

**AN ASSESSMENT OF PERFORMANCE AND SUSTAINABILITY  
OF MICROFINANCE INSTITUTIONS:**

**A Case Study of Village Credit Institutions in  
Gianyar, Bali, Indonesia**

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## ABSTRACT

Microfinance institutions have evolved as an economic development tool intended to benefit low-income people. The benefit, however, can only be achieved if the institutions have a good financial and outreach performance. This study has three objectives. The first objective is to assess the influences of informal and formal institutions and their interrelationships on the practical operational arrangement of Village Credit Institutions of Bali (*Lembaga Perkreditan Desa* or LPD). Second, to evaluate the financial performance and outreach indicators of the institutions and to assess the influence of informal and formal institution on the sustainability of the institutions, which has received little attention from previous studies. Finally, to outline some elements of a strategic business plan for two selected village credit institutions (LPDs) in Gianyar district, LPD Mas and LPD Kerta.

By using a case study approach, this study finds that the informal institutions (such as social values, norms, and sanctions) have significant influences on the practical arrangements of the LPDs, including the organisation, recruitment procedure, delivery mechanism, and remuneration system. Along with the influence of informal institutions, the formal institutions have also had some direct influences on the practical operational arrangements of the LPDs that are reflected in the supervision and guidance system of LPDs, an obligation to apply prudential principles of banking, and the remuneration system. The findings also show that the local government regulations (formal institutions) concerning the LPDs have accommodated the informal institutions of the Balinese in the background of their establishment, status and ownership, and organisation of the LPDs.

Based on the performance indicators - portfolio quality, leverage, capital adequacy ratio (CAR), productivity, efficiency, profitability, self-sufficiency, and outreach – the LPDs in Gianyar district could be considered as success microfinance institutions. The success is influenced by some important factors. First, the use of local people in managing the LPDs and the application of character-based lending system in screening the clients. This has resulted in a high clients' sense of belonging and moral obligation to support the development of the LPD. Second, the use of social (custom) sanctions in the contractual enforcement has forced the borrowers to comply with their credit contract in a timely fashion. Third, the use of local community personnel whose remuneration is based on performance and low transaction costs has resulted in the high efficiency of LPDs. Fourth, a growing economy and supporting government policy at all levels through provision of a legal basis for the LPDs and the Central Bank regulation (formal institutions) have also contributed to the success of the LPDs. Thus, based on the necessary conditions of sustainable microfinance institution proposed by some scholars (Yaron 1994; Christen 1998), it can be concluded that the Gianyar district LPDs have been sustainable, and by that implication they have positive net social benefits for their clients.

Any attempt, however, to replicate the achievements of the LPDs by imitating its mode of operations should be conducted with great caution. A mechanism that works well in one socioeconomic environment (in this instance, in Bali) will not necessarily work in another, where the social system including social norms and values are different. But, the experience of the LPDs is a valuable thing since it has highlighted some critical issues that should be considered when handling the complex issue providing financial services to rural people

## CANDIDATE'S DECLARATION

I certify that this thesis does not incorporate without acknowledgement any material previously submitted for a degree or diploma in any university, and that to the best of my knowledge and belief it does not contain any material previously published or written by another except where due reference is made in the text

Lincoln Arsyad

/ /2005

## SUPERVISORS' DECLARATION

We believe that this thesis is properly presented, conforms to the specifications of thesis presentation in the University and is *prima facie* worthy of examination.

Assoc. Professor Susanne Schech

/ /2005

Joe Williams

/ /2005

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## ABBREVIATIONS

AVB	Algemeene Volkscredietbank (General Popular Credit Bank), a precursor of BRI
Bank Pasar	market bank, a secondary bank
Bank Umum	general bank, the first of two bank categories recognized by the 1992 Banking Law
BI	<i>Bank Indonesia</i> (Central Bank of Indonesia)
BIMAS	<i>Bimbingan Massal</i> (Mass Guidance), the government's subsidized agricultural credit program operated through BRI, 1970-1975.
BKD	<i>Badan Kredit Desa</i> (village credit board), village-owned credit organizations established in the late 19 <sup>th</sup> century during the Dutch colonial era; today they are supervised by BRI
BKK	<i>Badan Kredit Kecamatan</i> , sub-district credit board in Central Java and South Kalimantan
BPD	<i>Bank Pembangunan Daerah</i> (Regional Development Bank), classified as general bank under the 1992 Banking Law
BRI	<i>Bank Rakyat Indonesia</i> (People's Bank of Indonesia), a state-owned bank
BRI Unit Desa	The lowest-level permanent outlet of BRI which is located in at sub-district level and provide financial services to the villages of their sub-districts.
BPR	<i>Bank Perkreditan Rakyat</i> (People's Credit Bank)
BPUPKI	<i>Badan Penyelidik Untuk Persiapan Kemerdekaan Indonesia</i> (Investigation Committee for the Preparation of Indonesia's Independent)
CAMEL	Capital, Asset quality, Management, Earnings, Liquidity
CAR	Capital Adequacy Ratio
CGAP	Consultative Group to Assist the Poorest

GBPKMI	<i>Gerakan Bersama Pengembangan Keuangan Mikro Indonesia</i> (United Movement for the Development of Indonesian Microfinance)
GDP	Gross Domestic Product
GRDP	Gross Regional Domestic Product
GNP	Gross National Product
GTZ	Gesellschaft für Technische Zusammenarbeit (German Agency for Technical Assistance)
IDT	<i>Inpres Desa Tertinggal</i> (Presidential Instruction on Backward Villages)
KLBI	<i>Kredit Likuiditas Bank Indonesia</i> (Bank Indonesia liquidity credits)
KOSIPA	<i>Koperasi Simpan Pinjam</i> (Saving and Loan Cooperative)
KSM	<i>Kelompok Swadaya Masyarakat</i> (Self-help Group)
KUD	<i>Koperasi Unit Desa</i> (Village Unit Cooperative)
KUK	<i>Kredit Usaha Kecil</i> (small business credit program)
KUKESRA	<i>Kredit Usaha untuk Kesejahteraan Rakyat</i> , the credit component of Prosperous Family Program
KUPEDES	<i>Kredit Umum Pedesaan</i> , the loan product of BRI's unit desa
KURK	<i>Kredit Untuk Rakyat Kecil</i> , small enterprise credit institutions in East Java
KUT	<i>Kredit Usaha Tani</i> (Credit for Farm Enterprise Program), a government-subsidised agricultural credit that is channeled through BRI's branches, but not through BRI Unit Desa.
LDKP	<i>Lembaga Dana dan Kredit Pedesaan</i> , rural fund and credit institutions owned by provincial or local governments.
LPD	<i>Lembaga Perkreditan Desa</i> , village-owned credit institution/s supervised by the provincial government of Bali
LPN	<i>Lumbung Pitih Nagari</i> , Village's Credit Bank in West Sumatra
MFI	Microfinance Institutions
NBFI	Non-bank Financial Institution

NGO	Non-government Organization
P4K	<i>Pembinaan Peningkatan Pendapatan Petani-Nelayan Kecil</i> (Income Generating Program for Small Farmers and Fishermen), a program sponsored by Indonesia's Ministry of Agriculture
PERBARINDO	<i>Persatuan Bank BPR seluruh Indonesia</i> (Association of Indonesian Rural Credit Banks)
PHBK	<i>Pengembangan Hubungan Bank dengan KSM</i> (Project Linking Banks with Self-help Groups)
PLPDK	<i>Pembina Lembaga Perkreditan Desa Kabupaten/Kota</i>
PLPDP	<i>Pembina Lembaga Perkreditan Desa Propinsi</i>
PT	<i>Perusahaan Terbatas</i> (limited company)
ROSCA	Rotating Saving and Credit Association (Kelompok Arisan)
SIMASKOT	<i>Simpanan Perkotaan</i> (urban savings), a savings product offered by BRI's Unit Desa
SIMPEDES	<i>Simpanan Pedesaan</i> (rural savings), a savings product offered by BRI's Unit Desa
SME	Small and Medium Enterprise
UNDP	United Nations Development Programme
USAID	United States Agency for International Development
WOCCU	World Council of Credit Unions