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THE ROLE OF SOCIAL LENDING IN FINANCING ENTERPRISES

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Purpose: The main purpose of the article is to examine and understand the specific role that social lending plays in financing enterprises in Poland. The article also aims to shed light on the benefits and drawbacks of social lending.
Design/methodology/approach: The article uses the prevailing literature as well as analysis and evaluation of documents, reports, and the websites of social lending platforms.
Findings: The obtained results will help to indicate the role of social lending in financing enterprises in Poland.
Research limitations/implications: The results cannot be generalised, but can form a basis for further deliberations. They shed certain light on the role of social lending in financing enterprises in Poland.
Originality/value: The article shows the role of social lending in financing enterprises in Poland. This article is mainly aimed at people who plan to start a business. Information on the role of peer to peer lending can be valuable for them, helping them to understand what opportunities they have and how they can use it to raise funds to develop their business.
Keywords: social lending, enterprises, peer to peer lending.
Category of the paper: General review.

1. Introduction

Social lending is a relatively new source of capital raising that can provide an alternative to traditional financing. Social lending constitutes a contract between private individuals that is concluded without the intermediation of banks or non-bank institutions. Instead, the loan is taken out through special platforms that connect those who need additional funds with those who are prepared to lend them. Social lending can be a good way to fund start-ups or to subsidise an existing business. These loans can also be used, for example, to launch new innovative products, invest in marketing campaigns or expand the business by hiring new employees, etc. It is worth adding that in the era of dynamic development of financial technologies, social lending platforms offer innovative solutions that can effectively support the development of small and medium-sized enterprises. In Poland, the social lending system is not yet as developed as in the Western European countries or in the United States of America. On the other hand, it is worth noting that new online lending platforms are emerging all the time where funds can be obtained. In consequence, it seems that this modern instrument for financing, among other things, innovative business projects will also gain importance in Poland over time. The future of the crowdfunding and social lending sector seems promising, especially in the context of technological development and growing public awareness of alternative sources of financing. It is worth noting that the global social lending market is expected to reach US$1,000 billion by 2025, while by 2050 the value is expected to be close to US$1 trillion (Statista, 2023).

This article aims to provide an insight into the role that social lending plays in business financing. Among other things, the article outlines the mechanism of social lending and the main advantages and disadvantages of this model of business financing.

2. Literature review

The history of social lending dates back to 2005, as the first social lending site, Zopa (Zone of Possible Agreement), was launched in the UK. Zopa's business model consisted of an exchange of funds between those who have a financial surplus and have spare cash to offer and those who want to borrow it. In later years, other social lending companies quickly emerged in the UK, for example Assetz Capital, Funding Circle, Wellesley, Folk2Folk, Ratesetter. After the UK, the next services enabling social lending were established in the United States, e.g. Prosper and LendingClub (today, the world's largest social lending portal). In Poland, the first social lending site was kokos.pl, which was established in 2008.

A global trend in lending markets in recent years has been so-called peer-to-peer (P2P) platforms. P2P lending platforms bring speed and efficiency to the lending market due to the rapid advances in modern information technology and the easy availability of data and its processing (Pokorna, Sponer, 2016). Social lending (peer-to-peer lending or crowdlending) is a direct alternative to a bank loan with the difference that instead of a single source, companies can borrow directly from dozens or even hundreds of willing individuals. Lenders often offer loans by stating the interest rate at which they are prepared to lend their funds. Borrowers then choose the offers with the lowest interest rate. Online platforms are used to communicate between lenders and borrowers (European Commission, 2017).

Various interpretations and definitions of social lending in the management science literature have emerged over recent years. There is no one-size-fits-all, universal definition of social lending, so in order to better understand and properly interpret the concept, it is worth quoting a selection of authors' definitions.

Social lending is the practice of lending money, intended for previously unconnected people, without the intermediation of traditional financial institutions, i.e. banks. The lending process itself is carried out with the help of online platforms that have a number of tools available to the investor to carry out a complete credit verification. Most Social lending processes are unsecured by the borrower, and are intended for the individual (Jeżewski, 2021). By a Social lending contract, the lender (loan giver), which is an individual with spare cash, undertakes to transfer a certain amount of money to the borrower (borrower), who is either a consumer or a non-business individual, and the borrower (borrower) undertakes to return the same amount of money (Robinski, 2021). Peer-to-Peer lending, which is also known as P2P, is an online financial investment platform in which individual investors fund projects by lending money to individual borrowers through social networks. (Purkayastha, Tuzlukaya, 2021). Social lending or peer to peer are online marketplaces where individuals can borrow from and lend money to each other (Gonzalez, McAleer, 2011).

The idea of raising funds through social lending is to prepare your project or investment. An entity or person wishing to obtain a loan must, among other things, specify the amount of the loan, define the purpose for which the funds will be raised, and specify the repayment period and interest rate for the investor. Investors are mostly individuals investing their own funds. An entity seeking funding can find lenders online on specially designed platforms/services. To obtain a community loan, you do not need to meet stringent conditions. In theory, therefore, it could be for anyone. They are aimed at individuals who are looking for financing for any purpose, but also companies and businesses who want to raise funds to expand their business but do not meet the criteria set by the bank, for example as to the minimum length of time they have been in business.

The pattern of social lending platforms is usually similar, although some details may differ. Borrowers send applications to the platform, declaring the amount requested along with the interest rate, also describing the purpose of the loan. In turn, lenders, based on the information available, assess the riskiness (profitability) of the applications they are interested in and make investment decisions. If the required amount is raised within a certain time regime, it is allocated through the platform to the borrowers, and the platform takes a commission on the transaction (Dziuba, 2017).

The author of the study interprets social lending as a modern, alternative and flexible source for individuals or companies to raise capital from other individuals through an intermediary in the form of an online platform, without personal contact between the parties to the loan agreement. In this case, the transaction takes place without the intermediation of banks and other financial institutions. It should be noted that social lending occupies a growing segment of the non-bank lending market in Poland. This is evidenced, for example, by the growing number of sites operating on the basis of social lending. Social lending is a good example of how modern technology and the internet are creating opportunities for businesses to grow, especially in the SME sector.

3. The social lending market in Poland

The social lending market is not yet strongly developed in Poland. Social loans are encountered mainly in Western Europe and the United States, but there are also social loans in Poland, which are popular and have already managed to win the approval of their customers.

Private lending markets are an innovation that is part of the trend towards the de-mediation of financial markets, striking directly at one of the fundamental roles played by institutionalized intermediaries. Taking advantage of the unique properties of the global network, online marketplaces promise to effectively reduce transaction costs, connect actors in a dispersed market to each other, and ultimately eliminate the need for an intermediary entity. The rapid development of the social lending phenomenon, the budding of new ventures in various parts of the globe brings with it not only extensive growth in this segment of the financial market, but also innovations of various kinds (Kisiel, 2009, p. 443).

The first social lending platform on the Polish market was Kokos.pl. However, the service stopped offering community loans from private investors in 2019. For almost 10 years, it offered community loans that service users gave to each other. Investors willing to grant loans and earn on them as well as potential borrowers could register on the platform, while the merging of the parties took place as a result of an auction. A single loan was usually made up of several investors, which reduced their investment risk and meant that borrowers were more likely to receive a loan. The security of the transaction was overseen by the Kokos.pl service, which carried out initial verification of both investors and borrowers, set loan limits depending on the rating of the borrowers, or, finally, assisted investors in debt collection activities (Kaminski, 2021). Currently, Kokos.pl is only involved in brokering instalment loans from lending companies. In 2024, there are only a few social lending platforms active on the Polish market. At this point, it is worth recalling one of the rankings comparing European social lending sites that are popular in Poland. The twojinteres.pl ranking includes platforms that mostly have a Polish language version. In addition, some of these loan services have branches in Poland. The ranking was based on: the size and transparency of the platform, the returns offered, the guarantees offered, the minimum investment value, the types and variety of loans available, the functionality of the platform itself, customer service and any welcome bonuses for new investors. Six social lending platforms were ranked: Mintos, Bondora, Finansowo, Robocash, PeerBerry, Iuvo (twojinteres.pl, 2023).

In order for the idea of community lending to develop better, a sustained industry-wide effort is needed to create positive public relations. It should be borne in mind that this trend is still in its infancy, and its position is not yet as strong as that of the instant lending sector, and any negative action by at least one player could significantly undermine everything that has been achieved with so much hard work since the first Polish P2P service was established. Currently, the community lending sector is no threat to the banking sector. On the other hand, in the future, when it gains more user trust, it will certainly become a player that banks will have to take into account. Accordingly, a new trend called social banking may form on the basis of the community lending trend, due to its social nature of operation, which differs from the traditional banking model (Jeżewski, 2021).

4. Benefits and drawbacks of social lending

Social lending has its strengths and weaknesses. Skillful use of such loans can prove profitable for a startup or growth-stage company. Undoubtedly, social lending can be a successful source of funding for small and medium-sized enterprises, providing an alternative to the banking market. The speed and convenience of raising capital, and often a more favorable interest rate than at a bank, are strong arguments for using community lending to fund a business. Online services offer the possibility of setting up company accounts and obtaining loans directly for the benefit of a business, whether in the form of an individual's company or a commercial company.

The main advantages of community lending include (Zastrzeżyński, 2019):

- wide range of loans, availability of significant amounts,
- high loan eligibility,
- loan outside of financial institutions,
- speed and application without leaving home,
- the possibility of using the money for any purpose,
- the possibility of obtaining better loan terms through voluntary verification,
- the possibility of adapting the loan to the borrower's current financial situation,
- the possibility for the investor and the borrower to negotiate the cost of the loan,
- loans to both individuals and companies.

One significant advantage of social lending is the speed of raising capital. The process of obtaining such a loan is uncomplicated and quick, while providing maximum security. Financing can be obtained within a few days and, sometimes, even within a few hours, without leaving home, as all matters can be dealt with online. The process of granting a loan or credit at a bank is longer, as the institution has to, for example, analyse documents in detail and assess creditworthiness. Only after these steps are taken does the bank decide whether to grant one a loan. What's more, social lending sites can offer better interest rates than banks. In addition, when using a community lending site, the entrepreneur can negotiate the cost of the loan. The costs of a community loan include: interest rate, notary costs, commission for the community loan service. Community loans do not have a predetermined interest rate. It is only determined between the transaction partners. Community loans are tailored to the borrower's current financial situation, in which case even those in debt have a chance of receiving a loan.

An important advantage of social lending is that it promotes entrepreneurship among those who are unemployed and unable to start a business based on their own financial resources, yet unable to apply to large financial institutions. Another positive side of community lending for people affected by financial exclusion due to the lack of physical access to banking facilities is that community lending offers can be accessed from virtually anywhere, even in a small town where there are no banks or bank branches. However, the only condition is access to the Internet (Solarz, 2011).

The extent of the benefits of social lending depends largely on the model used and the specifics of the online platform in question. In this case, the costs of platform commissions (up to several per cent of the value) or registration or (monthly) subscription fees should be taken into account. Additional charges (e.g. 2-3%) are set on financial transfers, processing credit card transactions. The costs of implementing a campaign related to, for example, creating presentations on the platform's website, communicating market signals, should also be taken into account (Dziuba, 2015, p. 104).

Based on the analysis of selected Polish and foreign websites dealing with, among others, the subject of social lending (https://invoice-funding.co.uk/, https://direct.money.pl/, https://corporatefinanceinstitute.com/, www.futurecapital.pl/), the author of the study includes the following among the most important disadvantages of social loans for investors:

- default risk: Borrowers may default on their loans, leading to potential losses for investors,
- lack of regulatory oversight: Lending platforms may not have the same level of regulatory oversight as traditional financial institutions, so it is important for investors to carefully assess the platform and the borrowers they are considering supporting,
- limited protection: investors may not have the same level of protection as with traditional financial institutions,
- limited diversification: P2P lending platforms may offer limited opportunities for investors to diversify their portfolios, potentially increasing their risk,
- limited availability: P2P lending may not be available in all locations or to all types of borrowers and investors,
- charges: P2P lending platforms may charge fees for their services, which may affect the total return on investment for investors or the cost of borrowing for borrowers,
- the obligation to pay capital gains tax - by the investor, i.e. the person making the loan,
- lack of insurance/government protection: the government does not provide insurance or any form of protection to lenders in the event of default by the borrower,
- returns may also be lower than expected if the borrower repays the P2P loan early.

The disadvantages of community lending can also be considered from the side of the individuals or businesses applying for such a loan. If this is the case, the main limitations of this source of funding may include:

- the Polish market lacks legal regulations that address the conditions for granting a social loan, as well as the protection of the interests of the two parties, i.e.: the lender and the borrower,
- the need to incur additional costs, e.g.: a few per cent commission on the loan disbursement amount charged by the lending platform, service charges, etc.,
- lower amounts compared to a bank loan/loan, many private investors do not want to risk lending significant money when they cannot be 100% sure that they will recover their investment,
- the obligation to pay tax on the received loan (PCC tax - 0.5%, Belka tax - 19%). However, there are some exceptions to this rule: tax-free amounts. The borrower does not have to fill out a PCC form if he has borrowed over a three-year period: no more than PLN 5000 from one person, no more than PLN 25 000 from several people,
- there is a risk associated with the collapse, liquidation of the loan service,
- the inability to receive funds in the short term, as the borrower has to wait for the loan auction to be completed. Loan auctions normally last for at least a few days and can be further extended. Interested investors come forward, usually several of them submit a loan and only when the requested amount is reached in the auction can the loan be activated. This is, therefore, a limitation of community lending,
- there is no guarantee of the success of our auction and thus of the receipt of funds,
- verification procedures (filling in online forms, uploading documents required by the social lending platform).

5. Conclusion

Social lending has many advantages, but also disadvantages for both borrowers and investors. A positive aspect is undoubtedly the fact that social lending can be a convenient, faster and potentially more affordable way to get a loan or get a higher return on investment. These loans are optimally convenient because you don't even have to leave your home to enjoy financial support for any purpose. Social loans are taken out with a minimum of formalities, and not only commitments for individuals but also social loans for companies are available on the market.

They also, however, entail some risks, e.g. limited regulatory oversight and limited investor protection. It is therefore important for both borrowers and lenders to carefully consider all the pros and cons before using P2P lending. In addition, lending platforms should be thoroughly researched and evaluated. However, despite the risks, social lending can be a valuable financial tool if approached with care and due diligence. The prospects for the future of the community lending market in Poland are promising. The introduction of appropriate regulation and the further development of technology can contribute to the security and stability of the market, which in turn will further increase its growth and popularity among companies seeking alternative sources of finance.

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