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Behavior analysis of MSMEs in Indonesia using fintech lending comparative study between sharia fintech lending and conventional fintech lending

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ABSTRACT

The presence of sharia financial technology (fintech) as a credible financial institution is expected to be able to help the problems that are often faced by Micro, Small and Medium Enterprises (MSMEs) in Indonesia. This study aims to determine whether there are differences in the behavior of MSME actors in the use of sharia fintech lending and conventional fintech lending. The research method used in this research is normative legal research by analyzing the laws and regulations as well as relevant studies through the issues in the study. This study uses a statutory and conceptual approach, both of which function to analyze the applicable legal rules so that differences can be found between conventional and sharia peer to peer lending fintechs and the extent to which sharia rules are applied in these fintechs. This study concludes that Islamic fintech plays a role as a driving factor in increasing the inclusiveness of Micro, Small and Medium Enterprises (MSMEs) in Indonesia. The presence of the sharia fintech industry can overcome the problems of Micro, Small and Medium Enterprises (MSMEs) in Indonesia, especially related to financing needs, ease of transaction processing, expansion of market access, and ease of preparation of financial reports.

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Introduction

In this era, technology continues to grow rapidly. Existing technological developments prove that science and technology are always developing and innovating rapidly. Technology that continues to evolve makes it easier for us to access various information and facilitate work in various aspects of life. Technological developments that can be felt, especially in Indonesia, are developments in information and communication technology such as smartphones and internet use. Digital technology is a breakthrough and innovation in all economic activities. This can affect the trade and agriculture sectors, particularly the financial sectors. One sector that is currently being intensively developed is Financial Technology or better known as Fintech which is the latest innovation today. New digital technologies automate a wide range of financial activities and may provide new and more cost-effective products in parts of the financial sector, ranging from lending to asset management and from portfolio advice to the payment system. In those segments, the impact of fintech competitors is beginning to be felt in the banking sector and capital markets(Mavlutova et al., 2020; Puschmann, 2017).

However, the fintech sector is small compared to the size of financially intermediated assets and capital markets, and lags behind in Europe, both in level and growth rate, compared to the US or China. In the European Union (EU), only the UK has a significant development(Rubini, 2018). Even the largest fintech market, in China, is of marginal size compared to the overall country financial intermediation. In the EU, much of fintech is concentrated in the United Kingdom. Furthermore, fintech in Europe tends to be based domestically and with very limited cross-border flows. This is in contrast to the US and China where new entrants can develop the economies of scale of serving a large market (Coleman et al., 2016)

According to the definition outlined by the National Digital Research Center (NDRC), financial technology is a term used to describe an innovation in the field of financial services, where the term comes from the words "financial" and "technology" (FinTech) which refers to financial innovation through modern technology (Saksonova & Kuzmina-Merlino, 2017). Fintech itself is not a new thing in the financial services industry, it has been around since 1866 (Arner et al., 2015). According to Leong & Sung (2018), fintech is an innovative idea in improving financial service operations by providing solutions in the form of technology that are in accordance with business scenarios. While Maier (2016) explains that fintech is a combination of finance and technology with more innovative solutions and sustainable business models.

According to OJK Regulation Number: 77/POJK.01/2016, fintech lending/peer-to-peer lending/ P2P lending is a service to borrow money in rupiah currency directly between creditors/lenders (lenders) and debtors/borrowers (recipient loans) based on information technology. Fintech lending is also known as Information Technology-Based Lending and Borrowing Services (LPMUBTI).

Financial technology is a business focused on providing modern, software-based financial services ideas (Shanmuganathan, 2020). Fintech refers to the use of technology to provide solutions in the financial sector (Arner et al., 2015;Romānova & Kudinska, 2016). Now anyone can send money without needing to go to a bank to borrow money only online or commonly known as fintech peer-to-peer (P2P) lending (Lee & Shin, 2018). Peer-to-peer (P2P) lending platforms provide credits without bank intermediation where individuals and companies invest in small business. Those platforms match borrowers and lenders directly: some allow the lenders to choose the borrowers; in others they form packages of loans, and online auctions are often used. These platforms frequently provide risk rankings of the business obtained by algorithms to screen borrowers using big data. From a modest base, P2P lending is growing fast in the United States (with Lending Club and Prosper as leaders), and in the UK (with Zopa as an example). Other leading European countries for P2P consumer lending are Germany, France, and Finland. P2P business lending is prominent in China, but its role is limited in the EU. Crowd-funding platforms have increased significantly in EU countries, with France, the Netherlands, Italy, and Germany taking the lead(Das, 2019; Goldstein et al., 2019; Nicoletti et al., 2017).

FinTech lending has grown rapidly, though in developed economies like the United States it still accounts for only a small share of total credit(Fuster et al., 2021). An increase in convenience and speed appears to have been more central to FinTech lending's growth than improved screening or monitoring, though there is certainly potential for the latter, as is the case for increased financial inclusion(Philippon, 2016). FinTech, as the name suggests, is the fusion of finance and technology. Of course, technology has always influenced the financial industry, with advancements changing the way the financial industry operates(Mention, 2019;Vives, 2017)(Mention, 2019; Vives, 2017). The scope of activity in FinTech started from mobile payments, money transfers, peer-to-peer loans, and crowdfunding, spreading to the newer world of blockchain, cryptocurrencies, and robo-investing(Alt et al., 2018).

Indonesia has great potential for the development of fintech, both sharia-based and conventional. Indonesia is also a digital ready country with a very large number of internet users. With this technological capital, Islamic fintech is able to increase the reach of the Islamic financial market so that Islamic financial literacy and inclusion can continue to increase. The growth of fintech P2P lending is currently growing rapidly and is easily accessible to people who are still difficult to get loan funds and for MSME actors who need capital for business development(Agustina et al., 2021; Ramukumba, 2014). Not only MSME businessmen, there are also P2P lending fintechs that provide access to loans for those who need funds for education and health care with their respective standards, ranging from loan creditworthiness, loan nominal and tenor, interest rates, to security levels. The Indonesian government is currently looking at the potential of the fintech market in Indonesia to support MSMEs that have not been served by the banking industry(Minerva et al., 2016).

In Indonesia, the existence of MSMEs has been proven to be able to overcome various economic problems, ranging from reducing the number of unemployed, increasing people's income, alleviating poverty, reducing income distribution gaps, to increasing people's welfare (Indika & Marliza, 2019; Krisnawati, 2016; Sarfiah et al., 2019; Setiawan, 2017). Therefore, optimal support from the government is needed to provide financial assistance in an effort to develop existing MSMEs.

In August 2020, there were 157 fintechs in Indonesia, with total assets of 3.12 trillion rupiah. Of these, 11 of them are sharia fintech with a percentage of total assets reaching 2.04% (64.97 billion rupiah) of the total fintech assets as a whole (OJK, 2020). When viewed from the number of financing disbursements, overall fintech in Indonesia has reached 121.87 trillion rupiah with a growth of 122.74% per year. This figure shows the enormous potential of the existence of fintech in Indonesia, where more than 99% of borrowers from fintech are MSMEs.So there is no doubt that fintech has a very big role in encouraging the growth of MSMEs in Indonesia. However, further efforts are still needed to accelerate the growth of MSMEs initiated by sharia fintech (Saripudin et al., 2021). This proves that the market share and prospects for Islamic fintech in Indonesia are indeed very large. Therefore, sharia fintech in Indonesia must be continuously developed so that Indonesia can become the center of Islamic finance in the world, in this case including becoming the center of sharia fintech in the world and this is not impossible so it is worth fighting for.

Research related to fintech can be seen from the research of Marlina and Fatwa (2021) which states that the presence of the sharia fintech industry can overcome the problems of Micro, Small and Medium Enterprises (MSMEs) in Indonesia, especially related to financing needs, ease of transaction processing, expansion of market access, and ease of access. financial preparation of financial statements. Furthermore, research from Perwira (2018) states that conventional fintech and sharia fintech lie in education and communication and literacy of Islamic principles in daily life which are still not optimal for Indonesian people. Lova's research found that there are differences between conventional fintech peer to peer lending and sharia fintech peer to peer lending and how the application of sharia principles in Islamic peer to peer lending fintech(Lova, 2021). Then research from Saripudin, Nadya and Iqbal(2021) stated the need to optimize the potential of sharia fintech in managerial capabilities and sharia contract capacity as well as massively and directed in socializing and promoting sharia fintech. This research is different from previous research because in this study it focuses more on the behavior of MSMEs in the use of fintech lending. If previous research has discussed a lot in theoretical and technical terms regarding fintech lending itself, in this study the main focus will be on the behavior of the object of research (MSME actors) in using fintech lending, both sharia and conventional. Thus, the novelty of this research is to find out whether there are differences in behavior among MSME actors in the use of sharia fintech lending and conventional fintech lending.

The limited research comparing the behavior of MSMEs in the use of sharia and conventional fintech lending is the reason why this research is important for the advancement of fintech and MSMEs in Indonesia. This study aims to determine whether there are differences in the behavior of MSME actors in the use of sharia fintech lending and conventional fintech lending.

Method

The research method used in this research is normative legal research by analyzing the laws and regulations as well as relevant studies through the issues in the study. This study uses a statutory and conceptual approach, both of which function to analyze the applicable legal rules so that differences can be found between conventional and sharia peer to peer lending fintechs and the extent to which sharia rules are applied in these fintechs. Sources of legal materials used include primary legal sources consisting of Financial Services Authority Regulation Number: 77/POJK.01/2016 and National Sharia Council Fatwa MUI Number: 117/DSNMUI/II/2018 as well as secondary legal sources in the form of literature, namely books and journals.

Results and Discussions

Sharia fintech regulation with conventional fintech

Regulation is a regulation that is designed, formulated, compiled or made in such a way to help control a community group, institution, organization, and company with a specific purpose. There are six regulatory functions that are generally perceived by those implementing them: 1) providing greater limits and control; 2) create an environment that feels peaceful and serene; 3) protect the rights and obligations of those who feel it; 4) provide direction in behaving; 5) can help to achieve common goals; and 6) improve discipline so that it will not harm others.

From the regulatory aspect, regulations regarding fintech are still very minimal compared to regulations of other financial institutions. Especially from the aspect of sharia rules which still require many amendments to its rules. A comprehensive regulatory instrument is needed in order to protect the work process of the sharia fintech industry and the parties involved in it. The existence of rules that cover the existence of sharia fintech in terms of business form, business model and operationalization will be able to provide a sense of security for sharia fintech stakeholders(Gomber et al., 2017).

We also need to take a comparison with Malaysia and the UK by looking at several aspects in the preparation of the fintech regulatory model(Dorfleitner et al., 2017). First, Malaysia is able to prove its capability in handling and creating collaborative sharia fintech ecosystem conditions through the establishment of regulations that favor the protection of the parties involved in it. Likewise, the Malaysian government's commitment in this regard is strengthened by the existence of special institutions that specifically have a function to support and facilitate the development and growth of the Islamic fintech industry in Malaysia. Second, the UK has efficient and transparent fintech regulations and there are important regulators whose initiatives have had an impact around the world(Allen et al., 2021; Dorfleitner et al., 2017).

Sharia fintech in Indonesia still feels empty of legal regulation. The existence of fintech actually requires regulation that is no longer solely dependent on entities/intermediaries (entity-based regulation), but provides a greater proportion of activity-based regulation. The current regulation governing fintech is OJK Regulation (POJK) Number: 77/POJK.01/2016 concerning Information Technology-Based Lending and Borrowing Services, which was issued at the end of December 2016. However, the regulation only regulates fintech financing with conventional systems and does not regulate the sharia system which is currently also starting to develop. In addition, sharia fintech must also comply with the Fatwa of the National Sharia Council-Indonesian Ulema Council (DSN-MUI) Number: 117/DSN-MUI/II/2018 concerning Information Technology-Based Financing Services Based on Sharia Principles. On the other hand, Bank Indonesia has also set regulations for fintech operators whose activities are related to the payment system. Several regulations issued by both the OJK and Bank Indonesia are still unclear about the separation between the rules for conventional fintech and sharia fintech. Therefore, there needs to be firmness from the government to be able to protect fintech in Indonesia with one regulatory umbrella. In addition, unlike banks that have a deposit guarantee institution, fintech does not yet have a guarantee institution for lenders.

Second, there is still a lack of capital and infrastructure to support sharia fintech. Capital is the basis for running a company's household. The company will only be able to run if it has sufficient capital for its company activities. For fintech companies themselves, OJK has a new minimum capital requirement, namely new fintech companies that want to join the P2P Lending industry must have a minimum capital of 25 billion. This decision is the result of discussions with various parties and it is a way to reduce the risk of failure and a way for the authorities to ensure that only platforms that achieve internal financial stability can operate co-financing services. OJK does not want to meet a platform that is still building its digital infrastructure from debt and is only busy looking for investors after obtaining a permit, until finally it is unable to meet the operational health ratio and chooses to resign. The difficulty of fintech getting investors (lenders) is still a classic fintech problem, especially sharia fintech. The business model that exists in sharia fintech does not necessarily make it easier for sharia fintech to get investors. Then, as Muzdalifa et al. (2018) found, the development of sharia fintech is still constrained by infrastructure problems. There are limited facilities and infrastructure to support sharia fintech.

Therefore, related parties who have authority in sharia fintech need to make efforts so that sharia fintechs are not constrained in capital matters. For example, how to convince how investors (lenders) can have high trust in sharia fintech so that investors believe in entrusting their funds to sharia fintech because they believe there will be promising returns. In fact, if it can be done, the government can support the progress of sharia fintech directly, because then it will definitely be easier to develop because there is direct support from the government. Likewise, infrastructure issues need to be addressed in order to compete with conventional fintechs that already have fintech infrastructure that is more advanced and in accordance with standards.

Third, public knowledge and literacy regarding Islamic finance, especially Islamic fintech, is still very minimal, especially among MSMEs. As the results of a survey conducted by OJK in 2019, that the level of Islamic financial literacy only reached 8.93%. This can be easily seen, for example, when someone still asks about interest when they want to borrow through sharia fintech.

Risk

In its development, due to the absence of specific umbrella regulations, Islamic fintech also faces operational risks in addition to legal risks. This risk overshadows Islamic fintech investors or lenders, such as fraud or bad loans or loans not returning. This risk is very likely to occur because the contract process is only done online and there is no face to face. Even though the contract has been agreed, there is no guarantee that the borrower will be honest in submitting his business financial statements even after the contract has been agreed.

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So Lutfi Adhiansyah, founder of Ammana.id. said, “the high risk can be minimized by implementing the underlying transaction. The guarantee can later be confiscated if the borrower is proven to have intentionally fraudulently related to his financial statements or loan funds.” He also revealed that a competent supervisory body from Islamic microfinance institutions is needed to monitor business partners in the amount of loan eligibility and the use of funds in the field as a form of prudence.

Apart from the development of conventional fintech, sharia fintech is a bright solution and hope for Micro, Small and Medium Enterprises (MSMEs) or mustad'afiin families, namely those who lack effort in terms of finance, time range and location for capital. Especially MSME actors who want to obtain non-usury capital.

The difference between sharia fintech and conventional fintech

In general, in terms of function, Islamic fintech and conventional fintech are no different because, both types want to provide services in the financial sector. The difference between the two is only a financing contract where sharia fintech follows the rules of Islamic law. There are three sharia principles that must be owned by this fintech, namely no maisir (betting), gharar (uncertainty) and usury (the amount of interest past the stipulation). Although using a sharia basis, a basic reference has also been made by the National Sharia Council related to the existence of this sharia financial technology. The basis is MUI No. 67/DSN-MUI/III/2008 which regulates what provisions must be followed by the latest financial technology institutions in Indonesia.The following are some of the differences between Islamic and conventional fintech:

Interest Rate

In conventional financing, credit given to consumers is made as a loan agreement so that the customer later has an obligation to repay the loan along with the interest determined by the borrower (conventional fintech), depending on the size of the loan taken. While in Islamic finance financing, where interest is not allowed because in interest there is an element of usury. In sharia financing, you will not find credit provided by a contract as a loan but with a murabahah, ijarah waiqtina, and musyarakahmutanaqishah contract. Murabahah contract can be interpreted as a sale and purchase agreement where the organizer or fintech will act as a buyer for the object or product that the customer wants. Then the ijarah waiqtina contract is a lease agreement. This means that fintech acts to buy the object that the customer wants, then the fintech leases the object to the customer within a certain period of time. Meanwhile, musyarakahmutanaqishah means that both fintech and customers jointly put capital for something that later the customer can buy part of the fintech to fully own the object.

Risk and Installment

When a customer applies for a conventional loan, the customer will fully bear the risk when the customer does not have the ability to pay the installments. This is different from the financing system with sharia contracts, both parties, both Fintech and customers, will bear the risk.

Loan Availability

Sharia financing uses product offerings for certain purposes. In this case, there is no conventional financial financing such as for education, hajj and umrah, or others.

Regulation

Conventional fintech lending is regulated by BI Regulation No. 19/12/PBI/2017, OJK Regulation Number: 77/POJK.01/2016, while sharia fintech is regulated by BI Regulation Number 19/12/PBI/2017, Regulation OJK Number 77/POJK.01/2016, Sharia Council Fatwa National MUI Number 117/DSN-MUI/II/2018.

Causes of the slow development of sharia fintech in Indonesia

Islamic fintech uses Islamic law as the basis for their financial services. There are several sharia principles that must be owned by this sharia fintech, namely no maisir (betting), gharar (uncertainty), and usury (the amount of interest past the stipulation). One of the other differences between Islamic fintech and conventional fintech is that there is no interest charged on the loan amount, but rather uses a profit-sharing and risk-sharing system. In addition, Islamic fintech tends to provide funding to the real sector where the social impact that Islamic fintech wants to generate is not just looking for profit, but to help business actors to be able to "level up" and succeed with their business so that they can have a better life.

In the process of working, this sharia fintech must be carried out in accordance with the specified contract, namely the mudharabah and musyarakah contracts. Mudharabah contract is a technique of cooperation between capital owners and fund managers. Both parties compromise to determine the amount of profits to be shared fairly. If there is a loss, the owner of the capital must be responsible except for negligence committed by the fund manager. While the Musyarakah contract is a technique of cooperation between two or more people which is based on an even distribution of profits. If there is a loss, both parties must bear the same burden of loss.

Currently in the world and especially in Indonesia, fintech continues to experience positive improvements, making many people start choosing fintech for their transaction services. According to data from DarminNasution as the former Coordinating Minister for the Economy, among the many developing fintechs, Peer-to-Peer (P2P) Lending is a type of fintech that has experienced a significant increase compared to several other types of fintech such as payment, wealth management and others.

However, the positive and rapid development or improvement is actually still dominated by conventional financial technology (fintech). The development of sharia fintech is still very slow when compared to conventional fintech. How can this happen? In fact, if you look at the population of Indonesia, the majority of whom are Muslims, this should not have happened. In fact, the development of sharia fintech in Indonesia is still inferior to the UK, which incidentally is a country with a non-Muslim majority population. The UK has also become the center of Islamic business and finance in Europe and even the world.

Of course, this is very unfortunate considering the potential for Islamic finance, especially Islamic fintech, is also very large in Indonesia. According to the author, the actual cause is not much different when compared to the cause of the slow development of Islamic financial institutions in Indonesia. Concrete steps are needed to resolve existing problems and this is mandatory as an effort to accelerate the development of sharia fintech in Indonesia.

If we look at the data as of September 2021, according to the Indonesian Sharia Fintech Association (AFSI), the number of sharia fintechs in Indonesia that have permits or are registered with the OJK is only 17. This is very one-sided when compared to the number of conventional fintechs in Indonesia. Based on reports from the United Overseas Bank (UOB), PwC, and the Singapore Fintech Association (SFA), the number of financial technology companies (fintech) in Indonesia continues to grow every year. The figure rose 3.56% to 785 fintech companies as of September 2021. If in that period there were only 17 sharia fintechs, it means that around 768 conventional fintechs existed in that period. Then, according to OJK data as of May 2021, specifically for P2P Lending fintechs that have been registered and licensed, there are 131 companies.

Based on the data, of course, this is very unfortunate considering the opportunity for sharia fintech in Indonesia is very large, especially because Indonesia has its main supporting strength, namely Indonesia has a majority Muslim community and the largest in the world. There are several causes or obstacles that are the reason for the slow development of Islamic fintech in Indonesia. First, the lack of regulations governing sharia fintech in Indonesia. Second, there is still a lack of capital and infrastructure to support sharia fintech. Then the third is the low financial literacy of the Indonesian people about Islamic finance, especially in this case is sharia fintech.

The role of fintech for MSMEs in Indonesia

The role of fintech for MSMEs in general is to provide capital loans. Some aspects that fintech can work on for MSMEs are digital payment services and financial arrangements. The role of fintech will continue to grow along with the answers to the challenges of sharia fintech in Indonesia. The following is the role of fintech for MSMEs: 1) Relatively Easy Capital Loan. The process of borrowing capital by fintech is easier than applying for a capital loan to conventional financial institutions. This is because fintech only needs to complete a few documents and the disbursement time is faster than conventional institutions. However, in some conventional institutions, online services are now available that speed up the process of borrowing capital; 2) Digital Payment Services. The payment process will be easier and faster with digital payment services. Without the hassle of withdrawing money at ATMs, digital payment services such as DANA with the tagline Payment in Hand, make it easier for consumers to pay for the products purchased or services used; 3) Financial Management Services. Of the two fintech roles offered, financial regulatory services are the most important. Financial management services offered include recording expenses, monitoring investment performance, as well as free financial consulting. For MSMEs that have just been initiated, this service is clearly helpful for future financial expenses and income.

Conclusions

This study concludes that Islamic fintech plays a role as a driving factor in increasing the inclusiveness of Micro, Small and Medium Enterprises (MSMEs) in Indonesia. The presence of the sharia fintech industry can overcome the problems of Micro, Small and Medium Enterprises (MSMEs) in Indonesia, especially related to financing needs, ease of transaction processing, expansion of market access, and ease of preparation of financial reports. Indonesia with a large Muslim population has great potential for the development of sharia-based fintech. Not to forget that Indonesia's goal of becoming an International Fintech Hub must be achieved by solving several sharia fintech challenges such as increasing public financial literacy, creating a reasonable infrastructure for startups in Indonesia, and making mature policies for the security of customer transactions.

Micro, Small and Medium Enterprises (MSMEs) can take advantage of the facilities provided by sharia fintech as an alternative to obtaining business capital financing outside of conventional financing, including banking. In addition, sharia fintech can also encourage Micro, Small and Medium Enterprises (MSMEs) to improve their digital literacy and better record their business financial transactions. If we can answer the challenges of sharia fintech in Indonesia, in the end the role of fintech will increase, not only for MSMEs but for our national finances.

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