



SEKRETARIAT WAKIL PRESIDEN
REPUBLIK INDONESIA

National Strategy for Financial Inclusion Fostering Economic Growth and Accelerating Poverty Reduction

To Achieve a Financial System that is Accessible
by all Layers of the Community and to Promote Economic Growth,
Poverty Reduction and Income Equality





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November 2011

**Judul: National Strategy for Financial Inclusion
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Accelerating Poverty Reduction**

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Abbreviations & Glossary

AML	Anti-Money Laundering
Arisan	Traditional savings group
ASEAN	Association of South East Asian Nations
Bapepam-LK	Badan Pengawas Pasar Modal dan Lembaga Keuangan (Financial Institution and Capital Market Supervisory Board)
BI	Bank Indonesia (Central Bank of Indonesia)
BKDs	Badan Kredit Desa (Village Credit Board)
BPDs	Bank Pembangunan Daerah (Regional Development Bank)
BPRs	Bank Perkreditan Rakyat (People credit bank, often referred as Rural Bank)
BPS	Badan Pusat Statistik (the Central Statistical Bureau)
BRI	Bank Rakyat Indonesia (Indonesia People Bank)
BTPN	Bank Tabungan Pensiun Nasional (National Pension Fund Bank): a [privately
BUMDes	Badan Usaha Milik Desa (Village Owned Enterprise Bureau)
CFT	Combating the Financing of Terrorism
CSR	Corporate Social Responsibility
FIN	Financial Identification Number
ICT	Information and Communication Technology
IFC	International Finance Corporation
Jamkesmas	Jaminan Kesehatan Masyarakat (Community Health Guarantee)
KPIs	Key Performance Indicators
KUR	Kredit Usaha Rakyat (People Enterprise Credit)
KUTTKI	Kredit Usaha Rakyat untuk Tenaga Kerja Indonesia (People Enterprise Credit for Immigrant Workers)
KYC	Know-Your-Customer regulations
MFI	Micro Finance Institution
MFIs	Micro Finance Institution
MoF	Ministry of Finance
MoHA	Ministry of Home Affairs
MoNE	Ministry of National Education
MSME	Micro, Small, and Medium Enterprises
MW	Migrant workers
NBFIs	Non-Bank Financial Institutions
NGOs	Non-Government Organizations
OJK	Financial Services Authority
PerumJamkrindo	Perusahaan Umum Jaminan Kredit Indonesia (Credit Guarantee Company)

PKBL-BUMN	Program Kemiteraan dan Bina Lingkungan –Badan Usaha Milik Negara (Environment Mentoring and Partnership Program of the State Owned Enterprises)
PKH	Program Keluarga Harapan (National program for family welfare)
PNPM	Program Nasional Pemberdayaan Masyarakat (National Community Empowerment Program)
PPKD	Perusahaan Penjamin Kredit Daerah (Local Credit Guarantee Company)
PT Askindo	Perusahaan Terbatas Asuransi Kredit Indonesia (Indonesian Credit Insurance Limited Company)
RLFs	Revolving Loan Funds
SIN	Single Identification Number
SKB	Surat Keputusan Bersama tentang Lembaga Keuangan Mikro (Joint Decree Regarding Micro Finance Institutions)
SME	Small and Medium Enterprises
SOEs	State Owned Enterprises
TabunganKu	Low cost saving account
TKI	Tenaga Kerja Indonesia (Indonesia Migrant Workers)
TNP2K	Tim Nasional Percepatan Penanggulangan Kemiskinan (National Team for the Acceleration of Poverty Reduction)

CHAPTER 1

VISION AND MISSION FOR FINANCIAL INCLUSION

INTRODUCTION

A well-functioning financial system is a fundamental pre-requisite for the economic and social development of every community and individual. Financial markets and institutions play a crucial role in allocating funds and evaluating risks. By doing so, they help mitigate the effects of information asymmetries and reduce transaction costs – two classic causes of market failure - thus boosting economic growth, spreading equality of opportunities, promoting redistribution of wealth and alleviating poverty.

This document sets out a financial inclusion strategy for Indonesia. It is expected that such a strategy will enhance the prospects of the poor to engage in Indonesia's financial system, including access to credit, savings accounts, insurance, leasing and payment services. Through better access to the financial system, the poor will have greater opportunities to improve their lives. The Financial Strategy is set out in three chapters. This chapter provides the background, vision and mission to the strategy. The second chapter provides a brief analysis of the financial landscape and identifies barriers and opportunities for greater financial inclusion for those currently excluded. The third chapter provides the details of the strategy. The strategy outlined in chapter three is linked to the underlying principles, vision and mission described in chapter one and addresses the gaps identified in chapter two. The last chapter also identifies a means forward and describes the process of developing in partnership and cooperation between government agencies a road map that identifies existing and new initiatives and their implementers. In doing so it ensures that the strategy's vision is realised and groups currently excluded have a greater opportunity to participate in the financial system.

In setting out the background, vision and mission for the strategy, this chapter first discusses the rational for having a financial inclusion strategy. The argument is that a significant proportion of the

population are currently excluded from a range of financial services. In meeting these unmet demands, not only do people become better off, but it also contributes to economic growth and reduces poverty. Following the rationale for the strategy, this chapter identifies the underlying principles for a financial inclusion strategy. These principles are based on international experience of what works. The principles are then aligned to the Indonesian context in order to provide a vision and set of objectives that reflect the country's circumstances and needs.

RATIONAL FOR A FINANCIAL INCLUSION STRATEGY

There is a substantial number of empirical studies showing a strong causal relationship linking the development of the financial system (and therefore the banking system and capital markets) with economic growth and individuals' welfare¹. An efficient and inclusive financial system empowers individuals, facilitates the exchange of goods and services, integrates people into the economy and offers protection against economic shocks. Inclusive finance - through access to financial services such as savings, bank accounts, credit, insurance products, payment services and pensions – helps vulnerable, low income groups to increase their incomes, acquire capital, manage risk and work their way out of poverty.

To date, a sizeable majority of the population, especially the poor and vulnerable, have no access to financial services. This is due to limited availability and accessibility of financial services.² The dimension of “access” then becomes a fundamental issue, that is, financial exclusion precludes people from the opportunities of managing income fluctuations, mitigating risks and investing in health, education and income generating activities.

Therefore, designing and promoting an inclusive financial system means contributing to remove the causes of inequality, directly influencing the processes and mechanisms that prevent segments of the population from fully participating in the economy. However, a financial inclusion strategy cannot represent an isolated initiative. The economic literature recognizes that among the main causes of poverty and vulnerability is the lack of access to various forms of capital: physical, natural, human, social and financial. Therefore, a financial inclusion strategy should not be developed in isolation. The links between financial and social exclusion suggests that promoting access to financial services represents an important means for contributing to the process of breaking the chain of poverty, thus fostering economic growth and individual welfare.

Financial inclusion makes people, especially the poor, connected with economic opportunities. Lack of access to financial services constrains the ability of people to improve their lives. For example, one

¹Honohan P. (2004), *Financial Development, Growth and Poverty. How close are the links?*, in C. Goodhart *Financial Development and Economic Growth. Explaining the links*. London, Palgrave.

Levine R. (2005), *Finance and Growth. Theory, Evidence and Mechanism*, in P. Aghion and S. Durlauf *Handbook of Economic Growth*, Amsterdam.

Claessens S. (2006), *Access to Financial Services. A Review of the Issues and Public Policy Objectives*, in World Bank Research Observer No 21, 2, pp. 207-240.

reason why the poor have few opportunities to participate in higher education is because current consumption dominates their spending with very few opportunities to save money to pay for education. Another example is the constraint faced by small scale entrepreneur taking on additional orders because of a lack of access to credit to buy additional machinery. Similarly, a home-based entrepreneur selling clothes or handicrafts is likely to refuse an order if the potential buyer can only pay by bank transfer. The connection between these three examples is the 'lost opportunities' for individuals when they are not connected with financial services. The examples illustrate that social benefits could be obtained if access to financial services could be improved. If the entire population had savings accounts, the government could distribute cash subsidies directly to the recipient's account. Long queues for the distribution of the cash subsidies would no longer occur. Distribution of the People Small-business Loan (Kredit Usaha Rakyat) would also be easier if the recipient had a savings account. Indonesian migrant workers abroad would also benefit from being able to send money more easily to their families in the village. These are just some examples of how financial inclusion can benefit people who are currently not connected into the financial system.

Access to the formal financial systems covers only about half the population of Indonesia. A nationwide household survey on access to financial services in Indonesia² conducted by the World Bank, showed that only 49 per cent of the population has access to the formal banking sector. If combined with access to formal non-bank financial institutions, only 52 percent of the population is served by the formal financial system. It means there are more than 110 million people who have little or no access to formal financial institutions. Approximately 31 percent of the population obtains financial services from non-formal institutions. Thus, 17 percent of the population (or nearly 40 million people), are excluded from the financial system. If we focus only on the poor, nearly 40 percent (or 28 million people) in this group are not covered by the financial system.

Banks, which dominate the Indonesian financial sector, serve a relatively small proportion of Indonesian households. One-third of Indonesians do not save at all, and can be considered financially excluded. Similarly, less than half of Indonesians save at banks, and of those who do save at banks, two-thirds also save at some other type of service provider. Considering the overlap between banks and the informal sector, informal institutions service more savers than the banks. A mere 17 per cent of Indonesians borrow from banks, with about one third more borrowing from the informal sector. Microfinance institutions cover another 10 percent. Most of the loans obtained are from informal sources such as friends, family, neighbours, and include 'loan sharks'. On this basis, roughly 40 per cent of the population is financially excluded from credit. The most important reason for exclusion appears to be difficulties in satisfying documentation requirements. The evidence suggests that lack of collateral is a secondary reason.

The single most important financial service identified by households is a bank savings account. The most important stated reason for having a bank account is 'security'. By far, the most common stated reason for not having a bank account is 'lack of income' or not having a job. While the survey's

² World Bank (2010). *Improving Access to Financial Services in Indonesia*, April 2010.

respondents claimed that access to credit from banks was also important, it was considerably further down the list of priorities than access to a savings account.

There is a need for synergy to be developed between the strategy for increasing access to financial services and economic development programs, as well as, poverty reduction efforts. Taken together, the above findings underscore the importance of expanding financial service institutions abilities to offer both savings and credit services, while raising depositors' incomes through broader policies of economic development. These findings also underscore the challenge for Indonesia's formal financial system, especially the banks, of significantly expanding its client base, to reach a much larger portion of the population. The 'truly financially excluded', or those who have neither a savings account nor access to credit, are predominantly poor, poorly educated, live off-Java in rural areas, and do not own non-farm enterprises. Off-Java residents are more than twice as likely to have neither a bank account nor a loan, than those on Java.

PRINCIPLES AND APPROACH TO FINANCIAL INCLUSION

At the outset it is important to define financial inclusion. In doing so, it provides direction not only for guiding what activities should occur and what variables to measure, but also helps to identify the benchmarks against which success or failure can be measured. This strategy defines financial inclusion as:

The right of every individual to have access to a full range of quality financial services in a timely, convenient, informed manner and at an affordable cost in full respect of his/her personal dignity. Financial services are provided to all segments of the society, with a particular attention to low-income poor, productive poor, migrant workers and people living in remote areas.

The definition and the strategy more generally represents a mutually reinforcing link between three key concepts: poverty reduction, financial stability and economic growth. The first component of poverty reduction is achieved by promoting a graduation process of substantial segments of the population from the "low-income poor" to the "non-poor" category, as well as, paying attention to special needs categories like domestic and international migrant workers and people living in remote areas. The second component of financial stability is achieved through the promotion of an enabling regulatory environment and consumer protection practices. The last component of economic growth is achieved through the promotion of initiatives aimed at fostering and empowering local economic development.

The strategy is designed as a people-centred strategy, aimed at broadening access to financial services for all segments of the population and unlocking financial and small business opportunities. The strategy aims to address all layers of the population but with a clear understanding that different layers have different social and financial needs. Among the latter, small businesses represent the bulk of economic activity in Indonesia and require a special effort to unlock their full potential. Furthermore, it

tends to be the poorer segments of society that finds it difficult to engage with the financial sector, and therefore represents a special group to target.

A people-centred financial inclusion strategy needs to bring together a wide range of national interest and agencies. At the national level, it requires the involvement of representatives from all stakeholders in the domain of public, private and civil society sectors. The strategy should represent a concerted and coordinated effort aimed at achieving the desired level of financial inclusion within a specific time frame. Such effort requires a clear and shared “vision” about the challenges and opportunities offered by the financial system and about what the nation wants to achieve in the future. In turn, such vision needs to be grounded in the national context, requires milestones and measurable goals, as well as, a nation-wide awareness of the role financial inclusion can play in the creation of new opportunities for the most vulnerable and low-income groups of the population. While the safety and the stability of the financial system should always be a major concern for regulators, the exploration of new routes and the use of new tools to enhance traditional financial activities represent a fundamental pattern for building an inclusive financial system that places the poor at the centre.

It is important Indonesia’s strategy reflects and draws on the lessons learned by other economies. These lessons are captured in the G20 “principles for innovative financial inclusion”. As now widely recognized³, financial inclusion has become a relevant issue in economies of the under-developed, developing and developed nations. The G20 Leadership Summit in Toronto in June 2010 endorsed nine “Principles for Innovative Financial Inclusion” that have been elaborated by a Financial Inclusion Experts Group appointed by the G20. These principles provide a foundation for developing a strategy that will improve access to financial services for the poor. The nine principles are not intended as a binding set of requirements, but are designed to help policymakers in their decision making process and can be adapted to different country contexts. Given that these principles derive from the experiences and lessons learned by policymakers (especially leaders from developing countries) around the world, it is important that a country’s financial inclusion strategy reflects the policy and regulatory environments inspired by the G20 principles. The nine principles from which Indonesia’s financial inclusion strategy draws inspiration are:

1. **Leadership:** Cultivate a broad-based government commitment to financial inclusion to help alleviate poverty.
2. **Diversity:** Implement policy approaches that promote competition and provide market-based incentives for delivery of sustainable financial access and usage of a broad range of affordable services (savings, credit, payments and transfers, insurance) as well as a diversity of service providers.
3. **Innovation:** Promote technological and institutional innovation as a means to expand financial system access and usage, including by addressing infrastructure weaknesses.
4. **Protection:** Encourage a comprehensive approach to consumer protection that recognises the roles of government, providers and consumers.

³ United Nations (2006), *Building Inclusive Financial Sectors for Development*, UNDESA and UNCDF, New York.
World Bank (2008), *Finance for All? Policies and Pitfalls in Expanding Access*, Washington DC.

5. **Empowerment:** Develop financial literacy and financial capability.
6. **Cooperation:** Create an institutional environment with clear lines of accountability and co-ordination within government; and also encourage partnerships and direct consultation across government, business and other stakeholders.
7. **Knowledge:** Utilize improved data to make evidence based policy, measure progress, and consider an incremental “test and learn” approach acceptable to both regulator and service provider.
8. **Proportionality:** Build a policy and regulatory framework that is proportionate with the risks and benefits involved in such innovative products and services and is based on an understanding of the gaps and barriers in existing regulation.
9. **Framework:** Consider the following in the regulatory framework, reflecting international standards, national circumstances and support for a competitive landscape: an appropriate, flexible, risk-based Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) regime; conditions for the use of agents as a customer interface; a clear regulatory regime for electronically stored value; and market-based incentives to achieve the long-term goal of broad interoperability and interconnection.

THE VISION FOR FINANCIAL INCLUSION

A national strategy requires a vision that identifies the goals Indonesia aspires to achieve. Having previously identified the rationale for the strategy and drawing on the underlying principles which reflect a wide range of experiences, the strategy now identifies and discusses the vision and objectives for the Financial Inclusion Strategy. Building an inclusive financial system needs to be a commitment at the national level. It requires a coordinated effort involving all major stakeholders from the government, the private sector and civil society. For this reason, a national vision is needed that is inspirational and captures the goals as well as the challenges and opportunities. The national vision therefore is as follows:

To Achieve a Financial System that is Accessible by all Layers of the Community
to Promote Economic Growth, Poverty Reduction and Income Equality in
Indonesia.

Indonesia's vision for financial inclusion can be expanded and elaborated through identifying a series of objectives that will improve welfare and alleviate poverty. As previously mentioned, a financial inclusion strategy requires planning at a national level, involving representatives of all stakeholders in the domain of public, private and civil society sectors. It requires a concerted and coordinated effort aimed at achieving the desired level of financial inclusion within a specific time frame. Against this background, the vision for the national strategy on financial inclusion can be expanded through six key objectives described in the following paragraphs.

Objective 1: Make financial inclusion part of the grand strategy of economic development and poverty reduction. As already outlined in the vision statement above, financial inclusion is ultimately a strategy aimed at achieving broader economic development goals, in this case poverty reduction and improvement of public welfare. A poor and marginalized group is also a group that has a limited access to financial services. There is a reciprocal relationship between poverty and access to financial services. Therefore, addressing the financial inclusion goal requires simultaneously a greater focus on the poor.

Objective 2: Provide financial services and products tailored to the needs of the community. Given its role in promoting economic growth and poverty reduction, financial inclusion cannot be addressed by a single product or technological innovation. Rather, it requires a whole set of solutions able to expand financial access and opportunities for the most disadvantaged segments of the population. While financial inclusion, in a narrow and more traditional sense, can be restricted to the provision of credit, a comprehensive financial inclusion strategy should be able to address all the different needs arising from different segments of the population, and do so through a holistic set of services. This would include not only credit, but also basic bank accounts for making and receiving payments, saving products suited to the pattern of cash flow of poor households, money transfer facilities (including more affordable remittance services from abroad), small loans for productive, personal and other purposes and insurance products (both life and non-life). The provision of financial services and products must be tailored to the specific needs of different segments of the population. The availability and accessibility of micro-insurance, micro-savings and micro-credit do not only represent an integral part of a wider program of financial inclusion, but also constitutes a social protection mechanism for helping an important segment of the population out of poverty.

Objective 3: Improve people's knowledge of financial services. A large proportion of the community, particularly the poor and marginalized groups, have limited knowledge regarding financial services and products. This remains one of the major obstacles faced in achieving financial inclusion. As a first step in connecting people to financial products and services it's important they understand the range of financial products and services available and the benefits and risks of each. In addition, knowledge related to the rights and legal protections for consumers of financial services also need to be understood by the public so that they will feel safe in their interaction with financial institutions.

Objective 4: Improve people's access to financial services. Barriers to the poor accessing financial services are generally due to, among others, geographical isolation (i.e. physical access) and legal obstacles (e.g. collateral issues, lack of legal form, absence of business permits, lack of personal identity, high costs). Overcoming these barriers will create a fundamental breakthrough in simplifying access to financial services. Such improvement in access, however, needs to be done without compromising the principles of stability and prudent banking.

Objective 5: Strengthen the synergies between banks, microfinance institutions and non-bank financial institutions. Given the dominance of the banking sector in Indonesia, a comprehensive financial inclusion strategy needs to assign a prominent role to the banking sector, leveraging its strengths and addressing its limitations. This means not only empowering the existing branch network, but also enabling the optimal regulatory environment in order to expand outreach of formal financial

services through new distribution channels and routes. However, in order to fill the gap of the underserved consumers, the synergy between the banks, MFIs and non-bank financial institutions becomes crucial and should be encouraged. In order to realize such a synergy it is important to allow MFIs, which have been serving the poor and SMEs, the ability to transform themselves into legal entities. This should be done in order to ensure the protection of the clients, as well as, the overall stability of the financial system. The Joint Decree (SKB) of the Minister of Finance, the Minister of Home Affairs and the State Minister for Cooperatives and SMEs, as well as, the Governor of Bank Indonesia, represents a first step in this direction.

Objective 6: Optimize the role of information and communication technology (ICT) to expand the scope of financial services. Technology can enable some of the most important bottlenecks to be overcome and increase the supply of financial services. ICT can reduce transaction costs and expand the formal financial system outreach in regards to saving and loan services. Clear regulatory guidelines are needed to balance the benefits of increased outreach with the risks to financial stability. However, early movers among developing countries have been successful in implementing innovative solutions and should be encouraged (e.g. in the mobile phone banking). Peer-to-peer learning activities are an important vehicle for transmitting and sharing experiences among developing countries. Branchless banking in the form of mobile phone banking (i.e. mobile money), internet banking or transactions using a card or electronic machine, are technological breakthroughs with huge potential for extending the coverage of financial services to consumers who are not yet served by the banking sector. The high access of Indonesian residents to cellular telephone technology makes it very convenient to increase access to financial services through this technology. This innovation could be combined with e-money services, utilizing post offices and retail networks as outlets for banks.

CHAPTER 2

ACCESS TO THE FINANCIAL SYSTEM

INTRODUCTION

The previous chapter identified the need for an inclusive financial strategy to meet the unmet demand of a large segment of the population, and in doing so, identified a set of principles. This chapter looks at the other side of the coin by examining the supply of financial services and what access people have to those services. The chapter first identifies the various types of services demanded by people. These include access to savings, credit, insurance and access to payment systems. This leads to an examination of what services are being supplied, including those services provided by banks, sharia banking, MFIs and NBFIs. The discussion then turns to the regulatory framework for the provision of financial services. Finally, the chapter identifies a range of issues that create barriers for segments of the population to the provision of financial services. Together, the various parts of the chapter provide an outline of existing financial services and identify the gap in providing inclusive financial services.

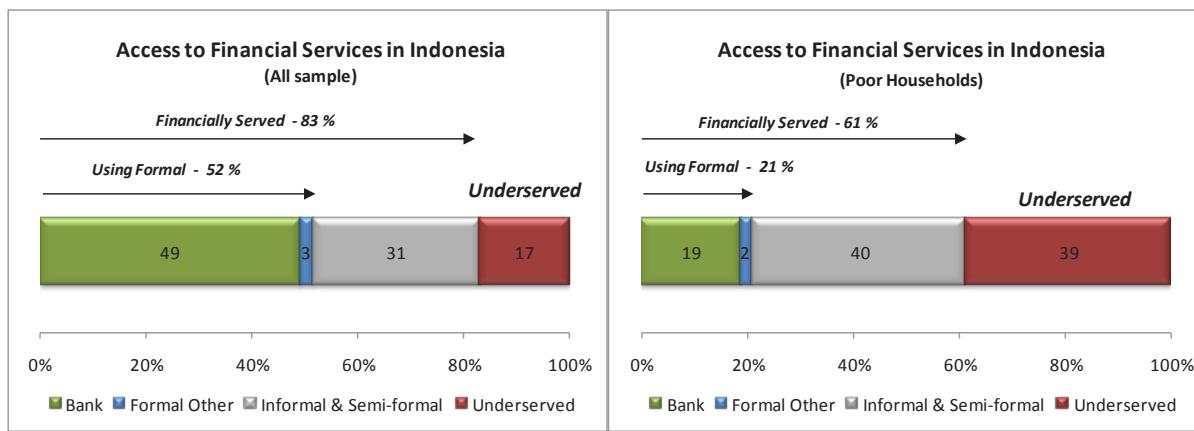
ACCESS TO FINANCE

Approximately 80 per cent of Indonesia's poor has no access to formal financial services, and nearly a fifth do not have access to financial services at all (see figure 2.1). About 4 out of 5 poor people in Indonesia are not served by formal financial services (banks, cooperatives), and almost 40 per cent of poor population have no access to financial services at all (either formal or informal). In general, households use banks, or traditional *arisan* as a medium for saving. However, for the purpose of borrowing money, the informal sector (neighbours, friends, employers, small shops) are more commonly used. There is a significant imbalance in access related to geographic location, type of work,

and of course, level of income. Residents outside of Java and those working in the agricultural sector generally have less access to financial services.

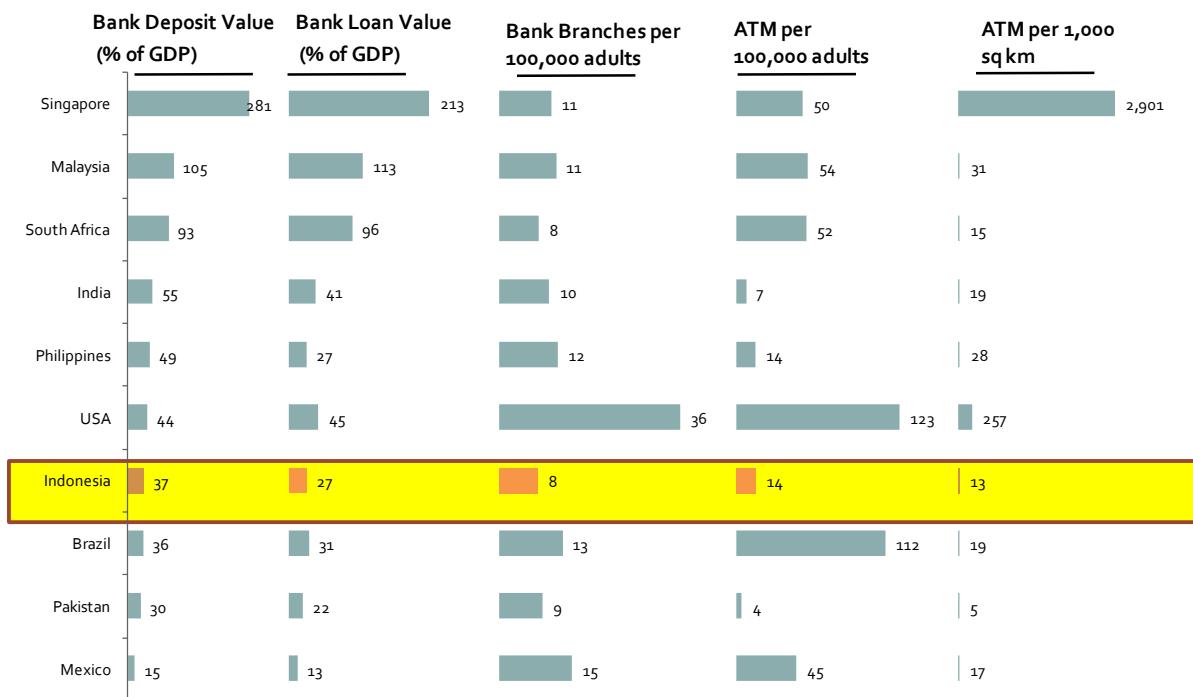
Compared to other developing countries, access to financial services in Indonesia is moderate. According to the World Bank study (2010) those who do not have access to financial services generally are those who belong to the rural poor, with low education levels and living outside of Java. There is a strong linkage between access to financial services, poverty and marginalization. Indonesians' access to financial services can be compared to other countries as shown in Figure 2.2.

Figure 2.1 Conditions of Access to Financial Services Today



Source: World Bank (2010).

Figure 2.2 Comparison of Community Access to Financial Services

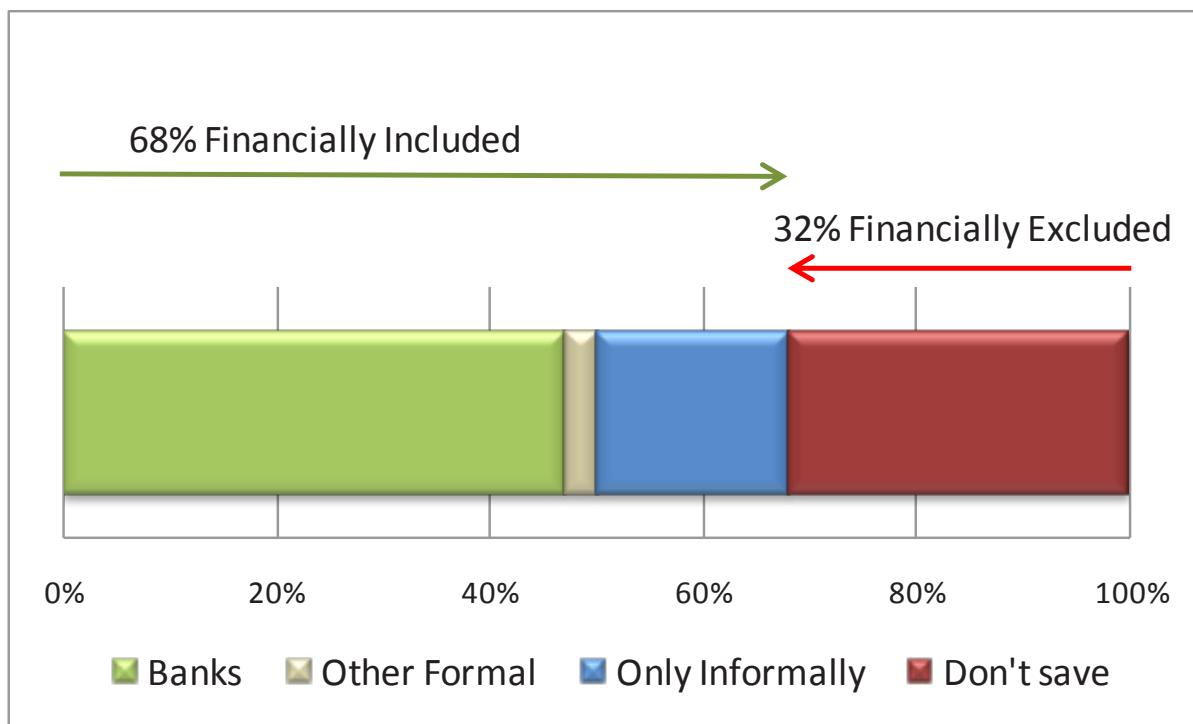


Source: CGAP Financial Access 2010.

Access to saving accounts

Approximately two-third of the population has savings of some form or other. As much as 50 per cent of deposit can be found in formal savings accounts. The majority are in banks (a small number are in cooperatives and MFIs). The remaining 18 per cent have savings in schemes such as arisan (informal social saving), savings club, or a revolving fund group (Figure 2.3).

Figure 2.3 The Use of Savings in Indonesia



Source: World Bank (2010).

"Not having money" is given as the main reason for not opening a savings account at a bank. Of the one third of the population who do not save, 79 per cent said it was because they do not have any money. Other reasons included "not having a job" (9 per cent), "do not see any advantage of having savings" (4 per cent) and "do not understand the procedures" (3 per cent).

There is a strong perception that to have a savings account, a person must have enough revenue. This perception may be based on the fact that for most of the poor, their income is too small and there is nothing left to save. However, Karlan and Morduch (2010) write many poor or low-income residents have enough money to be saved. A person can save money by reducing consumption today with the potential of additional profit in the future. The implication is that in planning a policy that encourages people to save money, especially for low-income groups, it should consider the wider context and not just the promotion of saving services.

Access to Credit

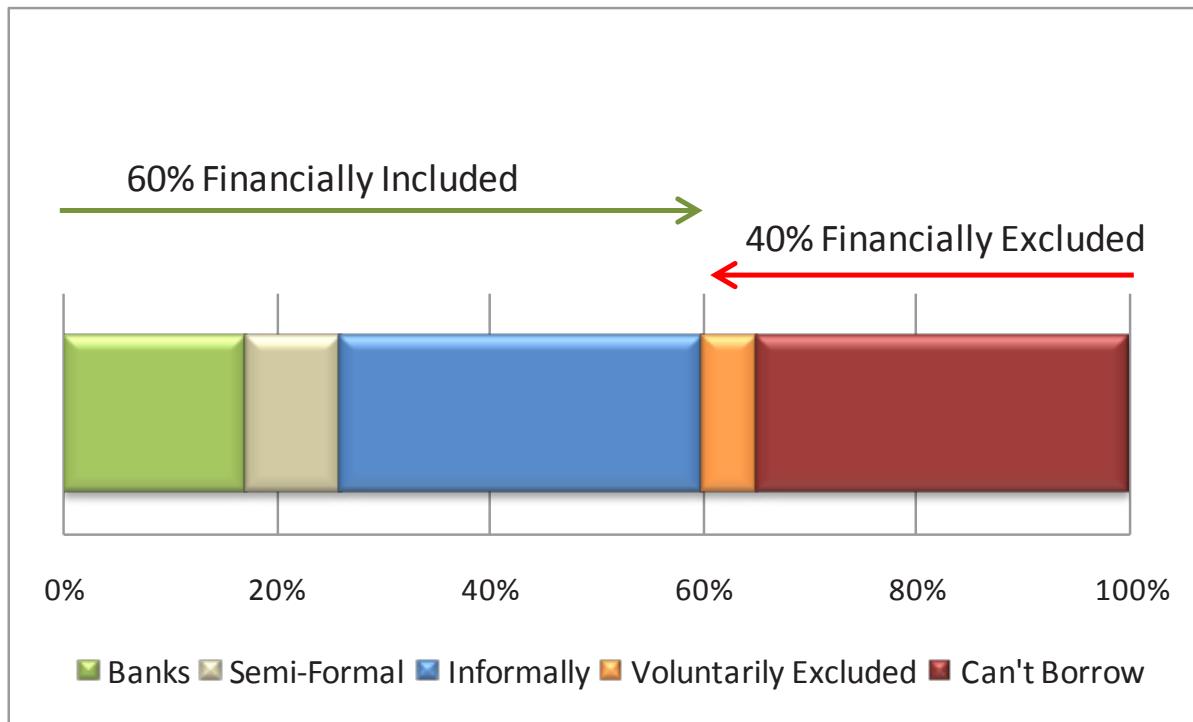
In Indonesia, the use of loans is lower than for savings and is predominantly from informal sources. As much as 60 per cent of the population have access to loans. While most people keep their savings in the formal sector, such as banks, access to loans is more commonly obtained from informal sources such as

friends, families, neighbours, employers, and including 'loan sharks'. Bank credit only covers 17 per cent of the population, while the micro finance institutions account for only 10 per cent (Figure 2.4). Loans from informal institutions generally have interest rates higher than that provided by formal institutions, but are more routine and widely used by the community. The interest rates charged by informal lenders can reach 40 per cent per year or more, compared to formal institutions which usually charge 25 per cent per year or less.

Significant unmet demand for loans exists. Approximately 77 per cent of those that have not previously taken out a loan wish to do so. The major reason for not borrowing is because they do not fulfil the eligibility criteria or do not have collateral. From the sub-population that have applied for credit in the past 12 months, the main reason for rejection is incomplete supporting documents, lack of collateral, too low income, or their current existing debt is too large.

Loans from banks and MFIs are usually used for financing businesses and investment, while borrowing from the informal sector is often used for consumption. More than 70 per cent of bank loans are used to finance businesses and investment. MFI credit is commonly used for business expansion. While in contrast the main use of loans from informal sources is for consumption. It is also important to note that the majority of banks and microfinance institutions charge a lower interest rate if the borrower has a savings account.

Figure 2.4 Level of Credit Usage in Indonesia

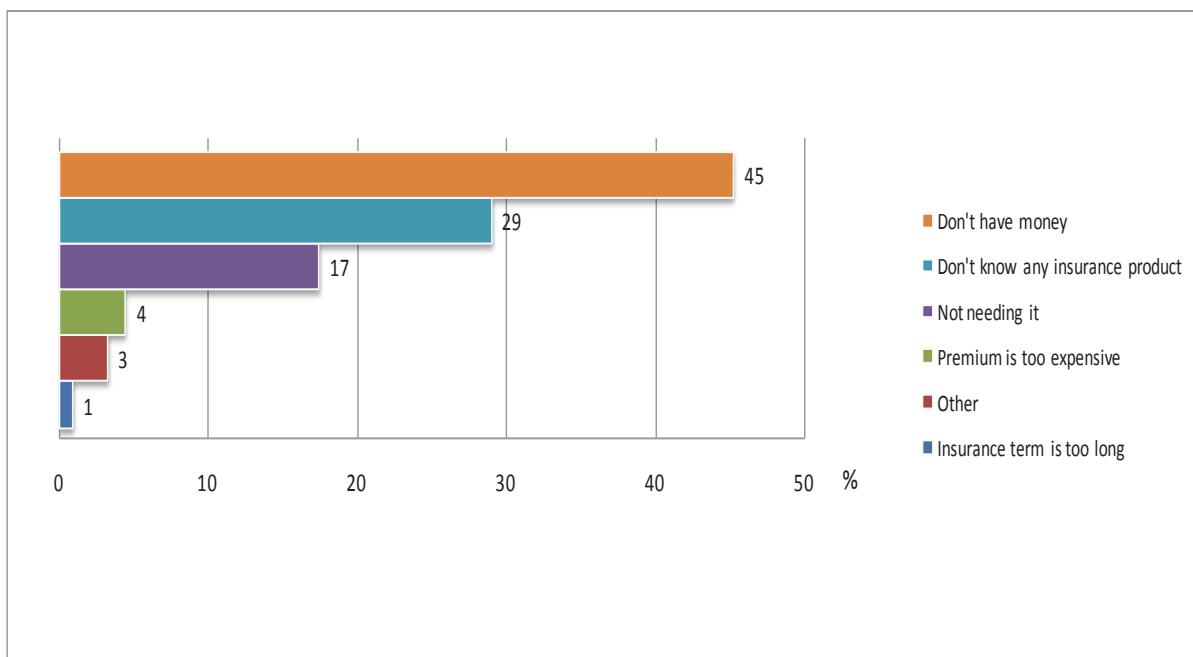


Access to Insurance

Approximately 50 per cent of Indonesia households have some kind of insurance (as indicated by the survey on Access to Finance (A2F) in Indonesia). The surprisingly high rate of usage mainly comes from travel insurance and public health insurance. Excluding non-self-initiative⁴ take up types of insurance, about 24 per cent of the total household population had some form of insurance.

The survey indicated that relatively higher insurance take up occurs among the urban, upper income groups. Further econometric analysis using the survey data confirms that households are more likely to have insurance of some kind if they are living in urban areas; have better than average mathematical skills; and if they are relatively well off as indicated by house size.

Figure 2.5 Reason for Not Having Insurance



Source: World Bank 2010

Given the appropriate insurance product is available, the uninsured showed a preference for education insurance, followed by medical insurance, and accident insurance. Among the uninsured, the common reason for not having any type of insurance were; lack of affordability and lack of

⁴ Government health insurance and travel insurance were part of the insurance product being surveyed. Government employee and the poor are provided with government health insurance, but the premium is being paid by the government. Travel insurance usually comes in one package within the travel cost; hence travelers are automatically being insured while the transport company will pay the premium. As a result the take up decision for these insurance does not come from the insured but from other entities.

knowledge of insurance products. This underlines the importance of consumer education, low-cost options for insurance products, such as micro insurance, and simplified insurance products.

Access to Payment Services (remittances)

Indonesia is the third largest recipient of remittance inflows in the Asia-Pacific region. There is a significant potential for Indonesian Migrant Workers to contribute to economic growth and the local economy through their productive activities and the overall annual remittances of approximately US\$ 6.8 billion (2009). The number of Migrant Workers leaving Indonesia has steadily increased over the last ten years and now totals approximately 632,000 Indonesians per year (2009), with approximately 6 million Indonesian Migrant Workers abroad (2008).⁵ In addition, domestic migrants also represent a large group with significant remittances.

Electronic bank transfers are by far the most popular remittance vehicle. This is followed by friends or relatives, and by carrying the remittance on return trips (World Bank 2010). Most of the time, family members pick up the money themselves, but it is also common to use an account mediator (with additional cost incurred).

Migrant workers can reduce the cost of remittances by a third or more, by shopping around to find a service appropriate to their needs. The cost of remittances to Indonesia is about average relative to available comparators and there is a range of services available to meet different needs, with varying levels of speed, convenience and security and cost (see Annex 1 for most recent status of the various payment systems and their operations). Financial literacy plays an important role in Migrant Workers understanding the various options offered by service providers. Despite, the level of services opportunities exist to reduce costs, improve security and increase reliability of transfers through the introduction of new technologies.

THE FINANCIAL SYSTEM

A well-functioning financial system is a fundamental pre-requisite for the economic and social development process of every community of individuals. Financial markets and institutions play a crucial role in channelling funds to the most productive uses and allocating risks to those who can best bear them. By doing so, they help to mitigate the effects of information asymmetries and transaction costs – two classic causes of market failure – thus boosting economic growth, spreading equality of opportunities, promoting redistribution of wealth and alleviating poverty. The following describes the existing financial system and the role it can play in the National Strategy for Financial Inclusion.

⁵ For reference see: <http://www.bnptki.go.id/content/view/791/231/>

Banks

The financial system in Indonesia is dominated by banks. Of the total formal financial assets in Indonesia, banks manage about 79 per cent. Moreover, between the years 2000-2008, the number of bank branches increased by 70 per cent. In the same period, the numbers of ATMs increased by nearly three-folds. In terms of assets, non-banks account for only a small percentage. Insurance and pension fund companies manage about 10 per cent of the total assets. Other formal financial institutions, such as those more focused on serving rural consumers, for example, pawnshops or cooperatives, only manage a small percentage of the overall assets available (the World Bank 2010).

Banks tend to be present in densely populated areas, which are closely associated with the volume of economic activity. Numbers of branch offices, sub-branches and cash offices of banks are concentrated on Java. If we compare the density of banks (excluding Jakarta), as measured by the number of bank branches per one hundred thousand inhabitants, the difference between Java and outside Java is not significant. Of the more than 400 districts/cities across Indonesia, about one third, mostly remote areas, do not have bank branches. Most of the low serviced districts are low population density areas such as Papua, Kalimantan and Sulawesi. Overall, the banking sector is concentrated in and around Jakarta while low population and remote districts tend to be underserviced.

Sharia financial institution

In Indonesia, the Sharia financial institution can play an important role in reaching the segment of consumers who are reluctant to enter into conventional banking transactions. The Sharia financial system is based on principles of Islamic law. The most fundamental characteristic of the Islamic system is 'transaction without interest'. Sharia financial institution also do not operate activities involving gambling or the sale of alcohol.

In recent years, sharia financial service has grown quickly. The sharia Financial Service now includes banking services, the BPRs, cooperatives, pawnshops and even includes investments. The products offered are no longer limited to savings and loans, but include insurance, credit cards, mutual funds and stocks. In the 1990s, it was only Muamalat Bank that offered sharia banking services. Today there are many commercial banks, state-owned banks, private and even foreign banks who provide sharia banking services.

Sharia financial services are consumed mostly by SMEs and low-income groups. Apart from religious motives, the profit-sharing system offered by the sharia finance fits with the activity pattern and the needs of SMEs and low income groups. According to data from Bank Indonesia (2007), 70 per cent of sharia bank loans are granted to SMEs. At the same time, the sharia BPR which focus on low-income groups is experiencing a steady growth. This suggests that sharia finance can play an important role in improving financial inclusion.

Micro-Finance Institutions (MFIs)

MFIs generally provide small amounts of credit and other relevant financial services to the poor, low income people and/or microenterprises that have encountered difficulty in access to formal financial institutions such as banks. Micro-Finance Institutions (MFIs) are defined as a financial entity that provides microfinance services. As an effective tool of poverty reduction, microfinance covers a variety of products (besides typical microcredit) and may include; micro-saving, micro-insurance, lease service and settlement service (cashing a check, remittance, etc.).

In Indonesia, there exist a variety of MFIs spread across the country. This includes regulated MFIs, as well as, MFIs that operate under unclear legal status or outside of existing regulations. Bank Indonesia regulates the microfinance windows of commercial banks, BPRs and BKDs. However, savings and loan cooperatives, credit unions and other similar organizations are fully or partially regulated by the Ministry of Cooperatives and SMEs. The pawnshop, finance companies and venture capital companies are under the supervision of Bapepam-LK (this is likely to be transferred to the newly established Financial Services Authority (OJK). The village microfinance units initiated by local governments are supervised and supported by BPDs or NGOs under the provincial regulations. Village-owned enterprises (BUMDes) that deal with microfinance services are partially regulated by district governments.

At present Indonesia has around 80,000 MFIs, of which 45 per cent are savings and loans cooperatives and 33 per cent are unregulated informal MFIs including deposit-taking entities. Overall, the key characteristics of the MFI landscape in Indonesia can be summarized as follows:

- i. MFIs are distributed throughout the country but tend to concentrate in Java, leading to an uneven distribution of microfinance services to the poor.
- ii. Cooperatives and unregulated MFIs account for the majority of MFIs in number, but BRI Units, commercial bank's microfinance units, dominate the microfinance industry in terms of the lending volume and the number of clients.
- iii. The regulatory and supervisory regime for partially regulated or unregulated MFIs is unclear or non-existent.
- iv. The government encourages MFIs to become part of the formal financial sector through regulations and advocacy.

Significant efforts have been made to improve the regulatory environment for MFIs. As part of the government's strategy to promote SMEs, work has been ongoing on a new law for MFIs. While this law is still being finalised, in September 2009, Bank Indonesia, the Ministry of Cooperatives and SMEs, the Ministry of Finance and the Ministry of Home Affairs entered into a Joint Decree on MFI Promotion Strategy, including a short-term action plan (2009-2011). The Joint Decree allocated specific duties to each of the regulators:

- i. Bank Indonesia to provide consulting services for MFIs to be converted to BPRs.
- ii. The Ministry of Home Affairs, in cooperation with local governments, to take the role of fostering MFIs to be converted to BUMDes.

- iii. The Ministry of Cooperatives and SMEs, in cooperation with local governments, to take a role in supporting and vitalizing MFIs to be converted into cooperatives.
- iv. The Ministry of Finance (Bapepam-LK) to provide consulting services for MFIs to be converted to non-bank financial institutions (NBFI).

Savings and Loans Cooperatives

Indonesia has approximately 150,000 cooperatives that serve about 28 million members and are regulated by the Ministry of Cooperatives and SMEs. The function of cooperatives is to mobilize savings and extend loans to members or other cooperatives and or their members. With such a large customer base, cooperatives play a significant role in providing financial services to low-income households in Indonesia.

A wide variety of cooperatives are regulated under the Cooperative Law No. 25/1992. Savings and Loan Cooperatives (KSP), are deposit taking institutions. Village Unit Cooperatives (KUD) commands a significant market share and represents a traditional disbursement channel for subsidized lending programs of the government. Despite their numbers, cooperatives have so far played a relatively minor role as financial intermediaries. The cooperative sector in Indonesia has been characterized by the dualism of formal cooperatives and a variety of informal organizations that work according to cooperative principles, but have not adopted the legal status of cooperatives. The cooperative-type of MFIs are regulated not only by the Cooperative Law (Law No.25/1992) but also by the Ministerial regulation on credit provision and deposit acceptance for members (Regulation No.9/1995 concerning Savings and Loan Cooperatives). Savings and loan cooperatives, backed by subsidized loan programs, are spread in large numbers throughout the country but their total credit outstanding remains much less significant.

Non-Bank Financial Institutions Sector (NBFI)

Given regulators focus on consolidation within this sector, most of Indonesia's NBFI are likely to continue to offer products that are mainly relevant for larger corporates and the better-off segments of society. The important exceptions to this rule involve service providers offering leasing products such as motorcycle financing and micro-insurance products. The Non-Bank Financial Institutions sector (NBFI) are not considered MFIs as they do not necessarily or exclusively engage in microfinance. Indonesia's non-bank financial sector is small, comprising approximately 20 per cent of the total financial system. This is a considerably lower proportion in relative terms to that found in several other large developing countries and many countries in the East Asia region.

Several important NBFI are present in the financial sector and offer a range of services and products important for financial inclusion. This includes the following institutions which are under the

jurisdiction of Bapepam-LK, the regulatory arm of the Ministry of Finance (see Annex 2) for more details):

- i. Finance companies (sometimes referred to as 'multi-finance companies'). These companies offer a wide range of services, including leasing, consumer financing, mutual funds, factoring, credit-card financing, and securities trading. However, finance companies in Indonesia are usually relatively sophisticated and are less likely to be designed to serve the needs of MSMEs and low-income households (with the exception of those that provide certain leasing and insurance products).
- ii. Leasing and multi-finance companies. These are important for some MSMEs, particularly those involved in fields such as construction. Indonesian leasing industry is heavily dependent upon banks for its financing, and many finance companies have joint financing arrangement with banks.
- iii. Leasing firms. The firms are taking an important first step in developing micro-insurance products. However, this is still in the early stage of development. A useful step in broadening access to insurance services would be to increase the level of transparency with the publication of a range of information (see Annex 2), possibly implemented in cooperation with industry associations.

REGULATORY FRAMEWORK

Bank Indonesia has implemented several financial inclusion initiatives and has played a key role in promoting a strategic vision of financial inclusion. Among the various initiatives promoted and implemented by Bank Indonesia it is worth mentioning their financial education activities ("Ayo ke Bank"), promoting no-frills saving under the "TabunganKu" label, providing capacity building for rural banks (BPR), linkage programs, building an MSMEs database and a number of other programs.

Bank Indonesia framework for financial inclusion is based on a 5 pillars strategy. The 5 pillars are fully consistent and in line with the current proposed national strategy. All the initiatives presented in this strategy can be mapped to Bank Indonesia's pillars. The pillars are:

- i. **Financial Education.** Its focus is to increase the level of understanding (knowledge) among communities regarding the financial product and services. It includes: a) Information on financial products; b) Information on consumer protection; and d) Information on financial management.
- ii. **Financial Eligibility.** This pillar aims to improve the eligibility of the productive poor from unfeasible to feasible and becoming bankable in the latter stages. The pillar includes the following: a) Increasing the capacity of individuals in society; b) Introducing alternative guaranteeing systems; c) Simpler credit services; and d) Identifying potential customers.
- iii. **Supportive Regulation.** It refers to the need of adding or modifying regulation, either by the government or BI, in order to increase access to financial services. It includes: a) Providing license to MFI and agent banking; b) Creating regulation to promote active role of banking

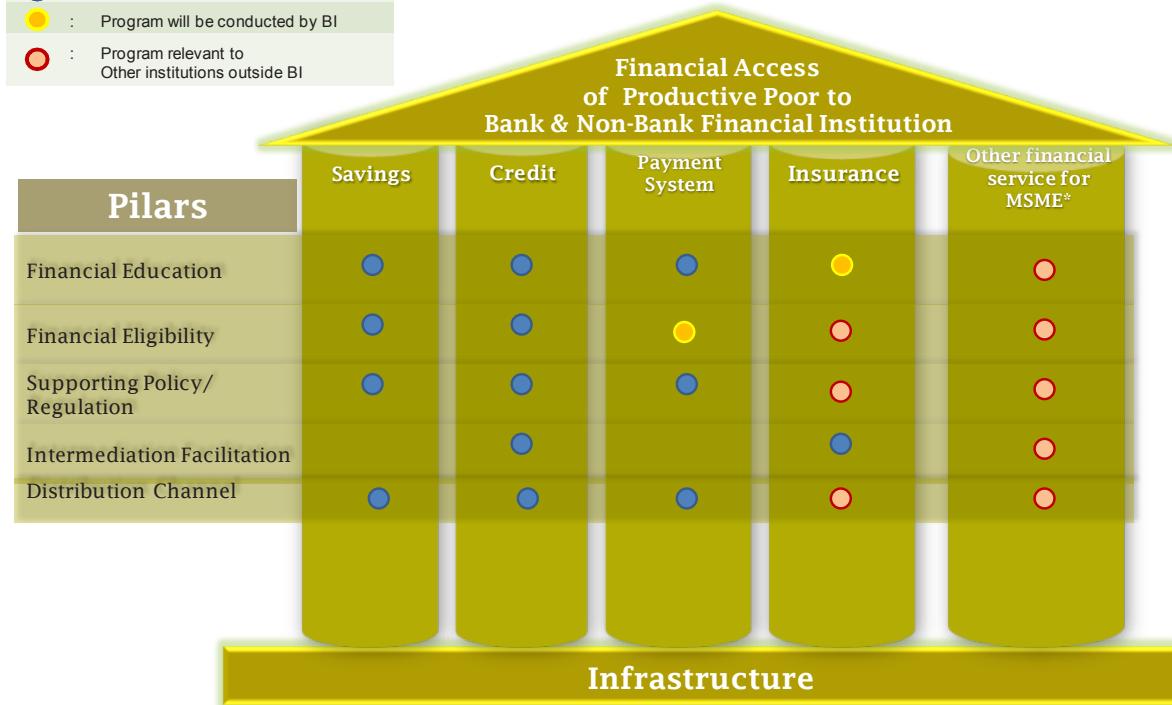
industry in providing financial education; and c) Analysing regulation related to bank's community development disbursement mechanism program.

- iv. **Facilitating Intermediation.** This pillar seeks to increase the awareness of financial institution on the existence of potential (bankable) segments of the community. The pillar includes several aspects, including the following: a) Asymmetric information factor between financial institution and potential bankable poor segment; b) Business scale factor of financial institution by bridging commercial banks with BPR, Cooperatives, or informal financial institutions.
- v. **Distribution Channel.** This pillar seeks several alternative methods to increase the distribution of financial products and services through (for instance): a) Agency Banking; b) Phone banking; c) Mobile banking; and d) supporting infrastructure.

Figure 2.6 Bank Indonesia 5 Pillar Strategy

Legends:

- : Program already conducted and will be continued by BI
- : Program will be conducted by BI
- : Program relevant to Other institutions outside BI



Several Ministries host programs that directly relate to the financial inclusion strategy. This includes the Ministry of National Education and Ministry of Religious Affairs, who are the obvious counterparts to Bank Indonesia for the financial education initiative. The Ministry of Manpower and Transmigration manage initiatives related to migrant workers. The Ministry of Communication and Information is the relevant ministry for initiatives related to ICT. The Ministry of State-Owned Enterprise manages the SOEs and issues the requirement for SOEs to allocate part of their profit for social activities. The Ministry of

Health manages the current health insurance for the poor (Jamkesmas), and is one of the key Ministries for the proposed social security system. There are also a number of other programs and activities under different government agencies that are in line with the financial inclusion initiatives, these include;

- i. **Ministry of Finance.** Bappepam-LK, which is under the MoF, oversees non-bank financial institutions (insurance, capital market). Under the joint decree, Bappepam also oversees venture capital entities (some of these function will be transferred to the newly created OJK).
- ii. **Ministry of Cooperatives and MSMEs.** The main role of the Ministry is to supervise and develop cooperatives and MSMEs, including issuing the relevant policies. The joint decree mandates the ministry to oversee financial sector cooperatives (Koperasi Jasa Keuangan and Koperasi Simpan Pinjam).
- iii. **Ministry of Home Affairs.** The Ministry manages the National Program for Community Empowerment (PNPM), of which one component is the establishment of microfinance institutions at the local level. Under the joint decree, MoHA is responsible for overseeing MFIs that are legal entities as village-owned enterprise (Bumdes).
- iv. **Coordinating Ministry of Economic Affairs.** The Ministry manages the Credit for People's Enterprises (KUR) program.
- v. **Ministry of Social Affairs.** The Ministry is the host for the government's conditional cash transfer (PKH). The PKH program plans in the near future to distribute cash transfers through Giro Pos and bank accounts.

The National Team for Accelerating Poverty Alleviation (TNP2K), which is under the office of the Vice President, coordinates various government's poverty alleviation program, including PKH, Jamkesmas, PNPM and KUR. Although TNP2K is not an implementing agency, its role is to coordinate and provide policy inputs for programs. TNP2K and Bank Indonesia are jointly coordinating the financial inclusion strategy and initiatives.

FINANCIAL INCLUSION POLICY ISSUES

The following is a series of key issues that identify opportunities to improve financial inclusion. The issues represent a range of opportunities and barriers that if addressed will improve financial inclusion, particularly for the poor.

The financial sector faces problems related to information asymmetries. Two classical problems are adverse selection and moral hazard, which are relevant in the context of credit provision. Adverse selection occurs when a financial services provider cannot distinguish if the prospective customer is a high or low risk customer. Moral hazard occurs when a financial service provider cannot monitor the behaviour of the prospective customer after the credit is granted. These problems related to information asymmetries make financial service providers, especially banks, require strict requirements before proving credit. Consequently, many segments of the population, especially those from poorer groups or small entrepreneurs, are unable to meet administrative requirements.

For most large financial institutions dealing with many small scale customers is not very profitable. ‘Small’ customers, who come from poor socio-economic groups or small entrepreneurs, generally engage in small scale financial transactions. On the other hand, there are fixed costs for every transaction that must be paid by financial institution, regardless of the value of the transaction. The high cost per transaction often leads to financial service providers being reluctant to deal with a large number of small size loans or other small transactions, creating a disincentive to serve this segment of the market.

The design and type of service do not fit the requirements of specific groups in the population. At the micro level, an obstacle to financial inclusion occurs when the design of a certain product or service is intended for people who have a certain amount of stable minimum income. For example, in a savings product, the administrative cost of the savings for some members of poor community will be hard to bear by the client and cannot be covered by the interest they earn.

The lack of an enabling regulatory environment for the provision of innovative financial services represents another crucial barrier to be addressed. In order to provide services that can match the needs of the poor communities, innovation is often a key factor, but often the regulatory environment is not supportive enough to allow for such innovations to be tested and implemented. This has a negative consequence for the promotion of access to finance.

Demand-side barriers can include the lack of formal identification system, low levels of financial literacy, inability to track an individual’s financial history and the absence of appropriate consumer protection mechanisms. Each of the above mentioned barriers needs to be properly addressed with specific interventions that are part of a clear and comprehensive financial inclusion strategy aimed at shielding the most vulnerable from unexpected shocks, while providing them with a wider range of development opportunities.

For low income groups, dealing with financial institutions is generally seen as a difficult process. The most obvious example is in applying for credit. It has become a standard practice that in applying for a loan, applicants must be able to convince that he/she will be able to repay the loan on time. This is usually required in the credit proposal with a plan showing the source of repayment and use of loan funds. The problem is that a large number of people, especially those engaged in micro businesses, are not able to produce such a financial report. This often complicates the bank’s investigation of the credit worthiness of the prospective borrower.

Banks are often geared to more prosperous clients, discouraging lower socio-economic groups from applying for banking services. For example, many financial institutions create an image of a modern and progressive organisation, indirectly, signalling to the poor that these are not meant for them. Poor communities are generally more comfortable if served by a bank in an ordinary service office with a traditional appearance. In addition, people also tend to be more comfortable if served by a bank officer who they know or at least see as coming from the same environment.

There is a significant need for quick, reliable, save and low cost solutions for transmitting funds. For example, there are approximately 6 million Indonesian Migrant Workers abroad and an even greater

number of internal migrants who all earn money that they remit home. New banking services in the form of electronic transaction facilities, such as bill payment, and transfer facilities through ATMs, internet and mobile banking (mobile money) provide part of the solution. Indonesia has a high level of mobile phone usage. According to a recent IFC report, titled “Mobile banking in Indonesia”, at the end of 2008 there were an estimated 96 to 114 million mobile phone subscribers. Approximately one fifth of the population who has savings accounts mainly use them to send or receive money. Furthermore, about 22 per cent of the population has shown an interest in using mobile phones to conduct banking transactions. The same survey found that 29 per cent of the population who own mobile phones, but do not have bank accounts, are interested in banking via mobile phones.⁶

For some consumers, their socio-cultural background may make it difficult to ask for financial services. Some community member's may find it difficult to ask for financial services because of their faith or other socio-cultural characteristics. For example, some Muslims believe that the interest rate used in conventional banks amounts to usury and is against their faith. For this group, Sharia-based financial services are an appropriate solution.

⁶ Annex 2 presents the most recent status of the various payment systems and their operations.

CHAPTER 3

THE NATIONAL STRATEGY FOR FINANCIAL INCLUSION

INTRODUCTION

In line with the vision and mission set out in Chapter 1, financial inclusion is a national development strategy that aims to contribute to poverty reduction. It is a cross sector and cross institution effort. By making it a national strategy, the government hopes that existing resources can be used to maximum outcomes and ensure that it makes a significant contribution to the overall government strategy of poverty reduction.

In line with the vision and objectives identified in Chapter 1, the goal of the national strategy for financial inclusion is to increase public access to financial services among all layers of the population. Such a people-centred strategy requires targeting community groups that have been hampered in their access to financial services. Therefore, in the implementation, this strategy gives special attention to groups that have so far had only limited access to financial services or have special needs such as domestic and international migrant workers and people living in remote areas.

The strategy targets the poor and near-poor who have limited access to financial services and identifies a number of ways to address their needs. The strategy, as described in this chapter, consists first of a description of the characteristics of the target groups. It then identifies a number of strategies to address their needs. These strategies are based on the vision and objectives set out in Chapter 1. Finally, this chapter contains a number of issues that are important to consider in the implementation of the strategy. The strategies identified in this chapter are more fully described in the following chapter

THE TARGET GROUPS

The Financial Inclusion Strategy gives prominence to the concept of providing financial services based on the different needs of specific categories of the population. While the financial inclusion strategy covers all segments of the population, it explicitly targets those groups with the greatest need or unmet demand for financial services. Therefore, it is particularly important to understand the different segments of the population, making sure that all key segments are taken into consideration.

The strategy distinguishes three segments of population (low-income poor, working poor and near-poor) and three cross-cutting categories (migrant workers, women and people living in remote areas). These categories are consistent with those used by BPS. Table 3.1 below describes the different features distinguishing low-income poor, working poor and near-poor, based on their financial capacity and in relation to each of the main financial services considered in the strategy.

Table 3.1 Characteristics of Targeted Groups

Financial capacity /Target	Low-income poor	Working poor	Near-poor
Ability to Save	No ability to save at all or just very small amounts but with no access to any saving services	Have ability to save part of the income generated through their activities. Saving mostly informally	Some ability to save with access to formal banks
Access to credit	Not able to repay	Access to informal credit. Able to repay with non-traditional collateral	Some access to both formal and informal sources. Able to repay with collateral
Need for insurance	Highly exposed to personal and community-level shocks	Have some buffers but still might be heavily affected by shocks	Have wider range of instruments to cope with risk
Money transfer needs	Receiving remittances from MW family members	Need for remittances as well as possibility of transfer money through mobile devices	May need to operate bank transfers, bill payments etc.
Financial literacy	None	Moderate	Moderate
Financial identity	None	Limited	Limited

Low Income Poor: This category includes all those with very limited or no access to any type of financial service. This category refers to the extremely poor who receive social assistance, as well as, those segments of the poor who are part of community empowerment programs. In terms of financial capacities, low-income poor belonging to this category, usually have little or no capacity to save and have no access to any saving services. They are normally not in a position to repay loans and their exposure to both personal and community-level economic shock is extremely high. Their money transfer needs are mainly limited to receiving remittances from family members working abroad or in other provinces. Finally, they often lack basic financial literacy and rarely have any form of financial identity.

The Working Poor: This category includes the self-employed poor, which consists of small and marginal farmers, fishermen, artisans and craftsmen, petty traders and micro-entrepreneurs in the urban and rural informal sector. The lack of resources restricts their ability to expand production or undertake improvements in productivity and or income. More specifically, in terms of financial capacity, the poor belonging to this category have the ability to save part of their income that they generate, but do so mostly through informal means. Most in this group have access to informal sources of credit and they are able to meet their repayment obligations under certain conditions (e.g. no collateral required). Their ability to manage economic shocks may be limited and can push them back to the low-income poor category. If they have accumulated savings, this may act as a buffer against economic shock. In terms of money transfer needs, they not only benefit from more efficient access to remitted funds, but also would need to transfer money from person to person in a safe and convenient way. This group usually has a moderate level of financial literacy but often lack any sort of financial identity number.

Near Poor: This is a residual category, including all those who do not meet the definitions of low-income or working poor.⁷ The near-poor category consists of those people who have the ability to accumulate substantial savings and have access to formal banks. In terms of credit, they have access to both formal and informal sources and are generally able to meet their repayment obligations. Although exposed to risks, they have a wider range of instruments to cope with it. Their money transfer needs are mostly related to the need of operating bank transfers and the possibility of paying bills online through mobile banking. They have a good level of financial literacy and possess financial identity linked to their bank accounts.

Domestic and International Migrant Workers: Indonesia is the third largest recipient of remittance inflows in the Asia-Pacific region. About 80 per cent of Indonesian Migrant Workers are women and more than 85 per cent of female Migrant Workers are found in the informal sector. Migrant Workers are usually underserved and have limited access to financial services. They specifically need the means to transmit funds in a save, quick and low cost manner from their work place to their home, which are often located in remote under-served areas. These Migrant Workers originate from dominantly poor agricultural households, notably from rural and low-income regions and they have limited access to formal financial services or products in each stage of migration (i.e. pre-, during and post migration).

Women: In many developing economies significant differences can exist between men and women in their access, needs and preferences for financial services. It is important in developing access to finance that these differences are taken into account. In Indonesia, men and women are equally likely to have savings accounts but males are more likely to be motivated to have a bank account in order to obtain a formal loan, while women are more likely to be motivated to have a bank account in order to save for future needs. In relation to insurance, women more often purchase education insurance, whereas men prefer life insurance, and to a lesser degree, asset insurance. A significant initiative to bring poor women into the financial sector is already occurring through the PKH payments for women heads of households being made into savings accounts.

⁷ This category, while primarily focused on the near-poor, also includes the non-poor. That is, the strategy encompasses all those excluded from financial services, including the non-poor, who, while unlikely to lack access, are nevertheless captured by this strategy.

People living in remote areas: The challenge is to provide greater access to people living in rural areas, as well as, people located in areas lagging in development (which may be rural or urban). Approximately 52 per cent of Indonesian population lives in rural areas and around 60 per cent of Indonesia's population in rural areas have no access to formal sector financial services. Of the 13 per cent of the population living below the poverty line, 64 per cent live in rural areas. These numbers, coupled with the scattered geographical composition of the Indonesian archipelago, suggest that it is important for a national strategy on financial inclusion to keep a special focus on the category of people living in remote areas. The State Ministry for Rural Development (Kementerian Negara Pembangunan Daerah Tertinggal) provides a special focus on lagging regions. The significant gap in access to financial services for this category can, in part, be addressed through the use of information and communication technologies (e.g. mobile money to facilitate transfers and payments across islands, as well as, between the rural and the urban areas).

THE STRATEGY: FINANCIAL SERVICES FOR TARGETED GROUPS

The national strategy can be summarized as shown in Figure 3.1 below. It maps the key financial services and products (in the first column on the left) against the key target groups (first row on top). The Figure provides a convenient overview to identify the type of initiatives targeted at each category of the population. The initiatives are discussed in detail in the following paragraphs outlining the strategy. The strategy itself will be supported by a roadmap to be developed by the first quarter of 2012.

Figure 3.1 Key Financial Products Mapped against Targeted Groups

	Low-income Poor	Working Poor/MSME	Special Needs		Near-poor
			MWs	Remote Areas	
Savings	No frills account (TabunganKu)		TKI savings (limited)		
	G2P				
Credit		Basic Bank Accounts			
		Cluster program	KURTKI		
		PNPM			
		KUR			
		Linkage program			
		Credit rating and promotion of credit bureaus			
		Establishing local credit guarantee companies (PPKD)			
		Value Chain Financing			
		Business Development Support			
Savings + Credit	Replication of innovative schemes based on CSR (e.g. SOE PKBL)				
	Agent banking				
	Revisiting KYC requirements for small value customers				
Insurance	Jamkesmas		TKI insurance		
	Microinsurance				
Savings + Credit + Insurance					
Transfer facilities	Bundle insurance program (Credit/savings + insurance)				
	Promoting expansion of ICT based distribution methods & possible implementation				
Financial Education	Mobile money		Mobile banking		
	Ayo ke Bank & 3P				
	Financial education by local government		Financial education training for MWs & families		
Financial Identity	Financial Identity number				
Regulation	Enabling regulatory environment				
	On going				
	Will be implemented				

Savings Related Initiatives

Saving is the single most important financial product, acting as a ‘gateway’ for consumers to access other financial products. It therefore forms a key component of the strategy. Savings-related initiatives in the financial inclusion strategy aim to increase the access to saving, particularly among the poor or low-income groups. The agenda includes:

- Promoting Government-to-Person (G2P) transfers through saving accounts.** A first concrete initiative relates to conditional cash transfer (PKH) payments. Up to now, PKH beneficiaries received their assistance in cash distributed through post offices. This year PKH will expand its coverage to an additional 300,000 households. These new households will receive their benefit through ‘Giro Pos’ accounts, instead of cash. The early expansion will also serve as a pilot project for future cashless social assistance delivery. In the future, PKH plans to distribute benefits through saving accounts in banks (BRI is the proposed partner). At the same time, this initiative

enables the Government to use its social assistance program as an instrument to increase savings among the poor. The initiative should include a financial education component.

- ii. **Provide flexible, cheap and convenient savings product for the poor and low-income customers (Basic Bank Accounts).** This initiative includes strengthening the current BI program “TabunganKu”, a no-frill, no-cost savings product, as well as, mandating private commercial banks to have similar products. TabunganKu is an individual saving account program with less requirements and administrative costs. The program aims to promote saving behaviour among low-income customers, to enable them to have a record of saving history and creditworthiness, and provide them access to financial payment mechanisms. However, it is crucial for such initiative to succeed that the promotion of basic bank accounts is done within a broader framework of financial education initiatives aimed at fostering the understanding and the demand for such a fundamental financial service, especially among the lowest-income segments of the population.
- iii. **Strengthen cross-institutional cooperation to offer non-traditional means of savings.** For example, the role of post office and retail networks as agent banking could be strengthened. Post office and retail networks have been providing financial transaction services (cash out, remittance etc.) in limited scope.⁸ Post office branches have served as physical location for bank branches (in this case, BTN). The financial inclusion strategy, aims to increase the role of these networks. For example, retail traders in traditional markets can also be agents that provide cash-out facilities; customers are enabled to open bank accounts in retail shops that serve as bank agents so they don't have to physically go to bank branches.
- iv. **Revisit regulations related to opening bank accounts for small value customers.** The first step is to revisit for small value customers the Know-Your-Customer (KYC) regulations. If the KYC requirements can be revisited, banks may be able to use retail networks as ‘outsourced agents’ in attracting new customers. Small value customers (with low-income, low-value, low-risk transactions) can then go to retail outlets instead of bank branches to open bank accounts. At the same time attention needs to be paid to the prudent and safety aspects.

Initiatives in Support of MSMEs

MSMEs represent a core target group for fostering local economic development and contributing to poverty reduction and should continue to be supported through market friendly interventions. MSMEs have often been associated with the category of “working poor”, where the microenterprises usually exist of one individual. Nevertheless, the aim here is to highlight specific initiatives that can directly contribute to MSMEs development. While several existing programs and activities already provide important opportunities for developing and supporting MSMEs, the following is a list of proposed new activities and strengthening of existing programs. It includes:

⁸ The strategy recognizes that Post offices are allowed to open bank saving account for bank BTN (e-batarapos) and bank muamalat.

- i. **PNPM-RLFs should consider how to become more sustainable.** PNPM has a community-level Revolving Loan Funds (RLFs) component. The main challenge of PNPM is its future after 2014. In the remaining time the program needs to plan the future sustainability of the RLFs, in terms of governance, operational and financial performance and legal status.
- ii. **Improve targeting of Credit for the People (KUR) program.** KUR needs to be able to reach the unbanked enterprises. A study by World Bank (2010) indicated that KUR has provided significant benefits to recipients. However, an internal study by TNP2K (2010) also shows that around 40 per cent of the beneficiaries were informed about KUR from banks, possibly indicating that many KUR beneficiaries are existing bank clients.
- iii. **Provide credit rating services for MSMEs.** Credit rating, especially for MSMEs, enables bank to select potential clients for loans. It would allow banks to assess MSMEs individually rather than pool all MSMEs into the same risk group. The priority in the short-run is to provide basic information (credit report, credit scores). In the longer-term, the service should expand to include business prospect, fraud analysis and consumer profiling.
- iv. **Further expand local credit guarantee corporations (PPKD).** The role of PPKD is to guarantee credits for MSMEs. PPKD is expected to complement and synergize with the existing financing institutions of Perum Jamkrindo and PT Askrindo. Two provinces, East Java and Bali, have successfully established PPKDs. Other Provinces may need to be allowed to establish joint PPKD, so as to attain economies of scale and to enable them to co-share the initial capital.
- v. **Encourage value chain financing linkages, involving: Bank/finance Company, Large scale enterprises, and Small/Micro enterprises.** The initiative should come from large enterprises (buyers) who wish to secure supplies from small/micro suppliers (producers). Banks may also wish to participate in order to extend their service outreach. Under this type of arrangement MSMEs produce under the supervision and technical assistance of the larger enterprise, which plays a lead role in the value chain coordination. The financial institution provides the necessary financial services (i.e. 30 per cent of the total working capital) to the targeted small/micro producers identified by the large enterprise (the buyer). The financial institution do the financing based on an agreement with the buyer, under which the latter provides some guarantee on the loan risk and will collect the loan repayment (deducted from the sale). This model appears to work in Indonesia's tobacco, broiler, chicken-eggs and condensed milk sectors.

Credit-Related Initiatives for Individuals

Encourage the development of saving and credit bundling initiatives, targeted to the poor and funded by PKBL-BUMN (the CSR-like program for SOEs). This initiative is based on a model previously managed by an NGO. Currently, all SOEs are required to allocate 5 per cent of their profit for social activities. Part of the funds could be allocated to further pilot such initiatives.

The strategy also supports the ongoing implementation of the KUR TKI program (a variation of KUR), that provides access to credit for migrant workers.

Insurance Related initiatives

In the short to medium-term, insurance-related initiatives should focus on promoting insurance products for the poor, such as micro insurance. Government programs aimed at increasing access to insurance is still limited to Jamkesmas (health insurance for the poor) and insurance for migrant workers. The social security law (2004) mandates the government to provide universal coverage of health insurance. However, this has yet to be fully implemented. The immediate need is to focus on promoting insurance products for the poor. The role of the private sector is likely to play a key role. The government's role is to promote innovations through incentives and supporting the regulatory framework. Financial institutions (banks and non-banks) should also promote insurance products through bundling with savings and credit products.

Remittances & Mobile Money

Greater use should be made of Information and Communication Technology (ICT) as an instrument to enable financial inclusion. ICT enables greater access to financial services, particularly related to transfer payments. With ICT, consumers can access transfer payment services regardless of the physical location of bank branches or ATMs. Migrant workers and their family will benefit from ICT, as well as, consumers in remote areas and MSMEs. The private sector will need to play a key role. The financial inclusion strategy supports ICT through:

- i. **Promoting studies and pilot projects on mobile money.** Specific issues include the likely impact of mobile money, the risk to consumers and the banking sector; possible modification required to the current regulations, as well as, finding the correct incentives for the private sector.
- ii. **Carrying out a pilot study on expanding financial transactions through Information and Communication Technology (ICT).** The rate of cellular phone usage in Indonesia is a positive starting condition for utilizing an ICT payment system. MSMEs and the families' of migrant workers, as well as, people living in remote areas are potential consumers of such services.

Financial Education

Financial education aims to increase knowledge and awareness of consumers on financial products and services. Consumers' awareness will increase their interest and confidence in accessing financial products. The scope of financial education covers:

- i. Knowledge and awareness on financial products and services.
- ii. Knowledge and awareness on risks associated with financial products.
- iii. Adequate consumer protection.

iv. Skills in financial management.

The strategy supports strengthening existing financial education programs. For several years Bank Indonesia has implemented the “Ayo ke Bank” and 3P financial education programs. The financial inclusion strategy supports these initiatives and recommends innovations such as “national day of saving” campaign is considered as well. BI will also work together with MoNE to include financial education in the school’s curriculum, with specific materials adjusted for different educational levels.

Local government are encouraged to play a greater and more significant role in financial education. Given the central government’s ability to reach wide geographical area is limited and consumers characteristics vary across regions, local governments are encouraged to focus on educating consumers and MSMEs. The service should include not only an understanding about available financial service products, but also includes financial planning and financial management.

Financial education for migrant worker’s families should continue to be offered. This initiative aims to make financial education one of the compulsory materials for future migrant workers. The materials include entrepreneurship and financial management for the workers, as well as, their families. Bank Indonesia has started a pilot in cooperation with the Indonesian Embassy in Tokyo (Kensushei program). The pilot could be used to improve and expand this initiative.

Financial Identification Number

The Financial Inclusion Strategy supports the pilot project aimed at people using a Financial Identification Number (FIN). The objective of the FIN pilot is to reduce asymmetric information related to consumer’s background. The FIN initiative will be in line with the proposed Single Identification Number (SIN). A pilot FIN program is planned to start very soon and will be implemented in several regions. The main challenge will be to find the correct incentives so that MSMEs will voluntarily register.

Regulation and Consumer Protection

The Financial Inclusion Strategy supports consumer protection rights in relation to micro-finance institutions. Such regulations can be an effective and efficient means for people to hold institutions accountable. More general, the strategy supports an enabling regulatory environment for strengthening MFIs, at regional level. Until now, many microfinance institutions, in particular those that provide micro-loans for social objectives cannot be legally held responsible for the quality and sustainability of the services they provide their clients. Existing Voluntary Codes should be reviewed and assessed as to whether they are adequate or relevant. The provision of professional financial services in a manner that responds to the needs of clients and according to rules applicable to all, protecting consumers (especially the poor), are an important tool for achieving social justice.

IMPLEMENTING THE STRATEGY

In going forward, the implementing of the strategy requires several institutions to work closely together. It also requires that some functions are put in places that will assist in the implementation. The following is a brief discussion of the institutional and functional arrangements needed to implement the strategy.

The banking sector will remain the backbone of financial inclusion. Banks will continue to play a major role in the provision of financial services. In this context it's important to see how the branch networks can be strengthened and expanded to reach a greater proportion of the population.

The synergy between banks, Micro Finance Institutions (MFIs), NBFIs and non-financial institutions (such as communities or associations) should be strengthened.⁹ Non-bank financial institutions and non-financial institutions can be directed to be 'windows' for the banking sector to reach smaller and more remotely located consumers who are not yet included in the financial sector. For the MFIs, the first important step for making them a 'window' of a commercial bank is to provide a legal basis for their operations. The existence of a legal basis for MFIs would provide the authority for them to explicitly carry out various financial services and activities, while at the same time guaranteeing adequate protection of clients. Ideally, the legal basis for MFIs is the existence of a Law concerning Micro Finance Institutions. The existence of a Joint Decree (SKB) between the Minister of Home Affairs, Minister of Finance, State Minister for Cooperatives and SMEs and the Governor of Bank Indonesia is the beginning of such a legal framework.

Communication and information technology should be supported to further expand the coverage of financial services. Through technology, consumers can carry out 'banking' without ever stepping into a bank. This convenience can be a great incentive for consumers to have a bank account. In addition, businesses can also make payment transactions quickly and easily. In Indonesia, the fact that the majority of the population are familiar with cellular phone technology provides the base to expand the scope of financial services through communication technology. This development can be combined with other innovations such as electronic money and using post offices and retail networks as banking agents.

Supervisory Arrangements for MFIs

In the absence of a microfinance law, the joint decree by the three Ministers and Bank Indonesia's Governor provides an alternative legal basis for regulating microfinance institutions. While providing a legal basis for MFIs is an important first step, further development are required and include the establishment of new institutions delivering the following key functions:

- i. Supervisory and development of MFIs;

⁹ Such synergy depends on 1. Sharing of vision, 2. Agreeing on primacy of bank regulation principles, 3. Agreeing on market-oriented development that includes fair competition.

- ii. Consumer protection (including risk management and deposit insurance).

Ideally, we should have at least two institutions that cover all MFIs. Each institution would provide one of the specific functions above. While this is the long term goal, in the short to medium term, the following institutional arrangement should be considered:

- i. **A supervisory and development institution for cooperatives should be established.** The financial services operations of cooperatives should be supervised by a single institution focusing on such functions and separated from the bureaucracy and daily function of the Ministry. Ideally, it should be an independent institution that does not place an additional burden on the bureaucratic structure, or be constrained, by the Ministry of Cooperatives.
- ii. **In the short to medium term the focus should be on establishing, consumer protection, risk management and deposit insurance unit for financial cooperatives.** Financing the deposit insurance scheme will be the main challenge. The existing institution for banks, Lembaga Penjamin Simpanan (LPS), is financed through the premium paid by member banks. A similar institution for cooperatives should work under the same premium-based scheme. However, it will depend on the financial capacity of the members, and what the incentives are for the cooperatives to join the scheme. Deposit insurance will be effective if a significant number of cooperatives join the scheme. Failing to include a sufficient number of cooperatives in the scheme will make it less effective.

Alternative Scheme for Self-Regulating Institutions

The government should consider promoting the development of APEX that are self-regulating institutions, which are formed by a group of cooperatives or other MFIs.¹⁰ Establishing new institutions, even though only designed to serve financial cooperatives, may require several steps, bureaucratic procedures and introduction (or elimination) of specific regulations. An APEX¹¹ can serve as a supervisory body, as well as, a deposit insurance provider for its members. Many APEX go beyond these two basic functions. Other functions can include; acting as a wholesale institution to receive and channel donor funds, managing liquidity mismatch, rating system and ICT development. APEX Members can use their APEX to synergize their potential and increase their capacity to provide financial services.

The establishment of an APEX should be a voluntary decision by its members. But the role of the government in the financial inclusion strategy should be to commission studies and make an assessment of several models of APEX, which may become a guideline or a set of best practices principles. Without the presence of a deposit insurance institution, ideally an APEX for cooperatives should be linked to the

¹⁰ Bank Indonesia has assigned some regional banks (BPD) and commercial banks to be APEX for BPR in some provinces.

¹¹ An APEX can only work on the basis of strict performance standards and transparency with regular external audit. At the moment coops don't operate that way. World-wide there exists little good experience with self-regulation. Good cases are some Coop Banks and Municipal Banks in Europe that benefit from some extent of "delegated supervision" responsibilities in a long-term flexible regulatory relationship with central bank.

banking sector by becoming a customer of a bank so deposits can be (indirectly) insured by the LPS. Alternatively, banks can also be the APEX for some cooperatives.

KEY PERFORMANCE INDICATORS (KPIs)

It is important to identify and single out those key variables to measure that will become the key performance indicators against which measuring the effectiveness of the strategy itself. Such an evidence-based approach to policymaking, guided by a thoughtful and focused data collection strategy, is in line with the approach proposed by AFI¹², and critical to ensure efficient use of resources towards delivering results with impact.

Given the multi-faceted concept of financial inclusion, AFI proposes four commonly used lenses through which financial inclusion:

- i. **Availability (or Access):** This component refers to the ability to use formal financial services in terms of physical proximity and affordability (i.e. minimal barriers to opening an account).
- ii. **Usage:** This component measures the actual usage of financial services/products (e.g. in terms of regularity, frequency or length of time used).
- iii. **Quality:** This component focuses on measuring whether the product attributes match the needs of customers.
- iv. **Welfare:** This component looks at the effects on the livelihoods of the customers (e.g. in terms of welfare/consumption).

Table 3.2 below proposes a set of indicators for the key financial services. In developing a roadmap of activities these should be taken into consideration. The services are grouped according to supply, demand and financial identity while the corresponding indicators are divided according to the four lenses of financial inclusion.

It is clear that, at the current stage, many of the indicators listed in the table (and particularly those referring to “quality” and “welfare”) are extremely difficult to be measured. They would require the collection of data that are not currently available. At the same time, this strategy is forward looking; therefore, the proposed set of KPIs includes some immediately implementable measures, as well as, more sophisticated measurements. In doing so, it provides an overview of how to measure financial inclusion initiatives in line with international best practices.

The central statistical office (BPS) will play a crucial role in proposing, implementing and coordinating such improvements to current data collection. In terms of envisaged activities, once the main financial inclusion initiatives to be implemented have been identified and approved, then each leading institutions will have to decide the set of key performance indicators that they intend to use. A

¹² “Financial inclusion measurement for regulators: Survey design and implementation”, AFI Policy Paper, No. 2, Feb. 2010

dedicated working group or task force coordinated by BPS could be set up in order to evaluate costs and implementation of the additional data required to measure the above mentioned performances.

Figure 3.2 A Set of Indicators for Key Financial Services

KPI	Availability (average effective transaction costs, %)	Usage	Quality	Welfare
Supply: Services (Savings, Credit, Transfers, Insurance) Service Provider Association Led	<ul style="list-style-type: none"> - Branches/ATMs/Agents per area or population - hours open per week - time, documents and cost to open accounts 	<ul style="list-style-type: none"> - Number of active accounts per capita - Size of active accounts relative to GDP - (For Loan size categories IDR <5 mn and < 50mn) 	<ul style="list-style-type: none"> - Rate of Usage = Usage/Availability - Consumer Protection - Number of competing products 	<p>Improve ment in “poor” categoriz ation</p> <p>Increased consumpt ion</p>
Demand: Basic Financial Literacy Education	<ul style="list-style-type: none"> - % Population with access to Financial Education 	<ul style="list-style-type: none"> - Number of people who go through basic Financial Education 	<ul style="list-style-type: none"> - Financial Literacy Exam score improvements 	Usage of Services
Identity	<ul style="list-style-type: none"> - Effective % people able to get Identities - time, documents and cost to client 	<ul style="list-style-type: none"> - % people with Identities 	<ul style="list-style-type: none"> - Rate of Usage 	Usage of Services

LEADERSHIP AND COORDINATION

Building an inclusive financial system based on the criteria described above requires an effort from all the relevant stakeholders, but in particular from policymakers and regulators. While promoting financial inclusion historically tended to fall outside the traditional functions of central banks and or other financial system regulators, this is now of central importance. The key role of financial inclusion for poverty alleviation, economic growth and financial stability requires clear leadership and ownership of the issue by policymakers. The policy environment represents a critical factor in determining the scope and speed at which the financial access gap in a country and across its diverse regions will be closed. It is therefore crucial that the Government assigns to specific institutions the explicit role of leading and coordinating each relevant initiative in an effort to accomplish this national mission of extending financial inclusion. This certainly represents a more demanding role for policymakers but it is a key step in guaranteeing the success of the whole process. There exists now a unique opportunity to

engage in this process, provided that a clear institutional approach is supported and properly coordinated at all level of governments (i.e. national and local).

THE WAY FORWARD: A ROAD MAP

By assigning to specific institutions the explicit role of leading and coordinating each relevant initiative a road map can be developed. The road map should list the ongoing, the quick wins, the medium and the long-term plans related to financial inclusion implementation. For each initiative there should be clear commitments to milestones by the relevant government institution. The roadmap is expected to be completed by first quarter of 2012.

ANNEXES

ANNEX 1

RECENT STATUS OF VARIOUS PAYMENT SYSTEMS AND THEIR OPERATION IN INDONESIA

System	Transactions Processed	Operator	Members
Bank Indonesia Real Time Gross Settlement (BI-RTGS) System	<ul style="list-style-type: none"> - High value interbank electronic funds transfers - Settlement: interbank money market, customer transfers, government transactions and monetary management - Funds settlement for Bank Indonesia Certificates and Government Securities traded on the BI-Scripless Securities Settlement System (BI-SSSS) 	Bank Indonesia	<ul style="list-style-type: none"> - All banks in Indonesia, including sharia divisions (143 banks) - One switching company
Bank Indonesia Clearing System	<ul style="list-style-type: none"> - Debit funds transfers by means of electronically processed cheques, <i>bilyet giro</i>, debit notes - Credit funds transfers processed electronically for small payments 	Bank Indonesia	All banks in Indonesia (143 banks including all branch offices numbering about 2100)
Central Depository and Book Entry Settlement System (C-BEST)	Funds settlement for securities transactions on the capital market	Indonesian Central Depository (PT KSEI)	All stock exchange members, funds settlement conducted through 4 settlement banks where stock exchange members maintain settlement accounts
Shared ATM Network – National Brands	Electronic funds transfers by means of ATM cards	PT Artajasa Pembayaran Elektronis (ATM Bersama)	67 banks are members of the ATM-Bersama network, interbank settlement processed through the BI-RTGS system
		LINK	4 state banks, interbank settlement processed through the BI-RTGS system
		PT Rintis Sejahtera (PRIMA)	ATM and Debit Prima network settlement processed through member accounts at BCA. Membership totals 25 banks.

		PT Daya Network Lestari (ALTO)	15 banks are members of the ALTO network, settlement processed through member accounts at one member bank.
		Cakra	3 banks are members of the Cakra network, settlement processed through member accounts at one member bank.
Intrabank ATM Networks	Electronic funds transfers using ATM cards for book entry account transfers at the same bank.	70 banks provide this facility	-
Shared ATM Network – International Brands		MasterCard International (Cirrus)	9 banks are Cirrus members, settlement processed through member accounts at one member bank.
		Visa International (Plus)	10 banks are Plus members, settlement processed through member accounts at one member bank.
		Others	-
Debit Card Networks – National Brands	Electronic transfer at Point of Sale (POS)	BCA (Debit BCA)	16 banks are members of Debit BCA
		Kartuku	2 banks are members, settlement processed through member accounts at one member bank.
Debit Card Networks – International Brands		Visa International (Visa Electron)	10 banks are members, settlement processed through member accounts at one member bank.
		MasterCard International (Maestro)	9 banks are members, settlement processed through member accounts at one member bank.
Credit Card Networks	Electronic payment by credit card	Visa International	15 banks are members, settlement processed through member accounts at one member bank.
		MasterCard International	13 banks and 1 NBFI are members, settlement processed through member accounts at one member bank.
		JCB	2 banks are members, settlement processed through member accounts at one member bank.

		Diners Club	1 member (Diners)
Funds transfers/remittances – domestic networks		PT Pos Indonesia (postal money orders)	-
		Courier companies providing cash delivery services	-
		Other companies specialising in remittance services	-
		Money changers offering remittance services	-
		Shops and travel agents also offering remittance services	-
		Others (not identified)	
Funds transfers/remittances - international networks	Funds transfers/remittances with receipt in cash or beneficiary account - international payments only.	Western Union	One bank, PT Pos Indonesia and non-bank companies operating as agents for Western Union
		Money Gram	Some banks and non-bank companies, such as shops and travel agents, operating as agents for Money Gram.
		Others (not identified)	-

Source: Bank Indonesia

ANNEX 2

NON-BANK FINANCIAL INSTITUTIONS SECTOR (NBFI)

Given regulators focus on consolidation within this sector, most of Indonesia's NBFI are likely to continue to offer products that are mainly relevant for larger corporates and the better-off segments of society. The important exceptions to this rule involve service providers offering leasing products such as motorcycle financing and micro-insurance products. The Non-Bank Financial Institutions sector (NBFI) are not considered MFIs as they do not necessarily or exclusively engage in microfinance. Indonesia's non-bank financial sector is small, comprising approximately 20 per cent of the total financial system. This is a considerably lower proportion in relative terms to that found in several other large developing countries and many countries in the East Asia region.

Finance companies (sometimes referred to as 'multi-finance companies') offer a wide range of services, including leasing, consumer financing, mutual funds, factoring, credit-card financing, and securities trading. Their common characteristic is that they are non-deposit taking and they fall under the jurisdiction of Bapepam-LK, the regulatory arm of the Ministry of Finance. The regulatory objectives of Bapepam-LK in its management and supervision of finance companies is similar to that of commercial banks (i.e. to improve the role of finance companies as engines of national economic growth and support the efficiency of economic activities in Indonesia). It should also be noted that the operations of finance companies in Indonesia are usually relatively sophisticated and are less likely to be designed to serve the needs of MSMEs and low-income households (with the exception of those that provide certain leasing and insurance products).

The leasing/multi-finance industry is important for some MSMEs, particularly those involved in fields such as construction. The main distinguishing advantages for the client are simple collateral arrangements; availability of medium- to long-term financing to purchase equipment; more financing (relative to cost of the equipment) than provided by banks; flexible contracting arrangements; and tax incentives. For the multi-finance company, collateral is easier to repossess, despite being movable; capital requirements are lower; and there is less supervision than for banks. Currently, the Indonesian leasing industry is heavily dependent upon banks for its financing, and many finance companies have joint financing arrangement with banks.

In addition to traditional services for lower income segments, leasing firms have taken new initiatives in order to provide micro-insurance products. However, this is still in the early stage of development. Indonesia's insurance industry is small and highly fragmented, with a large number of relatively small operators specializing in life insurance and other insurance products. By international standards, the rate of penetration (premiums relative to GDP) and density (premiums per capita) are low, and the industry is only moderately concentrated. A rapidly growing number of operators offer Sharia-related products. The legal framework for the insurance industry is established by the Insurance Law of 1992,

which was significantly modified in 1999/2000 to introduce risk-based capital requirements. Bapepam-LK regulates and supervises the insurance sector. There are also important issues of transparency in the industry, with public disclosure requirements being particularly important in the insurance business. At present, companies are required to publish their financial information, including their risk-based capital ratios, but a complete set of all risk-based capital ratings is not available from the regulator and there are no private sector ratings of insurance companies available in Indonesia. The regulator monitors company information and validates company reports, but it does not publish risk-based capital ratios. Measures to increase the level of transparency with the publication of such information, possibly implemented in cooperation with industry associations, would be a useful step in broadening access to insurance services.

The micro-insurance industry remains at an early stage of development and it will need an enabling regulatory framework for further micro-insurance products to be developed. In 2004, GTZ engaged in a public-private partnership with German insurer Allianz to develop a range of micro-insurance products, with this program being supported by the United Nations Development Program (UNDP). The partners aimed to develop a range of demand-based private micro-insurance products on a model basis. The resulting study concluded that the legal framework for insurance needed to be strengthened. It also concluded that the capacity of insurance agents needed developing and that market education was necessary. As a result of this program, a regulation was issued to allow BPRs to sell insurance as agents of established insurers. Furthermore, credit life insurance with additional benefits covering the loan client, named 'Payung Keluarga' (Family Umbrella), was developed. However, availability and the range of micro-insurance services and products continue to be limited. Moreover, there is not yet an enabling regulatory framework to facilitate further micro-insurance development.

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