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UNDERSTANDING PEER-TO-PEER LENDING MECHANISM IN INDONESIA: A STUDY OF DRIVERS AND MOTIVATION

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Abstract. *Peer-to-peer (P2P) lending has become an alternative source of profit by investors all over the world as well as an alternative option for lending both by the bankable and unbankable market. The paper seeks to explore and understand the drivers of P2P lending sectors in Indonesia and to determine the challenges faced by the peer-to-peer lending sector in Indonesia by analyzing the three perspectives of this sector: users (lenders & borrowers), businesses, and regulator. A qualitative approach is used to collect and analyze data. The data is collected through open-ended and in-depth interviews with users, companies and government agency. A thematic analysis method using code mapping was developed during data analysis. The finding shows different results, from the regulator's perspective, business lending users' and borrowers' views. Business opportunity and platform convenience are the drivers, policy risks and lending system are the challenges. The paper concludes there is still a potential sector in an early stage of development. Many improvements can be done through regulations, businesses approach (i.e., policy), and user participation in supporting small businesses. The findings found that OJK might be one party that has planned far in the future of P2P lending, such as the planning of users' data privacy regulations, and regulations for P2P lending businesses that will not be too strict and still supports its innovation and development. Thus, with such changes, there could be more drivers and challenges in the future that can be explored.*
Keywords: Financial technology, Peer-to-peer lending, Drivers and challenges, Regulation, Indonesia

1. **Introduction.** Peer-to-peer (P2P) lending is a new financial market that has been emerging since the recent years [1]. Encouraged by the global financial crisis and the development of SMEs in developing countries [2], which resulted in less trust toward banks and less attractive consumer loans caused by more strict regulatory oversight and more requirements of capital, P2P lending has become an alternative source of profit by investors all over the world [3]. As banks were forced to become stricter on disbursing loans by the heavy losses, the weakness in the system created dissatisfaction among borrowers toward commercial banks [4]. Hence financial sector disruptions in the form of financial technology phenomenon gained strength from the market. Furthermore, P2P lending is also seen as a representation of one of the latest financing forms that work toward "financial inclusion" [5]. Therefore, P2P lending is a non-bank alternative, and it works significantly different compared with traditional banks.

When talking about peer-to-peer lending, financial technology is often considered as its "mother". Financial technology or commonly known as "FinTech" is a relative innovation

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in Indonesia but has been in the global financial market for more than a decade. This innovation is based on the fast development of technologies, leading it to the emergence of the new market of fintech that is very attractive to investors today [6]. However, "Fintech is more than just the convergence of the technology and finance sectors. It also refers to the ways technology is impacting the services and infrastructure that define the financial sector" [7]. According to [8], "Fintech has the flexibility that conventional banking and financial services providers do not have". It combines the use of technology with financial services which aims to help the users to be able to get easy access in financial services such as banking, money transfer, money lending, general payment, stock investment. Nowadays, people do not need to go to a bank to make a payment or transfer money as it can be done online. Almost everything can be purchased online as well through different e-payment apps. Moreover, lending and borrowing money have become a lot easier, especially for non-bankable people, who do not meet the legal requirements to lend/borrow from a bank. Thus, it creates a new and changing market behavior that pushes the traditional system to adapt.

Although there are arguments about whether fintech is a threat for conventional banks or perhaps an opportunity as more and more banks are adapting by launching their mobile or digital banking system, its development is undoubtedly inevitable. Since the first introduction of automatic teller machine (ATM) in 1967 [9], the financial industry has faced many disruptive innovations resulting from technology development, which leads to today's fintech that is supported mainly by the Internet. In addition, one of the reasons why fintech is getting more spotlight is because it creates ease of use for both bankable and non-bankable people. Therefore, it reaches a more significant market scope than conventional banks or other financial institutions.

According to [10], "The existence of fintech aims to make it easier for people to access financial products, to facilitate transactions and also to improve financial literacy". There are many examples of fintech types, according to OJK (n.d.) that support these aims; one example from the *payment* sector is M-Pesa, "a mobile-phone-based payments network serving millions of 'unbanked' in Kenya" [11]. *Peer-to-peer lending* or P2P lending is a loan service among the society, in which the community can obtain from a company that built the platform. An example of financial technology in the peer-to-peer (P2P) lending sector is Modalku [12]. One of the *crowdfunding* sector, *Kitabisa.com*, is a fundraising platform using technology to fund a project or to donate to disaster victims.

Another example is *DuitPintar.com*; a *market aggregator* serves as a platform to monitor various financial service information. Risk and investment management sector serve as a platform for users who are interested in investment to be directed to investment products that match their preference (i.e., Investree investment company). In sum, fintech is not only acting as a payment gateway, but also serves as an investment, P2P lending, crowdfunding, and market aggregator. This paper focuses on peer-to-peer lending mechanism in Indonesia.

Despite its growth and contribution in Indonesia, there is still a lack of study in sectors of fintech such as peer-to-peer lending, which is a promising sector in fintech in Indonesia. And therefore, it is essential to survey peer-to-peer lending in Indonesia from the three perspectives which are users, business players, and regulators. Thus, the aim of this paper is to explore and understand the drivers of P2P lending sectors in Indonesia and to determine the challenges faced by peer-to-peer lending sector in Indonesia. The following question is to follow: How does peer-to-peer lending operate in Indonesia? The order of the paper starts from introduction, literature review, methodology, findings and discussion, and conclusion.

2. **Fintech and P2P Lending Development in Indonesia.** According to a report conducted in 2017 by [13] or Finance Service Authority, there has been a significant growth

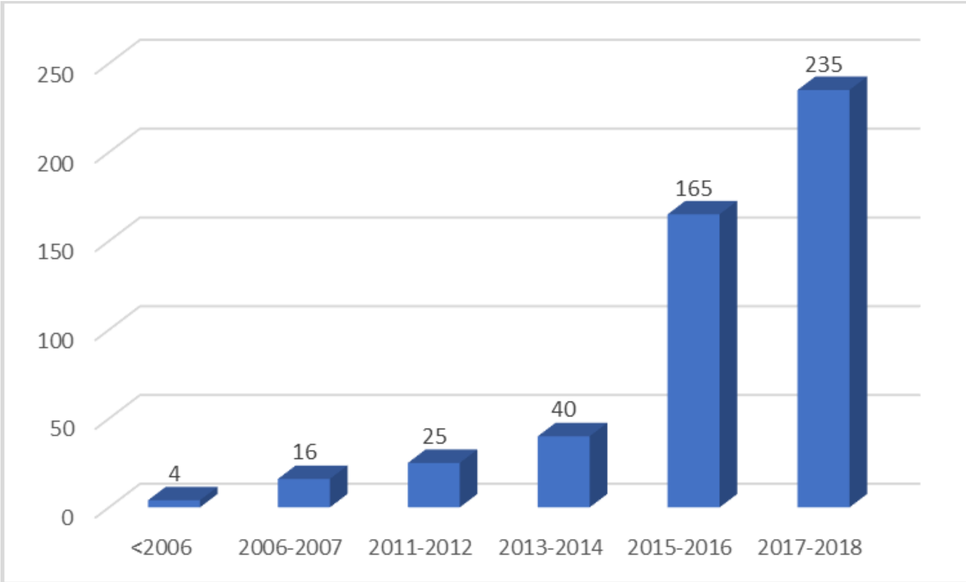

Figure 1. Number of fintech companies in Indonesia (Source: Otoritas Jasa Keuangan, 2017 [13])

of fintech companies in Indonesia. As a regulator, there were 40 new fintech companies from 2013-2014 and jumped to 165 fintech companies in 2015-2016.

The number of fintech companies in Indonesia, as described in Figure 1, shows a tremendous increase the last 4 years. The primary fintech sector is in Payment by 42.2%, followed by Lending (17.8%), Aggregator (12.6%) and Crowdfunding (8.2%). Some examples of fintech in the payment sector are *Go-Pay*, *OVO*, *Jenius*, and *Doku-Pay*. These features help customers in the payment process such as paying for transportation, parking fees, groceries, and other purchases.

[14] describes peer-to-peer lending as "a new online source of financing", which differs from, e.g., funding in traditional banks. He argues that the first peer-to-peer lending platform was established in 2005 named ZOPA, a UK based firm. Moreover, since the past five years, the number of P2P lending platforms has grown significantly, as shown in Figure 2.

Figure 2 shows the number of fintech P2P lending borrowers and fund providers accounts from January to October 2018. Interestingly, it shows an increasing number from January to May 2018, yet it experienced a decline in May 2018, followed by steady growth, with 182,900 lenders account and 2.8 million borrower accounts in October 2018. According to the same website [15], "The loan value of fintech peer-to-peer (P2P) lending has reached Rp. 15.99 trillion until the end of October 2018", which shows a large number of P2P lending user accounts.

In Figure 3, P2P platform is connecting borrowers and lenders in the sector. It provides a marketplace where borrowers can ask for loans, and lenders can lend their money to them when agreed under the loan agreement. When applying for a P2P loan, P2P platforms will rate borrowers by checking their information. Lenders have different preferences, for example, for personal loans, they will need the borrowers' necessary information to financial records, and for business loans, lenders will usually require the company information and past financial reports to review. The borrower would do the signing up process that takes time as the platform review and verifies the applied knowledge, the platform then decides based on the previous data which level or grade the borrower is. Many lenders have strict criteria as to how sure a borrower will be able to return the loan [16]. If eligible to continue, the grades will help lenders or investors calculate the risk of return by lending to these borrowers. The borrower then can make a description of their loan, including

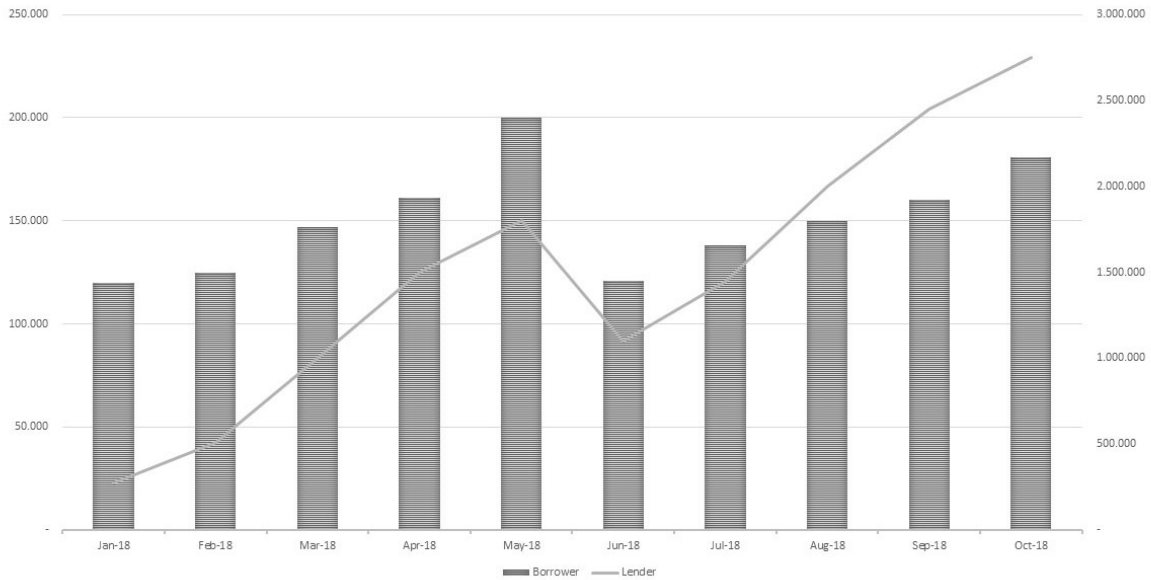

Figure 2. The Indonesia's P2P lenders and borrowers trend (Source: Katadata.co.id [14])

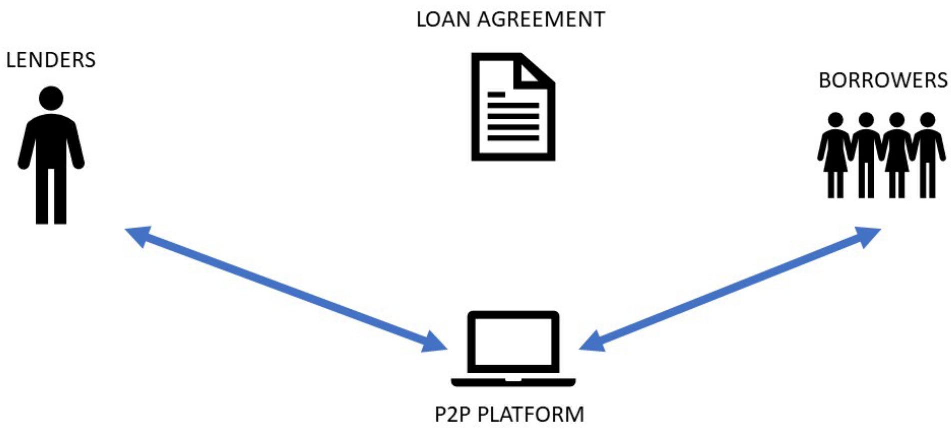

Figure 3. How P2P lending works (Source: www.lendenclub.com [15])

the rate of interest that they are willing to return (most platforms will give each grade a percentage interest scale that the borrowers can choose in between).

Drivers, in this study, imply the pressure and reason to adapt. According to [17], the term of 'drivers' refers to "People, knowledge, and conditions (such as market forces) that initiate and support activities for which the business was designed are known as business drivers". However, it is defined slightly different in A Partner White Paper by Microsoft (2009), as it defined business drivers as "[Business driver] a brief statement that defines clearly and specifically the desired business outcomes of the organization along with the necessary activities to reach them". [18] stated that there are four factors that can cause organizations under pressure from the external environment; those factors are as follows:

- Consumer demand elements (i.e., speed of delivery)
- Technology inputs
- Market-related factors (i.e., competition)
- Societal strains

A study by [19] on value drivers theory explored the effects of business value driver on the valuation of businesses in the United States and developed value driver theories. The writer developed the theory of value drivers possibilities frontier and value driver chain from the theory of value drivers and several sources, mainly from previous studies. One of his findings is that value drivers are interrelated and they rarely stand alone. However, they do influence each other. From those theories, it can be implied that P2P lending as fintech as disruptive innovation is influenced by business value drivers that are interrelated and influence one another. Thus, this study will explore P2P lending drivers among the targeted subjects.

In terms of Indonesia context, [8] conducts a study on assessing the dynamics of fintech in Indonesia. He emphasizes that fintech business was initially expected to harmonize the financial inclusion in Indonesia through its benefits (i.e., expanded access, reduced costs, and increased efficiency). However, there had been critics on how fintech turned out to be focusing only on big cities and targeting 'tech-savvy' market who are not financially excluded. In addition, it was found that among all 142 fintech companies registered in the Indonesian Fintech Association, it showed that most of those companies' operations are still based in Java and other big cities. It also seemed that those companies ignore the remote areas and outer areas in terms of the market. The results of the study showed that "Fintech is more than just a phenomenon; it cannot be compared to other start-ups and has the potential to fundamentally change the business and economic landscape".

In terms of whether fintech is a disruptive or a collaborative economy, [21] states that positive impacts will occur in Indonesia's national economy. Fintech encourages equitable population welfare distribution, assists domestic financial needs, improves national financial inclusion, and promotes the ability of SMEs in Indonesia. It also results positive impacts, social impacts, and recommendations of fintech in Indonesia. [21] also suggests that in optimizing the role of fintech in Indonesia, an intervention from financial institutions and business players of fintech incorporated in the Association of Fintech Indonesia (AFI) is necessary.

More specifically, [22] explains that P2P lending has brought a new dimension to the financial market by giving access to new types of investments and new investors. The entity has given borrowers, such as consumers and SMEs, access to finance that can be of better terms and lower costs. Hence, financial service provides better terms at a lower cost, which presumably become the driver of this sector in Indonesia. [23] found that in the process of investment decision making, the lender tries to gain as much information as possible to assess in the best way the profit and its probability to be reached. Another finding was about the rating of the borrowers, which was explained as "The better is rating class, the higher is the probability of successful listing, as was proved by most of the authors in the field". In some cases, issues in P2P lending involve regulatory action that varies in different countries [24].

3. **Research Methodology.** This study uses a qualitative approach, interpretive because researchers need to understand the subjective of the meanings expressed about the studied phenomenon. This study is exploratory research that explores a case, problem, or event [25]. The emphasis in the exploratory analysis is to observe an argument or a situation to develop a new angle of such evidence. Therefore, this study will explore the drivers and challenges in peer-to-peer lending sector.

This research will use non-probability sampling with purposive sampling to recruit the right respondents or participants who can provide in-depth and detailed information about the subject of study [26]. This sampling technique is highly subjective and determined by the researcher generating the criteria that are qualified and must be met by each participant to be considered for the study of the research. Sampling was taken from fintech peer to peer companies, two persons, from borrowers four-person, and decision-maker and analyst from Indonesia Financial Service Authority (OJK).

This study will use a thematic analysis method. According to [27], "Thematic analysis is a systematic approach to the analysis of qualitative data that involves identifying themes or patterns of cultural meaning; coding and classifying data, usually textual, according to themes". Researchers who conduct this method make diverse yet meaningful conclusions and interpretations by studying different factors.

4. **Findings and Discussion.** Data was collected from the interviews with P2P lending users, business players, and regulator. The purpose of this arrangement is to understand accurate data from the people that represent this financial sector. Using the coding technique, the interview results were processed into codes from themes according to what the respondents had stated. The results will be later formed into a mapping that consists of 'supercategory', 'category', 'subcategory', and 'codes'. This mapping can be used to develop deeper research in this sector (see Figure 4).

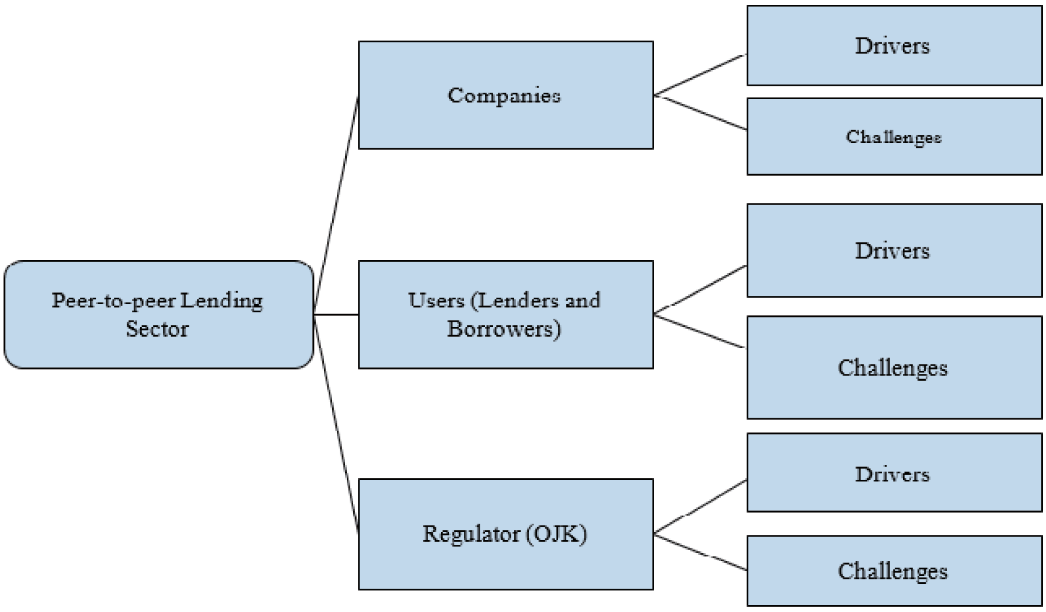

FIGURE 4. Research model

4.1. **Users' perspective.** Four users based in Jakarta and Yogyakarta, aged between 21-25 were interviewed to gain insight into P2P lending sector in Indonesia. The respondents were found through social media survey by asking if there is anyone with the following criteria: Indonesian, have used peer-to-peer lending for at least a year, and have successfully understood the process of borrowing or lending in the platform.

Below are findings which are quoted from the interviews, as follows:

- There is a significant opportunity in investing in P2P lending platforms which drive investors to participate.
- Peer-to-peer lending platforms give P2P lenders the convenience that banks do not have.
- Return policy and data policy are among the risks that are faced by P2P lending users (lenders).
- Competition between lenders is a challenge that is faced by P2P lending users (lenders).

- There is a business opportunity that drives people into borrowing in P2P lending platforms.
- Peer-to-peer lending platforms provide P2P borrowers the convenience that banks do not have.
- Data policy is a risk that is faced by P2P lending borrowers.
- Grading and collecting systems are the challenges that are faced by P2P lending borrowers.

4.2. **Business players' perspective.** Two peer-to-peer lending business players in Indonesia were interviewed to gain insight into P2P lending sector in Indonesia. The respondents were found by reaching out via email, and both companies had asked for anonymity due to confidential matters. The companies interviewed were based on the following criteria: peer-to-peer lending business based in Indonesia, has been operating for at least three years and registered by OJK.

Below are findings which are quoted from the interviews, as follows:

- Innovation in financial technology development has driven business players in the peer-to-peer lending sector.
- Social development by supporting SMEs and education has driven business players in the peer-to-peer lending sector.
- The peer-to-peer lending business has impacted economic growth as it supports SMEs and increases financial inclusion.
- With a growing number of competitors, it is a challenge for P2P lending business to compete.
- Limited manpower in the peer-to-peer lending sector has been an on-going challenge for businesses in this sector.
- There is a need for comprehensive regulations as it has become a challenge in P2P lending for business players.

4.3. **Regulator's perspective.** The Directorate of Regulations, Licensing, and Supervision of Fintech of Otoritas Jasa Keuangan or OJK was interviewed to gain insight into P2P lending sector in Indonesia from the regulator perspective. The representative was reached out by email in order to complete the data collection of this study.

Below are findings which are quoted from the interviews, as follows:

- Financial inclusion, expansive growth, and increased employment rate are among many proofs of economic growth that drives OJK in regulating the peer-to-peer lending sector.
- Fintech innovations and P2P lending being in an early stage are the P2P lending development opportunities that drive OJK in this regulating this sector.
- Lack of academic and regulatory resources in P2P lending is among many challenges for OJK.

4.4. **Synthesis of discussion.** The mapping (Figure 5) represents the findings of this qualitative study. It is divided into four parts which are supercategory, categories, subcategories, and codes. The mapping was conducted by separating themes and developing it into codes, which was later developed into subcategories and then to categories until lastly to supercategory. This mapping was done to simplify and conclude the findings from the transcripts of the in-depth interview. Based on the code mapping, the results were found that explored the drivers and challenges in the peer-to-peer lending sector. To answer the research question, below are the findings.

a) Users

There is a significant opportunity in investing in P2P lending platforms which drive investors into participating. This could result in an increased number of P2P lenders

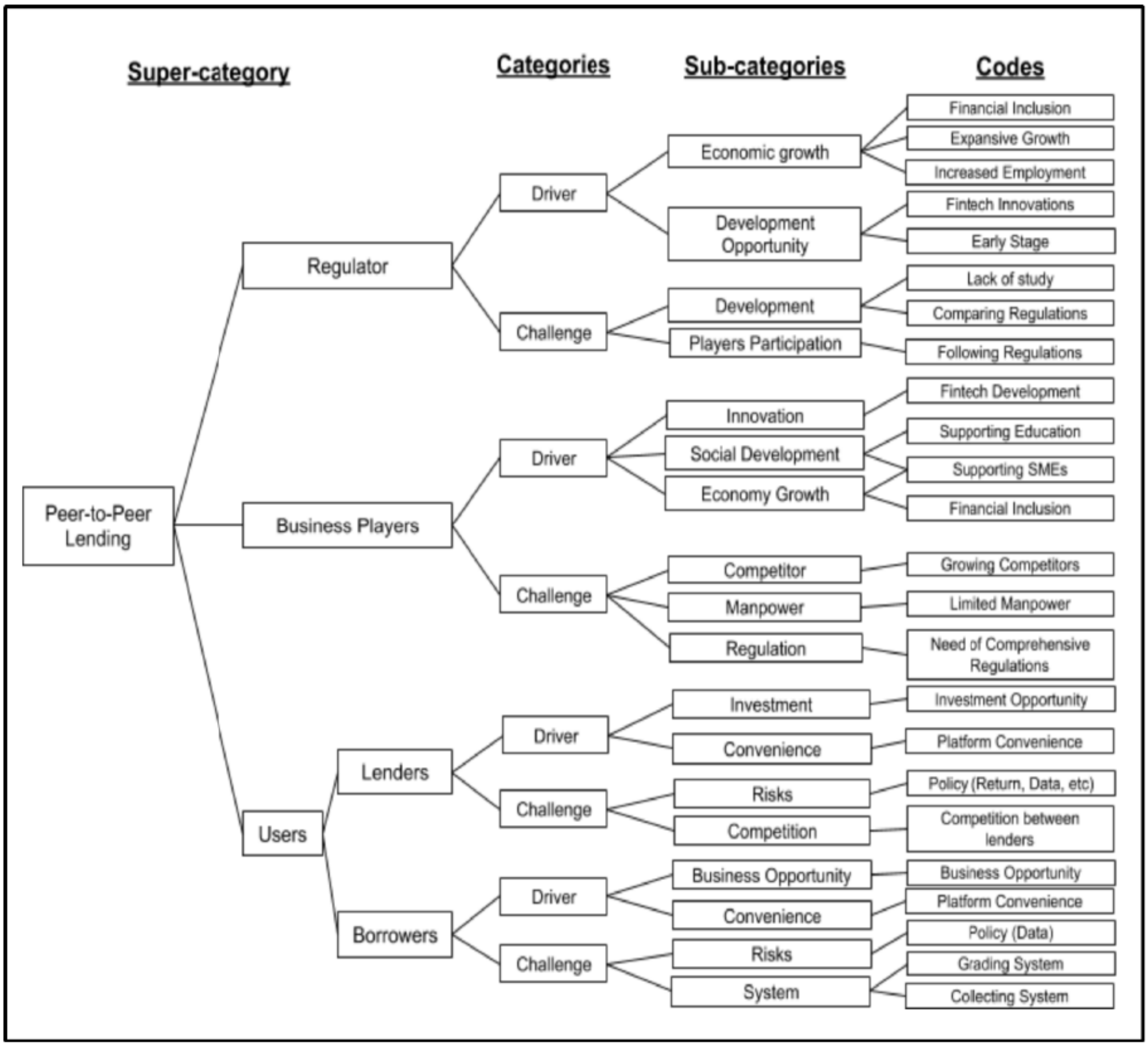

FIGURE 5. Code mapping

in the future, especially with more trust is developed toward the sector. Then, peer-to-peer lending platforms give P2P lenders the convenience that banks do not have, such as understandable platforms, excellent customer service, easy process of lending. There is a business opportunity that drives people into borrowing in P2P lending platforms, especially people who are considered ‘unbankable’ and have limited access to banks. Peer-to-peer lending platforms give P2P borrowers the convenience that banks do not have, and just as the lenders, it is resulted from its practicality, ease of use, and time-saving.

b) Business players

Innovation in financial technology development has driven business players in the peer-to-peer lending sector. Social growth by supporting SMEs and education has driven business players in peer-to-peer lending sector. Many P2P lending companies aim to help financial inclusion by assisting small businesses to get funding. The peer-to-peer lending business has impacted economic growth as it supports SMEs and increases financial inclusion.

c) Regulators

Financial inclusion, expansive growth, and increased employment rate are among many proofs of economic growth that drives OJK in regulating the peer-to-peer lending sector. According to OJK, 2018 economic growth had increased by IDR 25.97 billion because of fintech lending sector. OJK sees this as a potential to improve the economy of Indonesia.

Fintech innovations and P2P lending being in an early stage are the P2P lending development opportunities that drive OJK in this regulating this sector as well, as stated in the interview that this sector is still considered new and its ecosystem can be more expanded.

The finding also addresses some of the challenges of peer-to-peer lending in Indonesia. Based from the finding, the respondents show some of the concerns related to these challenges.

a) Users

Return policy and data policy are among the risks that are faced by P2P lending users (lenders). Here, there are still lenders that feel risked in investing in these platforms because of the inconsistence of P2P lending platforms policies; for example, different platforms have a different return policy. Competition between lenders is a challenge that is faced by P2P lending users (lenders) because more and more people are interested in investing in these platforms, there is an imbalance between lenders and borrowers; thus, lenders compete in getting the suitable potential investments, and some are left with the 'leftovers'. Data policy is a risk that is faced by P2P lending borrowers. Grading and collecting systems are the challenges that are faced by P2P lending borrowers.

b) Business Players

With a growing number of competitors, it is a challenge for P2P lending business to compete. Especially as P2P lending sector is still relatively new, and it was found that illegal P2P lending platforms are part of the competition that legal businesses have to face. Then, limited manpower in peer-to-peer lending sector has been an on-going challenge for businesses in this sector. As more businesses in P2P lending emerged, they need more workers that have experienced in fintech P2P lending industry. However, the numbers might not match the needs of this sector. There is a need for comprehensive regulations as it has become a challenge in P2P lending for business players. As mentioned in the interviews, P2P lending businesses can be different from one another. Thus, a more detailed regulation is needed so that all P2P lending businesses can benefit more in the market.

c) Regulators

As mentioned above, there has been a lack of academic and regulatory sources in P2P lending. OJK has compared their regulation to other rules in other countries such as the US and China. With US having three regulatory bodies; "The Securities and Exchange Commission (SEC) is responsible for the investing side of these platforms, while the Consumer Financial Protection Bureau and the Federal Trade Commission regulate the borrowing side" [23] that result in laborious process for P2P lending business owners to develop their platform. On the other hand, China's P2P lending industry remained mostly unregulated though, despite its rapid growth in the past few years, it resulted in one of the biggest China's finance sector crisis [5]. In the future, OJK seeks to improve the regulation according to the nature of the industry. Players participation in following the rules is a challenge faced by OJK in P2P lending sector. Among all peer-to-peer lending companies in Indonesia, almost 80% of them are illegal companies operating without being registered under OJK. Thus, it is difficult to control if there was an issue with such companies.

5. **Conclusion, Limitation and Recommendation.** This research aims to explore peer-to-peer sector in Indonesia by the three perspectives in the industry, which are P2P lending users (both lenders and borrowers), P2P lending business players, and OJK as the regulator. By conducting a qualitative method with interviews as the research instruments, the author had gathered enough data that shows the idea of the drivers and challenges in peer-to-peer lending from three said perspectives. A code mapping had been developed from the collected data to ensure that the reader can understand the theme

of this study. To conclude, based on the findings it can be seen that peer-to-peer lending is still a potential sector in an early stage of development. Many improvements can be done through regulations, businesses approach (i.e., policy), and user participation in supporting small businesses. One thing to note that from all the interviews, it was found that OJK might be one party that has planned far in the future of P2P lending, such as the planning of users' data privacy regulations, and regulations for P2P lending businesses that will not be too strict and still supports its innovation and development. Thus, with such changes there could be more drivers and challenges in the future that can be explored.

This study only covers P2P lending in Jakarta and therefore for further research the data collection could be improved, such as the number of respondents especially in P2P lending businesses, variety of respondents (i.e., P2P lending borrowers who succeeded to pay their loans back and the ones who did not), questions, comparison of regulations in different cities, or countries.

This study only investigates driver and motivation of P2P lending; therefore for additional insights further study should also examine aspects on the system in which borrowers and lenders/investors can understand more about P2P lending environment, such as grading system, return policy, data security. A generalization of the platform surface should be taken more seriously as many unbankable might have lack of understanding in P2P lending usage. A different set of approach must be developed to reach a variety of markets.

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