DVARA Research

UNPACKING CUSTOMERS' TRUST: HOW DO CUSTOMERS COME TO TRUST DIGITAL LENDERS

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Background

Innovations in technology and finance in the last few decades have resulted in the rise of digital financial services (DFS). Through scale efficiencies, lower transaction costs and increase in speed, DFS offers pathways to serve people excluded from traditional financial systems. Evidence from Randomized Controlled Trials hints at the potential of DFS as an instrument for advancing financial inclusion (J-PAL, 2024; Pazarbasioglu et al., 2020). It appears prospective borrowers could also stand to benefit from the promises of digital credit. The data-intensive nature of DFS can decrease information asymmetry between lenders and borrowers (Suri et al., 2021), reduce credit-decisioning time (Chappel et al., 2018) and lower transaction costs (J-PAL, 2018) in some cases. Further certain studies point evidence that digital lending improves subjective welfare (Björkegren et al., 2022), reduces volatility (Dalton et al., 2019) and increases resilience (Suri et al., 2021).

Yet, customers exhibit perceptible hesitation in engaging with DFS, at least initially. On the one hand, despite stated benefits and convenience, there is a general preference to physically visit banks or shops (Home Credit, 2023) or approach other familiar sources to obtain loans over digital platforms. A key reason for this appears to be the lack of trust in digital lending (Sawhney et al., 2022). A similar lack of trust has been observed to be a key impediment to adoption of various other digital financial services (Jünger & Mietzner, 2020; Chawla & Joshi, 2019; Alalwan et al., 2017; Gao & Waechter, 2017; Filipiak, 2016).

On the other hand, is the problem of misplaced trust, where customers end up placing trust in fraudulent actors, resulting in misuse of their personal data, imposition of high fees without disbursement, usurious interest rates and harassment through aggressive recovery practices (Microsave, 2024; Tiwari, 2023). As per the report of Digital Lending Working Group, nearly 54% of the lending apps available in 2021 were illegal. Despite efforts to remove these from app stores, such apps continue to survive through alternate channels (Microsave, 2024). The lack of trust in digital lending as noted above is partially caused by the presence of fraudulent actors in the space (Venkatesan & Totolo, 2023). These bad actors, thus, end up jeopardizing the reputation of responsible players as well.

To harness the potential benefits of digital lending while safeguarding borrowers, it is crucial to understand how borrowers come to trust and contract with a digital lender. In early 2024 we commenced a study of DFS borrowers to understand how they gauge trustworthiness. By studying people's instinctive, unguided 'trust-decisions', we hope to uncover their mental models of trust. More specifically, we aim to (i) articulate the expectations that customers have of trustworthy lenders, (ii) help lenders design their products in a manner consistent with the customer's expectations, and (iii) translate these principle-level expectations into processes that lenders may adopt in their customer service to become trustworthy. This note speaks to the first objective noted here.

Uncovering customers' conceptualisation of trust: A mixed-methods study

It is difficult to uncover what people mean by trust by directly asking them about it partly because the word trust has a dual nature- it is both a noun and a verb (Ghosh, Ashraf, & Kulkarni, 2023). Owing to this dual nature, it may be difficult to define trust without implicating trust itself. Instead, we attempt to define trust in terms of the *proximate grounds* that people rely on to trust someone or something. Therefore, our inquiry of trust was guided by a mixed-method study, designed to probe into the respondents' perceived and affective notions of trust.

Between March and April 2024, we interviewed 65 respondents (organised into focus groups and individual, in-depth interviews) from Thane, Ahmadabad and Ghaziabad, to understand what they perceived as trustworthy. The discussions and interviews spanned a range of topics such as what trust meant in personal

relations, in financial transactions and the obligations that come with being considered trustworthy. This was further complemented by an experiment where respondents were shown the user interfaces of digital lending apps. The suite of apps contained both rogue and credible players and respondents were probed on the level of trust they placed in each app, basis their user interface.

The making of trust in digital lending

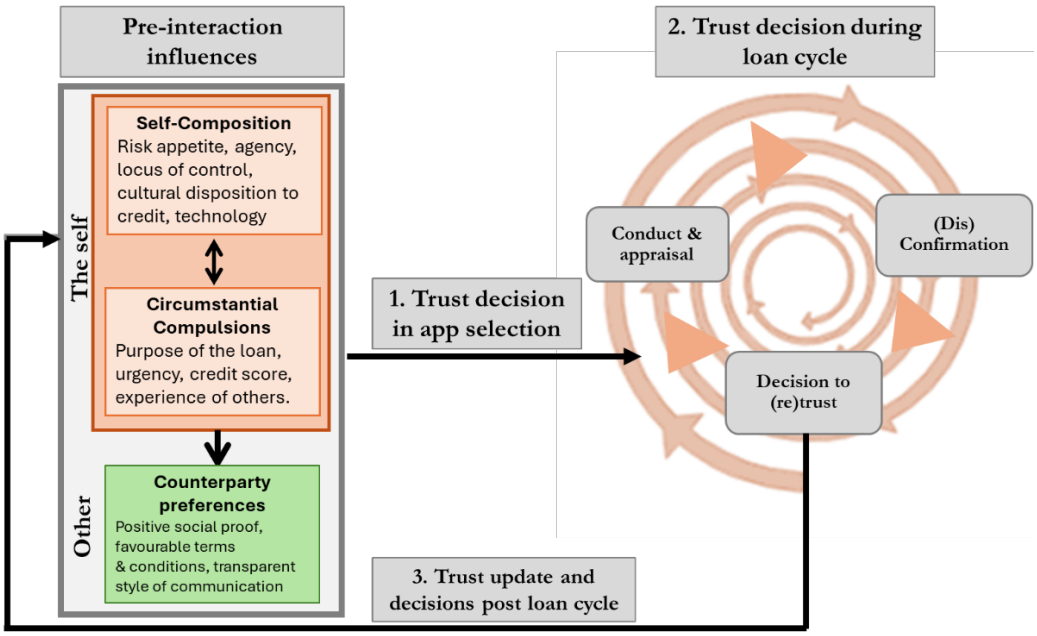
From our discussions with DFS borrowers, we inferred that to trust someone or something people relied on several proximate grounds that gave them *predictability* to base their future expectations on. Where repeat interactions are involved, they primarily base their trust on how consistently the counterparty or trustee conforms to expectations or promises. It is important to note that trust is not derived from a single factor/ proximate ground; often, a combination of factors is relied on to base one's trust.

In the digital lending landscape, there are different trust decisions that a (prospective) borrower may need to make, such as whether to place trust in the digital lending landscape to begin with and, if so, which specific digital lender to trust. Further, trust decisions in one setting could have implications for trust decisions in another. For instance, a lack of trust in digital lending would make it harder for a prospective borrower to trust any digital lender, regardless of their reputation. Acknowledging the interrelatedness of trust decisions, we focus on one specific setting- that of someone who is encountering a digital lending app for the first time- to develop our theory of trust. This focus allows us to arrive at a more simplified and explainable theory of trust, which can be buttressed with layers of interrelatedness given the context.

When encountering a lending app for the first time, trust gets implicated at different stages in the borrowers' journey: (i) in the prospective user's decision to take loan from a specific lending app, (ii) in each interaction (major or minor) with the lending app once the loan cycle has commenced, and (iii) post interaction, in the user's decision on whether to return to the lending app for future needs. At each of these stages, borrowers/ prospective borrowers rely on different factors (or proximate grounds) to base their trust. Further, at each of these stages, the borrower's self-composition and the circumstances within which they make decisions also influence trust decisions. It is worth noting that the segregation of these stages allows us to simplify and readily appreciate the trust process. Outside of lab settings and in the real world, these stages may not be sequential, and many of these decisions may be taken subconsciously.

Building on findings from the qualitative enquiry into respondents' notion of trust, we model the formation and reinforcement (or depletion) of borrowers' trust in a specific digital lender as a composite of trust formed across the different stages of the user journey. We visualise this trust process in the graphic that follows. Next, we discuss each of these individual stages of decision-making.

Theorising Borrowers' Trust in Digital Lending



Pre-interaction influences on trust

While trust decisions are made across the three stages noted above, decisions at each stage are influenced by a certain set of a priori factors associated with the self/truster and counterparty/ trustee. In a trust decision, the truster's self-composition or emotional make-up interacts with their circumstances, together shaping their preferences (of the counterparty). In digital lending, these factors get implicated at each stage of the user journey.

When deciding which lending app provider (the counterparty in this case) to go with, different factors associated with the prospective borrower's (the self) mental and emotional composition appear to be relevant, including: their risk appetite, their locus of control and cultural disposition to both credit and the digital landscape.

In addition to the self-composition of prospective borrowers, the circumstances within which they make decisions also have an influence on the decision. When deciding on a lending app, circumstantial compulsions influencing the decision could include: the purpose for which the prospective borrower may be taking the loan, the urgency of the requirement, their credit score, what they know about others' experience with credit/ digital spaces and their own assessment of their capacity to repay and ability to navigate the digital landscape.

Composition of the self can have an impact on how one would act under different circumstances. Similarly, the circumstance can also have an impact on the self itself. Therefore, preferences appear to be affected both by the person's emotional, mental, and cultural constitution and the circumstances that they find themselves in. Findings from the study suggest the following preferred features in a lender:

1. *Positive social proof*: Positive social proof can take the form of recommendations or endorsements for an app (in the form of number of app downloads, reviews and ratings available on different platforms) from other borrowers. Trust in these cases is directly related to the number of endorsements; the higher the number of endorsements, the greater the trust. Endorsements have an even greater bearing on the

customers' decision if those borrowers are part of the customers' social circle and enjoy the customer's trust. Similarly, endorsements from other trusted sources (such as trusted celebrities) also reinforce borrowers' trust.

2. *Favourable terms and conditions*: Relevance of the amount offered, low interest rates, minimal processing charge, flexible repayment terms, document and permission requests that are proportionate to the loan offered are some of the terms and conditions prospective borrowers look for.

3. *Transparent style of communication*: This would entail disclosure of all terms (no hidden charges), clear explanation of terms and proactive reminders before repayment (without harassment of borrowers).

4. *Borrower experience*: Prospective borrowers are on the lookout for those apps that offer simple process and quick disbursal, are discrete (any data shared is secure and privacy is protected) and are available when needed. Availability of support when needed, both at the time of onboarding (navigation support) and during the loan cycle (through guaranteed response to concerns) and overall respectful treatment by the lender are other factors they look for.

5. *Accountability*: Borrowers look to some indicators of physical presence (in the form of office locations or agents) to hold the lender to account. A guarantee of support that you can hold the lender against and being backed by a respected entity (this could either be a government authority or a legacy brand) are other markers prospective borrowers look for to ensure accountability.

Depending on the prospective borrower's self-composition and circumstantial compulsions, some of these preferences gain more priority over others. Furthermore, a prospective borrower may not be fully conscious of these preferences when they explore the lending app options available to them. Some of these preferences may only get revealed over the course of the loan journey.

Stage 1: Trust decision in app selection

When they go through the options available to them, a prospective borrower takes a decision to trust a specific app based on how well it maps against their preferences noted above. To decide, they ask the following about the app:

1. *Is it useful given my need?* – Relevance could be assessed based on whether the lending app is available when needed and offers favourable terms;

2. *What do others think of it?* – This could be assessed through endorsement by trusted others, popularity of app, reviews and recommendations;

3. *Will I be treated fairly?* - Reasonable document/ permission requests, clear explanation of terms could be ways to judge this;

4. *Will I be able to navigate the app?* - How simple and quick the process is and whether navigation support is available are possible indicators;

5. *What happens if something goes wrong?* - Physical presence or any such indicators to be able to hold the lender to account, mechanisms that allow for correction when onboarding are a few useful indicators.

Once an internal threshold of markers is met (such a threshold may vary across categories of self-composition, circumstances and preferences a prospective borrower may prioritize), the prospective borrower would make the decision to trust a particular app to take loan from. While a lender may not necessarily respond positively to a loan application, for simplicity, we are only considering scenarios where the lender offers the loan requested, initiating the loan cycle with them.

Stage 2: Trust decisions during loan cycle

Our findings suggest that trust is built iteratively, over repeat interactions, with each interaction incrementally adding to (or taking away from) the endowment of trust. In game theoretic terms, it can be thought of as a finite game between the two counterparties, i.e., the lender and the borrower. The borrower continually assesses the conduct of the lender—how the lender is communicating with them, if their personal data is being used in line with the terms and conditions, etc. The instances of repayments mark important punctuations (or moves in the parlance of game theory) that become occasions for both counterparties to revise their behaviour, if they feel the need to.

This relation of the counterparties can be visualised as a spiral, each loop of the spiral indicating the journey from one repayment obligation to the other. This 'appraisal-confirmation-decision to re-trust' spiral (or a trust spiral) constantly operates throughout the loan period. Both counterparties observe the behaviour of the other at every instance in the journey, and each repayment obligation presents an opportunity to make a different move. The borrower may choose to pay, default or foreclose, for instance. The lender may exhibit forbearance in the event of a default or may resort to stringent collection practices.

From the customer's vantage point, trust is maintained when the lender acts in line with the terms and conditions promised at the start of the relationship. Some of the indicators they look for here include: whether the lender stays true to terms and conditions initially set out, offers flexibility in repayments, sends reminders proactively and without harassment, responds to queries/grievances if any, ensures privacy of borrowers and always treats borrowers respectfully. Borrowers' trust may be strengthened when the lender exhibits understanding or extends forbearance to them in their time of distress. We imagine this as an upward movement along the spiral. Similarly, if the customer feels dissatisfied with the lender, trust may be lost, visually a downward movement along the spiral. However, if not in a state to be able to foreclose the loan, despite the negative shift being significant, a borrower may have to see the loan cycle to its end.

How much trust will be gained (or lost) is not easily quantifiable, if at all. To continue with our analogy, it is not easy to comment on just how far along the spiral a satisfied customer moves or how quickly a dissatisfied customer moves out of the spiral. These decisions are deeply rooted in the emotional make-up of the borrower, the salience that they attach to the lenders' conduct and the freedom afforded by their financial circumstances. It will also not quite be the same for every borrower, nor even for the same borrower every time.

Stage 3: Trust decisions post-loan cycle

When the trust endowment after a loan cycle increases, it signifies a strengthening of borrowers' trust in the lender. This could lead the borrower to endorse the lender to other prospective borrowers and provide positive reviews. They also have an increased likelihood of returning to the same loan app provider should there be another requirement. However, if the trust endowment reduces during the interaction, borrowers are unlikely to return to the lender for future needs. They may not only not recommend the lender to others but may also express their distrust through negative reviews.

Regardless of whether the shifts are positive or negative, each loop within the trust spiral impacts both the borrower's self and their counterparty preferences. For instance, it could impact how the borrower assesses their ability to navigate the space of digital credit. Similarly, borrowers' own experience would now be a major factor in determining counterparty preferences.

During the loan cycle, the impact caused by each interaction and the subsequent trust loop may be incremental. However, at the end of the loan cycle, the collective experience from all interactions may have a more significant impact on the self and counterparty preferences. The impact may get reflected in other

trust decisions as well, beyond just the domain of digital lending apps, indicating a negative anchoring effect that trust appears to have- one negative incident tends to make people cautious, in some cases with everything or everyone else.

Conclusion

This study unpacks customers' inherent expectations of a lender. The loan market in India is star-crossed, being constantly shaped by deep ironies. First, the availability of formal credit to the (small) individual and enterprise borrower continues to be scarce. Second, there is the simmering issue of over-indebtedness, where the same borrower is targeted by lenders over and over, borrowers often borrowing to repay older loans. Third, the lending space is flooded with informal loan apps that mimic formal lending apps but operate outside of the regulatory perimeter. These apps do not adhere to customer protection guidelines but appear to expend significant energy in 'appearing' trustworthy. This confuses unsuspecting customers who often fall prey to these apps. A final irony is that customers may borrow even when they may not need credit right away. This could be driven by a scarcity mindset where they are uncertain if credit would be available in the future leading them to borrow even when not strictly necessary. Another factor could potentially be the culture of consumption. The nudges to consume that are now rampant—it is impossible to navigate a social media app without being lured into buying something, data-fuelled targeting of products with the use of dark patterns, the rise of influencers promoting consumption goods—operate to sway consumers into buying status and consumption goods.

This nexus of (i) financial uncertainty, (ii) a scarcity (perceived or otherwise) of formal credit, and (iii) a culture that encourages borrowing to consume, moulds the lending relation into a power dynamic, often leaving the customer vulnerable. Curiously, the customers appear more cautious yet more ready than ever to borrow. They approach the lending decision, seeking out certain assurances from the lender. This study unpacked these unspoken assurances through a suite of mixed methods research instruments. Yet, this is only the first step to imagining a trustworthy lending environment. This research lends itself to at least three urgent research initiatives:

1. Translation of customers' expectations into concrete processes for the lender

In its current form, the study has unearthed the customers' expectations of the lender. These expectations are imperceivable and need to be translated into processes and practices that can help lenders to conform to them. For instance, customers associate transparency in communication with trustworthiness. The logical next step would be to unpack 'transparency in communication' for the practices and processes that lenders must embed in their systems. It could include standards around the quality of the Key Fact Statement, for instance, or stipulating the cadence of payment reminders, confirming payment receipts, standards around the use of nudges in the app design and prohibiting the use of Dark Patterns. These practices will need to evolve from mixed-methods research, benefitting from multiple disciplines such as semiotics and behaviour science while incorporating learnings from customer protection and financial health.

2. Signalling trustworthiness

The issue of creating a trustworthy lending environment comprises two integral components. First, lenders must become worthy of customers' trust. Second, lenders must be able to communicate their trustworthiness in a non-repudiable and non-replicable manner. The second may appear a trivial issue but is necessary to secure customer trust. The internet, by definition, does not have bounds and cannot be gate-kept. Consequently, informal, predatory lenders cannot be kept out of the system. Further, this study highlights that customer trust is prone to anchoring effects, i.e., an unsatisfactory experience with one lender adversely affects the customer's trust in all lenders. Therefore, distinguishing themselves as trustworthy appears to be a commercial and moral imperative of formal lenders alone.

In this context it appears that any signal of trustworthiness should at least have two properties. It must be non-repudiable, i.e., it cannot be tampered with. It must also be non-replicable, i.e., rogue players should not be able to reproduce it. This could take the form of certification by the SRO, for instance. This certification could be anchored in the conformation to best practices as indicated in the research initiative (1) above. The SRO could audit lenders at stipulated periods to ensure their processes continue to uphold the expectations of trustworthiness. Such certified apps could be awarded a special hallmark (such as the blue tick in the social media platform X) or their names could be hosted in a whitelist or there could be other easier ways for the customer to gauge their veracity.

3. Customer education

A rather unsettling finding from the study suggests that customers found fraudulent apps more trustworthy time and again, clearly highlighting the thought and care that rogue actors put into the design of the app and user interfaces. Also, predatory lenders are not bound by any customer protection guidelines. Emboldened by their aggressive recollection practices, these lenders wilfully extend loans beyond the customers' paying capacity with minimal paperwork. The customer especially when desperate may misconstrue a large loan amount or minimal paperwork as favourable terms and conditions and therefore, a mark of a trustworthy lender. An important facet of building a trustworthy lending environment then entails educating the customer that a lender that appears to provide easy money may indeed be violating customer protection norms.

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