



THE DETERMINANTS OF SUCCESSFULL
MICROENTERPRISES: A CASE STUDY OF BRI
CLIENTS IN MEDAN CITY, INDONESIA

BY

WENI HAWARIYUNI

A dissertation submitted in fulfilment of the requirement for
the degree of Doctor of Philosophy of Economics

Kulliyyah of Economics and Management Sciences
International Islamic University Malaysia

JANUARY 2014

ABSTRACT

This study focuses on the determinants of the success of microenterprise owners in receiving loans from one of the successful microfinance institutions, namely, BRI Unit in Medan City, North Sumatra, Indonesia. This study applies the methodology of the before and after approach for measuring the success. It utilizes some financial indicators to measure the success of the microenterprises, namely income, fixed assets, and household expenditure. The findings show that financing in terms of the amount of loan accessed has a positive relationship with success indicators in terms of changes in income and fixed assets. However, it does not have a positive relationship with changes in household expenditure. In the meantime, firm characteristics in terms of dummy variable for type of business of food and household facilities and necessities have a positive relationship with changes in income. In terms of KUPEDES loan, financing indicates that it has a positive relationship with changes in income, changes in fixed assets, and changes in household expenditure. The dummy variables for food; and household facilities and necessities indicate that they have a positive relationship with changes in income. In terms of KUR product, the firm characteristics in terms of dummy variables of garment, and technician and repair of vehicles and watches show a positive relationship with changes in fixed assets. Further, the household characteristic in terms of household income indicates a positive relationship with changes in household expenditure. In conclusion, financing, firm characteristics, and household characteristics are the factors that determine the success of microenterprises in terms of income, fixed assets, and household expenditure. It is expected that policy makers of microfinance institutions (MFIs), including the BRI Unit and Indonesian government could solve the common problems faced by MSMEs, such as financing, raw materials, marketing, advanced technology, and others, as MSMEs play a crucial role in increasing economic growth in terms of reducing poverty and unemployment; and increasing GDP. In this respect, the policy makers of MFIs including the BRI Unit are also expected to provide the facilities besides credit services, such as training, health programmes, education, family planning, and other programmes to make greater effectiveness of the microfinance on the performance of microenterprises.

ملخص البحث

تركز هذه الدراسة على محددات النجاح لأصحاب المشاريع الصغيرة في الحصول على قروض من أحد مؤسسات التمويل الأصغر الناجحة ألا وهي وحدة ال BRI بمدينة ميدان، شمال سومطرة بإندونيسيا. تنطبق منهجية هذه الدراسة على نهج "ما قبل و ما بعد" لقياس عوامل النجاح. تستخدم المنهجية بعض المؤشرات المالية لقياس نجاح المشاريع الصغيرة وهي: مستوى الدخل، الأصول الثابتة و الانفاق المنزلي. تظهر النتائج بأن التمويل من حيث كمية القروض المتاحة له علاقة إيجابية مع مؤشرات النجاح من حيث تغيرات مستوى الدخل و الأصول الثابتة. ومع ذلك فإنه لا توجد أي علاقة إيجابية من حيث التغيرات في الإنفاق المنزلي. أثناء هذا، نجد بأن خصائص الشركة التي تتمثل في شكل متغير وهمي لنوع الأعمال التجارية للمواد الغذائية و المرافق المنزلية و الضروريات لها علاقة إيجابية مع تغيرات مستوى الدخل. أما من حيث قروض ال KUPEDES فإن التمويل يؤثر بأن هنالك علاقة إيجابية مع التغيرات في مستوى الدخل، الأصول الثابتة و الانفاق المنزلي. تشير التغيرات الوهمية للأغذية و المرافق المنزلية و الضروريات إلى علاقة إيجابية مع تغير مستوى الدخل. بالنسبة لنتائج ال KUR فإن خصائص الشركة من حيث التغيرات الوهمية للملابس و فني و إصلاح المركبات و الساعات تشير إلى علاقة إيجابية مع التغيرات في الأصول الثابتة. علاوة على ذلك، فإن الخصائص المنزلية من حيث الدخل المنزلي تشير إلى علاقة إيجابية مع تغيرات الإنفاق المنزلي. ختاماً نجد بأن التمويل و خصائص الشركة و الخصائص المنزلية كلها عوامل تشير إلى نجاح المشروعات الصغيرة من حيث مستوى الدخل و الأصول الثابتة و الإنفاق المنزلي. من المتوقع بأن يتمكن صانعي السياسات لمؤسسات التمويل الأصغر MFIs بما في ذلك وحدة ال BRI والحكومة الإندونيسية بحل المشاكل العادية التي تواجه المشاريع الصغيرة و المتوسطة MSMEs كتلك التي تتعلق بالتمويل و المواد الخام و التسويق و التكنولوجيا المتقدمة و غيرها نسبة للدور الهام التي تلعبه المشاريع الصغيرة و المتوسطة MSMEs في زيادة النمو الإقتصادي من حيث الحد من مستوى الفقر و البطالة و زيادة الناتج المحلي الإجمالي. في هذا الصدد، من المتوقع أيضاً من صناع السياسات لمؤسسات التمويل الأصغر MFIs بما في ذلك وحدة ال BRI تقديم التسهيلات بجانب الخدمات الإئتمانية مثل التدريب و برامج الصحة و التعليم و تنظيم الأسرة و برامج أخرى لجعل فعالية أكبر للتمويل الأصغر على أداء المشروعات الصغيرة.

APPROVAL PAGE

The dissertation of Weni Hawariyuni has been approved by the following:

Gairuzazmi Bin Mat Ghani
Supervisor

Alias Bin Mat Derus
Supervisor

Norma Md Saad
Internal Examiner

Mohd Dan Bin Jantan
External Examiner

Abdi Omar Shuriye
Chairman

DECLARATION

I hereby declare that this dissertation is the result of my own investigations, except where otherwise stated. I also declare that it has not been previously or concurrently submitted as a whole for any other degrees at IIUM or other institutions.

Weni Hawariyuni

Signature:

Date:

INTERNATIONAL ISLAMIC UNIVERSITY MALAYSIA

**DECLARATION OF COPYRIGHT AND AFFIRMATION
OF FAIR USE OF UNPUBLISHED RESEARCH**

Copyright © 2014 by International Islamic University Malaysia. All Rights Reserved

**THE DETERMINANTS OF SUCCESSFULL
MICROENTERPRISES: A CASE STUDY OF BRI CLIENTS IN
MEDAN CITY, INDONESIA**

I hereby affirm that The International Islamic University Malaysia (IIUM) holds all rights in the copyright of this Work and henceforth any reproduction or use in any forms or by means whatsoever is prohibited without the written consent of IIUM. No part of this unpublished research may be reproduced, stored in a retrieval system, or transmitted, in any form or by means, electronic, mechanical, photocopying, recording or otherwise without prior written permission of the copyright holder.

Affirmed by Weni Hawariyuni

.....

Signature

.....

Date

TO

My beloved Husband and my beloved son, Zulfikri SE and Abhizar Khairi Rashdan,

My beloved parents, Dr. Shafwan Hadi Umry M.hum and Zulhaida Amin,

My beloved brother, Dr. Miftahul Ihsan

ACKNOWLEDGMENTS

A major research project like this is never the work of anyone alone. The contributions of many different people, in their different ways, have made this possible. I would like to extend my appreciation especially to the following:

Thanks to Allah SWT for the wisdom and perseverance that he has been bestowed upon me during this difficult times, and indeed, throughout my life. Thanks to Allah SWT for everything that you gives it to me.

I would like to thank my husband, Zulfikri S.E. His support, encouragement, quiet patience, and unwavering love were undeniably the bedrock upon which the past four years of my life have been built. His tolerance of my occasional vulgar moods is a testament in itself of his unyielding devotion and love. Thank also for my beloved son for his love, Abhizar Khairi Rashdan.

I thank my parents, Dr. Shafwan Hadi Umry M.Hum and Zulhaida Amin for their faith in me and allowing me to be as ambitious as I wanted. It was under their watchful eye that I gained so much drive and an ability to tackle challenges head on. Thanks for both of you for unconditional support, both financially and emotionally throughout my studies. Also I thank to Zulfikri's mother, Dewi Sjafriyeni for her unending encouragement and support.

I thank my academic supervisors, Assoc. Prof. Dr. Gairuzazmi Mat Ghani and Dr. Alias bin Mat Derus for guiding and helping me. During my tenure, they contributed to a rewarding graduate school experience by giving me intellectual freedom in my work, supporting my attendance at various conferences, engaging me in new ideas, and demanding a high quality of work in all my endeavours. Additionally, I would like to thank my former supervisors, Prof. Dato' Jamil bin Osman and Prof. Muhamad Ariff Zakaullah.

I would like acknowledge for the whole lecturers and staffs at the Department of Economics at IIUM, especially for my Head of Department, Prof. Dr. Norma Md Saad. My graduate experience benefitted greatly from the courses I took, the opportunities I had as a research and teaching assistants, and the high quality seminars that the department organized.

I am grateful also for the research grant that I received from Research Management Centre (RMC) and thank also for the whole staffs in Kulliyah of Economics and Management Sciences (KENMS), especially for sister Norlin and Sister Rohamah.

I would like to acknowledge PT. Bank Rakyat Indonesia (BRI) Tbk for helping me in completing this thesis, especially thank to Mr. Herry Husni. I would

like also thank to IAIN (Institut Agama Islam Negeri), particularly for Mr. Akmal Tarigan, Prof. Amiur, and ten students as my surveyors from IAIN.

Finally, I would like to acknowledge family and friends who supported me during my time here. I would like to thank to my beloved brother, Dr. Miftahul Ihsan for his unconditional support, both financially and emotionally throughout my studies. I really appreciate it. Thank also to my beloved brother, Sopian Hadi, my beloved aunty, Syafrinawati S.H., my beloved sisters, Maladina Sariosa, S.S and spouse, Afridini S.T, and spouse, and Meigia Hapsari S.T. Thanks also to my whole family in Medan and other states in Indonesia, my family in Kuala Lumpur, and thanks to my favourite English teacher, Mr. Syafrial Pasha S.S, and my ustadz, Ust. Rizal.

Thanks to my best friends, Marhanum, Siti Maimunah, Dewi Sarah, Bidayatul Akmal, Nyimas Rohmah, Aishah, Dwi Rahayu, Inggrid, Gita Rulyani, Alfi, Hani, Dr. Azlina Hanif, Dr. Zahira, Dr. Suriawati, Dr. Ronald Rulindo, Tomi, Ratna, Sharifah, Juwayriya, Laila, Asmalina, Dr. Suzi, Dr. Hafas, Dr. Ismaeel, Sarfina, Nor Fariza, Zahra, Masahina, Rulia, Ina Pohan, Dr. Yusuf, Dr. Aliyu, Asst. Prof. Dr. Abideen, Naviu, Fuad, Azmi, Nurzaman, Hidayatul Ihsan, Ruliah, Ros, Ruhila, Dimas, Muhammad Fani, Farizah, Seyama, Normia, and other friends in PhD female and male rooms. Thank also to my friends in Pangsapuri Harmonis, ISEFID and other friends in IIUM.

TABLE OF CONTENTS

Abstract	ii
Abstract in Arabic	iii
Approval Page.....	iv
Declaration	v
Copyright Page.....	vi
Dedication	vii
Acknowledgments.....	viii
List of Tables	xi
List of Figures	xiii
List of Abbreviation	xiv
CHAPTER 1: INTRODUCTION.....	1
1.1 Overview	1
1.2 Problem Statement	9
1.3 Objectives of the Study	10
1.4 Research Questions	12
1.5 Limitations of the Study.....	12
1.6 Contributions of the Study	13
1.7 Organisation of the Study.....	13
CHAPTER 2: PERFORMANCE OF PT. BANK RAKYAT INDONESIA (PERSERO) TBK.....	15
2.1 Introduction	15
2.2 The History of PT. Bank Rakyat Indonesia Tbk.....	15
2.3 Transformation of the BRI Units and their Success as a Commercial Microfinance Provider	19
2.4 Conclusion	26
CHAPTER 3: LITERATURE REVIEW.....	27
3.1 Introduction	27
3.2 The Development of Microfinance	27
3.3 Microfinance and Microenterprise	32
3.4 Impact Assessment of Microfinance on Poverty and Microenterprises	35
3.5 Factors Determining the Success of Microenterprises.....	44
3.6 The Measurement of Success.....	50
3.7 Theory of Microfinance	52
3.8 The Importance of Micro, Small, and Medium Enterprises for Employment and Economic Growth in Indonesia	53
3.9 Conclusion	58
CHAPTER 4: THEORETICAL FRAMEWORK	60
4.1 Theoretical Framework	60
4.2 Empirical Model and Variables	65

CHAPTER 5: DATA AND RESEARCH METHODOLOGY	76
5.1 Introduction	76
5.2 BRI Units in Medan City, Indonesia	76
5.3 Survey Area.....	77
5.4 Survey Design and Data Collection	82
5.5 Description of Respondents	84
5.6 Methodology and Model	86
5.6.1 Before and After Approach	86
5.6.2 The Diagnostic Models.....	88
 CHAPTER 6: RESULTS OF THE DETERMINANTS OF THE SUCCESS OF MICROENTERPRISES THAT RECEIVED LOAN FROM THE BRI UNIT.....	 93
6.1 Introduction	93
6.2 Characteristics of Microentrepreneurs	93
6.3 Type of Business Before and After Accessing BRI Microloan	104
6.4 Type of Business and Business Location After Accessing BRI Microloan	107
6.5 Life Necessities and Business Assets of Microenterpreneurs Before and After Accessing a BRI Unit Microloan	109
6.6 Characteristics of BRI Unit Loan.....	114
6.7 Microloan Products of BRI Unit	120
6.8 Performance of Microenterprises	122
6.9 Empirical Results from Regression.....	139
 CHAPTER 7: CONCLUSION.....	 151
7.1 Findings.....	151
7.2 Implications of the Findings	154
7.3 Recommendations for Further Research.....	154
 BIBLIOGRAPHY	 156
 APPENDIX I	 172
APPENDIX II	182
APPENDIX III	189
APPENDIX VI.....	203
APPENDIX V	205

LIST OF TABLES

<u>Table No.</u>		<u>Page No.</u>
2.1	Deposits and Loans in BRI Units, 1984-2000	22
2.2	BRI Unit Profits, 1984 to 2004.	24
2.3	The Development of Net Profit, CAR, and ROA of PT. BRI PERSERO Tbk, 2007 to 2011	25
4.1	The Description of the Determinants of Success of Microenterprise	66
5.1	Selected Regional Economic Indicators in Medan City in 2010	80
5.2	Selected Banking Indicators of North Sumatra in 2011 - 2012	81
6.1	Characteristics of Microentrepreneurs who Received Microloan from the BRI Unit (n = 412)	94
6.2	Household Income of Microenterprise Owners (2009) (Rupiah)	100
6.3	Type of Business for Before and After Accessing BRI Microloan	105
6.4	Type of Business and Business Location After Accessing BRI Microloan	107
6.5	Life Necessities and Business Assets Before and After Accessing BRI Unit Microloan	110
6.6	Facilities and Infrastructures Available Nearby the Houses of Microentrepreneurs	113
6.7	Characteristics of BRI Unit Loans	114
6.8	The Starting Years of Microloans from the BRI Units.	120
6.9	Type of Microloan Product of BRI Unit	121
6.10	Cross Tab of Gender and Type of Loan	122
6.11	The Microenterprise Performance in Nominal Terms (in thousands Rupiah)	123
6.12	The Microenterprise Performance in Real Terms	127
6.13	The Performance of Microenterprises Accessing KUPEDES Products in Nominal Terms (in thousands Rupiah)	128

6.14	The Performance of Microenterprises Accessing KUPEDES in Real Terms	129
6.15	The Paired-Samples T-Test for Performance of Microenterprises Before and After Receiving KUPEDES Loan	131
6.16	The Microenterprise Performance of BRI Unit Accessing KUR Product in Nominal Terms (in thousands Rupiah)	132
6.17	The Microenterprise Performance of BRI Units Accessing a KUR Product in Real Terms	133
6.18	The Paired-Samples T-Test for Performance of Microenterprises Before and After Receiving KUR Loans	134
6.19	Profit Before and After Receiving Loan and Year of Business Establishment	135
6.20	Members Employed Before and After Accessing a BRI Unit Microloan	138
6.21	The Determinants of the Success of Microentrepreneurs who Received Loan from the BRI Unit	140
6.22	The Determinants of the Success of Microentrepreneurs who Received KUPEDES	144
6.23	The Determinants of the Success of Microentrepreneurs who Received KUR	148

LIST OF FIGURES

<u>Figure No.</u>		<u>Page No.</u>
4.1	Determinants of the Success of Microenterprises that Received a Loan from the BRI Units	64
5.1	Map of Medan city	79
6.1	Household Income Per Month of Microenterprise Owners (2009)	101
6.2	The Duration of Loan (Years)	116
6.3	Amount of Loan (Rp.Million)	117
6.4	Duration of Loan Provision (Months)	118
6.5	Monthly Instalment of Microloan of BRI Unit (Rp.Million)	119
6.6	Profit Before Receiving Microloan	136
6.7	Profit After Receiving Microloan	137
6.8	Year Business was Established	138

LIST OF ABBREVIATIONS

AIMS	Assessing the Impact of Microenterprise Services
ANCOVA	Analysis of Covariance
ANOVA	Analysis of Variance
APEC	Asia-Pacific Economic Cooperation
BANCOSOL	Banco Solidario
BI	Bank Indonesia (Central Bank of Indonesia)
BIMAS	Bimbingan Massal (Mass Guidance)
BKD	Badan Kredit Desa (Board of Village Credit)
BKK	Badan Kredit Kecamatan (Board of Sub-District)
BKPD	Bank Karya Produksi Desa (Bank of Village Production and Creation)
BMT	Baitul Mal wa Tamwil
BNI	Bank Negara Indonesia
BPG	Breusch Pagan Godfrey
BPR	Badan Perkreditan Rakyat (Rural Credit Bank)
BPS	Biro Pusat Statistik (Central Bureau of Statistic)
BRAC	Bangladesh Rural Advancement Comiittee
BRI	Bank Rakyat Indonesia (Indonesia People Bank)
BTM	Baitul Tamwil
CARD	Centre for Agriculture and Rural Development
CERUDEB	Centenary Rural Development Bank
CMF	Centre for Microfinance
CYSD	Centre for Youth and Social Development
D-W	Durbin Watson
FID	Focus Individual Discussion
FINCA	The Foundation For Internationalcommunity Assistance
GDP	Gross Domestic Product
GEMA PKM	The Indonesian Movement For Microfinance Development
IAIN	Institut Agama Islam Negeri (Institution Of Islamic State)
ICT	Information and Communications Technology
IFBN	Index of Fulfillment of Basic Needs
ISP	Informal Sector Program
KIE-ISP	Kenya Industrial Estate Informal Sector
KREP	Kenya Rural Enterprise Program
KUPEDES	Kredit Umum Pedesaan (Rural General Credit)
KUR	Kredit Usaha Rakyat (Micro People Business Credit)
KURK	Kredit Usaha Rakyat Kecil (Credit for Small Business People)
LAPO	Lift above Poverty Organization
LDKPS	Lembaga Dana Dan Kredit Pedesaan (Village Credit and Fund Institution)
LES	Large Enterprises
LKP	Lembaga Kredit Pedesaan (Village Credit Institution)
LPD	Lembaga Perkreditan Desa (Village Credit Sector Institution)

LPK	Lembaga Perkreditan Kecamatan (Sub-District Credit Institution)
LPN	(Lumbung Pitih Nagari)
MDA	Multivariate Discriminant Analyses
MFIS	Microfinance Institutions
MLE	Maximum Likelihood
MSMES	Micro, Small and Medium Enterprises
NGOS	Non-Governmental Organizations
OLS	Ordinary Least Squares
PCGS	Production Credit Groups
PINBUK	Pusat Inkubasi Usaha Bisnis Kecil
PRADAN	Professional Assistance for Development Action
PRODEM	Fundación Para La Promoción Y Desarrollo De La Program
PROMUC	Promoción De La Mu Jer Y La Comunidad
PT	Perseroan Terbatas
PTCCSS	Primary Thrift and Credit Cooperative Society
RD 12	Rural Development Project
ROA	Return on Assets
RRB	Regional Rural Banks
SACA	Smallholder Agricultural Credit Administration
SAT	Sinapi Aba Trust
SDI	Subsidy Dependence Index
SEEP	The Small Enterprise Education And Promotion Network)
SHARE	Social for Helping Awaken Rural Poor Through
SHGS	Self Help Groups
SIMASKOT	Simpanan Masyarakat Kota (Urban Saving)
SIMPEDES	Simpanan Masyarakat Pedesaan (Rural Saving)
SMES	Small and Medium Enterprises
TABANAS	Tabungan Nasional (National Saving)
TBK	Terbuka
TRDEP	Thana Resource Development and Employment
USAID	United States Aid
VIF	Variance Inflation Factor
WLS	Weighted Least Squares

CHAPTER 1

INTRODUCTION

1.1 OVERVIEW

Countries from around the world are giving attention to microfinance institutions (MFIs) because of their role in generating employment and economic growth (Bhasin and Akpalu, 2001; Santos, 2003). MFIs such as Grameen Bank in Bangladesh, BancoSol in Bolivia, and Bank Rakyat Indonesia (BRI) in Indonesia have spread throughout the world indicating their success in alleviating poverty and improving microenterprise performance. Various studies in the past have successfully proven that MFIs are not only crucial in alleviating poverty but also play an important role in supporting the performance of microenterprises in various countries. Mosley (1997), for example, deliberated on how microfinance has helped to improve the income and employment of borrowers of the BancoSol lending programme. And in another study where the Subsidy Dependence Index (SDI) was used, Mosley and Hulme (1998) showed how BancoSol has had a positive impact on income in Bolivia. Similarly for Bangladesh, Khandker, Samad and Khan (1998) demonstrated how MFIs in the country, such as Grameen Bank, Bangladesh Rural Advancement Committee (BRAC) and Rural Development Project (RD 12) had positively influenced income, production, and employment in Bangladesh; while Bhasin et al. (2001) and Vogelgesang (2001) showed that microfinance has helped improve technical efficiency, productivity, and growth of microenterprises in Cape Coast and Bolivia respectively.

A case study by Yamauchi (2005) demonstrated how microcredit can generate more employment for Indonesia. This is supported by Retno and Adwin (2011) who illustrated how microcredit can bring significant improvement on female entrepreneurs' standard of living. Furthermore, according to Agricultural Finance Corporation Limited (2008), many clients use microcredit to develop their existing activities or diversifying into new activities with a view of increasing their sources of income. Microfinance has also brought positive effect on performance of microenterprise in terms of income, savings, and loan repayment (Simeyo, Martin, Nyamao, Patrick, and Odondo, 2011). Microfinance indicates positive on education in Philippines (Karlan and Zinman, 2009). And in a case study of Amanah Ikhtiar Malaysia (AIM), Saad and Duasa (2011) explained how microfinance had brought positive effect on the business performance of microenterprises. AIM is also said to have positive impact on assets owned by older clients compared to new clients (Al-Mamun, Adaikalam, and Mazumder, 2012). Given these studies, it can be concluded that microfinance helps to alleviate poverty and improve the performance of microenterprises.

This study focuses on factors that determine the success of microenterprises that access microloans from the BRI Units in Medan City, the third biggest city in Indonesia. BRI is a world leader in commercial microfinance (Robinson, 2005). Development of microenterprises plays an important role in supporting economic growth in Indonesia by generating employment (job opportunities) and increasing productivity. This view is supported by Sandiaga Uno (2010), Vice Chairman of the Board of Industry and Trade of Indonesia (KADIN), who stated that Indonesia needed around 4.4 million enterprises including microenterprises to achieve economic

growth¹. For this reason, KADIN motivates Indonesian enterprises, including microenterprises, to keep expanding their business activities.

The development of microenterprises has been the focus of Indonesia's development policy, particularly in improving and broadening access to financial sources (Asia-Pacific Economic Cooperation [APEC], 2003). APEC also indicates that one of the problems faced by microenterprises is access to credit, particularly from commercial banks. Microenterprises face many obstacles in getting credit from commercial banks. Only 12 per cent of Small and Medium Enterprises (SMEs) are able to receive credit from commercial banks, with the following reasons being cited as the main problems (Indonesia Delegation for APEC SMEs Ministerial Meeting, 2003):

- i. Products of banks do not match the needs and conditions of SMEs
- ii. Banks often overestimate lending risk to SMEs
- iii. High credit transaction costs for SMEs
- iv. SMEs are not able to fulfil banking technical requirements
- v. Limited access of SMEs to financial equity
- vi. Inefficiency in monitoring and collection of SMEs credit
- vii. Less effective technical assistance provided by the bank itself, therefore service cost for SMEs is high
- viii. General bank is not used to financing SMEs

In addition, commercial banking credit creates difficulties for SMEs to fulfil banking technical requirements, especially collateral and other administrative requirements. Furthermore, according to Timberg (1999), formal financial institutions are sometimes the critical missing factor in supporting or promoting the growth of small and microenterprises (SME). He also added that many Indonesian SMEs do not have access to financial services for which they would be willing to pay.

The complex requirements from commercial banks are obstacles for microenterprises to start or to expand business productivity. This is similar in African

¹ Sandiaga Uno," Pengusaha Minta Bunga Kredit UMKM Bisa 10%, Detik.com, 10 April 2013, <http://www.finance.detik.com>.

countries where the main problem faced by micro, small, and medium enterprises (MSMEs) is to secure financing (Santos, 2003).

Due to the difficulties faced by microenterprises in accessing loans from commercial banks, MFIs have emerged as an important alternative source of financing for many new business ventures or enterprises. MFIs have emerged as a solution for microenterprises due to the reluctance of formal financial institutions to provide microcredit to microenterprises that may not have the capability for repayment. APEC (2003), therefore, suggested the establishment of MFIs is an important factor that encourages the development of microenterprises. MFIs help microenterprises by increasing business activities of microenterprises by providing working capital or investment funds, and by promoting and developing the spirit of entrepreneurship.

The role of MFIs is, therefore, critical in improving microenterprises' self-sustainability. Schreiner and Yaron (2001) defined self-sustainability as the long-term ability to meet goals. They further explained that for financial institutions and business firms, self-sustainability requires private profitability; namely, a return on equity and net subsidy that exceeds the private opportunity cost of resources. Thus, by accessing microloans from MFIs, microenterprises could augment their capital to enlarge their business activities and improve their self-sustainability. In addition, microenterprises could also raise the number of their workers and raw materials or inputs to boost their production. At the same time, microenterprises could gain access to microcredit to improve their fixed assets, current assets, market size, and financial performance, such as income and profit (USAID, n.d.).

According to Copestake, Simanowitz, and Knotts (2005), in the last few years, the fundamentals of MFIs have shifted from a supply led industry; inspired by a number of blueprint models of how access to financial services might be improved, to

a more client-focused and demand led approach. Furthermore, the success of a number of MFIs such as BancoSol, BRI, FINCA, Grameen Bank and BRAC, and Inicjatywa Mikro in Bolivia, Indonesia, Latin America, Bangladesh and Poland respectively have inspired the growth of a new generation of MFIs. However, even though a few of these new MFIs have managed to replicate the success achieved by their predecessors, MFIs in general are still facing various problems. One of which is that many MFIs are still heavily dependent upon subsidies (Copestake et al., 2005). MFIs also have to face the reality that they have to compete with each other, facing high client exit and turnover rates. These problems are stern reminders for all MFIs to review and redesign their services (Copestake, 2005).

According to Olu (2009), microfinance has emerged as an economic development approach targeted to benefit low-income, by providing financial services to low-income clients, including the self-employed. He stated that the general objective of any MFI as a development organisation is to service the financial needs of the served and underserved market as a means of meeting development objectives. Specifically, the development objectives are as follows:

- i. To reduce poverty,
- ii. To empower women or other disadvantaged population groups,
- iii. To create employment,
- iv. To help existing businesses grow or diversify their activities,
- v. To encourage the development of new businesses,
- vi. To create employment and income opportunities through the creation and expansion of microenterprises,
- vii. To increase the productivity and income of vulnerable groups, especially women and the poor; and finally,
- viii. To reduce rural families dependence on drought prone crops through the diversification of their income generating activity.

In this regard, the Indonesian government has realised the importance of MFIs in providing microcredit to microenterprises for many years, and has encouraged the growth of MFIs in urban and rural areas, including those based on *sharī'ah*

principles. There are a variety of conventional and Islamic MFIs in Indonesia, with the conventional MFIs consisting of BRI Units (Microbanking Division of BRI), and BPR (*Bank Perkreditan Rakyat/Rural Credit Bank*). Seibel et al. (1999) classified three types of rural MFIs in Indonesia. They are as follows:

- i. BPR-Non-BKD: This is the transformation of LDKPs (*Lembaga Dana dan Kredit Pedesaan/Village Credit and Fund Institutions*).
- ii. BPR-BKD (*Badan Kredit Desa/Board of Village Credit*): These are village-based, hitherto semiformal financial institutions established and owned by local villages and controlled by BRI.
- iii. LDKP consists of BKPD (*Bank Karya Produksi Desa*), LPK (*Lembaga perkreditan Kecamatan*), BKK (*Badan Kredit Kecamatan*), KURK (*Kredit Usaha Rakyat Kecil*), LPD (*Lembaga Perkreditan Desa*), LKP (*Lembaga Kredit Pedesaan*), and LPN (*Lumbung Pitih Nagari*). These LDKPs were sponsored by the provincial and local governments of Indonesia in the early 1970s as non-licensed rural credit institutions. They are controlled by provincial law and usually supervised by the provincial development bank (BPD).

Indonesia also has many types of Islamic microfinance institutions. In the Indonesian banking sector, there are banks such as Bank Muamalat Indonesia and BPR Syariah (Rural Bank of Syariah), as well as cooperatives like the Baitul Mal Wa Tamwil (BMT); which is under the supervision of Pusat Inkubasi Bisnis Usaha Kecil (PINBUK), Baitul Tamwil (BTM), and Koperasi Syirkah Muamanah. However, Budiantoro (2005) cautioned that the progress of microfinance in serving microenterprises in Indonesia is quite slow. He further added that even though microfinance activities are backed up by well known institutions such as Bank Rakyat

Indonesia/Indonesia people's Bank (BRI) and Bank Perkreditan Rakyat/Rural Credit bank (BPR), there is still a huge gap between the demand and supply of microfinance. The Indonesian Movement for Microfinance Development (Gema PKM) stated that MFIs has helped finance only 10 million of the 41.8 million microenterprises in Indonesia. Obviously, this rate is far from ideal if Indonesia is to encourage the growth of microenterprises.

Even though there are still microenterprises that lack access to working capital from MFIs in Indonesia, BRI has shown its success in improving the performance of microenterprises in almost every province in Indonesia. BRI has demonstrated the success of transformation from the microfinance section of a government-owned bank to become a highly profitable, self-reliant financial intermediary; and a major microfinance provider by offering microsavings and microcredit products to low-income people at market rates of interest (Seibel, 2005).

Nowadays, BRI uses savings mobilisation as its source of funds, and no longer depends on the Indonesian Government or World Bank. Seibel (2005) added that by December 2003, BRI had been successful in achieving 30 million accounts for savers and 3.1 million accounts for borrowers. In this regard, BRI has covered its costs from the interest rate margins and financed its expansion from its profits. Furthermore, BRI's Microbanking Division noted that by December 2003, its portfolio had reached US\$1.7 billion in loans outstanding and US\$3.5 billion in savings balances. Its excess liquidity was around US\$1.85 billion. Seibel (2005) further noted that other MFI providers; both in Indonesia and other countries, can learn several lessons from BRI. These lessons are in terms of its success in transforming itself from a subsidised government-owned bank to a viable, competitive and self-sufficient financing intermediary; and its ability to remain profitable during the 1997-1998 East Asia

economic crisis (Seibel, 2005). While many Indonesian banks collapsed, BRI Units somehow managed to secure 1.3 million new savers during the crisis (Seibel, 2005).

BRI is also recognised as the first commercial bank in the world to provide commercial financial services; such as savings and loans, as well as other products to millions of economically active poor and lower-middle income households, and, most importantly, does so profitably (Robinson, 2005). Robinson further added that BRI's microbanking, otherwise known as the BRI Unit system, which has been profitable every year since 1986, is now an integral part of Indonesia's financial system and provides microcredit for microenterprises. This study concentrates on factors determining the success of microenterprise owners who access microloans from the BRI Unit. BRI Unit is chosen because it is one of the largest and most successful microfinance institutions in the world (Maurer, 2004), and one of the most successful government-owned bank in Indonesian that offers microcredit schemes for micro, small, and medium enterprises (MSMEs). The success factors applied in this study are based on previous studies. In this regard, it focuses specifically on BRI Units under the supervision of BRI Medan Putri Hijau in Medan City, North Sumatra, Indonesia. BRI Medan Putri Hijau is located in Medan and is one of the five branches of BRI in Medan². There are two branches of BRI in Medan which have the authority to control BRI Units in Medan, namely BRI Medan Putri Hijau and BRI Medan Iskandar Muda. In 2009, BRI Medan Putri Hijau had 27 BRI Units, while BRI Medan Iskandar Muda had 25 BRI Units.

² Mr. Herry Husni, former supervisor of the administration unit, which focuses on micro units in BRI in Medan, North Sumatra, Indonesia. Recently, he became the supervisor of the business support unit, which handles credit administration in BRI. Mr. Husni was interviewed over the phone from Gombak, Selangor on 5 January 2012.