Financial Inclusion in Indonesia

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Roadmap of Presentation

- Key questions:

  What is financial inclusion and why should we care about it?

- Progress:

  Innovations in microfinance over past 30 years

- Perils:

  Current constraints to further microfinance development

- Proposals:

  Creating a more enabling policy environment

What is financial inclusion?

- Ensuring access to formal financial services for everyone, not just those at the top of a nation’s economic pyramid

- Especially those most often excluded, namely low-income households and family businesses

- Referred to as “unbanked” or “underbanked” majority, since they consist of most of society in developing and transitional countries

- Also a significant subset of the market in high-income countries, comprised primarily of immigrants and the economically marginalized

Why should we care about financial inclusion?

- Provides those with the greatest potential to gain from economic development the financial tools necessary to realize these benefits
- Addresses the paradox of rapid economic growth with increasing inequality at the same time
- Same services provided to conventional markets, but tailored to specific conditions of the working poor and poorest-of-the-poor
- Tailoring entails adapting product design, pricing, and delivery systems to customer needs and preferences
- Tailoring also requires institutional innovation to provide financial services to low-income households and family businesses in a financial sustainable manner
- We should promote financial inclusion as an essential component of a nation's strategy for achieving inclusive development, since inclusive development requires equality of economic opportunity

Innovations in Microfinance (1)

- Over the past 30 years, we have developed a variety of successful institutional models for the sustainable delivery of microfinance services to low-income households and family businesses
- Many of the models can be found in Indonesia
  - Specialized strategic business units within general commercial banks: Bank Rakyat Indonesia (BRI)
  - Village banks: Badan Kredit Desa (BKD)
  - Community banks: Bank Perkreditan Rakyat (BPR)
  - Membership-based orgs: KUDs, Coops, Credit Unions
- Also bank-service agency and bank-telcom models

Innovations in Microfinance (2)

<u>Bank Rakyat Indonesia (BRI)</u>

- World's largest, most profitable microbanking operation
- Commercialized 30 years ago, still growing and evolving
- Has inspired other Indonesian commercial banks (Danamon, BTPN) to enter the market, as well as creation of the first for-profit apex microbank (Bank Andara)
- In 2014, BRI Indonesia's largest bank in terms of assets, profits, network → BRI microbanking was ⅓ of the value of total BRI loans outstanding, ¾ of BRI profits, and was provided via a network of 9,331 Units, Teras/Teras Mobile, cash offices + thousands of agents and e-channels; will soon launch its own satellite
- Microloans: \$12.2b, 7.3m borrowers, 1.12% NPLs
- Microsavings: \$13.3b, 37.5m savings accounts

Innovations in Microfinance (3)

- Microfinance has responded to evolving markets by developing viable products
  - Transfer and payment services (domestic household to household transfers and bill payments; foreign remittances from abroad to home village) → reduce transaction costs, increase disposable income
  - Savings services (giro/demand deposits, passbook savings, time deposits, commitment savings) → income smoothing, cushion for shocks, provision for retirement, asset/wealth accumulation
  - Credit services (working capital, investment loans) → increase income and wealth, improve quality of life
  - Risk mitigation services (loan, life, health, weather-indexed crop insurance) → decrease vulnerability to common risks
- and appropriate delivery systems
  - Sometimes down to the village level (ex: BKK village posts)
  - Increasingly directly to the client via mobile phones (ex: mobile banking)
- under adapted regulatory and supervisory regimes
  - Regulation recalibrated, not more lenient (same risks measured differently, sometimes stricter regulations)
  - Supervision often delegated (ex: BRI and BPDs)

Current Constraints to Further Development of Microfinance

- Although we have applied theory to practice, and we know the policies and practices necessary to create an effective microfinance market, still:
  - Considerable unmet effective demand (lack of financial depth indicates large unbanked/underbanked market)
  - Unsolved challenges in product design and product delivery systems (especially agriculture credit)
  - Prudential and non-prudential regulatory barriers (such as full risk weighting for loans secured by non-conventional collateral)
  - Failure of competition (counterproductive consolidation and homogenization of banking sector)
  - Constant risk of backsliding into failed practices and financial repression (directed credit such as KUR)

Creating a More Enabling Policy Environment

- Smart regulation to avoid unintended consequences
  - Balance between over-exuberant deregulation and excessive re-regulation → managed competition
  - Appropriate prudential metrics → effective risk mitigation
- Mainstream microfinance into national strategy for financial inclusion
  - Demarginalize microfinance → integrate balkanized markets and link to SME finance
  - Include in a national poverty alleviation strategy → more sustainable and equitable growth

Want to know more about financial inclusion in Indonesia?

- Jay K. Rosengard and A. Prasetyantoko, “If The Banks Are Doing So Well, Why Can’t I Get A Loan? Regulatory Constraints to Financial Inclusion in Indonesia,” *Asian Economic Policy Review* (vol. 6, no. 2): https://dash.harvard.edu/handle/1/8705903

- Bank Indonesia, *Financial Inclusion Development Policy in Indonesia*, 2012: http://www.ilo.org/wcmsp5/groups/public/---asia/---ro-bangkok/---ilo-jakarta/documents/presentation/wcms_216688.pdf

- World Bank, Global Financial Inclusion Index (Global Findex), 2014: http://data.worldbank.org/data-catalog/financial_inclusion