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PERSPECTIVE

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The Pandemic's Benefits for Indonesia's Fintech Sector

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The Covid-19 pandemic has benefited the fintech sector in Indonesia, with more people going online to socialize, work, study and do their shopping. In this picture taken on 3 July 2021, a woman cycles past a banner on a shopfront alerting customers that it is only open for online services in Jakarta, as Indonesia imposed a partial lockdown in the capital due to the COVID-19 coronavirus Delta variant. Picture: Bay Ismoyo, AFP.

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EXECUTIVE SUMMARY

- The Covid-19 pandemic has benefited the fintech sector in Indonesia, with more people going online to socialize, work, study and do their shopping. E-payment fintechs have therefore seen their transaction volume rise dramatically, especially among those collaborating with major e-commerce outlets.

- While bank loan growth has been flat, fintech loan growth has been positive, picking up the slack through SME and micro loans during 2H20. But lending in a recession has risks, as seen in the worsening of problem-loan ratios through 2Q20 and 3Q20, before improving by year-end and into 2021.

- Indonesia's Financial Services Authority (OJK) is drafting tighter regulations, with plans to raise the fintech capital requirements to IDR15 billion from the current IDR2.5 billion, and to set quotas to encourage inclusive and productive lending.

- Fintechs need access to reliable data for their credit assessment algorithms to quickly grow their loans, as well as securing funding to sustain their business.

- The pandemic has depressed certain sectors, allowing more funds to be diverted into fintechs. This has led to some early steps towards fintech consolidation and collaboration, most notably the recent merger of two unicorns, GoJek and Tokopedia.

- To access data and secure funding, fintechs are also deepening their collaboration with other financial institutions, such as banks and insurance companies. It is still early days yet for serious merger and acquisition activity, but regulatory work is underway in anticipation of this trend.

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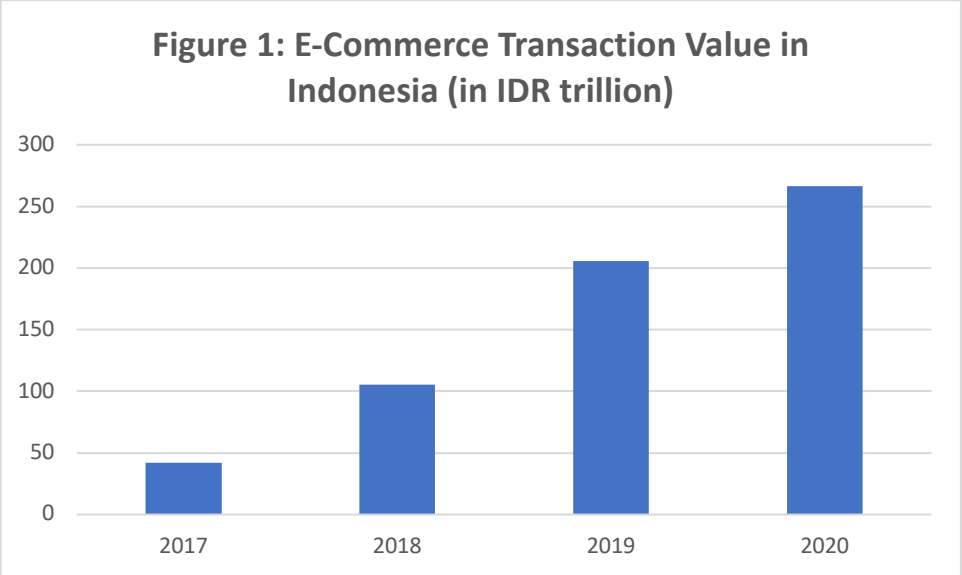
INTRODUCTION

It has been a year since the Covid-19 pandemic began ravaging the Indonesian economy. The economy contracted, company activity ceased, and some firms have been forced to close. In the financial industry, banks severely curtailed lending as they tightened their credit criteria and focused on expense control and restructuring their worsening loan portfolio.

It was in this challenging banking environment, that the lending fintechs picked up the slack and grew their SME loan portfolio in the second half of 2020. But growing loans in a recession remains a risky initiative, reflected by a rise in their problem-loan ratios during that year. Another segment that was among the larger pandemic beneficiaries was the e-payment fintechs. Riding on e-commerce growth, there was a sharp transaction volume surge to IDR 266.3 trillion in 2020 and a sizable number of new e-payment users, as people began to buy their daily needs online (Figure 1).



Source: databoks.katadata.co.id and Bank Indonesia January 2021[1]

Fintechs covers a wide range of categories, but this paper will limit its pandemic assessment on the lending and the e-payment fintechs; reviewing their opportunities and challenges; and what trends to expect going forward.

A GROWING AND CONSOLIDATING FINTECH LANDSCAPE

One major impact of Covid-19 has been the early signs of consolidation in Indonesia's fintech landscape. The pandemic has increased investors' interest in pandemic-resistant sectors, which for Indonesia have been e-commerce, logistics and fintech.

Indeed, the prospects for fintech, in a country of 270 million people with a significant internet and smart phone penetration (67% for internet and 60% for smart phones); with about half of internet users already using mobile banking and more than 80% using e-commerce; and about a third of the population still unbanked, are alluring.[2]

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Indonesia's unicorns and several leading players in e-commerce and fintech have been obvious beneficiaries. With financial backing and facing increased competition, they have sought acquisitions. This explains recent strategic partnerships and mergers between e-payment fintechs and e-commerce companies. The lending fintechs, like their bank counterparts, were focusing their loans to large diversified business groups, operating in still-growing sectors such as consumer goods, food and beverage and pharmaceuticals. However, trying to differ from banks, fintechs have focused more on smaller SMEs distributing for large companies and which are on the supplier end of the supply chain.

As of early this year, Indonesia had five unicorns (those with valuations above USD1 billion). But just recently, this number shrank to four when GoJek, the ride-hailing, e-payment, courier and food-delivery super app announced its merger with fellow unicorn, Tokopedia, the online-store. The merged entity is now rebranded as GoTo, with an estimated USD18 billion in valuation.[3] This led to speculation that Tokopedia might sell its sizable stake in OVO, another unicorn focusing on e-payments, since GoJek owns GoPay, also a leading e-wallet app. It remains to be seen if OVO ends up with another unicorn, which could bring the number of unicorns down further to three. The third unicorn is another online store called Bukalapak, which closely collaborates with Dana, another e-wallet player. Unlike its fellow unicorns, Traveloka has been more subdued during the pandemic, because of the depressed travel industry it focuses is on.

THE POSITIVE PROSPECTS OF E-PAYMENT FINTECHS

The pandemic has accelerated the ongoing shift from bank transfers and card payments into e-wallet transactions. In 2020, total e-wallet transactions reached Rp201 trillion (USD14 billion), up 38.6% from a year before and is expected to grow to USD18.5 billion in 2021[4]. A 2019 study noted that the country's e-wallet payments at 20% that year, still lagged traditional credit cards and bank transfers which reached 34% and 26% usage.[5] But e-wallet due to its simplicity and growing usage is expected to match and overtake the two earlier payment models, especially for daily and low-value transactions. This is supported by e-wallet payment usage, which was used for retail purchases (28%), transport (27%), food orders (20%), e-commerce (15%) and bill payments (7%).[6] Concurrently, cash payments have declined to 14% and are expected to decline further. Interestingly, the portion of payments using credit cards and bank transfers has remained roughly stable.

It is not surprising that e-payment fintechs have benefited the most from the pandemic, especially those with ownership of or collaborative linkages with booming e-commerce and online store players. Five e-wallet fintechs dominate this segment, which has 48 licensed players (Figure 2). These are GoPay (part of GoTo), OVO (owned in part by Tokopedia and Grab), Dana (part of Emtek, a broadcast and hospital chain group, which has just recently sold its controlling stake to a third-party), ShopeePay, part of the Shopee online store and LinkAja (owned by state banks, Mandiri, BRI and BNI).[7]

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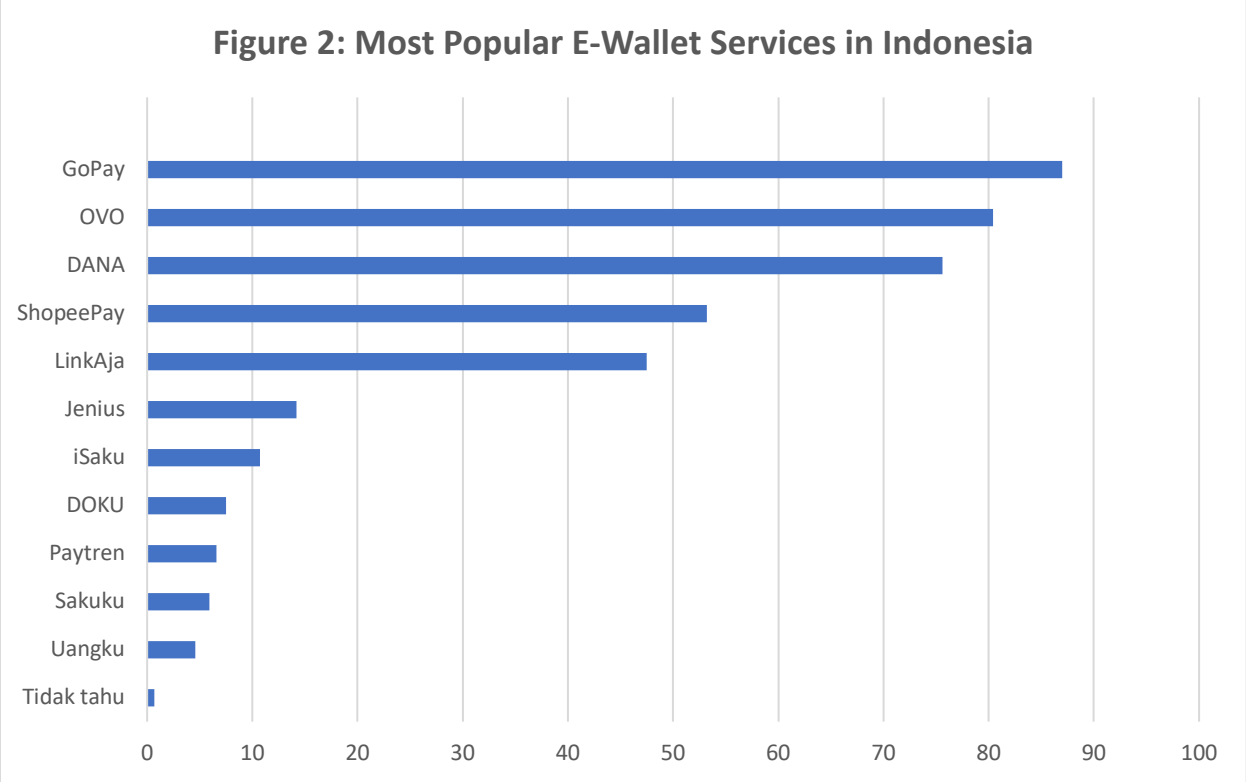

Source: databoks.katadata.co.id and DailySocial.id 22 December 2020[8]

Banks are aware of this trend and have aggressively responded with their own version of e-wallet services, which has helped banks defend their share of the market. Three other bank-owned popular e-wallet platforms are Jenius (BTPN), GoMobile (CIMB Niaga) and Sakuku (BCA).[9]

However, the largest beneficiaries of this trend are the consumer, which now has a wider choice of goods, food and services to buy, without having to leave the safety of their homes. The wide choice extends beyond purchases, as consumers can now also choose the way they pay for their purchases whether it be the familiar funds transfer and credit/debit cards or the newer e-wallets.

CHALLENGING GROWTH PROSPECTS FOR LENDING FINTECHS

The pandemic has resulted in two contrasting prospects for lending fintechs. On one hand, the pandemic has allowed lending fintechs to pick up some of the slack from banks, at least for loans to the SME sector. This was obvious during the second half of 2020 and into 1Q 2021. Bank loan growth contracted in 2Q 2020 and remained flat throughout the year since banks have been focusing on managing their worsening loan quality through loan restructurings. In contrast, the lending fintechs, though experiencing a similar contraction in 2Q 2020, rapidly grew their SME and micro loan volume for the remaining period in 2020.

Still, growing loans during a recessionary period do carry risks, which is reflected in the deterioration of lending fintechs' 90-day past-due loan ratio in 2Q and 3Q 2020, which reached a 8.3% high, above OJK's 5% tolerance limit (Table 1). However, loan growth and

a drop in problem loan levels, likely due to loan restructuring efforts, helped improve the non-performing loan (NPL) ratio towards year-end and into 1Q 2021. However, even with fintech loans growing and bank loans remaining flat, fintech loans remain a small percentage of bank loans, at 0.3%.

Table 1: Outstanding Bank and Fintech Loan (and NPL) Trend for 31Mar2020-31Mar2021

(IDR trillion)	31Mar2020	30Jun2020	31Sep2020	31Dec2020	31Mar2021
Bank Loan	IDR 5,712.0 Tn	IDR 5,549.2 Tn	IDR 5,530.6 Tn	IDR 5481.6 Tn	IDR 5496.4 Tn
NPL	2.8%	3.1%	3.1%	3.1%	3.2%
Fintech Loan	IDR 14.8 Tn	IDR 11.8 Tn	IDR 12.7 Tn	IDR 15.3 Tn	IDR 19.0 Tn
NPL	4.2%	6.1%	8.3%	4.7%	1.3%

Source: OJK Indonesia Banking Statistics March 2021 and Fintech Statistics March 2021

As of 24 May 2021, there are 56 licensed and 75 registered lending fintechs.[10] All fintechs go through a two-stage OJK approval process, with registering in the first stage and, after a year of operations, applying for a fintech license in the second stave. Unfortunately, outside these two categories of fintechs, the government's Investment Alert Task Force (SWI) has identified an additional 126 illegal fintechs operating in the country.[11] It is this category that has often appeared in the media with reports of them harassing and pressurising delinquent borrowers, including their close contacts (obtained from the borrower's handphone), to repay their loans.

The fintech lenders cover distinct markets, which banks have yet to tap effectively with their high loan-transaction costs. Some, like Amartha, Mekar and Crowde, focus on channelling smaller micro loans, with an emphasis to rural women-led micro-businesses. Then there are sector-focused fintech lenders such as Granada that focus on the property market for those needing mortgage down payment, rental and residential renovation loans.

However, most fintech lenders, like the major Investree, Modalku, Crowdo and Akseleran fintechs, focus on loans to SMEs and small entrepreneurs in major cities. Fintech loan rates are generally higher than bank loans due to fintech loans' unsecured nature. With Covid-19, fintech lenders are redirecting their loans towards more pandemic-proof sectors and SMEs within that sector that are preferably part of a larger company's supplier and distribution network.

CURRENT FINTECH SPEED BUMPS

One pandemic-induced challenge for fintechs is that of having to operate under a changing regulatory environment. As noted earlier, the licensed and registered fintech lenders have to compete with a sizable number of illegal fintechs that are not under OJK's scrutiny and oversight. Since 2018, the government's Investment Alert Task Force, through the Communications and Informatics Ministry, has blocked more than 1,350 illegal fintech

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sites[12] and the government has gone on a social media campaign to warn the public about their activity.

But current fintech regulations[13] have limited enforcement effectiveness and plans are underway for parliament to prepare fintech legislation and also for consumer protection and personal data security. OJK is also drafting new and more stringent fintech regulations. Among the key changes in this draft is a major increase in required capital from the current IDR2.5 billion to IDR15 billion. Also, at any one time, capital levels should not fall below 0.5% of outstanding loans, or a minimum of IDR10 billion. And to ensure that development and financial inclusion goals are met, productive loans need to reach at least 40% of a fintech's loan portfolio, and loans provided to borrowers located outside of Java needs to reach at least 25%.[14]

Another challenge has to do with data; its availability, consistency and the willingness of institutions to share them. Fintechs need this data to determine a borrower's credit worthiness. Such data are not easy to obtain, especially in emerging markets. Fintech's target market of SMEs and small entrepreneurs does not produce regular financial statements, which is why banks have more challenges assessing SME loans than corporate loans. So fintechs often rely on alternative data, such as a borrower's bank statements or utility and mobile phone bills to assess financial capacity as well as reliable and prompt bill payments.

But the availability and authenticity of the data, even when available, are difficult to verify. There is also the added difficulty of using data to assess a borrower's willingness as opposed his capacity to repay. Furthermore, there are privacy and personal data security issues involved in obtaining and using these data.

A final challenge is one of getting sufficient funding or lenders to pass on as loans to borrowers. A broader and diversified lender base, with a range of risk profiles is needed to get a reliable and stable funding base. Some fintechs are trying to attain this by insuring a portion of the loan's principal amount. For example, Akseleran, insures 90% of its lenders loans through Lippo General Insurance.[15]

A MORE COLLABORATIVE FINANCIAL LANDSCAPE AHEAD

Over time, technology adoption in the financial industry has helped bring down transaction and distribution costs sufficiently to make financial services more affordable and accessible to a broader market. A few decades ago, banks used mainframe core banking systems to introduce consumer banking services, and launching ATMs together with credit and debit cards at the customer end. Now this has advanced further to online banking through the use of laptops and mobile phone apps. This trend is expected to continue.

The entry of fintechs both in e-payments and lending has shaken up banks as well as finance and insurance companies. It has spurred them to speed up their digitisation plans and adopt new technologies at a faster pace. Fintechs, in addition to having a first-mover advantage are not burdened with legacy systems, or with strict and costly regulatory requirements. Besides, fintech management being decades younger than those running banks, fintechs are

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also much more inclined to try out new ideas and connect with younger tech-savvy customers.

CONCLUSION: WHERE IS FINTECH HEADING?

Financial institutions, including fintech lenders, have mostly focused on the asset side of the business; on growing loans, and now on upgrading to more automated and algorithmic ways of assessing credit. But there is growing awareness of the importance of funding, or the liability side of the business.

For fintechs, with their revenue derived from a flat platform fee (ranging between 3% and 5%, depending on the loan risk level), growing their loan portfolio quickly is key. This, in turn, depends on their ability not only to automate credit assessment, but also to get sufficient funding and data access. The risks fintech's face have some similarities with those banks have to deal with, both on the loan and funding end. Even though the funder in a fintech bears the loan risk, if fintech loans start to deteriorate and experience repayment problems, then funding sources could easily dry up. The difference is more due to regulation, with the banks being heavily regulated and, among others things, needing to maintain high capital levels and set aside costly provisions should their loans deteriorate.

Fintechs, on the other hand, are more lightly regulated and thus are more flexible in their operations and willingness to innovate. This is one reason why there is increasing discussion and collaboration between banks and fintechs, ranging from strategic partnerships to acquiring each other—either fintechs buying into small banks, with a minimal branch network or system legacy issues, or, at the opposite end, large banks buying into fintechs.

For banks, collaborating or owning a stake in fintechs allows them to better service the SME segment, with fintechs taking care of loans and the banks focusing on SME cash management and payment needs. By increasing their transactional banking business, banks aim to increase the share of lower-cost demand deposits in their deposit mix (along with costlier savings and time deposits). This brings down their cost of funds, widening loan margins and ultimately improving profitability.

This melding or collaboration of fintechs, both e-payment and lending fintechs, with banks was illustrated early this year when GoPay, which is part of the GoTo e-commerce group, took a stake in Bank Jago.[16] Anticipating further mergers and acquisitions, OJK is preparing regulations on that as well.[17] Fintechs are disrupting the financial industry by encouraging collaboration among players with different specialisations. But with Indonesia's large and dispersed market, there appears enough room for everyone to have a role, at least for the moment.

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[9] https://www.trade.gov/market-intelligence/indonesia-e-wallet-market
[10] https://keuangan.kontan.co.id/news/ini-daftar-lengkap-131-pinjol-yang-terdaftar-dan-berizin-dari-ojk
[11] https://scholar.ui.ac.id/en/publications/detection-of-fintech-p2p-lending-issues-in-indonesia
[12] https://scholar.ui.ac.id/en/publications/detection-of-fintech-p2p-lending-issues-in-indonesia
[13] Fintech regulation starts with POJK 77, which covers fintech's establishment, registration, licensing, lending limits, governance and consumer protection. POJK 13 covers innovation and regulatory sandbox requirements. POJK 37 covers equity crowd funding. POJK 18 covers customer complaints service
[14] https://www.lexology.com/library/detail.aspx?g=c6ddcc1f-bf38-4246-b5e9-d216b14bc73c
[15] (https://www.akseleran.co.id/blog/asuransi-kredit/)
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