Crowdfunding via Facebook: Puddle's P2P Platform Allows Friends to Pool Funds to Loan to Each Other

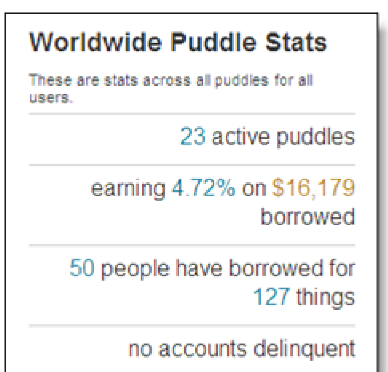
By Jim Bruene on June 3, 2013 4:37 PM | Comments

When Prosper launched seven years ago, much of it's initial promise revolved around the notion that people would be more likely to repay loans made by their peers. To create peer pressure, borrowers were encouraged to join loosely affiliated "groups" (*see note 1*). Over time, groups with good repayment performance would be rewarded with lower borrowing costs.

It was brilliant on paper, but early repayment behavior didn't follow the model. Had there been more runway (funding and/or regulatory tolerance), it might have worked. But the wicked combination of adverse selection (many initial borrowers were financially desperate and/or quasi-fraudulent, despite all the heart-warming stories posted) and the Great Recession pushed Prosper, and it's contemporary, Lending Club, into more standard unsecured lending procedures. And it seems to be working. The two are on track to do more than $2 billion this year, with revenues of $100 million or more (*Note: 85% of current volume is from Lending Club, see latest numbers here*).

Fast-forward five years: With the ubiquity of Facebook, it makes sense for newcomers to test the waters of the original Prosper/Lending Club hypothesis (*note 2*). That friends can lend to friends (F2F) at a far lower cost. And that a third-party platform is needed to facilitate lending relationships, which can become tense if borrowers fall behind or default on their obligations.

Puddle (formerly Puddle.io) is a new startup from **Kiva** CEO & Co-founder Matt Flannery and early Kiva developer Skylar Woodward along with Jean Claude Rodriguez. It uses Facebook bonds to create pools of money that friend groups can share amongst themselves. With suggested interest rates in the 4% range, it's a win-win, assuming the money is repaid. Borrowers save 10% or more from credit card rates and lenders get a return much higher than bank savings accounts.



How it Works

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1. Register with the company using your Facebook credentials

2. Connect a PayPal account or debit card to the platform (Wells Fargo holds the money)

3. Start a new "puddle" by setting the rate from 0% to 20% (current average is 4.7%, see inset) and the maximum leverage rate (you can only borrow a multiple of what you put into the pool, the allowable range is 2:1 to 10:1 with the recommended rate of 8:1).

4. Invite Facebook friends to throw cash into the pool

5. Borrow from the pool (if that is your intent). Currently, loan sizes range from $300 to $3,000 with repayment on an installment schedule spread over a maximum of 12 months (current average outstanding is $320 across 50 borrowers). You can only borrow a max of 40% of the entire pool.

6. Puddle manages the repayment process, including assessing late fees (the late penalty is equal to the interest owed on the previous month's installment, i.e., you pay double interest if late)

7. As funds are repaid, they become available to other members of the pool to borrow.

Analysis

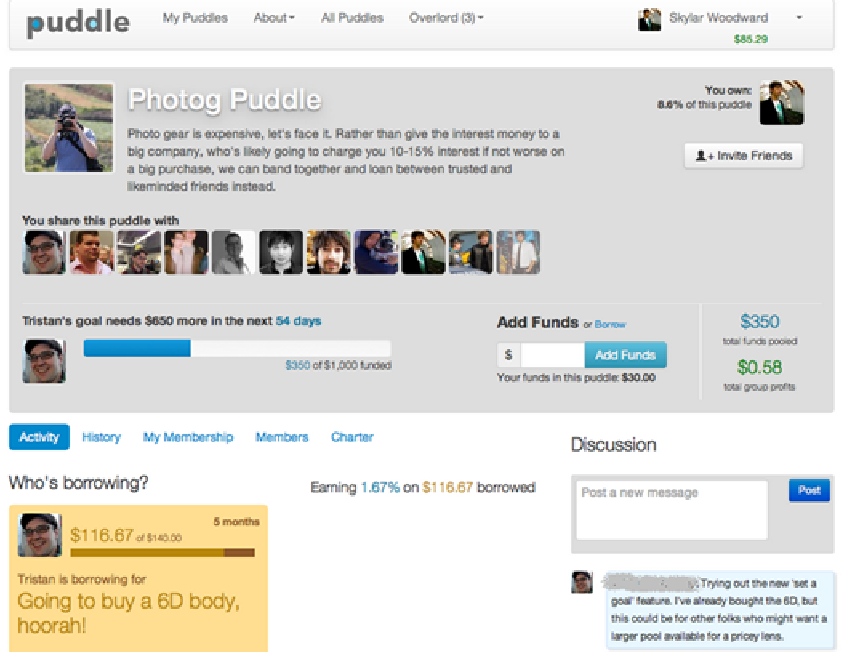
Like Prosper/Lending Club in 2006/2007, the Puddle model sounds great in theory. But should friends be encouraged to lend to their friends online? I can see this ending badly, with unfortunate borrowers losing more than just the $1,000 they took out of the pool. With a public default to your (ex)friends, will a bad situation just get worse?

But given the founders experience at online microfinance leader Kiva, which has spread $440 million around the globe from nearly 1 million lenders, they fully understand the pitfalls. They also know that affordable credit can change lives.

Bottom line: I think it's a great experiment (and it is an experiment, the founders admit to not knowing how they will monetize or how regulators will react). But I'm not sure it scales without more financial controls (underwriting, collections, income verification) at which point it becomes nuch like Lending Club in 2007 (though not a bad outcome...given the P2P pioneer's recent $1.6 billion VC valuation).

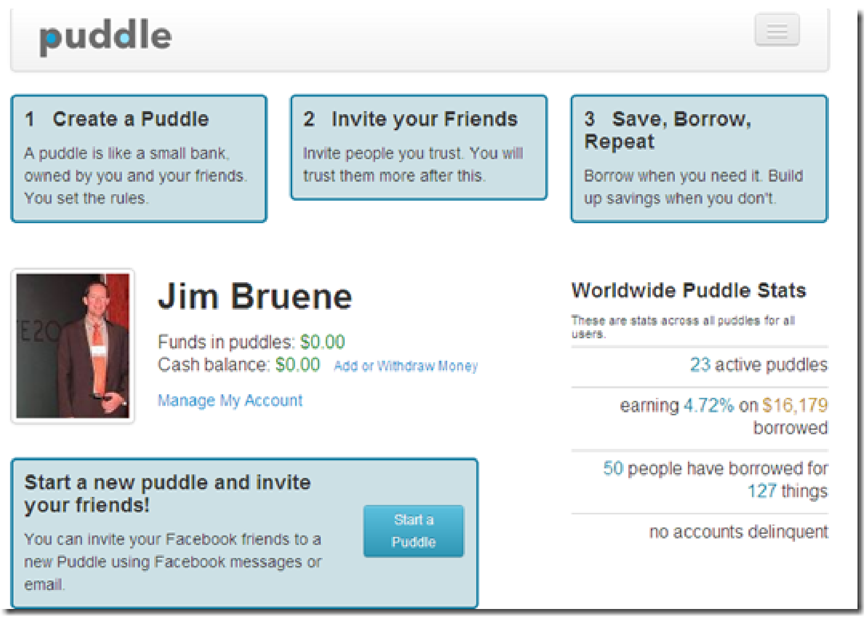
I'd like to see financial institutions (or accredited investors) stepping in to backstop the loans (perhaps keeping the default confidential). For example, for a 4% to 5% annual fee, investors would agree to reimburse the pool for 80% to 90% of losses from any defaulting borrower. The fee would vary depending on the credit profile of borrowers in the pool. While borrowing costs would be significantly higher, down-on-their-luck borrowers would be less likely to lose their friends just when they needed them most.

Puddle dashboard (active user)



The Puddle dashboard through the eyes of a new user

Note: The great definition in box 1, "A puddle is like a small bank owned by you and your friends. You set the rules."



Notes:

1. For a review of circa-2006 Prosper "groups" see our March 2006 report on P2P lending (subscription).
2. Lending Club initially launched as a Facebook-only p2p lending service (our original 25 May 2007 post). The original Lending Club Facebook page is shown at right (click on inset).
3. For the latest on crowdfunding, see our latest Online Banking Report on Crowdfunding (subscription).

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