Fintech Lending: One of the Key Enablers for Financial Inclusion

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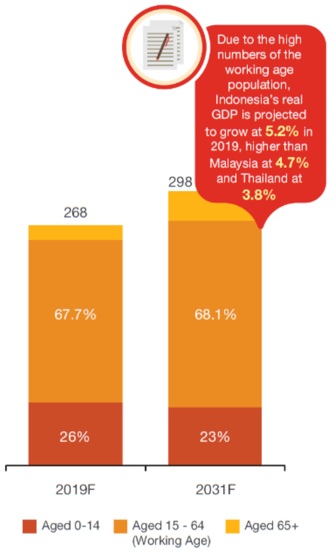
Indonesia's demographic segments have a unique economic potential that comes with certain risks

The large proportion of Indonesia's working age population has the potential to boost economic growth. However, even at the peak of its working age population, Indonesia still trails behind in terms of its own potential to raise GDP per capita

As the world's fourth most populous country, and with more than 60 percent of its people of working age (*Fig.1*), Indonesia has unique economic potential. This working age population has the potential to drive Indonesia's Gross Domestic Product ("GDP") through consumer spending and local production capability, if it is fully utilised. However, according to the International Monetary Fund, Indonesia is projected to only produce 32 percent of the United States' GDP per capita (during its own peak working age population) even at the peak working age population in 2031 (*Fig.2*)[1]. This projection shows that unique opportunity comes with the potential risk of having a large working age population deteriorating in productivity, without having fully utilised its potential to boost economic growth.

Fig.1 Population based on age

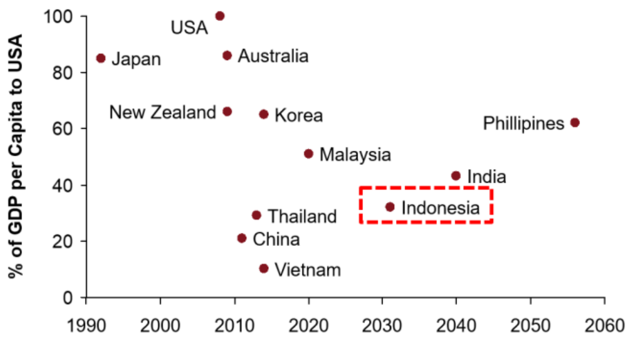
In percentage, 2019F – 2031F



Source: Central Bureau of Statistics; PwC Analysis

Fig.2 Per capita income level at the peak of working age population share[1]

In percentage of USA GDP per Capita (PPP based)



Source: IMF; PwC Analysis.

Note: Figures are reported according to the peak or projected peak of working age population years 1992 – 2056 and does not consider improved financial inclusion rate in the GDP Per capita calculation.

[1] "Indonesia: Selected Issues" Report, International Monetary Fund (2018)

One of the key elements that can boost economic growth effectively is providing access to financial services, and consequently utilising credit to boost spending and accelerate production capability. However, Indonesia had a very low loan disbursement per GDP compared to other countries in 2017 (*Fig. 3*), indicating that its financing capacity is not yet fully utilised. In addition, across Indonesia, around 73% of middle to lower individuals[2] and 74% of micro, small and medium enterprises ("MSMEs") still do not have access to financing (*Fig. 4*) (financing gap for MSMEs account for approximately USD 165.8 billion per year in 2017[3]). Without better access to financing, instead of becoming the engine of economic growth, the majority of individuals and MSMEs in Indonesia will be excluded the growth and its many benefits.

Fig. 1 Household Debt per GDP

By Percentage, 2017

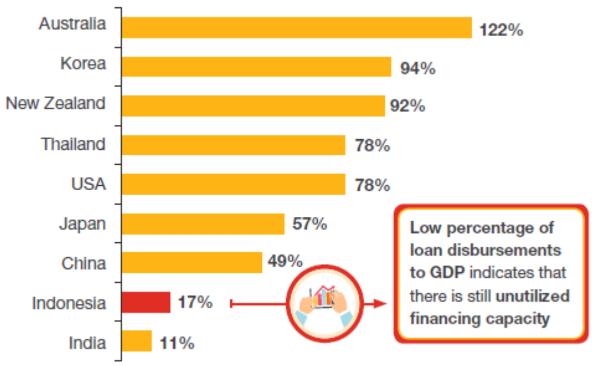
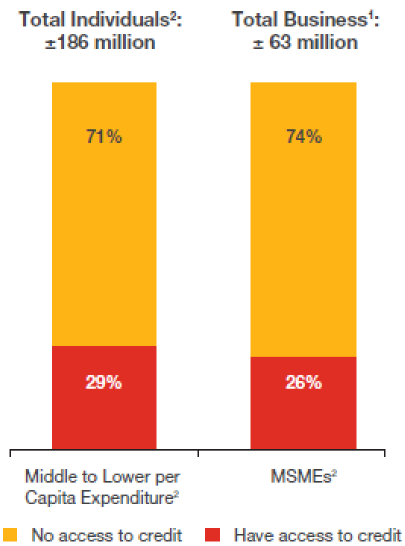


Fig. 4 Access to Credit for Working Age Middle to Lower Individuals and MSMEs

By Percentage, 2018



Source: International Monetary Fund; Asian Development Bank; PwC Analysis.

Notes:
1) Based on individuals aged 15+, see Appendix for definition of "Access to Credit" and "No Access to Credit"
2) Based on 2017 data from Ministry of Cooperative and MSME
3) Based on the statistics for MSME credit accounts for August 2017, Central Bank of Indonesia

> **"Without access to formal financial services, the unserved and the underserved segments of society will be excluded from growth and its benefits…**
>
> **… the effects of leveraging digital technology to bank the unbanked could boost GDP by 2% to 3% in markets like Indonesia".**
>
> **ASIAN DEVELOPMENT BANK**
>
> (Accelerating Financial Inclusion in Southeast Asia with Digital Finance, 2017)

Conventional lending providers see this as an opportunity to tap into; however, they have certain limitations (*Fig. 5*) that opens up room for innovation via financial technology (Fintech) to provide alternative solutions. Fintech Lending players match different risk appetites for lenders with different risk levels of borrowers to fulfil the borrowing needs of the broader segments of Indonesian society. Fintech Lending players have leveraged a combination of different business models, technology and innovative approaches, enabling them to achieve wider coverage

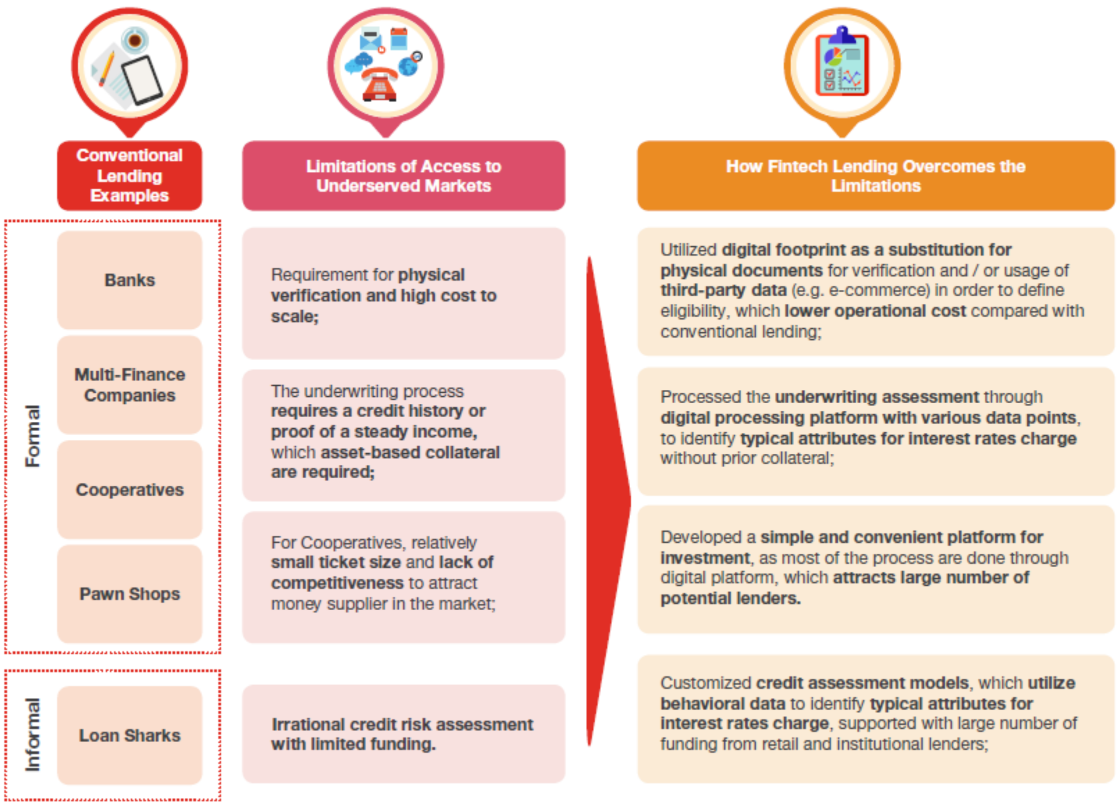
[2] Referring to middle to lower social economic status (SES)
[3] MSME Report, International Finance Corporation (2017)

within remote areas, and solve infrastructure and risk management challenges that are typically faced by banks in serving untapped segments (*Fig.5*).

Within the Fintech Lending industry, different business models have emerged (e.g., peer-to-peer vs. institutional-to-peer, productive vs consumptive loan providers).

Some players even leverage innovative approaches, such as various Online to Offline ("O2O") channels, to provide an alternative means in driving loan origination and disbursements for non-mobile phone users.

Fig.5 How Fintech Lending overcomes conventional lending providers' limitations



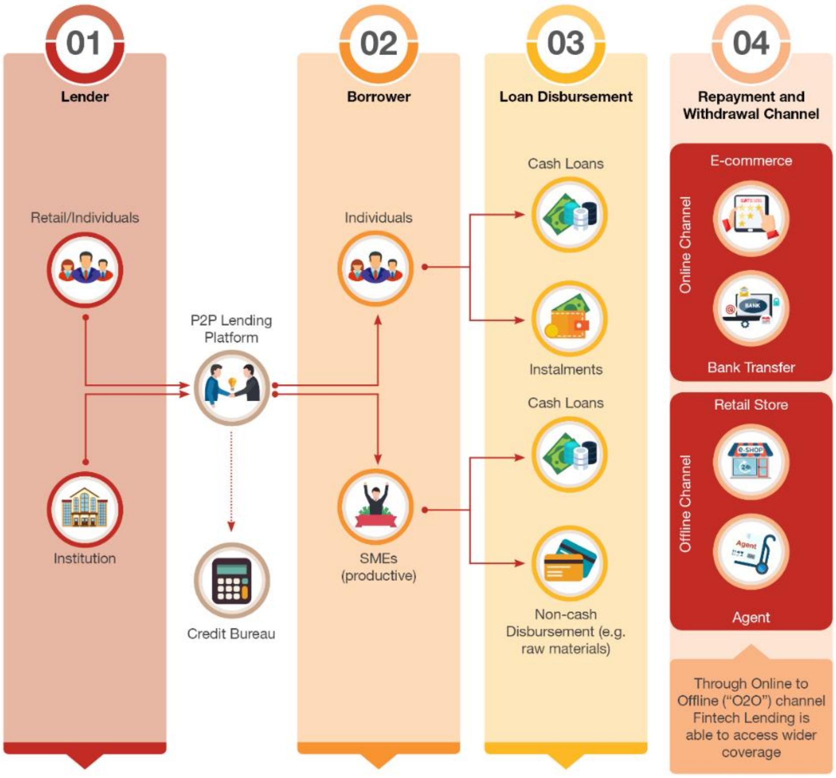
Source: Financial Services Authority (OJK); PwC Analysis.

There are various methods of loan disbursement and repayment within the Fintech Lending business model, which creates the formation of multiple access channels for consumers. The typical marketplace model (*Fig 6*) can be broken down into four steps. Firstly, you have lenders (whether individuals or institutional), who have excess capital and are willing to lend these capital for a certain level of return. Then there are borrowers (whether individuals or productive MSMEs), who have submitted their loan request to the P2P Lending platform. The P2P Lending Platform then acts as the marketplace "connector" that matches borrowers' loan needs to the financing capital provided by lenders. Besides acting as a "connector", the P2P Platform may also utilise the services of a credit bureau to analyse a potential borrowers' credit history and assess the risk of the loan.

During the loan disbursement phase, individual borrowers can either take a full cash disbursement or receive disbursement in instalments. Enterprises have the option of a cash disbursement or a non-cash disbursement that, for example, could be raw materials needed for their businesses. The fourth step, the repayment and withdrawal channel, has both online (e-commerce or bank transfer) and offline (retail store) options.

Through the online-to-offline channel, Fintech Lending is able to obtain wider coverage.

Fig. 6 Typical Marketplace Model of Fintech Lending



Source: PwC Analysis.

As shown in Fig.6, the sustainability of any Fintech Lending players will depend greatly on being able to satisfy two different customers: borrowers and lenders. By doing so, it can create an end-to-end impact covering all market segments in Indonesia (*Fig. 7*).

Fintech Lending is tapping into markets throughout the end-to-end economic value chain, specifically those that are still underserved by conventional financial institutions. As a raw material provider, Sayfudin, a farmer, says Fintech has helped him to expand his land holdings and obtain farming training. Within the production sector, Ratna, who weaves and sells doormats, was able to get working capital to start her business. Bayu, a university student, is an example of a Fintech Lending end user who was able to receive help in paying his university tuition fees and finally earn his degree.

Fig. 7 Impacts of Fintech Lending

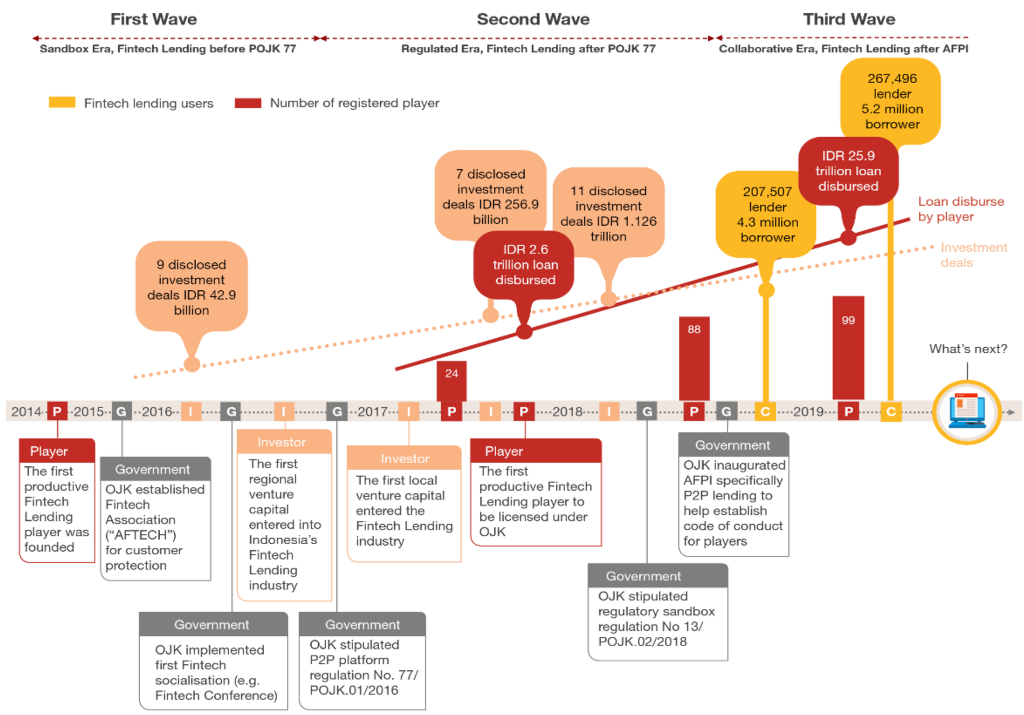
Source: PwC Analysis.

Indonesia's Fintech Lending ecosystem: A different regulatory approach

Indonesia has huge market potential in Fintech Lending, and some are looking at China's Fintech boom beginning in 2013 as a benchmark. Indonesia has benefitted from analysing China's initial mistakes, which has shaped the Government to take a more supportive regulatory approach. China's market and business model targets the hundreds of millions of lower-income individuals who do not have credit cards, which resulted in a majority of Chinese P2P players offering short-term consumer loans. Indonesia, for its part, is targeting both underserved individuals and MSMEs, which provides a balanced mix.

China's regulation only started to implement increasingly strict regulations (with stringent compliance procedures) in 2017 to eliminate the increasingly large number of "delinquent" P2P Lending platforms, which resulted in a negative effect of a market fall-out. From the start, Indonesia's regulatory framework has taken a principle-based and collaborative approach, which aims to control the market and minimize the proliferation of "delinquent" platforms early on.

Fig. 8 Milestones in Indonesia's Fintech Lending



Source: Financial Services Authority (OJK); PwC Analysis.

PwC defines the industry evolution of Fintech Lending based on its regulatory involvement. Through the establishment of AFPI, Indonesia is currently entering the “Third Wave,” (*Fig. 8 and Fig. 9*) where players have a clearer code of conduct, the government has a better view for licensing legal players, and investors also have higher confidence to invest in or acquire a Fintech Lending companies. This differs from the previous waves where the “First Wave” marked the unregulated era where players were testing out business models; and the “Second Wave”, which marked the involvement of OJK to ensure customer protection by establishing distinction between legal and illegal Fintech Lending players.

Fig. 9 Fintech Lending Industry “Waves”

	01 First Wave	02 Second Wave	03 Third Wave
01 Regulations Milestone	The beginning of Fintech socialization activities with help of OJK and the Fintech Association (e.g. the Fintech Festival)	• The release of Fintech Lending regulations (i.e. POJK 77) • The tracking of Fintech Lending performance under OJK	The establishment of the Fintech Lending Association (AFPI)
02 Business Models Milestone	Entrance of mostly productive loan providers (41%), but **none of the Fintech Lending players are registered/licensed** under OJK	• Rise in the number of **productive loan providers registered** under OJK (63%) • Release of the first OJK license status for a productive Fintech Lending player	Rise in the number of **consumptive loan providers registered** under OJK (49%)
03 Investments Highlights	The entrance of **regional venture capital** firms	• First acquisition of a Fintech Lending player by a multi-finance company • Participation of **local, bank-backed, and international** venture capital firms	Acquisition/ partnerships of registered Fintech Lending players by other companies (from Payment to e-Commerce)

Source: Financial Services Authority (OJK); PwC Analysis.

Going forward, the capability to understand and cater the perspectives and needs from various stakeholders within the ecosystem will determine the next evolution of the industry (*Fig. 10).*

Fig. 10 Voices of Fintech Lending's Stakeholders

CUSTOMERS
What do customers want and need?

PLAYERS
What are the gaps between customer expectations and current offerings of players that may be addressed in the future?

GOVERNMENT AND ASSOCIATIONS
What has the government done or planned in order to accelerate industry growth while protecting stakeholders?

INVESTORS
How confident are investors towards the market?

Source: PwC Analysis.

About the Report

With the rapid growth of the Fintech Lending industry, there are some market and regulatory challenges that require stakeholders to work together to ensure its sustainability. This is why PwC's 2019 Fintech Lending report is focused on the market potential of Fintech Lending and perspectives of Customers, Players, Investors and Government.

In PwC's 2019 Fintech Lending report, our most comprehensive to date, we asked over 2,800 Fintech Lending customers (including borrowers and lenders) across Indonesia about their behaviour and expectations. Their answers can help players to be more informed on how to position themselves for the future, while at the same time, help government to assess the impact of Fintech Lending to facilitate financial inclusion in Indonesia.

Aside from customers, players have a major stake in determining the future of the Fintech Lending industry. First, the number of registered players under OJK and new entrants queuing to be registered has never been higher. To compete in today's Fintech Lending landscape, new entrants do not require as much capital as other financial institutions. For instance, the minimum capital requirement to register as a Fintech Lending player is IDR 2.5 billion, compared to a multi-finance company that requires IDR 100 billion. Not only do pure play Fintech Lending players rise up, but multi-finance and technology companies (e.g. e-commerce, ride-hailing companies, online travel agencies) have started leveraging their networks and capabilities to tap into the online lending landscape. Second, Indonesians' limited financial literacy poses a significant challenge to raising awareness and increasing the conversion of untapped market segments into Fintech Lending.

In terms of investors, managing financial returns or realising strategic objectives is critical. This forces them to make smarter investments. Therefore, there are many factors going into investment decisions, ranging from players' value propositions to expected industry growth to the expected end game of Fintech Lending players.

The four "Voices of The Stakeholders" that will be described in PwC's 2019 Fintech Lending report will unveil a range of perspectives including current and future expectations, challenges and opportunities, and the impact of Fintech Lending.