



Empowering of Village Fund-Based Microfinance Sustainability; Banking Capital Preferences of Rural Communities

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Abstract : This research study about empowering of village fund-based microfinance sustainability; banking capital preferences of rural communities, aimed to analyze the factors influencing the sustainability of microfinance institutions based on Village Funds and the capital preferences of rural communities. The study employed both qualitative and quantitative approaches to gain a comprehensive understanding of the subject matter. The research findings identified four main factors contributing to the Preference for capital and Sustainability of Microfinance based on Village Funds, such as the ownership factor, the Interest rates factor, the facilities factor, and the Benefits factor. In conclusion, the research findings highlight the pivotal role of the Ownership Factor, Interest Rates, Facilities Factor, and Benefits Factor in determining the Preference for capital and Sustainability of Microfinance based on Village Funds. By optimizing these factors, microfinance institutions based on Village Funds can better support economic growth and welfare improvement in rural communities. This research offers valuable insights for policymakers and practitioners in developing microfinance institutions and empowering rural communities more effectively.

Keywords : Village Fund; Microfinance Sustainability; Rural Communities.

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INTRODUCTION

Economic activities in Indonesia, especially in the financial sector, are strongly supported by financial institutions. Financial institutions play a crucial role in the economic activities of modern society. Micro enterprises or micro businesses have significant importance in the economy, and they support the government's efforts to alleviate poverty (Bogan, 2012). However, in reality, this sector seems to face difficulties in growing due to the lack of access to formal financial institutions by micro entrepreneurs, particularly those from the lower-middle-income segment, resulting in underserved communities with limited funding potential (Quayes, 2012).

The limited access to financing faced by Micro, Small, and Medium Enterprises (MSMEs) in traditional banking has led them to rely on information sources and Microfinance Institutions (MFIs) directly supported by the government (Esubalew & Raghurama, 2020). MFIs offer financial services to micro-entrepreneurs and low-income individuals, both in formal and informal settings. These MFIs create job opportunities by establishing and developing micro-businesses, increasing the productivity and income of vulnerable groups, especially women and the poor, and reducing rural communities' dependency on rainfall-dependent harvests through diversified income-generating activities (Esubalew & Raghurama, 2020).

Bank Indonesia launched a financial inclusion program in 2010 as a means to alleviate poverty and stimulate economic growth. The establishment of MFIs is expected to contribute significantly to poverty reduction, which is considered a crucial development goal for the government. Microfinance services encompass a wide scope, including savings, loans, and payment services that are usually managed simply. As lending institutions, MFIs function as loan providers for various micro-enterprises' productive and consumptive activities of low-income families. Savings activities, as a prerequisite for granting loans, often lead to the provision of larger loans than the funds initially collected.

The success of MFIs in achieving development goals has been revealed in various studies. Evidence from developing countries shows that MFIs serve not only as financial institutions but also as tools for development and poverty alleviation. The strength of MFIs lies not only in their asset size but also in their financial balance, which is associated with the ability to mobilize funds from members and non-members and to channel them into productive capital for the poor. A strong Microfinance Institution (MFI) will positively impact the development of micro, small, and medium-sized enterprises across all regions. Continuous regulation, supervision, and guidance are expected to position MFIs alongside traditional banking institutions. Thus, enhancing financial inclusion through village funds can significantly contribute to Indonesia's development process (Huda, 2012).

Village funds are sourced from the state budget, allocated to villages through regional budgets of districts and cities, and used to finance government operations, development projects, community empowerment, and community development.

Empowering villages with adequate authority and resources enables them to manage their potential to improve their economy and welfare (Morris & Tucker, 2021).

Given the importance of villages as the lowest level of government administration, the government should also pay attention to the economic conditions and welfare of rural communities by ensuring their economic protection through the innovation of Village Banks. Village Banks can serve as an alternative for communities heavily reliant on loan sharks. The difficulty of accessing capital when starting or expanding businesses can be alleviated with Village Banks, as they create a vibrant market and economic activities. The ultimate goal of establishing Village Banks is to facilitate the development of communities and their businesses, creating new employment opportunities. Additionally, Village Banks aim to encourage rural communities to deposit their money in the bank and utilize the pooled funds for the collective benefit of the community (Faedlulloh, 2018). In the face of high commodity prices and difficulties in obtaining loans, Village Banks can offer solutions to economic challenges in society. By controlling their needs and not depending on commercial banks and loan sharks, villages can take charge of their own development (Kania et al., 2021).

Microfinance services are not only dominated by financial institutions, but also by various types of services and subsidies provided by the government. Almost every change of government launches different programs for the poor and low-income communities. The limitations in accessing financial resources faced by Microfinance Institutions (MFIs), especially from formal financial institutions such as banks, lead them to rely on informal sources (Perez et al., 2011). These sources vary from loan sharks to the development of savings and credit units, cooperatives, and other forms.

Based on regulations and legislation, MFIs can take the form of cooperatives or people's credit banks (BPR). Cooperatives are regulated by Law no. 25/1992, while BPRs are regulated by Law no. 10/1998, and Islamic People's Credit Banks (BPRS) by Law no. 21/2008. Cooperatives are supervised and guided by the Cooperative and SME Agency, while BPRs are supervised and guided similarly to other commercial banks by the Financial Services Authority (OJK). This overlapping of programs, regulations, and authorities among MFIs leads to difficulties in measuring and evaluating the success of existing programs. Consequently, rural-based MFIs face challenges in sustaining their operations, leading to lower sustainability. Intense competition and policy overlaps make it difficult for MFIs to compete, resulting in some having to cease their operations, leaving only a name behind. The most challenging aspect for MFIs is when they have to compete with modern institutions such as commercial banks and BPRs (Huda, 2012).

In general, scholars examine sustainability through two approaches: the welfare approach and the institutional approach. In the microfinance movement worldwide, reaching out to the poor through access to financial services, there are two main approaches:

the institutional approach and the welfare approach. Research shows that microfinance institutions are significantly characterized by the institutional approach to sustainability. The institutional approach focuses on establishing financial institutions to reach customers underserved by the formal financial system (Piot-Lepetit & Nzongang, 2014). On the other hand, the welfare approach emphasizes the depth of outreach, which means the level of the poorest communities served. This approach does not always look at institutional aspects, but emphasizes the impact of financial services on economically active poor communities. The key aspect is to provide profitable credit and savings services that can reach a large number of customers. This is achievable when MFIs are regulated and independent.

METHOD

Research methodology on empowering of village fund-based microfinance sustainability; banking capital preferences of rural communities, aims to analyze the factors influencing the sustainability of microfinance institutions based on Village Funds and the banking capital preferences of rural communities. This discussion will explain how this research is conducted, including research design, data sources, data collection techniques, and data analysis. This study uses a mixed-methods approach, combining qualitative and quantitative methods to gain a comprehensive understanding of the factors influencing the sustainability of microfinance institutions based on Village Funds and the banking capital preferences of rural communities. Qualitative design is employed to gain in-depth insights through interviews, observations, and case studies. Meanwhile, quantitative design is used to analyze the preferences of a larger population through surveys and statistical analysis.

The population of this study consists of rural communities who have access to or interact with microfinance institutions based on Village Funds. A random sample is chosen from the relevant population. Additionally, strategic sampling may be employed to select samples from various regions or communities to represent the diversity of rural communities. This research gathers data from two main sources: primary data and secondary data. Primary data is collected through interviews, surveys, and direct observations with rural communities and representatives of microfinance institutions based on Village Funds. Secondary data is obtained from financial reports and documents related to the sustainability of microfinance institutions, as well as existing literature and previous research on banking capital preferences of rural communities. To collect primary data, researchers use in-depth interviews with structured and unstructured questionnaires as a guide. Structured questionnaires may also be used for larger respondent samples. Direct observations are also conducted to understand the social and economic context of rural communities.

Qualitative data is analyzed through reduction, presentation, and drawing conclusions. Findings from interviews and observations are interpreted to identify factors influencing the sustainability of microfinance institutions based on Village Funds.

Quantitative data is analyzed using statistical methods such as regression analysis, t-test, and descriptive analysis to identify the banking capital preferences of rural communities.

The research evaluates the sustainability of microfinance institutions based on Village Funds based on financial, social, and economic indicators. Banking capital preferences of rural communities are assessed based on criteria such as interest rates, service flexibility, facility availability, and perceived benefits by the community. To ensure the validity and reliability of the research, various steps such as data triangulation, verification, and the use of tested and reliable instruments are taken. By utilizing both qualitative and quantitative approaches and combining primary and secondary data, this research aims to provide comprehensive insights into the factors contributing to the sustainability of microfinance institutions based on Village Funds and the banking capital preferences of rural communities. The findings of this research can offer valuable information for policymakers and practitioners in the field of microfinance development and rural community empowerment.

RESULT AND DISCUSSION

Microfinance Institutions (MFIs) in the form of Village-Owned Enterprises (BUM-Desa) have the task and function of providing financial services that bring capital closer to rural communities through an easy and targeted credit system. They also aim to protect rural communities from the clutches of loan sharks, which are prevalent in rural areas. When BUM-Desa MFIs operate independently, they promote equity and provide services within rural communities by providing capital through the credit system to enhance productive economic activities (Faedlulloh, 2018).

Exempting interest rates can hinder the access of the poor to financial services. The majority of rural communities agree with the imposition of interest rates for financing in microfinance institutions. They believe that interest rates should be charged because the source of capital for MFIs is not a grant, and MFIs still need to pay interest to their depositors. When communities borrow capital and seek sources other than informal institutions (loan sharks) with exorbitant interest rates, many small rural businesses still operate under this system. Therefore, with a moderate interest rate burden, the development of small and micro-enterprises in rural areas is expected to progress more rapidly (Bogan, 2012).

Preference is an individual's evaluation of two or more objects. It involves comparing among objects. Preference is defined as "choice or liking." It is a fundamental part of consumer behavior towards two or more objects. Preference means that an individual can express what they desire between two available choices. One must also be consistent and rational in expressing their preferences for a product. Preferences formed by a customer differ from one customer to another. To determine someone's preferences for a

product or service is not an easy task, as there are many interrelated characteristics. The key characteristics in preference include stimuli that motivate customers, such as the product, marketing, and marketing methods (Darwanto, 2014).

Consumer preferences indicate their likings for various product and/or service options. Consumer preferences can be known by measuring the level of usefulness and relative importance of each attribute found in a product or service. Umar (2002) explains that factors influencing variations in consumer behavior can be divided into two main factors: environmental factors, such as culture, social class, and personal influence; and psychological factors, such as motivation, perception, knowledge, and belief (Darwanto, 2014). The preference for the capital structure of large companies is related to business characteristics such as company size, ownership structure, and debt structure. In microenterprises, besides company characteristics, the characteristics of the owners can also influence this financing preference. Entrepreneurship and the experience of small and medium-sized business owners, as well as the size of the business, can play a role in determining sources of funding.

Several factors may influence the preferences of microeconomic agents' customers. Service factors, the more satisfied customers are with their expectations being met, the more loyal they will be to the bank. Product factors, an attractive product packaging will stimulate customers to consume it, such as the variety of financing products and low-interest rates. Microfinance institutions can expand their reach by making outreach efforts, such as streamlining administrative complexities that have been obstacles so far. Microfinance institutions must be able to target micro, small, and medium-sized business owners, especially traders in traditional markets who need capital for their trading or business activities, farmers for agricultural capital, and rural communities burdened with debt from loan sharks (Darwanto, 2014).

Preference for capital and Sustainability of Microfinance based on Village Funds consist of;

1. Ownership Factor

Based on the initial analysis, ownership factor becomes the main reason for the community to choose to use Microfinance based on Village Funds to address financial issues. This institution is specifically dedicated to the village community. Microfinance institutions base their activities on the principles of mutual support within the community. For example, they do not require collateral, and loans and interest rates are fairly distributed among the community members. If any member faces difficulties in repayment, it is resolved mutually within the community.

The ownership factor in the context of Preference for capital and Sustainability of Microfinance based on Village Funds refers to the principle of community ownership and control over the microfinance institution. In this model, the microfinance institution, often referred to as BUM-Des (Badan Usaha Milik Desa) or Village-Owned Enterprises,

is specifically established to serve the financial needs of the local community in rural areas (Faedlulloh, 2018). Key aspects of the ownership factor include; 1) community-based. Microfinance based on Village Funds is designed to be community-focused and community-driven. The institution is owned and controlled by the villagers themselves, which means that the decision-making power and governance of the institution lie in the hands of the local community members; 2) local empowerment. The ownership factor promotes the empowerment of the local community as they have a direct say in how the microfinance institution operates and serves their needs. It allows the community to tailor the financial products and services to suit their specific requirements and aspirations. 3) principles of mutual support. The ownership factor is often characterized by principles of mutual support and social cohesion within the community. By adopting a cooperative and collective approach, microfinance institutions based on village funds aim to foster a sense of solidarity among the members and promote financial inclusion; 4) non-profit orientation. In many cases, these microfinance institutions prioritize social impact over profit-making. The main goal is to provide access to affordable financial services and support local economic development rather than maximizing profits for external shareholders; 5) Local ownership of resources. The funds used in microfinance activities are often sourced from local village funds or government programs that allocate financial resources to rural areas. This ensures that the capital remains within the community and benefits local development; 6) Participation and transparency. The ownership factor promotes transparency and accountability as community members have a direct role in the decision-making process. This fosters trust between the institution and its members, enhancing the sustainability of the microfinance initiatives.

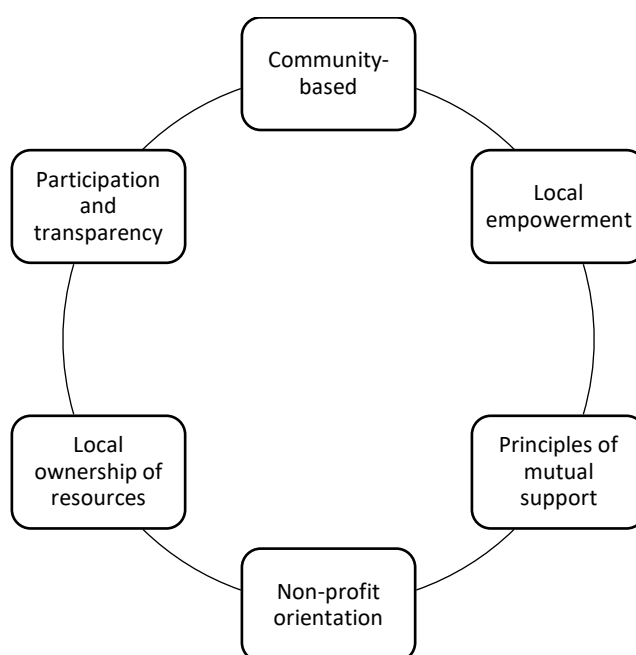


Figure: The Key Aspects of Ownership Factor

Overall, the ownership factor in Preference for capital and Sustainability of Microfinance based on Village Funds emphasizes the importance of community involvement, local empowerment, and collective ownership to ensure the relevance, effectiveness, and sustainability of microfinance services in rural areas.

2. Interest Rates

The analysis shows that Microfinance based on Village Funds has a positive impact on the welfare of the lower-middle-income community. The lower the interest rate, the higher the interest of the community in utilizing Microfinance based on Village Funds. Every financial institution will levy charges on every transaction carried out by customers, such as administrative fees or interest charges. These fees are used to provide additional services to prospective customers who need assistance with their financial issues.

Interest rates play a crucial role in the preference for capital and sustainability of microfinance based on Village Funds. Microfinance institutions, including those based on Village Funds, provide financial services to low-income individuals and small businesses who may not have access to traditional banking services. The interest rates charged by these institutions are an essential factor in determining their attractiveness to borrowers and their long-term viability (Hartarska & Nadolnyak, 2007). The interest rate charged by microfinance institutions affects the preference for capital among potential borrowers. Lower interest rates are generally more attractive to borrowers, as they result in lower overall borrowing costs. When microfinance institutions offer competitive and affordable interest rates, more individuals and small businesses in the community may

prefer to access capital through them. This preference for capital from the microfinance institution can lead to increased demand for their services, positively impacting their sustainability (Quayes, 2012).

The sustainability of microfinance institutions based on Village Funds depends on various factors, and interest rates are among the most critical factors. Setting appropriate interest rates is a delicate balance for these institutions. Charging high-interest rates may generate more income in the short term, but it can also lead to increased default rates and potential customer dissatisfaction. On the other hand, setting very low-interest rates may jeopardize the institution's ability to cover operating costs and make it unsustainable in the long run. Microfinance institutions must find a balance between financial viability and social impact (Hermes & Lensink, 2011). On one hand, they need to generate enough revenue from interest charges to cover their operational costs and maintain sustainability. On the other hand, they should strive to keep interest rates affordable for their target customers to promote financial inclusion and alleviate poverty.

The setting of interest rates in microfinance is often subject to regulatory oversight to protect consumers and ensure fair practices. Some countries have interest rate caps to prevent exploitative lending practices. Microfinance institutions need to comply with these regulations while still offering competitive and attractive interest rates. In conclusion, the interest rates charged by microfinance institutions based on Village Funds significantly influence borrowers' preference for capital and the overall sustainability of the institution. Striking the right balance between financial viability and social impact is essential for the success and long-term survival of such microfinance initiatives (Hermes & Lensink, 2011). Properly managing interest rates can help create a positive impact on the community, improve financial inclusion, and support economic development at the grassroots level.

3. Facilities Factor

The research results indicate that the facilities provided by Microfinance based on Village Funds are adequate for the community. Simple facilities like savings accounts and timely pickups make it easy for the community to access their funds and reduce the distance from their homes to the village hall. Furthermore, friendly staff can assist individuals who are less familiar with the borrowing and repayment process, addressing any concerns or queries they may have.

The facilities factor in preference for capital and sustainability of microfinance based on Village Funds refers to the availability and quality of services and amenities provided by these institutions to their clients. The level of facilities offered can significantly impact borrowers' preference for accessing capital from microfinance institutions and contribute to the overall sustainability of the Village Funds-based microfinance program (Bogan, 2012). Here's how the facilities factor can influence

preference and sustainability; 1) Accessibility and Convenience. The presence of accessible and conveniently located microfinance centers or branches can increase the preference for capital among potential borrowers. When microfinance institutions have branches or offices in close proximity to the target communities, it becomes more convenient for borrowers to access their services. Easy accessibility encourages more people to utilize the microfinance facilities, thereby increasing the institution's client base and fostering sustainability; 2) Simple and Efficient Processes. Microfinance institutions that offer streamlined and efficient loan application and approval processes are likely to be more preferred by borrowers. Simplified paperwork, quick loan disbursement, and flexible repayment terms can make borrowing from Village Funds-based microfinance institutions more attractive to individuals and small businesses. A smoother and faster process can lead to higher client satisfaction and repeat business, contributing to the institution's long-term sustainability; 3) Customer Service and Support. The level of customer service and support provided by microfinance institutions is crucial in influencing preference and sustainability. Friendly and knowledgeable staff who can assist clients with their financial needs and answer their queries create a positive experience for borrowers. Excellent customer service fosters trust and loyalty, making clients more likely to return for future financial services and refer others to the institution; 4) Financial Education and Training. Microfinance institutions that offer financial education and training programs to their clients can improve borrowers' financial literacy and business skills. Empowering borrowers with knowledge on financial management, budgeting, and entrepreneurship enhances their capacity to use the borrowed capital effectively and grow their businesses. As borrowers succeed and generate income, they are more likely to repay their loans on time, reducing default rates and strengthening the sustainability of the microfinance program; 5) Additional Services: Some microfinance institutions go beyond basic loan services and provide additional value-added services such as savings accounts, insurance options, or training workshops. Offering a range of financial products and services tailored to the needs of the community can enhance the institution's appeal and make it a one-stop-shop for financial solutions. Diversifying revenue streams through additional services can contribute to the financial sustainability of the microfinance program (Nurfiyani & Khanifa, 2021).

In conclusion, the facilities factor, encompassing accessibility, efficiency, customer service, financial education, and additional services, significantly impacts borrowers' preference for capital from microfinance institutions based on Village Funds. By prioritizing the needs and preferences of their clients and providing excellent facilities, these microfinance programs can foster a positive reputation, attract more clients, and enhance their long-term sustainability.

4. Benefits Factor

Based on the research, the benefits resulting from the savings and borrowing activities in the Village Fund-Based Microfinance have a significant impact on reducing loan sharks in the village. It helps address family financial issues, provides capital for micro-enterprises, and ensures safe savings for loans and profit-sharing between the customers and the Village Fund-Based Microfinance institution.

The benefits factor in preference for capital and sustainability of microfinance based on Village Funds refers to the advantages and positive outcomes that borrowers gain from accessing financial services from these institutions (Nurfiyani & Khanifa, 2021). The perceived benefits of borrowing from microfinance institutions can influence individuals' and businesses' preference for utilizing their services, and in turn, affect the overall sustainability of the microfinance program. Here's how the benefits factor can impact preference and sustainability;

- a. Access to Capital. One of the primary benefits of microfinance based on Village Funds is improved access to capital for individuals and small businesses, especially those who are excluded from traditional banking services. Village Funds-based microfinance institutions provide financial resources to those who lack collateral or formal credit histories, enabling them to start or expand their businesses. This increased access to capital can lead to a preference for borrowing from such institutions among underserved communities;
- b. Financial Inclusion. Microfinance programs based on Village Funds promote financial inclusion by reaching out to marginalized and low-income populations. These programs give people an opportunity to participate in the formal financial system, which was previously inaccessible to them. Being financially included can lead to increased economic stability, reduced vulnerability, and improved livelihoods, making Village Funds-based microfinance more attractive to potential borrowers;
- c. Flexible and Customized Services. Village Funds-based microfinance institutions often offer flexible loan products tailored to the needs of their clients. Borrowers may have different financial goals, repayment capacities, and risk tolerances. Microfinance institutions that can customize their services to suit individual and business requirements are more likely to be preferred by borrowers. Flexibility in loan terms and repayment schedules can contribute to higher borrower satisfaction and improved sustainability;
- d. Empowerment and Social Impact. Borrowers from microfinance programs may experience a sense of empowerment and improved social standing. Access to capital allows individuals to invest in income-generating activities and become self-reliant. The success of their businesses can lead to increased confidence and status within their communities. Additionally, the positive impact of microfinance on poverty

reduction and economic development can further enhance the preference for Village Funds-based microfinance;

- e. **Community Development.** Village Funds-based microfinance programs often prioritize local community development and reinvest a portion of their profits back into the community. This reinvestment can be in the form of community projects, social programs, or capacity-building initiatives. Borrowers who value community development and see tangible benefits in their localities are more likely to prefer borrowing from microfinance institutions that prioritize social impact and sustainability.
- f. **Affordable Interest Rates.** Microfinance institutions that offer competitive and affordable interest rates on loans can be highly preferred by borrowers. Lower interest rates reduce the cost of borrowing and the burden of debt repayment for borrowers. Affordable rates also contribute to higher loan repayment rates and lower default risks, promoting the sustainability of the microfinance program.

In summary, the benefits factor, including improved access to capital, financial inclusion, flexible services, empowerment, social impact, community development, and affordable interest rates, plays a significant role in influencing borrowers' preference for capital from microfinance institutions based on Village Funds (Perez et al., 2011). By focusing on delivering tangible and meaningful benefits to their clients, these microfinance programs can attract more borrowers, build trust and loyalty, and contribute to their long-term sustainability.

CONCLUSION

Based on the research findings on "Empowering of Village Fund-Based Microfinance Sustainability; Banking Capital Preferences of Rural Communities," it was found that Preference for capital and Sustainability of Microfinance based on Village Funds consists of four main factors that influence the sustainability of microfinance institutions based on Village Funds and the capital preferences of rural communities; 1) **Ownership Factor.** Ownership factor is one of the main reasons why communities choose to use Village Fund-Based Microfinance for their financial needs. Microfinance institutions based on Village Funds operate on the principle of kinship, where community members are treated equally in terms of loan allocation and interest rates without requiring collateral. The sense of ownership and empowerment is evident as these institutions are specifically designed to cater to the needs of the rural communities; 2) **Interest Rates.** The research results indicate that interest rates have a positive impact on the welfare of rural communities and their interest in using Village Fund-Based Microfinance. Lower interest rates offered by these microfinance institutions lead to higher interest from the community to utilize their services. Low interest rates help reduce the community's dependency on loan sharks (rentenir) and facilitate their access to capital for business ventures; 3) **Facilities Factor.** Having adequate facilities in Village Fund-Based Microfinance is crucial for rural communities. Simple

facilities such as passbook accounts, timely reminders for payment, and friendly customer service by the staff assist the community in accessing the services and understanding the loan application and repayment processes better. Sufficient facilities also contribute to building trust and loyalty among the community towards the microfinance institutions based on Village Funds, and 4) Benefits Factor. The benefits derived from using Village Fund-Based Microfinance are significant for rural communities. These microfinance institutions help reduce the presence of loan sharks in villages and address the financial issues faced by families. The capital acquired from these services is utilized for microenterprise development, and secure savings are utilized for mutually beneficial profit-sharing between clients and the microfinance institutions based on Village Funds.

The research findings highlight the four main factors, namely Ownership Factor, Interest Rates, Facilities Factor, and Benefits Factor, that contribute to the Preference for capital and Sustainability of Microfinance based on Village Funds. Microfinance institutions based on Village Funds that implement the principles of kinship, offer low-interest rates, provide adequate facilities, and offer significant benefits to rural communities can enhance sustainability and become the primary choice for financial services. These findings provide valuable insights for the development of microfinance institutions based on Village Funds and the empowerment of rural communities as a whole. By considering and optimizing these factors, it is expected that microfinance institutions based on Village Funds can better support economic growth and welfare improvement in rural communities.

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