COMPOSITE LENDING: EVOLVING THE BALANCE SHEET LENDING MODEL

Risk exposure, funding sources, and scalability and are the main differences between the marketplace and balance sheet lending models. By using the composite lending model, loan originators enjoy the benefits of both models.

Marketplace lending and balance sheet lending are the main lending business models in the world of alternative lending.

MARKETPLACE LENDING FOR LOWER RISK

Marketplaces are financial intermediaries that originate loan portfolios for sale to investors. Marketplace lenders collect a service fee throughout the loan's duration, and an upfront origination fee, while giving up the interest on the portfolio, reducing their overall return. But in exchange for a reduced return, they reduce their exposure to risk of loan defaults, as this is passed to the investors. Beyond reducing both risk and profit, these transactions bring in new capital, allowing the lending companies to originate more loans and grow their business.

Marketplace lending companies typically focus on long-duration loans, such as unsecured consumer loans, small and medium enterprise (SME) loans, and real estate property financing. These are generally low-margin deals, so these companies often require lengthy and substantial capital investments from VC firms to ramp up operations to a breakeven point.

BALANCE SHEET LENDING FOR HIGHER RETURN

Balance sheet lenders retain the portfolio and so collect the interest rate spread over the lifetime of the loans. This increased return and steady cash flow come with the risks of possible loan defaults.

As a rule, balance sheet lenders tend to focus on specialized lending, such as subprime short term loans, cash installments, POS loans, merchant cash advances, and factoring. On average, the duration of these portfolios is shorter than those of marketplace lending models. Focus on current profitability and high capital turnover allows these companies to access equity for business growth rather than rely on VC commitments.

WHY INVESTORS PREFER THE MARKETPLACE LENDING MODEL

While assets originated by balance sheet lenders may achieve a higher return, the marketplace lending model is more attractive for investors. Marketplace lending portfolios more readily attract mainstream investors for a variety of reasons:

Assets originated by marketplace lenders are more transparent and accessible for analysis than those of balance sheet lenders.

Investors are typically unfamiliar with the specialized assets in these portfolios, leading them to compare the lender with a bank and draw incorrect conclusions.

The short-term near-prime and subprime loans typically found in balance sheet lenders' portfolios are difficult for investors to evaluate using a classical approach.

The highly illiquid direct loans in balance sheet portfolios are risky for third-party investors.

However a bigger issue facing balance sheet lending companies is the need to generate capital for business scalability. While a lender's record of proven portfolio performance is the key for success for every business model, marketplace lenders have advantage. This is because the loans are sold to the investors with no risk retained to the company, which is not the case for balance sheet lenders that concentrate the risk. And few balance sheet lenders have scaled their operations sufficiently to raise debt through securitizations or off-balance-sheet arrangements.

INTRODUCING THE COMPOSITE LENDING MODEL

The composite lending model combines the benefits of balance sheet and marketplace lending. In this model, a portion of the portfolio is retained on the balance sheet funded by the company's capital, while the other part is financed by outside investors.

The benefits of such transitions are:

The originator retains the profitability and cash flow of the current portfolio.

The new portfolio is funded by outside investors with no effect on the balance sheet of the originator.

Leverage and risk per unit of originations decreases.

Additional income from origination and the servicing fee improves the cash cycle as well as the bottom line.

The company remains flexible to invest in new products and markets.

Up to 2.7x higher price to earnings multiples for being a marketplace.

Developing a marketplace lending business is not the core business of balance sheet lenders, so it typically requires investments in IT, legal and marketing. These companies must also safeguard against an inherent conflict of interest due to loans being selected for sale to investors and priced by the same party.

BLACKMOON FINANCIAL GROUP: A GATEWAY TO COMPOSITE LENDING

Blackmoon Financial Group offers a platform that uses a concept called Marketplace Lending as a Service (MPLaas). The Blackmoon Platform is used by balance sheet lenders to access off-balance-sheet funding to scale their businesses without requiring major IT and other investments, and by institutional investors to invest in loans issued by balance sheet lenders.

The Blackmoon API (application programming interface) provides a data exchange between the platform and originator. Calculations occur on the Blackmoon Platform in less than a second, adding no latency to the loan applicants' user experience. And the advanced loan-by-loan pricing on the Blackmoon Platform ensures to both originators and investors that cherry picking and selection bias does not occur.

Investors benefit from using the Blackmoon Platform as well. They get independent analysis of originators, access to originators in different geographies, and flexible loan selection criteria: powerful tools to expand their alternative lending portfolios.

The result is execution of a pure marketplace lending approach in a transparent and informed way for the mutual benefit of composite lenders and institutional investors.

For more information about Blackmoon Financial Group, please visit us online at www.blackmoonfg.com or contact us at info@blackmoonfg.com.