CHAPTER I

INTRODUCTION

A. Background

Currently, the world has entered the era of digitalization in various sectors of human life, including the digitalization of financial transactions. This digitalization of financial transactions includes financial transactions via the internet, such as money transfers and debit transactions. The digitalization of financial services is accompanied by the rapid development of technology, including gadgets. Today's digital financial services are being accommodated by various fin-tech businesses which are in rapid growth.

According to Bank Indonesia (2019), Financial Technology (Fin-Tech) was a combined result of financial services with technology that eventually changes the business model from conventional to moderate, which initially had to pay face to face and bring some cash, now can make long-distance transactions by making payments that are can be done in seconds. Fin-tech promises easy services for users so that various financial features can be accessed and used just in a fingertip (Bromberg & Ramsay, 2018). The Section Head of Financial Technology, Bank Indonesia has classified Fin-Tech in Indonesia into four types:

1. Crowdfunding and Peer-to-Peer Lending
2. Market Aggregator

3. Risk and Investment Management
4. Payment, Settlement, and Clearing

In the recent development, the Financial Services Authority (OJK) as the supervisor of various banking transactions, including financial transactions, issued regulations to protect the parties bound in transactions through fin-tech, both customers and digital financial service providers. The regulation is OJK Regulation Number 77/POJK.01/2016 concerning Information Technology Loans and Peer-to-Peer (P2P) Lending, followed by other provisions related to fin-tech so that the regulations become clearer and more comprehensive. With this regulation, OJK stated that every fin-tech providing digital financial services and services must be registered and supervised by OJK. In this case, the financial service provider with the P2P Lending Fin-tech system is included in the type of non-bank financial institution and must be a legal entity in the form of a Limited Liability Company or Cooperative and must have a license from the OJK before carrying out its operation.

However, there are still many fin-tech businesses that have not been registered and supervised by the OJK. Until October 2019, the Financial Services Authority (OJK) managed to capture 263 illegal investment entities that do not have licenses. There are at least two things being highlighted by OJK: shadow banking and the Ponzi scheme. Shadow banking is an activity to raise funds, investments and loans that are not monitored by the authorities. The method varies, for example, fin-tech lending to borrow money from banks and then distribute it to the borrowers at very high-interest rates. While the Ponzi scheme is a fake investment mode that pays profits to investors from the next investor's money. This certainly threatens the safety and comfort of consumers because fin-tech has no obligation to provide digital financial service schemes that are profitable for service provider companies and consumers. It even tends to harm consumers. Both of those illegal activities have been intercepted by OJK through OJK Regulation (POJK) Number 77 of 2016 concerning information technology-based lending and borrowing services and POJK Number 3 of 2018 related to digital financial innovation (Setyowati, 2018).

Peer-to-peer lending demonstrates a connection with *ta'awun* (mutual help) based on kindness and piety, which is highly advised in Al-Quran Surah An-Nisa verse 29:

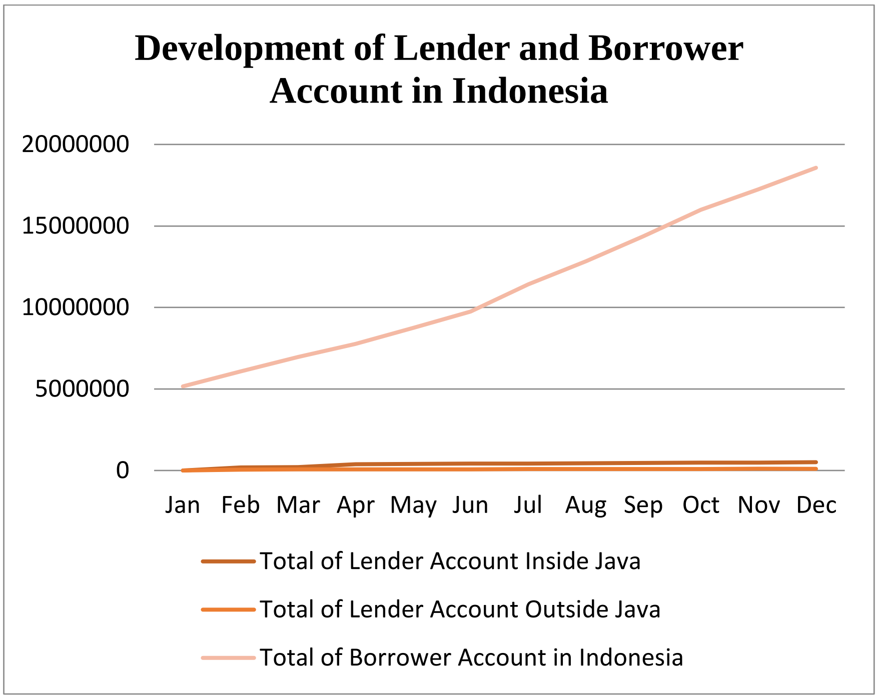
يٰٓاَيُّهَا الَّذِيْنَ اٰمَنُوْا لَا تَأْكُلُوْٓا اَمْوَالَكُمْ بَيْنَكُمْ بِالْبَاطِلِ اِلَّآ اَنْ تَكُوْنَ تِجَارَةً عَنْ
تَرَاضٍ مِّنْكُمْ ۗ وَلَا تَقْتُلُوْٓا اَنْفُسَكُمْ ۗ اِنَّ اللّٰهَ كَانَ بِكُمْ رَحِيْمًا

Meaning:

"O believers! Do not eat each other's property in a false way, Instead, let people trade with each other by mutual agreement. And do not kill yourselves; Surely, Allah is Most Merciful to you."

It is related to the verse above in this case, that fin-tech peer-to-peer lending shows the practice where creditors/lenders and debtors/borrowers carry out direct lending and borrowing transactions which provide benefits for both parties. On the other hand, few perpetrators exploitthis media by conducting fraud due to the transaction. Samad and Bukido (2022) stated that based on the Islamic Economic viewpoint, peer-to-peer lending is allowed if only following the principles of Islamic economics and cause no harm to anyone who gets involved in the transaction. Furthermore, *Otoritas Jasa Keuangan* in Indonesia has guaranteed the peer-to-peer legal companies which are operating based on Islamic principles. We concluded that, in Islam, it is allowed to conduct p2p lending transactions by using shariah legal peer-to-peer lending provided by *Otoritas Jasa Keuangan* (OJK).

In Indonesia, peer-to-peer lending is in high demand due to a variety of reasons; one of which is the ease and speed in disbursing funds. This can be seen from the fact that the number of loans disbursed has increased by 200 percent from December 2018 to October 2019 (OJK, 2019). As seen in the Graph 1.1, peer-to-peer lending account tended to rise from January to December 2019. Similarly, large increase in the number of borrower accounts in Indonesia from January to December 2019 shows that Fin-tech, particularly peer to-peer-lending, has been increasingly popular.



Source: Statistik Fintech OJK (2019)

Figure 1.1 Development of Lender Account and Borrower Account 2019

According to Figure 1.1, the number of people using peer-to-peer financing has been growing from January to December 2019. However, the increase was clearly visible on the borrower side. It can be seen from greater number of borrowers compared to that of the lenders. There is a rapid growth in the number of borrower accounts from 5,160,120 users in January 2019 to 18,569,123 users in December 2019. Therefore, peer-to-peer financing are quite appealing to certain people nowadays. This indicates that interest in peer-to-peer financing will continue to grow in the upcoming years.

The rapid growth of peer-to-peer lending in Indonesia cannot be separated from its simplicity to apply and a growing number of enthusiasts. Peer-to-peer lending service can allocate loans to almost everyone and at any amount in an efficient and transparent manner. It is a technology platform that connects borrowers who need money for business and lenders who have excess money. Basically, peer-to-peer lending is quite similar to the concept of an online marketplace which connects buyers and sellers for lending and borrowing activities. In the case of peer-to-peer lending, the existing system connects the borrower with the loan provider. People can apply for loans to the public through peer-to-peer lending system as an alternative to borrowing through formal institutions which are much more complex and difficult to apply with the disbursement of funds taking a lengthy time.

As an alternative to the most recent financial products, providing funds through peer-to-peer lending has its own set of risks. According to Tampubolon (2019), here are some risks faced by the lenders:

1. Risk of being unable to withdraw investment in the middle of transaction

   This risk exists because the lender is unable to withdraw the loan from the borrower before the loan period finishes.
2. Risk of Late Payment

   Borrowers sometimes have problems in paying interest to lenders or the principal of their loans on time. Each platform usually punishes borrowers with late payment. Financial penalties often vary between 0.1% every day and approximately 3% per month. This penalty is in addition to the interest and principal that must be paid as a compensation.
3. Risk of Default

This is a risk in which the borrower is unable to repay the loan. This risk exists not only in the realm of peer-to-peer lending, but also in the banking industry, or as known as a Non-Performing Loan (NPL). In line with banking, this is seen as the most serious danger of a peer-to-peer lending platform. However, this risk can be mitigated through examining whether the service provider selects borrowers based on specific indicators to ensure that the loans given are of high quality.

Despite the high risks in transactions, peer-to-peer lending activities continue to be in high demand among the Indonesian population. Risk taking is affected by both external and internal factors. Competition among banks in the Indonesian banking sector is one of the external factors influencing risk taking behaviour. According to Berger et al. (2009), competition and concentration can influence each other and have a major impact on bank risk taking.

Several previous studies have attempted to study risk taking of the banks in Indonesia, including Mulyaningsih and Daly (2011), explaining that the banking market in Indonesia is monopolistic in nature, meaning that it is highly concentrated and consequently affecting risk taking of the bank. This indicates that businesses in Indonesia tend to take risks due to several factors, as well as peer-to-peer lending companies who dare to take major risks in carrying out lending and borrowing activities. Peer-to-peer lending companies' willingness to take a risk certainly affects the demand for peer-to-peer lending in Indonesia.

Apparently, the government is attempting to prevent the spread of the corona virus in a variety of ways, one of which is mobility restrictions and limiting the number of workers, requiring most people to work from home. Furthermore, the implementation of mobility restrictions and an appeal to work from home creates a new problem for the company considering that not all types of work can be done at home by workers. This pandemic has affected people from various strands of life. People are forced to look for various sources of income from anywhere else to meet their needs. This would be more difficult for people to make rational decisions in order to meet their financial needs (Raharjo, 2021). Consequently, many people have turned to peer-to-peer lending as a way to obtain cash with easy requirements and quick disbursement.

Based on the background, the activities of peer-to-peer lending or peer-to-peer loans in Indonesia are continuously growing and soaring in demand, especially during pandemic. Therefore, the author intends to conduct a research regarding peer-to-peer lending in Indonesia which are compiled under the title "**The Role of Risk Profile and Time Impatience on the Demand for Peer-to-Peer Lending Amidst the Covid-19 Pandemic**".

B. Formulation of Problem

Based on the background, this research specifically addresses these following questions:

1. What is the role of risk profile on the demand for peer-to-peer lending amidst the pandemic?
2. What is the role of time impatience on the demand for peer-to-peer lending amidst the pandemic?
3. What is the role of individual characteristics on the demand for peer-to-peer lending amidst the pandemic?
4. What is the role of location attributes on the demand for peer-to-peer lending amidst the pandemic?

C. Purpose of Research

Based on the research questions above, the purpose of this research are:

1. Finding out the role of risk profile on the demand for peer-to-peer lending amidst the pandemic.
2. Finding out the role of time impatience on the demand for peer-to-peer lending amidst the pandemic.
3. Finding out the role of individual characteristics on the demand for peer-to-peer lending amidst the pandemic.
4. Finding out the role of location attributes on the demand for peer-to-peer lending amidst the pandemic.

D. Benefits of Research

The following are some of the benefits gained from this research:

1. Academic relevance

   This research can be used to contribute to the body literature about financial technology, especially peer-to-peer lending, as well as a reference for similar research in this area.

2. Practical relevance

   This research is expected to:

   a. Assist the relevant Peer-to-Peer (P2P) Lending organizers in knowing The Role of Risk Profile and Time Impatience on the Demand for Peer-to-peer Lending Amidst the Covid-19. In addition, it is also expected to be able to provide input and suggestions to the relevant organizers.

   b. Provide additional information to lenders to make them understand how the borrower's risk profile and time impatience can influence their desire to borrow from peer-to-peer lending.

   c. Raise public awareness about peer-to-peer lending and can be used as a consideration in making decisions on using peer-to-peer lending services.