Network Effects on Interest Rates in Online Social Lending[*]

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Abstract: Peer-to-peer lending platforms such as Prosper Marketplace facilitate lending by matching potential borrowers with potential lenders using an auction mechanism. Borrowers can post loan requests and lenders can bid on a request specifying a minimum interest rate and an amount they are willing to lend. In this paper we analyze the impact of social information on the interest rate of funded loans and on the credit default risk. While externally determined credit grades strongly influence these outcomes, there is large variation within classes. We hypothesize that potential lenders use social information—including group membership and endorsements from other users—to trust some borrowers more than it is suggested by their credit grade. Furthermore we analyze whether this social behavior is rational in the sense that it leads to lower credit default risk for those that get lower interest rates.

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