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**Financial Inclusion, Financial Education,
and Financial Regulation:
A Story from Indonesia**



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Abstract

Many reforms have taken place in Indonesia following the Asian financial crisis of 1997–1998. The government has embarked upon institutional transformation, making the country one of the region’s most vibrant democracies. In social, economic, and political areas, Indonesia has seen much progress. Wide reforms have been carried out in all areas of governance, including in the financial sector, and a new development strategy has been adopted for “inclusive” economic development. This paper examines the shift in Indonesia’s national economic development strategy from its “exclusive” orientation during the New Order era before the Asian financial crisis, to its “inclusive” orientation after the crisis. It also examines the impact the reforms have had on poverty reduction and the campaign to create a better environment for micro, small, and medium-sized enterprises (MSMEs). The constraints that Indonesia faces in implementing inclusive development, particularly financial inclusion, are also discussed.

JEL Classification: G21, G28, I25

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1. INTRODUCTION

During the so-called “New Order” era (1966–1998) Indonesia experienced rapid economic development and annual growth rates of 6%–8%. The regime lowered rates of poverty through rural economic development based on agricultural modernization and industrialization. Through these achievements, Indonesia was called one of the “Asian Tigers,” along with Malaysia and Thailand. However, this economic performance at the macro level hid some problems, since the development strategy adopted by the country created inefficiencies and market distortions. Indonesia suffered from high economic costs and a growing gap in income levels. During the New Order era, the development process was indeed exclusive, and affected only certain regions, such as Java, and only certain groups in society, i.e., those who were considered important by policymakers.

The Asian financial crisis of 1997–1998 hit Indonesia particularly badly. Indeed it was the most severe economic crisis to occur in Indonesia since the country’s independence in 1945. It led to an economic recession in 1998, with levels of growth of –13%. Following Indonesia’s recovery from the recession, the country has undergone a profound transformation. It has embarked upon far-reaching institutional changes and has become one of the region’s most vibrant democracies. In social and economic terms, Indonesia has also seen much progress. Wide reforms have been carried out in all areas of economic, social, and political policy, and a new development strategy, “inclusive” economic development and growth, has been adopted. In this inclusive development, the Indonesian government has adopted a triple-tracked strategy, i.e., “pro-growth,” “pro-job,” and “pro-poor.” This strategy is considered important for Indonesia, given that despite robust economic growth after the 1998 crisis, Indonesia still faces serious poverty issues (Tambunan 2012).

One important element of “inclusive” development is financial inclusion, which means broad access to financial services. This implies an absence of price and non-price barriers that might deter people from obtaining financial services. Nowadays, more institutions are paying attention to the issue of financial inclusion. At the G20 Toronto Summit held in June 2010, global leaders pledged to support financial inclusion to empower about one-third of the world’s population who are still living in poverty. Financial inclusion has also been integrated into the 2015 Association of Southeast Asian Nations (ASEAN) Economic Community Blueprint.

In Indonesia too, financial inclusion is linked to poverty alleviation and financial stability. The Government of Indonesia strongly believes that improving access to finance and improving the use of financial services will raise people’s welfare. One concrete course of action taken was the launch of the National Strategy of Financial Inclusion, in December 2010, by Bank Indonesia (BI), the Indonesian central bank. Since then, the government and monetary authorities, such as BI and the Indonesia Financial Services Authority (OJK) have had many high-level discussions on financial inclusion, which have focused on how to provide better access to banking services. They recognize that a major issue is asymmetric information between the supply (banks) and the demand (especially for the poor) of information on financial inclusion (Hadad 2010).

This paper is based on an ongoing study on inclusive economic development in Indonesia with a focus on financial inclusion for the period 2013–2015. The project has been conducted by the author and a team from the Center for Industry, SME and Business Competition Studies, Trisakti University. The main objectives are to (i) study the significance of the shift in national economic development strategy from an “exclusive” orientation during the New Order era (before the Asian financial crisis of 1997–1998) toward an “inclusive” orientation; (ii) explore the impact of the shift on the poor, including micro, small, and medium-sized enterprises (MSMEs); and (iii) understand the main constraints currently facing Indonesia in implementing inclusive development, particularly financial inclusion.

2. INCLUSIVE ECONOMIC DEVELOPMENT

According to Ali and Zhuang (2007), Ali and Son (2007), and Rauniar and Kanbur (2009), the term “inclusive economic development” has no widely accepted definition. The concept clearly encompasses inclusion and economic development, and views inclusion as a process as well as a goal. Inclusion can be seen as social transformation to accommodate difference through the removal of all barriers that discriminate against, or exclude, certain individuals or groups within that society. It sees society as the problem, not the individual. Rauniar and Kanbur (2009) state that inclusive economic development is economic growth coupled with equal economic opportunities. It focuses on creating economic opportunities and making them accessible to everyone in society at all levels, not just to the poor. An economic development process is said to be inclusive when all members of a society participate in, and contribute to, that process equally regardless of their individual circumstances or backgrounds. In the same way, inclusive economic growth is one that emphasizes that economic opportunities created by economic growth are freely available to all, particularly the poor. Inclusive economic development therefore, is the process of ensuring that all marginalized and/or excluded groups within a society are included in the development process. Because inclusion involves all members of a community, collaboration, partnership, and networking among individual members in the community are core strategies to achieve inclusion (Tambunan 2012).

According to Sachs (2004), however, inclusive development strategy requires three components to give all members of a community the same opportunities. First, it is essential to ensure the exercise of civil, civic, and political rights. Thus, Sen (1999) emphasizes that democracy is a truly foundational value, as it also guarantees the transparency and accountability necessary for development processes to work. For Sachs, civil, civic, and political rights are the precondition for inclusive development. Second, all citizens must have equal access to welfare programs for the disabled, mothers and children, and the elderly, which are designed to compensate for natural or physical inequalities. Compensatory social policies financed out of the redistribution of income should also include benefit for the unemployed. Third, the whole population should have equal opportunities to access public services, such as education, health protection, and housing.

The idea of inclusive economic development came after the introduction of the Millennium Development Goals (MDGs). The goals were developed because, although many countries have achieved remarkable results in their long-term economic development in terms of high economic growth, high income per capita, and rapid structural change from agriculture-based to industry-based economies, poverty is still high in many countries and the gap between the rich and poor has become wider. It is widely acknowledged that sustained poverty reduction depends on a rapid pace of economic growth. But the connection is not automatic. Some fast-growing economies have failed to tackle poverty, while some countries with slower economic growth have been more successful (Tambunan 2012). Even the United Nations Conference on Trade and Development (2010) argues that a fundamental problem in achieving the MDGs has been the lack of a more inclusive strategy of economic development that could integrate and support its “human development” ambitions.

It is not difficult to understand why many countries, especially those in South Asia and some parts of Africa (notably sub-Saharan Africa), still struggle to lower poverty and have a large proportion of their citizens living in extreme states of deprivation. In many of these countries rates of poverty have actually increased. This happens because many groups, so called “disadvantaged” people, such as women, children, those suffering from HIV/AIDs, ethnic minorities, nomads, and people in conflict and/or refugee situations, have been marginalized or excluded from participation in economic development. Poverty is a consequence and also a cause of disadvantage and, thus, poverty will not be alleviated without including disadvantaged persons in the process of economic development (Tambunan 2012).

It can be seen from the above discussion that key issues in inclusive economic development are poverty, participation, collaboration, and networking. This means that poverty alleviation is, or should be, at the center of inclusive economic development policies. In order to eliminate or reduce poverty, there is a need not only for direct policies to alleviate poverty but there is also scope for wider economic development policies, programs, and projects to favor poverty reduction, although not at the expense of efficiency, productivity, and competitiveness.

3. INDONESIA'S INCLUSIVE DEVELOPMENT STRATEGY

From 1997 to 1998 Indonesia was badly affected by the Asian financial crisis and, following that, by social and political disturbances and conflicts. This multidimensional crisis led to the fall of Soeharto's New Order regime in May 1998. Since then the Indonesian people have decided to pursue the path of democracy. The political system has been fundamentally transformed by the implementation of democracy and decentralization, and by the amendment of the 1945 constitution. Society has changed drastically and some of the previous public institutions are no longer functional.

Although the government during the New Order era seriously tried to address poverty issues in the country and initiated many pro-poor programs, which led to a significant decline in poverty rates, the gap between the rich and poor did not decline significantly. In fact, during this era, the adopted development strategy was more exclusive rather than inclusive, as many regulations, policies, and facilities favored a small group of big companies (or conglomerates) at the cost of MSMEs (Tambunan 2012).

In the new era that followed the Asian financial crisis, known as the era of reform (or *Reformasi*), government attention has been shifting toward "inclusive" economic development. In his 2009 address on national development in regional perspective,¹ Susilo Bambang Yudhoyono, then President of the Republic of Indonesia, stated that the paradigm of development for all in the context of Indonesia, can only be carried out by adopting six fundamental development strategies (Sekretariat Negara Republik Indonesia 2011). The first of these strategies is inclusive development that ensures equity and justice and that respects and maintains the diversity of the Indonesian people. To reach this goal, the central and regional governments formed a consensus on Indonesia's development. This consensus is guided by Indonesia's medium- and long-term visions and missions.²

In this inclusive development, the Indonesian government has adopted a triple-tracked strategy, i.e., "pro-growth," "pro-job," and "pro-poor." With respect to pro-poor strategies, the government has various programs to alleviate poverty directly or indirectly. The implementation of these programs complements economic growth as the main engine to eliminate poverty, rather than being a substitute for it. The most popular program is the National Self Reliant Community Empowerment Program (*Program Nasional Pemberdayaan Masyarakat Mandiri*). It empowers people directly at the level of subdistrict and village enabling them to decide on the development priorities of their respective regions (Tambunan 2012).

¹ The speech was presented before the special plenary session of the House of Regional Representatives of the Republic of Indonesia in Jakarta, August 2009.

² Indonesia's long-term direction for 2005–2025 is stated in Law No. 17/2007, National Long-Term Development Plan, 2005–2025, and the country's medium-term direction is given in each of the five year stages of the Medium-Term Plans (RPJMs). Each of the stages has a scale of priorities and development strategies that constitute a continuity of priorities and development strategies from preceding periods.

Other pro-poor programs include Unconditional Direct Cash Assistance (*Bantuan Langsung Tunai*) Public Health Insurance (*Jamkesmas*), School Operational Support, the provision of subsidies (e.g., rice, fertilizers, and program credits), and the Family Hope Program (*Program Keluarga Harapan*), which are earmarked for poor and near-poor families all over the archipelago. The Family Hope Program is implemented to meet the basic needs of households that are unable to meet them in any other way. Some of the programs, such as the *Program Nasional Pemberdayaan Masyarakat Mandiri*, are in the form of the “fishing rod,” to empower people and communities through the provision of funds up to Rp3 billion per subdistrict per year, the use of which is determined by the people themselves at the village level.

In addition, the government also allocates a budget for MSMEs in the form of subsidized credit, and the banking sector has been requested to channel a certain portion of their funds as credit for MSMEs. This MSME credit policy is a key element of Indonesia’s policies for financial inclusion.

4. FINANCIAL INCLUSION

After the Asian financial crisis in 1997–1998, Indonesia changed its national development strategy in all areas, including in the financial sector, from an “exclusive” orientation toward a more “inclusive” one. The country has a strong reason for adopting financial inclusion as its new national development policy objective, given that (i) the financial sector is highly concentrated, i.e., dominated by banks (most profitable, with low levels of intermediation), with growing capital markets, although they are still concentrated in a few big companies, and with a low penetration of pension funds, insurance, and other nonbank financial institutions; (ii) only a small part of Indonesia’s total population has access to banking services; and (iii) poverty is still a serious problem in Indonesia.

4.1 Current Developments

The most frequently used indicator to measure the level of financial inclusion is the percentage of the adult population with access to a bank account in the formal financial sector. According to the 2011 Global Financial Inclusion Index from the World Bank (World Bank, Financial Inclusion Database website) (Table 1), Indonesia has a low rate of uptake of slightly under 20%. This contrasts with Thailand’s uptake rate of almost 78%. Further, Table 2 shows statistics relating to bank account use by the adult population—those aged 15 and above—in Indonesia.

Table 1: Share of the Adult Population with a Bank Account in the Formal Financial Sector in Indonesia and Other Selected Countries and Regions, 2011

Country/Region	Share (%)
Indonesia	19.6
Malaysia	66.7
Philippines	26.5
Thailand	77.7
Viet Nam	21.4
India	35.2
PRC	63.8
Russian Federation	48.2
Brazil	55.9
High-income OECD and non-OECD	92.0
Middle East and North Africa	42.0
Central Asia and Eastern Europe	50.0
East Asia and Pacific	42.0
Latin America and Caribbean	40.0
Sub-Saharan Africa	12.0
South Asia	22.0

OECD = Organisation for Economic Cooperation and Development; PRC = People's Republic of China.

Source: World Bank; Financial Inclusion Data: Indonesia.

Table 2: Share of the Adult Population with an Account in the Formal Financial Sector in Indonesia, East Asia, and the Pacific, and Lower Middle Income Groups by Selected Components of the Financial Balance Sheet, 2011

(%)

Component	Indonesia	East Asia and the Pacific	Low Income Group
ATM is the main mode of deposit*	5.9	13.9	4.5
Bank teller is the main mode of deposit*	84.9	76.4	80.2
Bank agent is the main mode of deposit*	5.9	2.5	4.0
ATM is the main mode of withdrawal*	51.1	39.1	31.0
Bank teller is the main mode of withdrawal*	43.9	55.9	56.8
Bank agent is the main mode of withdrawal*	3.0	1.3	3.0
Has debit card	10.5	34.5	10.1
Uses an account for business purposes	3.2	3.2	4.1
Uses an account to receive wages	7.7	16.9	8.5
Uses an account to receive government payments	2.6	6.3	3.9
Uses an account to receive remittances	6.1	8.8	3.7
Uses an account to send remittances	5.5	7.1	3.0
Saved any money in the past year	40.5	39.8	27.6
Saved at a formal financial institution in the past year	15.3	28.4	11.1
Saved using a savings club in the past year	13.9	4.3	7.2
Loan from a formal financial institution in the past year	8.5	8.6	7.3
Loan from family or friends in the past year	42.3	27.2	26.6
Loan from an informal private lender in the past year	2.0	1.9	5.3
Personally paid for health insurance	0.9	36.8	5.1

ATM = automated teller machine.

Note: * percentage of those with an account

Source: World Bank (2012).

Furthermore, the BI Household Balance Sheet Survey 2011 shows that only 48% of households in Indonesia have accounts with banks and other formal financial institutions (BI 2013). These two sources of information suggest that access to banking services or formal financial institutions in Indonesia is, indeed, still low. Also, less than one-fifth of the population borrows from banks, and access to risk management (pension funds and/or insurance) is also quite low. By region, there tends to be low access to banking financial

services in east Indonesia, and high access in Java and Bali, with Jakarta, the capital city, having the highest uptake (BI 2013).

In terms of savings, a report on *Improving Access to Financial Services in Indonesia* by the World Bank in 2010 (Wibowo 2013), suggests that 68% of the population of Indonesia save, and the remaining 32% do not. The reasons given for failing to save include having no money (79%), having no job (9%), being unable to see the benefit (4%), and having a lack of understanding about banks (3%). Of the 68% who have savings, half hold them with institutions in the formal financial sector and half keep them in the informal sector. Of the 50% with savings in financial institutions, 47% hold them with banks and 3% use nonbanking financial institutions. Of the 47% who save with a bank, 41% use their own bank account and the remaining 6% use the bank account of another person.

Regarding loans, 60% of the population borrows money, and 40% does not currently borrow for the following reasons: not credit worthy (60%), no wish to borrow (20%), no collateral (4%), and other reasons (16%). Of the 60% who borrow money, 43% do so from the informal sector and 17% do so from banks.

The Financial Services Survey by the International Monetary Fund (IMF) also provides two interesting facts about financial inclusion in Indonesia, both from the demand side (use of finance) and supply side (access to finance). First, as can be seen in Table 3, from the supply side, for instance, the number of commercial bank branches per 1,000 km² is 9.24 or 9.59 per 100,000 adults. Second, from the demand side, there are 222.93 household loan accounts with commercial banks per 1,000 adults. Further, as the aim of the financial inclusion policy in Indonesia is for all households to have access to bank services, the annual changes in the number of household deposits and loans accounts with commercial banks (Table 4) may show the trend of financial inclusion over time for households in Indonesia.

Table 3: Access to and Use of Formal Financial Services in Indonesia, 2012

Commercial bank branches per 1,000 km ²	9.24	Commercial bank branches per 100,000 adults	9.59
ATMs per 1,000 km ²	35.15	ATMs per 100,000 adults	36.47
Outstanding deposits with commercial banks (% of GDP)	39.13	Outstanding loans from commercial banks (% of GDP)	32.85
Deposit accounts with commercial banks per 1,000 adults	708.12	Loan accounts with commercial banks per 1,000 adults	225.89
Household deposit accounts with commercial banks per 1,000 adults	672.97	Household loan accounts with commercial banks per 1,000 adults	222.93

ATM = automated teller machine, GDP = gross domestic product, km² = square kilometer.

Source: IMF (2012).

Table 4: Number of Households in Indonesia with Deposit and Loan Bank Accounts, 2004–2012

Variable	2004	2005	2006	2007	2008	2009	2010	2011	2012
Household deposit accounts with commercial banks per 1,000 adults	485.00	497.29	451.94	458.04	467.23	486.27	566.43	615.20	672.97
Household loan accounts with commercial banks per 1,000 adults	117.51	135.94	139.89	148.72	175.29	193.48	200.31	218.00	222.93

Source: IMF (2012).

4.2 Credit

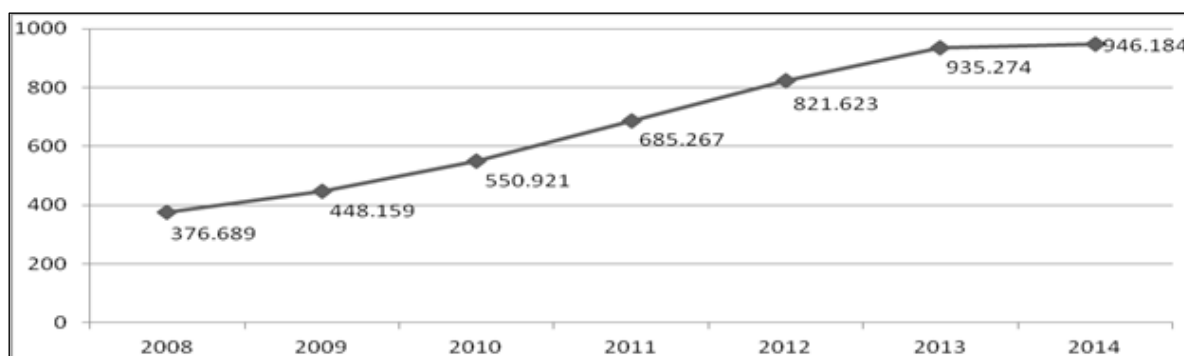
Indonesia Banking, published monthly to give an overview of banking developments in Indonesia, receives its data from figures published by Indonesia Banking Statistics. In turn, the data used in the Indonesian Banking Statistics is derived from commercial bank monthly reports, Sharia bank monthly reports, and rural bank monthly reports. Data from the commercial bank monthly reports and the Sharia bank monthly reports, submitted by the reporting banks to BI, are processed using the BI Banking Information System and presented in PDF as well as Excel format. Recorded data includes information about credit distributed and outstanding loans in rupiah and foreign currency from commercial and rural banks. The data is organized by banking group, economic sector, debtor group, type of loan (investment, working capital, or consumption), location (province), loan utilization purpose, and outstanding MSME credit for commercial banks (OJK 2014).

4.3 Credit for Households

Of all the banks that provide household credit in various schemes—commercial banks, state-owned banks, rural banks, and regional development banks—*Bank Perkreditan Rakyat* (BPR), *Bank Pembangunan Daerah* (BPD), and *Bank Rakyat Indonesia* (BRI) (or the Indonesian People's Bank), are among key institutions providing microfinance to households (e.g., housing loans [mortgages], vehicle loans, and other consumer credit). BPR is also known as a rural bank, people's credit bank, smallholder credit bank, or second-tier bank to serve MSMEs, lower income groups, and/or poor households. BPD is a regional or provincial development bank owned by provincial governments, and has a legal form that is now the same as that of a commercial bank. BRI has various credit schemes, including microcredit known as *Kredit Umum Pedesaan* (KUPeDES), allocated through all BRI Unit Desa (village branches of BRI). KUPeDES is a general-purpose rural loan scheme with competitive interest rates. It offers loans (working capital and investment) to those who fulfill the requirements in all economic sectors, from businesses in agriculture, trade, industry, and services, to individual borrowers who require loans for education, house renovation, purchase of vehicles, etc. Figure 1 shows the trend for outstanding consumption loans of commercial banks and rural banks by bank group over time. Unfortunately, specific data on microcredit consumption are not available. Official data from BI on household credit from commercial banks and rural banks are for all types of household credit.

Figure 1: Outstanding Consumption Loans (in Rupiah and Foreign Currencies) of Commercial Banks and Rural Banks, 2008–2014

(Rp billion)



Note: 2013 = December; 2014 = March.

Source: OJK (2014).

4.4 Credit for Micro, Small, and Medium Enterprises

In Indonesia, the number of MSMEs has steadily increased every year (Table 5). In 2012, the share of MSMEs in total enterprises (including large enterprises) was around 99%. The majority of them are micro and small enterprises (MSEs), which are scattered widely throughout rural areas and, therefore, likely to play an important role in helping develop the technical and entrepreneurial skills of villagers, and particularly women. However, most MSEs are established and run by poor individuals or households, either as their primary or secondary (supplementary) source of income, because they cannot find better employment. Therefore, the presence of MSEs in Indonesia is often seen as a reflection of the problems of poverty and unemployment, rather than as a reflection of entrepreneurial spirit.

Table 5: Total Number of Enterprises by Size in All Economic Sectors of Indonesia, 2000–2012

(‘000)

Size Category	2000	2003	2005	2007	2009	2010	2011	2012
MSE	39,705	43,372.9	47,006.9	47,720.3	52,723.5	53,781.1	55,162.2	56,485.6
ME	78.8	87.4	95.9	120.3	41.1	42.6	44.2	48.997
LE	5.7	6.5	6.8	4.5	4.7	4.8	4.95	4.97
Total	39,789.7	43,466.8	47,109.6	49,845.0	52,769.3	53,828.5	55,211.4	56,539.6

LE = large enterprise; ME = medium enterprise; MSE = micro and small enterprise.

Source: Processed data from BPS (2010) and website of Kementerian Koperasi dan Usaha Kecil dan Menengah Republik Indonesia.

The majority of MSMEs in Indonesia are engaged in agriculture activities. In 2008 there were about 42.7 million laborers in the agriculture sector, of which almost 99.5% were employed in MSMEs. There were about 26.4 million firms in the sector, of which almost 100% were MSMEs. Within the MSMEs, more MSEs are agriculture-based than for medium enterprises. The second important sector for MSMEs is trade, hotels, and restaurants. Indonesian MSMEs are traditionally less strong in the manufacturing industry than large Indonesian enterprises or MSMEs in developed Asian economies such as Japan, the Republic of Korea, and Taipei, China. In those economies, MSMEs are traditionally well represented with production linkages with large enterprises as suppliers or vendors, especially in the automotive, electronics, and machinery industries. The structure of Indonesian MSMEs by sector is, however, not unique to Indonesia. It is a key feature of this category of enterprise in developing countries, especially in countries where the level of industrialization and income per capita are relatively low.

MSMEs' access to formal financial institutions can be a good indicator of financial inclusion since they are often excluded from them. Based on limited information from various sources, e.g., government reports, national surveys, and case studies, Tambunan (2008a, 2008b) has made a list of key constraints common to MSMEs in some Asian developing countries (Table 6). He found that a lack of capital is a key constraint (although not the only one) faced by MSMEs in all countries under review. The lack of capital is mainly due to the lack of access to banks and other formal nonbank financial institutions. In many developing, Asian countries, this problem is experienced mainly by MSEs, especially those located in rural or less developed areas.

Table 6: Main Constraints Facing Micro, Small, and Medium Enterprises in Developing Countries in Asia

Country	Main Constraints										
	Raw materials	Marketing	Capital	Energy	Information	Technology and skills	Infrastructure	Tax	Inflation	Market distortions	Labor issues
Indonesia	√	√	√	√	√						
Philippines		√	√			√					
Viet Nam			√			√	√			√	
Cambodia			√	√		√				√	
Lao PDR	√		√					√	√		
Thailand	√	√	√		√	√					
Malaysia	√		√		√	√					
Brunei Darussalam		√	√			√					
PRC		√	√			√	√				
India		√	√				√			√	
Pakistan		√	√							√	√
Bangladesh			√	√		√				√	
Nepal		√	√			√				√	

Lao PDR = Lao People's Democratic Republic; PRC = People's Republic of China.

Sources: Tambunan (2008a, 2008b).

Next, based on BPS data from 2005 and 2010, Table 7 highlights the main constraints faced by MSEs in the manufacturing industry in Indonesia. Lack of capital is the most important constraint, followed by marketing difficulties and a lack of raw materials. Within the group of MSEs, a lack of capital—mostly working capital—is a more serious issue for micro enterprises (MIEs) than for small enterprises. The majority of MIEs facing capital constraints are located in rural or less developed regions where access to financial credit from banks or other government-sponsored MSME credit schemes is either minimal or absent.

Table 7: Main Constraints Facing Manufacturing Micro and Small Enterprises in Indonesia, 2005 and 2010
(number of firms)

	2005	2010
Have no serious obstacles	674,135	599,591
Have serious obstacles:	2,054,565	2,133,133
(i) Lack of raw materials or high cost of raw materials	421,277	483,468
(ii) Marketing difficulties	629,406	495,123
(iii) Lack of capital	714,629	806,578
(iv) Transportation and distribution obstacles	54,945	39,571
(v) Lack of energy supply or high cost of energy supply	55,420	34,759
(vi) Lack of skilled labor or high labor costs.	16,650	89,046
(vii) Other constraints	162,238	184,408
Total	2,728,700	2,732,724

Source: Tambunan (2008a); BPS (2010).

The data in Table 7 are consistent with the fact that only a small percentage of MSMEs in Indonesia have ever obtained credit from banks or other nonbank formal financial institutions. For example, for MSEs in the manufacturing industry, 2005 data from the National Agency for Statistics (BPS) show that the majority of sampled producers used their

own money to fully finance their businesses. The actual share was 82.41% for MIEs and 68.85% for small enterprises. Very few producers borrowed money to finance their business: about 2.90% for MIEs and almost 1.80% for small enterprises. Based on data from 2010 (Table 8), the majority of them financed their operations completely by themselves (although the ratio varies by industry sector). From those who financed their businesses partially or fully from outside sources, only a few borrowed money from banks.

Table 8: Micro and Small Enterprises in the Manufacturing Industry in Indonesia, by Industry Sector and Source of Capital, 2010

Industry Sector	Number of Firms	Source of Capital (% of total)		
		100% Owned	Partly Owned	100% Outside Source
Food	929,910	0.83	0.15	0.02
Beverages	30,395	0.91	0.08	0.01
Processed tobacco	53,169	0.57	0.41	0.02
Textiles	234,657	0.76	0.16	0.08
Garments	276,548	0.74	0.22	0.04
Leather and its products, including footwear	32,910	0.57	0.38	0.05
Wood and its products (not including furniture) and handicrafts	639,106	0.87	0.098	0.03
Paper and its products	7,268	0.41	0.39	0.2
Publishing and recording media reproduction	24,305	0.698	0.28	0.22
Chemicals and their products	19,168	0.75	0.19	0.06
Pharmaceutical, chemical, and medical products, and traditional medicine	5,043	0.93	0.05	0.02
Rubber, plastic, and their products	13,786	0.58	0.22	0.2
Excavated, non-metal products	215,558	0.72	0.25	0.03
Base metals	1,553	0.57	0.42	0.01
Metal products, non-machinery, and tools	61,731	0.75	0.23	0.02
Computers, electronic goods, and optics	434	0.98	0.02	0
Electrical tools	199	0.61	0.39	0
Machinery and its tools	1,540	0.53	0.34	0.13
Vehicles, trailers, and semi-trailers	3,488	0.99	0.01	0.0014
Other transportation tools	4,708	0.75	0.21	0.04
Furniture	107,166	0.73	0.24	0.03
Other manufacturers	62,898	0.75	0.2	0.05
Repair services, machines, and their tools	7,184	0.86	0.139	0.01
Total	2,732,724	0.795	0.1696	0.035

Source: BPS (2010).

This is consistent with findings from the Financial Service Survey by the IMF, which shows that in 2011, total outstanding loans from commercial banks were 29.64% of Indonesia's total gross domestic product, while that of MSMEs in the same period was only 6.17%. In 2012 the ratio was 32.85% against 6.39% (IMF 2012). This is also consistent with findings from the 2009 Enterprise Survey by the World Bank and International Finance Corporation (2010) (Table 9).

Table 9: Enterprise Survey, 2009: Financial Indicators of Micro Small and Medium Enterprises in Indonesia
(%)

	Indonesia	Firm Size		
		MSEs	MEs	LEs
Internal finance for investment	88.3	88.9	87.4	82.0
Bank finance for investment	6.4	6.1	6.8	8.7
Trade credit financing for investment	0.8	0.9	0.1	1.5
Equity, sale of stock for investment	3.2	2.6	5.1	6.2
Other financing for investment	1.3	1.4	0.5	1.7
Working capital external financing	14.4	13.3	23.5	18.6
Value of collateral needed for loan (% of the loan amount)	53.1	51.3	56.1	68.5
Firms with bank loans and line of credit	18.2	16.5	27.6	47.1
Firms with a checking or savings account	51.5	46.3	89.1	92.5

LE = large enterprise (100+ employees); ME = medium enterprise (20–99 employees); MSE = micro and small enterprise (1–19 employees).

Source: World Bank and International Finance Corporation (2010).

Tables 10–12 show the sources of capital for MIEs and small enterprises in the manufacturing industry (Table 10), the origin of loans for those MIEs and small enterprises that received them (Table 11), and the main reasons why MIEs and small enterprises do not borrow money from banks or other formal nonbank financial institutions (Table 12). Table 10 shows that more MIEs than small enterprises used their own money to run their businesses. Interestingly, of those who took loans from the formal financial sector, more MIEs than small enterprises used credits from banks (Table 11). Table 12 shows the major reasons for not borrowing money from banks or other formal nonbank financial institutions are that the businesses do not have collateral and they find the administrative procedures too complex to apply for credit.

Table 10: Sources of Capital for Micro Enterprises and Small Enterprises in the Manufacturing Industry in Indonesia, 2005

(% of total sampled enterprises)

Source of Capital	MIEs	SEs
Own	82.41	68.85
Borrowed	2.86	1.75
Own and borrowed	14.73	29.4
Total	100	100

MIE = micro enterprise; SE = small enterprise.

Source: BPS (2010).

Table 11: The Origin of Loans for Micro Enterprises and Small Enterprises in the Manufacturing Sector in Indonesia, 2005

(% of total sampled enterprises)

Origin of Loan	MIEs	SEs
Formal Sources		
Bank	54.54	15.62
Cooperative	5.57	3.83
Ventura capital	1.63	1.34
Nonbank institutions	4.75	3.06
Informal Sources		
Family	12,61	11.21
Friends	23,64	44.35
Others	14,24	28.35

MIE = micro enterprise; SE = small enterprise.

Source: BPS (2010).

Table 12: Reasons Why Micro Enterprises and Small Enterprises Do Not Borrow Money from Banks, 2006

(%)

Reason	MIEs	SEs
No collateral	20.69	28.55
No knowledge of procedure	10.56	14.5
Procedure is too complex	24.31	10
High interest rate	14.12	8.67
Not interested	28	37.5
Application rejected	2.32	0.78
Total	100	100

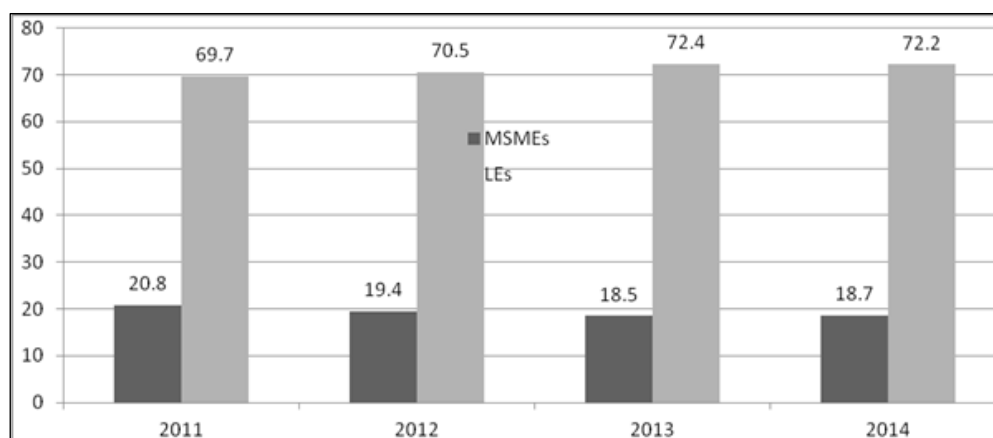
MIE = micro enterprise; SE = small enterprise.

Source: Tambunan (2011).

Finally, Figure 2 presents the allocation of credit to MSMEs (mainly for working capital and investment) by commercial banks in Indonesia from 2011 to 2013, and Tables 13 and 14 provide data on MSME credit by sector. The supply of credit to MSMEs does increase annually, though the level of credit received by enterprises and the rate of credit growth vary by sector. The largest amount of MSME credit is found in the trade and manufacturing industries, as these are the two key sectors for MSMEs. However, in terms of the percentage of total credit (which consists of credit for business [investment and working capital] and consumption credit) by commercial banks, the level is, on average, much less than 30% per year and is much lower than the percentage of credit received by large enterprises.

Figure 2: Total Credit Received from Commercial Banks in Indonesia by Large Enterprises, and Micro, Small, and Medium Enterprises, 2011–2014

(% of total business and consumption credit)



MSME = micro, small, and medium enterprise; LE = large enterprise.

Note: 2013 = December; 2014 = March.

Source: OJK (2014).

Table 13: Total Bank Credit of Micro, Small, and Medium Enterprises by Sector, 2002–2010

(Rp trillion)

Sector	2002	2003	2004	2005	2006	2007	2008 Dec	2010 Aug
Agriculture	8.6	8.6	12.1	12.6	13.3	16.1	19.4	18
Mining	0.5	0.6	0.9	0.97	1.3	1.5	1.8	6.1
Industry	22	24.4	26.6	32.5	36.7	37.8	46.1	53.99
Electricity, gas, and clean water	0.1	0.1	0.1	0.3	1.5	0.3	0.6	0.95
Construction	3.6	4.6	5.9	7.7	10.1	13.2	17.1	21.4
Trade	38.6	52.8	67.2	87.5	107.3	134.6	157.1	194.2
Transport	3.7	5.1	6	6.5	6.6	7.2	8.6	11.96
Business services	7.96	13.3	15.6	20.7	23.5	30.5	40.9	46.99
Social services	2.2	3	4.3	5.3	6	6.7	7.6	35.3
Others	73.6	94.7	132.4	180.9	203.5	254.9	334.8	481
Total	160.86	207.2	271.1	354.97	409.8	502.8	634	869.89

Source: Bank Indonesia website.

Table 14: Total Bank Credit of Micro, Small, and Medium Enterprises by Sector, 2011–2014

(Rp billion)

	2011 Dec	2012 Dec	2013 Dec	2014 Mar
All sectors	458,164	526,397	608,823	619.4
Agriculture, livestock, forestry and fishery	29,794	43,609	51,900	53.094
Mining and quarrying	3,938	5,427	4,753	5.047
Manufacturing industry	52,231	59,500	60,087	64.187
Electricity, gas and water supply	1,218	1,474	1,750	1.664
Construction	24,279	30,594	38,780	36.314
Trade, hotel, and restaurant	212,462	262,584	341,188	346.287
Transport and communication	18,068	20,219	23,882	23.969
Financial, ownership and business Services	30,594	40,465	46,009	46.897
Services	85,579	62,524	40,473	41.94
Others	1	0	1	-

Source: Bank Indonesia website.

With respect to financing MSMEs, Indonesia had some successes with institutional development in the years leading up to the 1997–1998 Asian financial crisis, including the development of a comprehensive set of institutions serving all levels of the market. However, these institutions were neither particularly efficient nor comprehensive, and they faced some difficulties even before the crisis. The fact that many of them were financially and structurally weak manifested in high transactions costs and limits on their penetration of the market. As a result, an overwhelming number of MSEs were not served (Martowijoyo 2007).

Information from BI also shows that the loan portfolios of most of Indonesia's big banks are still dominated by loans to large businesses and corporate clients. As of 2012, total financing of MSMEs in Indonesia was only around 20.1% of total bank credit. MIEs received only 20.7% of the total MSME finances of around Rp612 trillion. According to BI, there are many reasons why only a small portion of total MSMEs in Indonesia were ever financed by banks. First, their businesses are often considered by banks or other formal nonbank financial institutions to be “invisible,” either because, from a market perspective, their products are not in high demand, or from a management perspective, because they lack the ability to manage their businesses professionally. This latter issue is especially true for MSEs, since they are often not well organized, or lack a well-developed organizational and management system. Second, MSMEs often lack valuable assets that can be used as collateral (Kompas 2013).

Rosengard and Prasetyantoko (2012) also conclude that Indonesia is underbanked, especially for microfinance and MSME finance. Of the six largest banks, only the portfolios of BRI and Bank Danamon include a majority share of MSME loans. They state that despite potentially lucrative unserved or underserved markets—including low-income households and family businesses—the monetary policy and regulatory regime in Indonesia set by BI has unintentionally created barriers to outreach and innovation for microfinance institutions. This has also incentivized commercial banks to forsake MSME finance in favor of consumer finance and alternative non-loan investments.

During the Asian financial crisis, MSMEs proved to be more resilient to the crisis than their larger counterparts, and because of them, a rapid increase in unemployment (caused by the bankruptcy of many of the large enterprises directly hit by the crisis) was prevented. Since then, BI has encouraged commercial banks to lend to MSMEs through self-determined targets in their business plans. BI has also defined micro-credit to include loans up to Rp50 million (approximately \$5,450). Under this broad definition, commercial banks in Indonesia dominate microcredit, which in 2007 served 48.0% of total borrowers, with loans totaling 82.8% of the

aggregate outstanding microfinance loan portfolio. BRI Units, which up to 2007 numbered nearly half of all commercial banks' outlets, accounted for 10.8% of borrowers and 12.6% of outstanding micro-loans. The average size of a micro-loan given by commercial banks was \$983.50 (around 85% of income per capita), as compared to \$53 (approximately 5% of per capita income) for *Badan Kredit Desa* (BKDs) or village credit institutions (Martowijoyo 2007).

4.5 Microfinance

4.5.1 Developments in Microfinance since the New Order Era

Indonesia is one of the developing countries that have successfully run sustainable microfinance on a relatively large scale. It has long experience of the implementation of microfinance, having started in the early 1970s with BRI as the key engine. The Government of Indonesia keeps improving systems of existing microcredit schemes and strengthening their process of implementation. BRI Unit network is now the largest and one of the most profitable rural micro-banking networks in the developing world. This makes microfinance in Indonesia an interesting research subject from which we hope to learn some best practices. The Government of Indonesia has taken measures to improve microfinance, and has recently launched two new regulations, namely UU No. 17 Tahun 2012 on cooperatives (since the government encourages cooperatives in Indonesia to act as microfinance institution), and UU No. 1 Tahun 2013 on microfinance institutions. Microfinance or microcredit is defined by BI as a loan below Rp50 million (\$5,373), and/or a financial product provided by formal and semi-formal financial providers in Indonesia (Bramono et al. 2013).

During Soeharto's New Order era (1966–1998) there were many popular microfinance programs. These included *Bimbingan Massal*, or mass guidance—a rice intensification program with a subsidized credit component for rice farmers, allocated through village unit credit or *Kredit Unit Desa* (KUD)—and BRI Unit Desa (village-based BRI), which was later succeeded by *Kredit Usaha Tani*, a subsidized farming credit for small-sized farms. There were also two special credit schemes for MSEs in agriculture, *Kredit Investasi Kecil*, or small investment credit, and *Kredit Modal Kerja Permanen*, or permanent working capital credit, as well as various special credit schemes for MSEs in other sectors, e.g., *Kredit Mini*, *Kredit Midi*, KUPEDES, and *Kredit Candak Kulak*, allocated through KUD. Yet many other microfinance schemes were implemented at a local level during that period, such as *Kredit Usaha Rakyat Kecil* (KUR), or business credit for the poor, in 1984 in East Java, and *Kredit Usaha Kecil*, or small business credit, which offered loans to small enterprises and cooperatives to fulfill the banks' credit quota of 20% of their loan portfolios (Martowijoyo 2007).

Besides those microfinance schemes, during the New Order era a special village-based microfinance nonbank institution was established, namely *Lembaga Dana Kredit Perdesaan* (LDKP), or rural credit fund institution. Many others were also set up, such as *Badan Kredit Kecamatan* in Central Java and South Kalimantan, which is a sub-district-level microfinance institution founded by the Provincial Government of Central Java in the 1970s, as well as *Lembaga Perkreditan Kecamatan* in West Java, *Lumbung Pitih Nagari* in West Sumatra, and *Lembaga Perkreditan Desa* (LPD) in Bali (Baskara 2013).

Indonesia has also replicated the Grameen Bank program, starting with Bogor, West Java province, by *Karya Usaha Mandiri* in 1989. This initiative was followed in 1993 by *Mitra Karya East Java* in Malang, East Java province. In Sumatra, the Grameen Bank model was replicated by *Yayasan Pokmas Mandiri* (Sarumpaet [2005], cited by Siti Khadijah et al. [2013]).

Islamic finance was introduced to Indonesia—the largest Muslim country in the world—during the New Order era as an option to enable people on low incomes to access funds to improve their lives and lift them out of poverty. However, Indonesia only started to implement Islamic microfinance after the Asian financial crisis of 1997–1998. There are three types of Islamic microfinance: (i) the Islamic Rural Bank, which is well known in Indonesia as *Bank*

Pembiayaan Rakyat Syariah (BPRS); (ii) *Koperasi Baytul Maal wat Tamwil* (BMT), which is a savings and credit cooperative implementing a profit and loss sharing approach; and (iii) Grameen-model Islamic microfinance. These three institutions are contracted to a micro *Takāful* provider (who provides micro insurance in an Islamic context) via an agent known as *Takāful Mikro Indonesia*. (Timberg 1999; Haryadi 2010; Siti Khadijah et al. 2013).

BPRS, begun in the early 1990s, is governed by BI under Law No. 10, 1998. It operates under the same effective prudential regulation and supervision as commercial banks and conventional rural banks such as BPR, and it focuses on micro economic activities. While both BPR and BPRS were (mostly) established by wealthy local people, the owners of BPR are commercially-oriented toward increasing their wealth, while the owners of BPRS have a social mission, combined with an intention to at least cover their costs. In a financing transaction (loan), BPRS provides funds to mainly MIEs, either with a purchase system (*murabahah*), profit and loss sharing (*musyarakah*), or lease (*ijarah*). The choice of the Islamic system is dependent upon the type of financing proposed by society to the BPRS. In addition, the BPRS also practices an Islamic pawnshop (*ar-rahn*) run by the Islamic system (Haryadi 2010; Siti Khadijah et al. 2013).

There are several other equally important microfinance institutions. The first is BKD, which has the longest history as it was among the first microfinance institutions to be established before the independence of the country. It comprises *Lumbung Desa* (paddy banks) and *Bank Desa* (village banks), which are microfinance institutions originating in the Dutch colonial period and still operating in Java and Madura. They have been awarded a BPR license. Second is LDKP, or rural credit institution, established in the 1980s by the Soeharto government to consolidate all nonbank microfinance institutions that had been operating throughout the country, especially in Java, since the 1970s. The third group comprises *Badan Kredit Kecamatan*, *Lembaga Perkreditan Kecamatan*, *Lumbung Pitih Nagari*, and LPD (mentioned above), which were established in the 1970s and 1980s (Martowijoyo 2007; Baskara 2013).

There are five main types of old and new microfinance institution in Indonesia. The first are BRI Units. The second are BPRs, consisting of BKDs (village credit institutions) and non-BKDs. Non-BKDs are “new” BPRs and old microfinance institutions that have converted to BPR status. The third type is nonbank, non-cooperative, microfinance institutions (LDKPs and subdistrict and village-level microfinance institutions founded by provincial or district governments). The fourth group comprises cooperatives (credit cooperatives and saving and loan units, including credit unions and BMTs). Finally, the fifth type is Grameen Bank replicators (mostly unlicensed), and some nongovernment organizations (NGOs), most of which have a foundation license (Martowijoyo 2007).

Among this huge number of microfinance institutions, the key microfinance institutions in Indonesia at the moment are (i) BRI, which is still considered to be the leading microfinance institution; (ii) Bank Syariah; (iii) BPR; (iv) BPD; and (v) a number of commercial banks. BRI and BPR have the longest experience in microfinance, having been established in the early 1970s in all 27 provinces (BRI itself was established in 1896 from *Algemene Volkerediet Bank*). In addition, there are many nonbank organizations also providing microfinance such as cooperative and local-community initiated NGOs.

However, according to some observers, there are currently too many total microfinance banks, nonbank institutions, and microfinance services in Indonesia. It is argued that they have overlapping regulations, coverage, and responsibilities that make it difficult for the government and monetary authority to evaluate and control the development of microfinance in the country. Baskara (2013) finds that, for instance, in the province of Bali alone there are many formal microfinance institutions and banks that target MIEs: LPD; KUD (or village-based cooperatives supported by the government); *Koperasi Serba Usaha*; *Koperasi Simpan Pinjam* (like credit unions) established by the local community; BPR, Bank Rakyat Indonesia; and Danamon *Simpan Pinjam*, i.e., savings and loan units of Bank Danamon (a private commercial bank). He also finds many microfinance institutions, unregistered by the monetary

authority, which are operating locally, not only in Bali, but also in other provinces in the country. These include *Badan Usaha Kredit Pedesaa* in Daerah Instimewa Yogyakarta, *Lembaga Pembiayaan Usaha Kecil* in the province of South Kalimantan, *Lembaga Kredit Pedesaan* in West Nusa Tenggara, and *Lembaga Kredit Kecamatan* in Daerah Instimewa Aceh. But, many of these informal, local-based microfinance institutions have stopped operating because they were run in unhealthy, non-professional ways.

The Asian Resource Center for Microfinance (ARCM) indicates that there are almost 9,000 public, rural, financial institutions that are not licensed, and which can be categorized as generic BPRs. These include village-owned BKDs in Java and Madura, and the *Lembaga LDKPs*, or Rural Fund and Credit Institutions, owned mainly by provincial governments (or in some cases, by villages) (Banking With the Poor Network website).

Within the informal sector, a traditional and the most popular microfinance institution found throughout the country is the *arisan*, of the Indonesian Rotating Savings and Credit Association. The number of *arisan* is estimated to be in the millions. Many people join more than one *arisan* for economic and social purposes, while others manage *arisan* as a side job. In rural areas, traders offer loans against standing crops through the *tebasan* and *ijon* systems. Even smaller loans called *mindring* are provided by retail traders of clothes or household utensils. Farmers also commonly get in-kind loans of rice and farm inputs from traders or shopkeepers at prices higher than cash prices. Commercial moneylenders are also still operating in rural areas and catering to the short-term needs of the poorest, although they are not flourishing as they did in the past. Some moneylenders are disguising their activities under the name of “cooperatives” (Martowijoyo 2007).

Unfortunately, the current number of microfinance institutions in Indonesia, especially nonbanks, is not clear. According to a study by Martowijoyo (2007), as of mid-2005, there were over 54,000 outlets for microfinance, serving over 29 million borrowers (13% of the population) and more than 43 million depositors (19% of the population). Haryanti (2014) suggests that there are about 600,000 microfinance bank and nonbank institutions (including local-based, informal institutions) in all provinces, but the exact number is still being ascertained by the OJK. Some of those microfinance institutions already have a status as a formal legal entity such as a limited liability company (PT) or a cooperative, and also have a legal operating license as nonbank financial institutions. Nonetheless, they were still regarded as semi-formal entities. Some of those microfinance institutions have proved to be effective in providing financial services to the so-called “excluded” or “unbanked” segment of society, such as the poor, MSEs, women, and other economically active poor who mainly work in the informal sector and do not have assets that are valuable enough to act as collateral, or have valuable assets but do not have legal documents protecting those assets. Those microfinance institutions have offered make innovative approaches (including nourishing social capital and local wisdom to make social sanctions work effectively in replacing the function of physical collateral).

Annual aggregate data on microcredit are also limited. BI does have data on total distributed credits and loans (monthly, quarterly, and annually) by bank group, sector, type of credit, and region. Data on total distributed credit include microcredit, but there are no specific data on microcredit. ARCM, which has information about microfinance institution development in Indonesia on its website, does not have data on total microcredit provided by all banks and formal nonbank financial institutions (Banking with the Poor website).

Siregar (2014), in his presentation about microfinance institutions in Indonesia, only provides aggregate data for 2005 (Table 15). According to his data, microfinance institutions in Indonesia are dominated by informal institutions which consist of 637,838 LDKP, BKD, and various microfinance units, initiated by the local community such as credit unions, BMT, and NGOs. Table 17 summarizes data on microfinance by key institutions which was collected from various sources by Martowijoyo (2007) and data from OJK (2014).

Table 15: Total Microfinance Institutions, 2005

Institution	Total Units	Total Depositors and Debtors
BRI Unit Desa	4,046	30,776,000
BPR	2,161	5,480,000
Nonbank finance institutions	7,617	2,084,000
Cooperatives	6,495	6,100,000
<i>Arisan</i>	250,000	5,000,000
Others	105,147	22,855,000
Total	375,466	72,295,000

Arisan = Indonesian Rotating Savings and Credit Association; BPR = Bank Perkreditan Rakyat; BRI Unit Desa = village unit of *Bank Rakyat Indonesia*.

Source: Siregar (2014).

Table 16: Microfinance by Key Institution in Indonesia

Institution	Number of Units or Offices	Borrowers ('000)	Outstanding Loans (\$ million/Rp billion)	Depositors ('000)	Deposits (\$ million/Rp billion)
Commercial banks' micro loans (2006)	8,069	14,271	\$14,036	na	na
(March 2014)	18,704	na	na	na	Rp1,652,976
- BRI Units (2002)	3,916	3,000	Rp12,000	28,200	R 23,460
(2005)	4,046	3,211	\$2,134	31,271	\$3,288
(2007)	5,400	na	na	na	na
(March 2014)	9,350	9,794.8	Rp27,721.1	na	na
Rural banks (BPR):					
(2003)	2,133	1,900	Rp7,088	5,100	Rp6,629
(2005)	4,482	395	\$21	466	\$51
(March 2014)	4,717	na	Rp58.977	na	Rp34.963
- BKD (2002)	5,345	450	Rp185	540	Rp25,000
(2005)	2,062	2,331	\$1,380	5,864	\$1,223
LDKP (2005)	1,620	1,326	\$45	na	\$42
Credit cooperative (2004)	1,596	885	\$116	481	\$33
- Credit Unions (2004)	1,041	na	\$958	480	\$0.94
S&L Units (2004)	36,466	10,524	\$1,349	5,016	\$145
- BMT (2004)	3,038	1,200	\$20	na	\$26
Grameen Bank Replicators (2007)	21	20	\$0.52	20	\$0.30

BKD = *Badan Kredit Desa*; BPR = Bank Perkreditan Rakyat; BMT = Koperasi Baytul Maal wat Tamwil; BRI = *Bank Rakyat Indonesia*; LDKP = Lembaga Dana Kredit Perdesaan; na = not available; S&L = savings and loans.

Sources: Martowijoyo (2007) and OJK (2014).

Alternatively, information on microcredit should be collected from individual microfinance-providing banks (e.g., BRI, BPR) and other nonbank organizations. One organization that is doing so is MixMarket Organisation. It has a unique database sourced from data submissions from more than 15,000 microfinance institutions over the past 10 years, covering more than 2,100 microfinance institutions in over 110 countries, including Indonesia. Data from selected microfinance institutions in Indonesia are presented in Table 17.³

³ For more data see <http://www.mixmarket.org/microfinance-data#ixzz34PL8lam6>.

Table 17: Profiles of Selected Microfinance Institutions in Indonesia from 2011 Onward

Microfinance Institution	Report Year	Loans (\$)	Number of Borrowers	Deposits (\$)	Number of Depositors
Amartha Microfinance	2013	205,890	2,612	26,143	2,617
Bina Artha	2012	2,041,313	21,397	na	na
BMT Sanama	2012	452,733	188	55,748	342
BPR AK	2011	5,739,431	7,841	3,156,576	30,852
BPR DMG	2011	920,710	525	904,781	1,910
BPR Hitamajaya	2011	2,117,364	2,344	1,111,037	7,565
BPR NBP 2	2011	5,119,451	6,302	2,525,500	20,817
BPR NSI	2011	4,587,175	14,523	1,052,444	9,242
BPR Pinang Artha	2012	5,470,846	3,683	5,813,842	33,241
BPR Surya Yudha Kencana	2011	70,274,699	35,530	50,295,139	74,679
BRI	2012	10,897,400,395	na	12,918,433,257	na
CU Sawiran	2012	5,470,846	3,683	5,813,842	33,241
Dian Mandiri	2013	2,709,156	44,276	819,459	na
KOMIDA	2011	5,583,754	68,278	530,937	45,518
Koperasi SK	2012	5,470,846	3,683	5,813,842	33,241
MBK Ventura	2014	54,721,534	369,738	na	na
Mitra Usaha	2010	489,684	5,277	389,627	4,664
TLM	2013	12,597,849	32,407	13,836,030	na
WKP	2011	87,086	684	17,579	na
MBK Ventura	2014	54,721,534	369,738	na	na

Bina Artha = PT Bina Artha Ventura; BPR AK = Koperasi Bank Perkreditan Rakyat Arta Kencana; BPR DMG = Bank Perkreditan Rakyat Dana Multi Guna; BPR Hitamajaya = PT Bank Perkreditan Rakyat Hitamajaya Agamandiri; BPR NSI = PT Bank Perkreditan Rakyat Nur Semesta Indah; BRI = Bank Rakyat Indonesia; CU Sawiran = Koperasi Kredit Sawiran; Dian Mandiri = Dian Mandiri Foundation; KOMIDA = Koperasi Mitra Dhuafa; Koperasi SK = Koperasi Simpan Pinjam Surya Kenchana; MBK Ventura = PT Mitra Bisnis Keluarga Ventura; Mitra na = not available; Usaha = Yayasan Mitra Usaha; TLM = Tanaoba Lais Manekat; WKP = Wahana Kria Putri; MBK Ventura = PT Mitra Bisnis Keluarga Ventura.

Source: MixMarket website.

Probably the most important and famous microfinance scheme in Indonesia in the post-Soeharto era is KUR, or people/community business credit, launched by President Susilo Bambang Yudhoyono in November 2007. The main aim of KUR is to help finance feasible, but not bankable, MSMEs. This is known as credit without collateral and is a loan for working capital and investment capital for individual producers or owners of productive MSMEs and cooperatives with a credit upper limit up to Rp500 million. The scheme is 100% financed by national commercial banks, i.e., BRI, *Bank Negara Indonesia*, *Bank Mandiri*, *Bank Tabungan Negara*, *Bank Syariah Mandiri*, *Bank Bukopin*, and *Bank Negara Indonesia Syariah* (Table 18) Since 2012 all regional development banks (BPD) in all provinces in Indonesia also play an important role in allocating KUR. Nonbank financial institutions are not involved in this program.

KUR received by MSMEs is guaranteed (70%) by two insurance companies, i.e., *PT Asuransi Kredit Indonesia* and *Perusahaan Umum Jaminan Kredit Indonesia* (PT Jamkrindo) and by other companies which have voluntarily joined the program. *PT Asuransi Kredit Indonesia* provides two types of services: (i) credit guarantees: bank and nonbank credit guarantees, counter bank guarantees, and regional credit guarantees; and (ii) credit insurance: trade credit insurance, surety bonds, customs bonds, and reinsurance. The main aim of PT Jamkrindo is to provide credit guarantee services, including government programs and commercial credit, to MSMEs. It has various MSMEs credit guarantee products: microcredit

guarantees; guarantees for construction, goods, and services procurement loans; commercial credit guarantees; counter bank guarantees; multipurpose credit guarantees; guarantees for distribution; Islamic financial guarantees (*Kafalah*); and loan program credit guarantees (KUR).

Among the eight national banks providing KUR, BRI, the leading one, has three main objectives: (i) give MSMEs and cooperatives better access to financing from banks; (ii) provide lessons for MSMEs for becoming a bankable debtors that can therefore be served in accordance with banking commercial terms in general; and (iii) enable financed businesses to continue to grow and develop. BRI has two types of KUR: (i) micro KUR for an individual running a feasible, productive business (MIE) that has been in operation for at least 6 months, and (ii) retail KUR for an individual (individual person and/or legal entity) or cooperative running a feasible, productive business that has been in operation for at least 6 months. For micro KUR, the upper credit limit is Rp20 million with an effective interest rate of 22% per year, and for retail KUR, the upper credit limit is Rp100 with an effective interest rate of 14% per year. Credit types are working capital credit, with a maximum of 3 years (in case of renewal, suppletion, or restructuring, the maximum is 6 years) and investment credit with a maximum 5 years (in the case of renewal, suppletion, or restructuring, the maximum is 10 years).

Table 18: Realized KUR by National Banks, 31 March 2014

Bank	Realized KUR			Average per Debtor (Rp million)
	Plafond (Rp million)	Outstanding (Rp million)	Total Debtors	
BNI	14,336,912	3,904,556	205,550	69.7
BRI (Ritel KUR)	18,045,443	7,077,418	103,993	173.5
BRI (Micro KUR)	75,789,311	20,643,642	9,690,827	7.8
Bank Mandiri	14,945,991	6,525,545	315,432	47.4
BTN	4,368,962	1,918,574	24,238	180.3
Bukopin	1,795,455	605,849	12,011	149.5
Bank Syariah Mandiri	3,658,132	1,387,260	52,019	70.3
BNI Syariah	245,784	109,897	1,256	195.7
Total	133,185,989	42,172,743	10,405,326	12.8

BNI = Bank Negara Indonesia; BTN = Bank Tabungan Nasional; KUR = Kredit Usaha Rakyat.

Source: Komite Kredit Usaha Rakyat, Ministry for Economic Coordination (<http://komite-kur.com/article-95-sebaran-penyyaluran-kredit-usaha-rakyat-periode-november-2007-maret-2014.asp>).

Table 19 provides data on the realization of KUR allocation by province during Q1 2013. It shows that by 31 March 2014, provinces in Java dominated the share. Within Java, Central Java, as the largest province, had the largest share, with almost Rp23.4 trillion, or around 15.8% of the total KUR allocated, followed by the province of East Java with almost Rp22.2 trillion (or 15.1%), and the province of West Java with Rp18.9 trillion (12.8%). This is not surprising, given that the majority of MSMEs, as well as the majority of the poor population, is found in Java, and mainly in the Central Java province. For regions outside Java, the province of South Sulawesi had the highest position, with almost Rp8.2 trillion, or almost 5.6%, and the province of North Sumatra took second place with almost Rp7.3 trillion, or 4.9%.

Table 19: Realized KUR by Province, 31 March 2014

No.	Province	Total		
		Plafond	Outstanding	Total Debtors
		(Rp million)	(Rp million)	
1	Nanggroe Aceh Darussalam	2,364,496	648,536	168,438
2	North Sumatra	7,264,283	2,594,090	432,277
3	West Sumatra	4,630,976	1,638,272	250,960
4	Riau	4,206,021	1,629,153	175,761
5	Jambi	2,412,055	802,431	142,784
6	South Sumatra	5,146,169	1,932,699	195,461
7	Bengkulu	1,066,015	346,883	79,026
8	Lampung	3,242,068	1,025,554	250,818
9	Kepulauan Riau	928,050	335,189	36,151
10	Bangka Belitung	641,713	269,490	27,710
11	DKI Jakarta	6,914,999	2,192,217	252,798
12	West Java	18,916,168	5,872,558	1,515,755
13	Central Java	23,296,417	6,740,265	2,463,777
14	DI Yogyakarta	2,938,643	978,422	275,517
15	East Java	22,181,907	6,763,259	1,847,612
16	Banten	3,061,934	948,978	169,733
17	Bali	3,256,654	1,079,148	241,233
18	West Nusa Tenggara	1,862,875	598,853	164,062
19	East Nusa Tenggara	1,555,844	490,150	107,329
20	West Kalimantan	3,436,226	1,646,565	121,513
21	Central Kalimantan	2,120,552	856,657	96,693
22	South Kalimantan	3,606,257	1,386,808	194,705
23	East Kalimantan	3,818,287	1,451,491	175,096
24	North Sulawesi	1,483,909	525,647	101,652
25	Central Sulawesi	1,801,367	660,456	135,676
26	South Sulawesi	8,167,028	2,434,586	569,814
27	Southeast Sulawesi	1,244,051	373,469	94,870
28	Gorontalo	744,984	209,116	65,535
29	West Sulawesi	756,396	189,670	53,338
30	Maluku	1,014,177	261,477	53,220
31	North Maluku	636,584	190,592	27,369
32	West Papua	760,537	274,249	26,214
33	Papua	1,734,640	644,805	69,633
Total		147,212,280	47,991,733	10,582,530

Source: Komite Kredit Usaha Rakyat, Ministry for Economic Coordination (<http://komite-kur.com/article-95-sebaran-penyyaluran-kredit-usaha-rakyat-periode-november-2007-maret-2014.asp>).

With respect to the allocation of KUR by sector (as the main target of this scheme), trade (which is integrated with upward sectors) has become the dominant sector to access KUR, accounting for 50.8% of the allocation. Agriculture and fishery received 13.7%, and industry manufacturing 2.6%. When the amounts of KUR allocated to upward sectors (agriculture, maritime, fishery, forestry, and industry) are taken together, they account for a share of 31.4% (Table 20) (Muis and Sipayung 2013).

Table 20: Realized KUR by Sector, 31 March 2014

Sector	Total		
	Plafond (Rp million)	Outstanding (Rp million)	Total Debtors
Agriculture	25,220,484	9,959,299	1,659,144
Fishery	837,614	213,788	11,695
Mining	117,323	50,191	3,729
Manufacturing industry	4,066,523	1,673,872	216,945
Electricity, gas, and clean water	74,599	32,094	2,400
Construction	2,066,813	580,478	11,390
Trade	82,368,475	27,716,357	6,972,338
Accommodation supply	1,050,399	328,918	41,337
Transportation	2,018,075	957,995	51,466
Financing services	1,032,825	300,719	7,008
Rental	6,768,982	2,869,136	350,437
Government administration	33,741	22,648	1,694
Education services	87,212	28,436	716
Health care services	383,267	103,885	3,120
Community services	4,277,720	1,128,842	113,235
Individual services	145,269	53,835	1,232
Other	16,662,958	1,971,239	1,134,644
Total	147,212,280	47,991,733	10,582,530

KUR = Kredit Usaha Rakyat.

Source: *Komite Kredit Usaha Rakyat*, Ministry for Economic Coordination (<http://komite-kur.com/article-95-sebaran-penyaluran-kredit-usaha-rakyat-periode-november-2007-maret-2014.asp>).

Besides producers or owners of MSMEs, Indonesian migrant workers are also targeted for KUR, as they are considered to be an important source of foreign currency for Indonesia. Recent information from the Ministry for Economic Coordination indicates that until March 2014 total credit plafond reached Rp46 billion for 3,649 workers. (<http://komite-kur.com/article-95-sebaran-penyaluran-kredit-usaha-rakyat-periode-november-2007-maret-2014.asp>).

The target of KUR for the whole year of 2013 was Rp36 trillion, which means an increase of Rp6 trillion (20%) compared to the KUR target for 2012. For 2014, the Indonesian government has taken steps to increase the absorption rate of KUR, by for example, expanding the coverage of the scheme, whilst maintaining its quality. One indicator adopted by the government to measure the quality of the KUR allocation is the level of so-called nonperforming loans (NPL), and, fortunately, it is always low. During the first quarter of 2013, the level of NPL KUR was, on average, 4.4%, which is still under the maximum limit determined by the monetary authority (BI), i.e., 5.0% (Muis and Sipayung 2013).

The steps taken by the government aim (i) to improve coordination among key, related ministries and other agencies, including regional government; (ii) to encourage all key stakeholders, especially regional and local government, to be more active in supporting and promoting local MSMEs to make them ready as potential receivers of KUR; (iii) to be more aggressive in publicizing and disseminating information about the scheme, including the application procedure and potential benefits; and (iv) to facilitate coordination between the implementing banks and KUR companies which provide guarantees.

Many people have assessed KUR as a successful microfinance program, especially for MSEs. In October 2012, President Susilo Bambang Yudhoyono was awarded "Letter of Recognition" by the International Micro Finance Community for his successful implementation of KUR in particular, and microfinance in general, in Indonesia. The success of KUR is indeed not unrelated to the internationally-recognized success of Indonesia, and BRI in particular, in

implementing microfinance. Therefore, Indonesia has been mentioned as a potential “world laboratory” for microfinance.

Besides KUR, the previous cabinet under Susilo Bambang Yudhoyono also launched three other special credit schemes. The aim of the first, *Kredit Ketahanan Pangan & Energi*, is to secure food and energy. The purpose of this credit scheme is for loans for working and/or investment capital only for farmers, through farmers’ association cooperatives. The interest rate is set between 5% and 7% per annum for a maximum of 5 years. The second scheme is *Kredit Pengembangan Energi Nabati & Revitalisasi Perkebunan* which aims to support the development of energy based on plantation commodities. It is a loan for working and/or investment capital for farmers through farmers’ associations or cooperatives. The interest rate ranges from a minimum of 5% to a maximum of 7% per annum for 13–15 years. The third scheme is *Kredit Usaha Pembibitan Sapi*, which aims to support seed financing for cattle breeding and is also a loan for working and/or investment capital for farmers, through farmers associations or cooperatives. The interest rate is between 5% and 6% per annum for a maximum of 6 years.

Of course, whether a credit or financial inclusion program is considered successful depends on the criteria used in assessing it. In the past, the Indonesian government, as with governments in other countries, and even international bodies such as the Asian Development Bank and the World Bank, used to only use the total number of recipients and the level of NPL as their criteria, where a credit program financing a high number of debtors or MSMEs, in combination with low levels of NPL, is considered successful. This is, of course, not the right way to assess the effectiveness of a credit program. The main measure of the success of the program should be whether a recipient has become better-off after using it since the main aim of a credit program or financial inclusion is not to get the highest possible number of recipients, or the highest possible number of people with access to banks, but to improve their welfare. Unfortunately, banks involved in KUR or other credit schemes in Indonesia have never evaluated the effectiveness of their schemes in terms of changes in the welfare of their debtors.

4.5.2 Challenges in Running Successful Microfinance Schemes

Although Indonesia has a long history of implementing microfinance schemes, with the first ones starting in the early 1970s, and the country is considered to be one of the few developing countries that has successfully run sustainable microfinance on a relatively large scale, the country still faces many challenges. According to an evaluation made by ARCM (ARCM: Indonesia Country Profile), the key challenges include the following:

- (i) Several studies have demonstrated that there is still an unmet demand for microfinance services in Indonesia, as the majority of rural households still do not have access to a source of funds from a semi-formal or formal institution. The key microfinance providers, i.e., BRI Units and BPRs, tend to cover the upper levels of MSMEs in district capitals, subdistrict towns, and economically active regions (e.g., Java and Bali) with loans of more than Rp3 million (\$320), while NGOs, cooperatives, and village-based institutions (BKDs) reach the lower end of the market (rural MIEs) but still have a limited outreach in rural areas. BRI Units expansion seems constrained by the “cash cow” status it has within the bank. BPRs mostly operate in affluent, urban areas of Java and Bali. Their expansion is limited by the high capital requirements to open new branches or operate outside a specific district.
- (ii) The supply-led subsidized microcredit programs initiated by the government do not provide a conducive environment where sustainable microfinance providers can operate.
- (iii) There is a lack of awareness of basic microfinance principles and their applications among government agencies, semi-formal organizations, and some commercial

banks that have recently entered the microfinance field. There is still no central microfinance training provider in Indonesia.

- (iv) Technical assistance and capacity building support to microfinance providers have been limited by the diversity and geographical spread of the country, and only a few organizations have benefited from nonfinancial support, although BI has recently tried to address this problem.
- (v) There is no formal credit bureau in Indonesia that could be used to lower risks of over-indebtedness in areas of strong competition (cities and towns in main districts). Banks involved in microfinance, such as BRI Units and BPRs, exchange information relating to their clients on an informal basis.

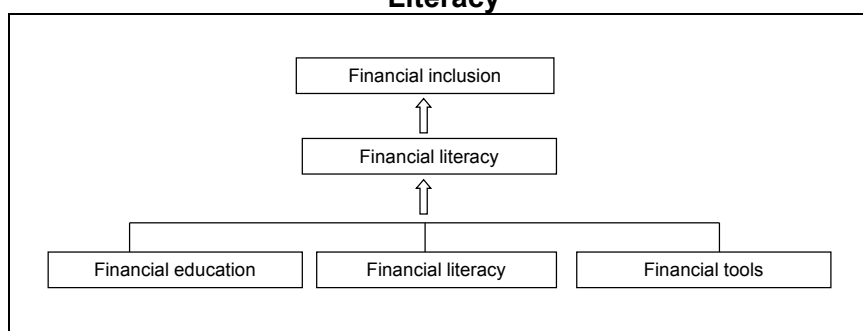
5. EFFORTS TO ACHIEVE FINANCIAL INCLUSION

5.1 Financial Education

The Indonesian government has recognized that the success of financial inclusion depends on many factors; the most important one is the level of financial literacy of the population. This factor is considered crucial because the average level of formal education in Indonesia is still low (the majority of the population only has a primary education). In turn, financial literacy is dependent on three factors: financial education, financial information, and the availability of financial tools (Figure 3) (Wibowo 2013).

Financial education, which is a continual process, is offered to the public, the lower classes, communities in remote or border areas, and societies with certain types of work where a lack of financial knowledge could be assumed. BI made a blueprint of financial education in 2007 and created a timetable for the program. From 2011 onward they planned that education programs would be offered to the public, including students, children, and youth. From 2012 onward the program would be offered to migrant workers, and from 2013 onward to fishermen, and communities in border and remote areas, and civil society. From 2014 onward it would be offered to cooperatives and MSMEs, and from 2015 onward to factory workers (Figure 4). Financial education is delivered in a way that is easily accepted by these different population groups. Other activities in the financial education program have been: the distribution of leaflets, booklets, brochures, and comics from 2008 onward; an education mobile in 2008–2010; and memoranda of understanding with related government agencies, including the Ministry of Education and Culture and the Indonesian Consumer Organization in 2008 and with the Ministry of Manpower and Transmigration in 2011. Advertising began in 2009 for the Indonesian saving program, *TabunganKu* (“My Savings”), and it was launched in Jakarta and 41 other big cities in Indonesia from 2010 onward. This built on a national campaign in 2008 called “Let’s go to the Bank” that was conducted by BI, in cooperation with all commercial and rural banks, and was aimed at local communities (especially workers and students). The aim of the campaign was to improve consumer understanding of financial services, products, planning, management, and literacy (Hadad 2010; Wibowo 2013).

Figure 3: Three Key Elements to Achieve Financial Inclusion through Financial Literacy



Source: Wibowo (2013).

One channel for disseminating educational material has been a car that can visit public areas, such as schools, markets, housing complexes, and office buildings. This has been done successfully in a number of cities, including Jakarta and its surrounding areas, Medan, Bandung, Semarang, Surabaya, Denpasar, and Makassar. So far, 48 kinds of brochures on six topics have been distributed. The topics are: banking institutions, customer complaints and mediation, savings and investments, loans, banking services, and other information, including tips for addressing the global financial situation (Wibowo 2013).

The goals of financial education as formulated by the BI are to: (i) build bank-mindedness and awareness in society; (ii) build public understanding of banking products and services and awareness of customer rights and obligations; (iii) build risk awareness in relation to financial transactions; and (iv) disseminate information about the complaints and dispute-resolution mechanism for resolving problems with banks (Wibowo 2013).

Given those goals, it could be expected that the success of the financial education program would be measured by the increased number of people with accounts in banks. In other words, a positive correlation would be expected between the financial education program and access to formal financial services. However, many other factors influence people's decisions to open bank accounts or to use banks for their businesses or personal transactions. These factors include individual income or employment status, the availability of bank offices, and geographical issues relating to infrastructure and/or transportation. So, methodologically, the best way to measure the success of financial education programs in Indonesia is by making field observations and doing interviews with new bank account holders to discern their main reasons for opening a bank account. This kind of assessment has never been conducted by OJK or by individual banks. The quantitative approach (statistical analysis) would be not sufficient to gauge success or failure, indeed, it may even be misleading.

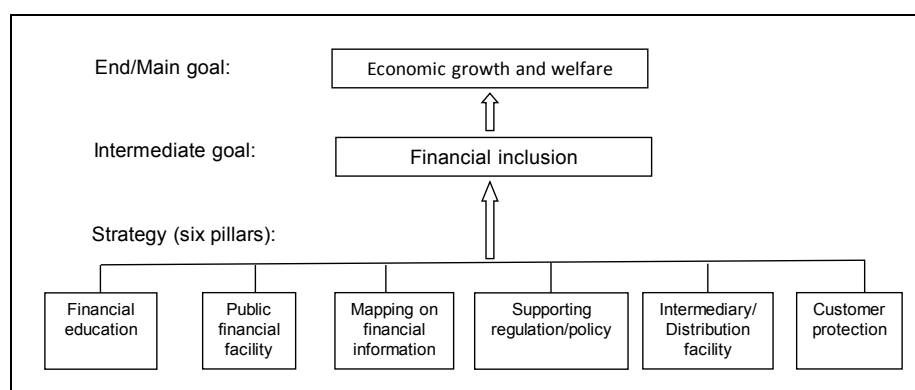
5.2 Financial Regulations and Policies

From its long experience of development strategy gained during the Soeharto era (1966–1998), the Indonesian government has realized that financial exclusion has a major impact on the lives of the poor. In the absence of proper storage facilities such as a savings deposit bank account, whatever small amount of savings the poor are able to amass becomes vulnerable to theft and natural disasters, e.g., flooding. The poverty financial-exclusion cycle is a vicious one that needs to be broken. To counter this, BI and the Ministry of Finance (MoF) have launched the National Strategy for Financial Inclusion.

BI defines financial inclusion as broad or full public access to financial services, including the poor. This implies an absence of price and nonprice barriers in the use of financial services. Although financial inclusion is usually linked to poverty alleviation, particularly through subsidized credit schemes, it also has strong links to financial stability (Hadad 2010).

The main goal of the Indonesian financial inclusion policy is to achieve high and sustainable economic growth and social welfare through poverty reduction, equitable income distribution, and financial system stability. This will be achieved by creating a financial system that can be accessed by the whole population. BI believes that inclusive finance is an important prerequisite for reducing poverty and at the same time for sustaining the country's economic development and growth, since financial inclusion gives the population better access to financial sector services, thus enabling them to contribute more to the economy. The national strategy for financial inclusion consists of six pillars: (i) financial education; (ii) public financial facility; (iii) mapping of financial information; (iv) creation of supporting regulations and policies; (v) an intermediary and/or distribution facility; and (vi) customer protection (Figure 5). The aim of the first pillar is to strengthen financial education, especially for low-income earners with the hope that it will change unproductive financial management behavior and encourage the broader utilization of financial services. The aim of the second pillar is to improve public access to financial services by developing payment system infrastructure, the utilization of information technology, and economic innovation networking at the local community level. The aim of the third element is to provide better profiling of financial services and information on related services to educate the public and reduce misconceptions. These related services include the establishment of a credit rating agency for MSMEs; a credit information bureau; a database for unbanked people to be compiled through a comprehensive, baseline survey; and development of a Financial Identity Number (FIN). The aim of the fourth component is to strengthen the regulatory framework to stabilize the financial system and to function as a reference point for other institutions that issue financial policy. This framework will include regulation of multi-licensing for banks to improve the effectiveness of banking operations and the creation of guiding principles on branchless banking to facilitate the implementation of this kind of banking. The aim of the fifth pillar is to provide better intermediary, or distribution, facilities to increase the access of unfinanced or unbanked people to formal financial services. This will be done through a number of programs including the national campaign *TabunganKu* (My Saving), the implementation of "Start-Up" credit, and the implementation of branchless banking. Branchless banking is a system of payment and limited financial services conducted not by means of a physical bank branch, but by means of technology and/or third party services. It is being developed primarily to serve unbanked people. The aim of the sixth pillar is to provide protection to customers within the banking sector through product transparency, a special unit handling customer complaints, customer mediation, and customer education (BI 2013; Wibowo 2013).

Figure 5: National Strategy for Achieving Financial Inclusion



Source: Wibowo (2013).

In the past few years, the Indonesian government has initiated and implemented a number of actions to promote financial inclusion:

- (i) The government has issued various new regulations. These include, in June 2007, Presidential Instruction (Inpres) No. 6/2007 relating to the real sector and MSMEs Development Policy, which mention the need to strengthen the credit guarantee system for MSMEs. Two further regulations are the Presidential Regulation (Perpres)

No. 2/2008 relating to Guarantee Corporations and the Regulation of Ministry of Finance No. 222/PMK.010/2008 relating to the Credit Guarantee Company and the Credit Re-guarantee Company. The main aim of the Credit Guarantee Company is to help MSMEs that do not have any collateral, do not have enough collateral, or that have collateral but no formal license (for instance, a land certificate).

- (ii) The Financial Identity Project is a new, ongoing, innovative project carried out by BI to build a more systematic pathway to greater financial inclusion in Indonesia. It is BI's intention to bring as many as 40 million people into the banking system. They are developing a mechanism to introduce a unique FIN for each person in order to make accessing financial services more effective and efficient and to make it easier for everyone to access financial services, especially those who do not currently have any access to banking services (the unbanked society), such as MSMEs, and productive poor households. The program will give each person an identification number that will allow banks and financial service providers to access their financial history. FIN contains basic data and the financial profile of FIN cardholders based on e-KTP data. Using a single identity that also includes a financial profile is expected to reduce the repetitive administrative process for different service requests. Consequently, this will help members of the public receive approval for loans (up to a specific value) in a much shorter time period. (Alliance for Financial Inclusion website).
- (iii) The rationale for this FIN program came from a 2009 survey conducted by BI, which found that 43 million Indonesians did not use banks. In 2012, two companies, PT. Arah Cipta Guna and PT. DEFINIT, were appointed by BI to build and implement a pilot FIN program that was expected to provide a stepping stone for large-scale implementation. The consulting work also included a survey, "Financial Identification Number Year 2012," which begun in August 2012 in six provinces (Banten, Central Java, East Java, Jakarta, West Java, and Yogyakarta). The objective of the survey was to collect data and assess the number of individuals and households that had potential access to the banking sector. It describes the respondents' financial situations and financial activities. In addition, the data collection could be used to improve access to the banking sector for all in society (Kencana and Bisara 2010).
- (iv) Financial Service Authority (OJK). Until now, microfinance institutions in Indonesia have largely operated without a comprehensive regulatory framework to guide their operations, and with little supervision from BI. Many of them are operated in a distinctive way, neither like banks nor like savings and loan cooperatives. Many semi-formal and/or informal institutions such as LDKPs, LPDs, but also microfinance cooperatives, credit unions, and NGOs are outside the legal framework of banks, and do not have a clear legal status in the financial system. This might represent a risk for small depositors in some cases. In addition, many of the government development programs from various ministries include a microfinance component, and are often managed without consideration of microfinance best practices and without good coordination with BI. This creates an unsustainable source of cheap funds, and unfair competition to commercial microfinance providers. In order to regulate the financial sector, including the operation of all microfinance institutions in the country, an autonomous agency, the OJK, was established in 2011 (under Act No. 21 of 2011).
- (v) Law No. 1 of 2013 on Microfinance Institutions. In order to strengthen the role of the OJK, the government issued the Microfinance Institution Law, which was enacted on 8 January 2013. The law does not come into effect until 2015, however, giving microfinance institutions 2 years to adjust to the new requirements. The law governs all aspects of microfinance institutions operating in Indonesia, from their establishment, to their areas of operation and their permitted activities. The law is seen as a tool to give these institutions the support they need to provide financial and other types of support to small entrepreneurs. The OJK is given extensive powers

under the law to develop, regulate, and supervise microfinance institutions. The OJK is authorized to approve the restructuring of a microfinance institution through either a merger or consolidation, and it can also approve the liquidation of a microfinance institution.

- (vi) Under the law, several requirements must be fulfilled for the establishment of a microfinance institution. It must have a legal status as either a cooperative or a limited liability company (PT) and it must meet the capital requirements. It also must obtain a business license from the OJK. Foreign nationals, any entity owned by foreign nationals, and foreign-owned enterprises are prohibited from owning a microfinance institution (Eddymurthy and Kolopaking 2013).
- (vii) The OJK has also initiated a similar program to increase public knowledge about financial literacy called the National Financial Literacy Strategy. This program has three aims: to boost financial literacy education through public campaigns, to strengthen financial infrastructure, and to develop accessible and affordable financial services products (Qorib and Sidauruk 2013).

6. CONCLUSIONS AND POLICY RECOMMENDATIONS

Following the Asian financial crisis of 1997–1998, Indonesia has adopted a financial inclusion strategy as part of its “inclusive national development policy” in order to increase economic growth and the welfare of the population. One way to achieve financial inclusion is through financial education; an ongoing process to change the behavior and culture of society and to increase familiarization with the financial world. To guarantee the continuity and the effectiveness of the education program and to optimize its results, it needs to include the following measures.

- (i) There needs to be good coordination and collaboration between stakeholders and parties (including those involved in the education sector, and particularly those in primary through to high school). A strong commitment among the parties is essential for success. The stakeholders with a crucial role to play include not only BI, OJK, banks, nonbank financial institutions, and the Ministry of Education, but also the private sector, especially chambers of commerce, business associations, and other NGOs.
- (ii) Financial institutions must include financial education programs as an integral part of their businesses.
- (iii) There should be an ongoing commitment to improving efficiency (cost reduction) in the implementation of the programs.
- (iv) The implementation of the program should be accompanied by a vigorous and continuous campaign to encourage saving, especially for young people and children, to create a younger generation who have an understanding of good financial management.
- (v) The implementation of the program should be supported either by formal financial services that are located in the area, or as a minimum, by agents of the financial institutions that are based in the area.
- (vi) There should be adequate monitoring and evaluation mechanisms, and for that, quantitative indicators should be created.

The following issues should be considered to ensure the effectiveness, efficiency, sustainability, and healthy development of microfinance in Indonesia.

First, as there is a lack of awareness of sound principles of microfinance within the implementing organizations in Indonesia, there is a need for centralized training centers,

located throughout the country, where all those involved in microfinance can receive additional training and support.

Second, as most of the relatively successful microfinance programs have been located in Java and Sumatra, and the bulk of the microfinance institutions and programs in Indonesia are located in urban areas, the coverage should be expanded into other parts of the country, especially rural communities or those living in less developed, isolated, or border regions, like Papua and Kalimantan. To realize this, three actions should be taken:

- (i) Financial inclusion should focus on (a) regulations, so that banks maintain their sound risk management without pursuing non-competitive and non-inclusive business practices, and (b) the composition of lending, namely to increase the share of the poor or MSMEs in total credits, not only at the national level but, more importantly, at the provincial or district level, by increasing the aggregate level of financial intermediation. They should not focus on artificially pumping out and administratively allocating more credit.
- (ii) Local organizations, both formal and informal, that have the potential (based on their current activities: human resources capacity, especially with reference to financial management; past experience with microfinance; and their business relationship with banks as microfinance providers) should be given the first priority to be selected and promoted as local microfinance providers. Such organizations can include local cooperatives, post offices, pawnshops, retail outlets, businesses and MSMEs, associations, foundations, NGOs, or even *arisans*. The introduction or implementation of mobile banking should also be considered as a distribution channel.

Existing local microfinance institutions, including those in the informal sector, need to become more efficient and competitive. This would help them to bring down the interest rates on loans and capitalize on this exceptional opportunity to profitably tap into a large base of people with deposits to offer. For this, BI, local BRI, chambers of commerce, and universities should provide technical assistance and capacity-building support.

Third, in order to have sustainable, successful microfinance programs in Indonesia, the following three steps should be taken:

- (i) All implementing institutions need to operate efficiently and be independent of continued financial support from the government. To increase their overall efficiency, implementing institutions need to take the following steps: (a) They should adopt standards, principles, and guidelines that ensure the prudent operation of the financial institution or bank in a way that is in line with international best practices. This would include adopting standards relating to credit administration, fund management, internal control systems, and staff development. Partnerships between Indonesia's microfinance providers and external actors, particularly bilaterals and international NGOs, can serve as conduits of both international best practices and finance. (b) The government should shift resources from subsidized program credits to capacity building of existing microfinance institutions for expanded outreach and to ensure their sustainability. Capacity building is needed, especially in the development of management and staff skills. (c) There should be policies to create competition in microfinance institution activities, both between different microfinance institutions for the same borrowers (i.e., horizontal competition) and between the same type of microfinance institutions (i.e., vertical competition). This will give clients a wider range of products.
- (ii) The monetary authority or government should have full control of the growing number of microfinance institutions and their ways of operating methods. This is particularly important for nonbank institutions.

- (iii) As there are too many microfinance services providers with overlapping targets, coverage, and regulations, reorganization of microfinance services at both the national and regional levels is needed.

Fourth, the government should provide a conducive environment, supported by law, to ensure the security of the microfinance institutions and to instill confidence in them.

Fifth, the BI plan to establish a credit information bureau should be realized as soon as possible with offices in all cities and towns in the main districts. This could prevent the risk of over-indebtedness in areas of strong competition among microfinance institutions.

However, the overall success of programs or policies to increase financial inclusion does not only depend on the quality of the policies themselves, but, also on at least two other factors that should be considered to be the preconditions of success. These are first, better income or employment opportunities for those in society targeted for financial education to enable them to save their money or to open a bank account; and second, easy access to financial tools and institutions, together with their supporting infrastructure, for all Indonesians, even those in remote or less-developed areas.

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