

# Market Opportunities and Regulations Microfinance in Indonesia

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(Abstract)

This paper provides a systematic assessment of market opportunities and regulations microfinance in Indonesia based on social economic, demographic conditions, potential SMEs Industry, market segmentation, market penetration and how new regulations microfinance in Indonesia. Indonesia has potential market for microfinance sector, with a range of commercial banks and over 60,000 MFIs, more than 28,07 million poor people or 11,37% from total population and more than 55,8 million microenterprises representing 98,79% of the total business industry in Indonesia. Currently, many people in Indonesia do not have adequate access to the bank financing they need to grow their businesses, particularly in rural areas and lack of training for micro businesses and poor people. To that end, Bank Indonesia issued a rule that requires banks to have at least 20% of their loan portfolio dedicated to microloans by 2018 opening up new opportunities to further grow the sector. Successful microfinance influenced by some factors such as social-economic, demographic conditions and regulations, so it is important to know about this conditions. Law Act No.1 of 2013 gives full authority to Otoritas Jasa Keuangan or OJK as a Financial Services Authority Institution to make regulations, licensing, and supervisions MFIs and expected to help the government of Indonesia to improve economic growth and reduce poverty in microfinance sector. This paper give information new regulations microfinance and concludes with presenting recommendation to improving the microfinance in Indonesia for sustainable development of the microfinance sector in Indonesia.

Keywords: Indonesia. Microfinance. Market. Opportunities. Regulations

## 1. Introduction

Microfinance be explained in terms of the 'inferiority' of limitations, namely the inferiority of the poor's that are difficult or limited access to financial services/banking. The Asian Development Bank explain definition microfinance as the provision of financial services is the broadest, such as deposits, loans, payment services, money transfers and insurance to poor and low-income households and micro businesses<sup>1</sup>. Indonesia has the population of over 253 million covering an expanse of 17,508 islands and is one of a member the G20 in Southeast Asia. Indonesia's economy has grown at for the past ten years, with key improvements in business climate and poverty reduction. Indonesia is renowned for its large-scale microfinance sector with a range of commercial banks and over 60,000 MFIs reaching more than 50 million people<sup>2</sup>.

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Indonesia has a potential market to development microfinance through micro-business enterprises with more than 55,8 million (Micro Enterprises), representing some 98,79% of all enterprises and contributing no less than 35,81% of GDP growth in 2012<sup>3</sup>. Despite this progress, the Central Bank Indonesia report in May 2014, Indonesia still finds only 10,1 million have formal accounts for microcredit. Indonesia has approximately one hundred million people who cannot or do not access financial services of any kind across a vast and diverse economy. Currently, many of these do not have adequate access to the bank financing they need to grow their businesses, particularly in rural areas. To that end, Bank Indonesia issued a rule that requires banks to have at least 20% of their loan portfolio dedicated to microloans by 2018 opening up new opportunities to further grow the sector<sup>4</sup>.

Indonesia has a relatively long microfinance history, especially commercial microfinance. The end of the 19th century precisely in 1890 Indonesia had already established the Indonesian People's Credit Banks and now were the Bank Rakyat Indonesia (BRI). Indonesia has microfinance potential market, but the strict regulations and high-interest rates have hampered efforts to the development of microfinance and forcing poor people trapped by unscrupulous money-lenders. Demographic conditions in Indonesia is challenge micro banking that still not able to reach the whole rural community in Indonesia, so the role of MFIs in Indonesia very important to reduce poverty in Indonesia.

The slow pace of reform in the regulatory and legal environment also deters growth in the microfinance sector. In 8<sup>th</sup> January 2013 the government of Indonesia finally make new law regulation on Microfinance Institutions. This rule gives full authority "Otoritas Jasa Keuangan" or OJK as a Financial Services Authority Institution to make regulations, licensing, supervisions microfinance in Indonesia. The role of OJK as a Financial Services Authority Institution very necessary for development micro banking and MFIs to give finance access for micro business sector and poor people. Expected to help the government program to economic growth and reduce poverty in Indonesia.

The indicators of success on microfinance not only reflected by the economic growth of a country but also influenced by other factors such as social-economic, demographic conditions, regulations microfinance<sup>5</sup>. So it is important to know about this conditions, this paper provides a systematic assessment of microfinance based on existing key reports on social, economic conditions, demographic conditions, potential SMEs Industry, market segmentation, market penetration and how regulations microfinance in Indonesia. This paper give information about new regulations microfinance in Indonesia and concludes with presenting recommendation to improving the microfinance for sustainable development of the microfinance sector in Indonesia.

## 2. Indonesia Potential Microfinance Market

Indonesia was one the first countries to develop commercial microfinance in Asia<sup>6</sup>. Indonesia has total of population of over 253 million and total of poor people in Indonesia reached 28.07 million or 11.37 percent (data from Central Statistics Agency Indonesia in September 2013), but MFI's penetration rate/active borrowers to the extreme poor population only 1,2% (very low). This case shows that the market share of micro-finance for the poor people in Indonesia is still quite large, so it takes a government policy through appropriate regulation to reduce poverty through microfinance by enhancing the role of MFIs. Table 1 shows comparative the history of starting microfinance industry and MFIs penetration rate (active borrowers to the extreme poor population).

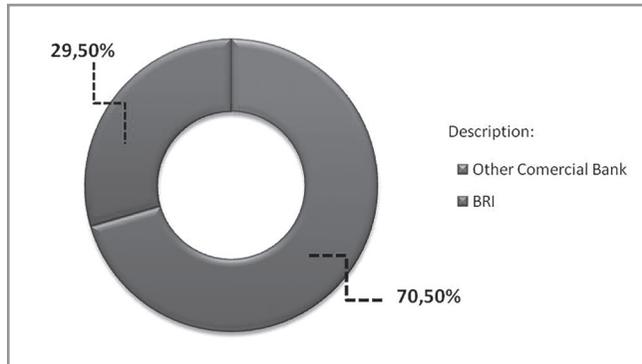
**Table 1. Comparative history microfinance industry, MFIs penetration rate (Active Borrowers to the extreme poor population) Indonesia and selected Asian countries.**

Country	History Microfinance (starting from)	MFIs' penetration rate (active borrowers to the extreme poor population)
Bangladesh	1970s	Relatively high (32.5%)
China	1990s	Very low (0.4%)
India	1960s	Low (6.7%)
Indonesia	1890s	Very low (1.2%)
Pakistan	1950s	Low (5.2%)
Philippines	1960s	Low (2.0%)

Sources: Sustainable Microfinance in Asia, Landscapes, Challenges and Strategies, Milken Institute, January 2014.

Micro banking market in Indonesia is still very potential, example one of bank that the first developed microcredit is BRI, one of the commercial bank in Indonesia that consistently to support business developments micro enterprises through BRI Unit Microfinance System. Bank BRI has total micro loans Rp 132,1 trillion with micro loans grew 23, 72% in 2013 and Micro Loan NPL at just 1.04%. Figure 1 show market share Bank BRI at the end of 2013 is 29,50% from other commercial Bank. Currently, BRI serves its customers through 9,808 operating units and e-channel network spread across Indonesia<sup>7</sup>, but the bank only concentrated in Java and Sumatra. It is a challenge for bank BRI to improve services micro banking remote rural area in Indonesia.

Figure 1. Market Share Bank BRI



Source : Annual Report Bank BRI, 2013

The challenges development BRI Unit is the global market competition and the competition micro banking industry in Indonesia, current situation many bank conventional began to open the product micro to take advantage of large market opportunities microeconomic such as Bank Danamon, and Bank Mandiri. The high micro banking interest rates in 2014 with micro effective interest rate of 22% /years is considered by the micro enterprises very weight, it is one challenges with presence of non-bank microfinance institution especially cooperative makes micro banking competition increasingly fierce but market is still big potential for micro business in Indonesia and open opportunity for Bank BRI unit and another commercial bank in Indonesia to develop product in micro-banking. Bank BRI must develop BRI Unit Micro to remote villages, especially outside Java is still considerable development opportunities, more creative to develop for micro products and more maximize assistance or training business management to micro enterprises like as Grameen Bank in Bangladesh that has been success with micro banking.

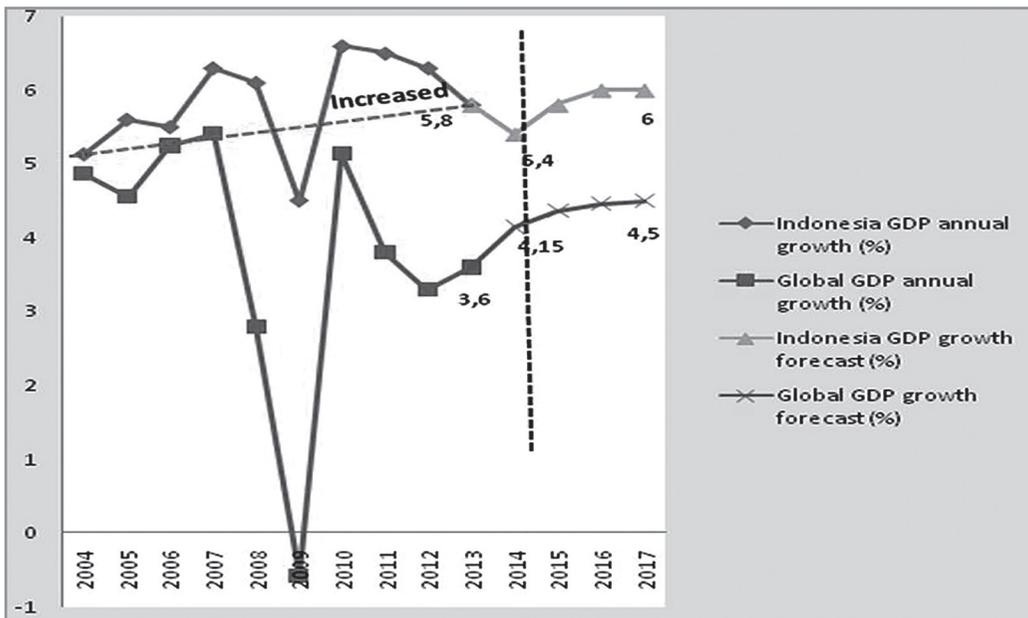
Analysis of the potential market microfinance in Indonesia can be seen from the perspective of economic growth, socio-economic conditions, the potential of SMEs Industry, microfinance market segmentation and market penetration. Will be discussed as follows:

### 2.1 Indonesia Economic Growth.

Economic growth is the most fundamental indicator of an economy's health, the rate at which national income is growing. It is measured by the annual percentage rate change in a nation's gross domestic product (GDP)<sup>8</sup>. In general, economic growth is an indicator commonly to see the progress or the ability of a country. Economic growth can be a powerful indicator to measure the success of a reduction poverty program. Now in addition to economic growth, focus on poverty alleviation has become the fundamental objectives of development in Indonesia.

Currently Indonesia wants to develop program poverty reduction through microfinance, it is associated with the role of the microfinance institution, SMEs and empowerment efforts on the micro level. For this reason, SMEs in Indonesia should focus on accelerating economic growth, which in turn can absorb labor. In this context, the role of MFIs very crucial, such as cooperatives in Indonesia should be involved in economic growth and poverty reduction. Microfinance institutions must provide training and assistance to the micro entrepreneurs and poor people, and together with government through the development of microfinance with training and social program to support government programs to poverty reduction and economic growth. Figure 2 presents the statistic ratio between Indonesia and global gross domestic product (GDP) from 2004 to 2013.

Figure 2. Indonesia and Global Economic Growth Forecast<sup>9</sup>



Source: Indonesia and global economic growth forecast by writer calculation based on:  
 a. Central Statistic Agency (BPS) Indonesia  
 b. IMF  
 c. World Bank

Indonesia's economic growth in 2013 is 5,8% and targeting economic growth of 6% in 2017. Indonesia Gross Domestic Product (GDP) per capita over the last ten years is steadily increasing, this indicates that the level of income of the people of Indonesia is increasing. However, currently people's income increase has not been followed by a pattern of good financial management. Data from central statistics, people's desire to save money due to the increase in revenue (marginal propensity to save) tends to decline during the period 2003-2012. In contrast to the same period, the public desire for consumption (the marginal propensity to consume) tend

to increase. Based on the National Survey of Financial Literacy by OJK Indonesia in 2013, the level of financial literacy amounted to 21.84%, or only about one-fifth of the population of Indonesia which has a well literate category. This condition needs the role of OJK as Financial Services Authority Institution in Indonesia to develop training program for financial literacy. Table 2 presents a statistic ratio between Indonesia and selected Asian countries on microfinance.

**Table 2. Statistic ratio between Indonesia and selected Asian countries on Microfinance<sup>10</sup>**

Country	2013 GDP growth rate (%)	Population living on below PPP \$1,25 a day (%)	MFI Active borrowers to the total population (%)	Percent of female borrowers (%)	ROA (%)	Average loan balance per borrower (\$)
Bangladesh	6.0	43.3	14.1	93.6	3.67	134
Cambodia	7.5	18.6	9.2	77.3	4.04	1.170
China	7.7	11.8	0.04	77.1	1.07	23.254
India	5.0	32.7	2.2	95.9	-10.12	163
Indonesia	5.8	11.37	0.2	86.8	4.03	289
Nepal	3.8	24.8	2.6	98.5	2.44	250
Pakistan	6.1	21.0	1.1	61.2	0.46	156
Philippines	7.2	18.4	3.4	91.5	3.19	200
Sri Lanka	7.3	4.1	2.9	77.7	1.92	355
Vietnam	5.4	16.9	10.1	61.2	-2.74	610

Source: Microfinance Information Exchange Market, International Monetary Fund, World Bank, Milken Institute, Central Statistic Agency Indonesia.

In Indonesia approximately only 0,2% of the total population in Indonesia as micro financial active borrowers on microcredit and small-scale businesses to earn a living. If compared with other countries such as Bangladesh, the country with successful microfinance programs have active borrowers to the total population of 14.1 percent and GDP growth 6.0 percent in 2013. The Grameen Bank is a bank that puts micro-credit for the poor, in Bangladesh pioneered by Muhammad Yunus. In 1976, Muhammad Yunus launched a micro-credit to poor people in Bangladesh, micro-credit is what is also the origin of the formation of the Grameen Bank in Bangladesh. The system adopted by the Grameen Bank is a belief system and kinship system and without must make the letter agreement, as do other conventional banks. Grameen Bank is not applying sanctions for its customers if it does not return the money, so the real belief system - fully awake. The system adopted by the Grameen Bank different with conventional existing banking system. This system is a bold breakthrough applied by Muhammad Yunus in overcoming poverty and famine in Bangladesh. Micro-credit method is successful in overcoming the problem of poverty in Bangladesh. This system is evidenced by the increasing economic growth in Bangladesh. This system is different from the current situation in Indonesia where many microfinance institutions and micro banks prefer to get profit though the government has planned programs of poverty alleviation through development microfinance.

## **2.2 Social Economic and Demographic Conditions in Indonesia**

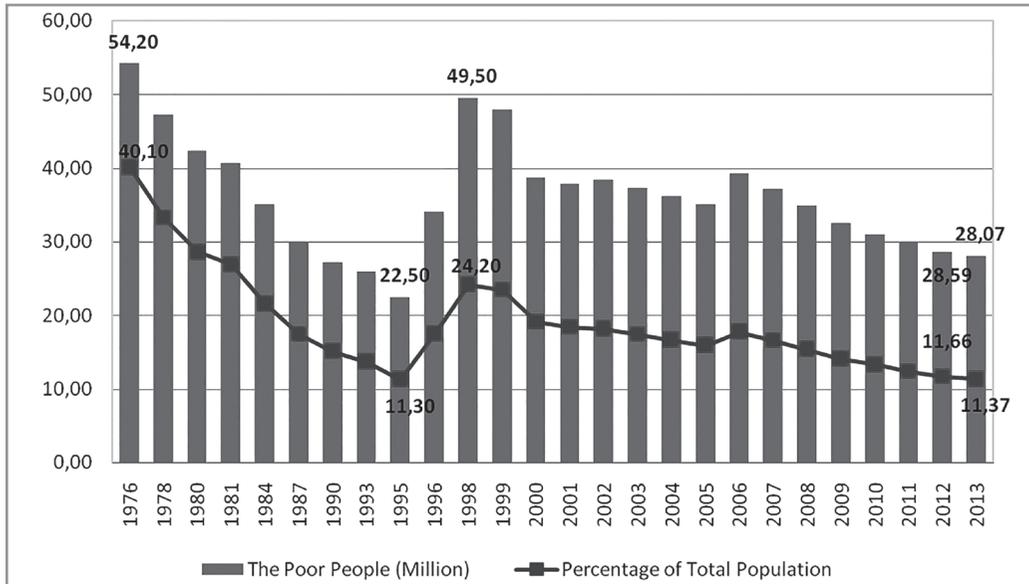
Indonesia is one of the world's biggest archipelagic country. Situated between two continents Asia and Australia/Oceania, it has a total of 17,508 islands. This strategic location has a significant influence towards its Culture, Social conditions, Politics, and Economy. Total Population in Indonesia 253,609,643 (CIA World Factbook, 2014). Based on Central Statistics Agency Total percentage of gender in Indonesia, total percentage male 50.35% or 127, 69 million people and total percentage female 49.65% or 125.9 million people. Potential market to develop a microcredit system as has been done successfully by Grameen Bank in Bangladesh, which gives credit to the poor is granted to groups of households.

Indonesia has 250 million mobile subscribers, with 143 million unique mobile subscribers enabling the poorest people to have access to reliable financial transactions. This condition is a potential market can be used to improve services to develop microfinance products in Indonesia. Muslim population in Indonesia is 88% of the total population of 253 million. Data from the central bank Indonesia shows Islamic banking assets tripled, increasing by an average of 31.5% annually in 2013. This is a potential market to develop Islamic microfinance because for some Muslim people, interest rate is "Riba/Usury" and is not allowed in the religion of Islam, so that Indonesia develop systems Microfinance Islamic/Sharia micro banking with investment and revenue-sharing system. Islamic microfinance or Shariah-compliant microfinance plays a significant role in Indonesia as the largest Muslim majority market in the world<sup>11</sup>.

Most micro-lending has been located in the urban areas of Java and Sumatra, where the Indonesian population is concentrated. The density of population in Indonesia is concentrated in Java, with the densest population of the capital Jakarta. Java is a very potential market for developing microfinance in Indonesia. Based on the poverty line in Indonesia, poverty found in some islands in Indonesia, among others, on the island of Java, Sumatra, Sulawesi, West Nusa Tenggara, East Nusa Tenggara, and the highest percentage of poverty in Maluku, Papua. In these islands is a potential market to develop microfinance with training and social program for poverty alleviation programs in Indonesia. Figure 3 shows poverty in Indonesia 1976 until 2013.

Role of MFIs in Indonesia become a critical factor in poverty reduction efforts are effective. Increase in access to and provision of storage facilities, finance and insurance that can efficiently build the empowerment of the poor and their chances to get out of poverty, through the rate of consumption is more definite and not fluctuate, gradually can build assets, develop a micro-business activities, to strengthen the capacity acquisition earnings, can feel better life.

Figure 3. Poverty in Indonesia (1976-2013)



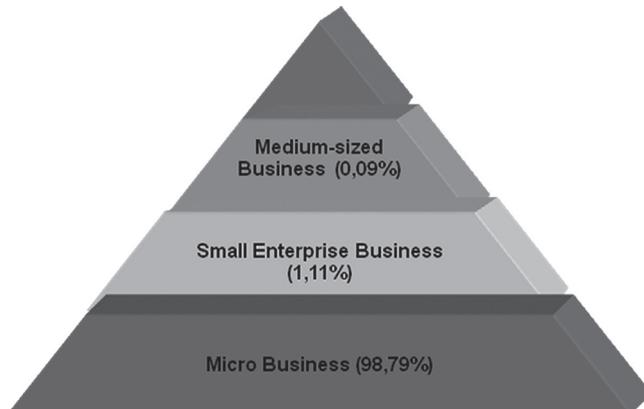
Source: by writer based on Central Statistic Agency (BPS) Indonesia

Without adequate access to MFIs, almost all poor households in Indonesia will depend on the ability of financing them self, very limited and depend on informal financial institutions such as moneylenders or middlemen. This condition would limit the ability of the poor to participate in and benefit from development opportunities. Poor groups who live in rural areas and strive in the agricultural sector are supposed to be empowered so that they can get out of the cycle of poverty. Current situation in Indonesia social program for poor people still limited with direct cash money, empowerment assistance and social program to training and education for micro business or financial literacy for poor people still not enough. This condition need the role Financial Services Authority Indonesia to create regulation in enhance the role of MFIs to help the government to reduce poverty through training or assistance for micro business and poor people in Indonesia and the OJK as a new Financial Services Authority Institution does not yet create the regulation about this matter.

### 2.3 Microfinance Industry in Indonesia

Finance access for SME sector and the development of the microbanks and microfinance institutions become necessary in order to boost economic growth in Indonesia. Local government efforts to develop the sector of SMEs would have a direct impact on improving the living standards of the poor people and income distribution in the region, which in turn can promote economic growth in Indonesia. So it becomes significant efforts to improve SME access to sources of capital, particularly of the microfinance sector. Figure 4 shows the percentage of Industry in Indonesia.

Figure 4. Percentage of Industry in Indonesia

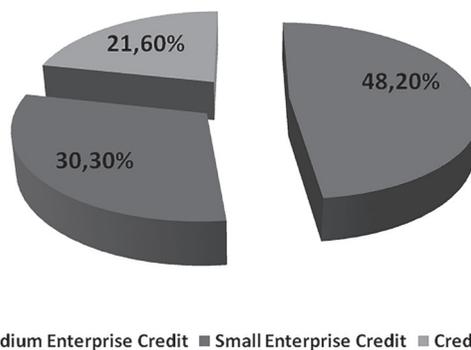


Source: by writer based on Ministry of Cooperatives, Small and Medium Enterprises The Republic of Indonesia Report (2011-2012)

Based on a survey report Ministry of Cooperatives and Small and Medium Enterprises Republic of Indonesia, in 2012 total of micro business industry is 55.856.176 or 98,79% of the entire business industry in Indonesia, potential market to develop microfinance with empowerment micro business in Indonesia.

Based on data from the Central Bank of Indonesia in 2013, according to most business classification SMEs loans disbursed credit micro loans amounted to 21.6% (see figure 5). This suggests that micro business lending is still very low compared with the potential microfinance market in Indonesia, this condition is a challenges for micro banking with the high level of interest rates that is considered by micro business are very weight. Need the role from OJK as a new Financial Authority Services Institution in Indonesia to make regulation about maximum interest rate for micro business in line with the government program to improve economic growth in Indonesia.

Figure 5. Percentage of SME Lending in 2013

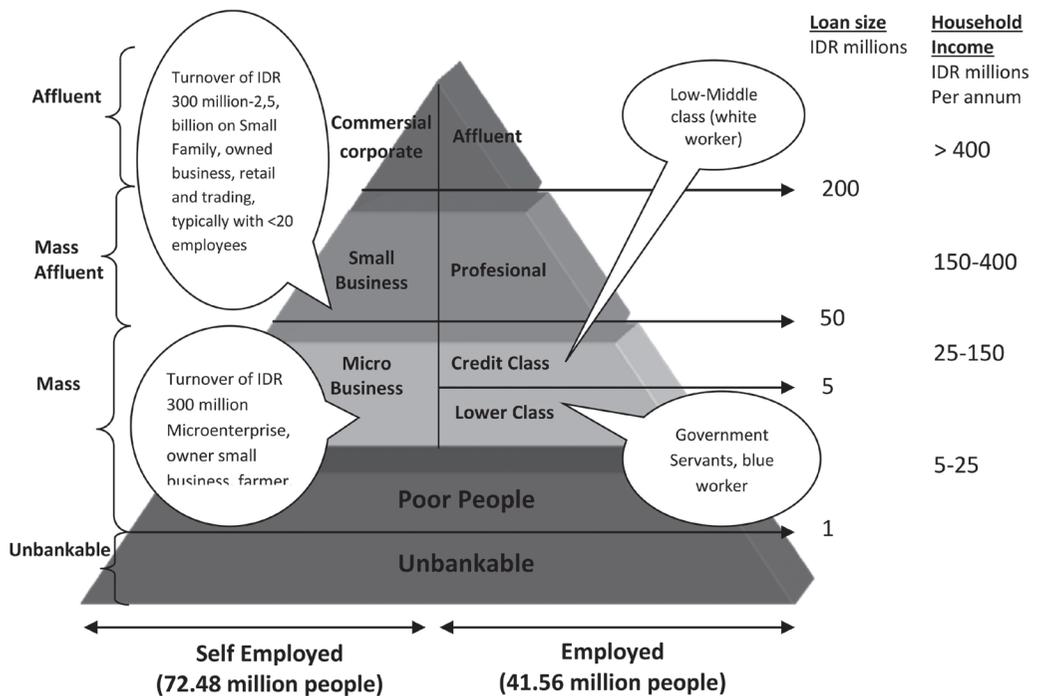


Source: by writer based on Central Bank Indonesia Report, 2014

### 2.4 Microfinance Market Segmentation

Based on data reported by Central Bank Indonesia in May 2014, by the end of 2013 recorded bank account growth of SMEs as a whole recorded 10.1 million and approximately 80 percent of Indonesia’s poor do not have access to formal financial institutions. Market segmentation for microfinance in Indonesia for households is divided into two groups that are self-employed and employee segments. Figure 6 shows mass segmentation microfinance in Indonesia, the customer mass market segment in Indonesia is comprised poor people, micro business and household with income 5-150 IDR million per annum, there are around 50 million households in Indonesia. This condition suggests that the market potential for microfinance and the effort to expand access to financial institutions by the lower layers of society (financial inclusion) becomes imperative in Indonesia. Need the role MFIs to increase microfinance services for to utilize mass segmentation in the microfinance sector, including reaching the poor to remote vil-lages area.

Figure 6. Mass Segmentation Microfinance in Indonesia<sup>12</sup>



Source: Writer

## 2.5 Market Penetration

Market penetration is comparison of the current market versus the potential market demand for products. Based on the writer calculation market penetration for rural area product is 2,3%. This current condition indicates that lack of access microfinance for poor people especially rural area in Indonesia so needs role of MFIs to develop microfinance in rural area product with assistance or training and education program for microfinance customer. Table 3 shows demand and supply calculation outreach of microfinance for poor people in the rural area Indonesia.

**Table 3. Demand & supply analysis outreach of microfinance for poor people in the rural area Indonesia (as of 2013)**

Country	Population	Poverty head-count 11,37%	Number of poor people (P)	Number of Poor in rural Area (H)	Potential Market (70%) (M=H*0.7)	Active Borrowers (10%)	Market Penetration (%)
Indonesia	253.609.643	11,37	28.835.000	17.740.000	12.418.000	1.241.800	2,3

Source: Writer calculation based on Central Statistic Agency (BPS) Indonesia, 2013

Based on writer calculation Indonesia market penetration microfinance industry is 1,2%, this current condition indicates that still much micro business that lack access microfinance for their business, this is due to the high level of interest and considered by micro enterprises are very weight and business management training for micro customer not yet maximal, so need role of OJK as new Financial Services Authority Institution to make regulation for stimulate MFIs to develop micro-business with social and training program. Table 4 shows demand and supply calculation outreach of the microfinance industry in Indonesia.

**Table 4. Demand & supply outreach of the microfinance industry in Indonesia (as of 2013)**

Country	Micro Enterprises (ME)	Active Borrowers /The number of credit micro account (H)	Potential market (M=ME-H)	Market penetration (%)
Indonesia	55.856.176	10.100.000	45.756.176	1,2

Source: Writer calculation based on Central Bank Indonesia, 2013, for active borrower and Total Micro Enterprises from Ministry of Cooperatives, Small and Medium Enterprises The Republic of Indonesia 2011-2012

### **3. Regulation for Microfinance in Indonesia**

The Law Act 21 of 2011 about Lembaga Otoritas Jasa Keuangan or OJK as a Financial Services Authority Institution makes Indonesia has a new independent agency in terms of regulation and supervision are integrated into the overall activity in the financial services sector. The establishment of OJK, making powers possessed by Central Bank Indonesia (BI) will move to OJK. The Central Bank Indonesia will be more responsible in dealing with macro (macro-prudential supervision) that focus on the stability of the financial system with mitigating systemic risk, and OJK authorized in dealing with micro (micro-prudential supervision) that focus on the health of individual banking institutions. The formation of the OJK gives high hopes to the Indonesian government, the Financial Services Industry community, and, in general, the Indonesian society. Starting in January 2014 Central Bank Indonesia provides authority to supervise the banking sector including micro banking sector.

The Law Act No. 1 of 2013 gives full authority to the OJK in licensing, regulations and supervisions of MFIs. The current challenges for OJK are the many types and kinds of MFIs in Indonesia so very difficult to monitoring and need efforts for developing MFIs. With integration regulation and supervision of MFIs, expected the data and information related about MFIs in Indonesia can be accessed with the better but until now OJK not been able to determine how many MFIs in Indonesia in real terms. The challenge OJK as a new Financial Services Authority Institution is needed long time to the transfer process of the previous supervisory agencies, such as the transfer of cooperative whose implementation will begin in 2015 and several other financial institutions such as the BMT that still need long time to takes data collection and make clear regulation. Besides that for the future OJK must develop program like as training & social for micro enterprises and poor people and another program in line with focus and expectation of the government that establishment of OJK can help the government in economic growth and reduce poverty in microfinance sector.

#### **3.1 Microfinance Institution Regulation**

Microfinance Institutions (MFIs) when referring to Act 1 of 2013 on Microfinance Institutions are defined as special financial institution established to provide business development services and community empowerment, either through loans or financing for micro-enterprises and community members, the management of deposits, as well as the provision of consulting services for business development is not solely for profit. The definition implies that the MFI is an institution that also for social motive, which is more community development activities with without prejudice to its role as a financial intermediary. As a financial institution that serves as intermediary institutions, MFIs are also conducting savings and loans, which activities in addition to providing loans, but also required to provide awareness to the public saving, especially low-income communities.

Law Act POJK.05 of 2014 is new Regulation from OJK that concerning the licensing of Business and Institutional Microfinance Institutions, in Article 2 states the legal status of Microfinance Institution is cooperative or limited liability company, limited liability company specialized at least 60% of its shares owned by local government/district/city or village-owned enterprises while the rest of the limited liability company shares can only be held by citizens of Indonesia or cooperatives. The amount of paid-in capital or principal payments is set at a minimum:

- a. Rp 50 million, - (fifty million rupiah) for the business area coverage villages / wards.
- b. Rp 100 million, - (one hundred rupiah) for coverage of the districts.
- c. Rp 500 million (five hundred million rupiah) to the coverage area of the business district / city.

Licenses for a period of 60 days, after all, the procedures declared complete.

### **3.2 Micro - Bank Regulation**

The regulation of Bank Indonesia Number 14/22 / PBI / 2012 describe commercial micro banking regulation in the provision of micro-credit and technical assistance in the development of micro, small and medium and also explains the criteria for financing SMEs in Indonesia. In Indonesia, the transaction value of microfinance is only defined at the micro-credit limit only the maximum of 50 million. As for other financial transactions such as savings, insurance, remittance, payment systems no clear regulation.

New Regulation from OJK Act 20 / POJK.03 / 2014 about the establishment of Micro Banking Rural Bank, in which the legal Rural Bank is Limited Liability Company, Cooperative and Regional Company may only be owned by Indonesian citizens, Indonesian Legal Entity or Local Government, paid-up capital to establish minimum BPR:

- a. Rp 14 billion (fourteen billion rupiah) for area coverage zone 1.
- b. Rp 8 billion ( eight billion rupiah) for area coverage zone 2.
- c. Rp 6 billion (six billion rupiah) for area coverage zone 3.
- d. Rp 4 billion (four billion rupiah) for area coverage zone 4.

Zone determined based on the economic potential of the region and the level of competition of financial institutions in the district or city concerned. Challenges of OJK as new Financial Services Authority Institution to make clear regulation about saving, micro insurance, remittance, payment systems because until now no clear regulation.

Summary of type and regulations microfinance in Indonesia can see in Table 5 which shows the type and regulations microfinance in Indonesia.

Table 5. Type and Regulations Microfinance in Indonesia

Type Microfinance in Indonesia	Regulatory Low Act	License Regulation	Supervision Regulation	Deposit Insurance Agency
Bank	Bank BRI Unit (BRI Special for MicroCredit)	The Bank Act No 10/1998	BRI Branches, Bank Indonesia for BRI as a Whole (Commercial Bank) New Role: <b>After 1 January, 2014 based on Ac No 21/2011</b> about OJK supervision by Otoritas Jasa Keuangan (OJK) as Financial Services Authority Institution	Has Deposit Insurance Agency, has the guarantee for secure customer
	Rural Bank (BPR/BPR Syariah)	The Bank Act No 10/1998 (People Credit Bank or Rural Bank, with private, local government or cooperative ownership)	Bank Indonesia, the Central Bank <b>After 1 January, 2014 based on Act No 21/2011 about OJK supervision by Otoritas Jasa Keuangan (OJK) as Financial Services Authority Institution</b>	Has Deposit Insurance Agency, has the guarantee for secure customer
	Commercial Banks for Micro Credit (like as Mandiri Unit Micro, Danamon Credit Micro, etc)	The Bank Act No 10/1998 (Commercial Banks, Government & Private (BPDs))	Bank Indonesia, the Central Bank <b>After 1 January, 2014 based on Ac No 21/2011 about OJK supervision by Otoritas Jasa Keuangan (OJK) as Financial Services Authority Institution</b>	Has Deposit Insurance Agency, has the guarantee for secure customer
	Village Credit Board (Badan Credit Desa =BKD)	The Bank Act No 10/1998 (Village Credit institutions)	Act POJK.05/2014 Otoritas Jasa Keuangan (OJK) as Financial Services Authority Institution	Has Deposit Insurance Agency, has the guarantee for secure customer
	Cooperatives (KOSIPA), credit unions	Cooperative Act No 25/1992	KSPs & USPs, (include Syariah, Also credit unions. Subject to Cooperatives Act. State Ministry of Cooperative & Small Enterprise	Did not has Deposit Insurance Agency, not has guarantee for secure customer
Non-Bank	LDKP (The Funds and Credit Institution)	Government Act No 1/2013	Act POJK.05/2014 Otoritas Jasa Keuangan (OJK) as Financial Services Authority Institution	Did not has Deposit Insurance Agency
	Pawnshops Perum Pegadaian	Owned by the government	Otoritas Jasa Keuangan (OJK) as Financial Services Authority Institution	Did not has Deposit Insurance Agency
Non Formal	Informal Development Financing Institutions: NGOs, unregistered MFIs, Self-help groups	NGOs, MFIs, BMT (Syariah) Self-help groups. Special new BMT license Regulation Act No 1/2013 by Otoritas Jasa Keuangan (OJK)	NGOs, MFIs, BMT (Syariah) Self-help groups. <b>in the process next supervision by Otoritas Jasa Keuangan (OJK) as Financial Services Authority Institution</b>	Did not has Deposit Insurance Agency

Source: by writer analysis 2014, based on Act 21/2011 about Otoritas Jasa Keuangan (OJK) as Financial Services Authority Institution, Act No 1/2013 about Microfinance Institution Act POJK.05/2014 about Business Licensing and Institutional Microfinance Institutions, data from Authority Institution or Otoritas Jasa Keuangan (OJK) and data from Central Bank Directorate of Rural Banking Supervision.

### **3.3 Comparative microfinance regulatory authorities in Indonesia and with another country.**

The fundamentals economic problem in Indonesia is an internal challenge in the form of a gap which is characterized by the presence of unemployment and poverty, while the external challenge is improving the competitiveness of the era of free trade. Establishment of OJK as a Financial Services Authority Institution has been very precise with integrated Microfinance regulation and supervision, expected can develop MFIs and can help the government of Indonesia to encourage economic growth and reduce poverty. MFIs can be an instrument for the government program to in alleviating poverty due to the development of micro enterprises in the context of poverty reduction can not be separated from the role of MFIs. While banks are not able to reach out to micro enterprises, MFIs can provide financial support with appropriate characteristics to support micro enterprises. MFIs can help the government to alleviate poverty through community efforts to increase productivity and development micro enterprises at the rural level. MFIs has a function as an intermediary in an economic activity if functioning properly will produce added value. The function can add by utilizing the services of intermediation of financial institutions, including the productive efforts made by the poor so can improve the income poor people. With current phenomenon, it can not be denied that role OJK as Financial Services Authority Institution very important to make regulations in line with development of MFIs and the empowerment MFIs is one prerequisite that must be met in order to develop a micro business aimed at reducing poverty in Indonesia.

OJK as new Financial Services Authority Institution in Indonesia can learn and adopt the system of Bangladesh which success to poverty alleviation through microfinance. The government of Bangladesh has been promoting public sector microfinance programs with financial support from international financial institutions or agencies for poverty alleviation. The enactment of the MRAA Microcredit Regulatory Authority Act in 2006 marked a significant change in policy on NGO-MFIs. The regulation of microcredit activities of microcredit organisations in Bangladesh with a view to ensuring transparency and accountability of their operations, requires NGO-MFIs to become LMFIs if they want to continue their operations and allows LMFIs to “provide various insurance services and other loans for social welfare purpose to the creditors and their family members<sup>13</sup>”.

In Bangladesh, there are mainly four types of institutions involved in microfinance activities<sup>14</sup>:

- a) Grameen Bank (GB)
- b) NGO-MFIs having licenses from Microcredit Regulatory Authority (MRA)
- c) Commercial and Specialized Banks
- d) Government sponsored microfinance programs (e.g. through BRDB, cooperative societies and programs under different ministries).

Judging from the current situation where the condition of microfinance institutions in Indonesia did not has the Deposit Insurance Agency to give a guarantee secure for customer, and many microfinance institutions not been able to develop microinsurance products, so need

active role from OJK. The government of Indonesia through OJK as a Financial Services Authority Institution expected can develop the social programs or training and assistance to micro businesses and poor people with adopt a system from the Grameen Bank in Bangladesh which has been successful with Poverty Alleviation through micro-credit development. Besides Bangladesh, Pakistan, India also has an integrated regulatory system while China Regulatory authorities conducted the People’s Bank of China (PBC) and the China Banking Regulatory Commission (CBRC). Table 6 shows Comparative microfinance regulatory authorities in Indonesia and with another country.

**Table 6. Comparative microfinance regulatory authorities in Indonesia and with another country**

Country	Regulatory authorities
Bangladesh	Microcredit Regulatory Authority (MRA)
China	People’s Bank of China (PBC), China Banking Regulatory Commission (CBRC)
India	Reserve Bank of India (RBI)
Indonesia	Financial Services Authority Institution/ Otoritas Jasa Keuangan (OJK)
Pakistan	State Bank of Pakistan (SBP)

Source: by writer based on data from Milken Institute, CGAP and Financial Services Authority Institution (OJK).

#### **4. Improving Microfinance in Indonesia**

Poverty reduction can be carried out through many tools and programs that are either directly or indirectly by encouraging micro business productive through the provision of microfinance loans (microcredit). In addition, OJK as a Financial Services Authority Institution need to create a blueprint a structured design to develop MFIs and strengthen the MFIs in Indonesia. OJK also must reinforce the institutions with coordinating all government institutions at central and local levels to provide guidance and oversight of the operational activities of MFIs in Indonesia. On the other, the insurance for small communities is still constrained in terms of distribution so, not to touch those who live in rural areas. The absence of protection of the financial risk for low-income people could potentially encourage people fell into poverty in the event of a disaster. This condition is noteworthy considering the insurance company can prevent that. Low-income people need a micro-insurance products that provide benefits in accordance with the needs, with premiums that are accessible, easy to understand policy, and payment of claims quickly. The system becomes necessary because of the ease of access to be a real thing. For this condition, OJK is expected to get data about insurance companies have been providing micro-insurance products, it is time the insurance is also beneficial to the poor (insurance for poor people) in Indonesia. The duty and responsibility OJK as Financial Services Authority Institution to encourage MFIs develop microinsurance products MFIs in Indonesia. OJK must

give consumer protection, and the OJK has regulations Act No. 1 / POJK.07 / 2013 about Consumer Protection Financial Services sector which explains the promotion policy in which the sale of products and services from MFIs should include the name or logo of MFIs and must be registered and supervised by OJK, but until now the OJK has not cooperated with the Deposit Insurance Agency, this matter is a challenge for the future of the OJK to give guarantee for secure microfinance customers in Indonesia.

The challenges of OJK to develop microfinance also the social condition problems in which the weak financial literacy Indonesian society, especially the poor people. Based on financial literacy survey in 2013, the national financial literacy levels are still relatively low only 21.84%. Lack of knowledge about the industry and finance products make the community easy to be tempted in investment products that offer high returns in the short term without considering the risks. For the next starting in 2015, OJK need to improve the microfinance market, make clear regulations and make program to implement business education and finance literacy with a mission to educate micro business and poor people in microfinance, improving access to information and marketing microfinance through the development of supporting infrastructure for financial literacy. For the development of micro-finance in the future OJK need to develop training and social programs for micro businesses and poor people are in line with the government's focus on reducing poverty through microfinance as has been done by other countries such as Bangladesh and India.

OJK must have promotion program and appropriate strategies to reduce poverty alleviation. Indonesia needs an aggressive poverty reduction strategy. Now social programs to alleviate poverty in Indonesia is merely a program providing direct give in the form of money. The Indonesian government rarely does hold training skills to open a small business, marketing training and importance of money management and knowledge/financial education, support for micro-enterprises also have not been able to reach a whole Indonesia should support increased non-governmental organization ("NGO") participation in microfinance programs by permitting NGOs to conduct the full range of activities of a state-run microfinance program. Such a move would help to ensure that microfinance services reach people with the least access to the formal financial sector.

Based on the potential market in Indonesia authors provide recommendations for OJK to implement the "model of development of microfinance in Indonesia" like as Figure 7. Indonesia has potential market of poor people and micro business, so need the role of OJK to make a clear regulation for develop service microfinance through training and social programs in line with focus the government to economic growth and reduce poverty in Indonesia.

Figure 7. A model of development microfinance in Indonesia



Source: Writer

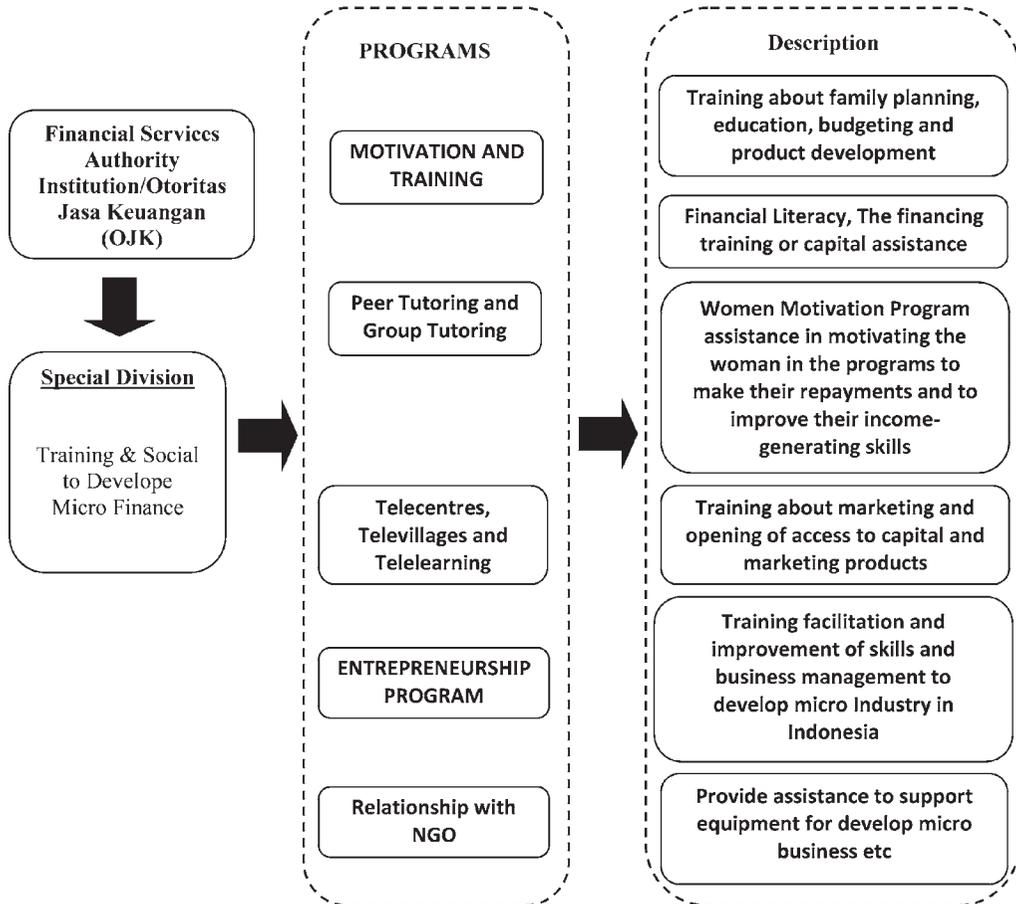
Potential market with of mobile banking users in Indonesia enabling the poorest people to have access to reliable financial transactions based on location demographics and Indonesia with it has a total of 17,508 islands, for it microfinance development program must be balanced with adequate infrastructure to take advantage of information technology such as mobile banking, etc. and provide the best service for micro banking customers and for the future development of microfinance. Poverty reduction programs based on empowering micro businesses is a program that aims to provide access and economic empowerment for micro businesses. Important aspects of the reinforcement is to provide the broadest access to the poor to be able to try and improve the quality of life, but now OJK did not have division Training & Social program to develop microfinance, so author give recommendation to develop microfinance for the future with training and social program coverage-based empowerment program group micro enterprises in Indonesia, Figure 8 shows the recommendation.

OJK as a Financial Services Authority Institution in the future must have a special division for Training and social program to develop microfinance in Indonesia. Motivation and Training Program, Telecentres, Televillages and Telelearning, Peer Tutoring and Group Tutoring, Entrepreneurship Program, like as a short training talk is given on issues relating to training in health, sanitation, clean environments, family planning, education, financial literacy, budgeting and product development. Training is needed, not just at the beginning of a program, but throughout the life of the program and Assistance in motivating the women in the programs to make their repayments and to improve their income-generating skills.

Tele Cottages are community centers that have modern electronic communication facilities that enable the population to share resources in education, training, employment, and social and economic development. For effective and efficiency, the telecottages need a community facility with telecommunications and information processing equipment so that the public can access them. The telecottage concept was meant to benefit the local communities by providing services to local businesses and distance working opportunities, and in some places has already

provided local training facilities, open learning access points for distance education, and expanded social networks<sup>15</sup>.

Figure 8. Improvement training & social program coverage-based empowerment program group micro enterprises in Indonesia to development microfinance for the future



Source: Writer

Based on the discussion above, it can be concluded that in order to develop microfinance in Indonesia, which the government of Indonesia have potential market for microfinance business it would be better for OJK as a Financial Services Authority Institution to makes clear regulation and make special division in training and social program with professionalism and implementation of government practice to develop microfinance in Indonesia to reduce poverty in Indonesia.

## 5. Conclusion

Microfinance market based on socioeconomic, demographic condition and micro business in Indonesia is very potential. The number of people who have access to micro-finance institutions covers only 10 percent. With current conditions, the effort to expand access to financial institutions by the lower layers of society (financial inclusion) becomes crucial. With the Indonesian laws rules requiring banks to have a minimum of 20% of their loan portfolio dedicated to micro-credit in 2018 opened new opportunities to develop the microfinance sector in Indonesia for the future.

The Success of Microfinance influenced by the social economic, demographic conditions and regulation. Law Act no 21 of 2011 gives full authority to Lembaga Otoritas Jasa Keuangan or OJK as a Financial Services Authority Institution make the government Indonesia has a new independent agency in terms integrated of regulation and supervision to the overall activity in the financial services sector including microfinance sector. Fundamentals economic problem in Indonesia is an internal challenge in the form of a gap that is characterized by the presence of unemployment and poverty, while the external challenge is improving the competitiveness of the global market. Establishment of OJK has been very precise with integrated Microfinance regulation and supervision, expected can develop MFIs by encouraging business micro productive through the provision of microfinance loans can help the government to promote economic growth and reduce poverty.

For the future OJK need to develop training and social programs for micro businesses and poor people are in line with the government's focus on reducing poverty through microfinance as has been done by other countries such as Bangladesh and India. Important aspects of the reinforcement is to provide the broadest access to the poor to be able to try and improve the quality of life, but OJK as a new Financial Services Authority Institution not yet have division Training & Social to Develop Microfinance, so the author give recommendation for OJK is to make new division for develop microfinance for the future with social program coverage-based empowerment program group micro enterprises in Indonesia.

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## Note

<sup>1</sup> The definition of Microfinance from Asian Development Bank, Microfinance have many definition but no standard definition of the microfinance, microfinance except that all relate to the activities of financial services for the poor's who have limited access when dealing with formal financial institutions. Although some different argument, microfinance can be a powerful way to reduce poverty and promote economic development ( e.g., Littlefield et al. 2004; Goldberg, Nathanael 2005; Appah, Ebimobowei 2012).

<sup>2</sup> See An Outlook on Indonesia's Microfinance Sector. Retrieved [http://www.gbgindonesia.com/en/finance/article/2013/an\\_outlook\\_on\\_indonesia\\_s\\_microfinance\\_sector.php](http://www.gbgindonesia.com/en/finance/article/2013/an_outlook_on_indonesia_s_microfinance_sector.php)

<sup>3</sup> Based on data from Ministry of Cooperatives and Small and Medium Enterprises Republic of Indonesia Report, 2012.

<sup>4</sup> Based on the Central Bank Indonesia Regulation number 14/22/PBI/2012 Article 2.

- <sup>5</sup> Some studies suggest that the factors influencing the sustainability of microfinance institutions is the financial regulations in the country and the geographical coverage and reach, which is the study of Lawrence. Kimando N. et al, Factors Influencing the Sustainability of Micro-Finance Institutions in Murang'a Municipality, *International Journal of Business and Commerce*, 2012.
- <sup>6</sup> See BWTP Asia Resource Centre for Microfinance. Retrieved [http://www.bwtp.org/arcm/indonesia/I\\_Country\\_Profile/CountryProfile\\_Indonesia.pdf](http://www.bwtp.org/arcm/indonesia/I_Country_Profile/CountryProfile_Indonesia.pdf).
- <sup>7</sup> Data based on Annual Report Bank BRI in 2013.
- <sup>8</sup> Sally Bolton and Stefanie Khaw Economic Growth opinion. Retrieved <http://www.theguardian.com/business/2006/jul/10/ukeconomy.globalrecession>.
- <sup>9</sup> Annual growth the global GDP data are as of 2004-2013 taken from world bank data; Annual growth Indonesia GDP data are as of 2004-2013 take from Central Statistic Agency (BPS) Indonesia; Forecast growth Indonesia and global GDP data are as of 2014-2017 taken from IMF World Economic Outlook, April 2014.
- <sup>10</sup> GDP data are as of 2013; poverty data as of latest-available years ranging from 2009 to 2012 taken from the world bank data; other data as of 2011 take from the Microfinance Information Exchange Market and poverty data from Central Statistic Agency Indonesia 2013 .
- <sup>11</sup> See the Outlook for Indonesia's Islamic Banking Sector, *Global Business Guide Indonesia*. Retrieved [http://www.gbgingonesia.com/en/finance/article/2013/the\\_outlook\\_for\\_indonesia\\_s\\_islamic\\_banking\\_sector.php](http://www.gbgingonesia.com/en/finance/article/2013/the_outlook_for_indonesia_s_islamic_banking_sector.php).
- <sup>12</sup> Improvement author from analyzed by Adimarwan, Karim, Faith-Based Microfinance in Indonesia, *Formic Arequipa Peru*, 2009. Which state that Adimarwan Karim does not classify poor people into the mass market, while Indonesia has a potential market of the poor, especially in rural areas are still many unreached by micro finance.
- <sup>13</sup> Retrieved Policy and regulation for microfinance in Asia, *The Foundation Development Cooperation, Banking With The Poor Network*, Citi Foundation, 2010
- <sup>14</sup> See Microcredit and Poverty Alleviation: The Best Practice in Bangladesh. Retrieved <http://saarc-sec.org/uploads/document/Bangladesh>.
- <sup>15</sup> Retrieved Gibbons, D.S. (Ed). (1994). *The Grameen Reader: Training Materials for the International Replication of the Grameen Bank Financial System for Reduction of Rural Poverty*. (2nd Ed.). Dhaka: Grameen Bank

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