What can we learn from the rise and fall of P2P lending?

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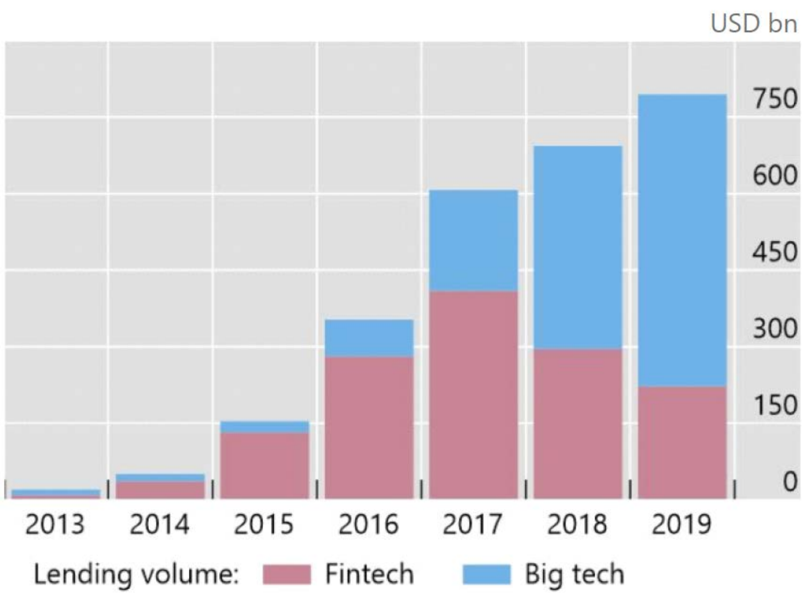
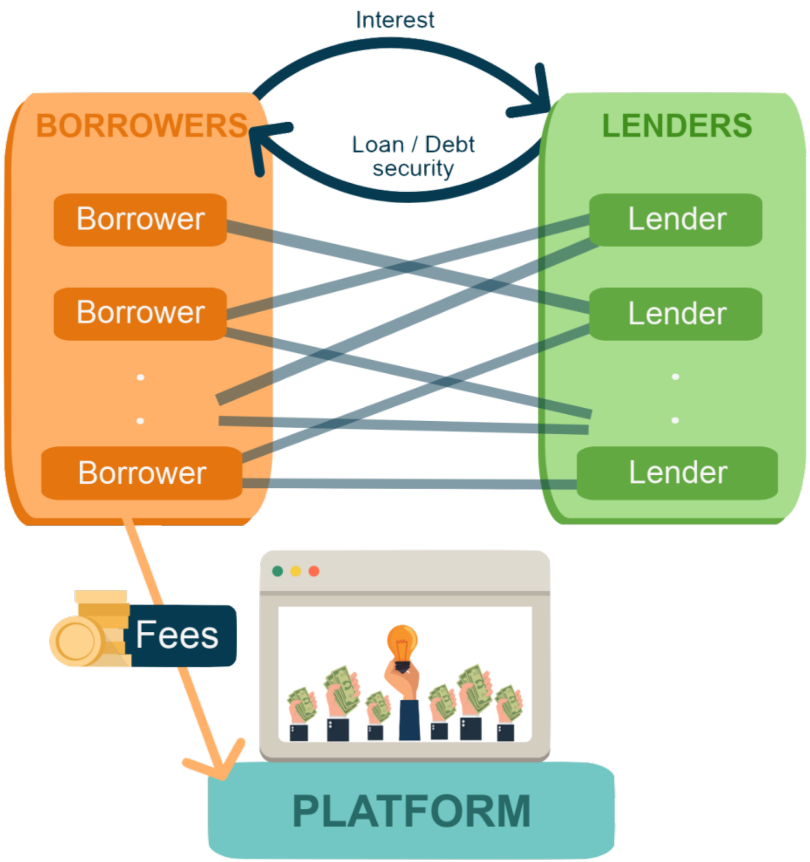


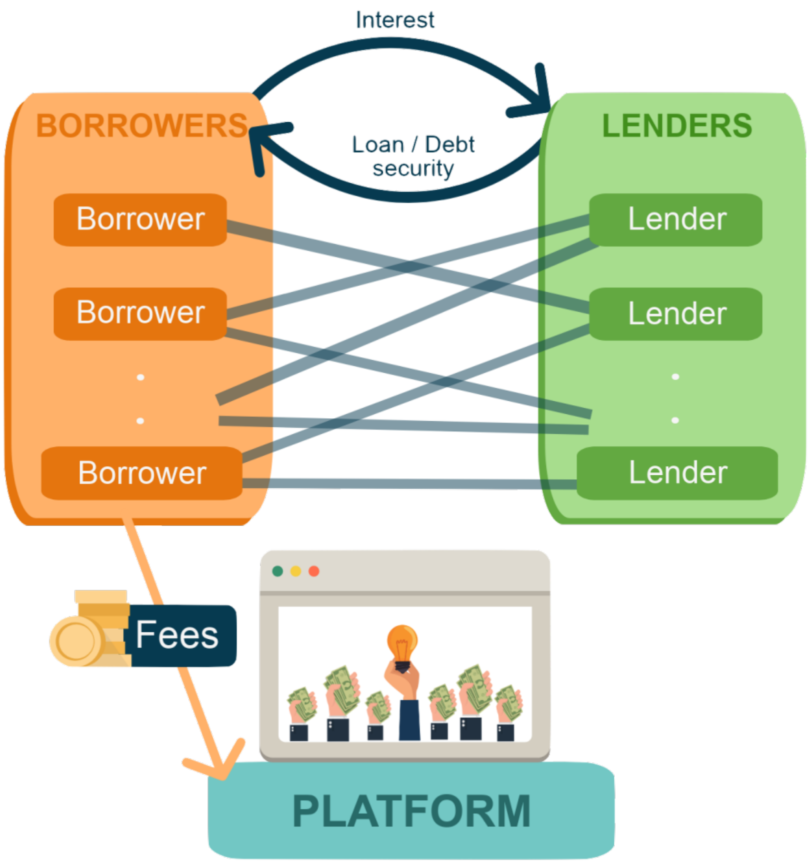
Source: BIS Fintech and Big Tech Credit: a new database

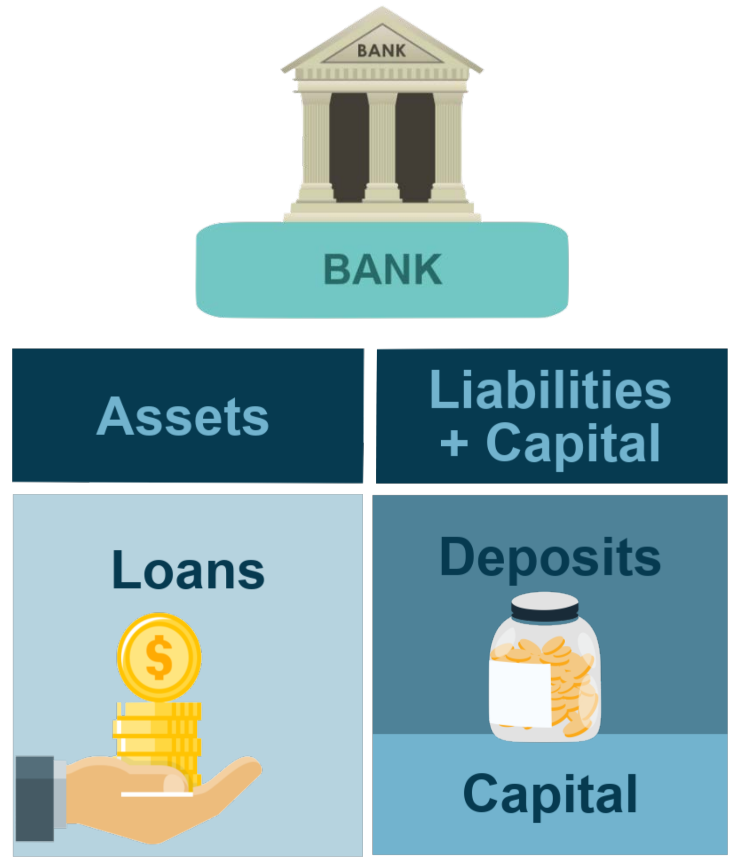
The rise of P2P lending



Platforms have attracted borrowers underserved by banks in the wake of the financial crisis (Havrylchyk, Mariotto, Rahim & Verdier, 2021).

New business model





	VS	
No risk transformation		Risk transformation
No maturity transformation		Maturity transformation
No monetary creation		Monetary creation

The decline of P2P lending

- **Business model of P2P lending has evolved**
  - Retails investors are replaced by banks (Lending Club, RateSetter)
  - Retail investors cannot choose in which firms they invest (Funding Circle).
- **Amount of P2P lending is on the decline**
  - Chinese P2P lending platforms have been banned by the regulator in 2020 after numerous defaults.
  - In France, loans to SMEs provided by platforms are on decline.

What explains the decline?

Explanation 1: Adverse selection

- Fintech lenders serve **risky borrowers** (Havrylchyk, 2018; Havrylchyk, Mariotto, Rahim & Verdier, 2021; Havrylchyk and Mahdavi, 2021).
- and claim to finance **intangible assets** that are underfinanced by banks (Dell'Ariccia et al., 2017)
- "Wisdom of crowds" does not solve adverse selection problems. "Data and algorithms" do (Iyer et al., 2015; Vallée and Zeng, 2019).

Explanation 2: Moral Hazard

- Platforms have taken the role of delegated monitor à la Diamond (1984) but the design of P2P platforms does not solve the problem of « Who monitors the monitor ?».
- There are no mechanisms to align incentives of lenders and platforms (Havrylchyk, 2018)
  - EU Crowdfunding Regulation (2020) forbids platforms to have any stake in listed loans. No skin in the game.

Explanation 3: Banks have lower cost of funding

- Implicit bank subsidies lead to lower cost of funding for banks (Davies and Tracey, 2014), creating an uneven playing field
- Higher cost of funding translates into higher lending rates for borrowers via platforms

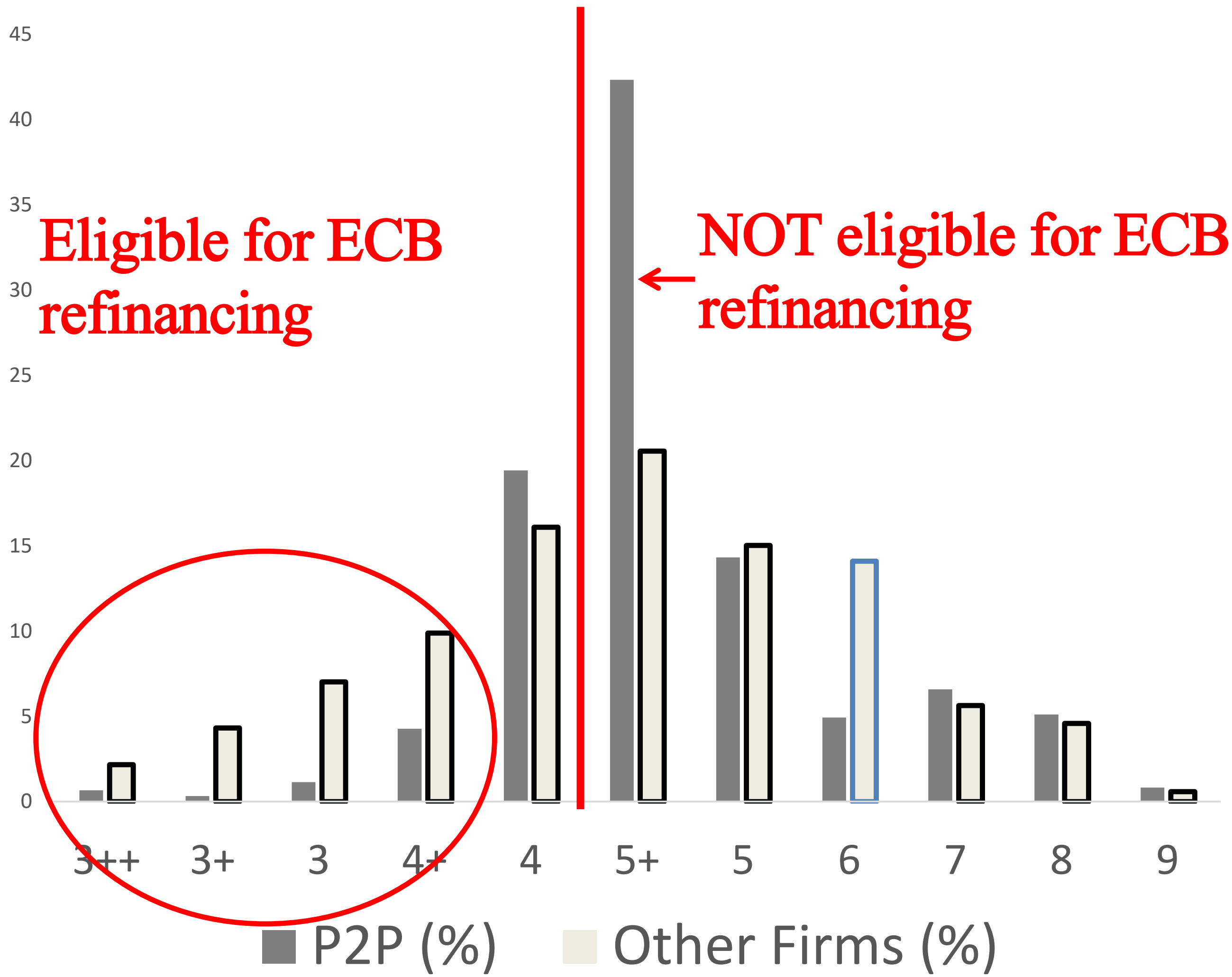
Real effects of P2P lending on the borrowing firms (with A. Mahdavi)

- An empirical study of the French market
  - 7 Platforms: Unilend, October, Credit.fr, Les Entrepreteurs, Prexem, PretUp, Lendopolis

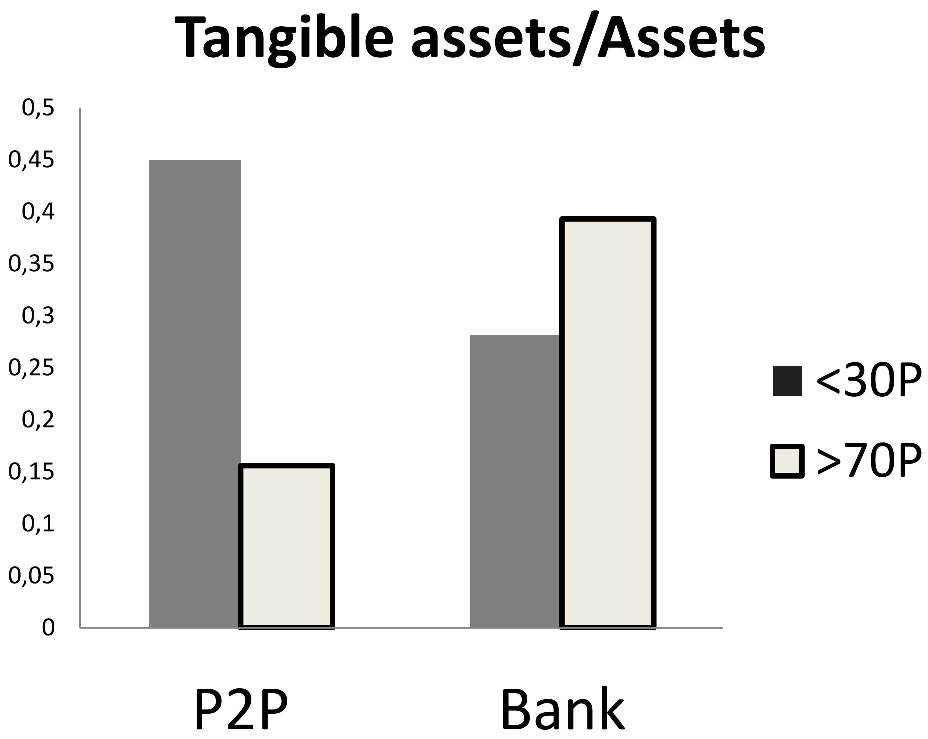
- Firms that borrow from P2P lending platforms are younger, riskier, have less tangible assets, higher funding costs, lower leverage, higher growth

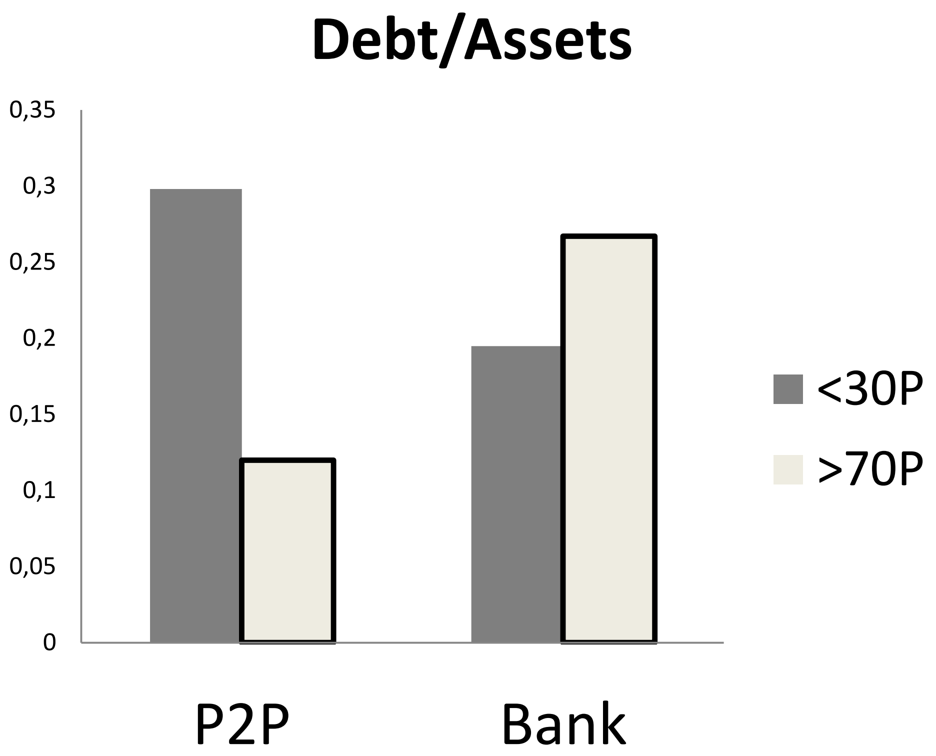
Firms borrowing from P2P platforms are riskier

(BoF credit risk score)



… have less collateral and less leverage





Identification strategy

- Given the **selection bias,** we use **matching methodologies** (PSM, Mahalanobis distance, coarsened exact matching). Balancing tests confirm the use of the PSM.
- DiD estimation

Limitation: We match on **observables** from financial statements, which might lead to an **overestimation of positive impact** of P2P lending

Two sources of data for firms' financial statements

Available for P2P platforms:

- Published financial statements for larger firms (Diane)

NOT available for P2P platforms:

- Tax returns for ALL French firms.

Short-term effects (0 + 1 years) of P2P lending on firms

	Interest rate	Risky debt	Wage growth	Sales growth	Tangible investment	Intangible investment	Default
With public financial statements	0.008^{***}	0.3^{***}	NS	NS	0.93^{***}	NS	NS
Number of firms	1252	1252	1252	1252	1252	1252	1252
Without public financial statements	0.01^{***}	0.47^{***}	NS	NS	NS	NS	0.14^{***}
Number of firms	572	572	572	572	572	572	572

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Conclusions

- French P2P lending platforms increase borrowing costs and risks for borrowing firms with negligible real impacts on intangible investment, wage growth, sales growth.

- **Interpretation:** platforms cannot overcome adverse selection problems and high funding costs.

Implications for other fintechs & Big Tech

- Access to data matters!
  - Data availability of Big Tech might mitigate adverse selection problems (Frost et al., 2019; Gambacorta et al., 2020), but data access might create a barrier to entry.

- Business model matters!
  - What mechanisms align the incentives of investors and Big Tech?