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### TRUST, PARTICIPATION, FINANCIAL AND SOCIAL PERFORMANCE: EMPIRICAL EVIDENCE INDONESIA REVOLVING FUND MICROFINANCE PROGRAM

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#### ABSTRACT

This study explores the impact of trust on financial performance and social performance, the impact of trust on participation, and the impact of participation on financial performance and social performance, as well as the impact of financial performance on social performance. Explanatory research quantitative approach to analysis. The population was 63 MFI southern Kalimantan. We analyzed the data using WarpPLS. Study findings show that trust has a significant positive impact on financial performance and social performance, that trust has a significant positive impact on participation, that participation has a significant positive impact on financial performance and social performance, and that financial performance has a positive impact on social performance. These findings indicate that there is no trade-off between sustainability and social mission

#### 1. Introduction

The Indonesian government has implemented various poverty alleviation programs. One of the poverty alleviation programs being implemented is PNPM Mandiri Rural, which is a refinement of the Kecamatan Development Program. In its implementation, this program prioritizes infrastructure development and developing microfinance through the provision of revolving

funds sourced from government funds for the development of productive businesses and welfare for people in rural areas, especially for women. Where these funds are managed by the Community Empowerment Trust Fund Activity Management Unit (UPK DAPM) (Bappenas, 2003)

Microfinance has shown itself to be capable of rising poverty and the quality of life of the poor. The impact of microfinance is both individual and household (Littlefield et al., 2003; Morduch, 1999) and nation (Khandaker, 2005; Mosley & Hulme, 1998). Microfinance is intended to provide those with little to no valuable assets, which can be used as capital or leverage, access to financing.

Sometimes, problems associated with the MFI community empowerment initiatives include economic growth because of low trust due to fraud, low participation, weak corporate governance, low levels of internal control, low transparency and tools for grant and revolving funds that are vulnerable to abuse due to lack of oversight (Hollo, 2001). In order to achieve maximum benefits for the disadvantaged, MFIs have a long term emphasis on organizational sustainability. Unsustainable microfinance will now support the poor. In order to achieve maximum benefits for the disadvantaged, MFIs have a long-term emphasis on organizational sustainability. Unsustainable microfinance will now support the poor, but in future it will not help the poor, for microfinance was lost (Schreiner, 2000)

The balance between financial sustainability and the social mission must be balanced, which are the key microfinance priorities (Dunford 2006). Two facets of microfinance are outreach and sustainability. This view illustrates the complementary importance of achieving low and sustainability and in particular, sustainability. The funds needed to service a large number of poor customers are made available to only top performers of sustainable microfinance programs (Rhynes 1998). Lasting service to the poor will be provided by sustainability microfinance (Nyamsogoro, 2010; Brau & Woller, 2004; Woller et al, 1999).

Microfinance is proven to be able to increase the standard of life of the poor and their hopes of getting out of poverty. Microfinance impacts not only at the individual and household level (Littlefield et al., 2003; Morduch, 1999) but also at the country level (Khandaker, 2005; Mosley and Hulme, 1998). Microfinance is designed to provide access to finance for those who have little or no valuable assets that can be used as capital or collateral.

Problems often faced by MFI community empowerment programs are sustainability issues, due to low trust due to fraud, low participation, poor corporate governance practices, low internal control systems, and a low level of accountability and sources of use of grants or revolving funds which are prone to be misused due to lack of supervision (Hollo, 2001). MFIs need to pay attention to operational sustainability to provide optimal benefits for the poor in the long term. Unsustainable microfinance can help the poor now, but will not help the poor in the future because the microfinance has disappeared (Schreiner, 2000)

There needs to be a balance between financial sustainability and social mission, which are the main goals of microfinance (Dunford 2006). Outreach and sustainability are two sides of microfinance. This view emphasizes that

reaching the poor and sustainability are complementary, and especially that sustainability serves outreach. Only high performers of sustainable microfinance programs gain access to the funds needed to serve a large number of poor clients (Rhyne, 1998). Sustainability microfinance will provide lasting service to the poor (Nyamsogoro 2010; Brau & Woller, 2004; Woller et al, 1999).

Criticism of approaches that prioritize financial sustainability can contribute to a move away from the social goals of poverty reduction in the microfinance mission (Aubert et al., 2009; Copestake, 2007), while Welfarist argues that microfinance is established to reduce poverty, so the success of the MFI must be calculated in terms of how many poor clusters of poverty are established (Nyamsogoro, 2010; Brau & Woller., 2004).

Some MFIs have survived successfully with respect to MFI sustainability, while others seem less successful. Successful MFIs will retain their financial viability and the capacity to pursue successful business practices. Meanwhile, unsuccessful MFIs fail and are also mismanaged due to bad business practices (Abraham & Balogun, 2012 ; Agyapong 2015; Amoo & Kolawole 2015; CGAP, 2003; Congo, 2002; Dunford, 2000, Zuru et al., 2016).

Sustainability in microfinance requires trust from customers and investors (Karlán, 2014). Trust is the foundation of many facets of microfinance operations and is a determinant of microfinance's performance. In borrower classes, between clients and loan officers, and between clients and institutions, trust governs interactions (Epstein & Yuthas, 2011). In order to achieve financial sustainability and economic growth, trust is very important for the success of lending programs (Norell, 2001; Knack & Keefer, 1997; Bastelar & Leather, 2006).

Trust in an institution needs a belief that it is possible to trust the institution, comply with the laws, and represent the public interest. This implies the belief that the organization is professional, fulfills its duties and behaves responsibly (Devos et al., 2002). By a the risk of bank runs in a country, trust in banks promotes financial stability (Fungacovaj & Weill, 2017). The motivational model of members participating in cooperative governance was studied by Birchall & Simmons (2004) and found that trust is central to member participation.

In community development projects, participation is a requirement that is required. Invite people to contribute to group goals and share responsibility for achieving them by engaging in the mind and emotional participation of people in group circumstances (Davis & Newstrom 1989); MFI management participation is seen in different ways, including the custodian, in order to engage in cooperative governance. The cooperative strategy can be governed and supervised by managers (Siebert & Park, 2010).

Based on this context it is important to research the impact of trust on financial and social performance, the effect of trust on participation and participation on financial and social performance as well as the effect of the social performance. The breakthrough of this research is its impact on social performance and its influence on social performance and its added empirical evidence of financial

performance's effect on social performance. To prove whether there is a trade between sustainability and the social performance of microfinance in rural Indonesia.

## **2. Literature Review And Hypothesis**

### **2.1. Trust and Performance**

Trust is the basis of many aspects of microfinance operations and is a determinant of microfinance's performance. In borrower classes, between clients and loan officers, and between clients and institutions, trust governs interactions (Epstein & Yuthas, 2011). Trust is the result of assessing an individual's honesty or goodwill (affect-based trust) and trusting in a person's capacity, organizational performance, integrity, and reliability (cognitive based trust) (Mc Allister, 1995). Humphrey & Schmitz (1996) reported that faith among developed countries facilitates economic trade and economic development. Not only is it important for the industry to gain a competitive edge, but it also recognizes increased confidence as a key to fostering co-operation in supply chains and groups that is crucial to economic development. Trust in an institution needs a belief that it is possible to trust the institution, comply with the laws, and represent the public interest. This implies the belief that the organization is professional, fulfills its duties and behaves responsibly (Devos et al., 2002). First the positive effect of high trust motivates members of the borrower community to increase loan repayment (Bastelaer and Leather, 2006; Karlan, 2007), the second trust improves the borrower group's sustainability over time, thus minimizing default (Mc Evily, Perrone & Zaheer, 2003) and the three type a loan officer and customer relationships. and the customer received substantial data from loan officers, which in turn enables officers to charge a lower interest rate (Uchida, et al., 2012).

In order to create and sustain trust between people and organizations, MFIs must establish systems and processes that promote the organization. To enhance the operations and lives of customers, alignment of these methods, processes, and management systems is important. Increasing the financial resilience of MFIs along with economic growth and increasing the economic and social effects on microfinance clients is part of the success of microfinance (Epstein & Yuthas, 2011).

Empirical research shows that trust can influence governance mechanisms, negotiating costs, strategic alliance risk perceptions, and performance of the business unit (Davis et al, 2000; Nookoom et al, 1997; Zaheer et al, 1998; Morrow et al., 2004). Trust makes it easier for banks to pool savings and grow credit, which are the key prerequisites for financial growth. By a the risk of bank runs in a country, trust in banks promotes financial stability (Fungacovaj & Weill, 2017). Based on theoretical studies and empirical studies, the following hypothesis is developed

H1.Does trust has a significant effect on financial performance.

H2.Does trust has a significant effect on social performance?

## 2.2. Trust and Participation

Trust is also the basis for the involvement of participants of the organization. The study by Barraud-Didier et al. (2012) focuses on the efficacy of member trust and cooperative trust through the affective involvement of members and continuing dedication of members to member participation. The results showed that the relationship between trust and member involvement in cooperative governance is mediated by successful commitment. The motivational model of members engaging in cooperative governance was studied by Birchall & Simmons (2004) and found that trust is central to member participation.

Participation in people's mental and emotional participation in group contexts helps them to contribute to and share responsibility for the achievement of group objectives (Davis & Newstrom, 1989). There are several facets to the involvement of participants in the group, namely: passive. The views of members of cooperative governance participation are regarded as a socio-psychological element that explains an important part of the members' commitment to and trust in the board (Österberg & Nilsson, 2009).

Trust is also used in social exchange relationships to describe individual actions towards their organisation (Ferrin & Dirks, 2003; Kramer, 2009). In comparison to structured economic exchange contracts that guarantee that both parties meet their short-term obligations, social exchange between two parties entails reciprocal obligations that are long-term (Blau 1964). According to this principle, the theory of social exchange is primarily based on the reciprocity standard of Gouldner (1960), where mutually beneficial activities take place between members of the cooperative and the cooperative, the exchange relationship must take place where reciprocal obligations are reinforced and valued. Members are optimistic that the cooperative will fulfill its future duties (finding the best crop market, giving the best guidance, etc.) and will behave reciprocally and be kind to the cooperative. This impacting member participation. The following inference, based on theoretical studies and observational studies, Based on theoretical studies and empirical studies, the following hypothesis is developed

H3. Does trust has a significant effect on participation

## 2.3. Participation and Performance

Participation contributes to democratic organizational management, better oversight and strength, and alignment of internal interests, and fulfillment of members' expectations (Banco Central Do Brasil, 2008). Osterberg & Nilson. (2009) stated that the participation, commitment, and loyalty of members are important, complex, and sensitive issues in the development and progress of cooperatives. The commitment of members and their trust in the management is influenced by their economic background, age, and experience in cooperating

The most significant factor in promoting an organization's progress or growth is participation. All aspects related to the execution of goal-scoring events are realized by participation. All projects that need to be initiated by management need to be endorsed by all organizational elements (Faidah & Dewi, 2013). Meanwhile, research by Rejeki et al. (2017) shows that participation by

members has a substantial impact on business performance. Aini et al. (2012) found that for the growth of cooperatives in Malaysia, member participation is very significant. While participants may not be actively engaged in cooperative administration, their opinions are very relevant at the annual meeting. Based on theoretical studies and empirical studies, the following hypotheses were developed:

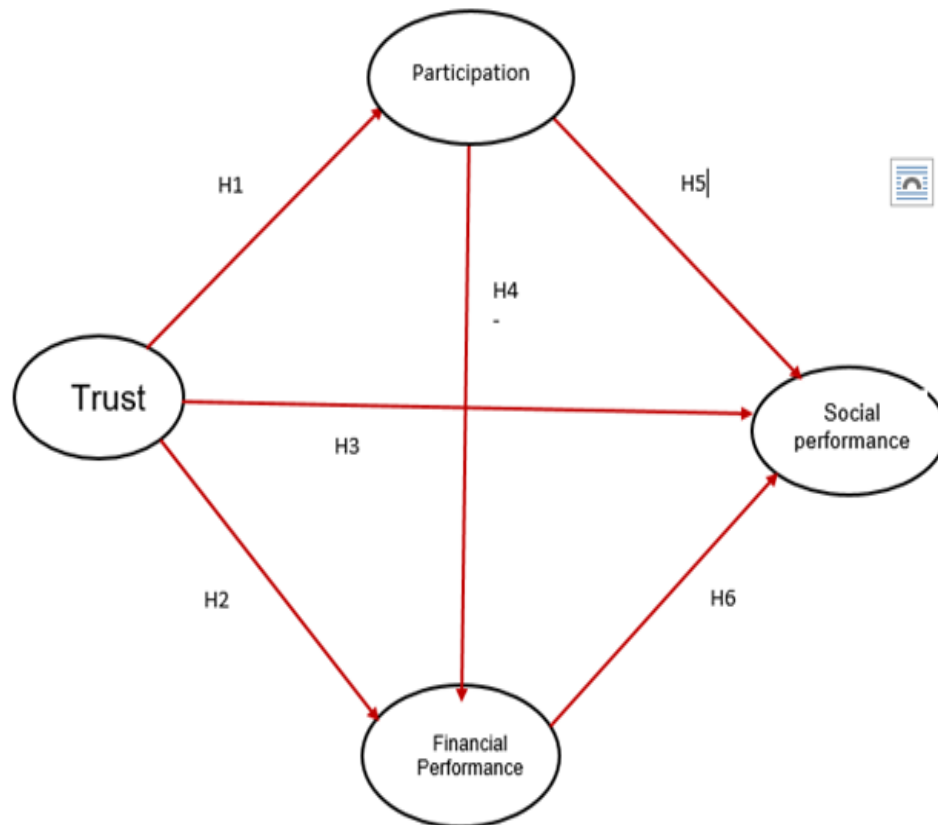
H4. Does participation affect financial performance?

H5. Does participation affect social performance?

**2.4 Financial performance and social performance**

Dunford (2006) notes that the principal goal of microfinance is the need for a balance between financial sustainability and a social mission. Microfinance outreach and sustainability are two sides of the whole. This view emphasizes that it is complementary to reaching the poor and sustainability, and specifically that sustainability serves outreach. The funds needed to support a large number of poor clients are accessible only to high performers of sustainable microfinance programs (Rhyne, 1998). Microfinance for survival would provide the poor with permanent service (Nyamsogoro 2010; Brau and Woller, 2004; Woller et al., 1999). Several studies have shown that economic performance has a positive influence on social performance (Gakhar and Meetu, 2016). (2016, Kaur). The hypothesis is established as follows, based on the theoretical and empirical study:

H6. Does financial performance have a significant effect on social performance



*Figure 1 - Hypothesis Model*

### 3. Research Methods

This research is an explanatory research with quantitative methods, secondary data were collected from the annual report of MFIs the Community Empowerment Trust Fund Activity Management Unit (UPK DAPM) The Nasional Program Community Empowerment (PNPM Mandiri pedesaan) in South Kalimantan from 2014-2018.

#### 3.1. Data collection and sample

The study population contains a total of 80 MFIs rural areas of South Kalimantan Province, with the criteria

- Consecutively from 2014 to 2018 doing the annual Meeting.
- The MFIs reported the statement of financial position and the report of income statement consecutively from 2014 to 2018.
- The age of MFIs is above 10 years.

Based on these three criteria, the ones fulfilling the requirements of population for the research are 63 MFIs. The sampling technique used is saturated sampling for the ones fulfilling the criteria for the research sampling. This research uses the data panel that is mixture between the data of time series and cross section data. The panel data consists of 63 MFIs X 5 years, so that the data is in the total 315..

#### 3.2. Measurement

**Table 1.** Variables, Indicators, Measurement and Sources

Variable	Indicator	Measurement	Source
( X 1 ) Trust	(Y1.1) Growth in the number of users	The percentage increase in the number of users in a year	Fungacoa and Weill (2017)
	(Y 1.2) Loan growth	The percentage increase in the number of loans granted in a year	Fungacoa and Weill (2017)
(Y 1 ). Participation	(Y2.1.)% Of users present in RAT	Percentage of MFI users who attend RAT	Pozzobon and Zylbersztajn (2011)
	(Y2.2.) % Users who are administrators	Percentage of LKM users who are administrators	Pozzobon and Zylbersztajn (2011)
( Y 2 ) Financial Performance	(Y3.1.1) ROA (Return On Asset)	Return on assets is net income divided by total assets	Marwa and Aziakpono (2015)

	(Y3.1.2) OSS (Operational Self Sufficiency)	Operational self-sufficiency is total income divided by total expenses	Marwa and Aziakpono (2015)
	(Y3.3) FSS (Financial Self Sufficiency)	Financial self-sufficiency is the ratio between income to total expenditure + 5% of the total loan	Marwa and Aziakpono (2015)
(Y3) Social Performance	(Y3.2.1) Number of active Borrowers	Number of active borrowers	Bakker et al. (2014)
(Outreach)	(Y3.2.2) Average Loan	Total funds borrowed / total borrowers	Bakker et al. (2014)
	(Y3.2.3) Number of female borrowers	The ratio of female borrowers to the total number of borrowers	Bakker et al. (2014)

Source: Previous Research (20 20 )

### 3.3. Data analysis

The analysis data used inferential statistics analysis is used to test the effect of the variables in this study. Researchers used the WarpPLS statistical tool (Solimun. et al., 2017).

## 4. Research Findings

### 4.1. Hypothesis testing

Hypothesis test used to test the significance of the relationship between variables by looking at the *p-value* . If the *p-value* is less than the error rate of 0.05, it can be concluded that there is a significant relationship between variables. Path coefficients and hypothesis testing are presented in Table 2.

**Table 2.** Hypothesis Testing Result

Hypothesis	Influence between variables	Coefficient	p-value	Information
1	Trust → financial performance	0.0 55	0.0 13	significant
2	Trust ⇒ social performance	0. 055	< 0.001	Significant
3	Trust ⇒ participation	0. 055	0.02 8	Significant



4	Participation $\Rightarrow$ in financial performance	0.054	<0.001	Significant
5	Participation $\Rightarrow$ social performance	0.055	0.001	Significant
6	Financial performance $\Rightarrow$ social performance	0.055	0.005	Significant

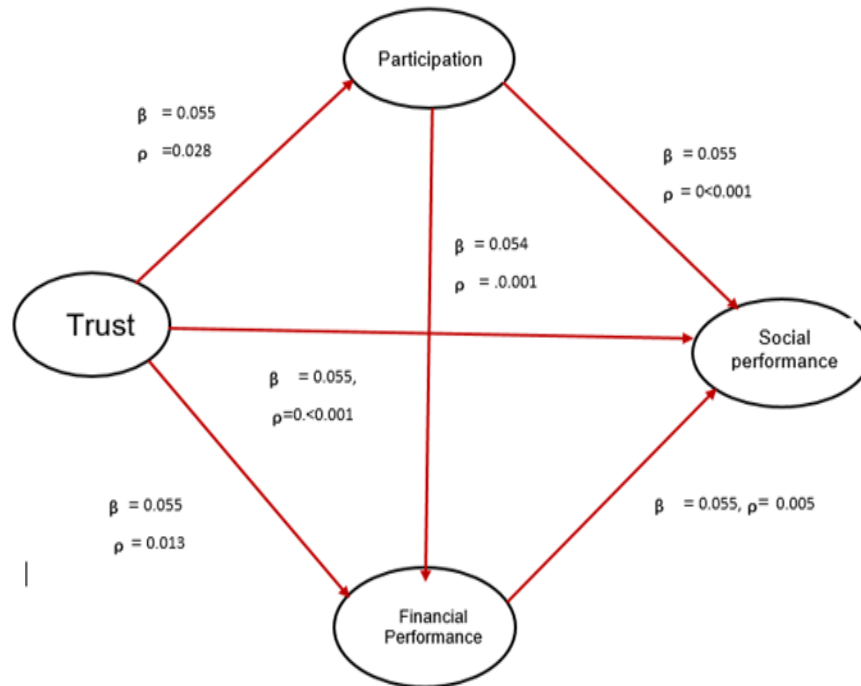


Figure 2 - Final Structural Model

### 5. Discussion Of Results

The results showed that trust had a significant positive effect on financial performance and social performance. The higher the trust, the higher the financial performance and social performance. The results showed that customer trust had a positive and significant effect on customer transactions. The results of this study indicate that MFIs are trusted by the community to apply for loans. This is indicated by the average growth of users during the 2014-2018 period of 3.47% and loan growth during the 2014-2018 period of 8.70%. Loan growth shows an increase in loan transactions, an increase in transactions has an impact on increasing income as indicated by an increase in MFI income, and an increase in the number of borrowers. The average financial performance during the 2014-2018 period is as follows; ROA of 7.24%, OSS for 225.98%, and FSS at 140.05%, while the social performance is as follows; The average number of active borrowers is 552 people, the average loan is Rp. 3.718,482.03 and percentage of female borrowers 97.82%.

The theoretical model developed by Epstein & Yuthas (2011) that includes trust as a significant determinant of MFI performance is supported by these findings. First of all the positive effect of a high trust motivates group members

borrower to repay the loan (Bastelaer & Leather, 2006; Karlan, 2007), both trusts increase the sustainability of borrower groups from time to time, thus reducing the default (Mc Evily, Perrone & Zaheer, 2003) and the three trusts form the relationship between loan officer and customer, and loan officers receive significant information

The results of the study also support Murti & Santika's (2016) research on the effect of customer trust, product mix, and location mix on customer transactions in cooperatives in Tabanan, Bali. The results of the study support the research of Tuyishime et al. (2015) which shows that an increase in users can lead to an increase in deposits over the years. It also makes ROA, ROE, net profit increase as the volume of borrowing increases. The statistical correlation shows that there is a positive relationship between deposit mobilization and financial performance. Loan activity is possible if the bank can mobilize sufficient funds from users because it is an indispensable tool for profitability.

Murti & Santika's (2016) research on the impact of customer trust, product mix, and location mix on customer transactions in cooperatives in Tabanan, Bali, is also supported by the study results. The findings of the study support Tuyishime et al. (2015) research, which shows that an increase in users over the years will lead to an increase in deposits. As the amount of borrowing increases, it also increases ROA, ROE, net profit. The statistical correlation indicates that deposit mobilization and financial results have a positive relationship. Loan operation is feasible if the bank is able to mobilize ample user funds, as it is an invaluable profitability method.

These findings also support the concept of Morrow et al. (2004) who found that trust can affect governance structures, negotiation costs, risk perceptions in strategic alliances, and business unit performance. Wherefrom the perspective of transaction costs, the trust is expected to reduce the cost of governance, because of the reduced threat of opportunistic behavior. Reductions in governance costs can lead to increased efficiency, which in turn improves organizational performance. These results also support the principle of Morrow et al. (2004), who found that trust can affect the mechanisms of governance, negotiating costs, perceptions of risk in strategic partnerships, and the performance of the business unit. From the point of view of transaction costs, due to the reduced threat of opportunistic conduct, trust is supposed to reduce the cost of governance. Reductions in the cost of governance can lead to improved productivity, which in turn increases the performance of organizations.

Other research findings indicate that trust has a significant positive influence on participation. The result confirms Barraud-Didier et al. (2012) study, which explored the affective impact of member trust and trust value through the affective commitment of members and the continuing commitment of members to member participation. The results of this study also support the social exchange theory (Blau, 1964) which states that trust affects participation, where the social exchange theory is based on reciprocal norms, according to this theory when MFIs provide benefits to users/members, members will return

the favor. By upholding responsibilities and being kind to MFIs by participating in MFI-organized activities.

The findings of further studies suggest that participation has an important positive influence on financial performance and social performance. The results of the research are in line with the theory of the agency (Jensen & Meckling, 1976), where higher participation will reduce the cost of the agency since the performance of the MFI is controlled by more members. The results of this study support the research results of Hammad, H et al. (2016), which show that the participation of members is very important, especially in the long term, for the success of cooperatives. As a result, the current organization actively communicates and facilitates its members' involvement across multiple channels, including their participation in the decision-making process, which can help sustain the organization's course and ensure effective results. Research by Redjeki et al. (2017) also confirms the findings of the report, which indicates that participation by members has a substantial impact on business success.

The final result of this study is that there is a significant positive impact of financial performance on social performance. These findings support the view that reaching the poor and sustainability are complementary, and that outreach is primarily served by sustainability. The funds needed to support a large number of poor clients are accessible only to high performers of sustainable microfinance programs (Rhyne, 1998). Several studies by Gutierrez-Nieto et al., 2009; Louis et al., 2013; Kar, 2011; Adhikary & Papachristo, 2014; Gakhar & Meetu, 2016; Kaur, 2016. are supported in this research showing that financial success has a positive influence on social performance.

## **6. Conclusion**

Study findings show that trust has a significant positive impact on financial performance and social performance, that trust has a significant positive impact on participation, and that participation has a significant positive impact on financial performance and social performance. Finally, there is a significant positive impact of financial performance on social performance.

The research findings show that financial sustainability is a need to serve the poor, which is the social mission of microfinance. Financial sustainability and social performance are in fact influenced by trust and participation. Therefore, microfinance needs to continue to increase trust and increase the quality and quantity of user and member participation, so that sustainability and social performance are better. For this reason, good governance is needed so that microfinance is increasingly trusted and able to increase its participation.. Increasing user participation can be done through regular education of users and members, the increased quality of participation will be able to increase the performance of the MFI.

Research conducted through financial data and data quality trust and participatory studies is a limitation of the study, so that user participation has not been photographed to the fullest, it is important to deepen the study of the quality of trust and participation from the user perspective. Because of the

contribution of trust, participation and financial performance and social performance, the next study needs to add another variable, so the remainder is the contribution of other variables that have not been discussed in this study

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