

Risk Mitigation Strategy in Islamic Crowdfunding Institution (Case Study at Islamic Crowdfunding Instituion in Indonesia)

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ABSTRACT

Fintech began to grow rapidly in Indonesia, there were 216 institutions that joined the Indonesian fintech organization. One of the fast growing finteches is lending based crowdfunding or P2P lending. At present 127 registered lending based crowdfunding institutions are registered. Unfortunately, crowdfunding growth is still not maximized, found crowdfunding that collapsed in Indonesia, one of which is indves. To avoid failure, a discussion about risk and risk mitigation from crowdfunding is needed. The purpose of this study is to explain the risks arising from various crowdfunding institutions in Indonesia, along with their mitigation strategies. The results of this study are the risk mitigation strategies carried out by crowdfunding institutions in Indonesia by providing super lenders and raising funds again. Suggested implication from this paper is the application of risk mitigation strategy by other crowd funding.

Keywords: crowdfunding, Islamic crowdfunding, P2P lending, fintech, risk mitigation

DISCUSSION

Introduction

At present fintech is starting to grow rapidly in Indonesia. Both lending fintech, digital payment systems, wealth management, market aggregators, insurtech and fintech sharia.¹ To date, there are 216 institutions that have joined the AFTECH (Asosiasi Fintech Indonesia).² One of the fast growing fintech is lending fintech and lending based crowdfunding or P2P lending. At present 127 institutions lending based crowdfunding institutions are registered and 6 institutions have been licensed by OJK.³ This number indicates that P2P lending is the most type of crowdfunding in Indonesia.

The number of P2P lending that arises in Indonesia is due to the massive opportunity for P2P. This opportunity is seen from the number of residents in Indonesia who remain unbanked. Around 40% of the population in Indonesia are unbanked, this opens up opportunities for P2P lending to become an alternative for those unbanked populations. In addition, SMEs in Indonesia cover 95% of the total existing business and absorb almost 70% of the workforce. However, SMEs that have access to bank loans as a source of funding are even less than 20%.⁴ The P2P lending boom is also caused by high internet and mobile usage. As explained in the following picture:⁵

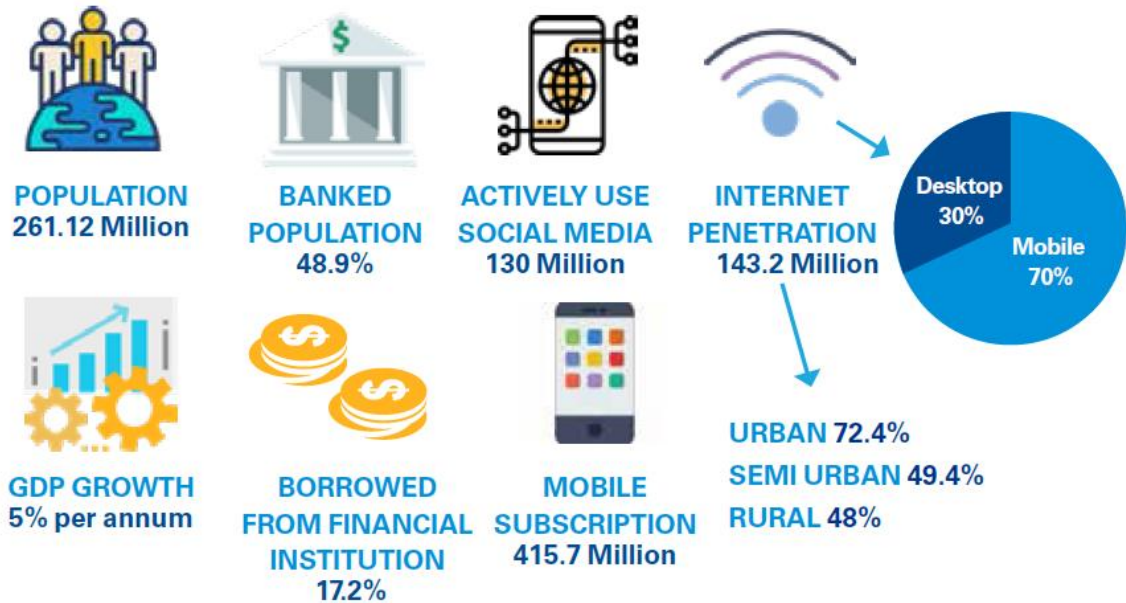
¹ Melihat Perkembangan Industri Fintech di Indonesia Fintech Summit & Expo 2019, <https://wartakota.tribunnews.com/2019/09/20/melihat-perkembangan-industri-fintech-di-indonesia-fintech-summit-expo-2019?page=2>. Editor: Aloysius Sunu D

² See: <https://fintech.id/members/>

³ See: <https://www.ojk.go.id/id/berita-dan-kegiatan/publikasi/Documents/Pages/-Penyelenggara-Fintech-Terdaftar-dan-Berizin-di-OJK-per-30-September-2019/Penyelenggara%20Fintech%20Terdaftar%20dan%20Berizin%20di%20OJK%20per%2030%20September%202019.pdf>

⁴ Crowdfunding Syariah Solusi Bagi UKM, <https://kapitalboost.com/blog/crowdfunding-syariah-solusi-bagi-ukm>, Sabtu Juni, 2017

⁵ See www.wearesocial.com



Despite the large crowdfunding developments and opportunities, there are institutions that fail. Examples of lending-based crowdfunding that do not operate are PT. Indves Dana Syariah. In addition, crowdfunding in China can be used as an example. There are 223 P2P lending institutions in China that failed, either because they stopped operations or are being investigated by the police for fraud.⁶ To avoid failure, a discussion about risk and risk mitigation from crowdfunding is needed. The purpose of this study is to explain the risks arising from various crowdfunding institutions in Indonesia, along with their mitigation strategies.

A Brief Overview of Risk and Its Mitigation

According to Donald E. Fischer & Ronald J. Jordan risk is uncertainty in the probability of return distribution.⁷ This risk is faced by every investor who invests. These risks can be divided into four types:⁸

Business Risk

The possibility of losses suffered by the company due to the profits obtained are smaller than expected profits. This business risk is related to the company's business scope.

Financial Risk

Risks arising from the way companies finance activities, for example, the use of debt in financing company assets.

Liquidity Risk

There are uncertainties that arise when securities are on the secondary market. This risk is related to the speed of buying / selling an asset and the price level formed in the transaction.

Exchange risk

⁶ Roy Franedy, Banyak yang Tutup, China Akan Inspeksi Langsung P2P Lending, 20 August 2018 18:24. <https://www.cnbcindonesia.com/tech/20180820174755-37-29436/banyak-yang-tutup-china-akan-inspeksi-langsung-p2p-lending>.

⁷ Fischer, Donald E. & Jordan, Ronald J., "Security Analysis & Portofolio Management", 6th edition, New Jersey: Prentice Hall, 1995, p. 65

⁸ Reilly, Frank, et all., "Investment Analysis and Portofolio Management", Thomson-Western Inc., US,2003.

This risk is related to fluctuations in the exchange rate of the domestic currency with the value of other countries' currencies. This risk is usually faced by international investors or companies that use foreign currencies in their operations and funding.

Country Risk

This risk is related to political stability and the economic environment in a country.

Glimpse Discussion about Crowdfunding

Until now there is no internationally recognized definition of crowdfunding, there are various opinions regarding the definition of crowdfunding. Oxford dictionary defines crowdfunding as the practice of funding a project or capital by raising a small amount of money from many people, usually via the internet.⁹ Whereas in McMillan Web-Dictionary crowdfunding is defined as a process of getting large groups of people to finance a project, specifically using a website to contribute.¹⁰

Many scholars also defined crowdfunding. According to Rubinton crowdfunding is The process of one party progressing towards a goal by requesting and receiving small contributions from many parties in exchange for a form of value to those parties.¹¹ Whereas Marom and Sade stated that Crowdfunding is an innovative funding mechanism which leverages the internet and social networks in order to raise funds from a large number of investors, usually raising small amounts from each investor.¹²

As for the history of crowdfunding starting from 2003, begins by "artist share" which was founded by Brian Camelio in the United States. Artist Share is a website where musicians can seek donations from their fans to produce digital recordings.¹³ Over time crowdfunding continues to grow and serve the various needs of the community. Large crowdfunding companies have emerged such as Indiegogo in California, Kickstarter and Circle Up. The success of these platforms makes crowdfunding an appropriate alternative for funding.

The success of crowdfunding as an alternative funding is also proven through various scientific works. In a thesis entitled "Crowdfunding in Japan: Expanding as the Popular Measure for Success and Support" Kezuka explained that Crowdfunding in Japan was successful for funding. Japan has a government crowdfunding based on a tax donation system at home. Local governments can propose fundraising for regional revitalization, then Japanese people can directly pay taxes for fundraising.¹⁴

Crowdfunding is considered an alternative funding because crowdfunding has high potential for it. Mushthaq Ahammed in his paper entitled "Sharia Compliant Crowd Funding: An Alternative Optimal Platform for Funding MSMEs". He said that Crowdfunding not only gave money to organizations, but also increased their human strength because the crowd that funded it also placed their institutional structures on a broader footing. The supporters unwittingly become additional marketing teams by promoting the projects they fund to their friends and networks.¹⁵

Crowdfunding consists of four types. First, donations based; crowdfunder in this type donates funds for a project without expecting anything in return. For example, the Kitabisa.com platform.

9 Oxford Dictionary, 2019, <https://www.oxfordlearnersdictionaries.com/definition/english/crowdfunding?q=crowdfunding>

10 McMillan Web-Dictionary, 2019, <https://www.macmillandictionary.com/dictionary/british/crowdfunding>

11 Rubinton, B.J. 2011. "Crowdfunding: disintermediated investment banking. Available at SSRN 1807204.", https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1807204.

12 D. Marom, A. Robb, and O. Sade. 2015. "Gender Dynamics in Crowdfunding (Kickstarter): Evidence on Entrepreneurs, Investors, Deals and Taste-Based Discrimination. Investors, Deals and Taste-Based Discrimination. Investors, Deals and Taste-Based Discrimination (December 6, 2015)".

13 David M. Freedman dan Matthew R. Nutting, **A Brief History of Crowdfunding: Including Rewards, Donation, Debt, and Equity Platforms in the USA**, (<http://www.freedman-chicago.com/ec4i/History-of-Crowdfunding.pdf>, 2015), p. 1

14 Hiroyuki Kezuka, "Crowdfunding in Japan: Expanding as the Popular Measure to Success and Support", **Thesis Centria University Of Applied Sciences Degree Programme in Business Management December 2017**, p. 43-44

15 Dr. Mushthaq Ahammed K, "Sharia Compliant Crowd Funding: An Alternative Optimal Platform For Funding MSMEs", **Kaav International Journal Of Economics, Commerce & Business Management, Kijecbm/Jul-Sep (2017)/Vol-4/Iss-3/A13 Page No.87-93**, p. 92

Second, reward-based crowd funding; crowdfunder in this type expect coupons or vouchers from the funds he spent on the project. Examples such as ovo, shopeepay etc.¹⁶

The third type of crowdfunding is lending based or peer to peer. Crowdfunding has become the fastest growing crowdfunding. Crowdfunder in this type of funding a project expects profit sharing or interest from the project. For example, syariah funds, ethiscrowd, syarfi etc. The fourth type is equity-based crowd funding; crowdfunder on this type of funding to get shares from the project. An example is alumnia.¹⁷

Islamic Crowdfunding in Indonesia

This section will explain the profile and mechanism of some Islamic crowdfunding, especially P2P lending in Indonesia. These institutions are Dana Syariah, Syarfi, Alami, and Ethis Crowd.

Dana Syariah

Reporting from Mr. Atis Sutisna, Director of Dana Syariah, the background to the establishment of Dana Syariah is the large number of Indonesians who are unbanked, either because of problems in principle, credit scores, or guarantees. It was also due to the fintech boom. The other mission of the Dana Syariah is to Islamize economics. done by introducing to the public that Islamic investment has greater benefits. If in the bank a maximum profit of 7% per year, while in Islamic funds the profit can reach 20% per year.

The lending mechanism in the Dana Syariah is carried out with a murabahah agreement. The steps are as follows: (a) Borrower submits a proposal; (b) Analysis of borrowers, both in terms of legality, collateral, credit score, and so on; (c) Acceptance and rejection of borrower proposals; (d) If the proposal is accepted, the project needs will be negotiated; (e) Dana Syariahs channel investment in the form of goods, except payment for services, such as handyman services, foremen, and others. The Syariah Fund has so far focused on financing property projects for MSMEs. Does not serve financing for other fields.

Syarfi

As explained by Ratih, the director of Syarfi, Syarfi stood on the basis of the rise of fintech cash loans, whose ribs were entangled, with limited time. Then the idea of creating Islamic fintech to overcome this. The P2P mechanism in Shariah is not much different from Sharia Funds, but it is different from the field being worked on. Dana Syariah focus on the property sector, Syarfi does not focus on one area, but all fields in SMEs. Its products are invoice financing, working capital financing, goods financing, and service financing.

Alami

Nizar Head of Product in Alami, said that 87% of Indonesia's population is Muslim. This number has the potential for a large market share for Islamic finance companies. So, with this Islamic finance in Indonesia should be more advanced than other countries. There are three maqashid which underlies its establishment of Alami, namely: education, justice and welfare. Alami not only focus on the business or tijary point, but also focus on the social point. All-natural steps are based on sharia maqashid.

The P2P mechanism in Alami is also the same as Syarfi and Dana Syariah. Starting from registration, borrower analysis and others. At present, the product in Nature is factoring with a contract called wakalah bil ujroh, can be accompanied by qard or without qard.

Ethiscrowd

As reported by Husni Bajamal Business Development Manager at PT Ethis, Ethiscrowd's mission is to accelerate the provision of adequate housing for the community, so that investors have a business and social impact when investing in ethiscrowd. Ethiscrowd was initially based in Singapore, but due to high operational costs, the ethiscrowd office moved to Malaysia. Of all the projects in ethiscrowd, only four are located in Malaysia, the others are located in Indonesia. Therefore, ethiscrowd opens branches in Indonesia.

The P2P mechanism in ethiscrowd is the same as in other agencies, but the underlying contract is a musharaka contract. This musharaka agreement makes the percentage of profit

16 UNDP, "Crowdfunding", Financing Solutions for Sustainable Development, 12/6/2017.

17 Ibid

sharing here determined after the project is realized. This is what distinguishes P2P lending in ethiscrowd and other P2P lending.

Risk Mitigation in Islamic Crowdfunding

After knowing at a glance, the profile and mechanism of sharia P2P lending in Indonesia, this section will explain the risks and mitigations that exist in P2P lending in Indonesia.

Dana Syariah

From the results of an interview with Danil, a risk analysis at the Syariah Fund. The main risk that can arise from the Dana Syariah is the failure of the borrower to pay. This risk has an impact on investors and also the Dana Syariah, investors are disadvantaged because the investment does not return and the Dana Syariah is disadvantaged because it does not pay for its investment time service. In addition, failure to pay will put a risk on the reputation of the Dana Syariah, if many projects fail to pay, the Dana Syariah loses public trust even though it has built it painstakingly and for a long time. Other risks that can arise are project failures, this can be caused by fraud, disasters or others. Once again this is a risk borne by investors and the Dana Syariah. In addition to the risks borne by investors and Dana Syariahs, there are also risks for borrowers, the risk for them is the failure of funding or not reaching its target at the end of the campaign period.

To avoid these risks, Danil explained that the Dana Syariah implements risk mitigation. First is the screening borrower. Each borrower who submits a proposal will be analyzed both in terms of legality, financial capacity, financial statements and so on. Not only the borrower is analyzed, but the project is also analyzed, both in terms of market, quality and others. The second risk mitigation is to put in place a guarantee system for borrowers and also insure the funding. third risk mitigation is funding projects in the form of goods not money. This is intended so that there is no fraud in the use of funds. The borrower will be asked for the following supplementary data with his account. Then the goods will be sent to the borrower without receiving money from the Dana Syariah. Fourth, the Dana Syariah also requires the borrower to guarantee the project, so that if the project fails, the Dana Syariah can take over and continue the project. Fifth, is the mitigation of the risk of the borrower, namely by adjusting the project standards with a promising market so that there is no funding failure.

Syarfi

Ratih said that the main risk of P2P lending is default. Same is the case with Dana Syariah which also emphasize the risk of default. This failure to pay can occur either because the borrower runs away or is unable to pay. This is a risk borne by investors and Syarfi. The second risk is the risk of Syarfi's reputation, when MPF defaults go up, making investors decline. In addition, other risks for Syarfi are website problems, lagging, hacking and so on.

To mitigate this risk, Ratih said that Syarfi implemented various mitigations for this. First, to avoid default, risk mitigation is done by paying the borrower's salary, insurance and guarantees. Secondly, to mitigate reputation risk, Syarfi sorts, supervises, and analyzes borrowers, so there are no defaults that reduce Syarfi's reputation. Third, to mitigate IT problems, Syarfi works closely with other vendors to check systems and use a strong firewall for data security and also conduct maintenance testing.

Alami

Nizar said that the risk for investors and Alami is the failure of borrower payments. This will also have an impact on the reputation risk Alami has. If, the TKB level continues to be 100% then, Alami will be trusted by investors, but if it decreases and MPF rises, public trust in Alami will decrease. In addition, there is also the risk of failure of fundraising for the borrower, it is caused by the credibility of the borrower itself.

Mitigation carried out by Alami is maintaining public trust by providing services, processes, analysis, access to service convenience, and attractive promotions. In addition, to avoid default, to date Alami only received financing for factoring and also analyzed the credibility of the two related companies.

Ethiscrowd

Husni Bajamal said that the risks involved in P2P lending were project failure and borrower failure to return the funds. To mitigate this risk, ethiscrowd strictly selects incoming project proposals. Projects favored by investors, safe, good and trusted. In addition, Ethiscrowd also continues to assist borrowers who are running the project so that they are always aware of the obstacles in the field. When the borrower is open to existing obstacles, ethiscrowd will continue to help. However, if the borrower runs away, has been warned many times but there is no response, ethiscrowd will bring it into legal channels.

CONCLUSIONS

The conclusion from the whole discussion above is that the risk faced by all P2P lending is the failure of the borrower to pay. This is due to various things ranging from fraud, project constraints and so forth. All P2P lending has their respective risk mitigations. The risk mitigation undertaken by all institutions is the analysis of borrowers, guarantees and insurance. In addition, each P2P has special risk mitigation, such as guaranteeing a funded project, payment through salary deductions, only accepting factoring financing and in-depth analysis of financing objects.

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