

# Institutional Economic Reconstruction by Optimizing The Role of Middlemen

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**Abstract.** This study is aimed to analyze the role of middlemen in rural economic institution and formulate the economic development model through optimizing the role of middlemen. This study was done by conducting literature research. Data were analyzed by using qualitative method. The results of study conclude that middlemen have strategic positions in rural economic development although their role has negative and positive side. In evolving the positive side, there must be other institution which has capability to substitute part of middlemen role. That is microfinance institution (MFIs) which also play the role as an empowerment institution. In loan mechanism, the middlemen can be functioned as a credit guarantee institution. Credit guarantee from middlemen is not only as a contract in agriculture product marketing, but also as the supervision way to create obedience in loan repayment by farmers. The implementation of this pattern is purposed to nurture the social capital in rural economic system.

**Keywords:** middlemen, patron client, microfinance institution, social capital

## Introduction

The critical role of middlemen in the marketing of agricultural commodities in many cases is still dominant. This fact related to Indonesian farming condition which is still small scale and scattered in space area, it leads to involving the middlemen as a traditional institution that is able to work efficiently. Can this role be able replaced by modern institution such as cooperatives or other marketing institution ?. Of course, it has to wait its reality. In other words, the existence of middlemen in rural economic systems is not only as a result of market realities, but also as a response from small scale farming characteristics and lack of formal institutions that capable to replace this role more efficiently.

Although the middlemen is an institution that is required in the rural economy, but in many occasions are often regarded as a negatif job, so it is often get insult or stereotype. Negative views or stereotypes, sometimes come not only from ordinary people, but also from various parties, including the policy

makers or planners. This condition has impact that the role of middlemen never got adequate development interventions. According to Syahyuti (1999), the public's view toward middlemen role is often ambivalent. It means, on the one hand is insulted, but on the other hand is expected of their existence.

At one side, the emergence of ridicule must be recognized because in some cases there is behavior of middlemen who get the economic benefits prominently. This condition may occur when middlemen are overly strong position in a structure of relationships (market structure). For example in the case of livestock marketing, many middlemen do exploitative action to the small scale farmers who are in a weak position (see Syahyuti, 1999). But on the other hand, there are many middlemen who have a major role in helping the success of farming. Therefore, the problems related to middlemen role should be seen in a more proportional, so that the government policy can be better applied in the development context.

Theoretically, the patron of client

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**Received:** December 11, 2015, **Revision:** March 16, 2016, **Accepted:** June 20, 2016

**Print ISSN:** 0215-8175; **Online ISSN:** 2303-2499. Copyright©2016. Published by Pusat Penerbitan Universitas (P2U) LPPM Unisba  
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relationship between the farmers and middlemen could contain positive and negative side. According to Sudarmono et al. (2012) the benefit is determined by how much the client relied on their patron. While according to the Sudrajat finding (2015a) , the relationships will give positive impact if it is folowed by the existence of social capital. In line with this, Ferrol-Schulte et al. (2014) identified several positive side of the patron client relationship which can be seen from its benefits for clients and patron. Usually, positive benefits to clients are in the form of credits for security of subsistence or even loan for investment purposes, flexibility on loan repayment period, protection when facing difficulties, providing production facilities, legal protection, improvement access to markets, personal support, and improvement access on variety of resources and information, while the benefit for patron cover the loyalty of clients, availability of labor, increasing the prestige in community, providing information related to competitors, local political support, and decreasing production costs.

This phenomenon has been demonstrated in several previous studies showing that social capital has an important role in the marketing of agricultural commodities (Fafchamps and Minten, 1999; Fafchamps and Minten, 2001; Syahyuti, 2008). This study shows that the success of trade in agricultural products is determined by the strength of relationship rather than input prices, output prices, access to credit, and access to transportation and communication (Fafchamps and Minten, 1999). It indicated that in the marketing of agricultural commodities is facilitated strongly by existence of social capital in every transaction.

The role of middlemen, in terms of government policy, is categorized as informal economic institution. The position of this institution was still considered subordinate when compared with the existence of formal marketing agencies. It can be proved by low attention from government especially if it is compared to other agricultural support institutions, such as producers of fertilizers, agricultural machinery services, seed producers, and so forth. Almost no program is intended specifically to empower the role of middlemen. It is characterized by a minimum of regulations issued by the government to regulate this trade (see Syahyuti, 2007). In other words, the trading activity which organized by middlemen is not recognized yet by the government. This phenomenon can be

seen from the fact that trading activities are not recorded in formal government statistics. Development planners often overlook the fact that the role of middlemen is actually very significant in rural and economic development of the nation as a whole, mainly in creating and expanding market access for farmers.

In rural areas, this informal economic are not only run by middlemen, but also carried out by moneylenders (Nugroho, 2001: 5-19). The existence of informal financial institutions is actually as a response to the inability of formal financial institutions in providing credit to the villagers. This inability is characterized by rigidity in setting lending rules that complicate the farmers in accessing the financial institution by lower cost, fast, and modestly. The role of middlemen is also often overlapping to the role undertaken by the moneylenders, because the middlemen also often lend money for facilitating the farm. The middlemen role, seem unavoidable or even increase in line with increasing of agricultural activity in rural areas. Although the role of middlemen often caused controversy, but in reality should be recognized it can provide significant economic contribution in development of rural economy. It becomes important to be studied from various aspects of science, so that the role of middlemen can be understood holistically viewed from several different perspectives.

The important and strategic questions relevant in this context are: does the role of middlemen will cause poverty in the society through the practice of capital accumulation on one social class in rural areas or conversely encourage greater economic activity ?. What kind of condition the role of middlemen can give benefit to the farmer in rural areas ?. The scope of this question must be understood by comprehensive framework. Based on that idea, it can be formulated two aspects as main objectives in this study: (a) analyze the role of middlemen in rural economic institution, and (b) formulate the model of economic development by optimizing the role of middlemen.

In order to achieve the objectives of study, the main method used is literature study, while the data were analyzed by qualitative methods refer to Idrus (2009: 61-75) and Bungin (2015: 57-71). The source of literature in this study cover the conceptual and research literature. The conceptual literature includes concept or theory in the books or scientific articles that have been

written by experts based on the idea and experience, while the research literature includes articles that have been published in scientific journals. Conceptually, the role of middlemen is explored either in economic or sociological aspects and its impact on rural development, while based on the results of research is carried out the comparative study in the marketing some agricultural commodities.

The study is divided into three parts. The first part is an introduction, while the second section is a discussion of the economic institutional system in rural of Indonesia that in the fact heavily influenced by the existence of middlemen in marketing of agriculture product. In this section discussed the roles of middlemen in economic and sociological views, the impact of existence of middlemen toward another economic institution, the comparison several results of study that describe positive and negative side of the middlemen existence, and aspects that can be done to develop the rural economic system. Furthermore, at the end of this article is raised about the conclusions and recommendations of this study.

### **Review Economics and Sociology Aspects**

Since the mercantilist in pre classic formulated the idea, it has been known that the economic growth of a region can be achieved by trading interaction with other regions. Based on this idea, it is no doubt that interconnectedness through trading between the rural areas as a producer of raw materials and the urban area as a location of industry is an important prerequisite for the advancement of the rural economic. Therefore, it is understood that a rural area will be progressed if it has commodities that can be traded with other regions. It can happen, because only by trading the capital can flows into rural areas. Furthermore, the flow of capital and process of multiplier will leads rural area to better stage in economic growth.

Refer to the trade paradigm the role of middlemen became very important as an institution that brings agricultural production to urban areas and monetary flow into rural areas. In other words, the role of middlemen is very strategic for the economic advancement of rural areas and improving the farmers welfare. Furthermore, the rural urban interaction in trading will enhance economic progress of a nation through the

role of agriculture sector as the foundation of economic development.

However, the important role of middlemen is often face obstacles, because according to Damsar (1997: 90), sociologically the middlemen often face a dilemma. On the one hand, traders have to deal with farmers who have a value system based on the subsistence ethics, while on the other hand middlemen must face a market system that upholds the values of economic rationality. But, if it is viewed from the trader orientation, trading activities is intended to gain profits and capital accumulation, so psychologically it could create heavy conflict within the mental of traders. Therefore, in trading it is needed patience or mental endurance to do it. The traders who are success in doing business in rural communities have long experience, complexity, and dynamics high patience.

The description above gives the sense that in order to become success trader is not easy. In rural areas, it is required the skills in complicated of financial and social calculations, that is between the portion that must be acquired and ability to maintain good relationships to the farmers. Abandonment on the one hand can cause the trading loss that can leads to hardship financial or on the other hand, the traders received improper action from farming community in the form of anger and ostracism. Until this situation, the traders are tested in running their business capability and the ability to protect the farmers in the community. The ability to manage dilemma could be a selection way for merchants to be able survive.

The description above gives meaning that in trading activities required the skills, attitude, and behavior that is more complex than the activities on farm level. This fact indicated that skill in trading is often gotten by traders through direct experience in practice (Syahyuti, 1999). Thus, the existence of middlemen in the marketing of agricultural commodities must be viewed more thoughtful, even this institution is regarded as local institutional by some scientists, a form of bonding associational of patron clients in rural area, and therefore it is an important part of social safety net mechanism in rural area (Dharmawan, 2007).

### **The Impact of the Middlemen Existence on the Other Economic Institution**

The development of small scale business

requires the marketing agency that has capability to organize the business collectively. In some commodities, the institutions that do this function are cooperative as a formal institution that recognized its role by the government, because since independence of Indonesian, the cooperatives have been designated as a moderator in organizing small scale business. But, it is not easy to build good cooperative, especially related to marketing of agricultural products, so until now there are many commodities that still organized by middlemen. What kind of situation cooperative could be success in organizing the small scale business ?. This is one of aspects that will be described in this section which is linked to the existence of middlemen exactly.

Example of success cooperatives in marketing of agricultural production is a cooperative of dairy farmers, such as in South and North Bandung Regency, West Java. There are some technical reasons why the cooperatives related to dairy farmers can run well. One reason is characteristic of milk highly perishable that is in few hours can be damage if it is not immediately handled in cold storage. Therefore, for small scale dairy farmers are effective if it is sold to cooperatives that have cold storage. Another reason, it is not easy for middlemen to collect milk from dairy farmer, because in operating this business requires a huge investment in setting up the cold storage building. It means, this business is not easy to be accessed by the beginner businessman such as the middlemen with lack of capital. Dairy farmer cooperative in South and North Bandung Regency can run well because at the beginning of growth, they get huge government support.

Furthermore, when it is viewed from the economic perspective, the market of milk is limited in an area or lead to monopoly case in the region (spatial monopoly). This means in a region, the dairy milk can not be sold freely to other traders who do not have a cold storage. Therefore, the success history of cooperatives related to agriculture everywhere, always featuring cooperative of dairy farmers or milk producers as an example of their success (Perhepi, 2004).

The success of milk producers cooperation at national level is also shown by the formation of Indonesian Milk Cooperation Association to bridge the various problems of dairy cooperative development nationally. Dairy cooperatives are generally formed by a computation for organizing the cluster agribusiness of dairy farm by placing

cooperatives as development agencies.

In addition, naturally the dairy farm tend to be clustered in an agro climatic condition that suitable for the cultivation, that is in the area of high altitude or low temperature, thereby naturally it will form an economic agglomeration in a region or cluster. Therefore, the development of dairy farm through cooperative is cluster closed model (spatial monopoly) that is unique and effective, so it may be difficult to be imitated for development of other commodities which have different characteristics (Perhepi, 2004). This understanding is very important in providing policy direction of agriculture and economic development in Indonesia to avoid misdirected.

Turning to other commodities such as corn, rice, marine and plantation products, etc., the marketing of those agricultural products are organized dominantly by the middlemen. In those commodities, usually followed by open market structure relatively or more competitive market, so the existence of middlemen is greatly important for the farmers. This case is very easy to find out in marketing of marine products. Although this commodity is perishable, but it can be handled by simply way with ice cubes as a coolant without expensive cost, so the marketing of marine products are generally organized by middlemen. The important aspect of this case is: when the marketing of the commodities can be controlled by the middlemen, the cooperative is very difficult to run well. This case is also very easy to find out in marketing of products which has similar characteristics.

In South Sulawesi, according to Satria (2002: 38) the role of middlemen in marketing of marine product seen clearly, even it is highly stratified. They call as "*pappalele*", for example in the cultivating and marketing of grouper fish. On the one hand, the *pappalele* as patron provide financing support to fish farming, while on the other hand they acts as a fish buyer. Meanwhile, the small scale fishermen as clients heavily relied on the existence of his patrons.

This pattern is not only to bind the fishermen in selling fish to *pappalele*, but also to guarantee the supply of fish to the customers who have become *pappalele*'s partners. Besides, the patron client relationship is not only limited between *pappalele* and fishermen, but also between *pappalele* and other *pappalele*. The stronger *pappalele* in having capital become patron for a weaker *pappalele*.

## Comparison of Some Studies on the Role of Middlemen

The important role of middlemen has been expressed by many researchers before, for example in the marketing of marine products in the Gulf of Nikoya-Costa Rica, Pollnac study (1978) found that the middlemen do a lot of functions, not only buying fish from the fishermen, but also performing other functions, such as lending of money and providing a reasonable price. It means, the middlemen not only perform the economic functions solely, but also social functions.

The study results of Sulistyowati et al.(2014) in the marketing of mango in West Java, showed some benefits for farmers who establish partnerships with middlemen, that is providing market guarantee, the certainty of sale price, giving access to loan of capital and production facilities, provide efficiency in harvesting and transportation, and risk sharing. In addition, the other important aspect is the transfer of technology from middlemen to mango farmers who play the role in improving the quality and productivity of mango. The partnership between farmers and middlemen in marketing of mango is based on principles and business strategies to gain advantage among them, because in this partnerships can only run properly if every doer can feel the reasonable benefit. Thus, the role of middlemen is very useful in facilitating agribusiness of mango in West Java.

The relationships between farmer and middlemen in agricultural marketing are generally done through cooperation in long period, so that according to study of Rustinsyah (2011) it will have some positive benefits for the farmers. The relationships are maintained by patron to get supply stability of goods, so their business sustainability can be assured. Meanwhile, the client gets protection of their subsistence security, because they often get loans (credits) to fulfill farming input or other household needs. The finding in line with the Scott idea (1976: 176), that the client is associated with a patron aims to obtain a protection guarantee of their subsistence.

Furthermore, the study results of Sudrajat (2015a) found that sustainability of relationship between farmers and middlemen is determined by the existence of social capital. The existence of social capital is evidenced by the loans without interest rate and the flexibility of loan repayment period. Social capital with elements including mutual

trust, solidarity, and reciprocity, it proved has important role in maintaining the agribusiness sustainability. The result of this study has strengthened of Syahyuti opinion (2008) that in the marketing of agricultural commodities in Indonesia is heavily influenced by the existence of social capital.

The contrary finding, referring to the study of Febrianto and Rahardjo (2005), that the patron client relationship in the marketing of marine products has a negative side. Based on the result of study, the patron has exploitative behavior such as blocking the client to access the market, so the clients always relied on the patron. According to Rahardjo (2010: 60) the negative aspects of patron client occur when the structure of society lead to the strengthening of social polarization (structure of village community in two classes) which indicates a wide gap, for example in the relationship between the ship owner and fishermen laborers in coastal community.

Thus, it is wise to be stated that there are positive and negative aspects of the patron client relationship. It means, the positive and negative aspects of a relationship are depending on the cases, it can not be generalized from one or few cases. In the case that displays negative aspects, the patron allegedly get more benefit than the client, or impress there are exploitative mechanisms. On the contrary, it has a positive side when the patron is capable to facilitate clients to develop more advanced, so it can encourage vertical mobility. So, the positive side happened when the patrons were able to push the client exit from poverty trap (Satria, 2002: 40).

## Optimizing the Middlemen Role and Fostering of Social Capital

Until now, it seems there is no effective effort to empower economy in rural area, despite in the fact there are some potential aspects can be developed. The potency does not empowered seriously yet, such as facilitating and recognizing the middlemen in agricultural marketing activities. Based on this opinion, the middlemen should not be viewed negatively or even scorned, but must be regarded as an institution that can optimize its role in building the agribusiness, because actually their role is heavily needed. The problem is strong position of trader in the market structure. It needs the efforts from inside and outside the village to create the

balance of economic structure (the position of farmers are not too weak or position of traders are not too strong). Therefore, ideally in rural areas, there must be other institutions that capable to do competition toward the role of middlemen.

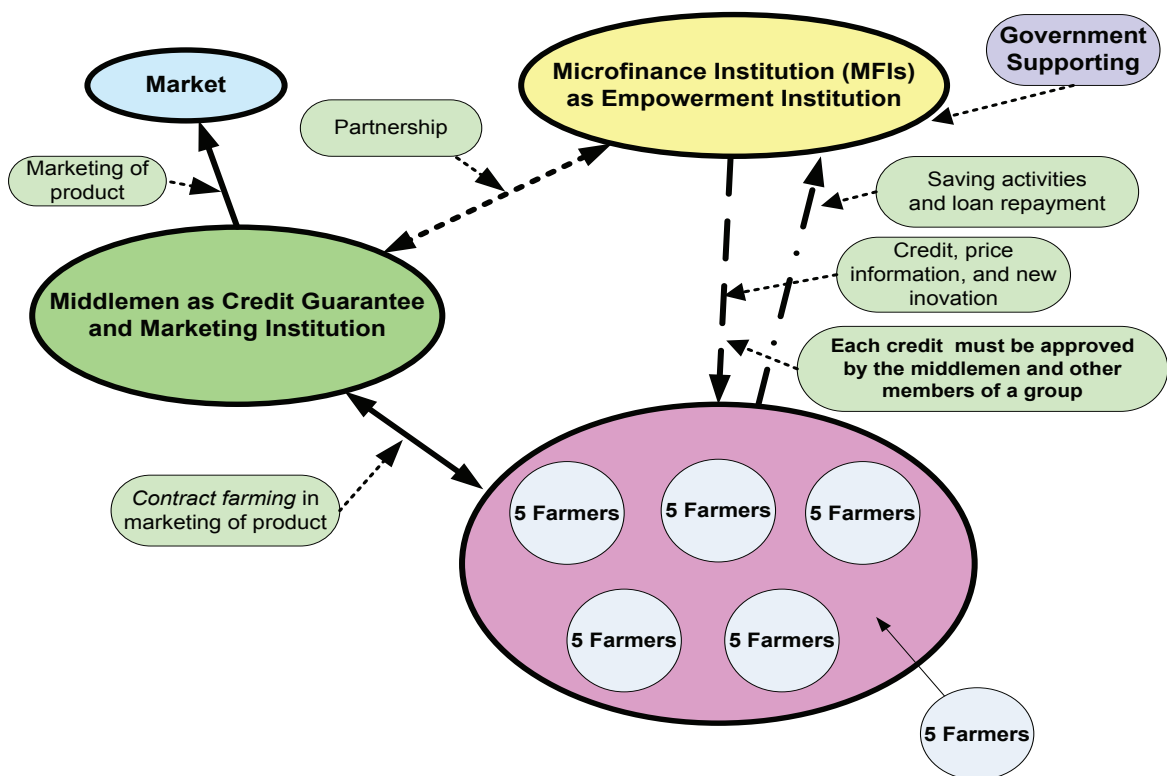
An institution that ability to do competition toward the middlemen is a microfinance institution (MFIs) that is easily accessible by farmers. The existence of the MFIs is expected can replace a part of the middlemen role in providing credit facilities to the farmers. But, in order to guarantee the repayment of loan by farmers, MFIs can use the middlemen as credit guarantee institution. The middlemen as loan guarantee institution is intended as a form of contract in the marketing of agricultural products, so that the sales of farmer product can be assured. Besides, it is also intended as an effort to do supervision, so there is obedience in loan repayments by farmers. This model is expected to create the mutual supervision mechanism in organizing agribusiness or fostering the economic in rural areas.

The importance of giving credit to farmers has been recognized by development planners in Indonesia, and credit scheme for

the farmers has been alternated. However, the problems of the various credit schemes caused to jamming, due to weak in lending mechanism. One of weakness is the absence of a credit guarantee institution. The idea in this article through placing the middlemen as credit guarantee and marketing institution of agricultural products is expected as effective solution to facilitate the cheap credit to the farmers. In addition, the existence of MFIs is also expected as the balance of the social structure in the society, when it was dominated by the role of middlemen.

MFIs function in this case unlike the conventional institutions which lending of money solely, but should act as a public empower institution (benevolent institution) who received full support from the government. Furthermore, MFIs function as intended above has a noble purpose that is as an effort to foster entrepreneurship (agribusiness) and maintain social capital.

The effort to foster and nurture of social capital is the real empowerment, when there are phenomena of decreasing social capital in rural communities of Indonesia (Hasbullah, 2006: 112). Actually, good micro credit will be followed by fostering social capital when



Picture 1. Model of Institutional Economic by Optimizing the Role of Middlemen

lending is based on mutual trust among the institution involved. Moreover, if the loans must be approved by other member in the group, the existence of group as credit guarantee which among their members should be based on mutual trust, so that it will be more fostering social capital. Thus, the credit guarantor who is formed in this model is not only middlemen but also members of their groups, so it is also expected to be more effective in minimizing the jamming credit. The institutional model of economic development in rural areas as described above is illustrated in Picture 1.

The benefit of credit mechanism to foster social capital has been proven by the success of Grameen Bank in Bangladesh (Larance, 1998; Dowla, 2006). In the Grameen Bank model, the credit channeled through the groups is intended to foster and maintain social capital. According to Ajani and Tijani (2009), when the loans were distributed through a group, it will be filtering through the group (peer screening), monitoring through the group (peer monitoring), and guarantee through the group (peer collateral), so it will foster social capital in the communities.

Furthermore, the social capital has been believed by many parties. It has important benefits for poverty reduction. Recent study in Indonesia reported that social capital has a positive effect on improving the welfare of rural households that are measured from the expenditure per capita (Nasution et al., 2014). The results of this study suggest that rural households need to participate actively in community activities through organizations that can improve social interaction and access to social capital. The establishing of credit institution in rural areas is also as effort in this context. The existence of the micro credit agency as empower institution will enhance interaction among doers in the process of cooperation. Refer to the study of Fiisabilillah et al. (2014) found that intensive interaction is an important component of social capital in cooperation. Through the MFIs as empower institution, the interaction among the three components in Picture 1 (MFIs, farmers, and middlemen) can be more intensified, so that it will more strengthen the existence of social capital.

The role of credit agencies as an empowering institution mean that the MFIs is not only as channel of credit, but also has function more widely, that is to educate the public in the working area by applying

social capital. The statement was in line with the opinion of Sudrajat (2015b), that the intervention of credit in poverty reduction or empowerment has a deep meaning, which include foster self discipline, self respect, encourages saving behavior, and foster social capital.

## Conclusions

The existence of middlemen is a fact that can not be avoided, because they are needed. Their existence is as a response from small scale farming and scattered in the space of region. Therefore, it is unwise if their existence viewed negatively. On the contrary, its existence can be a potential if it can be utilized optimally. The most important role of middlemen is in expanding of farmer access to markets. Furthermore, through trading mechanism the economic of rural areas can grow up and develop.

To be a success middlemen is not easy, because sociologically the middlemen is often face a dilemma. At one hand the middlemen have to deal with the farmers who have a value system based on the moral economic principle (subsistence ethics), while on the other hand middlemen must also face a market system that upholds the economic rationality. There has been long debate with regard to the existence of middlemen, because it has a positive and negative side. The negative effect appear when the context of the relationship leads to social polarization, which is indicated by inequality and imbalance in the structure of society, while the positive effect it appear when the relationship is directed to facilitate the farmers (the client) to develop or exit from poverty trap. The newest understanding indicated that the patron client relationship has a positive effect when the relationship is based on the existence of social capital.

The fact shows that there is middlemen position who overly strong in a market structure. Therefore, there should be other institutions in rural areas that could replace a part of the middlemen role. So, the positive side of middlemen role appears more than the negative side. It is microfinance institutions (MFIs) which has the role not only as giving credit solely, but also as a social and economic empowerment institution (benevolent institution).

Furthermore, based on the framework to help the weak farmers, by moving the rural economy, and balancing the structure of

society, the middlemen could be potentially used as a credit guarantee institution. By this idea, the middlemen still do the function as marketing agencies because no one can replace their function more efficiently.

Provision of credit guarantee by the middlemen is not only as a form of contract in the marketing of agricultural products, but also as efforts of credit supervision, so that there is obedience in loan repayments by farmers. Through this empowerment pattern by introducing microfinance institution is intended to foster social capital in the rural economic system and as an important factor in improving the farmer welfare.

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