Peer-to-peer lending to small businesses

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*The views expressed herein are those of the authors. They do not necessarily reflect the views or opinions of the Federal Reserve Board or its staff.
Where do small businesses get credit?

Share of outstanding dollars

- Commercial and savings banks: 63.1%
- Credit union: 8.5%
- Finance company: 5.3%
- Insurance company: 3.1%
- Brokerage or mutual fund company: 2.2%
- Leasing company: 0.5%
- Mortgage company: 16.2%
- Other: 0.3%

Source: 2003 Survey of Small Business Finances
Small business lending from commercial and savings banks fell and has not rebounded.
Lending Club loan applications

Thousands of loans

- Other-rejected
- Other-funded
- Small business-rejected
- Small business-funded

Years:
- 2007
- 2008
- 2009
- 2010
- 2011
- 2012
Lending Club loans funded

Thousands of loans

2007  2008  2009  2010  2011  2012

56   127   368   466   975  1,386

Other  Small business
Lending Club dollars funded

2007: $0.1
2008: $0.7
2009: $3.7
2010: $5.2
2011: $13.6
2012: $22.5

Millions of dollars

2007 2008 2009 2010 2011 2012

Other  Small business
Are loans for small business loans more likely to get funded?

• 6-7% of applications for small businesses are funded vs. 10-12% of applications for other purposes
• Estimate logit model controlling for observable characteristics
  • Loan for small business $\Rightarrow$↑ likelihood of funding
  • Each $1000 requested $\Rightarrow$↓ likelihood of funding
  • Each year employment $\Rightarrow$↑ likelihood of funding
  • Higher home price index $\Rightarrow$↑ likelihood of funding
  • Higher Fico score $\Rightarrow$↑ likelihood of funding
Average loan size by loan purpose

<table>
<thead>
<tr>
<th>Year</th>
<th>Pay off credit card</th>
<th>Pay off debt</th>
<th>Home improvement/purchase</th>
<th>Small businesses</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>$2,000</td>
<td>$3,000</td>
<td>$4,000</td>
<td>$5,000</td>
</tr>
<tr>
<td>2008</td>
<td>$4,000</td>
<td>$6,000</td>
<td>$8,000</td>
<td>$10,000</td>
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<tr>
<td>2009</td>
<td>$6,000</td>
<td>$8,000</td>
<td>$12,000</td>
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<tr>
<td>2010</td>
<td>$8,000</td>
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<tr>
<td>2011</td>
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<td>$16,000</td>
<td>$18,000</td>
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<tr>
<td>2012</td>
<td>$12,000</td>
<td>$14,000</td>
<td>$18,000</td>
<td>$20,000</td>
</tr>
</tbody>
</table>
Average interest rate paid by loan purpose

- Pay off credit card
- Pay off debt
- Home improvement/purchase
- Small businesses
How does this rate compare to other small business loan rates?

![Bar chart showing comparisons between LC Small Business Loans, NFIB Firms with 10+ employees, and NFIB Firms with <10 employees over the years 2007 to 2012.](chart.png)
Are loans for small business loans charged a higher rate?

• Average rate similar across loan types
• Estimate regression model controlling for observable characteristics
  • Loan for small business ⇒ $↑$ rate paid
  • Each $1000 requested ⇒ $↑$ rate paid
  • Each year employment ⇒ $↓$ rate paid
  • Higher Fico score ⇒ $↓$ rate paid
  • County per capita income ⇒ $↓$ rate paid
  • Home price index, county population ⇒ no impact on rate paid
Conclusions

• Peer-to-peer loans for small businesses have increased substantially since 2007
• Peer-to-peer loans for small businesses more likely to be approved, controlling for quality
• Peer-to-peer loans for small businesses pay a slightly higher interest rate, controlling for quality
Looking forward

- Peer-to-peer lending likely to continue to grow
- More research needs to be done on the long term impact of such loans on the longevity and profitability of firms using such loans (data not currently available)
- More education on the cost of such loans for potential borrowers seems in order