

**Sustainable Microfinance in Indonesia:
A Sociocultural Approach**

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Abstract

Microfinance programs were established in the Netherlands East Indies as a strategy to alleviate poverty in pre-dominantly Moslem rural communities. When Indonesia won its independence, these government-subsidized microfinance programs based on the payment of interest were continued until 1983, when the Indonesian government deregulated the banking system. Subsequently, microfinance programs were developed on a commercial basis to become one of the largest microfinance sectors in the world, but one that has not been focused on poverty alleviation.

This research has examined issues of sustainability of microfinance institutions, poverty alleviation, sociocultural and religious values in three local communities in West Java. It contends that sociocultural and religious factors influence human behavior as well as the agency of borrowers and the microfinance institutions. With respect to Sundanese cultural and Islamic values, the borrowers and microfinance institutions, guided by their own interests, accommodate complimentary and contradictory elements. In this accommodation, bank officials play a critical role as arbiters and mediators. Local religious leaders, supporting the economic interests of their community, have sanctioned the payment of interest on microloans.

Microfinance has supported the businesses of the economically active and 'bankable' borrowers and enhanced successful borrowers' social status. The poorer members of the three communities studied were unable to meet the commercial requirements of the lender institutions and could not gain access to microfinance. Microfinance has also facilitated gender role change for 'bankable' female borrowers. Successful female borrowers enjoyed enhanced social standing in the family and community, although patriarchal values have persisted. Government subsidized empowerment programs have not been effectively linked into commercial microfinance programs. Commercial microfinance and government empowerment programs have not accommodated a growing concern in Moslem communities about the payment of interest. Non-*riba* microfinance institutions have yet to be established in village communities.

Student Declaration

“I, Iwan R. Prawiranata, declare that the PhD thesis entitled ‘Sustainable Microfinance in Indonesia: A Sociocultural Approach’ is no more than 100,000 words in length including quotes and exclusive of tables, figures, appendices, bibliography, references and footnotes. This thesis contains no material that has been submitted previously, in whole or in part, for the award of any other academic degree or diploma. Except where otherwise indicated, this thesis is my own work”.

Signature:

Date: 30 April 2013

Iwan R. Prawiranata, MIB (Melb.), MA (Vic.)

Acknowledgements

In the name of Allah *swt*, Most Gracious, Most Merciful.

Indeed, this doctorate thesis is a result of curiosity developed when I was a President Director of three state-owned commercial banks: Bank Ekspor Impor Indonesia (BankExim), Bank Rakyat Indonesia (BRI), Bank Bumi Daya (BBD), a member of Board of Directors and a Deputy Governor of Bank Indonesia and a Chairman of the Indonesian Bank Restructuring Agency (IBRA). It seemed that microfinance was not simply a financial issue, but one in which the culture of the customers and their behavior needed to be considered by microfinance institutions as well as by government policymakers. The researcher recognizes a Sundanese expression: "*Jawadah tutung biritna sacarana-sacarana*" which means people living in a community or region maintained their own customs, traditions and local culture. I felt that these matters needed to be recognized and respected by financial institutions. It seemed to me that business relationships should not only be determined by financial considerations, but also influenced by cultural and religious values.

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Glossary and Acronyms

Adat: customs and traditions.

Ajengan: Islamic local religious authority or teacher, leader of a *pesantren*.

Anyaman: plaited works.

Arisan: rotating, savings and credit association (rosca).

AVB (Algemeene Volkscrediet Bank): General Popular Credit Bank, established in 1934, merger of *Volkscredietwezen* (Popular Credit System Service), Central Fund and 91 Popular Credit Banks and responsible for the supervision of the village credit institutions. The AVB was a predecessor of today's BRI.

Basa Sunda: the Sundanese language.

Bimas (bimbingan masal): government agricultural extension program, 1965-1983 designed to boost national rice production. It consisted of paddy centers program, fertilizer procurement activities; a mass supervision program, with some provision of credit, '*kredit bimas*'.

BMT: Baitul Mal wa Tamwil, cooperatives micro financial institution with *shari'ah* principles. Accepts *zakat*, *infaq*, *sadaqa* and saving as financing resources and also preserve micro loan activities. It maintains not only financial relationship (*mudhorobah*, *musyarakah*, *murabahah*, *bai assalam*, *ijarah musyarakah mutanaqisah*, *saving mudharabah*) but also social relationships (*qordhul hasan*) between members.

BPR: Bank Perkreditan Rakyat, People's Credit Bank, local or community bank which mostly collects deposits, provides small loans and other services. In general, BPR is a stand-alone network in the local area.

BRI: Bank Rakyat Indonesia, Indonesia People Bank.

BRI Unit: Bank Rakyat Indonesia Unit, BRI small business unit developed in rural and coastal villages, urban areas and cities. BRI Units are organized under a BRI branch office and these offices have integrated nationwide networks.

Bu: ibu, a name of a woman, wife or mother.

Budaya Sunda: the Sundanese ethnics' culture.

5Cs: Character, Capacity, Capital, Collateral and Condition of economics, the five criteria generally used to access a loan application.

Cooperative: economic enterprise based on its members' cooperation and benefits (*koperasi*).

Desa: village.

Desa adat: customary village.

Dukun: practice of native healing, deals with the supernatural entities.

Fatwa: a principle or declaration from a respected Islamic leader or institution as a binding ruling in religious matters.

GBT or *Golbertap*: *golongan berpenghasilan tetap*, fixed income group.

Golkar: *Golongan Karya*, a political party established by the New Order government.

Gotong royong: mutual community self-help.

Guru: teacher.

Hadith: narrations concerning the words and deeds of the Islamic prophet Muhammad *saw*.

Hajat: ritual or ceremonial feast with food and blessing prayers, *salametan*.

Haji: Hajj, a pilgrimage to Mecca.

Halal: kosher, in compliance with Islamic rules.

Haram: proscribed, not in compliance with Islamic rules.

Ibadah: act of devotion, religious service.

Ibu: *Bu*, a name of a woman, wife or mother.

Idul Adha: a holy day associated with the pilgrimage to Mecca that commemorates the sacrifice of Ismail by Ibrahim.

Idul Fitri: feast celebrating the end of fasting period.

Infāq: spending.

Jalur pantura: *jalur pantai utara*, the north coastal Java Island main road.

Jamaah: Muslim community, followers.

Jilbab: female Muslims headgear that exposes only the face.

Kampung: settlement, hamlet, village.

Karuhun: ancestor.

KIK: *Kredit Investasi Kecil*, small investment loan.

KMKP: *Kredit Modal Kerja Permanen*, small permanent working capital loan.

Kodrat: God's Will.

Koperasi: cooperative, economic enterprise based on its members' cooperation and benefits.

Koperasi Simpan Pinjam: Saving and Loan Cooperative.

Kredit: loan, credit.

Kredit bimas: credit provided as part of government agricultural extension program (*bimbingan masal*), borrowers were selected by government officials.

Kredit Kecil: microcredit.

Kredit Kelayakan: loan based on its viability with less assets collateral.

Kredit Koperasi: loan provided to Cooperatives.

Kredit likuiditas Bank Indonesia: credit facility provided by Bank Indonesia to a commercial bank to support financing of specific programs or projects determined by the government. The funds are provided at a lower rate of interest with equal tenor to the programs.

Kredit Midi: microcredit provided by BRI in June 1980 from 200,000 rupiah up to 500,000 rupiah, the program was ended in 1984.

Kredit Mini: microcredit provided by BRI in March 1974 offered loan up to 200,000 rupiah, the program was ended in 1984.

Kredit Mikro: small credit, microcredit.

Krismon: abbreviation of *krisis moneter*, monetary crisis swept Indonesia in 1997- 1998.

Kupedes: abbreviation of *Kredit Umum Pedesaan*, general purpose microcredit for the villagers, a Bank Rakyat Indonesia's microcredit product launched since January 1984.

KUK: Kredit Usaha Kecil, small business credit.

KUR: Kredit Usaha Rakyat, people's business development credit for micro, small, medium businesses and cooperatives.

Larung: dispose of offerings by floating them out to sea.

Lebaran: celebration at end of fasting month.

Lumbung Desa: paddy storage by the villagers to supply in emergency situation, the paddy bank.

Madrasah: Islamic school dealing with the teaching with religious subjects but also the teaching of conventional or general subjects. There are *Madrasah Ibtidaiyah* (MI), in conventional school system is equivalent to Primary School, *Madrasah Tsnowiah* (MTs) is equivalent to Junior High School and *Madrasah Aliyah* (MA) is equivalent to Senior High School.

Majelis Ulama Indonesia (MUI): the Indonesian *Ulama* Council

Mandiri PNPM (Program Nasional Pemberdayaan Masyarakat Mandiri):

National Program for Community Empowerment, Mandiri.

Mantri: BRI Unit loan officer.

Menak: high society, aristocratic.

Mudik: home coming, especially at the end of the fasting month.

Musola or musholla: small building or room for prayer.

Ny: *nyonya*, madame.

P4K: abbreviation of Pembinaan Peningkatan Pendapatan Petani/Nelayan

Kecil was official translation of the Income-Generating Project for Marginal Farmers and Landless, operated under IFAD (the International Fund for Agricultural Development), Bappenas, the Ministry of Agriculture and BRI. The project's primary objective was to raise the standard of living among the poorest rural families, including both farmers and fishers, by promoting microbusiness activities (both on- and off-farm), through the provision of credit and training.

Pak: abbreviation of *bapak*, a man, husband or father.

Pamali: taboo.

Pasar kaget: temporary market.

Pegadaian: pawnshop.

Pengajian: reading and studying *al Quran*.

Penyuluh: instructor.

Pesantren: traditional Islamic boarding school.

Peziarah: visitors to sacred place.

Pinjaman Kemitraan: loan to finance small business that BRI sets aside from its profits.

Priyayi: Sundanese or Javanese aristocrat or senior official

PT: abbreviation of *Perseroan Terbatas*, Limited Liability Corporation.

Qur'an: the religious text of Islam, the Muslims believe the Qur'an to be the verbal divine guidance and moral direction for mankind.

Qurban: the offering made at rites celebrating *idul adha*.

Riba: Islamic term for usury, excessive interest.

Rupiah: Indonesian currency.

S^hadaqa: *sedekah*, voluntary spending or charity, donation.

Salamatan: ritual or ceremonial feast with food and blessing prayers.

- Santri*: student at traditional Islamic school; strict devotion in accordance with principles of Islam.
- Saung*: simple shelter made from bamboo tree with dry foliage roof.
- Saw*: abbreviation *sallallahu alaihi wa sallam*, Muhammad saw, May Allah bless him and give him peace. Saying this phrase after uttering Prophet Muhammad's name.
- Sedekah*: give alms, religious meal.
- Shari'ah* or *Syariah*: declare a certain deed to be Islamic law.
- Silaturakhim*: strengthen bond of friendship, kinship or personal relationship.
- Silih asih, silih asah jeung silih asuh*: kindhearted, educate and caring.
- Simaskot*: abbreviation *simpanan masyarakat perkotaan*, saving for urban and city, offered in BRI Units in urban area.
- Simpedes*: abbreviation *simpanan pedesaan*, villagers' saving offered in BRI Units in rural and coastal area.
- SIUP*: abbreviation *Surat Izin Untuk Perusahaan*, License for a business or enterprise to operate
- Swt*: abbreviation *subhanahu wa ta'ala* in *Allah swt*, glorious and exalted is He. Saying this phrase is seen as an act of reverence and devotion towards Allah among Muslims.
- Tabungan terbeku*: compulsory saving required as a condition of obtaining a loan and cannot be withdrawn until the loan is repaid.
- Tarekat*: path of mystics to follow such as Sufism.
- Tolak bala*: protection from catastrophe.
- Tumpengan*: special yellow rice cone completed with vegetable, fish and meat for ceremonial meal.
- Ulama*: religious Islamic leader.
- Upacara adat*: customs or traditional ceremony.
- Urang Sunda*: Sundanese person
- Ustad*: religious Islamic teacher.
- Waqf, Wakaf*: property or money donated for religious or community use.
- Warung*: small shop.
- Wong dagang*: trader.
- Zakat*: compulsory payment (2.5% of assets or income) to the needy.

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CHAPTER 1

INTRODUCTION

1.1 Introduction

The aim of the thesis is to investigate the sociocultural attributes that influence microborrowers' behavior and the role of women borrowers that relate to sustainability of the microfinance institutions. This thesis explores the influence of culture, religion, ethics and trust on microfinance, as well as the controversial issue of the payment of interest as *riba*.¹

This study will examine how sociocultural factors influence the handling of money and debt by borrowers, and the screening processes of the poor and low income people by microfinance institutions, as well as the relationship of socioeconomic risk of bad debt and the sustainability of microfinance programs. Gender is another issue that is discussed, as women have a unique social and economic position in Sundanese society. Although, there is a slightly different treatment in traditions and patriarchal family structures, women are highly respected in Sundanese culture and the Islamic religion.² With microcredit support, they play an important role as income earners in the family. The study will also investigate the impact of income on and socioeconomic benefit available to the poor and better-off microborrowers that relate to and influence the sustainability of microfinance institutions in the research areas.

Within the framework of the study, the role of microcredit and microfinance institutions as strategies for poverty alleviation will be examined. And how the sociocultural and religious values of the borrowers influence their behavior and affect their loan performance. The Sundanese socio-culture in

¹ *Riba* is the Islamic term for high or exploitative interest rates charged on loans. In the terminology of the Qur'an, *riba* denotes an addition to, or an 'increase' of, a thing over and above its original size. It signifies any unlawful addition, by way of interest, to a sum of money or goods lent by one person to another. See Hosein, I.N. 1997, *The Prohibition of Riba, in the Qur'an & Sunnah*, Ummavision Sdn. Bhd. Kuala Lumpur, Malaysia, p. 22.

² Rosidi, A. 1984, *Manusia Sunda, sebuah esai tentang tokoh-tokoh sastra dan sejarah*, Inti Idaya Press Jakarta and Sumardjo, J. *Perempuan dalam Masyarakat Sunda Lama*, viewed 17 December 2010, <http://group.yahoo.com/group/wanita-muslimah/message/12941> and *Al Qur'an*, Luqman 31:14, Al Ahqaf 46:15, *Hadith Bukhari al Adab*, no. 5971.

West Java and Islamic teaching constitute the structure of beliefs in the rural, coastal and urban research areas. The study will enrich our understanding of microfinance and poverty alleviation policy. The history of microfinance institutions in Indonesia is discussed in order to evaluate the development of poverty mitigation policies.

1.2 Microfinance in support of poverty alleviation

These sociocultural features are related to financial aspects of microcredit development on value benefits and services for the borrowers over time through financial self-sufficiency. As microfinance institutions have been used as tools to help poor people, the sociocultural aspects of their local community need to be well identified. Thus the important sociocultural role will be discussed, as well as the similarities and differences among local cultural practices that result in different microfinance management.

Poverty is a universal, multidimensional problem and grows as an international issue.³ The World Bank has taken an active part in lending for small and medium enterprises since 1973. Then it shifted to become a centerpiece of poverty related loans in the early 1990s through development of microfinance institutions. From those activities between 1989 and 1993, the World Bank lending report indicates there are three objectives of microfinance institutions: a) to create employment and income opportunities through the creation and expansion of micro enterprises; b) to increase the productivity and incomes of vulnerable groups, especially women and the poor; and c) to reduce rural families' dependence on drought-prone crops through diversification of their income generating activities.⁴

World Bank researchers found that poverty alleviation by using microfinance institutions, especially in poorer countries, has been a success, especially when it has provided transparency, education and support for borrowers and flexible payment options. Robinson explains the benefit of

³ The World Bank measures poverty by the absolute poverty headcount index, below a particular poverty line at US\$ 1 a day.

⁴ Webster, L.M. *et al.* 1996, *World Bank Lending for Small Enterprises, 1989-1993*, The World Bank, Washington, D.C.

microfinance institutions' services in 16 developing countries including Indonesia.⁵ Ledgerwood points out that the goals of microfinance institutions, as development organizations, are to service the financial needs of un-served or underserved markets.⁶ It is a means of meeting development objectives such as to create employment, reduce poverty, help business grow or diversify their activities, empower women or other disadvantaged population groups (poor people or low income people), and encourage the development of new business.

Microfinance has been the subject of much debate, and a major study on Asia including Indonesia, Africa and Latin America provides evidence that microfinance benefits the poor.⁷ The benefit arises from well-designed lending programs achieving high loan performance for a positive economic and social impact.⁸ The programs are based on market-determined interest rates, the availability of savings and insurance facilities, intensive loan collection and incentives for borrowers and agency staff. Hulme and Mosley make three general points:⁹

1. Well-designed lending programmes can improve the income of poor people and for a proportion of cases can raise the income of poor households above official poverty lines in large numbers (Bangladesh Rural Advancement Committee/BRAC's; Rural Development Programmes/ RDP-Bangladesh; Grameen Bank, Bank Rakyat Indonesia/BRI's Unit *desa*, Badan Kredit Kecamatan/BKK-Indonesia and Federation of Thrift and Credit Cooperative Societies/SANASA-Sri Lanka).
2. There is clear evidence that the impact of a loan on a borrower's income is related to the level of income. For rural Asia the Bangladeshi cases (BRAC and Thana Resource Development and Employment Programme

⁵ Marguerite S. Robinson studied poor peoples' experiences in using institutional microfinance services in 16 developing countries. See Robinson, M.S. 2001, *The Microfinance Revolution: Sustainable Finance for the Poor*, The World Bank, Washington, D.C., pp.102-124.

⁶ Ledgerwood, J. 1998, *Microfinance Handbook: An Institutional and Financial Perspective*, The World Bank, Washington, D.C., p. 34.

⁷ See Appendix 1 and 2 of this thesis

⁸ Hulme, D. and Mosley, P. 1996, *Finance Against Poverty*, vol. 1, Routledge, London.

⁹ *Ibid*, pp. 109, 114, 113.

(TRDEP-Bangladesh) illustrated this most clearly, and the available data on Sri Lanka and Indonesia confirmed this picture (p. 109). It is indicated by the average increase in percent in borrower household income (real terms), a comparison of the average incomes of borrowers and the average increase in household income since the last loan. The average income increase of BRAC is 6.4%, TRDEP 23.2%, SANASA 26.0% and 18.9% and BRI 20.7%.

3. The impact of income-generating credits in the medium term cannot be simply understood in terms of a promotional model of credit, investment and income.

Since the early 20th century, Indonesia has established rural financial institutions to reduce poverty.¹⁰ Poverty alleviation continued after independence through economic development policy and various microcredit programs. To understand the role of government and the dynamic of microfinance institutions, the history of microfinance institutions in Indonesia, either for poverty alleviation or commercial purposes, are discussed in section 1.7 in this chapter. The poverty level was considerably reduced from 60% in 1970 to 11.3% or 34.5 million people in 1996, prior to the 1997/1998 economic crises.¹¹ Various microcredit programs such as loans for mass rice guidance program (*kredit bimas*), BRI small loans up to 200 thousand rupiah (*kredit mini*), BRI small loans up to 500 thousand rupiah (*kredit midi*), BRI general microcredit (*kupedes*), small investment loans (*kredit investasi kecil*), small, permanent working capital loans (*kredit modal kerja permanen*), loans based on its viability with less assets collateral (*kredit kelayakan*), loans for cooperatives (*kredit kepada koperasi*) and others (*kredit kecil lainnya*) are developed side by side with government poverty alleviation policies. These programs have played an important role in reducing the poverty level.¹² Under government strategy on

¹⁰ Steinwand, D. 2001, *The Alchemy of Microfinance*, VWF, Berlin.

¹¹ Manshur, A. et al. 2005, *Kemiskinan di Indonesia: Perkembangan Data dan Informasi Mutakhir Tahun 2002-2004*, Tim Koordinasi Penanggulangan Kemiskinan Kementerian Kesra, Jakarta, Tabels 2.1 and 2.4.

¹² Robinson, M.S. 2001, *ibid.* xxii; Sumodiningrat, G. 2001, *Responsi Pemerintah terhadap Kesenjangan Ekonomi, Studi Empiris Pada Kebijakan dan Program Pembangunan Dalam*

microcredit and poverty improvement projects, and confronting a variety of unresolved economic and social problems, there were 39.1 million poor people or 17.7% in poverty in 2006. But this percentage decreased in 2009 to 32.5 million people or 14.14%.¹³ Since 1980, to alleviate poverty, the government developed a project named *Pembinaan Peningkatan Pendapatan Petani-Nelayan Kecil* or *P4K* (Income-Generating Program for Marginal Farmers and Landless).¹⁴ More recently, the government of Indonesia has extended various poverty reduction programs financed by national and regional budgets or foreign exchange loans from international institutions and donor countries for *Program Nasional Pemberdayaan Masyarakat Mandiri* or *PNPM Mandiri* (the National Community Empowerment Program Mandiri).¹⁵

The PNPM Mandiri program is designed by the government to address various strategic problems such as:¹⁶

1. Inequality and high levels of rural poverty. Poverty is particularly high in rural areas, where the majority of the population and more than two-thirds of

Rangka Pemberdayaan Masyarakat di Indonesia, PerPod, Jakarta and Kementerian Koordinator Bidang Kesejahteraan Rakyat, 2005 dan 2006, Inventarisasi Program Penanggulangan Kemiskinan, Jakarta.

¹³ Bappenas, 2009, Strategi Penanggulangan Kemiskinan di Indonesia, <<http://www.bappenas.go.id/node/116/2157/strategi-penanggulangan-kemiskinan-di-indonesia>>.

¹⁴ Sponsored by the Ministry of Agriculture and subsidized by donors and the government, *P4K* (*Pembinaan Peningkatan Pendapatan Petani-Nelayan Kecil* or Income-Generating Project for Marginal Farmers and Landless in Indonesia, <http://www.ifad.org/media/success/indonesia.htm>) is subsidized credit and training programs for poor rural self-help groups. Participants include small and marginal farmers, farm laborers, sharecroppers, and fishermen organized into small groups of 8-16 households. See Robinson, M.S. 2002, *The Microfinance Revolution: Lesson from Indonesia*, vol. 2, The World Bank, Washington, D.C., p. 347. It is jointly implemented by the Ministry of Agriculture and BRI. The program receives significant financial and management support from the International Fund for Agricultural Development (IFAD), the United Nation Development Program (UNDP), the Dutch government and the Asian Development Bank (ADB). BRI supplies 20% of loan funds.

¹⁵ Keputusan Menteri Koordinator Bidang Kesejahteraan Rakyat no. 25/KEP/MENKO/KESRA/VII/ 2007 tentang Pedoman Umum Program Nasional Pemberdayaan Masyarakat Mandiri (PNPM MANDIRI), tanggal 30 Juli 2007. PNPM Mandiri program is supported by a loan from the Asian Development Bank for 80% of the total cost or equivalent to US\$ 50 million. Indonesian counterparts (the government and BRI) contribute 20% or US\$ 12.5 million. It runs for a 32-year term, including eight year's grace, with interest charges of 1% per annum during the grace period and 1.5% per annum for the remaining period. See ADB Report Project no. 40247, 'Proposed Loan: Republic of Indonesia: Rural Infrastructure Support to the PNPM Mandiri Project', September 2008.

¹⁶ Asian Development Bank (ADB), 2009, Report and Recommendation of the President to the Board of Directors Proposed Loan Republic of Indonesia: Rural Infrastructure Support to the PNPM Mandiri Project II, Project Number: 38385-01, October 2009 and PNPM Mandiri regulation no. NO: 25/KEP/MENKO/KESRA/VII/2007.

poor people live. In 2009 the poverty incidence continued to be much higher in rural areas (20.62 million people or 17.53%) than in urban areas (11.91 million people or 10.72%).¹⁷

2. Limited access to service delivery and rural infrastructure. Poor roads or no roads mean that government services are inaccessible and the high transportation cost into communities is a major cause of poverty. Lack of water and sanitation: only 15% of rural households have access to drinking water from piped or pumped sources, and just 21% have septic tanks for disposal of human waste. Access to quality health and education services is particularly limited in rural and remote areas.

3. Weaknesses of local government decentralization. While in theory the new regulations should make local planning processes more efficient, effective, and responsive by integrating community aspirations with national, regional and *sectoral* policies and plans, in reality the capacity of district governments to provide equitable and accessible services remain limited. Other issues include inadequate consideration of local aspirations and needs, especially poor people, in planning processes; limited synergy between programs in different sectors; and a disproportionately high proportion of regional budgets allocated to administrative rather than development activities.

PNPM Mandiri applies community participation principles, community mutual self-help (*gotong royong*), for poverty alleviation efforts in the community driven development (CDD) model. It is the involvement of the participants in the process of planning, executing, controlling and evaluating and their participation is the subject of development, not the object. The researcher found that the objective of community participation was often thwarted by protracted bureaucratic processes involved in the administration of PNPM Mandiri. Program participants want to see their sociocultural values incorporated in the activities, but instead encounter bureaucratic obstacles and the commercial imperatives of contractors. However, development needs efficiency, low costs

¹⁷ A total of 32.5 million poor people or 14.14% of Indonesian people. See Statistical Year Book of Indonesia, 2009, Badan Pusat Statistik, Jakarta.

and competitive efforts. The desire for efficient management of PNPM Mandiri is supported by the program participants but encounters many bureaucratic obstacles. PNPM Mandiri implementation programs, decision-making processes and financial responsibility are indeed suppressed by bureaucracy. It is expected that government programs will reduce poverty and improve local governance of rural communities in the project areas, which is in line with the overall objective of PNPM Mandiri. The outcome is improved access to service delivery and existence of basic rural infrastructure for the poor, and for women in the project communities.

The government has also designed a new microfinancing model, microcredit scheme through a banking system named *Kredit Usaha Rakyat/ KUR* (loans provided for micro, small- and medium-sized businesses and cooperatives).¹⁸ Bappenas, Indonesia Development Planning Board describes government support for poverty alleviation for 2010 as consisting of *KUR* for 100 trillion rupiah and PNPM Mandiri for 13 trillion rupiah.¹⁹ Until 2009 the microfinance institutions in Indonesia managed microcredit services equivalent to US\$ 16.4 billion, routed through 95.7 thousand offices and serving 42.0 million small borrowers, constituting about 30% of 139.9 million Indonesians above 15 years old or 18.8% of the total population.²⁰ Among the banks, Bank Rakyat Indonesia or BRI (Indonesian Peoples Bank) has developed the biggest role in collecting small deposits, number of depositors, outstanding microloans,

¹⁸ Kredit Usaha Rakyat (KUR) designed by the government commenced in November 2007, and in the beginning was routed through Bank BRI, Bank Mandiri, Bank BNI, Bank BTN, Bank Syariah Mandiri and Bank Bukopin. See <<http://www.smecca.com/files/KUR/>>, viewed 5 February 2009. It is a loan of up to Rp. 500 million (eq. US\$ 50,000.00) also assessable by prospective microbusiness but lack or less assets collateral and 70% insurance scheme coverage for the lending bank by state-owned insurance companies Perum Sarana Pengembangan Usaha (SPU) and PT Asuransi Kredit Indonesia (Askrindo). The government provides financial support from the state budget that guarantees funds for this purpose.

¹⁹ Prof. Armida S. Alisjahbana, Minister of National Development Planning/Ketua Bappenas/ Indonesia Development Planning Board, in Workshop on Constraint Analysis of Millennium Challenge Corporation Compact Program, Jakarta 10 November 2009. See <www.bappenas.go.id/.../pengembangan-program-pengentasan-kemiskinan/> viewed 8 October 2010. Beside PNPM Mandiri, with ADB support in 2008, there are 11 poverty alleviation programs including Bantuan Langsung Tunai (Direct Cash Support), Beras Untuk Rakyat Miskin (Rice for the Poor), Bantuan Operasional Sekolah (School Support Financing), Jaminan Pemeliharaan Kesehatan Untuk Keluarga Miskin (Health Care for the Poor), P4K, see ADB TA 4762 INO Proyek Perencanaan dan Penganggaran Yang Berfihak Pada Kaum Miskin, Pebruari 2008, Bappenas, ADB.

²⁰ See Table 1.1, Chapter 1 in this thesis. Indonesian Main Microcredit Service, December 2009; Statistical Year Book of Indonesia, 2002, *Poverty*, Badan Pusat Statistik, Jakarta.

number of microborrowers and bank networks in Indonesia.²¹ BRI can be identified as one of the largest microfinance banks in the world with total microcredit loans equivalent to US\$ 5.4 billion in 2009, or around 33% of the market share in Indonesia. This is why Bank Rakyat Indonesia Unit (BRI Units), their officers and microborrowers are the focus of this study.²² As BRI microcredit, named *Kredit Umum Pedesaan* called *Kupedes* (general rural microcredit) is operated with commercial motives, the data and information on BRI Units available is only related to commercial activities.²³ Consequently, information on direct financing for individual applicants in the framework of poverty alleviation efforts with BRI's own funds could not be found. Although BRI has ideas on poverty alleviation programs in various circular letters, to see relatively small amounts of microcredit for the poor indicates the BRI's mentality; it is only viewed as additional or extra activities on microcredit as part of the total credit operations. The structure of *Kupedes* is capital support for self-employed microborrowers, where the BRI is not responsible for empowerment or training. The government's support for the alleviation of poverty is evident with the appointment of the BRI as the channeling bank for various government designed microfinance and poverty alleviation programs. BRI is considered to have experience as a government partner for this model of

²¹ The BRI has a history that dates from the establishment of the *Poerwokertosche Hulp-en Spaar Bank der Inlandche Bestuur Ambtenaren* (Poerwokerto Support and Savings Bank for Netherlands Indies Civil Servants) established 1895 in city of Poerwokerto. The District Bank (*Afdeelingsbank/Bank Rakyat*) then converted to *Algemeene Volkscredietbank (AVB)* in 1934. During the Japanese occupation AVB was changed to *Syomin Ginko*. In 1946 the government of Indonesia established the Bank Rakyat Indonesia (BRI) and in 1950 AVB operation was integrated into this new bank. In 1960 government changed BRI into *Bank Koperasi Tani dan Nelayan (BKTN)* and renamed Bank Rakyat Indonesia in 1968. It is a state-owned bank mainly with business in financing on microfinance operations which turned out to be the biggest microfinance operation in Indonesia and also in the world. In 1992 it was established as a Limited Liability Company, wholly owned by government of Indonesia, and in 2003 it was converted to a public company when government divested 30% of its share to the public. See also Bank Rakyat Indonesia, Annual Report 2007. PTBRI, Jakarta, and Fruin, T.A. 1933, *History, Present Situation and Problems of the Village Credit System (1897-1932)*, Klaas Kuiper, 1999 (trans.) and (ed.), Ministry of Foreign affairss DRU, The Hague.

²² A BRI Unit is a BRI operational office at village level. It is the lowest level of the BRI's microbanking system, providing financial services to the villages: saving (*simpedes*), microcredit (*kupedes*) and other banking services.

²³ *Kupedes* or *Kredit Umum Pedesaan* is the microloan product of BRI's Unit. It is an acronym for general rural credit, but after 1989 when these loans were offered in urban units as well as rural ones, *kupedes* became widely known as general purpose credit. See Robinson, M.S. 2001, *ibid.* p. 272.

programs with an extensive network all over the country. Besides the BRI, the Bank Perkreditan Rakyat or BPR (People's Credit Bank) has a similar commercial character in its village network in that it only does business with bankable individual borrowers.²⁴ Cooperatives have a different mission to low income members in the villages; although profit is also important for their sustainability the cooperatives seek to support their members based on familial principles.²⁵

There are microfinance activities in other countries with leading microfinance institutions. For example, Bangladesh had 18 million borrowers with outstanding microcredit loans equivalent to US\$ 2.1 billion in 2005, and in Bolivia 100,000 borrowed US\$ 170 million in 2007.²⁶ Although the data fluctuates each year, it can be seen that by international comparison Indonesia still maintains the highest figures for microfinance activities. Nevertheless, Indonesia needs more microfinance institutions and a broader outreach, as it is

²⁴ Bank Perkreditan Rakyat (BPR) may designate secondary banks (in opposition to commercial banks) such as the Badan Kredit Desa (BKD/village bank – village-owned credit organizations) and Lumbung Desa (village savings and loan institutions) that began to appear in the early 1900s. Their first goal was to promote agriculture by providing loans to farmers and as demand for money rose in other sectors, non-agricultural businesses were later included.

After the 1988 financial reforms, new secondary banks were established, also called BPR. Today, BPR mostly privately-owned, that meet the criteria specified in the 1992 Banking law, and number 2,148 in 2004 (accounting for 15% of the microfinance market), and almost 9,000 public rural financial institutions that are not licensed, and can be categorised as generic BPR, which include village-owned BKDs of Java and Madura, and the Lembaga Dana dan Kredit Pedesaan (LDKPs) or Rural Fund and Credit Institutions, owned mostly by provincial governments (or in some cases by villages).

BPR can accept deposits, but is limited in terms of location, function and portfolio composition. BPR operate on banking principles, offering loans, savings and term deposits, but no cheque accounts.

They are locally based and mostly privately owned. Initially set up with paid-up capital of 50 million rupiah, this requirement was increased in 1999 to 500 million rupiah, for local areas. Minimum capital requirements were also increased for BPR operating in the Jakarta region, from Rp 50 million to Rp 2 billion and for provincial capitals to Rp. 1 billion. BPR do not generally focus on the poor but serve the upper end of the microfinance market and the middle classes. See also http://www.bwtp.org/arc/indonesia/II_Organisations/MF_Providers/BPR.htm and www.bi.go.id.

²⁵ A cooperative is a business unit consisting of people as members or a legal entity that based its activities on cooperative principles and a society economic business unit which is based on familial principles. See Undang-Undang Perkoperasian/Indonesian Cooperative Law, no. 25/1992.

²⁶ Rashid, M. 2006, 'Microfinance in Bangladesh, challenges and prospects', *The Daily Star*, 5 (877), 15 November. See Inter-American Development Bank, 4 September 2007, viewed 3 November 2007 < <http://www.iadb.org/NEWS/articledetail.cfm?artid=4011&language=En>>.

challenged by the high demand of another estimated 30 million Indonesians in small business that have no access to financial services.²⁷

Microfinance is an important service that can empower the poor, reduce poverty and provide positive flow-on effects in depressed areas.²⁸ Certainly, microfinance institutions have been expected to link and reduce poverty, which is considered as the most important development objective, as found by many studies (Khandker; Rutherford Remenyi and Quinones Jr Montgomery and Weiss).²⁹ In their study Remenyi and Montgomery use Indonesian microfinance institutions *Badan Kredit Kecamatan (BKK)*, *Kredit Usaha Rakyat Kecil (KURK)* and *Bank Rakyat Indonesia (BRI Units)* as cases in their research. In those institutions, they find that growth in borrowers' income always exceeds that of the control group. An increase in borrowers' income is largely for better-off borrowers. This is especially so because the multiplying impact is concentrated in the wealthier sections of society.

1.3 The need for a sociocultural approach

A wideranging debate on poverty eradication took place at the General Assembly of the United Nations in 2000 with many delegates arguing for pro-poor economic growth strategies. The debate concluded that there was a need for improving access to productive resources, for developing microfinance, and establishing programs to raise productivity, improve knowledge, skills and capabilities. Microfinance is the provision of a broad range of financial services such as deposits, loans, payment services, money transfers, and insurance to the poor and low income households and their micro-enterprises.³⁰ The strategy

²⁷ Shrader, L.W. 2004, 'Regional trends in microfinance: Indonesia'. In Pakpahan, A. (ed.), *Creating Opportunities for the Poor through Innovation*, PT Bank BRI, Jakarta, p. 91.

²⁸ World Summit for Social Development 1995. Copenhagen Declaration on Social Development, Part C.

²⁹ Khandker, S.R. 1996, 'Grameen Bank: Impact, cost, and program sustainability', *Asian Development Review*, 10(1), pp. 97-130; Rutherford, S. 1998, 'The savings of the poor: Improving financial services in Bangladesh', *Journal of International Development*, 10(1), pp.1-15; Remenyi, J. and Quinones, B. Jr, 2000, *Microfinance and Poverty Alleviation: Case Studies from Asia and the Pacific*, Pinter, London; and Montgomery, H. and Weiss, J. 2005, *Great Expectation: Microfinance and Poverty Reduction in Asia and Latin America*, Research Paper Series no. 63, ADB Institute, Manila.

³⁰ This thesis adopts the Asian Development Bank's definition of microfinance provided in Asian Development Bank 2000 Microfinance Development Strategy, Finance for the Poor.

is people-centered, nondiscriminatory and consistent with gender equality.³¹ It can be argued that those three integrated tactics represent a shift: humans, culture and sociological factors need to be accessed in addition to financial calculations.

Most studies of microfinance programs have focused on the assessment of their financial performance by evaluating financial indicators, efficiency, pricing policy, return or profitability, outreach in terms of number of depositors and borrowers, size of loans, loan losses, and delivery mechanism as discussed by Yaron, Chaves and Gonzales-Vega, Christen and Charitonenko and Afwan.³² Cernea however argues that using only financial assessment is not sufficient to sustain poverty alleviation projects.³³ He reveals that over a half, or 13 of 25 World Bank projects in Africa, Asia and Latin America had left no lasting development impact six to 10 years after completion, and had failed to produce the expected flow of benefits. It is reported that among the basic causes of non-sustainability was the neglect of sociological factors, such as social action, the relationship among people, culture, motives and values that influence their behavior, in project design and the lack of supportive institutions and grassroots participation. Cernea argues that World Bank projects that succeed and prove to be sustainable undertake purposive institution building from the beginning. In contrast, poverty alleviation using traditional tools, such as natural capital, physical or produced capital, is not sufficient to keep poverty at a minimal level. Project management needs to recognize the way in which the poor interact and organize themselves to generate growth and development. Neubert explains an integrated approach to poverty alleviation

³¹ The World Bank and the Copenhagen Declaration: *Ten Years After: Social Development Department Environmentally and Socially Sustainable Network*, 20 September 2004.

³² Yaron, J. 1994, 'What makes rural finance institutions successful?' *The World Bank Research Observer*, 9(1), pp. 49-70; Chaves, R.A. and Gonzales-Vega, C. 1996, 'The design of successful rural financial intermediaries: Evidence from Indonesia', *World Development*, 24(1), pp. 65-78; Christen, R.P. 1998, 'Keys to financial sustainability'. In Kumenyi, M.S. (ed). *Strategic Issues in Microfinance* (Contemporary Perspectives on Developing Societies), Ashgate, England; Charitonenko, S. and Afwan, I. 2003, *Commercialization of Microfinance – Indonesia*, Asia Development Bank, Manila.

³³ Cernea, M.M. 1993, 'The sociologist's approach to sustainable development', *Finance & Development*, 30(4), pp. 11-13.

programs that needs to consider all social dimensions to attain a better quality of life.³⁴

The term 'culture' in this thesis is used to describe a set of attitudes, knowledge, art, laws, beliefs, mores, customs, values and practices which are common to or shared by members of a society.³⁵ This usage concurs with Thorsby who argues that culture is not only about traditions from the past, but, most importantly, a society's ideals and aspirations for the future. In the context of modern Indonesia, culture is not only to protect and support traditions and values, but also to encourage new technologies and ideas, strengthen the capacity of the arts and support creativity. It is about supporting and strengthening communities and to develop a creative culture and economy.

Many authors describe how culture and religion influence human behavior, which is the approach used in this study. Linton explains that borrowers are members of the local society, an organized group of people, and living in a culture with a particular behavioral pattern.³⁶ It is necessary to understand individual behavior that will influence business attitudes determined by various factors, such as experience in contacts with the environment, with other groups of individuals within society and with a particular way of life which is characteristic of the society, as discussed by Allport and Wallace.³⁷ Religion and ethics (i.e. knowledge of what is just and what is not, what should be done and what should not, what kind of behavior is good for the environment and what is not), are expected to create good behavior, good intentions and trust, and a positive character in business and management.³⁸ Cernea explained people's economic behavior is also guided by economic rationality, by the way in which they perceive obligations to their family and to other people in their

³⁴ Neubert, S. 2000, *Social Impact Analysis of Poverty Alleviation Programmes and Project*, Frank Cass Publishers, London, pp. 6-9.

³⁵ Thorsby, C.D. 2001, *Economics and Culture* (pp. 3-4), Cambridge University Press, Cambridge.

³⁶ Linton, R. 1968, *The Cultural Background of Personality*, Routledge & Kegan Paul Ltd. London.

³⁷ Allport, G. W. 1963, *Pattern and Growth in Personality*, Holt, Rinehart & Winston, London and Wallace, A.F.C. 1970, *Culture and Personality*, Random House, New York.

³⁸ Ahmad, K. and Sadeq, A.M. 2001, *Ethics in Business and Management: Islamic and Mainstream Approaches*, Asian Academic Press, London.

societies.³⁹ Economic rationality is not universally similar as it is influenced by cultures and social aspects which in turn affect economic outcomes and social objectives of communities.

Indonesia is rich in sociocultural diversity with various ethnic groups, cultures, local languages, religions, customs and traditional lifestyles. Many Indonesian authors including Garna, Soedjatmoko and Soemardjan⁴⁰ are concerned with the balancing of culture, politics and economics in society for future development. From a strategic management perspective, several studies on poverty alleviation in Indonesia, usually based on targets and magnitudes, are now completed by empirical measurement. This new strategy was launched in 2001, and in the *World Bank Report* No. 23028-IND, there were not only analyses on the role of natural resources, financial and physical capital but social aspects.⁴¹ Culture and ethics were also part of the evaluation.⁴²

As microfinance is one of the poverty alleviation tools, many authors, such as Schmit and Robinson, discuss a similar approach for Indonesia, which is an integration of financial and sociocultural approaches.⁴³ The diversity of local culture in Indonesia is reflected in different conduct and this study seeks to understand cultural influences on microcredit borrowers' behavior. The Sundanese way of life how this influences borrowers' behavior using microfinance services will be explored.

Sundanese culture is one of the most diverse cultures in Indonesia, which includes a set of attitudes and practices shared by people living in West

³⁹ Cernea, M.M. 1993a, 'Culture and organization: The social sustainability of induced development', *Sustainable Development*, 1(2), pp. 18-29.

⁴⁰ Garna, J.1977, *The Sociocultural Strategy of Development in Indonesia*, PT Gasco, Bandung; Soedjatmoko, 1958, *Economic Development as a Cultural Problem*, Cornell University, Ithaca and Soemardjan, S. 1972, *Imbalance in Development: The Indonesia Experience*, Ohio University, Ohio.

⁴¹ The World Bank, 2001, *Poverty Reduction in Indonesia: Constructing a New Strategy*, Report no. 23028-IND.

⁴² See also Mukherjee, N. et al. 2002, *People, Poverty and Livelihoods: Links for Sustainable Poverty Reduction in Indonesia*, The United Kingdom, Department for International Development and the World Bank Office Jakarta and Suryadarma, D. et al. 2006, *From Access to Income: Regional and Ethnic Inequality in Indonesia*, SMERU, Jakarta.

⁴³ Schmit, L.T. 1991, *Rural Credit Between Subsidy and Market*, Leiden Development Studies, Leiden, no. 11 and Robinson, M.S. 2002, *The Microfinance Revolution: Lessons from Indonesia*, vol. 2, The World Bank, Washington, D.C.

Java, also called *Tatar Sunda* or *Pasundan*, especially in the Priangan area.⁴⁴ Ekajati explains that the Sundanese are recognized by their sociocultural outlook, not by their physical appearance or any place where they live.⁴⁵ The Sundanese social culture in West Java is influenced by the natural environment, education, language, the structure of community, literature, arts, kinship, religion, beliefs and customs.

Rosidi describes the Sundanese culture as follows: “Beside Indonesian language as national language, Sundanese language (*basa Sunda*) is used in daily conversation. It is the second most widely spoken regional language after Javanese. *Sundanese* language characterises degrees of politeness (*undak usuk*), with three levels including polite and refined (*basa halus, lemes*), moderate (*sedeng*) and coarse and colloquial (*kasar*), used according to the social status of the speaker and the interlocutor. There is also Javanese-Cirebon language spoken in the coastal area of Cirebon and Indramayu”.⁴⁶

The traditional Sundanese elite (*menak, priyayi*) and consequently all social strata was defined by descent until independence. In comparison to the Javanese, the Sundanese preserve a less hierarchical social structure. The Sundanese today consider themselves more democratic and individualistic than the Javanese.⁴⁷ On kinship, the Sundanese maintain close family relationships and ties to their original village. They have principles of togetherness with relatives in the birthplace or village; the Sundanese express it as *bengkung ngariung, bongkok ngaronyok jeung dulur di bali geusan ngajadi*.⁴⁸ This is the

⁴⁴ Harsojo, 2004, ‘Kebudayaan Sunda’, in Koentjaraningrat (ed.) *Manusia dan Kebudayaan di Indonesia*, Jambatan, Jakarta, pp. 307-327; Rosidi, A. and Ekadjati, E.S. 2000, *Ensiklopedi Sunda, Alam Manusia dan Budaya termasuk budaya Cirebon dan Betawi*, Pustaka Jaya, Jakarta, p. 503.

⁴⁵ Ekajati, E.S. 1980, *Masyarakat dan Kebudayaan Sunda*, Pusat Ilmiah dan Pembangunan Regional, PIPR, Jawa Barat, Bandung.

⁴⁶ Rosidi, A. 1980, ‘Ciri-ciri Manusia dan Kebudayaan Sunda’, in Ekajati, E.S. *Masyarakat dan Kebudayaan Sunda*, Pusat Ilmiah dan Pembangunan Regional, PIPR, Jawa Barat, Bandung, pp. 95-121.

⁴⁷ Glicken, J. 1983, *Sundanese Socialization and Indonesia Education: The Hidden and Stated Curricula in the Classrooms of Bandung, West Java*, Doctor of Philosophy, Faculty of the Graduate School of Cornell University.

⁴⁸ Traditional Sundanese expressions are one resource of Sundanese culture. This thesis follows the expression used in Warnaen, S., Rusyana, Y., Wibisana, W., Garna, Y., and Djiwapradja, D., 1987, *Pandangan Hidup Orang Sunda Seperti Tercermin Dalam Tradisi Lisan dan Sastra Sunda*, Bagianj Proyek Penelitian dan Pengkajian Kebudayaan Sunda

reason why they return to their village to celebrate the end of fasting month (*lebaran*), making homecoming to the village a yearly mass ritual (*mudik*). The Sundanese are polite, friendly (*someah*), keep smiling, maintain discipline and respect the elderly. However, they are able to stand up for what they believe in and talk openly.⁴⁹

The Sundanese culture is rich with literature and arts. Traditional prose and oral stories (*pantun*) have developed since Padjadjaran Kingdom during the 16th century as well as songs such as *tembang*, *cianjuran*, *kawih*, *papantunan*, and *dedegungan*. Wooden puppetry (*wayang golek purwa*) is a specific Sundanese art, besides *reog*, *calung*, *angklung*, *kendang penca*, *ketuk tilu*, *longser*, *tayuban*, *gamelan* and *degung*. There are also various classic or modern forms of Sundanese dance (*tari Sunda*).

The Sundanese confess Islam, which provides guidance (*ageman*) in their daily life and for the hereafter. Islamic teaching is deepened and spread through interpretation and recitation of *al Qur'an* in houses, schools and mosques. Although Islam is the Sundanese religion, in the villages they respect various traditions, animism, mysticism, spirits, god and goddess (*dewa-dewi*), use numerical values to determine auspicious days, taboo and believe in supernatural practices.⁵⁰ They believe every stage in life, from building a house to planting seeds in a paddy to harvesting need the help of Nyi Pohaci Sanghyang Sri, life cycle ceremonies that hold special rituals (*adat*) that are not found in Islam. This creates a balanced integration of Islamic and non-Islamic rituals. The Sundanese perform a ritual circle used to draw power from the cosmos through prayers and the sharing of food (*hajat* or *salametan*). *Salametan* is to bring into a state of wellbeing (*nyalametkeun*) on an occasion, object or person. The Sundanese culture considers human existence in this

(Sundanologi) Direktorat Jendral Kebudayaan Departemen Pendidikan dan Kebudayaan, Bandung.

⁴⁹ A seminar on Sundanese culture: *Kepemimpinan Putra Sunda* (the Sundanese leadership) in Bandung, 21 August 2006. See Rosidi, A. 2008, *Kajian Tentang Falsafat Sunda*, <<http://ajip-rosidi.com/makalah/kajian-tentang-falsafah-sunda/>> viewed 20 June 2009>.

⁵⁰ Suhamihardja, A.S. 1980, *Agama Kepercayaan dan Sistem Pengetahuan*, in Ekajati, E.S. *Masyarakat dan Kebudayaan Sunda*, Pusat Ilmiah dan Pembangunan Regional, PIPR, Jawa Barat, Bandung, pp. 212-234.

world is part of cosmic power that the place, the actions, and the time should be related to universe that determines their fate and social and economic status.⁵¹

Over time, the Sundanese culture has been challenged by change and development. In the 1980s there were serious efforts by the government through the Department of Education and Culture to codify and classify the Sundanese culture into five pillars: a) their own personal value as human beings; b) personal interrelation with community; c) connection with nature or environment; d) relationship with God; and e) the need to fulfil material and spiritual satisfaction.⁵²

The Sundanese culture as manifested in local traditions, community relationships, religious proceedings and arts and literature endeavors to fulfil economic needs through various productive activities. This research examines how sociocultural beliefs and practices influence economic behavior and activities that enhance livelihood. Specific cultural beliefs and practices that will be examined include:

1. Conviction that things have to be done or not done in order to get support or blessing from “someone great” to expect economic result or avoid losses such as ritual (*hajat* or *salametan*), taboo, celebration and various customs or traditional ceremony (*upacara adat*).
2. Promulgation of Islamic teaching by Islamic local leader (*ajengan*) of an Islamic boarding school (*pesantren*) accommodates Hindu and animist beliefs through spiritual enrichment in mosques, in *pesantren* and through commercial activities.⁵³ It makes Islamic teaching able to integrate into various conditions in community and also establishes Sundanese culture where *ajengan* as a teacher (*guru*) is a respected

⁵¹ Wessing, R. 1978, *Cosmology and Social Behavior in a West Java Settlement*, Ohio University Center for International Studies, Ohio.

⁵² See Rusyana, Y., Sariyun, Y., Ekajati, E.S. and Darsa, U.A. 1988, *Pandangan Hidup Orang Sunda, Seperti Tercermin Dalam Kehidupan Masyarakat Dewasa Ini (Tahap III)*, Departemen Pendidikan dan Kebudayaan, Direktorat Jendral Kebudayaan, Proyek Penelitian dan Pengkajian Kebudayaan Sunda, Jakarta. Bab III Kesimpulan, pp. 254-259. This is discussed in detail in the literature review in Chapter 3 in this thesis.

⁵³ Woodward, M.R. 1988, ‘The *Slametan*: Textual knowledge and ritual performance in central Javanese Islam’, *History of Religions*, 28(1) pp. 54-89. See also Reid, A. 1993, *Southeast Asia in the Age of Commerce, 1450-1680*, Yale University Press, New Haven and London.

figure.⁵⁴ When *riba* emerged as a national issue during the revival of Islamic beliefs and when bank interest was declared *haram* by a *fatwa* of the Majelis Ulama Indonesia in 2004, the villagers have continued to follow their local *ajengan's* guidance to accept the payment of bank interest.⁵⁵ In fact it is a pragmatic response as the payment of interest is the only financial system existing in the villages, as well as reflecting the Sundanese cultural value to obey the recommendation of their *ajengan (tuhu ka guru)*.⁵⁶

3. Habit in balancing needs, income and expenses, or do not be wasteful and live modestly (*ulah muragkeun duwegan ti luhur*), and do not feel rich before having something in reality (*ulah beunghar memeh boga*).⁵⁷ These values support the habit of saving.
4. Beside Islamic study, the Islamic students (*santri*) are taught to work hard and are provided with practical training for self-employment in the *pesantrens* in Priangan. Traditionally the *pesantren* educate the *santri* in agriculture, fishing, weaving, sewing, *batik* works, craftsmanship and trading. *Santri* play an important role in business, especially in the region of Tasikmalaya, Garut and Cianjur.

⁵⁴ Sudrajat, E. 2008, *Relasi antara budaya Islam dan budaya Sunda*, <http://sundaislam.wordpress.com/2008/01/20/relasi-antara-budaya-islam-dan-budaya-sunda/> viewed 16 December 2009.

⁵⁵ This movement began in the 1970s at a time when the Islamic world was entering its 15th century. It took shape in the 1980s and, in the late 1990s, developed a political dimension that has continued to carry forward efforts to the present. The Sundanese have taken an active part in the Islamic revival. A study by Dr Rifky Rosjad describes the resurgence movement among young people and students in Bandung driven through prominent public mosques, the Lembaga Dakwah Kampus (LDK), and Lembaga Penelitian dan Pengembangan Pesantren Kilat (LP3K, Research and Development Organisation of Islamic Education Short Course). See Rosjad, R. *Quest for True Islam: A Study of the Islamic Resurgence Movement among the Youth in Bandung, Indonesia*. Also see via Islamic Resurgence and Tajdid (Renewal) Tradition, Rifky Rosjad, Paper, the Australian National University, Canberra. eprints.anu.edu.au/islamic/quest/mobile.../ch01s02.html viewed 1 July 2010.

⁵⁶ Warnaen, S., Djiwapradja, D., Wibisana, W., Adimiharja, K., Sukmana, N.H. and Rotoyati, O. 1987, *Pandangan Hidup Orang Sunda seperti tercermin dalam tradisi lisan dan sastra Sunda, Konsistensi dan Dinamika*, Bagian Proyek Penelitian dan Pengkajian Kebudayaan Sunda (Sundanologi) Direktorat Kebudayaan Departemen Pendidikan dan Kebudayaan, Bandung.

⁵⁷ Warnaen, S., Rusyana, Y., Wibisana, W., Garna, Y., and Djiwapradja, K. 1987, *Pandangan Hidup Orang Sunda seperti tercermin dalam tradisi lisan dan sastra Sunda*, Bagian Proyek Penelitian dan Pengkajian Kebudayaan Sunda (Sundanologi) Direktorat Kebudayaan Departemen Pendidikan dan Kebudayaan, Bandung.

5. Maintain a positive view on the capability and value of their ancestors while also deeply considering new ideas for products. Some products show a direct link with local culture such as *batik* (*batik trusmi cirebon*, *batik garut*, *batik tasik*), handicraft and blacksmiths producing machetes and agricultural equipment from Ciwidey (Pasirjambu and Lebak Larang) which is believed to have derived from Padjadjaran Kingdom.⁵⁸
6. Local know-how and traditions supported by raw materials from the environment that gives economic value such as plaited works and various handicrafts, especially *anyaman mendong* from Tasikmalaya, ceramics from Plered developed since 1904.⁵⁹
7. Creativity to develop traditional foods, traditional music, arts and the Sundanese wedding ceremony that have been developed into professional productions. Ujo's Shelter (*Saung Ujo*) is an example of professional traditional Sundanese bamboo music (*angklung*) performances in Bandung since 1958.⁶⁰

Although there are general patterns in Sundanese culture, this research argues that location, migration, occupation, the influence of other cultures and technology and the role of religious teachers influence behavior and attitudes of the people in a community in relation to their financial activities. The researcher argues that there are particular Sundanese cultural practices of the people living in rural, urban and coastal areas in West Java that also impact financial

⁵⁸ Hasanuddin, 2001, *Batik Pesisiran Melacak Pengaruh Etos Dagang Santri pada Ragam Hias Batik*, Kiblat Buku Utama, Bandung and Linder, A. *Panday Domas: Tentang nenek moyang mitos pandai besi Sunda di Jawa Barat dan kesulitan pada percobaan untuk mencari jejaknya*, <<http://www.opensubscriber.com/message/urangsunda@yahoo.com/9456319.html>> viewed 1 July 2009.

⁵⁹ Suhandi, S. et al, 1985, *Pola Kehidupan Masyarakat Pengrajin Anyaman di Tasikmalaya*, Departemen Pendidikan dan Kebudayaan, Direktorat Jendral Kebudayaan Proyek Penelitian dan Pengkajian Kebudayaan Nusantara (Javanologi), Bandung; *Mendong* handicraft or *anyaman mendong* is a specific traditional products of Kecamatan Cineam, Karangnunggal, Manonjaya, and Salopa and support their people living for so many decades. Local government has determined *anyaman mendong* as a special product of Kabupaten Tasikmalaya as stated in SK Bupati Tasikmalaya No. 522.4/189-LH/94 Tahun 1994

<<http://www.tasikmalayakab.go.id/content/view/140/31/>> viewed 24 June 2009 and Adimihardja, K. 1986, *Keramik Kerajinan Rakyat Plered di desa Anjun*, Bagian Proyek Penelitian dan Pengkajian Kebudayaan Sunda (Sundanologi) Direktorat Jendral Kebudayaan, Departemen Pendidikan dan Kebudayaan, Bandung.

⁶⁰ *Saung Angklung Ujo*, <<http://www.angklung-udjo.co.id/content/view/16/44/>> viewed 24 June 2009.

practice. As will be discussed in Chapter 2, the research will focus on the characteristics of three communities in rural, coastal and urban areas. This will include similarities and differences in bank interest; values and norms; traditional ceremonies; mutual community help (*gotong royong*); and the role of informal local leaders; work ethics, trust and honesty are influencing people's behavior in economic and social relationships.⁶¹ The role of women is also part of the study. Many women are poor, but as income earners their role is important in their households.

Two main differences distinguish this sociocultural approach from previous studies of microfinance in Indonesia. Firstly, this study focuses on how religious and cultural values influence human behavior in relation to economic improvement. Mukherjee and Suryadarma discuss the need for physical activities to support a better living such as access to basic services, education, health, infrastructure, and the right to use public utilities.⁶² Secondly, this study will examine the capacity of self-employed borrowers to improve their standard of living. This is the demand side or users' point of view in comparison to the supply side, the microfinance institutions point of view being the most common approach in Indonesia. Self-employment of borrowers is a requirement to maintain the microfinance institutions' sustainability, and to avoid direct subsidies through government budget intervention, non-government organizations or donor institutions' support to alleviate poverty.

To understand sociocultural norms and how they influence borrowers' behavior with regard to microcredit performance is an objective of the study. There are also two supplementary issues that need to be examined: 1. how far the loan officer of BRI Units (*mantri*) and BPR officers can go in accommodating borrowers' culture versus tight microcredit regulations, and 2. how microcredit influences gender relationships in family units. Microcredit induces a dynamic in social relationships; monetization of the villages makes long lasting and repeat business for the microborrowers, and develops mutual trust to support the sustainability of the microfinance institutions.

⁶¹ See Chapter 2, Research Methodology, in particular, Table 2.1: The research areas in West Java.

⁶² Mukherjee, N. et al. 2002, *ibid*, p. 3.

Concerning the level of financial sustainability, Christen divides microfinance institutions into three categories.⁶³ The first category includes the institutions in which revenue from interest and fees do not cover operating costs. Microfinance institutions in this category are heavily dependent on subsidies in the form of grants or low interest loans from donors or the government. This model of micro-financing was supported in Indonesia prior to 1983 when the government provided subsidies via the Central Bank, named liquidity support from Bank Indonesia (*kredit likuiditas Bank Indonesia*) and funding from the state budget. At that time there were various loan schemes and programs such as the rice production extension program (*kredit bimas*), small investment loans (*KIK/kredit investasi kecil*) and small, permanent working capital loans (*KMKP/kredit modal kerja permanent*). Today there are government subsidies from state and local government budgets among others for community development integrated under PNPM Mandiri programs, although the term 'microfinance' is not always used, but rather 'project financing'. Government funding is also provided for insurance premiums when the government guarantees the appointed insurance companies that give surety for the designated commercial banks that provide microcredit to microborrowers under the scheme of *Kredit Usaha Rakyat (KUR)*.

The second category includes institutions in which revenue covers operating costs but does not cover the commercial cost of borrowed funds. This category refers to microfinance institutions in which fees and interest charges cover non-financial costs, but still depend on subsidies to varying degrees for the cost of borrowed funds. In BRI this model of financing of small loans for groups of poor peasants is evident. For selective government programs this subsidy is still maintained for food procurement in disadvantaged regions or social groups. BRI has to use its own funds or share with the government and the interest (BRI income) is subsidized by the government.

The third category includes self-sufficient microfinance institutions that cover all costs and risks and generate profit. Revenue fully covers financial and

⁶³ Christen, R.P. and Rhyne, E. 1995, '*Maximizing the Outreach of Microenterprise Finance: The Emerging Lessons of Successful Programs*', CGAP Focus Note no. 2, The World Bank, Washington, D.C.

non-financial costs working on a commercial basis. This is the main system of microfinance in Indonesia practiced especially by commercial banks, such as Bank Perkreditan Rakyat and *Pegadaian* (Pawnshop). It means the poor do not have easy access to microfinance institutions meaning that over 30 million micro-entrepreneurs have less access to the existing microfinance system.⁶⁴ Local savings and credit cooperatives also need to make a profit, while the various microfinance programs in *pesantren* and in Koranic recitation and study organizations (*majelis taklim*), such as *Baitul Mal wa Tamwil* (BMTs), are in fact more dedicated to social support than financial or business activities.

Those three categories of microfinance institutions are important in determining the policy to support and provide easy access, either for the poor or better-off micro-entrepreneurs. The core of microfinance activities goes beyond mere access and distribution of money, but to deeper issues of how money is utilized and invested. It is important therefore to understand that microfinance does not stand-alone, but overlaps with existing developmental activities in their implementation. For this long-term development, sustainable microfinance institutions cannot be achieved if the institutions do not meet the needs of the people they have to support. Snow points out that those sustainable microfinance institutions must be embedded in and link with networks in local communities.⁶⁵ Here, the microfinance institutions need support, not only by building a strong financial foundation, but a socioeconomic one. This socioeconomic nature is related to the characteristics of economic activity, its demographic, physical access and environmental considerations, as discussed in the next chapter.

1.4 The importance of the study

The intention of the study, however, is not to test theory or to develop new theoretical explanations, but to understand fundamental aspects and motives of human behavior to do business, generate income, and spend money so as to

⁶⁴ Shrader, L.W. 2004, 'Regional trends in microfinance: Indonesia'. In Pakpahan, A. (ed.), *Creating Opportunities for the Poor through Innovation*, PT Bank BRI, Jakarta, p. 91.

⁶⁵ Snow, D. 1999, 'Microcredit: An institutional development opportunity', *International Journal of Economic Development*, 1(1), pp. 65-79.

fulfil microborrowers' needs in the three research locations in West Java: the rural areas of Pagerageung and Puteran, the urban area of Cimahi and the coastal areas of Kapetakan and Gebang. Furthermore, the significance of the study relates to three issues:

1. The study will contribute to our understanding the role of sociocultural factors in microfinance. Microfinance has a capacity to generate income, as well as being one of the tools to increase welfare and to alleviate poverty. As the main actor is a human being, microfinance needs to be regarded not only from a financial or business point of view, but also from a sociocultural perspective of the customer-borrower as an individual and member of the community. This integrated approach intertwines the economic aspect, that is, income generation to show borrowers' ability to pay the microloan, with sociocultural factors reflecting consistency of willingness to fulfill the loan commitment. The ability and willingness to pay the microcredit by the borrowers is a necessity to support the sustainability of microfinance institutions.

2. The study develops our knowledge of the need for microfinance institutions to pay more attention to human behavior in sociocultural and religious communities, where the institutions' borrowers live.

3. The study expects will contribute to microcredit policy, for government and non-government organizations and microfinance institutions, as well as identify issues for further research.

1.5 The contribution to knowledge

Research on microfinance in Indonesia is extensive. However, there is a need to specifically discuss the issue of microfinance with a social analysis focusing on the interaction of microfinance policy and practice, in particular, cultural settings and the link to microfinance outcomes. The study takes a sociocultural approach by raising awareness of the positive communal traits found in the culture, work ethics, and trust and honesty as a resource for business

commitment. It is an argument to convince the microfinance industry that local cultural systems should be taken into account with microcredit development.⁶⁶

1.6 Research questions

1.6.1. The objectives of the study

This study contends that sustainable microfinance, a requirement to support the poor and micro entrepreneurs are influenced by financial and sociocultural aspects. It will examine how a variety of sociocultural practices and values influence microborrowers' behavior, and how these practices and values impact the sustainability of microfinance programs. The study will cover and examine three issues:

The first is to access and ascertain how, why and to what extent Sundanese culture influences, positively or negatively, the behavior of the microborrowers in rural, coastal and urban areas. In order to maintain microfinance sustainability it is not sufficient if microcredit is handled only by using traditional banking practices.⁶⁷ Microcredit risk and control should be developed not only from an economic and business perspective, but also local cultural practices need to be considered. In other words, sustainable microfinance requires some accommodation with the cultural values of borrowers' communities.

Sociocultural issues need to be analysed, as practiced in everyday life, such as the prohibition of interest as *riba* under Islamic principles, trust and honesty, work ethics, maintaining a balance of natural resources, cost bearing for traditional ceremonies, the role of gender, the role of informal leaders, attitude to money, effects of migration and self-help. This is how culture and local cultural systems link individual traits to the success or failure of

⁶⁶ The local cultural system is a term for a ('local') society. It contains value system, perception, knowledge, ethics, morale, rules, and technology that are based on cosmological perspectives. See Turmudzi, M.D. et al. 2005. *Berkarya di Belantara Budaya: Dinamika Budaya Lokal, Partisipasi dan Pembangunan*, Indra Prahasta, Bandung.

⁶⁷ Sustainable is generally defined according to the standard of the Consultative Group Against Poverty, implying that the credit effort covers all of its costs including what the 'real,' i.e. unsubsidized cost of its capital would be. See Timberg, T.A. 2003, *What I Learned in Indonesia: Nine Salient Points on the Indonesian Financial System and Small and Micro Credit*: Nathan/Checchi Joint Venture Partnership for Economic Growth (PEG) Project, USAID Contract 497-0357.

microfinance. In short, the socio culture of borrowers is the focus for this study as Garna, Soemardjan and Soedjatmoko argue that economic development cannot be value-free. In this context, it is useful to examine the interpretation of culture and its impact on the economy.⁶⁸ It is to understand how to treat people in different local social, cultural and economic settings that need a different human approach. This is why three case studies in rural, coastal and urban settings were undertaken in order to identify the similarities and differences in respective sociocultural practices that can influence the local people's behavior.

The second issue is to examine the effect of sociocultural practices to develop creditworthiness and trust to link borrower's individual characteristics to the success of the microfinance program. It means how the BRI produces more profits and promotes micro-business and how the microborrowers increase their income and develop their businesses. Here, promoting business is the mutual concern for both microfinance institutions and borrowers.

Building trust is the most important process in microcredit assessment; this is the way microfinance institutions and borrowers bridge asymmetric information, reduce social complexity and develop cooperation through direct communication.⁶⁹ This is a character-based lending approach to maintain borrowers' willingness to pay the loan and indirectly supervise them. Here we explore whether the microfinance institutions in the villages of three different research areas adopt different approaches, recognizing divergent economic structures and cultural settings. Or, on the contrary, do they employ a uniform approach that considers microfinance is only business and profit without any local sociocultural sensitivity? This study examines the lenders' strategies on microfinance: how far local cultures and social and economic structures influence microcredit evaluation and supervision by the microfinance institutions.

The third issue is to look at the role of women in microfinance. It is interesting to understand the position of men and women in relation to

⁶⁸ DiMaggio, P. 1994, 'Culture and economy'. In Smelser, N.J. and Swedberg, R. (eds.), *The Handbook of Economic Sociology*, Princeton University Press, Princeton.

⁶⁹ Misztal, B.A. 1996, *Trust in Modern Societies: the Search for the Bases of Social Order*, Polity Press, Cambridge.

microcredit, since it is commonplace assumption that one of the main disadvantages for poor women is their limited access to formal credit. Women suffer even greater discrimination because traditional patriarchal values, as in Sundanese culture, exclude their de facto ownership of assets and because the work that women generally engage in at home is not classified as economically productive. The role of women in microfinance will be explored as many advocate that microcredit mostly benefits women. But women need empowerment to generate cash income for self-employment.⁷⁰

1.6.2. Propositions and research questions

To achieve the objectives of the study, prior to field research, the researcher investigated the following propositions.⁷¹ These propositions are regarded as concepts to be used as a precursor for interviews, focus group discussion and observations to find evidence relating to the research questions as follows:

1. Access to microfinance institutions: BRI Units and BPR determine the standard operating procedure to be accessed by the applicants. Although the regulations are gender neutral in that women and men have equal opportunity to access loans, it is anticipated that men have priority in patriarchal communities.
2. Empowerment and the risk: Empowerment to make the applicants bankable through training is needed to protect the bank from risk of the borrowers' business failure.
3. Debt and poverty: Providing microcredit to alleviate poverty is considered a risk. If the business fails and the loan turns bad, the microborrower is faced with financial and legal problems and can slip back into poverty. Poverty alleviation is normally implemented through government programs.
4. Debt and social status: Having debt influences social status. In the Sundanese culture for *menak* (*priyayi*, civil servant, bureaucrat), having

⁷⁰ Khandker, S.R. 1998, *Fighting Poverty with Microcredit: Experience in Bangladesh*, Oxford University Press for the World Bank, New York.

⁷¹ The propositions as assumptions prior to the field research are influenced by experiences and inevitably framed by our implicit concept, our own feelings and perceptions. See Miles, M.B. and Huberman, A.M. 1994, *Qualitative Data Analysis*, Sage Publications, Thousand Oaks, p. 9.

- debt decreases one's social standing. On the contrary, for the trader (*pedagang*), non-civil servants (*orang partikelir*), supported by microcredit and with success in creating wealth, this can enhance the borrowers' social status in the community.
5. Monetization of village economy and culture: It challenges traditions and disrupts social status and hierarchy. Money is an effective tool to absorb external cultures and can be used to replace mutual social obligations (*gotong royong*) with a monetary payment. However, monetization fuels the village economy.
 6. Bad debt and religion: There is a positive relationship between strong religious beliefs and a low level of bad debt.
 7. Bank interest and *riba*: Interest payments are against Islamic principles and prohibited (*haram*). The reason why the villagers in this study accepted payment of interest was because of their financial needs. In addition, the payment of interest was endorsed by the local *ajengan*.
 8. Microcredit and gender equality: The Sundanese maintain the tradition of patriarchy and, as in Islam, the husband plays a role as leader and protector of the family unit. Although the bank provides women with microcredit the wife and husband are not equal and the husband remains the decision maker of the business and the loan.
 9. Traditions, habits and religion versus microfinance regulations: Local tradition and religion are held and practiced in villagers' daily lives and business. But when they are faced with microcredit regulations they have to make a choice: either to mitigate their tradition and religion to comply with banks' orders or discard microcredit.
 10. Work ethics: The borrowers' work ethics are influenced by religion and local traditions. But the researcher argues that microborrowers also follow business ethics as determined by the bank.
 11. Trust: Generally the villagers can be trusted as they have good intentions to use microcredit for agreed purposes. Trust is more fragile however in urban areas.

12. External influences: The dynamic of external values influence villagers' lives as they can support, disturb and conflict with traditional ideals of borrowers.
13. Sociocultural sensitivity in loan analysis: The *mantri* of BRI and the BPR officers investigate and accommodate the role of culture in their microcredit assessment.
14. Profit making: BRI and BPR are profit-making institutions, which induce them to make loans, mainly with better-off borrowers. Poverty alleviation is indirectly supported through a trickle-down effect.

The researcher considers these propositions can be used as a frame of reference, as the building blocks of the study. Applied in the research methodology they are an entry point to explore the data collected in the research areas. The study is directed to answer the following research questions:

1. What are the influences of sociocultural aspects, such as local customs, values, norms, ethics and trust of the borrowers, on the practical operation arrangement and sustainability of microcredit? By understanding people's socio culture in daily practices, can borrowers' creditworthiness and trust be accepted as collateral?
2. Most of the borrowers profess Islam, but payment of bank interest is *riba* and is prohibited in Islam. How has the payment of bank interest been accepted and how do the borrowers reconcile their religious beliefs with their use of microcredit?
3. How do poor and low income men and women experience the screening process of microfinance institutions?
4. Men are responsible by law and Islamic principles as head of household and as the principal income earner. Do the microfinance institutions give priority on borrowing to men rather than women?

1.7 The history of microfinance in Indonesia

Indonesia has a long history of microfinance and here we can find both continuity and change. It began when the Dutch colonial administration supported the Poerwokerto Support and Savings Bank for Netherlands Indies Civil Servants (*Poerwokertosche Hulp-en Spaar Bank der Inlandche Bestuur Ambtenaren*) established in 1895 in the city of Poerwokerto (Central Java). Later, it was followed by various rural financial institutions, such as the Paddy Storage (*Lumbung Desa*), providing paddy loans and the Village Bank (*Bank Desa*). A *Bank Desa* historically was a *Lumbung Desa* but has provided loans since 1904.⁷²

In 1901, the Netherlands government proclaimed a colonial policy of decentralization and cooperative development. A new policy became well known as the Ethical Policy, with its primary objective to raise the standard of welfare among the people in the Netherlands Indies. To implement this policy, the colonial government took initiatives among others to improve agricultural productivity and to develop rural credit institutions with microcredit. This government intervention was designed with the following considerations:

1. Microcredit was used as a tool for poverty reduction to encourage mutual self-help practices (*gotong royong*) between the villagers to store paddy supplies for emergency situations.⁷³
2. In the opinion of the colonial officials, the exploitative operation of the Chinese and Arabic moneylenders was the reason for indigenous poverty. In fact, poverty, rural indebtedness, the usury and other misconducts arose from the impact of government economic policies

⁷² Steinwand, D. 2001, *The Alchemy of Microfinance*. VWF, Berlin and Fruin, T.A .1933, *History, Present Situation and Problems of the Village Credit System (1897-1932)*, Klaas Kuiper, 1999 (trans.) and (ed.), Ministry of Foreign affairss Development Cooperation Department (DRU), The Hague.

⁷³ J. Homan van der Heide explained the decline in the prosperity of the indigenous population in Java as an impact of liberalism on Dutch colonial policy. He argued for the need to increase indigenous population's buying power to support the Netherlands and the Netherlands India economy. The expectation was stated in various newspapers in Amsterdam, Batavia and Semarang that 'the government will do everything possible to increase people's prosperity'. See van der Heide, 1901, *Economic Studies and Criticism*, in Penders, C.L.M. 1977, *Indonesia, Selected Documents on Colonialism and Nationalism, 1830-1942*. (ed. and trans.), University of Queensland Press, St. Lucia, p. 60.

over many decades.⁷⁴ It seems there was an attempt by the Dutch officials to shift the blame from government policy to the moneylenders. But the government realized that the moneylenders remained a major obstacle to rural development. Then the government used microfinance to fight moneylenders, in order to maintain the stability of colonial society from social and political disturbances.⁷⁵

3. The colonial administration pursued a dual approach to Muslim communities in the Indies. On one hand, the government supported the performance of Islamic rituals, the development of Islamic education and, in the economy, the provision of microcredit to raise welfare in the hope that Muslims would be loyal to the government. On the other hand, the Dutch authorities sought to totally destroy any effort of the indigenous (*pribumi*) and Muslims to challenge the government's authority or show any signs of support for the fanaticism of Pan-Islamism.⁷⁶ Microcredit did not represent a 'good deed and kind-hearted' intentions of the colonial government, but it was the strategy designed to bind the Muslims to the Dutch colonial policy and suppress any resistance.

To implement these strategies, the government developed the rural credit institutions: the District Bank (*Afdeelingsbank/Bank Rakyat*) then converted into *Algemeene Volkscredietbank (AVB)*; the Village Bank (*Bank Desa*); the Paddy Bank (*Lumbung Desa*); and took over the Chinese licensed pawnshops which meant the government directly controlled all pawnshops in the colony. From 1913 those microfinance institutions were supported by government funds.⁷⁷ Schmit describes the progress of rural credit institutions:⁷⁸

⁷⁴ By 1900 the majority of Dutch politicians worried about the serious decline in indigenous buying power and had become convinced that *laissez-faire* colonial policies had run aground and more effective policies should be developed to improve the colonial economy. See Penders, C.L.M. 1977, *Indonesia, Selected Documents on Colonialism and Nationalism, 1830-1942*. (ed. and trans.), University of Queensland Press, St. Lucia, p. 62.

⁷⁵ Steinwand, D. 2001, *The Alchemy of Microfinance*, VWF, Berlin.

⁷⁶ Khuluq, L. 2002, *Strategi Belanda Melumpuhkan Islam, Biografi C. Snouck Hurgronje*, Pustaka Pelajar, Yogyakarta, pp. 43-44. Pan-Islamism is the movement which accentuated the religious content of politics and stressed the importance of cooperation among all Muslims of the Middle East and Asia. See also Federspiel, H.M. 2001, *Islam and Ideology in the Emerging Indonesian State, The Persatuan Islam (Persis) 1923 to 1957*, Koninklijke Brill NV Leiden, The Netherlands, pp. 101-102.

⁷⁷ Fruin, T.A. 1933, *History, Present Situation and Problems of the Village Credit System (1897-1932)*. Klaas Kuiper (trans. and ed.), 1999, Ministry of Foreign Affairs DRU, The Hague.

1. The rural credit institutions with interest systems were developed in Java and Madura, and the Outer Islands.
2. The Muslim villagers did not reject the system, especially in West Sumatra, Bengkulu, Palembang, South Sulawesi, Java and Madura; many Muslims accepted bank interest as they earn their living from trading. This attitude was reflected in the views of Sarekat Dagang Islam, established in 1905 by H. Samanhudi and Muslim traders in Surakarta central Java, which became the largest anti-colonial organization before the Pacific War.⁷⁹
3. Microcredit was the only government system that supported the indigenous population with capital and replaced the usury of the moneylenders.
4. Government efforts to alleviate poverty were not a success, and the government faced the downward spiral of world prices that dramatically decreased the indigenous populations' income during the Great Depression.

The impact of the Japanese occupation from 1942 to 1945, and during the early years of Indonesian independence microfinance activities were obstructed by the lack of infrastructure, organization and management problems.⁸⁰ During the Sukarno presidency in 1946 the government established the Bank Rakyat Indonesia/BRI to provide financial services to farmers, cooperatives and Indonesian entrepreneurs. In 1950, the former *Algemeene Volkscredietbank/ AVB* merged with the BRI, with 63% of its loan portfolio in village domain credit.⁸¹

⁷⁸ Schmit, L.Th. 1991, *Rural Credit Between Subsidy and Market*. Leiden Development Studies, Leiden. See also Marguerite S. Robinson (2002), who described Bank Rakyat Indonesia's history and other financial institutions established in Indonesia from the Dutch period until 1999 in *The Microfinance Revolution, volume 2: Lessons from Indonesia*. Washington, D.C. The World Bank and Djohadikusumo, S. 1989, *Kredit Rakyat di Masa Depresi*, Jakarta: LP3ES, translated from his PhD thesis *Het Volkscredietwezen in de Depressie*, 1943.

⁷⁹ Kahin, G.M. 1952, *Nationalism and Revolution in Indonesia*, Cornell University Press, Ithaca, New York.

⁸⁰ Interview with Jamie Mackie, Melbourne, 24 August 2006.

⁸¹ Schmit discusses the conditions of the District Banks, the Village Bank and the Paddy Banks since the Japanese occupation during 1942-1945, establishment of The Syomin Ginko

During the New Order period we can see two phases in the government's microfinance policy. The first phase was the period from 1970 to 1983 when the government provided liquidity, goods and services to support the poor and small indigenous enterprises. The second phase commenced in 1983, when the government allowed the market forces to function with less government intervention. The change in government policy on poverty was important as the government determined that microfinance programs were to be administered through the banking system. Consequently, the market for microfinance shifted from 'unbankable' borrowers to 'bankable' customers and microcredit was provided based on commercial considerations.⁸²

In the first period, the government adopted a top-down approach of promoting government policies and mobilizing the rural population for the implementation of centrally planned programs. Within this period various subsidized microcredit schemes were promoted by the government through the banking system. The schemes were designed to support indigenous individuals, indigenous small enterprises and cooperatives. These schemes included credit to rice farmers, a massive government-subsidized agricultural credit program for rice cultivation (*kredit bimas*), *Kredit Usaha Tani /KUT*, *Kredit Mini and Kredit Midi* routed through Bank Rakyat Indonesia Unit Desa. After that Bank Indonesia issued Small Investment Loans (*Kredit Investasi Kecil/KIK*) and Small Permanent Working Capital Loans (*Kredit Modal Kerja Permanen/KMKP*). These were unsecured loans, but they had to be insured by a state insurance company, PT Askrindo.⁸³

From an institutional point of view, Bank Indonesia, the Central Bank of Indonesia, reorganized the operation of the Village Banks (*Bank Desa*), the Paddy Banks (*Lumbung Desa*), Market Bank (*Bank Pasar*), Cooperative Bank (*Bank Koperasi*), and Employees Bank (*Bank Pegawai*) that existed in the economy with their own funds. The reorientation of these secondary banks was

Corporation, co-existence of the AVB and BRI between 1947 and 1949 and BRI under Sukarno's presidency. See Schmit, L.Th. 1991.

⁸² 'Bankable' is a term used in the in the financial sector for a business or individual customer who has sufficient collateral, future cash flow and high probability of success. In contrast, 'unbankable' means that an applicant has insufficient collateral, negative or slow cash flow and low probability of success.

⁸³ These are subsidized loans, as discussed by Robinson, M.S. 2002, *ibid*, pp. 48-52.

managed under the name *Bank Perkreditan Rakyat/BPR*, a generic term for People's Bank and reminiscent of their colonial predecessors: the people's banks (*Volksbanken*). The BPR had to collect their own source of funds and design their own loan schemes and the government did not provide liquidity for their operation.

In the second period, post 1983, Indonesia began a process of economic deregulation to free entrepreneurs and markets from government intervention. Bank reform was the essential element of the deregulation movement, where the credit ceiling of the banks, as determined by Bank Indonesia was removed, and all banks were given authority to determine their own interest rates for deposits and loans and growth of loan portfolios. The government terminated subsidies for microfinance loan programs and all banks were free to collect funds, including savings, demand deposits and time deposits and to finance loans including microcredit.

These reforms sought to minimize the role of the government and to apply outward looking strategies.⁸⁴ It stimulated market forces and the government could only step in if the market could not achieve the desired outcomes.⁸⁵ On the other hand, the government considered the important role of societal self-organization besides the role of market. Various non-government organizations (NGOs) sought to monitor and hold the government accountable for its programs, policies and budget. These NGOs advocated the development of good corporate governance. Cernea argues this societal perspective is developed by a new view on participatory development.⁸⁶ Jazairy explains that growth inducing poverty alleviation and the drive to promote participation should

⁸⁴ Gindle, M.S. and Thomas, J.W. 1991, 'Policymakers, policy choices, and policy outcomes: Political economy of reform in developing countries' and Roemer, M. and Radelet, S.C. 1991, 'Macroeconomic reform in developing countries'. Both in Perkins, D.H. and Roemer, M. (eds.), *Reforming Economic System in Developing Countries*, Harvard Institute of International Development, Harvard.

⁸⁵ Roemer, M. and Radelet, S.C. 1991, 'Macroeconomic reform in developing countries'. In Perkins, D.H. (ed.), *Reforming Economic System in Developing Countries*, Harvard Institute of International Development, Harvard.

⁸⁶ Cernea, M.M. 1987, *Putting People First: Sociological Variables in Rural Development*, Oxford University Press, New York.

be seen as the expression of democracy at the grassroots by strengthening the economic and political power of those previously marginalized.⁸⁷

Since 1983, microfinance institutions in Indonesia have had to design their own microcredit programs to be financed by their own resources and without government subsidy. This means a shift from subsidized credit programs toward business orientation credits; this is a commercialization process where microcredit is not only provided to develop the poor and small-enterprises but also for profitability and sustainability of institutions. With this shift in government policy, microfinance institutions were required to prioritize profitability and sustainability, rather than alleviate poverty, with the result that more poor people had limited access to microcredit.

Bank Indonesia considers microcredit loans up to a maximum of 50 million rupiah (about US\$ 5,000) and microfinance is operated through a large variety of private and public institutions.⁸⁸

1. Most of the microfinance activity in Indonesia is operated by formal institutions on a commercial basis. There are commercial banks, either fully private or partly owned by the government (such as Bank Mandiri, BRI, Bank Tabungan Negara (BTN) and Bank Negara Indonesia (BNI), owned by provincial government Bank Pembangunan Daerah (BPD), the BPR system; the *Shari'ah* Bank is regulated by Bank Indonesia. Some banks channel funds to small financial institutions or cooperatives to be re-lent as microcredit, but only a few commercial banks have their own units to provide microcredit. Another formal non-bank financial institution is *Perum Pegadaian*, a state-owned network of pawnbroker shops. As mentioned previously, the government liberalized the pawnbroker business in 2002, ending its monopoly after more than a century, allowing the banks or private firms to act as pawnbrokers.

⁸⁷ Jazairy, I.M. et al. 1992, *The State of World Rural Poverty: An Inquiry into its Causes and Consequences*. New York University Press, New York.

⁸⁸ This discussion is based on Charitonenko, S. and Afwan, I. 2003, Steinwand, D. 2001, Holloh, D. 1998, and Robinson, M.S. 2001.

2. The main semiformal microfinance institutions are the Rural Fund and Credit Institutions (*Lembaga Dana dan Kredit Pedesaan/LDKP*) and the Village Credit Board (*Badan Kredit Desa/BKD*). *LDKP* is a general term to describe a variety of regional non-bank financial institutions established by provincial or district governments, mainly during the 1970s to 1990s and unable to be upgraded to reach BPR status. It also consists of various local 'quasi banks' such as *BPR Lama*, *Badan Kredit Kecamatan/BKK* in Central Java, *Kredit Usaha Rakyat Kecil/KURK* in East Java, *Bank Karya Produksi Desa/BKPD* and *Lembaga Perkreditan Kecamatan/LPK* in West Java, *Lembaga Kredit Pedesaan/LKP* in Lombok, *Lumbung Pitih Nagari/LPN* in West Sumatra, and *Lembaga Perkreditan Desa/LPD* in Bali. *Badan Kredit Desa/BKD* consists of the Village Bank and the Paddy Bank is a semiformal BPR system, a village-level financial institution established in the Dutch colonial period. They are tiny institutions without any government or local government subsidy, and they try to reach their low income members or customers in the villages. The BKDs provide financial services on demand with a significant outreach to low income groups in the villages, but they are not commercial in their approach to microfinance. The BKDs in East Java performed well but in general they were poor. The BKDs are supervised by the BRI.
3. Microfinance cooperatives are defined as cooperatives that provide microfinance services and are licensed, regulated and supervised by the Ministry of Cooperatives. Cooperatives specializing in financial services are known as Savings and Credit Cooperatives (*Koperasi Simpan Pinjam/KSP*). Multipurpose cooperatives are allowed to finance microfinance if they operate an organizationally differentiated Savings and Credit Unit (*Unit Simpan Pinjam/USP*). Credit Unions (*Koperasi Kredit*) do not differ in terms of organization and operations from savings and credit cooperatives. There are also *Baitul Mal wa Tamwil (BMT)* that operate as cooperative *shari'ah* institutions.

4. Other alternative forms of microfinance include informal networks such as friends and relatives, traders, financial self-help groups or *arisan* (rotating savings and credit association/*rosca*) and moneylenders.

The abovementioned formal institutions: the banking system, cooperatives and pawnshops, and semiformal microfinance institutions together serve micro customers.⁸⁹ Table 1.1 represents their operations in 2009:

1. Only 42.0 million (or less than 30.02%) of about 139.9 million Indonesians above 15 years old have access to microcredit.⁹⁰ Limited to only 20–50% of the population; this is not enough and would leave large segments of the population and their talents and innovative capacity untapped.⁹¹ To promote pro-poor growth, it is important to improve access, not only to the poor, but to all who are currently excluded. This means that microfinance institutions face a high, unmet demand of an estimated over 30 million Indonesians with small businesses who have no access to financial services.
2. From the supply side, the outreach capacity of microfinance institutions is relatively low, as they have limited networks to access and tend not to cultivate less poor and ‘unbankable’ people. They prefer to serve lower-middle class or solid middle class clientele.⁹² In this complicated situation, the villagers who need credit have no alternative to informal microfinance providers.
3. Cooperatives and pawnshops serve about 70% of all microborrowers. Pawnshop borrowers provide sufficient assets for collateral as the means to get a loan; it is collateral based on lending and not business assessment risk. The Koperasi *Syari’ah*, BKD, LKM and LDKP show the

⁸⁹ See also Bedson, J. 2009, *Laporan Industri Keuangan Mikro: Indonesia*, Global Innovation Consulting (GIC), The Foundation for Development Cooperation (FDC), Banking with the Poor Network (BWTPNetwork).

⁹⁰ Sensus 2000, Indonesians above 15 years was 139.991.800. Statistical Year Book of Indonesia, 2002, *Poverty*, Badan Pusat Statistik, Jakarta.

⁹¹ World Bank, 2008, *Finance for All? Policies and Pitfalls in Expanding Access*, A World Bank Policy Report, The World Bank, Washington, D.C., p. 12.

⁹² For example, see Asian Development Bank 2000a, *Report and Recommendation of the President to the Board of Directors on Proposed Loans and Technical Assistance Grant to the Republic of Indonesia for the Community Empowerment for Rural Development Project*, RRP: INFO 32367. ADB, Manila. <http://www.adb.org/Documents/RRPs/INO/rrp-L1765.pdf>

lowest ratio of one borrower to average loans outstanding of 400,000 rupiah per borrower. It indicates most of their members have limited access to a bigger loan as they use the loan for consumption and have a low capacity to generate income.

Table 1.1 Major Indonesian microcredit providers, December 2009

Institutions	Number of institutions	Number of borrowers (000)	Loans Rp. (billion)	Number of depositors (000)	Deposits Rp. (billion)
1	2	3	4	5	6
Banks:					
BRI Units: 1)	4,539	4,742	54,076	21,429	75,334
Bank Pembangunan Daerah, BPD 2)	1,876	1,672	38,657	n.a	n.a
BPR 2)	1,733	3,800	28,001	7,735	25,552
Danamon SP 3)	1,200	500	12,300	p.m	p.m
Cooperatives:					
Saving/Credit Coop 4)	71,365	5,707	8,916	5,707	7,466
Credit Union 4)	947	1,350	5,762	1,350	4,239
BMT/Syariah 5)	138	n.a	793	n.a.	726
Koperasi Syariah 6)	3,038	1,200	157	n.a.	209
NonBank Fin Inst:					
Badan Kredit Desa/BKD 7)	4,171	359	285.0	,438	63.2
LSM/NGO/LKM 6)	1,146	400	508	290	188
LDKP 6)	2,272	1,300	358	n.a	334
Pawnshop 8)	3,297	20,979	14,195	No savers	No deposits
Total:	95,722	42,009	164,008	36,949	114,680

- Sources: 1) Statistik BRI Unit December 2009, including KUR Micro up to 5 million rupiah. KUR Retail from BRI, BNI, Bank Mandiri, BTN, Bukopin, BSM from 5mo to 500mo is not included as microcredit.
- 2) Bank Indonesia 2011, Direktorat Kredit, BPR dan UMKM; Kementerian Dalam Negeri, Dirjen Keuangan Daerah, 2008, Perkembangan Jaringan Kantor Bank Pembangunan Daerah Seluruh Indonesia s/d December 2008.
- 3) Danamon Simpan Pinjam <http://bataviase.co.id/node/127334> and <http://www.kabarindo.com/?act=dnews&no=14748>.
- 4) Kementerian Koperasi dan Usaha Kecil dan Menengah, 2010, Urusan Pengembangan dan Pengendalian Simpan Pinjam.
- 5) BMT Center 2009; the figure only represents the BMT institutions under the BMT Center Network majority in Java Islands.
- 6) Kementerian Koperasi dan UKM, Statistik Koperasi 2007.
- 7) Bank Indonesia, 2011, Direktorat Kredit, BPR dan UMKM.
- 8) Pegadaian, Annual Report 2010.

Prior to its cash ratio calculation, BRI Units accumulated 75,334 billion rupiah from small depositors but provide only 54,076 billion rupiah for microcredit. After 10% reserve ratio there was 13,725 billion rupiah (at US\$ 1.3 billion in 2009) from an excess of savings deposits over loans that have grown since 1989.⁹³ This means that the BRI has reinvested more than 18% of the deposits mobilized from the villagers and invested these funds in retail, medium or corporate services for urban borrowers and the more affluent clientele of the bank, rather than helping the poor.⁹⁴ Except for emergency situations, the government has supported the commercialization of microfinance, most notably in the BRI. However, there is popular pressure for bottom-up approaches with greater social participation, as has been developed in the PNPM Mandiri program.⁹⁵

Bank Rakyat Indonesia (BRI) plays an important role in this study, reflecting the bank's history and the character of the microcredit programs in the BRI Units. It is in this context that the villagers' sociocultural life needs to be understood, as follows:

1. The BRI has maintained a long relationship with villagers. The bank is well situated to provide financial services to the rural areas. This role has developed since 1957 when BRI was appointed by the government to be involved in national rice production programs, paddy center programs, fertilizer procurement activities and especially for the mass guidance program (*bimbingan masal/ bimas*) in 1964.⁹⁶ These programs were channeled through the BRI Village Units (*BRI Unit Desa*). Here the BRI only executed government designed programs as a government agency. During this *bimas* period the BRI had no influence in the selection of microborrowers' and also ignored sociocultural factors in the enforcement of loan repayments. The

⁹³Table 1.1, BRI Units column 4 for microloans and column 6 for deposits are collected from villages. See also Bank Rakyat Indonesia, 2009, *Laporan Statistik BRI Unit, bulan Desember 2009*, Kantor Pusat PTBRI (Persero) TBK, Jakarta.

⁹⁴ See Chapter 5, Table 5.6, BRI loan portfolio and its 'direct poverty lending', rows 1, 2 and 4.

⁹⁵Holloh, D. 1998, *Microfinance in Indonesia: Between State, Market and Self-Organization*, Lit Verlag, Hamburg.

⁹⁶ Kuiper, K. 2004. *Act or Accident? The Birth of Village Units of Bank Rakyat Indonesia*, GTZ GmbH, Esschborn.

bimas programs were abolished in 1983, with the government's deregulation of the banking system.

2. Following advice from the Harvard Institute for International Development's (HIID) study, subsidized loans that had been channelled through BRI Village Units, were transformed into a sustainable system of commercial loans.⁹⁷ The *Kupedes* loan program, implemented from early 1984, was a form of general purpose credit provided at commercial interest rates. The World Bank supported *Kupedes* at a time when the program was still fragile and prone to outside pressure, which had suffered setbacks from droughts in 1988 and in 1990 to 1992 caused a rural recession, increasing arrears and reducing demand for credit. The BRI worked hard to reduce bad debts and paid more attention to the creditworthiness of borrowers and productive loans. The dynamics of market competition, the monetary crisis in 1997/1998, and policy to accommodate cultural values in 2003 and 2006 made microcredit available not only for productive purposes but also for consumptive and sociocultural purposes as long as the sources of repayment were clear and sufficient.
3. BRI Units inherited from BRI Village Units are free to offer *Kupedes* to any creditworthy borrower including general financing for small business in the villages, not just in the agriculture sector, but in any sector and for whatever purpose.⁹⁸ It means that *Kupedes* is eligible for business and also non-business needs as long as the source of repayment is well calculated and sufficient.⁹⁹ Since 2008 BRI Units

⁹⁷ See Robinson, M.S. 1995, The paradigm shift in microfinance: A perspective from HIID, <www.cid.harvard.edu/hiid/510.pdf>.

⁹⁸ See Independent Evaluation Group (IEG), The World Bank Group, 2001, <http://lnweb90.worldbank.org/oed/oeddoclib.nsf/DocUNIDViewForJavaSearch/7DBBAC3B636F7FDC852567F5005D8AD3>.

⁹⁹ BRI policy on microcredit and the abovementioned evaluation of IEG, The World Bank Group in 2001 is consistent with BRI Units officer's explanation in three research areas as found in interviews with Nanang Suhendra, BRI Unit Cimindi, 13 February 2006; Endang Sumarna, BRI Unit Puteran, 3 March 2006; Aris, BRI Unit Gebang, 28 March 2006. *Kupedes* is used for general purpose financial needs of the borrower as long as it is supported by a clear and sufficient source of repayment.

have been assigned to provide *Kredit Usaha Rakyat Mikro (BRI KUR-Micro)* as a new microcredit product to villagers in rural, coastal and urban areas.

4. Instead of charging an annual rate, the BRI follows rural lending traditions, charging a flat lending rate of 1.50% a month. This method translates into a 33% annual interest rate, as opposed to 12% under the pre-1983 subsidized program. In addition, a refund is provided to borrowers who pay the installments and interests on time; this incentive system is stipulated in *Kupedes* regulations.¹⁰⁰ *Kupedes* microcredit has been operating for more than 25 years; the system has dominated BRI Unit's standard operations all over the country and has become a model of microcredit in Indonesia. The village community is the BRI Unit's main market for its microcredit programs, which makes the village economy, environment and culture as the socioeconomic entity to be understood by the *mantri* and BRI Units management. It is important to note how far sociocultural factors influence financial aspects and business risk, either to support or restrain in the process of loan assessment. The BRI Unit determines whether a microcredit loan can be made based on BRI's commercial criteria but it has discretion to consider local sociocultural conditions regarding moral issues, religion and customs of the community. Combining commercial criteria with sociocultural considerations is general policy for BRIs' microcredit as BRI head office resolved that business and economics are not culture-free. BRI microcredit transactions are not only an economic processes but also have an irreducible cultural component.¹⁰¹

¹⁰⁰ It is known as *Insentif Pembayaran Tepat Waktu (IPTW) dan Restitusi Bunga*, see Surat Edaran/Circular Letter Bank Rakyat Indonesia no. NOSE S.57-DIR/BUD/04/90 dated 23 April 1990: Beberapa Perubahan Dalam Ketentuan Kupedes.

¹⁰¹ Bank Rakyat Indonesia, 2003, *Pedoman Pelaksanaan Kredit Bisnis Mikro PT Bank Rakyat Indonesia (Persero)* Bab I hal. 9, BRI Kantor Pusat, Jakarta See also DiMaggio, P. 1994, 'Culture and economy', in Smelser, N.J. & Swedberg, R. (Eds.) *The Handbook of Economic Sociology*, Princeton University Press, Princeton, p. 27.

In this study, the writer examines how BRI Units, the BPR and cooperatives accommodate local sociocultural values in loan assessments, on one hand, while maintaining commercial considerations and risk assessments, on the other.

1.8 Organization of the thesis

The thesis will be divided into eight chapters.

Chapter 1 discusses the important role of microfinance as one of the instruments to support poverty alleviation and to support micro entrepreneurs. This study is directed to social cultural aspects and behavior of the borrowers in a three-research area in West Java in order to produce an integrated understanding of the impact on microfinance institutions. In this chapter we can see the significance of the study, the interaction between individual traits of culture to the success of microfinance implementation and to convince microfinance industry of the important role of a social and local culture approach. In the last part of the chapter there is a discussion of the history of microfinance institutions in Indonesia since the early twentieth century and the role of the government to support microfinance and poverty mitigation.

Chapter 2 outlines the research methodology. This chapter describes the research paradigms adopted in this study, the use of triangulation, and the underlying reasons why three different research areas were chosen. In addition this chapter also describes the research procedures, data collection procedures through secondary data and primary data of interviews, focus group discussion and observations and how the data is analysed.

Chapter 3 is a review of the literature. It discusses the theoretical framework of microfinance, the role of microfinance in the economy and the reason it is recommended as one of the significant tools for poverty alleviation. The important role of socio culture that supports microfinance development as stated by various authors and the important issue of *riba* is part of discussion of this chapter. This chapter is followed by the findings of the field research and analysis is presented in Chapters 4, 5, 6 and 7.

The impact of the local social value system, work ethic and trust on microborrowers' behavior is examined in Chapter 4. The researcher has examined the sociocultural aspects of the respondents' daily life and it is argued that cultural values influence their behavior and their microcredit transactions. The research found extra spending derived from the conduct of traditions and *salametan*, various Islamic celebrations and family life cycle events. It is argued that the microfinance institutions should recognize that borrowers need microcredit money for these unavoidable consumptive purposes. On the other hand, socio culture is a rich resource for business opportunity financed by microcredit to generate incomes. Ethics and trust building in changing social environments is an important part of the discussion besides trustworthiness as a concept to support capability of microborrowers.

Chapter 5 discusses and analyses socioeconomic impact of microcredit, screening system and risk of bad debt to the borrowers and lender that links to sustainability of microfinance institution. It is found that outreach of microcredit facilities is important to achieve effective results on villagers' livelihood and how far money and debt have sociocultural and financial influence. Screening mechanisms are the way to find bankable borrowers but exclude the poor people in the villages as they lack capacity to repay and lack of assets collateral. They need direction to find access to formal microfinance recourses. Screening process is also discussed from the lenders point of view, as they have to select good and trusted borrowers at higher level trust and ethics need to generate income and minimize risk. This chapter examines the borrowers' risk if the business fails or experience malpractice and sociocultural reasons that bring the borrowers into financial problems the way they are trapped into non-performing loan. The risk of bad debt is also discussed from the lender point of view as it challenges for a loss.

Chapter 6 concerns issues of borrowers accepting the interest system and critical problems associated with *riba*. It is microcredit interest as if it is *riba* or usury that is prohibited in Islam, whereas the borrowers are Muslims and confess themselves as devout. The chapter discusses how Muslims conduct business in a capitalistic system and they accept bank interest as the means of

paying for loans, but it creates controversy with *riba* in *shari'ah* principles. This chapter examines the problem of bank interest and *riba* that confront Muslim borrowers, the dilemma between access to credit to meet household needs and beliefs. Besides, there are discussions and analysis of poverty and burden of interest, distinctions between interest and *riba*, declaration from a respected Islamic leader or institution (*fatwa*) on interest as *riba* and emergency situation (*darurah*) and the existence of *shari'ah* banking system in the villages.

Chapter 7 discusses and analyses the role of gender, gender mainstreaming and the important role of women in microfinance. Most women are deprived that need for special treatment prior to microcredit facilitations. Here, women have not only to overcome the housewife's dilemmas, but also lack of income and business opportunity that create bigger risk in microcredit. The women need empowering to build and increase their ability on business, a process to reach gender equality.

Chapter 8 draws together and concludes the various threads running through the thesis with a view to addressing the research questions posed for this study. It also develops some ideas about the policy implications of this study for microfinance policy and regulation. Finally, the thesis suggests some issues for further research.

CHAPTER 2

RESEARCH METHODOLOGY

2.1 Introduction

This chapter outlines the research methodology used in this study. The primary sources of data and information consist of government, BRI and BPR documents, print media materials such as newspapers, articles and data collected through interviews, focus group discussion and observations with respondents. The secondary data are published books and articles.

The study endeavors to identify how Sundanese culture is practiced in the research areas and what most influences the economic behavior of the microborrowers. The researcher seeks to identify the different economic structures as well as cultural and religious values of the three research areas and how these influence the operations of microfinance programs.

Given the need to focus on both historical and contemporary socio-economic and cultural phenomena, the research strategies largely involve direct interaction between the researcher and the stakeholders in microfinance. This determines the research paradigm and techniques for collecting primary data through interviews, small group discussions and observation with the informants of this research. The collection of secondary data is a continuous effort throughout the research period and available from several sources. Documents that relate to microfinance such as laws, government documents, presidential decrees and instructions, ministry regulations, Bank Indonesia regulations, Bank Indonesia reports on banking including Bank Perkreditan Rakyat, Banks annual reports, cooperatives annual general meetings, are additional primary sources. Various reports on microfinance, books, journals, newspapers and magazines are the principal secondary resources used to understand the socio and economic dynamics that influence microfinance. The researcher accessed

numerous web sites that are important and rich sources of information for this study.

This research involves discovery of sociocultural traits previously unidentified in the utilization of microcredit in Indonesian villages, but they appear in a variety of activities. The researcher engages in descriptive research in order to collect data to address questions concerning the subject of the study on characteristics of microcredit borrowers' behavior, and also the phenomenon from the microfinance institutions' point of view. With descriptive research through interviews, focus group discussion and observation, the study is expected to address the questions of who, what, where, when and how in identifying the patterns and causes of borrowers' behavior that influences microcredit performance and the sustainability of microfinance institutions.

Sociocultural values are the center of the research, and an initial step in the research is to identify the economic and local social cultural characteristics of the three chosen research areas.¹⁰² Besides, descriptive research is needed to gain access to the respondents' ways of thinking and hence to interpret their actions and manners. In order to grasp the meaning of microborrowers' behavior the researcher attempts to analyze the respondents' point of view.¹⁰³ Bryman calls it "seeing through the eyes of the people being studied".¹⁰⁴

This primary source of exploratory research is backed up by secondary research sources such as reviewing available literature and data. Exploratory research is important as it connects the causality relationship between the data observed or information reported. The researcher is in agreement with Zikmund who defines exploratory research as initial research conducted to clarify and define the nature of a problem, and descriptive research is designed to describe characteristics of a population or a phenomenon.¹⁰⁵ Veal explains empirical

¹⁰² Sociocultural values mean systems of values and thought in society. It concerns non-physical aspects that relate to a society's system of values and thought or stand for its cultural identity. See Neubert, S. 2000, *Social Impact Analysis of Poverty Alleviation Programmes and Projects*, Frank Cass Publishers, London, pp. 7-8.

¹⁰³ Bogdan, R. and Taylor, S.J. 1975, *Introduction to Qualitative Research Methods: A Phenomenological Approach to the Social Sciences*, Wiley, New York, pp. 13-14.

¹⁰⁴ Bryman, A. 2004, *Social Research Methods*, Oxford University Press, New York, p. 279.

¹⁰⁵ Zikmund, W.G. 2003, *Business Research Methods*, Thomson/South-Western, Cincinnati, Ohio, p. 33.

research as research which uses data to reach conclusions, while non-empirical research results arise mainly from thinking, reading and contemplation.¹⁰⁶

This study of the relationship between sociocultural life and the effectiveness of microfinance projects uses qualitative research. It has the advantage of going beyond asking the 'what' questions to asking the 'how' and 'why' questions. And to be able to assess explanation and causality as they actually play out in this particular setting.¹⁰⁷ It allows exploration and discovery and it shows how the variables under study impact each other.

However, in contrast to a quantitative method, qualitative research methodology has its disadvantages; according to Punch, the researcher cannot always specify the quantitative outcome¹⁰⁸. Qualitative research is commonly criticized as being too impressionistic and subjective. Bryman argues "It is impossible to generalize, to know how the findings could be generated in other settings and how just one or two cases could be representative of all cases".¹⁰⁹ Here, Miles and Huberman suggest a solution by linking qualitative and quantitative methods to strengthen the overall research design; and to give a clearer interpretation of the findings, to elaborate or develop analysis and provide richer detail.¹¹⁰

From the above discussion, the approach taken for this study is descriptive and exploratory in nature and mainly empirical, using a qualitative research methodology. This method is considered appropriate as the study seeks to delve into the complexities of processes in which little information exists. Therefore, this method is suitable for research that seeks cultural description and ethnography.¹¹¹ The strength of qualitative studies is that they stress the importance of context, setting and participants' frames of reference. This method allows for well-grounded, rich descriptions and explanations of the processes in identifiable contexts. With qualitative data, it is possible to

¹⁰⁶ Veal, A.J. 1992, *Research Methods for Leisure and Tourism: A Practical Guide*, Pitman Publishing, London, pp. 21-22.

¹⁰⁷ Miles, M.B. and Huberman, A.M. 1994, *Qualitative Data Analysis*, Sage Publications, Thousand Oaks, California, pp. 144-145.

¹⁰⁸ Punch, K.F. 2000, *Developing Effective Research Proposals*, Sage Publications, London.

¹⁰⁹ Bryman, A. 2004, *Social Research Methods*, Oxford University Press, New York.

¹¹⁰ Miles, M.B. and Huberman, A.M. 1994, *ibid*, pp. 40-43.

¹¹¹ Marshall, C. and Rosman, G.B. 2006, *Designing Qualitative Research*, Sage Publications, Thousand Oaks, California.

preserve the chronological flow to understand precisely which events led to which consequences and derive fruitful explanations for both.¹¹²

2.2 Data collection methods

Qualitative researchers typically rely on four methods for gathering information: participating in the research setting; direct observation; in-depth interviewing and focus group discussion as well as analyzing documents and material culture.¹¹³ Information is collected from primary and secondary resources. These sources are present during an experience or time period for of a particular event. Some primary sources include: original documents such as diaries, manuscripts, letters, interview transcripts, news film footage, autobiographies; creative works including poetry, drama, novels, music and art; and relics or artifacts including pottery, furniture, clothing and buildings. A secondary source interprets and analyses primary sources and as such they are removed from the main event. Secondary sources mainly contain pictures, quotes or graphics of primary sources. Some secondary sources include: textbooks, magazine articles, histories, criticisms and encyclopedias.¹¹⁴

2.2.1. Qualitative interviews

This study relies extensively on qualitative interviewing. An interview is a conversation with a purpose and carried out from purposive samples chosen from the population¹¹⁵. Through in-depth conversational interviews the respondents have been asked to discuss their opinions, experiences and expectations of microcredit programs. This is preferred, because the interview has the potential to generate detailed descriptions of the individual's experience, integrating multiple perspectives, describing processes and flexible enough to allow the discussion to lead into areas that are relevant to the study.

¹¹² Miles, M.B. and Huberman, A.M. 1994, *ibid*, p. 1.

¹¹³ Material culture consists of economics and the fulfilment of wants, technology and the utilization of the natural resources, see Bakker, S.J. J.W.M, 1984, *Filsafat Kebudayaan Sebuah Pengantar*, Kanisius, Yogyakarta. p. 50.

¹¹⁴ Primary vs secondary sources, < <http://www.princeton.edu/~refdesk/primary2.html>>.

¹¹⁵ Strauss, A. and Corbin, J. 1990, *Basics of Qualitative Research, Grounded Theory Procedure and Techniques*, Sage Publications, Newbury Park, California.

¹¹⁶ Interviews are guided by open-ended questions. It is expected that each respondent can and will respond as he or she wishes. Such questions are broad, often specifying a topic and they allow the respondents considerable freedom in determining the amount and kind of information to give.¹¹⁷

The interviews discuss issues with key informants. This study is focused on Bank Rakyat Indonesia Units (BRI Units), Bank Perkreditan Rakyat (BPR) and selected microcredit customers. The respondents were chosen because they had been longstanding borrowers with good financial records. They were relatively easy to contact and they reflected the gender balance of the BRI Units' borrowers. Their businesses were typical of those in the area. Some of the borrower respondents have experienced problem loans. The other respondents are selected officers (*mantri*) and managers of BRI Units, loan officers of BPRs and cooperatives in the research areas. At the district level, formal and informal community leaders are also informants.

2.2.2. Focus group discussion

Focus group discussion is conducted to find out as much as possible about participants' experience and feelings on a given topic and tend to produce conformity. The basic goal is to hear from the group about the topics of interest to the researcher and the topics that are also appropriate for them. Focus group discussion is not used to gather statistical data or for decision making.¹¹⁸ Instead, these discussions explore specific topics, and individuals' views and expediencies, through group interaction to obtain perceptions about defined areas of interest as discussed by Barbour and Kitzinger and Litosseliti.¹¹⁹

Instead of individual interviews to understand an individual borrower, focus groups discussions are used to investigate group opinion, where members' interaction is a key element. In comparison to interviews, focus

¹¹⁶ Jones, R. A. 1996, *Research Methods in the Social and Behavioral Sciences*, Sinauer Associates, Sunderland, MA.

¹¹⁷ Stewart, C.J. and Cash, Jr. W.B. 2003, *Interviewing, Principles and Practices*, McGraw Hill, Boston.

¹¹⁸ Morgan, D.L. and Krueger, R.A. 1993, 'When to use focus groups and why', in Morgan, D.L. (ed.) *Successful Focus Groups*, Sage Publications, Newbury Park, California.

¹¹⁹ Barbour, R.S and Kitzinger, J. 1999, *Developing Focus Group Research*, Sage Publications, London and Litosseliti, L. 2003, *Using Focus Group Research*, Continuum, London.

groups have the advantage of enriching the discussion through cross-fertilization between participants. That is how focus group discussion builds group opinion efficiently.¹²⁰

There were three focus group models used in this study. The first group consisted of small farmers, traders and fishermen (*Kelompok Petani-Nelayan Kecil/P4K*), who were customers of the BRI branch office of Majalaya, Ciamis and Cirebon. They were participants in the Income-Generating Project for Marginal Farmers and Landless workers in 18 provinces in Indonesia that fell under the responsibility of the International Fund for Agricultural Development (IFAD), the Asian Development Bank (ADB), the Ministry of Agriculture and the BRI. The second group consisted of 28 BRI Unit *mantri* who were involved in a program at the BRI Training Center in the city of Lembang to discuss ethics and bad debt in their Units. A third group were borrowers who had secured their loans through the *Pinjaman Kemitraan* program at the BRI branch offices of Cibadak and Cianjur.¹²¹

2.2.3. Observation

Observation entails the systematic noting and recording of events, behavior and objects in the social setting chosen for the study. The observation record is frequently referred to as field notes including detailed, non-judgmental, concrete descriptions of what has been observed.¹²² With this data collection method, loan applications analysis, process of delivery and site supervision of microcredit were observed. The researcher also observed the way in which officers of BRI Units, BPR and cooperatives communicated with their microcredit customers.

As the result of the data collection through interviews, focus group discussion and observation, the researcher was able to describe sociocultural

¹²⁰ Schuck, N.G., Allen, B.L. and Larson, K. 2004, *Focus Group Fundamentals*, Methodology Brief, Departments of Agricultural Education and Studies of Sociology, Iowa State University, pp. 1-6.

¹²¹ BRI set aside 3% of its yearly profits to support the development of micro entrepreneurs. See Bank Rakyat Indonesia, *Surat Edaran/Circular Letter*, NOSE:S.19-DIR/ADK/04/2007 28 April 2006 Tentang: Program Kemitraan dan Bina Lingkungan (PKBL), Bank Rakyat Jakarta.

¹²² Marshall, C. and Rosman, G.B. 2006, *Designing Qualitative Research*, Sage Publications, Thousand Oaks.

experiences of the respondents. We also get a picture of external factors such as local community relationships, local economic conditions, and professions that influence microborrowers' behavior and attitude to microcredit.

2.3 The case study research areas

The case study is one of several ways of doing social science research. It is a research approach, an empirical inquiry that investigates a phenomenon within its real-life context. In order to clarify and make the research effective, a case study is built up to illuminate why decisions are taken, how they are implemented, and with what result.¹²³ Rather than using large samples and following a rigid protocol to examine a limited number of variables, case study methods involve an in-depth, longitudinal examination of a single instance or event: a case. They provide a systematic way of looking at events, collecting data, analyzing information, and reporting the results.

The case study approach adopted in this study is consistent with that of Flyvbjerg, who explains that case study research: a) can justify that theoretical knowledge is as valuable as practical knowledge; b) can generalize from a single case and contribute to scientific development; c) is not biased towards verification; d) is useful for generating and testing hypotheses and theory building, and e) can summarize a specific case study without difficulty.¹²⁴ This is the rationale for adopting a case study approach in this study.

This qualitative study uses purposeful sampling to select a specific locale, according to a preconceived but reasonable set of dimensions relating to time, space, identity or power.¹²⁵

2.3.1. Research areas

Using a case study paradigm, the researcher identified three research areas that have different sociocultural and socio- economic environments respectively

¹²³ Yin, R.K. 2003, *Case Study Research, Design and Methods*. Sage Publications, Thousand Oaks, California.

¹²⁴ Flyvbjerg, B. 2006, 'Five misunderstandings about case study research', *Qualitative Inquiry*, 12(2), pp. 219-245.

¹²⁵ Goulding, C. 2002, *Grounded Theory, A Practical Guide for Management, Business and Market Researchers*, Sage Publications, London.

including a rural, coastal and urban area in West Java. As the coastal area in the study, the researcher chose the Kapetakan and Gebang community, with its rich Sunda-Java-Cirebon blend, reflecting Sundanese and Javanese cultures. The Pagerageung and Puteran communities were chosen as a rural area strongly influenced by a traditional Islamic boarding school (*pesantren*) as well as agricultural and trading activities. This rural area has easy access to the neighboring urban areas of Tasikmalaya and Ciamis, where Sundanese traditions, Islamic beliefs and modern values have informed social and cultural life. Cimahi, chosen as the urban area for the study, is a trading and service centre, where external cultural influences mix with Sundanese customs. These three communities are confronted with rapid acculturation and the impact of developing business opportunities as well as expanding production and employment. The environment, demographics and human livelihood for each area are described in Table 2.1.

With the same research questions informing all interviews, focus group discussion and observation, the researcher sought to examine the similarities and/or differences of individual respondents' practical knowledge of their sociocultural life that has impacted their economic behavior. A comparison of findings in each research area is used to develop an overall picture of the issues to be analyzed in the study.

The field research was conducted in the province of West Java, Indonesia. This province was chosen as the locale for this study because of its rich culture and diversity of economic activities, industries, plantations, trading, agriculture and other services throughout the districts. West Java is a strategic province in political and economic activities in that it attracts people from other provinces. This area has a long history of microfinance activities in villages since the colonial period, and the microfinance programs have been accepted by the villagers as part of the financial system in their village economy.¹²⁶ West Java has an extensive banking network of BRI Units and BPR throughout the villages.

¹²⁶ Fruin, T.A. 1933, *History, Present Situation and Problems of the Village Credit System (1897-1932)*, Klaas Kuiper 1999 (trans. and ed.), Ministry of Foreign affairs DRU, The Hague and Djojohadikusumo, S. 1989, *Kredit Rakyat di Masa Depresi*, LP3ES, Jakarta.

Table 2.1 The research areas in West Java

Characteristics	1. Rural area	2. Coastal area	3. Urban area
Research area:	Pagerageung and Puteran village, District of Tasikmalaya, 250 km south-east of Jakarta, 100 km east of Bandung	Gebang and Kapetakan village, District of Cirebon, 300 km east of Jakarta, 120 km north-east of Bandung	Cimindi village, City of Cimahi 150 km south- east of Jakarta, 10 km west of Bandung
Economic activity:	Mainly primary production, based on land and natural resources	Fishing and marketing seafood	Regional centre of manufacturing, trade and services
Demographics:	Population dispersed in small clusters	Population dispersed in small clusters; move to wherever the catch is good and seasonal changes	Population concentrated and growing
Transport infrastructure:	Scattered, low quality transportation infrastructure and services, time and travel costs high	Scattered along the coast, poor transportation quality, time and travel cost high	Locus of transport infrastructure but quality of service variable, due to congestion and high demand
Environmental risks:	Related largely to productive process and deterioration of natural resources	Local fishermen pose a relatively low risk towards natural resources	Related to both production and population density in terms of waste and air pollution

Source: For rural and urban areas see Klugman.¹²⁷
Coastal area based on Firth.¹²⁸

The Sundanese, who mainly live in this province, number about 43,021 million or 18.11% of the Indonesian population and they are the second biggest ethnic group after the Javanese.¹²⁹ The Sundanese culture is rich in traditions, ceremonies, arts and Islamic beliefs, which have strongly influenced the people. In addition to the official Indonesian national language, the other widely-spoken language in the province is Sundanese (*basasunda*), but in some areas near the borders with Central Java, Javanese is also spoken. The ethnic language

¹²⁷ Klugman, J. 2002, *A Sourcebook for Poverty Reduction Strategies*, The IBRD/The World Bank, Washington D.C.

¹²⁸ Firth, R. 1946, *Malay Fishermen: Their Peasant Economy*, The Macmillan Company, New York.

¹²⁹ Badan Pusat Statistik 2010, *Penduduk Indonesia menurut propinsi*, BPS, Jakarta.

spoken in the northern part of Cirebon and nearby areas (Indramayu) is Cirebonese, which is a mix between Sundanese and Javanese. Indonesian is widely spoken, except in some remote rural areas. Most of the population is Muslim (96.5%), while the rest are Protestants, Catholics, Buddhists and Hindus. This province lies in the hinterland of Jakarta, the capital city of Indonesia, so the Sundanese have easy access to the national and cosmopolitan values of Jakarta as well as to Bandung, the capital of the province.

The Pagerageung and Puteran communities are administered as part of the district (*kabupaten*) of Tasikmalaya, in southeastern West Java, on the south side of the two major road routes across Java.¹³⁰ The population of the entire regency is about 2.5 million. Tasikmalaya is sometimes called the 'District of a Thousand *Pesantren*' for its many Islamic religious schools. The area is known for producing silk goods printed with batik, Muslims clothes, embroidery, paper umbrellas and handbags woven by hand from bamboo and pandanus leaves. The production of handicrafts for domestic and international consumption is an important local industry. Besides these industries, the economy of Tasikmalaya is predominantly agricultural.

Pagerageung and Puteran are the locale of a well-known *pesantren*, Suryalaya. The *pesantren* also operates a modern education system from primary school to university level and runs cooperative services and various social activities. As there are many visitors and events throughout the years, this *pesantren* is able to develop an active local market. It is expected that the idea of money and Islamic principles in business is intertwined in this local economy including in relation to the payment of bank interest from the borrowers and other business actors. Many microcredit borrowers live in remote villages, but the road network provides them with reasonable access to financial services. The villagers have strong community identity in a relatively homogeneous Sundanese culture.

Gebang and Kapetakan villages are administered as part of the district of Cirebon in the eastern part of West Java near the border with Central Java

¹³⁰ Kabupaten Tasikmalaya, www.tasikmalayakab.go.id and Suseda 2008, Biro Pusat Statistik (BPS), Statistic of Jawa Barat.

province, with a population of 2.2 million.¹³¹ Cirebon has rattan industries, handicrafts and batik home industries, sugar mills and fish products. It is an old trading city, where Chinese merchants have played an important role for five centuries. The coastal areas in the district of Cirebon are dominated by fishing. Islam and Islamic clerics have a long historical relationship with the people of Cirebon, and along with the interaction of Sundanese and Javanese cultures have created in Cirebon a particular cultural environment. The local fishers in Gebang and Kapetakan have easy access to markets and services through the main north coast road, *jalur pantura*, which is of high economic value to them. Both villages are open to external influences; Gebang and Kapetakan have a more heterogeneous culture than other areas in the northern part of West Java, such as Bekasi, and Karawang or Pelabuhan Ratu, Pameungpeuk and Pangandaran in the southern part of the province.

Cimindi is part of the city of Cimahi located west of Bandung. It has an area of 4000 ha and a population of 0.5 million.¹³² The city is a major textile producer and exporter. Several military education facilities have operated in Cimahi since the Dutch period. Cimahi is a growing urban area with Sundanese and a growing migrant population. Cimahi is close to the city of Bandung and the road to Jakarta, which makes it a centre of economic and cultural change, and no longer dominated by a homogeneous Sundanese culture like rural Pagerageung and Puteran.

To collect data and information for this study, three types of microfinance institutions have been selected in the three research areas. The study is focused on the Bank Rakyat Indonesia Units (BRI Unit), Bank Perkreditan Rakyat (BPR) and the Koperasi Simpan Pinjam (Saving and Loan Cooperatives called cooperatives). They are located in rural villages at Pagerageung (BRI Unit Pagerageung, BPR/BKPD Pagerageung, Koperasi Hikmat Suryalaya, Koperasi Eka Mulya) and Puteran (BRI Unit Puteran) district of Tasikmalaya; coastal villages at Gebang (BRI Unit Gebang) and Kapetakan (BPR/BKPD

¹³¹ Kabupaten Cirebon, www.cirebonkab.go.id and Suseda 2008, Biro Pusat Statistik (BPS), Statistic of Jawa Barat.

¹³² Kota Cimahi www.cimahikota.co.id and Suseda 2008, Biro Pusat Statistik (BPS), Statistic of Jawa Barat.

Kapetakan) and Koperasi Pesat Tani, district of Cirebon, and in the city of Cimahi (BRI Unit Cimindi, BPR Kencana and Koperasi Karya Maju, Cimahi). These institutions have different modes of establishment and ownership and therefore will have different management, policy settings and operations. Bank Rakyat Indonesia, a former state-owned enterprise, is a publicly listed national bank with branches and units in villages all over the country. The Government of Indonesia owns 70% of the bank's shares. Bank Perkreditan Rakyat (BPR) is a limited liability entity, often established as a bank by a district government or individuals in the suburbs or villages. BPR are in a position to accommodate local cultural values in its operations. Cooperatives are established by individuals and groups in local communities based on Cooperative Law no. 25/1992.

2.3.2. Sources of data collection and the main issues

From the previously mentioned research propositions, the study identified four strategic sociocultural aspects incorporated as the objectives of the study.¹³³

They are:

1. The impact of local social value system, work ethics, and trust on microborrowers' behavior.
2. Socioeconomic impact of microcredit, the screening processes and the risk of bad debt to the borrowers and lenders that relate to the sustainability of microfinance institutions.
3. The issue of borrowers' acceptance of the payment of interest on microcredit loans and the crucial problem of *riba*.
4. The role of gender.

The data and information relating to the above issues are collected from respondents in the three research areas using the questions designed and developed for interviews, focus group discussion and observation. The number of respondents and the main issues discussed are presented in Table 2.2. By examining facts and information with the abovementioned methods of data collection, the researcher is optimistic that the research will show that

¹³³ The five pillars of the Sundanese culture are discussed in Chapter 3 in this thesis.

Sundanese sociocultural values and practices generally support the sustainability of microfinance programs.

Theoretically there are some reasons to successfully undertake the study such as:

1. The objectives of the study have been determined clearly and incorporated into the research framework, focusing on the impact of sociocultural issues such as: impact of borrowers' behavior on microcredit, the controversial issue of bank interest and *riba*, the role of gender, ethics in business and trust and socioeconomic impact and risk. This is a study of users or borrowers' behavior, a demand side approach, about microfinance institutions' customers. The researcher examines the screening processes and bad debt from both the borrowers' and lenders' points of view.

2. Prior to the fieldwork, a research program has been designed within a time frame practical for doctoral research, including a tentative list of number of respondents, respondents' requirements, gender, institutions to be visited and the supervision schedule of the loan officers. Certainly changes are made during the fieldwork and a final list of respondents is described in Table 2.2. The researcher believes the respondents are able to provide the data and information needed. There are 180 respondents, with 120 individual customer-respondents or 67% of total respondents, with 55 participants in group discussions; the remainder are officers of the microfinance institutions, constituting a total of 59 respondents or 33% of those interviewed.

They come from 12 institutions and 28 members of group discussion from BRI Units in BRI Training Center at the city of Lembang in West Java. The data indicates the percentage of borrowers' respondents is higher than suppliers' microfinance institutions for this study.

3. Derived from the assumptions and objectives of the study, the questions for interviews, focus group discussion and observation have been designed to focus on the core issues of the research.

4. The three research areas contribute a rich output of similarities or differences between respondents.

Table 2.2 Primary sources of data and information

Respondents	Number of Respondents	Issues
Interviews		
1. Microfinance institutions:		1. Customer's data base:
a. BRI Unit		a. Customer's identity
- BRI Units officer/manager:	4	b. Historical business relations
b. Bank Perkreditan Rakyat (BPR)		c. Financial and social condition before and after microcredit support
- Loan officer/manager	4	2. Knowledge of customers:
c. Saving and Loan Cooperatives		a. Customer cultural background
- Loan officer/manager	8	b. Customer reference
d. Bank <i>Shari'ah</i>		c. Role of customer in the local society
- Manager	3	d. Character and reputation
		e. Customer commitment
		f. Creditor's personal relationship with customer
Subtotal	19	3. Profits taking from the poor?
		4. Microcredit supervision system
		5. Education and training
2. Selected individual customers		1. Customers attitudes to interest and <i>shari'ah</i> principles
a. BRI Units borrowers	20	2. Customer attitude to money and debt, debt and social status, money politics.
b. BPR borrowers	14	3. Customer cultural identification: idea (religion, belief, morals, trust and honesty, laws) and activities (social customs, habit, traditional ceremonies), work-ethics.
c. Cooperatives borrowers	14	4. Customer-community relationships /self-help (<i>gotong royong</i>)
d. BRI Unit borrowers with bad debts	9	5. External influence, technology, communication, other cultures
e. Bank <i>Syariah</i> customers	5	6. Role of gender
		7. Bad debt, reasons for non-performing loans.
Subtotal	61	
3. Formal and informal local leaders:		1. Demography, occupation and social strata
a. Local community leaders	3	2. Local government structure
b. Religious leaders	2	3. Role of custom and tradition, education, and schools of Koranic study (<i>pesantren</i>).
		4. Social system, feudalism, community self-help (<i>gotong royong</i>), social sanction
Subtotal	5	5. Role of formal and informal leader to maintain social value system

Group discussions		
1. BRI Branch customers		1. Group development
Three focus groups of Small Farmers and Fishers (<i>Kelompok Petani-Nelayan Kecil/P4K</i>)	36 members	2. Group benefits 3. Group responsibility 4. Maintain group spirit
2. Two BRI Branch Manager, 2 officers and customers Two focus groups on <i>Pinjaman Kemitraan</i>	17 members	1. General policy on <i>Pinjaman Kemitraan</i> . 2. Program implementation type of loan used to alleviate poverty?
3. Group of BRI Unit officers BRI Unit officers	28 <i>mantri</i>	Non-performing loans
Subtotal	5 groups with 85 members	
Observation		
1. BRI Units officers	4	1. Loan applications, evaluation, loan delivery, control and site inspection 2. The creditors' communication with the customers and local society.
2. BPR officers	3	
3. Cooperatives officers	3	
Subtotal	10	
Total Respondents	180	

From a practical point of view the success of the study is determined by a process of data collection and maintaining good relationships with respondents during the study. To achieve the maximum input from each respondent, the researcher sought to build good relationships with borrowers as well as with other villagers, as follows:

1. The researcher stayed in or near to the villages which helped make him a familiar participant in the community, including Friday prayers at the local mosque as well as sharing meals with local people at the small restaurant (*warung nasi*).

2. It was important to take some time to chat very informally and personally prior to interview. The pace of interviews is important, so respondents do not feel pressured to give quick answers.

3. Interviews were very flexible in time and place to accommodate respondents' commitments and work demands. The respondents often felt most comfortable if the interview was held in their home or place of work.

4. Politeness was essential in communication or conversation, not only with the respondents but also with anybody in the villages. Using *basa Sunda* or the local language properly was of great assistance to the researcher. The researcher has a good appreciation of the respondents' culture and speaks Sundanese as well as Indonesian. By knowing Sundanese culture and as a Muslim, the researcher experienced few difficulties in communicating with the respondents in the study.

5. Questions for the interviews and group discussions are standard and consistent. The researcher was flexible to follow the flow of conversations in order to reach the substance of the research issues. Educational background, age and experience were the main reasons why respondents tended to give indirect answers. To get the objective responses the researcher had to be very patient.

2.4 Data analysis

The qualitative data derived from interviews and discussions usually took the form of unstructured material and were not straightforward to analyze¹³⁴. The approach to data analysis and interpretation was to integrate the findings and connections between them. Miles and Huberman describe how to develop a framework for qualitative data analysis with three components: data reduction, data display and drawing and verifying conclusions¹³⁵.

1. Data reduction refers to the process of selecting, focusing, simplifying, abstracting and transforming the data that emerges from the fieldwork. The collected data is reduced and transformed by way of summarizing or paraphrasing. By following this process, there were two types of research reports produced. The first consisted of three separate reports that develop the findings in the research areas of Cimahi Kota, Tasikmalaya and Cirebon. The reports describe the outcome or findings during the interviews, group discussion and observation of the relevant topics and issues using the questions listed.

¹³⁴ Bryman, A. 2004, *Social Research Methods*, Oxford University Press, New York.

¹³⁵ Miles, M.B. and Huberman, A.M. 1994, *Qualitative Data Analysis*, Sage Publications, Thousand Oaks, California.

The second was a report on the issues where the respondents in rural, coastal and urban areas had different perspectives or responses.

2. Data display is an organized assembly of information that permits conclusions to be drawn and actions to be undertaken. The reduced data is displayed in the form of matrices that are designed to assemble organized information in an immediately accessible, compact form. All the data and information from the abovementioned reports was reorganized and regrouped based on the four main topics of this research. These are integrated findings and written into the first and second sections of the chapters describing the findings (Chapters 4, 5, 6 and 7), followed by analysis of the issues.

3. After a review of the findings and discussion on four issues of the research, the final step is drawing conclusions and verification. At this stage, Chapter 8 is dedicated to integrating the material that addresses the research questions and objectives of the study as set out in Chapter I. In this concluding chapter, the main theme of the sociocultural approach on which the research is based and sustainability of microfinance institutions is clearly spelt out, with special reference to the research implications and knowledge contributed by the study.

2.5 Strengths and limitations of the research

Throughout the conduct of the field research, every effort was made to achieve accuracy and objectivity. Nevertheless, the researcher worked with a number of possible strengths, weaknesses and limitations.

1. Researcher's cultural background and values: the researcher comes from a Sundanese Moslem family with Sundanese culture and Sundanese education at home and school. As a student leader in various student organizations during high school and university, this had given him a strong personal touch in human communication. His national and international experiences in commercial banking for more than three decades and central banking matters have enriched his understanding of professionalism with Islam and Sundanese values, and convinced him that sociocultural factors influence human endeavor.

2. Researcher's professional experience: since the researcher and the respondents are human beings, it is difficult for him to fully guarantee objectivity, even though every effort has been made. As Esterberg explains, all researchers have a vested interest in what they study, unless they are indifferent to the knowledge that they pursue.¹³⁶ Given the possible influence of the researcher's background, norms and values, previous studies, past experience as a Managing Director of Bank Ekspor Impor Indonesia, a President Director of three state-owned commercial banks: Bank Ekspor Impor Indonesia, PT Bank Rakyat Indonesia (Persero) and PT Bank Bumi Daya (Persero), then Managing Director of Bank Indonesia (Indonesia Central Bank), a chief executive officer of Indonesian Banks Restructuring Agency (IBRA/Badan Penyehatan Perbankan Nasional/BPPN) and as a Deputy Governor of Bank Indonesia, it is not surprising that bias may have occurred at some stages of the study, with or without the researcher being aware.
3. Inconsistency: between responses given by the respondents and their actual behavior human behavior is very context specific, and can vary according to different situations. It is understood that respondents can alter their behavior because they know they are being studied. Bearing this in mind, it is quite likely that the responses given during the interviews or focus group discussion might not be fully reflective of their behavior, especially where more sensitive questions are discussed.
4. Respondents' error: the accuracy of responses to some delicate and sensitive topics may be questionable; for example, the income level to fulfil household needs or the role of the wife to support and manage family income. For a variety of reasons it is likely that husbands are unwilling to disclose their income as to show their important role as family income earners. Since human behavior is not mechanistic the researcher treated the respondents with respect and humanity.
5. Unanswered questions: there were questions unanswered by the respondents. Knowing the respondents' backgrounds, experience and

¹³⁶ Esterberg, K.G. 2002, *Qualitative Methods in Social Research*, McGraw-Hill, Boston, Massachusetts.

education, the researcher tried to give the best possible explanation, but some respondents were reluctant to respond or acted as if they did not understand the question.

CHAPTER 3

LITERATURE REVIEW

3.1 Introduction

This chapter will review the role of culture and microfinance as discussed by Archer (1996), Fukuyama (1995, 2001), Neubert (2000) Prawiranegara (2011), Rahardjo (2006, 2011, 2011a) , Robison (1986, 1988) and Solow (1956, 1994). The ideas of Ahmad and Hasan, Cernea (1987), Chapra (1984, 2009), Fernandez (2007), Gulli (1998), Hulme and Mosley (1996, 1997), Montgomery and Weiss (2005), Morduch (1998,2000, 2002), Thornton (2011), Wethery (2007) and Woller (1999) are also discussed.

Culture is a key variable that influences behavior which in turn affects economic activities. Debates about how culture influences economics re-emerged in the 1980s and 1990s. Fukuyama called it the revival of cultural interpretation. Economists have become much more aware of the importance of history, culture, tradition, and other so-called 'path dependent' factors in shaping economic behavior. Fukuyama also explains the lessons learnt from the Asian Miracle, that is, the difference in transition outcomes in many countries was simply the result of differing designs of formal institutions. It was found that the outcomes largely followed cultural factors driven by specific Asian cultural characteristics, for example, the work ethic or deference to state authority.¹³⁷ As a result, international financial institutions like the World Bank and the International Monetary Fund began to examine cultural factors as key variables explaining successful transition strategies.

The important role of culture was also highlighted by Neubert. She argues that a development project, in this case poverty alleviation, needed to consider all social dimensions including sociocultural values as well as economic and political aspects to attain a better quality of life. Sociocultural values mean a system of values and thought in society. It concerns non-

¹³⁷ Fukuyama. F. , 2001, 'Culture and Economic Development: Cultural Concerns', *International Encyclopedia of the Social & Behavioral Sciences*, ISBN: 0-08-043076-7, p. 3132.

physical aspects that relate to a society's system of values and thought or stand for its cultural identity.¹³⁸

According to Rahardjo, Prawiranegara explained "Human activities, politics, social, economy and culture were the act of devotion (*ibadah*)"¹³⁹ Rahardjo describes "Non-economic factors, especially religion, moral, law, human resources and human rights, as needing to be considered in the process of development".¹⁴⁰ He confirmed that economics should be derived from and designed to follow the idea of how Indonesians want to develop their country for prosperity, as determined in article 33 of the 1945 Constitution, which determined that the government should support the people's economy (*ekonomi kerakyatan*).¹⁴¹ On the other hand, Prawiranegara argued that the private sector should be supported, including direct foreign investment, and that the role of government should be extended in sectors where private enterprises were not involved.¹⁴²

Rahardjo was concerned with people's prosperity (*kesejahteraan rakyat banyak*) as central to economic activities, but this concern was not in conflict with globalization, the role of capital, entrepreneurship, management and technology.¹⁴³ He stated that so many non-economic factors influenced the economy which impacted neo-liberalism since the New Order period. He argued that government ought to provide fair treatment between small and big business, as well as minimize the degradation of social values and dependency on international capital. Rahardjo disagreed with the Washington consensus (deregulation, liberalization, privatization and non-subsidy) as the economic solution. What was needed was pro-people policy.¹⁴⁴ Dependency on international capital was a disturbing factor that prompted Rahardjo to argue for the role of human development as social capital, entrepreneurial capital, cultural

¹³⁸ Neubert, S. 2000. *Social Impact Analysis for Poverty Alleviation Programmes and Projects*, Frank Cass Publishers, London, pp. 6-9.

¹³⁹ Rahardjo, M. D. 2011. *Ekonomi Neo-Klasik dan Sosialisme Religius, Pragmatisme Pemikiran Ekonomi Politik Sjafruddin Prawiranegara*, PT Mizan Publika, p. 56.

¹⁴⁰ Rahardjo, M.D. 2011, *ibid*, p. 73.

¹⁴¹ Rahardjo, M.D. 2011, *ibid*, pp. 199-201.

¹⁴² See Prawiranegara ideas in Rahardjo, M.D. 2011, *ibid*, pp. 39-42.

¹⁴³ Rahardjo, M.D. 2011a. *Nalar Ekonomi Politik Indonesia*, PT Penerbit IPB Press, Bogor, p. vi.

¹⁴⁴ Rahardjo, M.D. 2011a, *ibid*, pp. xvi-xvii.

capital, intellectual capital and spiritual capital.¹⁴⁵ Rahardjo argued that one means of supporting the people's prosperity was through microfinance programs that reflected the communities' cultural and religious values.¹⁴⁶

The approach taken in this thesis is informed by the work of Margaret Archer.¹⁴⁷ She conceptualizes culture as an objective phenomenon and makes the distinction between culture as structure and agency. Archer recognizes that a cultural system is replete with similarities and contradictions. There is sociocultural interaction in which groups drawn upon and elaborate various parts of the cultural system in accordance with their interests and objectives. Archer explains the relationship between culture and agency¹⁴⁸ and religion and agency (a person or an entity). It is self-interest that influences an agent's behavior to think, consider, make decisions and act. Self-interest and the pursuit of material interests play a role in agency. However, there is also an endeavor to reconcile, accommodate and rationalize actions, motivated by self-interest, with cultural values and religious principles, so as to make them, as far as possible, mutually consistent.¹⁴⁹

In contrast to Archer's analysis of the role of culture, Robison argues that economic conditions determine all social arrangements and activities that achieve and justify current power relationships. For example, government policies sought to gain access for Indonesian goods and services in the international market. To reach this economic goal the government exercised tight state control with centralized and authoritarian regulations, together with the exclusion of political parties from the decision-making process.¹⁵⁰ It was an ideology of state above politics to protect the national interests by using free market economic policy.¹⁵¹ The state controlled the banking system until the 1980s, maintained a grip on state corporations, but then privatized them, and

¹⁴⁵ Rahardjo, M.D. 2011a, *ibid*, p. xxiii.

¹⁴⁶ Rahardjo, M.D. 2009, *Pembangunan Pasca Modernisasi: Membangun Masa Depan*, in *Buletin Bina Swadaya*, no. 59/XIV.

¹⁴⁷ Archer, M.S. 1996, *Culture and Agency: The Place of Culture in Social Theory*, Cambridge, University Press, New York.

¹⁴⁸ Archer, M.S. 1996, *ibid*, p. xiv.

¹⁴⁹ Archer, M.S. 1966, *ibid*, pp. 158-159.

¹⁵⁰ Robison, R. 1986, *Indonesia, the Rise of Capital*, Asian Studies Association of Australia, Sydney, p. 105.

¹⁵¹ Robison R. 1986, *ibid*, pp.108-109.

provided distribution of economic resources and opportunities to cronies. This constituted the development of a strong patron–client relationship between state and corporate groups, mostly in strategic industries, and became what many would term as another arm of the state.¹⁵² Economy including poverty alleviation was run by centralized planning where civil society, human rights, judicial and security sectors were managed by and dedicated to state political control.

Robison describes how economic policy dictated processes of social changes which arose from the dynamics of capitalism and became the dominant mode of production. He argued that economic and political structures were the critical factors and made few allowances for cultural influences. Cultural values were only symptoms or reflections of economic realities. Robison gives limited attention to the autonomous struggles of subordinate social groups and policy sought to advance the interests of the government as the dominant actor in the economy. This economic policy sought to integrate Indonesia into the globalization process.¹⁵³ Sklair explained that global economies are dominated by a transnational capitalist class, big corporations and their local cronies, bureaucrats and politicians as well as global professionals.¹⁵⁴ On sociocultural activities, Hay and Rosamond argue that instead of promoting a variety of cultures, globalization was a threat to culture heterogeneity.¹⁵⁵

The fall of Soeharto led to the displacement of individuals and even of key elements of patrimonial New Order oligarchy. Robison and Hadiz show the established oligarchs have had to reinvent themselves, and have seen new players emerge to share their advantages, but most have remained powerful. Again, we see the use of state power to advance private gain.¹⁵⁶

¹⁵² Robison, R. 1988. 'Authoritarian states, capital-owning classes, and the politics of newly industrializing countries: The case of Indonesia', *World Politics*, vol. 41, no. 1, pp. 63-64.

¹⁵³ Robison R. 1986, *ibid*, pp. 196-197. See also The context: Globalization of the Indonesian economy <http://archive.unu.edu/unupress/unupbooks/uu11ee/uu11ee14.htm>.

¹⁵⁴ Sklair, L. 2002 'Democracy and the Transnational Capitalist Class', *ANNALS AAPS* 581, pp. 144-157.

¹⁵⁵ Hay, C. and Rosamond, B. 2002. 'Globalization, European integration and the discursive construction of economic imperatives', *Journal of European Public Policy*, 9(2), pp. 147-167.

¹⁵⁶ Robison, R. and Hadiz, V.R. 2004 *Reorganising Power in Indonesia: The Politics of Oligarchy in an Age of Markets*, Routledge Curzon, City University of Hongkong.

Solow explains his theory of growth, focusing on labor and capital and technology as key to production for consumption and capital formation. The Solow model was so straightforward that factors such as government policies, output of goods, changes in employment, natural resources, geography and social institutions were ignored. It was, however, this simplification that allowed for a better understanding of the role of capital, labor and technological progress, considered to be a key determinant of growth in the long run.¹⁵⁷ The Solow model also has implications for the stimulation of human capital, new technology and research and development (R&D) activities.¹⁵⁸ Economic development was created from human activities, which makes human capital a strategic factor. Human capital was therefore a measure of the economic value of an employee's skill set to produce goods and services. This capital could be invested through education, training and enhanced benefits with experience and abilities that will lead to an improvement in the quality and output of production. Labor productivity growth appears to be enhanced by the joint introduction of training and innovation.¹⁵⁹ Meanwhile technology change and development was driven through R&D that needed physical capital to drive the engine of growth.¹⁶⁰

From the abovementioned review, we understand Robison and Solow's ideas have different approaches to that of Archer, Fukuyama, Neubert, Prawiranegara and Rahardjo. Neither Robison nor Solow consider sociocultural factors were an important influence on economic behavior.

Thornton et al. argue that it is necessary to integrate sociocultural factors and entrepreneurial activity. They contend that entrepreneurship is embedded

¹⁵⁷ Solow, R.M. 1956, 'A contribution to the theory of economic growth', *The Quarterly Journal of Economics*, vol. 70, no. 1, pp. 65-94.

¹⁵⁸ Solow, R.M. 1994, 'Perspective of growth theory', *The Journal of Economic Perspectives*, vol. 8, no. 1, pp. 45-54.

¹⁵⁹ Strengthening People and Skills, 2007. Productivity Commission Public Support for Science and Innovation, p. 55

<<http://www.innovation.gov.au/Innovation/Policy/Documents/NISChapter05.pdf>>

¹⁶⁰ Ahuja, I.P.S. 2011. 'Managing research and development for core competence building in an organization', *Journal of Technology Management and Innovation*, vol. 6, issue 1, p. 61.

in a social context. Their study suggests a suitable framework is to analyze sociocultural factors that influence the decisions to create new businesses.¹⁶¹

Fernandez identifies that the effect of culture on economic outcomes and she addresses the question, 'does culture matter and, if so, how much?' In answering the question, she explores the propagation mechanisms of culture, to theorize about the relationship between institutions and culture, as well as to investigate the dynamic of culture.¹⁶²

Wetherly describes a two-sided approach when he says "The relationship between business, culture and society involves a two-way interaction". Wetherly explains that business is not only influenced by the sociocultural setting, but that business also affects the wider culture and society. These influences can be seen as either positive or negative; hence the culture of a society might be seen as hindering or assisting business performance.¹⁶³ Therefore governments might be interested in promoting cultural change as a way of boosting economic competitiveness or to regulate business. Wetherly indicates that the economy is also able to influence the culture of a society. As an example, Wetherly examines the culture of *wantok* in the Solomon Islands, where there are endemic problems of political instability, corruption, and slow private sector development, hindering the country's economic development, politics and bureaucracy.¹⁶⁴ Supported by large donor projects from international organizations, the Solomon Islands have sought to develop their economy, strengthen the private sector, political cohesion, and

¹⁶¹ Thornton, P.H. Sopriano, D.R. and Urbano, D. 2011. Sociocultural factors and entrepreneurial activity: An overview, *International Small Business Journal*, 29(2), pp. 105-118.

¹⁶² Fernández, R. 2007, *Culture and Economics*, E 000282, Nyu, New York University, pp. 1-17. <<https://files.nyu.edu/rf2/public/Research/palgravePaperFinal.pdf>>.

¹⁶³ Wetherly, P. 2007, *The Social and Cultural Environment* www.oup.com/uk/orc/bin/9780199203055/wetherly_ch05.pdf.

¹⁶⁴ *Wantok* system comes from the word 'wan talk' and 'system', loosely used to describe a people speaking the same tongue and this is very common in the Solomon Islands and Papua New Guinea. It is an unwritten social contract that acts like a safety net. In countries where unemployment is high and development moves slowly, people rely on the *wantok* system. Traditionally it was all about family, the clan and the tribe. Today the *wantok* system extends beyond villages into towns, government and the work force. <<http://melanesiancurrents.com/profiles/blogs/wantok-systemwantokism-1>>.

reinforce public administration; but, accordingly to Wetherly, the tradition of *wantokism* needs to be changed.¹⁶⁵

From the literature review we can also see how development projects need collaboration across disciplines and careful consideration of sociocultural factors if they are to avoid failure. A study was conducted with a sampling of 14 'failed' development projects financed by the World Bank. Nine projects failed, not only because of insufficient due diligence and/or understanding of the context and fell short of being holistic or strategic, but also because they lacked any sociocultural consideration, development culture and mentality, which limited their success.¹⁶⁶ Cultural differences need cultural understanding and cross culture management needs flexible leadership in order to succeed. Anbari et al. reported evidence of cross-cultural differences and their implications for success or failure in project development.¹⁶⁷

3.2 Sociocultural studies, influences on economic behavior

3.2.1. The role of socioculture and religion

Culture is a significant economic variable to the extent that it is known to influence behavior in economic activities. It is a useful variable to the point that the process by which it does so and the intervening factors involved can be uncovered. Theoretically, the outlook constitutes cultural influence on individual behavior in economic interactions, which in this study influences microfinance performance. Chuah et al. support this view in demonstrating a linkage between cultural attitudes and individual behavior as a potential intervening variable.¹⁶⁸ Laurence argues that religious beliefs influence behavior as well as social and

¹⁶⁵ Haque, T.A. 2012. The Influence of Culture on Economic Development in the Solomon Islands: A Political Economy Perspective, SSGM Discussion Paper 2012/1, Australian National University.

¹⁶⁶ Courtney, K. 2007. Development Projects that Didn't Work; The Perils of Narrow Approaches to Complex Situations, Globalhood Research Paper [http://globalhood.org/articles/briefingnotes/Development Projects That Didnt Work.pdf](http://globalhood.org/articles/briefingnotes/Development%20Projects%20That%20Didnt%20Work.pdf) and www.globalhood.org/articles/Table%20of%20Failed%20Projects.doc.

¹⁶⁷ Anbari, F.T., Khilkhanova, E.V., Romanova M.V. and S. A. Umpleby, S.A., Cross-Cultural Differences and their Implications for Managing International Projects <file:///D:/Documents%20and%20Settings/User/My%20Documents/Project%20Fail%203.htm>

¹⁶⁸ Chuah, S.H. et al. 2005, *Economic Anatomy of Culture: Attitudes and Behaviour in Inter- and Intra-National Ultimatum Game Experiments*, CeDEX Discussion Paper No. 2005-11 <http://www.nottingham.ac.uk/economics/cedex/papers/2005-11.pdf>.

economic values. He contends that studies of religion promise to enhance economics at several levels, which show how economic models can be modified to address questions about belief, norms and values, and explore how religion, morals and culture affect economic attitudes and activities of individuals, groups and societies.¹⁶⁹

One important aspect of this study is the role of religion and it has long been part of economic thought. For example, Smith notes that the progress of modernity is not undermining religion but could be viewed as a rational action by which individuals enhance the value of their human capital.¹⁷⁰ Weber later acknowledges that religion has a strong social component: religion can be a force of change in the economic activities of a society. He explains that Protestant ethics have ascetic morals with a simple and strict way of life that makes modern capitalism spread quickly.¹⁷¹ Weber argues that religion is a social process that can be considered as the basis of rationalism in economic behavior.¹⁷² He also contends that Protestant values have contributed profoundly to the influence of rationalism in the Western world, but the ethics of Confucianism and Hinduism constrain rationalism and the development of capitalism.¹⁷³ Here changes in religious values are a factor in the transformation process, from traditional economic systems to modern ones. Lechter argues that religious callings inspire people to work hard, be rational and efficient and regard the pursuit of profits as something virtuous.¹⁷⁴

¹⁶⁹Laurence, R.I. 1998, 'Introduction to the economics of religion', *Journal of Economic Literature*, 36, pp.1465-1496.

¹⁷⁰Smith, A. 1991, *Inquiry into the Nature and Causes of the Wealth of Nations*, London, Everyman's Library and Anderson, G. M. 1988, 'Married. Smith and the preachers: The economics of religion in the wealth of nations', *Journal of Political Economy*, 96(5), pp.1066-1088.

¹⁷¹Weber, M. 1995, *The Protestant Ethic and the Spirit of Capitalism*, T. Parson (trans.), Unwin Paperbacks, London.

¹⁷²Weber, M. 1977, *Economy and Society*, Berkeley, University of California Press.

¹⁷³Weber, M. 1964, *The Religion of China: Confucianism and Taoism*, Macmillan, New York and Weber, M. 1958, *The Religion of India: the Sociology of Hinduism and Buddhism*, Free Press Glencoe, Ill.

¹⁷⁴See also Lechner, F.J. 2006, *Rational Choice and Religious Economies*, Emory University, p. 3, view 5 January 2011, <<http://www.sociology.emory.edu/flechner/Rational%20Choice%20and%20Religious%20Economies.pdf>>. Treating religion as rational activity involves three assumptions: individuals act rationally to maximize net benefits, the ultimate needs to assess costs and benefits and social outcomes emerge from individual actions.

In Indonesia, religion took an active part in the beginning of economic modernization and this relationship between religions and economic activities was evident, especially when Islam started to expand and spread throughout coastal areas of northern Java (Groeneveldt & van Leur).¹⁷⁵ Castles and de Jonge also show the important role of religion in economic transformation in many places in Indonesia.¹⁷⁶ Geertz argues that there was a similarity in the spirit of capitalism in Muslim communities in Java and among Protestant capitalists.¹⁷⁷ He asserts that in light of Weber's theories concerning the role of Protestantism in stimulating the growth of business communities in the West, it is perhaps not surprising that leaders in the creation of such a community in Mojokuto, Geertz's study area, are for the most part reformist Muslims. It has in some ways approached that of Protestantism in Christianity.

Camerer explains that behavior is influenced by culture and behavioral differences are most commonly attributed to corresponding differences in culture.¹⁷⁸ This relationship offers an explanation for differential behaviors in response to identical conditions that conform to intuition, and highlight new dimensions not captured in traditional approaches to economic decision-making. As a result, cultural explanations of economic behavior have recently flourished in many areas of economics, particularly in economic development and growth theory (Harrison & Huntington; Walton & Rao).¹⁷⁹ However, Frederking reminds us there is a danger in treating culture as an unclear, collective term for the type of factor that traditional models cannot easily

¹⁷⁵Groeneveldt, W.P. 1960, 'Historical notes on Indonesia and Malaya: Compiled from Chinese sources', in Bharata, Jakarta and van Leur, J.C. 1983, *Indonesian Trade and Society: Essays in Asian Social and Economic History*, The Netherlands Foris Publication, Dordrecht.

¹⁷⁶ Castles, L. 1967, *Religion, Politics and Economic Behaviour in Java: The Kudus Cigarette Industry, Cultural Report, Series no. 18*, Yale University and De Jonge, H. 1989, *Madura dalam Empat Zaman: Pedagang, Perkembangan Ekonomi dan Islam*, Gramedia, Jakarta.

¹⁷⁷Geertz, C. 1967, 'Social change and economic modernization in two Indonesian towns: A case in point', in Dalton G. (ed.), *Tribal and Peasant Economies*, The Natural History Press, New York, pp. 366-394.

¹⁷⁸Camerer, C. F. 2003, *Behavioral Game Theory*, Princeton University Press, Princeton, NJ.

¹⁷⁹ Harrison, L. E. and Huntington, S. P. 2000, *Culture Matters: How Values Shape Human Progress*, Basic Books, New York and Walton, M. and Rao, V. (eds.) 2004, *Culture and Public Action: A Cross-Disciplinary Dialogue on Development Policy*, Stanford University Press, Stanford, California.

capture. This danger arises to the extent that the processes by which culture generates behavioral differences are not specified.¹⁸⁰

With the abovementioned convictions we have to place sociocultural aspiration into the economic framework, in this case microfinance activities. It means that microcredit flourishes in a supportive cultural environment. Since the 1990s, poverty alleviation and the role of microfinance institutions have become important issues of international concern. Along with the growth in microfinance institutions, various studies indicate that microfinance can challenge the established idea that poor people are excluded from the formal financial system because they are not bankable.¹⁸¹ Thus poverty is declared a worldwide priority and an international joint effort is needed to address poverty. And this is reflected in the development of microfinance institutions.¹⁸² The strategy is people centered, non-discriminatory and gender neutral, as announced by the World Bank.¹⁸³

There are discussions on people-centered issues such as the demand side or the borrowers' perspective in microfinance operations and how a sociocultural approach to borrowers and potential borrowers can be applied.

The first reason is that microfinance is focused on people and their behavior influences microcredit operations. The sociocultural area of overlapping specifically concerns non-physical aspects that relate to society's system of values and thought, or stand for its cultural identity, as discussed by

¹⁸⁰Frederking, L. C. 2002, 'Is there an endogenous relationship between culture and economic development?' *Journal of Economic Behavior and Organization*, 48(2), pp. 105-126.

¹⁸¹ The proposition that the poor are excluded from the financial system because they are not able to fulfill bank requirements is examined by many authors such as: Remenyi, J.V. 1991, *Where Credit is Due: Income-Generating Programmes for the Poor in Developing Countries*, IT Publications, London; Webster, L.M. et al. 1996. *World Bank Lending for Small Enterprises, 1989-1993*, The World Bank, Washington DC.; Hulme, D. and Mosley, P. 1996, *Finance Against Poverty*, vols. 1 and 2, *Routledge*, London and New York; Hashemi, S.M, et al. 1996, 'Rural credit programs and women's empowerment in Bangladesh', *World Development*, 24(4), pp. 635-653; Khandker, S.R. 1996, 'Grameen Bank: Impact, cost, and program sustainability', *Asian Development Review*, 10(1), pp. 97-130; Pitt, M.M. and Khandker, 1996, 'Household and intrahousehold impact of the Grameen Bank and similar targeted credit programs in Bangladesh', *World Bank Discussion Paper 320*, The World Bank, Washington, DC; Remenyi, J. and Quinones, B. J (eds.) 2000 *Microfinance and Poverty Alleviation: Case Studies from Asia and the Pacific*, Pinter, London; Remenyi, J. 2004, 'Microfinance best practice, shelter: Special issue on microfinance', *Human Settlement Management Institute*, 7, pp. 88-94.

¹⁸²World Summit for Social Development, 1995, Copenhagen Declaration on Social Development, Part C.

¹⁸³ The World Bank and the Copenhagen Declaration: Ten Years After Social Development, Department Environmentally and Socially Sustainable Network, 20 September 2004.

Neubert.¹⁸⁴ As people are the starting point, the center and end goal of each economic activity, their sociocultural variables are critical for development activities.¹⁸⁵ This is explained by Cernea who also clarifies that 'Putting people first' in any project improves social organization by providing a set of concepts that help explain such issues as social action, the relationships among people, their institutional arrangements, as well as the culture and values that govern their behavior vis-a-vis each other and natural resources. It means that an understanding of local culture and human behavior is critical to the success of microfinance programs.

The second reason is the issue of gender in microcredit, as women are the majority among the poor. This gender issue is one of the sociocultural issues discussed by Neubert.¹⁸⁶

Unlike traditional forms of capital, such as economic capital and social capital, sociocultural life is not depleted by use, but in fact depleted by non-use: use it or lose it. This is the reason why the power of culture should be used for the benefit of economic development. Smith describes culture as a set of attitudes and practices, beliefs, morals, customs, values and practices which are common to, or shared by, people in society.¹⁸⁷ DiMaggio illustrates a similar meaning of culture as shared cognitions, values, norms, and expressive symbols.¹⁸⁸ This generally refers to patterns of human activity and the symbolic structures that give such activity significance. Within the culture we recognize tradition, a practice, custom, ceremony or story passed down from generation to generation, originally without the need for a writing system.

According to Glaeser, social culture, ethics, trust and trustworthiness are important issues. They indicate that social connection strongly predicts trustworthiness and some people have individual social culture, a

¹⁸⁴Neubert, S.2000, *Social Impact Analysis of Poverty Alleviation, Programmes and Projects: A Contribution to the Debate on the Methodology of Evaluation in Development Cooperation*, Frank Cass, London.

¹⁸⁵Cernea, M.M. 1987, 'Putting people first: Sociological variables in rural development', *Contemporary Sociology*, 16(2), pp. 201-202.

¹⁸⁶Neubert, S. 2000, *ibid*, p. 11.

¹⁸⁷ Smith, P. 2001, *Cultural Theory: An Introduction*, Blackwell Publishers; Malden and Trosby, D. 2001, *Economics and Culture*, Cambridge University Press, Cambridge.

¹⁸⁸Di Maggio, P. 1994, 'Culture and economy' in Smelser, N.J. and Swedberg, R (eds.), *The Handbook of Economic Sociology*, Princeton University Press, Princeton, pp. 27-57.

subcomponent of human capital that reflects the ability to earn returns from social situations.¹⁸⁹ Fukuyama describes trust as the expectation that arises within a community of regular, honest and cooperative behavior based on commonly shared norms on the part of other members of that society.¹⁹⁰ Social norms influence people's preferences and constraints, lower transaction costs, and facilitate the exchange of information. Based on commonly shared norms, trustworthiness is reciprocal behavior.¹⁹¹

3.2.2. The codification of Sundanese culture

Indonesia is composed of various ethnic groups (*suku bangsa*) with their own local languages, their own culture, and traditional lifestyles and religions. The New Order Government worried that cultural differences were used as resources to create conflict and jeopardize the unity of the nation. In accordance with Indonesia's five basic principles, *Pancasila*, the New Order Government attempted to codify local cultures within the frame work of nation and character building.¹⁹² As part of this endeavor the Department of Education and Culture published studies of the major regional cultures in Indonesia including Sundanese. In keeping with the government's policy objectives, these studies emphasised the positive side of these cultures, the idealized, normative and naive so that unity and the integrity of the nation was fostered (*menjaga persatuan dan kesatuan bangsa*). The restraints of the government's culture policies notwithstanding, the Department of Education and Culture's study of Sundanese culture fostered a debate among Sundanese

¹⁸⁹Glaeser, E. et al. 2000, 'Measuring trust', *Quarterly Journal of Economics*, 115(3), pp. 811-846.

¹⁹⁰ Fukuyama, F. 1995, *Trust: The Social Values and the Creation of Prosperity*. Free Press, New York.

¹⁹¹ Fehr, E. and Gächter, S. 2000, 'Fairness and retaliation: The economic of reciprocity', *Journal of Economic Perspective*, 14(3), pp. 159-181. Also see Sethi, R. and Somanathan, E. 2003, 'Understanding reciprocity', *Journal of Economic Behavior and Organization*, 50(1), pp.1-27.

¹⁹²*Pancasila* is the basic principles of Indonesia and consists of: 1. the belief in God Almighty, 2. just and civilized humanity, 3. the unity of Indonesia, 4. democracy guided by wisdom of representative deliberation and 5. social justice for all Indonesians. This is the accomplishment of Ketetapan Majelis Permusyawaratan Rakyat (the People's Advisory Assembly), MPR, No.II/MPR/1978 on P-4 Pedoman Penghayatan dan Pengamalan Pancasila /Eka Parasetia Pancakarsa (Guidelines of Pancasila implementation).

cultural figures and intellectuals about how their culture should be represented in modern Indonesian society.

Sundanese society has a written history dating back over a millennium. In its cultural development, it has accommodated animism, Hinduism and the conversion to Islam. West Java was one of the regions of Indonesia that experienced early and intensive administrative and economic intervention under Dutch colonial rule and thus became one of the principal administrative, economic and education centers. Since Indonesian independence, the Sundanese have sought to preserve their identity within the Indonesian state as well as promote and preserve Sundanese culture. During the 1980s a group of Sundanese scholars and cultural figures, using historical and traditional oral stories, sought to present a construction of Sundanese culture reflecting its values and aspirations, so far as this was permitted within the context of New Order Government policy.¹⁹³ This study examined selected Sundanese prose (in the second 1987 version) in seven sample areas.¹⁹⁴ It sought to codify Sundanese culture. The study was published by the Indonesian Department of Education and Culture as its official study of Sundanese culture and identified the following key values:¹⁹⁵

¹⁹³It is a traditional poetry (*ceritera pantun*) Lutung Kasarung, a well-known ancient *pantun* in Sundanese region. See *Pandangan Hidup Orang Sunda seperti tercermin dalam tradisi lisan dan sastra Sunda*, 1987, written by Warnaen, S., Rusyana, Y., Wibisana, W., Garna, Y., and Djiwapradja, K. Bagian Proyek Penelitian dan Pengkajian Kebudayaan Sunda (Sundanologi) Direktorat Kebudayaan Departemen Pendidikan dan Kebudayaan, Bandung.

¹⁹⁴ Prose was used as a source of analysis: Sanghyang Siksa Kandang Karesian, manuscript use letter character and old Sunda language dated 1518; *Sawer Panganten* by Yus Rusyana, 1971; *Pangeran Kornel*, 1930, by R. Memed Sastrahadiprawira and Mantri Jero, 1928, by R. Memed Sastrahadiprawira; See *Pandangan Hidup Orang Sunda seperti tercermin dalam tradisi lisan dan sastra Sunda*, 1987, written by Warnaen, S., Rusyana, Y., Wibisana, W., and Garna, Y., Djiwapradja K. Bagian Proyek Penelitian dan Pengkajian Kebudayaan Sunda (Sundanologi) Direktorat Kebudayaan Departemen Pendidikan dan Kebudayaan, Bandung.

Bab Adat-adat Oerang Prianganjeung Oerang Soenda Lian Ti Eta, 1913 by H. Hasan Moestapa, the stories of Si Kabayan written by Moh. Ambri, M.O. Kusman, Ahmad Bakri and Min Resmana; *Rasiahnu Goreng Patut*, 1928 by Yuhana; *Lain Eta* by Moh Ambri; *Mayit Dina Dahan Jengkol*, 1986, by Ahmad Bakri. See *Pandangan Hidup Orang Sunda seperti tercermin dalam tradisi lisan dan sastra Sunda, Konsistensi dan Dinamika*, 1987, written by Warnaen, S., Djiwapradja, D., Wibisana, W., Adimiharja, K., Sukmana, N.H., and Rotoyati. O., Bagian Proyek Penelitian dan Pengkajian Kebudayaan Sunda (Sundanologi) Direktorat Kebudayaan Departemen Pendidikan dan Kebudayaan, Bandung, The sample areas were Bandung city, Sumedang city, Cianjur city, Sumedang rural, Garut rural, Tasikmalaya rural, Sukabumi rural.

¹⁹⁵ The discussion below is based on the following source: Rusyana, Y., Sariyun, Y., Ekajati, E.S. and Darsa, U.A. 1988. *Pandangan Hidup Orang Sunda, Seperti Tercermin Dalam Kehidupan Masyarakat Dewasa ini (Tahap III)*, Departemen Pendidikan dan Kebudayaan,

1. Personal values

Basically a Sundanese determines positive goals in life and maintains good behaviors such as well-mannered, modest, honest, courageous, strong convictions, fairness, trust, and ethics to respect other people, broad minded and honor the country. In social relationships, the Sundanese talk openly, but keep a watchful eye on outsiders (*pendatang*). Customs and working practices can be changed when need be and when there is economic advantage, for example, from wet rice cultivation to fish farming, and the growing of vegetables or fruits. To find a good way of life, a Sundanese needs a teacher (*guru*), or to follow the good practices of other people as well as be open to criticism and advice. It is found that contact with external values had given the impact of speaking in Indonesian language (*bahasa* Indonesian) or English to be more prestigious than using good Sundanese language. The government supported schools to develop the *bahasa* Sunda.¹⁹⁶

2. Personal relationships in the community

The objective of a Sundanese is to live sufficiently and happily in a calm and peaceful lifestyle; to be honored by others; avoid indignity and digression; live serenely with family, neighbors and community; enjoy freedom; and live peacefully. To reach the good life a Sundanese has to follow traditions of the ancestors, follow advice or guidance from elders and *guru*, sustain individual and social control, and to maintain peacefulness in community life. The Sundanese are open to disagreement but it should be explained, negotiated or even protested. Marriage with non-Sundanese is accepted and husband and wife maintain equal relationship in marriage. The spirit of togetherness (*gotong royong*) is sustained and developed. Although *gotong royong* is frequently translated into a monetary transaction, someone in need can be provided help, but dependence on others should be avoided.

Direktorat Jendral Kebudayaan, Proyek Penelitian dan Pengkajian Kebudayaan Sunda, Jakarta. Bab III Kesimpulan, pp. 254-259.

¹⁹⁶The West Java province issued Perda No. 5/ 2003 related to "Pemeliharaan Bahasa, Sastra, dan Aksara Daerah". See also Glicker, J. 1983, Sundanese Socialization and Indonesia Education: The Hidden and Stated Curricula in the Classrooms of Bandung, West Java, Doctor of Philosophy thesis, Faculty of the Graduate School of Cornell University.

3. Personal relationships with nature and the environment

The Sundanese believe environment can give maximum benefit for the human being and community if it is well managed and maintained and if only used sufficiently. Excessive use of environment and natural resource and lack of preservation creates great disaster and torment. There are ancient Sundanese expressions that explain that eating is just enough to ease hunger, drinking is just enough to reduce thirst, and crop growing is just enough to supply daily food. This means the Sundanese are encouraged to take the middle way, not less but not more (*siger tengah*), exploiting the natural resources is not excessive for a luxurious life but just enough for daily needs. It is the message how to manage the resources and environment in order to maintain its sustainability. Since the New Order period natural resources in West Java have been exploited excessively. It seems that business interests are proving stronger than the Sundanese value to maintain sustainability of the environment.

4. Relationship with God, *Allah subhanahuwata'ala (swt)*, glorious and exalted is He

The Sundanese believe in Allah *swt* but they understand the influence of animism and Hinduism that recognize *Hyang Tunggal, Guriang Tunggal* or *Batara Tunggal* and various gods and goddesses (*dewa dan dewi*). They are Muslim and confident that Allah *swt* is *Maha Mengetahui* (Al-Alim, The Knower of All) to what they do the reason they have to honor and obey what to do and don't. They call Allah as *Nu Murbeng Alam* (Al-Malik the Absolute Ruler), *Nu Maha Wisesa* (Al Kabir, the Greatest), *Nu Maha Asih* (Ar-Rahman, The All Merciful), *Nu Maha Suci* (Al-Quddus, the Pure One). Those are parts of 99 beautiful names that belong to God (*Al-Asma-UI-Husna*). Allah *swt* gives His creatures' life, health, prosperity, and death at a determining time. The Sundanese now keep stronger faith on The One (*Al-Ahad*, the only one God) and as a human being has to make serious effort and pray but has to entrust the result to Allah. Education on Islamic rules and practices such as *pengajian*, (*Al Qur'an* reading and Islamic teaching) are more extensive in houses, schools

and mosques. The younger generation tends to be less observant of traditions such as *hajatan*, *salametan* or offering of foods and flowers to spirits (*sasajen*).

5. The effort to fulfill material and spiritual satisfaction

Some of the Sundanese culture is directly or indirectly related to human effort to earn a living or occupation. The Sundanese avoid competition and they prefer to cooperate or work together and they value deliberation. They are hard workers and refuse to give up, prioritize quality of work, never postpone the work or provide it to the unqualified and want to do good things although they only find rough jobs. They maintain the positive value of their ancestor and deeply consider new ideas, keep responsible, thrift, and try to balance between needs, income and expenses and able to live modestly. The Sundanese maintain creativity to find employment and confidence in their own capability, high adaptation to new environment and accept new development. They find it easy to adapt to new environments and places to live in the search of a better future.

Much of the above discussion is of Sundanese culture constructed as a set of ideals by the New Order Government as part of its more comprehensive cultural policy. Nevertheless, some of the cultural ideals codified in the government's construction of Sundanese culture are still held in the communities of the research areas. The cultural ideals were frequently expressed in the interviews and group discussion and some of the sayings have been quoted in this thesis.

Beside the ideals of Sundanese culture, the study also examines the cultural behavior of the respondents, and how cultural ideals are reflected in both the respondents' understandings of their culture and their behavior. The researcher argues that location, migration, occupation, influence of other cultures and technology and the role of religious teachers influence the behavior and attitudes of people in a community in relation to their financial activities.

Rosidi¹⁹⁷ criticizes this government depiction of Sundanese culture as being too idealized and not recognizing processes of change.¹⁹⁸ The following points reflect Rosidi's arguments and the seminar debate that followed his paper:

1. The attitude to be brave, strong and firm on truth and justice and broad-minded is questionable. Yes there are many individuals with that character but it seems not as the Sundanese spirit as a whole. Rosidi explains that the Sundanese show tough character instead of "the pleasant one" and dare to express their own strong personality, rather than play things for safety.

2. To change Sundanese closed ways of thinking to be open-minded, to accept and have the courage to criticize.

3. Preservation of environment, to keep it well maintained and used sufficiently in practice is also doubtful. In fact natural resources in West Java have been damaged and uncontrollably exploited. The Sundanese officials in government offices do not show any concern to save the environment from the destruction of rivers, fertile areas, and productive land and protected forest (*hutan lindung*).¹⁹⁹

4. The expression "to eat just enough to satisfy hunger, to drink just enough to quench thirst, farm just enough to feed the family" has been changed with the idea to get prosperity. This is a strategic change where economic values and profit motives turn to be the driving force to produce goods and services, not only for self sufficient consumption needs, but also to supply the market. This transformation of economic purpose brings with it the need to develop new business ethics that guide the development of business relationships in a competitive environment.

¹⁹⁷ Rosidi Ajip is a distinguished authority on Sundanese culture. He was a senior lecturer at various universities in Indonesia and Japan. He has established his own foundation to promote the Sundanese culture.

¹⁹⁸ Discussion on the Sundanese culture in a seminar *Kepemimpinan Putra Sunda* (the Sundanese leadership) in Bandung at 21 August 2006. See Rosidi, A. 2008, *Kajian Tentang Falsafat Sunda*, <http://ajip-rosidi.com/makalah/kajian-tentang-falsafah-sunda/> viewed 20 June 2009.

¹⁹⁹ Sobirin, 2007, 'Tragedi Kawasan Lindung dan Hilangnya Hak Azasi Alam' in Bachtiar, T, Setiawan, H, *Menyelamatkan Alam Sunda dan Kajian Lainnya mengenai Kebudayaan Sunda*, Pusat Studi Sunda, Bandung.

5. They rush into the 'new value' of culture, leave behind tradition and neglect their ancestral guidance. They adopt the "new Sundanese practical culture" when culture is not seen as static traditions but as "mixed and dynamic tradition" with opportunity to create them as saleable products and services. It also influences economic behavior where benefit is better than aesthetic, where the dynamics of the market are tempting the traditions.

The researcher is in agreement with Rosidi's view that changes are challenging the Sundanese culture. In this study the researcher examines the influence of Sundanese sociocultural life on economics, especially the behavior of microborrowers of BRI Units and BPR.

Julia Suryakusuma is another Sundanese scholar who has researched contemporary Sundanese society. In her 1988 study, Suryakusuma examines the New Order Government's gender ideology as this was reflected in the PKK program (*Pembinaan Kesejahteraan Keluarga*/Family Welfare Movement). The PKK was a nationwide social movement supposedly "motored" by women to support the New Order Government by developing mental, spiritual and physical material aspects of family life in rural and urban areas.²⁰⁰

In the context of her evaluation of how the PKK program was implemented, Suryakusuma examines life patterns, local conditions, male-female relations, models of womanhood, motherhood, and the family. The principal factors considered in Suryakusuma's research were ethnicity and *adat* (local tradition), socioeconomic factors, religion (Islam), and government policies and regulations. Suryakusuma's study area was Buniwangi and Citandoh sub-district of Pelabuhan Ratu, district of Sukabumi, West Java.

According to Suryakusuma, the PKK program employed a top-down approach designed to make women "subordinate" to their husband (*istri hanya menjadi pendamping suami*) and the families used to support the regime. The women, especially the wives of civil servants (*pegawai negeri*) in the villages were expected to participate in all 10 PKK programs. The role of PKK was significant because it sought to mediate between the state and village women,

²⁰⁰ Suryakusuma, J. 2011. *State Ibuism, The Social Construction of Womanhood in New Order Indonesia*, Masters Thesis, Institute of Social Studies, The Hague, The Netherlands (1988) and Komunitas Bambu, Depok, West Java, p. 27.

and it did so through various spheres of influence: social, cultural technological, political and economic.²⁰¹

Suryakusuma argued that the PKK's top-down centralized approach was too Javanese-centric and disregarded the socioeconomic and cultural circumstances of women who were expected to participate. The study concluded that the values embodied in the PKK conflicted with ideals of womanhood and the family as perceived by the villagers. The PKK did not recognize the realities of life in the villages. Rural women suffered the most from the manipulation and misinterpretation of traditional-cum-religious values and practice, as constructed by the government and reflected in state ideology, government policies and programs.²⁰²

However, Sundanese culture is not articulated in the form of written regulations, consequently there are no legal sanctions (*hukuman/sanksi adat*) for breaching of customs (*adat*). In this sense, it is different from what can be observed in other cultural settings such as Bali.²⁰³ Arsyad examines the sociocultural influence of informal institutions in Bali, such as various regulations and practices, values, norms and social sanctions that determine individual or borrowers' behavior.²⁰⁴ These sociocultural influences determine the way in which microfinance institutions are managed; this is reflected in their organizational structure, recruitment, loans procedure and remuneration systems. In relation to microfinance institutions, social customs, values and norms of the Balinese people are not only integrated in custom villages (*desa adat*) with written custom regulations named *awig-awig* but also accommodated in the Bali Provincial Regulation no. 6/1986 on the Status, Function and Role of Custom Villages and no. 8/2002 on Village Credit Institutions. The elucidation of the regulations clearly states and recognizes that customary law is more likely to be obeyed by members of *desa adat* than any government regulations, since these social customs, values and norms have existed for centuries and

²⁰¹ Suryakusuma, J. 2011, *ibid*, p. 40.

²⁰² Suryakusuma, J. 2011, *ibid*, p.107.

²⁰³ Arsyad, L. 2005, An Assessment of Performance and Sustainability of Microfinance Institutions: A Case Study of Village Credit Institutions in Gianyar, Bali, Indonesia, PhD thesis, Faculty of Social Sciences, Flinders University, Adelaide, Australia.

²⁰⁴ See also Arsyad, L. 2008, *Lembaga Keuangan Mikro Institusi, Kinerja dan Sustainability*, Andi Offset, Yogyakarta, pp.185-192.

there are strong social sanctions (*hukuman adat*). Meanwhile, the management of the Village Credit Institutions has to be accountable to the custom based village unit through its leader. In Bali microfinance activities benefit from the working together of formal and informal institutions as an effective means of enhancing the success and sustainability of local institutions.²⁰⁵

Working together economically as a group is discussed by Durlauf and Fukuyama. Durlauf argues that in the economy individuals maximize their own welfare; however they are also expected to care about the welfare and intention of others, such as between members of a group. Through sociocultural values, as a set of informal values or norms shared in a community, they cooperate. If members expect that others will behave reliably and honestly, they will come to trust one another.²⁰⁶ Trust is needed, as it acts like a lubricant that makes any group or organization run more efficiently, as explained by Fukuyama.²⁰⁷

Based on these arguments, the researcher agrees with the proposition that religion, culture, tradition, norms, ethics and trust between human beings influence behavior and attitudes in interpersonal relations. However, this study aims to explore, directly or indirectly, relationships with microfinance sustainability, reflected in failure or success in microbusiness and microcredit, either in increasing extra costs or reducing pay out.

3.3 The interest system and issue of *riba*

One of the main costs of microcredit is bank interest and when bank interest is identical to *riba* in Islam, it is prohibited or *haram*.²⁰⁸ The *Qur'an* declared the prohibition of *riba*.²⁰⁹ It referred specifically to delayed payment of interest

²⁰⁵ The World Bank, 2002, *World Development Report 2000/2001*, The World Bank, Washington D.C., p.178.

²⁰⁶ Durlauf, S. 2003, 'On the empiric of social capital', *The Economic Journal*, 112(483), pp. F459-F479.

²⁰⁷ Fukuyama, F. 1995, *Trust, the Social Virtues and the Creation of Prosperity*, Free Press, New York.

²⁰⁸ See *Fatwa Majelis Ulama Indonesia (MUI)*, prohibition on interest system, 24 January 2004.

²⁰⁹ The prohibition of *riba* appears in the *Qur'an* in four different revelations. The first of these (Al-Rum, 30:39), revealed in Makkah, emphasized that while interest deprived wealth of God's blessings, charity raised it manifold. The second (Al-Nisa', 4:161), revealed in the early Madinah period severely condemned it, in line with its prohibition in the previous scriptures. It placed those who took *riba* in juxtaposition with those who wrongfully appropriated other people's

(*riba al-nasi'ah*).²¹⁰ It is a loan transaction in which there is no additional amount charged to the agreed loan, but if the debt could not be repaid upon maturity, the creditor would accommodate the debtor with additional time to meet the payment at an additional charge. Since the charge amounts to heavy rates of usury, it is an exploitation of the poor by the rich and thus banning *riba* prevents social injustice.

Legal and academic discussions of *riba* should refer to its main source, the Holy *Qur'an*. By reviewing verses in *al-Qur'an* and the *Hadith* we can find the reasons behind prohibition of *riba* in direct or indirect statements, and reasons can be inferred from the texts read in context. Here we are also going to see how *riba* influences the economic behavior of Muslim borrowers. *Al-Qur'an* declares *riba* is *haram* but there is room for different interpretations that are traceable to the time of Hadrat-i-Omar in the first century of the Islamic period, who is quoted as saying: "The last to be revealed is the verse of usury and the Prophet Muhammad *salla'lahualaihiwasallam* (*saw*, may Allah bless him and give him peace) expired without explaining it to us. Therefore, give up usury or anything resembling it".²¹¹ When *riba* is usury or exploitative charged interest, the statement of Omar is an entry point for interpretation and Islamic behavior requires two kinds of patterns: 1) follow the given interpretation established by a *fiqh* (systematic interpretation of the *Qur'anic* injunctions) and

property and threatened both with severe punishment from Allah. The third revelation (Al-Imran, 3:130-2), around the second or third year after *Hijrah*, enjoined Muslims to keep away from *riba* if they desired their own welfare (in the comprehensive Islamic sense). The fourth revelation (Al-Baqarah, 2:275-81), close to the completion of the Prophet's mission, severely censured those who take *riba* by declaring them to be at war with God and His Messenger, established a clear distinction between trade and *riba*, and required Muslims to annul all outstanding *riba*, instructing them to take only the principal amount, and to forego even this in case of the borrowers' hardship. See Chapra, M.U. 2009, *The Nature of Riba in Islam*, <[The Right Path, http://al-hussaini.blogspot.com/2009/10/nature-of-riba-in-islam.html](http://al-hussaini.blogspot.com/2009/10/nature-of-riba-in-islam.html)>.

²¹⁰ *Riba al-nasi'ah* and *riba al-fadl* are, thus, essentially counterparts of the verse "Allah has allowed trade and prohibited *riba*" (Al-Baqarah, 2:275). While *riba al-nasi'ah* relates to loans and is prohibited, in the second part of the verse, *riba al-fadl* relates to trade and is implied in the first part. Because trade is allowed in principle, it does not mean that everything is allowed in trade. The *riba* which is prohibited by *al-Quran* is called *riba al-duyun* or *riba al-jahil* or *riba al-nasiah*. See Adawiah, E.R.E.A. *Riba and its prohibition in Islam*, International University Malaysia, p. 10, viewed 10 August 2010, <<http://www.nzibo.com/riba/riba%20and%20its%20prohibition.pdf>>.

²¹¹ Noorzoy, M.S. 1982, 'Islamic law on *Riba* (Interest) and the economic implication', *International Journal of Middle Eastern Studies*, 14(1), pp. 3-17.

2) in case of doubt, a person must follow his best judgment until assessment is given by *ifta* (the scholarly exercise of such judgment).

This discussion has identified two interpretations on the payment of interest: firstly, based on *fiqh* and the *Qur'an*, interest is prohibited and, secondly, based on economic considerations, interest payments are applicable. Here the arguments of some Islamic experts on these two conflicting opinions are reviewed.

3.3.1. Interest is totally prohibited

Siddiqi explains why the payment of interest as *riba* is prohibited.²¹² *Riba* is a corrupting element in society as explained in *al Qur'an sura al Rum*, 30: 37-41. Corruption has the implication of *fasadas* resulting from men's behavior through illegal means, such as usury, bribery, profiteering and fraudulent trading; all unlawful grasping of wealth at other peoples' expense is condemned. Farooq disagrees with Siddiqi's logic that can be identified by simply examining this point that *riba* corrupts society.²¹³ Farooq explains why *riba*-based transactions are unjust and thus may have a corrupting influence on society, but the corruption studies or corruption-related literature does not identify interest anywhere as one of the determinants of corruption. Indeed, most countries with a Muslim majority rank high in the Corruption Perception Index (CPI).²¹⁴ But corruption related studies either by Muslims or non-Muslims pertaining to these countries have never identified interest as one such determinant of corruption.

1. *Riba* amounting to unlawful appropriation of other people's property is indicated in the verse from chapter four, *sura al-Nisa'* 4:161 '.....for admonish taking usury when they were forbidden it, and of their devouring people's wealth by false pretences'. Significantly, *al Qu'ran* equates the tendency to appropriate

²¹² Siddiqi, M.N. 2004, *Riba, bank interest and the rationale of its prohibition*, Islamic Research and Training Institute, Islamic Development Bank, King Fahd National Library Cataloging-in-Publication Data, Jeddah, p. 41.

²¹³ Farooq, M.O. 2005, *The Riba-Interest Equation and Islam: Reexamination of the Traditional Arguments*, Upper Iowa University, p.7.

²¹⁴ Transparency International. *Corruption Perceptions Index 2005*, http://www.transparency.org/cpi/2005/cpi2005_infocus.html.

other people's wealth without any justification to more serious crimes. In *sura Tauba*, 9: 34 it is associated with hoarding.

2. *Riba's* ultimate effect is negative growth. *Riba* is subject to destruction (*al Baqara*, 2: 276) which means decrease after decrease, a continuous process of diminishing. Once we leave out the improbable interpretation of individual wealth amassed through *riba* business being subject to continuous decrease, we have to turn to social wealth.

According to al-Qaradawi the strict prohibition of interest in Islam is a result of its deep concern for the moral, social and economic welfare of mankind. Islamic scholars have developed sound arguments explaining the wisdom of this prohibition, and recent studies have confirmed their opinions, with some additions and extensions of their arguments.²¹⁵ Thus al-Qaradawi merely refers to and quotes al-Razi's economic related arguments:

1. Unfair exchange, taking something from a party without giving him something in return. The taking of interest implies appropriating another person's property without giving him anything in exchange, because one who lends one *dirham* for two *dirhams* gets the extra dirham for nothing. Now, a man's property is for the purpose of fulfilling his needs and it has great sanctity, according to the *hadith*, 'A man's property is as sacred as his blood.' This means that taking it from him without giving him something in exchange is *haram* (p. 265). However, Farooq explains, the argument is misleading and erroneous.²¹⁶ When a non-charitable transaction is involved, both the parties know what the lending and borrowing entail. The borrower is borrowing for some commercial or personal benefit and the lender is lending for profit. In such non-charitable context, the lender is giving up or foregoing the purchasing power for a specific period. In other words, the lender is 'renting out' the purchasing power of his/her capital for a specific period of time and interest constitutes the 'rent' that is paid by the borrower.

²¹⁵ Al-Qaradawi, Y. 198-. *The Lawful and the Prohibited in Islam*, trans. Kamal El-Helbawy, M. Moinuddin Siddiqui, Syed Shukry; translation reviewed by Ahmad Zaki Hammad, American Trust Publications, Indianapolis, USA, pp. 265-266.

²¹⁶ Farooq, M.O. 2005, *ibid*, p. 8.

2. Qaradawi argues that interest promotes idleness. Dependence on interest prevents people from working to earn money, since the person with *dirhams* can earn extra *dirhams* through interest, either in advance or at a later date, without working for it. The value of work will consequently be reduced in his estimation, and he will not bother to take the trouble of running a business or risking his money in trade or industry. This will lead to depriving people of benefits, and the business of the world cannot go on without industries, trade and commerce, building and construction, all of which need capital at risk (p. 265). There is confusion here between individual lenders and institutional lenders. In modern times, commercial lending and borrowing usually does not take place involving an individual lender at a personal level and the context of modern commercial banking has changed fundamentally since the days of al-Razi in the 13th century. The real and ideal instruments of financing in *shari'ah* are equity participation (*musharakah*) and profit sharing (*mudarabah*).²¹⁷

Study of Ahmad and Hassan identifies several modernist and conservative views in regard to the prohibition of *riba* as discussed below:²¹⁸

1. What is prohibited is pre-Islamic *riba*. It has been claimed by some modernists that what is prohibited in *al-Qur'an* is the form of *riba* which referred to the then prevailing practice of lending in the pre-Islamic era.

2. Interest versus usury. Another controversy of *riba* is due to the *Qur'anic* injunctions against *riba*, whether it is 'interest', or 'usury'.²¹⁹ Modernists asserted that the *riba* which is prohibited, and on which there is consensus of opinion, is 'interest' when it equals the principal or more, but not the 'usury'.

²¹⁷ Usman, M.T. 2002, *An Introduction to Islamic Finance*, Kluwer Law International, The Hague, London, p. xv.

²¹⁸ The term 'modernist' is referring to some contemporary Muslim scholars like Fazlur Rahman (1964), Muhammad Asad (1984), Sa'id Al-Najjar (1989) and Sayyid Tantawi (1989) for whom it appears that prohibition of *riba* is due to the exploitation of the needy, rather than the concept of interest rates. Keeping this in view, many attempt to differentiate between various forms of *riba* practiced under the conventional banking system, advocating the lawfulness of some while rejecting others. While conservative views refer to the traditional interpretation of *riba*, which reinforces the point that any kind of interest falls under the banning of *riba*. See Ahmad, A.U.F, Hassan, M.K. 'Riba and Islamic banking', *Journal of Islamic Economics, Banking and Finance*, p. 7, <http://www.ibtra.com/pdf/riba_islamic_banking4.pdf>.

²¹⁹ Usury is the lending of money at excessively high rates of interest. See Elliot, J. 1999, *Paperback Oxford Large Print Dictionary*, Oxford University Press, Oxford, p. 1224.

3. Consumption loan versus investment loan. Some modernists tend to differentiate between 'consumption loans' and 'investment loans', and argue that *riba* on consumption loans is unlawful, but on investment or production loans, it is lawful.

4. Nominal versus real rate of interest. Inflation reduces the real purchasing power of money, whereas deflation increases its purchasing power. Indexation, they argue, is the solution to maintain the value of money.²²⁰

5. Compound versus simple interest. The proponents of the modernists view towards *riba* say that its prohibition applies to compound, not single interest.

6. Individuals versus institutions. The modernists explain institutions do not cover the prohibition of *riba* that only covers individuals. As opposed to this view the *Qur'anic* prohibition does not make any distinction between an institution and an individual.

An interest free or non-*riba* economy based on *shari'ah* principles needs to be developed to support various activities that govern a Moslem society with Islamic laws. In countries like Pakistan, Indonesia, Malaysia, Bangladesh and Sri Lanka a *shari'ah* banking system has been established side by side with an existing conventional capitalistic system. The abolition of interest replaced by profit sharing with a fair ratio between financier and entrepreneurs removed the source of uncertainty and injustice and more conducive to growth. Islam stands for steady economic growth with harmonious development, both in spiritual and economic assets.²²¹

3.3.2. Interest is acceptable

The second interpretation of *riba* is based on pragmatic considerations in economy and business. The global rise of Islamic banking institutions was inspired by neo-revivalist thinking on the issue of *riba*, which holds the view that any interest is *riba*. But now there is a general consensus among Muslim

²²⁰ With indexed loans at its maturity, interest, principal, or payments subject to change based on some variables, such as the inflation rate, consumer price index or the principal rate.

²²¹ Chapra, M.U. 1984, 'The prohibition of *riba* in Islam: An evaluation of some objections', *The American Journal of Islamic Studies*, 1(2), pp. 23-40.

economists that *riba* is not restricted to usury but encompasses interest as well.²²² Interest payment is prohibited under strong commandment of Allah *swt* in *al-Qur'an* and also supported by many respectable *ulamas* and Islamic jurists, but in practice we can easily find Muslims in many countries who adopt an interest system in their various financial transactions.²²³ Here, we review the reasons why an interest system is still applied, as discussed by Mohammad Nejatullah Siddiqi, Abu Umar Faruk Ahmad and M. Kabir Hassan.

Siddiqi summarizes the arguments of those who accept the payment of bank interest, given the proliferation of Islamic financial institutions, the widespread availability of mutual funds, and increasing disintermediation in financial markets has changed the situation.²²⁴ The businesses have hardly any problem with bank services other than those involving interest bearing credit facilities, and Islamic financial markets now offer several products and services catering to Muslim financial needs. The defenders of interest payments argue that:

1. It is needed to afford savers a safe means of earning a return.
2. It is necessary for Muslims engaging in business.
3. It is an essential part of the modern system of money and finance without which the whole system will collapse.
4. Interest is the price of capital. If it is removed there is nothing to establish equilibrium between supply of capital and demand.
5. Interest is necessary for efficient allocation of resources over time as in project evaluation.
6. It is not the *riba* prohibited in Islam. It is part of a system entirely different from the one in Arabia, of which the prohibited *riba* formed a part.

²²² Ahmad A.U.F. and Hassan, M.K, *ibid*, p. 16.

²²³ There are countries that adopt a dual system, interest system and *shari'ah* system such as Indonesia since 1999, Malaysia in 1980 and Bangladesh in 1983. Meanwhile, Pakistan that adopts the Islamic economy has totally banned interest in all forms, and by whatever name it may have been called since March 2000. There are complexity of attempts to reform Pakistan's banking sector into a purely Islamic-based system and the contests between government, the central bank and religious authorities. The re-emergence of a dual banking system is ongoing with compromise and accommodation between national religious culture and a global financial environment.

²²⁴ Siddiqi, M.N. 2004, *ibid*, pp. 55-63.

7. Modern bank interest does not violate norms of justice, so there is no moral case against interest.
8. It is not the *riba* prohibited in Islam. It is paid by rich banks to ordinary people in contrast to that paid by the poor to the rich lenders as in Arabia in earlier times.
9. It is not the *riba* prohibited in Islam as it is related to commercial loans, whereas the former related to consumption loans.
10. It is not the *riba* prohibited in Islam that related to very high rates of compound interest.
11. It is not the *riba* prohibited in Islam as bank deposits are not in the nature of loans made to banks but in the nature of capital supplied in *mudarabah*.
12. It is not the *riba* prohibited in Islam, as it is only a predetermined rate of profit that the bank agrees to pay as an agent of the depositor who entrusted to it the task of profitable employment of the deposited capital.

Abu Umar Faruk Ahmad and M. Kabir Hassan argue that extra charges are permitted towards *riba* when they are used as follows:²²⁵

1. For purposes other than exploiting the weak people in the community by the strong.
2. For loans similar to what were practiced in the pre Islamic period.
3. For the present form of interest-based banking transactions but not for usurious transactions.
4. For business investment but not for consumption loans.
5. For the losses suffered by the creditor due to inflation.
6. For simple interest but not for compound interest.
7. For institutional credit.

From this review of the literature, the interpretations of Islamic principles that permit interest are mainly based on economic considerations to allow Muslims to survive and develop their livelihoods. The Muslims as Islamic community (*ummah*) become stronger if their economic activities are also in

²²⁵ Ahmad, A.U.F. and Hassan, M.K, *ibid*, p. 8.

their hands. In fact they challenge their own conviction and devotion to *Allah swt*, but they prioritize solving the material problems of this world. For the Muslims in Indonesia there are the alternatives of either paying interest or *shari'ah* loans, although *shari'ah* bank offices are not yet available in the villages. It becomes an emergency situation (*darurah*) when their needs for non-*riba* system cannot be accommodated.

The researcher agrees with Engku Rabiah Adawiah Engku Ali from International University Malaysia that the contemporary socioeconomic circumstances facing the Muslim community need to be considered.²²⁶

She identifies three theories. The first theory confines *riba al jahil* to doubled and multiplied interest prohibited, whilst simple *riba* which is stipulated in the first contract of debt before the due date is over, is not included in the prohibited type. The second theory is about a comprehensive public need, whereby its proponents talk about *al hajah* (need) to justify the category of *riba*, which is prohibited and this includes the interest rate. The third theory is *dharurah* (necessity) and changing circumstances in which its proponents claim that *riba* is only prohibited on consumption loans. Thus, because of necessity and changing circumstances, interest rates become permissible.

From this discussion of the literature on *riba*, we understand the debates between Islamic jurists are ongoing. Shamsul explains that an understanding of the theological formulation of Islam (in this case *riba*) is influenced by ethnic, linguistic and cultural variation, and the colonial systems of government and administration.²²⁷ He argues for a more informed analysis and understanding of Islam and Muslims. And their contemporary articulations must be 'embedded' in the historical reality of both plurality and society templates that become the 'mould' of social life in the region. Here we can see the complexities of *riba* as a subject to be interpreted differently in plural societies, such as we find in the conflicting interpretations of Nahdlatul Ulama and Muhammadiyah. However, theological formulation is not subject to debate as in the Persatuan Islam

²²⁶ Adawiah, E.R.E.A. *Riba and its prohibition in Islam*, International University Malaysia, p. 20 <<http://www.nzibo.com/riba/riba%20and%20its%20prohibition.pdf>>.

²²⁷ Shamsul A.B. 2005, 'Islam embedded: Religion and plurality in Southeast Asia as a mirror for Europe', *Asia Europe Journal*, 3, p. 159.

(Persis) view.²²⁸ Meanwhile Majelis Ulama Indonesia on its *fatwa* of *riba* in 2004 retained the theological formulation of *riba* as it is revealed, but kept it open for compromise for practical emergencies and for the benefit of the *ummah*.

This study wants to explore how these conflicting interpretations can be managed for the benefit of borrowers, the sustainability of microfinance institutions and the local community in general. The researcher agrees with Antonio, that Islamic microfinance institutions need to be established in the villages to enable Muslims to develop their economy in a manner consistent with their beliefs.²²⁹

3.4 Microfinance, means and impact

3.4.1. Definitions and characteristics

Microfinance is a much researched topic. Broadly speaking, the term microfinance implies small loans to poor people for self-employment, coupled with the collection of savings, insurance and payment services. At the outset these loans support the poor to alleviate poverty, but in practice, they develop as the provision of financial services to low income consumers and businesses, particularly those in developing countries. Microfinance as the name implies is clearly more than just credit, otherwise it would be called microcredit. Thus both terms represent the provision of small-scale financial services to poor or low income people who need 'guidance' to access commercial banking services.

The measurement of poverty varies from country to country as explained by Hatch, Hulme and Mosley and Hulme.²³⁰ The World Bank measures poverty

²²⁸ *Persatuan Islam (PERSIS, Islamic Union)* is known because of its strict attitude to some Muslim customs, which were considered as superstition in contradiction with the main Islamic teachings (*aqidah*, faith), although other Muslims accepted those customs as proper Islam. See Federspiel, H.M. 2001, *Islam and Ideology in the emerging Indonesian State, The Persatuan Islam (Persis) 1923 to 1957*, Koninklijke Brill NV Leiden, The Netherlands.

²²⁹ Antonio, M.S. 2004, *Islamic Banking in Indonesia: A Study of Riba and the Development of the Islamic Banking Industry and its Role in the Advancement of Small and Micro Financing*, PhD thesis, Institute of Asian Languages and Societies, University of Melbourne.

²³⁰ Hulme, D. and Mosley, P. 1997, 'Finance for the poor or poorest? Financial innovation, poverty and vulnerability'. In Wood, G.D. and Sharif, I.A. (eds.), *Who Needs Credit? Poverty and Finance in Bangladesh*, Zed Books, London and Hulme, D. et al. 2001, *Chronic Poverty: Meaning and Analytical Frameworks*, Chronic Poverty Research Centre Working Paper 2 IDPM,

by the absolute poverty headcount index, below a particular poverty line at US\$ 1 a day. In Indonesia, poverty means a condition in which a person cannot afford to fulfil the daily minimum requirement of 2,100 kcal per capita plus non-food minimum requirements for living such as clothing, schooling, transportation, household necessities, and other basic needs.²³¹ In fact, microfinance is no longer exclusively for the poor; it depends on how we define poverty as a requirement for the loans and whether the objective of microfinance institutions is to alleviate poverty or make profit.

Microfinance, according to Otero, is the provision of financial services to low income and very poor self-employed people.²³² These financial services as explained by Ledgerwood generally include savings and credit, but can also include other financial services such as insurance and payment services.²³³ Meanwhile, the Asian Development Bank (ADB) exposes the definition of microfinance provided in its 2000 Microfinance Development Strategy. Thus microfinance is the provision of a broad range of financial services such as deposits, loans, payments services, money transfers, and insurance to the poor and low income households and their micro-enterprises. Microfinance institutions are defined as institutions whose major business is the provision of microfinance services.²³⁴ Thus it is evident that microloans or microcredit are part of microfinance activities. This thesis adopts the ADB definition, as it is broad but clear and simple. The terms 'microfinance' and 'microcredit' are often interchangeable.

Although there is a lot of literature on microfinance, surprisingly Karlan and Goldberg state that the definition of microfinance is less clear or not clearly articulated.²³⁵ They argue that how we define small and poor affects what does

University of Manchester, viewed 17 June 2007, <<http://www.Chronicpoverty.org/pdfs/meanings.pdf>>.

²³¹Statistical Year Book of Indonesia 2002, *Poverty*, Badan Pusat Statistik, Jakarta.

²³²Otero, M. and Rhyne, E. 1994, *The New World of Microenterprise Finance: Building Healthy Financial Institutions for the Poor*, Kumarian Press, West Hartford, Connecticut

²³³Ledgerwood, J. 1998, *Microfinance Handbook: An Institutional and Financial Perspective*, The World Bank, Washington D.C.

²³⁴Asian Development Bank, 2000, *Finance for the Poor: Microfinance Development Strategy*, ADB, Manila.

²³⁵Karlan, D. and Goldberg, N. 2006, *The Impact of Microfinance: A Review of Methodological Issues*, viewed 17 June 2007, <http://www.econ.yale.edu/karlan/downloads/WBmethodology_paper_aug7pdf>.

and does not constitute microfinance. Not all programs for small and poor borrowers are to do with microfinance; it depends on models, target groups and services offered. There are at least seven general features of microfinance generally used as criteria although this is debatable: 1) small transactions, whether loans or savings; 2) loans for entrepreneurial activity; 3) collateral free loans; 4) group lending; 5) focus on poor clients; 6) focus on female clients and 7) market-level interest rates. The features are also different from place to place such as the value of small loans and savings, the measurement of poverty, legal aspects of collateral, monetary policy and transaction cost to obtain market level of interest.²³⁶ Montgomery explains that the character of microfinance development in rural areas is also different from those in urban areas; for example, the case of Bangladesh (Grameen Bank) and Bolivia (BancoSol) or microfinance that is run by commercial banks such as in Indonesia (Bank Rakyat Indonesia and Bank Perkreditan Rakyat), Pakistan, Malaysia, Nepal and many other countries in Asia and Latin America.²³⁷ Rock argues that the character of microfinance is also influenced by the governance of microfinance institutions regarding their policies, financial mechanisms and whether program objectives are to alleviate poverty, make profits or strike some balance between these objectives.²³⁸

Grameen Bank starts with the belief that microcredit should be accepted as a human right and builds a system where a borrower who does not possess anything has the highest priority in obtaining a loan.²³⁹ In fact, microfinance as a system is not a new concept. Siebel argues that every country has some history of microfinance, for example, Ireland since 1720s and Germany.²⁴⁰

²³⁶ See Outreach indicators of average loans and savings balance by region (Asia, Africa, Eastern Europe, Central Asia, Latin America, Middle East, North Africa), *Microbanking Bulletin*, 2003, issue 9.

²³⁷ Montgomery, H. and Weis, J. 2005, *Great Expectations: Microfinance and Poverty Reduction in Asia and Latin America*, Asian Development Bank, Manila. ADB Institute Research Paper Series, no. 63.

²³⁸ Rock, R. et al. 1998, *Principles and Practices of Microfinance Governance*, viewed 17 June 2007, <<http://www.unCDF.org/mfdl/readings/MFGovernance.pdf>>

²³⁹ See Banking for the Poor, Grameen Bank <<http://www.grameen-info.org>>.

²⁴⁰ Siebel, H.D. 2003, 'History matters in Microfinance: Small enterprise development,' *International Journal of Microfinance and Business Development*, 42(2): 10-12.

Increasing income is a good starting point for poverty alleviation but Sen argues it is not a good ending point for the study of poverty.²⁴¹ Here, Sen explains that poverty needs to be seen as the deprivation of basic capabilities, rather than merely as a consequence of low income. Deprivation is reflected in premature mortality, significant undernourishment (especially of children), persistent morbidity, widespread illiteracy and other values. Development is the way to overcome deprivation and provide people with greater freedom and choice. It consists of the removal of various types of restrictions that leave people with little choice and little opportunity of exercising their reasoned agency.²⁴² Microfinance becomes the instrument of freedom by providing greater financial choice, not only supporting economic development but also encouraging greater social inclusion. This is Sen's broad framework to incorporate development strategies, such as microfinance uses for assets accumulation as a means, along with income transfers to help address systemic poverty.

Using this framework, microfinance is adopted in a developed country such as in Australia where microfinance is applied as an assets-building policy amongst the poor, as noted by Sherraden.²⁴³ It is income generation accumulated as assets that have a positive effect on individual's lives, providing a sense of security for families, a buffer against financial hardship and, more importantly, providing individual choice and opportunity.²⁴⁴ In the United States of America where assets based social policies have been in place since the 1990s, there is growing evidence and agreement that higher levels of wealth and other assets are associated with better health and living conditions, higher levels of education, increased levels of economic household stability, higher levels of civic involvement and greater inter-generational wealth transfers.²⁴⁵

²⁴¹Sen, A. 1999, *Development as Freedom*, Oxford University Press, Oxford, p. 20.

²⁴²Sen, A. 1999, *ibid.* p. xii.

²⁴³Cabraal, A., Russell, R. and Singh, S. 2006, *Microfinance: Development as Freedom*. Paper presented to the Financial Literacy, Banking and Identity Conference, RMIT University, Melbourne and Sherraden, M. 1991, *Assets and the Poor: a New American Welfare Policy*, M.E. Sharpe Inc, Armonk, New York.

²⁴⁴Lombe, M, and Sherraden, M, 2005, Impact of Assets Ownership on Social Inclusion, Center for Social Development, Washington University. CDS Working Paper No. 05-06.

²⁴⁵Bynner, J. 2001, 'The effects of assets on life chances', in Paxton, W. and Bynner, J. *The Asset Effect*, Institute for Public Policy Research, London, pp. 17-35.

Following Remenyi and others the researcher recognizes that the important role of microfinance, when used as a poverty alleviation strategy, increases income for self-employed microbusiness and supports assets building.²⁴⁶ Microcredit is not only needed by the poor and low income earners but in practice it is also used by those who are not so poor to accumulate assets and improve welfare. Robinson explains that microfinance is used for the extremely poor with subsidized programs including employment generation, skills training and relocation, as well as for the economically active poor with commercial microloans and for lower middle income borrowers with standard commercial banking loans.²⁴⁷

3.4.2. The impact of microfinance

Supporters of microfinance have argued that microfinance institutions can not only have a major impact on the fight against poverty, but they can do so on a sustainable basis. There are various studies about the impact of microfinance, covering a variety of microfinance institutions in many countries in Asia and Latin America, with a certain methodology as summarized by Montgomery and Weiss.²⁴⁸ The reports can be found in Appendices 1 and 2, and most studies indicate the significant positive impact of microfinance to income and livelihood. In Montgomery's report, it is found that Coleman describes a negative impact of a village bank in Thailand; there was no evidence of program impact and no impact on assets or income variable.²⁴⁹ A study of the Grameen Bank by Neff is an example of where microcredit is not always a success, consistent with the

²⁴⁶Remenyi, J.V. 1991. *Where Credit is Due: Income-Generating Programmes for the Poor in Developing Countries*, IT Publications, London; Hulme, D. and Mosley, P. 1996, *Finance against Poverty*, vols. 1 and 2, Routledge, London and New York; Remenyi, J. and Quinones, B. J (eds.) 2000 *Microfinance and Poverty Alleviation: Case Studies from Asia and the Pacific*, Pinter, London; Cabraal, A. et al. 2006, Sherraden, M. 1991, *ibid*.

²⁴⁷Robinson, M.S. 2001, *The Microfinance Revolution: Sustainable Finance for the Poor*, The World Bank, Washington, D.C, p. 21.

²⁴⁸Montgomery, H. and Weis, J. 2005, *Great Expectations: Microfinance and Poverty Reduction in Asia and Latin America*, Asian Development Bank, Manila. ADB Institute Research Paper Series, no. 63.

²⁴⁹ See Appendix 1 in this thesis. Coleman compares his findings in 1994 and 2004 but explains no difference between these two studies. The programs are not reaching the poor as much as they reach relatively wealthy people. Impact is larger on richer committee members rather than on rank-and-file members.

manner in which Grameen Bank has been promoted.²⁵⁰ Neff states that after eight years of borrowing, 55% of Grameen households are still not able to meet their basic nutritional needs, resulting in many women using their loans to buy food rather than invest in business. She adds that microcredit is not yet able to empower women. It appears that Grameen is using the women as collection agents.

Another study reported by Hulme and Mosley examined the impact of 13 microfinance institutions in seven countries.²⁵¹ They found that for very poor borrowers the impact of the loan is on average small or negative, relative to the control group. However, households above the poverty line generally experience a positive impact compared to the control group. They argue that clients above the poverty line are more willing to take risks whereas the poor tend to take out small protection loans with minimal risk.

On the contrary, a number of critics of microfinance, such as McGuire and Donroy, argue that microfinance can make a contribution to poverty reduction in some circumstances, but it is hardly a panacea.²⁵² Microfinance is not in the position to solve poverty problems; it does not stand-alone but overlaps with existing development activities and helps with their implementation. Macro-economic policy and other government supports are needed besides good practices in microfinance management such as organization and operation aspects, skill and leadership, trust building, networking and small enterprise management. Microfinance needs to be understood not only from financial and business perspectives but also from a broader cultural and religious dimension.²⁵³

3.5 Microfinance policies

²⁵⁰Neff, G. 1996, 'Microcredit, micro results', *Left Business Observer*, 74, viewed 14 February 2007, <<http://www.leftbusinessobserver.com/Micro.html>>.

²⁵¹Hulme, D. and Mosley, P. 1996, *Finance against Poverty*, vol. 1, Routledge, London and New York.

²⁵²McGuire, P.B. and Donroy, J.D. *The Microfinance Phenomenon, The Foundation for Development Cooperation*, Brisbane, Australia, viewed 2 July 2007, <[http://www.fdc.org.au/Files/Microfinance/Microfinance%20phenomenon%20-%202000%20nroy,%20McGuire\).pdf](http://www.fdc.org.au/Files/Microfinance/Microfinance%20phenomenon%20-%202000%20nroy,%20McGuire).pdf)>.

²⁵³See *Microfinance is not just money ...* viewed 21 February 2007, <<http://www.gdrc.org/icm/not-just-money.html>>.

Policy here refers to microfinance either as a poverty alleviation strategy or as a financial institution with profits, but both strategies aim to reach sustainability under regulatory conditions such as central bank regulations. Gulli explains that microfinance theory is characterized by the debate between two camps regarding the best way to help the poor: the financial system approach and the poverty lending approach.²⁵⁴ Meanwhile, Woller calls this the *institutionist* approach, with its emphasis on financial self-sufficiency and institutional scale, and the welfarist approach, with its emphasis on direct poverty alleviation among the very poor.²⁵⁵ This literature review attempts to assess the arguments and assumptions of these approaches. There are four main issues, in reviewing these two different approaches: profit seeking versus social return, commitment to the poor, the role of donors and subsidy and group lending.

3.5.1. Financial self-sufficiency and profit seeking versus social return

The financial system approach views the overall goal of microfinance as the provision of sustainable financial services to low income people, but not necessarily to the poorest among them. The services are not targeted exclusively to the poorest, but underserved market niches in general, and serve profits toward achieving self-sufficiency. Here the primary objective of microfinance is financial strengthening and sustainable financial intermediation for the poor plus profit seeking with a high quality of financial service for the poor. Morduch explains the system tends to ignore borrowers' sociocultural values, as they do not directly benefit investors or lenders. The microfinance industry is dominated by this financial approach based on the assumption that microfinance operations should be able to cover their operating and financing costs with revenue.²⁵⁶ This paradigm is the conceptual foundation of the Ohio State University's Rural Finance Program, based on the analysis of the failed rural subsidized government credit programs of the 1960s and 1970s, due to

²⁵⁴Gulli, H. 1998, *Microfinance and Poverty: Questioning the Conventional Wisdom*, the Inter-American Development Bank, Washington, DC.

²⁵⁵Woller, G.M. et al. 1999, 'Where to microfinance?' *International Journal of Economic Development*, 1(1), pp. 29-64.

²⁵⁶Morduch, J. 2000, 'The microfinance schism', *World Development*, 28(4), pp. 617-629.

the lack of institutional viability.²⁵⁷ This weakness brings lower loan repayment rates because borrowers have little incentive to repay loans to institutions whose future is in doubt. The analysis leads logically to two principles of the financial system approach: 1. institutional sustainability is the key to successful provision of financial services to the poor, and 2. financial self-sufficiency is a necessary condition for institutional sustainability.

The financial system argument is consistent with a 19th century study by Hollis and Sweetman of six microcredit organizations in the UK, Germany and Italy, which identified institutional designs that were conducive to success and sustainability.²⁵⁸ The authors conclude that the organizations that depended on charitable funding are more fragile and tend to lose their focus more quickly than those that obtain funds from depositors. An ability to adjust interest rates also appears important for sustainability. Another study by Patten provides a more recent historical example of strong and sustainable microfinance institutions and their customers.²⁵⁹ Patten compares the performance of the Indonesian microfinance institutions Bank Rakyat Indonesia (BRI) to other banks in Indonesia during the monetary crisis in 1997. He found that BRI, supported by BRI Units with strong smaller savings and microcredits, performed better than the formal banking sector when comparing both savings and loan repayment rates and customer service. Besides the Ohio school of thought, the financial or *institutionist* approach is articulated in virtually all the literature from the World Bank and the Consultative Group to Assist the Poorest (CGAP) in the World Bank and USAID.²⁶⁰ This approach is also found in the writings of Maria Otero and Elisabeth Rhyne.²⁶¹

The second approach is poverty lending or the *welfarist* approach, which claims that the overall goals of microfinance should be poverty reduction and

²⁵⁷Gonzales, V. 1994, *Stages in Evolution of Thought on Rural Finance: A Vision from Ohio State University*, Occasional Paper, no. 2134, Rural Finance Program, Ohio State University.

²⁵⁸Hollis, A. and Sweetman, A. 1998, 'Microcredit: What can we learn from the past?' *World Development*, 26(10), pp. 1875-1891.

²⁵⁹Patten, R.H. et al. 2001, 'Microfinance success amidst macroeconomic failure: The experience of Bank Rakyat Indonesia during the East Asian crisis', *World Development*, 29(10), pp. 1057-1069.

²⁶⁰Woller, G.M. et al. 1999, 'Where to microfinance?' *International Journal of Economic Development*, 1(1), pp. 29-64.

²⁶¹Otero, M. and Rhyne, E. 1994, *The New World of Microenterprise Finance: Building Healthy Financial Institutions for the Poor*, Kumarian Press, West Hartford, Connecticut.

empowerment. Some donor funding and subsidies may be needed because availability of funds is the most binding constraint in expanding the supply of financial services to the poor. While the financial system approach considers provision of financial services to be the main objective of microfinance institutions' operations, Gulli considers that the provision of such services is a means to achieve the main objective of poverty reduction.²⁶² As von Pische explains, credit is perceived as an important and effective tool for poverty reduction, even if the credit requires subsidies. This approach emphasizes the depth of outreach, instead of breadth of numbers of clients, and increases the trade-off with sustainability.²⁶³ The objective tends to be self-employment of the poorest people, especially women, and to empower them to improve their lives and their children's.²⁶⁴ The focus is the family, not the investors. The most prominent example of this poverty lending approach is the Grameen Bank in Bangladesh and similar banks elsewhere, the Foundation of International Community Assistance (FINCA, a non-profit NGO), and village banking programs in Latin America, Africa and Asia.²⁶⁵

In comparing those two approaches, the practical implications are:

1. The population segments served: between the not-so-poor entrepreneurs versus those who struggle on the margins of survival.
2. The designs for service delivery to these populations: lending to individuals versus lending to solidarity groups.
3. The institutional structures and financing to support these services: commercial banks, finance companies, individual investors versus social

²⁶²Gulli, H. 1998, *Microfinance and Poverty Questioning the Conventional Wisdom*, the Inter-American Development Bank, Washington, D.C.

²⁶³Von Pische, J. 1996, 'Measuring the trade-off between outreach and sustainability of microenterprise lenders', *Journal of International Development*, 8(2), pp. 225-239.

²⁶⁴See Mayoux, L. *Micro-finance and Empowerment of Women: A Review of the Key Issues*, viewed 20 June 2007, <<http://www.ilo.org/public/english/employment/finance/download/wpap23.pdf>, and also Rahman, A 1999, *Women and Microcredit in Rural Bangladesh: Anthropological Study of the Rhetoric and Realities of Grameen Bank Lending*, Westview Press, Boulder, Colorado.

²⁶⁵Yunus, M. 2003, *Banker to the Poor: Micro-Lending and the Battle Against World Poverty*, Public Affairs, New York.

services, NGOs, community credit unions, community-based financial institutions in the villages.²⁶⁶

These issues are the ones facing the Indonesian government when microfinance is used as a policy of poverty alleviation or for direct financing through national or regional budgets.²⁶⁷ Here, the government has to review whether to expand access to financial services, to evaluate legal frameworks of informal microfinance institutions especially in rural areas, issues on prudential regulations and supervision, technical support and assistance, and how to provide financial support and to invite community involvement.²⁶⁸ The government examined existing poverty programs of various ministries for 2005-2006 to determine whether they were run ineffectively, crowding out the market and discouraging participation by non-government financial institutions. In 2007 the government restructured all poverty alleviation programs under the Coordinating Minister for People Prosperity (Menteri Koordinator Kesejahteraan Rakyat) and in July 2007 issued a new poverty alleviation policy named *Program Nasional Pemberdayaan Masyarakat Mandiri, PNPM Mandiri* (the National Community Empowerment Program Mandiri).²⁶⁹ The objective of this program is to reduce poverty by promoting community participation in development planning and management, and delivery of basic services to achieve Millennium Development Goal (MDG) targets by 2015.

3.5.2. Commitment to the poor

As the financial system approach accepts self-sufficiency and retains the profit motive, it is argued that the system is inadequate to serve the poor. In this approach, the management of microfinance institutions represents the interests

²⁶⁶ Those are the dynamics of the villagers to use village financial institutions to develop their livelihood; see Sumodiningrat, G. 2004, *Pemberdayaan Masyarakat Melalui Pengelolaan Lembaga Dana dan Keuangan Pedesaan*, eN Publishing, Jakarta.

²⁶⁷ Sumodiningrat, G. 2004, *Otonomi Daerah Dalam Penanggulangan Kemiskinan*, Badan Penerbit Fakultas Ekonomi Universitas Gajah Mada, Yogyakarta.

²⁶⁸ See Komite Penanggulangan Kemiskinan, 2003, *Buku Pedoman*, Sekretariat Komite Penanggulangan Kemiskinan, Jakarta and Komite Penanggulangan Kemiskinan 2004, *Pedoman Umum*, Sekretariat Komite Penanggulangan Kemiskinan, Jakarta.

²⁶⁹ See Keputusan Menteri Koordinator Bidang Kesejahteraan Rakyat no. 25/KEP/MENKO/KESRA/VII/2007 tentang Pedoman Umum Program Nasional Pemberdayaan Masyarakat Mandiri (PNPM MANDIRI), tanggal 30 Juli 2007.

of owners and not customers. It is understood that when profit and social motives conflict, management is bound to give greater weight to the interests of the owners.²⁷⁰ Otherwise, management fails to represent the owners and creates a situation in which selfish investors involuntarily subsidize the social motives of the microfinance institution. The protection of investors' interests comes in the form of board members, who must ensure that maximizing returns does not overtake the overall objective of reaching the poor.²⁷¹ In other words, who invests in microfinance institutions and the values they bring as shareholders will either safeguard or compromise the social commitment of these institutions.

According to Prawiro, in the 1980s pragmatism in government policy was applied (*deregulasi perbankan*) where market forces were the determinants.²⁷² He noted that the poor were considered as microbusiness owners who needed to comply with bank requirements, such as collateral, despite their businesses having good prospects. As a result, the poor without collateral could not gain access to the banking system. Prawiro argued that in order to maintain their livelihood, the poor required greater access to credit, although they would have to pay market interest rates.

This shift in paradigm among policymakers from poverty alleviation to a commercial approach raised the question: did microfinance remain part of the government's approach to poverty mitigation? The government's view was that it was not only its duty but also the role of the poor to help themselves. In the *reformasi* era there was a further paradigm shift in the government's approach to poverty alleviation and microfinance. The national strategy for poverty alleviation was more a rights based approach, where poverty alleviation for

²⁷⁰Morduch, J. 2000, 'The microfinance schism', *World Development*, vol. 28, no. 4, pp. 617-629.

²⁷¹Otero, M. and Rhyne, E. 1994, *The New World of Microenterprise Finance: Building Healthy Financial Institutions for the Poor*, Kumarian Press, West Hartford, Connecticut.

²⁷² Prawiro, R. 1998, *Indonesia's Struggle for Economic Development: Pragmatism in Action*, Oxford University Press, Kuala Lumpur.

those who could not access commercial microfinance was supported from the budget. The government also subsidized the operations of cooperatives.²⁷³

Although we can see a commitment to the poor in the policies of *reformasi* governments, there was a debate among policymakers about how to support those who were not regarded by microfinance institutions as 'bankable'. From this literature review two approaches have been identified. The first approach is advocated by Fernando's "Microfinance Outreach"²⁷⁴ and Matin, Hulme and Rutherford's "Financial Services".²⁷⁵ Both argue that it is preferable for the poor not to get microcredit but rather direct support such as cash or food, health, education or infrastructure development. In Indonesia this approach is evident in government programs like *Bantuan Tunai Langsung* (BTL/Cash Direct Support) and *Raskin* (*Beras untuk yang Miskin*/Rice for the poor) and physical infrastructure projects with PNPM Mandiri.

Another approach is to provide the poor with access to microcredit on terms and conditions suitable to their needs. As part of this debate, Woller et al. argues for a more balanced approach between 'welfarist' and 'institutionist' approaches. Woller et al. describes the concerns of both camps and provides a solution to achieve a productive balance between selfish, commercial and social returns.²⁷⁶

Average loans provided are indicators of the role of institutions in supporting the poor. An average loan ranges between US\$ 75 and US\$ 100. Table 1 in Morduch's article shows two flagships of microfinance institutions, Bank Rakyat Indonesia and BancoSol, which have an average loan size of US\$ 1,000 and US\$ 900 respectively.²⁷⁷ Bayadas explained that the commercial banks that have entered microfinance so far have provided borrowers with an

²⁷³ Strategi Nasional Penanggulangan Kemiskinan – SNPK 2004 – 2009, Kementerian Koordinator Bidang Kesejahteraan Rakyat Republik Indonesia, pp. 2-3, <<http://oldkesra.menkokesra.go.id/content/view/226/317/>>

²⁷⁴ Fernando, Nimal A. 'Microfinance outreach to the poorest: A realistic objective? Finance for the poor'. *ADB Finance for the Poor*, vol. 5, no. 1, March 2004, pp. 1-5.

²⁷⁵ Matin, Imran, David Hulme and Stuart Rutherford. *Financial Services for the Poor and Poorest: Deepening Understanding to Improve Provision*. The University of Manchester, October 1999.

²⁷⁶ Woller, G.M. Christopher, D. and Woodworth, W. 1999, *ibid*, pp. 29-64.

²⁷⁷ Morduch, J. 1999, 'The microfinance promise', *Journal of Economic Literature*, XXXVIII, pp. 1569-1614.

average loan size of around US\$ 1,400.²⁷⁸ These loans are clearly not for poor customers.

One of the important objectives of microfinance is to safeguard people from short-term poverty. They are vulnerable to fluctuations in income that can bring them close to or below the poverty line. Microfinance provides the possibility of credit in times of need. Morduch explains: “The most important potential impact is thus associated with the reduction of vulnerability, not of poverty *per se*”.²⁷⁹ Morduch and Haley report that there is an overwhelming amount of evidence demonstrating a beneficial effect for borrowers of increases in income and reductions in vulnerability.²⁸⁰

In line with Morduch’s findings, Navajas argues that microfinance is suitable for the poor: those slightly above or below the poverty line. Indeed, from the study of five Bolivian microfinance institutions, Navajas finds that not only were 96% of rural households poor, but 74% were among the poorest. In contrast, 17% of urban households were in the poorest class. Poverty in Bolivia, especially rural poverty, was broad and deep.²⁸¹

Whereas the poverty lending approach was distinguished from the institutionist approach primarily by its commitment to serve the poorest, and placed greater weight on outreach. This however does not reduce the degree of commitment to sound operational and management practices, or efficiency and effectiveness of microfinance activities.²⁸²

²⁷⁸ Bayadas, M.M. et al. 1997, ‘Commercial Banks in Microfinance: New Actors in Microfinance World’ Occasional Paper, no. 2372, Rural Finance Program, Ohio State University, viewed 20 June 2007, <<http://www.unctf.org/mfdll/readings/CommBanks.pdf>>

²⁷⁹ Morduch, J. 1998, *Does Microfinance Really Help the Poor? New Evidence from Flagship Programs in Bangladesh*, viewed 20 June 2007, p. Abstract <http://www.princeton.edu/~rpds/downloads/morduch_microfinance_poor.pdf>.

²⁸⁰ Morduch, J. Haley, B. 2002, *Analysis of the Effects of Microfinance on Poverty Reduction*, NYU Wagner, Working Paper, no. 1014, p. 2.

²⁸¹ Navajas, S. et al. 1998, *Microcredit and the Poorest of the Poor: Theory and Evidence From Bolivia*, Economics and Sociology, Occasional Paper, no. 2524, Rural Finance Program Department of Agricultural, Environmental, and Development Economics, Ohio State University, p. 15.

²⁸² Many authors agree that for sustainability of microfinance institutions, a poverty lending approach needs to be effectively operated. See Hulme, D. and Mosley, P. 1996, *Finance against Poverty*, Routledge, London; Robinson, M.S. 2001, *The Microfinance Revolution*, World Bank, Washington DC; Morduch, J. 1998, *Does Microfinance Really Help the Poor? New Evidence from Flagship Programs in Bangladesh*, viewed 20 June 2007 <http://www.princeton.edu/~rpds/downloads/morduch_microfinance_poor.pdf>.

Similar to Morduch, Rhyne observes that the poorest people suffer much more than the moderately poor, particularly people who are starving. Helping someone who is absolutely poor contributes more to alleviation of human suffering. For Rhyne, undoubtedly it is more challenging to serve people with very small loans or to reach remote rural clients. She argues: “Those in the poverty camp feel strongly that it is important to reach the poorest possible people. Many in the sustainability camp are more interested in opening access to the full spectrum of the poor who lack access to financial services; although most do include the poorest in the spectrum”.²⁸³

Rodey argues that microfinance should be a systematic application of spiritual principles, values and ethics for all levels of need. According to Rodey, microfinance programs can help build vibrant, united, prosperous communities by stimulating healthy civic engagement and strong community enterprise. The alleviation of poverty requires a change in how people see themselves and the world around them. Rodey concludes:

The end of poverty requires, at all levels of the microfinance effort, an organic change in how people see themselves and the world around them. Practical measures alone – the delivery of credit and other services – will not solve the basic problems which are human attitudes and behavior.²⁸⁴

There are spiritual principles at stake, which include the noble effort to eradicate poverty to ensure that it does not become ‘business as usual’, with money as the bottom line. What Muhammad Yunus and the Grameen Bank of Bangladesh started in the mid to late 1970s was to focus on people, especially poor women. The Grameen Bank continues to give individuals and families financial fuel to stand on their own feet, without the repressive burden of repaying moneylenders beyond their means. By awarding the Nobel Peace Prize to Muhammad Yunus in 2006 highlights a new awareness of the potential power of microfinance programs. What’s more, the Nobel committee has

²⁸³ Rhyne, E. 1998, ‘The yin and yang of microfinance: Reaching the poor and sustainability’, *MicroBanking Bulletin*, no. 2, p. 7.

²⁸⁴ Rodey, B.J. 1997, *The Spiritual Dimensions of Microfinance: Towards a Just Civilization & Sustainable Economy*, Part VII, Conclusions, viewed 20 June 2007. <http://www.chs.ubc.ca/brazil/detailpub_803.html>.

validated the link between poverty alleviation and peace by stating that lasting peace cannot be achieved unless large population groups find ways in which to break out of poverty.²⁸⁵ Meanwhile, the microcredit the Grameen Bank, other private banks and NGOs provide is part of poverty alleviation programs of the government of Bangladesh. Poverty alleviation for government is viewed as a priority through expansion of public services, creation of employment opportunities, acceleration of agricultural production, infrastructure development and credit facilities. The government implements a number of microcredit programs/projects through various ministries, directorates and state-owned banks.²⁸⁶ Besides, various international organizations such as the Asian Development Bank, the International Fund for Agricultural Development and donor countries support the government's poverty alleviation policies.

From the above discussion, we can see that commitment to the poor is a foundation for microfinance; but the gap widens because the poor have easy access to microfinance institutions, but they are challenged by various screening problems. These problems are related to evaluation of borrowers' viability, generally in socioeconomic aspects such as their character, capital, capacity and collateral. The screening problems form part of this study.

3.5.3. Sustainability, the role of donors and subsidy

The financial system approach argues that institutional sustainability finances self-sufficiency to support microfinance development. In general, 'sustainability' means institutions are and will continue to be ongoing concerns. For example, Navajas believes that sustainability means to reach goals in the short term without harming the ability to reach goals in the long term.²⁸⁷

Edgomb and Cawley argue that to be sustainable small enterprises need institutional development for support, and the institution should be managerially,

²⁸⁵ See Chowdhry, S. 2006, *Creating an Islamic Microfinance Model – The Missing Dimension*, viewed 23 June 2007, <<http://www.dinarstandard.com/finance/MicroFinance111806.htm>>

²⁸⁶ See Nath, D.K. 2003, *Assessment of Microcredit Programme in Bangladesh (Government Sector)*. Paper presented at the International Seminar on "Attacking Poverty with Microcredit", 8-9 January 2003, Dhaka Bangladesh, <http://www.pksf-bd.org/Seminar%20Paper/Paper_Dhiraj%20Kumar%20Nath.doc>.

²⁸⁷ Navajas, S. et al. 2000, 'Microcredit and the poorest of the poor: Theory and evidence from Bolivia', *World Development*, 28(2), pp. 333-346.

financially and technically self-sufficient, effective and capable of promoting sustainable development. They explain that microfinance institutions should have a vision to think creatively and critically about the organization and its mission as well as a capacity to act. Sustainability is one of the important concepts. Edgomb and Cawley argue “The aim of institutional development is to sustain the flow of valued benefits and services to its members/clients, over time, in ways that are self-reliant”.²⁸⁸

Brinkerhoff writes that institutions need continuity and their management needs to establish particular programs, identify gaps in performance and improve performance. According to Brinkerhoff, performance targets should have three dimensions: efficiency and effectiveness, capacity and sustainability. And further: “Sustainability is the ability of a program to produce outputs that are valued sufficiently by beneficiaries and other stakeholders that the program receives enough resources and inputs to continue operation”.²⁸⁹

According to the financial system approach, sustainable microfinance institutions are achievable if they are financially self-sufficient and profitable in order to maintain a commitment to poor customers. To be viable for the long term, these institutions need sufficient funds to finance microcredit operations, cover their operational costs for continuity, regardless of dependence on donor funding.²⁹⁰

Sustainability of microfinance institutions requires a balance between the fees the poor can afford and generating revenue high enough to cover the costs of these institutions. Donations and subsidies are the solution when they have a positive impact on efficiency. Hudon and Traca’s study found that microfinance institutions that receive subsidies are more efficient. However, they explain that subsidization beyond a certain threshold renders the marginal effect on efficiency negative. They note: “In our sample, 26% of microfinance institutions

²⁸⁸ Edgcomb, E. and Cawley, J. 1991, *The Process of Institutional Development: Assisting Small Enterprise Institutions to Become More Effective, Growth and Equity through Microenterprise Investment and Institutions* Bethesda Maryland, Gemini Working Paper, no. 15, pp. ix-x and p.3.

²⁸⁹ Brinkerhoff, D.W. 1991, *Improving Development Program Performance: Guidelines for Managers*, Lynne Rienner Publishers, Boulder, Colorado, p. 22.

²⁹⁰ Gulli, H. 1998, *Microfinance and Poverty Questioning the Conventional Wisdom*, the Inter-American Development Bank, Washington, D.C.

receive levels of subsidization higher than that threshold, which implies that a marginal cut in subsidy would increase their efficiency”.²⁹¹

Schreiner explains that donors, even if they own shares, are not the same as private owners. They are not interested in dividends, nor do they plan to sell their shares for a gain. In contrast, private owners care a lot about dividends and retained earnings. Schreiner says that unlike private owners, the people in donor organizations are not gambling with their own money, and the goals of society may sometimes take a backseat to their personal goals. He asserts that it is often safer to assume that a private investor will be selfish than it is to assume that a donor will be selfless.²⁹²

The possibility that rational donors seek to maximize social returns on social investments is rarely, if ever, allowed. However, Morduch argues it is by no means certain that rational donors, in particular governments, remain committed to finance poverty alleviation, although international donors move to other social investment projects.²⁹³

In this financial approach the microfinance institutions want to see that borrowers can be relied on to repay their loans and so enable the institutions to provide financial services for the poor through market-based enterprises without subsidy. The term ‘subsidy’ is used in the institutionist literature to describe any financial resources received from investors by a microfinance institution at below market price, which include all types of donations.

In contrast to the above financial system approach, the poverty lending approach argues that the microfinance institutions can achieve sustainability without achieving financial self-sufficiency.²⁹⁴ They argue that donations serve as a form of equity and as such, the donors’ funds can be viewed as social investors who do not expect to earn a financial return, but realize a social or

²⁹¹ Hudon, M. and Traca, D. On the Efficiency Effects of Subsidies in Microfinance: An Empirical Inquiry

www.aeaweb.org/aea/2011conference/program/retrieve.php?pdfid...

²⁹² Schreiner, M. 2000, ‘Ways Donors Can Help the Evolution of Sustainable Microfinance Organizations’, pp. 10-11, microfinance.com/English/Papers/Donors_and_Evolution.pdf.

²⁹³ Morduch, J. 1999, ‘The microfinance promise’, *Journal of Economic Literature*, XXXVIII, p. 1592.

²⁹⁴ See Morduch, J. 2000, ‘The microfinance schism’, *World Development*, 28(4), pp. 617-629 and Woller, G.M. et al. 1999, ‘Where to microfinance?’ *International Journal of Economic Development*, 1(1), pp. 29-64.

intrinsic return. Brau explains that the social return from microfinance takes this notion to the limit, generally earning zero financial return, relying totally on intrinsic return.²⁹⁵

3.5.4. Group lending and social collateral

Microfinance institutions have a choice between offering microcredit to individuals or selected groups. Microcredit is frequently faced with the problem of inadequate collateral. It is a requirement for borrowing that makes most of the poor loan applicants unable to participate and thus they are excluded from the formal system. As a solution, Natarajan explains that group lending is an alternative, especially if the applicants do not have physical capital. In this situation, microfinance institutions focus on social collateral and harnessing of local knowledge via group lending. In essence, the self-selected group takes over the underwriting, monitoring and enforcement of the loans agreement with the microfinance institution.²⁹⁶

There is a great deal of discussion in the literature on this issue. Joint liability is the solution for a lack of individual collateral among group members. Under joint liability each member is responsible. Wenner describes the way out through distribution of default risk among members, peer monitoring, moral persuasion, social exclusion and mutual insurance to honor commitment for future borrowing.²⁹⁷ Five cases of failure within group programs in Ireland, India and Bangladesh are studied in relation to the nature and extent of social relations among individual group members. It was found that social collateral developed by the group members through their social standing in the community.²⁹⁸ Goldmark finds that peer lending and group-based approaches to

²⁹⁵Brau, J.C. and Woller, G.M. 2004, 'Microfinance: A comprehensive review of the existing literature', *Journal of Entrepreneurial Finance and Business Ventures*, 9(1), pp. 1-26.

²⁹⁶Natarajan, K. 2004, *Can Group Lending Overcome Adverse Selection Problems?* Department of Financial and Management, University of London, viewed 20 June 2007, <<http://www.cefims.ac.uk/documents/research-35.pdf>>.

²⁹⁷Wenner, J.D. 1995, 'Group credit: A means to improve information transfer and loan repayment performance', *Journal of Development Studies*, 32(2), pp. 263-281.

²⁹⁸Woolcock, M.J.V. 1999, 'Learning from failures in microfinance: What unsuccessful cases tell us about how group-based programs work', *The American Journal of Economics and Sociology*, 58(1), pp. 17-42.

business service delivery can help to build social capacity²⁹⁹. In some cases, peer groups function well also because they draw on communities' reserves.

Ghatak suggests methods that may help build social collateral, making loans even more secure. Joint liability credit contracts used by group lending schemes can achieve high repayment rates, even when borrowers have no conventional collateral to offer.³⁰⁰ It is based on the fact that borrowers are asked to self-select group members. This leads to differential costs of borrowing among borrowers depending on the type of business. The difference in risk is not reflected in the group's joint liability contract. However, there are some differences between social collateral and economic collateral used to guarantee loan repayment, which is why microfinance institutions prefer to accept assets or economic collateral. Mogues explains that social collateral has specific characteristics:³⁰¹

1. It is valuable to borrowers in the network, but it is not a capital good that can be easily transferred to someone outside of the group and that can be found immediately valuable for the outsider.
2. There are no costs to the lender in seizing it.
3. It is not direct value to the lender; it is not exchangeable for money in the marketplace.
4. Social collateral does not serve the purpose of providing economic redress in the event of default.

The researcher assumes that social collateral is challenged by the individualistic way of thinking as influenced by changing sociocultural environments, especially with the increasing monetization of rural, urban and coastal communities in developing countries. This attitude is not only to be found among borrowers, but also by the management of microfinance institutions. It seems there is a vicious circle on the risk of social collateral

²⁹⁹Goldmark, L. 2001, 'Microenterprise development in Latin America: Towards a new flexibility', *Journal of Socioeconomics*, 30(2), pp. 145-149.

³⁰⁰Ghatak, M. 1999, 'Group lending, local information and peer selection', *Journal of Development Economics*, 60(1), pp. 27-50.

³⁰¹ See Mogues, T. and Carter, M.R. 2003, Social Capital and Incentive Compatibility, Modeling the Accumulation and Use of Social Collateral, Department of Agricultural and Applied Economics, University of Wisconsin-Madison, pp. 1-34, viewed 22 June 2007, <<http://www.aae.wisc.edu/pubs/sps/pdf/stpap460.pdf>>.

versus assets collateral. Borrowers agree to hold joint liability but microfinance management prefers assets collateral as a real contribution to microfinance risk.

These two approaches to microfinance are also differentiated by their ultimate objectives. Yaron, Chaves and Vega argue that in the financial system approach, self-sufficiency and sustainability avoid subsidies and in the long run have more outreach, meaning this approach is synonymous with microfinance success.³⁰² The key paradigm is that low income households need credit, but not cheap credit. Hence high interest rates do not come at the cost of outreach. In light of this argument, Morduch argues that poverty can be reduced without costs to government or donors and may even produce a profit.³⁰³ Navajas opts for a poverty lending approach and argues that the ultimate measure of its mission is to improve social welfare, particularly the depth of outreach, and by measuring social cost and its social benefits.³⁰⁴ The dichotomy has produced a fruitless debate for the poor who are more concerned with improving their welfare.

Although an increasing number of institutions have integrated new technologies to reach the poor more effectively, the majority of poor households do not have access to financial services. What the poor need is an inclusive financial system that provides access to financial services, reducing unevenness in growth patterns and broadening the scope of services.

On the other hand, most formal financial institutions deny the poor financial services because of perceived high risks.³⁰⁵ The Asia Development Bank (ADB) gives three main reasons.

Firstly, microfinance institutions need to bring down the high cost of microcredit; for example, institutions in Asia and the Pacific charge effective annual interest rates in the range of 40% to 80%. The total costs of microloans

³⁰²Yaron, J. 1994, 'What makes rural finance institutions successful?' *The World Bank Research Observer*, 9(1), pp. 49-70. See also Chaves, R.A. and Vega, C.G. 1996, 'The design of successful rural financial intermediaries: Evidence from Indonesia', *World Development*, 24(1), pp. 65-78.

³⁰³Morduch, J. 2000, 'The microfinance schism', *World Development*, 28(4), pp. 617-629.

³⁰⁴Navajas, S, et al. 2000, 'Microcredit and the poorest of the poor: Theory and evidence from Bolivia', *World Development*, 28(2), pp. 333-346.

³⁰⁵Asian Development Bank, 2000, *Finance for the Poor: Microfinance Development Strategy*, ADB, Manila.

average 31% in comparison to 14% for corporate loans.³⁰⁶ Many poor people borrow at high rates because their alternative sources of credit are informal markets, where interest rates are much higher and beyond their ability to pay. It is also essential to improve efficiency and reduce costs of operations so that interest rates do not have to be so exorbitant. This would enable microfinance institutions to serve an increasing number of poorer people. However, there are neither subsidies nor interest rate caps on loans to the poor because both would reduce, rather than increase, poor people's access to financial services, and thereby eventually hurt them.

Secondly, the challenge is the poor's inability to provide marketable collateral for loans. And thirdly, there is the crucial role of government support.³⁰⁷ Kuroda, the President of the ADB, explains the need to pay more attention to creating an enabling environment for profitable investment opportunities for the poor and to improve rural infrastructure and other facilities.

In wading through the different views on poverty reduction versus the financial system approach, the poor need another alternative. This could be an integrated approach to strike a balance between financial sustainability and lending opportunities for the poor to access. The Asian Development Bank (ADB) describes the adoption of the financial system approach as key to achieving sustainable results and maximizing the development impact.³⁰⁸ However, as it is primarily targeted to the poor, who are disadvantaged, social mobilization should necessarily be introduced to a formal or semiformal, market-oriented institutional environment. This is particularly true for women and the poorest of the poor. It is important, however, that microfinance institutions have to distinguish between financial intermediation and social intermediation in designing support programs. Mahajan and Dichter explain the need for a contingency approach, where the capabilities of an organization have to match

³⁰⁶ See Microfinance: An Innovative Solution, viewed 23 June 2007, <http://www.unitus.com/sections/poverty/poverty_mf_main.asp?_kk=microcredit%20definition&_kt=a5889a19-74b8-4368-8c78-435550dceba4&gclid=CK3T57SR5lwCFRK1YgodqXUH6w>.

³⁰⁷ Kuroda, H. 2005, *Pushing the Frontiers: Towards A More Inclusive Financial System*, Speech by President of Asian Development Bank at the Empowering the Grassroots Economy: Microfinance for Growth and Happiness, International Conference, Bangkok.

³⁰⁸ Asian Development Bank, 2000, *Finance for the Poor: Microfinance Development Strategy*, ADB, Manila.

the requirements and situation of each type of task determined.³⁰⁹ This contingency approach is also advocated by Gulli who argues that rather than analyzing the question of whether or not microfinance is an important tool of poverty reduction, this approach analyses how, to what degree, and under which conditions microfinance can contribute to poverty reduction.³¹⁰ Here, microfinance policy should be designed within a government policy framework on poverty, if it is to have any effect.

Rock explains the notion of the board of a microfinance institution being in a position to determine a dual mission, balancing social impact with financial objectives.³¹¹ This combines a social mission – provision of financial services to the lowest income – with a financial objective that drives the microfinance institution to achieve self-sufficiency. These two objectives are not mutually exclusive and the board, with its strategic decision making and policies, can move institutions in the direction of achieving superior profitability and reaching an expanding clientele of low income entrepreneurs. Charitonenko and Afwan observe that in Indonesia saving mobilization from micro-savers is undertaken by predominantly formal microfinance institutions, in this case the BRI Units, which have fueled a broad microcredit outreach.³¹² It means that from the source of funds side, microfinance institutions have self-sufficient resources and ample opportunity to distribute microcredit. The mission to support the poor with microcredit is mainly dependent on the governance of the board of management and the board of supervisor's policy, but if the feasibility of the business and creditworthiness of the loan applicant is the requirement, the poor will find it difficult to access credit.

The debate, as discussed in this literature review, between institutionist and welfare approaches to microfinance is ongoing. It is argued here that, from a practical perspective, the sustainability of financial institutions is a pre-

³⁰⁹Mahajan, V. and Dichter, T.W. 1990, 'A contingency approach to small business and microenterprise development', *Small Enterprise Development*, 1(1), pp. 4-16.

³¹⁰Gulli, H. 1998, *Microfinance and Poverty Questioning Conventional Wisdom*, Inter-American Development Bank, Washington, D.C.

³¹¹Rock, R, et al. 1998, *Principles and Practices of Microfinance Governance*, viewed 17 June 2007, <<http://www.unctf.org/mfdl/readings/MFGovernance.pdf>>.

³¹²See Charitonenko, S. and Afwan, I. 2003, *Commercialization of Microfinance in Indonesia*, Asian Development Bank, Manila.

condition to supports both the poor and better-off borrowers. Microfinance institutions need to compromise in order to finance both bankable and not yet bankable borrowers. It is about policy setting; the loan portfolio needs to be able not only to support poverty alleviation but also generate profits to sustain the institution. It is the joint responsibility of owners and management to ensure sustainability.

3.6 Gender and empowerment in microfinance

3.6.1. Gender issues in microfinance

It is generally accepted that women have less economic opportunity to improve their livelihood. Mikkola describes how women are often restricted in terms of education, the ownership of wealth, monetary return for their employment, financial and other opportunities to influence decision making at the level of family and society.³¹³ Concerns about gender issues in financial services is not new, especially since the 1970s when the women's movement in a number of countries focused increasingly on poverty credit programs, as reflected in debates at various international conferences. Some aspects of women's poverty may indeed be rooted in inequality between women and men. In fact women's risk of impoverishment is greater than men's in three ways: being disadvantaged in respect of entitlements and capabilities; having heavier work burdens and lower earnings; and facing constraints on upward mobility as well as geographical mobility due to cultural, legal and labor market barriers.³¹⁴

Johnson identifies a number of obstacles to women accessing microfinance: the lack of access to bank/financial services in their own right; undertaking activities which produce low returns and have a heavy domestic workload; women may not be literate or well educated; and women lack the confidence to claim political/legal rights.³¹⁵ On the other hand, women are a

³¹³Mikkola, A. 2005, *Role of Gender Equality in Development*, Helsinki Centre of Economic Research, Discussion Paper, no. 84.

³¹⁴Murray, U. and Boros, R. 2002, *A Guide to Gender Sensitive Microfinance*, SEAGA (Socio-economic and Gender Analysis Programme), FAO, Rome.

³¹⁵Johnson, S. *Gender and Microfinance: Guidelines for good practice*, viewed 14 February 2007, <<http://people.bath.ac.uk/hssaj/gender.htm>>.

good credit risk and investment for family. And they benefit from higher social status within the home when they are able to provide income.³¹⁶

The World Bank research on strengths and weaknesses of women justifies placing a higher priority on increasing women's access to microfinance services because gender inequalities inhibit economic growth and development.³¹⁷ Various statistics indicate women have higher unemployment rates and are the poorest of the poor.³¹⁸ Women spend more of their income on their households and maintain good repayment records and cooperativeness.³¹⁹ On their weaker points, women need empowerment to strengthen their business capability, a prerequisite for achieving better income through microfinance support. The basic theory is that microfinance empowers women by putting capital in their hands, and allowing them to earn an independent income and contribute financially to the household. Mayoux argues women are effective targets for empowerment, supporting poverty reduction and gender equality.³²⁰ As output, this economic growth is expected to generate increased self-esteem, respect, and other forms of empowerment for women.

3.6.2. Empowerment

Since the mid-1980s, the term 'empowerment' has become popular in the development field, especially with reference to women, but it invites confusion. A study by Batliwala indicates women's empowerment challenges patriarchal power relations, resulting in women having less control over material assets and

³¹⁶ The Microcredit Summit Campaign 1997, *Why target women?* Viewed 24 June 2007, <<http://www.microcreditsummit.org/aboutmicrocreditsummit.htm#women>>, see also Mayoux, L. 2011, *Women are Useful to Microfinance: How can We Make Microfinance More Useful to Women?* Workshop paper, Global Microcredit Summit, Valladolid, Spain.

³¹⁷ World Bank, 2001a, *Engendering Development: Through Gender Equality in Rights, Resources and Voice Summary*, World Bank, Washington DC; <<http://www.worldbank.org/gender/prr/engendersummary.pdf>>.

³¹⁸ See World Bank website, Gender Statistics database, <<http://devdata.worldbank.org/genderstats/home.asp>>.

³¹⁹ Deshpanda, R. 2001, *Increasing Access and Benefits for Women's Practices and Innovations among Microfinance Institutions*, Survey Result, UNCDF, New York.

³²⁰ Mayoux, L. 2006a, *Not only reaching, but also empowering women: Ways forward for the microcredit summit's second goal*, viewed 28 June 2007, <<http://www.genfinance.info/Documents/Reaching%20and%20Empowering%20Women.pdf>>.

intellectual resources.³²¹ With new consciousness and solidarity women can assert their rights to control resources and participate equally in decision making. Kabeer explains that women's empowerment should be about their ability to make self-determined choices.³²² Mayoux explains the need for empowerment as it initiates a series of virtuous spirals of economic improvement and increased wellbeing for women and their families.³²³ However, a high demand for loans by women may be a sign of social pressure to access resources for in-laws or husbands, rather than an indicator of empowerment. Women need to solve gender inequality to avoid becoming dependent on loans to continue in low paid occupations with heavier workloads. To support women, microfinance institutions need to review repayment schedules and interest rates, so as to reflect the reality of women's economic activities and life cycles.

Some studies on evidence of empowerment are described in the research reports of Cheston and Kuhn.³²⁴ Other studies by the International Labor Organization (ILO) have also detected negative impacts including an increase in women's workloads, debt traps and increased social pressure to ensure loan repayments.³²⁵ Empowerment offers a mixed picture, showing success as well as limitations. Some positive changes for women include increased participation in decision making, more equitable status in family and community, increased political power and rights and higher self-esteem.

³²¹Batliwala, S. 1994, 'The meaning of women's empowerment: New concepts from action'. In Sen, G, Germain, A & Chen LC (eds.), *Population Policies Reconsidered: Health, Empowerment and Rights*, Harvard University Press, Boston.

³²²Kabeer, N. 1999, 'Resources, agency, achievements: Reflection of the measurement of women's empowerment', *Development and Change*, 30(3).

³²³Mayoux, L. 2006b, Women's empowerment through sustainable micro-finance: Rethinking 'best practice', viewed 24 June 2007, <http://www.enterprise-impact.org.uk/pdf/Women_Empowerment_throughSustainableMicrofinance.pdf>.

³²⁴Cheston, S. and Kuhn, L. 2002, *Empowering women through microfinance*, Draft 7/8/02, viewed 12 February 2007, <http://www.microcreditsummit.org/papers/empowering_final.doc>. See also Buckley, ME 2000, *Beyond the rhetoric of empowerment: A critical analysis of gender participation and empowerment*, Dalhousie University, Halifax, viewed 28 June 2007, <http://www.collectionscanada.ca/obj/s4/f2/dsk2/ftp03/MQ57274.pdf>. and Roy, T.K. and Niranjana, S. 2004, 'Indicators of women's empowerment in India', *Asia Pacific Population Journal*, 19(3), pp. 23-38.

³²⁵ILO, 1998, *Women in the informal sector and their access to microfinance*. Paper prepared by ILO, viewed 14 February 2007, <<http://www.gdrc.org/icm/wind/uis-wind.html>>.

Although women maintain business capabilities, microfinance institutions with the financial system approach are reluctant to adopt empowerment because they fear this will interfere with the efficiency and professionalism of their financial operations. They are concerned that it may lead them to include additional activities that could draw resources and energy away from their core business.

Empowerment for women in Indonesia is a need insofar as women play an important role in microbusiness. They have been very active, especially in Java, and have continued to dominate local trade since long before the colonial period.³²⁶ There are secret female entrepreneurs as well as formally recognized businesswomen; in total, more than one-third of Indonesian small and medium enterprises are in the hands of women. These businesswomen shape invisible, unrecognized and unexploited societal resources.³²⁷ Although women maintain capabilities in business; for many decades their role was influenced by the thought of inequality with men in technical, social and political spheres. If a problem is tackled merely at the technical level, such as women's lack of land, their lack of literacy, skills training, access to markets and limited access to agricultural information, without solving women's social and political problems, inequality remains unchanged. There is a longstanding tradition that men are the head of the household, and this leaves women with little control over land and capital, even her own labor. It is therefore to be expected that men will resist any program intervention that seeks to lessen their privileges, power and control over women. Dewayanti and Chotim's report found that women in business were often marginalized and exploited, which meant there was little progress by women in microbusiness.³²⁸ Strong efforts have been made by government and various women's organizations to reduce women's subordination, facilitate equal opportunity and promote gender awareness. Since 2000, the government and all local government institutions in Indonesia

³²⁶Brenner, S.A. 1998, *The Domestication of Desire: Women, Wealth, and Modernity in Java*, Princeton University Press, Princeton.

³²⁷Berninghausen, J. 2001, *Towards Gender Conducive Planning in SME Development*, ADB Technical Assistance SME Development, State Ministry of Cooperatives & SME, Jakarta.

³²⁸Dewayanti, R. and Chotim, E.E. 2004, *Marginalisasi dan Eksploitasi Perempuan Usaha Mikro di Perdesaan Jawa*, Yayasan AKATIGA, Bandung.

have promoted gender mainstreaming so that all programs, policies and projects adopt a mainstream gender approach.

Microcredit programs, from commercial banks in Indonesia, mostly adopt supply side principles of customer's bankability and creditworthiness as normally determined by banking regulations. Consequently, there is no explicit support for women, for example, in Bangladesh. However, Johar and Rammohan found that women play an active role in microbusiness. There is an unmet demand for microcredit by Indonesian women that cannot be met by informal sector lenders.³²⁹

The West Java P4K report in 2005 and Panjaitan et al's study of subsidized microcredit found that 60% of the participants were women.³³⁰ A case study in Lombok also indicates that the women who received loans increased their income substantially; this improved family nutrition and faithfully repayed their loans. The credit also helped its recipients to create work for other members of the family. Women involved in decision making with their husbands, had higher aspirations for their children's education and were more likely to reduce fertility. Okten and Osili evaluate the 2000 Indonesia Family Life Surveys and conclude that community participation and family networks have an important influence on the individual's ability to access credit.³³¹ The empirical results of their study also shed light on the importance of community participation for women and others in enhancing access to credit.

As will be discussed in Chapter 7, this study found the role of women in microfinance was changing. Generally speaking, the economic status of women is generally lower than that of men. The status of women tends to be better where the woman is the breadwinner in the family. Women enjoy a better social position in the community when they have a business and are supported by microfinance.

³²⁹Johar, M. and Rammohan, A. 2006, *Demand for Microcredit by Indonesian Women*, Working paper, Discipline of Economics, University of Sydney, Sydney.

³³⁰*West Java RIGP Completion Report, Stage III 2005*, SatkerPeningkatanPendapatanPetani-Nelayan Kecil (P4K) PropinsiJawa Barat danBanten, Lembang and Panjaitan, et al. 1999, 'Gender, self-employment and microcredit programs: An Indonesian case study', *The Quarterly Review of Economics and Finance*, 39(5), pp. 769-779.

³³¹Okten, C. and Osili, U.O. 2004, 'Social networks and credit access in Indonesia', *World Development*, 32(7), pp. 1225-1246.

Trusted by the bank, women borrowers are respected in their own communities and enjoy a relatively higher social status. In patriarchal family structures however women need their husbands' approval for any legal action. The role of women is nevertheless changing. Women in business make their own decisions and patriarchal patterns of behavior in the family are moderate. The double bind issue – lack of control over assets and problematic legal standing of women – make the risk of loans greater than for men, from the bank's perspective. However, the banks and their officers respect women customers and afford them equal treatment.

CHAPTER 4

THE ROLE OF CULTURE, ETHICS AND TRUST IN MICROFINANCE

4.1 Introduction

This chapter seeks to discuss how and in what ways sociocultural values influence borrowers' behavior in business and finance. These values are dynamic factors in the community that influence individual behavior. On the other hand, the Bank Rakyat Indonesia (BRI) credit officers (*mantri*) and the Bank Perkreditan Rakyat (BPR) loan officers strictly apply commercial microcredit regulations, as determined by their superiors.

Microcredit is one of the tools that improves people's welfare and increases their quality of life. It is not neutral and does not exist in pure form, but overlaps with other aspects in the community. Neubert explains the social development of people and argues that quality of life is related to various factors including cultural values and identity, as well as respect for human rights.³³² It is understood that a borrower in running his business needs access to credit, a regular income, flexible use of assets plus a network of social resources.³³³ Neubert as well as Hulme and Mosley argue that successful poverty alleviation programs require not only microcredit financing, but also empowerment training that takes into consideration the political, cultural and religious beliefs and practices of participants.³³⁴ In Indonesia, two government programs – *Pembinaan Peningkatan Pendapatan Petani-Nelayan Kecil/ P4K* (the Income Generating Project for Small Farmers and Landless) program³³⁵ and *Program*

³³² Neubert, S. 2000, *Social Impact Analysis of Poverty Alleviation Programmes and Project*, Frank Cass Publishers, London, pp. 7-8.

³³³ Neubert, S. 2000, *ibid*, pp. 13-14.

³³⁴ See Hulme, D. and Mosley, P. 1996, *Finance Against Poverty*, vol. 1, Routledge, London, pp. 108-118.

³³⁵ *Pembinaan Peningkatan Pendapatan Petani-Nelayan Kecil/ P4K* (Income Generating Project for Small Farmers and Landless) was a poverty alleviation program designed by the Asian Development Bank (ADB), the International Fund for Agricultural Development (IFAD), the Ministry of Agriculture Republic of Indonesia and Bank Rakyat Indonesia (BRI) and implemented in the period 1980-2005.

Nasional Pemberdayaan Masyarakat Mandiri/PNPM Mandiri (the National Program for Community Empowerment, Mandiri) – have provided both subsidized microcredit and empowerment training.³³⁶

In this chapter, the researcher is going to discuss how far sociocultural factors articulated in values, thoughts, beliefs, the Sundanese cultural identity, ethics and creditworthiness influence have impacted borrowers' behavior. By using a combination of production factors, such as natural resources (land, water, biodiversity, environmental sources), competence and know-how and infrastructure (transport, housing, water, energy, communication), productive work is possible.³³⁷ In the following chapter, the researcher will examine the impact on incomes that link and influence the sustainability of microfinance institutions.

Dynamic factors in community culture are not always uniform and explicit patterns in rural, coastal or urban areas encourage the BRI Units' *mantri* and the BPR loan officers to understand specific practices. Syncretism is essential for harmony between community, borrowers and bank officers. This promotes success while avoiding distressing factors in microbusiness. Harmony is a successful building block that develops ethics and trustworthiness to maintain a good business relationship between borrowers and banks.

4.2 The role of culture in microcredit development

The researcher will identify how cultures in the abovementioned research areas are inextricably intertwined in society and will indicate how far cultural dimensions influence economic behavior.³³⁸ There is controversy surrounding the role of culture in economics. Modern neoclassical economics tends to downplay the importance of culture to economic growth. For example, Robert

³³⁶ Keputusan Menteri Koordinator Bidang Kesejahteraan Rakyat no. 25/KEP/MENKO/KESRA/VII/ 2007 tentang Pedoman Umum Program Nasional Pemberdayaan Masyarakat Mandiri, (PNPM MANDIRI), 30 July 2007.

³³⁷ Neubert calls it the five different types of assets: natural capital, human capital, social capital, physical capital, and financial capital; see Neubert, S. 2000, *ibid*, p. 13.

³³⁸ Cultural values can support economic growth, as discussed by Cernea, M.M. 1993, 'The sociologist's approach to sustainable development', *Finance & Development*, 30(4), pp. 11-13 and Linton, R. 1968, *The Cultural Background of Personality*, Routledge & Kegan Paul Ltd., London.

Solow looks exclusively at inputs of capital and labor³³⁹. Economists make the basic assumption that human beings are rational individuals by maximization of exclusively materialist objectives, namely profit by producers and utility for consumers. Sociologists, on the other hand, have tended to believe that cultural norms permeate economic life and that the latter cannot be understood apart from the culture.³⁴⁰

With reference to the Sundanese culture from interviews with respondents the researcher identifies five sociocultural aspects that can influence borrowers' behavior in business and also drive expenses: customs and traditions to maintain harmony with natural resources in the environment such as land for farmers and sea for fishermen, events marking Islamic celebrations, rituals marking the family life cycle and business ethics practices and trust development.

The following section describes these dimensions in the Sundanese cultural environment and how they simultaneously impact microborrowers' and microfinance institutions' economic behavior.

4.2.1. Traditions to maintain harmony with the environment

The farmers in rural areas and fishermen in coastal areas maintain strong relationships with their environment, the land and the sea, in the belief that 'someone great' takes care of their living. They perform a set of ceremonies on special occasions (*hajatan* or *salametan*) that links blessings (*barakah*) presented to express gratitude in expectation of security (*kasalametan*), and good things for the future. *Salametan* is also easily found in our daily lives on any occasion when people feel blessed. The element of *salametan* is derived from pre-Islamic traditions then interpreted in Islamic terms, although *salametan* is also directly related to Islamic occasions.³⁴¹

³³⁹ Solow, R. 2000, *Growth Theory: An Exposition*, Oxford University Press, New York.

³⁴⁰ Granovetter, M.S. 1985, 'Economic action and social structure: The problem of embeddedness', *American Journal of Sociology*, 91, pp. 481-510.

³⁴¹ See Woodward, M.R. 1988, 'The *Salametan*: Textual knowledge and ritual performance in Central Javanese Islam', *History of Religions*, 28(1), pp. 54-89. The Sundanese adopted the genre of *salametan* from their neighbors, the Javanese, during domination of the Sunda region by the Sultanate of Mataram in the 17th century. *Salametan* has a central role in Sundanese

It is used to express gratitude for achievement of business performance during the year. *Salametan* is not the microfinance institution's formal business but the BRI Units loan officer (*mantri*) and BPR officers understand *salametan* is one of the sociocultural aspects where they are involved. *Salametan* need their personal appreciation as they are also part of the community and village environment. It has become common practice for BRI and BPR officials to conduct *salametan* in a private capacity and not in the name of the banks. These *salametan* are gestures that accommodate tradition as well as express gratitude, and they provide cultural and psychological support for management, employees and borrowers. The borrower respondents perform *salametan* to develop new business networks, to offer new products and services and to show their intention to strengthen business commitments.³⁴² Supported by traditional ceremonial practices, such as preparing special yellow rice cones for ceremonial meals (*tumpengan*), prayers and requests; the microborrowers find strong psychological and social support for developing successful businesses. On the other hand, *salametan* requires money, time, and direct involvement of the respondents. *Salametan* also shows the social status of borrowers; the higher the social status the more they have to pay.

There are various *salametan* found in the research areas that have a direct or indirect impact on borrowers' behavior, and which need to be considered by the *mantri* of BRI Units or BPR officers in their management of microcredit loans:³⁴³

1. A thanksgiving ceremony by farmers (*salametan sedekah bumi*) is a

society. Geertz identifies the *salametan* as a core ritual in Javanese culture and as a animistic rite intended to reinforce village solidarity. See Geertz, C. 1960, *The Religion of Java*, Free Press, Glancoe, Ill, pp. 10-15.

³⁴²Although *salametan* is not a formal institutional activity and not found in the job description of BPR officers (interviews with Hadi Susilo, BPR Pola Dana in Indihiang, district of Tasikmalaya, 4 May 2006; Sunarko, BPR Kencana Cimahi, 17 January 2006; Mukmin, BPR Kapetakan, 29 March 2006 and BRI Units), nevertheless they agreed to perform it. *Salametan* is held personally not formally as an institution. It is to maintain good business relationships with customers at the end of the year or at the time of *lebaran*, a day of celebration at the end of the fasting month. The borrowers perform the ceremony (*syukuran* or *salametan*) and ceremonial meal as an expression of gratitude to Allah *swt* and these are commonly held in the houses of families or in offices internally between management and employees.

³⁴³ Geertz differentiates between four main types of ceremonies in which a *salametan* meal is an essential part: life cycle ceremonies, ceremonies of the Muslim calendar, ceremonies concerned with the social integration of the villager and ceremonies held irregularly and when needed. See Geertz, C. 1960, *ibid*, p. 30.

ritual to bless the land as a source of living. This comes from the basic idea that human beings are created from the soil, which is lived on and the villagers have to maintain the soil and environment. The ritual is also to respect their ancestors who prepared and developed the land for them.

Pak Kunjang Ruslan, a borrower of BRI Unit Puteran, is about 41 years old with a high school education, who was born and is living in Paseh village, Puteran, in the Pagerageung district of Tasikmalaya. He has his own paddy fields and he has been trading in agricultural products since 1988. *Pak* Ruslan admits that in order to run his business he takes rational actions in price calculation and risk, good business practice and follows all the regulations and what his Islamic religion says. He doesn't believe in and doesn't seek advice from a native healer (*dukun*) who deals with supernatural entities. In planting paddies, he says he follows the seasons and generally practices good paddy cultivation. He says:

"I see visitors (*peziarah*) and peasants go by, bringing foods and rice cone for ceremonial meal (*tumpengan*) to Geger Beas, in Sukadana village, before their paddy is harvested. There is a sacred place of two graves of local people's ancestors who pioneered the conversion of forests into living areas and paddy fields. The visitors pray at the graves and ask Allah SWT to bless all of them, be grateful for good rice production and bless the next harvests. After praying they eat the foods they bring. The devotional visit is held once a year although the harvest occurs twice or three times yearly. I do not attend what people usually call earth offerings (*sedekah bumi*). I thank Allah *swt* directly for every fortune (*rezeki*) I get and fulfill my entire obligation on zakat, i.e. 2.5% of my income, donations (*sedekah*), taxes and all social contribution to my local community".³⁴⁴

2. Fishermen and people living in coastal areas perform annual *salametan* called sea offerings, a thanksgiving ceremony held by fishers (*sedekah laut*). The researcher met nine respondent borrowers. They live in Gebang Mekar village; Gebang is a coastal area of Cirebon district. They maintain stalls (*warung*) that supply the fishermen and fish traders (who are also the owners of some boats) with their daily needs. The respondents explained that:

³⁴⁴ Interview with Kunjang Ruslan, Puteran, Pagerageung, 27 February 2006.

“Sea offering is *salametan* especially held by people whose livelihood is fishing. The fishers prepare ritual offerings consisting of buffalo head, variety of foods, cigarettes, flowers, and drinks to be presented for what they deem as the Rulers of the Sea who support and protect their life while fishing. They also pray to Allah SWT to request His blessing and protection, grateful for the catch they have during the year and hope for better fishing in future seasons. They prepare the offerings in the form of a boat, directed to the sea, and followed by many decorated fishing boats during a carnival. Then the offerings are sunk into the sea, which is called *dilarung*. *Salametan* is continued on the beach with various entertainments, such as *wayang kulit* or shadow puppetry, music and a bazaar. The respondents explain a sea offering ceremony (*nadran*) needs a lot of money. The participants have to contribute based on their capability. They feel they should perform it, because working in the sea is risky and they need protection from natural calamity and uncertainties of the catch.³⁴⁵

3. A *salametan* that involves a big gathering of people is held when a factory starts to mill sugar cane, as the new cycle of sugar production begins. One sugar factory, Rajawali II Cirebon, is located in the research area and the ritual for sugar cane milling (*salametan giling*) has just begun. There are fifteen members of P4K groups³⁴⁶ in the rural village of Cipeujeuh Wetan, Lemah Abang, district of Cirebon and *salametan giling* emerges as one of the topics of discussion. They explain that:

“The participants of the ritual are mainly the management and employees of the sugar factory and the farmers as suppliers of fresh sugar cane. It is a rite of the first cut of selected fresh sugar canes (*petik tebu*), called the bride of sugar canes (*panganten tiwu*), where there are prayers, turning on the machines for the first shift of milling and other rituals followed by various entertainment such as *wayang golek* or wooden puppet show, music and games. This *salametan giling* is extended to thank Allah swt for a good harvest of sugar canes and a high expectation that the factory will run well during its production. It is also to maintain good relationships between the farmers, the management and employees of the factory, people in the local community and local government. The ritual attracts people who come to watch. It is a big gathering and supported by a bazaar, usually

³⁴⁵ Interview with a group of nine borrowers, Gebang Mekar, Gebang, 30 March 2006.

³⁴⁶ The BRI branch office charges P4K groups at a fixed rate of 1% interest per month or 22.15% per annum. They receive a lower rate of interest in comparison to *kupedes* microcredit with a flat interest rate of 1.5% per month or equivalent to 33.2% annually. The lower interest rate is funded by the BRI rather than the government.

for about two weeks. We conclude that the bazaar is a marketing opportunity for our products".³⁴⁷

The abovementioned ceremony in rural and coastal areas is a combination of Islamic and animistic beliefs intended to support economic activities, boost psychological confidence, as well as to reinforce villagers' solidarity and to maintain their relationship with the environment. In contrast, borrowers in urban areas like Cimahi have a different relationship with the environment. They feel a greater distance from nature and from "someone great" as a source of their livelihood.³⁴⁸ They are a loosely knit community; so *salametan* are held less frequently and only when needed. In these urban areas the ritual is less significant in people's lives. Their relationship becomes more dependent on business and organization of capital or professionalism with rational and individualistic relationships. The holding of *salametan* also has no effect on social status in urban areas.

Differing from urban areas, such as in Cimahi, in villages (*kampongs*) in coastal and rural areas where most of the people live close to nature and with strong community relationships, *salametan* is still a routine ceremony to protect their livelihood. The *mantri* of BRI Units and BPR officers stated that some sociocultural components need to be assessed as part of the standard operating procedure of their work.³⁴⁹ Here microcredit regulations and microcredit procedures are up against sociocultural values of borrowers and the community. The borrowers admit that holding a ceremony involves excessive expenditure but they consider *salametan* as part of their cultural and community obligations. Consequently the borrowers have to meet the costs for this sociocultural ritual when ceremony costs cannot be funded by microcredit.

³⁴⁷ Group discussion with a P4K group, Cipeujeuh Wetan, Lemah Abang, Cirebon, 1 April 2006.

³⁴⁸ Lucky Ibrahim, a producer and trader of furniture, and Djadja, who manages a pharmacy and drugstore, recognize that capital, banking relationships and professional networks and professionalism are the resources of their businesses. *Syukuran*, a meal for the blessing of Allah *swt*, is held within their families. Interviews with Lucky Ibrahim, Cimahi Tengah, 17 January 2006; Djadja, Cimahi Tengah, 23 January 2006.

³⁴⁹ Interviews with Endang Sumarna BRI Unit Puteran, 3 March 2006, Aris BRI Unit Gebang, 28 March 2006, Mukmin BPR BKPD Kapetakan, 29 March 2006 and Hafid Wahyudi BPR BKPD Pagerageung, 4 March 2006.

4.2.2. Islamic celebrations

All of the respondents in the three research areas confess Islam. Interviews with *Hj. Popon*, *H. M. Hidayat*, *Hj. Mimi* and *H. Ayat Hidayat* indicate that certain *ibadah* activities need money and they admit:

“We spend extra expenses for going on the hajj and expenditures during the Islamic holy days such as the fasting month (*ramadhan/bulan puasa*), day of celebration at the end of the fasting month (*eid ul-fitr’/lebaran syawal*) or the feast of sacrifice (*eid ul-Adha’/lebaran haji*)”.³⁵⁰

Hajj, the religious pilgrimage to Mecca, is one of the five fundamental religious obligations of Islam. It is a religious calling, once in one’s life. Anyone who wants to be a hajj (male hajj) or *hajjah* (female hajj) should have good command of Islamic practice. There is limited opportunity and due to the high cost of the journey, hajj and hajjah induces social status of the villagers. Prior to departure and after returning from Mecca and Medina, usually hajj and hajjah perform a ritual blessing (*syukuran*) called *walimatul hajj*, attended by relatives and neighbors. It is recognized as a cultural habit and serves to enhance the social status of the pilgrims, but also needs to be financed. This mostly happens in rural and coastal areas where there are close relationships with kin and neighbors but not usually practiced in urban areas. The microfinance officials need to check if the microborrowers’ intend to go for hajj and that the cost will not be funded by the microcredit loan.³⁵¹ There are villagers who sell their assets, such as land, house or livestock, to fund the hajj. For microborrowers, the banks expect the cost will be financed by borrowers’ own funds. The religious requirement is that the person embarking on the hajj should have

³⁵⁰ Interviews with *Hj. Popon*, Cimahi, 18 January 2006, *H. M. Hidayat*, Cimahi Selatan, 16 January 2006, *Hj. Mimi* Pagerageung, 28 February 2006, *H. Ayat Hidayat*, Ciawi, 23 March 2006, *Abas*, Cirebon, 6 April 2006.

³⁵¹ In 2009 the government charged the *hajj* for flight and accommodation based on the port of embarkation: from Aceh \$US 3,243, Medan \$US 3,333, Batam \$US 3,376, Padang \$US 3,329 US\$, Palembang \$US3,377, Jakarta \$US 3,444, Solo \$US 3,407, Surabaya \$US 3,512, Banjarmasin \$US 3,508, Balikpapan \$US 3,544, Makassar \$US 3,575 plus Rp. 100,000.00 per person, see *Peraturan Pemerintah no. 31/2009 Biaya Penyelenggaraan Ibadah Haji 2009*. In addition to these government charges, there are various social expenses incurred by pilgrims (*jemaah haji*) for *salametan*, praying or *ratiban*, being farewelled and welcomed home, and souvenirs for relatives and friends.

enough funds from *halal* sources to fund the pilgrimage. In the case of loans from the BRI and BPR, which involve the payment of interest, for religious reasons these loans cannot be used to fund these costs.

For the respondents and Muslims in general, *ramadhan* and *lebaran* is to purify human relationships with Allah swt, and strengthen family and social relationships (*silaturahmi*). It is not only to develop a better life, but also has a wide social and economic impact. The BRI Units *mantri* and BPR officers explain that during the month of *ramadhan* villagers spend more money preparing foods. The holy days of *lebaran* are celebrated with *idul fitri* morning prayer; donating to *zakat* and charity, and *silaturakhim* by visiting relatives. Social and economic aspects are recognized when the villagers enjoy the holy days with new clothes, new shoes, more food and recreation. The villagers from rural and coastal areas visit in the cities and have picnics. Consequently, significant expenses during *ramadhan* and *lebaran* make demands on the villager's savings, so they sell assets or use microcredit money. These expenses also increase demand for goods and services in the local economy. BRI Units, BPR and cooperatives usually prepare extra cash for the holy days in their office to accommodate cash withdrawals.

At the national level, the Indonesian government recognized long national joint holidays (*libur bersama nasional*), for the first time, before and after *lebaran* in December 2002 and December 2003³⁵² and this continued every year.³⁵³ It is an opportunity to perform a homecoming, a tradition of returning to the village (*mudik/ pulang kampung*) to recognize their family origins in the village where they were born. In Sundanese the expression is *muncang labuh kapuhu, kebo mulih pakandangan; kudu inget ka bali geusan ngajadi*. It is an opportunity for villagers working in urban centers, such as Cimahi, to return to their village to get together with their relatives and friends and to celebrate their success working in the city. This long national holiday

³⁵² Joint Decision by the Ministers of Religion, Workers and Transmigration and Efficiency of Government Organizations (Keputusan Bersama Menteri Agama, Menteri Tenaga Kerja dan Transmigrasi, dan Menteri Pendayagunaan Aparatur Negara Republik Indonesia,) no. 461/2002, no. EP.216/MEN/2002 no. 01/SKB/M.PAN/XI/2002, 25 November 2002 on national holidays (tentang Hari Libur Nasional dan Cuti Bersama), 2002 and 2003.

³⁵³ For 2009 the government released a Joint Decision of ministers: No. 4 Tahun 2008; KEP. 115/MEN/VI/2008 and SKB/06/M.PAN/6/2008, 9 June 2008.

goes for about 10 days, and results in postponing business activities, but people spend extra money to celebrate *lebaran*.

There are other important Islamic celebrations including the Islamic New Year on the first day of *Muharam* month; *Maulid Nabi*, the birthday celebration of the Prophet Muhammad *saw*, peace be upon him, and the *Isra and Mi'raj*. The last is regarded as when the Prophet Muhammad's *saw* made the miraculous night journey from Mecca to *Masjid al-Aqsa* or al-Aqsa mosque and the ascension from al-Aqsa mosque to heaven. These days are usually celebrated by groups of people in the community with Islamic related lectures, discussions and prayers by Islamic teachers, *ustad* or religious Islamic teacher. Islamic celebrations are based on Islamic happenings from *al Quran*, the *Hadith* or Islamic history.³⁵⁴ The celebrations are guided by habitual Islamic practices such as praying. *Pesantren* consider those celebrations are different from ceremonies (*salametan*) where culture, tradition and local customs are the source of these rituals. Muslims and borrowers believe that any expense for religious purposes is *ibadah* or an act of devotion. People say it is for *Penanaman Modal Akherat (PMA)* or an eternal investment for the thereafter, thus recorded for posterity.

4.2.3. The family life cycle events

Maintaining a tight-knit family and a good neighborhood is one of the characteristics found in the Sundanese community. The villagers and neighbors basically know what happens in families: whether a baby is born, schooling, marriage, sickness or death of a family member. This cycle is part of villagers' lives and the respondents admit they must care about these issues as part of their social obligations. Life cycle is the physical, emotional and intellectual stages passed through from childhood to retirement as a family member.³⁵⁵ The discussions with respondents indicate that the family life cycle does not stop at retirement, but continues until the death of a family member.

³⁵⁴ Discussions with *H. Nasution* and *H. Baban*, Management of *Pesantren Suryalaya*, 3 March 2006.

³⁵⁵ See *Bateman, M. 2005, Family life cycle*, viewed 12 March 2007 <<http://www.peacehealth.org/kbase/topic/special/ty6171/sec1.htm>>.

With reference to the seven stages, the researcher argues there are five phases in the Sundanese family life cycle.³⁵⁶ These phases are rites of passage and regarded as having great significance, and often of a religious and customary nature from birth, puberty, marriage, adulthood to death. They are marked with a ceremony or *salametan* that involves costs and influences borrowers' financial circumstances.

1. Marriage

In urban, rural and coastal areas, marriage is a special event. The respondents state that marriage is not only a family affair but also has social ramifications. In fact, Islam and marriage regulations are a simple process. But marriage produces social implications; marriage consists of a traditional wedding ceremony (*upacara adat kawin*), a family gathering with guests, and entertainment with direct social and financial impact on the family. Wedding ceremonies are not only an Islamic practice in the life cycle; a wedding party is also used to show family social status, hierarchy and prestige in the community.³⁵⁷ The bride's parents cover all the expenditure; mutual self-help (*gotong-royong*) between families and neighbors in rural and coastal areas are not sufficient to cover all wedding expenses.³⁵⁸

Here again, we can see one of the sociocultural aspects that can impact on microcredit regulations. It can be a temptation for the borrowers to use microfinance money for wedding expenses. Bank officers and borrowers recognize tensions between the conditions of the microcredit loan and social obligations. Instalments or payments on loans, on the one hand, and expenses from social responsibilities, on the other, can create tension, as those two

³⁵⁶ Roger, H. Neighbour describes seven stages of the family life cycle: pairing/marriage, childbearing, school-age children, family with adolescent children, family as 'launching ground', middle years and old age. See Neighbour, R.H. 1985, 'The family life cycle', *Journal of the Royal Society of Medicine Supplement*, 78(8), pp. 11-15.

³⁵⁷ Interviews with H. Oman Kuswandi, Camat, Head of sub-district, Pagerageung, 23 March 2006, H. Abun Bunyamin, a government officer, Cimahi, 18 January 2006.

³⁵⁸ Marriage ceremony, education and medical treatments constitute high cost expenditures; selling assets or securing a loan from the family, pawnshop or moneylender is the short-term solution. BPR are able to provide multi-purpose loans based on fully covered collateral value with clear source of repayment. Interviews with Sunarko, BPR Kencana Cimahi, 17 January 2006; Mukmin, BPR-BKPD Kapetakan, 29 March 2006, Nandang BRI Unit Cimindi, 25 January 2006.

obligations must be fulfilled simultaneously. They must meet repayments for the microcredit and at the same time they need to preserve a stable relationship with the community environment. Making it balance is part of their devotion.

2. Birth and child care

Birth is a special occasion, not only for the baby's parents, but also for the family. During the pregnancy, the Sundanese tradition recognizes the ritual at four months and at seven months (*tingkeban*). Forty days after birth there is a dry navel ceremony (*salametan puput puseur*) followed by a ritual for the first time the baby's feet touch the soil (*salametan nincak bumi*). Child care is the process of caring for and supervision of a child until the newborn baby reaches school age at 5 to 7 years old. At this time boys are circumcised, and parents pay the expenses for the *salametan* where the family invite friends.

Bu Amini, bu Ambah and bu Dede Roslina expressed the same opinion:

"We understand that the occasion of birth is more a family event, even more specially for women. The celebration involves only close relatives and neighbors and does not involve the community and for this reason has less cost impact to the parents".³⁵⁹

3. Caring, from school age to youth

The respondent borrowers pay more attention to their children's education. Although it is a heavy burden they want their children to get a better education than their own. In comparison with respondents in the urban area, it is found that most of the borrowers in rural and coastal villages had only low levels of formal education. Most completed only primary school or *madrasah ibtidaiyah* (Islamic elementary school), either secondary school or *madrasah tsanawiyah* (Islamic junior high school).³⁶⁰ They say they do not have sufficient knowledge to manage the problems they face in business. Although they are able to survive in microbusiness, they recognize their limited capacity to further develop their business. Knowing government campaigns on education, the news they hear and the facts they see, they are aware that a good education is essential

³⁵⁹ Interviews with *bu Amini*, Kapetakan, Pagerageung, 29 March 2006, *bu Ambah*, Pagerageung, 28 February 2006 and *bu Dede Roslina*, Budiasih, 7 March 2006.

³⁶⁰ Interviews with *Hj. Mimi*, Sukapada, Pagerageung, 28 February 2006, *Tatang*, Tanjungkerta, 28 February 2006, *bu Mamah*, Puteran, Pagerageung, 1 March 2006.

for their children. However, borrowers in the urban area of Cimahi have the benefit of a higher education as they have access to better education facilities.

The respondents agree their children's education expenses are an important issue in the borrower's life. Specifically, the respondents in Pagerageung recalled that during the campaign for the election of the head of the district government (*pilkada kabupaten*), a proposal for free tuition was one of the most contentious issues. Such political promises notwithstanding, the respondents understand that education is a major long-term expense to cover the twelve-year education program for their children.³⁶¹ Under the government free education program, a child needs six years education for primary school and three years for secondary school.³⁶² The researcher encountered one borrower who prioritizes the payment of school fees over microcredit instalments.³⁶³ Another borrower, who experienced similar problems in paying school fees, explains³⁶⁴ that it was a short-term business problem. But he was able to negotiate with the bank officers to reschedule the repayment instalments as his business continued to perform well. But he said unpaid tuition fees are too risky and there was a danger that it might result in his child dropping out of school, risking his child's future. The research found that only a few of the borrowers' children graduated from high school.

Education expenses require long-term financing and influence the respondents' way of thinking. Respondents need continuous business activities to guarantee income flow during the years financed by microcredit. It is found that *mantri* or the bank officers have a good understanding of this issue. Repeat business, additional loans and continuity of microcredit are solutions where bank officers agree to make recommendations to their supervisors and calculate the cost of education in loan analyses. The cost of education is eligible

³⁶¹ See Government Regulation/Peraturan Pemerintah Republik Indonesia no. 19/2005, 16 May 2005 on Standar Nasional Pendidikan/National Education Standard.

³⁶² Government expenditure on education is for infrastructure, salary and operational costs. But it is found the government is not in the position to finance all the expenses. For 2009 the government suffered a deficit of Rp. 23 trillion for primary school and deficit Rp. 11 trillion for secondary school. See Pusat Informasi dan Humas Departemen Pendidikan <http://www.diknas.go.id/headline.php?id=47>.

³⁶³ Interviews with *bu* Mamah, Puteran Pagerageung, 1 March 2006, *bu* Aat, Sadaleuwih, Puteran Pagerageung, 4 May 2006. Although *bu* Aat's husband is a bad debt borrower, *bu* Aat and her husband continue to pay their children's school fees.

³⁶⁴ Interview with Ade Suryana, Guranteng, Pagerageung 2 March 2006.

to be financed in BRI microloans as stated in BRI *kupedes* for non-fixed income earners (*non-golbertap*) policy since 28 April 2006.³⁶⁵

4. Adulthood, middle years to old age

This productive period in the human life cycle, which is full of life challenges, declines during old age. The respondents anticipate various human dynamics in life that need financial support. Illness and medication, hospitalization, accidents, marital conflict, divorce and remarriage, lifestyle changes, stress and mental illness, mid-life crises and social conflicts are some aspects that can reduce borrowers' earning capacity. All these costs need to be calculated for the duration of the microcredit loan. The extra cost is a burden for borrowers and the research identified some of the reasons for business failure and bad debt.³⁶⁶

5. Death

Death is *Allah's swt* will. Death comes at any time, any place, is unpredictable but definite for all living creatures. The respondents in the three research areas and also the bank officers realize death seriously affects loss of business and income, especially if it occurs to the business owner. On the basis of an examination of borrowers' files, the researcher did not find any comments on the probability of borrowers' expenses related to death. Some bank officers explain that the cost to borrowers is relatively small and thus tolerable.³⁶⁷ However, they understand that the risk of death directly influences microcredit performance if the successor does not have the capacity to run the business. This is why assets collateral to cover the risk of loss is so important.

Interview with Akhmad Sanusi and Ari Suhartini, members of P4K Sukamaju II; Titi Suharti and Sriharyati, members of P4K Melati Putih,

³⁶⁵ *Non-golbertap* is non-fixed income earners. Usually the borrowers maintain self-employed businesses and *Kupedes untuk mengganti modal kerja debitur (untuk non-golbertap)*, Surat Edaran BRI/Circular Letter no. S.18-DIR/ADK/04/2006, 28 April 2006.

³⁶⁶ Interviews with Ibu Nani Mulyati, Cibeureum Cimahi, 10 May 2006 and Ibu Iwang, Melong Cimahi, 10 May 2006

³⁶⁷ Interviews with Sunarko, BPR Kencana, 17 January 2006; Abun Yamin, BRI Puteran, 8 March 2006; Mukmin, BPR-BKPD Kapetakan, 29 March 2006.

Cipeujeuh Wetan, Lemah Abang explain that risk of death needs to be considered:

“This ‘death’ risk that is linked to financial risk can be reduced or sheltered by an insurance scheme policy. Kupedes is an example where the microborrowers are covered by life insurance at the BRI Unit’s cost. The members of P4K groups are uncovered and P4K participants also secure life insurance at the BRI’s cost”.³⁶⁸

Taking into consideration these sociocultural values, borrowers have to pay for various non-business expenses related to family life cycle events. If these expenses are relatively high and there is no savings or cash flow to cover costs, there is a tendency for borrowers to use their microcredit loans.

The BRI and its colonial predecessors have long-term experience in the provision of rural finance in order to support poor people in the villages of Java.³⁶⁹ The BRI developed considerable understanding of cultural and religious values of the communities it served and the dynamics of the agricultural cycle. The New Order Government from 1966 to 1998 sought to impose a notion of cultural uniformity in Indonesia that undermined the BRI’s practice of accommodating a diversity of cultural practices and beliefs. In addition to the imposition of cultural uniformity, the New Order Government developed a microfinance system based on commercial sustainability. While borrowers sought to negotiate loan arrangements that recognized their cultural and religious values and practices, the BRI’s *mantri* were bound to follow the bank’s policy settings and standard operating procedures of microcredit.³⁷⁰ The *mantri* are in a strong position to ensure that financial considerations prevail over the sociocultural needs. Here the central role of *mantri* of BRI Units or BPR

³⁶⁸ Interviews with Akhmad Sanusi and Ari Suhartini, members of P4K Sukamaju II; Titi Suharti and Sriharyati, members of P4K Melati Putih, Cipeujeuh Wetan, Lemah Abang, 1 April 2006.

³⁶⁹ The history of the BRI beginning with the *Poerwokertosche Hulp-en Spaar Bank der Inlandche Bestuur Ambtenaren* (Poerwokerto Support and Saving Bank for Netherlands Indies Civil Servants) has been discussed in Chapters 1 and 3. See Fruin, T.A. 1933, *History, Present Situation and Problems of the Village Credit System (1897-1932)*, Klaas Kuiper 1999 (trans. and ed.), Ministry of Foreign affairss DRU, The Hague.

³⁷⁰ Bank Rakyat Indonesia, 2003, *Pedoman Pelaksanaan Kredit Bisnis Mikro PT Bank Rakyat Indonesia (Persero)* Bab I hal. 9, BRI Kantor Pusat, Jakarta.

loan officers ensures that commercial capacity is the dominant consideration in loan assessments.

Given its experience and increasing competition between banks to finance better-off microbusinesses, the BRI realizes the important role of non economic factors in microcredit development. This exerts pressure on the BRI to be more accommodative of the diversity of sociocultural practices in the villages where the bank is working. Acknowledgement of diversity of culture is reflected in two BRI policies on microcredit: microcredit analyses need to consider sociocultural aspects of the borrowers and BRI Units are able to finance multipurpose microcredit for non business activities or consumptive needs based on clear cost and income calculations.³⁷¹ Loans for consumptive purposes for fixed income earners (*kredit golbertap*) have been covered since 2003.³⁷² Finance for sociocultural needs have been available through loans for the self-employed (*kredit non-golbertap termasuk untuk mengganti modal kerja debitur pengganti pengeluaran*) since April 2006.³⁷³ Besides existing general *kupedes*, BRI Units can provide the same borrower with additional “special *kupedes – non-golbertap*” at a maximum of 100 million rupiah, equivalent at that time to US\$ 11,000 for fixed assets financing (home, land), working capital and for other personal expenses such as education, marriage and other costs. The idea behind the policy is to serve any borrowers financing needs in order to reach higher targets for the BRI’s microbusiness. It is understood that the BRI *mantri* are able to accommodate sociocultural expenses with this type of microloan.

Under the abovementioned policies, financial calculation remains the indicator but *mantri* of BRI Units now have discretion and are permitted to consider consumptive loans including sociocultural activities. The loans are based on capacity of repayment, especially with requirements of clear source of settlement, available cash flow and assets collateral in order to support the

³⁷¹ See Bank Rakyat Indonesia, 2003, *ibid*, p. 9.

³⁷² See Surat Edaran/Circular Letter Bank Rakyat Indonesia, nos. S.36-DIR/RTL/KRD/11/2000 and S.28-DIR/MKR/10/2003, 16 October 2003 mengenai Kupedes bagi Pegawai Golongan Berpenghasilan Tetap (Golbertap).

³⁷³ See Surat Edaran/Circular Letter Bank Rakyat Indonesia no. S.18-DIR/ADK/04/2006, 28 April 2006 mengenai pelayanan kupedes s/d Rp. 100 juta (untuk non-golbertap).

success of productive microcredit operation. With the BRI's loans for consumptive purposes, the tension between commercial loan requirements and expenses for sociocultural obligations is more easily accommodated.

4.2.4. Ethics that influence business practices

Ethics is the science of morals in human conduct, moral principles or codes.³⁷⁴ Virtues such as integrity, decency and honor are also encompassed within the broader interpretation of ethics. In practice business ethics may be simplified as a set of moral principles that distinguish what is right from what is wrong, thus prescribing what one should or should not do in business. It raises the issue of business ethics of borrowers and microfinance institutions.

During interviews and group discussions in the three research areas, the researcher identified similar intentions: within the business context, respondents, microcredit borrowers and microfinance officers all respect good conduct. The borrowers are Muslims; they are Sundanese or Cirebon-Javanese who have specific traditions reflecting the culture of their environment. The researcher believes there are three components, such as Islamic morality, tradition and ethics, which can describe the general ethical framework, although their personal values, personality and behavior are determined by their intentions³⁷⁵. In this study, borrowers had similar opinions on this issue. As Muslims, they believe that what they do is dependent on intention (*niat*). It is a faith that *niat* needs effort and after a strong effort they said "we'll get what we are intended to get".³⁷⁶

³⁷⁴ See Sopiie, N. and Ali, R.M. 2001, 'Business, ethics and politics' in Ahmad, K (eds.) *Ethics in Business and Management*, ASEAN ACADEMIC PRESS, London, p. 124.

³⁷⁵ See the theory of Reasoned Action/ Planned Behavior. Icek Ajzen's theory provides a framework to study attitudes and behavior. According to this theory, the most important determinant of a person's behavior is intent. The individual's intention to behave in a certain way is a combination of attitudes toward behavior and subjective norms. The individual's attitude toward the behavior includes behavioral beliefs, evaluations of behavioral outcome, subjective norms, normative beliefs, and motivation to comply, viewed 20 March 2007 <http://hsc.usf.edu/~kmbrown/TRA_TPB.htm>. See also Ajzen, I. and Fishbein, M. 1980, *Understanding Attitudes and Predicting Social Behavior*, Prentice Hall, Englewood Cliffs, NJ.

³⁷⁶ All actions are but driven by intention and for everyone is what he intended, The Sunnah, narrated by Al-Bukhari and Muslim. See also *All deeds are based on intention* <http://islamgreatreligion.wordpress.com/2010/03/25/all-deeds-are-based-on-intention/>.

1. Islamic morality

The microcredit provided by BRI Units and BPR or cooperatives is in compliance with the capitalistic system, while borrowers in the villages are Muslims who are concerned with Islamic ethics.³⁷⁷ There are two sets of ethics that need to be understood here.

The capitalistic ethos deals with ethics when humans are in the process of satisfying their needs. It addresses the materialistic side of human life and it is established on three principles: a) relative scarcity of commodities and services in relation to needs, b) the economic value of a product and the price, and c) the role of price in production, consumption and distribution.³⁷⁸ A free market approach is used to resolve the satisfaction of an ever growing human need using insufficient resources and means of satisfaction. It should be noted, however, that the challenge is to make the resources available, to supply goods and services, so as to satisfy the needs in society, but not necessarily every individual's. To fulfil these needs, materialistic behavior and profit is regarded as part of capitalism. This contrasts with Islamic faith that emphasizes life after death. From the perspective of Islam, capitalism is assumed to be endorsing hedonism, which is inappropriate according to the traditions of Muslim societies.³⁷⁹ It is also blamed for the social gap and economic breakdown; thus capitalism is regarded as socially insensitive. Lending money at interest is also one of the critiques of capitalism according to Islamic belief.

The indictment of global greed and corporate misbehavior shows that market aggression wrecks the capitalistic system in many developed countries, questioning the 'greed is good' ethic.³⁸⁰ Loose government regulations in the USA, the United Kingdom, France, Germany, Iceland, Greece and other

³⁷⁷ Within an Islamic context, the term is *khuluq*, see *Al Qur'an, Al Qalam*, 68:4: *Wa innaka la 'alaa khuluqin 'azhiim....*and in fact you are of good character.

³⁷⁸ Malkawi, M 2002, Economic Justice: Islam versus Capitalism, viewed 19 April 2010, http://www.internetmuslim.com/Economic_Justice.pdf. The economy in much of the Muslim world is capitalist. Saudi Arabia and other gulf states are major participants in international capital markets. Their sovereign funds have become significant owners of US and European financial institutions.

³⁷⁹ Zakiyuddin, B. 2007, *Rekonstruksi keadilan: etika sosial-ekonomi Islam untuk kesejahteraan universal*, Stain Salatiga Press, JP Books, Jakarta.

³⁸⁰ Ellis, B. 2009, *The Capitalism Delusion: How Global Economics Wrecked Everything and WTo Do About It*, Penguin, Camberwell.

developed countries, moral hazards, and the quest for greater profits by engineering various financial products that challenged existing business ethics facilitated the Global Financial Crisis (GFC) in 2008. The crisis forced governments to use huge sums to rescue banks and other financial institutions so their economies did not go into recession or worse. These government funds were used to solve problems caused by the belief that financial markets should be allowed to regulate themselves with minimum government intervention.³⁸¹ The GFC shows that financial markets do not automatically work well, the market is not self-regulating and there is an important role for government to play in establishing conventional wisdom with an efficient market hypothesis.³⁸² Besides, the world needs new global ethics in humanity and business for human development and to live together happily.³⁸³ The need to honor ethics is an important lesson to be drawn from the 2008 GFC. This crisis demonstrated that ethics in business are universal and need to be respected in any business activity, whether in the villages of West Java or on Wall Street.

Muslim ethics in economics have a different focus than in the capitalistic system. Muslim values aim at building a socioeconomic order based on justice, which considers economic activity as a means to an end and not an end itself. Islam is deeply concerned with the problem of economics but treats it as an important part of a wider human development problem. Human development is the focus with the result that economic development remains an integrated and indivisible element of moral and socioeconomic development of human society.³⁸⁴ Muslim societies have had long histories of highly developed and sophisticated businesses plus a trading system with various financing arrangements. Another Muslim value that differs from capitalism is the intention that business is devotion or *ibadah* and profit is not the ultimate goal. *Allah swt*

³⁸¹ The IMF estimated that the amount of loss for the USA was US\$11.9 trillion, while Ritholtz claimed it was US\$14 trillion. See Barry, R. 2009, *Bailout Nation: How Greed and Easy Money Corrupted Wall Street and Shook the World Economy*, John Wiley & Sons, Hoboken, New Jersey.

³⁸² See Stiglitz, J.E. 2010, *Freefall: America, Free Markets, and the Sinking of the World Economy*, WW Norton & Co, New York.

³⁸³ There has been an endeavour to establish new global business ethics in the wake of the GFC. See for example Manifesto Global Economic Ethic, Consequences for Global Businesses, UN Headquarters, New York, 6 October 2009.

³⁸⁴ Al Harran, S.A.S. 1993, *Islamic Finance Partnership Financing*, Pelanduk Publication, Petaling Jaya.

blessing is the final objective. Islamic ethics describe the concept of goodness, righteousness, equity, equilibrium and justice, truth and right as well as piety. The respondents in this research refer to those Islamic ethical principles based on the same sources of teaching of *al Qur'an* and the *Sunnah*.³⁸⁵

H.M. Hidayat says that business is worship, in doing business we have to apply Islamic principles for happiness and prosperity. While we are young, we have to work hard and seriously and only doing the good and the halal, besides we have to be trusted by everybody especially our business partners and banks.

Idris Abas explains that without any compromise, interest is *riba*. It is a pragmatic solution if people need capital and choose loan with interest but it is against to what Allah *swt* determines for Muslims.

Undang Rohman describes his experience that fulfilling obligation and truthfulness by the members is the reason the Saving and Loan "Koperasi Hikmat" in Ciawi able to survive and develop. Working and business are act of devotion and we need to maintain good human relations and follow what Allah *swt* wants from us. It is the challenge of us how we integrate those absolute moral dimensions into their daily work and economic life.

Based on interviews and discussions with the abovementioned respondents, the interpretations of Islamic teachings which can be converted into ethical business practices.

On these Islamic values and beliefs, three aspects are summarized from discussions with the respondents. Firstly, work is an act of devotion (*ibadah*) that is their starting point of doing business. The respondents in rural areas close to the *pesantren* who make a living from agricultural products give more attention to these religious matters. Secondly, business people have to insure that profits are honorably earned, not by exploitation.

Thirdly, kinship and community bonds in rural and coastal areas are still close. These social relationships influence the way they do business and make profits.

³⁸⁵ All borrowers are Muslims and in discussing Islamic business ethics they always refer to their main sources, *al-Quran* and the *Hadith*. For example, interviews with H. M. Hidayat, Cimahi Selatan, 16 January 2006; Ernawati, Padaulun Majalaya, 25 January 2006, Ade Suryana, Pagerageung, 2 March 2006; Herman, Picung Guranteng, 2 March 2006; Warno, Gebang Mekar, 30 March 2006, H. Nasution, Pesantren Suryalaya, 3 March 2006, Undang Rohman, Koperasi Pesantren Suryalaya, Unit Ciawi, 24 March 2006; Idris Abas, Cirebon, 4 April 2006.

Social relationships become more fragile in urban areas, such as Cimahi, where profit is the main concern in business. Although Islamic principles are strong in this urban area, it has a heterogeneous population and a mixed culture with loose community ties. Consequently, it means individualism is stronger than group consciousness. This environment influences microcredit in that it makes microcredit an individual matter between the micro borrower and microfinance institution. The loan is hidden from public eyes and therefore there is no community pressure when the microcredit turns bad.

On the basis of these ethical principles in Islam, business practices are reflected similarly in borrowers' behavior that encourages or restrains business relations in their quest for financial rewards such as:

- a. Fair trade is permitted but usury in Islam is prohibited.³⁸⁶
- b. In trading, measure, weight and quality should be transparent and correct.
- c. Trading activities should be on time, as with payment of installments in microcredit. Benefit or profits are only available after all business requirements are fulfilled.
- d. Trading as well as microcredit is based on trust between parties.
- e. Trading and microcredit involve individual responsibility and quality of service.

Applying Islamic ethics not only produces benefits and profits but also develops satisfaction between parties for long lasting business relationships. The researcher analyses how microfinance institutions and their loan officers respect these Islamic ethics and Sundanese customs. Apart from the important issue of payment of interest (see this discussion in Chapter 6), the BRI has

³⁸⁶ Controversy between bank interest and *riba* is a special consideration in this study; Chapter 6 discusses this important issue.

Table 4.1 Islamic ethics in business practice

Ethical principles in Islam ³⁸⁷	Business practice
That man can have nothing but what he strives for....'. (An Najm, 53:39)	Reward should be received only after expending efforts.
God doth command you to render back your trusts to those to whom they are due.....' (An Nissa, 4:58)	Fulfilling obligations and trust business relationship and in workplace
'...For God loveth not the arrogant, the vain-glorious (nor) those who are niggardly, or enjoin niggardliness on others....' (An Nissa, 4:36-37)	Prohibition of hoarding, encouragement of spending investment in business enterprise and circulation of wealth.
'... give just measure and weight, nor withhold from the people the things that are their due' (Hud, 11:85)	Give full measure and weight.
'Of their goods take alms, that so thou mightest purify and sanctify them....' (At Tauba, 9:103)	Income redistribution: wealth should be shared with less fortunate.
'... But God has permitted trade and forbidden usury....' (Al Baqarah, 2:275)	Unlawfulness of loans by which lender obtains benefit.
'... after the payment, of legacy and debts. Ye know not whether....' (An Nissa, 4:11)	The legal heirs have to clear off the debts incurred by the ('borrower') deceased.
'... nor shall We deprive them (of the fruit) of aught of their works: (yet) is each individual in pledge for his deeds' (Ath Thuur, 52:21)	Importance of individual responsibility.
'Allah likes that when someone does anything, it must be done perfectly well'. (The Sunnah)	Excellence and quality of work.
'He who cheats is not one of us'. (The Sunnah)	Whoever knows of a defect in something is obliged to disclose it.
On the Day of Judgment, the honest Muslim merchant will stand side by side with the martyrs'. (The Sunnah)	Truthfulness.

³⁸⁷ See the Holy *Qur'an*, 1983, text translation and commentary by A. Yusuf Ali, Amana Corp., Brentwood, Maryland.

endeavored to recognize Islamic ethics and local customs as a policy that serves borrowers.³⁸⁸

Besides understanding borrowers' sociocultural values and beliefs, the BRI officers are obliged to follow the BRI code of conduct in dealing with day-to-day operations.³⁸⁹ However, the BRI has no detailed regulations to guide its officers in dealing with local customs, ethics and religion; it seems management transfers the responsibility for implementation to their bank officers.

Nanang Suhendra, Endang Sumarna and Aris explain:³⁹⁰

"We apply the business ethics with the borrowers as part of our ability to communicate with people. But we confess this capacity strongly depends on each individual capability of the *mantri*. As we are Sundanese and Muslims living in the communities we serve, we understand how we have to behave to our customers".

The research reveals that similar methods are applied by BPR officers.³⁹¹

2. The traditions from the ancestors (*adat karuhun*)

Sundanese ethics are also based on Sundanese customs (*adat kabiasaan karuhun Sunda*), some of which are still followed in West Java, more strictly in rural than in urban areas. How far does custom (*adat*) influence human behavior for the benefit of community, environment, business or microfinance? *Adat* provides a moral code of conduct to maintain the natural environment, balance worldly life and eternity, fortunate and good living, good relationships between people and the community. One of the customs in the villages in rural and coastal areas is community mutual-help (*gotong royong*).

Gotong royong is a traditional system of moral principle of reciprocity, an ancient social practice that is still widespread, especially in agricultural communities in the villages. It is based on the simple idea that one should help

³⁸⁸ Bank Rakyat Indonesia, 2003, *Pedoman Pelaksanaan Kredit Bisnis Mikro (PPK-BM)*, PT Bank Rakyat Indonesia, Jakarta, Bab I, p. 9.

³⁸⁹ BRI Units have to implement the Head Office's Code of Conduct, see Bank Rakyat Indonesia, 2003, *Kode Etik (Code of Conduct)*, BRI, Jakarta.

³⁹⁰ Interviews with Nanang, Suhendra BRI Unit Cimindi, 13 February 2006; Endang Sumarna, BRI Unit Puteran, 3 March 2006; Aris, BRI Unit Gebang, 28 March 2006.

³⁹¹ Interviews with Sunarko, BPR Kencana Cimahi, 13 February 2006; Mukmin, BPR-BKPD Kapetakan, 29 March 2006; Hedi Susilo BPR Pola Dana, Indihiang Tasikmalaya, 4 May 2006.

those who provide support or at least not harm them. The *gotong royong* forms of mutual assistance in Java are a celebrated example of structured reciprocity and they are ritually reinforced by a neighborhood communal meal (*salametan*), which marks crucial occasions in the life of peasant households.³⁹²

Clifford Geertz points to the importance of *gotong royong* in Indonesian life, facilitating cooperation in work, politics and personal relations. However, according to Geertz, popular understandings of the values and practices associated with *gotong royong* were often vague.³⁹³ Koentjaraningrat explains this value system of *gotong royong* is concerned with human relations; man does not live alone but is embedded in his community and dependent upon others. Therefore, he always makes every effort to maintain social solidarity and egalitarian relationships with others with the spirit of solidarity and equality (*sama rasa sama rata*) and working together with other members of community (*sama tinggi sama rendah*).³⁹⁴ In general, *gotong royong* can be found in terms of worker mobilization during busy periods of rice cultivation, asking for help (*sambatan*) in building houses, organizing funerals, wedding ceremonies, or cleaning the village.³⁹⁵ H. Oman Suwandi explains:

“In Pagerageung area *gotong royong* activities are based on voluntarily work although I admit money needed for living is important to the villagers. For certain activities, such as in paddy cultivation, in-kind payment has been replaced by payment of wages. Similarly, skilled laborers employed in the construction of a house expect to be paid in wages. But some time local government explains *gotong royong* in a different context

³⁹² Scott, J.C. 1976, *The Moral Economy of the Peasant: Rebellion and Subsistence in Southeast Asia*, Yale University Press, New Haven.

³⁹³ Geertz, C. 1983 ‘Local knowledge: Fact and law in comparative perspective’ in Geertz, C. *Local Knowledge: Further Essays in Interpretive Anthropology*, Basic Books, New York, pp. 167-234.

³⁹⁴ See Koentjaraningrat, R.M. 1974, *Kebudayaan, Mentalitet, dan Pembangunan: bunga rampai*, Gramedia, Jakarta.

³⁹⁵ When the economy began to penetrate rural areas in Java it was reported that some farmers were less involved in *gotong royong* practices in rice cultivation because employing wage labor would become more practical. See Kolff, G.H. van der, 1936, *The Historical Development of the Labour Relationships in a Remote Corner of Java as they Apply to the Cultivation of Rice: Provisional Results of Local Investigations*, National Council for the Netherlands and the Netherlands Indies of the Institute of Pacific Relations, Batavia.

and needs, it is as an obligation, *kerja bakti* labeled like voluntary work, night watch (*ronda malam*) and repairing village inland waterways".³⁹⁶

In rural and coastal areas, *gotong royong* is still maintained as a social obligation.³⁹⁷ However, in the urban area of Cimahi, there has been a sharp decline in *gotong royong* practices and these practices have tended to be replaced by monetary transactions.³⁹⁸ In relation to microfinance, traditional *gotong royong* is transformed from a social solidarity function into business solidarity among groups of microborrowers. The character of *gotong royong* can be altered from community to solidarity building and focused into smaller self-help groups. This model of *gotong royong* has been adopted to strengthen relationships in groups integrated into P4K programs developed, mostly in rural areas.³⁹⁹ In urban areas this type of collective solidarity is challenged by the values of individualism that reduce collective relationships in the community. While the *gotong royong* principle is incorporated in the group lending programs like P4K, microcredit Kupedes in the BRI is an individual scheme of financing. Consequently BRI does not incorporate *gotong royong* practices into its credit policy.

Since the P4K programs have ended, the government has incorporated the *gotong royong* principle as participatory development (*pembangunan partisipatif*) in its microcredit and empowerment program, *Program Nasional Pemberdayaan Masyarakat Mandiri* (PNPM Mandiri).⁴⁰⁰ *Gotong royong* has different characteristics compared with commercial microcredit provided by the BRI and BPR that emphasize wealth generation, self-interest and individual

³⁹⁶ Interview with H. Oman Kuswandi, *Camat*, Head of sub-district, Pagerageung, 23 March 2006.

³⁹⁷ Interviews with Kunjang Ruslan, Puteran Pagerageung, 27 February 2006, Surip Gebang, 30 March 2006.

³⁹⁸ Interviews with H Suryono Cimahi, 19 January 2006, Djadja Cigugur Tengah Cimahi, 23 January 2006.

³⁹⁹ Interviews with Panjaitan, Account Officer of BRI Cirebon Branch as a supervisor of P4K Cipeujeuh Wetan, Lemahabang, 1 April 2006; Een Hendarli and Endang Softina, Account Officer of BRI Ciamis as a supervisor of P4K Budiasih, Sindangkasih, 7 March 2006; Akhmad Sofyan, Account Officer BRI Majalaya as a supervisor of P4K Padaulun, Majalaya, 25 January 2006.

⁴⁰⁰ See Keputusan Menteri Koordinator Bidang Kesejahteraan Rakyat no. 25/KEP/MENKO/KESRA/VII/ 2007 tentang Pedoman Umum Program Nasional Pemberdayaan Masyarakat Mandiri, (PNPM MANDIRI), 30 July 2007.

gain. *Gotong royong* does not emphasize material wealth, but rather favors general welfare over personal gain.⁴⁰¹

3. Ethics in small business

Interviews, discussions and intensive communication with the respondents, revealed their mixed social economic behavior to the researcher where Islamic principles and traditions interweave and soften the capitalistic morality. Business ethics can be simplified to what the respondents have to do in order to maintain their sound business without any conflicts with their business partners and banks. In practice, their business ethics is an effort to apply basic principles of devotion (*ibadah*). The regulations and the important role of business ethics, role of the borrowers, BPR officers and *mantri* BRI Units in the morality of capitalism of microcredit as found during the interviews and discussion in three research areas will be described. Basically the findings are similar, firstly with the borrowers and secondly with banks officers respondents.

Herman, Cucu Yuningsih, Iah Sariah, Iin Lemanah, Usep Jejen, Damsori and Warno explain ethics from the borrowers' point of view.

"After we sign the loan agreement with the microfinance institution we admit legal and financially responsible to repay the microcredit as stated in the agreement. Consequently, we have our individual rights to use the loan money for specific business activities to accumulate profits in order to get the free cash flow for loan instalments. We recognize the existence of moral concepts or ethics identifying our personal values to avoid such vices".⁴⁰²

Their moral values, influenced by Islamic beliefs, Sundanese customs and their general views on acceptable human behavior are used to make decisions in microbusiness. Some examples of the borrowers' code of ethics can be summarised as follows:

⁴⁰¹ Hahn, R.A. 1999, *Anthropology in Public Health: Bridging Differences in Culture and Society*, Hahn, R.A. and Harris, K.W. (eds.), Oxford University Press, New York.

⁴⁰² Interviews with Herman, Guranteng Kampung Picung, Pagerageung, 2 March 2006, Cucu Yuningsih, Kampung Puteran Kidul, Puteran 1 March 2006, Iah Sariah, Cigugur Cimahi Selatan, 24 January 2006, Iin Lemanah and Usep Jejen, Desa Sukaraja, Cicendo, 24 January 2006, Damsori, Bungko Lor, Kapetakan, 29 March 2006, Warno, Gebang Mekar, Gebang, 30 March 2006.

i. The borrowers explain that the bank officers do not want us to lie. They expect us to answer any question accurately and provide data as requested. But it is difficult to answer their questions precisely, as we do not have the data they want. We understand that maintaining accounting is important as a means of gaining control to our business and also as a source to answer bank loan control but we do not maintain written calculations at home. We hope they can help us to structure data for loan applications, so we can avoid telling a lie. We also understand the need for honesty and to keep promises when dealing with others, but do our business partners keep the same values?

ii. The borrowers say *mantri* and BPR officers tell us how to treat business partners equally, regardless of class, gender or age and pay employees based on the quality of their work and performance. Although we understand the value of justice we have to consider reciprocal treatment from business partners. The borrowers explain that this too is part of the ethics in treating business partners properly. They note that the BRI treats them differently, in the way it discriminates between bankable and non-bankable applicants.

iii. The borrowers understand the need for efficiency by minimizing costs, to get the most output from a particular input and to finish work on time. Borrowers are also obliged to pay their workers the minimum regional/local wage (*upah minimum regional*) as determined by the provincial government. This requirement can place a strain on the sustainability of the microbusiness.

iv. The borrowers describe their involvement in community related issues and activities. This is important and demonstrates that their business is a responsible community contributor. Consequently it has to balance strong community relationships with personal interests such as pursuing financial success versus supporting the poor, competition versus cooperation, individual responsibility versus collective responsibility. How far can the borrowers benefit from their own business? They admit they are not well educated but they are acquainted with Islamic values. They say “modern business ethics” are recognized by trial and error after they develop business with the bank over many years. From observations, discussions and interviews in rural areas, the

villagers tended to follow the advice and guidance of the BRI's *mantri* and assume that the *mantri's* advice is consistent with Islamic norms and Sundanese customs. The Sundanese tradition expresses ethics and trust should be maintained in life (*ulah bengkung bekas nyalahan*), beside always tell the truth (*nu lain kudu dilainkeun, nu enya kudu dienyakeun, nu ulah kudu diulahkeun*). The researcher observes how the respondents trust and respect the *mantri* and BPR officers maintain ethics and develop the trust of borrowers. This is why borrowers appreciate the ethics of business they have built together with BRI Units and BPR. These attitudes are also found in the urban area of Cimahi and coastal Gebang area, but here the officers need to remind borrowers repeatedly to honor the relationship and the commitment they have developed with banks.

Ethics from the BRI and BPR loan officers' point of view.

BPR does not have written guidelines on ethics in business.⁴⁰³ However, from discussions with their management, the bank believes their officers understand what ethics mean and how to practice it in their business dealings with borrowers. The loan officers know the borrowers personally, as they live in the same community. In the research areas the researcher saw firsthand how BPR officers apply ethics in business during their work with borrowers.⁴⁰⁴ The bank officers say they are in the position to take care of and maintain their customers; they are well-mannered and trusted in business development (*kudu bisa ngurus jeung miara langganan*). In rural areas they speak the high, refined level of Sundanese language (*basa Sunda halus*), while in urban areas (especially to non-Sundanese) they speak Indonesian (*bahasa Indonesia*) and in coastal areas they speak either Sundanese, Cirebonan, Javanese or *bahasa Indonesia*. Understanding the local language is a benefit for business communication. In addition, the bank officers acknowledge that they maintain personal contact with borrowers and they are ready to give advice whenever

⁴⁰³ Interviews with Hendi Efendi, manager BPR-BKPD Pagerageung, 3 March 2006; Sunarko, manager BPR Kencana Cimahi, 17 January 2006; Mukmin, manager BPR-BKPD Kapetakan, 29 March 2006.

⁴⁰⁴ Observations of Agil, loan officer BPR-BKPD Kencana, Cimahi, 17 January 2006; Djaja, loan officer BPR Kapetakan, Cirebon, 29 March 2006; Hapid Wahyudin, loan officer BPR-BKPD Pagerageung, 3 March 2006.

borrowers need help, such as consultation for business development or non-business matters. Practicing business ethics means developing trust, maintaining pleasant business relationships and building respect between BPR officers and borrowers.

The mantri of BRI Units

In discussing business ethics, Heads of BRI Units (*Kepala BRI Unit*) explain they have to refer to the designated values as formal rules of conduct for the *mantri* and employees based on three main pillars: follow all the rules and regulations on banking business, avoid conflicts of interest and maintain customers and banking secrecy.⁴⁰⁵ They describe some technical guidelines such as: ethical behavior and mutual trust with customers, increasing service quality, openness to inform bank products, policy and regulations, customer respect, avoiding vices such corruption, collusion and nepotism (*korupsi, kolusi dan nepotisme/KKN*), excessive entertainment, and political activity.

At the implementation level, the researcher follows the *mantri* when visiting borrowers and observes how they apply and adopt the ethics articulated in their actions.⁴⁰⁶ The researcher observes in process of negotiation of bad debt settlement the *mantri* does not bluster and not intimidate the borrower. He does not exercise his power but uses a persuasive approach. It is understood when a *mantri* faces diverse characters in different communities in rural, coastal and urban areas. What a *mantri* does is to keep the principles of ethics as his guide in maintaining relations with borrowers when discretion on microcredit regulation is not in hand. The ethical code represents the way humans should interact, but the *mantri* realizes that ethics is not necessarily the way to influence borrowers' business or financial calculations. Ethics is not to be 'commodified'; consequently the *mantri* maintains microcredit as his guide in his profession, while ethics is considered as a supporting mechanism to secure

⁴⁰⁵ Interviews with Heads of BRI Units: Nanang Suhendra KaUnit Cimindi, 13 March 2006; Endang Sumarna KaUnit Puteran, 3 March 2006; Aris KaUnit Gebang, 28 March 2006. BRI Units have to apply to the Head Office of Bank Rakyat Indonesia's regulation on Code of Conduct, see Bank Rakyat Indonesia, 2003, Kode Etik (Code of Conduct), BRI, Jakarta.

⁴⁰⁶ Observations with Abun Yamin, BRI Unit Puteran, 4 May 2006; Aris Purwanto, BRI Unit Gebang, 27 April 2006; Yuda, BRI Unit Cimindi, 10 May 2006.

success in business transactions. Here we can see how a *mantri* as an ethics officer plays an important role in making ethics a central concern in the organization of the BRI workforce. The researcher finds that ethics and the code of conduct are included in the *mantri* training program curricula. But without clear guidance from the BRI Head Office and branch offices, it appears little consideration is given to how a *mantri*, a small minority of individuals, is supposed to shape the cultural dynamics of the BRI.⁴⁰⁷

In the Training Centre of Lembang the research findings related to ethics problems in borrower–*mantri* relationships are discussed:⁴⁰⁸

1. A *mantri* is not in a position to be flexible on the bank's microcredit regulations, such as borrowers' requests for lower interest rate levels, less collateral requirements, different methods of assessment and more flexible legal agreements. Under these circumstances, a *mantri* holds a decisive position in BRI Unit decision-making processes for loan approvals.
2. A *mantri* plays an important role in the asymmetrical relationship between the BRI Unit and microcredit applicants and borrowers. An examination of the borrowers' files indicates that microcredit recommended by the *mantri* is approved by the *Kepala* BRI Unit. The role of a skillful *mantri* is to accommodate the sociocultural values of bank borrowers and sustain strong human relationships in order to secure microcredit, both financially and socially. *Mantris* maintain the unique capacity in BRI networking. They apply the head office's policy on microcredit in dynamic village economies, with a diversity of sociocultural values, as well as compete with other financial institution lenders. They accommodate the complexity of the bank–borrower relationship. For this tough job the *mantri* needs ability and ample experience in small business financing, in order to understand psychology and human behavior, know and appreciate local culture, feel at ease to communicate with people as well as be hospitable and friendly. These skills

⁴⁰⁷ See also Mollie, P.M. 2008, *Business Ethics as Practice: Ethics as the Everyday Business of Business*, Cambridge University Press, p. 5.

⁴⁰⁸ The researcher visited the BRI Regional Training Centre in Lembang, district of Bandung and discusses the role of *mantri* on ethics with *mantri* in training sessions, 13 March 2006.

can not be developed in training and experience while working, but ability should be detected when the *mantri* applies for the job in BRI.

It can be concluded that business ethics is about human qualities when business people apply ethical values to business behavior. It is found that both parties (bank officers and microborrowers) respect human values for a smooth business relationship, profits and human dignity.

The researcher also discussed issues regarding relationships in microfinance institutions and local community with formal local leaders at a sub-district level (*kecamatan*).⁴⁰⁹

“We confess the important presence of microfinance institutions as a support to economic and social development in our areas. Employment created from microfinance is expected to multiply with more micro-customers to be supported. Microfinance stimulates our local economic activities, increases income of the villagers, raises tax for local government income and also contributes to education and various social activities”.

Local government officials in the rural research area hope that more microfinance institutions will operate to support a better lifestyle in their local community and to increase social security.

4.2.5. Efforts to build trust in microfinance

To be ‘trusted’ by the bank is a magic word that microborrowers need to hear when they contact the bank to ask for their first loan. Respondents are required to answer all questions in the loan-application forms and follow the guidance of bank officers who help them to comply with all the microcredit requirements. While applicants seek to access a bank loan, the bank tries its best to assess information and decide whether loan applicants can be trusted. The bank needs to be convinced that it has sufficient information about the applicant and whether he/she can be trusted to receive a loan. Based on interviews and discussions with borrowers about their experiences, their first contact with the BRI, BPR and cooperatives is noted. The diverse circumstances of initial

⁴⁰⁹ Interviews with H. Abun Bunyamin, Cimahi, 18 January 2006; Drs. H. Oman Kuswandi MSi, Camat Pagerageung, 23 March 2006; Ir H. Ayat Hidayat, Head of Koperasi Pondok Pesantren Hidmat Suryalaya Pagerageung, 23 March 2006.

contact, the different backgrounds of applicants and the response of lending institutions are reflected in the following summaries:

1. Experience of applicants

a. Applicants running businesses who have maintained saving accounts on the basis that the bank can see their business activities. As bank customers, they have access to credit officers and apply for a loan.⁴¹⁰ The *mantri* or bank officer explained the bank's standard procedure and the terms and conditions of how to apply for a loan. The applicants recalled their experiences with helpful officers as well as others who were not so helpful with their applications. This experience had a major impression on respondents, as this was the first time they had exposed their business activities and financial position in detail. This was the first step in their efforts to build trust with the bank.

b. Other applicants had different experiences of being introduced to the bank by customers as a friend, business partner or family member.⁴¹¹ The recommendations testified that the applicant had a good business, good reputation and needed credit. One applicant explained that the bank wanted to know about him and his business in detail, and asked him to open a savings account. This applicant needed to understand that the bank required time to assess his business, and to get to know him and his family before it would evaluate the loan proposal.

c. Applicants who were not yet customers but who approached the bank for a loan. One respondent felt she was lucky to see the bank manager to discuss her business.⁴¹² She had to follow lengthy administration processes, open a savings account, route her transaction through her account and fill in application forms before the bank performed a loan analysis procedure. In this process, applicants and bank officers stay in contact to get to know each other personally and build a business relationship.

⁴¹⁰ Interviews with Marni, Cibeureum, Cimahi Selatan, 14 January 2006; Tatang Anwar, Tanjung Kerta, Pagerageung, 28 February 2006; Dasini, Gebang Mekar, Gebang, 30 March 2006.

⁴¹¹ Interviews with Herman, Picung, Pagerageung, 2 March 2006; Ade Suryana, Guranteng, Pagerageung, 2 March 2006; Dadan Ramdan, Guranteng, Pagerageung, 2 March 2006.

⁴¹² Interview with Hj. Mimi, Sukapada, Pagerageung, 28 February 2006.

d. Another applicant was invited by the bank officers of BRI Unit and BPR in Cimahi to meet the management and discuss her business.⁴¹³ She explained that her business with her own capital was running well. Both banks offered to support her with a loan to expand her business. Here the banks played an active role in soliciting the business and eventually this businesswomen obtained finance from three different banks.

e. Some members of a credit cooperative in Cimahi sought a loan from the management as part of their rights as members.⁴¹⁴ The borrowers wanted to increase their loans but they had to wait for the next term, when funds became available.

f. The group leaders of P4K programs in the three research areas approached the BRI branch office for a collective loan for members.⁴¹⁵ As it is a P4K microloan facility, the applicants had to follow the process for obtaining a loan, as determined by the program. Prior to their approach, these group leaders had been through empowerment training with the project manager (*penyuluh*) and BRI branch offices. Mutual help, values and practices had been integrated into the training programs to consolidate group solidarity. Group cohesion was one of the factors considered in the BRI's decision to provide loans for the P4K groups.

2. The banks' outlook

a. The banks play an active role in recruiting potential customers in the villages. The respondents, *mantri* of BRI Units and BPR officers, were of the view that to find a good borrower with prospective business in the village, even in an urban area, is difficult. In the villages with limited marketing reach a good businessman or woman stand out. Many microfinance institutions compete to attract business and offer their services, including loans, while endeavoring to assess the creditworthiness of potential borrowers. Trust building is a process

⁴¹³ Interview with Bu Hj. Een, wife of H. Suryono, Citeureup, Cimahi Utara, 19 January 2006.

⁴¹⁴ Interviews with Wiwi Siti Juariah, Cipageran, Cimahi Utara, 26 January 2006; Khoiriyah Tri Hastuti, Cipageran, Cimahi Utara, 26 January 2006; Amos, Cipageran, Cimahi Utara, 26 January 2006.

⁴¹⁵ Group discussions with P4K Melati, Padaulun, Majalaya, 25 January 2006; P4K Budiasih, Sindangkasih, Ciamis, 7 March 2006; P4K Sukamaju II/Melati Putih, Cipeujeuh, Lemahabang, Cirebon, 1 April 2006.

where the *mantri* or bank credit officer maintains contact with the applicants or borrowers to ensure the bank provides the necessary service to the customers.

b. The banks take a passive approach when applicants apply for microcredit. The bank's decision to provide a loan is made on the basis of its assessment as to whether the applicant fulfils their requirements, especially for collateral and the capacity to repay the loan.

In the microfinance institutions' assessment of a borrower's trustworthiness and 'bankability', the loan officers regard the first loan as very risky and as such will usually be for a small amount and tightly regulated. The loan official's assessment is about meeting the financial obligations of repaying the loan. The bank indicates its intention to trust the borrower and expresses an optimistic expectation of good behavior and is prepared to cooperate with the borrower for the benefit of both parties. The granting of the loan relies on the credit regulations bank officers apply, and the highly subjective judgments of the bank officer about trustworthiness.⁴¹⁶

Yuda Ismail is a *mantri* in the BRI Unit in Cimindi. The researcher discussed borrowers' problems with him and together we visited five business sites. Yuda Ismail remarked:

"A loan assessment in the BRI Unit has to refer to form no. 72, 70a or 70b, which is mainly a financial analysis of the ability of the borrowers in business, the capacity to repay the loan and the collateral the borrower can provide. I have to focus on business although character of borrowers is one aspect of the assessment. Non-financial aspects are not part of my analysis and so far have less influence on the loan analysis. But I am concern about the borrowers' norms and values because with my long experience as a *mantri*, sociocultural aspects – especially trust – influence strongly the performance of the borrower. I do my best to understand the borrowers' sociocultural values and practices and noted these in my supervision reports. It is more a matter of personal concern than compliance to regulations".⁴¹⁷

⁴¹⁶ The microfinance institutions rely on their standard operating procedure for the provision of microcredit such as: for Bank Rakyat Indonesia, 2003, Pedoman Pelaksanaan Kredit Bisnis Mikro (PPK-BM); BPR-BKPD Pagerageung, Tugas dan Tanggung Jawab Bagian Kredit, 1 January 2004; BPR Kencana Cimahi Kebijakan dan Prosedur Umum tentang Penerimaan dan Verifikasi Calon Nasabah Yang Akan Bertransaksi dengan BPR Kencana Cimahi May 2005; BPR- BKPD Kapetakan Cirebon Job Description Bagian Kredit, 5 October 2001.

⁴¹⁷ Interview with Yuda Ismail, BRI Unit Cimindi, 30 January 2006.

Similar concerns are shared by Aris, a *mantri* at BRI Unit Gebang, as he can see that loan assessment concentrates on financial aspects but the local value system is never officially recognized.⁴¹⁸ Three BPR loan officers, Yuda, Hafid and Yaya, have similar attitudes: borrowers' financial aspects are the most important consideration, together with borrowers' assets collateral, as stated in the credit regulations.⁴¹⁹ Knowledge about local values, norms and traditions is developed by *mantri* or loan officers individually. For the BPR, the consideration of cultural and religious issues is relatively less important than with the BRI.

Trust is the key factor in establishing a credit relationship, although the bank still requires collateral assets to protect the loans from business failure. The following points outline the work of either the *mantri* of BRI Units or the BPR loan officers, to develop trust as part of the process of loan analysis:

a. Collect information and cross-check applicants or borrower's behavior from other customers, local inter-bank informal information, neighbors, and the business community, formal and informal leaders.

b. Check the applicant's livelihood, family life as a married couple (from applicant's kinship or a close neighbor) and health status. The bank officers recognize that this type of information is only collected during the supervisory period after the loan is granted.

c. Check the applicant's sources of income, whether he or she has debts or other financial problems. This financial aspect is reported in the application form.

d. Check the applicant's references and the referee's knowledge of their capacity in business, family background, behavior and financial status.

e. Check collateral in the original documents and conduct a physical on-site inspection. If legally the collateral is not in his or her name, check the reason behind the proxy.

⁴¹⁸ Interview with Aris, BRI Unit Gebang, 28 March 2006.

⁴¹⁹ Interviews with loan officers: Yuda, BPR Kencana, 17 January 2006; Hafid Wahyudi, BPR-BKPD Pagerageung, 4 March 2006 and Yaya, BPR-BKPD Kapetakan, 29 March 2006.

After loan approval, the applicants become borrowers of microcredit. The BRI Units, BPR and their borrowers need to maintain good business relations and bank officers need to develop an understanding of cultural and religious values of borrowers. Their interpersonal skills and cultural understanding are critical elements in establishing trustworthiness and supporting financial success in microfinance activities. In Tasikmalaya, Cimahi and Cirebon, both bank officers and borrowers share similar views on business ethics and trust.

There is tension however in personal relations between them. The bank's microcredit regulations are strict and straightforward, but banks need to maintain a cooperative friendship (*silaturakhim*) as they are dealing with human beings. The bank asks borrowers to keep their business promise and integrity (*amanah*). Although borrowers understand the bank is in the position to claim bank rights as the lender and borrowers are bound by legal and financial regulations to fulfil their obligations, they feel pressured. A good human relationship between borrowers and bank officers can ameliorate the pressure and tension inherent in the lender–borrower relationship. Strict business relations with banks need to be softened with an ethical and more human approach by *mantri* and bank officers, who are familiar with local sociocultural values and practices. The bank shows trust to serve borrowers honestly and support to develop their business, while borrowers need to demonstrate their good intentions (*niat hade*).

It is understood that borrowers' opinions are strongly influenced by their Islamic beliefs and values as well as Sundanese traditional norms. These norms include the following principles: not to break commitments (*sulaya tina subaya*), not to break promises (*lanca linci luncat mulang*) and not to cheat (*basilat*). To assess whether respondents' behavior is consistent with their ideals, the researcher needs more time to observe their daily conduct. But *mantri* of BRI Units or BPR officers are the persons who endeavor to ensure that borrowers maintain ethical commitment during the long years of loan supervision.

However, the differences in implementing business ethics and trust in rural, urban and coastal areas only slightly vary in their expression (*tata krama-*

nya). The borrowers in rural areas try to express their opinion indirectly with body language, using refined language, and this manner of expression requires some cultural understanding on the part of the *mantri*. Understanding local culture, customs and local language or body language is important to support their daily work and to avoid misunderstandings. In coastal and urban areas people talk directly and openly as is their habit. This makes it easier for *mantri* or bank officers to understand their intentions.

4.3 Culture to support microborrowers

Each of the three research areas has a somewhat different economic structure as well as variations in social, cultural and religious beliefs and practices within the broader Sundanese Muslim society. These differences are also reflected in various economic sectors financed by microfinance lending institutions, which in turn influence the behavior of the borrowers, *mantri* or bank officers.

The sub-districts government data for 2005 describe the main economic sectors in the three research areas. The sub-district Pagerageung is a rural area where primary production employs about 65% of the workforce in the production of food crops, horticulture, smallholdings, animal husbandry and fishing. Trade, service businesses, civil servants and retirees follow⁴²⁰. The same pattern is found in the coastal area Gebang, where more people are employed in farming than fishing.⁴²¹ Cimahi Kota has a different economic structure.⁴²² It is an urban area where most of the inhabitants live from trading, as workers in factories and the service sector.

The composition of local economies and their labor forces do not reflect the productivity of local economies. This is especially the case in rural and coastal areas, where the 'income generators' who are the easiest to access microcredit are not found in the dominant sectors of the economy. The lending institutions in making their decisions about loans are attracted by the most

⁴²⁰ Program dan Kegiatan Pembangunan Kecamatan Pagerageung 2006-2007, 11 March 2006 and Data Monografi BRI Unit Pagerageung 2005.

⁴²¹ Laporan Perkembangan Kegiatan Ekonomi Kecamatan Gebang 2005.

⁴²² Laporan Perkembangan Ekonomi dan Pembangunan, Kecamatan Cimahi 2005.

productive individuals and businesses and they are not influenced by macroeconomic considerations.

The study found that the structure of the local economies in rural, coastal and urban areas is not always reflected in the loan portfolio of banks. Although farming is the largest sector in the rural area, the agricultural sector is not considered a good financial proposition. This lack of microcredit funding for agriculture was reflected in the monthly portfolio reports of the BRI Unit in Pagerageung, which indicated that in this rural area only 3.6% of total loans on average went to farmers.⁴²³ Local BRI managers consider that agriculture has a high risk because of its long production cycles, perishable products, supply oriented market and slow cash turnover.⁴²⁴ In contrast, traders have a faster cash turnover, which helps explain why trade is the main sector financed by microcredit by the BRI Unit in Pagerageung, a predominantly rural area, with about 59.7% of the loan portfolio. The trading sector was followed by loans to fixed income earners (*golongan berpenghasilan tetap/golbertap*) at 28.3%. The rest is for service businesses and small industry. BRI Unit Puteran maintained a similar pattern of financing to that of Pagerageung: agriculture 5.2%, trading 75.7% and *golbertap* 5.4%.⁴²⁵

Fishing and fish trading is a dominant sector in the local economies of coastal areas. However, as in the rural area, the main sector of the coastal economy financed by the BRI Unit in Gebang was trade.⁴²⁶ Bank managers are reluctant to finance fishing because of its perceived high risk, but those who trade in fish can access microcredit loans. The Unit financed agriculture (4.7%), trading (85.3%) and fixed income loans (5.0%). In the urban area, the BRI Unit in Cimindi provided about 62.2% of its loan portfolio to the trade sector, which was significant in the local economy.⁴²⁷ Fixed income earners, including many civil servants and private sector employees, received 20.8% of the loans, service businesses 9.8% and the remainder went to small industry. In distinction

⁴²³ Laporan Bulanan Realisasi Kupedes per Sektor Ekonomi tahun 2009 at BRI Unit Pagerageung.

⁴²⁴ Interviews with Endang Sumarna, BRI Unit Puteran, 3 March 2006; Kurniawan, BRI Unit Pagerageung, 8 March 2006.

⁴²⁵ Laporan Bulanan Realisasi Kupedes per Sektor Ekonomi tahun 2009 at BRI Unit, Puteran.

⁴²⁶ Laporan Bulanan Realisasi Kupedes per Sektor Ekonomi tahun 2009 at BRI Unit, Gebang.

⁴²⁷ Laporan Bulanan Realisasi Kupedes per Sektor Ekonomi tahun 2009 at BRI Unit, Cimindi.

to the rural and coastal areas, the BRI's loan portfolio in Cimindi reflected much more closely the structure of the economy. In each of the three research areas, it is the self-employed traders who have the greatest access to microfinance. They are the entrepreneurs who have the ability to generate income and profits and sell products to the local market.

4.3.1. Culture and microcredit relationship

Robbins argues that culture and economics have causal relationships, where human activity to fulfil material needs is influenced by cultural practice and social values. In economic activities, human behavior is conditioned by the countervailing pressures of limited means, many alternative uses and limitless needs.⁴²⁸ For example, the scarcity of microfinance resources in the villages drives Muslim borrowers to accept loans with “*non-shari'ah*” conditions to fulfil their finance needs. There are patterns of human activity and traditional practices in community that need financing. Borrowers have a vested interest to apply traditional practices for their own benefit and to avoid social tension. This research indicates that BRI *mantri* and BPR officers are able to control the effectiveness of microcredit and they are wise to maintain commercial parameters without conflicting with borrowers' sociocultural customs. Commercial consideration and sociocultural norms are two dynamically related aspects in microbusiness that need to be balanced in order to avoid deadlocks in business and social relations.

The capitalist economic system has penetrated into households in villages for many decades. This is a system in which the idea of *Homo Economicus* is applied as one of its basic assumptions.⁴²⁹ *Homo Economicus* is the human capability of rationally deciding to act in his or her best interest, which leads to the most personal gain when making decisions. This human

⁴²⁸ See Robbins, L. 1935, *An Essay on the Nature and Significance of Economic Science*, Macmillan, London, pp. 16-17.

⁴²⁹ The idea of *Homo Economicus* as we understand the concept nowadays can be found in the work of John Stuart Mill. The concept was developed in his *Essays on Some Unsettled Questions of Political Economy* (1844) and fully-fledged in his *Principles of Political Economy* (1848). See Peil, J. and van Staveren, I, 2009, *Handbook of Economics and Ethics*, Radboud University, Nijmegen, and Institute of Social Studies, The Hague, The Netherlands, p. 223.

behavior is guided by individual rational choice to maximize utility⁴³⁰. However, in a society where an individual still has close relationships with the family, neighbors and community, such as in the Sundanese villages, *Homo Economicus* needs *Homo Sociologicus*, where decisions have communal as well as individual interests⁴³¹. This is consistent with the Sundanese ideals: to be kind-hearted and caring and value education (*kudu silih asih, silih asah jeung silih asuh*). As Muslims, Sundanese villagers also respect their Islamic beliefs. Following Max Weber's proposition that rationalism is a cultural concept, Islamic rationalism is suggested as an alternative that is consistent with the Islamic values of *Homo Islamicus*.⁴³² The most important difference between *Homo Islamicus* and *Homo Economicus* is the assumption of altruism. As with other pre-capitalist systems, Islam is preoccupied with the welfare of a community where every individual behaves altruistically and according to religious norms.

All borrowers in the research areas in this study are Muslims and they participate in the capitalist economic system, which has developed since the 19th century. It is the long course of history, during and since the colonial period, when the Dutch government introduced capitalism under a series of policy frameworks, including the culture system (*Kultuurstelsel*), the liberal system and the ethical system, followed by the influence of Muslim business communities during the 20th century. These are significant contributions to change in many aspects of rural life. However, these economic policies and the Dutch rule in Java have had a strong tendency to conserve some degree of communal nature of the villages, as described by Furnivall, in that the villages

⁴³⁰This is rational choice theory. Lionel Robbins postulates that human behavior is guided by instrumental reason. Accordingly, individuals choose what they believe to be the best means to achieve their given ends. See Robbins, L. 1935, *An Essay on the Nature and Significance of Economic Science*, Macmillan, London.

⁴³¹ *Homo Sociologicus* was introduced by German sociologist Ralf Dahrendorf in 1958, to describe human nature in some sociological models that attempt to limit the social forces that determine individual tastes and social values. See Dahrendorf, R. 1973, *Essays in the Theory of Society*, Routledge & Kegan Paul Ltd., London.

⁴³² *Homo Islamicus* is discussed by Farooq, Mohammad Omar, 2006, *Self-Interest, Homo Islamicus and Some Behavioral Assumptions in Islamic Economics and Finance*, viewed 31 March 2007 http://globalwebpost.com/farooqm/writing/islamic/i_econ_fin/homo-islamicus.doc.

were left to manage their own affairs.⁴³³ After independence, village monetization permeated village households alongside traditional values. In financial practice the villagers are simultaneously challenged to synchronize existing values as *homo Economicus*, *Homo Sociologicus* and *Homo Islamicus*. The researcher observed how villagers think and act in using their microcredit when they combine these three concepts in order to create a synthesis, or maybe a compromise, rather than rejecting any of them, or flexibility to adapt the environment in order to survive as expressed in the traditional Sundanese expression *kudu bisa lolondokan*.

It is believed that culture can be transformed into economic activity through creativity and organizing initiatives that produce economic value. Most districts in West Java produce cultural, artistic and social resources that provide microbusiness opportunities. In practice we can re-examine West Java's culture, traditions and religion that can be turned into performances and business opportunities such as:

1. All along the coastal areas of Cirebon, the fishing communities maintain yearly sea offering ceremonies (*salametan sidekah laut*). These ceremonies occur also in other coastal areas of West Java such as Indramayu, Karawang, Pelabuhan Ratu, Pameungpeuk and Pangandaran. The local governments organize the ritual, which is listed on their tourist calendar guides. The ceremony attracts big crowds and has a lively bazaar (*pasar kaget*). The sugar cane refining ceremony (*pesta giling tebu*) has the same capacity to generate business opportunities for the local people.

2. The Sundanese traditional wedding ceremony has become an opportunity for families to display their wealth and social status. Managing Sundanese wedding ceremonies, including catering, provision of party equipment and entertainment has become good business.

3. The traditional Sundanese cuisine, usually cooked in the villages, is easily found in the many restaurants in urban areas, big cities and international hotels. It is a big business often complemented by Sundanese architecture, decoration and performance art.

⁴³³ Furnivall, J.S. 1956, *Colonial Policy and Practice*, New York University Press, New York, p. 241.

4. The traditional Sundanese music *angklung*, wooden puppetry (*wayang golek*), *gamelan*, dancing, design and visual arts can be found in conservatories and galleries, and appears as commercial performances.

5. The handicrafts, *batiks* and embroidery in the district of Tasikmalaya have developed as an industry after they improved the quality and design to meet consumer tastes. All these cultural activities create business opportunities that require financing, capital for investment, production and marketing.

This analysis shows that culture, traditions and/or customs not only influence borrowers' behavior and cost-bearing activities but also provide opportunities for business. The sociocultural aspects can be explored and developed with creativity into a practical operation, saleable commodity and financed by microcredit. The Sundanese expression is to get business and money one has to do one's best (*mun teu ngopek moal nyapek, mun teu ngakal moal ngakeul, mun teu ngarah moal ngarih*). Certainly, culture is a business opportunity for microborrowers and can maintain sustainability of microfinance institutions.

4.3.2. Microcredit in a changing sociocultural environment

It is argued here that the respondents' behavior reflects their accommodation of various values. It is found that monetization of the villagers' economy strengthens capitalism and microcredit borrowers are required to perform cost benefit calculations in their decision making. However, their Sundanese norms and traditions are influenced by modernization, their Islamic religion and patterns of social and economic change which affect them. The villagers tend to maintain a balanced relationship with the community, nature and the environment, as reflected in the Sundanese expression: one has to be able to associate with anybody (*kudu bisa ka bula ka bale*).

Thus culture is a process of acculturation, in which cultural traits, communication and openness make it a never ending process.⁴³⁴ The dynamics of change in technology, culture, and economic, social and political activities via

⁴³⁴ Koentjaraningrat, 1975, *Anthropology in Indonesia*, S-Gravenhage-Martinus Nijhoff, The Hague, p. 5.

information technology spread easily, without much respect for political and cultural boundaries. The development of communication has made the villages open to an increasing range of information and cultural influences. This is a process whereby the existing culture and values including business ethics are influenced, and the microfinance institutions need to understand the subsequent impact on borrowers' behavior. Some factors will be analyzed to see how they influence business ethics and behavior and to what extent.

The attitude of the villagers, especially in rural areas, is influenced by development in agricultural sectors and the level of poverty or prosperity. It was Dutch colonial policies that helped create a 'dual economy', where villages were left with subsistence economies and high levels of poverty. Boeke characterizes the indigenous agriculture as subsistence oriented and static in contrast to the capitalist, dynamic, foreign dominated plantation economy⁴³⁵. He argues that since social needs prevail over economic needs, the chance of a substantial development of the indigenous economic sector is poor⁴³⁶. Geertz agrees with Boeke's assessment. He further argues that colonial policy creates a kind of dual economy: the stagnant indigenous economic sector and the rapidly growing, extremely profitable colonial plantation economy. Geertz introduces the concept of involution and shared poverty⁴³⁷. Involution is different from evolution in that it leads to refinement and increased output from irrigated rice paddy but not technological change. Involution took place when the Javanese economy was confronted by demands for increased production from the colonial Dutch government at a time of rapid population growth. Increased labour inputs into the paddy fields intensified cultivation, increasing output per hectare but not increasing output per head.

Geertz argues that it always seems possible to squeeze a little more out of mediocre paddy fields (*sawah*) by working harder.⁴³⁸ As a result, more and more people can gain their subsistence from the same piece of land. The

⁴³⁵ Boeke, J.H. 1953, *Economics and Economic Policy of Dual Societies as Exemplified by Indonesia*, Institute of Pacific Relations, New York.

⁴³⁶ Boeke, J.H. 1948, *The Interests of the Voiceless Far East. Introduction to Oriental Economics*, Universitaire Pers, Leiden.

⁴³⁷ Geertz, C. 1963, *Agricultural Involution: The Processes of Ecological Change in Indonesia*, University of California Press, Berkeley, California.

⁴³⁸ Geertz, C. 1963, *ibid*, p. 35.

economic pie is thus divided into smaller and smaller pieces by applying the principles of shared poverty. According to Geertz, this process explains why Javanese village society could maintain a comparatively high degree of social and economic homogeneity.⁴³⁹ Involution also prevents serious rifts developing between small, but wealthy landowners and the majority of small landowners or those without land. The structure of land ownership in the villages indicates that peasants do not own sufficient land. Land reform introduced in the early 1960s by the Sukarno government did not succeed in changing the structure of land ownership.⁴⁴⁰ Regarding this problem of landownership, Collier criticizes Geertz because Geertz ignores the existence of a large number of landless peasants in Javanese villages, thus removing them from his analysis.⁴⁴¹ In Geertz's view, the smaller land parcels are taken to mean the absence of large landlord groups, but to Collier, this inference is not substantiated.

Countless critics challenge Geertz's conclusions on agricultural involution as his fieldwork was contained in one limited area which did not take into account various regions and shared poverty⁴⁴². Collier comments on other critics of Geertz's work.⁴⁴³ Non-farming activities in villages are not observed and analyzed decisively, thus making income per capita decline. The off-farm labor of Javanese peasants in fact needs to be accounted for because per capita income would then be rising instead of declining. Geertz takes insufficient account of the geographical diversity of the socioeconomic structure in Javanese villages and tends to over generalize regarding a single village in East Java. He exaggerates his impression of the chaotic period (the early 1950s) following World War II and the national independence revolution and thus tends to be too pessimistic in his conclusion. Benyamin White and Hiroyosi Kano point out a crucial weakness in Geertz's position: Geertz fails to observe and analyze the actual state of affairs in landownership and thus ignores the

⁴³⁹ Geertz, C. 1963, *ibid*, p. 97.

⁴⁴⁰ Mortimer, R. 1974, *Indonesian Communism Under Sukarno, Ideology and Politics 1959-1965*, Equinox Publishing (Asia), Singapore, pp. 63, 95.

⁴⁴¹ Collier, W.L. 1977, *Agricultural Evolution in Java: The Decline of Shared Poverty and Involution*, mimeograph, Bogor, Indonesia, pp. 7-8. He is actively involved in conducting agricultural surveys in Java with Agro Economic Survey members at Bogor.

⁴⁴² Geertz, C. 1963, *ibid*, p. 97.

⁴⁴³ Collier, W.L. 1977, *ibid*, pp. 3-6.

class divisions existing between landowners and non-landowners.⁴⁴⁴ Recent developments actually negate Geertz's postulate that the involitional process of adapting to a rising population by applying more labor to a fixed land area has become institutionalized. These two criticisms constitute nothing less than a broad frontal attack on the relevance and usefulness of Geertz's two fundamental concepts: agricultural involution and shared poverty.

Furnival, Boeke and Geertz argue that the backward economy in villages is the reflection of socioeconomic structure, where land is the main production factor and income derived from land utilization is the core of village economic activities. This study finds that although poverty still exists in the villages, the main role of income from agriculture in the research areas has changed.⁴⁴⁵ There are many reasons for change: aggressiveness of village monetization; disparity of value between agricultural and industrial products; no trading barriers in villages; intensive access to the urban market; villages are the suppliers of products and labor; and turnover is faster in the trading sector in comparison with the agricultural sector. All these linked factors create capital in the village as commodity with dynamic productive effects. Land as a factor of production remains important; but the increasing monetization through the provision of microcredit has created a more diversified local economy.

The arguments of Furnival, Boeke and Geertz provide the historical background of subsistence agriculture, patterns of landownership and the prevalence of poverty in rural Java including West Java. The economic structures of the three research areas plus the analysis of the BRI loan portfolios show that the dominant agricultural sector has little access to microfinance. Landlessness or the ownership of very small pieces of land means that farmers do not have sufficient collateral to satisfy bank requirements. On a national scale, 40.0 million borrowers had microcredit loans,

⁴⁴⁴ White, B. 1983, *Agricultural Involution and Its Critics: Twenty Years After Clifford Geertz*, Working Paper Series, no. 6, Institute of Social Studies, The Hague and Kano, H. 1980, 'The economic history of Javanese rural society: A reinterpretation', *The Developing Economies*, Institute of Developing Economies, Tokyo, 18(1), p. 10.

⁴⁴⁵ See Table 5.8 Five socioeconomic levels of microcredit loan applicants: they are the laboring poor and the poor of the poorest.

but another 30 million people need microcredit and it is suggested here that a significant proportion of this group works in the agricultural sector⁴⁴⁶.

The BRI Units loan portfolio reports in 2009 indicate that 41.4% microcredit was allocated for trading business, 41.0% for fixed income borrowers, only 11.1% for the agricultural sector, 1.0% for smaller industries and 5.6% for the rest.⁴⁴⁷ Those economic sectors were reflected in the BRI Unit's pattern of financing. Here we can also see that microcredit for trading and consumption sectors totalled 82.4%, dominating BRI Unit business; the reason why the village economy has changed with regard to the social environment is because productivity, efficiency and profit motives are prioritized and older collective values of cooperation have become less important. We also understand the changes in agricultural habits that differ from trading habits. The microfinance programs of the BRI Units and BPR and their microborrowers continue to bring capitalism into the villages, and villagers are confronted with the ethics of *Homo Economicus* and the values of individualism. The success and failure in this more competitive village economy has created a wider gap between those who are better off and the poor. The division between rich and poor has deepened to such an extent that it is very different from the homogenous situation pictured by Geertz. This dynamic of change has increased class differences, leaving poorer villagers in poverty. The creditworthy villagers have utilized the opportunities provided by micro-finance at some cost to shared religion beliefs and sociocultural norms.

The society has been shaped by technology.⁴⁴⁸ Information and communication technology offers enormous potential for development and improving the lives of the people it serves. To use this technology people need infrastructure support including electricity, telephone lines, hardware and software. The rural and coastal villages are supplied by limited electrical and communication networks to support mobile phones. Only a few microborrowers have fixed telephones in their homes, while internet and fax machines are very

⁴⁴⁶ Shrader, L.W. 2004, 'Regional trends in microfinance: Indonesia'. In Pakpahan, A. (ed.), *Creating Opportunities for the Poor through Innovation*, PT Bank BRI, Jakarta, p. 91.

⁴⁴⁷ Statistik BRI Unit, December 2009, Kantor Pusat, PT Bank Rakyat Indonesia (Persero) Tbk. Jakarta, Kupedes Per Sektor Ekonomi.

⁴⁴⁸ Tofler, A. 1970, *Future Shock*, Bantam Books, New York.

limited and only available in local government offices, banks and to few individuals. Urban areas have better communication infrastructure. Mobile phone technology is easily accessed, and most microborrowers maintain this technology for communications. The researcher observed that most business transactions and banking matters can be managed by using mobile phones. But in the villages, especially in rural and coastal areas, face-to-face communication is the mode of human contact. And it is more ethical than making a phone call. To discuss banking matters the borrowers feel it is better manners to come over and visit the bank office instead of discussing the business via phones. On the other hand, the bank officers prefer to use their mobile phones for work. A mobile phone gives them an effective communication tool, a better image for social status as a bank officer, symbolizing freedom to open up a new culture of communication and to achieve social acceptance in the community. They think using a mobile phone is a means of making a phone call; the most important thing is how to communicate respectfully. Here the traditional Sundanese expression in communication is still valid: we need to have good language and manners (*kudu hade gogog hade tagog*) and good words should be used in conversation (*nyaur kudu diukur nyabda kudu diungang*).

Different environments have different impacts on social behavior. In urban areas, having a debt to a microfinance institution is hidden from public eyes. The loan is only an ordinary business matter and for this reason the microfinance institution cannot use social pressure if the loan turns bad. For borrowers in rural and coastal villages, having a loan affects their social status in the community. The village community knows the borrowers' business. The microfinance institution can use informal leaders' influence and peer pressure as a means to support compliance with bank regulations and loan repayments. The borrowers in the three research areas in this study honor business ethics although their expression is influenced by different cultural values. The borrowers in urban and coastal areas speak directly and openly about their business affairs, but in rural areas they discuss their business affairs in a more oblique manner.

With reference to the findings and analysis in this chapter, it can be concluded that sociocultural values and religious beliefs influence borrowers' behavior including their use of microfinance programs. The study also described how microfinance institutions and borrowers' activities influence sociocultural life. These aspects and religion build a relationship with and influence the capacity of microfinance institutions, and help borrowers make choices and decisions. According to Margaret Archer, although cultural systems complement and contradict, there are opportunities for the resolution of inconsistencies in accordance with the interests of those involved.⁴⁴⁹

Sundanese cultural traditions, various types of *salametan*, Islamic celebrations, family life cycle events and ethics provide guidance in the social life of the villagers. The borrowers seek to follow their traditional practices while benefiting financial and socially from their microloans. They also want to avoid social tension with their community while complying with microfinance regulations. The microfinance institutions and their officials have to follow microfinance regulations. Here we find the important role of the BRI Unit's *mantri* and BPR's loan officers as financial and cultural mediators to accommodate differences and contradictory cultural elements, as they have some discretion to interpret regulations. The microfinance institutions accommodate sociocultural values of communities and, following the BRI's circular letter of 2006, have endeavored to reflect these values in their regulations.

⁴⁴⁹ Archer, M.S. 1996, *Culture and Agency: The Place of Culture in Social Theory*, University of Cambridge, New York, pp. 158-159.

CHAPTER 5

MICROFINANCE IMPACT, INCOME AND RISK

5.1 Introduction

As discussed in the previous chapter, this study examines how sociocultural factors influence borrowers' behavior, endeavors to alleviate poverty, and how the income generated from loan repayments underpins the sustainability of microfinance institutions. Chapter 4 explored how the cultural dimension of traditions and the Sundanese culture and Islamic beliefs influence economic behavior of borrowers; for example, the development of trust with the microfinance institution, creditworthiness, attitudes to payment of interest and *shari'ah* principles in producing income. Culture creates positive or negative affects on borrowers' behavior and can influence the success or failure of the business. The study finds that culture is a dynamic factor and that cultural creativity can be transformed into business opportunities. In other words, culture can be exploited as a source of income instead of merely being expenditure as traditionally recognized. In this chapter, we explore how business and microcredit managed effectively by borrowers generates income. To maintain profit margins, microfinance institutions select bankable borrowers; then both the bank and the borrowers endeavor to ensure that the business grows and the loan does not turn bad.

There is strong evidence to show that with well designed programs microfinance produces income and has a positive impact. For example, growth in income, borrowers are removed from poverty, increasing income is positive for other households, including non-participants, as there are spillover effects and savings.⁴⁵⁰ It helps to accommodate sudden fluctuations in income and changes village attitudes and other village characteristics. Increasing income

⁴⁵⁰ Microfinance Impact Studies: Asia and Latin America, in Montgomery, H. and Weiss, J. 2005; Great Expectations: Microfinance and Poverty Reduction in Asia and Latin America, *Asia Development Bank Institute Research Paper Series* no. 63, Table 2, p. 10 and Table 3, p. 14. Indonesia is also part of the study in Badan Kredit Kecamatan (BKK), Kredit Usaha Rakyat Kecil (KURK), Bank Rakyat Indonesia (BRI). See Appendix 1 and 2 in this thesis.

supports greater female participation in the economy. It was found that credit and women's groups established by government subsidized programs and training programs have facilitated a positive growth in assets. The reliance on moneylenders was also reduced. Nevertheless, the provision of microfinance loans involved risk and where business failure occurred, there was a negative impact on both borrowers and lenders.⁴⁵¹

The success or failure of microbusiness, as influenced by sociocultural factors, in turn impacts on cash flow and sustainability of the lender institution. With respect to cash flow and risks associated with microcredit institutions, it is argued that:

1. Microcredit creates positive impacts to generate income for livelihood, to alleviate poverty and to improve quality of life for those who are able to manage microbusiness successfully, while instalment and interest payments support sustainability of the lender.

2. Microcredit is inherent with business risk and if it becomes a bad debt it impacts negatively on borrowers and the lender.

These arguments are based on data from two different microfinance models: a) commercial microcredit: *kupedes* of BRI Units, microcredit from BPR, and b) microcredit development schemes or *Pembiayaan Pemberdayaan dengan Mikrokredit*: P4K financing scheme and also local government development projects designed in the district of Bandung Selatan, sub-district Soreang, and the district of Bekasi in the West Java province.

The researcher endeavors to understand easy access to microfinance institutions to assess the impact of microfinance loans on borrowers through the use of structured interviews with key informants, focus group discussion, and participant observation. The objective is to assess whether the provision of microfinance facilitated growth in income and/or a reduction in poverty for the two groups of borrowers. The outcomes for these groups were then compared and analysed.

⁴⁵¹ See Adam, D. and von Pischke J.D. 1992, Microenterprise credit programs: 'déjà vu', *World Development* 20(10), pp. 1463-1470; Wood, G. and Sharrif, S. 1997, *Credit Where Credit is Due*, UPL and Zed Books, Dhaka and London.

5.2 Microcredit: socioeconomic impact

5.2.1. Income impact on livelihood

During field study in Cimahi, Pagerageung, Kapetakan and Gebang, the researcher identified two types of programs: a commercial microcredit approach in BRI Units and BPR and a poverty reduction approach in government programs. Examples are *Pembinaan Peningkatan Pendapatan Petani-Nelayan Kecil/ P4K* (Income Generating Project for Small Farmers and the Landless), and local government financing projects in Soreang and Subang that produce income-generating activities, since these are likely to increase microborrowers' revenue. Increased income with the commercial approach for the bankable and better-off small entrepreneurs are delivered to expand and diversify their business, or for capital and assets formation or other personal expenses. In contrast, the poor borrowers of P4K and participants of local government financed projects meet their basic needs first and then repay their loans. It is expected that their income will be sufficient to maintain their survival. Meanwhile, cooperatives finance small, productive business activities for profit but also the consumption needs of members. These two approaches will now be discussed in more detail.

The respondents in rural, urban and coastal areas recognize the benefits of *kupedes* BRI Units and BPR microcredit. The experience of three borrowers can be summarized as follows:

"Pak Hidayat, who is 59 years old, lives in the urban area of Cimahi Kota. He started his business as a rice retailer in 1970 and has been provided with microcredit by the BRI Unit since 1981. After so many years of hard work with his work philosophy 'work seriously to get the wealth' (*soson soson gawe nyiar dunya*), he succeeded in his business in the agricultural sector, transportation and communication. Pak Hidayat confirms with bank support his business is running well and profits are escalating from his income to nourish his family, to pay education costs, medical care and various social costs.⁴⁵²

This increasing income is also recognized by Pak Tatang Anwar, a 57-year-old farmer living in the rural area of Pagerageung Tasikmalaya. He trades agricultural products

⁴⁵² Interview with Hidayat, Cimahi, 16 January 2006.

and has managed a freshwater fishery since 1978 and has been a microcredit borrower for 17 years. *Pak Anwar* stated that his business so far has been good, he has increased his income and the bank has continuously extended and raised his loans. Now, *Pak Anwar* and his wife, *Ny.Emah*, are living in their own house, and invest more in assets of land and ponds.⁴⁵³

Ny. Patona, 40 years old, is a fishing boat owner and fish trader, living in the coastal village of *Kapetakan*, district of *Cirebon*. She has been a microcredit borrower for 17 years. Although fishing is a fluctuating business, she recognizes that her income is still sufficient to maintain her business and to finance her household expenses.⁴⁵⁴

These three cases indicate that microcredit, sustained through serial borrowing, has increased their incomes as reflected in more money earned or net cash inflow after various transaction costs. This increasing income is a resource for borrowers to request additional loans to continue and expand their businesses.⁴⁵⁵ For the bank, this increased capacity leads to repeat business and a higher income for existing microborrowers plus a greater profit for the bank. This process supports the sustainability of microfinance institutions but increases the dependency of borrowers on BRI Units or BPR. The increase in income can be confirmed from various sources such as affirmation of the borrowers, ever-increasing average individual loans in the BRI Units and BPR, and from business analysis and assets evaluation when the borrowers ask for additional loans from the BRI Unit.

The borrowers are self-employed and manage small businesses. They are owners of assets or production equipment supported by microcredit that meets their individual requirements or can be sold for income. Three physical variables can be found as the evidence of a better living: a) the condition of borrowers' houses, b) assets they own, and c) their children's education. Most respondents' houses have a tiled roof, brick walls, ceramic floors, electricity and their own toilet. Generally they have other assets including furniture, a radio or television set, and a motorcycle. Some have mobile phones or own another house or land. Supported by information from the BPR officers and *mantri* of the

⁴⁵³ Interview with *Tatang Anwar*, *Pagerageung*, 28 February 2006.

⁴⁵⁴ Interview with *Patona*, *Kapetakan*, 29 March 2006.

⁴⁵⁵ BRI call this *Suplesi Kupedes*.

BRI Units, the researcher observed that the borrowers' houses are generally better in comparison their neighbors', who are not supported by microcredit. Observations and interviews with BRI Units and BPR managers and informal leaders in the villages create an impression of how successful borrowers are, especially females, who are able to place themselves in a respected position in the village community.⁴⁵⁶

According to Hidayat, Rohman, Abun Yamin, Purwanto, Mukmin and Sunarko the borrowers are getting richer and are able to contribute more money for community development, share more funds for community self-help (*gotong royong*) and give more donations (*sedekah*) for mosques and religious activities. They also create employment for other villagers and pay taxes. A positive impact of their participation in the local economy places successful borrowers in an esteemed position in the village community.

Another positive effect of microcredit is on education among borrowers, who are concerned about their children's education. They would even prioritize their children's school fees over bank instalments. They expect their children to get a better and higher education than they themselves achieved.

Ibu Mamah, a 46-year-old farmer living in the village of Puteran, Pagerageung, has five children. Supported by microcredit since 1994 from Pesat Tani cooperatives, she sets aside her increasing income to send two of her children to primary school; another two are at secondary level and the eldest is at high school. She argues that her former primary school education is not sufficient for her business development and she wants her children to enjoy better education for a better living.⁴⁵⁷

Furthermore, the borrowers explain that the microcredit they utilize boosts their morale and encourages them to work diligently. They are financially responsible and microcredit has also created an opportunity for an entry point to a better life. Microcredit produces self-confidence when the bank supports their efforts, and they can rely on the bank to obtain credit in times of need. The researcher was of the impression that microcredit can change not only the

⁴⁵⁶ Interviews with Ir. H. Ayat Hidayat, Tanjungkerta, Pagerageung, 23 March 2006; Undang Rohman, Pakemitan Ciawi, 24 March 2006; Abun Yamin *mantri* BRI Unit Puteran, 8 March 2006; Anis Purwanto *mantri* BRI Unit Gebang, 28 March 2006; Mukmin manager BPR Kapetakan, 29 March 2006; Sunarko, manager BPR Kencana, 17 January 2006.

⁴⁵⁷ Interview with Mamah, Puteran Pagerageung, 1 March 2006.

economic vision of borrowers but also villagers' attitudes and other characteristics, such as being able to see the challenge of free market competition and the importance of building business networks with urban and city areas.

For the better-off borrowers, microcredit increases borrowers' working capital and investment in assets. It has multiple effects on growing more crops, manufacturing more goods and, catching or buying more fish, as they pay in cash and in advance. More working capital also generates a faster financial turnover. Table 5.1 shows that two-thirds of respondents have maintained an established banking relationship for more than five years. The duration of the microcredit loan is one of the indicators of success; here a minimum of five years duration indicates at least two loan extensions. During that period the bank has enough time to evaluate the microcredit relationship and decide whether to extend the loan or cease business relations. It is found that many borrowers (see Table 5.1) should have the capacity to shift to bigger retail credit facilities at more than 100 million rupiah, equivalent to US\$ 11,000.

Table 5.1 Borrowers and the duration of loans

Stage	Number of years as a borrower	Cirebon	Tasikmalaya	Cimahi	Total	% of respondents
1	1 – 3	7	1	2	10	10.5
2	4 – 5	16	2	4	22	23.2
3	6 – 10	9	21	12	42	44.2
4	11 – 15	4	3	10	17	17.9
5	> 15	0	3	1	4	4.2
	Total	36	30	29	95	100.0

However, borrowers prefer to stay in the microcredit scheme as they feel that they can better manage the risks involved. In fact, most of the BRI microborrowers survived the monetary crisis (*krismon*, 1997-1998) relatively well, in part because they received addition loans from the BRI. The BRI borrowers were able to contend with massive increases in food prices and the rural crisis caused by a major drought in 1998, as well as changes in

employment, wages and education created by the crisis, which resulted in a dramatic decline in real income per capita.⁴⁵⁸ Although microborrowers did not have foreign exchange exposure their customers in the cities were subject to the fluctuating value of the Rupiah, which affected the liquidity of microbusiness. The borrowers often needed additional loans from the BRI Units and BPR. Microcredit helps them to survive and avoid bad debts and prevents poverty. The experience of the respondents in this study can be compared to broader experiences in North Subang and East Cirebon villages during the *krismon*, as studied and discussed by Breman and Wiradi.⁴⁵⁹ The economic crisis in 1997-1998 was a lesson for borrowers in the importance of business relationships with the banks, to maintain their businesses. Repeat business through additional loans (*suplesi kredit*), are a lifeline in a situation of need. This serves as an effective tool to develop small business and break the cycle of poverty.

Repeat business and microborrowers' additional loans are a way for BRI to expand microloans to get profits; an alternative to increasing the numbers of borrowers. The increasing amount of microcredit is reflected in BRI Units' microcredit portfolios. And loan data show an ever-increasing average of total microcredit granted for one borrower in one BRI Unit office. Table 5.2 shows that within 14 years, a BRI Unit borrower is given an average of rupiah 12.9 million or a loan 8.77 times larger than what he or she received in 1995 at rupiah 1.4 million, while the number of borrowers increased by only 1.98 times.

Increasing the borrower's loan makes the average outstanding microcredit in one BRI Unit increase more than 13.14 times from rupiah 906.7 million to rupiah 11,913 million. The abovementioned national data of BRI is consistent with data found in BRI Units. BRI Units in the research areas are on average two times larger in growth of microcredit in comparison to growth of borrowers during the period 2006-2009.⁴⁶⁰

⁴⁵⁸ Strauss, J. et al, 2002, *Indonesian Living Standards Three Years after the Crisis: Evidence from the Indonesia Family Life Survey*, World Bank, Washington DC.

⁴⁵⁹ See Breman, J. and Wiradi, G. 2002, *Good Times and Bad Times in Rural Java: Case Study of Socioeconomic Dynamics in Two Villages Towards the End of the Twentieth Century*, Institute of Southeast Asian Studies, Singapore.

⁴⁶⁰ Laporan Keragaan Usaha BRI Unit, Cimindi, Puteran, Pagerageung, Gebang 2006-2009.

Table 5.2 National figures of Kupedes loans per borrower and total average of outstanding loans

End of December/ Year	Average outstanding loan per borrower/Rp (000)	% to 1995	Number of borrowers (000)	% to 1995	Average total outstanding loan in one BRI Unit/Rp	% to 1995
1995	1,473.7	100	2,090	100	906,667	100
1996	1,718.3	117	2,286	109	1,133,849	125
1997	1,889.2	128	3,362	161	1,269,400	140
1998	2,017.8	137	2,196	105	1,268,368	139
1999	2,537.7	172	2,276	109	1,612,487	178
2000	3,021.5	205	2,526	121	2,101,862	232
2001	3,671.5	249	2,631	126	2,586,611	285
2002	4,099.3	278	2,883	138	3,069,104	339
2003	4,932.7	335	2,875	138	3,590,991	396
2004	6,326.0	429	2,974	142	4,742,669	523
2005	7,310.8	496	3,072	147	5,540,973	611
2006	8,470.9	575	3,178	152	6,451,729	712
2007	9,994.6	678	3,222	154	7,587,069	837
2008	10,523.3	714	4,018	192	9,679,931	1,068
2009	12,918.3	877	4,128	198	11,913,558	1,314

Source: Bank Rakyat Indonesia, Head Office, Laporan Statistik BRI Unit, December 2009.

The growth of BRI microcredit *kupedes* loans is the objective of the BRI head office, as found in the increasing outstanding *kupedes* loans at a national level. Since the financial crisis, *kupedes* loans have increased steadily from 4.6 trillion rupiah in December 1997 to 9.8 trillion in December 2001; 19.1 trillion rupiah in December 2004 to 32.6 trillion in December 2007; and reached 54.1 trillion in December 2009, or an annual growth of 53.10%.⁴⁶¹ These are the patterns of microcredit growth that support BRI interest income. The BRI Units under the BRI business plan has to expand the microcredit portfolio, either to increase

⁴⁶¹ Statistik BRI Unit Desember 2009.

individual loan limits or to find new borrowers. In fact, to give additional loans is the fastest way to reach the microcredit target of expansion.

As a commercial bank, BRI is managed for profits and loan activities including microcredit, which are the main sources of income. The higher the loan portfolio the higher the bank profits to reach sustainability through repeat business with additional loans to each borrower and/or additional new borrowers. The figures in Table 5.2 show that an increasing amount of microcredit per borrower is prioritized rather than growing the number of new borrowers. Another reason is the limitation in the number of customers a single *mantri* in BRI Units can manage. The study indicates that one *mantri* in a BRI Unit on average manages between 450 to 573 microborrowers, with on-site supervision taking 25 to 26 working days per month.⁴⁶² Given the distance of the borrowers' residence is within a radius of 10 to 20 km, that travel is by motorcycle and that road and weather conditions are often not good, even though borrowers only have to be visited once every three months, the *mantri* nevertheless has a heavy and time-consuming workload. The researcher estimates that perhaps on average 200 to 250 borrowers per *mantri* is an ideal ratio; but the BRI Unit Cimindi manager explained that 300 is the highest number he can manage. Additional *mantri* are not easy to recruit and train and these processes are controlled by the BRI Head Office. The BRI Units need to follow a protracted bureaucratic process to acquire additional *mantri*.

As a result, the BRI prefers to deal with familiar borrowers whose behavior and business risk they understand, rather than to search for new borrowers that have yet to be risk assessed. The implication for this policy is that the BRI tends to have limited outreach to new borrowers. Table 5.3 shows that within 14 years from 1995 until 2009 the BRI expanded (1,027 new BRI Unit offices averaging 73.3 offices per year), although there was only an

⁴⁶² Total micro-borrowers (current and non-assessed) divided by number of *mantri* in BRI Unit Gebang, Cimindi, Puteran, Pagerageung, averages for 2007, 2008 and 2009.

Table 5.3 National figures for new *Kupedes* borrowers 1995/2009

End of December/ Year	Number of borrowers (000)	Additional borrowers of column 2 /year (000)	BRI Units offices	Average additional borrowers per BRI Unit/year	Average additional borrowers per BRI Unit/month
1	2	3	4	5=3/4	6=5/(12)
1995	2,090	-	3,512	-	
1996	2,286	196	3,595	54.52	4.54
1997	2,362	76	3,691	20.59	1.72
1998	2,196	(166)	3,703	(44.83)	(3.74)
1999	2,276	60	3,694	16.24	1.35
2000	2,526	250	3,724	67.13	5.59
2001	2,631	105	3,817	27.51	2.29
2002	2,883	252	3,916	64.35	5.36
2003	2,875	(8)	4,049	(1.98)	(0.17)
2004	2,974	99	4,046	24.47	2.04
2005	3,072	98	4,112	23.83	1.99
2006	3,178	106	4,229	25.07	2.09
2007	3,222	44	4,297	10.24	0.85
2008	4,018	796	4,417	180.21	15.02
2009	4,128	110	4,539	24.23	2.02
Average additional offices & borrowers			73.35	24.23	2.02

Source: Bank Rakyat Indonesia, Head Office, Laporan Statistik BRI Unit, December 2009.

average of 2.02 new additional borrowers a month per BRI Unit office. These figures reflect growth in loans per borrower and indicate the pressure to increase income, stimulating repayment capacity. This evidence reinforces how BRI Units prefer to grow their loan portfolios with old and trusted customers rather than establish new relationships with potentially risky borrowers, as shown in Table 5.3.

As there is more demand for microcredit in the market, although potential borrowers may still be 'unbankable' according to BRI assessment standards, the additional 2.02 new borrowers per month per Unit represent, for the BRI head office, a limited outreach. There is an average of 146,285 additional borrowers per year at BRI Units all over Indonesia. This is a low figure in comparison with the over 30 million microbusinesses that need access to

microcredit.⁴⁶³ It raises questions as to whether the BRI is able to assist the poor to alleviate poverty and what more has the capacity to finance them. The BRI's policy and its operations have been set up for commercial purposes. It is BRI policy to stay away from poverty alleviation and keep on a commercial track to maintain a sustainable microfinance institution that will support social and economic development in Indonesia⁴⁶⁴. This is the policy alternative which takes a capitalistic approach, although it is clearly evident that poor applicants increasingly find it difficult or impossible to access BRI micro loans.

The researcher found two types of financing schemes for poor participants with national government or local government funds involved.

a. *Pembinaan Peningkatan Pendapatan Petani-Nelayan Kecil / P4K*
(Income Generating Project for Small Farmers and Landless).

For the poor or 'unbankable' people, who are vulnerable to fluctuations in income, microcredit is used to finance their business in a self-help group after participating in empowerment training programs and retaining a 10% saving (*tabungan terbeku*) from the total loan. Members of the self-help group are selected by officers of the Ministry of Agriculture; the BRI branch office does not participate in this process. This is followed by six months empowerment training for selected participants of the P4K program. These participants have great hopes in this program: "one day if I were to succeed in this process; I will be classified as a bankable customer and I will have direct individual access to the bank". This process also needs bank guidance; it is a social mission of the bank to educate and help people achieve a better living.

The researcher found 'groups of poor people' organized under P4K Program in rural villages at districts of Majalaya (with 10 members since 1993), Ciamis (12 members since 1999) and Cirebon (13 members since 2000). Members of the groups earn their own living as small farmers; daily food

⁴⁶³ Shrader, L. W. 2004, 'Regional Trends in Microfinance: Indonesia', in Pakpahan, A. (ed.), *Creating Opportunities for the Poor through Innovation*, PT Bank BRI, Jakarta, p. 91.

⁴⁶⁴ *Kupedes* is provided to support government policy to develop small businesses in the villages (see BRI Circular Letter/ *Surat Edaran* NOSE.S. 18-INV/1/1984, 30 Januari 1984, p. 3) for viable business with good prospects or *usaha yang layak yaitu usaha yang benar-benar mempunyai prospek yang bagus untuk dikembangkan* that subsequent with government regulations, moral, religion, tradition of the local community and to maintain living environments (see *Pedoman Pelaksanaan Kredit Bisnis Mikro*, 2003, PT Bank Rakyat Indonesia (Persero), Jakarta, p. 9).

traders; chicken or duck breeders; fresh water fisheries; various foods, cakes and garment makers. These are self-help groups, to be empowered in their business and network supported by microcredit from government and donor funds through BRI and supervised by dedicated counselors from the Department of Agriculture. The respondents recognize how microcredit supports their work and generates more income. Microcredit brings about the expectation to improve their living and now they have access to the bank to develop their business.⁴⁶⁵

Members of the P4K group are poor; their income is below the poverty line at an equivalent of less than 320 kg rice per capita per annum. They do not have capital or assets and they lack ability in business that needs empowerment for self-employment. They stand as a group member and differently to the better-off borrower who stands alone in running the business. By developing group lending, this self-help empowering process encourages poor entrepreneurs to do business under the supervision of *penyuluh*, a designated government officer. It is found that they are still challenged by the requirement to provide asset collateral. Observation of the P4K groups indicates that social collateral developed through group solidarity and empowering in practice is not sufficient. Besides the 10% members' saving, it is the head of the group of P4K who takes over the problem of assets collateral. The solution is accepted by all parties: the project manager, head of the group and members agree the gap is covered by group lending responsibility. Members who are not able to submit collateral are responsible to support a cash payment to other members within the group; but in the end, the head of the group maintains his or her responsibility to the project manager with assets collateral submission. It is understood that the head of the group can determine members of the group and maintains stronger bargaining power to the lender. The BRI branch office evaluates loan applications based on financial viability, as the BRI carry the risk of the loan. The applications are not in the hands of the government, the

⁴⁶⁵ Group interviews with P4K Melati, Padaulun, Majalaya, 25 January, P4K Budiasih, Sindangkasih, Ciamis, 7 March, and P4K Sukamaju II, Cipeujeuh Wetan, Lemah Abang, Cirebon, 1 April 2006.

International Fund for Agricultural Development (IFAD) or the Asian Development Bank (ADB).⁴⁶⁶

Table 5.4 Growth of average income among P4K program participants

Year	Average per capita income per year equivalent to rice/kg	% to 1986 base year
1986	289.00	100.0
1988	289.40	100.1
1990	289.91	100.3
1992	292.33	101.2
1994	295.15	102.1
1996	301.02	104.2
1998	308.60	106.8
2000	325.62	112.7
2001	331.62	114.7
2002	347.72	120.3
2003	404.33	139.9
2004	467.00	161.6
2005	508.14	175.8

Source: District of Sumedang, West Java province: Report of Agriculture Office, 2006

This is the process to increase the group's ability to access existing financial resources. Since 1980 the government and BRI branch offices have provided microcredit for each member of the group, and the impact study of this microcredit shows the increasing benefit of the system to borrowers.⁴⁶⁷ Evidence is found in reports of Sumedang district in West Java, which was used as a model, and Table 5.4 shows the benefits of the P4K program to borrowers.

⁴⁶⁶ *Laporan Studi Dampak Proyek Peningkatan Pendapatan Petani dan Nelayan Kecil (P4K) di Propinsi Jawa Barat tahun 2005*, Kerjasama P4K Propinsi Jawa Barat, Badan Pusat Statistik (BPS) Propinsi Jawa Barat, pp. 25-26.

⁴⁶⁷ Bappenas, 2008, ADB TA 4762 INO PROYEK PERENCANAAN DAN PENGANGGARAN YANG BERPIHAK PADA KAUM MISKIN, Kertas Kerja Hasil Review dan Evaluasi atas Program-program yang Berpihak pada Rakyat Miskin di Indonesia: Rangkuman Dokumen dasar untuk Lokakarya "Menggunakan Hasil Evaluasi: Cara Meningkatkan Program-program yang Berpihak pada Rakyat Miskin", Hickling, Jakarta, program P4K, no. 11, p. 8.

Ten years after the program commenced in Sumedang, income growth was only 4% in 1996, but during the last five years, participants' income has increased sharply. This represents an increase in income of 76% over 20 years, from 1988-2005, or an average of 3.8% per annum, which suggests a low rate of growth. It can be compared with the annual average growth in borrowers' income of 20.7% from the Sumedang BRI Unit, from 1988-1992, compared with 1.1% income growth of participants in the P4K Program in Sumedang during the same period.⁴⁶⁸

b. Local government poverty alleviation projects

Supported by the local government budget under district economic development programs, the district governments of Soreang and Subang in West Java organized direct financing for the poor. In fact, this local government program was controversial among micro-finance borrowers, who felt it was too small and only available for some people. It was a program through which the local government attempted to demonstrate its capacity to help poor people. The policy is set up with the agreement of Local Council of Peoples' Representatives (*Dewan Perwakilan Rakyat Kabupaten*) as part of the realization of the Head of the District's (*Bupati*) campaign promises in the local election.

For this purpose, the local government opened and guaranteed fund accounts with the BRI branch office. Under agreement with the BRI, it provided microcredit to the group of borrowers, fully assured by the guarantee fund. It means that if the borrowers fail to pay on the due date, the BRI is allowed to directly charge the fund account. Basically the bank only provides administration and supervision support without any financial responsibility. Two groups of borrowers were observed in the districts of Soreang and Subang to understand this model of financing.

Fish farmers at Ciparay village, Pacet, Soreang, district of Bandung, West Java province, about 40 km south of the city of Bandung, have small fish ponds, have rented

⁴⁶⁸ Hulme, D. and Mosley, P. 1996, *Finance against Poverty*, vol. 1 (see Table 4.1), London and New York: Routledge.

ponds from the family or neighbors, or work as fish farmers. They understand that they are too small, lack capital and business licenses, have no administration back-up, and lack assets, all of which makes them unviable to access a bank to improve their living standards. Since May 2006, the district of Bandung government has been determined to develop fish farming for poor people supported by the West Java province and local government (kabupaten Bandung) budget, deposited in a BRI sub-branch in Soreang. It is organized under *Unit Pelayanan Pengembangan (UPP) Perikanan Kabupaten Bandung*. A special officer (*Petugas Penyuluh Lapangan/PPL*) is assigned, dedicated to increasing the group of fish farmers, developing training on fish farming, supporting simple administration, and managing the market information. The officer and UPP have important roles to determine members' capability to be financed by the bank. BRI Soreang provides and administers the loans and an account officer is appointed to supervise loans. Loan granting is a simple process as the bank only channels the loan to the previously UPP chosen group members.⁴⁶⁹

A similar method of financing is also found in the district of Subang, about 60 km north of Bandung City. Since April 2006 the West Java province and local government (kabupaten Subang) provides funds (*Program Pendanaan Kompetisi/PPK*) in BRI Subang branch to support development of patchouli oil (*minyak nilam*), farming of catfish, farming of mushrooms, cattle fattening, and working capital for small traders, handicrafts and furniture. As the risk of the loan falls on the local government, a special unit or Task Force to Increase Human Development Index, IHD (*PPK Indeks Pembangunan Manusia*) has been designed to develop and determine the eligibility of borrowers and maintain their growth. The bank does not select or evaluate the borrowers, thus the BRI Branch Office does not take any financial risk. BRI only passes on the microcredit to the appointed borrowers, maintains loans administration and supervises them together with Task Force IHD officers (*Contact Officer/Petugas Pembina*).⁴⁷⁰

Those program borrowers can be distinguished from *kupedes* borrowers of BRI Units as they have different screening and evaluation processes, maintaining separate administration, reporting systems and account numbers in the BRI branch office.

⁴⁶⁹ Observation and interview with the Fishmen and Farmer's Group, Ciparay, Pacet, UPP Perikanan, Soreang, 3 November 2006.

⁴⁷⁰ Observation and interview with Pembina Group Pendanaan Kompetisi, Kabupaten Subang, 14 November 2006.

The researcher observed two local government initiated projects in Ciparay Soreang district of Bandung Selatan and the district of Subang. Both supported poverty alleviation programs financed by local budgets. Despite this financial support, the managers of the Subang projects asked the participant borrowers to provide assets as collateral. The project was conducted on the basis of collateral provided by the participants. Trust and assessed creditworthiness of participants were not considered sufficient.

In contrast, the project in the district of Subang was designed for viability. A professional business consultant was hired by the local government of Subang to design programs and determine the requirements of borrowers. The idea of commercialization and sustainability of the projects are developed, although the projects are financed through local budgets. The researcher met three participants in these projects in different locations. They have been customers of the banks and by observing their businesses, one of them remained on a low income while the rest were better off and able to provide collateral for new loans. It seems the Subang local government has different ideas about the way they should support the micro-entrepreneurs, hoping to produce trickle-down effects to the poor. The local government expects the project will create a positive welfare impact for people, companies and community with spillover effects.

Although the project is financed as a development cost with the potential for loss, the project manager needs protection from financial risk as well as legal and financial responsibility vis-à-vis the local government budget. The researcher found that project managers require assets as well as social collateral; there is no other choice, the heads of each group must submit assets collateral prior to loan withdrawal. Here, trust and creditworthiness has not yet been accepted as social collateral to guarantee loans. The project manager is a civil servant; he or she has to be responsible for the success or failure of projects. Success is reflected in increased personal credibility. Failure means that guaranteed funds have to be used to cover losses. Here we can see the

weakness of theoretical arguments about social collateral.⁴⁷¹ In the event of default, the lender requires assets as collateral, which can be exchanged for money and repaid to the bank.

The data relating to *kupedes*, BPR microcredit, the P4K program and local government projects shows that microborrowers have benefited from microcredit. The borrowers manage larger amounts of money, reflected in savings, borrowings and assets, as a measure of success in their small business, and having more money is the symbol of better living and good destiny. The borrowers feel that to have more credit is key to developing their business. And for poor borrowers microcredit is one way to alleviate poverty.⁴⁷² For borrowers using commercial or poverty alleviation approaches, to have more income gives them the means to improve their livelihood. Most respondents living in urban and coastal areas clearly stated their strong desire to be richer and they believe money can change their quality of life. In urban areas, the idea of materialism is considered to be a driving force. Any business issue or problem can be solved by the power of money. Money is not only used as capital to support business but also to improve borrowers' social standing in the community.

However, respondents in rural areas explain their philosophy on the role of money.⁴⁷³ To become rich is not their direct ambition, but they clarify that the most important goal is living serenely and satisfactorily, or in the Sundanese culture *genah tur tumaninah*. This explanation seems strongly influenced by the cyclical nature of rural culture. The religious way of life means that money is only a tool but respondents confirm the importance of money to survive. Furthermore, the microcredit they utilize gives them increased moral support

⁴⁷¹ Mogue, T. and Carter, M.R. 2003, *Social Capital and Incentive Compatibility, Modeling the Accumulation and Use of Social Collateral*, Department of Agricultural and Applied Economics University Wisconsin-Madison, viewed 22 June 2007 <<http://www.aae.wisc.edu/pubs/sps/pdf/stpap460.pdf>>.

⁴⁷² Interviews with Djadja, Gigugur Tengah, Cimahi Tengah, 23 January 2006; Ade Suryana, Guranteng, Pagerageung, 2 March 2006 and Surip, Gebang, 30 March 2006 and Focus group discussion with P4K Melati participants, Padaulun, Majalaya, 25 January 2006; interview with member of P4K, Tatang Sanjaya, Budiasih, Sindangkasih, 7 March 2006 and Arisuhartini, member of P4K Sukamaju II, Cipeujeuh Wetan, Lemah Abang, 1 April 2006.

⁴⁷³ Interviews with Dadan Ramdani, Cibogo, Guranteng Pagerageung, 2 March 2006, Herman, Group leader Picung I, Picung, Guranteng Pagerageung with members: Rusmana, Emi Sulaemi, Ihat, Cicih, Siti Robiah, 2 March 2006.

and drives them to seriously consider work. It is not only that they are financially responsible, but also microcredit has given them an entry point to work towards a better standard of living. Microcredit gives them strong self-confidence as the banks, BRI Units and BPR support their efforts, and on which they can rely.

Furthermore, the increasing income of commercial microcredit borrowers in this research confirms the findings from other research in Indonesia. For example, a 1988 sample survey of BRI Units shows that microfinance has a major impact on their families' standard of living. The study estimates that net household incomes of borrowers increased by about 76% and employment increased by 84% during three years of program participation.⁴⁷⁴ Ten years on in 1998, the median and average incomes of regular BRI Unit borrowers had more than doubled those of respondents who were not BRI Unit customers.⁴⁷⁵ An impact study post the economic crisis in 15 provinces is reported by Bank Indonesia. From 1998 to 2001, 47% of respondents affirm their increasing working hours and income on average at 633,000 rupiah.⁴⁷⁶ A study of the Bank BNI from 2000 to 2002 indicates an increase of microborrowers' sales, profits, assets, cost of living and savings.⁴⁷⁷ These are not national surveys, but specific bank studies with representative data, in order to assess the explicit goals of commercial microfinance programs and their impact.

Integration of data and information found in this study indicates that both the BRI Units and the BPR commercial microcredit including government poverty alleviation programs are directed to three main objectives that are comparable.

Firstly, microcredit is provided to increase borrowers' incomes and expand or diversify borrowers' economic activities; secondly, to improve the quality of borrowers' living standards. Microcredit is important to create employment and promote livelihood. Livelihood is activities of people with

⁴⁷⁴ Sutoro, A. D. 1988, *Case Studies of Kupedes Investment Loans*, BRI Planning and Research Department, Jakarta. Also see BRI 1990, *Kupedes Development Impact Survey*, BRI, Jakarta.

⁴⁷⁵ Bank Rakyat Indonesia, 2001, *BRI Microbanking Services: Development Impact and Future Growth Potential*, BRI and John F. Kennedy School of Government Harvard University, Jakarta.

⁴⁷⁶ Bank Indonesia, 2001, *Laporan Pemantauan dan Penilaian Dampak Sosial bagi nasabah proyek kredit mikro*, Bank Indonesia Biro Kredit, Jakarta.

⁴⁷⁷ Bank Indonesia, 2003, *Penelitian Dampak Pola Pembiayaan Usaha Skala Mikro Terhadap Kinerja Bank dan Nasabah*, Bank Indonesia Biro Kredit, Jakarta.

regard to the management of means and opportunities and directed towards the protection or improvement of material living conditions.⁴⁷⁸ This protection or improvement can be achieved by gaining direct access to a source of income, in this case microcredit, and assets, but may also aim at improving living and working conditions in such a way that a person or household becomes less vulnerable; and thirdly, to build self-confidence and the expectation of borrowers to maintain and develop their businesses.

Commercial microcredit systems in BRI Units and BPR have been operating for many years and their sustainability and access makes borrowers comfortable and reliant on the system. This makes for close and often long-term relationships, reflected in repeat business between banks and borrowers, instead of the banks searching for new borrowers in the marketplace. The commercial approach is the way the BRI and BPR maintain sustainable cash flow. Whereas for the P4K and local government projects, management needs to consolidate and empower new applicants who need time, special effort and the involvement of the funds provider. The program is considered as a “project or mission” for a relatively short duration and sustainability of the program is therefore questionable. It can thus be concluded that income impact can only be maximized if the borrowers’ socioeconomic welfare can be maintained for as long as the borrowers’ business receives financial support. Consequently the bank, project management, national or local government and funding providers need to achieve sustainable financial standing and outreach performance.⁴⁷⁹

5.2.2. Money and debt, sociocultural impact

Prior to the field research, the researcher developed the propositions that led to research questions as discussed in Chapter 1. The assumptions are constructed and influenced by the researcher’s experiences, feelings and

⁴⁷⁸ See Hospes, O. and Lont, H. 2004, *Livelihood and Microfinance: Anthropological and Sociological Perspective on Savings and Debt*, Eburon Academic Publishers, Delft.

⁴⁷⁹ Yaron, J. 1994, ‘What makes rural finance institutions successful?’ *The World Bank Research Observer*, 9(1), pp. 49-70; Christen, R.P. and Rhyne, E. 1995, ‘Maximizing the outreach of microenterprise finance: The emerging lessons of successful programs’, CGAP Focus Note no. 2, The World Bank, Washington, DC, and Chaves, R. A. and Gonzales-Vega, C. 1996, ‘The design of successful rural financial intermediaries: Evidence from Indonesia’ *World Development*, 24(1), pp. 65-78.

perceptions.⁴⁸⁰ There are presumptions about the role of money and debt that directly or indirectly affect poverty, culture and behavior and microcredit performance of borrowers. With findings from the field research in rural, urban and coastal areas, the researcher observes there are some similarities as well as differences in the sociocultural impact, as discussed below.

The role of money

Respondents in the three research areas explain that money is used as the means to maintain their livelihood and to support their role in the community. Money is needed to fulfil their primary needs such as food, clothes and housing, followed by education and health care expenses. In rural and coastal areas money is also needed to pay for religious activities including traditional ceremonies (*hajatan or salametan*). Families contribute to payments for community purposes, while in urban areas less money is needed for these social obligations. Debt is one of the main resources to generate income; a loan has become an accustomed way to obtain money to support these expenditures.

The respondents in rural and coastal areas argue that money is needed to support various matters in business, public affairs and social relationships, costs related to religion and for local government expenditure such as obtaining business licenses (*izin usaha*) and personal identification (*kartu tanda penduduk*).

Wealth, rather than just money, usually manifests in the village in the form of houses, land (rice paddy, agricultural field, plantation, fish pond), cars, motorcycles, jewelry, furniture and electronic equipment. The villagers realize that the physical appearance of properties indicates the prosperity of the owner and social status in a village community. An old Sundanese expression that indicates wealth can be detected from the way villagers manage their livelihood,

⁴⁸⁰ The assumptions made prior to the field research are influenced by experiences and inevitably framed by our implicit concepts, our feelings and perceptions. See Miles, M.B. and Huberman, A.M. 1994, *Qualitative Data Analysis*, Sage Publications, Thousand Oaks, California, p. 9.

the cleanliness of the house, maintaining fertile paddy fields or farming to get sufficient foodstuffs and clothes (*nyertakeun bumi lamba, caang jalan, panjang tajur, paka pridana, linyih pipir, caang buruan*).

Monetization of the village economy and culture

The monetization of the village economy has an impact on social and economic relations of the villagers. The effects of the transformation of rural societies has been to commodify many personal interactions, such as labor, which is paid in cash; tenants have to pay rent for land in advance instead of at the time of harvest. The respondents in this study recognized that farmers' decision making is no longer determined by subsistence needs, but the market determines what should be planted. There is the impact of expenditure such as land revenue payment, land rent, production input and religious ceremonies, but there is a time delay with income generated from marketing of the harvest, which needs to be bridged by savings or credit. The peasants sell their produce to buy produce or products which they cannot obtain within their community. The need for credit by the villagers was one of the reasons the colonial government designed people's credit systems and government pawnshops in the early 20th century. The cycle of commodity, money or credit cycle made the villagers become more dependent upon money, wages and the market, thereby creating a demand for money and credit.⁴⁸¹ As Schrieke explains, this was a revolution in spirit of the villagers. The economic mentality made its entry upon the scene.⁴⁸² This hunger for money and credit continued in the villages after independence. Prior to and in the 1970s, the incursion of *kredit bimas*, *kredit mini*, *kredit midi*, *kredit modal kerja permanen* and *kredit investasi kecil* accelerated monetization of villages.⁴⁸³ The provision of credit and market mechanisms, together with a capitalistic approach, integrated village economies

⁴⁸¹ Schrader, H. 1997, *Changing Financial Landscapes in India and Indonesia: sociological aspects of monetization and market integration*, St. Martin's Press, New York, p. 173-175.

⁴⁸² Bertram J.O. Schrieke explains in his report after the abortive 1927 communist insurrection in Minangkabau (Sumatra's West Coast), in Wim F. Wertheim *The contribution of Weberian sociology to studies of Southeast Asia*, <<http://www.questia.com/googleScholar.qst;jsessionid=MC8MzKnV0fV2ZnNLgWM8hB6gZghJ1r5KZQzms2k57rK19xQGmHhF!-1787087723!-685608593?docId=5000344387>>, viewed 17 July 2010.

⁴⁸³ Sugianto, Purnomo, S. and Robinson, M.S. 1993, *Bunga Rampai Pembiayaan Pertanian Pedesaan*, Institut Bankir Indonesia, Jakarta.

in rural and coastal areas with urban markets. Since 1984 microcredit *kupedes* BRI Units have played an important role in the paradigm of capitalist systems in the villages followed by other formal institutions such as BPR and informal credit suppliers'.⁴⁸⁴

In general, money is used as a tool to interrelate or place on a par of the value differences or dissimilar social economic interests in the community. Here, the researcher observes the economics that dominates the village is not totally destructive of culture or local traditions or the way villagers maintain their religious obligations. It seems the villagers separate economic decisions in the way money is used for social or community advantage and even for religious purposes. All of the respondents confess Islam, and Islam asks its followers to maintain their direct relationship with Allah *swt* and with other human beings. Those relations cannot be measured by money or transformed into monetary calculations.

There are impacts on social and 'human' relationships that tend to be substituted by money, such as with *gotong royong* in the community, where personal involvement in cooperative work is needed, especially in urban areas, can be transformed into monetary compensation. But in brief, although money has strongly influenced the villagers, the dualism between economic gain and sociocultural values remains. These are moral values, a conviction that social relationships and religious fidelity should not be bought by money. This dualism lives side by side and requires attention to fully understand how far these two aspects influence each other and thus determine behavior, either in urban, rural or coastal areas.

Debt and social status

Debt is the source of funds that make the micro borrower "rich" with the benefit of business and investment on assets such as savings, houses, land and cattle. Having a debt increases social standing; respondents are recognized as being in a better position in the social hierarchy, as they are trusted by the bank and have higher incomes than their neighbors' and provide

⁴⁸⁴ McLeod, R.H. *A changing financial landscape: the evolution of financial policy in Indonesia*, <http://library.wur.nl/way/catalogue/documents/FLR06.pdf>, viewed 17 July 2010.

employment for the villagers. The researcher observes that successful BRI Units and BPR borrowers benefit financially and they also gain a social reputation in their local community, especially in rural and coastal areas. Debt incurs physical and intellectual challenges as the borrower has to adhere to the repayment schedule.

On the issue of wealth, the researcher finds differences in each of the three research areas in this study. In the rural area, to be rich is not the final objective of one's life, but living sufficiently or in Sundanese *hirup cukup* is the most important goal. This philosophy means people get what they need by self-control and attitude besides considering environmental conditions. Needs, ability and limitations must be balanced to fulfil one's life. Richness, in terms of materials that can be calculated with money is expressed indirectly and obscurely in the rural area. In urban and coastal areas the aspiration to become rich is clearly stated by respondents. In urban areas materialism is a way of life; all matters are solved by money, including services that should be provided by the bureaucracy, such as business licenses, official documents of identification, birth certificates, and other assets of ownership. In coastal areas where poverty is entrenched in the community, the respondents say they are tired of living in poverty (*cape jadi jalma miskin*). They are living with heavy debts and increase their debts in order to find a better way of life (*hidup gali lubang, tutup lubang*). Microcredit is their hope; they want and imagine that one day, with the support of the bank, they will be rich.

Bad debt and religion

Bad debt and fidelity on religious services is another issue. All respondents in this study are Muslim, and although they have similar values and beliefs they have different views regarding microbusiness performance. In urban areas they view bad debt and religious obligations as two separate matters, which have no causal relationship. Bad debt that cannot be recovered over time is a business matter; when the borrower fails to run the business as expected and is not able to fulfill commitments to the lender, this is perceived as a risk. The respondents say bad debts are the result of external factors or

business factors with no direct relationship to their religious duties. In the rural area religion has a different influence in that borrowers with good faith try their best to settle the loan and even use another source of income outside of their main business. The respondents in the pesantren neighborhood explain that although they have their children who will inherit their wealth, they have to be careful with debt that may fall due after they have died. They do their best in business, but success or failure is accepted as fate (*terima nasib*). In urban areas, by contrast, bad debt is considered as a business risk and cultural and religious values have little influence.

Table 5.5 Microfinance institutions' non-performing loans

Respondents	Urban		Rural		Coastal	
	Borrowers	Total loan	Borrowers	Total loan	Borrowers	Total loan
BRI Units	2.58	1.52	1.52	0.99	3.19	1.24
BPR*)	6.87	4.72	9.12	9.41	6.93	4.60
Cooperatives*)	55.43	26.57	53.15	55.72	n.a	n.a

Average 2007-2009 in % *) 2006

With bad debt, greater differences were found between cooperatives and banks as a result of the economic capacity of borrowers, management of loan supervision and philosophy of lending. Bad debt is not always related to the area where business is conducted by borrowers and microfinance institutions. Table 5.5 indicates BRI Units maintain lower bad debts than BPR, either in number of borrowers or in percentage of the total loan portfolio. BRI Units in rural areas have the lowest rate as generally BRI Units have more experience in managing microcredit than BPR. At the national level, bad debt with BRI microcredit was 1.42%.⁴⁸⁵

The borrowers take their work seriously and with good intention, but if the reasons for business failure are beyond their control and unavoidable, it turns microcredit into bad debt. The borrowers explain that business failure is always

⁴⁸⁵ Statistik BRI Unit, *Laporan Statistik BRI Unit, Desember 2009*, Kantor Pusat PTBRI (Persero) Tbk, Jakarta, Table 4A.

a threat because microbusiness is highly competitive. There is no barrier when everybody can enter as competitors, especially medium size or even big businesses from the cities; these are now very active, directly or indirectly, through networking systems in the villages. Lack of working capital is a continual problem; microborrowers have to compete against companies with more capital and they are networked based on who can offer lower prices, better services and better terms of trade. Borrowers recognize that to maintain customers or buyers is very important; competition narrows their market share and can endanger their business. This is why borrowers need a helping hand from the bank, such as guidance or repeat business, to maintain the existence of their microbusiness. The respondents admit they accept risk as a financial consequence of running a business and they also believe in fate (*nasib*) and destiny (*takdir*); but the most important thing is how to reach a fair and clear solution with the bank.

Debt and moral obligation

The respondents in the three research areas disclose their microcredit facility is not only a business but it also has a moral connection with BRI Units, BPR and cooperatives. They explain they are selected applicants who passed a screening process to obtain a microloan. Borrowers risk debt and use the bank's money to live a better life and they are deeply indebted. This view is mainly expressed by borrowers in rural and coastal areas. It is indebtedness to realize an opportunity; in Sundanese this means *kahutangan budi*, *kahutangan kahadean*. Although the bank has a stronger bargaining position, a debt relationship is not an arrangement to place subordinate borrowers against the lender. In fact, it is not easy for a bank to find a good and prospective borrower as the village has a small economy. While there is fierce, continuous competition among microfinance institutions in the villages, limited opportunity to access the loan facility makes borrowers see the loan as an act of kindness

by the banks. It makes debt a moral obligation for the borrowers.⁴⁸⁶ This feeling of gratitude towards the bank is reflected in the asymmetrical relationship.

The researcher observes that the bank develops (or maybe 'exploits') this moral relationship to maintain a long business relationship with borrowers. This relationship is complex: borrowers depend on microcredit, and want to maintain trust and expect to find repeat loans to develop their business. On the other hand, the bank wants to maintain willingness of borrowers to repay their loans to secure cash flow for sustainability. Here the BRI Units and BPR apply various binding regulations, but also they make good personal contact through their loan officers who understand borrowers' psychology. This personal relationship is used to accommodate many strict or uncompromising microcredit regulations. Personal relations with loan officers are strategic in microcredit operations in villages.

Debt and social sanction

In the Cimahi urban area social relationships tend to be less formal and not as influenced by traditional values, compared to rural Pagerageung and Puteran villages and coastal Kapetakan and Gebang Mekar villages that introduce differences in human relations and social sanctions. In rural and coastal areas, social endorsement can be used to pressure individual borrowers if the bank has had to deal with bad debts. Similarly cultural factors, family relationships, support from informal and charismatic community leaders, public opinion building and informal approaches are effective factors to alleviate bad debts and meet repayments. The researcher met the bad debt borrowers in their homes, and they prefer to live outside of the village to look for money and avoid contact with their neighbors. This social pressure cannot be applied in urban areas where economic and business considerations and formal approaches are dominant factors.⁴⁸⁷ However, in rural and coastal areas where relationships

⁴⁸⁶ Interviews with Hj. Popon and H. Abun Bunyamin, Cimahi Tengah, 18 January 2006; Ai Sukaesih, Cimahi Utara, 26 January 2006; Cucu Yuningsih, Puteran, Pagerageung, 1 March 2006; Damsori, Bungko Lor, Kapetakan, 29 March 2006.

⁴⁸⁷ Nandang, the manager BRI Unit Cimindi describes his experience in handling bad debt in Cimahi. He needs direct actions both to the borrower's husband or wife and almost impossible to ask help from the neighbors or community (*Rukun Tetangga/RT* or *Rukun Warga/RW*). They

between neighbors remain close, the *mantri* or BPR credit officers use these relationships to pressure borrowers with bad debts by imposing social sanctions.⁴⁸⁸ Here social standing is exploited by lending institutions to settle bad debts of microborrowers.

The abovementioned controversy between generating income and risk of bad debt is a never ending dynamic in microcredit business. To lessen the debt risk, an applicant has to pass screening processes as an initial entry point to access BRI Unit, BPR and also cooperative programs. Microcredit however does face inherent risk. Non-performing loans should be recognized and managed by borrowers and officers of microfinance institutions. If microcredit turns out to be a bad loan, this impacts microfinance institutions and their assessment of creditworthiness and trustworthiness. These issues are analyzed in section 5.3 in order to seek answers to the research questions on easy access of the poor to microfinance institutions.

5.3 Microfinance, screening problems, bad loans and creditworthiness

5.3.1. The role of socioeconomic structure in the screening process

Having access to microfinance institutions is the wish of the poor, or those in the low income strata, in the hope that they can eliminate poverty. Access is the core issue. However, BRI Units and BPR prefer to reach self-employed

do not care about borrowers' problems and also the neighbors resist interfering in other people business; interview 13 February 2006. The researcher joins interviews and observes on site together with Yuda, *mantri* BRI Unit Cimindi visiting four bad debt borrowers: Abdul Rochman, Achmad Rauf, Wahyu and Wata. In fact bad debt is a business relationship solely between the bank and the borrowers; this is closed to the neighbors or community; interview and observation 10 May 2006.

⁴⁸⁸ The researcher joins Abun Yamin, *mantri* of BRI Unit Puteran to visit four problem borrowers: Aan on 2 May 2006, Iskandar, Dede and Komar on 4 May 2006. Their neighbors come out and greet us and as the *mantri* repeatedly calls the borrowers, the neighbors know the borrowers are in financial problems. Although the neighbors cannot help, they tell us they provide moral support and expect their neighbor's problem can be solved. The same finding happened when the researcher and Aris Purwanto, *mantri* of BRI Unit Gebang on 27 April 2006, visited two non-performing borrowers, ibu Tarli and ibu Saniti. It is not surprising when the children of their neighbors along the village alley (*jalan kampung*) recognize Aris and his motorcycle as *mantri*-bank and they know whom Aris will visit. We see some curious faces of the neighbors who appear in the windows of bu Tarli and bu Saniti's guest room, and some of them even sit on the floor of the terrace. It seems they want to know what is going on and eavesdrop on our conversation. The borrowers live in a densely populated coastal area; it is very difficult to keep ones' private matters a secret and unknown to neighbors.

bankable people who are economically active in small business. To support the poor and low income earners sustainable microfinance institutions are needed and arguably registered as a bank. These institutions should be a viable vehicle for delivering microfinance services to households, to maintain public confidence, to tap commercial markets for funds and to offer sound legal arrangements with borrowers. Consequently, the banking operation should be strictly regulated by the central bank.

If the microfinance provider is not a bank and cannot offer their clients the protection of their rights and responsibilities; doubt and uncertainty becomes a great challenge to microfinance institutions' sustainability. As a bank, to overcome business risk and maintain sustainability, a microfinance institution will be bound to formal banking requirements, which applicants need to comply with. The loan applicants try their best to meet the terms and conditions of the bank. But poor and low income applicants have many difficulties as they have no collateral assets, less business capability, lack accounting skills, are weak in business administration and licensing, and lack their own capital.

This part of the analysis is related to the research question. How do the poor and low income earners, including women, find easy access to microfinance institutions? Different approaches will be discussed from the lender's and borrower's point of view.

Prior to its operations, a microfinance provider has to clearly determine its policy framework: whether to work with better-off people on a commercial basis for profit, or to adopt a poverty reduction policy with less profit. The policy is strategic and relates to screening applicants, which serves as an entry point. It would seem that the financial system approach and the poverty lending approach⁴⁸⁹ are kept separate.⁴⁹⁰

1. Commercial microcredit for bankable borrowers

⁴⁸⁹ Gulli, H. 1998, *Microfinance and poverty questioning conventional wisdom*, the Inter-American Development Bank, Washington, D.C.

⁴⁹⁰ See de Aghion, B. A. et al 2002, *Poverty reducing credit policies*, viewed 12 February 2007, <<http://www.williams.edu/Economics/rai/raimf-policies.pdf>>.

Besides interviews with officers of the microcredit banks (BRI Units and BPR), examination of the borrowers' loan files, the researcher also carried out on-site visits to observe the process of the applicant's evaluation, following the loan granting procedure in accordance with management policy. It was evident that microcredit is provided to bankable applicants, who are able to fulfil the customer selection criteria, especially regarding their character, repayment capacity and provision of collateral, discussed as follows:

a. The BPR respondent officers provide less than 100 million rupiah microcredit; they assess character and repayment capacity. BPR tend to operate as pawnshops as the granting of loans is mainly based on assets collateral.

b. BRI is a public commercial bank and at the national level provides more than 96.60% of its loan portfolio to bankable borrowers: microcredit borrowers, as stated in Table 5.6. The accounts are microcredit *kupedes*, *Kredit Usaha Rakyat (KUR)* non Micro, retail credit, medium and corporate financing. Microcredit *kupedes* is basically a commercial assessment, indicating that the applicant has a viable business. Full value assets collateral is also a requirement, although BRI Units assess on case-by-case basis.

2. Microcredit programs for poor borrowers:

a. The BRI's non-commercial microcredit loans (non-*kupedes*) can be considered as directly related to poverty alleviation and are administered as part of government programs. These loans constituted an average of 3.40% of total BRI loans in 2007, 2008 and 2009, as shown in Table 5.6. The main role of BRI here is to support government programs that are designed to help poor farmers produce more food (*program ketahanan pangan*), and to preserve cooperatives and the P4K project.

Except in the selection of participants, the BRI participates in various government subsidized programs, channeling financing, designing administrative works, preparing reports and supervising programs. Usually they are stand-alone projects and do not integrate with BRI's programs.

It seems BRI does not act as a bridge between participation in these government programs and BRI commercial operations. It was found that the government subsidized program only constitutes a small percentage of BRI activities.

Table 5.6 BRI loan portfolio and its 'direct poverty lending'

(in %)

No.	Items	December 2007	December 2008	December 2009
1	Microcredit <i>kupedes</i>	28.92	23.92	24.92
2	KUR micro	---	2.79	1.39
3	KUR non micro	0.21	1.50	1.20
4	Direct poverty lending - microcredit non <i>kupedes</i>	3.41	3.62	3.17
5	Retail credit	42.48	41.14	43.43
6	Medium size loan	7.41	7.78	7.25
7	Corporate loan	17.57	19.24	18.63
	Total BRI loan	100.00	100.00	100.00

Source: Bank Rakyat Indonesia, Head Office, Loan Administration Division, 2009.

In addition to these government programs, the BRI develops group lending, fully financed by BRI funds, so consequently BRI's take the risk. Loans are granted with a lower market rate of interest and the government subsidizes the difference (Table 5.7, B1-9). In addition, BRI has designed its own individual loan schemes for borrowers who are short of collateral, but maintains a good and profitable business (Table 5.7, C1-6).

In fact these loans have a high risk factor and BRI branch offices are challenged by moral hazard of borrowers and lack of bank supervision. Limited human resources in branch offices can be an issue. This type of loan is at the BRI's own risk so branch offices are concerned about non-performing loans. These loans are a low priority for the BRI and this is reflected in the fact that they constitute a small portion of the BRI's loan portfolio: 1.00% in 2007, decreased to 0.59% in 2008 and 0.27% in 2009 (Table 5.7 C 1-6). BRI loans, provided on the basis of reduced collateral, constituted only 3.72% of the total microcredit portfolio.

b. Members of cooperatives in the research areas experience a members are either poor or on low incomes. Their membership and saving accounts are used to obtain a cooperative loan, mostly for consumption

Table 5.7 BRI microcredit loans

	Types of loans	December 2007	December 2008	December 2009 (billion Rp. and %)
A	Kupedes, BRI risk	32.602=89.49%	42.756=92.12%	54.076=94.57%
B	Program credit, BRI risk: group lending			
1	KKPA Umum	377	349	220
2	KKP Tebu Rakyat	337	524	613
3	KKP Ints. Padi, Ubi Kayu	101	152	206
4	KKP Pengm. Tebu	0	0	0
5	Kredit Koperasi Non KLBI	93	251	210
6	KKP Pengadaan Pangan	16	18	24
7	KKP Peternakan	93	212	369
8	KKGUK	24	28	24
9	P4K Fase II & III	38	7	3
B 1-9	Total group lending	1,114=3.06%	1,541=3.32%	1,668=2.92%
C	Program credit, BRI risk: individual lending			
1	KKUM	10	23	11
2	BKD	1	0	0
3	KUMLTA	4	0	0
4	KIK Pasca Konversi Pirtrans	54	31	23
5	Kredit Wirausaha 5jt	0	0	0
6	Kredit Dana SUP	295	219	118
C 1-6	Total individual lending	364=1.00%	274=0.59%	153=0.27%
D=B+C	Program credit BRI risk	1,478=4.06%	1,815=3.91%	1,821=3.18%
E	Program credit government risk	2,349=6.45%	1,841=3.97%	1,286=2.25%
F=D+E	Total microcredit program loan	3,827=10.51%	3,656=7.88%	3,107=5.43%
G=A+F	Total microcredit	36,429=100%	46,412=100%	57,182=100%

Source: Bank Rakyat Indonesia, Head Office, Loan Administration Division, 2009.

purposes. It is a relaxed process with loose loan supervision; which is why the cooperatives struggle with bad debts.⁴⁹¹

b. Members of cooperatives in the research areas experience a members are either poor or on low incomes. Their membership and saving accounts are used to obtain a cooperative loan, mostly for consumption purposes. It is a relaxed process with loose loan supervision; which is why the cooperatives struggle with bad debts⁴⁹². This high level of bad debt hinders the performance of cooperatives, causing losses, insolvency and a lack of cash for operations. Some of the cooperatives have difficulty in operating and members cannot get new or additional loans. This is why cooperatives programs are not sustainable.

Cooperatives face the problem of bad debts on subsidized loan *Kredit Usaha Tani (KUT)* or Agricultural Loan Facilities that are routed through cooperatives, among others, Koperasi Hikmah Pagerageung Tasikmalaya. *KUT* in many areas is declared a bad debt by the central government. The government found that loans to cooperatives were provided but not repaid by the non-agricultural borrowers, which meant the cooperatives, in turn, were not able to repay the funds to the government. Although there is a national general policy for settling KUT bad debt, the cooperative office of local government in Kabupaten Tasikmalaya is not in a position to write-off the bad debts of Koperasi Hikmah Pagerageung Tasikmalaya. On the other hand, the government still uses cooperatives to pass on project funds for poverty alleviation or programs such as PNPM Mandiri. Cooperative activities are

⁴⁹¹ Some cooperatives are found to be dormant such as Koperasi Mina Waluya Bondet, Cirebon, observation 28 March 2006; Koperasi Perikanan Laut, Gebang Cirebon, observation 29 March 2006; others are active although they have high bad debt and low performance. Interviews with Karya Maju, Cimahi, 26 January 2006; Eka Mulya, Pagerageung, 1 March 2006; Hikmah Suryalaya, Pagerageung, 23 March 2006 and Koperasi Simpan Pinjam Hikmat Ciawi, 24 March 2006. Savings and loans activities are running well and Koperasi Pesat Tani, Cirebon, interviewed 26 April 2006 that maintains good management and performance.

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generated by and for members but today they still depend on government subsidies.

c. The central government designs various programs to reduce poverty, to develop institutions and their human resources to manage credit programs, indirect finance programs and direct finance programs for poor groups. These programs are funded by the state or regional government as “government projects” on a yearly basis. The projects are evaluated yearly and the funds allocated in the national and regional governments’ budgets can be terminated by the decisions of the national parliament or the regional people’s representative councils.⁴⁹³ If the sources of funds are from the national or regional budgets the projects should be planned, determined and provided following the budget procedure. This is one of the reasons why it is difficult to sustain subsidized programs and be certain they will continue beyond program management. Since 2007, programs from various departments are integrated into the centralized *Program Nasional Pemberdayaan Masyarakat Mandiri (PNPM Mandiri/National Community Empowerment Programme Mandiri* under the coordination of the Minister of Social Welfare (*Menkokesra*).⁴⁹⁴

The poverty alleviation programs face difficulties with participants who lack business capabilities. These programs are created to develop those types of capabilities. The channeling bank, in this case the BRI, is not in a position to select and guarantee applicants are bankable. The BRI does not choose participants and they do not need to follow the BRI screening process. The programs that run outside the BRI therefore need support to empower the poor. The BRI is only used to pass on funds without asking for any collateral. It establishes legal arrangements and supervision but has no financial responsibilities. The findings indicate that BRI branches maintain less significant, direct involvement and risk in these poverty alleviation programs.

For the BRI, microcredit, in this case *kupedes* has been designed based on viability of finance, and policy consistently applied by the branches and units.

⁴⁹³ See Program from various Departments, 2005-2006, Kementerian Koordinator Bidang Kesejahteraan Rakyat, Inventarisasi Program Penanggulangan Kemiskinan, Jakarta.

⁴⁹⁴ See Keputusan Menteri Koordinator Bidang Kesejahteraan Rakyat selaku Ketua Tim Koordinasi Penanggulangan Kemiskinan no.: 25/KEP/Menko/Kesra/VII/2007 30 July 2007.

As previously stated and in Table 5.6, at the national level, microcredit non-*Kupedes* directly or indirectly supports the poor at the BRI's own risk, with an average less than 3.40% of its loan portfolio. This indicates that the main objective of microfinance in BRI is to support eligible micro-entrepreneurs. However, the BRI steps in to help poor or low income borrowers only if the risk is covered by government support programs. BPR as private business institutions maintain a policy of viability and fully guaranteed loans with assets collateral or certain fixed income for personal loans. Bankable borrowers are their market; zero risk with assets collateral is their concern. The cooperatives are challenged by the dilemma as to whether to support members with small loans, mostly for consumption, where members are reluctant to provide assets collateral.

While the main objective of microfinance institutions is to finance the poor and to reduce poverty, why do they prefer to deal with bankable borrowers? To answer this question we have to explore and understand the socioeconomic conditions and how microfinance institutions screen microcredit applicants in the process of loan evaluation.

As discussed by Remenyi there are four levels of the poverty pyramid that constitute a unique market for microfinance services that need intermediation assistance.⁴⁹⁵ At the bottom is the poorest of the poor; above them are the laboring poor and then the self-employed poor. At the apex of the poverty pyramid are the entrepreneurial poor. Each level of the poverty pyramid demands tailored financial products. The researcher observes that the level of socio-economy of the applicants can be classified based on their capacity to generate income, the capital they own and the assets they have for collateral.

As an alternative to Remenyi's four levels of poverty, the researcher observes that loan applicants can be classified under five categories with credit ratings that can be used as an entry point by microfinance institutions, as shown in Table 5.8. The applicants evaluate themselves and choose the socioeconomic level they fall under, from levels 1 to 5. It is important to see how

⁴⁹⁵ Remenyi, J. and Quinones, Jr. B. 2000, *Microfinance and Poverty Alleviation: Case Studies from Asia and the Pacific*, Pinter, London and New York.

applicants are able to comply with microfinance requirements in the eyes of the institution. One of the purposes of government subsidized programs is to empower and support the poor to be able to manage their own life and business, or to provide them with the capacity to be self-employed (see level 3, Table 5.8) and who expect to move eventually to level 4.

More variance in capacity, capital and collateral can be found in their credit rating but the five categories should be maintained as the basic classification. Level 1 is the poorest of the poor and level 2 is the laboring poor, both of which will be rejected from the list of applicants by the banks. In contrast, level 5 are bankable micro-entrepreneurs that, after loan assessment, will be considered by the bank for financing. Screening for applicants at levels 1, 2 and 5 by formal microfinance institutions is a standard loan analysis procedure to assess their business practice, which means approval or rejection without any additional intervention from the banks.

Table 5.8 Five socioeconomic levels of microcredit loan applicants

Level	Categories	Credit rating and financial solution
5	Micro-entrepreneur	Maintains capacity, capital and collateral; rated as bankable. Solution: commercial microcredit
4	Micro-poor entrepreneur	Maintains less capacity, less capital, less or no collateral; rated as non-bankable. Solution: empowerment followed by commercial loan with assets collateral dispensation
3	Self-employed poor	Maintains low capacity, low capital, and no collateral; rated as non-bankable. Solution: empowerment followed by group and program loan with social collateral
2	Laboring poor	Maintains low capacity, no capital, and no collateral; rated as non-bankable. Solution: social safety net or cash subsidized
1	The poorest of the poor	Maintains no capacity, no capital, and no collateral; rated as non-bankable. Solution: cash subsidized

Screening and loan evaluation of applicants at levels 3 and 4 is the focus of the lending institutions. Basically, commercial banks (corporate banks and BPR) do not lend to those who are poor as they need assurance that loans will be repaid on time. There are strong impressions that commercial banks protect their microcredit contracts in the same way as pawnshops; loans will be

provided if the borrower submits sufficient assets collateral. Although level 3 and 4 applicants may have excellent investment opportunities, they are often excluded from the financial market and confront various credit constraints from microfinance institutions due to socioeconomic conditions.

Applicants explain the inconsistency of BRI policy and its implementation in supporting poor and low income people. The BRI annual report of 2006 shows the policy to set aside 3% of the bank's net profit or 114.26 billion rupiah for *Program Pinjaman Kemitraan* or Small Borrowers' Development Program and 1% or 38.09 billion rupiah for *Program Bina Lingkungan* or Environment Development Program.⁴⁹⁶ One of the goals of *Pinjaman Kemitraan* is to develop small business entrepreneurship through empowerment in order to alleviate poverty. The applicant or recipient is the smallholder who maintains feasible business, but not yet bankable, to be financed by BRI commercial microfinance. The applicant can access better terms and conditions for this type of loan such as: lower rate of interest of 12% per year, lower administration fee, maximum 5 year term to reach commercial capability. The primary collateral for this *Pinjaman Kemitraan* program is funded by the program itself and no secondary collateral is required.

Although *Pinjaman Kemitraan* or the Small Borrowers' Development Program is directed to alleviate poverty, on the contrary, poor applicants are not able to fulfil loan requirements such as: the applicant has been in business for a minimum of one year with the prospective business.⁴⁹⁷ It seems that the *Program Pinjaman Kemitraan* is only available for established microbusinesses, i.e. small business at level 5, not for the poor at levels 3 and 4 of Table 5.8. To find the implementation of this *Pinjaman Kemitraan*, the researcher conducted two focus group discussions with nine borrowers: the applicants, the branch manager and one loan officer in Cibadak Branch and eight borrowers, the branch manager and one loan officer in Cianjur Branch, both in West Java

⁴⁹⁶ Bank Rakyat Indonesia, Laporan Tahunan/Annual Report 2006, Sustainable, Bank Rakyat Indonesia, Jakarta, pp. 73-76.

⁴⁹⁷ See Bank Rakyat Indonesia, *Surat Edaran/Circular Letter*, NOSE:S.19-DIR/ADK/04/2007 28 April 2006, Tentang: Program Kemitraan dan Bina Lingkungan (PKBL), Bank Rakyat Indonesia, Jakarta.

province.⁴⁹⁸ The policy and target of *Pinjaman Kemitraan* is purposely designed by the BRI Head Office. It is an off balance sheet transaction and the result does not influence branch profit and loss. The branch management acknowledges that the loan is dedicated to poverty alleviation as determined by the head office, but, on the contrary, the applicants have established businesses with good prospects.

They admit they can fulfil all normal bank requirements but prefer to apply for *Pinjaman Kemitraan* because it offers a concessional rate of interest. When they apply for the loan, they are at level 5 in the socioeconomic strata. In the Cibadak branch office, it is found that the loan is provided to ex-P4K borrowers who have reached bankable evaluation and also small entrepreneurs at levels 3 and 4. To finance these ex-P4K borrowers is good practice to maintain the continuity of the program, as the branch is already acquainted with the borrowers and can maintain their relationship.

It can be noted that poor applicants have difficulty in accessing *Pinjaman Kemitraan*. There is a contradiction in the implementation of the program between the empowerment of poor people and the bank's acceptance of the associated business risk. Although the outcome of *Pinjaman Kemitraan* is neutral towards branch profit and loss, the branch manager tightly supervises this type of loan to prevent bad debt that will influence personal performance.

This analysis indicates that the answer to the research question regarding easy access for the poor (in this case at level 3 and 4) regardless of whether the applicants are men or women, this is still a great challenge. The microcredit institutions such as BRI Units and BPR constrain poor applicants as follows:

1. Under their cost and benefit considerations, the microfinance institutions clearly state their microfinance policy is to develop commercially oriented businesses. The owners or investors of BRI and BPR, at the annual shareholders meeting, have rights to determine policy and profit targets; and the management is in the position to implement that policy in operations. This commercial microcredit operation refuses subsidy or any government poverty

⁴⁹⁸ Focus group discussion, BRI Cibadak Branch, 29 August 2007, in the morning and Focus group discussion, BRI Cianjur Branch, 29 August 2007, in the evening.

reducing intervention because it is thought this will undermine the incentives and result in mis-targeting. But if the BRI needs to be involved in government subsidized programs, it does not use its own funding. It is government funds and the BRI receives a channeling fee to administer and supervise the loan. If the project needs BRI money, BRI participates as part of financing, with guaranteed payment from the government.

The BRI management also designs various poverty alleviation programs as shown in Table 5.7, B 1-9 and C 1-6; and microcredit, either for group lending or for individual borrowers, is initiated usually under 'government or public pressure'. BRI's own policy and government poverty alleviation programs of mixed funding schemes, between BRI and government, can be distinguished from the name and the type of the loans, number of accounts or grouping of programs and borrowers' names as found in BRI loan portfolio reports.

The BRI's own poverty alleviation program measures the risk of the programs according to commercial requirements. Although the BRI's view of microfinance is on a commercial basis, poverty alleviation programs are required to support the poor. Public pressure has resulted in frequent changes in microcredit policy with the consequence that the BRI's poverty alleviation program has not been continued.

2. The management, organizational structure and human resources development of commercial microfinance institutions, especially banks, are not designed to reach the poor. If these institutions offer microcredit it is a business choice. . In contrast, if they finance the poor, they do so under social and political pressure, and they face high costs, time-consuming loan operations, lack of personnel and supervision, and slow growth.

3. The BRI Units and BPR in rural, coastal and urban areas are guided by classic rules of banking business, which are to serve and follow the business of the customers. Of course, microfinance institutions do not take the risk towards poor and incompetent applicants; beyond that, they are not in a position to make applicants feasible, nor to educate them in business.

4. To deal with poor applicants (see levels 3 and 4 in Table 5.8), formal microfinance institutions, such as BRI Units and BPR, have to accept higher

levels of risk, as potential borrowers do not have the collateral. The decisive factors are the borrowers' capacity to generate income and capital and convince the bank of their good character. This means collateral is required by microfinance institutions to safeguard their loans.

5. Sociocultural obligations of applicants are regarded as a potential problem. The researcher believes the lending institutions' attitude needs to be transformed so these obligations can be considered as indicators of trustworthiness and solidarity.

6. Poor applicants need empowering in their business activities and in general they lack networks to suppliers, quality products, marketing and management. They are too poor to have basic business support such as business licenses, accurate accounting and cost calculation, administration and reporting systems. And the banks do not provide this support. To alleviate poverty it will take a change in the mindset of management.

What the poor and low income applicants need is a different risk assessment process and, at the early stage, it should be on a non-commercial basis and specific policy measures are of particular importance. Within the framework of microfinance sustainability there needs to be a balance between the institutions' profitability and borrowers' risk.

5.3.2. Microcredit risk, impact of bad debt

After a microfinance institution approves a loan, the responsibility is transferred into the hands of the borrower. It is the borrower who has to be productive, make the business work, manage the money and achieve the best value when the repayment is due. The most beneficial deployment of money is achieved through a clear business plan, a realistic budget and target. Financial planning, one of the essential elements, generates liquidity and adequate profits. The borrowers who fail to maintain liquidity, whether their business is profitable or not, are in imminent danger of collapse. While profits are essential in the long term, liquidity is essential at all times.

Financial planning and liquidity management is essential for a microfinance institution and it is a prerequisite that a borrower is able to design

and operate both. Vulnerability may be attributable to factors beyond the borrower's control or inadequacy of planning and implementation. Credit risk is critical for the microfinance institutions to forecast: the risk the borrower may present in the future as identified in the credit assessment or subsequently as a result of a periodic credit review and supervision. Consequently, microcredit can become a non-performing loan. This is where the microfinance institution reclaims its money through borrower's collateral. This is why microfinance institutions prefer to finance bankable borrowers as their debt and business risk can be recovered.

Observations and interviews with non-performing borrowers, their families and bank officers give an informed understanding as to the causes of such failure and subsequent socioeconomic impact. Table 5.5 shows the microfinance institutions report for non-performing loans in rural, urban and coastal research areas. These loans are classified to safeguard against borrowers failing to pay instalments of interest instalments and loan principal. Bank Indonesia has determined non-performing loans as problematic and consisting of: irregular (*kurang lancar*), doubtful (*diragukan*) and lost (*macet*) payments.

From an institutional point of view, more than a half of the cooperative members maintain non-performing microcredit loans (see Table 5.5). Most members are poor and they still retain the idea that a loan through cooperatives is their basic right. Cooperative management is not able to apply good governance and loan evaluation properly as they are not equipped with sufficient personnel and budget. Many cooperatives in the coastal research areas are dormant and in a process of redevelopment.

Table 5.5 also indicates that in comparison with BRI Units, BPR maintain a higher percentage of bad debts. BPR compete with BRI Units; for service purposes they often tolerate and/or compromise on some loan conditions with the exception of assets collateral. The BRI Units maintain a lower portion of non-performing microcredit loans compared with BPR and cooperatives. The BRI Units have years of experience with well-trained officers and their organization is specially designed for small financing projects and they are

supported with stronger networks and technology. They are also more conservative with loan assessments. The BRI Units are strong in rural areas with low rates of non-performing loans, as indicated by the research findings. During the same period (December 2007 to 2009) the BRI maintained non-performing microcredit loans at an average of 1.21% of the total *kupedes* portfolio.⁴⁹⁹ This average is far below the Bank Indonesia standard at a maximum of 5%.

All microfinance institutions are guided by a written manual, including a job description, on applicant screening, loan evaluation, loan administration and supervision.⁵⁰⁰ For commercial transactions, the BRI and BPR officers are required to follow procedures; this is not only for financial control but they must also comply with legal aspects or they can be accused of breaking the law. And financing with government funds for poverty alleviation must follow all related government regulations. Thus spending government money can also have associated financial and legal risks.

Unlike financial aspects, the sociocultural aspects are not clearly stated as important factors to be appraised in loan assessment and supervision. The *mantri* and BPRBPR officers are local people of the research areas who are familiar with the local sociocultural aspects of the communities. They understand which sociocultural aspects need to be practised, with or without extra costs, for borrowers to have peace of mind and security and happiness to achieve success in business. However, *mantri* and BPR officers have to follow their institutions' microcredit regulations. In this case, sociocultural aspects of borrowers have little influence. Here the *mantri* and BPR credit officers are obliged to advise management that the business of the borrower is not working against the moral value, religion, culture, custom and tradition of the local people. Within the framework of commercial consideration, *mantri* and BPR

⁴⁹⁹ Bank Rakyat Indonesia, 2009, Laporan Statistik BRI Unit bulan Desember 2009, Kantor Pusat PT BRI (Persero) Tbk, Jakarta, Table 4A.

⁵⁰⁰ For BRI Units see Bank Rakyat Indonesia 2003, *Pedoman Pelaksanaan Kredit Bisnis Mikro (PPK-BM)*, (2003). Jakarta: PT BRI (Persero). For BPR, Bank Indonesia has determined that every BPR office has to produce manuals on loan granting and supervision issued by BPR management. Cooperatives however do not have specific regulations for loan evaluation.

credit officers are able to accommodate sociocultural values and practice for the benefit of the business.

Non-performing loans are fully recognized as business risks but it puts credit officers under stress and makes management nervous. From a financial point of view there is a policy and accounting system to cover the loss of risk, but bad debt impacts on the manager's credibility. This invites other challenges for the microfinance manager, especially if the loan is only based on borrowers' creditworthiness and trust, or under a social collateral scheme that maintains zero value liquidation in the market. This is one of the reasons why management tends to refuse to finance the poor without any assets collateral. Thus, in response to the research question, creditworthiness and trust is not sufficient as microcredit collateral. The provision of microcredit on the basis of good character and social collateral needs to be supported by the microfinance institutions' policy, and a clear delineation of legal and financial responsibility at operational level.

Consequently, it is important to determine the policy of microfinance development; either policy is used as a vehicle for commercial business development or as a means to alleviate poverty. Thus policy is related to the research question: can borrowers' creditworthiness and trust be accepted as collateral? The research findings indicate that creditworthiness and trust (or social collateral) is not sufficient from the bank's point of view to balance the risk of non-performing loans. In fact, the banks request assets collateral as protection from bad debts and to avoid outstanding legal problems.

To eliminate the risk, microcredit institutions can take action: to insure the loan with a credit insurance company, to intensify loan supervision and personal contact, restructuring or rescheduling the loan, to reserve funds for writing off bad debts based on regulations. The last measure is a legal action to collect the collateral as money to pay off the loan. In this case the borrower will be black listed for many years by the lending bank that will inform other banks in the area.

Non-performing borrowers live under constant worry, not only financially against the creditor and their own family, but also psychologically and socially.

Usually they avoid seeing bank officers and argue they are working hard to collect money for instalments.

Here is a summary of interviews with non-performing borrowers and family members to identify why they fail to pay instalments on time.

...All the operation costs for fisheries, fuel, foodstuff, fishing equipment increase sharply; more and more fishing boats operate in the same area...on the other hand the catch is small and the fish price is low...after so many months the income is getting worse and I failed to pay my debt to the bank (*Ibu Dani Tarli, Gebang Udik and Ibu Saniti, Gebang Mekar*⁵⁰¹)

...My husband is ill and paralyzed; all our money from business and loans has gone to pay the medical bills. I am going to sell my business and warong to continue medication.... How can I pay the bank? (*Ibu Nani Mulyati, Cibeureum Cimahi; Ibu Iwang, Melong Cimahi*⁵⁰²)

...My father and mother divorced a year ago, everything is in ruin, and they have no money to pay the bank; nor even for our daily food (*Ina daughter of Pak A'an and Ibu Enung, Kampung Pagerageung Tengah*⁵⁰³)

...I draw on my husband's loan money to help my daughter to release her from the pressure from a fierce moneylender (*Ibu Cucu wife of Pak Wahyu*⁵⁰⁴)

...I utilized the bank's money to buy a motorcycle for my son, otherwise he does not go to school, but now the motorcycle is broken. I am going to sell my assets to pay the bank with... (*Pak Wata, Cimahi*⁵⁰⁵)

...My husband's business partner deceives him but it is getting worse as that man reports my husband to the police. This I don't understand, since then my husband has to report to the police office and also has to pay them some money continuously. We lose a lot of money; my husband's business is wrecked. How can we pay our loan? (*Ibu Mimih, wife of Pak Iskandar, Tanjungkerta Pagerageung*⁵⁰⁶)

⁵⁰¹ Interview with Dani Tarli, Gebang Udik and Saniti, Gebang Mekar 27 April 2006.

⁵⁰² Interview with Nani Mulyati, Cibeureum Cimahi and Iwang, Melong Cimahi, 10 May 2006.

⁵⁰³ Interview with Ina Pagerageung, 2 May 2006.

⁵⁰⁴ Interview with Cucu, Cimahi, 10 May 2006.

⁵⁰⁵ Interview with Wata, Cimahi, 10 May 2006.

⁵⁰⁶ Interview with Mimih, Pagerageung, 4 May 2006.

...My husband says his traded goods are stolen; on the other hand his buyers refuse to pay the goods they take. We don't report it to the police; we hear we even have to pay them some money to trace the matter. I don't know how to get money from...will the bank sell our house where we live? (Ibu Aat, wife of Pak Komar, Sadaleuwih, Puteran Pagerageung⁵⁰⁷)

The borrowers in this research give various reasons to justify or excuse their problem of late payment. Their failures are not only based on external factors, such as economic causes, but also sociocultural factors related to the borrower's behavior in their daily life and family matters. To get a better understanding of these sociocultural aspects, the researcher conducted a focus group discussion on non-performance loans in the BRI Training Centre in Lembang.⁵⁰⁸ 28 BRI Unit officers (*mantri*) from 28 offices in West Java explain why borrowers fail to pay their *kupedes* microcredit repayments on time. As discussed with *mantri*, some specific reasons cause the business to fail and bad debt can be noted. These include:

1. The death of husband or wife who was the main operator of the business.
2. Marriage breakdown and failure to agree about who is responsible for the settlement of the debt.
3. Long illness in the family, especially the borrower or income earner, who needs extra costs for medication.
4. Being a victim of deception.
5. Natural disaster.
6. Marriage conflict that distracts attention from the business.
7. Moral hazard by imitating other bad debtors.
8. Gambling.
9. From the beginning the borrower intentionally uses the credit for purposes other than previously requested and the borrower seeks to avoid repayment.
10. Changes in lifestyle that consume a lot of money.

⁵⁰⁷ Interview with Aat, Puteran Pagerageung, 4 May 2006.

⁵⁰⁸ Focus group discussion with *mantri* from 28 BRI Units, Sentra Pendidikan, Lembang, 13 March 2006.

11. The borrower utilizes the money to help close relatives or friends, without any financial reward and clear repayment conditions.
12. The borrower has to deal with non-business matters which take energy, time and money.

These participants of focus group discussion admit that personal and family risks are not part of the screening process and therefore they cannot anticipate this probability. The discussion comes to the conclusion that the abovementioned reasons can create extra expenses and increase risk to microcredit loans. As bank officers, the *mantri* of BRI Units realize they must always be alert during the borrowers' life cycle as problems may occur at any time. This is the reason the bank officer needs to supervise the borrower on site: not only their business but also their behavior and lifestyle. Closeness to the borrowers, their families or neighbors and their environment is an important source of information. The shortage of bank supervisors produces less one-on-one support, greater unpredictability and the bank can suddenly be caught by surprise with social and cultural problems that result in non-performing loans.

As bad debt is derived from the business, it is the borrower behind the business that determines the success or failure of the loan. Some causes of business failure can be forecast in the loan analysis process. The most frequent causes are: inadequate capital, miscalculation of the cost of goods sold, official government behavior and policy changes, lack of adequate planning and control, inadequate financial records and loss of customers. The failure can be recognized from liquidity symptoms of low capitalization and gaps in cash flow. Excessive funds in inventories and debtors, high gearing with loan funds and lack of profitability also contribute to business failure. On the contrary, the lenders, BRI Units and BPR experience difficulties in evaluating borrower's behavior that is unpredictable. One of the symptoms is decreasing contact of borrowers with the bank. It is understandable that banks or microfinance institutions can be caught; microcredit that is provided to their selected borrower is going sour by the borrower's non-business actions.⁵⁰⁹

⁵⁰⁹ The researcher met the problem-borrowers: A'an and Enung, who were divorced, and interviewed their daughter Ina, Pagerageung Tengah, Pagerageung on 2 May 2006; interviewed with Wahyu and Cucu, Cimahi, 10 May 2006, they lost a lot of money from loans as they have

The bad debt creates long-term difficult problems for the family of the borrower. It is not only financial difficulties that influence their livelihood but also social relations with the community. Some impacts of bad debt can be noted as follows:

1. All the borrower participants in the research areas are married; husband and wife who build the family with children. They are self-employed, supported by microcredit, which provides education for the children, care of the elderly, transmission of occupational skills and religious instruction.⁵¹⁰ Simultaneously, they act as a unit of consumption, supported by income produced by microcredit, to fulfil their need for food, water, shelter and safety. These are basic human needs as discussed by Maslow.⁵¹¹ Since the borrower fails to generate sufficient income from the business, he or she is not able to pay instalments to the bank. It is understood the borrower will maintain the expenditure for the basic needs of the family but the bank has a right to claim payment. This will exert pressure on the borrower to reduce or postpone their basic expenses and that pushes the family into misery.

2. The situation will worsen if the microfinance institution liquidates the collateral. All non-performing respondents in the research areas worry that their creditors, in this case the bank, will confiscate collateral. The researcher also finds that the collateral the borrower provides is not only their assets, but often belongs to other parties such as parents, mother or father-in-laws, relatives, or friends under proxy from the title holder. Usually, liquidation of the borrower's collateral is the last action by the creditor to reclaim the money. The physical seizure is a complex legal process that nearly always involves pressure and conflict between the borrower, collateral owner and creditor. The release of collateral will reduce the assets of the borrower or collateral owner, returning the borrower and family to poverty.

to repay their daughter's loans to a fierce moneylender; interviewed with Iwang wife of Achmad Rauf, 10 May 2006. Rauf was sick and paralyzed for years.

⁵¹⁰ Marber, P. 2003, *Money Changes Everything*, Prentice Hall, Upper Saddle River, New Jersey.

⁵¹¹ Maslow, A. H. 1998, *Toward a Psychology of Being*, Wiley & Sons, New York.

3. The microcredit borrowers, especially in rural and coastal areas, are living closely with their neighbors. It is no wonder there is no business confidentiality among them, which means that the non-performing loans of a borrower quickly become common knowledge in the community. The borrower, who is under the bank's scrutiny, realizes their case will be a source of rumor among neighbors and relatives. Rumor is one of the forms of social pressure, making the non-performing borrower avoid seeing the bank officers, keeping away from the neighbors and trying hard to find debt solutions. Financial support from relatives or liquidation of assets is an alternative; this is a traumatic process but money should be sought to avoid the debt trap.

Non-performing loans strongly influence the reputation of borrowers with direct impact on the family, recorded by the microfinance institutions and also known by the community. As microfinance institutions blacklist bad borrowers, it is a big challenge for borrowers with a bad record to restore their creditworthiness.⁵¹² Usually it takes time to recover a damaged reputation and rejoin the credit market.

Integration and analysis of the findings in this part of the study concludes that microfinance, either using a commercial approach or poverty alleviation approach, positively impacts or increases the income of borrowers in order to better their livelihood. For better-off borrowers, increased income means the opportunity to expand the business or increase assets, which is why they can ask for an additional loan from the bank. Income is their means to maintain and expand the business. The microcredit from the BRI Units and BPR result in an increasing gap between rich and poor, while the banks' provision of microcredit does not directly contribute to the alleviation of poverty. This is the consequence of the assessment policy of BRI Units and BPR that seeks to discriminate between bankable and unbankable applicants. Microcredit stimulates the dynamic of individual initiatives in business, and there is the

⁵¹² For the non-performing borrower who can settle the whole microcredit *Kupedes* principle and interest, and the fact that bad debt has not occurred due to external factors or the borrower's character, the BRI Unit is willing to consider a new microcredit loan as long as the business is viable and has potential. See Bank Rakyat Indonesia, *Surat Edaran*/Circular Letter no. S`31-DIR/MKR/10/2004 dated 25 October 2004.

social acknowledgement when successful men and women in business can improve their social hierarchy in the village community.

Besides *kupedes*, BRI provides its own scheme of microcredit with “less commercial” requirement such as microloans without assets collateral (*Kredit Usaha Mikro Lancar Tanpa Agunan*, KUMULTA) or partnership loans (*Pinjaman Kemitraan*). They have a low standing in the BRI loan report as the branches are reluctant to push these loans. Although the intention is worthy, the performance of the branch management is hit when this type of loan goes bad. BRI also provides loans to groups of participants in specific government development programs. Any profits are shared between the BRI and the government. With these two types of ‘development’ loans BRI finds an opportunity to serve poor people; but the growth of loans are insignificant which indicates less interest in financing ‘non-commercial’ activities.

In comparison with better-off borrowers, increasing income for the poor is used to repay the loan, to fulfil the basic needs of their livelihood. In other words, for the poor this income is a means for their survival. If lending institutions are to provide loans for poorer borrowers, they have to develop stronger management systems that screen the participants, organize group networks, empower the poor for self-employment, develop access to the market as well as provide working capital, guidance and supervision. This is extra work that the commercial bank wants to avoid. The success of the P4K program is evidence of how the alleviation of poverty needs an integrated effort from the planning stage, guidance from *penyuluh* and loan granting and supervision from the bank. Funding from IFAD, ADB and BRI is provided for about 25 years, which is long enough to help the poor. Although not all group members succeed to be individual self-employed entrepreneurs; they are happy working together in a group, but at the end of the program, they feel uncomfortable to do business without *penyuluh* or guidance. Thus the alleviation of poverty programs does not always flow through into the commercial scheme. The BRI does not support ex-P4K members to become borrowers of commercial microcredit, as it applies its own screening criteria and does not automatically accept them as borrowers. The project finance in Ciparay and Subang is still in

its early stages, where borrowers have optimistic expectations that they will pass the screening process to participate in the programs. The projects are influenced by local government bureaucracy, especially the sustainability of funding as determined by political negotiations in the local parliaments (*Dewan Perwakilan Rakyat Daerah Kabupaten*). These local government projects tend to be developed as part of political and election campaigns and they are not based on sound commercial considerations. The BRI supports the project managers to secure loan agreements, channeling funds, administering and supervising loans. However, BRI and BPR screening is difficult. To reconcile the needs of the poor with commercial requirements is demanding.

Bad debt in microcredit is related to both business risk and the human frailties of borrowers' behavior. The possibility of risk is explored from the outset when the management of the bank, *mantri* or loan officer contact the applicants. Screening the borrower's application and sector of the business will identify the business risk and human risk. Screening processes can be differentiated by the intention of the loan. For commercial purposes screening requires commercial indicators but poverty alleviation programs need to consider social considerations. A list of social, cultural and religious issues can be used as indicators in screening as well as monitoring during the loan. There are some unpredictable human issues for borrowers that arise during the process of financing which are usually detected during supervision. The loan must be continuously monitored for healthy microcredit to avoid bad debt and to protect borrowers from falling back into poverty.

In this discussion on the benefits and risks of microfinance, it is argued that respondents in urban, rural and coastal areas recognize similar benefits: that microcredit is able to improve income for better living and education, encourage borrowers to work diligently and expand their business. They are convinced that microfinance is an effective tool to develop a small business and create economic advancement. Designed for development and sustainability of microfinance institutions, BRI Units and BPR need to attract new microborrowers.

On the role of money, as influenced by their religious beliefs, respondents in the rural area explain that money or wealth is not the ultimate goal. Money is needed to support a secure and peaceful existence. *Gotong royong* is still practised in the rural area, while in the urban area money is usually used as a compensation for labor. The study indicates that bad debt in the rural area is lower than in urban and coastal areas. This finding is not only about business reasons; but religion and social sanctions influence borrowers' behavior and servicing loans is a means of maintaining their faith as devout Muslims.

To answer one of the research questions, the study found that poor and low income men and women rarely meet loan requirements, as assessed in the screening processes of microfinance institutions. The screening requires assets collateral that poor and low income earners do not have. The study found that microcredit institutions prefer to finance better-off borrowers rather than the poor and low income earners.

This chapter has argued that there are relationships between microfinance and the cultural system and beliefs of the community that influence the agency of both borrowers and the operation of microfinance institutions. By following Archer's ideas on culture and agency, microcredit is an exchange within a cultural system, in which microfinance institutions and borrowers reach an agreement to make financial transactions based on their shared interest.⁵¹³ The borrowers decide to access and accept microcredit in conducting their microbusiness. They have the capacity to follow microfinance practices and regulations. And they are able manage differences and contradictions within their culture. At the same time, microfinance institutions share the same vested interest as borrowers in terms of increasing income and profits to sustain their operations.

⁵¹³ Archer, M.S. 1996, *Culture and Agency: The Place of Culture in Social Theory*, Cambridge University Press, New York, p. xiv.

CHAPTER 6

MICROCREDIT INTEREST AND *RIBA*

6.1 Introduction

In Indonesia, since the early 20th century, the colonial government has developed a poverty alleviation policy and established rural microfinance institutions. Although the borrowers were Muslims, the government applied the interest calculation system for credit institutions consisting of popular banks (*Algemeene Volkscredietbank – AVB*) and thousands of village banks, village rice banks (*lumbung*) and pawnshops that provided small, usually short-term loans to millions of households.⁵¹⁴ In addition to supporting the villagers, it is interesting to note that these microfinance institutions managed to operate at a profit.⁵¹⁵ The payment of interest was an integral part of these microfinance programs, adopted from the capitalist financial system prevailing in the Netherlands and the Netherlands Indies although the indigenous borrowers were nearly all Muslims, for whom the payment of interest is *riba* and prohibited.⁵¹⁶ One of the objectives of the colonial government was to strengthen the local economy and to protect rural communities against exploitation by moneylenders. Schmit argues that colonial policies, the cultivation system and the 1870 Agrarian Law plus the activities of the Chinese and Arab usurers contributed to increasing levels of poverty.⁵¹⁷ Kartodirdjo notes that Dutch policymakers were also concerned about the potential for insurgency in certain Islamic areas like Banten.⁵¹⁸ When Sarekat Dagang Islam

⁵¹⁴ Fruin, T.A. 1933, *History, Present Situation and Problems of the Village Credit System (1897-1932)*. Klaas Kuiper (trans. and ed.), 1999, Ministry of Foreign affairss (DRU), The Hague, pp. 26-30.

⁵¹⁵ Fruin, T.A. 2000, *Provisional Manual for the Credit Business of the General Popular Credit Bank*. Klaas Kuiper (ed.), Development Cooperation Information Department of the Ministry of Foreign Affairs, The Hague, Netherlands.

⁵¹⁶ The AVB charges interest to the borrowers as each year the AVB has to repay the government via the Central Fund, equivalent to half of the operating surplus from the previous financial year after covering any outstanding losses from previous years plus a fixed rate of interest of 3.17% on capital stock.

⁵¹⁷ Schmit, L.T. 1991, *Rural Credit between Subsidy and Market*, Leiden Development Studies, Leiden, no. 11.

⁵¹⁸ Kartodirdjo, S. 1966, *The Peasants' Revolt of Banten in 1888*, Martinus, Nijhoff.

was established in 1905, the colonial government's microfinance programs were a critical poverty alleviation strategy in which the payment of interest was considered as *riba* by Sarekat Dagang Islam. By 1914 when the organization had changed its name to Sarekat Islam, it also changed its view on the payment of interest, as it considered microcredit programs to be of use to its members.⁵¹⁹

In 1929 there were 90 popular banks, 5,986 village banks which made 3.3 million loans and 5,682 village rice banks providing 1 million quintals of rice to 1.1 million borrowers. According to the 1930 census, there were 13,226 villages with 24,914,007 inhabitants in Java and Madura.⁵²⁰ In addition to these government supported village banks, moneylenders continued to provide credit at high rates of interest. Microcredit from both the moneylenders and village banks facilitated the penetration of the money economy into rural villages.

Rural financial institutions, pawnshops and informal commercial moneylenders were the only sources of cash villagers could find. The colonial government provided a pawnshop service (i.e. cash against assets collateral with interest payments). Pawnshops began business when *Bank van Leening*, a credit institution extending credit on pawning system, was established in 1746. In 1870 the colonial government introduced a registration system for pawnshops (*lisentie stelsel*). In 1901 colonial administration took over the pawnshops because of excessive rates of interest and other malpractices. And in 1914 the government created a government monopoly, which became a state-owned company in 1967 and a *Perusahaan Umum (Perum) Pegadaian* from 2000.⁵²¹ Most pawnshops were located in cities and urban areas. The researcher did not find *Pegadaian (Pawnshop) Offices* in rural and coastal areas.

In contemporary Indonesia, informal moneylenders in the villages are the families, neighborhood associations, religious associations, *arisan* club (*rosca*, rotation saving and credit association), business networks and individual

⁵¹⁹ Suryanegara, A.M. 2010, *Api Sejarah: Mahakarya Perjuangan Ulama dan Santri dalam menegakan Negara Kesatuan Republik Indonesia*, Salamadani Pustaka Semesta, Bandung.

⁵²⁰ Fruin, T.A. 1933, *ibid.* p. 5. "Preliminary Results of the Census of 1930 in the Netherlands East Indies, part I, Java and Madura, Table VIII: Distribution of villages and their inhabitants by the size of villages", *Landsdrukkerij* (Government Press), 1931 (data excludes Klaten and the major towns).

⁵²¹ Pegadaian, *Annual Report*, 2010, Perum Pegadaian, Jakarta.

moneylenders.⁵²² In colonial times, one form of credit was repaid in kind after the harvest or on standing crops (*ijon*). Arab moneylenders operated in Java in towns between Cirebon and Semarang. Indigenous moneylenders are a more contemporary phenomenon. The Chinese itinerant moneylenders in Java provided small-scale instalment credit to villagers, market vendors and artisans.⁵²³ They travelled around villages to collect instalments and to offer new loans and repayment terms. This had the effect of making money lending less apparent.⁵²⁴ Money lending is known in Sundanese villages as *Cina minding*, because of the high rates of interest charged. The need for credit and rural indebtedness occurred parallel to monetization of villages. Millions of Muslim borrowers have utilized this interest-based system.

The controversy regarding payment of the interest system and *riba* emerged during the colonial period as a critical issue among Muslim leaders and national organizations. The objective of poverty alleviation was thought more important than the payment of bank interest. Muhammad Hatta, Indonesia's first Vice President, in his numerous articles published before the Second World War and in the early 1950s describes the evil (*mudharat*) of interest (*rente*), arguing that high interest rates charged on money lent for consumption purposes is forbidden (*haram*).⁵²⁵ The money lent constitutes capital, which is productive and produces income for borrowers, and this is the price to be paid for opportunity for others. In this case it is productive *rente* as part of the profits of borrowed money and in Hatta's opinion it is not *riba*. To support his stand, Hatta quotes the liberal *ulama* Syeikh Haji Abdullah Ahmad

⁵²² Robinson, M.S. 2001 *The Microfinance Revolution, Lessons from Indonesia*, vol. 2, The World Bank, Washington D.C. The operation of informal commercial moneylenders is discussed by Robinson (pp. 170-222).

⁵²³ Schrader, H. 1997, *Changing Financial Landscapes in India and in Indonesia: Sociological Aspects of Monetization and Market Integration*, St. Martin's Press, New York; also see Heiko Schrader, *Monetization, Moneylenders and Merchant Bankers in India and Indonesia* <http://library.wur.nl/way/catalogue/documents/FLR20.pdf>.

⁵²⁴ The *mantri* of BRI Unit Gebang and the BPR loan officers in Kapetakan informed the researcher that moneylenders operate in their work area and they are loan competitors. The researcher was introduced to a man with a motorcycle full of household goods by the BPR Kapetakan loan officer. The man was collecting payments and offering credit as well as merchandising.

⁵²⁵ Rahardjo, M.D. 1992, 'The Question of Islamic Banking in Indonesia'. In Afiff, M. (ed.) *Islamic Banking in Southeast Asia: Islam and the Economic Development of Southeast Asia*, Institute of Southeast Asian Studies, Singapore, pp. 137-163.

from West Sumatra who argues that *rente* is not *riba* if it is announced publicly beforehand, so anybody who wished to borrow already knew and had agreed.⁵²⁶ Hatta's opinion on bank interest as *riba* reflects his attitude on the appropriate role of government in expressing religious views. Hatta's view reflects the post independence accommodation of a capitalist financial system, with the Islamic beliefs of the majority of Indonesians, whose faith determined that *riba* is *haram* and therefore prohibited. *Riba* or bank interest is interpreted as consumptive as it brings suffering and injustice. When loan money is used for productive purposes and generates income for a better livelihood, the rationale for *riba* or bank interest is that it is a fair price, as the cost of money to be paid by the borrower to the lender. Under President Soekarno and Vice President Muhammad Hatta, the Indonesian government maintained colonial interest-based finance following efforts to introduce *shari'ah* principles into the preamble of the original Indonesian Constitution in 1945 failed. This preamble would have required Muslims to practice Islamic principles. The seven words of the Jakarta Charter (*Piagam Jakarta*) however were dropped from the draft of the 1945 Constitution.⁵²⁷ Islamic revival emerged in the 1970s and one of the impacts was when the profit and loss sharing system was successfully introduced by Bank Muamalat in 1992. This is the entry point of *shari'ah* financing followed by banking and other financial sectors.⁵²⁸ As the interest system dominates financial activities in a country where Muslims constitute a majority, it raises the question as to whether the interest charged on credit is appropriate to Islamic practices. One of the reasons why it took such a long time to introduce a non-*riba* system was that the government believed an interest-based system was required to maintain economic stability and international support for Indonesia's financial system. The New Order Government was able to sustain this view in part because the major Islamic organizations, Muhammadiyah, Nahdlatul Ulama, Persis and Majelis Ulama Indonesia held

⁵²⁶ Hatta, M. 1958, *Islam dan Rente, Beberapa Pasal Ekonomi Jalan ke Ekonomi Islam dan Bank*, Balai Pustaka, Jakarta; See also Abas, A. 2008, *Bung Hatta dan Ekonomi Islam, Pergulatan Menangkap Makna Keadilan dan Kesejahteraan*, MultiPressindo and LP3M STIE Akhmad Dahlan, Fakultas Hukum Universitas Muhammadiyah, Jakarta.

⁵²⁷ Azra, A. 2006, *Indonesia, Islam and Democracy: Dynamics in a Global Context*, Solstice Publishing, Jakarta, p. 21.

⁵²⁸ See Indonesian Banking Law no. 23/1992 revised with no. 10/1998.

opposing and inconsistent views about the payment of interest as *riba*. The creation of Ikatan Cendekiawan Muslim Indonesia (ICMI, Indonesian Intellectual Muslims Association) chaired by B.J. Habibie, the Minister of Research and Technology, facilitated the establishment of a non-*riba* bank (*shari'ah* bank) in 1992.

In Chapter 3, we discussed the definition of *riba* and how religion influences the behavior of human beings. Religion for the Sundanese is guidance (*ageman*) in the world and hereafter: that God is the Absolute Ruler, the ruler of the entire world and universe. He has full knowledge of all things, He whose glory is most great and most high. One aspect of the Islamic religion is *riba* and this chapter examines how the microborrowers deal with benefiting from microcredit when the interest they pay is equivalent to *riba* and prohibited. The researcher discussed the issue with borrowers in the cities of Cirebon, Cimahi and Tasikmalaya, where *shari'ah* banks have been established, and with respondents in villages where a *shari'ah* bank network is not yet available.

As mentioned earlier, all the borrowers in this study are Muslim. This research seeks to understand why borrowers who profess Islam agree to pay interest on microcredit to BRI Units, BPR and cooperatives. Secondly, although various rationales have been developed to justify payment of interest, borrowers recognize interest is *riba* that is prohibited in Islam. How do borrowers reconcile these issues with their religious beliefs? What does the local religious authority in Sundanese villages (*ajengan*) say about *riba* and how are the *ajengan* and *pesantren* views used to justify payment of interest? Here we are going to see a complexity of various outlooks such as the influence of the Sundanese culture, the *ajengan*-followers relationship, money needs for livelihood, financial and payment systems in the villages and adherence to government rules.

6.2 Capitalist system in Muslim societies and *shari'ah*

6.2.1. Borrowers' acceptance of microcredit interest

In relation to interest system acceptability, a literature study and field research have been conducted to understand the background to Indonesia adopting a capitalistic economic system, the borrowers' practices of paying microcredit

interest, the role of the local *ajengan* and *pesantren*, and the attitude of national Islamic organizations about *riba*.

The indigenous peoples and Muslims remained in the traditional sector as small holders in various small businesses, mostly trading. They were a pre capitalist society in a colonial community.⁵²⁹ Their business was financed by their own limited capacity and by business community or moneylenders until the government established rural microfinance institutions with the interest-based system in the early 20th century.⁵³⁰ This represented was the government effort under the ethical policy to support indigenous people, mostly poor Muslims, to get working capital for trading, to develop business and to support the alleviation of poverty. From 1902 onwards, popular credit banks were assigned a central role in welfare policy for the Netherlands Indies and in 1910 the colonial government decreed to give popular credit banks the status of “philanthropic association” and confirm village banks as decentralized village credit institutions.⁵³¹ Although the borrowers were Muslims and an interest-based system is equivalent to *riba*, the Dutch microcredit scheme for poverty alleviation with the interest-based system was continued and accepted by Muslim borrowers in many Muslim areas.

At the first congress of the Sarekat Islam in 1913 Tjokroaminoto, who was vice chairman at that time, strongly supported the policy to improve people’s prosperity.⁵³² Using Islam as the foundation of the movement, Sarekat Islam debated and disagreed with the interest system the government applied, but then accepted the system as it helped finance the businesses of its members.⁵³³ The original name of Sarekat Islam was Sarekat Dagang Islam, established in 1905, by the Islamic Traders Union, a movement of *batik* entrepreneurs, indigenous and Muslims traders from East and Central Java with

⁵²⁹ Boeke, J. H. 1953, *Economics and Economic Policy of Dual Societies as Exemplified by Indonesia*, Institute of Pacific Relations, New York.

⁵³⁰ Steinwand, D. 2001, *The Alchemy of Microfinance*, VWF, Berlin, p. 85.

⁵³¹ Schmit L, *A History of the “Volkscredietwezen” (Popular Credit System), 1895-1935*, ed. Klaas Kuiper, 1999, Development Cooperation Information Department of the Ministry of Foreign affairss, The Hague.

⁵³² Tjokroaminoto: Speech at the Sarikat Islam Congress, 1916, In Penders, C. L. M. (ed.) 1977, *Indonesia, Selected Documents on Colonialism and Nationalism, 1830-1942*, University of Queensland Press, St. Lucia.

⁵³³ Gani, M. A. 1984, *Cita Dasar & Pola Perjuangan Syarikat Islam*, Bulan Bintang, Jakarta.

the aim to protect their *batik* trade against Chinese interlopers.⁵³⁴ Here we can see the important role of *santri* in business as described by Geertz.⁵³⁵ *Santri* is the pioneer in trading and the most dynamic group in society. They are *wong dagang* or traders, professional small businessmen from well integrated, regionally based groups tending to specialize in a certain branch of trade.

Initially Geertz uses the concepts of *santri*, *abangan* and *priyayi* to understand the nature and variety of Islam in Java, commonly consisting of a balanced integration of *abangan* religious tradition, purer Islamic *santri* and acculturating *priyayi*. But then they are used to making a difference in occupation and class.⁵³⁶ *Abangan* stresses animistic aspects of the overall Javanese syncretism and broadly related to peasant elements in the population. *Santri* stresses the Islamic aspects of syncretism and is generally related to the trading elements. *Priyayi* stresses the Hindu aspect and is related to bureaucratic elements and *kraton* or palace.

Anderson explains that Islam was brought by traders and has never lost its origins, developing its strongest hold in the intermediate and commercial, rather than the upper official or lower peasant strata.⁵³⁷ From the beginning of the arrival of Islam in Java, Muslim traders were members of the middle class group. Wertheim argues that in Java, with the urge for emancipation among *santri*-oriented middle class traders, who suffered from discrimination, from the middle of the 19th century onwards, they developed a value system quite distinct from both Javanese values of aristocracy and Western intelligentsia. As an expression of new cultural values the rising Muslim middle class created their own organizational apparatus.⁵³⁸ Anderson, Geertz, Hatta, van Leur and Wertheim argue the case for the close link between trade, entrepreneurship and Islam. They recognize that the prohibition of *riba* is a principle that has to be

⁵³⁴ Lowensteyn, P, *Indonesia Between 1908 and 1928, The Sarekat Islam*, viewed 23 July 2007, <<http://www.lowensteyn.com/indonesia/sarekat.html>>.

⁵³⁵ Geertz, C. 1963, *Peddlers and Princes: Social Change and Economic Modernization in Two Indonesian Towns*, University of Chicago Press, Chicago and London, pp. 11-13.

⁵³⁶ Geertz, C. 1960, *The Religion of Java*, Free Press, Glancoe, Ill, p. 6.

⁵³⁷ Anderson, B. ROG, 1972, 'The Idea of Power in Javanese Culture'. In Holt, Claire (ed.), *Culture and Politics in Indonesia*, Cornell University Press, p. 58.

⁵³⁸ Wertheim, W. F. 1969, 'From *Aliran* towards class struggle in the countryside of Java, *Pacific Viewpoint*, 10(2), pp. 1-17.

complied with, but in practice it was accommodated as it provided finance to support Muslim business activities.

This description of Wertheim points out that the development of *santri*-oriented traders cannot be separated from the preventive attitude of the influence of *priyayi* and *abangan* or other foreign values. The development of *santri* positioning among Javanese society has several objectives such as commercial interest, freedom from the power of aristocracy, or from the influence of foreign values and religion. It is understood if *santri* traders do not accept financial support from *priyayi* or other outside sources (as discussed by van Leur and Reid), they generate financing for their business between *santri* traders and through their internal apparatus. Geertz explains that large and well integrated trade organizations are employed to pool resources to enable *santri* traders to finance their activities, manage competition and enforce the repayment of debt within the group.⁵³⁹ Muslim traders and entrepreneurs in Mojokuto were reformist *santri*. As Geertz finds, Islam reformism and puritanism was doctrine for entrepreneurs in that area and as a religious calling (*ibadah*).

After independence, Indonesia had to deal high levels of poverty. At the beginning of the New Order period, the government developed various interest-based microloan programs. Islamic revival emerged in the 1970s and *riba* was one of the issues of debate. From the introduction of microfinance by the Dutch until the Islamic revival, the issue of *riba* and the need for a *shari'ah* system was not a focus compared with the priority to address poverty. It seems government continues to make a similar decision as in colonial times. Lack of capital was the critical concern and the government had to provide funds for small business, most of which were owned by Muslims. Although the government has taken an active role in economic development since 1983, Indonesia follows a self-regulating market mechanism in running its economy. Consequently, the government shifts its policy on microfinance as in the non-government domain. This change of government policy is not related to *riba* or non-*riba* issues in financing. Rather it reflected a government view that microfinance was not a strategy to alleviate policy that the government wanted to support. The political

⁵³⁹ Geertz, C. 1963, *ibid*, p. 13.

constellation at that time was not open to thinking about *shari'ah* finance as an alternative to an interest-based system. Microfinance is only one of the business mechanisms in the capitalist market economy, and it is directly used to alleviate poverty only if designed under the special dispensation scheme. Also there is a change when microfinance becomes a means of facilitating business and generating profits in addition to poverty alleviation.

The Islamic revival associated with a younger generation of Islamic leaders who returned from studies in the Middle East and North America in the 1970s, together with the influence of the Iranian Revolution were catalysts for a growing demand to balance the economic power of large corporations through Muslim small business. Some, like N. H Chotib, argued that more than 90% of Indonesians are Muslims and constitute most of the consumers in this country. As such, they are the target market of Indonesia's capitalistic system.⁵⁴⁰ There was also a rising challenge from Islamic leaders making an issue of *riba*. In fact *riba* is the general issue for Muslims. The Islamic revival found strong support from Islamic organizations and Muslim communities. This induced the government to permit an alternative system in banking based on *shari'ah* principles in 1992. The Islamic revival raised other issues such as marriage, the Islamic court, *zakat* management, *haji* services, *waqf* rules and the application of *shari'ah* principles in several cities and districts. The development of sufism, *pesantren* and sufism (*tarekat*) is also part of the wider Islamic revival. Sufism has inspired a new enthusiasm, even in the sector of Indonesian society most intensively engaged in modernization.⁵⁴¹ The Islamic way of life emerged and easily found expression in daily life such as halal food and restaurants, women wearing headgear (*jilbab*), more Islamic schools emerging, various Islamic services including hospitals and more prayer rooms (*mushala*) in offices.

After the New Order period, stimulated by the increased democratization of political institutions, freedom of thought and worship, the expansion of education and a challenge to economic regulation, the capitalist system was

⁵⁴⁰ See Chotib, N. H. 1998, 'Konsep Pengembangan Ekonomi Umat di Indonesia'. In Sasono, A. (ed.), *Solusi Islam Atas Problematika Umat*, Gema Insani, Jakarta.

⁵⁴¹ Howel, J.D. Sufism and the Indonesian Islamic Revival
<<http://www.indopubs.com/indosufism.pdf>>

further entrenched. There are arguments for capitalism: it is a dynamic efficient system, produces rapid growth and anyone can go into business. Anybody is free to set up a business and millions of small businesses ensure that no control exists over what is produced.⁵⁴²

In the capitalist system that developed under the New Order Government, the *shari'ah* system was a solution for the government to accommodate the revival of Islamic values. The Islamic revival had convinced many Muslim leaders and organizations that the presence of *shari'ah* banking and financing was important as it enabled Indonesian Muslims to choose between conventional and *shari'ah* banking – between *haram* and *halal*.

For many decades, the capitalist and interest system penetrated households in the villages where most Muslims were living. This study indicates that Muslim microborrowers of BRI Units, BPR and cooperatives accept the loans and are influenced by this interest system, even though this conflicts with their Islamic belief.

Hajjah (Hj) Mimi is living in a rural village far away from the dynamic city of Tasikmalaya. She is not free from the capitalistic way of doing business that is based on market forces; supported by a BRI Unit loan her business is for profit.

“I am 50 years old with primary school education, living at Sukapada village Pagerageung, district of Tasikmalaya. The village where I live is a Muslim community with regular religious service activities.

I trade various agricultural products such as paddy, cloves, cardamon, and I also sell clothes, kitchen wares, and household equipment on installments basis. I have run the business for more than 20 years with ever increasing and repeat loans from the bank. With my own capital and microcredit support I can pay in cash for goods from farmers, other producers, or suppliers to be delivered to my collectors (*bandar*) in the city. I have to calculate very carefully all of the costs including bank interest as the *bandar* have determined the maximum buying price, quality and amount of goods they order. On the other hand, I have to understand to choose the goods I want to sell with instalments such as clothes in fashion, good quality and for a reasonable price. I also have to

⁵⁴² Those are the arguments economists have used in favor of capitalism as discussed by Zimbalist, A. *et al.* 1989, *Comparing Economic Systems: A Political-Economic Approach*, Harcourt Brace Jovanovich, New York, pp. 7-8.

determine the terms of payment for my clients. I have to follow the dynamics of market and consumers' taste for maximum benefits.

Supported by microcredit, I calculate bank interest into my business. It is computed in the cost of goods sold and so pay the bank on time. As a Muslim, I admit I need a *shari'ah* bank, but the nearest *shari'ah* bank is located in the city of Tasikmalaya, more than 20 km from my village".⁵⁴³

The idea that business has to follow market demands reflects the needs of microborrowers in the rural, urban and coastal research areas. These business people see their objective as meeting the buyers' needs (*dagang mah kumaha nu meuli, kumaha ramena pasar bae*). Their supply of goods, volume or size of business is limited by potential demand from their local community. They explain that business is a cost calculated for profit and income: retaining earnings from profit after cost of living, cost of education, taxes, and various social costs are used for savings and sometimes for hoarding. But to continue in business they need more capital or when the bank offers new loans. The borrowers' business depends on capital, market conditions, their good relationships with the bank and their capacity to compete. It is no wonder *Ibu Marni*, 42 years old, who has been running her stall (*warung*) for 23 years living in an urban area in Cimahi, states:

"I need money and loans from the bank to maintain my business and to compete with other nearby stalls (*warung*)".⁵⁴⁴

Credit is business and business is risk. The lender needs to guarantee to pay the money back, and it needs the capacity to repay from the borrower and asset collateral for the last option. This capitalistic approach in business has penetrated village economy in rural, urban and coastal areas and affects community development. The findings in the research areas indicate the capitalist pattern continues to develop with private ownership of the means of production; businesses operate in a market system, interest is price of money and the market pricing system is the arena of self-interest. But, as micro-

⁵⁴³ Interview with *Hj. Mimi*, Sukadana, Pagerageung, 28 February 2006.

⁵⁴⁴ Interview with *Marni*, Cimahi, 14 January 2006.

entrepreneurs are Muslim, they argued they should use Islamic principles for trading and borrowing, but are challenged by the limited infrastructure of *shari'ah* banking.

Suryono and Ella Hayati explain their opinions as noted by the researcher.

Pak H. Suryono is about 63 years old, living in the village of Citeureup, Cimahi Utara. He operates a restaurant and has been in business for 31 years and as a micro borrower for 15 years. He understands the interest he paid falls into *riba* category but he has no other choice to find other financing. He is not eligible for BRI Syari'ah in Cimahi, as the minimum loan should be 50 million rupiah. He is happy with the service and uses the money for productive purposes and follows good Islamic practices. Pak Suryono and his wife *bu* Een explain paying interest does not disturb their religious feeling; it is used for *halal* business and they consider that the bank does not exploit them.⁵⁴⁵

Ibu Ella Hayati and her husband Nana are living in a rural village, Buana Mekar, Panimbangan. She is about 36 years old, manages a shop (*warung*) selling daily needs for more than 10 years and has been a borrower for 6 years. They say they have to pay interest as the business earns profit and interest is pre-calculated as cost. The most important aspects of their business is *halal*, they follow good business practices and fair trade principles. As Muslims they need *shari'ah* transaction but their village is 30 km away from the closest *shari'ah* bank. They accept this reality and admit it does not disturb their religious belief.⁵⁴⁶

Fair trading is based on trust, which is lawful and allowable in Islam, as long as it does not involve: forbidden commodities, usury (any increase without corresponding counter value), uncertainty (e.g. sale of agricultural product before it is harvested, or fish before they are caught), fraud (e.g. charging higher prices to travelers unaware of local prices) and extortion (e.g. manipulation of market conditions). On borrowing, Islamic principles indicate that interest is unfair and unlawful because interest takes a fixed amount of wealth; is a secure advantage for the lender; the lender continuously receives

⁵⁴⁵ Interview with Suryono, Citeureup, Cimahi, 19 January 2006.

⁵⁴⁶ Interview with Ella Hayati and Nana, Buana Mekar, Panimbangan, 2 March 2006.

profits on the principal; without any effort the lender becomes a dominant partner in the earning of the borrower. Here, the controversial issue of interest and *riba* challenges them, as they have an urgent need to run the business and overcome the lack of capital. But there is no other alternative; as a *shari'ah* source of financing is not yet available they adopt a capitalist interest system.

For the Sundanese, religion is strong guidance for life (*ageman*) with a strong link to the Holy *Qur'an* and the *Hadith*. In fact as for microborrowers, the Sundanese are challenged by the controversy around bank interest or *riba*, which is considered *haram*. Sundanese people honour their traditions by seeking advice from the *ajengan* whenever they face crucial problems. One of the well-known *pesantren* in the research area is *Pesantren* Suryalaya in Pagerageung district of Tasikmalaya, established in 1905 and now led by *ajengan* Kiai Haji A. Shohibulwafa Tajul Arifin, popularly known as Abah Anom. *Pesantren* Suryalaya, a branch of *Tarekat Qodiriyyah-Naqsyabandiyah (TQN)* has been a strong supporter of the central government since the Presidency of Sukarno, when it joined forces against the secessionist Darul Islam movement operating in the 1950s. In the New Order, TQN became a strong *Golkar* supporter, the governing party, and enjoyed patronage at the highest level of the national government. TQN Suryalaya records include newspaper articles featuring the participation of many Jakarta dignitaries at its functions.⁵⁴⁷ Through these official networks, the *pesantren* leaders had good access to news of developments and new debates associated with the Islamic revival in Jakarta and beyond. Abah Anom was not available for interview due to his physical condition but the researcher did interview H. Nasution, senior manager of *Pasantren* Suryalaya.⁵⁴⁸ Nasution explains as follows:

“For many decades, when Abah Sepuh, K.H. Syeh Abdullah Mubarok, the father of the current leader Abah Anom, *riba* has been a common issue. As a counterbalance to the issue of *riba*, the *pesantren* leaders were also concerned with poverty alleviation for the villagers and the *pesantren* followers and the opportunities that the BRI Unit Desa programs

⁵⁴⁷ Howel, J.D. *Sufism and the Indonesian Islamic Revival*, *ibid.* p. 714.

⁵⁴⁸ Interview with Nasution, Senior Manager of *Pesantren* Suryalaya, 3 March 2006.

provided for microbusinesses. With the Islamic revival, the *pesantren* leaders expected the government to find a solution to the issues of *riba* and poverty alleviation such as through the establishment of non-*riba* banks in the villages.

Microcredit with interest-based loans from the BRI Units, BPR and cooperatives, is the only adequate source of financing that enables the villagers to have good life, and to be able to pay for their religious and community obligations. Although *riba* is prohibited it does not mean Allah *swt*, glorious and exalted is He, wants to place human beings into difficulties.⁵⁴⁹ The *pesantren* understands the followers need guidance or “wisdom” on an interest-based system although it is not a compromise between prohibition and the need to survive. Wisdom as guidance is needed to help Muslims avoid poverty and the neglect of economy. Poverty can disturb relationships with Allah *swt* because it can push the Muslims to apostasy”.

Nasution also explains *pesantren* is not only a source of religion to protect from sin and spiritual empowerment, but also it is a resource to strengthen villagers “non-spiritual” needs. This is the reason the *pesantren* pays attention to social, economic and cultural issues. *Pesantren* organizes separate entities to support schools, training, trading activities, cooperation (*koperasi*), saving and financing through *Baitul Mal wa Tamwil (BMT)*. To finance a business, the management of *pesantren* advises its followers to maximize use of various existing micro financing schemes available, but expects an Islamic microfinance institution to be established in the villages where Muslims remain.

These non-spiritual factors are also discussed with H. Baban Ahmad Jihad SB Ar⁵⁵⁰ and the researcher observed his initiatives to develop *pesantren's* external relations with formal organizations, government institutions, business activities, connections with conventional and *shari'ah* banks and public relations. In dealing with the banks, the researcher found the management of *pesantren* contacts both conventional banks and also *shari'ah* banks in the city of Tasikmalaya. The *pesantren* maintains conventional bank accounts for financial services and incoming and outgoing funds but it does not deal with any bank loan facility.

⁵⁴⁹ God intends every facility For you; He does not want To put you to difficulties. See The Holy *Qur'an*, 1983, text translation and commentary by A. Yusuf Ali, Amanah Corp., Brentwood, Maryland, Al Baqara 2: 185.

⁵⁵⁰ He is a senior manager of the *pesantren* and one of the sons of Abah Anom.

Suryalaya is not only an Islamic religious institution, but it is a *pesantren* that has adapted to modernity and plays a sociocultural, educational and economic role in the community. From discussions with Nasution and Baban, the researcher noted their understanding of financial issues, bank interest and *riba* that influences the attitudes of villagers in the community.

1. The *pesantren* recognizes *riba* is prohibited in Islam, but in the history of Suryalaya since 1905, except development of *Baitul Mal wa Tamwil (BMT)*, there are no real solutions of non-*riba* infrastructure or practical operation of non-*riba* financial mechanism in the villages. Savings and borrowing with the interest system is an instrument of local financing and has been practised in the village community for a considerable time. The followers (*ummah*) are familiar with microcredit that has been part of village dynamics for many decades.
2. Microcredit is needed as a support system for the villagers' household business in order to increase their quality of life. The *pesantren* understands the villagers have to make use of all microfinance institutions' terms and conditions including the interest system applied by BRI Units, BPR and cooperatives. *Riba* is *Allah swt* regulation but *Allah swt* says there shall be no difficulties in religion, which means there should be a road out of the problem found.⁵⁵¹
3. The *pesantren* "tolerates" microcredit with the interest system because non-*riba* financing is not yet available in the villages. It is to finance the villagers' business and needs, to earn their living, to feed and educate their family, to pay various social economic costs and perform religious services. The *pesantren* explains Muslims have to strive and to gain salvation in the hereafter, but they should not forget their welfare in this world.
4. The *pesantren* admits that villagers have to follow the existing financing system of the legally financial institutions at village level derived from the national economic system. An interest-based system is officially

⁵⁵¹ He has chosen you, and has imposed no difficulties on you in religion. See The Holy *Qur'an*. al Hajj 22: 78.

determined by the government and should be obeyed by the people.⁵⁵² On the other hand, until today there is no *shari'ah* financial institution available in the villages that can supply *shari'ah* financing to the Muslim community (*ummah*).

The “wisdom” of *pesantren* in accepting the interest-based system on financial transaction is adopted by the villagers as the rationale to maintain savings or microcredit transactions with BRI Units, BPR and cooperatives. The function of *pesantren* is not only central to religious education but also central to cultural enlightenment for the surrounding society. This is related to the argument about how economic behaviour and interest-based system acceptance is influenced by sociocultural factors, in this case personal relations of the borrowers with the *pesantren* as discussed with Nasution and Baban:

1. *Pesantren* Suryalaya is an education and teaching establishment and also maintains community development which has roots in its history, culture and social enlightenment.⁵⁵³ In those activities *ajengan*, is a leader of the *pesantren* and a teacher (*guru*) who is respected and obeyed by his followers. It is important that followers see the *pesantren*'s ideas as a reference for creative social and cultural activities.
2. The *pesantren* emerges as a community which is also able to engage in creative activities where Islam needs to be explored and offered to followers as a culture with Islamic values,⁵⁵⁴ which is considered as a dynamic role facilitating the process of modernity within an Islamic framework. Consequently the idea of the modern *pesantren* is that it influences all aspects including the orientation of education, social ethics and values system. The followers obey the *pesantren*'s ideas and believe they are valid and right.

⁵⁵² To obey the government regulations is part of the *iman* or creed,Obey God, and obey the Apostle, And those charged with authority among yousee The Holy Qur'an, *ibid* An Nissa 4: 59.

⁵⁵³ See also Ismail SM et al, 2002, *Dinamika Pesantren dan Madrasah*, Pustaka Pelajar, Yogyakarta, p. xiv.

⁵⁵⁴ See also Soetjipto Wirosardjono, *The Impact of Pesantren in Education and Community Development in Indonesia*, (Berlin: Fredrich-Naumann Stiftung, Indonesian society for Pesantren and community Development (P3M), and Technical University Berlin, 1987), p. 218.

3. The discussion indicates that Islamic religious values encourage and motivate *pesantren* to explore economic, social and cultural functions.⁵⁵⁵ There is a spirit of capitalism in business, financing and the interest system used by followers of the *pesantren* in the villages. The system has been their financial support system for many decades.
4. As senior management of *Pesantren* Suryalaya, Nasution and Baban understand the national debate on *riba* and the *fatwa* of Majelis Ulama Indonesia. They say that *riba* is *haram*, a common issue for the *pesantren* and it was no surprise when Majelis Ulama Indonesia announced that all payments of interest should be considered as *riba*. However, the most important issue for the *pesantren* was to formulate an interpretation of *riba* that recognized that there were not yet any *shari'ah* institutions in close proximity to the villagers where its followers lived. The establishment of *shari'ah* infrastructure is beyond the *pesantren's* control. They explain that from the *pesantren* point of view the Muslims who are members of Islamic organizations (Nahdlatul Ulama, Muhammadiyah, Persis) and who are also followers of the *pesantren* are free to follow the ideas of either their national leaders or *pesantren* wisdom. This means that *pesantren* leaders accommodate the practicality that their followers have to pay interest.

Obedience to the guidance of the *ajengan* from a *pesantren* is also a reflection of local culture. It is found that the Sundanese expression explains that God has “agents” or “representatives” here in the world⁵⁵⁶ by the phrase: the mouth is to extend message, the leg extending step, I am the great Muslim leader, to correspond as Islamic ruler, to be a witness how *Allah* is the Greatest, (*sungut sambung lemek, suku sambung leumpang, kaula panghulu agung*,

⁵⁵⁵ It is relevant to the Weberian approach. See Max Weber, *The Protestant Ethics and the Spirit of Capitalism* (New York: Charles, 1958), pp. 50-57.

⁵⁵⁶ It is strong confession of faith that God is the Only One but the attribute of Him is bundle characters of gods and goddesses in Hinduism and Allah in Islam. See Warnaen, S., Rusyana, Y., Wibisana, W., Garna, Y. and Djiwapradja K. 1987, *Pandangan Hidup Orang Sunda seperti tercermin dalam tradisi lisan dan sastra Sunda*, Bagian Proyek Penelitian dan Pengkajian Kebudayaan Sunda (Sundanologi) Direktorat Kebudayaan Departemen Pendidikan dan Kebudayaan, Bandung, p. 158.

wawakil panatagama, neda panaksen, agungna ka Gusti Allah nu Maha Wisesa). It means that *Panghulu Agung's* words should be followed as he is an "agent" to rule the believers. *Panghulu Agung* is *ajengan*, a respected leader in Islamic teaching and also a teacher or *guru*. His words or advice has to be followed by his supporters. In Sundanese *guru* is an abbreviation of "*di-gugu jeung di-tiru*" that means *gu-ru* or the teacher should be followed and imitated. Here the *ajengan* resolves the controversial issue after deeply thinking and considering (*ijtihad*) the benefits and detriments of the interest system.

It is essential that Muslims are to be more aware and loyal to Islamic creeds and its norms of behavior, not only in the field of ritual, but also in socioeconomic activities. A Muslim has to reinforce his role in worldly interests as part of his religious duties. The Indonesian Constitution of 1945 determined that the government would not apply Islamic principles in its governance. Consequently, although the majority of the Indonesian population are Muslim and have many Muslim leaders and ministers, the government is not bound to implement Islamic principles in economic policy.

On the other hand, the problem of *riba* is not related to the constitutional foundation, either Islam or non-Islam. This is the distinction between Allah's *swt* commandments and the constitution and government policy, which are products of human beings. *Riba* is related to the belief as stated in the Holy *Qur'an* and the *Hadith* and it does not require an Islamic state to be applied. This is a crucial problem, which has caused debates and controversy on the relationship between the state, government, politics, economic policy and implementation of religious principles. These debates have influenced government policies post independence on economic development. The debates among leading Muslim intellectuals on the relationship of religion and politics as well as state foundations are ongoing issues. Nurcholish Majid, Abruurrahman Wahid and Amien Rais have distinct opinions on the form of an Islamic state in Indonesia.⁵⁵⁷

⁵⁵⁷ Nurcholish Majid or Cak Nur, as he was popularly known, prefers to separate religion and state. To him politics is material life where dimension is rational and collective while religion is another aspect of human life where dimension is spiritual and personal. The idea of an Islamic state has been developed more as an apologetic attitude and defensive mechanism among Muslim leaders. See Majid, N. 1983, *Aspirasi Umat Islam Indonesia*, Leppenas, Jakarta.

Here and there, we can find the accommodation of some Islamic teaching. Since the 1970s there has been an Islamic revival in Indonesian society, partly initiated by Nurholic Majid's speech⁵⁵⁸, in which he argued for the necessity of greater observance of Islamic principles including government. The Marriage Law 1974, the Islamic Court, *Zakat* management, *Hajj* services, *Waqf* rules, the implementation of *shari'ah* in Aceh and *shari'ah* principles in numerous cities and districts in Java, Sumatra and Sulawesi, have determined that specific Islamic practices are followed. The controversy between conventional bank interest and *shari'ah* bank principles are solved by the government through Banking Law no. 23/1992 (revised with Banking Law no. 10/1998).⁵⁵⁹ It is clearly stated in the 1998 Banking Law that banking in Indonesia is supported by two systems: general banking activities (*Bank Umum*)(article 1.3) and Bank Perkreditan Rakyat (article 1.4). Any bank can deal either as a conventional bank with interest or with *shari'ah* principles. Here, the profit sharing option is developed as alternative financing, side by side with the interest rate system. This is the way the government and parliament have sought to accommodate the long, outstanding controversy about interest and *riba* vis-a-vis a solution in the conflict between that of business interest and belief, and between the government and Muslim needs. This is an important step towards Islamizing capitalism with the establishment of Indonesia's first Islamic bank.⁵⁶⁰ Dawam Raharjo, a leader Islamic scholar who initiated much of the debate, argued that such a bank would address the shortcomings of

Gus Dur states the Muslim communities have fully carried out their religious duties, the context and the format of their government is not the prime object of their concern. See Wahid, A.1982, *Nahdatul Ulama dan Islam di Indonesia*. Prisma no. 4, p. 35.

Amien Rais says that Islam is entirely contradictory to secularism. So each and every good Muslim must strive to make his or her life, family, community, and nation governed by and based on Islamic ethics and guidance. See Rais, A. 1987, *Cakrawala Islam*, Mizan, Bandung.

⁵⁵⁸ There is a speech by Nurcholis Majid on Islamic revival value in a seminar on "Keharusan Pembaharuan Pemikiran Islam dan Integrasi Umat" in Jakarta, 3 January 1970, as the trigger of the Islamic revival < <http://formuda.files.wordpress.com/2010/01/keharusan-pembaruan-pemikiran-islam-dan-masalah-integrasi-umat.pdf>>.

⁵⁵⁹ Indonesian Banking Law no. 23/1992 article 1, verse 12.... jumlah bunga, imbalan atau pembagian hasil keuntungan; and no. 10/1998 article 1 verse 3 and 4, Kegiatan usaha secara konvensional atau berdasarkan prinsip Syariah

⁵⁶⁰ Recent development in Indonesian Islamic thought in various issues is compiled by Mark R. Woodward in *Toward a New Paradigm* (1996). Tempe: Arizona State University. The issue on Islamizing capitalism is written by Robert W. Hefner, p. 291.

capitalism and socialism, and encourage Muslims to return to Islamic principles to solve their problems, religiously and economically.⁵⁶¹

The issue of bank interest has generated a long debate among Islamic organizations (Muhammadiyah, Nahdlatul Ulama, Persatuan Islam) and Majelis Ulama Indonesia (MUI) and between prominent modernist Muslim figures.⁵⁶² Muhammadiyah was established in 1912 to promote the purified teaching of Islam to its followers. The *Lajnah Tarjih* of Muhammadiyah was set off in 1927 to issue *fatwa* or formal legal opinion on religious *shari'ah* matters. During colonial times, the issue of *riba* is not yet a special concern as poverty alleviation of Muslims (*ummah*) is the priority obligation by using rural financing with the interest system established by the government. Muhammadiyah was more active in *al Ma'un* theology as declared by Achmad Dahlan, Muhammadiyah founder, such as education, health and supporting orphan services. The issue emerged about *riba* in Sarekat Islam (SI) when in 1924 Tjokroaminoto, chairman of Sarekat Islam, put forward the idea of Islamic socialism: liberty, equality and fraternity based on Islamic values.⁵⁶³ He says Sarekat Islam disallows *riba*; it is also against surplus value and capitalism. His ideas were not accepted by Muslim intellectuals, especially those in the *Jong Islamisten Bond* (Young Islamic Association) and *Studenten Islam Studieclub* (Muslims Students Study Club), as these organizations were not supported by entrepreneurs and traders who needed access to finance through interest-based credit.⁵⁶⁴

After independence, the Muhammadiyah *Lajnah Tarjih* discussions on the issues of finance and interest had been held several times: in 1968 on bank interest, in 1972 on banking issues, in 1976 on finance in general, and in 1989 on stock market and shares. The *Lajnah Tarjih* concludes that if the rate of interest is excessive and there is a burden on the weaker sections of society, it can be considered *haram*, while if the rate is attainable and controllable it

⁵⁶¹ Rahardjo, M.D. 1987, *Perspektif Deklarasi Mekkah: Menuju Ekonomi Islam*. Bandung: Mizan.

⁵⁶² See Antonio, M.S. 2004, *Islamic banking in Indonesia: a study of ribā and the development of the Islamic banking industry and its role in the advancement of small and micro financing*. PhD thesis, University of Melbourne, Institute of Asian Languages and Societies, Melbourne.

⁵⁶³ Tjokroaminoto, U.S., 2003, *Islam dan Sosialisme*. Tride, Yogyakarta.

⁵⁶⁴ Rahardjo, M.D. 1993, *Intelektual Intelegensia dan Perilaku Politik Bangsa*, Mizan, Bandung.

should be permissible. Muhammadiyah disagrees that bank interest is *haram* but there needs to be a deeper contemplation of the issue as it influences the economy of their members or *ummah*.⁵⁶⁵ It means that Muhammadiyah bank interest is *shubhah* or doubtful, neither *halal* nor *haram*.⁵⁶⁶

Strong support for the interest system came from Kasman Singodimejo, a senior member of the Central Board of Muhammadiyah and among the elite of ex Masyumi party leaders. He states that bank interest is not *riba* and therefore not forbidden.⁵⁶⁷ He concludes that in modern banking activities there is no element that contradicts the principles of Islamic law. Dawam Rahardjo argues that bank interest is not identical to *riba* for many reasons. It is not exploitative and is regulated, rates of interest represent the equilibrium of supply and demand of money, and loans are trading in the commodity of money; interest is compensation on inflation and reward of sacrifice in not having the utilization of capital.⁵⁶⁸ We can see the dynamics of change in the Muhammadiyah. In the Commission IV at 27th National Congress of Tarjih and Tajdid Muhammadiyah in Malang in April 2010 it was determined that bank interest is *riba* and is therefore prohibited. It is understood the decision will bind the Muhammadiyah followers although it allows some time for adjustment.⁵⁶⁹

Nahdlatul Ulama was established in 1926 and the *Lajnah Bahsul Masa'il* discussed law derivation such as the issue on *riba* and bank interest on several occasions in Surabaya in 1927 and in 1937, in Banten in 1938, in Magelang in 1939 and in Bandar Lampung in 1992. From the beginning, bank interest or *riba* is discussed from three opposing legal opinions: *haram* or forbidden, *halal* or permissible or *subhah* or doubtful.⁵⁷⁰ Nahdlatul Ulama is consistent with these interpretations although Majelis Ulama Indonesia has determined the payment

⁵⁶⁵ Muhammadiyah Tidak Setuju Fatwa Haram Bunga Bank, 09 November 2003, See <http://www.tempo.co.id/hg/ekbis/2003/11/09/brk,20031109-03,id.html> viewed 1 January 2008.

⁵⁶⁶ Haedar Nasir, Secretary to Central Board Muhammadiyah in *Tempo Interactive*, 7 January 2004 Soal Bunga Bank, Muhammadiyah dan NU Tidak Berubah.

⁵⁶⁷ Singodimejo, K. 1972, *Bunga itu Bukan Riba dan Bank itu Tidak Haram*, Pustaka Antara, Jakarta.

⁵⁶⁸ Infobank, 1990, *Riba, Ijtihad dan Kesejahteraan*, April, no. 124, pp. 30-31.

⁵⁶⁹ Antara News, *Muhammadiyah Tetapkan Bunga Perbankan Riba*, 3 April 2010, <http://www.antaranews.com/berita/1270295014/muhammadiyah-tetapkan-bunga-perbankan-riba>.

⁵⁷⁰ Keputusan Musyawarah Nasional Alim Ulama dan Konferensi Besar Nahdlatul Ulama di Bandar Lampung, 21-25 Januari 1992.

of interest is *haram*, except in emergency situations. However, the issue remains unclear and open to further debate and Majelis Ulama Indonesia has differing opinions. It is understood that if the Nahdlatul Ulama followers, during the colonial period and after independence, took any chances that gave benefit for their economic needs such as bank interest, it is permissible as they needed microcredit to run their businesses.⁵⁷¹ Economic issues, such as poverty alleviation, have high priority to support the members of the Nahdlatul Ulama. Abdurrahman Wahid, or Gus Dur, was one of the strong supporters of interest bearing loans⁵⁷² as well as a senior NU scholar, Masdar F. Mas'udi. Gus Dur explains bank interest is not *riba*, as interest is the price of the utilization of loans and productive for borrowers' business. Bank interest is more profit sharing in nature than exploitative, as compared to the practice of moneylenders. In contemporary society, we can find Nahdlatul Ulama followers applying pragmatic principles. The interest system is applied by Bank Perkreditan Rakyat (BPR) Nusuma⁵⁷³ (5 in West Java, 2 in Central Java, 5 in East Java), established by the Nahdlatul Ulama. The Nahdlatul Ulama's cooperatives (*koperasi*) are developed either with an interest system or *shari'ah* and *Baitul Mal wa Tamwil (BMT)* are operated with *shari'ah* principles.⁵⁷⁴ Nahdlatul Ulama has not yet developed a *shari'ah* bank, and many NU ulama doubt if a *shari'ah* bank is able to practice strict *shari'ah* principles.⁵⁷⁵

Persatuan Islam (Persis), another major Islamic organization, was established in 1923. The Persis jurists define usury merely as excessive profit and state that interest gained from banks and cooperatives is reasonable and should not be considered as *riba*. There are three important declarations (*fatwa*)

⁵⁷¹ Since 1997 Gus Dur shows his attitude on *riba*. As a top leader of Nahdlatul Ulama he is also the chairman of PT Harawi Sekawan, he establishes BPR Bank Nusuma and cooperatives in *Pesantrens*. He takes action to develop networks in business with conglomerates. See Suara Merdeka 28 February 1997, viewed 15 December 2007, <<http://www.hamline.edu/apakabar/basisdata/1997/03/07/0141.html>>.

⁵⁷² Institute of Culture and Religion Studies, 2000, *Beyond the Symbols: Jejak Antropologis Pemikiran dan Gerakan Gus Dur*, Rosda, Jakarta.

⁵⁷³ Nahdlatul Ulama: Tingkatkan Kinerja, 12 BPR Nusumma akan Di-merger, viewed 3 February 2010, http://www.nu.or.id/page.php?lang=id&menu=news_view&news_id=9097

⁵⁷⁴ Nahdlatul Ulama: Nusumma Kembangkan Koperasi Berbasis Syariah, viewed 3 February 2010, <http://www.nu.or.id/page.php?lang=id&menu=news_view&news_id=8540>.

⁵⁷⁵ Nahdlatul Ulama: Ulama NU Belum Satu Kata tentang Bank Syariah, 2009, viewed 3 February 2010 http://www.nu.or.id/page.php?lang=id&menu=news_view&news_id=19013.

issued by Persis related to *riba*⁵⁷⁶: Firstly, it arose from the practice common to pre-Islamic Arabia, where double the amount of interest is sometimes called for extending the duration of a loan, the sum of one hundred dirham becomes two hundred, and so on, several times. This first *fatwa* notes that such a practice could easily lead to a considerable loss of wealth on the borrower's part; such loss is unjust and forbidden. The second *fatwa*, returning a sum greater than was borrowed, is usury and forbidden. The third religious *fatwa* states that Muslims are permitted to use modern banks and to accept the interest on savings. This *fatwa* concludes that a Muslim is remiss in this obligation if he fails to accept interest from a bank and states that if a person regards it as unclean, let him give it to an orphanage or a school.

After long and arduous debates, on 24 January 2004 Majelis Ulama Indonesia (MUI) declared a *fatwa* on *riba*.⁵⁷⁷ It stated that the contemporary interest dealing in banks, insurance, cooperatives, capital market, pawnshops and individuals has fulfilled every criteria of *riba* and, as such, are *haram*. The following is the translation of the *fatwa*:

A. The definition of interest/*fai'dah*.

1. Interest is an addition (*ziyādah*) to the loan (*al-qardh*) counted to the principle of the loan without considering the purpose of the loan, counted based on time and percentage prior to the loan withdrawal.
2. *Riba* is additional (*ziyadah*) without compensation for the postponement of the payment stipulated in the contract. This is *riba nasi'ah*.

B. The law (*hukm*) of interest

1. The practice of charging and giving interest in modern times has fulfilled every criteria of *riba* that has been found since the time of the Prophet. Therefore, every financial transaction involving interest fell under the category of *riba* and *riba* is *haram*.
2. This practice is widely found in banks, insurance companies, capital markets, pawnshops, cooperatives and individuals.

C. Dealing (*mu'amallah*) with conventional financial institutions.

⁵⁷⁶ Federspiel, H.M. 2001, *Islam and Ideology in the Emerging Indonesian State: The Persatuan Islam (PERSIS), 1923 to 1957*. Brill, Leiden, Boston, Koln, pp. 302-303.

⁵⁷⁷ Fatwa Majelis Ulama Indonesia (MUI) on interest, 24 January 2004.

1. In areas where Islamic financial institutions are available, and easy to access, dealing with interest-based financial institutions is prohibited.
2. In areas where Islamic financial institutions are not yet established, dealing with interest-based financial institutions is permissible temporarily for the reason of emergency (*dharurah/hajat*).

The MUI *fatwa* was disseminated widely through the national mass media, seminars and public debates. Although Majelis Ulama Indonesia (MUI) releases *fatwa* the bank interest is *riba*, except in emergency situations, but Muhammadiyah and Nahdlatul Ulama did not automatically obey the *fatwa*. They retained their own ambiguous opinion that the payment of interest was either *haram* or *halal* or *subhah*. In June 2006 the *Majelis Tarjih Muhammadiyah* issued its *fatwa* no. 8, which declared bank interest to be *haram*. The *fatwa* is binding for Muhammadiyah followers and this *fatwa* was confirmed at the Muhammadiyah Congress of April 2010 in Malang.⁵⁷⁸

The researcher sought to determine how far the debates about *riba* at the national level influence behavior of the microborrowers and *pesantren* in the research areas. It is understood the arguments of *riba* emerge from differences in theological interpretation, schools of thought and usage of religious acts either between Islamic organizations or *ulama* inside their own organization. Differences of opinion are accepted amongst the credible *ulama* in Islam as they agree with the argument that “my idea is right but there is a possibility of being wrong, others are wrong but they have a possibility of being right”.⁵⁷⁹ These Islamic organizations maintain their hierarchy from the head office (*Pengurus Pusat*) to the sub-branch (*Pengurus Ranting*) in the villages; but as long as their opinions on *riba* are not clear and consistent, the head office will find difficulty in demanding conformity from their followers. They give opportunity to their followers to make a choice depending on the followers’

⁵⁷⁸ Republika, 22 August 2006, PP Muhammadiyah Haramkan Bunga Bank, viewed 1 January 2008, see <http://www.republika.co.id/koran_detail.asp?id=261519&kat_id=256>; and the bank interest is *haram*, see Antara News, *Muhammadiyah Tetapkan Bunga Perbankan Riba*, 3 April 2010, <<http://www.antaranews.com/berita/1270295014/muhammadiyah-tetapkan-bunga-perbankan-riba>>

⁵⁷⁹ See Perbedaan pendapat dalam Islam, Makalah Dewan Syariah DPP WI di diskusi ICMI Sulawesi Selatan 30 September 2007, viewed 6 February 2010, http://www.wahdah.or.id/wis/index2.php?option=com_content&do_pdf=1&id=895.

appreciation, benefits and needs. Meanwhile the government wants to accommodate Muslim beliefs as contributions in the reformation process, but the provision of non-*riba* banking requires the development of a branch infrastructure in the villages. The respondents in the research area are aware of the debate and the MUI's *fatwa* of 2004, but what the villagers need is practical guidance to maintain their material welfare: not just the idea but real action to support their needs, or no action talk (*ulah kalah ka omong bae*). The respondents continue to pay interest on loans from conventional banks as these loans are accessible and their local *ajengan* provides legitimacy to this pragmatic solution. They feel they are protected by *ajengan* with a personal touch without any intention to exploit their financial interest.⁵⁸⁰ The villagers are confident to follow the *ajengan's* advice instead of the national Islamic organizations' judgments.

6.2.2. Microcredit interest, a controversy with *shari'ah* returns

Although bank interest at a normal and bearable rate is the price that borrowers have to pay for the use of the loan, respondents agree that having microcredit with an interest system is rational but emotionally disturbs their Islamic convictions. There were three sets of attitudes among microfinance borrowers in the three research areas about payment of interest: those who accept bank interest, those who reject it, and finally those who do not agree with the payment of interest, but have no choice

The first group of borrowers rationalize the payment of interest as they are following the wisdom or interpretation of local *ajengan* from a local, respected *pesantren* that endorses the payment of interest, as the rate is determined by the government and the loan is used to finance *halal* business activities. The attitude of these borrowers is a reflection of the reverence to follow (*taqlid*) that many villagers attribute to the views of the *ajengan*. Some of the borrowers' thinking can be summarized in the following three points:

⁵⁸⁰ See also Qodir, Z. 2008. Islam, Muhammadiyah dan Advokasi Kemiskinan, La Riba, *Jurnal Ekonomi Islam*, vol 2, no. 1.

1. Members of cooperatives consider that the interest they pay is not *riba*, as it is determined and agreed by members and approved at the annual general meeting as well as endorsed by government regulations.
2. Borrowers accept that the interest rate is determined when the loan is agreed with the bank and that while the rate may change during the period of the loan it will not become excessive.
3. Borrowers consider that interest-based loans are beneficial in that they support the creation of employment opportunities and a cost benefit calculation is straight forward.

These attitudes are held by the largest number of borrowers in the research areas. Respondents such as *pak* Tatang Anwar and *pak* Muhamad Hidayat are examples of this group of borrowers.

Pak Tatang Anwar and his wife have been living in his village since 1971, originating from the neighboring district of Ciamis. He earns his living from agricultural production; manages fish ponds and also buys fish from other fish farmers. The discussion with *pak* Tatang and his wife shed their historical background of their struggle to come to better living as they are enjoying nowadays. They explain how the bank has supported them since the beginning of the business more than 20 years ago. BRI Unit is the only bank near his house, and he also feels they have grown together with the development of the bank. *Pak* Tatang Anwar says he pays interest on his microcredit as an obligation of a good borrower.

“I live close to Pesantren Suryalaya, and I am part of the *pesantren* community. I am familiar with bank interest in my business and in my opinion it is not *riba* because it is used for productive purposes, the interest is not an excessive burden for me and not at a double or redouble rate. I understand I am legally protected and the *pesantren* does not prohibit me to borrow money from the bank. The bank interest should be paid; it is not prohibited and the *pesantren* tells us bank interest is not *riba* (*bunga mah kedah dibayar, henteu haram, da saur ti pasantren oge sanes riba*).

My wife and I are convinced that our business is *halal* (permissible) and we feel lucky to deal with the bank”.⁵⁸¹

⁵⁸¹ Interview with Tatang, Tanjungkerta, 28 February 2006.

In the case of *pak* Tatang, we can see the influence of the local religious leader and the credibility of the Islamic boarding school that *pak* Tatang respects and trusts. *The Pesantren Suryalaya* has been operating since 1905, the *pesantren* is not only known for its Islamic beliefs but is well known with modernist scholars, contributing to the government missions, implanting honor for the country, caring for the community and economic improvement and helping the poor. The followers obey (*taqlid*) and follow the opinion (*fatwa*) given by the leader of *Pesantren Suryalaya*. The *pesantren* leaders understand there is not an Islamic bank in the area, and dealings with the conventional banks are the only opportunity the villagers have to develop their businesses and improve their livelihood.

The existing financial system is important for the villagers to support their ritual (*ibadah*) and social and cultural activities (*mu'amalat*) in local communities. These are the ways in which a Muslim achieves happiness, both in this world and in the hereafter.⁵⁸² Rituals and human interaction are the reasons why microborrowers in the research areas believe that conducting their business is part of their religious devotion.

Haji Muhammad Hidayat, one of the micro borrower respondents in Cimahi, is convinced about salvation principles after his long experience in business for more than 40 years.

"I am about 61 years old, with secondary school education living at Cibeureum village, an urban area of Cimahi Kota, encourage that doing business should be permissible and seriously looking for wealth or in Sundanese *usaha kudu halal bari soso-soso nyiar dunya*. I started my business selling rice, carried on my shoulder by walking around the area of Cimahi and Bandung. It is hard work and my business is a success. I have developed my bank relationship since 1970 and now I am deal in agricultural business, trading, communication services and transportation. I believe that my success is supported by my conviction that:

1. Business is worship, in doing business we have to apply Islamic principles for happiness and prosperity.
2. While we are young, we have to work hard and conduct a business that is *halal*.

⁵⁸²Our Lord! Give us Good in this world and good in the Hereafter...the Holy Qur'an, *ibid*, Al Baqara 2: 201.

3. We have to be trusted by everybody especially our business partners and banks".⁵⁸³.

H.M. Hidayat's way of life follows what has been determined in the Holy *Qur'an* such as the prohibition of bribery and misappropriation (Al Baqara 2:188), larceny (Al Maida 5:38), short weight and measures (Al Taffif 83:3), income from prostitution and adultery (An Nur 2-33), gambling (Al Maida 5:90), fortune telling and drawing lots (Al Maida 5: 90) and usury (Al Baqara 2:275-280 and Al Imran 3:130). These principles of morality and law reflect the spirit of Islam in business.

The second group of borrowers do not accept bank interest and have loans with *shari'ah* banks, but previously they were borrowers of conventional banks. These borrowers reside in the cities of Cimahi Kota, Tasikmalaya and Cirebon where the *shari'ah* banks have been established. They believe that the payment interest is *haram* because the rate is unfairly calculated, as it is determined at the beginning of the loan. The risk of business is on the borrowers' side, and only the lender gets the benefit. They believe that their business is *halal* because it is financed by a *shari'ah* loan.

Among this second group of borrowers with a loan from a *shari'ah* bank was *pak Idris Abas*:

"I am a public notary; I am also a lecturer in a university besides dealing as a carpet trader. I am 38 years old, used to work with a private conventional bank, living in the city of Cirebon. I am challenged by the dichotomy of bank interest and *riba* and I am yet to be convinced that the bank interest is not *haram* (not prohibited) in this modern economy. But I take a safe side of the dilemma by dealing only with *shari'ah* banks since 2003. There is an ambivalent opinion in the community that as long as the loan is not exploitative; the bank service is fast and clean, interest system is a proper system. On the other hand, people doubt if the interest is *riba* without any compromise especially after *shari'ah* banks were established in city of Cirebon. Meanwhile the people are pragmatic; they choose any system that can help them to fulfil their need of loans for business".⁵⁸⁴

⁵⁸³ Interview with Muhammad Hidayat, Cibeureum, Cimahi, 16 January 2006.

⁵⁸⁴ Interview with Idris Abas, Cirebon, 4 April 2006.

Pak Idris is much better educated than the other respondents. His own business experience and his Islamic beliefs allow him to understand what is really going on in the financial markets. He can judge if they are in accordance with his daily Islamic practice. Cirebon is a unique city, a centre of Islamic teaching since the early sixteenth century, where Islamic traditions and culture have been strongly maintained. Trading is the main activity and trading was developed 500 years ago when Chinese, Arabic and Indonesian traders were very active. It is a city where rural, coastal and urban activities have created a mixed culture of Sundanese, Javanese and Cirebonan, a city of diversity. Living in the urban area is marked by pragmatism that has influenced the attitudes of the people. *Shari'ah* principles are *pak Idris'* choice, a process of comprehension, supported by the presence of many *shari'ah* banks in the city of Cirebon.

As mentioned previously, *shari'ah* banks cannot be found in villages in rural and coastal areas. Their offices and infrastructure do not reach the village level where most Muslims are living. The *shari'ah* bank customers in urban areas of Cimahi Kota, Tasikmalaya and Cirebon are among the respondents in this study. Four customers of BRI Syariah, who used to be borrowers in the conventional interest system, described the benefit of *shari'ah* financing, although they still use conventional bank calculations, but they believe they are treated fairly, and find comfort in the knowledge that their transactions are in line with their Islamic beliefs.⁵⁸⁵ Nevertheless, these customers continue to do business with conventional banks as their business partners and customers use the conventional banking system. Their experience identifies the issues relating to *shari'ah* banking when they recognize that *shari'ah* banks need to be sustainable and profitable:

1. *Shari'ah* banks are in direct competition with established conventional banking services that establish financial benchmarks and quality of service.
2. *Shari'ah* banks need to educate the community about *shari'ah* practice and principles.

⁵⁸⁵ Interview with H. Achmad T. Cirebon, 6 April 2006, Abdullah, Tasikmalaya, 5 May 2006, Yusup Sarjuanto and Supiyardi, Cimahi, 11 May 2006.

The *shari'ah* banks recognize that in order to be competitive, they have to see the operation of conventional banks as benchmark to obtain the expected income from a transaction. It is understood that the borrower of *shari'ah* banks will find similar results and equal financial benefits as if he or she was a conventional bank borrower. Borrowers of the BRI Syariah Bank are definitely able to compare the financial benefit of a *shari'ah* bank customer with that of a conventional bank. They believe that the payment of interest is *haram* for two reasons: it is calculated when the loan is negotiated and the rate is exploitative. The respondents as Muslims understand bank interest is prohibited as *riba*, but they have to accept it to support their livelihood, even though they feel uneasy.

From an economic point of view a *shari'ah* bank is a business entity that needs net income for its sustainability. However, the differences between *shari'ah* and conventional interest systems is not only found in terms of benefit or detriment, cheaper or expensive costs but also whether the end result is right or wrong or consistent or inconsistent with *shari'ah* principles as determined by Allah *swt.*⁵⁸⁶ However, the benefits of conventional banking are based on financial considerations. In banking business practice, both systems compete with each other. Murabaha is one example. The *shari'ah* banking system as the newcomer into the market tries its best to reach similar level of costs in terms of purchase price plus a specified mark-up or profit agreed for sale transaction plus a specified mark-up (*murabaha*) in comparison to the interest rate on credit in a conventional bank.⁵⁸⁷ It means in the economy of money *shari'ah* and the conventional system offer a parallel competitive position with a similar financial result. The *shari'ah* system is attractive from a moral perspective; it gives more non-materialistic benefit consistency with borrowers' Islamic beliefs, as *shari'ah* is Allah's Will, an ascertainment, and they must definitely obey. The respondents explain *shari'ah* gives calmness in mind and peacefulness in heart and they serve by an Islamic quality of service in an

⁵⁸⁶ Gozali, A. 2005, *Serba serbi kredit syariah, Jangan ada bunga diantara kita*, PT Elex Media Komputindo, Jakarta, p. 15.

⁵⁸⁷ See the model of *murabaha* calculation. The result is similar to conventional credit transaction, in Zulkifli, S. 2007, *Panduan Praktis Transaksi Perbankan Syariah*, Zikrul Hakim, Jakarta, p. 65.

Islamic work climate. Fairness, openness, transparency in transaction and contracts give them reassurance about bank transactions so that profits are calculated based on final rather than speculative transactions.

The third group of borrowers acknowledges that bank interest is *riba*. However, in the absence of *shari'ah* banks in their area, they take out loans from a conventional bank with interest. These villagers prefer to use conventional banks rather than moneylenders as banks offer lower interest and legal protection.

Pak Lili Gazali is an example of the third group of borrowers who recognize that the payment of interest is *riba*, but have no access to a *shari'ah* bank. The necessity for survival is a “wisdom” that has persuaded him to accept a loan with bank interest.

“I trade in vegetables and freshwater fish. I am 46 years old with a high school education, living at Budiasih village district of Ciamis. With my friends, I develop a self-help group for empowerment in microbusiness within the P4K program. A three month training program was held in 1998 and since 1999 our group has been provided with microcredit. An account officer of BRI branch and an officer (*penyuluh*) from the P4K project under the Ministry of Agriculture (*Dinas Pertanian*) supervise the group of 12 people.

I am a member of an Islamic organization that clearly determines that any percentage of bank interest is equivalent to *riba* and *haram*. Besides, I have to donate regular amounts of money, as is compulsory for members of the organization. I admit the microcredit I get is very important to support my business and I have no alternative source of financing. Although I have to pay bank interest and it is ‘against’ my own belief and organization’s rules, I have fulfilled my donation and the loan urgently needed for my family to survive is the reason I accept to pay the interest. I also argue there is no *shari'ah* bank close to my village; I think it is an emergency situation I face. Then for me, bank interest is no longer a problem”.⁵⁸⁸

The case of *pak* Lili illustrates one solution to the problem of *riba*. His need to support his family and the absence of *shari'ah* finance has meant that he has accepted conventional bank finance, despite his belief and the teaching of his Islamic organization that this is *riba*. The dilemma for *pak* Lili is that he is

⁵⁸⁸ Focus group discussion P4K Budiasih and interview with its group leader Lili Gazali, 7 March 2006.

confronted by an emergency situation. He has the choice between microcredit with a lower rate of bank interest, or an exploitative rate of interest from a fierce moneylender. As long as there is no *shari'ah* bank *pak* Lili has to deal with a conventional bank.

To develop a *shari'ah* financial system banks will need to construct an extensive network of branches with competitive electronic capacity. However, if *shari'ah* infrastructure reaches the villages, the users will still be in the position to choose which system suits their conviction and needs.

6.3 Conclusion

Given the persistence of three views among microfinance borrowers in this research about payment of interest, the way out of this predicament is the establishment of a *shari'ah* banking system alongside the conventional banks. The existence of an alternative banking system provides a means to exploit financial capital for the generation of income and development of prosperity for those Muslim borrowers who reject the payment of interest, and allow this group of borrowers to comply with the *fatwa* issued by the Majelis Ulama Indonesia in 2004. However, this only becomes a real-world solution when the infrastructure for *shari'ah* banking is expanded in rural areas.

All of the respondents are Muslims and they understand why Islam prohibits *riba* as stated in the *al Qur'an*.⁵⁸⁹ Islam was concerned with protecting socially and economically disadvantaged people in the Mecca community at that time (pre-Islamic period before AD614) and after the battle of Uhud (AD625). *Riba* was practised (called *ribā al-jāhiliyya*) in the pre-Islamic period when people in Mecca were under severe conditions: high unemployment and income uncertainty, borrowers were poor; if borrowers were unable to repay the interest on their loan was doubled and then doubled again.⁵⁹⁰ It was an exploitation of the economically weak by the powerful rich. It is unjust and at that time there was no legal protection for the poor.

⁵⁸⁹ *Al Baqara* 2:278-279.

⁵⁹⁰ *Aali 'Imraan* 3:130.

Contemporary Muslim scholars have differed on whether the *riba* in the pre-Islamic period applies to modern bank interests. In comparing pre-Islamic socioeconomic conditions, the Islamic modernists explain that now the condition is totally different: debt is not derived due to poverty as for consumption needs, but instead it is used for productive purposes, profit to borrowers and community benefit.⁵⁹¹ It is based on calculated future income with a clear legal system to protect the debtor. Interest is not doubled or redoubled, if the borrower falls behind with repayments. The loan is supervised by the government and market and provided by formal financial institutions. The loans are made for microbusinesses that provide for the basic needs of the borrowers.

It would seem that locality does not determine whether borrowers consider the payment of interest as *halal* or *haram*. Rather it depends on the borrowers' interpretation of the guidance from a credible *ajengan*. And this interpretation in turn is influenced by economic circumstances and financial business needs. This raises the question for borrowers as to whether it is possible to interpret religious rules in order to support their business and economic interests. The *shari'ah* banking system is expected to resolve this dilemma, but as *shari'ah* infrastructure is not available in the villages, the controversy will continue.

The traditional rationale of interest prohibition, as declared in the *Qur'an* and *fatwa* Majelis Ulama Indonesia, reflects concerns about exploitation and injustice. It is important to protect people, their businesses, social and cultural activities as well as human dignity from exploitation by the financially and socially stronger members of the community. However, the interpretation of religious teaching and its implementation is complex and controversial as religious principles are often challenged by economic considerations.

The interpretation through *fiqh* of the Qur'anic injunctions, Allah *swt* (*subhanahu wa ta'ala*, glorious and exalte) will always provide a solution for every issue confronting believers as He imposes no difficulties for believers. This means, in case of bank interest, although *riba* is prohibited, it does not mean Allah *swt* imposes obstacles, in this case for microcredit and

⁵⁹¹ Saeed, A. 1999, *Islamic Banking and Interest*, Brill NV, Leiden, pp. 41-50.

microbusiness.God intends every facility For you; He does not want To put you to difficulties; interpretation through *fiqh* enables Muslim borrowers to accept conventional interest payments whenever it is fair, beneficial and humane. Following the *ajengan's* wisdom is another means by which Muslim borrowers in the three research areas can reconcile their beliefs with the use of conventional interest loans or to choose *shari'ah* loans, where available. The *ajengan* enable Muslims to strive for salvation in the hereafter, but not forget their welfare in this world and risk becoming infidels (*kafir*).

At a national level, bank interest and *riba* is still a controversy between Islamic jurists and Islamic organizations, but in the three research areas of this study the *ajengan* plays a dominant role in this complex issue. The *ajengan* is not bound to the dictates of any Islamic organization; his legitimacy and credibility rests on his standing in his local community. The most influential *ajengan* in this study, on the basis of their understanding of Islamic teaching, local cultural values and the economic interests of their communities, have given practical guidance on bank interest and *riba* to be followed by his *ummah*, that support the use of conventional banks and the payment of interest.

The study indicates that the *halal* or *haram* status of paying bank interest is influenced, in eyes of the borrowers, by the interpretations of *ajengan* in local *pesantren*, the views of Islamic *fiqh* experts and Islamic organizations like the Majelis Ulama Indonesia, which issued a *fatwa* in 2004. Given that these interpretations are diverse and inconsistent, the borrower has some latitude to make decisions that reflect their family and business interests.

It is interesting to note from this study how Muslim borrowers have a capacity to accept the bank interest system. This practice has lasted for more than a century and has been become part of the financial cultural system in the villages. The Majelis Ulama Indonesia's *fatwa*, which declared that bank interest is *riba* and *haram*, is quite recent. Following Archer's ideas, bank interest versus *riba* is an interesting case in point to show that where there are conflicting values, beliefs and teachings, members of a cultural system can exercise their agency and make decisions that advance their own interests.⁵⁹²

⁵⁹² Archer, M.S. 1996, *ibid*, p. 154.

With reference to Archer's ideas, we can see how the contradictory views on bank interest and *shari'ah* profit and loss sharing in Islamic values can be resolved when members of a cultural system exercise their agency to advance their own interests.⁵⁹³ The borrowers exercise agency to follow these interests and use various values and teaching to rationalize their choice. Self-interest and syncretism are entry points to accommodation and reconciliation of contradictions when Muslim borrowers need microcredit with interest payments to support their livelihood. The microfinance institutions use the revenue from their interest-based microfinance services to sustain their business. The *ajengan's* interpretation that interest-based microcredit is permissible when used for *halal* business supports both the borrowers and the business model of microfinance institutions.

⁵⁹³ Archer, M.S. 1996, *ibid*, pp. 158-159.

CHAPTER 7

GENDER AND MICROFINANCE

7.1 Introduction

The role of women in microbusiness drives the discussion in this chapter since gender is one of the social and cultural aspects which influence the treatment of microcredit applicants and borrowers by the microfinance institutions. Gender study is complex. While women have come to take on important roles in business, traditional activities and religion, they still suffer significant disadvantages in rates of literacy, employment and in larger scale businesses. From this research and other studies, two main issues have been identified that relate to gender in the research areas.

Firstly, traditional patriarchal values remain strong, except in coastal community, where it has moderated somewhat. However, these patriarchal values have been moderated by Islamic belief and traditional Sundanese culture. Sundanese men honor their women (*memuliakan perempuan*) and the need for economic survival that allows more freedom of movement for women, although a woman's position cannot be judged solely by this measure.⁵⁹⁴ A woman's income earning capacity may improve her decision about her position and influence at home, but it may not significantly change her subordinate position; it depends on how much she earns.⁵⁹⁵ Anke Niehof's study, also in West Java, indicates that women's access to greater financial resources automatically leads to a stronger position within the household.⁵⁹⁶ Women

⁵⁹⁴Kurnia, A. 2009, *Orang Sunda Memuliakan Perempuan*, Pusat Studi Sunda, Bandung, <<http://cetak.kompas.com/read/xml/2009/03/07/1548023/orang.sunda.memuliakan.perempuan>> and Saptari, R. 2000, 'Woman, family and household: Tensions in culture and practice', in Koning, J., Nolten, M., Rodenburg, J. and Saptari, R. (eds.) *Women and Households in Indonesia: Cultural Notions and Social Practices*, Curzon Press, Richmond, Surrey.

⁵⁹⁵ White, B. and Hastuti, E.L. 1980, *Different and Unequal: Male and Female Influence in Household and Community Affairs in two West Javanese Villages*. Working Paper no. 06. Rural Dynamic Study Agro Economic Survey and Centre for Rural Sociological Research, Bogor Agricultural University, Bogor, p. 39. See also *Hj Popon, Bu Amini and Hj Ambah* in this chapter.

⁵⁹⁶ Niehof, A. 1995, 'Who Benefits from Income-Generation? Some Theoretical Considerations and Evidence from West Java'. Paper presented at a conference on Indonesian Women in the Household and Beyond, Leiden; also Niehof, A. 1998, 'The changing lives of Indonesian

manage their household's money and are in a position to find opportunities for saving. In the villages, low income households save informally in a variety of ways: cash, grain and cash crops, animals, gold, silver, jewelry or other valuables, land, raw materials, construction materials and finished goods. Robinson describes the advantages and disadvantages for savers of common forms of informal saving.⁵⁹⁷ For the better off, savings accounts and various investments are provided by the banks, but for the poor, the primary need is to convert the commodities saved into cash needed for a variety of purposes.⁵⁹⁸ The emergency cash requirements of the better off, including women, are met through access to their saving accounts (*simpedes: simpanan pedesaan*, since 1984) and *simaskot (simpanan perkotaan*, from 1990 until 2005) with the BRI Units or general savings with the BPR. A savings account is the entry point to access microcredit in BRI Units or the BPR. This study found that for women who were able to save and demonstrate ability in small business, BRI Units and the BPR provided microcredit that further enhanced women's business opportunities and strengthened their economic role in the family.

Javanese customs (*adat*) recognizes women's contribution to the household economy, as explained by Geertz, and women control family finances and dominate the decision-making process.⁵⁹⁹ What Geertz, Niehof, Jay, Koentjaraningrat and before them Raffles suggest are that sociocultural and economic life in rural Java was relatively static, and that Sundanese and Javanese have maintained patriarchal values.⁶⁰⁰ However, the faster pace of

women: Contained emancipation under pressure, in *Bijdragen tot de Taal-, Land- en Volkenkunde, Globalization, localization and Indonesia* 154 no: 2, Leiden, pp. 236-258. <http://www.kitlv-journals.nl>.

⁵⁹⁷ Robinson, M.S. 2001, *The Microfinance Revolution: Sustainable Finance for the Poor*, The World Bank, Washington, D.C, vol. 1, Table 7.1, pp. 236-237.

⁵⁹⁸ Rutherford, S. 1999, *The Poor and Their Money, An Essay about Financial Services for Poor People*, Institute for Development Policy and Management, University of Manchester, p. Lxi.

⁵⁹⁹ Geertz writes, 'Since husband and wife are an economic unity, even though the wife may not participate directly in the acquisition of income, her performance of household tasks is considered part of the productive economic enterprise', in Geertz, H. 1961, *The Javanese Family*, Free Press, New York, p. 34. See also Jay, R. 1969, *Javanese Villagers: Social Relations in Rural Madjokuto*, M.I.T. Press, Cambridge, Mass., and Koentjaraningrat, R.M. 1960, 'The Javanese of South Central Java', in G.P. Murdock (ed.), *Social Structure in Southeast Asia*, Quadrangle, Chicago.

⁶⁰⁰ Koning, J. 2000, 'Different times, different orientations: Family life in a Javanese village'. In Koning, J., et al. (eds.), *Women and Households in Indonesia: Cultural Notions and Social Practices*, Curzon Press, Richmond, Surrey, p. 182.

change in the New Order period has meant that the long established economic role of women has been further enhanced.

Secondly, the gender issue relates to microcredit policies of the BRI and the BPR, which purports to be gender neutral. But in practice, in the experience of the BRI Unit's *mantri* and BPR loan officers, women with their double burden involve a higher risk, and need to be treated with the deference required by Sundanese culture and Islamic beliefs.⁶⁰¹

The Sundanese patriarchal tradition and Islam recognize that the man is the leader of the family unit and should dominate the decision-making process. This tradition is challenged by the dynamics of socioeconomic change, which makes gender relations within the family more complex. To contribute to the financial needs of the household is one of the reasons why a woman, with the accommodation of her husband, enters the business to support family income. Microcredit is one of the tools used to strengthen the economic and social position of women and also reduces financial vulnerability by increasing knowledge related to business and legal affairs, controlling assets, decision making and various social concerns such as gender mainstreaming issues.

Berninghausen's study of women's activities in Indonesia indicates more than 30% of Indonesian small and medium enterprises are in the hands of women, either alone or together with their husbands.⁶⁰² However, the more formalized and the bigger the business, the fewer women are involved. Following the national statistics less than 12% of women are involved in enterprises with 5 or more employees. In urban industrial sectors, women's participation in the labor force has increased; but the majority of women are still

⁶⁰¹ The term 'double burden' refers to the combination of women's paid employment outside the home and unpaid caring in the home for the husband, children and family; see Summerfield, P. 1992, 'Women in Britain since 1945: Companionate marriage and the double burden', in Obelkevich, J. and Catterall, P. (eds.), *Understanding Post-war British Society*, Routledge, London and New York, p. 69. Phyllis Moen describes how women perform a role as the wife/mother in the family as well as in employment. It is the combination of employment with the mothering of babies and toddlers that are especially demanding and controversial; see Moen, P. 1992, *Women's Two Roles: A Contemporary Dilemma*, Auburn House, Westport, CT, pp. 4-5. This phenomenon is also known as the second shift, as described in the study of Hochschild, A. and Machung, A. 1989, *The Second Shift: Working Parents and the Revolution at Home*, Viking, New York. 'Most women work one shift at the office or factory and a second shift at home,' p. 4.

⁶⁰² Berninghausen, J. 2001, *Towards a Gender Conducive Planning in SME Development*, ADB Technical Assistance SME Development, State Ministry of Cooperatives & SME, Jakarta, viewed 30 January 2007, <<http://www.bappenas.go.id/index.php?module=....>>.

employed traditionally in agriculture, small trading and services⁶⁰³. In the formal sector, of the 3.9 million civil servants, 38% are women compared to 62% men, but most women, are employed as teachers and nurses.⁶⁰⁴

The Indonesian government published statistics in 2010 that clearly show that women are disadvantaged: women's participation in the workforce (51.25%) compared to men's (83.58%); women's unemployment rate (7.69%) compared to men's (6.11%), women's literacy (86.8%) compared to men's (94.0%). In 2009, women received lower average monthly wages for the job with the same education level. Women are paid on average 873,103 rupiah per month while men receive 1,165,697 rupiah per month. Most women are working in the informal sector (about 70%). Women are also working in households as unpaid workers. Thirty-two out of 100 women over 15 years of age were unpaid workers in households compared to 8 (out of 100) men.⁶⁰⁵

These statistics show how women in many cases are left behind compared to men. But this is paradoxical as in other ways women have been in a relatively strong position in trading and small businesses.⁶⁰⁶ This trend has its origins in a tradition where women in Java, such as in Banten, Solo and Yogyakarta, were active in trading and in many business sectors well before the colonial period. Women have been involved in village credit systems since the

⁶⁰³ Berninghausen, J. 2001, *Towards a Gender Conducive Planning in SME Development*, ADB Technical Assistance SME Development, State Ministry of Cooperatives & SME, Jakarta, viewed 30 January 2007, <<http://www.bappenas.go.id/index.php?module=...>>.

⁶⁰³ The affects of the 1997-1998 financial crisis on female employees in urban and rural areas are reported in the Indonesia Country Gender Assessment, 2006, Southeast Asia Regional Department, Regional and Sustainable Development Department, Asian Development Bank, Manila: "The gap between the number of female employees in urban and rural areas has widened. Women have lost a significant number of paid jobs in rural areas. This is the significant finding in the context of poverty. From its height in 1997, around 4 million women had access to paid work in rural areas, and by 2003 this was reduced to around 1.9 million. In relative terms, women lost around 50 jobs (p. 13).

⁶⁰⁴ *Ibid*, p. 11.

⁶⁰⁵ Peraturan Menteri Negara Pemberdayaan Perempuan dan Perlindungan Anak Republik Indonesia, 2010, *Pedoman Perencanaan dan Penganggaran Responsif Gender Bidang Ketenagakerjaan dan Ketransmigrasian*, nomor 08/2010.

⁶⁰⁶ Lembaga Penelitian SMERU: *Upaya Penguatan Usaha Mikro dalam Rangka Peningkatan Ekonomi Perempuan (Sukabumi, Bantul, Kebumen, Padang, Surabaya, Makassar)* in December 2003, viewed 30 January 2007, <<http://www.smeru.co.id/report/research/usahamikro2>>.

beginning of the 20th century.⁶⁰⁷ Raffles reported that in the early part of the 19th century public markets were established in many places in Java where thousands of people gathered. Most were women who sold their own market produce.⁶⁰⁸ Moreover, in Java and during Raffles' time women were considered to be more astute in trade and business than men.⁶⁰⁹ The pattern of women dominating local trade is also evident in the domestic market of rural Southeast Asia from the 15th century to the 17th century.⁶¹⁰

In the villages, women make significant contributions to household income as well as bearing most, if not all, of the burden of unremunerated domestic work. Women have to take care of household members, which ultimately make production possible.⁶¹¹ Also we find the Sundanese women are familiar with commerce; they are producers and retailers in many marketplaces and are recognized for contributing to the household economy.⁶¹² The scale of women's business operations remains small, but they are self-employed and also need financing to develop their businesses. However, women face gender discrimination in political activities, in employment as administrators and managers, as professional and technical workers and real income per capita.⁶¹³

Muslim women in Indonesia are living in a traditional patriarchal system where women are considered inferior to men and therefore must be protected by them (fathers, husbands or brothers).⁶¹⁴ A woman's proper place is in the

⁶⁰⁷ Fruin, T.A. 1933, *History, Present Situation and Problems of the Village Credit System (1897-1932)*. Klaas Kuiper 1999 (trans. and ed.), Ministry of Foreign Affairs DRU, The Hague, p. 20.

⁶⁰⁸ Raffles, T. S. 1965, *The History of Java*, Oxford University Press, London, vol. 1, p. 198.

⁶⁰⁹ *Ibid*, p. 353.

⁶¹⁰ See Brenner, S.A. 1998, *The Domestication of Desire, Women, Wealth, and Modernity in Java*. Princeton University Press, Princeton, p. 265.

⁶¹¹ White, B. and Nicholas, F. 1982, *Production and Reproduction in a Javanese Village*, University Microfilms International, Ann Arbor.

⁶¹² It would seem that the Sundanese have similar customs with Javanese. For example, Hildred Geertz explains that Javanese *adat* recognize the female contribution to the household economy. She writes: "Since husband and wife are an economic unity, even though the wife may not participate directly in the acquisition of income, her performance of household tasks is considered as part of the productive economic enterprise. For this reason all goods acquired during the marriage, other than by inheritance, are thought to be community property" (*ganagini*). See Geertz, H. 1961, *The Javanese Family: A Study of Kinship and Socialization*, The Free Press of Glencoe, Inc., New York, p. 49.

⁶¹³ United Nations Development Programme (UNDP), 1995, *Human Development Report*, Oxford University Press, New York, Oxford, pp. 72-86.

⁶¹⁴ *Al Qur'an*, An Nissa, 4:34 explains that "Men are the protectors and maintainers of women because God has given the one more (strength) than the other and because they supported

house; women are too weak to deal with public matters, inclusion in household decision making, excluded in problem solving, education and marriage, and blocked from making any financial contribution to the family.⁶¹⁵ In practice, traditional patriarchal values are confronted by rapidly changing socioeconomic, cultural and technological environments that enable women to play roles not endorsed by these values. For example, the dominant role of women in coastal areas is evident when they need to make decisions when their husbands are not at home. The fishing community has a highly mobile labor force with wives often managing household finances on the land. In urban areas, women make decisions although they may consult their husbands first to show respect. In rural areas husbands make decisions about money and business matters, but always after consulting their wives. In this rapidly changing environment, gender roles and relations are adapting more quickly than patriarchal ideals.

From sociocultural point of view, in the Sundanese culture, women or mothers have a special, respected position. A Sundanese expression explains: do not praise mountains, do not praise oceans, but you have to honor your mother than honor your father (*ari munjung ulah ka gunung, muja ulah ka sagara, munjung mah kudu ka indung, muja mah kudu ka bapa*). It is virtuous to prioritize the mother and sons and daughters have to obey and seek blessings from the mother before the father.

With respect to the general policy of microcredit, both the BRI and BPR have formal policies of gender neutrality.⁶¹⁶ In accessing microbusiness, they seek to discriminate between the bankable and 'unbankable' applicants or borrowers based on their commercial capability rather than on gender considerations. The BRI Unit's *mantri* and BPR loan officers, who have direct contact with borrowers, understand the their sociocultural environment, and

them from their means". Therefore the righteous ... Neo-modernist like Nurcholis Majid and Masdar F. Mas'udi acknowledge that conventional interpretation of *al Qur'an* is based on textual interpretation. They agree that the real intention of *al Qur'an* is to guarantee equality of all humans and *al Qur'an* says that all human are the same before *Allah*; what distinguishes them is their piety or *taqwa*.

⁶¹⁵ See also Hancock, P. 2001, 'Gender empowerment issues from West Java'. In Blackburn, S. (ed.), *Love, Sex and Power: Women in Southeast Asia*. Monash Asia Institute, Clayton, p. 77.

⁶¹⁶ Bank Rakyat Indonesia, 2003, *Pedoman Pelaksanaan Kredit Bisnis Mikro PT Bank Rakyat Indonesia (Persero)*, BRI Kantor Pusat Jakarta and Bank Rakyat Indonesia, 2003, *Pedoman Pelaksanaan Kredit Bisnis Mikro PT Bank Rakyat Indonesia (Persero)*, BRI Kantor Pusat Jakarta.

they are aware of women borrowers' success in business, but also have to consider the higher risk of making loans to women as well as strict microcredit regulations. Their appreciation of what they regard as the 'double burden' carried by women make them more reluctant to give loans to women. From the perspective of Sundanese cultural values and Islamic beliefs, they support women borrowers, but at the same time they are cautious about the higher risk of granting loans to women.⁶¹⁷ Studies on the role of women borrowers in the family and the nature of their relationship with microcredit institutions is also a way of understanding how traditional patriarchal values are challenged by evolving gender roles. Where women make a contribution to family income, as previously mentioned, they are carrying the double burden of family duties and their responsibilities as a breadwinner. When they are successful as an income earner, women contribute to the material and social standing of both the family and themselves.

Under the abovementioned conditions and arguments, the researcher discusses gender issues of the borrowers that influence women's treatment by BRI Units and BPR. The discussions include why women need to support their husbands to work as entrepreneurs with risk, but simultaneously shoulder the household burden; the need for women's empowerment and the microfinance institutions' perspective on women borrowers' behaviour in gender mainstreaming.⁶¹⁸ The issues relate to the research questions: how do women find easy access to microcredit and do microfinance institutions give priority on borrowing to men rather than women?

7.2 Women and microcredit

7.2.1. Businesswomen and the housewife dilemma

⁶¹⁷ Interview with Jaya loan officer BPR-BKPD Kapetakan, 29 March 2006; Aris Purwanto, *mantri* BRI Gebang, 28 March 2006; Agil, loan officer BPR Kencana Cimahi, 17 January 2006, Yuda, *mantri* BRI Unit Cimindi, 17 January 2006, Abun Yamin, *mantri* BRI Unit Puteran, 8 March 2006.

⁶¹⁸ Gender mainstreaming is gender justice in order to enhance the role of women in various fields of development by placing priority on quality of life and women's role as well as the welfare and protection of children. See Asian Development Bank, 2006, *Indonesia, Country Gender Assessment*, The Asia Foundation, ADB, Manila, p. 31.

By studying microcredit borrowers' files in BRI Units and the BPR plus interviews with men and women borrowers in the three research areas, it appears that there were no different procedures and treatment of microcredit applicants or borrowers by the *mantri* or bank officers for either gender.⁶¹⁹ During the loan assessment process, *mantri* of BRI Units and BPR loan officers evaluate the role and reputation of both the wife and husband in business, completion of business license and assets collateral ownership. If the bank approves the loan, the loan agreement is jointly signed.⁶²⁰ The loan is administered in one joint account and registered under both names. Bound by the loan agreement, the husband and wife individually and jointly have equal authority, legally and financially, and they are responsible for managing the business and loan settlement. As there are two names, the *mantri* of BRI Units and BPR credit officers get confirmation orally or in writing from the borrowers whom they to deal with, either wife, husband or both, regarding authority to make a decision. Individual rights in can also be noticed from the first signature of the loan agreement, but more frequently it refers to business licenses or ownership of the assets collateral submitted. For this research, the respondents are borrowers who run the business, either man or woman or both, if the business is actively run together, or a woman whose husband is a civil servant or employee of a state- owned company. Among the respondents were women borrowers who have their own assets used as collateral, such as in the case of *Hj. Popon, Amini and Ambah*. From monthly loan reports BPR, men and women

⁶¹⁹ The borrower's file is based on BRI Unit or BPR regulations such as: Tugas dan Tanggung Jawab Bagian Kredit, Pedoman Perkreditan, BPR-BKPD Pagerageung, 1 January 2004; Kebijakan dan Prosedur Umum Tentang Penerimaan Dan Verifikasi Calon Nasabah Yang Akan Bertransaksi Dengan BPR Kencana Cimahi, Mei 2005; Job Description Bagian Kredit BPR Kapetakan, 5 Oktober 2001; Data Profil Nasabah yang wajib diketahui terkait Penerapan Prinsip Know Your Customers, surat BRI Wilayah Bandung kepada Pemimpin Cabang BRI seKanwil Bandung, B.73-KW-VI/OPS/02/ 2007, 20 February 2007, Model 72 Kupedes Keterangan-Keterangan Berhubungan Dengan Permintaan Kredit Umum Pedesaan (Kupedes) melalui BRI Unit, Model 70 a atau b Kupedes Laporan Penilaian Sehubungan Dengan Permohonan Kredit Umum Pedesaan (Kupedes) Serta Hasil Pemeriksaan Di Lapangan, Bank Rakyat Indonesia, 2003, *Pedoman Pelaksanaan Kredit Bisnis Mikro (PPK-BM)*, PT Bank Rakyat Indonesia, Jakarta.

⁶²⁰ In case the bank has to take charge of collateral, legally the bank has taken the safe side with regard to assets of the husband and wife after marriage (*harta yang diperoleh dalam perkawinan, harta bawaan, harta hadiah dan warisan*) as stated in the Indonesia Marriage Law, no. 1/1974, article 35.

borrowers are doing business in the same economic sectors.⁶²¹ Women tended to be involved in small-scale trade, services, handicrafts and food processing. It is understood these types of business do not require a specific skill or training and can be run from home; this makes it possible for a woman to do business and run her household simultaneously.

This section discusses how dual career respondents work, and the attitudes of three women borrowers in relation to how they balance their microbusinesses and household tasks. In the urban area of Cimahi, one of the informants was a micro-borrower, *Hajjah* Popon and her husband, who is a civil servant in the local government of Cimahi, H. Abun Bunyamin.

“I am 55 years old and have four children living at Cigugur Tengah, Cimahi. My husband, next to me, is a civil servant who is nearing his retirement. I had a high school education and various beauty care training qualifications, and have maintained my own business since 1981. The bank account is under joint names with my husband, who used to manage a catering business, a bridal salon, party rental equipment, and rental rooms. My business is running well and I received the first loan of 5 million rupiah 15 years ago, now 50 million rupiah at the time of the interview.

I worked prior to my marriage, as I have a talent for business, and after marriage I need more money for our family's livelihood. Working or doing business is normal for a woman; even now it is a necessity to get more income. I understand my husband has a responsibility to take care of the family, but in reality his income was not sufficient, especially to finance our children's education. My husband is very supportive of my business, managed from my own home, which means I can also take care of household work and pay attention to our children. I do not have any dilemma to give birth, take care of children and the home and work my business; I could manage my time, especially after the children grew up. Besides my husband's strong support, my business is suitable for a woman and I am assisted by my family and some workers that help with taking care of the family. My tax income is attached to my husband's tax file number and is managed by him”.⁶²²

H. Abun Bunyamin, Hj. Popon's husband, explains his salary as a civil servant is not sufficient to cover all monthly expenses, especially for education,

⁶²¹ Laporan Keragaan BRI Unit Cimindi, Puteran, Pagerageung, Gebang, tahun 2007, 2008, 2009; Laporan Realisasi Kredit BPR Kencana Cimahi, BKPD Pagerageung, BKPD Kapetakan 2005-2006.

⁶²² Interview with Popon and Abun Bunyamin, Cimahi, 18 January 2006.

health care and other social expenditures. He recognizes that his wife's earnings from her business are far more than his income, which is the reason he comes to the agreement that his wife has to continue her business as well as look after the house. In regards to managing her work, *Hj.* Popon has flexibility to arrange her time for her own house matters. It is different for women working in offices, factories, schools, hospitals, and shops as they are bound to working hours.

Hj. Popon has been working since before she was married when she helped with her parent's business. In fact, it has been a long empowerment process for her, as working in business is a tradition in her family, and especially since *hj.* Popon is in a business which is compatible with her duty as a wife. From her business achievements, she derives personal reward and satisfaction, but has to make some trade-offs to balance work and family; for example, during her pregnancy, baby caring and her toddler's education that needed her special attention, *hj.* Popon reduced her working hours. This is why she does not agree with the double burden issue. As a Muslim woman, she believes *Allah swt*, glorious and exalted is He, has arranged tasks for men and women; to perform house-work and care for the family is an act of devotion or *ibadah*, not a burden. It is absolutely a woman's responsibility. Here we can see how *hj.* Popon is the principal income earner in the household and her business has been sustained by microcredit, and has been accommodated within her family's religious and cultural values. She makes her own decisions in business and she has also empowered herself by her success in business. It is also a fact that her business motivation is related to her husband's low income as a civil servant.⁶²³

The hardship of life in coastal areas makes husband, wife and the whole family work hard. The husband, who is a fisherman, spends most of his time at sea. Living as a fisherman, he has an uncertain livelihood and low income. It

⁶²³ Interview with Abun Bunyamin, Cimahi, 18 January 2006. See also Peraturan Pemerintah (Government Regulation) no. 6/1974, which regulates civil servants and their wives work in private sector including their own business. Special permission is required from the civil servants superior; and Komara, R. 2007. Pembatasan PNS Dalam Kegiatan Usaha Swasta, *Jurnal Ilmu Administrasi*, vol. 4, no. 1.

forces the wife to do her best to help the family survive by running a microbusiness.

Bu Amini has been a borrower with her own collateral for more than six years. Her husband is a fisherman, who was at sea when the interview was conducted:

“I have been a fish-trader prior to my marriage and have to continue my business, as my husband’s income is not sufficient for family’s living expenses. Women working or in trading is very common in this area, women has to work hard to feed and support the family. My business generates income larger than her husband’s. My business is conducted close to my house, the reason I can manage time to take care for my housework and to see my children. Working hard is not a problem for me and I have not any dilemma between business and housework. This way of life is common here in coastal areas”.⁶²⁴

Poverty or lack of income has forced wives to work or to open a business as a source of additional or even main income. Husbands have to recognize their limitations to provide for their families in a cultural, religious and legal environment, where there is an expectation and legal requirement to be the principal breadwinner.⁶²⁵ What *hj.* Popon and *bu* Amini have been doing is common in urban areas and villages.

Women at work are also found in rural areas in a situation where the husband is not able to be an income earner. It happened with *hj.* Ambah whose husband is disabled and he expects his wife to work to earn money for their living. Ambah explains her role as follows:

“I am 53 years old with a primary school education living in this village of Pagerageung Kidul district of Tasikmalaya. I have four children, two of them in secondary school. I have worked in agricultural business since I was a young woman and this continued as my source of earning after marriage. I have been a bank borrower for more than 10 years. My husband, Suhdi, next to me, does not work or earn an income as he has a problem with his sight and is nearly blind.

⁶²⁴ Interview with Amini, Kapetakan, Cirebon, 29 March 2006.

⁶²⁵ Undang-Undang Perkawinan (Marriage Law) no. 1/1974, pasal (article) 34 (a) menyebutkan bahwa Suami wajib melindungi isterinya dan memberikan segala sesuatu keperluan hidup berumah tangga sesuai kemampuannya (A husband has to protect his wife and provide for all her household needs, according to his capacity).

I have to work and manage my business, as I am the only income earner in the family; I take over my husband's financial function. As I am self-employed, I am in the position to manage my time, I can return home whenever I need. My husband stays at home all day long but can only do limited housework. Low income and lack of tax administration in the village doesn't make taxation an issue for me".⁶²⁶

A positive point is that *h.j.* Ambah has the ability to manage all her business and make money; besides she and her husband have assets for collateral to obtain microcredit. *H.j.* Ambah recognizes her dual role in the family as provider as well as wife and mother, but she considers this as her responsibility.

Apart from these respondents, the researcher also asked other borrowers to explain the use of credit money, and the sociocultural implications for women working. This influences men's responsibilities as the family income earner and decision maker in the household.⁶²⁷

On the first issue, the researcher studied the loan and savings accounts of women borrowers, on site credit control reports, on site observations and discussions with the *mantri* of BRI Units and BPR officers to ascertain how and by whom credit is utilized. The findings indicate that the money from microcredit is received directly and controlled by the women borrowers for their own business. It is always a concern if women are merely passing on their loans to their husbands, sons or sons-in-law, with little and no access to the income generated and repaying monthly loan installments.⁶²⁸ The researcher found that women borrowers tended to keep to their agreement on microcredit. They maintained control of the business and income generated, because they accessed the market for produce or purchasing or selling goods and controlled assets.

On the second issue, all borrower respondents recognize how women as entrepreneurs and self-employed microcredit borrowers are successful in

⁶²⁶ Interview with Ambah, Pagerageung, 28 February 2006.

⁶²⁷ Interviews are also conducted with wife and/or husband: Ibu Een Rochaeni and Ir. Kusmawan, Cigugur Tengah, Cimahi Tengah, 8 January 2006; Ibu lah Sariah and Ujang Miharja, Cigugur, Cimahi Selatan, 24 January 2006; Ibu Ela Hayati and Nana, Buana Mekar, Panumbangan, 2 March 2006; Ibu Juju Juariah and Lyon Mulyono, Leuwi Halang, Pagerageung 3 March 2006; Ibu Dasini, Gebang Mekar, Gebang 30 March 2006; Ibu Ramini, Gebang Mekar, Gebang 30 March 2006; Ibu Raisa and Warno, Gebang Mekar, Gebang, 30 March 2006.

⁶²⁸ Goetz, A.M. and Sen Gupta, R. 1996, 'Who takes the credit? Gender, power and control over loan use in rural credit programmes in Bangladesh', *World Development*, 24(1), pp. 45-63.

generating income for family living expenses. They have unconventional gender roles in a patriarchal family tradition; supported by microcredit loans, the women provide support as the family breadwinner, solve problems, make decisions in business, and they are involved in their children's education. Although women succeed in business, it does not mean they change their family values. In other words, they continue to conduct their household duties, as well as treat their husbands with deference as the head of the household. They believe that working and family responsibilities are their destiny. They are grateful to *Allah swt*, glorious and exalted is He, who gives them the capability to earn money for family living expenses, money for going to Mecca and Medina, supported by the husband and trusted by the bank with repeat business. As women make a greater contribution to their family's income, does this mean that they participate more in the household decision-making process and in determining the allocation of financial resources? In discussing this sociocultural aspect, the researcher observed a range of responses, from complete domination by the wife to complete domination by the husband in urban, rural and coastal areas in this study. The spectrum of behavior can be attributed to the different cultural and religious values and economic structures that prevail in these research areas. It is argued here that local social, cultural and religious values have influenced relations between men and women, as well as in the broader community, and their relations with the lenders.

In coastal areas, where men spend most of their productive time at sea, women take the initiative in many decisions relating to household matters, even though she still pays lip service to her husband's participation. Although the husband is part of the loan agreement, the decision made by the wife is the final decision since her suggestion is normally accepted by her husband and by the BRI Unit and BPR management. In coastal areas, the men move to follow fishing seasons while the women run the family business. They manage assets, the children's education, maintain social and civil relations with local government officers, such as *Rukun Tetangga*, *Rukun Warga*, *Kelurahan*, deal with business partners, and maintain financial relations with BRI Units, BPR, cooperatives and/or moneylenders.

In rural areas, decisions on household matters and money management tend to be made by the husband. But women borrowers explain that final decisions are made with the husband's agreement. It seems that decisions are mostly made together but the husband is the dominant influence. Here their approval is only a formality in order to maintain traditional patriarchal values and reinforce women's subordinate position in society. This limits women's ability to participate openly in a publicly acknowledged manner.⁶²⁹

In urban areas of Cimahi, the women explain that they make decisions with their husband's approval. But discussions with *mantri* of BRI Unit Cimindi and loan officers of BPR Kencana indicate that women borrowers make the decisions, especially regarding microcredit matters.

7.2.2. Women's empowerment, the goal and access to microfinance

It is general practice in the banking business that a loan will be granted if the applicant fulfills the five Cs of bank assessment: character, capacity, capital, collateral and conducive economic conditions to support the borrower's business. Capacity, capital and collateral are often the weak points, especially levels three and four of the five social economic levels in this research.⁶³⁰ The capacity of an applicant to manage a small business and make a profit is considered key to microfinance success. Capacity can be developed and capacity building is a strategy to empower applicants, the poor and the low income strata, especially helping women to gain access to the bank for capital support.⁶³¹ Empowerment via training programs is an interactive process based on synergy.⁶³² Kabeer explains that empowerment is not only a process but an

⁶²⁹ See also White, B. and Hastuti, E.L. 1980, *Different and Unequal: Male and Female Influence in Household and Community Affairs in two West Javanese Villages*. Working Paper no. 6. Rural Dynamic Study Agro Economic Survey and Centre for Rural Sociological Research, Bogor Agricultural University, Bogor.

⁶³⁰ See Table 5.8, Chapter 5.

⁶³¹ SMERU found that women had poorer access to loan facilities than men. See Laporan Penelitian SMERU 2003, Buku I: *Peta Upaya Penguatan Usaha Mikro/Kecil di Tingkat Pusat 1997-2000*, Jakarta, viewed 11 February 2007 <<http://www.smeru.or.id/report/research/usahamikro/BUKU.....>> p. 2.

⁶³² See Freedmen, J. 1992, *Empowerment: The Politics of Alternative Development*, Blackwell, Cambridge Massachusetts and Perkins, D.D. and Zimmerman, M.A. 1995, 'Empowerment theory, research and application', *American Journal of Psychology*, vol. 23, pp. 569-79, viewed 10 February 2007 <<http://www.people.vanderbilt.edu/douglas.d.perkins/.....>>.

end result.⁶³³ Empowerment of women is important to support their bankability and enable equal participation. This is found in the P4K program, which is gender neutral and provides empowerment for men and women. The training programs are designed with women in mind but men can also take advantage of this program to manage their own business affairs, building self-confidence in order to become self-reliant.⁶³⁴ The P4K program was established in 1980 but was discontinued in 2005. It was a self-help group lending scheme covering a wide range of activities from livestock and fisheries, petty trade, handicrafts, agricultural processing and crop agriculture. The program was designed to support poor men or women as smallholders, farmers, farm workers and fishermen who had no collateral, with no hope of obtaining a bank loan. The program was based on the principle of gender equality, but in practice women constituted the majority of participants. For example, in 2005 in the West Java and Banten provinces, 60% of P4K small business groups were women. In 12 provinces in Indonesia there 35.7% of these groups were exclusively women and 32.7% were mixed groups.⁶³⁵ Women stayed at home and did the housework but they still had time for business dealings. Women find it easier to communicate, are disciplined and they are expected to be present at empowerment gatherings. They are patient and eager to learn.⁶³⁶ The researcher assumes that more women than men in the P4K program does not mean the program is women centered; it is to raise the standard of living among the poorest rural families in Indonesia and there are more poor women than

⁶³³ Naila Kabeer argues that empowerment is related to three things: access to control of resources, the ability to use these resources to bring about new opportunities, and the attainment of a new social outcome. See Kabeer, N. 1999, 'Resource, agency, achievements: Reflections on the measurement of women's empowerment'. *Development and Change*, vol. 30, no. 3 July 1999, Blackwell Publishing, viewed 13 February 2007 <<http://www.ingentaconnect.com/content/bpl/dech/1999/00000030/00000003/art00002;jsessionid=gbzx6e7d6tax.alice>>.

⁶³⁴ One of the P4K guiding principles is a total family approach, where guidance is given to the husband, wife and children impartially – all learn, all develop. P4K is an income-generating project for marginal farmers and landless people in Indonesia designed for men and women. It operates as a credit scheme, which is run by the Ministry of Agriculture <www.tve.org/ho/series2/outoftheforest.htm>.

⁶³⁵ See *Laporan Akhir Pelaksanaan Proyek P4K Fase III-RIGP 1998/1999 – 2005 (West Java RIGP Completion Report) 2005*, Satker Peningkatan Pendapatan Petani-Nelayan Kecil (P4K) Propinsi Jawa Barat dan Banten, Lembang.

⁶³⁶ Interview with Sri Haryati, *Pemimpin Grup/Group Leader* of P4K Melati Putih, Cipeujeuh Wetan, Lemah Abang, Cirebon, 1 April 2006.

men. Most men have been working to earn a living either in or out of the village. Women are still at home and they are interested in earning an income for the family.

Empowerment was explored in focus group discussions in urban, rural and coastal areas in West Java province where women constituted the majority of P4K group participants. The *penyuluh* (the Department of Agriculture official responsible for program coordination) selects participants with the objective of creating a group who have a similar way of life, live close together and know each other.⁶³⁷ They are poor and bankability is not the requirement, but they want to improve their quality of life. The leader of the group is selected by participants based on his or her ability to lead and understand members' needs. The focus groups were drawn from the following P4K programs:

1. P4K Melati, Village Padaulun, sub-district Majalaya, district of Bandung, a group of 10 members, 6 of whom are women, established in 1993. They are sellers of rice, vegetables, fish and oil, and trading material for curtains.⁶³⁸ The group leader is Ernawati.
2. P4K Cihideung II, Village Budiasih, sub-district Sindangkasih, district of Ciamis, a group of 12 members, 7 of whom are women. They work as farmers and sell vegetables, food processors, sundries and ready-made clothes; they are also chicken farmers and fishermen. The group was established in 1999.⁶³⁹ The group leader is Lili Gozali.
3. P4K Melati Putih and Sukamaju II, Village Cipeujeuh Wetan, sub-district Lemah Abang, district of Cirebon, two groups of 13 members with 9 women. They work as fruit sellers, caterers, and they sell sundries, foods and cake processors. The group was established in 2001.⁶⁴⁰ The group leader is Sri Haryati.

When fieldwork was in progress, the P4K program was in its last stage, having been implemented in 1998 until 2005.

⁶³⁷ The program is executed by the Agency for Agricultural Education, Training and Extension (AAETE) in the Ministry of Agriculture, which works at the field level through a wide network of field extension workers (FEWs) or *penyuluh*.

⁶³⁸ Focus Group Discussion, P4K Melati, Padaulun, Majalaya, 25 January 2006.

⁶³⁹ Focus Group Discussion, P4K Cihideung II, Budiasih, Sindangkasih, Ciamis, 7 March 2006.

⁶⁴⁰ Focus Group Discussion, P4K Melati Putih and Sukamaju II, Cipeujeuh Wetan, Lemah Abang, Cirebon, 1 April 2006.

The focus group discussion about the empowering process can be summarised as follows:

1. The participants were organized in groups established after the local government identifies them as “poor” people (yearly per capita income equivalent to 320 kg of rice) based on where they live, community structure and their wealth ranking. In fact, most group members (averaging 62.5% in the research areas) are women and participants admit the selection is fair. Female members say they are lucky to participate in the program. Group development increases self-confidence through a process of study, and an exchange of experience and business networking.
2. The first six months are allocated to empowerment training, which covers group dynamics, microbusiness planning preparation, and understanding micro enterprise development. All group members found the training materials were sometimes complex and theoretical and consumed a lot of their time. The women found it difficult to comprehend the training materials because they had only reached primary school education.
3. Capacity building towards self-reliance is supported by non-collateral credit facilities with program funds routed through BRI branch offices at a maximum of 2 million rupiah per borrower. The participants thought the P4K loan application process was difficult and took too much time to be approved. This non-collateralized credit requirement is important for poor women and men, as the lack of assets collateral is their weakness. The P4K program participants are selected by the *penyuluh*, the Department of Agriculture official, but loan applications are evaluated by BRI branch account officers.
4. In day-to-day operations, P4K borrowers are guided and supervised by a *penyuluh* supported by a BRI branch account officer. Evaluation of the groups’ activities prior to the first loan application is monitored after six months and followed by monthly monitoring. The women thought the gatherings were useful, but time consuming. During the program, capital and marketing constitute the borrowers’ main problem, given that they

have only a limited business network at the village level. As they have limited capital, they are anxious, but they realize the program is run carefully, and their business development depends on a P4K program loan.

5. The participants understand that the program is limited, but they consider themselves fortunate to have been supported in their business activities. They would like to access a bank directly or individually without any assistance from the program. The women particularly feel comfortable, having worked together in a group for so many years, and this makes them reluctant to deal individually with the bank. They are also concerned that the the P4K program has been discontinued; they are uncertain about the possibility of repeat business as a group with the bank⁶⁴¹. BRI understands the benefits of the P4K program. And since 2003 the BRI has designed loans for groups and individual microcredit followed by *Kredit Usaha Rakyat (KUR)* through BRI Units. Following the success of the P4K program ex-members are often unable to access a new loan as they have to comply with BRI commercial requirements.

Post the P4K programs, participants in local programs were exposed to different experiences in their endeavors to continue micro-finance loans for their businesses, as the following examples illustrate:

1. P4K Melati, Padaulun, Majalaya: the bankable members of the group have been provided with individual KUR micro loans from the BRI Unit.
2. P4K Budiasih, Sindangkasih, Ciamis: the businesses were reported to still be running well, and individual members had been given KUR micro financing through BRI Units in Sindang Kasih.

⁶⁴¹ In fact Bank Rakyat Indonesia has designed a special scheme at their risk called *Kredit Kepada Kelompok dan Gabungan Kelompok Usaha Kecil/KKGUK*. This scheme supports groups of P4K, established for a minimum of two years, with success in their business with loans to a maximum of 5 million rupiah per member. It is a commercial loan, but provides an opportunity for a member who cannot provide collateral to join group guarantee under the loan agreement he or she signed. See Bank Rakyat Indonesia *Surat Edaran/Circular Letter* NOSE: 4-DIR/PRG/03/2003, 31 March 2003. This type of loan to group borrowers (KKGUK, ex P4K, KPKU, KPTTG-Taskin) –*Kredit Kepada Kelompok Usaha Kecil (KKUK)* is a commercial loan for better-off borrowers. See *Surat Edaran/Circular Letter*, NOSE: S11-DIR/ADK/04/2007 dated 24 April 2007. Since 2008 *Kredit Usaha Rakyat (KUR)* has been relocated from BRI branch offices, and this has enabled successful ex-P4K customers to access BRI Units.

3. P4K Melati Putih and Sukamaju II, Cipeujeuh Wetan, Cirebon: the group members have been supported by the local government and prefer to continue working as a group, instead of obtaining individual KUR microcredit from the local BRI Unit.⁶⁴²

From these P4K programs and from a gender perspective, women and men benefit equally in accessing the program, having opportunities for empowerment or training, and risks and transaction costs are reduced through self-selected joint liability. Peer pressure creates social solidarity, generating a cost-effective outreach in order to minimize paperwork and misuse of loan monies.

Interviews with individual members following focus group discussion gave the researcher a description of the benefit of experiences and of individual effects of the P4K program to women borrowers. Ibu Aning, Dede Roslina and Sri Haryati discussed their activities in the group and these experiences were noted as follows:

Ibu Aning is 31 years old from Padaulun village, district of Majalaya, with an elementary school education. Before becoming a member of the Melati group, she had a small stall (*warung*), but her life was quite difficult. On joining the P4K program she received various and difficult training to develop the business but the most important aspect was that the bank granted the loan. Since she received the loan, she could buy more daily goods from villagers such as rice, spices, instant noodles, salt, sugar, salted fish, cakes and various processed foods. This helps her to increase the business and her income and to have a better life, especially for her family.⁶⁴³ Ibu Aning considers that she enjoys a better life with increased earnings as a result of the loan.

Ibu Dede Roslina lives in Budiasih village, district of Ciamis. She is 40 years old and a member of the Cihideung II group. On empowering of women she explains: I produce and sell ready-made clothes, including Muslim dresses, and embroidery. After I joined the group, I received training and a loan, the business increased and my life got better. I can now afford to produce more through my workers or ask my neighbours, which enables me to sell more goods in the village and in the district market. Training in the group is very important for me; it increases my self-confidence to do business. Women working and

⁶⁴² Report from BRI West Java Region (Kantor Wilayah), Bandung, 5 August 2010.

⁶⁴³ Interview with Aning, Padaulun, Majalaya, 25 January 2006.

doing business is common here in my village. Unemployed women or those who do not have a will to work are called 'lazy women' and 'unproductive'. Women are equal to men; women have to work to support the family.⁶⁴⁴ Ibu Dede Roslina creates employment by increasing other workers' involvement in her business.

Ibu Sri Haryati is head of the Melati Putih group at Cipeujeuh Wetan village, Lemahabang, district of Cirebon. She is an active 60 year old. Her main activity is to process and sell ginger drinks, salt-fish cooked in banana leaves, cakes and various fried foods. She says that training within the P4K program gives me a better understanding of how to organize, team building and working together between members of the group and to maintain money-administration. When the group started obtaining the loans my production increased considerably, it gave me more income to have a better life. I feel better now because I can help my younger friends to develop networks for their businesses. I can also associate with others in the community, and I can voice my opinion at meetings. The bank informs us that the P4K program will be stopped, but we do not know how to get loans to develop our businesses without guidance from the program.⁶⁴⁵ She considers that the program has helped her increase production, boost self-confidence and broaden her business networks.

On the basis of focus group discussion and interviews with individual members and with the *penyuluh* together with information from BRI account officers, the three groups of P4K faced a number of challenges: 1) the problem of distance and bureaucracy with the BRI branch offices. The group wants to locate the program closer to poor customers, with loan approval channeled through BRI Units instead of the BRI branch offices; 2) the program distributed loans equally among all members but in fact the needs of members are different, depending on the size and type of business. The group recommends that the loan be distributed on varying terms and maturities of lending within the group; 3) the borrowers explain that loan money is needed and used for two or more activities, and even for emergencies and consumption, but with a good repayment result. The members of the group would like to have the banks' permission to use credit for emergency circumstances; 4) a *penyuluh* has asked for asset collateral that has been compiled by *Ketua kelompok* or the head of

⁶⁴⁴ Interview with Dede Roslina, Budiasih Ciamis, 7 March 2006.

⁶⁴⁵ Interview with Sri Haryati, Cipeujeuh Wetan, Lemahabang, Cirebon, 1 April 2006.

the group. The other members of the group have to fulfill installments properly. This means the solidarity is also built based on financial pressures from a group head.

The women P4K respondents also discussed the positive impact of empowerment, which provided access to microcredit that broadened their vision in business, developed trust from their husbands to manage all the loan money, and supported their empowerment. As a result of their improved position, some of the women wanted their husbands to play an increasing role in family financial decisions. They were aware that their own social status in the village community had improved because of their participation in the group and the provision of credit. They are trusted by the bank and they are starting to leave poverty behind. However, male respondents explained that women that develop greater self-reliance make them worry about their traditional standing. Participation in the group and access to microfinance changes the role of women in the household. The women feel they are in a “stronger” position in the family and less dependent on their husbands. These findings indicate that “the poor”, in this case represented by members of P4K groups, gain access to the BRI branch office, benefit from their empowerment training and succeed in small business. Without an empowerment training program recognized by the banks, these men and women will have difficulty in accessing the microcredit they need. These findings relate to the key issue of microcredit accessibility, in that poor women access loans as long as they are able to fulfill microfinance requirements and after empowerment training. This training is gender neutral as it provides easier access to microfinance for both women and men. However, empowerment and success as group members of the P4K program did not automatically make participants bankable, as the BRI maintains its own bankability requirements.⁶⁴⁶ The issue is whether an ex-P4K group borrower

⁶⁴⁶ BRI has designed the KUR Linkage Program to facilitate potential applicants from participants in programs like the Badan Kredit Desa (BKD), Koperasi Simpan Pinjam (KSP/USP), *Baitul Mal wa Tamwil* (BMT) and Lembaga Keuangan Mikro (LKM), as long as there is no problem with the repayment of debt. The KUR micro loans provide a maximum of 5 million rupiah at 16% interest per year for a three-year term. The cash flow of the projects financed must be able to cover all liabilities to the bank. Additional collateral is not obligated to be fulfilled. See Retnadi, D., 2008, People based small business loan KUR: Prospects and

can become a BRI Unit customer, which represents a shift from being a group borrower to becoming an individual borrower. The bank assesses the applicants' capacity to make this shift together with the bank loan amount and collateral and other legal aspects such as a business license. Ex-P4K applicants have to fulfill the five C's in loan assessment, which constitutes the basic standard for commercial microcredit in BRI Units.

7.2.3. Microfinance institution's relationship with women borrowers

There is a cultural disposition and influence of Islamic belief in Sundanese society to see the wife and husband as a team, working together for the good of the family together with the Sundanese respect for women.⁶⁴⁷ The research indicates that issues of gender risk, collateral availability and fulfilment of financial requirements determine bankability and women's access to a microfinance institution. The role of gender is reflected in the decision-making process. Household matters are influenced by local sociocultural practices and religion, but the final decision still "needs" the approval of the husband, although basically the money for day-to-day expenses is held by the wife. One reason for this spirit of teamwork is the impact of financial decisions on assets growth during the marriage as this influences joint assets (*harta gono-gini*).⁶⁴⁸ Although the man is the protector and leader of a family, the legal aspect of a marriage requires equal participation of men and women in all household activities.⁶⁴⁹ Wives and husbands have the same rights, responsibilities and opportunities, especially in assets development. Women are still at a disadvantage, and in order to be self-employed, poor women need empowerment training and financial support to play a greater role in the family.

Yet, as is the case everywhere in Indonesia, there are gendered discrepancies between the ideal and the reality. This is clearly the case with

challenges, *Economic Review*, no. 212, <www.bni.co.id/Portals/0/Document/Loan%20KUR-June2008.pdf>.

⁶⁴⁷ Ekadjati, E. S. 1995, *Kebudayaan Sunda: Suatu pendekatan sejarah*. Pustaka Jaya Jakarta and Marlina, I. 2006. Kedudukan wanita menak dalam struktur masyarakat Sunda (Studi kasus di kota Bandung). *Sosiohumaniora: Jurnal ilmu-ilmu social dan humaniora*, 8(2), pp. 182-204.

⁶⁴⁸ Indonesia Marriage Law, no. 1/1974, article 35.

⁶⁴⁹ Married women challenge discrimination in access to credit. Article 108 of the Indonesian Civil Code impedes married woman from entering into contracts on their own behalf. It requires the husband's presence or permission.

women's access to credit. The average proportion of female clients served by major microfinance institutions has remained fairly constant at 25% over 20 years, indicating no improvement in women's access to microcredit⁶⁵⁰. Some studies indicate that the share of women borrowers at the Bank Rakyat Indonesia is lower and in fact has declined from 24% in 1996 to 18% in 2002.⁶⁵¹ The main obstacle for women's access to credit is lack of collateral and legal status in contracts. In the three research areas, the BRI Units, branches and BRI Head Office do not give special access to women borrowers and banks do not collect data on the gender of their borrowers. Borrowers are thus mixed and registered without a gender indicator in BRI credit reports. A similar situation is also found with BPR. This is inconsistent with a Bank Indonesia regulation instructing commercial banks, including BPR, to record the gender status of their borrowers in their monthly microcredit report.⁶⁵²

The following narratives present the business risk of two women borrowers, *bu Patona* and *bu Tiah*. The first is *bu Patona*, the wife of a fisherman. She is one of the borrowers at the *BPR Kapetakan*, where the majority of borrowers are women. Like other women borrowers in this coastal region, her business is not exclusively related to fishing. She also runs a stall (*warung*).

Bu Patona is 42 years old, with a primary school education, living in the village of Bungko Kidul, Kapetakan, a coastal area of Cirebon; she is a fish-trader, who buys from fishermen in addition to the catch from her own boats. She describes her experience dealing with the bank as follows:

⁶⁵⁰ Asian Development Bank, 2006, *Indonesia, Country Gender Assessment*, The Asia Foundation, ADB, Manilla, p. 18.

⁶⁵¹ Ravisc, R.M. 1999, Searching for Sustainable Microfinance: A Review of Five Indonesian Initiatives' Development, Economics Research Group, Indonesia, p. 30 viewed 15 February 2007, <<http://www.worldbank.org/html/dec/Publications/Workpapers/WPS1800series/wps1878/wps1878.pdf>> and Khawari, A. 2004, 'Microfinance: Does it hold its promises? A survey of recent literature, Hamburg Institute of International Economics (HWWA) Discussion Paper no. 276, Table 2, pp. 15-16, viewed 15 February 2007 <http://www.hwwa.de/Publikationen/Discussion_Paper/2004/276.pdf>.

⁶⁵² Circular Letter of Bank Indonesia to all banks (*Bank Umum*) and Bank Perkreditan Rakyat no.3/3/BKr dated 16 January 2001 instructed that the monthly report on microcredit should indicate the gender status of the borrowers.

“I ran my business long before my marriage and have continued as my husband’s income from his fishing and coastal ponds are not sufficient and uncertain. I have to earn my own income to finance my household expenses, especially education for our children. As I have assets, a land and a house where we live, and also a car, I asked the bank for a loan. I had to try hard to convince the bank of my experience, my capability to repay the loan, and the benefit of creating employment. I had to come, to see and negotiate directly with the bank. It took some time until my loan was approved. Now my loan has lasted for more than 10 years. The loan is my own responsibility; I have to manage all of my income, as I do not trust my husband to manage my money. I am afraid the money is misused by him for other purposes such as gambling, drinking, and entertainment, or even to remarry.

I recognize I am well treated and supported by the employees and management of the bank; besides, the bank officer comes on a regular basis to see my business and to give advice. I feel there is no difference in treatment between women and men customers by the bank. In fact my business runs well and I get repeat business. The bank also asks my opinion on other applicants from my area”.⁶⁵³

It is understood if the microcredit supports *bu* Patona’s business, she has increased her independence from her husband through the capacity to earn income and to manage household money. However, microcredit means *bu* Patona must consider financial and legal obligations that necessitate involving her husband in decision making.

In the opinion of the bank loan officers, fishing is a relatively high risk business. Fishermen have a harsh living as they have to contend with variable seasons, periods of fish shortage, and competition with others; fish are perishable with a low price. Women in the coastal areas have to work hard to support the family and they cannot depend totally on their husband’s uncertain income. They continuously live with poverty. In the coastal areas, the bank usually deals with women as their husbands are not at home and are difficult to contact. This is one of the reasons why, among the informants, there were more women borrowers than men in the coastal areas in comparison to urban and rural areas. Thus far, *bu* Patona maintains a good track record with the BPR

⁶⁵³ Interview with Patona binti Sarmita, Kapetakan, Cirebon, 29 March 2006.

although the bank realizes it is very risky to provide microfinance for fishing and trading.

The second case is *bu* Tiah. A projected ability to generate income and a willingness to pay is not sufficient for *bu* Tiah Rakhmawati to get a loan from a BRI Unit or BPR. She is 38 years old with a high school education; she used to work in a textile factory and then developed her own ready-made clothes business. She has the opportunity to be a member of the P4K program living in Sindangkasih village, district of Ciamis.

“I believe working is important in my life; it is not only imperative to get an income to finance my household needs but also I understand working is worship (*ibadah*). Working and business should be performed seriously and in a manner considered *halal*. My ready-made clothes business is not running well as I need more working capital; and I receive information from my business colleagues that the bank always asks for assets collateral for any loan granted. I had no way out, until I joined a group of a P4K program with BRI. The bank provides me with microcredit without any physical collateral that makes my business run better. However, I hear that the program will end, and it makes me worried about how to get a new loan, as I have no collateral to comply with the bank conditions”.⁶⁵⁴

Women and men borrowers in the P4K program found that the program was very supportive of their businesses. It is not only an empowering process for the poor but mainly the P4K microcredit support is available without any assets collateral. The responsibilities of the BRI to assess the collateral depends on program regulations, with some programs having less stringent conditions than the BRI's own commercial microcredit loans.

Another weakness of this poverty alleviation scheme is the dependence on government subsidy, which enables a lower rate of interest and a longer period for repayment. P4K funding finished in 2005, which means no new loans have been available and existing loan have to be repaid. Experience from many poverty alleviation programs with government or foreign donor subsidies indicates these programs will be stopped whenever funds are no longer available or the government decides to terminate the program.

⁶⁵⁴ Interview with Tiah, Sindangkasih, Ciamis, 7 March 2007.

Successful borrowers in poverty alleviation programs ideally should be able to continue with loans from a commercial microcredit institution. The leader of one P4K group acknowledged that he had to provide collateral to the program manager or *penyuluh*. Basically collateral, although this does not constitute the full value of the loan, is still a key factor for loan assessment and the strategic issue in microcredit. However, there is a BRI microcredit scheme designed without any collateral (*Kredit Usaha Mikro Layak Tanpa Agunan/KUMLTA*), but branch offices are strictly limited in their capacity to grant this type of loan facility.⁶⁵⁵ The moral hazard is a high pressured situation and BRI branch managers are not in a position to take the risk.

The next issue is the problem of collateral which enables borrowers to be classified as bankable. Women borrowers complain of an absolute requirement for collateral. It challenges both male and female applicants such as *pak* Sisera, a 56-year-old man living in the village of Gebang Mekar, a coastal area in the district of Cirebon. He has a primary school education, and he has been a fisherman since he was a boy.

“I wish I was rich, I am tired of being a poor man. I want to be a *juragan* (fishing boat owner) but the banks never trust me because I have no collateral to get their loan”.⁶⁵⁶

The researcher met *bu* Een and her husband *pak* Kusmawan in their house at Cigugur Tengah village, district of Cimahi, and discussed bank requirements for women borrowers. The discussion is noted as follows:

⁶⁵⁵ This KUMLTA scheme is designed to implement the program of state-owned enterprise funds placement in the BRI, calculated on the basis of a 10% maximum risk of bad debt; see *Surat Edaran/Circular Letter* BRI no. B-658-DIR/PRG/08/04 of 20 August 2004. To avoid the wrong public perception of ‘loan without any collateral’ and the moral hazard the name of the loan scheme has changed to *Kredit Kepercayaan Usaha Mikro/KKUM* as stated in *Surat Edaran/Circular Letter* BRI no. 01-BRI/ADK/03/2005 of 30 March 2005. KUMLTA policy was suspected of being designed with ‘political flavor’ to give ‘a positive image’ of government intention to support poverty alleviation following the 2004 legislative election on 5 April, and the presidential election on 5 July 2004 and 20 September 2004. From a financial point of view the branch officers are reluctant to implement the loan, as it is risk related and the loan concessions provided in KUMLTA disturb the existing microcredit market. It was also found that KKUM was not a loan scheme for the poor, but used instead for productive business purposes at the maximum assets of 200 million rupiah excluded land and buildings.

⁶⁵⁶ Interview with Sisera, Gebang Mekar Cirebon, 30 March 2006.

Bu Een is 50 years old; she has developed a ready-made clothes business, selling sewing materials such as buttons and threads; she sells cakes and processed foods, operates a public phone kiosk and rents 14 rooms to the factory workers close by. Her husband, who joins the interview, has a service business repairing water pumps and produces water filters.

They have been dealing with the bank for more than 15 years. Bu Een maintains day-to-day contact with the bank and she feels bank employees and management take care of female customers and she does not find that men are treated differently. Although women are treated equally with men to fulfil loan requirements, she considers that women borrowers are treated somewhat better and often prioritized for service.⁶⁵⁷

Bu Een complied with the bankability criteria of BRI Unit Cimindi. Men and women borrowers are challenged by equal requirements. Borrowers' bankability can be measured through financial calculation and collateral to cover financial risk, but this also involves an assessment of character of the applicant. It is also the responsibility of the BRI *mantri* to make this subjective assessment of creditworthiness.⁶⁵⁸

Bankability is gender neutral and gender does not directly determine bankability. Although women's empowerment reduces gender inequality, men and women have to meet the same criteria on bankability as commercial requirements. In human relationships with *mantri* of BRI Units or BPR loan officers; it seems women consider they receive "better" non-financial treatment than men, reflecting Sundanese tradition and Islamic belief to respect women and mothers. The bank officers recognize and respect that women borrowers carry a double burden.⁶⁵⁹

These cases indicate that women have to meet the same financial requirements as men in the screening process to fulfil all terms and conditions to qualify as a borrower of BRI Units or BPR. The banks' requirement for collateral is strictly adhered to by men and women. However, as the bank

⁶⁵⁷ Interview with Een and Kusmawan, Cigugur Tengah, Cimahi, 18 January 2006.

⁶⁵⁸ Interview with Nandang Suhendra, BRI Unit Cimindi manager and *mantri*. Yuda, 18 January 2006.

⁶⁵⁹ See also Smyth, I. 1992, 'Indonesian Women as (economic) mediators, some comments on concepts', in van Bermelen, S (eds.) 1992, *Women and Mediation in Indonesia*, KITLV Press, Leiden, p. 43.

officials consider women a greater financial risk, it seems that bank regulations are stricter for female borrowers.

From the *mantri* of BRI Units and BPR officers' point of view, they consider that they understand their institution's gender equality policy. The officers are all Sundanese Muslims and, following the Sundanese culture, they are well mannered and modest (*berperilaku sopan dan rendah hati*), and apply Islamic principles to appreciate and respect women. The experience and attitudes of BRI *mantri* and officials about gender issues they encounter are reflected in the following summary of discussions.

1. The borrowers want less collateral value.

Pak Yuda is a *mantri* of BRI Unit Cimindi. He explains that collateral is always a frequent issue of protest by the *kupedes* borrowers.

Yuda explained: "Women borrowers' complain that they are treated unfairly and ask the bank to reduce the collateral requirements especially after the scheme for small loans ('small-Kupedes/K3') was introduced with a maximum loan of three million rupiah".⁶⁶⁰ This scheme was intended for borrowers with fewer assets to offer as collateral. The detail of collateral is specified in the loan agreement without submission of any formal document of ownership. Yuda adds that male borrowers and female borrowers ask the same question, but the female borrowers tended to be more persistent and critical of the bank for taking their assets 'hostage'. Yuda says he needs a lot of patience and tolerance to explain to women borrowers more fully than to men".⁶⁶¹

2. The applicant pushes to get faster access to a larger loan.

Pak Nandang is the head of BRI Unit Cimindi; he describes his experience, anticipating the behavior of new and old borrowers, both women and men.

"I visited a new borrower who pushes the bank to get an immediate loan approval. His application is processed as the bank needs some time to do the final assessment.

⁶⁶⁰ There are microcredit schemes designed with collateral dispensation. The first 1 million rupiah scheme was announced on 16 December 1999, subsequently the size of loans was increased. Bank Rakyat Indonesia *Surat Edaran*/Circular Letter BRI no. S.64-DIR/MKR/12/99; 2 million rupiah in 12 November 2001, *Surat Edaran*/ Circular Letter BRI no. S.28-DIR/MKR/11/2001 and increase up to 3 million rupiah since 16 October 2003 *Surat Edaran*/Circular Letter BRI no. S.27-DIR/MKR/10/2003.

⁶⁶¹ Observation and interview with Yuda, BRI Unit Cimindi, 30 January 2006.

Double checking of the assessment is needed to convince the bank that the decision is right. External information on an applicants should be rechecked as my experience indicates that frequently 'bad-borrowers' from other banks try to push hard to get a higher loan limit. A similar experience happened with the old borrowers who intimidate the bank officer by threatening to move to another bank if the loan limit is not increased.

In my experience female applicants do not dare take the risk of this kind of 'bad behavior'. I believe that women basically have good intentions in protecting themselves; they are closely involved with their home and family and resist taking risks. On the other hand, based on my long experience, every borrower has a certain capacity to absorb the loan. Financing a 'wrong borrower' and exceeding the loan limit brings risk to the bank, and usually the bank refuses this additional loan".⁶⁶²

3. Poor women are looking for effective means to build their capacities and their access to information and markets.

It is evident from interviews with BRI branch account officers, Kusnadi, Cimahi branch and Akhmad, Majalaya branch; Een Hendarli and Endang Softina, Ciamis branch; and Panjaitan, Cirebon branch that in BRI there is no specific credit scheme designed exclusively for women, neither microcredit Kupedes, credit retail, nor corporate credit.⁶⁶³

"Our understanding is that BRI loans are for men and women and their access to the credit depends on the bankability of the applicant based on their capability.⁶⁶⁴ Also other government funded programs do not have any affirmative action for women. It is the clear policy of the BRI that men and women applicants are treated equally".

On P4K program: "Although the majority of participants are female the program is gender neutral. The greater participation of women reflected the fact that women are the majority of poor people in the villages. Both male and female participants need empowerment training to increase their eligibility for credit. All the bank officials interviewed confirm that most members of the three P4K groups were women. They feel that the women are still bound to their household work and need more support for their

⁶⁶² Interview with Nandang BRI Unit, Cimindi, 13 February 2006.

⁶⁶³ Interview with Kusnadi account officers, BRI Cimahi branch and Akhmad, account officer BRI Majalaya branch, 25 January 2006; interview with Kusnadi account officers, BRI Cimahi branch and Akhmad, account officer BRI Majalaya branch, 25 January 2006; interview with Panjaitan account officer BRI Cirebon branch, 1 April 2006.

⁶⁶⁴ See Table 5.7, Chapter 5.

businesses, but this sort of support is the responsibility of the empowerment program organizers rather than the banks”.

These bank officials consider that men and women receive the same financial treatment from the BRI Units, BPR and cooperatives as dictated by Indonesian Banking Law no. 10/1998 and Indonesian Cooperative Act no. 25/1992. Bank officials will assist female borrowers by visiting them at home instead of inviting them to the office, but women have to meet the same financial requirements as male borrowers. The bank officials’ attitudes toward female borrowers are influenced by their appreciation of Sundanese culture and Islamic values; but their financial decisions are based on bank regulations, in which there is no affirmative support for women.

7.3 Microfinance to support women’s livelihood

7.3.1. Gender and risk in microcredit

Most microbusinesses of women entrepreneurs are in home-based industries, small trading and services. SMERU asserts that there is a common perception that Indonesia has a long tradition in which women have been active in trading and in many business sectors, and Indonesian women are better at handling money than men.⁶⁶⁵

In urban areas, money for household expenses is managed together by the wife and husband; money for household and business are mixed together with household expenses, taken from money generated by the business. Some women respondents explain the deficit of the household budget is discussed with their husbands to find a solution. The wife is dominant in managing business operations, especially when the husband’s income is fixed and insufficient for household needs. The women make decisions on business matters.

⁶⁶⁵ Lembaga Penelitian SMERU: *Upaya Penguatan Usaha Mikro dalam Rangka Peningkatan Ekonomi Perempuan (Sukabumi, Bantul, Kebumen, Padang, Surabaya, Makassar)* in December 2003, viewed 30 January 2007 <<http://www.smeru.co.id/report/research/usahamikro2>> and Berninghausen, J. and Kerstan, B. 1992, *Forging New Paths: Feminist Social Methodology and Rural Women in Java*, Zed Books, London, translated by Barbara A. Reeves.

In the rural areas women manage money for household expenses, while money for business is managed together. Money for business and household expenses is mixed and it is the husband's responsibility to resolve the household deficit. The husband usually maintains savings for emergencies.

In coastal areas, where women borrowers are more numerous, both sexes recognize that women play a dominant role in money management. This reflects the character and division of work between wife and husband in fishing communities, where there is often an insufficient and uncertain income from fishing. In addition, the wife is on land at home and in a position to look after the business. Women in coastal areas have tighter control over money and worry if money is managed by the husband and misused for entertainment, gambling, drinking and even remarriage. The women respondents explain that husbands are involved managing money for business although women dominate the decision making.

The researcher via direct observation and discussions with market officers (*mantri pasar*) found that more women trade in these markets; men assist their wives with transportation and other supporting functions such as parking, cleaning and security. These observations confirm Brenner's argument. Brenner argues that "women stood at the centre of this nexus (economy, material, cultural and social) as the primary agent of domestication in the household, often to a greater extent than their husbands, took on the responsibility for generating material, cultural and social value for their families".⁶⁶⁶ Hart explains the important role of women "Women maintain a strategic role in the household economy but their access to microcredit is lower than men, which suggests that granting more loans to women will support poverty alleviation".⁶⁶⁷

Microcredit is provided as a personal loan, not as a corporate loan, that makes both husband and wife legally and financially responsible. Analysis of

⁶⁶⁶ Brenner, S.A. 1998, *The Domestication of Desire*, Princeton University Press, Princeton, New Jersey, p. 17.

⁶⁶⁷ Hart, G. 1990, 'Pattern of household labor allocation in a Javanese village' in Binswanger, H.P. (ed.), *Rural Household Studies in Asia*, Singapore University Press, Singapore; Asian Development Bank, 2006, *Indonesia, Country Gender Assessment*; Asian Development Bank, 2006, *Indonesia, Country Gender Assessment*, The Asia Foundation, ADB, Manila, p. 16.

BRI loans to men and women is made more difficult by the fact that the bank does not collect data on the gender of its borrowers. However, the gender of borrowers can be identified in loan portfolios of BRI Units in the three research areas. These reports form the basis of the analysis in Table 7.1 below. The BRI *mantri* and BPR loan officers are aware of the gender and other personal characteristics of their borrowers, and carefully assess business risk and sociocultural risk in dealing with them.

It is evident from interviews with bank officials and women borrowers that BRI Units and BPR evaluate women's loan applications carefully. Bank officials' assessments of risk and women borrowers can be summarized in the following points:

1. The BRI Units and BPR do not assume that women applicants can be trusted more than men in managing business risk.⁶⁶⁸
2. Women-owned businesses are challenged with two important dilemmas that make risks greater for women: how women combine their double burden simultaneously with managing their microfinance risk.⁶⁶⁹ Besides managing their business risk, women simultaneously care for an extended family in a wide range of personal and cultural matters. This double burden is a non-business issue that forces women entrepreneurs to manage their time carefully, as time is important for the business. Women entrepreneurs are responsible for the costs of supporting their broader family. Bank loan officers consider this double dilemma in providing microcredit to female borrowers: her business risk plus her management of domestic matters, kinship and sociocultural relationships.

⁶⁶⁸ Discussions with Yoyo Suryana, Kepala BRI Unit Puteran, Ade Susandi and Budi Herawan *mantri* BRI Unit Puteran, Asep Koswara and Heni Handayana *mantri* BRI Unit Pagerageung, Puteran Pagerageung, 22 July 2011, Hendi Suhendi, Kepala BRI Unit, Cimindi, Widi Anandita, Ari Irawan, Alia Maharani, *mantri* BRI Unit, Cimindi, 21 July 2011.

⁶⁶⁹ Interview with Yuda, BRI Unit, Cimindi, 30 January 2006, Aris Purwanto, BRI Unit, Gebang, 28 March 2006; and also discussions on risk of non-performing borrowers with Yuda, BRI Unit, Cimindi, 10 May 2006, Abun Yamin, BRI Unit, Puteran, 2 May 2006, Aris Purwanto, BRI Unit, Gebang, 27 April 2006; Yuda, BPR Kencana, Cimahi, 17 January 2006, Hafid Wahyudi, BPR-BKPD Pagerageung, 4 March 2006 and Yaya BPR-BKPD Kapetakan, 29 March 2006.

There is a tension, if not a contradiction, in the views of BRI *mantri* toward female borrowers; it is recognized that women play an important role in small business and have a good reputation for managing money, but they are viewed as high risk. The data in Table 7.1 suggests that in the three research areas in this study the risk associated with female borrowers is somewhat higher.

Table 7.1 shows the gender structure of the microcredit portfolio and their non-performing loan ratio. In the coastal area most microborrowers were women. They constituted two-thirds of total borrowers, significantly higher in comparison to women borrowers in BRI Units in urban and rural areas, which constituted one-third or about 11% respectively. These areas have different sociocultural and socioeconomic environments that influence how people earn a living.

The data in Table 7.1 shows that the local BRI unit has provided loans to many fishermen's wives and supported their businesses. Indeed these women borrowers dominate the BRI unit's loan portfolio in coastal areas. In rural areas, where men mostly work in the village, traditional patriarchy values remain strong and men dominate how the family earns a living, decision-making processes and money management.

Women require their husband's agreement to borrow from the bank. Whereas in urban areas, women have higher mobility and greater opportunities to develop businesses. Women have been more successful in securing loans from the BRI in urban areas than in rural areas, but they do not dominate the loan portfolio as their counterparts do in coastal areas. Table 7.1 shows that the gender allocation of loans in the three research areas is significantly different. The *mantri* and heads of BRI Unit assessment of borrowers takes into consideration the local economic and social structures of the three research areas in this study in calculating risk and business opportunities for each application.

The BRI regulations concerning loan applications are 'gender blind' in that they do not specify gender. There are no specific BRI regulations relating to risk management associated with loans to women. The BRI *mantri* considered

Table 7.1 Gender, borrowers and non-performing loans in the three research areas

No		2009		2008		2007		Average	
		Female	Male	Female	Male	Female	Male	Female	Male
	BRI Unit Cimindi								
1	Number of borrowers	525	924	550	908	278	866		
2	%=F : (F+M)x100%	36.23%		38.73%		25.93%		33.63%	
3	Non performance borrowers	79	138	59	118	28	72		
4	% = 3/1 x 100%	15.05 %	14.93%	10.73%	11.94%	10.07 %	8.31%	11.95%	11.73%
	BRI Unit Pagerageung								
1	Number of borrowers	147	808	157	793	121	672		
2	%=F : (F+M)x100%	15.39%		16.53%		15.26%		15.73%	
3	Non performance borrowers	3	7	2	7	2	13		
4	% = 3/1 x 100%	2.04%	0.87%	1.27%	0.88%	1.68%	1.93%	1.66%	1.23%
	BRI Unit Puteran								
1	Number of borrowers	88	997	65	1110	58	830		
2	%=F : (F+M)x100%	8.11%		5.53%		6.53%		6.72%	
3	Non performance borrowers	3	17	2	11	5	14		
4	% = 3/1 x 100%	3.41%	1.71	3.08%	0.99%	8.62%	1.69%	5.04%	1.46%
	BRI Unit Gebang								
1	Number of borrowers	344	228	385	250	364	148		
2	%=F : (F+M)x100%	60.14%		60.63%		71.09%		63.95%	
3	Non performance borrowers	10	11	20	4	7	4		
4	% = 3/1 x 100%	2.91%	2.28%	5.19%	1.60%	1.92%	2.70%	3.34%	2.19%

Source: Laporan Kupedes dan KUR Mikro tanpa Golongan Berpenghasilan Tetap (GBT, fixed Income Group) Desember 2007, 2008 dan 2009, BRI Unit Cimindi, Pagerageung, Puteran dan Gebang. The gender of the borrower is based on name recognition and the advice of the *mantri*.

that the risk involved was higher and this view is supported by the data presented in Table 7.1. The *mantri* and heads of BRI Units have considerable autonomy in decision making regarding loan applications from women, particularly in the absence of specific regulations from the BRI central office, and that gender is not discussed in BRI training programs. They believe that they can manage women borrowers based on past experience.

BRI *mantri* know there are risks associated with granting loans to women borrowers, but they also recognize bank profits by making loans available to women micro entrepreneurs. These loans enable women to support their family

and husbands, who are responsible for the loan in law and religion. The BRI *mantri*'s views are reflected in the following points:

1. Microfinance is appropriate for women as it provides small amounts of money, and depends on very little startup capital and can help women with little or no formal education.
2. Although women may have worked prior to their marriage, they usually start their business with little professional work experience and/or knowledge of their sector. They can start their business without fulfilling bureaucratic procedures such as acquiring a business license (*ijin usaha*).
3. The size of their business is small, and they are mostly self-employed where the owner is also a worker. Some employ less than five people and most are family members.
4. The women borrowers use simple and traditional technologies.
5. They focus on local trade, services and light manufacturing activities.
6. The women often operate in local markets where there are low barriers to entry. It is a free entry that creates competition between similar microbusinesses, which makes it easier for small businesses to enter into the market, but they can easily fail.
7. Their business is often home-based, enabling women to perform their household responsibilities as well as manage their businesses.
8. In fact, BRI *mantri* view women borrowers as not always consistent.

Some BRI *mantri* consider that women are more disciplined and maintain good cooperation with BRI Units and BPR. In their experience, women find it easy to follow the bank's advice.

On the basis of bank officials' experience, the BRI's loan portfolios and the views of the borrowers themselves, there are various sources of risk associated with loans to women borrowers. These relate to the character of the small businesses the women manage, economic or financial factors and their Sundanese sociocultural aspects and Islamic beliefs. These risks can be summarized as follows:

1. The financial risk is related to external factors like inflation, increasing

the cost of goods and services but reducing consumer purchasing power, business cycle effects, changes in weather and natural disasters. In addition, the common characteristics of small businesses involve elements of risks such as small quantities of low cost products of daily consumption, traded in a highly competitive market, with low entry costs as well as unpaid labor of the owner and family members. Another factor is traditional patriarchal values that are evident when a husband's intervention in the business may serve to increase costs.

2. Women are often particularly vulnerable to sociocultural risks due to the structure of gender relations in Sundanese society. Women in business still have household duties; consequently their business operations are affected by household responsibilities. Women's subordinate position places them under pressure to support their husband and relatives from the loan, for which they remain responsible. Although women are considered by the bank to be suitable borrowers and they make key decisions relating to the loan and business, their decisions still require their husband's approval.

They have also to manage crisis and emergencies including sickness of family members, marriage breakdown, life cycle events, such as birth, marriage that creates risk because of the high financial costs, death of the husband or being a victim of deception. Risk is reflected in the degree of bad debt as examined in Chapter 5, where the behavior of the husband is one of the risk factors. Gambling, drinking and drug-taking, excessive entertainment, changes in lifestyle and infidelity consume a lot of money. These are some of the reasons why the wives seek to control the management of money independently from their husbands. Among the borrowers in this research, many women control the family's finances. The *mantri* of BRI Units and BPR credit officers recognize this factor and take it into consideration in assessing loan applications; thus the greater economic and cultural challenges women

have to contend with in managing family responsibilities and running a small business.⁶⁷⁰

3. However, women understand that the financial and legal consequences for microcredit (Indonesian Marriage Law no. 1/1974, especially article 35) on the ownership of assets before and after marriage. Their collateralized assets, the patriarchal system and the social status of women are entry points for a husband's intervention in his wife's business. This research suggests that women's ability to generate income allows women to be self-sufficient and to influence the value system in marriage. In urban areas women have developed financial independence and are demonstrating a greater willingness to divorce their husband and become single mothers.⁶⁷¹

7.3.2. Women's empowerment and gender equality

The experience of women participants in empowerment programs like P4K suggests that this sort of training enhances women's capabilities to manage business risk. This process contributes to women's ability to earn an income; microcredit can potentially initiate a 'virtuous spiral' of economic empowerment, increase wellbeing for women and their families and create wider social improvement.⁶⁷² The researcher believes that the empowerment of men and women is important to achieve two main goals: to develop the bankability of a loan-applicant and to promote gender equality.

⁶⁷⁰ Interview with Nanang Suhendra BRI Unit, Cimindi, 13 February 2006; Endang Sumarna, BRI Unit, Puteran, 3 March 2006; Aris, BRI Unit, Gebang, 28 March 2006. Interview with Sunarko, BPR Kencana, Cimahi, 13 February 2006; Mukmin, BPR-BKPD, Kapetakan, 29 March 2006; Hedi Susilo BPR Pola Dana, Indihiang Tasikmalaya, 4 May 2006.

⁶⁷¹ See "Dominan, Wanita Menggugat Cerai Suami", *Harian Pikiran Rakyat*, Bandung, 24 April 2005, penjelasan Ketua Pengadilan Tinggi Agama (PTA) Jawa Barat, bahwa "terhadap harta gono gini itu ada hak suami dan istri serta berapa haknya. Umumnya (yurisprudensi) yang diputus oleh Pengadilan Agama dengan rasio 1:1, tapi bisa merujuk dari riwayat terkumpulnya harta apa dominan suami atau istri. Secara umum harta bersama haknya sama, tapi secara fisik bisa salah satu pihak lebih besar daripada pihak lainnya. Misalnya, suami pengangguran dan istri bekerja, bisa saja hak istri untuk menentukan berapa suami dapat harta. Kita harus mengetahui suami berkewajiban untuk mencari penghasilan dan membiayai keluarga. Tapi karena suatu hal, istri yang mencari nafkah, sehingga bisa menentukan persentase bagian istri dan suami".

⁶⁷² The term 'virtuous spiral' is discussed by Linda Mayoux in many of her papers. See Mayoux, L. 2002, *Microfinance and women's empowerment: Rethinking "best practice"*, *Development Bulletin*, no. 57, pp. 76-81; Mayoux, L. 2006, *Women's Empowerment Through Sustainable Microfinance: Rethinking Best Practice*, Discussion Draft, Figure 1.

The first goal, empowerment, is an attempt to strengthen the ability of men and women in business to obtain microcredit. However, *mantri* of BRI Units and BPR have no responsibility to conduct empowerment programs. The BRI does not consider the bank has any role to educate or prepare men and women to be bankable applicants. The P4K programs were channeled through BRI branch offices, but the empowerment of participants was not the responsibility of the BRI, rather it was the function of the Ministry of Agriculture that managed the program. The P4K program is an example of a government program to alleviate poverty, in which empowerment training and the provision of credit are integral parts. From the BRI's perspective, empowerment training is a prerequisite so that poor borrowers can access microcredit on a commercial basis. Empowerment is a great challenge for Indonesia, given its vast scale and steadily growing informal sector, especially after the economic crisis in 1997-1998 that created an additional 15 million poor people.⁶⁷³ This presents a dilemma and challenge for government and civil society. It is a problem as this informal sector covers employment situations that not only differ from those in the formal sector, but also often contravene rules and laws. The informal sector absorbs a large and growing fraction of the labor force, including women, and provides a 'safety net' for the poor, who are excluded from formal employment and income opportunities. However, men and women in the informal sector require working capital to support their businesses.

This research suggests that successful empowerment as a capacity building program is needed by microfinance institutions to be considered as collateral substitutes in order to overcome applicants' lack of conventional collateral assets. Collateral substitution can consist of peer pressure in group solidarity and probation or credit scoring by the *penyuluh* or supervisor/trainer. However, collateral substitution⁶⁷⁴ is financially weak for creditors as it is not enforceable through a formal judicial process and this social capital cannot be

⁶⁷³ In 1996 there were 34.5 million poor people which increased to 49.5 million in 1998. See Manshur, A. et al. 2005, *Kemiskinan di Indonesia, Perkembangan Data dan Informasi Mutakhir Tahun 2002-2004*, Tim Koordinasi Penanggulangan Kemiskinan, Menko Bidang Kesejahteraan Rakyat, Jakarta.

⁶⁷⁴ International Labor Organization, 1966, *Collateral, collateral law and collateral substitutes*, viewed 1 March 2007 <<http://www.ilo.org/public/english/employment/ent/papers/collat.htm>>.

sold in the market. This is the reason the *penyuluh* require the head of the group to provide assets collateral.

The second goal of empowerment is to bring men and women into interdependent relations and involve a willingness to establish a balanced distribution of responsibilities. It is to eliminate differences between men and women, so this may never be used as grounds for discrimination, but rather to build a partnership to ensure that both participate in decision making and power in opportunities and progress; and also benefit equally from social resources. Gender mainstreaming in microfinance development can help overcome gender specific constraints. Women who have direct access to formal microfinance institutions and who have joined P4K groups are in a position to be able to contend with the financial constraints they encounter. Nevertheless, women still have to deal with negative cultural biases, husbands who are not always willing to support the business of their wives, men who want their wives to allocate part of the loan for their husband's expenses, as well as the difficulties of providing collateral. These become disincentives for engaging in business.⁶⁷⁵ This research clarifies a number of controversial issues in microfinance as follows:

1. Women respondents do not see their double burden as a constraint. They take on both, as they believe the reproduction function and caring for a family is the nature of women, because it is God's will. Women who work create earnings for the family livelihood, so they are carrying out *ibadah* and are pious. They serve their husbands and the family; it is something great to Sundanese women and Muslims. The respondents recognize that to maintain a relationship with Allah *swt* or *ibadah* and maintain good relationships with human beings, (*hablum minallah* and *hablum minan naas*), especially with husbands and families, supported by sufficient income, is the goal they want to achieve.

2. Women are capable of managing a small business and organizing their time. Women want their business to grow, but the risk is the burden they bear. Women borrowers in this research think they are treated equally by the

⁶⁷⁵ Gender specific constraints in small business also surveyed in Semarang and Medan in 2001. See Berninghausen, J. 2001, *Toward a Gender Conducive Planning in SME Development*, ADB Technical Assistance SME Development & State Ministry for Cooperative & SME, Jakarta.

bank officers in BRI Units and BPR and there is no gender bias in credit procedures.

3. For women, establishing a business is mostly based on the wish to add to the husbands' earning. However, as the duty of the husband is head of the family, the wife's contribution is seen as supplementary income, but this research indicates that the wife's income is often the main family income. In the Sundanese culture there is a term: the man is powerful in the world (*lalaki lalanang jagat*) and in Islam, man has full responsibility for the maintenance of his family.⁶⁷⁶ The husband must ensure material prosperity, and be responsible for providing financial support for his family in accordance with his abilities, as well as maintaining a healthy atmosphere in family life. It is not only legal and cultural and the moral aspect of marriage, but also the *shari'ah* obligation.⁶⁷⁷ If a woman generates earnings and supports the family, this is her act of devotion and she is respected as a noble person.⁶⁷⁸ It indicates the equality and the respectable status of women in Islam, and the economic imperative is a principle for men and women. Incomes are needed to pay *zakat*, *qurban*, pilgrim to Mecca and Medina, to take care of orphans, the elderly, the disabled and various humanitarian activities. But Islam determines that wealth is sought through Islamic principles and must be *halal*.

In the three research areas in this study, women have opportunities to work to support the family livelihood. Women in urban areas have access to better education facilities and more job opportunities. Women have more options to work and generate income and develop a career. Women have more flexibility in an environment where gender equality is openly discussed. In contrast, women in rural and coastal areas have fewer education and employment opportunities, with the consequence that all family members have to work for an income.

⁶⁷⁶ See Equality and status of women in Islam, viewed 1 March 2007 <<http://www.jamiat.org.za/isinfo/ewomen.html>>.

⁶⁷⁷ See *Al Qur'an*, An Nissa 4:34. See also Islam: Meaning and message, rights and obligations, viewed 1 March 2007, <<http://www.jamaat.org/islam/WomanRights.html>>.

⁶⁷⁸ It would be useful for every married woman to become familiar with the following reliable statement of the Prophet Muhammad *sallallahu alayhi wasallam*, "A wife, who does not burden her husband in financial matters, is the greatest one in her piety and grace". *Hadith* from 'Aisha; the holy a *hadith* from Ahmad, al-Hakim and al-Bayhaqy. *What does family mean?* viewed 1 March 2007 <http://umma.ws/Fatwa/family/#_ftn14>.

Lack of infrastructure makes for slower economic growth in rural and coastal areas compared to the urban area. According to the BRI's data in Table 7.1, there are more women borrowers than men in the coastal area as men are often away, fishing at sea.⁶⁷⁹ Women tend to have a more dominant role in managing family finances. In rural areas women have to work to support their husband's income, while their husbands endeavor to maintain their family authority. The bank officials profess to treat women equally and honor them in accordance with Sundanese values, but nevertheless consider that loans to women entail a higher risk.

A study on sociocultural aspects of gender indicates not only similarities but also various contradictions with respect to the role of women.⁶⁸⁰ Culturally, women are respected in Islamic beliefs and in Sundanese culture; however, the women borrowers in this study are expected to remain the central figure in the family to educate children, manage finances and maintain kinship relationships as well as run their businesses. They experience unfair treatment in comparison with men in education, employment and inequitable legal positions. In the patriarchal tradition of Sundanese culture and Islam, women have a different legal standing and economic position. However, in fact, men are not always able to play their role as head of the family, to maintain and protect the family livelihood. In this study, a number of successful women microfinance borrowers provided financial support for their families more effectively than their husbands.

A good and prosperous family life is a shared interest of husbands and wives. In this study, women ran their own microbusinesses as well as managed their family responsibilities. The study indicates that the support of women's microbusiness through credit facilitated change in family gender roles worked, despite the conflicting values within Sundanese culture and Islamic beliefs. The capacity of women borrowers and the action of microfinance institutions has been able to create a financial cultural system that improves the destiny of women and the family.

⁶⁷⁹ See Table 7.1, Chapter 7 in this thesis.

⁶⁸⁰ Archer, M.S. 1996, *Culture and Agency: The Place of Culture in Social Theory*, Cambridge University Press, New York, pp.143-158.

CHAPTER 8

CONCLUSION

8.1 Issues of the study

This research has examined how various sociocultural attributes influence microborrowers' behavior and how this affects the sustainability of microfinance institutions. The study analyzed religion, traditions, customs and gender roles for borrowers, the impact of microcredit on their incomes as well as profit motives of BRI and BPR. The role of the BRI Units, *mantri* and BPR loan officers as arbiters and intermediaries between Sundanese cultural values and Islamic beliefs regarding bank regulations is also explored. The study is focused on Bank Rakyat Indonesia (BRI), Indonesia's largest microfinance institution and Bank Perkreditan Rakyat (BPR). The BRI Units manage village saving accounts (*simpedes* and *simaskot*) and mainly provide microcredit loans (*kupedes*, *kredit umum pedesaan*), not only in agricultural sectors but also in other economic sectors, and offer simple payment system services in the villages of rural, coastal and urban regions of West Java, and indeed throughout Indonesia.

According to many researchers, economic life in Javanese villages during the Dutch colonial period until post independence (in the Old Order era) appears to have somewhat changed.⁶⁸¹ There have been changes but they are not obvious and have been slow. Rural society appears traditional, with little change from generation to generation, governed by custom, not law. The social structure is hierarchical and traditional beliefs and practices have inhibited economic growth. Rural society in Java seems static.⁶⁸² However, initiation of

⁶⁸¹ See among others: Boeke, J.H. 1953, *Economics and Economic Policy of Dual Societies as Exemplified by Indonesia*, Institute of Pacific Relation, New York.; Wertheim, W.F. 1955, *Changes in Indonesia's Social Stratification*, Pacific Affairs, University of British Columbia, 28(1), pp. 41-52 and Furnivall, J.S. 1976, *Netherlands India*, BM Israel BV, Amsterdam.

⁶⁸² After the influential works by Clifford and Hildred Greetz, Robert Jay and Koentjaraningrat in the late 1950s and early 1960s on sociocultural life in Java, major interest in this theme has waned, See Koning, J. 2000, 'Different Times, Different Orientations, Family Life in a Javanese Village' In Koning, J., et al. (eds.) *Woman and Households in Indonesia, Cultural Notions and Social Practices*, Curzon Press, Richmond, Surrey, p. 182.

the New Order Government in Indonesia has attained impressive economic growth. This growth has influenced life in the villages through the impact of rapid demographic change and communication and transportation networks, especially in Java.⁶⁸³ Economic growth has created jobs and reduced poverty. Although the social structure has changed slightly, there has been a revitalization of agriculture and a diversification of rural economies. The scale and pace of change has been constrained by limited access to credit, poor roads and unreliable electricity.⁶⁸⁴ Microcredit played a strategic role in supporting the development of village economies and improving the livelihood of villagers. The 1983 government decision to deregulate the banking system made microfinance a less effective strategy for alleviating poverty, but the viability of commercial microfinance programs has been strengthened. This research found that this policy change continues to shape microfinance programs.

The researcher argues that since the 1970s the pattern of economic growth has influenced both the socio culture of microborrowers in rural, coastal and urban areas and government policy on poverty and the microfinance sector. Since the 1983 government decision, microfinance institutions, such as the BRI and BPR, have developed a substantial market for microloans in villages, where borrowers were able to pay market interest rates sufficient for the banks' sustainability and profit generation. Economic development in villages has meant that cultural and religious *rite de passage* and cultural production were not merely financial costs, but also business opportunities. The century long practice of payment of interest and the permissive interpretation of local Islamic leaders (*ajengan*) has meant that the teaching of *al Qur'an* concerning *riba* has not inhibited the development of commercial microfinance. The role of *mantri* of the BRI Units and BPR loan officers has been crucial in the development of

⁶⁸³ See among others: Booth, A. 1992, *The Oil Boom and After: Indonesian Economic Policy and Performance in the Soeharto Era*, Oxford University Press, New York; Hill, H. 1994; *Indonesia's New Order: The Dynamics of Socioeconomic Transformation*, Allen & Unwin, St. Leonards, NSW; Dick, H.W. et al. 2002, *The Emergence of a National Economy: An Economic History of Indonesia, 1800-2000*, Allen & Unwin, Crows Nest, NSW.

⁶⁸⁴ The World Bank Office Jakarta, 2006, *Revitalizing the rural economy: an assessment of the investment climate faced by non-farm enterprises at the district level*, p. x. <<http://www.worldbank.org/id/rica>>.

commercial microfinance, acting as brokers between village borrowers, with their religious and cultural values, and bank regulations and credit screening procedures.

Although the focus of the research has been on describing social behavior rather than developing a theory, the theoretical implications of these findings are nevertheless highlighted in the following six sections.

8.1.1. Sociocultural influences on borrowers' achievement and behavior

It has been argued that Sundanese culture (*budaya Sunda*) influences the way microborrowers think and behave. There are five sociocultural issues and phenomenon that have been used as a framework for this study in rural, coastal and urban research areas. From the research findings it is evident that microcredit impacts borrowers' achievements and behavior.

Three sociocultural issues were examined: traditions and local customs; Islamic guidelines on *riba*; celebrations and *rite de passage* in the family life cycle. Villagers follow these sociocultural beliefs and Islamic teachings in order to achieve a balance between their values and the need to earn a livelihood as well as sustain a peace of mind.

The study found that there are various rituals (*hajat/ salametan*) and cultural practices that advise what to do or not to do in order to seek fortune, to diminish failure, to avoid sin and to live happily. From a financial point of view, the impact of rituals is cost-bearing activities. In rural and coastal areas, with a strong community relationship and close kinship, dependency on natural resources, traditions and religious practices support community cohesion and these are reflected in various ceremonies. *Salametan* with food and blessing prayers are held, as borrowers endeavor to balance their business and living environment with Islamic beliefs and traditions, attempting to create social and psychological benefits along with financial expectations. They perform the rituals as an obligation in the community with social impact, as they adhere to social hierarchy and avoid social sanction. The rituals are also an opportunity to show their social status although they have to pay some money as a social cost. In

urban areas where external dynamics influence sociocultural and economic structures, ritual is discretionary and focused on individual need, not social obligation.

The BRI *mantri* and BPR officers know what and when sociocultural rituals and activities should take place and proactively manage and control expenses to safeguard microcredit loans. The bank officers calculate the cost carefully but mostly refuse to finance these indirect non-productive activities. The challenge is a complexity of sociocultural influences on microcredit. This is resolved when BRI Units and BPR officers accommodate these sociocultural expenditures by asking borrowers to set aside a certain amount of their own funds as savings. The 2003 BRI microcredit policy recognized the important role of culture and since April 2006 the BRI Units have accommodated sociocultural expenditures of microborrowers. These have been calculated as part of sociocultural costs as consumers' (non-*golbertap*) microcredit, which is separate from productive microcredit *kupedes*.

Two other sociocultural issues in this study are business ethics and trust development. Ethical business conduct not only matters between business partners but also concerns microfinance institutions. The BRI Units, BPR and cooperatives in rural, coastal or urban areas need creditworthiness and good behavior from their borrowers. The assessment of character is the first criteria of the 5C's (Character, Capacity, Capital, Collateral and Condition of economy) of the loan analysis, an entry point to access microcredit that requires ethical behavior from borrowers. The study indicates that business ethics and trustworthiness are social and cultural virtues that have a reciprocal impact in raising awareness of positive individual traits. They encourage borrowers to develop good intentions and readiness to fulfil their contractual obligations.

The microfinance institutions have developed an integrated, quantitative and qualitative evaluation that considers financial and non-financial factors to assess trustworthiness and bankability. The research indicates that trustworthiness and business ethics help consolidate the asymmetrical relationship between microfinance institutions with their borrowers. It also helps to reconcile tensions between individual values of borrowers and microfinance

regulations of lenders. The research suggests that village borrowers mostly accommodate the strict microfinance rules, lenders' imperative for profits maximization and interest-based repayment of loans.

One of the research issues in this study has been to understand the influence of sociocultural aspects on sustainable microcredit operations, and how far borrowers' creditworthiness and trust can be accepted by microfinance institutions as collateral. The study found that accommodation of local social cultural values and practices helps create: business opportunities for borrowers and support for sustainable microfinance institutions.

With respect to business opportunities, the study concludes that local culture practices are resources. And with innovation and creativity, the traditional culture is not a static primordial creation. Culture is dynamic; local culture is not isolated from external cultural influences from elsewhere in Indonesia as well as globally, as a result of revolution in technology, communication and transportation. The dynamics of local culture should be understood as a continuous process of acculturation, accumulation and innovation that influences human behavior in the creation of products and services. The importance of cultural creativity is captured in the Sundanese expression: there is no outcome without endeavor, no benefit without effort (*mun teu ngakal moal ngakeul, mun teu ngarah moal ngarih*). In day-to-day practice, we can see how innovation and creativity are transformed from 'culture as tradition' into 'culture as industry' with added value. It can be found in various expressions such as in songs, music, dancing and theatre, as well as a complete wedding ceremony. The production of ceramics, handicrafts, mosaic, embroidery, batiks, wood carvings and paintings for tourists are other examples of 'culture as industry'. This is the benefit of cultural transformation; 'culture as industry' is an entry point into business opportunities and marketing creates demand for raw materials, designs and services. These business activities produce a market for microcredit financing, either through conventional or *shari'ah* banking systems, and enable villagers to develop profitable microbusinesses. In the villages this 'culture as industry' is part of the process of monetization of the village economy that links the producers and traders into

the market, and connects rural and coastal bazaars to consumers in urban, regional or national economies.

When BRI Units, BPR and cooperatives recognize and value the sociocultural practices and values of their customers, they help develop a more trusting and productive business relationship that ultimately supports the financial sustainability of microfinance institutions. For example, among some of the BRI *mantri* and BPR loan officials there was a rather skeptical attitude towards the holding of *selamatan*. Such rituals were thought to be wasteful, but for borrowers' *selamatan* were a necessity and social obligation.

The borrowers in this study considered that business relationships need good deeds and humanity (*hade laku lampah, hade basa*). In rural areas most of the borrowers think microcredit is not only a rational profit oriented transaction but also a kindness of BRI Units, BPR and cooperatives. The loan creates emotional relationships and a moral obligation. Borrowers regard themselves as being indebted by kindheartedness (*kahutangan kahadean, kahutangan budi*) and they endeavor to maintain good long-term relationships with microfinance institutions. This is one of the reasons why there is a relatively low level of bad debt among village borrowers, compared to corporate financing in the cities.

The village borrowers enhance their social standing and community respect through demonstrating their creditworthiness by maintaining their relationship with the microcredit lender. Creditworthiness and trust are important factors in business transactions and they are intangible assets; consequently they do not have materialized market value. Although borrowers' creditworthiness and trust are important to support business viability, the microfinance institutions cannot accept them as collateral. Lack of creditworthiness and trust means microcredit applicants lose the opportunity to obtain loans, as BRI Units or BPR are reluctant to assume higher levels of risk.

Through cultural sensitivity and knowledge of their communities, the BRI Units' *mantri* and BPR officers endeavor to accommodate the borrowers' cultural and religious values and establish a satisfactory relationship by treating

borrowers humanely (*dijelemakeun*). The borrowers in turn are pleased to follow microcredit requirements; they are not exploited as an object of business and they can grow as good, loyal and trusted customers. Successful borrowers, even with debt, enjoy a higher social status as well as a better material livelihood. It is argued here that there is a nexus between sustainable microfinance institutions and their net cash flows, and the trust these institutions establish with their customers by the respect they show for cultural values and practices.

8.1.2. Acceptance of payment of interest

All of the borrowers profess Islam yet they are involved in interest-based microfinance that has fulfilled every criteria of *riba*, making it *haram*, as declared in the Holy *Qur'an*. This research found there are a group of borrowers who accept bank interest, another group who reject it, and a third group who do not agree with the payment of interest but accept it through the absence of any alternative means of finance. For those borrowers who accept payment of interest they have found various ways to reconcile and rationalize their Islamic beliefs with microfinance loans.

Muslim villagers need money for business, working capital and fixed assets financing to pay taxes and household expenses. This study found that they tolerate and accept the existing interest system. They obtain finance from formal institutions, such as BRI Units, BPR, cooperatives and BMTs, or informal institutions such as rotating savings and credit association (*rosca/arisan*), shopkeepers, brokers, families, friends and moneylenders. In the three research areas under study there was a high demand for microcredit, but few if any *shari'ah* finance institutions prompted many Muslim borrowers to disregard teaching on *riba*.

This study confirmed that interest-based microfinance has been an accepted part of local economies of Muslim communities in West Java, at least since the colonial period. The payment of interest has been accommodated in households and enabled villagers to accomplish their financial needs. The study concludes that one reason for the continued acceptance of interest payments

and the feeling of being “free of sin” in applying “*haram* bank interest system” is that borrowers are following the advice (*taqlid*) of Islamic leaders (*ajengan*) from local *pesantren*. The villagers recognize that *pesantren* is a source of guidance (*pituduh pikeun hirup*) and to follow the *ajengan*’s guidance is the way to salvation (*jalan kana kasalametan*). They believe God blesses the *ajengan*, whose guidance protects his people from sin.

On *riba*, the *ajengan* says that *riba* is determined by *Allah swt*, as stated in *al Qur’an*, which means the solution of problems arising from *riba* should be found in the same source that is in the Holy *Qur’an*. *Allah swt* says religion is not to make people experience difficulties but to make things easy in devotion. Muslims want to have a good life in this world and not only in the hereafter. Believers are challenged by difficulties and limitation of resources and infrastructure to fulfil their material needs. This is the reason the *ajengan* recommends a pragmatic solution to make use of available resources for devotion, for *halal* purposes with Islamic practices. The *ajengan* is aware of the long debate, and inconsistent and conflicting opinions among Islamic organizations and scholars about *riba*. In this contested situation, the *ajengan* takes a pragmatic attitude to interest and *riba* as the *ajengan* have the responsibility to guide his followers. The *ajengan* are not part of any hierarchical Islamic organization and seek to maintain their independence. From the borrowers’ point of view, the echo of the national *fatwa* issued in 2004 by the Majelis Ulama Indonesia, declaring that bank interest is *riba*, was faintly heard in the villages in the research areas. In the villagers’ eyes, the local *ajengan* are more influential than national Islamic leaders in Jakarta or Bandung. There was some apathy among borrowers as the non-*riba shari’ah* finance was not yet familiar and *shari’ah* banks did not exist in their villages. The borrowers tended to accept the pragmatic guidance from their *ajengan* to continue using the interest system they had enjoyed.

The government is also conscious of the problem of interest and *riba*. In 1992 the government permitted the establishment of the first *shari’ah* bank and in 1999 issued new regulations for both conventional and *shari’ah* banks. The government supports *shari’ah* based finance, but it cannot impose religious

duty. It is dependent on individual Muslims to follow their beliefs and the government role is limited in administrative matters. From a sociocultural point of view, Muslims and the Sundanese respect government policy; it is imperative for believers to follow the law, to obey the government and to be in agreement with public interest (*kudu nyanghulu ka hukum, nunjang ka nagara, mupakat ka balarea*). Muslims must obey government regulations as part of their Islamic belief (*iman*).

Acceptance of the interest-based system serves to support the borrowers' livelihood and keep local business activities in Muslim hands. Individuals and households earn a living for the family, and pay the cost of worship and social expenditures to maintain social obligations in their community. While there is unease about interest-based microfinance and *riba*, villagers cannot wait until a *shari'ah* institution is established in their community. The microcredit they receive provides a means to improve their destiny; either through increasing their economic position or social status. Consequently it creates borrowers' high dependency on this interest system. However, there is currently no alternative to this financial system. Thus microcredit with the interest system continues to be accepted by borrowers for now. The interest earnings from the villagers' loans contribute to profits that sustain the BRI Units, BPR and cooperatives. However, villagers expect that one day they will be served by a *shari'ah* finance system.

8.1.3. The screening process

Access to microfinance loans is based on an initial assessment by the BRI Units and BPR of loan applicants to assess trustworthiness and creditworthiness. The objective of the screening process is to reduce business risk and human risk by understanding the borrowers' financial capability and their character as this relates to their willingness to pay off the loan and maintain a persistent net cash flow that will support the sustainability of the lenders' institutions.

Besides trust and creditworthiness, the BRI and BPR tightly regulate to ensure that only viable and promising businesses are provided with loans. At the operational level, the BRI Units' *mantri* and the BPR credit officers consider

that their assessment 'guarantees' the borrowers' risk, ensuring financial exposure and assets collateral that the poor cannot meet. This strict process is a standard bank operating procedure, but it is an obstacle for the poor and those on low incomes, as they can rarely meet loan requirements. The impact is that these people have limited access to microfinance institutions and need empowerment to be able to meet loan requirements. The result of the screening process is reflected in the quality and performance of microcredit. The BRI Units maintain the lowest level of bad debt as they have more experience in screening, analyzing and supervising microborrowers, followed by BPR. The cooperatives have the highest level of bad borrowers as they are weak in managing the process. Cooperatives are still weighed down by the attitude of their members, that is, that cooperatives have a responsibility to give members loans. Their family character gives the impression that cooperatives do not act strictly as a business entity. Additionally, they lack human resources to control members' loans.

The BRI Units, BPR and cooperatives in the three areas under study do not provide any empowerment training for poor applicants. The BRI branch offices make group empowerment training available only if borrowers are organized under a special microcredit scheme designed by their head office. The outcomes of empowerment for this study are outlined in relation to the P4K (*Pembinaan Peningkatan Pendapatan Petani/Nelayan Kecil*, the Income Generating Project for Small Farmers and Landless) scheme, fish farmers groups in Ciparay and projects financed in Subang. Access for low income borrowers is made available not only through financial and business empowering but also through sociocultural aspects to build a solid borrowers' group. The members come from the same community with similar customs, traditions, religion and ethics and live close to one another. Self-selected members build trustworthiness and social solidarity to guarantee all members of the group in their loan and to cover liability in case of default. The sense of group identity and interest is reflected in the Sudanese expression; don't measure a shirt only for your own size (*ulah ngukur baju sasereg awak*). Peer lending technologies and group based approaches to business service delivery

with social and religious consideration found in the P4K program is relevant to Sundanese culture, as expressed in the saying: do not be selfish but build solidarity hand in hand (*ulah pagiri-giri calik, pagirang-girang tampian tapi kudu paheuyek-heuyek leungeun*).

Empowerment and joint liability credit contracts used by group lending schemes are the solution when poor and low income earners have no asset collateral to offer. It is based on the fact that borrowers are asked to self-select group members. Using social solidarity to gain access to credit is a prerequisite under the P4K model, but doesn't apply to individual borrowers. Social collateral has no market value and in the case of business failure, repayment is difficult. These matters make it problematic for ex-P4K group borrowers to become a BRI Unit customer, or change from being a member of a group of borrowers to becoming an individual borrower. The BRI Unit assesses the mental switch, the changes in mindset, and the viability of the business, the business acumen of the applicant, the size of the bank loan needed, collateral assets and other legal aspects such as a business license. The ex-P4K applicants have to meet the requirements of the 5C's in loan assessment, the basic standard for commercial microcredit in BRI Units. In fact, if individual borrowers or groups of borrowers are not in a position to be able to bear the risk, subsequently the risk has to be transferred to the third party on cost, such as a payment on credit insurance.

8.1.4. The role of women in microfinance

The study found that women prefer to manage home-based food businesses including stalls (*warung*), trading in farm products, dressmaking, Muslim clothing, beauty salons and catering. Besides, there are commercial activities run mainly by women, as fishmongers, as found in the coastal areas of Cirebon or embroidery, batik, garments and handicrafts in Tasikmalaya. These microbusinesses are appropriate for women. They are well matched with women's capacities and manageable regarding caring for husband and family. Women comprise the majority of people who deal as small traders; they dominate the marketplace in the three research areas.

On lending to men and women, BRI Units, BPR and cooperatives do not discriminate on the basis of gender in their policies. The bank attitude indicates men and women in business are evaluated based on their capacity, character, creditworthiness and whether they are legally equal.

In the screening process, women have to meet the same requirements as men. From the BRI Unit, the *mantri's* perspective is that women are easier to communicate with as they stay in the same village, are loyal and easily accept microcredit regulations. These are the main reasons why women with their small businesses are suitable for microcredit, and with their husbands' support and sufficient collateral women gain the opportunity to generate more income for the family. Nevertheless, to access the BRI Units or BPR, the poor and low income women and men still face a complicated process.

The analysis of findings in BRI Units, BPR and cooperatives indicate there is no gender bias in microcredit policy or easier access for women. They also do not give priority to men, as heads of households and do not assume that women applicants can be trusted more than men. It means a loan is provided based on the applicants' compliance to microcredit requirements rather than gender status. However, the view of some loan officers is that by providing loans to women involves a greater risk as women have to combine their family responsibilities with their business roles. The BRI Units and BPR recognize that women have an important role in small business and also have good reputations in managing money, but women are thought to be a higher risk. The *mantri* and the manager of BRI Units have experience in managing risky women borrowers. Although the BRI regulations are gender blind, the *mantris* assess women applicants as being a higher risk.

To respect a woman is one aspect of Sundanese culture, in that a husband is responsible for his wife's safety and prosperity, for guiding and educating her and caring for her with good manners. The wife has to obey her husband and help him to maintain a good family life. The culture illustrates that the main role of a woman is maintaining the household, but it does not mean the woman is not permitted to do business in order to support the family while simultaneously caring for her family. The research finds that from a financial

and sociocultural point of view women play a role in business as it is important to support the family and to improve their social status. The microfinance institutions, BRI Units, BPR and cooperatives give equal opportunity to men and women for microcredit.

Receiving microcredit provides the opportunity for women to be independent in small business. Women borrowers play an important role in microbusiness and it is understood that bank officers, mostly male, treat women more gently and calmly, as expected in Islamic belief and Sundanese culture.

8.1.5. Microfinance impact, risk and social status

Microcredit that supports self-employment financing is needed to generate income through a 'virtuous' circle: begins from low income, supported by credit can create more income, and then more credit can produce an even higher income, and the cycle can be continued. This notion of sustained microcredit growth providing benefits to borrowers is supported by this research, not only on the basis of BRI Units and BPR reports and analysis and statements from individual respondents, but also from borrowers' assets. It produces repeat business for the BRI Units and BPR but makes borrowers more dependent on microcredit. Microcredit remains as a permanent component of the microborrowers' financial structure, which is never ending in maintaining their microbusiness. The BPR are also only eligible for better-off borrowers; collateral evaluation is their main focus with less social and cultural considerations. However, BRI branch offices have to implement some poverty lending programs designed by the BRI Head Office. Cooperatives design saving-lending programs for their members, but their sluggish cash flow hampers their growth.

This study confirms that microcredit can raise the income of borrowers with similar patterns in the three research areas. It can be observed from the assets the borrowers owned, the sustainable businesses they manage, and the financial performance they maintain with the bank and their children's education, compared to non-borrower neighbors. Another benefit to borrowers is intensive contact with other business people. With financial support, the bank

forces them to develop self-confidence, make more rational decisions and take their work seriously. Borrowers have to generate a cash flow that sustains their loan repayments. They realize business competition is getting tougher. And with their low education, it is very difficult to compete. Education is an important issue for their children, and even school fees are viewed as microcredit instalments.

The sociocultural impact of having debt and successful use of microfinance services increase the social standing of borrowers in the community hierarchy and strengthen their economic position, although they are reluctant to admit this openly. In the closed community in the villages, in rural and coastal areas, the borrowers are recognized by their neighbors as the bank's selected customers and value them as trusted and rich members of the community. The successful borrowers are also respected and are seen to generate business to make the village economy active, create employment and create prospects for a better life for poor and low income villagers. It can be concluded that in the three research areas under study, the appropriate use of microfinance creates multiple socioeconomic benefits for the community. Consequently, borrowers are weighed down by higher social costs of participation in the community, and microfinance officers have to be aware that the borrowers have a tendency to raise their consumptive pattern of living.

Borrowers who fail to make their repayments are threatened with termination of the loan. The borrowers who are not able to improve their financial position after a certain period of time definitely indicate that they have been unsuccessful in running their businesses. There are various business and sociocultural reasons behind borrowers' failure that brings them into financial difficulties. The non-performing borrowers live under constant financial worry from the creditor, and psychologically this affects their own family and social sanction from their environment. It is difficult to protect privacy and confidentiality of borrowers in closely knit village communities. In practice, the microfinance institutions tolerate some extra time, giving borrowers a chance to find their own source of cash prior to the physical seizure of their assets

collateral. This is the worse risk scenario, where liquidation of assets can push the borrower's family back into poverty.

8.1.6. The government policy framework

The government is concerned about the nature, strengths and weaknesses of the microfinance sector and this is reflected in government strategy. The microfinance sector in Indonesia has developed within the structure of a centralized government policy. It was a direct intervention policy when the Indonesian government in the 1970s targeted small credit programs in agriculture and non-agricultural sectors, mainly for Indonesians, with highly subsidized interest rates. These channeled credit programs have mostly failed and suffered from low repayment rates. The government phased out these credit schemes in 1983 and adopted a commercial approach to microfinance. Consequently, microfinance shifted into the business domain, operating through various commercial banks and microfinance institutions, most notably the BRI, then a state-owned bank.

Yet, the government continued to fund poverty reduction programs, some with a microfinance component, through ministries, central government institutions and local government. This government involvement is financed through central or local budgets, foreign aid, grants and semi-commercial credit, such as in the Income Generating Project for Small Farmers and Landless (P4K) program. But many of the programs are short term with different stipulations and conditions in comparison to microcredit schemes managed by commercial institutions. The government programs are developed with a 'political flavor' and are deficient in commercial viability. The programs are likely to be bureaucratic and executed as government projects, lack professional field officers and can be destabilized by changes in local government policy as a result of local autonomy and decentralization. The research found that the P4K program was one of the success stories of a poverty alleviation program, combined with the microcredit approach. The program was routed through BRI branch offices from 1980 but terminated in 2005 when the agreement between ADB and IFAD ended and foreign funding ceased. However, these types of

subsidized programs have been continued through local government budgets and the PNPM Mandiri program. The P4K program model is effective for poverty alleviation but needs government support and a professional manager *penyuluh*. In an ideal world, the group borrowers of P4K should have the opportunity to become individual borrowers from commercial microcredit lenders, but this research suggests that this transition has proved difficult.

Another government policy is providing small loans through cooperatives. The study found cooperatives are hindered by weak management and human resources, lack of capital, limited networks and high bad debt. It is questionable as to whether cooperatives can be used to alleviate poverty with their limited capacity, capital and outreach.

With respect to government policy, this research identified two issues. Firstly, the Ministries, under the Minister for Coordinating of Peoples' Prosperity, planned government poverty alleviation programs. The government needs to cooperate with commercial banks and cooperatives so that its poverty alleviation programs are integrated with commercial microfinance programs. Thus participants in government programs will be able to gain access to commercial microfinance loans. This research found that even successful participants in the government poverty alleviation programs were not automatically accepted as 'bankable' applicants who were viable for microcredit in commercial microfinance institutions such as BRI Units or BPR. The successful participants produced by P4K programs were sometimes able to access microloans through the BRI; but others, for example, the participants in a P4K program in Cirebon, were not willing to apply for individual BRI loans. Greater coordination between government programs and the BRI and BPR will be required to overcome these difficulties and facilitate better commercial microfinance for poorer members of the community.

Secondly, the government intends to support self-employed microborrowers with good business capability, but who lack capital and assets collateral. The government needs to balance social and financial objectives. *Kredit Usaha Rakyat (KUR/People's business development credit for micro, small, medium business and cooperatives)* established a microcredit insurance

scheme where government funds were provided for insurance premiums to designated insurance companies. In case microborrowers fail and their *Kredit Usaha Rakyat* turns into a bad loan, the lending banks (Bank BRI, Bank Mandiri, Bank BNI, Bank BTN, Bank Syariah Mandiri, or Bank Bukopin) are able to claim 70% of the bad borrowers' loan from the insurance company, PT. Askrindo or Perum Sarana Pengembangan Usaha.

This research found that the government's poverty alleviation programs were conducted separately from commercial microfinance schemes and operated in different socioeconomic and business conditions. But the government needs to balance sociocultural and financial strategies and give greater consideration to local sociocultural values and practices. The government has established a centralized and uniform policy for business development credit for micro, small, medium businesses and cooperatives (*Kredit Usaha Rakyat/KUR*), designed to make microfinance programs more sensitive to political change. The following issues need to be considered in this type of policy:

1. Empowerment training is needed to support the poor or 'unbankable' applicants.
2. Poverty alleviation programs and commercial microfinance schemes need to be coordinated.
3. The *KUR* microfinance program should be associated with an individual bank, so as to provide proper credit supervision.
4. It is also a recommendation that regional government owned banks (*bank milik pemerintah daerah provinsi, kabupaten, kota*) should be involved in the *KUR* scheme.
5. As government poverty alleviation programs are directly related to people, the study strongly proposes government projects be designed to reflect local social and cultural sensitivities and encourage local participation.

8.2 Lessons learned and contributions

8.2.1. The lessons

It is often argued the important role of microfinance is to support poverty alleviation to create better livelihoods and local economic development. The government is concerned with supporting microfinance activities with economic policy, political deliberation, bank financing and social development programs. The microfinance institutions face counter pressures in structuring their microfinance programs between commercial sustainability, on one hand, and alleviating poverty, on the other. This research concludes that *Kupedes*, the type of microcredit provided by BRI Units and microcredit from BPR, do not directly contribute very much to the poor. The BRI and BPR commercial microfinance programs mostly benefit better-off borrowers. This is the reason why BRI Units and BPR in the villages are reluctant to support poverty alleviation directly. It is agreed that microcredit creates a trickle down effect and creates economic activities for the poor or low income strata in village communities, but how far it can go in generating income that places people above the poverty line is another question.

The P4K model was a well-designed poverty alleviation program from which the BRI Units and other microfinance institutions could take advantage. The relationship between government empowerment and poverty alleviation programs, such as the P4K program, and commercial microcredit programs could be strengthened by a bridging program. Such a program could prepare successful 'low income borrowers' from government programs to be acceptable as bankable applicants for the BRI Unit's *kupedes* or *KUR Micro* or BPR microcredit. Here there is an opportunity for BRI Units and BPR to play two important roles: to make poor and low income participants in government programs become their prospective customers and to accommodate applicants and borrowers' sociocultural values and practices within their microcredit regulations.

What the researcher found at the village level is a reflection of government strategy. The government does not provide financial support for 'bankable' villagers, as viable self-employed borrowers are the business of

commercial banks. It was found that the poverty alleviation effort is routed through bureaucracy and financed through national or local government budgets. Although these funds are allocated for poverty alleviation, the official responsible for the empowerment program still is held accountable for the program budget, and has to insure that loans provided to poor participants are repaid.

Here the government still has options to support the poor through special policies such as those on empowerment and those creating ways to underwrite the risk with a special scheme of credit with insurance. What can be improved is the management of government poverty alleviation programs, so that it is coordinated with the bank's financing programs, with the aim of making it possible for a successful poor or low income borrower to transfer and become a borrower in a commercial scheme.

However, the better-off microborrowers should continue to be supported by commercial schemes in order to maintain a trickle-down effect to the poor and a multiplier effect on microbusinesses. The commercial approach is designed as one of the solutions to avoid business failure and bad debt.

As the villages in West Java province are not villages based on customary law (*desa adat*), local traditions and practices are not in the form of written custom regulations and are therefore not legally binding or subject to *adat* sanctions from the village community. These sociocultural practices are not clearly accommodated by formal banking regulations. In contrast, microborrowers have to abide by bank regulations, which are not always locally user friendly. To some extent microborrowers are in a position to synchronize their behavior to support bank regulations to meet their financial needs.

It is an advantage when the bank understands the influence of local sociocultural values and practices on the business of borrowers. The researcher identifies the way *mantri* in BRI Units, BPR credit officers and cooperatives show good manners, taking into consideration borrowers' social and cultural norms within the framework of microcredit regulations. The Sundanese proverb explains that good and bad is a matter of conversing (*hade goreng ngan ku omong*) with proper body language (*rengkuh*), praising and not directly

criticizing, and avoiding comments that are not constructive regarding borrowers' religion or habits. Appreciation of borrowers' norms by bank officers has developed respect and confidence and a better reciprocal relationship for the benefit of borrowers and microfinance lenders. The BRI Units, BPR and cooperatives understand the social and cultural risks, although there are no detailed written guidelines in relation to urban, rural or coastal research areas. Given their experience, the *mantri* and bank officers use their personal judgment during loan analysis and supervision and demonstrate their ability to take cultural factors into consideration.

8.2.2. The study and its contribution to knowledge

The findings and analysis from this study indicate that BRI Units and BPR are regulated and managed based on a commercial approach, mainly to benefit self-employed and better-off borrowers. These commercial microcredit programs do not contribute much to poverty alleviation. However, we believe microfinance is one of the poverty alleviation tools that can be suitable for Indonesia, as evaluated by Schmit and Robinson.⁶⁸⁵

The study has explored the relationship between cultures, behaviour and actions of borrowers as well as the operations of BRI Units, BPR and cooperatives by drawing on the work of Margaret Archer.⁶⁸⁶ There is a cultural system in the three research areas in this study in which borrowers maintain their cultural values and practices, and endeavor to comply with the terms and conditions of microfinance regulations. In fact, borrowers exercise their agency to manage the tensions and conflicts between their cultural and religious ideals and the requirements of microfinance organizations. The pursuit of self-interest is an important dynamic in how borrowers manage these tensions and conflicts.

This study shows there are two main functions of microfinance programs. Firstly, microfinance is one of the economic tools that promote people's welfare, which requires both physical and social capital. This research supports

⁶⁸⁵ Schmit, L.T. 1991, *Rural Credit between Subsidy and Market*, Leiden Development Studies, Leiden, no. 11 and Robinson, M.S. 2001, *The Microfinance Revolution, volume 2: Lessons from Indonesia*, The World Bank, Washington DC.

⁶⁸⁶ Archer, M.S. 1996, *Culture and Agency: The Place of Culture in Social Theory*, Cambridge University Press, New York.

Neubert's argument that economic development has to be supported by the society's system of values, thought and cultural identity.⁶⁸⁷ The physical support for better living has been studied by Mukherjee and Suryadarma such as access to basic services, education, health, infrastructure and public service.⁶⁸⁸ The researcher is in agreement with Neubert, Mukherjee and Suryadarma, and this study contributes a comprehensive analysis of the economic and sociocultural factors that influence the effectiveness of microfinance programs.

Secondly, this study confirms that self-employment capability is a prerequisite to effective microcredit performance. It identifies the importance of empowerment programs to strengthen both the poor and better-off micro-entrepreneurs (*penguatan kemampuan berbisnis*) as a strategic objective for government, microfinance institutions and business organizations.

8.3 Policy implications

8.3.1. Local sociocultural issues

The government will promote greater acceptability and effectiveness for its microfinance strategies in regional communities if local sociocultural values and practices are accommodated. Local government autonomy (*otonomi daerah*) has provided the opportunity to apply cultural sensitivity. Local approaches can be practiced in economics, politics and sociocultural development. It is believed local people feel comfortable and support the microfinance and poverty alleviation policy, if they are involved in policy design and its implementation.

Bank Rakyat Indonesia as the biggest microfinance institution has identified sociocultural factors as a general policy issue in its microcredit programs, although no detailed guidelines on implementation are available. It means there is flexibility for BRI Units to consider local sociocultural issues and

⁶⁸⁷ Neubert, S. 2000, *Social Impact Analysis of Poverty Alleviation Programmes and Project*, Frank Cass Publishers, London, pp. 6-9.

⁶⁸⁸ Mukherjee, N. *et al.* 2002, *People, Poverty and Livelihoods: Links for Sustainable Poverty Reduction in Indonesia*, The United Kingdom, Department for International Development and the World Bank Office Jakarta and Suryadarma, D. *et al.* 2006, *From Access to Income: Regional and Ethnic Inequality in Indonesia*, SMERU, Jakarta.

the *mantri* can take advantage of this policy to consider and accommodate cultural factors within the bank's strict microcredit regulations. The BRI Units and BPR have to deal with the diverse complexities of their microborrowers' culture in a multitude of socioeconomic settings. The bank borrowers live in an evolving cultural and religious environment. Villagers have been accustomed to the payment of interest for their microloans and these payments have been sanctioned by local religious leaders, but the payment of interest and the teaching of *al Qur'an* on *riba* have become a matter of debate among national religious leaders since the Islamic revival in the 1970s. The debate on implementation of the interest system and *riba* is ongoing. If increasing numbers of microfinance borrowers want to avoid *riba*, there will be a demand for the establishment of *shari'ah* financial institutions that can be accessed by Muslims living in village communities. The government is not in a position to invest in this *shari'ah* infrastructure, but it can establish a supportive policy and administrative and legal framework. The development of *shari'ah* banking would require an extensive branch and information technology infrastructure, together with working capital and human resource development, financed by *halal* money. The qualifications and experience of the BRI Units *mantri* and BPR loan officers contribute greatly to the development of conventional commercial microfinance. *Shari'ah* microfinance programs will require similar personnel with business skills and professional training in *shari'ah* principles and Islamic law plus an understanding of local cultural values and practices.

The microborrowers feel more content to run their business when sociocultural factors and women's role in the family are respected. The BRI Units find opportunities to explore positive norms to develop loyalty and trust to make individual borrowers aware of self-assessment in business. However, greater consideration of sociocultural factors can endanger microcredit programs. Too much accommodation of sociocultural factors or the neglect of financial risk can create different standards of performance. Sociocultural factors can then be blamed as the main reasons for non-performing loans.

However, if the BRI or BPR neglect these sociocultural factors, the relationship with borrowers will only be based on money calculation and this has

the potential to create tension. Basically microcredit is linked into business where the human factor is at the center of the relationship. Neglecting the culture of borrowers make the business relationships grow less comfortable and become open to disagreement and conflict. It is also the quality of service and thus the borrowers' satisfaction that guarantees that they fulfil their commitments. Sensitivity to sociocultural factors is the way to protect microfinance from human behavior risk and to anticipate the disturbance to the flow of income as an effect of borrowers' behavior. Therefore, in order to protect themselves from human risk, microfinance institutions need to have clear policy guidelines to deal with local sociocultural aspects of community and borrowers.

Local sociocultural factors are part of a qualitative analysis to support loan assessment. The ideas can differ from area to area, as follows:

1. Environment and seasonal factors in agriculture and fishing financing should be considered in determining flexible schedules of microcredit instalments instead of fixed time schedules of repayment.
2. Community status of a borrower should be noted in rural or coastal areas whenever he or she has to be involved in high cost cultural and religious obligations, such as *selamatan*.
3. In urban areas where social sanctions and an informal approach cannot be used to pressure borrowers, asset collateral is absolutely needed to fully cover the loan.
4. In urban areas, to be rich is clearly the objective of borrowers, where efficiency and cost consciousness is tightly negotiated.
5. The dominant role of women in microfinance in coastal areas in comparison with men's domination in rural areas is noteworthy, whereas in urban areas men and women play relatively similar roles in business. These significant disparities in the gender profiles of BRI loans have developed, despite gender-blind bank regulations, and this suggests the importance of the *mantri's* judgments and local economic structures.

These sociocultural issues influence the financial risk in microfinance and should be analyzed and followed up during routine borrowers' supervision.

Sociocultural sensitivity can be included as specific subjects in any program study of internal microfinance training.

8.3.2. Empowerment and expansion of the insurance scheme

Compliance with commercial requirements of the existing system is the objective of screening methods. However, the unmet demand for microcredit, mostly from the 'unbankable' poor, is a big challenge for the government and microfinance institutions. Microcredit is one of the tools to alleviate poverty, and there are two integrated policies that government and microfinance institutions need to design.

The first policy initiative is an empowerment process to improve capability for select self-employed people or groups of people. This can be affirmed as the microfinance institutions' social responsibility to develop the community and it can be organized in various ways through training programs followed by day-to-day guidance or *penyuluhan*. The BRI has been involved in aspects of the government's empowerment programs like P4K, but more can be done to make use of the business expertise of *mantri* and BPR loan officers in empowerment programs in order to bridge the gap between successful participation and access to commercial microfinance.

The second policy initiative is to expand the microcredit insurance scheme. Outreach needs to be broadened to cover more microfinance institutions so that more microborrowers can gain access to microfinance programs. Under this insurance risk cover, the microfinance institution is going to accept more new and viable individuals or group borrowers who do not have enough assets collateral. This is a method of subsidization, bridging and developing empowerment to enter a commercial scheme, and to be provided with microcredit that is covered by an insurance program.

8.3.3. The policy dilemma

Microfinance institutions develop their programs within the policy framework established by the government. The present policy framework means that it is very difficult for a microfinance institution to develop a program for policy

alleviation rather than for commercial sustainability. The existing commercial basis of microfinance creates a dilemma for government, as it does not contribute much in terms of poverty alleviation. If the government wants a stronger poverty alleviation approach, it needs to create a supportive microbusiness policy environment. To develop such an environment, the government would have to: 1. work closely with the banking system to design an integrated framework to provide loans for the poor to alleviate poverty, guaranteed by the government through an insurance mechanism; 2. Bank Indonesia, as the central bank which supervises operations of the banks, must establish a policy that encourages banks to make loans to the poor; 3. the government, in coordination with Bank Indonesia, needs to integrate related bank regulations with government department policies and processes on such matters as taxation; and 4. the alleviation of poverty needs to become a higher priority for governments and legislatures.

Here the government needs to coordinate efforts and keep strong control over all subsidized microcredit programs through various line ministries. It also needs to strengthen existing microfinance institutions, reorganize non-banks and informal microfinance institutions, mostly in the villages, and establish prudential regulation and supervision. Consequently, the government has to coordinate and integrate poverty alleviation programs with microfinance policy strategy, so the government will be challenged to run given existing market mechanisms. But the researcher believes there is still room for government intervention in terms of coordination with the central bank and banking system, and the Department of Cooperative and Small Business, designing certain poverty alleviation programs with particular microcredit scheme support, such as in the P4K and PNPM Mandiri programs, and making better use of BRI and BPR loan officers' expertise.

However, to sustain outreach to self-employed 'unbankable' poor and low income people through microfinance systems, the microfinance institutions need support to extend empowerment training and to set up appropriate microcredit insurance schemes. This has policy implications regarding government intervention, such as development of business planning and

financing programs for the selected villages or regions, and the need to consolidate the source of funds for microfinance financing and marketing integration. The system which designs and prepares alternatives needs new organization and financing arrangements besides the existing scheme, which tends to consolidate socioeconomic hierarchies in village communities, in order to narrow the gap between the poor and the relatively well off.

The ad hoc and uncoordinated nature of government empowerment programs, as evident in the central government's poverty alleviation projects and a variety of local government initiatives, involve a sustainable commitment of budget resources as well as coordination with microfinance institutions. It is the complexity of central planning at the national level with respect to regional autonomy, budget coordination between central government and regional governments as well as the many and various priorities of the local governments that make the development of effective poverty alleviation programs difficult.

As this study does not specifically evaluate strategies to alleviate poverty, such a review of strategy and policy implications needs further research and might address the following questions: How should government strategy on poverty alleviation link with microfinance mechanisms? How to envisage empowerment programs and to develop appropriate new financing schemes to support poverty alleviation? Should the government commit more funds for microcredit insurance schemes with selected insurance companies? Should the lending banks take an active part in developing empowerment and accept less assets collateral in their commercial microfinance schemes?

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Appendix 1: Microfinance Impact Studies: Asian Countries

Study	Coverage	Methodology	Results
Hulme and Mosley (1996)	Indonesia (BKK, KURK, BRI)	Borrowers and control samples, before and after	Growth of incomes of borrowers always exceed that of control group. Increase in borrowers income larger for better-off borrowers
MkNelly et al (1996)	Thailand (village banks – Credit with Education)	Non-participants in non-Program villages used as Control	Positive benefits, but no statistical tests for differences reports
Khander (1998)	Bangladesh (Grameen, BRAC)	Double difference comparison between eligible and ineligible households and between program and non-program villages	5% of participant households removed from poverty annually. Additional consumption of 18 taka for every 100 taka of loan taken out by women
Pitt and Khander (1998)	Bangladesh (BRAC, BRDB, Grameen Bank)	Double difference estimation between eligible and non-eligible households and programs with and without microfinance program. Estimations are conducted separately for male and female borrowing	Positive impact of program participation on total weekly expenditure per capita, women's non land assets and women's labor supply. Strong effect of female participation in Grameen Bank on schooling of girls. Credit program can change village attitudes and other village characteristics
Coleman (1999)	Thailand (village bank)	Double difference comparison between participant and non-participant households and between villages in which program introduced and villages where not yet introduced	No evidence of program benefit. Village bank membership has no influence on asset or income variables
Chen and Snodgrass (2001)	India (SEWA bank)	Control group from same geographic area	Average income increase for bank's clients in comparison with control group. Little overall change in incidence of poverty, but substantial movement above and below poverty line.
Coleman (2004)	Thailand (village bank)	Double difference estimation between participants and non-participants and villages with and without microfinance program	Programs are not reaching the poor as much as they reach relatively wealthy people. Impact is larger on richer committee members rather than on rank-and-file members

(cont.)

Study	Coverage	Methodology	Results
Park and Ren (2001)	China (NGOs, government programs, mixed NGO-government programs)	Probit estimation of participation and eligibility for each type of program; OLS and IV estimation of impact of microcredit on household income	In NGO and mixed programs the Very rich even if eligible (for mixed program) are excluded from participation. In the government program the rich are both eligible and more likely to participate. Impact estimation find evidence of positive impact of microcredit on income.
Duong and Izumida (2002)	Vietnam (VBA 84% of total lending), VBP, PCFs, commercial banks, public funds)	Tobit estimation of (i) participation in rural credit market; (ii) behavior of lenders toward credit-constrained household and (iii) weighted least square estimation for impact on output supply	The poor have difficulties in accessing credit facilities; livestock and farming land are determinants of household participation; reputation and amount of credit applied for to MFI are determinants of credit rationing by lenders. Impact estimation showed positive correlation between credit and output
Kaboski and Townsend (2002)	Thailand (production credit groups, rice banks, women groups, buffalo banks)	Two-stages LS and MLE test of microfinance impact on asset growth, probability of reduction in consumption in bad years, probability of becoming moneylender, probability of starting business and probability of changing job. Separate estimation according to type of MFI and policies of MFI	Production credit groups and women groups combined with training and savings have positive impact on asset growth, although rice banks and buffalo banks have negative impact. Emergency services, training and savings help to smooth responses to income shock. Women groups help to reduce reliance on moneylenders
Amin et al. (2003)	Bangladesh (grameen Bank, BRAC, ASA)	Non parametric test of stochastic dominance of average monthly consumption of members Maximum likelihood test of microcredit membership on vulnerability, consumption and household characteristic	Members are poorer than nonmembers. Programs are more successful at reaching poor, but less successful at reaching vulnerable. Poor vulnerable are effectively excluded from membership
Gerler et al. (2003)	Indonesia (Bank Rakyat Indonesia, Bank Kredit Desa, commercial banks)	Basic consumption-smoothing test on household's ability to perform daily living activities (ADL Index) State dependence test of basic regression (relative man-woman earning physical job, savings) Test of geographical proximity to financial institutions of consumption smoothing	Significantly positive correlation between household's consumption and measure of health. Wealthier households are better insured against illness Households that live far from financial institutions suffer more from sudden reduction in consumption.

Study	Coverage	Methodology	Results
Khander (2003)	Bangladesh (Grameen bank, BRAC, BRDB)	Fixed effect Tobit estimation of borrowing dependent on land education endowments of households. Panel data fixed effects IV estimation to define long-term impact of microfinance borrowing on expenditure, non-land assets and poverty (moderate and extreme)	Households who are poor in landholding and formal education tend to participate more. Microfinance helps to reduce extreme poverty much more than moderate poverty (18 percentage points as compared with 8.5 percentage points over 7 years) Welfare impact is also positive for all households including non-participants, as there are spillover effects.
Pitt et al. (2003)	Bangladesh (BRAC, BRDB, Grameen Bank)	Maximum likelihood estimation controlling for endogeneity of individual participation and of the placement of microfinance programs. Impact variables are health of boys and girls (arm circumference, body mass index and height-for-age)	Significantly positive effect of female credit on height-for-age and arm circumference of both boys and girls. Borrowing by men has either negative non-significant impact on health of children

Source: Montgomery, H. and Weiss, J. 2005, Table 2, p. 10.

Appendix 2: Microfinance Impact Studies: Latin American Countries

Study	Coverage	Methodology	Results
Hulme and Mosley (1996)	Bolivia, BancoSol	Borrowers and control samples, before and after. Retrospective assessment of incomes	Growth of incomes of borrowers always exceeds that of control group. Absolute increase in borrowers income larger for better-off borrowers
Mosley (2001)	Bolivia, BancoSol, ProMuyer, PRODEM and SARTAWA	Borrowers and control samples, before and after. Time series data for BancoSol only; for other retrospective assessment of incomes	Growth of incomes and assets of borrowers always exceeds that of control group. Increase in borrowers' income larger for better-off borrowers. No evidence of impact on 'extreme poverty'
Banegas et al. (2002)	Ecuador, Banco Solidario and Bolivia, Caja de los Andes	Logia model. Control group selected from households working in the same sector but with no loans from other institutions	Being a client of a program is associated with rising income
Dum and Arbuckle (2001a, 2001b)	Peru, Mibanco	Longitudinal study using "analysis of covariance" methodology; control group based on non-participants with similar observable characteristics to participants. Focus on micro-enterprises	Micro-enterprises of participants are found to have substantial increases in net income, assets and employments relative to those of non-participants. Positive impact on poverty reduction with incomes in participating households rising relative to control group. Poor participants are more likely to sell assets in face of a shock than control households
MkNelly and Dunford (1999)	Bolivia, Credit with Education program	Longitudinal study of comparison with baseline for nutritional data. Control group of communities who would be offered same program two years later	No evidence of improvements in household food security or nutritional status of client's children relative to the control group

Source: Montgomery, H. and Weiss, J. 2005, Table 3, p. 14.