

Establishing the Sustainability of Community-Based Microfinance:
— A Case Study of *Lembaga Perkreditan Desa* (LPD) in
Kedonganan Customary Village, Bali —

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Ratih Ineke Wati

Summary

学位論文要旨

Establishing the Sustainability of Community-Based Microfinance:

A Case Study of *Lembaga Perkreditan Desa* (LPD) in Kedonganan Customary Village, Bali

共同体を基盤としたマイクロファイナンスの持続可能性

—バリ島ケドンナン村金融組織 (LPD) の事例研究—

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Microfinance institutions (MFIs) have supported the alleviation of poverty thus the national economic development efforts in developing countries. The large number of poor households is benefitted by microfinance programs. Since the improved household income and living standard induces the changes in behavioral responses to the socioeconomic condition of poor people, it results the increased difficulties in measuring the precise extent of the socioeconomic impacts of improved livelihood. While Microcredit Summit Campaign still struggle collecting and verifying data to measure movement out of poverty, this research tries to provide a deeper study of one of community-based microfinance in Indonesia so-called *Lembaga Perkreditan Desa* (LPD) which successfully have improved Balinese community life.

In Indonesia, recently more than 600 thousand MFIs are operated in two broad categories, bank and non-bank type. The non-bank type is further grouped into formal and non-formal types based on the legislation of Indonesian Microfinance Act. LPDs in Bali are categorized as the “non-bank” and “formal” MFI. These institutions are established uniquely by upholding Balinese Hinduism in managements, rules, and practices. One LPD is owned and governed by one customary village (*Desa Pakraman*) of Bali. To strengthen its position as customary-village institution, LPD attends village/hamlet meeting (*Paruman Desa/Banjar*) which is the highest authority of Balinese culture. LPD serves two kinds of customers, i.e. native (*Krama Desa*) and non-native residents (*Krama Tamiu/Tamiu*) who are tied particularly with social capital system. The management

regularly allocated 20% of profits for village development programs and 5% of profits for social activities. In addition, the services and facilitations keep improved by adopting the current technology of rural banks. Recently 1,422 of 1,472 customary villages in Bali have established their own LPD and 94% of them were categorized as well-performing MFIs in Indonesia.

Through the case study of LPD in Kedonganan Customary Village, this research found two major changes along with the above summarized development of LPDs in Bali: (1) the downward trend of borrowers but the increment of loan outstanding, and (2) the large account numbers of non-native residents in all products. The first finding raises the concerns as it coincided with the stagnated foreign and domestic investment to the service sector, which includes the tourism, for the last five years. Bali, known to be established as the target location of international and domestic tourists, also received less investment lately. Hence, the community tended to diminish the number of credit application. The second finding is caused by the rapid growth in number of migrating population to Bali due to its relatively attractive job market situation than other parts of the country although the situation in Bali was not much favorable for all. From the field survey, it was found that a large portion of incoming-migrant to Bali is employed as temporary workers in primary sectors. In addition, this study also found two minor findings: (1) lowering asset quality index figures in 2013 and 2014, and (2) unfinished agenda of successor issue in head position which is depicted the behavior nature of community and LPD in Kedonganan Customary Village.

In order to promote the sustainability of LPDs and Balinese community life, the situations of the community as well as of the regions need to be well understood and known. Moreover, there are indispensable needs of nation-wide or regional wide efforts to support the LPDs as well as other MFIs because the situations of the village community have been largely modified by the external economic or social factors. Local and central governments should provide the adequate guidance to village communities for help developing their decisions. In this context, the ongoing “transformations in national socioeconomic conditions” need to be measured and monitored in comprehensively and in systematic manner.

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Chapter 1.

General Introduction

1.1. Background of Study and Problem Statements

The microfinance establishment could not be separated from the changing issues in agriculture, rural development, and rural finance during the 1960s and 1970s. In those periods, the key issue of rural development was to promote “Green Revolution” by carrying out the new technology in agriculture sector, including seeds, seedlings, fertilizers, pesticides, tools, and machines. Agriculture microcredit with subsidized interest rate was then chosen by government and donor as one of the inputs to support this project. Agricultural development bank was appointed as the disbursement channels which link farmers as the target clients to government/donors as the funders. The agriculture products from this project were purchased by the government at guaranteed prices. However, since many farmers could not repay the loans, the banks did not cover the costs, and the government ran out of money to finance the subsidies; the businesses became costly, inefficient, and ineffective for reaching the poor (Seible 2007 and Cull *et. al.* 2009).

Given the increasing number of rural people who could not be relied on agriculture sector alone, at the beginning of 1980s the microfinance focus has been shifted to people who engaged in nonfarm activities, such as making handicrafts, raising livestock, and running small stores. In practice, the generating income of nonfarm business tended to be more stable than agriculture business sector which highly stick on the change of weather and crop price. Cull *et. al.* (2009) state that by also serving customers in nonfarm sectors, more than 98% of repayment rates were achieved without requiring the collateral as loan security.

Nowadays microfinance initiatives have become common in a large number of countries and adopted as part of many international cooperation projects. Microfinance is recognized as an integral share of United Nations Organization's collective effort to meet the Millennium Developments Goals as mentioned on Secretary General's Draft Program of Action [A/58/179] presented in December 2003 (Foschi 2010). The 2012 Report of Microcredit Summit Campaign emphasizes that:

“As of December 31, 2010, 3,652 MFIs were reported reaching 205,314,502 clients, 137,547,441 of whom were among the poorest when they took their first loan. Of these poorest clients, 82.3% or 113,138,652 are women... assuming five people per family, the 137.5 million poorest clients reach by the end of 2010 affected some 687.7 million family members” (Maes and Reed 2012).

The achievements of microfinance program are actually not enough if only depicted from how many poor have been served or how many loan have been issued. Recently the biggest issue in the operational management of MFIs related to harm to clients emerges after two sound-performed MFIs, Banco Compartamos of Mexico and Andhra Pradesh in India, were proven to burden the clients with high interest rate and much peer pressure, in order to pursue the profits and attract the more investors (Cull *et. al.* 2009 and Maes and Reed 2012). A case study of Andhra Pradesh was reported allegations of suicides by its clients. The Microcredit Summit Campaign¹⁾ now is on the way to realize the second goal to measure the transformation in microfinance clients' life after joining program, including the client protection, transparency, and social performance of MFIs to reach poor people and help them move out of the poverty. This international microcredit association via State of Microcredit Summit Campaign Report 2012 asks the all actors of MFIs to not only gain the high profits but also to bring back the MFIs' main goal to reduce the poverty; because the attention of microfinance actors currently tend to shift to the financial performance and

sustainability of MFIs rather than on poverty alleviation and social impact of microfinance program (Foschi 2010 and Maes and Reed 2012).

So far the Campaign is still struggling with collecting and verifying data to measure the movement out of poverty after serving by MFIs. Through this research, the author report the findings obtained from a case study of LPD, one of the Indonesian-style of MFI. LPDs successfully improve the living standard of Bali communities as well as to maintain their assets and profits almost 30 years. These institutions are model of community-based microfinance recognized nationally in legal framework of Indonesia without changing their unique characters. Their strong social implication in controlling the risk of credit-defaults can be another alternative to maintain the financial sustainability of MFIs without harming to customers. Both findings and discussion from a case study of LPD Kedonganan hopefully can add and contribute to further deepening of understandings about the MFIs.

1.2.Objective of Study

This study goal is to find all factors that support the establishing sustainability of community-based microfinance through the case study of LPD in Kedonganan customary village²⁾, Bali. Given the uniqueness of LPD, the aims are then divided into the objective focusing on case study, the relation to national issue, and the contribution to microfinance development in developing countries.

The first aims of this study concern with analyzing all factors which support and challenge the sustainable development in the study site:

(1) LPD Kedonganan has proven successfully to maintain the sound performance over five years. Although only has one office located in Kedonganan customary village, in 2012

this institution could achieve the fifth rank for the highest assets and profits of LPDs in Badung Regency (www.lpdkedonganan.com). Amongst the tight competition of MFIs especially in Bali, LPD Kedonganan can keep loyal customers using its services. This study would like to identify all factors which influence the sound performance of LPD Kedonganan by investigating the operational managements (Chapter 2), financial statements (Chapter 3), and social implementation (Chapter 4).

- (2) The existence of LPD Kedonganan as the only one community-based microfinance in Kedonganan customary village over 24 years has changed many aspects of community life. LPD Kedonganan has played the important roles in livelihood alteration from fishery to tourism industry. An increase in community income and the growth of migrant population caused by the above features are assumed to shift the customers' motivation using financial services of LPD Kedonganan. In addition, the issue on management renewal has become the unfinished agenda of this institution since five years ago. This study would like to analyze deeper related on those challenges and their relation to sustainable development of LPD Kedonganan (Chapter 5).

The sustainable development of LPD as community-based microfinance is not only influenced by the community itself but also by the national development program. In the last five years from 2010 to 2014, the foreign and domestic direct investments in both service sectors including tourism industry and Bali tended to decrease (Indonesia Investment Coordinating Board 2015). The second aim of this study is to analysis the impact of investment trend in Indonesia on the sustainable LPDs in Bali.

In the end, the third aim of this study is to present a deeper discussion on the community life change after served by microfinance for more than two decade through the

case study of LPD Kedonganan. The findings could be another initial model to identify the microfinance clients' life transformation and its impact for the further research.

1.3. Research Sites and Data Collection

This research was conducted in *Lembaga Perkreditan Desa* (LPD) located on Kedonganan Customary Village, Badung Regency, Bali Province, Indonesia (See Figure 1.1). The study site itself is part of Jimbaran Bay which is well-known as the tourism spot and is only five kilometer from Denpasar International Airport. Kedonganan customary village is known as one of fishing village which supply fresh fishes to growing number of tourists in Bali. Before the 1990s, 90% of job opportunities were provided by fishery resources but recently the most of community residents prefer to work in private sectors, business, and services.

Field study was conducted twice on 1st – 14th June 2012 and on 26th November – 9th December 2014. The first field research collected primary data from 29 respondents who were selected randomly, including the representative of three managers, five staffs, seven members of customary village board, and fourteen ordinary customers. The second field research interviewed other 42 respondents who were selected by stratified random sampling based on the amount and the duration of savings. Data collecting techniques used the combination of open-ended and close-ended questions, and also semi-structured interview in order to investigate: (1) the history of LPD Kedonganan (Chapter 2); (2) the microfinance practices in LPD Kedonganan (Chapter 2 and Chapter 4); (3) the development of LPD Kedonganan in respondents' viewpoint (Chapter 2); and (4) the opinion about the factors which affect their motivation and satisfaction to LPD Kedonganan (Chapter 4 and Chapter 5).

In addition, secondary data were also collected to support the findings of primary data, including various regulations on LPD, annual reports of LPD Kedonganan, and monograph data of Kedonganan Customary Village.



Figure 1.1. The location of LPD Kedonganan

1.4.Outlines of Thesis

This dissertation contains of six chapters, including: (1) the general introduction; (2) historical background; (3) financial analyses; (4) the implication of social capital; (5) current issues and future challenges; and lastly (6) general conclusions and policy implications.

Chapter 1 is the general introduction started with presenting the study background on microfinance and problem statement of sustainable operational management of MFIs. The

study background and problem statement, in the end, focus on an Indonesian MFI which well-known as *Lembaga Perkreditan Desa* (LPD) located in Kedonganan Customary Village. Study objective mentions about the purpose of conducting this study including the reasons of choosing the field site. Research sites and data collection explains the field site location and the way of collecting and analyzing data. Lastly, Chapter 1 is closed with outline of thesis which listed each chapter of this dissertation.

Chapter 2 is the historical background which explains the historical overview of MFIs in Indonesia, LPDs in Bali, and LPD in Kedonganan Customary Village. The discussion continues with the identification of unique operational management of LPDs as community-based microfinance which combine traditional and modern financial service applications.

Chapter 3 discusses the financial analyses of LPD Kedonganan based on its annual financial statements. The analyses include: (1) percentage growth rate of achievement report for 24 years; (2) annual growth rate of deposits and outstanding loans; (3) analyses of balance sheets and income statements; (4) ratio analysis of capital, asset, management, earning, and liquidity; and lastly (5) CAEL rating³⁾. Except the percentage growth rate of achievement report, all are analyzed for the last five years from 2010 to 2014.

Chapter 4 discusses the implication of social capital in LPD. The elements of social capital including social networks, institutions as rules-in-use, patron-client relationship, and trustworthiness are found in operational management system of LPD.

Chapter 5 mentions about the current issues and future challenges of LPD Kedonganan. At first, the socioeconomic characters of the customers are explained based on the previous researches, oral and written history, village monograph, and observation. The findings of current issues are then listed and discussed, including (1) the position of non-native resident customer in LPD Kedonganan; (2) customer satisfaction to LPD Kedonganan; and

(3) successor issues in LPD head position. Those issues become discussion root of future challenge to keep the sustainable development of LPD Kedonganan.

Chapter 6 is the last chapter of this dissertation which presents the general conclusion and policy implications. In this chapter, the findings of each chapter are concluded and some policy implications are offered.

Chapter 2.

Historical Background of LPD

2.1.Introduction

The uniqueness of LPDs in Bali lies in the ability to combine between traditional and contemporary financial services into one institution so-called *Lembaga Perkreditan Desa*. Similar to other LPDs, LPD Kedonganan has been established as traditional financial institutions which uphold Balinese Hinduism in managements, rules, and practices. Along with the rapid development of financial institutions, LPD Kedonganan improves the services and facilitations by adopting the current technology of rural banks. In this chapter, the characteristics of MFIs in Indonesia and brief story of LPDs in Bali are presented following with the deep discussion about the uniqueness of LPD through the case study of LPD Kedonganan.

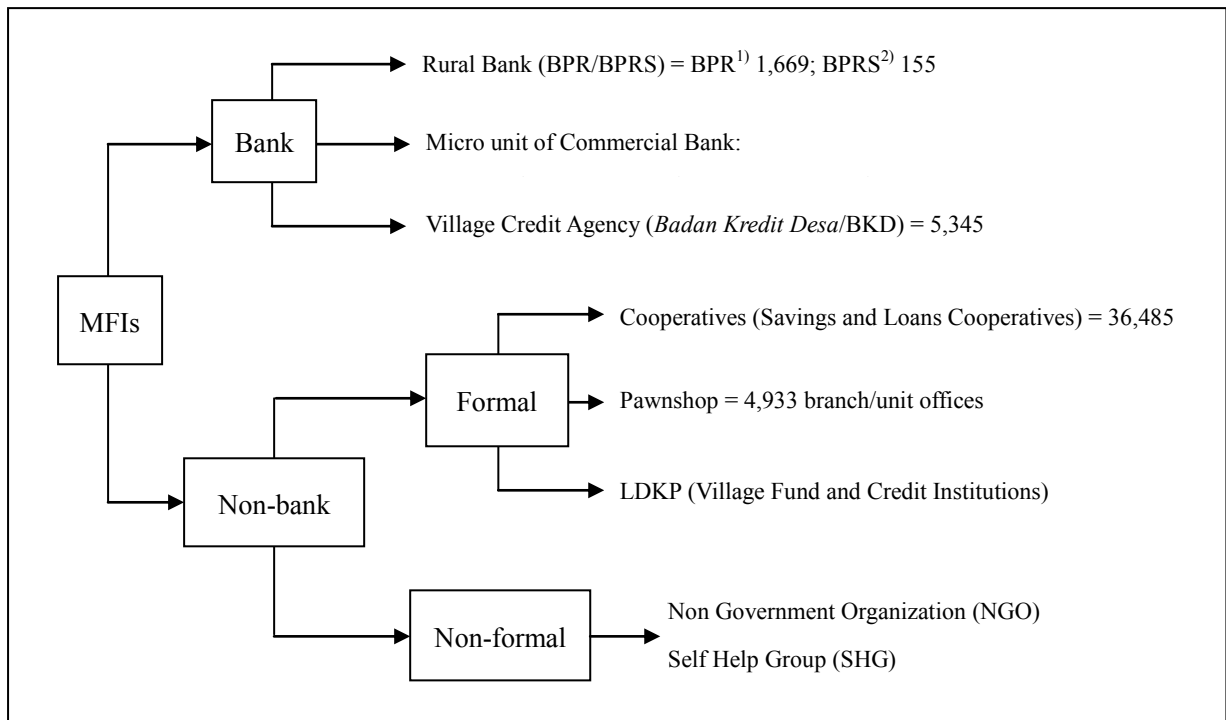
2.2.History Overview

2.2.1. Microfinance Institutions in Indonesia

Microfinance services are successfully developed in Indonesia because the regulated financial institutions have been able to extend sustainable financial services deep into the countryside and reach many of the poor (Conroy 2003). As depicted in Figure 2.1, recently more than 600 thousand MFIs are operated as bank and non-bank type in Indonesia. Microfinance banks are run their business under the supervision of Bank Indonesia. As of 2012, this type of MFIs reached 1,824 rural banks, 6,989 micro unit of commercial banks, and 5,345 village credit agencies. In the case of the non-bank, this type of MFIs is divided into formal and non-formal based on Indonesian Microfinance Act, so-called UU

No.1/2013. As of 2012, there were more than 40 thousands formal non-bank MFIs including 36,485 savings and loans cooperatives, 4,933 branch/unit offices of pawnshop, and 1,351 units of *Lembaga Perkreditan Desa* (LPD) in Bali as the sample of village fund and credit institutions. While rest of them is categorized as non-formal non-bank type commonly operated by non-government organization (NGO), self help group (SHG), and microfinance based on Islamic principle (*Baitul Maal wat Tamwil* – BMT) with local financial management system (Sembiring and Purwanti 2012). Majority of microfinance services in Indonesia is applied individual-lending method due to the dominance of sector by regulated financial institution following normal banking practices. They does not focus serving specific community group but more broadly serving urban and rural people which meets difficulty to access the services from commercial banks. However, microfinance services organized by NGOs commonly uses solidarity group-based lending approaches which are the most popular concept applied by many MFIs in developing countries. They often only serve the certain groups, such as women, farmers, small business community, etc. (Conroy 2003).

Both bank-types and non-bank-types of MFIs have served many low income people in Indonesia. Their services are accessible for local region communities given their locations which are close to them. Today a lot of MFIs has expanded their financial services by targeting micro, small, and medium enterprises in villages, rural, urban, and city. Although the main purpose to reduce poverty on a large-scale level has not accomplished yet, the economic development of Indonesia has been supported in a certain sense by the existence of MFIs.



Note: ¹BPR (*Bank Perkreditan Rakyat*); ²BPRS (*Bank Perkreditan Rakyat Syariah*) is rural bank operated with Islamic principle, ³BRI (*Bank Rakyat Indonesia*) Unit and *Mandiri* are state-owned commercial bank, DSP (*Danamon Simpan Pinjam*) is private-owned commercial bank

Figure 2.1. MFIs Structures in Indonesia

Source: Sembiring and Purwanti (2012)

2.2.2. LPDs in Bali

At first, provincial government of Bali which was led by Prof. Dr. Ida Bagus Mantra in 1983 initiated to establish a financial institution by adopting and developing *sekka* concept (community organization engaged in socio-economic sectors), *banjar*²⁾ (customary hamlet), and *desa pakraman*²⁾ (customary village) which had been thrived in Bali community. His teams even conducted comparative study at LPN⁴⁾ (*Lumbung Pitih Nagari*) located in Padang, West Sumatera to learn how it supported the financial needs for community custom (Seible and Nurcahya 2009). A year later, Department of Home Affair held seminar about rural credit and financial institution in Semarang, Central Java, Indonesia on 20th – 21st February 1984. The seminar concluded the importance of establishing credit

institutions in rural area to facilitate small enterprises which could not access commercial banks. This was a green light for Bali provincial government to officially realize the idea to establish a rural financial institution (*Lembaga Perkreditan Desa* – LPD) in each customary village, which is concerned on social, economy, custom and religious life of local communities.

Prof. Dr. Ida Bagus Mantra soon issued the Governor Decree about LPD so-called SK Gubernur Kepala Daerah Tingkat I Bali No. 972/1984 as first regulation. Several months later, eight LPDs have established on 1st March 1985 as pilot projects with two million rupiah initial financial support (1US\$ = Rp 1,110). Those locations were separated, one LPD in a regency of Bali. After three years, LPDs began to show good achievement. Regional regulations (*Peraturan Daerah* – PERDA) on LPDs were then issued for the first time in 1988 to strengthen LPDs position in the state law. As explained in Table 2.1., PERDA on LPDs had been amended four times as of 2012 and always accompanied with issuing PERGUB (*Peraturan Gubernur* – Governor Regulation), which explains some articles of PERDA in detail. In 2013, UU no. 1/2013 on microfinance issued by central government of Indonesia mentions in article 39 point 3 that:

“LPD, LPN, and similar institutions established before this law applies are recognized based on their own customary law”.

Main council of customary villages in Bali (*Majelis Utama Desa Pakraman Bali* – MUDP Bali) supported by this legislation then issues *Pararem Lembaga Perkreditan Desa* (LPD) Bali as the standard provision for each customary village to draw up customary law (*Awig-awig*) on LPD.

Table 2.1. The Legislations of LPDs in Bali

Time	Legislations
19 th November 1984	SK Gubernur Kepada Daerah Tingkat I Bali ¹⁾ No. 972/1984. This is the first regulation concerning LPDs in Bali.
1988	PERDA ²⁾ no. 2/1988. Provincial Regulation about LPDs was issued for the first time. This regulation power is higher than SK Gubernur Kepada Daerah Tingkat I Bali (Governor Decree).
1991	PERGUB ³⁾ No.27/ 1991: The establishment of LPD in Province Level in 1990/1991. PERGUB No.199/ 1991: The establishment of LPD in Province Level in 1990/1991. PERGUB No. 368/ 1991: The establishment of LPD in Province Level in 1991/1992. PERGUB No. 588/ 1991: The establishment of LPD in Badung Regency Level in 1991/1992. PERGUB No. 624/ 1991: The establishment of LPD in Klungkung Regency Level in 1991/1992. PERGUB No. 645/ 1991: The establishment of LPD in Gianyar Regency Level in 1991/1992.
1992	PERGUB No. 84/ 1992: The establishment of LPD in Tabanan Regency Level in 1991/1992. PERGUB No. 143/ 1992: The establishment of LPD in Province Level in 1991/1992. PERGUB No. 144/ 1992: The establishment of LPD in Buleleng Regency Level in 1991/1992. PERGUB No. 755/ 1992: The establishment of LPD in Province Level in 1992/1993.
1993	PERGUB No. 344/ 1993: BPD as technical guidance. PERGUB No. 422/ 1993: The establishment of central LPDs.
2002	PERDA No. 8/2002 improved the content of PERDA no. 2/1988.
2003	PERGUB No. 3/ 2003: The duties of guidance board. PERGUB No. 4/2003: Deposit and Distribution of LPD profit. PERGUB No. 7/ 2003: Protection funds. PERGUB No. 8/ 2003: The establishment of guidance board. PERGUB No. 12/ 2003: Precautionary principle in management.
2006	PERGUB No. 17/ 2006: The establishment of developing and training institution.
2007	PERDA no. 3/2007. This regulation renewed some articles i.e. organization, guidance, and monitoring.
2008	PERGUB No. 16/ 2008 management and monitoring in LPD.
2012	PERDA No. 4/ 2012 improves some article in previous PERDA i.e. establishment, capital, organization, planning and budget, activity report, guidance and monitoring, protection and guarantee funds, profit sharing, and general sanction to LPDs.
2013	PERGUB No. 11/ 2013: Implementation guidelines of PERDA No. 4/ 2012. UU ⁴⁾ no. 1/2013 article 39 (3).
2014	<i>Pararem Lembaga Perkreditan Desa (LPD) Bali</i> ⁵⁾ . <i>Awig-awig Lembaga Perkreditan Desa</i> ⁶⁾ .

Note: ¹⁾Governor Decree, ²⁾Regional Regulation, ³⁾Governor Regulation, ⁴⁾Indonesian law, ⁵⁾issued by main council of all customary villages in Bali (MUDP Bali), and ⁶⁾issued by each customary village

Source: <http://simkum.baliprov.go.id/>

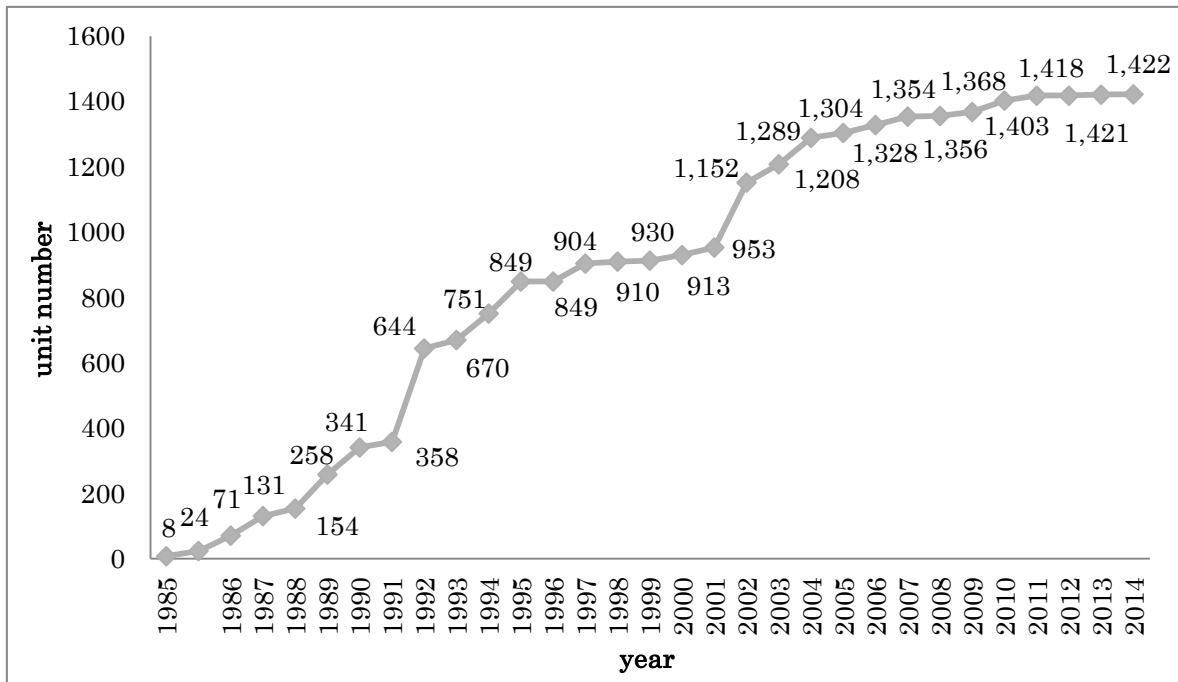


Figure 2.2. The growth of LPDs' number in Bali

Source: LPD Profil (2009), Sulistyowati (2011), Patria (2013), and Kristianto (2014).

As depicted in Figure 2.2, the number of LPDs in Bali reached 1,422 units recently or just remained 50 customary villages which had not established this institution yet. The growth of LPDs' number also recorded the sharp increment twice in 1992-1993 and 2001-2002. The first increment in 1992-1993 was influenced more by the promulgation of first formal regional regulation so-called PERDA No. 2/ 1988 accompanied with PERGUB in 1991-1993. These legislations supported Bali province including five regencies to officially establish LPD in their areas (see Table 2.1). The second increment in 2001-2002 occurred when the units' number at the first time reached more than half of total customary village in Bali. This was mostly influenced by Indonesian economic crisis in 1997-1998. During that time, many customers of 16 liquidated commercial banks moved their money to microfinance institutions including LPDs.

2.2.3. LPD Kedonganan

The establishment of LPD Kedonganan was fully supported by customary village, government, and community. In the beginning, government and customary village promoted this institution through managing initial capital and providing office location respectively. The consistency of LPD Kedonganan in improving living standard and infrastructure development in Kedonganan customary village could slowly attract public attention and built trust of native residents to use the service. The process of LPD Kedonganan which has been established successfully as financial institution trusted by local community is depicted in Table 2.2.

LPD Kedonganan plays its role to the community not only as microfinance but also as customary village institution. LPD Kedonganan conducted many activities to support the development of Kedonganan customary village, in which all were funded from LPD Kedonganan's profit sharing. As depicted in Table 2.2, this financial institution chose the renovation activities of village temples (*pura*) as the priority, because temples are the center of all custom and religious activities in Bali. Moreover, by supporting the village temples, LPD Kedonganan carried out the order of provincial governance to maintain the custom and religious life. Table 2.2 also shows that LPD Kedonganan supported economic development of customary villagers especially in business sector, through building traditional market and promoting collective owned and managed seafood restaurants.

As of 2014, the assets climbed up to Rp 16 billion and the profits rose to more than Rp 570 million. The number of individual and institutional customers served by this institution was 1,723 borrowers and 12,877 depositors. LPD Kedonganan issued outstanding loans of Rp 75 billion and managed deposits of Rp 74 billion. In order to service the customers, customary village board appointed three managers and employed 60 staff from native residents as full-time employees.

Table 2.2. The profile of LPD Kedonganan

Time	Explanations
1989	Kedonganan Customary Village achieved forth rank in Balinese customary village competition. As the gift, provincial government granted initial financial source and management training to establish a LPD in Kedonganan customary village.
9 th September 1990	LPD Kedonganan was established officially. The total of initial capital sources were 4.6 million rupiah consisting of 2 million rupiah from provincial government and 2.6 million rupiah from government of Badung regency (1US\$ = Rp 1,901).
1990	I Ketut Madra, S.H., M.M., the leader of LPD Kedonganan, applied credit in local bank with personal guaranty to improve the capital of LPD establishment. Fortunately the loan request was granted in the amount of one hundred million rupiah and automatically it increased the initial capital of LPD Kedonganan.
1991	-Kedonganan customary village supported 12 million rupiah to build LPD Kedonganan office (1US\$ = Rp 1,992). -LPD Kedonganan supported the repair of village road.
1992-1993	LPD Kedonganan succeeded to support temple renovation in <i>Pura Dalem Khayangan</i> .
1998	LPD Kedonganan supported the temple renovation of <i>Pura Segara</i> .
2000-2002	LPD Kedonganan supported the temple renovation of <i>Pura Penataran</i> .
2003-2005	LPD Kedonganan supported the temple renovation of <i>Gedong Ratu Ayu</i> .
2005	LPD Kedonganan supported the renovation of meeting hall in <i>Palguna</i> temple.
2006	LPD Kedonganan supported mass cremation ceremony (<i>Ngaben</i>) for free at first time. Thereafter this event becomes biennial agenda.
2007	-LPD supported the establishment of traditional market in Kedonganan customary village -LPD started to promote the 24 collective owned and managed seafood restaurants along Kedonganan coastal ⁵⁾
2009	LPD Kedonganan office was mostly renovated for the first time.
2010	LPD Kedonganan supported tutoring of school children so-called <i>Widya Wijaya</i> .
12 th January 2010	The newest office of LPD Kedonganan has been inaugurated by <i>bupati</i> (regency head) of Badung, A.A. Gde Agung, S.H.
9 th June 2012	For the first time, LPD Kedonganan, WWF, CTI-CFF and almost of seafood restaurants along Kedonganan costal worked together to promote an international event called Kedonganan Coral Triangle Day ⁶⁾ .
2014-2015	LPD Kedonganan supported the temple renovation of <i>Pura Puseh Desa</i> , <i>Pura Toya Ning</i> , and <i>Pura Dalem</i> .

Source: www.lpdkedonganan.com

2.3. Traditional and Modern Implementation in LPD Kedonganan

2.3.1. Maintaining Traditional Aspect

Tradition is the foundation for all components in LPD organizational structure to establish its rules and running its business services. Every generated rule is based on Balinese Hinduism philosophy (*Tri Hita Karana*) and Balinese customary law⁷⁾ (*Awig-awig*). For example, LPD Kedonganan places all native residents⁸⁾ (*Krama Desa*) as LPD's shareholders, customary hamlet assembly⁹⁾ (*Paruman Banjar*) as the higher authority, and customary sanction¹⁰⁾ (*Sanksi Adat*) as the way to prevent credit-default. LPD Kedonganan also provides products and services to support native residents when conducting ritual ceremonies, and devotes the profit sharing to promote cultural activities and renovate village temples. Following sub-chapters are discussed deeply about the tradition applied in LPD Kedonganan.

2.3.1.1. Following Balinese Hinduism Philosophy (*Tri Hita Karana*)

LPD Kedonganan has been run by following the rule of Balinese Hinduism philosophy which is called *Tri Hita Karana* in Balinese language. This philosophy contains element of *parahyangan* (harmonious relationship between human and God), *pawongan* (harmonious relationship between human), and *palemahan* (harmonious relationship between human and environment). Balinese believe that the well maintained of *Kahyangan Tiga* temple as representative of *parahyangan* can influence the better arrangement of rural life related to *pawongan* and *palemahan*. Hence, the managements of LPD Kedonganan have high concern about village temple and all activities inside including the renovation of village temples and ritual ceremonies (Astawa, et. al. 2012, Damayanthi 2012, Gunawan 2011, Khrisna 2010, and Vickers 2012). LPD Kedonganan has renovated eight village temples (see Table 2.2.) and has supported the implementation of *Panca Yadnya*¹¹⁾ (five

sacred rituals) for native residents of Kedonganan Customary Village so far. These activities are part of LPD Kedonganan obligation to allocate 20% of profits for village developments in cultural and religious sector.

2.3.1.2. Based on Customary Law (*Awig-awig*)

LPD Kedonganan as community-based microfinance established in Bali Province of Indonesia is regulated uniquely. In Balinese custom, every institution owned by customary village including LPD has to follow the basic law so-called *Awig-awig* (customary law), which has the highest power inside customary village and/or Bali Province (Atmadja, 2011). On the other hand, LPD Kedonganan is the operated microfinance in Indonesia which has to obey state rules. Before UU no. 1/ 2013 on microfinance is issued, the customary law (*Awig-awig*) did not have power to protect LPDs' existence in legal framework of Indonesia law. Thus provincial government issued regional regulation (PERDA) on LPD which could support their development. Confusing function occurred because there were two institutions i.e. customary village and provincial government which have strong power in one side but no power in the other side. Customary village conducted monitoring and evaluation in LPD but the result is not considered in provincial and state level. In the other side, provincial government arranged training, guidance, and monitoring then reporting the result to province and state without involving customary village as the owner.

Recently central government of Indonesia issued UU no. 1/ 2013 on microfinance. Article no. 39 (3) confirmed that LPDs are recognized based on customary law (*Awig-awig*) as the legal framework. The main council of customary villages (MUDP) in Bali supports each customary village to regulate the own *awig-awig* on LPD by issuing the standard provision so-called *Pararem Lembaga Perkreditan Desa* (LPD) Bali. Customary

village is entitled to make adjustment of *Pararem Lembaga Perkreditan Desa* (LPD) Bali with the approval of MUDP in order to set the own *Awig-awig* on LPD.

2.3.1.3. Entering Customary Hamlet Assembly (*Paruman Banjar*)

LPD Kedonganan has succeeded to put itself in community system. This institution enters to the highest authority so-called *paruman banjar* or customary hamlet assembly and plays the important role as financial institution owned by customary village. LPD Kedonganan has responsibility to protect all assets of customary village and allocate them in appropriate sectors. The head, secretary, and cashier leader of LPD Kedonganan are elected in *paruman banjar* every four years. Financial statements are reported at this meeting in front of the representative of native residents in order to build the openness among them. The management of LPD Kedonganan also brings the issue on profit sharing allocation and non-performing loans in this assembly, thus they can discuss it together through the approach of Balinese Hinduism philosophy and customary law (Seible 2008).

2.3.1.4. Tying The Native Residents

As written in Regional Regulation (PERDA) on LPD and *Pararem* LPD Bali, the owner of LPD Kedonganan is the customary village as well as native residents. The initial capital was awarded by provincial government and government of Badung regency. Because the amount of initial capital was relatively small, the head of LPD Kedonganan made a starting deposit for its operation by taking a private loan in a local bank (see Table 2.2). His loan was repaid from LPD profits gained after it successfully ties all native residents into operational of business LPD Kedonganan.

LPD Kedonganan ties the native residents though the unique way based on culture. This institution has never pushed the native residents to be its customers. However, LPD Kedonganan is the official institution of Kedonganan customary village which is

established deliberately to support village development, cultural maintenance, and keeping the religious life. Customary village also emphasizes that all native residents are the owners of LPD Kedonganan. Successful development of the institution is a shared responsibility of the owners. When native residents refuse to be a part of LPD Kedonganan, they ignore to participate in village development program which is their responsibility (Atmadja, 2011). Customary village and LPD Kedonganan subtly rebuke native residents who have not used LPD's service. The following interview recorded the way of this LPD to tie native residents as following:

“One of the effective notifications to respect the native residents’ participation as loyal customers in LPD is by giving compensation to their family when they die. The large group on behalf of LPD comes to their house, prays the bodies, and gives compensations to the heirs. Contrarily that situation will not be found in non-customer of LPD. Neighbors would notice it and rumors will spread quickly among the residents. Those native residents should be ready with the negative community responds about their loyalty to customary village.” (Cashier Leader in LPD Kedonganan, 2012)

“Savings our money in LPD is an obligation as a native. My family will get back the money when I die one day.” (Collector in LPD Kedonganan, female, native resident, 33 years old, 2012)

“Our money will be returned back to customary village thus we can share the funds together.” (Housewife, female, native resident, the owner of small shop in her house, 40's years old, 2012)

2.3.1.5.Using Customary Sanction

LPD Kedonganan applies customary sanction to bind the debtors and to overcome non-performance loans. When the debtors are categorized as defaulters, at first credit officers ask them to face LPD managers, the leader of hamlet, and the leader of customary village. Guarantors would be also called if the debtors are non-native residents⁸⁾. They

discuss together in order to solve the loan default amicably. Firstly, LPD managers close the debtors' access to apply for more loans before repaying their previous one. Secondly, LPD managers ask their willingness to settle the loan default within the certain period, or the name of debtor and guarantor will be announced in customary hamlet assembly (*paruman banjar*) as sanction. The debtors and/or guarantors have to explain the default reasons in front of native residents in this meeting. They have to answer the questions; apologize to undermine the trust of community, LPD, and customary village; and also promise to repay their loan in front of native residents before the specified time limit. If debtors and/or guarantors are still unable to meet their obligations to pay off loan, LPD Kedonganan will impose customary sanctions (*Sanksi Adat*) with family approach. The following interviews are some examples of loan default sanction cases:

“As you see, the seafood restaurants built along the Kedonganan coastal are supported by LPD. This institution has been developing our living standard. Majority of drivers from Kedonganan also take some credit both for running their business and their daily life. Unfortunately, I have not settled my loan yet in LPD thus I am applying another one for this car in BCA (Bank Central Asia – commercial bank).” (Driver, male, native resident, 30's years old, 2012)

“It is tough, LPD stop my access to apply for loan recently because I am not finishing my previous one. The collectors of LPD are always walking around and the guarantor is also keeping an eye on me.” (A fish seller in fish market, male, migrant, 20's years old, 2012)

“We are now discussing about one of defaulters from neighboring village. We are still measuring his asset which is pledged as collateral with a value of 200 million rupiah. However we have not determined depreciation cost of building and land yet. We have planned to visit him tomorrow together (LPD managers and the guarantor) since he always absents in each meeting. We will take along the collateral and once again estimate its value.” (The head of LPD Kedonganan, 2012)

“When Mr. A could not repay the loan in LPD Kedonganan because his boarding house was collapse, customary village helped him by buying his land which actually guaranteed

his debt in LPD Kedonganan. The money from its sale was used to pay off his debts and interest in LPD Kedonganan. Customary village and LPD Kedonganan try the best to help the defaulters who actually have good records but involve in loan-default due to some circumstances. In the case of Mr. A, customary village also considered the land collateral location which is close to banyan tree. In Balinese Hindu, this type of land is suitable for temple compared to private ownership. Now customary village is building a village temple there.... If we discuss about the toughest sanction so far, LPD Kedonganan has imposed sanction to a customer by putting the descents in debt. LPD Kedonganan and customary village leave the debt to his son, because the debtor could not pay off the debt, although the collateral was seized. This is how the Balinese culture works” (The staff of LPD Kedonganan, 29 years old, female, 2014).

2.3.1.6.Special Products and Services

LPD Kedonganan can compete successfully with surrounding financial institutions¹²⁾ although having limitations to provide financial services. Based on regulations, LPDs' authorized products consist of saving, time-deposit, and credit only. However, the management can create innovative products from those. They have divided the saving into saving investment (*Tindak*), saving education (*Tabepius*), saving for ritual ceremony preparation (*Sipadat*), and voluntary saving. They further complete the financial products by providing time-deposit and credit service. Customers can take a loan to repair house, send their children to high-level education, and develop the business now. In 2014, 78%, 16%, and 6% of total credits were allocated to working capital, investment, and consumption credits respectively.

All of those products are adjusted to local customs and culture in Kedonganan customary village. For example, *Sipadat* is released as special saving product for ritual ceremony preparation. This product is original from LPD Kedonganan which helps native residents preparing financial needs of *Panca Yadnya* implementation especially in family temple. As compensation, native residents can be participated in free *Ngaben*¹³⁾ (cremation ritual ceremony) supported by LPD Kedonganan. In addition, not only *Sipadat* but each

product in LPD Kedonganan also gives death compensation for the customers. The heirs are entitled to get compensation with the amount of Rp 2 million (Madra and Sujaya 2010).

Products innovation makes this institution more unique than the others and gives additional value for LPD Kedonganan. The limitation area to build the office is not the big problem to attract both native residents and non-native residents inside and outside customary village. LPD Kedonganan applies the general rules of traditional financial agencies which serve customers with easy and fast procedures, low collateral requirements, and door-to-door services to all social levels and resident status (Seible 2007).

2.3.2. Implementing Modernization

In order to maintain its position as competitive financial institutions around Kedonganan customary village, the management implements modernization in services and facilities. LPD Kedonganan provides competitive interest rate, facilitates the staff with computer and internet, and promotes the financial services and social responsibility activities via free magazine, booklet, website, and local newspaper as discussed in following sub-chapters.

2.3.2.1. Competitive Interest Rates

LPD Kedonganan provides competitive interest rates both in deposit products and in credit services. This institution always checked the local interest rates among the financial institutions in order to determine the right position. As mentioned in Table 2.3., the annual interest rate of LPD Kedonganan in 2014 for deposit was 6-7 % and for loan was 15-21%. LPD Kedonganan was the second highest interest rate for savings and time deposits after cooperative which provided 10% on average. Similar to cooperative, the management rewards the customers who entrust their money in LPD Kedonganan by giving high interest rate in deposit products. The interest rate is determined based on the term of

product and of currency. On the other hand, the highest percentage of interest rate for credit was just below to commercial banks around Kedonganan customary village. According to Table 2.3., the range for interest rate was quite diverse between 15% and 21% which was adjusted to the record and loyalty of customers. Both the duration to be a customer and the willingness records to obey the credit rules can decrease the percentage of interest rate in credits. If having good performance, the customers can be rewarded with the lowest interest rate in credit but with the highest interest rate in deposits depending on the terms they choose. When calculating with this method, the interest rate of LPD Kedonganan did not much different with rural banks.

Table 2.3. The annual interest rate of financial institutions around Kedonganan customary village

Financial Institution	The Annual Interest Rate	
	Savings and Time Deposits	Credits
LPD Kedonganan	6-7% (nominal interest rate) depending on terms	15-21% depending on term (nominal interest rate) and the loyalty of customers
Cooperative	10% (an average) depending on terms	17% (an average) depending on the members' agreement
BPD Bali (rural bank)	3-6% (nominal interest rate) depending on terms	Micro credit. 10-12% (nominal interest rate) Term loan max. 15 years. Business activity for at least 6 months.
BSH Bali (commercial bank)	3-7% (nominal interest rate) depending on terms	Micro credit. 22% (nominal interest rate). Term loan max. 36 months. Business activity for at least 6 months.
BRI (state owned commercial bank)	3-7% (nominal interest rate) depending on terms	Micro credit. 22 % (nominal interest rate). Term loan max. 3 years for working capital and max. 5 years for investment. Business activity for at least 6 months.

Source: Interview (2014)

The native residents are the faithful customers of LPD. Although depositing money in cooperative and applying for loan in rural bank are more profitable in this case, they keep using LPD's financial services. In additional, the procedures to access deposit and loan products in LPD Kedonganan are easier than cooperative and rural bank. The cooperatives mostly choose their members based on specific categories, such as occupation, religion,

family tree, etc., while the rural banks provide the more complicated procedures to apply for loan, such as tiresome interview, business plan report, high value of collateral, etc.

2.3.2.2.Data Managements and Facilities

LPD Kedonganan has renewed the data management with the latest technology. Most employees work with computers connected to internet. LPD Kedonganan has recruited computer programmers to create some particular programs which help the employees to record daily transactions. Nowadays, manager does not accept a stack of manual reports because all employees send the daily transactions via internet connection. The accepted reports are posted neatly by particular computer programs and are separated by certain criteria such as savings data, time-deposit data, installment debt data, expenditure, etc. The daily, monthly, and annual data have been categorized automatically by these programs. After accepting all of them, the manager checks each balance and soon confirms the deficiency when finding discrepancies. Furthermore, LPD Kedonganan has been completed with modern facilities such as office telephones in all departments, printers, the counter machines, CCTVs, and an office car.

2.3.2.3.Advertisements

The management realizes that the achievement of LPD Kedonganan should be shared openly among customers. Besides informing customers through hamlet meetings, they publish free magazines, booklets, and website about LPD Kedonganan. The assembly is the appropriate place to discuss its performance because the management can receive feedback directly from native residents. However, the customers are not only from native but also non-native residents. Free magazines, booklets, and website are the tools for non-native resident customers to get real information about LPD achievements periodically. In order to promote its business activities, the management also regularly invites several

local and national reporters to record various innovative programs and social activities supported by LPD Kedonganan.

2.4. Developing Warm Money Institution

As mentioned in history overview, provincial government initiated LPDs in order to help customary village to maintain cultural and religious life. LPDs have been established as warm money institution in which their duty is not only to pursue maximum profit for institution but also for community. In the case of LPD Kedonganan, although setting the quite high credits interest, this institution allocates the high profit sharing for community. LPDs with the concept of both warm money institution and community-based microfinance create the differences with the other financial institutions such as public banks and cooperative.

2.4.1. LPD Kedonganan and Other Financial Institution

As general, all LPDs in Bali have the same characteristics which distinguish them from the other financial institutions in Indonesia. Table 2.4 shows that LPDs have their uniqueness compared to public banks and cooperatives which are two types of popular financial institutions especially in Bali. The differences can be found in the corporation, covering region, capital sources, ownership, authorize activities, customers, social responsibility, supervisors, and regulations. LPDs focus more on customary village and the community especially in the type of cooperation, covering region, capital sources, ownership, customer types, social responsibility, and supervisors.

Table 2.4. The characteristics of LPDs in comparison with public banks and cooperatives

	Banks	Cooperatives	LPDs
Corporation	Limited liability co. / cooperation / government enterprise	Cooperative	Not bank, not cooperative, village-owned MFIs, community-based MFIs
Covering region	Village, sub-district and district	Village or bounded with the types of cooperatives	Limited to the customary village
Capital Sources	Private and/or state	Members	Reserves, community, and supported fund from government
Ownership	Private or state (central, provincial, or local government)	Members	Customary village (community)
Authorize activities	Commercial bank: full-service bank Rural bank: savings, time deposits, microfinance loans	Saving and credit	Saving, credit, and time deposit
Customers	Public	Priority for the members	Priority for customary village members
Social Responsibility	Tax payment and corporate social responsibility	Social fund such as sympathetic care for member	Direct financial support to customary village
Supervisor	Bank of Indonesia or other bank permitted by regulation	Ministry of Cooperation or other name related to cooperative	Internal supervisor (<i>badan pengawas</i>) elected by customary village, the main council of customary villages in Bali (MUDP), and LPD committee elected by MUDP
Regulation	The 1992 Bank Act, amended in 1998	The 1992 Cooperation Act	The 2013 Microfinance Act; <i>Pararem Lembaga Perkreditan</i> (LPD) Bali, and <i>Awig-awig</i> (customary law) on LPD

Source: Galardo (2001), Suadi (2010), UU no 1/2013 on microfinance, and *Pararem Lembaga Perkreditan Desa* (LPD) Bali

2.4.2. High Interest Rate and Profit Sharing

LPD Kedonganan allocates 25% of profit for social responsibility activities to substitute the high interest rate in credit. Profit sharing is the obligation of LPDs as regulated in *Pararem Lembaga Perkreditan Desa (LPD) Bali*. All LPDs in Bali must allocate 20% of net profit to village development fund and 5% of net profit to social fund as depicted in Figure 2.3.

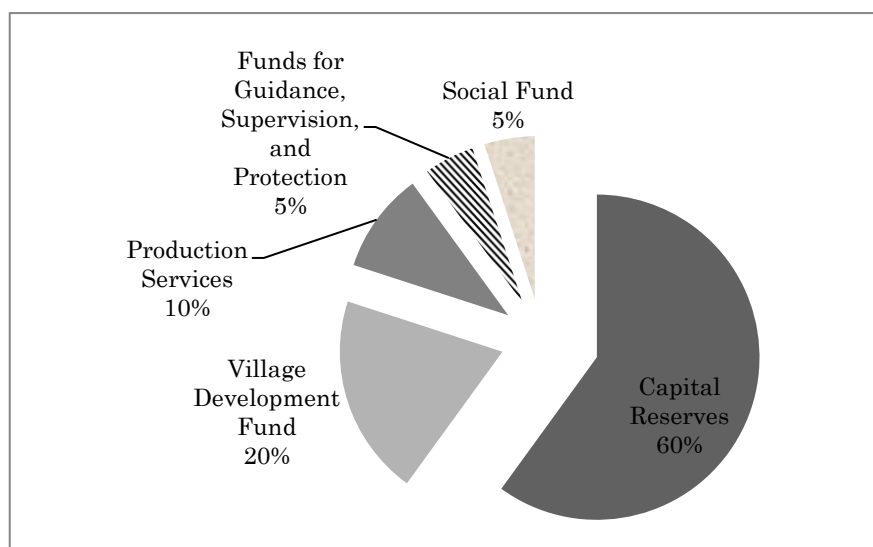


Figure 2.3. LPD's net profit sharing

Source: PERDA no. 4/ 2012

Over 24 years, LPD Kedonganan had allocated the profits for village development funds and social funds as listed in the Table 2.5. The increment of profit year by year affected the increasing amount of money which was allocated in village development and social activities. The management always showed this data to encourage native residents using LPD Kedonganan as the first priority.

Table 2.5. Village development funds and social funds of LPD Kedonganan (in thousand rupiah)

Year	Profit	Village Development Funds	Social Funds
1990	4,063	813	203
1991	20,781	4,156	1,039
1992	47,999	9,600	2,400
1993	69,451	13,890	3,473
1994	91,738	18,348	4,587
1995	103,319	20,664	5,166
1996	150,900	30,180	7,545
1997	167,647	33,529	8,382
1998	194,112	38,822	9,706
1999	277,044	55,409	13,852
2000	353,408	70,682	17,670
2001	440,415	88,083	22,021
2002	491,052	98,210	24,553
2003	451,440	90,288	22,572
2004	438,429	87,686	21,921
2005	429,242	85,848	21,462
2006	381,834	76,367	19,092
2007	382,071	76,414	19,104
2008	378,664	75,733	18,933
2009	370,461	74,092	18,523
2010	343,890	68,778	17,194
2011	366,762	73,352	18,338
2012	426,911	85,382	21,346
2013	485,745	97,149	24,287
2014	570,649	114,130	28,532

Note: Normalized the collected nominal based data with **GDP deflator** of 1990 based

Source: Tabulated using achievement report of LPD Kedonganan 1990-2014

2.5. Conclusions

The ability of LPD Kedonganan to compete with surrounding financial institutions could not be separated from its uniqueness. LPD Kedonganan has succeeded to build a model of financial institution through traditional and contemporary approaches. This institution put tradition into management and regulation. LPD Kedonganan is the official institution owned by customary village (*Desa Pakraman*). Its main duties are to protect customary village assets and to allocate them in appropriate developing sectors. The basic rule of this institution follows Balinese Hinduism philosophy (*Tri Hita Karana*). Its

existence must be regulated in customary village law (*Awig-awig*). Local customs, norms, and sanctions require all native residents (*Krama Desa*) to get involved as stakeholders who share the responsibility to its financial performance. LPD Kedonganan has been grown in local community system. This institution is entitled to attend in the assembly of customary hamlets (*Paruman Banjar*) as the highest authority. LPD Kedonganan elects the management team, reports monthly performance, discusses social responsibility, and manages the debtor performance in this meeting. As the output, most of products, services, management, rules, and social responsibility activities are on target. The social responsibility funds taken from profit are dedicated to maintain custom and religious life. On the other hand, modernization is applied in financial services. LPD Kedonganan provides the competitive interest rate in savings, time-deposit, and credit service. The management frequently compares the interest rate with neighboring financial institutions in order to offer the competitive one. LPD Kedonganan also facilitates the employees with computers and internet service. Data managements are organized by computer program and connected with internet service. The security system is equipped by CCTV and handy talky. The advertisements are packed in website; monthly magazine; booklet; and local news paper addressed more for non-native resident customers.

LPD Kedonganan has supported the customary village establishments both in culture-religious maintenance and in socioeconomic developments. This institution covers the costs of ritual ceremony in village and hamlet temples, funds the village temples renovations, holds free cremation ritual ceremony, conducts charity programs, and supports cultural activities for young generations. In term of economic developments, the native residents get the simplicity to use its financial services. They can take a loan to repair house, send their children to high-level education and develop the business. In the other side, they learn to invest their money in the new business with LPD Kedonganan helps.

This institution supports the native residents to participate in collective owned and managed seafood restaurant along Kedonganan costal.

Chapter 3.

Financial Analyses of LPD Kedonganan

3.1. Introduction

The business, projects, budget, and finance-related entities have to be evaluated regularly using financial analysis in order to assess them into category of stable, solvent, liquid, or profitable enough to be invested in. Financial analysis involves the company's past performance to estimate the company's future performance. The analysts often focus on the financial statements such as income statement, balance sheet, and cash flow statement when conducting financial analysis.

In the case of LPDs in Bali, Ikatan Akuntan Indonesia (2009) defines that generally the management reports LPD performance to stakeholders in the form of balance sheet, income statement, statement of changes in capital, cash flow statement, and transactions reports. They shall submit those financial statements every a month, three month, six months, and a year to internal supervisors which are elected by customary villagers and are accompanied by *Bendesa* (head of a customary village) and *Prajuru Desa* (council of a customary village) to supervise LPD performance regularly (*Pakraman Lembaga Perkreditan Desa* (LPD) Bali 2014).

One of the most common ways to analyze financial data is by calculating ratio and comparing against other companies or against the company's own historical performance. In this chapter, financial analyses including percentage and annual growth rate, common-size analysis, ratio analysis, and also CAEL (Capital, Asset, Earning, and Liquidity) rating focus on comparing the own historical financial performance in LPD Kedonganan in the last five years from 2010 to 2014. CAEL rating is the official

assessment of financial performance in LPDs as regulated in SK BPD Bali No. 0193.02.10.2007.2 (Suidarma and Diatmika 2013). Previously BPD¹⁴⁾ (*Bank Pembangunan Daerah – Rural Development Bank*) was appointed as Bali governor subordinate to conducts monitoring of LPD performance using CAEL rating. The final result of measurement was reported to provincial governor and related LPD in the form of final score and sound classification. However BPD did not show the detail work of CAEL rating in the reports.

3.2. Methodology

Various issues of LPD Kedonganan annual reports including balance sheets, income statements, and activities reports from 2010 to 2014 were collected as the main data. As mention before, five types of financial analyses were used, i.e. percentage and annual growth rate, common-size analysis, ratio analysis, and also CAEL rating, to measure the sustainability of LPD Kedonganan for investment.

At first, asset, equity, profit, savings, time-deposit, and credit were analyzed by percent (straight-line) growth rate. Financial analysis used data from achievement reports of LPD Kedonganan between 1990 and 2014. The percent growth rate formula is:

$$PR = \frac{(V_{Present} - V_{Past})}{V_{Past}} \times 100\% \quad [1]$$

Where, PR = percent rate, $V_{Present}$ = present or future value, and V_{Past} = past or present value.

Second, deposits and outstanding loan data including number of borrowers, outstanding loan, average outstanding loan per borrowers, number of savings' and time-deposit's customers, the size of savings and time-deposit, average savings per savings customers, and average time-deposit per time-depositor were analyzed to get the annual growth rate for the last five years. The data were tabulated from balance sheets, activities reports, and achievement reports between 2010 and 2014. The formula used for this analysis is:

$$\text{Annual Growth Rate} = \sqrt[n-1]{\frac{\text{the amount of of item in n year}}{\text{the amount of item in the first year}}} \times 100\% \quad [2]$$

Where, n = measured year.

Third, balance sheets and income statements from 2010 to 2014 were analyzed by common-size (vertical) analysis. The formula of common-size analysis is:

$$\text{Percentage of base} = \frac{\text{amount of individual item}}{\text{amount of base}} \times 100\% \quad [3]$$

In balance sheets, each item of assets was divided by total assets while each item of liabilities was divided by total liabilities. Similarly for income statements, each item of revenue was divided by total revenue and each item of expenses was divided by total expenses.

Forth, capital, asset, management, earning, and liquidity were analyzed with ratio analysis. The data were tabulated and calculated using balance sheets, income statements, and activities reports of LPD Kedonganan from 2010 to 2014. For capital, the analyses included capital adequacy ratio (CAR) and fixed assets and inventory to capital. Asset was analyzed using asset quality ratio, allowance for doubtful account ratio, and nonperforming loan (NPL) ratio. Management was determined using net profit margin (NPM) ratio. Equity was measure from return of asset (ROA) ratio, return of equity (ROE) ratio, cost to income ratio, and net interest margin (NIM) ratio. Lastly, liquidity was analyzed through quick ratio, current ratio, and loan to deposit ratio (LDR). The formulas of ratio analysis used for these measurements are (Suidarma and Diatmika 2013 and annual report of LPD Kedonganan 2014):

$$\text{CAR} = \frac{\text{main capital+additional capital}}{\text{risk weight asset}} \times 100\% \quad [4]$$

Note: Main and additional capital is tabulated in Appendix B. Table 7.4; risk weigh asset is tabulated in Appendix B. Table 7.5.

$$\text{Fixed assets and inventory to capital} = \frac{\text{net fixed assets and inventory}}{\text{total capital}} \times 100\% \quad [5]$$

Note: Net fixed assets and inventory is tabulated in Appendix B. Table 7.6; total capital is mentioned in Appendix B. Table 7.4.

$$\text{Asset quality ratio} = \frac{\text{classified asset}}{\text{productive asset}} \times 100\% \quad [6]$$

Note: Classified asset is tabulated in Appendix B. Table 7.8; productive asset is tabulated in Appendix B. Table 7.7.

$$\text{Allowance for doubtful account ratio} = \frac{\text{allowance for doubtful account}}{\text{allowance for doubtful account should be provided}} \times 100\% \quad [7]$$

Note: Allowance for doubtful account is tabulated in Appendix B. Table 7.9; allowance for doubtful account should be provided is tabulated in Appendix B. Table 7.10.

$$\text{NPL ratio} = \frac{\text{NPL} - \text{allowance for doubtful account}}{\text{outstanding loan}} \times 100\% \quad [8]$$

Note: NPL is tabulated in Appendix B. Table 7.11; allowance for doubtful account is tabulated in Appendix B. Table 7.9; outstanding loan is tabulated in Appendix B. Table 7.3.

$$\text{NPM ratio} = \frac{\text{income of the year}}{\text{revenue}} \times 100\% \quad [9]$$

Note: NPM is tabulated in Appendix B. Table 7.12.

$$\text{ROA ratio} = \frac{\text{income for the year}}{\text{average of total asset}} \times 100\% \quad [10]$$

Note: ROA is tabulated in Appendix B. Table 7.13.

$$\text{ROE ratio} = \frac{\text{income of the year}}{\text{equity including profit}} \times 100\% \quad [11]$$

Note: ROE is tabulated in Appendix B. Table 7.14.

$$\text{Cost to income ratio} = \frac{\text{expenses}}{\text{revenue}} \times 100\% \quad [12]$$

Note: expenses and revenue are tabulated in Appendix B. Table 7.15.

$$\text{NIM ratio} = \frac{\text{interest revenue}}{\text{average of productive assets}} \times 100\% \quad [13]$$

Note: NIM is tabulated in Appendix B. Table 7.16.

$$\text{Quick ratio} = \frac{\text{liquidity components}}{\text{current liabilities}} \times 100\% \quad [14]$$

Note: quick ratio is tabulated in Appendix B. Table 7.17.

$$\text{Current ratio} = \frac{\text{total productive assets}}{\text{total current liabilities}} \times 100\% \quad [15]$$

Note: current ratio is tabulated in Appendix B. Table 7.18.

$$\text{Loan to deposit ratio} = \frac{\text{total received funds}}{\text{outstanding loan}} \times 100\% \quad [16]$$

Note: total received fund is tabulated in Appendix B. Table 7.19; outstanding loan is tabulated in Appendix B. Table 7.3.

Fifth, CAEL rating was the last financial analyses conducted. CAEL is abbreviation of

Capital, Asset, Earning, and Liquidity which were analyzed using the components as listed in Table 3.1, based on SK BPD Bali no 0193.02.10.2007.2. Capital as the first factor of CAEL rating was determined from Capital Adequacy Ratio (CAR). Asset was measured from asset quality and allowance for doubtful account. Earning was calculated from return of assets (ROA) and cost to income ratio. Liquidity as the last factor of CAEL rating was derived from quick ratio and loan to deposit ratio. All ratio components were measured and calculated into a formula to get the score. Score calculation is counted using the following formulas (Annual report of LPD Kedonganan 2014):

$$\text{CAR Score} = \left(81 + \left(\frac{\text{CAR}-12}{0.1} \right) \right) \times 30\% \quad [17]$$

$$\text{Asset quality score} = \left(\frac{22.5-\text{asset quality ratio}}{0.15} \right) \times 30\% \quad [18]$$

$$\text{Allowance for doubtful account score} = (\text{allowance for doubtful account} \times 1) \times 10\% \quad [19]$$

$$\text{ROA score} = \left(\frac{\text{ROA ratio}}{0.015} \right) \times 10\% \quad [20]$$

$$\text{Score of cost to income ratio} = \left(\frac{100-\text{cost of income ratio}}{0.08} \right) \times 10\% \quad [21]$$

$$\text{Score of quick ratio} = \left(\left(\frac{\text{quick ratio}}{0.05} \right) \times 1 \right) \times 5\% \quad [22]$$

$$\text{Score of loan to deposit ratio} = ((115 - \text{loan to deposit ratio}) \times 4) \times 5\% \quad [23]$$

These score calculations were further compared with the maximum score which have been regulated in SK BPD Bali no 0193.02.10.2007.2. If the score calculation is more than maximum score, the result is written as maximum score. However if the score is less than maximum score, the result is written as score calculation. In the end, all score component are summed and classified into sound (score 80-100%), fair sound (score 66-80%), less sound (score 51-65%), or unsound (0-50%).

Table 3.1. The components of CAEL rating

Factor Measured	Components	Maximum Score
Capital	Capital Adequacy Ratio (CAR)	30%
Assets	Asset quality ratio	30%
	Allowance for doubtful account ratio	10%
Earning	Return of assets (ROA) ratio	10%
	Cost to income ratio	10%
Liquidity	Quick ratio	5%
	Loan to deposit ratio	5%

Source: Suidarma and Diatmika 2013

3.3. Financial Analyses of LPD Kedonganan

3.3.1. Percent Growth Rate of Achievement Report in LPD Kedonganan

In the beginning of year, the management always announces LPD Kedonganan's achievement to stakeholder which includes the data of asset, equity, profit, saving, time-deposit, credit, and the customer number. Those data were divided into the achievement report from 1990 to 2014 and the achievement report for the last five years. The achievement report from 1990 to 2014 was usually informed in the formal meeting such as internal supervisors meeting, hamlet meeting, comparative study program, etc., while the achievement report for the last five years was hung in the front office so the customers could monitor the achievement easily.

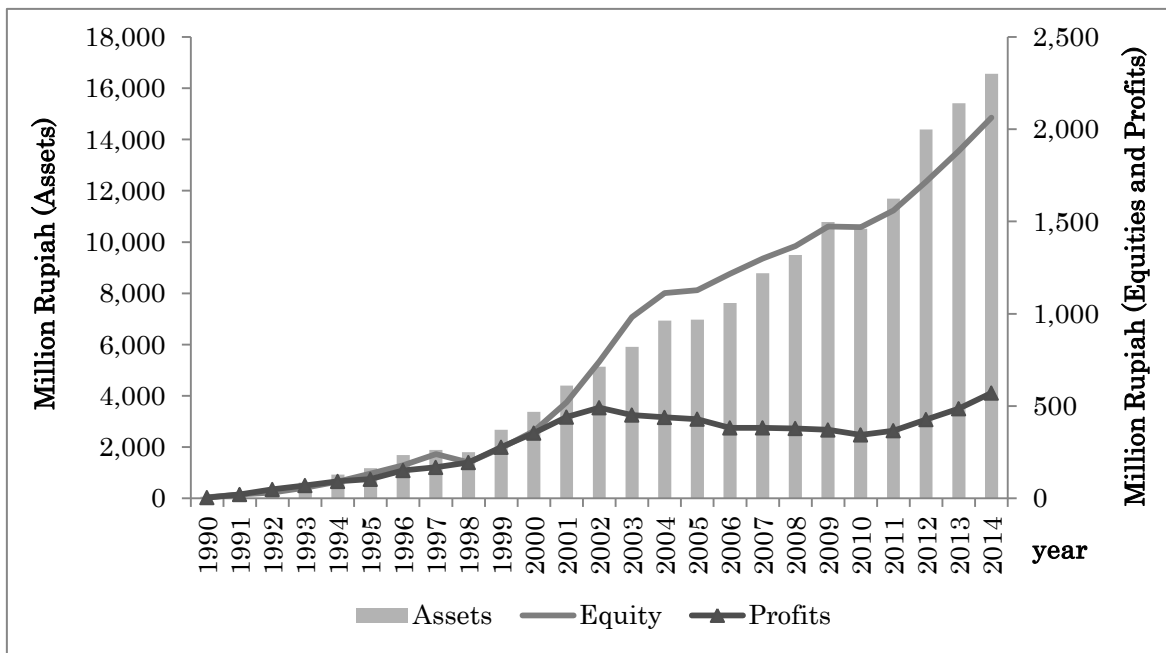


Figure 3.1. Assets, equity, and profits of LPD Kedonganan from 1990 to 2014

Note: Normalized the collected nominal based data with **GDP deflator** of 1990 based

Source: The annual achievement reports and annual balance sheets of LPD Kedonganan published in 1990-2014

Given the fluctuating annual percentage of inflation in Indonesia; the assets, equity, and profits of LPD Kedonganan had made the sizable ups and downs as depicted in Figure 3.1 and Table 3.2. Although dominated by increase achievement, respectively the assets had decreased by 4.3% and 2.4% as well as equity had shrunk by 19% and 0.15% because influenced by Asia economic crisis in 1998 and Europe economic crisis in 2010. On the contrary, majority of profits decreased from 2003 to 2010. The profit decline started in 2003 when new bank mergers established after Indonesia economic crisis in 1997-1998 have already expanded their business to Bali. In order to compete with them, the management increased the expenses especially in advertisement and labor cost. The profit increment was hardly raised until 2010 because the inflation kept climbing above 7%.

Table 3.2. Assets, equity, profits, and growth percentage of LPD Kedonganan from 1990-2004

Year	Asset		Equity		Profit	
	Nominal (Rp 1,000)	Percent Rate (%)	Nominal (Rp 1,000)	Percent Rate (%)	Nominal (Rp 1,000)	Percent Rate (%)
1990	67,824		4,600		4,063	
1991	183,071	169.92	20,113	337.25	20,781	411.48
1992	344,158	87.99	30,758	52.92	47,999	130.97
1993	610,346	77.34	56,514	83.74	69,451	44.69
1994	927,787	52.01	90,785	60.64	91,738	32.09
1995	1,173,803	26.52	132,750	46.23	103,319	12.62
1996	1,684,633	43.52	178,960	34.81	150,900	46.05
1997	1,882,015	11.72	239,704	33.94	167,647	11.10
1998	1,800,489	-4.33	194,152	-19.00	194,112	15.79
1999	2,668,153	48.19	272,088	40.14	277,044	42.72
2000	3,377,014	26.57	365,052	34.17	353,408	27.56
2001	4,401,330	30.33	519,968	42.44	440,415	24.62
2002	5,129,778	16.55	740,554	42.42	491,052	11.50
2003	5,903,614	15.09	981,335	32.51	451,440	-8.07
2004	6,931,404	17.41	1,112,183	13.33	438,429	-2.88
2005	6,969,953	0.56	1,128,490	1.47	429,242	-2.10
2006	7,615,470	9.26	1,216,158	7.77	381,834	-11.04
2007	8,779,229	15.28	1,299,009	6.81	382,071	0.06
2008	9,490,032	8.10	1,367,202	5.25	378,664	-0.89
2009	10,776,275	13.55	1,472,551	7.71	370,461	-2.17
2010	10,520,621	-2.37	1,470,383	-0.15	343,890	-7.17
2011	11,694,113	11.15	1,560,231	6.11	366,762	6.65
2012	14,395,545	23.10	1,715,877	9.98	426,911	16.40
2013	15,410,257	7.05	1,883,338	9.76	485,745	13.78
2014	16,567,332	7.51	2,063,522	9.57	570,649	17.48

Note: Normalized the collected nominal based data with **GDP deflator** of 1990 based

Source: Tabulated using annual achievement report and annual balance sheets of LPD Kedonganan published in 1990 to 2014

All of the components have the highest percent growth rate (>100%) in the beginning of LPD Kedonganan (see Table 3.2). This percentage indicated that LPD Kedonganan actually received many support from customary villagers even from the beginning. Although not all of native residents had been the customers yet, they who used its financial service confidently gave their trust to the inexperience management of LPD Kedonganan to maintain their precious assets. The reliable figure in management position is one of the reasons behind the act of native resident customers. From 2005 to 2014, annual growth rate of asset, equity, and profit was increased by 10%, 6.5%, and 1.3% respectively. Besides the

huge amount of total savings and time-deposit managed by LPD Kedonganan; loan received, interest cost from third parties (customers), and labor cost contributed more than 8% of different gap between annual growth rate of assets and profits.

Table 3.3 shows six other components in achievement reports, i.e. saving, time-deposit, and credit in the amount of rupiah and person. Savings, time-deposits, and credits in the amount of rupiah from 1990 to 2014, mostly increased compared to the previous year. However the customer number of savings, time-deposits, and credits tended to fluctuate especially after 2000. The competition has become tighter since government gave permit to the bankrupt banks during Indonesian economic crisis in 1997-1998, to merger with others and establish new one if they fulfill the requirements (Latumaerissa 2011). The other reason is LPD Kedonganan has received most of support for native residents as the main customers. For the last five years, 98% of native residents were the savings customers. It means that LPD Kedonganan has been in the highest peak position during these five last years. LPD Kedonganan could keep increase the number of savings, time deposits, and credits in amount of rupiah because economically the native residents life had improved. Moreover, the presence of non-native resident customers was also one of the reasons behind the increment of savings, time deposits, and credits in LPD Kedonganan. Customers' number of savings, time deposits, and credits rose 4%, 8%, and 2%; while in amount of rupiah; savings, time deposits, and credits increased by 12%, 10%, and 9% respectively in the last decade.

Table 3.3. Savings, time deposits, credits, and their growth percentage of LPD Kedonganan from 1990-2014

Year	Savings		Savings Consumers		Time Deposits		Time Depositors		Credits		Creditors	
	Nominal (Rp 1,000)	Percent Rate (%)	Nominal (person)	Percent Rate (%)	Nominal (Rp 1,000)	Percent Rate (%)	Nominal (person)	Percent Rate (%)	Nominal (Rp 1,000)	Percent Rate (%)	Nominal (person)	Percent Rate (%)
1990	52,161		452		3,000		3		66,275		96	
1991	96,048	84.14	713	57.74	46,128	1437.60	24	700.00	157,235	137.25	217	126.04
1992	120,053	24.99	786	10.24	110,321	139.16	62	158.33	325,157	106.80	493	127.19
1993	238,173	98.39	1,637	108.27	242,535	119.85	108	74.19	469,477	44.38	746	51.32
1994	297,346	24.84	2,213	35.19	437,065	80.21	173	60.19	659,568	40.49	785	5.23
1995	407,181	36.94	2,766	24.99	507,238	16.06	174	0.58	869,684	31.86	856	9.04
1996	594,085	45.90	3,525	27.44	671,942	32.47	200	14.94	1,363,923	56.83	1,033	20.68
1997	735,968	23.88	4,259	20.82	693,131	3.15	216	8.00	1,573,632	15.38	1,085	5.03
1998	773,857	5.15	5,289	24.18	583,305	-15.85	250	15.74	1,522,430	-3.25	1,124	3.59
1999	1,091,264	41.02	6,286	18.85	998,105	71.11	256	2.40	2,053,535	34.89	1,196	6.41
2000	1,485,306	36.11	7,366	17.18	1,144,195	14.64	290	13.28	2,719,133	32.41	1,319	10.28
2001	1,687,551	13.62	8,751	18.80	1,685,055	47.27	258	-11.03	3,752,137	37.99	1,421	7.73
2002	1,763,018	4.47	7,876	-10.00	2,046,104	21.43	303	17.44	4,279,977	14.07	1,596	12.32
2003	1,990,099	12.88	7,755	-1.54	2,424,655	18.50	327	7.92	4,989,123	16.57	1,646	3.13
2004	2,647,936	33.06	7,478	-3.57	2,686,971	10.82	349	6.73	5,360,708	7.45	1,532	-6.93
2005	2,603,555	-1.68	7,533	0.74	2,761,527	2.77	362	3.72	6,294,896	17.43	1,464	-4.44
2006	2,708,464	4.03	7,646	1.50	3,070,578	11.19	359	-0.83	5,862,292	-6.87	1,646	12.43
2007	3,244,189	19.78	8,035	5.09	3,742,411	21.88	427	18.94	6,256,273	6.72	1,892	14.95
2008	3,312,153	2.09	8,043	0.10	4,380,254	17.04	457	7.03	7,421,344	18.62	1,861	-1.64
2009	4,044,266	22.10	8,463	5.22	4,660,321	6.39	507	10.94	7,836,264	5.59	1,915	2.90
2010	3,966,046	-1.93	8,913	5.32	4,334,603	-6.99	521	2.76	8,061,279	2.87	1,901	-0.73
2011	5,020,077	26.58	9,351	4.91	4,421,431	2.00	551	5.76	9,032,433	12.05	1,859	-2.21
2012	5,976,564	19.05	10,207	9.15	6,009,657	35.92	597	8.35	10,558,154	16.89	1,867	0.43
2013	6,444,405	7.83	11,226	9.98	6,255,509	4.09	715	19.77	11,993,623	13.60	1,837	-1.61
2014	7,426,838	15.24	12,114	7.91	6,045,919	-3.35	763	6.71	13,583,480	13.26	1,723	-6.21

Note: Normalized the collected nominal based data with **GDP deflator** of 1990 based

Source: Tabulated using annual achievement report of LPD Kedonganan published from 1990-2014

3.3.2. Annual Growth Rate of Deposits and Outstanding Loan in LPD Kedonganan for the Last Five Years

Savings, time deposits, and credits of LPD Kedonganan from 2010 to 2014 are presented in Table 3.4. The interesting result found in number of borrowers and outstanding loan which were opposite each other. Over the last five years, annual growth rate showed that the number of borrowers tended to decrease at rate of 2.4% but total outstanding loan tended to increase by 13.9%. As the result, the average outstanding loan per borrower expanded by 16.8%. The high percentage of average outstanding loan per borrower depicted a recent trend of shifting borrower's mindset from consumption needs to business-oriented. They confidently applied for a loan in the high amount of money to develop their business. On the contrary, the customers who did not have much business passion tended to stop using credit service soon after meeting their living standard. Most of them decided to break from debt because they were uncomfortable with the pressure. Hence, in order to offset the high enthusiasm of customers putting their money in term of savings and time-deposits, recently the management granted the commercial credit and slowly reduced the microcredit issue. The downward trend of borrowers' number is the challenge for LPD Kedonganan. The management confirmed that this condition had not given any significant impact to institution performance yet because the customary sanctions relatively succeeded to keep borrowers' reputation in order to refrain from default risk so far.

Table 3.4 also shows that savings was the most popular products for the last five years. Both percent growth rates of total savings in rupiah and in customers' number highly rose 17% and 7.9%. Savings was the most useful, flexible, and easy requirement product in LPD Kedonganan. Savings-customers just had to deposit their money with the minimum opening balance in the amount of Rp 10,000 (≈ 1 US\$) and settled balance in the amount of

Rp 50,000. In order to encourage native residents to actively save their money, they could deposit minimally in the amount of Rp 1,000 (≈ 0.1 US\$) per transaction. For compensations, the customers would receive various benefits such as compensation of credits collateral, competitive interest rate per year, death compensation in the amount of Rp 2 million, sacrificial meat (pork) in *Galungan* day¹⁵⁾, etc.

Table 3.4. Basic data of LPD Kedonganan from 2010 to 2014

	Units	2010	2011	2012	2013	2014	Annual growth rate (%)
Savings							
No. of savings consumers	person	8,913	9,351	10,207	11,226	12,114	7.9
Savings	Rp 1,000	3,966,046	5,020,077	5,976,564	6,444,405	7,426,838	17
Average savings per saving consumer	Rp 1,000	445	537	586	574	613	8.3
Time-Deposit							
No. of time depositors	person	521	551	597	715	763	10
Time-Deposit	Rp 1,000	4,334,603	4,421,431	6,009,657	6,255,509	6,045,919	8.7
Average time-deposit per depositor	Rp 1,000	8,320	8,024	10,066	8,749	7,924	(1.2)
Savings and Time-Deposit							
No. of consumers of savings and time-deposit	person	9,434	9,902	10,804	11,941	12,877	8.1
Savings and time-deposit	Rp 1,000	8,300,649	9,441,508	11,986,221	12,699,914	13,472,757	12.9
Credits							
No. of borrowers	person	1,901	1,859	1,867	1,837	1,723	(2.4)
Outstanding loan	Rp 1,000	8,061,279	9,032,433	10,558,154	11,993,623	13,583,480	13.9
Average outstanding loan per borrower	Rp 1,000	4,241	4,859	5,655	6,529	7,884	16.8

Note: (1) Figure in parenthesis shows the negative numbers; (2) Normalized the collected nominal based data with **GDP deflator** of 1990 based

Source: Calculated from annual achievement reports, annual activities reports, and annual balance sheets of LPD Kedonganan from 2010-2014

Similarly, time-deposit showed the increment in the number of customers (10%) and total in rupiah (8.7%) for the last five years. However the time-deposit tended to fluctuate compared to savings. The number kept increasing highly until 2013 and then decreased by 3.35% in 2014. After establishment of collective owned and managed seafood restaurants

along Kedonganan coastal in 2007, the income of native residents climbed and affected the demand of time-deposit. However, time-deposit were reported decreasing in 2014 when the foreign and domestic investment realization both for service sectors including tourism industry and for Bali were stagnating in 2013 and 2014. Many customers thus moved their assets from time-deposit to savings which are more appropriate under that condition.

3.3.3. The Analyses of Balance Sheet and Income Statement in LPD Kedonganan for the Last Five Years

Table 3.5. The average percentage of balance sheet items in LPD Kedonganan from 2010 to 2014 using common-size analyses (in percentage)

Balance Sheet	2010	2011	2012	2013	2014	average
Cash	0.05	0.07	0.39	0.02	0.01	0.11
Inter-bank assets	14.75	16.97	17.35	16.50	12.80	15.68
Outstanding loan	76.62	77.24	73.34	77.83	81.99	77.40
(-) Allowance for doubtful account	2.29	2.43	2.30	2.45	1.85	2.26
Fixed assets and inventory	3.93	3.33	2.75	2.47	2.11	2.92
(-) Accumulated depreciation	1.08	1.25	1.20	1.22	1.10	1.17
Other assets	8.01	6.07	9.66	6.85	6.03	7.33
Total assets	100.00	100.00	100.00	100.00	100.00	100.00
Savings	37.70	42.93	41.52	41.82	44.83	41.76
Time deposits	41.20	37.81	41.75	40.59	36.49	39.57
Loan received	2.21	1.85	0.00	0.00	1.08	1.03
Other liabilities	1.65	0.94	1.85	2.21	1.70	1.67
Equity (including profit of the year)	17.24	16.48	14.89	15.37	15.90	15.98
Total liabilities	100.00	100.00	100.00	100.00	100.00	100.00
Profit of the year	3.27	3.14	2.97	3.15	3.44	3.19

Note: (1) Data is tabulated in percent growth rate (%), data in rupiah is presented in Appendix B. Table 7.1.;

(2) Normalized the collected nominal based data with GDP deflator of 1990 based

Source: Calculated from annual balance sheets of LPD Kedonganan from 2010-2014

Based on common-size analysis of balance sheet from 2010 to 2014, LPD Kedonganan tended to keep cash under 0.1% and put more into inter-bank asset every year. This low percentage did not affect the liquidity level in LPD Kedonganan because all inter-bank assets mentioned in Table 3.5 were kept in BPD (*Bank Pembangunan Daerah – provincial government bank*) which came to this financial institution every day to manage excess liquidity. When LPD was short of cash, BPD was on the duty to bring the cash

money.

Savings and time deposits were the highest liability component in LPD Kedonganan. The average savings and time deposits achieved 41.76% and 39.57% from total liabilities respectively for the last five years. Since saving did not have time restriction, the savings customers could withdraw money anytime. Hence, LPD and BPD must always be ready to provide the enough cash. On the other hand, Table 3.5 also shows that assets of LPD Kedonganan were dominated by outstanding loan in the amount of 77% per year. This institution tended to invest the collected funds more in credit service. Allowance for doubtful account and accumulated depreciation of fix asset and inventory which affect the decrease in assets were recorded just 2.26% and 1.17 % from total asset per year respectively between 2010 and 2014.

Income statement of LPD Kedonganan from 2010 until 2014 mentions that 92.12% of total revenue came from interest rate of third parties (non-bank) which consists of outstanding loan, commission, and fee. This result shows that LPD Kedonganan were highly depend on interest rate received from third parties. In the expenses list, 53.52% of total expenses were paid as interest cost from third parties (non-bank) who were the customers of savings and time-deposit. The high percentage of interest rate and interest cost from third parties was found commonly in financial institution like LPD Kedonganan. The list of expenses also mentions that 19.43% of total expenses were allocated as labor cost. Although most of the employees worked voluntarily in the first year of establishment, LPD Kedonganan pays them with full-time employee salary now (see Table 3.6).

The percentage of profits fluctuated in the last five years (see Table 3.5 and Table 3.6). The lowest profits were found in the year of 2012, when the percentage of other operating expenses of LPD Kedonganan increased into 9.64% due to the increment in the overtime cost of employees. LPD Kedonganan supported two big events i.e. Kedonganan Coastal

Triangle Day and Free Cremation Ceremony (*Ngaben*) in that year, thus the management and staffs had to work extra time to manage allocated funds for them and causing increase in overtime cost (see Table 2.2). Moreover, since 2012 the other operating expenses reached more than 5% from total expenses because the management started to budget family gathering with employees approximately twice in a year. To maintain the profits, the managements cut the depreciation cost and cost of doubtful loan both in 2013 and in 2014. For the last five years, the average profits per total expenses were 30.6% while the average profits per total liabilities were 3.19%.

Table 3.6. The average percentage of income statement items in LPD Kedonganan from 2010 to 2014 using common-size analyses (in percentage)

Income Statement	2010	2011	2012	2013	2014	average
Revenue						
Interest income from other banks	7.25	6.08	5.26	7.62	5.47	6.34
Interest income from third parties (non-bank)	91.51	93.17	93.83	90.23	91.85	92.12
Other operating income	1.24	0.75	0.91	2.15	2.68	1.54
Total Revenue	100.00	100.00	100.00	100.00	100.00	100.00
Expenses						
Interest cost from other banks	0.00	0.00	0.00	0.00	0.00	0.00
Interest cost from third parties (non-bank)	55.46	52.47	50.64	55.79	53.26	53.52
Labor cost	19.73	19.24	19.34	18.63	20.19	19.43
Maintenance	6.16	5.18	5.67	4.91	4.91	5.37
Depreciation cost (fixed assets and inventory)	5.89	3.43	2.07	1.70	1.26	2.87
Cost of doubtful loan	5.96	4.97	5.39	4.24	4.14	4.94
Fare	0.28	0.23	0.18	0.20	0.15	0.21
Marketing and advertisement	3.78	6.59	6.30	6.72	6.59	6.00
Service and general expenses	2.62	6.39	0.77	0.78	0.73	2.26
Other operating expenses	0.13	1.50	9.64	7.04	8.78	5.42
Total Expenses	100.00	100.00	100.00	100.00	100.00	100.00
Profit	31.57	30.12	27.88	30.47	32.96	30.60

Note: (1) Data is tabulated in percent growth rate (%), data in rupiah is presented in Appendix B. Table 7.2.;

(2) Normalized the collected nominal based data with GDP deflator of 1990 based

Source: Calculated from annual income statements of LPD Kedonganan from 2010-2014

3.3.4. Ratio Analysis of Capital, Asset, Management, Earning, and Liquidity in LPD Kedonganan

Capital performance in LPD Kedonganan was investigated using capital adequacy

ratio (CAR) and the ratio of fixed assets and inventory to capital. As mentioned in Table 3.7, LPD Kedonganan could maintain CAR more than 8% as the minimum of bank standard for international settlement over the last five years. Although decreasing twice in 2012 and 2014, those CARs were still categorized as good achievement. On the other hand, the ratio fixed assets and inventory to capital kept declining along with impairment of fixed assets and inventory. The management needs to review the feasibility of fixed assets and inventory for the better performance.

Assets performance of LPD Kedonganan was assessed using asset quality ratio, allowance for doubtful account ratio, and non performing loan (NPL) ratio as mention in Tabel 3.7. Kasmir (2002), Madra and Sujaya (2010), and Imamah (2012) had different standard especially to measure assets quality ratio. Kasmir (2002) categorized assets quality ratio into sound ($< 10.35\%$), fair ($10.36-12.61\%$), less sound ($12.61-14.85\%$), and unsound ($> 14.85\%$); Madra and Sujaya (2010) set 1-5% as the best achievement; while Imamah (2012) chose 12.6% as maximum percentage for sound performance. If following the standard of Kasmir (2002) and Imamah (2012), the asset quality ratio of LPD Kedonganan for the last five years was categorized as sound performance. However the management of LPD Kedonganan tended to follow Madra and Sujaya (2010) by putting 1-5% as the achievement for sound performance. According to Madra and Sujaya (2010), the exceeding asset quality ratio of LPD Kedonganan to 5% in 2011, 2013, and 2014 identified the failure of the management of LPD Kedonganan to maintain the assets, given the 4% increment in substandard and doubtful loan performances (see Appendix B. Table 7.3). For allowance for doubtful account ratio, Kasmir (2002) and Madra and Sujaya (2010) had the same standard as following: sound ($> 81\%$), fair ($66-81\%$), less ($51-66\%$), and unsound ($< 51\%$). Allowance for doubtful account ratio of LPD Kedonganan achieved more than 81% once in 2012 but less than 81% in the other years. Especially for the last

year, allowance for doubtful account ratio was categorized as unsound performance because just achieving 33.89%. The last measurement for asset performance was NPL ratio. As mentioned by Imamah (2012), sound performance was achieved by financial institutions if the NPL ratio was less than 5%. However similar with asset quality ratio and allowance for doubtful account ratio; the management of LPD Kedonganan could not maintain the NPL ratio which climbed to 8.19%, 8.99%, and 10.43% in 2011, 2013, and 2014 respectively. All of the low components' measurement for asset performance was found in 2014, when the worse loan performance categorized as substandard, doubtful, and loss rose into 3.5%, 6.6%, and 2.5% respectively (see Appendix B. Table 7.3).

According to the result of asset quality ratio, allowance for doubtful account ratio, and NPL ratio; the management should be more careful to grant a loan. The trend shows that average outstanding loan per borrower increased in the last five years (see Table 3.4). When a borrower fails to repay the loan, LPD Kedonganan will suffer the huge losses easily and will affect the performance of outstanding loan. As community-based microfinance institution, the management of LPD Kedonganan served the customers with simple and easy procedures of loan application. However, these procedures should be review since LPD Kedonganan has risked the investment by granting high amount of outstanding loan per borrower. If the management of LPD Kedonganan still wants to maintain easy and simple procedure, prioritizing microcredit is suggested compared to commercial credit in order to secure the investment. Moreover, the 72% of borrowers recently were non-native residents guaranteed by native residents. The loyalty of non-native residents to keep the performance of LPD Kedonganan was less than native residents as the owner. Mostly their motivation was to access easy credit application provided by LPD Kedonganan (see Chapter 5). The interview conducted in 2012 and 2014 found that native residents tended to agree to be a credit-guarantor of non-native residents

mostly because they had close relationship. They put the ability of non-native residents in repaying the loan as the second place after their relationship.

Table 3.7. Financial analyses of LPD Kedonganan from 2010 to 2014 (in percentage)

Components	Ratio				
	2010	2011	2012	2013	2014
Capital					
Capital Adequacy Ratio (CAR)	21.53	21.52	19.72	20.14	19.08
Fixed assets and inventory to Capital	15.00	11.18	9.17	7.17	5.91
Asset					
Asset quality	4.74	6.37	2.77	6.70	8.02
Allowance for doubtful account	68.35	60.73	142.47	63.13	33.89
Non Performing Loan (NPL)	4.59	8.19	2.32	8.99	10.43
Management					
Net Profit Margin (NPM)	23.99	23.15	21.80	23.36	24.79
Earning					
Return On Asset (ROA)	3.46	3.41	3.33	3.33	3.66
Return On Equity (ROE)	18.95	19.03	19.92	20.50	21.66
Cost to income ratio	76.01	76.85	78.20	76.64	75.21
Net Interest Margin (NIM)	15.80	15.75	16.39	15.07	15.19
Liquidity					
Quick ratio	18.76	21.11	20.85	19.52	15.24
Current Ratio	110.42	112.79	106.55	111.47	112.72
Loan to deposit ratio (LDR)	79.70	79.45	74.45	79.08	83.43

Source: Calculated from annual activities reports, annual balance sheets, and annual income of LPD Kedonganan published in 2010-2014 (see Appendix B. Table 7.6 to Table 7.17)

Management performance in LPD Kedonganan was rated using net profit margin (NPM) ratio. For the last five years, NPM ratio decreased between 2010 and 2012 but returned to increase in 2013 and 2014 as presented in Table 3.7. After 2012, the management of LPD Kedonganan performed well due to the increase of profit per revenue in 2013 and 2014.

Earnings performance was measured using return on asset (ROA) ratio, return on equity (ROE) ratio, cost to income ratio, and net interest margin (NIM) ratio. In the case of ROA ratio, Kasmir (2002), Madra and Sujaya (2010), and Imamah (2012) had different minimum percentage for sound performance. Kasmir (2002) categorized ROA into sound

(> 1.22%), fair (0.99-1.21%), less (0.77-0.98%), and unsound (0.76%). Madra and Sujaya (2010) stated that sound performance was achieved if ROA ratio was more than 1.5%. While Imamah (2012) chose 2% as the minimum ROA ratio to gain sound performance. According to Table 3.7, ROA ratio of LPD Kedonganan passed all standard above since achieving more than 3% over the last five years. This result shows that LPD Kedonganan could generate profits more than 3% from assets from 2010 to 2014. In the other side, LPD Kedonganan could increase ROE ratio gradually per year from 2010 to 2014. Especially in 2014, LPD Kedonganan could generate profits by 21.66% from the equity. Cost to income ratio was also calculated to measure earning performance. Kasmir (2002) categorized cost to income ratio into sound (< 93.52%), fair (93.52-94.74%), less (94.74-95.92%), and unsound (> 95.92%). Madra and Sujaya (2010) set 92% while Imamah (2012) put 94.72% as the maximum ratio to achieve sound performance. In the last five years, LPD Kedonganan could maintain cost to income ratio around 70% which was less than the all maximum standard above. On average 70% of income was used for operating cost in 2010 to 2014. Lastly, for NIM ratio, LPD Kedonganan achieved once more than 16% in 2012 and more than 15% in 2010, 2011, 2013, and 2014. This ratio means that the interest revenue per average of productive assets was around 15% to 16% in the last five years. From these four ratios, LPD Kedonganan could be categorized as sound based on earnings performance.

Liquidities performance was investigated using quick ratio, current ratio, and loan to deposit ratio (LDR). Kasmir (2002) categorized quick ratio into sound (> 4.05%), fair (3.30-4.05%), less (2.55-3.29%), and unsound (< 2.54%); while Madra and Sujaya put 10% as minimal quick ratio to achieve sound performance. As mentioned in Table 3.7, LPD Kedonganan always gained more than minimal standard of Kasmir (2002) and Madra and Sujaya (2010) in the last five years. However in 2014, quick ratio dropped into 15.24%

because the total current liabilities tended to be higher than previous years. As also explained before, LPD Kedonganan chose to put less amount of cash money for security reason. This institution cut cash twice in 2014 compared to the previous years. In the case of current ratio, LPD Kedonganan achieved more than 100% for the last five years. This result showed that more than 100% total productive assets of LPD Kedonganan could ensure total current liabilities from 2010 to 2014. LDR as the last ratio analysis conducted in LPD Kedonganan was in the range of 80%. According to Kasmir (2002) and Madra and Sujaya (2010), the sound performance was achieved in this percentage. Kasmir (2002) categorized LDR as sound ($< 94.755\%$), fair (from 94.755% to 98.54%), less (from 98.54% to 102.5%), and unsound ($> 102.5\%$), while Madra and Sujaya (2010) explained that LPD achieve sound performance if LDR was more than 70%. Imamah (2012) stated that LDR was normal in the range of 85% to 110%. LPD Kedonganan in the last five years maintained around 80% of all received funds to be allocated in outstanding loan. From these three ratios, LPD Kedonganan could be categorized as sound based on the liquidities performance over the last five years.

3.6. CAEL Rating in LPD Kedonganan

CAEL rating is determined using the final score which is obtained from comparing score calculation and maximum score. Score calculation is counted by formulas as explained in Methodology. The calculation of all score components are listed and compared with maximum score as mentioned in Table 3.8. When score calculation is more than maximum score, final score is written in the amount of maximum score. On the contrary, final score is written as score calculation if it is less than maximum score. The score calculations of CAR, ROA, cost to income ratio, quick ratio and loan to deposit ratio from 2010 to 2014 reached more than maximum score, so that their final score was written

as maximum score. Asset quality in 2014 was less than maximum score thus the final score is written 28.96%. However score calculation of asset quality from 2010 to 2013 was reported as maximum score because the score calculations were more than 30%. The low result was found in allowance for doubtful account. Score calculations in 2010, 2011, 2013, and 2014 were less than maximum score. In those years, the final score of allowance for doubtful account was recorded in the amount of score calculation. The best performance of LPD Kedonganan over the last five years was occurred in 2012 when CAEL rating achieved 100 point. However after 2012, CAEL rating of LPD Kedonganan tended to decrease because decrease achievement in allowance for doubtful account. Overall, LPD Kedonganan were categorized as sound performance over the last five years, since the entire CAEL ratings were more than 81% (see Table 3.8).

Table 3.8. Score of CAEL rating in LPD Kedonganan from 2010 to 2014 (in percentage)

Components	Score Calculation					Final Score					Maximum Score
	2010	2011	2012	2013	2014	2010	2011	2012	2013	2014	
CAR	52.89	52.87	47.46	48.72	45.54	30	30	30	30	30	30
Asset quality	35.52	32.25	39.46	31.6	28.96	30	30	30	30	28.96	30
Allowance for doubtful account	6.84	6.07	14.25	6.31	3.39	6.84	6.07	10	6.31	3.39	10
ROA	23.08	22.76	22.2	22.2	24.4	10	10	10	10	10	10
Cost to income ratio	29.99	28.94	27.25	29.2	30.99	10	10	10	10	10	10
Quick ratio	18.76	21.11	20.85	19.52	15.24	5	5	5	5	5	5
Loan to deposit ratio	7.06	7.11	8.11	7.18	6.31	5	5	5	5	5	5
CAEL rating						96.83	96.07	100	96.31	92.35	100

Source: Calculated from financial analyses of LPD Kedonganan from 2010 to 2014 (Table 3.8)

The result of CAEL rating shows that the management has to pay attention with the asset quality and allowance for doubtful account more. Due to these two components, the final score could not achieve the maximum result based on SK BPD Bali no 0193.02.10.2007.2. As also suggested in ratio analysis, the management of LPD

Kedonganan should consider managing the quality of outstanding loan by minimizing the average outstanding loan per borrowers and by selecting the borrowers more stringent.

3.4. Conclusions

The analyses of financial statements show that the management succeeded to maintain the sound performance of LPD Kedonganan in the last five years. For the future challenges, the results of financial analysis found two interesting points, i.e. the high average outstanding loan per borrower and the less quality of assets performance. In the last five years, the borrowers tended to decrease but the total outstanding loan issued by LPD Kedonganan kept climbing. As the result, the annual growth rate of outstanding loan per borrower climbed 16.8%. According to this situation, if the borrower fails in repayment, LPD Kedonganan will suffer the high loss. The quality of assets performance in the last five years tends to show the effects of the increment of average outstanding loan per borrower. The ratio analyses and CAEL rating show that assets quality, allowance for doubtful account, and NPL did not met the standard especially in 2014 because outstanding loan categorized as substandard, doubtful, and loss rose to 3.5%, 6.6%, and 2.5% respectively. In order to maintain the asset performance, the management of LPD Kedonganan supported by customary village board should consider minimizing the average outstanding loan per borrowers by increasing the number of borrowers. In addition, the management is also suggested to select the borrowers more stringent since recently the number of non-native resident borrowers who were not the owner of LPD Kedonganan were counted 72% of total debtor number.

Chapter 4.

The Implication of Social Capital in LPD

4.1. Introduction

Foschi (2010) states that the successful spread of microfinance is due to the assumption that local social networks between people who know and trust each other are able to reduce the failure of financial markets in developing countries. In this sense, shared information and collective-action among members of social network produce mutual benefits. Social networks are considered as a resource or ‘capital’ for microfinance program itself. Moreover, social capital and microfinance also play the dual role. Social capital is a resource for the microfinance program which could improve credit access by poor, while microfinance can favor the creation of new social capital”.

According to Atmadja (2013), social capital including social networks, values, and norms which are retained by customary village encourage cooperation among all parties that interact together to achieve goals. LPD is given power by customary village to control the rights and obligations of both customers and managers. As the results, LPD frees from the classic problems such as bad credits and abuses by employee. This chapter aims to identify major factors which work on the achievement of sound performance in LPD Kedonganan from the perspective of social capital theories.

4.2.Social Networks

LPD runs as a rotating credit association which cannot function unless all members continue to keep their obligation. The participant’s reputation for honesty and reliability are important prerequisites before gaining access to this institution (Putnam *et. al.*, 1993). On

the other hand, LPD is community-based microfinance founded by kinship principle. The type of family relationship embedded among native residents is characteristic of dense social networks and strong interpersonal ties (Ostrom and Ahn, 2003). Dense social networks encourage the development of reciprocity norm including the members' seriousness to keep their reputation and refrain from the risk of default. Strong interpersonal ties facilitate the managements to measure the honesty and reliability of the members in real daily life. In order to minimize reputational uncertainty and risk of default, the LPD managers raise the arrears topic in hamlet/village meetings (*paruman banjar/desa*). *Bendesa* (head of customary village) or *Klian* (the representative of customary hamlet) reads the names of people who are late in their repayments as initial punishments (see Chapter 2). The strong family relationship will bring sharing responsibility out when the names of their family members are arrears in payments. They feel ashamed and remind each other to save face by repaying the installments on time.

LPD Kedonganan uses the cultural approach to unite the native residents in order to strengthen its position as an institution owned by customary village. All information about LPD Kedonganan officially is transferred from the management and internal supervisors (*badan pengawas*) to *klian* in the form of monitoring reports every month, three months, six months, and a year. *Klian* presents those reports in hamlet meetings in-front of family heads every seven months. Family heads then spread the information to their family. In practice, the dense social network makes this process overlapping. Typically, native resident receives information from many sources since he/she knows members of customary village, especially customary hamlet, as well. For example, 36% of female respondents claimed that they received their information from *klian* who officially only presents information related to LPD Kedonganan in hamlet meetings to male respondents who are also the head of these families. At the same time, they also confessed that their

husbands attend hamlet meetings. A typical network which connects LPD Kedonganan to customers is depicted in Figure 4.1.

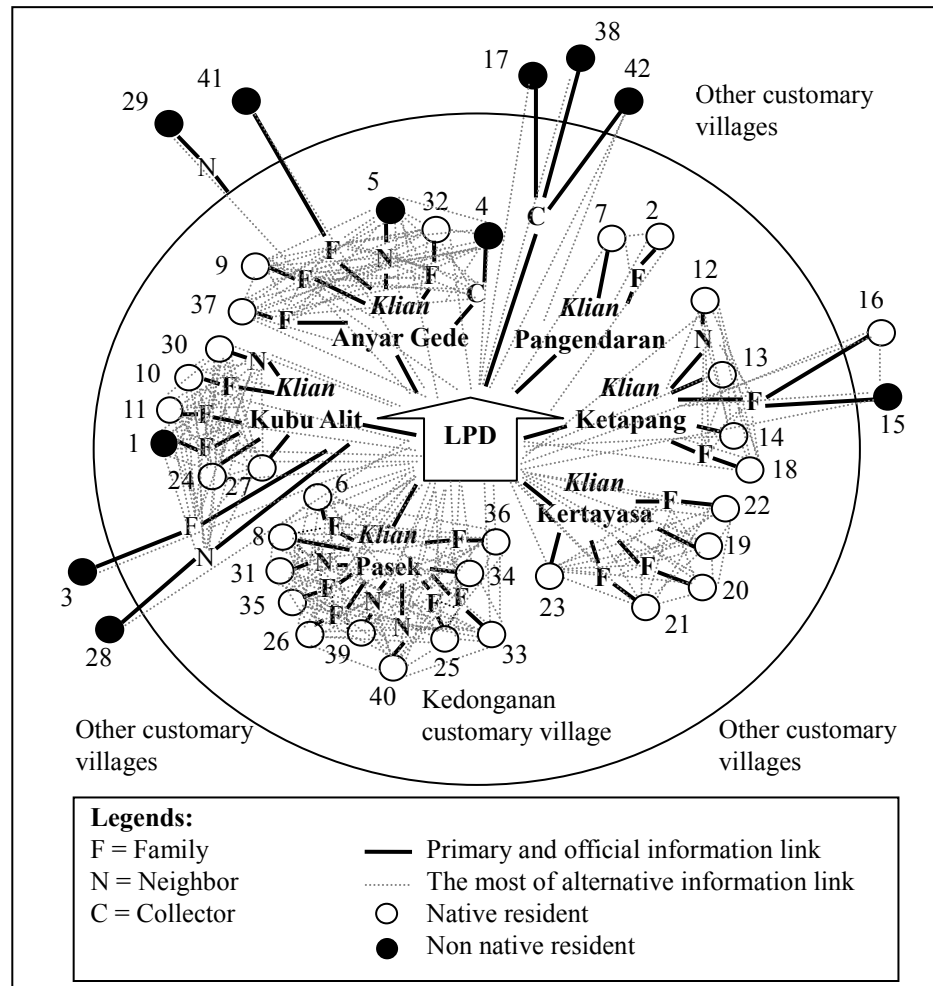


Figure 4.1. Network to LPD Kedonganan

Source: Primary data analysis 2014

Strong interpersonal ties among the members of community in customary village could persuade one another including the decision to put money, apply a loan, and repay the installment on time to LPD. Respectively 50% and 19% of respondents claimed that they become customers of LPD Kedonganan because influenced by their families and their neighbors. On the other hand, customary village board and the collectors could convince 21% and 12% of respondents to use financial services in this financial institution.

In the case of non-native resident customers, the LPD management has applied

bridging social capital¹⁶⁾ (Narayan 1999, Putnam 2000, and Field 2003) by asking the native resident to connect LPD to their non-native resident acquaintances who can be the potential customers. As depicted in Figure 4.1, non-native resident customers have never been linked to LPD Kedonganan without native resident customers. Especially when non-native resident customers apply for a loan from LPD Kedonganan, the management always confirms that they have a guarantor from native resident customer to share the responsibility of loan repayment (see Chapter 2).

Unlike native residents, non-native resident customers were tied weaker¹⁷⁾ (Granovetter 1973). The management did not allow them to discuss together with native residents in stakeholder meeting which was usually conducted in customary hamlet/village assembly (*paruman banjar/desa*) in order to keep the role of native residents and customary village as the owner of LPD. Given their limitation, non-native resident customers usually receive LPD Kedonganan information from family, friends, neighbors, and/or collectors. This research reported that non-native customer respondents received information in the amount of 54.5% from neighbor, 36.4% from collectors, 27.3% from *klians* in Kedonganan customary village, 18.2% from family, and 9.1% from friends.

4.3. Institutions as Rules-in-Use

Institution could be described as simply set of rules actually used (or the working rules or rule-in-use) by a set of individuals and potentially affecting others (Ostrom 1992). Working rules are used to determine who is eligible to make decisions in some arena, what actions are allowed or constrained, what procedures must be followed, what information must or must not be provided, and what costs and payoffs will be assigned to individuals as a result of their actions (Ostrom 1986). In contrast, norms or moral strictures which are

closely defined as the individual prescriptions to impose on personal actions without expecting other to impose the same prescriptions on their own action are not included in this definition of rules. Working rules might or might not closely resemble formal laws expressed in national legislation, administrative regulations, and court decisions. A system governed by a rule of law is one in which formal laws and working rules are closely aligned and enforces (Ostrom 1992).

At first, LPDs were one of non-bank type of Indonesian MFIs protected by provincial government of Bali. To strengthen the power of customary law (*Awig-awig*), the provincial government issued a regional regulation on LPD which was last amended as PERDA no. 4/2012. This regulation supports the autonomy of customary village in running LPD. At start of 2013, Indonesia is issued regulation on microfinance so-called UU no. 1/2013. According to this act, Indonesia recognizes customary law in Bali as the highest regulation protecting LPD. After the promulgation of UU no. 1/ 2013, LPDs are categorized as one of particular formal microfinance institutions in Indonesia which have their own rules so-called customary law (*Awig-awig*). The main council of customary-villages (*Majelis Utama Desa Pakraman – MUDP*) then discussed about standard law, so-called *Pararem Lembaga Perkreditan Desa (LPD) Bali* to regulate general operations of LPD. Each customary-village has their own authority to form customary law on LPD which is compiled with *Pararem Lembaga Perkreditan Desa (LPD) Bali* and is adjusted with the real situation of local community. Customary villages are entitled to discuss the contents of *Pararem Lembaga Perkreditan Desa (LPD) Bali* a second time in hamlet/village meetings as the highest authority of customary village. In the meetings, the native residents could participate to develop customary law on LPD. The support of above institutions to each LPD in Bali is also depicted in Figure 4.2 (see Chapter 2).

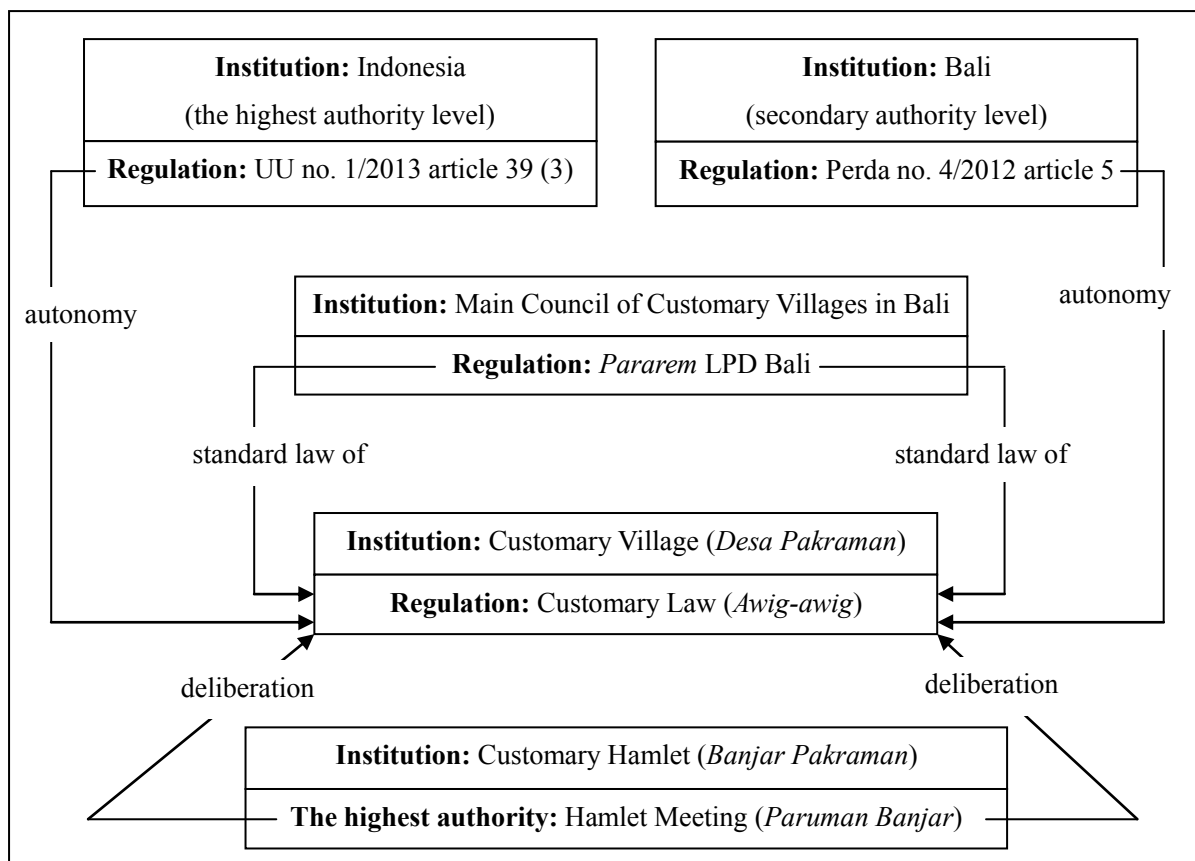


Figure 4.2. Institutions and Rules of LPD

Source: Field study 2014

In conducting the operational activities, LPD is managed collectively by native residents who play their roles as depicted in Figure 4.3. The supreme power of LPD lies on all native residents of customary village (*Krama Desa*). In order to ensure LPD operational activities running for the sake of customary village, native residents delegate the regulatory process to the customary village board (*Prajuru Desa*). This board has the obligation to elect the LPD management, to protect LPD existence, to facilitate LPD needs, to report LPD performance, and to promote the LPD financial service.

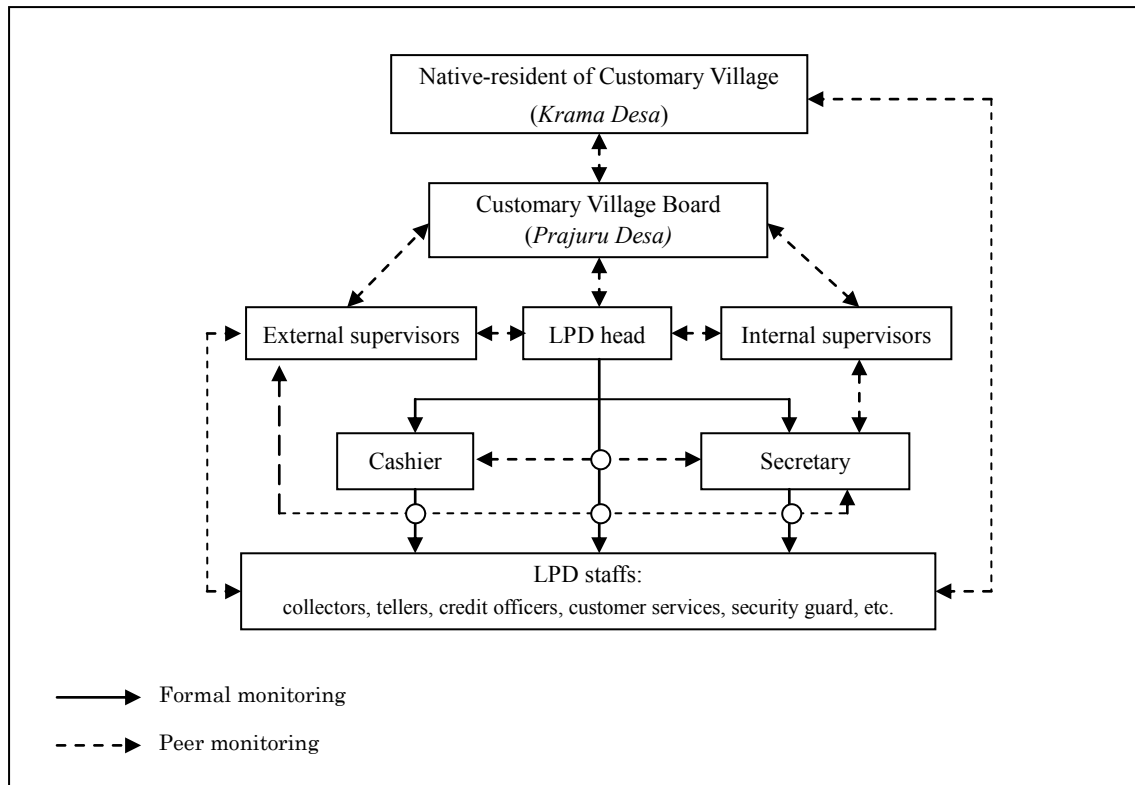


Figure 4.3. The organizational structure of LPD

Source: *Pararem Lembaga Perkreditan Desa (LPD) Bali 2014*

The LPD management board consisting of internal supervisor, LPD head, secretary, and cashier takes the position under native residents and customary village board. The internal supervisor is three to five elected native residents who are mandated to monitor the LPD daily performance and report it to customary village board. The other three management board, namely LPD head, secretary, and cashier have the responsibility in running LPD financial service. LPD head handles the management including planning, organizing, directing, and controlling. Function of planning is related to prepare Work Plan and LPD Budget Plan (RAPB) in a period of one year. Function of organizing is seen in action to synergize all components in LPD organization body including human resources, material resources, financial resources, technology resources, and information resources. Function of directing is found in the action to conduct operational activities and to ensure all staffs working optimally. Lastly, function of controlling is the LPD head's duty to

control the staff formally and informally using customary sanctions. LPD secretary plays his role to: (1) analyze credit applications, (2) save the file of credit applications, (3) create a Letter of Credit Agreement and Letter of Authorization for Collaterals, (4) save the debtor files, (5) create the receipt of credit decision making, (6) record of all customer payment, (7) maintain the general ledger, and (8) prepare LPD financial statements. Generally secretary is the management board who run accounting information systems of LPD. LPD cashier has the responsible in LPD storage and cash management, including managing the cash flows every day; reporting daily transaction to secretary; and serving savings, deposits, and loan repayment from customers. In order to support the operational activities, LPD staffs are recruited especially to deal directly with customer through collecting activities of savings, deposits, and loan payments. They also play important role in bringing information about various products and services in LPD (Atmadja 2013).

Autonomy does not restrain the main council of customary villages (MUDP), provincial government, and regency government of Bali to assist customary village operating LPD. *Pararem Lembaga Perkreditan Desa* (LPD) Bali mentions that as the external supervisors, these three institutions work together in order to protect LPDs. The main council of customary villages (MUDP) also forms a committee to empower LPDs (*Dewan LPD*). When customary villages fail to manage LPD, these institutions would take over the customary village authority to run LPD.

Ostrom (1992) argues that the difficulty of observing institutions frequently results in two errors. First is the assumption that the rule-in-use is always same as formal laws or procedures. It leads to misplace confidence in effectiveness of changing behavior by changing formal law. In a polity characterized by high conformance to legal prescription, working rules will fill in the details of general legislation that is drafted particularly by officials located in distant capital cities. If analysts erroneously assume that individuals

automatically learn about, understand, and use all the rules contained in formal laws; the development strategy adopted will focus primary on the activities of central legislatures and administrative agencies, with little attention to what actually occurs in the field. The second error is the assumption that no institutions exist except for those that have been formally created through governmental actions. It might lead to actions that destroy existing institutions.

The customary villages of Bali had struggled over 28 years to legalize LPDs status as Balinese Hinduism community-based MFIs in Indonesian legal framework. Previously, LPDs could not work optimally when the existence of customary law is not recognized legally. The regional regulation (lastly amended as PERDA No. 4/2012) is not enough to protect the real operational management of LPDs whose different basic policy in each customary village. Provincial government as the institution issuing regional regulation did not have enough information actually related to the unique character developed in each customary village. In the end, the unnecessary intervention of provincial government created inefficient and ineffective work because its existence had ruined the position of customary village as the appropriate existing institution for LPD in the end (see Chapter 2). Fortunately in the early 2013, Indonesian government understands this situation and promulgates Indonesian Microfinance Act (UU No.1/2013). The clear position of customary law as the basic regulation of LPD in Indonesian Microfinance Act automatically strengthens the position of customary village as the LPD owner. Both customary village board and LPD management team are able to play their roles now as depicted in figure 4.3, without unnecessary intervention from provincial government and/or its subordinates.

In addition, Seible (2008) finds that LPD Kapal Menguni, LPD Gelgel, LPD Kayu Kapas, and LPD Sastra met the difficult moments to sustain respectively in 1994, 1999,

2004, and 2008 when: (1) management was fraudulent, lack of communication and coordination, observed slack repayment rule, and used manual bookkeeping; (2) internal supervisors were interference, irresponsibility, unawareness, and inexperience; and (3) external supervisors were ineffective. As a customary-village institution which is dense with practice of rule-in-use, the main problems of the above LPDs are the absence of peer monitoring in the organizational structure to ensure that each components plays the roles optimally (see Figure 4.3). In general, Balinese community engages with this type of informal monitoring in their daily life.

4.4. Patron – Client Relationship

According to Foschi (2010), the hierarchical relationships which are developed between borrower and MFI staff provide a more effective repayment than peer monitoring embedded in microfinance group lending. As also found in LPD Kedonganan, the case studies on Montgomery *et. al.* (1996), Ito (1999), and Jain and Moore (2003) show the evidence that MFI staff takes the detailed records of client repayment rates. This practice produces considerable pressure on borrowers exerted by MFI staffs as well as creates an underlining hierarchical patron-client relationship between MFI staff and borrower.

Ito (2003) states that in patron-client relationship, the MFI staff that is under the tremendous pressure to maintain high loan recovery rates pass the pressure to borrowers. Subsequently, the borrowers will feel obliged thus show their commitment to their “patron” who carrying peer pressure on those facing repayment problems. The behavior nature of community in Kedonganan customary village characterized by dense social networks and strong interpersonal ties has also creates the peer pressure between LPD staff and borrowers. They easily share the obligated feeling in credit-repayment issue. Montgomery *et. al.* (1996) are also in the same opinion that in the case of BRAC’s Rural Development

Programs, the staff pressure sometimes leads to violent collective-action by fellow members against defaulters.

According to Jain and Moor (2003), MFI staff actually use the same procedures applied by traditional moneylender to exert pressure on the borrower. If further pressure is necessary, MFI staff also involves the second group that participates in weekly meeting and whose members are not responsible for repayment but could still exert pressure of defaulters. Although the LPD lending method is not based on joint liability, the hamlet/village meeting is representative enough to bring same condition to exerting pressure for defaults.

Peer pressure in patron-client relationship is another form of social capital which contributes the success in microfinance program. However, it is important to ensure that the pressure does not create destructive or negative condition for microfinance clients. In the case of LPD Kedonganan, the customers so far understand with all staff pressure because, in the end, the management always uses the approach of family relationship to deal with defaulters, such as invite those privately at first to negotiate with their late credit repayment (see Chapter2).

4.5. Manifesting Trustworthiness

LPD Kedonganan was established when native residents had suffered from the high interest debt charged by moneylenders. The idea to build LPD in Kedonganan customary village was at first ignored by the native residents. The leader of customary village (*Bendesa*) then appointed a reliable figure as chairman who guaranties the security for native residents to use LPD financial service (Madra and Sujaya, 2010).

The existence of reliable figures is not only found in the chairman position, but also in the entire managements, staffs, and internal supervisors of LPD Kedonganan. They

represent six customary hamlets (*Banjar*) who work professionally according to their function. Their important role as guarantor of native residents is stressed by the following statements from key informant and respondents.

“From the beginning, we have hired managements and staffs who represent the six customary hamlets. They will be security guarantee of native residents to use financial service in LPD Kedonganan.”

(The current chairman of LPD Kedonganan, 2014)

“I believe that customary village has strong power to maintain the performance of LPD Kedonganan by sending the internal supervisors periodically.”

(A customer, businessman, 44 years old, 2014)

“Collector rotation has never made me feel insecure when depositing money or paying installment thru door-to-door service, because I have already known them for long time.”

(A customer, female, business woman, 66 years old, 2014)

“It does not matter if they change the collector. All of them come from this village.”

(A customer, female, housewife, 44 years old, 2014)

In order to compete with others financial institutions, the management team continuously develops the reliable services of LPD Kedonganan. As mentioned in Table 4.1., the interview reports that services achieved 59% of respondents' reason to use LPD Kedonganan. Around 18% of reasons mentioned that respondents were interested in the advantage of credit services. LPD Kedonganan offers easy credit application that involves a simple procedure, low collateral requirements, fast disbursement, and longer due date. The debtors feel respected by this institution policy, in which LPD Kedonganan rewards the good performance debtors though cutting the interest rate, credits insurance, and deliberating the sanction for defaulters. Savings as another product became the 8% of customers' reason using LPD Kedonganan. They confirmed that this institution has various type and function of savings i.e. savings for investment, savings for education, savings for

ritual ceremony, and time deposits with high interest rate. The respondents also mentioned that LPD Kedonganan could be reached easily because of door-to-door services (11%) and near office (10%). The other 5% customers' reason to use LPD Kedonganan is the strong power of LPD Kedonganan to provide security. As mentioned before, since the customers and the employees know each other well, they easily do peer monitoring. Compensation was other 5% of customers' reason. Customers receive compensations as the gratitude to be loyal customers both as individual and as part of community in Kedonganan customary village (see Chapter 2). Lastly, 2% of costumers confirmed that LPD management team treated respectfully.

Table 4.1. Reasons to be customers

Reasons	Numbers	Proportion (%)
Owned by community	14	23
For community village	11	18
Services:	36	59
<i>Credits</i>	<i>11</i>	<i>18</i>
<i>Door-to-door Services</i>	<i>7</i>	<i>11</i>
<i>Near</i>	<i>6</i>	<i>10</i>
<i>Secure</i>	<i>3</i>	<i>5</i>
<i>Savings</i>	<i>5</i>	<i>8</i>
<i>Compensations</i>	<i>3</i>	<i>5</i>
<i>Respected</i>	<i>1</i>	<i>2</i>

Source: Primary data analysis 2014

According to Ostrom and Ahn (2003), trustworthiness is an effective term to refer to the characteristics of individual preferences in a trust action situation aside from different terms such as habit and value. In this context, the culture of society is reflected in the preferences or the habits and values of individuals aggregated at societal level. By appointing reliable figures who represent each customary hamlet in management team and providing reliable services which are adjusted to community financial service needs, LPD Kedonganan has established the trust action situation rooted from community habits and local values.

4.6. Conclusions

Microfinance and social capital are linked with causal relationship given social capital can be the source as well as the new product of microfinance program (Foschi 2010). From the case study of LPD Kedonganan, this research found that community uses the elements of social capital not only to form but also to develop MFI. At first, social networks are found in the form of family and kinship relationship between native resident customers, non-native resident customers, and LPD staffs as the characteristic of dense social networks and strong interpersonal ties. Reciprocity norm, as part of these, is applied to minimize reputational uncertainty and default risk of customers. Second, LPD is supported by integrated institutions from customary village to national level. Institutions as rules-in-use create the clear management of task division in LPD organizational structure. Both formal and peer monitoring is applied to prevent risk of credit-default and abuses from employee. Third, LPD uses the same type of traditional relationship between patron and borrower. Peer pressure is found as the form of shared obligation between LPD staff and borrower in facing credit-repayment problem. Forth, since the main function of LPD is to provide financial service and manage the community properties, manifesting trustworthiness is important as the foundation of running its business. Appointing reliable figures and providing reliable services are the manifestation to establish the trustworthiness.

Chapter 5.

Current Issues and Future Challenges

5.1. Introduction

The development of MFI is largely depended on the customers' financial services needs which have been varied over the time. The improved income level or living standard is typically mentioned as the major driver of the transformation. In Asia, many MFIs focus on serving farmers who gradually transform their production from substance to the intensive style of farming (Conroy 2003 and Seible 2007). The success of 1983 established Grameen Bank was supported directly or indirectly by made achievement productivity in agricultural production.

The achievements of LPD Kedonganan are closely linked to the growing household income of native residents similar to the most of MFIs in Asia. In the examined case, the primary driver of its success is the national infrastructure development efforts of promoting the tourism industry in Bali. Getting benefits from its location which is just in south of Denpasar International Airport and north of Jimbaran resort beach, Kedonganan customary village was able to strengthened its position as a fishing village by supplying fresh fish to growing number of tourists. In the process, the labor market situation in the village has been modified. When LPD Kedonganan was established in 1990, the native residents were engaged in small-scale fishing activities that is equivalent to subsistence type of production activity. Nowadays many of them are employed as higher wage-paid service worker. The employment development in the village has induced the associated changes in labor market. The growing demands for cheap-labor fishing-works or low-skilled service-works are largely filled by non-native resident who migrated from outside Bali recently.

Among the current emerged issues in Kedonganan customary village, two most concerned issues are chosen to examine the implications on future sustainability of LPD Kedonganan. First issue is the increased number of non-native residents in the community. They now hold larger number of accounts on all financial products than native resident. The faster growth in number of non-native resident is obviously linked to the improved per capita national income, the national population growth, and favorable labor market situation in Bali relative to other places in Indonesia. Hence, the management team has to cope with the increased number of non-native resident customers. Second issue is related to behavior nature of LPD and community. The customary village board (*Prajuru Desa*) and LPD management is preparing the successor candidates for the first time to replace current LPD head, who is going to retired in less than 10 years. Since the current LPD head has been leading the community of customary village in establishing the community-owned LPD, understanding customer reaction to this issue is important for the future operational activities of LPD Kedonganan.

5.2. Socioeconomic Characteristic of Customers

In the early time, native residents of Kedonganan customary village were only the customer of LPD Kedonganan (Suadi 2010). Before the 1990s, 90% of job opportunities were provided by fishery resources (Suadi and Nakagawa 2009). They lived in the line of poverty during that time due to the lack of capital. After LPD Kedonganan has been established in 1990, native residents have been given the precedence to apply a loan with simple application and low collateral. Slowly the main employment has shifted from fishing to tertiary sector (Madra and Sujaya 2010). Recently the most of community residents prefer to work in private sectors, business, and services as depicted in Table 5.1. This field study recorded that 67% of respondents were employed by business, services,

and craft related to tourism industry.

Table 5.1. Main employment of native residents

Main Employments	Numbers (person)
Public service	88
ABRI (military)	28
Private sectors	1,039
Self-employed:	
• Business and services	823
• Farming	113
• Fishing	218
• Craft	53

Source: Village Monograph, 2014

In order to keep the financial stability, LPDs in Bali expanded their services to the non-native residents. The non-native residents are required to have guarantor from native residents in applying for a loan to reduce the risk of credit-default in line of the existed measure through the customary sanction (*Sanksi Adat*). In Bali, customary sanction works effectively for native residents. Although differentiated-requirements are imposed, the number of non-native resident customers was higher than the native-resident customers. As shown in Table 5.2, respectively 53%, 64%, and 72% of saving-customers, time-depositors, and debtors in LPD Kedonganan came from the non-native residents. The total number of savings-customers was more than twice of the total population in Kedonganan customary village. Non-native residents did not mind for being imposed the limitations in services because they felt they were well treated and were provided reasonably competitive financial services from LPD Kedonganan.

5.3. The Position of Non-native Resident Customer in LPD Kedonganan

Non-native residents were playing the important role now to keep balancing of financial activities in LPD Kedonganan. The field study found that 54% of the sampled non-native resident customers had decided to use its financial services because LPD

Kedonganan proved easy procedures for loan application, such as shorter application form, more casual interview, simpler financial reports and business plan, and lower collateral, compared to other surrounding financial institutions. While, 46% of them were motivated by reasons sourced from social relations, such as they had the obligation to keep money in this institution since they had lived in Kedonganan customary village, they had family working in LPD Kedonganan who could be contacted easily if they need to save or withdraw money, and customer's daughter was married to native resident of Kedonganan customary village. For some non-native residents, LPD was regarded on behalf of customary village. They needed to support the establishment in order to ease their life.

Table 5.2 The number of native and non-native customers in LPD Kedonganan

Resident status	Savings		Time-deposit		Credit	
	number*	%	number*	%	number*	%
Native (<i>krama desa</i>)	5,704	47	293	36	487	28
Non-native (<i>krama tamiu and tamiu</i>)	6,335	53	518	64	1,279	72
Total	12,039	100	811	100	1,766	100

Note: *including number of residents (person) and number of institution (unit) that registered as customers of LPD Kedonganan

Source: Data base of LPD Kedonganan in October 2014

The field study also found that mostly non-native respondents were satisfied with financial services in LPD Kedonganan. They scored highly in all satisfaction items except time-deposit procedure and compensation. Only one respondent scored zero for interest rate of credit without aware how competitive interest rate in LPD Kedonganan compared to other financial institutions. Around 64% of the sampled non-native resident customers complained for the time-deposits procedure due to the inflexible withdrawal. On the compensation scheme, some non-native residents complained the differentiated minimum balance requirement to be qualified for the benefit. They must meet approximately 10 times higher requirement than native residents. Other case, Muslim customers do not receive any substitute compensations for the sacrificial pork meat which is prohibited by

their religion, although they have high amount of deposits and good record in credit as the requirement for compensation.

Table 5.3. The number of native residents in Kedonganan customary village in 2009 and 2014

Year	Household (family)	Population (person)
2009	1,072	5,097
2014	1,172	5,207

Source: Kedonganan village monograph of 2009 and 2014

Ek (2011) reports her findings that one indicator of sustainable features in microfinance institution was the ability to reach more clients on average. Since the number of borrowers kept decreasing in the last five years (see Table 3.4) and the number of native resident customers tended to be stagnant (see Table 5.3), LPD Kedonganan should begin to consider the position of non-native resident customers including their right and obligation. The increasing number of non-native resident customers potentially becomes one of stimulators of the sustainable LPD Kedonganan when the number of native-resident customers does not develop.

5.4. Customer Satisfaction to LPD Kedonganan

5.4.1. Customer satisfaction score

Measuring the level of customer satisfaction to LPD Kedonganan is one of the ways in evaluating how successful this financial institution serves them (Krishnan *et. al.* 1999). The result of this survey can be served as reference for LPD management to plan and to perform the sustainable development in financial services, because it help to understand the strength and weakness of LPD Kedonganan's current services from customer viewpoint. Although the findings in this section are not freed from bias measurements due to the possible involvements of the respondents' subjective and unstable judgments biases, it represents the satisfaction feeling of respondents.

Table 5.4. Satisfaction score

Description	Mean	SD	Min	Max
Savings				
• Procedures	4.45	0.55	3	5
• Interest rate	4.43	0.50	4	5
Time-deposit				
• Procedures	2.93	1.73	1	5
• Interest rate	4.43	0.50	4	5
Credit				
• Procedures	4.17	1.06	0	5
• Interest rate	3.79	1.16	0	5
Staff services	4.33	0.53	3	5
Facilitations	4.19	0.59	3	5
Compensations	3.79	1.00	1	5
Compared to others MFIs	4.45	0.59	3	5
Satisfaction score	40.95	4.21	34	50

Note: Score level: 1 = unsatisfied, 2 = less, 3 = so-so, 4 = satisfied, 5 = very;

Source: Field survey 2014

As listed in Table 5.4, satisfaction was formed from seven components including the procedures and interest rate of savings, the procedures and interest rate of time-deposit, the procedures and interest rate of credit, staff services, facilitations, compensations, and their satisfaction compared to other financial institutions around Kedonganan customary village. Except time-deposit, credit, and compensations, the components of satisfaction score had standard deviations of less than 1, which indicates a high level of consensus among respondents. Moreover, the mean of those components were also close to maximum score. Respondents gave high satisfaction score for them.

Overall respondents gave high appreciation to LPD Kedonganan. In average, satisfaction score achieved 40.95 of 50. Standard deviation tends to be high (4.21) because there were some different opinion from respondents in time-deposit, credit, and compensations. Some of respondents had not deal yet with procedures and interest rate of both time-deposit and credit. Around 43% of respondents gave score 1 for the less flexibility of time-deposit procedure. While due to their shared Balinese Hinduism based social habit or belief, owing the credit were not regarded as favorable acts among the

native residents. Balinese people culturally feel ashamed if the relatives find they apply for a loan. The conservative groups tend to judge the debtor as someone who has luxurious lifestyle, failed household financial management, and/or irresponsible to maintain financial security in their family without considering the business development opportunities from credit application. Among the pro and cons on applying for credit, they do not face with any problem in procedures, except for a rule that LPD Kedonganan cannot approve the new loan application as a penalty for recording the bad credit. Some respondents who had never applied loan gave zero score both in procedure and interest rate of credit because did not have enough information. Some of others complained about interest rate once they learned other financial institutions lowered their interest rate of micro-credit (see Table 2.3). For the satisfaction in compensations, respondents tended to give more various score level depended on how often they received gifts from LPD Kedonganan.

5.4.2. Customer satisfaction in relation to socioeconomic factors

The relationship between satisfaction and socioeconomic factors was measured using linier regression models with an option of robust standard errors, given inclusion of extreme sampled savings, time-deposit, and credit data. Customer satisfaction measurement used all set of socioeconomic factors of selected-respondents in Table 5.5. The result showed that savings, time-deposit, and number of products the customer used had positive significant relationship, while gender had negative significant relationship with customer satisfaction as mentioned in Table 5.6.

The customers felt more satisfy to LPD Kedonganan when they had high amount of savings, had high amount of time-deposit, and/or used more number of products in LPD Kedonganan. By keeping deposits in savings product, customers could access easily to other products especially credit. The interest rate of savings tended to be set at higher so as

to reduce the net interest rate payment on credit they had (see Table 2.3). Customers who deposited much money in time-deposit were satisfied with LPD Kedonganan, although 43% of respondents scored low in the procedures. These customer groups said that they could extend time-deposit easily via phone when maturity notice of this product was issued. Immediately the staff would come to their place to ask their sign in new contract. Since the time-depositors tended to deposit high amount of money, they easily received compensation from LPD Kedonganan. Customers who used all products including savings, time-deposit, and credit were also satisfied with LPD Kedonganan. By using more financial products, they received more opportunity to get various types of compensations such as death compensation (including free cremation ceremony), sacrificial pork meat, prize coupons, fruit parcel, and free pilgrimage. While for gender, dummy variable were used by taking value 1 for male and 0 for female. The negative coefficient means that the male respondents were not satisfied to LPD Kedonganan. Specific reason is not so clear and waits for the further investigation. One possibility is that the staff makes more frequent and more direct services to female customers than male customers.

Table 5.5. Basic statistics of independent variables

Variables	Units	Variable type	Mean	SD	Min	Max
Savings ¹⁾	Rupiah	Continuous	3.84E+07	8.03E+07	14963.87	3.43E+08
Time-deposit ¹⁾	Rupiah	Continuous	3.97E+07	1.34E+08	0	8.22E+08
Credit ¹⁾	Rupiah	Continuous	5.13E+07	1.65E+08	0	1.03E+09
Periods	Year	Continuous	13.33	6.58	1	22
Age	Year	Continuous	48.71	11.35	28	72
Residents status	Dummy	Dummy, taking the value of 1 if native and 0 if non-native	0.74		0	1
Gender	Dummy	Dummy, taking the value of 1 if male and 0 if female	0.52		0	1
Number of products	Unit	Numbers	2	0.66	1	3

Note: 1) Normalized the collected nominal based data with GDP deflator of 2000 based; 2) Sample size = 42
Source: Data base of LPD Kedonganan in October 2014 and field survey 2014

The mission of LPD Kedonganan as a MFI is then questioned when there is the positive significant relationship between satisfaction and the amount of savings and time-deposit of respondents. The results raise the assumption that recently LPD Kedonganan serves better the middle to high economic level of customers compared to the poor and weak financial groups. However, by understanding the history (see Chapter 2), actually those middle and high economy level of customers are the low-income native residents who were facilitated by LPD Kedonganan to accessed the microfinance services in the early of 1990s. They gradually improve their living standard after becoming its customers for several years. Given the groups of weak-financial native-resident customers also using its services, LPD Kedonganan still needs to consider improving the services for them.

Table 5.6. Result of regression analysis using robust standard errors of customer satisfaction

Explanatory variable	Coefficient	Robust Std. Err.	z	P
Savings	1.76E-08	7.35E-09	2.4	0.022**
Time-deposit	4.04E-09	1.90E-09	2.13	0.04**
Credit	1.04E-09	2.62E-09	0.4	0.694
Periods	0.167434	0.10191	1.64	0.11
Age	0.007617	0.055887	0.14	0.892
Residents status	-0.65292	1.185613	-0.55	0.586
Gender	-2.3587	1.150744	-2.05	0.048**
Number of products	1.7168	0.887036	1.94	0.062*
constant	35.62902	4.390064	8.12	0

Note: 1) *= P<0.1, **= P<0.05; 2) Sample size = 42, STATA 12

Source: Field survey 2014

Based on the analysis of satisfaction, it seems safe to assume that the declined number of loan application and stagnating total loan outstanding is caused by factors other than satisfaction (see Chapter 3). One of the possible explanations is the start stagnating national investments to service sector particularly to tourism industry (Indonesia Investment Coordinating Board 2015). The lowering number of loan application might

indicate the need of transformation of structure of Bali economy which is heavily dependent on tourism.

5.5. Successor Issue in LPD Head Position

5.5.1. An influence of current LPD head

The leader and leadership have remarkable role in all achievements of LPD Kedonganan (Suadi 2010). Leadership seems important both in dealing with day-to-day matters and for more long-term decision (Ternstöm 2006). At first, many native residents put the current LPD head as their guarantor when deciding to deposit money in LPD Kedonganan (Madra and Sujaya 2010). He has been re-elected over six times in the same position since the initial establishment of LPD Kedonganan. Because the LPD manager tenure is restricted until 60 years old¹⁸⁾, the successor issue is rolling in the community nowadays. As listed in table 5.7, this study found that 21% of respondents did not want customary village board to replace the current LPD head. Another 14% of respondents put the current LPD head's commendable attitudes and high achievements as requirements that must be met by successor to get their support. Lastly, 64% of respondents did not mind on this issue as long as the successor can maintain the reliable services of LPD Kedonganan.

Table 5.7. Successor Issue

Successor Issue	Numbers (person)	Proportion (%)
Did not want new LPD head	9	21.43
Same characters and achievement with current LPD head	6	14.29
Did not mind / Did not know / Leaving the decision to assembly / Support the successor issue	27	64.29
Total	42	100

Source: Field survey 2014

Respondents who did not want new LPD head confirmed that only the current one was the most compatible person to serve as leader of LPD Kedonganan. They believed that

they got support from other native residents and even from customary hamlet to stop the replacement of current LPD head. The respondents who put the current LPD head's characters and achievements as requirement for the successor said that, they will support customary village board to appoint new LPD head if the successor meet their requirements. For them, the current LPD head can meet his obligation by being leader who is trustworthy, loyal, and responsible. He takes high educational degree to improve knowledge, creativity, and vision. Taking advantage of his private business activities, he successfully builds relationship and gains experience from many financial experts, lawyers, and businessmen to develop LPD Kedonganan. The most important things for the community are that he frees from political parties and has adorable family. On the contrary, most of the respondents did not give any comment about this issue. They just asked the new LPD head to keep facilitating them with simple procedure. In addition, there were two respondents who fully supported if customary village board appointed new LPD head because it can be learning process of native residents in management renewal of a village institution.

In evaluating the customer's response to current LPD head, interview results from respondent were grouped into two categories: highly admiring and not-so-highly admiring ("high" and "low"). Respondents who did not want new LPD head and who put current LPD head's characters and achievements as the main requirement were grouped as they who had "high admiration" to the current LPD head. Due to his dedication, the figure of current LPD head is embedded strongly in some group of customers. On the contrary, respondents who did not mind, who answered "I do not know", who left the decision to assembly, and who support the successor issue in LPD head position, were grouped as they who had "low admiration" to current LPD head. Dummy variable was used by taking the value of 1 to assign high admiration and valued 0 to assign low admiration.

5.5.2. The admiration to leader in relation to socioeconomic factors

Relationship between admiration to current LPD head and socioeconomic factors of respondents were investigated using the probit regression model. This model was chosen because admiration to current LPD head as dependent variable presented in dummy variable. Similar to the relationship investigation between customer satisfaction and socioeconomic factors, admiration to current LPD head also used the same set of socioeconomic factors of respondents as explanatory variables (see Table 5.5). The result found that the admiration to current LPD head had positive significant relationship with time-deposit, age, resident status, and gender as mentioned in Table 5.8.

First, respondents who used time-deposit products had positive significant relationship with admiration to current LPD head. Amid the spread rumors in community, this group was reported to strongly hold the current LPD head. They even threatened to withdraw all their money if customary village board would elect the new one.

Table 5.8. Result of regression analysis of admiration to current LPD head

Explanatory-variable	Coefficient	Std. Err.	z	P
Savings	-7.09E-09	5.52E-09	-1.28	0.199
Time-deposit	6.25E-09	3.07E-09	2.04	0.042**
Credit	3.89E-10	2.01E-09	0.19	0.846
Periods	-0.07185	0.055954	-1.28	0.199
Age	0.047447	0.026397	1.8	0.072*
Residents status	3.211404	1.722573	1.86	0.062*
Gender	1.875436	0.767722	2.44	0.015**
Number of products	-0.65591	0.511072	-1.28	0.199
constant	-4.15964	2.01561	-2.06	0.039

Note: 1) *= P<0.1, ** = P<0.05 2) Sample size = 42, STATA 12

Source: Field survey 2014

Second, the elderly respondent had positive significant relationship with admiration to current LPD head. They are thankful to the current LPD head who tirelessly begged them to support LPD Kedonganan during the early stage of LPD establishment for the sake of

customary village. They salute to him who kept personally promoting this financial institution by attending hamlet meeting (*Paruman Banjar*), providing innovative products and services, supporting customary village activities, and doing many charities by playing his rule as the representative of LPD Kedonganan.

Third, resident status of respondents had positive significant relationship with admiration to current LPD head. For resident status, dummy variable were used by taking value 1 for native resident and 0 for non-native resident. The positive regression coefficient in resident status showed that customer from native resident had high admiration to current LPD head. The managers of LPD Kedonganan including head, secretary, and cashier are elected directly or indirectly by native residents as the owner of this financial institution. Admiration can be the reason of native residents to appoint these figures.

Forth, gender had positive significant relationship with admiration to current LPD head. The positive regression coefficient in gender shows that male respondents tended to form higher admiration to the current LPD head. As the family head, they often meet in various customary activities including hamlet meetings and ritual ceremonies. Through those intensive meetings, their admiration to the current LPD head might be formed.

5.6. Conclusion

Influenced by livelihood changes in community after LPD Kedonganan establishment, recently there are two issues which challenge the sustainable development of this financial institution:

First, as community-based microfinance, the increase number of non-native resident customers is a challenge given local culture applying in its operational management. For the financial sustainability, the LPD is suggested to consider adjusting the traditional

management system especially in products and compensations to maintain and further expand of the customer number. However the adjustment should keep maintaining the implication of local community custom which is the key of sustainable development in LPD Kedonganan for over 24 years. The field survey found that so far native and non-native resident customers gave the high satisfaction score to financial services of LPD Kedonganan. Customary satisfaction had positive significant relationship with savings, time-deposit, and number of products the customer used, and had negative significant relationship with male. Based in this result, LPD Kedonganan has the strength in savings and time-deposits product. That is why the number of depositors keeps climbing. However, because the number of debtors shows oppositely, the LPD management should find ways to attract the customers to also apply for a loan. So far, LPD Kedonganan can meet the diversifying product demand of customers given the positive significant relationship in number of product. Since male customer relatively had low satisfaction to LPD Kedonganan, the management should be more attractive to serve them.

Second, although successor issue is too specific even for the case of LPDs in Bali, the first experience in management replacement is not easy for a community-based microfinance, which from the early stage of its establishment put same leader as guarantor of native residents and customary village properties. The customers groups which had positive significant relationship with admiration to current LPD head (i.e. time-depositors, elderly, male, and native resident) have power in community to destabilize the sustainable development of LPD Kedonganan, even if accounting around one third of selected-customers only. The intensive discussion with them is suggested to make deal with this issue. The hamlet meeting could be one of the appropriate places to conduct the discussion in order to protect the community ownership among the high number of non-native resident customers.

The analysis of customer satisfaction and admiration to current LPD head used the same set of independent variables. The parameters shall be claimed as appropriate model to reduce the simultaneous estimation bias. Unfortunately, the regression analysis has made under the strong technical constrain from the data. The results were interpreted carefully because of the present of the estimation bias.

Chapter 6.

General Conclusions and Policy Implications

6.1. General Conclusions

Lembaga Perkreditan Desa (LPD) is a community based-microfinance institution, which has developed well as sound microfinance in Indonesia. This institution is owned and governed by customary villages (*Desa Pakraman*) of Bali, which is fully integrated into Balinese culture. The main members are native residents (*Krama Desa*) bound as customers, staffs, managers, and internal supervisors. LPD business activity is to connect those who have excess funds to the parties that lack funds. The rapid growth of LPD in units' number and assets shows that this institution has played the important role in community. Recently, its unit number has achieved 1,422 units of 1,472 customary villages in Bali. The assets reached Rp 11.6 trillion in the end of May 2014 or climbed 20% compared to total assets in same period of last year.

The research was conducted in LPD Kedonganan as one of well-performing LPDs in Bali. LPD Kedonganan has succeeded to build a new model of financial institution through traditional and modern service approaches. As other LPDs in Bali, LPD Kedonganan has been established as traditional financial institutions which uphold Balinese Hinduism in management and regulation. The basic rule of this institution follows Balinese Hinduism philosophy (*Tri Hita Karana*). Its existence is regulated officially in customary village law (*Awig-awig*). Since owned by customary village, all native residents (*Krama Desa*) have to support LPD development. Local customs, norms, and sanctions require them to get involved in its performance. LPD is entitled to be part of hamlet/village meeting (*Paruman Banjar/Desa*) and to use customary sanction (*Sanksi Adat*) in order to prevent default risk.

LPD Kedonganan also provides products and services based on native resident needs, such as savings for investment (*Tindak*), savings for education (*Tabepus*), savings for ritual ceremony (*Sipadat*), voluntary savings, time-deposits, and credit services. Along with the rapid development of financial institutions, LPD Kedonganan improves the services and facilitations by adopting the current technology of rural banks in order to compete with them. The management provides the competitive interest rate; facilitates the employees with computers, data management, and internet service; sets the security system including CCTV and handy talky; and regularly promotes this financial institution via website, monthly magazine, booklet, and local news paper.

The assets and profits of LPD Kedonganan kept increase over 24 years. In the last decade, this institution's assets increased by 10% and profits rose 1.3% as well as savings, time deposits, and credits which respectively climbed by 12%, 10%, and 9%. The financial analyses including percentage growth rate, common-size analysis, ratio analysis, and CAEL rating show that the management succeeded to maintain the sound performance of LPD Kedonganan for the last five years. However, the ratio analyses and CAEL rating find that assets quality, allowance for doubtful account, and NPL did not met the maximum score as regulated in SK BPD Bali No. 0193.02.10.2007.2, when the outstanding loan categorized as substandard, doubtful, and loss rose into 3.5%, 6.6%, and 2.5% respectively in 2014. On the other side, annual growth rate analysis mentions the downward trend of borrowers but the increment of outstanding loan, thus causing the high percentage of average outstanding loan per borrower in the last five years. This condition depicts a trend that recently the borrower's mindset changes from consumption needs to business-oriented. They confidently apply a loan in LPD Kedonganan in the high amount of money to develop their business. On the contrary, the customers who do not have much business passion tend to stop using credit service soon after their living standard are achieved.

Customary village applies social capital i.e. social networks, institutions, patron-client relationship, and trustworthiness as the foundation of operational LPD. First, social networks are embedded using family and kinship relationship between native resident customers, non-native resident customers, and LPD staffs. Reciprocity norm is applied to minimize reputational uncertainty and default risk of customers. Second, LPD is supported by integrated institutions from customary village to national level. Institutions as rules-in-use create the clear management of task division in LPD organizational structure. In monitoring process, LPD uses not only formal but also peer monitoring as the part of community habit which effectively prevent the risk of credit-default and the abuses from employees. Third, LPD applies the same type of traditional relationship between patron and borrower. LPD staff and borrower share the obligation in facing credit-repayment problem in the form of peer pressure. Forth, since the main function of LPD is to provide financial service and manage the community properties, trustworthiness is important as the foundation of running its business. Appointing reliable figures and providing reliable services are the manifestation to establish the trustworthiness.

The analysis of customer satisfaction to LPD Kedonganan was conducted by taken 42 customers using stratified random sampling based on the amount and duration of savings. The result shows that the customers were satisfied to LPD Kedonganan. However, 43% of respondents claimed “unsatisfied” to the less flexibility of time deposits procedures. Few also complained about the relatively high interest rate of credit. In addition, some respondents kept refusing to apply a loan due to their shared habit or belief. For the compensations, the score given by selected-customers were various. The low score of compensation especially came from non-native resident customers who had low deposits. They could not receive compensation as easy as native resident customers because the different minimal deposit regulation. Along with the change in community, LPD

Kedonganan has to deal with the growth number of non-native residents who recently hold larger number of accounts on all financial products than native resident. The faster growth in number of non-native resident is obviously linked to the improved per capita national income, the national population growth, and favorable labor market situation in Bali relative to other places in Indonesia. Given the limitation services provided to non-native resident customers, LPD Kedonganan has to cope with the increased number of non-native resident customers.

Regression analysis conducted to see the relationship between customer satisfaction and socioeconomic character of customers. The result showed that customer satisfaction to LPD Kedonganan had positive significant relationship with the amount of savings, the amount of time-deposit, and number of products the customer used, but had negative significant relationship with male. These findings show that LPD Kedonganan has the strength in savings and time-deposit products. That is why the number of depositors keeps climbing. However, because the number of debtors shows oppositely, LPD management should find ways to attract the customers to also apply for a loan, particularly for the product of collective loan activities. So far, LPD Kedonganan can meet the diversifying product demand of customers given the positive significant relationship in number of product. Since male customer relatively has low satisfaction to LPD Kedonganan, the management should be more attractive to serve them. The result of regression analysis on customer satisfaction brings to an assumption that the declined number of loan application and stagnating total loan outstanding is caused by factors other than satisfaction. One of the possible explanations is the start stagnating national investments to service sector particularly to tourism industry and to Bali as the location of investment.

The high dependency of customers to reliable figures for maintaining their precious asset is found as challenge in maintaining the sustainable LPD Kedonganan. The

management and customary village board have to face long approval with especially native residents, when preparing successor of LPD head in 10 years before the current one is retired. This study found that from 42 selected customers, around 21% of respondents did not want customary village board to replace the current LPD head. Another 14% of them put the current LPD head's commendable attitudes and high achievements as requirements that must be met by successor to get their support. Lastly, 64% of them did not mind on this issue as long as the successor can maintain the reliable services of LPD Kedonganan. In evaluating the customer's response to current LPD head, interview results are grouped into two categories. The respondents who did not want new LPD head and who put current LPD head's characters and achievements as the main requirements were grouped as they who had "high admiration" to the current LPD Kedonganan. The respondents who did not mind about successor issue were grouped as they who had "low admiration" to current LPD head. The regression analysis showed that the admiration to current LPD head had positive significant relationship with time-deposit, age, native resident, and male.

The regression analysis of customer satisfaction and admiration to current LPD head used the same set of independent variables. The parameters for the first time were set as appropriate model to reduce the simultaneous estimation bias. However, the regression analysis has made under the strong technical constrain from the data. The results were then interpreted carefully because of the present of the estimation bias.

The findings of this study hopefully can add and contribute to further deepening of understandings about the sustainable concept of MFIs which are indicated from the efforts not only to increase profits and donors but also to reduce the poverty. Through a case study of LPD Kedonganan, this study introduces a model of community-based microfinance recognized nationally in legal framework of Indonesia. LPD Kedonganan successfully improves the living standard of community as well as maintains assets and profits more

than two decades. Amongst the current issues about the high interest rate and the unhealthy pressure of some MFIs to their clients, this research can be a sample that a MFI is able to make profits by keeping the goal to improve the clients' life. Establishing the loyalty of clients to continuously use its financial services is the key of maintaining the sustainable operational management of MFIs.

6.2. Policy Implications

For the future implementations, the management team and customary village board should cope with local, national, and global challenges in order to maintain the sustainability of not only LPD Kedonganan but also all community-based MFIs in Indonesia and developing countries.

First, financial analyses over the last five years find that: (1) low performance of assets quality, allowance for doubtful account, and NPL; and (2) the downward trend of borrowers but the increment of outstanding loan, causing risk in credit-default due to the high percentage of average loan outstanding per borrower. Given the success story of collective owned and managed seafood restaurants along Kedonganan coastal, customary village board and the management of LPD Kedonganan are suggested to encourage native residents to apply loan by supporting more this type of collective-business. The board can ask native residents in hamlet meeting of customer village to take micro-credit in LPD Kedonganan and joining in collective-business for the sake of customary village. Micro-credit is assumed to control the high average loan outstanding per borrowers which tended to affect the deterioration of assets performance in LPD Kedonganan in 2014. Moreover, micro-credit provides another credit-type option for native residents who are uncomfortable with loan.

Second, the changes in community life including the increase in household income, population growth, and customer motivation challenge the sustainable development of LPD Kedonganan. Recently the account number of non-native residents dominated in all products. In order to maintain and further expand their number, the management team is suggested to consider adjusting the traditional management system especially in the rules of applying products and receiving compensations. However the adjustment should keep maintaining the implication of local community custom, such as Balinese Hinduism philosophy (*Tri Hita Karana*), customary law (*Awig-awig*), and hamlet meeting (*Paruman Banjar*), which is the key of sustainable development in LPD Kedonganan for over 24 years. The management team and customary village board are also facing the various reactions of the successor issue in LPD head position currently. The intensive discussion with the customer groups which had high admiration to current LPD head (i.e. time-depositors, elderly, male, and native resident) is suggested. In order to protect the community ownership among the high number of non-native resident customers, the hamlet meeting is one of the appropriate places to conduct this discussion.

Third, in order to promote the sustainability of LPDs and Balinese community life, the situations of the community as well as of the regions need to be well understood and known. Moreover, there are indispensable needs of nation-wide or regional-wide efforts to support the LPDs as well as other MFIs because the situations of the village community have been largely modified by the external economic or social factors such as domestic and foreign direct investment. Local and central governments should provide the adequate guidance to village communities for help developing their decisions. In this context, the ongoing “transformations in national socioeconomic conditions” need to be measured and monitored in comprehensively and in systematic manner.

Appendix A. Footnote

- 1) “The Microcredit Summit Campaign is global network linking all actors in the microfinance sector that sets and regularly measures progress toward bold goals for using microfinance to end poverty. It announces progress towards these goals through the publication of the State of the Microcredit Summit Campaign Report.”
(<http://www.microcreditsummit.org/about-the-summits2.html#sthash.E3Zcr6mg.dpuf>).
- 2) Suadi and Nakagawa (2009) explain that “based on Autonomy Law No. 24/2004, there are two types of village: (1) urban village (*Kelurahan*) and (2) rural village (*Desa*). One of the main differences between them is the selection process of leader. The leader of an urban village is appointed as a civil servant by the higher authority in district or city, while of rural village is elected through an election process. Beside these two formal village types, there is also customary village (*Desa Pakraman*) in Bali. The regional regulation No. 3/2001 defines a customary village as a traditional law community in Bali Province which has Hindu community traditions, etiquette, oneness passed from generation to generation within *Kahyangan Tiga* or *Kahyangan Desa* (three adobe of Hindu Gods), bonds with specific religions, and their own wealth as well as the right to take care of their own household. Customary village has strong connection with local community, traditions, customs, and religion.” Generally a customary village is formed from one or several traditional community group which has close family ties so-called customary hamlet (*Banjar Pakraman*).
- 3) As regulated in SK BPD Bali No. 0193.02.10.2007.2, CAEL (Capital, Asset, Earning, and Liquidity) rating is chosen as the official tool to evaluate the financial performance of all LPDs in Bali in a year (Suidarma and Diatmika 2013).
- 4) LPN (*Lumbung Pitih Nagari*) is community-based MFI established in West Sumatera Indonesia. It follows the rules of *Minangkabau* (name of ethnic in Sumatera) culture embedded from Islamic principle. Its functions are to maintain the property of *Nagari* (customary village in West Sumatera language) and community as well as the culture and religious activities.
- 5) Initially the local institutions recommended building only 12 restaurants. After long discussion through customary village meeting (*Paruman Desa*), it was finally decided that 24 units would be built. The restaurants were equally distributed to six hamlets. Groups of minimal 30 people (called *Tempekan*) in each hamlet collectively became the shareholders of one restaurant. To run the business, the *Tempekan* elected manager and decided on the sharing system within their own group. Because every member of the community had the same right to own and to contribute in terms of capital sharing in the business, LPD supported those who had the willingness to participate but lack financial resources (Suadi and Nakagawa 2009).

- 6) Kedonganan Coral Triangle Day was the first event of Coral Triangle Day held in Kedonganan Customary Village, Bali. The aim is to raise awareness of the importance of marine conservation in the area with the highest marine biodiversity on earth. This first event were supported by World Wildlife Fund (WWF), Udayana University, the village's local organization, and some other institutions to hold a full-day celebration, including beach clean-ups, sustainable seafood dinners, educational exhibitions, a marine-themed bazaar and carnival, and beach parties. The kitchens of 24 seafood restaurants located along Kedonganan coast were invited to discuss and give tips on responsibly caught seafood. The restaurant managements were also called to build the awareness of how their suppliers caught the fish.
- (<http://www.thebalidaily.com/2012-06-11/coral-triangle-day-promotes-marine-conservation.html>)
- 7) Balinese customary law (*Awig-awig*) is regulation issued by native residents (*Krama Desa*) of customary village/hamlet (*Desa/Banjar Pakraman*) as the foundation to implement Balinese Hinduism philosophy (*Tri Hita Karana*). This is adjusted to the ordinances of each customary village/hamlet.
- 8) As written on The Decision of Main Council of Customary Villages in Bali (*Majelis Utama Desa Pakraman Bali*) No. 050/Kep/Psm-1/MDP Bali/III/2006, Bali resident is categorized into three groups based on religion and domicile: (1) *Krama Desa*, (2) *Krama Tamiu*, and (3) *Tamiu*. *Krama Desa* is native resident who embraces Hindu and is registered as member of a customary village. *Krama Tamiu* is non-native resident who embraces Hindu but is not registered as member of a customary village because has been registered in another one. *Tamiu* is non-native resident who does not embrace Hindu and is not member of customary village. Each resident group has different rights and obligations to customary village. For this study, native resident customer is customer classified as *Krama Desa* of Kedonganan customary village, and non-native resident customer is customer classified as *Krama Tamiu* and *Tamiu* of Kedonganan customary village.
- 9) *Paruman* or assembly is the highest deliberation institution in customary law of Bali. Based on Regional Regulation No. 3/2001, there are four main types and level of *Paruman*: (1) *Paruman Banjar/Desa*, (2) *Paruman Alit*, (3) *Paruman Madya*, and (4) *Paruman Agung*. *Paruman Banjar/Desa* (hamlet/village meeting) is the highest level of decision making in customary hamlet/village. *Paruman Alit* is a session including all customary village leaders at sub-district level (*Kecamatan*). *Paruman Madya* is a session at the district level (*Kabupaten/Kota*). While *Paruman Agung* is a session at the provincial level (Suadi and Nakagawa 2009)
- 10) Customary sanction (*sanksi adat*) is punishment for anyone who breaks the rules of customary law. Every customary village/hamlet has its own authority to determine the

type of punishment.

- 11) *Panca Yadnya* (five sacred rituals) *Panca Yadnya* consists of *Dewa Yadnya* (a sacred ritual devoted to the Gods); *Butha Yadnya* (a sacred ritual devoted to the elements of nature); *Manusia Yadnya* (a sacred ritual devoted to man); *Pita Yadnya* (a sacred ritual devoted to the deceased); and *Resi Yadnya* (a sacred ritual devoted to the sacred people). Since LPD Kedonganan established, *Panca Yadnya* has been held well and humbly. The high cost of these five sacred rituals is able to handle smoothly due to LPD Kedonganan assistance.
- 12) In surrounding Kedonganan customary village, there are seven cooperatives, one rural bank so-called BPD Bali (*Bank Pembangunan Daerah Bali*), one unit of state-owned commercial bank so-called BRI (*Bank Rakyat Indonesia*), and one commercial bank so-called BSH Bali (*Bank Sinar Harapan Bali*) which provide micro-credit services.
- 13) *Ngaben* is the most expensive ritual ceremony which costs more than Rp 6 million, but is very important as believed the deceased can only go to the next life after *Ngaben*.
- 14) BPD (*Bank Pembangunan Daerah*) is type of rural bank owned by provincial government. BPD in Bali is appointed by Bali governor to support the LPDs performance by: (1) being the only bank which save up the cash money in LPD and (2) being the evaluator of LPD's annual performance using CAEL rating as the tool. However, since the promulgation of Indonesian Microfinance Act in 2013, BPD in Bali only plays its role to maintain the LPD cash money.
- 15) *Galungan* is a Balinese holiday which occurs every 210 days and lasts for 10 days. *Kuningan* is the last day of the holiday. During this holiday the Balinese Gods visit the earth and leave on *Kuningan*.
- 16) Putnam (2000) in Warren (2010) explains that "Bonding social capital is exclusive in nature, and develops within inward-looking and exclusive groups of similar people such as a might be found in churches, reading groups, or ethnic fraternal organizations. Social relations that function as bridging social capital are outward looking and encompass people across diverse social cleavages. Such social capital can be found, for example, in civil rights movement, many youth services, and ecumenical religious organizations. These two kinds of social capital have differing qualities and benefits: bonding social capital creates strong in-group loyalty, is good for specific reciprocity, and can provide social and psychological resources for marginalized groups. Bridging social capital extends networks, and connects groups to resources they might not otherwise able to access. It enhances information flows, and can generate broader identities and reciprocity"
- 17) Granovetter (1973) states that "weak ties are more likely to link members of different small groups than are strong ones which tend to be concentrated within particular groups". In LPD, this type of ties is used for bonding non-native resident customers

who come from entire parts of Indonesia and bring heterogeneity in the community.

- 18) As written in *Pararem* LPD Bali article 12, LPD managers are appointed by customary village board (*Prajuru Desa*) until he is 60 years old. *Pararem* LPD Bali is issued by the Main Council of Customary Villages in Bali (*Majelis Utama Desa Pakraman Bali*) consisting of the representative of each customary village in Bali.

Appendix B. Financial Analyses

Table 7.1. Balance Sheets of LPD Kedonganan from 2010-2014 (in thousands rupiah)

Balance Sheet	2010	2011	2012	2013	2014
Cash	5,227	8,353	56,809	2,930	1,575
Inter-bank assets	1,552,224	1,984,360	2,497,719	2,543,184	2,121,429
Outstanding loans	8,061,279	9,032,433	10,558,154	11,993,623	13,583,480
(-) Allowance for doubtful account	240,712	284,122	331,364	378,266	306,115
Fixed assets and inventory	413,112	388,923	395,408	381,369	349,619
(-) Accumulated depreciation	113,560	145,878	172,307	188,309	181,828
Other assets	843,051	710,043	1,391,126	1,055,726	999,173
Total assets	10,520,621	11,694,113	14,395,545	15,410,257	16,567,332
Savings	3,966,046	5,020,077	5,976,564	6,444,405	7,426,838
Time deposits	4,334,603	4,421,431	6,009,657	6,255,509	6,045,919
Inter-bank liabilities	0	0	0	0	0
Loan received	232,040	215,920	0	0	179,151
Other liabilities	173,658	109,692	266,536	341,259	281,253
Equity (including profit of the year)	1,814,273	1,926,994	2,142,788	2,369,083	2,634,171
Total liabilities	10,520,621	11,694,113	14,395,545	15,410,257	16,567,332
Profit of the year	343,890	366,762	426,911	485,745	570,649

Note: Normalized the collected nominal based data with **GDP deflator** of 1990 based

Source: Tabulated using annual balance sheets of LPD Kedonganan from 2010-2014

Table 7.2. Income statements of LPD Kedonganan from 2010 to 2014 (in thousands rupiah)

Income Statement	2010	2011	2012	2013	2014
Revenue					
Interest income from other banks	103,976	96,283	103,051	158,444	125,976
Interest income from third parties (non-bank)	1,311,513	1,476,087	1,837,559	1,876,539	2,114,547
Other operating income	17,743	11,910	17,739	44,695	61,694
Total Revenue	1,433,232	1,584,281	1,958,349	2,079,678	2,302,218
Expenses					
Interest cost from other banks	0	0	0	0	0
Interest cost from third parties (non-bank)	604,100	638,860	775,579	889,213	922,181
Labour cost	214,935	234,308	296,186	296,871	349,599
Maintenance	67,100	63,111	86,806	78,210	85,046
Depreciation cost (fixed assets and inventory)	64,142	41,757	31,707	27,157	21,750
Cost of doubtful loan	64,971	60,457	82,549	67,574	71,661
Fare	3,032	2,739	2,728	3,155	2,542
Marketing and advertisement	41,203	80,278	96,495	107,099	114,126
Service and general expenses	28,492	77,742	11,768	12,475	12,572
other operating expenses	1,366	18,266	147,619	112,179	152,091
Total Expenses	1,089,342	1,217,518	1,531,437	1,593,933	1,731,568
Profit	343,890	366,762	426,911	485,745	570,649

Note: Normalized the collected nominal based data with **GDP deflator** of 1990 based

Source: Tabulated using annual income statements of LPD Kedonganan from 2010-2014

Table 7.3. Classified outstanding loans in LPD Kedonganan from 2010 to 2014

Classification	2010		2011		2012		2013		2014	
	Amount (Rp 1,000)	%	Amount (Rp 1,000)	%	Amount (Rp 1,000)	%	Amount (Rp 1,000)	%	Amount (Rp 1,000)	%
Standard	7,450,240	92.42	8,008,508	88.66	9,982,231	94.55	10,537,617	87.86	11,860,952	87.32
Substandard	150,232	1.86	472,670	5.23	345,560	3.27	545,134	4.55	475,658	3.50
Doubtful	321,852	3.99	341,408	3.78	164,491	1.56	837,832	6.99	900,730	6.63
Loss	138,955	1.72	209,847	2.32	65,873	0.62	73,040	0.61	346,139	2.55
Total	8,061,279	100	9,032,433	100	10,558,154	100	11,993,623	100	13,583,480	100

Note: Normalized the collected nominal based data with **GDP deflator** of 1990 based

Source: Annual activities reports of LPD Kedonganan from 2010 to 2014

Table 7.4. Capital of LPD Kedonganan from 2010 to 2011 (in thousands rupiah)

No.	Capital	Year				
		2010	2011	2012	2013	2014
1.	Main Capital					
	paid-in capital	8,707	8,102	7,809	7,458	7,076
	general reserve	1,461,676	1,552,129	1,708,068	1,875,880	2,056,446
	retained earnings (50%)	171,945	183,381	213,456	242,872	285,325
	Total Main Capital	1,642,328	1,743,612	1,929,332	2,126,211	2,348,846
2.	Additional Capital					
	allowance for doubtful account	240,712	284,122	331,364	378,266	306,115
	accumulated deprecation	113,560	145,878	172,307	188,309	181,828
	Total Additional Capital	354,271	430,000	503,671	566,574	487,943
	Total Capital	1,996,600	2,173,613	2,433,003	2,692,785	2,836,789

Note: Normalized the collected nominal based data with **GDP deflator** of 1990 based

Source: Tabulated using various annual balance sheets of LPD Kedonganan from 2010 to 2014

Table 7.5. Risk weight assets of LPD Kedonganan from 2009 to 2014 (in thousands rupiah)

Risk Weight Assets	Year				
	2010	2011	2012	2013	2014
Cash (0%)	0	0	0	0	0
Inter - bank assets (20%)	310,445	396,872	499,544	508,637	424,286
Outstanding loans (100%)	7,820,567	8,748,310	10,226,790	11,615,357	13,277,365
Fixed assets (100%)	299,552	243,046	223,101	193,060	167,790
Other assets (100%)	843,051	710,043	1,391,126	1,055,726	999,173
Total	9,273,614	10,098,271	12,340,561	13,372,780	14,868,614

Note: Normalized the collected nominal based data with **GDP deflator** of 1990 based

Source: Tabulated using various annual balance sheets of LPD Kedonganan from 2010 to 2014

Table 7.6. Net fixed assets and inventory of LPD Kedonganan from 2010 to 2014 (in thousands rupiah)

Items	Year				
	2010	2011	2012	2013	2014
Fixed assets and inventory	413,112	388,923	395,408	381,369	349,619
(-) Accumulated depreciation	113,560	145,878	172,307	188,309	181,828
Net fixed assets and inventory	299,552	243,046	223,101	193,060	167,790

Note: Normalized the collected nominal based data with **GDP deflator** of 1990 based

Source: Tabulated using various annual balance sheets of LPD Kedonganan from 2010 to 2014

Table 7.7. Productive Assets of LPD Kedonganan from 2010 to 2014 (in thousands rupiah)

No.	Productive Assets	Year				
		2010	2011	2012	2013	2014
1.	Outstanding loans					
	Standard	7,450,240	8,008,508	9,982,231	10,537,617	11,860,952
	Substandard	150,232	472,670	345,560	545,134	475,658
	Doubtful	321,852	341,408	164,491	837,832	900,730
	Loss	138,955	209,847	65,873	73,040	346,139
	Total	8,061,279	9,032,433	10,558,154	11,993,623	13,583,480
2.	Inter-bank assets	1,552,224	1,984,360	2,497,719	2,543,184	2,121,429
	Total Asset	9,613,503	11,016,794	13,055,873	14,536,807	15,704,909

Note: Normalized the collected nominal based data with **GDP deflator** of 1990 based

Source: Tabulated using various annual activities reports and annual balance sheets of LPD Kedonganan from 2010-2014

Table 7.8 Classified assets for assets quality ratio of LPD Kedonganan from 2010 to 2014
(in thousands rupiah)

Classified Assets for Assets Quality Ratio	Year				
	2010	2011	2012	2013	2014
Outstanding loans					
Substandard (50%)	75,116	236,335	172,780	272,567	237,829
Doubtful (75%)	241,389	256,056	123,368	628,374	675,548
Loss (100%)	138,955	209,847	65,873	73,040	346,139
Total	455,460	702,238	362,021	973,981	1,259,516

Note: Normalized the collected nominal based data with **GDP deflator** of 1990 based

Source: Tabulated using various annual activities reports of LPD Kedonganan from 2010-2014

Table 7.9. Allowance for doubtful account of LPD Kedonganan from 2010 to 2014 (in thousands rupiah)

Items	Year				
	2010	2011	2012	2013	2014
Allowance for doubtful account	240,712	284,122	331,364	378,266	306,115

Note: Normalized the collected nominal based data with **GDP deflator** of 1990 based

Source: Tabulated using various annual balance sheets of LPD Kedonganan from 2010 to 2014

Table 7.10. Allowance for doubtful account should be provided of LPD Kedonganan from 2010 to 2014 (in thousands rupiah)

Items	Year				
	2010	2011	2012	2013	2014
Outstanding loans					
Standard (0.5%)	37,251	40,043	49,911	52,688	59,305
Substandard (10%)	15,023	47,267	34,556	54,513	47,566
Doubtful (50%)	160,926	170,704	82,245	418,916	450,365
Loss (100%)	138,955	209,847	65,873	73,040	346,139
Total	352,155	467,861	232,585	599,158	903,375

Note: Normalized the collected nominal based data with **GDP deflator** of 1990 based

Source: Tabulated using various annual activities reports of LPD Kedonganan from 2010-2014

Table 7.11. Non-performing loan (NPL) ratio measurement items of LPD Kedonganan from 2010 to 2014 (in thousands rupiah)

Items	Year				
	2010	2011	2012	2013	2014
Non-performing Loan	611,039	1,023,925	575,923	1,456,006	1,722,528
Allowance for doubtful account	240,712	284,122	331,364	378,266	306,115
Outstanding loans	8,061,279	9,032,433	10,558,154	11,993,623	13,583,480

Note: Normalized the collected nominal based data with **GDP deflator** of 1990 based

Source: Tabulated using various annual balance sheets of LPD Kedonganan from 2010 to 2014

Table 7.12. Net profit margin (NPM) ratio measurement items of LPD Kedonganan from 2010 to 2014 (in thousands rupiah)

Items	Year				
	2010	2011	2012	2013	2014
Income of the year	343,890	366,762	426,911	485,745	570,649
Revenue	1,433,232	1,584,281	1,958,349	2,079,678	2,302,218

Note: Normalized the collected nominal based data with **GDP deflator** of 1990 based

Source: Tabulated using various annual income statements of LPD Kedonganan from 2010 to 2014

Table 7.13. Return on assets (ROA) ratio measurement items of LPD Kedonganan from 2010 to 2014 (in thousand rupiah)

Items	Year				
	2010	2011	2012	2013	2014
Income for the year	343,890	366,762	426,911	485,745	570,649
Total asset	10,520,621	11,694,113	14,395,545	15,410,257	16,567,332
Average total asset	9,934,904	10,741,919	12,833,279	14,579,205	15,594,595

Note: Normalized the collected nominal based data with **GDP deflator** of 1990 based

Source: Tabulated using various annual balance sheets and annual income statements of LPD Kedonganan from 2010 to 2014

Table 7.14. Return on equity (ROE) measurement items of LPD Kedonganan from 2010 to 2014 (in thousands rupiah)

Items	Year				
	2010	2011	2012	2013	2014
Income for the year	343,890	366,762	426,911	485,745	570,649
Equity (including profits)	1,814,273	1,926,994	2,142,788	2,369,083	2,634,171

Note: Normalized the collected nominal based data with **GDP deflator** of 1990 based

Source: Tabulated using various annual balance sheets and annual income statements of LPD Kedonganan from 2010 to 2014

Table 7.15. Total expenses and total revenue of LPD Kedonganan from 2010 to 2014 (in thousands rupiah)

Items	Year				
	2010	2011	2012	2013	2014
Expenses	1,089,342	1,217,518	1,531,437	1,593,933	1,731,568
Revenue	1,433,232	1,584,281	1,958,349	2,079,678	2,302,218

Note: Normalized the collected nominal based data with **GDP deflator** of 1990 based

Source: Tabulated using various annual income statements of LPD Kedonganan from 2010 to 2014

Table 7.16. Net interest margin (NIM) measurement items of LPD Kedonganan from 2010 to 2014 (in thousands rupiah)

No.	Items	Year				
		2010	2011	2012	2013	2014
1.	Interest Revenue					
	Interest income from other banks	103,976	96,283	103,051	158,444	125,976
	Interest income from third parties (non-bank)	1,311,513	1,476,087	1,837,559	1,876,539	2,114,547
	Total interest revenue	1,415,488	1,572,370	1,940,610	2,034,982	2,240,523
2.	Average of Productive Assets					
	Productive Assets	9,613,503	11,016,794	13,055,873	14,536,807	15,704,909
	Average	8,959,005	9,981,211	11,837,036	13,502,768	14,749,002

Note: Normalized the collected nominal based data with **GDP deflator** of 1990 based

Source: Tabulated using various annual balance sheets and annual income statements of LPD Kedonganan from 2010 to 2014

Table 7.17. Quick ratio measurement items of LPD Kedonganan from 2010 to 2014 (in thousand rupiah)

No.	Items	Year				
		2010	2011	2012	2013	2014
1.	Liquidity components					
	Cash	5,227	8,353	56,809	2,930	1,575
	Inter-bank assets	1,552,224	1,984,360	2,497,719	2,543,184	2,121,429
	Total	1,557,451	1,992,714	2,554,528	2,546,114	2,123,004
2.	Current liabilities					
	Savings	3,966,046	5,020,077	5,976,564	6,444,405	7,426,838
	Time deposits	4,334,603	4,421,431	6,009,657	6,255,509	6,045,919
	Loan received	232,040	215,920	0	0	179,151
	Other liabilities	173,658	109,692	266,536	341,259	281,253
	Total	8,706,348	9,767,119	12,252,757	13,041,174	13,933,161

Note: Normalized the collected nominal based data with **GDP deflator** of 1990 based

Source: Tabulated using various annual balance sheets of LPD Kedonganan from 2010 to 2014

Table 7.18. Current ratio measurement items of LPD Kedonganan from 2010 to 2014 (in thousand rupiah)

Items	Year				
	2010	2011	2012	2013	2014
Total productive assets	9,613,503	11,016,794	13,055,873	14,536,807	15,704,909
Total current liabilities	8,706,348	9,767,119	12,252,757	13,041,174	13,933,161

Note: Normalized the collected nominal based data with **GDP deflator** of 1990 based

Source: Tabulated using various annual activities reports and annual balance sheets of LPD Kedonganan from 2010-2014

Table 7.19. Funds received by LPD Kedonganan from 2010 to 2014 (in thousand rupiah)

Items	Year				
	2010	2011	2012	2013	2014
Savings	3,966,046	5,020,077	5,976,564	6,444,405	7,426,838
Time deposit	4,334,603	4,421,431	6,009,657	6,255,509	6,045,919
Loan received	232,040	215,920	0	0	179,151
Other liabilities	173,658	109,692	266,536	341,259	281,253
Main capital	8,706,348	9,767,119	12,252,757	13,041,174	13,933,161
Total	1,642,328	1,743,612	1,929,332	2,126,211	2,348,846

Note: Normalized the collected nominal based data with **GDP deflator** of 1990 based

Source: Tabulated using various balance sheets of LPD Kedonganan from 2010 to 2014

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