

# Emergence of Financial Intermediaries in Electronic Markets: The Case of Online P2P Lending

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## Executive Summary

Peer-to-peer (P2P) lending marketplaces receive a lot of attention lately. Consumers gather in the Internet to loan and borrow money from each other, and the electronic marketplace replaces a bank as the traditional intermediary. In such an electronic credit market, lenders may bid in an auction process to supply a private loan.

We analyze the American lending platform Prosper.com using detailed data of more than 14,000 originated loans. Our analysis of the P2P credit market starts with the observation that, despite the direct mediation of loans in the marketplace, new types of intermediaries emerge as market participants provide paid intermediary services.

Screening of potential borrowers and the monitoring of loan repayment can be delegated to designated group leaders. We find that group leaders may significantly improve borrowers' credit conditions, predominantly for borrowers with less attractive risk characteristics. The recommendation of a loan listing and, moreover, the intermediary's bid has a strong impact on the resulting credit spread. Our results indicate that intermediation costs could be more than compensated for by lower credit spreads for borrowers, but borrowers should consider the intermediary's reputation. Based on our analyses, one can quantify the effect of other available listing features on the credit spread, such as the auction mechanism or visual self-disclosure.

We apply a new data set to analyze theoretical predictions from the literature on financial intermediation and find that, as suggested by traditional intermediation theory, the intermediary creates value by reducing information asymmetries between borrowers and lenders. Our findings are robust to self-selection and characteristics of the financial transactions, and may be surprising given the replacement of a bank as the traditional intermediary by an electronic marketplace.