

Digital Lending: The Phenomena Of Intermediation Through Disintermediation

Asamani Akhileshwari¹, Dr.Jayavani Majumdar²

¹Research Scholar, Department of Management,
Koneru Lakshmaiah Education Foundation (KLEF),
Hyderabad, Telangana-500084
Email: 2002550003@kluniversity.in

²Associate Professor, Department of Management,
Koneru Lakshmaiah Education Foundation (KLEF),
Hyderabad, Telangana-500084
Email: vani@klh.edu.in

Abstract:

The context of lending companies has changed substantially over the course of the past century, from the days when pawnshops would lend money in exchange for collateral to the present day when sophisticated technology are used to carry out credit underwriting. It is quite difficult to find a financial institution that is still operational in this day and age that has not digitized at least one part of the loan process. It is appropriate to conclude that the traditional "brick and mortar" model for the lending company will soon be a thing of the past due to the quick breakthroughs being made in areas such as blockchain technology, artificial intelligence, and cloud computing. Additionally, internet connectivity is becoming faster and more affordable. The purpose of this paper is to investigate the growth, current scenario, and regulations governing digital lending in India.

Keywords: Traditional Lending, Digital lending architecture, Reserve Bank of India, digital lending apps, credit

Introduction:

In recent years, India has seen a rise in the number of

successful digital lending companies. It still seeks expertise in its technology, despite the fact that its influence on the customer segments and competitive arena is highly intimidating to traditional banking business models. The digitization of the lending procedure delivers a variety of substantial benefits to financial institutions, including enhanced decision-making capabilities, a markedly enhanced experience for customers, and significant cost reductions. Automation has become essential to achieving maximum throughput, but there are some components that do not appear to be prepared for it yet.

Traditional lending refers to the conventional approach of providing financial loans and services through established banks and financial institutions. In traditional lending, borrowers typically visit physical branches to apply for loans, fill out extensive paperwork, and provide physical documents for verification. The process involves manual review, underwriting, and assessment of borrower eligibility based on criteria like credit history, income, and collateral. Traditional lending emphasizes personal interactions with loan officers or customer service representatives, offering face-to-face assistance and guidance. The loan approval process can be time-consuming, and funds are usually disbursed through traditional channels. Traditional lending has been the dominant form of lending for many years, but it is gradually evolving with the integration of digital technologies to streamline processes and enhance convenience.

Contrary to this, Digital lending, also known as online lending, refers to the use of technology and digital platforms to provide financial loans and services. In digital lending, borrowers can apply for loans online through websites or mobile apps, eliminating the need for physical visits to bank branches. The application process is streamlined and automated, often requiring minimal paperwork and digital document submission. Digital lending platforms leverage technology, data analytics, and algorithms to assess borrower eligibility and creditworthiness based on various digital data points. This enables faster loan approvals and fund disbursements. Digital lending expands accessibility by transcending geographical barriers, allowing borrowers in

remote areas to access loans and promoting financial inclusion. While personal interactions are limited, digital lending platforms often provide online support and chat functionalities. Digital lending is characterized by its speed, efficiency, convenience, and ability to leverage alternative data for risk assessment, catering to the evolving needs of borrowers in the digital age.

Digital lending: Intermediation through Disintermediation

Since the beginning of the Vedic period, lending money has been an important aspect of the Indian economy. Usury, also known as 'kusidin' (which literally translates to 'usurer,') was mentioned in the very first Indian scripture. During that historical period, the practice of making unethical or immoral financial loans was known as usury.

An instrument known as the adesha was developed later on during the Mauryan period (321–185 BCE). The adesha was an order placed on a banker, directing him to pay the sum on the note to a third party; its definition is comparable to that of a modern bill of trade.

It has been documented that a significant amount of usage is made of these instruments. In the larger towns and cities, it was common practice for merchants to extend letters of credit to one another. The practice of using loan deeds, also known as dastawez, was perpetuated during the Mughal Empire.

Although early India had its own credit instruments and system for money lending, both of these aspects were drastically altered after the British took control of the country. The British brought with them a very structured and anglicized type of banking and lending with them to North America.

The Union Bank of Calcutta was the first bank to be established in India, and it did so with the assistance of the British. The Commercial Bank and the Calcutta Bank merged to become what is now known as the Union Bank. In a same vein, the Allahabad Bank first opened its doors in 1865 and is still much operational even today.

The Indian Banking Industry saw a golden age between the years of 1983 and 1946. The newly established government of independent India quickly took involved in the day-to-day operations of the country's economy and instituted a number of significant reforms. The Reserve Bank of India, which serves as India's central banking authority, was one of the changes that had to take place as a result of the need for reform. Another important law that was passed in 1949 was the Banking Regulation Act. This gave the RBI the authority to supervise and manage India's financial institutions.

In this manner, the conventional process of lending money was marked by inefficiency and inaccuracy, and it was made up of multiple procedures that took a significant amount of time. Finding an appropriate bank, acquiring actual copies of essential papers, visiting various branches, and going through a protracted manual verification procedure were all necessary steps. Traditional lending also excludes many micro, small, and medium-sized enterprises (MSMEs) and clients who are new to credit because the qualifying requirements are stringent and the screening is based on previous credit histories. Traditional lending institutions view loans for amounts below a specific threshold as high risk and so make it difficult for borrowers seeking modest loans to obtain the financing they require from these institutions.

However, in recent years there has been a growth in access to internet at low costs, and there has been a major explosion in the adoption of smartphones, which meant that India was ripe for the growth of digital lending. Digital lending allows borrowers to apply for loans and receive funds fully online, without having to visit a physical bank. The use of alternative data sources and algorithms to evaluate a borrower's creditworthiness is a widespread practice in digital lending. This aided in the disbursement of loans by smart phone anywhere at any time, with minimum paper labor and speedier loan processing. Credit scores and various other types of financial information are often utilized in the traditional loan process. Additionally, it makes it possible for people to borrow money from one another on a peer-to-peer basis, eliminating the need for financial

institutions to act as the intermediaries in such transactions. This way, the phenomenon of intermediation through disintermediation was brought about as a result of this manner of lending through digital platforms.

Difference between Traditional and Digital lending:

Digital lending is gaining more traction nowadays, because of the technological advancements, speed and convenience, enhanced customer experience, data driven approaches, and several more factors associated with it.

Traditional lending and digital lending are two distinct approaches to providing financial services. The following explain the key differences between the traditional lending and digital lending:

Process and Convenience:

Traditional Lending: In traditional lending, borrowers need to visit physical branches of banks or financial institutions to apply for a loan. The process typically involves filling out lengthy paperwork, providing physical documents, and waiting for manual verification and approval. This process can be time-consuming and inconvenient.

Digital Lending: Digital lending, also known as online lending, takes advantage of technology to offer a more streamlined and convenient process. Borrowers can apply for loans online through websites or mobile apps. The application process is often automated and involves minimal paperwork. Verification and approval are typically faster, and borrowers can receive funds electronically, reducing the need for physical interaction.

Accessibility and Reach:

Traditional Lending: Traditional lending is usually limited to established banks and financial institutions with physical branches. Borrowers need to be located near these branches to access their services. This can be a challenge for individuals in remote areas or those with limited mobility.

Digital Lending: Digital lending transcends geographical barriers and provides broader accessibility. Online lending

platforms can be accessed from anywhere with an internet connection, making it easier for individuals in remote locations to apply for loans. This expands the reach of lending services and promotes financial inclusion.

Speed and Efficiency:

Traditional Lending: Traditional lending processes often involve manual verification and underwriting, which can be time-consuming. Loan applications may go through multiple levels of review, leading to delays in approval and disbursement of funds.

Digital Lending: Digital lending platforms leverage automation and data analytics to expedite the loan approval process. Algorithms quickly assess borrower eligibility and creditworthiness using digital data points. As a result, loan approvals and fund disbursements are typically faster, providing borrowers with quicker access to funds.

Documentation and Paperwork:

Traditional Lending: Traditional lending involves significant paperwork, such as filling out physical application forms, providing hard copies of documents like bank statements, payslips, and identification proofs. This paperwork can be cumbersome and prone to errors.

Digital Lending: Digital lending minimizes paperwork by utilizing electronic forms and digital document submission. Borrowers can upload soft copies of the required documents online, reducing the need for physical paperwork. This simplifies the application process and enhances accuracy.

Personal Interaction and Customer Support:

Traditional Lending: Traditional lending often involves face-to-face interactions with loan officers or customer service representatives. Borrowers may have the opportunity to discuss their needs, ask questions, and receive personalized advice. However, these interactions are typically limited to the operating hours and availability of bank branches.

Digital Lending: Digital lending offers limited personal interaction. Borrowers interact with the lending platform

primarily through digital channels. While this may lack the human touch, digital lending platforms often provide online support and chat functionalities to address customer inquiries and concerns.

Risk Assessment and Underwriting:

Traditional Lending: Traditional lenders typically rely on conventional credit scoring models and collateral assessment to evaluate borrower creditworthiness. The underwriting process can be more stringent, and loan approvals may be based on historical credit data and fixed eligibility criteria.

Digital Lending: Digital lending platforms leverage technology to employ alternative data sources and non-traditional credit scoring models. They can analyze a broader range of data, such as social media profiles, transaction history, and digital footprints, to assess borrower risk. This allows for more inclusive lending, especially for individuals with limited credit history.

It's important to note that the distinctions between traditional and digital lending are not always clear-cut, as many traditional lenders are embracing digital transformation and incorporating online lending services into their offerings. Additionally, regulatory frameworks and legal requirements may differ between traditional and digital lending, further impacting the lending process and borrower experience.

Key drivers of Digital lending:

There are several reasons why businesses and individuals are backing digital lending. The following are some of the reasons why businesses prefer digital lending to traditional banking:

1. Application process:

To obtain a business loan from a bank, we would need to visit the branch in person, complete extensive application forms, and submit a number of supporting documents. Even though some banks offer the option to complete out the

loan application online, we will still need to visit the bank at least twice before our loan is processed.

Digital lending eliminates the need to forego work to wait in line. Completely online, sparing you time and effort.

2. Documentation

Obtaining a business loan from a bank requires copious documentation. We must submit forms, attest documents, submit reproductions, provide references, etc. This creates unnecessary inconveniences, as the process is arduous and time-consuming.

With digital lending, documentation is drastically reduced. We only need to provide scanned copies of a few essential documents, such as evidence of address and proof of identity.

3. Processing and disbursement duration

The time required for processing and disbursement is another significant difference between traditional and digital lending. When applying for a business loan with a bank, the clearance and processing time can be interminable. It can take weeks or even months for banks to process loan applications and disburse the necessary funds.

Digital lenders, on the other hand, process loan applications within hours, and the funds are deposited into our account within a few business days, typically two to four. This is an excellent option, particularly for small business owners and startups who need funds quickly.

4. Eligibility

The eligibility for bank loan disbursement is determined by a variety of factors, including employment history, current income, assets, housing, and credit score in particular.

In determining your creditworthiness, digital lenders also consider our income and credit scores, as well as your social media authorization, education levels, professional background, and prospective future earnings.

5. Adaptability

Digital lending platforms provide variable credit lines ranging from Rs. 25,000 to Rs. Digital lenders typically classify these as small-dollar loans. In addition, we can repay these loans over a period of 2 to 36 months with flexible and affordable EMIs.

In contrast, banks typically view loans under Rs. 1 lakh as a high-risk proposition.

6. Lenders

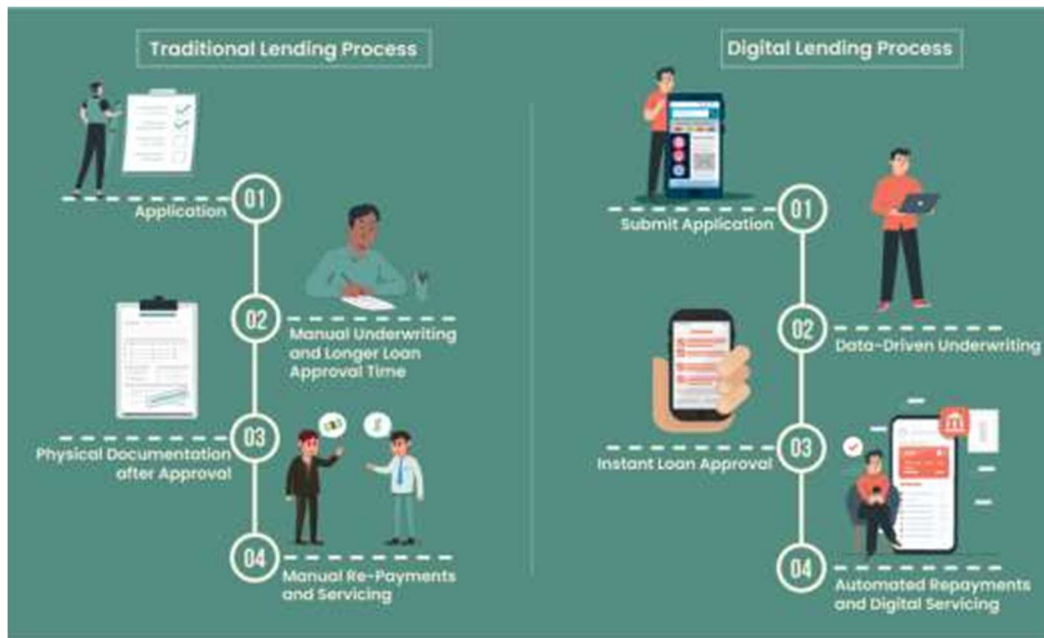
In the case of digital lending, we will have access to multiple lenders at once and be able to compare offers from the convenience of our own home before selecting the best-suited loan.

This is not the case with conventional lending, where we must visit numerous institutions to obtain all the necessary information.

7. Technology

Due to clumsy, outmoded systems and technology, conventional lending is frequently difficult. The majority of banks struggle with legacy infrastructure and are unable to provide products and services with agility and efficiency. Inefficient and ineffective banking operations are caused by a cumbersome user interface, complicated user procedures, and inadequate customer tech support for inquiries.

At every stage of the customer journey, digital lending makes use of technology to optimize every customer interaction. Interfaces are seamless, intuitive, user-friendly, and extensive in functionality.



Source: (Tewari, n.d.)

Digital lending architecture:

Digital lending architecture refers to the underlying technology and system design that enables digital lending services. It encompasses the various components and processes involved in facilitating online lending, including loan origination, underwriting, loan servicing, and borrower management.

The following is a high-level overview of the typical architecture of a digital lending platform:

User Interface: The front-end component of the architecture consists of the user interface (UI) through which borrowers and lenders interact with the platform. It includes web or mobile applications that provide a seamless and user-friendly experience for loan application, document submission, and account management.

Application Programming Interface (API) Layer: The API layer serves as a bridge between the user interface and the backend systems. It enables communication and data exchange between different components of the architecture, such as credit bureaus, payment gateways,

identity verification services, and other third-party integrations.

Loan Origination System (LOS): The LOS is responsible for managing the loan application process, from initial application submission to loan approval. It captures borrower information, performs credit assessments, and supports automated decision-making based on predefined lending criteria. The LOS may also handle document management and e-signature capabilities.

Credit Scoring and Underwriting: This component involves analyzing the borrower's creditworthiness and risk assessment. It may include integration with credit bureaus and data analytics tools to evaluate credit scores, income verification, and other relevant factors. Machine learning algorithms and predictive models can be used to automate underwriting decisions and streamline the process.

Loan Servicing and Management: Once a loan is approved, the loan servicing component takes over. It handles loan disbursement, repayment schedules, interest calculations, and manages ongoing borrower communication. It also supports features like online payments, account statements, and loan modification requests.

Data Management and Security: Data management is a crucial aspect of digital lending architecture. It involves securely storing and managing borrower information, transactional data, and other relevant data points. Adequate measures, such as encryption, access controls, and compliance with data protection regulations, should be implemented to ensure data security and privacy.

Integration with Third-Party Services: Digital lending platforms often integrate with external services to enhance their capabilities. This may include credit bureaus for credit reporting, payment gateways for transaction processing, identity verification services for KYC (Know Your Customer) compliance, and other financial systems for seamless fund transfers.

Analytics and Reporting: Analytics and reporting modules provide insights into loan performance, portfolio risk, and

operational efficiency. They enable lenders to monitor key metrics, identify trends, and make data-driven decisions for risk management and business optimization.

Digital lending market size in India

Digital credit products have created new opportunities for borrowers without a credit history, particularly those in underserved small towns, to obtain credit, thereby narrowing the financial inclusion divide even further.

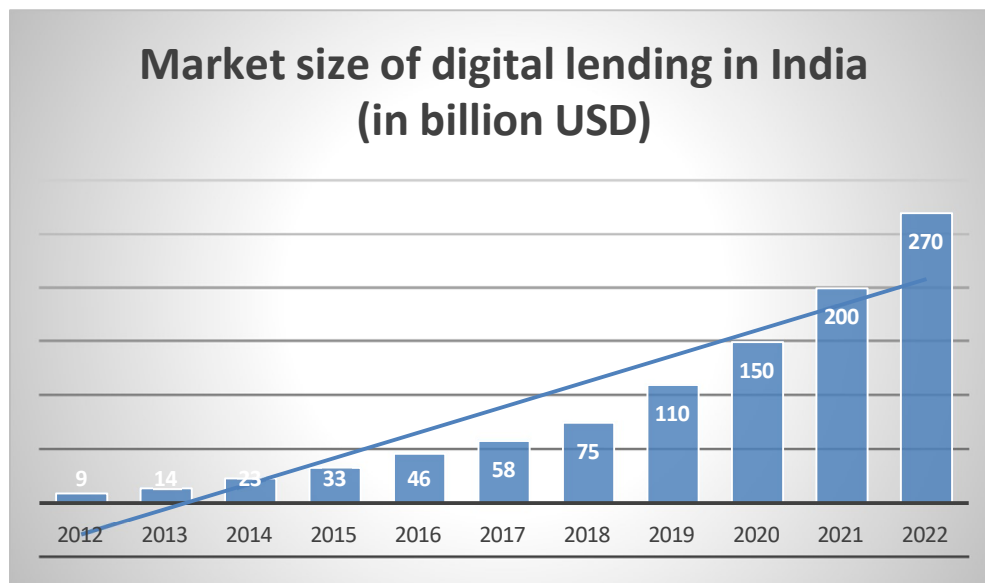
Fintech startups in India have enthusiastically embraced the challenge of improving access to credit, resulting in an abundance of lending apps that offer various forms of credit, including direct bank transfers, retail checkout EMIs and other consumer durable loans, scan and pay, Buy Now, Pay Later (BNPL), Save Now, Pay Later (SNPL), and more. Currently, retail checkout EMIs, BNPL, and SNPL dominate the consumer loan industry, allowing consumers to obtain credit at the point of sale.

A recent survey conducted by a neo-banking platform revealed that millennials will account for 44% of all lending product transactions in 2022. Younger generations, including Millennials and Generation Z, are increasingly employing micro-credit and Buy Now Pay Later services for purchases, as these financial options serve as a potent tool for achieving their aspirational purchases.

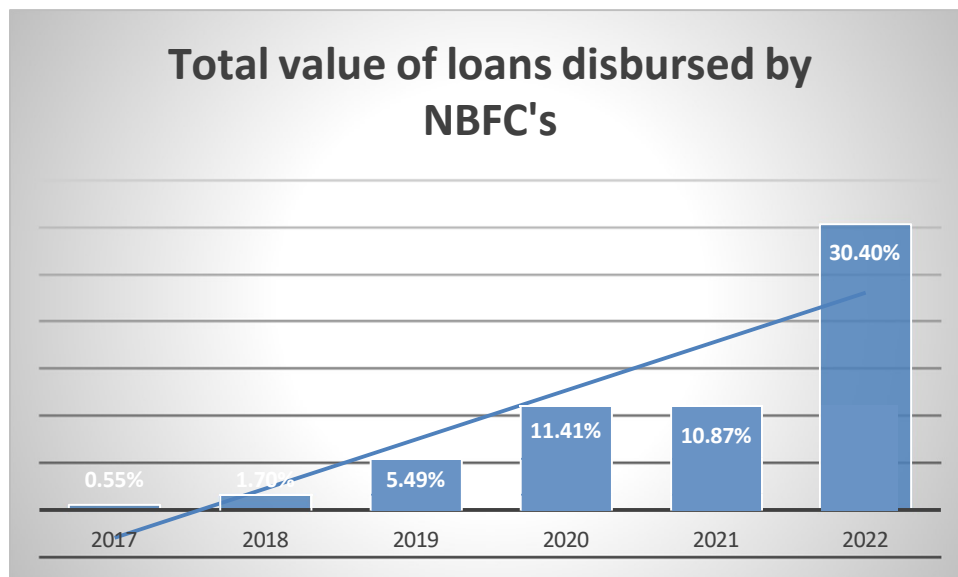
During the Covid-19 pandemic, credit card payments increased from INR 6,30,414 crore in fiscal year (FY) 2020-21 to INR 10,49,014 crore as of September FY23, according to RBI data.

Despite these positive statistics, India has a long way to go in terms of credit card usage. With less than 5% of India's population of 1.4 billion possessing a formal credit card, the market for credit is expanding. However, traditional financial institutions have been unable to satisfy this demand, as the majority of Indians have poor or nonexistent credit scores. Due to the reluctance of traditional banking institutions to extend loans to individuals with poor credit and low incomes, numerous digital lending platforms, such as NBFCs, fintech companies, and others, have emerged to fill the void.

In addition, due to the uncertainty of the pandemic and the economic climate, many individuals who were hesitant to use credit cards or take out traditional loans turned to consumer durable loans as a more flexible and affordable alternative. This has allowed fintech companies to expand their offerings and establish a foothold in this expanding market.



Source: Author's own



Source: Author's own

According to CRIF High Mark's report captioned 'How India Lends – 2022' NBFCs dominate the Consumer Durable Loans market, which has a portfolio outstanding (value) of INR 37,400 crores as of March '22, with 30.4% Y-o-Y value growth and 22.3% Y-o-Y volume growth. From FY21 to FY22, Originations (by value) and Originations (by volume) for Consumer Durable Loans increased by 66% and 43%, respectively, according to the same report. These development rates indicate a rise in the consumption of smaller portions by the general public. Overall, India's financing market has rebounded from the downturn in FY21 and experienced a phenomenal recovery in FY22.

Regulatory framework for Digital Lending in India:

The Reserve Bank of India (RBI) has issued circulars and directions to DLAs and lenders that collaborate with such platforms to prevent the misuse of consumer data and to not impose interest rates that are considered usurious. The rules outline norms for the use of prepaid payment instrument (PPI) wallets for credit line products and the role that cloud infrastructure plays in digital lending. In order to provide efficient systems that are in line with the rules, as well as a seamless implementation and transition, the Reserve Bank of India (RBI) has requested that Regulated Entities comply by the 30th of November in 2022.

Regulations have been imposed on digital lending in order to guarantee transparency, protect the interests of customers, and make owners of fintech companies and other stakeholders accountable for their actions. It is anticipated that the circulars and guidelines released by the RBI will evolve the digital lending ecosystem with core banking fundamentals, hence making online credit easy to obtain, accessible, consumer-focused, and accountable.

These guidelines include major thematic pillars such as systemic risk, transparency, the onus of compliance, and the relationship between banks and fintech companies.

Transparency

There should be no involvement from any third-party Lending Service Providers (LSPs) in any of the digital loan

disbursals or repayments that take place. These transactions should take place only between the borrower's bank accounts and the licensed digital lender.

The borrower is not responsible for paying any fees or charges that are owed to LSPs as part of the lending process; rather, the lender is responsible for doing so.

Before signing the loan agreement, each potential borrower must first get a Key Fact Statement, often known as a KFS.

The annual percentage rate (APR) of the total cost of a digital loan must be disclosed by the lender to the borrower by the borrower in the form of a digital loan.

Systemic risk

Systemic risk is the chance that the entire financial system will fail due to the risks that are imposed by interlinkages. In this type of risk, the failure of a single business or a cluster can create a failure that cascades throughout the entire system.

In order to mitigate the knock-on effects of systemic risk, the central bank permits synthetic securitization, which is a kind of securitization in which the ownership of the securitized exposures is retained in the balance sheets of the originators (the lenders). On the other hand, the credit risk can be transferred through the use of credit derivatives or financial guarantees, both of which perform the function of a hedge against the risk posed by the credit portfolio.

Maintaining a capital adequacy ratio of 15–20 percent is required of all Regulated Entities (REs) that operate as originating partners in order to assist in the balancing of systemic risks.

Additionally, RBI has done away with regulatory arbitrage. It has made certain that all products, including BNPL, no-cost EMIs, and others, that carry credit risks are acknowledged as being lending products.

Compliance

The data that is gathered by DLAs ought to be done so only with the borrower's prior authorization, ought to be need-based, and ought to have different audit trails.

In addition to this recommendation, the research suggests the formation of a Self-Regulatory Organization (SRO) in order to define standards and regulate operations in the digital lending area.

Complaints that customers have against their particular digital lending applications (DLAs) will be handled by a grievance redressal officer, and such details will be widely displayed on the websites of the regulated company, DLAs, and LSPs.

In the event that the borrower files a complaint, the lender has thirty days to investigate and fix the issue. In such a circumstance, a grievance can be submitted through the Reserve Bank's Integrated Ombudsman Scheme, abbreviated as RB-IOS.

Collaboration between banks and fintech companies

It is imperative that fintech companies and banks work together to enhance operational efficiencies as well as the quality of service provided to customers.

The Reserve Bank of India (RBI) emphasized the necessity of a unified setting for the development of fintech innovations and the testing of application programming interfaces (APIs) that were created by partnerships. Separately, RBI has also shown support for the Interoperable Sandbox, which is designed to facilitate product development innovations involving many regulators.

In addition to this, it instructed authorities in the financial sector to identify fintech products and regulatory procedures that are sector-specific.

Conclusion:

When it comes to the conception of new business models, technology has recently assumed the central role. Because of this, the expansion and development of the digital lending ecosystem has been sped up, which has made it possible for

fintech companies and financial institutions (FIs) to provide credit online.

The increase in the use of internet-connected devices by younger borrowers in India has helped to facilitate the development in popularity of digital lending in that country. Other factors that have contributed to the rise in popularity of digital lending in India include quick and flexible financing and a larger credit spectrum.

The expansion of online lending is posing problems for the regulatory body. The Reserve Bank of India (RBI) has expressed concern regarding the exponential growth of digital lending apps (DLAs) in India as well as the business methods employed by these DLAs. The regulatory agency is concerned about a variety of issues, including discretionary regulatory arbitrage, abusive and predatory collecting practices that are inconsistent with legislation, exorbitant interest rates, and data security breakdowns, among other issues. The Reserve Bank of India has emphasized how important it is to have controlled vigilance.

References

- (n.d.). DIGITAL LENDING A \$1 TRILLION OPPORTUNITY OVER THE NEXT 5 YEARS. Boston Consulting Group.
- Dr. Anshu Gupta, K. K. (2021). AUTOMATION IN ACCOUNTING AND FINANCIAL REPORTING . Indian Journal of Business Administration (IJBA) .
- Kale, S. (2021). Digital Lending: Issues, Challenges and Proposed Solutions. Indicus Foundation.
- R, D. J. (2023). A Critical Analysis of the Digital Lending Market in India and its Future Prospects. INTERNATIONAL JOURNAL OF INNOVATIVE RESEARCH IN TECHNOLOGY.
- (2021). Report of the Working Group on Digital Lending including Lending through Online Platforms and Mobile Apps. Reserve Bank of India.
- Sarungu, C. M. (2020). Digital Lending High Level System Architecture in Indonesia. 2020 1st International Conference on Information Technology, Advanced Mechanical and Electrical Engineering.
- Tewari, N. (n.d.). Retrieved from Why should MSMEs consider Digital Lending over Traditional Lending?:

<https://datasutram.com/blog/why-should-msmes-consider-digital-lending-over-traditional-lending-ODc1>

- The Digital Fifth Fintech News. (n.d.). Retrieved from LinkedIn: <https://www.linkedin.com/pulse/analysis-digital-lending-guidelines-fifth-newsletter-jaini/>
- Value of digital lending market in India from 2012 to 2020, with estimates until 2023. (n.d.). Retrieved from Statista: <https://www.statista.com/statistics/1202533/india-digital-lending-volume/>