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P2P lending platforms in China help meet unmet investment and business needs, but regulation is needed

In 2007, Ppdai.com became the first P2P (peer-to-peer) lending platform in China, just two years after Zopa blazed the trail as the world's first such platform. Between 2007 and 2010 there was slow growth in the sector until 2011 following interest rate liberalisation by the Chinese authorities. The boom was followed by a bust where 75 P2P lending platforms defaulted in 2013, and many more hanging on by a thread.

"There is no minimal capital requirement as there are for banks," explains **Rui Meng** of the China Europe International Business School (CEIBS) at the recent SKBI Conference 2015. "P2P platforms are not subject to other requirements such as loan-to-deposit ratios etc. In other words, P2P platforms are free to act as they please."

Reasons for P2P lending growth in China

The 'Wild West' mentality explains in part the explosive growth in the number of P2P platforms in China, which has grown from 948 in February 2014 to more than 1,700 in March 2015. Within the same time period, the monthly amount of P2P loans originating in China jumped over 300 percent from 10.5 billion RMB to 48.3 billion RMB.

However, Rui points out what he believes is the biggest contributing factor to the popularity of P2P lending platforms: the high demand for market-based interest rates in China's state-controlled financial system. Deposit rates barely beat inflation, and the country's underdeveloped capital markets limit investment choices. Furthermore, there are restrictions on investing in foreign markets.

"Individuals are not well-served – if you want to buy wealth management products, the minimum amount you need to commit is 50,000RMB," says Rui. In a country where 94 percent families have wealth of less than US$100,000, many cannot afford to engage regular banks, leading to unmet demand for maximising investment returns. With P2P platforms offering returns of up to 30 percent or more, it is an enticing prospect.

Businesses, meanwhile, turn to P2P platforms for different reasons. "There are two ways of allocating capital," Rui says, referring to direct financing such as IPOs and corporate bonds, and indirect financing such as through commercial banks. “In China, 15 percent of financing is done through direct financing. In other words, 85 percent is done through state-owned commercial banks.

“The top 5 commercial banks in China control more than 50 percent of the assets in 2008. These banks will only lend to state-owned enterprises, so SMEs often cannot get loans.”

Regulations on the way

The unregulated nature of the sector’s growth has led to many lenders folding or absconding with the money. The official Xinhua news agency in December described a third of these companies as fraudulent, and in January this year the China Banking Regulatory Commission (CBRC) announced restructuring plans to address issues facing the P2P lending sector.

The CBRC is expected to announce new regulations in June, and media reports say P2P lending companies will be required to register with local regulatory bodies while high-risk products will be banned. Zhu Mingchun, Secretary General of the Guangdong Internet Financial Association, was quoted as saying, “The supervision aims to clean up fraud platforms as well as allow room for further developing the industry. We expect the regulations to be launched by the end of June.”