

BANKS' REAL OPPORTUNITY IN P2P LENDING--AND THE OPPORTUNITIES LURKING BEYOND THAT

Access to untapped markets and new streams lies hidden below P2P's surface “threat”

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UNconventional Wisdom is a periodic guest blog, where authors hold up the so-called common wisdom to a fresh perspective. To propose a guest blog, email either William Streeter, editor in chief, or Steve Cocheo, executive editor

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By Ron Shevlin, Aite Group. For more about the author, see the end of this blog

The emergence of P2P (person-to-person) lenders like Prosper, Lending Club, and Zopa was once thought of as a disruptive force in the financial services industry. However, although Lending Club's loan volume has been steadily increasing month-over-month for the past year, the \$20 million in loan volume it did in June 2011 is a drop in the ocean of overall consumer lending.

Not only is this not much of a threat to banks' traditional lending business, there's really no reason why banking couldn't create an online lending marketplace of its own. In addition to the organic traffic that lenders could drive to such a site, they could refer to it those loans they decide to pass on themselves. They'd give the option of funding them to those investors and savers looking for higher rates of return than they'd obtain with CDs, by lending money in the marketplace. Banks could easily underprice Lending Club's processing fee (which ranges from 2.25% to 4.5% of the loan amount), and avoid charging the 1% service charge for each payment received that Lending Club hits investors with.

But that's not the main opportunity for banks in P2P.

Running the administrative side

There's another P2P lending opportunity for banking institutions to capitalize on: P2P loans between consumers who already know each other, and who have agreed to borrow from and lend to each other.

According to research by my company, Boston-based research firm Aite Group, U.S. consumers borrow (and presumably, repay) nearly \$75 billion from each other annually. On average, every household in the U.S. makes two loan

payments to other people for money they've borrowed.

That last number is actually pretty useless, because a large percentage of households don't make any P2P transactions for the purpose of repaying loans. But in our research on consumers who use alternative financial services--payday loans, check cashing services, etc.--borrowing from family and friends is the second-most-popular source of funds (after overdrawing on their checking accounts).

In fact, of the alternative financial services customers that Aite Group surveyed, one in four borrowed from family or friends three or more times in 2010, and more than one-third did so more often in 2010 than they did in 2009.

This is a huge P2P payment opportunity for banks. But please note that I didn't say it was a P2P lending opportunity.

How are these loans and agreements documented? In many cases they're not documented at all. After all, among friends, verbal agreement is just fine, right?

But if there was a cheap (i.e., free) and convenient way to capture the details of that loan, and a way to actually transfer the money between participants--again, cheaply and conveniently--don't you think a lot of people would use it?

The money in the P2P lending space for banks isn't necessarily from loan processing fees or from taking a cut on the interest rates. The money is in the movement of funds.

Revenue in running the system

Let's take a cold reality check. To date, banks, as a whole, have floundered with their P2P payment offerings. CashEdge and Zashpay have gained some traction, but have hardly become household names. PayPal is a household name, but the vast majority of its business isn't P2P.

Why haven't P2P payments taken off? Banks have been marketing it all wrong. They're pitching the "electronic" aspect.

Big deal.

People don't care about channels and methods. They simply care about what's the most convenient thing to do when they want to do it.

Banks should be marketing convenient alternatives to transacting certain types of P2P payments--repaying loans to other people being one type.

Taking that as an example: Banks could provide an online capability for the parties to document the terms of the agreement; establish repayment parameters; and enable either the automatic or manual transfer of funds. All for the low fee of a P2P transaction, and not a cut on the loan. No future disagreements about the terms of the agreement, and proof of payment.

In addition to improving the way existing customers transact P2P loans between family and friends, this approach might help attract unbanked and under-banked consumers. The latter could fund an account that could either be a savings account or take the form of a prepaid card account.

Rise of virtual P2P gifting

The real winner, though, will be P2P payments. By driving trials of the service, consumers may find it convenient for other uses. For example, gifting is another large component of the P2P payment universe. P2P spending on gifts in the U.S. exceeded \$210 billion in 2010. Cash accounted for nearly half of that. In 2011, half of all Americans will give a gift card instead of cash. Overall, the number of gift card transactions will exceed 1.25 billion.

Over the past decade, gift cards have displaced cash and checks in many gift-related P2P transactions. During the next five years, Aite Group believes that virtual P2P gifting will make significant inroads, further displacing cash and checks. The dollar volume of virtual gift cards will grow from less than a half-billion dollars in 2010 to nearly \$10 billion in 2015.

This represents further opportunity in the P2P payment space for banks--but only if they can drive trials and use of the service among their customer.

About the author

Ron Shevlin is a senior analyst at Aite Group specializing in retail banking issues. This range of subjects includes sales and marketing technologies; customer and marketing analytics; loyalty management; P2P lending; personal financial management; social computing; online banking; customer experience; and consumer behavior.

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