

Redefine Micro, Small, and Medium Enterprises Classification and the Potency of Baitul Maal wa Tamwiel as Intermediary Institutions in Indonesia¹

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ABSTRACT

The micro, small, and medium enterprises (MSMEs) in Indonesia are considered as the most sustainable and crisis proof business entities. They are ranged from street seller and home industry to small factory with total asset up to Rp5 billion. The current classification of MSMEs seemed too broad so that the real micro businesses of the poor and low income society are not well catered by the government. Therefore, MSMEs classification should be redefined to be able to reach the poor and low income society, to assist and guide them to move their businesses up until graduated and self reliant. The proposed super micro enterprises are those personal businesses with asset less than Rp10 million and credit limit of less than Rp5 million. Meanwhile, micro enterprises are businesses with asset Rp10 – Rp100 million and credit limit Rp5 – Rp50 million. Moreover, small and medium enterprises are similar to those old classifications. When a company has grew bigger than medium scale, it considered to have graduated from needed assistance. This new proposed classification is intended to assist each business level to step the ladder up until graduated. Meanwhile, the most proper Islamic financial institutions to provide Islamic financial services to MSMEs, especially super micro and micro enterprises are Baitul Maal wa Tamwiel (BMT) that have natural characteristics to interact with them in their own habitat, since BMTs are spread out in the rural and suburban areas throughout Indonesia. With this, it is expected that unemployment be reduced and welfare of the poor and low income society can be improved.

JEL Classification: G23, G28

Keywords: Micro Business, Baitul Maal wa Tamwiel, Micro Finance

1. Introduction

1.1 Background

There are plenty researches and papers that have been conducted and discussed with regard to the positive relationship between micro, small and medium enterprises (MSMEs) and economic growth, its role in poverty alleviation as well as reducing unemployment

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rate. Compared to the large scale of business or enterprise, MSMEs is proven to be endured and resistant to the economic crisis shock.

The role of MSMEs, especially after monetary crisis, considered as a safety valve in the process of national economic recovery both in enhancing economic growth and reducing unemployment rate. In the research held by Central Bank of Indonesia in 2001 titled “Credit Crunch in Indonesia After Crisis: The Fact, Causal Factor and Policy Implication” published by Department of Economy and Monetary Policy Bank Indonesia in 2001, there exist acknowledgment from our industrial Banking that credit distributed to SMEs⁴ had minimum risk and – compare to large enterprises – SMEs has sound and better business performance.

Several data show the significance of MSMEs’ contribution towards Growth Domestic Product for about 56.5% in 2005. It is more than that of the contribution of large enterprises towards GDP. MSMEs sectors could absorb for about 79 million labors (99.4% labor force) and provide 43.8% of commodity needs and national services. During 2000 – 2004, the value creation of MSMEs sectors increased significantly while on the contrary large enterprises decreased.

Further, the contribution of MSMEs to the national income through export activities reaches Rp75.80 trillion or 19.90 % from the total national export. With its specialties – especially with its low financial capital –, MSMEs could produce in the short-term process. Having simple management and huge unit volume scattered in the whole nation, brought about MSMEs to have better resistant toward the fluctuation of business cycle.

Tambunan (2004) stated seven years after economic crisis, the most valuable lessons that should be taken into account are: (1) Indonesian economy cannot depend mostly on large enterprises, (2) SMEs has more resistant compare to the large one and (3) there is no clear industrial policy that enhances economic growth and creates vocation for poor and unemployed people.

Despite historical success of MSMEs, there exist interesting issues that need to be further discussed whereby the role of MSMEs towards the economic development considered as generalization (*sweeping statement*). In fact, MSMEs in Indonesia consists of three different groups; Micro Enterprise, Small Enterprise and Medium Enterprise. It is in the context of MSMEs’ role that need to be analyze critically pertaining to the composition as well as contribution of each three different groups to the poverty alleviation and economic growth; which group that has more opportunity to have credit or financing so far; is it true that credit composition or formula accommodate the needs of poor or low-income society.

Certainly, the question addressed above has its reasonable background; limit credit formula ranging < Rp.50 million for the micro-enterprise should be reviewed carefully as so many poor or low-income society only need credit for about Rp300.000 - Rp1 million. Compare to Grameen Bank established by Dr Muhammad Yunus, they do give credit for micro-enterprises not more than US\$200 (Rp1.82 million with exchange rate Rp9,100 = US\$1). It is base on this issue; this paper is trying to analyze and discover the real problem of MSMEs from the credit limit aspect and trying to reformulate the MSMEs’s credit limit being applied so far.

1.2 Problem Statement

⁴ Micro enterprises sometimes are grouped together with Small enterprises, so that MSMEs sometime is termed as MSEs.

Looking through the preposition above, it is clearly stated that MSMEs has a great role to the economic development and it resistant to the economic crisis shock. Since MSMEs consists of three groups with different nature (micro, small and medium), it is therefore needs further critical analysis with regard to the role and chance of each three groups – especially micro-enterprise – to the enhancement of poor or low-income society. Research questions that being addressed in this paper are:

1. What is the rationale of the classification and credit limit that being applied to MSMEs.
2. Which of the three different groups that has a better chance to have credit financing.
3. Does the classification being applied to the MSMEs have served the purpose to reach the real Indonesia poor or low-income society?

1.3 Research Objectives

The objectives of this study can be summarized as follows:

1. To explain the profile of MSMEs in Indonesia with respect to the current classification and credit limit.
2. To identify problems of classification and credit limit formula of MSMEs in Indonesia.
3. To propose new classification and formula of credit limit so as to better serve the purpose to reach the need of Indonesia poor or low-income society.

1.4 Data and Methodology

This study will employ secondary data obtained from several publications of Bank Indonesia, Center of Statistics Bureau, Ministry of Cooperation and MSMEs, Peramu Bogor and other related resources. While analysis tools employed in this research is descriptive statistics to analyze and describe existing phenomena findings from secondary data analysis. Other descriptive study will be done through literature studies from textbooks, journals, papers, and other publications.

2. The Profile of Micro, Small, and Medium Enterprises in Indonesia

This part will discuss the theory of micro, small and medium enterprises (MSMEs) from financing or credit point of view and describe profile and problem of MSMEs in Indonesia in general. What is the credit limit formula that being put forward by government? Is the credit being distributed has reached Indonesian poor or low-income society? Is it true that those MSMEs having such strategic position in the process national economy recovery?

Generally, financial institution that involve in providing micro-credit so called by microfinance institution. According to *Asian Development Bank (ADB)*, *microfinance* is an institution that provides deposits services, loans, payment services and money transfers that *insurance to poor and low-income households and their micro enterprises*. The form of microfinance institution could be as: (1) formal institution such as village bank or

cooperation, (2) quasi-formal institution such as NGO, and (3) other informal institution such as money release. According to *Micro credit Summit* definition (1997), micro-credit is “*programs extend small loans to very poor for self-employment projects that generate income, allowing them to care for themselves and their families*” (Kompas Marc15th, 2005).

Micro, Small, and Medium Enterprises (MSMEs) in Indonesia have been long believed to be the main pillar of Indonesian Economy. This fact is supported by the huge number of enterprises across almost all economic sectors, the labor intensive production modes, and the significant contribution to the gross domestic products (GDP).

To improve the role of MSMEs in accelerating economic growth, the profile of MSMEs in the main economic sectors should be identified to provide detailed picture of characteristics, potentials, and problems faced by MSMEs, including managerial, legal, financial, production, human resource, marketing, and business expansion aspects. This profile is very important to identify problems, to formulate policy recommendations, to set MSMEs development priorities. The results of MSMEs survey conducted by Bank Indonesia in 2005 will be presented in this chapter.

2.1 Respondents Profile

There are three groups of respondents, namely 1) MSMEs, totaling 11,000 units from 4 economic sectors (agriculture, trade, industry, and services), conventional and Islamic banks customers (33.4%) and non customers (66.6%), in 11 provinces; 2) Banks, totaling 140 Conventional and Islamic banks, main and branch offices, including rural banks; and 3) Government and Association, totaling 137 institutions.

Based on yearly revenue, the MSMEs respondents comprise of 32.7% micro, 49.4% small, and 17.9% medium enterprises, which come from agriculture (12.2%), trade (34.4%), industry (24.6%), and services (23.4%). Most of MSMEs (83.5%) are informal (personal) businesses that do not have formal legal form. Moreover, most of the entrepreneurs are men (81.2%) with the education level of high school (44.1%), undergraduate (17.9%), and 3-year diploma (7.4%).

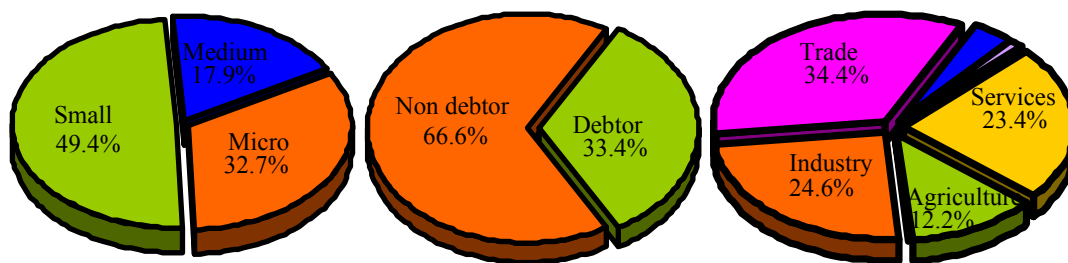


Figure 2.1 Respondents Profile

Respondent profiles across regional area do not show any significant differences. However, there are some regions that show strength in certain aspect. Most MSMEs involve in trade sector, while hotel and restaurant are prevalent (51.7%) in North Sulawesi. Moreover, MSMEs in industry sector are prevalent (41.5%) in West Java and agriculture sector is not dominant in any region.

2.2 Results

The results of the survey will be presented, which include managerial aspect, legal aspect, financial, financing and capital aspects, production aspect, marketing aspect, human resource aspect, and business development aspect.

2.2.1 Managerial Aspect

Most of MSMEs operators have been involved in the similar field before. The main motivation of respondents to enter into MSMEs is to become self sufficient entrepreneurs (79.6%), while the main reason they choose their current business is that because they already have the skills and experiences (49.2%). This satisfying fact shows that generally they have entrepreneurship minds. Their businesses mostly provide main incomes for their families.

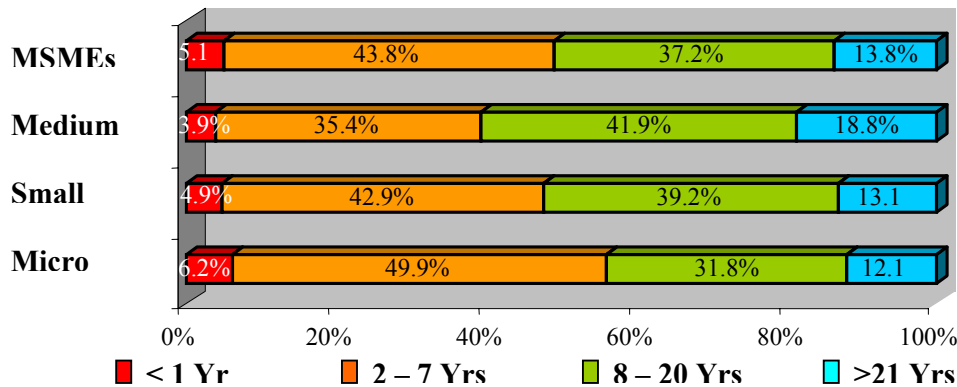


Figure 2.2 Length of Business

Viewed from the length of business they hold, unlike the majority perception, MSMEs entrepreneurs are not 'hit and run' entrepreneurs that can easily shift from one business to another. The survey shows that most MSMEs (51%) have run the business for more than 7 years, while 13.8% of them have run the business for more than 21 years. This fact shows that MSMEs are sustainable businesses in the long run.

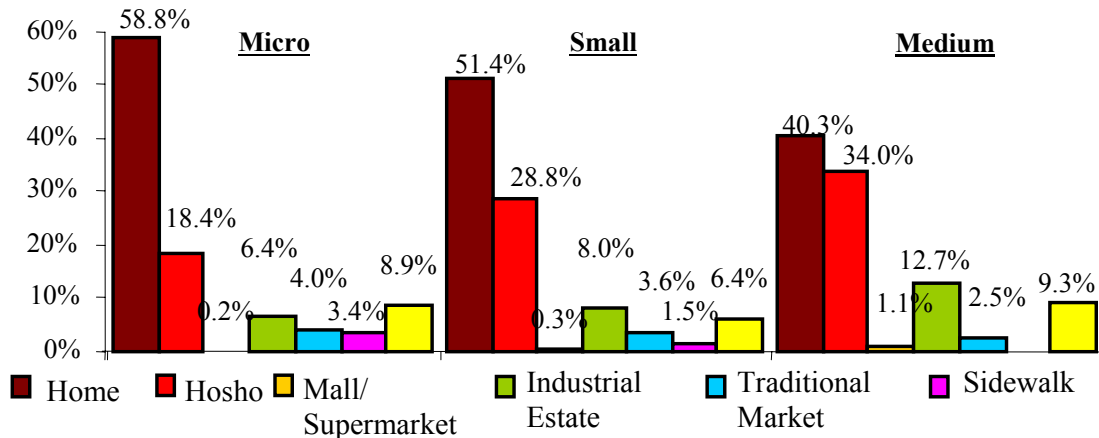


Figure 2.3 Place of Business

Most MSMEs are personally owned and managed by them selves. Most MSMEs choose home as their place of business, followed by home-shop and industrial estate. Only small part of them chooses traditional market or mall and supermarket as their place of business. Moreover, most of them do not have formal organization structure.

Micro and small enterprises established after the financial crisis (2-7 years old) mostly are situated in East Kalimantan (71.4% and 58.6%, respectively). Meanwhile, micro and small enterprises older than 7 years mostly are in Bali (52.1% and 60.3%, respectively). Moreover, most medium enterprises older than 7 years are in West Java (74.8%).

2.2.2 Legal Aspect

Most MSMEs are not in the form of formal legal institutions, especially micro enterprises (98.6%). MSMEs in transportation and communication sectors usually already have legal form. In term of business permits, the larger the business the more formal the structure of MSMEs. Therefore, there is only small number of micro enterprises (around 20%) that holds business permit (TDI/TDP and SIUP) and NPWP, while most medium enterprises (more than 80%) holds necessary business permits. Moreover, around 50% of small enterprises hold business permits. MSMEs that hold business permit, most of them do not need an agency to process their permits that take less than one month (for TDI/TDP and SIUP) and less than two weeks (for NPWP). The costs, procedures, and administration requirements are not constrained them to get these business permits. The main reasons for MSMEs to obtain these various business permits are to fulfill government regulations and to fulfill loan application. Almost 50% of micro enterprises view that business permits are constrained them, while more than 50% of micro enterprises view financial statements are still constrained them.

The fact that only small numbers of micro and small enterprises that already hold some kind of business permits show that the government needs to give incentives for those MSMEs that already hold the permit so that they recognize the benefits of holding business permits. Moreover, it is necessary for the government to relax the requirements, to simplify the process, and to abolish informal/hidden costs in the process of obtaining business permits.

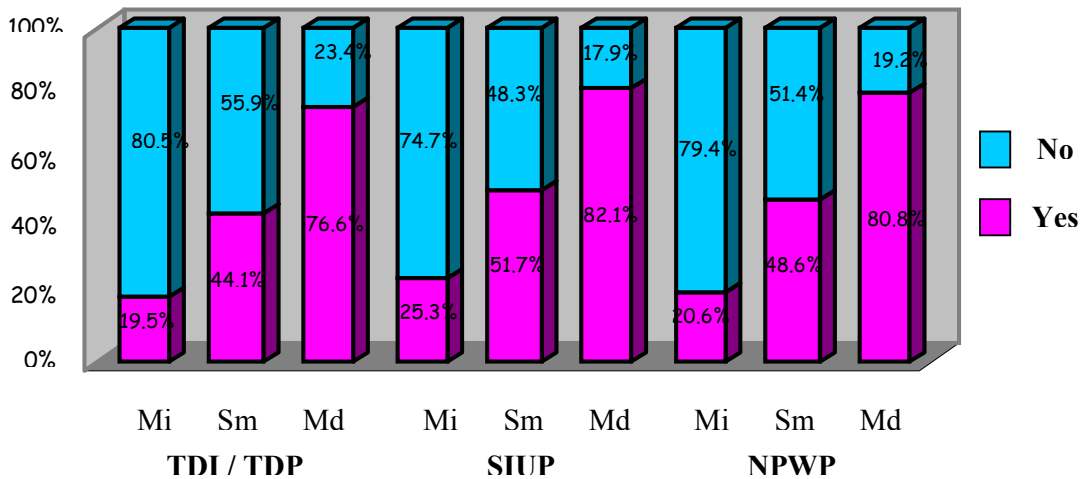


Figure 2.4 Business Permits Ownerships

Most MSMEs do not have legal form, yet. But, most MSMEs in the form of limited company are resided in Jabodetabek (7.7%) and most MSMEs in the form of public company are located in East Kalimantan (2.5%). Moreover, MSMEs that already have business permits are located in Bali.

2.2.3 Financial Aspect

Most micro enterprises own assets (excluding land and building) of less than Rp100 million (US\$11,000) with the mean of Rp50 million (US\$5,500), while most of small enterprises own assets (excluding land and building) of less than Rp200 million (US\$22,000) with the mean of Rp189 million (US\$20,770). Moreover, most medium enterprises own assets (excluding land and building) between Rp1 billion (US\$111,000) and Rp5 billion (US\$555,000), with the mean of Rp3 billion (US\$333,000). From banking standpoint, the asset of each scale of enterprise should be higher. For example, micro enterprises assets should range from Rp119 million (US\$13,000) to Rp369 million (US\$40,550). Therefore, there is a business scale gap between the reality and the expected by the banking sector, so that the banking sector should lower their expectation to reduce the gap with the real financial condition of MSMEs. Working capital mean of micro enterprises is Rp85 million, small enterprises is Rp514 million, and medium enterprises is Rp2 billion, which come from own capital 71% and 66.9% and family and friend 29% and 33.1%, for micro and small enterprises, respectively.

Table 2.1 MSMEs Financial Profile (Rp million)

	ASSET*	WORKING CAPITAL	YEARLY REVENUE	CREDIT LIMIT**	LABOR
Micro	50	85	< 50	<50	3.6
Small	189	514	101-250	50 – 500	16.6
Medium	3,000	2,000	1,000-5,000	500 – 5,000	38.2

US\$1 = Rp9,100; * Asset excluding land and building; ** Bank Indonesia Regulation

Micro enterprises with the largest average asset is located in Bali (Rp152 million) and the smallest is located in Java (Rp18.2 million). Similarly, small enterprises with the largest average asset is also located in Bali (Rp292.8 million) and the smallest is located in North Sumatera (Rp92.7 million). Moreover, the largest average asset of medium enterprises is located in East Kalimantan (Rp7.12 billion) and the smallest is located in North Sumatera (Rp1.32 billion).

The yearly revenues of most micro enterprises are less or equal to Rp50 million, small enterprises are between Rp101 million to Rp250 million, and medium enterprises are between Rp1 billion to Rp5 billion. Even though the revenues of micro and small enterprises are relatively small, they enjoy greater profit margins between 10% and 50%, while the profit margins of medium enterprises are less than 10%. These facts are inline with the mythos that micro and small businesses can get high profit margins. With high profit margins MSMEs should not have any difficulty to pay loans at market interest rate, so that they do not really need financial support in terms of interest rate subsidy. While from banking perspective, even though MSMEs earn high profit margins, they lack financial management, so that it is necessary for bank and MSMEs mentor to assist MSMEs in managing their financial in order to maintain the sustainability of their profits.

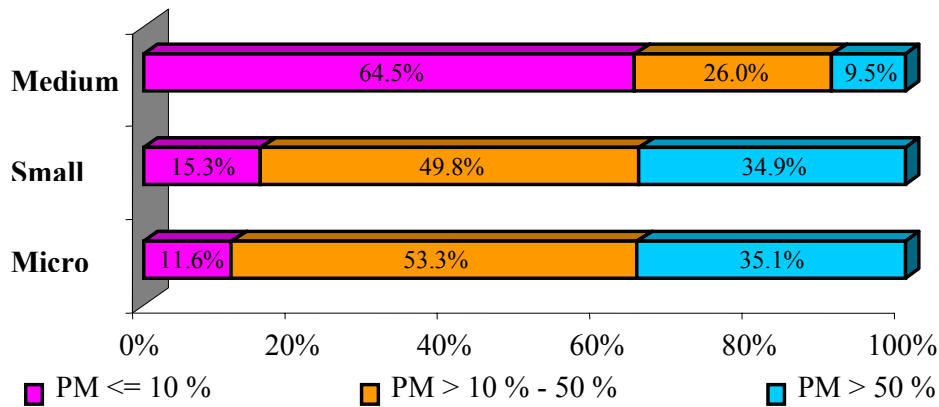


Figure 2.5 Profit Margins of MSMEs

The most micro enterprises with average revenue less than Rp50 million is located in West Sumatera (94.4%), small enterprises with average revenues between Rp101 million and Rp250 million is located in Bali (35.1%), and medium enterprises with average revenue between Rp1 billion and Rp5 billion is located in West Sumatera (83.1%). Moreover, the most micro enterprises with profit margins between 10% and 50% is located in Riau (84.6%), and those with profit margins over 50% is located in South Sulawesi (61.5%). Meanwhile, the most small enterprises with profit margin between 10% and 50% is located in East Kalimantan (73.3%), and those with profit margins over 50% is located in West Sumatera (55.2%). Whereas, most medium enterprises only earn profit margin of less than 10%, and most of them is located in West Java (58.3%).

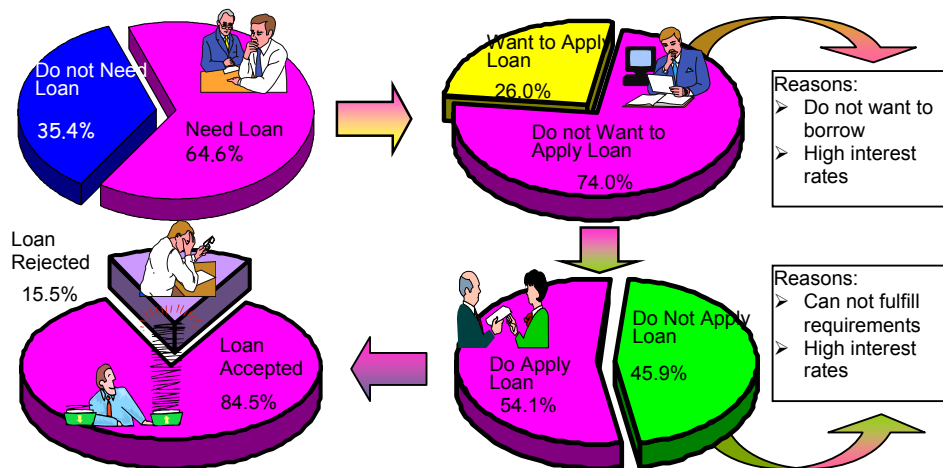


Figure 2.6 Financing Need, Application, and Realization

Almost all micro and small enterprises, and all medium enterprises utilize banking products and services, especially deposits, loans, and ATM. The main reason to choose bank is the safety. Although most MSMEs state that they need financing, but not all of them try to apply, due to inability to provide collateral (micro) and high interest rates (small and medium). While from banking perspective, the main problem of MSMEs in loan application is the feasibility of the business in terms of financial, marketing, as well as human resource. Of those MSMEs already submit their loan applications, most of them are accepted (84.5%). Moreover, most micro and small enterprises believe that banking does not extend enough financing to them, while medium enterprises believe that banking does extend enough financing to fulfill their financial needs.

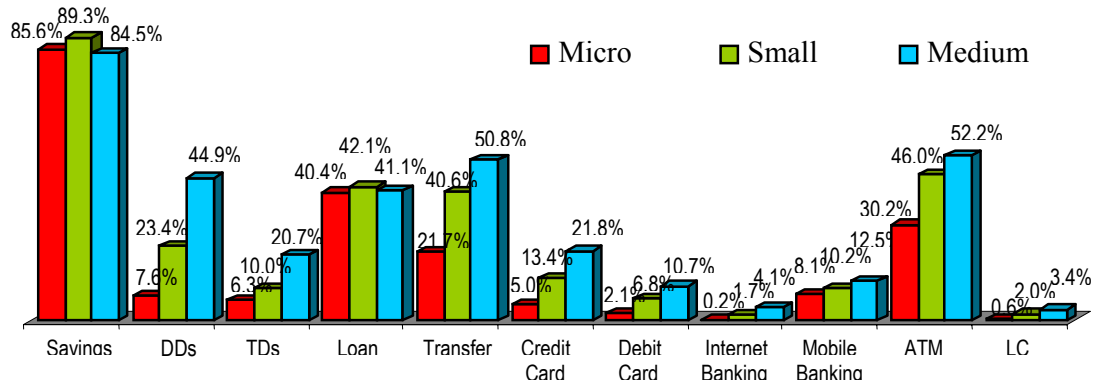


Figure 2.7 Utilization of Banking Products and Services

The main source of MSMEs capital is their own capital, and additional capital (if bank loan is not enough) comes from families and friends, so that it is clear that capital needs of MSMEs are mostly depend on sources other than bank. Therefore, there is an opportunity and challenge for banking to provide loan to fulfill capital demand of MSMEs.

Most MSMEs operated with own capital is located in West Java, while most MSMEs utilizing bank loan is located in Bali. Similarly, most MSMEs utilizing bank's products and services is located in Bali. Moreover, most MSMEs submit credit application and has enjoyed bank loan is located in North Sulawesi.

2.2.4 Production Aspect

The raw material supplier of micro and small enterprises mostly comes from other MSMEs in the same municipality area, while for medium enterprises mostly comes from other MSMEs in the same province area. Most MSMEs consider raw material supply is not a problem, but the cost of raw material dominates the production cost. The high cost of raw material is believed because of long distribution channels, informal retributions, and the increase of oil price.

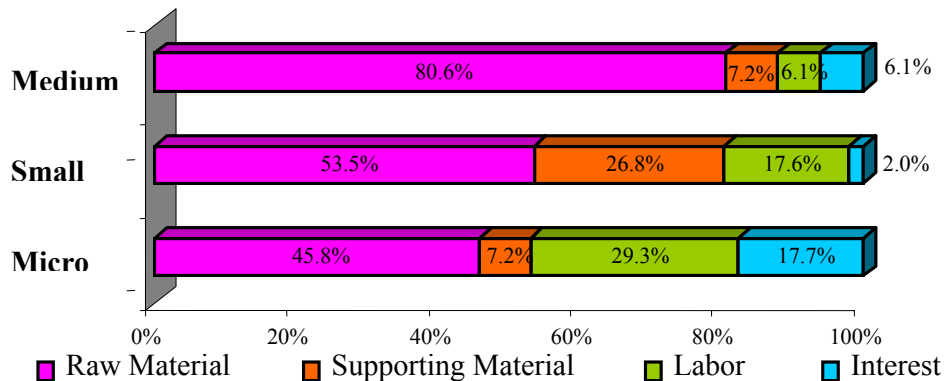


Figure 2.8 Production Costs Structure

The survey shows that the majority of micro businesses apply manual production process (59.5%), while small (58.6%) and medium (69.2%) enterprises apply semi-automatic production process. Quality control of production has been applied by most MSMEs, manually, while production capacity utilization has reached 80%, and increasing, so that most MSMEs increase their production capacity.

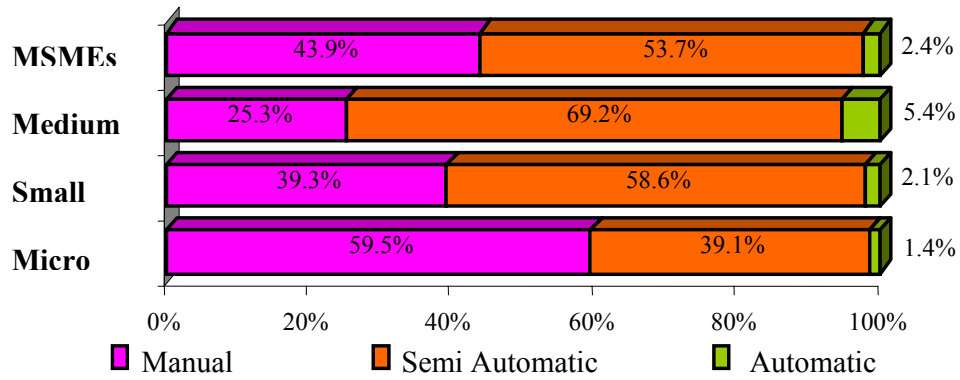


Figure 2.9 Mode of Production

2.2.5 Labor Aspect

The survey shows that average number of labor in micro business is 3.6 persons, small business is 16.6 persons, and medium business is 38.2 persons. The most labor intensive sectors are industry and trade. Education level of labor is mostly high school (39.4%), junior high school (24.4%), and elementary school (21.6%). Only 9.5% of them hold diploma or higher education. Most MSMEs labor (72.1%) are in their productive age (15-45 years), while the rest are older than 45 years.

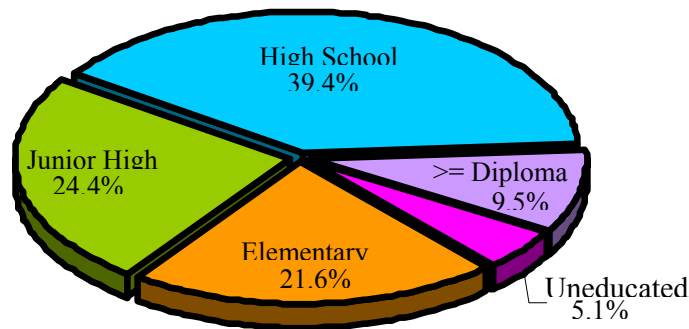


Figure 2.10 Labor Education

Both, the owner and the labor of MSMEs have not received any kind of training, yet. Consequently, most MSMEs labor only possesses low skill level. The survey indicates that both MSMEs and bank consider skills and experience as the main problem of MSMEs labor. The improvement of labor skills is our responsibilities, especially related government institutions that should improve the quantity and quality of training, including the revival of the dormant workshop centers (balai latihan kerja).

Most entrepreneurs that have received training are located in West Sumatera, while most labor forces that have received training are located in Bali. The most frequent training is skill/technology training related to business area.

2.2.6 Marketing Aspect

Most MSMEs conduct direct marketing to their customers through retail/individual sales and through distributor. The main marketing destination area of MSMEs is mostly local market, within the same township, municipality, or city. Only small part of their market is oriented toward export. The main export market of MSMEs is Asean and East Asia

(Japan, China, and South Korea). The dominant marketing strategy is service improvement, product quality improvement, and price discount. Market competition of MSMEs is relatively high, especially in trade sector. However, their sales are generally sound, with only minor problem due to price competition and market information.

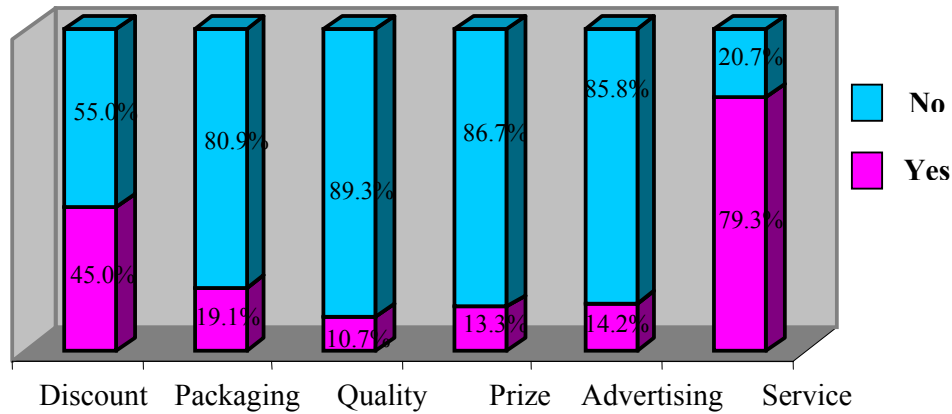


Figure 2.11 Marketing Strategy

There is only small portion of MSMEs (22.4%) stated that they really need marketing assistance, in terms of market access to routine/fixed corporations, marketing coordination by the government, and market information. Moreover, there is only small portion of MSMEs that join business associations (16.8%) and cooperation (11.2%).

Survey shows that only 6.9% of micro and small enterprises which are subsidiaries of business groups. Moreover, there are only 34.9% of MSMEs that have partnership relation with other business, especially as supplier (42.8%).

2.2.7 Business Development Aspect

In relation to government policy of MSMEs development, there is only 14.1% of MSMEs that have received support / facility from the government, especially in terms of credit facility, management training and workshop. Most MSMEs expect credit facility. This fact shows stigma of government support that is always associated with credit facility, so that government supports should also give attention to other aspects of MSMEs that need improvements, since MSMEs are highly profitable and prospective businesses.

MSMEs view that future business prospect is promising, especially in individual/household services, trade, hotel and restaurant, and agriculture sectors. The majority of MSMEs will continue and expand their businesses in the next year by capital increase, market expansion, and production capacity improvement. In the next 3-5 years, medium enterprises plan to invest in land, transportation means, and machinery. This investment plans show that medium enterprises are optimistic about their sustainability and business expansion.

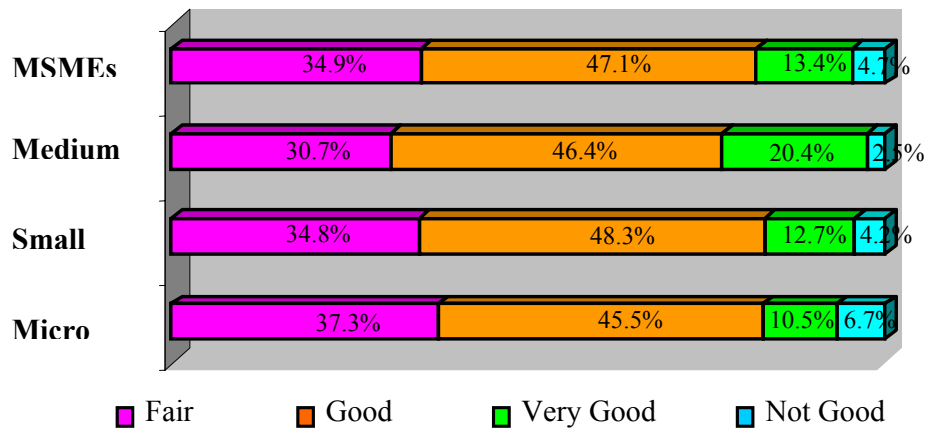


Figure 2.12 Future Business Prospects

Moreover, most MSMEs put capital increase as their priority for the next year business development planning, followed by market expansion and space expansion. Skill improvement and productivity improvement are their subsequent priorities for their development plan.

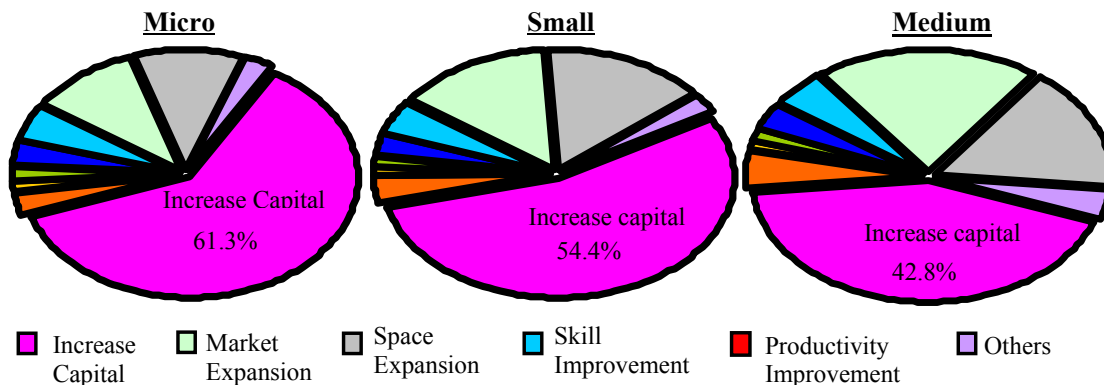


Figure 2.13 Future Business Plan

2.3 MSMEs from the Perspective of Bank

The survey also explores information and perception of banking sector about loan extension to MSMEs. Banks propose that the criteria of MSMEs in getting loan should be based on business scale measured by asset, yearly revenue, and number of labor, as well as credit limit.

Table 2.2 MSMEs Business Scale Proposed by Banks (Rp million)

	ASSET	REVENUE	LABOR
Micro	119 – 369	44.6 - 346.3	1 – 8
Small	1,500 - 2,100	543 - 3,300	8 – 35
Medium	4,000 - 31,500	3,000 - 27,000	35 – 138

US\$1 = Rp9,100

To increase the share of loan to MSMEs, internally banks provide special training to their employees/ loan officers, relax requirements and simplify procedure, and expand office

network. While externally banks engage in partnership with rural banks through linkage program for micro and small enterprises, and cooperate with credit underwriter institutions for medium enterprises.

Most banks believe that MSMEs are potential market for their loan, since MSMEs are considered as highly profitable business. Almost all banks perceive that the key success factor in extending loan to MSMEs is in feasibility study analysis, collection strategy, and embedded control.

In calculating interest rate for MSMEs loan, banks usually determine that the higher the credit limit, the lower the risk premium, and the lower the margin. So that, interest rate for micro credit generally is higher than interest rate for small and medium credit. It is believed that micro credit risk is higher than small or medium credit risk, so that there should be an innovation to lower risk premium to lower interest rate. Some of these innovations are credit underwriting and linkage program between commercial bank and rural bank.

In order to improve collection rate of MSMEs loan, all commercial and rural banks agree on the improvement of credit supervision/monitoring. Whereas, the assistance needed by bank to improve loan extension to MSMEs is on customer information and potential economic sectors.

MSMEs, banks, and government institutions agree that skilled labor is the most important variable that performs poorly. Moreover, MSMEs and banks also believe that obtaining business permits is the second most important variable to be improved. These two variables should be given priority attention by the regulators to develop and improve MSMEs optimally.

In this context, financial institution has a function as intermediary institution in economic activities. If this function is well managed, this financial institution will generate positive effects and value added for the entire of national economic life. Economic activity in this context does not differentiate either small or large enterprises. What matter is how these enterprises distinguished in term of how large are their value added. It means that small enterprises have a change to provide value added more compare to the large one. Therefore, one possible way to enhance and develop people income is through productive activities by means of utilizing intermediary services provided by financial institutions including productive enterprises made by poor or low-income society.

**Table 2.3 The Contribution of Small, Medium, and Large Enterprises to GDP
In 2001 - 2004 (percentage)**

No	Economic Sector	Average 2001-2004			
		Small	Medium	Large	Total
1	Agriculture	85.89	9.05	5.06	100
2	Mining & Excavation	7.42	3.09	89.49	100
3	Manufacture Industry	14.95	12.8	72.25	100
4	Electricity, Gas & Water	0.54	7.34	92.12	100
5	Construction	43.57	22.61	33.82	100
6	Trading, Hotel & Restaurant	75.19	21.06	3.75	100
7	Transportation & Communication	35.35	26.4	38.25	100

8	Finance, Rental & Service	16.17	46.32	37.51	100
9	Services	35.78	7.22	57	100
	GDP	40.65	15.39	43.96	100
	GDP Non-Petroleum & Gas	46.00	17.27	36.73	100

Source: The Development of SMEs Macro Indicator 2005, Statistics News March 2005, Dept of Statistics Centre with Ministry of Cooperation and SMEs. Micro enterprises are included under Small enterprises category.

According to the data released by Department of Statistics Center (2005), SMEs condition during 2001 - 2004 showed a positive development. During this period, SMEs contribution to GDP was 56.04% on average. By sector, these SMEs activities dominate agriculture sector, construction, trade, hotel and restaurant (Table 2.3). These sectors are absorbed more labor compare to the others.

The ability of business sectors will be different one and another in term of creating value added and will depend on their own characteristics. Center of Statistics Bureau (BPS) data in 2005 showed that there was an increase of SMEs 1.61% or 43.22 million in 2004 compared to that of 2003. While employment rate that could be absorbed by SMEs in 2004 was decreased 0.25% or 70.92 million compare to that of previous year (read table 2.4).

The development and the ability of SMEs to absorb labor during that period indicated the productivity of SMEs agent in running the business. The productivity of small enterprises for about Rp10.37 million per labor in 2003 was increased significantly to Rp11.57 million per labor in 2004. Meanwhile, the productivities of medium and large enterprises in 2003 were recorded at Rp33.70 million and Rp1.87 billion per labor, respectively. This volume was increased in 2004 for about Rp38.71 million and Rp2.22 billion per labor.

Table 2.4 Total Business Unit, Labor Absorption, and Productivity (2003 – 2004)

Business Scale	Total Business (Million Unit)		Labor (Million People)		Productivity (Rp/Labor)	
	2003	2004	2003	2004	2003	2004
Small	42.48	43.22	71.09	70.92	10.37 Mil/Lab	11.57 Mil/Lab
Medium	0.05	0.06	8.30	8.15	33.70 Mil/Lab	38.71 Mil/Lab
Large	2.17	2.25	0.42	0.40	1.87 Bil/Lab	2.22 Bil/Lab

Source: Macro Indicator Development 2005, Statistics News March 2005 Center of Statistics Bureau in collaboration with Ministry of Cooperative, Small and Medium Enterprises Republic of Indonesia.

From the above description, it is seen that each of enterprises groups has comparative advantage and complements each other. Large enterprises group has potency as a growth motor, while small enterprises group function as distribution balance as well as labor absorption. However, the figure also shows that generally small and medium enterprises units still being an alternative for the majority of poor people.

3. Analysis of MSMEs and the Potency of BMT

Despite historical sound of MSMEs performance, there exist interesting issues that need to be discussed further. This part will come up with a critical discussion on some issues with regard to the mapping of micro-enterprises credit whether fitted well with condition and needs of Indonesia poor or low-income society. Does micro-enterprises credit limit has accommodated condition or needs of the real Indonesia poor or low-income society (*loan for the poor*). A discussion in this chapter will be ended with the possibility of proposing a new formula with regard to credit limit formula for MSMEs especially for micro-enterprises.

3.1. The Problem of MSMEs Classification and Credit Limit Formula

Looking through the issues of the MSMEs to the process of national economy recovery, we are strongly believed that there exist generalization (*sweeping statement*) of MSMEs' role to the poverty alleviation program and its role to the economic development. One thing that imperative to be criticized is the role of MSMEs to empower economy of poor or low-income society. Table 2.1 on financial aspect discussion puts forward argument that credit distributed through micro-enterprises does not reflect and fit in with the condition and needs of Indonesia poor or low-income society.

The following table 3.1 shows that there exists a business scale gap between the reality and the expected by the banking sector, so that the banking sector should lower their expectation to reduce the gap with the real financial condition of MSMEs. The average credit/financing in Peramu foundation being allocated for micro-enterprises credit needs IS ranging from Rp300,000 to Rp 1million or Rp300,000 on average. If it is compared to Bank Indonesia data pertaining to the average of capital financing or micro-enterprises credit that reached Rp58 million, it will come up with an opinion or thesis that credit or loan being distributed so far do not accommodate and answer the real needs of Indonesia poor or low income society.

Such opinion also being supported by other Bank Indonesia data with regard to the ability of micro-enterprises to have credit or financing access from investor or financial institution with regard to the business permits (see figure 2.4). Some of the prominent issues that restrict micro-enterprises to have credit is the legality of enterprises (permits issue), limited access to the formal financial institutions as well as collateral existence. Therefore, it is necessary for the government to relax the requirements, to simplify the process, and to abolish informal/hidden costs in the process of obtaining business permits.

Table 3.1 Portfolio Report of Sukaresmi Ikhtiar Program (PERAMU Foundation)

No	Name of Partner	Name of Group	Financing	Contract	PYD	Dropping Date	Maturity Date
1.	Yuyun	Sirsak	250.000	QH	1	27 April 05	26 April 06
2.	Ati	Sirsak	250.000	QH	1	27 April 05	26 April 06
3.	Sami	Kenanga	300.000	QH	1	3 Mei 05	2 Mei 05
4.	Isah	Kenanga	300.000	QH	1	3 Mei 05	2 Mei 05
5.	Atih	Kenanga	300.000	QH	1	3 Mei 05	2 Mei 05
6.	Mirah	Kenanga	300.000	QH	1	3 Mei 05	2 Mei 05
7.	Mariyati	Kenanga	300.000	QH	1	3 Mei 05	2 Mei 05
8.	Sami	Belimbing	300.000	QH	1	4 Mei 05	3 Mei 05
9.	Sanah	Belimbing	300.000	QH	1	4 Mei 05	3 Mei 05

10.	Anah	Belimbing	300.000	QH	1	4 Mei 05	3 Mei 05
11.	Emur	Belimbing	300.000	QH	1	4 Mei 05	3 Mei 05
12.	Wiyah	Belimbing	300.000	QH	1	4 Mei 05	3 Mei 05
13.	Rumsih	Belimbing	300.000	QH	1	4 Mei 05	3 Mei 05
14.	Enah	Cempaka P	300.000	QH	1	4 Mei 05	3 Mei 05
15.	Emi	Cempaka P	300.000	QH	1	4 Mei 05	3 Mei 05
16.	Sati	Cempaka P	300.000	QH	1	4 Mei 05	3 Mei 05
17.	Rukmini	Cempaka P	300.000	QH	1	4 Mei 05	3 Mei 05
18.	Hindun	Cempaka P	300.000	QH	1	4 Mei 05	3 Mei 05
19.	Tion	Markisa	300.000	QH	1	4 Mei 05	3 Mei 05
20.	Ijah	Markisa	300.000	QH	1	4 Mei 05	3 Mei 05
21.	Heni	Sirsak	200.000	QH	1	4 Mei 05	3 Mei 05
22.	Anah	Sirsak	200.000	QH	1	4 Mei 05	3 Mei 05
23.	Nani	Sirsak	300.000	QH	1	4 Mei 05	3 Mei 05
24.	Oom/Acah	Sirsak	300.000	QH	1	4 Mei 05	3 Mei 05
25.	Aah	Cempaka P	300.000	QH	1	10 Mei 05	9 Mei 05
26.	Juju	Cempaka P	300.000	QH	1	10 Mei 05	9 Mei 05
27.	Asih	Cempaka P	300.000	QH	1	10 Mei 05	9 Mei 05
28.	Sa'ah	Cempaka P	300.000	QH	1	10 Mei 05	9 Mei 05
29.	Ningsih	Cempaka P	300.000	QH	1	10 Mei 05	9 Mei 05
30.	Erum	Cempaka P	300.000	QH	1	10 Mei 05	9 Mei 05

Source: Peramu Foundation Bogor East-Java, INDONESIA*; QH: Qardhul Hasan

Having identified the profile and problems of credit limit formula of MSMEs in Indonesia, it is imperative to propose a new credit limit formula for MSMEs that be well fitted with and answer the needs of Indonesian poor or low-income society. The new classification and credit limit formula can be viewed as follows:

Table 3.2 MSMEs Proposed Classification

CLASS	CREDIT LIMIT*	ASSET*	LABOR	BUSINESS PERMITS	COLL'RAL	CLASS
Super Micro	< 5	< 10	1	NR	NR	Super Micro
Micro	5 – 50	10 – 100	1 – 4	Optional	Optional	Micro
Small	50 – 500	100 – 1,000	5 – 19	Required	Required	Small
Medium	500 – 5,000	1,000 – 5,000	20 – 99	Required	Required	Medium

* In Million Rupiah; NR: Not Required

The classification and credit limit formula in first row table 3.2 is trying to accommodate and answer the need of Indonesia poor or low-income society, called super micro enterprises, that mostly needs credit or financing ranging from Rp300.000 to Rp1 million. However, the emergence of Rp5 million in the figure for super micro enterprises is subject to inflation possibility, variety of businesses, and other technical variability. Business permits and collateral should not be required in the financing application, since all super micro enterprises are informal business. But, these application requirements can be substituted by a guarantee by underwriting institution. Hence, it is urge also to define

* The completed data (2000 partners) could be obtained from the author

carefully the term of micro-credit so that really represent the real condition or the needs of poor or low-income society.

The proposed new micro enterprises are the old micro enterprises, where assets ranged Rp10 – Rp100 million and credit limit Rp5 – Rp50 million with optional business permits and collateral requirements. Moreover, the new small and medium enterprises are similar to those old classifications. When a company has grew bigger than medium classification, it considered to have graduated from needed assistance, since all of them should have business permits and in the form of formal business institutions that are very bankable with at least semi formal organization. This new proposed classification is intended to assist each business level to step the ladder up until graduated.

3.2. The Potency of Baitul Maal wa Tamwiel (BMT)

Islamic financial institutions (IFIs) started to emerge in Indonesia in the early 1980s with the establishment of *Baitut Tamwil-Salman* in Bandung and *Koperasi Ridho Gusti* in Jakarta. The first Islamic Bank in Indonesia, Bank Muamalat Indonesia, established in 1992. The development of Islamic bank has been accelerated since Bank Indonesia (the central bank of Indonesia) allowed conventional banks to open Islamic branch. This Islamic branch can offer Islamic banking products and services separated from its conventional parent with its own infrastructure, including staff and branches.

The Islamic banking system in Indonesia is currently represented by 3 Islamic banks, 20 Islamic branches, and 92 Rural Islamic Banks, with 620 offices and 439 office channelings, as well as 3400 BMTs (Islamic microfinance institutions), spreaded through out the country. They offer comprehensive and wide range of Islamic financial products and services and cater 1.54% of the banking market share.

There are two part of BMT that are having different meaning as well as function (Ridwan, 2006): *first*, Baitul Maal as a collector institution of zakat, infaq, sadaqah, wakaf and distributor to those who are deserve it (mustahiq). *Second*, Baitul Tamwiel is financial institution with business oriented and develops productive businesses as well as investment which addressed to enhance the quality of human economic life especially for those who are having small scale economy.

Table 3.3 Institutional and infrastructure condition of microfinance

Aspect	BPR & BRI Unit	Cooperation	Other MF Institutions
Regulation	Banking Law	Cooperation Law	n.a
Regulator	Bank Indonesia	Ministry of Cooperation & SMEs	n.a
Supervision	Bank Indonesia	n.a	n.a
Insurance	Government	n.a	n.a
Liquidity	Bank Indonesia	n.a	n.a
Rating	Bank Indonesia – Soundness Rate	Ministry of Cooperation & SMEs	n.a
Association	Perbarindo-Asbisindo	Main Cooperation Centre	PINBUK/Credit Union

Source: Didin Wahyudin, *Key Success Factors In Micro Financing*, paper in Panel Discussion *Microfinance Revolution: "Future Perspective for Indonesian Market"*, Jakarta Dec 7th, 2004

Apart from the issue of limit credit formula, another issue of micro-credit that comes into emergence is legal reason. In fact, most of poor or low-income societies are having no license to do their own business (see figure 2.4). It is in this context, BMT has a chance to cover the needs of poor or low-income society. Table 3.3 shows this condition whereby other microfinance institutions in the table are relatively ‘simple’ compared to that of other formal institutions i.e. BPR (Rural Bank), BRI (Bank Rakyat Indonesia) and Cooperation (Koperasi). This figure denotes that BMT as part of other microfinance institutions is fit in with the nature and the needs of Indonesia poor people. Though, BMT do not require customer to have any licenses or permits to run their businesses.

Another issue that might be covered by BMT is the availability of credit or financing fund. BMT could utilize a sustained Islamic financial instrument i.e., ZISWA to answer the issue of limited access to the formal financial institutions. As a matter fact, it is clearly being stated in the figure above, credit/financing being distributed do not touch the real needs of poor people. **The reason why BMT is considered as an answer to the issue is lies on its nature, whereby it could touch informal micro enterprises that need not any rigid formal requirement.** Hence, BMT will also comply with Shariah principle since it is free-interest based financing. Dompet Dhuafa (DD) for instance, they can do well as a function of BMT. They come up with positive contribution with regard to people empowerment in term of income generation and business skill (Khatimah, 2005).

Table 3.4 Potency and Problems of Microfinance Institution

Aspect	BPR & BRI Unit	Cooperation	Other Microfinance
Ability to collect fund	Rely on interest rate > average of commercial bank	Depend on member quantity	Depend on own capital and member
Ability to distribute fund	Loan to Deposit Ratio (LDR), but the quality should take into account	Limited because of human resource ability and business experience	Limited due to Human resource skill and business experiences
Ability of operational management	Depend on the main human resources	Depend on staff	Depend on staff
Ability to earn profit	Relatively better than-commercial bank (ROE & ROA)	Depend on the ability and the commitment of member	Depend on the ability and commitment of members
Network ability and market access	Focus on trade enterprises	Still limited	Still limited
Planning ability and reporting	Still diversified, especially BPR with limited capital outside Java and Bali	Not enough yet	Not enough yet

Source: Didin Wahyudin, *Key Success Factors In Micro Financing*, paper on Panel Discussion *Microfinance Revolution: "Future Perspective for Indonesian Market"*, Jakarta, December 7, 2004

However, BMT has certain deficiencies that should be well improved to enhance it services in order to develop MSMEs performance. Apart from regulation issue, as mentioned in table 5, the issue of human resource also becomes another main issue that should take into account critically. BMT staff is not merely limited to have sound vision on financial background and community development but also having a vision on how to

develop people in term of their religious performance. Table 3.4 shows potency as well as problem of microfinance Institution including BMT which grouped as other microfinance.

4. Conclusion and Recommendation

To conclude, there is interesting issue that has been clearly discussed in this study; the possibility of financial intermediary dysfunction to provide financing or loan for the poor that are considered as micro-enterprises group. One possible answer that being put forward in this study is that there exists an absolute error with regard to the classification and credit limit formula of MSMEs, especially for micro-credit that ranging < Rp50 million. In fact, this range does not fit in with the real conditions and needs of Indonesia real poor or low-income society, since they need credit or financing ranging from Rp300.000 – Rp1 million or Rp300.000 on average. Therefore, it is imperative to propose and recommend a new MSMEs classification and credit limit formula that could accommodate and answer the needs of Indonesia poor or low-income society. Some recommendations can be formulated to develop and enhance financial services to MSMEs so that increase economic performance of poor or low-income society:

- The government should come up with a new formula of credit limit for MSMEs that will concern more on poor or low-income society. In this context, government should also provide huge fund for those who are included in new micro enterprises classification with credit limit below Rp5 million. This initiative program could be realized by having strategic synergy with microfinance institutions like BMT that really in nature with MSMEs. Hence, the term of formal and informal enterprises should take into account critically.
- The government should simplify the process of obtaining business and legal permits in all regions, which already done in several regions by applying one-door policy to process business permits. Moreover, it is necessary for MSMEs development through legal and regulation aspects that support intellectual property rights and business competition regulation.
- The government should relax the requirements and to abolish informal/hidden costs in the process of obtaining credit.
- With respect to the potency and problem of microfinance institutions, the development of MSMEs human resources should be focused on the improvement of skills, entrepreneurship, and technology. The government can actively involves in providing incentives and facilities to encourage cooperation between MSMEs and big corporations, universities, or research institutions. For example, the government should revive workshop centers, insert entrepreneurship in the high school curriculum, and provide tax incentives for MSMEs that cooperate with universities or research institutions to develop products through research and development.

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