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PERSON-TO-PERSON LENDING

IS FINANCIAL DEMOCRACY A CLICK AWAY?

Prepared under AMAP/Financial Services, Knowledge Generation Task Order

microREPORT #130

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I. EXECUTIVE SUMMARY

Direct lending between friends, family and neighbors has existed since before formal banks, legal agreements and even currencies. These loans were often small, and much like today's "microfinance" loans relied on relationships of trust between individuals, or social capital. Today, formal banks play a large role in financial intermediation, which has allowed for scale, transparency and efficiency, but has failed to meet the financial needs of the poor. The birth of the microfinance industry stems from this need to provide even the smallest businesses with sources of financing. Microfinance institutions (MFIs) and other specialized financial institutions have been able to serve as delivery channels for micro and even small and medium enterprise (SME) lending where banks cannot. With the birth of the internet, a new form of non-bank lending has arisen, borrowing from traditional reliance on trust within communities but extending the concept of community beyond geographic boundaries. Beginning with Zopa in the United Kingdom in March 2005, person-to-person (P2P) internet sites began serving as intermediaries between borrowers and lenders in various developed economies including the United States, United Kingdom, Australia, Germany, and Poland. Although these platforms still represent only a small portion of the financing available to businesses, they have been growing rapidly and could be a significant source of capital in the future. Moreover, they may help expand access to finance for the "unbanked", reduce unnecessarily high interest rates and "democratize" both developed and developing country credit markets by reducing the role the middle man in financial intermediation.

The P2P lending market, which began as a web-based market between borrowers and lenders in the same country, has begun to expand internationally, extending virtual communities and linking lenders in developed countries to borrowers in developing countries. As such, it has drawn attention to its potential to contribute to a broader effort to improve access to finance to the poor in the developing world, an area which is currently being addressed by international and bilateral donor organizations, socially responsible investment funds and to some extent, commercial investors and banks. For micro, small and medium enterprise (MSME) lenders, and particularly for microfinance institutions, the growing success of the P2P marketplace offers an opportunity to increase access to capital and diversify funding sources by attracting a new investor class of small, socially motivated investors.

As the microfinance industry has grown and developed over the past ten years so has the variety of funding sources available to MFIs. Many MFIs were initially started up and financed with funding from donors and multilateral agencies through the late 1990s. Donor loans, guarantees and donor-supported investment funds provided an important demonstration effect to commercial investors, showing that these institutions were financially viable as well as profitable investments. By the early-2000's, as stronger MFIs became sustainable and sought to bring their models to scale, there was an increasing need for them to access greater sums of capital, which donors alone could not provide. Where regulation allowed, many MFIs began to transform into regulated entities, raising deposits to fund their expansion. In other cases, institutions issued debt in local capital markets and borrowed from commercial banks. Despite these successes, the need for capital far exceeded the supply and a number of socially motivated yet commercially oriented funds developed in response. Most of these funds, which have grown significantly over the past four years, provide debt funding to MFIs through direct loans, which are sometimes re-packaged as CDOs (Collateralized Debt Obligations) or CLOs (Collateralized Loan Obligations) or sold to investors through other investment and fund vehicles. The majority of these funds have relatively high minimum investment criteria and are generally accessible only to high net worth individuals, private foundations, and socially responsible or commercial institutional investors.[1] Individual or retail investors, seeking to lend small amounts, have had limited access to these investments until recently. In November 2005, the launch of Kiva (www.kiva.org) began to eliminate some of the constraints that private individuals face to investing in microfinance by both reducing the minimum investment amount required and providing easy access though an online P2P lending platform. Since Kiva's launch, a number other web based platforms with similar goals have emerged including MicroPlace (www.microplace.com), dhanaX (www.dhanax.com), MyC4 (www.myc4.com), RangDe (www.rangde.org), Investors Without Borders (www.investorswithoutborders. wordpress.com) and Globefunder India (www.globefunder.in). The geographic coverage and business models of these sites differ, but all aim to provide (directly or indirectly) additional capital to micro, small and medium enterprises in developing countries.

This paper explores the different models employed by the existing P2P platforms, their outreach and potential for scale in the future, the constraints to their growth and new issues which may arise with the growth of online P2P lending. It seeks to outline the benefits and constraints to these models as an alternative to formal financial institutions as we strive for universal access to finance. P2P sites have the potential to advance the democratization of access to capital as well as access to investments. They offer borrowers a convenient source of loan capital, often at more favorable terms than formal financial institutions. The recent credit crisis in the United States has revealed that they may become an important and perhaps the only source of funds for large groups of borrowers as credit conditions continue to tighten. P2Ps offer investors access to a broader range of investment opportunities previously available only to institutional or high net worth individuals. However, we have seen that some models may offer greater advantages than others. Many domestic models that use auction techniques to set rates are moving towards less expensive financial intermediation. In microfinance, we have yet to see a significant impact on borrowers in the form of cheaper funds; however, we do not discard the importance of greater access to finance and diversification of funding sources for borrowers and MFIs alike. Recently many larger MFIs have turned to savings to reduce their costs of funds; however, for many smaller institutions the cost of transforming into a deposit taking institution is prohibitive due to limited volume, capacity or positioning in highly competitive environments. These institutions are often the ones serving some of the poorest segments of the population and who may be most vulnerable to the whims of "commercial" external funders. Their ability to

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[1] The exception to this was the Calvert Foundation's community investment notes which were available in denominations of $1,000. After Calvert Foundation's listing on MicroPlace, the minimum note denomination fell to $50.

tap into new socially oriented funds including P2P platforms may be the difference between success and failure over time.

While the P2P lending space has shown signs of quickly adapting to market changes and to broadening access to financial intermediation for both borrowers and lenders, it is still a nascent industry and has yet to demonstrate its potential for scalability. Constraints including regulatory hurdles, limited and inconsistent transparency of information, and marketing challenges are significant, and could stifle industry growth. The current credit crunch and complex environment for financial services worldwide will likely test these models and provide greater clues as to whether the democratization of financial intermediation is really a click away or whether traditional credit sources will prevail, perhaps borrowing some of the mechanisms of these models.

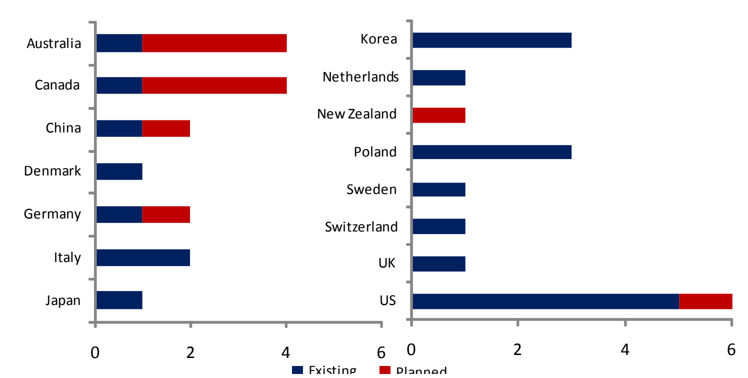
II. INTRODUCTION

HISTORIC CONTEXT AND INFLUENCE OF THE INTERNET

Person-to-person lending is not a new concept. People have been circumventing traditional bankers and lenders for thousands of years lending both money and goods (such as grains and other crops) to family members, friends and neighbors in times of need or surplus. More formal systems for lending directly to one's peers have also been around for many years, such as ROSCAs (Rotating Savings and Credit Associations) and self-help groups (SHGs).[2] In ROSCAs and SHGs individuals in a community pool their limited resources so that a few members of the group can use the funds to invest in their business or other activity. During the next cycle, once the first loans are repaid or the members have saved enough to make new loans, different members of the group will receive the pooled funds.

In 2005, Zopa UK was founded by James Alexander and Richard Duvall, who reinvented the concept of P2P lending by combining a traditional community based P2P lending model with a more "modern" concept of online commerce and social networking. It looked to the success of platforms like eBay, where strangers responsibly bought and sold goods following a fixed set of rules responsibly despite limited supervision and regulation. Other online social networking sites such as MySpace and Facebook showed that the internet could eliminate the need for geographic proximity in social relationships. In dating and friendship, for example, functions once exclusively performed in person, these internet sites have complemented and even replaced traditional forms of social interaction and trust building. Similarly, Zopa removed the geographic constraints of traditional P2P lending mechanisms and extended the community from which someone can borrow. Today, there are over 25 P2P lending sites in Australia, Canada, China, Denmark, Germany, India, Italy, Japan, Korea, the Netherlands, Poland, Sweden, Switzerland and the United States and at least another ten are expected to launch soon. Most seek to maintain the personal nature of P2P lending despite the often great distances between the borrower and the lender. VirginMoney from the UK most closely imitates historic P2P

Figure 1: Domestic P2P Platforms by Country



[2] Hans Dieter Seibel found that ROSCA's date back until at least the 16th century when Yorubas slaves brought the practice with them to the Caribbean. Seibel, Hans Dieter. "Mainstreaming Informal Financial Institutions," Journal of Development Entrepreneurship, Vol. 6 no. 1(April 2001): pg 83-95.

lending by working exclusively with loans between family and friends. On most platforms, heartfelt borrower stories and pictures are posted in order to personalize lending. Some platforms have added blog features which allow lenders and borrowers to communicate on an ongoing basis (i.e. Zopa, MyC4, Investors Without Borders, Prosper). In addition, many of the platforms in developed countries have leveraged the idea of internet based social networking to connect borrowers and lenders. LendingClub partnered with the very popular social networking platform Facebook in order for lenders and borrowers to connect through their own network or their friends' networks. Later they expanded beyond Facebook but continued to use the idea of social networking by allowing lenders to search by affinity groups or borrower characteristics such as hometown, university, profession or hobbies. Lenders feel a bond and a greater degree of trust because of these shared characteristics while borrowers are meant to feel a greater responsibility. Zopa USA also encourages borrowers to tap into their existing social networks to help reduce the interest rates on their loans. (See Box 1). Domestic P2P platforms where borrowers and lenders are in one (typically developed) country have been able to connect borrowers and lenders directly. In developing countries, however, where computer and internet usage is more limited, social networking is less prevalent and information and transparency less available, the borrowers on P2P sites do not typically access the platform themselves but work through an intermediary such as an MFI. These P2P sites, geared toward international micro, small and medium enterprise (MSME) finance present their own set of challenges and opportunities.

OVERVIEW OF P2P LENDING PLATFORMS IN DEVELOPED ECONOMIES

All of the P2P lending platforms in *developed* countries reviewed for this research were established as for profit companies to provide alternative sources of capital for personal loans. Most serve as a marketplace for loans, where buyers and sellers "meet online" and can set their own "prices", or interest rates, and terms of the loan. One of the goals of many platforms is to "democratize" financial intermediation, eliminating the role of the traditional bank in financial intermediation and instead allowing lenders to control her/his own asset management decisions and borrowers more flexibility and access to capital. Zopa UK's founders Alexander and Duvall saw the site as an opportunity to create an online community to serve the financial needs of the "freeformer", a new type of consumer, tired of institutions and who thinks like an entrepreneur.[3] It was designed to bring lenders and borrowers together and to cut out the middleman in lending to create a marketplace for "social lending" offering "a smarter, fairer and more human way of doing money".[4] P2P platforms allow lenders to build their own individualized loan portfolio based on their personal risk, financial return and social return preferences and provide a channel to invest in asset classes previously reserved for "elite" formal financial institutions, such as small and medium enterprise (SME) loans and consumer credit. For borrowers, these

[3] http://www.financial-spread-betting.com/Richard-duvall-zopa.html
[4] http://uk.zopa.com/ZopaWeb/public/about-zopa/big-idea.html

platforms have the ability to eliminate or reduce many of the potential prejudices in the formal banking sector such as race or gender.[5]

Table 1: Key Characteristics of Domestic P2P Platforms

Name	Launch Date	Legal Status	Country of Orgin	Geographic Coverage	Methodology	Funds Lent on Site to Date (1)
Zopa	Mar-05	For Profit	United Kingdom	United States, United Kingdom, Japan, Italy	P2P "silent" auction site in UK; Credit Union partnership US	44,500,000
Donjoy	2005	NA	Korea	Korea	NA	NA
Prosper	Feb-06	For Profit	United States	United States	P2P Auction	164,000,000
smava	Feb-07	For Profit	Germany	Germany	P2P Auction	5,400,000
boober	Feb-07	For Profit	Netherlands	Netherlands, Italy and "International"	P2P Auction	3,800,000
fairrates	Apr-07	For Profit	Denmark	Denmark	P2P Auction	Closed
Frooble	May-07	For Profit	Netherlands	Netherlands	NA	Closed
lending club	May-07	For Profit	United States	United States	P2P Resaler, Affinity Group Lending	18,000,000
Ppdai	Jun-07	For Profit	China	China	P2P Social network - friends and friends of	NA
Igrin	Oct-07	For Profit	Australia	Australia	P2P Auction	150,000
Loanland	Dec-07	For Profit	Sweden	Sweden	P2P Auction	NA
Money Auction	2007	NA	Korea	Korea	P2P Auction	NA
Popfunding	2007	NA	Korea	Korea	P2P Auction	NA
IOU Central	Feb-08	For Profit	Canada	Canada	P2P Auction	Suspended
Kokos	Feb-08	For Profit	Poland	Poland	P2P Auction	600,000
Monetto	Mar-08	For Profit	Poland	Poland	P2P Auction	500,000
Finansowo	Mar-08	For Profit	Poland	Poland	P2P Auction - Acquaintances	NA
fynanz	Mar-08	For Profit	United States	United States	P2P for Students	NA
cashare	Apr-08	For Profit	Switzerland	Switzerland	P2P Auction	NA
greennote	Jun-08	For Profit	United States	United States	P2P for Students	NA

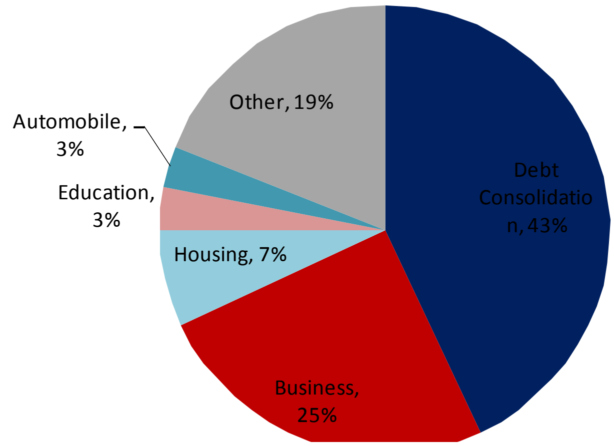
Note: Does not inlcude P2P platforms which are planned but have not yet been launched.

(1) Most recent available as reported by the respective platforms or elsewhere online. Note the $9.4MM reported by Lending Club excludes $8.6MM in loans which have been made by the site and are currently being held by LendingClub.

[5] Freedman, Seth and Jin, Ginger Zhe (2008 preliminary study) "Dynamic Learning and Selection: the Early Years of Prosper.com", University of Maryland, available at http://www.glue.umd.edu/~ginger/research/Freedman-Jin-ProsperStudy-061008.pdf.

Borrowers on domestic P2P sites can generally access loans for a broad range of *uses*,[6] resulting in greater weighting of the types of loans that tend to be most costly or difficult to access from banks, as can be seen by the usage of loans originated on Prosper in Figure 2. The flexibility of these market places has helped borrowers reclaim control of their finances and escape the debt cycle of high fee, high interest credit cards or money lenders as loans can be used for debt consolidation or in lieu of payday loans.

Figure 2: Distribution of Prosper Loan Usage



The increase in the number of P2P lending platforms launched over the last three and a half years has been exceptional. There are now at least twenty active P2P platforms, ten of which were launched in 2007 and seven of which were launched thus far in 2008 (at least another 9 platforms are currently underway). P2P usage is also booming: as of August 2008, US$164 million in loans had been transacted on Prosper, nearly US$45 million had been arranged by Zopa UK and, as of July 2008, US$5.4 million on Smava. Part of this growth can surely be attributed to a growing awareness of online P2P lending, but it is likely that some of these sites have also been boosted by the changing credit landscape worldwide. Three years ago, borrowers had easy access to credit, and as the recent credit crisis has shown, more than many people could handle. The ensuing credit crunch and the burden of existing debt on families have likely attracted many families to the P2P marketplace. As banks tighten credit criteria, borrowers are turning to social financing networks for their credit needs. Managers of Prosper report that even on P2P platforms, lenders are not immune to the credit crisis and have also changed their behavior, tending to favor less risky, higher rated borrowers; the market has not shut for riskier borrowers but lenders are demanding higher interest rates. Whether this marketplace will provide any relief for some of the casualties of the credit crisis is unclear, but it is encouraging to see signs that the model incents prudent lending behavior that adapts to market conditions and risk perceptions.

OVERVIEW OF ONLINE LENDING PLATFORMS GEARED TOWARDS MICROFINANCE OR DEVELOPING ECONOMIES

Since 2005, the Year of Microcredit, when Dr. Mohammed Yunnus was awarded a Nobel Peace prize for his work in microfinance and poverty alleviation, demand for microfinance investment vehicles has also grown significantly. It is not surprising that this growth paralleled an era of

[6] Exceptions include specialized sites such as www.fynanz.com and www.greennote.com which cater to students.

extreme liquidity in global credit markets and a positive financial market environment where commercial investors began to turn to microfinance, initially to complement their strong performance with activities that also provided a social return, and in some cases to “reach for yield” or provide diversification of international portfolios. Investing in microfinance and MSMEs taps into the growing market for corporate social responsibility that aims to invest “responsibly” in products with a double or triple bottom line: financial return, social return and environmental return. It follows that such a desire to invest responsibly should not be limited to institutional investors, international or bilateral organizations, or high net worth individuals that make up the bulk of the international microfinance investment market. Thus, one of the major innovations of online platforms geared towards developing economies has been their ability to make investments in the microfinance sector or directly in MSMEs accessible to individual or retail investors for as little as $10 or $20.

The first online P2P lending platform geared towards microfinance was Kiva, which launched in November 2005, approximately six months after the launch of Zopa in the UK. There are now seven online platforms dedicated to providing capital to micro, small and medium enterprises in the developing world: three work exclusively in India, two work exclusively in Africa but plan to expand their geographic coverage over time, and two work globally.

Table 2: Key Characteristics of International P2P Platforms

Name	Launch Date (1)	Legal Status	Country of Orgin	Geographic Coverage	Methodology	Funds Lent on Site to Date (2)
Kiva	Nov-05	Non-profit	Un ited States	Global	Intermediary Model	49,000,000
MyC4	May-07	For Profit	Denmark	Uganda, Kenya, Cote D'voire, Rwanda, Ghana	Intermediary Model	6,750,000
MicroPlace	Oct-07	For Profit	Un ited States	Global	Investment Fund Model	NA
Rangde	Jan-08	Non-profit	India	India	Intermediary Model	20,000
dhanaX	Feb-08	For Profit	India	India	Intermediary Model (Pure P2P to come)	25,000
Investors Without Borders	Expected in 2009	For Profit	Un ited States	Ghana (to start)	Intermediary Model and Pure P2P	-
Globefunder	Pending	For Profit	India	India	Intermediary Model	-

(1) Investors Without Borders and Globefunder India are not yet operational.
(2) As of September 2008 as reported by the respective platform on-line or during interviews with management

One of the major differences between the P2P lending platforms in developed economies and those which target developing countries is the use of intermediaries to identify, verify and register borrower information and to handle repayment and collection efforts. The use of intermediaries has been necessary, in part because potential borrowers do not have access to the internet and/or do not have the financial, computer or even alphanumeric literacy necessary to apply for a loan and in part because of the need for a local presence to ensure credit quality and to facilitate disbursement. Whereas in developed economies, lenders can use credit history, credit scores and some of their own local knowledge to make lending decisions, developing markets rarely have reliable credit bureaus, and microentrepreneurs in particular are rarely registered in local credit bureaus. Moreover, money transfers across borders, particularly

Box 1: An Independent Woman in a Male Dominated Business

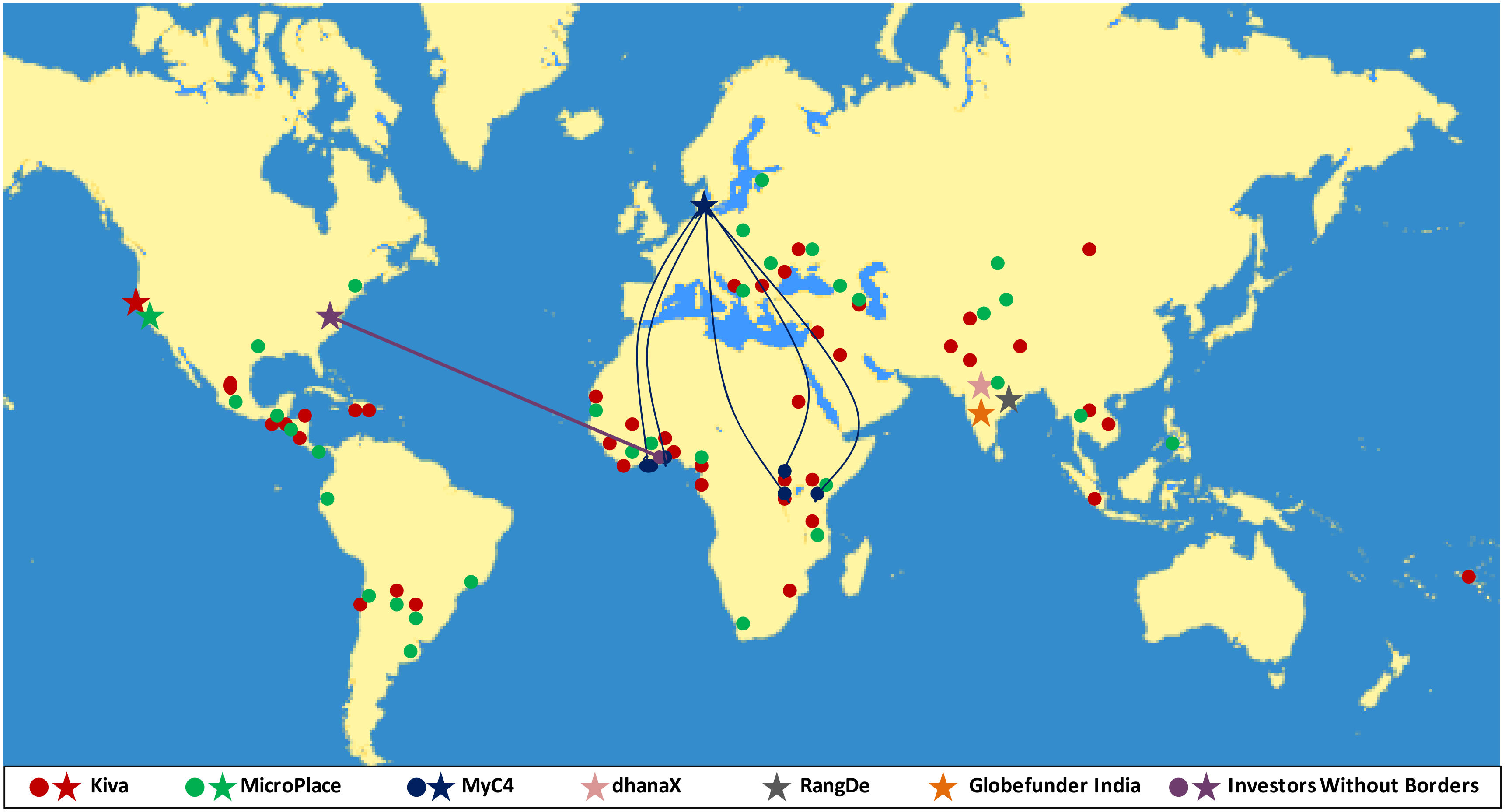
An example of one of the many female entrepreneurs who has received loans through MYC4 is Catherine Akwir, who sells vehicle parts at Uganda's biggest market for spare parts. In 2007 she received her first loan of EUR 250, which enabled her to buy spare parts of a higher quality and increase her stock to meet customers' demands. Using this loan, she increased her monthly income by 30% making it possible to support her household and send her children to school. Catherine's entrepreneurial spirit is her driving force. In spring 2008, she applied for a new loan. Having paid back her first loan as scheduled, she was quickly approved for the next loan. On May 16, 2008, Catherine received her second loan to expand and develop her business. When asked about MyC4, Catherine says, "The loans I have received from MYC4 give me the opportunity to become an independent business woman so that I can support my household and pay for the schooling of my children."

Photo and story provided curtosy of MyC4.

to unbanked individuals in developing countries, are subject to complex regulatory restrictions and are costly. Intermediaries allow resources to be pooled to reduces costs and facilitate the disbursements of these small fund transfers. New models are emerging that seek to tackle some of these constraints and provide direct lending through P2P sites. Investors Without Borders (IWB), which is expected to be operational in 2009, for example. Its target borrowers are small enterprises, however, rather than microenterprises. If these businesses meet certain criteria they are able to apply for a loan directly on the IWB platform.[7] If they do not meet these criteria, they can still work through one of IWB's field partners in order to access a loan on the platform. dhanaX in India also plans to allow larger businesses to apply for loans directly; however, this feature is not currently operational.

[7] In order for a business to apply for a loan directly on IWB, it must be a registered business; have been operational for at least 2 years; have tax, bank or financial statements to prove its operational history and be a member of a local, regional or global business or professional association. Even if it meets these requirements, it is still visited by one of IWB's local partners.

Figure 3: Geographic Coverage of Microfinance Focused Platforms



III. COMPARISON OF DIFFERENT "P2P" LENDING MODELS

The lending platforms described in the previous section all ultimately connect those with surplus capital to those in need of capital; however the manner in which they do so varies dramatically. Below we outline the three main models used to facilitate on-line lending and investing: the "Direct" P2P model; the "Intermediary" P2P model; and the " "MicroPlace" model. The latter, cannot really be considered a person-to-person lending platform, as the investor's risk is not with the ultimate beneficiary of the funds (the MSME), but rather with a security issuer which uses the funds to expand its portfolio of loans and investments in the microfinance sector. Nevertheless, this model is included below because of its potential for scale and its focus on making microfinance and other social investments accessible to the retail investor. The model used by Zopa in the United States is also discussed separately in Box 2 given its use of social networks and unique risk structure.

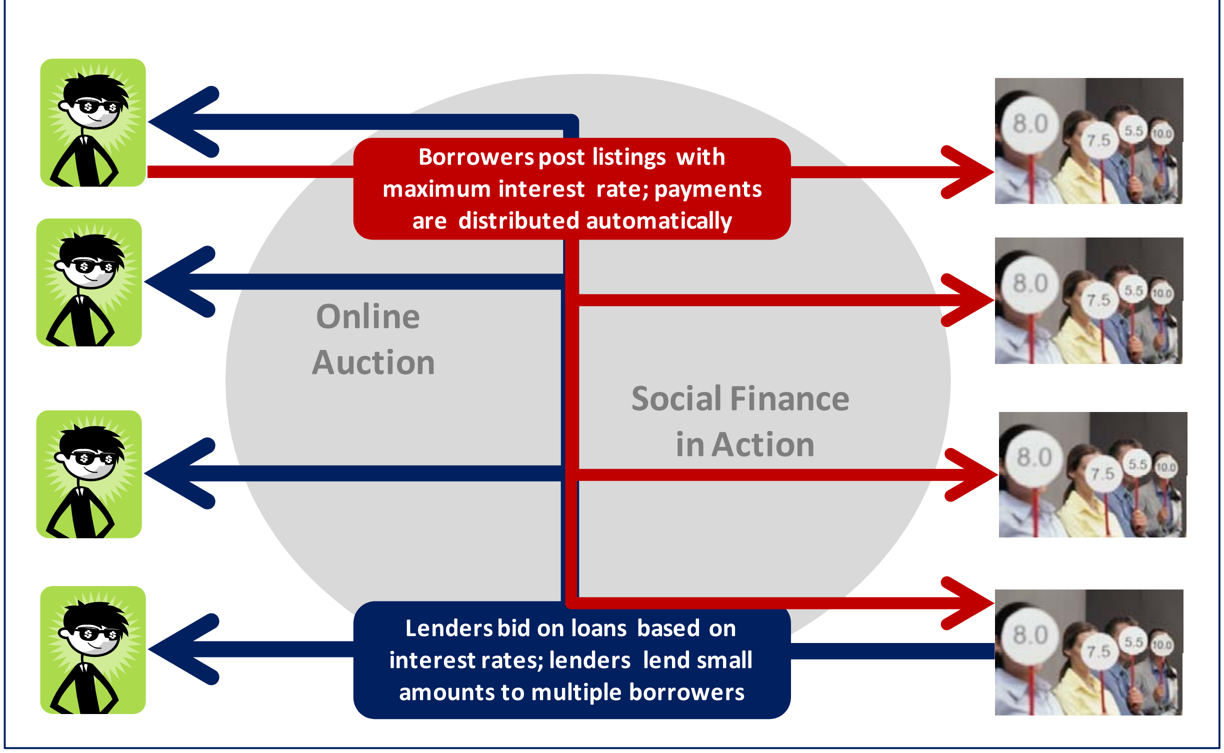
DIRECT P2P MODEL

In the Direct P2P model, the online platform is designed to be a virtual marketplace for lenders and borrowers to meet and to facilitate the transaction once the loan terms have been agreed upon. (See Figure 4). Borrowers can share information about themselves, what they plan to use the loan for and what their price or maximum interest rate is, while lenders can browse through the loan "offerings" and chose who they would like to lend to based on their risk appetite and other preferences. They can also chose the amount they would like to lend to each borrower, within a range set by the P2P platform. In order to assist lenders in their decision making, most Direct P2P models provide some type of credit rating or other financial ratios, as well as the credit history of the borrower on the site, but they do not set the interest rate on loan. This is determined by the lenders and borrowers, usually through an open auction with lenders biding on the interest rate they are willing to receive for a particular loan. Once the auction ends, the winning bids are consolidated and one loan made to the borrower. After closing, generally the P2P platform handles the administration of the loan, but there is at least one notable exception in Poland, Finansowo (www.finansowo.pl), which leaves loan disbursement and repayment to be arranged by the lender and borrower.

Chris Larson, founder and CEO of Prosper (www.prosper.com) in the United States, sums up the concept of a Direct P2P lending platform well, "we see ourselves as the EBay for loans". In order to ensure decision making power rests with Prosper users, the company seeks to regulate borrowing and lending on the site as little as possible. Mr. Larson believes that given enough time and scale, lenders will eventually get the pricing on loans "right", just as they would the fair price of an item on EBay. Prosper strives to make transactions and data as transparent and easily assessable as possible to facilitate lenders' ability to "get it right".

Other platforms that can be considered to be Direct P2P models include: Kokos (www.kokos.pl) and Monetto (www.monetto.pl) in Poland; Loanland (www.loanland.se) in Sweeden; Cashare (www.cashare.ch) in Switzerland and IOU (www.ioucentral.ca) in Canada. There are currently no microfinance or developing economy platforms which could be considered Direct P2P models, however as mentioned previously dhanaX (www.dhanax.com) and Investors Without Boarders (www.investorswithoutborders.wordpress.com) both seek to operate through intermediaries and with a Direct P2P lending model. dhanaX founder Siva Prasad Cotipalli has dubbed this an “online offline” P2P platform.

Figure 4: Diagram of Direct P2P Model



Given the regulatory environment in most countries, the actual loan disbursement process may be more complicated than the above diagram shows (for example, loans originated through Prosper are actually made by its affiliate WebBank in Utah based on the terms determined by Prosper lenders).

There are variations of the Direct P2P model, such as LendingClub (www.lendingclub.com) in the United States, Zopa (www.uk.zopa.com) in the United Kingdom and Ppdai (www.ppdai.com) in China. LendingClub sets the terms of a loan itself and then offers the loan online to investors. Normally a loan would not be funded until investors had committed to finance 100% of it; however as LendingClub is awaiting SEC approval for a $660 notes issuance, it has temporarily halted its operations with lenders. It is still making loans and holding them on its balance sheet to later resell to investors.[8] Zopa UK allows lenders to set their interest rate thresholds according to loan term and risk rating; borrowers can then see what type of financing is available to them and choose to borrow when the terms are favorable. China’s Ppdai uses a

[8] Once LendingClub receives approval from the SEC, they will issue Notes to investors with terms and amounts corresponding to the loans in which they have invested.

standard Direct P2P auction model, but has limited transactions to acquaintances in order to reduce risk, meaning borrowers can borrow from their friends or friends of friends. Similarly VirginMoney works to facilitate loans between family and friends, but it does not match the borrowers and lenders; rather it provides loan documentation templates and servicing once a loan has been agreed.[9]

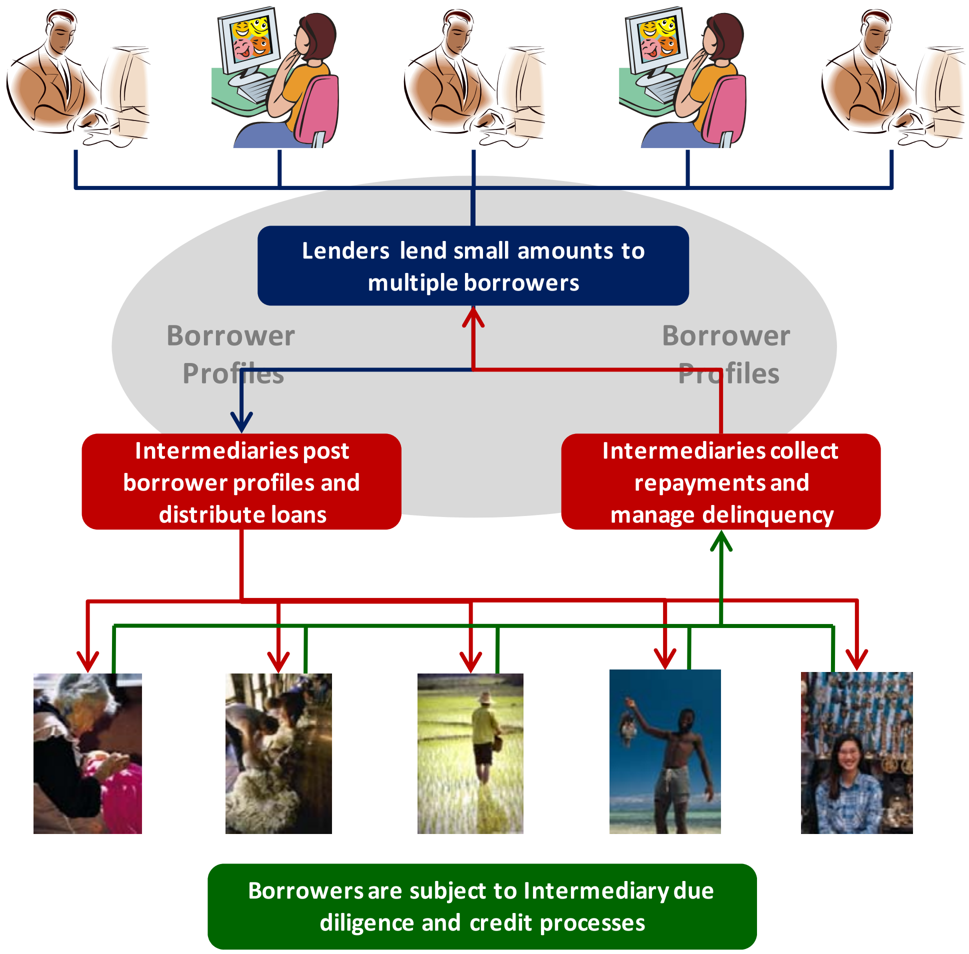
INTERMEDIARY P2P MODEL

In developing countries there are many constraints to using a Direct P2P model to connect borrowers and lenders. One constraint is a lack of internet access and/or financial and computer literacy on the part of the borrower, another is the absence of reliable credit bureaus or ways of confirming borrower information and credit worthiness. To address these constraints, *intermediary* P2P models such as Kiva (www.kiva.org), MyC4 (www.myc4.com), dhanaX (www.dhanax.com), RangDe (www.rangde.org) and Investors Without Borders were established to facilitate lending to *developing* countries. Under this model, the website itself still serves as a marketplace for lenders, who can search for and select their borrowers, but the loan is sourced, verified, disbursed and serviced by an intermediary such as an MFI or NGO with a local presence. (See Figure 5). Partner institutions play an important role in the intermediary P2P model in the selection and credit assessment of borrowers because many of the platforms targeting *developing* countries are located in *developed* countries. This distance, combined with the absence of credit bureaus, makes it difficult to otherwise identify strong borrowers and confirm the information provided by potential borrowers to maintain the integrity of the platform. Hence, all of the developing country oriented platforms looked at in the research, currently use local intermediaries to facilitate loans made on their sites.[10] The type of partner varies by platform. Kiva works exclusively with MFIs who already have an existing loan portfolio, while MyC4 works with organizations that source borrowers specifically for the site including MFIs, local NGOs, business development providers and even a large exporter that facilitates loans for its suppliers. Some P2P platforms require that the partner work exclusively with them, while others are open to the organization working with multiple platforms. The level of support given to the partners also varies. dhanaX in India for example has developed an automated credit scoring tool for its partners to use. The partners are taught what type of data they need to collect, but this automated tool determines the credit rating posted on the site.

[9] VirginMoney (www.virginmoneyus.com) helps to formalize the lending process between family and friends to make it more transparent, easier to recuperate loans and so that parties can take advantage of tax and legal benefits. It plans to eventually have loans originated on the site as well.

[10] The exception to this is Ppdai in China, however as their lending is restricted to acquaintances, there is less need for an automated and reliable way to check the accuracy of borrower information.

Figure 5: Diagram of Intermediary P2P Model



Note: Interest rates and terms are usually set by the Intermediary or the P2P

Although the use of intermediaries facilitates the loan between the lender and the borrower and likely improves credit quality thanks to the local presence during due diligence and repayment, it raises two issues: where is the lender's credit risk and how does working through an intermediary affect the end borrowers' interest rates? Technically, dhanaX, RangDe, MyC4, Investors Without Borders and Kiva have structured their product so that the lender's credit risk is with the end micro or small enterprise. In the case of Kiva, however, practically speaking many of the MFIs will take on the loan repayments themselves if a client defaults as they want to protect their own reputation.[11] For the other platforms, the link between how much the borrower repayments and how much the lenders receive does appear to be stronger, but with

[11] Comments provided during interviews with Kiva field partners and management.

time this may change as many of the platforms are still quite young.[12] In terms of the interest rate paid by borrowers, working through an intermediary does increase the margin between the interest a lender receives and what the borrower pays. With the exception of RandDe and dhanaX, the Intermediary P2P platforms do not seek to limit this margin, which can result in very high final interest rates to the borrowers. The model's main strength to date has been on the lender side, in that it has opened the door for retail investors to invest in micro, small and medium enterprises in developing countries, reducing barriers to entry and spreading information about the sector. These individual investors are generally new to the industry, have diverse backgrounds and promise to bring greater volumes of capital to small businesses in developing countries.

THE MICROPLACE MODEL

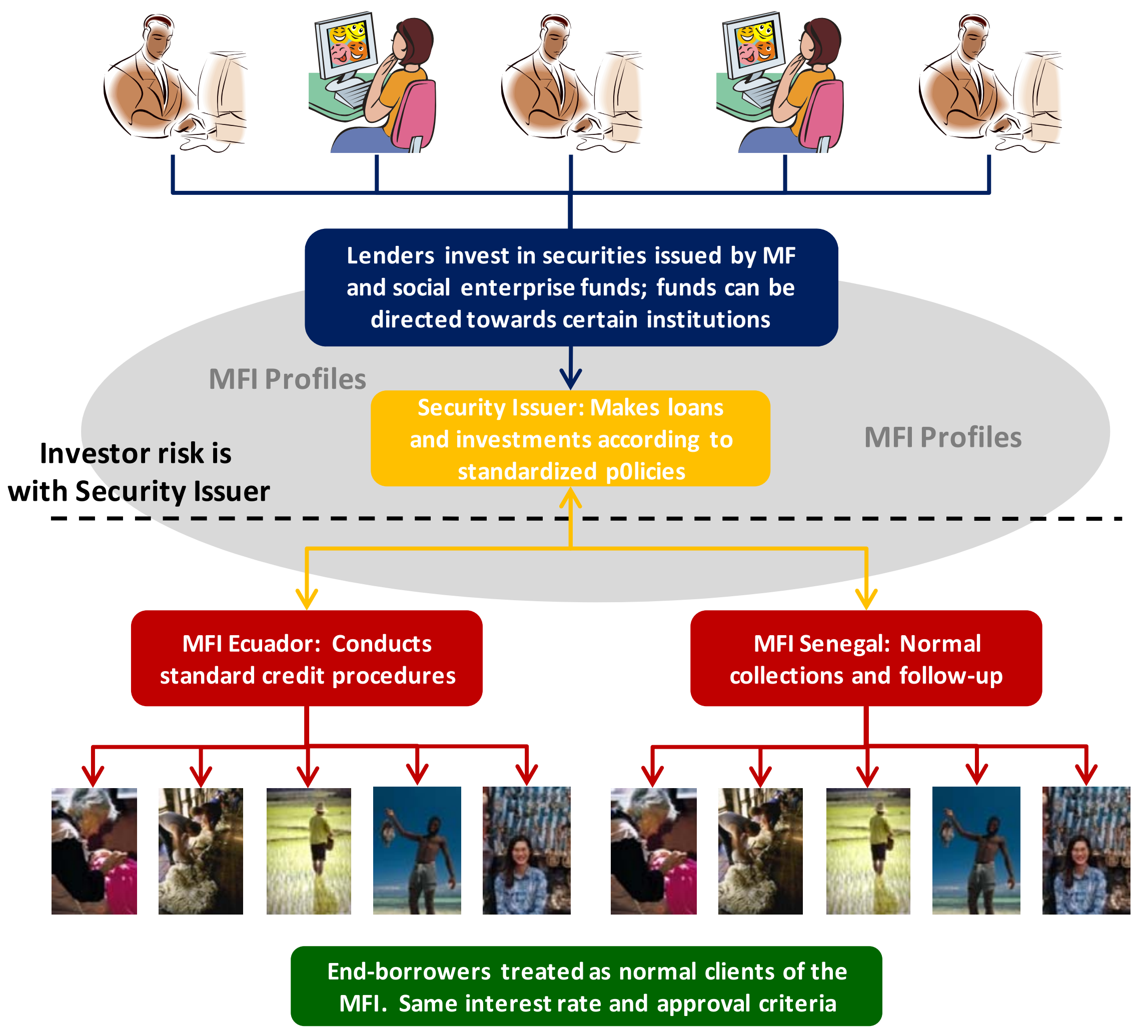
MicroPlace's approach to making microfinance assessable to the retail investor is unique in that it utilizes the "investment" concept of the Direct P2P model and the outsourcing of credit analysis of the "Intermediary" P2P model, yet also changes the credit risk of the investor such that it cannot really be considered a person-to-person platform. On MicroPlace (www.microplace.com) an investor does not choose which individual entrepreneurs he/she wants to lend to, but rather invests in securities issued by an investment fund that invests or lends to a pool of MFIs. (See Figure 6) This is similar to the online platform of a mutual fund company such as Vanguard, except that the investment amounts are much smaller (as little as $50) and the investment options geared towards microfinance and other social investments. MicroPlace's parent company is eBay, and like Prosper, MicroPlace's goal is to create an eBay type marketplace for socially responsible investments. In order to reach this goal and to ensure compliance with United States regulations, MicroPlace has been licensed as a regulated Broker-Dealer by the Securities and Exchange Commission (SEC).

Securities issuers, such as Calvert Foundation and Oikocredit USA, can use MicroPlace as an alternative distribution channel for their securities. The capital raised is then invested in the microfinance sector, generally through loans or guarantees to MFIs. These MFIs in turn on-lend the funds to micro and small entrepreneurs. Although the investor's risk is with the security issuer not the MFI or the ultimate beneficiary of the funds (the MSME), the MicroPlace platform allows investors to direct their funds to a particular MFI and to view the stories of the MFI's typical clients. While the link between the borrower and investor is less personal, the MicroPlace model provides advantages such as positive, albeit low, returns to investors (currently between 0.5%-3.0% per annum which are comparable to money market and CD rates), SEC supervision, and portfolio diversification. Given the ample supply and the ease of reporting, with the right product diversity and investor message, the MicroPlace platform has the potential to scale-up very rapidly. It will likely do so in a way that leverages the investment and sector knowledge of the security issuers and is not overly burdensome for the MFI as it does not

[12] Globalfunder.in is not yet operational, but mentions a shared risk between the MFI and the lender.

require a separate set of reports from MFIs that those that existing lenders (Calvert, Oikocredit etc.) require.

Figure 6: Diagram of the MicroPlace Model



Note: Return to investors set by security issuer; interest rate to borrower set by MFI. While investors Can direct funds to a certain MFI, their credit risk is with the Security Issuer who is generally supported By a portfolio of loans/investments in diverse MFIs.

Box 2: Socially Responsible "Investment" in Zopa USA

Zopa's original model in the United Kingdom was a modified "Direct" P2P model. However when it launched its platform in the United States two and a half years later (www.us.zopa.com), it did not feel the individual US lender was willing to take on the level of risk inherent in Direct P2P lending. So rather than use the same model as in the UK (and also risk direct competition with previously established platforms such as Prosper), Zopa decided to partner with several Credit Unions in the United States in order to all but eliminate the risk of default for "lenders" on its platform.

A borrow joins a partner credit union online and immediately can apply for a loan from the credit union (who determines the interest rate and terms). The borrower then posts his/her profile on Zopa for potential "lenders" or "helpers" to view; this can include a personal story, photos, blog, etc. "Lenders" can browse borrower profiles and choose who they want to help. However, rather than lending directly to the borrower, they invest in FDIC (Federal Deposit Insurance Corporation) insured CDs (Certificates of Deposit) at the credit union (which they also join) and a portion of their return is applied towards the borrower's monthly payment as "Help." The more help a borrower receives, the lower the effective interest rate of his/her loan; essentially borrowers loans are subsidized by third parties seeking a social and financial return on their funds.

Although the Zopa US platform cannot be considered a P2P *lending* platform, it does rely on the concept of social networking. It benefits "lenders" by offering a nearly risk-free investment with slightly higher returns than CDs at traditional banks and the ability to help their peers. For the Credit Unions Zopa has partner with, Zopa serves as a relatively cheap distribution channel for their savings and loan products and may also result in better repayment rates as borrowers report they feel more pressure to repay their loans on times so as not to let down the people that have helped them.

IV. THE SOCIAL IMPACT AND ADDED VALUE OF P2P LENDING

Recently, both domestic and international P2P lending platforms have received significant attention, and a few have started to achieve significant scale. Nevertheless, this is still a nascent industry that has yet to fully demonstrate its value added to investors, borrowers, intermediaries, and the microfinance industry overall. Below, we outline some of the main themes related to the impact and value added of P2P sites, and suggest some areas that would benefit from further investigation. Figures 8, 9 and 10 show the extent to which individual platforms exhibit the types of benefits and drawbacks discussed.

VALUE ADDED TO INVESTORS

P2P marketplaces represent in some sense the "democratization" of asset management and financial intermediation, one of the few professions that remains reserved for "elite" bankers and professional asset managers. The main benefit that online P2P lending platforms offer individual investors is that they have very low minimum investment requirements, providing broad access to investments in micro, small and medium sized businesses, an investment class previously reserved for institutional investors or very high net worth individuals. *Developed* country P2Ps allow investors to play the role of a small bank. Investors use their own "deposits" to build individualized loan portfolios according to their personal risk preferences, and social and financial criteria. Most *developing* country P2P's offer investors some level of discretion over which borrower to finance, and also provide investors the chance to invest directly in international micro, small and medium businesses, a sector which has not been accessible in the past. As investment minimums are so small (as little as US$20 on Zopa UK per borrower), investors are able to diversify their portfolios significantly, especially on sites with high volumes of transactions and large numbers of borrowers. Sites such as

Box 3: Why do Lenders Lend?

"*It's empowering to know that you can help people out and make money like banks do at the same time.*" -Bob, Prosper lender, www.prosper.com

"*I liked the idea of helping someone in particular, that I could see, that I could read about. It is the connection between lender and borrower that I admire and that is the catch for me*." - Oli, Kiva lender, www.kiva.org

"*I hope these micro loans can be an efficient means to alleviate poverty and hunger in the developing countries. I like the idea of letting the money work for local people in local settings*." Heinze, MyC4 investor, www.myc4.com

"*It's a relatively safe place for me to invest my extra savings and to feel good about the fact that I am supporting the microfinance sector*." Elise, MicroPlace investor, interviews

"*Good rates, cool concept. Again, I like the peer-to-peer thing; it's like going back to basics. Only with insurance through the credit unions. Best of both worlds!*" eg192, Zopa USA investor, www.us.zopa.com

Prosper, Zopa and LendingClub even have mechanisms which allow investors to delegate their investment choices to automated tools on these sites based on a set of pre-established criteria. MyC4 will also launch this capability soon.

In addition to greater diversity, many sites also offer higher expected rates of return than investors could receive in a savings account or by investing in CDs by reducing the margin paid to the "middle man", the traditional bank or financial institution. However, the trade-off to this higher return is generally a significantly higher degree of risk than that of federally insured CDs or savings accounts or government treasuries.[13] By their nature, loans are generally made directly to individuals and are uninsured, and for those P2Ps that do not use intermediaries to source borrowers, it is difficult to check the accuracy of the information provided by the borrower, increasing the risk further. By using these sites, investors must rely on transparency of information and "trust" to succeed. Examples of online marketplaces such as ebay and other popular social networking sites suggest that "trust" is easier to achieve online than we could ever imagine. Nevertheless, transparency and accuracy of information remain an important concern in this relatively new market. If a small business claims to need funds to purchase inventory, the investor cannot be sure that the loan will not be used to buy a new car or television. In fact, in many cases it is difficult to know whether there is a legitimate business at all.

Figure 7: Risk vs Return Tradeoff?

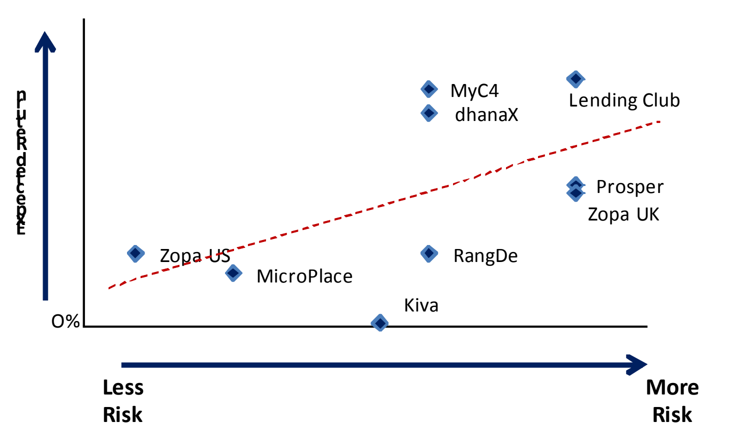


Figure 7 plots the risk[14] and return[15] trade-off for various P2P platforms. (A savings account or traditional CD would have the same degree of credit risk as an investment on Zopa US, given

[13] In the United States, the FDIC covers up to $100,000 for each individual account holder in case of a bank failure.

[14] Risk assessments are subjective and reflect the perceived *credit risk* of investments on a platform. They do not include other risk factors, such as currency risk, country or political risk or diversification. The assessment of risk is largely based on where the investors' credit risk lies (US government agency, large institutions/foundations, intermediary or individual borrower) and whether or not there is an intermediary in place to select and verify borrower information.

[15] Where available, the expected returns shown are after fees and expected losses, however, given the limited time many of these platforms have been in existence, there is not sufficient historic data to accurately measure expected losses. As such, it is expected that for platforms such as MyC4, LendingClub, DhanaX and RangDe, expected returns will be lower going forward as platforms begin to experience more defaults. Lower returns on Kiva may also be experienced in the future, especially if MFIs stop covering their clients' loans in the case of defaults. Prosper, Zopa UK and LendingClub data are self reported based on actually loan performance through August 2008, February 2007 and February 2008 respectively.

these CDs are federally insured (see Box 2).

Interestingly, as demonstrated in the charts above, higher risk platforms do not necessary offer higher financial returns, especially when the social return on an investment is considered high. Obtaining a social return is often a stronger motivation for lenders to lend than the financial return. This is especially true for sites like Kiva and RangDe, where the financial returns are substantially below “market” for the risk associated with the investment. Social returns also play an important role in more commercially oriented sites such as Prosper, Zopa UK or even MyC4, however.

Figure 8: Benefits and Drawbacks of P2Ps for Investors

		PURE P2P MODEL			INTERMEDIARY P2P MODEL						MICROPLACE	OTHER
		Prosper	Zopa UK	Lending Club	dhanaX	Globe-funder	IWB	Kiva	MyC4	RangDe	MicroPlace	Zopa US
BENEFITS	Access to new types of investments	✓	✓	✓	✓	✓	✓✓	✓	✓✓	✓	✓✓	
	Small investment minimums	✓✓	✓✓✓	✓✓	✓✓✓	**TBD**	**TBD**	✓✓✓	✓✓✓	✓✓✓	✓✓	
	Easy diversification of investments on platform	✓✓✓	✓✓✓	✓✓✓	✓✓	**TBD**	**TBD**	✓	✓✓	✓	✓	
	Higher interest rates than bank savings and CDs	✓✓	✓✓	✓✓	✓✓	**TBD**	**TBD**		✓✓			✓
	Online platforms are easy to use	✓✓	✓✓	✓✓	✓✓	**TBD**	**TBD**	✓✓	✓✓	✓✓	✓✓	✓✓
	Feel good about investment / personal connection	✓✓	✓	✓	✓✓	✓	✓✓	✓✓✓	✓✓✓	✓✓✓	✓✓	✓✓
	Identification with individual they are lending to	✓✓		✓	✓		✓	✓	✓✓	✓✓		✓✓
DRAWBACKS	Higher risk investment	✓✓✓	✓✓✓	✓✓✓	✓✓	✓	✓✓	✓	✓✓	✓✓		
	Difficult to check borrower information	✓✓	✓✓	✓✓	✓		✓✓	✓	✓	✓		
	Personal sentiment may influence investment	✓✓✓		✓✓✓	✓✓✓		✓✓✓	✓✓✓	✓✓✓	✓✓✓		

Notes:

The Pure P2P sites above are only a sample of the many platforms which have been developed. The characteristics of other platforms should e similar, but are not identical, especially in terms of their investment size and interest rates.

Globefunder.in and Investors Without Borders (IWB) are not yet operational, so assessment is based on information available on their websites to date. Once launched the benefits and disadvantages of each site could change.

Access to new type of investments: the majority of sites above offer invexstors a new type of investments, however sites such as MyC4 and IWB offer access to the SME or "missing middle" market, one which few institutions or individuals have had access to, and MicroPlace offers retain investors access to various new arenas (domestic and international microfinance, low-income housing, etc)

Small investment miniums: 3 checks, less than $50, 2 checks between $50-199

Easy Diversification takes into consideration whether or not there is an automatic way for lenders to diversify their portfolio, minimum investment size per borrower and the number of loans available through which to diversify.

Higher interest rates: based on the expected acheivable interest rates on the platform.

Degree of "feel good" factor based on the personal nature of the loan, where the end borrower is located and the interest rate earned (for more commercial interest rates, the feel good factor is considered to be lower because the end borrower may not benefit as much).

Higher risk investment: Risk assessment looks at where the lender's credit risk is (end entrepreneur, MFI/intermediary, investment fund, FDIC) and the use of intermediaries to select and check borrower information.

VALUE ADDED AND IMPACT ON BORROWERS

Both domestic and international P2P lending platforms provide borrowers with an alternative source of financing than that offered by traditional banks. Direct P2Ps allow borrowers to directly appeal to individual lenders and hopefully receive a loan that better meets their financial needs, while Intermediary P2Ps increase their partners' ability to serve their local communities. But although they increase the supply and diversify the sources of credit, do these platforms also democratize access to finance by broadening the availability of credit to a wider population or provide improved financial terms for the "unbanked"?

Increasing access to finance is one of the main goals of P2Ps in *developing* countries. Platforms which have set out to work with MFI partners such as Kiva, Globefunder India, and MicroPlace (indirectly through security issuers) are supporting the efforts already established by their MFI partners to reach out to populations excluded from the traditional banking sector. Specific metrics supporting this assertion are not readily available from these platforms, in large part because of the youth of the organizations. In 2009, Kiva plans to clearly define, in conjunction with its MFI partners, metrics for the social impact of its funding (such as reaching out to new underserved markets or sectors, lowering interest rates, etc) and plans to hold partner MFIs accountable for social impact targets. One of Kiva's field partners interviewed pointed out that Kiva actually helps remind them of their social mission to serve lower income segments of the population due to some of its restrictions on loans such as the maximum size of $1,200. The platforms targeting larger microentrepreneurs and SMEs such as MyC4 and Investors Without Borders, are also adding value by providing access to finance to small and medium-sized enterprises in developing countries. Smaller SMEs are often considered to fall into the "missing middle" in financing.[16] They are largely excluded from the formal financial sector because they are informal or too risky for banks, yet MFIs generally do not offer products or services appropriate for their greater financing

Box 4: MyC4 Works to Achieve the UN Millenium Development Goals (MDGs)

MyC4 has chosen to work exclusively with Africa in order to help end extreme poverty and achieve the MDGs by 2015. By focusing on larger microenterprises and SMEs, MyC4 seeks to put capital into the hands of businesses that can have a significant and sustainable impact on job creation and economic growth. While tapping into the retail market like many P2Ps, by keeping costs low and offering competitve returns, the platform can also be used to channel institutional capital and investments to Africa - further increasing is potential impact. Additionally, MyC4 is looking beyond finance and is committed to building a international community of investors and businesses which can lift Africa out of poverty by harnessing the power of business.

[16] Sanders, Theirry and Wegener, Carolien. "MESO Finance: filling the financial service gap for small businesses in developing countries", NDCO, September 2006, available at http://www.bidnetwork.org/artefact-40006-en.html.

needs. Mads Kjaer, CEO of MyC4, says that one of the main reasons MFIs chose to work with MyC4, is not that it allows them to serve more clients, but that it allows them to better serve their existing clients. Many of the MFIs larger clients' financing needs have outgrown the MFIs loan limits, so they can limit their exposure by co-lending to these clients with MyC4 lenders. Given much of economic growth and job creation in developing economies comes from the SME sector, improving access to finance for these businesses can help not only the individual entrepreneurs but overall development and poverty alleviation goals in a country.

After only six months in operation, RangDe points to anecdotal evidence that it is helping expand access to financial services in rural areas. One of its partners had an existing microfinance loan portfolio with an annual interest rate of 15% flat prior to partnering with RangDe; however, because RangDe imposes an interest rate cap of 8.5% flat for loans originated on its platform, it could not offer RangDe funded loans in its existing coverage areas and instead offered RangDe loans in a new rural market. Previously this market was not deemed sustainable for the company as the types of businesses were not thought to be able to afford the higher 15% interest rate and the MFI could not lower its interest rate because of its own cost-of-funds. This has interesting implications for microfinance in rural economies, where high interest rates typically charged by MFIs may not be feasible for some small farmers. Lending costs in rural areas are high, and donors and international organizations may consider coupling technical assistance efforts to reduce the cost of making loans locally with the benefits of lower interest rates availabe on some P2P sites. It is possible that the P2P technology itself could even be leveraged to reduce operational costs.

Although P2P platforms have the potental to reduce the interest rates paid by borrowers, RangDe is one of the few platforms that has imposed a maximum interest rate on what its partners can charge. Many platforms such as Kiva, which offers MFI's zero percent financing[17], do not set any limitations on final interest rate charged to the borrower and often do not know themselves what the final interest rate on an individual loan may be. Their MFI partners set the interest rates based on their regular lending criteria and local market interest rates. While it is understandable that an intermediary take a spread for his/her work to source, verify and track a loan, this can result in large margins (ranging broadly from 20% to over 50% p.a.) betweeen what a lender earns on his/her loan and the rate that a borrower pays. This is one reason why, in general, the Intermediary P2P model has had limited effect on reducing the final interest rate on borrowers' loans to date. For those platforms which allow borrowers and investors to bid on interest rates, there is room for a greater reduction in rates. MyC4 (and soon Investors Without Borders) allows lenders to bid on the interest rate they are willing to accept (as in the Direct P2P auction model). Intermediary and bank fees (in cases where the intermediary is not allowed to make loans directly because of regulatory constraints) are still charged at the discretion of the intermediary, but MyC4 requires that they be "fair and competitive", maintaining a de facto right

[17] One reason Kiva decided to pay lenders 0% interest was for US regulatory purposes as well as cross-border funds regulations; this may evolve over time.

to cap interest rates.[18] A market study conducted by MyC4, revealed that despite the often high fees charged by MyC4's agents, loans originated on MyC4 usually offered the cheapest or second cheapest funding available to these types of business in the countries[19]. To address the concern that interest rates on loans can be burdensome and may seem more exploitative than supportive, dhanaX also allows borrowers and lenders to set the interest rates that they are willing to except and has also limited additional fees; it sets its commission at 6% upfront and 1.5% of the monthly loan payments received and shares a portion of these commissions with its partners.

For *developed* country oriented platforms it is less clear to what extent P2Ps are "democratizing" access to finance rather than just providing alternative sources of finance. There are surely some individuals who are able to borrow through a P2P who would not be able to take out a loan from a bank or credit card company, but because most of these platforms require a minimum credit score there is still a tendency to exclude many potentially credit worthy individuals who lack a credit history. The current credit crisis in the United States may lead a greater number of people with credit histories to the P2P marketplace as banks close their doors to all but the strongest clients. However, this remains to be seen. Zopa UK recognizes that P2Ps are not sufficiently reaching the "unbanked" and has a specific risk category for new younger borrowers. As for Prosper, a University of Maryland study showed that although initially there were many borrowers with riskier credit profiles (perhaps the "unbanked") who received loans on Prosper, that number has been declining as a percentage of total loans as lenders started to congregate around borrowers with less risky profiles.[20]

Box 5: Prosper, Seeking to Serve the "Unbanked"

Prosper would like its platform to be a marketplace for all types of borrowers, including the "unbanked", with the appropriate pricing. It hopes to expand its services to users of payday lending services which generally charge usurious interest rates. Prosper is currently looking at ways to minimize investor reluctance to lend to these types of clients by reducing the loan term for payday loans to one year (as opposed to the three year standard currently available on Prosper).

Direct P2P sites, do suggest some benefit to borrowers in terms of reducing the cost of funds. This is largely because these sites directly

[18] MyC4 does its best to be transparent about these fees and requires intermediaries to report the additional costs to the borrower in the loan listings and is working to introduce standard APR usage in the industry to further promote transparency

[19] In Uganda, the average annual interest rate paid by MyC4 borrowers was 42% compared to 54% charged by Stanbic, 84% charged by U-Trust, 105% charged by Faulu and 109% charged by UML. Only Centenary Bank offered a lower interest rate (28%) but had strict collateral requirements most borrowers are unable to meet. Source: www.myc4.com.

[20] Freedman, Seth and Jin, Ginger Zhe (2008 preliminary study) "Dynamic Learning and Selection: the Early Years of Prosper.com", University of Maryland, available at http://www.glue.umd.edu/~ginger/research/Freedman-Jin-ProsperStudy-061008.pdf.

connect lenders and borrowers, cutting out the role of the middle man (formal banks) and also avoiding costly fees to intermediaries. The auction system used by many models to determine borrower interest rates further encourages rate reductions. Direct P2Ps in developed countries also offer value in their convenience. These sites offer borrowers more straightforward loan terms (fixed payment, no early repayment penalties, no collateral) than they might receiveon a bank loan or a credit card; and often an easier and quicker loan application and disbursement process, all from the comfort of their home. Finally, just as lenders often use P2P lending platforms for personal rather than just financial reasons, many borrowers claim that they prefer to pay interest to a person than to a formal financial institution.

Figure 9: Benefits and Drawbacks of P2P for Borrowers

		PURE P2P MODEL			INTERMEDIARY P2P MODEL						MICROPLACE	OTHER
		Prosper	Zopa UK	Lending Club	dhanaX	Globe-funder	IWB	Kiva	MyC4	RangDe	MicroPlace	Zopa US
BENEFITS	Increase access to finance for "unbanked"	TBD	✓	TBD	✓✓	✓✓	✓✓✓	✓✓	✓✓✓	✓✓	✓✓	TBD
	Opportunity to escape debt cycle	✓✓	✓	✓	✓✓	✓✓	TBD	✓✓	TBD	✓✓	✓✓	✓
	Lower interest rate	✓	✓	✓	✓	TBD	TBD	TBD	✓✓	✓✓✓	TBD	✓✓✓
	More straightforward loan terms than alternatives	✓✓	✓✓	✓✓	✓✓	TBD	TBD	TBD	✓✓	✓✓	TBD	✓✓
	Alternative source of capital during economic downturns	✓	✓	✓	✓			✓	✓	✓	✓	TBD
	Easy application and disbursement process	✓	✓	✓								✓
	Limited collateral requirements	✓	✓	✓	✓	TBD	✓	TBD	✓	✓	TBD	
	Satisfaciton of paying interest to a person rather than a	✓	✓	✓	✓		✓		✓	✓		
DRAWBACKS	Privacy could be compromised online	✓		✓	✓		✓	✓	✓	✓		✓
	Loan amounts are limited	✓	✓	✓	✓	TBD	TBD	✓		✓		✓
	More borrowers than lenders	✓✓	TBD	✓✓	✓	TBD	TBD		✓	✓	✓	

Notes:

The Pure P2P sites above are only a sample of the many platforms which have been developed. The characteristics of other platforms should be similar, but are not identical, especially in terms of their investment size and interest rates.

Globefunder.in and Investors Without Borders (IWB) are not yet operational, so assessment is based on information available on their websites to date. Once launched the benefits and disadvantages of each site could change.

Lower interest rate: further study and time is need to assess whether or not these platforms are actualy lowering the interest rates paid by borrowers. Initial studies of Prosper and MyC4 indicate that they are and Zopa US and RangDe have both built lower rates into their models.

Straigthforward loan terms: As the loan terms of many intermediary models are set by the intermediary and not the platforms, it is difficult to know whether or not they are more straightforward.

More brrowers than lenders: with the exception of Kiva, all sites currently appear to have a surplus of borrowers. MyC4 expects to reduce this surplus by allowing institutial investors to also use the site, but will initially limit the amount so as not to crowd out individual invetsors.

VALUE ADDED AND IMPACT ON THE MICROFINANCE INDUSTRY

As discussed in Section 3, the developing country P2P platforms work through intermediaries to source, verify, and administer the loans originated on their platforms. The majority of these intermediaries are MFIs who already had an existing lending business prior to partnering with the P2P platform. Thus, if looking at the impact of these P2P platforms, one must also consider the impact on the partner MFIs as well as the microfinance industry overall. Kiva is the largest, most established and most geographically diverse of the P2P platforms working with MFIs, so much of the following discussion revolves around its impact on the microfinance sector. Many of the considerations below are based on anecdotal evidence in a relatively immature sector and require ongoing monitoring and further study.

Figure 10: Benefits and Drawbacks For the Microfinance Industry

		INTERMEDIARY P2P MODEL						INVESTMENT FUND
		dhanaX	Globe-funder	IWB	Kiva	MyC4	RangDe	MicroPlace
BENEFITS	Expansion of Funding Sources	✓	TBD	TBD	✓✓✓	✓	✓	✓✓
	Diversification of Funding	✓	✓	TBD	✓✓	✓	✓	
	More inelastic supply of funds	TBD	TBD	TBD	✓	✓	TBD	✓
	Cheap source of funding		TBD	TBD	✓✓✓	✓	✓	✓
	Target smaller MFIs	✓	TBD		✓✓		✓✓	✓
	Raises awareness of microfinance	✓	✓	✓	✓✓✓	✓✓	✓	✓✓
DRAWBACKS	Hidden costs to MFIs	✓	✓✓		✓✓		✓✓	
	Short-term, unpredicable financing	✓	TBD	TBD	✓✓		✓✓	
	Risk of Moral Hazard in Client Selection	✓	✓	✓	✓	✓	✓	

Notes

Expansion of Funding Sources: considers the volumes transacted to date as well as how much of those funds have been channeled through MFI intermediaries.

Diversification of funding: considers whether or not the platforms offers a new source of funds for the MFI and the volume to date.

Inelastic supply of funds: this considers the continued growth achieved recently despite the global financial difficulties, but is not based on an economic analysis.

Cheap source of funding: considers the financial \cost to the intermediary MFI of the funds

Hidden costs to MFIs: includes special reporting requirements of platforms or the time it takes to enter borrower information onto the platform, ect.

While Kiva has facilitated nearly US$50 million since its inception for microfinance loans;[21] this has not necessarily been its greatest achievement. Kiva's IT focused platform, personal stories and links to broad social networks online has raised the profile of microfinance globally. Kiva has become an ambassador for microfinance to a mass market audience in the United States, which spans various generations, professions and interests. Kiva has been featured in the Wall Street Journal, BBC World, the Economist, the Oprah Winfrey Show, and many more news sources. Kiva estimates that 36% of their approximately 330,000 lenders had never even heard of microfinance prior to using Kiva and the majority of the rest had very little to no knowledge of microfinance. As Kiva's popularity has grown, Kiva accounts have become popular baby, wedding and graduation gifts – exposing new people, and new generations, to microfinance. They are well packaged, easy to purchase and marketed as gifts that keep on giving, passed on from one microentrepreneur to the next over a lifetime, since loans are automatically renewed unless the investor decides to ask for her money back. Kiva has also helped to raise awareness of microfinance through its Kiva fellows program as well as its team of nearly 300 part-time volunteers.[22] Many of these individuals have become ambassadors for the company as well as the industry. Kiva is not the only platform which has helped raise awareness of microfinance, MicroPlace and MyC4 have also received a significant amount of press.

While there is little evidence to date that P2P platforms have reduced interest rates to final borrowers, with the exception of RangDe and MyC4, as commercial funds play an increasingly larger role in financing MFIs, the availability of lower cost funds through P2P sites may allow mission driven MFIs that lend to poorer clients to continue their efforts without needing to drift toward more profitable larger loans and larger clients. The US$50 million in funding Kiva

Box 6: Hidden Costs of Kiva Funds

Although Kiva charges a no interest to MFIs for loans funding on its site, there are other non direct costs for MFIs that are not always taken into consideration, such as the time spend on posting loans, specialized reporting and monitoring. Only one of the MFIs interviewed was able to quantify these indirect costs. Its standard loan procedures did not capture all the information required by Kiva, such as photos and the specifics impact past loans had had on the borrower's business, so it developed an additional form to be completed by loan officers to capture this information, which takes approximately 30 minutes to fill out. In order to ensure loan officers were motivated to take this time for Kiva loans, the MFI offered US$2 "Kiva bonuses". These bonuses and the extra administrative costs associated with Kiva loans amount to approximately 5% of the total lent, which is significant but substantially cheaper than the 8-10% loans available to them from commercial sources.

[21] From www.kiva.org as of September 22, 2008.

[22] The Kiva Fellows program is a volunteer program which offers individuals the opportunity to travel abroad to spend time with one or more of Kiva's field partners and to learn first-hand about microfinance. It is designed to increase Kiva's impact and add value to its field partners. At any one time there are approximately 30 Kiva Fellows in the field and most Fellows go for 3 to 4 months.

has provided MFIs has facilitated more than 60,000 loans since it launched. While still small compared to institutionally-focused microfinance funds, this number is growing rapidly.[23] RangDe, dhanaX and GlobeFunder India promise to channel funds to MFIs in India as they scale up, and MyC4's with nearly US$7 million lent to date, is channeling some funds to its partner MFIs. MicroPlace is also increasing the supply of funding available to MFIs by providing investment funds such as Calvert Foundation and Oikocredit with a way to tap into the retail markets for additional investment capital.

The sustainability of P2P platforms as a consistent and long term funding source for microfinance institutions has yet to be proven. P2P lenders often base their decisions on personal preferences and can be fickle. For example, on geographically diverse platforms such as Kiva and MicroPlace, opportunities in Africa, Asia, and Latin America have generally been more popular than opportunities in Eastern Europe or Central Asia. One Kiva field partner interviewed, mentioned that Kiva funding for his MFI had declined from a high of around US$1 million to US$400,000 because of a slowdown in loans being funded on Kiva. Much like many NGOs, foundations and international organizations, Kiva's more socially motivated investors may shun lending to micrentrepreneurs in “middle income” countries, regardless of their level of income or business size. As funding from P2P platforms match the short-term tenor of the underlying client loans, changes in investor preferences can present liquidity challenges for some MFIs whose P2P funding represents a large percentage of their portfolio, and can limit the availability of funds to end-clients seek to roll over their loans. Kiva has responded to these risks by investing in market intelligence to better understand investor preferences; improving the communication with partner MFIs about investor trends; and designing a tool that can help MFIs better manage their liquidity which will be ready by the end of 2008. By working with security issuers who make loans directly to MFIs as opposed to the individual microentrepreneurs, MicroPlace avoids the problem of short-term unreliable funding. Funding is generally available to the MFIs for 2 to 4 years and repayment horizons are clearly defined from the beginning. Moreover, as MicroPlace is just one way security issuers raise capital, an expected loan to an MFI will not necessarily be delayed or canceled just because investors change their investment preferences.

Another benefit of P2P funding, much like that provided by donor agencies and other socially responsible investors, is that it can also serve as a launching pad for MFIs wishing to begin diversifying their funding sources, but not yet ready for commercial loans. According to Kiva's internal risk ratings, 35% of its partners receive five stars, 42% receive four stars and 13.6% receive 3 stars, 5.7% receive two stars and 3.4% receive one star. However, even among the 31 institutions that received a 5 star risk rating there are only a handful which would be considered investment ready MFIs by more commercial investors in the industry. For example, when Norwegian Microcredit LLC (Normicro) in Azerbaijan began to obtain Kiva financing in late 2006, its only source of other debt financing was from its founder and very socially oriented local

[23] For example, institutionally focused funds include the Global Commercial Microfinance Consortium (GCMC) managed by Deutsche Bank is $80.6MM. The Dexia Micro-credit Fund managed by BlueOrchard is $400MM.

funds; it now receives financing from many commercially oriented funds such as BlueOrchard, GCMC, Microvest and Planet Finance and has nearly quintupled is loan portfolio. Kiva is also able to work with MFIs in politically unstable countries that commercial funds cannot, such as Afghanistan, Iraq and Palestine. According to Kiva management, these are actually some of the more popular countries for Kiva lenders because the social impact of these loans is considered to be greatest. RangDe and dhanaX have also both partnered with small community based MFIs with limited international exposure, while MicroPlace indirectly targets smaller MFIs as its current fund partners are two of the more socially oriented microfinance investment funds.

One final potential benefit P2Ps and retail platforms like MicroPlace may bring to the industry is a more inelastic supply of funding. The credit crisis in the United States which began in mid 2007 did not immediately affect the microfinance industry. However, as the crisis is prolonged and the overall economic conditions in the country continued to worsen, it has started to affect the ability of specialized microfinance funds to raise new capital, especially in the hard-hit CDO and CLO markets. Shortly following the close of BlueOrchard's BOLD 2, the CDO markets all but closed and at least two planned microfinance CDO/CLOs were postponed indefinitely. Microfinance funds have started to adapt, but the cost of commercial funds has increased significantly (on a spread basis). As retail platforms tap into a different investor base, that balances social and financial return objectives, it is possible that there will be less volatility in these funding sources. Interviews with management at some platforms' indicate that with the credit crisis, growth rates of loans funded on their sites have slowed but not stopped, and Calvert Foundation asserts that the 3% return they offer investors on MicroPlace is actually quite attractive now that interest rates in the United States are so low.

V. SCALABILITY OF THE P2P INDUSTRY

Both domestic and international P2P platforms have already demonstrated the ability to rapidly grow their businesses. It took Kiva one year to fund its first US$1 million in loans, whereas now they are funding US$1 million in less than ten days. Prosper is now funding between US$6MM and US$10MM a month versus the 6 months it took to fund its first US$10MM. Despite these successes, loans funded on P2P platforms still represent only a small portion of the total market, but with the growing number of P2P platforms and the growing awareness among both lenders and borrowers, the industry has the potential to scale up significantly. Online Banking Report estimates that the domestic P2P market will grow from approximately US$100 million in loans funded in 2007 to $1 billion by 2010 funding.[24] The microfinance specific market will unlikely reach the same scale, but with global and multi-country platforms such as MicroPlace, MyC4 and Kiva as well as newer country specific platforms, the potential for growth is remarkable. However, in a nascent industry, reaching scale is never easy and both the domestic and the international P2P platforms face substantial constraints to their growth.

Despite the rapid growth posted by many of the P2P platforms interviewed for this research, none have yet reached sustainability or break-even. For those non-profit platforms such as Kiva and RangDe, their business plans do not call for unsubsidized sustainability, but as they continue to grow and the novelty of their models perhaps wanes, ensuring reliable revenue or donation streams will become increasingly important to achieving and maintaining significant scale. RangDe does not enjoy the same recognition that Kiva does and its funding for operations is currently limited to one major donor. Kiva has developed a more diversified source of funds,

Box 7: Diversifying Your Portfolio with MicroPlace

MicroPlace, a company solely owned by the Ebay Corporation launched in October of 2007. It offers investment notes online to individual investors in increments as small as US$50 and with returns of 0.5%-3.0%. MicroPlace believes that investors who buy these notes are looking for a product that provides a social return, a financial return and something more. It has begun to position its products as an attractive diversification opportunity for investors who see microfinance as "counter-cyclical" to other developed country and international investments. Microplace distinguishes itself because of its potential to scale up, to work with various social investment sectors and to offer a variety of different financing instruments. Through the Calvert Foundation, it has recently started offering domestic microfinance investments and investments in low income housing through Habitat for Humanity. It is also planning to launch a liquid international microfinance investment product through Oikocredit.

[24] http://online.wsj.com/article/SB120526439925827991.html?mod=hps_us_inside_today

which includes donations from many large corporations and foundations, small individual donations from lenders (the site prompts a 10% suggested donation at the end of an investment) and interest earned on funds held before disbursement. Of the for-profit platforms interviewed during the research (dhanaX, Microplace, MyC4, Prosper) all expect to reach sustainability in 3-5 years from their launch, but their sustainability is dependent on achieving a minimum loan volume. So what is preventing these platforms from achieving scale more quickly? Among the constraints are finding the right message and breadth of product offering for investors, creating the necessary partnerships, dealing with complex regulatory environments, and overcoming the challenge of balancing transparency with borrowers' privacy. In addition, platforms which cross international borders face many of the same constraints as microfinance investment vehicles, such as political risk and currency risk and determining who is best equipped to manage this risk.[25]

As the P2P industry ventures forward aiming for sustainability, it must in parallel address the considerations mentioned above regarding their value added to investors and borrowers, their impact on democratizing financial access and their transparency. Otherwise, they risk becoming a "fad" comparable to the dot.com era of the 1990s that suffers significant consolidation and restructuring. Given the history of financial intermediation, where bubbles bust and schemes unravel, this risk should not be ignored.

THE CHALLENGES OF TRANSPARENCY

A major issue which threatens the growth of the P2P lending industry is the issue of transparency and specifically finding a balance between protecting the privacy of borrowers and the interests of lenders. There is an inherent asymmetry of information in any lending relationship, only the borrower truly knows whether or not they plan to repay the loan; however this asymmetry is amplified in P2P lending where borrower and lender do not meet and where information provided by the borrower is often not checked. As noted in the Accenture study, 66% of people surveyed expressed a concern that borrowers would not pay them back. (See Box 8). In order to achieve scale, P2P platforms need to develop mechanisms to both promote repayment and to demonstrate this to lenders. Many platforms have sought to remedy this asymmetry by leveraging the public data available in credit bureaus. However in less developed countries where credit bureau data is often non-existent, incomplete, or unreliable, P2P platforms have chosen to use intermediaries to check borrower information (dhanaX, Kiva, MicroPlace, MyC4, RangDe). Additional mechanisms adopted by P2Ps to promote transparency include allowing lenders to ask borrower's questions online, spot checking of

[25] Some platforms such as Kiva and MicroPlace (indirectly) have put foreign exchange rate risk on their partner MFIs. The risk on MyC4 is now exclusively with the investor, but this additional risk is often reflected in interest rates. By mobilization local capital, RangDe and dhanaX (and other domestic developing coutnry P2Ps) avoid the issue of currency risk all together, but mobilizing sufficient local capital is not an option for many countries.

borrower information by the platform itself, and endorsements from family and friends. A Prosper study found that borrowers were more likely to repay their loan on time if a friend or family member was one of their lenders.

In addition to doing their best to ensure transparency of borrower information, P2P platforms have a need and perhaps an obligation to be as transparent as possible themselves. Most of the more mature P2P platforms interviewed have adopted the view that the more information available to lenders, the better, and are quick to publish statistics on the performance of loans by risk rating and other characteristics. This allows investors to make investment decisions based on the expected return of a given loan and to diversify their loan portfolio accordingly. In the case of Kiva, and other intermediary models, there is a trade-off between promoting the direct P2P relationship between borrowers and lenders, which is very powerful in attracting socially oriented lenders, and the transparency involved in explaining the relationship with the intermediary. As mentioned above, Kiva, for example, is a worldwide site with frequent visitors, from a reputational standpoint it is often “cheaper” for an MFI to re-pay a Kiva loan even when a client is not re-paying his/her loan to the MFI. This is perhaps appropriate given the margin MFIs earn on the loans, but also inflates repayment statistics because MFIs will not report when they cover a client’s loan. Recognizing the risk of appearing non-transparent, Kiva is currently revising its operating system so that MFIs will be required to report on delinquent loans even if they choose to cover the loan themselves.

Finally, in order to avoid borrower or investor outrage in the future, P2P platforms should also be as transparent as possible regarding the interest rates charged to end borrowers. The majority of platforms charge origination and facilitation fees to borrowers, which increases the real cost of their loan, and when intermediaries are involved, they often also charge high fees for sourcing, posting and managing the loan. Thus a 0% interest loan on Kiva may ultimately cost the borrower 30%, 40% or even 50% annually. This poses concerns about transparency given that it is difficult for an NGO like Kiva to advertise to its lenders that their borrowers may pay interest rates of well over 40% per annum while lenders receive 0% interest. Microfinance practitioners understand that the cost of delivering tiny loans to the poor can be very high, and that interest rates of even 40% can offer a safe and economical alternative to money lenders and other informal sources of finance for the unbanked. However, the users of these sites are often unfamiliar with microfinance and may be very surprised and disappointed to learn such information without receiving an explanation. Most Intermediary platforms interviewed for this research understood the importance of transparency, yet offered lenders varing degrees of transparency on annual interest rates. One of most transparent platforms is MyC4 which shows all the fees paid to the platform and the intermediaries for each loan as well as the final APR (Annual Percentage Rate) for the borrower.

DEMAND AND SUPPLY SIDE CONSTRAINTS TO GROWTH

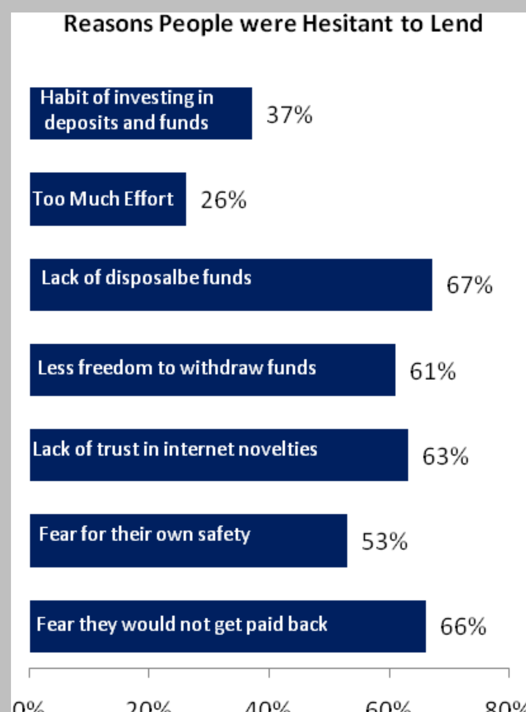
Marketing has been a constraint to growth for some international, microfinance oriented sites which have not yet gotten the traction they need with investors to quickly fund loans. RangDe and dhanaX are relatively new organizations that are targeting a specific sector of the Indian population. dhanaX especially has the technology it needs to be successful, but does not yet have sufficient capital to launch a sophisticated marketing plan to attract lenders. The message itself is also important. In the case of Microplace, for example, there is not the same kind of personal connection between investors and borrowers as there is on sites where investors lend directly to borrowers; thus the message used to attract investors must also be different. It is also probable, because of the investment versus donation-like opportunities on MicroPlace, that it will attract a slightly different type of investor, one focused on the social return but also attracted to the diversification potential of the platform.

Prosper and MyC4, and to a greater extent Kiva, seem to have gotten the investor message right for their existing products, but for these sites, one key to achieving even greater scale is to offer a greater variety of products. Kiva, for example, is considering offering a positive financial return on its loans to increase investor demand. All Prosper loans currently have three year maturities, which is a significant hurdle for many lenders, especially when lending to riskier borrowers. Prosper is working to offer more flexibility in its loan terms. For example, it is considering developing a one-year loan product geared towards "payday" borrowers. The aim of the shorter-term is to encourage lenders to accept the riskier nature of these borrowers as well as to attract new lenders to Prosper.

Other platforms, mostly Intermediary P2Ps also expressed supply side concerns to growth. According to Isabelle Barres, Microfinance Partnerships Vice President for Kiva, one of Kiva's greatest challenges is finding and screening field partners. Because the site seeks to work with "Tier II" and "Tier III" MFIs who generally do not have access to commercial sources of funds, Kiva staff must spend a great deal of time searching for MFIs in developing countries and ensuring that their operations and credit policies are relatively sound. Following selection, Kiva continues to invest

Box 8: Concerns of Potential Lenders

A study conducted in Poland by Accenture found that potential lenders on P2P sites expressed several concerns. Sixty-one percent of people expressed concern about liquidity, so efforts by Prosper, MyC4 and MicroPlace to make their products more liquid or shorter-term should help increase the number of lenders.



[1] Survey conducted by Accenture of a sample of internet users to determine what percentage had heard of P2P lending (25%) and what percentage of those would consider funding loans on a P2P (8.5%). Survey results available at www.pliki.gemius.pl/2008/2008/Social_Lending_in_Poland_2008_EN.pdf

substantial resources in its partner MFIs in order to ensure data integrity, so it is costly if a partnership ends. So far, twelve of Kiva's 100 partnerships have been paused and twelve have ended, four for data integrity issues. RangDe also considered partner selection to be among its greatest challenges in India, especially given the strict terms on which RangDe is willing to work with an organization. Meanwhile, Direct P2P models do not have the same constraint of working with intermediaries to source and screen borrowers and their funding ratios indicate that their largest constraint to growth is not a lack of supply, but rather attracting enough investors. In its first year and a half of operations, 8% of the loans posted on Prosper were funded, with borrowers relisting their loans 2.7 times;[26] LendingClub reported a 11% funding ratio through the end of August 2008. This leads one to wonder if a Direct P2P model might be a better solution in developing or emerging economies, as many informal sector loans in developing economies already come from friends and family as opposed to from moneylenders or MFIs. In middle income countries, with fewer constraints related to internet access and connectivity, could a Direct P2P facilitating loans from local lenders to local borrowers build off of existing social networks effectively without face to face personal contact?

REGULATORY OBSTACLES

Regulatory issues are a constraint for nearly all of the P2P platforms interviewed for this study. While person-to-person lending is not a new phenomenon, the formalization of person-to-person lending is, and most countries have not determined the government's role in regulating this industry. In the United States, P2P platforms have worked within existing regulations, partnering with registered banks (Prosper, LendingClub) or credit unions (Zopa) in order to operate their sites; as such they are subject to state and federal regulations on lending, privacy laws, and interest rates. However, because the regulatory environment differs in each country, it is difficult to replicate a given model exactly in other countries. Some platforms have tried to do so: Prosper expects to launch its site in Japan soon. In Europe both Zopa (UK) and Boober (Netherlands) have successfully replicated their sites in Italy; however, they have put other plans for replication on hold, because of regulatory uncertainty, in Spain for example. Platforms in other countries have also encountered difficulties. IOU Central, which launched in Canada in February 2008, was later required to suspend its lending or any transaction resembling a "security" until further review by the regulatory authority.

For international P2P platforms, the regulatory environment can be equally if not more complicated. Platforms must abide by lending regulations within their home countries as well as in those countries where they have borrowers or lenders. In addition, platforms must comply with restrictions on capital flows between countries and withholding taxes where applicable. The complexity of these regulations requires significant spending in legal counsel and can

[26] Freedman, Seth and Jin, Ginger Zhe (2008 preliminary study) "Dynamic Learning and Selection: the Early Years of Prosper.com", University of Maryland, available at http://www.glue.umd.edu/~ginger/research/Freedman-Jin-ProsperStudy-061008.pdf.

drastically inhibit the international P2P industry's ability to achieve scale. The very existence of three domestic P2P platforms in India, which has strict capital controls and restrictions on external borrowing, speaks to the constraints capital controls and restrictions on external borrowing can impose on international P2Ps.[27] In the United States, regulatory constraints have had an impact on P2P business models. Kiva, for example, registered as a non-profit because as a for-profit company, it would have had to register as an broker-dealer with the SEC, something very difficult without substantial financial backing. The co-founder of Kiva, Matt Flannery, writes, "Since the concept of online person-to-person lending didn't exist, microfinance was less well known in the business community, and the model was highly experimental, we decided that a 501(c)(3) status would help us form a bond with our users and raise a small amount of donation capital to get the idea off the ground."[28] The regulatory environment also dictated Kiva's decision not to charge interest on Kiva loans, which contradicted the original business plan and which Kiva's founders are still striving to rectify.

Thanks perhaps to others who had gone before it and certainly thanks to its partnership with ebay, MicroPlace had the financial backing to launch as for-profit site and a SEC registered broker-dealer which has allowed it, among other things, to offer its users a return on their investments. However, despite this, as an SEC registered broker-dealer MicroPlace is still subject to many stringent regulations which make it challenging to quickly expand its product offering. For example, in order for a securities issuer such as Calvert Foundation to offer its community investment notes online, it must not only have an investment prospectus, but also seek approval for the notes in all 50 states. For an organization like Calvert Foundation that was already issuing its notes in all 50 states, it is relatively simple to change its prospectus to incorporate its listings on MicroPlace. However, other organizations could find this requirement more onerous and it might deter them from listing their products on the site. MyC4 is another example of a platform that has successfully registered as a for-profit company (in Denmark), yet it continues to deal with the regulations of other European countries, from which it would like to attract investors, as well as the African countries in which it operates. The legal environment in each country it works in must be examined to ensure that capital can flow freely in and out of the country, that lenders will have some legal recourse in the event of a default, and that the local tax ramifications of the transaction are fully understood and made publicized to lenders. As the P2P market matures, and is better understood by consumers and regulators alike, we can hope that the grey area in which many platforms are still working becomes clearer and that the regulatory authorities will adopt policies conducive to the industries growth and transparency.

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[27] Such restrictions make it difficult if not impossible for foreigners to lend directly or indirectly to Indian nationals or companies, without prior approval from the Reserve Bank of India.

[28] Source: Flannery, Matt "Kiva and the Birth of Person-to-Person Microfinance," Innovations, Winter & Spring 2007 available at http://www.mitpressjournals.org/doi/pdf/10.1162/itgg.2007.2.1-2.31?cookieSet=1

MOVING BEYOND LENDING

The potential for scale and growth of the P2P model is immense. Many of the platforms have been designed in such a way that they allow for a multitude of products and services to be transacted through the sites even beyond existing loans. As mentioned above, Prosper is working on a shorter maturity product to make payday loans a feasible product for the site. MyC4, the Denmark based platform targeting MSMEs in Africa, is considering opening a secondary market for loans which would make the sector more liquid and more appealing to a larger range of investors. They are also considering expanding into the marketplace for equity in the future.[29] Such a product would open up and democratize a whole new asset class previously reserved for the "elite" – private equity, and has the potential to put much needed seed capital into the hands of entrepreneurs, reinvigorating the small and medium enterprise sectors. The MicroPlace platform is already being used for other social finance sectors such as low-income housing, and because of the model it employs, it would be easy to leverage for other asset classes such as equity and for new social sectors such as renewable energy and healthcare. New online platforms have also recognized the potential of using the concept of social networking to make markets more efficient. PeerFX, launched in August 2008, provides travelers with a venue for exchanging currencies (currently limited to US dollar and Canadian dollar exchanges). Partizipa in Spain and Valuna in Germany offer retail investors the opportunity to invest directly in small and medium businesses, or peer-to-company investing. P2P platforms can also provide a valuable venue through which borrowers and lenders can interact. Such interaction not only facilitates loans or investments, it can also lead to the creation of business relationships and opportunities.

MyC4 has placed great emphasis on creating a community of lenders and borrowers and promoting such relationships. They are also working to help delivery capacity building courses for their providers and ultimately the MSMEs they support, but they are facilitating the courses rather than delivering the courses themselves. Education related to business, financial literacy and health are just some additional possibilities that can be made available through P2P sites. In developed countries, frequent visitors to P2P sites can be engaged more actively in other "social" efforts that include opportunities for volunteering abroad, information about hunger and relief efforts in emergencies and programs to encourage greater community engagement. Moreover, by using of local intermediaries, P2P platforms can have an additional impact on job creation.[30] The opportunities for the P2P sector are tremendous, if we can work out an appropriate regulatory system for such sites and find the right balance between privacy and transparency of information.

[29] These products have already been conceptually developed by MyC4, but are not likely to be implemented before the end of 2009.

[30] MyC4 reports that it's first field partern ('provider") only had 2 employees when they started their relationship with MyC4 and that they now have 38.

VI. PARTNERSHIP OPPORTUNITIES FOR DEVELOPMENT AGENCIES

This document describes how existing P2P websites have leveraged technological platforms to transform traditional concepts of community lending and trust that are as old as time. These P2P platforms have the potential to be a significant source of capital for the domestic and international financial markets and to complement if not partially replace traditional banks' role in financial intermediation. They have the potential to "democratize" the credit markets, increasing access to finance for segments currently excluded from the formal financial markets and offering investors access to a new, socially responsible asset class previously reserved for the "elite". However, there are significant constraints faced by P2P platforms, and despite the largely private efforts which have launched the P2P lending industry, there is still a role for development agencies to play to help reduce or eliminate these constraints.

MACRO-LEVEL SUPPORT OF THE ENABLING ENVIRONMENT

- Development agencies can commission further research on the existing regulatory issues surrounding P2P platforms and publish easy to read guidelines for P2Ps to establish themselves under prudent regulatory management in major countries.
- Development agencies could help raise the profile of P2P lending and build awareness of P2Ps with regulatory agencies. Regulation and transparency ultimately pose some of the greatest bottlenecks to the industry and significant growth can be achieved if it is inclusive of supervisory and regulatory efforts. Regulators need to understand the risks and opportunities of these models before offering support and greater research and consideration is needed around the main risks of P2P lending.
- In order to promote greater information transparency and pave the way for the development of Direct P2P Models in developing countries, development agencies can continue to support the development and/or strengthening of credit bureaus in these countries. This would also help the financial sector more generally, but could initially exclude many poor people who have not yet had a chance to build a credit history. This has greatest potential for impact in middle income countries where intermediary P2P models are struggling, yet small businesses have greater access to the internet.
- Although specific studies on various P2P platforms have been commissioned, there is limited publicly-available industry-wide information about the sector. Donors can begin to include P2P platforms in discussions about democratizing access to finance to begin to stimulate innovation in this area and promote networking and partnerships between P2P platforms, MFIs, and investors.

PLATFORM SPECIFIC SUPPORT

- Development agencies could provide partial guarantee mechanisms for specific countries where investors are hesitant to lend. It is unclear how effective or how necessary this strategy may be as some of the riskiest countries (i.e. Iraq, Afghanistan, and Palestine) have been among the most popular on Kiva for example because of the perceived social return. However, for those P2P sites offering a return, investors may be more sensitive to the risk of losing their investments. Additionally, guarantees could help focus P2P sites on countries that are not currently in their radar but that may need resources.

- In order to raise the profile of P2P lending platforms among investors, development agencies could invest a small portion of their available funds to provide technical assistance aimed at strengthening selected P2P platforms. This would serve as a stamp of approval for the sites, which can advertise the donor's participation and support and some sites have suggested that this type of support would benefit their marketing. Caution should be taken in not appearing to "guarantee" loans, information published on the site or specific borrowers.
- Development agencies could also leverage the existing local partner relationships established by P2P platforms to channel resources to micro, small and medium enterprises in developing countries, thus directly promoting the private sector. Sites such as MyC4 encourage the institutional as well as individual investors to use the site, so development agencies could similarly set up a revolving loan fund on the platform. This would be most feasible on platforms which offer automatic bidding technology.
- Donors could support due diligence and monitoring efforts of intermediary P2P sites that are investing in countries where the cost of due diligence is high, such as in post-conflict environments. Donors could provide special technical assistance teams, perhaps leveraging existing field projects, to help identify, assess and monitor partner MFIs in these countries.

VII. APPENDIX

INTERNATIONAL P2P PLATFORMS

Name	Launch Date (1)	Country of Orgin	Geographic Coverage	Methodology	Website
Kiva	Nov-05	Un ited States	Global	Intermediary Model	www.kiva.org
MyC4	May-07	Denmark	Uganda, Kenya, Cote D'voire, Rwanda, Ghana	Intermediary Model	www.myc4.com
MicroPlace	Oct-07	Un ited States	Global	Investment Fund Model	www.microplace.com
Rangde	Jan-08	India	India	Intermediary Model	www.rangde.org
dhanaX	Feb-08	India	India	Intermediary Model (Pure P2P to come)	www.dhanax.com
Investors Without Borders	Expected in 2009	Un ited States	Ghana (to start)	Intermediary Model and Pure P2P	www.investorswithoutborders.wordpress.com
Globefunder	Pending	India	India	Intermediary Model	www.globefunder.in

DOMESTIC P2P PARTNERS

Name	Launch Date	Country of Orgin	Geographic Coverage	Methodology	Website
Zopa	Mar-05	United Kingdom	United States, United Kingdom, Japan, Italy	P2P "silent" auction site in UK; Credit Union partnership US	www.zopa.com
Donjoy	2005	Korea	Korea	NA	www.donjoy.net
Prosper	Feb-06	United States	United States	P2P Auction	www.prosper.com
smava	Feb-07	Germany	Germany	P2P Auction	www.smava.de
boober	Feb-07	Netherlands	Netherlands, Italy and "International"	P2P Auction	www.boober.nl
fairrates	Apr-07	Denmark	Denmark	P2P Auction	www.fairrates.dk
Frooble	May-07	Netherlands	Netherlands	NA	www.frooble.nl
lending club	May-07	United States	United States	P2P Resaler, Affinity Group Lending	www.lendingclub.com
Ppdai	Jun-07	China	China	P2P Social network - friends and friends of	www.ppdai.com
Igrin	Oct-07	Australia	Australia	P2P Auction	www.igrin.com.au
Loanland	Dec-07	Sweden	Sweden	P2P Auction	www.loanland.se
Money Auction	2007	Korea	Korea	P2P Auction	www.moneyauction.co.kr
Popfunding	2007	Korea	Korea	P2P Auction	www.popfunding.com
IOU Central	Feb-08	Canada	Canada	P2P Auction	www.ioucentral.ca
Kokos	Feb-08	Poland	Poland	P2P Auction	kokos.pl
Monetto	Mar-08	Poland	Poland	P2P Auction	www.monetto.pl
Finansowo	Mar-08	Poland	Poland	P2P Auction - Acquaintances	www.finansowo.pl
fynanz	Mar-08	United States	United States	P2P for Students	www.fynanz.com
cashare	Apr-08	Switzerland	Switzerland	P2P Auction	www.cashare.ch
greennote	Jun-08	United States	United States	P2P for Students	www.greennote.com

P2P PLATFORMS PENDING LAUNCH

Name	Launch Date	Country of Orgin	Geographic Coverage	Methodology	Website
Lending Hub	Expected Q4 2008	Australia	Australia	P2P Real time - affinity groups	www.lendinghub.com.au
Fosik	In Beta Testing	Australia	Australia	P2P Auction and Family/Friends Facilitator	www.fosik.com.au
CommunityLend	Pending	Canada	Canada	Direct P2P	www.communitylend.com
FriendsClear	Pending	France	France	Direct P2P	www.friendsclear.com
Qifang	Pending	China	China	P2P students / Intermediary Universities	www.qifang.cn
Maneo	Expected 2008	Japan	Japan	Direct P2P	www.maneo.jp
one2money		Germany	Germany		www.one2moneyde.web131.discountasp.net
Peermint	Expected	Canada, Australia, New Zealand	Canada, Australia, New Zealand	Direct P2P	www.peermint.com
Lendary		Canada	Canada	Direct P2P	www.lendary.com
Loanio		United States	United States	Direct P2P	www.loanio.com

VARIATIONS OF P2P PLATFORMS

Name	Launch Date	Country of Orgin	Geographic Coverage	Methodology	Website
PeerFX	Aug-08	Canada / United States	Canada / United States	P2P Currency Exchange	www.peerFX.com
partiZipa.com		Spain	Spain	P2 Company	www.partizipa.com
Valuna	Jun-05	Germany	Germany	P2 Company	www.valuna.de
Virgin Money	2001	United Kingdom	UK, US, Australia,	Loan facilitator or	www.virginmoney.com
Globefunder	Oct-07	United States	United States	Direct-to-Consumer	www.globefunder.com