White Paper

Building a Sustainable Fintech Portfolio

Experiences and Lessons for Future.

Foreword by

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Fintech have established themselves as a serious player in the lending ecosystem and have clearly come of age. However, now it is time to brainstorm on what trajectory fintech should take given developments (such as Digital Personal Data Protection Act and Digital Lending Guidelines) and portfolio performance to achieve their next wave of growth. This event will provide participants with just the right platform to engage with all stakeholders in their growth journey.

The advent of fintech, enabled by rapid advancement in digital public infrastructure, led to transformational growth in small ticket unsecured lending in India. This also spurred incumbent lenders to adopt the "fintech way" leading to further proliferation of technology led credit growth.

The fintech operating model is fundamentally different from those of traditional lenders. There is a greater emphasis on leveraging technology and analytics to create customer journey with reduced friction while ensuring underwriting due diligence standards do not get diluted.

The share of fintech in overall lending, even though low currently, is increasing at a rapid pace. Hence, it becomes important to understand long term implications of the accelerated growth of fintech in terms of portfolio vulnerability to default risk. Further, it is critical to understand the genesis of this growth. Are the fintech helping create "new markets" or is their growth merely a matter of redistribution of the lending pie?

This white paper "**Building a Sustainable Fintech Portfolio: Experiences and Lessons for Future**" attempts to objectively evaluate the portfolio built by fintech to assess its sustainability while also examining potential to scale up in times to come. Critical review of the experiences of fintech will help build empirical foundations basis which optimal pathway for fintech can be established. We have following key takeaways based on empirical analysis:

- Fintech have made significant inroads in the small ticket lending as also enabled many private lenders to ride the digital wave through partnership model such as **Co-Lending and being Lending Services Provider**

- Fintech created a niche by creating "blue oceans" as against focusing on available white spaces in the addressable market such as customers who are new to credit or with bureau score below 700. By offering frictionless journey and contextual selling (embedded finance) fintech even got credit averse segment to opt for credit

- Fintech portfolio had higher delinquency but seem to price the risk as interest rates were found to be higher than industry. Hence, while there is no apparent sign of deep stress it is important to grow the portfolio cautiously given limitations of digital collection

- Further, given limited product mix of fintech it is important for them to find new revenue streams such as being a partner in the growth of other regulated entities on asset-based products

- **The Fintech Economy:** Blue Ocean Analysis
- **Fintech Portfolio:** Addressing the Issue of Sustainability and Scalability
- **Fintech at the Cross-Roads:** Defining the Growth Pathway

The Fintech Economy: Blue Ocean Analysis

Fintech brought a paradigm shift in the lending landscape in just a decade...

Pre-Fintech (Before 2008)	Early Fintech Era (2008-2016)	Fintech: Coming of Age (After 2016)
Brick and Mortar Lending	Rise of Platforms	AI-Driven Credit Scoring
Manual Underwriting	Fintech capture STPL market	Embedded Financing
Credit Access-Limited	Digital Infrastructure as enabler	Quantum Lending
✓ Limited focus on small ticket unsecured lending	✓ Peer-to-Peer lending and online microloans	✓ AI-Powered credit scoring, embedded finance
✓ Mainly physical and collateral based	✓ Online applications, mobile apps, web platforms	✓ AI-Driven applications, digital identity verification
✓ Limited straight through decisioning, reliance on manual methods	✓ Small business owners, quick loan seekers	✓ Underserved individuals (digital onboarding), new entrepreneurs (OCEN)
✓ Good credit history or ability to demonstrate credit worthiness		

Through an approach led by 4 Cs: Decoding the fintech phenomenon

The 4 C Perspective

1. Collaboration with Incumbent

- Direct lending
- Lending services
- Co-lending

2. Cost Leadership

- Leverage digital public good
- Algorithm based decisioning
- Ride the cloud wave

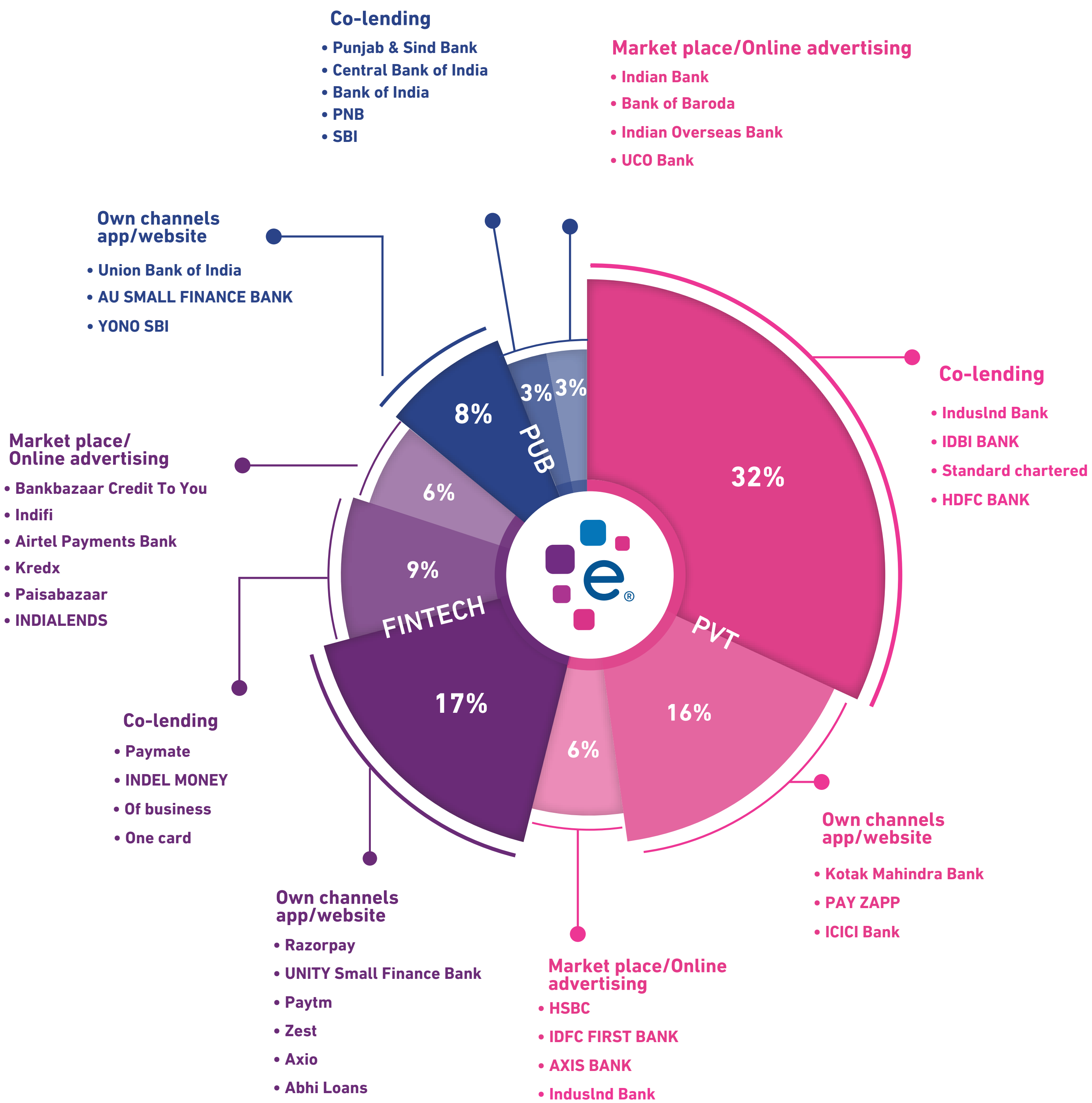
3. Coverage of Credit

- Alternate data to u/w on NTC
- Penetrate the hinterland
- Credit hesitant segment

4. Consumption Financing

- Consumption led by rising aspiration class
- Demographic dividend

Multitude of collaborative operating model innovations led by fintech co-exist today

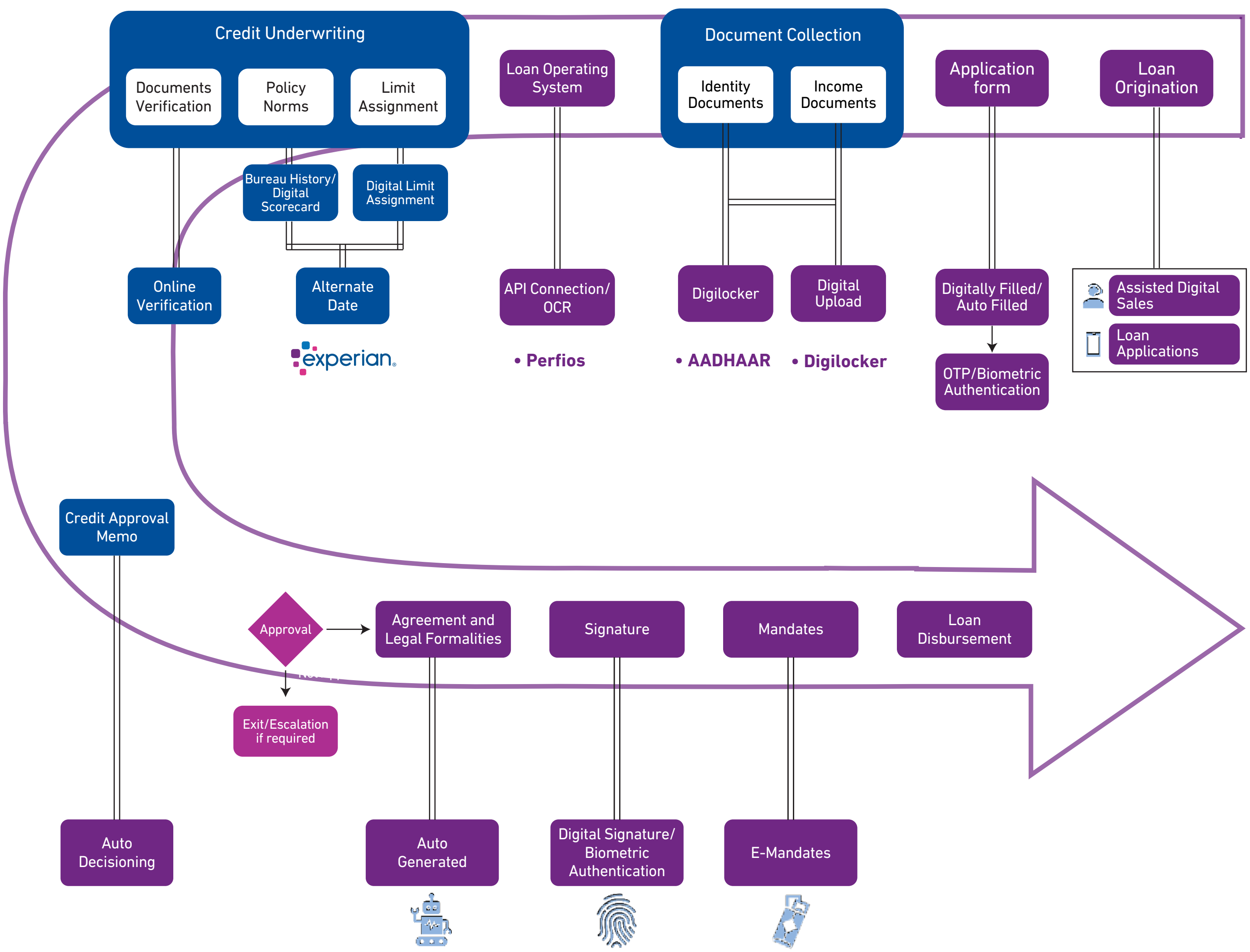


*Based on Focus group discussions with various Lenders.

Fintech made the most of thriving digital infrastructure to reduce cost of customer onboarding at scale

- Technological breakthroughs have helped fintech create a frictionless lending journey with the help of alternate data, digital marketplace and embedded finance
- Consequently, certain products especially high ticket asset backed segment is yet to pickup on digital adoption

Credit Process Reimagined



Speed and convenience are the primary drivers of fintech adoption as per Experian voice of the customer survey

Initial Choice & Future Intentions

- ~ 40% of borrowers chose fintech for speed and convenience
- ~ 68% express intent to borrow from fintech again
- Half of the population are drawn by fintech's tailored loan options

Benefits & Drawbacks Experienced

- Convenience is key; 76% find paperless process beneficial
- 61% appreciate fintech's inclusivity using alternative data
- Drawbacks include higher interest rates and data security concerns

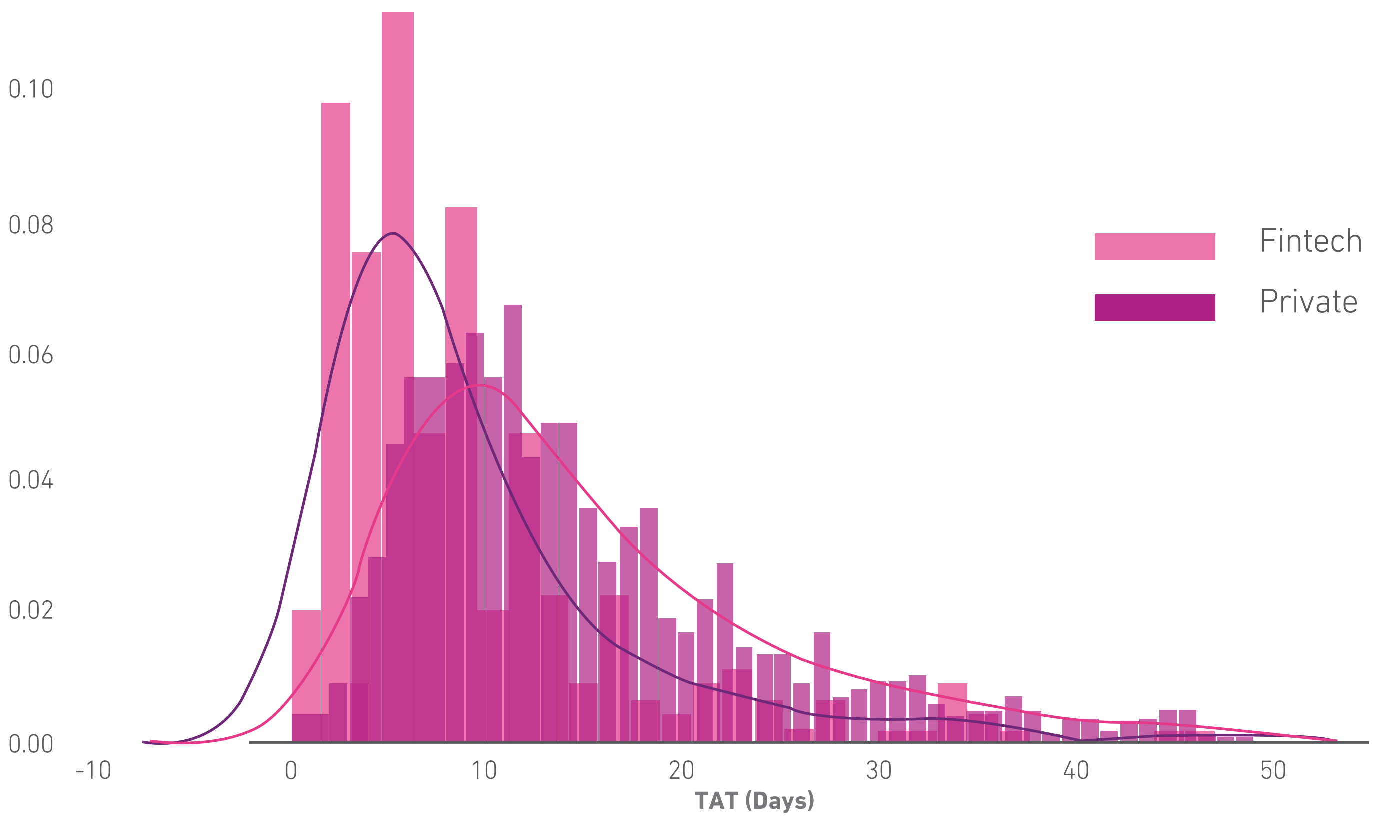
Preferred Products & Segment Opinions

- 42% prefer personal loans for flexibility
- 34% opt for small business loans to foster growth
- Young professionals favor personal loans; entrepreneurs choose small business loans

* Experian survey

Frictionless digital onboarding leading to simplified user journey creating stickiness

TAT for traditional lenders on mid-sized asset backed products

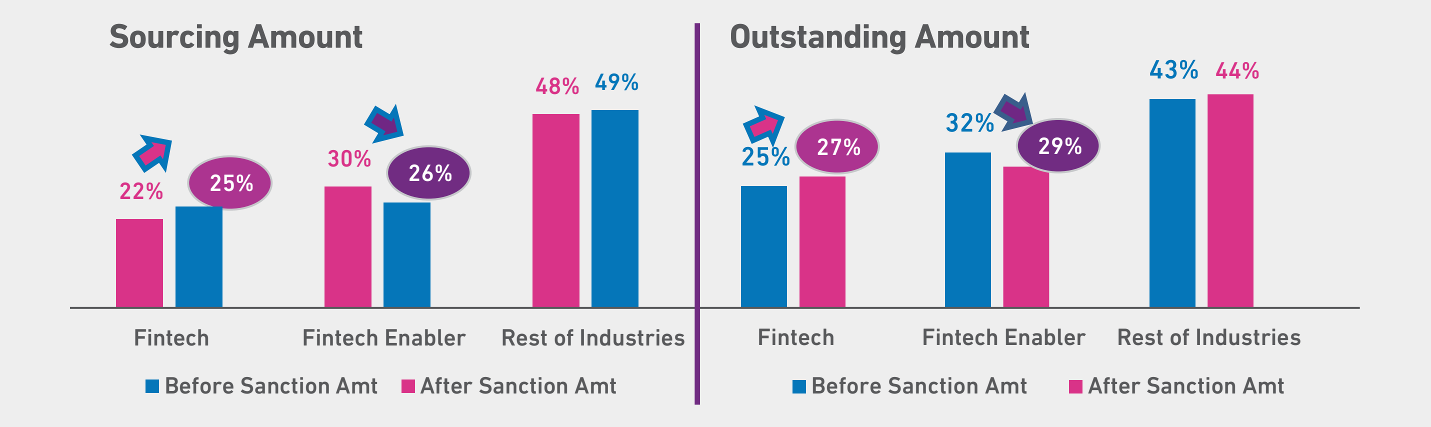


- Borrower expectation today is to get access to credit instantly, anytime and anywhere, thus turn around time plays a critical role in paving success for digital lending. A recent study by Experian on TAT of asset backed mid ticket sized products revealed that **the median TAT time is approximately a week**
- Many new age lenders, are offering instant unsecured personal loans, the loan process being 100% digital with ensured disbursement within 15 minutes into the Bank accounts

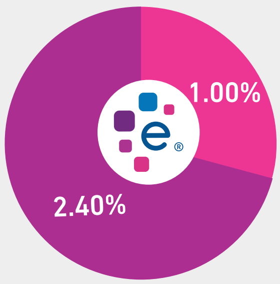
*Based on Experian Research for Personal Loans sourced in FY23.

Fintech have been able to create greater stickiness despite absence of a physical touchpoint in the onboarding journey

Fintech are net customer gainers and do so at the expense of fintech enabler



- Subsequent product purchase by customers can be a good indicator on their loyalty towards their lender
- We tracked a sample of customers well distributed across different lender types over a period of twelve months
- Chart above gives the distribution of loans across different lender types taken before and after the study. We can clearly see fintech are able to increase their share of wallet at the expense of fintech enablers
- This implies fintech have been able to create integrations hook better than the fintech enablers
- Customers shifting their loyalty to other lenders perform well on delinquencies. Thus, the segment of customers migrating are a good acquisition



	Ever 90+ Off Us	
Ever 90+ On Us	0	1
0	89.3%	6.2%
1	2.4%	2.0%

	Ever 30+ Off Us	
Ever 90+ On Us	0	1
0	84.9%	7.4%
1	4.4%	3.3%

- Further, based on the behavior of customers we can identify potential high risk early and take preventive steps
- Likewise, we can identify segment to win back customers who are in deep delinquency bucket but have shown roll back tendency with other lenders

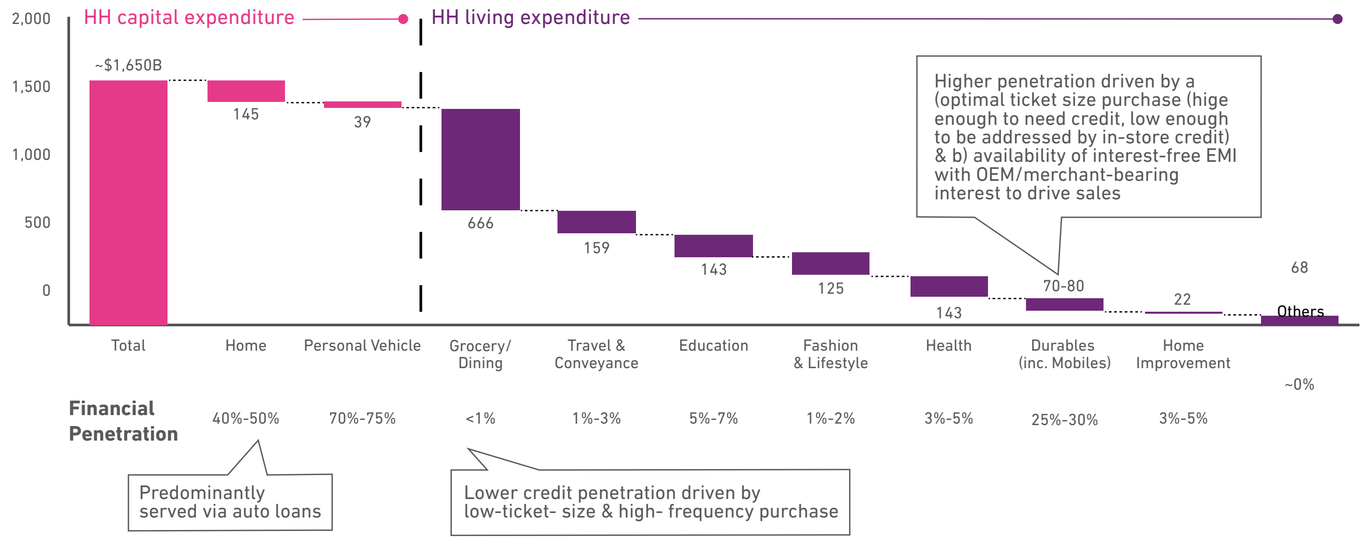
*Based on Experian research on Personal Loan sourced in FY23.

![experian logo]

Consumption Financing: Consumption financing penetration increased on select categories but there is still untapped potential

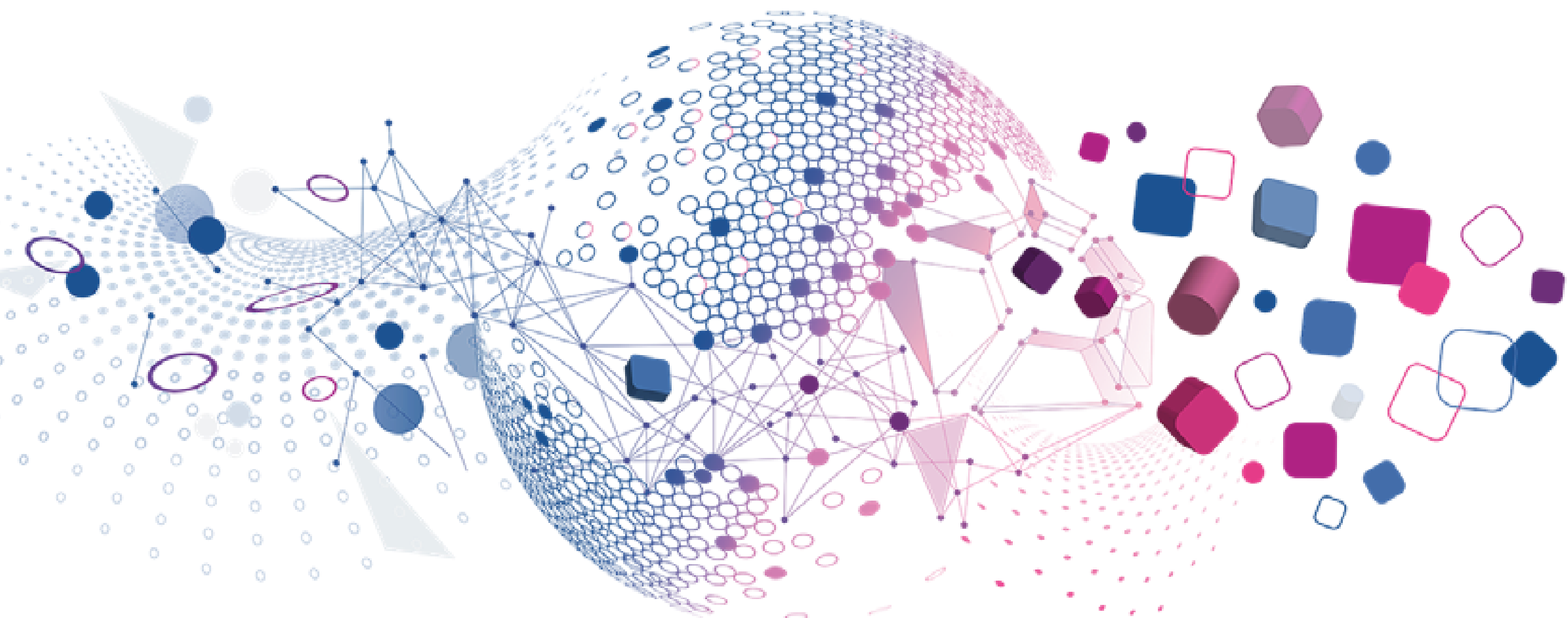
Credit penetration is <5% for most of the key spend categories

India consumption spend by basket ($B), FY21



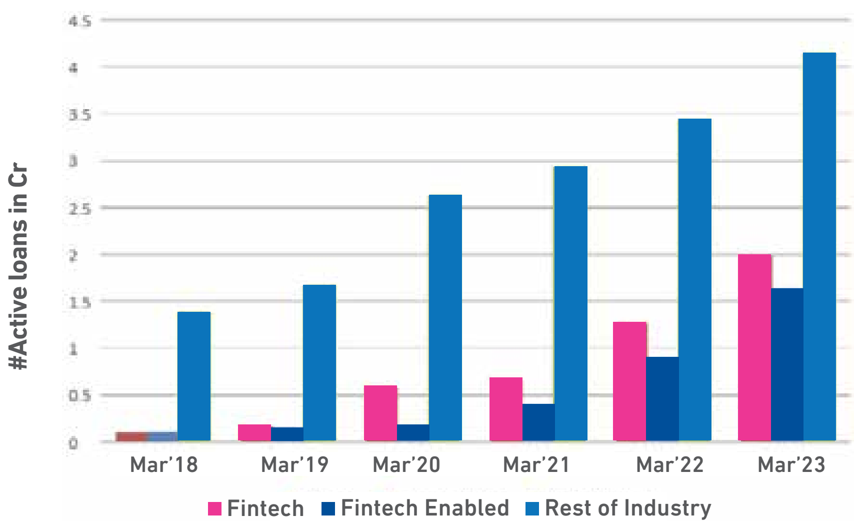
Notes: HH Household. Grocery/Dining incl grocery dining out and food delivery, Travel & conveyance Incl. spend on airfare taxi, train,etc.; Health Incl. only Out of Programme Experience ((OOPE) expenditure by HHs, Home Improvement Incl. home, furniture, 70%+ in car financing and 50%+ in 2-Wheeler, Lifestyle Incl apparel Books and General Merchandise (BGM), Others Incl. HH services (e g . domestic help) rent, water, entertainment, barber etc. OEM-Original Equipment Manufacturer Sources: Nielsen; Euromonitor; RBI, secondary research; CEIC data Bain analysis.

Fintech Portfolio Snapshot



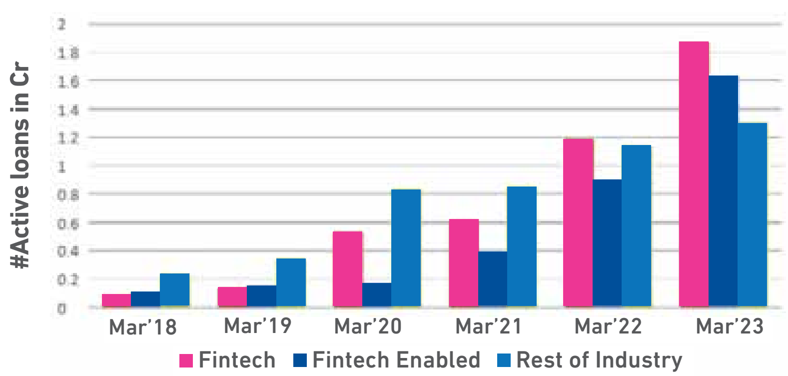
Unsecured Small Ticket Personal Loan Lending Snapshot

#Active Loans - PL Industry

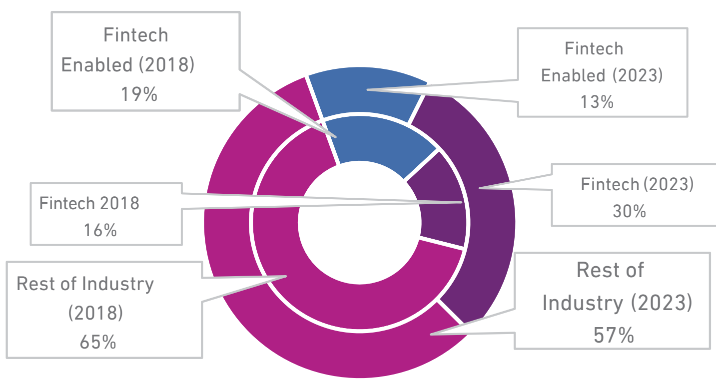


	2018	2023
Fintech & Fintech Enabled combined PL market share (overall count)	13%	47% ⬆
Rest of the industry PL market share (overall count)	87%	53% ⬇
Fintech & Fintech Enabled combined PL market share (count : Tkt <1L)	45%	73% ⬆
Rest of the industry PL market share (count : Tkt <1L)	55%	27% ⬇
Fintech & Fintech Enabled combined PL market share (amount : Tkt <1L)	35%	43% ⬆
Rest of the industry PL market share (amount : Tkt <1L)	65%	57% ⬇

Small Ticket Active Loans (<10L)



Lender Wise Market share shift from 2018 to 2023 (<1L)

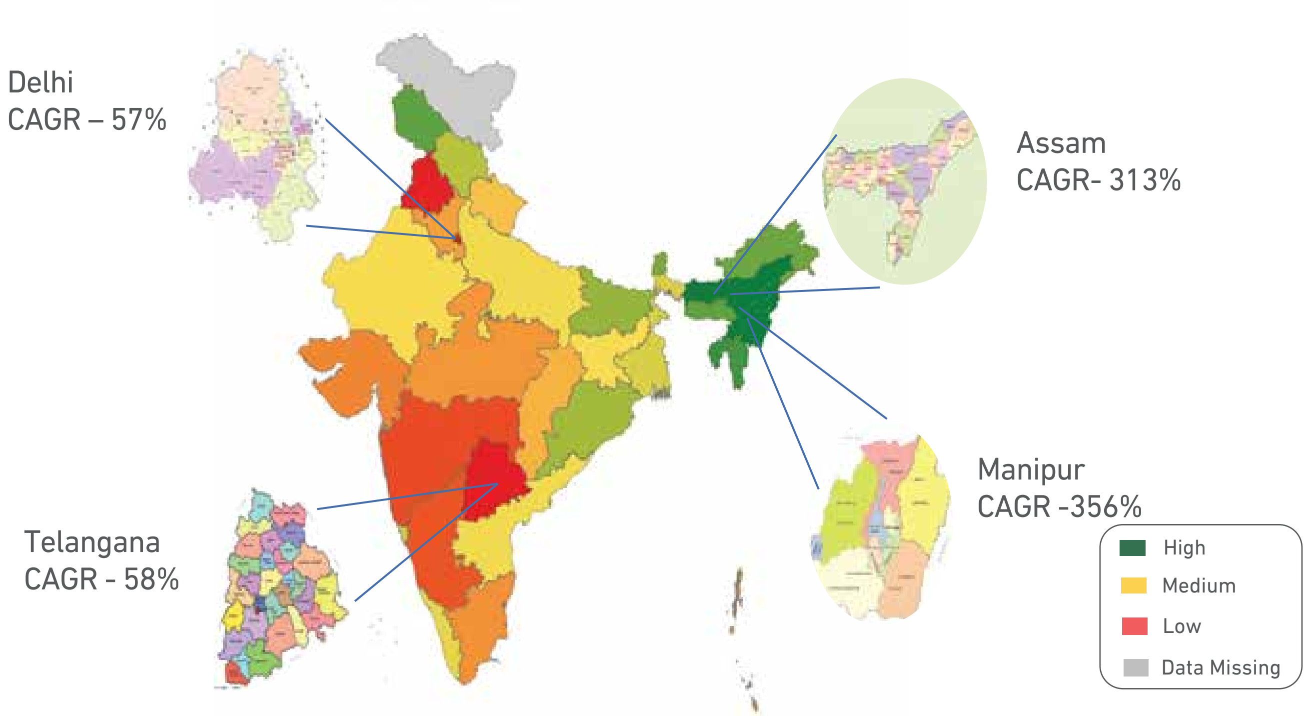


Fintech: NBFC with strong focus on technology led acquisition.

Fintech Enabled: Loans originating from one lender but aided by partnership with another fintech are tagged as Fintech Enabled loan. These loans are of small ticket size (< 1 lacs for PL and < 10 lacs for BL).

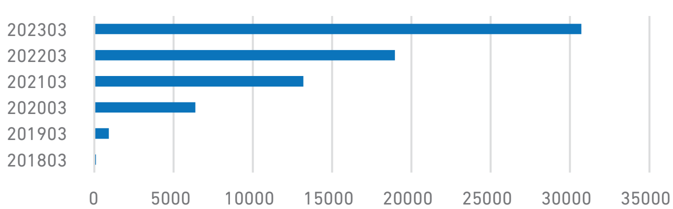
Cities with high CAGR on Personal Loan are all non-metros

PL Fintech Adoption Across States (2018-2023)



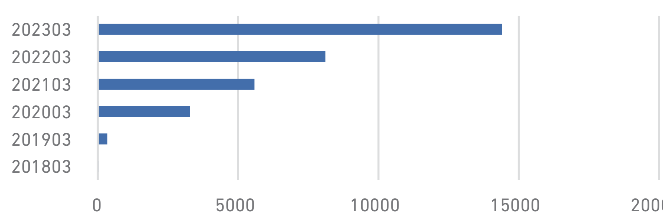
Cities with exponential PL growth led by Fintech

Alwar*



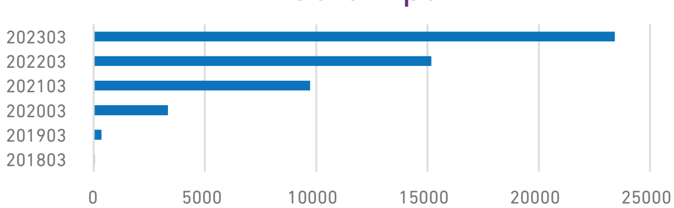
CAGR : 206% New acct. : ~ 31K

Idukki*



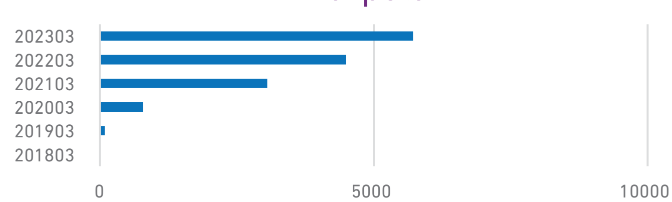
CAGR : 241% New acct. : ~ 14.5K

Gorakhpur*



CAGR : 245% New acct. : ~ 23.5K

Barpeta*



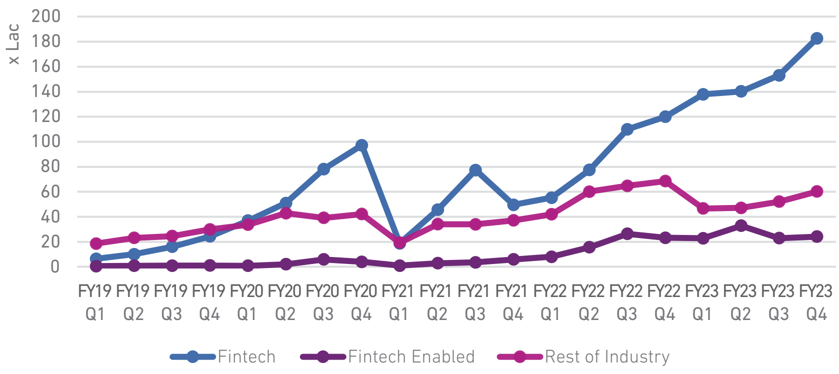
CAGR : 464% New acct. : ~ 6K

*Year | Month
2023 | 03

Fintech growth leapfrogged on small ticket unsecured personal loan post pandemic

Rest of industry has a larger market share in big ticket size loans and hence has higher overall market share by amount

Overall Count

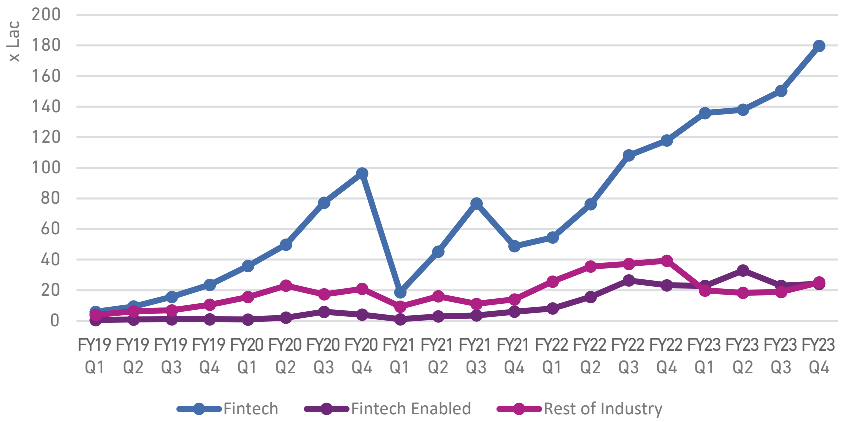


Fintech : 18.27M (2746%)

Fintech Enabled: 2.42M (4605%)

Rest of Ind.: 6.02M (225%)

Count <1L



Fintech : 17.98M (2983%)

Fintech Enabled : 2.42M (4605%)

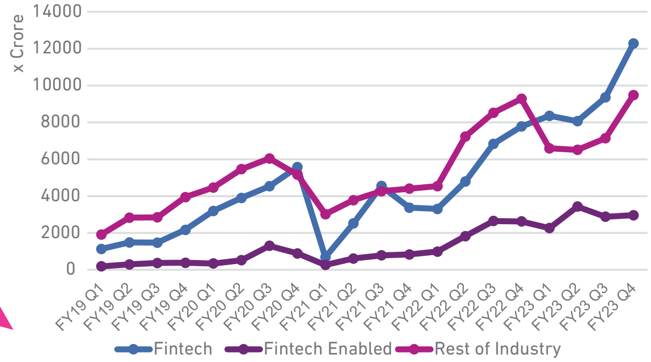
Rest of Ind. : 2.51M (559%)

Amount <1L

Fintech : 122.8B (986%)

Fintech Enabled: 29.63B (1495%)

Rest of Ind.: 94.77B (395%)



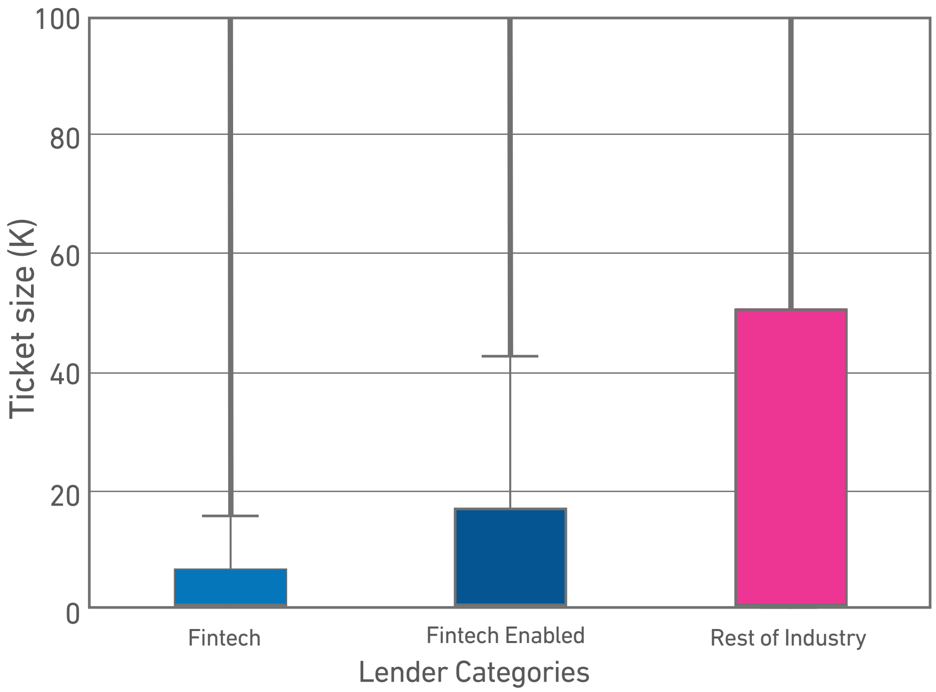
Fintech: NBFC with strong focus on technology led acquisition.

Fintech Enabled: Loans originating from a private lender but aided by partnership with a fintech are tagged as Fintech Enabled loan.

Generally these loans are of small ticket size (< 1 lacs for PL and < 10 lacs for BL).

Fintech operate in the small ticket size segment and dominate these segments completely

Ticket size distribution of STPL across lender categories



Fintech: NBFC with strong focus on technology led acquisition.
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Fintech

Median ticket size:

₹2,000

Fintech Enabled

Median ticket size:

₹6,500

Overall Industry

Median ticket size:

₹22,000

- **Median ticket size of overall industry is ₹22,000** while that of fintech is only ₹2,000
- **Fintech dominate the small ticket segment highlighting borrower preference for fintech in this segment**

Fintech acceleration in Chittoor: Case study on how different stakeholders can come together to generate exponential growth

Chittoor, a tier 4 city of Andhra Pradesh, has shown tremendous growth in fintech adoption and growth due to MSME boom in the region.

Chittoor - CAGR of Fintech PL market

200% by Amount 148% by Count

Share of Chittoor in Fintech PL Market 2023

0.6% by Amount 0.8% by Count

- **GOVERNMENT OF ANDHRA PRADESH**

Collaborations of the Government with companies such as **Paytm and Visa** to launch initiatives in order to increase regional financial inclusion.

- **Paytm**
- **GOVERNMENT OF ANDHRA PRADESH**
- **VISA**

Chittoor has thus shown **an increasing trend both in amount and count of personal loan lending done by fintech.**

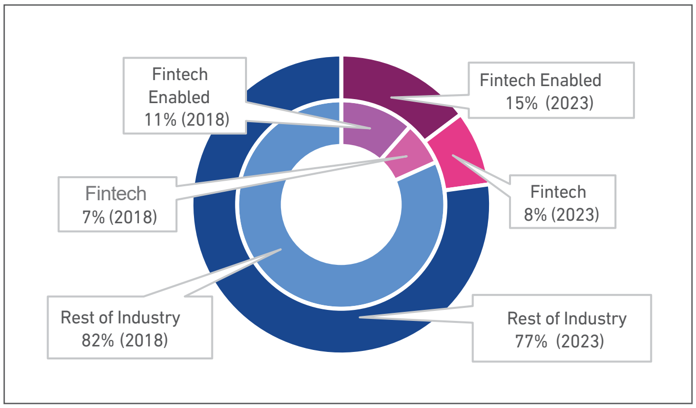
- **Airtel**
- **Jio**
- **VI**
- **BSNL**
- **MTNL**

Government of Andhra Pradesh: Promoted fintech through their Fintech Accelerator Program.

Other factors driving the growth can be increasing population of middle class and **increasing internet penetration.**

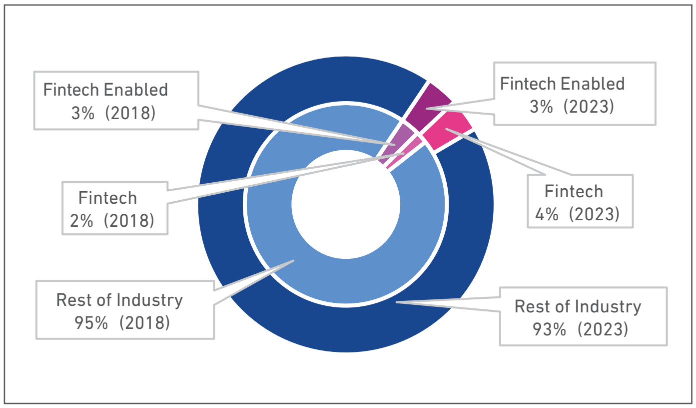
Unsecured Business Loan Lending Snapshot

Market share of BL by count



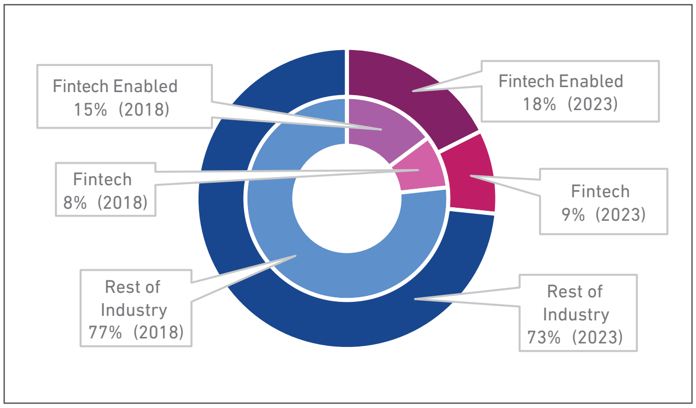
	2018	2023
Fintech and Fintech Enabled	18	23
Rest of industries	82	77

Market share of BL by amount



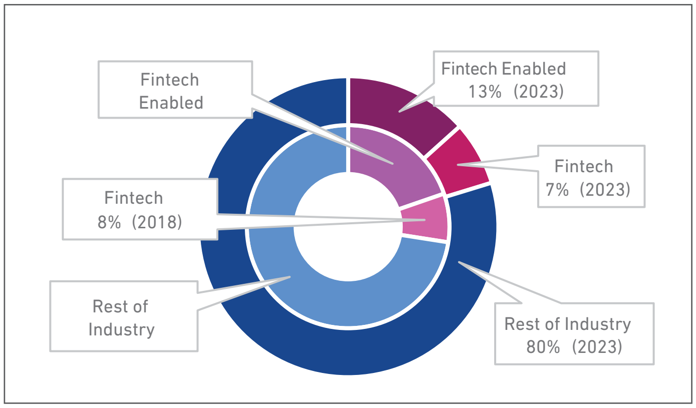
	2018	2023
Fintech and Fintech Enabled	5	7
Rest of industries	95	93

Market share of low ticket size BL (<10L) by count



	2018	2023
Fintech and Fintech Enabled	23	27
Rest of industries	77	73

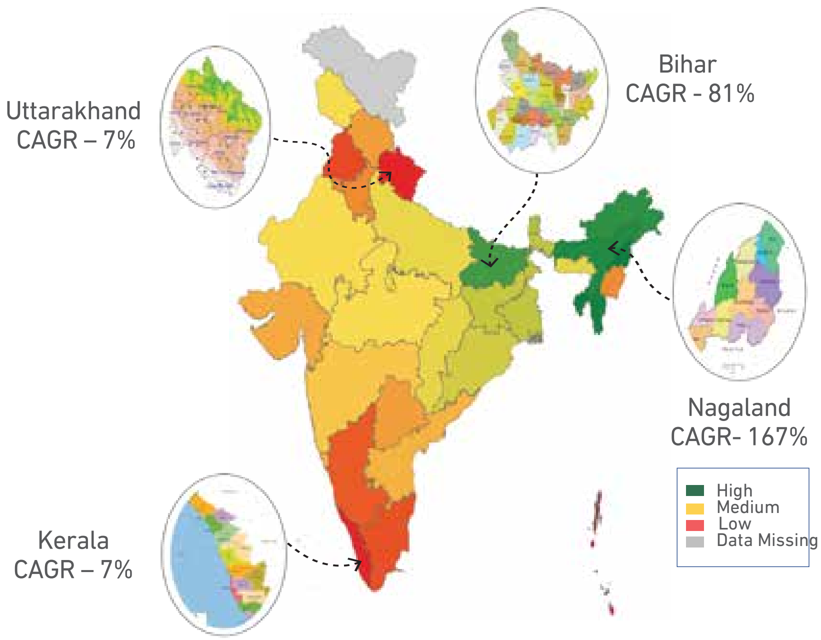
Market share of low ticket size BL (<10L) by amount



	2018	2023
Fintech and Fintech Enabled	28	20
Rest of industries	72	80

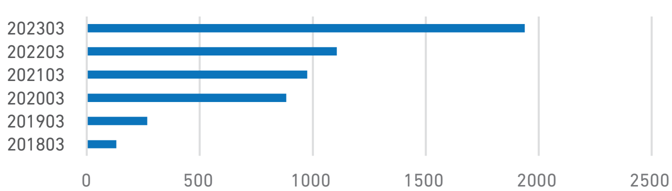
Growth in business loan was higher in smaller towns and these locations hold lot of promise on adoption of fintech

BL Fintech Adoption Across States (2018-2023)



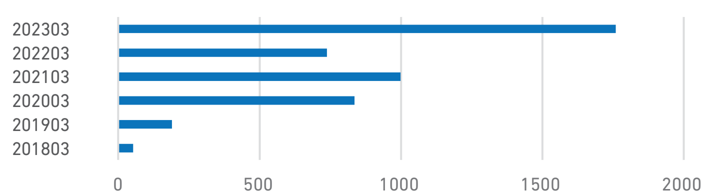
Top 4 cities with growth in Fintech BL Loans

Kamrup*



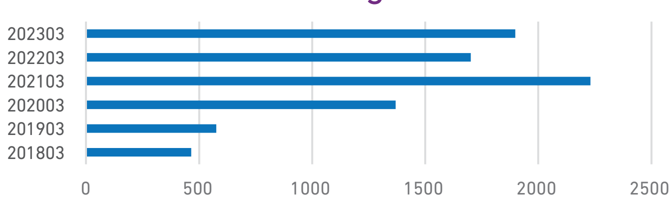
CAGR : 71% New acct. : 1938

East Midnapore*



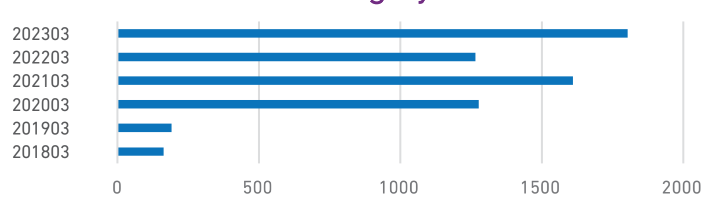
CAGR : 101% New acct. : ~ 1760

Warangal*



CAGR : 32% New acct. : 1900

Hooghly*

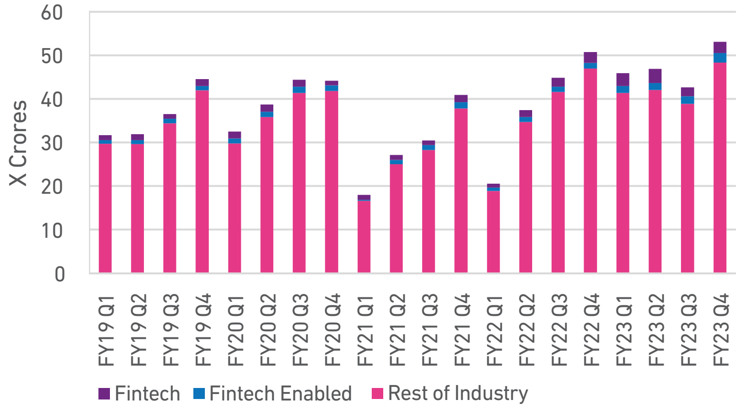


CAGR : 62% New acct. : 1800

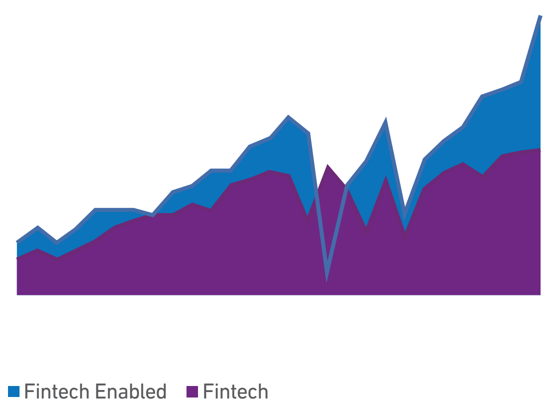
*Year | Month
2023 | 03

Fintech and Fintech Enabled lenders grew at the expense of rest of industry on unsecured business loan over last five years

Sourcing Trend by Amount and Lender Type (Overall in Cr)

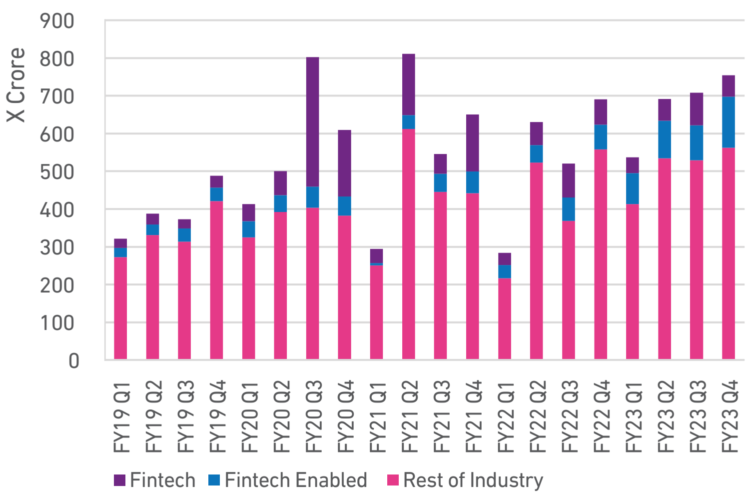


Sourcing Trend by Amount and Lender Type (<10L Ticket Size)

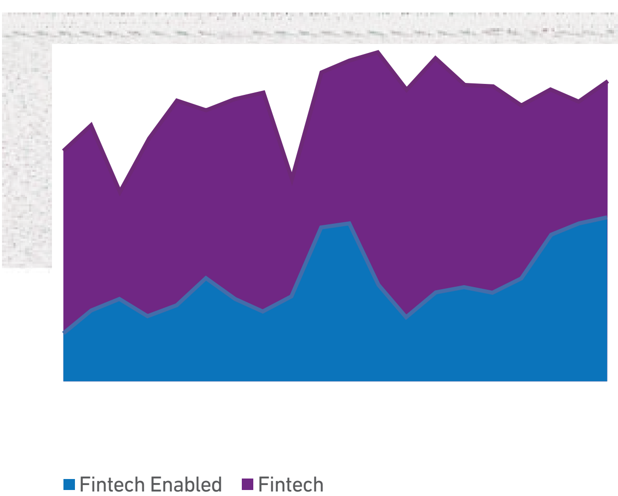


Overall Amount:
Fintech and Fintech Enabled : 1994 Cr > 2744 Cr Market Share : 7% > 9% 2
ROI : 29672 Cr > 48313 Cr Market Share : 93% > 91% 2

Sourcing Trend by Count and Lender Type (Overall)

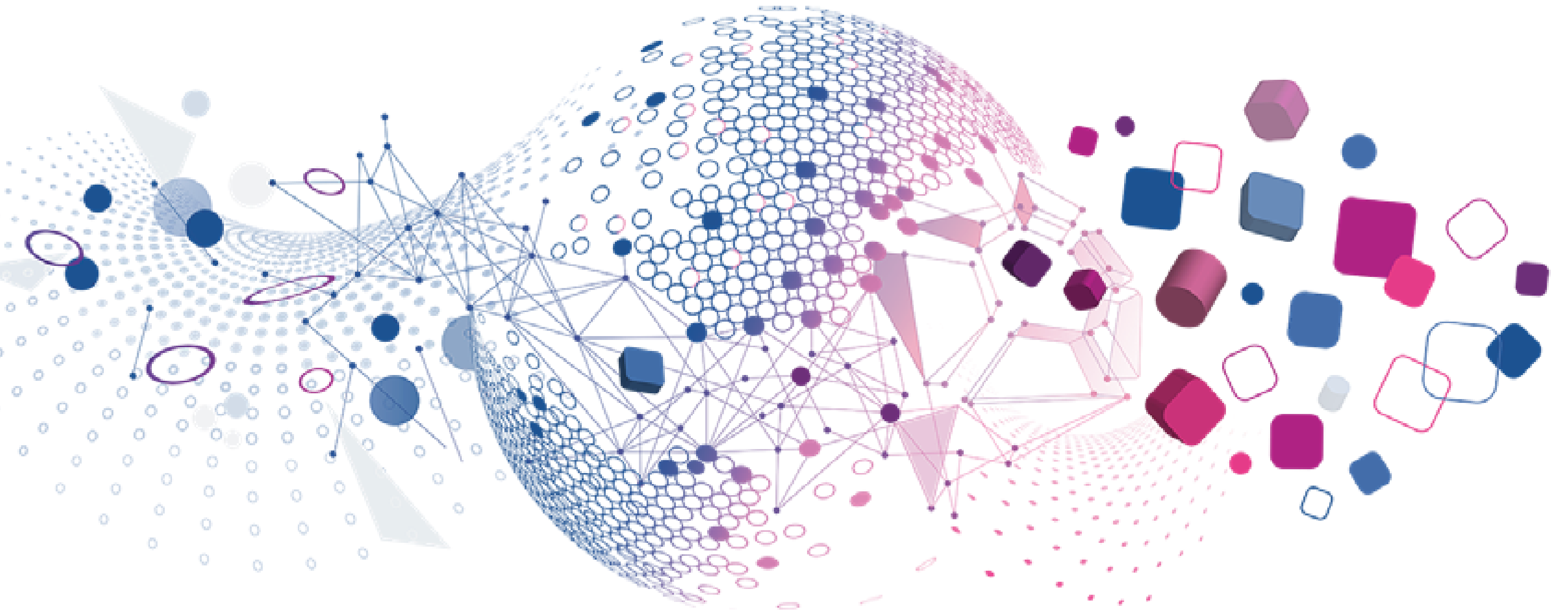


Sourcing Trend by Count and Lender Type (<10L Ticket Size)

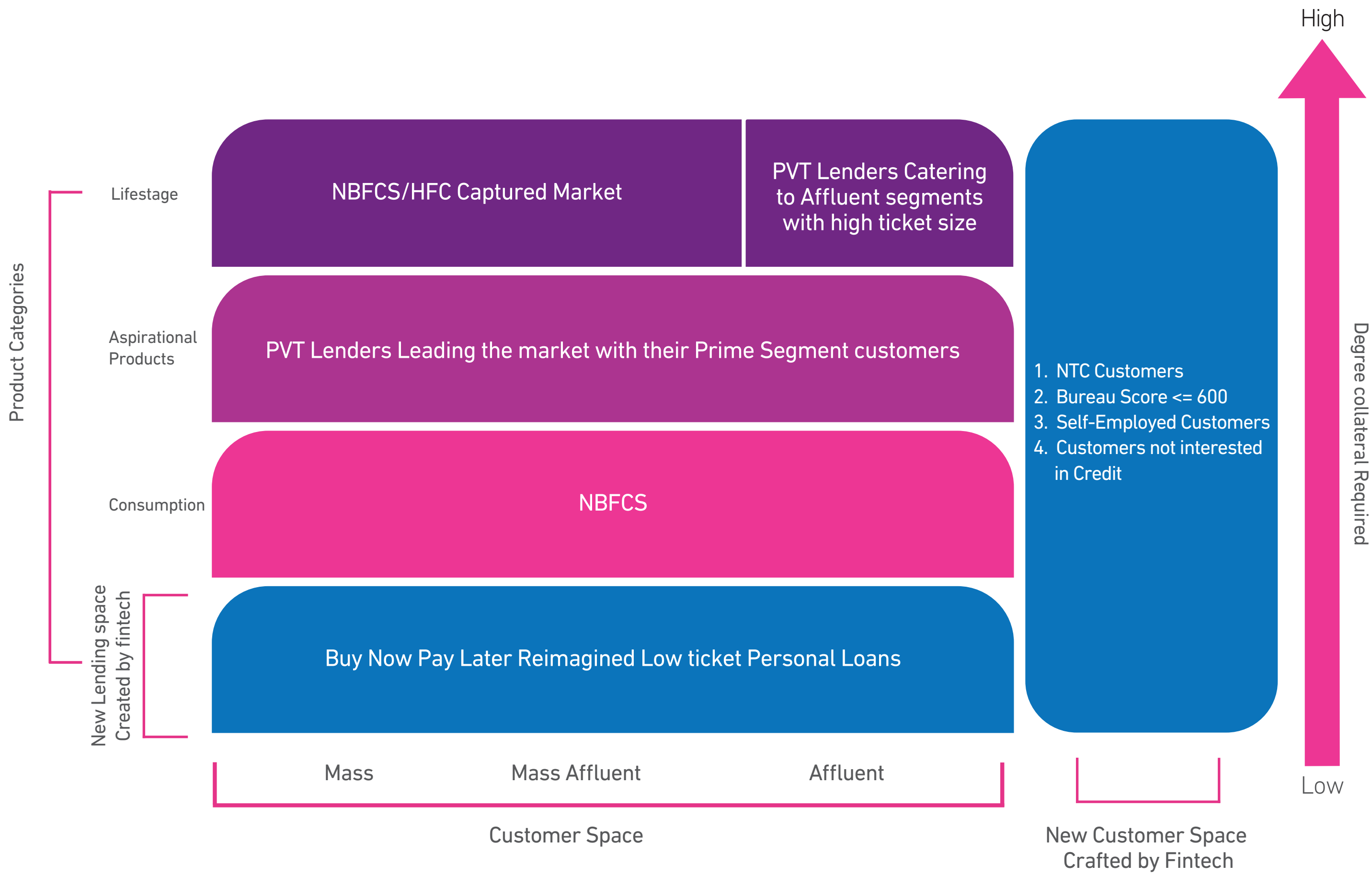


Overall Count:
Fintech and Fintech Enabled : 49K Cr > 192K Cr Market Share: 15% > 25% 10
ROI : 273K Cr > 562K Cr Market Share : 85% > 75% 10

Fintech Blue Oceans



Fintech created and nurtured Blue Oceans (metaphor for new markets)



Traditional market spaces had gaps in the market which can be divided into the following categories:

- Unserved Market
- Underserved Market
- Not inclined to take credit

- Consumption based products include Small Ticket PL
- Aspirational Products consists of Credit Cards, Auto Loans, Two Wheeler Loans
- Life stage Products are Home Loan, Loan Against Property

The Fintech Blue Oceans

1. Credit Unserved:

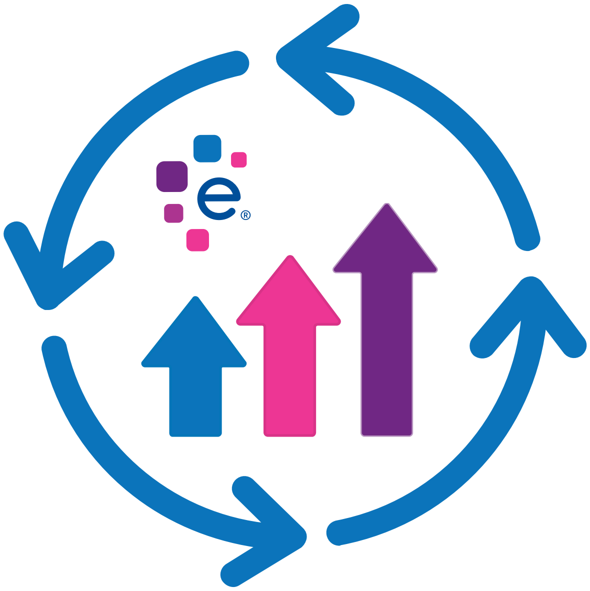
Customer profiles with no credit access

2. Credit Underserved:

Cohort with limited credit access

3. Credit Hesitant:

Customers with no apparent need for credit

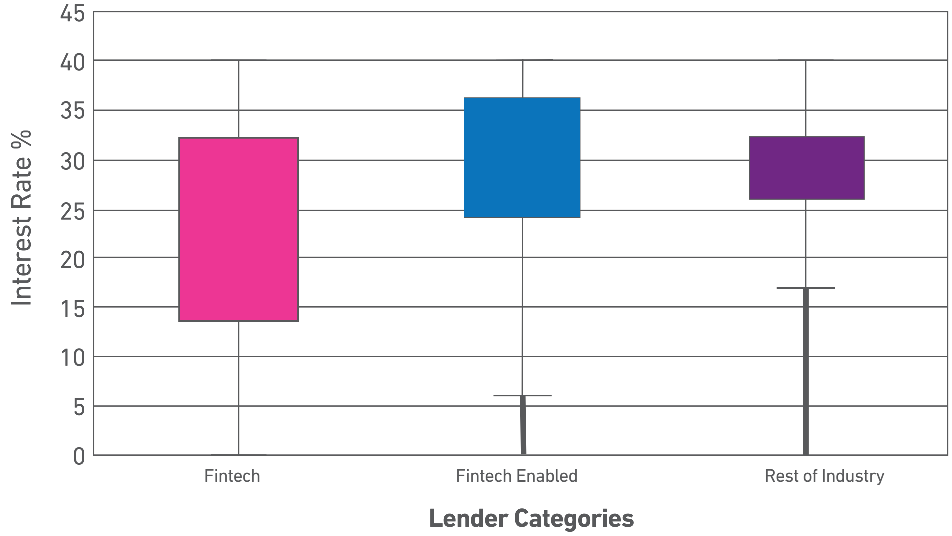


Not just Credit Whitespaces, But Blue Oceans

- Not just Whitespaces: Fintech cannot achieve scale by just looking at whitespace as the same is small and at high risk
- Blue Oceans: Segment of customers not taken too prominently by incumbents in their acquisition strategy

Fintech are able to attract higher NTC through lower interest rate. Despite this, they are likely to maintain asset quality as is evident from score migration

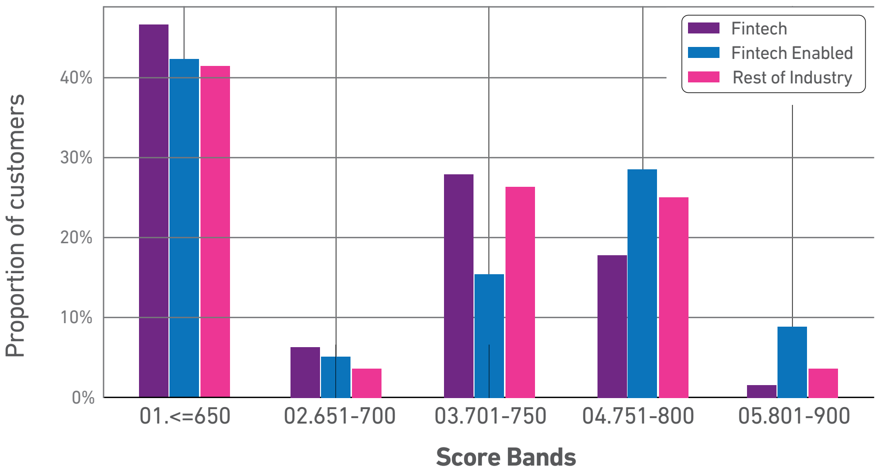
Interest Rate distribution across Lender Categories



NTC approval rate for fintech: 27%

Fintech lenders provide lower interest rates on personal loans for NTC customers, compared to rest of industry and Fintech Enabled lenders.

Distribution of bureau score as on Mar-2022 for previously NTC customers across lender categories



Category	Fintech	Fintech Enabled	Overall
Approval Rate	35%	20%	27%

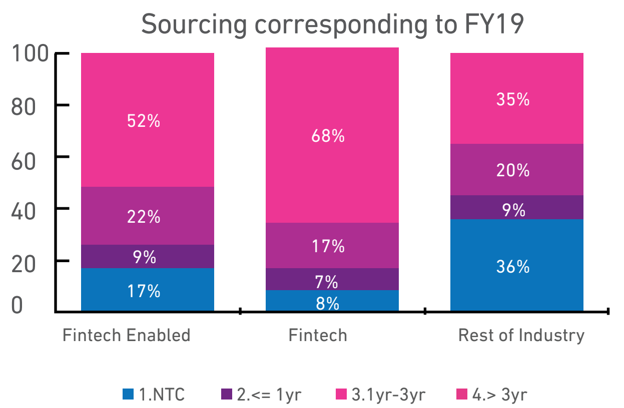
A larger share of NTC customers migrate to "near prime" score band implying due diligence at acquisition by fintech.

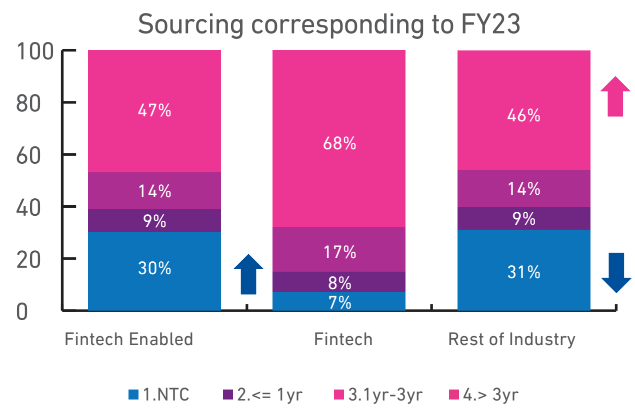
*As per Experian Study on industry representative sample for Personal Loans < 10L.

“Fintech Enabled” lenders spurred by lending services provided by fintech were able to capture a large share of New To Credit (NTC) customers, with focus on smaller towns

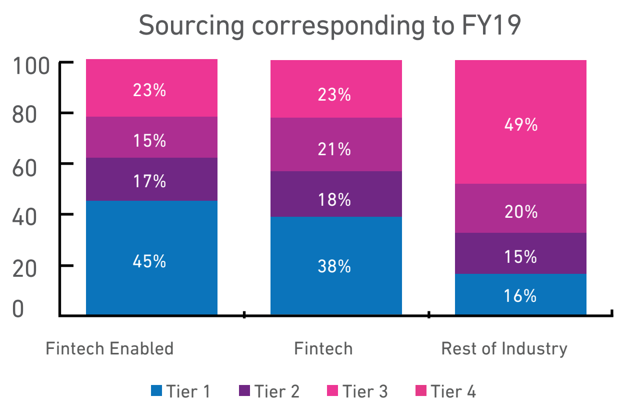
As per Experian study on industry representative sample for Small Ticket Business Loans (<10L)

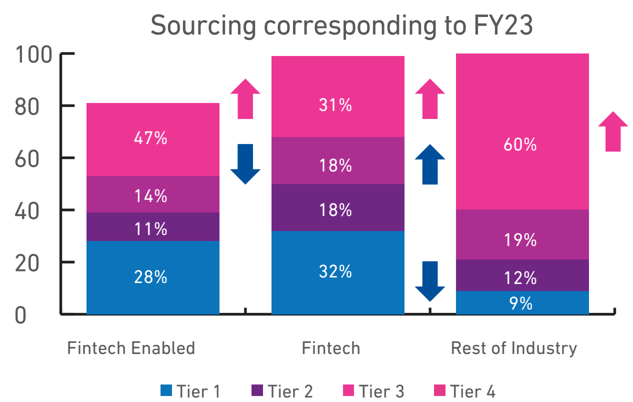
1. Sourcing Distribution FY18 v/s FY23 across Vintage on Bureau





2. Sourcing Distribution FY18 v/s FY23 across Tier





Key Observations:

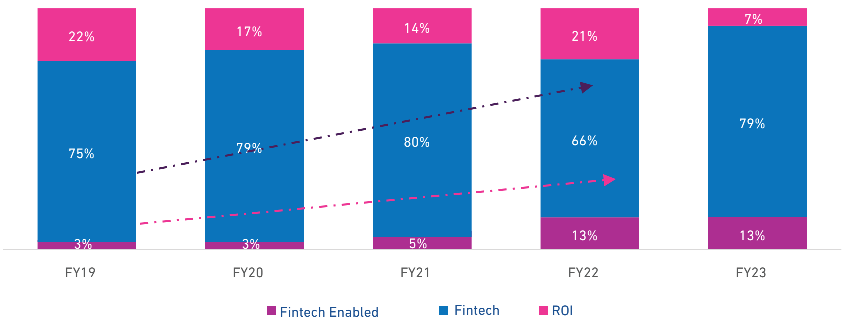
As compared to sourcing in FY19, FY23 the **Fintech Enabled** show increased sourcing to ‘New to Credit’ segment, whereas **rest of the industry** which have majority sourcing in this product move backwards sourcing more to higher vintage groups.

As compared to sourcing in FY19, FY23 the **Fintech Enabled** show increased sourcing to Tier 4, but decrease in sourcing in all the other tiers. Whereas **fintech** show increase in sourcing for both Tier 3 & Tier 4. **Rest of the industry** shows significant increase in sourcing in Tier 4.

Changes in sourcing trends in STPL heavily impacted by pandemic and subsequent increase in digital penetration

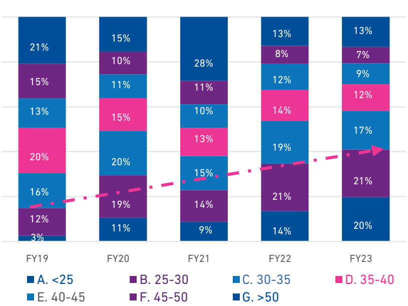
As per Experian study on industry representative sample for Small ticket Personal Loans

1. Sourcing share by count for ticket size < 50k

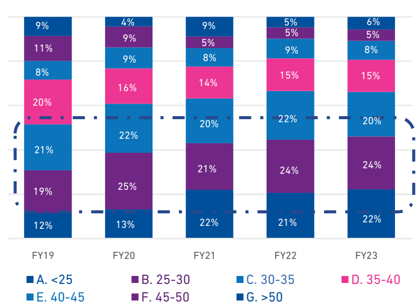


2. Sourcing share by count for ticket size < 50k across Age

Fintech Enabled

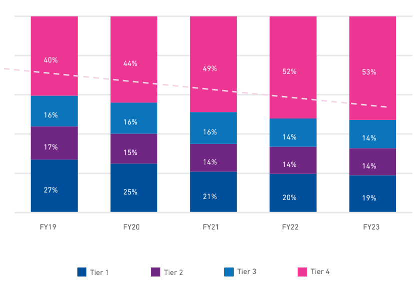


Fintech

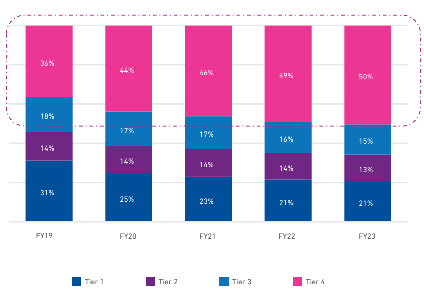


3. Sourcing share by count for ticket size < 50k across Tiers

Fintech Enabled



Fintech



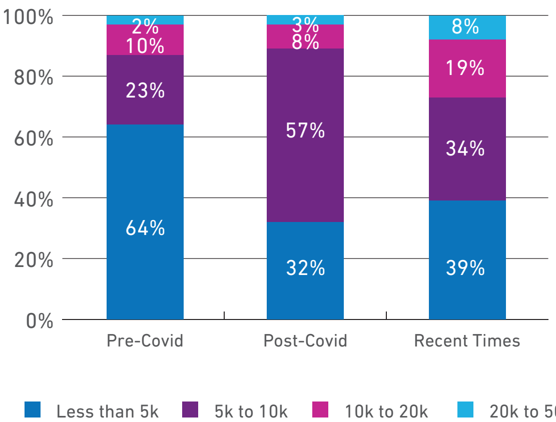
Key Takeaways:

1. Fintech were already the dominant players in this segment, post pandemic both Fintech & Fintech Enabled are at neck to neck in this segment.
2. Fintech Enabled's preferred segment was 25 years - 40 years within this thicket & product but a great shift observed in sourcing to age less than 25 years post pandemic. Fintech NBFC's on the other hand have always focused on this segment.
3. Although there is drastic increase in sourcing to Tier 4 by Fintech Enabled post pandemic which may be attributed to increased digital penetration & hybrid working system, Fintech NBFC's have consistently sourced almost half of the base to Tier 4.

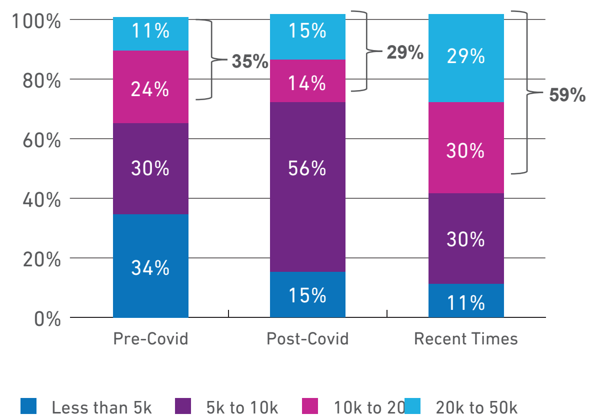
Fintech created and nurtured a new class of borrowers (BNPL) with no apparent need for credit by building affinity through creation of simplified customer journey

Distribution across periods for BNPL lenders (ticket size <50k)

Distribution of New Loans

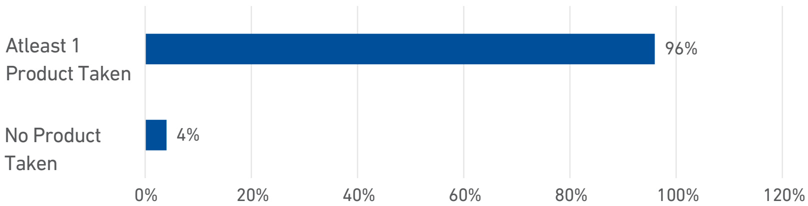


Distribution of Sanctioned Amount



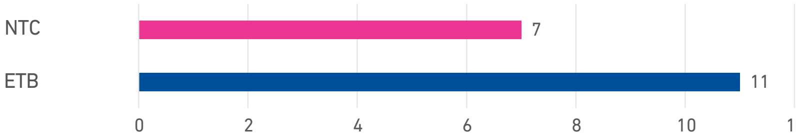
Opportunity Value with BNPL customers Analysis (1/2)

Proportion of BNPL Customers Taking Another Product Post BNPL

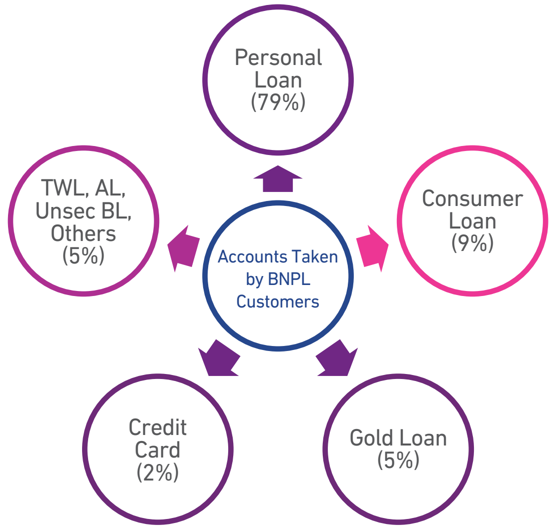


Opportunity value with BNPL customers analysis (2/2)

Number of Products Taken by BNPL Customers Post BNPL

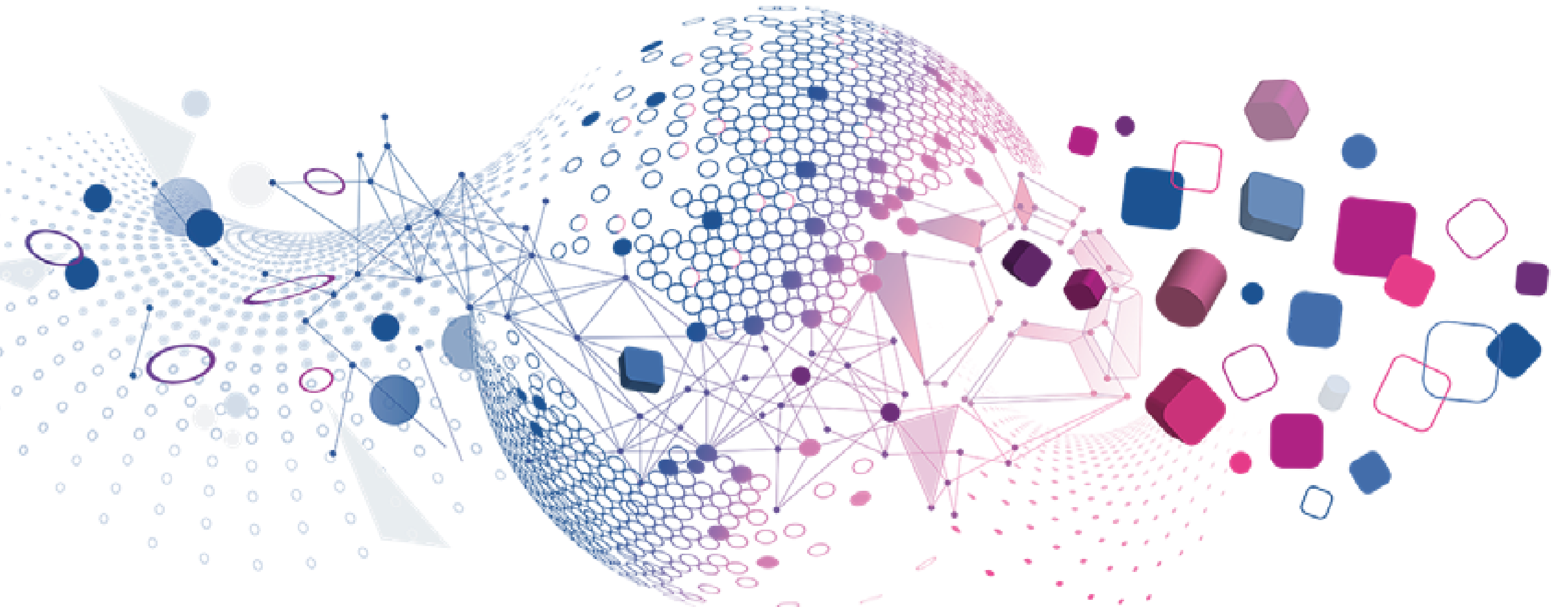


Composition of Product Taken Post BNPL



*Opportunity Value is calculated based on 36 months observation period post BNPL Sourcing.
Time Period of Sourcing is Post-Covid: FY22, Recent: FY23.

Fintech Portfolio: Addressing the Issue of Sustainability and Scalability



Fintech Top of Mind Concerns

Top of Mind Concern

"I have a straight through process with minimal manual intervention. Will this impact risk in my portfolio?"

Chief Credit and Risk Officer

"I do not have feet on street workforce for Collections. Am I at a disadvantage compared to other lenders?"

Head - Collections

"How do I know I'm pricing the products optimally. Will I be making good margin on my products?"

Head - Product

How do we Assess

Delinquency - Coincidental and Lagged	Coincidental 90+ delinquency Vintage 90+ delinquency Performance comparison across Lender categories
Collection Efficiency - Account Normalisation	Roll Forward across collection stages Roll Backward rates Performance comparison across Lender categories
Credit Cost and Risk Based Pricing	Interest Rate Comparison Expected Credit Loss (PD, LGD and EAD)

Addressing the Big Elephant in the room-sustainability of fintech portfolio

1. Fraud Risk

Is the fintech portfolio prone to higher fraud risk compared to other lending cohorts?

2. Credit Risk

Portfolio delinquency and lagged delinquency comparison on similar ticket size with other lending cohorts.

3. Collection Risk

Do fintech with limited investment in field force have lower collection once an account becomes delinquent?

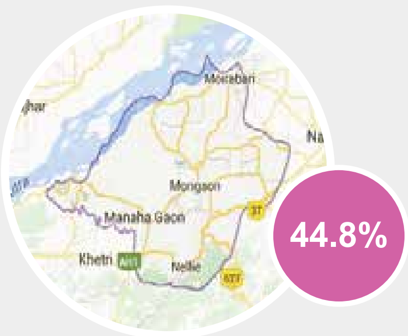
4. Profitability

Are the fintech pricing the products in line with delinquency experience and higher cost of fund?

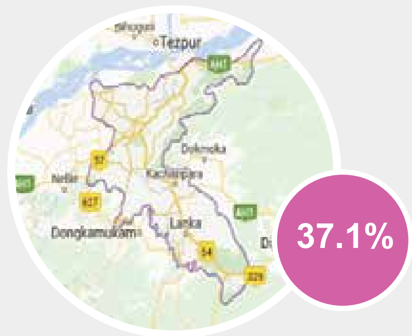
Fraud and Credit Risk

Fraud hits the bottom line hard and fintech are especially vulnerable to this. We found even incumbents face significant challenges in curtailing fraud in certain pockets

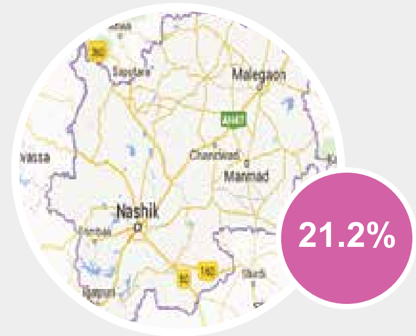
Leading Private Sector Bank



Morigaon

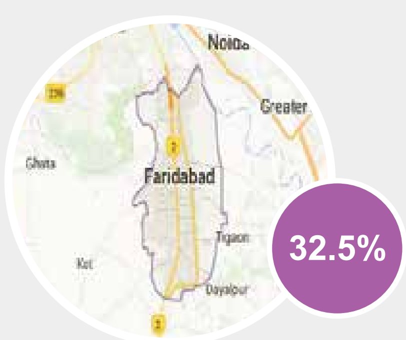


Nagaon

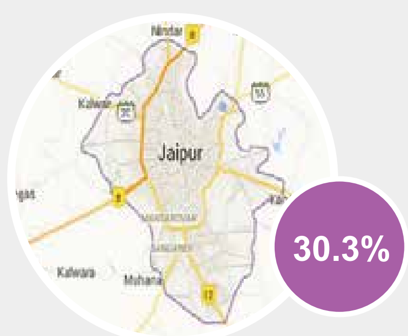


Nashik

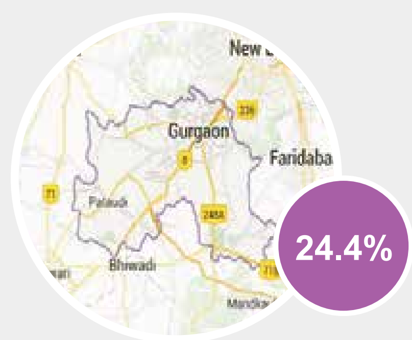
- Match rates are a precursor to potential frauds, reported by the CUG members, the following places consists small population pockets of high match rate
- The match rates are based on the Experian Hunter Rules which can be categorised into inconsistency rules, non clear rules and velocity rules



Faridabad



Jaipur



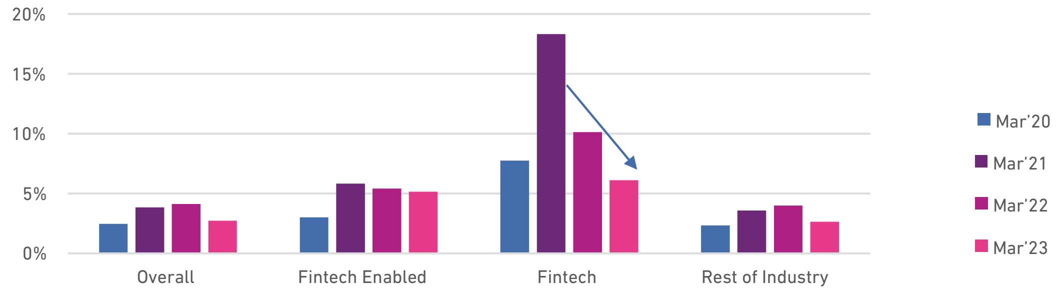
Gurgaon

*Based on Experian Hunter data analysis.

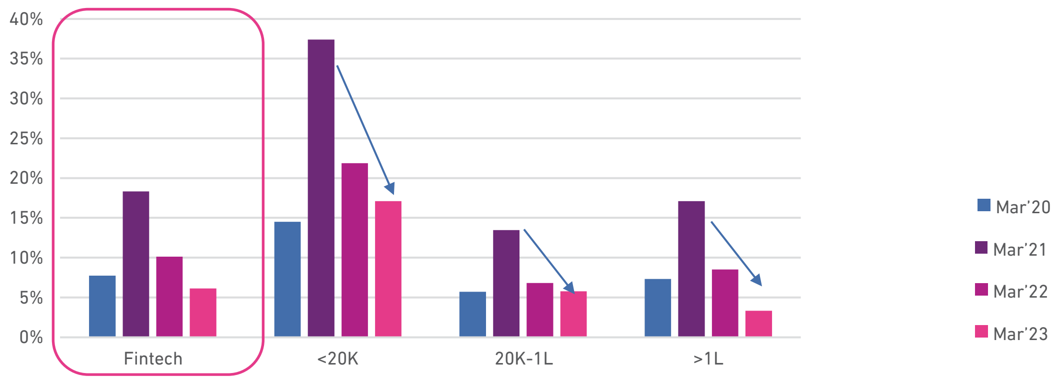
**Based on data submitted by Hunter CUG and Hunter System (Fraud Database) rules triggered against it for FY23 Q3.

Since pandemic fintech have shown improvement in their overall portfolio delinquency, this maybe explained by rapid growth in new disbursals over last few years

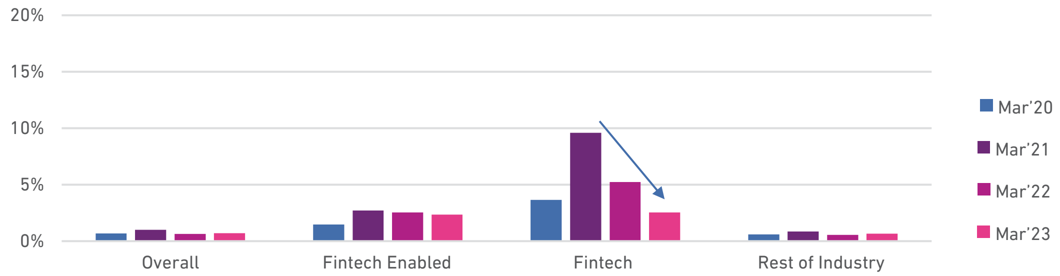
Net 30+ (By Amount) Overall Industry



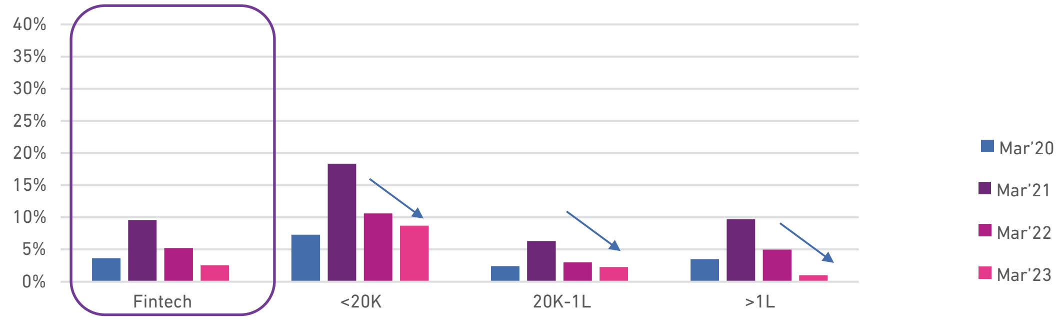
Net 30+ (By Amount)



Net 90+ (By Amount) Overall Industry

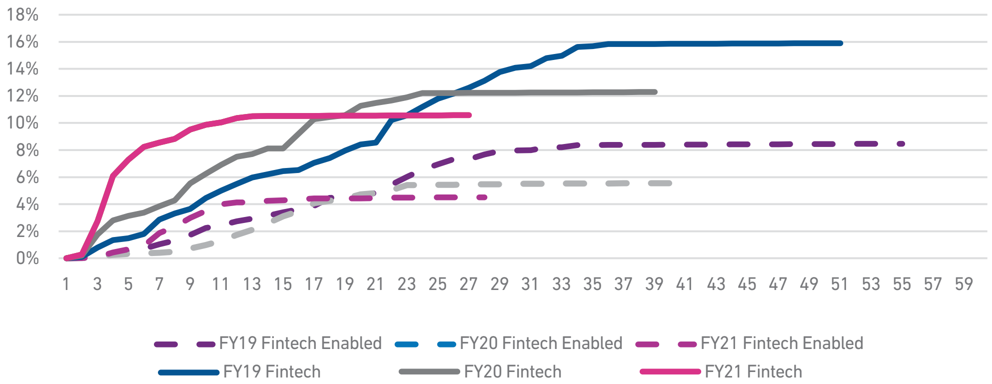


Net 90+ (By Amount)

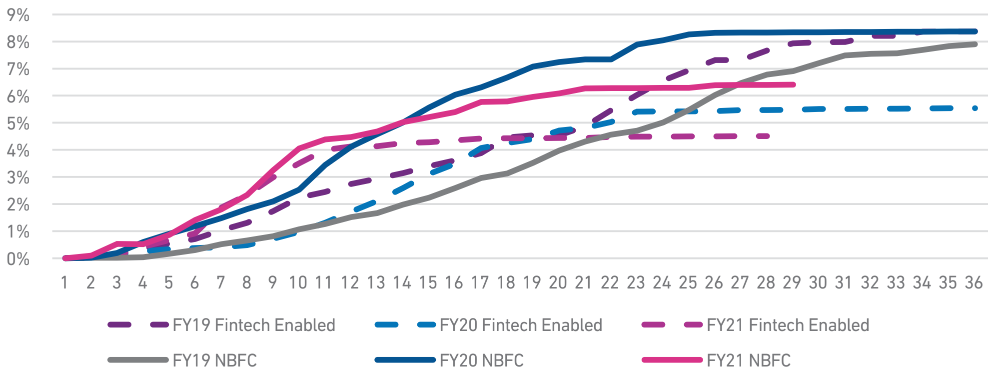


Loan Performance - Vintage delinquency (Personal Loan)

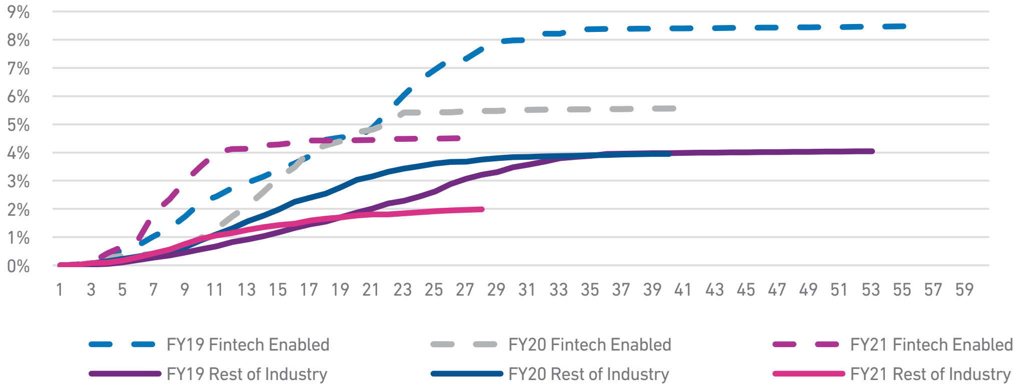
90+ Ever Vintage Curve Fintech Enabled Vs Fintech



90+ Ever Vintage Curve Fintech Enabled Vs NBFC



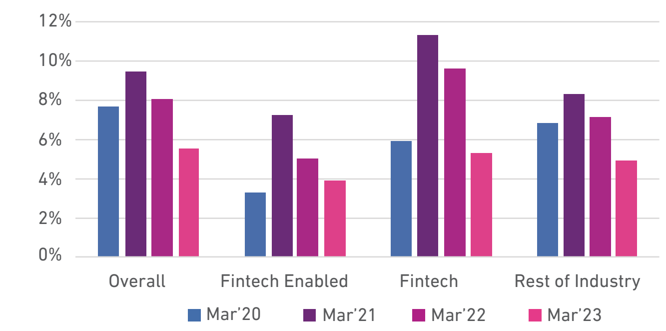
90+ Ever Vintage Curve Fintech Enabled Vs Rest of Industry



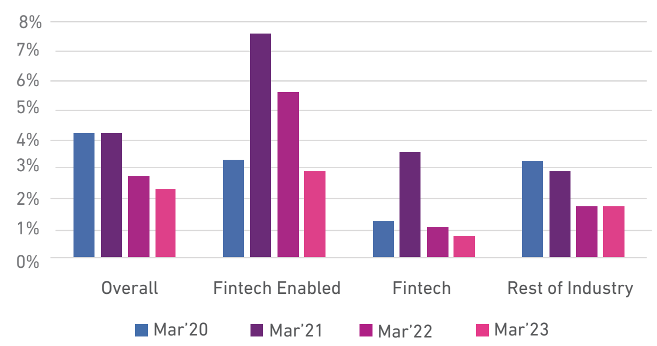
- Fintech show a rapid stabilization of delinquencies in the first 12 months while Fintech Enabled and Rest of the Industry mature at a later stage
- Fintech have the highest 90+ ever, followed by Fintech Enabled
- Fintech have shown a better quality of sourcing post pandemic

Post pandemic net delinquency has improved for fintech. This could be attributed to higher charge-off and may not necessarily be indicative of improvement in asset quality

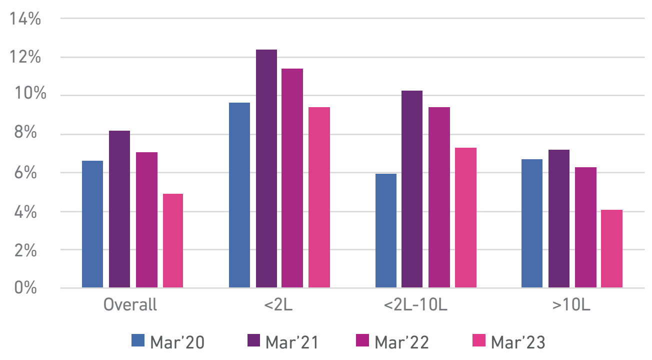
Lender type -Net 30+ (by amount)



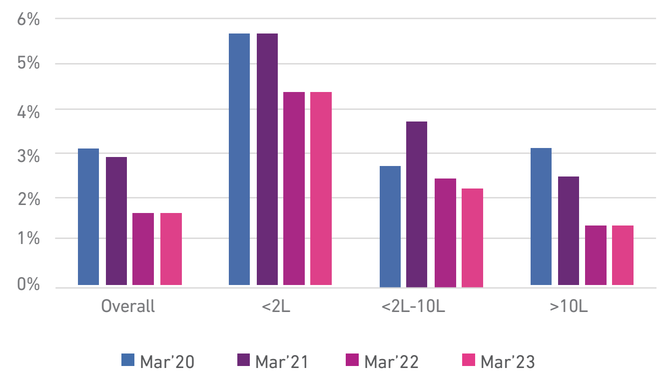
Lender type -Net 90+ (by amount)



Ticket band wise -% Net 30+ (by amount)

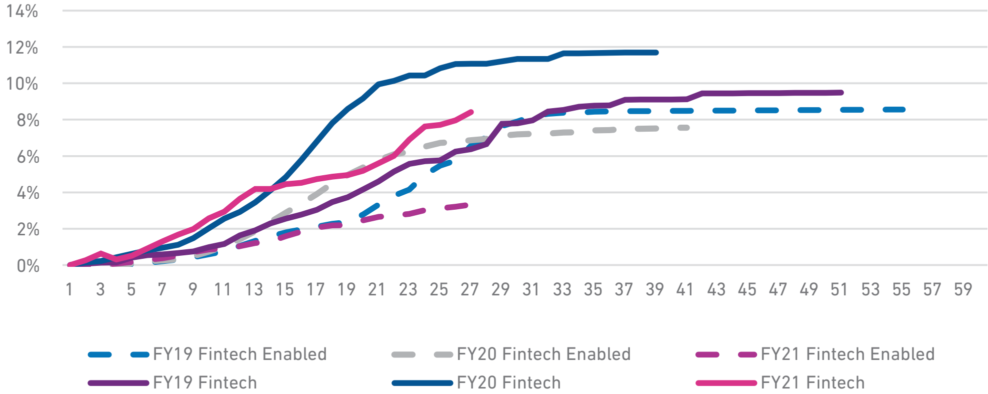


Ticket band wise -% Net 90+ (by amount)

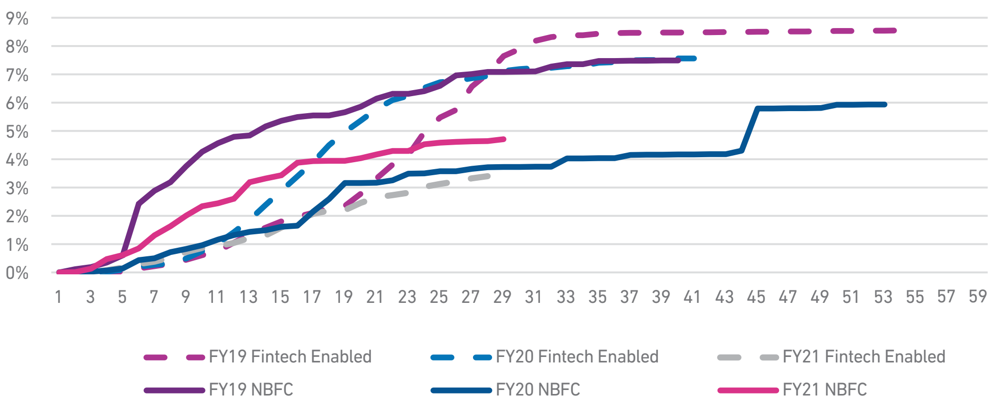


Loan Performance - Vintage delinquency (Business Loan)

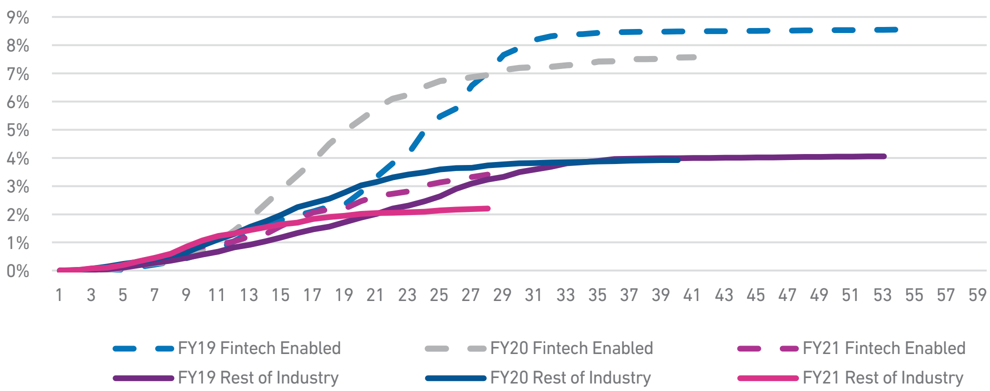
90+ Ever Vintage Curve Fintech Enabled Vs Fintech



90+ Ever Vintage Curve Fintech Enabled Vs NBFC

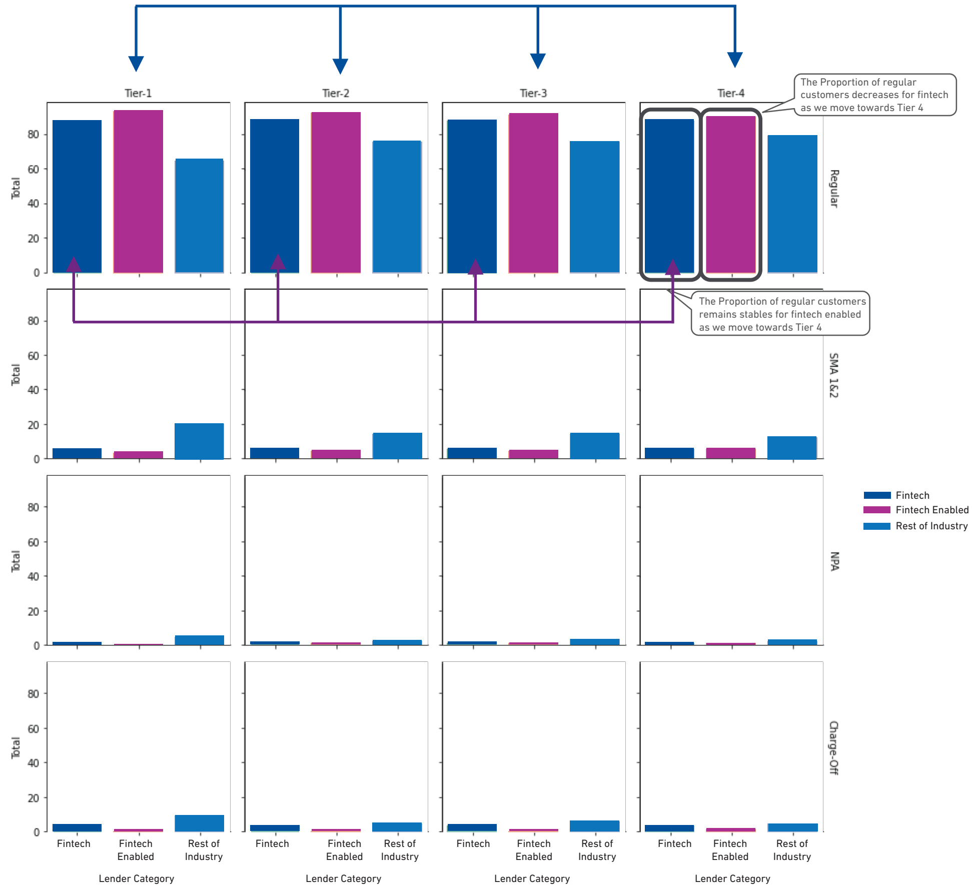


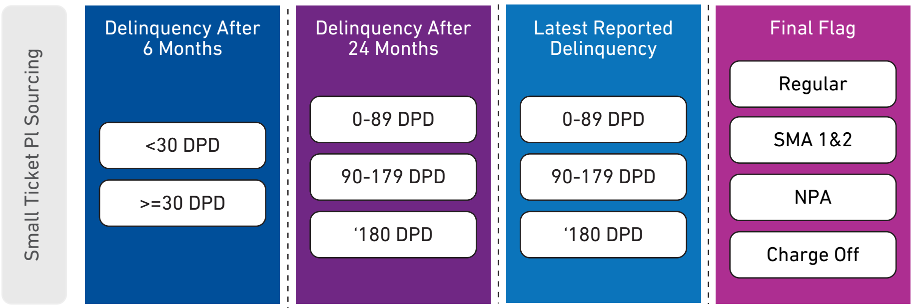
90+ Ever Vintage Curve Fintech Enabled Vs Rest of Industry



- Loan Maturity is approximately stable across all lender types at ~30 months
- Fintech have shown a higher quality of sourcing post pandemic
- Fintech have the highest 90+ ever, followed by Fintech Enabled

Fintech show a stable trend across various tiers whereas Fintech Enabled show a suboptimal sourcing in Tier 4 as compared to Tier 1





- A sourcing sample for PL <3L and their performance at three different time periods was considered (After 6 months from the time of application, 24 months from the time of application and latest reporting delinquency)
- Customers who were always in the lowest delinquency bucket are considered as Regular, inversely customers who were in the highest delinquency bucket are considered to be Bad/Charge Off
- Customers who have rolled back are subdivided into two further categories SMA 1&2, and NPA based on the severity of the delinquencies

Collection Risk

Traditional lenders' collection performance with larger Prime PL share is mostly unchanged. "Fintech NBFC's" have improvised on collection in early buckets. The deterioration of early buckets roll forward rates in "Fintech Enabled" was by growth in volumes and lack of collection infrastructure.

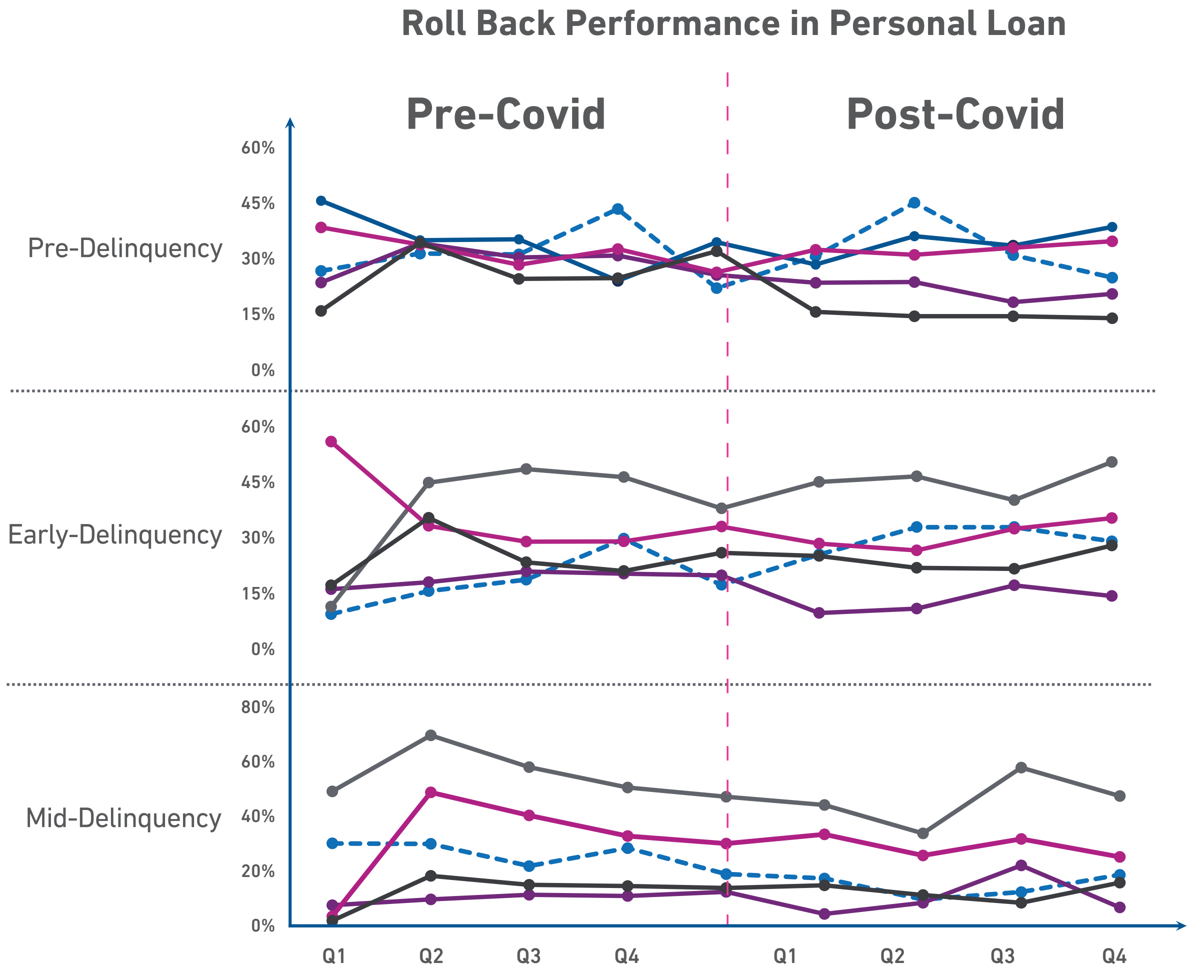
Lender Type Classification

- Fintech Enabled
- Fintech
- PUB
- PVT
- NBF

Fintech experienced improvement in roll forward post pandemic except for early delinquency pool

*Time period for sourcing is : Pre-Covid: FY19, Post-Covid: FY22 & FY23.

"Fintech Enabled" are collecting more in Pre-Delinquency situation but as the overdue EMI's are increasing, its increasingly difficult to roll back. PSB's are performing the best in this KPI.



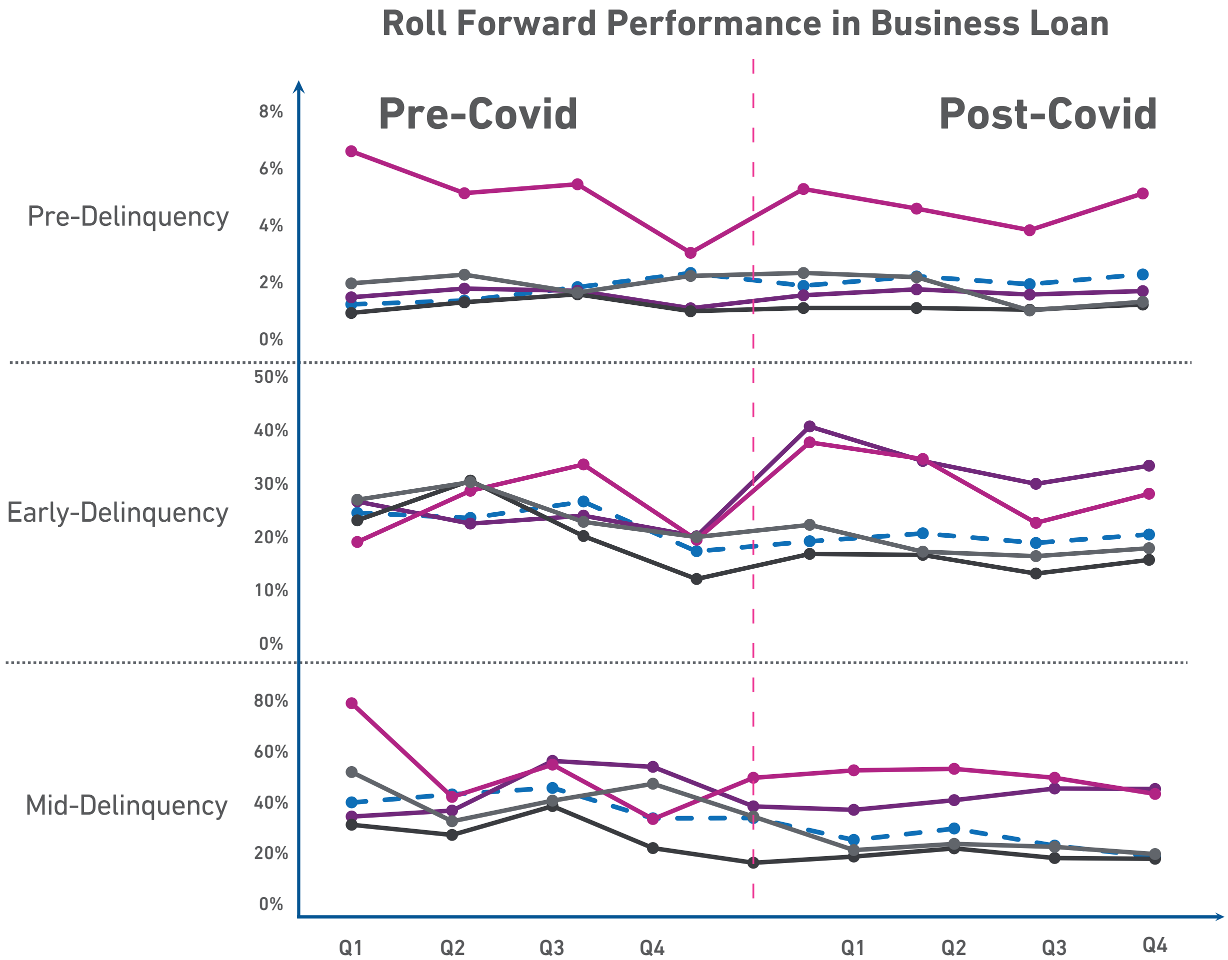
Lender Type Classification

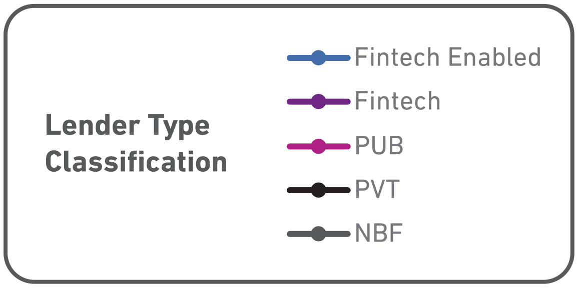
- Fintech Enabled
- Fintech
- PUB
- PVT
- NBF

Normalisation reduced post pandemic except of early delinquency pool

*Time period for sourcing is : Pre-Covid: FY19, Post-Covid: FY22 & FY23.

The roll forward rates are better in Fintech Enabled inline with the other cohorts. PSB are witnessing the higher roll forward rates but they are able to collect through roll back.

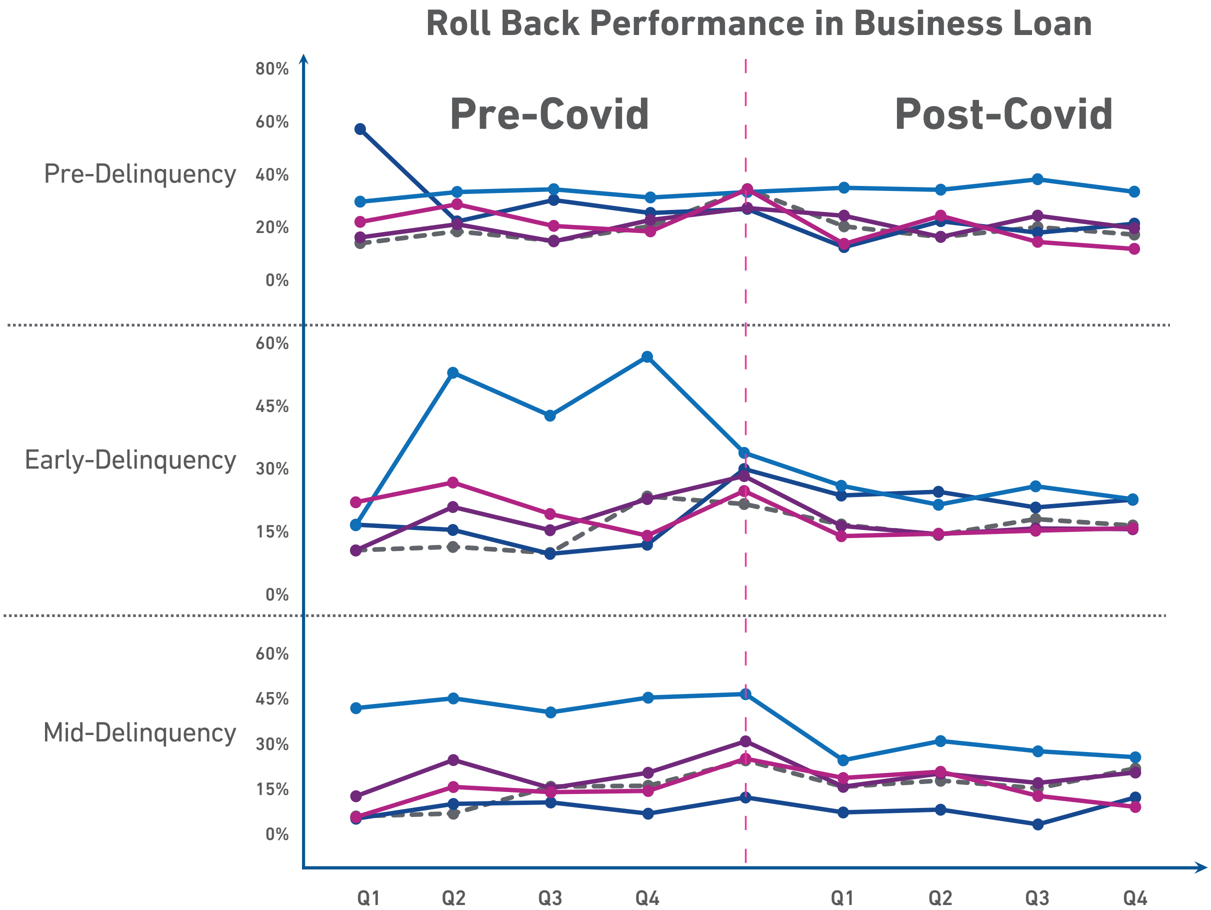




Largely, fintech are witnessing higher roll forward rates as compared to other cohorts except for PSBs

*Time period for sourcing is : Pre-Covid: FY19, Post-Covid: FY22 & FY23.

Largely the collection performance of BL in pre and post Covid period is similar. All the cohorts are showing similar performance.



Lender Type Classification

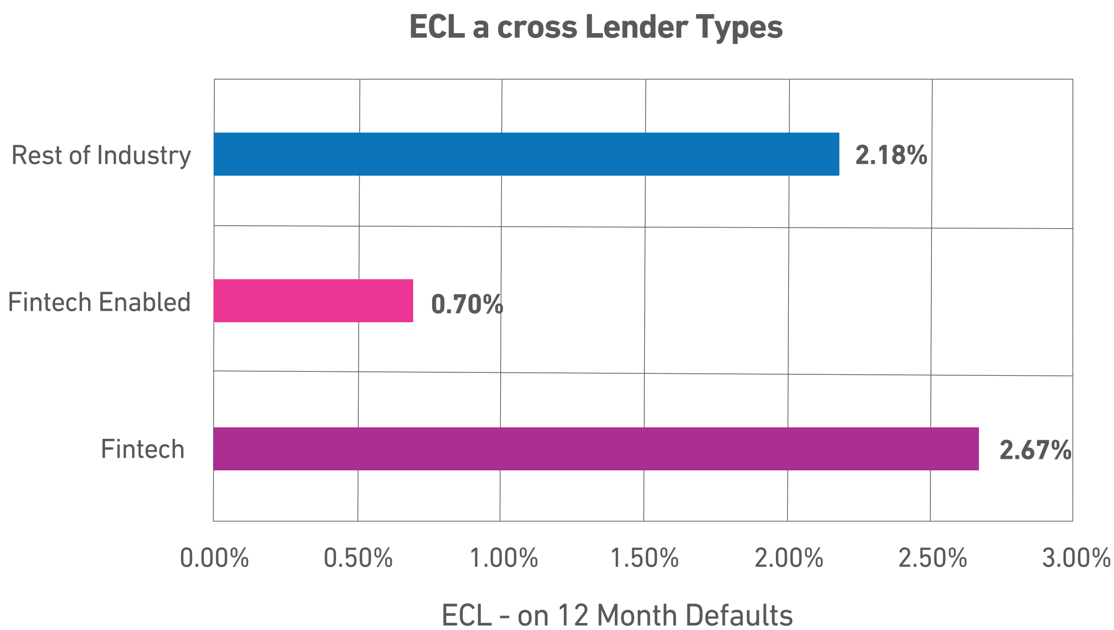
- Fintech Enabled
- Fintech
- PUB
- PVT
- NBF

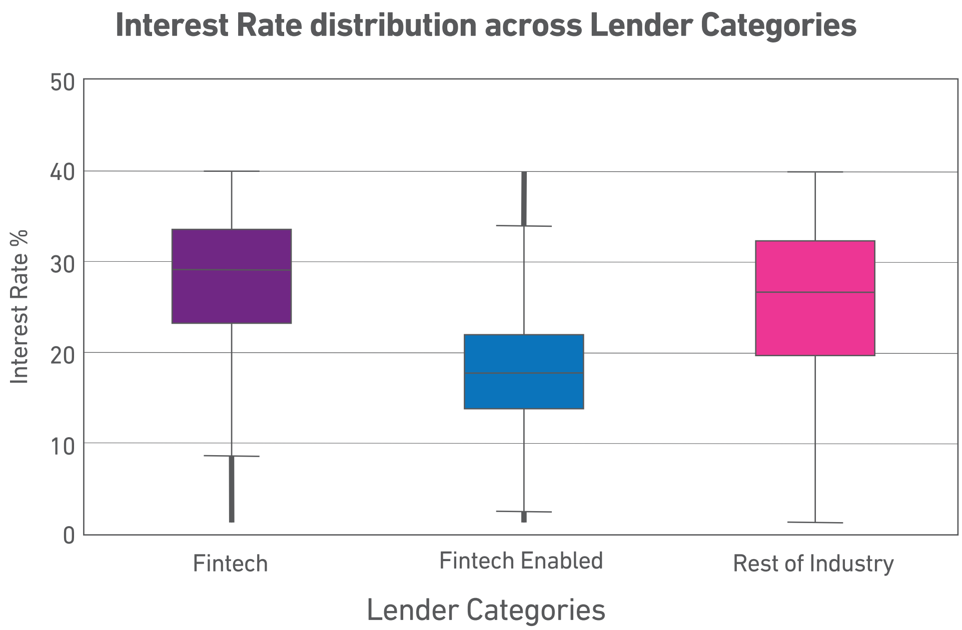
Across different periods collection performance in BL can be attributed to the customer awareness on better credit management and business needs

*Time period for sourcing is : Pre-Covid: FY19, Post-Covid: FY22 & FY23.

Profitability

Fintech interest rates 3% higher than rest of industry – while ECL is 0.40% higher – Fintech Enabled has considerably lower interest rate and ECL.





Fintech can leverage the advantage offered by fintech enabled lending – which has considerably lower Interest Rates and Expected Credit Losses

*As per Experian study on industry representative sample of personal loans <10L.

Fintech at the Cross-Roads: Defining the Growth Pathway

Understanding the evolving lending ecosystem to arrive at optimal pathway for Fintech

1. Regulatory Regime

- Regulatory clarity is required for fintech to operate with confidence
- Latest guideline on digital lending brings about significant changes in FLDG schemes with far reaching consequences

2. Government Impetus

- Government investment in JAM trinity and other initiatives to create digital public good aided the first wave of fintech growth
- Digital Data Protection Bill will go a long way in empowering the customer but will also cost implications in short term for fintech

3. Exponential Technologies

- Exponential technologies like artificial intelligence, cloud has helped remove entry level barriers for fintech
- Lenders are increasingly being seen as a "Platform". Fintech leveraging these the most will be here for long run

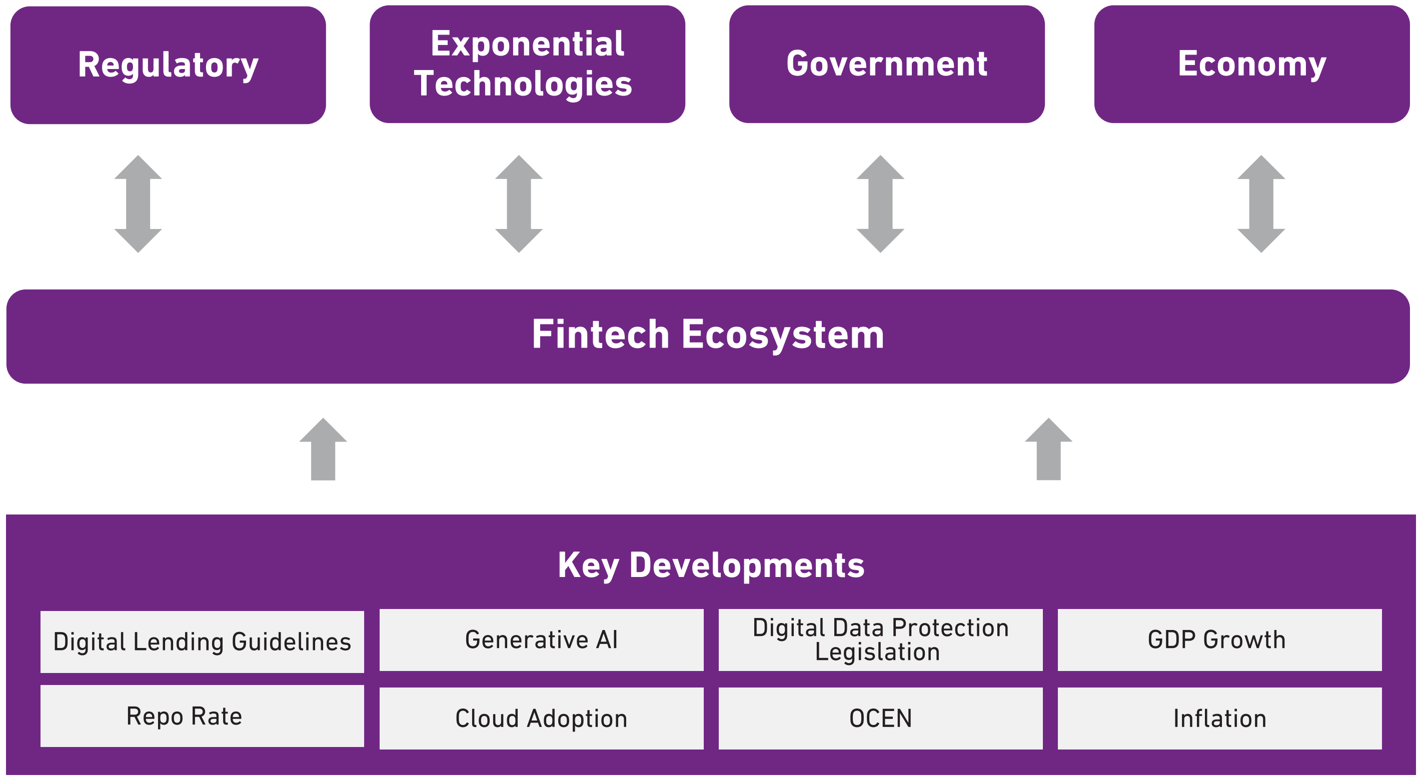
4. Economy

- As India races to become the third largest economy over next five years there will be significant increase in aspirational class with appetite for credit
- Demographic changes will also favour fintech as the share of digital customer in lending pie goes north

Fintech Industry - Key Externalities

Fintech ecosystem is likely to face tailwinds spurring growth due to positive externalities

Key Externalities



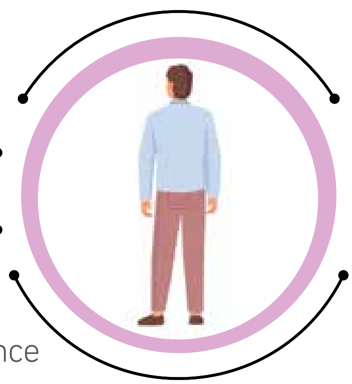
Introduction to the Digital Personal Data Protection Bill, 2023

On August 9, 2023, the Digital Personal Data Protection Bill, 2023 ("DPDP Bill") was passed by Indian Parliament. The DPDP Bill is the fifth iteration of the personal data protection legislation and appears to be based on the draft Bill released by the Ministry of Electronics and Information Technology on November 18, 2022, titled Digital Personal Data Protection Bill, 2022, which was open for public consultations. The DPDP Bill focuses on digital personal data and does not apply to non-personal data.

What are the rights of individuals under this law?

The right to correction and erasure of data

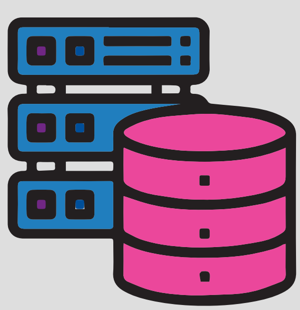
The right to access information about personal data processed



The right to grievance redressal

The right to nominate a person to exercise rights in case of death or incapacity

What are the obligations of data fiduciary under this law?



01	To have security safeguards to prevent personal data breach
02	To intimate personal data breaches to the affected Data Principal and the Data Protection Board
03	To erase personal data when it is no longer needed for the specified purpose
04	To have in place grievance redressal system and an officer to respond to queries from Data Principals
05	To fulfill certain additional obligations in respect of Data Fiduciaries notified as Significant Data Fiduciaries

Source: https://pib.gov.in/PressReleaseIframePage.aspx?PRID=1947264

Impact of Digital Personal Data Protection Bill, 2023 on Fintech

The upcoming Personal Data Protection Bill would have an impact on fintech Companies that engage mainly in processing digital personal data within India where such data is collected online or collected offline & are digitised. Some of the examples are as follows:

01 **Data Security & Compliance**

Fintech companies might need to invest more in data security measures to ensure compliance with the new law. This could lead to enhanced data protection practices, which can build customer trust and confidence.

02 **User Consent & Transparency**

The Act might require clearer communication about data usage and obtaining explicit user consent. Fintech platforms could need to provide more transparent information about how user data is collected, processed and shared.

03 **Business Process & Technology**

Fintech companies might need to review their data related processes, systems, and technologies to align with the bill's requirements. This could impact how they handle customer information and conduct their operations.

04 **Liability & Accountability**

The Act might establish liability for data breaches or mishandling of data. Fintech firms might need to take more responsibility for the data they handle, which could lead to stricter data governance measures.

05 **Cross-Border Data Transfer**

The new Act has provisions on cross border transfers. Fintech dealing with international transactions and partnerships should comply with this.

Impact of RBI's new digital lending guidelines with respect to FLDG

A "First Loss Default Guaranty" (FLDG) is a risk management mechanism that involves a guarantor absorbing the first portion of losses in case of default. As RBI has limited First Loss Default Guarantees (FLDG) to 5%, it could have a significant impact on fintech Sector. By capping FLDG at 5%, it might result in:

1. **Increased Caution & Market Growth:**

   Fintech lenders might become more cautious in extending loans to riskier borrowers since the cushion provided by FLDG would be limited. This could affect access to credit for certain segments of borrowers. The growth of the fintech lending market might slow down due to reduced risk protection and increased uncertainty.

2. **Lending Practices:**

   Fintech platforms might revise their lending criteria, focusing on lower risk borrowers to stay within the 5% FLDG limit. This could impact their ability to serve underserved or higher risk segments. Investors providing first loss guarantees might need to reevaluate their risk exposure. With the capped guarantee, they might become more cautious or demand higher returns.

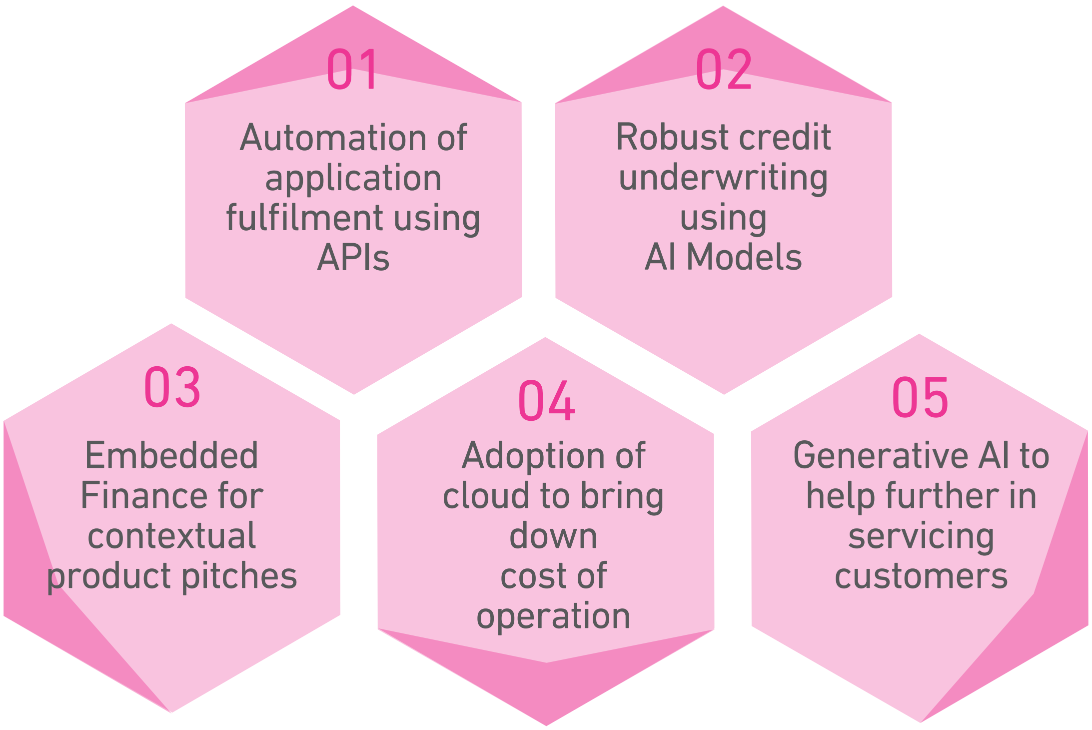
3. **Business Models:**

   Fintech companies might need to adjust their business models, pricing, and risk management strategies to accommodate the new FLDG limit. The cap could influence the development of new fintech lending products and services that rely on higher levels of FLDG.

   Ultimately, the impact would depend on how fintech companies, investors, and borrowers adapt to the new FLDG cap and how the regulatory change shapes lending practices and risk management strategies in the fintech sector.

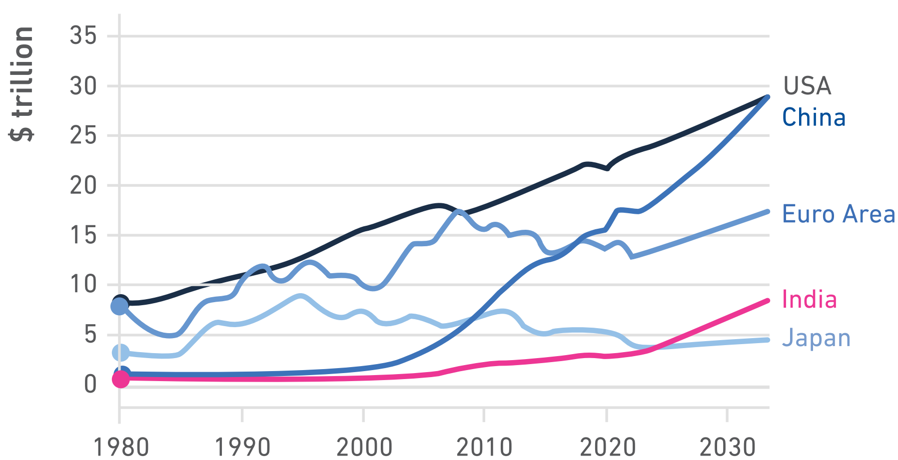
Exponential Technologies like AI and Outlook for Economy provide tailwinds for accelerated growth of fintech led lending

Exponential Technology



Outlook for Economy

India projected to be the third largest economy in five years



Source: Goldman Sachs Research

Defining the Pathway for Fintech: Key Recommendations

Putting everything together: Key Learnings

1. **Fintech comes of age in the small ticket unsecured lending market by creating "Blue Oceans" (metaphor for new markets). However, there is a need for a horizontal growth by diversifying product mix for next decade of growth.**

   Fintech have had a strong growth so far in the unsecured small ticket space. Their growth outpaced that of other lender categories like private and public sector banks. Not only this, fintech also enabled other lenders on digital acquisition. Hence, we have a new class of lending which we are calling as "Fintech Enabled". The full impact of fintech, we believe, is on what they source and what they enable to be sourced.

   Presence of fintech today is largely restricted to small ticket and bite size products. Traditional lenders have a near monopoly on asset backed products. With further inroads into digitization this segment too may become accessible to fintech. With this it would be a more level playing field. Fintech with greater agility would make up a significant lending pie. Currently, the focus is primarily on small ticket personal loan and unsecured business loan.

   We believe, product segment like two wheelers, used car financing can be the next big foray for fintech as these also have similar customer characteristics and experience expectations.

2. Fintech have a tough job maintaining margins given their portfolio comprises of high risk segment. Risk based pricing addresses the same. However, fintech need to identify new revenue streams to offset higher funding cost for them. Being a partner to lenders on non-compete products can be a potential high revenue line for fintech.

We found Expected Credit Loss (ECL) for fintech to be ~2% higher compared to their private counterpart. Fintech offset this by positioning their products at higher interest rate. However, fintech also have higher cost of fund and need new revenue line to maintain margin. Given fintech operate in a narrow product basket they can collaborate with other lenders on non compete products to assure themselves a new revenue stream. This is in fact already happening today but needs to scale up further.

Fintech obviously have difficulties in collections as they have limited physical collection shop. Digital collection method can help in targeting situational defaulters who tend to cure or normalize on simple but contextual nudges. In order to get improved margin there is a need to focus on customer life time value through cross sell and up sell is going to be of utmost importance.

Overall, fintech need to continue with their leadership on technology adoption as this is what makes up their DNA. Data ecosystem is likely to explode with the proliferation of open data, but this needs to be harnessed well. Industrialised use of analytics is an imperative.

3. Fintech will also need to reinvent themselves as the incumbents swiftly convert themselves into a platform player by embarking on a digital transformation journey. Embedded finance will assume a larger role in creating differentiation with the incumbents and capture Customer mindshare.

Fintech have pioneered experience or context based lending as against traditional approach based on product and services. However, this is currently focused on consumption based financing which has a natural pull. This approach needs to extend to unaddressed need such as home purchase, wheels, long term financing, etc.

With digitization being on top agenda of the government, bottlenecks on this may soon be a thing of the past. With that new opportunities to cater to customer needs will emerge and hence fintech need to extend similar frictionless experience to new products as well.

We believe big technology firms will play a more dominant role here given the advantage they have on both depth of data as also the ability to harness the same.

4. Regulatory clarity, government investment in digital public good, adoption of exponential technologies and positive outlook on economy provide tailwinds to the growth of the sector and fintech would especially be the primary beneficiary of these.

Recent developments like the passage of Digital Personal Data Protection and now becoming an Act is a move in the right direction. This will instill confidence to a large segment who are concerned about how their data will be used. This augurs well not just for the fintech lenders but the entire financial sector. While this will help in increasing trust it would also entail greater compliance cost in the short run.

Digital lending guideline by Reserve Bank of India has brought about clarity on schemes such FLDG (First Loan Default Guarantee). Overall, this will bring greater ownership by the risk bearing regulated entity leading to improvement in asset quality in the long run. Government initiatives such as OCEN will further help in increasing access to credit at favourable terms to a large segment. Fintech can leverage such frameworks to their advantage.

Finally, as India races to become the third largest economy in this decade itself she will offer tremendous opportunity for everyone to grow. Rising aspiration class and millennials will be significant contributor in the lending pie and these being core to the fintech they will sure benefit from the India story.

Disclaimer

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