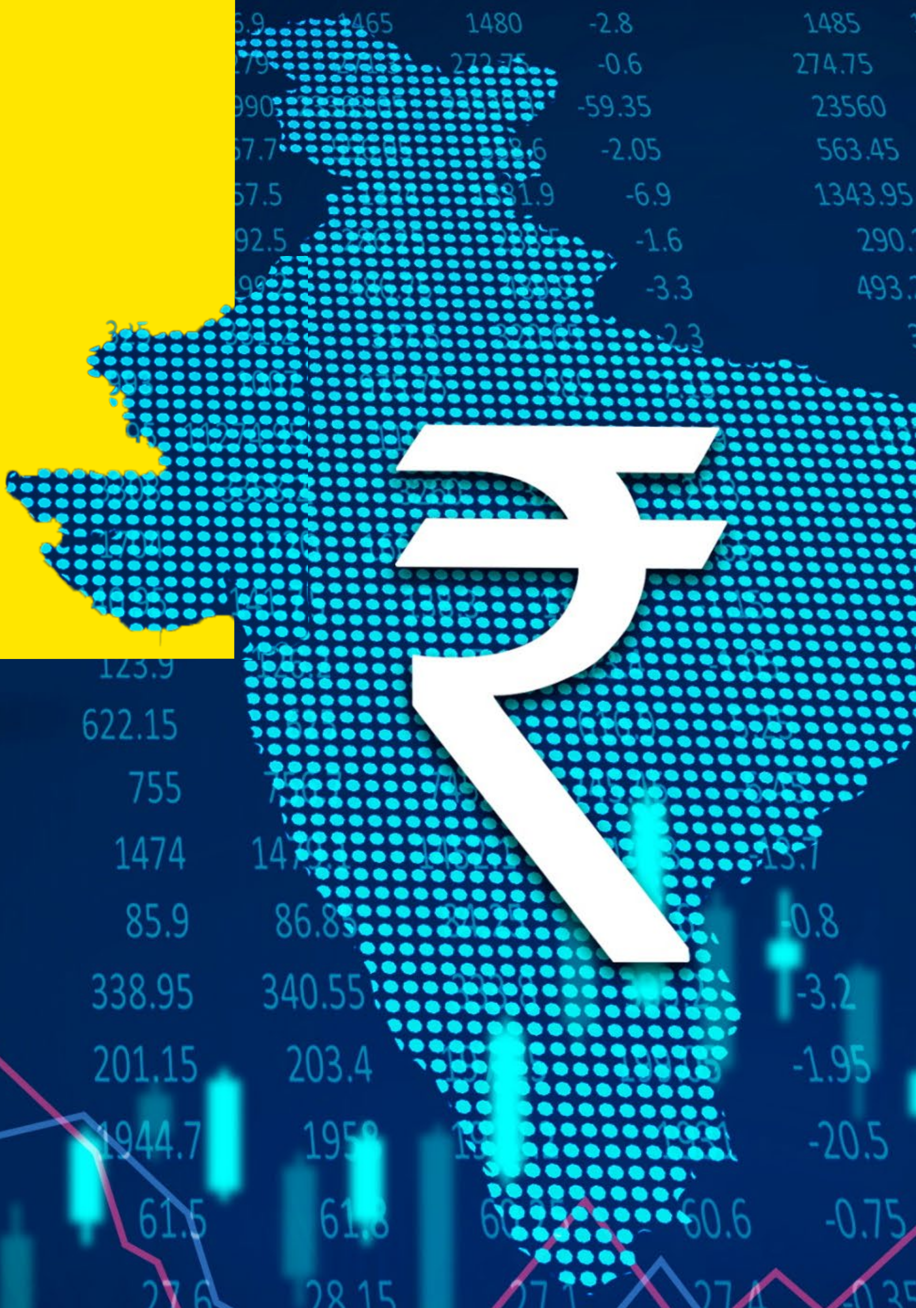
Unleashing potential

The next phase of digital lending in India

September 2023



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Foreword

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DLAI

India's FinTech sector is currently witnessing a remarkable surge, with digital lending emerging as a frontrunner in driving this transformative wave. In collaboration with Ernst & Young (EY), the Digital Lenders Association of India (DLAI) is delighted to present the report titled "Unleashing potential: the next phase of digital lending in India".

Over the past 8 to 10 years, digital lending has traversed a remarkable journey. The sphere has seen substantial growth driven by factors, such as embedded lending, data-driven loan targeting, and innovative business models. Regulatory support from the Reserve Bank of India (RBI) has also been instrumental in fostering this success, with recent guidelines further recognizing and facilitating digital lending.

This report provides an in-depth analysis of the digital lending landscape in India, addressing challenges and opportunities.

As we embark on a journey to explore the next phase of digital lending in India, we invite you to discover the immense potential and navigate the intriguing challenges that await.

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Executive summary

India is one of the fastest-growing nations with household consumption projected to increase to ~INR224 lakh crore (US$ 3 trillion) by FY26, across all income levels. The growing consumption pattern is creating massive opportunities for financial services, particularly credit. However, there continues to be a huge gap in the demand and supply of credit. Credit availability to households and MSMEs in India remains among the lowest compared to global averages.

While scheduled commercial banks have been the pioneers in meeting credit needs, there is a rapid influx of new technology-led players that are driving digital lending transformations. Digital lending in India is at a nascent stage compared to traditional lending. However, it is expanding rapidly with total digital lending disbursement expected to surpass INR47.4 lakh crore by 2026.

Socio-economic factors, demographics, technological advancement, infrastructure, and surge in credit demand are factors unique to India and are driving the growth of digital lending in the country. Digital lending players (LendTechs) are growing beyond boundaries and constitute a significant portion of the overall Indian FinTech market. Their market share is further expected to rise to 60% of the total FinTech market by 2030.

Infrastructure development initiatives, such as eKYC, Open Network for Digital Commerce, Open Credit Enablement Network, etc., and policy-led initiatives such as First Loss Default Guarantee (FLDG) program approval are being targeted towards the promotion of digital lending and are helping solve persistent challenges of Indian lending market. There is also a concerted attempt on the part of the government and regulators to push financial institutions to scale up green/ sustainable digital lending and financial inclusion via collaboration among FinTechs, banks, and NBFCs.

Technology innovation is flourishing across the digital lending value chain. The use of artificial intelligence (AI) can further reorient processes and encourage good lending practices.

However, funding inflows are decelerating, and investors are becoming increasingly cautious of the cash-burning business models of LendTechs. Reassessing existing business models with a focus on increasing scale and profitability is the need of the hour.

Business imperatives can help in mitigating ecosystem challenges. Additionally, the CODE framework has been designed to provide indicative pathways to help LendTechs strategize and build their business models of the future with an inclination towards innovative disruption.

Ripples to waves: Digital lending in India is at a revolutionary stage of growth

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Digital lending in India is at a revolutionary stage of growth

As India continues its impressive growth trajectory, it is poised to ascend from the fifth-largest economy to the world's third-largest, reshaping the global rankings. Despite global economic challenges, India is resilient and growing rapidly, making it one of the world's fastest-growing nations, according to the World Bank[1].

India's growth story relies heavily on consumption, which is considered the primary driving force and foundation. Household consumption is projected to increase from ~INR164 lakh crore (US$ 2.2 trillion) in FY22 to ~INR224 lakh crore (US$ 3 trillion) by FY26[2], across all income levels. The government's strong emphasis on financial inclusion and the steady rise in consumption patterns have led to exceptional growth in India's financial services industry, particularly in credit availability. The demand for credit in the country has consistently increased over the years, with a compounded annual growth rate (CAGR) of 14.4% between March 2000 and January FY23[3]. Approximately, 140 million customers were added to the New-To-Credit (NTC) category between FY19 and FY22, with 57% of NTC consumers concentrated in the rural and semi-urban areas. Consumer durable loans were the most common product taken by NTC customers, followed by agricultural and personal loans[4].

Despite the continuous growth in demand for credit over the years, the unmet credit needs from untapped segments continue to be huge in the country due to various factors such as the high-risk profile of borrowers, insufficient traditional data for risk assessments, lack of collateral, and high costs of service, particularly for those in rural areas who require smaller value loans for personal consumption. The gap is further widening due to the rising credit needs of Gen-Z and millennials and transforming consumer behavior patterns – for example – increasing use of e-commerce and growing traction towards pay-later schemes. Households and MSMEs in India still have relatively low formal credit penetration compared to global averages (Figure 1).

Digital lending in India is at a revolutionary stage of growth, however, the unmet credit needs from untapped segments continue to be huge

[1]https://www.worldbank.org/en/news/press-release/2023/04/04/indian-economy-continues-to-show-resilience-amid-global-uncertainties

[2]CEIC Private consumption, India GDP outlook, EY analysis

[3]CEIC India domestic credit growth

[4]Empowering Credit Inclusion: A Deeper Perspective on New-to-Credit Consumers, Global Research Study, TransUnion

Fig 1 - The credit led opportunity gap in India vs. top two largest start-up ecosystems

Total number of MSMEs	32M	44M	64M
MSME credit penetration	50%	37%	14%
Retail credit penetration	75%	55%	11%
Credit card penetration	67%	38%	4%

Source - EY analysis, CII, Avendus, US Chamber of Commerce, Worldbank, OECD

Traditional banks are meeting the growing need for credit, but digital banks, NBFCs, and FinTech companies are using technology to offer new business models and products that expand credit access.

1

The digital lending ecosystem in India is evolving rapidly

The lending industry in India is undergoing a significant transformation as it moves away from traditional lending methods towards a more digitally focused approach. This revolution is reshaping the way borrowers access funds, making lending more convenient, efficient, and accessible than ever before (Figure 2).

12X growth in digital disbursements between 2017 and 2020

Fig 2 – Digital lending provides significant advantages compared to traditional channels

Traditional lending		Digital lending
Banks, NBFCs	**Key players**	Tech-savvy banks and NBFCs, Neobanks, LendTechs, etc.
Funds for investment are in the hands of few VC or PE firms	**Investors**	Multiple sources such as VC/PE firms, accelerators, govt. Grants, etc.
Credit score and income statements	**Risk assessment**	Enhanced credit scoring using alternate data, advanced algorithms, AI/ML
Relies heavily on physical documentation which results in weeks of processing time	**Operations**	Relies on digital and online channels which uses advanced technologies to reduce processing time to minutes
Human Biases/Errors with limited CX	**Customer experience (CX)**	Personalized experience through AI and data
Mostly in urban areas	**Accessibility**	'Accessibility to all' is the fundamental principle of digital lending

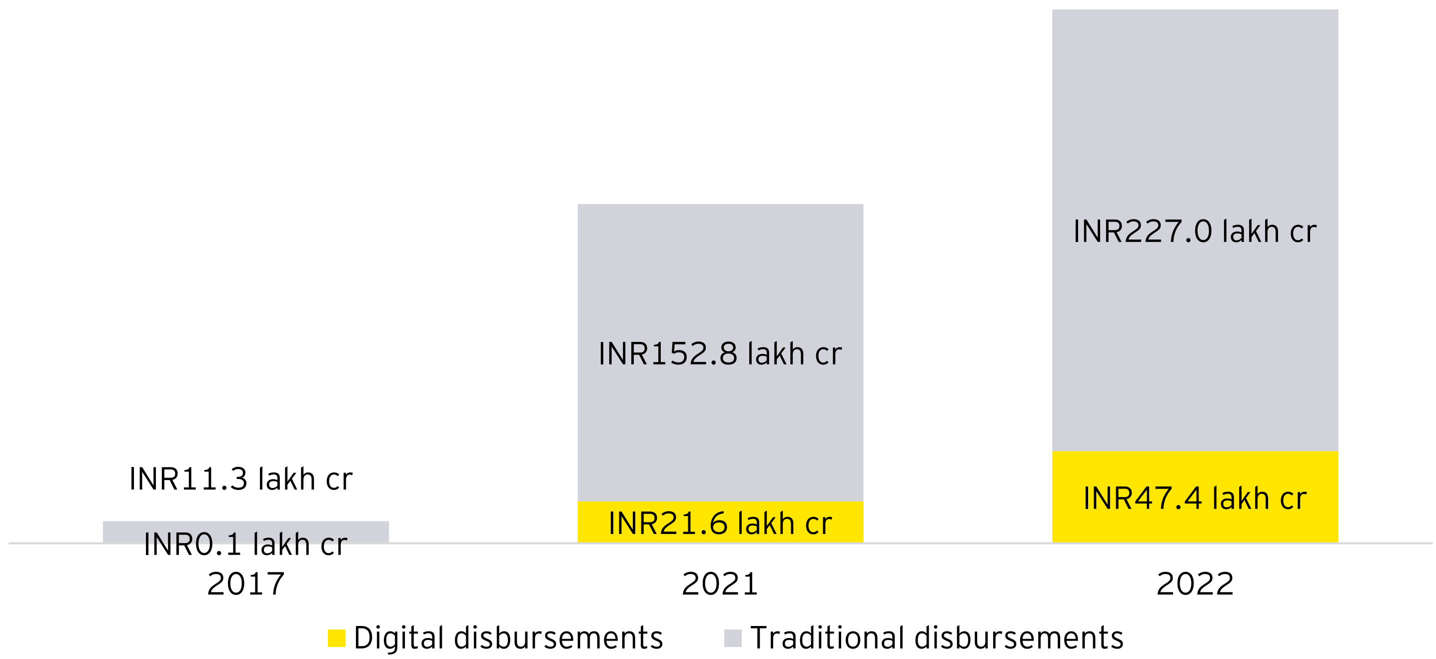
Source: Inc42

[1] RBI
[2] Praxis – Emerging opportunities for digital lending

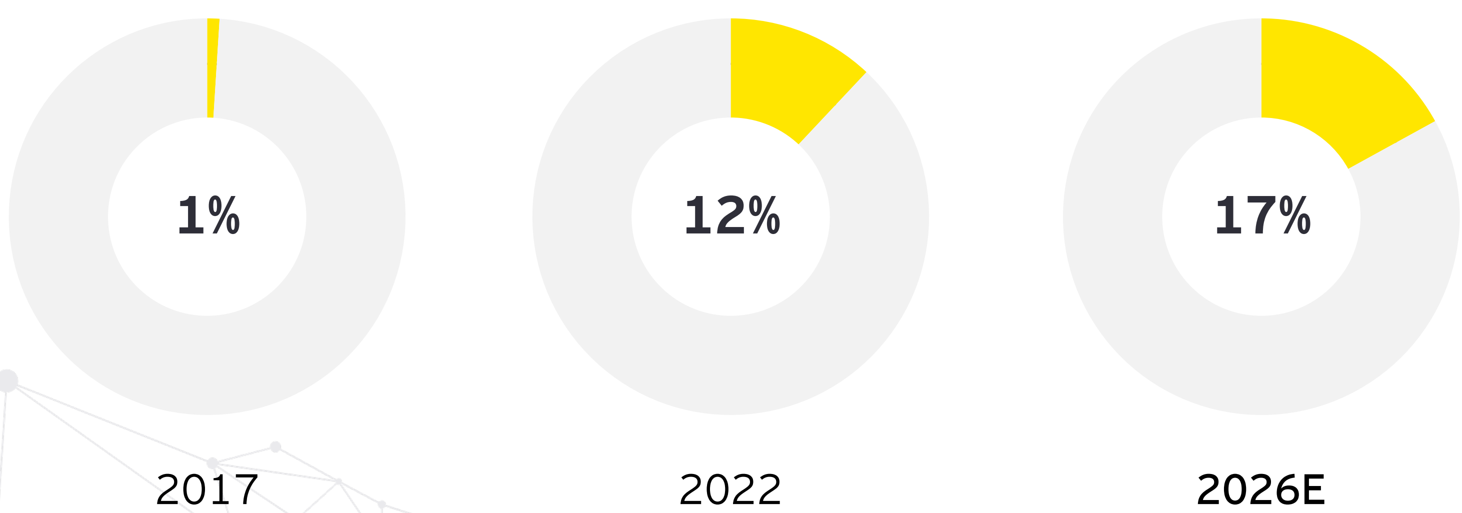
Although digital lending in India is still in its early stages compared to traditional lending, it is snowballing. From FY17 to FY20, digital disbursements grew by over 12 times . As per estimates, the digital lending industry is poised for impressive growth. It is estimated that the total disbursements would reach more than INR47.4 lakh crore by FY26, up from INR21.6 lakh crore in FY22, representing a CAGR of 22% while the overall disbursements (traditional and digital) would grow at a CAGR of 12% during the period (Figure 3).

Fig 3 – Disbursements via digital channels continue to garner a higher share of overall disbursements

Disbursement in India lending market, traditional vs. digital, 2017-26E



Share of disbursement in India's lending market, 2017-26E



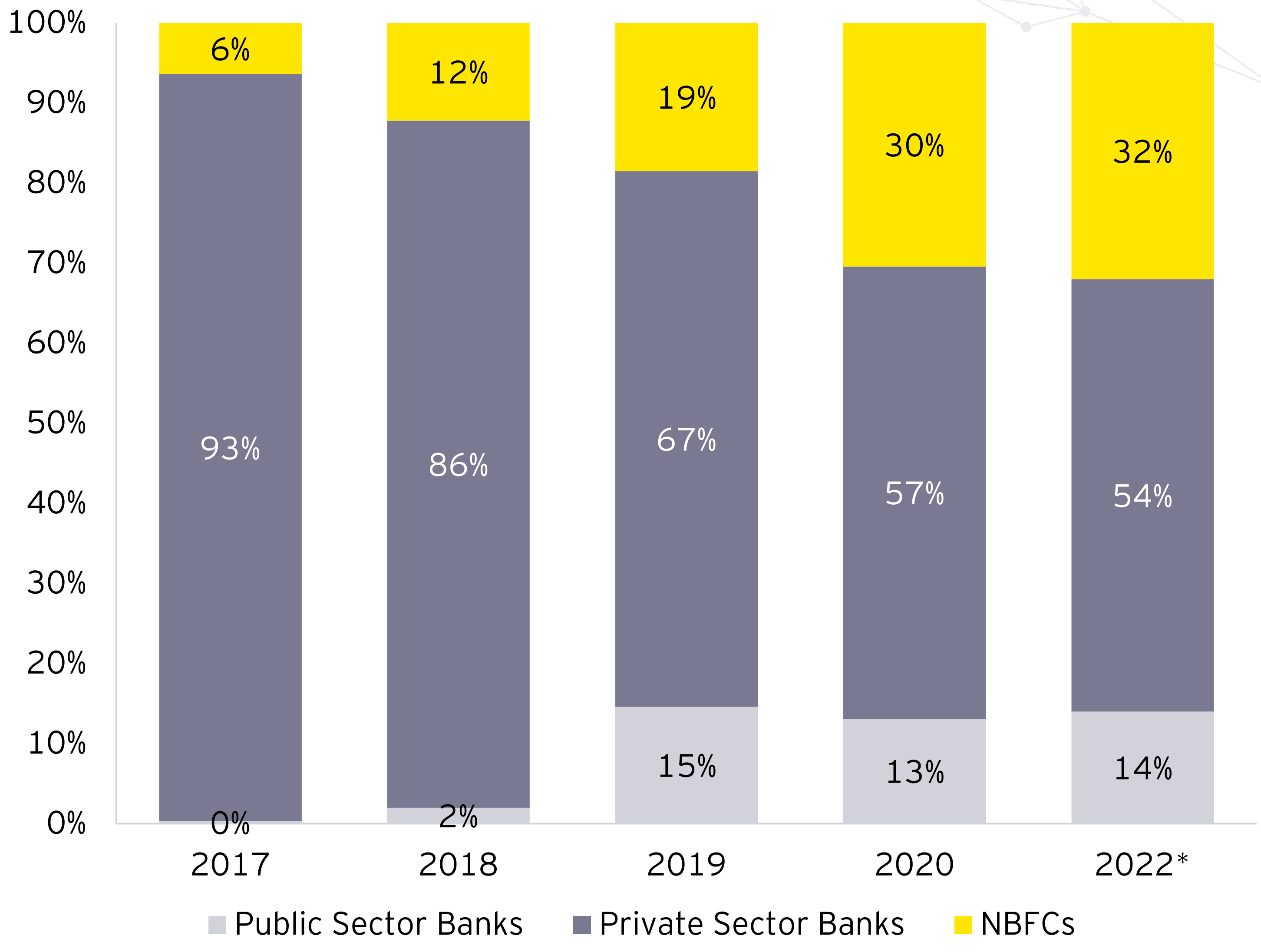
Source: Praxis – Digital lending report

[5]RBI
[6]Praxis – Emerging opportunities for digital lending

The use of digital payments was mostly by private banks in the beginning, but now NBFCs and FinTech companies are using them more and more. In FY22, the share of NBFCs has risen to 32%, up from a mere 6% in FY17[7] (Figure 4).

Fig 4– The share of NBFCs in digital disbursements has increased materially

Share of different lenders in loan disbursed through digital channels (in %)



**2022 numbers are from an Experian survey*

Note: For 2017-2020 data is sourced from RBI and private sector banks include foreign banks as well.

Source – RBI, Experian

[7] RBI

2

Unique factors are driving the growth of digital lending in the country

The widespread availability of information and technology has spurred the development and distribution of innovative financial services products, facilitating the growth of digital lending in India. Moreover, the growth of digital lending has been driven by various factors on both the supply and demand sides, including low levels of financial inclusion, high levels of smartphone and internet penetration, improving socio-economic factors, and supportive regulatory frameworks (Figure 5).

Strategic developments are creating opportunities for FinTech players and providing an impetus for digital lending

Fig 5 - Key drivers for the growth of digital lending market in India

Socio-economic factors

- **Increase in employment:** Worker population ratio increased to 54.1% in 2022 against 46.8% in 2018.
- **Improving banking access:** 77.3% of people in 2021 had bank account.
- **Higher per capital income:** During 2011-21, Gross national income (GNI) per capita for India increased by ~1.6x.

Increasing smartphone and internet access

Smartphone penetration in India increased to 54% in 2020 compared to 23% in 2016 with the country having the **highest data consumption per user (12GB/month) in the world.**

Enabling public infrastructure

Account Aggregator (AA) Framework, Open Credit Enablement Network (OCEN), TReDS, Open Network for Digital Commerce (ONDC).

Demographic trends

Increase in tech savvy millennial and Gen-Z customers: India had 52% of Gen-Z and millennials in 2021 vs. the global average of 47%.

Digital trail of data and technological advancements

- Interconnected systems and platforms.
- Widespread use of Aadhar, PAN, GSTIN for audit trail.
- Cloud, Big data and analytics, AI, open APIs, automation, etc.

Rise in credit demand

- **Untapped MSME market:** Credit gap of ~INR25 lakh crore.
- **Rising demand for small ticket loans:** 85% of personal loans originations in FY22 were with a value of less than INR1 lakh.
- **Rising gig economy:** India had 7.7 million workers in gig economy and is expected to expand to 23.5 million in 2030.

Source: Ministry of Statistics and Programme Implementation, Worldbank, Nasscom, Statista, Economic Times, Standing Committee on Finance, CRIF, NITI Ayog, EY analysis

The lending market in India is being significantly disrupted by the increasing digital penetration resulting from the proliferation of smartphones, advancements in technology, and the wide availability of data. Extensive transformation in real-time payments, with India leading the way in terms of adoption[8], along with multiple government reforms within India Stack and other open banking initiatives, are further enabling the ongoing trends in lending. These developments have created strategic opportunities for FinTech players and provided a strong impetus for digital lending in the country.

[8] https://www.business-standard.com/article/current-affairs/india-leads-the-world-in-real-time-digital-payments-says-pm-modi-122081500622_1.html

FinTechs are the harbingers of this ongoing transformation

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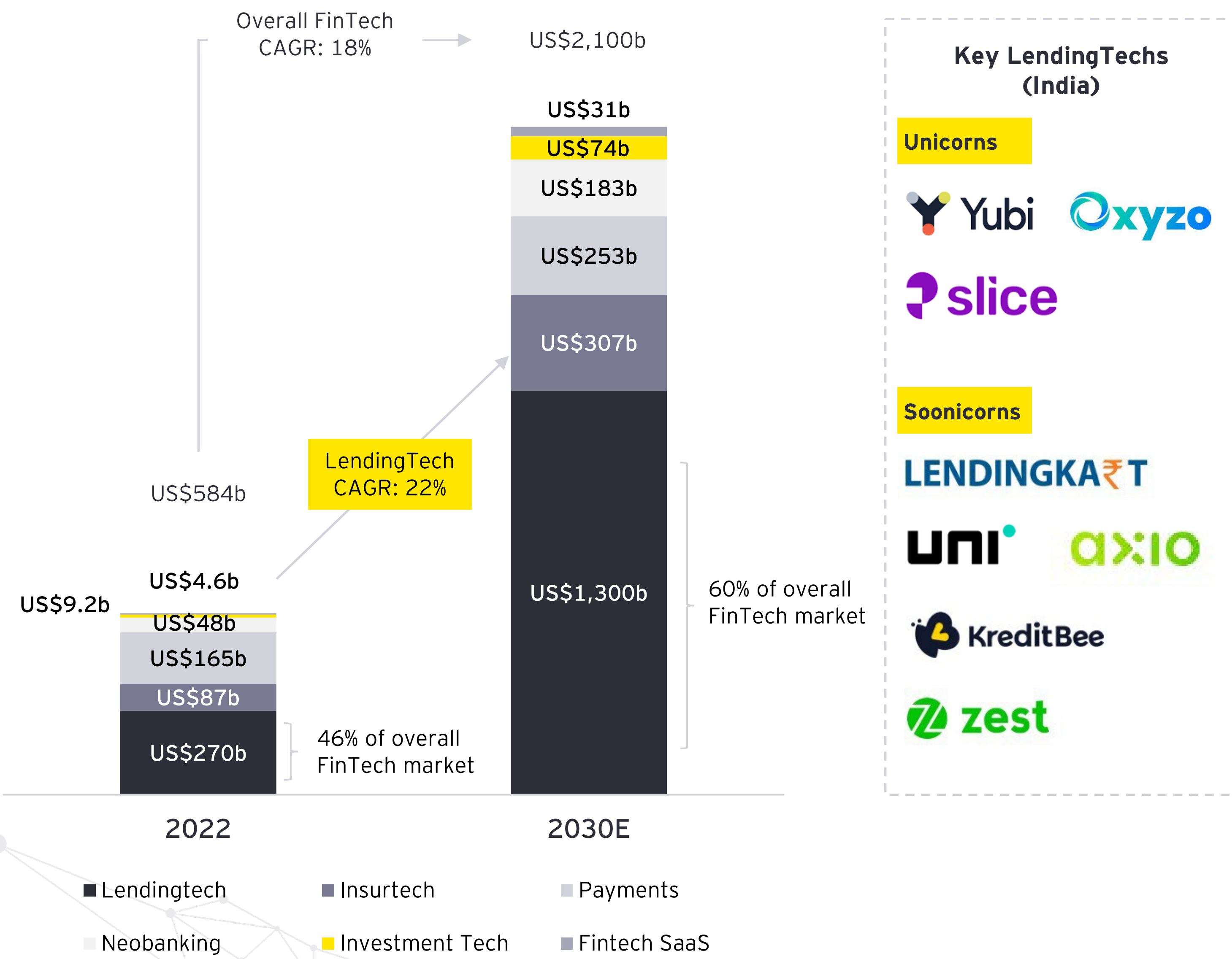
The global financial services industry has undergone significant transformation through the adoption of emerging technologies and innovative solutions, and India's financial services industry is no exception. Furthermore, with India's FinTech adoption rate at 87%, significantly surpassing the global average of 64%, the pace of change has accelerated even more[9].

LendingTechs, which provide digital lending solutions, constitute a significant portion of the overall Indian FinTech market, accounting for 46% of the total market in FY22 and expected to rise to 60% by FY30[10] (Figure 6).

Fig 6 – LendingTechs are the largest contributor to the FinTech ecosystem in India

India FinTech market opportunity (market size), total vs. digital lending, 2022-30E



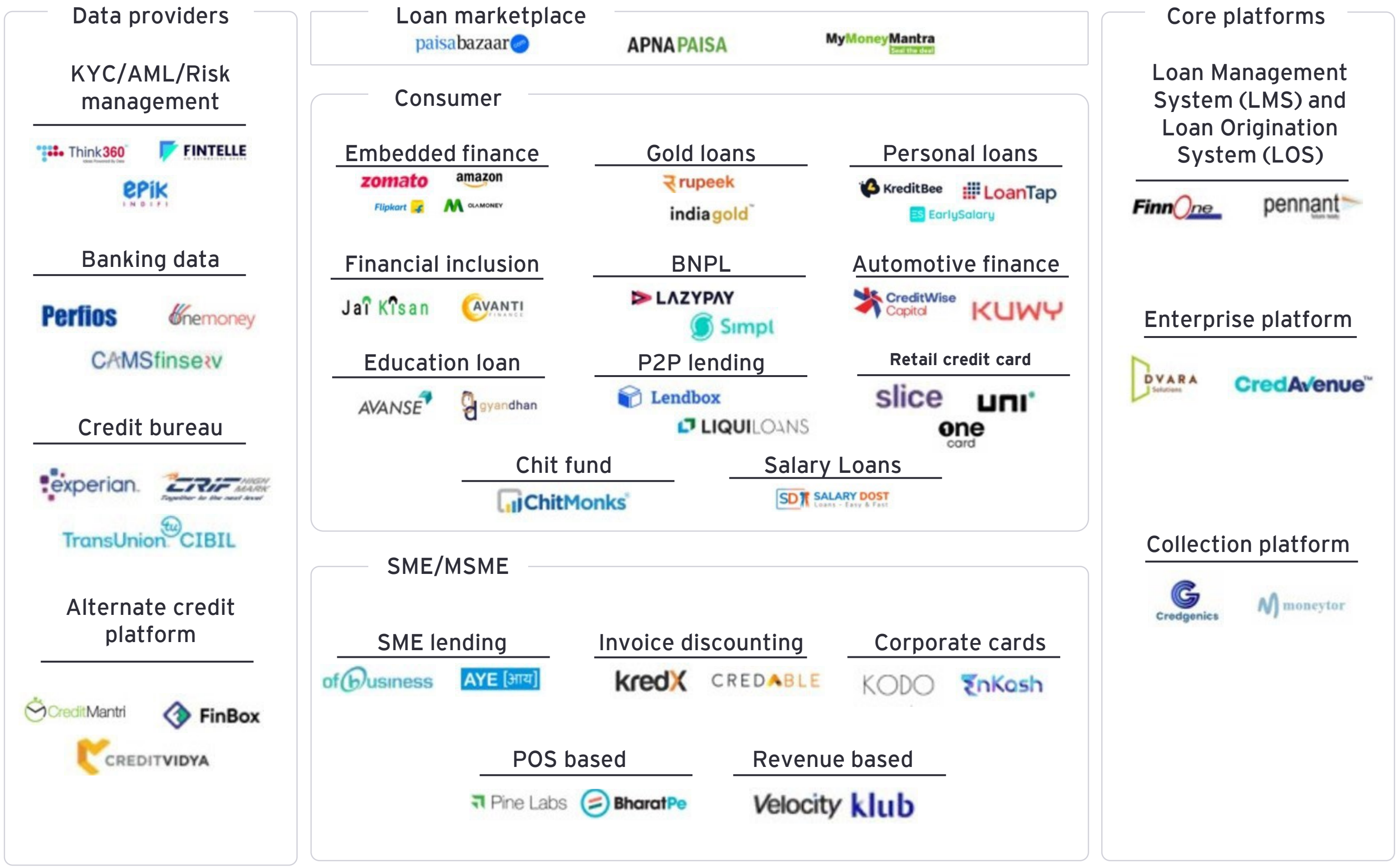
Source: Inc42

[9]Press Information Bureau, Govt. of India
[10]Inc42

FinTechs have played a key role in the digital lending revolution by identifying the needs of the credit-deprived population. They have achieved this through the launch of multiple new business models (like P2P, BNPL, Co-lending, etc.), designing customer-specific product categories, and integrating themselves with various customer interaction points (Figure 7).

Fig 7 – India's LendingTech ecosystem is expanding through the evolution of multiple innovative business models

The unaddressed lending opportunity exists across existing segments, players are building the product and market share by targeting specific customer groups and solving core pain points



Note – The list is indicative and not exhaustive.

Source – EY analysis

LendingTechs have effectively leveraged the demand for quick access to funds through a seamless experience and have made progress in reducing credit disparities based on geography, age, and gender through collaborations with NBFCs and SCBs. Notably, FinTechs have a larger share of customers who are "New to credit" (NTC) or have a credit score below 700[11](Figure 8).

Fig 8 – FinTechs source a higher share of NTC and customers with credit scores <700

The unaddressed lending opportunity exists across existing segments, players are building the product and market share by targeting specific customer groups and solving core pain points

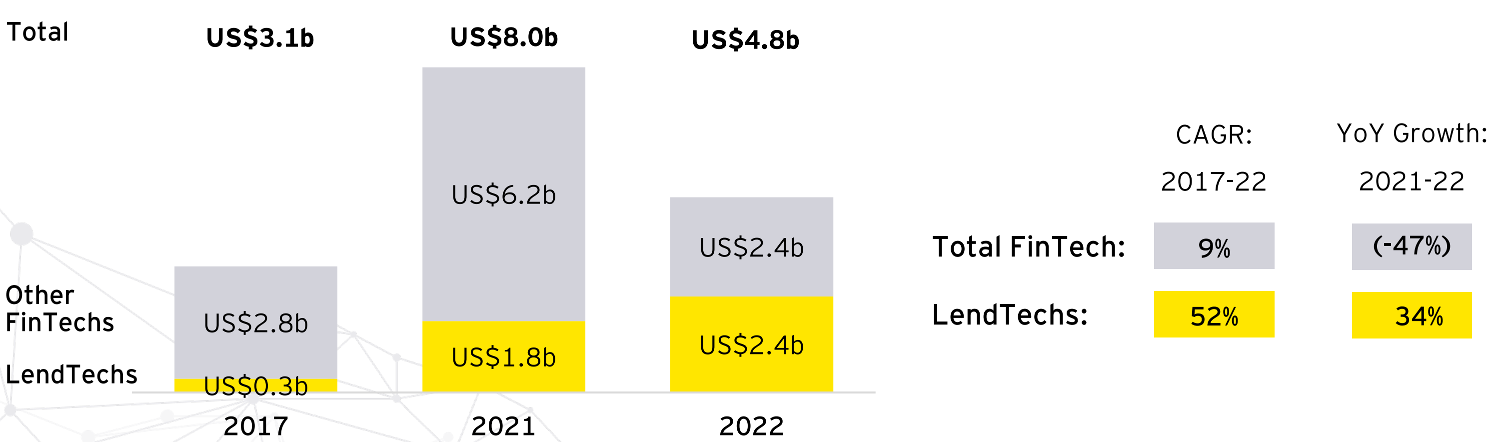
% of customers sourced based on score				
	Fintech		Private	
New to credit	19%		8%	
<=650	17%	48%	10%	28%
651-700	12%		10%	
701-750	30%		30%	
751-800	18%		32%	
>801	4%		10%	

They have also been able to manage better churn in subprime customers (credit rating <700) with 40% of them moving towards Prime categories (credit rating >725)[12].

Given the lucrative and largely untapped market, LendingTechs continued to garner fund inflows from investors despite a 47% YoY dip in Indian FinTech funding in 2022. Funding raised by LendTechs increased by ~34% from FY21 to INR 179 billion (US$2.4 billion) in FY22[13] (Figure 9).

Fig 9 – LendingTech's raised 49% funding of the total India FinTech funding in 2022

Share of funding raised by LendTechs in India's total FinTech funding, 2017-22



[11]Experian
[12]Experian
[13]Inc42, State Of Indian FinTech Report Q1 2023

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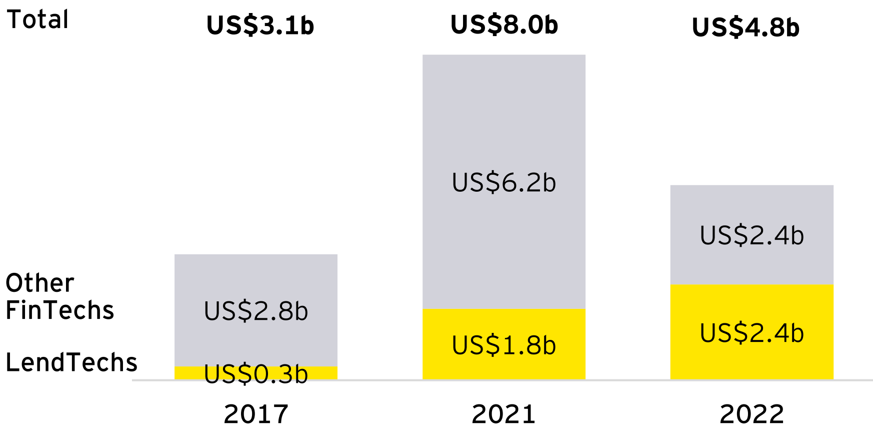
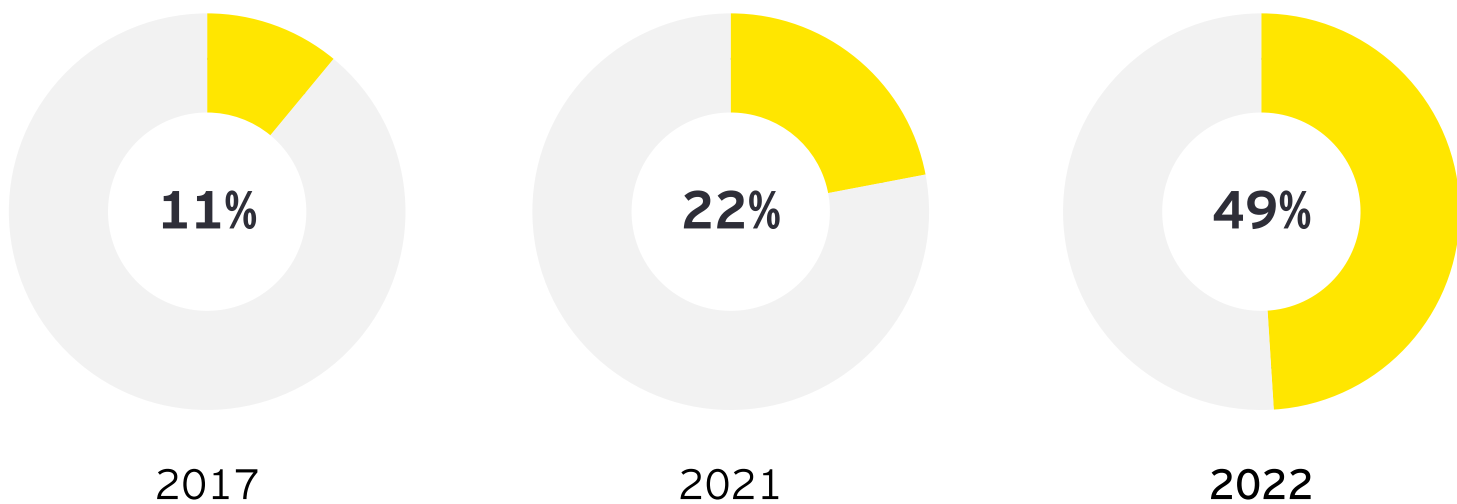


	CAGR: 2017-22	YoY Growth: 2021-22
Total FinTech:	9%	(-47%)
LendTechs:	52%	34%



Source: Inc42

US$7bn

Of cumulative funding has been secured by Lendingtech start-ups over 2014-22.

Source: Inc42

201+

funded digital lending startups across 502 deals.

47.9%

of the total funding was invested in consumer lending players, followed by B2B with 39.4% and the 12.7% for others.

Key takeaway

Positive investor sentiment towards LendTechs could be attributed to numerous other factors, apart from the largely untapped market, like a collaborative regulatory ecosystem, ripening technology innovation across the value chain, etc. **However, there also remain multiple risks and challenges to the overall performance of this segment.**

An organic and collaborative ecosystem is driving the growth momentum

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1

Infrastructure development initiatives are the torchbearers

The lending market in India is facing persistent challenges that hinder commercial momentum. However, the rapid growth of FinTech firms and the increasing demand-supply gap in credit have led to the launch of several initiatives by the Government of India (GoI) as part of India Stack. India stack is a collection of open and interoperable APIs aimed towards building a national-level unified software platform and digital infrastructure. The initiatives launched under the program are reshaping the digital lending ecosystem for a new era, as they aim to promote the use of standardized protocols, advocate transparency, and commoditize lending products (Figure 10).

Fig 10 – Government initiatives are reshaping the digital lending ecosystem for a new era

Government initiatives are reshaping the digital lending ecosystem for a new era

1	2	3	4
Converging demand-supply gap	Safeguarding consumer interests	Lowering financial system risks	Fostering innovation

Source: EY analysis

India Stack, being implemented in phases, has gained remarkable coverage, enthusiasm, and participation from financial institutions, MSMEs, and individuals, especially those previously excluded from formal credit sources. Each initiative of this distinct digital infrastructure adds a layer to connect credit and commerce gaps, creating a more inclusive, efficient, progressive, and sustainable value chain.

Digital lending in India has made significant progress towards creating a **paperless** and **cashless** ecosystem while ensuring **transparency** and **credit availability**, thanks to ongoing government reforms and the implementation of standards (Figure 11).

The striking comprehensiveness of government initiatives are helping credit providers identify the financial services needs of individuals and businesses and are building an inclusive digital economy from the bottom up.

Fig 11 – GoI's initiatives and their impact on digital lending

The unaddressed lending opportunity exists across existing segments, players are building the product and market share by targeting specific customer groups and solving core pain points

Go paperless

Aadhaar

- Since June 2021, 99% of the adult population hold an Aadhaar card
- Aadhaar holders carried out over 90k million authentication transactions, two billion in Jan 2023
- RBI has mandated lenders to include Udyog Aadhaar Memorandum (UDYAM) registration details in the KYC

eKYC

- Aadhaar e-KYC transactions jumped 18.53% to 840.8 million in Q3 of FY 2022-23
- 170 entities including 105 banks are live on e-KYC, as of Jan 2023

DigiLocker

- 100+ financial companies - banks, NBFCs, insurance, e-commerce, digital lenders, payment companies, and FinTechs, are at different stages of integration with DigiLocker
- New Entity DigiLocker will be set up for use by MSMEs, large businesses, and charitable trusts
- Currently, 150 million+ users have used DigiLocker. 90% of users are between the 18-40 age group

Source: (99%), (90k million), (18.53%), (170 entities), (100+), (150 million+), EY analysis

Become cashless

UPI

- UPI 2.0 allowed the linking of overdraft accounts with the platform which was seen as a way to offer credit.
- UPI credit takes 15 minutes, while a plastic credit card usually takes 15 to 20 days to activate

Source: EY analysis

Build transparency

Account Aggregator (AA)

- 94 financial institutions (FI) onboarded as financial information users (FIUs) – regulated by RBI, SEBI, IRDAI, PFRDA
- 26 FIs onboarded as financial information providers (FIPs) including Goods and Service Tax Network (GSTN)
- Enabled 1.1 billion+ accounts and disbursed INR17 billion worth of loans
- Usage penetration is at 0.2% currently, but growing monthly at 50-60%
- Axis Bank increased its loan disbursals by 30% month-on-month since going live on AA

Open Network for Digital Commerce (ONDC)

- Currently, in the pilot stage in Delhi, Bengaluru, Coimbatore, Bhopal, and Shillong. Expected to be rolled out in 75–100 towns across India in 2023
- The target for the next five years is to register 900 million buyers and 1.2 million sellers and generate USD48 billion gross merchandise value (GMV)
- GMV for the e-tail sector in India was at USD38 billion in 2020, projected to reach USD140 billion in 2025 and US$350 billion in 2030, securing the spot for the third-largest online retail industry globally

Source: (94), (1.1 billion+), (0.2%), (30%), (900), (USD350 billion) EY analysis

Credit culture

Trade Receivables Discounting System (TReDS)

- Digital platform for MSMEs to auction their trade receivables at competitive rates through online bidding by financiers and banks
- 45,000 medium and small enterprises are registered sellers
- 35,000 invoices worth INR7,200 crore financed on TReDS every month
- RBI proposed to expand scope of TReDS by providing insurance facility for invoice financing to improve cash flows for MSMEs

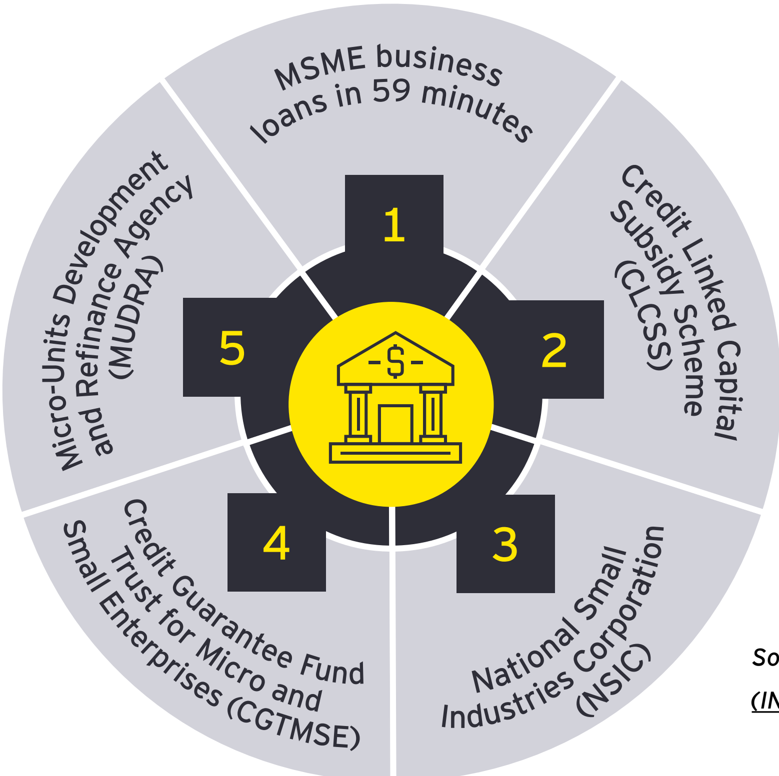
Open Credit Enablement Network (OCEN)

- Provides an API framework to connect LSPs with consumers, thus helping in the democratization of credit and financial inclusion
- Currently in the pilot stage, but has the potential to transform many consumer-facing companies to becoming LSPs through the power of embedded finance
- The global embedded finance market size has a CAGR of 53.71% between 2021-27, while in India the market is expected to hold a 30.4% CAGR between 2022-29

Source: (45,000), (35,000), (TReDS), (53.71%), (30.4%), EY analysis

Apart from digital infrastructure development initiatives, GoI is also launching dynamic schemes targeted towards improving the efficiency of the lending value chain to encourage seamless availability of credit in the country and safe disbursals (Figure 12).

Fig 12 – GoI's schemes and their impact on digital lending



Source: (2.45 lakh), (LendingKart), (INR 2 crore), (INR one lakh), (Walmart), (PHD), EY analysis

1 MSME business loans in 59 minutes

- Allows MSME business owners to get AiP for a business loan of up to INR5 crore in 59 minutes from various public sector banks
- 2.45 lakh loans sanctioned in FY23, up 2.2% Y-o-Y

2 Credit Linked Capital Subsidy Scheme (CLCSS)

- Provides access to subsidized capital to MSMEs. Eligible enterprises can enjoy a capital subsidy of 15% on loan availed from a financial institution
- Recently, the PHD Chamber of Commerce and Industry urged the government to reintroduce the scheme for technology up-gradation for MSMEs

3 National Small Industries Corporation (NSIC)

- Facilitates MSMEs with a set of specially tailored scheme to enhance their competitiveness
- Walmart, Flipkart sign an agreement with NSIC to help MSMEs grow, unlock export potential

4 Micro-Units Development and Refinance Agency (MUDRA)

- Enables borrowers to borrow from banks, MFIs, NBFCs for loans up to INR10 lakh for non-farm income generating activities
- Lendingkart recently partnered with Bank of India for a co-lending agreement to disburse loans under Mudra using its technology platform 2gthr

5 Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE)

- Provides guarantee to enable MSMEs access credit, and reduces guarantee fee for loans up to INR1 crore
- Increased the coverage ceiling under its Credit Guarantee Fund Scheme from INR2 crore to INR5 crore per borrower for credit facilities extended by lending institutions
- Touched the milestone of approving guarantees worth INR1 lakh crore

While financial institutions are under pressure to embrace and adopt new-age technologies, the initiatives and schemes launched by the government are providing them necessary groundwork and a launch pad for upgrading their digital lending software and applications with analytics, unified dashboards, and digital client accounts. This integrated approach being adopted by India to harness innovation in its financial services' DNA, is being lauded the world over.

"Foundational digital public infrastructure (DPI), consisting of unique digital identification, payments system, and data exchange layer has the potential to support the transformation of the economy and support inclusive growth. India's foundational DPI, called India Stack, has been harnessed to foster innovation and competition, expand markets, close gaps in financial inclusion, boost government revenue collection, and improve public expenditure efficiency. India's journey in developing a world-class DPI highlights powerful lessons for other countries embarking on their digital transformation, in particular a design approach that focuses on shared building blocks and supporting innovation across the ecosystem."

- International Monetary Fund, March 2023

2

Tech innovation is ripe across the value chain

The lending ecosystem has undergone a revolution in the past decade, with new technologies and non-traditional players creating a niche market for "value-based credit", prioritizing speed, convenience, and customer service (Figure 14). However, these trends have also led to a complex lending ecosystem, where new players are leveraging technology throughout their processes to outpace traditional banks and fuel innovative products like BNPL.

FinTechs are using the power of technology to build a market for ‘value-based lending’. They are optimizing processes and redefining protocols based on the needs of the credit-deprived category.

Fig 14 - Key factors differentiating value-based lending from traditional lending

Personalizing **digital experience** and customizing lending products

Optimizing **data security** and identity protection with heightened focus on fraud prevention

Creating opportunities for **embedded financial products** across all purchase avenues

Ensuring an **end-to-end digital journey** from origination to servicing

Elevating **connectivity** and scaling and re-purposing data through micro-services architecture run on cloud

Building consumer **trust** in the lender and confidence in their lending journey

Source: EY analysis

FinTechs are using the power of technology to disrupt traditional practices in the lending value chain. They are optimizing processes and redefining protocols based on the needs of the credit-deprived category.

The lending industry has witnessed a significant transformation with the widespread use of advanced technologies and the emergence of digital lending. Digital lending has revolutionized the lending value chain by providing quick access to credit through reduced decision time and faster disbursal (Figure 15).

Fig 15 – The digital lending value chain has transformed into an innovative, simple, and cost-effective process

Digital lending value chain	What has changed?	Technologies and innovations that are endorsing accelerated transformation of lending into value based process
Prospecting Borrower scans through specialized lenders and products and selects the best option	**More variety:** Digital lenders offer competitive interest rates and specialized product suit for borrowers to compare from	▶ Partnerships ▶ Integration of APIs with RPA ▶ Biometric identity verification ▶ Big data analytics
Onboarding Borrower interacts with multilingual chatbots and provides basic details to track identity online	**Convenient and quick application process:** Borrowers apply for loans online. The process is simple, and the application is completed in minutes	▶ Multilingual chatbot ▶ AA framework ▶ Video KYC, facematch ▶ Liveness detection, OCR
Underwriting Lenders make use of alternative data sources to assess credibility	**Quick assessment of credit worthiness:** Digital lenders use advanced algorithms to process applications - loan approval takes few minutes, funds disbursed in few hours	▶ Alternative data sources ▶ Affluence score ▶ Satellite image analysis ▶ Social media activity
Disbursement Borrower is onboarded online	**Transparent lending process:** Borrowers use digital platforms to track loan application status in real-time	▶ User friendly mobile apps ▶ Blockchain ▶ 100% cloud-based infrastructure ▶ Internet of things
Repayment Borrower uses the network and power of digital payments	**Automated and hassle-free payments:** Digital lenders provide flexible repayment options – online, pre-approved payment facilities, automatic debits	▶ The power of digital payments ▶ Initiatives such as eNACH

Source: EY analysis

FinTech (LendingTech) companies have played a crucial role in leveraging advanced technologies to achieve transformation (Figure 16). They have been instrumental in integrating lending and financial services into the daily lives of MSMEs and consumers, which has resulted in substantial investment, partnerships, and the adoption of non-traditional methods among traditional players.

Fig 16 - Leading digital lenders have set high standards of innovation

Examples of leading LendingTechs	The technical prowess of leading digital lenders
Lendingkart[15]	**2gthr:** provides end-to-end asset servicing and customer onboarding journey **xlr8:** enables real-time sourcing, approval, instant payouts, and single window access to monitor service status **Cred8:** credit intelligence platform that provides MSME credit score based on LK proprietary underwriting model **Atom/Zero Touch:** provides modularization of customer journey via micro-processes to provide seamless customer experience, low turnaround time
Mobikwik[16]	▶ Full stack FinTech company provides facilities for bank transfers and loans ▶ Instant 3-minute loan, credit line, term loan ▶ Uses advanced analytics, AI, and machine learning built by its data science Centre of Excellence (CoE)
MoneyTap/Freo	▶ Instant access to approved unsecured funds ▶ Interest payment only on the money spent rather than the whole amount approved ▶ Flexibility to pay back the money in EMIs
Axio	**Tech and underwriting prowess in disbursing loans "in under 3 seconds"**

Source: EY analysis

Traditional banks[14] are also undertaking huge transformation projects to upgrade their processes, products, and services to seize the opportunities from the growing demand for credit. These banks are directing huge[15] funds toward building digital-native products and services based on open API frameworks. Most banks are also undergoing accelerated digital transformation whereby they are launching unified lending platforms that digitize the end-to-end lending process. They are also undertaking strategic partnerships for building scale and technology prowess (Figure 17).

Fig 17 – Digital lending initiatives by traditional banks in India

Upgrade to tech stack

1 HDFC
- Partnered with Microsoft for digital transformation using Azure
- Developing and co-creating in-house intellectual properties (IPs)
- Partnered with Accenture to accelerate digital transformation in lending using cloud-native applications, machine learning, automation and advanced analytics
- Chose Backbase for digital banking

2 ICICI
- Upgraded online banking services built exclusively for small businesses to allow instant and paperless overdraft facility of up to INR25 lakh
- Investing in operating model changes to allow lending to MSMEs based on cashflows and not on solvency

3 Axis Bank
- Started lending through the Account Aggregator (AA) Framework
- Partnered with OPEN to provide fully native digital current account journey to customers

New platforms for digital lending

1 ICICI
- Launched digital lending platform iLens using lending platform from TCS. The platform digitises the entire lending process

2 Kotak
- Launched corporate customer platform fyn - a unified portal for corporate customers to manage bank transactions. The bank plans to introduce a new loan origination and management system that would digitize the lending process

Strategic partnerships

1 HDFC
- Partnered with Flipkart Wholesale to launch co-branded credit card for Kirana members and small merchants

2 SBI
- Working closely with SIDBI, SBI Cards, and other players for rolling out credit cards for MSMEs. Also, working on a risk scoring model that would enable banks to disburse loans to MSMEs through straight-through process (STP) without a bank visit
- Partnered with Yubi Co.Lend to grow co-lending portfolio

3 Axis Bank
- Partnered with Yubi Co.Lend to grow co-lending portfolio
- Partnered with ITC to offer lending services to farmers leveraging ITCMAARS (Meta Market for Advanced Agricultural Rural Services)

Source: Recent news articles, EY analysis

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[14] https://www.expresscomputer.in/interviews/lendingkart-technology-first-approach-for-financial-resiliency/80831/
[15] https://startuptalky.com/mobikwik/

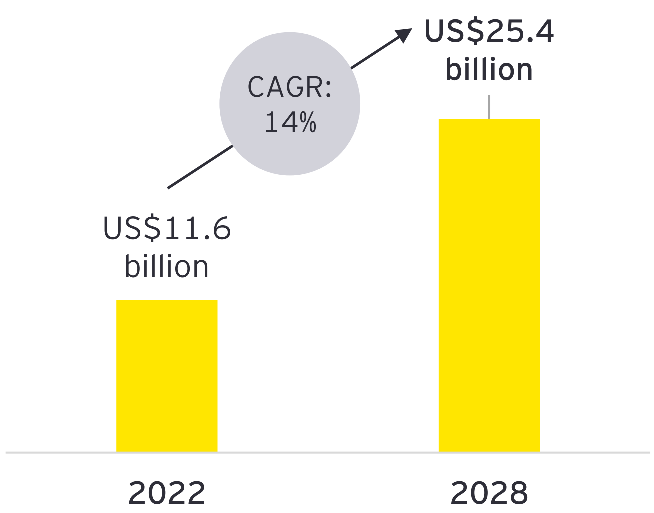
Tech innovation gave birth to BNPL, which is now setting the stage for the growing adoption of embedded finance

The widespread adoption of BNPL in India is experiencing a sustained surge, backed by the expanding reach of e-commerce. This category of products exemplifies the transformative potential of blending payment and lending services. The popularity of flexible payment options, particularly in Tier II and Tier III cities, and a growing interest in short-term, small-sum credit, are key consumer trends driving the growth of BNPL (Figure 18).

This product has captured the interest of individuals across different age groups and socio-economic backgrounds and is now the preferred payment option for many people in India. An increasing number of lending firms are entering the BNPL product market with innovative services and differentiated business models (Figure 19).

Fig 18 – BNPL in India: growth story of a customer-centric lending product

BNPL Gross Merchandise Value, 2022-2028E



CAGR (2023-28): **12.2%**

BNPL payment adoption

Channels

Online POS

End user

Consumer electronics, Fashion and garments, Healthcare, Leisure and entertainment, Retail Others

Leading BNPL providers in India

LAZYPAY, CAPITAL FLOAT, OLAMONEY POSTPAID, Simpl, Paytm POSTPAID, zest EMI FOR EVERYONE, amazon pay, Bullet UPI Now, Pay Later., sezzle

1. Leading banks are forging alliance with BNPL players
2. B2B BNPL is gaining traction to cater to MSMEs
3. E-commerce platforms are raising funding rounds to embed BNPL services

Source: Research and Markets, EY analysis

Fig 19 – India's BNPL market is being driven by multiple business models

	Pure-play pay-later	Cards-led pay-later	In-app revolving credit	Omni-channel
Key players	Zest, Simpl, Capital Float, Sezzle, Kissht	Pine Labs, RazorPay, SBI Cards, Banks (working with POS platforms)	Mobile wallets: Paytm, PhonePe, and MobiKwik	Bajaj Finance
Products	Online-focused installment-based payment facility	Installment-based loans on cards	Revolving credit line that can be settled fortnightly/ monthly	Revolving credit: In-store and online pay-later model on their partner merchants or own marketplace
Revenue model	MDR on GMV, late fees, and penal charges	Platform subscription fees, MDR, and cash management income	Revenue take rate on the loans originated	Interest component on loans/ subvention fee/ commission from brands
Solutions for merchants	In-store merchant partnerships	Merchant credit, online merchant payments	Wide array of business solutions	Strong in-store partnerships and ease of accessibility
Differentiating features	• One-click checkout • Taps underserved market offering short-tenure, small value loans • E-commerce platform and brand partnership	Pay-later offering for small offline and online merchants	• Larger active user base • Co-origination of loans with banks and NBFCs • Underwriting based on app-spending	• Assisted in-store buying experience • Strong brand recall and trust

Source: EY analysis

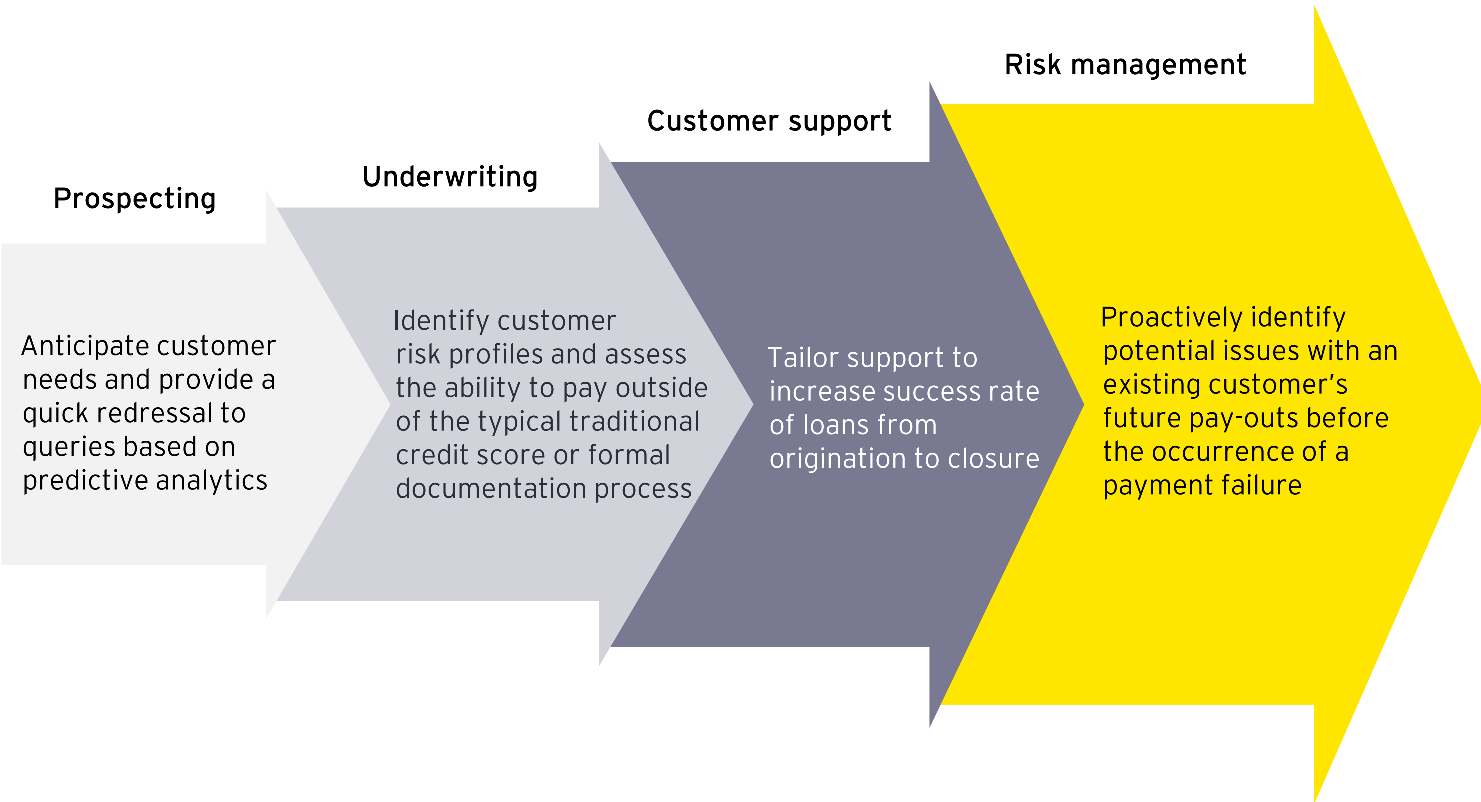
BNPL providers are witnessing a immense surge in demand for both online and offline purchases. The growth story is expected to continue, however, updated regulatory measures and general uncertainty in financial markets may impact the operations of BNPL providers. These challenges also prevail for other digital lending operations and players.

Digital lending players are now also burdened with a challenging FinTech funding environment. Yet, digital lending has managed to maintain a strong foothold and reach greater heights in terms of penetration and scale. However, the viability of digital lending players is now being called into question due to their unprofitable business models coupled with high valuations.

Maximizing the use of artificial intelligence will serve as the impetus for success

Efficient utilization of artificial intelligence (AI) and advanced analytics can redefine and accelerate the success of digital lending. The technology can streamline the lending process, eradicate inaccuracies, and ensure that lenders effectively provide successful loan products to eligible borrowers. (Figure – 20).

Fig 20 – A few use cases of AI that can help reorient the digital lending journey and advocate good lending practices



The sustainable finance drive is intense

The sustainable finance drive is intense

In India, sustainable finance has gained significant momentum in recent years as awareness of the need for sustainable development has grown, and there is increasing recognition of the potential risks and opportunities associated with ESG factors. FinTech companies, banks, and non-banking financial players have exhibited traction for digital lending to streamline seamless loan disbursement, approval, recovery, credit assessment, and other credit services while imbibing ESG considerations into lending decisions.

Regulators are playing a critical role in enhancing the need for sustainability. The Reserve Bank of India (RBI) has taken several steps to promote sustainable finance within the country. In May 2021, the RBI set up a Sustainable Finance Group (SFG) within its Department of Regulation (DoR) to lead the efforts and regulatory initiatives in climate risk and sustainable finance. On the other hand, to meet the "Panchamrit" targets set by India would require an aggressive nature of lending to happen in the market.

To meet the Nationally Determined Contribution (NDCs), lending in the range of INR160 lakh crore by FY30[16] is expected, creating significant space and opportunity for digital lending. Just two use cases (EV financing and residential rooftop financing) present an INR1 lakh crore opportunity in the next four years, much of which can be catered to by digital lending models.

There is a concerted attempt on the part of the government and regulators to push financial institutions to scale up green digital lending via collaboration among FinTechs, banks, and NBFCs.

"India has a huge role to play in guiding the world towards sustainable finance, and that the Indian fintech industry should look deeper into green finance to explore innovation opportunities. Financial regulators have already adopted 'sustainability' as a cornerstone of their operation, adding that Budget 2022 had stipulated the government's plan to issue a green sovereign bond for achieving net carbon neutrality by 2070."

- FM Sitharaman, speaking at the Global Fintech Fest 2022

Expected lending range of **INR160 lakh crore** by 2030 to meet the Nationally Determined Contribution (NDCs)

EV financing and residential rooftop financing present an **INR1 lakh crore** opportunity in the next 4 years

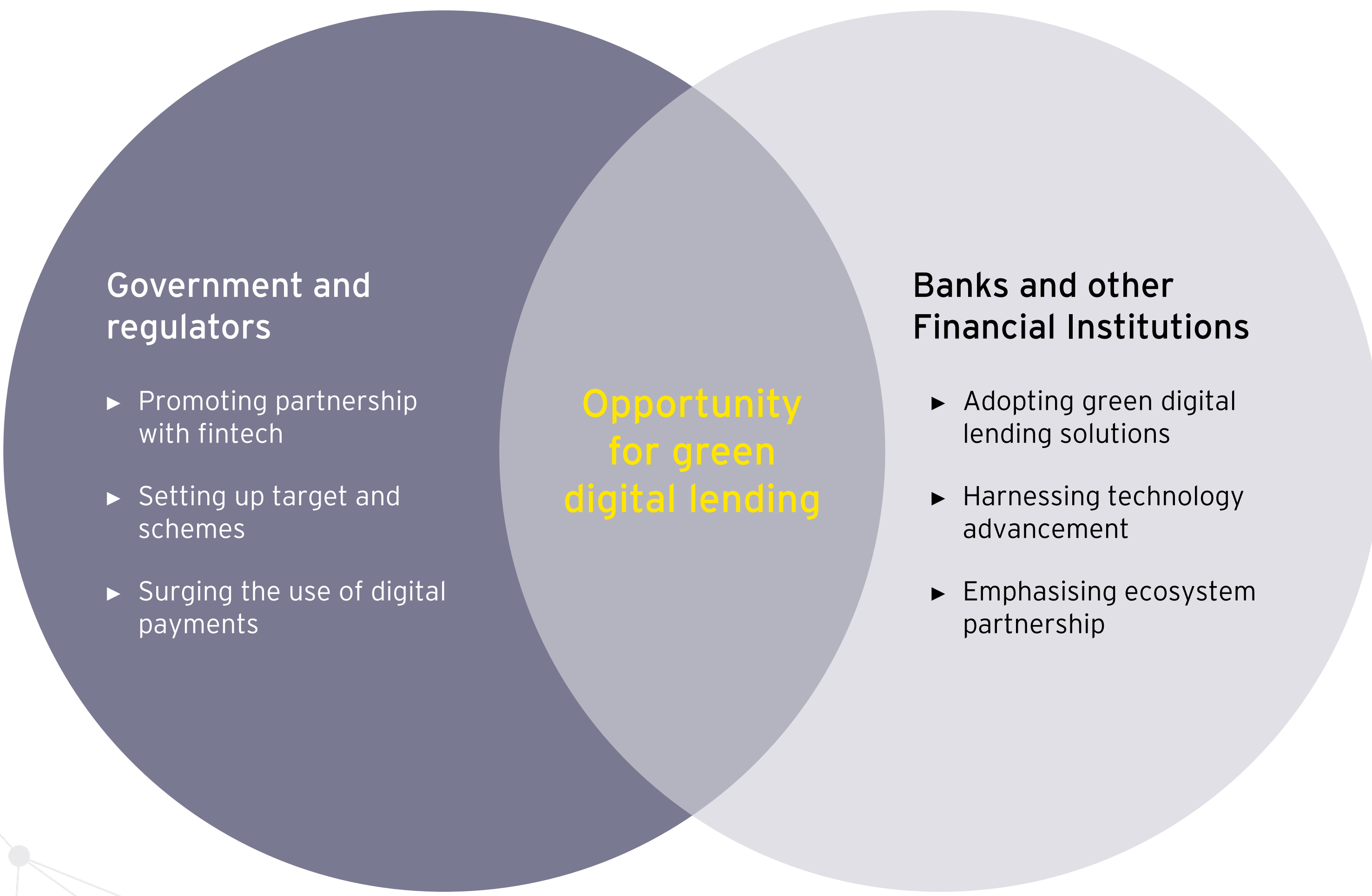
[16]https://www.praxisga.com/PraxisgaImages/ReportImg/emerging-opportunities-for-digital-lending-in-india-Report-3.pdf

Despite global turmoil, the outlook stays positive for sustainable finance in digital lending

In the wake of the COVID-19 crisis, banks globally faced increasing calls to contribute to addressing today's environmental and social concerns. Banks are mobilizing new capital to scale up green lending and investment, increasing digital lending for sustainable finance, and launching green deposits to support environment-friendly businesses[17]. On the other hand, regulators are actively involved in promoting sustainable finance by promoting partnerships (between FinTechs and other financial institutions), expanding digital payments (e.g., digital loans for solar and agriculture), and launching various schemes, etc. (Figure 21).

In order to truly embrace green finance in the digital lending space, banks, and financial institutions must have a digital transformation plan in place. By adopting digital lending solutions, banks and other institutions can harness technology to acquire and process information at a greater pace, with reduced operational costs, and less negative impact on the environment.

Fig 21 - Key initiatives driving opportunity for green digital lending space in India



Source: EY analysis

[17] https://www.assocham.org/uploads/files/Knowledge%20Report.pdf

Digital lending acting as a bridge towards financial inclusion

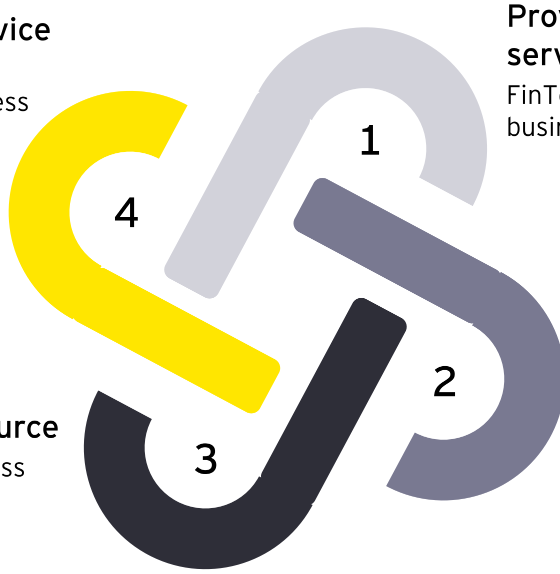
Digital lending acting as a bridge towards financial inclusion

Financial inclusion of the unbanked and under-banked population is the key to inclusive economic growth in India, and accessibility of credit on demand is one of the crucial components that may help in achieving the goal of inclusive economic growth. Financial Inclusion has been one of the primary goals that the Government of India wants to achieve through its new initiatives. The Indian government has been promoting digital lending to increase financial inclusion and access to credit for underserved populations.

Growth of FinTech emerges with the objective of financial inclusion

FinTechs are playing a key role in promoting financial inclusion in India, particularly in rural areas. FinTechs are using a combination of technology and government partnerships to tap the rural unserved market to drive financial inclusion (Figure 22).

Fig 22 - Key FinTech solutions that can promote financial inclusion in India



Source: EY analysis

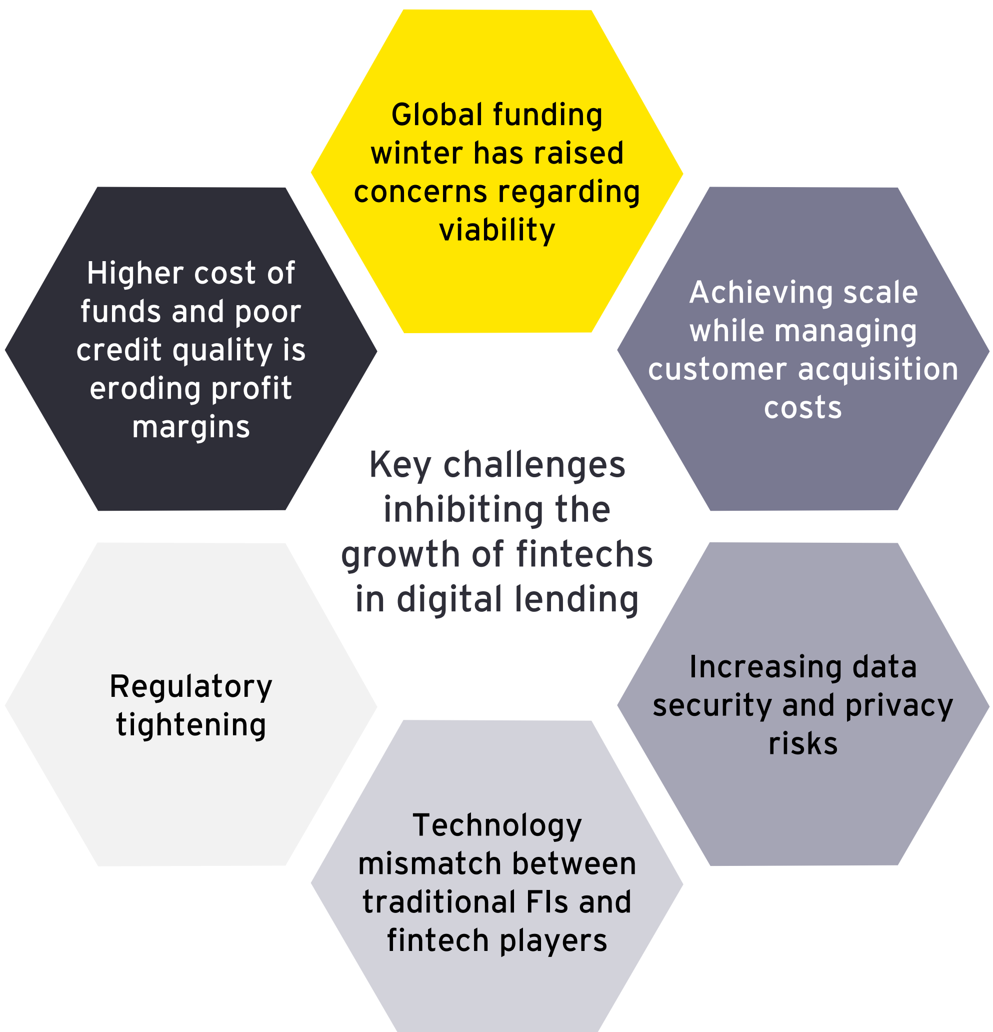
The FinTech platforms that offer lending services have garnered massive popularity among Micro, Small, and Medium Enterprises (MSMEs), especially after the outbreak of the COVID-19 pandemic. Options like flexible tenure, minimum documentation requirements, low-interest rates, easy KYC, and loan disbursement within minutes have attracted MSMEs to online platforms for securing credits.

Monetizing innovations and ensuring sustainability remains challenging

Monetizing innovations and ensuring sustainability remains challenging

The LendingTech space is growing exponentially, but despite the immense growth potential, these players face a range of challenges that can hinder their overall growth story. From regulatory hurdles to tightening funding inflows, and from the need for a robust infrastructure to customer trust, they must navigate a complex landscape to achieve sustained growth and profitability (Figure 23).

Fig 23 – Key challenges faced by Indian LendTech players



Source: EY analysis

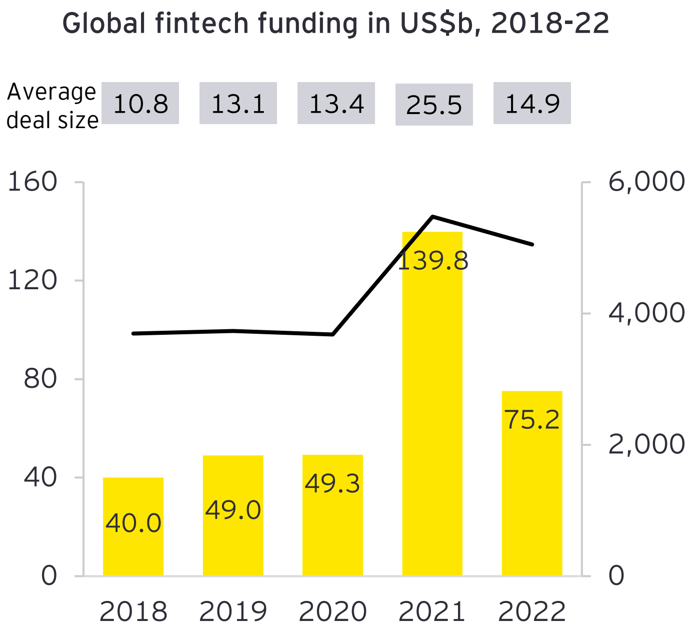
Managing scarcity: global funding winter has raised concerns regarding the viability

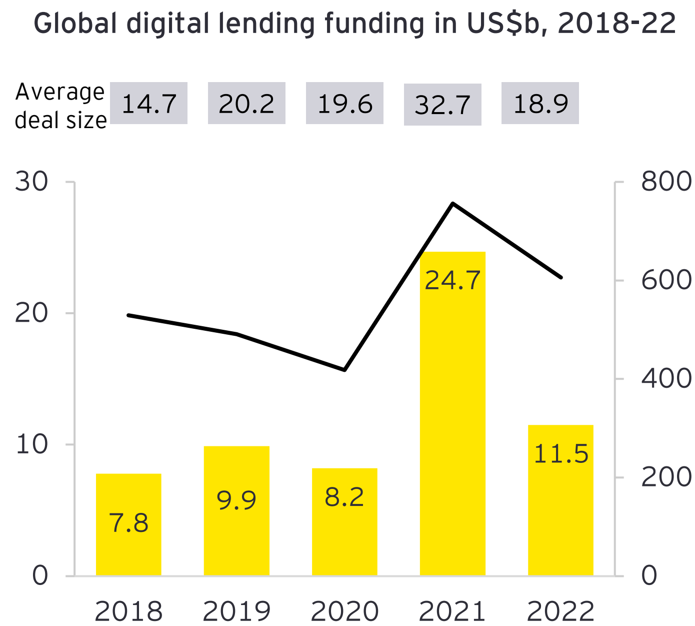
FinTechs do not have a liability base and neither have access to deposits or competitive funding costs that can allow them to grow the book. Moreover, the global liquidity squeeze is drying up funding inflows. This tightness in funding conditions would likely persist for close to two more years[18] and would in all likeliness force many of these players to re-orient their business models, away from their burn-based business model to a value-generating model and reduce their overall customer acquisition cost (CAC).

Global FinTech funding fell 46% YoY in FY22 while deal volume fell 8% YoY. The average deal size fell 40% YoY in FY22. The global digital lending funding is also down by 53% YoY with deal volumes declining by 20% YoY with funding and deals dropping below COVID-19 levels[19] (Figure 24).

Global funding winter is raising questions on the viability of existing business models and the health of LendTechs

Fig 24 – Investors have become cautious due to uncertain macro-economic conditions which have led to a decline in funding inflows





Source – CB Insights, EY analysis

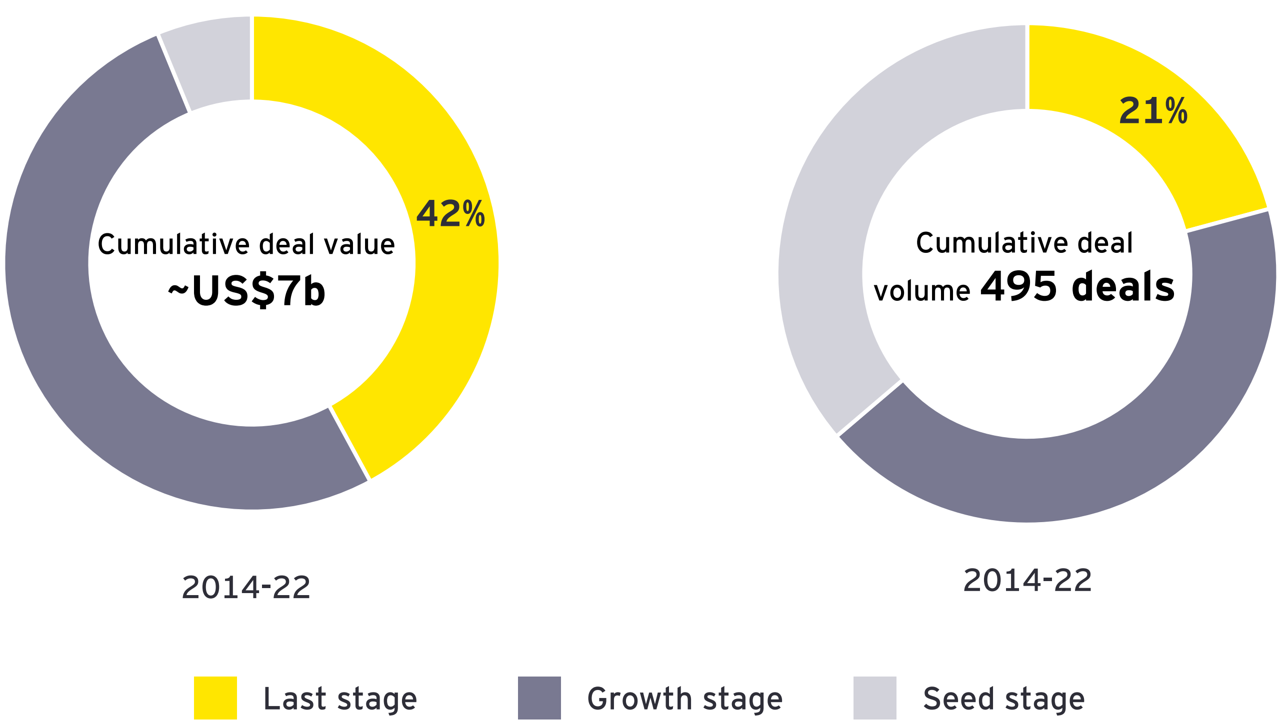
[18] JP Morgan - India Financials - 05 July 2022
[19] CB Insights

This toughening funding situation has brought significant challenges for the Indian FinTech players, both larger and smaller players. A majority of India's digital lending players are sitting on lofty valuations with higher revenue multiples (~30x) than their global peers (in the range of 15x-20x for high-growth companies)[20], which would make it extremely difficult for companies to raise fresh funds at existing or higher valuations.

Additionally, the slowdown in funding is expected to have a more adverse impact on early-stage start-ups given only 6% of the total funding went into early stages (seed stage) and close to ~42% went to established and matured companies during FY14-22[21] (Figure 25).

Fig 25 – A major chunk of deal value is concentrated in fewer deals with established LendingTech start-ups

Stage wise funding analysis of LendingTech start-ups in India, 2014-22



Source - Inc42

As a result, several questions are being raised regarding their long-term viability as only 17 out of 80 unicorns from the entire start-up ecosystem in India are profitable in FY22[22]. This has led to an increasing need for FinTechs to focus on profitability and the need to draw a path to sustainable growth instead of focusing on growth at all costs.

Out of **80** unicorns in the entire start-up ecosystem in India, only **17** were profitable in FY22

Indian digital lending players are sitting at higher valuations of **~30x**, compared to global average of **15-20x**

[20] Moneycontrol
[21] x Inc42
[22] Tracxn

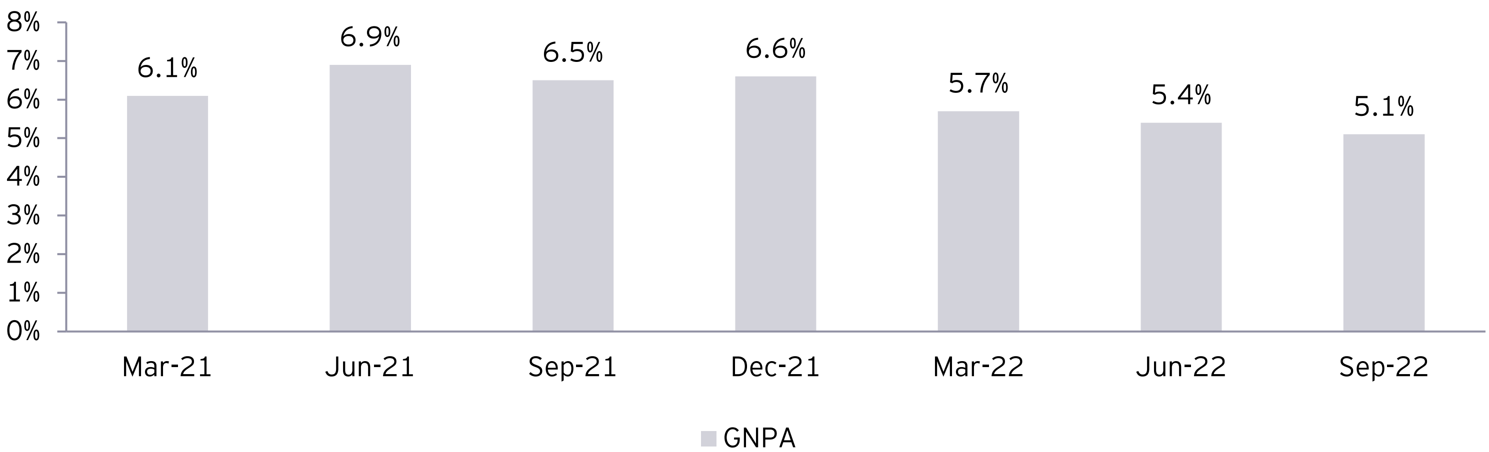
Higher cost of funds and poor credit quality erode profitability margins

Lowering the cost of funds is one of the key priorities for FinTechs to improve their unit economics and portfolio credit quality. Following the IL&FS debacle, the market appetite for lower-rated bonds and investment instruments for NBFCs has gone down. Even in peak liquidity cycles, more than 70% of the debt flows were to NBFC in the AAA category[23]. The higher cost of funds for NBFCs in AA or lower bracket adds pressure on FinTech partners to seek out loans with higher yields which further increases risk. This dynamic could potentially contribute to an overall increase in credit risk throughout the financial system.

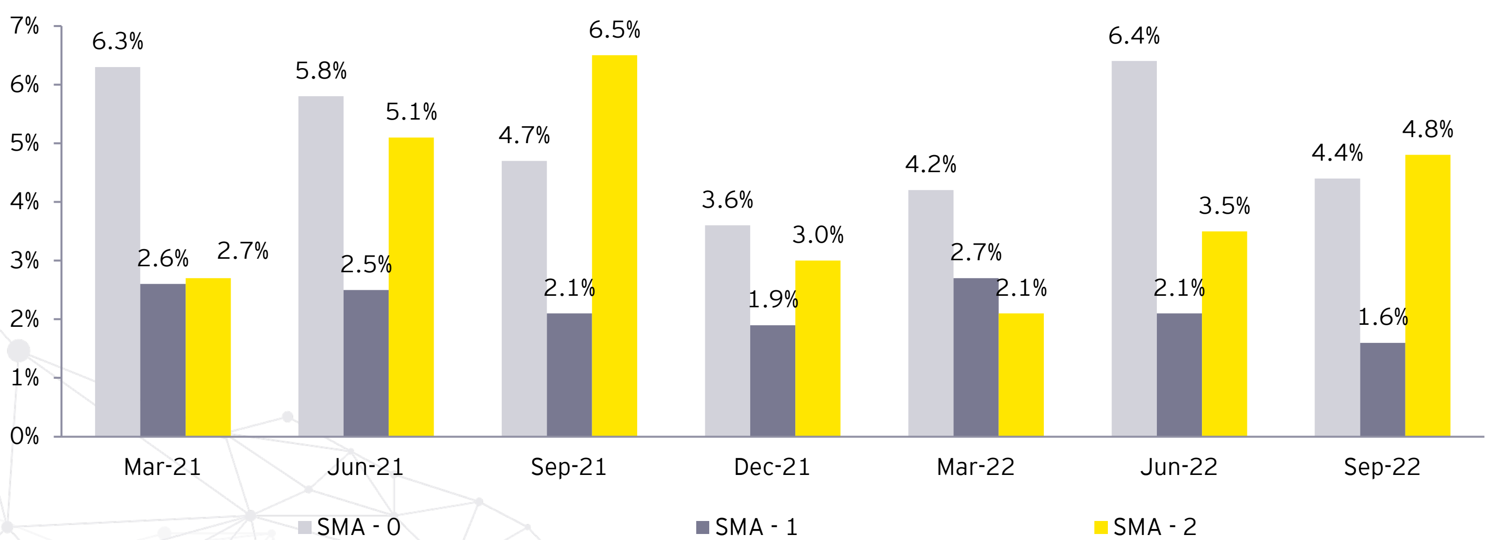
Although asset quality for NBFCs improved post-COVID with the GNPA ratio of the sector falling from 6.9% in June 2021 to 5.1% in September 2022, it remains high. Additionally, stress was observed in NBFC Investment and Credit Companies, which primarily are the lending partners for FinTechs, with GNPAs at 6.9%[24]. Special mention accounts (SMAs), increased from 8.5% of total advances in December 2021 to 10.8% in September 2022 (Figure 26).

Fig 26 – Although the asset quality of NBFCs has improved, NPA levels remain high

Gross non-performing assets



Special Mention Accounts (SMAs) as a percentage of total advances



[23] CRISIL Year Book 2021
[24] RBI FSR report

Fig 27 – Illustrative example of a pure play BNPL which shows the impact of poor asset quality on the bottom line

Model	Pureplay BPNL
Product features	14-30 days deferred payment solution @ 0% Interest
Typical Revenue source	MDR + Late Payment Fees
Profitability Tree (% of AUM)	
Interest income	-
Processing fees	-
Merchant discount revenue	~2.0%
Less: Cost of Funds(1)	~0.6%
Net interest income	**~ 1.4%**
Subscription fee	-
Penal fees(2)	~ 5.0%
Total Net Revenue	**~ 6.4%**
Customer acquisition cost	~ 2%
Tech / Platform expenses	~ 2%
Other Opex	~ 1%
Operating Expenses	**~ 5.0%**
Loan losses & provisions	~ 3.0%
Risk Adjusted Margins (before Tax)	**~ (1.6%)**

Note: (1) Assuming 3x leverage and 10% average annualised rate of interest (2) INR250-300 late payment fees on an Avg. Ticket size of INR5000;

[23] CRISIL Year Book 2021
[24] RBI FSR report

Tightening regulatory scrutiny

The LendingTech industry is constantly progressing, and regulatory uncertainty makes it challenging for businesses to operate. While the RBI considers the benefits and the potential growth of FinTechs and digital lending in India, it also understands that there may be certain risks in such endeavors. Hence, the RBI constituted a Working Group (WG) to study and examine the practices and it issued the Report of the WG on Digital Lending including Lending through Online Platforms and Mobile Apps (Report on Digital Lending) for public comments in December 2021. Considering the inputs provided by different stakeholders, the RBI issued a Press Release dated 10 August 2022 viz. Recommendations of the Working group on Digital Lending – Implementation. Subsequently, RBI issued the Digital Lending Guidelines dated 2 September 2022 and was further followed through Frequently Asked Questions (FAQs) on the same.

The digital lending guidelines are likely to have a considerable impact on the business relationships between the NBFCs and FinTechs. Stakeholders, including investors, have become more cautious as increased regulatory scrutiny would increase compliance costs, which in turn would weigh down on profitability (Figure 28).

Fig 28 – Tightening regulatory standards would increase compliance costs and bring uncertainty concerning their business models

Few key regulations and their impact on FinTechs

Regulations	Implications on FinTechs
Restrictions to fund-flows relating to loan disbursement and repayment	Increased operational complexities for lenders as well as fintech platforms in managing the disbursement and repayment fund flows
Loading of non-bank PPI from credit lines	Drastic change in the BNPL model as fintechs used to leverage credit lines from NBFC-linked wallets to facilitate instant buying for customers
Digital Data Protection Act, 2023	This would attract additional compliances such as mandatory appointment of data protection officer, independent data auditor, and perform data protection impact assessment.

[23] CRISIL Year Book 2021
[24] RBI FSR report

Technology mismatch between traditional FIs and FinTechs

It is becoming increasingly common for traditional financial institutions and FinTechs to collaborate and create new opportunities in the financial services industry. However, the technological systems and infrastructure of traditional financial institutions, such as banks, are often incompatible with the innovative digital lending platforms of new-age FinTechs. While traditional FIs may have established systems and processes in place, these may not be equipped to handle the demands of the modern, digitally driven financial landscape. On the other hand, FinTechs are often built on innovative cloud-native platforms.

The lack of technological compatibility between traditional financial institutions and digital lending platforms can result in inefficiencies and friction, hindering the seamless flow of data and communication necessary for successful collaboration. This can also lead to a fragmented user experience for consumers, creating frustration and confusion.

Increasing data security and privacy risks

The FinTech industry heavily relies on data and associated technologies, which serve as the backbone of its operations. However, this reliance on data also exposes the industry to a range of risks such as data leaks, platform downtime, fraud, and information theft. These risks have become more severe in recent years, with the proliferation of cyber-attacks and phishing activities. In 2020, the Indian FinTech sector witnessed a staggering 60% increase in phishing activities, highlighting the growing threat posed by cybercriminals[25].

FinTechs need to invest significantly in data security mechanisms to control this risk and comply with regulatory requirements. Failure to do so can result in significant reputational and economic costs for FinTech companies, making data security a top priority for the industry.

Achieving scale while managing Customer Acquisition Costs (CAC)

More than 70%[26] of India lives in rural areas where telecom penetration is just 58.2% vs. 134.7% in urban India[27]. As a result, the use of FinTech platforms is largely concentrated in the urban segment. Moreover, according to a SEBI report, only 27%[28] of Indians are financially literate, which is a major bottleneck to onboarding new and informed customers. A lack of awareness regarding digital products and people's preference for in-person communications have pushed FinTechs to adopt an omnichannel approach for smaller cities and towns.

Additionally, given the current state of the market, other players (apart from pure play LendingTechs) are also foraying into this space to diversify their income streams and maximize their revenue potential given the largely untapped market.

As a result of the above factors, the customer acquisition cost is expected to rise to raise further questions on profitability.

[25]https://timesofindia.indiatimes.com/blogs/voices/the-increasing-importance-of-cybersecurity-compliances-in-the-FinTech-industry-in-2023/

[26]https://www.business-standard.com/article/economy-policy/70-indians-live-in-rural-areas-census-111071500171_1.html#:~:text=The%20rural%E2%80%93urban%20 distribution%20is,from%2072.19%25%20to%2068.84%25.

[27]1https://www.trai.gov.in/sites/default/files/PR_No.40of2022.pdf

[28]https://www.financialexpress.com/money/the-growing-significance-of-financial-literacy-in-india-gaps-and-opportunities/2410548/

Business imperatives to drive scale and profitability

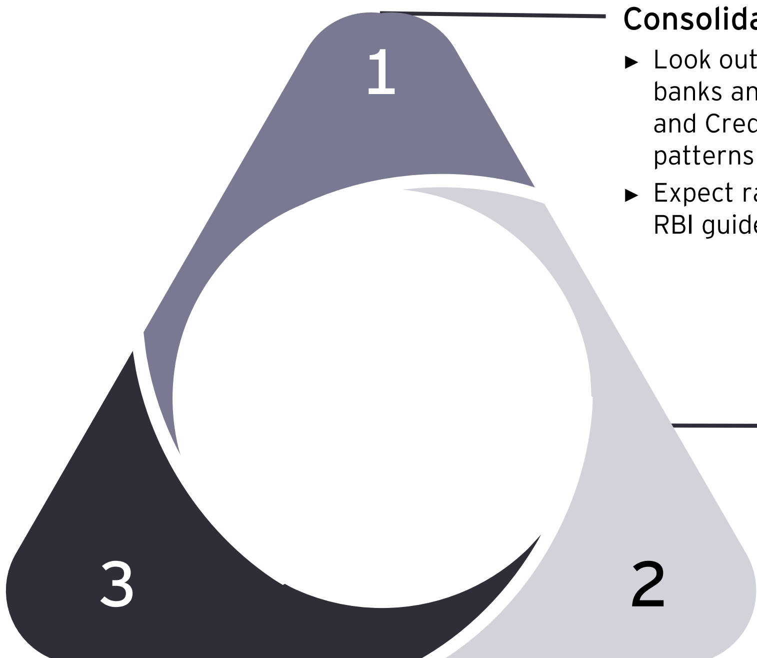
FinTechs have experienced significant growth in recent years, thanks to the influx of capital. However, the tide has turned, and FinTechs are now facing a challenging time as PE/VC funding has shifted from abundance to scarcity. Most of these companies are still in the expansion phase and a limit to capital availability may pose a significant challenge to their growth and development, and profitability may continue to remain elusive. The FinTech business cycle of fund scarcity is a global phenomenon. For instance, Klarna's valuation dropped from US$45.6 billion in FY21 to US$6.5 billion in FY22[29].

Business imperatives cannot be ignored and the adoption of standard protocols to reorient business processes needs to be addressed with meticulousness. We provide a diverse set of imperatives that should be put into action immediately.

A	B	C
Aim towards scale and profitability	Proactively integrates with regulatory reforms	Adapt to co-lending and embedded lending

A Indian FinTechs need to take immediate strides towards gaining scale and profits. (Figure 29).

Fig 29 - Immediate actionable



Consolidate

- Look out for consolidation opportunities with neo banks and peers PhonePe's acquisition of ZestMoney and Cred's acquisition of CreditVidya show similar patterns and early signs of consolidation
- Expect rapid market consolidation provoked by new RBI guidelines

Diversify

- Capture new revenue stream
- Avoid the risk of reliance on one product category
- Ensure customer stickiness and avoid flight risk
- Remain agile and responsive

Explore

- Improve unit economics via alternate forms of capital
- Showcase unique value and risk capabilities to attract debt
- Ensure transparent reporting and governance

Source: EY analysis, PhonePe[30], Cred[31]

[29] https://techcrunch.com/2022/07/11/klarna-confirms-800m-raise-as-valuation-drops-85-to-6-7b/
[30] https://www.livemint.com/companies/news/phonepe-acquiring-zestmoney-deal-pegged-at-200mn-300mn-11669364662889.html
[31] https://techcrunch.com/2022/11/29/cred-acquires-creditvidya/

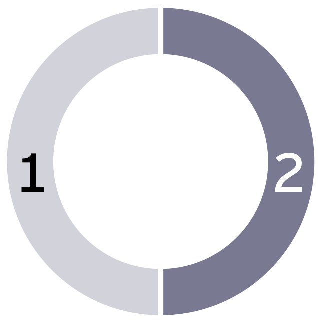
B Indian FinTechs need to prepare for further regulatory reforms

Indian FinTechs need to prepare for further regulatory reforms, challenges presented by the funding winter, there is reason to believe that regulatory and technological intervention will create a summer of opportunities for Indian FinTech lenders (Figure 30). The recent approval of the FLDG program by the RBI is a strong indication of the positive intentions of the government and regulators towards promoting and expanding digital lending in the country.

Fig 30 - Time for FinTech to proactively integrate regulatory reforms in their DNAs

Integration of reforms

- Quickly act on new FLDG guidelines which brings fresh wave of opportunities to provide credit in collaboration with incumbents and other players
- Integrate government launched reforms and initiatives like AA framework, OCEN, Payments vision 2025, etc. towards growth channels and remove walled gardens of data
- Increase GST penetration along with AA adoption to drive the growth of machine readable MSME data that can be used to provide credit using algorithmic risk-based lending approach through open market platforms like OCEN
- Proactively prepare for tighter regulatory oversight with RBI further observing and mulling over emerging practices and procedures



Formation of governing bodies

- Formation a Self Regulatory Organization (SRO) by industry bodies like The FinTech Association for Consumer Empowerment (FACE) and Digital Lending Association of India (DLAI), will promote ethical lending and ethical lending behaviours by curtailing growth of rogue lenders
- They will create an ecosystem for dynamic regulatory strategies through their regular interactions with RBI
- Expect these upgrades to bring positive transformation in the sector by building trust and credibility

Source: EY analysis, Self-Regulatory Organization (SRO)[32], [33]

Approval of FLDG scheme by the RBI allows partnership between FinTechs and banks and NBFCs. What will change?

- Democratization of credit and enhanced penetration of lending products
- Deeper and meaningful partnerships between incumbents, regulated entities and FinTechs
- Transparency and discipline in digital lending
- Potential for FinTechs to increase business scale and volumes – first movers will attract maximum benefits
- Harmony between industry players driven by healthy competition

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[29]https://www.financialexpress.com/industry/banking-finance/face-applies-to-rbi-to-become-self-regulatory-organisation-for-digital-lending/2412075/

[33]https://www.businesstoday.in/opinion/columns/story/how-a-self-regulatory-organisation-can-help-digital-lending-industry-323665-2022-02-23

C Indian FinTechs need to adapt to co-lending and embedded lending delivery

Indian FinTechs need to adapt to co-lending and embedded lending delivery models for digital lending services. These models have the potential to manage both consumer expectations and compliance risks.

- Co-lending as an industry will see a significant boost. It is likely to evolve as a marketplace model that assists lending partners in mitigating risk[34]. (Figure 31)

Fig 31 - Co-lending business model

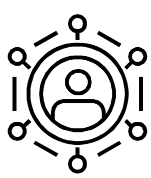
Capital partner/lender has more degree of control

Based on the borrower's profiles, the banks and NBFCs (acting as a capital partner) might choose whether or not to participate in lending.

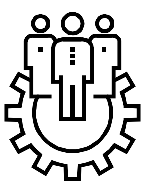
Borrower with credit profile (credit score, demographic data, repayment history)

Fintech provides risk management and technology support

Potential market changes



Improves credit flow



Better customer reach and integration of technology

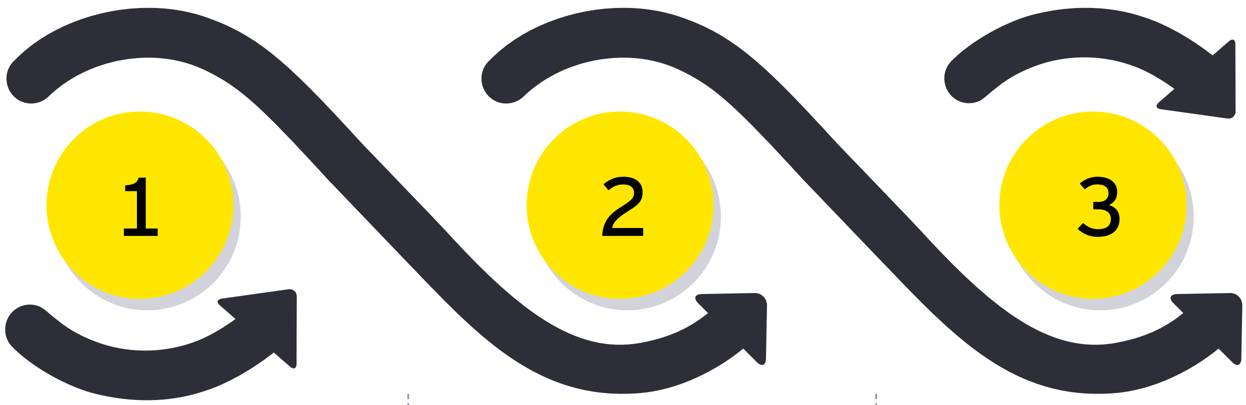
Boosts growth, assets and profitability

Source: *Chiratae Ventures-EY FinTech Report*

[34]https://assets.ey.com/content/dam/ey-sites/ey-com/en_in/topics/financial-services/2022/ey-one-trillion-dollars-india-fintech-opportunity-chiratae-ventures-ey-fintech-report_v1.pdf?download

- **Embedded lending is expected to drive digital payments and credit penetration** by integrating end-to-end credit products with a broader tech ecosystem or any e-commerce platform. While there are multiple forms (Figure 32) of embedded lending, the aim is to allow non-FS payers to provide loans as a feature directly through their consumer platform, usually in partnership with banks and licensed debt providers.

Fig 32 - Multiple forms of embedded lending are emerging



Routine transactions

- Consumers finance a retail purchase using a lending product, either through a traditional method or a new-age BNPL solution
- For example, BNPL solution provider Klarna enables over 250,000 global retailer partners such as H&M, IKEA, Expedia Group, Samsung

B2B solution

Direct loans are provided without the condition of a transaction or being part of a merchant ecosystem

Non transactional loans

- B2B solution that enables ‘cash flow-based lending’ for use cases such as inventory management, payroll, and marketing
- For example Shopify Capital offers quick application processing and approval based on historical revenue. It allows the loan to be repaid as a percentage of future sales made through Shopify

However, the viability of embedded finance remains to be proven globally. Global BNPL players like Afterpay lost a sizeable portion of their market cap in 2021 due to tighter regulations following rising defaults.

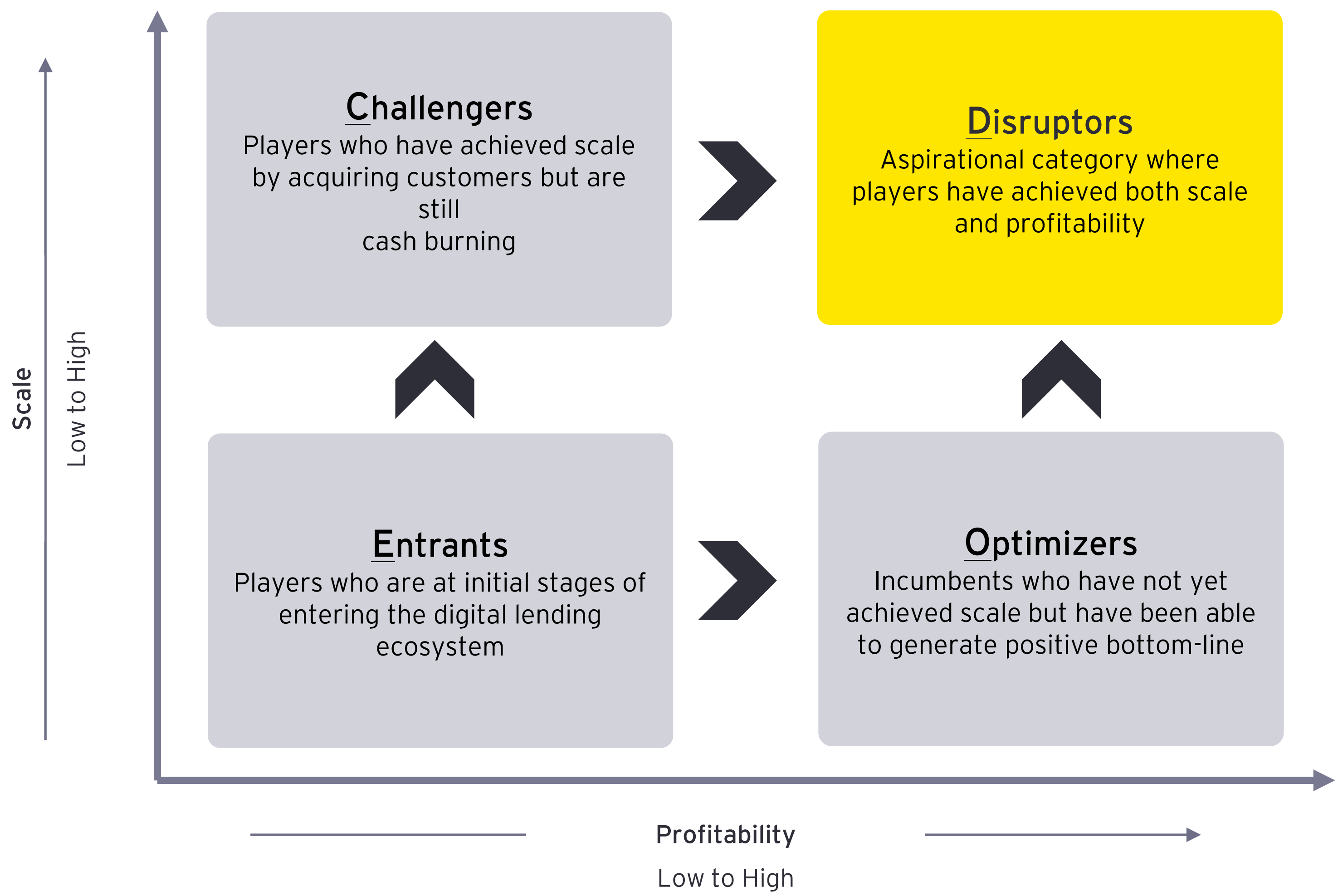
CODE framework: hack to build business model of the future

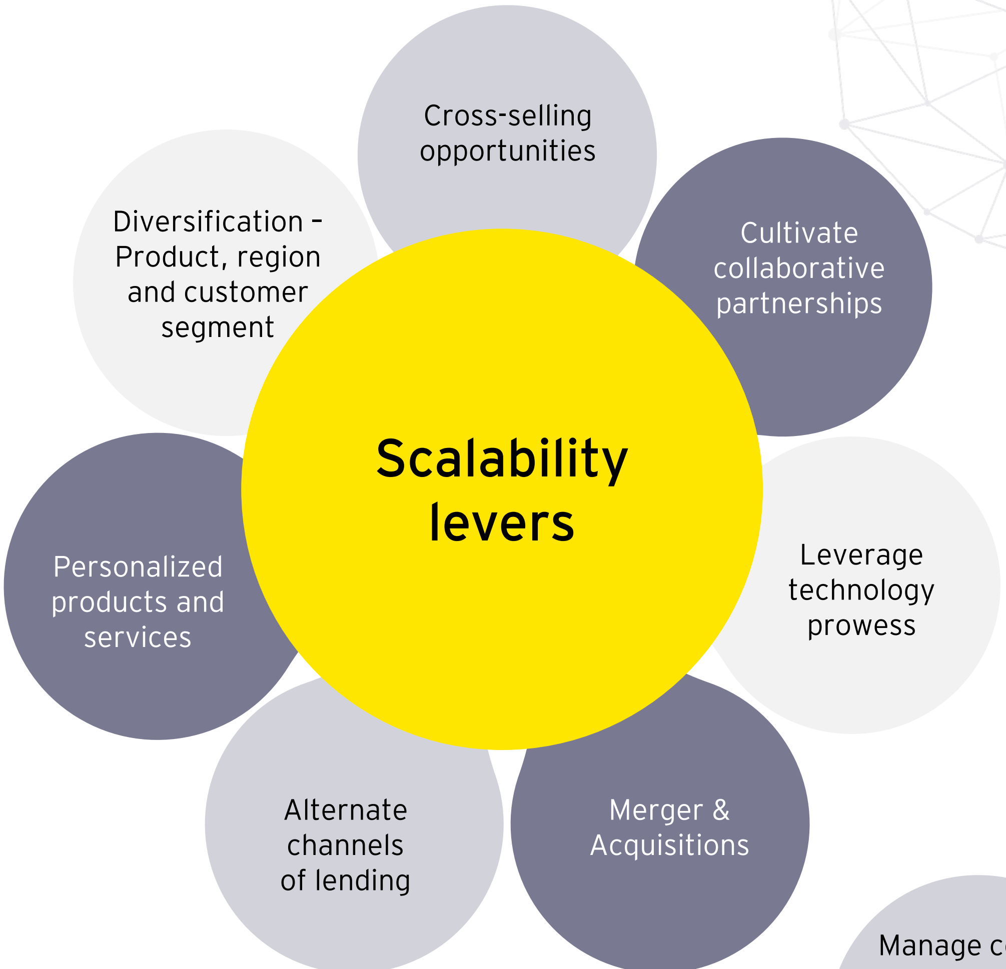
CODE framework: hack to build business model of the future

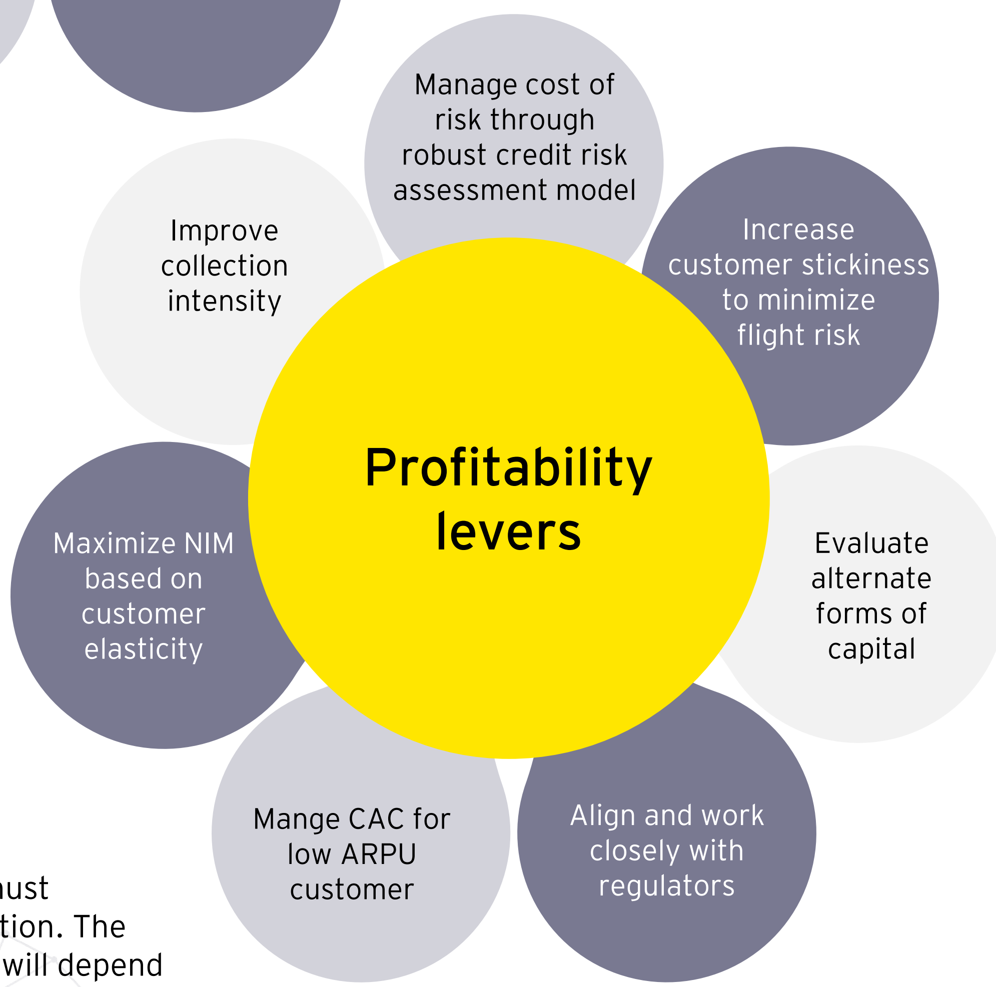
Amid the noise, the CODE framework can help in selecting the right business model

There is no clear-cut answer to what kind of business model would drive incumbents to profitability and one size does not fit all. Each player is positioned uniquely in the digital lending ecosystem and can assess its position based on the 'CODE framework' which is built on two key elements – Scale and Profitability. The players can follow different approaches and use the levers to become disruptors depending upon their DNA construct and strategic imperatives. (Figure 33)

Fig 33 – CODE framework to manage scale and profitability







Source: EY analysis

To gain a competitive edge and disrupt the market, businesses must quicken their pace of transformation. The exact approach to achieving this will depend on their unique DNA and strategic goals, but the goal remains the same, to accelerate their journey towards success.

Conclusion

India is one of the fastest-growing economies in the world and has one of the most resilient ecosystems. Additionally, it has a robust financial system with abundant opportunities and growth prospects. The government is steadfast in its commitment to provide a conducive environment of growth and innovation to ensure that positive industry dynamics prevail and that the financial services backbone is protected from global dips and uncertainties.

In this thriving financial services landscape, Indian LendTechs and other FinTechs have witnessed immense popularity among consumers, especially those who were previously underserved due to traditional underlying processes.

While scheduled commercial banks have been pioneers in addressing credit needs, LendTechs have disrupted the industry with innovative capabilities to reach new customers and offer unique credit experiences required by untapped market segments.

A positive market response, coupled with a robust infrastructure and quality funding, has led to LendTechs rapidly expanding their market share, and we believe that the market has even greater exponential potential. However, fluctuations in the business cycle, global economic slowdown, and increasing regulatory supervision may impede the pace of growth.

While LendTechs delve into change implementation plans to overcome obstacles, we believe the CODE framework can help accelerate the course of action towards sustainability through profitability. The framework is tailored to accommodate the distinctive DNA, propositions, and visions of LendTechs, enabling the design of a pathway to disruption.

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