

# Branchless Banking as a Disruptive Innovation in Indonesia

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## ABSTRACT

Branchless Banking is part of the financial inclusion program, which provides financial services performed outside bank branches using information and communication technology, also non-bank retail agents. Branchless Banking aims to provide financial products that are simple, easy to understand and in accordance with needs, for people who have not been reached by financial services. It is expected to reinforce community economic activities so as to encourage economic growth and equitable development among regions in Indonesia, especially between villages and cities. The purpose of this research is to find out whether Branchless banking services in Indonesia can be said as Disruptive Innovation. Based on the concept and also the success of other countries, Branchless banking service is a Disruptive Innovation, because it is targeting a new market, namely the lower classes that have not been reached by banks (unbanked) with enormous potential in Indonesia; The services are offered in the form of banking products suited to the needs of the market target which are low cost, easy to use for its customers and use information technology solutions, in this case cellular phones, as a tool for conducting transactions.

**Keywords:** *Branchless Banking, Disruptive Innovation*

## 1. INTRODUCTION

The development of e-commerce businesses in the industries of banking was shortly elephantiasis in order to follow the trend of digital transactions, including in the case of cashless payment, branchless banking, as well as the services of financial and banking are internet based (Chu et al., 2007; Kamaruzaman and Hanrich, 2010; Kumar and Petersen, 2006; Lambertini and Shy, 2002). Bank Indonesia data (2016) recorded, total e-money transactions in 2015 jumped sharply to Rp 5.2 trillion from Rp 4.3 trillion in 2014. Therefore, the banking industry is one of the business sectors required to carry out digital transformation. If the bank does not utilize technology to its full potential, it risks losing 30% of the total customers (Accenture, 2015). So we need a strategic government policy that plays a role in developing the digital ecosystem.

Technological innovation has negative impact on the development of conventional business, technological innovation has led to a conventional business disrupted or closed down (Cuesta et al., 2015; Ebert and Duarte, 2018). This condition is called Disruptive Innovation or is interpreted as a disruptive innovation. "Disruptive innovation" is a global phenomenon that cannot be stopped (Christensen et al., 2016; Markides, 2006; Schmidt and Druehl, 2008).

As a sovereign country, the government through the Financial Services Authority (OJK) and Bank Indonesia (BI), needs to get around this invasion so that long-term public interests are still given priority. The Government has launched a National Inclusive Financial Strategy to increase Indonesia's financial inclusion by creating Digital Financial Services (LKD) and Officeless Financial Services programs in the framework of Inclusive

Finance (Laku Pandai) or commonly known as branchless banking .

Branchless banking is a financial service that uses digital technology facilities, such as cellular phones and EDC (Electronic Data Capture) machines, through third parties (agents). Services offered through branchless banking include basic saving accounts (BSA), microcredit, and microinsurance. Branchless banking is aimed at people who have not been touched by banking. Through branchless banking, people who have not been touched by banks can enjoy financial services in the form of depositing funds through BSA, making installment and bill payments, purchasing electricity tokens, pulses, etc., and sending funds.

## **2. LITERATURE REVIEW**

### **2.1 Branchless Banking**

In the Preliminary Study of Bank Indonesia (2011), it is stated that Branchless Banking in general is a strategy to serve the public for financial services without physically relying on bank branches or outsourcing the transaction process of banking services to third parties. This strategy is a complement to the existing office network to reach wider consumers efficiently. According to CGAP (Consultative Group to Assist the Poor) the definition of Branchless Banking as the provision of financial services performed outside bank branch offices using information and communication technology and non-bank retail agents (Lyman et al. 2006).

Branchless Banking is a financial service outside the conventional Bank branch using agents or other third party intermediaries as the main interface with customers, and relies on technologies such as point-of-sale (POS) card readers and cellphones to send transaction details. Utilizing technology and agents can save administrative costs and increase public convenience. Although using the term "Banking", Branchless Banking is not only limited to Bank services; including broad policies of financial services that are often provided by non-banks. Branchless Banking acts as a gateway for people who have never been involved with financial institutions. The presence of this innovation provides greater access to the public regarding financial services in the formal sector. That is because through agents, the Bank can effectively connect unbanked people to the entire economy, placing the poor in a wider network so that they have the opportunity to get a better life. In addition, Branchless Banking makes it easy for

stakeholders such as banking institutions, nonbank financial institutions, and the government to reach the poor with micro payments ( Claire Alexandre , 2011)

Branchless Banking can offer basic banking services to customers with minimal fees , more cost-effective than to serve customers through conventional banks. Broadly speaking, Branchless Banking helps overcome the two biggest problems of financial access, namely the roll-out costs due to physical presence and the cost of handling transactions with low value ( Gautam Ivatury and Ignacio Mas, 2008 ) . All of this can be done through a network of agents or third parties to make cash transactions and open accounts so that the poor can make transactions online and for people who have mobile phones can make online transactions via mobile phones. H al this will result in cost reductions by the sharp and can create opportunities increasing the share of people with access to formal financing significantly, especially in rural areas, where many poor people live.

The Branchless Banking model implemented in Brazil uses retail agents such as supermarkets, pharmacies, and other retail agents. Using this model, it only costs 0.5% of the cost of establishing a branch office (Khatab 2012). Besides Brazil, the other most popular countries applying Branchless Banking include India, South Africa, the Philippines and Kenya.

### **2.2 Financial Inclusion**

Financial Inclusion as providing broad access to financial services without barriers of price and non-price in its use ( Demirguc-Kunt and Klapper, 2012). Bank Indonesia (2014) defines financial inclusion as all efforts aimed at eliminating all forms of price and non-price barriers to public access to financial services.

Indicators that can be used as a measure of a country's financial inclusion are availability / access to measure the ability to use formal financial services in terms of physical affordability and price, use to measure the ability to use actual financial products and services (including regularity, frequency and duration of use), quality to measure whether the attributes of financial products and services meet customer needs, and welfare to measure the impact of financial services on the level of life of service users.

That the concept of access to financial services with the use of financial services is a different concept (Beck et al. 2006) states Economic actors may have access to financial services but do not want to use them. This can be due to socio-cultural reasons or the

proportionate fees that are too high to use financial services. Therefore, Beck et al. distinguishes two concepts related to the reach of the financial sector, namely (i) the existence of access and possibility in using financial services, and (ii) the use of actual financial services means that actually use financial services.

Financial inclusion is a process to guarantee easy access, availability and use of the formal financial system by all economic actors. Financial inclusion provides financial services such as savings, credit, insurance, and payments at a price level that can be paid by all economic actors, especially low-income economic actors (Okaro, 2016). According to the Reserve Bank of India (2016) financial inclusion is a process to guarantee access to financial products and services needed by every part of the community both the general public or vulnerable people such as those affected

Based on data from Bank Indonesia, the obstacles faced in expanding financial inclusion in general can be grouped into two, namely the constraints faced by the public and banking financial institutions. For the community, problems faced such as the absence of a bank in the vicinity of their residence or take a long time to get to the nearest branch office, in addition to that the level of understanding of financial management is still lacking. The problem faced by banking financial institutions is the limited area of coverage in expanding office networks. On the other hand, to add office networks in remote areas, banks are faced with the issue of relatively expensive establishment costs. So Branchless Banking is expected to bridge these obstacles to bring banking services to the public, especially those far from the bank office.

### **2.3 Disruptive Innovation**

The term "disruption" was coined by 1997 Clayton Christensen, *The Innovator's Dilemma*. In it, Christensen introduces the idea of "disruptive innovation" in the business world. He uses this expression as a way to think of successful companies that not only meet the needs of today's customers, but anticipate their needs in the future. His theory explains how small companies with minimal resources are able to enter the market and replace established systems. Disruptive innovation (disruptive innovation) is an innovation that helps create new markets, disrupt or damage existing markets, and ultimately replace the previous technology. Disruptive innovation develops a product or service in a way that is unpredictable to the market,

generally by creating different types of consumers in new markets and lowering prices in old markets.

The behavior patterns of people affected by technological developments will change in finding information and accessing existing technology through easier access to technology by providing services that are easier and cheaper to make each individual or company use technology as a tool in achieving their respective goals. . Sophisticated technological development provides innovations that are newer, creative and cheaper. With new innovations, community activities will be more effective and efficient. But on the other hand, new innovations that appear can disrupt the old market players (incumbent). This term is referred to as disruptive innovation.

(Hamid, 2017) said that when compared to current market competition in modern times, technology has a very high role, especially in companies that have a high level of establishment and feel leading the industry, often too much confidence turns a blind eye to innovation by competitors or newcomers. The emergence of new technology will eventually be liked and accepted by consumers so that it will be able to replace the previous technology. This is what is meant by innovation that replaces and more easily is called a disturbing innovation. Currently, almost all industrial sectors in Indonesia are offered new innovations that can change the business models of each industry to be more effective and efficient, one of which is the financial sector. The financial sector is a sector that has a stake in national economic growth. A new technological innovation that is developing in the financial sector is known as financial technology. Financial technology (fintech) is the maximum utilization of technology in improving financial services. The concept of fintech is to use software, internet and communication today. Fintech is worked on by startup companies that provide convenience in transactions, especially financial transactions, and challenges conventional companies that still lack technology. The presence of fintech also has its own place for its users. This rapid increase shows the existence of technological systems that provide services that have advantages compared to existing systems.

Fintech comes with various types of businesses, including: Payment Channel System, Peer to Peer (P2P) Lending, Crowdfunding, and others. The most dominant fintech business performer in Indonesia today is the type of payment. Payment system is an electronic service that replaces currency and demand deposits as a means of payment, for example e-money cards and bitcoin. The current

fintech phenomenon in Indonesia is a warning to conventional institutions included in the financial sector in terms of their duties and responsibilities and future job prospects. It appears that fintech can provide convenience and lower prices compared to the services of existing institutions. This is also accompanied by a millennial generation that is fast in accepting changes and is supported by regulations that are difficult to change from conventional financial institutions that encourage fintech growth. of course, with this situation, Indonesia which is full of regulations must be able to take action. In this case, those who take a stand and act are the Financial Services Authority (OJK) to be able to respond to existing developments by looking at any aspect. All provisions or regulations provide direction and guidance in addressing any existing developments including fintech.

Some previous studies such as those conducted by Santoso (2015); Yesi and Kasmianti (2013); and Mustada (2015), analyzing opportunities and challenges in implementing branchless banking and indicators of banking readiness in implementing branchless banking.

Some countries have successfully implemented the branchless banking model with the support of communication technology, to achieve financial inclusion. Among them are Mexico, India (Hegde & Kotian, 2016), Kenya (Kamana, 2014), Africa (Collings, 2011), and Tanzania (Nyamtiga, et.al., 2013). The following is a table of branchless banking applications in several countries (Yudiana FE, 2018 ):

Table 1. Financial Inclusion and Branchless Banking Development in several countries

Country	Sectors involved	Strategy implementation
Mexico	Private bank,	- Private banks offer financial services - micro to unbanked people
	ICT provider, Financial institutions, public sector	- Holding CEMEX as a non-financial private sector to provide services in the form of savings and credit for the poor and unbanked.
India	- public sector, - Cooperative, - Microfinance institutions,	- The public sector provides the entire framework, financial

Country	Sectors involved	Strategy implementation
	- ICT.	inclusion policies regulated and issued by the central bank
Kenya and African Countries (South Africa, Ghana, Nigeria, North Africa)	- Bank, - ICT provider, - public sector, - private company, - financial and non-financial institutions - finance	- Microfinance and bank services promote financial inclusion - Promoting financial inclusion to entrepreneurs & unbanked - Develop information technology to support such as mobile phones, prepaid cards and electronic stores

Source : several previous studies, (Fetria Eka Yudiana, 2018)

**3. METHOD**

The research method in this research is in the form of a literature study or literature study that contains theories that are relevant to research problems. This section reviews the concepts and theories used based on the available literature, especially from articles published in various scientific journals. Literature study serves to build concepts or theories that form the basis of studies in research (Sujarweni, 2014). Which are carried out to solve a problem which is basically based on critical and in-depth study of relevant library materials.

**4. RESULT AND DISCUSSION**

In Indonesia, the implementation of branchless banking is still relatively new, so research on branchless banking is still very limited. Santoso and Ahmad (2016) concluded that developing a branchless banking model must consider social values, religious values, community trust, community, local wisdom and culture. So the recommended branchless banking implementation model is community based by involving several stakeholders.

The implementation of the branchless banking model is determined by the government through the

Financial Services Authority Regulation (POJK) No.19/POJK.03.2014. This is as one of the government's programs to realize financial inclusion. This moment should be the basis for banks to explore new market segments (unbanked people) and increase market share.

According to Bank Indonesia's analysis (2017) there are several factors that cause people to become unbanked, in terms of supply (service providers) and demand (community), namely price barrier (expensive), information barrier (not knowing), design product barrier (product design) and channel barrier (appropriate means).

Inclusive finance has the following objectives: (1) Improving economic efficiency; (2) Supporting financial system stability; (3) Reducing shadow banking or irresponsible finance; (4) Supporting financial market deepening; (5) Potential new markets for banks; (6) Improving Indonesia's Human Development Index (HDI); (7) Contribute positively to economic and sustainable growth; (8) Reducing inequality and low income trap rigidity, so as to improve community welfare and reduce poverty. Thus, inclusive finance is a national strategy to encourage economic growth. According to Carmel and Scott (in Purwati et al, 2014), branchless banking as a form of financial services to the community outside the traditional bank branches using information and communication technology (ICT). The main segment of branchless banking, is poor and unbanked (low income people) because traditional banks (having physical branches and infrastructure) consider them to be costly enough to be provided banking services and products. In this case information technology becomes a branchless banking positioning and key differentiator.

#### **4.1 Branchless Banking Model in Indonesia**

In the branchless banking application there are three commonly used models, namely: (1) bank based model; (2) non-bank based models and (3) Hybrid Models;

##### **a. Bank Based Model**

In this model, the service provider is a bank. Banks create financial products and services, but the distribution of products and services is done through retail agents who manage all or almost all interactions with customers (Lyman et al, 2006). Banks in this model play a full role in the licensing, operational, financial management and financial system processes (Wibowo, 2013).

The type of distribution channel used in this model is through retail agents and mobile banking. Retail agents interact with customers in providing financial services. Retail agents communicate directly with banks using telephone or Point of Sale (POS) terminals. There are two types of Retail Agents, namely: (1) Super Agent, which is a legal entity that cooperates for the distribution of financial services, has an extensive network and business that is already running; (2) Sub Agent, which is a network of super agents spread throughout the region. Face to face transactions with customers will take place with sub agents. The Asian country that successfully uses this model is India (Disha et al, 2012).

##### **b. Non-Bank Based Model**

In this model the bank only acts as a supporter. Telecommunications companies that act as providers of banking services without involving banks. In Indonesia the application of this is in the form of mobile banking, as a means of supporting transactions for customers who already have accounts.

##### **c. Hybrid Model**

The Hybrid Led Scheme is a Branchless Banking scheme in which there is collaboration between the Bank and non-Bank institutions (telecommunications operators, Agents and others) in the form of joint ventures or partnerships, to provide full banking services for customers through mobile phones. Both parties (banks and telco) make use of their respective advantages to dominate the intended market. J as-service mobile wallet or services related to telecommunications networks such as sending money through sms, charging electronic balances, and so the responsibility of the MNO, while, the services of mobile banking related to the management of deposits or savings accounts, transfers between accounts, checking the savings balance, etc. is the responsibility of the Bank.

## **5. CONCLUSIONS**

It can be concluded that substantially Branchless Banking include such things as the following:

- a. The use of technology, such as payment cards or mobile phones, to identify customers and record electronic transactions and in some cases, to enable customers to make long-distance transactions.
- b. Banking Agent, which functions as the leading unit. The form of the Banking Agent itself is very diverse. It can be in the form of individuals, as well as exclusive and non-exclusive third-party

retail outlets, such as post offices and small retailers / shops, who act as agents for financial service providers and enable customers to perform functions that require physical presence, such as cash handling and customer due diligence before open an account.

- c. Offer at least a cash deposit and withdrawal basis, in addition to transactional and payment services.
- d. There is protection from the government, that those entitled to do so are officially licensed Banks that have obtained licenses to issue Branchless Banking services.
- e. Good operational management so customers can use banking services regularly, such as Branchless Banking services available during normal business hours without the need to go to the Bank's branch office at all, if that is what the public want

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