

ISSUES OF ENHANCING THE ROLE OF MICROFINANCE INSTITUTIONS IN SUPPORTING SMALL AND MEDIUM-SIZED ENTERPRISES

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*The role of Micro Finance Institutions (MFIs) is to support micro/small businesses to work for people's welfare and provide funds as capital to develop their own businesses. This study aimed to examine the extent to which the legal culture of a country defines the role of MFIs in improving the welfare of micro and small businesses. For this purpose, a comparative study was made between Bangladesh, the Philippines, China, India and Indonesia to understand their respective legal culture and whether the laws and regulations of the country helped in resolving the poverty issues. The study adopted a normative legal research design to analyze descriptively this qualitative research. A comparative approach with a historical analytical design was also adopted with the view to investigate the laws and regulations of each country in the context of MFIs and their contribution to poverty alleviation and community welfare. Both primary and secondary sources were used for data collection. The primary sources included the informants of MFIs and micro and small medium enterprises (MSMEs). It was found that the legal culture of each country was strongly influenced by its local economic wisdom. In Bangladesh, the goal of Grameen bank or MFIs was to make people feel ashamed of begging which was very successful. The Grameen Bank model in Bangladesh was a breakthrough in alleviating poverty as beggars, who were benefitted with micro finances to establish their micro businesses of weaving and embroidery, and selling candies and matches, had to give up begging because they had started a new business and begging was redundant. However, this model was not successful in the Philippines, China, and India due to the government*

*interference while in Indonesia, the Grameen Bank pattern was modified slightly by introducing the Islamic principles of siddiq, amanah, tabligh, and fathonah, which guided the MFIs to synergize with the local economic wisdom, but not all regions in Indonesia met the same success due to the requirement of collateral and high interest rates.*

## Introduction

Globally, all banking and finance institutions adopt credit assessment policies to determine the borrower's ability to repay the debt. Also known as a credit check, credit assessment helps to determine any individual's solvency. Several criteria are used to reach the final decision to lend credit including credit rating, time period, cash flow throughout the year and a good payment history. For instance, credit rating is calculated by culminating an individual's credit cards, previous loans and mortgages; a credit company will also check the time period which a business is functioning to determine the borrower's business credibility; cash flow is reflected in end of year financial statements which help in the assessment of assets and liabilities; finally, a good payment history will give a high credit score.

Such credit assessment is now gradually becoming mandatory in banking sector for all prospective customers who apply for loans. The credit assessment by banks is carried out through diverse assessment procedures to gain confidence in their customers (Kasmir, 2008). For instance, a few banks use the 5C Principles (Character, Capacity, Capital, Condition, and Collateral). In Indonesia specifically, based on Financial Services Authority Regulation No. 42/POJK.03/2017 plus Financial Services Authority Regulation No. 19/POJK.05/2021, this 5C Principle is heavily relied upon to provide loans. Hence, all Financial Services institutions including banks assess the collateral guarantee first. Any prospective customer who does not have a collateral, cannot apply for loan facilities. This helps in determining other factors like character of the applicant, capacity to repay the capital and in what conditions the loan will mature. In fact, the 5C principle the customers themselves as they should know whether their capital could help expand their business and in what conditions.

Besides this, there are various other assessment criteria carried out by banks including the 6C, 7P, 5P, and 3R principles (Meher, 2021). The 6C principles consist of Character; Capacity; Capital; Collateral; Condition; and Competence (Ismanto et al., 2019). The 7P principles consist of Personality; Parties; Purpose; Prospects; Payments; Profitability; and Protection (Syafri, 2020). There are also known approaches such as 5P principles, namely People; Purpose; Payments; Protection; and Perspective (Ibrahim & Sirait, 2021). The credit assessment using the 3R analysis method consists of Returns, Repayments, and Risk

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Bearing Ability (Malayu, 2008). Despite these many approaches, the risk faced by the banking industry still remains and default is committed by borrowers, turning loans into non-performing assets (NPAs).

Undoubtedly, non-performing loans in the banking sector have continued to rise, especially during and after the COVID-19 pandemic. Figure 1 presents the ratio of banking non-performing loans, as received from the Financial Services Authority and Bank Indonesia.

The Indonesian Banking Statistics Data from the Financial Services Authority (OJK) shows the ratio of banking non-performing loans has been above three percent since May 2020, while the value of bank credit has decreased. Based on OJK data, banking NPLs in April 2021 reached Rp. 176.48 trillion or 3.22% of the total loans disbursed, which is Rp. 5,482.17 trillion. Out of this, a total of Rp. 2,463.1 trillion (4.9%) of bank loans was provided to finance working capital, Rp. 1,558.4 trillion (28.4%) for consumer loans, and the remaining Rp. 1,460,6 trillion (26.64%) for investment credit (Kusnandar, 2021).

Such a failure of a most promising scheme taught valuable lessons to the government, which helped greatly to the development of implementation practices and operation of microfinance. A new approach to credit methodology was developed wherein non-governmental organizations (NGOs) became potential partners of the government in fighting poverty. Through the microfinance sector, NGOs provided loans for small business activities to the needy. These NGOs designed alternative micro finance options in the form of unsecured loans and savings instruments for the poor. These NGOs also provided individual and group loans but used group pressure or group accountability instead of collateral. Although microfinance NGOs faced certain regulatory and prudential issues, they succeeded in meeting the needs of business actors from the poorest communities (Anwar, 2023).

Ever since the success of use of NGOs to microfinance, the Philippines witnessed a social development, which motivated the country to take initiatives for poverty alleviation and take micro finance from marginal to mainstream and then towards commercialization. In contrast to other development approaches, “microcredit” can also be sustained from existing resources and donor subsidies. This proved an interesting point for government officials, to support regulations and mobilize public resources to adopt microfinance programs from formal and semi-formal MFIs in poverty alleviation efforts. In 1993, the Philippine government tried to develop a credit master plan for the poor. This master plan identified three strategies to reduce poverty through microfinance, namely: policy reform; mobilization of financial resources, and capacity building. The steps taken to increase financial resources were by forming the People's Credit and Finance Corporation (PCFC) organization in 1996. The second step was to develop a conducive policy environment by lobbying for articles in Republic Law 8425 and the establishment of a representative

government agency the National Anti-Corruption Eradication Commission. Poverty Commission (NAPC). The third step was related to increasing the capacity of MFIs, especially through government funds, namely the People's Development Trust Fund (PDTF) (Habaradas & Umali, 2023).

**Conclusion.** The findings of the study based on the comparison of legal cultures of Bangladesh, the Philippines, China, and India with Indonesia has given strong implications about the local economic wisdom of each country. In Bangladesh, the goal of poverty alleviation was the main objective of instilling a culture of shame in begging, and hence the Grameen Bank in Bangladesh became successful. In contrast, this type of model did not show real success in the Philippines, China and India due to the government interference and a supervision of the central banks. However, in Indonesia, due to the Islamic characteristics, the model was partially successful but the patterns applied by the Grameen Bank have been implemented so far in Indonesia. On the contrary, MFIS have used the local economic wisdom and expanded to all regions in Indonesia.

The study recommends to establish a legal format to influence micro and small businesses to be able to improve their standard of living. It needs a Planning Format by making use of local economic wisdom institutions that can transform the mindset of the people as per the Law on MFIs. A business format is also needed to determine the interest rate applied to customers of micro and small business actors. The format of supervision by the Financial Services Authority on MFIs can also no longer be passive, so the Financial Services Authority must actively establish representative offices in every district/city throughout Indonesia in collaboration with the local government. Finally, the format of accountability for MFIs to the Financial Services Authority, although reports are given periodically (passive), the Financial Services Authority itself must be active in viewing and measuring these reports.

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