How small businesses are utilising P2P lending to scale faster

By Sadie Williamson

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It can be hard for small businesses and startups to get ahead, with fluctuating project cycles, seasonal slumps and late payments causing cash flow strain. With 82% of unsuccessful small businesses attributing their failure to cash flow issues, the importance of appropriate financing becomes strikingly apparent.

Source: pixabay.com

Peer-to-peer lending (or P2P lending) is emerging as a viable solution, with the number of P2P loans growing by 10.5% year-on-year. As a fintech consultant, I've seen many of my clients reap the benefits of P2P loans in recent years.

At its essence, P2P lending is a type of financing that allows an individual to obtain a loan from another individual through a dedicated platform. This eliminates the middleman – typically a bank or lending institution – with individual investors pooling together small sums of money instead of supplying the full amount of the loan in order to mitigate their risk.

The businesses that I work with have found P2P loans to be an especially attractive option, as they can offer sustainable cash flow, scalability, and ultimately, a successful and resilient business. Some leading lenders to keep an eye on include the global platforms FastInvest, Mintos and PeerBerry, and the regional platforms Rainfin, Peerfin and Ovamba. The latter three are available in South Africa.

Let’s take a closer look at how P2P loans help entrepreneurs develop sustainable, scalable and successful businesses.

Why small businesses are flocking to P2P lending

Small businesses can use P2P loans as a form of gap funding, cash flowing the business and paying salaries while they wait for the next funding cycle to begin or for a contract to commence.

P2P loans can also be used to grow your business, allowing you to expand into new markets, purchase equipment, or otherwise invest in the development of your business. The specific pain points that P2P loans can alleviate for small businesses include the following.

1. More forgiving acceptance standards

Banks and other traditional lenders typically require a strong credit history or an extensive business track record before loaning money. If an individual or business does not have sufficient history, they may be subject to higher interest rates in order to mitigate the lender’s risk.
Following the Global Financial Crisis of 2008, banks have raised their capital requirements even further, creating a significant barrier for startups and small businesses.

P2P loans can fill this void, as the loan is taken out in the individual’s name and not the business. This means that the borrower only has to provide information about their own personal finances and their plans for the loan. Their loan will not depend on the amount of time they’ve been in business, the losses on their tax return or their lack of current cash flow.

This accessibility allows more businesses to launch, and actually thrive, alleviating early-stage financial pressures.

2. Competitive interest rates

High interest rates from traditional lenders can also be prohibitive for small businesses. Startups are more likely to be slapped with high interest rates when borrowing from a traditional lender, as these institutions see a new business as a risk.

P2P loans, on the other hand, offer individualised interest rates. From what I’ve observed, as long as you have a strong personal history, you can enjoy a lower rate. Interest rates also stay low as there are less overheads associated with running an online lending platform, and therefore less costs passed onto the borrower.

Finally, the greater competition between lenders and the lower origination fees also helps to keep interest rates competitive. As the bulk of the interest paid goes back into the pockets of the investors, they are incentivised to offer mutually beneficial rates.

3. No need to put up collateral

Small businesses may also have trouble obtaining a traditional loan due to not having a viable piece of collateral.

An entrepreneur who is just starting out is unlikely to own a home or other asset to secure their loan with, meaning they could have their application rejected or face high interest rates.

P2P loans usually don’t require you to tie up collateral, which means they’re a more accessible option for those who are just starting out.

4. Efficient processing

Small businesses need to move fast, responding to the demands of the market and the competition in a prompt manner.

The lengthy processing times of traditional loans can be a hindrance, with P2P loans usually being processed much faster. There is no need to meet with a bank manager or to process collateral, and application is conducted entirely online, allowing the borrower to obtain the necessary funds in a timely fashion.

The underwriting process is also much more efficient, as credit checks don’t require the same level of detail as a traditional bank would require. P2P lending platforms use modern underwriting processes, innovative credit scoring, and non-financial data like customer reviews, business reputation and social media footprint to come to a decision instead.

The P2P lending process

While not as extensive as a traditional loan, the P2P lending process still follows certain protocol and requires particular documentation. Typically, the prospective borrower will need to provide bank statements. The borrower will also need to detail their plans for the loan and their vision for their business as a whole. This information is then uploaded onto the P2P lending platform, with investors being able to contribute as they desire.

From my perspective, P2P lending fills a gap in the market, allowing small businesses to sustain themselves and hopefully grow, while minimizing friction. As with all financial products, it is important to carefully consider the suitability of P2P loans for your business, and to weigh up other options as well.

ABOUT THE AUTHOR

Sadie Williamson is the founder of Williamson Fintech Consulting. Her many years of experience in FinTech consulting have inspired her passion for digital payments and cryptocurrency investments.