

## PEER TO PEER LENDING: A COMPARATIVE ANALYSIS OF I-LEND AND FUNDING CIRCLE

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### **ABSTRACT**

*This study is to identify the new lending platform for short term borrowers and lenders over the internet. It focuses on the scope and forecasts the success or failure of peer to peer lending companies in the market. The research consists of secondary data, which provides different perspectives towards the research question.*

*Funding Circle is one of the largest peers to peer UK based exchange for borrowing and lending money. I-lend are the company operating in the same industry in India. A small overview of their business model and working provides an insight into its system and market.*

**KEYWORDS:** *Borrowing and Lending, Riskiness of the Investment, Emergence of Internet and E-Commerce*

### **INTRODUCTION**

“Never lend money to friend and family the saying goes but how about complete strangers”

From the beginning of time, man has been motivated to succeed in life, to amass more good and expand his own horizons of being. For some people it meant getting a loan from a friend to return it back until the next harvest or until a next supply comes in. Peer to peer lending has been in existence since a long time, though it was not called by the same name in the earlier days of its presence. Its existence has not been a rise and fall criteria rather it has been a constantly growing concept and is still being used today.

Peer to peer loans is unsecured loans. They are provided to individuals rather than companies. For these loans, the borrower does not have to provide any kind of mortgages or collaterals in case of default to a lender. Peer to peer concept tends to bridge the gap between the people (consumers) who want a loan and the people who have the capacity to fulfill this want of a loan. The peer to peer concept is a concept that dismisses the role of the middleman such as banks, between the needful and the lenders. And in general, it is supposed that the borrowers would get a lesser rate than the banks and the lenders grow their investment at a much faster rate. The lending rates are chosen by the investor depending on the riskiness of the investment he is making and the evaluation of the borrower's ability to pay back.

With the emergence of internet and e-commerce, it is possible to abolish the traditional financial intermediaries. The emergence of the peer to peer lending platform in the form of peer to peer (p2p) lending sites have led to an increased

time and cost saving and has also introduced people to the concept of crowd sourcing (meaning: the practice of obtaining needed services, ideas, or content by soliciting contributions from a large group of people, and especially from an online community, rather than from traditional employees or suppliers(source: <http://www.merriam-webster.com/dictionary/crowdsourcing>) which opened up the lenders and the borrowers to a whole new world of opportunities to earn and gain more profits.

Peer to peer loans may have the following common characteristics

- Conducted for faster profits
- There is no necessary relation between the lender and the borrowere
- Intermediation is done by only a peer to peer lending company that provides a platform for the interaction of the lenders and the borrowers
- Online transactions take place Lenders have a choice of where to invest
- Loans are not protected by any government guarantee or insurance

## OBJECTIVES

- Identify the scope and working of the funding circle and i-lend over the internet.
- Identify whether the peer to peer lending is a new alternative for the short term loan industry.
- Critically evaluate the risks associated with the borrowers and lenders in it.
- Compare and contrast the business models and strategies of both the companies using swot analysis and porters 5 forces of competition.
- Analyze the future of both the companies by the market trends and their success charts in previous years.
- Recommend both the companies

## I-LEND: THE INDIAN BUSINESS MODEL

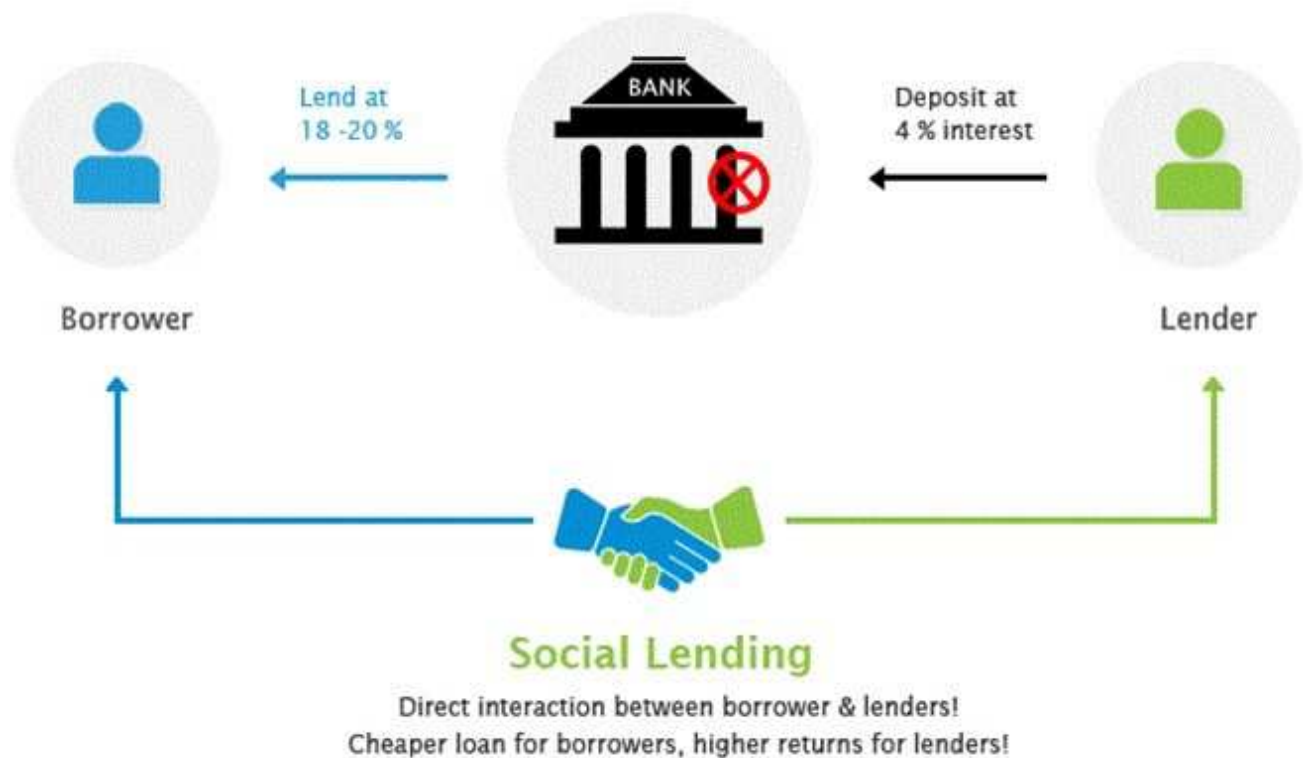
I-lend India's first peer to peer lending initiative provides a platform for the borrowers and the lenders to facilitate a financial transaction. It connects borrowers and lenders in such a way that both of them derive much more benefits out of the transactions as compared to conventional intermediaries such as banks. The site aims to provide individuals low-cost loans for their minor expenses.

In the Indian market, the banks offer personal loans and loans through credit cards on high-interest rates; the repayment of these loans has become a difficult task. The global economic crisis has further worsened the accessibility to credit. Through, i-lend, lenders offer loans online at competitive interest rates and get good returns.

Getting loans through this site depends on the creditworthiness of the borrower and the ability to convince the lender about his need through various recommendations from family and friends, endorsement through groups, colleagues

at the workplace or any other informal group, individual goals, needs, etc. I-lend offer loans for different purposes such as educational fees, medical emergencies, vacation, relocation, etc. Loans can be availed up to rs. 3, 00,000 (three lakhs only) and can be repaid over a period of three years.

The main target of this site is the young working Indians who have just entered the corporate world and do not have the access to credit through channels such as the banks due to a very little amount of credit history.



**Figure 1**

(Source:<http://www.i-lend.in/index.php/about-ilend>)

## THE ORGANIZATION

Started in the year 2010, i-lend is headed by V.V.S.B Shankar, who is the director and the founder of the company. Mr. V.V.S.B. Shankar has an experience of over 22 years in different industries and this is his second entrepreneurial venture. Niti Gupta, the co-founder, and head – operations, is an MBA from T.A. Pai Management Institute, Manipal. She has previously worked with TVS Electronics Pvt. Ltd. as a product manager. The advisory team is headed by justice C.Y. Somayajulu. He has an experience of over 40 years in the court of law and has retired as judge of Andhrapradesh high court.

## PARTNERS

Singapore based group that invests in start-ups. The angaros group is a boutique investment holding company.

Mehulumkati and associates (financial advisors)

Mehulmukati is a qualified chartered accountant and a financial analyst for more than 13 years having experience in different industries.

R & A associates (legal advisors)

It is an integrated service firm focused on corporate and registered as a practicing company secretary firm with the Institute of chartered secretaries of India (icsi).

## **BUSINESS MODEL**

I-lend work as an exchange platform for facilitating transactions. Individuals choose their terms and conditions for the transaction which is beneficial to borrowers and lenders giving a scope for negotiation between the parties involved which results in a fair transaction.

It offers only relevant information of the lenders to the borrowers and vice-versa making the process transparent. All background checks identity check, verification and documentation are done by the company itself.

A transaction fee of 2%-3% of loan amount or Rs. 1000 whichever is higher is charged from borrowers and 1.5% of the loan amount or Rs. 750 as servicing fees are charged to lenders. Pre-closure of loans does not attract penalties. Online advertising and cross-selling of other products are the sources of income for it.

## **WORKFLOW**

### **BORROWER SIDE WORKFLOW**

A borrower creates and activates a personal account on [www.i-lend.in](http://www.i-lend.in). Register his account providing personal and financial details. Two-step verification and approval of the account is done. The borrower can put up his desire of the loan and its specifications such as the amount, the tenure of the loan, the interest/EMI, the purpose of the loan, and some evidence to convince the lenders about the loan request. Browse the lender listing and approach lenders or try and be approached by them. If there is one lender that is ready to lend the entire loan then negotiate the interest rate and close the loan. Loan documentation, handover EMI cheques to i-lend. I-lend keeps the loan agreements in its own custody. Once the loan is paid, the documents are returned to both the parties

### **LENDER SIDE WORKFLOW**

A borrower creates and activates a personal account on [www.i-lend.in](http://www.i-lend.in). Register his account providing personal and financial details. One step verification and approval of the lender via pan card, address proof and photographs. Browse the borrower listing and approach borrowers or try and be approached by them. Negotiate the interest rate on the loan after analyzing the risk in the investment to be made. Loan documentation, handover loan amount cheques to i-lend. I-lend keeps the loan agreements in its own custody. Once the loan is paid, the documents are returned to both the parties.

I-lend has followed the peer to peer to the concept as a whole but has modified some of its processes according to the Indian scenario such as every borrower has to undergo a physical verification of his residence and employment.

## TARGET MARKETS

Currently, i-lend is targeting the unorganized form of peer to peer lending in the country. India has a lending business of Rs. 47 lakh crore of which 35% (i.e. 16.45 lakh crore) in urban space is done from family and friends in the form of unorganized peer to peer lending. It is one of a kind model in India. Borrowers can apply for loans between rs. 25000-rs. 300000 and the maximum period of 3 years. The minimum interest rate offered is 12%. Lenders can offer Rs. 5000- Rs. 300000 and can lend multiple borrowers.

## SWOT ANALYSIS

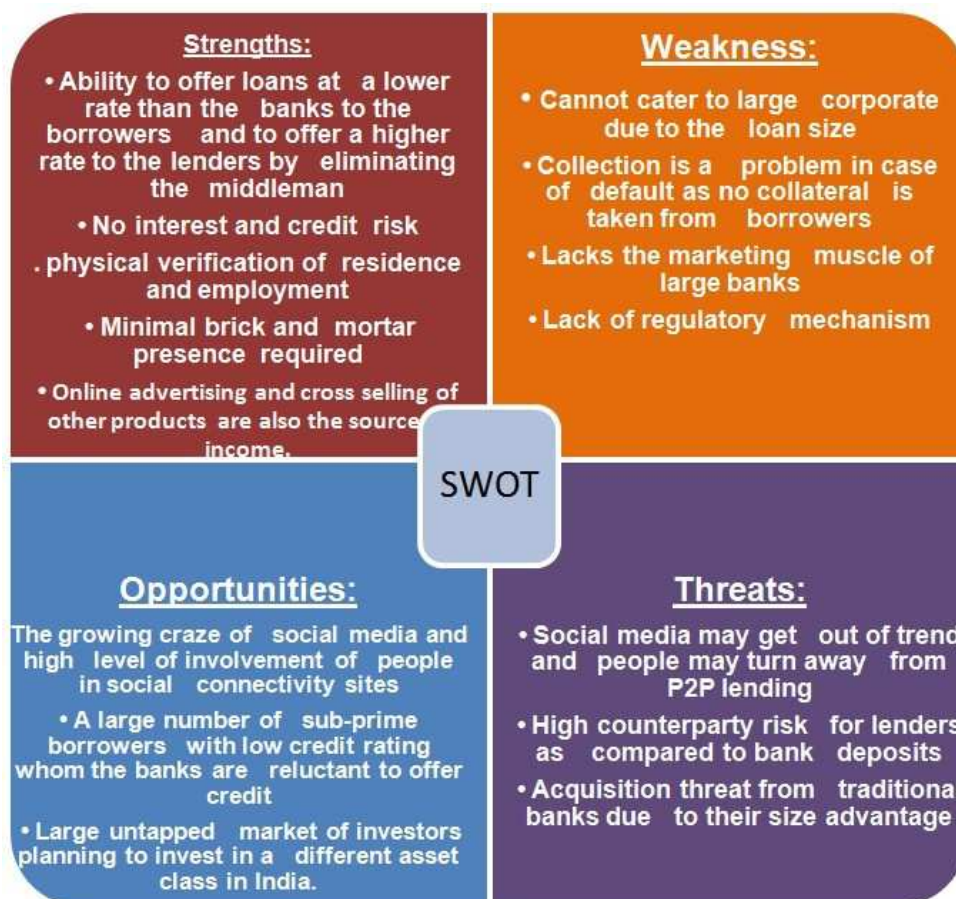


Figure 2

### PORTERS 5 FORCES MODEL

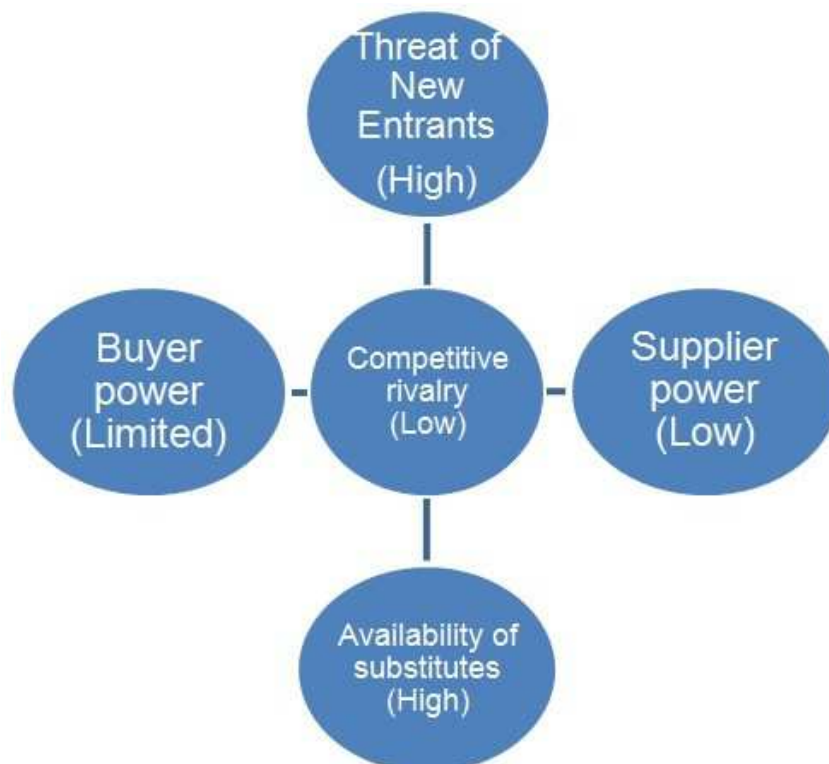
Buyer power – limited bargaining power of customer or borrower as the company provides more interest rates than banks or other financial institutions. But there exists freedom of choice for borrowers to choose the investment area or field they are interested in.

Supplier power- low bargaining power of supplier or investor because of the low-interest rate given by them to the company for their finances.

Competitive rivalry- low competition as this is a new emerging source of finance in India and not many platforms are there operating on the same line.

Availability of substitutes - high menace from substitutes like NBFC's, banks mutual funds, government securities, and T-bills.

Threat of new entrants - a high threat of new entrants on account of no government regulations. Before setting up a new peer to peer website, it is not essential to take the consent of RBI or any other regulation body.



**Figure 3**

### Funding Circle: Business Model

Funding Circle was launched in 2010 because of two key problems prevailing in the financial industry:

- Businesses were struggling to access finance
- People were getting a poor return on their money.

Then the solution was to make it possible for people to earn a return on their money by directly lending it to businesses looking for funding. Funding circle launched a business of peer to peer lending in the market. Zopa was there in the market having the same business model since 2005.

Funding circle was set up to let people lend directly to SMEs, cutting out the banks' traditional role as middlemen between savers and borrowers. The company says low overheads – it has no branches – and the latest technology can provide investors with better returns than a bank while extending credit to businesses the banks steer clear of. Funding circle has grown with the backing of prominent venture capitalists, including index ventures, union square ventures, and Accel partners, together with prominent British entrepreneurs Charles Dunstone, Ed Wray and Jon Moulton.

### **THE BUSINESS MODEL**

Funding Circle is an online marketplace which can help businesses access fast and simple finance, whilst investors have the potential to earn better returns by lending to them. By directly connecting people and organizations who want to lend, with vetted, established businesses who want to borrow, we eliminate the complexity of the banking world.

As the loans are repaid, you receive a proportion back every month. In an emergency, for a 0.25% fee, you can trade the debt and should get your capital back within a day.

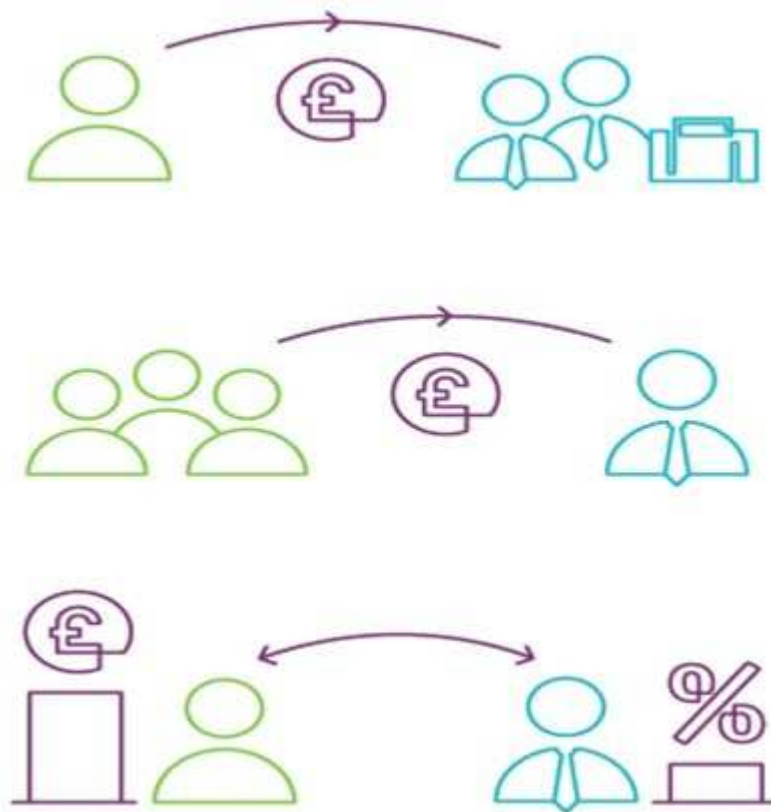
As an investor, it's important to remember you're lending to businesses so your capital is at risk.

Taking a business loan through funding circle means **you'll be borrowing directly from people and organizations.**

Once your loan is on the marketplace, hundreds of investors compete with each other to lend you money, giving you the most competitive interest rate possible for your risk band.

After you accept a loan, you make one repayment each month which is collected by funding circle and distributed to all the investor





**Figure 4:**

- One investor can lend to a number of creditworthy businesses to spread their risk and at interest rates they choose.
- One business borrows from lots of different investors, with only the lowest interest rates being accepted on their loan (subject to minimum bid rates).
- Once accepted, the business makes monthly repayments back to the investors who lent to them.

### **INVESTOR BENEFITS**

- A 6.1% average return\* after fees and bad debts
- Options to access your money early
- Manage your level of risk

An investor is lending to businesses so their capital is at risk.

### **BUSINESS BENEFITS**

- Quick and convenient
- Only accept rates that suit your business
- Independent from your bank



This is the weighted average return across all investors lending for 180 days or more through funding circle over an annualized period. It includes all earnings and is calculated after fees and bad debt but before tax. Investment through funding circle involves lending to small and medium-sized businesses so your investment can go down as well as up. Remember, past returns are not necessarily a guide to future returns. Data correct as of 19 February 2014.

## **ROLE OF GOVERNMENT**

Funding circle has lent to small businesses almost all of £20m in March 2013 provided by the government. The business secretary, Vince cable, ordered that £55m of government money should be lent to smes through funding circle and other social lenders. The online peer-to-peer lender has lent £15.3m to 1,438 businesses on the government's behalf and has re-lent £2.3m of repayments, taking the total to £17.6m.

Vince Cable, the business secretary, ordered that £55m of government money should be lent through funding circle and other social lenders to small and medium-sized enterprises (SMEs) starved of lending by the banks.

The government does not choose which companies it lends to and instead contributes to every loan funding circle makes. For the first £15m lent by funding circle, the government provided 20% of each loan. After that, the government's contribution has been 10%.

The average loan the government has contributed to is £60,000. The biggest is £500,000 and the smallest is £5,000. Funding circle claims the loans have helped create 4,000 jobs at businesses that are the backbone of the economy.

A spokeswoman for the business department declined to comment on individual applications to the British business bank but said £255m was still available from its £300m investment programmed for small firms.

The financial conduct authority (FCA) has proposed new rules on 1<sup>st</sup> April 2014 on peer-to-peer and crowdfunding companies, which include the likes of Zopa, funding circle, and rate setter.

It wants them to ensure they have plans in place so people get their cash back if the firm goes bust, information about how they operate is clearly presented and easy to find, and comparisons on interest rates being offered are fair and not misleading.

But there are concerns that people may not understand how they work, or that there is a risk, as investments are not protected under the financial services compensation scheme.

“Christopher Woolard”, director of policy, risk, and research at the FCA, said: consumers need to be clear on what they're getting into and what the risks are. Our rules provide this clarity and extra protection, balanced by a desire to ensure firms and individuals continue to have access to this innovative source of funding.”

## COMPARATIVE ANALYSIS OF FUNDING CIRCLE AND I-LEND

Table 1

Basis	Funding Circle	I-Lend
Size of Loans Available	£5,000-£1,000,000	£250-£3,000
Term of Loans	6 Months To 5 Years	1 Year To 5 Years
Unsecured Loans	Yes	Yes
Secured Loans	Yes	Yes
Large Asset Hire Purchase Loans	Yes	No
Variable Rate Auctions	Yes	Yes
Fixed Rate Auctions	No	No
Application Fee	No	No
Loan Servicing And Monitoring	No	Yes
Early Repayment Penalty	No	No
Typical Process	2-3 Weeks	4 Weeks
Value of Loans	£259,791,500	Unknown
Maximum Loan Arranged	£500,000	£3,000
Minimum Loan Arranged	£5,000	£500
Minimum Investment	£20	£50
Number of Investors	>50,000	Unknown
Investor Interest Rates	5-7%	15-24%
Borrower Interest Rates On Loans	8-12%	15%
Commission Charged	2%	1%

From the above -drawn table following observations can be made and analyzed:

- Funding Circle has lent more amount of loans to the public than i-lend since the both launched in the year 2010.
- Interest rates of funding circle are lower than of i-lend because of the difference in the economic and financial policies of both the countries.
- Funding circle charges a high percentage of commission than i-lend.
- Sizes of loans and investing amount differ because funding circle majorly lend money to businesses and i-lend also lends to the common public having small needs.
- Bank rates in UK and India differ due to different saving policies of both the countries.
- Funding circle can arrange loans for 6 months also but i-lend lends minimum for 1 year.

## FINDING AND ANALYSIS

By performing an in-depth analysis of case studies, market positions and future growth of the peer to peer lending industry, following recommendations can be made to both funding circle and i-lend to sustain in the market for a longer period:

### FOR I-LEND

- It should expand its existence from Hyderabad to the whole country and establish a contact office so that it becomes more reachable because according to the Indian mindset a tangible service is more reliable.
- It should provide loans to people for a period of six months also so that it can have access to short term loan seekers which will increase its market share,
  - It should have a regulation body which will minimize the risks of the investors in the market.
  - It must reach the businesses seeking finance as its more of loans are offered to the general public.
  - It should improve on its marketing strategies so as to tap an unidentified market available for finances in the country.
  - Like funding circle, it should contact the government for the upliftment of rural areas by providing them the loans set aside by the government for social development.

### FOR FUNDING CIRCLE

- Funding circle should also advertise other products on its website so as to earn revenues as its only source of income is commission fees and annual maintenance charges.
- It should also provide a small amount of loans to the general public like i-lend.
- Some kind of written agreement should be done with borrowers or collateral can be taken for huge borrowings so as to safeguard the investor's money and minimizing the risk associated.
- There is a growing craze of social media and a high level of involvement of people in social connectivity sites. Funding circle should establish itself more through social media marketing.
- There are a large number of sub-prime borrowers with low credit rating whom the banks are reluctant to offer credit, it should contact them and can offer them a loan with high fees and some security.
- A large untapped market of investors planning to invest in a different asset class exists should be tapped upon.
- It can share the platform with other lending sites so as to offer the credit across lending networks

It is of no secret that the interest rates have been in the doldrums for an extremely long time. And while that is very good news for those trying to borrow money or pay off a mortgage, it is less good if you are trying to find a descent rate of return on your investments or savings.

Peer to peer lending is an extremely attractive option for savers with rates that are generally much higher than you find at a bank or a building society. With that in mind, it is hardly surprising that fed up savers are looking for ways to protect their investments, which is one of the reasons for a rising peer to peer lending.

Peer to peer lending, also known as social lending, is a way for savers to earn better rates of interest by lending directly to businesses or individuals.

Andy Haldane, executive director for financial stability at the bank of England, said that peer to peer lenders could eventually replace high street banks. "At present these lenders are tiny," he said. "But so a decade and a half ago, was Google. If ebay can solve the 'lemons problem' (substandard products) in the second-hand sales market, it can be done for the market for loans." The major players of the peer to peer lending industry are funding circle, Zopa and rate setter.

According to a survey, the top 5 reasons why people are interested in peer to peer lending are:-

- Ethics
- Returns
- Peer to peer lending as a future.
- Bypassing banks
- Feeling of control and less risks.

Looking at the position of the main players in the market and their growth it can be said that peer to peer lending is having a good future but risks such as lack of regulation and compensation associated with this business model also exist. It can be of great threat to high street banks in the near future and banking industry if adequate rules and regulations are applied to make it a less risky proposition for both the lender and the borrower. New regulations are introduced by financial conduct authority (fca) in UK on 1<sup>st</sup> april 2014 with a view to minimize the risk of the model and regulating the peer to peer lending companies and to promote this type of source of finance in the emerging economy.

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