# The Impact of Fintech on Indonesia's Banking Industry

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The rise of financial technology (fintech) — a new industry that uses technology and the internet to improve financial services — is a global phenomenon, including in Indonesia. The popularity of smartphones and emergence of mobile applications have driven the rapid increase in use of online transactions for daily activities. While largely portrayed as benefitting consumers, the digital revolution has also adversely affect the performance of companies in Indonesia offering services through traditional platforms, such as land transportation (conventional taxis and motor taxis) and physical retail stores for goods such as gadgets or clothes. On the other hand, food and beverage businesses have benefitted from new technologies providing easier modes of delivery to customers. All these bring into question how fintech will change the financial industry, particularly banking — one of the pillars of economy and a mature industry that is tightly regulated and capital intensive. Is it possible for fintech to have a crippling effect on banks similar to what digital technology has done to other sectors?

## Most common applications of fintech

While fintech has many applications, it is most commonly used for payment/transfer and lending services. Payments or transfers are done via blockchain or distributed ledger technology, which records the transactions digitally. Payments can also be in the form of digital currencies or cryptocurrencies, which bypass traditional currencies altogether. For lending, the most common type is peer-to-peer (P2P), which matches individuals and businesses with financing needs to funds from investors or creditors, which could be individuals or institutions.

In Indonesia, P2P lending appears to be the most popular use of fintech. Majority of the 32 fintech companies registered with the Financial Services Authority (OJK) as of end-March 2018 offered services through P2P platforms, giving borrowers quick access to financing with minimal data requirements, as well as higher-than-deposit-rate returns for investors. Common characteristics of P2P lending include having no collateral requirement, disbursement of funds in 2-5 days, short-term financing tenors (10 days to 6 months), and relatively high interest rates (ranging from 15%-30% per annum to 1% per day).

Transfer/payment services, on the other hand, have not yet developed significantly in Indonesia, as most fintech companies are focused on tapping the opportunities presented by the country's large unbankable micro, small and medium-sized enterprise and consumer segments.

## Fintech advantages over traditional banking

Fintech thrives on two things: cutting the costs of intermediary services to make transactions cheaper, and offering much faster services than traditional banks or finance companies. In Indonesia, most banks still rely heavily on interest income, and their fee-based income accounts for about 15% or less of their total operational income. Therefore, the entry of fintech companies into the transfer/payment business does not really pose a threat to the banking industry. In fact, Indonesia's incoming remittances was about IDR118 trillion in 2016 (*source: World Bank*), or only about 2.4% of the banking assets that year.

Rather than viewing fintech companies as a threat, banks can collaborate with them, serving as an anchor funding provider, while gaining access to a new base of customers that can be tapped if and when they eventually become bankable. Banks could also partner with fintech firms to develop their own digital platforms and establish new ways of accessing customers that are unreachable through traditional means.

In fact, many banks have already started developing their digital banking services to reach a new generation of customers: the millennials, who encompass young professionals adept at interacting through social media channels and the internet, and who are thus more likely to do their banking transactions digitally than older banking customers. Banks, especially the smaller ones without large traditional office networks, can also use digital platforms to partner with third-party institutions — such as post offices, grocery stores (Indomaret and Alfamart), and cellphone service providers — to extend banking services such as transfers and payments to those otherwise unreached by the banks.

In our view, this strategy will bode well for the banking industry in the long term, as digital channels would increase the bankable portion of society. They will also reduce operational costs as establishing partnerships with third parties through digital services is cheaper than opening more branches or representative offices. However, we do not expect traditional banking practices to be replaced by digital services entirely, as some sort of physical presence is still needed by customers from a psychological point of view to ensure the safety of their deposits.

Overall, the presence and continued growth of digital banking services will benefit the industry due to improvements in operational efficiency, customers due to increased access to financing, and regulators as these initiatives will boost financial inclusion — particularly among micro, small and medium-sized enterprises (MSMEs) which have had limited access to banking — and overall economic stability.

**Fintech and banks operate in different segments**

As stated above, PEFINDO is of the view that fintech companies do not pose a threat to banks in the near to medium term. First, they have different target segments. Majority of P2P lenders primarily target individuals and businesses that are non-bankable — those that have not been served by banks, or barely touched by finance companies — given that the loans are mostly unsecured by any collateral. There are more than 55 million businesses in Indonesia, and only about 30% of these are bankable, leaving a huge portion for fintech companies to tap. Unsecured bank lending products such as credit cards and KTA (Kredit Tanpa Agunan) make up only small portions of total loans, well below 5%. The relatively high interest rates offered by fintech companies also price bankable customers out of range, as those customers have better pricing options.

**Banks control funding sources**

In fact, there are opportunities for collaboration between fintech companies and the banks, which further illustrates why fintech is not a threat to the banking industry. Banks still control a large portion of the total funding in the market. As of the end of December 2017, third-party bank deposits were recorded at IDR5,289 trillion, much larger than outstanding government bonds (IDR2,099 trillion) or corporate bonds (IDR397.8 trillion), about 38.9% of Indonesia's GDP. Due to the banks' key role as intermediaries, controlling a large part of the funds means banks control the lowest cost of funds. In fact, many fintech companies are dependent on off-shore banks for funding for their operations. Our view is that as long as banks maintain a significant portion of total public funding, it will be difficult for fintech companies to displace their position as primary lenders.

**Banks have greater threshold to absorb credit losses**

As the business model of P2P lenders requires investors to bear credit risks, how far P2P lenders will be able to go will ultimately depend on the quality of loans they generate and the risk appetite of the investors. Given the large amount of capital held by banks, it is fair to expect that they can absorb higher credit risks than their non-bank counterparts. In the early growth period of P2P lenders since 2016, the ratio of non-payment has been very low at around 1%, much lower than the average non performing loan (NPL) ratio of MSME loans of 4.0% as of December 2017. However, at this early stage, it is difficult to ascertain whether this low NPL ratio could be maintained over the long term. We expect this ratio to rise but remain below the MSME loan NPL of 4.0%, given the P2P firms' improved business models through more rigorous risk management, collection, and monitoring processes. Still, given the limited track record, it is difficult to forecast how investors would react to a rising trend in NPLs in the future.

**While banks are safe, how will fintech companies affect finance companies?**

Similar to fintech firms, finance companies also target a segment that is non-bankable and focus on no-collateral financing products, which typically also offer relatively high interest rates. Therefore, there is greater probability of direct competition between finance companies' whitegoods financing operations and fintech firms. As such, a finance company customer could easily switch to more convenient financing products offered by P2P lenders.

**Regulators' role**

Bank Indonesia (BI) and OJK are fully cognizant of the rise of fintech, and both have issued regulations regarding the sector (PBI no.19/12/PBI/2017 and POJK no. 77/POJK.01/2016). Both regulators share similar concerns of preventing money laundering and terrorism financing practices, as well as protecting customers' rights and the integrity of transactions. Moreover, both regulators seem eager to use the fintech platform to support the government's financial inclusion agenda, which in our opinion will be beneficial to all parties involved: the non-bankable customers, the fintech companies, and the regulators.

Although there is a threat of direct competition to a specific segment of the multifinance industry, there are many positives to be had from the emerging presence of fintech companies, primarily to increase financial inclusion, which has been slow to develop in Indonesia. In line with this, both OJK and BI have established what is called a regulatory sandbox, which is a controlled environment for a fintech company to test its systems and products. Here, the regulators can analyze and determine the integrity and safety of the systems in a closed environment to come up with a satisfactory regulatory framework. As such, it can allow new financial service innovations to grow and even flourish, while continuing to safeguard existing financial institutions, especially banks, which contribute significantly to the overall stability of the economy.

| **Table 1. Fin Tech Companies** | | | |
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| **No.** | **Company Name** | **Website** | **Business Focus** |
| 1 | PT Pasar Dana Pinjaman | https://p2p.danamas.co.id | productive, working capital for phone voucher |
| 2 | PT Lunaria Annua Teknologi | https://koinworks.com | productive and consumer (education and health) |
| 3 | PT Danakita Data Prima | https://www.danakita.com | consumer loans |
| 4 | PT Amartha Mikro Fintek | https://www.amartha.com | micro segment, productive, women |
| 5 | PT Mitrausaha Indonesia Group | https://www.modalku.co.id | productive loans, operations of min. 1 year and revenue of IDR20 mn/ month |
| 6 | PT Investree Radhika Jaya | https://www.investree.id | multiple products of productive loans (including invoice financing) and personal loans |
| 7 | PT Pendanaan Teknologi Nusa | http://www.pendanaan.co.id | consumer loans |
| 8 | PT SimpleFi Teknologi Indonesia | https://www.awantunai.com | consumer loans |
| 9 | PT Aman Cermat Cepat | https://klikacc.com | productive loans (micro and SME segments) |
| 10 | PT Mediator Komunitas Indonesia | https://crowdo.co.id | productive SME loans (and equity partnership) |
| 11 | PT Akseleran Keuangan Inklusif Indonesia | https://www.akseleran.com | productive loans for SME businesses and startups |
| 12 | PT Digital Alpha Indonesia | https://uangteman.com | consumer, multipurpose loans |
| 13 | PT Indo Fin Tek | https://www.dompetkilat.co.id | - |
| 14 | PT Indonusa Bara Sejahtera | https://www.taralite.com | productive and multipurpose loans |
| 15 | PT Dynamic Credit Asia | http://www.dynamiccredit.co.id | provides direct lending, asset management, and advisory services |
| 16 | PT Fintegra Homido Indonesia | http://fintag.id | productive loans for maritime industry |
| 17 | PT Sol Mitra Fintec | http://invoila.co.id | supply chain financing, including factoring |

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| 18 | PT Creative Mobile Adventure | http://kimo.co.id | productive, working capital for phone voucher |
| 19 | PT Digitak Tunai Kita | https://www.tunaikita.com | consumer, multipurpose loans |
| 20 | PT Progo Puncak Group | https://pinjamwinwin.com | consumer, multipurpose loans. Provides guarantee to investment principal of <IDR2 bn |
| 21 | PT Relasi Perdana Indonesia | https://www.relasi.co.id | working SME capital loans with revenue of IDR1 bn/year |
| 22 | PT iGrow Resources Indonesia | https://www.igrow.asia | productive loans for agriculture and plantation industry |
| 23 | PT Qreditt Indonesia Satu | https://qreditt.com | productive loans |
| 24 | PT Cicil Solusi Mitra Teknologi | https://www.cicil.co.id | consumer loans (student loans, e-commerce purchases) |
| 25 | PT Intekno Raya | http://www.danamerdeka.co.id | - |
| 26 | PT Kas Wagon Indonesia | https://www.cashwagon.id | consumer, multipurpose loans |
| 27 | PT Esta Kapital Fintek | https://www.estakapital.co.id | productive, focus on micro sector |
| 28 | PT Ammana Fintek Syariah | https://ammana.id | productive, focus on SME sector, sharia |
| 29 | PT Gradana Teknoruci Indonesia | https://gradana.co.id | property financing for purchase and rental |
| 30 | PT Mapan Global Reksa | http://www.danamapan.id | - |
| 31 | PT Aktivaku Investama Teknologi | http://www.aktivaku.id | - |
| 32 | PT Karapoto Teknologi Finansial | https://karapoto.co.id | - |

*Source: OJK Website, processed by PEFINDO*

## PEFINDO's view of fintech

PEFINDO is of the view that as the fintech industry in Indonesia is still at the early stages of development, though at a rapid pace, it poses limited threat to the banking industry in the near to medium term. In addition, BI and OJK have been active in trying to keep up with fintech developments. Both have issued regulations specific to the industry, and have created a regulatory sandbox to allow fintech innovations to be tested in a controlled environment. As BI and OJK have interests in both protecting the banking industry and increasing the public's access to financial services, it is important to create a balanced environment that will benefit banks, fintech players, and end-consumers at the same time.