P2P LENDING: BRIDGING INDIA’S CREDIT GAP

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Abstract

With the financial meltdown, new financial innovations and alternative investment products made their way to India. The concept of Peer to Peer lending is an alternative financing option available to the unbanked section of the population or people with limited institutional credit exposure. Developments in new digital tools, alternate credit models enabled bridging of the credit gap. With RBI devising a regulatory framework and stringent policies, these NBFC-P2Ps have been given a needed push to the cause of financial inclusion in the Economy.

Keywords: Peer-to-peer lending, Financial Innovation, E Finance, Alternative lending

Introduction

Peer to peer (P2P) lending is a financial innovation where borrowers and lenders come together on a common platform via internet. It is a kind of a business model which recently gathered momentum globally, and is now flourishing in India also. Although it is still nascent in India, with its potential benefits, its promises to its stakeholders and the risk association to financial system cannot be ignored. This model is contrary to centralized network where the financial institute conducts the transaction with every user directly. It is a decentralized financial network where P2P users borrow and lend directly. The term often used is crowd funding, but with different aspects like that of investment and loans instead of charity or some social cause.

It is a debt financing tool where people want to borrow, get finance from individuals who tend to invest. The whole concept is centred on getting higher rate of interest by lending rather than saving, and borrowers get loans at cheaper rate of interest.
Most of the Fin-Techs that continuously research for financial innovative products clubbed with technology may have potential to disrupt the financial system of a country. These new technologies seem to gain faster market shares in lending to emerging, than in developed countries. Fin-techs provide novel financial services and also lead a way to new startups out of which few grew to the remarkable size like Alibaba and Amazon.

**Literature Review**

Peer to peer lending mainly involves investors, borrowers and P2P lending platforms. In 1983, Mr Yunus had taken an initiative to open Grameen banks to fund small and micro enterprises. Later, there was a huge development in Micro-credit companies. It offers funds to the small enterprises who cannot stand to have high credit ratings as required by traditional banks (Agarwal and Hauswald, 2008) but also provides an opportunity to avail high interest benefits to investors (Slavin, 2007). The borrower’s credit rating has positive impact on interest rates and vice versa (Wang and Liao, 2014). Investors can identify certain risks on the basis of information provided by the borrower through the platform (Huang, 2015). And the main risk taken by the p2p platforms are the operational risk and financial risk (Gai, 2016).

**Magnetism of P2P Lending innovation**

**Investment Tool:** Investments of surplus are often done in Equities, Mutual Funds, Real Estate and Deposit schemes. But what next? Investors can diverse their portfolio by adding lending to other Asset class. The traditional investment tools generate the returns which are low in comparison to the returns on P2P lending.

**Returns not related to Stock Market conditions:** Most of the market investment tools are related to stock market conditions, and return also varies. As the returns are not directly related to market conditions, a portfolio can be diversified in a better way. Mostly market related tools yield around 12 to 14% while it can offer higher returns.
Power of Compounding: Another important aspect is it has the power of compounding. Lenders are receiving back a proportion of their investment every month, can reinvest and can counter the inflation through compounding effect.

Risk Mitigation: Being a debt based investment tool, there is a risk of default. Just like other debt instruments risk can be mitigated by diversifying the different types of loans and borrower categories. Lenders can ensure consistent returns by carefully diversifying debt.

Steady and quick returns: The most distinct feature of P2P lending is that returns are quick and steady. In P2P lending process the entire process from loan application to disbursal is done online. Hence reduction in operational cost and quick returns.

Global Perspective

The technological advancements opened new doors for many startups, and the concept of FinTech surfaced. In 2005, Zopa was founded in UK as many banks failed to fulfil the demands of borrowers. In 2007-08 the financial crisis hit the debt market and banks began to tighten their lending prepositions due to stringent capital reserves. This created a debt funding gap and many companies like Zopa started to launch their peer to peer lending platform. According to a report by CBInsight and KPMG, FinTechs gained momentum since 2013 where most of the investments were made in US. However, since 2014 there has been a significant increase in investments in Asian countries also. The biggest deal traced back in 2016 with Ant Financial (USD bn) a subsidiary of Alibaba.

The previous studies reflect that most of the FinTechs focus more on developed countries like UK and US. But there is a remarkable expansion of FinTechs in developing countries also. According to a report by KPMG, China is the market with most peer to peer lending platforms, amounting to around 2,300 as of March 2017, with a lending volume of CNY 9,210 bn. A report by McKinsey Global Institute (2016) states that Fin Techs could also boost economic
growth in emerging economies. For China they calculate a possible 4.2% increase in GDP until 2025, due to digital financial services.

The explosive growth of P2P industry gave rise to many incompetent and dubious companies to play in the market. As a result, investors started withdrawing their funds and platforms started to collapse. The reason behind was the regulation system.

At present, Australia, Argentina, Canada (Ontario), New Zealand, United Kingdom, France, Germany, Italy and USA, it is partially or fully regulated. It is banned in Israel and Japan. Although China has the largest P2P market in the world, with number of platforms offering varied services, the sector is still not regulated currently.

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**Figure 1.1 : Growth of Fintech credit of various countries**

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1. Europe, Middle East and Africa.  
2. Data are based on two platforms for Australia and New Zealand, all platforms covered by WDZJ.com for China, 32 platforms for Europe, 30 for the United Kingdom and six for the United States.

Sources: AltFi Data; Cambridge Centre for Alternative Finance and research partners; WDZJ.com; authors’ calculations.
Financial Innovation backfires

According to the Bloomberg report, 4500 P2P platforms were closed in China since 2013. The reason for crisis of China’s P2P market was a fallout of regulations which leads to issues like high interest rates, misuse of funds and inadequate credit information. Many platforms shut operations instead of complying with the regulations. This leads to withdrawal of confidence among the investors. Due to high default rates, non-performing assets rise which is not good for the financial health of the platform. In China, platforms become the intermediary between lenders and borrowers, i.e money is firstly invested with platform and then deployed to borrowers. The absence of regulations leads to major conflicts.

Indian Scenario

Peer to Peer lending has seen a tremendous growth in countries like US, UK, Germany, France and China. The massive growth and popularity influenced the market in such a way that these countries have given it a status of mainstream financial and investment product. India is also now ready to officially recognize this Fintech innovation. RBI has announced that peer to peer lending companies will be treated as non banking financial companies (NBFC’s) in gazette notification on 18 September, 2018.

Paisa Dukaan got the first certificate of Registration from RBI in peer to peer lending market in India. In 2019 Rupee Circle and India Money Mart also got the license from RBI. Both these companies started their business in 2017 and have already disbursed multiple crores to unbanked customers. These platforms are backed up Oracle Global Startup Ecosystem and Mahindra Finance and others.
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<tr>
<th>Regional Office</th>
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<td>Luharia Technologies Private Limited</td>
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<td>Mumbai</td>
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<td>6</td>
<td>BRIDGE FINTECH SOLUTIONS PRIVATE LIMITED (NBFC - P2P)</td>
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**Table 1.1: List of NBFC P2P registered with RBI as on December 27, 2018**

However the number of P2P lenders registered is quite low as in comparison with their actual existence in the market (Table1.1). One of the foremost reasons is the stringent conditions imposed by the RBI. One such condition is the requirement of net owned funds of Rs 2 crore which weeded out the small market players. Even the online platforms with non serious business also exited.
Impacts of Regulation

**Cap sized Funding:** P2P lenders who are registered with RBI have to adhere to regulations of NBFC’s. The new regulations cap the lender’s exposure at Rs 10 lakh. This regulation has extended to all lending and borrowing P2P platforms. But at the initial stage cost of operations are high, and margins can be improved if volumes are increased.

**Logistical problems:** P2P operators have to appoint a bank promoted trustee to monitor the fund flows between the escrow accounts of borrowers and lenders. At present, IDBI trusteeship is enjoying the monopoly in offering such services.

**Confidence built up:** Registration with RBI boosted the confidence of both borrowers and lenders. The ticket size of loans also improved as the platform is under the surveillance of RBI.

**Access to Credit Data:** Being registered, P2P lenders have the access to the data from credit bureaus which provides the pool of potential customers or borrowers who were rejected due to less credit scores or due to risk profile.

**Conclusion**

Peer to peer lending is a financial innovation which bridges the credit gap. In a global scenario the rapid growth of the sector also brought some drawbacks, as most of the platforms were deregulated and no proper credit evaluation of borrowers forced the investors to pull back their money. In India though it is at an early stage but seeing its potential growth, RBI has decided to regulate this market and stage peer to peer lending as one of the investment tools for investors and bridge the gap of credit by funding unbanked potential customers.
References


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