

## Micro Finance Existence in Global Competition: Case Study of Balinese Traditional Microfinance Institution

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**Abstract:** Lembaga Perkreditan Desa or LPD is a traditional micro finance institution in Bali. It's called traditional because they operate based on local government regulation which is roots from traditional village rules (namely awig-awig). Both of LPD strength and weakness lies on their limited operational areas within a traditional village as tightly regulated in awig awig. This study was conducted to map out the LPD ability to face financial inclusion challenge, especially in the ASEAN Economic Community (AEC) era that forced LPD to compete with other financial institutions including overseas banks. The result indicates if the LPD has its own place in the course of economic development and the traditional structures of Balinese people. Hence the challenge of increasingly fierce competition in the banking sector can be transformed into opportunities by products diversification and more professional management.

**Keywords:** microfinance institution; Lembaga Perkreditan Desa (LPD); traditional village custom; ASEAN Economic Community (AEC); financial inclusion.

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### I. INTRODUCTION

The leaders of Southeast Asia countries have called for the formulation of a strategic plan to accelerate and realize the vision of doubling the financial inclusion in the ASEAN region in 2020. Regional approach for financial inclusion has been identified as one important factor for national development in many ASEAN countries. In addition, it has also become an important strategy to support the broader goals of regional economic integration as contained in the blueprint of the ASEAN Economic Community (AEC). The deepening of the financial sector is one of the main objectives in the AEC. It mainly affects the capital and capacity constraints on the financial system in several ASEAN countries, including Indonesia.

The entry of financial inclusion in the AEC blueprint forcing financial institutions to get ready in facing global competition. The entry of foreign financial institutions to Indonesia will allows public to access capital more widely with greater choice not only to national financial institutions but also foreign financial institutions. Hence competition in the financial sector eventually gets heavier and tighter in directing people choice to the financial institutions that they will use, including microfinance institutions.

*Lembaga Perkreditan Desa* (LPD) is one of several microfinance institutions that recognized their existence and advantages not only locally but also globally. Social system called "*banjar*" has proved be able to make LPD as a people's choice of traditional financial institution. The magnitude of LPD functions includes not only the flexibility of community to access financial resources but also social functions of LPD within society itself. Competing in the AEC becomes unavoidable choice.

LPD grown since 1984 through a decree of the Governor of Bali which is then reinforced by Local Government Law called *Peraturan Daerah* (*Perda*) No. 2/1988 concerning LPD. Totally eight indigenous villages pioneered its development at the time. Since its inception, LPD has developed very rapidly. Based on data from a variety of selected indicators used to describe the performance showed very significant improvement, ranging from financial indicators until the service indicator and range or outreach (Setyari, 2012). A total of 1,600 indigenous villages (called *Desa Pekraman*) in Bali, with targets all of them had LPD, until the year 2009 has been reached by 1,379 LPD unit. In 2015, the number of LPD has reached 1,466 units. This means that indigenous villages have been reached LPD ranging from 91.2 percent. Total assets also jumped up from IDR2.9 billion in 1988 to more than IDR 13.9 trillion to 2015, primarily due to increased lending. LPD development indicators one of which is of the amount of savings and deposits that have been collected. Saving rate jumped sharply, including in terms of the number of clients served. Seeing the range of performance

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indicators, it is not surprising if the LPD become the foundation of economic movements of SMEs and rural community in Bali.

The existence and survivability of LPD questioned before the enactment of financial inclusion in the region in 2020. Free entry of foreign financial institutions as a source of accessible financial Indonesian society is a challenge to maintain this existence. Therefore, this study is expected to provide an overview and real solutions in the LPD's readiness to face AEC.

## II. LITERATURE REVIEW

### 2.1 *Microfinance Institutions Role*

Ledgerwood (1999) confirms the main purpose of microfinance institution (MFIs) as an organization builder is to provide financial contributions intended to benefit low-income women and men. The term refers to the provision of financial services to low-income clients, including the self-employed. More specifically the World Bank states where microfinance institutions are expected to reduce poverty as one of the most important development goals. However, the positive impact of microfinance institutions to the socio-economic welfare of the poor can only be achieved and maintained if the institutions have a good financial condition and performance. Ito (2003) states microfinance institutions are in areas where the role of social capital gets big attention. Social capital defined as the norms and social relations embedded in the social structure that allows people to coordinate in order to achieve the expected goals.

As with many other financial institutions, microfinance institutions have intermediation function in the financial sector, aimed to provide better access to people who fall into the category of low-income. Financial services generally include savings and credit; however, some microfinance organizations also provide insurance and payment services. In addition to financial intermediation, many MFIs provide social intermediation services such as group formation, development of self-confidence, and training in financial literacy and management capabilities among members of a group. Thus the definition of microfinance often includes both financial intermediation and social intermediation. Microfinance is not simply banking; it is a development tool (Ledgerwood, 1999).

This organization should be able to be financially independent. Consequently, performance measurement MFIs remained based on financial performance, which refers to the ability of MFIs to cover its operational costs with the revenue earned (Arsyad, 2005b). MFI performance is not only measured by its financial independence, but also of its operational range (outreach). Both indicators have become benchmark in measuring the MFIs performance. MFI's business activities, as reported by the Financial Services Authority: 1)

- MFI's business activities include business development services and community empowerment, either through loans or financing to public micro enterprises, saving management, as well as the provision of business development consultancy services
- The business activities as intended can be done conventionally or based on sharia principles.
- MFIs can perform fee-based activities which are not contrary to the statutory provisions in the financial service sectors.

MFI's objectives are: 1) Improving access for community to micro credit; 2) increasing economic empowerment and productivity of society; 3) increasing community income and welfare, especially the poor or low-income people

### 2.2. *Aspects of the Lembaga Perkreditan Desa (LPD) in Bali*

In accordance with the explanation Local Government Law No.8 / 2002, which is then converted into Local Government Law No. 3 / 2007, LPD establishment aims should be directed towards improving standards of living community in their village and many activities to support rural development. LPD business sectors have following objectives: 1) encourages the economic development of rural communities by improve people saving behaviour and provide credit for small-scale businesses; 2) eliminates various forms of credit relationship exploitation (include debt bondage, dark pawn and others can be equated with it); 3) creates same business opportunities for villager; and 4) increases the degree of monetization (the purchasing power and launched a payment traffic and money circulation) in rural areas.

LPD establishment, though targeted to exist in the entire traditional village, cannot be imposed by government. Because in accordance with Article 5 Local Government Law No. 8/2002, LPD can only be established in the traditional village who already have "awig awig" (a local community law) in writing and when viewed from the socio-economic aspects, these villages have potential to develop. This rule indicates regulation (formal institutions) created by the provincial government pay greater attention and accommodates existing informal institutions (including social customs, values, and norms included in the rules and habits of society). It is becoming a key factor for the effectiveness of formal regulations in achieving the expected goals

(Arsyad, 2005a). In the explanation of the local regulation also clearly stated that the customs and habits of local people will be adhered by the villagers because it has been there since the first.

Informal institutions accommodation into formal institutions is also reflected in another explanation of the regulation which emphasizes that this regulation was passed intentionally to maintain and improve the existence and independence of the indigenous villages. Moreover, the emphasis on LPD is a financial institution that is owned, managed and used by members of the indigenous villagers, and management should be based on the Balinese customs. Indigenous villages' obligation to have written "*awig awig*" implies LPD try to find rules, behaviour norms and public code of conduct in the traditional villages' area. It is becoming LPD competitive advantage compared to other competitors such as cooperatives and BRI unit (Arsyad, 2005a). It also became evident that in daily operations, LPD should be supervised by the village community (represented by *Bendesa Adat*) as LPD manager should be recruited and selected by the villagers in traditional village meeting

### III. DATA AND RESEARCH METHODOLOGY

The study was conducted using primary data. Samples were taken by random from LPD in Denpasar. Given the large number of LPD, but the nature and rules that are used tend to be homogeneous, the sampling LPD in Denpasar expected to represent the population. The data used is the result of in-depth interviews with all relevant stakeholders in this case are managers of the LPD, *Bendesa Adat*, borrowers, and savers in the LPD. Data in 2015 showed there were 35 LPD around Denpasar, with a distribution of 10 units in North Denpasar LPD, 12 units LPD in East Denpasar, 11 units in South Denpasar, and two units of LPD in West Denpasar.

The analytical tool used here is the SWOT method. SWOT analysis is to identify the various factors systematically to formulate business strategies. This analysis is based on the logic that maximizes strengths and opportunities, but simultaneously can minimize weaknesses and threats. The decision making process is always associated with the development strategy of the mission, goals, strategies, and business policies. Thus strategic planners (strategic planner) should analysed the strategic factors (strengths, weaknesses, opportunities, and threats) in the existence conditions.

## IV. 4. RESULTS

### 4.1 General Picture of LPD Bali

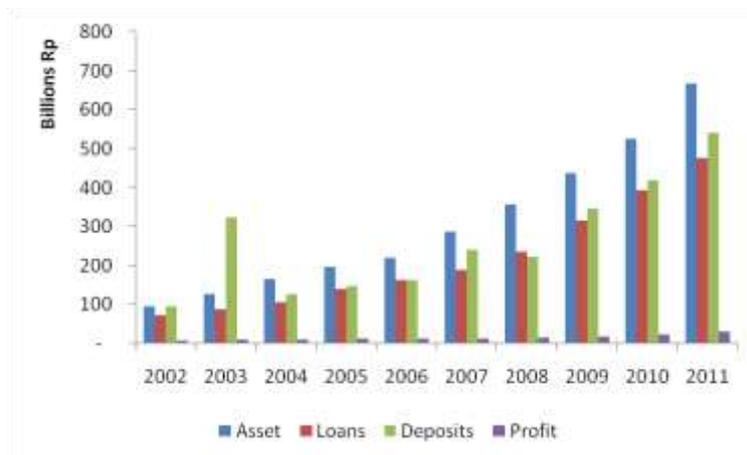
LPD has a strategic role because it has been serving the small micro enterprises (MSEs) and the rural community (villagers) in Bali through financial services which are conducted in accordance with the customer requirements, simple procedure, short process, a personalized approach, as well as nearby location. LPD relatively high growth over time indicates that the presence of LPD is needed by rural communities including MSEs that had been served. LPD specifications which has cultural affinity and psychology to customers, as well as location factors allows them to reach wide customers. In addition, their flexible business character becomes the strengths of LPD to survive and have competitiveness against similar institutions. LPD advancement which is expected to be an effective financing institutions in rural communities, will positively affect the development of rural areas. The community will assisted in funding to develop potential business in the region that will encourage rural competitiveness in this global economic.

LPD occupies a strategic position at the level of rural development to accelerate economic growth and development of indigenous villages in order to improve the living standards of rural communities. As a means of village economic wealth, LPD is expected to play a role in improving the village economy efficiency, boosting productivity in society and contribute to the regional development. Because LPD role in such a way, the general target LPD directed to (Denpasar City Government, 2012): 1. Increases LPD productivity; 2. Encourages professionalism of LPD management; 3. Increases productivity of traditional village society; 4. Increases LPD competitiveness; 5. Increases LPD institutional quality.

In less than 20 years LPD has shown a very rapid development, both in terms of number and business development. As one of the microfinance institutions, LPD has been instrumental in stimulating economic development and creating opportunities for rural communities as well as participating in supporting government programs in terms of poverty reduction. There are 35 units of traditional villages in Denpasar and overall there has been 35 LPD which means the whole village in Denpasar has LPD. LPD development in Denpasar in last 5 years showed a positive trend both in terms of assets, loans, and profits. Results of LPD operations has been contributed in accordance with the functions of the LPD to build the traditional village through LPD profit share by 20% for development of traditional village, meanwhile 60% for LPD assets, 5% for social funds, 5% to fund coaching, supervision and protection, and 10% for production services.

Assets of LPD in Denpasar in 2011 achieved IDR667 billion, up 21.25 percent to IDR1.384 trillion in the year 2015. The profit in 2011 amounted to IDR29.9 billion, rose 23.5 percent to IDR 65 billion in 2015. The high customer growth, outstanding credit, savings and deposits are evidence of strong public demand (Arsyad, 2005b). There are two important things to note. First, these data indicate LPD has succeed to stimulate and

encourage public saving behaviour in the village, which means they succeed to reach one of the founding goals at once increasing the degree of monetization in the region. Second, LPD also succeed to offer a mechanism to mobilize existing funds. Customers feel if the mechanisms offered by LPD in accordance with their needs. This condition can also mean the level of customer confidence in the LPD is very high, which is the reason for someone to use a financial institution. LPD ability to meet their customer needs becoming the power of LPD in order to survive. It shows the LPD operational range, as one of the performance indicators, provides social benefits to its customers and economic development in rural areas where they stand.



**Figure 1** LPD Development in Denpasar 2002-2011

LPD specifically are targeting the economically disadvantaged who have limited access to formal banking financial institution. However, LPD customers are no longer the economically disadvantaged (poor) but also trusted by middle- and high-income people as their financial institution to perform various financial transactions. Establishment of LPD was basically intended as strategic business information centre and society productivity aims to improve and empower local economic potential which in turn enhances competitiveness and welfare of indigenous villagers. LPD is expected to have a strategic role in serving small micro enterprises (MSEs) and the rural community (villagers). In fact, if it is seen from credit purposes accessed from LPD, business capital loan has the largest share compared to consumption or other purposes, such as education financing. This indicates that the LPD financing has delivered for productive purposes.

The growing value of assets and customers cannot be separated from the diversification and business strategies undertaken by LPD. LPD services in its development are not only in the accumulation of savings and lending, but once into other financial services, such as water and electricity bill payment. LPD seek to reach a variety of financial transactions required by the community, with all its limitations.

Public deposit collected by LPD also increasing over the years, but most savers in LPD also has a savings elsewhere (banks) with a variety of reasons. The bank advantages with ATM facilities is the mostly reason. The amount of credit that distributed by LPD also gets bigger, even though each credit value is relatively small. This is consistent with the purpose of establishing LPD itself. Unlike customers of savers who still have accounts at other banks, credit customer in LPD generally do not have credit elsewhere. Many factors becoming reasons, such as awareness to empower LPD for village betterment, LPD distance is closer, and customer satisfaction

**4.2 Discussion of SWOT Analysis**

Results of analysis allows us to identify opportunities, threats, strengths, and weaknesses that are owned by LPD.

**Table 1.** Internal Factor Analysis Survey (IFAS)

No	Strengths and Weaknesses	Weight	Rating	Score
	Strengths	1	2	3
1	LPD is a financial institution that is not under the banking laws, but under local regulations	0,20	4	0,80
2	LPD credit application is relatively easy and fast service compared to other financial institutions	0,20	3	0.60

3	LPD personnel and their client have its own ties by customs and daily life in their neighborhood	0,20	4	0,80
<b>Weaknesses</b>				
1	A rule requiring LPD to appoint a manager and personnel from indigenous village limits the choice of management possibilities from other parties who are more competent/professional	0,20	4	0,80
2	Health assessment of LPD (by BPD) is not as strict as that imposed by central bank to the banking sector, because of the sanctions given to LPD considered unhealthy if less obvious	0,20	3	0,60
<b>TOTAL</b>		<b>1</b>		<b>3,40</b>

Analysis of the internal environment shows LPD has a strong general conditions because of total weighted value (score IFAS) is  $3.40 > 2.50$ .

**Table 2.** External Factor Analysis Survey (EFAS)

No	Opportunities and Threats	Weight	Rating	Score
<b>Opportunities</b>				
1	Trust given by the local community as shown by people participation to save or borrow at LPD	0,20	4	0,80
2	Legality and protection provided by the local government as outlined in the regional regulation	0,20	3	0,60
3	Optimism on rural economic development that will drive operational improvement for LPD	0,10	4	0,40
4	LPD, are in an area where the role of social capital, in this case is social cultural of Balinese daily life, given great attention	0,10	3	0,30
<b>Threats</b>				
1	Entering the era of the ASEAN Economic Community (AEC) challenges in terms of competition in the financial institutions will be intense	0,10	3	0,30
2	In the case of LPD, this explicitly has a limited area that is narrower than other financial institutions	0,20	3	0,60
3	ATM and mobile banking, by rules and technology, both of these facilities are still difficult to be built in to LPD	0,10	3	0,30
<b>TOTAL</b>		<b>1</b>		<b>3,30</b>

Analysis of the external environment shows LPD faces opportunities in general. It is defined as the total weighted value (score) is  $3.30 > 2.50$ . Based on the analysis of LPD's internal strategic factors shows that the total score of internal strategic factor reached a value of 3.40 which is categorized in the relatively strong position because they are in the value range from 3 to 4. The results of external strategic factors analysis showed a total score of 3.30, which means LPD have relatively high chances. Referring position on these results the appropriate strategy that should be chosen by the LPD is growth and build strategy.

## V. CONCLUSION

LPD is a microfinance institution that is still deeply rooted in the indigenous community because of the trust placed by the public. Customary ties and local regulations make LPD as the only financial institution in writing are recognized as part of social community in Bali. Internal supervision from indigenous village leaders and local governments as external supervision can ensure continuity and soundness of LPD. However, those strong supports were not always able to guarantee the continuity of LPD without human resources

professionalism of all LPD officers. It is a little bit difficult because of the LPD officers shall come from within their village, so that LPD management can said to be "less professional". Various challenges have to be faced by LPD, particularly in the era of the financial markets liberalization in the AEC. Strategies must be prepared to support LPD continuity and existence as a part of the local community in supporting village economy.

The local government and traditional village leaders as part of the external and internal LPD supervisor should be able to provide the right direction policy and professional without being accompanied by a personal interest that could lead to conflict of interest which is very sensitive in indigenous communities. All LPD team, managers and officers, should still be selected from the local community who have high integrity and ability to manage public funds so there is no possibility of funds manipulation. In addition, regular training should be part of the LPD plans in effort to improve services to the community. Extending the operational areas and the establishment of ATM / mobile banking may be a difficult thing embodied by LPD, but if LPD still able to maintain public confidence and satisfaction service to customers, the AEC is not really a big challenge for LPD. This is because the LPD should already have the loyalty of villagers.

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