

# **PUBLIC-PRIVATE PARTNERSHIP POLICY: SYSTEM APPROACH TO MICROFINANCING**

**B.S Kusmuljono**

Chairman, Center for Policy Reform (CPR Indonesia)  
Chairman, National Committee for Microfinance Indonesia (Komnas PKMI), Email:  
cpr\_indonesia@yahoo.com

## **ABSTRACT**

More than 95 percents of business units in Indonesia are small and micro enterprises (SME). Problem facing by SME beside market and human resource is lack of investment support and less access to the banking sector. A closer investigation of the microfinancing problems reveals that rather than being technological, they are complex combinations of social, economic, cultural, psychological as well as legal and communications factors.

This research using system approach, aims to analyze and design the public-private partnership policy to establish microfinancing for less developed regions. The system methodology is philosophically committed to serve as a guide to action and primarily concerned with providing information relevant to a policy decision. Case study and face validation was carried out in model building process using Houghton (2009) generalization principles.

This research produced a conceptual framework (BSK model) related to the finding about the importance of institutional **linkage** between banking and Microfinance Institution (MFI) to set up sustainable SME financing. The linkage structure should be support by government budget for MFI empowerment and SME loan guarantee. Private companies roles is providing low interest credit for SME and CSR-fund to reduce its transaction cost appropriately. This linkage was found useful for smallholder's farmers and work effectively to reduce rural poverty.

The partnership policy must be planned and coordinated well by local government administration with local banks involvement. This study recommend independent MFI rating agency to facilitate capital formation of MFI by the bank. The BSK model was verified in the case of micro credit-KUR scheme linked to saving and loan cooperative units. In conclusion, microfinancing must be viewed as holistic efforts on system that can not be reduced to components that are separable.

Keywords: Microfinancing, Small Micro Enterprises (SME), Linkage System, Policy Model.

## **INTRODUCTION**

Global financial crisis had severe impact to Indonesia economy since October 2008, and already affects banking sector as well as real sector especially on agriculture. At present, the government of Indonesia already launched several recover program including food security, domestic market improvement and fiscal stimulus for infrastructures. Those programs are focused on poverty alleviation objectives and job creative efforts known as the "Program Nasional Pemberdayaan Masyarakat (PNPM)" or National Program for Community Empowerment.

The PNPM consist of various projects done by technical department in collaboration with business entity and local community organization. The PNPM projects mainly are:

- Social safety net such as cash transfer and food aid
- Job opportunity through cash for work activities
- Microfinance for productive business and smallholders

The paper discuss merely on the efforts to provide micro-credit in order to strengthen working capital and additional investment for 44 million Micro and small Enterprises (MSE). 91.26 percent of enterprises in Indonesia is MSE, which contribute about 53,3 percent to the GNP. There are 42, 5 million workers in MSE including self-employed at informal sector. Most of them are economically active poor and located in less-developed region and rural area. Their professions include farmers, fishermen and small-traders.

## **PROBLEM STATEMENT**

The main problem facing MSE are product marketing, infrastructure, human resource and financing support. The latest problem is due to the lack of accessibility to the bank sector. As we understand, most of MSE do not have sufficient collateral and hardly meet banking requirement for credit loan. There are only 9 percent MSE served by banks and merely 3 percents link with **Microfinance Institution** (MFI). Consequently MSE must rely on money lender which charged them whit high loan interest, sometime could be 10 percent a day or more those 200 percent per month.

In the midst of credit crunch, basic questions are the MSE business growing, declining or relatively stable? What is MFI role in these matters? A close investigation of the Microfinancing performances reveals that rather than being technological, they are complex combinations of social, economic, cultural, technological as well as legal and communications factor.

## **APPROACH**

This research using system approach (Jackson, 2000), aims to analyze and design the public-private partnership policy to establish microfinancing for less developed regions. Public administration office will be considered to establish policy instruments, while private institution mainly financial sector act as supporting agencies for MSE development.

The system methodology is philosophically committed to serve as a guide to action and primarily concerned whit providing information relevant to policy decisions. Policy design process was started by SAST technique (Mason and Mitroff, 1981) through four stage: group formation, assumption surfacing, dialectical debate and synthesis. Case study, focus group discussion and face validation methods were carried out later on in conceptual model building and verification.

## **SYSTEM ANALYSIS**

During situational study of recent MSE development, we have moved beyond a simple confrontation of state and market. Rather there has been recognition that we need a system analysis, considering in each domain the appropriate balance between public and private action. We need to consider the form of government aid such as fiscal stimulus. Equally, we need to consider markets institution and governance.

The current reform in the financial sector will allow capital to flow into MSE business promising high returns. However, the global financial crisis induced credit crunch in banking sector. This will decrease the sustainability of the existing MSE and inhibit of new ones,

To cope with those problems, the government on November 2007 had launched **Kredit Usaha Rakyat (KUR)**, which is micro-credit supplied for MSE development supported by government budget allocation for state credit insurance agencies. The KUR scheme carried out by state owned banks whit loan size less than Rp 500 million for each MSE. This policy was designed as public-private partnership scheme for Microfinancing.

In line whit financial crisis impact recovery, the government on March 2008 initiated **KUR-Micro**, where the maximum loan size is up Rp 5 million. This is related to the PNPM goals to reduce poverty and increase job opportunity. By March 2009, the KUR has reached 1.86 million MSE whit credit volumes up to Rp 13.66 trillion (see figure 1).The non Performing Loan is only 1.61 percent with overage loan size is Rp 4.02 million for KUR-Micro.

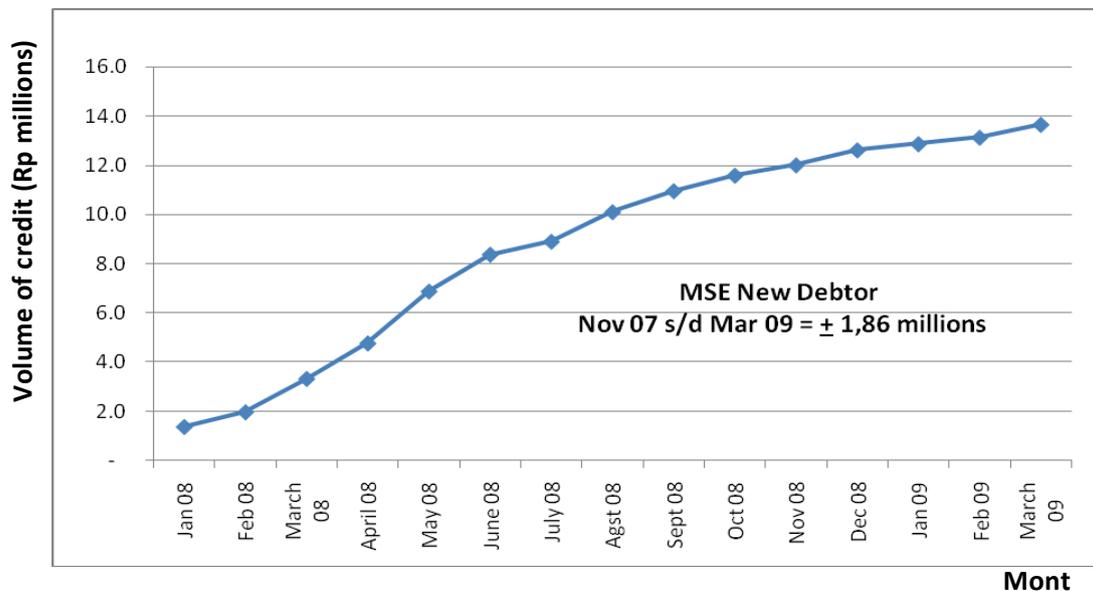


Figure 1. KUR Volume Accumulation

From the Figure 1, we can observe that in the last 5 month, the curve tend to be slowed in growth, due the limitation of banking outlets and infrastructure to reach the MSE. This is why, the study proposed to form a functional linkage between banks and MFI in all over regional.

There are several advantage to set up **linkage program** with local MFI, which are:

- MFI spread out over less developed regions which hardly reach by banks **outlets**;
- MFI has extensive experiences in micro credit handling and distributor;
- MFI mostly supported by local community and accustomed to inhabitants culture.

However, so much variation of MFI capability and service quality all across country. Therefore, there must be a rating agency which independently assesses the credibility of MFI. The MFI rating will be used by the banks for loan evaluation related to linkage program. This is very important to ensure MFI sustainability.

## POLICY MODEL

The policy model for MSE development has objective to blend various sources of governmental fund with people saving within the bank framework. The linkage program must be strengthened through interest loan subsidy so that credit interest for MSE could be lower and affordable. The conceptual model was formulated known as the HYBRID MICROFINANCE (BSK Model) which apply **synergetic** approach to integrate various sources of MSE financing. BSK means Built Synergy of Knowledge.

The modeling process applied Houghton principles (2009) to create “generalization”. The four principles are variegation, Perspective Shifting, Pluralism and Synthesis. This process begins with the recognition of the various perspectives. Synthesis is what occurs at the end of the process to create actual generalization and creative tensions are explored.

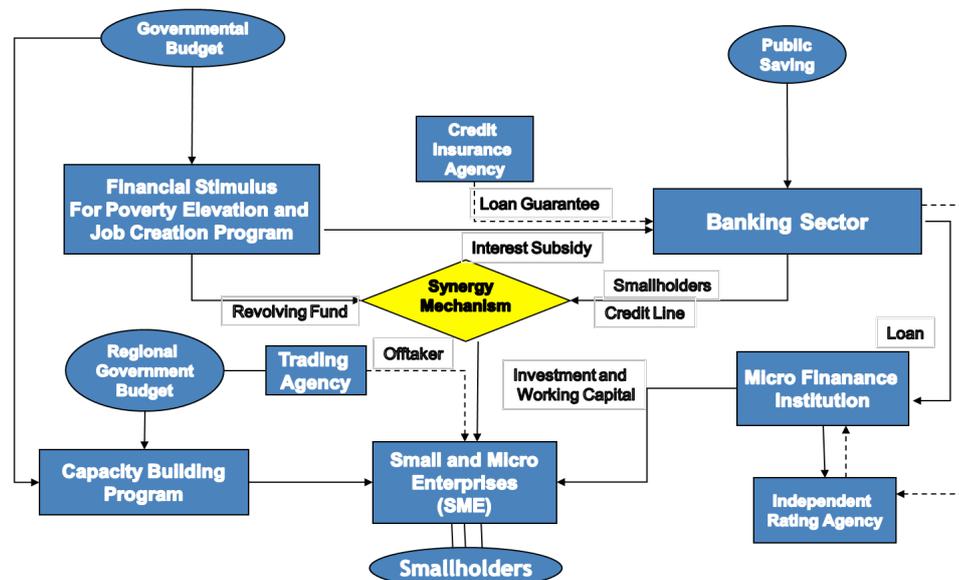


Figure 2. Hybrid Microfinance

In the BSK model, MFI is the heart of public private partnership policy instruments. Nowadays, in Indonesia there are more than 500.000 MFI unit including 37.000 Saving and Loan Cooperative, 1800 rural banking and hundreds thousand MFI semi-formal and informal, most of them does not have legal entity.

In the future this policy study recommends public input such as:

- Formation of Micro Enterprises Development Agency
- Establishing Regional Loan Guarantee Agency in each province to support local MSE
- Endorsement by Central Bank and Ministry of the selected MFI independent rating company
- Focusing the PNPM on agricultural and food sector in line whit crisis recovery
- Strengthening microfinance coordination among various related institution.

Such operational research program should be conducted to back up Hybrid Microfinance model with empirical analysis and real projects evaluation. We believe that crisis recovery could be accelerated through micro-financing in the troubled area and reduced the negative impacts due to massive lay-off and unemployment. Exchange of information among stakeholder must be encouraged to learn from past experiences for better policy.

## CONCLUSION

This research produced a conceptual framework (BSK model) related to the finding about the importance of institutional linkage between banking and Microfinance institutional (MFI) to set up sustainable MSE financing. The linkage structure should be supported by government budget for MFI empowerment and MSE loan guarantee. Private companies' role is providing low interest credit for MSE and CRS-fund to reduce its transaction cost appropriately. This linkage was found useful for smallholder's farmers and works effectively to reduce rural poverty.

The partnership policy must be planned and coordinated well by local government administration with local bank involvement. This study recommends an independent MFI rating agency to facilitate capital formation of MFI by the bank. The BSK model was verified in the case of micro credit-KUR scheme linked to saving and loan cooperative units. In conclusion, micro-financing must be viewed as holistic efforts on a system that cannot be reduced to components that are separable.

## REFERENCES

- ASEM. 1999. *States and Markets: Roles of Public Authorities and Private Actors*. Copenhagen.
- Bailey, K.D. 2006. Public and Private Codes in Living System Theory. *System Research and Behavioral Science*. Vol 23, (6), 715:727.
- Barrow, C. 1994. *The Essence of Small Business*. Prentice Hall Europe, London.
- Checkland, P.B. 1999. *System Thinking, System Practice*. John Wiley Pub, Chichester.
- Colin, B. 1995. *Financial Management for Small Business* Kogan Page, London.
- Houghton, L. 2009. Generalization and Systemic Epistemology. *System Research and Behavioral Science* vol 26, (1), 99:109.
- Jackson, M.C. 2000. *System Approaches to Management*. Kluwer Academic/Plenum Pub. New York.
- Mason, R.O and I.I. Mitroff. 1981. *Challenging Strategic Planning Assumptions*. John Wiley & Sons Pub, Chichester.
- Wilby, J. 1996. Developing Total System Intervention (TSI), *System Practice* vol 9, (3), 231:263.