

# The Unbanked: Evidence from Indonesia

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Why do so few poor households borrow from formal banks? Is it a question of access—i.e., are the unbanked excluded despite having worthy uses for capital? That account is sometimes assumed to be the case, but it isn't the only possible explanation. It could be that the unbanked are not credit-worthy (and thus their constraints go beyond lack of access), or that they are credit worthy but simply not interested in taking on debt. This study by Don Johnston and Jonathan Morduch addresses these possibilities using survey data from Indonesia. It also goes further to uncover the uses of loans, examining the extent to which education, health, and social needs drive the demand for credit. Somewhat surprisingly, about half of credit-worthy poor households report being averse to taking on debt. While loans for small business were desired, respondents often highlight broader household needs, including paying for school fees, medical treatment, and home repair.

### A Survey of the Unbanked

In this study, Johnston and Morduch examine household-level data from 1438 households in six provinces in Indonesia. The research is unique in that it uses professional credit officers based in Indonesia to collect data and judge the creditworthiness of households. Researchers relied on the lending criteria of Bank Rakyat Indonesia's (BRI) microfinance unit, Indonesia's leading commercial microfinance provider. BRI professionals assess the creditworthiness of all households, whether or not they were BRI customers, and surveys provide information on household characteristics and loan use.

### Results

Although fewer than 10 percent of the poor population borrowed recently from a formal sector bank (BRI or another), nearly 40 percent are determined to be credit worthy according to BRI's standards. Lack of collateral is not perceived as a major constraint on their ability to borrow and repay. The survey also reveals that about half of poor households that are credit worthy are averse to taking on debt and do not seek credit. Moreover, many households save but do not borrow (BRI has a 10 to 1 ratio of customers who save versus those who also

borrow—but many BRI savers borrow from other banks). Financing small businesses is the most common use of loan funds, but low-income households in the survey use loans for household needs about one third of the time on average. Important non-business uses include paying for school fees, medical treatment, home repair or expansion, meeting daily consumption needs, and meeting social and holi-day expenses. This finding holds for a wide range of low-income households: households below regional poverty lines, just above the lines, and well above the lines.

### Policy Implications

Contrary to microfinance orthodoxy, the demand for micro-credit in Indonesia extends beyond households with small businesses to include those who need loans for non-business purposes. In addition, lack of access does not fully explain lack of use, as evidenced by the gap between the 40 percent of households deemed credit worthy and the less than 10 percent that are borrowing from formal sources. To improve programs to expand financial access, policymakers and practitioners should strive to advance their understanding of who the unbanked are, and the kinds of financial services that will best serve them, paying special attention to loans for general purposes and savings products.