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The Role of Strategic Management toward Microfinance Institution Performance in Indonesia

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Abstract: ***The development of industrial microfinance in Indonesia gained the appreciation and attention of various experts in the field of microfinance. Microfinance in Indonesia is considered to be one of the greatest in the world, and has undergone a shift in the service paradigm undertaken by Micro Finance Institutions in Indonesia. This paper seeks to uncover the role of management strategies in improving the performance of MFIs in Indonesia, in addition to internal and external factors of the MFI itself as an aspect that significantly affects performance. The literature review shows that management strategy plays a significant role in improving the performance of MFIs, in addition to internal factors of MFIs and the external conditions of MFIs in Indonesia.***

Keywords: Strategic management, microfinance, microfinance institutions (MFIs), MFIs Performance

1. Introduction

This paper attempts to conceive an idea about management strategies at Microfinance Institutions (LKM) in Indonesia. Why MFI? MFIs are an institutional form of microfinance systems and processes that today are one of the most important topics in economic development in the world. Microfinance has even become one of the tools in achieving Sustainability Development Goals (SDGs), which in the previous period also played an important role in achieving the MDGs targets. International institutions, governments and national banks often hold national and international events on the development paradigm by placing the role of microfinance in important aspects especially in improving access to finance, financial literacy, poverty reduction, water and sanitation infrastructure, microfinance industry and financial inclusion. The significance of microfinance in the context of economic development in the world, therefore, Microfinance Institutions (MFIs) become fundamental enough to be lifted in the topic of this paper.

Management strategy is an important activity for business organizations at various scales, ranging from multinational companies, national, regional and local companies, including SMEs. MFIs are institutions both in the form of banks and non-banks that aims to provide microfinance services to MSMEs in general in the sub-urban or rural areas. In Indonesia, the MFI's target market of SMEs is quite large, more than 50 million business units require services from MFIs in Indonesia, it is reasonable that the number of MFIs in Indonesia is also large, therefore any MFIs in the form of banks and cooperatives require management strategies in providing services sustainably. This paper aims to analyze how the role of management strategies in MFIs to improve performance.

2. Microfinance Paradigm

Marguerite Robinson (1995), argues that microfinance has undergone a paradigm shift, from government funded microfinance and donor subsidies to credit for sustainable financial intermediation. This shift has occurred due to the many hard work of many people in many countries. This opinion, based on the government's policy implications of microfinance on the role and contribution of banks and microfinance institutions to improve sustainable services, and the performance of Microfinance Institutions.

Microfinance in Indonesia serves as a basis for Marguerite Robinson in stating the results of the analysis of the paradigm shift in microfinance in the world, therefore, further analysis related to microfinance paradigm is how microfinance services performed by Microfinance Institutions implement a strategy in the paradigm shift.

The authors argue that the management strategy of the Microfinance Institution is a consequence of the implications of the paradigm shift. From the old paradigm that uses the classical management of subsidy and charitable systems to a new paradigm that uses modern management that prioritizes independence, capital adequacy and operations. Thus, management strategies as a medium for achieving performance in sustainable services.

According to Jay B. Barney and William S. Hesterly (2015), that strategy is a theory of how to gain profit in competition. It means that the current paradigm shift in microfinance is oriented towards the process of achieving the goals in an organized way to achieve the benefits of microfinance institutions, in order to be able to compete within the scope of the microfinance industry. This requirement, therefore, requires the MFI's strategy to achieve its objectives in well-organized ways through a management strategy. This in-line with opinion that, the microfinance industry in Indonesia is exceptionally old. It is made of a largevariety of institutions, programs, services, clients, target groups, and is also subject to various legal, regulatory, and supervisory frameworks (Holloh, 2001). The country's microfinance industry is also one of the most commercialised in the world in terms of its provision of sustainable microfinance with wide scale and sustainable outreach (Charitonenko and Afwan, 2003; Ahmad Hermanto, 2017).

3. Microfinance Institutions (MFIs)

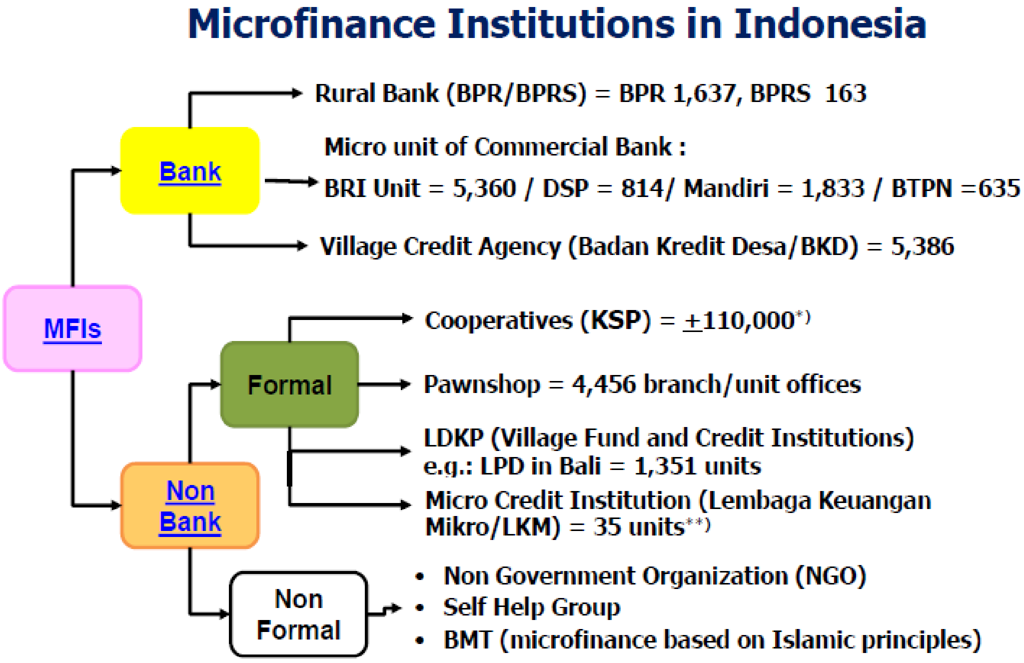
Microfinance institutions have evolved as an economic development tool intended to benefit low-income people since late 1990s. Ledgerwood (1999: 34) points out that the goals of microfinance institutions as development organizations is to service the financial needs of unserved or underserved markets as a means of meeting development objectives such as to create employment, reduce poverty, help existing business grow or diversify their activities, empower women or other disadvantaged population groups (poor people or low-income people), and encourage the development of new business. In short, microfinance institutions have been expected to reduce poverty, which is considered as the most important development objective (World Bank 2000).

The definition, reflecting that the organization and management of MFIs has developed in a modern way and become an instrument of economic development in a country, which is not only done by large-scale companies. The MFI is a legal entity and legal entity, with more than 150,000 units in Indonesia. Furthermore, The Asian Development Bank (ADB), provides an overview of MFI products and services to the public.The Asian Development Bank (ADB) defines microfinance as the provision of a broad range of financial services such as deposits, loans, payment services, money transfers, and insurance to poor and low-income households and their micro-enterprises (ADB 2000. Finance for the Poor: Microfinance Development Strategy. Manila: Asian Development Bank).

In the process of service to the community, microfinance institution consists of 2 forms.Institutions are classified in two types which are formal and informal institutions (North1991: 97; World Bank 2002: 6). Formal institutions include the rules written into the law and regulations by government, rules codified and adopted by private institutions, and public and private organizations operating under public law. Informal institutions, which often are operating outside the formal legal system, reflect unwritten codes of social conduct such as social norms and sanctions and using social mechanisms to creditworthiness based on the reputation of the agents involved.

It is clear that the MFI is an important business organization in various roles for economic development and requires management strategies in improving service performance to the community.

4. Microfinance Institutions in Indonesia



Source : Indonesia Banking Statistik, December, 2015, Annual Report ; on Ahmad Hermanto, 2017)

5. Strategy& Firm Performance

Organization's strategies as its goal-directed decisions and actions in which its ca-pabilities and resources are aligned with (matched to) the opportunities and threats in its envi-ronment. The chosen strategy should help an organization achieve its goals, but deciding on (formulating) a goal-directed strategy is not enough. Strategy also involves goal-directed ac-tions, that is, implementing the strategy. Organization"s strategy involves not only what it wants to do, but doing it. The organization's strategy should take into account its key internal strengths (capabilities and resources) and external opportunities and threats (Coulter, 2008)

Based on the definition, an organization will not be anything despite having a strategy formula but not implemented based on the ability and resources owned. This is also confirmed by opinion Frank T Rothaermel (2016), that strategy is a set of goal-directed actions a firm takes to gain and sustain superior performance relative to competitors.To achieve superior performance, companies compete for resources: New ventures compete for financial and human capital. Existing companies compete for profitable growth. In any competitive situation, therefore, a good strategy enables a firm to achieve superior performance.

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This leads to the question: What is a good strategy? According to Frank T Rothaermel (2016), a good strategy consists of three elements :

a) A diagnosis of the competitive challenge. This element is accomplished through analysis of the firm's external and internal environments.
b) A guiding policy to address the competitive challenge. This element is accomplished through strategy formulation, resulting in the firm's corporate, business, and functional strategies.
c) A set of coherent actions to implement the firm's guiding policy. This element is accomplished through strategy implementation.

Referring to the above definition, it is clear that the MFI needs a strategy to achieve its goals and further to be able to compete and improve performance among other MFI competitors in the microfinance industry. However, there are weaknesses, some weaknesses of MFIs in strategic management applications, as stated by the following opinion;The benefits of using strategic management in MFIs will prepare the company to get ready to confront any controlled and/or uncontrolled issues, evaluating the implementation of the strategy, providing information of the issue of „fit‟ with the environment, and aids for understanding of the nature of environmental change. However, there are still limitations of using strategic management due to lack of knowledge of strategic management techniques, lack of time and planning; feeling uncertainty about the future, lack of managerial skills and being heavily in-volved in the daily and routine operations (Analoui & Karami, 2003).

Firm performance is determined primarily by two factors: industry and firm effects. Industry effects describe the underlying economic structure of the industry. They attribute firm performance to the industry in which the firm competes.The structure of an industry is determined by elements common to all industries, elements such as entry and exit barriers, number and size of companies, and types of products and services offered. In a series of empirical studies, academic researchers have found that about 20 percent of a firm's profitability depends on the industry it's in. when studying external analysis, we'll gain a deeper understanding of an industry's underlying structure and how it affects firm performance.

Competitive advantage is always relative, not absolute. To assess competitive advantage, we compare firm performance to a benchmark—that is, either the performance of other firms in the same industry or an industry average strategy is about creating superior value, while containing the cost to create it. Managers achieve this combination of value and cost through strategic positioning.

That is, they stake out a unique position within an industry thatallows the firm to provide value to customers, while controlling costs. The greater the difference between value creation and cost, the greater the firm's economic contribution and the more likely it will gain competitive advantage.

6. Strategic Management

Strategic management is a process of analyzing the current situa-tion; developing appropriate strategies; putting those strategies into action; and evaluating, modifying, or changing those strategies as needed. These activities usually called situation analysis, strategy formulation, strategy implementation, and strategy evaluation (Mary Coulter, 2008). Strategic management included four characteristics: interdisciplinary, external fo-cus, internal focus, and future oriented (Coulter, 2008).

The definition of strategic management according to Mary Coulter and Coulter (2008), it is clear that strategic management is a concept that requires practice in carrying out business objectives, and MFI as a business institution in providing services to the community requires management strategy. The change in the microfinance paradigm proposed by Marguerite Robinson (1995), according to the author strongly inspired the need for strategic management for microfinance institutions.

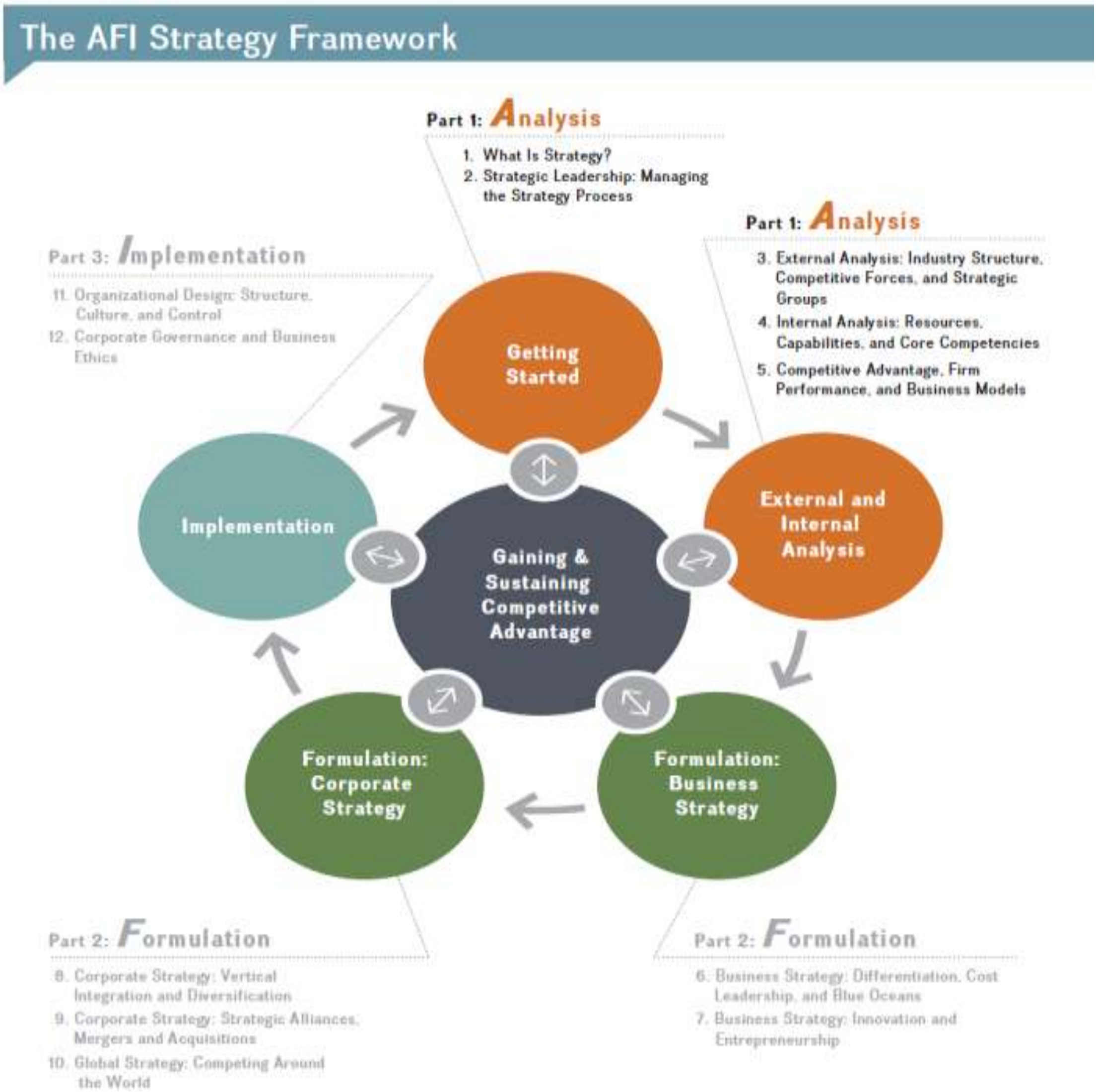
7. Strategic Management Model (The AFI Startegy Framework)

Frank T Rothaermel (2016), proposed the **AFI strategyframework**A model that links threeinterdependent strategicmanagement tasks—analyze, formulate,and implement—that,together, help managersplan and implementa strategy that canimprove performanceand result in competitiveadvantage.How do firms craft and execute a strategy that enhances their chances of achievingsuperior performance? A successful strategy details a set of actions that managers take togain and sustain competitive advantage. Effectively managing the strategy process is theresult of three broad tasks:1. Analyze (A), 2. Formulate (F), Implement (I).

The tasks of analyze, formulate, and implement are the pillars of research and knowledgeabout strategic management. Although we will study each of these tasks one at atime, they are highly interdependent and frequently happen simultaneously. Effective managersdo not formulate strategy without thinking about how to implement it, for instance ; Likewise, while implementing strategy, managers are analyzing the need to adjust to changingcircumstances.We've captured these interdependent relationships in the **AFI strategy framework**. This framework (1) explains and predicts differences in firm performance,and (2) helps managers formulate and implement a strategy that can resultin superior performance. In each of the three broad management tasks, managers focuson specific *questions*, listed below.

Internal analysis (A): *What effects do internal resources, capabilities, and core competencieshave on the firm's potential to gain and sustain a competitive advantage? Howshould the firm leverage them for competitive advantage?* ■ Competitive advantage, firm performance, and business models: *How does the firmmake money? How can one assess and measure competitive advantage? What is therelationship between competitive advantage and firm performance?*

Strategy Formulation. ■ Business strategy: *How should the firm compete: cost leadership, differentiation, or value innovation.* ■ Corporate strategy: *Where should the firm compete: industry, markets, and geography?*■ Global strategy: *How and where should the firm compete: local, regional, national, orinternational?*



Source : The AFI Strategic Framework : Frank T Rothaermel, 2016.

8. Implementation of microfinance business through MFIs:

1) Indonesia's microfi nance industry is among thelargest in the world, with over 50,000 microfi nanceinstitutions (MFIs), of which the majority are characterised by low growth in outreach andineffi cient systems. They cite a lack of access toaffordable capital as their main constraint. There isno legal defi nition of microfinance, but BankIndonesia (BI, the central bank) defines microcreditas loans of up to Rs50m (US$5,500). Theexistence of large-scale subsidised programmesand institutions puts private MFIs at adisadvantage.
2) The biggest programmes are theWorld Bank-funded National Programme forCommunity Empowerment (PNPM) and the socalledrevolving fund agency (LPDB) set up by theMinistry of Co-operatives, Finance and Industry.
3) Bank Danamon is one of the largest banks involvedin microfi nance with a portfolio of small tradersand micro-entrepreneurs, worth around US$1bn.
4) The market for microfinance is highlyfragmented and demand for micro-loans outstripssupply. Around one-fi fth of Indonesia's populationof 234m lacks access to fi nancial services. Highdemand has allowed private operators to thrive,despite the state's heavy involvement

in ruralfi nance. The private bank with the fastest-growingMF unit is Bank Tabungan PensiunanNasional(BTPN).

5) Banks and other financial institutions are free toset interest rates on loans; they do not faceexcessive documentation and the capital-adequacyratios are not excessively burdensome.
6) The main informal providers of micro credit arecooperatives. Cooperatives must register with theMinistry of Cooperatives. There is a capitalrequirement of Rs100m to establish a savings andloan co-operative (S&L). Co-operatives are notclosely regulated or supervised and capacityconstrains them from playing a greater role inproviding MF.
7) The prudential standards, know-your-client(KYC) principles and anti-money laundering (AML)requirements faced by microfinance banks (MFBs)are the same as those faced by all banks in thecountry. Non-formal MFIs are not subject to thesestandards, have very little oversight and face fewrestrictions on deposit taking.
8) BI has regulations for e-money. However, anRs5m limit on e-cards and mobile phones hasseverely limited the use of e-money. Mobile andelectronic banking has spread, but is still limited.
9) There is no effective dispute-resolutionmechanism for microfi nance borrowers in place.However, there have been a number of high-profi lelegal cases involving credit card holders andissuing banks. The cases have contributed togreater public awareness of consumer rights andresulted in the creation of a Consumer ComplaintsUnit located within BI, but the Unit does not coverMF clients. It deals with complaints fromconsumers of commercial banks and, to a muchlesser extent, from rural banks.

Key changes and impacts since since 2014 :

10) In January 2013, parliament passed a longpendingMicrofi nance Institutions Bill with a viewto providing legal certainty for microfi nanceproviders (LKM). The new Bill establishes that aLKM must take the legal form of either a PerseroanTerbatas (PT, limited liability company) or koperasi(cooperative). In the former case, 60% of theshares must be owned by a regional government orregion-owned company. The remaining 40% maybe owned by either an Indonesian national or a cooperative.Non-governmental organisationmicrofinance institutions (NGO-MFIs) and informalproviders of microfi nance feel that the Bill does notaddress their needs.
11) There has continued to be interest from foreigninvestors in entering MF in Indonesia. The routesvary from investment in private providers, such asBTPN, to establishing venture-capital fi rms. BPRs areincreasingly partnering up with organisations suchas Bank Andara, a wholesale bank for MFIs, in orderto bring more services to their customers, such asclearing cheques and access to liquidity lines. Thenew Otoritas Jasa Keuangan (OJK, the fi nancialservices authority) is slowly taking over regulatoryfunctions from BI. Non-bank fi nancial companies(NBFCs) are already being supervised by the OJK;banks are scheduled to be supervised by the OJKfrom 2014. The OJK is staffed by people from BI andthe Finance Ministry. It is still too early to saywhether the OJK's regulatory capacity will comparefavourably with the previous institutional set-up.
12) The regulatory and supervisory environment formicrofi nance remains in transition. BI hasdeveloped draft regulations for private-creditbureaus (PCBs), but there is signifi cant politicalopposition to surrendering BI's monopoly on creditinformation to a private entity.
13) Regarding transparency in pricing, banks arerequired to publish clear prime lending rates(those offered to their best customers andinstitutions, accounting for a large share of thetotal loan portfolio)that comply with regulations.
14) The issuance of guidelines on branchlessbanking and agents by BI is still pending. BI hasgranted a handful of commercial banks the right toconduct pilot projects on agency banking. Thefi ndings of the pilots are expected to feed intoguidelines that would provide a framework forfi nancial transactions through agents and allowfinancial institutions (FIs) to make better use ofexisting technologies.

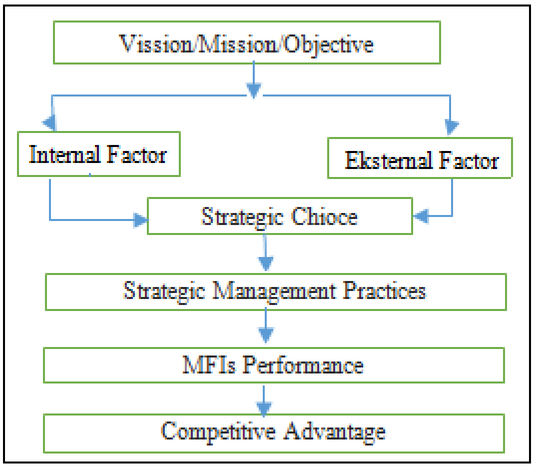
Indonesia has come to be considered by many, including World Bank sources, a model country: both with regard to its success in poverty reduction in recent decades and with regard to the vigor and diversity of its microfinance sector as it evolved over the past one hundred years. Since 1983 it has also provided an outstanding example of the direct impact of financial and economic liberalization policies on microfinance and poverty alleviation, proving beyond doubt that policies work. Decision-makers in countries that are just about to embark on such a course may greatly benefit from a thorough exposure to some of the experiences in Indonesia (Hans Dieter Seibel & Uben Parhusip, 1997; Ahmad Hermanto,2017).

9. Analysis of the the role of strategic management toward MFIs Performance.

Micro Finance Institutions (LKM) in Indonesia face the challenge of changing the paradigm in providing services to the public. In addition to the large number of beneficiaries, MFIs are also facing quite a tough competition, given the large number of MFIs and the competition also comes from national banks. The performance of the MFI is therefore of great importance to be maintained for the sustainability of the MFI's existence. To prepare for these challenges and competition, management strategies are a fundamental requirement for MFIs in Indonesia.

The author tries to propose a framewok analysis of how the role of management strategies in improving performance, so as to be able to face the dynamics of community needs and SMEs, as well as competition in the microfinance industry, as follows:

Figure: Analysis the role of strategic management toward MFIs.

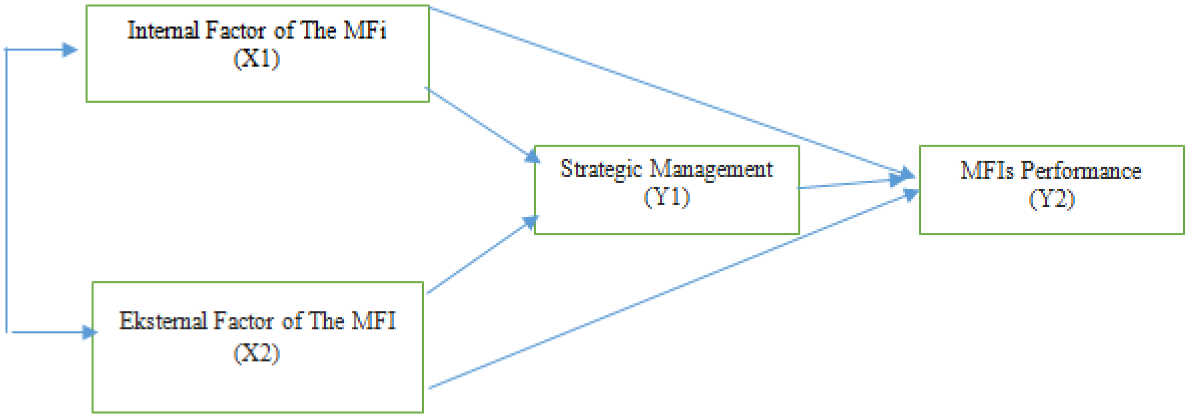


Flow model : The Role of Strategic Management toward MFIs Performance in Indonesia , by own author 2017.

10. Propose Framework

In respect of the formulation of The Role of Strategic Management toward MFIs Performance to explore of shift in paradigm microfinance in this decade.

The previous literature review is useful to complement this model. The model used to test the hypothesis and get the model fit and get the standard regression weight, the level of significance of output will be the basis for the hypothesis of conclusion. If the significance level is less than 0.05, there is a significant relationship and if it is higher than 0.05, there is no significant relationship.The elements of this approach are described as follows



Propose Model : The role of strategic management toward microfinance performance in Indonesia, author, 2017

11. Conclusion

One of the main results of this study is expected to answer the main variables that can improve the development of MFIs performance in Indonesia. These findings can illustrate how the role of management strategies in improving MFIs performance and enhancing competitiveness in the microfinance industry.This study will prove that the strategic management is an intervening strategy in developing MFIs performance in Indonesia. Besides the effects of internal and external factors of MFIs. Performance MFIs can also be an important indicator for the development of MSMEs in Indonesia.

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