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LOAN APPS AND FINANCIAL DISTRESS: AN INQUIRY INTO INDIA’S EMERGING CREDIT CRISIS

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**Abstract:** Digital lending contributed to meeting the financial needs of people who had otherwise faced many difficulties in getting the required money in a very short period of time. All that comes with ease cannot be presumed to have a happy ending. Loan apps increased and created havoc. In the wake of many undesirable situations leading to the suicidal deaths of people who have fallen prey to unscrupulous lending through loan apps, this paper tries to bring into light the digital loan apps and their features, the factors responsible for unscrupulous digital lending, the mechanism adopted by loan apps operators to cheat and harass the borrowers, and finally studies the intervention by the regulatory bodies. The loan app operators leveraged the gaps in the regulatory system to override their business coupled with the dire need of people to raise easy finance via loan apps. This paper aims to explore the RBI (Reserve Bank of India), the regulatory body for the supervision and control of the banking system of India, guidelines on digital lending, and provide precautions to whosoever wants to avail finance through digital loans. The data is collected from the report published by the RBI and various articles from the electronic media. The study highlights that the financial user must be vigilant at every step in the loan availing process and ensure that the process happens transparently and within the regulatory ambit laid by the RBI.

**Keywords:** Digital Lending, Digital Lending Apps, Lending Service Provider (LSP), Know Your Customer (KYC)

INTRODUCTION

In recent years, India has witnessed a surge in the popularity of loan apps, promising quick and hassle-free access to credit. These digital platforms have become a convenient solution for individuals seeking financial assistance, especially in emergencies or when traditional banking services are out of reach. However, beneath the veneer of convenience lies a dark underbelly, as numerous reports of exploitation, harassment, and unethical practices have plagued the loan app industry in India. This article aims to demystify the misery behind loan apps in India,

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shedding light on some operators' deceptive tactics and their detrimental impact on borrowers, particularly vulnerable sections of society. By exploring the root causes of this issue and raising awareness about the potential pitfalls, we hope to empower individuals to make informed choices and advocate for stronger regulations in the lending industry (Asheq et al., 2022). Technology has been a significant driver in reshaping the financial services industry. This paper assumes significance because it will highlight how digital lending backed up by technology development is creating strides in the lending business. It is easy to borrow money online, but digital lenders use a crooked way of recovering from digital borrowers. The present study assumes importance as it attempts to bring awareness to the public by providing information relating to loan apps. The paper aims to present the murkier side of digital lending facilitated by loan apps. It throws light on the predatory lending practice adopted by loan app operators. Small traders, students, and daily wage laborers were the victims of these operators, and when the harassment reached a peak stage, the victims committed suicide. The takeaway from this paper proves to be socially relevant as it provides precautions for the general public before availing of digital finance. This paper is conceptual in nature as the topic is contemporary, and there are only a few research articles on this topic. It speaks about digital lending, features of loan apps, and factors responsible for unscrupulous digital lending; no particular statistical analysis is taken, and the conclusions are not based on any empirical evidence. The structure of this paper is as follows: The subsequent section presents a thorough literature review, followed by a description of the materials and methods used for data collection. Subsequently, the paper delves into a discussion of the results and findings obtained from the analysis. Finally, the concluding remarks summarize the key insights and implications derived from the study.

**LITERATURE REVIEW**

A bank's erstwhile services, which would happen only through desk contact, are moving towards digital connect. The traditional face-to-face banking transaction has been replaced with fintech-enabled financial services. The financial services industry has undergone tremendous change with the adoption of technology. Banks whose primary business of accepting deposits and lending loans can happen without customers' physical appearance at a bank branch. Digital lending has become a buzzword, and as per the Reserve Bank of India (RBI), 2021, it involves a technology-oriented lending process with an online human interface, driven by unified digital technologies in acquiring customers, their credit appraisal, loan sanction, disbursement, recovery, and related customer service. Digital lending is facilitated by digital lending apps run by regulated entities such as banks and NBFCs (Non-banking Finance companies) solely or in partnership with Lending service providers (LSPs). LSPs (Reserve Bank of India, 2021) are primarily technology-oriented entities that perform both main and auxiliary lending services. The services rendered by LSPs include establishing a marketplace and creating a link between the lenders and borrowers, sourcing a loan, underwriting, repayment collection services, data collection and analysis, rating services, etc. Digital lending apps (Reserve Bank of India, 2021) are applications that can be run on mobile, and others are web-based with a user interface that can help lending and borrowing from a digital lender to any consumer in need of finance.

The market for digital lending in India has shown signs of progress, and it disbursed \$2.2 billion in digital loans in 2021-22. Startup lenders who advanced digital loans were supported by foreign investors, prompting conventional banks a run for their money in their lending businesses (Reuters, 2022).

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Due to the pandemic, challenges, such as the loss of jobs and subsequent financial constraints, prompted many people to utilize loan apps to meet their financial needs. Loan app operators disbursed small amounts of money to people in need. However, the loan contract was opaque and adopted cyberbullying, harassment imposed through electronic or communication devices such as computers, laptops, mobile phones, etc., to recover money from borrowers. This cruel practice has led to the suicidal deaths of borrowers. This topic assumes importance as it attempts to bring awareness to the public by providing information relating to loan apps.

The present article is based on a novel work. Many articles in the print and electronic media have attempted to create awareness among the general public regarding predatory loan apps so that they will not fall victim to this menace. As the topic is contemporary, the newspaper articles on the web and the RBI Report of the Working Group on Digital Lending, including Lending through Online Platforms and Mobile Apps, are primarily utilized for constructing this paper. (Gupta et al., 2020) explored the cryptic challenges faced by users of different age groups towards complete acceptance of digital payments and modes (Tandon et al., 2019) speaks about the design and challenges of a financial management application for a specific audience. Hulikal et al. (2018) highlight the changes in the monetary ecology surrounding loan payments after introducing a mobile app.

## MATERIALS AND METHODS

As this paper is conceptual and relies on existing literature sources, the materials and methods employed revolve around data collection and analysis from secondary sources. The research methodology does not involve hypothesis formulation or testing. Instead, it aims to provide an overview and analysis of the predatory lending practices adopted by loan operators through lending apps in India.

- **Data Collection:** The primary data source for this study is published print media literature sources, including research articles, reports, and studies related to loan app lending practices in India. These sources were obtained from reputable academic journals, government publications, and industry reports. Additionally, research results and findings from regulatory bodies such as the Reserve Bank of India (2022) were used to gather relevant information on the subject.
- **Literature Review:** A comprehensive literature review was conducted to identify and analyze studies, reports, and publications that discussed the predatory lending practices employed by loan app operators in India. Key themes and findings from the literature were extracted, summarized, and synthesized to form the basis of the conceptual understanding presented in the paper.
- **Data Analysis:** The data collected from the literature sources underwent a qualitative analysis. The predatory lending practices, patterns, and implications discussed in the literature were examined to identify common themes, trends, and examples of exploitation. Data analysis involved categorizing and organizing the information to present a coherent narrative of the misery behind loan apps in India.
- **Limitations:** It is important to acknowledge the limitations of this study. As a conceptual paper relying on secondary data sources, the findings are subject to the quality and availability of the literature reviewed. There may be limitations in the scope and representativeness of the literature sources. Additionally, the dynamic nature of the loan app industry implies that the findings may need to capture the latest developments and emerging practices. Hence, further empirical research is encouraged to explore and validate the concepts discussed in this paper.

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Overall, the materials and methods employed in this study involve gathering and analyzing secondary data from published print media literature sources, including research articles, reports, studies, and survey results conducted by regulatory bodies. The focus is on providing an in-depth understanding of predatory lending practices in the loan app industry in India based on existing knowledge and insights from relevant sources.

**RESULTS AND DISCUSSIONS**

**Features of Loan Apps**

**Tenor:** 7 days to one month (Mallikarjunan, 2020)

**Amount of loan:** The amount lent via digital loan apps ranges from Rs. 2,000 to 10,000 (Chadha, 2022).

**Processing procedure and disbursement time:** The digital loan apps are installed on a prospective borrower's phone. The loan disbursal happens within 2 hours of filling out an application to the borrower's bank account or wallet. It is understood that most of the apps are found to route disbursement through deemed brokers (RBI, 2021). The application process is done by submitting a photo I.D., such as an Aadhaar number, and uploading a selfie photograph to validate the identity from the registered mobile number. The interest rates vary from 25-72% p.a., while the processing fee ranges from 15% to 20% of the loan amount. Besides, GST at 18% is charged on the processing fee (Mallikarjunan, 2020).

**Target group:** The target group is low-income, financially constrained individuals, especially in the range of 21-40 age belonging to diverse groups such as daily wage laborers, college-goers, and business owners of small and micro ranges. Numerous customers downloaded at a time 4-5 such apps and took loans from all at the same time period (Mallikarjunan, 2020)

**Rates of interest:** Minimum of 1 percent to a maximum of 12.99 percent per month (The New Indian Express, 2023)

**Operated by (RBI, 2021):** Regulated Entities (R.E.s) of RBI such as all commercial banks, NBFCs (including Housing Finance companies, and Co-operative banks at the Urban, State, and District levels. Due to technological advancements, banks are partnering with LSPs to operate in the digital era. There are two types of LSPs:

**Regulated Entities:**

- Credit information-sourcing companies controlled by financial sector regulators, □ NBFCs are controlled by RBI and are in the category of:
  - a) Account Aggregator (NBFC-AA),
  - b) Peer to Peer Lending Platform (NBFC-P2P)
- The Securities and Exchange Board of India controls credit rating agencies.

**Unregulated Entities:** Those that any financial sector regulator does not specifically regulate.

It is understood that LSPs are not undertaking the business of a financial service provider as per the RBI Act, 1934. The loans which are sourced, evaluated, or disbursed by them are not their assets. They are entering an outsourcing arrangement with a bank or an NBFC, and their activities are regulated by the guidelines on outsourcing of financial services issued for banks and NBFCs by RBI. There are no similar guidelines on outsourced activities other than banks and NBFCs. Therefore, LSPs are bound to fall outside the regulatory ambit.

**Factors Responsible For Unscrupulous Digital Lending**

**Lack of Regulation:** As mentioned in the features of loan apps, digital lending is growing by exploiting the lapses in the regulatory regime.

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**Ease of Borrowing:** Low formalities, a small loan amount available, short-tenure period, no collateral, and quick disbursal. These are some of the features luring prospective borrowers to avail of a digital loan.

**Smart Phone Revolution and Internet Penetration:** The smartphone revolution and internet penetration have thrown open new opportunities in the digital sphere. The number of smartphones in India has skyrocketed from 100 million in 2014 to over 700 million in 2021 (RBI, 2021), and this trend will be increasing soon. Internet penetration is also one of the primary factors which spurt the growth of digital banking.

**Pandemic Thrown Challenges (Poonam, 2020):** Due to challenges thrown by the pandemic, such as loss of employment and resultant financial distress, constrained mobility, and social distancing, people had no choice but to search for quick online loans.

**Murkier side of Loan Apps:** Digital lending apps collect a substantial amount of data, including customers' sensitive personal information, spending habits, and social media connections. This data will be utilized to assess the credit score, and risk profiling of the potential customer will be done. The information is collected without the customer being unaware that he is supplying the information, which may land him in future pathetic troubles. One of the primary unethical practices implemented by the lending apps is that they charge very high-interest rates, and they collect the user's entire phone contacts, media, and gallery as part of the installation process and for the proper functioning of the app. Potential borrower is compelled to share the information, and later, lending apps misuse this highly sensitive information and indulge in a brutal recovery process. Borrower's relatives are telephoned, and using the media and gallery data of the user, pictures of the borrowers are morphed and showcased in social media in an acute indecent manner crossing all borders of modesty. In many cases (Mengle, 2022), borrowers repay their loan within the prescribed deadline, and as per the EMIs (Equated Monthly installments) stated in the agreement, still app's executives continuously pester the borrowers by calling them and stating that the repayment is not reflecting in their records and systems and harass the borrowers to pay the same amount again and again. The recovery agents send to the borrower's phone and address fake documents which seems to be genuine FIRs (First Information reports issued by the police against filing a complaint), legal notices, court orders, and, in some cases, signed and stamped warning issued by RBI (Poonam, 2020). This fatal indecent recovery process has led to the suicidal deaths of many borrowers.

**RBI Guidelines on Digital Lending**

Small ticket loans, short tenure periods, quick disbursal, minimum documentation, and easy processing loans requiring no collaterals have proved to be the most dangerous credit facility. The interest rate charged was exorbitant, but the financial consumer availed of these loans over the advantages mentioned above, not knowing the disaster it would bring in postborrowing.

In the wake of the undesirable consequences of digital lending, RBI established a Working Group to conduct a study on digital lending, including lending through online platforms and mobile apps. Based on the recommendations made by the working group, RBI has issued the following guidelines on digital lending (Reserve Bank of India, 2022).

- All the proceeds of a sanctioned loan and later repayments by the borrowers are mandatory to be made only between the bank accounts of the borrower and the Regulated entity without any intermediation of the Lending Service Provider (LSPs) or any third party through pass-through or pool account of the LSPs. This measure would eliminate the routing of disbursements through deemed brokers.



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- Any fees, charges, etc., payable to Lending Service Providers shall be directly paid by the regulated entity and not by the borrower. This measure will reduce the burden of high-interest rates, which include fees, charges, etc., payable to (LSPs).
- The borrower should be provided a standardized Key Fact Statement (KFS) before onboarding the loan contract.
- KFS should include all cost components of digital loans, which are reflected in the form of the Annual Percentage Rate (APR).
- The explicit consent of the borrower is required to increase the credit limit. No Automatic increase in credit limit is permitted.
- The loan contract should include a cooling-off or look-up period during which the borrowers have the option to exit digital loans. They can exercise this option by remitting the principal amount and the equivalent APR without any penalty payment.
- Regulated entities and the LSPs engaged by R.E.s must put suitable nodal grievance redressal officers in place to handle complaints related to FinTech or digital lending. Such grievance redressal officers must also deal with complaints against their respective Digital Lending Apps (DLAs). Grievance redressal officer details shall be displayed at the appropriate places, such as on the websites of the RE, its LSPs, and on DLAs.
- According to the existing RBI guidelines, if the RE does not resolve any complaint raised by the borrower within the specified period, presently 30 days, then the borrower will have a right to complain to the Reserve Bank – Integrated Ombudsman Scheme (RB-IOS).

**Precautions to be Taken by the Prospective Borrower before Availing Digital Loans (ET Online, 2022):** Nothing is so rosy behind every easy. The following are the precautions a financial consumer or a prospective borrower should follow before using digital loans.

**RBI Registration Mandatory:** RBI website displays the list of registered NBFCs.

The prospective borrower is required to ensure that the loan facility is given by a registered or regulated entity of RBI.

**Website Maintenance:** An app that maintains a website and directs the user to the registered or regulated entity upon navigating the loan app is trustworthy.

**Avoid Messages With Connected Links:** Fraudsters often entice the victim by sending messages with links connected to them. It is advised that prospective borrowers avoid such messages and do not click on the links.

**Not adhering to KYC (Know Your Customer) Norms:** Lenders must follow KYC norms before advancing a loan. If a lender does not do it, borrowers are advised not to enter into a loan contract with that particular lender.

**Maintain Silence When Asked for Card Verification Value (CVV) and card numbers:** Fraudsters are interested in knowing victims' personal details and would lure the victim to reveal the card numbers and CVV, etc. Prospective borrowers are required to please maintain silence when asked for such details.

**Missing Loan Agreement Verification:** If loan apps avoid providing the loan agreement details, prospective borrowers are required not to onboard those loans. Hiding the details is the characteristic feature of a fraud loan app.

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**CONCLUSIONS**

Digital loans are easy to avail but often keep the much-needed details hidden and drag much confidential information about the user. This happens due to the prospective borrower's need for adequate knowledge regarding the app's functionality and, in many cases, the dire necessity for the borrower to want funds. Technological innovation without the regulatory lens has led to a lot of undesirable consequences. A digitally savvy financial consumer can enjoy the benefits of digital lending and fintech, provided he/she is aware of the regulatory guidelines and precautionary measures to protect himself/herself from unethical practices of solely profit-oriented entities. This paper is limited to the general overview of loan app lending happening in India. This paper is theoretical and empirical analysis needs to be included in this paper. This paves the way for further research to be carried out in this area.

This topic is relevant in this digital era and provides ample opportunities for further research. This paper could be the base paper for further research in the area of financial crime, digital finance, financial literacy, and the relevant regulatory regimes.

- Various factors compel the prospective borrower to avail of the digital loan. Each factor and its interlinkages can be empirically tested.
- The research findings can provide inputs to the policymakers as to where the regulatory noose can be tightened and where it can be made slightly liberal in order to enhance the reach and coverage of the digital India mission.
- The interlinkage between financial literacy and digital finance can be empirically tested.

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