rp.77 trillion for 5 years, but only 6% is estimated to be financed from banking institutions. According to the problem analysis by MOA, inadequate access to the capital, especially by the small-holder and landless farmers in the rural community, is caused by, firstly, the limitation of existing formal financial institutions; secondly, procedures and requirements needed by existing formal financial institutions are difficult for rural community to be carried out; and thirdly, farmers are unable to access credit due to the regulation and high interest rate applied to commercial businesses. The banking system thus far is not supporting the rural economy, particularly agriculture and tends to drain capital from rural areas.

The essence of finance policy by MOA is to stimulate the community fund by spending budget allocation of APBN and APBD, in the form of program credit, intervention to commercial credit, and facilitating capital access through non-bank finance.

In order to realize this mandate, the Center for Agriculture Financial Services was set up in 2005 under the Secretary General, which has the sections of credit program, Syariah finance, commercial finance, and administration. The strategy taken by the Center is as follows:

- (i) modification of the existing funding policy
- (ii) increase accessibility of farmers/stakeholders to the existing bank/non-bank finances
- (iii) socialization of existing financing sources
- (iv) intensification of cooperation with financial institutions and donors
- (v) development of: (a) the existing credit scheme for agriculture/agribusiness; (b) credit interest subsidy scheme, (c) credit guarantee scheme, (d) Syariah finance scheme, (e) MFIs for rural areas and agricultural SMEs, (f) concept of agribusiness funding agency, (g) agriculture commodity insurance and agency.

3.1.2 Finance Program

Major finance program implemented by MOA is listed as follows:

- (a) BIMAS Credit (Bimbingan Masal): Mass Guidance Credit
- (b) KUT (*Kredit Usaha Tani*): Farm Credit Scheme
- (c) KKP (*Kredit Ketahanan Pangan*): Food Security Credit
- (d) DPM-LUEP (*Dana Penguatan Modal Lembaga Usaha Ekonomi Pedesaan*): Capital Strengthening Fund for Rural Economic Business Institution
- (e) P4K (*Proyek Peningkatan Pendapatan Petani Kecil*): Rural Income Generation Project
- (f) BLM (*Bantuan Langsung Masyarakat*): Community Direct Assistance
- (g) BPLM (*Bantuan Pinjaman Langsung Masyarakat*): Community Direct Loan Assistance
- (h) PMAM-PMUK (*Pemberdayaan Masyarakat Agribisnis Melalui Penguatan Modal Usaha Kelompok*): Program of Empowerment of Agribusiness Community through Strengthening Group Business Capital
- (i) LKM-A (*Lembaga Keuangan Mikro Agribisnis*): MFIs in Agribusiness
- (j) SP-3 (*Skim Pelayanan Pembiayaan Pertanian*): Agriculture Financing Service Scheme

The transition of finance programs over the period of time is summarized in Figure 3-1: Transition of Major Finance Program under the Ministry of Agriculture. And the detailed description, achievement, and issues and problems of the programs are summarized in Table 3-1: Summary of Major Finance Programs under the Ministry of Agriculture.

Other than those mentioned above, MOA currently has minor programs to improve financial access in agriculture sector such as the study on Syariah Banking on Agriculture Commodity (see Box 3-1), and program of linking agribusiness to venture capital service (see Box 3-2).

The series of MOA finance programs can be categorized in to two, based on their objectives: (i) community welfare improvement, and (ii) agribusiness promotion, with overall goal of food security. The two objectives tend to be mixed up. Regarding the community welfare improvement, the efforts have been made not only by MOA but also by other Ministries and local governments, which also have various kinds of financial programs.

One striking point which came out from the review of MOA finance policy and programs is that the assistance for capacity development of farmers groups has not been enough. The additional capacity building efforts is strongly required so as to enable farmers' group to manage fund as well as to function as business entities. There are some groups and cooperatives which keep receiving the different kinds of assistance from the same and different government offices, and they are still stagnant at certain level in terms of capital base building, and do not have access to formal financial institutions. Although the attempt of capacity building has been incorporated in P4K, PMAM-PMUK and LKM-A, there is still room for improvement towards how to make the beneficiary farmers groups graduate from government assistance and have access to financial services.

Further analysis on P4K, BLM/BPLM/PMUK, and LKM-A based on the field survey is compiled in Appendix d: Additional Survey on Rural Microfinance Program.

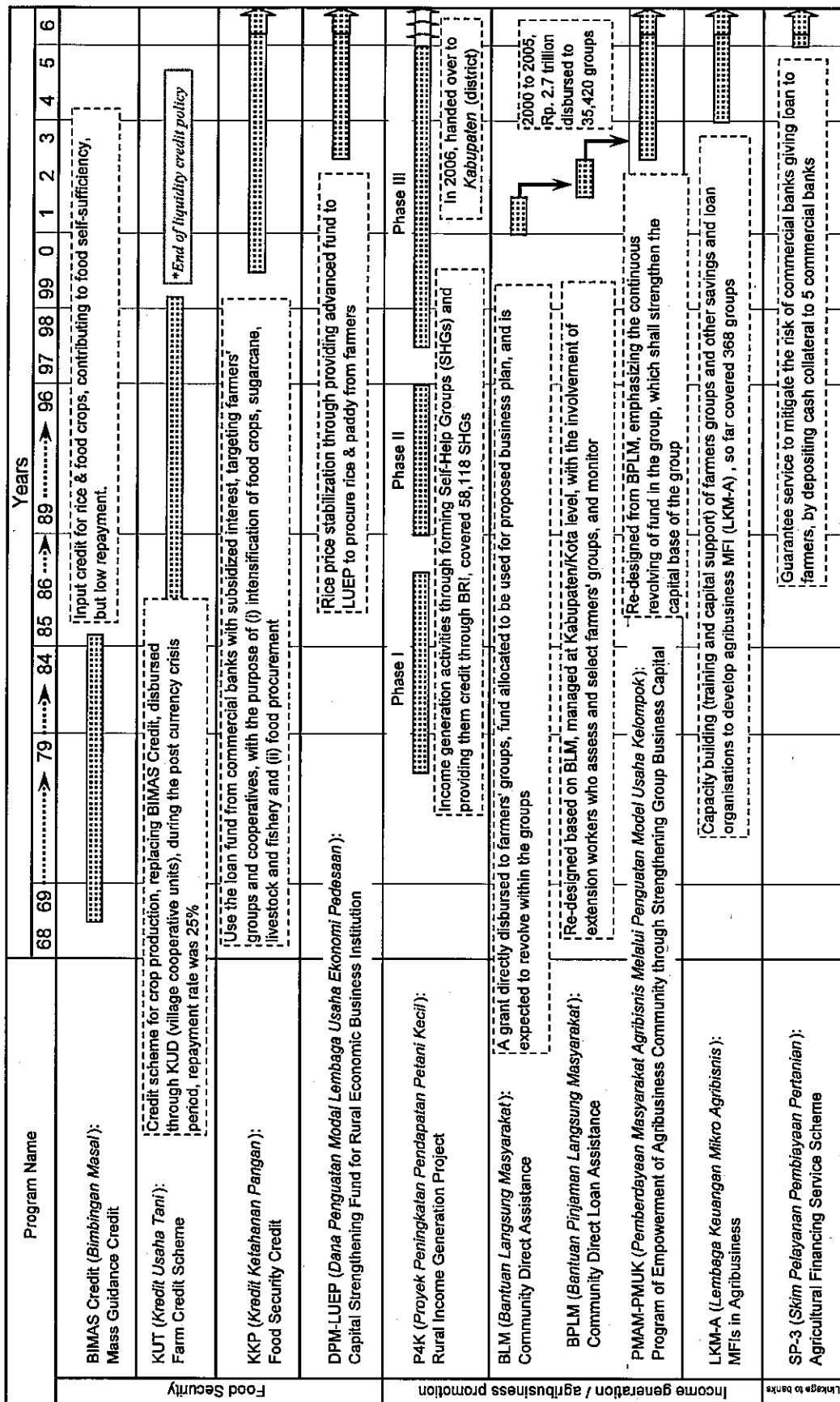


Figure 3-1 Transition of Major Finance Programs under the Ministry of Agriculture

Table 3-1: Summary of Major Finance Programs under the Ministry of Agriculture

| Name | Period | Description | Achievement | Issues / Problems |
|---|-----------|---|---|---|
| Mass Guidance (Bimbingan Massal: BIMAS) Credit | 1967-1985 | It was disbursed under Bimas Program, which was a guidance related to the application of science and technology to obtain optimal outputs of paddy and secondary crops. The Credit was channeled through BRI Units, at 3% p.a. interest rate to farmers, when the market rate was 12% p.a., and the difference was subsidized. | The total BIMAS Credit disbursed was Rp. 636.7 billion, reached 28,848 farmers. It contributed to achieve the national rice self-sufficiency in 1984/85. The repayment rate for 1970-75 was 80%, and 1976 and onwards, it was 57% ² . | The frequent debt cancellation announcement worsened the repayment rate. |
| Farm Credit Scheme (Kredit Usaha Tani: KUT) | 1985-1999 | It replaced BIMAS Credit, and it was a subsidized credit using liquidity credit from Bank Indonesia, disbursed from BRI branches through village cooperative units (Koperasi Unit Desa: KUD) to reach member farmers, for crop production purpose. KUD charged the interest rate of 12% p.a. It ended with the coming of the law 23/1999, which prohibited BI to provide liquidity credit. | Total KUT disbursed up to 1999 was Rp. 8 trillion | The repayment rate was only 25% ³ . When the impact of the economic crises and El Nino were combined, KUT was disbursed even through NGOs and MFIs, some of which were allegedly set up for this purpose. |
| Food Security Credit (Kredit Ketahanan Pangan: KKP) | 2000- | -It was introduced to use the loan fund from commercial banks (executing), but with subsidized interest rate, for the purpose of (i) the intensification of food crop (paddy, corn, soybeans, cassava and sweet potato), sugarcane, livestock (beef cow, dairy cow, chicken and duck), and fishery, and (ii) food procurement. It targets farmers' groups and cooperatives. -The major implementing banks are State-owned Banks such as Bank BRI, Bank Agro Niaga, Bank BUKOPIN, and Bank Mandiri, and Regional Development Banks. The banks use their own fund but receive the interest subsidy for the loan disbursed. For example, for the food crop intensification, the interest rate charged by BRI to the farmers has been 9% p.a. since November 2005. | -The cumulative disbursement amount as of September 2006 is Rp. 3,980 trillion. The maximum loan amount per farmer, set by BRI for example, is Rp. 15 million with maximum land ownership of 2 hectare, and the loan period is maximum 12 months. -According to the evaluation implemented by the Ministry, the average rate of non performing loan (NPL) at banks as of June 2006 is: for food crop: 6.07%, sugarcane: 0.02%, for livestock: 4.03%, for fishery: 14.10%, for food procurement: 3.01%. | -The banks became careful to approve funds and avoided the KUD which had non-performing loan from KUT, which resulted in very slow execution of loan. ⁴ - Limited registered collaterals owned by the farmers. ⁵ - Limited credit guarantor in the financial market. ⁶ |

² Ali, Y., et al. (2003) Agriculture Financial System in Indonesia, Ministry of Agriculture

³ Ali, Y., et al. (2003) Agriculture Financial System in Indonesia, Ministry of Agriculture

⁴ The proposed solution by MOA included the improvement of the role of Agriculture, Livestock and Estate Crop Dinas in bridging farmers and banks through (i) good farmer candidate selection, (ii) informing production centers which will be funded by KKP, and (iii) socialization to farmers that this is loan which should be repaid.

⁵ The proposed action against this problem is to ask executing banks to include additional certificates for lands such as temporary title, considering many farmers do not have formal land certificates. This has been implemented by the executing banks, and some banks do not ask physical collateral, and make the business itself as main collateral.

⁶ The action taken against it so far is while keeping credit guarantee companies such as AT Akrindo, and Sugar Factory PTPN, they included the food industry companies as guarantor such as PT Pertani, PT Dupont Indonesia, BULOG contractors, rice hullers, PT Citra Agro Buana Semesta, and PT Giant Livestock.

| Name | Period | Description | Achievement | Issues / Problems |
|---|--------------|---|---|---|
| <p>Capital Strengthening Fund for Rural Economic Institution (Dana Penguatan Modal Usaha Ekonomik Pedesaan: DPM-LUEP)</p> | <p>2003-</p> | <p>-On the different note of food security, in 2003, Capital Strengthening Fund for Rural Economic Business Institution (Dana Penguatan Modal Usaha Ekonomik Pedesaan: DPM-LUEP) was introduced as a part of the efforts to stabilize the purchase price of hulled rice and un-hulled paddy from farmers.</p> <p>-It had been the sole role of BULOG to purchase and control the prices of rice and paddy, but not at satisfactory level, because it had been able to purchase only around 7% of the national product.</p> <p>-DPM is the advance fund without interest from APBN distributed to LUEP, the Rural Economic Business Institution. LUEP is in partnership with farmers' group and purchase the farmers' rice and / or un-hulled paddy at agreed price, using DPM-LUEP.</p> <p>-The DPM should be returned to the state cash every end of the year.</p> <p>-LUEP has to set the fixed assets as collateral, which is equivalent to 150% of the DPM.</p> | <p>-The amount of DPM-LUEP disbursed has been Rp. 159.5 billion for 1149 LUEPs in 2003, Rp.157.5 billion for 1328 LUEPs in 2004, and Rp. 89.6 billion for 843 LUEPs in 2005. The budget allocation for the year 2006 is Rp. 238.5 billion.</p> <p>-The price of un-hulled paddy where LUEP was operating was higher than the prices where there is no LUEP in December 2005. The price of un-hulled paddy in LUEP areas tended to be above HPP in June 2005 until the end of December 2005.</p> <p>-The repayment rate of DPM-LUEP has been good, 94% in 2003, 95% in 2004, and 95% in 2005. The LUEPs which failed to pay arrears after the deadline were referred to the Office of Kantor Pelayanan Piutang dan Lelang Negara: KP2LN to execute the pledged fixed assets. The number of such LUEPs was 86 in 2003, 45 in 2004, and 7 in 2005.</p> | <p>(i) The delay in releasing fund from APBN, which started in April to June, resulted in shorter time for DPM-LUEP to synchronize with the harvest pattern.</p> <p>(ii) Marketing capacity of LUEP is still limited, so that some LUEP still depends on the purchase of PERUM BULOG.</p> <p>(iii) The human resource to financially administer DPM-LUEP is still limited, which caused difficulties for LUEP in making accurate point of benefit / advantages taken from this activity. The training has been delivered but there is still need to add more training on administrative work.</p> <p>(iv) The limited facilities owned by LUEP, such as warehouse and drying tools, and the insufficient condition of milling equipments made them difficult to offer fixed assets as collateral.</p> |

| Name | Period | Description | Achievement | Issues / Problems |
|---|---|--|---|---|
| Rural Income Generation Project (Proyek Peningkatan Pendapatan Petani Kecil: P4K) | (i) Phase I: 1979-86 (6 provinces) Phase II: 1989-1996 (10 provinces) Phase III: 1998-2005 (27 provinces) Emergency Response: 2006 (Nanggroe Aceh Darussalam and Nias) | <p>-P4K was an income generation project, lately funded by Asian Development Bank (ADB) and International Fund for Agriculture Development (IFAD). It targeted for small farmers and fishermen who were organized into small self-help groups (SHG) of 8 to 16 people (in Phase III, changed to 15 to 25) which received microfinance services from BRI.</p> <p>-The loan was approved without physical collateral, but based on the group liability and the 10% compulsory savings frozen at BRI. The interest rate was 1% per month flat rate, and the loan amount ranged from, at first cycle Rp. 500,000 up to 6 cycles of maximum loan amount of Rp. 2 million.</p> <p>-During Phase II, the institutionalization of SHG was conceptualized, to develop them into SHG Association (Gabungan) and/or microfinance institutions (LKM) and eventually to register them as cooperatives. The concept was succeeded to Phase III.</p> <p>-The main part of P4K as a project ended as of December 2005, and remaining SHG was handed over to District Government, to be continued with BRI up to December 2007.</p> <p>-After the original contract ended in 2005, one year extension was agreed between GOI and ADB to provide both loan and grant to assist reconstruction and rehabilitation of tsunami and earthquake hit area of Nanggroe Aceh Darussalam (NAD) and Nias District of North Sumatra. The family head who had suffered direct or non-direct catastrophe and already joined SHG received conditional aid of Rp. 2 million for development of his/her own micro-business and group business.</p> | <p>-The average repayment rate of each stage was Phase I: 85%, and Phase II: 95%.</p> <p>-As of December 2005, 13,962 SHG were deemed to have graduated the scheme, and 51,636 SHG out of the total of 58,118 have joined in 1,496 SHG Associations (Gabungan), out of which, 35 registered as cooperatives.</p> <p>-During the emergency response in 2006, it covered 8,400 families, which joined in 410 SHG at 12 districts and 36 villages.</p> | <p>-For Phase III, according to the tentative evaluation result, total loan disbursement was Rp. 1.3 trillion and the percentage of arrears against the outstanding loan balance as of December 2005 was 32%</p> <p>-Some of the Sample Kabupaten of this Study saw already the downturn of the activity, since the operational cost which had been borne by the project was not looked after at the same level by the districts.</p> <p>-In Sample Kabupaten, the idea of forming Gabungan and the transformation to LKM was not succeeded at the same level as before the handing over.</p> |

| Name | Period | Description | Achievement | Issues / Problems |
|--|--------------|--|--|--|
| <p>Community Direct Assistance (Bantuan Langsung Masyarakat: BLM) /</p> <p>Community Direct Loan Assistance (Bantuan Pinjaman Langsung Masyarakat: BPLM) /</p> <p>Program of Empowerment of Agribusiness Community through Strengthening Group Business Capital (Pemberdayaan Masyarakat Agribisnis Melalui Penguatan Modal Usaha Kelompok : PMAM-PMUK)</p> | <p>2000-</p> | <p>-MOA introduced Food Crops Development Program (PKP) in 2000, and Rural Food Crops Institution Development Fund (PKPP) in 2001, using the credit program of Community Direct Assistance (Bantuan Langsung Masyarakat: BLM). This is a revolving loan fund scheme directly disbursed to farmers' groups, which is expected to be revolving within the groups. The farmers' groups attach group business plan to the application, and members are supposed to use the fund for the specified purpose on the Plan, and repay with the agreed interest rate by the group members.</p> <p>-In 2002, MOA launched Commodity-based Agribusiness Development Project (PPABK) through Community Direct Loan Assistance (Bantuan Pinjaman Langsung Masyarakat: BPLM). It was redesigned from BLM in the context of decentralization, to be managed at Kabupaten / Kota level, with the extension workers carrying out the role of assessing the farmers' credit capacity, selecting groups, and monitoring.</p> <p>-In 2003, under the Program of Empowerment of Agribusiness Community through Strengthening Group Business Capital (Pemberdayaan Masyarakat Agribisnis Melalui Penguatan Modal Usaha Kelompok: PMAM-PMUK), BPLM was refocused to emphasize that the funds are meant to be a loan within the group, to be continuously revolved according to the development pattern of each commodity, and subsequently, to strengthen the capital base of the group. It aimed to promote the ownership of the group by stressing the group members' contribution to the proposed business, to strengthen the monitoring, and to suggest Dinas to involve not only extension workers, but development partners such as universities, NGOs, and private sector.</p> | <p>-For the period starting from 2000 to 2005, Rp. 2.7 million was disbursed to 35,420 groups.</p> <p>-In order to increase the avenues of ascertaining PMUK to revolve in the community, the use of the fund to develop microfinance institutions (MFIs, or Lembaga Keuangan Mikro: LKM) in rural areas, was also included.</p> | <p>-Both BLM and BPLM were not returned to the State Treasury, Regional Treasury, or any official account of Dinas or the individual account of its staff, but they were meant to be managed by the groups.</p> <p>-BLM/BPLM was recognized that these resources were revolving poorly within the targeted groups, which considered the funds more as charity than as a capital resource to be preserved and revolved.</p> <p>-The interview in Sample Kabupaten indicates that officials face the problems of: (i) beneficiaries do not understand the concept of BLM/BPLM, and often disregard repayment thinking it is a grant not a loan, (ii) low education level of the farmers affects the performance of adopting the proposed cultivation technique and managing the fund, (iii) lengthy bureaucratic process in fund disbursement caused delay in implementation, (iv) balanced fertilizing technology was ignored due to capital constraints, (v) especially for rice cultivation, lack of land to work on (Mojokerto)⁷.</p> |

⁷ To solve these problems, the interviewee proposed that: (i) priority should be on working capital, not investment (in case of duck in Cirebon), (ii) choose the Kelompok Tani, whose leader is disciplined and strict, and which is productive, (iii) good monitoring and evaluation process is required, (iv) relations with financial institutions are required to make the program suitable, (v) disbursement process should be shortened and less bureaucratic, (vi) monitoring and guidance not only the year of disbursement but after the disbursement is required, (vii) revolving period to be 5 years, not 3 years, (viii) delays in repayment can be avoided by announcing the payment due date to Kelompok Tani well in advance, and (ix) technical and financial sanctions should be imposed to achieve order.

| Name | Period | Description | Achievement | Issues / Problems |
|---|--------|---|---|--|
| MFIs in Agribusiness (Lembaga Keuangan Mikro Agribisnis: LKM-A) | 2004- | <p>-The concept of developing agribusiness MFI (LKM-A) was introduced with PMUK when the fiscal budget for 2004 and coming 2005 got tight, due to the deficit, and it was recognized that there was a limit in government funding. On the other hand, the directorate of financing at MOA in 2001 formulated the policy of optimizing the fund source outside MOA, namely, banking and non-banking financial institutions, donor funding, as well as the funds managed by the community. It was a way of utilizing the funds managed by the community, which could finance farmers and agribusiness, and to facilitate the community to become self-reliant and autonomous.</p> <p>-This was a clear step ahead from BLM / BPLM pattern of funding, in a way that it intended to show the exit for LKM-A to graduate government support in the future, and to become self sustainable. The program is, in principle, a capacity building (training and working capital injection) of LKM-A.</p> | <p>- MOA supported 368 LKM-As in 12 provinces, in the period of 2004 to 2006.</p> <p>- Utilizing the Counterpart Fund - Second Kennedy Round (CF:SKR), MOA in 2006 implemented the capacity building of 30 LKM-A transformed from BMT, KSP, Koptan and Kopontren, together with 30 LKM Embryo transformed from farmers' groups, in Ciamis District of West Java Province, West Nusa Tenggara Province, and Central Java Province.</p> | <p>- It is yet to be proved that if the experience so far could be replicated to wider areas, with the coming of the budget of Rp. 1 trillion for 10,000 villages in fiscal year 2008.</p> |
| | | <p>-It was suggested to have three components of:</p> <ol style="list-style-type: none"> (i) optimization of existing LKM (transforming existing LKM in the community to serve farmers and agribusiness); (ii) building LKM-A from farmers' groups, BLM/BPLM/PMUK recipients, farmers' associations, and existing self-help groups in the community (which are LKM Embryo), to be a self-sustainable LKM-A; and (iii) development of regional specific microfinance, which includes a suitable repayment pattern according to the specific community. | <p>- Established that the use of BDS is necessary for capacity building of LKM-A, thus the budget for BDS is being included in the new fiscal year.</p> | |
| | | <p>These LKMs are expected to operate under the Law No. 25/1992, as agriculture cooperatives (Koperasi Tani: Koptan). Loan fund was entrusted as revolving fund at BPD in each province, from where, it was disbursed to the target institutions as loan for the period of two years. The ministry has a program of transforming farmers' groups into Gabungan Kelompok (GAPOKTAN).</p> | | |

| Name | Period | Description | Achievement | Issues / Problems |
|---|--------|---|--|--|
| Agricultural Financing Service Scheme (Skim Pelayanan Pembiayaan Pertanian: SP-3) | 2006- | <p>-The Agriculture Financing Service Scheme (Skim Pelayanan Pembiayaan Pertanian: SP-3) is designed to provide guarantee service to reduce farmers' credit risk.</p> <p>-MOA deposited cash collateral to five executing banks of BUKOPIN, Bank Mandiri, Bank Syariah Mandiri, Bank Jabar, and Bank Sursel. Based on this fund, a part of the loan risk of individuals, groups, and federation of farmers (Gabungan Kelompok Tani: Gapoktan) is covered.</p> <p>-The loan purpose should be marketable commodity of food, estate, livestock, and horticulture, for the period not exceeding 2 years. The profit from SP3 is designed to be shared between the executing banks and MOA.</p> <p>-From FY 2007 the fund allocation is projected to be</p> <ul style="list-style-type: none"> (i) 50% for micro enterprise loan (max. Rp.10 million per enterprise) via LKM-A (interest rate for LKM-A is 12% p.a.), (ii) 20% for micro enterprise loan 2 (max. Rp. 50 million per enterprise, interest rate 2-3% below commercial rate, which is the same for the following 2 categories), (iii) 15% for small enterprises loan 1 (max Rp. 250 million per enterprise), and (iv) 15% for small enterprise loan 2 (max. Rp. 500 million per enterprise). | <p>-It has just started in October 2006, and yet to see the performance.</p> <p>- The disbursement of loan under SP3 for 2006 was Rp. 20 billion, compared to the projection of Rp. 255 billion.</p> | <p>- Banks use their own fund as a loan fund so they are reluctant to disburse funds, on the other hand, farmers are afraid to enter into transaction with banks. Both resulted in slow disbursement of loan under the scheme.</p> |

Source) Interview with MOA officials, and guidelines and internal documents of MOA

BOX 3-1: Academic Study on the Development of Shariah Financing for Agriculture Commodity

On 24 November 2006, a seminar was conducted at the Ministry of Agriculture, which was entitled; "Academic Study on the Development of Syariah Financing for Agriculture Commodity". The outline of the seminar is introduced here.

1. The importance of agriculture and rural sector
 - Most of Indonesian people are engaged in agriculture and live in rural area
 - Significant contribution to GDP
 - Significant contribution to export (as foreign currency income)
 - Most of agriculture products are used as raw material for industry.
 - Source of food and nutrient material
 - It is proven that agriculture sector became a support to national economy during economy crisis
2. Problem: LACK OF CAPITAL
 - The need of capital will continually increase in line with variety of commodity and plant pattern, the development of cultivation technology, post-harvest handling and production process.
 - Most farmers are not able to finance their own intensive capital business with their own fund.
 - Moreover, the intention of financial institution to agriculture sector is relatively low, since this sector has many risks
3. The existing Agriculture Credit:
 - High interest rate compared to other sectors, such as trade and industry.
 - It only finances the high value commodity
 - Banks prefer to be a channeling of government credit program
4. Characteristic of agriculture credit scheme that cause ineffectiveness:
 - a. The credit is always based on fixed interest. If the farmer suffers from harvest failure, he/she will be trapped in the endless debt.
 - b. There is a gap between the debtor and creditor. The debtors are purely engaged in real sector, while creditors are engaged in monetary sector. Risks are only borne by the debtor, while creditor still gain profit from the interest rates.
 - c. Agriculture financing is integrated into non-agriculture financing, therefore agriculture business is always overlooked
5. Solution conducted by Ministry of Agriculture:
 - a. Syariah Financing as one alternatives
 - b. Gema Syariah program, in 2005
6. Based on the report of Bank Indonesia in Bandung, until 1st quarter of 2005, the number of BPR in Bandung area were 177 consisted of Conventional BPR and 12 Syariah BPR.
7. Characteristic of Syariah Financing:
 - a. Free from interest rate
 - b. Profit and Loss sharing
 - c. Justice principle
8. Syariah Financing Scheme for Agriculture
 - a. Mudharabah
 - b. Musyarakah
 - c. Muzara'ah
 - d. Musaqoh
 - e. Bai murabaha
 - f. Bai istina
 - g. Bai as-salam
 - h. Mortgage (rahn)

9. Type of Financing for Micro farmers

a. Mudharabah

- Profit and Loss sharing between farmers and Bank Syariah
- Farmers managed its business, while Bank Syariah extends credits to finance farmers' businesses.
- Profits gained are shared based on the contract agreed by both parties

b. Muzara'ah

- Cooperation between the land owner and the farmers who work on the land
- Yield are shared by both of them (50:50)
- Seed, fertilizer and agricultural equipment provided by the land owner or the farmers, depend on the agreement.

c. Murabahah

- Trade between farmers and the bank
- Payment is made through some installment
- Farmers should form a group headed by land owner
- Land certificate is used as collateral

10. Type of Financing for Small and Medium Farmers

a. Mudharabah

- Same as the above explanation

b. Murabahah

- Bank Syariah sell fertilizer, seed, agricultural equipment, etc. to farmers.
- LKM Syariah gain profit from the mark up of selling price
- This type is suitable for food and horticulture credit.

c. Musyarakah

- Profit and Loss sharing. Both Bank and farmer provide Capital
- Profit and Loss are borne by both parties proportionally

d. Ijarah

- Bank lend production equipment/business places/products to the farmers
- Farmers pay the rental for every certain period, such as: monthly.
- At the end of certain period, the equipment/business place/products belongs to the farmer
- This type of financing is fit for agriculture machineries and storage.

e. Isthisna

- Bank buys unfinished products from clients based on its order with specific criteria.
- When the products become final products, the Bank sell those products based on the previous agreement.
- Payment is made after receiving the products.
- It is fit for financing machineries for plantation and animal husbandry

f. Salam

- Bank buys agriculture products from the farmers with advance payment and certain criteria.
- Bank then sells those products to other party
- Before purchasing those products, Bank has offered those products to other party
- Selling and buying prices are agreed by the first and second clients
- Payment is made before receiving the products.

11. The consultant (PT. Sewun Indo Konsultan) is conducting academic study on Syariah Financing Development for Agriculture Commodity.

12. The Consultant will focus on 17 Prospective Agriculture Commodities: rice plant, corn, soybean, red chili, orange, banana, onion, rubber, cacao, coconut, palm, clove, herbal medicine, sugar cane, beef cattle, poultry, goat-sheep.

13. The methodology used in this study will be:

- Quantitative Research: Structured questionnaires
- Desk Research: Literature Study
- Information Source: Farmers, the Ministry of Agriculture, Syariah Commercial Banks, BPR Syariah, and BMT.

BOX 3-2 : Is "Venture Capital" a Venture Capital? - The Case of PT.Bahana Artha Ventura -

At the Ministry of Agriculture, the Center for Agriculture Financial Services is promoting utilization of Venture Capital for agribusiness. The Center is publishing a brochure for agriculture business describing how they can apply for assistance from Venture Capital. One of the Venture Capital Companies introduced in the brochure is PT.Bahana Artha Ventura. The JICA Study Team visited the company. The following are the findings;

1. Company Profile

Established in 1993 as a member firm of the wider financial group of PT.BAHANA Pembinaan Usaha Indonesia (BPUI).

2. Vision and Mission

The mandate of the company is to support the development of small and medium-sized enterprises (SMEs) by providing capital, funding and management support.

3. Products and Services

The company covers multi-sector; industry, trading, agriculture, services.etc. It has serviced 16,518 SMEs as of June 2006, from only 22 SMEs in 1994. Investment and "Profit-Sharing Loan" are available. In fact, 90% of portfolio is profit-share loans, not investments.

4. SME Development Strategy

The company position itself between BPR (rural small banks) and major commercial banks. Its loan amount is set at higher level than that of BPR. It targets customers who are marginal customers for major commercial banks. Sector-wise, approximately 30% of total loan is for agribusiness.

5. Fund Source

Domestic fund source are Government budget, financial institutions, banks, and non-banks. International fund source includes major donors (Kfw, ADB, World Bank). The company participated in JBIC's Two Step Loan program. In addition, the internal fund from BAHANA group is also available.

3.2 Provincial and Kabupaten Government Policy and Program

The rural and agriculture microfinance policy of Provincial and Kabupaten governments currently focuses on food security and poverty alleviation. They have financing programs for food crop cultivation, and cooperatives and small and medium enterprises (KUKM), which include agribusiness entity. Some also aim at fostering cooperative MFIs. In general, their programs concentrate on capital support and lack in technical guidance for capacity building to go along with capital.

Salient features of Provincial and Kabupaten Government policy and program particularly focusing on finance are summarized in Table 3-2, 3-3, and 3-4 as follows:

Table 3-2 Salient Features of West Java Provincial Government Finance Policy and Program

| |
|---|
| <p><u>9 Acceleration Strategies</u></p> <ol style="list-style-type: none"> (1) Consolidation of cooperative movement, (2) Identification of potential and leading small and medium enterprises (<i>Usaha Kecil dan Menengah: UKM</i>), (3) The mapping of UKM center as cluster, (4) Strengthening of alliance network among KUKM, (5) <i>Developing financing scheme for KUKM (details of which are described below)</i>, (6) The development of cooperative activities in processing industry to increase the added value of commodity, (7) Establishing cooperatives in farming and on manufacturing, (8) Establishing distribution center for KUKM products, (9) Providing market and business source information to KUKM. |
| <p><u>Program</u></p> <p>The Strengthening of KUKM Financial Institution</p> <p>Eight Components</p> <ol style="list-style-type: none"> (1) intermediation between KUKM and banking and non-banking institutions, (2) improvement of the role of Credit Guarantee Organization, (3) improvement of the role of PT BPR Cooperatives, (4) improvement of the role of advocator on KUKM financing access, (5) improvement of KSP/USP cooperative role, (6) development of financing scheme under the hedge scheme, (7) capitalization of KUKM assets, and (8) increasing the intensification of financial resources for cooperatives from their members. |
| <p><u>DAKABALAREA</u></p> <ul style="list-style-type: none"> • Credit program introduced in 1999 • In order to save people from economic crisis • Target: groups of KUKM in agribusiness, industry, trade and other services • Financed a revolving fund as loan fund channeled from Bank Jabar, through “People’s Economy Institutions (muslim organizations)” to the groups. • Based on syariah principles, and the profit sharing among the stakeholders. • Reached 2,941 groups and 25,881 people⁸. |
| <p><u>Others</u></p> <p><i>GPKPMP</i></p> <ul style="list-style-type: none"> • Program for Increasing Food Security in Village Communities, also to save the people from economic crisis, employing a group approach. <p><i>Kredit Ketahanan Pangan Pola Kemitraan :KKP</i></p> <ul style="list-style-type: none"> • Province own version of Food Security Credit for paddy, dry season second crop, and horticulture, and Small Business Credit (<i>Kredit Usaha Kecil: KUK</i>) meant for corn. |

⁸ www.jabar.go.id

Table 3-3 Salient Features of East Java Provincial Government Finance Policy and Program

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|--|
| <p>Vision: Poverty alleviation with economic growth</p> |
| <p>Three Agenda</p> <p>1. Alleviating poverty, unemployment, improvement of working environment, and development of entrepreneurship, among other things:</p> <p>(1) <i>opening access to capital</i> in creating and developing business, (2) developing economic clusters for rural areas, (3) improvement of Integrated Movement on Poverty Alleviation (GERDU-TASKIN) program through the approach of empowering human resource, business and environment, and (4) increasing capacity of rural institutions and community group capacity are included.</p> <p>Program: GERDU-TASKIN program: to <i>increase access for poor community to capital</i>, production, information, technology and market, and its supporting activity is to <i>provide alternative financial schemes by banks</i> without distorting the market.</p> |
| <p>2. The acceleration of sustainable economy growth and infrastructure development towards agriculture revitalization⁹.</p> <p>Objective: Improving farmers' / fishermen's access to productive resources by developing agricultural business system supported by <i>access to capital</i>, information and transportation and improving human resource skills of farmers / fishermen.</p> <p>Program: Agribusiness development, targeting mango production centers including Kediri with its main activities including <i>developing and strengthening rural micro finance institutions</i>.</p> |
| <p>3. Empowerment of cooperatives, micro, small, and medium enterprises (KUMKM)</p> <p>Objective: Improvement of people's welfare to support economic growth and create new job opportunities.</p> <p>Program: (1) Business supporting system for KUMKM, one of its main activity to <i>increase access of capital</i> for KUMKMs (2) Improving institutional quality of cooperatives, and the main activity of the program is to <i>strengthen organizational and structural institutions of cooperatives, microfinance institutions (LKM), and KSP/USP</i>, and to facilitate legal status and advocate the development of cooperatives</p> |
| <p>Others</p> <p>Institutional development of food processing business groups</p> <ul style="list-style-type: none"> • To tackle both food security and the development of small and medium enterprise in food sector. • To set up a revolving fund at Bank Jatim, which is used for soft loan to business groups¹⁰ |

⁹ This agenda also covers forestry promotion, which is relevant to the sample Kabupaten of Kediri, where the mango farmers are also engaged in forestry activity.

¹⁰ The interest rate is 3% p.a., for the period of maximum one year. It should be used for working capital of food processing activity such as buying raw materials, processing, and marketing, and it is not for savings and loan activity, nor hardware / machinery investment. The loan disbursement is in two phases, the second portion of 60% will be disbursed only after the confirmation of the usage of the first 40% disbursement.

Table 3-4 Salient Features of Sample Kabupaten Government Finance Policy and Program

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| <p>Kabupaten Cirebon</p> <p>Cirebon District Strategic Plan (2005-2009) has the agenda of community economic development, under which, four programs of investment, food security, poverty alleviation, and industry, trade and tourism are designed. The poverty alleviation program has a financial component of <i>providing business capital to poor families</i>. And industry, trade and tourism program has two financial components of (i) <i>facilitating capital assistance, partnership assistance and bank loan</i>, and (ii) <i>assisting with disbursement of credit programs</i>.</p> |
| <p>Kabupaten Kuningan</p> <p>One of the objectives is to increase farmers' self-reliance through the empowerment of farmers' institution. As for the finance, its policy directions include <i>the optimal use of BPLM (Community Direct Lending Assistance) revolving fund, and the reinvention of community and investor self-finance potential</i>. For 2005-2008, the Dinas has the program of (i) food security enhancement program, (ii) agriculture human resources quality improvement program, and (iii) agribusiness development program.</p> |
| <p>Kabupaten Majalengka</p> <p>Their vision is to accelerate <i>agribusiness development</i>, based on religious and participative community to improve community welfare and implement vision of the District in 2010. The Plan states that one of the five sub-systems of agribusiness development is a set of supporting services, which is an economic activity which provides services to up-stream agribusiness sub-system to down-stream agribusiness sub-system, including research and development, <i>credit and insurance</i>, transportation, education and training, information system and government policy supports.</p> <p>In order to achieve the vision, empowering farmers and farmers' groups, and agribusiness associations is emphasized, and the development of agribusiness cooperatives is included in their strategy. Its agribusiness program has a component of <i>strengthening BPLM fund, credit, and investment</i> in agribusiness and agroindustry. The district also has the program of <i>strengthening capital for small and medium enterprises and cooperatives (KUKM)</i>, which as three components of: (i) <i>channeling of capital</i> to KUKMs; (ii) <i>channeling of revolving fund</i> for KUKMs; and (iii) <i>partnership between KUKMs with banks, financial institutions and the funds from state owned companies (BUMN)</i>.</p> |
| <p>Kabupaten Mojokerto</p> <p>One of the missions specified in Mojokerto District Strategic Plan (2001-2005) is to improve regional economy and income per capita of the community through empowerment of natural/economy resources, improve the development of economic activity centers and empower people-based small medium business enterprises. This has stipulated into one of its economic development policies as to develop agribusiness and agro industry as efforts to empower rural economy through <i>supports from banking service</i>, trading communication, consultancy, research, development, education and training. Another part in their economic development policies, which is related to finance, is to develop supportive and beneficial partnerships between cooperatives, private sector and region-owned economic structure.</p> <p>Mojokerto Agriculture and food Security Dinas Strategic Plan (2001-2005) has the objective of developing farmers self reliance in farming to support rural economic development. It has a policy of developing production center, with the program of <i>microfinance institution development</i>. The program has the action plans of (i) <i>facilitation of rural microfinance institution development</i>, and (ii) development of farming system management.</p> |
| <p>Kabupaten Kediri</p> <p>Kediri District Work Plan of 2006 indicates that one of the priorities is to rescue and strengthen regional economy as well as infrastructure development. The policy direction for this priority includes the empowerment of small and medium scale oriented people's economy <i>through capital support</i>.</p> |

CHAPTER 4 FINDINGS FROM THE FIELD SURVEY

This chapter embodies the analysis extracted from Appendix c: Field Survey Report on Sample Commodity Kelompok Tani, and Appendix d: Additional Survey on Rural Microfinance Program.

4.1 Outline of Field Survey

4.1.1 Sample Commodity based Kelompok Tani

From August to October 2006, the Study conducted the field survey in the Sample Sites (Kabupaten Cirebon, Kuningan, and Majalengka, in West Java Province, and Kabupaten Kediri and Mojokerto in East Java Province) chosen based on the Sample Commodity (duck, sweet potato, and mango). The objective of the field survey was to grasp the present situation and activities of agriculture processing, marketing, and microfinance. In addition, the assumption was made that the improvement plan, which the Study Team would propose later, target a group of farmers (Kelompok Tani: KT). Thus the field survey was designed to select model KT, or rather, potential target KT for the improvement plan as well. The steps taken are as follows:

(1) Listing up of Sample Commodity Kelompok Tani

Kelompok Tani surveyed under the Basic Research were selected based on the discussion with DINAS and on the production data of sample commodities. In general, 5 to 9 Kelompok Tani were listed for sample commodities and other 2 or 3 Kelompok Tani was chosen for sub-commodities as a reference for other Kabupaten.

(2) Basic Research

In each Kabupaten, over a week of the basic research was conducted on agriculture production, processing, marketing, microfinance, and KT organization in the Sample Kabupaten. As for microfinance, (i) outline of the central and local government microfinance programs, (ii) services and performance of the existing financial institutions, and (iii) KT's organizational and financial aspects were studied.

(3) Selection of the KT as a potential target for the improvement plan

2 to 3 KT in each Sample Kabupaten were selected as model and the potential target KT for the improvement plan was selected through qualitative evaluation made from the viewpoints of: (i) finance, (ii) socio-economy, (iii) organization, (iv) production and processing technology level, (v) marketing potential and (vi) future plan. The emphasis was put on the KT which showed strong motivation and potential capacity to improve their agricultural processing as business, and its savings and loan activity. The details of the process are found in the Main Report and Appendix D of the Final Report. In total, 13 KT were selected.

(4) Poverty Ranking, Household Survey, and Situation Analysis Workshop

As for the 13 Selected Kelompok Tani, the following research was conducted.

(i) Poverty ranking

The exercise was carried out for half day at each community of the selected KT, with key informants, to analyze livelihood and wealth situation of the farmers' community. The household was classified into four ranks of destitute (very poor), poor, fair, and rich. Poverty is multi-dimensional, complex, and each local community embraces different concepts of risks. Classification is, therefore, made from the viewpoint of (a) income level, (b) asset owned, (c) education level, (d) basic human needs satisfaction, in terms of staple food, and (v) financial transaction experience with financial institutions. The results of the poverty ranking are included in Appendix D of the Final Report.

(ii) Household Survey

Rapid household survey was conducted for each KT community, with a sample set of 12 households, 8 from the selected KT members, and 4 from the KT's community members (not the selected KT members). It was conducted to obtain more in-depth data of the household than the poverty ranking, therefore it covers the similar areas of information as poverty ranking, but data collected are more detailed.

(iii) Field Workshop

One day workshop was organized at the community of the selected Kelompok Tani with stakeholders. The session included producing Mobility Map, Institutional diagram, and conducting Problem Census. As a result, the workshop mapped the stakeholders around processing, marketing, and microfinance with the order of importance, and assessed needs and constraints on processing, marketing, and microfinance with possible solutions in long-term and short-term.

4.1.2 Additional Survey on Rural Microfinance Program

In addition to the Sample Commodity based survey described above, additional survey was conducted from October 2006 to February 2007, to collect information on government microfinance programs. This survey even covered outside Sample Kabupaten. The focus of this survey was MOA programs which have capacity building component: (i) Rural Income Generation Program (RIGP, or P4K), (ii) Empowerment of Agribusiness Community through Strengthening Group Business Capital Program (known as BLM, BPLM., or PMAM-PMUK), and (iii) MFIs in Agribusiness Program (LKM-A).

The survey was conducted through interview (to government officials in charge, NGOs involved, and beneficiaries of the programs), and the collection of program reports from government offices and relevant MFIs. From P4K, the list of Self-Help Group Association (KPK Gabungan) and LKM were obtained for the future selection of beneficiaries for the proposed microfinance improvement plan.

4.2 Poverty Level of the Selected Kelompok Tani and its Community

The Sample Kabupaten are poorer areas compared to the national average. According to the UNDP National Human Development Report 2004, while the national average of poverty headcount ratio is 16.7%, that of the Sample Kabupaten ranges from the lowest of 17.2% in Mojokerto to the highest of 19.6% in Kediri in 2004. The official poverty line of Sample

Kabupaten ranges from Rp.112,907 to Rp.140,862 of expenditure per capita per month. The official poverty headcount ratio of Sample Kabupaten, and the result of poverty ranking in the communities of selected Kelompok Tani¹ are shown in the Figure below:

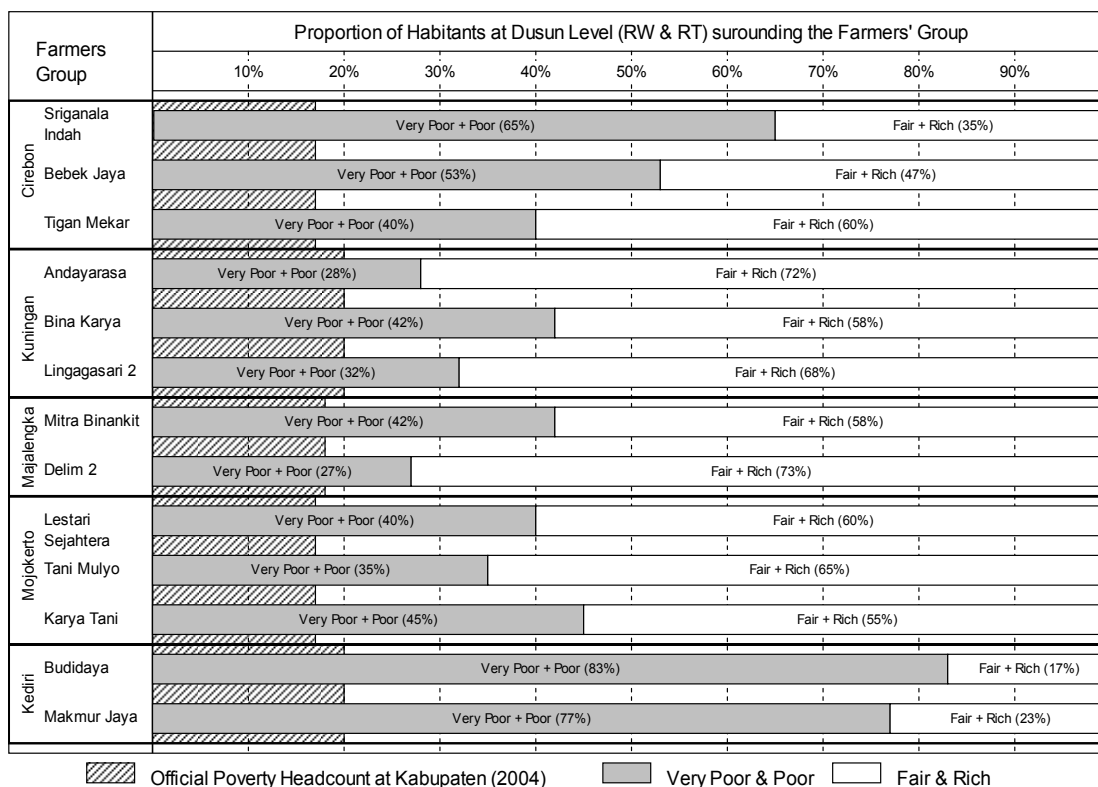


Figure 4-1: Poverty Headcount Ratio and Poverty Ranking Results at Farmers' Community

According to the poverty ranking, it was also noticed that the sense of poverty differs by community. People feel there is more poverty in their community, even their expenditure level is more than the official poverty line. The border income level between the poor (very poor plus poor) and the fair is summarized in Table 4-1.

Farmers in the selected Kelompok Tani mostly scatter from poor to fair categories in the poverty ranking, although the income level differs by commodity.

The results of the sample household survey indicate that the majority households of sweet potato and mango Kelompok Tani earn Rp. 100,000 to Rp. 400,000 income per capita per month. This is after adding incomes from sources other than sweet potato or mango, since these commodities tend to constitute only a part of the income sources.

On the other hand, duck in general constitutes the main source of income for the households, and they fetch more income than sweet potato and mango households, mostly from Rp. 300,000 to Rp. 2 million per capita per month. However, the communities of KT Bebek Jaya (53% households have income of less than Rp.300,000/capita/month), KT Karya Tani (45% households have income of less than Rp.250,000/capita/month) have more poor

¹ In the poverty ranking exercise, the facilitator gave the background explanation to the participants that the poverty line for the very poor category according to Dr. Sayogyo is 240 kg of rice per capita per year or around Rp. 100,000.- per capita per month, while for the poor is 320 kg of rice per capita per year or around Rp. 120,000,- per capita per month. The poverty line for the Poor according to BPS is Rp. 152,847,- per capita per month.

households.

Table 4-1: Border Income Level between Poor and Fair in Poverty Ranking

| Income Border between Classes of Poor and Fair | No. of Communities and Percentage of the Poor (very poor + poor) |
|---|--|
| Rp.125,000 per capita per month | <u>1 community</u> of Makmur Jaya (Kediri: Mango) 77% of community members fall under this category. |
| Rp.250,000 to Rp.300,000 per capita per month | <u>7 communities</u> of Bebek Jaya (Cirebon: Duck), Bina Karya and Lingasari 2 (Kuningan: sweet potato), Mitra Binangkit 2 (Majalengka: sweet potato), Tani Mulyo and Karya Tani (Mojokerto: duck), and Budi Daya (Kediri: Mango) 32% to 83% of the community members fall under this category. |
| Rp.450,000 to Rp.750,000 per capita per month | <u>5 communities</u> of Sigranala Indah, Tigan Mekar (Cirebon: duck), Andayarasa (Kuningan: sweet potato), Delima 2 (Majalengka: sweet potato), and Lestari Sejahtera (Mojokerto: duck) 27% to 65% of the community members fall under this category. |

Source) Result of Poverty Ranking conducted by the JICA Study Team from September to October 2006.

The detailed poverty ranking results are included as the attachment at the end of this chapter.

4.3 Overview of Financial Services Available for the Farmers' Community

4.3.1 Physical Accessibility

Most of the farmers and rural population have physical access to a few commercial banks except for some farmers' groups (Kelompok Tani) in Mojokerto, and to non-bank microfinance institutions, and informal finance. The financial services physically available in the community of the selected Kelompok Tani are summarized in the following table.

Table 4-2 Financial Services Available in the Community of Kelompok Tani

| | Selected Kelompok Tani | Bank and BPR | Non-Bank | Others |
|-------------------------------|--|---|---|--|
| Cirebon, Duck | Tigan Mekar Karanganyar Village Kec. Panguragan | <ul style="list-style-type: none"> ▪ BRI Unit Panguragan ▪ BRI Unit Gegesik ▪ BPR Panguragan | <ul style="list-style-type: none"> ▪ Cooperative Sumber Rejeki ▪ Pawnshop ▪ Village Bank | <ul style="list-style-type: none"> ▪ Trader |
| | Bebek Jaya Bayalangu Village Kec. Cirebon Utara | <ul style="list-style-type: none"> ▪ BRI Unit Kapetakan ▪ BPR Cirebon Utara (handled at BPR Kapetakan) | <ul style="list-style-type: none"> ▪ Syariah KSP Prambabulan Al Qomariyah ▪ KUD*¹ Mina Waluya | <ul style="list-style-type: none"> ▪ Feed trader |
| | Sigranala Indah Bayalangu Village Kec. Gegesik | <ul style="list-style-type: none"> ▪ BRI Unit Gegesik ▪ BRI Unit Cilimus ▪ BPR Kapetakan ▪ BPR Gegesik | <ul style="list-style-type: none"> ▪ Pawnshop ▪ Village Bank ▪ KUD Karya Bakti ▪ Moneylender | <ul style="list-style-type: none"> ▪ Middlemen ▪ Arisan |
| Kuningan, Sweet Potato | Andayarasa Bandu Rasa Wetan Village Kec. Cilimus | <ul style="list-style-type: none"> ▪ BNI Kuningan ▪ BRI Unit Cilimus ▪ Bank Jabar Cilimus ▪ BPR Cilimus | <ul style="list-style-type: none"> ▪ KUD Bangkit Abadi ▪ Moneylender ▪ Pawnshop | <ul style="list-style-type: none"> ▪ Trader ▪ Arisan |
| | Binakarya Manis Lor Village Kec. Jalaksana | <ul style="list-style-type: none"> ▪ BRI Unit Jalaksana ▪ BRI Unit Cilimus ▪ BRI Unit Kramat Mulya ▪ Bank Jabar Cilimus | <ul style="list-style-type: none"> ▪ KUD | <ul style="list-style-type: none"> ▪ Trader ▪ Warung |
| | Linggasari 2 Lingga Indah Village Kec. Cilimus | <ul style="list-style-type: none"> ▪ BRI Unit Cilimus ▪ BPR Cilimus | <ul style="list-style-type: none"> ▪ KUD Gemah Ripah ▪ Pawnshop | <ul style="list-style-type: none"> ▪ Trader ▪ Arisan |

| | Selected Kelompok Tani | Bank and BPR | Non-Bank | Others |
|-----------------------------------|--|---|--|---|
| Majalengka Sweet Potato | Mitra Binangkit 2 Tajur Village Kec. Cigasong | <ul style="list-style-type: none"> ▪ <i>BRI Majalengka (far from the community but P4K)</i> ▪ BPR Cigasong | ▪ KUD Makar Tani | ▪ Arisan |
| | Delima 2 Lampuyang Kec. Talaga | <ul style="list-style-type: none"> ▪ <i>BRI Majalengka (far from the community but P4K)</i> ▪ BRI Unit Talaga | - | ▪ Arisan |
| Mojokerto, Duck | Lestari Sejahtera Modopuro Village Kec. Mojosari | <ul style="list-style-type: none"> ▪ <i>BNI Mojokerto</i> ▪ <i>BRI Unit Mojosari</i> ▪ <i>BRI Unit Wonokusumo</i> ▪ Bank Danamon ▪ BCA Mojosari ▪ Bank Syariah Mandiri ▪ Bank Jatim Mojokerto ▪ BUKOPIN ▪ BPR Mojosari | <ul style="list-style-type: none"> ▪ Livestock cooperative Sejahtera ▪ Village Credit Bank (BKD) | <ul style="list-style-type: none"> ▪ Feed collector ▪ Arisan ▪ Moneylender |
| | Karya Tani Pungging Village Kec. Pungging | <ul style="list-style-type: none"> ▪ <i>BRI Unit Pungging</i> ▪ <i>Bank Jatim Mojokerto</i> ▪ BPR Pungging | ▪ KUD Pungging | ▪ Middlemen |
| | Tani Mulyo Mojoyo Village, Kec. Bangsal | <ul style="list-style-type: none"> ▪ <i>BRI Unit Bangsal</i> ▪ BRI Unit Mojosari ▪ BNI Mojokerto ▪ Bank Danamon ▪ BUKOPIN ▪ BCA Mojosari ▪ Bank Jatim Mojokerto | <ul style="list-style-type: none"> ▪ Village Credit Bank (BKD)*1 ▪ Cooperative ▪ Pawnshop | <ul style="list-style-type: none"> ▪ Feed collector ▪ Moneylender |
| Kediri, Mango | Budi Daya Tiron Village, Kec. Banyakan | <ul style="list-style-type: none"> ▪ <i>BRI Kediri (for P4K)</i> ▪ BRI Unit Banyakan (10km) | ▪ <i>Cooperative Budi Daya (registered but not active, savings and loan section of the Kelompok Tani)</i> | - |
| | Makmur Jaya Tarokan Village, Kec. Tarokan | <ul style="list-style-type: none"> ▪ <i>BRI Kediri (for P4K)</i> ▪ <i>BRI Unit Kaliboto (6km)</i> ▪ BPR Gregol (Bank Pasar) (Followings are far from the village: <ul style="list-style-type: none"> ▪ BNI ▪ Bank Mandiri ▪ BCA ▪ Bank Jatim Kediri) | <ul style="list-style-type: none"> ▪ KSP Bina Usaha Makmur ▪ Pawnshop | <ul style="list-style-type: none"> ▪ 2 Warung ▪ Arisan |

* 1 BKD is not recognized under the Banking Law, thus categorized under Non-Bank here.

* 2 Financial institutions in ***bold italic*** are used by one or more Kelompok Tani members for financing production processing, in addition to the Kelompok Tani savings and loan.

The microfinance accessed by the selected Kelompok Tani is (i) banks (BRI Units, BPD, and BPR), (ii) registered cooperatives (KSP, USP, KUD), (iii) BKD, pawnshops, and (iv) informal sector including Kelompok Tani and non-registered farmers cooperatives, *arisan*, traders, moneylenders, and *warung*.

Two women's Kelompok Tani (Mitra Binangkit 2 and Delima 2) in sweet potato processing, and one mango Kelompok Tani (Budi Daya) in Kediri are located in mountainous remote area, and they have access to only one or two bank and non-bank institutions, which are BRI Units or BPR. In addition, Delima 2 raised the issue of transport, which costs them Rp. 10,000 for return to get to BRI Unit, which can eat up their savings or loan amount.

Other finance which is not shown in the Table, but available for the farmers is the

government finance program for agriculture sector, cooperatives, and MSMEs.

4.3.2 Access by Poverty Level

Although there are various kinds of financial services available within the physical reach, it was revealed that not all the services are utilized by the all layers of community people, let alone farmers in the Kelompok Tani.

From the result of poverty ranking, in general, the fair and rich ranking people have access to banking institutions. The exceptions for this are the community of Bebek Jaya, (Cirebon, duck), Linggasari 2 (Kuningan, sweet potato), and Mitra Binangkit 2 (Majalengka, sweet potato), where only the rich was described to have access to banks. On the other hand, in the community of Tani Mulyo (Mojokerto, duck), it is the poor, fair, and rich who have access to banks.

Other categories, mostly very poor and poor, have access to moneylenders, *Arisan*, pawnshop, small shops (*warung*), and traders (middlemen). In some worst cases (the communities of Linggasari 2 in Kuningan, Delima 2 in Majalengka, Lestari Sejahtera, Tani Mulyo, Karya Tani in Mojokerto, Budi Daya and Makmur Jaya in Kediri), the very poor category of people have no access to any of the financial services.

The financial access by poverty ranking is summarized in the Table below:

Table 4-3 Access to Finance by Poverty Ranking in West Java Province

| | Community of Kelompok Tani | Destitute | Poor | Fair | Rich |
|------------|----------------------------|------------------------------|-----------------------------|---------------------------------------|--------------------------|
| Cirebon | Tigan Meker | 12% | 28% | 45% | 15% |
| | | Money lender | Money lender | Bank Cooperatives Arisan | Bank Cooperatives Arisan |
| | Bebek Jaya | 28% | 25% | 38% | 9% |
| | | Saving Rp. 10.000,-per month | Arisan Rp.50.000,-per month | Cooperatives | BRI Cirebon Utara, BPR |
| | Sigranala Indah | 20% | 45% | 27% | 8% |
| | | Money lender | Pawnshop Money lender | BRI unit Desa BPR Arisan | BRI Unit BPR Arisan |
| Kuningan | Andayarasa | 3% | 25% | 60% | 12% |
| | | Money lender | Money lender Pawnshop | BRI Cilimus BPR Cilimus Kelompok Tani | Bank |
| | Bina Karya | 11% | 31% | 43% | 15% |
| | | Often small shops | Credit | BRI | BRI |
| | Lingasari 2 | 18% | 14% | 58% | 10% |
| | | None | None | Kelompok Tani Savings | BRI Cilimus |
| Majalengka | Delima 2 | 9% | 18% | 65% | 8% |
| | | None | None | BRI Unit Talaga Warung | BRI |
| | Mitra Binangkit 2 | 11% | 31% | 43% | 15% |
| | | Often small shops | Credit | Kelompok Tani | BRI Majalengka |

Table 4-4 Access to Finance by Poverty Ranking in East Java Province

| | Community of Kelompok Tani | Destitute | Poor | Fair | Rich |
|------------------|----------------------------|-------------|-------------------------|------------------------------------|------------------------|
| Mojokerto | Lestari Sejahtera | 4% | 36% | 50% | 10% |
| | | None | None or Moneylender | Arisan Bank | Arisan Bank |
| | Karya Tani | 14% | 31% | 52% | 3% |
| | | Moneylender | Moneylender Pawnshop | Arisan Kelompok Tani Bank | Bank |
| | Tani Mulyo | 6% | 29% | 57% | 8% |
| | | None | Arisan Bank Moneylender | BRI Kelompok Tani Trader Pawn-shop | Bank Trader |
| Kediri | Budi Daya | 38% | 45% | 14% | 3% |
| | | None | Kelompok Tani | BPR | BNI, BRI |
| | Makmur Jaya | 26% | 51% | 20% | 3% |
| | | None | None or Trader | BRI, BPR Kelompok Tani | BRI, BCA, Bank Mandiri |

4.4 Conditions of Finance Services

4.4.1 Institutional Finance

(1) Savings

Interest rates for savings at BRI Units are from 0 to 6% p.a., from the starting amount of Rp.25,000 to the minimum balance requirement of Rp.10,000. BRI branches require starting amount of Rp.200,000 for savings, and the minimum balance requirement is Rp.50,000. Other commercial banks such as BNI require Rp.150,000 for starting and the minimum balance of Rp.10,000, at the interest rate of 0 to 4% p.a. Bank Jabar savings require Rp.25,000 and the same amount to maintain the account, with the interest rate from 5 to 7% p.a. Savers at cooperatives are also the members and they normally have savings obligations at the entry and compulsory monthly savings which start from Rp.5,000. The savers get the profit sharing from the cooperative as a member.

Table 4-5 Conditions for Savings

| Bank | BNI | BRI Branch | Bank Jabar | BRI Unit | Cooperative / KT |
|-----------------|------------|-----------------|------------|-----------|--|
| Starting amount | Rp.150,000 | Rp.200,000 | Rp.25,000 | Rp.25,000 | from Rp.5,000 monthly compulsory savings |
| Minimum balance | Rp.10,000 | Rp.50,000 | Rp.25,000 | Rp.10,000 | Entry fee start from Rp.5,000 |
| Interest rate | 0-4% p.a. | 5.5% on average | 5-7% p.a. | 0-6% p.a. | Profit Sharing |

*Other than savings, commercial banks offer time deposits with higher interest rates.

(2) Loan

Loan from BRI Units do not require collateral up to Rp. 3 million (more amount require collaterals). Their loan amount is minimum of Rp. 0.1 million to the maximum of Rp. 100 million, and the interest rate is 1.0 to 1.5 % per month. At BRI branches, the loan amount start from Rp. 0.2 up to Rp. 2 trillion, with the interest rate of 9 to 24 % p.a. BNI loan

amount starts from Rp. 5 million and goes up to 350 million, with the interest rate of 14 to 22 % p.a. Bank Jatim loan starts from Rp. 1 million up to 350 million, with the interest rate of 6 to 22 % p.a. At one BPR, minimum loan amount is Rp. 15 million and maximum is Rp. 50 million, with the interest rate of 1.95 % per month. While at one KSP, minimum loan amount is Rp. 0.1 million and maximum is Rp. 5 million, with the interest rate of 2.75% per month for maximum 4 months.

Table 4-6 Conditions for Loan

| Bank | BNI | BRI Branch | Bank Jatim | BRI Unit | Cooperative (one example) |
|---|---------------------------------|----------------------------------|---------------------------------|-----------------------------------|--|
| Loan Amount | Rp.5 million - Rp.350million | Rp. 0.2million - Rp.2trillion | Rp.1 million - Rp.350million | Rp.0.1million - Rp.100million | Rp.0.1 milion – Rp.5 million |
| Amount offered without collateral of land or vehicles | N/A | N/A | N/A | up to Rp.3,000,000 | Rp.0.1 million - Rp.1,000,000 depend on the situation |
| Interest rate | 14-22% per year, sliding | 9-24% per year, sliding | 14 % per year, sliding | 1.0 to 1.5% per month, flat | Profit Sharing or 2.75% per month, flat (depend on the situation) |

(3) Preference of Financial Institutions

Commercial banks are in general limited to serve the customers who are within 5 km from their branches and units, while BPD (Bank Jabar and Jatim) cover the customers who are 10 km away from their cash offices. This policy and the fact that they handle more government programs, seem to complement them having less number of establishments (branches and cash offices) in the rural area, and achieve a level of outreach following BRI Units.

The existence of banks near the community does not necessarily help to fill the gap of demand and supply. From the bank side, different banks have different priority areas, which are not necessarily agriculture sector. Currently banks started increasing micro, small, and medium enterprises (MSME) loan, but money is not flowing enough into the agribusiness.

Banks analyzed the difficulties of lending to farmers as: (i) their low capacity of marketing, managing fund (how much loan they can handle), and book keeping, (ii) harvest risk, (iii) profit margin decrease due to the impact of kerosene price hike, and (iv) bird flu risk. All these would cause the delay in following the installment in time. Due to bird flu outbreak, some banks stopped to finance new chicken and bird farmers.

On top of these elements, Bank Jatim Kediri Branch analyzed the difficulties in serving rural poor as (i) poor transportation network, (ii) limited support by the government office to MSMEs, and (iii) less coordination among these offices in supporting MSMEs.

BRI has the biggest outreach through Units, and its priority is to serve micro, small, and medium enterprises, including agriculture and livestock farmers. BRI Units, in particular, see the opportunities in keeping the current MSME customers including farmers, financing

them to grow bigger. On the other hand, BRI Units mentioned some MSME customers can only handle simple book keeping, or do not know how much loan they can handle, and for the purpose of loan application and administration, their staff has to help the customers to produce the necessary data for business plan and performance. BRI also handle most of the government programs for poverty alleviation, community empowerment, and rural credits.

Bank BUKOPIN has a priority to serve MSMEs including agriculture and livestock farmers, but reaching them through *Kelompok Tani* and cooperatives. BUKOPIN does not have lots of branches to cover all the districts, so it has a limited outreach.

On the other hand, Bank Danamon has started to have more outreach through establishing their *Simpan Pinjam* (savings and loan) branches, but these branches target traders, including those who handling farm products, and not the production farmers.

BNI used to include MSMEs in one of their priorities but recently it changed the policy to target industry, trade, and services and to more the cooperate clients

Bank Jabar handles Provincial Government programs, serving mainly for civil servants and individual farmers. Bank Jatim is also the agent of government programs, and serving civil servants, *Kelompok Tani*, and clients in the industry and trade sector. These BPDs would like to support farmers through the government finance program for MSMEs.

BPRs and KSP/USPs tend to prefer loanees in trading sector.

4.4.2 Commodity (Cycle) based Finance

As loan repayment cycle or installment set by banks came out as one of the major barriers for farmers to borrow from banks, this is normally not the case with the credit supplied by traders (or middlemen and collectors) and feed suppliers. In fact, they are the main financier of farmers, following the banking, non-banking institutions, and *Kelompok Tani*. In most cases, they provide input credit in the form of in-kind (such as fertilizer, seeds and feeds) or cash. The common practice of repayment is *yarnen* (farmers sell the products to the traders / suppliers after harvest, and they deduct the loan amount, and give back the difference to the farmers).

The power relations between the farmers and traders / suppliers differ case by case. Some farmers take it positively, to utilize the marketing network of traders / suppliers, and to secure the sales even before the harvest. As for the *Kelompok Tani* such as *Karya Tani* (duck, Kab. Mojokerto), and *Makmur Jaya* (mango, Kab. Kediri), leaders are also the traders and some of them provide loan for *Kelompok Tani* members. In this case, *Kelompok Tani* is a disguised vehicle for traders to bundle the products and to secure the quantity and quality of them. Cirebon livestock cooperative *Sumber Rejeki* entered an agreement with the members of *Kelompok Tani Tigan Meker* for marketing, and utilizing the trader members' marketing capacity and network. This, in a way, is the formalization of trader-producer relationship and made the transaction more transparent and accountable by setting up a cooperative. *Linggasari 2* sweet potato farmers even proposed to ask credit from traders as a short-term solution to tackle the lack of capital.

On the other hand, *Sigranala Indah* (duck, Kab. Cirebon) and *Tani Mulyo* (duck, Kab.

Mojokerti) feel the relationship with feed supplier-cum-collector as bondage, stating that they are charged market price when they are supplied feeds on credit, and when their products are collected, the purchase price is lower than the prevailing market price.

Others who accept the payment after harvest are cooperatives, especially KUD, and local small shops (*warung*) which sell inputs and staple foods are more flexible in financing agriculture needs, in terms of repayment timing. They tend to accept the payment after harvest (*yarnen*).

New attempts of combining finance and marketing are being made, in order to give farmers better transaction terms. One is the warehouse receipt scheme, which was about to start in Majalengka, supervised by the Dinas Industry and Trade. Under this scheme, rice producing farmers can borrow money from financial institutions by making rice stored at the warehouse as collateral. This gives farmers better access to finance, and financial institutions can secure their loan better with collateral. In addition, with the warehouse facility, farmers can choose when to sell rice, avoiding the negative impact of price fluctuation.

The other attempt is auction market conducted by East Java Province Dinas Industry and Trade, with the cooperation of Dinas Agriculture. The Dinas facilitates small farmers and small medium enterprises (SMEs) to sell their commodities and products through auction, even before the production, with a sample. So far the auction was held for 29 times and has realized the transaction of more than Rp. 700 billion. Farmers and SMEs can apply for production loan from Bank Jatim, where the auction is conducted. The main commodities handled are food crops including paddy and vegetables, but for certain commodities, less and less buyers are joining the auction.

4.4.3 Ministry of Agriculture Programs

Among the financial support programs of the Ministry of Agriculture (MOA), there are three program finances targeting Kelompok Tani and Self-Help Groups (SHGs) for agribusiness promotion and/or income generation.

(1) Rural Income Generation Project (*Proyek Peningkatan Pendapatan Petani-Nelayan Kecil: P4K*)

P4K was supported by the loan amounting to US\$117.5 million from ADB and IFAD, supplied microfinance through BRI to poor small farmers and fishermen who were organized into small Self-Help Groups (SHGs or KPK). It had three phases from 1979 to 2005, and had one year extension for tsunami emergency operation in 2006. P4K achieved high repayment rate (Phase I: 85%, and Phase II: 95%), and covered 58,118 SHGs. However, towards the end of the project period and after it was handed over to Kabupaten government and BRI branch in 2006, the number of new loans decreased. At the same time, the monitoring and supervision budget and incentives for field extension workers were not allocated of late, which contributed to the down turn of the performance. According to the tentative evaluation result for Phase III, total loan disbursement was Rp. 1.3 trillion and the percentage of arrears against the outstanding loan balance as of December 2005 was 32%².

² ADB (2005) *The 4th Draft of Project Completion Report: Rural Income Generation Project P4K-Phase III*, Indonesia

It should be noted that under P4K, the exit strategy for SHG was conceptualized, to develop them into SHG Association (Gabungan KPK), and transform them into microfinance institutions (MFI, in Indonesian, LKM) including non-KPK members from the community, which were expected to be eventually registered as cooperatives. The purposes of forming Gabungan comprise (i) to facilitate government services, (ii) to obtain additional chance for business capitalization outside P4K credit, (iii) to enable loan service for members at appropriate time and amount with more simple procedure. This exit strategy part of P4K, however, seems not to be penetrating into Kabupaten governments. Thus Gabungan KPK and LKM which had already been formed face difficulties in sustaining the organization. The state of the Gabungan KPK and LKM in the Sample Kabupaten is shown below:

Table 4-7: State of LKM (MFI) and Gabungan KPK in Sample Kabupaten in 2006

| Kabupaten | Type | Total | No. of KPK | No. of Members | Capital (Rp.) | Capital per member (Rp.) |
|-------------------|----------|-------|------------|----------------|---|--|
| | | | | | min. & max. | min. & max. |
| Cirebon | LKM | 1 | 18 | 288 | 100,000,000 | 347,222 |
| | Gabungan | 13 | 66 | 675 | min. 125,000 max. 5,000,000 total. n.a. | min. 2,500 max. 110,000 av. n.a. |
| | total | 14 | 84 | 963 | N/A | N/A |
| Kuningan | LKM | 6 | 51 | 643 | N/A | N/A |
| | Gabungan | 12 | 69 | 779 | min. 450,000 max. 10,000,000 total 36,714,200 | min. 11,538 max. 1,065,000 av. 47,130 |
| | total | 18 | 120 | 1,422 | N/A | N/A |
| Majalengka | LKM | 4 | 29 | 274 | min. 2,296,750 max. 15,000,000 total 36,507,000 | min. 69,598 max. 182,759 av. 133,237 |
| | Gabungan | 17 | 92 | 1,003 | min. 400,000 max. 86,000,000 total 149,799,500 | min. 5,128 max. 1,178,082 av. 149,351 |
| | total | 21 | 121 | 1,277 | 186,306,500 | 145,894 |
| Mojokerto | LKM | 9 | 59 | 1,135 | min. 6,500,000 max. 160,783,000 total 525,097,396 | min. 51,400 max. 1,674,823 av. 462,641 |
| | Gabungan | 29 | 133 | 1,819 | min. 512,000 max. 12,097,335 total 95,190,835 | min. 11,615 max. 337,912 av. 52,331 |
| | total | 38 | 192 | 2,954 | 620,288,231 | 209,982 |
| Kediri *no LKM | Gabungan | 4 | 16 | 186 | min. 2,000,000 max. 15,000,000 total 28,108,000 | min. 35,088 max. 468,750 av. 151,118 |
| TOTAL | | 95 | 533 | 6,802 | N/A | N/A |

(2) Community Direct Assistance (*Bantuan Langsung Masyarakat*: BLM)

BLM is a revolving fund scheme for Kelompok Tani, which was introduced in 2000, and continued up to date by changing name to Community Direct Loan Assistance (*Bantuan Pinjaman Langsung Masyarakat*: BPLM), and then, to Program of Empowerment of Agribusiness Community through Strengthening Group Business Capital (*Pemberdayaan Masyarakat Agribisnis Melalui Penguatan Modal Usaha Kelompok* : PMAM-PMUK).

BLM has experienced problems such as (i) ad-hoc Kelompok Tani formed only to receive the fund, (ii) the fund not utilized for the set purpose in the group business plan, and (iii) the fund revolving poorly in the group.

In order to solve these problems, adjustments and modification have been made. Where the Kelompok Tani loan developed from the revolving fund was not repaid, Kelompok Tani members were asked to make repayment to the bank account of Dinas. Another attempt is to transform Kelompok Tani into MFIs. A series of interview, however, revealed that staff of Sample Kabupaten government still faced problems such as (i) farmers recognized the fund as grant, (ii) lack of close guidance and monitoring to utilize the fund for the set purpose – normally to improve agribusiness, and (iii) delay in disbursement.

The scheme has nationally disbursed Rp. 2.7 trillion to 35,420 groups for the period from 2000 to 2005.

(3) Microfinance Institution Serving Agribusiness (*Lembaga Keuangan Mikro – Agribisnis: LKM-A*)

The Center for Agriculture Financial Services of MOA initiated LKM-A in 2004. It is a capacity building (training, guidance, and capital support) program for Embryo of MFI (=Embryo LKM) and MFI (LKM) developed from Kelompok Tani, SHGs, and other savings and loan organizations in the community. It is a way of utilizing the funds managed by the community, which could finance farmers and agribusiness, and to facilitate the community to become self-reliant and autonomous. It is a clear step ahead from BLM/BPLM/PMUK pattern of funding, intending to show the exit for Kelompok Tani to graduate government support in the future and to become self sustainable.

Total Embryo LKM and LKM covered under LKM-A program between 2004-2006 is 368 in 12 provinces. Out of these, Japanese Government fund of CF-SKR has partly financed the pilot project for LKM-A since late 2005, covering 30 Embryo LKM and 30 LKM in West Java, Central Java, and Nusa Tenggara Barat (NTB). So far, socialization, disbursement of fund to the target, and the profit sharing based on the utilization of fund within the target is observed as it was planned.

LKM-A utilizes the expertise of Small Business Incubation Center (Pusat Inkubasi Bisnis Usaha Kecil: PINBUK), an NGO which fosters Baitul Maal wat-Tamwil (BMT) and micro-enterprise groups. PINBUK has established a methodology to develop community-based MFIs through facilitating BMT, where the community has to fund raise the seed capital to start the MFI. During the period of 1995 to 2005, PINBUK developed approximately 3,000 BMTs, with 30,000 organizers.

4.5 Financial Experience of Kelompok Tani

4.5.1 Different Level of Group Activity

Most of the selected Kelompok Tani have some forms of savings and loan activity, except for the three (Sigranala Indah of Cirebon, and Bina Karya and Linggasari 2 of Kuningan). These three are deemed to have weak group cohesion, and it is the leader who dominates the

whole group activity.

The Kelompok Tani which experience P4K demonstrated the financial discipline and good team work, for example, Delima 2 (Majalengka), Lestari Sejahtera (Mojokerto), Makmur Jaya, and Budi Daya (Kediri).

The strong group activity case is drawn from Tigan Meker (Cirebon), which formed the Livestock Cooperative: Sumber Rejeki, with other Kelompok Tani. The Cooperative provides not only savings and loan service, but also marketing members' products.

Bebek Jaya duck Kelompok Tani in Cirebon market together through the group and profit sharing is observed. The Kelompok Tani is a member of a Syariah KSP, which gives loan for duck production.

4.5.2 Reliance on Government Program

Other points which should not be overlooked are government finance programs for farmers and for poverty alleviation.

Farmers, especially from Cirebon duck Kelompok Tani Tigan Meker have received a massive supports including revolving fund grant and soft loans from the Ministry and Dinas Cooperative, and technical assistance from Dinas Industry and Dinas Livestock. On top of these, Tigan Meker is said to receive Urban Poverty Project (P2KP) funding, and Bebek Jaya receiving BLM as well. Mojokerto Lestari Sejahtera members at the moment receive P4K loan and also received technical assistance from Malang Extension Research Center (Lestari Sejahtera).

Delima 2 and Mitra Binangkit 2 in Majalengka, Budi Daya and Makmur Jaya in Kediri, also benefits / benefited from P4K program. Linggasari 2 in Kuningan received BLM in 2002³

And other non-financial assistance program which provides duck in kind, food processing equipment and machine, and insecticide sprayers also help them financially at the end.

Some of the Kelompok Tani which received softer condition finance program seem to be ready for financial independence, from any form of grant or soft loan. In a way, for them to receive massive assistance, they were chosen as a showcase. But the cumulative assistance obviously contributed bigger expectation to additional financial program with soft terms.

On the other hand, those Kelompok Tani which have less or no experience of receiving government program presented more business minded attitude.

4.5.3 Savings Experience

KT members save for the purposes of Sample Commodity production, accumulating capital for loan repayment, family use including education and daily goods, and some for religious reason (*haj* saving). Among the members who answered to household survey that they had never saved, the reason in most cases is that they do not save because they do not have surplus to save. This group of respondents thinks that if they had surplus, they would have

³ Rp. 16 million was said to be shared among members, each one them got Rp. 0.8 million. They designed to revolve by charging interest rate of 1% per month, for the loan period four months, and the interest rate income of the group to be share between the group and the members by 50%. It seems, however, it did not revolve as it was planned.

saved, for education and building house. The minor answered that they do not see the necessity to save.

When people save, they save at the nearest banks and cooperatives. Safety, being near, and offering flexible conditions are the reasons for the people to save at banks and cooperatives. Some save in the form of *arisan*, because it is near and for establishing solidarity.

Some buy input for production whenever they have surplus, and that is their savings, for example, some duck farmers save in the form of duck and rice.

Regarding the nominal cash amount of savings, **Cirebon** duck farmers save from R. 2.5 to 8.4 million (except for one answered Rp.30 million), for the purpose of accumulating duck production capital. On the other hand, **Mojokerto** duck farmers, who save Rp. 1 to 25 million, most of whom are from Lestari Sejahtera women's Kelompok Tani, save for variety of reasons, not only for duck production but also for the family future, accumulating money for loan installment payment, and daily use.

Kuningan savers save Rp.0.5 to 6 million, for sweet potato farming, but also for children's education, emergency, and family daily needs. **Majalengka** sweet potato processing women's Kelompok Tani respondents save Rp.0.05 to 0.7 million mostly for education, except for the compulsory savings for P4K.

Not many **Kediri** mango farmer respondents answered they save, except for the few who save 3 to 5 million for house construction. P4K compulsory savings were not reflected in the household survey answers.

4.5.4 Different Loan Accessibility among Members

Respondents who borrow from banks do so, because they are near and they can afford to offer collaterals, most of which are land certificates, and some are car certificates. Those who borrow from cooperatives added the reason of easy application process.

Most farmers borrow from BRI Units, Kelompok Tani and cooperatives they belong to, and some from group leaders. The loan from banking institutions are, if not from BRI Units, from other banks which are not necessarily that near from their community, but this is more the case with the group leader-cum-traders, member-cum-traders, and land owners.

Within the Kelompok Tani, the bank customers are more the group leaders or a few members of the group, who happened to be traders as well. In some cases, Kelompok Tani leaders (some of them are traders) borrowed from banks and re-lend it to group members.

4.5.5 Characteristics of Loan Utilization by Commodity

Commodity-wise, duck farmers utilize more the banks than mango and sweet potato farmers and processors, except for Kelompok Tani members who are on the P4K program.

Most of **Cirebon duck** farmer respondents have borrowing experience either from BRI or Syariah KSP, and their current loan balance ranged from Rp.0.5 to Rp. 5 million, for the purpose of duck production and trading. **Mojokerto** Lestari Sejahtera **duck** farmer respondents borrow money at the range of Rp. 3 to 20 million from BRI, and other Kelompok Tani with the amount of Rp. 0.1 to 5 million from within the group, for duck

production.

The loan from traders seems to be phenomena especially for duck and sweet potato production. This did not come out clearly in the household survey, but more from the interview to the traders. The impression is that farmers who are not organized in formal Kelompok Tani are more organized by the traders for them to secure the stable quantity and quality of the commodity production.

Kuningan sweet potato farmer respondents when they borrow, mostly borrow from BRI for the different reasons, not only for sweet potato production but for their other source of income, and a few for education. The current loan balances ranged from Rp.0.4 to 6 million, except for one with Rp. 16 million.

In **Majalengka**, both Mitra Binangkit 2 and Delima 2 are P4K groups under BRI Branch. Some Delima 2 respondents borrowed from the group, and head of the group. Current loan balances ranges from Rp. 0.3 to 1.0 million. Their loan purposes are for mostly for trading, with some for education.

Some women from two **Kediri mango** Kelompok Tani also joined P4K. The respondents from both Kelompok Tani answered they borrow from BRI. For Budi Daya respondents, they also answered they borrowed from the cooperative within the group, for agriculture inputs (non-mango purpose) and daily goods, with current loan balances of Rp. 0.05 to Rp. 0.2 million. Makmur Jaya respondents borrow from BRI for the mango production and trading purpose.

4.5.6 Financial Relations within and outside Kelompok Tani

As explained in the previous section, Kelompok Tani use banks to finance production and other income generating activities, it tends to be either only a few members of the Kelompok Tani, or the members which are covered under P4K. Others rely on (i) savings and loan within the Kelompok Tani or the Cooperatives, (ii) government program rendered to the Kelompok Tani or the Cooperatives, (iii) loan from the leader (bank loan re-lending), and /or (iv) traders.

The schematic image of financial relations of the Selected Kelompok Tani is summarized in the Figure 4-2 to 4-14 as follows:

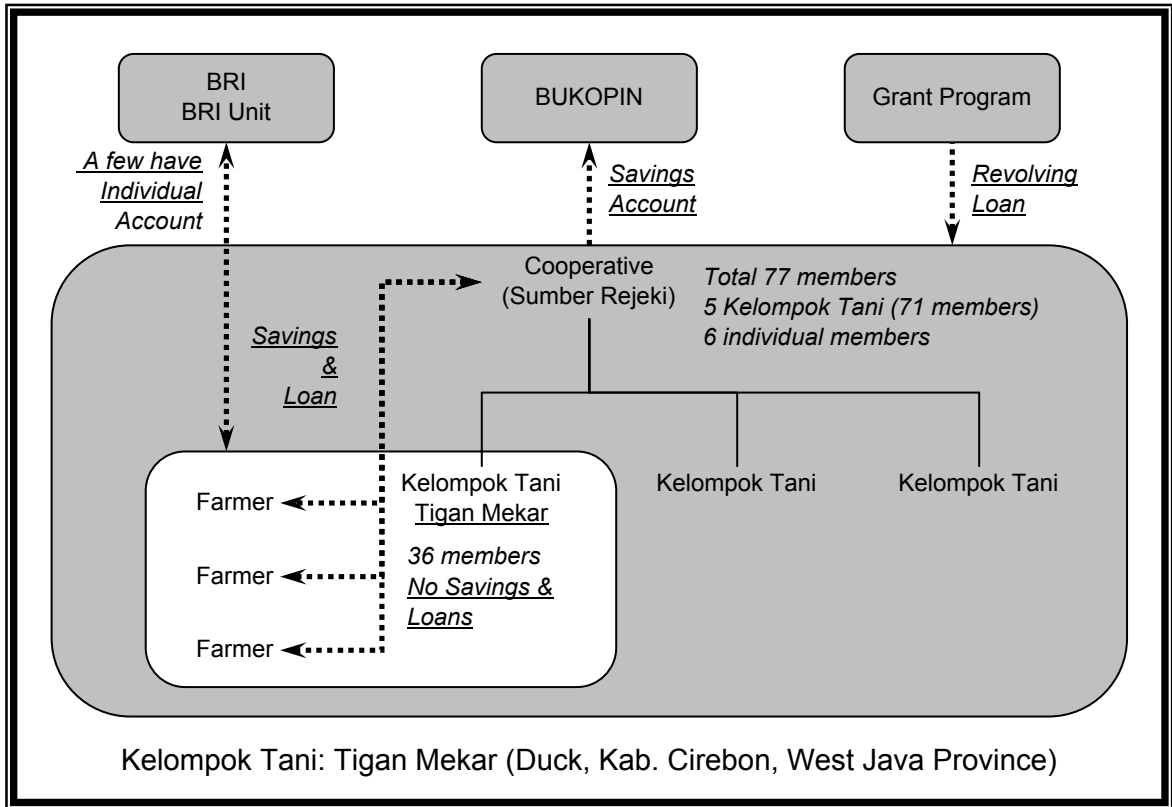


Figure 4-2 Financial Transaction (Tigan Mekar, Kabupaten Cirebon)

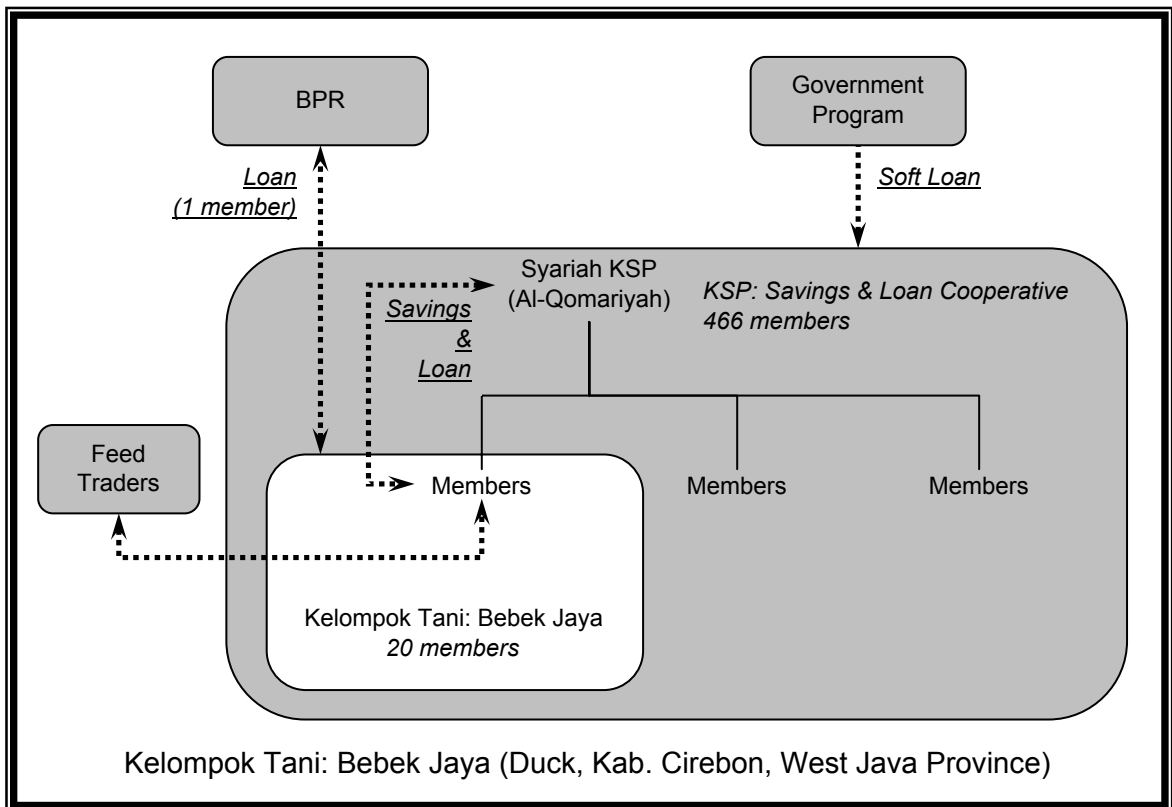


Figure 4-3 Financial Transaction (Bebek Jaya, Kabupaten Cirebon)

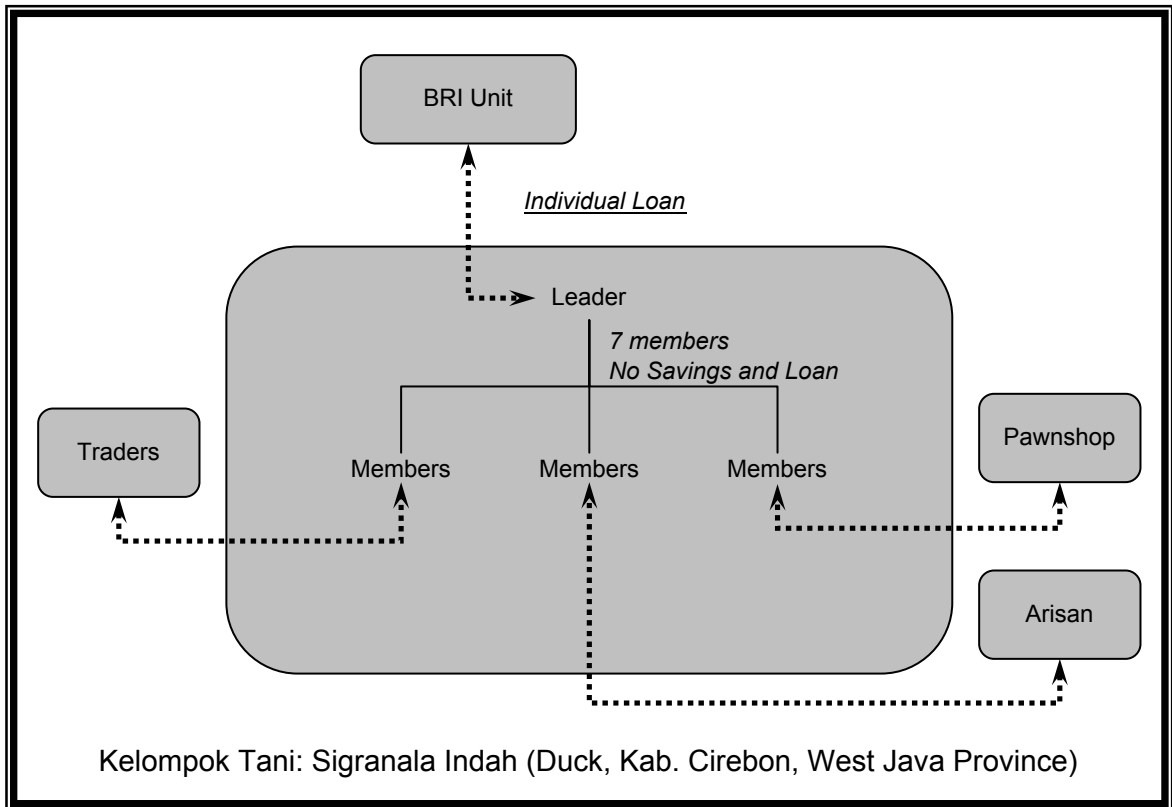


Figure 4-4 Financial Transaction (Sigranala Indah, Kabupaten Cirebon)

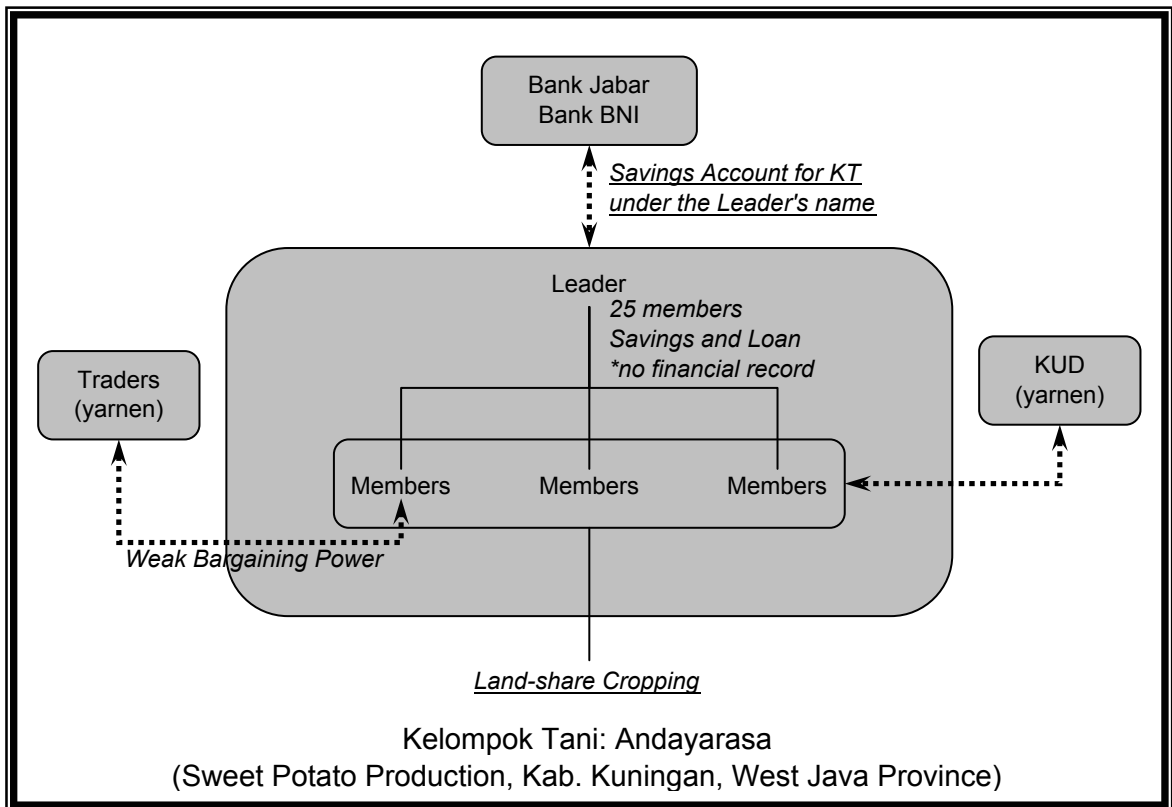


Figure 4-5 Financial Transaction (Andayarasa, Kabupaten Kuningan)

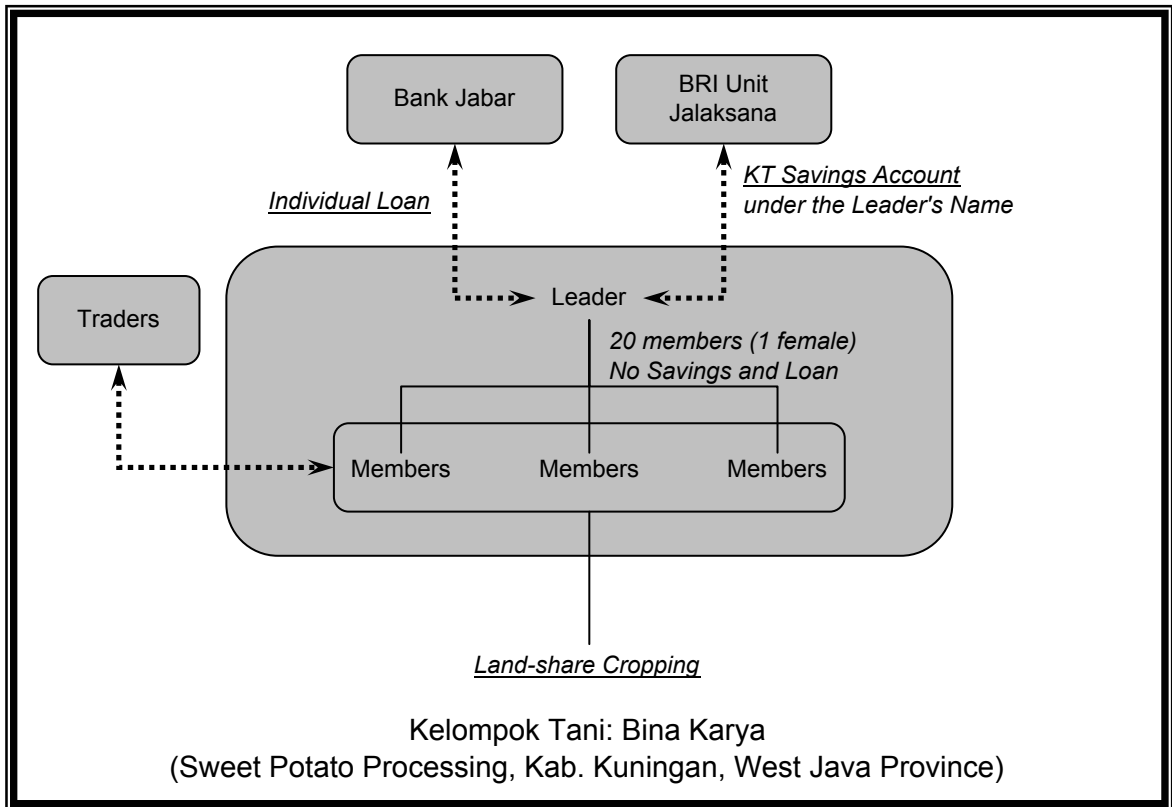


Figure 4-6 Financial Transaction (Bina Karya, Kabupaten Kuningan)

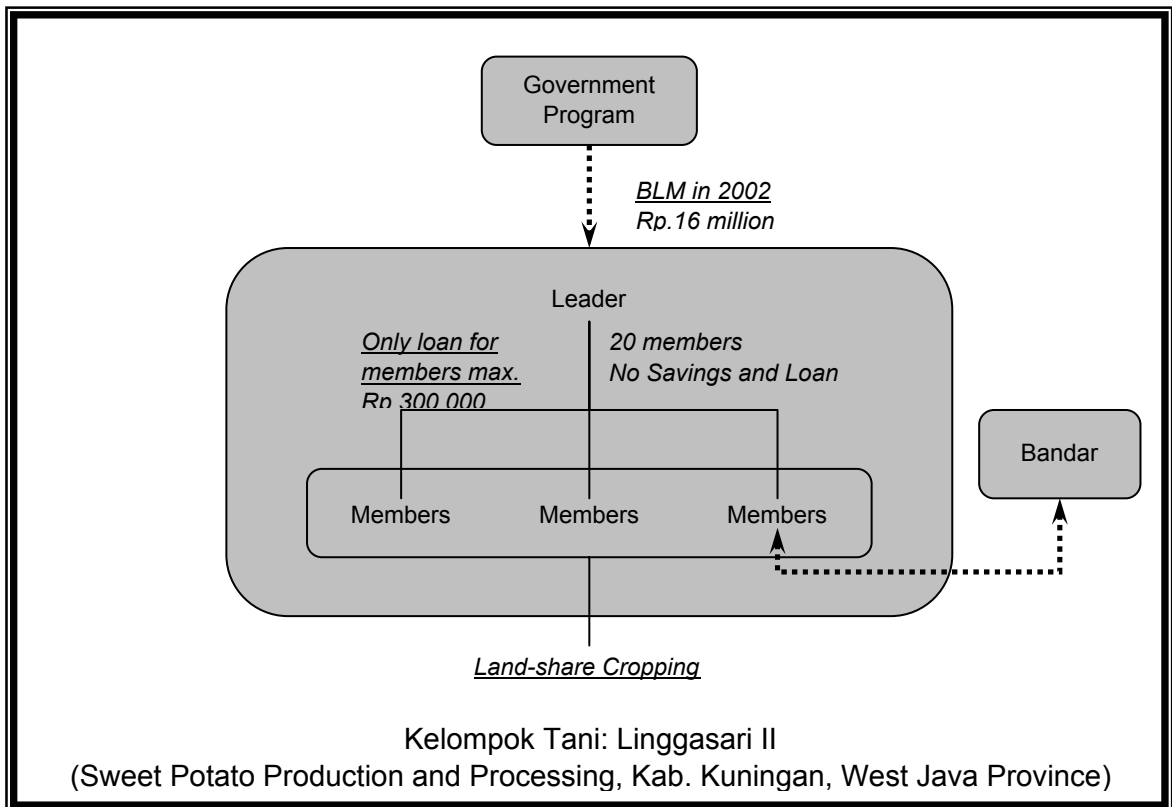


Figure 4-7 Financial Transaction (Linggasari II, Kabupaten Kuningan)

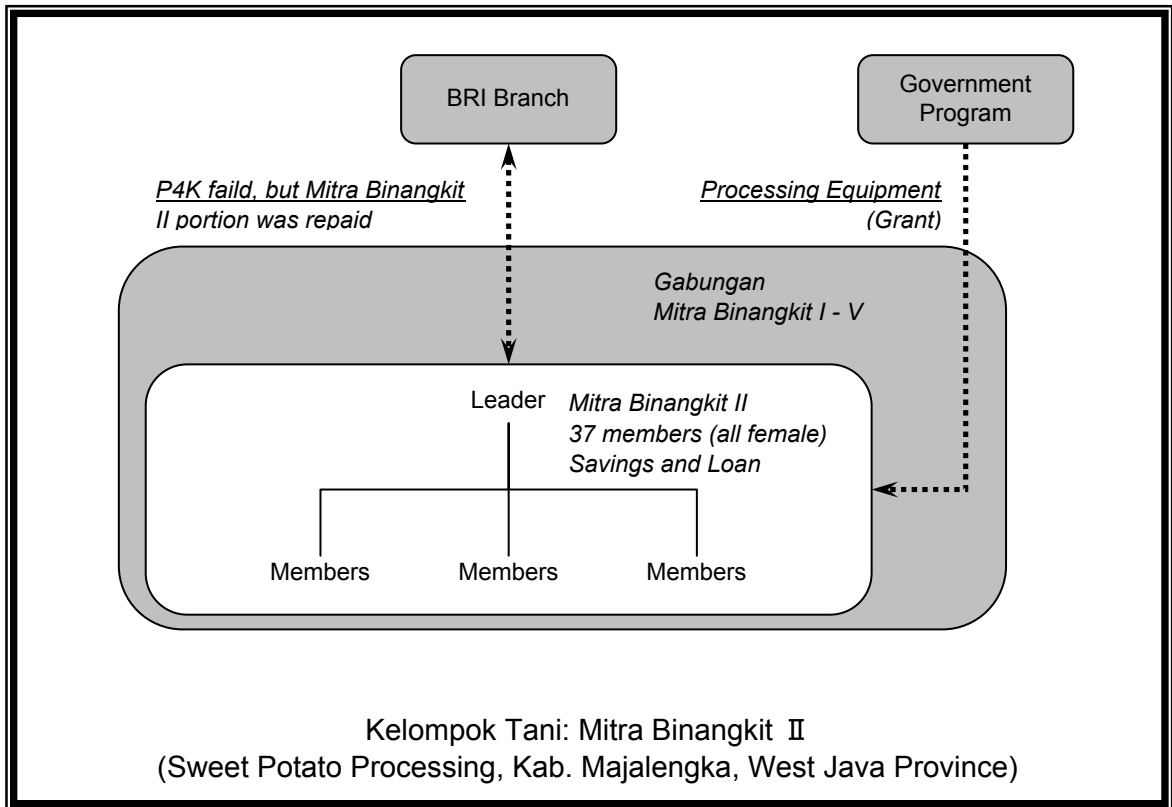


Figure 4-8 Financial Transaction (Mitra Binangkit II , Kabupaten Majalengka)

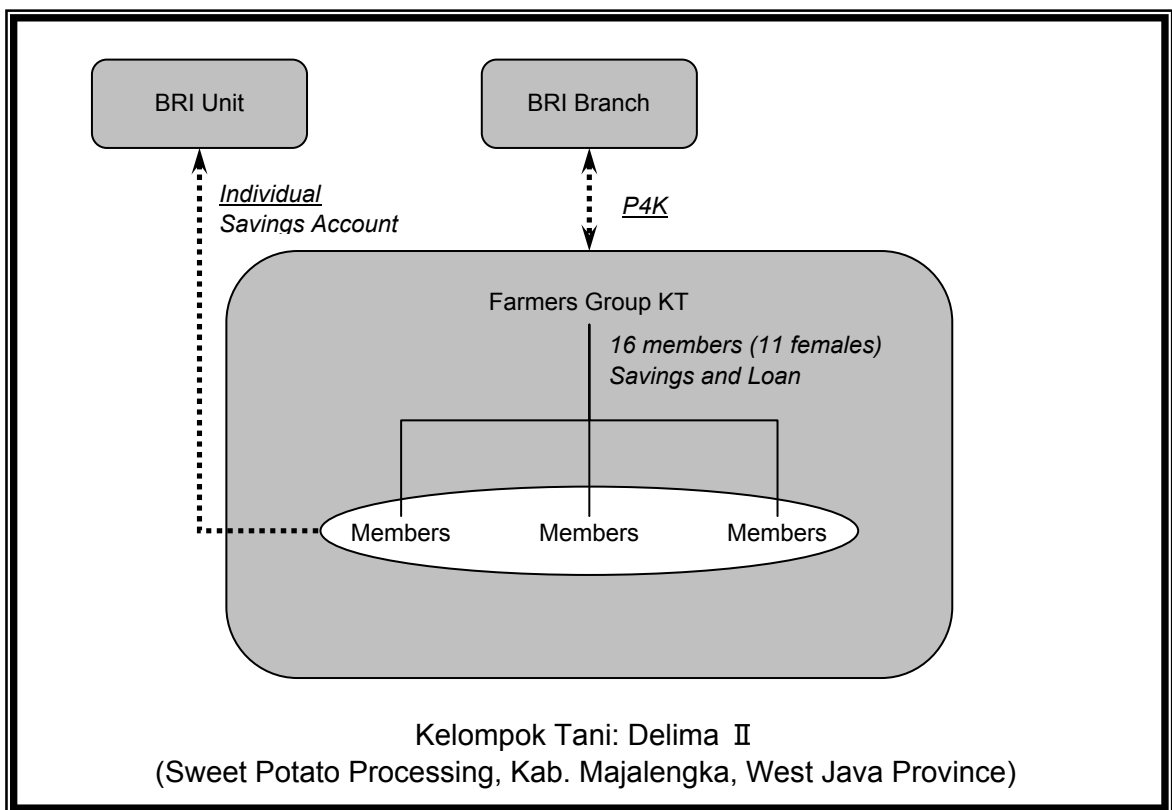


Figure 4-9 Financial Transaction (Delima II , Kabupaten Majalengka)

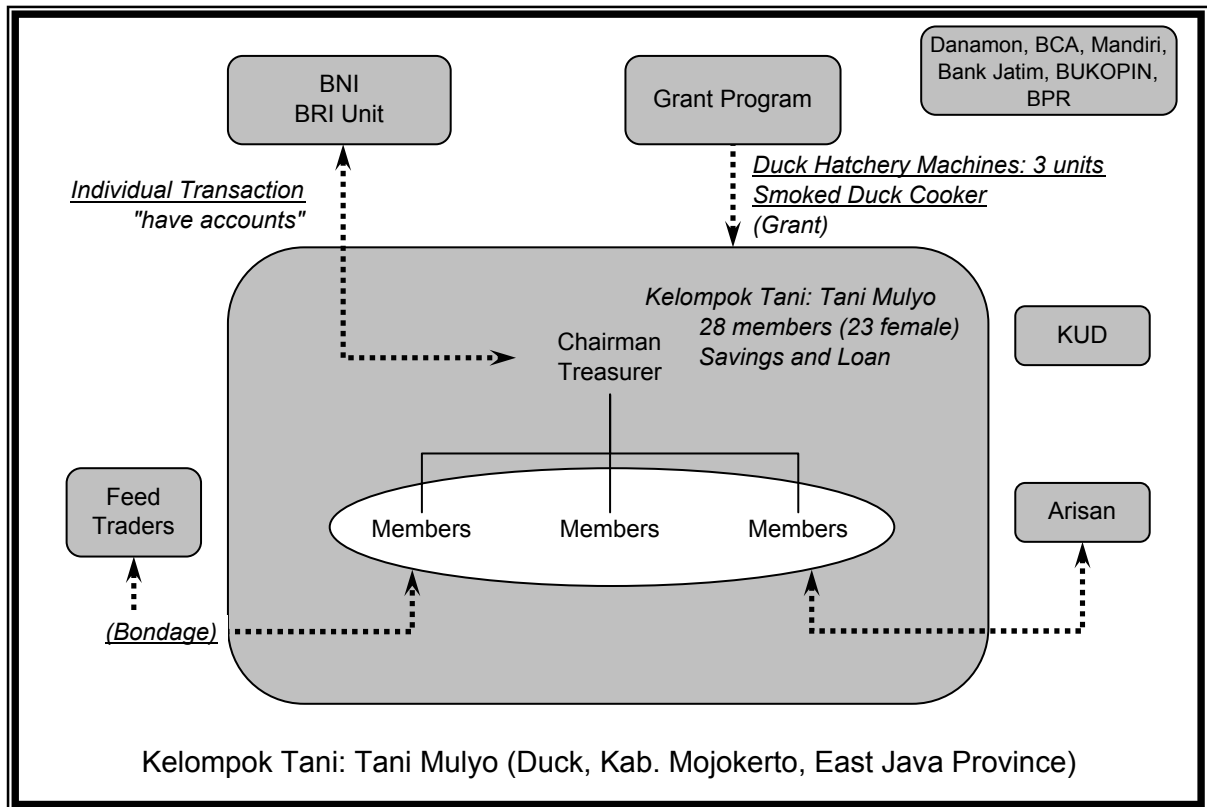


Figure 4-10 Financial Transaction (Tani Mulyo, Kabupaten Mojokerto)

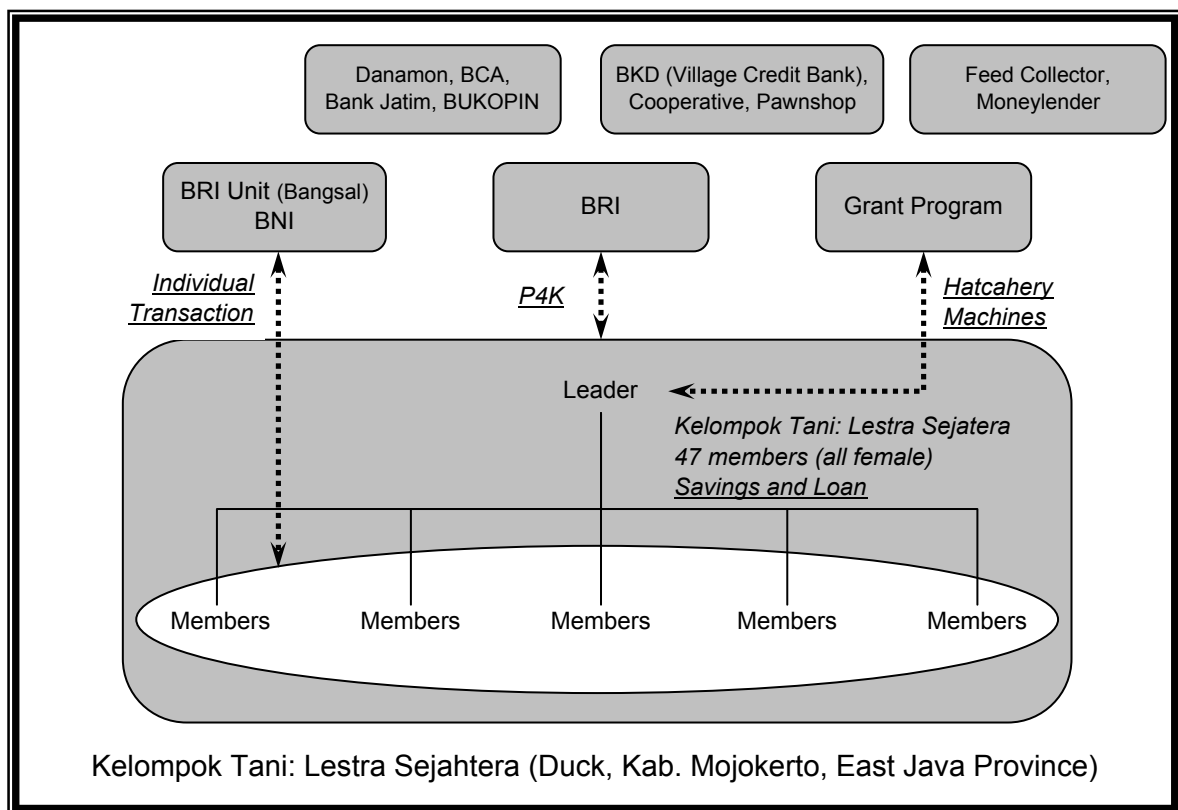


Figure 4-11 Financial Transaction (Lestari Sejahtera, Kabupaten Mojokerto)

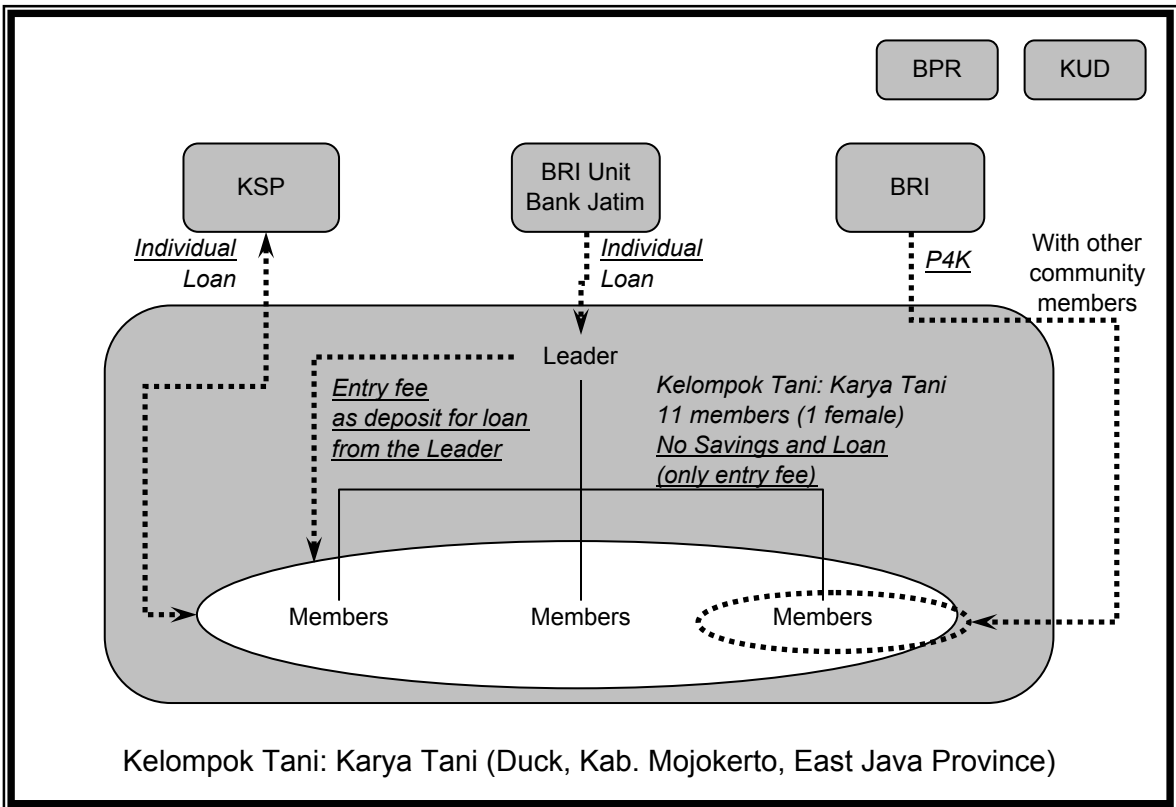


Figure 4-12 Financial Transaction (Karya Tani, Kabupaten Mojokerto)

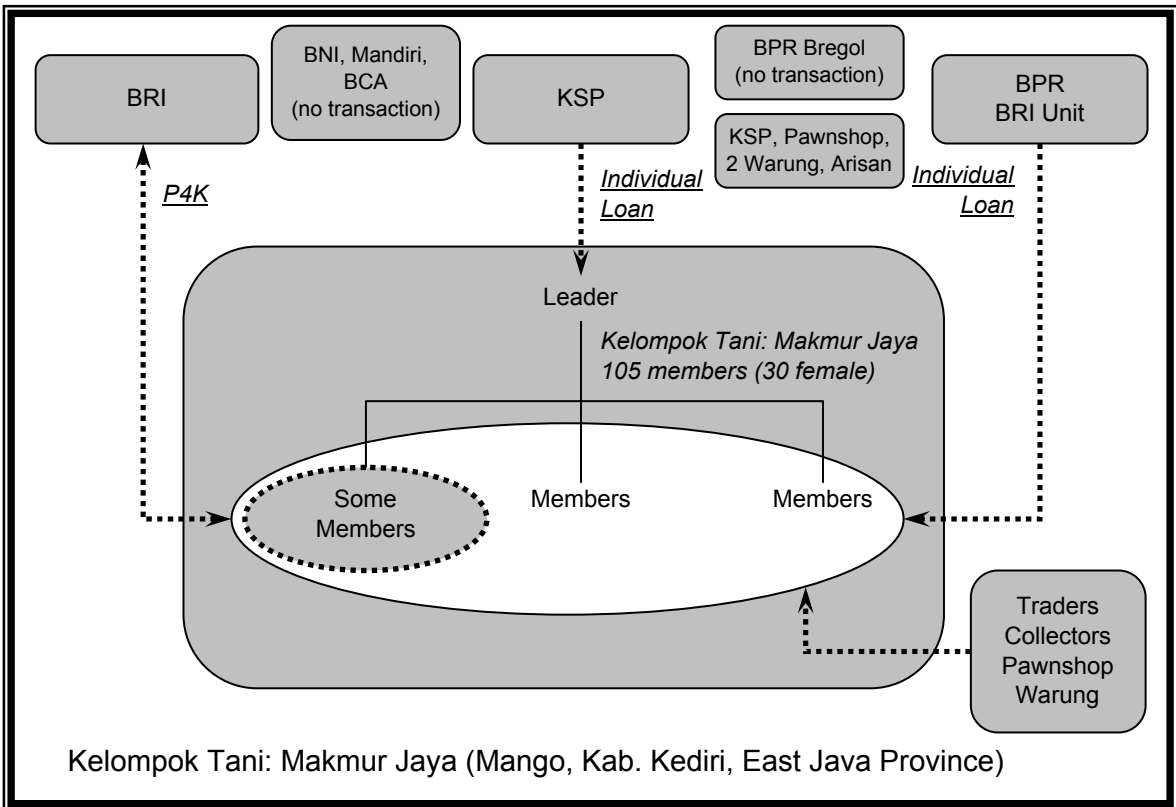


Figure 4-13 Financial Transaction (Makmur Jaya, Kabupaten Kediri)

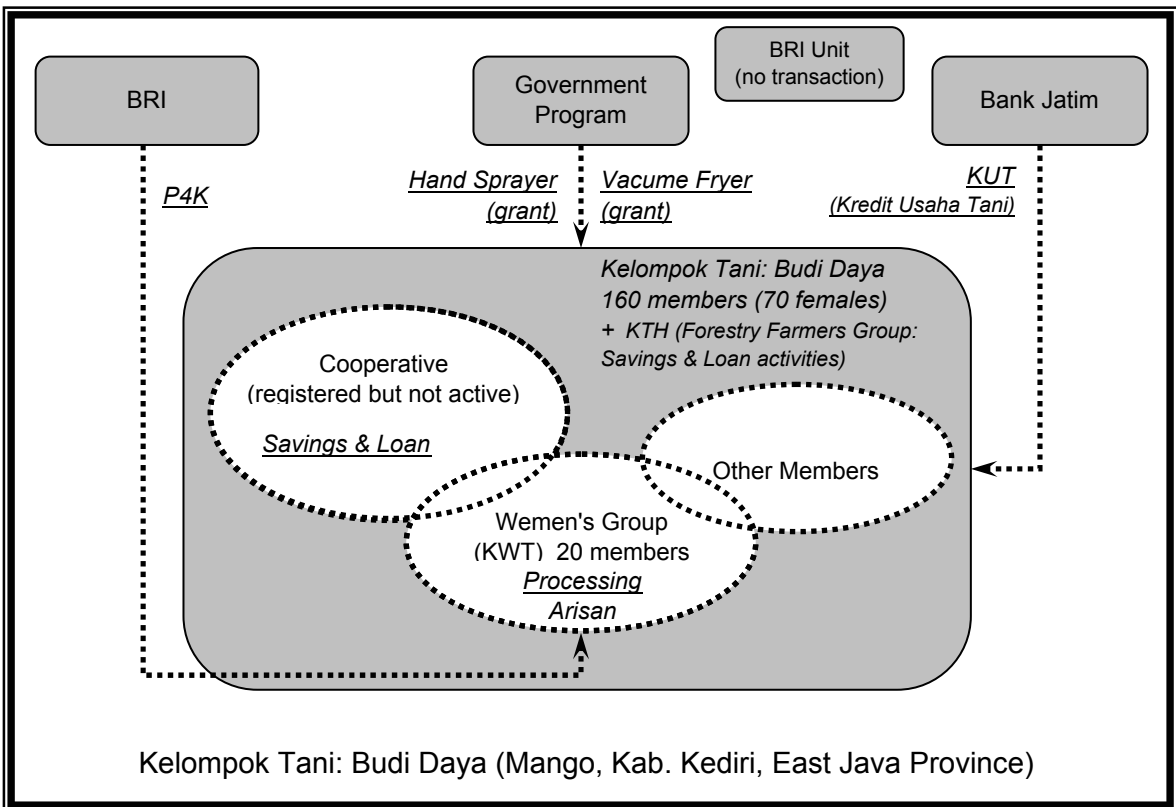


Figure 4-14 Financial Transaction (Budi Daya, Kabupaten Kediri)

Figure 4-15: Poverty Ranking in Kabupaten Cirebon

| | | 10% | 20% | 30% | 40% | 50% | 60% | 70% | 80% | 90% | |
|---|--|--|--|--|---|--|-----|-----|-----|-----|--|
| Community of duck KT | | <div style="display: flex; justify-content: space-between; width: 100%;"> Very Poor (20%) Poor (45%) Fair (27%) Rich (8%) </div> | | | | | | | | | |
| Sriganala Indah Class Monthly Income Income Source Asset: Land Asset: Transport Asset: TV, radio Asset: Livestock Education-adult Food Finance | ↑ Very Poor Rp.100,000 - Labor No land Old 2nd-hand bicycle No TV 2 ducks, 3 chickens Elementary Food not sufficient Money lender | ↑ Poor Rp.200,000 - Rent farmer No land 2nd-hand or new bicycle Black & White TV 50 ducks, 10 chickens Elementary Food not sufficient Pawnshop/money lender | ↑ Fair Rp.600,000 - Land own farmer 0.5 - 1 ha motor bicycle (credit) Color TV 600 ducks, 60 chickens Junior high Enough Group savings, BRI Unit, BPR | ↑ Rich Rp.800,000 & more Land owner average 2 ha Motor bicycle/car/truck Color TV, video, VCD 1200 ducks, 60 chickens, 20 goats Senior high More than enough Group savings, BRI Unit, BPR | | | | | | | |
| | Bebek Jawa Class Monthly Income Income Source Asset: Land Asset: Transport Asset: TV, radio Asset: Livestock Education-adult Food Finance | ↑ Very Poor Rp.100,000 - Labor No land Old 2nd-hand bicycle Radio No livestock Elementary Very insufficient Saving Rp.10,000 per month | ↑ Poor Rp.150,000 - Farm Labor No land Bicycle Black & White TV 10 chickens Elementary Insufficient Arisan Rp.50,000 per month | ↑ Fair Rp.300,000 - Duck farmer/farmer 0.5 ha motor bicycle Color TV, Video 200 - 600 ducks Senior high Sufficient Cooperatives | ↑ Rich Rp.900,000 & more Land owner 5 ha Car, truck Color TV, video, VCD More than 1,000 ducks, 50 goats University Very sufficient BRI Cirebon Utara, BPR | | | | | | |
| | | Tigan Mekar Class Monthly Income Income Source Asset: Land Asset: Transport Asset: TV, radio Asset: Livestock Education-adult Food Finance | ↑ Very Poor (12%) Rp.60,000 - Irregular hard labor No land Old bicycle None 0 - 5 chickens Elementary drop-outs Very insufficient Money lender | ↑ Poor (28%) Rp.150,000 - Irregular had labor No land Bicycle None to Radio, TV 5 - 10 chickens Elementary Insufficient Money lender | ↑ Fair (45%) Rp.750,000 Duck farming, duck sales 0.5 ha, 2ha (rent) Motor bicycle + bicycle TV, Radio, Video 100 ducks, 30 - 50 chickens Junior - senior high Enough Bank, cooperative, group saving | ↑ Rich (15%) Rp.1,500,000 & more Duck entrepreneur, duck trader 3 - 5 ha Car, truck TV, radio, video, refrigerator, etc. 700 ducks, 50 chickens, 50 goats Junior-senior high, university More than enough Bank, cooperative, group saving | | | | | |

Figure 4-16: Poverty Ranking in Kabupaten Kuningan

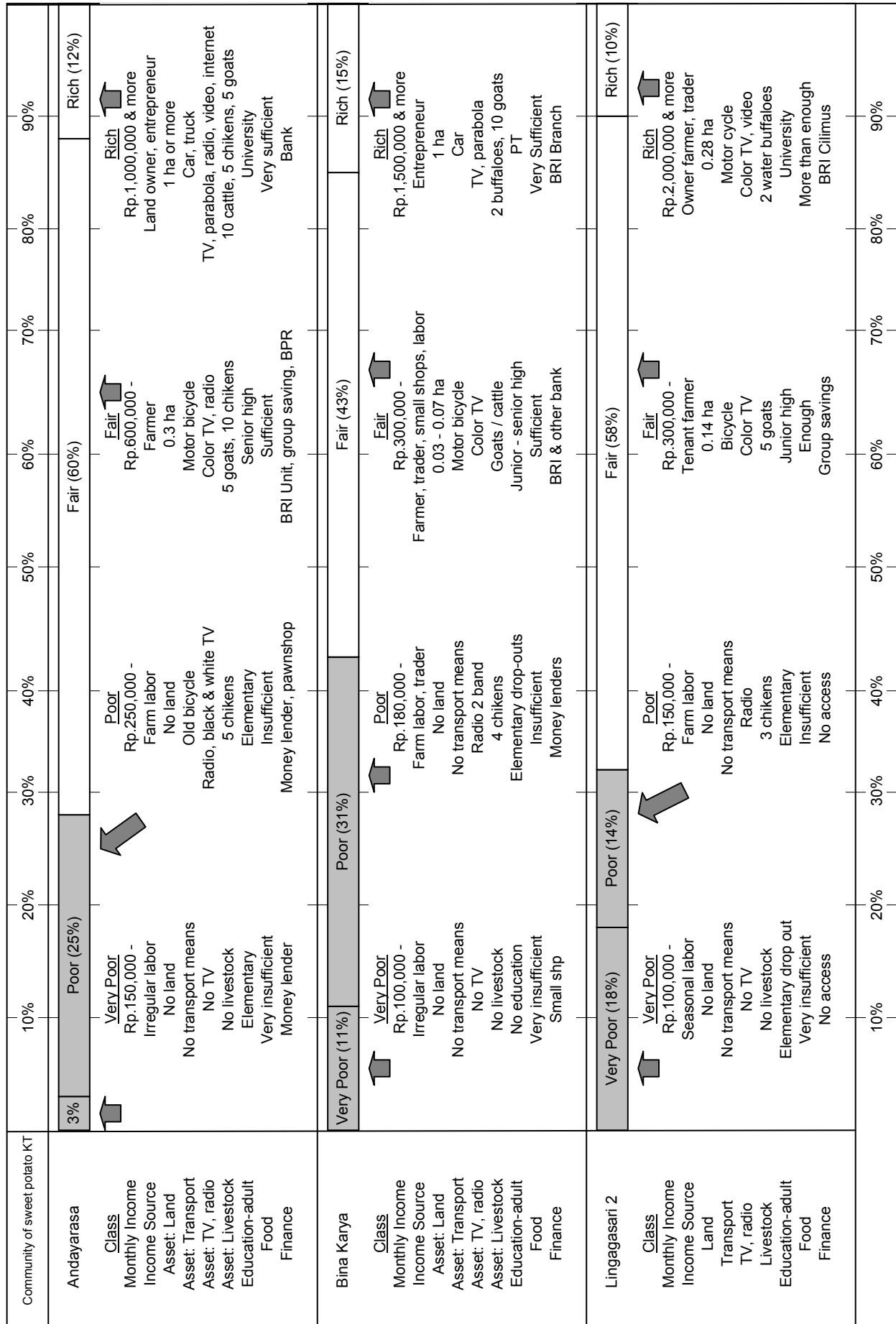


Figure 4-17: Poverty Ranking in Kabupaten Majalengka

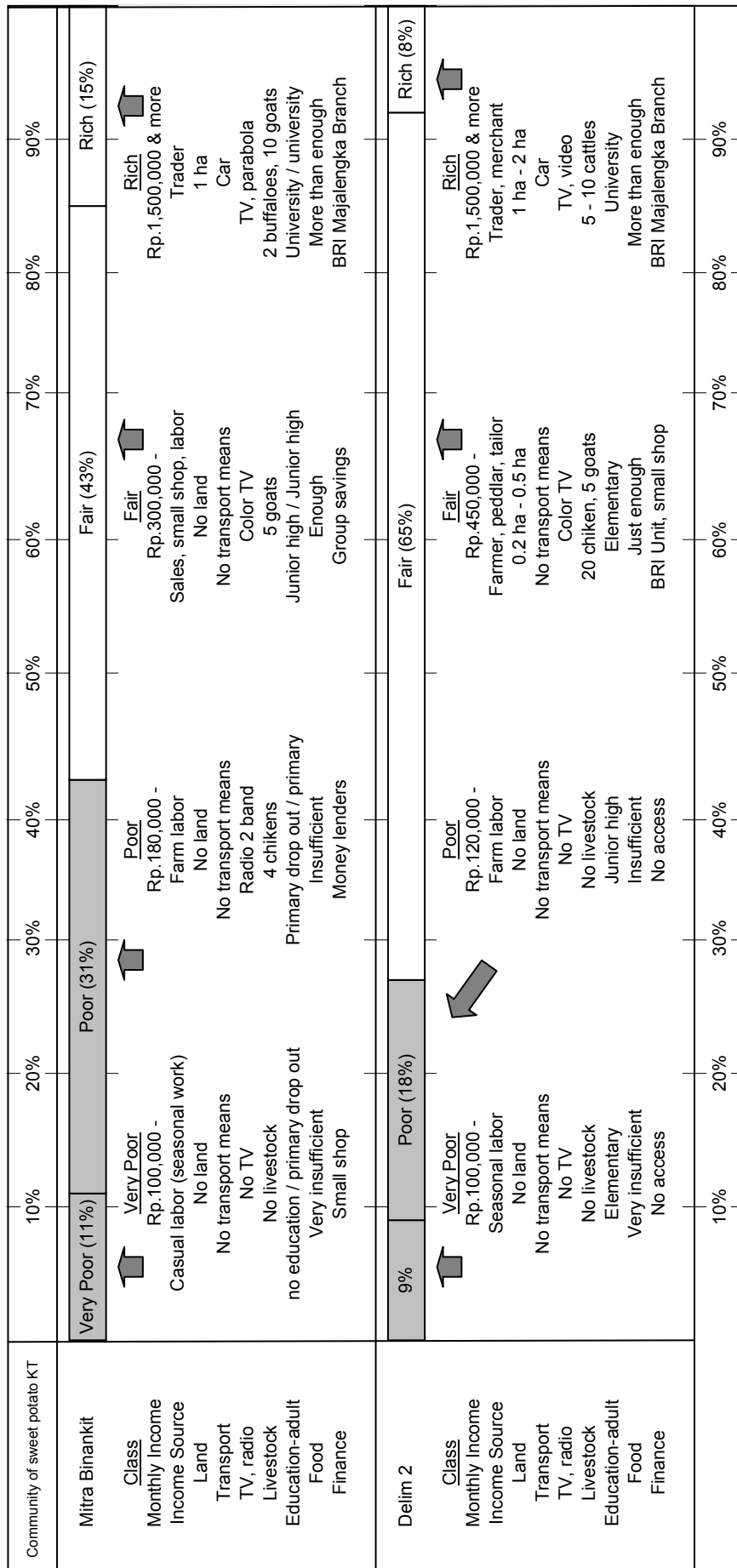
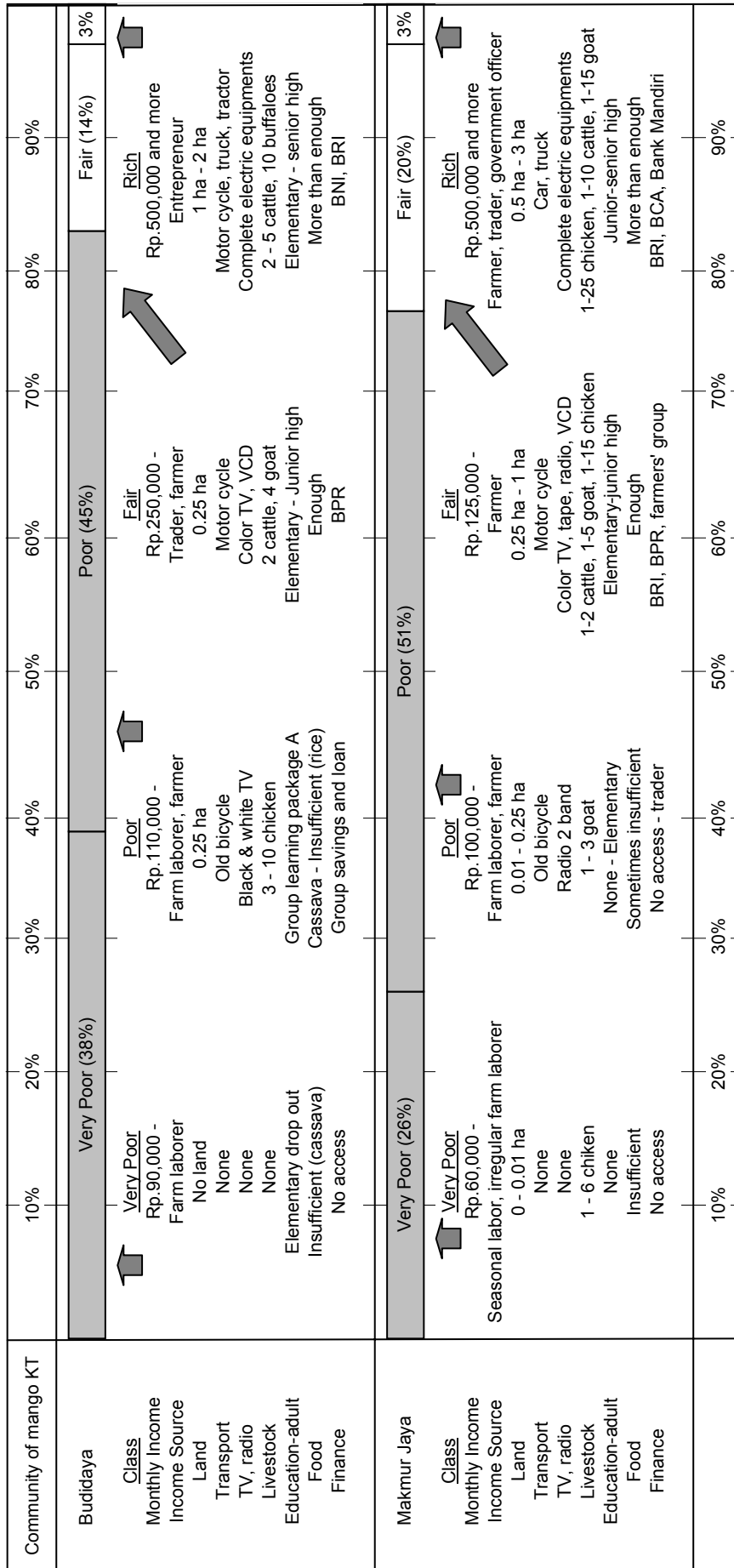


Figure 4-18: Poverty Ranking in Kabupaten Mojokerto

| Community of duck KT | | 10% | 20% | 30% | 40% | 50% | 60% | 70% | 80% | 90% |
|----------------------|--|--|---|---|---|-----|-----|-----|-----|-----|
| Lestari Sejahtera | <p>Class Monthly Income Income Source Land Transport TV, radio Livestock Education-adult Food Finance</p> | <p>Poor (36%)</p> | | | | | | | | |
| | | <p>Very Poor Rp.100,000 - Farm labor 0 - 0.001 ha None or Old bicycle None or Radio 1 band 2 chicken Group learning package A - elementary Very insufficient No access</p> | <p>Poor Rp.200,000 - Farm labor 0.004 - 0.017 ha Old bicycle - motor cycle Radio 3 - 10 chicken Elementary Insufficient No access - money lender</p> | <p>Fair Rp.500,000 - Duck farmer/seller/collector/hatcher 0.024 ha - 0.5 ha Motor cycle - car TV, radio, VCD, refrigerator 100 - 500 ducks, 1000 DOD Junior - senior high Enough Group savings, bank</p> | <p>Rich Rp.2,250,000 - Duck farmer/hatcher, shop owner 0.08 ha - 0.27 ha Bicycle - 3 cars Complete electric equipments, computer 300 - 1000 ducks, 100 chicken Senior high - university More than enough Bank</p> | | | | | |
| Tani Mulyo | <p>Class Monthly Income Income Source Land Transport TV, radio Livestock Education-adult Food Finance</p> | <p>Poor (29%)</p> | | | | | | | | |
| | | <p>Very Poor Rp.80,000 - Irregular labor 0 - 0.01 ha Old bicycle Radio 2 band 2 chicken None - Elementary Very insufficient No access</p> | <p>Poor Rp.100,000 - Seasonal farm labor 0.005 - 0.007 ha Old bicycle Radio 8 - 15 chicken Elementary Insufficient Group saving, bank, money lender</p> | <p>Fair Rp.300,000 - Farmer, government official 0.024 ha - 2 ha Motor cycle, old bicycle TV, radio 20 - 100 chicken, 20 - 400 ducks Elementary - university Enough BRI, group saving, trader, pawnshop</p> | <p>Rich Rp.1,700,000 and more Farmer, entrepreneur, gov. official 0.07 ha - 3 ha Motor cycle, car, old bicycle TV, VCD, radio, computer 50 - 300 chicken Elementary - university More than enough Bank, trader</p> | | | | | |
| Karya Tani | <p>Class Monthly Income Income Source Land Transport TV, radio Livestock Education-adult Food Finance</p> | <p>Poor (31%)</p> | | | | | | | | |
| | | <p>Very Poor (14%) Farm labor, irregular labor, peddler 0.003 - 0.01 ha Old bicycle None - radio 5 - 10 chicken Elementary drop-outs Very insufficient Money lender</p> | <p>Poor Rp.100,000 - Peddlar, driver 0.004 - 0.03 ha Old bicycle, old car Radio, 2nd-hand color TV 10 - 20 chicken, 1 goat Elementary Insufficient Money lender, pawnshop</p> | <p>Fair (52%) Rp.250,000 - Farmer, small business person 0.04 ha - 0.08 ha new car, tractor Color TV, video, radio 20 chicken, 300 duck Junior high - SMA Enough Bank, group savings, farmers' group</p> | <p>Rich Rp.400,000 and more Entrepreneur 1 ha - 4 ha Complete set of vehicles Complete electric equipment Senior high - university More than enough Bank</p> | | | | | |
| | | 10% | 20% | 30% | 40% | 50% | 60% | 70% | 80% | 90% |

Figure 4-19: Poverty Ranking in Kabupaten Mojokerto



CHAPTER 5 IMPROVEMENT PLAN

5.1 Gap between Demand and Supply

5.1.1 Commercial Bank Financing Situation surrounding Farmers

Currently commercial banks have abundant cash from the deposit, and they have been strengthening its efforts to expand their credit to micro, small and medium enterprises (MSMEs), directly, and indirectly by re-lending to legally registered microfinance institutions (MFIs) such as BPRs and cooperatives. At the same time, the mechanisms to increase loan from commercial banks and BPRs to MSME have been established. Bank Indonesia introduced Syariah banking, started conducting bank account officers in charge of MSME lending, and established the system of Banking Partner Financial Consultants (KKMBs), who are Business Development Service Providers (BDSPs) and bank account officers in charge of MSME lending and they are trained for MSME lending. Indeed the share of MSME lending in total bank lending is growing (51% in 2005). However, the share of agriculture sector in MSME lending is decreasing.

On the other hand, the efforts are made by the Ministry of Agriculture to create the environment for farmers to have easier access to bank loan. One of them is Food Security Credit (KKP), a subsidized credit for food crops, sugarcane, livestock, fishery, and food procurement, introduced in 2000. Another scheme, Agricultural Financing Service Scheme (SP3) has just been introduced in 2006, which is a guarantee service to mitigate the risk of commercial banks giving loan to farmers, by depositing cash collateral to five commercial banks. For both schemes, loan fund is derived from banks' internal cash and the loan appraisal is conducted according to the bank's criteria to weigh the agricultural risk. As a result, it ends in slower loan disbursement than expected.

In conclusion, the fund from commercial banks reach a part of farmers who obtain MSME lending, fulfilling the banks requirement of collateral, or farmers who are members of cooperatives which receive loan from commercial banks. Otherwise, farmers who do not have collaterals, and who have no link to cooperatives, who seem to be the majority, are out of reach from commercial bank loans.

5.1.2 Financial Gap in the Farmers' Community

In summary, the selected Kelompok Tani farmers have already had access to the finance up to certain extent, but not with the conditions they prefer. The kind of financial institutions they have access to differ. The elements they cannot control as of now is the community's geographical set up, and the profitability of the commodity. Some have access to banks, save and borrow their working capital and small investment capital around Rp.5 million. Some have access to cooperatives, save and borrow mainly the working capital around Rp.1 million without collateral, others use Kelompok Tani, to save and have loan around Rp.0.5 million without collateral, and to *warung*, and individuals (group leader, traders, feed suppliers). Other farmers do not have physical access to banks because they are located in the remote area, and they are currently served by P4K scheme.

All these situations arise from demand and supply gaps as follows:

(1) Lack of Physical Access

For Kelompok Tani in remote area, such as the ones in Majalengka and Kediri, the physical access to financial institutions is difficult. The link to BRI will be cut off when P4K loan cycle ends, because there are no other financial services available at convenient location.

(2) Financial Needs of the Rural Community

As for the members of the community where the selected Kelompok Tani are located, destitute and poor category of people either has no access to any financial services, or has access to only informal microfinance such as moneylender and traders. They also have a willingness to save money, which is not realized under current situation.

(3) Financial Needs of Agribusiness

Kelompok Tani members, even they have access to loan from banks, cooperatives, Kelompok Tani, and other financial services, they feel the production capital is not enough.

Duck farmers, who want more capital, have the intension of using it for increasing the number of ducks, and investing in hatchery machine, renting more land for keeping ducks, and creating more duck cages. Sweet potato production groups in Kuningan would also like to have more capital, for purchasing agricultural inputs, and for controlling marketing and price by themselves. Majalengka sweet potato processing groups want more funding for modernization of their processing equipment and improvement of packaging.

(4) Not meeting the Conditions for Loan

For the farmers who do not borrow, the reasons are, firstly, the fear of not following the repayment cycle which financial institutions can set. Secondly they think they do not have collateral, whether in terms of the volume or in terms of the form of ownership documents (e.g. not in the form of certificate, but in the form of letter¹). They also feel the collateral coverage ratio set by bank is too strict. Thirdly, they feel their business is not running well enough to pay the high interest.

The average of agriculture loan amount at BRI Units visited is approximately Rp. 5 to 6 million, which coincides the maximum loan amount of the target farmers get, except for those who own bigger land and who are traders get loan in tens of millions of rupiah. The collateral requirement exemption at BRI Units is up to Rp. 3 million, and at BPD it is Rp. 1. million. These amounts are almost the maximum which cooperatives can provide to farmer members. The P4K group is qualified for the loan amount up to Rp. 2 million with the 10% compulsory savings frozen at bank.

(5) Reliance on Traders' Finance

Farmers who do not have enough financial resources other than commodity, tend to opt for traders finance to source agricultural inputs and to meet quick cash needs, using the commodity as informal collateral. In turn, some do not have the bargaining power and get

¹ Processing a land ownership letter to a formal certificate may cost Rp. 1 million and it takes time.

the unfavorable conditions. On the other hand, it is also because of the lack of marketing capacity on farmers' side, which let them rely on traders to sell their commodities. This side of traders' finance has a positive connotation, the farmers cannot fail to sell by going through the traders. To get away from this problem, farmers should either (i) have financial resources by accumulating assets, (ii) increase bargaining power through collective action, or (iii) build marketing capacity.

(6) Limit of loan amount offered by KT / Cooperative

The problem of cooperatives and Kelompok Tani as membership organizations, is that they hit the ceiling of loan amount easily, because their loan funds are mainly sourced from internal savings. The common loan amount within the Kelompok Tani mentioned was Rp. 0.5 million, and for example, the maximum loan amount Bebek Jaya members are allowed to borrow from Syariah KSP is set at Rp. 1 million, when duck farmers would like to have the capital of more than Rp. 10 million. If their capital was not boosted by borrowing from other financial institutions, or through government finance program, such as grant (meant to be revolved in the organization) and soft loan, it keeps facing this ceiling. To solve this problem, the membership organization should increase the number of members and/or the contribution from the members.

5.2 Improvement Direction for Gap Filling

It is better to link farmers to more formal financial institutions, but it was found that in most cases, it is not possible right away because of the gaps between financial demand of farmers and farmers' community, and the supply, as is stipulated in the previous section.

Since our focus is the farmers and rural communities, we propose the government and donor assistance programs to bridge these gaps by: (i) establishing a strong MFI around Kelompok Tani in the rural community to serve both farmers and community members, and, (ii) improving capacity of agribusiness itself, i.e. mainly to improve its profitability. The details of the two directions are as follows:

(i) Establishing a strong MFI in the community

This can be achieved in different ways. Followings are the three approaches of establishing a MFI, based on the savings and loan experience, characteristics of leadership, and the level of group cohesion in the target Kelompok Tani to improve the situation:

a) Establishing community MFI

This approach is for Kelompok Tani in which group activities are inactive, its leader dominates, and members have passive attitudes. This type of Kelompok Tani tends not to have active savings and loan activities.

In order to change the circumstances of the group, the intervention to strengthen group activity shall be made at the same time of agribusiness improvement. But for financial access improvement, it is recommended to establish an MFI in the community, not based on the said Kelompok Tani, but outside Kelompok Tani. This is to avoid the leadership and other power relation problems attached to the said Kelompok Tani, and to take advantage of other leaders in the community.

This approach applies to Sigaranala Indah (Kab. Cirebon), Linggasari 2 (Kab. Kuningan), and Mitra Binangkit 2 (Kab. Majalengka).

b) Establishing own MFI

This approach is for the Kelompok Tani, in which regular savings and loan is taking place, and collective action is observed. The potential of group discipline, leadership, and financial management of the said group is also recognized.

This applies to KT such as Lestari Sejahtera in Kab. Mojokerto, Budi Daya in Kab. Kediri, P4K groups / Gabungan / LKM, Andaya Rasa in Kab. Kuningan, Delima 2 in Kab. Majalengka, Karya Tani and Tani Mulyo in Kab. Mojokerto, and Makmur Jaya in Kab. Kediri.

c) Strengthening existing function of cooperative (KSP/USP)

If Kelompok Tani already have a strong linkage with cooperatives, which are the nearest convenient financial institutions, the intervention shall be the one to strengthen this linkage, and the capacity of the cooperatives.

This applies to the case of Tigan Meker in Kab. Cirebon, which is a member of the cooperative Sumber Rejeki, and Bebek Jaya in Kab. Cirebon, which is a member of the Syariah cooperative KSP Al Qomaliah.

(ii) Agribusiness Improvement

To improve the profitability of agribusiness and capacity of running agribusiness, it requires the intervention of technical assistance plus finance. The improvement directions are explained in 4.2.1 Agricultural Processing and 4.2.2 Marketing.

The three options under (i) are the financial improvement intervention parallel or subsequent to the agribusiness improvement.

In case of the promising venture such as KT: Karya Tani in Kab. Kuningan, it is recommended to transform it into a business entity in the form of a company. Then it is expected to have an access to commercial banks for finance.

(iii) Asset Building

Asset building shall be incorporated in all the improvement options stated above.

Farmers, Kelompok Tani, cooperatives, and MFIs are supposed to build assets for livelihood stability and organizational sustainability.

(iv) Goal

The approaches of (i) to (iii) shall lead to the Goal of the farmer and their community owning and running a financially viable MFI and/or individuals become financially profitable enough and having enough assets, and if necessary, have access to financial services of their preference as an individual or as an institution.

The problem analysis of six gaps and improvement directions described above are shown in the Figure in the next page.

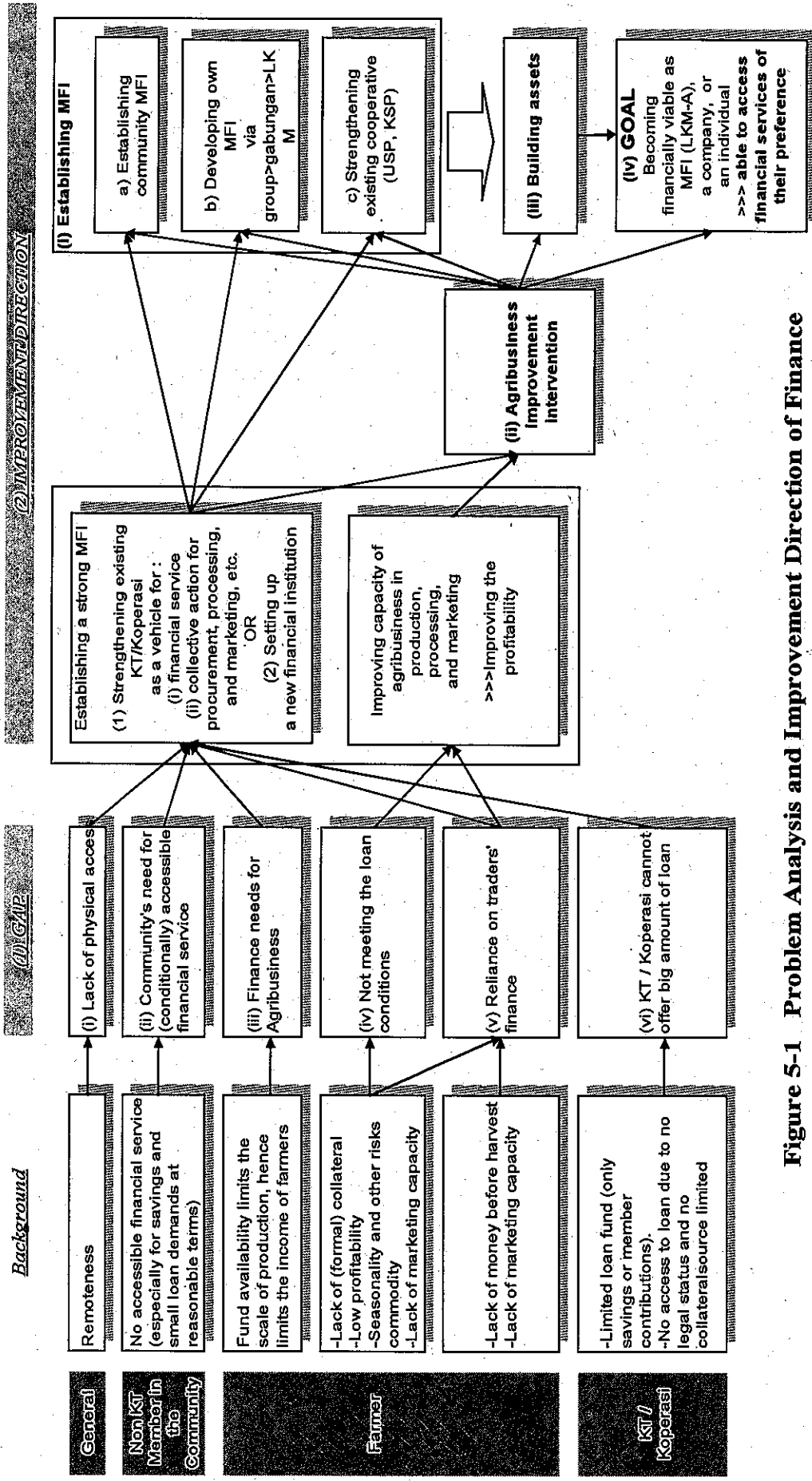


Figure 5-1 Problem Analysis and Improvement Direction of Finance

5.3 Business Model for Finance

Based on the improvement approach of (a) establishing community MFI, (b) establishing own MFI, and (c) strengthening existing function of cooperative described in the previous section, three business models for financial improvement are proposed as follows:

(1) Model for establishing Community-based Microfinance Institution (MFI)

Under this model, to improve financial access of the Kelompok Tani, the establishment of MFI in the community is pursued, but the MFI shall not be developed from the said Kelomopok Tani. This MFI shall be established under the different leadership from the KT, and shall embrace the said KT as a member. This model is for Kelompok Tani in which group activities are inactive, and sometimes a leader dominates whereas members have passive attitudes. They tend not to have active savings and loan activities. In order to change the circumstance surrounding the group, MFI shall be formed in the community to serve the Kelompok Tani as well. The way to establish and foster BMT can be the reference for this model.

(2) Model for establishing own MFI

This model is for Kelompok Tani which has already demonstrated certain level of savings and loan activity and the high group cohesion. This type of Kelompok Tani shall aim at establishing own MFI led by the same leader as KT.

There are two ways of developing this. The first way is to expand the scale of the group itself, when the group has strong capacity and potential of capital accumulation. It is suitable for KT such as Lestari Sejahtera in Mojokerto. Budi Daya in Kediri which has a registered cooperative but inactive could pursue this way. The second way for the KT to form a federation with other groups in the community (Gabungan), and transform it into MFI. In this way, the groups can combine their capital bases. The methodology to combine groups into Gabungan can be drawn from P4K manuals and guidelines.

(3) Model for strengthening existing function of cooperative

This model is for Kelompok Tani where the cooperatives are already established. The capacity building shall be made to strengthen its savings and loan unit, at the same time, agribusiness service unit can be strengthend as well.

Apart from the above models, some Kelompok Tanis are small but highly business oriented with strong line-up of products. This kind of groups shall rather aim at registration as a company to conduct agribusiness, than remaining as a farmers' group.

The improvement approach of (ii) agribusiness improvement and (iii) asset building constitute the essential elements in all the three models.

Classification of business model for each Kelopok Tani is shown in Table 5-1. The detailed description of improvement approach including current conditions, approach, importance, main components, and benefit is summarized in Table 5-2.

Table 5-1 Classification of Business Model in Finance

| Kabupaten: Commodity | Features | Improvement Direction | Business Model |
|--|--|--|---|
| Kab. Cirebon: Duck | | | |
| 1. Sigranala Indah | <ul style="list-style-type: none"> - Financial access by the leader to commercial bank (BRI Unit) - Strong leadership but low self-reliance of members - No savings & loans activities | <ul style="list-style-type: none"> - Empowering members through group savings and loan - MFI shall be established outside the group but in the community | Model to establish community-based MFI |
| 2. Bebek Jaya 3. Tigan Mekar | <ul style="list-style-type: none"> - Credit cooperative and credit unit in multi-purpose cooperative available. - High group discipline, savings & loans or arisan by some members - Financial access by some members to commercial bank (BPR, BRI unit) | <ul style="list-style-type: none"> - Strengthening cooperatives to be more efficient and effective in finance and agribusiness support services. | Model to strengthen existing cooperatives |
| Kab. Majalengka: Sweet Potatoes | | | |
| 4. Mitra Binagkit II (all female) | <ul style="list-style-type: none"> - Savings & loans, but experience of non-performing loan under P4K program - Dominating by a leader and passive attitude of members | <ul style="list-style-type: none"> - Empowering group members through activating savings and loan activity - MFI shall be established outside the group but in the community | Model to establish community-based MFI |
| 5. Delima II (majority is female) | <ul style="list-style-type: none"> - Higher group discipline through P4K program - Savings & loan in progress under P4K - Low physical access to banks | <ul style="list-style-type: none"> - MFI shall be developed from the KT. | Model to establish own MFI |
| Kab. Kuningan: Sweet Potatoes | | | |
| 6. Andayarasa (a few female) | <ul style="list-style-type: none"> - Savings & loans in progress, well organized group and high group discipline - Savings account for the group is opened under the leader's name, and loan from KUD in yarnen - Weak bargaining power to traders (yarnen) | <ul style="list-style-type: none"> - Grow KT to MFI with traders and other community members, which may have agribusiness supporting services | Model to establish own MFI (involving traders, middlemen and collectors) |
| 7. Bina Karya | <ul style="list-style-type: none"> - Financial access by the leader to the commercial bank (Bank Jabar and BRI Unit) - Members working as employees - No savings & loan | <ul style="list-style-type: none"> - Improve profitability of KT and formalize it by company registration | Register as business entity, which will enable them to have access to a financial institution |
| 8. Lingga Sari II | <ul style="list-style-type: none"> - Limited activities as Kelompok Tani and low group discipline - Low level in savings & loans | <ul style="list-style-type: none"> - Empower members through activating savings and loan activity - MFI shall be established outside the group but in the community | Model to establish community-based MFI |
| Kab. Kediri: Mango | | | |
| 9. Makmur Jaya (some females) | <ul style="list-style-type: none"> - Savings & loan in progress by a part of the members who are under P4K program | <ul style="list-style-type: none"> - Grow KT to MFI with traders and other community members, which may have | Model to establish own MFI |

| Kabupaten: Commodity | Features | Improvement Direction | Business Model |
|--|---|--|---|
| | <ul style="list-style-type: none"> - Financial access by the leader to the credit cooperative, individual loans from BRI Unit & BPR by members - Low physical accessibility to banks | agribusiness supporting services | |
| 10. Budi Daya (some females) | <ul style="list-style-type: none"> - Savings & loans in progress a part of the members who are under P4K program - Savings & loan sub-group was registered as a cooperative, but not active - Low physical accessibility to banks | - Re-activate the cooperative and develop it into MFI, which may also have agribusiness support services | Model to establish own MFI (reactivating a cooperative) |
| Kab. Mojokerto: Duck | | | |
| 11. Karya Tani | <ul style="list-style-type: none"> - Financial access by the leader to the commercial bank (re-lending to members) - Strong leadership and higher group discipline - No experience in savings & loans - Leader act as a producer and trader | - Grow KT to MFI with traders and other community members, which may have agribusiness supporting services | Model to establish own MFI |
| 12. Tani Mulyo (majority is female) | <ul style="list-style-type: none"> - Progress in savings & loan and arisan - Bank accounts BRI Unit and BNI by leader and treasurer - Financial bondage by feed traders | - Grow KT to MFI with traders and other community members, which may have agribusiness supporting services | Model to establish own MFI |
| 13. Lestari Sejahtera (all female) | <ul style="list-style-type: none"> - Good performance in financial access (access to BRI Unit and BNI by some members), and P4K experience - Savings & loan in progress | - Formalize KT as a cooperative with traders, which will have both financial and agribusiness services | Model to establish own MFI (multipurpose cooperative) |

West Jawa Province

Table 5-2 Financial Improvement Approach and Components

| Kabupaten | Kelompok Tani | Member | Back ground | Approach | Necessity and Importance of the Project | Project Component (a. Input) | Project Component (b. Activity Steps) | Benefit and Effect of the Project |
|-----------|-----------------|-------------------------|---|--|--|---|--|---|
| Cirebon | Sigranala Indah | 7 Men 6 Women 1 | <ul style="list-style-type: none"> ➤ Leader and his family dominate the group. Members dependence on the leader observed ➤ Only leader borrows money from BRI and buying hatchery machine, which is the base of group production activity ➤ Group members' financial experience is with non-bank (pawnshop, traders, and arisan) and less savings. ➤ No group savings and loan activity | <p>Approach 1: <i>Processing and Marketing Model</i></p> <ul style="list-style-type: none"> ➤ 1-1: Improve financial awareness and discipline of members through group savings and loan activity. ➤ 1-2: Improve duck production technology of members <p>Approach 2: Establishing Community-based MFI Model</p> <ul style="list-style-type: none"> ➤ For the members to have accessible finance, establish membership organization which provides savings and loan services. ➤ For the members to be more independent mind, establish MFI outside KT but in the community | <ul style="list-style-type: none"> ➤ Improve financial discipline ➤ Improve profitability of duck agribusiness ➤ Each member becomes more self-reliant and confident | <p>Approach 1</p> <ul style="list-style-type: none"> ➤ As a component of <i>Processing and Marketing Model</i> <p>Approach 2 Establishing Community MFI Model</p> <ul style="list-style-type: none"> ➤ Soft loan for working capital support ➤ Monitoring & guidance by BDS ➤ Various support by the government | <p>Approach 1</p> <ul style="list-style-type: none"> ➤ To introduce group savings and loan activity <p>Approach 2</p> <ol style="list-style-type: none"> (1) To mobilize community and raise fund for embryo MFI (2) To form an embryo MFI (3) Training and apprenticeship (4) Monitoring and Guidance (5) Support towards formalization | <ul style="list-style-type: none"> ➤ Financial awareness and disciplines instilled into the members ➤ Self reliance and business mindset of the members strengthened ➤ Community provided with the accessible financial service ➤ The capacity of KT and the management of MFI improved ➤ Asset of individuals and MFI built |
| | Bebek Jaya | 20 Men 20 Women 0 | <ul style="list-style-type: none"> ➤ KT is a member of Syariah KSP: Al Qomariah, where members save and borrow ➤ Excellent group activity, record of duck productivity and income, business plan kept ➤ Members feel money they can borrow now is not enough for improving duck production. ➤ Government program recipient | <p>Approach 1: <i>Processing and Marketing Model</i></p> <ul style="list-style-type: none"> ➤ Improve duck business to be more profitable ➤ Increase members' income (and asset) to be more financially viable, so that (i) more investment shall come from own funding, (ii) more asset to be rendered as collateral for institutional loan <p>Approach 2: Strengthening Existing Cooperative</p> <ul style="list-style-type: none"> ➤ Intervene in Syariah KSP to increase loan amount for duck farmers | <ul style="list-style-type: none"> ➤ Improve profitability of duck agribusiness ➤ Increase financial self-reliance of farmers ➤ Graduate from government assistance ➤ Increase loan for duck farmers through Syariah KSP | <p>Approach 1</p> <ul style="list-style-type: none"> ➤ As a component of <i>Processing and Marketing Model</i> <p>Approach 2 Strengthening Existing Cooperative Model</p> <ul style="list-style-type: none"> ➤ Soft loan for working capital support ➤ Monitoring & guidance by BDS ➤ Various support by the government | <p>Approach 1</p> <ul style="list-style-type: none"> ➤ Initial deposit or frozen savings by members as a condition to join the model <p>Approach 2</p> <ul style="list-style-type: none"> ➤ Awareness raising and training of Syariah KSP | <ul style="list-style-type: none"> ➤ Self-reliance and business mindset of the members strengthened ➤ MFI in the community, which already finances farmers' agribusiness, strengthened ➤ Asset of individuals and MFI built |
| | Tigan Mekar | 36 Men 33 Women 3 | <ul style="list-style-type: none"> ➤ KT formed a multi-purpose duck cooperative, where they have savings and loan activity ➤ Some individuals get credit from BRI ➤ The duck cooperative has incorporated 5 KTs and traders, and has since focused on marketing ➤ Members want more capital to increase number of ducks | <p>Approach 1: <i>Processing and Marketing Model</i></p> <ul style="list-style-type: none"> ➤ Improve duck business to be more profitable ➤ Increase members' income (and asset) to be more financially viable, so that (i) more investment shall come from own funding, (ii) more asset to be rendered as collateral for institutional loan <p>Approach 2: Strengthening Existing Cooperative Model</p> <ul style="list-style-type: none"> ➤ Strengthen the role of savings and loan activity ➤ Expand the membership ➤ Strengthen the linkage with banks | <ul style="list-style-type: none"> ➤ Improve profitability of duck agribusiness ➤ Increase financial self-reliance of farmers ➤ Graduate from government assistance | <p>Approach 1</p> <ul style="list-style-type: none"> ➤ As a component of <i>Processing and Marketing Model</i> <p>Approach 2 Strengthening Existing Cooperative Model</p> <ul style="list-style-type: none"> ➤ Soft loan for working capital support ➤ Monitoring & guidance by BDS ➤ Various support by the government | <p>Approach 1</p> <ul style="list-style-type: none"> ➤ Initial deposit or frozen savings by members as a condition to join the model <p>Approach 2</p> <ul style="list-style-type: none"> ➤ Building asset ➤ Guidance and training | <ul style="list-style-type: none"> ➤ Self-reliance through the services of duck cooperative achieved ➤ Asset of individuals and MFI built |

| Kabupaten | Kelompok Tani | Member | Back ground | Approach | Necessity and Importance of the Project | Project Component (a. Input) | Project Component (b. Activity Steps) | Benefit and Effect of the Project |
|------------|--------------------|-------------------------|---|---|--|---|---|--|
| Majalengka | Mitra Binangkit II | 37 Men 0 Women 37 | <ul style="list-style-type: none"> ➢ KT used to be a P4K KPK, which was a part of KPK Gabungan. All of them had NPL and it was written off by BRI. ➢ KT has savings and loan activity ➢ Leader (also Head of <i>Dusun</i>) dominates the group ➢ Leader uses BPR. | <p>Approach 1: <i>Processing and Marketing Model</i></p> <ul style="list-style-type: none"> ➢ Improve sweet potato processing business to be more profitable <p>Approach 2: Establishing Community-based MFI Model</p> <ul style="list-style-type: none"> ➢ For the members to have accessible finance, establish membership organization which provides savings and loan services. ➢ For the members to be more independent mind, establish MFI outside KT but in the community ➢ To eliminate the leader's domination, third party intervention is required to set up the community MFI | <ul style="list-style-type: none"> ➢ Improve financial discipline ➢ Improve profitability of agribusiness ➢ Each member becomes more self-reliant and confident ➢ Dilute the control of the current leader in the activity | <p>Approach 1</p> <ul style="list-style-type: none"> ➢ As a component of <i>Processing and Marketing Model</i> <p>Approach 2 Establishing Community MFI Model</p> <ul style="list-style-type: none"> ➢ Soft loan for working capital support ➢ Monitoring & guidance by BDS ➢ Various support by the government | <p>Approach 1</p> <ul style="list-style-type: none"> ➢ To introduce group savings and loan activity <p>Approach 2</p> <ul style="list-style-type: none"> ➢ To have third party to facilitate the whole process to dilute the influence of the leader as Kepala Dusun ➢ To mobilize community and raise fund for embryo MFI ➢ To form an embryo MFI ➢ Training and apprenticeship ➢ Monitoring and Guidance ➢ Support towards formalization | <ul style="list-style-type: none"> ➢ Financial awareness and discipline into the members instilled ➢ Self reliance and business mindset of the members strengthened ➢ Community is provided with the accessible financial service ➢ Bad influence of the leader on the improvement process of agribusiness and finance is eliminated ➢ Asset of individuals and MFI built |
| | Delima II | 16 Men 5 Women 11 | <ul style="list-style-type: none"> ➢ KT is a P4K KPK, and has a good leadership and team work ➢ KT members conduct <i>arisan</i> ➢ The community has difficult access to the nearest bank (access road is not good) | <p>Approach 1: <i>Processing and Marketing Model</i></p> <ul style="list-style-type: none"> ➢ Improve sweet potato processing business to be more profitable <p>Approach 2: Establishing Own MFI Model</p> <ul style="list-style-type: none"> ➢ For the members to have accessible finance, grow KT, involving other community members, and develop to MFI | <ul style="list-style-type: none"> ➢ Improve profitability of agribusiness ➢ Establish accessible financial service in the community | <p>Approach 1</p> <ul style="list-style-type: none"> ➢ As a component of <i>Processing and Marketing Model</i> <p>Approach 2 Establishing Own MFI Model</p> <ul style="list-style-type: none"> ➢ Soft loan for working capital support ➢ Monitoring & guidance by BDS ➢ Various support by the government | <p>Approach 1</p> <ul style="list-style-type: none"> ➢ To increase group asset <p>Approach 2</p> <ul style="list-style-type: none"> ➢ To mobilize other groups and community members and raise fund for embryo MFI ➢ To form an embryo MFI ➢ Training and apprenticeship ➢ Monitoring and Guidance ➢ Support towards formalization | <ul style="list-style-type: none"> ➢ Community is provided with the accessible financial service ➢ The MFI to be the base for economic activity promotion in the area ➢ Asset of individuals and MFI is built |

| Kabupaten | Kelompok Tani | Member | Back ground | Approach | Necessity and Importance of the Project | Project Component (a. Input) | Project Component (b. Activity Steps) | Benefit and Effect of the Project |
|-----------|----------------|-------------------------|--|---|--|---|--|--|
| Kuningan | Andayarsa | 25 Men 20 Women 5 | <ul style="list-style-type: none"> ➤ Good leadership and group discipline ➤ Savings & Loan is currently carried out. ➤ Weak bargaining power against traders ➤ Land share-cropping | <p>Approach 1: <i>Processing and Marketing Model</i></p> <ul style="list-style-type: none"> ➤ Improve sweet potato processing business to be more profitable <p>Approach 2: Establishing Own MFI Model</p> <ul style="list-style-type: none"> ➤ For the members to have accessible finance, grow KT to MFI with traders, other community members, and develop MFI. MFI can have agribusiness supporting service | <ul style="list-style-type: none"> ➤ Improve profitability of agribusiness ➤ Establish accessible financial service in the community ➤ Change the power relation with traders | <p>Approach 1</p> <ul style="list-style-type: none"> ➤ As a component of <i>Processing and Marketing Model</i> <p>Approach 2</p> <p>Establishing Own MFI Model</p> <ul style="list-style-type: none"> ➤ Soft loan for working capital support ➤ Monitoring & guidance by BDS ➤ Various support by the government | <p>Approach 1</p> <ul style="list-style-type: none"> ➤ To increase group asset <p>Approach 2</p> <ul style="list-style-type: none"> ➤ To mobilize other groups and community members and raise fund for embryo MFI ➤ To form an embryo MFI ➤ Training and apprenticeship ➤ Monitoring and Guidance ➤ Support towards formalization | <ul style="list-style-type: none"> ➤ Community is provided with the accessible financial service ➤ The MFI to also work as agribusiness supporting provider ➤ Bargaining power of farmers increased ➤ Asset of individuals and MFI is built |
| | Bina Karya | 20 Men 19 Women 1 | <ul style="list-style-type: none"> ➤ KT is rather like a company, where the leader is a president and other members are employee. A disguised group. ➤ No group savings and loan activity ➤ Leader borrows from commercial banks ➤ Land share-cropping | <p>Approach 1: <i>Processing and Marketing Model</i></p> <ul style="list-style-type: none"> ➤ Improve sweet potato processing business to be more profitable <p>Approach 2: Establishing a company Model</p> <ul style="list-style-type: none"> ➤ To formalize KT by company registration | <ul style="list-style-type: none"> ➤ Improve profitability of agribusiness ➤ Have access to bank service by formalization | <p>Approach 1</p> <ul style="list-style-type: none"> ➤ As a component of <i>Processing and Marketing Model</i> <p>or</p> <p>Approach 2</p> <p>Establishing a Company</p> <ul style="list-style-type: none"> ➤ Soft loan for working capital support after registration ➤ Monitoring & guidance by BDS ➤ Various support by the government | <p>Approach 1</p> <ul style="list-style-type: none"> ➤ To increase profitability <p>Approach 2</p> <ul style="list-style-type: none"> ➤ To prepare the initial capital ➤ Training and apprenticeship ➤ To register it as a company ➤ Monitoring and Guidance | <ul style="list-style-type: none"> ➤ The self-reliant and profitable agribusiness model is embodied ➤ Asset of individuals and a company is built |
| | Lingga Sari II | 20 Men 20 Women 0 | <ul style="list-style-type: none"> ➤ Limited activity as a group. No regular meetings held, and savings and loan not observed clearly. ➤ Traders' finance observed ➤ Land share-cropping | <p>Approach 1: <i>Processing and Marketing Model</i></p> <ul style="list-style-type: none"> ➤ 1-1: Improve financial awareness and discipline of members through group savings and loan activity. ➤ 1-2: Improve sweet potato processing agribusiness technology and marketing of members <p>Approach 2: Establishing Community MFI Model</p> <ul style="list-style-type: none"> ➤ For the members to have accessible finance, establish membership organization which provides savings and loan services. ➤ For the members to be more independent mind, establish MFI outside KT but in the community ➤ KT to maintain agribusiness marketing base | <ul style="list-style-type: none"> ➤ Improve financial discipline ➤ Improve profitability of agribusiness ➤ Each member becomes more self-reliant and confident | <p>Approach 1</p> <ul style="list-style-type: none"> ➤ As a component of <i>Processing and Marketing Model</i> <p>Approach 2</p> <p>Establishing Community MFI Model</p> <ul style="list-style-type: none"> ➤ Soft loan for working capital support ➤ Monitoring & guidance by BDS ➤ Various support by the government | <p>Approach 1</p> <ul style="list-style-type: none"> ➤ To introduce group savings and loan activity <p>Approach 2</p> <ul style="list-style-type: none"> ➤ To mobilize community and raise fund for embryo MFI ➤ To form an embryo MFI ➤ Training and apprenticeship ➤ Monitoring and Guidance ➤ Support towards formalization | <ul style="list-style-type: none"> ➤ Financial awareness and discipline into the members instilled ➤ Self reliance and business mindset of the members strengthened ➤ Community provided with the accessible financial service ➤ The capacity of KT and the management of MFI improved ➤ Asset of individuals and MFI built |

East Jawa Province

| Kabupaten | Kelompok Tani | Member | Back ground | Approach | Necessity and Importance of the Project | Project Component (a. Input) | Project Component (b. Activity Steps) | Benefit and Effect of the Project |
|-----------|---------------|--|--|--|--|---|--|---|
| Kediri | Makmur Jaya | 105 Men 75 Women 30 | <ul style="list-style-type: none"> ➤ Leader (Head of <i>Dusun</i>) is a mango producer, but also acts as a trader. ➤ 45 members form P4K KPK ➤ Other than P4K, no group savings and loan activity ➤ Leader uses various financial institutions (banks and cooperatives) ➤ Some members use BPR, others rely on traders finance (before harvest), pawnshop, and <i>warung</i>. | <p>Approach 1: <i>Processing and Marketing Model</i></p> <ul style="list-style-type: none"> ➤ Improve duck business to be more profitable <p>Approach 2: Establishing Own MFI Model</p> <ul style="list-style-type: none"> ➤ For the members to have accessible finance, grow KT to MFI with traders, other community members, and develop MFI. MFI can have agribusiness supporting service | <ul style="list-style-type: none"> ➤ Improve profitability of agribusiness ➤ Establish accessible financial service in the community ➤ Change the power relation with traders | <p>Approach 1</p> <ul style="list-style-type: none"> ➤ As a component of <i>Processing and Marketing Model</i> <p>Approach 2</p> <p>Establishing Own MFI Model</p> <ul style="list-style-type: none"> ➤ Soft loan for working capital support ➤ Monitoring & guidance by BDS ➤ Various support by the government | <p>Approach 1</p> <ul style="list-style-type: none"> ➤ To increase group asset <p>Approach 2</p> <ul style="list-style-type: none"> ➤ To mobilize other groups and community members and raise fund for embryo MFI ➤ To form an embryo MFI ➤ Training and apprenticeship ➤ Monitoring and Guidance ➤ Support towards formalization | <ul style="list-style-type: none"> ➤ To provide community with the accessible financial service ➤ The MFI to also work as agribusiness supporting provider ➤ Bargaining power of farmers increased ➤ Asset of individuals and MFI built |
| | Budidaya | 160 Men 90 Women 70 <i>Kelompok Wanita Tani</i> Women 20 | <ul style="list-style-type: none"> ➤ Some members formed P4K KPK. ➤ KT has an inactive (but once registered) cooperative which is a main section for savings and loan activity ➤ KT has a women's group which has <i>arisan</i> ➤ KT members duplicate Forestry Farmers Group members, which has savings and loan activity ➤ Physical access to banks is difficult ➤ Farmers more worried about mango price fluctuation than lack of finance | <p>Approach 1: <i>Processing and Marketing Model</i></p> <ul style="list-style-type: none"> ➤ Improve mango processing business to be more profitable <p>Approach 2: Establishing Own MFI Model</p> <ul style="list-style-type: none"> ➤ For the members to have accessible finance, grow KT to MFI | <ul style="list-style-type: none"> ➤ Improve profitability of agribusiness ➤ Establish accessible financial service in the community | <p>Approach 1</p> <ul style="list-style-type: none"> ➤ As a component of <i>Processing and Marketing Model</i> <p>Approach 2</p> <p>Establishing Own MFI Model through reactivating an existing cooperative</p> <ul style="list-style-type: none"> ➤ Soft loan for working capital support ➤ Monitoring & guidance by BDS ➤ Various support by the government | <p>Approach 1</p> <ul style="list-style-type: none"> ➤ To increase group asset <p>Approach 2</p> <ul style="list-style-type: none"> ➤ To mobilize other groups and community members and raise fund for activating an existing cooperative ➤ Training and apprenticeship ➤ Monitoring and Guidance ➤ Support towards formalization | <ul style="list-style-type: none"> ➤ Community provided with the accessible financial service ➤ The MFI to be the base for economic activity promotion in the area ➤ Asset of individuals and MFI built |

| Kabupaten | Kelompok Tani | Member | Back ground | Approach | Necessity and Importance of the Project | Project Component (a. Input) | Project Component (b. Activity Steps) | Benefit and Effect of the Project |
|-----------|-------------------|-------------------------|---|--|--|---|---|---|
| Mojokerto | Karya Tani | 11 Men 10 Women 1 | <ul style="list-style-type: none"> ➤ Leader is a duck producer but also acts as a trader ➤ Financial access by the leader re-lending bank loan ➤ Strong leadership and good group discipline ➤ No group savings and loan activity ➤ Due to lack of capital they cannot expand their business scale | <p>Approach 1: <i>Processing and Marketing Model</i></p> <ul style="list-style-type: none"> ➤ 1-1: Improve financial awareness and discipline of members through group savings and loan activity. ➤ 1-2: Improve duck production technology of members <p>Approach 2: Establishing Own MFI Model</p> <ul style="list-style-type: none"> ➤ For the members to have accessible finance, grow KT to MFI with traders, together with agribusiness supporting service | <ul style="list-style-type: none"> ➤ Improve profitability of duck agribusiness ➤ Establish accessible financial service in the community ➤ Each member becomes more self-reliant and confident | <p>Approach 1</p> <ul style="list-style-type: none"> ➤ As a component of <i>Processing and Marketing Model</i> <p>Approach 2</p> <p>Establishing Own MFI Model</p> <ul style="list-style-type: none"> ➤ Soft loan for working capital support ➤ Monitoring & guidance by BDS ➤ Various support by the government | <p>Approach 1</p> <ul style="list-style-type: none"> ➤ To introduce group savings and loan activity <p>Approach 2</p> <ul style="list-style-type: none"> ➤ To mobilize other groups and community members and raise fund for embryo MFI ➤ To form an embryo MFI ➤ Training and apprenticeship ➤ Monitoring and Guidance ➤ Support towards formalization | <ul style="list-style-type: none"> ➤ Community provided with the accessible financial service ➤ The MFI to be the base for economic activity promotion in the area ➤ Asset of individuals and MFI built |
| | Tani Mulyo | 28 Men 5 Women 23 | <ul style="list-style-type: none"> ➤ Duck business was originally started using grant from DINAS. However, many members quit membership due to its low profitability. ➤ Savings and loan not very active ➤ Some use commercial banks, some transact with feed traders (bondage), some in <i>arisan</i> circle. | <p>Approach 1: <i>Processing and Marketing Model</i></p> <ul style="list-style-type: none"> ➤ 1-1: Improve financial awareness and discipline of members through group savings and loan activity. ➤ 1-2: Improve duck production technology of members <p>Approach 2: Establishing Own MFI Model</p> <ul style="list-style-type: none"> ➤ For the members to have accessible finance, grow KT to MFI with traders, together with agribusiness supporting service | <ul style="list-style-type: none"> ➤ Improve profitability of duck agribusiness ➤ Establish accessible financial service in the community | <p>Approach 1</p> <ul style="list-style-type: none"> ➤ As a component of <i>Processing and Marketing Model</i> <p>Approach 2</p> <p>Establishing Own MFI Model</p> <ul style="list-style-type: none"> ➤ Soft loan for working capital support ➤ Monitoring & guidance by BDS ➤ Various support by the government | <p>Approach 1</p> <ul style="list-style-type: none"> ➤ To activate group savings and loan, and agribusiness support function ➤ To accumulate asset of KT <p>Approach 2</p> <ul style="list-style-type: none"> ➤ To mobilize other groups and community members and raise fund for embryo MFI ➤ To form an embryo MFI ➤ Training and apprenticeship ➤ Monitoring and Guidance ➤ Support towards formalization | <ul style="list-style-type: none"> ➤ To provide community with the accessible financial service ➤ The MFI to also work as agribusiness supporting provider ➤ Bargaining power of farmers increased ➤ Asset of individuals and MFI built |
| | Lestari Sejahtera | 47 Men 0 Women 47 | <ul style="list-style-type: none"> ➤ This KT is a famous and a leading group of duck business in Kabupaten. ➤ Members used to be a P4K KPK. ➤ Good financial discipline, group savings and loan activity ➤ Some members use commercial banks as individual | <p>Approach 1: <i>Processing and Marketing Model</i></p> <ul style="list-style-type: none"> ➤ Improve duck business to be more profitable ➤ Increase members' income (and asset) to be more financially viable, so that (i) more investment shall come from own funding, (ii) more asset to be rendered as collateral for institutional loan <p>Approach 2: Establishing Own MFI Model</p> <ul style="list-style-type: none"> ➤ Formalize KT as a cooperative ➤ For the members to have accessible finance, grow KT to MFI with traders, together with agribusiness supporting service | <ul style="list-style-type: none"> ➤ Improve profitability of agribusiness ➤ Have access to bank service by formalization of the organization ➤ Establish accessible financial service in the community | <p>Approach 1</p> <p>As a component of <i>Processing and Marketing Model</i></p> <p>or</p> <p>Approach 2</p> <p>Establishing own MFI (register as a multi-purpose cooperative)</p> <ul style="list-style-type: none"> ➤ Soft loan for working capital support ➤ Monitoring & guidance by BDS ➤ Various support by the government | <p>Approach 1</p> <ul style="list-style-type: none"> ➤ To increase profitability <p>Approach 2</p> <ul style="list-style-type: none"> ➤ To prepare the initial capital ➤ Training and apprenticeship ➤ To register it as a cooperative ➤ Monitoring and Guidance | <ul style="list-style-type: none"> ➤ Self-reliant and profitable agribusiness model embodied ➤ Asset of individuals and MFI built ➤ To provide community with the accessible financial service ➤ The MFI to also work as agribusiness supporting provider |

5.4 Linkage between Processing, Marketing, and Microfinance in Business Models

In the Study, Business Models for Processing and Marketing are proposed for the Selected Kelompok Tani, separate from the Business Model for Microfinance which is stated in 5.3

At the Kelompok Tani level, processing, marketing, and finance are closely related, therefore the linkage between both business models are required. In this regard, the following points are considered:

(1) Linkage with Microfinance, and Production and Processing

- (i) MFI to be established in the Finance Models will enable Kelompok Tani to improve and expand their agribusiness through improving the financial access and management capacity.
- (ii) At the same time, financial activities will provide Kelompok Tani members with environment and circumstances to create their own business mindset.
- (iii) MFI will involve the community members surrounding the Kelompok Tani, who may join or start the processing business. Then, the groups engaging in the processing business will increase and the local processing cluster for the commodity would be formed.

(2) Linkage with Microfinance, and Marketing

Another important point is to involve middlemen and collectors into MFI for sharing information on price, market, and consumers' preference about products. Presently farmers are in weak position against the middlemen and collectors because farmers lack in such marketing price information and production capital. This situation gives chance to middlemen and collectors to take advantage through the unfavorable and transaction for farmers. If the marketing information reach farmers, they will adapt their products according to market. And by having link with MFI, farmers will have access to finance so that they do not have to rely totally on finance from middlemen and collectors. The situation will benefit to both farmers and traders, because farmers still utilize their marketing channel, but they can provide better products.

CHAPTER 6 RURAL MICROFINANCE SCHEME

6.1 Financial Improvement for Selected Kelompok Tani

6.1.1 Microfinance Business Model as a Component

In order to promote the business model of finance described in Chapter 5, both finance and agribusiness (production, processing, and marketing of the commodities) have to be strengthened. For the selected Kelompok Tani, the implementation plan based on the business models for processing and marketing are designed and described in Annex B of the Final Report. Thus for the financial improvement of these KTs, the implementation plan is not proposed independently from the ones of processing and marketing, but rather the components of the finance business model will be incorporated in the processing and marketing implementation plans as follows:

(1) Loan and grant

The scheme will be financed in the form of loan and grant. The grant portion caters for business development service (BDS) providers who will provide technical and management support. The BDS for Processing and Marketing Improvement Plan will look after financial management as well.

The capital support to farmers shall take the form of loan from banks to KT, Gabungan and LKM, not in the form of revolving fund directly given to them. This fund for capital support shall revolve at province level, as shown in Figure 47 of proposed implementation organization. The interest rate shall be adjusted according to the change of market rate.

In the implementation plan for processing and marketing, the loan caters firstly for the investment capital, and the initial working capital. The interest rate of the loan is set at around the same level as commercial bank agribusiness loan (currently 14% per year, declining balance), but with the grace period of one year to accommodate the stabilization of production and processing. The interest payment can accommodate the production and processing cycle of the commodity

In the implementation plan for microfinance, the loan caters for the working capital of Gabungan and LKM. The interest rate of the loan is set at around the same level as RIGP (P4K) loan (currently 1% per month), but for the declining balance, and with the grace period of one year to accommodate the stabilization of organizational capacity.

(2) Contribution by the members as savings collateral

For the loan, KT members shall contribute 5%, and members for Gabungan and LKM contribute 10% of the loan amount as frozen savings. The savings will be kept at the time deposit as collateral, and when the loan repayment is confirmed, it will be handed over to the KT, Gabungan and LKM. This will also help KT, Gabungan and LKM to build financial assets during the period.

(3) Incentive for loan repayment

For the implementation plan for processing and marketing, a part of the loan interest will be given back to KT members as incentives for loan repayment at the end of five years. The proposed portion is 2% per year out of 14% interest payment.

For the implementation plan for Microfinance, it is recommended that from the overall profit made by Gabungan and LKM, members shall agree on the portion of profit sharing.

(4) Activity components

For the Implementation Plan for Processing and Marketing, the activity shall be carried out for strengthening financial aspect of KT in parallel as follows:

- (a) Strengthening savings and loan activities (for all KTs)
- (b) Formalizing the organization towards obtaining a legal status (for KT which shall aim for building own MFI and community MFI)
- (c) Identifying key persons for establishing community MFI (for KT community which shall aim for building community MFI)

6.1.2 Financial Analysis for Implementation Plan for Processing and Marketing Schemes

Assuming the above microfinance components and the very objectives of agribusiness part worked well, The income improvement effect for each commodity is as follows:

Table 6-1 Effect of Household Income Improvement

| Sample Commodity and Improvement | Current income from the sample commodity (per household per year) | Additional Income (Profit) from the Implementation Plan (per household per year) |
|---|---|--|
| Duck with expansion of breeding scale | Rp.18 – 60 million (except for the few more than Rp.60 million) KT Sigranala Indah: the range is less than Rp.6 to Rp.18 million except for the leader with Rp.120 million | Rp.5.2 million to Rp.18.0 million |
| Mango dried (based on the harvest of once a year) | Majority less than Rp.6 million except for the few with Rp.18 million | Rp.2.0 million |
| Sweet potato: primary processing | Less than Rp.6 million (KT Andayarasa) | Rp.7.2 million |
| Mango juice (based on the harvest of once a year) | Less than Rp.6 million | Rp.3.1 million |
| Sweet potato: cottage level processing | Rp.0 to Rp.12 million | Rp.1.2 million to 11.4 million |

Source: Current income based on the household survey conducted by the JICA Study Team, and additional income estimated in Table 5.6.1. The average number of household members is assumed to be five.

Sweet potato and mango tend to constitute only a part of the income sources for the households. Compared to sweet potato and mango, duck in general, constitutes the main source of income for the households, and they fetch more income than sweet potato and mango households. In summary, at the end of 5 years, income increase of Kelpmpok

Tani members (net profit) are Rp.4.8 million ranging from Rp.1.2 million to Rs. 18.0 million per annum.

Other than the profit explained above, the Kelompok Tani will have Rp.2.8 million to Rp.38.6 million of own capital from the frozen savings attracting interest. Some of the Kelompok Tani may have enough capital, more than Rp.10 million to start aiming at becoming Embryo MFI. These groups will operate and expand their business based on their own assets, and eventually be accessible to formal financial institution. The financial projection is summarized in Table 6-2-1 to 6-2-3. The production assumption is included in Appendix B of the Final Report.

In case of the Kelompok Tani whose capital formation is less than Rp.10 million, further assistance will be required to accumulate capital up to the appropriate level. Utilization of SP-3¹ scheme (Agricultural Financing Services Scheme under MOA) would be recommended as a link to the access to formal financial institution

6.2 Supporting Mechanism for Implementation Plan

In addition to the financial improvement mechanism described above, supporting mechanism is incorporated into the implementation plan to tackle the issues arising from the previous programs as follows:

6.2.1 Target Selection

The Implementation Plans are formulated taking into account the poverty level of the target farm households and the community, and the minimum conditions for the income improvement are strong motivation and potential capacity to improve their agricultural processing as business, and savings and loan activity. The target Kelompok Tani are expected 1) to have the willingness to be self-reliant, 2) to recognize the importance of organizational management capacity, and 3) to consider the burden of women and gender balance.

The selection criteria for Kelompok Tani explained in Chapter 3 would be referred from the aspect of finance, socio-economy, organization, production and processing, marketing potential, and future plan.

In addition, the target shall also fulfill the minimum financial conditions such as: (i) having no bad record in receiving government program (utilized properly), (ii) no non-performing loan in banking, credit or other financing transactions, (iii) having difficulty in accessing commercial financial sources to implement recommended technology and to exploit market opportunities completely.

Since the implementation plans here are proposed as pilot, they do not completely exclude the Kelompok Tani which is currently under other government financial

¹ MOA's suggested SP-3 scheme for 2007 has four categories: (i) Micro I Enterprise, loan amount maximum Rp. 10 million per person via LKM-A, interest rate 12% p.a., and risk sharing 90%, (ii) Micro II Enterprise, loan amount Rp. 10 million to Rp. 50 million, and risk sharing 40%, (iii) Small I Enterprise, loan amount Rp. 50 million to Rp. 250 million, and risk sharing 30%, and (iv) Small II Enterprise, loan amount Rp. 250 million to Rp. 500 million. For (ii) to (iv), the interest rate is 2-3 % below commercial interest rate applied by the Executing Bank.

assistance programs. Instead, such Kelompok Tani is required to submit the convincing explanation how they accommodate different programs at the same time.

6.2.2 Technical Support

The processing and marketing implementation plans aim at synergy effect in supporting hard portion (capital / equipment) with support in soft portion by the 3rd party (financial and organizational management / marketing). This is to avoid the past experience of the government intervention, which tended to concentrate on hard portion support (capital or equipment grant without any conditions) without thorough guidance, and led to insufficient results.

The assumption here is that KT has a certain level of capacity with which they can carry out agro-processing works without difficulty, but KT indispensably needs the assistance from the 3rd party for strengthening marketing and financial and organizational management capacity. Especially those KT which aim for establishing their own MFI need strong guidance from the experienced third party. Therefore, budgets are allocated in the implementation plan for such soft portion of support by the 3rd party.

6.2.3 Decentralization and the Role of Government Offices

Past experience shows that for the programs which are designed centrally, the intention of the assistance seems to get diluted as it gets to the local government, and then to the grassroots of the community. It is proposed therefore, in the implementation plan these processes shall be controlled through monitoring and evaluation. Regarding monitoring and evaluation, the above mentioned 3rd party can play the role, together with DINAS and MOA. The proposed implementation organization, as shown in Figure 6-1, is to utilize the leadership of DINAS Province at the beginning, and later, DINAS Kabupaten could possibly take over some roles as they accumulate the experience.

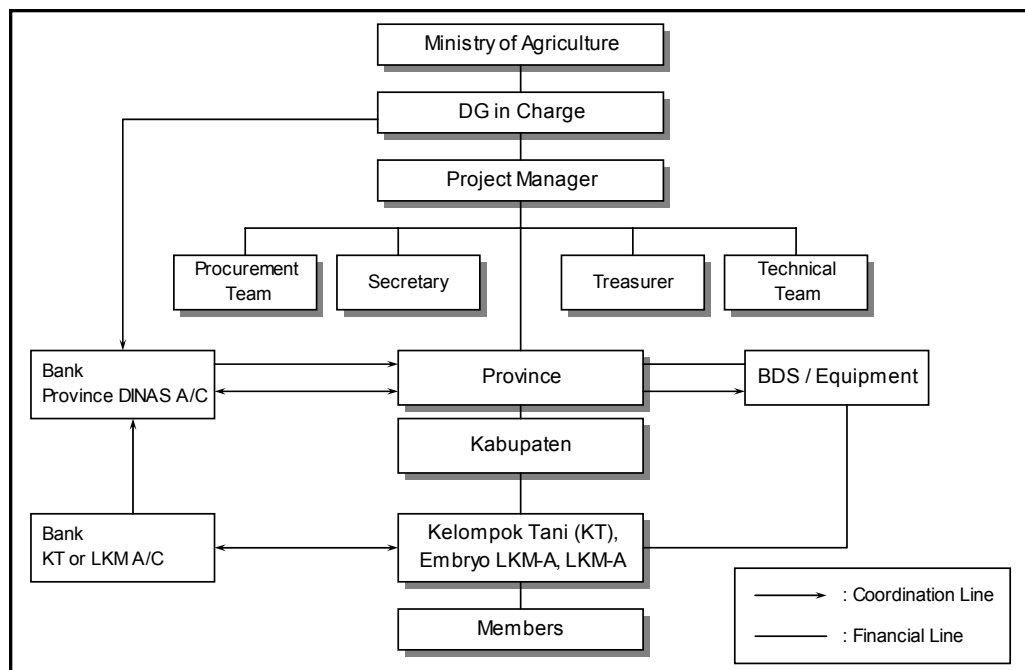


Figure 6-1 Proposed Implementation organization (Flow of Coordination and Fund Disbursement)

6.2.4 Exit Strategy

Many groups and cooperatives keep receiving the different kinds of assistance from the government office, and they are still stagnant at lower level of capital or asset building, as a result do not have access to finance. The past program design did not have this in mind, neither had an exit or graduation strategy for the beneficiary to be self-reliant after. In the implementation plan proposed here, the goal of the model is to be financially viable entities, which means the exit or graduation from government programs. The components enabling the asset building and leading to the exit is explained below.

6.3 Implementation Plan for Rural Microfinance Scheme

6.3.1 Outline of the Scheme

- 1) Scheme Name: Strengthening of Rural Non-Bank Embryo Microfinance Institutions (Rural Embryo MFIs) developed from Self-Help Group (SHG, Kelompok Petani Kecil: KPK) formed under the previous project
- 2) Location: 10 Rural Embryo MFIs (either in the form of Gaungan KPK: SHG Federation or Lembaga Keuangan Mikro (LKM, MFI) based on the Self-Help Groups (SHG) developed under P4K in 5 Sample Kabupaten. The pool of Gabungan KPK and LKM is as follows:

| Kabupaten | Number of Gabungan/LKM | Description |
|------------|------------------------|--|
| Cirebon | 13 Gabungan, 1 LKM | <ul style="list-style-type: none">• Total 75 Gabungan and 20 LKM (95 Embryo MFI candidates), covering 533 KPK, 6,802 members• Capital size: Rp.0.125 - 161 million• Select 10 Embryo MFI candidates from 5 Kabupaten as target |
| Kuningan | 12 Gabungan, 6 LKM | |
| Majalengka | 17 Gabungan, 4 LKM | |
| Mojokerto | 29 Gabungan, 9 LKM | |
| Kediri | 4 Gabungan, 0 LKM | |

- 3) Background:

MOA, together with the international cooperating partners, and the cooperation with other Ministries, has been implementing the previous programs from late 1970s, in which poor farmers with micro-business were organized into a Self Help Group (SHG) for savings and loan activity through Bank Rakyat Indonesia (BRI). After several cycles of loan, SHG members were meant to graduate SHG and be independently transacting with banks. But some graduates of SHG were reluctant or not confident enough to continue with a bank individually.

In order to solve this problem, the avenue for several SHGs to form a federation and transform it into a Rural MFI was pursued as well. Meanwhile, facing the programs closure in 2005, the program was handed-over to District government and BRI District Branch, in terms of SHG groups, loan fund, and operational cost. But no agreement was made on the Rural Embryo MFIs.

Some SHGs under the previous program are graduating the program and after that, if they had not accumulated assets which can be used as collateral, they will only have access to loan through the Embryo MFIs.

Although the Embryo MFIs were established, some of them are struggling to grow, especially the ones in rural areas, due to inadequate training, lack of appropriate and frequent guidance, and limited amount of loan fund which in general is mobilized only from members' savings.

Meanwhile, the program's handing over to the Districts and BRI Branches is not smooth. Memorandum of understanding (MOU) between them on loan fund injection and sharing of operation funds were not realized in all Districts, and in 2006 some Districts already saw the downturn in the activities of extension workers monitoring and guidance activities. In addition, the suggested MOU, in general, include only SHGs as a target, but not the Rural Embryo MFIs.

Thus there is need to assist for a while for Rural Embryo MFIs to take off, based on the following strategies:

- a. Utilize the asset of the previous programs
 - b. For farmers, only income generation is not enough. Asset building component should also be included.
 - c. For Rural Embryo MFIs, increase own capital base should be prioritized, in addition to instilling the more professional financial administration
 - d. More solid mechanism of fostering Rural Embryo MFIs and transforming it into sustainable MFIs should be established based on the financial system principles.
 - e. Choose the communities, in the remote areas where people do not have easy access to other financial institutions than the said Embryo MFIs.
- 4) Purpose:
- a. To increase income and build assets of the Rural Embryo MFI members
 - b. To strengthen the capacity of Rural Embryo MFIs to become the real community bank in the remote area.
 - c. To establish the Rural Embryo MFI supporting mechanism in the Kabupaten.

5) Necessity and Importance of the Scheme

This scheme is along the line with one of the Ministry of Agriculture's financial policies, which is to set up financial institutions serving for farmers. It is hoped that the Rural Embryo MFI is developed not only for farmers but eventually to include other members from the community, who otherwise do not have easy access to financial institutions nearby.

6) Component

- a. Input:
 - (i) Capacity building (trainings, workshops, and apprenticeship)
 - (ii) Working capital support

- (iii) Simple equipment support
 - (iv) Consultant or facilitator
 - (v) Monitoring
 - (vi) Evaluation: baseline survey, mid-term evaluation, and final evaluation which should cover household income and asset survey.
- b. Activity:
- (i) Target Rural Embryo MFIs selection and appraisal. This will be done by conducting Participatory Rural Appraisal (PRA)

Box 6-1 Rural Embryo MFIs Selection Steps

- (1) Identify all the existing embryo MFIs in agribusiness in the District
- (2) Check their human resources, financial condition, business plan, and social and institutional aspects. The economy of scale may require the total members of approximately 50 or more, and the own capital of Rp. 10 million or more.
- (3) Check the business situation of the members
- (4) Check the number of farmers groups around the embryo MFIs, and their agribusiness situation
- (5) Check the population of the community where embryo MFIs is located to see the potential growth, including potential saving customers such as education institutions.
- (6) Check the competitors
- (7) Site visit and confirm the willingness of the group members and community leaders to develop the embryo MFIs

- (ii) Conduct baseline survey including household survey.
- (iii) Socialization of the pilot scheme to the community.
- (iv) Capacity building and apprenticeship on book keeping and rural banking for credit scheme administrators. This also will be done in cooperation between local government and local NGO. In addition, it is expected to have technical guidance on promoting members' business.
- (v) Working capital support in terms of loan from revolving fund set at BPD, for building assets of the rural household involved and building capital for the Rural Embryo MFIs.
- (vi) Infrastructure support
- (vii) Supervision
- (viii) Monitoring and evaluation.
- (ix) Final Evaluation and wrap-up workshop

7) Implementation Period: Loan period by the revolving fund (5 years): 2007-2012

| | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 |
|--|------|------|------|------|------|------|
| (i) Target Selection | ■ | | | | | |
| (ii) Baseline Survey | ■ | | | | | |
| (iii) Kick-off Workshop | ■ | | | | | |
| (iv) Capacity Building | ■ | | | | | |
| (v) Working Capital Support (Loan) | ■ | | | | | |
| (vi) Facilitation and Guidance all through the Period | ■ | | | | | |
| Coordination and linking up with other local resources such as relevant DINAS (Industry, Trade, Cooperative, etc.) | ■ | | | | | |
| (vi) Mid-Term Evaluation, Final Evaluation, & Workshop | | | | ■ | | ■ |

Figure 6-2 Implementation Schedule of Finance Scheme

*The appropriate implementation period should be explored according to the development stage, capital size, and experience of the Embryo MFI.

- 8) Total Scheme Cost: Rp.1,971.2 million.
- a) The breakdown of the cost is: loan Rp. 1,000 million and the balance in grant. The detailed breakdown of the cost is shown in the attached Table 6-3 and 6-4.
 - b) Loan fund per Embryo MFI is Rp. 100 million.
 - c) Frozen savings of 10% of the loan fund
 - d) Loan period is for five years
 - e) Interest rate to MFI is set at 1% per month
 - f) Interest spread income for MFI is recommended to cater for operation cost, capital accumulation and profit sharing by members.
 - g) Compulsory savings by members are recommended.
- 9) Benefits and Effects of the Scheme:
- a. 10 Rural Embryo MFI member households' income and assets are increased.
 - b. 10 Rural Embryo MFIs' capacity is strengthened (savings and loan balance increased, capital base increased, number of members increased, and administration capacity improved)
 - c. Rural Embryo MFI supporting mechanism is tested and established
- 10) Government Follow-Up
- a. This pilot scheme aims to develop a model for improving small farmers' access towards credit in remote area, by developing the existing Rural Embryo MFIs whose members have proved their business minded performance up to certain extent, but yet to be self-dependent in terms of asset building and institutional capacity. To achieve the sustainability of the scheme, the local government

should allocate fund for monitoring and evaluation activities, upon the completion of this pilot scheme.

- b. In the long run, after the completion of pilot scheme, the model will be replicated to other areas/provinces in Indonesia, especially remote areas / provinces which have existing farmers groups and federations having proven financial records, and which have no physical access to other reliable financial services. The Indonesian Government should allocate fund for this replication process.

11) Advisory, Consultancy, and Supervising Entity, and Manuals

- a) Advisory and Supervising System shall take the trace of Rural Income Generation Project (RIGP) and LKM-A. Any improvement shall be made for the betterment of the model.
- b) Manuals for Financial Management, Organisational Development shall be developed. The set of manuals developed by RIGP, LKM-A, and the manuals for other programs under the MOA and local governments could be utilized.
- c) Consultancy entity shall take the trace of LKM-A, that is, to involve the third party such as NGOs, which have the experience of fostering LKM and the set of standards to develop LKM. Any improvement shall be made for the betterment of the model. The entity should have an experience of fostering MFIs with a set of standard and regulations.

12) Legal status

The target Rural Embryo MFIs should follow the movement of MFI legislation. Under the current legislation, they should aim for registration as cooperatives, thus the close cooperation and coordination with Dinas Cooperative is required. Arrangement could be made to visit those who were successfully registered from Gabungan / LKM to cooperative.

It should however, be taken note of the MFI legislation movement led by the Coordinating Ministry of Economy and Cooperatives for non-bank non-cooperative MFIs.

13) Exit Strategy

At the end of 5 years, MFI will have at least Rp. 27 million of own capital for 50 members, and Rp. 35 million for 100 members (depends on the repayment schedule and internal rules and regulations on financial management). It means Rp. 350,000 to Rp. 540,000 per member.

This may be enough capital if income generating activity is conducted as group business, on the other hand, if each member has his/her own business, they may require Rp. 1-2 million at least. Even assuming utilizing their own savings, the members need to have access to another source of funding.

Then the utilization of SP-3 as a link to the access to formal financial institution is