THE RELATIONSHIP BETWEEN DEBT-TAKING, CHARITY-GIVING, AND FINANCIAL EDUCATION ON FINANCIAL INCLUSION: THE CASE OF LOW-INCOME HOUSEHOLDS IN INDONESIA

BY

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ABSTRACT

This study aims to investigate the link between debt-taking, charity-giving and financial education and their contribution towards achieving financial inclusion. This research is important since it involves various stakeholders including low-income households, the government and authoritative bodies, industry players including financial planners, social institutions and educators, to objectives of this research are to explore the driving forces that influences the perception of low-income households regarding consecutive debt-taking behaviour in Indonesia, to explore the driving forces that influence the perception of low-income households regarding regular charity-giving behaviour in Indonesia, to investigate the influence of regular charity-giving on consecutive debt-taking behaviour and conversely the influence of consecutive debt-taking on regular charity-giving behavior, to assess the effects of financial education on consecutive debt-taking behaviour and regular charity-giving behavior, to assess the effect of the selection of financial institutions by low-income households on consecutive debt-taking behaviour and regular charity-giving behaviour in the extent of financial inclusion and to formulate a financial education strategy taking into account debt and charity considerations among low-income households in Indonesia which is significant in overcoming the problem of financial inclusion. Questionnaires were utilised as tools to gather data primarily from six areas in Indonesia: Aceh, Jabodetabek, Yogyakarta, East Borneo, Central Sulawesi and Eastern Nusa Tenggara through the purposive sampling technique. Exactly 1800 questionnaires were distributed. However, only 1780 were used in the analysis through the cluster sampling technique. The research questions in this study were answered by using three different statistical methods including logistic regression to achieve the first and second objectives, the structural equation modelling (SEM) to achieve third, fourth, and fifth objectives, and the analytic network process (ANP) to achieve sixth objective. Consecutive debt-taking behaviour is proven to affect financial ratios and lifestyle satisfaction. Level of education, income, financial education, financial institutions and charity institutions significantly indirectly affect consecutive debt-taking behaviour. In the context of regular charity-giving behaviour, those socioeconomic demography factors are indirectly affecting the behaviour, except income. Meanwhile, consecutive debt-taking influences regular charity-giving behaviour negatively by performing the behaviour of taking debt consecutively. Apparently, regular charity-giving affects consecutive debt-taking behaviour negatively through intention towards regular charity-giving behaviour. This study suggests that financial education for low-income households in Indonesia should be conducted in formal education institution by using government funds and collaborating with financial institutions. Experts, comprising of financial educators, public figures, financial planners, social finance activists and regulators, choose women as top priority in general to be educated on financial inclusion. Finally, behaviour on taking debts is perceived to be the main targeted behaviour in conducting financial education. This study mainly contributes to financial education, especially for low-income households in managing their money. The Islamic perspective on regular charity-giving that is expected to overcome households' financial difficulties is also demonstrated in this study, which is introduced as a shifting paradigm from a more taking to a more giving behaviour from low-income households. The models presented in this study are useful for users, especially future researchers, from around the world who are interested in the same research area.

ملخص البحث

تهدف هذه الدراسة إلى تحقيق كيفية الاندماج المالي، والتي يمكن أن تتعزز بين الأسر ذات الدخل المنخفض في إندونيسيا من خلال أخذ الدين، وخيرية العطاء، والتعليم المالي. على وجه التحديد، هذه الدراسة: (ا) تستكشف مفهوم الأسر ذات الدخل المنخفض فيما يتعلق بسلوكهم في أخذ الدين على التوالي، (ب) تحقق مفهوم سلوك الصدقة العادية، (ج) يصوغ استراتيجية التعليم المالي في اتخاذ الدين، وإعطاء اعتبارات الخيرية بين الأسر ذات الدخل المنخفض في إندونيسيا. هذا البحث مهم لأنه ينطوي على مختلف أصحاب المصلحة بما في ذلك الأسر ذات الدخل المنخفض نفسها والحكومة والتخطيط المالي، والمؤسسات الاجتماعية، والمربين. استخدمت الاستبيانات بوصفها أدوات لجمع البيانات في المقام الأول من أباء الأسر في ست مناطق في إندونيسيا: آتشيه، وجابوديتابيك، ويوجياكرتا، وشرق بورنيو، وسولاويسي الوسطى، ونوسا تينجارا الشرقية. وبالضبط تم توزيع ١٨٠٠ استبياتٍ، ومع ذلك، تم استخدام ١٧٨٠ استبياناً فقط في التحليل. تمت الإجابة عن أسئلة البحث في هذه الدراسة باستخدام ثلاث طرق إحصائية المختلفة بما في ذلك الانحدار اللوجستي، نمذجة المعادلة الهيكلية، وعملية شبكة التحليلية. ثبت أن التعليم المالي ذو علاقة كبرى مع العوامل الديموغرافية. هذه العلاقة تؤثر فى سلوك أخذ الدين باستمرار بشكل غير مباشر من خلال السيطرة السلوكية المتوقعة، والمعيار الشخصي بوصفهما وسطاء. ثبت المنصوص عليها متغير النتائج التي تتكون من النسب المالية ورضا نمط الحياة أن تتأثر سلوك أخذ الدين باستمرار. ثبت أيضاً أن التعليم المالي ذو علاقة كبرى مع التكوين الديموغرافي نحو سلوك الصدقة العادية. فهذا التكوين يؤثر في السلوك الصدقة العادية بشكل غير مباشر من خلال سيطرة السلوكية المحسوسة، وبنية السلوك. وفي الوقت نفسه، كان أخذ الدين على باستمرار يؤثر في السلوك الصدقة العادية سلبا. على ما يبدو، من خلال خيرية العطاء يؤثر في السلوك وأخذ الدين باستمرار أكثر سلبية من خلال النية بدلاً من أداء سلوك الصدقة العادية. ومع ذلك، ثبت التعليم المالي أنه يكون فهماً في كلا الأنموذجين. وبناءً عليه، هذه الدراسة تقترح أن التعليم المالي للأسر ذات الدخل المنخفض في إندونيسيا ينبغي أن يتمّ في المؤسسات التعليمية الرسمية باستخدام ميزانية الحكومة، وكذلك بالتعاون مع المؤسسات المالية للتوعية بهذا الأمر. وكذلك اختار الخبراء النساء من الأسر ذات الدخل المنخفض عموماً من أجل تعليمهن المسائل المالية. وأخيرا، السلوك على أخذ الدين ينظر إليه على أنه السلوك المستهدف الرئيسي في إدارة التعليم المالي.

APPROVAL PAGE

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DECLARATION

I hereby declare that this thesis is the result of my own investigation, except where otherwise stated. I also declare that it has not been previously or concurrently submitted as a whole for any other degrees at IIUM or other institutions.

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LIST OF ABBREVIATIONS

ANP	Analytic Network Process
BAZNAS	Badan Amil *Zakāt* Nasional (National Board of *Zakāt*)
BI	Bank Indonesia
BPS	Badan Pusat Statistik (Statistics Indonesia)
BKKBN	Badan Koordinasi Keluarga Berencana Nasional (National Coordinating Agency for Family Planning Programme)
CFI	Comparative Fit Index
GFI	Good-of-Fit Index
MFI	Microfinance institutions
NFI	Normed Fit Index
OJK	Otoritas Jasa Keuangan (Financial Service Authority)
RMSEA	Root Mean Square Error of Approximation
SEM	Structural Equation Modelling
SLF	Standardized Loading Factor
SPF	Social Production Function
SRMR	Standardised Root Mean Residual
TPB	Theory of Planned Behaviour

CHAPTER ONE

INTRODUCTION

1.1 BACKGROUND OF STUDY

Financial inclusion means that individuals and businesses have access to financial products and services to meet their needs in manner that is affordable, useful and delivered in a responsible and sustainable way (World Bank, 2017 – updated). Financial inclusion agenda is aimed at improving people's ability to deal with risk, and enabling them to manage money that can be spent for current and future consumption. It should also allow them to make financial gain by investing it; and to give benefit to both the owner and the society (Driver, 2015). It is also a matter of providing customers who are financially excluded especially the low-income group with access to formal financial services through affordable, transparent, and regulated schemes (Bank Indonesia, 2015).

The issue of financial inclusion emerged globally prior to the 2008 global financial crisis; it has become the main agenda in many countries after the crisis, especially in non-developed countries. The agenda serves mainly the population at the bottom of the economic pyramid (BOP) that includes low-income people mostly staying in remote areas such as disabled people, undocumented labourers, and villagers (Bank Indonesia, 2015).

The G20 Summit in 2010 pledged to support financial inclusion as an effort to reduce poverty in the world as it also an enabler for 7 of the 17 Sustainable Development Goals (SDGs) (World Bank, 2017). The Association of South East Asian Nations (ASEAN) also integrated this programme into its 2015 Economic

Community Blueprint. World leaders at the United Nations (UN) developed the poverty eradication agenda into the eight Millennium Development Goals (MDGs) of 2000. The MDGs targeted to reduce poverty by half, and this target had been achieved in 2010. By 2015, the number of people who live under extreme poverty declined by more than half (United Nations, 2015). Even though financial inclusion has more than doubled in most developing countries as reported by the World Bank[1], there is still a lot more that needs to be done.

As one of the developing countries, Indonesia implemented a multi-pronged strategy comprising pro-growth, pro-job and pro-poor policies in 2004, and pro-environment, which was added in 2007 (Dhewanthi, 2012). This means that the government attempted to boost the economic growth, and simultaneously create employment opportunities and reduce poverty and inequality among the Indonesian people. The quality of environment also needed to be maintained. The financial inclusion programme is considered to be one of the most effective ways to realize this strategy. However, Tambunan (2015) argues that inadequacies in technology, skills and infrastructure remain the major constraints for the financial inclusion programme in Indonesia.

Financial inclusion has remained low in Indonesia. As of 2015, 78% of adults among the poorest 40% in Indonesia do not have a bank account (Kendall & Klapper, 2015). Based on a survey done by the World Bank in 2010, the Ministry of Finance of the Republic of Indonesia (2013) disclosed that only 49% of the Indonesian people had access to formal banking institutions and another 3% to other formal (non-

[1] Infographic: Global Findex 2014 – Gender and Income. Retrieved on October 8th, 2015, from: http://www.worldbank.org/en/programmes/globalfindex/infographics/infographic-global-findex-2014-gender-income

banking) financial institutions. This means that approximately 48% of the country's citizens had no access to formal financial institutions as of the time of the survey.

Low-income households need funds mainly to fulfil their basic needs as well as to finance various economic activities in order to make ends meet. Despite their genuine need for credit, the low-income households' access to formal finance is indeed very limited, if not impossible. Various efforts have been undertaken by the Indonesian government to overcome this problem; these include providing microfinance services through financial institutions in order to achieve the financial inclusion agenda.

For example, the government has launched *Kredit Usaha Rakyat* (KUR) or People's Business Credit programme through various banking institutions in Indonesia. This is an initiative to provide greater financial access especially for micro and small-scale enterprises. This programme engages banking institutions, financing companies, and underwriting companies (guarantor) as distributors of the KUR fund. The program is supervised by various ministries under the coordination of the Ministry of the Economy, Bank Indonesia and *Otoritas Jasa Keuangan* (OJK – Financial Services Authority).

The financial inclusion programme would usually require high operational costs on account of which many financial institutions consider it as not commercially viable to participate in. The high costs are levied on the customers, which made the financing/credit offered by the microfinance institutions (MFIs) more expensive compared to that offered by commercial financial institutions such as banks (Cull, Demirgüç-Kunt, & Morduch, 2009; Hamada, 2010; Rosenberg, Gonzalez, & Narain, 2009). In the case of Indonesia, although the operational cost is high, micro lending rate is still lower than commercial lending rate including credit card rate. This is despite the potential offered by the high transaction velocity of credit card and economies of scale, which can be used to overcome the operating costs issue (Rosenberg et al., 2009). Volume of financing for merchandises, which utilised commercial financing mode, appeared to be less than microcredit volumes. Furthermore, the commercial financing mode requires collateral while microcredit is generally uncollateralised. Therefore, the rate of microcredit in average is lower than consumer rates. This lower microcredit rate in general happened in institutions such as banks that offered both micro lending and commercial lending products. The case was not the same with those financial institutions that offered micro lending only, such as MFIs, which also offered high interest rate. Furthermore, high interest rates lead to the possibility of financing/credit default (Rosenberg et al., 2009). In the case of micro lending, group lending system is introduced to minimise default risk (Cull et al., 2009). While the loan repayment pattern may still not be perfect, the risk of default can be contained.

Sustainability is another issue when dealing with financial inclusion through the MFIs. Most of the MFIs that get help from subsidies tend to charge unsustainably low rates despite the high cost, as long as some donors or government give subsidy to cover the losses. The fact that unsustainable MFIs charge lower than sustainable MFIs lead to a paradoxical situation where annual loan losses for unsustainable MFIs are about five percent (Rosenberg et al., 2009). They can no longer avail the subsidies since they end up as unsustainable institutions.

Financial inclusion also involves issues related with low-income households' limited access to formal institutions. Limited access to formal financial institutions provides an opportunity for informal money lending institutions such as payday lenders or entities called "rentenir" or "loan shark" in Indonesian language to make