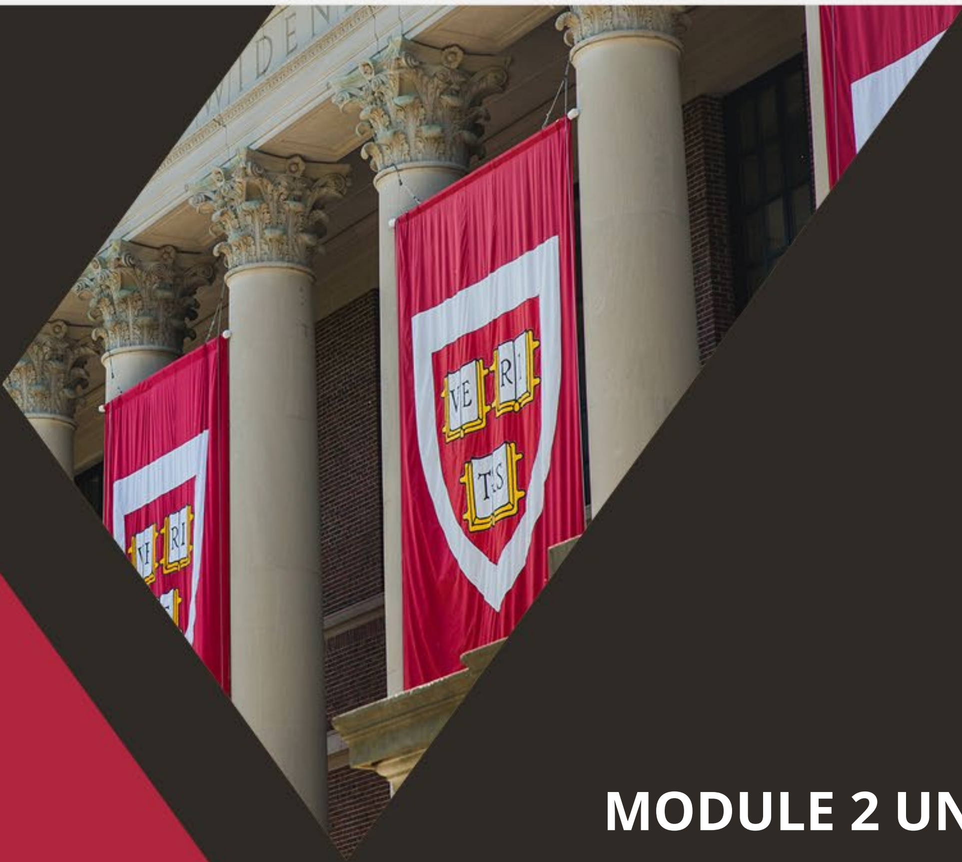
HARVARD
Office of the Vice Provost for Advances in Learning



MODULE 2 UNIT 1
Casebook Video 2
Transcript

Module 2 Unit 1 Casebook Video 2 Transcript

CHRISTOPHER MALLOY: Welcome back. In this video, we'll be talking about ThinCats, which is a small business lender – very similar to what we talked about with Zopa and LendingClub – but what ThinCats does, and their expertise, lies in lending to small businesses, and in doing so, those loans are actually secured. And what secured means, is that if someone were to default on the loan, potentially you can seize the assets of the underlying business.

How do these platforms make money? They all make money the same way, which is when they originated the loan – when they make the loan – they take a fee. And then, on the back end they do what's called servicing, and servicing means, essentially, you make sure all the payments happen, but also in the event of a late payment or a default, you try to go collect all that money.

Now, in this servicing component it's particularly important in small business lending, perhaps even more so than in consumer lending, because since there are underlying assets, the question is; how do you go seize those assets? And so, for some small business lenders, it's a matter of going to court, filing injunctions, and setting up a legal process whereby those assets can be seized, and that process can take a long time.

So, from the point of view of a lender, in the event that a borrower goes late – yes, it is true that the loans are secured by assets – but the ability of the lender to actually get those assets is actually quite hard and the time period is very uncertain.

The other big question we want you to consider is; what is going to happen to this industry over the next ten years? Because something that ThinCats was very worried about, and all these peer-to-peer lenders are very worried about, is that they've gone through an amazing cycle where there's been tremendous economic growth and very low interest rates. And the question was; is that why default rates were relatively low on these platforms? Is that why lenders got, by and large, a pretty good return on all these loans? And the question is; what's going to happen as interest rates start to rise? And that was something that the ThinCats team is quite worried about.

Now, it is true that, typically, these are fixed rate loans, but every new loan that is made by a platform, the interest rate will be at the new interest rate. So, in some sense interest rates do get passed on to the borrowers, but they don't get passed on perfectly. And then, the deeper question is; as interest rates start to rise a lot, what does that say for economic growth and future defaults? And ThinCats worried about this a lot, because they worried that perhaps their track record was driven by the fact that most of the loans they were making early on were driven by relationship bankers that they had on the ground that were helping to source these loans during a time when economic conditions were great.

And then, what's going to happen as the platform gets bigger and bigger? As it gets more and more automated? As competition comes in? Are these platforms going to be able to continue to make loans that don't default over the next coming economic cycle.

And the next issue we want you to consider and grapple with is; to what extent do we think these small business lenders, such as ThinCats, will eventually need to partner with large financial institutions? And why that's something we need to perhaps think about, is because small business lending, unlike consumer lending, is a much larger proposition. The amount – the dollar amounts – are much bigger.

So, instead of making a 15,000 dollar loan you're making loans in the hundreds of thousands of dollars, even millions of dollars. Will there be enough supply or demand for these loans? And is there a sense in which traditional banks are just better at managing relationships, at collecting soft information, at making those kind of larger loans?

And the other aspect that's important to consider when you think about large loans – large, small business loans – is the fact that, they typically require larger lenders. And so, ThinCats is an example where they had a big company come in and basically buy part of the company and agree to lend a lot of that capital; basically, an institutional investor.

And so, then again, it raises this issue of the interplay between a big institutional lender, which has a large amount of capital, versus some of the original lenders on these platforms, which were smaller, more retail, and what – to what extent – and this is something ThinCats worried a lot about – to what extent would the smaller investors on the platform be worried that these bigger investors were getting a better deal, getting access to loans that they weren't getting, or getting them at a better rate.

And now, given everything we've talked about, and everything you've learned by looking at both the Zopa case, the LendingClub case, and now the ThinCats case, the question we want you to grapple with and consider is; to what extent do you think peer-to-peer lending is here to stay, and that it will fully disintermediate banking and lending? Or do you think eventually – perhaps because of some of the issues we mentioned regarding the size of some of these loans – do you think eventually peer-to-peer lenders will have to partner with these large financial institutions in order to grow?