Online P2P Lending:
Factors, Behaviors, and Mechanisms

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INTRODUCTION

Online Peer-to-Peer (P2P) lending, which allows individuals to lend and borrow directly through online platforms, has transformed the way individuals search for fund. As an emerging alternative to banks and personal loans, online platforms have many strengths that traditional financial institutions are unable to achieve. For example, online platforms can alleviate the insufficiency of bank credit fund, and resolve some problems caused by traditional folk lending, such as limited scope and high risk. In addition, online platform plays the role of information showing, demand and supply matching and fund transferring.

The emerging internet financial market has challenged the traditional financial market with its advantage of direct matching between deposits and loans. Lendingclub.com has facilitated over $1 billion loans in the second quarter of 2014, which represents a more than 100% quarterly growth (www.lendingclub.com). Since 2005, online P2P lending has developed rapidly across a number of countries, such as US, UK, Korea and Japan (Chen & Han 2012). By the end of January 2015, there are 1627 online platforms in China alone (www.wangdaizhijia.com). Surprised by the growth, some experts are convinced that online P2P lending will become an alternative for traditional finance. Although online P2P lending is a new domain, research has been done on a broad range of issues. Therefore, an overview of the studies of this field can not only enrich the understanding of the current situation of online P2P lending and modern financial market but also provide valuable insights for future research.

The rest of this paper is organized as follows: Section 2 includes an overview of the online P2P lending. Section 3 summarizes and discusses the key research streams of this area. The three streams are factors on which lenders make decision, behaviors of lenders in dealing with information asymmetry, and mechanisms which platforms apply to alleviate information asymmetry. Section 4 discusses the future research directions.

ONLINE P2P LENDING

P2P lending refers to lending and borrowing between individuals through a for-profit online platform (Gonzalez & Loureiro 2014). The rest of this section describes the notion of the platform and the lending process.

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Platform

Online P2P platforms are regarded as an innovation of financial market. There are some differences between online platforms and traditional financial institutions. Traditional financial institutions are involved in the credit process and entail some degree of default risks, while online platforms disconnect themselves from the lending process and the risks they bear are from the platform operation. Generally, lenders in traditional context have no knowledge of the borrowers, whereas lenders in online platforms can browse borrowers' information and have the determination right. Revenue source of traditional institutions are mainly financial spreads, while online platforms charge service fee as an intermediary.

Online platforms are also regarded as part of the crowd funding movement that uses the internet to rally crowd for collective funding (Burtch, Ghose et al. 2013; Zvilichovsky, Inbar et al. 2013). However, P2P lending and crowdfunding are essentially different in purpose and funding model. The primary purpose of P2P loans is for debt consolidation and credit card refinancing (Zhu, Dholakia et al. 2012). Regarding to the funding model, P2P lending platforms all adopt all-or-nothing funding model, that is, the funds are returned to the funder unless the funding goal is reached (Gerber, Hui et al. 2012). Some crowdfunding platforms use Keep-what-you-raise model, such as RocketHub.com and IndieGoGo.com.

Lending Process

In a typical P2P lending process, individuals need to choose a platform and register as a borrower or a lender (Some platforms allow individuals to possess both identities). Then, individuals are required to submit personal information, such as phone number and educational status. The platform will verify the information and determine the register's credit grade based on the information collected. Each platform may have its own rating scales. Having passed the initial screen process, borrower is endowed with the right to release a loan request, in which borrower provides information about itself and the loan request. Lenders browse the loan requests on the platform and decide which one to invest, the investment amount and the interest rate. Once confirmed, the money of the lender is transferred from his/her bank account to his/her platform account. If 100% of the requested funds are received and the listing gets the approval of the platform, the requested money will be transferred from the lenders' platform account to the borrower's platform account. Then, the borrower can withdraw fund from the account. However, if the total investment from lenders doesn't meet the requested amount, the money will be returned to their accounts and the loan request will fail. Borrower needs to return the principal and interest as stated in the loan request. During the process, lenders get the opportunities to invest, while borrowers seek for access to fund. At the same time, P2P platforms, acting as intermediaries, play the role of information checking and ensuring the normal operation of the system.

RESEARCH STREAMS

Due to its novelty and rapid expansion, P2P lending has attracted significant attention from the mainstream media and academia. Many scholars propose that information asymmetry is the most common problem in P2P lending. The negative effects it causes may lead to a possible breakdown of this new capital market. It is imperative for borrowers and lenders to solve the problem to maintain the emerging market (Bachmann, Becker et al. 2011). Therefore, in regards to the central issue of "alleviating information asymmetry", we classify P2P literatures into three typologies: factors, behaviors and mechanisms.

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