

DIGITAL LENDING BOOM: GROWTH ENGINE OR RISK TIME BOMB?

AN APPLIED INSIGHT AND ANALYTICAL PERSPECTIVE ON INNOVATION, INCLUSION, AND FINANCIAL STABILITY IN INDIA



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Introduction - Credit at the Speed of Technology

The Indian financial ecosystem is undergoing a structural transformation, with digital lending emerging as a key driver of change. Traditionally, access to credit in India was constrained by rigid documentation requirements, lengthy approval processes, and a heavy reliance on collateral-based lending. These barriers excluded a major chunk of population, especially individuals in the informal sector and small enterprises lacking formal credit histories.

Abstract

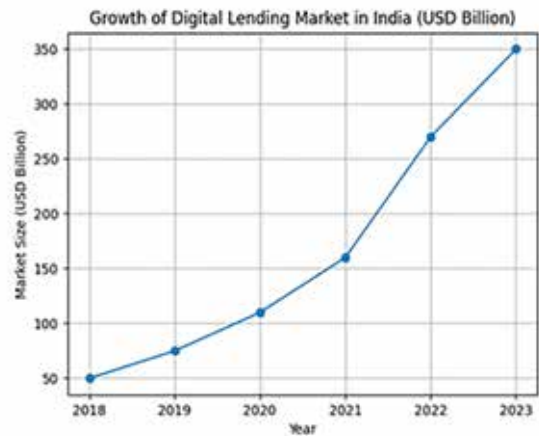
India's digital lending ecosystem has grown exponentially, driven by fintech innovation, data-driven credit models, and expanding digital infrastructure. The sector has significantly enhanced financial inclusion by enabling instant, collateral-free credit for underserved segments, including first-time borrowers and small businesses. However, this rapid expansion raises concerns related to credit risk, regulatory arbitrage, data privacy, and consumer protection. Rising default rates in unsecured lending segments and increasing regulatory scrutiny highlight the fragility underlying this growth. This article critically examines the drivers, operational dynamics, and emerging risks of digital lending, supported by Indian case insights and recent data trends. It argues that while digital lending serves as a powerful growth engine, its long-term sustainability depends on aligning technological innovation with prudent risk management, robust governance, and evolving regulatory frameworks.



The acceptance of digital lending platforms has changed this paradigm. Leveraging the IT developments and rapidly evolving ecosystem such as big data analytics, AI, ML and fintech firms have introduced streamlined processes that enable loan approvals and disbursements within minutes. This transformation has been further accelerated by the widespread adoption of digital infrastructure such as Aadhaar, e-KYC, and UPI, which have significantly reduced transaction friction.

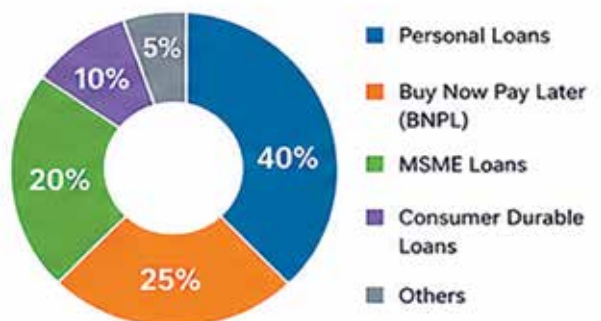
Exponential Rise of Digital Lending Market Witnessed by India

Phenomenal growth in digital lending market of India is witnessed, especially after 2018, as market size which was nearly USD 50 billion in 2018 rose to USD 350 billion by end of 2023. Further According to estimates, digital lending market in India is projected to grow to over USD 1 trillion by 2030. This remarkable expansion reflects both the demand for accessible credit and the scalability of digital lending models.



If we talk with respect to loan type then market is led by Personal Loan followed by Buy Now and Pay Later and MSME Loans as number two and three with share of around 40%, 25% and 20% respectively. Now Buy Now and Pay Later (BNPL) are growing at whopping pace due to growth of digital selling platforms

DIGITAL LENDING MARKET SHARE BY LOAN TYPE



However, such rapid growth also raises fundamental concerns regarding sustainability, risk management, and systemic stability. The central question remains whether digital lending represents a sustainable engine of growth or a latent financial risk waiting to materialize.

Drivers of whopping growth in Indian Digital Lending Landscape

The incremental numbers of digital lending in India are the result of a convergence of technological, economic, and institutional factors. Significant driver of such growth is the rapid penetration of smartphones and affordable internet connectivity. India’s digital user base, now exceeding 800 million internet users, provides a vast foundation for fintech adoption.

Equally important is the role of digital public infrastructure. Aadhaar-based identity verification and UPI-enabled payments have revolutionized financial transactions, enabling seamless onboarding and real-time disbursements. These systems have reduced operational costs and increased accessibility, making digital lending viable at scale.

Alternative data has become a critical driver in credit assessment within India, addressing the significant “credit invisible” population i.e. individuals who lack traditional financial records like credit card history or loan repayment records. Digital lenders, however, analyse diverse data points, including transaction patterns, mobile usage behaviour, and even social indicators, to evaluate creditworthiness. This approach has significantly expanded access to credit for underserved populations.

Demand-side factors also contribute to the sector’s growth. Rising consumption aspirations, coupled with the need for short-term liquidity, have created strong demand for quick and flexible credit solutions. Digital platforms cater to this demand by offering instant loans with minimal documentation, particularly appealing to younger, tech-savvy consumers.

KEY GROWTH DRIVERS

-  Smartphone & Internet Penetration
-  Digital Infrastructure (Aadhaar, e-KYC, UPI)
-  Alternative Data & AI/ML in Credit Assessment
-  Rising Demand for Instant Credit
-  Fintech Innovation & Partnerships

Operational Advantages and Growth Potential

Digital lending platforms offer several operational advantages that enhance efficiency and scalability. Automation reduces the time required for credit assessment and approval, enabling lenders to process high volumes of applications with minimal human intervention. This not only lowers operational costs but also improves customer experience.

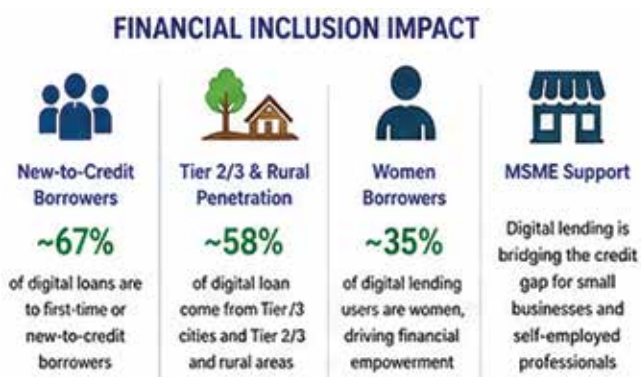
HOW DIGITAL LENDING WORKS



The use of advanced analytics allows for real-time risk assessment and personalized loan offerings. By continuously analyzing borrower behavior, lenders can adjust credit limits, interest rates, and repayment terms dynamically. This flexibility enhances both risk management and customer satisfaction.

The asset-light model adopted by many fintech firms further accelerates growth. By partnering with traditional financial institutions, digital lenders can leverage existing regulatory frameworks while focusing on technology and customer acquisition. This collaborative approach results in hybrid models with benefits of duo the fintech and traditional banking.

Filling or bridging the credit gap that India had is among critical role of digital lending, from a macroeconomic perspective. In India, MSMEs that contributed the major chunk of economic transactions, used to face challenges in getting the credit in formal set-up. Digital platforms provide these businesses with timely financing, enabling them to expand operations, manage cash flows, and contribute to economic growth.



Indian Case Insights: Growth in Practice

The practical implications of digital lending can be observed through leading Indian platforms.

Paytm, for instance, has integrated credit products such as Paytm Postpaid into its digital payments ecosystem. This seamless integration allows users to access credit at the point of transaction, enhancing convenience and driving consumption. However, the ease of access also raises concerns about over-borrowing, particularly among users with limited financial literacy.

Similarly, **LazyPay** has popularized the buy-now-pay-later (BNPL) model in India. By targeting young consumers and offering short-term credit with minimal checks, the platform has achieved rapid user growth. Yet, BNPL models often rely on high repayment discipline, and any deterioration in economic conditions can lead to rising defaults.

Another significant player, **KreditBee**, focuses on providing personal loans to individuals with limited credit histories. Its use of alternative data has enabled it to scale rapidly, demonstrating the potential of fintech innovation. However, maintaining asset quality remains a challenge as the borrower base expands into higher-risk segments.

Platform	Model	Target Users	Key Risk
Paytm Postpaid	BNPL	Mass Users	Over-spending
LazyPay	BNPL	Young Consumers	Defaults
KreditBee	Personal Loans	Low Credit History	Asset Quality

These examples highlight the dual nature of digital lending. While innovation drives growth and inclusion, it also introduces vulnerabilities that require careful management.

Emerging Risks and Structural Concerns

Despite being boons due to potential that can transform the economy for good, digital lending is associated with several banes or risks that could undermine its sustainability. One of the most critical concerns is the deterioration of credit underwriting standards. The emphasis on rapid growth and customer acquisition can lead to relaxed credit assessment processes, increasing the likelihood of defaults.

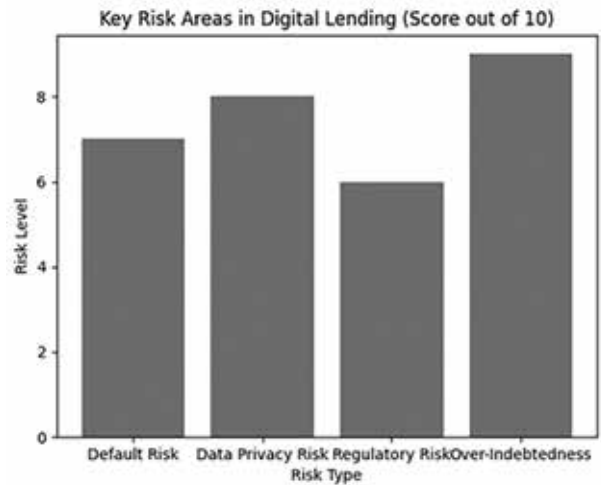
Recent trends indicate rising delinquency rates in unsecured digital loans, particularly in the small-ticket segment. As borrowers accumulate multiple loans across platforms, the risk of over-indebtedness increases, creating potential systemic concerns.

Transparency issues further exacerbate these risks. Many digital lending platforms have been criticized for

unclear loan terms, hidden charges, and aggressive recovery practices. Such practices not only harm consumers but also erode trust in the financial system.

Data privacy and security represent another significant challenge. Digital lenders collect extensive personal and behavioral data, which, if not adequately protected, can lead to misuse. Instances of data breaches and unethical recovery practices have attracted regulatory scrutiny and public concern.

Regulatory arbitrage also poses a structural risk. Some fintech firms operate through partnerships with licensed entities while maintaining control over key lending functions. This creates ambiguity in accountability and complicates regulatory oversight.



The Regulatory Response

In response to these challenges, the Reserve Bank of India has introduced comprehensive guidelines for digital lending. Rate of interest, any fees to be charged, and terms of repayment shall be clearly disclosed by lender as per these regulations. They also mandate strict data protection measures and limit the use of third-party lending service providers.

REGULATORY RESPONSE (RBI GUIDELINES)

Disclosure of all loan terms & charges	Limit on LSPs & outsourcing arrangements	Direct disbursement to borrower bank account	Data privacy & security standards	Grievance redressal mechanism

The RBI has further stressed the importance of direct disbursement of loans to borrower accounts, reducing the scope for intermediaries to misuse funds. Additionally, grievance redressal mechanisms have been strengthened to protect consumer interests.

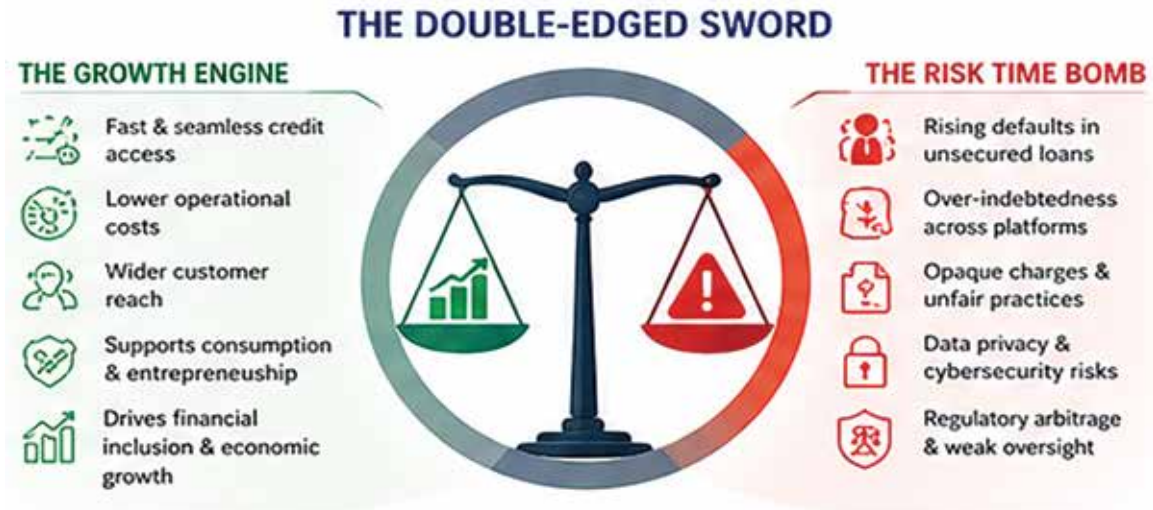
While these measures represent a significant step toward improving governance, but the dynamic fintech innovations require continuous regulatory adaptation. Reaching out to a state of balance between the technological and procedural innovation and financial stability is indeed a key challenge.

Balancing Innovation with Risk Management

The sustainability of digital lending depends on the ability to integrate technological innovation with prudent risk management. Lenders must prioritize responsible lending practices, ensuring that credit decisions are based on comprehensive and reliable data. Strengthening underwriting standards and monitoring portfolio performance are essential to maintaining asset quality.

Governance frameworks must also be enhanced. Transparent operations, ethical practices, and accountability mechanisms are critical for building trust among stakeholders. Fintech firms must move

beyond short-term growth objectives and adopt a long-term perspective focused on sustainability.



From a managerial standpoint, balancing growth and risk is crucial. Excessive focus on customer acquisition can lead to deteriorating credit quality, while overly conservative approaches may limit market potential. Achieving the right balance requires strategic alignment, data-driven decision-making, and continuous monitoring.

The Way Forward: Building a Resilient Digital Credit Ecosystem

The future of digital lending in India lies in developing a balanced and resilient ecosystem. Investments in advanced risk analytics, cybersecurity, and customer education will be critical in addressing emerging challenges. Collaboration between regulators, financial institutions, and fintech firms can facilitate the development of standardized practices and shared risk frameworks.

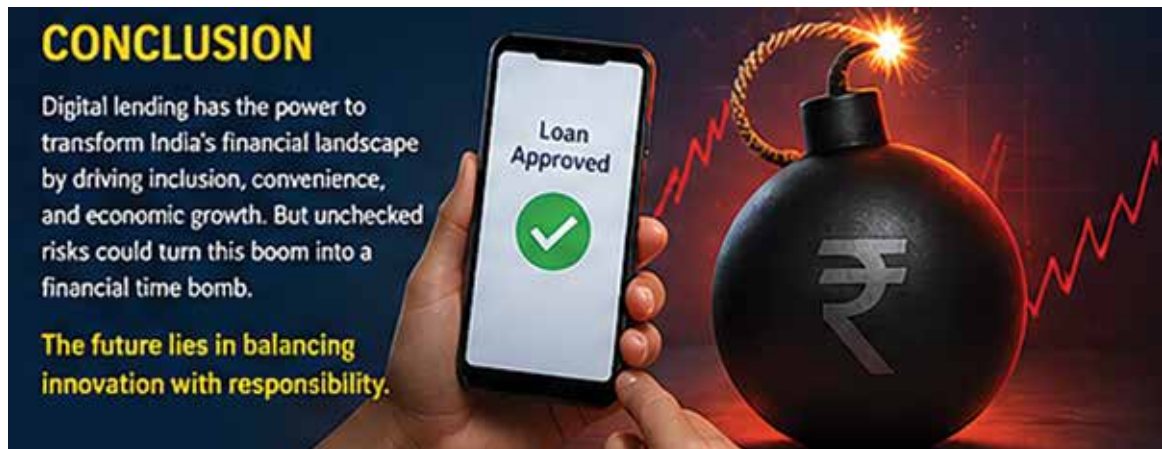


Financial literacy also plays a vital role. Educating borrowers about responsible credit usage can reduce the risk of over-indebtedness and improve repayment behaviour. At the same time, lenders must design products that align with the financial capabilities of their target customers.

Sustainable growth in digital lending requires aligning business incentives with broader economic and social objectives. By focusing on sustainable goal congruence for long that any sub-optimisation for short-term gains, the sector can achieve both inclusion and stability.

Conclusion: Growth Engine or Risk Time Bomb?

The digital lending boom represents a classic management puzzle, characterized by the interplay between opportunity and risk. On one hand, it serves as a powerful growth engine, expanding access to credit and supporting economic development. On the other hand, it introduces vulnerabilities that, if not properly managed, could pose significant risks to financial stability.



The answer lies in balance. Digital lending can sustain its role as a growth engine only if supported by strong governance, disciplined risk management, and effective regulation. Without these safeguards, it risks evolving into a systemic threat.

The success of digital lending will rest on the stakeholder’s ability to integrate innovation with responsibility. By building a transparent, resilient, and inclusive financial ecosystem, India can harness the full potential of digital lending while mitigating its risks. **MA**

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Congratulations!!!



CMA Rajesh Kumar Agarwal

Our heartiest congratulations to CMA Rajesh Kumar Agarwal on his appointment as Director (Finance) of Power Finance Corporation Limited. CMA Rajesh Kumar Agarwal has over 31 years of rich experience across the power and financial sectors. A commerce graduate and a member of The Institute of Cost Accountants of India.

Since joining PFC in 2009, he has handled several key functions, including corporate accounts, taxation, fund management, lending compliance, and loan disbursements. He has also played a significant role in driving digital transformation initiatives and strengthening financial reporting systems within the organisation.

Prior to joining PFC, he worked with leading power sector entities such as NTPC, Nuclear Power Corporation of India Limited, and Delhi Transco Limited, where he gained extensive experience in tariff matters, power purchase agreements, and sectoral reforms.

The Institute conveys its best wishes to CMA Rajesh Kumar Agarwal for continued success and excellence in his new role.