Technical Note

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Financial Sector Development

Multi Donor Facility
Trade and Investment Climate

Broadening financial inclusion: Untapped business opportunities and potential markets for the banking sector

Significance:

As the major provider of financial services in Indonesia, the banking sector plays a vital role in improving access to financial services by outreaching to some 80 million potential clients. Many international and domestic examples have proven that banks play a vital role and become institutional leaders in promoting financial inclusion. In indonesia, more than half of the population does not have access or does not use formal banking services. Significant business opportunities and markets for banks remain untapped. Just as the Government has an important role to play in broadening financial inclusion, so do the banks. Seeking innovative ways of outreaching to the unbanked population is essential for banks, and the recent evolution of information and communication technology (ICT) and the high level of penetration of mobile phones offer one possible means of addressing outreach as seen in other countries.

This technical note addresses the following questions: What is the role of the banks in building an inclusive financial system? What is the relevant banking experience in promoting financial inclusion both worldwide and domestically? What can be done to reach a more inclusive financial system?

Background

Benefits of acquiring access to banking services

Banks play a major role in providing financial services. In their simplest form, bank accounts allow people to manage money more securely and efficiently than using cash, while loans reallocate resources from savers to borrowers. The possession of a bank account provides a way to access more affordable loan products and better linkages to other financial products. Savings can act as a safety cushion during times of economic hardship, while loans provide opportunities to create productive investments that can increase future income flows. Bank loans are usually offered at lower interest rates than loans from the informal sector.

Huge market potential still exists

The banking sector controls almost 80 percent of total Indonesian financial assets. Since 2000, bank branches have increased by 70 percent, while the number of ATMs has almost tripled. Despite this increasing outreach, about half of Indonesian households do not have a bank account.[i] In 2008, over 54 million people were accessing non-bank financial services (mostly from the informal sector) while over 27 million others did not use any financial services at all.[ii] With the right approach, banks are well placed to reach these potential clients, especially those who regularly use informal financial service providers.

Commercial banks are too 'costly' for small customers

Aside from low levels of financial literacy, most small potential depositors avoid commercial banks because they perceive banking services to be out of their reach. A regular savings account with a bank usually requires a monthly administration fee and a minimum balance — both of which can be perceived to be high by lower-income populations. For small depositors, the interest earned on the deposit is often less than the total administration fee, hence the amount of savings decreases over time. Some small borrowers are also considered non-creditworthy by banks, because they lack collateral or a financial history, leaving more expensive informal loans as the only option for borrowing.

BPRs have good prospects… but are still facing difficulties

BPRs (rural banks) are relatively small and serve local areas. BPRs' banking products are often priced below commercial banks with lower administration fees and lower minimum balances. Some allow deposits in small denominations (even coins) and offer door-to-door deposit (loan repayment) collections. Despite this, BPRs feel that they still lack technology (networks) to support banking services, as well as qualified and affordable human resources. The high cost of funds also often creates difficulties for BPRs in competing with the micro divisions of commercial banks.

Promoting Access to Banking Services

Initiatives on financial inclusion by both the private sector (banking industry, bank associations, financial sector) and the authorities (central bank, government) are discusssed below, including both global experience and Indonesian examples.

Financial inclusion initiatives of Bank Indonesia

Bank Indonesia (BI) has introduced a basic bank account, TabunganKu, and has proposed financial identity regulations to promote financial inclusion. In conjunction with the Alliance for Financial Inclusion (AFI), BI is hoping to conduct a pilot project to develop financial identities for the unbanked. The project aims to create a financial identity database for the unbanked population. Unbanked individuals will be provided a financial identity number (FIN) from which they can be identified and their data accessed by authorized financial institutions. The blueprint for the program is still under review by the relevant agencies, along with a preliminary survey of the pilot project in a particular segment of the unbanked population (Arisan, Savings School Movement, Tasik Loan's Scheme, and MFI Customers). Basic bank accounts will be offered to these groups once they acquire a FIN. BI also plans to develop financial identifiers for the banked population which will include customer ID numbers (CIN) for those with bank accounts and debtor ID numbers (DIN) for borrowers. In due course, FIN, DIN,

and CIN will be integrated into a single ID number (SIN), a unique financial identity for each person recorded in the system.

A. Basic Bank Accounts

Mainly intended to attract unbanked potential customers, the basic bank account features a low or zero minimum balance and no monthly administration fees. The application procedure is simplified and few identity documents are needed. Since 2005, the Reserve Bank of India (RBI) has encouraged banks to offer such 'no-frills' accounts. Also with limited free transactions, the Mzansi account has been offered in South Africa since 2004. In 2008, two thirds of the 3.5 million active Mzansi users were first-time bank customers. From the 1970s to the 1990s, the Indonesian Government offered Tabanas savings accounts to specific target groups such as students, youth organizations and government employees to nurture saving habits. Interest rates were paid on a sliding scale with a higher rate for the lower balance to encourage small savers, calculated based on a minimum monthly balance, disbursed annually, and exempted from tax. In late February 2010, BI along with 70 commercial banks and more than 1,000 rural banks introduced TabunganKu, a basic bank savings account. Notable features such the low minimum balance, no administration fees, and low interest rates (up to 1 percent). While making saving cheaper, TabunganKu offers no incentives for making more bank transactions.

B. Savings Encouragement

Matched savings is an incentive to encourage saving habits in marginalized individuals by matching their savings to a predetermined goal or ratio, with a cap on the total amount. In the US, American Dream Demonstration applied this approach to 2,300 low-income individuals (80 percent were female) in 13 sites. Matched funds were kept in a separate account and disbursed only upon verifying receipts of small businesses or home repairs. The Taiwanese Government's Family Development Account is a 1-to-1 matched savings scheme for 36 months after the first deposit by welfare recipients, targeting women, high school students, or households with low-income single mothers with financial education class attendance requirements. Funds are accessible after three years for investment purposes, higher education, small businesses, or first home purchases. In Peru, more than 7,000 rural women living in the Puno-Cusco Corridor participated in a 1-to-1 matched savings scheme with initial deposits of up to US$34. Withdrawals could be made for productive purposes such as investments in education, health, housing or microenterprise. Matched savings are also practiced in Australia, Singapore, South Korea, the UK and Uganda.

C. Branchless Banking

The convenience of shorter trips to deposit-taking facilities can increase transactions and banking participation.

Doorstep savings collection schemes are one useful traditional example.

- The Pygmy deposit scheme,[iii] a daily deposit commitment savings scheme, was successfully implemented by the Syndicate Bank in Karnataka State, India. Field agents collected a minimum quarter of a rupee per day from the doorsteps of customers (street vendors, laborers, village traders) with a lower-than-regular interest rate to cover the high collection costs.
- Bank Dagang Bali[iv] offers daily mobile collections as part of its service. It has three types of collection team: one on foot, covering the areas nearest the branch; one traveling by motorcycle, covering more distant clients; and one traveling by car, serving the furthest clients from the branch.

Mobile banking technology allows lower-income customers to access banking services using their mobile phones. Transactions are conducted using secure SMS up to a certain monetary limit in compliance to the Anti-Money Laundering Act (AMLA). The services range from person-to-person (P2P) transfers, payment of bills, airtime purchases, and even deposits/top-ups or withdrawals in certain outlets.

- In Kenya, **M-Pesa** had 9 million customers in 2007 (40 percent of the adult population) with outlets outnumbering by nearly five times the total number of Postbank branches, post offices, bank branches, and ATMs combined in the country. The maximum cap for all transactions is US$500. Registration and deposits are free, but services are charged from US$1.3¢ to US$40¢ per specific transaction. The full value of all M-Pesa balances is stored in pooled accounts of two regulated banks and do not earn interest.
- **WIZZIT,** a division of the South African Bank of Athens, offers a transaction banking account that is accessible through mobile phones and (Maestro) debit cards. The signing-up fee is US$5.26, there is no minimum balance or monthly fees, only a pay-as-you-go pricing model with charges ranging from US$0.13 to US$0.66 per transaction. WIZZIT had an estimated 250,000 customers at the end of 2008.
- **G-CASH** in the Philippines is a mobile-wallet-type phone-banking technology provided by Globe. The P2P transfer costs from PhP 1 to PhP 40,000 per day or a total of PhP 100,000 per month. In addition to the PhP 1 cost of sending a text message, a flat fee of PhP 10 is charged for any transaction below PhP 1,000 and about 1 percent of the amount for transactions over PhP 1,000. In 2008, G-CASH had over 6,000 domestic outlets providing services to 1.9 million subscribers.

Mobile electronic data capture (EDC) technology enables bank employees to conduct teller transactions at consumers' locations (their house/business place), reducing the need for customers to visit their bank branch. It can process deposits, withdrawals, money transfers or balance inquiries. The GPRS module enables online transactions; a biometric sensor and a card chip reader set up a verification process; and a print-out provides a record of transactions. Bank Mandiri, Danamon Simpan Pinjam, Bank Sinar Harapan Bali, and BTPN have been utilizing this system to serve their microbanking segment. In April 2010, Bank Sinar Harapan Bali introduced Sir@t, *layanan transaksi sarat teknologi* (technologically equipped transaction services), an EDC service that also serves as a payment point for bills. Until May 2010, the bank operated 20 EDC devices across Bali and completed 2,097 withdrawal transactions and 1,694 deposit transactions. Due to their widespread acceptance, the bank planned to increase the number of operating EDCs to 100 by June 2010. BTPN (Bank Tabungan Pensiun Negara) has used mobile EDCs to serve its micro-banking segment since late 2008. Using mobile EDCs, off-branch transaction officers (OTO) on average can process 10 to 25 transactions daily

D. Linkage Program

Self-Help Groups (SHGs)[v] in India offer

interest-bearing loans to their members with the funds coming from regular voluntary thrift activities. Most SHGs are promoted and nurtured by institutions, such as NGOs, banks, farmers' clubs, government agencies, or self-employed individuals. The SHGs' experience in informal loans enables them to learn the essentials of financial intermediation, basic account keeping, and the skills needed to handle resources of a larger size. Encouraged by the Reserve Bank of India (RBI), banks offer non-collateralized loans to stabilized SHGs that show mature financial behavior. Banks decide on the interest rates but terms and conditions are up to SHG members. Since the SHGs have already acquired a certain degree of financial discipline (through their thrift activities and internal lending), as well as the existence of peer pressure, timely repayments and social collateral for loans are ensured. Three types of linkage model of bank-SHG exist: (1) direct linkage, without facilitation from other institutions; (2) indirect linkage, with promoting institutions as the facilitator; and (3) indirect linkage, with promoting institutions as a facilitator and a financing agency. Until March 2007, around 74 percent of the total linkage came from model 2, while model 1 had 20 percent and model 3 was 6 percent.

Swamitra is a partnership between Bank Bukopin and cooperatives to reach the feasible-but-not-bankable small and micro-business customers. As cooperatives, Swamitra partners of Bank Bukopin are able to offer their members savings and lending services with greater ease than banks. Bank Bukopin provides IT system enhancement, banking management training to officers, and working capital to its cooperative partners that enables the delivery of financial services accessible through online networks in a prudent manner. Swamitra has steadily grown over time: units expanded from 387 in 2007 to 488 in 2009, while total asset value increased from Rp 670 billion in 2007 to Rp 1,050 trillion in 2009. Credit ranging from Rp 2 million to Rp 50 million was given to 103,300 customers in 2009, totaling Rp 846 billion.

E. Nationally Coordinated Inclusion Strategy

India's financial inclusion program uses a multi-pronged strategy to promote financial inclusion. After explicitly introducing the term 'financial inclusion' for the first time in its Annual Policy Statement 2005-06, RBI applied the following policies to promote financial inclusion.

a) introducing a basic banking 'no frills' account in November 2005, with simplified KYC procedures;
b) introducing a General Credit Card (GCC) credit facility in 2005, with revolving credit entitling the holder to withdraw up to the limit sanctioned;
c) rolling out a financial inclusion drive (starting in 2008) requiring every SLBC[vi] to identify one or more districts in its home states for 100 percent financial inclusion;
d) allowing banks to use NGOs, SHGs, MFIs, or other civil society organizations as bank intermediaries able to receive deposits and provide withdrawals using innovative IT solutions in January 2006;
e) expanding the list of priority sectors in 2007 to more employment-intensive sectors such as agriculture, small enterprises, the retail trade, educational loans, microfinance, and low-cost housing, while also promoting financial literacy; and
f) launching a multilingual website in 13 Indian languages on all matters concerning banking and the common person in 2007.

South Africa's Black Economic Empowerment (BEE) Charter was released in October 2003 by the Banking Council of South Africa with the objective of increasing access to financial services for poor households and communities. While maintaining sound business practices, charter members[vii] agree that when sourcing products and services the financial sector should apply to the Charter and its scorecard. The Charter targeted that by 2008 a certain percentage of LSM 1-5 (the lower half of South Africa's measure of living standards) would have effective access to appropriate first-order and affordable financial services. The charter requires increases in access to LSM 1-5 as follows:

a) 80 percent increase in access to transaction products and services;
b) 80 percent increase in access to bank savings products and services;
c) a certain percentage increase in access to life assurance products and services;
d) 1 percent of LSM 1-5 + 250,000 from all segment increase in access to collective investments products and services; and
e) 6 percent increase in access to short-term risk insurance products. Financial institutions are also obliged to devote a minimum of 0.2 percent of post-tax annual operating profit for consumer education. Each financial institution is given a rating on an annual basis based on the results of the scorecard.

Concerns and Recommendations

Grand strategy on financial inclusion is necessary

Developing a comprehensive strategy on financial inclusion could offer a more cost-effective way of approaching the issue. Clearly articulated objectives, target populations, and inter-linkage between initiatives would improve the implementation of a strategy. Harmonizing the existing program among departments, ministries, and institutions would help to avoid duplication and achieve more effective synergies. The South African experience shows that a collaborative approach between government and the private sector with clear objectives and guidelines in a viable business manner can successfully extend the reach of financial services to the lower half of the population.

Promote financial education at an early stage

An example from India shows that introducing affordable financial products without effective financial literacy intervention for the targeted customers results in a low level of usage despite 100 percent access availability. Cases in Kenya and South Africa show that the younger generation are more open to technological solutions and this can help to drag the older generation to also participate. Regular transaction experience with a bank is also more effective than a conventional financial education approach. Limited free transactions was the banks' way to entice first-time banked customers to realize the costs and benefits of each bank transaction. In the past, Tabanas had a role in providing first-hand banking experience for students and members of youth organizations since early childhood. Apart from making a (mandatory) curriculum on financial education to school children, TabunganKu can be applied to replicate Tabanas school-segmented penetration. Once familiar with standard banking transactions, these young people can then become financial education facilitators for the banks by imparting

their knowledge to the older generation.

Savings can better reach low-income customers than credit

For unbanked customers, developing a relationship with a bank through a savings product is less intimidating than applying for credit. Basic banking services with free limited transactions and a simple KYC procedure are more effective than listing possible assets that qualify as loan collateral and more complicated KYC procedures in making a loan application. Unbanked customers should be gradually educated about accessing formal banking services to maintain their motivation while building their asset value through savings. The key issue here is the profitability of mobilizing such small deposits taking into account the costs of servicing this segment. Innovations from other markets can be helpful guides as to what can be done to lower the costs of deposit collection while providing a positive rate of return to clients. Once they understand the mechanics of banking services and own savings, affordable credit facilities can be offered upon request against depositors' savings instead of collateral. Historical deposit transactions can supplement financial history information. This approach makes for a smoother transition from being unbanked to becoming an active banked customer.

Provide incentives to promote inclusion

Active involvement by the private sector/banking industry is crucial to the sustainability of a financial inclusion program. Authorities in other countrie have used the following incentives to promote financial inclusion: tax incentives to banks that serve first-time banked customers or poor households, publicly rating banks on their performance in providing basic banking/affordable credit to low-income/ first-time banked customer, subsidies to establish a conducive environment for technologically innovative solutions, or restrictive branching laws that require banks to open rural branches before opening additional urban branches. These examples could give Indonesia guidance on some of the options available.

Improving the capacity of BPRs

BPRs could potentially serve customers living in remote locations. A 'tiering' system based on the size of BPRs holds more prospects than the current one-size-fits-all approach to regulation. While keeping prudential safeguards in view, consideration could be given to lowering minimum start-up capital requirements for small BPRs in remote locations, easing reporting requirements for small BPRs in regions with poor IT infrastructure, and easing written disclosure requirements in regions of low financial literacy and using oral briefings in the local language as a substitute, are possible options for promoting BPRs growth in these areas. Allowing partial foreign or NGO ownership in poor remote regions could also help provide necessary capital for BPRs

What the World Bank Can Offer

Collaboration on developing financial inclusion strategy

Some successful financial inclusion initiatives have already been implemented in Indonesia, but in a rather sporadic manner. A more coherent approach would benefit both the banks and low-income customers. The World Bank can assist the Government, Bank Indonesia, and the banking sector in formulating a financial inclusion strategy.

Bringing in best practice from other countries

Relevant international best practice examples can be provided and tailored to the Indonesian context if requested.

Collaboration to implement pilot programs

Public-private partnerships could pilot innovative products and services that can support financial inclusion for low-income segments. The World Bank can partner with the authorities and the commercial banking sector to help test specific products and services. The success of the pilots would drive the decision to scale up

i Improving Access to Financial Services in Indonesia (World Bank, 2010).

ii Bank Indonesia presentation in World Bank Workshop on Enhancing Access to Formal Financial Services in Indonesia assumed that in 2008 about 70% of 228,523,300 people were on productive age and potentially banked. World Bank study in 2010 found that out of all households in Indonesia about 49% used bank service, 3% used other formal financial services, 31% used informal financial service, and 17% were underserved.

iii The scheme was discontinued in the late '90s. It then re-launched in 2007 as Pigmy Plus.

iv It was liquidated in August 2004.

v Group of 15-20 people with similar social backgrounds to address common issues.

vi State Level Banking Committee: bank representatives in the state, state government, and RBI.

vii Representatives of banks, long- and short-term insurers, black professionals and black business, unit trusts, fund managers, and brokerage firms.

Further Reading:

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For further information, contact:
Yoko Doi
Financial Specialist
(ydoi@worldbank.org)

P.S. Srinivas
Lead Financial Economist
(psrinivas@worldbank.org)

Access to Finance
World Bank Office Jakarta
Indonesia Stock Exchange Building
Tower 2, 12th Floor,
Jl. Sudirman, Kav 52-53
Jakarta 12190, Indonesia

Ph. 62 21 52993000
Fax 62 21 52993111

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http://www.worldbank.org/id

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