

Shadow looms over China's Internet lending market



By Jane Lanhee Lee / Reuters – Thu, Nov 24, 2011

SUZHOU, China (Reuters) - One of the worst cash crunches in decades is hitting Chinese companies, but for [Pan Zhengqiang](#), borrowing money recently has been as smooth as the well-oiled machines at his widget factory in the farmlands surrounding Suzhou.

In [China](#), bank loans are mostly off limits to small businesses. Many entrepreneurs have long relied on funding from friends and family, but that source is drying up, too.

Instead, a boom in online sites that link up private lenders and borrowers, also known as peer-to-peer or [P2P](#) lending sites, have brought Pan and his wife [Huang Yanhong](#) a new stable stream of financing.

"Sometimes we have a sudden, short-term need for funding. We might get a new big order, or a client may delay a payment," said Huang, who like her husband is a former factory worker.

The couple have 60,000 yuan (\$9,375) in outstanding loans from [PaiPaiDai](#) (www.ppdai.com), one of China's best known online lending sites.

They pay about 22 percent in annual interest -- more than triple China's benchmark lending rate of 6.56 percent -- and can get the funds in as fast as three days.

"Without [PaiPaiDai](#), we'd have huge difficulty."

Small firms, which account for 75 percent of the urban job sin China, have borne the brunt of credit curbs as banks have preferred to lend to big, state-backed enterprises, forcing them to turn to high-interest informal loan markets and raising the risk of a credit collapse.

[PaiPaiDai](#) has more than 120 million yuan in outstanding loans to 10,000 borrowers, most of them tiny businesses like Pan and Huang's. The limit on lending is 200,000 yuan, and the average loan size is 9,000 yuan.

LUCRATIVE RETURNS FOR LENDERS

Borrowers need to upload a range of personal information, including a scan of their ID card and their household registration book, which contains all the details of the person's family, birth place, family home and education.

If the borrower is late in paying, the information, starting from the mobile phone number, is gradually released to the lender.

Less than 1 percent of its loans have gone bad, said co-founder [Hu Honghui](#).

For people like [PaiPaiDai](#) lender [Zhou Yongxin](#), who has lent out more than 400,000 yuan, these sites are a welcome investment channel. Stamps and coins, which he also invests in, are tricky to sell and he's been burned by the stock market.

[Zhou](#) has made about 20 percent on his investments through the site this year, with about 1 percent of loans going bad.

The lending business is risky as there is no collateral. When loans turn sour, lenders some times resort to posting information on the Internet and hounding borrowers to repay.

WARNING OF ABUSES

While online financing fills a crucial need in China, lack of regulation is leading to abuses. There are no statistics for the size of the [P2P](#) industry, but [Hu](#) of [PaiPaiDai](#) has counted more than 30 online [P2P](#) loan sites that have sprung up.

That is against a backdrop of micro-credit loans more than doubling in a year to 287.5 billion yuan by the end of June, according to data from the central bank.

Some firms guarantee principal and interest to lure money from Chinese lenders fed up with negative real interest rates on their savings deposits. Others essentially pool money into a fund, rather than offering the relatively transparent, one-to-one online matches of [borrowers](#) and lenders.

"It happens quite often that one person will borrow money from several online lending sites and then the risk is huge," PaiPaiDai lender Zhou said.

"So we hope the government will come out with some regulations for the industry."

In August, the [China Banking Regulatory Commission](#) issued a warning about P2P lending. It said some P2P lending firms have evolved into illegal financing firms, taking deposits and making loans.

The CBRC declined to answer questions on the issue.

"I think the information disclosure is very bad. Even the P2P company and the investor, they don't know whether the borrower is trustworthy or credible," said Gary Liu, deputy director at CEIBS Lujiazui International Finance Research Center, a Shanghai-based think tank.

"They don't have enough information to control the risk."

The CBRC warning alarmed some foreign venture capital investors, who had been interested in the vast potential of China's consumer finance market. A year ago, new regulations for online payment systems, the Chinese versions of PayPal, forced out some foreign investors who had taken stakes in that sector.

But foreign firms are keeping their eye on the opportunities. U.S. P2P lending site Prosper Marketplace Inc. hopes a recent \$7 million investment from China-focused investment firm IDG Capital Partners will help it get to China, according to CEO Chris Larsen.

IDG also invested in CreditEase, China's largest P2P lender. Larsen said he expects a period of regulatory adjustments will eventually help the industry in China.

CreditEase does not see any regulatory threats to its business or its big foreign investors, which also

include U.S. venture capital firm Kleiner Perkins Caufield Byers. KPCB did not reply to questions about its investment in CreditEase.

"We foresee more and more regulatory scrutiny. I think for a healthy industry, it's about self discipline," said CreditEase CEO Tang Ning.

Tang has built up a P2P lending business with more than 1 billion yuan in outstanding loans to over 70,000 Chinese, including farmers, students and entrepreneurs. The company has 8,000 team members screening applicants in over 50 cities across China.

Unlike PaiPaiDai, the CreditEase website does not allow new lenders or borrowers to meet directly. For Tang, how the two parties are paired up is less important than making sure both sides are real.

"How a loan is made is not legally regulated. A bank or an individual can make a credit or a collateral loan. No problem," he said.

(Additional reporting by Lucy Hornby in Beijing; Editing by Lucy Hornby and Jacqueline Wong)