# Mapping the Indian retail lending landscape

## An overview of the sector's performance and the impact of COVID-19 in Q1–Q2 FY21

May 2021

# Message from PwC

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Dear reader,

It is our pleasure to bring to you PwC's report on the performance of the retail lending sector in Q1 and Q2 of FY21.

The report is part of a series of publications focusing on the evolution of India's retail industry landscape. In this edition, we have analysed the trends in the retail lending space in India across several parameters. When combined with our surveys and interviews of industry participants, these trends provide novel insights to the reader.

This report has been prepared in collaboration with our partner Equifax. The scope of this edition is limited to sourcing and delinquency trends in the retail lending market viewed across multiple lenses, including geographies, sectors and products. This report covers the first two quarters of FY21, with an emphasis on the time period between March 2020 and September 2020. The next instalment of the series will cover trends from the period post September 2020 and analyse in greater detail the actual mid-term impact of the pandemic as well as regulatory actions such as the loan repayment moratorium.

We also conducted two surveys in collaboration with Equifax – one with chief financial officers (CFOs) of financial institutions, to gauge their expectations from a strategy and firm point of view; and the other with credit managers at such institutions, to assess the expectations at product and customer levels. Around 20 respondents participated in the CFO Survey and 70 respondents participated in the Credit Manager Survey. The results of these surveys are presented in this report along with the insights based on sourcing and delinquency trends.

We believe that the retail lending space in India is changing and evolving at a dynamic pace. As incomes rise and consumption levels increase, the demand for retail credit is increasing rapidly. While the industry is still plagued by the problems of sub-optimal asset quality, it is also one of the leaders in the world in terms of digital and technological innovation. The COVID-19 pandemic has been a major challenge for the industry, with lenders struggling with both sourcing as well as collections. Lenders such as banks, NBFCs and other financial institutions should consider the pandemic as a turning point for retail lending in India. They must move fast to emerge as lenders of the future.

This report provides insights into some of the points mentioned above. It also discusses certain likely future developments in the retail lending space based on the views of industry participants. We hope you find this report to be an informative and helpful read.

# Message from Equifax

**K. M. Nanaiah**
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Equifax Credit Information Services Pvt Ltd, and Country Leader – India and MEA, Equifax

The Indian financial services industry faced unprecedented challenges in 2020. Despite the initial roadblocks in navigating the unknown, this sector has shown exemplary resilience as evidenced by a turnaround and an almost V-shaped recovery. As we enter 2021, it is time to reflect on how retail lending trends shaped up in 2020 and identify the learnings that can drive credit offtake in this year.

Over the years, Equifax has worked with the financial services industry to help lenders maintain high levels of underwriting standards, manage risks and drive efficiencies. We are very pleased to partner with PwC and share with you our detailed insights and a more in-depth industry perspective on the retail lending sector. Our joint effort to bring out the first edition of the report on retail lending is the need of the hour, given the changing market dynamics in the past year due to COVID-19 and the impact of the lockdown on the industry.

This report will provide insights into the trends in the Indian retail financial services industry – from disbursements to delinquencies and from top-growing geographies to top loan categories, all viewed through the prism of the pandemic's impact.

We earnestly believe that this report will act as a beacon to the industry and policymakers, and help us all navigate the new normal.

I congratulate the teams from Equifax and PwC for preparing this report.

# Table of contents

# 01 Introduction

## 1 The impact of COVID-19 on the global and Indian economy

The COVID-19 pandemic has been one of the most impactful events in recent economic history. The pandemic affected both demand and supply worldwide, leading to a short-term recession in many countries and a long-term setback to growth. Both emerging and advanced economies were severely impacted in 2020. The supply shock was due to the implementation of lockdowns, disruptions in supply chains and decrease in output due to production cuts and workforce shortages. Business losses and liquidity crunches resulting in layoffs and pay cuts, increased unemployment and apprehensive attitudes towards economic recovery have severely impacted consumption and investments (demand shock). As per recent estimates by the International Monetary Fund (IMF), the global economy will shrink by 4.4%[1] in 2020–21, with developing countries being the worst affected.

As per the Reserve Bank of India (RBI), the Indian economy contracted by 23.9% and 7.5% in the first and second quarters of FY21 respectively owing to the pandemic, and is estimated to decline at an average rate of 7.5% in the year.[2] Most major economic indicators such as inflation and expectations thereof, repo rate, PMI, consumer confidence, CPI and vehicle sales have indicated signs of an economic slowdown.[3] With the Government of India and the RBI struggling to counter the demand slump even before the COVID-19 crisis, 2020 brought upon unprecedented challenges with regard to economic revival. The RBI undertook several measures, including open market operations and rate cuts to stimulate the economy. These resulted in the devaluation of the Indian rupee (INR) by 7% between the period from 30 January 2020 (when the first COVID-19 case was detected in the country) to 30 April 2020, and 4–5% till November 2020.

As of December 2020, Western economies have already shown signs of recovery in the second and third quarters of FY21 as restrictions were lifted and economic activities restarted. As per IMF estimates, the global economy will gradually start reviving in FY22 at an estimated growth rate of 5.2%, post which it will stabilise to around 3.5% till 2025.[4]

However, the pace of recovery and growth in emerging markets (including India) will be much slower. As per a leading credit rating agency's estimates in November, the Indian economy will contract by 10.6% in 2020–21 and rebound at a similar rate of 10.8% in 2021–22 to settle at a medium-term growth rate of 6%.[5] With a 2019–21 growth rate of -0.9%, the Indian economy is estimated to have a slower recovery than the global weighted average rate which is 0.6% in FY21 compared to FY19.

Within the Indian economy, the financial and professional service sector has been one of the worst by the COVID-19 pandemic. The sector witnessed a decrease in GVA of 5.3% and 8.1% in Q1 and Q2 of FY21 respectively.[6] While sectors such as trade, construction and manufacturing have recovered significantly in Q2 FY21, the BFSI sector is yet to show signs of improvement. The banking sector may be one of the last to recover fully from the impact of COVID-19 as well as certain pre-pandemic events.[7]

1 https://www.imf.org/en/Publications/WEO/Issues/2020/09/30/world-economic-outlook-october-2020
2 Reserve Bank of India, Database on Indian Economy
3 Trading Economics, India- Economic Indicators
4 https://www.imf.org/en/Publications/WEO/Issues/2020/09/30/world-economic-outlook-october-2020
5 Moody's research and ratings – India
6 http://www.mospi.nic.in/press-release/estimates-gross-domestic-product-second-quarter-july-september-2020-2021
7 Ibid.

# 2 Impact on the BFSI sector and the lending industry

The pandemic has aggravated the pre-existing systemic problems in India's banking sector. Macroeconomic problems, extensive debt restructuring, problems with the IBC, 2016, deprecating asset quality and multiple financial fraud and money laundering cases had already plagued the banking sector before the outbreak of the pandemic. The devastating impact of COVID-19 on the economy has put the industry under extreme stress. For example, the corporate sector debt of INR 15.5 lakh crore, accounting for approximately 30% of the total credit to the industry is now under stress post COVID-19, in addition to the 42% which was already stressed.[8] This takes the percentage of stressed assets in the Indian banking sector to over 70%.

From an overall industry perspective, lenders have shown preference for retail credit over corporate credit during the first two quarters of FY21. Due to factors such as larger ticket sizes associated with corporate loans and higher NPA rates among such loans compared to retail, there has been a growth in the personal secured loans vis-à-vis industry credit after the pandemic. Between March and October 2020, personal loan disbursements increased by 2.3%, while corporate loans disbursements decreased by 5.7%.[9] It is expected that a large portion of the restructuring required for non-performing loans would arise from the corporate portfolio. Retail-heavy lenders, including certain digital lenders and NBFCs, have fared well compared to certain larger NBFCs and banks who have large corporate portfolios.

## 2.1 Banks

Most bank-performance indicators have shown negative signs. Gross and net NPA have increased, CAR and PCR have decreased, current account savings account (CASA) ratio and RoA have decreased, and DCR and NIM have reduced.[10] These are indicators of diminishing asset quality, increasing vulnerability to insolvency, decreasing profitability and overstretching of the balance sheet. Larger banks would also have to bear the cost of restructuring NPAs and that would increase the cost of borrowing for them in the range of 2.6–3.4% in FY21.[11]

Public sector undertaking (PSU) banks have been more affected than their private counterparts across most financial performance metrics (as they had been before the pandemic).[12] Estimates by a rating agency suggest that most PSU banks will bear heavy losses in FY21 and will need a huge amount of capital infusion to maintain minimum capital adequacy requirements.[13] However, there have been signs of revival and the situation has improved in Q2 FY21 compared to Q1 FY21, especially in terms of liquidity indicators.

## 2.2 NBFCs and other smaller lenders

Smaller lenders such as NBFCs and home finance companies have been hit harder than larger and more established (private sector) banks. Collections were most affected due to the restrictions imposed during the lockdown, combined with the inability of the borrowers to repay. Most NBFCs tightened controls over credit assessment and disbursement as they became more apprehensive about increased NPAs.

The housing finance sector has come under greater scrutiny after financial fraud cases associated with a large player in the industry were revealed in September–October 2020. Some of the problems faced by the sector include reduced or more expensive credit from banks and reduction in property prices due to a slump in demand. The affordable housing lending sector was harshly affected as most low-income households applied for the moratorium or became delinquent.

FinTech and digital NBFCs were less affected by the problem of NPAs compared to traditional lenders. Shortage of funds has been the only problem faced by several digital lenders during the past few months. These companies usually target salaried individuals through secured personal loans. They rely on new-age underwriting models based on alternative data from multiple sources which improves the accuracy of credit risk calculation. Collections are also managed digitally and hence, the lockdown had a minimal impact on repayments.

8 https://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/EXPERTCOMMITTEED58A96778C5E4799AE0E3FCC13DC67F2.PDF
9 Reserve Bank of India, Sectoral Deployment of Bank Credit, October 2020
10 Capitaline Database
11 https://www.bloombergquint.com/business/india-ratings-cuts-banking-sector-outlook-to-negative
12 https://rbidocs.rbi.org.in/rdocs/Bulletin/PDFs/07FSR_11012021A8841538E27340A08A502704FB51FD1A.PDF
13 India Ratings and Research, Outlook report on banks, February 2021

# 3 Regulatory actions and impact

The RBI has taken several key actions since March 2020 with the objectives of expanding liquidity in the market, improving credit flow, easing the financial stress of financial institutions as well as the industry, and enhancing the overall functioning of financial markets in the country.

Several key initiatives[14] were announced in the corporate lending space such as collateral-free loans, subordinate debt for MSMEs and changes in MSME classification. Some of the key initiatives taken by the RBI are detailed below.

**01** Financial relaxation for three months (24 March 2020): Free ATM withdrawal and reduction in bank charges for trade finance customers.

**02** Rescheduling of payments (27 March 2020): Moratorium of three months on repayment of term loans, interest deferral, classification of SMA and NPA.

**03** Regulatory/Basel relaxation (27 March 2020): Implementation of NSFR by six months and implementation of the last tranche of CCB by six months.

**04** Liquidity management 1 (27 March 2020): Relaxation in maximum SLR dip for MSF by 100 bps to 3% and CRR relaxation by 100 bps to 3%a.

**05** Monetary policy 1 (27 March 2020): The RBI reduced repo rate from 5.15% to 4.4% and reverse repo rate from 4.9% to 4%, and announced a TLTRO of up to INR 100,000 crore.

**06** Liquidity management 2 (17 April 2020): Relaxation of LCR under Basel III to 80% till September 2020 and 90% till March 2021, and stopping of dividend payouts.

**07** Monetary policy 2 (17 April 2020): Reverse repo rate reduced from 4% to 3.75% and TLTRO 2 of INR 50,000 crore for NBFCs announced.

**08** Special clearing operations (31 March 2020): Special clearing was carried out exclusively for Government cheques at all clearing houses across the country on 31 March 2020.

**09** Provisioning on interbank exposure of UCBs (20 April 2020): The interbank exposures arising from deposits placed by UCBs under AID and their non-performing exposures to be fully provided within five years at the rate of 20% per annum.

**10** COVID-19 regulatory package (23 May 2020): Three months of deferment from 1 June 2020 to 31 August 2020 on the recovery of interest applied in respect of working capital.

**11** COVID-19 regulatory package (resolution of stressed assets) (23 May 2020): The period from 1 March 2020 to 31 August 2020 was excluded from the calculation of the 30-day timeline for the review period.

**12** Interest Subvention (IS) and PRI for short-term loans for agriculture (4 June 2020): The repayment period was extended for the availability of 2% IS and 3% PRI to farmers up to 31 August 2020.

**13** Maintenance of SLR and MSF (26 June 2020): The borrowing limit of scheduled banks under the MSF scheme was increased from 2% to 3% of their NDTL and the relaxed limit was extended till 30 September 2020.

14 Reserve Bank of India, Notifications, 2020–21

14 Change in the minimum daily maintenance of the CRR (26 June 2020): The minimum daily maintenance of CRR was reduced from 90% of the prescribed CRR to 80% and the relaxed limit was extended till 30 September 2020.

15 Distressed Assets Fund – Subordinate Debt for Stressed MSMEs (1 July 2020): The banks permitted to reckon the funds infused by the promoters in their MSME units through loans availed under the captioned scheme as equity/ quasi equity from the promoters for debt-equity computation.

16 Resolution Framework for COVID-19-related Stress (6 August 2020): A window under the prudential framework was created to enable lenders to implement a resolution plan in respect of eligible corporate exposures while classifying such exposures as standard.

17 MSME sector – Restructuring of Advances (6 August 2020): Existing loans to MSMEs classified as 'standard' may be restructured without a downgrade in the asset classification, with banks maintaining additional provision of 5% over and above the provision already held by them.

18 Basel III Capital Regulations (29 September 2020): The pre-specified trigger for loss absorption through conversion/write-down of Additional Tier 1 instruments (Perpetual Non-Convertible Preference Shares and Perpetual Debt Instruments) to remain at 5.5% of RWAs and will rise to 6.125% of RWAs from 1 April 2021.

19 Basel III Framework on Liquidity Standards (NSFR) (29 September 2020): The implementation of NSFR guidelines deferred by a further period of six months and to come into effect from 1 April 2021.

20 Interest Subvention Scheme for MSMEs – Co-operative banks (7 October 2020): The validity of the Interest Subvention Scheme for MSMEs 2018 has been extended till 31 March 2021.

21 Scheme for grant of ex-gratia payment (26 October 2020): A scheme was launched which mandates ex-gratia payment to certain categories of borrowers by crediting the difference between simple interest and compound interest for the period between 1 March 2020 to 31 August 2020 by respective lending institutions.

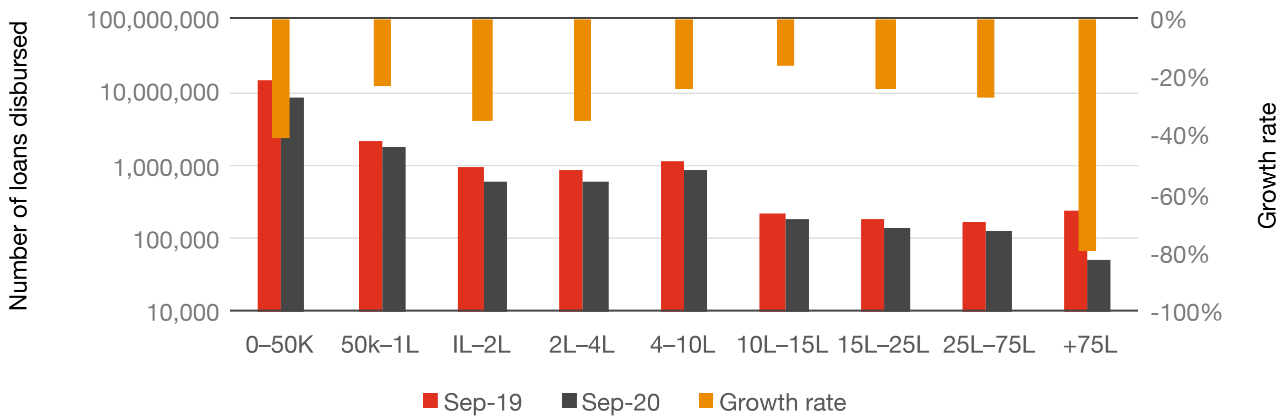
22 Review of regulatory framework for HFCs (22 October 2020): The regulatory framework for HFCs has been modified; an NBFC whose financial assets – in the business of providing finance for housing – constitutes at least 60% of its total assets.

23 24x7 availability of the RTGS system (4 December 2020): RTGS to be available on all days of the year with effect from 00:30 hours on 14 December 2020.

# 02 Sourcing and delinquency trends

In the wake of economic uncertainties, the demand for high ticket-size loans decreased significantly between January 2020 and June 2020. While the number of loans sourced across all ticket sizes reduced by approximately 20% in the second quarter of FY21 compared to the same period in FY20, disbursement of large ticket-size loans (>INR 75 lakh) witnessed the sharpest decline of around 80% owing to the inclination of borrowers towards small ticket-sized loans and cautionary appraisal mechanisms adopted by lenders based on borrowers' credit history and repayment behaviour.

**Comparison of ticket size (INR) based retail loans for the quarter ending in September 2020 compared to the quarter ending in September 2019**

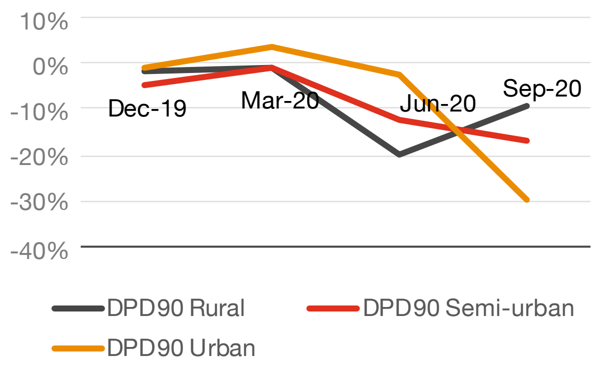



**Source:** Equifax

As of September 2020, a total of over INR 9 trillion was stuck in accounts classified as one of the various degrees of delinquent/bad loans, including standard delinquent accounts, sub-standard, doubtful and loss, and multiple DPD buckets ranging from 30 to over 720 days (excluding written-off and restructured loans). Overall, from March 2020 to September 2020 across all sectors, the number of customer accounts in delinquency initially saw a dip due to the moratorium offered by the RBI for loan repayments, followed by a resurgence of the DPD account numbers. The trend will be more concrete in the coming quarters. From Q3 FY21 to Q2 FY22, a negative trend was exhibited in the DPD90[15] and DPD120 [16] buckets wherein the number of delinquent accounts decreased by 28% and 5% respectively. While the total amount outstanding in DPD90 accounts fell by 39%, that in the DPD120 category increased by 1%. A growth of 12% and 11% was recorded in the number of accounts and value of restructured loans respectively, and a growth of 20% in number and 13% in the value of written-off loans was recorded in the first two quarters of FY21.

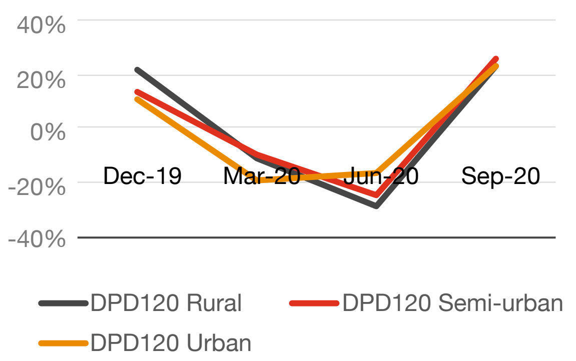
15 Accounts that are between 60 to 90 Days Past Due on repayment (RBI classification)
16 Accounts that are between 90 to 120 Days Past Due on repayment (RBI classification)

**QoQ growth rate of number of accounts – DPD90**




**Source:** Equifax

**QoQ growth rate of number of accounts – DPD120**



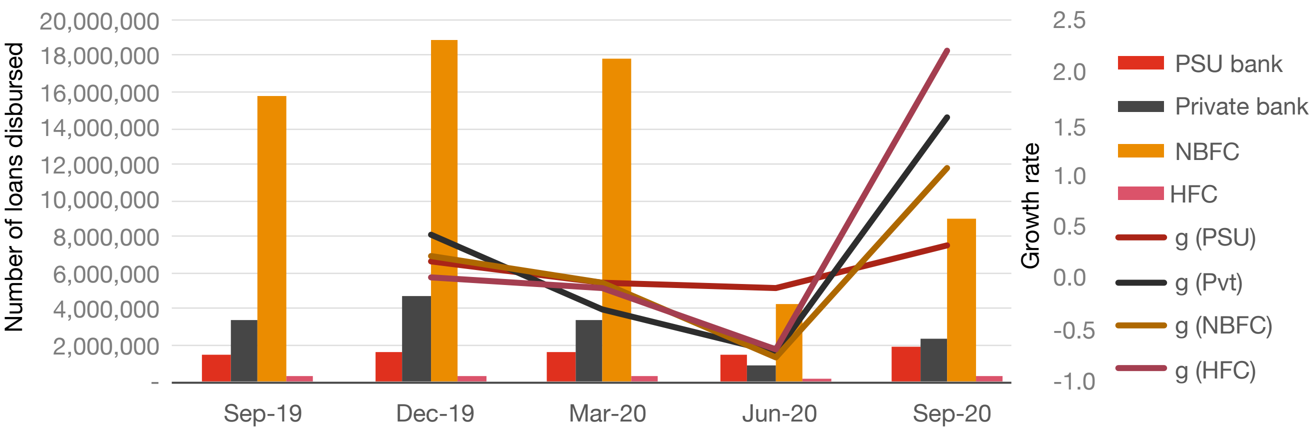

**Source:** Equifax

The COVID-19 crisis is forcing lenders to go back to their drawing boards and rethink sales, servicing, collection and operating models. At the same time, some organisations are utilising the pandemic as an opportunity to develop tactical and strategic interventions to develop long-term resilience.

## 1 Sector-wise performance

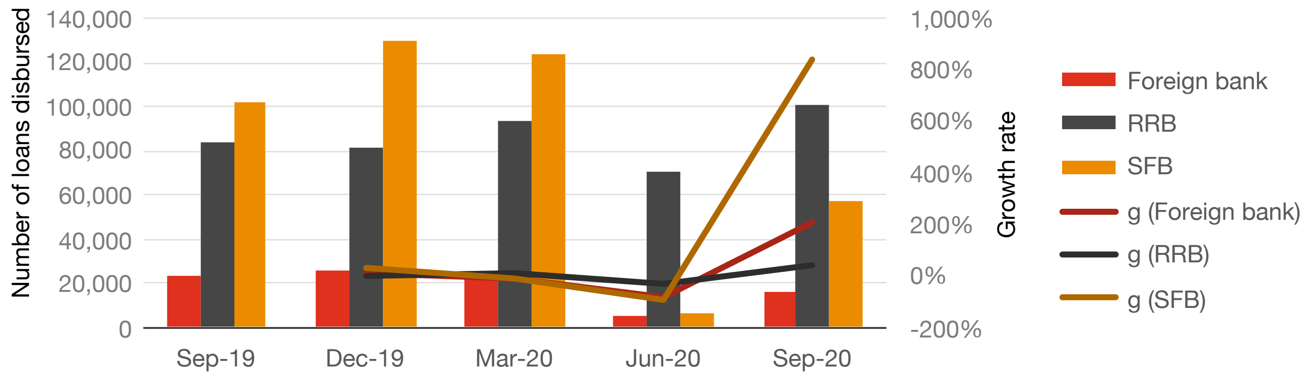
In the wake of the pandemic, restrictions on mobility due to lockdowns, change in new client-acquisition mechanisms and the limited availability of robust infrastructure for contactless selling coupled with muted customer demand resulted in a steep decline in the loan disbursements across all financial institutions in Q1 FY21. SFBs, foreign banks and private banks recorded the steepest declines. The decline for SFBs can be attributed to the high impact of lockdown-related restrictions, combined with the increased uncertainty in employment for middle- and low-income groups. Additionally, the mobility limitations significantly impacted the personalised high-touch service offerings of the SFBs in the form of monthly meetings with members which act as a differentiation factor compared to universal banks.

**QoQ growth rate and comparison of the number of disbursements for retail loans (FI-wise split)**




**Source:** Equifax

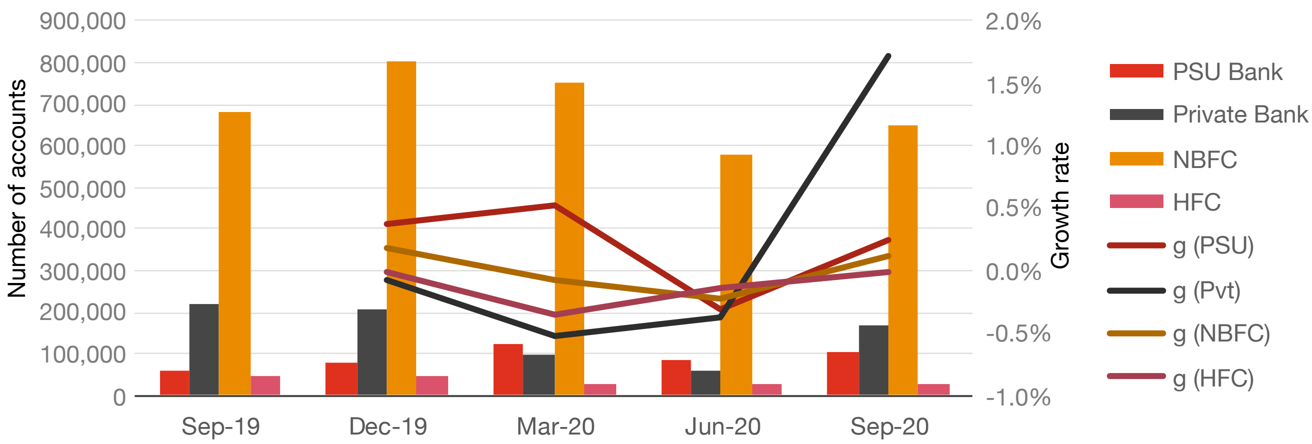
**QoQ growth rate and comparison of the number of disbursements for retail loans (FI-wise split)**




**Source:** Equifax

All financial institutions witnessed high QoQ growth in the second quarter of FY21 owing to the uptake in economic activity, except for regional rural banks which witnessed a negative growth rate in the period. However, compared to the same quarter for FY20, all financial institutions witnessed a decline in loan disbursements. Foreign banks accounted for the steepest decline, followed by NBFCs, private banks and SFBs.

**QoQ growth rate and comparison of the number of accounts in DPD120 (FI-wise split)**



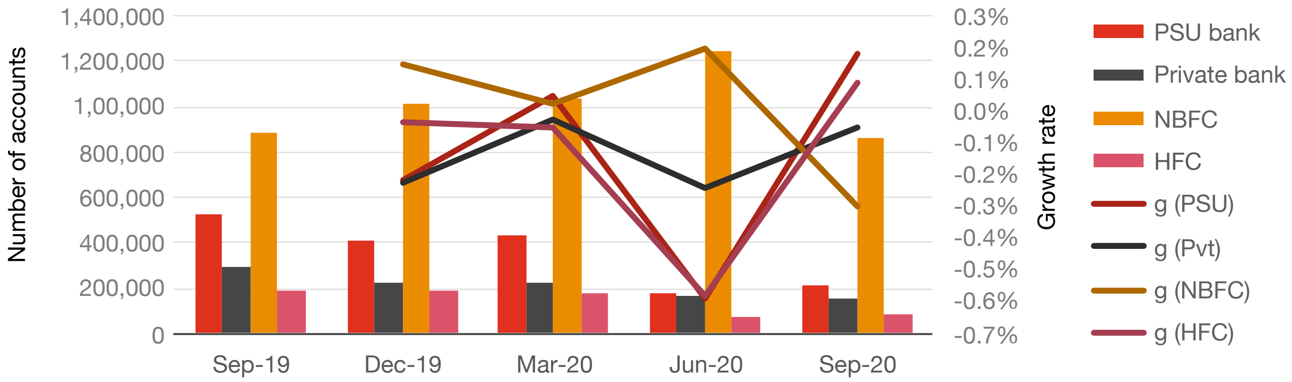

**Source:** Equifax

On the delinquency aspect, increasing number of layoffs, deferrals/salary reductions, higher unemployment, and decreasing economic activity due to lockdowns contributed to a significant short-term liquidity crunch for many middle- and low-income borrowers. Such cash shortages affected the repayment capacity of a large section of retail borrowers. This, coupled with regulatory interventions such as the moratorium and ex-gratia payments schemes, hampered lender profitability. Such schemes are also believed to have negatively affected the attitudes of borrowers and their and willingness to repay.

While all types of lenders have been affected by accounts turning delinquent, some were impacted more than the rest.

NBFCs were the worst-affected both in major DPD buckets (90 days and 120 days). Over 850,000 accounts were under the DPD 90 bucket in September 2020, accounting for a total of over INR 83 billion in balances. The number of delinquent accounts with NBFCs doubled from the Q1 FY21 to Q2 FY21. The numbers were very high for NBFCs even before the pandemic. Increased involvement in lending to 'traditionally unconventional' customers by NBFCs – those with a lower credit rating than typical bank customers – was one of the reasons for the high numbers of stressed assets.

**QoQ growth rate and comparison of the number of accounts in DPD90 (FI-wise split)**




**Source:** Equifax

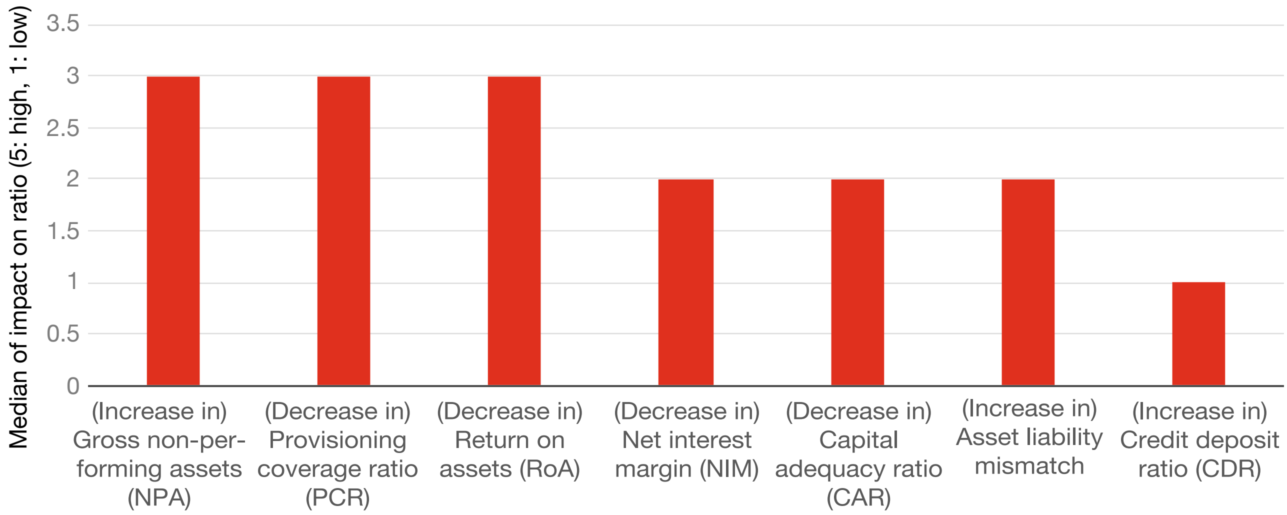
In terms of the QoQ growth rate of delinquent accounts across the DPD buckets, there was a dip in the growth rate in Q1 FY21 and a sharp rise in Q2. The moratorium on repayment of loans, first announced by the RBI for three months (March 2020–May 2020) and then extended for a further three months till August 2020 provided protection to stressed borrowers and is expected to have contributed to the sharp rise in delinquent accounts in September 2020.

## 2 Lender financial health

Key reasons of concern for banks and other lenders include:

1. Increased NPAs and SMAs: Deterioration in asset quality as many SMEs and retail customers are unable to repay loans due to falling sales, decreased income and job losses. Several corporates are unable to recover from the shock and have become delinquent.
2. Decreased CASA ratio: Higher cost of borrowing as the CASA ratio decreases due to eroding consumer savings. Consumers are becoming increasingly reluctant to deposit money in banks as the cost of deposits increases.
3. Lower demand/sales: Interest income for lenders has reduced as the consumption and demand for loans have decreased while NPAs have increased. Unsecured credit has been performing worse while secured loans are affected to a lesser extent.
4. Falling capital adequacy: There has been a dip in the CAR as credit and market risks increase and tier I and II capital decreases. Even though there are relaxations in risk-related regulatory requirements, maintaining capital adequacy remains a challenge.
5. Cash flow problems: Higher cost of capital and deferral of interest collections have led to liquidity crunches for banks. Higher operating expenditure and a reduced NIM have added to the problem.

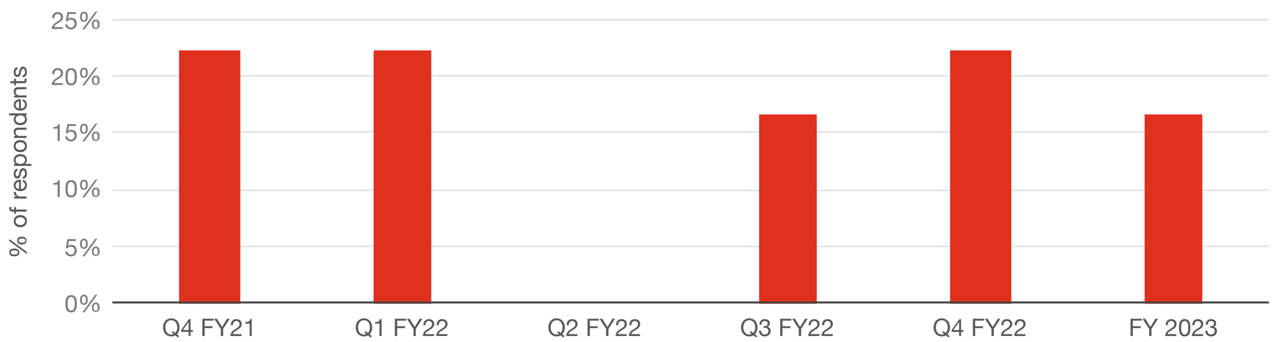
**Impact of COVID-19 on financial ratios of lenders**




**Source:** PwC-Equifax survey

As per the PwC-Equifax survey, the respondents rated certain key financial ratios that indicate an organisation's financial health on a scale of 1–5 (5 being the most affected). The ratios in decreasing order of the impact due to the pandemic are – gross NPA (increase), PCR (decrease), RoA (decrease), NIM (decrease), CAR (decrease), asset-liability mismatch (increase) and CDR (increase). Most market participants expect NPAs to increase rapidly due to factors such as increasing unemployment, job losses and the decreasing tendency to pay post the moratorium period. The greatest drivers for increasing NPAs are likely to be business loans and housing and property loans in urban areas. As a consequence of deteriorating asset quality and increasing NPAs, the PCR and RoA for lenders are also expected to decrease, thereby increasing the vulnerability of lenders even to relatively smaller economic shocks.

**Expectation of revenue streams coming back to pre-pandemic (normal) levels**




**Source:** PwC-Equifax survey

The lockdown and stagnation of economic activities coupled with regulatory interventions such as the moratorium on loan repayment and ex-gratia payment of difference between compound and simple interest have impacted the profitability of lenders, resulting in a decrease in the NIM. This slump in profitability is expected to continue in the short term. Bankers expected the CDR to be the least affected due to the pandemic. Consumers are focusing more on saving as spending has reduced and the expectations of a quick economic recovery are low. This, combined with a slower credit offtake and lenders being less willing to lend due to decreasing asset quality, is less likely to increase the CDR.

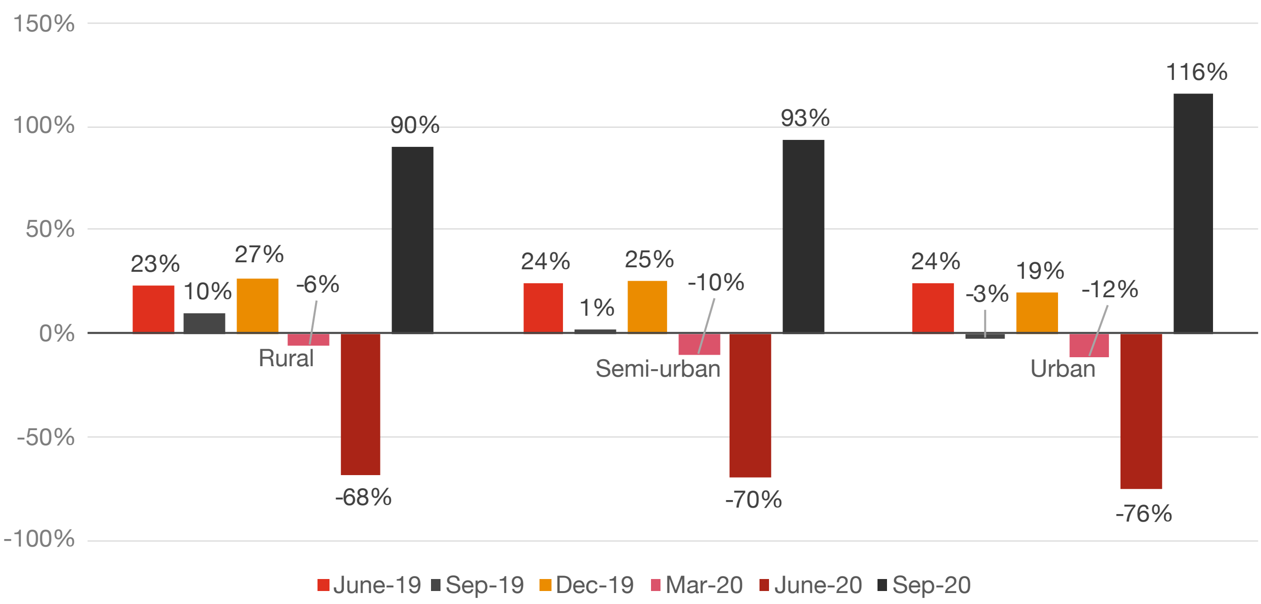
In terms of post-COVID-19 recovery expectations, there is a lack of consensus among industry participants on the timeline of recovering to pre-pandemic levels. The respondents in the PwC-Equifax survey were split into two major groups – those lenders who are confident of a faster recovery and those who believe in a slower one. The former group, comprising around 45% of the respondents, believe that revenues will be back to pre-pandemic levels (for the same quarter in the previous years) between Q4 FY21 or Q1 FY22. The latter group, comprising around 55% of the respondents believe that revenues would bounce back between Q3–Q4 FY22 or in FY23.

# 3 Geography-wise performance

## 3.1 Urban vs rural trends

The number of new loans sanctioned decreased significantly across both rural and urban areas with the onset of the pandemic. The number of new loans sanctioned decreased by 68%, 70% and 76% respectively across rural, semi-urban and urban areas during the first quarter of FY20 owing to the lockdown and limited availability of robust digital infrastructure to transition swiftly from partially digital lending journeys to end-to-end digital lending journeys. However, lesser number of job losses and containment zones in rural areas compared to semi-urban and urban areas resulted in a lower impact of the pandemic on retail lending in rural areas.

**QoQ growth rate for retail loans**

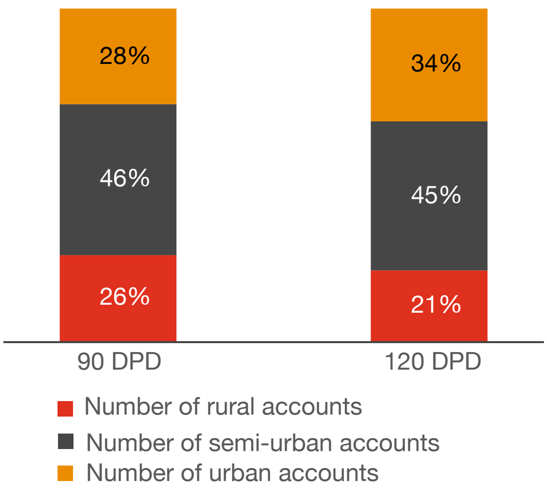



**Source:** Equifax

Comparing the share of delinquent accounts across regions by the degree of urbanisation, it was observed that as of September 2020, the contribution of semi-urban areas was the highest followed by urban and rural areas. However, in terms of contribution to the current outstanding in such accounts, urban areas were in the lead owing to the higher ticket size of loans.

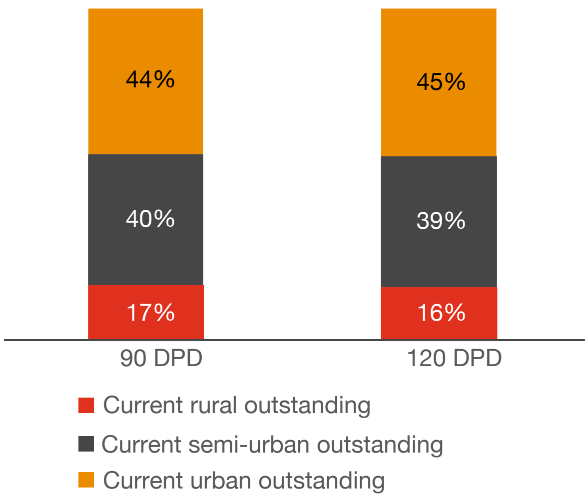
Looking at the growth rates of accounts in delinquency, the trend for DPD90 is opposite to those in DPD120. The number of accounts in the DPD120 category increased at an alarming rate after the first quarter of FY21 while those in DPD90 decreased at varying rates across urban/semi-urban/rural geographies. Compared to Q1 FY21, accounts delinquent up to 90 days in rural areas grew by 11%, those in semi-urban areas grew by 17% and those in urban areas grew at a rate of 29%. Such a high rate of growth among urban borrowers may be attributed to the higher dependency of urban household income on manufacturing and service sectors which were more drastically impacted due to the pandemic and the subsequent lockdown, compared to agriculture as well as migration from urban to rural areas. A higher prevalence of COVID-19 cases in urban areas compared to more remote areas also contributed to a greater disruption of day-to-day life and increased income instability. Semi-urban areas fared in between urban and rural areas in all measures. A sharp rise in delinquent accounts at the end of Q2 FY21 may also be attributed to the end of the moratorium period in August. The effect has not yet set in for DPD90 but is likely to develop in the third quarter.

**Distribution of the outstanding amounts in deilnquent accounts by rural/urban area**




**Source:** Equifax

**Distribution of number of delinquent accounts by rural/urban area**




**Source:** Equifax

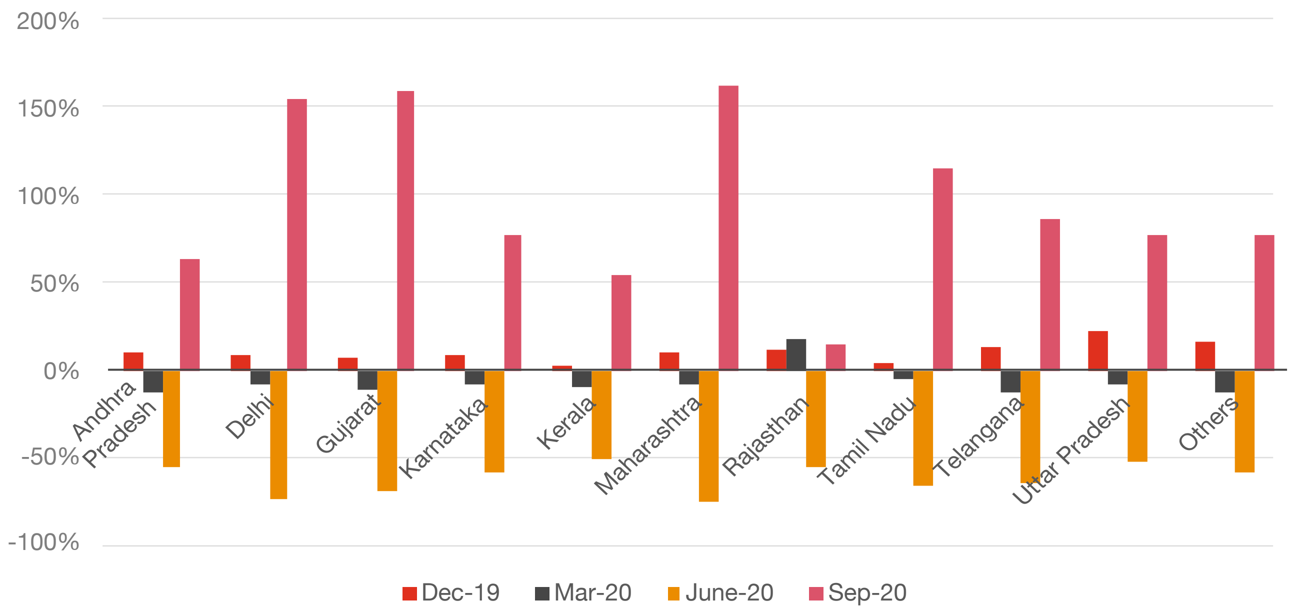
## 3.2 State-wise trends

As of September 2020, ten Indian states and union territories (UTs) had approximately 75% of the country's COVID-19 cases. Key states like Maharashtra, Andhra Pradesh, Karnataka, Kerala, Tamil Nadu, Uttar Pradesh and Delhi also witnessed the highest contraction in the disbursement of retail loans in Q1 FY21, to the tune of approximately 60% compared to the previous quarter. Among the key states/UTs, Maharashtra and Delhi witnessed the sharpest decline in disbursements in Q1 FY21 while the impact was lower in Kerala and Uttar Pradesh. However, with the resumption of economic activity, high QoQ growth was witnessed in Delhi, Gujarat and Maharashtra. On the other hand, though the pandemic's impact on Rajasthan was limited till September 2020, the growth in disbursements was muted in Q2 FY21.

Despite the growth in retail loan disbursements in the second quarter of FY21, the total value of disbursements across the key states decreased by approximately 30% compared to the same period in FY20. Among the states, Uttar Pradesh witnessed the lowest decline in loan disbursements value (around 7%) in Q2 FY21 compared to the same period in FY20.

Considering the product-wise distribution of retail loan disbursements for key states, Maharashtra had the highest share of auto loans (15%) for the first two quarters of FY21, Tamil Nadu and Uttar Pradesh registered the highest share in two-wheeler loans (17% and 16% respectively) and Gujarat registered the highest share of 14% in the used-car loan segment for the same period. In the tractor loan segment, Uttar Pradesh and Rajasthan had the highest share with 19% and 18% respectively, owing to the high agriculture-driven economic activity in these states.

### QoQ growth rate comparison for retail loans disbursements (state-wise split)

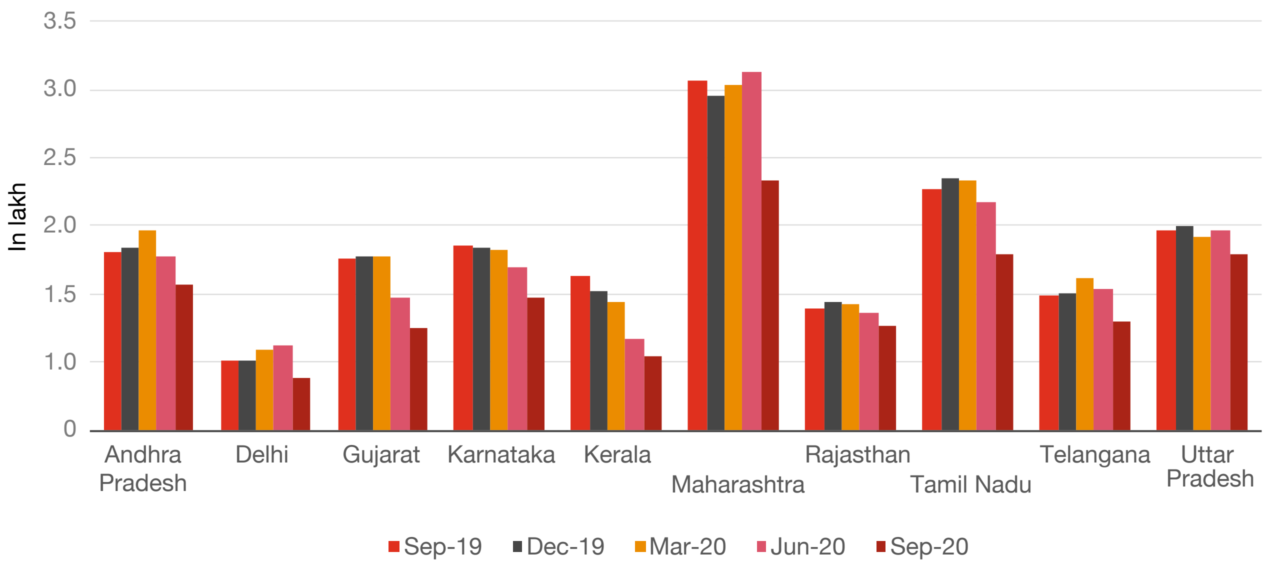



**Source:** Equifax

In the mortgage-related (home loans and LAP), personal and consumer loan segments, Maharashtra had the highest share among all the key states for the first two quarters of FY21 at around 20%. In the business loan segment, Uttar Pradesh had the highest share of 22% in loan disbursements in the first two quarters of FY21.

Looking at delinquency trends, the number of delinquent accounts in DPD90 category are higher in Maharashtra, Uttar Pradesh and Tamil Nadu compared to the other states. As of September 2020, there were a total of over 440,000 delinquent accounts overdue by 60–90 days in the three states combined. The top five states (Maharashtra, Uttar Pradesh, Tamil Nadu, Andhra Pradesh and Karnataka) alone contribute to almost 50% of the total number of delinquent accounts by 60–90 days of delay. Considering the larger number of loans outstanding in these larger states, higher delinquency rates are expected. However, looking at the growth rate for the DPD90 bucket from March 2020–September 2020, we observe that Uttar Pradesh and Rajasthan have been impacted the most. Among the large states, Gujarat and Kerala are better performing in the DPD90 category and saw the greatest decrease in the number of delinquent accounts in DPD90 between the same period. In all the major states, the number of accounts in delinquency have reduced in Q2 compared to the preceding three quarters, which may be indicative of recovery.

### QoQ growth rate for DPD90 accounts (state-wise split)




**Source:** Equifax

## 4 Product-wise performance

### 4.1 Home loans and LAP

Sourcing of home loans and LAP declined by approximately 50% in the first quarter of FY20 compared to the previous quarter. The lockdown and its impact led to potential homebuyers postponing their purchases. Additionally, the limited availability of resources to conduct field investigations and stricter mechanisms employed by lenders to evaluate the disposable income and repayment capacity of prospective borrowers – specifically buyers receiving soft sanctions through digital channels – further reduced the number of home loans and LAP sanctioned.

While the average ticket size of both housing loans and LAP declined significantly owing to the pandemic in Q2 FY20, incentivisation through the Pradhan Mantri Awas Yojana and the fall in interest rates coupled with lower registration costs in some areas resulted in an uptake in both the number of home loans and the average home loan ticket size in Q2 FY20. The uptake could also be attributed to the pandemic exposing the uncertainties associated with a rented accommodation.

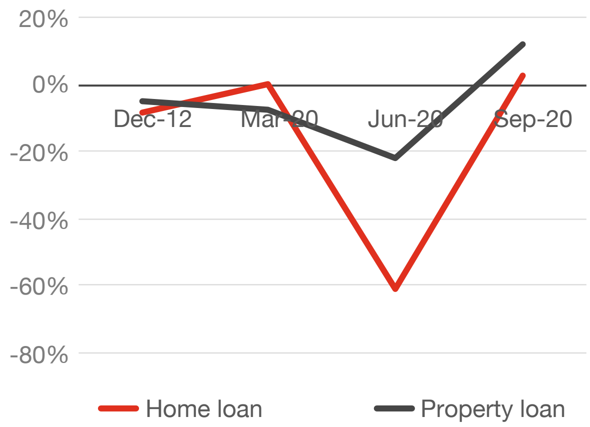
However, while the number of LAP sanctioned witnessed growth in Q3 FY20, the ticket size witnessed a sharp decline compared to the previous quarter. With small business owners being the primary consumers of LAP and demand from them being impacted significantly by the pandemic, such loans transitioned into instruments for sustaining businesses rather than expanding them.

Different trends were observed according to product groups by comparing the change in delinquent accounts by types of products. For housing type loans which comprise housing loans and property loans, a large increase in growth rate was observed in the number of accounts delinquent by up to 90 days, from March 2020 to September 2020. The sharp dip observed in June may be attributed to the RBI's loan moratorium.

**QoQ growth rate for the number of LAP and home loans sourced**


**Source:** Equifax

**QoQ growth rate for the number of DPD90 accounts for LAP and home loans**




**Source:** Equifax

### 4.2 Auto-related loans

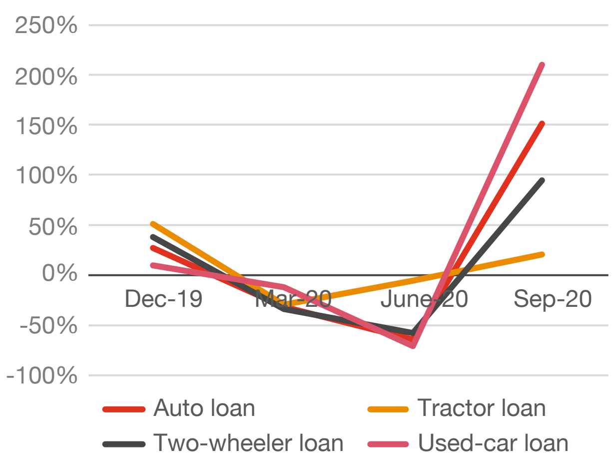
Auto, two-wheeler and used-car loans grew positively in Q2 FY21 owing to the need of personal transportation after declining by approximately 70% in Q1 FY21 as compared to the previous quarter. However, the number of loans sanctioned in Q2 FY21 decreased by approximately 30% compared to the same period in FY20.

Tractor financing grew negatively in the last quarter of FY20 and bounced back during in Q1 FY21 owing to the increased focus of banks and NBFCs on the rural portfolio, good monsoon forecasts, exemption of agricultural activities from lockdowns and fewer COVID-19 cases in rural and semi-urban areas. The growth continued in Q2 and Q3 of FY21. The Q3 growth rate was approximately 20% more compared to the same period in Q3 FY20.

For delinquency trends, the performance was not consistent across the group. A sharp rise in the number of accounts in DPD90 was observed in Q1 followed by a large dip in Q2 for two-wheeler and used-car loans. However, an opposite trend was observed for the other two products – auto and tractor loans. The performance of auto and tractor loans remained less volatile compared to two-wheeler and used-car loans.

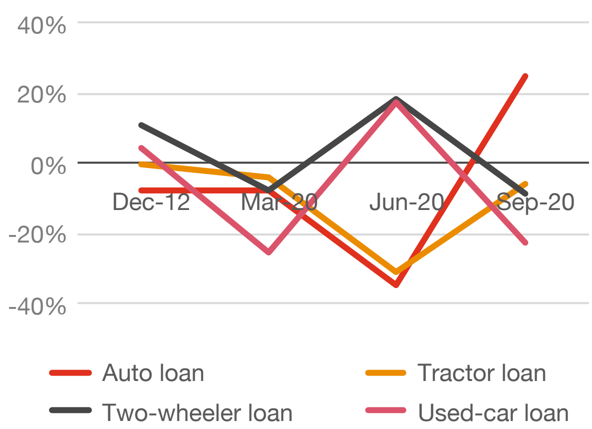
The number of delinquent accounts in smaller ticket-size loans (such personal, consumer and two-wheeler loans) is much higher than those in higher-ticket loans such as business, property and housing loans. Such higher-ticket loans still contribute to a majority of the stressed assets for lenders due to their larger sizes. In the DPD90 bucket, the number of delinquent accounts is much higher in the two-wheeler and personal loan categories.

**QoQ growth rate for the number of auto-related loans sourced**




**Source:** Equifax

**QoQ growth rate for the number of DPD90 accounts for auto-related loans**

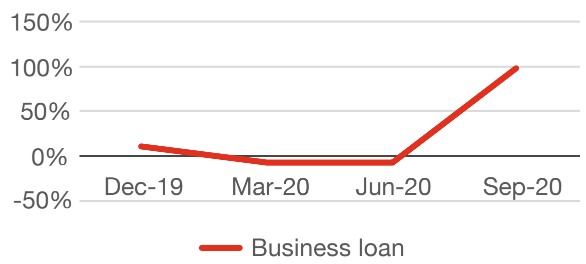



**Source:** Equifax

## 4.3 Personal, consumer and business loans

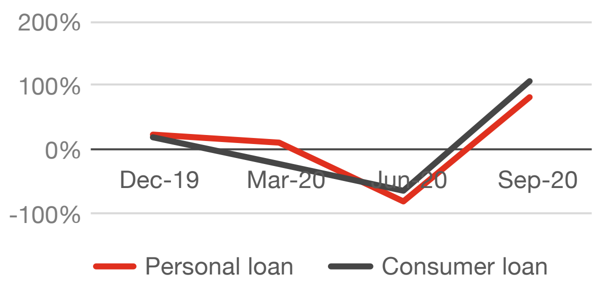
The COVID-19 crisis resulted in layoffs, pay cuts and a consequent decrease in disposable income. The aspiration-driven demand for personal and consumer loans transitioned into need-driven demand with consumers taking loans for educational purposes and health emergencies. This resulted in a decline of approximately 70% in the number of personal and consumer loans sourced in Q1 FY21 compared to the previous quarter. While the second quarter witnessed a growth in sourcing, the numbers decreased by approximately 40% and 20% respectively for personal loans and consumer loans compared to the same period in FY20. Though ticket sizes for both personal and consumer loans remained similar to the pre-pandemic quarters, the former contracted the most among all retail-lending products during the pandemic.

**QoQ growth rate for the number of business loans sourced**




**Source:** Equifax

**QoQ growth rate for the number of personal and consumer loans sourced**



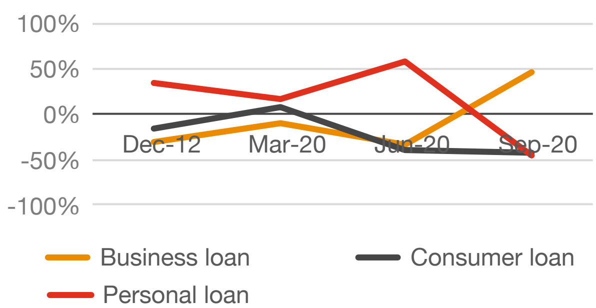

**Source:** Equifax

Cash flows of businesses were significantly impacted due to the lockdowns and muted consumption. Q1 FY21 witnessed business expansion being deprioritised, resulting in a decline in the number of business loans sourced. However, with the opening of the economy post the lockdown and tailored product offerings by banks and NBFCs for businesses, the number of business loans sanctioned grew in Q2 FY21. The number of loans sanctioned in Q2 FY21 increased by 84% compared to the same period in FY20. However, the average ticket size of business loans decreased by 61% compared to the same quarter in FY20 as businesses remained conservative in taking large ticket-size loans.

While the growth rates for personal and consumer loans in the DPD90 category fell in September 2020 compared to the previous quarter, business loans grew at around 50% in DPD90 accounts over the same time period.

Based on the data available for the time period from Q2 FY20–Q2 FY21, even though an upward trend was observed for delinquent accounts, the situation can be considered to be complicated at the moment and further trends will have to be observed in Q3 and Q4 of FY21 to understand the actual medium-term effects of economic conditions and regulatory actions. A lagged effect of the financial situation and regulatory interventions can be determined only in the coming quarters and the trends observed as of now may move towards either of the directions.

**QoQ growth rate for the number of DPD90 accounts for personal, consumer and business loans**

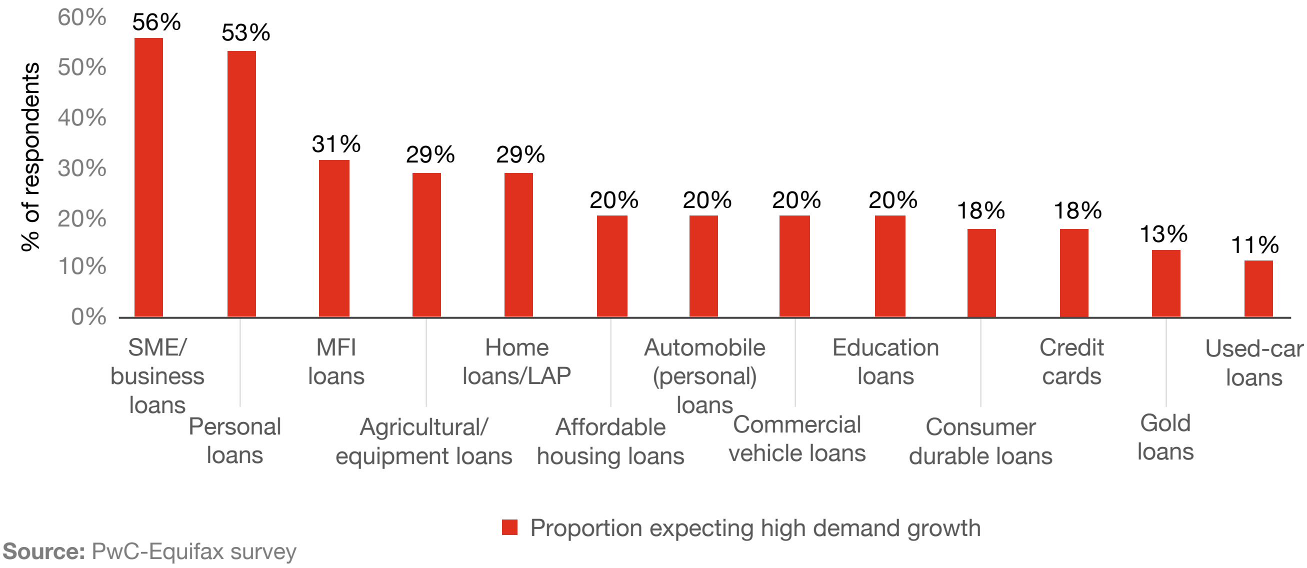



**Source:** Equifax

## 5 Portfolio realignment to reinforce revenue growth

The pandemic put lenders in a difficult position owing to falling liquidity and low growth prospects of major sectors. Consequently, lenders have become more conservative and are planning to expand their focus on existing customers and offer products to support them. As per PwC's Credit Manager Survey, 62% of managers will be targeting existing customers amidst muted credit demand and reduced discretionary spends by prospects, 22% are looking to target new to bank customers, and only 16% are focusing on new to credit customers.

**Credit managers' outlook for post-pandemic demand growth**



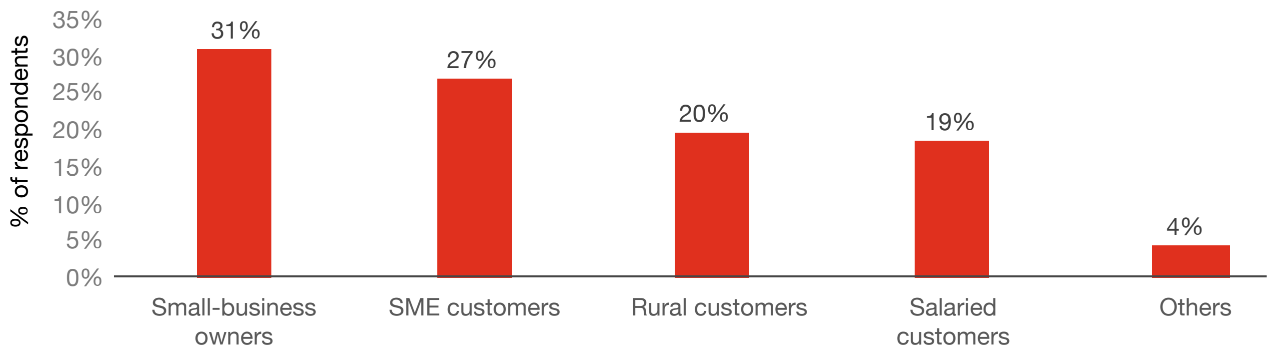

**Source:** PwC-Equifax survey

Within the different target groups, credit managers are expecting maximum demand growth for personal loans and SME/ business loans in the retail lending landscape. Additionally, 29% are optimistic about high growth in agricultural/equipment loans, while 31% are optimistic about growth in the MFI loan segment, primarily owing to the limited impact of the pandemic in rural areas compared to urban centres.

In line with the above findings, around 57% of credit managers have highlighted small business owners and SME customers as key focus segments. Further, 19% are looking to focus on rural customers, while around 18% are focusing on salaried customers.

The sentiment has been echoed in the launch of contextual offerings of both business as well as personal loans by lenders. In the personal loan segment, products like instant zero interest loans of specific amounts and rental deposit loans were introduced, while for small businesses, emergency credit lines have been introduced by multiple lenders. However, while lenders are revisiting their products, it is imperative to complement the same with a sector and geographical focus to achieve maximum returns.

**Focus customer segments for credit managers**

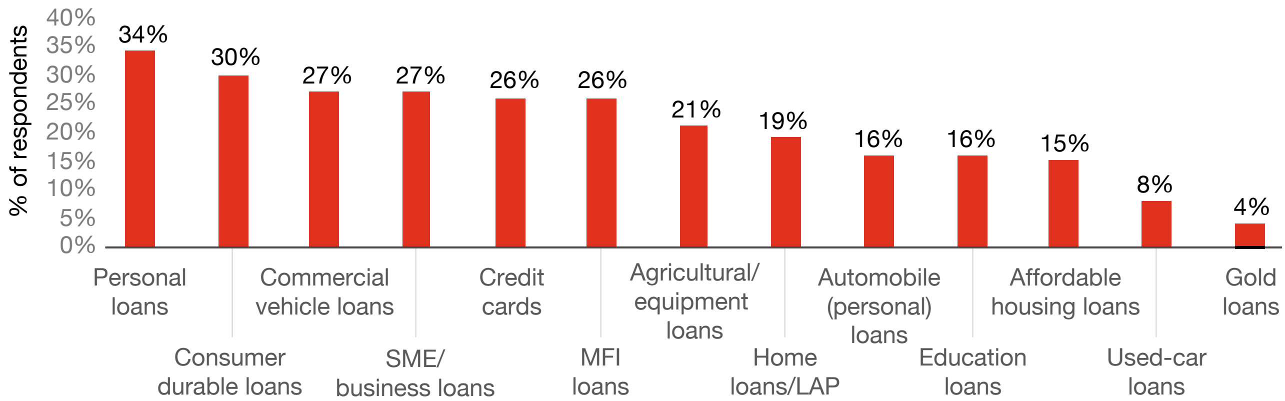



**Source:** PwC-Equifax survey

On the repayment front, from a product perspective, credit managers expect maximum stress build-up for personal loans and consumer durable loan segments owing to the reduced income of consumers (34% and 30% respectively). Other key products where recoveries are expected to be significantly impacted include SME/business loans (27%), commercial vehicle loans (27%) and credit cards (26%).

In such a scenario, lenders are expected to change their lending strategies, especially for the unsecured portfolio, in order to manage asset quality and mitigate emerging risks in the portfolio.

**Expected stress build-up across products**



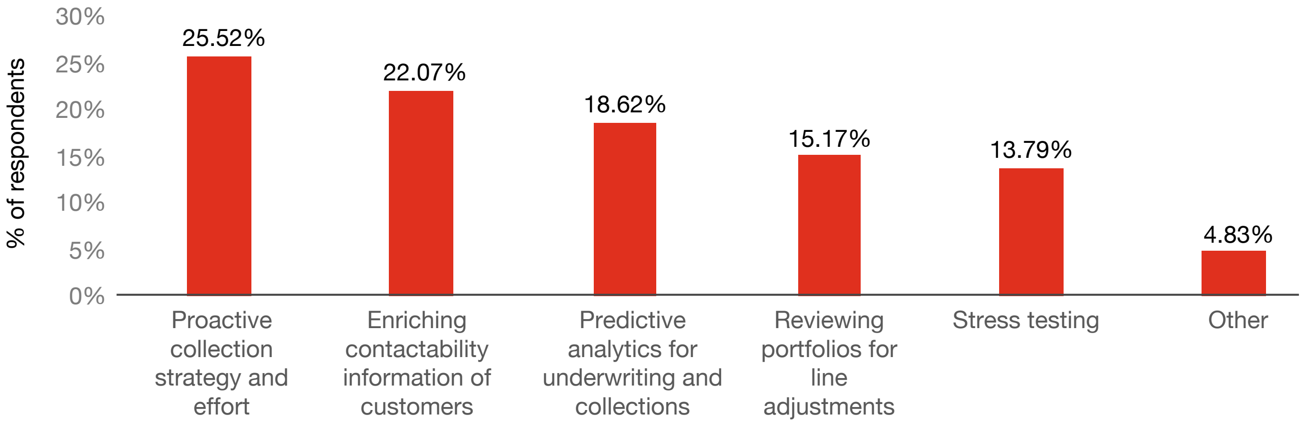

**Source:** PwC survey

73% of credit managers are exploring a change in their lending strategies in the unsecured portfolio

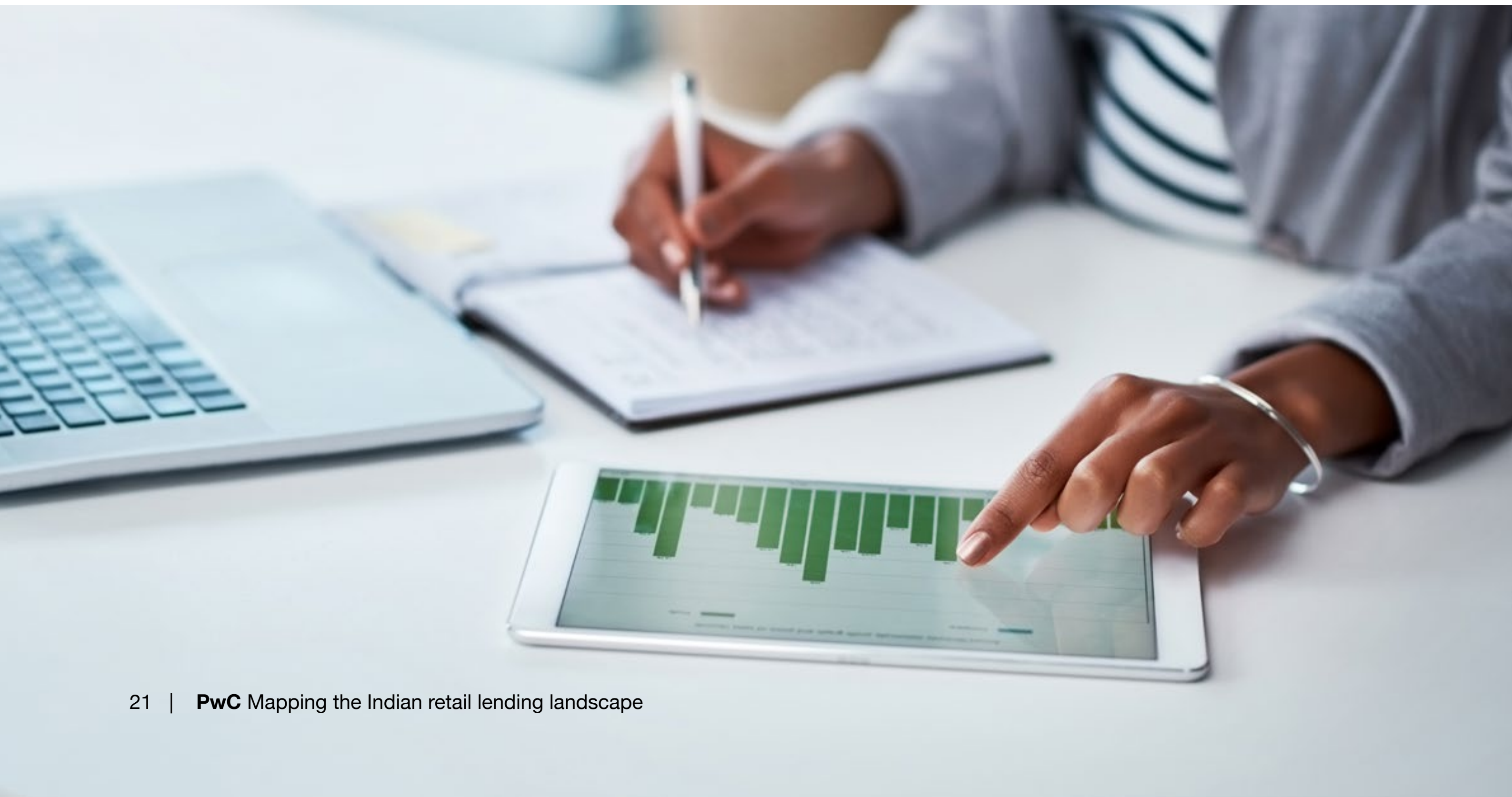
PwC-Equifax survey

The primary focus of lenders is to manage liquidity risk by increasing recoveries in the overall market. Around 25% of lenders believe that the moratorium negatively impacted the repayment behaviour of customers and hence a differentiated strategy needs to be adopted for managing recoveries and collections.

**Measures by credit managers to manage emerging risks in portfolio**

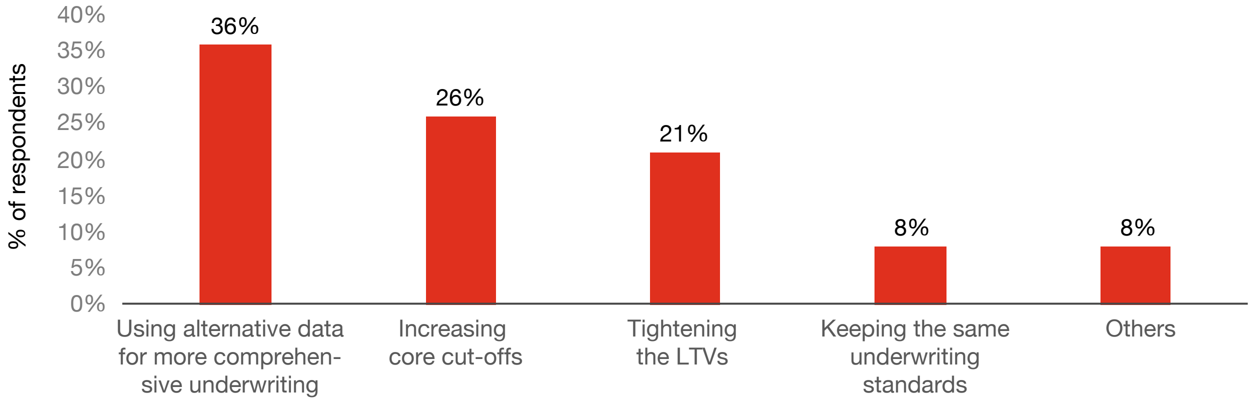



**Source:** PwC-Equifax survey



Further, 22% of lenders are focusing on enriching contact information for customers to maximise penetration within customer groups and speed up collections. Other key measures being adopted by credit managers for risk management include stress testing, portfolio realignment and data-driven collections and underwriting. Negatively impacted recoveries are driving credit managers to modify underwriting standards to balance sales in the short term with stability in the long term. The strategy of lenders of offering high-risk unsecured loans for higher returns is expected to undergo a significant change. Interestingly, 36% of credit managers are exploring the use of alternative data sources for comprehensive underwriting of prospects, and 26% are looking for a direct increase in score cut-offs for loan eligibility, while 21% are tightening LTVs. Tighter lending criteria may further lead to credit demand shrinkage with borrowers taking up loans only for essential services – hence the role of data in balancing risk and returns.

**New underwriting standards to be adopted for customer acquisition**




**Source:** PwC-Equifax survey

# 03 Way forward

## 1 Growth strategies

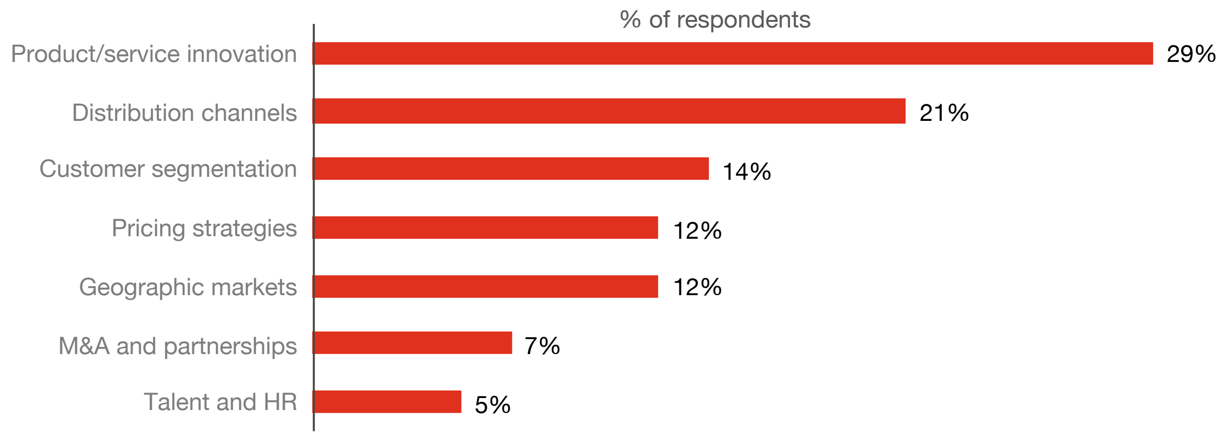
While expectations of recovery in revenue growth may vary for different groups of market participants, it is imperative for all factions to take certain measures to ensure the fulfilment of their expectations. Lenders need to look to identify sectors and geographies with a positive market outlook and build upon their portfolio, while for sectors and geographies with a negative market outlook, selective expansion and focused servicing of existing customers should be prioritised.

As per PwC's survey, respondents favoured multiple strategies for business growth, with product and service innovation being the most preferred one (29%). This was followed by innovation in distribution channels. Rethinking customer segmentation, product pricing and tapping new geographies emerged as moderately popular strategies

The high preference for product and service innovation in the retail lending space may be driven by the following factors:

1. developing mobile services into a lifestyle app rather than just a banking app
2. bundling traditional banking products with other services such as insurance and investment
3. offering value-added services such as financial planning and spend analysis
4. personalising banking offerings through micro-segmentation
5. partnering with third-party providers for disbursing pre-approved credit with reduced issuance TAT
6. partnering with FinTechs to offer value-added services.

**Focus strategies for rebuilding revenue streams during and post the recovery phase**




**Source:** PwC-Equifax survey

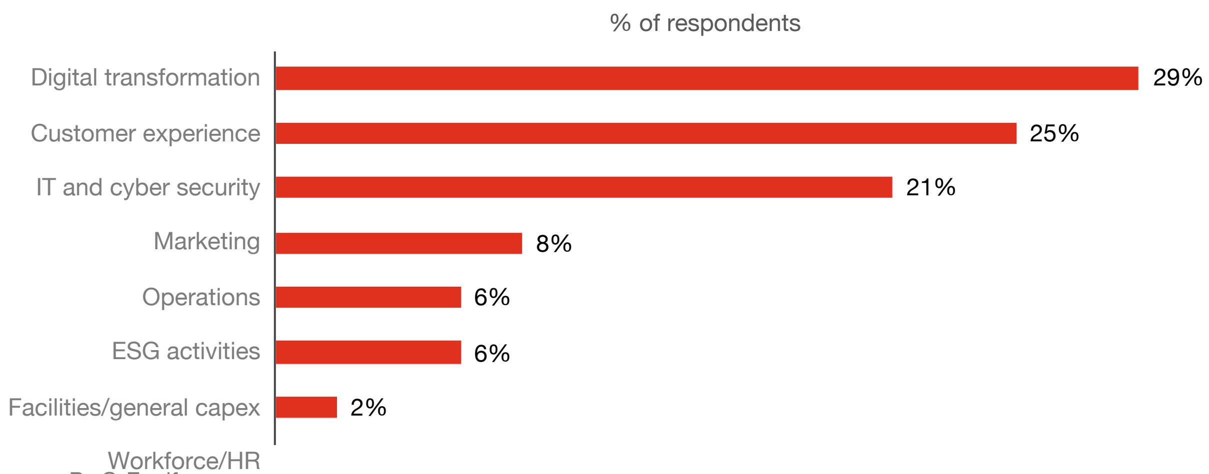
Many financial institutions have been facing liquidity and cash flow problems due to the economic slowdown since March 2020. The pandemic is still far from over and the effects of this disruption will be felt in the coming years. Expectations of economic recovery are slow in the short term. Organisations must therefore streamline their costs and prioritise essential expenditure to survive the acute cash shortages. They also need to realign their investment strategies optimally with their revenue growth objectives. Of multiple options, the areas of choice for investment by most respondents were, in descending order, digital transformation, customer experience and IT/cyber security

Digital transformation has emerged as the key strategic focus as well as the key area for investment and development at most financial institutions. Customer experience is the crux of the discussion on digital, and all digital interventions revolve around improving customer experience. These two strategies thus go hand in hand. As organisations transform their operating models to embrace digital, there will be an ever-increasing dependence on technology and data for all decision making. IT and cyber security thus cannot be neglected and will emerge as a key area for development at all financial institutions. Some key interventions required to develop differentiated customer experience by leveraging digital transformation may include:

1. developing a transformative digital strategy for sustainable growth and profitability
2. designing a collaborative and scalable technology operating model
3. using an agile approach to speed up and optimise implementation and results
4. engaging stakeholders and setting up effective programme management and change management initiatives
5. establishing end-to-end digital capabilities supported by state-of-the-art technology architecture.

Two key action areas for digital transformation are digitisation and data-driven intelligence. Some perspectives around these two areas are provided below.

**Focus areas for investing in the near future**



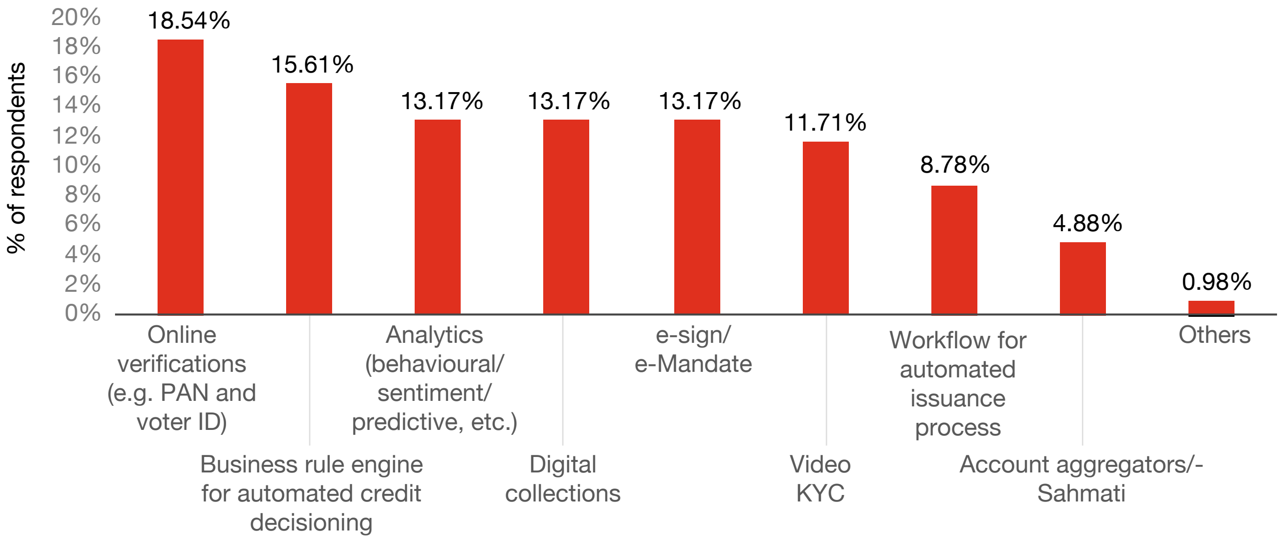

**Source:** PwC-Equifax survey

## 1.1 Accelerated digitisation

As the economy moves towards recovery in the post-pandemic phase, the key priority for retail lending credit managers is to build a sustainable lending ecosystem with accelerated digitisation both for customer acquisition and servicing.

Among the credit managers surveyed by PwC, around 50% are accelerating deployment of digital tools for customer acquisition, while nearly 40% are focusing on collections, customer servicing and fraud prevention.

**Digital tools that credit managers are exploring or have already adopted**




**Source:** PwC-Equifax survey

On the customer sourcing front, the pandemic along with the regulators' push for key drivers like video KYC has provided an impetus to both borrowers and lenders to accelerate the adoption of digital platforms. Lenders are focusing on optimising costs on physical channels to build agile and modular digital lending infrastructure driven by zero-touch selling solutions encompassing lead management, loan origination and end-to-end customer onboarding.

As per PwC's survey, 43% of credit managers are focusing on video KYC, online verification mechanisms and e-sign/e-mandates to streamline the process of origination. On the processing front, workforce efforts are being redirected away from repetitive manual tasks, with 24% of managers exploring workflows automation and business rule engines for automated credit decisioning.

The other key focus area for digitisation is collections and customer servicing, including repayment management, with around 15% of credit managers focusing efforts on digitisation of collections and 17% on servicing. With the growth of mobile and data penetration across all regions, lenders are looking to capitalise on this opportunity to inculcate digital repayment behaviour among customers and leverage innovative mechanisms like voicebot-enabled collections for improved customer experience, traceability and a reduction in operational costs.

## 1.2 Data-driven intelligence

In the current changing scenario of retail lending, data intelligence has become essential for building a resilient lending ecosystem. Credit managers are focusing on data-driven insights across the lending lifecycle, especially on underwriting and collections for improved risk management. Lenders are looking at adopting predictive data models for credit assessment of prospects and enriching the data models with alternative sources of data for a holistic 360-degree view of the customer, thus minimising the risk of default. On the servicing and collection front, lenders are looking to leverage advanced data intelligence for pre-emptive default predictions using customers' repayment behaviour, insights from customers' accounts as well as online and social activities.

However, it is also essential for lenders to realise that assessments based on data that is a year old may not be of relevance to lenders in the current scenario and thus to gain maximum insights, recent snapshots of data need to be captured in an agile manner.

**18%** of credit managers are moving towards predictive analytics for collections and underwriting

PwC-Equifax survey

**36%** of credit managers are looking to adopt alternative data for more comprehensive underwriting

PwC-Equifax survey

## 2 Looking towards the future

A large number of market participants have come to realise that black-swan events like COVID-19 are set to become more common in the future and organisations need to become more robust and resilient in order to minimise the impact of such events. Several possible interventions may help in achieving this goal of increased resilience. Digital transformation and adoption of technological initiatives was the most preferred strategy in this direction. The second-most important strategy selected by respondents was to control NPA growth and falling NIM by making their underwriting more robust. Leveraging alternative data sources for underwriting was another preferred option, followed by building customer trust and brand loyalty.

There is no doubt that COVID-19 has had an unprecedented impact on the retail lending industry – across geographies, sectors, customer segments and product categories. While it is still early to assess the full-scale economic impact of the pandemic, the repercussions of the same are likely to be felt in the coming years. Both sourcing as well as collection of loans has been drastically affected, with credit offtake at record lows and asset quality at highly degraded levels. Lenders are in a particularly challenging situation as they face multiple problems such as shrinking profit margins, bad debts and write-offs, and a liquidity crunch. After a major slump in the first two quarters of FY21, the later quarters are expected to bring in hope for lenders as the economy slowly witnesses signs of revival. As of September 2020, both sourcing and delinquency trends have been highly volatile due to multiple interventions by the Government, the RBI and lenders, and only in the following quarters will they be meaningfully analysable. In the following reports in this series, we will analyse, in greater depth, the impact of the pandemic on the industry in the mid and long term. However, one thing which is certain is that the industry will no longer be the same as before.

Lenders such as banks, NBFCs and other financial institutions should take this event as a turning point for retail lending in India. They must move fast to emerge as lenders of the future. As more and more customers are adopting digital banking and payments, these institutions must embrace digital to be relevant in the changing market. It is extremely important for financial institutions get back to the drawing board and redefine their strategy, and rethink what their organisation stands for. They must innovate across the board, including their service offerings, channels, operating model and customer service. They must also optimise their expenditure and invest in projects that provide the most returns while propelling the organisation towards their strategic goals. Lending organisations now have an opportunity to transform their operating models and emerge as modern, resilient and lean organisations, ready to adapt and overcome the challenges of the future.

# 04 Glossary

| Abbreviation | Full form |
|---|---|
| **AID** | All-Inclusive Directions |
| **CAR** | Capital adequacy ratio |
| **CCB** | Capital conservation buffer |
| **CPI** | Consumer price index |
| **CRR** | Cash reserve ratio |
| **DCR** | Deposits to credit ratio |
| **DPD** | Days past due |
| **DPD120** | Accounts that are between 90 to 120 days past due on repayment |
| **DPD90** | Accounts that are between 60 to 90 days past due on repayment |
| **GDP** | Gross domestic product |
| **GVA** | Gross value added |
| **HFC** | Housing finance company |
| **IBC** | Insolvency and Bankruptcy Code, 2016 |
| **IMF** | International Monetary Fund |
| **LAP** | Loan against property |
| **LCR** | Liquidity coverage ratio |
| **LTV** | Loan to value |
| **MFI** | Microfinance institution |
| **MSF** | Marginal standing facility |

| Abbreviation | Full form |
|---|---|
| **MSF** | Marginal standing facility |
| **MSME** | Micro, small and medium enterprises |
| **NBFC** | Non-banking financial company |
| **NDTL** | Net demand and time liabilities |
| **NIM** | Net interest margin |
| **NPA** | Non-performing asset |
| **NSFR** | Net stable funding ratio |
| **PCR** | Provision coverage ratio |
| **PMI** | Purchasing manager’s index |
| **PRI** | Prompt repayment incentive |
| **QoQ** | Quarter on quarter |
| **RBI** | Reserve Bank of India |
| **RoA** | Return on assets |
| **RTGS** | Real-time gross settlement |
| **RWA** | Risk weighted asset |
| **SFB** | Small finance bank |
| **SLR** | Statutory liquidity ratio |
| **SMA** | Special Mention Account |
| **SME** | Small and medium enterprises |
| **TLTRO** | Targeted long-term repo operations |
| **UCB** | Urban co-operative bank |

# About PwC

At PwC, our purpose is to build trust in society and solve important problems. We're a network of firms in 155 countries with over 284,000 people who are committed to delivering quality in assurance, advisory and tax services. PwC refers to the PwC network and/or one or more of its member firms, each of which is a separate legal entity. Please see www.pwc.com/structure for further details.

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