

Credit scores could fuel P2P commerce

People have always sought information about those they plan to do business with, from our early ancestors assembling hunting parties to Columbus recruiting crew members.

Historically, people knew most of those they did business with, and they did business within relatively small communities. In the modern electronic era, this is increasingly not the case. The difficulty of establishing and verifying trust and reputation in more anonymous electronic markets is an immense barrier to commerce. But this could be overcome by adapting existing credit scoring products, thereby fueling peer-to-peer (P2P) commerce.

In "The Nature of the Firm," Nobel Prize-winning economist Ronald Coase asserted the reason firms exist instead of simply a sea of individuals performing transactions is because firms reduce transaction costs. It is difficult to imagine General Electric, for example, operating as 300,000 independent contractors. However, contract programmers in Bangalore write software for GE businesses and enterprising Nebraska homemakers sell antiques to German collectors on eBay.



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Technology has been waging a relentless and successful assault on many transaction costs, including acquiring reputational information. Equifax, Experian and TransUnion built businesses providing reputational credit data on individuals and businesses. A bank assessing prospective borrowers can electronically retrieve credit reports. Relying on credit bureau data, it can issue a consumer it has never met a card with a \$10,000 credit line. But for P2P commerce, the ability to acquire reputation information has lagged.

eBay provides reputation scores for online auction participants. Stock exchanges, such as the NYSE and Nasdaq, stand behind transactions between buyers and sellers. Similarly, in credit card payments, Visa and MasterCard stand between and behind 21,000 banks, 21 million merchants and 1 billion cardholders worldwide. Individuals, however, still face enormous costs and inconvenience conducting commerce with other individuals.

Statistically based scoring systems, drawing on bureau data, enable better, faster and more effective decision making. Fair Isaac and Co. (FICO) scores are the most widely used credit risk predictor. The FICO model factors payment habits, indebtedness, outstanding credit, time at residence and other consumer credit data. Lenders rely heavily on FICO scores to evaluate prospective borrower and existing customer risk.

And, since credit risk correlates well with a variety of other behaviors, FICO scores are increasingly used by potential landlords, employers, insurance underwriters and marketers to gauge individuals' attractiveness and risk.

Virtually every adult American has enough data to calculate a FICO score. In 2001 bureaus started selling FICO scores directly to consumers so they could, presumably, better manage their credit. But there is a broader opportunity. Selling these scores, or modified versions, to individuals to be used as a reputation badge, would redefine the market and fuel e-commerce, particularly among individuals.

Bureau data have long been viewed as intrinsically personal and there are strict rules governing use. But privacy would not be an issue, because individuals would make their own scores available to others, and an authorized third party would validate the accuracy.

If reputation scores were widely disseminated by individuals, there would be a huge network effect. Consumers could buy their own scores and display them on their e-mail. At some point, the absence of a reputational badge would convey negative information. The consequences of P2P-score use could be socially far-reaching. If displaying a reputational badge became widespread, men and women would almost certainly use it in evaluating each other. Is it so hard to imagine? "Bachelor No. 1 is a lawyer with an 800 FICO score who enjoys tennis. Bachelor No. 2 is a state senator with a 550 FICO score who water skis."

By selling FICO scores directly to consumers, the credit bureaus have taken the first step in redefining and expanding their served market. As P2P commerce becomes more viable, enabling individual reputational transparency makes sense and is an enormous commercial opportunity.

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