

Analysis The Growth of Microfinance in Upland Areas

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Abstract. Farmers in upland areas struggle with the accessibility of financial institutions. Due to their remote location and the absence of finance branch offices; therefore, The Ministry of Agriculture and the Islamic Development Bank (IsDB) are working together to resolve finance access difficulties by developing Agribusiness Microfinance Institutions (MFI) in upland communities. The study aimed to assess the agricultural sector's potential and funding restrictions and examine the growth of microfinance in the Upland area. The study was conducted in Garut, Tasikmalaya, Lebak, and Subang districts in October and November 2022. Both primary and secondary data were included in the data set. The data were then descriptively and qualitatively analyzed. The findings indicate that the research area has the potential to expand microfinance based on the existing financial institutions established by the government in various programs. The fundamental issue with MFI is a need for more liquidity, the fulfilment of legality requirements, the role of local governments to arrange, microfinance financial management system plan, implementation of banks as microfinance fund distributors, and loan interest rates paid to farmers. Efforts are needed to speed up the microfinance development process in partnership with formal financing institutions dedicated to assisting farmers and business operators in providing capital.

1 Introduction

Micro and small-scale enterprises dominate economic activities in rural areas. The main actors are farmers, agricultural laborers, agricultural product traders, production facilities kiosks, processors, and household industries. However, these business actors, in general, still need to solve the problem of limited availability of capital. Weak capital in the agricultural sector is ordinary in developing countries, accompanied by household constraints in accessing credit [1]. This condition can hamper efforts to increase production and living standards of rural communities because limited capital will restrict economic activity [2].

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Some factors that cause capital problems in the agricultural sector : (1) there is no particular financial institution that finances this sector, (2) the credit distribution system and procedures are still complicated, (4) the ability of farmers' access to financing sources is limited [3], (5) agricultural businesses are still considered high risk and less feasible, (6) the credit scheme still focuses on production activities, still rare for pre-production, post-harvest activities, (7) business guarantee has not developed in agriculture [4], and (8) there is still limited insurance in agriculture [5]. The key to overcoming this is making financing institutions easily accessible to generally small-scale farmers.

Studies suggest that easy access to credit from financing institutions increases farmer competition and accelerates agricultural technology adoption [6]. Access to credit has also been shown to help in poverty alleviation [5],[8] and women's empowerment [9]. It can even support the UN SDGs to reduce poverty and inequality and improve health and education [10].

The limited capital problem could be overcome by optimizing the potential of microfinance institutions (MFIs). This institution can be an alternative source of funds for farmers and rural communities. This institution has grown a lot and taken root in rural communities. However, MFIs still need government support to continue to develop [11].

Government initiatives include establishing an Agribusiness Development and Income Generation Facilitation Program that provides access to Microfinance Services. This program is part of the Ministry of Agriculture's 2020-2024 "The Development of an Integrated Farming System in Upland Area" (UPLAND Project) activities. Based on the implementation of these activities, the purpose of this paper is: (1) to assess the agricultural sector's potential and funding restrictions; (2) to examine the growth of microfinance in the Upland area; and (3) provide recommendations for the establishment of microfinance as an easily accessible financial institution for UPLAND farmers.

2 Research methods

The research was conducted in the UPLAND districts of Garut, Tasikmalaya, Lebak, and Subang. From July to November 2022, a limited field visit (preliminary research) was performed. The research utilized both secondary and primary data. The Ministry of Agriculture and the District Agriculture Office provided secondary data. Direct interviews were conducted with the person in command of activities at the district office, financial consultants, extension workers, farmer groups, and administrators of rural microfinance institutions to collect primary data. Focus Group Discussion (FGD)-based questionnaires were used to acquire primary data. The data gathered was then descriptively analyzed.

3 Result and Discussion

Agriculture in the highlands is a sector with significant risk in agricultural financing institutions and trade systems [12]. The weak function of agricultural financing institutions has resulted in increasingly restricted access to sources of financing for smallholder farmers [13]. This condition hinders producers' management and expansion of farms [14]. Other problems found in agricultural sector financing institutions include: a) some farmer group associations (called *Gapoktan* in Indonesian) still consider loan funds, particularly those whose funds come from government funds / State Revenue and Expenditure Budget (APBN), to be grant funds that do not need to be repaid; b) the majority of agricultural products are still sold through middlemen; c) *Gapoktan* is unfamiliar with preparing balance sheets and income statements in financial statements.; and d) *Gapoktan*

needs more modern agricultural instruments to establish farming enterprises. e) The majority of *Gapoktan* have yet to form a legal entity.

3.1 Implementation of the UPLAND Activity

Microfinance is an institution that lends money to producers engaged in UPLAND endeavors. The microfinance institution's capital comprises a loan from UPLAND activities and local government capital participation administered by the implementing bank. The implementing bank's applicable provisions will disburse credit. Farmer-level microfinance institutions are created through (i) establishment, which entails commencing from scratch, and (ii) development, which refers to the institution's functional and legal development.

The way microfinance activities are carried out in the research sites is very different (see Table 1), especially in terms of (i) socialization of loan fund assistance in Garut, Lebak, and Tasikmalaya; (ii) legality of activities shown in the issuance of Regent Decree in Garut, Lebak, and Tasikmalaya; and (iii) the implementing bank that will be involved in giving business loans to farmers in Lebak and Tasikmalaya.

Table 1. Development of Upland Microfinance Project Activities in 2022

No.	Regency	Socialization Upland Project	Collaboration Arrangement	Regent Decree	Executing Bank
1	Garut	Yes	No	Yes	-
2	Lebak	Yes	No	Yes	BRI
3	Subang	No	No	No	-
4	Tasikmalaya	Yes	No	Yes	BPR Cipatujah

The government-prepared framework for connecting microfinance funding is executed via an executing mechanism. This means that the bank distributing the loan funds is also responsible for the entire loan risk. The channeling bank will employ sensible criteria such as character, capacity, economic position, capital, and collateral to mitigate risk. One of the conservative principles that farmers struggle to meet in its implementation is the collateral requirement [13]. For the distribution of microfinance funds to function effectively, the criteria of collateral ownership for farmers who will borrow must be eliminated.

3.2 Establishment of Microfinance Institutions in the Research Sites

3.2.1 Lebak Regency

The District Agriculture Office's extension unit establishes microfinance institutions in the Lebak Regency. The extension agent collaborated with a financial consultant and the Regional Finance and Asset Agency (BKAD) to establish the institution. According to BKAD, there are several important factors to consider when establishing microfinance institutions: (i) the government-provided capital must be returned; (ii) the repayment rate of farmers' loans must be monitored [15]; (iii) borrowers are not included in the BI Checking group; and (v) this activity has nothing to do with politics.

Microfinance Institutions (MFIs) should be involved in implementing the credit/financing program. In practice, however, finding MFIs willing and able to serve as credit/financing institutions for farmers in the highlands takes much work. Therefore, an incubation strategy was instituted for MFIs as part of a unified microfinance activity. Initially, a bank provides credit/financing to upland farmers participating in the UPLAND Program. The bank must also conduct incubation activities for MFIs, which will carry out microcredit and financing activities in the subsequent stage.

Farmers who borrow from the established microfinance institution are cultivators of mangosteen plants. These producers are required to establish a regional cooperative. A loan section in the cooperative will manage capital loans for its members. A single cooperative will govern mangosteen cooperatives in each mangosteen center region. This parent cooperative will manage or be accountable for capital loans from UPLAND activities and local government capital contributions. Each mangosteen-producing center was in the process of establishing a cooperative at the time of the field visit.

The establishment of the microfinance institution has been sanctioned by the Regent, who has also designated BRI as the institution's executor; a) Submission of micro-credit funds in stages to BRI by the UPLAND Program budgeting policy; b) Placing funds in BRI during the period of the cooperation agreement (initial cooperation is planned for three years); c) Determining the target/target of potential debtors and providing BRI with as accurate of data/information as feasible; d) Providing BRI with basic data on the UPLAND program about the micro credit plan of highland farmers participating in UPLAND; e) Seeking third parties that can be cooperated with, including off takers, suppliers, and other parties that can support the smooth distribution of microcredit funds if needed; f) Assisting in carrying out socialization and dissemination to highland farmers participating in the UPLAND program which will be given funding, related to the credit mechanism set by the channeling bank; g) Supervising and monitoring the utilization of funds received by farmers, farmer groups/farmer groups and farmer corporations participating in UPLAND; h) Conducting microfinance literacy to farm women and farmer youth receiving UPLAND program funds; i) Facilitate farmers, farmer groups and farmer corporations to open savings accounts at channeling banks; j) Assist farmers, farmer groups, farmer group associations, Joint Business Groups (KUBE), Farmer-Owned Enterprises (BUMP) that will be involved in the program. K) Together with BRI, conduct promotional activities and support promotional activities conducted by BRI related to the cooperation as outlined in the Cooperation Agreement; l) Assist BRI in the event of beneficiary default until applicable regulations resolve the problem; m) assist in carrying out verification, monitoring, and collection in order to maintain the quality of the distribution of microcredit funds (Microfinance).

BRI is authorized to (a) manage these credit funds under the applicable Standards and Procedures both internally and externally; (b) apply the precautionary principle; (c) establish credit schemes, requirements, loan interest, and other charges; (d) conduct confirmation, verification of loan documents, and proposed creditworthiness assessments; and (e) set out guarantees by existing policies in the distribution of loans. Cooperation with the Credit Insurance Agency can help implement the guarantee/guarantee. Some points that have become significant in looking for a way out are a) It has yet to be agreed on which institution will be a guarantor because the Bank does not want to assume risks, so it may have an off-taker. f) It is not determined how many years this agreement will be carried out or how long the UPLAND money will remain in the BRI; g) it is not agreed on by the financial administration what knowledge will be employed in the incubation activities for the microfinance institution manager in the future.

3.2.2 Garut Regency

There is legality or decree from the Garut Regent establishing a microfinance organization. Even though they haven't been chosen yet, the financial institutions that will handle the money from UPLAND activities already exist. The institutes are as follows:

- 1) PT LKM Garut, which is owned by the local government. But it cannot be continued because the authorized capital in PT LKM Garut has been fulfilled. If a new slot is

- opened for additional capital, it will require the creation of a regional regulation. While making local regulations is not an easy and fast thing to complete [16];
- 2) BPR Garut owned by the local government is the second option. But this also cannot be implemented because there is a requirement that the NPL (non-performing loans) should not be more than 5%. While for the current condition, BPR Garut has an average NPL ranging from 10-11% per year.
 - 3) KUBE (Joint Business Group). This KUBE is one of the government's activities in procuring seed potatoes in Garut Regency [17]. The land area involved in this activity is 200 ha and the farmers who cultivate it is 700 ha.

The transformation of a potato KUBE (joint business group) into a cooperative represents one potential route to establishing a microfinance institution. This is because the organization is still actively engaged in contract-based employment. Essential clauses in the contract are as follows: 1) Farmers may borrow funds for potato cultivation at a rate of 6% annually; 2) The loan is not in the form of cash; instead, it takes the form of seeds, fertilizer, and medicines; and 3) The loan is repaid after the harvest by withholding the proceeds from the cooperative's sale of potatoes. Farmers must sell the cooperative their whole crop of potatoes at a contracting price of IDR 9,000 per kilogram (all grades). 3) Potato producers will receive the remaining operating results in a year-end meeting and assurance of input costs and selling prices.

3.2.3 Subang Regency

Activities in the Upland area is intended to hasten the production of competitive mangosteen products. The Regent of Subang has signed a grant agreement for the Integrated Agricultural System Development Project in Highland Areas/UPLAND as a demonstration of commitment to the execution of the UPLAND project. Since 2021, the Upland Program has been implementing its efforts, particularly for the mangosteen commodity, and has been responsible for extension worker training.

Out of a total budget of IDR 4 billion that will be implemented until 2024, IDR one billion has been allocated to the regional budget for microfinance operations from the upland project in 2022. According to the interviews with organizations involved in the upland project in Subang, mainly the Regional Finance and Assets Agency (BKAD) of Subang Regency, there is still a disconnect between the proposed budget items made by the Agriculture Office and the rules of the budget category of grant funds (on granting), which are known as revolving funds [18]. Additionally, there still needs to be communication between agencies in Subang on the execution of upland projects. The design and execution of microfinance initiatives have not involved intensive communication. According to agricultural financing institutions' performance has resulted in farmers' access to financial resources being increasingly constrained [19].

Essentially, the Subang regional administration has allocated the funding. However, due to misallocated funds, it could not be implemented. The implementation of the microfinance component in the Subang district has stalled. However, preparing institutions to carry out microfinance activities has begun. Five cooperatives have been established, and management training has been completed. Based on present circumstances, the Subang District Agriculture Office can start microfinance activities with initial revolving fund capital in the form of grant monies by submitting a revised budget in Fiscal Year (FY) 2023. According to BKAD sources, proposing a revised budget will begin in May 2023. After a series of debates, the procedure will be concluded towards the end of September or October 2023. As a result, in November 2023, the bailout funds provided by the local

government for grants for microfinance activity will go into effect after going through the revised budget procedure.

The budget planning cycle at the local level, like the central budget planning cycle, begins in period N-1. This means that budget preparation for budget execution in 2023 began in February 2022. If grant money is to be rolled out, even if the post is on granting, the monies are put in the financing category rather than the expenditure post. As is well known, there are two forms of spending in the budget expenditure post: expenditure posts and finance posts. If the fund is classified as revolving, the on-granting monies are included in the financing post rather than the spending post. Because the monies will be returned to the area, it is different if the on-granting funds are distributed to upland farmers from the start in direct assistance funds, also known as social assistance funds (*bansos*), and the monies are included in the budget expenditure post [20].

Based on preliminary findings of upland microfinance initiatives in Subang District, the following recommendations are made: 1) The central PMU (Project Monitoring Unit) can quickly assess the planned budget for microfinance activities or components in each upland district. This ensures that the PMU's aims can carry out microfinance activities. 2) For districts that were unable to use bailout funds prepared by the local government for microfinance activities in the fiscal year 2022, the PIU (Project Implementation Unit) at the district level should immediately propose to submit a budget amendment for the on-granting grant in early 2023 so that the bailout funds can be executed in the fiscal year 2023; 3) Especially for Subang district, given that the bailout funds worth Rp 1 billion could not be executed in the fiscal year 2022, the PIU at the district level should immediately 4) To avoid delays in the implementation of the microfinance rescue funds for the fiscal year 2024, the PIU will propose the bailout funds in early February 2023. 5) Because building microfinance institutions at the farmer level takes a relatively long period, the assistance task funds, particularly the assistance funds for cooperative growth, should be budgeted consistently from 2023 to 2024. 6) By the general guidelines for access to upland microfinance services, it appears that greater urgency is required to ensure that bailout funds can be used immediately so that microfinance activities in upland can be carried out (Regent Decree, PKS between the Implementing Bank and PIU, readiness to grow MFI institutions that will manage grant or on-granting funds and other administrative documents).

3.2.4 Tasikmalaya Regency

In November 2021, Tasikmalaya Regency initiated Project Upland. Tasikmalaya Regency is a pioneer in organic rice production. In the southern region of the Tasikmalaya Regency, specifically the Cipatujah subdistrict, upland activities are conducted. The Organic Rice Institution has been transferred to the Management of Farmer-Owned Enterprises (BUMP), Organic Rice Business Development, and Organic Rice Business Partnerships. There are 3,020 cultivators in this subdistrict. One thousand farmers with a total area of 500 ha have been selected to receive microfinance funds for the upland initiative. The average land producers own 0.5 ha—500 hectares of upland in the Cipatujah subdistrict, with eight farmer organizations totaling one thousand farmers. From a total budget of 27 billion, the amount of funds allocated for Upland activities, particularly microfinance funds, is approximately 2 billion, with 1 billion budgeted for 2023 and 1 billion budgeted for 2024. The financing of microfinance institutions such as Microfinance Institutions has yet to be established because the center has yet to finalize its regulations and technical guidelines. Information from early December indicates that the Regent sent a letter designating one of the CIJ Banks in the Cipatujah subdistrict. During this period, before the Upland activity, the average cultivation business consisted of the farmers' capital derived from the harvest;

if this were insufficient, the farmers would seek out timber and livestock. Occasionally farmers need the funds by entrusting the name in groups of several farmers from someone who borrowed to the Bank; the number of farmers who do so accounts for approximately 20% of the 80% of farmers' capital; some farmers borrow from KOSIPA, but they are relatively few.

Microfinance for the Upland is a novel concept for the Tasikmalaya district, particularly considering the unfinished regulations for local governments. This is because the financing for the upland fund is uncertain. Over the next five years, the on-granting fund for the Tasikmalaya district will be 27 billion for all programs, including agriculture, farm machinery, marketing, and microfinance. Two billion dollars are allocated for microfinance development. At the outset of the contract with the Islamic Development Bank (IsDB) and the International Fund for Agricultural Development (IFAD), the output of the entire program was to be realized until 2024. However, the project has evolved to the point where all Upland programs, particularly microfinance, will be realized in 2022. The district of Tasikmalaya could not implement the microfinance program in 2022 due to the unreadiness of infrastructures such as agricultural institutions, APBD budget placement regulations, and poorly implemented regulations.

4 Conclusion

There are unique problems and disparities in four regencies (Lebak, Garut, Tasikmalaya and Subang) related to developing highland project microfinance activities. However, the problems generally concern legality, socialization, microfinance management system plans, banks or microfinance fund distribution institutions, loan interest rates, and the availability and readiness of local governments in preparing bailouts (on granting).

Several problems caused the distribution of upland project funds to be slow. It is necessary to accelerate the development of microfinance institutions that provide sources of financing that are easily accessible, sustainable, and capable of expansion in the future. Improvements needed include microfinance institutions, fund status, disbursement and return mechanisms, and clarity of local governments' positions.

A crucial factor in the development of microfinance institutions in the community is to change the mindset of farmers/communities related to credit, and it also requires intensive assistance. Mentoring programs should encourage farmers to save and improve their business development skills. Collateral terms still apply to raise recipients' responsibility for the loans they use.

5 Policy implication

With more limited government budgets, credit programs should focus more on educating and assisting people in accessing existing financing institutions independently. Nevertheless, grants are still needed to stimulate economic growth and development in particular regions. The distribution of funds sourced from grants needs to be executed carefully, and there should be no image that the funds do not need to be returned. It is better if credit distribution and grant distribution can empower healthy MFIs around the upland project site.

To further ensure the sustainability of highland microfinance projects, it is recommended that formal financing institutions (banks, rural banks) or advanced microfinance institutions be utilized. Indeed, the microfinance institution is established and reputable, with a strong track record and commitment to facilitating capital provision to farmers.

Community-based microfinance institutions should be considered when collaborating with microfinance institutions established by the Upland Project. This approach has advantages: (1) MFIs are more familiar with customer characteristics, the risk of default is small, (2) program/grant funds will remain intact because professional MFIs manage them, and (3) Cheaper transaction costs, (4) a means of education on how to access financial institutions, making it easier to deal with formal financial institutions in the future.

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