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Peer-To-Peer Lenders and Banks: Compete or Complement? A Position Paper

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Abstract

This paper is a position paper that aims to identify whether the presence of P2P lending is a problem for banking companies or vice versa. We answer this question through three approaches: in terms of business models, SWOT analysis, the risks faced by them, and market segmentation. Our identification shows that due to its easy communication channel (the Internet) and affordable infrastructure, P2P lenders are a competitive rival. P2P lenders should move to a niche market that is still available, namely SME financing. These SMEs are then expected to become more mature and bankable so that they can get financing from banks to grow bigger. They have qualified capabilities for this segment and capable technology. This could be their competitive advantage over banks. Banks operate in safe segments for them to avoid bank panics, bank runs, and economic instability. Meanwhile, banks can engage in other market segments, such as housing finance, commercial, and corporate financing. This synergy will have a harmonious impact on economic progress.

Keywords: Bank, Peer-to-peer, Competition, Financing, SWOT Analysis.

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1. Introduction

In the financial service ecosystem, banks have long served as intermediaries among both fund creators and fund users [1]. Whether it was the flow of money between two parties, banks served as the sole link between the various businesses [2]. They generated money by making a spread between lending and borrowing rates in the process [3]. However, the introduction of technological innovation has radically altered the situation, allowing a new set of businesses to supply financial services such as peer-to-peer (P2P) lending [4]. P2P lending refers to credit operations carried out using online P2P lending platforms that directly connect investors and borrowers and divide loans into payment-dependent notes [5]. It is also referred to as FinTech credit or crowd-finance [6]. P2P lending platforms offer an online marketplace where lenders and borrowers can connect [7].

Over the previous decade, the financial industry has experienced a significant increase in digital innovations, particularly in size and the number of financial technology (FinTech) firms including P2P lending [8]. However, incumbent players (banks) have been sluggish in accepting newer technology developments in the financial sector [9]. The comfort of existing relationships is one of the factors contributing to the delay in the bank's digital capabilities supply [10]. Although these connections were beneficial to the banking sector in the past, the financial services sector must alter its fundamental procedures to embrace new types of data, particularly real-time digital processing [11].

Although banks have owned FinTech companies in recent years, most FinTech start-ups are bank-independent and available for investment [12]. Due to this fact, many banks still offer outdated, costly, and inefficient financial services [13]. The development of FinTech firms will see them take over some of the most significant features of traditional banks [14]. This reality raises further questions, whether P2P lending is a bank competitor or complimentary for meeting the needs of financial services [15]. We explore the answer to this question based on four main aspects; business model, SWOT analysis of the bank compared to its competitors, risks faced, and market segments [16].

2. Research Method

Both peer-to-peer lending and banks take advantage of the needs of both parties, surplus unit and deficit unit in their business model [17]. The peer-to-peer lending company's established model allows the requirement for excess units and deficit units [18]. Borrowers post loan listings stating the amount and purpose of the loan they need [19]. Investors review loan listings and invest in those meeting their criteria [20]. P2P lenders act as middlemen between borrowers and investors. As a purely online platform, P2P also enables the implementation of quick and convenient loans. Compared to traditional banks, P2P platforms' substantial digitalization of procedures and specialized knowledge may result in lower transaction costs and more convenience for end customers. Furthermore, the P2P Lending Model is shown in Figure 1.

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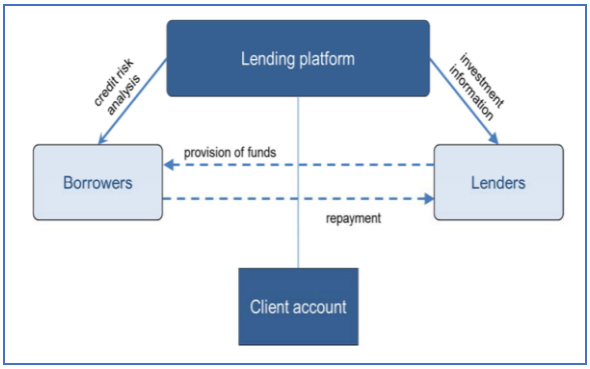

Figure 1. P2P Lending Model

Direct investments made through Figure 1 P2P lending networks have some characteristics. In the beginning, unsecured notes are often traded on FinTech platforms. Second, P2P lending platforms commonly divide loans into a number of mini-bonds (or notes) and provide aftermarket trading capabilities in order to boost liquidity. Alternative funding methods, such small-scale bond splitting or direct investments, are growing more and more popular in credit markets where it may be difficult to raise money through banks. Third, peer-to-peer lending platforms commonly give loans to borrowers with poor and fair credit ratings. The amount of non-performing loans will increase as P2P lending platforms place a greater emphasis on fee income than on correct creditworthiness evaluations. Due to the mentioned motives, banker discretion may be compromised to the point that P2P lending and bank loans function more as substitutes than as complements.

Meanwhile, banks serve as both mediators and providers of payment services. Banks benefit from the spread between credit and deposit interest, as well as fees for payment services. On the bank's financial accounts, this business model creates both interest-based and non-interest profits. By generating economies of scope through income diversification, banks are able to win the competition from their rivals. Banks can provide a range of services to their clients using the same assets. Through this diversification, the bank also gains a stability advantage following the advice don't put your eggs in one basket.

3. Result and Discussion

Banks' reputation has suffered since P2P lending became popular. The bank services are opaque, take a long time to make a credit decision, are challenging to apply, have unfavorable terms for repayment, and have a high-interest rate. According to a SWOT analysis, banks' strengths include strong customer relationships, in-depth local expertise, and a long-term perspective. However, they are deficient in digital data and have a split consumer base. Despite this, banks have the chance to strengthen current client relationships, collaborate with partners to integrate digital technology, prioritize local expertise, and use digital leverage to more completely embrace the ecosystem (e.g., local merchants and charitable causes).

While banks face pressures from an aging client base, peer-to-peer lenders use technology to offer more alluring products based on digital insights. This is the advantage of P2P with a digital spirit. Cost, resource, and time efficiency become a necessity. However, it is undeniable that as a financial institutions they are also faced with a number of risks.

P2P lending services are generally extremely affordable. Due to the growth of P2P's digital platform, which lowers intermediary costs due to its paperless and presence-free technique, credit may be made available more swiftly and inexpensively. P2P lending is sometimes regarded as an unsecured type of financial service. There are several stability issues brought on by the P2P business model. P2P platforms make money based on the amount of loans they create. In order to maximize loan origination even at the expense of credit criteria, they are therefore financially motivated. For P2P risk management, this aggression may be a ticking time bomb. Trust difficulties between lenders and P2P platform providers are impacted by this.

This is contrasts with banking, which has highly rigorous regulations. Regulations have been very tight when it comes to bank lending, from the conventional. Loan to Deposit Ratio (LDR) to several more recent measures like the Net Stable Funding Ratio (NSFR) and Loan Coverage Ratio (LCR), which the Basel Committee just proposed in 2019. In order to keep bank funding and liquidity at a high standard, this is done. This regulation's requirement is to preserve the standard of bank liquidity and financing.

Because the interest rate applied to the low-credit market segment would be greater than that applied to the benchmark case, borrowers in the low-credit segment would choose higher-risk, higher-return projects when there was an insolvency risk on the bank's side. Therefore, there is a higher chance that borrowers in the low-credit sector may default on specific bank loans, which raises the bankruptcy risk. Second, in terms of illiquidity risk, when banks supplant P2P lending platforms, the percentage of protected deposits in a bank's deposit portfolio would rise with loan market fragmentation. This would reduce the amount of crucial cash flow needed to avert a bank run, which would lessen the danger of illiquidity. Third, the aggregate credit risk of a bank is lower in the segmented market situation than it is in the benchmark case, suggesting that the lower illiquidity risk would be sufficient to offset the higher bankruptcy risk.

The platform's funding source is another drawback on the P2P side. They ultimately rely on investors' continued confidence in the platform to keep lending rates stable. P2P systems that allow early withdrawal of funds are susceptible to large withdrawals if investors lose trust because they cannot rely on deposit protection. Investor protection in the case of a platform failure is still up in the air, and a badly handled, widely publicized failure may not only result in losses for

investors but also undermine the trust that investors need to continue borrowing.

P2P lending is providing a glimmer of light for a sizable portion of the unbanked, including SMEs. Lending to smaller businesses is frequently less profitable due to greater default rates, a lack of data, and small size, traditional banks frequently avoid doing so. The high risk borne causes banks to have a reluctance to finance SMEs. In some conditions, the government takes part in mitigating this risk so that SMEs can still get access to proper financing. As in the Indonesian government which launched the Kredit Usaha Rakyat (KUR). Government-owned credit insurance becomes the guarantor if the credit fails to pay. This strategy reduces the risk from the banking side, but there are limitations from the government side so that other alternatives are needed for SMEs financing.

Many SMEs are unable to acquire capital as a result. On the other hand, SMEs play a significant part in a nation's economy. SMEs are aiding in the decline of the unemployment rate (OECD, 2017). By using automated procedures to cut costs and credit risk models that leverage unconventional data, P2P lending platforms try to address the issues associated with lending to SMEs. Improving their access to financing could have significant economic benefits. Therefore, P2P may make it easier for underprivileged populations or economic sectors to obtain funds and investments. The relationship between P2P lending and SMEs is one of mutualism. The growth of SMEs is also a major factor in the demand for P2P lending.

On the other side, SMEs that rely on P2P services for finance run the risk of having less access to cash or having to pay a higher price for it if the investor pool shrinks. Peer-to-peer lenders don't take on as much risk as traditional banks do. Investors take on the risk of the loans and bear the loss in the event of default by the borrowers. Peer-to-peer lenders set interest rates in accordance with the risks related to the loans they offer. Investors must determine how much risk they are willing to take. The rate of return increases as the risk does.

4. Conclusion

Banks and peer-to-peer lending both capitalize on the demand for deficit unit and surplus unit financial services. According to the SWOT analysis, their activities include strengths, witnesses, development opportunities, and each treat. Similarly, their risks are comparable, particularly in terms of liquidity and client confidence. Moreover, both banks and peer-to-peer lending have advantages in each area, with peer-to-peer lending being superior in managing the SME segment.

Due to its easy communication channel (the Internet) and affordable infrastructure, P2P lenders are a competitive rival. However, traditional banks have a benefit over P2P lenders attributable to their network of physical branches. In the communities where consumers work and live, traditional lenders are present. Customers can enter and speak with a live person. That is not something that peer-to-peer lenders can provide or match. A visit to the bank and a face-to-face conversation with a banker are two things that most people find to be very reassuring. P2P lenders should move to a market niche that is still available, namely SME financing. This trick requires regulatory support from the government or relevant authorities. Banks operate in safe segments for them to avoid bank panics, bank runs, and economic instability. Likewise, P2P operating in the realm of SMEs. These SMEs are then expected to become more mature and bankable so that they can get financing from banks to grow bigger. They have qualified capabilities for this segment and capable technology. This could be their competitive advantage over banks. Meanwhile, banks can engage in other market segments, such as housing finance, commercial, and corporate financing. This synergy will have a harmonious impact on economic progress.

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