Loan Price and Size in the Indonesian Retail Microcredit Market

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ABSTRACT

This study analyse microcredit loan price and size in the Indonesian retail trade sub-sector using data from 2015. The aim is to find out if micro enterprises (MEs), as debtors, are harmed in microcredit transactions with Microfinance Institutions (MFIs). It was found that MEs are harmed if the percentage of the loan price increase exceeds that of the loan size, from the first to the second loan. The behaviour of MFIs is also investigated. This study uses the ME as a unit of analysis and examined 400 MEs from all provinces in Indonesia. A non-probabilistic sampling technique was used to identify the MEs while three types of MFIs were examined: cooperatives, Baitul Maal wat Tamwils (BMTs), and others. Most microcredit transactions, except 'between MEs and MFIs' in the 'others' group, did not have a loan price movement that was greater than that of their loan size. Consequently, most MEs were not harmed by microcredit transactions with MFIs.

Keywords: Cooperatives, Indonesia, loans, microcredit

INTRODUCTION

Microenterprises (MEs) aiming to expand their businesses may need support from Microfinance Institutions (MFIs). Hence, it is important for MFIs in Indonesia to comply with good corporate governance policies. This compliance is required by the Indonesian Financial Services Authority, a government body that ensures that financial service sector activities are implemented in an organised, fair, transparent and accountable manner (see http://www.ojk.go.id). The MFIs can help to alleviate poverty, particularly through their ME support.

In Indonesia, MFIs provide a range of financial services to the poor (including MEs), while maintaining their profitability and sustainability goals (Munawar, 2010). In other words, MFIs operate to accomplish two objectives: profit and social motives (Baskara, 2013). Therefore, Otoritas Jasa

Keuangan (OJK or Financial Services Authority) monitors interaction between MEs and MFIs. In this way, MFIs are a formal source of loans for MEs.

The role of MFIs (including microcredit) in poverty alleviation is hotly debated. Some researchers believe that microcredit plays an important role in alleviating poverty, while many others do not. More specifically, Hickel (2015) states that lenders always benefit from microfinancing; many of these lenders charge interest rates up to 200% per annum. According to Brau and Woller (2004), high interest rates are difficult to avoid because MFIs operate with very high administrative costs per dollar lent, due to the small principal amounts of microcredit. As such, economies of scale does not exist in the lending process to cover fixed costs. On the other hand, MEs, as borrowers, are less sensitive to loan prices and are more concerned with their access to microcredit (Zachary, 2013).

In 2005, the World Bank reported on the investment climate of more than 90 countries in which, it stated that limited access to finance is a primary obstacle in the development and progress of ME. The need for loans in Indonesia, including MEs, is very high. Although 56% of the adult population in Indonesia has access to credit, only 13.1% are eligible to access formal financial sources (Presidential Decree No. 82/2016).

A new international approach suggests that microfinance should become an integral part of the financial system (Ledgerwood & Handbook, 1998). Therefore, MFI should be able to provide financial services for the poor, who otherwise cannot access financial services (Gutiérrez-Nieto, Serrano-Cinca, & Molinero, 2009). However, as a business organisation, MFIs cannot merely focus on social missions.

Rock, Otero and Saltzman (1998) reported that MFI institutions carry out many missions to achieve self-sufficiency. Therefore, it is a big challenge for MFIs to remain committed to carrying out its social missions, while maintaining its sustainability (Schellhorn, 2011). In line with these opinions, the shift from a social, to a sustainability mission is reflected in trade-offs. These trade-offs occur between the breadth of the range of services (outreach) of the social mission and the increase in the earnings, highlighting the mission for MFI profit (Abrar & Javaid, 2014). They found an inverse relationship between outreach and profitability. This implies that an MFI is side-tracked from a social to a profit mission when there is an increase in earnings accompanied by a decline in affordability.

Mersland and Strom (2010) analysed data of 379 MFIs in 74 countries from 2001 to 2008. They found no evidence of a shift from social to sustainability mission in the industry as a whole. They noted loan size increased corresponding with average gains and average costs. Hence, the shifting occurs when MFIs pursue higher financial returns. This effect can be neutralised if the MFIs also pursue cost-efficiency. Mersland and Strom investigated average cost and the average profit to determine the average loan size. They suggested average loan size is

most commonly used to measure the reach of MFIs in servicing poor clients. There was no conclusive evidence of a shift from social to sustainability missions in the literature.

The likelihood of a shift in profit-oriented MFI missions, with excessive loan prices in response to requests for certain loan sizes, would jeopardise the ME business as microcredit borrowers. The situation where MEs, as debtors, are harmed in microcredit transactions with MFIs in Indonesia is feared to jeopardise poverty alleviation programmes, particularly as a barrier for MEs to access microfinance. Therefore, it is important to secure MEs needs when accessing microcredit from MFIs. In this context, MEs, as microcredit demand side actors, need to continue borrowing from MFIs by maintaining the borrowing behaviour for their benefit, without harming themselves as debtors, and vice versa. Hence, MFIs, as lenders, should still be able to carry out their social missions while maintaining their profit missions. Therefore, this study will prove whether the MEs, as debtors, are harmed in microcredit transactions with MFIs.

Based on this study, MEs are harmed if the percentage of the loan price increases and exceeds the percentage of the loan size increase, from the first to the second loan. This study observed ME microcredit transactions in all provinces in Indonesia with MFIs as lenders focusing on three types of businesses: cooperatives, BMTs, and others (e.g., Penanaman Modal Madani, Gold/Pawn Shop and other similar types). The results show that most microcredit

transactions, except 'between MEs and MFIs' in the 'others' group, did not have a loan price movement that was greater than the loan size movement. Consequently, most MEs were not harmed by microcredit transactions with MFIs.

The remainder of this paper is organised as follows. Section 2 presents a brief review of literature on this topic followed by a discussion on methods of the study in Section 3. Section 4 discusses the findings of this study while research recommendations and conclusions are presented in Section 5.

LITERATURE REVIEW

Microcredit transactions between MEs and MFIs depend on the characteristics of the MEs as debtors, and the MFIs as lenders. Therefore, in this study, both need to be explored. MEs are very important because of their strategic role in the economy. As stated in Kuncoro (2008), in Indonesia, MEs employ a large number of workers, much more than small, medium, and large sized enterprises. They also contribute significantly to GDP growth and are highly resilient during financial crises. However, without proper support by MFIs, the role of MEs may not be realised.

There are many definitions of MFIs. Some define MFIs s a formal mechanism of the market used to reduce the risks faced by poor people in borrowing from informal groups (Nair, 2001; World Development Report, 2001). In general, the term MFI refers to financial institutions with a commitment to assisting poor households and micro enterprises in gaining access

to financial services (Hardy, Holden, & Prokopenko, 2002).

The financial sustainability of MFIs is one of the success factors of poverty alleviation programme. According to Morduch (2000), only 1% of MFIs are currently financially self-sustainable and that no more than 5% would ever be financially self-sustainable. The term financial sustainability is defined by Woller, Dunford and Woodworth (1999) as an MFI that covers its operating and financing costs through programme revenue. Welfare groups argue that profit mindset can be replaced by social investors (Morduch, 2000). However, little evidence exists that suggests that MFIs that loan to borrowers who are below the poverty line are able to financially be self-sufficient with the help of social investors (Navajas, Schreiner, Meyer, Gonzalez-Vega, & Rodriguez-Meza, 2000). In pursuing an increased programme revenue, MFIs can strategically do three things: capture economies of scale by extending larger loans to people above the poverty line, increase the interest rate (loan price), or both (Brau & Woller, 2004).

Kimutai and Jagongo (2013) define the interest rate as the price an individual or organisation pays for using borrowed money (loan). There has been a lot of discussion on the way MFIs increase their interest rate (loan price). It is commonly believed, in the field of microfinance, that MEs with very short period of loan and high yield business are not too sensitive to the level of the rates at which they borrow. They care more about access to funding (Zachary, 2013). This is

because there is a dire need for money to survive. Hence, the cost of borrowing is a strong argument in relation to how credit demand does not diminish if there is an increased loan price (Morduch, 2000). Access to funding is much more important to borrowers than rates, because their micro businesses are highly profitable, provided that they could get the working capital to start the business (Zachary, 2013).

Amonoo, Acquah and Asmah (2003) report that whether high interest rates affect demand for credit is inconclusive. According to them, there are two main schools of thought. The proponents of the first school, Stiglitz and Weiss (1981), and Besley (1994), argue that high interest rates encourage the adverse selection of loan seekers. Those who take a high risk and get their loans approved usually have high default rates. The second school of thought states that high interest rates do not affect the demand for credit. More specifically, Aryeetey (1994) indicates that the high interest rates were not a major concern for ME borrowers. In that study, the MEs considered an average annual interest rate of 19.5% to be fair and reasonable. This interest rate is above the average market rate at that time (i.e., 12.5%).

Karlan and Zinman (2008) state that there has been an assumption of "price inelastic demand of microcredit by MEs". Price inelastic demand means that the poor are largely insensitive to interest rates. This has provided a foundation for encouraging MFIs to run at sustainable (profitable) interest rates, on the basis that it

is unlikely to reduce poor people's demand for, or access to, credit. The study found that demand curves were gently downward sloping, throughout a wide range of rates below the lender's standard rates. Demand sensitivity rose sharply at prices above the lender's standard rates. Higher rates also reduced repayment. In addition, Karlan and Zinman (2008) found that the loan price was not the only contracting parameter that might affect demand, MFI profits and targeting may also affect demand.

A recent study discussed in Zachary (2013) looked at the demand impact when lending rates were 10% lower from previous loan. The study suggests that credit demand from current and new borrowers is elastic to pricing. Hence, borrowers do care about rates. From the perspective of borrowers, lower rates can increase the potential demand for loans and financial inclusion, while excessive rates can push borrowers into over-indebtedness. From the perspective of MFIs, lower rates can make them more dependent on donor's money, while higher rates can lead to higher regulatory scrutiny and attract the worst borrowers (adverse selection). Therefore, the question around fair rates is key to policymakers and MFIs (Zachary, 2013).

Lipsey, Courant and Ragan (1999) state that there are four demand and supply laws. One of them is that the rise in demand will shift the demand curve to the right, when the supply curve remains unchanged. In the microcredit point of view, this type of supply and demand interaction will lead to an increase in both the loan price and the

loan size. This study defines microcredit as mutually beneficial for MEs and MFIs, if the percentage of the loan price increase does not exceed the percentage of the loan size increase, from the first to the second loan. Thus, whether MEs are harmed in transaction with MFI depends on the elasticity of the supply curve.

Microcredit will not be beneficial for MEs if the supply curve is inelastic. This is because the percentage of the loan price increase exceeds that of the loan size increase, from the first to the second loan. The impact of the inelastic supply curve and the shift in the demand curve to the right in a microcredit transaction, where the percentage of the loan price increase exceeds the percentage of the loan size increase, from the first to the second loan, is illustrated in Figure 1.

Figure 1 shows that the value of loan prices (P_1 and P_2 for the first and the second loan respectively) and loan sizes (Q_1 and Q_2 for the first and the second loan respectively) are really the same value for the demand and supply curves. Therefore, there is no problem if the values of P_1 and P_2, as well as Q_1 and Q_2, are considered MFI data but surveyed using MEs as the sample and population. This is the case as long as the loan transaction between MEs as debtors, and their MFIs as creditors, are well surveyed and documented.

In Indonesia, according to Rudjito (2003), MFIs can be divided into four major groups. The first is the Banking Group, which includes the Rural Bank or Bank Perkreditan Rakyat (BPR) and the
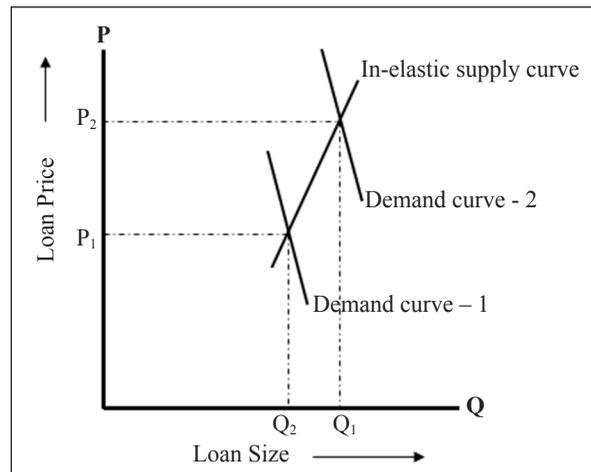
Figure 1. Supply and demand-side perspective of mission drift

Village Credit Institution or Bank Kredit Desa (BKD). This group has a mission of increasing shareholder value. According to the new MFI law, this group is now categorised under the banking sector, instead of the MFI sector. Therefore, in this study, the Banking group is excluded from the analysis. The second major group is the Cooperatives group, with a mission of increasing the wealth of its members. The third group is the Baitul Maal wat Tamwil (BMT), which has a similar mission to the Cooperatives group: to increase the wealth of its members. The last group is called the Others. The Others group includes, but is not limited to, venture capitalists, the PNM, Small Business Development and Cooperatives (PUKK), Pawn Shops, and Savings and Loans (TSP).

To assist in answering the research question (i.e., whether MEs in Indonesia are harmed as a result of financial transactions with MFIs in Indonesia in 2015), the following hypothesis was developed:

H0: The retail trade sub-sector MEs were harmed as the result of the microcredit transactions in Indonesia in 2015.

METHODS

This study employed the quantitative approach. Questionnaires were handed out to 400 ME owners between October and December 2015 (Sugiyono, 2014). The eight questions selected were based on the recommendations by Rhyne (1998). Questions were asked about loan prices and loan sizes. Survey questions also included the name of the institution that provided the loan, the type of institution that provided the loan, the date of the first loan, the nominal value of the first loan, the nominal interest rate of the first loan, the date of the second loan, the nominal value of the second loan, and the nominal value of the interest on the second loan. Respondents were selected through screening questions (e.g., whether MEs received the second loan, whether MEs

received a MFI loan from MFI, whether the second loan was in 2015, whether the first loan was made in 2013 or earlier).

The MEs were the demand-side players in the microcredit transactions with MFI. Among the many ME sub-sectors, the retail trade sub-sector was selected as the population in this study. The retail trade sub-sector is the largest population of MEs in the Indonesian economic sector, and hence, plays a significant role in poverty alleviation (Badan Pusat Statistik, 2007).

It was impossible to choose the research samples based on the probability sampling technique. This is because most of the latest secondary data were obtained from the 2006 Economic Census (covering 9,982,776 units of MEs, spread over all provinces in Indonesia in 2006). Therefore, due to the difficulty in accessing the required data, this study employed a non-probability sampling technique.

As stated previously, data was collected from 400 ME owners in Indonesia. A 95% level of confidence of the probability that the value of a parameter (population mean) falls within a specified range of values was obtained, as recommended in Isaac and Michael in Sugiyono (2014), and Wunsch (1986), in Tashakkori and Teddlie (2009). The sample was non-probabilistic. Therefore, the field survey was directed to the most reachable locations of the population (e.g., traditional markets in the capital city of each province). The researchers interacted with the respondents through the designed questionnaires.

The sampling technique involved several steps. First, the distribution of the population in each province, although very uneven, was clearly grouped based on the provinces in Indonesia. Second, from each of these provinces, the representative number of respondents were collected proportionately. For all provinces (33 provinces), the number of samples collected were proportionate with the population, with a minimum of 1 respondent. Following Bungin (2015), this study divides the 9,982,776 MEs by 400, resulting in 24,957. Each province's population was divided by 24,957 to determine the number of respondents. For example, the largest population of MEs is in West Java (i.e., 1,749,786), so the West Java sample size has 70 ME respondents. The smallest population is in North Maluku (24,229), so the number of ME respondents for that region is 1.

The structure of the loan suppliers was based on their transactions. Creditor were grouped into three MFI business types: Cooperative group, BMT group and the Others group (Rudjito, 2003). A total of 306 transactions were made by MFIs in the Cooperative group, 24 transactions were made by MFIs in the BMT group, and 70 transactions were made by MFIs in the Others group. In total, 400 transactions were made by the 400 MEs (one transaction for each MEs), as borrowers to various MFIs. After removing the outliers, the results from 230 MEs were analysed. Since the definition of MEs is being harmed in transaction with MFIs related to the increasing loan price as well as loan size, it is actually the form of the elasticity formula.

The demand elasticity formula used in the investigation is as follows:

$$E_d = \frac{P_2 - P_1}{(P_1 + P_2)/2} \times \frac{(Q_1 + Q_2)/2}{Q_2 - Q_1}$$

(1)

where:
E_d = Demand elasticity
P_1 = Price of the first loan
P_2 = Price of the second loan
Q_1 = Quantity of the first loan
Q_2 = Quantity of the second loan

If the t-value of the elasticity of demand is greater than 1, we accept the null hypothesis, where MEs are being harmed in the transactions. In improving the credibility of the finding, this study employs a Z Score criteria for accepting the data excluded by the outliers. The Z Score ranged from -3.5 to 3.5 which is the value being accepted.

RESULTS AND DISCUSSION

This section presents the results and discussion. The descriptive statistics of the structure of the ME retail trade business types are presented in Table 1. Of the 400 MEs in the retail trade sub-sector, most (46%) are from the food, beverage, and tobacco industry, while the smallest number (2.25%) represent the chemicals, pharmaceuticals and cosmetics industry.

Table 2 presents the results of the hypothesis test. The statistical tests for the three groups (i.e., MEs in microcredit transactions with MFIs in the total sample, Cooperatives group and BMT group) failed to prove that the MEs in the retail trade sub-sector were harmed by the microcredit transactions in 2015. Hence, there is a high probability of rejecting the null hypothesis. As we can see in Table 2, the overall t-value equals -1,08. For the MEs in the Cooperatives group, the t-value is -1,55, and for the BMT group, the t-value equals -1,61. For the Others Group we accept the null hypothesis that the MEs were harmed in the transaction.

Table 1
Structure of respondent's retail trade business type

No.	Type of Business of MEs	Samples	
		Unit	%
1	Food, Beverages, and Tobacco	183	45.75
2	Textile, Garment, and Footwear	48	12.00
3	Cars, Motorcycles, Accessories, and Fuel	24	6.00
4	Household Appliances, Sports Equipment and Musical Instruments	23	5.75
5	Street Vendors	20	5.00
6	Chemicals, Pharmaceuticals, and Cosmetics	9	2.25
7	Others (Covering many sub sectors with few units)	93	23.25
	Total	400	100.00

Table 2
Hypothesis test results

No.	Statistical Parameters	Value for MEs in microcredit transactions with MFIs			
		Total	Cooperatives Group	BMT Group	Other Group
1	N	230	183	17	30
2	Mean	0,96	0,94	0,77	1,2
3	Standard Deviation	0.,52	0.,51	0.,61	0.,5
4	Z Score Max	2,7	3,44	2,51	2,62
5	T-value	-1,08	-1,55	-1,61	2,22
6	Significant level	0,14	0,061	0,063	0,017

The T-values of microcredit transactions indicate a rejection of the null hypothesis for cooperative and BMT groups. The results also show that the rejection is significant at the 5% level for all types of MEs. These findings are understandable, since Article 17 of the 1992 Law No. 25 concerning cooperatives, stipulates that members of cooperatives are both owners and users of their services. The results prove that the t-value for the cooperative group is -1,55; this illustrates that the movement of a price is less than the movement of a quantity. The same argument is valid for the BMT group (t-value equals -1.61). This is due to the characteristics that are similar to the cooperative group's characteristics. More specifically, the majority of BMTs are cooperatives and have a history in protecting micro and small enterprises from moneylenders (Suraya, 2012).

The findings are in line with the results in Mersland and Strom (2010), suggesting that there is no evidence of the occurrence of MFI mission drift (i.e., moving from social missions to profit missions), in relation to harming MEs. In contrast, this study has clearly concluded that MEs are harmed in microcredit transactions in the Other group of MFIs in Indonesia. This finding is in line with the results in Woller et al. (1999) and Woller (2002). The t-values are 2,22 (> 1). Therefore, transactions are harmed by MFIs in the Others group. As such, they pursue the sustainability mission more than the social mission.

The findings have implications for governments and regulators. The new rule (Law No. 1/2013) only allows MFIs, in the form of cooperatives or limited liability companies, with dominant ownership (60%) by the local government, to be considered appropriate from the perspective of the prevention of the possibility of MFIs being led away from their social missions. MFIs in the Others group (e.g., PNPM, Gold/Pawn Shops) need to migrate into the allowed entity in accordance with the new law.

The successful implementation of the new rules is expected to reduce the dependence of the poor on receiving loan from Pawn Shops. Ismail and Ahmad (1997) argue that this is indispensable for emergency loans. Both forms of

entities, cooperatives and limited liability companies, will facilitate the OJK to direct or supervise the MFI, so as not to harm the MEs, as the debtors of their loans. All MFIs, as the respondents of this study, which are cooperatives or BMTs, that generally have the same mission with the cooperative (Suraya, 2012), are believed to more easily adjust to the new rules. This is because the cooperative is a suggested establishment. This research has also shown that cooperatives do not experience mission drift from the social mission. This means that both establishments do not have a tendency to be more profit-oriented.

For the MEs, as a whole, whether they are the respondents of this study or not, the findings can generally be utilized in several ways. Firstly, concerning the transition of new rules in coaching MFIs today, MEs can avoid borrowing from MFIs in the Others group. They should prefer to borrow from MFIs in the form of cooperatives and BMTs in terms of seeking loans. Secondly, it is important to realize that the micro-credit transactions by MFIs need to be conducted in an equally profitable manner. More specifically, the percentage increase in the loan price does not exceed the percentage increase in the loan size, between the first loan and the second loan. This can be used as the measuring instrument.

The methodology and results of this study illustrate significant contributions to the extant literature. Firstly, by using ME as a unit of analysis, this study has enriched the research methodologies in confirming whether MEs in the retail trade sector in Indonesia are harmed in transactions with MFIs. Secondly, in line with previous studies in other countries, the hypothesis for MEs in transactions with the Other Group of MFIs in Indonesia through this study (i.e., MEs, as debtors, are harmed by MFIs, as creditors, that shift their mission to sustainability) have revealed the same results in a certain case, but not in other cases.

CONCLUSION

The primary objective of this study was to analyse the price and size of microcredit in the Indonesian retail trade sub-sector in 2015 to prove whether MEs, as debtors, are harmed in microcredit transactions with MFIs. The results strongly suggest that MEs, in transactions with the Others group of MFIs (e.g., PNPM, Gold Shops), are harmed. This is because the microcredit transactions experience a larger price movement than a quantity movement. For the majority of the sample, MEs in transactions with MFIs in Cooperatives and BMTs groups are not harmed, because the microcredit transactions do not have a larger price movement than a quantity movement. This implies that most of the Indonesian MEs can rely on MFIs, especially those in the form of cooperatives and BMTs, as microcredit lenders. However, MEs need to be cautious and/or avoid engaging with MFIs in the Others group.

This study recommends taking a supply-side approach, using MFI as a unit of analysis. This was not possible when the study was conducted, because this research

was conducted prior to the adoption of the new MFI law. The OJK MFI data is large enough to allow the same research to be conducted from the supply-side.

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