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Islamic Financial Inclusion in Islamic Bank: A Study of Supply and Demand in Central Java

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Abstract

This study examines the constraints and strategies for enhancing Islamic financial inclusion in Central Java from the perspectives of supply and demand. Using a qualitative descriptive approach, data were collected through Focus Group Discussions with five Islamic Rural Banks (BPRS) and surveys involving 66 MSMEs. Findings reveal seven supply-side constraints, including limited public and human resource literacy, absence of ATMs, restricted branch networks, limited capital, difficulties in customer segmentation, and inadequate socialization efforts. Meanwhile, six demand-side barriers were identified, such as limited awareness of BPRS, perceived complexity in financing requirements, and concerns over collateral and loan repayments. To address these issues, two strategies are proposed: 1) targeted socialization and education campaigns and 2) enhanced collaboration with community organizations and stakeholders. The study underscores the need for joint efforts by BPRS, MSMEs, and the government to improve infrastructure and accessibility, thereby fostering broader Islamic financial inclusion.

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INTRODUCTION

Financial inclusion is one of the important aspects in national economic development, financial inclusion is one of the indicators of economic development that can improve the intermediary function of financial institutions. Financial inclusion programs need to be carried out to create a financial system that is easily accessible to all levels of society. The Financial Services Authority in collaboration with the National Council for Financial Inclusion has developed a program to improve financial literacy and inclusion known as National Financial Smart Movement.

Financial constraints relate to people difficulties in accessing financial products/services. Based on the World Bank's Global Findex data in 2021, 52 percent have bank accounts. However, more than 48 percent of the adult population is included in the unbanked people category (World Bank. 2021). Expanding MSME financial access is also one of the Financial Services Authority's policy priorities in 2022, in addition to increasing the role of the financial services sector in accelerating national economic recovery, preparing the financial services sector to face the normalization of developed country policies, developing sustainable financing schemes and encouraging digital finance.

Based on the results of the National Financial Literacy and Inclusion Survey for 2024, the National Financial Inclusion is 75.02 percent. Meanwhile, the Islamic financial inclusion rate is 12.88 percent (Financial Services Authority, 2024). This shows that the level of access to Islamic finance is still relatively low when compared to the level of financial inclusion in general. However, this figure has increased from 2022 which was 12,12 percent (Financial Services Authority, 2022).

Central Java based on the inclusion level is in fourth place out of six regions on the island of Java, which is 85.97 percent. DKI Jakarta is in first place with 96.62 percent, East Java is in second place with 92.99 percent, West Java is in third place with 88.31 percent (Financial Services Authority, 2022). However, based on the number, Central Java is the region with the largest number of BPRS in Indonesia, which is 28 BPRS (Financial Services Authority, 2023). Data shows that there is a gap between the number of banks and the level of inclusion which is still relatively low. With the large number of BPRS institutions in Central Java, it should be able to further increase financial inclusion for the people of Central Java. This is considering the importance of Islamic financial inclusion in increasing economic growth.

Micro, Small and Medium Enterprises are segments that need financial inclusion from the banking sector. Central Java is a representative region with a large number of Micro, Small and Medium Enterprises. Giron, Alicia et al (2021); Ajide, Folorusho M. (2020); Oshora, Betgilu et al (2021) measured the factors that influence financial inclusion in small and medium enterprises. Mohamad Maruf & Zheng Lu (2023) explored access to financial services in the financial sector. Research Financial inclusion is influenced by demand and supply. Srivastava, Ashish (2024); Givay, Haftu Girmay (2023); Takidah, Erika and Salina Kasim (2021) study emphasizes the demand side approach to financial inclusion, Meanwhile, research by Thathsarani, Shanika (2023); Oke, Dorcas and Temitope Wasiu Adamson (2023) identified the determinants of SME financial inclusion from the demand and supply sides. However, this research was not conducted at Conventional Banks and did not identify strategies for increasing financial inclusion. This research will be further conducted by identifying two sides, obstacles from the demand and supply side, to obtain more in-depth information regarding the aspects of obstacles and strategies in financial inclusion in Central Java.

LITERATURE REVIEW

Financial Inclusion is the availability of access to various financial institutions, products, and services according to the needs and capabilities of the community in order to improve welfare. Financial inclusion is the availability of access to various financial institutions, products, and services according to the needs and capabilities of the community in order to improve community welfare. In simple terms, financial inclusion is a condition where every member of society has access to various formal financial services (Financial Services Authority, 2021).

Srivastava, Ashish (2024) study emphasizes the demand-side approach to financial inclusion, which means understanding and managing the demand-side barriers and frictions to financial inclusion. The study critically examines various demand-side barriers, namely behavioral and financial factors, procedural barriers, digital divide, and customer protection issues, besides gaps in the skill development ecosystem and livelihood support initiatives. The study offers suggestions to address demand-side issues to ensure effective financial inclusion. The study was conducted on Conventional Banks and was conducted only on the demand side and ignored the supply side.

Givay, Haftu Girmay (2023) identified financial inclusion in Ethiopia from the demand side. The demand side results show that mobile phone users who are male, older, non-Muslim, married, more educated, know how to open a bank account are more likely to have a formal account than others. However, being from a rural area or from a larger household decreases the likelihood of having an account. The results show that rural residents, employed people, wealthier people, or unemployed people are more likely to use their accounts for savings than their counterparts. Furthermore, the third model shows that being non-Muslim, married, widowed, or poorer decreases the likelihood of using an account than their counterparts. Thus, policies should target the most vulnerable groups in society. In particular, rural households, women, Muslim population, the poor, the less educated, and the youth should be the focus of the Government's financial inclusion efforts. In line with these policy measures, awareness of opening a bank account and financial education programs should be promoted.

Takidah, Erika and Salina Kasim (2021) studied the determinants of Islamic financial inclusion from the demand side. The determinants used include Islamic financial literacy, trust, financial self efficacy, and social influence. The results of the study show that social influence is a significant determinant of Islamic financial inclusion in Indonesia. Therefore, policy makers and the Islamic financial industry need to increase social influence through campaigns involving local culture and community or religious figures to increase inclusion.

Thathsarani, Shanika (2023) identified the determinants of SME financial inclusion from the demand and supply sides. The findings of this study revealed that SME financial inclusion is mainly determined by demand-side factors ability to manage economic changes, provide record-keeping, and willingness to expand the business, supply-side factors collateral requirements and application procedures, institutional factors type of ownership and company sector, and some demographic characteristics of SME owner-managers. This study was conducted with Conventional Banks as the object. This study focuses on inhibiting factors and does not explore its development strategies.

Oke, Dorcas and Temitope Wasiu Adamson (2023) examined the demand and supply factors influencing financial inclusion among micro, small and medium enterprises (MSMEs) in Nigeria. Findings on the determinants of financial inclusion revealed that the major constraint to access to finance by MSMEs is the high interest rates charged on loans, while poor infrastructure facilities are the major constraints hampering financial inclusion from a supply perspective. Results on the demand determinants revealed that awareness of bank services positively and significantly drives access, use and quality of financial services of MSMEs. On the other hand, the availability of other means of savings other than banks negatively impacts access, use and quality of financial services, income constraints, illiteracy and lack of trust in financial institutions negatively impact financial inclusion. Similarly, supply-side determinants such as transaction costs/fees, distance of banks, collateral requirements, difficulty of withdrawal and interest rates negatively impact access, use and quality of financial services. The study recommends that lending rates should be attractive to encourage sustainable access to loanable funds. Financial providers must build an effective and well-functioning financial system that offers affordable and sustainable financial services to MSMEs. This study was conducted with the object of Conventional Banks. This study focuses on inhibiting factors and does not export its development strategy.

Financial inclusion can be influenced by demand and supply factors. Financial inclusion from the supply side is an effort by financial institutions to enable all people to access services provided by Banks and Non-Banks. How Banks can be closer to the community, both physically through branch office locations and technologically or digitally. meanwhile, financial inclusion from the demand side is the strength or ability of the community and business actors to meet the requirements of formal financial institutions. communities that are declared bankable are those that meet the Bank's requirements which are generally known as 5C (Ika, 2022).

RESEARCH METHODS

This research uses a qualitative descriptive method. This research aims to identify the constraints and strategies for increasing Islamic financial inclusion based on the perspective of supply and demand. The data collection method in this study on the supply side was carried out using the Focus Group Discussion or FGD method on BPRS Practitioners in Central Java. Focus Group Discussion or FGD is a method of collecting data by digging up in-depth information about a particular topic through discussion. The advantage of Focus Group Discussion is that it provides results in the form of an accurate and comprehensive picture (Sugarda, 2020). Focus Group Discussion was conducted with participants from BPRS Sukowati Sragen, BPRS Dana Mulia Surakarta, BPRS Artha Surya Barokah Semarang, BPRS HIK Tegal and BPRS Artha Mas Abadi Pati.

Meanwhile, Data collection on the Demand side was carried out using a survey on MSMEs in Central Java. The questionnaire contained questions related to the obstacles faced by MSMEs in using services at BPRS in Central Java. The questionnaire collected 66 responses from MSMEs in Central Java.

RESULT AND DISCUSSION

Constraints to Islamic Financial Inclusion in Central Java

Supply Side of Islamic Rural Banks

Factors inhibiting Financial Inclusion from the supply side were collected from Islamic Rural Banks by conducting Focus Group Discussions on five Islamic Rural Banks in Central Java. BPRS practitioners were asked for information regarding factors inhibiting financial inclusion in their institutions. Bank respondents included BPRS Sukowati Sragen, BPRS Dana Mulia Surakarta, BPRS Artha Surya Barokah Semarang, BPRS HIK Tegal and BPRS Artha Mas Abadi Pati. The following are the Focus Group Discussion Participants.

Islamic Rural Banks in Central Java response to the obstacles in Financial Inclusion include limited human resource literacy at BPRS. The obstacles experienced so far in its financial inclusion as the lack of understanding of Human Resources regarding product knowledge. Human resources are the parties directly involved in marketing Bank products so that adequate knowledge is needed in their role in increasing financial inclusion.

In addition, the obstacle is the unavailability of Automated Teller Machines (ATMs). The obstacles experienced so far in financial inclusion as the unavailability of an Automated Teller Machine (ATM) system owned by Islamic Rural Banks. The availability of ATMs makes it easy for people to withdraw cash anywhere and anytime. The unavailability of ATM facilities is seen as a limitation that makes it difficult for the Bank to promote ease of transactions at BPRS. The limitations of the BPRS Office Network are another obstacle faced by BPRS. The community in transacting can only be done directly through the available offices. So the availability of office networks plays an important role in financial inclusion.

BPRS experiences obstacles in terms of Capital/Budget Limitations. The capital/budget factor as one of the obstacles that have been experienced in financial inclusion. Capital limitations limit the bank's room for expansion. BPRS also has difficulty in determining customer segmentation that is the target for inclusion. Another obstacle in financial inclusion is the difficulty in determining customer segmentation that is the target for inclusion. Promotion to the right community segmentation makes it easier for banks to get potential customers and reduce the promotion budget. The next obstacle is limited Banking Socialization.

The results of this study are in line with the results of research by Oke, Dorcas and Temitope Wasiu Adamson (2023) on micro, small and medium enterprises (MSMEs) in Nigeria, which shows that supply-side determinants such as transaction costs/fees, distance of banks, collateral requirements, difficulty of withdrawal and interest rates negatively impact access, use and quality of financial services. Likewise with Thathsarani, Shanika (2023) who showed that supply-side factors collateral requirements and application procedures,

Demand Side of Micro, Small and Medium Enterprises

Obstacles to Financial Inclusion from the demand side were collected from 66 Micro, Small and Medium Enterprises (MSMEs) through a survey of MSMEs in Central Java. MSME actors were asked for information about the factors that hinder MSME actors from using BPRS services in Central Java. Based on gender, education level, length of business, number of employees and monthly income. The majority of respondents were female (53%), education level of SMA/MA/SMK (47%), length of business 1-5 years (53%), number of employees 1-4 people (89%), monthly income 1,000,000 to 5,000,000 (62%). The following is a table of MSME profiles.

Table 1. Profile of MSME Respondents

Profile		Percentage (%)
Gender	Male	47
	Female	53
Education Level	SD	2
	SMP/MTS	6
	SMA/MA/SMK	47
	D3	6
	S1	36
	S2	3
Business Period	Less than 1 year	20
	1-5 years	53
	6-10 years	11
	More than 10 years	17
Number of Employees	1-4	89
	5-19	9
	20-99	2
Income per Month	Less than 1.000.000	27
	1.000.000-5.000.000	62
	6.000.000-10.000.000	9
	More than 10.000.000	2

Source : Data Processed (2025)

The response of Micro, Small and Medium Enterprises (MSMEs) regarding the obstacles in using Islamic Rural Banks services in Central Java includes MSME literacy about BPRS is limited. Micro, Small and Medium Enterprises that do not know about the existence of BPRS in their residential area are 30 MSMEs (45%), 36 MSMEs (55%) have known about Islamic Rural Banks in their residential area. This shows that not all MSME actors know about Islamic Rural Banks. In terms of the Distance of Residence to the Location of the Bank Branch Office. Micro, Small and Medium Enterprises do not know the location of the BPRS branch office in their area, 22 MSMEs (33%). Meanwhile, 20 MSMEs (30%) think that the location of the BPRS office is far from their residence. The remaining 24 MSMEs (37%) think that the distance of the BPRS office is close to their residence. These results show that the existence of Islamic Rural Banks branch offices needs to be increased to make it easier for the public to use BPRS services.

In terms of Perception of Financing Application Requirements. Micro, Small and Medium Enterprises believe that the requirements for submitting financing at BPRS are complicated, amounting to 25 MSMEs (38%). Micro, Small and Medium Enterprises that believe that the requirements for submitting financing are relatively easy are 41 MSMEs (62%). This result shows that there are still MSME actors who believe that the requirements for submitting financing at BPRS are complicated. However, even though the majority of MSME actors believe that the requirements for submitting financing are easy, it does not encourage MSME actors to submit financing to BPRS.

Barriers in the collateral requirements. Micro, Small and Medium Enterprises believe that collateral requirements prevent them from submitting financing to BPRS, amounting to 33 MSMEs (50%), 33 MSMEs (50%) consider that collateral requirements are not an obstacle for them. In terms of MSMEs Not Yet Requiring Additional Capital. Micro, Small and Medium Enterprises believe that they do not yet feel the need for additional capital from other parties in their business, amounting to 14 MSMEs (21%). These Micro, Small and Medium Enterprise actors feel that the capital they have had so far in their business is sufficient.

Barriers for MSMEs in the perception of high financing payments. Micro, Small and Medium Enterprises are of the view that the reason they do not apply for financing is because they are afraid of not being able to repay the loan due to the high installment costs that must be paid to the Bank, amounting to 4 MSMEs (6%). This perception is caused by the large number of Micro, Small and Medium Enterprises that do not yet have knowledge about BPRS. In terms of MSMEs Not Having Financial Reports. MSMEs do not have business financial reports. MSMEs are of the view that preparing financial reports is difficult, takes a long time, and assume that they do not have the knowledge to prepare them.

The results of this research are in line with the results of Srivastava's research, Ashish (2024) study emphasizes the demand-side approach to financial inclusion namely behavioral and financial factors, procedural barriers, digital divide, and customer protection issues, besides gaps in the skill development ecosystem and livelihood support initiatives. Takidah, Erika and Salina Kasim (2021) The determinants used include Islamic financial literacy, trust, financial self-efficacy, and social influence.

Strategies to Increase Islamic Financial Inclusion in Central Java

Islamic Rural Banks took a strategic step in increasing Financial Inclusion, namely through socialization/education. This was done considering the large number of people whose literacy or knowledge about BPRS, both institutionally and in terms of products, is relatively limited. This Socialization Strategy was applied to the five BPRS in Central Java that were surveyed, including BPRS Artha Surya Barokah Semarang, BPRS Sukowati Sragen, BPRS Dana Mulia Surakarta, BPRS HIK Bahari Tegal and BPRS Artha Mas Abadi Pati. Socialization was carried out by involving community leaders, ustadz, and preachers. Socialization was carried out massively at Islamic boarding schools, study groups and others.

The next strategy carried out by BPRS in increasing Financial Inclusion is through collaboration/cooperation carried out with various parties. This collaboration/cooperation strategy was implemented in the five BPRS surveyed, including BPRS Artha Surya Barokah Semarang, BPRS Sukowati Sragen, BPRS Dana Mulia Surakarta, BPRS HIK Bahari Tegal and BPRS Artha Mas Abadi Pati. Collaboration was carried out with other institutions in improving Financial Inclusion. It was conveyed that collaboration with schools, collaborated with organizations and community groups in improving Financial Inclusion.

This research is in line with the results of research conducted by Givay, Haftu Girmay (2023) recommend that strategies to increase financial inclusion through financial education programs should be promoted. OK, Dorcas and Temitope Wasiu Adamson (2023) recommend that lending rates should be attractive to encourage sustainable access to loanable funds. Financial providers must build an effective and well-functioning financial system that offers affordable and sustainable financial services to MSMEs. Takidah, Erika and Salina Kasim (2021) recommend that policy makers and the Islamic financial industry need to increase social influence through campaigns involving local culture and community or religious figures to increase inclusion.

CONCLUSION

This study was conducted to the constraints to supply and demand for Islamic financial inclusion in Central Java, and strategies for improving it. This study involved practitioners at 5 BPRS in Central Java and 66 MSMEs in Central Java. The results of this activity indicate that the constraints to Islamic Financial Inclusion from the perspective of Islamic Rural Banks supply are seven factors including limited public literacy at BPRS, limited human resource literacy at BPRS, unavailability of ATMs, limited BPRS office networks, limited capital/budget, difficulty in determining customer segmentation as the target for inclusion and limited banking socialization. Constraints to Islamic Financial Inclusion from the perspective of demand for Micro, Small and Medium Enterprises are six factors including limited literacy of MSME actors at BPRS, some MSME actors do not know and think that the distance of their residence is far from the BPRS office location, some MSME actors think that the requirements for submitting financing are complicated, some MSME actors think that the existence of collateral requirements limits them in submitting financing to the Bank, MSMEs feel that they do not need additional capital for their business. And there are MSMEs that have high installment perceptions at BPRS.

On the other hand, the Strategies for Increasing Islamic Financial Inclusion applied to the Islamic Rural Banks surveyed is divided into two, namely the strategy of socialization or education in various groups of society, and the strategy of collaboration or cooperation involving collaboration between institutions, communities and community organizations. The implication of this study is that in order to increase financial inclusion, involvement of each party is needed. From the supply side by Islamic banking institutions, the demand side by micro, small and medium enterprises (MSMEs) and the government. Improvements in infrastructure, easy loan requirements are important factors to consider. Supported by government policies in encouraging MSMEs to develop their businesses through capital assistance from Islamic banks. This research is limited to the Central Java region in five BPRS, further research can be done by exploring information on Islamic Commercial Banks and Islamic Business Units in Central Java.

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