



*MicroSave*

*Market-led solutions for financial services*

# Lessons from Informal Financial Systems: An Indonesian Perspective

December, 2014 by [Ghiyazuddin Mohammad](#) and [Rahmi Yunaningsih](#)

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Over the past few years, *MicroSave* has conducted several research studies in Indonesia<sup>[1]</sup> to understand the household-level financial ecosystem in the country. Through focus group discussions (FGDs) and participatory rapid appraisal (PRA) tools, we gained insights on access to and use of financial products in communities across Indonesia.

This blog focuses on the role of informal financial institutions. It concludes by highlighting how the products and methods of informal finance offer valuable suggestions for formal financial service providers. The following are some of the financial products or services we have observed in the field.

## Savings

### Savings with *Arisan*/ROSCA

*Arisans* are a form of ROSCA (rotating savings and credit association) are very commonly used in all communities in Indonesia. As with most ROSCAs that are prevalent in other parts of the world, members contribute a fixed amount on a periodic basis. The *arisan* group meetings (typically weekly or monthly) are held at a time and location convenient for the members. The meetings also provide a platform for members to socialise and bond with family, friends, and neighbours. At the end of each meeting, one member receives the amount collected based on a lottery. In Indonesia, the administrators – an agent or a local institution - usually charge 5-10% of the collected amount.

Example: In a group of 30, each member contributes IDR 100,000 (USD 23.9) per week for 15 weeks. Each week, the *Arisan* holds a lottery and one member receives the total amount collected, after paying the administrator’s fee of IDR 100,000 (USD 23.9). Thus the lottery winner leaves the meeting with IDR 1,400,000 (USD 334.4).

#### ***Pyoh* Scheme**

*Pyoh* is a ‘bidding ROSCA’, an advanced version of ROSCA prevalent in the coastal regions of West Java. The scheme allows members to access the contribution from a given period by bidding for a discounted amount of the total pool of money available. Members of ethnic Chinese communities are largely responsible for offering or managing *Pyohs*. This is because customers perceive them to be trustworthy and reliable in managing bigger amounts of money. As Ibu Ayoh, a middle-aged fish retailer and a *Pyoh* member says – “*The Chinese are good at managing money and they never default*”.

Ibu Ayoh, along with 40 others, contributes IDR 1,000,000 (USD 83, or USD 239 adjusted for purchasing power parity – PPP) on a monthly basis for 40 months in the *Pyoh* scheme. When her turn comes, she is entitled to receive IDR 40,000,000 (USD 3,320 or USD 9,555 adjusted for PPP). However, after 20 months, she needed cash for her business and decided to bid for that month’s contribution. Ibu Ayoh won the bid for IDR 35,000,000 (USD 2,905 or USD 8,360 adjusted for PPP), after a discount of IDR 5,000,000 (USD 415 or USD 1,194 adjusted for PPP). This money (IDR 5,000,000) was equally distributed among the members at the end of the meeting.

### Package Saving Schemes

Offered either by individual agents or local grocery stores, or both, package savings schemes are popular among women. Members use these schemes to “save-up” enough funds for large events, such as the festival of *Eid-el-Fitr* and family functions. At the end of the savings period, members receive grocery packages, such as rice, syrup, sugar, cookies, flour, and meat. Agents charge anywhere between 5-7% of the amount collected from the members. The agents also make a good margin on the grocery packages. The product really adds value because Eid is the biggest event of the year where family members and friends meet, celebrate, and exchange gifts.

This requires large-scale expenditure on groceries, so members prepare for the expenditure by savings as little as IDR 3,000 (USD 0.72) on a daily basis. To put things in perspective, a pack of cigarettes costs between USD 3 and 5 in the country! Further, the enrolment process is easy and collections are typically made at the saver's doorstep – either at home or at their place of work.

## Cash Savings with Individual Agents

Under this scheme, members save periodically (daily, weekly, or monthly) to build up a lump-sum amount. But members receive cash instead of a gift package upon redemption. Savings range from as low as IDR 3,000 (USD 0.72) to as high as IDR 100,000 (USD 23.9) per instalment. Agents do not provide interest on the savings collected. Instead, they charge an administration fee of 5-10% on the total amount collected. This fee increases if a member wishes to withdraw funds before the scheduled date of redemption.

Agents visit the members' residence or business to collect savings. Moreover, members have the flexibility of skipping or prepaying instalments depending on their liquidity position. The scheme offers convenience and flexibility, but there have been instances of agents cheating and disappearing with the customer's hard-earned money. In one case in West Java, we observed a 'sub-prime' crisis at the local level, where an agent had disbursed risky loans using the savings he had mobilised. When some borrowers defaulted, the agent could not honour the savings redemptions and took to his heels.

## Savings with Schools

In some areas, schools collect savings to inculcate a habit of savings among their students. The students use the savings for specific needs, such as to buy books and uniforms, pay examination fees, and for recreation. Product features in terms of the amount, interest rate, frequency of collection, tenure, administration fee, etc. differ from one school to the other. For example, we learnt that some schools in Bogor, West Java charged 5-10% or IDR 50,000 (USD 12), whichever is less, as an administration fee for withdrawals. However, they paid interest on the savings deposited. In other instances, the schools do not charge an administration fee and in turn, do not pay any interest on savings.

## Loans

### Moneylenders

Ubiquitous moneylenders have a field day because there is virtually no competition for them across most of Indonesia. They offer hassle-free loans with limited documentation. To get a loan, all you need is a local identity card to prove who you are. However, moneylenders charge eye-wateringly high interest rates. For example, for an IDR 1,000,000 (USD 239) loan, the borrower pays an upfront fee of IDR 50,000 (USD 12) and then IDR 30,000 (USD 7.2) every day for 40 days. The annual percentage rate of interest for such loans is a whopping 336.12%! People still borrow from these moneylenders because they do not have any alternatives, and, of course, like the limited documentation required!

## Fish Traders in Cirebon

As in many fishing communities, people in Cirebon depend on fish traders for their credit needs. Traders usually buy fish from the fisherfolk, and process and sell it in domestic or overseas markets. They also provide soft-loans to the fisherfolk to meet their business or household needs. The amount varies between IDR 10-50 million (USD 822-4,112) depending on the need and repayment capacity of the borrowers and their relationship with the trader. Even though no interest is charged, fisherfolk who avail these loans are obligated to sell their catch to the trader, usually at 5-10% lower than the market rate. On the positive side, borrowers need not repay the loan until the time they decide to sell the catch to other traders. Effectively, this is like a retainer loan to ensure that the trader gets a steady supply of fish at a 5-10% discount compared to the market rate.



Photo: Ghiyazuddin Mohammed

## Loan from Local Warungs (Mom and Pop) Stores

Fisherfolk usually purchase diesel for fishing boats, cigarettes, and other essentials from local warungs (mom and pop stores) on credit. They usually pay higher rates (10-15%) for the goods purchased. However, they still prefer taking buying on credit from these stores because there is no documentation. These loans are also flexible, so they can repay based on their household cash flows, which are largely determined by their catches at sea.

## Remittances

With rapid urbanisation, domestic remittance services have been in high demand in Indonesia. A nationwide [survey performed by Gallup in 2013](#) showed that 24% of the population sent money to family or friends living in a different location. Banks were the predominant remittance channel with 43% of remitters using this method. Data from Bank Indonesia (the Central Bank of Indonesia) on domestic remittance transactions support this finding.

In 2013, domestic transfer reached 1,139 million transactions, which comprised:

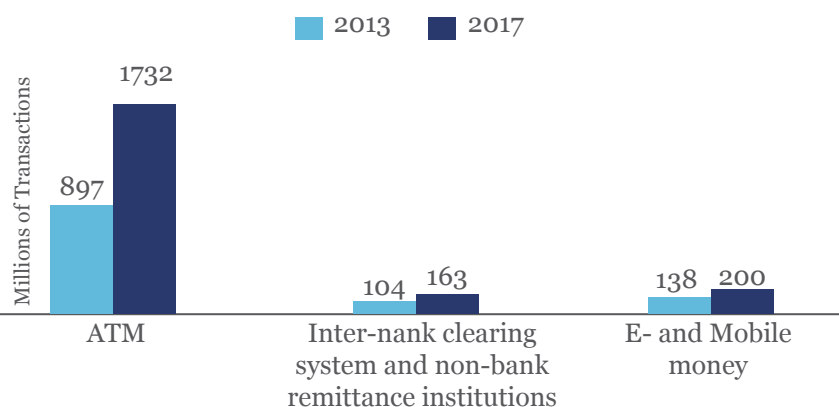
- 78.7% (897 million transactions) using an ATM or a debit card, that is, self-initiated account-to-account transfer through an ATM machine;
- 9.18% (104 million transactions) via inter-bank clearing system and non-bank remittance institutions;
- 12.1% (138 million transactions) using electronic money.

However, it is interesting to note that customers often use the bank channel in an inefficient manner. Workers based in Jakarta and other urban centres usually have a bank account, but use this to send money to an agent with a bank account at the receiving location. This agent, in turn, hands over cash to the recipient and charges around IDR 5,000 to 7,000 (USD 1.2-1.7) per payment. However, for international and large value remittances, these charges may exceed IDR 10,000 (USD 2.4).

The recent rapid growth in the use of technology in Indonesia has also changed the behaviour of people with regard to remittance and payment. In 2017, domestic remittance through debit or ATM cards reached **1,732 million** transactions or 82.71% of the total number of remittance transactions. This figure still exceeds the volume of remittance through inter-bank clearing and non-bank remittance institutions, which reached **162.6 million** – or 7.76% of the total number of transactions. This means that people prefer cashless transactions, which are more convenient and faster.

However, it is interesting to note that transactions using electronic and mobile money<sup>1</sup> in 2017 were also significant in volume. In 2017, these amounted to **163 million** (7.78%) transactions (IDR 1.95 trillion or USD 465.8 million (adjusted for PPP) in value) and **36.5 million** (1.74%) transactions (IDR 18 trillion or USD 4.3 trillion (adjusted for PPP) in value), respectively.

**Evolution of Remittance Channels 2013-2017**



This reflects the growth of e-commerce and government regulations that have encouraged the use of e-money for a variety of public payments in Indonesia, such as toll road, commuter line, and bus.

### So What Does This All Mean?

Our research confirms that people use diverse sets of informal financial products, as they offer value. The benefits for the customers include:

- Trust and familiarity (almost everything works on trust!)
- Easy and hassle-free enrolment with limited documentation
- Doorstep delivery of service
- Product or process design that meets the needs of the community, such as flexible schedules, small value payments, easy withdrawals, receipts or passbooks as physical evidence, among others



Photo: Ghiyazuddin Mohammed

However, along with benefits come costs. These include:

- High cost of transaction in terms of interest rates, fees, and charges
- Risk of fraud and misappropriation of fund

Insights from our research have begun to answer compelling questions that digital finance service providers often grapple with, particularly for providers in the launch phase – which is largely the case in Indonesia.

- Considering the household financial ecosystem, which financial activities or streams should providers focus on?
- How can we seamlessly digitise these cash-streams without radically changing the financial behaviour of customers?
- How can we ensure that there is value to all the stakeholders – and more so for customers – in shifting from cash to cashless?

We have helped some of our partners in Indonesia develop relevant DFS products or concepts by doing a deep-dive into the communities and understanding their financial activities and needs. Pilots are currently underway with leading telecommunication companies, banks, and agent networks – and these show definite promise.

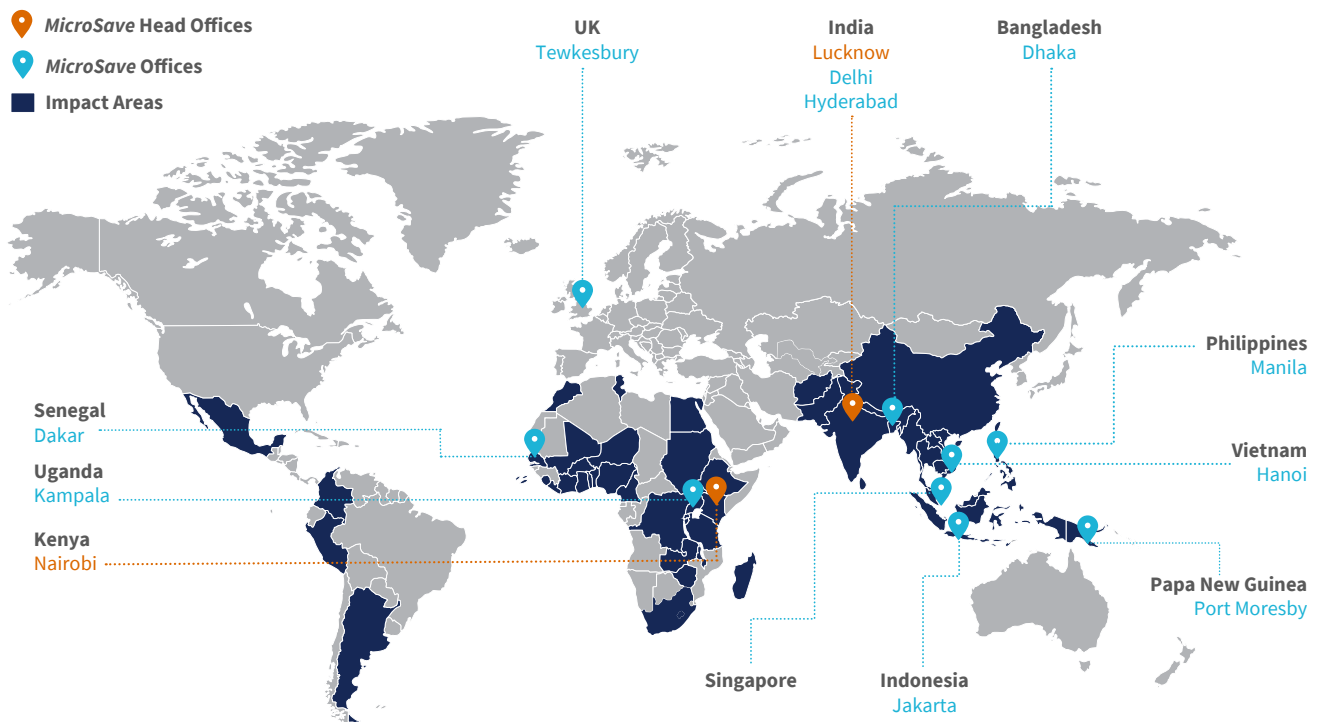
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<sup>1</sup> Research studies were conducted for individual clients and therefore not available in the public domain.

All conversion from IDR to USD are using Indonesia PPP rate (2017): IDR [4,186.361 per 1 USD](#)

## About *MicroSave*

*MicroSave* is an international financial inclusion consulting firm with nearly 20 years of experience, operating in eleven offices across Asia and Africa. Our mission is to strengthen the capacity of institutions to deliver market-led, scalable financial services for all. We guide policy, provide customised strategic advice and on the ground implementation support.



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