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The Unbanked: Evidence from Indonesia

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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 (Counis 2008).

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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 (Daly-Harris 2007). The measure of the potential market has been hard to pin down. Elizabeth Luriefeld, 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 (Luriefeld 2006, p. vi).

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