Development of electronic payment and fund transfer industries in Indonesia

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PEFINDO is of the view that the risk profile of the money transaction processing industry is moderate, with a stable outlook. The industry is characterized by strong potential growth supported by several market fundamentals: a high unbankable segment at around 40% of Indonesia's large population, high consumption, and improving market awareness. The evolving payment infrastructure in Indonesia is also encouraging cashless payment options. Various payment channels – mostly using mobile and internet technology – provide easier and faster payment services, supporting a shift in consumer behavior from cash to alternative payments, including card payment and electronic money (e-money). However, the industry is becoming increasingly competitive due to the growing number of players.

We also note the stricter regulatory environment with the issuance of *Peraturan* Bank Indonesia No.20/6/PBI/2018 (PBI No.20/2018) to repeal entirely PBI No.11/12/PBI/2009 on electronic money and its amendments. Notable provisions introduced in this regulation include foreign ownership limitations and a minimum capital requirement. However, the degree of regulatory oversight still has room to strengthen, especially compared to a more mature banking industry. Our risk assessment also reflects low barriers to entry and tight competition, given the wide diversity of companies offering similar services in the industry that may affect the competitive dynamics.

Money transaction processors facilitate money management transactions, including money transfers, bills payment, and other related services. With regard to money transfers, given the large unbanked population and high number of migrant workers, Indonesia's remittance market has strong potential to grow further. The limiting factors are a high price structure and inefficient transfer process that have resulted in non-optimal user experience and potential lost funds. Many migrant workers use risky channels to send money due to low awareness of financial services and remittance service providers. In the long run, we expect the regulator to promote efficiency and transparency in the remittance market through financial education, and by including more people in the financial system. We also expect the regulator to push synergy within the financial industry, one way being through reducing remittance cost.

High competition among industry players

The industry is highly competitive. As of October 2019, there were 38 licensed e-money operators in Indonesia under Bank Indonesia (BI) supervision, including 12 banks, with the remainder state-owned and private-owned companies. We expect more to follow in the near to medium term, as other participants are jostling to gain prominence in the electronic payment market. E-money infrastructure and instruments were 726,910 and 209,891,847, respectively, as of June 2019 (1H2019), growing from 206,826 and 34,314,795, respectively, as of December 2015 (FY2015). The e-money transactions flow has also shown an upward trend, with total transaction volume and value at 2,260,481,259 and IDR56.1 trillion, respectively, as of 1H2019, compared to 535,579,528 and IDR5.3 trillion, respectively, as of FY2015. We anticipate these trends to continue in the medium term as we expect more people entering the banking system, more retail customers adopting digital payment at points of sale, and the developing e-money infrastructure. Competition is further enhanced due to the low switching cost. Customers can easily move from one e-payment provider to another, depending on the promotion and benefit being offered. Merchants also provide various payment channels, not exclusive to one e-payment provider.

In terms of central payment infrastructure, we expect the national payment gateway (NPG) – regulated under PBI No.19/8/PBI/2017 – to accelerate adoption of electronic payment in Indonesia. This is in line with the main aim of NPG, which is to enable interoperability and interconnectivity among all electronic payment systems. Despite the upside of having the NPG instrument, the regulation imposes game-changing requirements which may affect existing payment processing service providers, particularly non-bank principals, in their business activities.

Table 1. E-money infrastructure and transactions

	1H2019	FY2018	1H2018	FY2017	1H2017	FY2016	FY2015
Reader machine (in 000 units)	726.9	923.6	806.4	691.3	454.3	374.9	282.0
Instruments (in 000 units)	209,891.8	167,205.6	125,182.8	90,003.8	63,707.4	51,204.6	34,314.8
Volume (in 000)	2,260,481.3	2,922,698.9	1,245,841.0	943,319.9	348,217.0	683,133.4	535,579.5
Value (in IDR billion)	56,106.0	47,198.6	20,668.4	12,375.5	4,756.8	7,063.7	5,283.0

Source: www.bi.go.id

Competition in the remittance market is high, with 150 money transfer operators licensed under BI. The scope of their activities is specified in PBI No.14/23/PBI/2012. They also compete with other industries considered to have stronger brand recognition and wider networks to tap the potential market, such as banks, telecommunication companies, and the state-owned postal service company.

Indonesia's remittance industry has been consistently growing over the past few years. Its total remittance market was IDR68.8 trillion as of 1H2019, increased from IDR53.2 trillion as of 1H2018 and IDR40.6 trillion as of 1H2017. Although they have been regulated, the remittance transactions are still routed through informal channels. Informal modes of remittance are not recorded and are facilitated through non-licensed individual remittance agents and hand-carried by migrants, co-workers, family or friends. Thus, we expect an improved regulatory environment and/or a more effective system to regulate the remittance channel. We also expect that fintech companies are eager to enter the space electronically, which would bypass the need for physical locations. So far, however, we have seen limited evidence that those companies possess any near-term threat. This is because most are focused on domestic payment only due to cross-border payments entailing additional operational complexity and regulatory considerations, such as anti-terror, anti-money laundering, and anti-fraud prevention measures.

Table 2. Money transfer transactions

	1H2019	FY2018	1H2018	FY2017	1H2017	FY2016	FY2015
Transfer volume outward (in 000)	395.9	437.4	212.4	353.7	187.0	372.0	322.4
Transfer value outward (in IDR billion)	13,680.6	116,519.9	7,830.0	8,361.1	4,640.7	8,558.1	6,431.7
Transfer volume inward (in 000)	17,027.2	13,946.2	5,829.6	10,532.9	6,331.7	13,317.0	10,954.3
Transfer value inward (in IDR billion)	28,632.9	60,587.2	30,405.6	46,802.2	27,134.7	54,563.4	43,764.1
Transfer volume within Indonesia (in 000)	54,651.8	32,035.6	11,355.2	12,247.7	6,042.0	12,401.9	15,186.7
Transfer value within Indonesia (in IDR billion)	26,509.6	32,719.9	14,933.9	17,270.1	8,865.1	22,614.2	30,456.9

Source: www.bi.go.id

We are of the view that fund transfer activities can help increase financial inclusion, because they are an entry point to financial services. The ease and simplicity of transferring funds will support people who do not yet have access to banks to use formal financial products and services. Transferring funds should also increase demand for savings accounts or electronic money wallets, where money can be stored more securely. Through savings and electronic money wallets, the track record of users becomes an important part in providing financing and determining the risk profile of debtors.

Risk profile of industry players

We view a high level of competition both in the electronic payment and remittance industries. They do not only compete with similar players, but also with banks that have more advantages due to their longer experience, more extensive network and infrastructure, and stronger brand recognition. If access to the banking sector becomes easier and broader to all of society, this will narrow the business scope for industry players, in our view. As for new players with below five-year establishment, we are of the view that they have a limited track record of operations and their business model has not been tested through various business and economic cycles. We are of the view that they have a limited track record in maintaining long-term relationships with their business partners that would ensure their revenue generation.

On the financial side, most companies in these sectors, except for banks, are in the expansion phase and face challenges in managing operational expenses – the majority of which are from personnel, marketing and infrastructure development – which are essential to improve their brand awareness in the market and fuel business growth. We project the economies of scale will likely take time to develop due to the highly fragmented industry they engage in. Being in the expansion phase, we view most of them as having limited financial flexibility to raise funding. We anticipate financial support will come from the shareholders, limiting the risk of default to third-parties.

Rating methodology assessment for electronic payment and fund transfer industries

Our rating methodology on the electronic payment and fund transfer industries is similar to business and consumer services. It includes three major risk assessments: industry risk, business risk and financial risk. In reviewing industry risk, our analysis includes the growth and stability of the industry, revenue and cost structure, barriers to entry and competition, regulation, and financial profile.

We assess business risk as measured by market position, diversification, quality of service, and operating management. In reviewing market position, our analysis includes a range of qualitative and quantitative elements that distinguish its competitive advantage from its peers. We review the degree of success in establishing leadership positions and growing market share in the markets in which it competes. We assess diversification as measured by the variety of services or products, customers, and geographical area. Companies with diversified business segments and a wide range of services generally show better stability during adverse operating conditions or market downturns, compared to those with a narrower business focus. Our analysis on quality of service includes evaluation of a company's distribution network to measure the degree of product or service accessibility by customers. We assess the capability to support daily operations through qualified personnel as well as proper technology and infrastructure. We consider it important to attract customers and support a company's growth, particularly in intense business competition. The operating management covers a review of a company's level of profitability and operating efficiencies. We analyze the expense structure, including the ability to control costs and expenses without eroding growth prospects or service quality.

In terms of financial risk, our assessment evaluates financial policy, capital structure, cash flow protection and liquidity, and financial flexibility. We review the financial policy including a company's policies toward financial risk. We review its adherence to commitments by examining its track record of fulfilling its previous financial obligations, which is also important to determine the degree of commitment and consistency to honor its obligations timely. We also consider management's operating performance and use of cash flow through different economic and industry cycles. Analysis of capital structure includes our review of a company's historical, current and projected leverage (total and net debt in relation to equity and EBITDA). We review the debt structure and composition to assess risk of maturity or currency mismatches between a company's sources of financing and its cash flow. On cash flow protection and liquidity aspects, we evaluate a company's cash flow generation and capability to meet its short-term and long-term financial obligations. The degree of its debt-servicing capability is measured by its interest and debt coverage ratio. Financial flexibility analysis covers combined evaluations of all financial measures above to arrive at an overall view of a company's financial health. It includes assessment of its ability to service and refinance debt, as well as attract various funding from the market. We also apply a parent support assessment to reflect potential support given to the company, particularly during financial distress.