"Peer-to-Peer Lending to Small Businesses"

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Summary and Findings: Our paper examines loan-level data from Lending Club to look at peer-to-peer borrowing by small businesses between 2007 and 2012. We begin by looking at characteristics of loan applications that were and were not funded and then take a more in-depth look at funded applications. The data show an increasing number of small business loan applications over time, from 73 in 2007 to 43,000 in 2012.

Beginning in 2010, business loans were less likely than loans for other purposes to have been funded. However, logistic regression results that attempt to control for the quality of the application show that, holding all else constant, applications for a loan for a small business were significantly more likely to have been funded than loans for other purposes.

Turning our attention to funded applications, we note that funded business loans were slightly larger than loans funded for other purposes but paid similar interest rates. However, relative to small business loans from traditional sources, peer-to-peer small business borrowers pay an interest rate that is about two times higher. Regression results show that peer-to-peer loans for small businesses are charged about a one percentage point interest rate premium over nonbusiness loans.

Implications for Policy and Practice: Peer-to-peer lending has grown substantially since its inception in 2007 and has shown no signs of slowing. To the contrary, Prosper, the largest competitor in the peer-to-peer space, just received a $20 million equity injection and may considerably expand its lending in the very near future. As small business owners are increasingly turning to this alternative source of money to fund their businesses, policymakers may wish to keep a close eye on both levels and terms of such lending. Because such loans require less paperwork than traditional loans, they may be considered relatively attractive. However, given the relatively higher rate paid on such loans, it may be in the best interests of the business owner to pursue more formal options. More research is required to understand the long-term impact of such loans on the longevity of the firm, and more education to potential borrowers may be needed.