

Cooperative Micro-Bank and the Splintering of Social Capital in West Kalimantan, Indonesia

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Abstract

Much has been written about the roles of microfinance institutions in the development of local economies in industrializing nations. Scholars have developed different perspectives and provided useful analyses, but they seem to have paid less attention to the socio cultural factors affecting the performance of microfinance institutions. By employing the concept of social capital, this paper aims to investigate the processes of development of *Star Cooperative Micro-Bank* in West Kalimantan. Extended case method has been used to collect data from various actors who have direct and indirect knowledge of *the Star Cooperative Micro-Bank*. This study reveals that the sound financial performance of *the Star Cooperative Micro-Bank* has been concomitant with a splintering of social capital indicated by its ethnic preference in outreaching clients. This phenomenon has made thicker the already thick boundaries of inter-ethnic relations. It suggests that state institution needs to act as a linking agency in order to bring other ethnic groups into the *Star Cooperative Micro-Bank*.

Keywords: microfinance institution, ethnicity, social capital, Embeddedness, Indonesia

1. Introduction

Much has been written about the roles of microfinance institutions (hereafter refers to as MFIs) in the development of local economies in industrializing nations. In general, two conceptual perspectives seem to dominate inquiry into the causes of successes and failures of MFIs, namely the organization perspective and the public policy perspective. They focus, respectively, on the dynamics of internal organizations and the policy environment that affects the development of MFIs.

Most studies on the internal organization advocate the advantages of decentralization over centralization in running MFIs. In his study of the Grameen Bank in Bangladesh, Sarker (2001) finds that three factors are considered to be responsible for its successful performance. They are: the relatively high degree of autonomy of the organizational units at the bottom level, close monitoring of groups of borrowers, and the borrowers' commitment to participating in the weekly meetings. A similar study points to change of the organizational mission in the successful performance of MFIs. While acknowledging the strategic importance of organizational decentralization, Yaron et al. (1998) insist that the successful financial performance of micro banks in Indonesia has to be attributed to the change of organizational mission from subsidy- to market-oriented.

Studying microfinance institutions in the Philippines, Seibel et al. (2000) reveal that the successful performance of the Grameen technology in Bangladesh cannot be replicated to other countries. They mention that the crucial factors responsible for the successes and failures of MFIs are the extent of core of social capital such as moral commitment of leadership, and of specific peer selection and enforcement, and credit discipline.

In contrast to the organizational perspective, the public policy perspective explicates the influence of state laws, government policies and regulations on the development of MFIs. Using Indonesia as a case study, Rosengard et al. (2007) argue that the introduction of banking law in 1998 has significantly changed the financial landscape of MFIs. Most MFIs have transformed into urban commercial micro banks, at the expense of villagers and the poor. While the above-mentioned studies focus on different perspectives and provide useful analyses and findings, they seem to have paid less attention to the socio cultural factors affecting the performance of MFIs, although Seibel et al. did hint at the role of socio cultural factors at micro level. This paper tries to fill this gap, and focuses on the relationship between the social context and the development of microfinance institutions in West Kalimantan, Indonesia. It argues that ethnicity plays a vital role in the success of the financial performance of MFIs. However, this contribution raises questions about the future development of local economies in the area.

Extended case method was used to collect data from various actors who have direct and indirect knowledge of *the Star Cooperative Micro-Bank* (hereafter refers to as *SCMB*), a type of microfinance institution. *SCMB* is a pseudonym. A desk review to assess available research findings was carried out before visiting the research areas. The *SCMB*, a non-government led MFI, has been chosen as a case study for a number of reasons. First, it has been praised by the government as the most outstanding microfinance institution in the country. Second, it has been a laboratory of success stories from which microfinance advocates can learn lessons. The success story of this microfinance institution has been published by the author (Achwan, 2012). Its aimed is to provide a case

of class room discussion for students of business school. It merely informs empirical facts without being supported by sociological frameworks. Some narrative information of this publication has been used in this paper for enriching the current concept of social capital.

The paper is divided into four sections. The first discusses social capital as a guiding framework for the study. The second section highlights the changing national financial landscape and the social context of ethnic relations in West Kalimantan, and the third analyses the financial performance and the processes of creation of the social capital of *SCMB*. The final section discusses ways to address the problems of the splintering of social capital.

2. The Conceptual Framework

The past three decades were momentum years in economic sociology. Granovetter's embeddedness was out in 1985, followed by publication of Putnam's social capital in 1993. Both works gave sociologists the impetus to make closer studies of the economy, a domain touched on less in the previous decades. The backbone of Granovetter's concept lies in social embeddedness in economic action. Recently, he developed his concept further by bringing in four core principles of networks that affect economic outcomes (Granovetter, 2005). All four principles focus on the flow and quality of information within personal relations.

The first, norms and network density, refers to the strength of the ties that connect nodes, be they people, firms or other social units. Such networks allow the flow of ideas, information and influence from one node to another. They make shared behavior and punishment of actors' deviances more likely. The second pillar, the strength of weak ties, states that distance, rather than closeness, of personal relations among actors is more likely to bring novel information. The third is the importance of structural holes, between individuals or groups, in bridging a variety of social networks in the society. Those that occupy these holes enjoy strategic advantage because of their access to a variety of information. The fourth pillar is the interpenetration of economic and non-economic action, which concerns with the extent to which the former links to the latter and affects the costs and the management of economic activity.

In contrast to Granovetter, Putnam focuses his study on the importance of social capital in generating vibrant associations and governance. He defines social capital as aspects of social structure such as norms, trusts and networks that facilitate coordination to pursue certain goals (1993). In a subsequent publication, Putnam (2000) enriches his concept by adding two dimensions, more or less similar to the Granovetter principles, namely, bonding and bridging social capital. They refer respectively to patterns of social relations based on similar and different social origins and statuses. His modified concept has made possible the study of different levels of social capital in any society. It helps to elucidate extra, inter and intra group relations, which are correspondingly called macro, meso and micro social capital.

However, Granovetter's and Putnam's concepts seem to have largely neglected the existing social and political contexts in which social capital operates. One can find social capital easily in every society, but it certainly does not guarantee the emergence of vibrant economies and civic associations, or responsive governance. The extent of resources – be they economic, political and social – affects the wealth and poverty of social capital in the society. Here, a society can be viewed as a hierarchy of social capital in which the locations of social capital are determined by the vector of resources (Lin, 2000).

Certain social capital may possess high social resources and be capable of bridging social groups in other areas. In a contested inter-ethnic society, however, such resources might embody an element of the primordial and work as a social mechanism for enlarging social capital. We would like to call this phenomenon the splintering of social capital, which is symbolized by the persistence of a primordial mechanism for geographically bridging social groups on one hand, and by the inability to bring the lower locations of social capital into the membership on the other hand.

Granovetter and Putnam have also neglected the role of the state in supporting the strength of weak ties and bridging of social capital in order to develop. Both seem to ascribe responsibility for this to individual actors. In his recent work, Victor Nee (2005) criticizes Granovetter's focus on proximity rather than distal social relations, and for ignoring the institutional environment - ideology, laws and state regulations - that obviously plays a facilitating role in achieving economic outcomes. He urges economic sociologists to pay attention to how the institutional environment interplays with existing social networks. The institutional environment and social networks respectively consist of formal and informal rules, and the task of economic sociologists is to explicate mechanisms that support and hinder the integration of both rules.

Nee coins the term 'close coupling' to indicate the synergy of formal and informal rules that provides the institutional bases for the achievement of economic outcomes. Conversely, 'decoupling' refers to the disconnection of both rules that ultimately hinders the development of the economy. In his study on the Mexican economy, Portes (2006) provides a good example of the emergence of decoupling of both rules. He explains that while Salinas was in power, Mexico adopted the market economy, i.e. privatization, free trade, and subsidy reduction (formal rules), without accounting for the existing social context. As a result, state company managers,

labour unions, and others resisted the new economic programs, and ultimately brought about the demise of the Salinas regime. The failure to enforce formal rules has been coined 'institutional monocropping' (Evans, 2003). In a similar vein, but with a different emphasis, Szreter (2002) enriches Putnam's concept by incorporating the new dimension of linking to make social capital a more plausible theory. He mentions that the depletion of social capital in America that Putnam laments cannot be separated from the economic ideology that dominates the country. This economic ideology - which is reflected in laws and economic policies made by the state - has delinked the possible bridging among civic associations.

In sum, this paper employs the concept of social capital appropriate to the social context by emphasizing the primordial mechanism within the dynamics of bonding, bridging and linking. We believe that a better understanding of such mechanism will contribute to the healthy development of microfinance institutions in developing economies.

3. The Contestation of Ethnicity

West Kalimantan was one of the provinces which sadly became an arena of deadly ethnic violence when President Soeharto resigned in 1998 (Varsney and Panggabean, 2004). Ethnic diversity is a major feature of West Kalimantan society. The Dayak and the Malay are two big ethnic groups who respectively control agricultural economy and local state bureaucracy. The other ethnic groups which play pivotal roles in the economy and society are the Chinese and the Madurese. Relationships among all these ethnic groups are dynamics characterized by harmonious, conflict and violence.

During the Soeharto in power (Achwan, 2012), the Dayak seemed to have a feeling of injustice over ways in which the Soeharto administration implemented its policies. The central government economic policies tended to favour national private companies to invest in logging and plantation at the expense of Dayak population. As results, the Dayak begun to organize a resistance movement against the government and the private sector. This movement has provided social energy to work side by side with the *SCMB*.

4. The Performance of the SCMB

It has been generally agreed among micro banking practioners about how to measure the performance of microfinance institutions. According to Siebel (Achwan, 2012) the measurement consists of the following three indicators namely, outreach, financial viability, and the percentage of non-performing loan.

By employing the above measurement, this study shows that the *SCMB* performs promising financial practices (*SCMB* Accountability Report, 2007). In 2007, it has 79,944 members who live across the province and its total assets reached IDR 301 billion with outstanding loans of IDR 301 billion. Non-performing loans were less than 1% which was considered as a healthy financial institution. The Indonesian Central Bank has declared that financial institutions which have non-performing loan above 5% are considered as unhealthy.

One may ask under what circumstances such financial performance can be achieved? There are at least three levels of social capital that have contributed to the performance of the *SCMB*. All three were consciously created by its leaders, and were not a historical endowment.

5. Macro-level Social Capital

SCMB was established by group of young Dayak activists and intellectuals. According to Achwan (2012) they envision a big, healthy and eternal Dayak-based financial institution, inspired by values and principles of credit union. Its legal status is a credit co-operative. Its mission is to educate members, changes in mental, emotional and spiritual appropriate to the values of a credit union. By educating its officials, *SCMB* will be able to provide professional services to their members (Policy direction of Star Cooperative Micro-Bank, 2006).

The existence of local leaders is worth mentioning from the point of view of sociological theory. Until recently, attempts to enrich the concept of social capital only focus on structure or social relations and neglect the role of actor, be it organization or individual. Agency in the forms of organization or individual has to be taken into account if theory of social capital wants to enjoy strategic place in an arena of social theory.

The development of *SCMB* is subsequently followed by the rise of local social movement. Its aimed is to reinstate Dayak customary law. This movement trains rural Dayak how to map out *adat* forest lands occupied by logging and plantation companies. Moreover, the movement organized forums to discuss the impact of 'bad laws' upon the economic and cultural life of the Dayak rural people. It was no wonder that this movement contributed to the rise of Dayak social solidarity. Such social solidarity had made possible for *SCMB* to recruit Dayak people to join in.

6. Meso-level Social Capital

The analysis of meso social capital focuses on the capability of the *SCMB* to develop external networks with other institutions. Such networks are important in order to continue adjusting to external developments.

Internally, the *SCMB* focuses only on providing saving and loan services to its members and, externally, it develops relationship with a Non government Organization (NGO) that has experience in supporting local economy. This relationship enabled the design of a specific and integrated scheme. It is through this network that the combination of the social movement and technocratic works has been developed. The NGO is responsible for organizing the saving movement, educating local Dayaks to change their habits in managing the household economy. The expected outcome is that these local Dayaks will become *SCMB* members.

Second, a program of technical assistance has been developed to help *SCMB* members promote their businesses. The *SCMB* provides loans to these groups and the NGO helps with production innovation and marketing.

Recently, there have been an alarming development that will shape the future of credit cooperatives in West Kalimantan. This relates to regional autonomy, which grants the provincial government the authority to collect income from taxation. West Kalimantan provincial parliament has passed a regional law on the taxation of credit cooperatives income and on dividends received by credit cooperatives members, on top of the institutional tax that already applies. This local law may adversely affect the financial health of credit cooperatives. Interest on savings and loans may change to the detriment of members, and in turn destroy the saving habits that have already developed. Following the arguments of Szreter (2002), one can draw the conclusion that linking social capital destroys the possible bridging among members and between credit cooperatives.

7. Micro-level social capital

Analysis of micro social capital focuses on the creation of social norms and enforcement of norms within organization. In contrast to conventional micro banking, *SCMB*, under the guidance of its leaders, develops specific mechanism of recruiting new members (Achwan, 2012). This mechanism relies on the important roles of existing members in recruiting new members. The cooperatives organize a short training to recommended new members. Moreover, the existing members play important roles in recommending his or her peer new members to apply loan. This mechanism is believed to reduce performing loans experienced by members. In other words, this mechanism functions effectively in enforcing financial regulations implemented by the cooperatives.

Another method that has been employed concerns with financial products the cooperatives offer. *SCMB* creates financial products by considering tradition of Dayak society such as saving for funeral and saving for future festivity. In his study on MFIs in various countries, Siebel (2000) concludes that the availability of variety of financial products tend to contribute to their successful performance.

8. The Splintering of Social Capital

The *SCMB*, a non government-based microfinance institution, has played a pivotal role in providing financial services to local people and inspiring other people to establish credit cooperatives in West Kalimantan. Its successful financial performance is inseparable from what it is called as 'the creation of social capital'. Hostile macro circumstances enabled the *SCMB* to attract local people as members, most of whom are of the same ethnicity. At the meso level, it initiates the establishment of networks relations with the institutions of people's economy, enabling members to expand their businesses.

One can draw the conclusion that the successful financial performance of the *SCMB* has been made possible by the creation of social capital at different levels. However, there are a number of challenges facing the *SCMB*. First, the Dayak dominate the membership base of this financial institution. This domination crosses village, sub-district and provincial boundaries. Second, the *SCMB* has targeted the middle and the upper levels of the Dayak community as members, and left the lower level untouched. Such a strategy raises questions over the merits of the *SCMB* as a development tool. I would like to call both challenges being faced by the *SCMB* as 'the splintering of social capital'. This type of social capital is marked by strong and extensive common ethnic and socio economic bonding on the one hand, and weak bridging between different ethnic origins and socio economic statuses on the other.

Earlier, we discussed the concept of social capital, pointing out the troika of bonding, bridging and linking. The employment of this concept is useful as a device to identify the embeddedness of social relations in economic and financial life. However, the proponents of social capital seem to have largely neglected the working of social structure, including power, in economic life. Our case study reveals that the emphasis on the role of social relations tends to gloss over their locations in the existing social stratification. One has to consider the locations of social relations as an additional dimension of social capital because they relate to the quantity and quality of resources (Nan Lin, 2000). They may or may not embody strategic information, and valuable economic, political and social wealth. Every pattern of social relations that possesses economic resources can be converted into political capital, social capital and symbolic capital and vice versa (Swedberg, 2003). If such resources are distributed unevenly, then they will become fertile soil for the rise of inequality in the society.

Referring to the performance of the *SCMB*, one may say that this microfinance institution seems to have transformed itself into an ethnically-based commercial micro bank at the expense of those on the lower rungs of

society. While such transformation contributes to sound financial performance, it also contributes to the thickening of both internal and external boundaries. In his article, Copestake (2007) adds new dimension of measurement of MFIs' performance namely, the depth of outreach. It refers to the level of the deepening of the coverage of MFIs in the society.

Obviously, the *SCMB* does not consider the importance of the depth of outreach and therefore may contribute to the rise of social inequality. The tendency to ignore this dimension seems to be the rule in microfinance at the global level. The development of microfinance institutions in Mexico is worth mentioning (The Economist, 2008). It began by targeting the poor, offering loans without collateral. As time went, however, it scaled up the target, as a stepping stone moving in a more a commercial direction. The management argued that the state, not microfinance institutions, is responsible for raising the poor out of poverty. While this argument has rational justifications, the management was walking away from one of its basic missions: economic empowerment of local people. While it is true that providing financial services to the poor is costly, considering they are usually 'un-bankable', attempts must be made to give the poor access to microfinance.

Most scholars seem to be unaware of the working of the social mechanisms that relate to the breath of the outreach of microfinance institutions. An ever-increasing number of members crossing local boundaries are regarded as an indicator of the performance of MFIs. Our study shows that ethnicity as a social mechanism delimits the breath of outreach and consequently paves the way for strengthening the boundaries of inter-ethnic relations.

What has to be done to make the depth and the breath of outreach neutral? One of way is to strengthen the linking of social capital. By strengthening this dimension, the *SCMB* would be able to walk on both legs, as a commercial and a social mission. Moreover, it would facilitate processes of social inclusion by bringing non Dayak ethnic groups into the *SCMB*.

The government of Indonesia could play a facilitating role by providing financially sound microfinance institutions access to cheap credit. It has already passed two laws on banking and cooperatives to facilitate growth of microfinance institutions. It has also established a program to empower the people's economy by providing loans to the poor. However, so far there are no data available on the actual beneficiaries of this program: are they the enterprising poor, the poor or others?

9. Conclusion

Since the publication of Putnam's *Making Democracy Work* in early 1990s, social capital has become one of the most contested concepts in social science. While some academics criticize it, others continue to enrich it so that it becomes a scientific device for understanding the working of the economy. Our case study reveals the locations and resources of social relations within the existing social stratification can be added to improve the concept of social capital. These two components consider the importance of the social context in which economic actors operate. They also give meaning to the troika of social capital – bonding, bridging and linking. The splintering of the social capital of *SCMB* in West Kalimantan could be remedied by improving the linking between government and MFIs. In these times of economic turbulence, it is high time for policy makers to reinvent MFIs in Indonesia. It should support the emergence of what I would like to call 'modern community banks', not commercial micro banks. These new banks would have to maintain their dual mission; their commercial and social responsibility. This mission could be achieved by facilitating MFIs to scale up their outreach by offering credit facilities to non micro-entrepreneurs, while nurturing micro-entrepreneurs as their prime borrowers. By careful scaling up, they could reduce the operating costs of providing micro credit.

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