

WHAT DRIVES THE EXPANSION OF THE PEER- TO-PEER LENDING?

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What Drives the Expansion of the Peer-to-Peer Lending?

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Peer-to-peer lending platforms directly match savers looking for an alternative means of investing their savings, with borrowers who need consumer and business loans. The first peer-to-peer (P2P) lending platform, Zopa, was found in the UK in 2006. In the same year Prosper was the first peer-to-peer lending platform in the USA, followed by Lending Club in 2007. Although P2P lending amounts to a small share of total lending in the US, it has been growing rapidly (Figure 1).

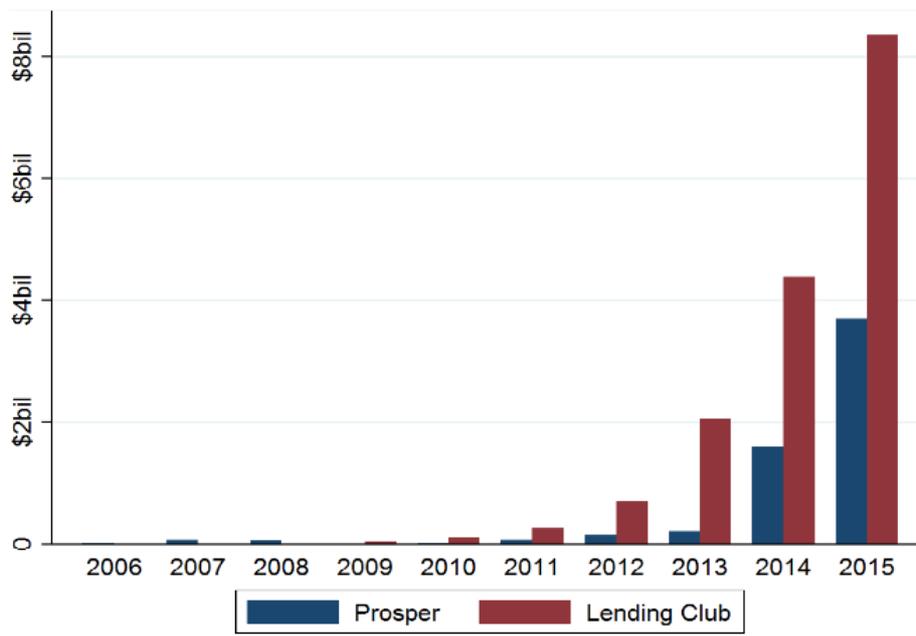
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Figure 1. P2P consumer lending growth in the US (in billions of dollars)



Source: Prosper and Lending Club websites

Unlike banks, P2P lending platforms do not perform risk and maturity transformation, however, they often organize secondary markets to trade loan contracts before maturity. From the borrower perspective, there are no fundamental differences between a bank and a P2P lending platform. Not surprisingly, the emergence of online platforms, which are a part of the wider FinTech movement, has provoked a lively debate about their ability to disrupt traditional (See Morse, 2015). Haldane (2016) suggests that the entry of new FinTech players could diversify the intermediation between savers and borrowers, which would make the financial sector more stable and efficient and could ensure greater access to financial services.

The entry of the P2P lending platforms has coincided with the Global Financial Crisis and its rapid expansion has happened as the banking sector was undergoing important structural transformations. In the wake of the crisis, banks were deleveraging, consolidating, reducing their credit supply and cutting costs by closing branches, while regulation and supervision of banks was strengthened. The objective of the paper “What drives the expansion of the peer-to-peer lending?” is to explore the idea that P2P lending platforms target underserved borrowers and succeed to enter markets from which banks have withdrawn in the wake of the crisis. Is P2P lending a substitute to bank credit or is

it a niche financing that is rather complementary to bank lending? What limits the development of the P2P lending?

In the paper, we outline three main hypotheses for the entry of marketplace lenders. Our first hypothesis is that P2P lending has been spurred by the global financial crisis, as numerous banks have failed and others have been forced to deleverage and reduce their credit supply. Our second hypothesis is related to the nature of the banking competition, characterized by high concentration and barriers to entry. Our third hypothesis links the speed of the development of the P2P lending to switching costs, which could be proxied by education, age and population density. Indeed, the young and educated share of the population experiences lower learning costs, and therefore lower switching costs. Moreover, a higher population density increases networks effects and human interactions, and decreases switching costs. Besides these main hypotheses, we explore other potential drivers of the P2P lending. It is possible that the surge in P2P lending is not caused by problems in the banking sector and the entry of online lenders simply reflects the sophistication of Internet users and readiness of the society to embrace internet to perform financial transactions. Indeed, P2P lending platforms are part of the larger information revolution as new internet platforms (Amazon, Uber, BlaBlaCar and AirBnB) are on the way to disrupt other service markets, such as retail trade, transport and accommodation.

Sorting out the above competing hypotheses is difficult because the expansion of the P2P lending has coincided with the post-crisis period, increased concentration of the banking sector following hundreds of merger and acquisition operations (See Philippon, 2016) and closing of banking branches. Our identification strategy relies on the exploration of the geographic heterogeneity of the P2P lending expansion at the county level. Since the expansion of the P2P lending is similar to the diffusion of other technologies, it could be explained by spatial network effects due to human interactions (Comin et al., 2012). Notwithstanding the online nature of the P2P lending, geography might still play a crucial role in its diffusion. Indeed, we document an important spatial correlation, as P2P lending per capita is higher in counties that are close to California, New York and Florida. Hence, our econometric approach relies on incorporating a spatial lag variable in our model.

Our findings are broadly consistent with the idea that P2P lending platforms have made inroads into counties that are underserved by banks and that their entry has been constrained by entry barriers and switching costs. Having controlled for demand factors, we find that borrowers from counties with lower leverage ratios are likely to borrow more from P2P lending platforms. This finding is consistent with the hypothesis that P2P lending platforms have partly substituted banks that have cut their credit supply due to high leverage. Importantly, we show that the impact of the low leverage at the peak of the crisis was long-term and has only disappeared in 2013. We also find that the entry of P2P lending is constrained by the high market concentration and branch density of incumbent banks. This has been interpreted in the earlier literature as entry barriers. However, lower branch density could also be a measure of the financial exclusion, reflecting the fact that borrowers that live far away from a brick and mortar bank branch or have a poor branch experience due to long waiting times are more likely to turn to online lenders. We document that counties with higher population density, as well as a higher share of educated and young people experience higher growth of P2P lending. Since these variables are correlated with learning costs, this is consistent with our switching costs hypothesis. Despite the online nature of the P2P lending, spatial effects play a crucial role, which could be another indication that switching costs are lowered by social interactions, allowing to build trust in online markets.

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