



## **Financial Inclusion in Indonesia and Its Challenges**

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### **ABSTRACT**

The purpose of this paper is to observe the implementation of financial inclusion in Indonesia. Using Micro Enterprises (MEs) in traditional markets around Jakarta – Indonesia as the object of the research, approximately 20% MEs were found to have no banking facilities. Furthermore, instead of using credit facility, around 78% MEs still utilise their own capital to facilitate their businesses. The paper also examines the personal characteristics that can explain financial inclusion. Results revealed that only gender and education could explain financial inclusion. Moreover, the findings also revealed that MEs generally demand for banking facility. Nevertheless, there are several barriers that hamper them from financially included. In particular, Self Exclusion and Marketing Exclusion are the most barriers that MEs face in accessing financial services.

*Keywords:* Financial Inclusion, Financial Exclusion, Micro Enterprises

### **INTRODUCTION**

In today's advanced economy, the bank takes a central role in the community life and is the engine of economic development. As the intermediary institution, banking has an important role to bridge between demand

and supply of the funds to improve the welfare of the community life. However, in most developing countries, access to banking and other formal financial services is limited to the lower classes.

It is estimated that around 2.5 billion people have no access to formal financial services. Financial exclusion tends to be higher in developing countries as compared to advanced economies. For example, in the United States and Germany only 9% and 4% of the population respectively have no access to financial services (Peachy &

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Roe, 2006). In developing countries such as Indonesia, about half of its population are without access to any formal financial services. Other countries which have the worst condition are China, Pakistan, the Philippines and Bangladesh (World Bank Report, 2010).

Limited access to formal financial services occurs at the lower class of society. This is commonly referred to as financial exclusion which is a classic problem, where financial services to lower-class are still limited and very expensive. In Mexico, for instance, financial transactions such as short-term credit application cost five times more higher to unbanked society (Solo, 2008). Another example, for transactions using cheques, the unbanked society has to visit the issuer, which means they have to spend more time and money, while the banked society only need to make a deposit (Amaeshi, 2006; Mitton, 2008).

Financial inclusion is that formal financial services can reach low-income (low-income groups) and cover an extensive range of financial services such as savings, insurance, payment services and credit facilities. In other words, financial inclusion is the opposite of financial exclusion, a financial condition that only benefits a few parties.

Financial inclusion has become an important topic that is discussed in many developing countries, and it is even a focus point for all participants in the G-20 forum. Therefore, financial inclusion is vital to be realized given that country's economy relies on the financial sector.

The financial inclusion can be viewed as a means to achieve economic growth and a reduction of inequality and poverty. Ease of access to financial institutions will allow the lower classes to take part in economic activities and experience financial growth (NABARD, 2009).

Hanig and Jensen (2010) also argued that the current economic condition shows that financial innovation can bring crisis and destructive systemic impacts. The better existence of financial inclusion may enhance financial stability. They also stated that financial inclusion carries risks at the institutional level, but has no systemic impacts. It is proven that low-income borrowers and savers tend to have a solid financial behaviour towards financial crises, maintaining deposit in a safe place and satisfying their loan obligations.

Given the fact that financial exclusion exists in the lower classes of society in developing countries, including Indonesia, the groups have limited access to banking facilities. To diminish the financial exclusion, therefore, a financial inclusion programme is required. In order to implement the targeted and intensive financial inclusion, government, regulators, along with the banks, are expected to work together to consistently and continuously socialise and educate people who have limited access to financial institutions. In this case, the government, regulators and banking industry claim that they have already reinforced numerous financial inclusion programmes, including

enhancing financial literacy and providing suitable financial products and services to the lower class of society.

Based on the explanation given above, this research focuses on the implementation of financial inclusion in Indonesia and its barrier. It will only focus on demander side (Micro-Finance Enterprises), about their needs and barriers to access formal financial services. This paper is organised as follows: section two covers several state of art that have been reviewed. The next section discusses research design and methodology, followed by analysis and results in section four and conclusion in section five.

## LITERATURE REVIEW

Financial inclusion is the situation when majority of the population have broad access to a wide range of financial facilities such as deposit, loans, pension and payment services, as well as insurance, financial literacy and consumer protection mechanism (Shafi & Medabesh, 2012). Furthermore, financial inclusion occurred when access to financial and banking services available transparently and fairly at affordable prices (Sarma, 2008; Solo, 2008). It is also mentioned by Fuller and Mellor (2008) that financial inclusion is the necessity to extend the concept of financial institution that focuses on the welfare (not merely for profit), reliable and affordable to all levels of society. The purpose of financial inclusion is to carry unbanked society into the formal financial services so that they have the access to financial

services which include savings, insurance, payment services and credit facility (Hannig & Jansen, 2010).

The strategy to implement financial inclusion has also been applied in various countries using various means and strategies. In El Salvador, the focus of their attention is on how private banks can embrace unbanked society. The Jordanian government uses macroeconomic approach and bond sales promotion (interbank bond markets) with the objective to increase the accessibility of credit facility to the middle and low class society. On the other hand, the governments of Brazil and Egypt strengthen the banking network to create new banking products for unbanked society. Indonesia and Peru are pursuing the same approach to improve their people's ability to use existing banking products (The World Bank, 2007).

Meanwhile, Pakistan gives full authority to the small branches of banks in the region to take decisions in an effort to accelerate financial inclusion. In Kenya, the mobile is one means of expanding the banking network and providing easier access to the community broadly (Shafi & Medabesh, 2012).

Financial exclusion problem has been occurring in many developing countries including Indonesia. According to the World Bank (2010), less than 50% of the population in Indonesia have bank savings, only 17% borrow from the banks and more than one-third borrow from informal sectors. Therefore, it can be said that around 40% of Indonesians are financially

excluded from credit. Reasons for savers being unbanked include: (1) lack of money to obtain saving, (2) do not have any job, (3) do not understand bank, (4) do not see the advantages of having bank account. Interestingly, the finding shows that the interest rate is not a concern for them. In addition, the reasons for why people do not borrow include: (1) lack of documentation, (2) inadequate collateral, (3) inadequate income, and (4) in excess of debt.

Cnaan, Moodithaya, and Handy (2012) said that once financial institution is not well regulated, they will then prefer to have rich clients who can bear the high cost and at the same time, minimise the number of employees and branches to increase their profitability. These will definitely lead to financial exclusion.

Other researchers such as Khaki and Sangmi (2012) argued that the biggest constraints to eliminate the existence of financial exclusion are both from demand and supply. The problem from demand is caused by illiteracy, reluctance and skepticism about the formal financial sector. Then, constraints from supply increase due to the perception of non-bankable, complicated procedure and unsuitable products to all segments of the society.

Similarly, Shankar (2013) also argued that demand and supply might prevent the improvement of financial inclusion; for demand, it is due to financial literacy and capability. With the lack of financial knowledge, people tend to have minimum contact with financial services. In the same

way, with poor financial capability, people could not afford any financial services. As for supply, the problems are due to unsuitable financial products, physical barriers, and complicated documentation.

Meanwhile, Leyshon *et al.* (2006, p. 161, as cited in Cnaan *et al.*, 2012), financial exclusion contains several barriers that may hinder the improvement of financial inclusion. The barriers consist of: (1) physical barriers; lack of physical financial institutions such as ATM machines, branch; (2) Access Exclusion occurred due to limited access for financial services like complicated requirement for opening a bank account; (3) Condition Exclusion where the product is unsuitable for low-income society; (4) Price Exclusion where people cannot afford financial services such as high administration cost for saving account; (5) Marketing Exclusion where marketing scope is created only for targeted customers; and (6) Self Exclusion when people voluntarily exclude themselves due to previous rejections or fear of being declined.

## RESEARCH METHODOLOGY

### *Research Question*

The explanation above describes the importance of implementing financial inclusion in developing countries, specifically in Indonesia since access to financial services is still difficult for low-income society. Hence, it is crucial to assess the implementation of financial inclusion in Indonesia, but only for the demand. Research has been conducted on the following questions:

1. How many Micro-Enterprises (MEs) in the studied market are financially included and what financial services they do they used?
2. What are the personal characteristics that distinguish the level of opportunity in gaining access to financial services?
3. What are the actual necessity of MEs on financial product and services?
4. What are the barriers for implementing extensive financial inclusion?

#### *Data and Methodology*

In this research, financial services refer to the financial services from the banks. The study was conducted among 270 respondents of ME's in and around nine municipalities of Jakarta including, Bogor, Depok, Tangerang and Bekasi. Three traditional markets were taken in each municipality as the objects of study, as outlined in Appendix 1. Then, 10 respondents were taken from each market, with a total of 270 respondents for all the markets around Jakarta.

As the objects of this study, MEs have to fulfil the following criteria:

1. MEs run their businesses in the traditional markets around Jakarta.
2. MEs have run their businesses for approximately one year.
3. MEs are still classified as Micro Enterprises based on the criteria

of Micro, Small and Medium Enterprises according to Law No. 20 of 2008 on UMKM Indonesia.

This study is a quantitative research using primary data attained from questionnaires. The questionnaires consists of close-ended questions with several possible answers for each question. The respondents were required to choose only one answer for each of the question.

The questionnaire was divided into four parts according to the four research questions. The first part is related to the number of MEs that has been included in financial access. Micro enterprises can be counted as included in the financial system if they already have a saving account. The second part is about personal characteristics that can distinguish the chance to gain the access to financial services. The subsequent part asks about the needs of MEs on financial services. The final part is about the barriers that MEs faced in the financial system.

Apart from the questionnaire, statistical tools were also utilised to analyse the data. To test the validity and reliability of the questionnaires, SPSS (Statistical Package for Social Science) version 20 was used. Also, binary logistic regression was used to explain question number 2.

#### **RESULT AND ANALYSIS**

In order to answer the first research question, a demographic analysis was conducted. There were 270 questionnaires distributed to 270 respondents, and all

the questionnaires were returned. The respondents consisted of 66% males and 34% females who were generally around 25-45 years old (63%) at the time of this study. Around 92% of the respondents are married, and about 50% of them have run their businesses for more than 10 years.

Furthermore, the average of their revenue turnover is below 25 million. As for the respondents' educational background, they have either high school or lower level of education. In term of their residential status, around 47% are still renting.

TABLE 1  
Distribution and percentage of respondents based on facilities owned

	Facilities	Total	Percentage
<b>Bank Facilities</b>	No Facility	55	20.37%
	Saving	171	63.33%
	Credit	9	3.33%
	Health/Life Insurance	7	2.59%
	Credit Card	1	0.37%
	More than one facility	27	10.00%
<b>Source of Capital other than bank</b>	No Answer	2	0.74%
	Cooperative	24	8.89%
	Fiduciary	0	0.00%
	Own Capital	211	78.15%
	Personal	33	12.22%

Results presented in Table 1 show that there are about 20% of the respondents who have no financial facilities at all. The most facilities owned by MEs are saving accounts (about 63% of the respondents), while unfortunately only about 3% have obtained a credit facility from the bank. Furthermore, in terms of source of capital, about 78% of the respondents still generally

use their own capital. This indicates MEs are still not familiar with the credit facility from the bank.

Question number two covers personal characteristics that can distinguish the level of opportunity in gaining access to financial services. The analysis was carried out using binary logistic regression.

TABLE 2  
Personal characteristics related to financial inclusion

Variable	Category	Sig. (p-value)	Exp(B)	Sig. Result
<b>Gender</b>	Female (ref: Male)	.002	3.766	S
<b>Age</b>	(ref: < 25 )			
	25-45	.868	1.153	NS
	46-65	.983	.981	NS
	> 65	1.000	156335080.920	NS
<b>Marital Status</b>	Married (ref: Not Married)	.983	1.017	NS
<b>Length of Business</b>	(Ref : < 1 year)			
	1-5 years	.292	3.349	NS
	6-10 years	.148	5.462	NS
	>10 years	.422	2.493	NS
<b>Revenue</b>	(Ref: < 25 mil)			
	25-50 mil	.165	1.762	NS
	50-100 mil	.186	2.919	NS
	>100 mil	.999	895887656.765	NS
<b>Education</b>	(Ref: Primary to Junior high)			
	High Schol or higher education	.002	3.043	S
<b>Status of Residence</b>	(Ref: House-rent)			
	Apartment-rent	.999	.000	NS
	Stay with family	.101	3.841	NS
	Owner	.855	1.069	NS
<b>R Square (Cox &amp; Snell)</b>	0.168			
<b>R Square (Nagelkerke)</b>	0.264			

From Table 2, it appears that gender can explain financial inclusion. Interestingly, during this time, the female is considered as a gender group that has difficulty gaining access to financial institutions. However, this study proves that females can significantly explain financial inclusion since  $p\text{-value} < 0.05$  and they have 3.7 times

greater chance to gain financial access than the males.

Similarly, the level of education can explain financial inclusion as well. Those with high school qualification or higher level of education have 3.04 times greater chances than those having lower levels of education (primary and junior



school) in gaining access to the financial system. This might be related to the fact that better education would improve their financial literacy. On the contrary, the other variables such as age, marital status, length of business, revenue and status of residence could not explain financial inclusion.

The third research question is about the need of MEs for financial facilities. In order to get clearer picture of their financial access needs, the respondents were given seven statements, as follows:

1. You need saving account to save and manage your business.
2. You need a loan facility from banks as additional capital for your business.
3. You need a close distance to banks or ATM machine to aid your business continuity.
4. You want to have deposits, insurance.
5. You need banking services to support your business.
6. You need a loan facility to expand your business.
7. Banks have an important role in helping your business and financial condition.

TABLE 3  
Results of the needs analysis

	Questions						
	P1	P2	P3	P4	P5	P6	P7
<b>Disagree</b>	19%	36%	31%	16%	28%	36%	39%
<b>Agree</b>	81%	64%	69%	84%	71%	64%	60%

Those questions have passed validity and reliability test. The analysis was conducted on the needs of MEs for financial facilities. The results presented in Table 3 revealed that 81% of the respondents wished to have savings and 64% of the respondents wished to obtain credit facilities from the banks. In addition, about 69% of the respondents wanted the bank or ATM location placed close to their business. Furthermore, majority of the respondents (84%) would like to have other banking facilities such as deposits, insurance and so on. On the the other hand, only about 28% of MEs did not require banking services, 36% did not require

credit facilities and 39% thought that the banks did not have an important role in helping their businesses and finances. In general, about 70% of MEs argued that they needed banking services and products.

In the fourth research question, a descriptive analysis was conducted on the barriers that have the tendency to affect the occurrence of financial exclusion. Barriers are categorised based on the research of Leyshon et al. (2006: 161), which was cited in the study of Cnaan (2012: 185). These barriers consisted of Physical, Access, Condition, Price, Marketing and Self Exclusion. In order to analyse each barrier, the respondents were given three questions



representing each exclusion covered with possible answers: (1) Strongly Disagree, (2) Disagree, (3) Agree, and (4) Strongly Agree. The list of questions is as follows:

### 1. Physical Exclusion

Q1: Around your business environment, you have difficulty in finding a bank branch.

Q2: Around your business environment, you have to go far to be able to find an ATM machine.

Q3: Around your business environment, you have never seen a bank employee who promotes products / services.

### 2. Access Exclusion

Q1: Banks have complex requirements when you want to open a savings account.

Q2: Banks have complex requirements when you want to apply for the credit facility.

Q3: Banks have complex requirements when you want to make a deposit or insurance.

### 3. Condition Exclusion

Q1: Banks do not have services and financial products that can support your business.

Q2: Banking products and services such as credit, savings, and insurance provide no benefits to you.

Q3: Bank loan does not match your needs.

### 4. Price Exclusion

Q1: Banking administrative fee for savings account is too high, making

it difficult for your business.

Q2: The interest on the bank loan is too high for you, making it difficult for your business.

Q3: Interbank funds transfer fee is too high for you, making it difficult for your business.

### 5. Marketing Exclusion

Q1: You do not understand well various banking products and services.

Q2: Financial products and facility information such as savings, credit, etc. have not been disseminated clearly in various media.

Q3: Bank services are not appropriate for all levels of society, including the needs of MEs.

### 6. Self Exclusion

Q1: During this time, you still have concerns about the money you deposit in the bank because you do not trust the bank.

Q2: During this time, you still have concerns that your loan application will not be approved by the bank.

Q3: During this time, you still have concerns that the bank will not be willing to serve your needs as MEs.

Validity and reliability testing was carried out before the descriptive analysis was conducted. The results showed that all the questions are valid and reliable. Based on the results of the descriptive analysis, all

the questions for Physical Exclusion show results that are below average. This finding indicates that MEs found no problems in finding bank branches, as well as ATM and bank employees. As for Access Exclusion, the highest average is the second question which indicates that respondents felt that the banks have complex requirements when they wanted to apply for credit facilities. However, they did not find difficulty opening any savings account. Furthermore, Condition Exclusion shows that the highest average is in the first question that indicates that most MEs felt that the bank has no programme and financial products that are able to support their business activities. For Price Exclusion, the highest average is for question two which reveals that the respondents felt that the interest on the loan facility is still high. Nonetheless, all the questions for Marketing Exclusion showed results that are above average. This result indicates that MEs do not understand various banking products and services well. In addition, they also found that information about financial products and facilities has not been clearly disseminated in various media. Moreover, they argued that the services provided by the bank are not suitable for their needs. Lastly, for Self Exclusion, Questions 2 and 3 have results that are above average. This finding shows that the respondents are still worried that the bank will reject their credit applications or their other financial needs.

## CONCLUSION

This study aimed to examine and analyse the implementation of financial inclusion in Indonesia. The results revealed that about 20% of the respondents still do not have banking facilities. The most banking facilities used by MEs are savings. In terms of capital, approximately 78% of the traders are still using their own capital to run their businesses. This finding supports the research of World Bank in 2010, whereby 40% of the Indonesian population were excluded from credit facilities.

For the second question, Bi-variate was conducted to analyse the personal characteristics that might explain financial inclusion. A previous research conducted by Cnaan *et al.* (2012) found that caste, religion, education and command of resources as the variables that explained financial inclusion. This paper used certain variables such as gender, age, marital status, length of business, turnover, level of education, and status of residence. It was found that only gender and level of education could explain financial inclusion. This finding suggests that female has more opportunities to gain access to banking products. In other words, women are assumed to be more reliable by the banks in giving financial access. In addition, MEs with higher educational level have greater opportunity than those with lower educational levels. This is probably because they have more knowledge about and understanding of banking product and services.

The third research question explored the needs of MEs on financial facilities to support their business activities. The question only focused on traditional banking products such as saving, loan, deposit and insurance. It is interesting to note that about 70% of MEs stated that they needed banking services and products in managing their businesses. About 84% of MEs needed savings, 64% wished to have credit facilities and 84% wanted to have other banking facilities such as deposit and insurance. Thus, it can be said that MEs basically needed banking product and services. Bank is expected as an institution that can help them (MEs) to solve their money management problems in saving, borrowing and lending money at reasonable rates. However, they usually do not enough knowledge about banking or capital and resources to offer as collateral.

The final question assesses six barriers that possibly hamper the implementation of financial inclusion. Those six barriers are using typology of financial inclusion by Leyshon *et al.* (2006). Each barrier is represented by three questions. It was found that physical exclusion (in this case, branches, ATM and employees) is not a serious problem for MEs since all the questions have results that below average. For other barriers such as Access exclusion, condition exclusion, price exclusion indicated only one question generated a result that is above the average. Therefore, those exclusions seem not to be serious problems for MEs either. On the other hand, the barriers that have the highest

average are marketing exclusion and self exclusion. It can be assumed that those barriers are related to their knowledge in banking products and services, as well as their educational level. This result is in line with the results of question two which illustrates that majority of which without savings are less educated. Due to their low educational level, they do not have the confidence to access the financial services, so they exclude themselves. In relation to educational level as well, the MEs might not fully understand and were therefore not familiar with the marketing and sale of banking products so that they would think twice before doing any transactions with any banks. From this result, it can be suggested to bank and regulators in order to overcome the financial exclusion problems. In fact, MEs need bank products and services but their scope of knowledge and education have hampered them from getting the financial access. Therefore, it is recommended that banks create products that are suitable for them and also make the products familiar to or easily understood by them.

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