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MARKETS

Online Lenders Offer New Competition for Banks

New York-based Bond Street raises $10 million in equity

Chef David Chang says 'fintech' lenders like Bond Street offer precisely what he needed when he launched his restaurants in New York. *PHOTO: CASSANDRA GIRALDO FOR THE WALL STREET JOURNAL*

By PETER RUDEGEAIR

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When executives at Bond Street, an upstart online small-business lender, were canvassing for investors earlier this year, they made the usual checks with venture-capital funds and Wall Street banks. It didn't occur to them to try celebrity chefs.

But David Chang, the impresario behind the hip Momofuku family of restaurants, heard about the lender from a friend and wanted on board. He said the service Bond Street was offering—one- to three-year commercial loans of up to half a million dollars that were approved quickly—was exactly what he needed when he launched his first eateries in New York.

“Several times for the first several years” it was impossible to get a bank loan, Mr. Chang said in an interview, adding that his father had to put his business and home up for collateral for a loan he took out to open his second restaurant, Momofuku Ssäm Bar in Manhattan, in 2006. “It drove me insane that I could not secure funding for things I knew we needed and we had the business history to prove that we’d be able to pay it back.”

Mr. Chang, who has won a number of cooking awards, now has more than a dozen restaurants around the world.

Mr. Chang is the latest investor to become enamored with the promise of “fintech” companies that aim to displace banks in many aspects of consumer and business lending. In the first three months of 2015, private companies that offer loans online raised a record $542.2 million in equity, a 76% increase from the same period a year earlier, according to data from Dow Jones VentureSource.

Some wonder if the trend is overcooked.

Kathleen Utecht, a partner at investment firm Core Innovation Capital, said she expects there will be 900 new fintech companies launched this year. “It’s wild to see some of this stuff,” she said.

New York-based Bond Street, which has eight employees and was founded by a pair of young Harvard grads, said earlier this month that it raised $10 million in equity and $100 million in debt from Spark Capital, Jefferies Group LLC, Airbnb co-founder Nathan Blecharczyk and others. Three of Bond Street’s larger rivals — Prosper Marketplace Inc.; Social Finance Inc. and Funding Circle Ltd.—achieved “unicorn” status by attracting a valuation of at least $1 billion in the first half of 2015.

Investor interest in the online lending sector is spilling over into related companies. Credit Karma, a website that doesn’t make loans directly but allows banks and online lenders to make personalized offers to its more than 40 million members, raised $175 million on June 23 at a $3.5 billion valuation. Shares in LendingTree Inc., which also matches borrowers with consumer lenders such as LendingClub Corp. and Prosper, are up 62% since the start of the year.

Wall Street has taken notice. Around $11 billion in profits from making and servicing loans is at risk of leaving banks and going to alternative lenders, according to analysts at Goldman Sachs Group Inc. In his annual letter to shareholders, J.P. Morgan Chase & Co. Chief Executive Officer James Dimon warned that “Silicon Valley is coming” and that online lenders in particular “are very good at reducing the ‘pain points’ in that they can make loans in minutes, which might take banks weeks.”

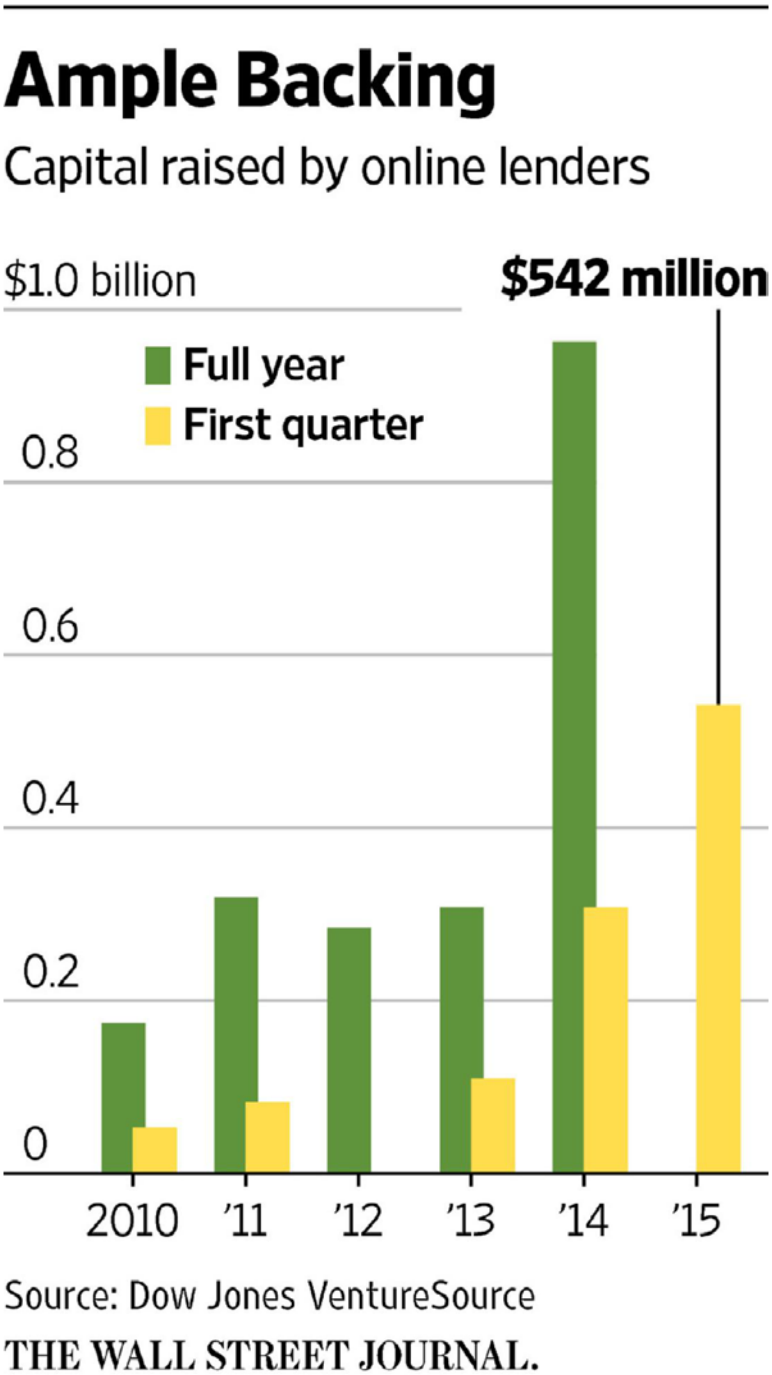
Bond Street’s automated underwriting process includes traditional variables like entrepreneurs’ personal credit scores and their businesses’ financial statements as well as data it pulls from social networks, which executives say can help reduce fraud. The company offers loans in smaller sizes than banks and approves and funds them more quickly, although the annual percentage rates on its loans range from 8% to 25%, above what many banks charge.

“More and more people seeking small-business funding today do so online,” said Bond Street co-founder Peyton Sherwood, adding “there’s a lot of inertia” that keeps banks from offering similar services.

Yet for all their potential, fintech companies still have to prove they can grow. Only 800,000 consumers have taken out a loan from one these upstart lenders, according to Autonomous Research LLP. Overall loan volume for the entire industry was about $9 billion last year, or around half of the volume of mortgages that J.P. Morgan extended in the first three months of 2014 alone.

Gordon Smith, who runs J.P. Morgan’s consumer bank and reports directly to Mr. Dimon, said at a May investor conference that online lenders have yet to demonstrate how their loans would perform in a recession. “I worry that some of the models, and they’re very, very small, how well will they really shake out when you come through a tough economy,” Mr. Smith said.

The pace of fundraising and the valuations certain companies are getting cause some in the industry to question whether investors are being discriminating



enough about whom they back.

"Am I concerned that it's rich? Yes. Should that give us some pause? It does," said Dinkar Jetley, a co-founder of Pivot Investment Partners and a former top J.P. Morgan executive. "A lot of people are piling on, and not all of them really understand fintech."

Bond Street executives are aware that not all of these new companies will succeed but believes their business model will enable them to endure.

"I'm sure there will be some shakeout," said Mr. Sherwood. "This is an easy business to hang a shingle on, but a harder business to build successfully."