



International Journal of Research in Finance and Management

P-ISSN: 2617-5754
E-ISSN: 2617-5762
IJRFM 2023; 6(1): 216-219
www.allfinancejournal.com
Received: 27-12-2022
Accepted: 30-01-2023

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Fintech lending changed lending ecosystem in India

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DOI: <https://doi.org/10.33545/26175754.2023.v6.i1c.213>

Abstract

Fintech lending is an alternative vehicle to traditional lending. In the modern lending industry, fintech lending will play a vital role as it ensures banking everywhere. The fintech lending ecosystem in India is improving every day and by 2023 it will emerge as the key lending source. The RBI issued detailed guidelines in this regard in Sept, 2022 to ensure a transparent and fair lending mechanism at a low cost. Fintech lending is providing new opportunities to borrowers and investors at lower cost, greater accessibility, and faster speed. However, there are still many challenges to overcome which are impeding the growth of the fintech lending industry. The regulators and the fintech companies need to overcome these challenges by developing a strong risk management system, creating trust in customers, and using new technology in the lending ecosystem as early as possible.

Keywords: Fintech, digital lending, financial stability, crowdfunding, peer-to peer lending

Introduction

The concept of lending is as old as the ancient civilization. The nature of lending is evolving and changing as does the civilization. The history of lending is constantly evolving and growing. Now the world has been talking about Bank 4.00 since 2014 indicating arrival of 4th generation in evolution of financial services comprising FinTech, online/ mobile banking, virtual global market and questioning the sustainability of conventional banking. The book "Bank 4.00" by Brett King published in 2018 carried the sub-title "Banking Everywhere, Never at a Bank". India has been whetting its appetite for digital transformation in financial services, slowly but steadily. Fintech lending is one of the most prominent off-shoots of Fin Tech in India.

The growth of fintech lending has important implications for borrowers, investors, financial service industry and the Regulator of the financial system in the country. Fintech lending offers greater access to credit to borrowers and provides new investment opportunities with potentially higher returns to inventors. Fintech lending imposes big challenge for the regulators to enact the new set of rules and regulation without impeding its growth. Fintech lending is both a challenge and an opportunity for all, as it disrupts traditional business models while creating new opportunities for growth and innovation.

The objective of this paper is to understand the role of fintech lending in general and its impact on India in particular. This paper will also examine the different types of fintech lending models in practice.

Fintech/digital lending-meaning

There is no universally acceptable definition of the term "Fintech Lending". In the absence of universally acceptable definition, the Financial Stability Board made an effort to define the term "Fintech credit 2" as below:

"FinTech credit2" includes all credit activity facilitated by electronic platforms whereby borrowers are matched directly with lenders comes close".

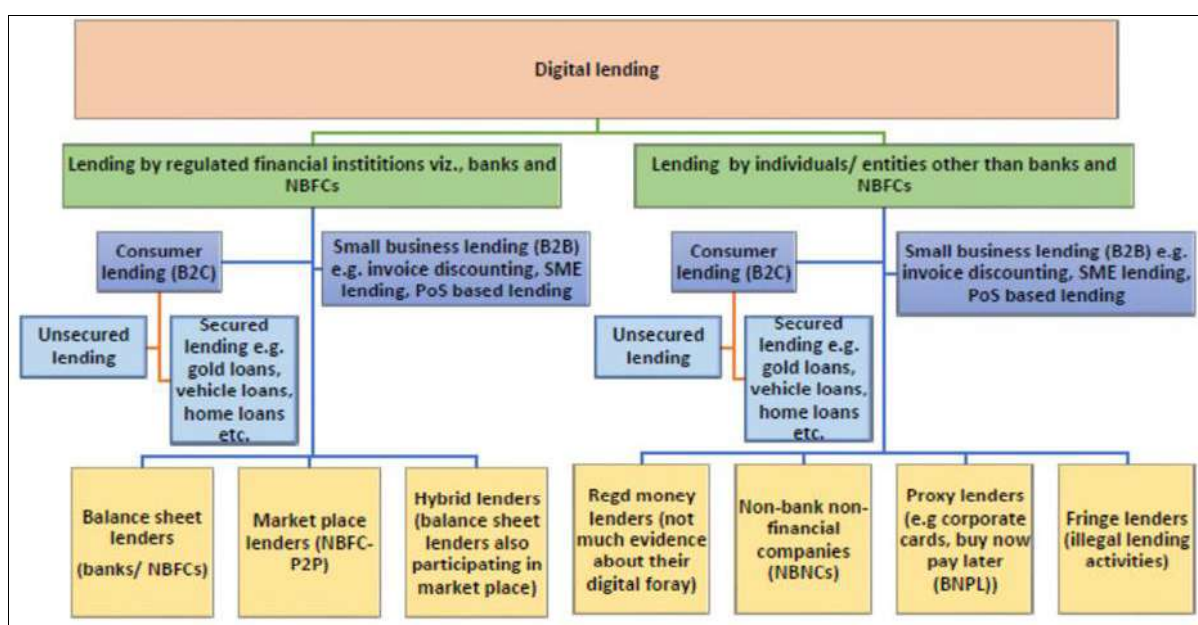
In this definition, FSB made an inclusive effort which includes market place lending such as invoice trading, Peer -to -Peer lending and loan based crow funding. Fintech lending is of two forms as mentioned below:-

1. Balance Sheet Lending (BSL)
2. Market Place Lending (MSL)

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1. Balance Sheet Lending (BSL), the RBI guidelines define Balance Sheet Lending as “Financial service involving extension of monetary loans, where the lender retains the loan and associated credit risk of the loan on its own balance sheet.”
2. Market Place Lending, RBI guidelines define Market Place Lending as a “Platform which connects lenders with borrowers/customers and investors who may buy or invest in such loans/ lend to such borrowers”. These MPL are also known as Market Place Aggregators (MPAs) and is P2P

The difference between balance sheet lending and market place lending lies, where the lending capital comes from and where the credit risks of such loans reside. Balance Sheet Lenders are in the business of lending who carry the credit risk in their balance sheet and provide capital for such assets and take associated credit risk. Market Place Lenders (MPLs) or Market Place Aggregators (MPAs) are those who essentially perform the role of matching the needs of a lender and borrower without any intention to carry the loans in their balance sheet. The Peer-to-peer lending is a clear example of MPL. The taxonomy of digital lending in universal context can be summarized as depicted in graph 1 below:-



Source: RBI report 2021

Fintech Lending Models

Fintech lending has emerged as a viable alternative vehicle to traditional lending methods. Fintech lending has very significant role in the overall growth of lending sector. Fintech lending typically use online methods to match borrowers with investors and provide both the parties the benefits of accessibility, transparency and greater efficiency. Fintech companies use various lending models to satisfy the need of customers and to meet the regulatory requirement. In India, the following innovative models are very popularly used for lending by the fintech companies.

1. Peer-to-Peer Lending (P2P)

Peer-to-peer lending is also known as P2P lending is an emerging lending model that connects individual borrowers with individual investors without any intermediary. This lending model matches borrowers with investors based on their creditworthiness. This lending model has gained popularity because it offers borrowers access to credit at lower interest rates than traditional lenders. It also allows investors to earn higher returns than they would with traditional investments.

2. Crowdfunding

Crowdfunding is a lending model which is similar to Peer-to-peer model, this model allows organizations or startups to

raise funds for a specific project or cause from general public. Crowdfunding model works in two ways, one is community crowdfunding where lending is made with social benefit objective and second is financial return crowdfunding where lending is made with the objective of a return in the future.

3. Marketplace Lending

Marketplace lending is also known as peer-to-business lending, is a lending model that match businesses with investors based on their creditworthiness. Marketplace lending platforms allow businesses to obtain loans from a large pool of investors. Marketplace lending has gained popularity because it allows businesses to obtain funding more quickly and easily in comparison to traditional methods. It also gives option investors to diversify their portfolios and earn higher returns on his investment.

Benefit of fintech lending

Fintech Lending is very useful and viable method which provide efficient, transparent and accessible platform to both the borrower and investors. The fintech lending also provides more flexibility and choices to both borrowers and investors. The details of major benefits that fintech lending provides are as:-

- **Lower Costs:** Fintech lending method has the potential

to pass on the benefit of lower costs to the customers in comparison to the traditional lending methods. This is a technology driven method which has lower overhead cost which ultimately pass the benefit of lower cost to both the borrower and investor.

- **Expedited loan approval:** Fintech lending can also expedited loan approval because fintech lending often uses online platforms, borrowers can apply for loans and receive funding more quickly than they could with traditional lenders.
- **Greater Convenience:** Fintech lending offers greater accessibility and convenience to borrowers as this method involves technology in decision making. Fintech lending also provides more options to borrowers who are facing difficulty in raising funds under traditional methods.
- **Diversification for Investors:** Fintech lending can also offer benefits to investors. By investing in loans through fintech lending platforms, investors can diversify their portfolios and potentially earn higher returns than they would with traditional investments. In addition, some fintech lending platforms offer tools for investors to manage their investments and assess risk.
- **Greater Financial Transparency:** Fintech lending platforms often provide more financial transparency in the lending process than traditional lenders. Borrowers can see the interest rates, fees, and repayment terms upfront, which can help them make more informed decisions about whether to apply for a loan.
- **Risk Mitigation:** Fintech lenders may be able to use advanced analytics and machine learning algorithms to better assess and manage risk. Use of data analytic approach fintech lending can help to reduce the risk of default for investors and increase the overall stability of the lending market.
- **Financial Inclusion:** Fintech lending also promote financial inclusion by providing access to credit for underserved or marginalized populations. Fintech lending help to expand the pool of eligible borrowers with the help of assessing the creditworthiness by using alternative models and increase access to credit for those who need it most.
- **Innovation and Disruption:** Fintech lending is driving innovation and disruption in the lending industry, which can lead to new business models and better outcomes for borrowers and investors. Fintech lenders are often able to offer more nimble and agile services than traditional lenders, which can help them adapt to changing market conditions and customer needs more quickly.

Fintech lending -issues and challenges

Fintech lending is technology enabled lending process which provides many benefits to all the stakeholders. However, it is also important to mention here that still this mechanism of lending is at nascent stage and have certain issues and challenges which needs to address. The detail of some of the major issues and challenges of fintech lending are as below:-

- **Regulatory Challenges:** Fintech lending companies often operate in a regulatory gray area, as traditional financial regulations may not apply to them. This can

make it difficult for fintech lending companies to obtain the necessary licenses and approvals to operate. Absence of regulatory authority has led to increased chances of fraud threat to investor protection and movement of money in the economy. Due to the diversity of offerings in Fintech, it is difficult to formulate a single and comprehensive approach to these problems.

- **Financial Illiteracy:** The lack of financial literacy is also a problem. Only 27% of Indian adults – and 24% of women meet the minimum level of financial literacy as defined by the Reserve Bank of India.
- **Illegal Digital Lending:** During the pandemic, digital lending through mobile apps became popular, but many problems accompanied it was found that more than half of these digital loan providers were operating illegally. Many apps used tactics to exploit the widespread lack of financial literacy, charging interest rates up to 500%.
- **Competition:** Fintech lending is a rapidly growing and highly competitive industry, with new companies entering the market constantly. The intense competition can make it difficult for fintech lending companies to differentiate themselves from the traditional companies and gain a significant market share.
- **Security:** As fintech lending companies deal with sensitive financial data, security is a major concern. Cyber attacks, data breaches, and fraud are significant threats that can damage a fintech company's reputation and customer trust. Fintech systems are vulnerable to hackers because of automation of processes and digitization of data. Recent hacks demonstrate the ease with which hackers can gain access to systems and damage them irreparably.
- **Scalability:** Fintech lending companies often face challenges in scaling their services to meet the needs of a growing customer base, particularly in terms of hiring and training of staff, developing new products, and expanding into new markets.
- **Credit Risk Assessment:** Fintech lenders rely heavily on data and algorithms to assess credit risk, but these models may not be as reliable as traditional lending methods. As a result, fintech lenders may have a higher default rate, which can affect their profitability and reputation.

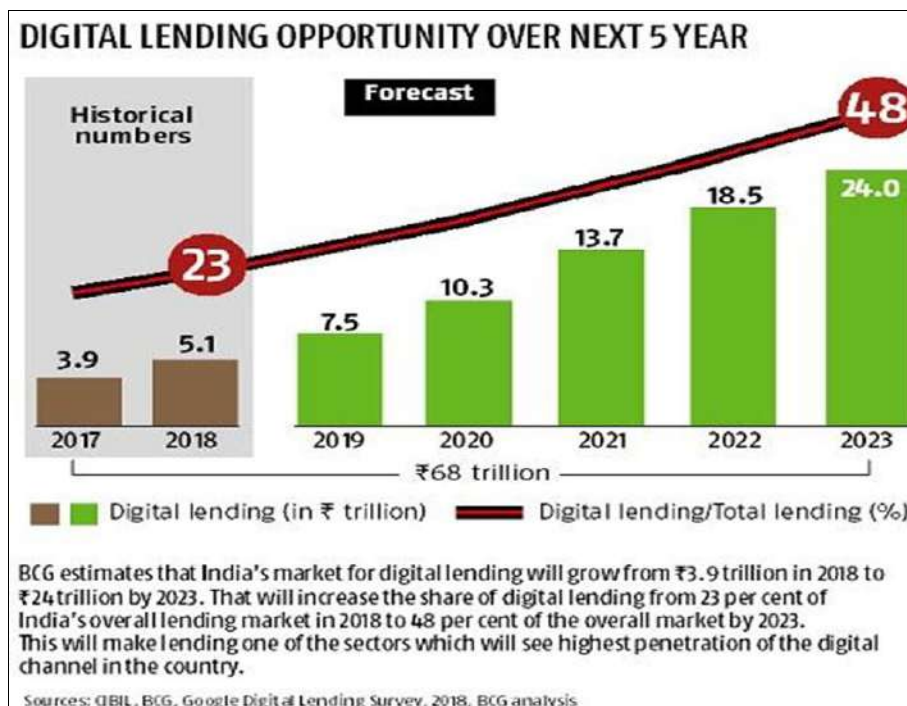
Fintech lending eco system in India

Fintech lending ecosystem is still evolving in India and is at its nascent stage. The traditional banking system is now constantly increasing use of innovative approaches in their operational processes. The role of NBFCs is also very significant in present scenario in promoting the fintech lending business. Fintech lending ecosystem has undergone a drastic change over last six to seven years. The RBI has issued comprehensive guidelines in Sept, 2022 for regulating and promoting the business of fintech lending. These guidelines states that the business of fintech lending in India will be carried out by only Regulated Entities (RE). These Guidelines address in detail a wide range of issues ranging from engagement of services of Service providers, credit appraisal, data privacy, maintenance of transparent process and systems, reporting and a grievance redressal

mechanism.

The fintech lending ecosystem is a set of interconnected information that can work as single unit. The fintech lending ecosystem is comprises of Banks & NBFC(As Regulated Lenders), Data Providers (Provide data through their platform), Core Platform (Provide API ready Loan

Organisation System and Loan Management System), Lending Finteches (Provide core part of the overall fintech lending ecosystem) and Investors (Provides funds for fintech lending). The fintech lending ecosystem is improving in India, by 2023 the fintech lending will emerge as significant player of the lending industry.



Conclusion

The development of fintech lending as an alternative vehicle to traditional lending is still evolving but it is growing phenomenally with a significant rate over last six to seven years. Fintech lending not only transformed but also changed the total lending ecosystem of the country. The fintech lending is providing new opportunities to the borrowers and investors at lower cost, greater accessibility and faster speed. However, there are still many challenges to overcome which are impeding the growth of fintech lending industry. The regulators and the fintech companies need to overcome these challenges by developing strong risk management system, creating trust in customers and using new technology in lending ecosystem as early as possible. The fintech lending will be the key driver of the lending industry in times to come. It will impact not only the lending industry but will impact the pace of economic development of the country. The future of fintech lending seems very bright and will play significant role in next decade.

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