Digital Lending: Is It Alternative Lending Revolution?

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Abstract: Digital lending is new and emerging area in the field of lending or credit. Lending through digital platform, right from receipt of loan application to disbursement of loans, is known as digital lending. Digital lending gains momentum as a result of employing new technologies, new credit scoring algorithms and inclusive approach. This article focuses on framework, working mechanism and growth of digital lending in India.

Index Terms: Digital lending, FinTech, India, Alternative lending.

1. INTRODUCTION

Over the last few years, Financial Technology (FinTech) has emerged as game changer in the financial segment. FinTech has completely redefined the way in which business has been carried out. Financial Technology is basically fusion of finance and technology to provide financial solutions which are considerably more efficient than those financial solutions provided by traditional financial institutions. However, FinTech is not a replacement for traditional banking system. But, FinTech is a facilitator for effective banking services. Most of the banking services are now being provided with the comfort of new technologies such as machine learning, big data analysis and algorithms.Traditional banking system has an integrated approach towards banking business. Traditional banking system performs primary functions of collection of deposits and lending as well as secondary functions such as remittances, point of sales, insurance and so on. But, FinTech enabled firms, mostly start ups; focus on certain banking functions instead of adopting integrated approach. Few FinTech firms focus on digital lending and some other firms focus on payment services, remittances and insurance.Digital lending is also known as alternative lending. Alternative lending refers to digital platforms that provide low-cost loans, which are simple to obtain for the large unaddressed market segment. Alternative lending is a growing industry for digital lending aimed at different borrowing needs, including consumer loans, Small Medium Enterprises loans, working capital loans, and payday loans among others. It serves as a relatively less volatile asset class for retail and institutional investors. The industry primarily consists of digital lending platforms and enablers who facilitate such platforms, such as alternate credit scorers and white label services. These platforms connect lenders, seeking higher returns than banks currently offer, with customers seeking fast, short-term loans.Digital lending has a larger opportunity in India and the total retail loan which could be distributed digitally in next five years – till 2023- would be over $1 trillion (Boston Consulting Group, 2018).

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2 STATEMENT OF THE PROBLEM

In the traditional banking and other formal financial system, lending happens through offline. The entire process of lending in the traditional system is, right from identifying prospective borrower to sanctioning of the loan or credit, carried out manually which is time consuming process and tiresome for the borrowers. The banks use traditional credit scores such as CIBIL credit score to determine the credit worthiness of the borrowers. The traditional credit scores have certain limitations and they do not consider the facts presented by the borrowers. Further, the bankers provide loans only to those people who can access the banks by having bank accounts and to those customers who have "Good Credit Score". As a result, the individuals and the businesses do not have access to the banks irrespective of larger number of financial inclusion initiatives of the Government of India and those who are short of convincing credit scores become financially excluded. Thus, the traditional banking system makes the individuals and the businesses financially excluded and it has cumbersome and time consuming lending process. These gaps are now filled by digital lending. Digital lending is vey speedy in nature and loans are approved in comparatively lower time period by using technology and alternative credit scores at affordable rate of interest. Some digital lenders sanction the credit in a minute after submitting the required documents and the digital lenders provide variety of credit to meet diversified needs of the individuals and the businesses. Digital lending has revolutionized the lending function and it has emerged as alternative to the bank credit. Therefore, it is essential to study about the emergence of digital lending and its growth in India as well as at the global level as an alternative to the bank credits.

3 CONCEPTUAL FRAMEWORK AND WORKING MECHANISM OF DIGITAL LENDING

There is a paradigm shift in the field of lending. Lending is undergoing a fundamental transformation from traditional 3-6-3 formula to 3-1-0 formula. 3-6-3 formula is more prevalent in the traditional banking which means "raise deposit at 3 percent, lend at 6 percent and play golf after 3 PM". But, FinTech powered Digital lending firms practice the new global formula 3-1-0 which refers "3 minutes to decide, 1 minute to transfer the money and 0 human touch" (Boston Consulting Group, 2018).

TABLE 1
DIGITAL LENDING MODELS

Online lender	Financial Service Provider (FSP) that provides end-to-end digital lending products via a website or mobile application.
P2P Lender	Digital platforms that facilitate the provision of digital credit between many borrowers and lenders, typically playing an ongoing central role in the relationship between these parties.
e-Commerce and Social Platforms	Digital platforms wherein credit is not their core business, but that leverages their digital distribution, strong brand, and rich customer data to offer credit products to their customer base.
Marketplace Platforms	Digital platforms that originate and match one borrower with many lenders for an origination fee; the lender and borrower then enter into a bilateral agreement.
Supply Chain Lender	Non-cash digital loans for specific asset financing, invoice financing, or pay-as-you-go asset purchase within a supply chain or distribution network
Mobile Money Lender	Partnership model wherein lenders work with mobile network operators (MNOs) to offer mobile money loans to their customer base, leveraging mobile phone data for scoring
Tech-enabled Lender	Traditional FSPs that have digitized parts of the lending process, either in-house or through partnerships.

Digital lending is the process of offering loans that are applied for, disbursed, and managed through digital channels, in which lenders use digitized data to inform credit decisions and build intelligent customer engagement. Digital lending takes many shapes and forms – from automating small pieces, to a fully digital lending process, from acquisition to renewal (ACCION, 2018).Digital lending isn't just doing the same thing better, but rather creating something new. It implies an end-to-end process of developing and delivering data-driven financial products that are applied for, disbursed, and managed through digital channels (ACCION, 2018).Alternative lending is an asset class borne of bank disintermediation and technological innovation (Ken Michlitsch, 2018).Thus, Digital lending is a lending process which provides speedy and smart credits to the borrowers using internet, technology, artificial intelligence, big data analytics and alternative credit scoring algorithms. There are three core components of digital lending which include use of digital channels, use of digitized data and focus on customer experience and engagement (ACCION, 2018). The digital lending ecosystem is complex and evolving. Around the world, digital lending models are characterized by distinct market structures, regulatory environments, and customer needs. Some players offer end-to-end digital solutions, while others focus on a specific component of the lending process and leverage partnerships to supplement their models. The major models of digital lending are presented in the Table 1.Due to complex ecosystem and technological and financial innovation, it is very difficult to classify the digital lending models strictly. A customer journey of Digital lending is presented in the following Figure – 1;

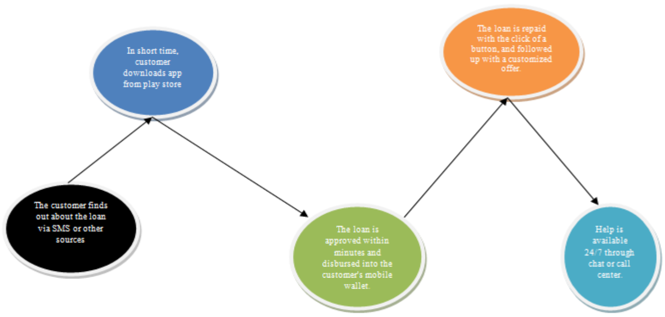

Fig.1 *Customer Journey of Digital Lending*

4 WORKING MECHANISM OF DIGITAL LENDING

Digital lending is rapidly growing sector in financial service industry all over the world and in India. The contributors such a growth are usage of internet, technological advancements and big data, digital ecosystem, innovative models, time saving and customer friendly approach.

a.Usage of internet
This is a digital era. Behavioral pattern of people across the world has become ever changing. Indian population is extensively using online transactions in these days which are fuelled by e-commerce websites, digital push of government, cashless economy and so on. In 2014, only 7% of urban people in India engaged in online purchases and in 2018, this percentage has increased to 30% (Boston Consulting Group, 2018).

b.Technological advancements and big data
Technological advancements like artificial intelligence, black chain technology, cloud computing, big data and analytics have remodeled the way the businesses are undertaken today. These technologies brought new Financial Technology companies in to existence. One of such Financial Technology companies is Digital Lending companies.

c.Digital ecosystem
Along with customers' behavior, it is very essential to have favorable digital ecosystem for the development of digital lending. India has pioneered in creating conducive ecosystem for development of FinTechs and digital transactions. Digital lending has grown significantly as a result of digital ecosystem through various initiatives like Aadhar, Unified Payment Interface (UPI), Bharat Bill Payment System, cashless economy push and Goods and Service Tax (GST).

d.Innovative Models
FinTech companies revolutionized the financial service industry in general and the lending sector in particular through innovative business models like point of sales based lending, invoice discounting exchanges, bank and FinTech partnership like capital float, market place lending and bank led digital models.

e.Time saving and customer friendly approach
Availing loans through digital way is not cumber some and tedious. But, In fact, digital lending is very simple and smart lending process. It has advantages in terms of time, cost and approach. Digital loans are processed and disbursed using the following mechanism;

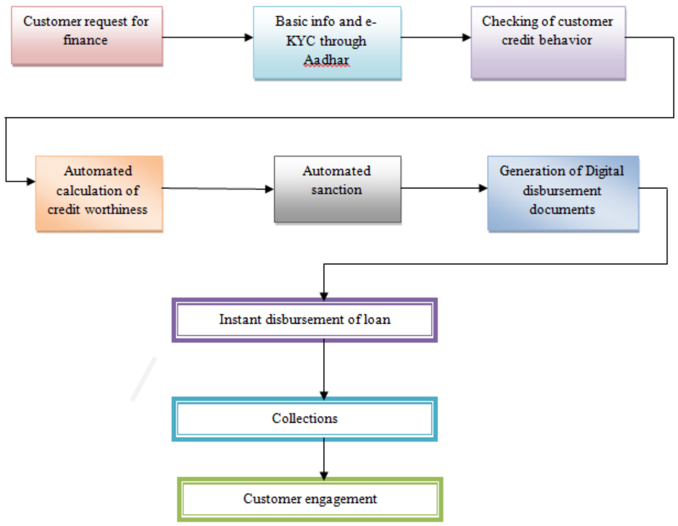

Fig.2 *Digital Lending Process*

5 GROWTH OF DIGITAL LENDING IN INDIA

In the beginning of internet boom, millennial, male and metro residents were the users of internet in India (Boston Consulting Group, 2018). But, this scenario has gone and all kind of people across India use internet today. According to research work of Boston Consulting Group on consumer behavior across purchase journey, 50% of loan seekers with internet access buy their loans online. Further, the research says that growth of digital infrastructure in India and readiness of the Indian consumers will drive the growth of digital lending exponentially. It is estimated that the total value of digital lending in India will exceed $1 trillion over the next five years (Boston Consulting Group, 2018). Small Medium Enterprise loans and personal loans are the leading digital loans of the customers followed by home loans.Technology is now allowing financial services providers to increase financial inclusion in India. The cell phone has become a differentiator, as is having an Aadhaar number. The number of Indians having either a cell phone or an Aadhaar card is now one billion. Armed with one or both of these two enablers, India's unbanked can now hope to access the benefits of the formal financial system.Although digital lending makes remarkable impact in the space of lending in India, there are certain constraints for growth of digital lending. The following initiatives may improve scope and growth of digital lending;

a. Increase the limit of digital loan amount through One Time Password based e-KYC from Rs 60000 to 5,00,000
b. Amend section 138 of Negotiable Instruments Act, 1881 to accommodate digital signature (e-sign) of loan documents
c. Permit e-mandate for collection digital loans disbursed

6 CONCLUSION

This article focuses on digital lending, its conceptual framework, growth and factors contributing digital lending. Digital lending revolutionized the field of lending across the world as well as in India. Digital lending is powered by technology and new business models. Digital lending is started to emerge as new alternative to traditional lending due to its cost effective, less time consuming and inclusive approaches. Digital lending is in fact an alternative to traditional lending because even the financially excluded people can access digital lending firms to avail loans and digital lending firms provide loans, mostly small and medium ticket loans, to such excluded people and their organizations using alternative credit scoring methodology.

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