

Information Technology-Based Money Lending and Borrowing Services Industry in Rating Perspective

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The digital revolution has fundamentally changed Indonesia's financial landscape, with peer-to-peer (P2P) lending emerging as one of the innovations in the digital financial ecosystem. The industry has become an alternative to traditional credit access and opened up funding opportunities for small and medium enterprises and individuals that previously could not be accommodated by the conventional banking system. The industry has now officially been labelled as Information Technology-Based Joint Funding Services (Layanan Pendanaan Bersama Berbasis Teknologi Informasi or LPBBTI) as per POJK 10/POJK.05/2022, with a previous name of Information Technology-Based Money Lending and Borrowing Services (Layanan Pinjam Meminjam Uang Berbasis Teknologi Informasi) as per POJK 77/POJK.01/2016. We are going to use the terms P2P lending platform and Information Technology-Based Joint Funding Services interchangeably for the sake of brevity.

Despite several P2P lending companies experiencing problems, the industry itself has recorded growth in terms of the size of transactions as well as its bottom-line profits. Through this article, PEFINDO would like to revisit and review the P2P industry.

Introduction

In line with technology development, an idea emerged to match those who need funds with lenders directly through the Internet. This is expected to increase financial inclusion, where banks are less flexible in penetrating this niche due to their more conservative core system and emphasis on collateral value for lending in the productive segment.

The basis of P2P lending is crowdfunding, a funding mechanism where parties needing funds can upload their proposals online, and individual investors can directly select debtors or projects to be funded via the platform. With this platform, ideally, the transactions are recorded transparently, driving the customers' confidence.

Overview

We view that the risk in this industry is still relatively high, as the industry's targeted segment is individuals and entities without credit track records or collaterals. We regard the issues of low barrier to entry, tight competition, high operating cost structure that burdens profitability, potential asset quality pressure, limited financial flexibility, and a number of high-profile fraud cases as the main challenges in this industry. This IT-based joint-funding industry is also still in an immature stage. We expect technology-enabled industries to reach maturity within at least 10 years, which matches its typical product development cycles and the time needed for regulatory frameworks to solidify, market structures to stabilize, trust to be built through proven track records, and for the platforms and financial mechanisms to go through several major iterations of development and refinement based on real-world performance and evolving requirements.

In terms of products being offered, they are complementary to direct financing services. Therefore, once the individuals or entities have established their credit track records, they typically obtain bank facilities to get more favorable interest rates. For P2P lenders, this intensifies the competition with banks in attracting good-quality borrowers.

In terms of revenue and cost structure, the industry is highly dependent on commissions, which are derived from the size and the number of transactions done by individuals or businesses, as well as the interest charge of the financing. This revenue is variable. On the other hand, many operating expenses, such as IT and personnel costs, are generally fixed and relatively high compared to revenues, driving

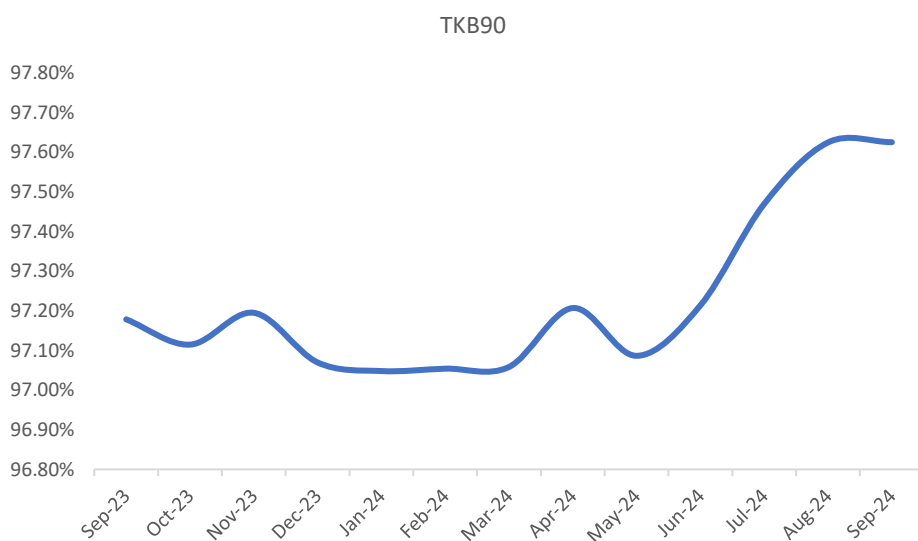
the industry-wise cost-to-income ratio to range between 88% to 96% during September 2023 to September 2024, higher than its banking counterparts (76%-92%) and financing companies (76%-80%). Barriers to entry and level of product variety in this industry are low, even with the minimum paid-in capital being raised to IDR25 billion and most companies offering similar products, driving up the level of competition.

The key success factors in this industry, in our view, boil down to how strong the company can withstand the losing period during the development stage, how efficient the operations are, how robust the scoring system is in rating the quality of borrowers, and how vigilant the management to navigate the company in a very competitive industry. The risk profile is also impacted by high-profile cases that occurred at one of the industry’s market leaders, such as Investree and Koinworks cases.

Similar to other industries, P2P lending companies’ ability to tap into ecosystems, such as supply chains, should help them grow their businesses healthily. As of September 2024, around 52% of the funds were channeled to the trading sector, while 15% went to the accommodation, food and beverage sector and 10% to the other services sector.

Transaction Quality

Chart 1. Success rate (Tingkat Keberhasilan - TKB90)



Source: OJK, processed by PEFINDO

The quality of the transactions in terms of repayability seemed to show a stable trend, where the success rate (tingkat keberhasilan – TKB), counted 90 days since the loan’s due date, showed a stable level of 97% to 98% monthly. However, despite this, there were some significant cases where the failure of one or few borrowers to repay the loans significantly damaged the P2P lending platform’s credibility and reputation, making it difficult to attract lenders for its new transactions.

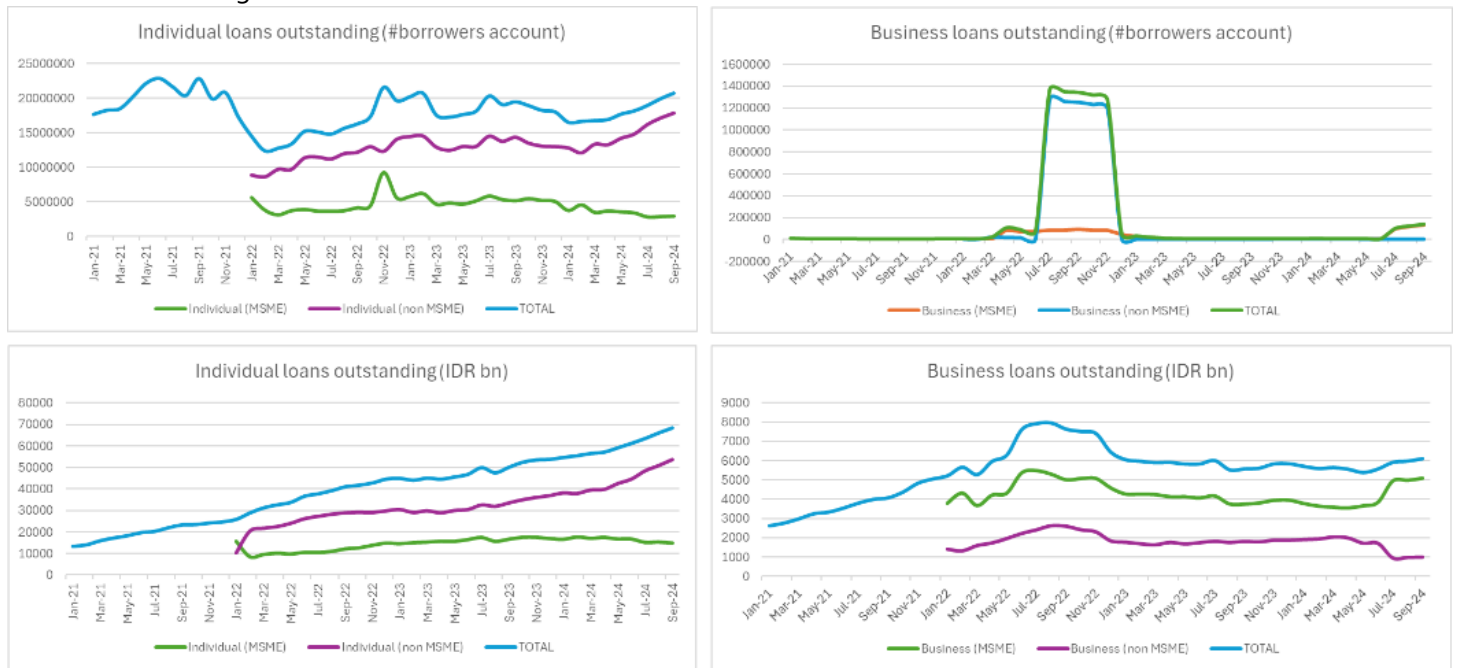
Under the P2P lending scheme, the platform does not take a direct hit from problems in transaction quality, but if there is any failure in repayment, the massive backlash from the lenders will ultimately hurt the platform as much.

Another quality issue is that these transactions are recorded in the financial statements (off-balance sheet) and unaudited. Without third-party audits, misrepresenting transaction figures becomes easier, increasing the risk of fraud.

Growth Prospects

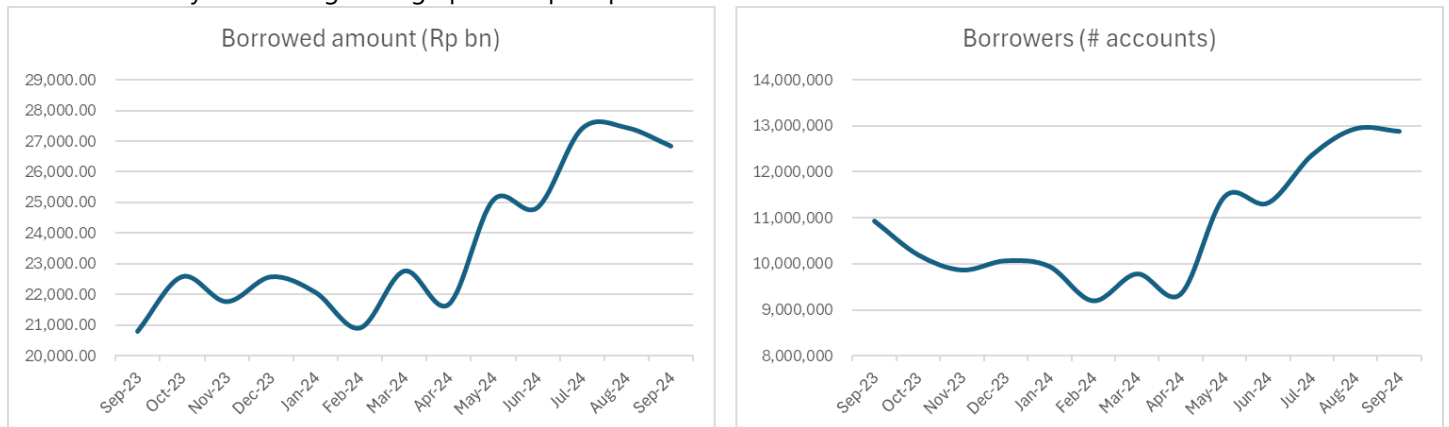
The industry statistics showed consistent growth over time. We measure the growth by looking at the transactions or loans outstanding for individuals and businesses in monetary terms and the number of participants.

Chart 2. Outstanding Loans



The borrowing size, therefore, was relatively granular at IDR1.9 million per borrower’s account.

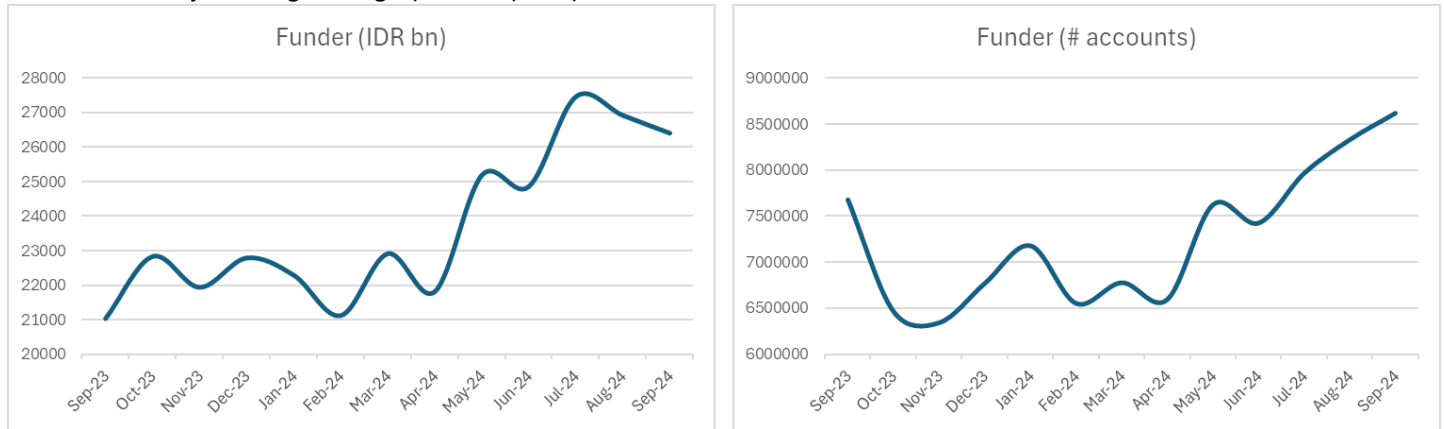
Chart 3. Monthly channeling through peer-to-peer platform



Source: OJK, processed by PEFINDO

The number of funders, as well as in Rupiah amount, matched with the channeling activity...

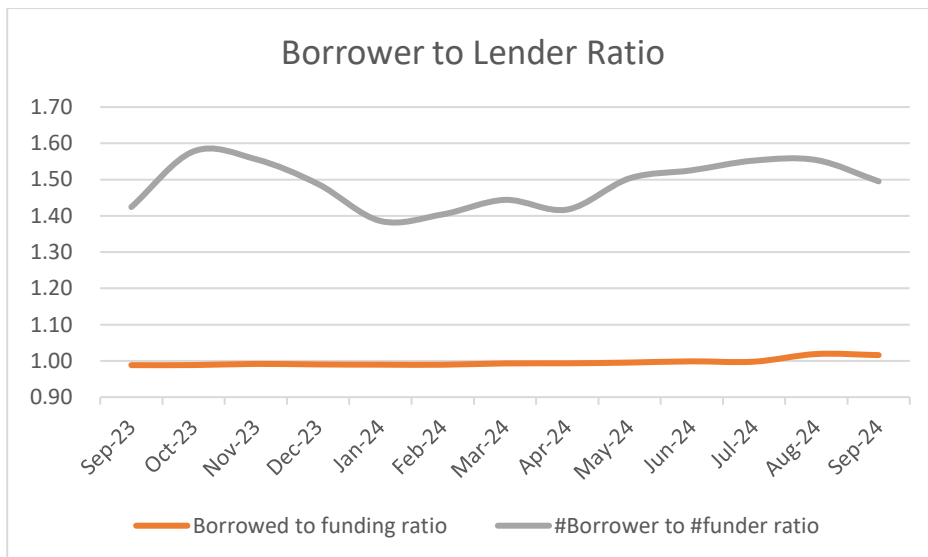
Chart 4. Monthly funding through peer-to-peer platform



Source: OJK, processed by PEFINDO

...with the ratios as follows:

Chart 5. Borrower to lender ratio



Source: OJK, processed by PEFINDO

The presence of large ticket size lenders, commonly known as super lenders (usually institutional), made the number of borrowers to a number of funders ratio consistently greater than 1.3. As of September 2024, banks dominated the funder portfolio in monetary terms by a share of 54.6% of total funding and 68.0% of total domestic funding in this industry. Individuals only contributed around 6.7% of total funding and 8.4% of total domestic funding, with the trend also decreasing from 13.5% and 10.9%, respectively, in September 2023. Banks are more accustomed, or even regulated, to set provisions on their loans, so the non-repayment issue in the peer-to-peer lending industry will not affect them as much as it does for the individual lenders. That is one of the reasons why the enthusiasm from the retail segment has relatively faded, looking at the contribution trend.

We do not view any impending risk in terms of leverage, as most of the companies in this industry are typically funded independently or using venture capital rather than borrowing from banks. Therefore, in terms of cash flow protection and liquidity, it is more relevant to be pitted against the business costs rather than debt or interest expense.

Regulatory Improvements

Many of the problems are seen to be borne by a lack of capital to support any profitability headwinds, lack of transparency, and corporate governance. The Financial services authority (Otoritas Jasa Keuangan – OJK) tried to overcome this by issuing new regulation in 2022. In short, a few significant changes have been made, with highlights as follows.

Table 1. Difference between POJK 10/2022 and POJK 77/2016

Issue	POJK 77/2016	POJK 10/2022
Title	Information technology-based money lending and borrowing services	Information technology-based joint funding services
Scope	Only covers conventional scheme	Covers both conventional and sharia scheme
Organizer	Limited liability company (Perseroan terbatas – PT) or cooperative	PT
Founder and owner	Indonesian citizen/legal entity or foreign citizen/legal entity	Indonesian citizen/legal entity, or foreign citizen/legal entity together with Indonesian citizen/legal entity
Foreign ownership mechanism	Not regulated	Only through transaction in stock exchange
Minimum paid in capital	IDR1 billion at the time of registration and IDR2.5 billion at the time of license application	IDR25 billion at the time of establishment, and sources of funds are prohibited from loans
Ownership structure	Not regulated	Must have a minimum of 1 Controlling Shareholder
Controlling shareholder having more than one P2P lending platform	Not regulated	Prohibited, unless the controlling shareholder is the Republic of Indonesia
Certification mandated	Not regulated	Directors, commissioners, and those below the board of directors must have a work competency certificate from a professional certification institution in the field of financial technology registered with the Financial Services Authority

Foreign worker provision	Not regulated	Prohibited from exceeding a period of 3 years for one term and cannot be extended, and prohibited from being employed other than in the field of Information Technology as an expert with a level one level below the Board of Directors or as a consultant
Fit and proper	Not regulated	Controlling shareholders, directors, commissioners, sharia supervisory board must be approved by OJK prior to being effective
Maximum deal size	IDR2 billion	IDR2 billion
Maximum financing given (including by affiliated entity)	Not regulated	25% of the final funding position at the end of the month
Use of account	Not regulated	Organizers must use escrow accounts and virtual accounts/payment gateways
Minimum equity	Not regulated	IDR12.5 billion with steps: <ul style="list-style-type: none"> • IDR2.5 billion in July 2023 • IDR7.5 billion in July 2024 • IDR12.5 billion in July 2025
Minimum number of directors	1 director, 1 year experience in financial services industry	2 directors, minimum 2 years of managerial experience in financial services in the areas of credit, risk management, and/or finance
Minimum number of commissioners	Minimum of 1	Minimum of 1, maximum half of the number of directors
Maximum number of company a commissioner can presume	Not regulated	Maximum of 3
Internal audit	Not regulated	Stipulated, there must be an internal audit unit with an audit background, and internal audits must be conducted at least once per year
Annual report	Not mandatory to be audited	Mandatory to be audited
Membership in association	Not mandatory	Mandatory

Source: OJK, processed by PEFINDO

Financial Examination

In terms of financial aspects, we look at: financial policy, capital structure, cash flow protection and liquidity, financial flexibility.

Management's philosophy, strategy, and policies toward financial risk form our view on financial policy, and examination of the company's leverage, debt structures and composition, and management of its liabilities forms our view on capital structure. We do not see any impending risk in terms of leverage, as most companies are typically being funded independently or by means of venture capital rather than by borrowing from banks, thus, the financial risk in terms of debt repayment ability is relatively absent. In terms of capitalization, however, there is a risk of deteriorating capital due to loss periods. Despite the equity being heightened to IDR12.5 billion, we still see that the cash burn rate (monthly cash outflow to cover expenses) will still be significant to stand out amid the highly competitive environment and income source that almost exclusively comes from commission fee that typically slows to take off in nominal terms.

This business model will also impact our view on cash flow protection and liquidity. In conventional business, we emphasize the degree of its debt-servicing capability level, which is measured by the company's interest and debt coverage ratio. However, operational short-term obligation dominates this type of industry (mostly in terms of payables), and cash flow protection is more relevant to be viewed against the business costs rather than to debt or interest expense. As mentioned, the operational source of cash comes from fee, while the most significant source comes from financing cash inflow in the form of capital injection or funds from funding round. The company's dependence on financing cash inflow or external funding through venture capital networks, as well as its low asset base and concentrated line of business, makes it relatively unfavorable regarding financial flexibility.

The company's options under stress, including contingency plans and other capabilities and flexibility to deal with various adverse scenarios, are relatively limited, despite the growing nominal transactions.

The business will likely persist, as the banks look to be the main customer from this industry, driven by the need to channel its loans to the small medium enterprise (SME) segment to satisfy RPIM (Macroprudential Inclusive Financing Ratio or Rasio Pembiayaan Inklusif Makroprudensial/RPIM) for the regulatory requirement. On the other hand, the peer-to-peer lending players will come and go as the industry is still fragmented, with over 90 companies being around since 2020.

Conclusion

In layman's terms, the challenges that occur or risks that may arise in this peer-to-peer lending industry can be mapped into:

- No third-party verification on the off-balance sheet transaction.
Unlike banks or financing companies that carry the lending portfolio on their books and get audited, the loan portfolios in this industry are off-balance sheet and, therefore, not audited. The cases in this industry were relatively undetected beforehand, and despite the success rate or TKB90 being consistently above 95%, a few market leaders suddenly encountered unprecedented problems.
- Unstandardized or relatively opaque scoring system.
Understandably, the scoring system is one of the secrets to a company's success in getting lenders and one of a crucial competitive edge, so this tends to be safely guarded. However, less transparency in this aspect also leads to less visibility for the lenders and regulators as to what measures the company imposed on the borrowers and what aspects and scores are being assigned to them.
- Fee-based business model with high operational costs makes it quite vulnerable to a decrease in borrower availability or lender confidence.

This is definitely a crucial factor, because the cash burn rate of a typical peer-to-peer lending company is typically high, especially in the phase of brand building, team building, and IT infrastructure development.

- Collection effort intensity that differs from that of an on-book lending business such as banks or finance companies. The collection efforts were typically made on best effort. The peer-to-peer lending business model also does not provide reserves because the lending portfolio is recorded off-balance sheet, and the non-repayment risk is being put on the lender's side.
- The industry is still relatively new and very dynamic, and regulations are still evolving. As mentioned, we expect this industry to reach maturity at least within 10 years or approximately match its typical product development cycles. The first regulation was made in 2016, so it may take until 2026 to see if the industry stabilizes.

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