

PEER-TO-PEER LENDING: OPPORTUNITIES AND RISKS

SVETLANA STRATAN,

Assoc. Prof., PhD

Academy of Economic Studies of Moldova,

Republic of Moldova, Chisinau, 61 Mitropolitul Banulescu -Bodoni Street

svetlanastratan@gmail.com

Abstract

The objective of this paper is to outline the phenomenon of peer-to-peer (P2P) lending as a new method of debt financing that enables individuals to borrow and lend money online without the use of an official financial institution as an intermediary. Also is analyzed the role of P2P lending as a mechanism for attracting financial resources into small business. The paper describes the key characteristics of crowdlending, as well as main benefits that it delivers to borrowers and investors. There are also presented the main risks that are characteristic to P2P lending.

Keywords: *peer-to-peer lending, alternative finance, crowdlending platforms, start-ups, Fintech.*

JEL CLASSIFICATION: G21, G23, C38.

The successful development of small innovative enterprises plays an important role in the dynamic growth of the national economy, as well as in improvement of its competitiveness. However, the practice has shown that startups and small businesses at the stage of conception are unable to take loans from banks. That is why, the problem of investing in startups and their innovative projects has become today of a significant importance. The sharp development of informational technologies has created incentives for the formation of non-banking financial institutions, of new financial services and of alternative sources for funding business projects and ideas. One of the most popular and modern instruments which allows the entrepreneurs, developers and creative people to increase the attractiveness of their ideas to investors, is crowdlending or peer-to-peer (P2P) lending – one of the innovations in the Fintech sector.

P2P lending is a new method of alternative financing, allowing borrowers and lenders to transact through internet platforms without traditional intermediaries [1]. Crowdlending significantly expands the access to financial resources for those individuals and entities, who are normally not eligible for contracting traditional bank loans. The mechanism of P2P lending functions based on an internet platform, which serves as an intermediary gathering lenders and borrowers at one marketplace. By making public a series of complete business projects, a typical crowdfunding platform helps a big number of small individuals to invest their available resources rapidly into various business opportunities. Such a platform evaluates the debtors' creditworthiness and has the right to reject the listing of doubtful or unreliable business projects, therefore helping investors in assessing credit risk. For their intermediation services, the online platforms earn a small commission from project participants, the size of which varies between 2% and 5% of the loan amount from the borrower and up to 1% per annum from the lender.

Zopa (Zone of Possible Agreement) was the first online P2P lending platform, established in the UK in 2005. Currently this is the largest crowdfunding platform in Europe, while the UK market is among the top ones on the international level. Since its creation, the total amount of loans issued amounted to 3.69 billion pounds. More than 76,000 investors earned profits by providing loans through this platform [2]. Following the UK, the idea of crowdlending has been further developed in the USA. In 2006 was founded the Prosper platform and in the following year – the Lending Club, which currently accounts for 45% of the American P2P market [3]. By the end of 2017, the Lending Club reported that it has financed projects of more than USD 24.5 billion in value since its launch [4].

China is also among the largest national P2P lending markets. Starting with 2009 the total volume of P2P lending transactions has increased from only USD 30 million to USD 150 billion by

the end of 2015 and to USD 175 billion in 2017 [5]. The first Chinese P2P lending platform, PPDAL, was launched in 2007. However, at the beginning of 2016 were registered already 3,383 online platforms [6]. Such countries as Australia, Switzerland, France, Germany and New Zealand also experienced a boom of private microloans through P2P platforms. Currently these platforms are among the fastest-growing segments in the financial services industry. According to research and intelligence firm Transparency Market Research, the “*opportunity in the global P2P market will be worth USD 898 billion by the year 2024, comparing to USD 26 billion in 2015*” [7]. The experience of world economies has shown that P2P platforms have become the most modern, actual and widespread way to obtain financing for young businesspersons, who can realize their ideas and innovative projects with the help of this tool.

Among the main advantages of the crowdlending are its simplicity and accessibility for a wider target group. In order to apply for a P2P loan, it is only required to register and place online the information about the lending object and specify the desired financing conditions for the borrower. Unlike with traditional financial institutions, with P2P platforms the lack of bureaucracy ensures the rapid and efficient process of financial services intermediation. Borrowers are not obliged to provide a collateral to secure their loan, and receive a loan on more attractive terms than from a regular bank or a microcredit organization. Crowdlending is attractive to the borrower also because there are no hidden fees and commissions that banks usually embed in their products. Besides this, also the lenders benefit from advantages of P2P lending: they are able not only to invest their money at more favorable interest rates than on deposits, but also to diversify their investment portfolios by choosing to finance various business projects at the same time.

However, despite significant advantages, P2P lending, like any other financing method, has its drawbacks. Among them is the risk of non-repayment on investment due to the insolvency of borrowers. Crowdlending platforms normally assess only the level of trustworthiness of the client and do not exclude the risk of obtaining loan applications from people with a bad or no credit history at all. There is also a risk of theft of ideas of potentially successful business projects made public on the platform, which could be stolen by competitors that would implemented them with their own resources.

Other common problem of online lending is fraud. Borrowers can provide false information about themselves using stolen identities of other people and/or using faked documents. For example, in China, a scandal erupted with the company Ezubao. It became known that more than 95% of the projects published on its crowdlending platform were fraudulent and fictitious, and the amount of losses suffered by investors reached USD 8.64 billion [8]. Additional risks are related to the fact that loans received through P2P platforms are, as a rule, unsecured and are not eligible to deposit insurance and do not guarantee the borrowers’ debt repayment. Therefore, in case of default on a loan, an investor can completely lose his investments and partially interest payments. Nevertheless, despite the existing shortcomings, the international experience has shown that P2P lending arouses the general interest of financial market participants.

If considering Moldova, then unfortunately the size of the crowdlending market is practically undeveloped at all. Among the main factors that impede the growth of P2P lending here, are the reduced public awareness about potentials of crowdlending platforms, the low level society’s trust in financial sector, as well as poor financial education of local population. Besides this, the lack of the entire toolset of normative and legal acts that purposefully regulate P2P lending could also be attributed to negative factors preventing the development of this type of lending in Moldova, as the existence of such legal base would help minimizing most of risks faced by newly created market segments. Considering the above-mentioned, for creating the fundamentals for launching the P2P lending market in Moldova, it is necessary mainly:

- to research the positive trends in the global practice of the crowdfunding development and to analyze and apply the successful experience of this segment of the financial market, tested in other countries;
- to develop a legal framework for its effective regulation;

- to create a favorable environment for attracting crowdfunding investments in the innovative projects and startups in Moldova;
- to develop a governmental program for the overall improvement of the financial education of the local population.

The consistent implementation of these measures will stimulate the development of the P2P lending market in the country and will contribute to the dynamic growth of the national economy by improving its competitiveness at the global level.

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