

Access To Capital For Micro, Small, And Medium Enterprises (MSMES/UMKM) Through Formal And Informal Financial Institutions

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Abstract: *This research examines Micro, Small, and Medium Enterprises (MSMEs) access to capital from formal and non-formal financial institutions in Indonesia. Using a qualitative approach through in-depth interviews with 30 MSME actors in three big cities and secondary data analysis, this study identifies various obstacles faced by MSMEs in accessing capital and potential solutions. The results show that limited collateral, lack of credit history, and administrative procedure complexity remain the main barriers for MSMEs' access to formal financial institutions. Meanwhile, non-formal financial institutions are more accessible but often at higher costs. This research recommends strengthening financial literacy, innovation in credit guarantee schemes, and revitalizing cooperation between formal and non-formal financial institutions to improve MSMEs' access to capital.*

Keywords: *MSMEs, Capital Access, Formal Financial Institutions, Non-Formal Financial Institutions, Financial Inclusion*

INTRODUCTION

Micro, Small, and Medium Enterprises (MSMEs), known in Indonesia as Usaha Mikro, Kecil, dan Menengah (UMKM), play a strategic role in the country's economy. According to data from the Ministry of Cooperatives and Small and Medium Enterprises (2023), MSMEs contribute approximately 61% of Indonesia's Gross Domestic Product (GDP) and absorb more than 97% of the national workforce. However, despite their vast potential, MSMEs often face significant challenges, particularly limited access to capital, which remains one of the main obstacles to their growth and development (Tambunan, 2019). Access to adequate financing sources is a crucial factor for the sustainability and expansion of MSMEs. According to a report by Bank Indonesia (2023), only around 30% of MSMEs in Indonesia have access to formal financial institutions such as banks.

This situation has led many MSME actors to seek alternative financing through informal financial institutions, including savings and loan cooperatives, microfinance institutions, loan sharks, and personal loans from family or friends. Various government programs have been implemented to improve MSMEs' access to financing, such as the People's Business Credit or Kredit Usaha Rakyat (KUR) and other MSME financing schemes. Nevertheless, the Financial Services Authority or Otoritas Jasa Keuangan (OJK) reported that the MSME financing gap in Indonesia still reached IDR 1,649 trillion in 2023 (OJK, 2023). This figure indicates a substantial room for improvement in expanding MSMEs' access to capital.

This study aims to analyze the patterns of capital access among Micro, Small, and Medium Enterprises (MSMEs/UMKM) to both formal and informal financial institutions, identify the factors influencing MSMEs' preferences in choosing financing sources, and formulate strategies to improve their access to sustainable funding. The findings of this research are expected to provide a significant contribution to the development of more effective policies and programs in supporting MSME financing in Indonesia.

LITERATURE REVIEW

Characteristics of MSMEs and Capital Needs

MSMEs have diverse characteristics in terms of business scale, sector, and level of formality. According to Law Number 20 of 2008 concerning MSMEs, the categorization of MSMEs is based on asset value and business turnover. This diversity in characteristics has implications for the variation in their capital needs (Hafsah, 2020). Prasetyo (2022) identified that the capital needs of MSMEs can be distinguished into working capital and investment capital. Working capital is needed for daily operations such as purchasing raw materials and paying employee salaries, while investment capital is used for long-term business development such as asset purchases and business expansion. The study shows that 67% of MSMEs in Indonesia experience difficulties in meeting their working capital needs. Hermawan and Lestari (2021) also emphasized that limited access to capital not only hinders the growth of MSMEs but also reduces their competitiveness in the market. The study found a positive correlation between access to capital and the level of innovation and productivity of MSMEs.

Formal Financial Institutions and Their Characteristics

Formal financial institutions include entities that operate under the regulation of financial authorities, such as commercial banks, rural credit banks (BPR), and other official financing institutions. Widyastuti (2023) analyzes that formal financial institutions offer several advantages, such as relatively lower interest rates, higher loan limits, and longer loan terms. However, Pribadi and Sutopo (2021) identify several barriers faced by MSMEs in accessing financing from formal institutions, such as difficult collateral requirements, complex and time-consuming administrative procedures, the lack of sufficient credit history, and limited understanding of formal financial products. Bank Indonesia (2022) highlights that the rejection rate of MSME credit applications by banks remains high, reaching 60-70%. This indicates a gap between the requirements set by formal financial institutions and the capacity of MSMEs.

Non-Formal Financial Institutions and Their Role

Non-formal financial institutions include various financing entities that are not under the direct supervision of financial authorities, such as savings and loan cooperatives, non-bank microfinance institutions, rotating savings and credit associations (arisan), and individual money lenders. Kuncoro and Setiawan (2021) emphasize that non-formal financial institutions play a crucial role in bridging the financing gap for MSMEs that are not accessible to formal institutions. The advantages of non-formal financial institutions, according to Supriadi (2022), include more flexible and simpler requirements, quicker fund disbursement processes, physical and emotional proximity to MSME actors, and the absence of formal collateral requirements. However, Rahmawati and Juhadi (2023) show that financing from non-formal institutions is often accompanied by higher interest rates, shorter loan terms, and greater debt trap risks for MSMEs. The study notes that loan interest from money lenders can reach 20-30% per month, much higher than bank credit interest rates.

Financial Inclusion and MSME Capital Access

The concept of financial inclusion is an important framework in understanding the dynamics of MSME capital access. According to Gunawan (2021), financial inclusion not only encompasses physical access to financial services but also the availability of products that meet needs, affordability, and adequate financial literacy. The National Strategy for Financial Inclusion, launched by the Indonesian government, aims for a financial inclusion rate of 90% by 2024. However, Santoso and Wijaya (2022) note that although the formal financial inclusion rate has increased, the quality of financial service usage by MSMEs remains relatively low, with a dominance of basic products such as simple savings accounts. Rahim (2023) identifies that the development of financial technology (fintech) offers new opportunities for MSMEs to access capital through peer-to-peer lending platforms, crowdfunding, and digital payments. However, the digital gap and financial literacy still pose challenges in optimizing the use of fintech by MSMEs.

RESEARCH METHODS

This study uses a qualitative approach with a case study method to gain an understanding of MSME capital access to formal and non-formal financial institutions. A qualitative approach is chosen because it allows for the exploration of the behaviour, perceptions, and experiences of MSME actors in accessing capital (Creswell & Poth, 2018). The research was conducted in three major cities in Indonesia, representing different geographical and economic characteristics: Jakarta (representing the western region and economic center), Makassar (representing the eastern region), and Medan (representing the northern region). In each city, 10 MSME actors were selected as primary informants, considering variations in business sectors (manufacturing, trade, services), business scales (micro, small, medium), and capital access experience. In addition to MSME actors, the study also involved 15 key informants, consisting of:

1. 6 representatives from formal financial institutions (commercial banks, BPR)
2. 6 representatives from non-formal financial institutions (cooperatives, BMT, P2P fintech)
3. 3 representatives from relevant government agencies (Ministry of Cooperatives and SMEs, OJK, Bank Indonesia)

Data in this study were collected through several techniques. In-depth interviews with MSME actors and key informants were conducted to explore experiences, perceptions, and preferences related to capital access. Focus Group Discussions (FGD) were held in 3 sessions (one session in each city) involving MSME actors, representatives from financial institutions, and other stakeholders to identify challenges and potential solutions.

Observations of the MSME financing application process in both formal and non-formal financial institutions were conducted to understand the mechanisms and direct barriers. Document analysis was performed on MSME financial reports, credit requirements from financial institutions, and government policy documents related to MSME financing. The collected data were analyzed using thematic analysis techniques, with stages including the transcription of interview and FGD data. The data analysis process was supported by the use of NVivo 14 software to facilitate the management of complex qualitative data and identify emerging patterns from the data.

This research upholds research ethics principles by obtaining written informed consent from all informants, ensuring the confidentiality and anonymity of the data, and providing informants with the right to withdraw from the study at any time. All research procedures have been approved by the Research Ethics Committee.

RESULTS AND DISCUSSION

MSME Profile and Capital Needs

MSME actors interviewed, 40% were micro-enterprises, 37% were small enterThe results of the research show the diversity of MSME characteristics among the research informants. Of the 30prises, and 23% were medium enterprises. In terms of business sector, 33% were engaged in manufacturing/production, 40% in trade, and 27% in services. The capital needs of MSMEs varied based on the scale and sector of the business. Micro-enterprises generally required working capital ranging from IDR 5-50 million, small enterprises needed capital of IDR 50-200 million, while medium enterprises required capital above IDR 200 million up to IDR 1 billion. As stated by one informant, "My business needs capital of around IDR 150 million to add stock and renovate the store, but the bank asks for a guarantee in the form of a certificate worth almost twice the amount of the loan I applied for." (Informant 7, Wholesale Trader, Jakarta). This finding aligns with the study by Hermawan and Lestari (2021), which identified a gap between the capital needs of MSMEs and their capacity to meet the requirements of formal financial institutions.

Patterns of MSME Access to Formal Financial Institutions

The research data shows that only 37% of MSMEs that were informants in the study have ever accessed financing from formal financial institutions, with details as follows: 27% from commercial banks, 7% from rural banks (BPR), and 3% from other formal financial institutions. This figure reflects the low penetration of formal financial institutions among MSMEs, as also found in a report by Bank Indonesia (2023). The factors that hinder MSME access to formal financial institutions based on thematic analysis include:

1. Limited collateral – 83% of informants mentioned the absence or insufficiency of collateral value as the main obstacle.
2. Complex administrative requirements – 76% of informants complained about the complicated procedures and the large number of documents requested.
3. Lack or inadequacy of credit history – 62% of informants did not have a sufficient formal credit record.
4. Limited financial literacy – 58% of informants acknowledged their lack of understanding of formal financial products.
5. Incompatibility of financing products – 47% of informants felt that the credit products offered did not match the characteristics and business cycles of their enterprises.

Interviews with representatives of formal financial institutions confirmed these findings, as expressed by a bank credit manager: "We have prudential banking obligations that must be met. Without adequate collateral and audited financial statements, it is difficult for us to extend credit to MSMEs due to the relatively high risk." (Informant K3, Bank Credit Manager, Makassar)

Patterns of MSME Access to Non-Formal Financial Institutions

The research found that 73% of MSME informants had accessed financing from non-formal financial institutions, with details as follows: 33% from savings and loan cooperatives, 20% from community-based microfinance institutions (including BMT), 13% from P2P fintech platforms, and 7% from moneylenders. This finding indicates a high preference of MSMEs for

non-formal financial institutions compared to formal ones. The main motivations for MSMEs in accessing non-formal financial institutions, based on thematic analysis, include:

1. Ease and speed of the process: 87% of informants mentioned that a faster and less complicated process was the main factor.
2. Flexibility of requirements: 79% of informants appreciated the minimal formal requirements.
3. Relational proximity: 68% of informants mentioned a personal relationship with the managers of non-formal financial institutions.
4. No formal collateral required: 65% of informants chose non-formal institutions because they did not have to submit a certificate or vehicle ownership document (BPKB) as collateral.
5. Suitability of payment schemes: 52% of informants found the installment schemes offered to be more suitable for their business cash flow.

Interestingly, even though they were aware of the higher interest rates, many MSME actors still chose non-formal financial institutions due to the speed and ease: "I know the interest at the cooperative is higher than at the bank, but if my business needs quick funds, the cooperative can disburse in 1-2 days. At the bank, it could take 2-3 weeks and may not even be approved." (Informant 15, Catering Entrepreneur, Medan)

Capital Source Combination Strategy

An interesting finding from this study is the strategy of combining capital sources implemented by 43% of the MSME informants. They access multiple sources of financing simultaneously or sequentially to meet different capital needs. Common combinations include:

1. Using financing from formal institutions for long-term investment capital, while relying on non-formal institutions for short-term working capital needs.
2. Utilizing government program credit (such as KUR) for basic needs, supplemented with financing from cooperatives or fintech for additional needs.
3. Using staged funding, starting with non-formal institutions to build a payment history, then switching to formal institutions once the business becomes more established.
4. This combination strategy reflects MSMEs' adaptive responses to the limitations of each capital source, as explained by one informant: "The initial capital came from my family, then for purchasing machines, I used KUR. For daily working capital, I use loans from cooperatives because the disbursement process is more flexible, although the interest is a bit high." (Informant 23, Processed Food Producer, Jakarta)

Impact of Digitalization on Access to Capital

The impact of digitalization and the development of fintech on MSME access to capital emerged as an important theme in this study. About 27% of MSME informants have utilized fintech platforms as a source of capital, either through peer-to-peer lending or invoice financing. The benefits of fintech perceived by the informants include:

1. An entirely online application process without the need for face-to-face interaction
2. Fast approval times (24-72 hours)
3. Use of alternative data (such as digital transactions) as a substitute for formal financial reports
4. Flexibility in loan amounts and tenors

However, the challenges faced in adopting fintech include:

1. Relatively high interest rates (18-24% per year)

2. Short loan tenors (generally 6-12 months)
3. Digital gaps among MSME actors

"As an online shop owner, fintech platforms are really helpful because I can apply for a loan through my phone without having to go to their office. They also assess based on my online shop transactions, not formal financial reports, which I don't have." (Informant 19, Online Shop Owner, Makassar).

These findings underscore the potential of fintech as a bridge between formal and non-formal financial institutions, in line with Rahim's (2023) study on the role of technology in enhancing financial inclusion for MSMEs.

CONCLUSION

Based on the research results and discussion, it can be concluded that MSMEs' access to capital from formal financial institutions still faces various structural barriers, while non-formal financial institutions are more accessible but come with higher costs. This gap encourages MSME actors to develop a strategy of combining multiple sources of capital to meet their business needs. The main factors influencing MSMEs' preferences in accessing capital include ease of procedures, product suitability with business characteristics, availability of collateral, and financial literacy levels. These findings imply the need for a comprehensive approach to improving MSMEs' access to capital, involving various stakeholders.

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