Digital lending: credit bubble or not?

While fintechs can make fast lending, their recovery process may tend to go the slower track:

The story of Indian fintech is now mostly about lending. Two years ago, it was all about payments. In a few years, India's digital payment industry reached $200 billion and it is now expected to reach $1 trillion by 2023, according to Credit Suisse. However, the focus continues to be on lending among NBFCs, microfinance companies, new age fintechs and angel investors. This model is on a trial and error mode, as the lending industry as a whole grapple with defaults. Yet, the digital lending hope is surviving. On what? The lack of an ecosystem.

"According to a microfinance study, 50% people in India do not have access to financial services. Most small borrowers remain in the clutches of (traditional) moneylenders who lend at exorbitant rates of 30-60%. This is more than twice the rate that financial services can offer," says Somya Srivastava, CEO at Prayatna Microfinance.

LET THERE BE HUNGER

India is a credit hungry economy and individuals and growing businesses are constantly looking for funds. They need favorable lending rates, smooth processes and easy disbursement. And none of these the large banks can or want to cater to. They ignore small ticket loans as customer acquisition costs do not make business sense. Lack of infrastructure is yet another impediment. This is a common problem that fintechs want to solve.

Innovation was driven by government's Mudra Bank, Digital India Movement and Aadhaar empowered them. Aadhaar-enabled KYC became a way to facilitate the entry of fintechs into the sector. Large NBFCs adopted the digital model and they could lend to people without meeting them. Digitally, micro-lending has few obstacles that larger banks faced.

Sharad Sharma

Gaurav Goyal

Manav Jeet

FLEXIBLE & FAVOURED

Flexiloans is a new age lending company. Its lending plan uses alternate data. Aadhaar number is a key identity tool. Flexiloans believes that unconventional models can authenticate a borrower like transaction history, contacts, social behavior, etc. "The idea was to disrupt the banking model where they lend to people they know. Flexiloans successfully built this model and is currently operating in 60 cities," explains Ritesh Jain, co-founder of FlexiLoans.

Flexiloans is one amongst many. A large number of companies entered the digital lending space with innovative and dynamic models. They now want to lend without physically meeting the customer. There is no competition in terms of lending rates, but the speed of disbursement has become a competing factor. A few fintechs claim to process loans within hours, a few even in minutes. A customer's social footprint, transaction history, business invoices, psychometric tests (which actually analyzes whether customer has the will to repay), image and appearance, including color of shirts and type of shoes and the place of shopping. It also includes what he buys on online platforms, how he pays and how much he is spending. It checks with Truecaller app which is used for online delivery. Lenders are collecting all such data that provides an accurate picture of the customer. Alternative data is used as a strong source to build credit score. NBFCs relied more on the alternative data they have generated than on scores from credit agencies.

As an example, Tradebulls Securities says 99% loans were disbursed online and customers were called for only to sign the POA at the last stage since its mandatory.

The entire lending model is based on offering superior customer service by disbursing loans as quickly as possible and using customers' alternative data to identify his risk appetite to build recovery mechanism. NBFCs built a tech system and also outsourced operations to many tech companies.

Many startups got into financial innovation and wove a model where they could offer the best rate to customers by partnering with banks and NBFCs. CashCow is one such example. By simply downloading a mobile app, anybody can become an agent or advisor. The company has partnered with many financial institutions and offers a variety of loans. Customers can choose the company offering best interest rate and apply for the loan.

"We have 2500 agents/advisors operating in 15 cities. We believe in offering financial products at doorsteps through advisors. Advisors help customers to make the right choice," says Gaurav Goyal, co-founder, CashCow.

TO BE OR NOT TO BE

RBIs guidelines on P2P lending also encouraged new players to enter this market. They mainly offer working capital to growing businesses or short term funds to individuals. Early Salary and Weekly Fund are some such companies. This model has been created to destroy the traditional (money) lenders.

But are they successful? How long will this rally last?

This scenario has led to a disrupting model, remarkable technologies and innovations. Many of the players ran their business successfully for 3-5 years. But later, several of them started lagging behind in the race and some of them were swallowed by big banks and IT players.

Many experts and industry leaders in the sector feel that 9 out of 10 such lenders will fail. If this happens, the scenario is alarming.

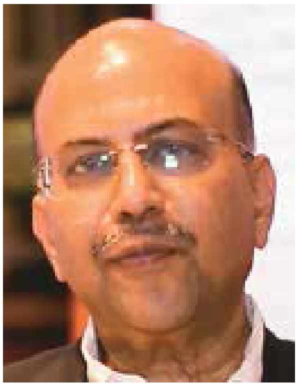
SME LENDING

Most of the fintechs are lending to SMEs. While analysts and economists believe the next growth will come from SMEs and MSMEs, it is not easy. Property rents are rising and that is the biggest problem for SMEs in major cities, since a major portion of their borrowings goes into serving the rent, according to Piyush Khaitan, Founder & MD at NewGrowth.

The SME market is huge but not all of the SMEs are eligible to borrow from conventional financial institutions due to weak credit score. Many of them borrow from non-traditional sources paying exorbitant interest. Fintechs as well as microfinance companies want to be the alternative source for funding for these SMEs.

But this quick digital lending model has its drawbacks too. Competition is increasing and currently there are more than 1000 companies operating in the lending space. While there is a potential, such a large number of companies does not fit in. "There is space for only 20-25 lenders in the SME lending business," affirms Khaitan.

Mid-level and small companies may have to struggle hard specifically when they do not have enough investments. Also, cost of funding is a big challenge for small companies compared to large institutions.


Piyush Khaitan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Ritesh Jain

RECOVERY NOT EASY

One crucial issue is recovery. Currently, Indian banks have bad loans worth ₹10 trillion. In spite of Insolvency and Bankruptcy Code (IBC), which strengthens bankers against debtors, recovery is still an uphill task. Can digital lenders be as quick in recovery as they are in disbursing loans?

Defaulters in digital lending are fewer than the traditional lending because recovery and repayment process have changed. Alternative data which includes customers' social footprints is the biggest tool for lenders to recover. But how will creditors reach customers when actual defaults occur? "We got the first bullet, when we have had a default from a customer who has CIBIL credit score close to 800," said a spokesperson of a top digital lending company. Perhaps that is the reason why many companies have realized that core online digital model will not work and they have started talking about a Phygital model.

Most of the banks and NBFCs have segregated categories and they have fixed a cap of ₹500,000 for certain categories. Most of the average small loans are between ₹300,000 to ₹300,000. And interest rates are slightly higher than those charged by large banks to have their position strong even if defaults occur.

So, the question is how long this lending phenomenon will last.

"Few of the old players survived due to evolutionary changes. But consolidation is bound to happen and 95 out of 100 lending companies will vanish in the next 5 years," affirms Sharad Sharma, Co-founder, iSPIRT.

BUILDING DIGITAL FUTURE

According to a Deloitte report, investments in fintechs who are into lending will increase to $11 billion by 2018. The investments were $9.3 billion in 2017 and $9.4 billion in 2016.

Fintechs which are into lending have innovative schemes and their procedures are quick. What will determine their success is how they scale up, compete and remain in the market. They have a major handicap now - the recent Supreme Court verdict which restricts financial institutions from making Aadhaar mandatory – since Aadhaar eKYC has been a fail-proof pillar for them.

"The judgement will compel these firms to re-evaluate consumer onboarding process through eKYC. Aadhar is a crucial link to bring the last mile under formal banking ecosystem. The judgment may impact the agenda of financial inclusion as well," says Manav Jeet, MD & CEO at Rubique.

Importantly, the lending business has more risk than any other business. As long as credit is concerned, it is important for all the digital lenders to relook at credit card issuance mishap that happened exactly a decade ago. Credit cards were issued freely. Most of the financial institutions burnt their hands when people refused to pay or were unable to pay. Recovery turned into settlements and banks hired goons. Ultimately, RBI intervened. The business of credit is lucrative but not easy. It is an unbalanced model where money can be disbursed within a few minutes but cannot be recovered at the same speed.

Amol Dethe