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SCOPE AND CHALLENGES OF ONLINE PEER TO PEER LENDING PLATFORMS IN INDIA

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Abstract

Rapid developments in financial technology and internet facilities have paved ways for new products and services in the financial sector. In fact, many new economies emerged due to the advancements in the field of internet technology. As a result the world is witnessing some of the unimaginable new trends in every sphere of life and the financial sector is not an exception to this. Among the many developments, the peer to peer to lending is one of them. As the scale and scope of diversity in terms of what is transacted and with whom is growing in manifolds, the field of peer to peer lending is gaining much attention within the lending and borrowing space. This article is an attempt to understand the growth of peer to peer lending in India, along with its scope and challenges.

Key Words: Peer to Peer lending, Fin-tech and Internet Technologies.

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1. Introduction

The banks in India are rigid compared to their counterparts in developing and developed countries when it comes to lending. The procedures of borrowing and lending are time consuming in Indian financial system. Procedural delays in lending are attributable to the factors like paper work, KYC norms and collateral requirements. In many cases, it has kept prospective borrowers away from the banking and financial sectors. The peer-to-peer (P2P) lending has become quite attractive for both borrowers and lenders and this has resulted in the emergence of a new industry which can be an effective competitor for the banking and financial sector from lending prospects.

The peer-to-peer lending works with an online platform. The online platform connects both the borrowers and lenders without the protocols of banks. However, the peer-to-peer platforms are not the one which lends their own funds; they are just the facilitators to the borrowers and the lenders. This lending system has eased the borrowing and lending business. By using the internet systems, one can easily get access to the loans without the hassles of long banking procedures.

The peer-to-peer lending system is witnessing success due to lower interest rates, quick decisions and simple application procedures. As the modern businesses are witnessing many changes in terms of its institutions, working mechanism, technological front and way of doing business, the new ways of transactions, mainly in the financial sector, is experiencing tremendous amount of technological innovations. This is leading for new financial models, products, services and new platforms for reaching out to every kind of customers. In this paper, an attempt is made to understand one such new financial model - peer-to-peer lending, working mechanism, and its scope and challenges. The objective of this paper is to understand the present position and prospects of P2P lending in India. The rest of the article is organised as follows; studies related to the field are reviewed in the next section. Section 3 discusses about the peer-to-peer lending scenarios at the global level and in India. Fourth section throws light on the working mechanism of these platforms. In section 5, an attempt is made to explain the scope and challenges of this system. Section 6 concludes the article.

2. Literature Review

In this section, an effort is made to look into the relevant literature which covers relevant areas of study related to peer-to-peer lending both in Indian and global context. The field of financial technology is witnessing much advancement in terms of its products and services. There are many research articles and conference papers related to the field of financial technology and advancements in its various areas. One such field is peer-to-peer lending wherein various experts from the field of academics, banking and finance, engineering and technology have contributed to the literature.

In an early study, Seth and Jin (2008) made an attempt to understand the online lending platforms, choosing Prosper.com, an US based P2P lending platform. The study tries to differentiate the online platforms with that of traditional banks, along with their credit risks, the behavior of lenders, borrowers and the future of consumer finance. On similar grounds, Berger and Fabian (2009) analysed the role of financial intermediaries in the American electronic P2P lending platform - Prosper.com. The study points out that, there are participants in the electronic marketplace who act as financial intermediaries, and that intermediation services significantly improve borrowers' credit conditions. The study focuses mainly on the impact of intermediation on borrowers' credit conditions. Whereas, Susan et al. (2010) reviewed the nature and characteristics of P2P companies in order to understand the role of the internet in reducing the costs of borrowing and lending. The study also examines the operational model of selected P2P lending companies in detail and discusses the characteristics of different models using the transactions cost analysis.

Ashta (2009) analysed the European online micro lending websites and found that web2.0 is playing vital role in permitting platform models. He also finds that most commercial or micro-lending sites have retained intermediary roles and have not permitted direct peer to peer contact. The paper also reviews the leading issues with the most significant impacts on the entrepreneurial business of P2P micro-lending on the internet. On the other hand, Wang et al. (2015) studied the important factors that affect lenders' loan trust and perception of information asymmetry. It also studies the impacts of these factors on lending intention, using PPDai.com, a most popular online lending platform in China. The study shows that, trust is the most important influencing factor in lending decisions, whereas, borrowers reputation and information integrity affects trust. The findings of the study show that online lending and online purchasing are totally different. Therefore, the results of e-commerce market cannot be blindly applied in the field of P2P lending.

Moenninghoff and Wieandt (2012) list the drivers for the growth of P2P lending platforms. As per the study, the developments in the field of internet, innovations through startups and financial regulation of the banks are the reasons for the growth of P2P platforms. The study also explains the financial risks arising from p2p transactions are borne by the participants and it includes all types of financial risks. According to the study the future of P2P finance will be decided by the risk assumption by individuals regarding growth and stability of the economy and the regulatory framework. However, Namvar (2013) opines that P2P lending intermediaries provide a new opportunity to access consumer lending market for unsecured consumer credit. He also states that these loans can in fact provide predictable short-duration and high-yield portfolio income.

In a particular study, Chen et al (2015) studied the relationship between individuals' group social capital and their lending outcomes in the online peer-to-peer financial credit market, where individual lenders make direct unsecured microloans to other individual borrowers. The study shows that the borrowers' group affiliation leads to improved funding performance, but no improvement on repayment performance. The study highlights that the effects of group social capital could vary with the collectivism of members that emphasizes group goals above individual needs or stresses the importance of cohesion within social groups. Whereas, Feller et al. (2017) have tested a theoretical model based on social identity theory and prior internet enabled p2p lending systems studies, through an analysis of huge number of loan records, and subsequent analysis of 1000 manually-coded records, to investigate the impact of information sharing on lenders and borrowers behavior. The study reveals the importance of social and financial data and their relationships.

Ge et al. (2016) provides a new angle by taking social media information as a source of individual creditworthiness. The study made an effort to understand the relationship between social media information of people and their financial behavior by taking two different sets of data. They provide a new insight on risk control among P2P lenders in China.

Yan et al. (2016) investigated the influence of big data on the transformation of the lending industry by taking information economics perspective to the study. The study identifies that the application of big data analytics reduces the signaling and search costs in p2p lending. The study also highlights that big data can reduce information asymmetry in the lending industry.

3. Peer-to-Peer Lending

3.1 Global Scenario

Technological improvements in the field of finance are allowing the companies to integrate innovations to provide greater solutions to the customers. The field of money lending is also witnessing the technological advancements seamlessly and leading to the growth of global peer-to-peer lending market. As the cost associated with the operations is low many users choose peer-to-peer platforms compared to banks and other financial institutions. The rise in the students' number studying at global level is another reason for the market to grow as they are preferring peer-to-peer lending to traditional loaning avenues.

In terms of value, the global p2p lending market was US$26.16 bn in 2015 and this is expected to increase to US$897.85 bn by the end of 2024. That means a phenomenal growth rate of 48.2% during the period from 2016 to 2024[1]. The number of mobile peer-to-peer payment users in the United States was predicted to increase significantly – from 53 million in 2014 to 126 million in 2020[2].

Segments in the Global Peer-to-Peer Lending Market

The global p2p market is divided into few segments based on three criteria; by end user, by regional presence and by business model. The end user market consists of segments like small business, student loans, consumer credit and real estate. Under this market the most prominent one is small business sector which accounts for a greater share in the total market revenue. This is because the small businesses will not be having sufficient capital and this makes them apply for the loans through p2p platforms. Even, if they have they will not have collateral securities to give as guarantee. Traditional p2p model and marketplace lending are the two important segments in the business model type. Traditional p2p model exists in large-scale basis in developing countries, mainly because of lack of modern technologies. However, gradually the market place lending model is becoming more prominent and might replace the traditional model in coming years.

Geographical Spread of Peer-to-Peer Lending Market

Globally the peer-to-peer lending market is mainly spread across North America, South America, Asia Pacific, Europe, Africa and the Middle East. More than 43% of the total p2p market was captured by North America in 2015, holding a dominant position in the global p2p market. The main reasons for the growth of p2p lending platforms in North America are decrease in the interest rates in banks, effects of financial crisis and increased dependency on online platforms. Some of the emerging economies like India, China, Japan, Australia and Brazil are witnessing fast growth in terms of this market as many businesses are looking for alternative sources of finance for their projects. As there is increase in the demand for finance especially from the small businesses, the global p2p market is expected to grow tremendously in near future.

Key Players in Global Peer-to-Peer Lending Market

The global p2p market is competitive in nature and is attracting many new players from different geographical markets. The numbers of players are expected to increase in the future leading to more competition in the sector. Some of the important players in the global market are Prosper Marketplace Inc, Circle Back Lending Inc, Funding Circle Limited, Peerform, Social Finance Inc, Upstart Network Inc, Common Bond Inc, and Pave Inc.

P2P Lending Markets Around the World				
Country	**Year of Origin**	**Lending Platforms**	**Market Size**	**Regulatory Body**
UK	2005	Zopa, Funding Circle, ThinCats, RateSetter, LendingWorks	$9.42 Bn	Financial Conduct Authority (FCA)

United States	2006	Prosper, Lending Club, OnDeck, Kabbage, LendUp, SoFi	$32.8 Bn	Federal Regulation Structure (Centre+State), Centre: Securites & Exchange Commission (SEC)
China	2007	LuFax, WeLab, Ppdai.com, Credittease.cn, Wokai (shutdown)	$103.43 Bn	Unregulated. Recently a set of new rules have been instated by the China Banking Regulatory Commission (CBRC), Ministry of Public Security, Cyberspace Administration of China and the Ministry of Industry and Information Technology.
Australia	2012	SocietyOne, Moneyplace, ThinCats Australia, RateSetter	$22Bn (by 2020)	Australian Credit Licence – mandatory
India	2012	I-Lend, Lendbox, Faircent, LendenClub, Rupaiya Exchange, Monexo, CapZest	$4-$5Bn by 2023	Reserve Bank of India (RBI)
Canada	2016	Lending Loop, Lending Arch, FundThrough, Lendified, Vault Circle	No data available yet	Canadian Securities Administrators (CSA), State/Province level regulation through bodies like Ontario Securities Commission (OSC)

Source: Inc42 DataLabs

Factors of Growth for Peer-to-Peer Lending Market

The internet technology is used to connect borrowers and lenders by the peer-to-peer lending platforms. As there is lot of development in the online technology, the field of finance is witnessing tremendous growth in terms of its products and services as well as new means of serving the needs of customers. Online peer-to-peer lending platforms are one of such innovations wherein people use internet for getting connected to the lenders and borrowers. However, only the developments in the field of internet technology are not responsible for the growth of peer-to-peer lending market. There are many other factors that are responsible for the growth of this sector. Few of those factors are listed out below.

1. The growth in the emerging markets in terms of demand for capital.
2. Increase in the knowledge of lending markets.

3. Improvements in the investment transparency.

4. Decrease in the interest rates to borrowers.

5. Growth in the small businesses whose demand for capital is high. The US small lending market share has grown from 4.35% in 2015 to 7.70% in 2016[3].

6. Low operating cost and market risk.

3.2 Indian Scenario

The number of fintech startups is rising in India. As per the reports of KPMG and NASSCOM, the industry is going to witness further growth and is forecasted to cross $2.4 Bn by 2020[4]. There is an increasing trend in the growth of mobile wallets, point of sales machines, UPI and many more which has resulted in the transformation of financial sector. Along with these changes the borrowing and lending platforms are also evolving rapidly. One such growing area is peer to peer lending platforms. Although the global peer to peer lending started way back in 2005, in India the first peer to peer lending platform started its operation in the year 2012. I-Lend is the first Indian p2p online lending company started by Shankar Vaddadi and his team.

According to a report by Inc42[5] demonetisation played a vital role in the growth of p2p lending platforms in the country. The cash crunch created after the demonetisation has made many small businesses to look out for new avenues to get the capital. There are more than 30 players in the industry who are specialized in their domain and are hopeful of doing the business with more visible growth in the coming years.

4. Working Mechanism of Peer-to-Peer Lending Platforms

Early stage entrepreneurs and startups require capital for starting their business. Public sector banks and other traditional lenders will not lend to the early entrepreneurs so easily and the interest rates are relatively high. Collateral requirement is another hurdle in getting the funds. In such scenarios P2P lending plays vital role in providing good avenues for borrowers to borrow at ease and for lenders to get more people who are in need of money. Borrowers' information is available on the P2P lending platforms. A lender or an investor can look into the borrowers profile and take a decision whether to lend or not. A lender can lend full loan amount or part of it also. Remaining loan amount can be borrowed from other interested lenders on the platform.

5. Scope and Challenges of Online Peer-to-Peer Lending in India

Growth Prospects

1. Growth in internet facilities and increase in the digital transactions.
2. Unfulfilled credit demands of individuals and small businesses due to stringent methods of traditional banks.
3. New place of investment for people.
4. As the RBI has framed the rules and regulations related to online lending and borrowing there will be more transparency and sense of security among the investors.

Key Challenges for the Sector in India

1. Assessing the borrowers based on their profile.
2. P2P operator sustainability taking into account the financial and operational risks.
3. Liquidity and reputation risks for the investors due to lack of guarantee.
4. Competition from existing financial models which might participate actively into p2p lending.
5. Unsecured lending might lead to high default risks.

6. Conclusion

The peer to peer lending and borrowing is a digital market place for loans. Revolution in the digital technology has made this new financial avenue to grow more rapidly all over the globe and India is not an exception to it. At the global level, the industry is growing at a rapid rate and is about to reach to US$897.85 bn by the end of 2022 and in India it is expected to reach to cross $2.4 Bn by 2020. P2P lending is fast emerging as a credible financing option for people who are not able to get loans from bank. Although the first player in the country has started their business in the year 2012, it is in the year 2017; the regulator (RBI) has made clear instructions related to the borrowing and lending along with general working mechanism. Moreover, demonetisation has also contributed to the growth of this sector in its own way. Due to the lack of cash after the demonetisation, the businesses were looking for new avenues for their capital requirements. It is in this period the sector has grown to visible levels due to more and more people reaching out to such platforms for both lending and borrowing. Overall the sector is witnessing higher growth rate and this has got further boost as the RBI has categorized this sector under the NBFC purview. As the regulator has clear rules and instructions, there is a sense of security among both the borrowers and lenders. Even though the sector is witnessing growth, it is not without challenges. There are financial, operational and default risks associated with the model. If these challenges are taken care of, p2p lending platforms can serve better the individuals and institutions in need of capital as well as the investors to get greater revenue.

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