Financial Inclusion Role of Sharia Banking to Strengthening Financial Stability

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ABSTRACT

The growth of account ownership and financing of MSMEs helps banks to manage the financial inclusion for the community. This study examines the relationship of financial inclusion of Sharia Banking and financial stability. Furthermore, the study describes financial inclusion proxied by the outstanding ratio of financing of MSME, and the financial stability is measured by Gross Domestic Product growth (GDP's growth). Samples include financial data of 5 sharia banks during the study period from 2011 to 2016 were analyzed using panel regression test. The result of study finds that financial inclusion as one determinant for strengthening financial stability which MSMEs financing of sharia banking in Indonesia has impact to GDP's.

Keywords: Financial inclusion, Financial Stability, Economic Growth, Sharia Banking

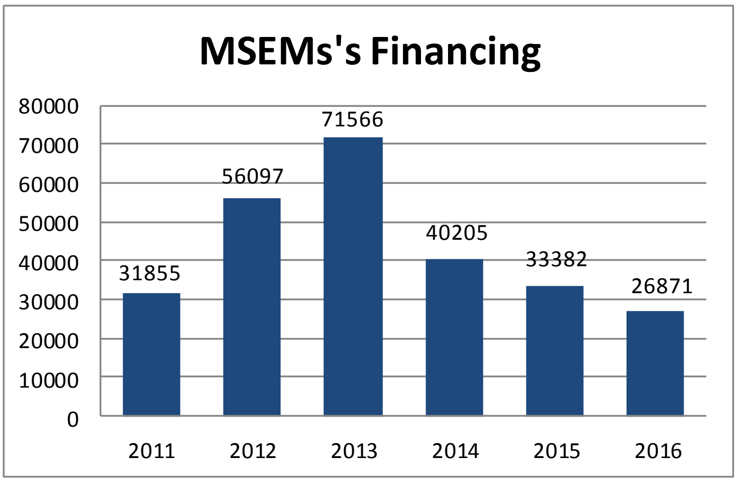
INTRODUCTION

Financial inclusion is an important issue of economic since unstable community income relates to macroeconomic environment turmoil then can impact to financial stability system. The community knowledge of financial institutions and access to financial institutions determines their growth income (Findex WorldBank, 2011). Therefore, a balance between financial inclusion and financial stability is essential.

Financial stability system has main role for strengthening economic growth through good financial intermediation function. Public distrust of financial system will make investor's fund attracted then liquidity difficulties occured. In context of Indonesia, one of goverment's policies to improve economic development is financial inclusion that allows the community to access financial services well which create income equity and overcome proverty. One of financial system stability measured by economic growth that Gross National Product growth as its proxy (GDP's growth).

Bank's financing as one of the financial services is form of financial inclusion efforted by Indonesia Central Bank for improving the efficiency of financial system through the development of Micro Small and Medium Entreprise (MSMEs). Financial inclusion is needed to extend the reach of the banking network to the entire community, so that the results will be able to reduce intermediary costs and improve the community welfare. The greater access to bank deposits can optimize deposit funding in banking then support financial stability (Han and Melekcy 2013).

Chart 1: MSEMs Financing (Million)

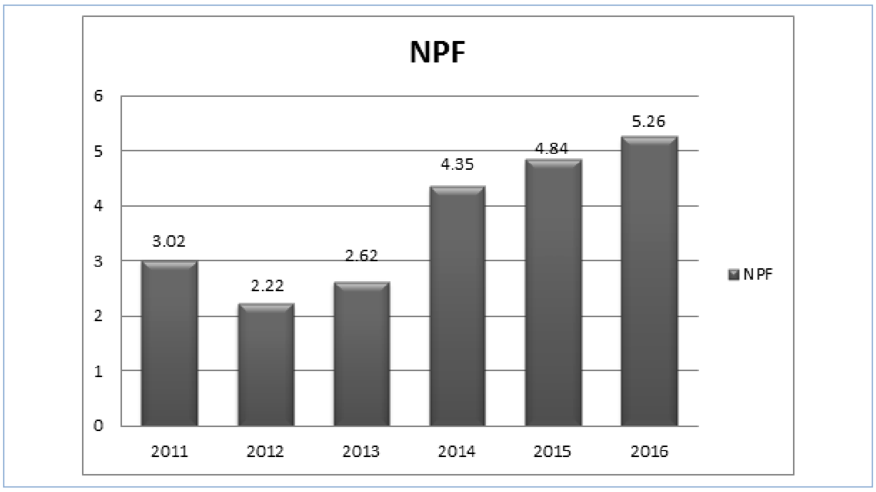


Source: Indonesis financial serices authority(OJK), 2011-2016

In other side, if there is problem financing on banking, it give difficulties liquidity for MSMEs and means a serious problem of financial system stability. The value of GDP can be decrease if the financing is at a high non-current level. Therefore, Non Performance Financing (NPF) in Sharia Banking can be one determinant of sharia inclusion financial.

For Indonesia, data from the Financial Services Authority (OJK), the surge in non-performing financing (NPF) in sharia banking has exceeded the maximum 5% limit of 5.26%.

Chart 2: NPF% of Sharia Commercial Banks

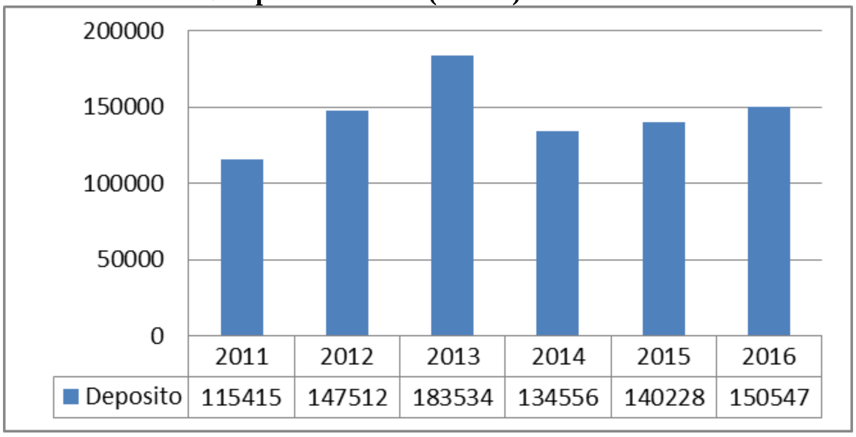


Source: www.ojk.go.id (Statistics of Sharia Banking 2011-2016)

Furthermore, the non-performing financing ratio (NPF) of sharia banking is still quite high in the first quarter of 2017 is still quite high and reached 4.50% in July 2017 which is said this value is greater than conventional bank NPLs. This is certainly a warning for the perpetrators of Sharia banks in maintaining the quality of financing. Financing problems are too big can lead to instability of the financial system.

Financing as one of the financial services a form of financial inclusion is done in hope of strengthening Indonesia's financial industry to address potential risks that may affect the stability of the financial system. Communities are expected to take advantage of formal financial services rather than informal financial services.

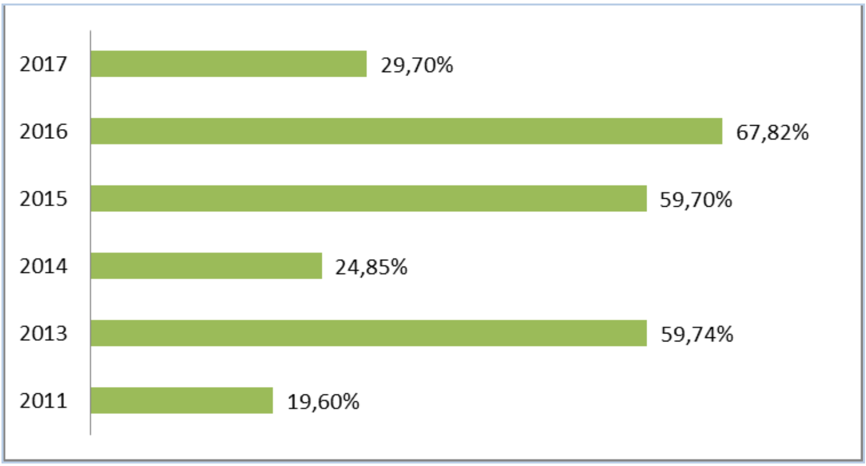
Chart 3: Deposit of Sharia (Billion) Commercial Bank



Source: www.ojk.go.id (Statistics of Sharia Banking 2014-2016)

Despite an increase from 2011, however, financial inclusion in Indonesia is still quite low. The number of Indonesians who do not have access to finance (unbanked) is still very large about 60% of the total population of Indonesia.

Chart 4: Value of Indonesian Financial Inclusion Index



Source: National Survey of Literacy and Financial Inclusion

The low level of financial inclusion has left many people with no financial access. This phenomenon is not only happening in Indonesia but also around the world. When compared to the value of Indonesia's Financial Inclusion Index that Indonesia has 3.56% growth rate has the lowest index of financial inclusion among the seven countries in Asia due to the access and use of relatively low financial services, high barriers, and people who have low income.

Several previous studies have shown the role of financial inclusion to financial stability (Kunt, et.al, 2014). Financial inclusion have positive contibution to stability of bank assets in diversification form to reduce risk, increase stability deposit base, reducing liquidity risk; and increase monetary policy transmission. Conversely inclusion may play a negative role by raising the erosion of credit standards such sub prime (Khan 2011).

This study analyzes the impact of financial inclusion to financial syatem stability in sharia banks in Indonesia within the period of 2011 - 2016 by using outstanding financing ratio of Sharia banks to MSMEs as a proxy of financial inclusion. It is based on the argument that sharia banking becomes one option to accommodate the financing of MSMEs. As for the financial stability of sharia banking is measured by GDP's growth as research Mulau et al (2018). Therefore, the Gross Domestic Product as measurement of financial system stability based on reason that its growth determined by level of liquidity difficulties from non current financing.

LITERATURE REVIEW

Financial Inclusion

The term inclusive financial inclusion became a trend in post-crisis 2008 mainly based on the impact of the crisis on the bottom of the pyramid (low income, irregular, remote, disabled, unlicensed workers, and marginalized communities) which is generally unbanked which is recorded very high outside developed countries.

In sharia perspective, the inclusion of sharia finance can be defined as an effort to increase public accessibility to sharia financial institutions so that the community can manage and distribute financial resources according to sharia principles. It is a means to encourage higher involvement of the community on sharia financial practices.

Khan (2011) states that financial inclusion is the process of ensuring access to timely and adequate financial and credit services which are needed by vulnerable groups such as the weak and low-income groups at affordable costs. This is primarily an access to bank accounts supported by insurance deposits, access to affordable credit and payment systems. Financial inclusion aims to attract populations "*who do not have access to finance*" into formal financial systems so that they have the opportunity to access financial services from savings, payments and transfer to credit and insurance (Hannig and Jasen, 2010).

The positive effect of financial inclusion for the lowest level of society that they can have savings recorded in financial institutions, access financing from financial institutions, and increase the ability of softskill and hardskill. In economic development in Indonesia, banks play a big role to be the driving force financial inclusion activities. From a macro perspective, this activity is expected to support more inclusive and sustainable economic growth, and can benefit the welfare of the people. Furthermore, financial inclusion is expected to support the financial stability of the basic foundation for solid economic development.

In the Indonesian context, there are several measurements of financial inclusion (BI, 2017) in terms of Access which measures the ability to use formal financial services such as the number of offices and ATMs, in terms of usage that measures the actual use of financial products and services such as the number of deposits (Saving, Giro) and the amount of credit / financing, as well as Quality aspects that measure the availability of attributes of financial products and services have met customer needs such as affordability, transparency, convenience, fair treatment, consumer protection, financial education, indebteness and other options (choice).

This study emphasizes two dimension of financial inclusion in sharia banks are bank usage and bank availability of financial product atrributes for MSMEs so that the proxies of financial inclusion is measured by deposits (Prochniak and Wasiak, 2017) and financing MSMEs's that follow the previous research of Mulau et al (2018).

Financial System Stability

Financial System Stability is a condition of a strong financial system and resistant to economic disturbances so that it remains able to perform the function of financial intermediation in order to function properly and support economic growth. Financial stability refers to the smooting of financial market and institution withour serious disruptions (Singala and Asher, 2008). Financial stability scope include economic's mechanisme.

The instability of the financial system can be triggered by a variety of causes and turmoil. This is generally a combination of market failure, both due to structural factors and behavior. Market failure itself can be sourced from external (international) and internal (domestic). Risks that often accompany activities in the financial system include credit, liquidity, market and operational.

The increasing trend of globalization of financial sector supported by technological developments causes the financial system to become more integrated without time lag and borders. It makes financial product innovations are increasingly dynamic and diverse with increasing complexity. These changes are sources increasing financial system instability and can lead to more difficulties having economic stability.

This 1998 crisis proves that financial system stability is a very important aspect in shaping and maintaining a sustainable economy. Unstable financial systems tend to be vulnerable to shocks, thereby disrupting the rotations of the economy. Financial stability is important in the economic system because it will form a good market, control and allocation of various existing resources can be optimally conditioned. The stability of the financial system has a direct impact on the banking world where a stable financial system will enable banks to perform their functions as collectors and distributors of public funds maximally which will also affect the real sector. Instability of the financial system has a considerable influence on the occurrence of monetary crisis, so it takes a maximum effort in maintaining the stability of the financial system.

Financial stability can be measured through capital adequacy, asset quality, financial system management, revenues and profits, liquidity, sensitivity to market risk, economic growth, and so on. In macro terms, it can be seen through aggregate growth rates, country deficits, and the adequacy of foreign exchange reserves, the amount of foreign loans, inflation volatility, interest rates, and exchange rates. While in micro-prudential (aggregate), financial system stability is reflected from the aggregate capital ratio, NPL, DER, LDR, ROA, ROE, exchange rate risk, and so on.

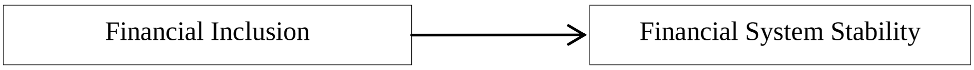
This study focuses on the financial system stability in Indonesia and use macro aprroch for measure it, therefore economic growth measured by Gross Domestic Product growth (GDP's growth) according Musau et al. (2018)[4] GDP's growth defined as growth of total value of goods and services produced in economy in one financial year. It based on argument that the increasing of GDP's growth means reducing inequalities and improving economic opportunity.

The Role of Financial Inclusion in Financial Stability

Kunt et al. (2013) state that sharia banking has great potential in implementing financial inclusion to maintain financial system stabilit. Its role is very important for the economic development. The financial services offered by Islamic institutions such sharia banks are expected to strengthing financial stability (Rashid et al 2017). This is supported by other some liteartures such Bourkhis and Nabi (2013) and also Ahmed (2010) that Sharia banks have been least impacted by financial crisis, and having role in stabilizing the economies. The role of Islamic or Sharia banking in promoting financial system stability is an important issue. There are some evidence that Islamic or Sharia banks contribute positively to the financial stability of banking sector and in turn, to the economy (Rashid et al, 2017; Borkhis & Nabi, 2013).

Indonesia is a country with medium category inclusion (Sanjaya, 2015) and requires increased inclusiveness through accessibility, usage, and availability. The availability of financial services and the ease of accessing financial services is an important aspect to enhance the role of the financial sector. If access to financial services does not run smoothly will be a financial risk. Financial risk, in this case, is related to financial inclusion reflected by the amount of deposit and outstanding loan. Financial inclusion also determines the bank's ability to provide financing services and optimize its management. If the financial inclusion does not run smoothly, it will result in impaired financial system stability. Below the framework of this research is as follows:

Figure 1: Research's Framework



Source: Authors, 2018

Deposits and the financing portions disbursed by financial institutions are illustrations of financial inclusion. This is done so that all levels of society, especially the middle to lower community can access banking easily. In general, middle to low-income people usually work in the informal sector such as MSMEs, so that when the distribution of financing in the sector increased it can be used as a picture of increased financial inclusion. Ease of banking access such as MSMEs sector financing able to develop their business and can generate income to repay the loan. Furthermore, accumulately it can strengthening economic growth ooportunity.

This study is in line with research conducted by Prochniak and Wasiak (2017) also find that bank financing as one of financial inclusion form can affect financial system stability. Therefore, this study forms the following hypothesis:
H1: Sharia bank's deposit have effect to improving GDP's growth
H2: Sharia MSMEs's financing have effect to improving GDP's growth

METHODOLOGY

Population, Sample, and Data

The data used from OJK, Central Bank, and national country economy's data. The population of this research is Indonesian Sharia Banks. The samples determined by purposive sampling is sharia bank with the completeness of data needed during the period of study 2011-2016. Therefore, the samples of bank having contained MSMEs's financing are Bank Muamalat, Bank Victoria Sharia, Sharia Mandiri, BCA Sharia, and BTPN Sharia.

Definition and Measurement of Variables
The dependent variables of this research are financial stability and independent variable in the form of financial inclusion. In detail, the following table operations:

Table 1: Measurement of Variables

Dependent Variable	Measurement
Financial Stability	Gross Domestic Product Growth (GDP's growth)
Independent Variable	
Outstanding Loan	Sharia MSMEs's financing

Sources: Authors, 2018

Data analysis method
The method of analysis used in this research is descriptive and quantitative and data analyzed using panel regression test with eviews.

EMPIRICAL RESULTS

Descriptively, it is known that the largest portion of MSME financing is in Bank Mandiri and the highest GDP's growth occurs in 2011. The following is a general overview of MSMEs's financing in sharia banking Indonesia and the value of GDP's growth in 2011-2016:

Table 2: Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
MSMEs's financing	30	2.46E+12	6.72E+12	3.67E+12	1.59E+12
Deposito	30	1.154E+11	1.84E+11	1.45E+11	2.25E+10
GDP's growth	30	.049	.062	.0545	.005244

Source: Authors, 2018

After the regression test with 10% significance using eviews, it showed that the deposits as proxy of financial inclusion which has no effect to financial system stability. It means H1 is rejected and this is contrast with Musau et al (2018) that find amount of bank account effects to financial stability. Furthermore, this study find that financing of MSMEs as a proxy for financial inclusion has positive effect on GDP's growth as measurement of financial system stability. It is in line with finding of Prochiak and Wasiak (2017)

Table 3: Partial Significant Test (t- Test)

	Coeffisient	Std. Error	t-Statistic	Prob.
C	.059780	.00644	3.1264	.0000
Deposits	-.035643	.01401	4.0608	.4630
MSEMs's Financing	5.04E-16	2.94E-16	1.7109	.1005*

* denote significance at 10% levels, respectively (two-tailed test).

CONCLUSION

Hypothesis testing result shows financial inclusion in proxies with deposits (X1) have no effect on GDP's growth as proxy of the financial stability while proxy financing of MSMEs (X2) has positive effect. This indicates that the high or low amount of bank account from sharia banks not determine improving GDP's growth. This is possible because the increase in sharia bank account not mean increasing fund using in production sector.

The other proxy of financial inclusion is MSMEs financing impact to financial stability through GDP's growth opportunity. It support the argument that financing in production sector can produce good and services which strengthening economic development. This finding is in line with study of Khan's (2011) also Prochniak and Waskita (2017) that financial inclusion may also have a positive impact as well as a negative impact on financial stability. Positive impacts can be attributed to financial inclusion may increase the diversification of banking assets, the stability of savings bases, and increase monetary policy transmission. Negative impacts resulted from financial inclusion may decrease credit standards because financial institutions are trying to reach unbankable lower societies by lowering loan terms, and can increase reputational bank risk. In order to improve the financial services facilities of some countries that lower the standard of establishment of a financial institution for rural areas, and may cause instability due to inadequate and inadequate regulation of Microfinance institutions.

The coefficient of determination of the relationship of financial inclusion and financial stability of 0.027 becomes the record for the government to optimize the financial inclusion program of GDP per capita rate, and MSMEs's banking credit.

The limitations of this study which use only the dimension of usage and availability as a proxy for financial inclusion, should encourage further research to include other indicators as established by Bank Indonesia, namely the dimensions of accessibility. Similarly, with the limited use of a single proxy as an indicator of financial stability, the GDP''s growth in this study, the next researcher should combine several other macro and micro measures of financial system stability to better illustrate the role of financial inclusion for strengthening financial stability.

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