

# *Loan brokerage and its role in shaping economic relations of creditors with business entities in the context of new industrialization*

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**Abstract**—The subject of the study is the business model of loan brokerage, implemented in the market of loan services for business entities under the new industrialization in the context of the national and regional dimension. The authors have submitted a conceptual approach to the study of the economic nature and essence of loan brokerage, its features with small and medium-sized enterprises in the national dimension. Loan brokerage is considered in the context of the global and national dimension. Particular attention is paid to the modern mechanisms of the business model of the loan broker. Decision making schemes for preliminary underwriting are proposed. The differentiated levels of management system formalization in loan brokerage are justified. The effective work of loan brokers in the current circumstances requires the use of special information and communication technologies and automation tools for maintaining databases of customers, partner banks, parameters of loan programs, calculation of customer payments, and reporting. The research presented makes it possible to reveal in detail the theoretical and practical aspects of loan brokerage, taking into account the identification of the problem content of its implementation and the identification of promising areas of development.

**Keywords** – *loan brokerage, business model, digital technology, loan brokerage product.*

## I. INTRODUCTION

Purpose of the study: a study of the theoretical and practical aspects of the loan broker's activities within his/her business model.

The methodological background of the study consists of such research methods as general scientific, statistical, and special research methods. The use of these methods has enabled provided a deeper understanding of the content of the analyzed problems and helped to identify consistent

coordination between the considered aspects of the formation of relationships between business entities within the business model of loan brokerage.

Key results: 1. Problems constraining the development of small and medium-sized enterprises, consisting in the need for the comprehensive improvement of loan technologies, have been identified; 2. Original judgments about loan brokerage as a type of intermediary and consulting activities of organizations / individual entrepreneurs (loan brokers) in the market of banking services, aimed at meeting the needs of potential borrowers in obtaining loan resources on terms as close as possible to the best ones, have been presented; 3. The attributive of the "loan broker product" service consumer value has been formed; 4. Analysis of the business model of the loan brokerage organization, including the mechanism of strategic management, has been carried out; 5. Directions for improving the business model of a loan brokerage have been determined.

Key findings of the study: 1. The theoretical and methodological provisions of loan brokerage based on a synthesis of known theoretical positions in the field of loan and brokering activities have been clarified and supplemented, as well as coordinated with published experimental data on the research topic, reflecting the impact of the results of expansion and addition of theoretical and methodological aspects using preliminary underwriting. 2. The developed strategy for increasing the demand for retail loan products with the participation of a loan broker provides an opportunity not only to improve broker's own business processes, but also to build a qualitatively new form of cooperation with commercial banks, taking into account the client's capabilities, optimizing loan tools and leveling basic banking risks. 3. The competitive advantages of working with brokers and using a loan

brokerage tool as an alternative source of high-quality clients and minimizing the costs of attracting clients have been determined.

The emergence of developed sectors of small and medium-sized enterprises is a prerequisite for the successful functioning of the state economy. Owners of small and medium-sized enterprises form the basis of the middle class of society, which serves as a guarantor of the stable development of the state. Small and medium-sized enterprises in market systems accumulate more employees, a larger share of GDP, and often a larger share of patents for inventions than large enterprises. The small and medium-sized business sector had undergone a period of a rather active development until 2014 inclusive, then there was a recession in 2014–2015, and in 2016 and to the present, there has been an intensification of small and medium-sized enterprises. Small and medium enterprises are more in need of borrowing than other business entities.

The Russian [10] and foreign [7] experience shows that when looking for external sources of financial resources, small and medium-sized enterprises focus on a bank loan. In 2016, despite the fact that many banks refuse to finance medium-sized and small enterprises, the share of Russian small and medium-sized enterprises, the share of small and medium-sized enterprises that received the loan requested from the bank in full amounted to 65% [16]. This is almost the average for the European Union and more than in countries like Spain or Italy [24]. In 2016-2017, according to the Bank of Russia [15], the loan activity of banks was largely associated with other financial organizations. As a result, the funds of banks fall into the sphere of small and medium-sized enterprises not directly, but through the mediation of specialized structures—financial intermediaries, for example, loan brokers.

## II. THEORY AND METHODS

Loan brokerage is one of the main and most developed types of banking services. A loan broker is an intermediary between a borrower and a loan institution that provides a range of services, which usually includes choosing the optimal lending scheme, holding negotiations with banks, as well as consulting and legal assistance in obtaining any type of loan with the best market conditions for the client [22].

Loan brokerage is still a new, almost unexplored direction for Russia, while abroad, it has been developing for a long time and quite actively. In the USA, for example, bank sales are practically not carried out directly, and most of the customers go through brokers [25]. The broker acts as an intermediary between the bank and the client. He/she conducts consultations, initial assessment of creditworthiness, and selects the optimal program. Abroad requirements for brokers are somewhat different from ours. In some countries, this activity is licensed, and such a license costs a lot of money.

Mortgage brokers in the United States [25] act as independent contractors—they are the coordinating link between the client, bank, realtor, appraisal, and insurance companies. At the same time, realtors are prohibited by law to

provide brokerage services and advise clients on mortgage issues, since it is too tempting to send a client to the bank that credits realtor's real estate purchase. The most common pattern of relations with banks is that the bank transfers its loan programs to the broker at the "wholesale" price, the broker sells them to his/her customers at the "retail" price, and the difference is the commission.

Summarizing the judicial and business practice, we can assume that the business activity of the loan broker is an independent activity carried out at his/her own risk through the provision of assistance in obtaining a credit (loan) and other services for the purpose of making a profit.

Regarding loan brokers, according to the results of the literature review, the following definitions can be given, providing for the following provisions:

1) loan broker—a legal entity—a resident of the Russian Federation or a physical person permanently residing in the territory of the Russian Federation and registered as an individual entrepreneur in accordance with the legislation, engaging in intermediary activities between lending agencies and the borrower in the process of implementation by the party of a transaction of lending to individuals and legal entities;

2) the activity of a loan broker is an intermediary activity carried out in the interests of the client, aimed at finding a lender and agreeing on the essential terms of a loan agreement [19] between the subjects of credit relations;

3) the activity of the loan broker is aimed at:

- brokering activities, during which the search and selection of optimal credit conditions for the future borrower are carried out in accordance with his/her requests;
- selection of a lending agency, assistance in forming a package of documents for submission to a lending agency;
- preliminary agreement with the lending agency on the possibility of lending to the borrower;
- preparation of recommendations for raising the status of the borrower to reduce the time for consideration of the application and reduce the risk of refusing to receive a loan;
- filing an application to the lending agency, support for the consideration of the borrower's documents in the lending agency;
- legal and financial advice to the borrower, including a detailed calculation of all associated costs, a comparative analysis of loan repayment schemes in order to explain to the borrower the specifics of lending at a particular lending agency.

In our opinion, loan brokerage is a type of intermediary and consulting activity of organizations / individual entrepreneurs (loan brokers) in the banking services market aimed at meeting the needs of potential borrowers in obtaining loan resources on conditions as close as possible to optimal ones.

## III. PRACTICAL ANALYSIS.

The problems of small and medium-sized enterprises remain unchanged for several years—these are very heavy

taxes [7], the impossibility of obtaining a loan on preferential terms, corruption of government institutions, falling consumer demand, and insufficiently high qualification of employees.

When lending to small and medium-sized enterprises (SME), a number of problems are faced [21] by both the lending banks and the borrowers themselves (Table 1).

TABLE I – SME LENDING ISSUES

From the banks' perspective	From the SME's perspective
The lack of transparency of doing business in this business segment	High lending rates, the almost complete absence of soft loans and "repayment holiday" for start-up entrepreneurs
Problems with the economic and legal literacy of most small business managers	Very strict conditions and lack of information in obtaining a loan
The actual absence of floating charges from small enterprises	Long term of application processing
Lack of real guaranteed state support for small enterprises	Lack of real guaranteed state support for small enterprises
Strict regulatory requirements for customer solvency evaluation technology	Inability to get credit support for business development from scratch

For the industrial development of bank lending to small and medium enterprises, it is necessary to fulfill a number of conditions [9,13]: firstly, the improvement of load technologies, which simplify the stages of application processing and technology services; secondly, a decrease in interest rates with a positive credit history of the borrower or a guarantee; thirdly, to optimize the choice of a lending agency—a commercial bank with the most acceptable loan terms. The subject of small and medium enterprises can fulfill all these terms through the intermediary of a loan broker.

The loan broker not only provides his/her client with professional services, but also sells him/her a bank loan service [20]. As a result, a potential client receives a loan brokerage product consisting of an optimal bank loan scheme, determined in accordance with his/her subjective criteria of optimality, and the loan broker's brokerage service, defined by a number of authors [5,11,23,26] as "loan brokerage product". Creation of the "loan broker product" service consumer value is shown in table 2.

TABLE II – THE ATTRIBUTIVE OF THE "LOAN BROKER PRODUCT" SERVICE CONSUMER VALUE

Attribute group	Attributive	Level	Loan broker product
Basic characteristics	Core benefits	Production level	Financing
	Basic service		Lending
Value added	Expected service	Service level	Lending for specific purposes and on acceptable terms

	Extended service	Level of competition	Terms and speed of obtaining loans, exceeding the average market ones; Individual approach Minimum time and operations performed by the client independently
	Potential service	Loyalty level	Optimum loan terms Guaranteed successful result Terms and speed of obtaining a loan, somewhat exceeding customer expectations

The multi-attributive model of the "loan broker product" service consists of five attribute groups. They form a hierarchy of values for the consumer, and the transition to a new level means an increase in the value of the product—loan resources—for the consumer—small and medium-sized enterprises.

Loan brokers also provide additional services to banks [8,14]. This is, in fact, a preliminary underwriting: a loan broker can not only select a loan product for a specific legal entity or an individual entrepreneur, but also independently assess the level of loan risk, provide this information to the bank, making it easier for it to prepare documents for making a decision on the advisability of issuing a loan (Figure 1).

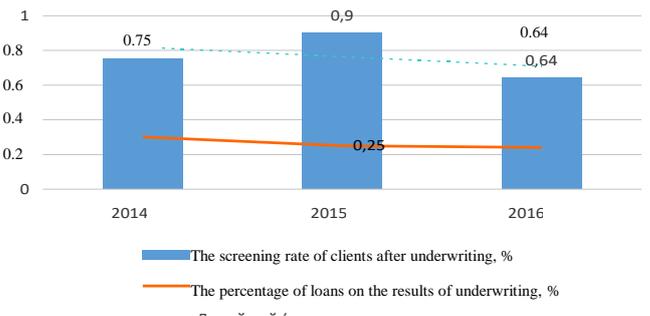


Fig. 1 – Dynamics and structure of preliminary underwriting

The preliminary digital underwriting is characterized by the average time interval  $u_0$ , necessary for its implementation, and the probability  $p_0$  that the borrower, after applying basic underwriting to him/her, will make another payment on time in the absence of delays and contradictions

The classification of loans issued by the bank (with the exception of loans grouped in a homogeneous portfolio) is carried out in five categories of quality [1]:

- Category I (the highest) (standard loans)—there is no credit risk (the likelihood of financial loss due to non-performance or improper performance by the borrower of obligations under the loan is zero);

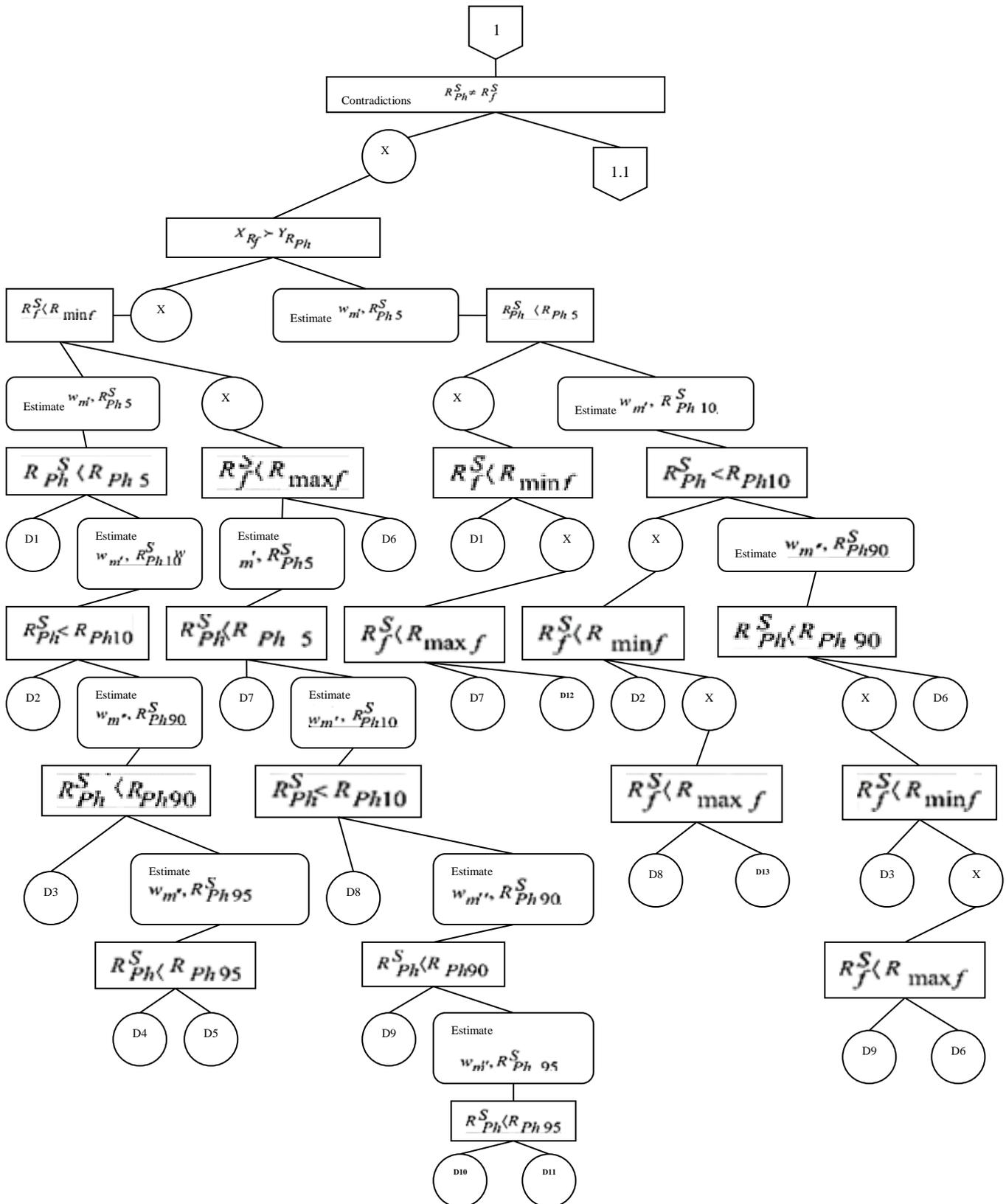


Fig. 2 – Decision making scheme for preliminary digital underwriting

- Category II (non-standard loans)—there is a moderate credit risk (the likelihood of financial losses leads to loan impairment in the amount of 1% to 20%);

- Category III (doubtful loans)—there is a significant loan risk (impairment in the amount of 21% to 50%);  
 - Category IV (problem loans)—there is a high loan risk (impairment in the amount of 51% to 100%);

- Category V (the lowest) (bad loans)—there is no likelihood of repayment of the loan due to the inability or refusal of the borrower to fulfill the obligations under the loan, which causes a complete (in the amount of 100%) its impairment.

The study found that a clear strategy, regulated and adaptive business processes, thoughtful organizational structure, and an effective interrelated loan brokerage management system as a whole are the main factors that will allow financial intermediaries to maintain their leading positions in the market in the coming years.

**IV. RESULTS**

The business model of the loan brokerage organization normalizes the strategic management elements [17,18]. This model describes the broker’s main strategies, their characteristics, and interrelation. There are various types of strategies: product, customer, functional, and financial. In addition, it formulates a strategic management goal—this is the desired future state of the broker, which can be achieved by executing a dedicated set of business processes and projects.

A business model is a formalized description (graphical, tabular, in some cases—textual one, or in the notation of a specialized software product) of a certain aspect or field of activity of an enterprise (Figure 3).

Thus, the formalization of customer service stages under the development of bank cooperation with loan brokers includes not only the segmentation and processing of the information base, but the promotion of retail loan products to the market.

**V. DISCUSSION ISSUES AND FINDINGS**

For a bank, a loan broker is an additional sales channel for its banking products. The more professional the broker is, the more effective this partnership is: the bank – the broker – the client.

The current state in the banking sector is characterized by the uneven development of loan infrastructure in a territorial aspect [2,3,6,12]. Differences in the reproduction potential of territorial economic complexes and asymmetrical fiscal relations between the center and the constituent Federation entities preserve and deepen the gap between the needs of the real economy and the population in monetary resources and the supply of retail loan products (including auto, mortgage, and retail loans) from the banking sector market, above all, at the regional level [9]. A general study of the current state of the Russian banking system has showed the availability of a number of systemic problems: interest rate policy of the Bank of Russia [27], high inflationary component, insufficient availability of long-term

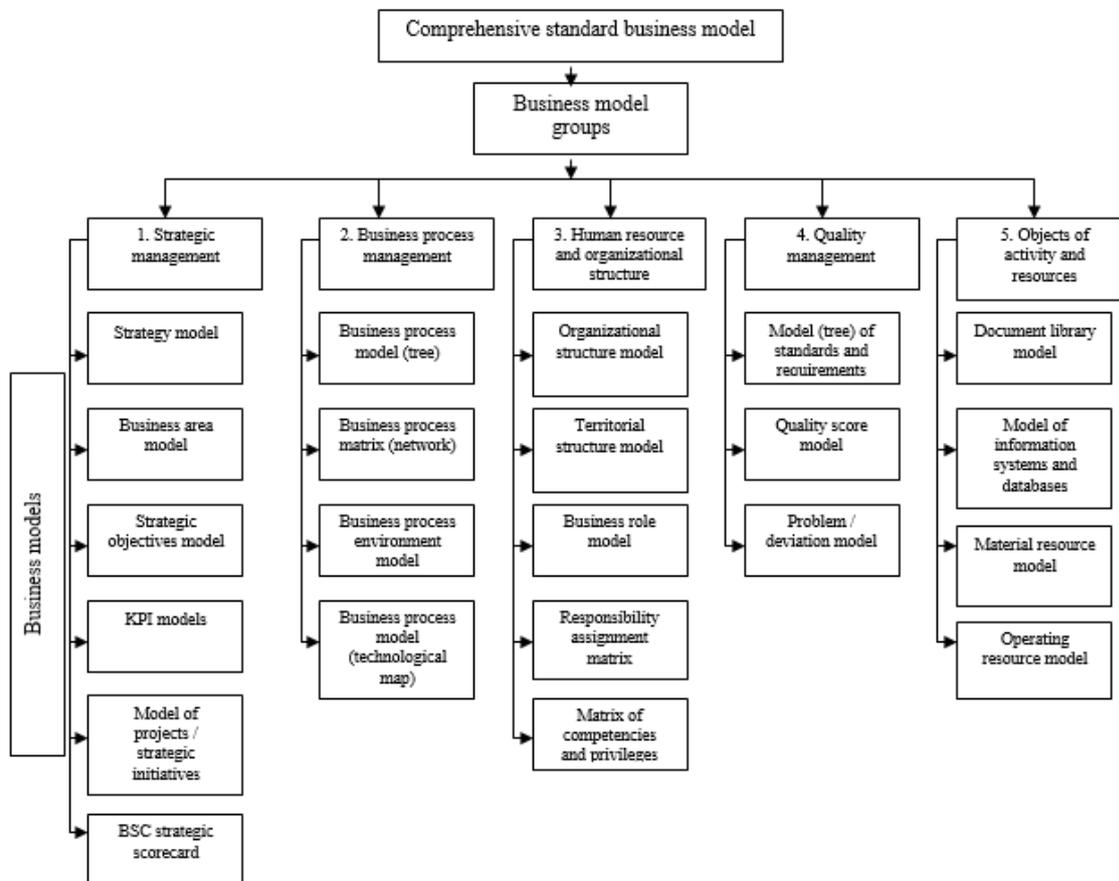


Fig. 3 – Loan brokerage business model

resources among lending agencies, especially at the regional level, unequal competition between the main participants in the retail lending market, and high differentiation of accessibility of retail loan products and services in the regions. Among the problems hindering the expansion of the retail loan products and services market [4], one should highlight the lack of remote access systems to banking services for the population, low financial literacy, and the lack of a comprehensive program to increase it among the population, as well as citizens' distrust of lending agencies.

Thus, the following main problems of loan brokerage have been highlighted: the lack of a conceptual apparatus that determines the activities of financial intermediaries, including brokerage organizations in existing legislation; inadequate legal regulation of the broker's responsibility to a commercial bank, as well as the insufficient legitimacy of the contractual relationship in terms of responsibility for disclosing information about the client to third parties.

The main disadvantages of Russian credit brokerage:

1. lack of regulatory and legal framework;
2. inconsistency of the national legal system and terminology with international standards;
3. lack of administrative and organizational infrastructure in the format of the existing Russian banking and financial system, as well as the lack of interaction mechanisms in the triangle "bank – loan broker – borrower";
4. lack of qualification framework for specialists in the industry and an effective system for their training.

## VI. CONCLUSION

There are two options for a loan broker in the context of new industrialization. The first option involves the payment of the services of a loan broker at the expense of a lending agency (bank). In this case, the loan broker is, as a rule, the agent of one or several lending agencies and offers the client a small amount of digitized loan products. His/her income is due to the volume of attracted customers, and therefore, in most cases, the broker is forced to work with a single lending agency.

The second option involves the payment of the services of a loan broker at the expense of the client. In this case, under the new industry, the broker selects optimally favorable loan terms at the expense of the client's funds, and the optimally favorable loan terms are not always determined by the interest rate on the loan. Essential conditions for the client may be the terms of the loan, currency; in case of the mortgage lending—the size of the down payment, the location of the collateral, the nationality of the borrower.

However, both in the first and in the second case, it is important to pay attention to the forms of contracts offered when a loan broker concludes based on digitization. The essential condition of such a contract will be a reference to membership in a professional organization and a professional liability insurance contract.

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