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Effect of Borrower Reputation on Amount of Funding and Loan Interest Received on Peer to Peer (P2P) Lending in Indonesia

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Abstract
The development of financial technology in Indonesia has been very rapid lately, leading to the growth of people's awareness and interest in the world of finance and investment. The presence of Peer-to-peer (P2P) Lending is beneficial for the public to borrow and invest. In Indonesia, since February 2020, there have been 161 P2P Lending registered, and 25 have permits. This study was conducted to determine the effect of borrowers' reputation on the amount of funding and loan interest earned on P2P Lending. Based on data collected from Investree with a total of 273 loans sample using the purposive sampling method, the results indicate that borrowers on P2P Lending with a good reputation will attract investors to provide funds so that borrowers will get a high amount of funding. Borrowers with good reputations will also get low loan interest through the mechanism carried out by the platform

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1. Introduction

P2P Lending is considered a significant innovation in retail banking (Dorfleitner et al., 2016). The first emergence of P2P Lending-based financial technology in the UK was called Zopa in 2005. In 2006 the United States created P2P Lending for the first time named Prosper, followed by the Lending Club. In Asia, China carried out the P2P Lending business in 2007. However, the P2P Lending business practice has existed and has been carried out by people offline for a long time, even since several centuries ago. Apart from Britain, the United States, China, P2P Lending has also penetrated developing countries such as Indonesia. Although lagging behind other countries, P2P Lending in Indonesia has grown significantly. According to Direktorat Pengaturan Perizinan dan Pengawasan Financial Technology (DP3F) OJK, as of February 19, 2020, there were 161 registered financial technology companies and only 25 that had licenses. The increasing number of financial technology will encourage financial inclusion in Indonesia by increasing economic activity.

P2P Lending-based technology finance helps the public in their financial activities, such as in financing capital. P2P Lending as a loan-based platform includes consumer and business loans. The phenomenon in Indonesia that many business people have problems making loans at research banks (Cai et al., 2016). The problem with credit loans is the high cost of credit and service, which harms the inability to repay. P2P Lending makes it easy for borrowers in terms of requirements and procedures. Borrowers can make submissions anywhere and anytime because requests are made using the internet or online so that the borrower does not need to come directly to the P2P Lending office. Fund disbursement time does not take a long time. The submission requirement only requires personal information, business information, and financial information does not require collateral.

For parties who lend funds or lenders, P2P Lending also provides benefits. Lenders will get a higher return than depositing funds at conventional banks. Lenders have the right to choose which loans to fund. Lenders can see borrower criteria from the information listed on the platform. This relates to the risk that the lender can accept. In this funding activity, the funder also has the risk of losing his funds either in whole or in part when the borrower defaults on it, causing a default. In terms of borrowing, there is no requirement for the borrower to provide collateral so that lenders must be aware of the risk of default, which is fully borne by the lender. P2P Lending managers do not experience the risk of default. If the borrower is in arrears in debt, the lender must be prepared to experience losses. The regulation regarding P2P Lending in POJK Number 77-POJK.01-2016 also does not regulate the existence of credit guarantees in the loan and loan agreement.

In minimizing losses, lenders or investors must be careful in choosing borrowers to fund. Information about borrowers listed on the platform can be a reference for lenders to invest or not. However, P2P Lending cannot ensure that the borrower's information on the platform is appropriate. One of the KoinWork platforms recognized this information regarding the risk of lending funds that borrowers can provide incomplete, misleading, or inaccurate information about themselves in the borrower's application. Studies conducted by Klafft (2008) show that it is difficult for lenders to ensure the authenticity and integrity of borrower information. Stiglitz and Weiss (1981) showed that asymmetric information exposes lenders to higher investment risk.

This information asymmetry problem in some previous literature has proposed a reputation mechanism to minimize the risk. By looking at the borrower's historical data, lenders can analyze whether the borrower is eligible to be funded or not. Cornée et al. (2012) show that reputation mechanisms play an important role in the traditional loan market. In bank credit loans, the borrower's historical record is one of the conditions considered by the bank. Every borrower who applies for credit will be evaluated through a government system through the Financial Services Authority with the Sistem Layanan Informasi Keuangan (SLIK), which collects information about financing facilities. This SLIK system allows banks or other financial institutions to determine if there are borrowers in arrears in credit. However, in lending and borrowing activities in P2P Lending, no system records the historical data of borrowers that are regulated by the government, so in this case, lenders cannot evaluate potential borrowers because the borrower cannot fulfill the loan requirements at the bank. One of the P2P Lending Investree platforms has provided borrowers historical data as one of its information. Lenders who join the Investree are given the convenience of evaluating prospective borrowers through the available information.

According to Diamond (1989), the historical data on borrower reputation plays a key role in controlling the moral hazard problem. Reputation theory assumes reputation reflects the borrower's historical records and characteristics (Kreps and Wilson, 1982). A good borrower's reputation will increase the borrower's bargaining power, but a bad reputation will provide a bad reflection for the borrower, thereby reducing bargaining power. (Jie et al., 2018) conducted a test that the reputation mechanism of P2P Lending in China. This research shows that the reputation mechanism plays a role in determining the probability of obtaining funds and the amount of borrowing costs. There are effective reputation

mechanisms in place that can discipline borrowers' behavior.

2. Theoretical Basis

Financial Technology

Financial technology is an implementation of information technology related to finance (Alimirruchi, 2017). In POJK Number 77/POJK.01/2016 concerning Information Technology-Based Lending and Borrowing Services, information technology has been used to develop the financial industry, encouraging the public's growth of alternative financing. Financial Technology can be a system that contributes to the national economy. According to Bank Indonesia, the existence of Fintech has changed the payment system in society and has helped many start-up companies reduce their initial high capital and operational costs.

Peer-to-peer (P2P) Lending

According to Otoritas Jasa Keuangan (OJK), P2P Lending is an implementation of financial services to bring together lenders and loan recipients in the context of entering into a loan and borrowing agreement in the rupiah currency directly through an electronic system using the internet network. The P2P Lending platform has a role as a meeting place between fund owners who need a place for investment and prospective borrowers who need funds. In (Santoso et al. 2019), the P2P Lending system can be considered to eliminate some of the intermediary processes that usually occur in traditional banking systems because of internet-based information processing benefits.

Asymmetry Information

In terms of borrowing on the P2P Lending platform, the borrower is required to include information related to submission requirements. POJK Number 77/POJK.01/ 2016 concerning Information Technology-Based Borrowing and Lending Services Record Electronic Documents is any electronic information that is created, forwarded, sent, received, or stored in analog, digital, electromagnetic, optical, or the like, which can be seen, displayed, and/or heard through computers or Electronic Systems including but not limited to writing, sound, images, design maps, photographs or the like, letters, signs, numbers, access codes, symbols or perforations that have meaning or meaning or may be understood by someone capable of understanding it as referred to in Undang-Undang No 11 of 2008 concerning Electronic Information and Transactions.

Several studies have shown that lenders combine objective and subjective information available in the market to assess their level of uncertainty with respect to the confidence of potential borrowers (Iyer et al., 2009, Larrimore et al., 2011, Sonenshein et al., 2011, Herzenstein et al., 2011b, Michaels, 2012 in Yum et al., 2012). Several literature works acknowledge the importance of information containing the borrower's transaction history in building lender trust.

Historical Reputation

The transaction history or reputation mechanism will influence the attitude of investors. This is related to the list of funding and borrowing costs. The government regulates the borrower's historical reputation in the traditional financial system through Bank Indonesia and the Financial Services Authority, whose function is to obtain debtor information data. This historical information is recorded in Sistem Layanan Informasi Keuangan (SLIK), an information system managed by the OJK to support supervisory duties and provide information services to stakeholders in the financial services sector. OJK provides an information service regarding Fintech loan customer data through Pusdafil (Fintech Lending Data Center), integrated with SLIK.

Studies that have been conducted by Jie et al. (2018) in China show that borrowers with better reputations will get a fulfilled list of funding, lower borrowing costs, and lower default behavior.

Previous Research

Dorfleitner et al. (2016) conducted a study on the relationship of the factors contained in the platform from the description text with the probability of successful funding and the probability of default in P2P loans for two European platforms. This study found that spelling errors, text length, and positive emotional mentions generated keywords to predict the probability of funding on the two less restrictive platforms, which even accepted applications without a credit score. The platform also shows a better risk-return profile. Text-related factors hardly predict the probability of default in P2P Lending.

The past work of Dietrich & Wernli (2016) using data from borrowers and investors from Switzerland to analyze the determinants of consumer loan interest rates show that in addition to loan-specific and macroeconomic factors that significantly influence interest rates, they encounter some lenders' discrimination. This study reveals that borrower-specific factors such as economic status significantly influence lenders in evaluating borrowers' credit risk and thus interest rates, especially when the market for P2P consumer loans matures.

Ge et al. (2017) examined the predictive power of self-disclosed social media information about borrower defaults in P2P Lending and identified social deterrence as a new basic mechanism explaining predictive power. Using loan data sets from P2P lending platforms with social media presence data from popular social media sites, the borrower's self-disclosure of their social media accounts and their social media activities is displayed to predict

borrowers' probability default. Leveraging social media marketing campaigns that increase the credibility of P2P platforms and lenders disclosing loan default information on borrowers' social media accounts found a significant decrease in loan default rates and an increase in the probability of repayment defaults after the incident, suggesting that borrowers are being held back by potential social stigma. The results show that the borrower's social information can be used not only for credit screening but also for default reduction and debt collection.

Research conducted by Santoso et al. (2019), which uses a dataset from three P2P

Based on some of the previous studies that have been mentioned above, it can be proposed as a hypothesis related to some of these previous studies. In the historical reputation that affects the number of loans financed, lenders will evaluate the historical information available. Borrowers with a good historical reputation are more likely to get loans that are fully funded. So the first hypothesis in this study is proposed as follows:

H_1: A borrower with a good loan reputation will get a higher amount of funding.

An excellent historical reputation shows the characteristics of borrowers who are disciplined in paying back loans so that borrowers with better reputations tend to have lower loan interest rates. So the second hypothesis in this study is proposed as follows:

H_2: A borrower with a good loan reputation will get a lower loan interest.

3. Research Methodology

The type of data used in this research is secondary data. In this study, the data collection method was from secondary data by directly observing the borrower list's movement up to date on the P2P Lending Investree platform within one month. In this study, the amount of funding and loan interest are the dependent

platforms in Indonesia, investigates the determinants of platform interest rates and borrower default status. The results show that loan and borrower specific factors are significantly related to borrowing rates and bad debts. However, the relationship can differ from one platform to another. The empirical results show that very small loan-focused platforms for micro-enterprises increased their level of interest after the introduction of formal regulations. This happened because an increase in the number of borrowers requires a minimum loan amount that is relatively larger than the number of lenders. The shortage of the lender's supply then drives up the loan rate.

variables. This study's independent variable is the borrower's good reputation, which is controlled by several variables, namely loan information and personal information. The research model can be formulated as follows:

$$\text{Amount of Funding} = \alpha_0 + \alpha_1 Reputation + \phi Controls + e \ldots\ldots\ldots\ldots\ldots(1)$$

$$\text{Loan interest} = \beta_0 + \beta_1 Reputation + \psi Controls + e \ldots\ldots\ldots\ldots\ldots(2)$$

In equation (1), the dependent variable is the percentage of total funding. In equation (2), the dependent variable is the loan interest rate. From equations (1 and 2), the main independent variable is the reputation of the borrower, which is measured by the ratio of the loan amount that the borrower has successfully paid to the number of times the borrower has sought financing.

This study uses regression analysis tools with coefficient testing conducted to test how far the independent variables included in the model affect all dependent variables. The data analysis was carried out with the help of the STATA version 14 program as a tool to regress the models formulated in this study.

4. Result

Table 1

Descriptive statistics

Variable	Definition	Obs	Mean	Std. Dev	Min	Max
Dependent Variable						
Loan Interest	Loan interest rate.	273	0,1553	0.0177	0,12	0,18
Funding Amount	The percentage of how much the loan gets funded by the lender.	273	0,4366	0,3194	0	1
Independent Variable						
Reputation	The ratio of the number of loans the borrower has successfully repaid to the number of times the borrower has sought financing.	273	0,6024	0,4615	0	1
Control Variable						
Loan Amount	The natural logarithm of how much the borrower intends to borrow.	273	20,4763	0,7588	18,4004	22,2981
Duration	Length of loan.	273	84,4029	25,0329	3	179
LU	Business location.	273	2,5128	1,356093	1	5
Industry	Type of Industry.	273	3,2161	1,453	1	5
SLU	Business location status.	273	2,0842	1,1929	1	4

Table 1 shows that the value of the Loan Interest variable has an average value (mean) of 0.1553, which means that the average loan on the Investree platform gets a loan interest rate of 15.53%. With a standard deviation of 0.0177 and the lowest value (min) 0.12, and the highest value (max) 0.18. The variable amount of funding has an average (mean) value of 0.4366, which means that the average loan on the Investree platform gets total funding of 43.66%. With a standard deviation of 0.3194, and the lowest value (min) 0, means that there is a loan that does not get funding, and the highest value (max) 1 means that the loan is fully funded.

The Reputation variable has an average (mean) value of 0.6024 with a standard deviation of 0.4615 and the lowest value (min) 0 and the highest value (max) 1, which means that the borrower's reputation is close to 0. So it can be concluded that the reputation of the loan bad and vice versa. If it approaches number 1, then the loan reputation is good. Control variable Loan amount is the result of the natural logarithm of the total loan amount with an average (mean) value of 20.4763 and a standard deviation of 0.7588, the lowest value (min) 18.4004 and the highest value (max) 22.2981.

Regression Test

Researchers used the Ordinary Least Square (OLS) method. Seeing the classic assumption test results that the data is not normally distributed, this study carries out a Robustness check or robustness test to avoid bias in variable identification, model specifications, or endogeneity. The data used in model 1 becomes 257 data, and model 2 becomes 253 data because it has experienced an outlier test. The following are the results of the OLS regression test using the Robustness check:

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Table 2

Regression Test with Robust Model 1

Dependent Variable: Funding Amount

Funding Amount	**Coef**	**Robust Std. Err.**	**t**	**P>|t|**
Reputation	0,1191592	0,0434468	2,74	0,007
LoanAmountLog	-0,1391562	0,0204207	-6,81	0,000
Duration	-0,0038396	0,0006178	-6,22	0,000
_ILU_2	0,0070348	0,0550094	0,13	0,898
_ILU_3	0,0088069	0,0560239	0,16	0,875
_ILU_4	-0,0073959	0,0571247	-0,13	0,897
_IIndustry_2	0,1339879	0,0721265	1,86	0,064
_IIndustry_3	0,3976358	0,0932549	4,26	0,000
_IIndustry_4	0,3879517	0,0720709	5,38	0,000
_IIndustry_5	0,4885973	0,0680628	7,18	0,000
_ISLU_2	0,0366089	0,0499076	0,73	0,464
_ISLU_3	0,0823214	0,0914548	0,90	0,369
_ISLU_4	-0,2200957	0,0626006	-3,52	0,001
_cons	3,283944	0,4196067	7,83	0,000
N				257
r^2				0,3875
F				18,77**

Significance level: ** $p < 0,05$

Table 3

Regression Test with Robust Model 2

Dependent Variable: Loan Interest

Loan Interest	**Coef**	**Robust Std. Err.**	**t**	**P>|t|**
Reputation	-0,0122174	0,0027407	-6,76	0,000
LoanAmountLog	0,0016941	0,0016842	1,44	0,152
Duration	-0,0001847	0,0000423	-5,64	0,000
_ILU_2	-0,0011518	0,0046686	-0,35	0,725
_ILU_3	0,0177874	0,0058142	6,84	0,000
_ILU_4	-0,0018681	0,0098909	-0,50	0,617
_IIndustry_2	0,0018512	0,0030159	-0,73	0,464
_IIndustry_3	-0,004354	0,0044097	-1,62	0,106
_IIndustry_4	0,0144959	0,0047283	4,05	0,000
_IIndustry_5	-0,0018471	0,0028272	-0,83	0,409
_ISLU_2	0,0072582	0,0034877	3,22	0,001
_ISLU_4	0,0036643	0,0027087	1,35	0,177
_cons	0,1385451	0,0243362	5,69	0,000
N				253
r^2				0,6230
F				64,46**

Significance level: ** $p < 0,05$

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Table 4

Probit Test with Robust

Dependent Variable: Funding Amount Dummy

Funding Amount Dummy	Category 1		Category 2		Category 3	
	Coef	P>|z|	Coef	P>|z|	Coef	P>|z|
Reputation	0,8047745	0,001	2,341038	0,000	1,030418	0,000
LoanAmountLog	-0,6837112	0,000	-1,139894	0,004	-0,7460324	0,000
Duration	-0,0233915	0,000	-0,0208629	0,002	-0,293313	0,000
_ILU_2	-0,1484214	0,701	0,1383586	0,827	-0,703314	0,079
_ILU_3	0,2283073	0,478	0,6836962	0,291	0,0814376	0,808
_ILU_4	0,3689889	0,315	-0,4916372	0,585	-0,1408772	0,695
_IIndustry_2	-0,2537196	0,573	1,846867	0,000	0,110148	0,808
_IIndustry_3	-0,4837627	0,563	-	-	-0,3730411	0,660
_IIndustry_4	1,65553	0,000	-	-	2,314761	0,000
_IIndustry_5	1,769755	0,000	3,219959	0,000	1,844573	0,000
_ISLU_2	-0,1769665	0,545	-0,4860106	0,213	-0,2068345	0,485
_ISLU_4	-1,390465	0,000	-0,81144411	0,107	-1,487729	0,000
_cons	14,64876	0,000	18,92077	0,023	16,4755	0,000
N	256		210		256	
Prob>chi2	0,0000		0,0000		0,0000	

Significance level: ** $p < 0,05$

Where:

Amount of Funding: The percentage of the loan funded by lenders.

Loan Interest: The loan interest rate.

Reputation: The ratio of the number of loans the borrower has successfully repaid to the number of times the borrower has sought financing.

Loan Amount Log: The natural logarithm of how much a borrower intends to borrow.

Duration : Length of loan.

_ILU_1: Location (DKI Jakarta)

_ILU_2: Location (Banten)

_ILU_3: Location (West Java)

_ILU_4: Location (Central Java)

_ILU_5: Location (East Java)

_IIndustri_1: Mining

_IIndustri_2: Basic Industry

_IIndustri_3: Costumer Goods

_IIndustri_4: Infrastructure

_IIndustri_5 : Trade (Services)

_ISLU_1: Owned

_ISLU_2: Rent

_ISLU_3: Mortgage

_ISLU_4: Others (No description)

Determination Coefficient Test (R^2)

In the Amount of Funding regression model, the value of R^2, which can be seen in Table 2, is 0.3875. The estimation results show that the ability of the independent and control variables to jointly explain the dependent variable is 38.75%, while 61.25% is explained by other variables. In the loan interest regression model, the value of R^2, which can be seen in Table 3, is 0.6230. The estimation results show the ability of the independent and control variables to jointly explain the dependent variable by 62.30%, while 37.70% is explained by other variables.

Simultaneous Statistical Test (Test F)

In this study, the significance value used is 0.05 (5%). The F test for Model 1, which can be seen in Table 2, shows the Prob> F value of 0,000, which means that the p-value <0.05, it can be concluded that all independent variables used in the study jointly affect the dependent variable, namely the amount of funding. In the F test for Model 2, which can be seen in Table 3 shows the Prob> F value of 0.000, which means the p-value <0.05, it can be concluded that all independent variables used in the study jointly affect the dependent variable on loan interest.

Effect of Borrower Reputation on Amount of Funding Obtained

The effect of the borrower's reputation on the amount of funding obtained can be seen in Table 2. The independent variable reputation is positive and significant on the dependent variable, the amount of funding. This is indicated by a significant p-value of 0.007 at a significance level of 0.05 and a positive coefficient of 0.1191592. These results are in accordance with the hypotheses proposed in this study. Therefore H1 is accepted, the good borrower's reputation will affect the amount of funding obtained. The better the reputation of the borrower, the higher the amount of funding obtained from lenders.

From the results of Table 4, the results of the probit test were carried out to compare the results of hypothesis one. The addition of a dummy variable to the dependent variable Amount of Funding indicates that borrowers with better reputations are more likely to get the fulfilled amount of funding.

Lenders (investors) take the borrower's historical reputation records listed on the platform as consideration for investing. A good borrower's reputation will illustrate the success of the borrower in repaying loan funds. This attracts lenders to invest in loan applications in the hope that if the lender invests in a borrower who has a good reputation, the risk of loss borne by the donor is getting smaller. Lenders will increasingly trust in providing their funds to borrowers with a better reputation so that the amount of funding obtained by borrowers is high.

Effect of Borrower's Reputation on Loan Interest Earned

The effect of the borrower's reputation on borrowing costs can be seen in Table 3. The independent variable has a negative and significant reputation on loan interest. This is indicated by a significant p-value of 0.000 at a significance level of 0.05 and a negative coefficient of -0.0122174. Based on these results, it is according to the hypothesis proposed in this study. Therefore H2 is accepted, then the reputation of a good borrower will get a low loan interest. The worse the reputation of the borrower, the higher the loan interest will be.

Effect of Control Variables on Dependent Variables

The regression test results in table 2 show the variable loan amount and duration are negative and significant for the dependent variable amount of funding. This means that the smaller the loan amount, and the shorter the loan duration, the higher the funding obtained. The regression test results on the business location variable show that the locations of Banten, West Java, and Central Java are not significant, meaning that the business locations have the same level of influence on the dependent variable as the benchmark business location (DKI Jakarta location). The type of industry variable shows that the basic type of industry is insignificant, meaning that the sector has the same influence on the dependent variable as the type of benchmark industry (Mining). Variables Type of consumer goods industry, infrastructure, and trade (Services) is significant. It has a positive coefficient value, meaning that the type of sector strongly influences the dependent variable. The kind of industry is different compared to the kind of benchmark industry (Mining). The variable of business location status indicates that the status of Rent and Mortage is not significant. This means that the status has the same effect on the dependent variable as the benchmark business location (Owned). The variable status of the business location has no significant information and has a negative coefficient value, meaning that the status that is not listed affects the dependent variable, and the status is different from the status of the benchmark business location (Owned).

The regression test results in Table 3 show the variable loan amount is positive and not significant to the dependent variable interest. The control variable duration is negative and significant to the dependent variable amount of funding. It can be concluded that the shorter the duration of the loan, the lower the loan interest. The regression test results on the business location variable show that the locations of Banten and Central Java are not significant, meaning that the business locations have the same level of influence on the dependent variable as the benchmark business location (DKI Jakarta location). Meanwhile, the location

of West Java is significant and has a positive coefficient, meaning that the business location has an influence on the dependent variable and is different from the benchmark business location (DKI Jakarta location). The industry type variable shows that the type of Basic Industry, Customer Goods, and Trade (Services) is not significant, meaning that the sector has the same effect on the dependent variable as the type of benchmark industry (Mining or Mining). Variable, The type of infrastructure industry is significant and has a positive coefficient, meaning that the type of industry has a strong influence on the dependent variable, and the type of industry is different compared to the type of benchmark industry (Mining). The variable of business location status indicates that the status that is not listed is not significant, meaning that the status has the same effect on the dependent variable as the status of the benchmark business location (Owned). The variable status of "*Rent*" business location is significant and has a positive coefficient, meaning that this status affects the dependent variable, and the status is different from the status of the benchmark business location (Owned).

5. Conclusions And Recommendations

The results of regression testing using a robustness check on the dependent variable on the amount of funding can be concluded that the borrower's reputation affects the amount of funding obtained. A borrower with a good reputation will get a high amount of funding. The better the reputation, the higher the amount of funding obtained from lenders. The results of the probit test for adding a dummy variable to the dependent variable Amount of Funding show that borrowers with a better reputation are more likely to get the fulfilled amount of funding. The results of the regression test using a robustness check on the dependent variable on loan interest can be concluded that the borrower's reputation affects the loan interest earned. A borrower with a good reputation will get a low interest. The better the reputation of the borrower, the lower the interest earned. Lenders will be increasingly interested and willing to invest in a loan with a good reputation.

This study uses the personal information control variable as the dummy variable used, namely the variable type of industry, business location, and business location status. The results show differences in the influence between one type of industry and another, between one business location and another, between one business location status and another. The insignificant dummy describes the same effect as the dummy used as the benchmark.

The research period is carried out in a short time. It is recommended that further research be carried out in a long time so that the data obtained is more varied so that more accurate results can be obtained and free from classical assumptions. This research data only covers certain areas, so it is suggested that further research is looking for platforms that already cover loans in all regions of Indonesia so that it can illustrate the influence of the borrower's reputation on P2P Lending throughout Indonesia. Research also suggests looking for data with various companies that make loans so that the data obtained is more varied and gets the reputation of the borrower that is not repeated.

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