Consumer Credit Without Collateral, Regulation, or Intermediaries

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Link to manuscript

BACKGROUND

4.5% of US households are unbanked, leaving millions of people without access to credit who must find alternative sources.

Intermediaries add another layer of incentives and rent-seeking, but also help efficiently allocate resources and alleviate frictions.

It is currently unknown how consumer credit markets function without intermediaries.

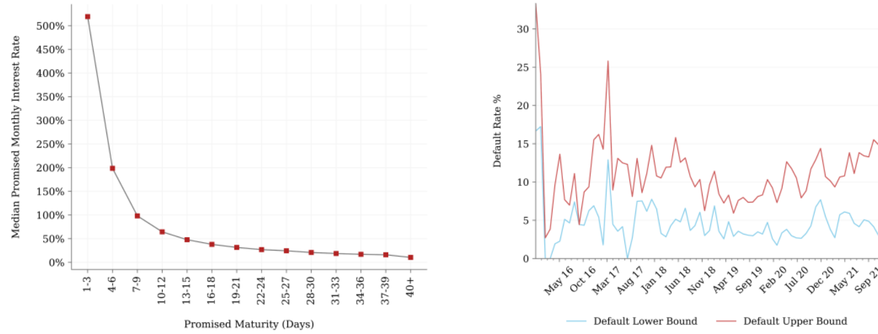
MOTIVATION & RESEARCH QUESTION

We investigate how consumer credit unfolds in the absence of a financial system to regulate loans using novel data from an online informal credit market.

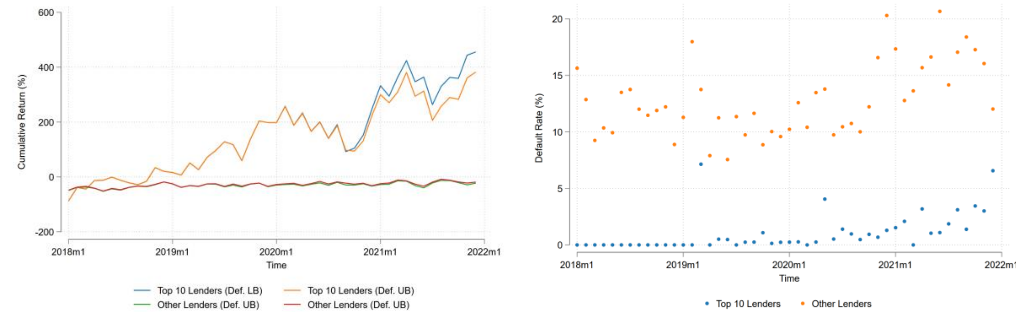
Borrowers display high rates of default and face high credit prices, while a minority of lenders gain a disproportionately large and very profitable market share.

Lenders with more experience achieve better loan outcomes and provide more lenient loan terms. Loans are more likely to be funded when borrowers and lenders have similar online interests.

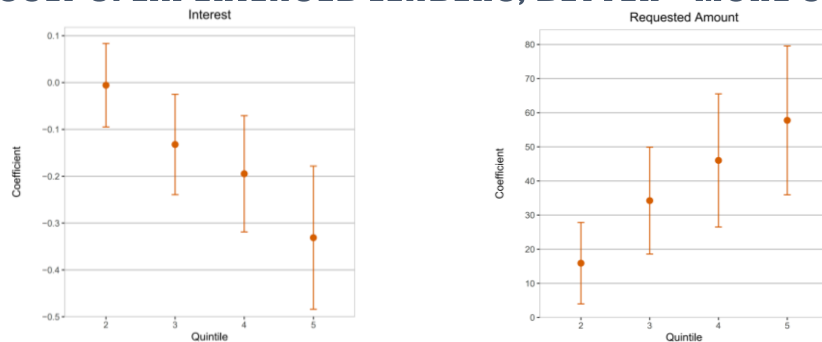
RESULT 1: HIGH COST OF CREDIT + HIGH DEFAULT



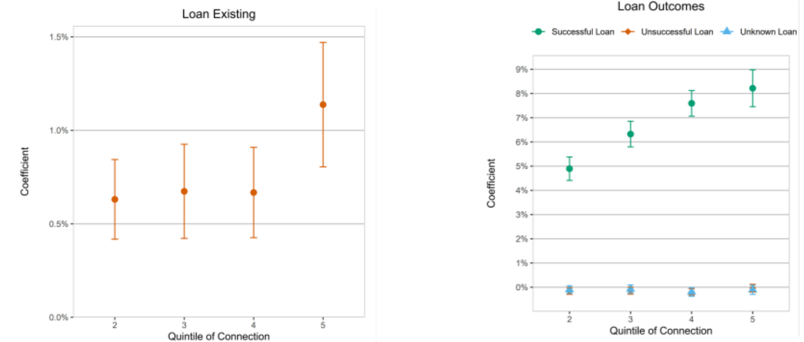
RESULT 2: CENTRALIZED MARKET POWER



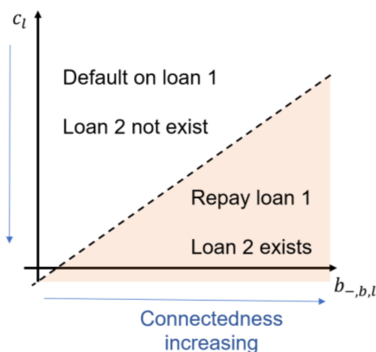
RESULT 3: EXPERIENCED LENDERS, BETTER +MORE CREDIT



RESULT 4: CONNECTEDNESS MATTERS



MODEL



The likelihood of loan repayment increases with both lender experience and lender and borrower connectedness.

IMPLICATIONS

- Millions of unbanked people in the US turn to alternative sources such as these for access to liquidity and suffer from extreme costs.
- Our dataset is one of the largest datasets on credit without intermediaries, collateral, or regulation collected to date.
- Our findings speak toward the important role of the financial system in consumer credit
  - Reduced screening costs through credit scores and relationships
  - Improved access from pooling funds and sharing risks
  - Higher liquidity and funding capacity for lenders
  - Creating systems that allow collateral