Research on the Effectiveness of P2P Lending in Smoothing Financing Channels of Small and Micro Enterprises

Jun HUANG^{1.a,*} and Ming-xi DAI^{1.b}

^{1}School of Accountancy, Nanchang Institute of Science & Technology, Jiangxi, China

^{a}476267903@qq.com, ^{b}34165475@qq.com

*Corresponding author

Keywords: P2P Lending, Financing Channels, Small and Micro Enterprises.

Abstract. In China, the rapid development of small and micro enterprises (SMEs) played an important role in promoting the solid growth of macro economy, solving the employment problems, maintaining social stability. However, nearly 90 percent of the demands cannot be met effectively, which restricted the sustainable development of SMEs. The P2P lending, which is more convenient, lower transaction costs and higher coverage than traditional financing channels high coverage, provides a new financing method for SMEs. While, there are some practical problems in the current development process of P2P lending, such as high transaction costs, incomplete credit rating system, imperfect law system, and lack of supervision. This paper puts forward corresponding countermeasures and suggestions, which aims to promote the sound development of the P2P lending in Chinese SMEs.

1. Current Financing Situation and Causes in Chinese SMEs

1.1 Current financing situation in Chinese SMEs

1.1.1 Difficulties in Bank Loan Financing

In China, there are numerous SMEs occupying 90% of the total companies. In recent 20 years, the non-state economy (almost all were SMEs), whose ratal accounted for 50% of the gross national tax, contributed to the GDP up to 63% and provided more than half of jobs in the national non-agricultural industry. Nevertheless, it has been difficult for SMEs to get loan from banks for a long time. The small and micro enterprise loan balance only accounted for over 20% of total bank loans, which is unfair for SMEs that played the role in market subjects and the development of national economy.

1.1.2 Unsound Financial System of Multi-level Support for SMEs

Initially, venture investment in China is still in the early stage. There are high requirements of IPO of small and medium-sized enterprises board and growth enterprises market board, so these financing channels are not available to SMEs. Secondly, it is limited to the bond market providing to SMEs with financing. The direct bond financing scale of small and medium-sized enterprises was 505.597 billion yuan, which only occupied 17.2% of total corporate bond financing in 2015. Additionally, the financing market of SMEs is increasingly focused by micro-loan and trust companies and other non-bank financial institutions, as well as social credit rating agencies, even though they cannot provide enough support for the financing of SMEs.

1.1.3 The Limited Development of Private Finance and the Effect of P2P Lending

On the one hand, private finance has been an important financial channel that has positive impact on smoothing financial channels of SMEs. On the other hand, most of private financing forms are walking in the gray zone that is beyond the reach of law. Especially, with the economic crisis and credit squeeze, a large amount of corporations bankrupted and borrowers defaulted. In order to avoid such risks, several investors stop lending, so the effect of private finance on SME financing is limited to some extent. The emergence of P2P lending has combined private finance with the Internet, which offered SMEs and individuals the more convenient and efficient lending services and became a new method of financing.
1.2 Causes of financing difficulty in SMEs

There are three internal reasons making SMEs hard to finance. The high cost of SME financing is the first factor because of the small scale, the relatively weak operating capacity, and the high operating risk. Besides, SMEs are difficult to meet the bank credit conditions, since the single business lines, extensive management, irregular accounting records, incomplete financial management system, as well as poor funds management. Moreover, SMEs are short of mortgage assets.

There are several external reasons of financing difficulty in SMEs. The first reason is unsound external financing channels due to the high requirements of direct and indirect financing. The second reason is the incomplete credit guarantee system of SMEs. Meanwhile, it is difficult to some extent to implement government’s relevant policies.

2. Characteristics and Advantages of P2P Lending in Solving the Financing Problems of SMEs

P2P lending is the abbreviation of peer-to-peer lending, which is applied based on internet and made to individual, company or charity. The core of P2P is to establish an online financing platform and provide information on both sides of the loan between the party with financing needs and the party with investment needs. Also known as crowd lending, P2P loans, unsecured loans with wide range of customers and relatively higher returns, can effectively reduce the cost and risk of credit vetting and provide the investment diversification to diversify risks.

Compared with commercial bank lending, loan application is available to corporations and individuals online through P2P companies that evaluate borrowers’ credit rating with simple process and short cycle. A majority of P2P platforms provide loan business without collateral or third-party guarantee. In general, when borrowers pass P2P checking, the loan requests will be available online so that investors’ funds will be automatically sent to borrowers who can take money from the account at any time via the platform.

Compared with micro-credit companies, a part of P2P platforms only offer intermediary service that don’t need to reveal all the details, which has relatively low risk. Most of P2P platforms introduce guarantee companies to control risks. As a whole, the risk control ability of P2P companies is better than micro-credit companies. There is a wide range of borrowings in P2P lending, because any individuals with fund demands are access to send loan application online, which greatly expands the customer base of P2P lending. In addition, for investors, it is super easy to take part in the P2P lending with only less requirements. For example, the minimum investment of PP Dai, a P2P intermediary established in Shanghai, is only 50 yuan, which affords more investment opportunities to various people with different income levels.

3. Problems Arising from the Practical Application of P2P Lending in China

3.1 The transition cost of P2P lending is still at a high level

Compared with benchmark lending rate of Chinese central bank (annual interest rate below 5%), P2P websites have higher interest on loan, besides some transaction costs and service charges are generally higher than abroad, which makes the annual comprehensive transition cost reaches about 20%. It also increases the financing cost of SMEs and other borrowers and decreases the demand of SMEs to some extent, an obstacle to the rapid development of the P2P lending.

3.2 Unsound credit investigation system of domestic individuals and corporations

Establishing and improving individual credit rating system is the precondition of the existence and development of P2P Lending. While, in China, only the People’s Bank of China has relatively authoritative individual credit rating system. The development of other credit rating industries is still in an embryonic stage. There is no convenient or reliable credit rating data available to P2P platforms. If they build their own credit rating system, there will be series of problems emerging, such as long cycle, high cost and lack of professionals. Hence, it is hard for P2P platforms to know the credit worthiness, which cannot guarantee the safety of investors’ funds.
3.3 Operating risk accumulation of P2P platforms and SMEs

In recent years, frequent risk events have been occurred in P2P platforms, which have negative influence on the stability of SME financing. The short life cycle, high bankruptcy rate and low risk tolerance make borrowing become harder.

3.4 Lack of supervision in P2P lending

Although P2P lending introduced lately into China, the pace of development outpaces the regulation followed. There are still some undefined areas in current management approaches. First problem is the vague and relatively low market barriers of entry. The second one is the vague exit strategy that results in borrowers defaulted. Lastly, the advance of regulation policy is not enough.

4. Solutions and Suggestions for P2P Lending Solving the Financing Problems of SMEs

4.1 Establishing and improving the credit rating system of SMEs

First of all, it is necessary to cultivate credit consciousness. In the environment of unsound credit evaluation and regulation system, the losing credit cost of borrowers is very low and tending to zero, so that the P2P lending cannot be continued, let alone play the role in SME financing. Secondly, establish the corresponding incentive system, which aims to motivate creditworthy people to invest and penalize people who lost the trust. The third way is building the sound social credit system step by step and developing professional third-party credit rating agencies. Besides, the development of internet technology enables credit data to realize information sharing. Credit files, as the basis of credit guarantee, is established by using the optimization and integration of social credit institution to record, investigate and evaluate individuals or corporations credit records.

4.2 Strengthening the risk control of P2P platforms

P2P platforms not only reinforce audit of SME borrowers, but also strengthen loan security control of SMEs and set up firewall mechanism. P2P platforms should establish a perfect risk control mechanism and a scientific and rational credit rating system in terms of personal identity, property income of borrowers, and existing credit records, which controls risk sources. Importantly, they should firmly implement the principle that the higher credit rating results in the lower loan interest rate and the longer loan period. They strengthen the financial security through cooperating with third-party-financial supervision platforms. Besides, they require top-level design guidance at the national level to effectively curb the occurrence of loan defaults through the external environment.

4.3 Improving laws and regulations on P2P lending and promoting sound and stable development of the credit industry

The financing model of P2P lending is essentially a kind of private loan, which can refer private financing laws and regulations in China and consider its own characteristics to help set up P2P financial laws and regulations. Furthermore, the large amount of funds of P2P platforms should be protected by law to prevent platforms from misappropriating funds or being theft.

4.4 Strengthening macro supervision

The priority is supervising P2P platforms by bringing relevant departments into the regulatory scope and mainly studying the market access (like capital and the talent requirements), compliance management and so on, which also can consider the supervision of micro-loan companies, regulated by local financial regulatory agencies through real-time monitoring and tracking of third-party fund lending platforms, etc. It also necessary to supervise borrowers, for example, using capital operations in bank and timely warning avoid the occurrence of credit default.

4.5 Promoting cooperation and self-discipline in P2P industry

China should set up the P2P financial industry association, or a P2P specialized committee in the
Chinese micro-credit alliance either or micro-credit institution, to promote the sound development of P2P financial model. The P2P financial industry association should have two functions at least. The first one is leading the establishment of the industry information and data sharing platform, to avoid excessive debts of borrowers and risks of repeated borrowing. The other one is setting the industry standard and promoting industry self-discipline, including compliance management (such as capital source, pricing, operational risk management, information security, risk reserve capital, risk-control mechanism, internal control, etc.), investor protection (information disclosure, customer information security, compliance and publicity of risk alerts, calculation methods of risk return index, etc.), industry environment construction (scientific exit mechanism and employees) and others.

4.6 Strengthening the development of SMEs

In the future, SMEs will gradually establish a perfect modern enterprise system to standardize the management and alter the patriarch-based management mode whose ownership and management are not separated, which will clear property rights and improve corporate governance. Meanwhile, SMEs need to improve the financial management ability, as well as transparency and standardized degree of information disclosure, in order to reduce the credit risks and information asymmetry between the P2P platform and the bank. Moreover, SMEs should learn relevant financial knowledge, enhance their credit consciousness, and be familiar with relevant business processes and principles of P2P lending to reduce the risk of default on P2P platforms.

Acknowledgement

This research was financially supported by the Nanchang Institute of Science & Technology Project Fund: Research on the Effectiveness of P2P Lending in Smoothing Financing Channels of Small and Micro Enterprises (GJKJ-16-08).

References


