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Supply and demand on crowdlending platforms: connecting small and medium-sized enterprise borrowers and consumer investors

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ABSTRACT

Consumer crowdlending to small and medium enterprises is an increasingly relevant financial service phenomenon which depends on platforms as an intermediary. To match borrowers' supply of loan requests and customers' investment demand, this article proposes that crowdlending platforms need to initiate double switching behavior. On the one hand, switching of enterprise borrowers from traditional bank financing to crowdlending is driven by greater convenience (speed, flexibility, simplicity) and process transparency. Consumers, on the other, predominantly invest in crowdlending loans based on their economic performance relative to the choice set on the platform. We contribute to the literature on crowdfunding, satisfaction and switching in financial services.

1. Introduction

Driven by technological advances, new service models have developed in the financial industry which offer additional opportunities to customers. Under the common denominator "fintech", these new businesses aim to challenge existing financial institutions by using technology to deliver value to the customer in an alternative way. One such model is crowdlending: the direct financing of credits by a group of consumers. In this, crowdlending aims to replace traditional banks by directly connecting potential borrowers and investors through a platform, where future lenders can directly invest into various credit requests.

In recent years, crowdlending has grown out of its nascent phase into an established industry. While only $0.15 billion had been financed via crowdlending platforms in the United States in 2010, already $10.1 billion were funded in 2015 on the two largest platforms alone—a 97% growth versus the previous year (NSR Invest, 2016). Also in Europe the industry has grown strongly, with the financed volume in the UK, for instance, having grown by 130% p.a. in the last 5 years to more than £2.3 billion in 2015 (altfi DATA, 2016). Along with this overall growth, investments have soared and major companies developed. U.S. credit marketplace SoFi, for instance, saw a $1 billion investment in September 2015 (Cushing, 2015). However, success and failure lie close, as the recent scandals at Lending Club show (McLannahan, 2015), which—less than a year after the platform had secured a $150 million investment by Citigroup (Back, 2016)—halved the company's market value to $1.8 billion in June 2016.

The focus area of this article are consumer investments into small and medium enterprises (SME) seeking financing (C2B lending), rather than into requests from private borrowers (C2C lending). In the UK crowdlending to SME has surpassed investments into consumer loans in June 2015 and continues to grow faster. In continental Europe consumer loans are still the predominant investment form, but the annualized growth of crowdlending to SME exceeds the increase in consumer loan investments by more than 50% (~90% vs. 150% in 2015, altfi DATA, 2016).

Though a technological vanguard, one of the major challenges of the industry is a classical one: matching supply and demand. Because crowdlending platforms work as intermediary that facilitate transactions between two parties (Sriram et al., 2015), charging a fee for funded loans or made investments, their income stream is dependent on actual consumer investment and funded credits. Even if a crowdlending fintech attracted investment demand from many consumers, these would still require a supply of loans as investment targets.

1.1. Approach and positioning

This article investigates means to bridge the gap between consumers' demand for investment and the supply of loan requests from company borrowers. To ensure they provide value to

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customers, crowdfunding platforms need to offer a sufficient number of qualified loan requests on their platform, as an investment platform without investment opportunities would be unattractive to customers. From a different angle, potential borrowers need to be confident that their loans will be financed in a reasonable amount of time, thus requiring a certain level of consumer investments. Thus, without the necessary diffusion of the platform both at the borrower and lender side (Rogers, 2003), the platform will not be attractive for either of these groups. Managing this interdependence is not only an interesting field for research (Sriram et al., 2015), but also a key challenge to this growing financial service industry and focus of the article. Thus, the subsequent parts will first discuss the supply of credits as investment opportunities (i.e., the borrower perspective) and then demand side (i.e., the consumer investors) to enable a full understanding of the business model (Belleflamme et al., 2015).

In this context, it is necessary to distinguish SME crowdlending from other forms of business crowdfunding. On the one hand, crowdlending can be distinguished by the form of investment. In crowdlending the lender only invests in specific loan requests (e.g., via platforms such as Lending Club or Funding Circle). This contrasts to other forms of crowdfinancing such as crowd equity (where investors acquires a share of another company, such as via Crowdcube), donation or reward-based crowdfinancing (which are more concerned with altruistic motives and do not involve a legal claim to an asset, such as Kickstarter; see Kshetri (2015)).

On the other hand, within crowdlending to companies, one can distinguish between different stages of the lifecycle of the company in which the investment is placed. While some platforms focus on financing loans from startup companies or new business ideas (e.g., Seedmatch; for a research perspective, see Zhang and Liu (2012)) others focus on financing projects from established companies, such as SME. Because the importance of SME for the overall economy is high (e.g., constituting 46% of the GDP in the U. S. or 56% in Germany; Kobe, 2012; Bundesministerium für Wirtschaft und Energie, 2015), we focus the present research on this type of businesses.

1.2. Contribution

Two field studies show that successfully matching supply and demand in crowdlending requires double switching behavior: both from companies away from their bank, and from consumers from other forms of investment (e.g., with their bank, on stock exchange or the internet). We argue that though the business model is novel, the drivers of switching are not.

To coerce SME to switch at least part of their financing to the crowd, the present research finds that crowdfunding platforms should predominantly market their functional performance, such as convenience (i.e., speed, flexibility, availability) or process transparency (i.e., process clarity and predictability), relative to the economic (i.e., fees, interest and collateral) or relational aspects (i.e., staff relationships) of their business. Image aspects, such as crowdlending innovativeness, are found to play a subordinate role.

Consumer investors in crowdlending base their decisions predominantly on an evaluation of hard criteria relative to alternative offers on the platform (e.g., relative yield, interest, offers available), rather than on an assessment of “soft” information (e.g., use of the loan, writing style).

This article contributes to extant research in three dimensions: firstly, it extends research on SME bank switching behavior (e.g., Colgate and Hedge, 2001) to switching to crowdlending. Secondly, it introduces consumer innovativeness as driver of switching. Thirdly, it broadens existing research on consumer investments into private loans (e.g., Berkovich, 2011) or company equity (e.g., Cordova et al., 2015) to SME loans, which has so far been out of the research focus despite its economic relevance.

2. The supply side: borrower loan requests

2.1. Theoretical background

SME have multiple options to finance their business, ranging from equity to loans. To finance their operations and business projects, SME so far predominantly relied on loans from banks (Mills and McCarthy, 2014). The relationship of SME to their main bank is characterized by stability and loyalty (e.g., 70% of U.S. SME only had a single bank in the year 2000; Trayler et al., 2000), though this situation is probably driven by inertia and a feeling of undifferentiated offering of the competing banks (Madill et al., 2002). However, satisfaction and loyalty levels with SME banks have been decreasing in recent years, driven by the loss of banks' role as trusted intermediary due to a higher standardization of financial products (Lundahl et al., 2009). Crowdlending platforms could capitalize on this dissatisfaction as an opportunity to overcome switching inertia. However, to do so they need to generate a high level of customer satisfaction with their own offering, which, in turn, is a driver of switching (Manrai and Manrai, 2007).

The subsequent arguments will be based on (dis-)satisfaction with different elements of lending services as driver of SMEs' intention to switch, and not on antecedents of technology adoption (e.g., Venkatesh and Bala, 2008). This focus is based on the understanding that crowdlending is not a fundamentally new service or technology—in which case adoption models would be more appropriate—but a comparable service offered by different provider, to which an SME would need to switch. First, in SME financing all utility components should be known to SME in advance (e.g., service quality, speed of financing, interest rates), although they might be evaluated differently across traditional banks and crowdlending. Though the source of the funds in crowdlending is innovative, the financing service itself is no innovation. This contrasts to the objects of evaluation in the most common adoption models, such as the Theory of Reasoned Action (Fishbein and Ajzen, 1975; Ajzen and Fishbein, 1980), the revised Technology Adoption Model (Davis, Bagozzi, and Warshaw, 1989) or its various extensions (Venkatesh, 2000; Venkatesh and Davis, 2000; Venkatesh and Bala, 2008; Shih, 2004). These models focus on innovations, which require an adoption of new technology by the user (e.g., use of a Word processing software in the 1980s, Davis et al., 1989; use of smartphones for mobile shopping today, Agrebi and Jallais, 2015). Most SME are, however, already using one ore multiple forms of external financing. Consequently, crowdlending platforms position themselves as alternative to banks, not as technical innovation (e.g., Funding Circle U.S. even advertises with an account manager, which handles the application process, just like a bank representative; Funding Circle, 2016).

Second, extant research most frequently uses satisfaction as an antecedent for switching behavior, both in general B2B models (Lam et al., 2004) and with regards to bank switching specifically (Chakravarty et al., 2004; Ennew and Binks, 1996; Manrai and Manrai, 2007), while intention to adopt has—to the best of our knowledge—not been used in this context. Thus, we will focus on (dis-)satisfaction as driver of switching and not on sources of technology adoption. However, as research on adoption models has been extensive (Marangunić and Granić, 2015), and, for instance, perceived usefulness and ease of use (Venkatesh and Bala, 2008) and satisfaction drivers (Lundahl et al., 2009) are likely to overlap, we will refer to the adoption models in the hypothesis development where it is appropriate.

SME customer satisfaction as driver of the intention to switch is usually characterized along three dimensions, including technical,