

Research on Operation Mode of P2P Network Lending Industry

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ABSTRACT

With the rapid development of Internet finance, P2P network lending, as a new form of lending, is increasingly accepted by the public. However, in the process of its rapid development, there are also some problems, such as deficient relevant laws and regulations, imperfect management system, weak effective risk control. Therefore, it is particularly important to study the current operation mode of P2P network lending and tap the hidden risks explore the hidden risks behind it.

Keywords: Internet finance, P2P network lending, Operation mode

1. INTRODUCTION

With the rapid development of Internet finance, crowdfunding, P2P network lending, third-party payments and other new lending models have been gradually derived. However, many problems have emerged in the process. This study is devoted to the research of P2P network lending.

2. THEORETICAL BASIS OF P2P ONLINE NETWORK LENDING

2.1. Information Asymmetry Theory

For P2P network lending, there is an obvious information asymmetry between the lender and the borrower. Specifically, the borrower has sufficient and comprehensive market information, while the lender is unable to obtain advantageous information due to the technical and knowledge limitations, which is the root cause of lending default risk [1].

2.2. Trust mechanism

For P2P network lending, the trust mechanism is the lender's trust in the information provided by the borrower. And only when the lender has trust in the general environment can the trust mechanism between the lender and the borrower be established.

2.3. "Herd behavior"

In P2P network lending, due to the information asymmetry between the borrower and the lender, investors will be more inclined to referring to the investment decisions of other investors in the market and make the same or similar investment decisions.

3. DEVELOPMENT STATUS OF DOMESTIC P2P NETWORK LENDING PLATFORM

3.1. Overview of the development status of domestic P2P network lending business

The development of P2P network lending in China has gone through the following 4 stages since 2007.

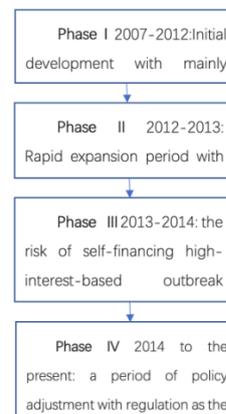


Figure 1 The development stage of China's P2P network lending platform

Phase I: The first P2P network lending platform was established in Shanghai in 2007. In the early stage of the development of P2P network lending platform, the total number of P2P network lending platform in China is small, only about 20, and less than 10 network lending platforms are active in transactions.

Phase II: P2P network lending platform began to have a new development, the scale of China's network lending platform has also increased greatly, from about 20 to about 240.

Phase III: Research on operation mode of P2P-revised in 1004.docx: P2P network lending platform has a relatively more mature template system. At this stage, P2P network lending platform attracts investors to pursuit high profits in the market to invest with high borrowing end interest rate. High interest will lead to higher of the company and further exacerbated the risk of the platform itself. In October 2013, most of the domestic network lending platform focused on the fund withdrawal crisis.

Phase IV: The state has strictly regulated the P2P network lending platform, and strongly support them with regular operation and good development momentum at the same time.

3.2. Data analysis of domestic P2P network lending platforms

3.2.1. Shutdown of problematic platforms

In the environment of fierce industry competition and increasingly stringent national regulation, a large number of P2P network lending platforms are confronting with the plight of closure, shutdown and rectification. By the end of 2019, the cumulative number of lenders involved in the history of the problematic platforms is about 2.52 million (regardless of the de-emphasis situation), and the loan balance involved is about 194.43 billion yuan. The specific data are shown in the table below.

Table 1. Statistics on the number of defunct and problematic platforms, the number of lenders, and the balance of loans involved in network lending platforms

Time	Number of defunct and problematic platforms	Number of people involved in lending(10,000 People)	Loan balance involved (billion yuan)
2014 and before	396	6.3	68.2
2015 and before	1686	27.1	167.5
2016 and before	3408	45.2	265.4
2017 and before	4133	57.4	331.9
2018 and before	5538	216	1771.8
April 2019 and before	5643	252	1944.3

3.2.2. Industry scale

With the continuous improvement of the system and the increasingly strict regulation, the P2P network lending

industry is gradually moving towards a good development trend. As we can see from the operating data ranking of the TOP 100 platforms of the P2P network lending industry in terms of loan balance and turnover at the end of April 2019: by the end of April 2019, the loan balance of the P2P network lending industry is 717.592 billion yuan, while the turnover of the P2P network lending industry is 93.774 billion yuan.

Table 2. Key scale data of P2P network lending

Indicators	End of April 2019	End of March 2019	Ringgit growth	End of April 2018	Year-on-year growth
Total loan balance (billion yuan)	7175.92	7334.96	-2.17%	12975.88	-44.70%
Volume (billion yuan)	937.74	1003.28	-6.53%	1730.95	-45.83%
Historical cumulative volume (billion yuan)	84200	83300	1.22%	69758.04	20.07%
Number of active lenders (10,000)	215.09	229.48	-6.27%	395.08	-45.56%
Number of active borrowers (10,000)	250.43	262.79	-4.70%	405.65	-38.26%

3.2.2.1. Cumulative Volume and Popularity

In April 2019, the cumulative volume of the entire P2P network lending platform is 8,420 billion yuan, an increase of 20.07% compared to the same period last year. In April, the number of active lenders and active borrowers on the P2P network lending platforms is 2,150,900 and 2,504,300 respectively, with the number of active lenders decreasing by 6.27% year-on-year, about 143,900 platforms. The number of active lenders and active borrowers decreased by 6.27% year-on-year, about 143,900 platforms, and the number of active borrowers decreased by 4.70%, or 123,600 platforms.

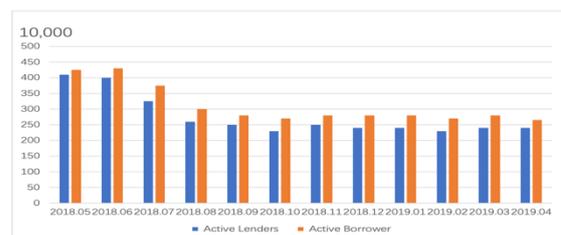


Figure 2 Statistics of yield and average borrowing period of P2P network lending

3.2.2.2. Online loan composite yield and average borrowing period

In April 2019, the composite yield of the network lending industry is 10.26%, an increase of 47 basis points over the previous year (1 basis point = 0.01%), an increase of 62 basis points over the previous year. Due to the growth of the platforms' composite yield, in order to gain higher returns, the network lending platforms need to attract more lenders to draw in more capital inflows, and

an effective way to attract potential customers is to increase the interest rate on the debit side.

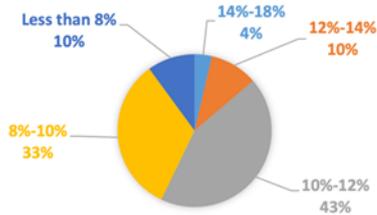


Figure 3 Number distribution of platforms in each composite yield range in April 2019

As can be seen from the above chart, the comprehensive rate of mainstream P2P network lending platform integrated yield this month ranges from 10% to 12%, and its platforms account for 43.40%. The second is the platform with an integrated yield rate of 8%-10%, accounting for 32.89% of the total number of platforms. The integrated yield of the platform is 10% below 8%, down 1.95 percentage points from the data of the previous month. The integrated yield accounts for the smallest proportion of platforms with 14% - 18%, which is 3.62%. The proportion of 18% platforms is the smallest, only 3.62%.

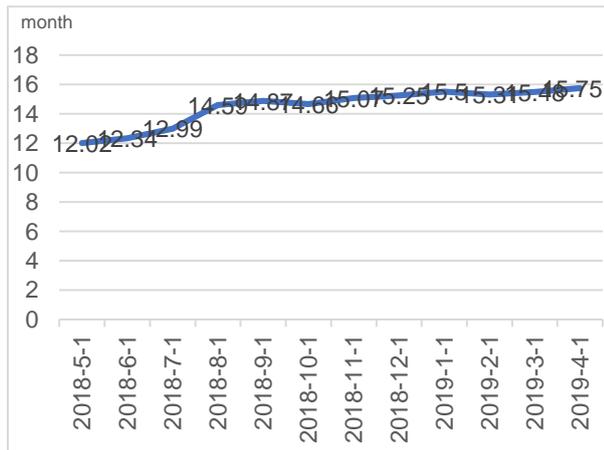


Figure 4 Trend of average borrowing period by month

In April, the average borrowing period of the network lending industry continued to grow, reaching the highest point in the history of the network lending industry at 15.75 months, a year-on-year increase of 0.27 months and a year-on-year increase of 4.17 months.

4. ANALYSIS OF DOMESTIC P2P NETWORK LENDING INDUSTRY OPERATION MODE

4.1. P2P network lending industry main operation mode and characteristics

In China, the P2P network lending platforms are mainly divided into three categories.

4.1.1. Characteristics of various operating models by credit link

4.1.1.1. Pure online model

The pure online mode of operation means that the P2P lending platform itself does not participate in borrowing, only plays the role of "middleman" in the transaction, and only provides corresponding information and technical service support. The pure online model refers to a whole transaction process between the platform and customer which is online, including materials view, fund release, and risk control. In this model, most of the risks are undertaken by investors themselves, and the overall lending amount is small.

4.1.1.2. Combined online and offline model

The combined online and offline model means that the P2P lending company online mainly undertakes the functions of financial management service, company promotion and maintenance online to attract lenders and make corresponding information disclosure, while the corresponding offline mainly undertakes the role of auditing the authenticity of customer information to control risks and solicit customers. P2P lending platform itself or joint cooperative institutions (such as small lending companies) needs to make a comprehensive assessment of the borrower's credit, financial status and repayment ability, so as to decide whether to conduct borrowing transactions with the borrower.

4.1.2. Characteristics of the various operating models in the lending process

4.1.2.1. Pure platform model

This model is the most traditional P2P network lending model. In this model, the P2P network lending platform only acts as an intermediary, the platform itself has no funds to involve in the transaction between the lender and the borrower. Therefore, the platform does not bear the risk of default of the borrower. In case of default, the platform only plays a role in helping the lender to collect the money owed.

4.1.2.2. Debt transfer model

In this model, the lender and borrower do not directly sign a lending contract. The operation process is that the capital lender does not directly lend funds to the borrower, but transfers the right to the third-party platform in its own name, and then the third-party platform lends to the borrower, and finally transfers the debt into the capital lender. In this model, the platform acts as a credit intermediary and bears greater risks. Therefore, the platform will expand its scale to cover the risk with the scale effect.

4.1.3. Characteristics of various operating models divided by guarantee mechanism

4.1.3.1. Unsecured guarantee model

The borrower do not need to provide any collateral or a third-party individual or company as the guarantee for borrowing from the platform, but only use personal credit as the guarantee. Since there is no collateral, the risk of the platform is relatively high, so unsecured guarantee is usually used for small loans.

4.1.3.2. Secured model

Collateralized guarantee means that the borrower needs to provide certain physical assets or a third-party company as a loan guarantee. There are the following models.

(1) Third-party guarantee model

The introduction of third-party guarantee is mainly guaranteed by guarantee companies, and the third-party guarantee can be divided into general guarantee company guarantee and financial guarantee company guarantee. Compared with the general guarantee company guarantee, the financial guarantee is more reliable in terms of both registered capital and insurable scale.

(2) Risk reserve guarantee model

Risk reserve model means that the P2P lending platform establishes a special fund account. Once the loan is overdue or in default, the network lending platform will use the funds in the account to return the funds of investors, and so as to protect the interests of investors.

(3) Mortgage guarantee model

The mortgage guarantee model means that the borrower borrows from the platform with real estate, such as property, cars and other physical assets as collateral. In case of overdue or bad debts, the P2P lending platform and investors have the right to deal with the collateral and recover the funds.

(4) Introduction of insurance company model

Some P2P lending companies have reached or are in the process of reaching certain insurance agreements with relevant insurance companies, in other words, the insurance company will act as a third-party guarantee agency to help the P2P platform share certain risks during the agreement period.

4.2. Risks of the operation model of P2P network lending industry

4.2.1. Credit risks

Unlike some developed countries, China's personal credit system is still in an imperfect stage, and P2P

network lending platforms cannot directly connect their lending business to the personal credit system. The platform can only measure the credit of the borrower through the identity proof, personal property proof, relevant payment records and other information provided by the borrower, so as to decide whether to lend to the borrower. As we all know, there is the possibility of tampering with all these personal information, which is one of the fundamental risks confronted with P2P network lending platforms. Even if the information provided by the borrower is true and reliable, it is impossible to make accurate judgment through this information.

4.2.2. Information leakage risks

After choosing a P2P network lending platform, the borrower generally needs to provide the platform with basic personal information such as personal ID, property status as a basis for the fund lender to select the borrower and judge the information. If the confidentiality technology of the P2P network lending platform website is not secure enough, once cracked by criminals, it will lead to the disclosure of the borrower's privacy and may damage the interests of the borrower.

4.2.3. Technical security risks (IT system security risks)

The daily operation of the P2P network lending platform relies on network technology, and the complexity and vulnerability of the network itself may bring fatal security problems to the P2P network lending platform[2]. Once the system vulnerability, hacking and other problems arise, it will bring huge economic losses to the platform and borrowers.

4.2.4. Liquidity risks

The funds of P2P network lending platform come from lenders holding idle funds. In most cases, the lenders' funds are obtained through appropriate channels, but we cannot rule out the existence of illegal channels. The P2P network lending platform itself lacks the technology and means to examine the source of funds, so it may be used as a money laundering tool by criminals.

5. THE MEASURES AND SUGGESTIONS ON REGULATING THE OPERATION MODE OF P2P NETWORK LENDING INDUSTRY

5.1. Improve industry laws and regulations

The regulatory authorities need to conduct a comprehensive investigation of the existing P2P network lending industry, understand the risks and drawbacks of the industry, and formulate corresponding laws and

regulations, such as establishing entry thresholds, implementing penalty mechanisms and so on. Truly achieve the industry standardization, so that the industry can develop well sustainably.

5.2. Improve the information disclosure mechanism

P2P network lending industry should be strictly in accordance with the requirements of the regulatory authorities, and regularly disclose its corresponding rating information and business information. At present, the business data disclosed by most platforms is relatively simple, and the improvement of business data will enable investors to truly understand the operation of the P2P network lending platform, so as to better make more reasonable investment decisions and avoid unnecessary investment losses. The regulatory authorities can also regularly review and investigate the relevant information of platform, and the platforms that does not meet the requirements can take corresponding control measures in time to avoid significant economic losses.

5.3. Standardize their own business processes

Whether operating in that mode of the P2P network lending industry depends on internal business risks, so internal risk control is an important condition for the sustained and healthy operation of the P2P network lending industry, and the establishment of standardized own business processes is an important means to effectively control internal risks.

- (1) Improve the professionalism of employees
- (2) Establish an effective risk control system
- (3) Standardize post-loan management

5.4. Accelerate the construction of personal credit system

The most fundamental risk of P2P network lending platform is credit risk, and the biggest reason for credit risk is the imperfection of personal credit system. In the general environment, China's personal credit system started late and is still in the stage of development and improvement, so it needs the efforts of the government, online lending platform and individuals to build a more perfect credit system.

5.5. Strengthen account supervision

According to the national policy, the funds of the P2P network lending platform must be deposited in the third-party bank. After receiving the funds from the P2P network lending platform, the third-party bank may misappropriate the funds, and once the platform is at risk and needs funds, the third-party bank may not be able to meet the investors' capital needs and cause liquidity risk.

The platform and third-party bank should jointly supervise the deposited funds, especially large accounts, to avoid liquidity risks and ensure the fund safety.

5.6. Return to small asset-side products

In 2016, the Interim Measures for the Management of Business Activities of Network Lending Information Intermediaries made the first clear setting of the borrowing cap for P2P network lending platforms, which stipulates that an individual's loan amount through a single network shall not exceed 200,000 yuan, and the total amount of borrowing from the same borrower on different platforms shall not exceed 1 million yuan. The regulations for enterprises and institutions are that a single enterprise and institution to the same P2P network lending platform shall not exceed 1 million yuan, the total amount of borrowing from different P2P network lending platforms shall not exceed 5 million yuan. With this policy requirement, it is actually to return the P2P network lending platform to small loans. It is an important means to effectively reduce P2P network lending, which is conducive to the benign development of the network lending industry.

6. CONCLUSION

This paper mainly provides a more comprehensive analysis of the development status, product types, business processes, profitability and risks of P2P network lending platforms, and puts forward some corresponding suggestions and countermeasures, mainly from the aspects of legislation, supervision, credit system and industry regulation, namely: improving the laws and regulations of the industry, improving the information disclosure mechanism, regulate their own business processes, accelerate the construction of personal credit system, strengthen the supervision of accounts, and return to the small asset side of the product. Through these countermeasures and suggestions, we hope to help China's P2P network lending embark on the road of sound development as soon as possible.

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