CHAPTER 1

INTRODUCTION

This chapter provides brief information regarding the research such as the research background, research problem and questions, research goals or objectives, the justification of research and the structure of research.

1.1. Research Background

Technology has revolutionized the way companies conduct their businesses by enabling small businesses to level the playing field with larger organizations (Vitez, 2019), and peer to peer businesses are no exception. Peer to peer lending is a concept in which two parties engage in a form of a contract system where one requests to obtain loans directly from the other, cutting out financial institutions as the middleman (Kagan, 2020). Thousands turned to peer to peer lending in the west as a result of the financial crisis of the late 2000s. Banks were reluctant to offer new loans and offered interest rates which were virtually 0% to savers. Low interest rates have been attributed to the development of liquidity traps. This is associated with a major global recession in an attempt to stabilize the economy. Liquidity traps happen when saving rates become high and render monetary policy ineffective (Nath, 2020). Due to this, borrowers had to look for alternative sources of loans, and savers actively looked for higher-yielding investments (KoinWorks, 2019). The peer to peer industry started with a personal finance peer to peer lending company named Zopa. Based in the United Kingdom, Zopa was founded in 2005 and it was the world's first peer to peer lending company (Sulte & Mintos, 2018). According to Morgan Stanley, peer to peer lending is in a period of high growth. It reached 25 billion USD in 2014 and may reach 290 billion USD by 2020. With new countries joining the trend and the product becoming more mainstream, the forecast may prove accurate.

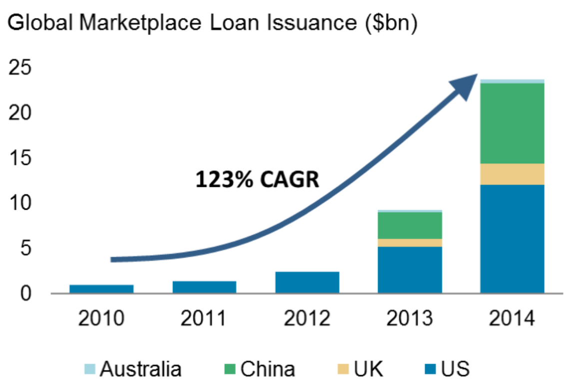

Figure 1. Compound Annual Growth Rate

Indonesia, in particular, offers peer to peer lending as an alternative method to provide loans for small to medium size businesses if said loans are inaccessible to be obtained from banks. There are many sources indicating the rise of peer to peer lending in Indonesia. According to the Indonesian Financial Services Authority (OJK), the lack of monetary inclusion is one of the reasons why peer to peer lending in Indonesia has started to rise (Otoritas Jasa Keuangan [OJK], 2019). Backing this theory is that the Indonesian Ministry of Cooperatives stated that there are over 50 million small to medium-sized businesses that are not rated as entities that banks might consider assisting. Whereas Aftech, the Indonesian FinTech Association stated the rise of peer to peer lending Industries in Indonesia started due to low credit penetration within the country, lower than 6 percent (Indonesia Fintech Association [Aftech], 2018). Peer to peer lending cash loan services fills the gap in financing needs in Indonesia and open access for those who are unbanked but are eligible for credit (Satria, 2018). It is not yet known when the peer to peer Lending industry entered Indonesia, but when referring to the regulations made by the Indonesian Financial Services Authority (OJK) regarding information technology-based lending and borrowing services, peer to peer lending was already in the country in 2016 (Ferdiani, 2019). Peer to peer lending industries in Indonesia has increased with reports stating that as of November 2019, the increase in peer to peer lending industries is directly proportional to the increase in the number of loan funds that were successfully channeled to Indonesian citizens. The amount reached 5.4 billion USD. This figure increased 228.88%

more than 1.65 billion USD in December 2018 (Otoritas Jasa Keuangan [OJK], 2019). Loans are mostly dominated by borrowers from Java Island reaching up to 4.6 billion USD. This amount has increased up to 225,54% in comparison to the previous year. Borrowers from outside of Java Island have also increased their loans up to 250,42% in comparison to the year before reaching up to 700 million USD. Peer to peer lending serves as an alternative investment for lenders and an alternative source of loans to its borrowers. Due to its independent and "decentralized" nature, investors/lenders, can exploit said nature and attempt to pull in borrowers and trap them into high percentages of debt that can be multiplied at will by the lenders. The way these so-called lenders pull in users or borrowers is by implementing "the ease of use strategy" so users do not have to go through a complicated and time-consuming process, and will have their funds delivered in as little as 30 minutes (Otoritas Jasa Keuangan [OJK], 2019). Chairman of the Task Force for Investment Alert Tongam Lumban Tobing said that the results of the Task Forces search in January have found 120 entities that conducted illegal peer to peer lending activities that are not registered with the OJK.

Thousands of illegal fintech peer to peer lending appears on websites, applications or offers via SMS are circulating. We always ask the public to be vigilant about utilizing the list of peer to peer lending registered in the OJK (Tobing, 2020). Previously in 2019, the Investment Alert Task Force suspended the activities of 1494 illegal peer to peer lending activities. The total that has been handled by the Investment Alert Task Force from 2018 until January 2020 is a staggering 2,018 entities. In addition to illegal peer to peer lending fintech activities, the Investment Alert Task Force also stopped 28 businesses that were suspected of carrying out business operations without the permission of the competent authority and the potential to harm the public. Regardless of lenders pulling money from the borrowers from high-interest rates, most borrowers also do not provide substantial information in their profile description of reasons for loans from legitimate lenders, further resulting in the distrust towards online peer to peer lending, and also further increases the risk of losing capital for both parties.

1.2. Research Problem and Questions

There is one research problem that will be investigated in this research, and that research problem is: The diminishing trust between both lending parties.

Research questions are as follows:

1. Do the antecedents of trust points that encompasses knowledge-based trust and Institution-based trust affect the lenders' trust in the intermediary?
2. Do the antecedents of trust points that encompass cognition-based trust affect the lenders' trust in the borrower?
3. Does trust in the intermediary affect the lenders' willingness to lend?
4. Does trust in the borrower affect the lenders' willingness to lend?
5. Does trust in the intermediary affect trust in the borrower?
6. Should all the proposed relationships above be accepted as a model?

1.3. Research Goals or Objectives

The research goals and objectives are as follows:

1. To determine how knowledge-based trust and institution-based trust affect the lenders' trust in the intermediary.
2. To determine how cognition-based trust affects the lenders' trust in the borrower.
3. To determine if trust in the intermediary affects the lenders' willingness to lend.
4. To determine if trust in the borrower affects the lenders' willingness to lend.
5. To determine if trust in the intermediary affects trust in the borrower.
6. To determine if the proposed relationships above can be accepted as a model.

1.4. Justification for Research

This research is purely for developmental purposes, by addressing the condition of peer to peer lending in Indonesia more focused on Jakarta, the diminish of trust from people towards the concept of peer to peer lending, and discussing the intricacies of said trust in order to build back trust to the people by building a trust model for them. Using the SEM and MLE method is a great approach due to the concept of approach in this research. It will also be an interest to find out the probabilities of building back the trust using statistical methods.

1.5. Structure of Research

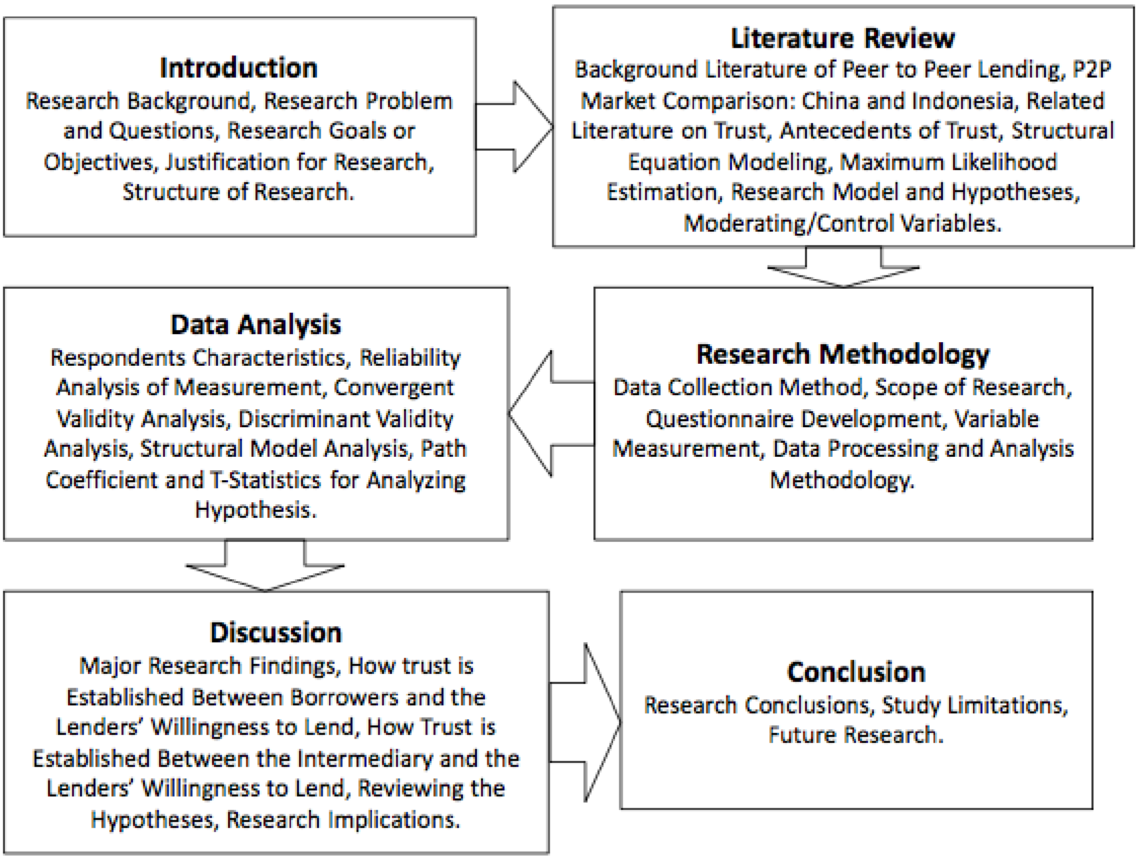

Figure 2. Research Workflow