Why Does Investment Experience Matter in Herding Rationality in P2P Lending?

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Abstract

Peer-to-peer (P2P) lending auction is the platform that offers online money lending by matching lenders with borrowers without intermediate. Comparing P2P model with traditional auction model, the administrative and service costs charged by the "middle-man" are saved. Although these explicit costs could be reduced, it deteriorates the problem of information asymmetry. P2P auction itself is difficult for borrowers to discern the credibility of lenders. However, the industry of P2P lending is astonishingly growing, especially in China. To explore this paradox, this study investigates how investor's experience influences investors' behavior and investment decision in PPĐai. This research project aims to fill the gap to study the interaction between investment experience and herding rationality in IS study.

Investment experience plays a critical role to influence herding decision. According to the theory of choice, the decision utility of an outcome could be different from the outcome from decision utility (Kahneman et al. 1997). The remembered utility measures the decision making based on the evaluation of past experiences. For the notions of herding behavior, Simon (1972) states the essential prerequisite to maximize gains is perfect information. These theories support our hypotheses of novice lenders to make perceived “best” but irrational behavior under information asymmetry. In the hypothesis testing, we argue that experienced lenders have accumulated rich experience and knowledge to recognize the quality and value of a listing with better information and to make faster decision. Novice lenders then observe this salient information and follow the “wisdom of crowd”. Rationality of herding during the decision making also possibly affects the quality and performance of the listing differently. We develop three concepts of irrational herding in P2P lending: Aggregated irrational herding (the ignorance of both credit and listing-based information), listing-based irrational herding (the ignorance of time-invariant credit information) and credit-based irrational herding (the ignorance of time-invariant listing attributes).

We develop several econometric models to test the hypotheses. We adopt OLS and probit regression to examine the results of listing performance. Cox proportional hazard model (CPH) with weighted Kaplan-Meier method is used to study herding rationality. The significance difference of coefficients is tested by the interaction terms and paired difference tests to examine impact of experience on loan performance in the econometric models. The result of this study is expected to contribute to both academic and practice.

Keywords

Investment experience, rational herding, irrational herding, P2P lending

REFERENCES

