

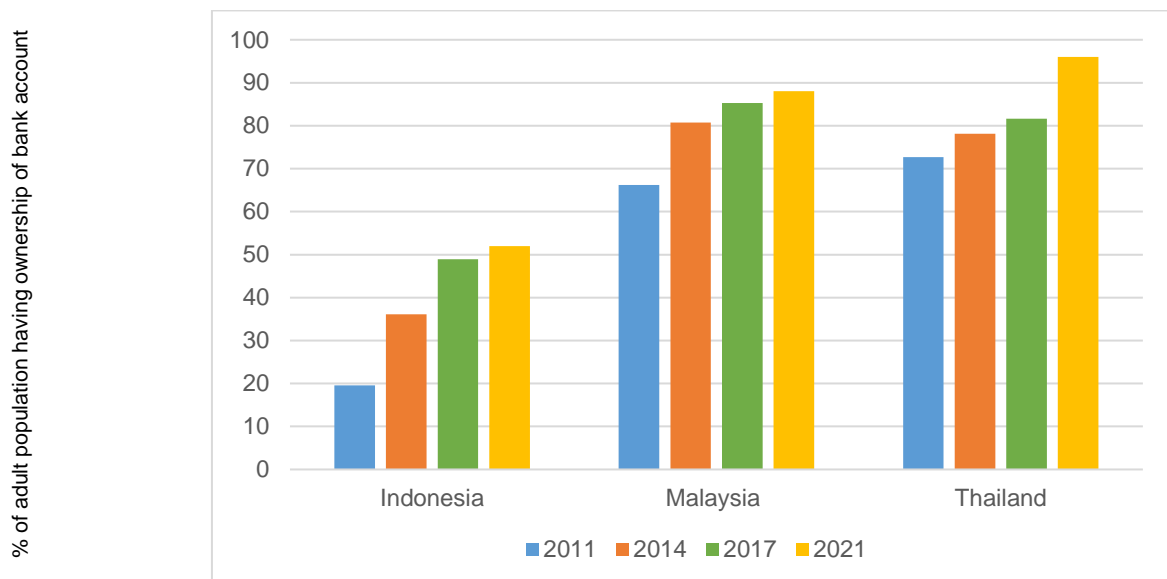
SECTOR ASSESSMENT (SUMMARY): FINANCE (INCLUSIVE FINANCE)

A. Sector Road Map

1. Sector Performance, Problems, and Opportunities

1. **Progress in financial inclusion.** According to Global Findex, financial inclusion—measured as the percentage of the adult population with ownership of a bank account—increased in Indonesia from 20% in 2011 to 36% in 2014, and then to 49% in 2017. However, financial inclusion had increased only modestly, to 52%, by 2021. Although mobile wallet penetration is reported to have grown, financial inclusion in Indonesia continues to lag that of neighbouring countries such as Thailand (96%) and Malaysia (88%) (Figure 1).¹

Figure 1: Progress of Financial Inclusion in Indonesia and Selected Southeast Asian Countries (2011–2021)



Sources: Global Findex 2012, 2015, 2018, and 2022.

2. Surveys on financial inclusion in Indonesia provide diverse narratives regarding the degree of success achieved.² The National Financial Literacy and Inclusion Survey (SNLIK) of 2019 indicates that 75% of the adult population used financial services including the national health insurance system. The Financial Inclusion Insights Survey (FII) indicates that bank account ownership by the adult population increased from 56% in 2018 to 62% in 2020. It also indicates that payments and savings continue to be the two most used banking services among the population. Progress of financial inclusion remains unequal, especially in the remote provinces of eastern Indonesia. According to FII, bank account ownership in the rural hinterlands (56%) continues to be lower compared with bank account ownership in urban areas (66%). With increased emphasis on digitalization, accessibility of banking services is becoming increasingly dependent on telecom connectivity. With the completion of the final phase of the Palapa ring project³ in 2019, the gap in mobile network connectivity between

¹ World Bank. 2012, 2015, 2018, 2022. *Global Findex Database*. Washington, DC. (accessed 1 August 2022).

² National Financial Literacy and Inclusion Survey by the Indonesia Financial Services Authority (OJK); Financial Inclusion Insights Survey by the National Secretariat for Financial Inclusion (DNKI); and Global Findex by the World Bank.

³ The project entails laying 35,000 kilometers of land and sea optic cables, with the aim to provide the country with 4G internet access.

Java and other remote islands is reported to have declined significantly. However, the much-improved infrastructure and connectivity has yet to translate into advances in economic activity in these regions.⁴

3. Intergovernmental coordination on financial inclusion. Presidential Regulation No. 82 of 2016 established the National Secretariat for Financial Inclusion (DNKI) to coordinate, implement, and monitor all financial inclusion efforts in Indonesia. The DNKI was extended by a presidential regulation issued in 2020.⁵ The DNKI is chaired by the President of Indonesia and led by the Coordinating Ministry of Economic Affairs in collaboration with 27 other implementing agencies. The DNKI is supported by a secretariat and seven working groups. However, there is a need to improve the monitoring of financial inclusion initiatives and coordination to reduce overlaps, compare lessons and results, and better use resources to promote approaches that are proven to achieve results. Better coordination and cooperation between the Indonesian Financial Services Authority (OJK), Bank Indonesia, and other key stakeholders can also help deliver impactful initiatives to enhance financial access and literacy.

4. Measuring and monitoring financial inclusion. The two official national surveys—the Financial Literacy and Inclusion Survey (SNLIK) by OJK and the Financial Inclusion Insights Survey (FII) carried out by the National Council for Financial Inclusion—consistently report different levels of financial inclusion. In the past, the SNLIK assessments typically reported higher levels of financial inclusion. However, in the absence of latest data from the recent SNLIK survey, this sector assessment largely relies on the FII survey in 2020 and 2021, the Global Findex in 2021, and data compiled from financial indicators of Bank Indonesia. Thus, there is a need for a clear metric to measure and regularly track the level of financial inclusion. Examples are the maintenance of basic savings accounts opened in banks, usage, dormancy levels, and the quality and sustainability of the other financial services rendered by financial institutions. These gaps in data measurement and monitoring conceal the real financial service needs of vulnerable segments of the population in diverse geographies. Therefore, a centralized mechanism to monitor progress in achieving financial inclusion is needed, along with a more comprehensive and independent national survey with clear metrics for measuring financial inclusion.

5. Access to finance by micro, small, and medium-sized enterprises and marginalized segments. Based on the latest available government data (2021), Indonesia had 62 million micro, small, and medium-sized enterprises (MSMEs), employing 98.0% of the workforce and accounting for nearly 57% of gross domestic product.⁶ Most MSMEs are small, family owned, and not legally registered. For this reason, MSMEs are challenged to access credit or financial services from formal financial institutions to start and grow their businesses.

6. Bank Indonesia data for 2022 indicate large growth in the total number of credit accounts in banks, which expanded from 44.8 million in 2018 to 107.19 million in 2022. A similar trend has been observed in MSME credit accounts, which expanded from 14.62 million in 2018 to 38.86 million in March 2022. Microenterprises constitute 99% of the MSME credit accounts. However, credit to MSMEs still represents only 36% of total credit accounts and about 20% of the government-mandated credit allocation. Factors driving the expansion of bank accounts could include the government's National Economic Recovery Program; and a push for accelerating MSME lending, with the government making higher budgetary

⁴ R. Eschachasthi et al. 2022. *Badan Pusa Statistik (BPS), Statistics Indonesia. A International Conference on Data Science and Official Statistics (ICDSOS) study*. Jakarta. The assessment suggests the need to improve the information and communication technology (ICT) and digital literacy skills of the rural populace and to increase the quantity of ICT facilitation centers to tap the potential of the improved infrastructure and connectivity.

⁵ Presidential Regulation No. 114 of 2020 on the National Strategy for Financial Inclusion.

⁶ Government of Indonesia, Ministry of Cooperatives and Small and Medium-Sized Enterprises. 2022. Data on MSMEs and Large Businesses. Jakarta.

allocations for the Peoples' Business credit program (KUR) and stepping up the issuance of land-right certificates to mitigate the challenges of collateral.

7. The KUR, launched in 2017, continues to be the bulwark of the government's credit expansion strategy for MSMEs. The program provides interest subsidies to participating banks that lend to MSMEs. Because of the coronavirus disease (COVID-19) pandemic, the government substantially augmented its funding for the KUR program, which increased from Rp120 trillion (2018) to Rp285 trillion (2021), and has further expanded to Rp373 trillion in 2022.⁷ In addition, the Government of Indonesia reduced interest rates to 6% per annum, with additional relaxations for small and medium-sized enterprises directly impacted by the pandemic. Government then allocated the largest portion of KUR loans to the trade sector, which accounted for 44.8% of the total. As per the OJK regulations, MSME loans are now in forbearance, and the nonperforming loan percentages for KUR loans have remained relatively flat at about 10% (footnote 2). However, it is unclear what the impact will be after the moratoria and relaxations end.

8. **Consumer protection, data privacy, and financial literacy.** In 2013, OJK established five principles of financial consumer protection, including the rights to: (i) transparency of information, (ii) fair treatment, (iii) reliability, (iv) privacy, and (v) access to redress. In 2022, a revised OJK financial consumer protection regulation (6/POJK.07/2022) clarified the form and procedures for disclosing information to consumers, mandated that providers offer "adequate education" to financial consumers, and obliged self-reporting by financial institutions regarding compliance with consumer protection regulations. Finally, the regulation affirms OJK's mandate to engage in market conduct supervision.

9. In January 2021, OJK published a web-based complaints handling and consumer services application. This is a tool for consumers to resolve complaints against financial institutions if they have failed to receive redress when directly contacting the service provider. Financial disputes brought to the new consolidated Alternative Dispute Resolution Agency in the Financial Services Sector still appear to be low. In 2021, OJK reported more than 4.7 million financial consumer complaints received pursuant to regulatory reporting requirements. Similarly, financial institutions reported receiving more than 9 million financial consumer complaints. OJK indicated that 94% of these complaints were resolved. However, without additional data on the types and sources of the complaints and how they were resolved, it is not possible to determine whether the process is efficient or whether it benefits financial consumers. There has been no change in the legal framework for data privacy; however, two financial sector self-regulatory organizations—Indonesia Fintech Association (AFTECH) and—Indonesia Joint Fintech Association (AFPI)—now have some measure of market conduct supervisory authority, at least for the fintech segment.

10. **Fintech and financial inclusion.** The fintech segment has grown dramatically and AFTECH has 352⁸ registered fintech members, including 103 in lending services and 56 as payment providers. Three fintech industry associations have been set up and recognized by OJK since 2019. Among the 102 peer to peer (P2P) lenders, 96 are classified as conventional lenders and the remaining seven are classified as Sharia P2P.⁹ The outstanding loans to the P2P fintech companies increased from Rp5 trillion in 2019 to Rp37 trillion by March 2022 (footnote 8). The number of lenders participating through the P2P lending platform increased to 0.7 million and the borrower base was about 7 million as of end-2021.¹⁰

⁷ Bank Indonesia. [Investor Relations Unit: Presentation Materials on Indonesia & Conference Calls.](#)

⁸ Fintech Indonesia. 2021. [AFTECH Annual Member Survey Report 2019/2020/2021.](#) Jakarta.

⁹ Sharia P2P refers to peer to peer lending conforming to Islamic Law (Sharia).

¹⁰ DNKI. National Financial Inclusion Survey 2021. Jakarta.

11. While some P2P lenders provide “productive” lending¹¹ to MSMEs and farmers—and these models are considered promising—many fintech lenders only provide consumption loans. Looking at cumulative lending and number of borrowers, lending by fintech companies has been largely concentrated in Java, which accounts for 83% of total accounts and 67% of the amount disbursed.¹² Thus, fintech companies are also clustering around major urban areas continues. Fintech can promote financial inclusion, but can also introduce new risks. Strong leadership is needed to develop robust regulatory regimes for the fintech sector. The COVID-19 pandemic has further demonstrated the importance of digital financial services during challenging circumstances.

12. **The potential of technology.** The National FII survey (2020) found that smartphone ownership is rising rapidly, with 56.8% of adults owning a smartphone compared with 28% in 2016, and 77.8% of Indonesia’s population owning some kind of phone by end-2020. However, significant gaps in phone ownership remain across gender, age, and income categories. Phone usage lags for those aged 51 years and above, and is highest among those aged 18–25 years. The Findex 2021 found that 73% of the adult population owned a mobile phone, but only 51% of them had access to the internet, and 37% of those surveyed have made or received digital payments. However, only 9% of the adult population use mobile money.

13. The rapid expansion of digital infrastructure—with 4G networks available in more than 74,000 villages—and the development of digital financial services (DFS) agent networks are major achievements that have enabled the expansion of basic savings accounts. However, the use of digital financial services and digitalization of regular government-to-persons (G2P) payments has yet to be fully achieved when compared with other developing economies in the region. The country would be better served by a single set of agent banking regulations supported by both Bank Indonesia and OJK, complemented by adequate supporting infrastructure to fully integrate the unbanked and underbanked into the formal financial system. In addition, removing barriers to digital identity verification (electronic know-your-customer) could help streamline the customer onboarding process and enhance the efficiency of account opening for financial institutions. Furthermore, broadening the digital payment architecture using QR codes, the national payments system infrastructure called ‘BI-FAST,’ and expansion of basic savings accounts for G2P payments, coupled with a strong existing e-commerce and ride-hailing presence, can spur a deeper digital economy if proper financial education of customers is undertaken.

2. Government’s Sector Strategy

14. The National Strategy for Financial Inclusion, 2020–2024, announced as a presidential decree in 2020, pledged to achieve financial inclusion for 90% of the population by end-2024.¹³ This focus on financial access led to novel financial inclusion initiatives, most notably by the National Team for Poverty Alleviation (TNP2K), which also devised the new system modernizing G2P payment using technology. To facilitate new G2P programs, the government launched the national identification system project (e-KTP) in 2011. Within a year of its launch, the e-KTP program had successfully registered and collected biometric data for more than 100 million Indonesians. This highlights the opportunities to expand formal financial account ownership through conditional cash transfer programs, which also support effective delivery of financial aid during crises such as the COVID-19 pandemic. However, the Findex 2021 reports that only 47% of the wages of public sector staff were paid into an account, while almost 52% were paid in cash. Similarly, government transfers into bank accounts were a

¹¹ Productive loans are those which are provided for a trade or business purpose; as opposed to consumer, personal and home mortgage loans which are not used for a business purpose.

¹² OJK. 2022. *Fintech Lending Statistics for the April 2022 Period*. Jakarta.

¹³ Government of Indonesia. 2020. *National Strategy for Financial Inclusion, 2020–2024*. Jakarta.

mere 41% and pension credits were even lower at 21%. The National FII survey also indicates that recipients of government assistance grew from 17.2% of adults in 2018 to 40.8% 2021, mainly because of the pandemic and the National Economic Recovery Program. Looking ahead, Bank Indonesia is implementing the National Payment Gateway initiative to make the national payment system more efficient, inclusive, and interoperable. Bank of Indonesia introduced standardized quick response codes that enable widespread use of low-cost electronic payments. By 2021, about 14.37 million merchants were enrolled in the quick response code system, compared with 5.78 million in 2020, representing a 156% growth rate in merchant enrolments.

15. Similarly, government efforts to expand the number of bank accounts and supportive enrolments of facilitating institutions like DFS agents, such as the OJK Laku Pandai agent banking program has been substantial. OJK oversees agent banking under its Laku Pandai program, while BI regulates e-money issuers under its Layanan Keuangan Digital (LKD) program, which also serve as DFS agents. The latest data (2021) shows that there are 14,52,383 Laku Pandai agents and 8,51,554 LKD agents offer low level banking services across the country, with the LKD agents opening 26.4 million server-based electronic money accounts. Despite these efforts, Findex 2021 indicates that 35% of utility payments continue to be in cash. Thus, there is further scope for digitizing routine payments, including wages on a priority basis and conducting digital literacy awareness campaigns. Improving financial and digital literacy could increase opportunities for financial deepening and enhance bank account ownership and utility.

3. ADB Sector Experience and Assistance Programs

16. Following more than a decade of support for deepening Indonesia's finance sector, ADB issued its first ever policy-based loan to the Government of Indonesia, in support of the government's ambitious financial inclusion agenda, under the Promoting Innovative Financial Inclusion Program, approved in December of 2020.¹⁴

17. The Promoting Innovative Financial Inclusion Program is composed of three subprograms designed to (i) improve the government's capabilities to target and track financial inclusion efforts and enhance supporting infrastructure; (ii) increase access to financial services for MSMEs and other underserved segments of the population (women, youth, and rural residents) through the use of innovative technologies; and (iii) strengthen the regulatory framework for the provision of digital financial services, data privacy, and financial consumer protection. The program has been working closely with and supporting OJK's Digital Innovation directorate, financial inclusion directorate, financial literacy directorate, and consumer protection directorate. The program also works in close collaboration with the Coordinating Ministry of Economic Affairs and DNKI. Ongoing technical assistance programs include but are not limited to the Eastern Indonesia Financial Innovation Lab, which seeks to facilitate partnerships between regional development banks and fintechs companies to serve MSMEs and youth and women-owned businesses as well as the tourism and agriculture sectors, and the implementation of the national women and youth financial inclusion strategies.

¹⁴ ADB. 2020. *Republic of Indonesia: Promoting Innovative Financial Inclusion Program, Subprogram 1*. Manila.

PROBLEM ANALYSIS DIAGRAM

