Digital Lending in the Philippines: Maximizing Opportunities and Mitigating Risks for MSME Finance

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Introduction

Micro, Small, and Medium Enterprises (MSMEs) have long been recognized as crucial contributors to the economic growth and development of the Philippines. With an overwhelming majority of 99.58% of all business enterprises falling under the category of MSMEs, this sector has a significant presence in the country's economic landscape (Department of Trade and Industry, n.d.). Moreover, MSMEs employ 64.67% of the country's total workforce, underscoring their vital role in generating employment opportunities and driving socio-economic progress (Department of Trade and Industry, n.d.).

However, despite their significance, MSMEs face persistent challenges in accessing the financing and capital needed to fuel their growth. One of the major obstacles hindering the expansion of this sector is the limited access to traditional funding, particularly for micro and small businesses (Shinozaki & Rao, 2021). The inability of these enterprises to access conventional bank loans stems from factors such as their lack of formal registration and established credit histories. Consequently, they are compelled to turn to informal sources for funding, relying on loans from family, and friends, or even borrowing from loan sharks (National Strategy for Financial Inclusion 2022-2028, NSFI).

To address the financing gap faced by MSMEs, there is a growing interest in exploring the potential of digital loans facilitated by financial technology (fintech). Digital loans offer a promising alternative, enabling MSMEs to overcome the challenges associated with traditional lending practices. Indonesia serves as a prime example of the benefits of fintech lending for MSMEs. During the COVID-19 pandemic, Indonesian small and medium enterprises embraced fintech solutions, including digital payments and lending. These businesses found digital-friendly services more accessible for obtaining funds than traditional banks, leading to Indonesia's emergence as the leading ASEAN country in FinTech development, especially during the pandemic (Karim et al., 2022).

This study delves into the realm of digital lending in the Philippines, specifically focusing on digital lenders, to explore the advantages, challenges, and regulatory framework associated with this form of financing. The primary objective is to examine potential improvements in the regulatory environment that can position digital lending as a viable alternative or supplement to traditional bank loans for MSMEs facing difficulties in accessing collateral and conventional financing options. By investigating the benefits, challenges, and regulatory framework of digital loans, we aim to shed light on the transformative potential of fintech in bridging the financing gap and empowering MSMEs in their pursuit of growth while ensuring that both consumers and service providers are protected from issues such as fraud. This understanding holds significant importance for policymakers, financial institutions, and MSME owners, as it can potentially reshape the financing landscape and contribute to the overall economic prosperity of the country.

In the following sections, we will explore the landscape of MSMEs in the Philippines, and examine the existing fintech ecosystem, with specific emphasis on digital lending. Additionally, we will analyze the digital lending landscape in Indonesia and discuss its implications for policy in the Philippines.

Micro, Small, and Medium Enterprises (MSMEs) in the Philippines

In the Philippines, MSMEs can be defined in two ways: 1) through the company's asset size, as outlined in Republic Act (R.A.) No. 9501, also known as the Magna Carta for MSMEs, and 2) through the number of employers, as stated by the National Statistics Authority (NSO). Table 1 presents a summary of the definitions:

Table 1. Definitions of Micro, Small, and Medium Enterprises in the Philippines

	R.A. No. 9501 (Legal Definition)	**NSO (Statistical Definition)**
Micro	Not more than Php 3,000,000	9 or fewer employees
Small	Php 3,000,001 - Php 15,000,000	Between 10 - 99 employees
Medium	Php 15,000,001 - Php 100,000,000	Between 100 - 199 employees

Sources: R.A. No. 9501; International Trade Centre (2020)

The significant impact of MSMEs on the economy is widely recognized. However, it is crucial to acknowledge that MSMEs are highly susceptible to external disruptions such as financial crises, disasters, and unexpected events like pandemics. Shinozaki and Rao (2021) highlighted this vulnerability, citing the example of the MERS outbreak, which resulted in a 0.4% decrease in the number of MSMEs and a 3.3% decline in employment between 2012 and 2014.

Similarly, the COVID-19 pandemic posed significant challenges for MSMEs in the Philippines. Research indicates that the pandemic and subsequent lockdowns had adverse effects on MSMEs. The same study revealed that in March 2020, 61.7% of microenterprises had no revenue due to business closures, followed by 49.1% for small firms and 35.8% for medium-sized firms (Shinozaki & Rao, 2021).

Access to finance has been a longstanding issue for MSMEs in the Philippines. Francisco and Canare (2019) observed that this is a major obstacle for MSMES in terms of accessing markets and expanding their operations. This is because traditional loans remain evasive to many of these companies. Lamberte (2001) revealed that small and medium-sized businesses rely on internal funding sources extensively, during their initial stages and also for ongoing business operations. The study further noted that banks still face many constraints with regard to providing financial services to MSMEs. This includes macroeconomic instability, inadequate infrastructure, regulation on deposit mobilization, shortage of capital, and competition with government banks.

Teves and Gloria-Santos (2021) emphasized this point by noting that despite the liquidity and stability of the Philippine banking system, lending to MSMEs has historically remained low. In 2019, only Php 228 billion, equivalent to 2.8% of banks' total loan portfolio, was extended to micro and small firms. This falls significantly short of the 8% mandatory allocation specified in the Magna Carta for MSMEs, which should have amounted to Php 651 billion in the same year. Banks face difficulties in complying with this mandatory loan allotment due to the lack of "investable enterprises." Consequently, some banks prefer to pay penalties rather than extend loans to MSMEs, as they struggle to identify suitable enterprises for investment.

The Philippines government has recognized the significance of MSMEs and enacted legislation, such as the Magna Carta for MSMEs (R.A. No. 9501), to support their financing needs and foster a favorable business environment. The law includes provisions mandating banks to allocate 10% of their lending portfolio to MSMEs, with 2% specifically for medium firms and 8% for micro and small firms. However, despite these measures, it was discovered that banks were not meeting their MSME loan requirements, resulting in a decline in the proportion of loans allocated to these enterprises from approximately 30% in 2002 to 16% in 2010 (Khor et al., 2015).

In order to address these financing constraints and encourage financial inclusion, the Bangko Sentral ng Pilipinas (BSP) (the central bank of the Philippines) has been actively advocating for the adoption of fintech (BSP Circular No, 2021).

The FinTech Environment of the Philippines

Fintech can be defined in various ways. Quimba et al. (2023) referred to the definition provided by the Cambridge Center for Alternative Finance (CCAF), which describes fintech as "the combination of technological advancements and changes in business models that can revolutionize the delivery of financial services through innovative instruments, channels, and systems" (p. 3). It is worth noting that there is no specific regulation in the Philippines that explicitly covers or defines fintech. However, the FinTech Alliance Philippines (2019) has created a taxonomy that comes closest to defining fintech in the country. According to their document, "fintech refers to financial services that are delivered through the Internet and/or mobile applications (p. 46)".

The fintech industry in the Philippines has witnessed significant growth in recent years. According to Quimba et al. (2023), the number of fintech companies in the country has risen by approximately 46% since 2017. Specifically, there were 115 fintech companies in 2017, and by December 2020, the number had reached 212. Furthermore, the BSP also noted an increase in the share of digital payments to total payment transactions and the number of e-payment transactions. These are reflected in Figures 1 and 2 respectively.

Figure 1.

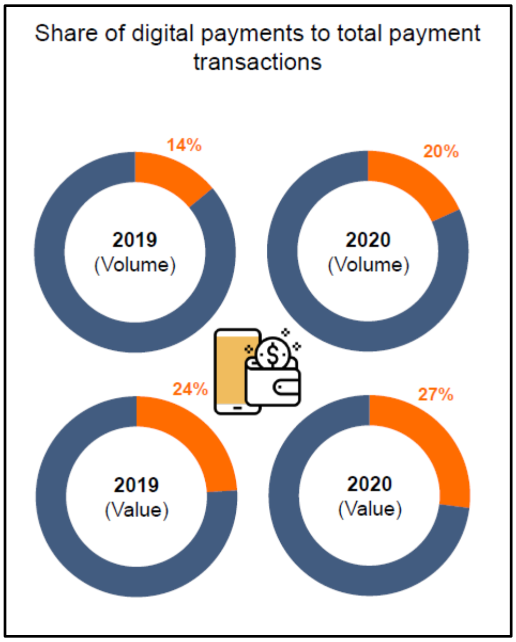
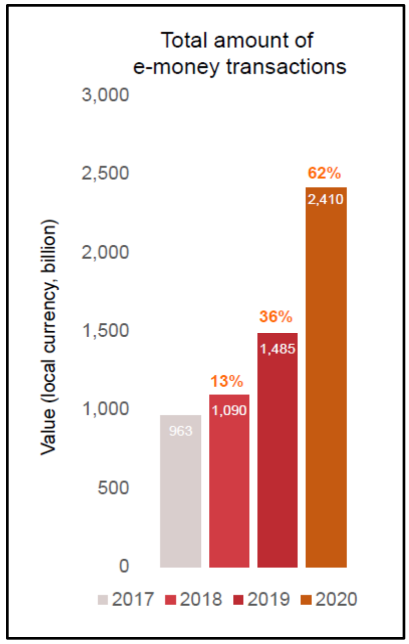


Figure 2.



Note. The tables are from "Philippine Fintech Report 2022" by the Fintech Alliance Philippine and Fintech News Philippines

Currently, there is no widely accepted taxonomy for classifying fintech activities. Different approaches, such as categorizing sectors based on the products they offer or the methods of data processing, are adopted depending on the specific study (CCAF et al., 2019; Fintech News Network & FinTech Alliance Philippines, 2021). For the purpose of this study, the taxonomy provided by the FinTech Alliance Philippines in their report "Uncharted Beyond: The Taxonomy of FinTech in the Philippines" will be used. According to the report, the categories for Philippine fintech companies include Payment and Remittance Services, Crowdfunding, Lending Platforms, Alternative Trading venues, and Insurance and Asset Management.

In the Philippines' fintech ecosystem, start-ups primarily focus on digital lending (53% of responses) and digital payments (29%). Additionally, majority of the companies providing digital loans operate through P2P/marketplace business models (CCAF et al., 2019). This is corroborated by the Philippines FinTech Report 2022, which indicates that lending represents 27% of the country's fintech landscape, while payments constitute 20% (Fintech News Network & FinTech Alliance Philippines, 2021). However, despite the significant presence of lending in the country's fintech ecosystem, there is a dearth of comprehensive studies exploring its potential impact on MSME financing, associated risks, and regulatory measures.

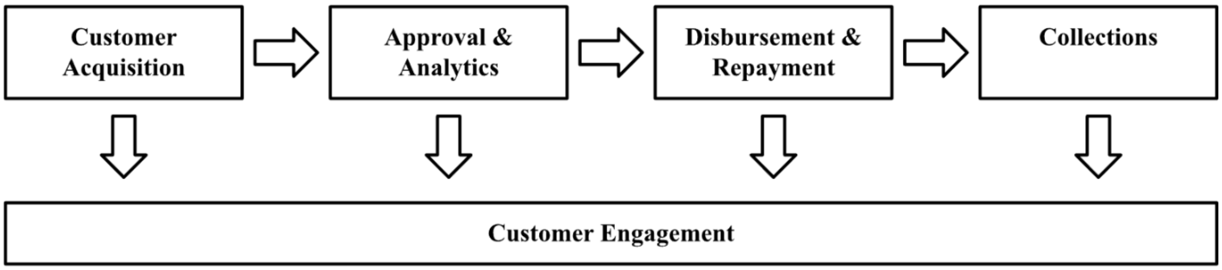
Digital Lending: Definition, Possibilities, and Challenges

Digital lending, also known as fintech lending, refers to the provision of lending products through technology, primarily online platforms, as an alternative to traditional banks or lending companies (Berg et al., 2021; Cornelli et al., 2021; Quimba et al., 2023). Ben-David and Stulz (2021) adds to this definition by characterizing fintech lending as loans provided through online platforms by "non-deposit-taking institutions" (p. 7).

Digital lenders share several common characteristics. Firstly, they typically offer small loan amounts ranging from Php 500 to Php 10,000, targeting segments with limited or no verifiable credit history (FinTech Alliance Philippines, 2019). Secondly, these lenders rely on digital channels such as web and mobile applications, email, and SMS for loan applications, disbursements, and customer communication. Thirdly, digital data plays a crucial role in assessing customers' creditworthiness, utilizing sources like bank statements, credit scores, and credit bureau data. Some lenders even employ machine algorithms to analyze this data. Lastly, digital lending prioritizes customer experience by providing swift access to funds through self-service loan applications, quick approval processes, and expedited disbursements. Personalized experiences are delivered via digital channels and data while ensuring security (KMS Solutions, 2022; Quimba et al., 2023).

The lending process involves a range of activities conducted by Financial Service Providers (FSPs) to offer credit, including customer acquisition, evaluation, loan disbursal, repayment management, and customer engagement. Customer acquisition entails utilizing digital marketing tools and onboarding channels such as SMS blasts, online platforms, and mobile applications to attract and register customers. Approval and analytics rely on digital data and advanced algorithms to expedite credit decisions and assess borrowers' creditworthiness using both traditional and alternative data sources. Disbursement and repayment are facilitated through digital channels like bank accounts, e-commerce platforms, and integrated mobile wallets, enabling remote loan disbursal and collection. To ensure effective collections, FSPs aspiring to become digital lenders leverage data and algorithms, employing delinquency scorecards to monitor customer conduct and tailor recovery strategies. Throughout the process, customer engagement is paramount, as lenders invest resources to comprehend their customers' behavior and promptly address their inquiries and concerns (KMS Solutions, 2022; Quimba et al., 2023; Vivek, 2023). Figure 1 presents a summary of the digital lending process:

Figure 2. The digital lending process



Sources: Quimba et. al. (2023); Vivek (n.d); KMS Solutions (2022)

Digital lending has witnessed a recent increase, attributed to several key factors. Fintech lenders stand out by diversifying their funding sources, including private equity, private debt, and bank credit facilities, unlike traditional banks that rely solely on deposits (Ben-David & Stulz, 2021). This advantage helps fintech lenders reduce overhead costs and expenses related to lending to risky borrowers while facing less regulatory scrutiny compared to banks (Ben-David & Stulz, 2021; Cornelli et al., 2021). Moreover, advancements in digital technology, such as data digitization and cashless transactions, empower fintech lenders to make informed credit decisions, leading to improved efficiency and shorter loan decision times without compromising security (Quimba et al., 2023). Beyond convenience and efficiency, digital lending offers additional benefits, including secure and cost-effective transactions that benefit both sellers and buyers, particularly boosting the performance of micro, small, and medium enterprises (MSMEs) (Quimba et al., 2023). Furthermore, digital loans enable previously unbanked individuals and small businesses to access formal credit products (Beaumont et al., 2022; Cornelli et al., 2021; Schellhase & Garcia, 2019).

Although digital lending offers numerous benefits, it also presents challenges, including the reliance of fintech lenders on hard information for loan assessment. This approach may be less effective during unexpected disruptions like the COVID-19 pandemic. Fintech lenders heavily rely on objective and verifiable data, such as credit scores and financial statements, as opposed to subjective factors considered by traditional lenders. This reliance on hard information becomes a challenge due to the absence of pre-established relationships with borrowers and limited access to soft information (Beaumont et al., 2022; Ben-David & Stulz, 2021; Jagtiani et al., 2019; Quimba et al., 2023). Additionally, in the case of P2P loans, determining the borrower's credit score using data from third parties raises concerns about its validity compared to data collected by traditional banks (Suryono et al., 2019).

Additionally, Suryono et al. (2019) noted five other common problems relating to P2P lending, these are information asymmetry, moral hazard, investment decisions, the feasibility of P2P lending platform, and regulations and policies. With regards to regulations and policies, the reduced regulatory framework for fintech lenders compared to traditional banks has its pros and cons. On one hand, it enables fintech lenders to minimize expenses and reduce the cost of lending to high-risk borrowers. On the other hand, it also means that they may lack the equivalent level of supervision and responsibility seen in traditional banking institutions (Agarwal & Zhang, 2020; Ben-David & Stulz, 2021). To ensure the sustainable growth of the digital lending sector and safeguard the interests of borrowers and service providers, it is crucial to establish appropriate regulations that address both the advantages and challenges associated with digital lending.

Digital Lending: Regulatory Framework in the Philippines

According to Quintero et al. (2022), the regulation of fintech participants providing financial services is primarily based on the specific service or product they offer, aligning closely with the regulations applicable to non-fintech entities engaged in similar services or products. The authors further mentioned that the current regulatory landscape for digital lenders in the Philippines does not exhibit significant differences in the regulation of loans to individuals, small businesses, and similar borrowers.

In general, there are four main government agencies that are involved in the regulation of the country's fintech industry. These are the BSP, Securities and Exchange Commission (SEC), Insurance Commission (IC), and Department of Information and Communications Technology (DICT). The BSP has the authority to oversee various financial institutions, including digital banks, and provides policy directions in money, banking, and credit. The SEC is responsible for creating policies and regulating securities and investment activities. The IC regulates insurance firms, while the DICT focuses on promoting the development of the ICT industry. The regulatory environment generally supports fintech, with a strong emphasis on public protection. The BSP encourages innovation in financial services and closely monitors the impact of fintech on the local banking industry (CCAF et al., 2019; Quimba et al., 2023). It must be noted that there are also additional oversight committees that were created by laws to fulfill specific functions.

The government has implemented several laws and regulations in order to support the growth of fintech and ensure consumer protection. Table 2 presents a breakdown of the laws and regulations and the relevant government agency.

Table 2. Philippine fintech regulations

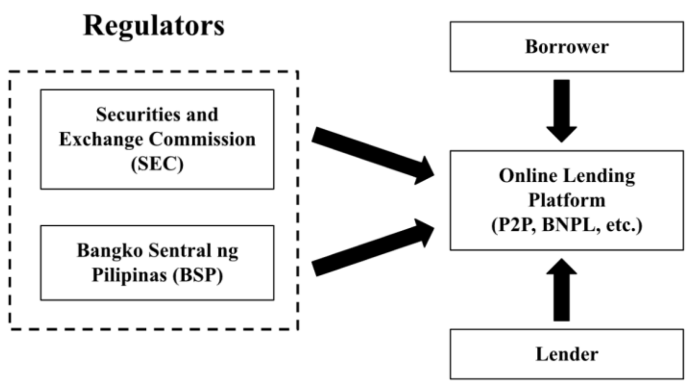
Law/ Regulation	Summary of content	Implementing Agency
Financing Company Act of 1998 (R.A. 8556)	Regulates and promotes the operation of financing and leasing companies	SEC under the supervision of BSP

Lending Company Regulation Act of 2007 (R.A. 9474)	Regulates the establishment of lending companies	SEC and BSP
BSP Circular No. 1108, s. 2021	Regulates the operations of virtual asset service providers (VASPs)	BSP
BSP Circular 1105, s. 2020 (Digital Bank Circular)	Provides guidelines for establishing Digital Banks	BSP
BSP Circular 1153, s. 2022 (Regulatory Sandbox Framework)	Provides guidelines on the new regulatory sandbox established by the BSP. This includes eligibility, conditions for approval, and the application process.	BSP
SEC Memorandum Circular No. 14, s. 2019 (Rules and Regulations Governing Crowdfunding)	The memorandum governs crowdfunding and specifies that it is only considered valid when conducted through an authorized platform operated by a registered intermediary.	SEC
Data Privacy Act of 2012 (R.A. 10173)	This legislation covers the handling of all kinds of personal information and applies to both individuals and organizations engaged in processing personal information.	National Privacy Commission
Philippine Innovation Act (R.A. 11293)	This Act aims to promote innovation and internationalization activities of MSMEs as a driver of sustainable and inclusive growth through education, training, research, and development.	National Innovation Council
Revised Intellectual Property Code (R.A. 8293)	The law establishes regulations for patents, trademarks, service marks, trade names, and copyright. It also establishes the Intellectual Property Office of the Philippines (IPOPHL), which is responsible for overseeing and assisting technological innovation, including financial technologies.	Intellectual Property Office

Sources: Quimba et al. (2023); Republic Act No. 8556 (1998); Republic Act 10173 (2012); Republic Act No. 11293 (2019); Republic Act No. 8293 (1997); Republic Act No. 9474 (2007); Khor et al. (2015); Quintero et al. (2022, p. 6); P&L Law 2020)

In terms of digital lending, the Philippines does not have specific regulations dedicated to governing it. Instead, it may fall under the purview of either the Lending Company Regulation Act of 2007 (R.A. 9474) or the Financing Company Act of 1998 (R.A. 8556). Consequently, online lenders in the country have the choice to obtain licenses as either a lending company or a financing company. The key distinction lies in their sources of funds. Lending companies are authorized to engage in lending activities using their own capital or funds from fewer than 19 individuals. However, the Lending Company Regulation Act excludes entities such as banks, investment houses, savings and loan associations, financing companies, pawnshops, insurance companies, cooperatives, and other credit institutions already regulated by existing laws. On the other hand, financing companies with a quasi-banking license can acquire funds from the public through the issuance of deposit substitutes, such as endorsing or accepting debt instruments on behalf of the borrower, for the purpose of re-lending (CCAF et al., 2019, p. 76; Quintero et al., 2022, pp. 5-10). It is important to note that currently, peer-to-peer (P2P) lending remains unregulated in the country (Quintero et al., 2022, p. 10). Figure 3 provides a summary of the digital lending stakeholders:

Figure 3. Digital Lending Stakeholders in the Philippines



Presently, the country's regulations formulate their own definitions of terms. However, these regulations were formulated alongside long-standing contractual agreements and institutions that have remained largely unchanged for many years. When faced with financial innovations, the government tends to evaluate them within the framework of traditional contexts and concepts. This often leads to contradictory rules and overlapping jurisdictions, as the new arrangements may not align seamlessly with existing legal structures. By maintaining the status quo in the legal realm, the government inadvertently shields established players and discourages innovation (FinTech Alliance Philippines, 2019).

Banez (n.d.) and FinTech Alliance Philippines (2019) have identified several potential challenges in this context. Firstly, there may be inconsistencies in terminology, where concepts in traditional and FinTech taxonomies have different meanings or interpretations, such as the term "currencies." Secondly, there may be overlapping regulations, with different agencies overseeing similar activities described by different terms but involving similar actors, relationships, and processes. Thirdly, emerging technologies may introduce new concepts that are not adequately accounted for in existing taxonomies. Fourthly, implementation can be mismatched, as regulatory agencies may only address certain aspects of a concept, resulting in missing or incompatible details. Lastly, conflicts between policies can arise, where certain norms may not align with other policy considerations (Banez, n.d.; Fintech News Network & FinTech Alliance Philippines, 2021).

Digital Lending: Framework in Indonesia

Indonesia ranks 6th globally for Digital Lending in 2020, according to the Cambridge Alternative Finance Benchmarks. Among ASEAN countries, it holds the highest position, while Singapore ranks 13th, Vietnam 32nd, Malaysia 36th, Philippines 52nd, Thailand 69th, Myanmar 75th, and Cambodia 85th. Thus, it would be valuable to understand Indonesia's digital lending market growth, challenges stemming from rapid growth expansion, and regulatory measures to aid in future policymaking.

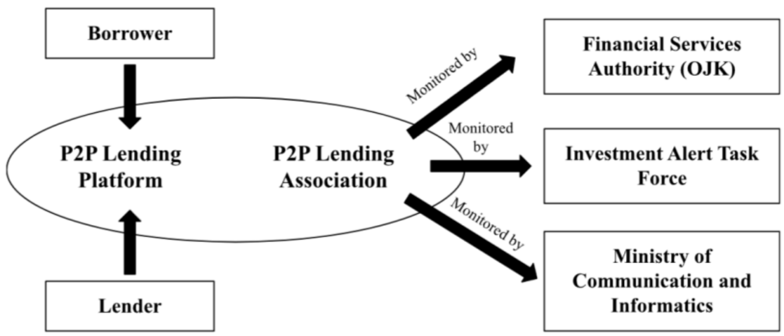
Fintech in Indonesia has experienced remarkable growth, driven by its focus on increasing lending to small and medium enterprises (SMEs) across the country (Suryono et al., 2021). Davis et al. (2017) noted that majority of businesses in Indonesia are considered small and face difficulties in accessing loans due to factors like proximity, collateral requirements, and the need for formal bank accounts. Fintech loans have helped bridge this financing gap, especially considering the country's widespread use of mobile phone technology. Additionally, the speed and convenience of fintech transactions have been instrumental in attracting a diverse user base (Suryono et al., 2021).

The majority of fintech companies in Indonesia adopt the fintech lending business model, as revealed by 55% of respondents in the ASEAN Fintech Ecosystem Benchmarking Study. Within this model, the most prominent sub-sectors are consumer and business peer-to-peer (P2P) marketplace lending (CCAF et al., 2019). The growth of P2P lending in Indonesia has been rapid, as reported by the OJK. By November 2020, there were 152 P2P lending platforms with total assets of Rp. 3.57 trillion, marking an 18.85% increase from the previous year. However, alongside the reported growth of P2P lending platforms, the Investment Alert Task Force has identified numerous illegal platforms that have emerged over the years (Suryono et al., 2021).

In light of their significant presence in the sector, the Financial Services Authority (OJK) and the Bank of Indonesia have implemented explicit regulations governing digital lending and payments. Consequently, fintech companies operating in these domains are obligated to undergo registration with these regulatory bodies (CCAF et al., 2019). These two regulatory bodies oversee different aspects of the fintech ecosystem. Fintech related to payments is governed by the Bank of Indonesia, while all fintech that offers financial services, such as digital banking, P2P lending, crowdfunding, insure-tech, investment, and market aggregators, is governed by the OJK (Batunanggar, 2019).

Suryono et al. (2021) laid out the stakeholders involved in P2P lending in Indonesia. The figure showed that the borrower and the lender converge at the P2P Lending Platform. These platforms are accommodated by the P2P Lending Association which has developed a structure for consumer protection that consists of a code of conduct, an ethics committee, and a consumer complaint line. The activities of both the platforms and the association are regulated by the OJK, the Investment Alert Task Force, and the Ministry of Communication and Informatics.

Figure 4. Stakeholders in P2P Lending in Indonesia



Source: Suryono et al. (2021)

The key regulations pertaining to fintech in Indonesia are summarized in Table 3:

Table 3. Indonesia fintech regulations

Regulation	Summary
Regulation POJK 10/2022 on Information Technology-Based Collective Funding Services *(replaced POJK No. 77/POJK.01/2016 on Information Technology-based Lending)*	The new law tightens control over the country's P2P lending. It changes the licensing process, sets minimum equity requirements, and introduces extra capital standards to address unethical and financially unstable fintech companies. Non-compliance could lead to administrative actions by OJK, including written reprimands, limitations on commercial activity, or revocation of the OJK License.
Regulation POJK No.13/POJK.02/2018 on Digital Financial Innovation in the Financial Services Sector	The regulation applies to all fintech types. It requires previously unregulated fintech businesses to apply to OJK for registration and undergo the regulatory sandbox process. Its goals include fostering accountability and innovation in digital money. It promotes compliance with consumer protection, anti-

	money laundering, and counter-terrorism financing laws, as well as implementing security measures and good governance.
Regulation POJK No.12/POJK.03/2018 on the Implementation of Digital Services by Commercial Banks	The regulation governs how information technology is used for online banking.
Regulation POJK No.37/POJK.04/2018 on equity crowdfunding	Regulation focusing on equity crowdfunding
Bank Indonesia Regulation No. 19/10/PBI/2017 on fintech companies	Regulation supports the payment sector. Fintech service companies must register with the Bank of Indonesia and undergo a year-long regulatory sandbox testing before applying for a license.
Bank Indonesia Regulation No. 19/12/PBI/2017	Regulation concerning the provision of financial technology.
Bank Indonesia Regulation No. 19/14/PADG/2017	Regulation to establish a regulatory sandbox for financial technology.
Bank Indonesia Regulation No. 20/6/PBI/2018 on E-money	The regulation improves the institutional capabilities of e-money issuers, such as capital and ownership structure. It regulates the creation of e-money business models and restricts foreign ownership to 49% for non-bank entities. Additionally, it requires the majority of the board of directors of non-bank institutions issuing e-money to be based in Indonesia.

Sources: Batunanggar (2019); Medina (2023); International Trade Administration (2022); Tauhid and Woo (2022)

Suryono et al. (2021) highlighted that the primary concerns in the fintech industry in Indonesia revolve around personal data fraud and illicit fintech lending. Yuniarti and Rasyid (2020) conducted a study that further supported this observation, noting an increase in consumer complaints, particularly in relation to peer-to-peer (P2P) lending.

A Comparison of Digital Lending Regulations in the Philippines and Indonesia

It would be beneficial to compare the digital lending regulatory environments of the Philippines and Indonesia due to their geographical proximity and demographic similarities. Firstly, both countries share common traits such as relatively young populations with a significant number of internet and smartphone users. According to data from the United Nations Population Fund, individuals aged 10-24 accounted for 28% of the population in the Philippines and 25% in Indonesia. In terms of internet penetration, the Philippines has an estimated 53% of the population using the Internet, with 79% owning mobile phones. In Indonesia, approximately 62% of the population are internet users, and 66% own mobile phones.

Secondly, both nations face challenges in terms of providing access to finance for their large number of micro, small, and medium-sized enterprises (MSMEs). These MSMEs encounter difficulties in obtaining financial support.

Thirdly, both the Philippines and Indonesia are experiencing rapid growth in their fintech sectors, particularly in digital lending. However, the Cambridge Alternative Finance Benchmarks indicate that fintech and digital lending are expanding at a faster pace in Indonesia. This raises the question: what factors contribute to the disparity in growth between the two countries?

By examining the regulatory frameworks of the digital lending industry in both nations, we can gain insights into the divergent growth rates and identify potential areas for improvement. Indonesia's digital lending sector is experiencing rapid growth due to clearer fintech regulations. Two specific regulations, OJK Regulation Number 13/POJK.02/2018 on Digital Finance Innovations in the Financial Services Sector and Regulation Number POJK 10/22 on Information Technology-Based Collective Funding, define key concepts like "digital finance innovation" and "fintech," as well as provide precise guidelines on regulatory procedures. In contrast, the Philippines evaluates financial innovations based on traditional concepts, resulting in discrepancies in regulations and jurisdictional overlaps. An illustration of this is the entry of Grab, a ride-hailing service, into the Philippines. At the time of their entry, there were no mechanisms in place to handle new disruptive technologies, and the traditional regulatory structure lacked provisions to address concepts like surge pricing (FinTech Alliance Philippines, 2019).

Besides gaps in regulatory coverage, traditional regulatory frameworks can impede the progress of emerging technologies. Within the realm of fintech, regulations imposed by governing agencies and other related rules may indirectly impact fintech firms. For instance, the SEC Rules on Mass Media illustrate this effect. Mass media encompasses diverse communication channels that aim to reach a broad audience, involving the dissemination of information and ideas to the public. This definition extends beyond physical structures and printed materials, encompassing online platforms like the Internet. Consequently, the SEC classifies corporations that facilitate online platforms for connecting parties and driving sales as falling under the scope of mass media. This classification holds significance since the Philippine Constitution mandates these entities to be wholly owned by Filipino citizens. As a result, such provisions create obstacles to competition and innovation in the sector (Banez, n.d.).

Given these factors, there are several lessons that regulators and legislators from the Philippines can learn from the fintech regulatory framework of Indonesia. The first is to maintain an agile regulatory framework. The OJK sets outlines of overarching principles and standards for digital financial innovation and gives the industry the flexibility and responsibility to define codes of conduct and operating standards. Second, the regulation and supervision of fintech fall under the jurisdiction of the OJK. On the other hand, fintech companies have the responsibility of implementing robust corporate governance, risk management, and compliance practices in their business operations. To oversee the development of fintech, the OJK has designated a Fintech Association. In general, it is good to note that the regulatory framework for fintech should foster innovation while providing guidance for responsible practices (Batunanggar, 2019).

Conclusion and Recommendations

The emergence of fintech lending is a result of financing gaps faced by small businesses, and its increasing prevalence is due to its accessibility and ability to cater to the needs of MSMEs. Therefore, it is crucial to regulate the sector effectively to ensure that MSMEs can fully benefit from it.

There is a lack of research on fintech regulation in the country, with most studies focusing on overall fintech environments or digital payments. Considering the rapid growth of the digital loans sector, it is important to gain more knowledge about the current status of MSMEs borrowing from digital lending platforms. A framework for assessing industry performance needs to be developed to understand and manage the risks associated with the rapidly changing fintech landscape.

Although an industry benefits from a cooperative and forward-thinking set of regulators, some laws and procedures need to be reviewed. It is vital to have precise regulations that map out and monitor the growth of the fintech sector. The lack of industry statistics makes it difficult to fully assess the sector’s development. The average number of transactions per user, the complexity and diversity of the goods and services offered by platforms, and the degree of integration of fintech apps are just a few examples of the variables that might be considered when evaluating performance.

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