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FOR YOUTHS

P2P: Shaping the Future?

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Peer to peer (or P2P) platforms have, in recent times, taken the Malaysian alternative finance sector by storm. These platforms link individual investors directly to borrowers, which may consist of either individuals or businesses; as follows, P2P platforms are able to offer unsecured debt financing to these borrowers, in contrast to an equity-based financing model offered by equity crowdfunding platforms.

So then, the question needs to be asked: What does this mean to *me*? And with that: How does it actually work? Is it a big thing right now? How did it come to *be*?

History and Origins

Consumers, even today, are forced to go through numerous unpleasant procedures in order to secure a loan, be it personal or business in nature. The cumbersome process may involve: producing important documents – payslips, income tax statements, and even property grants as collateral –, or finding a guarantor who is capable of vouching for our credibility, which means bearing remaining debts should we fail to repay them. (He or she may be an unsurprisingly difficult person to procure in such a mistrustful age!) On the flip side, financial institutions face similarly complex proceedings; bureaucratic management make the process of administration and accessing the debtor lengthy and hierarchical. It is clear that these pre-existing formulas need to give way for a sleeker, efficient system.

The UK firm Zopa became aware of these pressing problems, and, in 2005, tinkered a simplified, net-based financing method in order to fix them. This strikingly original initiative, first known as the P2P Lending System, targeted the personal loan segment; it eventually proved to be an unprecedented success. Fast forward to today, the firm has reportedly lent more than £1.42 billion in personal loans. In 2010, a fledgeling firm called “Funding Circle” became the first to facilitate P2P lending for business funding in the UK— it now operates in both US and UK markets. As of January 2016, Funding Circle has reportedly lent over £1 billion to small and medium-sized enterprises (SMEs).

Interestingly, the period between 2008 and 2010 saw a sharp increase in P2P companies; we may attribute this to the widespread collapse of traditional commercial banks, an unfortunate consequence of the Global Financial Crisis. The downfall of these industry giants stems from traditional lending's sloppy processing— a crucial factor that led to the related subprime loan crisis. Today, the P2P system is being utilized extensively in the UK and China, while advancing slowly yet steadily in the US… but, for practical purposes, we ask: what about sunny, homely Malaysia?

The news offers us an answer: it suggests that the concept of P2P remains a very new one to the general Malaysian population, and, unsurprisingly, one that is understood by a very small, alternative-embracing minority. Thankfully, our government seems to have warmed up to the initiative; noticeable efforts have been made in creating policies, rules and regulations to facilitate widespread implementation, and to spread awareness of the subject in public consciousness. In a much-lauded effort to expand the financing access for SMEs, the Securities Commissions of Malaysia appointed six operators to administer P2P platforms: (a) B2B FinPAL, (b) Ethis Kapital, (c) FundedByMe Malaysia (d) ManagePayServices, (e) Funding Societies Malaysia (Modalku Ventures), (f) Fundaztic (Peoplender). It is worth noting that, in 2016, Malaysia became the first ASEAN country to manage a regulated P2P financing system.

The evidence above certainly gives us the impression that the initiative is clearly one that has received substantial backing from several parties; the fact that the P2P platform is in for a very promising future in Malaysia no longer seems like such a stretch now— provided, of course, that accompanying challenges are deftly dealt with.

P2P as an Alternative to Conventional Loans and Conventional Investment

Now that some light has been shed on historical and geographical context, we may now fix our gaze on the mechanics and intricacies that belie P2P, and how they are responsible for the platform's immense profitability and efficacy.

To put it bluntly, P2P lending is a method of debt financing that enables individuals to borrow or lend money without the use of official financials institution working as intermediaries (Investopedia). This means that debtors (borrowers) are given access to financing through borrowing directly from creditors (lenders); there is no longer a need to go through a third party, which, in most cases, tend to consist of commercial banks. In short, the middlemen are removed from the loaning process, leaving only borrowers and lenders. Borrowers who utilize P2P have a lower chance of their loan application being rejected — often as a result of poor credit history —, and are able to dodge high interest rates and administration fees.

This simplified structure greatly accelerates the fund disbursement process, spelling good news for borrowers. More often than not, there are fewer prerequisites when applying for a loan through the P2P platform— the lender, in most cases, requires fewer documents from the borrowing side, thereby reducing unnecessary paperwork, administration and transactional costs. By linking borrowers to a constant stream of willing lenders, the P2P platform is also able to provide a greater availability of loans than traditional lending methods, ultimately reducing delay in relaying funds.

Creditors who utilize P2P, on the other hand, are able to enjoy lower interests rates and higher investment returns than commercial banks. These percentage returns scale much higher than those of a bank's fixed deposit. (A fixed deposit is an account that holds money for fixed amounts of time, usually 6-12 months.) Unfortunately, these higher investment returns are accompanied by higher risks, meaning that there is an increased chance of loan default. A creditor thus has to give much care when scrutinising potential borrowers and when selecting appropriate risk categories for lending purposes. Both lenders and borrowers can capitalize on lower interest rates and reduced transactional cost, making P2P a very viable option for both parties.

P2P's Current Role and Potential Role in Our Lives

Currently, the Securities Commission Malaysia permits P2P platforms to provide business financing at most— only invoice financing and business loans options are available. As defined by Investopedia, invoice financing is: "A way for businesses to borrow money based on amounts due from customers". This is able to: "help businesses improve cash flow, pay employees and suppliers, and reinvest in operations and growth earlier than they could if they had to wait until their customers paid them". Business loans are simply loans for businesses.

P2P financing, as it stands, is very limited in Malaysia; nevertheless, experts predict tremendous growth sometime in the near-future. Through adding personal financing products such as hire purchase, mortgage and student loan services to the platform, this new mode of financing stands to disrupt our lives in ways much closer to home. Commercial banks, in particular, will find this an unwelcome development; the increased competition could force them to provide better services at more competitive prices— providing a win-win situation for consumers.

Furthermore, a finding by Transparency Market Research (2016) suggests that "the opportunity in the global peer-to-peer market will be worth $897.85 billion by the year 2024, from $26.16 billion in 2015. The market is anticipated to rise at a whopping CAGR [Compound Annual Growth Rate] of 48.2% between 2016 and 2024." This signify immense growth opportunities for the sector and potentially be on par with the traditional banking lines in the future.

Conclusion

In conclusion, the P2P platform omits the need for financial intermediaries, offering a straightforward, direct means of financial transfer between borrowers and lenders. This reduces transactional costs for borrowers while offering higher returns (albeit with higher risk) to lenders. At time of writing, a lack of associated legislation is still causing Malaysia to lag behind global counterparts; regardless, sharp speculators should perk up and take notice. The legalisation of personal financing products on the P2P platform is anticipated to happen sooner than expected— a development that could herald our nation's financial ascension, and perhaps spell doom for pre-existing financial intermediaries.

References

Transparency Market Research (2016) ‘Increasing Small Business Units to Act as Building Blocks for Peer-to-Peer Lending Market’ Available at: https://globenewswire.com/news-release/2016/08/31/868470/0/en/Increasing-Small-Business-Units-to-Act-as-Building-Blocks-for-Peer-to-Peer-Lending-Market.html [Accessed 21 Nov 2017].

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