

Authors

Jonathan Morduch
New York University

The Unbanked: Evidence from Indonesia

Don Johnston Jr. and Jonathan Morduch

To analyze the prospects for expanding financial access to the poor, bank professionals assessed 1,438 households in six provinces in Indonesia to judge their creditworthiness. About 40 percent of poor households were judged creditworthy according to the criteria of Indonesia's largest microfinance bank, but fewer than 10 percent had recently borrowed from a microbank or formal lender. Possessing collateral appeared as a minor determinant of creditworthiness, in keeping with microfinance innovations. Although these households were judged able to service loans reliably, most desired small loans. Calculations show that the bank, given its current fee structure and banking practices, would lose money when lending at the scales desired. So, while innovations have helped to extend financial access, it remains difficult to lend in small amounts and cover costs. JEL codes: G21, O16

Microfinance is built on a compelling logic: hundreds of millions of poor and very poor households seek capital to build small businesses, but their lack of collateral restricts access to loans. Innovative "microbanks" meet the demand with more flexible collateral requirements and thus unleash untapped productive power.¹ The narrative, highlighted by the Nobel Peace Prize committee in awarding the 2006 prize to Muhammad Yunus and the Grameen Bank of Bangladesh, has driven the global expansion of microfinance (Cousins 2008).

Donald Johnston Jr. is an economist based in Jakarta, Indonesia. Jonathan Morduch (corresponding author) is professor of public policy and economics at the Wagner Graduate School of Public Service, New York University, and managing director of the Financial Access Initiative; his email address is jmorduch@nyu.edu. The article draws on joint work with Rabi Supram, Jay Rosengard, and staff of Bank Rakyat Indonesia on survey design and implementation. The authors appreciate comments from Xavier Gini on an earlier draft. Jonathan Brander and Javier Bruchman assisted with data analysis. The data were collected by staff of Bank Rakyat Indonesia with support from the United States Agency for International Development. Morduch appreciates support from the Gates Foundation through the Financial Access Initiative.

1. The Microcredit Summit's annual survey counted 133 million customers worldwide at the end of 2006, and its aim is to reach 175 million by 2015 (Daley-Harris 2007). The mission of the potential market has been hard to pin down. Elizabeth Luriefield, the CEO of the main donor consortium on microfinance, the Consultative Group to Assist the Poor, writes that "as many as 3 billion people still lack access to basic financial services," a figure subsequently cited in U.N. and World Bank publications (Luriefield 2006, p. vi).

see *World Bank Economic Review*, vol. 22, no. 3, pp. 517-537

doi:10.1093/wber/ebk016

Advance Access Publication October 22, 2008

© The Author 2008. Published by Oxford University Press on behalf of the International Bank for Reconstruction and Development / THE WORLD BANK. All rights reserved. For permission, please e-mail journals.permissions@oxfordjournals.org

The Unbanked: Evidence from Indonesia

To analyze the prospects for expanding financial access to the poor, bank professionals assessed 1,438 households in six provinces in Indonesia to judge their creditworthiness. About 40 percent of poor households were judged creditworthy according to the criteria of Indonesia's largest microfinance bank, but fewer than 10 percent had recently borrowed from a microbank or formal lender. Possessing collateral appeared as a minor determinant of creditworthiness, in keeping with microfinance innovations. Although these households were judged able to service loans reliably, most desired small loans. Calculations show that the bank, given its current fee structure and banking practices, would lose money when lending at the scales desired. So, while innovations have helped to extend financial access, it remains difficult to lend in small amounts and cover costs

March 01, 2007