Converging Lines: At the Intersection Of Payments And Lending

November 2018

pwc

Foreword

Dear Readers,

It is our pleasure to bring to you the latest edition of our Payments newsletter.

This report aims to provide key insights into the convergence of the payments and lending practices in India by utilizing PwC's intelligence and experience as well as insights from our work with clients. We take a look at how the lending space has evolved with the advent of FinTechs, look at upcoming trends and delve into the key challenges and PwC point of view for players in this space.

I hope you will find this to be a good and insightful read.

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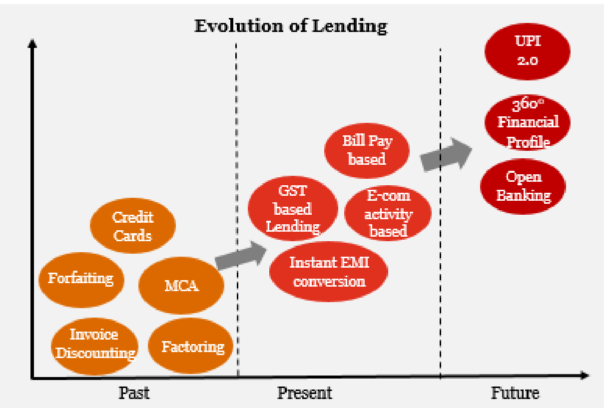
In this issue

Introduction

Traditional credit scores rely on repayment data of loans and credit cards to determine credit worthiness. This denies an estimated 90% creditworthy individuals/thin file customers from access to credit. The utilization of alternate data to enrich or replace traditional sources is the cornerstone of FinTech lenders. These data points can be obtained from social sites, device data, sms, email, digital footprints, social media accounts, bank account statements among others.

Traditional products in the payment based lending space involved in invoice discounting, factoring, forfaiting and have since moved on to alternate means like merchant cash advances, credit cards. However, with the advent of FinTech startups, we are witnessing a shift to more innovative lending practices based on the payment history of the loan seeker. Some of the products to hit the market incorporate GST data, ecommerce activity, and bill payments data amongst others. On an active basis, it allows a lender to decide the paying ability of a merchant/business/individual and accordingly sanction credit. Some FinTech firms have enabled instant lending at the point of purchase itself, without the need for any offline intervention and this has led to a seamless experience. The collection of these loans more often than not can be done from the payment platform itself, providing for seamless, and convenient customer experience.

Present Landscape



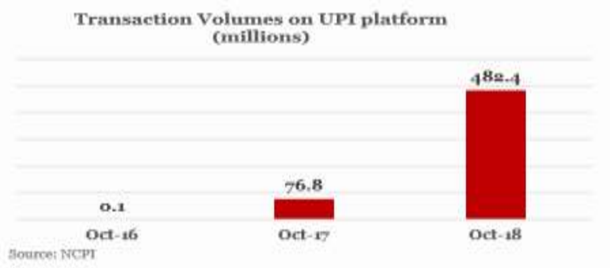
The payments space in India continues to be on the lookout for new opportunities to grow volumes so as to counter dwindling margins brought on by increased competition. Lenders are on the lookout for meaningful customer behavioral data with a need to diversify beyond core payments to create an interaction, which is more relationship based rather than just transactional. The lending and payment company models are starting to dovetail into each other as payments companies are monetizing their data to be consumed by lender models, while lenders are providing seamless 'lending in a box' credit facilities at the point of sale to drive more transactions.

Payment related data is considered more reliable compared to the other alternate data sources. Digital payments data gives an insight into the spending behavior, capacity and patterns of an individual. For instance, utility and phone bill payments data including bill amount, payment dates, payment mode, payment instrument help in profiling an individual. Spends on ecommerce websites and apps collected from various sources add another dimension. Further, tax data including IT returns, property tax, professional tax, GST filing help in painting a clearer picture of the potential borrower. Based on all these payment data points, proprietary algorithms are used to assess not only the customer's ability but also willingness to pay.

The number of startups in the online consumer lending space has grown significantly in the last few years. These firms either operate as NBFCs (Capital Float, Bajaj Finserve), intermediaries for banks/NBFCs (MoneyTap) or serve as a P2P lending marketplace (Faircent) to connect individual borrowers and lenders directly. Many FinTechs have also tied up with banks resulting in a win-win situation for both; the FinTechs leverage technology to source new creditworthy customers for banks who can expand their balance sheets.

Upcoming Trends

Ever since the inception and launch of Unified Payments Interface (UPI) more than a year ago, the digital transfer of funds has seen a massive rise.



Even though the volume of digital transactions has gone up it is yet to have a significant impact on digital lending. We estimate around 6.9cr overall credit accounts in India as of Oct 2018. A significant portion of the customer base struggles to avail lending options mainly due to their limited or non-existent credit history. UPI 2.0 can potentially become the innovative solution to bring credit facilities to this underserved class of customers.

1 Rise of UPI 2.0

The launch of UPI 2.0 unveiled an added functionality of the ability to link overdraft accounts to the UPI app. This facility allows the user to make withdrawals and payments even if the account has insufficient funds. This is another step towards improving the state of flow based lending as it allows the customers to have a line of credit through the UPI app. Not only does it provide a direct line of credit to the underserved, it also provides a metric to measure their credit. Financial institutions can associate a better credit score with those who clear their overdrafts on time and hence provide them access to more credit and at cheaper rate of interest.

Along with the ability to link overdraft accounts, the feature of one-time mandate activation is also a step towards realizing need based, short term credit facilities. In the near future, UPI could play a pivotal role in the development of a digital lending platform to provide small-ticket, scenario based loans, without traditional credit risk assessment. Players like ePayLater and iSPIRT are already making use of the capabilities of UPI platform to enable digital lending. However, the ability to extend credit to its customers is not the only attribute that makes UPI unique. Unlike a cash transaction, a UPI transaction has a technological layer between the buyer and merchant, which records the data associated with the transaction. This aggregated data can further be used to offer services such as loan origination. For SMEs, combining a merchant's transaction data flow from UPI to other sources such as GST will give important insights about the financial situation of the SME for loan assessment. This will lead to more reliable credit models as they provide better context and information about the borrower. This also helps SMEs in getting credit which they previously couldn't receive and provides an overall boost to the economy.

2 Open Banking

Tying in to the theme of utilization of financial data, the Indian banking sector may consider open banking, a system which involves banks using APIs to securely share customer data with third parties after obtaining customers' consent. This is especially useful for lending, as analytics performed on transaction data across all the customer's accounts yields information that is crucial for credit assessment and decision making.

The use of transaction data from initiatives such as Bharat Bill Pay System (BBPS) and GST can be expected to play out in conjunction with the public credit registry that the RBI is soon going to set up with the help of financial institutions to build a customer's complete financial profile. This can prevent defaults by providing the bank with early warnings and enable efficient collection by tracking funds and triggering alerts when customers miss repayments for any loans that they have taken across all lending firms. Open banking will facilitate the development of innovative lending offerings and eventually facilitate a move toward a more customer-centric business model. We will soon be entering a stage where competitive advantage won't solely be gained from digitization of processes to improve customer experience but with advances in data analysis, intelligent use of tech, AI and machine learning by building superior credit assessment models.

Challenges & Way Forward

1 Collaboration between FI incumbents and FinTechs

In recent years, incumbents have realized that collaborating rather than competing with FinTechs is a more effective digital innovation strategy and some are even embracing the disruption being created. A major challenge is trying to cultivate an environment where collaboration can flourish as opposed to stifling the beneficiary attributes of either partner. Cybersecurity and regulatory risks are among other key challenges to FinTech and Incumbents partnerships.

2 Concerns on transaction security – customers are still wary of trusting non-bank players

Cases of malware, phishing, hacking of software systems and accidental sharing of sensitive data of citizens are on the rise, which has created an atmosphere of mistrust. With the increased relevance of cybersecurity and safety, there is a growing need for FS players to invest in cyber threat management frameworks to ensure secure data storage.

3 Data privacy concerns

While data has become a very lucrative commodity, firms dealing with customer data will need to ensure that explicit customer consent is taken and will have to invest in robust data security mechanisms to ensure data privacy is maintained. In light of the Supreme Court's verdict on Aadhaar, it will be a challenge for new age entities to convince customers to share their Aadhaar details for identification purposes during the customer on-boarding process. It is envisaged that digital-only platforms could, also, possibly face initial hiccups and reluctance from customers, which would impact the growth rate of customer acquisition. With uncertainty around on-going and future initiatives built on top of Aadhaar, FinTechs and Financial institutions (FI) will need to work on strategies to handle various ongoing projects around those initiatives. Google's decision to limit the degree to which various mobile applications can access users' SMS and call logs, ends an era of a barrier less ecosystem for developers. This will have a direct impact on various lending FinTechs and financial services companies that rely on these data to determine customers' credit scores, as well as on ecommerce companies that scrape such kinds of information to build customer profiles for targeting products. Google later clarified that it may grant few exceptions if an application transparently provides a highly compelling or a very critical feature where there is no alternative method to provide the feature. Ultimately, it will come down to how strictly and fairly Google implements these changes. Similar kind of challenges in future could create unforeseen obstacles to the growth of this sector.

Way forward

FS industry behemoths and incumbents are at an interesting inflection point. There is a clear decentralization of power; FinTech players and traditionally non-FS actors have developed a foothold in the FS space, focusing on very specific points in the entire value chain and extracting service delivery opportunities. In such a scenario, incumbents need to assess their business models and figure out ways to become competitive in this emerging technology-dominated industry. Lending is one such area which would see major inroads by Non-FS players. With UPI 2.0, GST, and other avenues generating a lot of payment related useful information about the customers, incorporating them has immense scope to improve credit assessment models and also target the untapped demand. Incumbents would need to either collaborate with FinTechs to co-create new-age digital solutions or themselves find ways to utilize this important but sensitive payment data in order. Globally, few banks have already forged partnerships with FinTechs. Santander UK and ING partnered with Kabbage while JPMorgan Chase with OnDeck, to offer loans to small businesses. WSFS bank has partnered with Lendkey to offer private student loans. The incumbents would need to do something similar to continue enjoy superior economic position in the lending segment.

(With inputs from Zubin Tafti, Shekhar Lele, Krunal Kapadiya, Siddharth Gupta, and Sujay Agrawal)

Payments Technology Updates

NPCI: Financial players must take user consent to access utility bills data

Economic Times

Banks, utility and mobile players have been able to share and build collective databases via Aadhaar and BBPS. NPCI has asked payments platforms to ask for explicit consent of consumers to access a user's mobile and utility payments data under Bharat Bill Payment System (BBPS), in order to address concerns over data privacy.

(Read More)

Digital lending in India set to grow to $100 billion by 2023

Economic Times

Easier and cheaper credit through digital lending has the potential to trigger a virtuous cycle for formalization as well: up to 85 percent of MSMEs could be formal by 2023.

(Read More)

Why GST Data Stack is a One Stop Solution to SME's Credit Problem

Entrepreneur India

FinTech companies can use this data to create a customized product and offer better rates as per the borrower's need.

(Read More)

RBI starts process to set up digital Public Credit Registry

Economic Times

The PCR will include data from entities like market regulator SEBI, the corporate affairs ministry, Goods and Service Tax Network (GSTN) and the Insolvency and Bankruptcy Board of India (IBBI) to enable the banks and financial institutions to get 360 degree profile of existing and prospective borrowers

(Read More)

Equifax, PayU partner to enhance access to credit in India

Verdict

Under the collaboration, the two companies will work to enable the financial institutions receive deeper insights about transactional behavior of the consumers. It will target the consumers who are not part of credit bureau data.

(Read More)

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