Small is **BIG**

How Fintechs are Revolutionising Lending

Small is BIG - How Fintechs are Revolutionising Lending

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Foreword by

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"After establishing themselves as a formidable player in unsecured small ticket lending, fintech are looking for accelerating to a coupled trajectory of growth and profitability. In the light of evolving regulatory landscape, it is essential for financial institutions to re-design the existing risk management frameworks. This is also of particular interest to the fintech investor community as they are now looking at growth outcomes that also help improve the bottom line. Pure topline growth is not an attractive proposition anymore given the global headwinds and constraints on investment. This event will provide participants with just the right platform and tools to engage with all the stakeholders in their growth journey.

Despite massive inroads made by fintech in India the journey is still at a nascent stage. Given high credit gap in India, fintech community holds lot of promise in driving the reach and richness of credit penetration especially in the unserved and underserved cohorts. The growth potential is huge and fintech needs to identify segments for their next phase of growth in a prudent manner. This White Paper "Small is BIG: How Fintech are revolutionizing lending" attempts to objectively evaluate the portfolio built by fintech to assess its sustainability while also examining potential to scale up in times to come. We have following key takeaways based on empirical analysis:

- While the headline on fintech is around high growth in the small ticket segment, lot less has been debated about the impact they have created on Financial Inclusion. Fintech catered to underserved and unserved segments such as NTC/Thin File, Customers with sub-prime Bureau scores propelling the Financial Inclusion agenda.
- Fintech has experienced some worsening in asset quality. However, this needs to be seen in the context of where they largely operate in. The segment fintech cater to are inherently high risk but also enable credit unserved and underserved segments. Further, higher risk is also largely priced. However, certain micro-segments with high incidence of delinquency need to be reassessed (e.g., Customers with multiple personal loans, overleveraged segment going for spurious credit consumption).
- The lending market today is highly fragmented with diverse types of lenders with their niche value proposition. In such a situation, fintech need to adopt a differentiated strategy. Use of exponential technologies such as Blockchain, Artificial Intelligence & Machine Learning, Cloud in emerging areas such as Green Finance, Agri Finance, MSME lending can provide fintech with a competitive advantage to flourish in the market. Adoption of technology is in the core DNA of fintech and the extended use of the same will enable the next wave of growth.

This White Paper also delves into the transformative changes ushered in by the fintech industry in the way credit is delivered through digital innovation. Global best practices have also been cited to get insights into monetization of digital capacity. Regulatory sandbox and initiatives by government to build Digital Public Infrastructure (DPI) opens opportunities for fintech to innovate and enhance their value proposition.

I believe that you will find the report insightful, and I look forward to hearing your views and feedback."

1. The Fintech Lending Landscape in India

This section explores fintech operating model and the current landscape of digital lending in India. Further, this section provides a summary of size and characteristics of the fintech portfolio. Penetration of fintech in credit unserved and underserved segments is also examined.

1.1 Decoding the DNA of Fintech Lending

With digital adoption becoming ubiquitous, the distinction between fintech and traditional lenders has also blurred. Lending institutions have overt ambition to be identified as a platform player. Fintech lenders, however, reimagined customer journey reducing friction at every stage. Loan origination journey including sub-processes like Prospecting, KYC, Credit Assessment and Disbursement have clear stamp of technology. The extensive use of advanced technologies such as machine learning for credit assessment, APIs for data collection, and digital assistants for personalisation enhances the user experience. This has helped fintech become the lender of choice for new age borrowers, especially digital natives on their consumption loans.

Fintech has also enabled lending journey for traditional lenders through Lending as a Service proposition. Co-lending too has helped create win-win partnerships between lenders with disparate operating models. This White Paper covers various aspects of lending for both fintech NBFC and fintech-enabled business to get a full impact of fintech lending in India through a Bureau's lens.

Digital Lending Journey

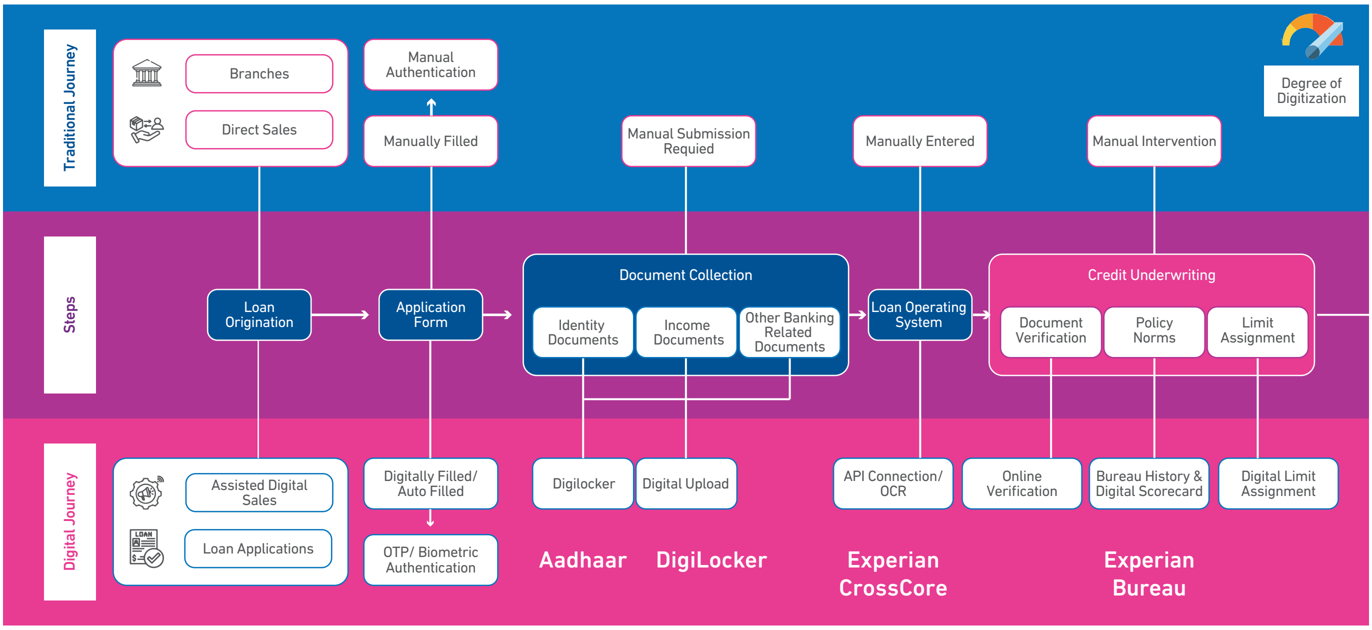


Figure 1 : Digital Lending Journey

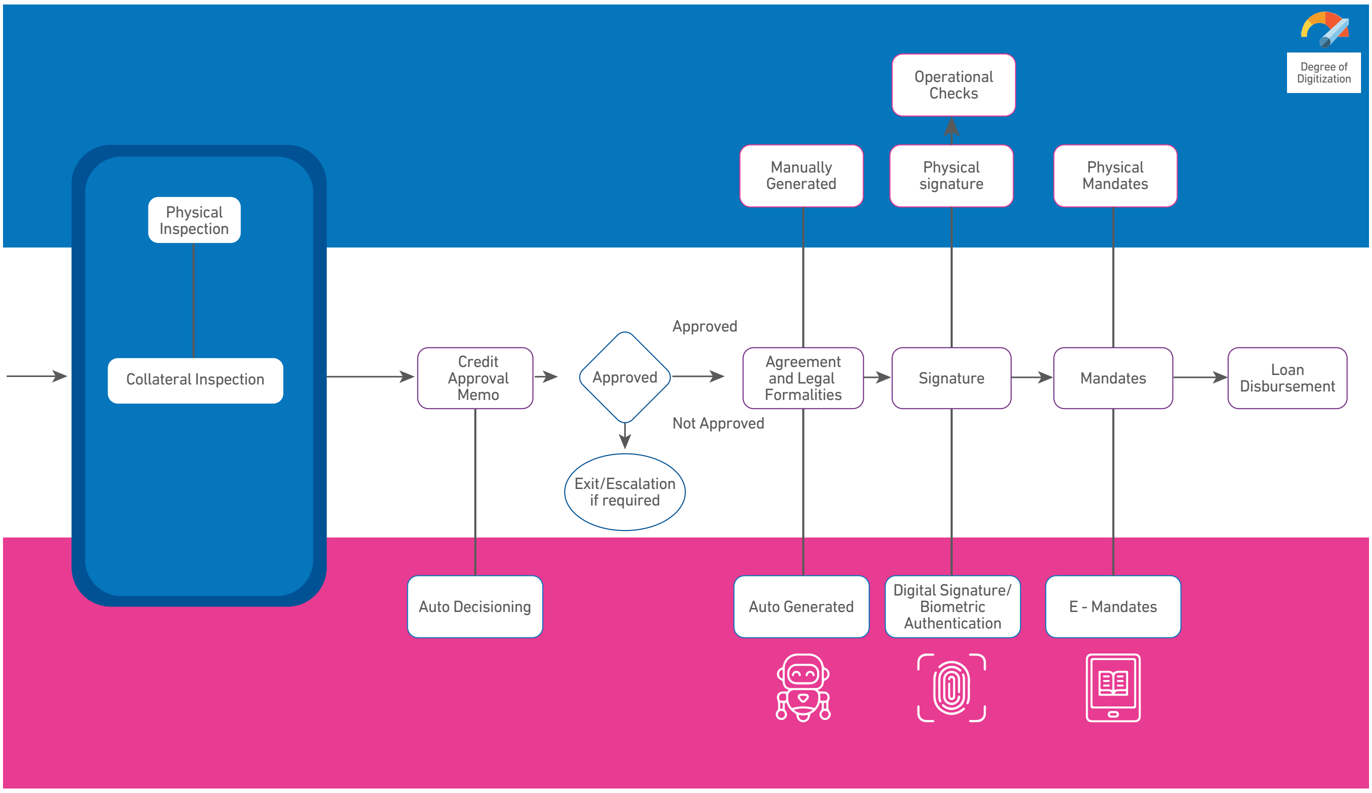


Figure 2 : Digital Lending Journey - An understanding of the Digital Lending landscape in India.

1.2 Product Proposition and Business Model

Fintech have nurtured niche customers and product segments (parallel can be drawn with how traditional NBFCs too specialized in narrow product and customer segments when they emerged on the lending scene in India). Consumption (Personal Loan) and working capital loans (Business Loan) are the key products fintech have focused on. These products do not require collateral for underwriting making them well-suited for digital adoption.

Common business models among fintech in India include direct lending, co-lending, marketplaces, and Lending Service Provider (LSP) roles. The chart given below illustrates digital lending landscape in India:

Multitude of collaborative operating model innovations led by Fintech co-exist

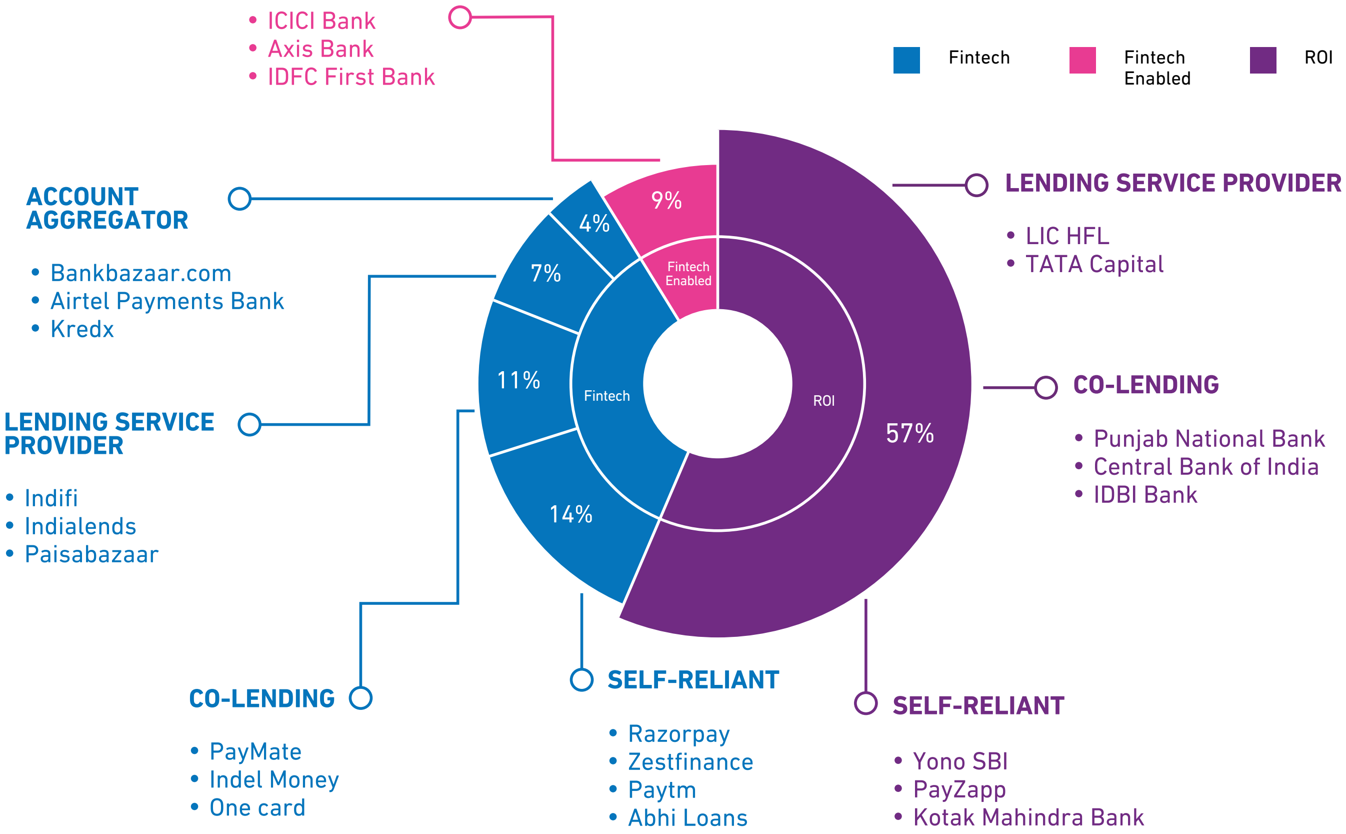


Figure 3 : Common Operating Models (Based on Experian study.)

1.3 Fintech Lending - Summary

As of March 24		Personal Loan	Business Loan
AUM Amount (in Cr)	Fintech NBFC	2,48,006	28,607
	Fintech Enabled	32,515	21,450
AUM # (in Lac)	Fintech NBFC	388	15
	Fintech Enabled	242	38
FY24 Disbursal Amount (in Cr)	Fintech NBFC	2,11,794	17,345
	Fintech Enabled	28,737	8,317
FY24 Disbursal Amount #(,000)	Fintech NBFC	49,193	951
	Fintech Enabled	11,318	1,684
FY 24 Market Share Amount	Fintech NBFC	25%	21%
	Fintech Enabled	3%	10%
FY 24 Market Share #	Fintech NBFC	52%	16%
	Fintech Enabled	12%	18%
Net 90+%	Fintech NBFC	1.51%	1.28%
	Fintech Enabled	1.35	1.75%

Figure 4 : Fintech Lending-Snapshot

Market Share (PL<1 Lakh)

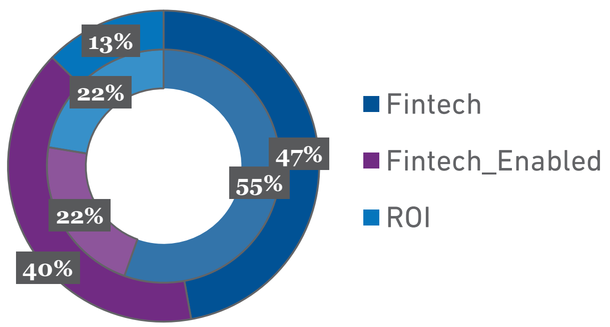


Figure 5 : Personal Loan Market Share <1 Lakh Mar'24

Market Share (BL<1 Lakh)

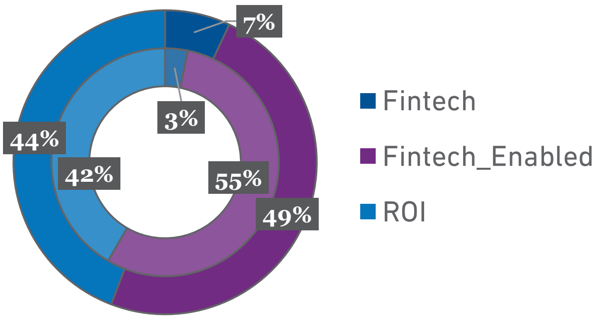


Figure 6 : Business Loan Market Share <1 Lakh Mar'24

Inner Circle: Amount Market Share
Outer Circle: Count Market Share

Fintech NBFC have captured approximately 47% of market share by count on small ticket Personal Loan (< 1 lakh) in FY 2024. ~87% of small-ticket personal loans (<1 lakh) were either directly sourced by fintech NBFCs or facilitated by them in their role as Lending Service Providers (LSPs). In case of Business Loan, fintech largely play the role of an enabler. ~56% of Business Loan (< 1 lakh) by count were sourcing with fintech stamp.

1.4 Improving access to credit in underserved segment-fintech shows the way

Higher Penetration of Fintech in Segments with low Credit Access

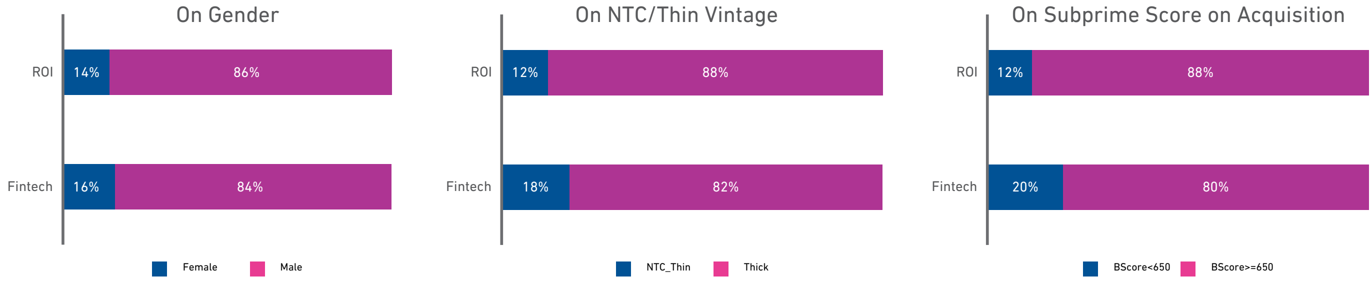


Figure 7 : Sourcing Distribution Across Multiple Categories (PL for FY22, FY23 and FY24)

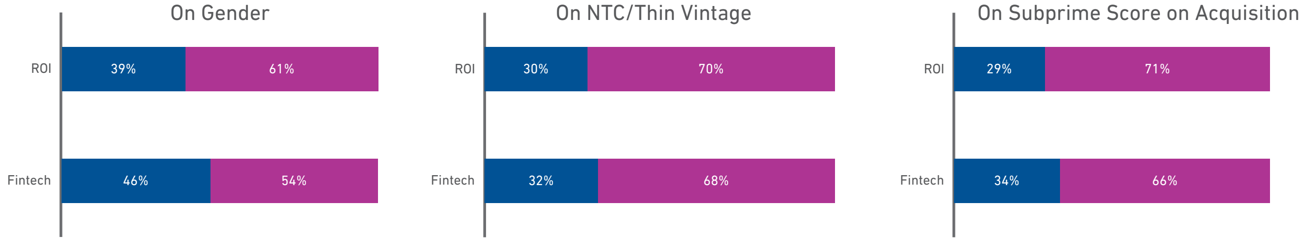


Figure 8 : Sourcing Distribution Across Multiple Categories (BL for FY22, FY23 and FY24)

Fintech majorly operates in smaller ticket Business and Personal Loans. Fintech have higher penetration in segments with low credit access such as Women, New To Credit/Bureau Thin and customers with sub-prime Bureau scores.

Subsequent Product-Lender Preference

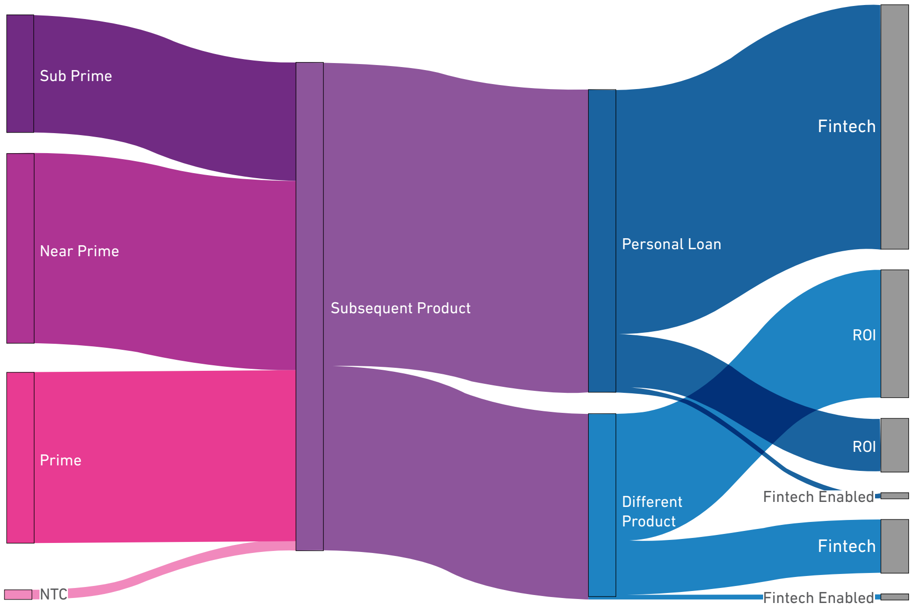


Figure 9 : Subsequent Product Selection & lender (PL for FY22, FY23 and FY24)

Due to superior customer journey customers with Prime and Near Prime Bureau scores often prefer fintech as their lender of choice. Most customers go for a personal loan as their next credit and within this segment fintech lenders are the top choice. On the contrary, if the customer goes for a different product, limited by their product offering fintech have a lower proportion of returning customers in this segment.

People after taking their first Personal Loan from fintech have a higher average number of live Personal loans. The loans start to pile up as soon as 3 months from the first sourcing. Within the first 24 months the average number of live Personal Loans increases to ~3.5 PL

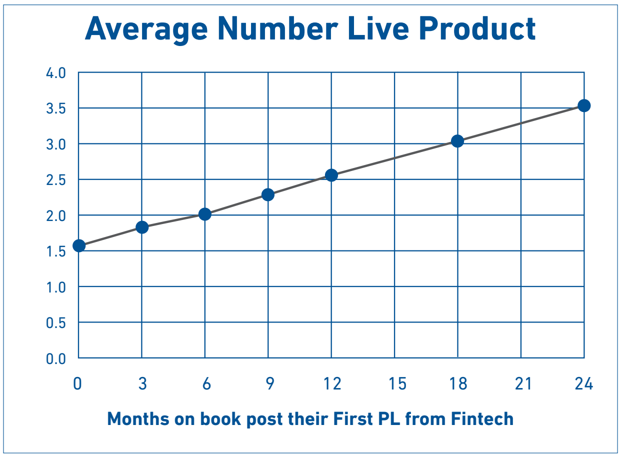


Figure 10 : Average Number Live Product

2. Fintech Portfolio Deep Dive: Addressing the Big Elephant in the Room

This section looks at the growth of fintech portfolio on their core product segments (Business Loan and Personal Loan - sanction amount < ₹1 Lakh). Further, asset quality aspects are examined and compared with the rest of industry.

2.1 Sourcing Trend - Personal Loan and Business Loan

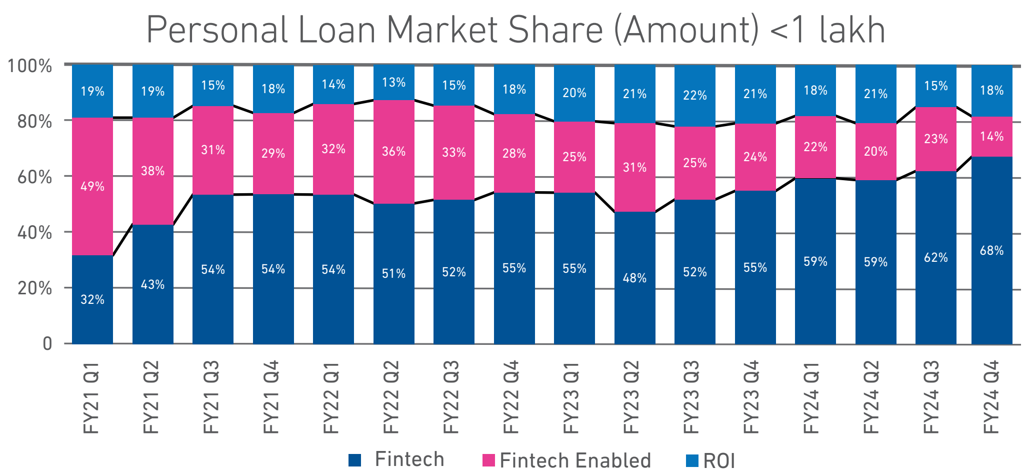


Figure 11 : Market Share for Personal Loan (Amount) <1L

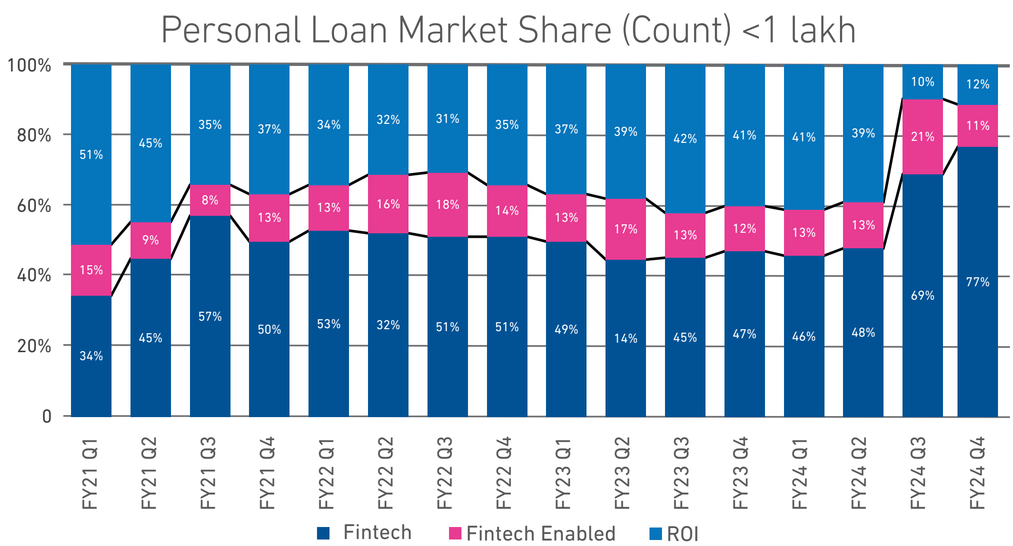


Figure 12 : Market Share for Personal Loan (Count) <1Lakh

In the second half of FY 2024, the market share by count on small ticket personal loans increased for fintech, as traditional lenders significantly reduced their sourcing in this segment. This shift could be attributed to regulatory guidelines on unsecured lending, particularly concerning small-ticket loans. Fintech NBFC, with limited storefront, could not pivot to secured products or towards higher ticket size segment in the same manner.

State wise growth for Fintech

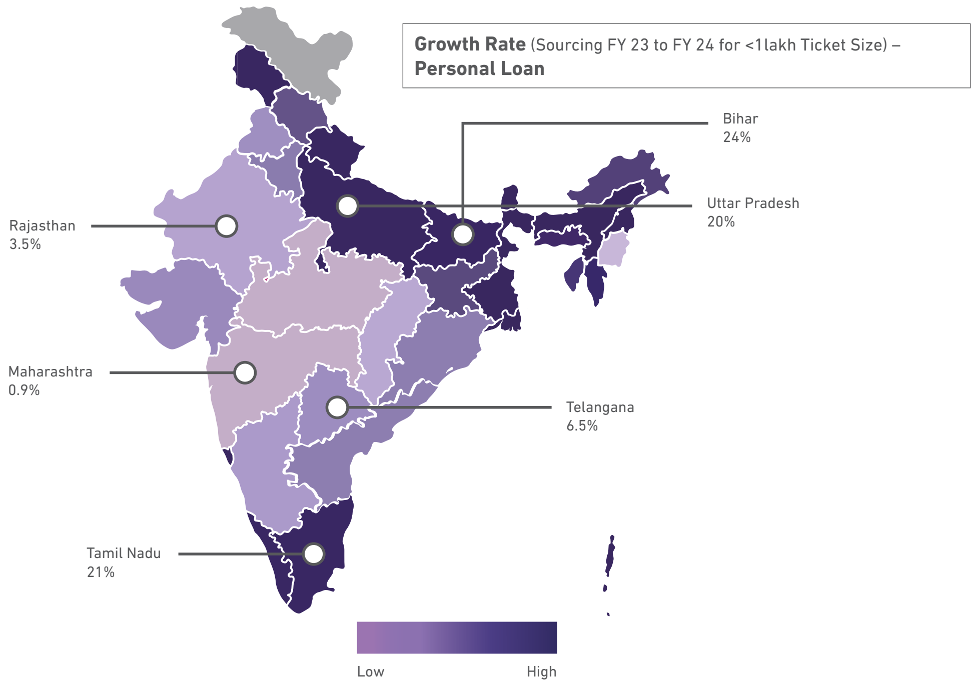


Figure 13 : Growth Rate of Fintech for Personal Loans <1L Across States

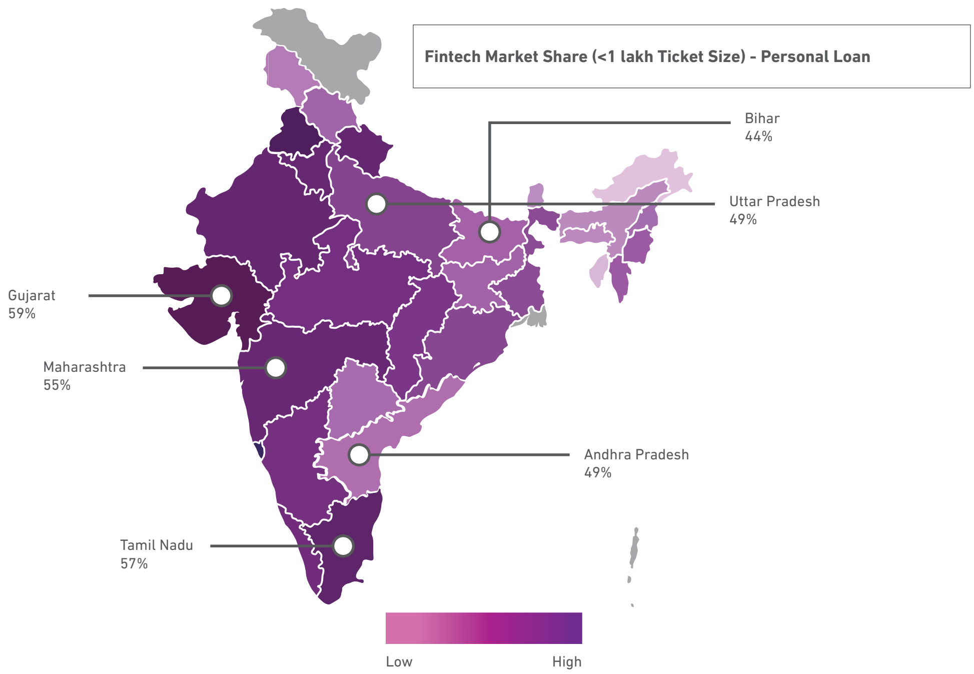


Figure 14 : Fintech Market Share <1L Personal Loans Across States

Study based on Bureau data

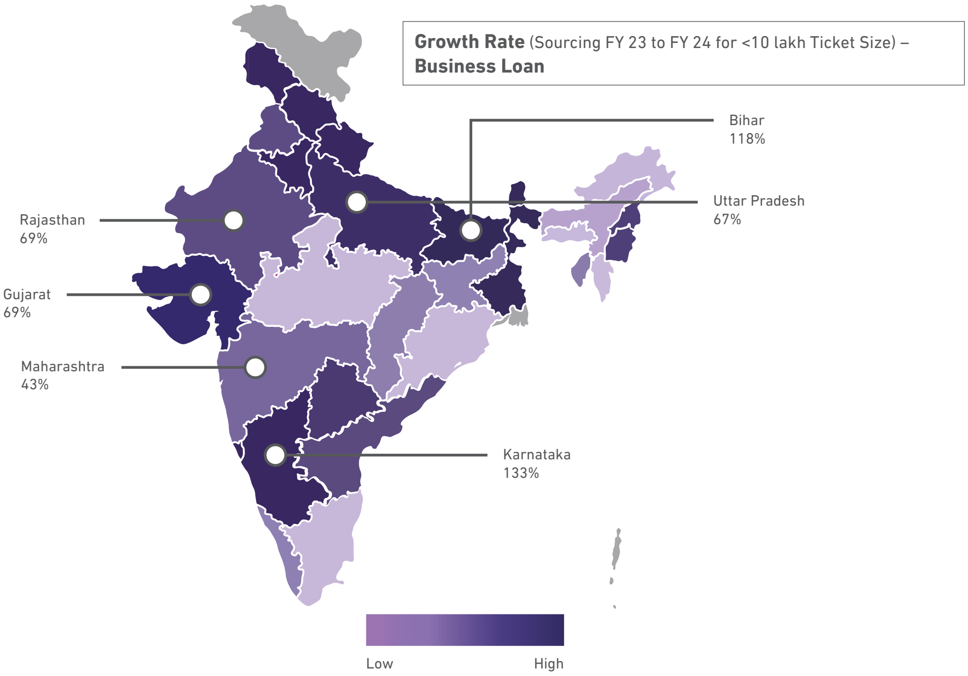


Figure 15 : Growth Rate for Business Loan <10L Across States

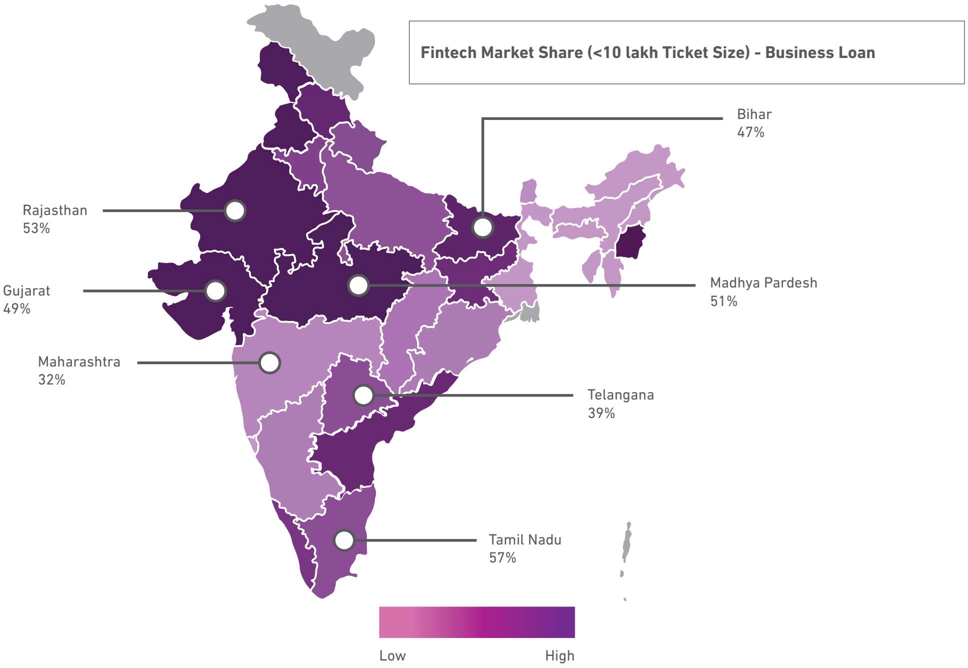


Figure 16 : Market Share for Business Loan <10L Across States

States like Bihar, Uttar Pradesh and Kerala have seen the highest growth in Personal Loans <1 Lakh. States like Gujrat, Maharashtra, Tamil Nadu have an established Fintech market share. Business Loan has a high growth rate like Personal Loans in states like Uttar Pradesh, Bihar.

2.2 Asset Quality and Collections

Portfolio Delinquency

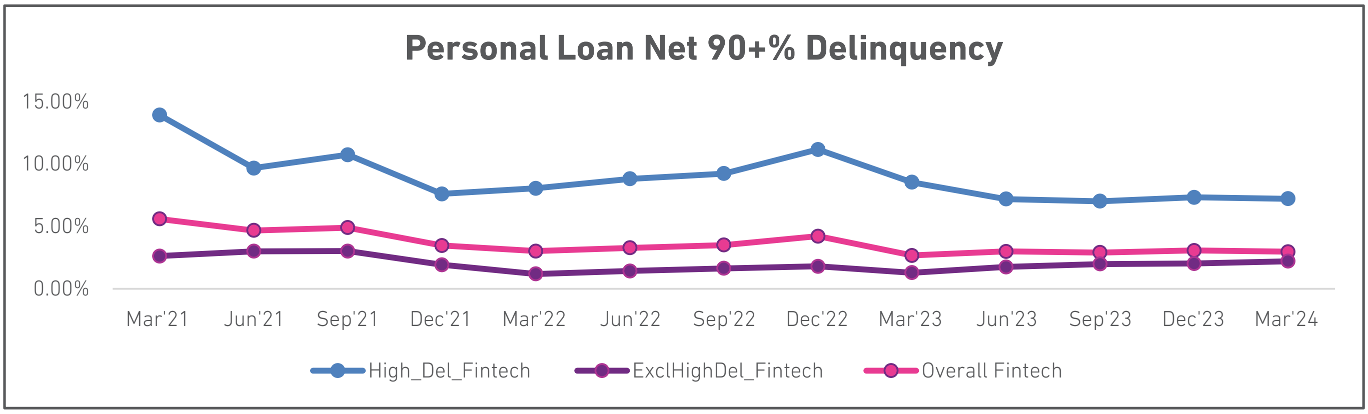


Figure 17 : PL Net 90+% Trend

Overall delinquency rates for fintech have been somewhat skewed due to a few players operating at a very high rate.

Coincidental Delinquency

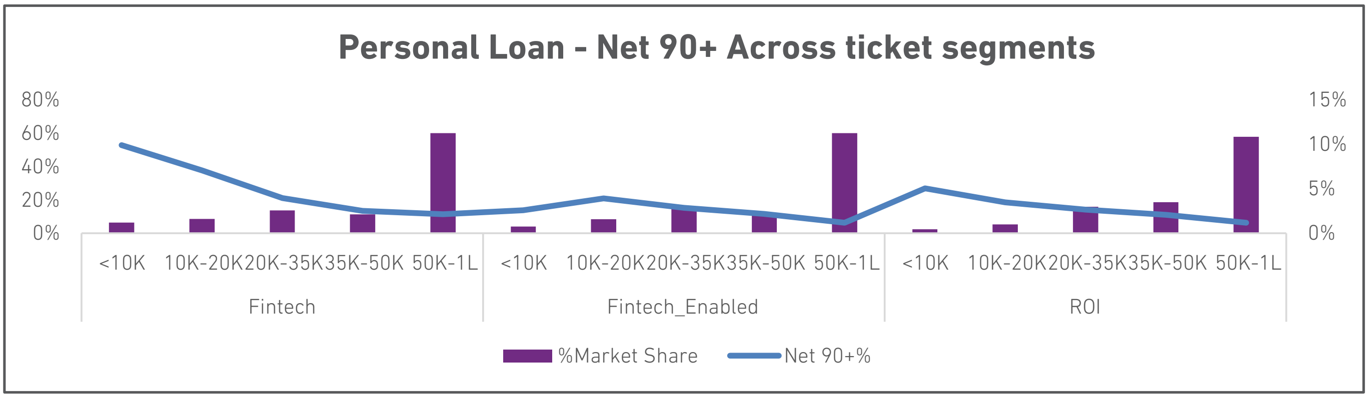


Figure 18 : Personal Loan Net 90+% Across Ticket Segments

Fintech has the highest delinquency rate and a dominant market share in the largest ticket band on amount, however on the count side lowest ticket size has major portfolio which is ~33% for fintech and ~37% for fintech-Enabled.

Slippage Ratio

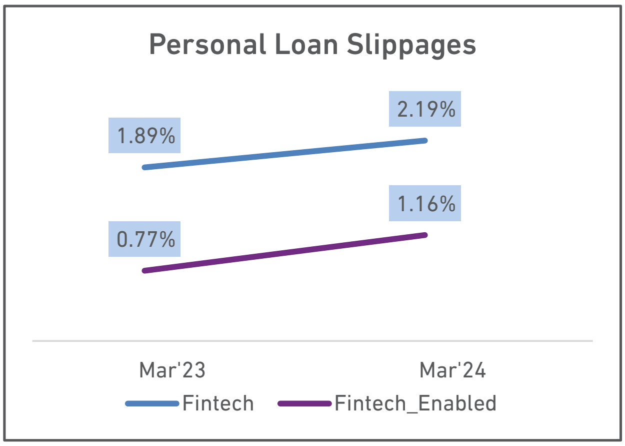


Figure 19 : Personal Loan Slippages

The worsening asset quality in FY23 is also reflected in the Slippage Ratio.

Vintage Charts

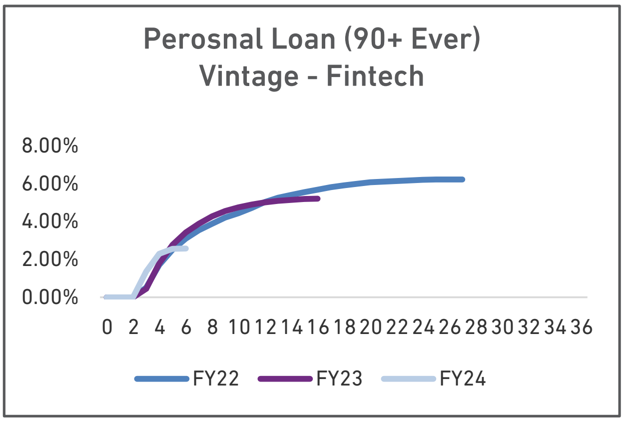


Figure 20 : Vintage Curve for Personal Loan

Asset quality for sourcing in FY2023 worsened. This was also the year when fintech NBFC grew at a very rapid pace.

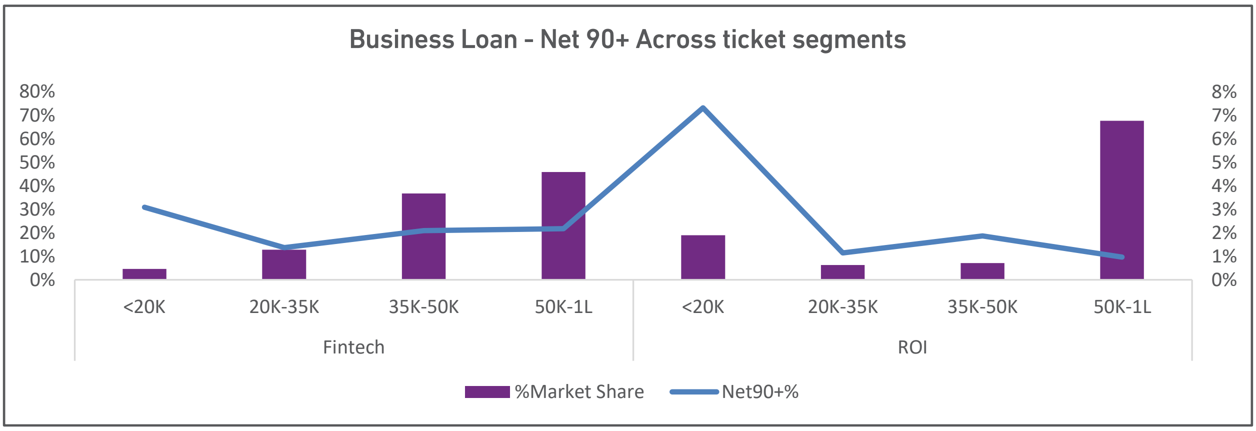


Figure 21 : Business Loan Net 90+% Across Ticket Segments

Lower ticket sizes having higher delinquency for fintech industry

Delinquency for fintech industry

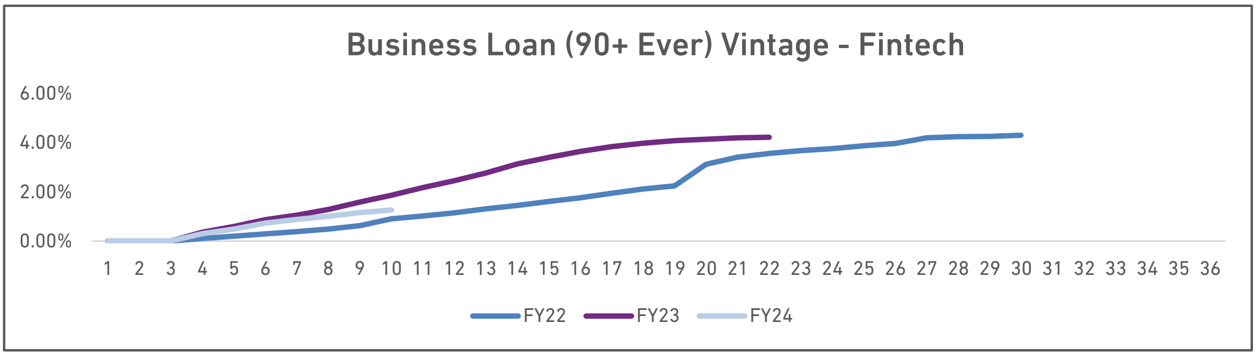


Figure 22 : Business Loan (90+ Ever) Vintage - Fintech

For business loans, we can see a rise in delinquencies after 12 to 14 months on book (MOB). This trend tends to stabilise after 24 to 25 MOB.

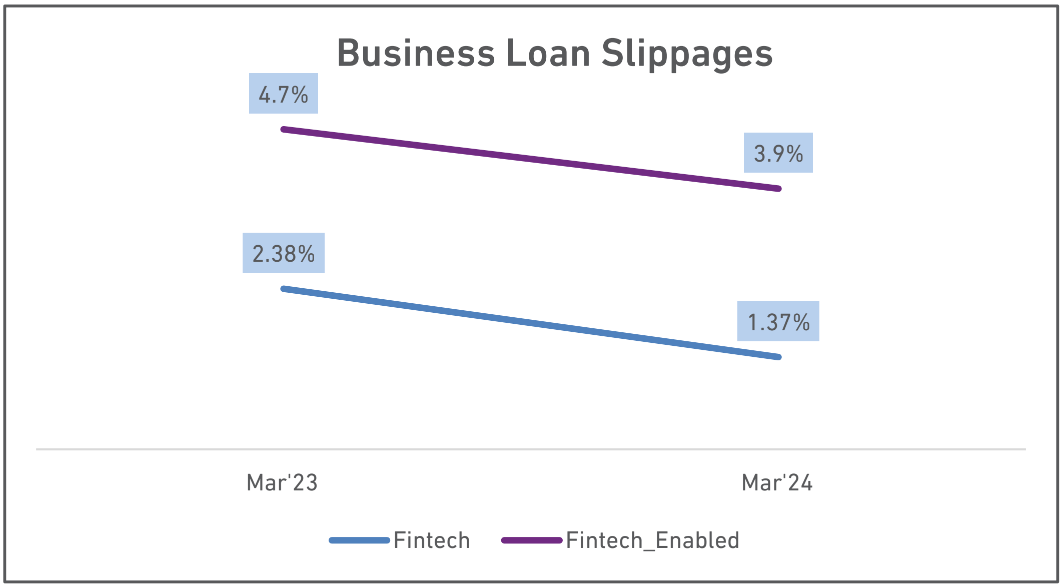


Figure 23 : Business Loan Slippages (FY22, FY23, FY24)

Slippages have improved for both fintech and fintech enabled compared to March-23.

Fintech have positioned themselves in a niche domain by defining novel segments, while concerns over their collection strategies & high delinquencies linger

Consumer Segment

Fintech embarked on the journey by focusing on onboarding credit invisibles' and the 'sub- prime population, mostly younger generation (<30 years), by leveraging alternative data and advanced analytics (AJ/ML). With time, as their models have matured, efforts are being made to get ETBs into the fold.

Product Segment

Strategy to tap into under-penetrated segments in Tier-3 and Tier-4 cities has reaped dividends for Fintech. Customizing product portfolio as per their needs and focus on small ticket size loans across the board (PL, CD and BL) has proven to be game changers in driving their topline growth.

Lending Channels

Fintech have championed emergence of new lending channels (E-Commerce, Food Delivery Platforms, Cab Aggregators, P2P lending etc.) which have enabled them expand the outreach amongst consumers seeking quick and hassle free loans for short term. LazyPay, Simpl and OlaPay are few such examples

Consumer Awareness

Fintech have primarily contributed to this spike in credit-consciousness. As access to credit becomes easier, consumers make efforts to maintain credit-worthiness to be eligible for it. More millennials are now checking their credit scores (10X increase in the last one year) prior to applying for a loan.

Concerns

Collection Strategy?

- Overwhelming focus on top-line growth has resulted in Fintech grappling with relatively high delinquency rates, 9ppts higher delinquency (90+ DPD in F6M) as compared to banks and NBFCs.
- Coupled with challenges pertaining to defining a structured collection process to recover small principal amount has added stress on their loan portfolios. Engaging additional physical resources also offsets the margins gained by low cost of acquisition through digital platforms

Roll Rate Analysis

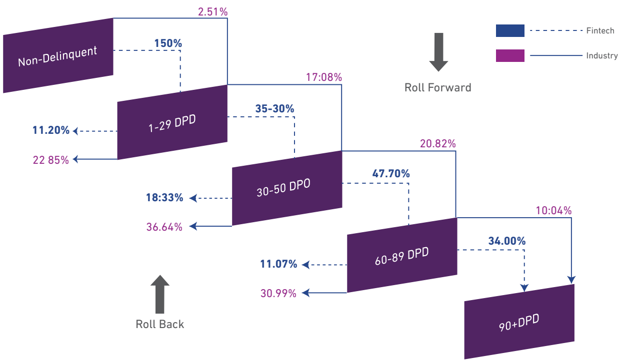


Figure 24 : Collection Flow Rates for PL <1Lakh

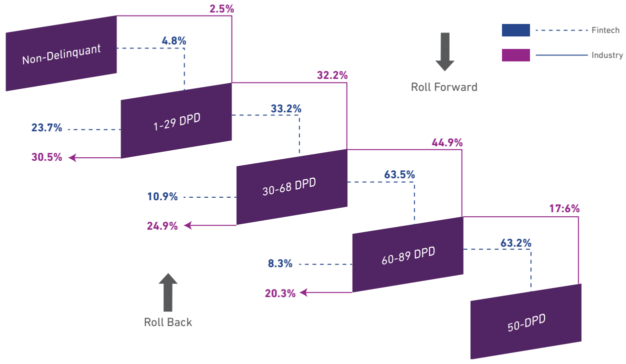


Figure 25 : Collection Flow Rates for BL <1Lakh

Roll forward rate across delinquency buckets is higher for fintech.

Roll forward rate is relatively higher for fintech.

Fintech do tend to have higher exposure in Customers with multiple Tradeline

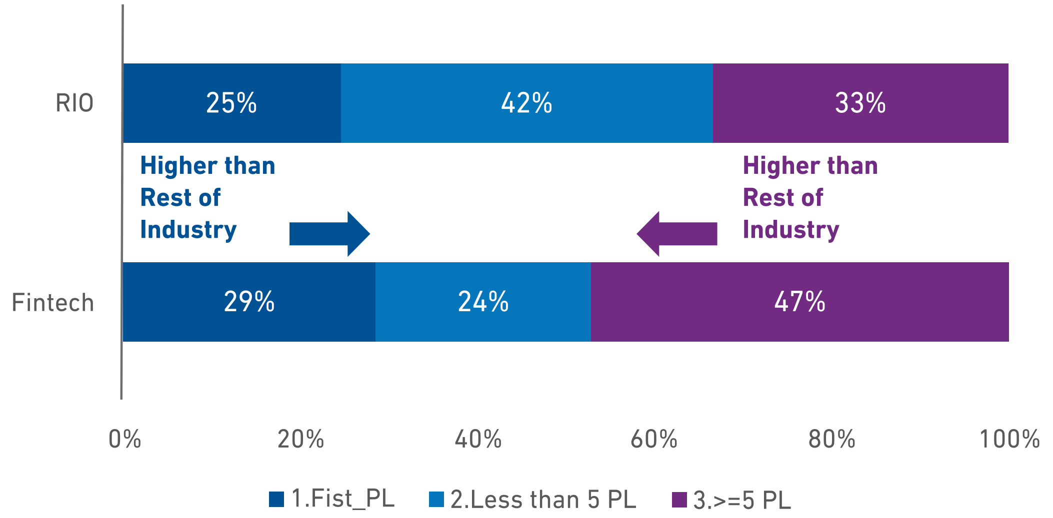


Figure 26 : Sourcing Share and Personal Loan Holding

This segment tends to worsen in credit profile over time as seen in Bureau Score....

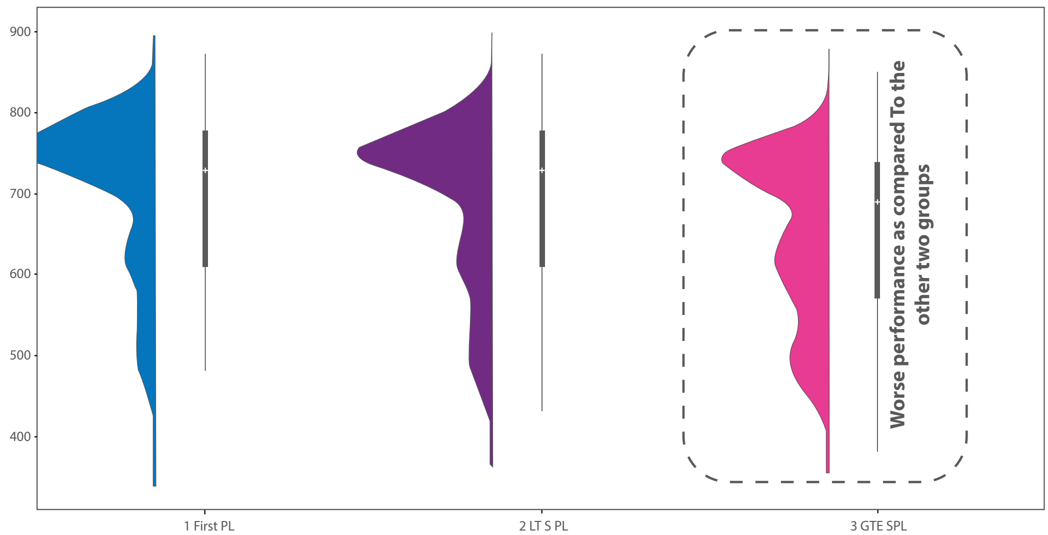


Figure 27 : Bureau Score Migration Across Personal Loan Holding (FY22, FY23, FY24)

Due to the sourcing mix skewed more towards overleveraged Customers Fintech Customers experience higher deterioration in Credit profile

Over the years fintech have steadily increased the sourcing amount within the <1 Lakh ticket segment. The sourcing amount is still largely within the <50,000 ticket segments. Fintech have established a healthy market share within the <1 Lakh ticket segment.

Net 90+ on Personal Loan has remained stable in recent times. Even though the delinquencies have remained stable it is still almost double within the low - ticket segment as compared to their overall portfolio.

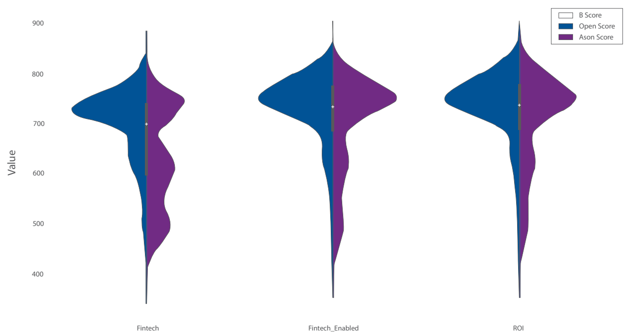


Figure 28 : Bureau Score Migration Across Lender Categories

Sourcing Characteristics - Ticket Size

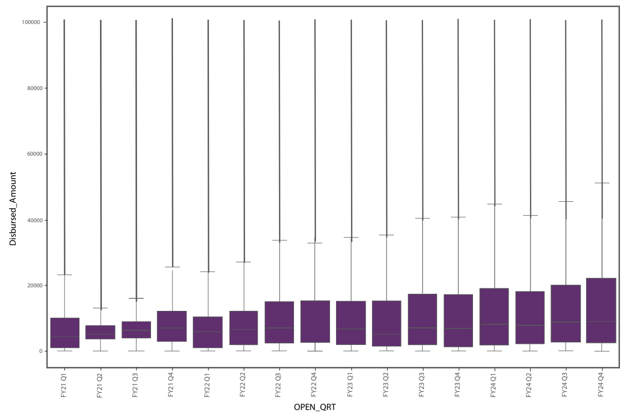


Figure 29 : Ticket Size Distribution for PL <1L for Fintech

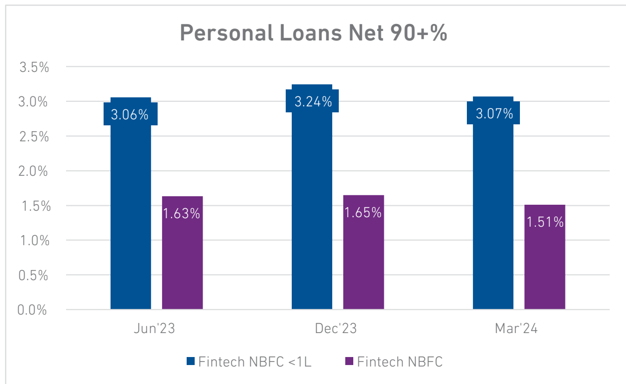


Figure 30 : Net 90+% For Personal Loan (Mar.24)

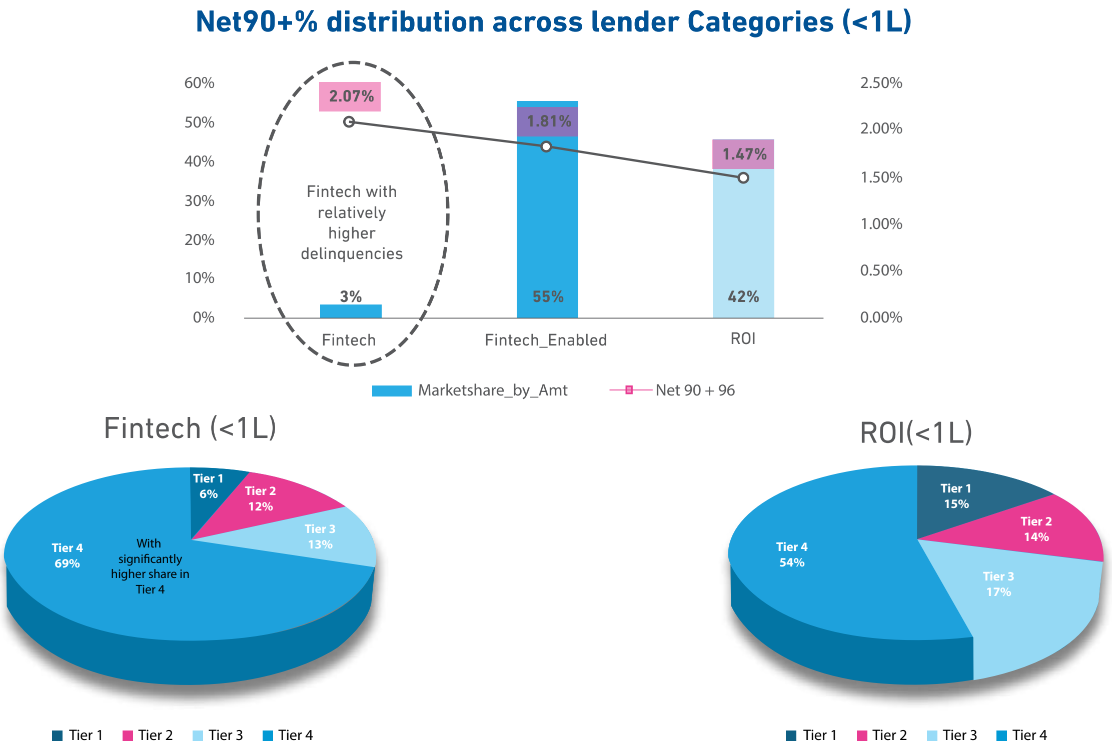


Figure 31 : BL Market Share and Net 90+% (Mar'24)

Fintech's having high delinquency in Business loan as compared to peers this could be they are more focusing on Tier-4 cities while new customers' acquisition.

ECL and Interest Rate

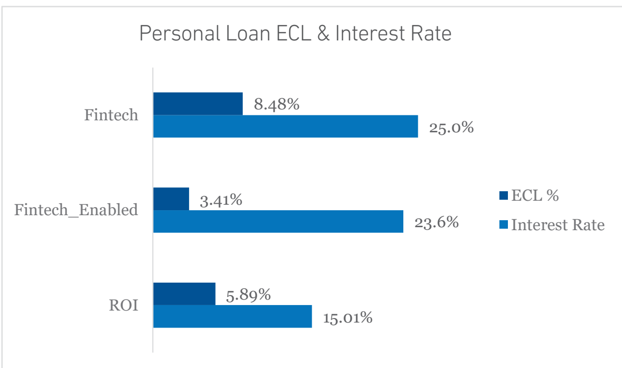


Figure 32 : Personal Loan ECL and Median Interest Rate

Interest rate distribution for across lenders within the <1 Lakh ticket segments is similar for both delinquent and non-delinquent customers. There exists a gap between the customer risk level and the interest rate allocated. This may require a stricter policy criterion or an advanced risk-based pricing methodology.

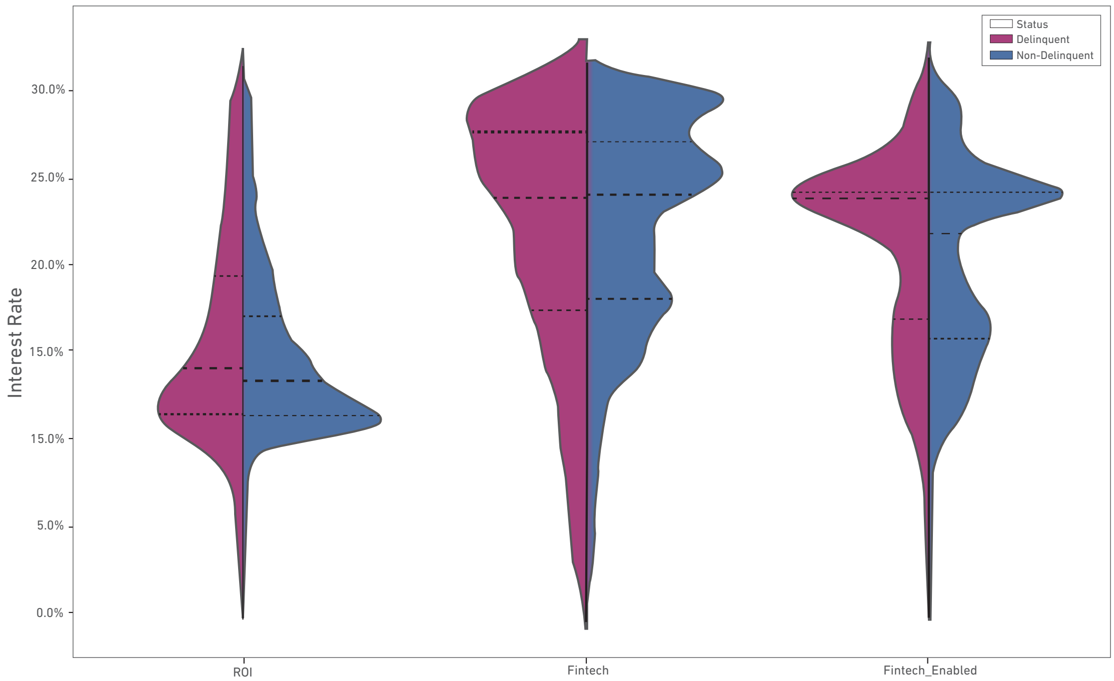


Figure 33 : Interest Rate Distribution Across Lender Categories (FY22, FY23, FY24)

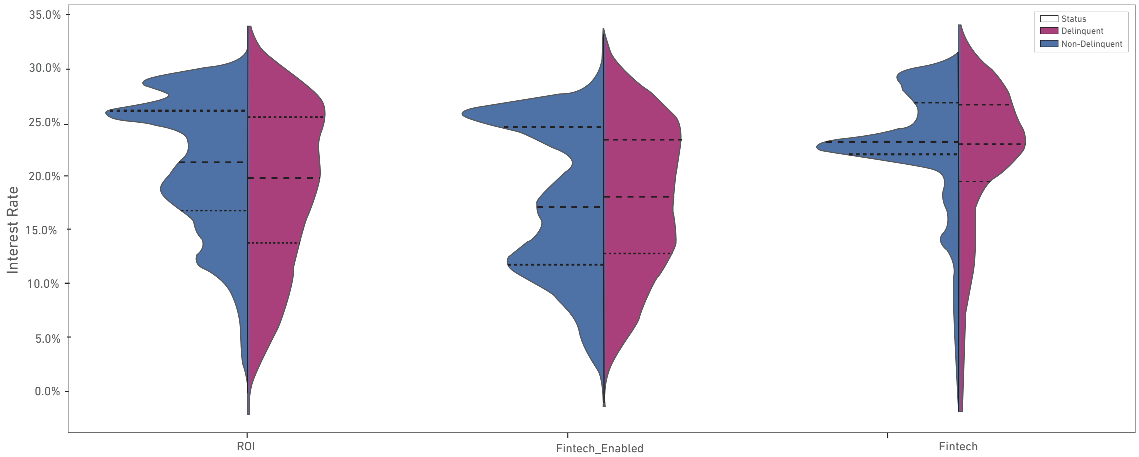


Figure 34 : Interest rate Distribution across lender categories for Business Loans (FY22, FY23, FY24)

3. Navigating the Future-Pathway to Scalability and Profitability

This section explores various aspects that must be considered to achieve scale without compromising on profitability.

3.1 Identify, nurture and lead in niche customer segment before diversifying - lessons from NBFC growth story in India

The emergence of NBFCs in India's lending market serves as a case study in establishing a foothold in a crowded sector. Traditional NBFC started out in India with a competitive disadvantage in terms of funding costs. This disadvantage was compensated for by building deep domain expertise in identified segments (e.g., Vehicle Finance, Housing Finance, Gold Loan etc.).

Resilience of NBFC was tested in the sub-prime crisis (2008) wherein adverse macroeconomic environment and liquidity concerns posed a challenge for their very existence. NBFC responded by strengthening their risk management practice across the value chain like building collection capacity. Once the tide was over, they diversified to adjacent segments and earned their right to win.

Fintech NBFCs have faced similar challenges, if not more. Funding winter, Covid pandemic has tested their resilience. It is important for fintech to take a leaf out of the NBFC playbook. Fintech needs to pivot towards a greater focus on asset quality and portfolio sustainability, even if this comes at the expense of growth. Adjacent markets (beyond pure consumption or working capital loans), where core competencies can be leveraged to the maximum, must be identified.

3.2 "One customer. Multiple Products. One-stop Services"- Reset for profitability using Ping An Playbook

Ping An's business philosophy is simple: shift from a product-centric approach to a customer-centric one. Every investment they make is in line with this philosophy. In 2015, Ping An developed its own cloud-based application called OneConnect, which provides users with a wide range of financial, healthcare, and lifestyle services.

Beyond traditional digital services like mobile banking and payments, it integrates wealth management tools, investment options, insurance purchases, peer-to-peer transfers, and bill payments. Ping An has adopted microservices architecture to enhance the scalability and flexibility of its digital platforms. It has developed several fintech platforms that solidified its position in the industry by focusing on user experience and personalisation.

- **Lufax:** An online finance marketplace launched in 2011, addressing the loan demands of small and micro business owners. It later became a major player in digital wealth management.
- **Ping An E-Wallet:** Introduced in 2012, providing a range of digital financial services.
- **Credit Approval Program:** Developed in 2017 using AI to streamline credit approvals.

By forming strategic partnerships and collaborations, Ping An has been able to offer comprehensive solutions that cater to a global audience, ensuring its services are accessible and compliant with different regulatory and market environments.

The story of Ping An is simple: build capacity and leverage it for diverse use cases, thereby providing value to end customers.

Back home many fintech have transformed to provide value addition on the back of capacity already developed. Consider Ola Money, which has transformed from a simple digital wallet into a financial companion for both drivers and riders. Drivers can now access instant loans through their app, while riders enjoy micro-insurance coverage for their journeys. Or take Flipkart Pay Later, which has seamlessly integrated credit into the e-commerce experience, offering interest-free periods and flexible EMI options based on a user's shopping history.

Most intriguing is the case of Khatabook, a digital ledger app that evolved into a full-fledged financial services platform for small businesses. By offering working capital loans, insurance products, and payment gateway integration, bringing formal financial services to a segment that has long been underserved by traditional banks. The growth of multiple Super app in India is also a step forward in enhancing customer centricity.

The key lesson for fintech is that the technology stack should be fungible across use cases and must keep customer value proposition at the center. This enables return on investment as well as scalability.

Source: https://asia.nikkei.com/Business/Company-in-focus-China-s-Ping-An-puts-the-tech-in-fintech

https://www.ft.com/partnercontent/ping-an-insurance/how-integrated-finance-ecosystems-are-empowering-millions-in-china.html

3.3 Identify stars of tomorrow, today! - Opportunities to diversify to new product segments

We believe opportunities in Green Finance, Agriculture, Education and MSME hold maximum potential for fintech to scale up in the short to medium term.

Sustainable and Green Finance

Green fintech solutions are gaining traction. Global green fintech market expected to grow 22.4% annually from 2024-2029. The Indian government has set ambitious climate goals, aiming to reduce carbon emissions intensity by 33-35% by 2030 and achieve net-zero emissions by 2070. As demand for sustainable finance grows, fintech solutions will play an increasingly vital role in driving positive environmental impact.

For instance, fintech can tap into a new and growing segment of consumers interested in Electric Vehicles, including individuals and businesses (half of the new demand needs to be financed). This is a segment with no clear leaders and lacks a dominant incumbent. Fintech can take lead in this segment like what they did in consumption finance.

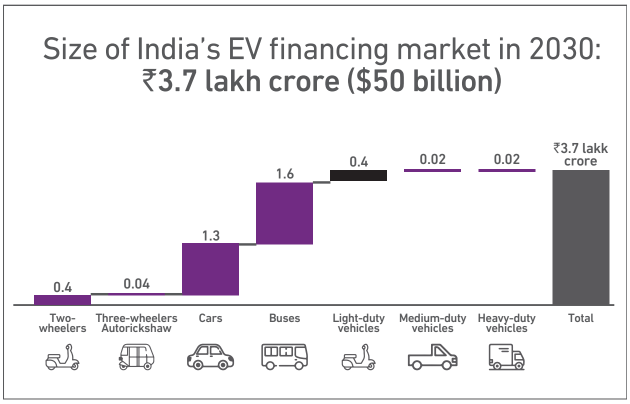


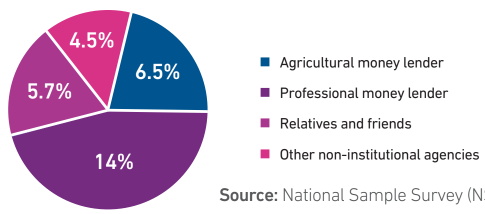
Figure 35 : EV Financing Market in 2030

Embifi, Loantap Financial Technologies, Mufin Green Finance, Revfin are some of the fintech who have already forayed in this field.

Agriculture Finance

The farm economy in India relies heavy on non-institutional sources of credit (read: informal credit). The benefits of credit formalisation are immense including improved accessibility, favourable terms of credit.

All India (%) of loan outstanding from non-institutional sources of credit



Source: National Sample Survey (NSSO 2019)

Figure 36 : Loan Outstanding from non-institutional credit sources

Implications for fintech:

- **Inclusive Financial Services:** There is a significant opportunity to enhance financial inclusion for small and marginal farmers by leveraging digital platforms and mobile banking solutions.

- **Microloans for Smallholders:** Develop microloan products tailored for smallholders (below 1.0 hectare) who form the majority. These loans should have flexible repayment options and lower interest rates.

- **Tiered Financial Services:** Accurate credit scoring models and risk assessment tools can be developed using agricultural data to support small-scale farmers effectively. Offer tiered financial services based on land size categories, ensuring that each group gets products suited to their needs and capacities.

https://www.credable.in/insights-by-credable/business-insights/financing-the-future-how-fintechs-are-accelerating-indias-electric-vehicle-revolution/

https://www.nabard.org/auth/writereaddata/tender/1201243818assessing-the-state-of-affairs-in-indian-agriculture-with-a-focus-on-credit-insurance-and-storage-marketing.pdf

Land registry is an unfinished agenda in India. This puts ~6 crore farmers in India at a disadvantage when it comes to getting access to formal credit. Lenders find it challenging to underwrite applications from farmers without information on available collateral.

The Union Budget 2024-25 proposes to implement Agri stack, the DPI for agriculture over the next three years. This will prove to be a boon for farmers as well as fintech who would then be able to replicate the "PL Model" in agriculture.

The digitisation of Kisan Credit Card (KCC) issuance opens new avenues for fintech companies in the agricultural sector. By leveraging technology, fintech can streamline the KCC application process, improve credit assessment for farmers, and provide value-added services like crop advisory and market linkages.

3.4 Open Banking provides a big opportunity to enhance accessibility among underserved segments

Open Banking is a financial technology innovation that allows third-party payment service and financial service providers to access consumer banking information, such as transactions, balance history, spending habits, and recurring payments (including service subscriptions, loans, and credits). This system is designed to promote competition and innovation in the financial services sector while providing consumers with more choices and better services.

Open Banking: Enhancing the Existing Lending Landscape

- **Enhanced Security:** Open Banking offers greater security compared to traditional methods like screen scraping, as consumers do not need to share their passwords or login details with anyone other than their bank or building society. This reduces the risk of fraud and unauthorised access.

- **Consumer Control:** Consumers have greater control over their financial data and can choose which third-party providers they wish to share their information with. This transparency and control build trust and empower consumers to manage their finances more effectively.

- **Innovation and Competition:** By enabling access to banking data, Open Banking encourages competition among financial service providers. New entrants can develop innovative products and services tailored to consumer needs, often at lower costs due to reduced IT overheads.

- Improved Financial Services: Open Banking allows for the development of personalised financial products and services, such as budgeting tools, financial planning services, and tailored loan products. These services can help consumers make better financial decisions and improve their overall financial health.

Where are we: Open Banking in India

The Indian lending market has matured significantly, supported by the rapid penetration of smartphones and advancements in digital technologies. Supply-side technologies such as Infrastructure-as-a-Service (IaaS), Platform-as-a-Service (PaaS), and Software-as-a-Service (SaaS) have enabled new tech-driven entrants to participate in the retail banking sector with lower IT overheads.

- **Digital Landscape:** India's digital landscape is robust, with a significant portion of the population using smartphones and internet services. This widespread digital connectivity provides fertile ground for the adoption of Open Banking.

- **Regulatory Support:** Regulatory interventions in India are evolving to support Open Banking initiatives. These interventions are designed to ensure consumer protection, promote competition, and foster innovation in the financial sector.

- **Market Maturity:** The Indian lending market is increasingly sophisticated, with a growing number of digital lending platforms and fintech companies offering a variety of financial products. Open Banking can further enhance this ecosystem by providing companies with access to consumer banking data, enabling them to offer more competitive and tailored products.

Top strategic priorities for Indian lending market reflect digitalisation, cloud technology and advanced analytics

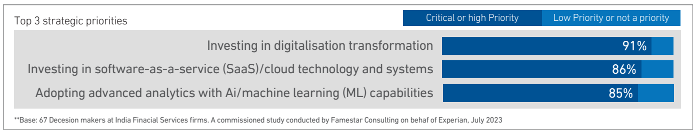


Figure 37 : Strategic priorities for Indian lending market

How Experian helps leverage Open Banking Capabilities

Data from banking transactions will be collected and verified to ensure its authenticity. To score customers, various variables need to be created and tested.
The selection of these features will be based on their statistical significance.

- Instantly categorises transactional banking data relating to consumers using powerful, continually improving Machine Learning (ML) based on highly localised data sets
- The outputs take the form of multiple actionable customer insights that provide a comprehensive view of the customer's behaviours and risks
- We then provide you with the visualisation tools and support to help you to optimise these insights within updated risk scores, models, and strategies

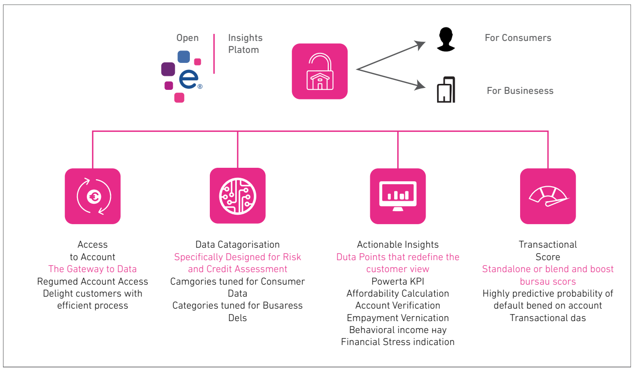


Figure 38 : Strategic priorities for Indian lending market

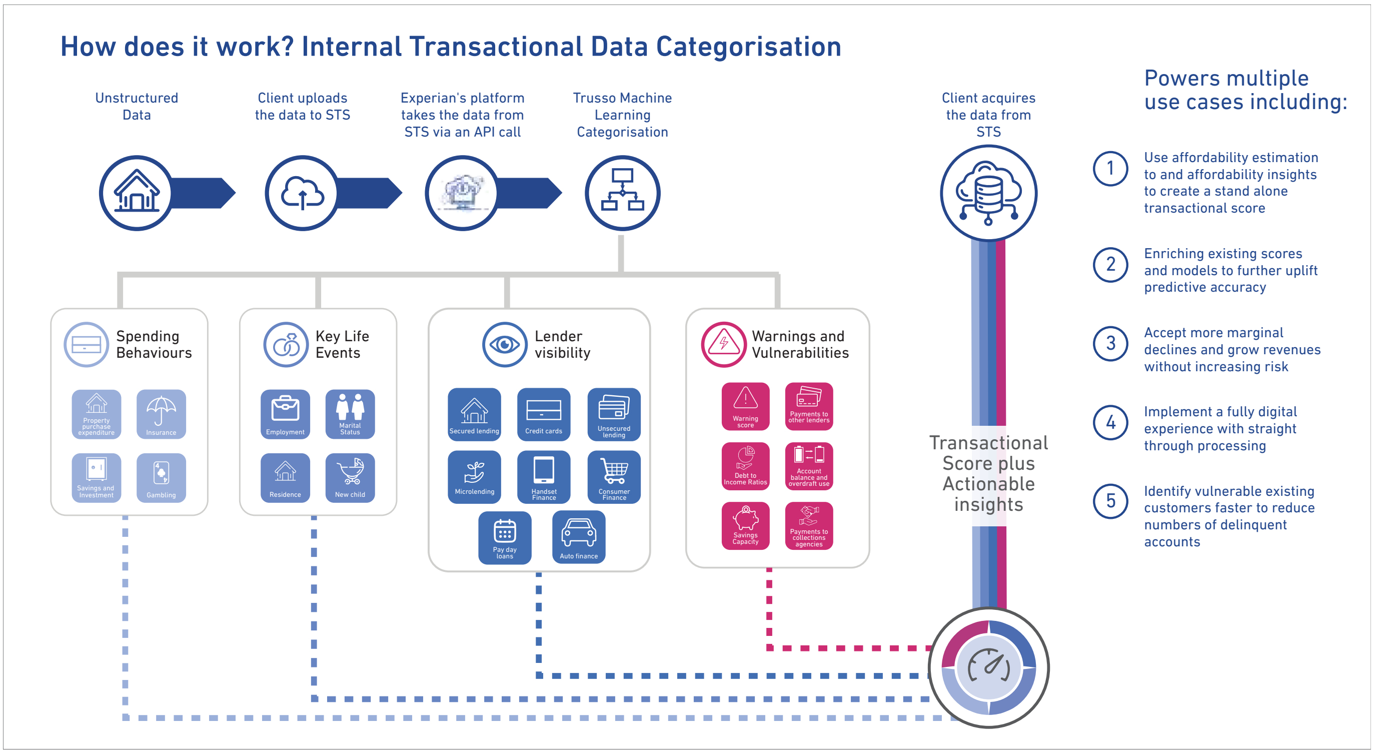


Figure 39 : Transactional Banking Workflow

Where can it be used?

- It can be used to prospect, Originations, and portfolio management, whenever it is required to predict probability of default.
- The Transactional Score can run as a stand-alone score or as complement to enrich client's scores.
- Transaction Score can be used to create a risk view on customer without any dependency on Bureau data-based features. The key segment where the Transaction Score (Prism) can be deployed will be New To Credit (NTC).
- Even for customers who have Bureau foot print Prism can be used to enhance the risk assessment since Bureau and Transaction data sets are orthogonal in nature.

3.5 MSME Lending-Everyone is talking about this, but can fintech solve the $530 billion credit gap puzzle

According to a CRISIL report, the biannual working capital requirement for businesses stands at ₹70 trillion, with only 25% sourced through formal channels. This reliance on informal sources leads to high capital costs. A significant structural issue with liquidity is due to an extended working capital cycle, higher working capital cycle and small band width from creditor. Including NBFCs in the TReDS platform is anticipated to help boost the economy, generate employment, and support the government's aim of achieving a $5 trillion economy.

The government's initiative to ease credit flow to the MSME sector, as highlighted in the budget, is expected to significantly benefit digital lending startups. These MSME-focused digital lenders aim to leverage credit guarantee schemes to better reach smaller businesses. Despite 46.9 million MSMEs being registered on the Udyam portal, only 82,000 are registered on all TReDS platforms, indicating substantial potential for growth. Since the pandemic, the volume of transactions on TReDS has consistently increased, with invoices uploaded and financed through TReDS seeing a 56% increase in FY2023 and a success rate of 94%.

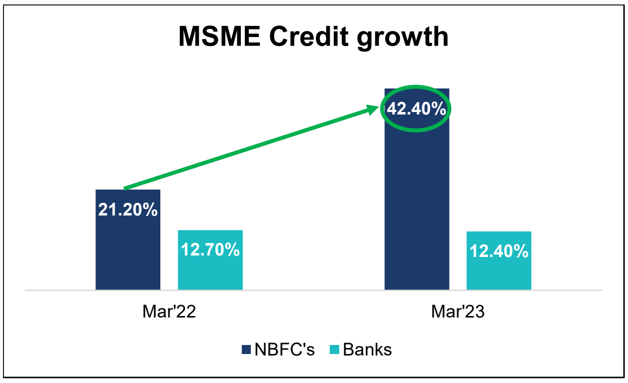


Figure 40 : MSME Credit growth in 1 year

Additionally, the enhancement of the Mudra loan limit to ₹20 lakhs for entrepreneurs who have successfully repaid previous Tarun loans will enable banks to offer larger credit to quality borrowers. The new credit assessment model based on digital footprints will further improve access to credit for small businesses. This presents an opportunity for fintech companies to leverage advanced technology to assess the credibility of applications using limited data.

RBI - Regulatory Sandbox

The RBI introduced its Regulatory Sandbox program, which operates on a thematic cohort basis. Each cohort focuses on specific areas such as retail payments, cross-border transactions, or MSME lending.
A Regulatory Sandbox facilitates live testing of innovative financial products and services in a controlled environment under RBI supervision. It enables regulators, financial service providers, and customers to conduct field tests, gathering evidence on the benefits and risks of new financial innovations while managing these risks.
Five entities were selected in the RBI's Regulatory Sandbox scheme. Out of the 5 entities, 2 proposed solutions for MSME financing:

- Finagg Technologies proposes a blockchain-based deep-tier vendor financing solution for MSMEs in the procurement supply chain of large enterprises.
- Indian Banks' Digital Infrastructure Company (IBDIC) offers a solution to make easy and affordable credit, accessible to lower-tier/small MSMEs.

https://www.drishtiias.com/daily-updates/daily-news-analysis/comprehensive-framework-for-a-regulatory-sandbox#:~:text=Thematic%20Cohorts%3A%20The%20RBI%20sandbox,lending%2C%20digital%20KYC%2C%20etc.

RBI selects 5 entities under its regulatory sandbox scheme - The Economic Times (indiatimes.com)

4. Summary and Recommendations

Fintech lending has now covered significant vintage, and an objective view can be taken on what the experience has been in terms of market penetration as well as asset quality. Thi s White Paper has taken both qualitative and quantitative approaches in studying the impact of fintech lending. The following are key highlights of this report:

- Fintech has taken a dominant position in the small-ticket personal loan and business loan segment. At the end of FY24, fintech portfolio AUM on a personal loan (PL) stood at 2,48,006 Crores with a market share of 52% and 25% on new sanction count and amount respectively in FY24. Business loan (BL) AUM at the end of FY24 stood at 28,607 Crores with a market share of 16% and 21% on new sanction count and amount respectively in FY24. In FY24, the fintech market share for PL<1 Lakh and BL<1 Lakh segments is dominated by several states:

  - **PL<1 Lakh Segment:** Gujarat, Maharashtra, Tamil Nadu, Bihar, and Uttar Pradesh hold over 50% of the market share. Bihar, Tamil Nadu, and Uttar Pradesh have experienced significant growth, with increases of 24%, 21%, and 20%, respectively.

  - **BL<1 Lakh Segment:** Gujarat, Maharashtra, Tamil Nadu, and Rajasthan account for over 50% of the market share. Karnataka and Bihar have shown more than double growth in this segment during FY24.

- Fintech has also played the role of an enabler to incumbent lending. Fintech through their best-in-class onboarding experience enables incumbents to source new customers. Customer prospecting and onboarding journeys are enabled by fintech even as the loans get written on the partner balance sheet (typically the traditional lenders). Based on the Experian study we found the AUM of such a business at ₹32,515 Crores for PL and ₹21,450 Crores for BL at the end of FY24.

- Asset quality of fintech needs to be seen from the perspective of segments they are active in. Fintech operates in segments that invariably are either underserved or unserved. These segments (such as low-income, NTC, or Sub-prime Bureau Score) also have inherently higher risk. In some cases, fintech also acts as a lender of last resort to many underserved segment customers and gets prospects who are high risk as their "through the door."

- The Net 90+ on personal loans has remained stable recently, thanks to fintech-enabled lenders implementing strict policy filters during acquisition. However, fintech lenders face higher delinquency rates in business loans, due to their focus on Tier-4 cities and new customer acquisition. The overall delinquency for fintech has been skewed by a few high-rate operators.

- Asset quality worsened in FY23, reflected in an increased slippage ratio, but is expected to moderate in FY24 as the vintage curve plateaus, indicating that the worst may be over. Despite this, the interest rate distribution within the <1 Lakh segment is similar for both delinquent and non-delinquent customers, suggesting that interest rates are not being adequately assessed based on customer risk. Pricing should instead reflect the expected credit loss (ECL) associated with each customer.

- There are certain pockets that need to be examined as this is suspected to comprise customers who are going after spurious consumption (for instance customers with more than three active personal loans) or customers suspected of "evergreening" (customers with a high level of existing debt). Fintech cater to over 30% of personal loans (PL) with terms longer than five years (PL > 5) sourced by the rest of the industry. However, the delinquency rate for this segment is twice the overall delinquency rate.

- If customer experience is a parameter of financial inclusion fintech scores high on this. We found numerous instances wherein fintech was the lender of choice for customers (consider customers who are tagged as Prime due to their high Bureau score but end up taking loans with fintech even with high interest rates.).

Recommendation

- It is time for fintech to pivot to new product segments. This foray need not necessarily be on their balance sheet. Fintech can enable the lending of secured products to traditional players by playing the role of Lending Service Provider (LSP). This collaboration can be a win-win for both, traditional lenders can bring the float while fintech can contribute through their platform and journey experience that delights the customers.

- Our recommendation would be to look at segments such as Green Finance, Agriculture Finance, MSME lending, Education loans, and Used Car loans for the next phase of expansion. Platform monetisation by "renting" the platform and capacity for the larger ecosystem of financial services can help add new revenue streams.

- Incumbents have been embarking on their tech transformation journey and have the ambition to be a platform player just like fintech. The diversity of players makes the market fragmented. In such a scenario each fintech needs to identify their key value proposition and strengthen the same for clear differentiation.

- Fintech also needs to be watchful of stress building on their portfolio in certain pockets. For Fintech companies, being vigilant about the stress in their loan portfolios, particularly in segments like PL > 3, is crucial for maintaining financial health. Effective collection strategies, proactive communication, and building robust collection capacities are essential measures to mitigate risks and ensure sustainable growth. By focusing on these areas, Fintech firms can enhance their resilience and better manage the challenges associated with loan collections.

- Cybersecurity is an area that no player can afford to ignore. We have seen cyber-attacks only increasing in recent times. Hence, any player with long-term ambition needs to invest heavily in this. This is also needed to build trust with not just Customers but also with the regulator. As Digital lending takes a big pie of credit demand regulators are likely to increase supervision and firms need to beef up their preparedness to respond to regulatory compliance requirements.

5. Appendix

Abbreviations:

- **PL :** Personal Loan
- **BL :** Business Loan
- **CD :** Consumer Durables
- **NBFC :** Non-Banking Financial Corporation
- **LSP :** Lender Service Provider
- **P2P Lending :** Peer-to-Peer Lending
- **ROI :** Rest of Industry
- **FY :** Financial Year
- **AUM :** Asset Under Management
- **Ticket Size :** The Disbursal Amount
- **BScore :** Bureau Score
- **ECL :** Expected Credit Loss
- **DPD :** Days Past Due
- **Net90+** = (90-180 DPD)/ (0-180DPD)
- **Slippage Ratio** = Fresh accretion of NPAs during the year/Total standard assets at the beginning of the year
- **KYC :** Know Your Customer
- **API :** Application Programming Interface
- **NTC :** New to Credit
- **ETB :** Existing to Book
- **OPEN QRT :** Open Quarter
- **MSME :** Micro, Small and Medium Enterprises
- **DPI :** Digital Public Infrastructure
- **IBDIC :** Indian Bank Digital Infrastructure Company
- **TReDS :** Trade Receivables Discounting System
- **AI :** Artificial Intelligence
- **ML :** Machine Learning
- **CRISIL :** Credit Rating Information Services of India Limited
- **SaaS :** Software-as-a-Service
- **IT :** Information Technology
- **IaaS :** Infrastructure-as-a-Service
- **PaaS :** Platform-as-a-Service
- **KCC :** Kisan Credit Card
- **Super app :** Super applications
- **E-wallet :** Electronic Wallet
- **EV :** Electric Vehicles

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