Why Do So Many Online P2P Lending Platform in China Turn Bad: Scenario Analysis Viewpoint

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Abstract. P2P lending companies eager to succeed in the online P2P lending platform are encouraged to imitate the strategies and business models of successful businesses. Yet they often ignore the lessons from online P2P lending platforms that failed with similar business models. Our analysis of the online P2P lending platforms turn to bad has identified several causes of failure, and the associated risks, when competing in the P2P lending. This research aims to highlight some of the most important aspects which can significantly reduce the inherent risks and can lead to sustainable growth in the online P2P lending market.

Introduction

P2P (peer-to-peer) lending is the practice of lending money to individuals or businesses through online services that match lenders with borrowers. Since P2P lending companies offering these services generally operate online, they can run with lower overhead and provide the service more cheaply than traditional financial institutions.

Zopa, which became the first P2P lender in Britain when it opened in 2005, in 2007, Ppdai.com became the first P2P lending platform in China, just two years after Zopa blazed the trail as the world’s first such platform. In recent years a very large number of micro loan companies have emerged in China, in 2016 there were more than 4000 P2P lending platform in total, but 2000 of them had already suspended operations. In June and July 2018, scores of Chinese online P2P lending platforms fell into financial or legal troubles because of tightened regulation and liquidity. According to WDZJ.com, a P2P industry information provider, 23 P2P platforms were reported to be in financial distress or under investigation in the first 10 days of July. That follows 63 such cases in June, a higher number than in any month in the previous year. People's Bank of China announced in early July 2018 said that regulators will extend a two-year-old nationwide campaign to clean up fraud and violations in the online financial market, targeting P2P and other online lending and financial activities. More than 5,000 operations have been shut down since the campaign began in 2016 [1].

In China, online P2P lending rapid developed as the background of inclusive financial and serving small and microenterprises, it has become an important trend in the development of Internet banking. However, the development of online P2P lending platform presents a chaotic state, since lacking of a better credit rating system, and there are no corresponding laws and regulations to regulate online P2P lending platform [1] [2].

These appearance attributes motivate us to examine firm survival in the online P2P lending industry. We ask: why do some platforms fail while others survive? What helps to sustain the survival of the online P2P lending platforms in the long term?

It is important for researchers to study the online P2P lending platforms survival. Survival or long-term viability has always been recognized as a basic business objective that is related to, but distinct from, firm financial performance. Survival is a prerequisite for market success and profitability.

In this study, we theorize that a online P2P lending platforms’ capabilities have a significant bearing on its survival. To illustrate, consider the P2P lending platform growth in China in recent
years. To understand why there are variations among online P2P lending platforms in their capabilities, we invoke a guiding platform level theory: the resource-based view, which regards a firm as a bundle of resources and suggests that resource deployments significantly affect a platform’s competitiveness and in turn its success or failure.

**P2P Online Lending in China**

Amazingly rapid development of mobile Internet has brought the boom in online P2P lending application.

Volume of transaction of online P2P lending platforms in China from 2008 to 2017 is shown in Figure 1 [1].

![Figure 1. Volume of transaction of P2P online lending platforms in China.](image)

Volume of transaction of online P2P lending platforms in China in 2017 is shown in Table 1.

<table>
<thead>
<tr>
<th>length of the loan</th>
<th>Volume of transaction (hundred million yuan)</th>
<th>percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>&lt;1 month</td>
<td>12614.38</td>
<td>32.38%</td>
</tr>
<tr>
<td>1-3 month</td>
<td>7363.46</td>
<td>18.90%</td>
</tr>
<tr>
<td>3-6 month</td>
<td>5606.07</td>
<td>14.39%</td>
</tr>
<tr>
<td>6-12 month</td>
<td>6084.27</td>
<td>15.62%</td>
</tr>
<tr>
<td>&gt;1 year</td>
<td>7284.17</td>
<td>18.70%</td>
</tr>
<tr>
<td>total</td>
<td>38952.35</td>
<td>100.00%</td>
</tr>
</tbody>
</table>

The change of the annual rate of online P2P lending platforms in China is shown in Figure 2.

![Figure 2. The change of the annual rate of P2P online lending platforms in China.](image)

Increase number and decrease number of online P2P lending platforms in China from July 2017 to June 2018 is shown in Figure 3 [1].

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Discussions

One of the main advantages of online P2P lending platform for borrowers can sometimes be better rates than traditional bank rates can offer. The advantages for lenders can be higher returns than obtainable from a savings account or other investments, but subject to risk of loss, unlike a savings account. Interest rates and the methodology for calculating those rates varies among P2P lending platforms. The interest rates may also have a lower volatility than other investment types.

Early P2P lending was also characterized by disintermediation and reliance on social networks but these features have started to disappear [3]. While it is still true that the emergence of internet and e-commerce makes it possible to do away with traditional financial intermediaries and that people may be less likely to default to the members of their own social communities, the emergence of new intermediaries has proven to be time and cost saving. Extending crowdsourcing to unfamiliar lenders and borrowers opens up new opportunities [4].

For investors interested in socially conscious investing, P2P lending offers the possibility of supporting the attempts of individuals to break free from high-rate debt, assist persons engaged in occupations or activities that are deemed moral and positive to the community, and avoid investment in persons employed in industries deemed immoral or detrimental to community [5].

P2P lending also attracts borrowers who, because of their credit status or the lack thereof, are unqualified for traditional bank loans [3] [6]. Because past behavior is frequently indicative of future performance and low credit scores correlate with high likelihood of default, P2P intermediaries have started to decline a large number of applicants and charge higher interest rates to riskier borrowers that are approved. Some broker companies are also instituting funds into which each borrower makes a contribution and from which lenders are recompensed if a borrower is unable to pay back the loan [7].

Even though, online P2P lending in China is still considered a viable business model with the help of the Internet technology and fast accepted internet financial services. To help the health growth of civil loan market, Chinese government has been trying to issue a series of moderate regulations to reduce the systematic risk in P2P lending market. Meanwhile, people in China never stop exploring innovative approaches and methods to reinforce the online P2P businesses [1] [2].

To establish Internet-based online credit risk management system. The online P2P lending platform is shown in Figure 4. This system is intended to provide quasi real-time and dynamic credit services for online financial services [4] [5].
To innovate existing P2P lending business models with support by advanced credit theories. There are two aspects: debt financing, and equity financing. So far all the P2P lending are aimed at debt financing to consolidate existing debt to be paid off in accordance with the contracted maturity term, just like mortgage loan and car loan [8]. Borrowers will pay fraction of principals and the interest based on the balance every month. Equity financing is now explored by some radical P2P lending players [9]. It is closely related to crowdfunding, but differentiated by involving the creditors who are no longer in the role of lenders but investors. More advanced business model is that these investors are involved into the business or project, which has the name of crowd wisdom.

Online P2P lending platforms benefit from low marginal costs because they are often not directly involved in delivering the service to customers. Rather, they provide value through matching lenders and investors, and facilitating value exchange transactions.

One of the failure cause of so many online P2P lending platforms in China turn bad is high competition for idle resources. A strength of online P2P lending platforms is that they use resources without owning them. But, as the industry grows and more firms enter the market, access to these resources becomes increasingly difficult.

Comparing the online P2P lending platforms with each other reveals that, although network effects and scalability represent common attributes of online P2P lending platforms, they do not necessarily contribute to a competitive advantage.

Another failure cause of so many online P2P lending platforms in China turn bad is the high costs of developing both market sides [1].

To be successful, online P2P lending platforms need to attract a critical mass of users on both the demand and supply sides. Developing both market sides can be a challenging task, particularly when the market environment is not accustomed to the principles of the online lending platforms.

And another more failure cause of so many online P2P lending platforms in China turn bad is unexpected changes in the legal environment.

The competitive advantage of online P2P lending platforms often stems from the fact that they operate outside the formal regulatory system. However, as online P2P lending platforms services become increasingly professionalized, lenders and investors become rational, and the public perception and legal treatment of these firms starts to shift.

Conclusion

Driven by the success of a few high-profile online P2P lending platforms, investors and entrepreneurs alike are keen to exploit the opportunities provided by the online P2P lending platforms. But because they focus on the success factors, many ignore the inherent risks in sustainably operating a business that does not own key resources, that depends on the voluntary contributions of independent actors and that operates in an environment with high regulatory uncertainty [10]. Indeed, several online P2P lending platforms have failed even though their
business models had the same characteristics that seemingly explain the success of the outstanding platforms.

Although online P2P lending business models can be highly successful, the identified causes of failure show that managers in online P2P lending platforms must be mindful of the risks they will face. When designing their business model, managers eager to maximize growth should not lose sight of the sources of the causes of failure and the associated risks.

Managers in online P2P lending platforms should reduce risk in the long run rather than maximize short-term growth with guidance on developing business models.

In the next few years, we expect several new online P2P lending business models to emerge and further blur the boundaries. Managers will find countless opportunities to succeed in the online P2P lending if they learn from early failures, mitigate common risks and build innovative business models that are not only scalable, but also financially sustainable.

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References


