PROPOSING A STRATEGY TO REDUCE THE NUMBER OF ILLEGAL FINTECH P2P LENDING PLATFORMS IN INDONESIA

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ABSTRACT

Fintech Peer-to-Peer (P2P) Lending Platform is a fintech service that transforms traditional lending or credit application to digital and is distinguished by faster and easier loan disbursement than traditional ones. Since 2018, the emergence of this platform has increased significantly in Indonesia while also opening up opportunities for criminality practices, such as the rise of illegal Fintech P2P Lending platforms. The distribution of illegal fintech P2P Lending Platforms was approximately 200 percent greater than legal ones. They have been conducting unethical financial practices, which harmed the users, and some even led to suicide. This report aims to propose a strategy for the government of Indonesia to reduce the number of Illegal Fintech P2P Lending platforms in Indonesia. It was conducted by analyzing the as-is strategy implemented by the government of Indonesia compared to the benchmark countries Republic of Korea and People's Republic of China. The to-be model was also designed according to the potentials and weaknesses obtained from the gap analysis of Indonesia compared to the two countries. This is expected to achieve a sound fintech ecosystem in Indonesia. Moreover, the future study should cover technology adoption to enable proactive-oriented work for the government to reduce the number of Illegal Fintech P2P Lending platforms in Indonesia.

Keywords: Indonesia; fintech; Peer-to-peer Lending (P2P); fintech ecosystem; lending; legal strategy; illegal fintech P2P Lending platform.

1. INTRODUCTION

Approximately 1.7 billion adults worldwide are unbanked. There are four countries in the world with the greatest percentage of unbanked citizens. Indonesia ranked number fourth with 95 million unbanked population (Loh, 2018). There is 36% of the total population to fall under the category of financially excluded. One of the main causes is a dispersed geographical location. The issue of financial exclusion also indicates that there is limited access to the credit system is high. Some implications emerge due to the credit access limitation in Indonesia such as, lowering the level of financial inclusion, creating a sizeable MSMEs financing gap by 19% in 2018, and reducing the national gross domestic product (GDP) significantly by nearly $130 billion or approximately 14% of the total GDP (Batunanggar, 2017).

Following the current ICT trend, those challenges have turned into opportunities for some people by allowing high credit demand populations with minor to no credit history records, also known as the credit invisible, to access an ICT-enabled platform that can connect them with yield-hungry investors. This innovation leads to the idea of enabling the credit Invisibles to enter the credit market, resulting in a proliferation of financial technology (fintech) in Peer-to-Peer (P2P) lending platforms (Loh, 2018). It began to emerge in Indonesia in 2018. Its popularity comes from its ability to provide a simple process and quick loan disbursement. In 2018, it contributed $25.97 trillion to Indonesia's GDP (PwC-Indonesia, 2019).

Between 2018 and 2020, the number of them registered with the government through the Financial Services Authority (OJK) out of the total number of digital platforms registered with the Ministry of Communication and Informatics (MCI) in Indonesia has been around 15%, or around 200 fintech P2P Lending platforms. This is shown in Graph **1**.

However, in the same period, the number of unregistered fintech P2P lending platforms distribution in

Indonesia has increased significantly. It was almost 200 percent higher than the total number of digital platforms registered in Indonesia. In other words, there were over 2,000 unregistered fintech peer-to-peer lending platforms circulating freely in society. These platforms are also classified as *illegal Fintech Peer-to-Peer Lending platforms*.

The Distribution of LEGAL and ILLEGAL Fintech P2P Lending Platforms Compared to the Digital Platform Registered in Indonesia from 2018 to 2020

Graph 1 Legal Fintech P2P Lending and Illegal Fintech P2P Lending Platforms in Indonesia (2018 -2020)
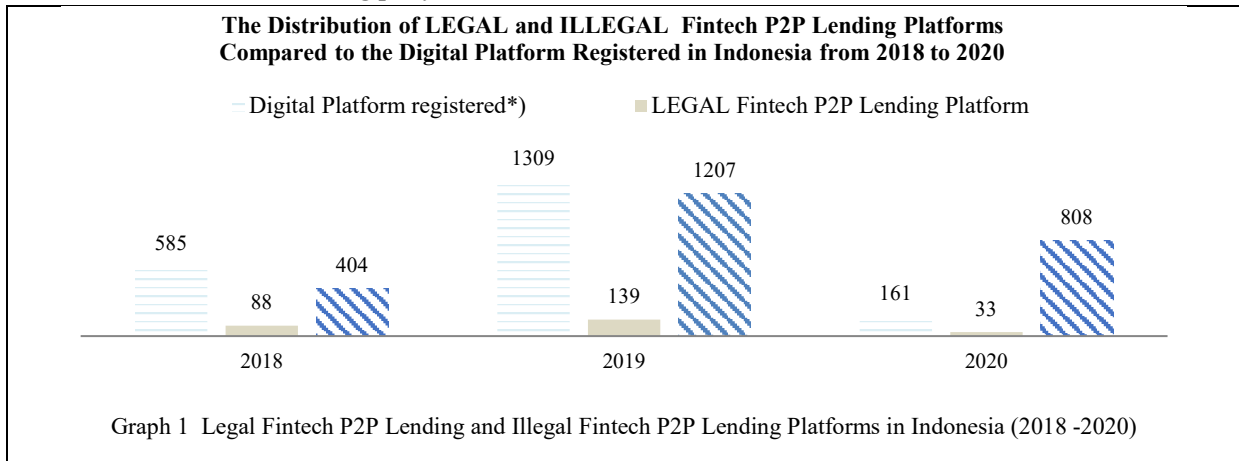
Some illegal Fintech P2P Lending platforms have engaged in unethical loan practices, some of which have resulted in suicide risk. This is due to improper loan repayment practices such as humiliation, cursing, abusive and sexual harassment, and collecting money before the due date (Hidajat, 2019). The most common problem has been the operators of Fintech P2P Lending platforms' lack of understanding of running the platforms appropriately. They also function as lenders and operators, pursuing big profits without sufficient due diligence (Loh, 2018). The government has been attempting to reduce the number of victims, including deploying techniques to shut down illegal Fintech P2P Lending Platforms based on user reports. However, this platform continues to emerge and grow, making it difficult for the government to respond (Hidajat, 2019).

Therefore, this study aims to generate and suggest a new strategy to reduce the growth of illegal fintech P2P lending in Indonesia by conducting a literature review to analyze what are the critical success factors of the fintech P2P lending ecosystem managed by the regulators, Indonesia's fintech P2P lending as-is analysis, benchmarking analysis with the Republic of Korea and the People's Republic of China, and Gap analysis. Then, it is expected to realize a more reliable and secured fintech P2P lending ecosystem through the suggestion of recommendation and a proposal of a to-be model.

2. LITERATURE REVIEW

To support the growth of fintech innovation in the country, particularly Fintech P2P Lending, the government must consider the Critical Success Factors (CSFs) to build a robust Fintech P2P Lending ecosystem. Identifying and comprehending these CSFs will allow the government to concentrate its efforts on the most important resources rather than wasting time on less important matters. This is identified under **Table 1**.

Table 1 Identified Critical Success Factors

No.	Critical Factors	Details	Source(s)
1	Telecommunication infrastructure	The availability of telecommunication infrastructure in supporting the fintech P2P Lending platform establishment.	(Gomber et al., 2018); (Zavolokina et al., 2016)
2	Internet penetration	The coverage of internet service in the country presents the ability of its citizens to adapt to the service offered by the fintech P2P Lending platform.	(Chen, 2016); (Huang, 2018)
3	Smartphone User Penetration	The number of smartphone users in the country is related to the number of customers who would be impacted by the service offered by the P2P Lending platform.	(Chen, 2016)

4	Fintech Technology Infrastructure	The availability of the established ICT infrastructure for financial purposes to support the fintech industry.	(IMF and World Bank, 2018)
5	Scalability	The government's strategy is to support the growth and promote the fintech P2P Lending platforms to drive the national innovation system.	(Au et al. 2020); (Hommel and Bican, 2020)
6	Regulatory Knowledge	The government institutional task and responsibilities over fintech P2P lending ecosystem in the country.	(Werth et al., 2019)
7	Customer Adoption / Financial Literacy	The capability of the society adoption to the fintech P2P Lending platform and financial literacy in general.	(Gomber et al., 2018); Ryu et.al, 2020
8	Unmet Financial Needs	The number of unbanked population in the country represents the potential of fintech P2P Lending platforms to emerge.	(Au et al. 2020); (Huang, 2018); (Zavolokina et al., 2016); (Chen, 2016);
9	Collaboration / Partnership	The stakeholders and actors involved in the fintech P2P Lending ecosystem represent the opportunity to create a firm and healthy network.	(Chen, 2016); (Hommel and Bican, 2020); (Werth et al., 2019)
10	Regulatory Framework	The government's availability of regulations/policies to support the growth of the fintech P2P Lending platform.	(Chen, 2016); (Jinasena et al., 2020)
11	Consumer Protection	The government's availability of regulations/policies to protect the customer of the fintech P2P Lending platform.	(Chen, 2016)
12	Safety Aspect	The government's availability of regulations/policies to ensure transaction safety through the fintech P2P Lending platform.	(Chen, 2016)
13	Risk Management	The government's availability of regulations/policies prevents the risk of criminality through the fintech P2P Lending platform.	(Chen, 2016); (Ryu and Ko, 2020)
14	Cybersecurity	The availability of regulations/policies by the government to prevent the risk of privacy or internet security breach through fintech P2P Lending platform	(Gomber et al., 2018); (Chen, 2016)

3. METHODS

The methodology used in this paper was developed by combining the critical factors listed in **Table 1** with the Analytical Framework Model, which is the TOE Framework, to examine the current state of the Fintech P2P Lending ecosystem in Indonesia and the Benchmarking countries' strategies for fintech P2P Lending platforms in particular. The analysis was also combined with the model from the World Bank – Guidelines for Policy Makers and Regulators to Address Fintech. This was done so that the government's current plans in Indonesia and the benchmarking countries could be measured in a structured way. The results of the analysis were then used to determine the gap in the Indonesian situation. And then, followed by defining recommendations by referring to the literature review and lessons learned from the benchmarked countries. Finally, the to-be model for Indonesia could be designed to assist the development of a strong and healthy fintech P2P lending ecosystem. The methodology is illustrated in **Figure 1**.
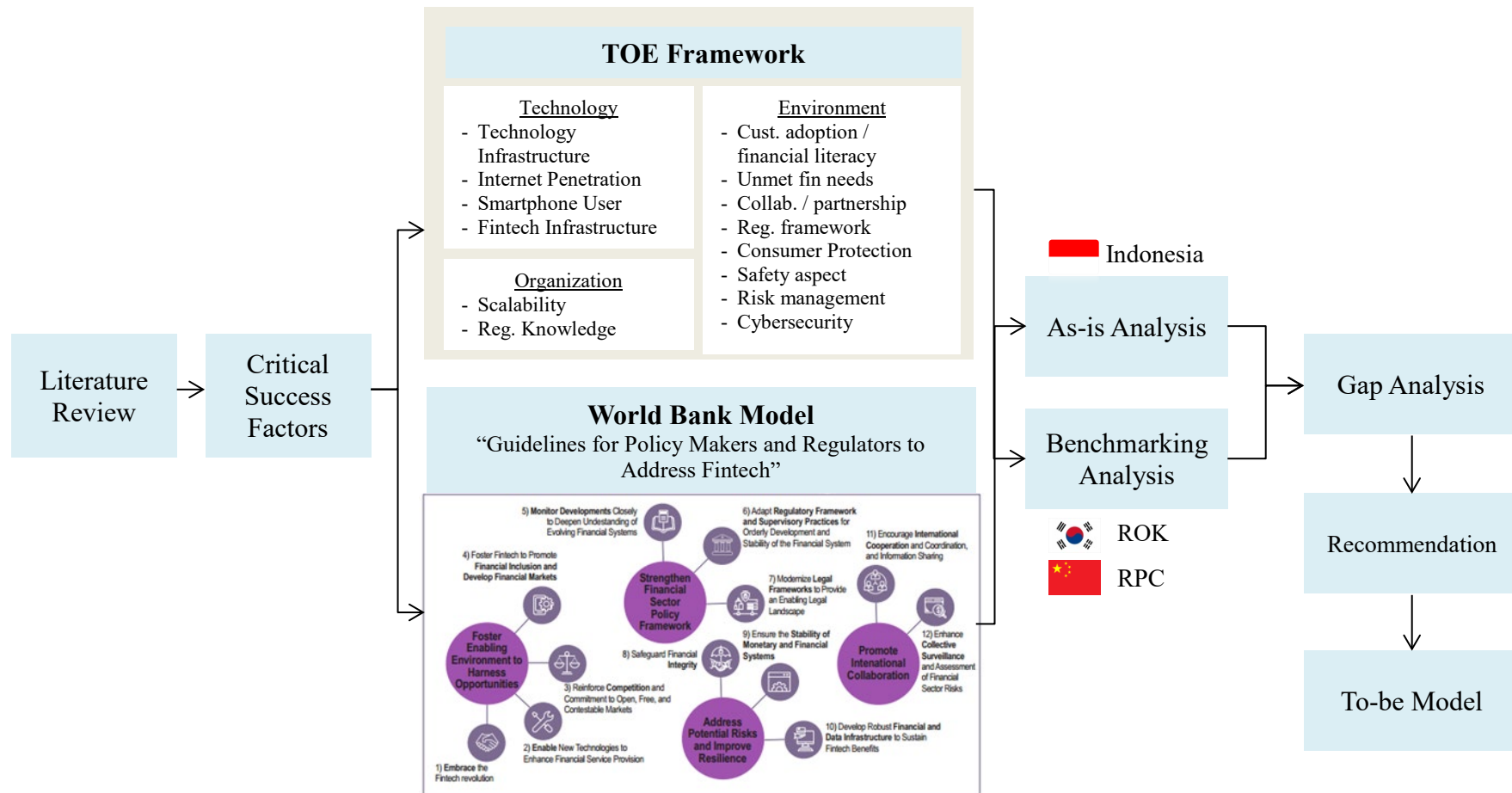
Figure 1 Research Methodology Framework

4. RESULTS

4.1. As-Is Analysis Indonesia

The ICT environment in Indonesia is currently centralized in Java island, resulting in a significantly low number of internet users outside this island (*Siaran Pers Pengguna Internet Indonesia @ Blog.Apjii.or.Id*, n.d.). It implies that the population in Java island is more in advantage in accessing government established ICT infrastructures. Moreover, this implies that financial education, commercial activities, and financial activities are more accessible on Java island in the financial domain. It corresponds to the inclusive financial condition of Indonesia, which is lower than the other two ASEAN countries due to the centralized financial activities in Java island (*Strategi OJK Untuk Kejar Target Inklusi Keuangan @ Money.Kompas.Com*, n.d.).

In increasing the accessibility of financial inclusiveness, Indonesia's government has taken action by supporting the fintech industry as the main actor to drive its growth within society through some programs and activities, such as financial literacy and in-depth development of financial education Sandbox regulatory (Nababan et al., 2019). However, there is still a long way to be able to increase the financial inclusiveness of Indonesia. As Indonesia's government has not been strict in controlling the industry, the illegal fintech P2P lending players are freely distributed. By collaborating under the SWI task force, the government blocked some illegal fintech P2P lending players on the internet (Terminanto, 2020).

Some conditions affecting the illegal fintech P2P lending in society are low financial literacy rate (Singapore, 2020), digital financial talent shortage, big MSMEs financing gap, and big unbanked population (Wahyuni & Turisno, 2019). In creating a safe ecosystem, the government established some regulations and the imposition of fines. Lastly, Indonesia does not have any regulations regarding international collaboration for the fintech P2P lending industry. In summary, the current strategy by the government of Indonesia is still performed in a reactive-oriented manner and not enough to create a deterrent effect for the illegal players.

4.2. Benchmarking Analysis
4.2.1.   Republic of Korea (R.O.K)

The trend of fintech P2P lending in South Korea is being used as an investment media. It is mostly being utilized as an alternative platform for people to invest their money. This ICT environment also developed innovative government financial ICT environments through fintech infrastructures such as the regulatory sandbox system, the national financial information disclosure system, and the national regtech platform (Kingdom, 2020). In general, the South Korean government has always treat emerging industries by embracing them gradually.

It also applies to the fintech sector. The government covered the fintech sector in three periods gradually (*Financial Services Commission (FSC) of South Korea*, n.d.). By implementing this method, the government can monitor the needs of the player in the field. The government had included the fintech industry under the national plan in 2015, the «24 key reform tasks in 2015», which include the deregulation, regulatory sandbox, and the establishment of the fintech support center (*AKR20151223092751001 @ Www.Yna.Co.Kr*, n.d.).

As the implementation of this plan, the government tried to lower the entry barriers for the new fintech businesses to allow new businesses to develop and encourage innovation. These approaches resulted in the firm and stable fintech ecosystem in South Korea. The important actor within the fintech ecosystem besides the fintech business players themselves is the people. South Korea is the most financially literate people amongst the APEC countries (*OECD/INFE Report on Financial*

Education in APEC Economies, 2019).

4.2.2. People's Republic of China (P.R.C)

China is a big country, making it difficult to cover all areas of telecommunication infrastructure, especially an ICT infrastructure (Hootsuite, 2020). This resulted in the number of internet penetration is slightly more than half of the population. Along with the incentive scheme, the Chinese government also has enacted the sandbox regulatory for the fintech industry in general (*China @ Iclg.Com*, n.d.). As part of the fintech industry, fintech P2P lending in China has been distracting the ecosystem with its scandalous criminal activities. Since China has a potential in the second highest number of financial literacy rate amongst APEC countries (*OECD/INFE Report on Financial Education in APEC Economies*, 2019). In addition, the government has appealed to the fintech P2P lending firms to appoint an incumbent financial institution as their custodian (Huang, 2018). This approach is intended to re-build the credibility of fintech P2P lending to the people since the criminal cases have negatively affected their lives.

5. DISCUSSION

5.1. Gap Analysis

The Gap Analysis for Indonesia in comparison to the Benchmarking countries South Korea and China according to Technology Organization Environment Framework, *twelve* implications are necessary for the government of Indonesia, especially the regulator in the fintech P2P lending ecosystem, to take into consideration.

According to the findings of the TOE framework analysis conducted between Indonesia, South Korea, and China, there are *seven key findings* that the Indonesian government should consider. Under the Technology aspect, the factor of *Telecommunication Infrastructure* and *Fintech Infrastructure* are found lacking due to the inadequate coverage of telecommunication infrastructure that is not equal across all regions in Indonesia and the low technological adoption for financial infrastructure. Moreover, in the Organization aspect, the *Scalability* and *Regulatory Knowledge* show that the government still has weak supportive strategies and a lack of supervision and law enforcement. As for the Environment aspect, the *Financial Literacy*, *Collaboration/Partnership*, and *Regulatory Framework* are the identified factors that show that the Fintech P2P Lending environment is still poorly governed. This explained in **Table 2** in APPENDIX.

In addition, the analysis of the three countries using the World Bank Model yielded *five key* findings for Indonesia. Under Foster Enabling Environment to Harness Opportunities, it is identified that Indonesia *does not have a dedicated fintech national plan* to manage the fintech environment appropriately. According to Strengthen Financial Sector Policy Framework, Indonesia still *lacks information-sharing with incumbents*, and there is *no particular fintech P2P Lending regulation* established. As for Address Potential Risks and Improve Resilience, Indonesia is currently *lagging in terms of financial infrastructure technology adoption*. Finally, for the aspect of Promote International Collaboration, it was discovered that Indonesia still *does not have a program for worldwide marketing and partnership* to support local fintech P2P Lending platforms. This explained in **Table 3** in APPENDIX.

5.2. Recommendation

According to the degree of similarity in the characteristics, all twelve essential elements were divided into four categories. After that, they were divided into two primary government functions of Policy and Service. This is shown in **Figure 2**.

Figure 2. Recommendation Determination Logic
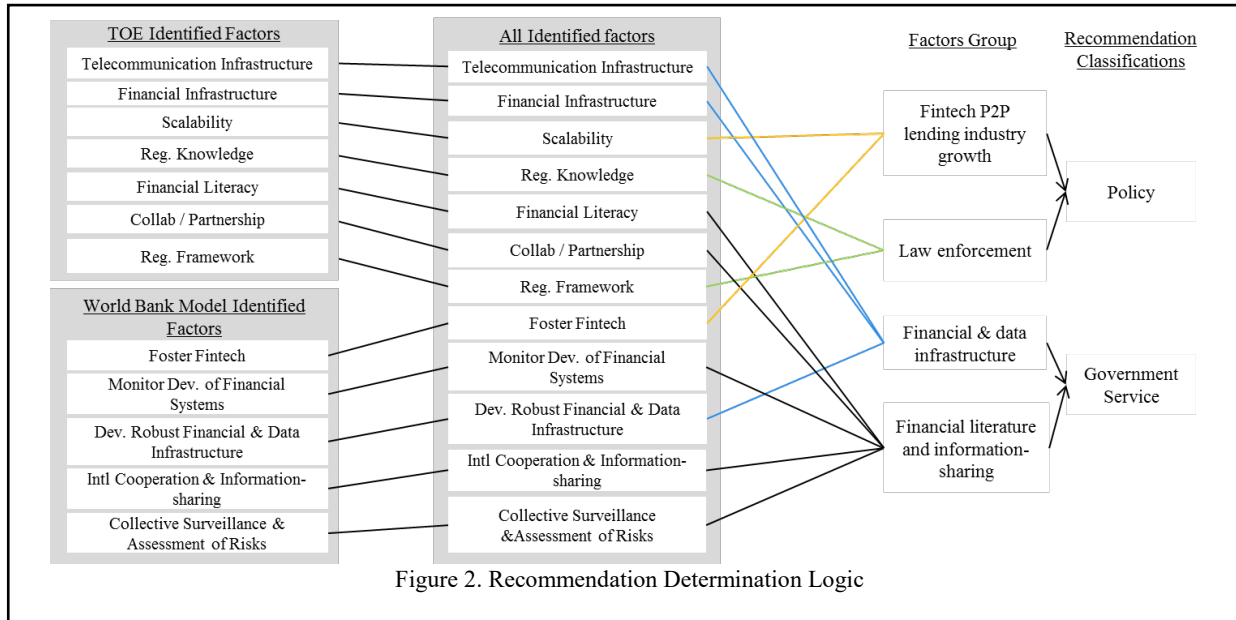
In the Policy Recommendation, the government of Indonesia needs to focus on Fintech P2P Lending industry growth based on the factor of scalability and foster fintech to promote financial inclusion through the deregulation to provide clear guidelines and fintech national plan. Moreover, the law enforcement should also be considered by focusing on the factor of regulatory knowledge and regulatory framework through improving supervision by establishing a sub-unit dedicated for supervising fintech P2P Lending platforms distributed in Indonesia, also to improve enforcement through a reward and punishment law.

In the Government Service Recommendation, the government of Indonesia needs to focus on Financial & Data Infrastructure through the factors of Telecommunication Infrastructure, Financial Infrastructure, and the Robust Financial and Data Infrastructure to Sustain Fintech Benefits by establishing a strong broadband connection, developing a Financial Credit Data Center, and adopting financial infrastructure technology. Also, the government needs to focus on Financial Literature and Information-sharing through the factors of Financial Literacy, Collaboration/ Partnership, and the International Relationship by setting an attractive strategy and to enhance publication approach, also to collaborate with the digital startup to allow citizen engagement, and setting an information-sharing with the incumbents and develop an international collaboration.

5.3. To-be Model

The recommendation then designed into the to-be model by considering the existing environment that is comprises by the actors and their activities. This was conducted by connecting the actors with the recommendations mentioned in the previous section. It is depicted in **Figure 3**. This to-be model is expected to improve the government to address the illegal fintech P2P lending platform by changing the government orientation from reactive to proactive.
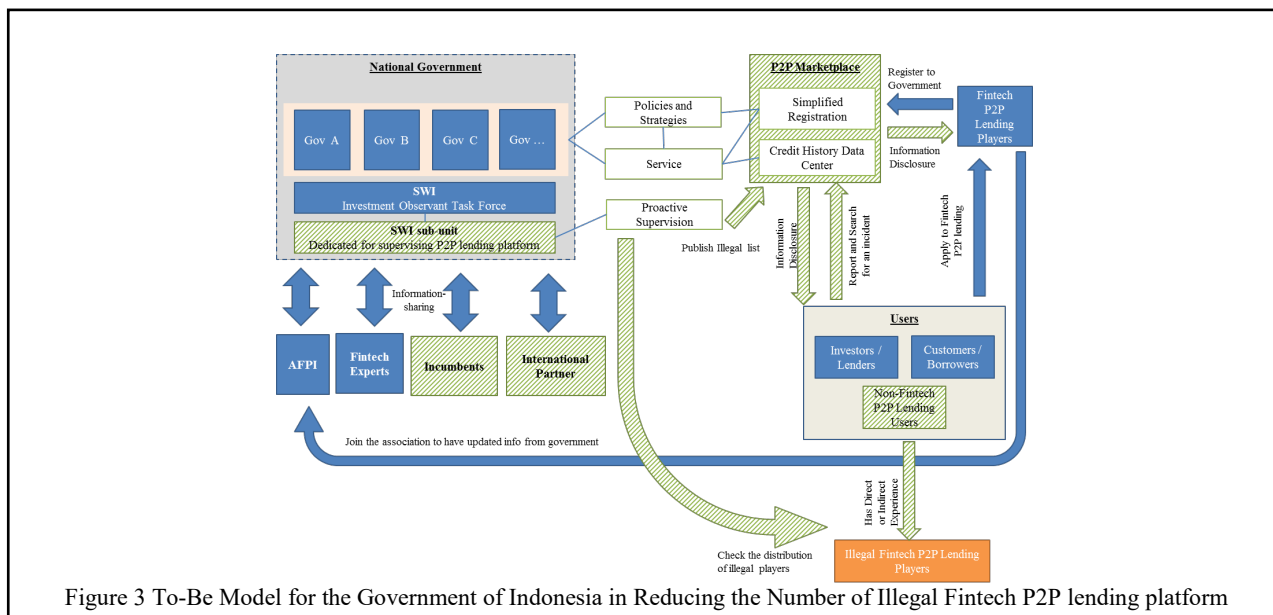
Figure 3 To-Be Model for the Government of Indonesia in Reducing the Number of Illegal Fintech P2P lending platform

6. CONCLUSION

Their inability to obtain the lending application services becomes the target customer of Fintech P2P Lending platforms. Fintech P2P Lending platforms transform the traditional services into technology-based services, allowing users to apply easily without many requirements. Even though the government's illegal fintech P2P lending platforms have been closed down, the new platforms keep appearing and increasing. This report plays a vital role in addressing the problem as it is identified the gap the government of Indonesia needs to take care of in handling the illegal fintech P2P lending platforms.

According to the analysis conducted from the benchmark countries South Korea and China, the gap was identified, creating a sound fintech ecosystem through their legal aspects and strategies. According to the analysis performed, the study proposed a policy and government service recommendations for the government of Indonesia to be able to handle the illegal fintech P2P Lending platforms appropriately. Through the Policy recommendation, the government needs to provide clear guidance for Fintech P2P Lending platforms to enter the market, a fintech national plan, improve supervision and law enforcement, and enable proactive-oriented regulations.

AUTHOR CONTRIBUTIONS

Vidyani, Faradina conceived and designed the analysis; collected the data; performed the analysis' and wrote the paper.

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APPENDIX

Proposing a Strategy to Reduce the Number of Illegal Fintech P2P Lending Platforms in Indonesia

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1. Gap Analysis

Table 2 TOE Framework Gap Analysis Result

	Critical Factors	INDONESIA	R.O.K	P.R.C	Findings for Indonesia
Technology	Telecommunication Infrastructure	57.39 with speed of 13.83 Mbps	Broadband 100%; speed is 103.18Mbps	73.90%, internet speed is 67.71 mbps	• Low telco infra coverage. • Low speed of mobile internet
	Fintech Infrastructure	An offline system of Historical Debtor Individual Information in Indonesia (SLIK).	Regulatory sandbox online registration system An online financial information disclosure system (DART system) Regtech platform	Availability of The Credit Reference Center (CCRC) a system that provides a credit information that is beneficial to facilitate financial lending activities.	Unavailable technology adaptation for fintech players credit history data yet.
Organization	Scalability	• A strategy available to increase financial inclusive index in Indonesia: Fin. Literacy program; Digital education; Sandbox regulatory • Low fin. Inclusive level compare to ASEAN	• Deregulation of fintech to lower entry barrier • Sandbox regulatory • The establishment of fintech support center (FSC)	• Adoption of comprehensive incentive schemes system • A 2 year P2P lending transition plan	Available (Weak Supportive Strategies) the government of Indonesia needs to consider: • Deregulation for fintech to lower entry barrier • Establishment of Fintech support center • Adaptation of tax incentives • Transition plan for P2P lending
	Regulatory Knowledge	• Formed a special task force named SWI • Fintech P2P Lending practices is the part of SWI supervision. • SWI works reactively. • Listing of legal & illegal fintech P2P Lending Platform.	• 3 period treatments. • 'P2P loan joint inspection meeting' to establish a cooperation system to cope with illegal activities related to P2P lending Platforms	• Each state has different laws and regulations to control illegal p2p lending perpetrator • Introduced the internet finance 'guidance' policy framework in July	Available (Weak supervision) • Unavailable specific P2P lending supervision • Reactive supervision and law enforcement
Environment	Customer Adoption / Financial Literacy	• Financial literacy rate: 38% • Financial inclusion: 76%	69% (ranked as the top APEC performers in terms of financial knowledge)	67% (ranked 2nd for financial literacy amongst APEC countries)	Lowest financial literacy rate amongst the benchmarking countries
	Collaboration / Partnership	• Collaboration with fintech P2P Lending platform association (AFPI) • Collaboration with the experts through IFSoc	• Korea P2P finance association • World Bank Group Korea Office • Collaborated with start-up firm to allow citizens involvement in the criminal reporting method	Collaboration with a commercial bank to be ready as the custodian for P2P Lending Platforms	• Unavailable collaboration with digital startup for information-sharing between citizens and government through developed system. • Unavailable custodian scheme.
	Regulatory Framework	Separate regulations available for financial and technology	Availability of dedicated fintech P2P Lending act (P2P finance act)	A standard to set up fintech P2P Lending businesses	Inexistence of a specific regulation for fintech P2P Lending platforms.

Table 3 World Bank Model - Guidelines for Policy Makers and Regulators to Address Fintech Gap Analysis

Elements		Indonesia	R.O.K	P.R.C	Key Findings for Indonesia
Foster Enabling Environment to Harness Opportunities	Promote Financial Inclusion and Develop Financial Markets	Available (dispersed regulations)	Available	Available	Available (dispersed regulations) The government of Indonsia needs to consider providing a specific fintech national plan which could covers all relevant regulations.
Strengthen Financial Sector Policy Framework	Monitor Developments Closely to Deepen Understanding of Evolving Financial Systems	Partially Available	Partially Available	Available	Partially Available
	Adapt Regulatory Framework and Supervisory Practices for Orderly Development and Stability of the Financial System	N/A	Available	Available	N/A
Address Potential Risks and Improve Resilience	Develop Robust Financial and Data Infrastructure to Sustain Fintech Benefits	Partially Available	Available	N/A	Partially Available
Promote International Collaboration	Enhance Collective Surveillance and Assessment of Financial Sector Risks	N/A	N/A	N/A	N/A