Fintech Lending and Sales Manipulation

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Abstract

Weak debt enforcement is a challenging issue, especially in small-firm lending. Fintech payment companies acting as lenders possess a potential solution to weak debt enforcement. Their location in the payment chain yields them a senior position in the digital revenue stream of the borrowing merchant, as the payment company can deduct part of the merchant's sales it processes to amortize the loan. Our analysis of the transactions processed through a fintech company in India offering such sales-linked loans suggests that some borrowers strategically default by diverting their digital sales away from the company. Sales diversion manifests as a discontinuous drop in borrowing merchant's transactions immediately after the loan disbursal. Mapping fintech-loan data with the credit bureau scores sourced independently, we find that sales diversion is more common among borrowers with higher credit scores i.e., borrowers with better access to the credit market. Using the spatial and temporal heterogeneity in cash availability generated by a cash-crunch episode, we find that manipulating borrowers employ cash as an alternative payment instrument to divert their digital sales.

JEL Classification: G20, G21, G23

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