Acuite
RATINGS & RESEARCH

Finnovate

The FinTech Lending Landscape

Content

Foreword

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Technology is bringing about a huge transformation globally in the financial sector. Every type of business in financial services is in the process of being re-engineered through digital technology and processes. This is set to bring in much higher efficiencies, customer convenience and productivity gains that what we would have achieved over the last few decades. It will also help in better control of the operating processes and therefore, will support compliance requirements. This is particularly true for the lending business in India particularly those that are outside the ambit of the banking system.

Globally CY 2021 had been a remarkable year for FinTech sector, with record number of deals and an aggregate investment flow of around $210 billion in this space. India is not far behind in such frenetic activity in the FinTech space; besides the investments by PE and VC firms, Indian FinTech has benefitted from various sector focussed incubators, accelerators, and technology hubs. The pandemic notwithstanding, CY 2021 marked a phenomenal growth in the domestic FinTech space compared to CY 2020 in terms of the funding amount and deal count which surged by 3.7x and 2x respectively with record funding of $7.9 billion and 280 deals. While the FinTech spectrum has become quite diversified across financial services, the lending FinTech space remains one of the dominant segment. The opportunity remains huge for the lending FinTech space in India, currently estimated at $210 billion, but this is further expected to more than double to $600 billion by 2025.

In the recent past, FinTech companies were seen as a threat for the existing financial institutions (Banks & NBFCs). The paradigm has clearly altered with financial institutions i.e. mainly banks now are seen collaborating with them through arrangements such as co-lending, thereby leveraging upon innovative technologies and new business models.

While the opportunity to build a scalable FinTech lending model in India is immense, the sector is going to be subject to increased regulations that will improve transparency and accountability. The newly released digital lending regulations may help curb the unregulated lending activities and make lending processes transparent and instil trust among the borrowers. Although this might lead to some disruption in the sector's growth for the short term, it would help the Indian FinTech lending ecosystem to attain a sustainable scale over the medium to long term.

Hope you find our publication interesting and enriching; do get in touch with us for any feedback or queries. Thank you.

Executive Summary

Acuité Ratings has conducted a study on 25 companies in the FinTech lending space to understand the key trends in this sector. Starting from small ticket size Consumer and Small Business (SMB) loans, the FinTech lending space is expanding rapidly to Auto loans, Trade Finance, Gold loans and Educational loans. The sample of companies are mostly rated by Acuité and predominantly from the consumer and small business loans segment. The assets under management (AUM) for FinTech NBFCs have recorded a robust 48% CAGR over the period March 2019-March 2022 (for the identified set of companies which we believe is fairly representative of the sector). While Covid-19 had sharply impacted the disbursements during the prolonged pandemic period in FY20 and FY21, they reached a high of ₹ 24000 Cr ($3.1 Bn) during FY22, reflecting a resumption of the growth trajectory for these lenders. Since their emergence in 2014, FinTech NBFCs in India have raised about ₹ 39000 Cr ($4.9 Bn) in capital funding and ₹ 42000 Cr ($5.4 Bn) in debt funding.

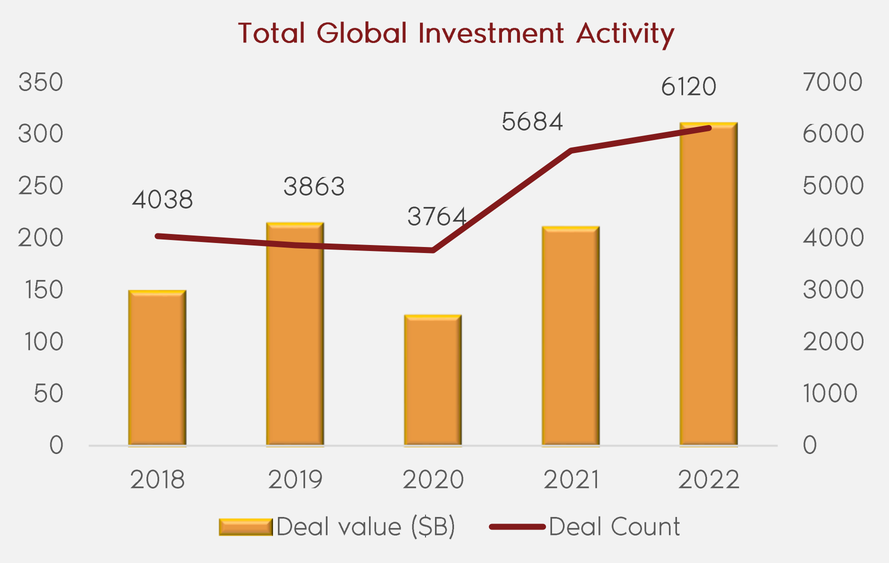
The consolidated earnings profile is constrained for most of the FinTech players given the substantial upfront investments in the technology platform apart from the relatively high credit and collection costs. However, we note that the profitability metrics remains better in the personal loan segment as compared to that in SMB segment. The asset quality trends indicate moderate improvements in the GNPA levels for the consumer space as the median GNPA ratio stood at 4.25% as on March 31, 2022 against 4.85% as on March 31, 2021, although write offs have also played a role. On the other hand, the SMB segment has seen a continuous spike in the GNPA levels over the last four years as a result of the economic slowdown and the subsequent disruption from the prolonged pandemic which had a severe impact on the small businesses. The median GNPA ratio in that segment stood at 5.1% as on March 31, 2022 against 4.14% as on March 31, 2021.

Given the copious infusion of capital in the FinTech lending sector at the initial stage of evolution, the leverage indicators remain moderate for these NBFCs as compared to the median level for the overall NBFC sector. Within the sector, leverage levels for SMB players have gradually gone up in last three years from an average of 1.7x as of March 2019 to 2.6x as of March 2022. For personal loan FinTech players, the leverage remains relatively low at around 1.1x as of March 2022

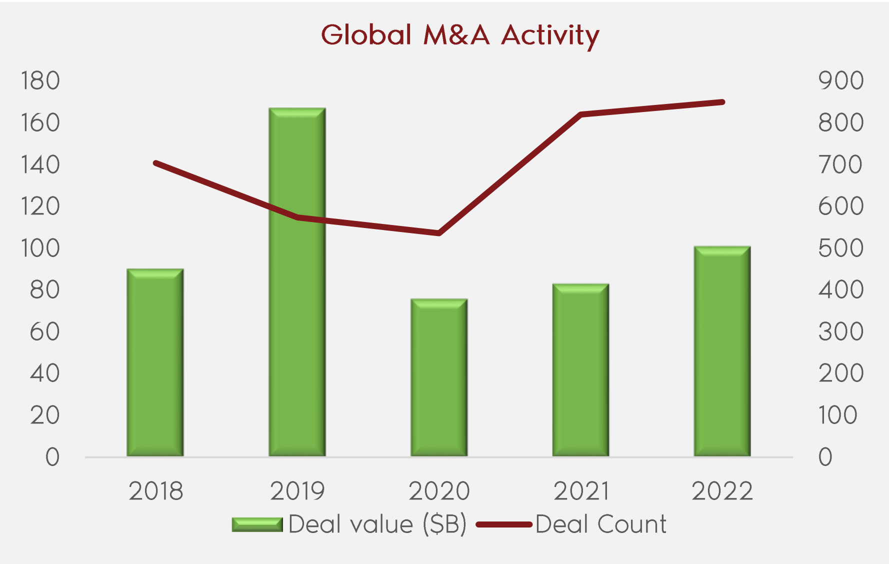
While the emerging digital platforms and various technological innovations augur well for customer convenience and better financial inclusion, the road to growth and sustainability for FinTech NBFCs is still long and can be bumpy. The regulatory framework for the sector is gradually evolving with increasing demands for data privacy, transparency, and accountability. Although any regulatory uncertainty can impact the sector's growth in the short term, well designed regulations will reduce systemic risks and facilitate a healthy development of the FinTech lending business over the longer run.

Global Perspective

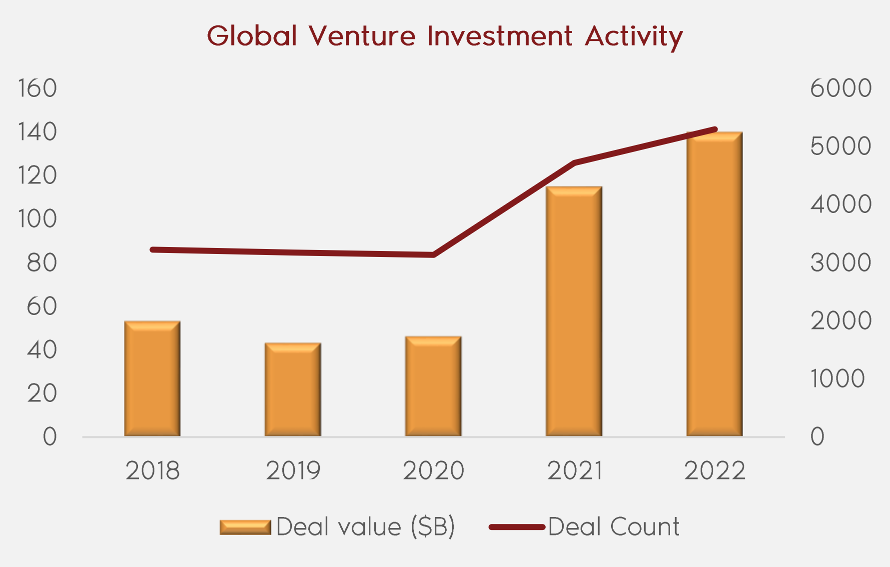
CY 2021 has been a remarkable year for the global FinTech sector, with a record number of deals aggregating to 5864 and an investment flow of around $210 billion in this space. The sector has witnessed large fund inflows particularly after the outbreak of the Covid pandemic given the potential of such digital platforms to transform existing business models and make them disruption proof. Further, the suite of FinTech solutions in the financial services sector has continued to widen and has led to an expanding base of investors.



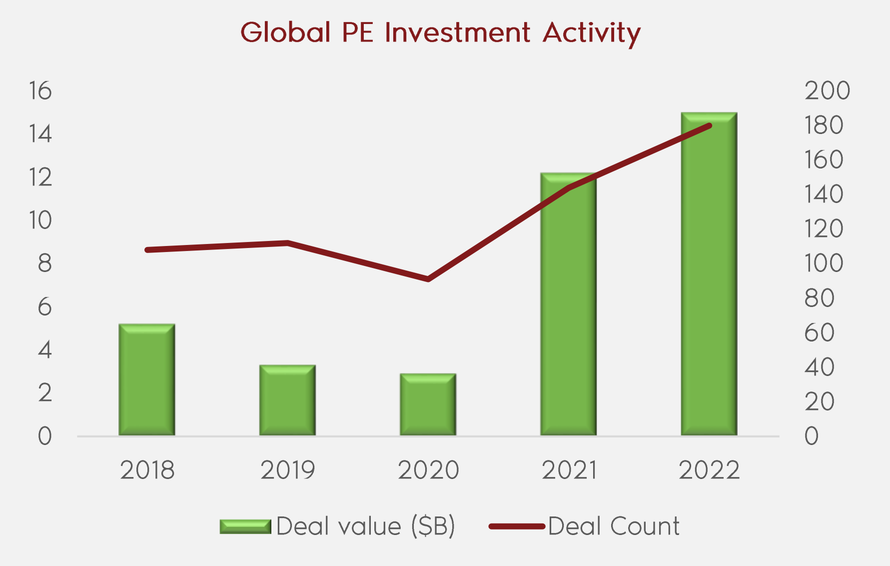
Healthy growth has been observed in overall global investment for the FinTech sector over the past three years. This gives a reassuring indication of the investors' confidence in this sector.



Global M&A activity in the FinTech sector is expected to recover after a slowdown during the pandemic period.



The global venture investment activity in the FinTech segment showed a steady uptick. Despite the pandemic, there was an increase of venture investment in 2021 as compared to 2020, 2019 and 2018.



The global PE investment activity in the FinTech segment has also been on the rise since 2021 and 2022, notwithstanding the dampening effect of the pandemic, which augurs well for the industry.

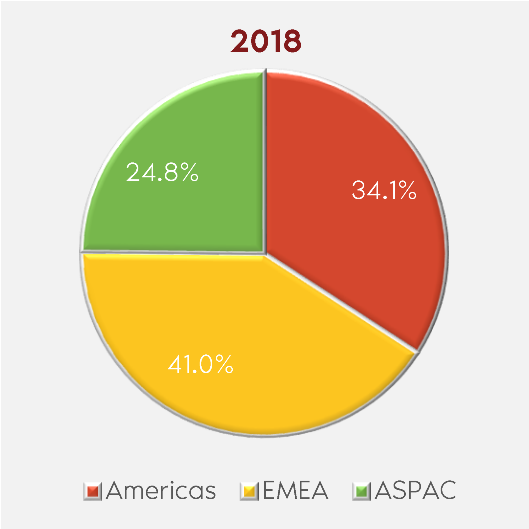
Some Global trends

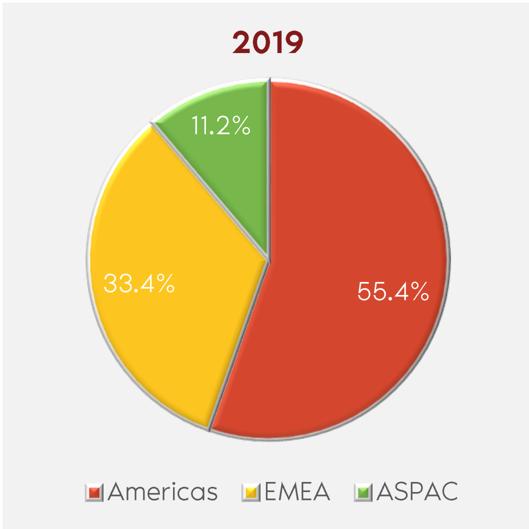
Growth of M&As and banks' embedded solutions	• Owing to the rise in the FinTech investments, both corporates and FinTechs will scale up in diverse markets, leading to an increase in the M&A activities. • Banks will explore providing services to non-banks and NBFCs for better customer experience. They will also provide these services as a subset of the portfolio offerings to the customers.
Higher regulatory supervision	• As the FinTech sector evolves and matures, more opportunities as well as challenges will get exposed. To safeguard this industry against the probable risks, the regulators are expected to come up with more comprehensive guidelines.
FinTechs in ESG segment to have faster growth	• ESG segment has been displaying healthy growth in the past few years. Hence, the FinTechs operating in this field will display better growth trajectory.
Greater focus on under-served areas	• Investors will show more interest in regions such as Southeast Asia, Latin America, the Middle East, and Africa where there is significant under penetration of financial services. These areas will witness more dealmaking by the investors.
More Unicorns in the developing markets	• There has been a significant rise in the unicorn companies in the developed markets. However, going forward, there will be more unicorn start-ups in the emerging markets given their demographic profile.
Data analytics a differentiating factor	• As the competition in the FinTech segment intensify, the companies' ability to upgrade their technology and data analytics will play a major role in separating the winners from the laggards.

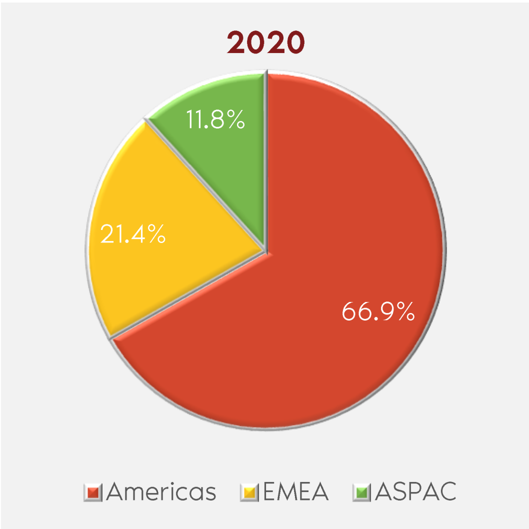
Region wise investment trend:

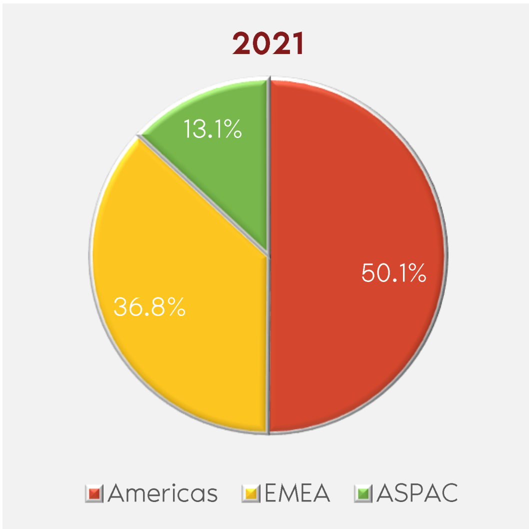
As global investors begin to acknowledge the size of the market opportunity in the Asia Pacific region, more investments are expected to pour into this region.

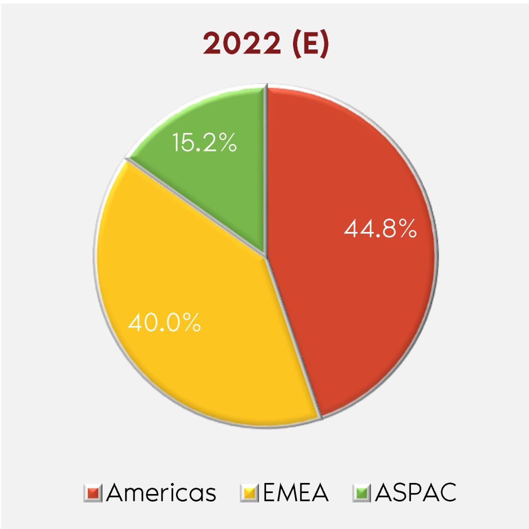
On tracking the trend for the regional share of global investment in 2022 vs 2021, it is clear that developing and emerging geographies of EMEA and ASPAC will play a bigger role going forward.







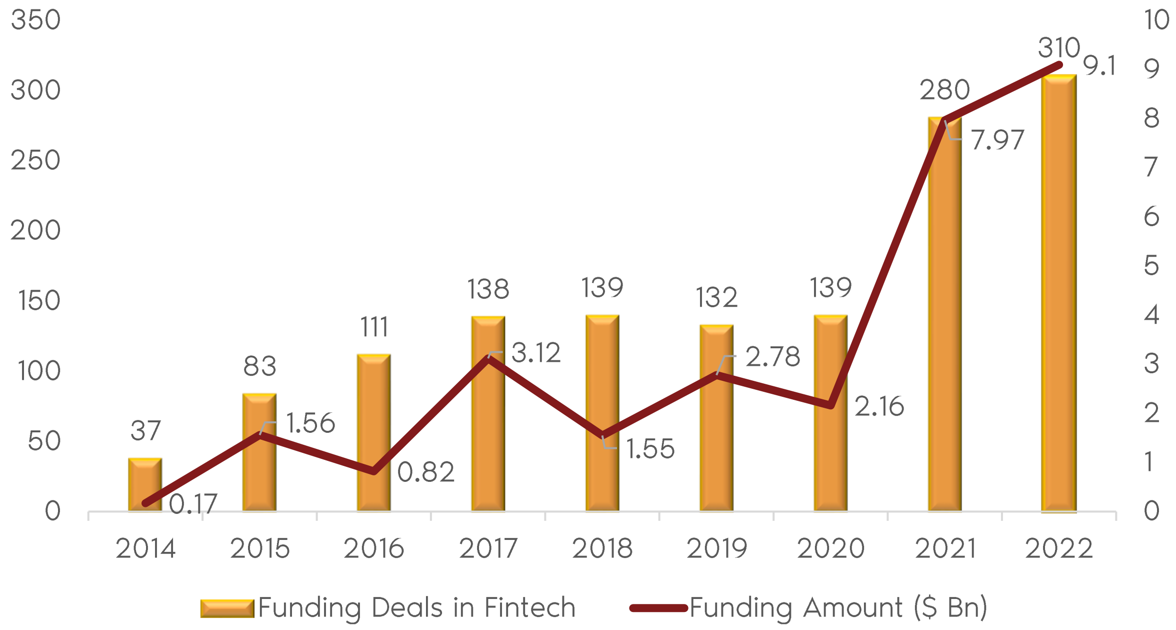




India's FinTech Landscape

India's FinTech sector also displayed resilience during the pandemic as investments increased steadily in the last three years. As of Q1FY23, the trend of rising investments in this space has continued, underlining the growing confidence of investors

Funding Scenario in Indian FinTech



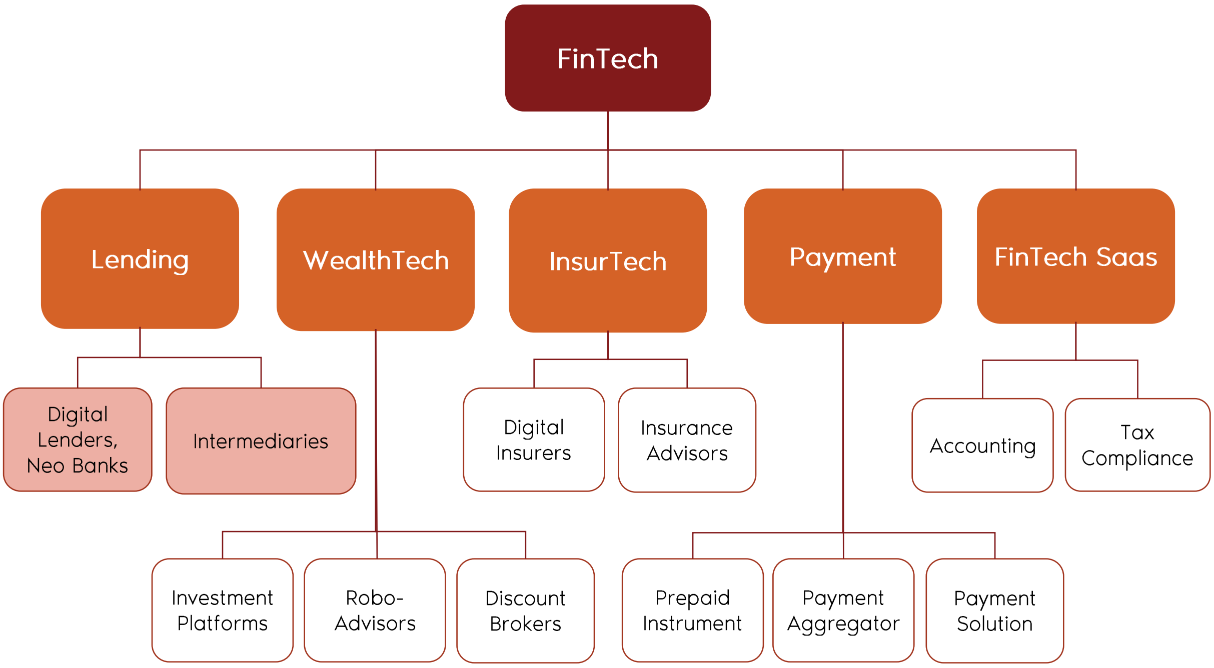
*2022 – Estimates by Acuité Ratings

Notwithstanding the pandemic's effect disruptive effect on the domestic economy, the investment in Indian FinTech has been increasing since the past two years.

The vibrant investment ecosystem in India continues to grow. Besides PE and VC firms, the Indian FinTech has benefitted from various sector focussed incubators, accelerators, and technology hubs. A major portion of the investment is coming from a set of key investors.

- Out of the 1,219 FinTech investments from 2014 to Jun-22, 676 can be attributed to the top 30 investors in the space i.e. > 55% of the total funding activity
- 14 of the top 30 FinTech investors are from the US, with 12 from India, two from Singapore and one each from the UK and Germany

FinTech Spectrum



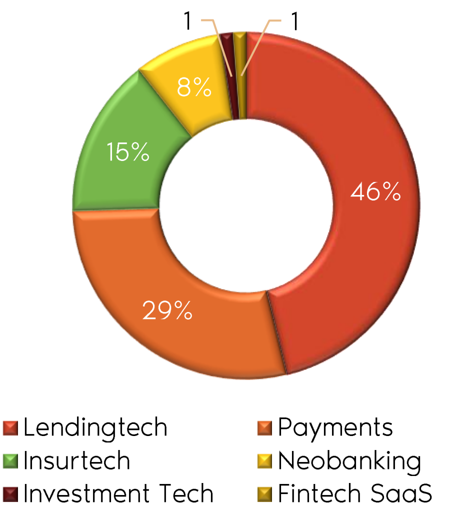
FinTech Spectrum Details:

FinTech Segment	Market opportunity (2022) ($ Bn)	Market opportunity est. (2025) ($ Bn)	Growth %	Amount Funded ($ Bn)	Number of Startups	Key companies
Lending tech	270	611	126.3%	5.4	160+	Capital Float, KreditBee, CredAvenue, Indifi
Payments	165	208	26.1%	9	70+	BharatPe, Cred, PayTm, PhonePe, Razorpay
Insurtech	87	338	288.5%	1.8	40+	Acko, Coverfox, Digit, Loop
Neo banking	48	104	116.7%	0.33	15+	Akudo, chqbook, Jupiter, Flobiz
Investment Tech	9.2	26	182.6%	0.9	50+	Deserve, Groww, Upstox, Zerodha
FinTech SaaS	4.8	13	170.8%	4.6	30+	Biconomy, Khatabook, Neogrowth, Chargebee

FinTech Market Opportunity

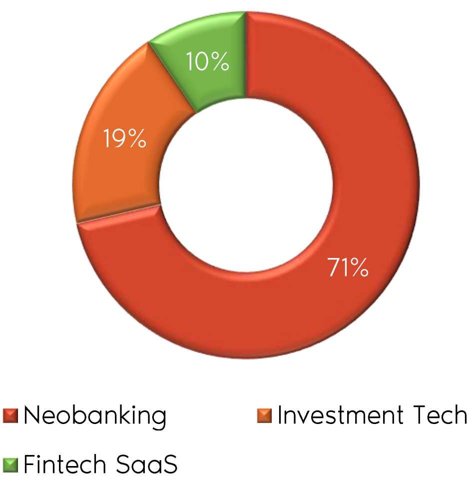
In 2022, out of the total Indian FinTech market potential of $584 Bn, lending tech constitutes a major share. The market opportunity is expected to more than double to $611 Bn by 2025.

2022 (Total Market Potential: $584 Bn)



Lending tech market potential: $270 Bn

2025 (Total Market Potential: $1.3 Tn)



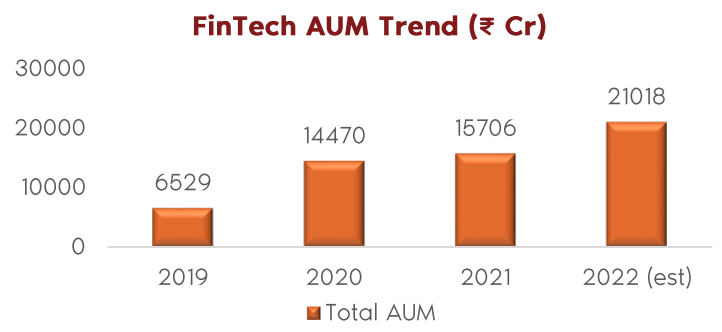
Lendingtech market potential : $611 Bn

- The market opportunity is expected to more than double to $611 Bn by 2025.
- The market opportunity for Lending tech is $270 Bn

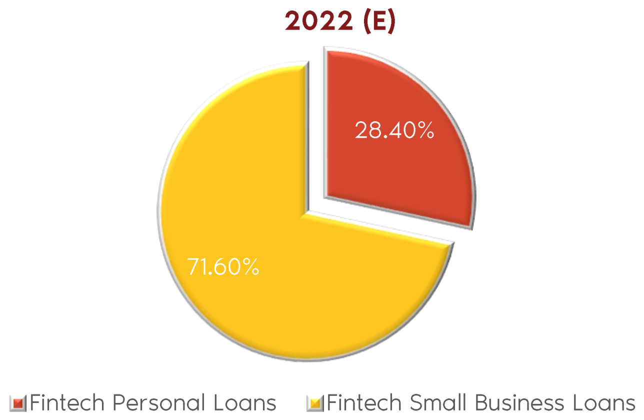
Some FinTech lenders in the key asset classes:

SME/MSME	• Lendingkart • Paisalo digital • Kinara Capital • SME Corner • Capfloat	• Neogrowth • Aye Finance • Indifi • Flexiloans • Oxyzo Financial / OFB
P2P Lending	• Faircent • 5paisa • Finzy • lendbox • Lending	
Personal/ Consumer	• Krazybee • Si Creva (Kissht) • Quadrillion Finance • Loantap • Early	• Bhanix (CashE) • Akara Capital • Zest Money • Flexisalary • India lendsOFB Tech
Gold/Education/ Auto Loan	• Rupeek • Golduno • Auxilo • AvanseCashkumar	• Eduvanz • Credit Chase Caputal • Kuwy • CARS

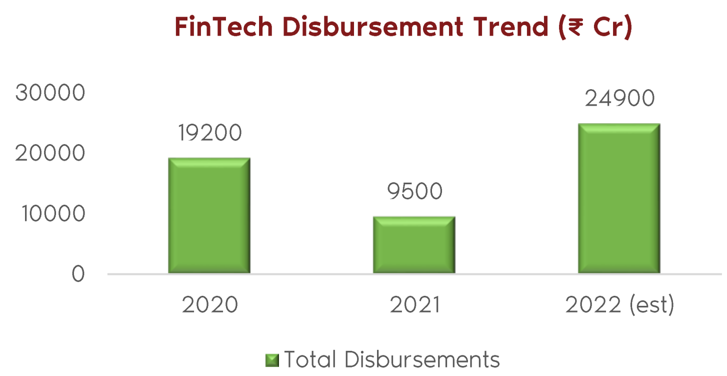
FinTech NBFC trends



Steady growth in AUM observed in the last 3 years, notwithstanding the Covid-19 pandemic.

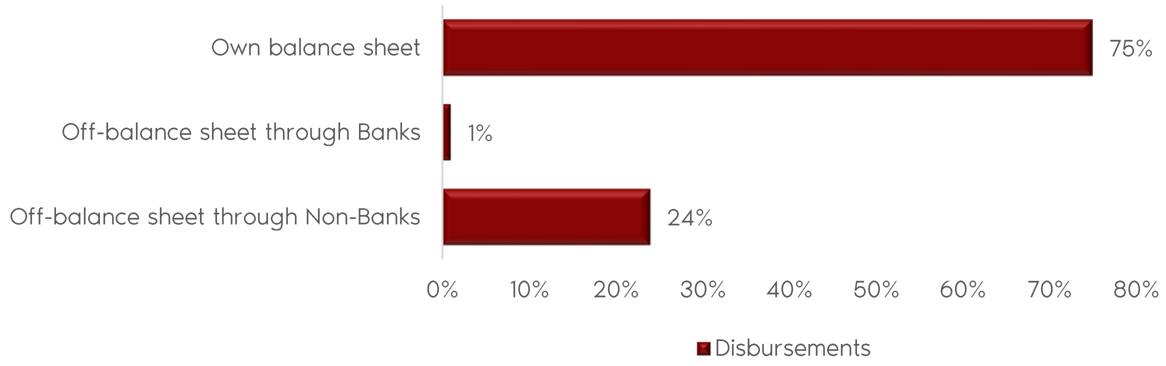


Personal loans constitute the majority of the total AUM in the FinTech ecosystem.

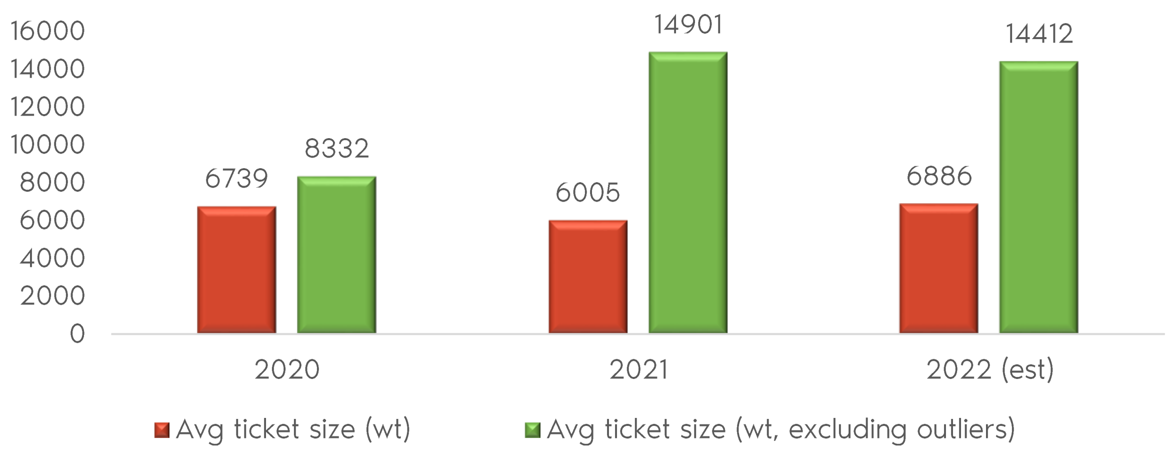


The disbursement volumes made a comeback after the pandemic, displaying the resilience of the industry. However, a sustained growth going forward is critical.

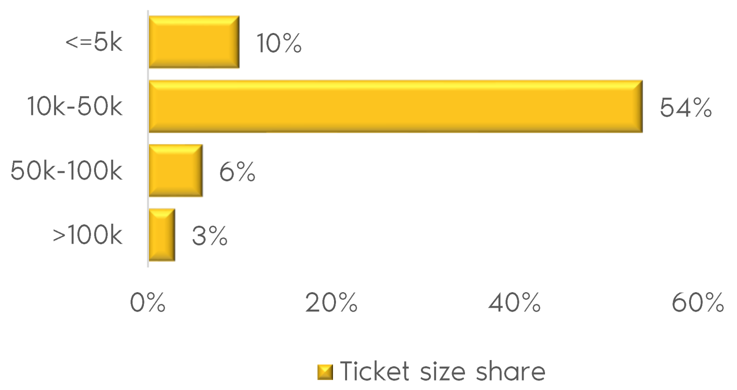
Balance sheet share for digital loans disbursed in FY 2022



Avg ticket size (₹): Personal Loans



Ticket Size (₹) composition: Personal Loans



The ticket size distribution for personal FinTech loans highlights the positive impact of technology that has facilitated the disbursal of such granular loans. Our data shows that 64% of the outstanding consumer loans in this category have an original ticket size of less than ₹ 50,000.

Profitability Analysis:

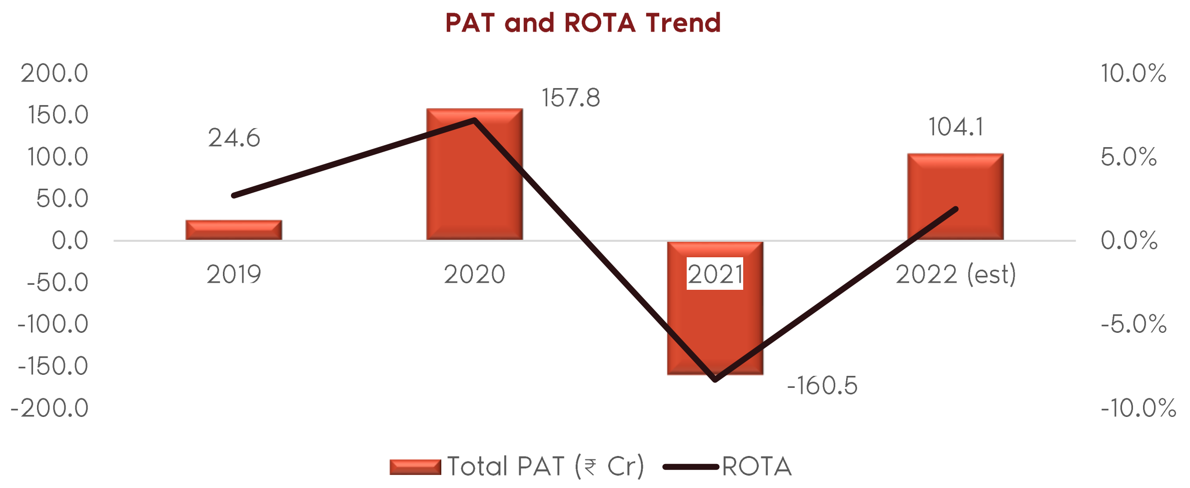
Personal Loan Segment:

For personal loans, the share of profitable companies increased sharply in 2022 as compared to those in 2021. This highlights the pickup in demand for small ticket and process friendly digital loans.

SME Loans:

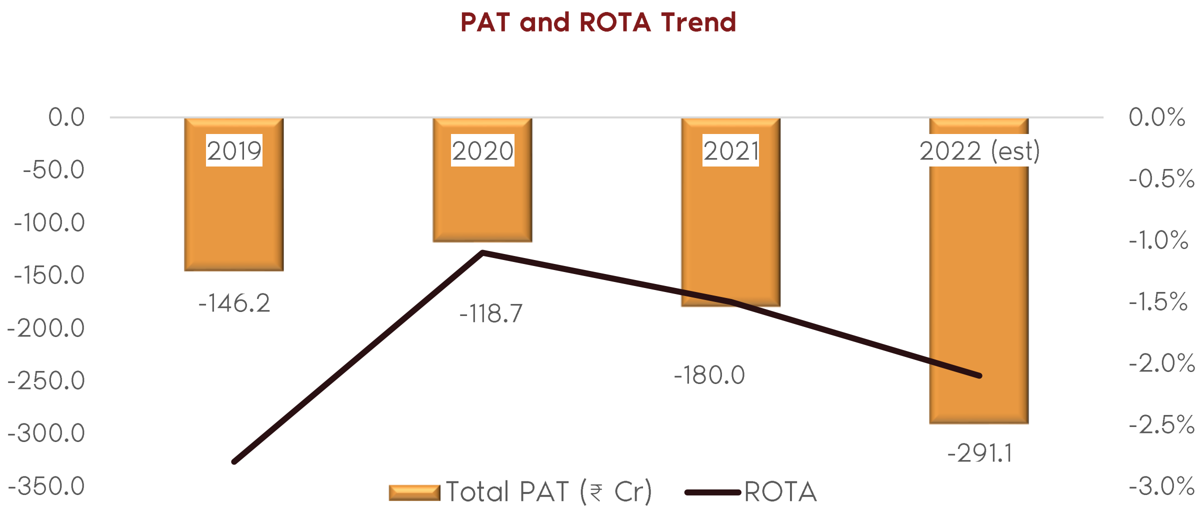
For SME loans, the proportion of profitable companies is estimated to have declined in FY22. This reflects the continuing challenges faced by SME FinTech lenders on the asset quality front, given the business disruption that emerged among small businesses in the wake of the prolonged pandemic.

Personal Loan Segment:



The PAT and ROTA metrics moved up from the negative domain to the positive domain in FY22.

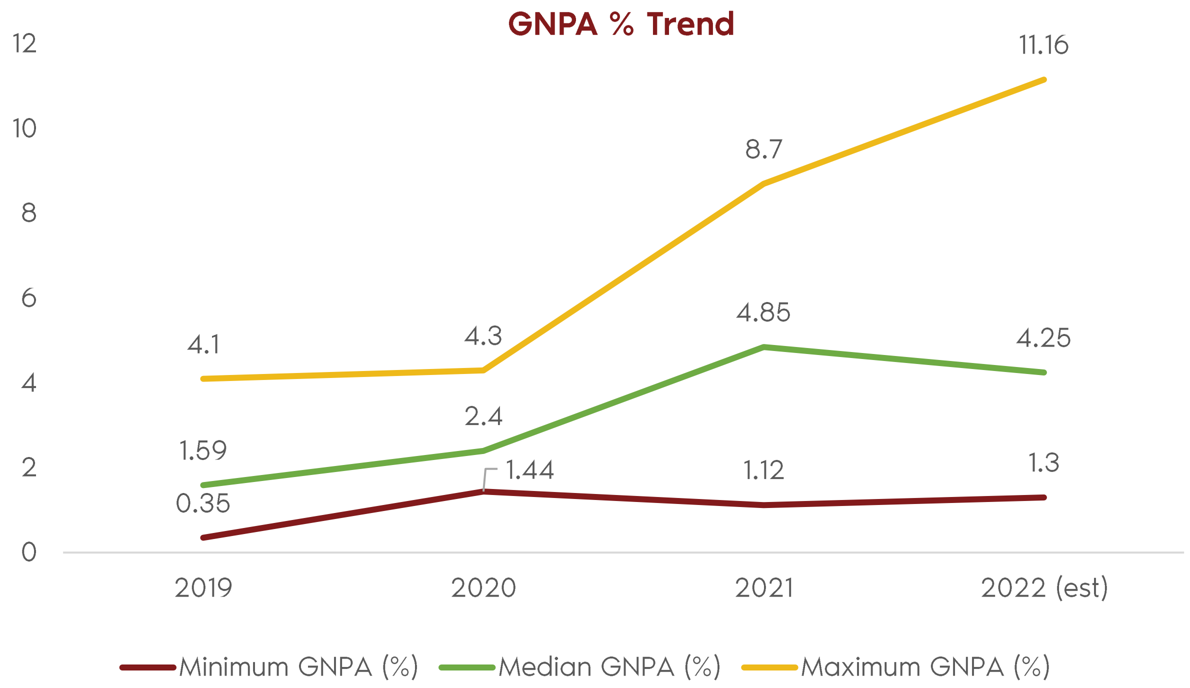
SME Loan Segment:



The PAT and ROTA continued to remain in the negative domain over the past few years.

Asset Quality Analysis:

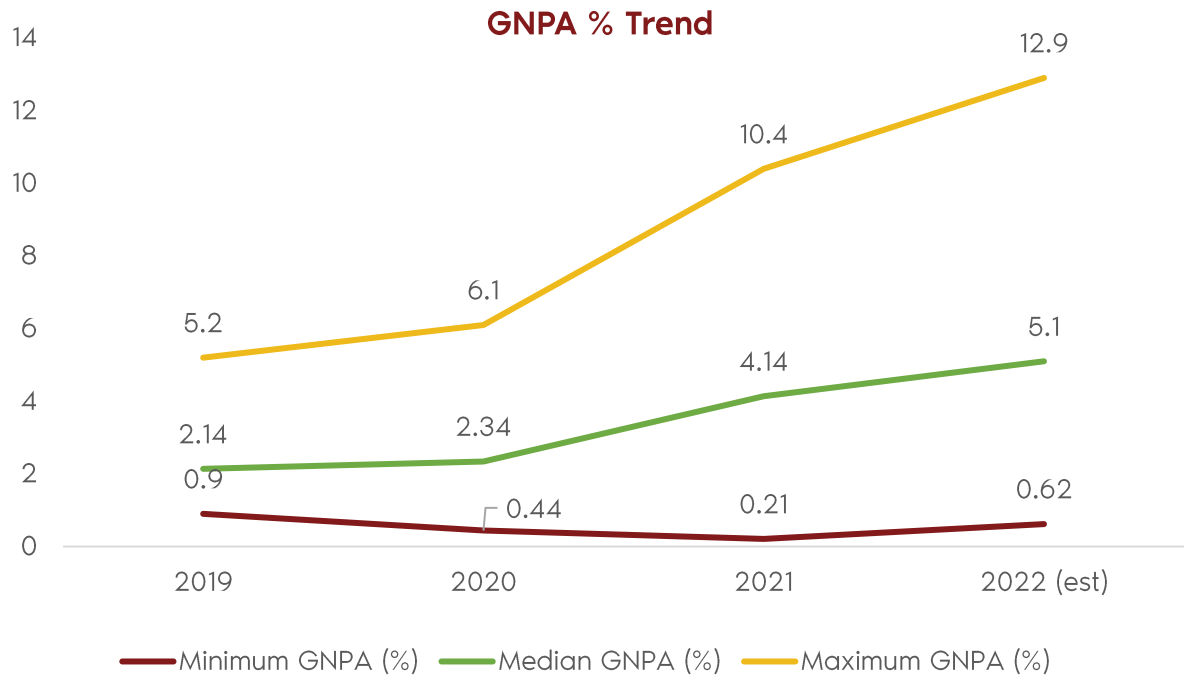
Personal Loan Segment:



In the consumer loan segment, some moderation in GNPA levels is observed in FY22 as compared to FY21. However, the gap remains wide between the minimum GNPA and maximum GNPA within the set of identified FinTech NBFCs.

The reported improvement in terms of asset quality can be partly attributed to the aggressive write-off policies undertaken by these companies.

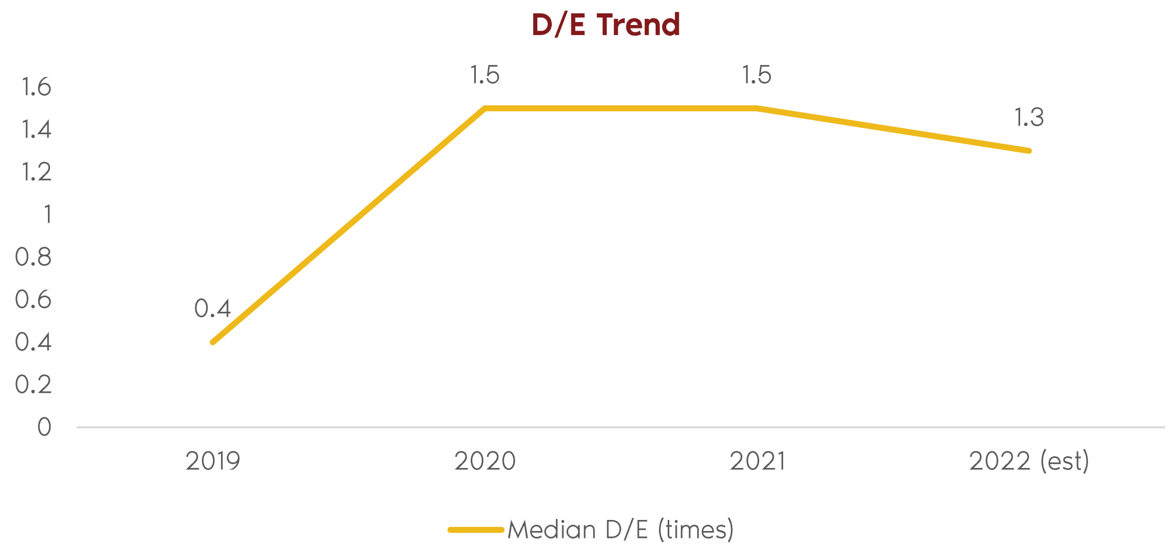
SME Loan Segment:



In the SME loan segment, we note a steady rise in the GNPA levels. This can be primarily attributed to the challenges faced by small businesses during the prolonged pandemic period which they are yet to recover from.

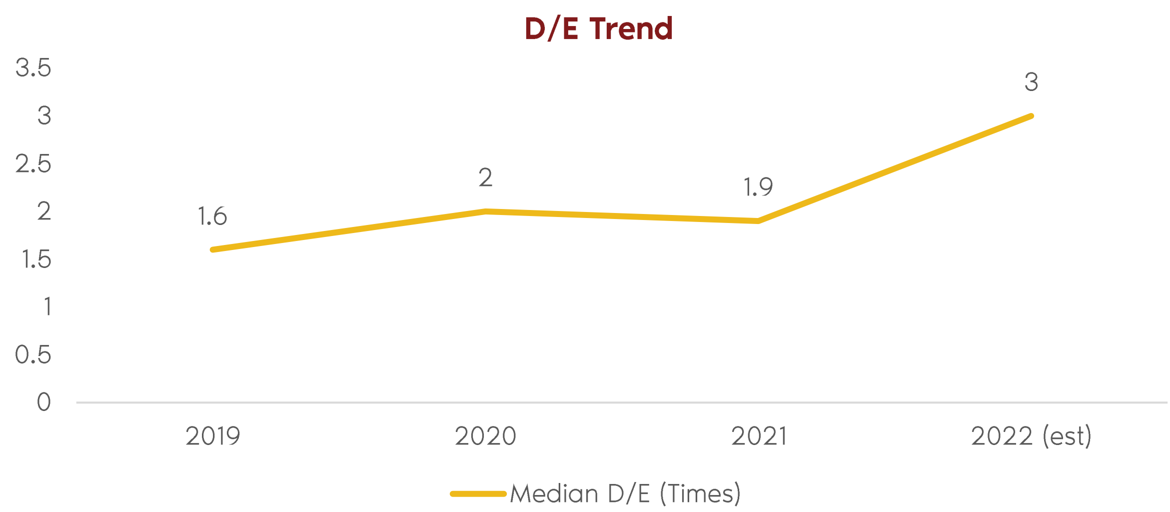
Leverage Analysis:

Personal Loan Segment:



For personal loan FinTech players, gearing has remained relatively low at around 1.3x as of March 2022 which reflects the steady infusion of capital in most of these companies.

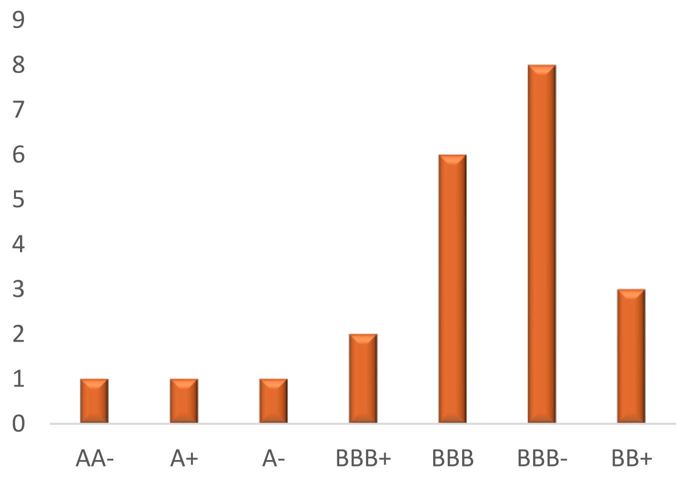
SME Loan Segment:



Leverage for the SMB lending FinTech players has sequentially gone up in last three years from an average of 1.6x as of March 2019 to 3.0x as of March 2022. In this segment, capital infusion has been partly offset by the relatively higher losses.

Industry Level Rating Distribution*

Rating	No. of FinTechs
AA-	1
A+	1
A-	1
BBB+	2
BBB	6
BBB-	8
BB+	3
Grand Total	22



*Includes all Credit Rating Agencies

- The credit quality of FinTech NBFCs are currently characterised by a technology driven business model, consistent capital infusion, relatively lower gearing, limited track record and a weakness in the earnings profile.
- Ratings of 87% of these companies are currently in the investment grade primarily due to their adequate capital position.
- However, the rating distribution is concentrated in the lower range of the investment grade, i.e. the 'BBB' category, given the challenges on their earnings side.
- Over the last 2-3 years, the downward transition in the ratings has remained minimal; a few of them have been either upgraded or given a Positive Outlook.

Regulations and Compliance

Technology Neutrality	Principle Backed Regulation	Addressing Regulatory Arbitrage
Neutrality towards technological differentials or business models while encouraging competition to maximize the benefits to the financial system.	Instead of a rule-based regime, a principle-backed approach to provide sufficient scope for innovation and adaptability in a dynamic environment.	Addressing the arbitrage between different sets of entities in the digital lending ecosystem to ensure level playing field and market integrity.

The regulatory guidelines talk about Technology Neutrality, Principle Backed Regulation and Addressing Regulatory Arbitrage.

To achieve these three objectives, the working group of the regulator had recommended a three-pronged measure. Some of the key recommendations are:

A. Legal & Regulatory Recommendations	• A nodal agency should be set up. It will primarily verify the technological credentials of Digital lending Applications of the balance sheet lenders and Lending Service Providers operating in the digital lending ecosystem.
B. Recommendations related to Technology	• Compliance with the prescribed baseline technology standards should be a pre-condition to offer digital lending by the Regulated Entities. • Each Digital lending Application should have publicly available policies regarding data storage, its usage and privacy.
C. Recommendations related to Financial Consumer Protection	• Each lender should provide a key fact statement in a standardized format.

Summary of the new guidelines of digital lending

RBI has issued digital lending guidelines for NBFCs and banks in Sep 2022. These guidelines are intended to ensure responsible lending and consumer protection in the FinTech lending space. On consumer protection, the regulator has attempted to address two concerns – data privacy and transparency in the lending activity. Further, it has also sought to address the systemic risks that currently exist due to the increased role of unregulated lending service providers in the disbursement and the collection processes. Some key pointers in these guidelines are as follows:

- Regulated Entities (REs) cannot store borrowers' data except for some basic minimal information.
- At the time of disbursing the loans using digital apps, a Key Fact Statement (KFS) to the borrower must be provided in a standardized format for all digital lending products. The borrower must be informed about the all-inclusive cost of digital loans in this statement, the recovery mechanism, contact details of grievance redressal officer and the cooling-off/ look-up period, which is the time given to the borrower for exit, in case a borrower decides not to continue with the loan.
- REs shall ensure that all loan servicing, repayment, etc., shall be executed by the borrower directly in the REs' bank account without any pass-through account/ pool account of any third party including that of Lending Service Providers and their Digital Lending Apps. The disbursements shall always be made into the account of the borrower.

Acuité's Rating Criteria for Lending FinTechs

Rating Approach: Consolidation

For FinTech lending businesses, there are typically two arms – (i) the parent entity which builds and owns the digital platform and the related technology. (ii) and the other is the regulated lending entity i.e. an NBFC which is usually held by the parent entity.

Generally, the parent entity has a high fixed cost structure, given the high investments in fixed assets and software technology. Often, the parent also provides various critical services to the lender including the underwriting platform and collections. Hence, it is critical to evaluate the FinTech lending business in totality to get the right perspective particularly on profitability. For this reason, Acuité takes a consolidated approach for rating such companies.

Evaluation of business model	• Asset class • Track record of operations • Average ticket size (for smaller ticket size, customer volumes) • Tenure of the loan • Break even period • Credit and Opex cost • Co lending tie ups (Number of Tie ups, type of lenders, escrow arrangement, FLDG Arrangement, hurdle rate) • Product diversification (if any) • Collection mechanism - team strength, in house/ outsourced, level of auto
Evaluation of financial position	• Net worth and track record of capital infusion • Capitalization and Gearing levels • AUM or Disbursement levels • Profitability (in loss making companies pre provisional earnings) • Gross NPA% • ROI (Break up of Processing Fees and Interest Income) • Operating expenses/AUM • NIM% • Net stage 3/Net worth • Write-offs/Disbursements (Policy guideline regarding a time frame for recognizing the write off)
Capitalization levels and investor base	• Profile of Investors and strategic linkage • Participation of existing investors in subsequent funding rounds • Ability to attract funding and improve funding diversity
Management quality	• Experience and reputation of the promoters • Representation of the investors on the board • Profile of the independent board members
Technology and digital infrastructure	• Technological linkage with parent/group company • Evaluation of risk management framework, systems and processes • Filtration Criteria • Data sources and API
Regulatory Risk	• Any changes in the regulatory framework that impacts the business position

Key Observations

Lending FinTechs to witness an expanding set of laws and regulations that will bring more transparency and accountability for the sector.	• This could lead to some disruption in the growth for the short term but is expected to support sustainability and scalability over the medium to long term • The regulatory supervision will make the industry more organized
Industry continues to attract lot of interest of marquee and global investors	• Compared to CY 2020, the funding amount and deal count surged 3.7x and 2x respectively for CY 2021 • Disbursement trends healthy with gradual diversification across various asset classes • Starting from small ticket size Consumer and Small Business loans, the FinTech concept is expanding into Auto loans, Auto Vehicle loans, Trade Finance, Gold loans etc.
The lending tie up with Banks and FIs is on an increase	• Leverage for the SMB lending FinTech players has sequentially gone up in last three years from average of 1.6x as of March 2019 to 3.0x as of March 2022. • For personal loan FinTech players gearing remains relatively low at around 1.3x as of March 2022 • Co-lending arrangements on an increase
The profitability remains a challenge on account of higher credit cost and amortization of initial investments in technology	• The profitability metrics has been better in personal segment as compared to SMB segment so far • But a significant proportion of players are yet to reach breakeven and incurring losses
With increasing track record and more cycles of lending, the debt funding is expected to increase	• Given the short tenure of the loans given, the number of lending cycles is gradually increasing for the sector • However, higher debt funding is subject to the operating and earning position as well as regulatory adherence

Conclusion

For the development of a healthy FinTech lending ecosystem, the FinTech players need to enhance their funding diversity. Currently, equity funding is the major source with debt funding limited to those from its own shareholders and mostly non-bank lenders.

It is expected that with increased seasoning of the FinTech portfolio, longer track record and the cushion available from a healthy capital base, the exposure of lenders particularly banks in the FinTech NBFC sector will increase. Nevertheless, it will continue to be linked to the quality of their earnings and compliance with enhanced regulations.

Overall, Acuité Ratings foresees an environment of healthy partnership and collaboration between the banks and the FinTech companies.

Acuité Ratings' presence in FinTech NBFCs

In the rated portfolio of FinTech NBFCs, there is a healthy diversity in the asset classes including personal loans and SME loans. Acuité Ratings has also rated FinTechs in the gold loans and the vehicle loans space.

Acuité FinTech Universe (Including Pass-Through Certificates and Partial Credit Enhancement transactions)	Si Creva (Kissht)
	Akara Capital (Stashfin)
	Quadrillion Finance (Slicepay)
	Krazybee Services Pvt. Ltd.
	Loantap Financial Technologies
	Orange Retail Finance
	Rupeek
	MPokket
	MoneyBoxx Finance
	1T9 TECHNOLOGY PRIVATE LIMITED

Acuité has also rated securitization transactions for most of these clients. Such transactions include Pass Through Certificates and Partially Credit Enhanced term loans and NCDs with a third-party guarantor.

Glossary

Asset Under Management (AUM):

The total amount disbursed less the total amount received/repaid i.e. money owed to the MFI's in the form of loan as on date. All outstanding principal for all outstanding client loans. It does not include interest receivable.

Average Outstanding Balance per Client:

Gross loan portfolio / No. of active borrowers.

Cost of Fund (COF):

Cost of funds paid by financial institutions for the funds that they use in their business. The spread between the cost of funds and the interest rate charged to borrowers represents one of the main sources of profit.

Capital Adequacy Ratio (CAR):

The capital adequacy ratio measures the ability of a financial institution to meet its obligations by comparing its capital to its assets. Regulatory authorities monitor this ratio to see if any financial institutions are at risk of failure.

DLA:

Digital Lending Application

Disbursement:

The disbursement of the loan reflects the transfer of the amount to the borrower from the lending party.

Gross Non-Performing Assets (GNPA)

Gross non-performing assets is a term used by financial institutions to refer to the sum of all the unpaid loans which are classified as non-performing loans.

LSP

Lending Service Provider

No. of Active Clients:

The number of individuals who are active borrowers, depositors, or both.

Net Interest Margin (NIM):

It is a profitability ratio that measures how successful a company is making investment decisions by comparing the income, expenses, and debt of the investments.

Net Non-Performing Assets (NPA):

Net non-performing assets is a term used by financial institutions to refer to the sum of the non-performing loans less provision for bad and doubtful debts.

Operating Expenses:

Expenses related to operations, such as all personnel expenses, rent and utilities and depreciation.

Portfolio at Risk (PAR):

PAR / Gross Loan Portfolio. The value of all loans outstanding that have one or more instalments of principal due more than 30 days.

RE

Regulated Entity.

Securitization:

Securitization is one-way microfinance institutions can access capital markets, improve liquidity and lend more money.

About Acuité Ratings and Research

Acuité is a full-service Credit Rating Agency registered with the Securities & Exchange Board of India (SEBI). The company received RBI Accreditation as an External Credit Assessment Institution (ECAI) for Bank Loan Ratings under BASEL-II norms in the year 2012. Acuité has assigned ratings to various securities, debt instruments and bank facilities of entities spread across the country and across a wide cross section of industries. It has its Registered and Head Office in Kanjurmarg, Mumbai.

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