# “Success factors for peer-to-peer lending for SMEs: Evidence from Indonesia”


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# SUCCESS FACTORS FOR PEER-TO-PEER LENDING FOR SMEs: EVIDENCE FROM INDONESIA

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## Abstract

Sharia fintech lending grew up at the teenage stage and has successfully taken a strategic place in the Indonesian loan market. Adopting the economics of information and signaling theory, this paper investigates the probability of successful crowdfunding. Using cross-section data, this study analyzes 1,153 funded projects on Ammana.id platform, a well-known Indonesia's sharia P2P lending. This study runs OLS regressions to examine the effect of loan information (ranking, estimated profit shares, and financing duration) on the amount of crowded funding. This finding support both theories, that the information about the loan is a signal in determining the success of project funding. Ranking and duration of financing significantly affect the success of the P2P sharia lending platform, nevertheless profit share estimation is not significant. Loans that operated in short, tend to raise more funding, and vice versa. Loan ranking can provide the lender with instant information about the borrowers' condition. Lenders tend to avoid low rankings loans due to the potential failure of loan payments. This study also found a surprising result that the coefficient of profit sharing is positive for Islamic funding but insignificant. This result shows that material gain is not the main issue for investors, but the elements of trust and justice are nobler according to Islamic beliefs. This study proves that loan information as a low-cost signal can be used by investors to make the best decision and reduce adverse selection problems. The findings support the strategic growth of Islamic platforms to build a sustainable Islamic investment and maintain financial stability.

**Keywords** fintech, crowdfunding, peer-to-peer lending, profit sharing, signaling theory

**JEL Classification** G21, G23

## INTRODUCTION

Peer-to-peer (P2P) lending has been the center of hot topics in every discussion of fintech recently (e.g, Barkley & Schweitzer, 2020; Fenwick et al., 2018; Kohardinata et al., 2020; Santoso et al., 2019; Sheng, 2021; Tambunan et al., 2021; Wang et al., 2020). P2P lending is subset of financial Technology service platform (financial technology/ fintech), which operated in the online-based credit market. P2P lending allows the investor to lend money to the borrower or business entities without any financial intermediaries (Thakor, 2020). P2P lending in Indonesia is gaining huge sympathy from the public with its tremendous growth. Since its first appearance in 2017 by Danamas (conventional), Indonesia's P2P lending grew by more than 100 percent in 2022. The Database published by the Financial Services Authority (OJK) as of April 2022 recorded 102 official fintech lending platforms in Indonesia, 7 of which are sharia platforms (Financial Services Authority (OJK), 2022). Pohan et al. (2020) explained that the rapid growth of Indonesia's P2P lending is due to the large public acceptance on this platform. The main reason is that it is fast and easily ac-



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cessed without any valuable collateral. Therefore, this study is interested to investigate the factors that influence the success of financing business in the context of financing disclosures.

Islamic P2P lending platforms in Indonesia are currently growing into the adolescent stage. P2P lending provides alternative financing solutions, especially for MSMEs and borrowers who are denied bank financing (Suryono et al., 2021). The profit-sharing system in Islamic P2P lending platforms provides more benefits to borrowers and lenders than interest-based financing (Atif et al., 2021). Yan et al. (2015) mentioned that P2P lending offers higher returns than conventional banks, which have higher risks and uncertainties. P2P lending also allows borrowers to apply for non-collateral financing (Muneeza & Mustapha, 2021; Muryanto et al., 2022). To be convinced to fund a project, investors will strongly rely on the information about the financing disclosed in the crowdfunding platform (Yan et al., 2018). Signaling theory can explain this scenario. Information about financing is signal that determines the investment decision for the investors. Its information becomes the attention of the investors to avoid information asymmetry and adverse selection matters (Khan & Xuan, 2022). Investors will release their money when they receive a good signal (good news) from the borrower/project.

This study focuses on the success of sharia financing on the P2P lending platform. Since the successful achievement of financing targets depends on investor interest, information about the loan plays an important role in the success of project funding. This study investigates the influence of financing rank, estimated profit share, and financing duration on the success of sharia funding for MSMEs. All business contracts (*akad*) were analyzed, including *ijarah*, *mudharabah*, *murabahah*, and *musyarakah*. This study contributes to the P2P lending literature, especially in the Islamic context. It provides a better understanding of how information about loans disclosed on the platform affects the success of MSME financing in the Islamic P2P lending.

## 1. LITERATURE REVIEW AND HYPOTHESES

The efficient market theory stated that all matters relating to an entity and/or its products/services are available information for the stakeholders that can determine their behavior (Fama, 1998). To make an investment decision in P2P lending platforms, information about loans and/or borrowers becomes a major concern for investors. The economics of information theory states that one will seek the lowest price with marginal benefit higher than marginal cost (Goldman & Johansson, 1978; Stigler, 1961). In the context of the loan market, lenders (investors) will gather information up to the point of equivalent between marginal benefit and marginal cost. On the other hand, borrowers will not convey information about their full loan profile to avoid signaling costs (Spence, 1978). Lenders need to spend more resources to select loans due to limited information (search cost), meanwhile borrowers face problems related to their trustworthiness (signaling cost). Such both costs increase the information asymmetry in adverse selection matters and moral hazard (Akerlof, 1970).

Yan et al. (2015) mentioned that P2P lending platforms have high information asymmetry, since lenders only obtain limited information presented on the platform. This causes lenders at a disadvantageous position, where the possibility of selection failure occurs. Lenders experience selection problems that make it difficult for them to access credit risk. In this situation, lenders experience adverse selection. A moral hazard occurs when borrowers misuse investor funds for projects that are different from those stated on the platform. Therefore, this study borrows signaling theory to examine the probability of successful sharia financing in P2P lending platforms. Previous literature uses the theory. Lin et al. (2013) and Cai et al. (2016) use signaling theory to explain their findings that friendship as a signal affects funding probability in P2P lending being successful. Serrano-Cinca et al. (2015) reported the loan characteristics, borrower characteristics, loan history, and borrower credit history as a signal of project feasibility in P2P lending. Meanwhile Nowak et al. (2018) found that signaling information about loan description and loan index affects the probability of small business loans being funded by P2P lending market. More recently Khan and Xuan (2022) used loan tenor, borrower age, and loan purpose as a signal which influences investors' decision in P2P lending.

Investor intentions in conventional P2P lending have been widely discussed in much empirical literature (Cai et al., 2016; Lin et al., 2013; Yan et al., 2018; Yang et al., 2017), but sharia platforms have not received more attention. Meanwhile, sharia P2P lending platforms are starting to grow into the teenage stage. Similar to conventional P2P lending, sharia P2P lending facilitates various of financing with online crowdfunding, such as donations (*infaq*), rent (*ijarah*), and MSME loans (*mudharabah/musyarakah*), of consumptive loans (*murabahah*). Sharia P2P lending platforms in Indonesia include Ammana.id, Alami, Dana Syariah, Duha Syariah, Qazwa.id, Papitupi Syariah, and Ethis. Ammana.id becomes the pioneer in implementing sharia-based online lending in Indonesia. 97.5% of financial campaigns have been successful since its official establishment in December 2019 with a total of more than 41 thousand users (Ammana.id, 2022). This scenario attracted the attention of researchers to investigate what influence the success of financing on sharia platforms, with Ammani.id in particular. Previous literature has investigated the individual attraction to sharia P2P lending platforms (e.g., Abidat et al., 2019; Ichwan & Kasri, 2019; Khan & Xuan, 2022; Puteri et al., 2018; Thaker et al., 2019). However, the factor on how the success factors of project funding in such platforms are not yet been explored.

This study uses three strands of literature to clarify the effect of credit ranking, profit share, and financing duration on the success of project financing in P2P lending platforms. Starting with credit ranking, Huang et al. (2021) examine how framing messages about credit ratings and interest rates affect to successful funding in P2P lending. Using funding success dummies and the number of investors as measurements of funding success, they suggest that well-framed messages give a positive effect on funding outcomes. Several other studies also confirm this, for example, Emekter et al. (2015), Klafft (2008), Wang et al. (2020), Zhang et al. (2017), and others. These studies agree that credit ranks are critical to controlling loan failure risk and platform viability. Wang et al. (2020) proposed a cost-based multiclass classification model to measure loan sensitivity. The analysis result suggests that credit classification can reduce total costs and maintain the viability of P2P lending platforms.

Atif et al. (2021) mentioned that the unique characteristic of the sharia economic system that is attractive is the profit-sharing system. Profit sharing is done with the concept of sharing either the entity's profits or losses. In conventional perspective, profit sharing is similar to dividends share or rates of return, which are usually more favorable to investors. Rahman (2010) mentioned that the beauty of sharia finance is the participatory method, where the profit and loss sharing model. Previous empirical literature has discussed the relationship between interest rates and the success of funded loans on conventional P2P lending platforms (e.g., Dharmastuti & Laurentxius, 2021; Emekter et al., 2015; Huang et al., 2021; Yan et al., 2018; Zhang et al., 2017). Meanwhile, the profit-share model has great potential to fulfill the risk-sharing needs of micro, small, and medium entrepreneurs (Rahman, 2010).

The effect of interest rates on the success of funded loans is being debated in the literature. For example, Zhang et al. (2017) found that positive coefficient of interest rates on the probability of a loan being funded. However, Yan et al. (2018) did not find a linear relationship between interest rates and the number of investors in P2P lending platforms. This contradicts the previous finding of Puro et al. (2010) that lenders 'decision probabilities increase when they earn higher interest rates on the loans funded. Similarly, Huang et al. (2021) found that high-interest rates attract lenders and increase the probability of loan success. Dharmastuti and Laurentxius (2021) added that loans in P2P lending platforms tend to provide higher benefits (interest rates) than traditional finance. This is because, the interest rates charged to the borrowers do not sufficiently compensate for the possibility of them payment failure (Emekter et al., 2015).

Finally, one of the reasons for investors' high intentions in P2P lending is the short loan duration. Even though recent studies have found that longer loan duration increases investors' intentions to fund loans on peer-to-peer platforms, as example


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Yan et al. (2018) and Khan and Xuan (2022). These studies contradict the signaling and economics of information theory. Yan et al. (2018) show that a longer financing duration is required to increase the number of investors. A similar direction of influence was also found by Khan & Xuan (2022). In their analysis, they concluded that longer loan duration allows borrowers to collect more total financing. Supporting signaling theory, Emekter et al. (2015) confirmed that loans with long duration are associated with higher credit risk due to uncertainty. Similarly, Cai et al. (2016) found that shorter loan duration can reduce uncertainty and moral hazard.

For this reason, this study proposes the following hypotheses.

*H1: Loans with higher credit rankings have higher funding success.*

*H2: Loans that promise higher estimated profit sharing have higher funding success.*

*H3: Loans with shorter operating times have higher funding success.*

## 2. METHODOLOGY AND DATA

For the empirical analysis, this study uses collected data from the sharia P2P lending platforms. As this study focuses on SMEs financing, the sample was determined by total ijarah, mudharabah, murabahah, and musyarakah projects that were funded. The total sample size is 1,217 loans. Since some data has extreme values, the final cross-section data analyzed was 1,153 loans. The data consist of the amount of collected funding, credit rank, estimated profit sharing, and loan duration. All data came from loan information disclosed on the platform. The data was then analyzed using OLS using STATA as a statistical tool. The empirical model is as follows:

$$Funding = \beta_0 + \beta_1 Rank + \\ + \beta_2 ProfitSharing + \beta_3 Duration + \varepsilon. \quad (1)$$

The dependent variable of this study is the success of funded projects (*Funding*) proxied by the amount of funding collected. While the explanatory variable is credit rank (*Rank*), profit sharing (*ProfitSharing*), and duration of financing (*Duration*). Ammana.id classifies financing into five main categories base on risk level, namely A, B, C, D, and E. Each of these risk categories has three derivatives, resulting in total 15 loan ranks, for example A1-A3, B1-B3, C1-C3, D1-D3, and E1-E3. Loans belong to A rank, have very low risk, while rank E is an extremely high-risk loan. For the empirical analysis, this study created a loan ranking scale, A1=1, A2=2, A3=3, B1=4, B2=5, B3=6, and so on. The profit sharing data is the estimated percentage of profit sharing promised by the borrower on the crowdfunding he/she opens. Meanwhile, the duration of financing is a period needed to collect fund.

## 3. RESULTS

The research analysis begins with the descriptive statistic of each research variable, including the number of observations, mean, standard deviation, minimum, and maximum value. Descriptive statistics are presented in Table 1. Within 9 days, the average amount of collected funds was IDR 10.3 million with average profit sharing estimates of 12.74% per year. The funded project on average has a low-risk level, which was indicated by the number 9.92, which means it is between points 4–5. This point range is included in the B risk category. In observation, the estimated profit sharing is from 2.4% to 70%. The range of the funds is from IDR500 thousand to IRD250 million with financing time 1 until 81 days. However, these estimations still depend on the type of a financing contract. For this reason, the sample characteristics are further discussed based on the type of financing contract. First, the Ijarah contract. The sample detected one ijarah contract with a financing value of IDR4 million, an estimated profit sharing of 9.6%, and a financing duration of 12 days. The financing is classified as quite low, which is ranked as B1. The most common financing contract is the murabahah contract, which is intended for the purpose of business goods/assets, totaling 1,059 projects. The range of funding collected is from IDR500 thousand to IDR100 million with a period of 1–36 days and estimated profit sharing of 3.6%–70%. This financing contract has the highest average risk of the other contracts. For the mudharabah contract, the sample was 89 with a financing range of IDR2 million, this type of fi-

**Table 1.** Descriptive statistics

| Variable | Obs | Mean | Std. Dev | Min | Max |
|---|---|---|---|---|---|
| All | | | | | |
| Funding | 1,153 | 10,300,000 | 26,200,000 | 500,000 | 250,000,000 |
| Rank | 1,153 | 4.93 | 2.06 | 1 | 15 |
| Profit Sharing | 1,153 | 12.74 | 4.78 | 2.4 | 70 |
| Duration | 1,153 | 9.06 | 5.54 | 1 | 81 |
| Ijarah | 1 | | | | |
| Funding | | 4,000,000 | 0 | 4,000,000 | 4,000,000 |
| Rank | | 4 | 0 | 4 | 4 |
| Profit Sharing | | 9.6 | 0 | 9.60 | 9.60 |
| Duration | | 12 | 0 | 12 | 12 |
| Mudharabah | 89 | | | | |
| Funding | | 63,783,713 | 70,194,338 | 2,000,000 | 250,000,000 |
| Rank | | 3.12 | 1.81 | 1 | 7 |
| Profit Sharing | | 20.91 | 6.44 | 2.40 | 54.00 |
| Duration | | 4.12 | 8.99 | 1 | 81 |
| Murabahah | 1,059 | | | | |
| Funding | | 5,544,518 | 6,200,308 | 500,000 | 100,000,000 |
| Rank | | 5.09 | 2.00 | 1 | 15 |
| Profit Sharing | | 12.04 | 3.88 | 3.60 | 70.00 |
| Duration | | 9.50 | 4.93 | 1 | 36 |
| Musyarakah | 4 | | | | |
| Funding | | 95,000,000 | 49,328,829 | 30,000,000 | 150,000,000 |
| Rank | | 2.00 | 0 | 2 | 2 |
| Profit Sharing | | 18.08 | 6.14 | 9.60 | 24.30 |
| Duration | | 3.50 | 1.73 | 2 | 6 |

nancing has a longer average operating time than other financings (1–81 days) and has the second highest risk after murahabah. In spite of this, this contract allows borrowers to obtain higher profit sharing. The average profit sharing is about 2.4%–54%. Finally, musyarakah contracts tend to be low risk and have shorter financing times compared to others. The loan range is around IDR30 million to IDR150 million with an estimated profit sharing of 9.6%–24.30%.

To obtain the best result, classical assumption tests were conducted and all were met. Table 2 displays the result of the normality test, multicollinearity, and heteroscedasticity. The analyzed data was found to be normally distributed, with homoscedasticity, and no collinearity problem on the explanatory variables.

**Table 2.** Classical assumption testing results

| Variable | VIF | 1/VIF |
|---|---|---|
| Duration | 1.12 | 0.89087 |
| Profit Sharing | 1.11 | 0.90252 |
| Rank | 1.04 | 0.95837 |
| Skewness-Kurtosis chi2(Prob.) | 5.95(0.0511) | |
| Breusch-Pagan chi2(Prob.) | 3.17(0.0749) | |

OLS regression was conducted to test the effect of loan ranking, estimated profit sharing, and financing duration on financing success on sharia P2P platforms. The results are presented in Table 3. Test results support the hypotheses of this study, except for H2. First, this study supports H1, where higher loan ranking (lower loan risk) has higher financing success. This support is evidenced by the negative coefficient of the rank variable. Secondly, the coefficient of length is negative and significant on funding. This study also supports H3, where loans with shorter operating times have higher funding success. Lastly, the coefficient of the profit sharing variable is positive, but not significant. This finding indicates that the estimated profit sharing does not significantly affect the amount of funding on sharia P2P lending platforms. Thus, overall this study supports signaling and economics of information theory. Ranking and duration as strong signals about information can influence investors' decision to lend a certain amount of funds. When investors perceive the information as a good signal, they are willing to inject more funds. So that the target funding can be collected faster.


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**Table 3.** OLS regression results

| Variable | Coef. | Std. Err. | t | P>\|t\| |
|---|---|---|---|---|
| Duration | –0.00526 | 0.00059 | –8.79 | 0.000 |
| Profit Sharing | 0.00476 | 0.00419 | 1.14 | 0.256 |
| Rank | –0.00709 | 0.00065 | –10.84 | 0.000 |
| _cons | 0.06762 | 0.00046 | 146.85 | 0.000 |
| F(3. 1149) | 87.61 | | | |
| Prob > F | 0.0000 | | | |
| R-squared | 0.1862 | | | |
| Adj R-squared | 0.1840 | | | |

## 4. DISCUSSION

P2P lending became an easy alternative to collect financing, especially for fund seekers who have difficulty accessing bank financing. Investors who are less proficient at playing with their money will be more attracted to P2P lending platforms than traditional banks due to the quality of service (Yang et al., 2017; Yang & Lee, 2016). In recent research, Baruna et al. (2023) found that investors could potentially switch from bank to P2P lending due to declining customer satisfaction and service quality. investors' knowledge regarding P2P lending. and reward sensitivity. Declining in customer satisfaction and service quality of bank-triggered investors' intention to switch to online lending platforms as their protest. Moreover. the knowledge about P2P lending and positive stimuli of P2P lending magnified their interest in investing in P2P lending. The tremendous user appreciation has resulted in significant growth of P2P lending, especially in developing countries. including Indonesia (Rosavina et al.. 2019). This study confirms that ranking and financing duration is a signaling tool for investors.

Ranking and loan duration founded significantly affect the funding success in sharia P2P lending platforms. but estimated profit sharing is not significant. Loans that operate with shorter duration tend to raise more funding, and vice versa. In agreement with the economics of information theory. investors may perceive that long-duration loans have higher uncertainty than short-duration loans. As found by Emekter et al. (2015) and Cai et al. (2016), investors prefer loans with shorter operating terms. A longer financing period allows investors to face uncertainty and moral hazard problems.

The profit-sharing estimation was found to be insignificant, but the coefficient is positive. In sharia business ethics, material gain is not the main issue, but the principle of fairness and justice is nobler (Beekun. 1997). The profit-sharing system applied in P2P lending platforms provides more benefits to both borrowers and lenders than interest-based financing (riba) (Atif et al., 2021). In previous research on SME lending behavior, Rosavina et al. (2019) have also confirmed that SMEs in Indonesia prefer profit-sharing schemes for funding over interest rates as some of them are Muslim. They added that this scheme has a good impact on customers' intention to use the platforms. That is the reason why the element of trust is very strong there. Profit-sharing schemes help borrowers get financing faster and are also benevolent for lenders. The element of trust also underlies the growth of P2P lending platforms, and profit is not the focus of investors.

Loan ranking has a strong influence on the success of funds collected in sharia P2P lending platforms. Again, this finding supports signaling theory and some previous research, such as Zhang et al. (2017) and Huang et al. (2021). Loan ranking can provide instant information to lenders regarding loan conditions. This information become signal to investors whether to take it as a favorable or unfavorable signal. A higher rank (category A) means the loan has a lower potential risk of payment failure. meanwhile a lower ranking (category E) indicates a potentially high-risk loan. When a loan belongs to a low-risk rank. financing on the loan is more successful than a loan with a high-risk rank. Even though in the research sample the estimated profit sharing is not the focus of investors to fund projects in sharia P2P lending platforms, the risk level of the loan is highly considered. This empirical finding illustrates that investors on P2P lending platforms tend to avoid low-ranking loans due to the potential payment failure of the borrower.

This study provides evidence that the rank and duration of financing are low-cost signals. which can be utilized to increase funded project probability in sharia P2P lending platforms. Borrowers provide signals about loan description. namely credit risk level. profit sharing and funding duration. Lenders access the information provided to take investment decisions (Herzenstein et al., 2011). Investors need to consider the information on loan ranking and financing duration before actually allocating their money. This interaction can reduce search and signaling costs. which in turn reduces the information asymmetry problem. By assessing significant factors about loans. investors can make the best decision and reduce adverse selection issues.

Although the estimated profit sharing is not significant. the coefficient is positive. The estimated profit sharing may also be useful for some investors, so this element also needs to be conveyed on the platform. Borrowers who open crowdfunding offers on sharia platforms should frame reliable information about the loans to attract investors' trust, especially the two significant factors in this finding, namely ranking and duration of financing. It is important for borrowers to pay attention to the term of their crowdfunding. as investors on sharia platforms tend to favor short financing to reduce uncertainty. Borrowers also need to win investors' trust by demonstrating better credit performance. such as making timely manner payments. The credit performance is evaluated by the platform provider. which is credited in form of a loan ranking. Thus, the loan ranking adequately reflects the level of repayment risk and the condition of the borrower. Finally, the findings will help new sharia P2P lending platforms to shape their growth strategies. The findings of this study, together with a strict regulatory framework, can build a sharia investment climate for the sustainability of sharia P2P lending as well as maintaining financial stability.

Finally, this study contributes to the P2P lending literature, especially in the sharia context as follows. First, it provides a better understanding of how information about loans being disclosed on the platform affects the success of MSME financing in sharia P2P lending. The empirical study shows that ranking and financing duration play an important role in the success of sharia financing for MSMEs. Secondly,this study supports the signal theory, where loan information as a signal influences investor behavior. Finally, by exploring one of the sharia P2P lending platforms in Indonesia, this study broadens the horizon of the online sharia lending market in developing countries.

## CONCLUSION

This study examines the effect of information about loans on the success of collected funding on the sharia P2P lending platform. This study confirms that information about loans is a strong signal for the probability of projects being funded, especially the information about loan rank and the duration of financing. The loan rank adequately describes the risk level and condition of the loan. Loans with a higher rank (lower risk) can attract investors' confidence to allocate their money. resulting in a higher success of funded loans. Loans at higher levels have the possibility of higher future returns or lower repayment risk. However, this study records that investors prefer short loans to reduce signaling costs due to uncertainty. The findings also documented that estimated profit sharing does not significantly increase the probability of the projects being funded on sharia P2P lending platforms. This is because the sharia economic principles applied in the platform are based on trust and fairness. Therefore, profit percentages are not the focus of sharia P2P lending platforms users. Furthermore, the study also documented that murabahah contracts tend to have a higher average risk than other contracts. Mudharabah contracts have a longer operating time of about 1 to 81 days. This one allows borrowers to earn higher profit sharing. The average profit sharing is around 2.4%-54%. Meanwhile, Musyarakah contracts tend to be low risk and have a shorter financing duration than others.

In the future, multi-level studies can be carried out to analyze human and environmental issues from both borrowers and lenders perspectives, which could affect borrowers' funding performance. This study only focuses on testing the effect of information about loans on the success of funding collected on sharia platforms. Other factors outside the model can be analyzed for future research, such as the effectiveness of P2P lending, the economic environment, and others. In addition, an important issue to be highlighted here is to what extent these results can be generalized to other sharia platforms and, more importantly, whether similar studies can be conducted using data from different platforms.


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