

# Development Trends and Main Problems of P2P and Crowdfunding Platforms in RA Banking System

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## Պ2Պ և քրաուդֆանդինգային հարթակների զարգացման միտումները և հիմնախնդիրները ՀՀ բանկային համակարգում

Գրիգորյան Գրիգոր Վ.

ՀՊՏՀ, Ֆինանսական ֆակուլտետ,

Բանկային գործի և Ապահովագրության ամբիոն, ասպիրանտ (Երևան, ՀՀ)

**Ամփոփագիր.** Նորագույն տեխնոլոգիաների զարգացման հետ մեկտեղ առաջացած թվային ֆինանսական ծառայությունները աստիճանաբար առաջ են անցնում ավանդական բանկային ծառայություններից՝ առաջարկելով առավել բարենպաստ պայմաններ, հարմարավետություն, արագություն, ժամանակի և ֆինանսների խնայողություն և այլն: Իրենց դերերն են սկսում փոխել նաև ավանդական բանկերը՝ փորձելով մնալ մրցակցության մեջ՝ թվայնացնելով իրենց ծառայությունները, ներդրելով տեխնոլոգիական լուծումներ, առաջ շարժվելով նոր բիզնես մոդելներով: Այդ լուծումներից են Պ2Պ վարկավորումը և քրաուդֆանդինգային հարթակները:

**Հանգուցաբառեր՝** Պ2Պ վարկավորում, քրաուդֆանդինգ հարթակներ, ֆինտեխ, թվային տեխնոլոգիաներ

## Тенденции и проблемы развития P2P и краудфандинговых платформ в банковской системе РА

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**Аннотация.** С развитием новейших технологий цифровые финансовые услуги постепенно превосходят традиционные банковские услуги, предлагая более выгодные условия, удобство, скорость, экономии времени, денег и т. д. Традиционные банки также начинают менять свою роль, пытаясь оставаться конкурентоспособными за счет оцифровки своих услуг, внедрения технологических решений и продвижения новых бизнес-моделей. Платформы P2P-кредитования и краудфандинга входят в число таких решений.

**Ключевые слова:** P2P-кредитование, краудфандинговые платформы, финтех, цифровые технологии

### INTRODUCTION

The work is aimed at highlighting the developments and main problems related to P2P and Crowdfunding platforms in Armenia which may be an obstacle to their mass use. In order to understand whether the mentioned fintech solutions are effective from the point of view of usage in RA we tried to conduct comparisons in the context of international experience and evaluate the environment of the RA banking system from the point of view of introducing and developing the latest fintech solutions, highlighting the positive aspects. The results were the basis for making appropriate conclusions and suggestions for the introduction and development of these technologies in RA.

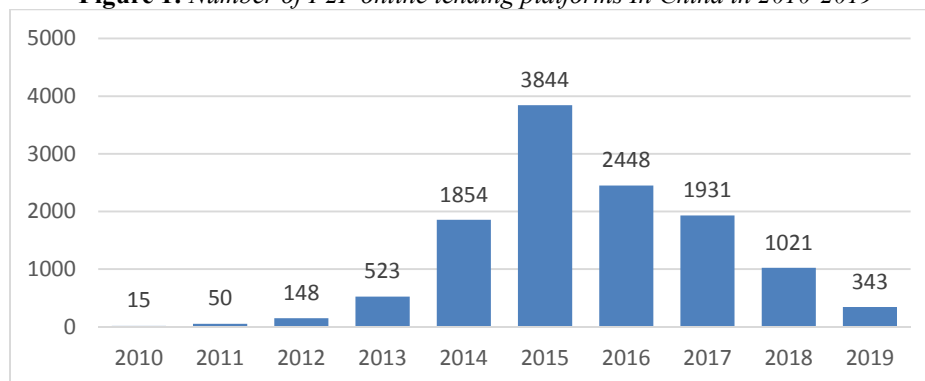
### ANALYSIS

**P2P lending** is a financial tool that allows people to give or receive credit without the intervention of a bank. This method of alternative lending pushes banks out of the role of intermediaries and lending becomes bilateral [5]. These platforms offer individuals the opportunity to earn higher returns compared to interest rates on bank deposits or savings accounts. The purpose of P2P platforms is to connect borrowers and lenders with each other, to receive income from transactions. In order to reduce the risk such platforms themselves can have reliable data on borrowers which will refer not only to traditional scoring systems, but also to alternative information that can give an appropriate assessment of the borrower's risk tolerance.

China is a clear example of many such companies from the beginning where the number of

P2P lending platforms on the eve of their emergence has grown at a fairly high rate [7].

**Figure 1:** Number of P2P online lending platforms In China in 2010-2019



The rapid growth of P2P lending platforms in China and the lack of legislation on them have allowed many dubious platforms to mislead customers in 2010-2015. Prospective investors were promised that investments would provide high returns but in many cases clients fell victim to fraud such as the disappearance of the platform's governing body, taking all clients' investments with it.

In 2015 the number of such companies had increased sharply to 3,844 after which the legislature passed legislation to tighten control over such companies, for example, requiring that withdrawals from such platforms should be made only through commercial banks and such companies should be registered with the market regulatory body. All that forced the companies already on the market to either go to the legal field or close down. As a result, the number of such companies gradually decreased and in 2019 there were already 343 of them [7].

With this change it can be said that the implementation of banking operations in alternative (non-banking) ways was limited for the public, however, it is very likely that the public expects that only banks should not provide financial services. As Bill Gates vividly described two dozen years ago, banking is necessary, banks are not [2].

In this digital lending platform the parties are the borrower, who borrows money, and the lender, who is ready to lend money [6].

The main advantages for borrowers can be described below:

- Competitive interest rates,
- Simplified lending process,
- Many types of loans,
- Access to financing,
- Transparency.

For investors who are the other side of the transaction, P2P platforms also have a number of advantages, which are [4]:

- Diversification of risks,
- High yield,
- Credit risk management,
- Control and flexibility.

Overall, P2P platforms offer a wide range of benefits and opportunities for both borrowers and lenders. This does not mean that there are no disadvantages and risks to such activities, but participants can reduce the risks by making the right financial decisions before becoming a party to this process.

The development of technologies led to the creation of P2P digital platforms in the world where meet the borrower and the lender or the borrower and the investor. Lending processes are carried out through these platforms and the process is carried out directly by 2 participants excluding the role of intermediaries. The function that the bank used to perform as an intermediary can be said to be excluded in this model.

There are still no P2P platforms in the RA financial and banking system, but this does not mean that it will never be used in RA. If the participants of the RA banking system do not take steps in this direction it is very likely that fintech companies will be more flexible and will enter the market sooner. It is true that there is still no legal regulation of P2P lending in RA, according to which the operating platforms would be regulated, but even if this problem is solved, other problems may arise.

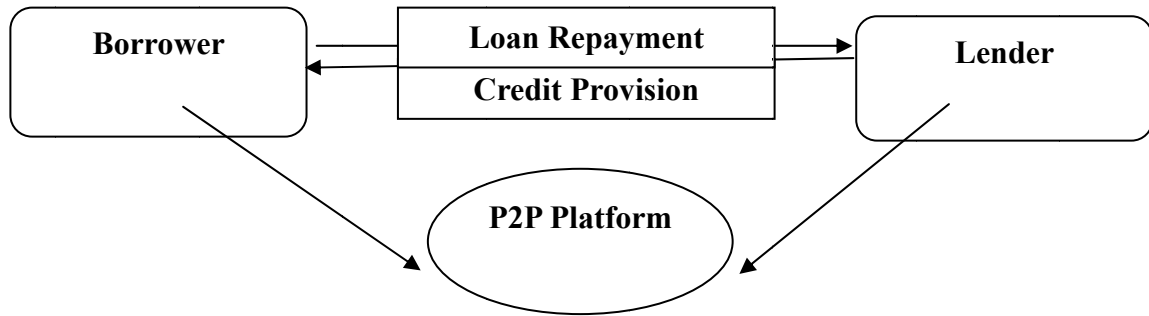
As a first problem, the concern of banks may be related to the reduction or loss of their role. When making transactions through these platforms, the role of the bank is excluded, due to which the banks are deprived of their intermediary role and suffer financial losses. Naturally, this should worry the participants of the RA banking system.

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**Figure 2:** *The traditional P2P lending model*



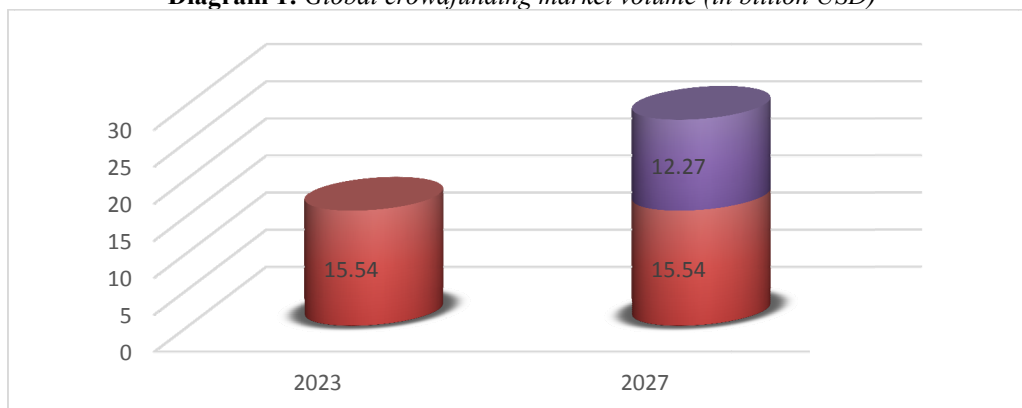
The second problem is related to credit risks, in particular, the introduction and operation of scoring systems. We know that these systems are mainly based on the idea of open banking so they can use information from many sources to collect information about users. Each platform may use scoring systems based on different information. Since the same customer's credit score may differ on different platforms an uneven and unfounded situation is created in the market and it becomes a reason for confusion and unfounded decisions for investors, as a result, the probability of default in the market can increase. Accordingly, banks should be able to ensure stability in the market due to effective risk management. Here the role of the regulatory body is important which should be consistent in assessing the reliability of the scoring systems of the platforms and carry out supervisory activities.

Accordingly, we can distinguish 3 primary **problems** related to the introduction of P2P platforms:

1. Non-regulation of the legislative field,
2. Loss of the role of banks as intermediary activity,
3. Difference in credit scoring models between platforms.

**Crowdfunding** has also gained international popularity in recent years but it is necessary to understand its essence. It is a funding platform where individuals can present their business ideas and collect funds to realize that idea [9]. Usually, this business model is realized with the presence of 3 parties: the idea proposer who presents the business prototype to be financed, the investors who are ready to implement the financing, and of course the digital platform through which the whole process is carried out.

**Diagram 1:** *Global crowdfunding market volume (in billion USD)*



The global crowdfunding market is estimated to be 15.54 billion USD in 2023 and the annual growth is 15.7% [8]. Accordingly, the volume of this market is predicted to be 27.81 billion US dollars in

2027. This financing model is already widely used in many countries of the world in the presence of relevant legislation which ensures the security of

transactions and increases the level of confidence of the parties.

When referring to crowdfunding platforms it is necessary to point out the main advantages that it provides. As we mentioned, entrepreneurs who are looking for capital investments and investors who are ready to provide money for business development can meet on this platform. Platforms have a number of advantages for entrepreneurs, including:

- Access to capital,
- Market research,
- Many financing options,
- Creation of communities,
- Marketing support.

These and many other circumstances encourage entrepreneurs to trust crowdfunding platforms with financing for the implementation of their business ideas. In turn, investors can also get quite a lot of advantages when investing through these platforms, including:

- Diversification of risks,
- Access to pre-embryonic investments,
- Involvement and participation.

In general, crowdfunding projects facilitate access to capital, stimulate innovation and entrepreneurship, and contribute to economic growth and development. However, participants must be able to correctly assess the existing risks, take into account the possibility of capital loss, project failure and accordingly diversify their risks.

Crowdfunding platforms are gradually becoming widespread in RA as well. Being an alternative financing method for the development of startup systems it can best stimulate investment and the development of new companies.

In contrast to the absence of other legislative regulations that hinder the introduction and development of financial technologies in RA crowdfunding activities in RA are regulated by Regulation 4/07, approved by Resolution 113-Ն of the Council of the Central Bank of RA of April 8, 2008.

On November 29, 2022, ARFI Investment Company, the operator of the first investment crowdfunding platform, was registered and licensed by the Central Bank of Armenia at the initiative of the Armenia National Interests Fund (ANIF) [3]:

Examining the projects presented on the arfi.am platform we notice that the platform is not very active. At the time of the study 4 projects were presented on the platform, only one of which collected 21% of the expected investments and the remaining 3 projects had 0% results.

If these crowdfunding platforms are effective they can be quite a serious competitor for banks because the investment direction of customers' free

funds can change from banks to crowdfunding platforms.

According to the results of the global index of innovation, the RA investment environment is in a rather low position occupying the 97th position among 132 countries. A clear proof of this is the small volume of investments in startups.

If we consider the volume of loans provided by RA banks to startups and newly created companies RA ranks 65th among 132 countries. This is an average indicator for banks which proves that this direction is of sufficient importance for banks so the entry of crowdfunding platforms into the market will reduce the loan portfolio of banks to a certain extent. It is noteworthy that as of the end of September 2022 RA commercial banks have invested USD 2.577 billion abroad in foreign financial organizations and bonds because of the limited capital absorption capabilities of the RA market. However, as we notice, the startups registered in the Republic of Armenia have difficulties in attracting financial resources in the Republic of Armenia. This is justified by the fact that the startups created in RA 48 million US dollars were attracted from foreign investment funds in 2020-2022. This means that at least this much money could have been invested in RA but RA banks preferred to invest abroad [1].

Of course, from the point of view of banks' risk assessment investing in startups can be considered quite risky, but as a result of the creation and large-scale use of crowdfunding platforms RA banks will most likely be deprived of the opportunity to invest even in low-risk startups having to make investments with not so high returns. This means that the RA banking system can gradually give up its positions in the market to crowdfunding platforms which also offer competitive interest rates.

The participants of the RA banking system should take steps to maintain their share in such a way as to complement the investment gap and the expected incomes as well as to maintain the incomes received from intermediary activities. Accordingly, as a result of large-scale use of crowdfunding platforms participants of the banking system face a number of **problems**, such as:

1. Loss of intermediary role as a result of direct cooperation of borrower-lender relations with corresponding loss of expected income,

2. As a result of relatively competitive interest rates or interest-free financial resources provided by the investors of the platform (depending on the model, financing methods may differ), the volume of banks' credit portfolio will decrease, which will be accompanied by the outflow of investments to foreign markets with relatively low interest rates.

Summarizing, we should note that the latest fintech solutions such as P2P lending, Crowdfunding platforms, etc., are gradually reducing the role of banks in financial processes as banks lose their role as an intermediary and as a source of financing in these processes. Therefore, banks should also take steps to transform, invest or move forward with other business models.

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