World Academy of Science, Engineering and Technology
International Journal of Economics and Management Engineering
Vol:11, No:11, 2017

The Role of Islamic Finance and Socioeconomic Factors in Financial Inclusion: A Cross Country Comparison

Authors : Allya Koesoema, Arni Ariani

Abstract : While religion is only a very minor factor contributing to financial exclusion in most countries, the World Bank 2014 Global Financial Development Report highlighted it as a significant barrier for having a financial account in some Muslim majority countries. This is in part due to the perceived incompatibility between traditional financial institutions practices and Islamic finance principles. In these cases, the development of financial institutions and products that are compatible with the principles of Islamic finance may act as an important lever to increasing formal account ownership. However, there is significant diversity in the relationship between a country's proportion of Muslim population and its level of financial inclusion. This paper combines data taken from the Global Findex Database, World Development Indicators, and the Pew Research Center to quantitatively explore the relationship between individual and country level religious and socioeconomic factor to financial inclusion. Results from regression analyses show a complex relationship between financial inclusion and religion-related factors in the population both on the individual and country level. Consistent with prior literature, on average the percentage of Islamic population positively correlates with the proportion of unbanked populations who cites religious reasons as a barrier to getting an account. However, its impact varies across several variables. First, a deeper look into countries' religious composition reveals that the average negative impact of a large Muslim population is not as strong in more religiously diverse countries and less religious countries. Second, on the individual level, among the unbanked, the poorest quintile, least educated, older and the female populations are comparatively more likely to not have an account because of religious reason. Results also show indications that in this case, informal mechanisms partially substitute formal financial inclusion, as indicated by the propensity to borrow from family and friends. The individual level findings are important because the demographic groups that are more likely to cite religious reasons as barriers to formal financial inclusion are also generally perceived to be more vulnerable socially and economically and may need targeted attention. Finally, the number of Islamic financial institutions in a particular country is negatively correlated to the propensity of religious reasons as a barrier to financial inclusion. Importantly, the number of financial institutions in a country also mitigates the negative impact of the proportion of Muslim population, low education and individual age to formal financial inclusion. These results point to the potential importance of Islamic Finance Institutions in increasing global financial inclusion, and highlight the potential importance of looking beyond the proportion of Muslim population to other underlying institutional and socioeconomic factor in maximizing its impact.

Keywords : cross country comparison, financial inclusion, Islamic banking and finance, quantitative methods, socioeconomic factors
Conference Title : ICBBF 2017 : International Conference on Business, Banking and Finance
Conference Location : Venice, Italy
Conference Dates : November 13-14, 2017