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The Peer-to-Peer Lending Market Report: The leading countries for alternative finance and the next high-growth markets

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BUSINESS INSIDER

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Key Points

- **The US is the largest P2P lending market in the world by loan volume, but the UK's is 72% larger on a per capita basis.** Low consumer confidence in banks (even before the financial crisis), a high degree of comfort with online platforms, and a positive regulatory environment have all helped nurture the UK's P2P lending market.
- **Europe is the next big market for P2P lending:** The alternative finance market in Europe reached nearly €3 billion ($3.9 billion) in 2014, a 144% jump, and small-business P2P loan volume in France grew almost 4,000% last year, to reach €8.2 million ($10.6 million).
- **Although the industry is flourishing, there are serious risks that could derail it:** Interest rate hikes, new regulations, frayed bank relationships, and other factors could put a stop to the industry's current surge.

Click here to download all the charts and associated data in Excel »

A note about currency conversion: This report uses primary data sources that originally present data in euros. To convert to US dollars, we took the US Treasury's listed conversion rates for each quarter in 2014, and averaged the figures to create a constant rate for all of 2014. We used this single conversion rate to convert across our time series in order to remove currency effects from the curve. The converted figures are meant to provide a look primarily at the market's growth and potential.

This report serves as a companion to our overview report, "THE PEER-TO-PEER LENDING EXPLAINER: How digital lending marketplaces work and why they're poised for major growth," which takes a close look at the mechanics of lending platforms and why this business segment is poised for growth.

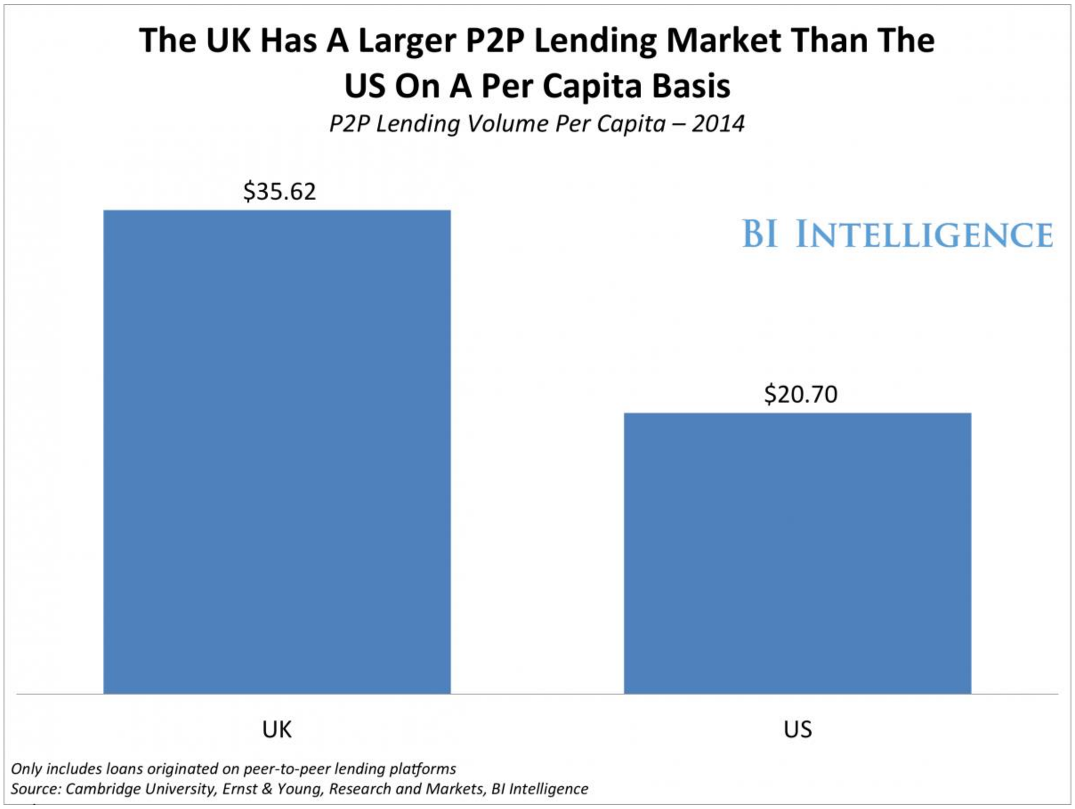
The UK is the most advanced P2P lending market, ahead of the US

The US and the UK are the two leading markets for P2P lending in the world.

The UK actually has a smaller P2P lending market than the US in terms of total volume. However, on a per capita basis, the UK market is larger.

- The **UK** generated nearly \$2.3 billion in peer-to-peer loans in 2014.
- The **US** generated \$6.6 billion in peer-to-peer loans last year.
- However, the UK's population in 2014 was one-fifth the size of the US, making the P2P market in the UK the largest in the world on a per capita basis. 72% more lending volume is transacted in the UK than in the US per person.

For this reason, the UK has become a case study for how other alternative lending markets might develop.



The UK has achieved these impressive alternative lending volumes in part because regulations are more supportive to alternative lending in the country compared to the US. In fact, current US laws make it difficult for alternative lending platforms to expand.

Although peer-to-peer lenders do not own any of the loans, the loans they service are currently considered "securities" by the SEC in the US, and therefore, lending companies must apply for a license with each state. Many states have not granted these licenses to P2P platforms because they don't believe the industry is established enough yet to be safe for investors. As a result, the two largest lending platforms in the country, Prosper and Lending Club, cannot operate in 19 states and 22 states, respectively.

The fact that two of the largest P2P lending platforms are shut out from nearly half the country has certainly prevented the industry from reaching its full potential in the US.

Although US regulations are still nebulous, the industry is showing signs of stability and maturation, with major financial institutions now investing their dollars in peer-to-peer loans and platforms. For instance, Prosper Marketplace recently raised $165 million in Series D financing, led by Credit Suisse NEXT Investors, JPMorgan Asset Management, SunTrust, and BBVA Ventures.

However, given that the regulatory environment in the UK is more developed, and loan volume in the country, in turn, is more significant, we will look closely at how the UK can provide a benchmark for other countries to facilitate the expansion of the peer-to-peer lending market and loan volume.

What's behind the UK's success

The market in the UK has developed on a similar timeline to the US. Zopa.com, the UK's first major P2P lender, launched in 2005, as the first lending startups emerged in the US. But, like in the US, alternative lending in the UK didn't really take off until after the financial crisis. The industry built momentum after the financial crisis, when banks were low on cash and seeking to avoid risky loans, compounded by the fact that confidence in banks plummeted after the crisis. This environment encouraged both consumers and businesses to start seeking alternative sources of finance.

Consumer attitudes and habits in the UK lend themselves to a thriving alternative finance market. Individuals in the country are quick to embrace new technologies related to commerce and finance, and show a strong skepticism towards traditional banks.

- **Low confidence in banks:** The UK's "confidence level" in banks dropped from 47% in 2008 to 23% in 2013. By comparison, the US's "confidence" level was 49% in 2013, higher even than confidence in the UK before the crisis. Such low confidence in banks makes UK consumers more open to switching to a non-bank provider if a good product is presented to them.

- **High mobile and internet penetration:** Mobile and internet penetration were 131% and 84%, respectively, in 2014. That internet penetration rate is among the highest in the world, while mobile penetration is one percentage point lower than EU frontrunner Germany.

- **Early adopters of e-commerce:** In 2012, the UK's consumer e-commerce spend per capita was $1754, higher than other developed nations like the US, France, and Germany, an Ernst & Young report shows. Even in 2010, the spend per capita was $1331, higher than the US's in 2012. Comfort around e-commerce lends itself to comfort around other types of monetary transactions via web-based platforms.
- **Faster adoption of new payment methods:** The UK launched the UK Faster Payment service in 2008, allowing UK citizens to receive mobile and online payments within minutes. Other developed countries like the US, meanwhile, are still debating how to implement a real-time system.

While consumers in the UK have an appetite for updated products and services, the government has bolstered the trend toward alternative finance by implementing supportive regulations:

- **Referral programs:** Large banks in the UK are now beginning to refer rejected small business applicants to alternative lenders. The Royal Bank of Scotland is referring applicants who do not receive loans with the bank to the P2P lenders Funding Circle and Assetz Capital as part of a pilot program. Now, the British government is sketching out a program that would *formally require* banks to refer rejected small business loan applicants to P2P platforms. The requirement is supposed to be in place in 2016.

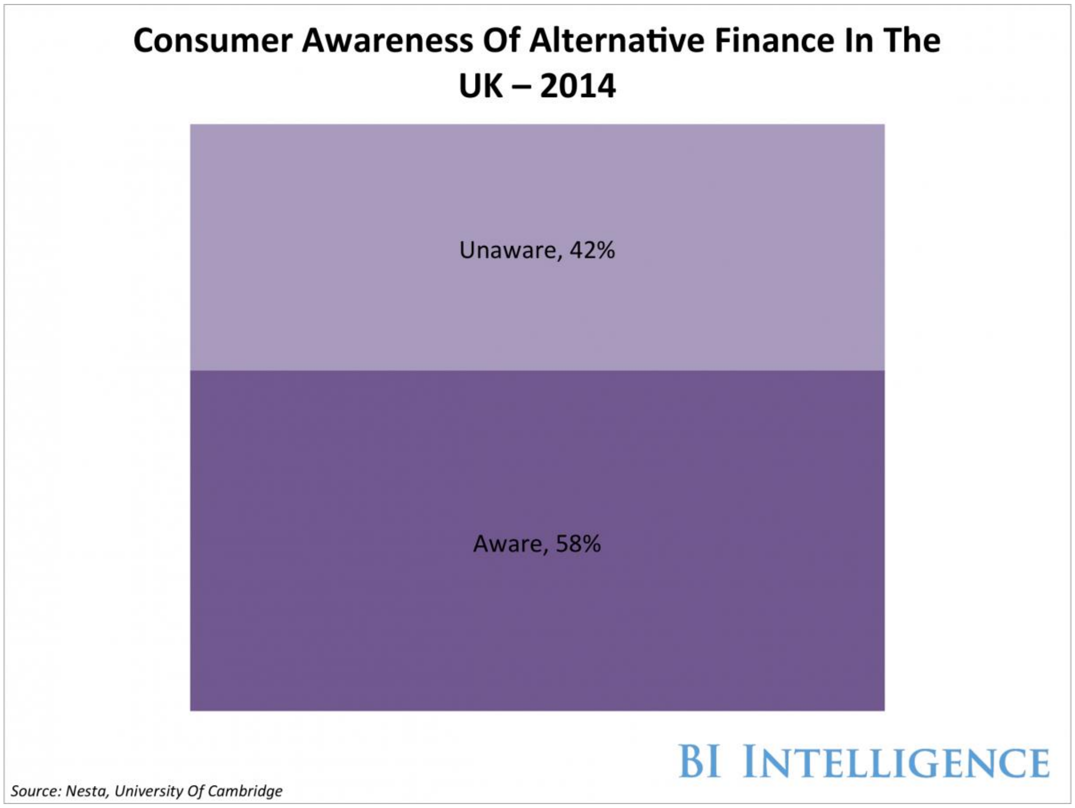
- **Dedicated government body:** The British Business Bank, created by the UK government to help provide financing to businesses, is spearheading the referral project. It is currently inviting companies to collaborate on creating platforms that will automatically refer rejected applicants to an alternative lender.
- **Formal laws:** In April 2014, the Financial Conduct Authority enacted laws regulating the peer-to-peer finance industry. The rules set standards for capital requirements, business conduct, the protection of client money, and countless other subjects. By having formal laws, alternative lenders can make business decisions and investments with greater certainty about the future.
- **Industry trade bodies:** Lending startups in the UK have the opportunity to join large trade bodies that track the industry, make recommendations to government bodies, and also give companies opportunities to network with each other and collaborate on larger initiatives. The Peer-to-Peer Finance Association, for instance, represents 90% of P2P lenders in the UK, and serves to promote the industry and develop rules and best practices for protecting consumers.

In addition to the supportive regulatory environment in the country, the P2P lending segment is also booming because SMEs (the British terminology for SMBs) have trouble receiving loans from banks. And this is also likely why the UK government is encouraging rejected small business applicants to apply for alternative P2P financing.

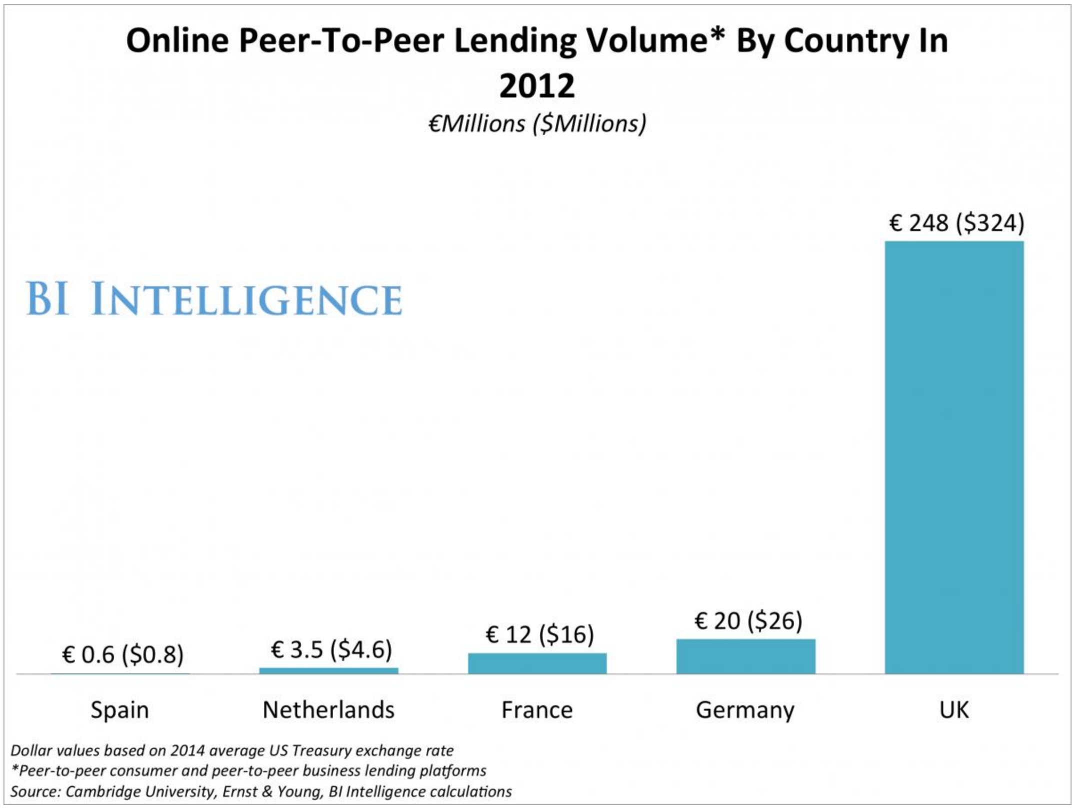
- In 2014, 79% of small businesses in the UK sought funding from a bank before approaching a P2P business lender, and only 22% actually received funding, according to a Nesta report.
- This suggests that 78% of business applicants were rejected from receiving a loan from a bank, although it's likely that some of the companies opted out of receiving a loan for other reasons. In either case, there is pent-up demand for financing.

The confluence of these factors breathes certainty and demand into the industry, and is likely the primary reason that so many lenders and borrowers have flocked to these platforms in the UK. It is also likely why alternative lending is well-understood by a large number of mainstream UK consumers.

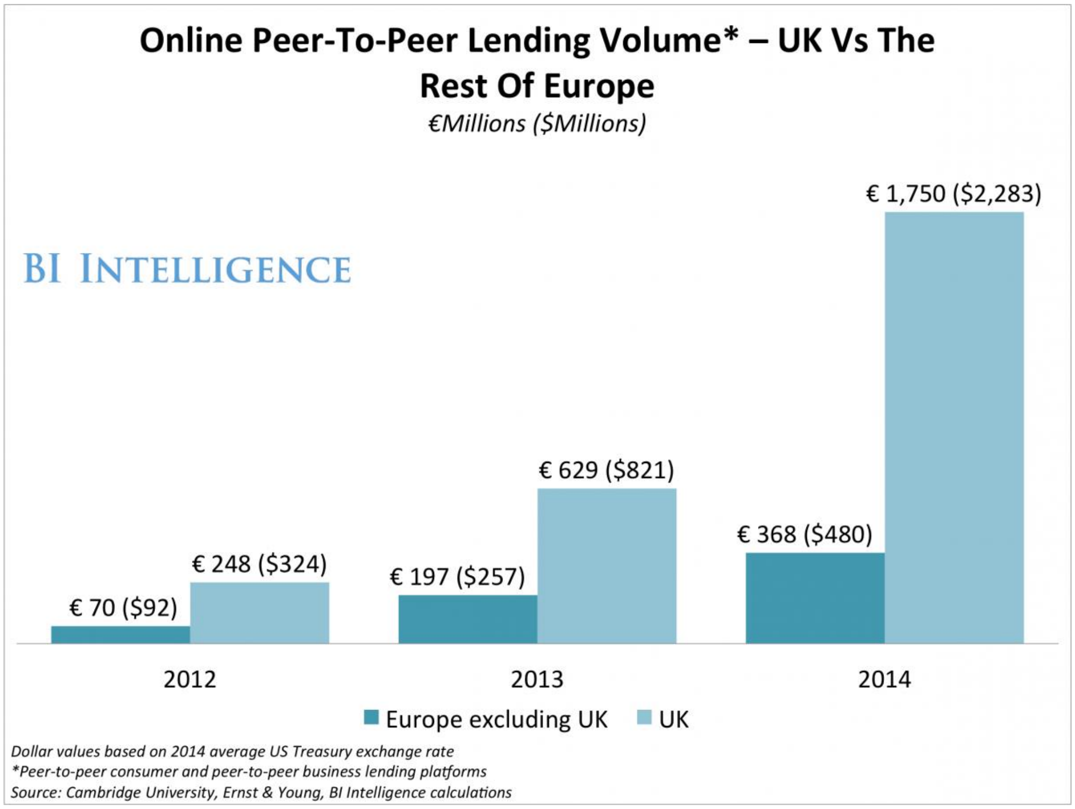
- 58% of consumers in the UK were aware of some type of alternative finance being available, whether crowdfunding or P2P lending, according to a 2014 Nesta report.
- 14% of those individuals had actually used alternative financing platforms. While this is far from a majority, it's still a significant number of consumers who have shown confidence in these relatively new forums as legitimate routes to seek out financing.



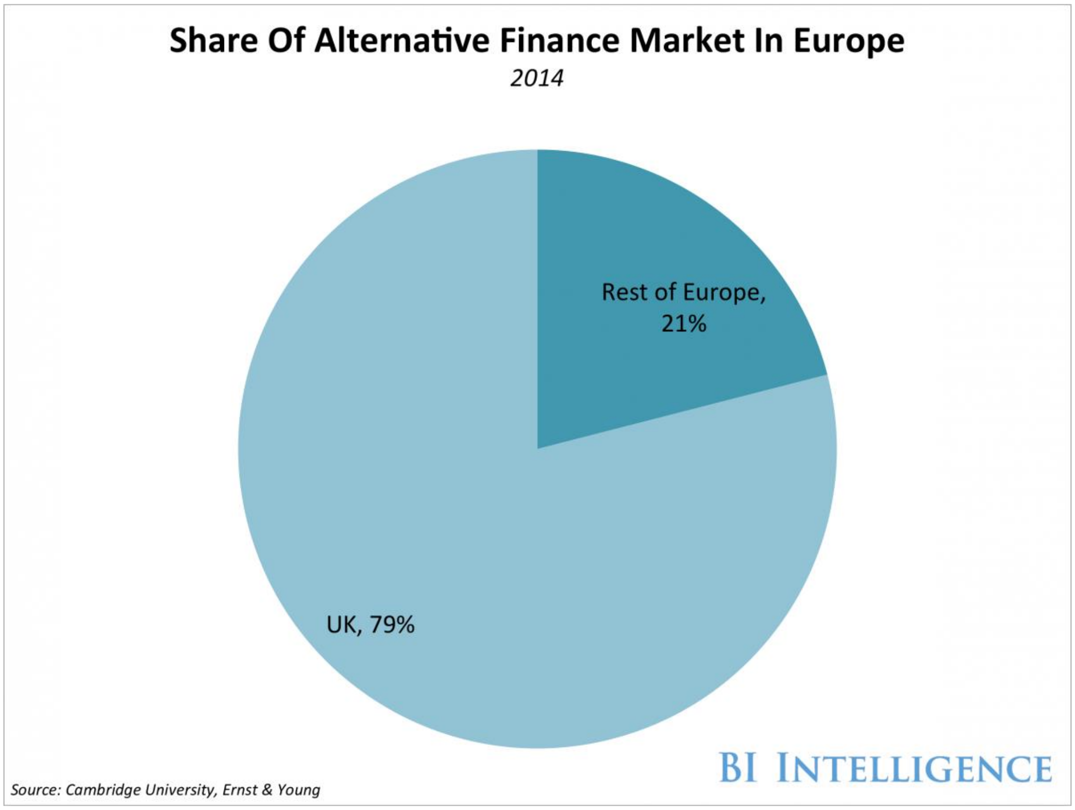
To illustrate how far ahead the UK is compared to continental Europe, by 2012, the UK was already facilitating over €248 million ($324 million) in lending volume through P2P platforms, 1,140% higher lending volume than second-place Germany.



P2P lending volume in the UK was 376% higher than the rest of Europe as a whole as recently as last year. Europe, excluding the UK, processed €368 million ($480 million) through lending platforms in 2014, compared to €1.75 billion ($2.28 billion) processed in the UK.

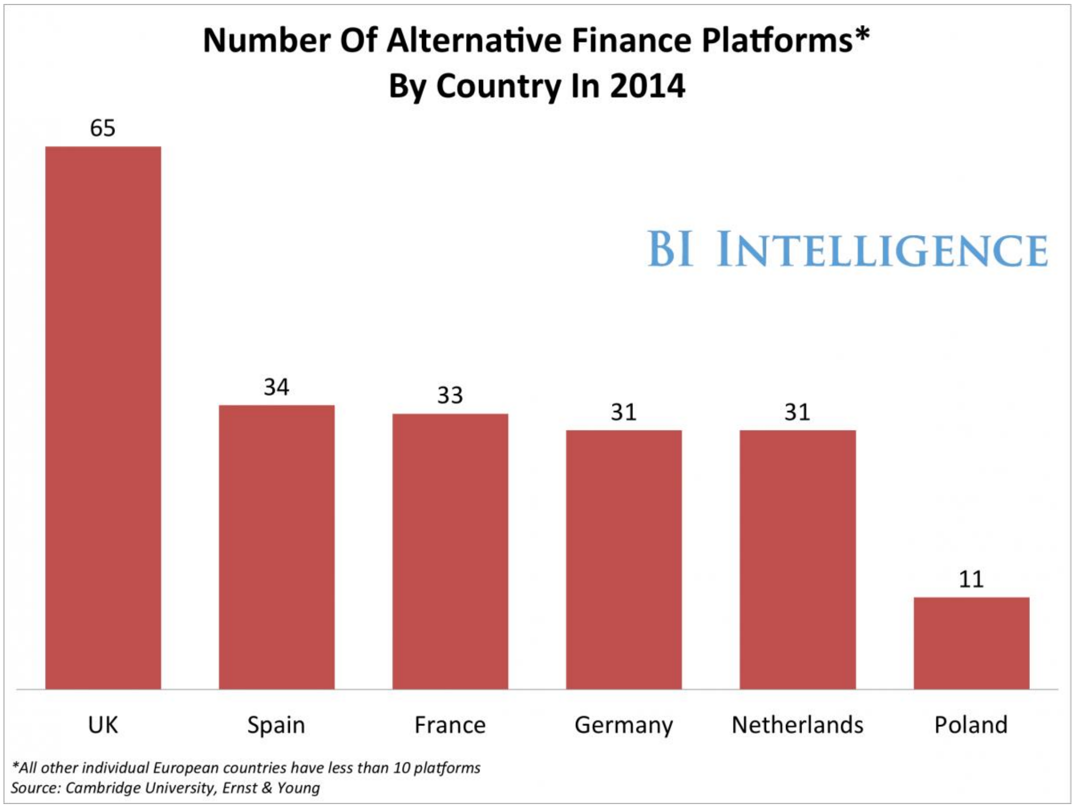


In terms of share, the UK held 79% of the EU market in 2014.



From another vantage point, the UK is generating more volume because there are more lending platforms in business. The UK currently has nearly twice as many alternative finance platforms as second-place Spain.

It's worth noting that only six countries in Europe have more than 10 platforms, and five of them are in Western Europe. This shows that alternative finance is very concentrated in the region and that the market in Europe as a whole is still in its infancy.

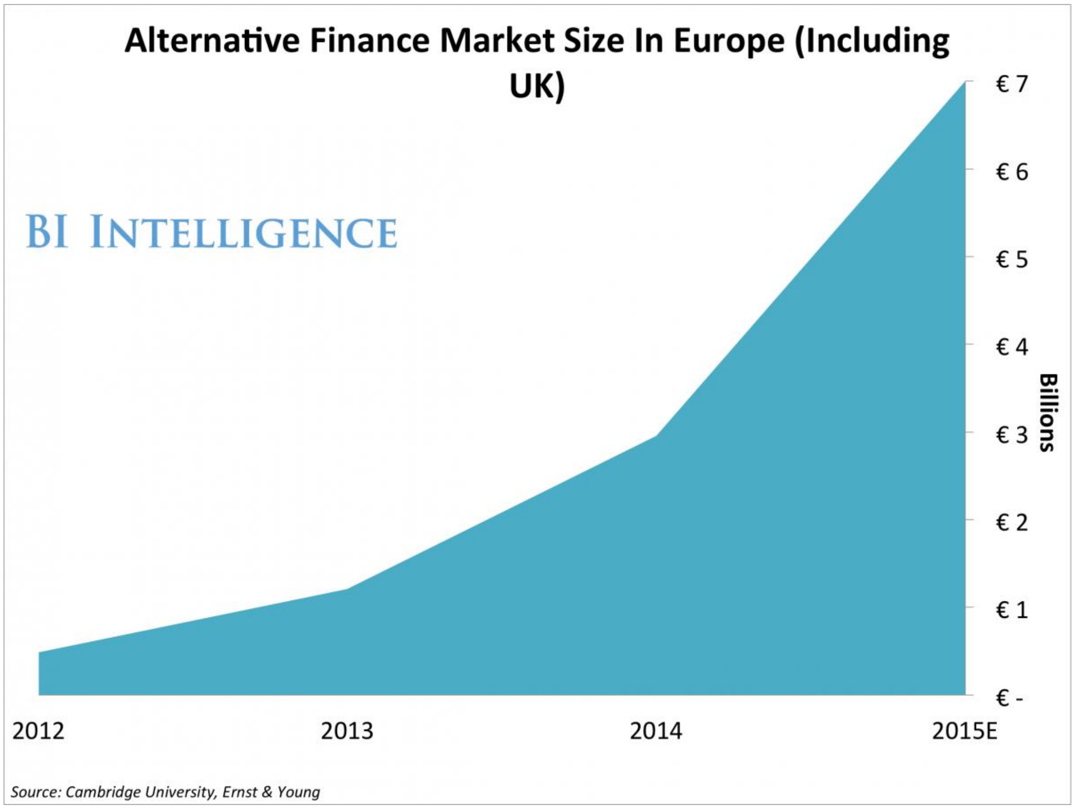


Europe will be the next alternative lending hotspot

Europe will be a major growth market for P2P lending in the coming years. The UK has long been a worldwide leader and now other countries in continental Europe are beginning to generate notable activity. Three years ago, many countries with large economies, such as France and Germany, were generating zero dollars in P2P business lending, but now are processing millions.

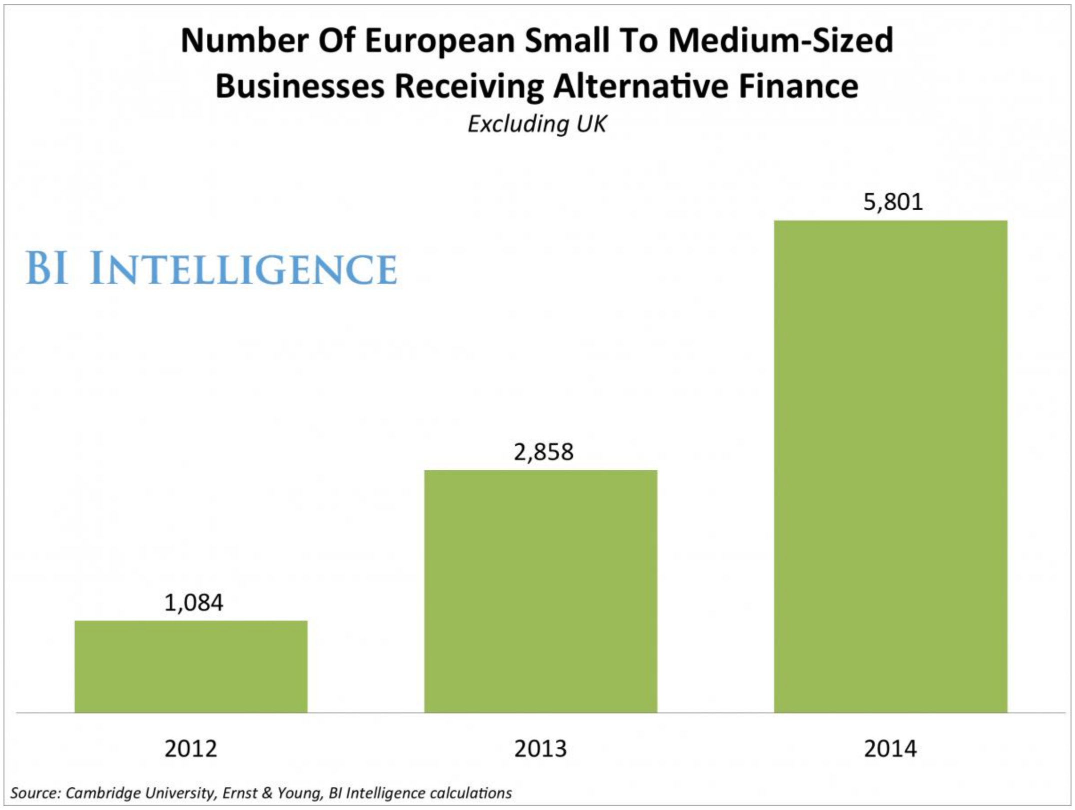
- **The alternative finance market in Europe reached nearly €3 billion ($3.9 billion) in 2014, a 144% jump,** according to The European Alternative Finance Benchmarking Report conducted by Ernst & Young along with the University of Cambridge.
- And the market is expected to reach over €7 billion ($9.1 billion) this year, if economic conditions remain stable, according to the report (see chart).
- If the forecast is accurate, this means that the growth rate will slow just slightly to 136% in 2015.

(Alternative finance in the EY report encompasses P2P lending, crowdfunding, microfinance, invoice trading, and debt-based securities.)

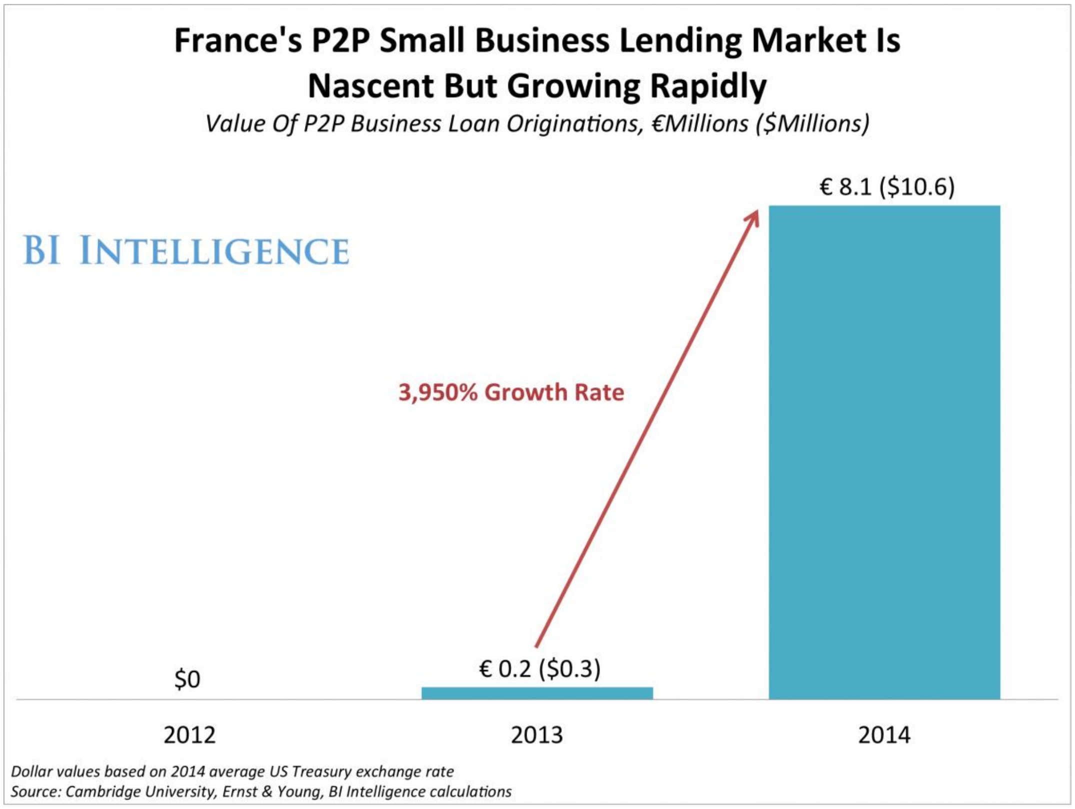


Alternative finance in Europe has grown more popular since the financial crisis, as confidence in traditional banks has waned. Lending startups in these countries are just now beginning to sprout up.

- 5,801 European SMBs, excluding those in the UK, received financing using a non-bank facilitator last year, over five times as many as in 2012.
- P2P business lending is the fastest-growing alternative lending segment in Spain, with a 363% average growth rate from 2012 to 2014.
- It is also the fastest-growing segment in Germany and the Netherlands, and the second-fastest in France.



In a clear example of just how quickly the market is taking off, no loans were originated through P2P small business lending platforms in France as recently as 2012. Two years later, in 2014, loan volume had reached above €8 million ($10.6 million).



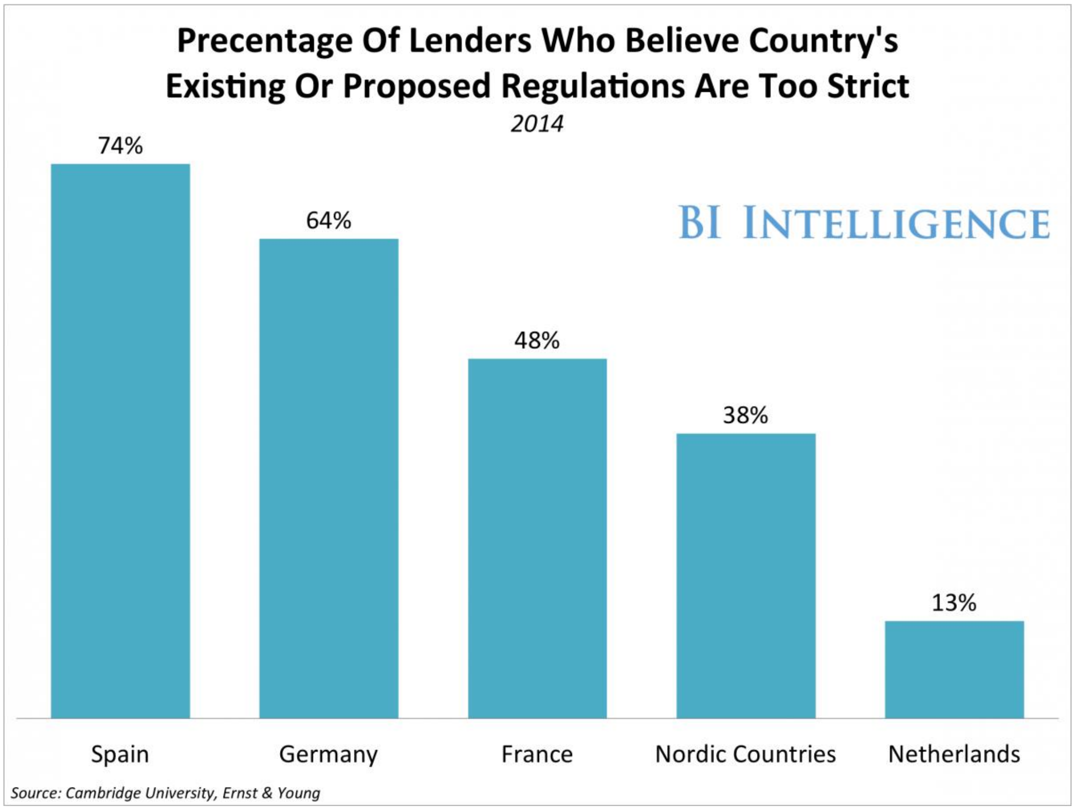
The risks

Even as the alternative finance market grows up, there are still a number of risks that could derail the industry in both Europe and the US:

- **Interest rate hikes**: Interest rates are currently at historic lows, in part to help grease the wheels of the lending system by encouraging people to borrow. If rates rise, borrowers might be less likely to seek out financing, which would limit the portfolio of loans that investors could benefit from.

This reduction in demand could cause a major slow down in industry growth.

- **New regulations**: As of now, the UK and the US have laws in place that allow alternative lenders to operate without hefty compliance costs. If countries begin to treat these startups as financial institutions, though, this would drive up the costs of conducting business, which would ultimately force these companies to raise fees for platform participants. This could drive away lenders and borrowers, reducing lending activity and ultimately damaging revenues. Currently, in Europe, many lenders believe their country's laws are too strict.



- **Bank relationships**: Many peer-to-peer lenders rely on the same bank to issue loans. For instance, in the US, major lenders like Prosper and Lending Club use Salt Lake City-based WebBank for loan originations. If these relationships fray, or if banks like WebBank become subject to new regulations barring the issuance of loans to platforms, peer-to-peer lenders would either be forced to find new partners, or would have to become banks to issue the loans themselves, both of which would be costly.

- **Market crowding**: The technology to facilitate loans has been so fine-tuned that it can take a startup just one year to set up a fully functional platform. Given the relatively low barrier to entry, it seems likely that a tidal wave of peer-to-peer lenders will enter the market in the coming years. This increased competition could ultimately improve the quality of the loan products. However, it could also make it difficult for consumers to differentiate between all the available platforms, which would spread the lending activity and revenues across a larger number of platforms. This won't be a major problem, though, if overall demand for alternative lending increases and keeps pace with the proliferation of platforms.

Although alternative lending is new and heavily dependent on many unknown future risk factors, based on the current trends and numbers, we expect the industry to flourish in the near term.

THE BOTTOM LINE

- Peer-to-peer lending is the most developed in the UK and the US. Although the US has the largest peer-to-peer lending market, the UK has a larger market on a per capita basis.
- The UK market has taken off fast because of a positive regulatory environment that breathes certainty and demand into the alternative lending market.
- While the UK and the US have established alternative lending markets, continental Europe is quickly building a successful market of its own.
- While the market for peer-to-peer lending is taking off, interest rate hikes and new regulations could quickly derail these nascent businesses.

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