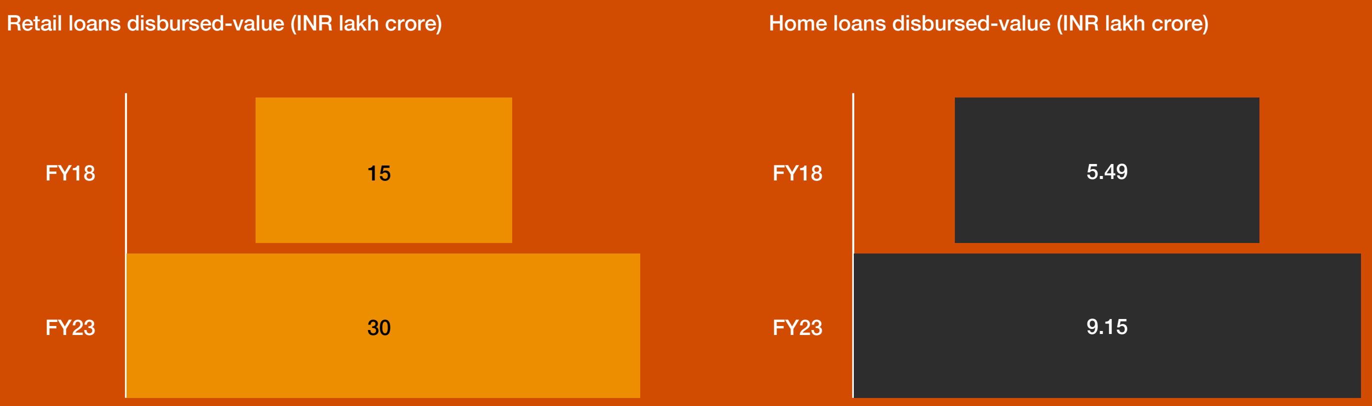
Emergence of co-lending business models in India: Opportunity for FinTechs

Introduction

Over the past five years, from FY18 to FY23, India's retail lending market has demonstrated a robust growth trajectory. The retail loans disbursed increased from INR 15 lakh crore in FY18 to INR 30 lakh crore in FY23 – i.e. a compound annual growth rate (CAGR) of 14.8%. Home loan consistently forms the highest share of retail loan origination, which increased from INR 5.49 lakh crore in FY18 to INR 9.15 lakh crore in FY23 – i.e. a CAGR of 10.7%.[1] During this period, its share in total retail loans increased from 30.5% to 36.5%.

Figure 1: Value of retail and home loans disbursed In India



Source: Aggregate data from RBI reports, PwC analysis

A significant fraction of this resurgence can be attributed to the infrastructure sector, which is a pivotal driver of India's economic expansion. This aligns with the Government's strategic focus on bolstering connectivity and logistics through initiatives such as PM Gati Shakti. This multimodal infrastructure project aims to enhance connectivity across various economic zones in India, propelling the nation towards its ambitious goal of achieving a USD 5 trillion economy by 2025.[2] While the share of personal loans among consumer lending products is comparatively lower than that of home loans, it has the highest share of more than 31% in terms of origination volume.[3]

From FY21 to FY24, the number and value of loans disbursed by FinTechs have grown by a CAGR of 81% (from 1.72 crores to 10.19 crore) and 46% (from INR 0.47 lakh crore to INR 1.46 lakh crore) respectively.[4] This growth has been facilitated by innovative FinTech entities that have harnessed technology to extend their reach, streamline operations through automation and enhance credit accessibility. These players offer a broad spectrum of loan products tailored to cater to the diverse needs of borrowers. As of 2023, digital lending constitutes 10% of the total loans disbursed by non-banking financial companies (NBFCs) and 2% of the total loans by scheduled commercial banks (SCBs).[5] With the advent of product innovations and distribution by FinTechs, digital lending is expected to further increase in the next few years. A significant majority of digital lending, amounting to 96% of the value of disbursed digital loans by FinTechs, has been in the form of personal loans – predominantly below INR 5,000.[6] This widespread acceptance of digital lending solutions can be ascribed to the convenience they offer through seamless application processes, quicker turnaround times, and flexible payment schedules and tenures.

1 Aggregate data from RBI reports
2 https://www.livemint.com/economy/indian-economy-set-to-hit-5-trillion-by-2024-25-double-to-10-trillion-by-2030-says-hardeep-puri-11706007765224.html
3 https://www.crifhighmark.com/media/3115/how-india-lends-fy2023.pdf
4 https://faceofindia.org/
5 https://ibsintelligence.com/ibsi-news/driving-financial-inclusion-key-takeaways-in-digital-lending-in-india-for-2024/
6 https://economictimes.indiatimes.com/industry/banking/finance/banking/personal-loans-account-for-96-of-all-fintech-lendings-mostly-below-rs-5000-report/articleshow/98313868.cms?from=mdr

Digital lending models in India have helped banks and NBFCs in streamlining their pre-existing, significantly offline lending processes through digitised documentation and validation, automating underwriting, customisation for businesses, and personalising customer experience for end-to-end lending journey. Use of technologies like artificial intelligence (AI), machine learning (ML) for credit scoring and fraud detection, blockchain for smart contracting and verification or embedded integration with e-commerce and super apps has helped in improving adoption of digital lending among businesses and individual customers by reducing disbursement time, facilitating ease in documentation and improving visibility of repayment plan.

As the digital lending industry evolved, new business models and partnership structures were formed between FinTechs and lenders – be it a bank or an NBFC. One such popular collaborative model is when a FinTech acts as a sourcing partner for the lender and nudges or collects information about borrowers on its behalf. While majority of the FinTechs' revenue and growth may come from offering financial services under their primary FinTech models like digital payments, bill payments, e-wallets and peer-to-peer lenders, acting as a lead generator and sourcing partner helps them increase their revenue surplus without going through the complexity of underwriting, additional regulatory compliances and risky loan book liabilities on their balance sheet. The growth of this model is also driven by the legitimacy, credibility and legal ambit provided under the first loss default guarantee (FLDG) framework approved by the Reserve Bank of India (RBI) in 2023[7] wherein a fixed default guarantee of up to 5% of the portfolio amount is provided by FinTech/ NBFC (guaranteer). This innovative collaboration helps both established lenders and digitally savvy FinTechs to share risks and capabilities to channelise their growth and expand their markets.

While there are certain differentiators in terms of risk sharing, lending structure and purpose, both the FLDG framework and co-lending models are driven by collaboration between FinTechs, NBFCs and banks to improve lending services experience, underwriting efficiency and shared risk management in order to tap into a larger borrower base.

7 https://www.livemint.com/companies/news/rbi-gives-green-signal-to-first-loss-default-guarantee-fldg-framework-heres-how-will-fintech-banks-nbfcs-benefit-11686244184070.html

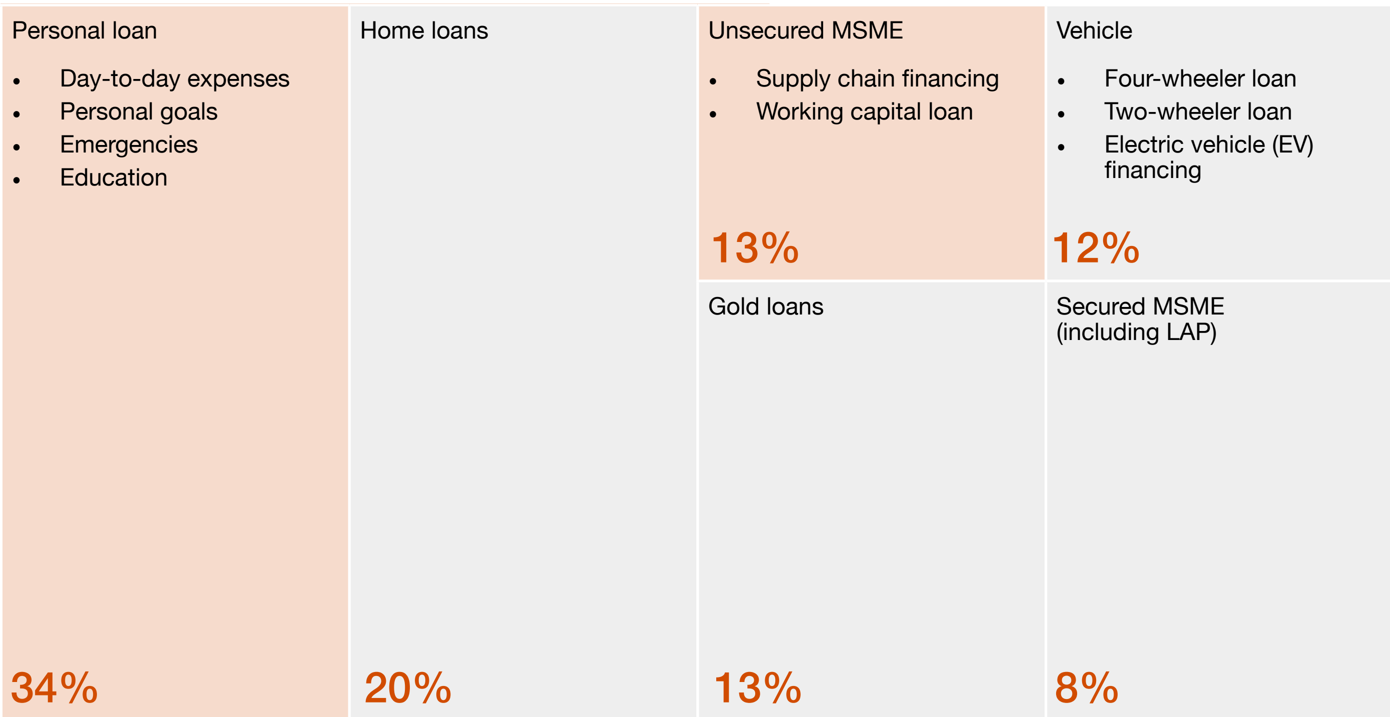
What is co-lending?

Co-lending is an innovative model which involves a collaborative arrangement where multiple entities partner to extend loans to a borrower (i.e. individual, group, micro, small and medium enterprise (MSME) or business). Such partnerships have been noted between a traditional bank and NBFCs, housing finance companies (NBFC-HFCs), microfinance institutions (MFIs) or FinTech firms. This synergy offers the dual advantage of the bank's capital accessibility and the co-lender's customer outreach capabilities, technological advancements and customer experience.

This collaborative framework is designed to augment the availability of loan facilities to the underserved or unserved individuals as well as the micro enterprises sector in the country. Presently, there is low accessibility to formal credit facilities in these sectors – especially due to a lack of awareness, low financial literacy or difficulties at the onboarding touchpoint. Co-lending may help in distributing the credit risks between lenders and target the relatively new-to-credit small businesses and retail customers who require flexible loans instead of informal alternatives and risky lending mechanisms. Under the co-lending arrangement, the industry is estimated to have lent around INR 470–520 billion in FY23 and is projected to grow by five times to reach approximately INR 2,000–2,500 billion in the next five years.[8]

About 34% of the portfolio is dedicated to personal loans covering a wide range – including day-to-day expenses, personal goals, emergencies and education. This significant portion indicates a high demand for flexible, unsecured financing options among consumers. Home loans, making up 20% of the total, reflect significant investments in real estate. Gold loans and unsecured MSME financing each account for 13%, highlighting the importance of short-term secured loans and support for small businesses. Vehicle financing represents 12%, with most loans being secured.

Figure 2: Co-lending portfolio, category wise percentage share



Source: CRIF High Mark, PwC analysis

Note: For the purpose of this report, we have considered small business loans are of value less than INR 1 crore.

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NBFCs typically source their capital from other financial institutions (alternative investment funds [AIFs], foreign investors, etc.) through a variety of instruments (debt financing, term loans, deposits, etc.).

The typical ticket size for loans to businesses is around INR 7 lakhs with a tenure ranging from 30 months to 50 months.[9]

Table 1: Classification of co-lending models operating in India

	Retail	Business
Secured	Vehicle loan	Working capital loan*
	House loan	Equipment financing#
	Loan against property	Loan against property
	Gold loan	Top-up loan
Unsecured	Personal loan	Revenue-based financing
		Working capital loan*
		Equipment financing#
		Supply chain financing

Source: PwC analysis

Note: * India's third-largest private sector bank offers unsecured lending solution (working capital loan) to small and medium enterprises (SMEs) and business.

An Indian NBFC partners with a public sector bank and an equipment leading startup to jointly offer loans against construction equipment to MSMEs/businesses – either on collateral or on purchase order/receipts.

9 PwC analysis of secondary resource

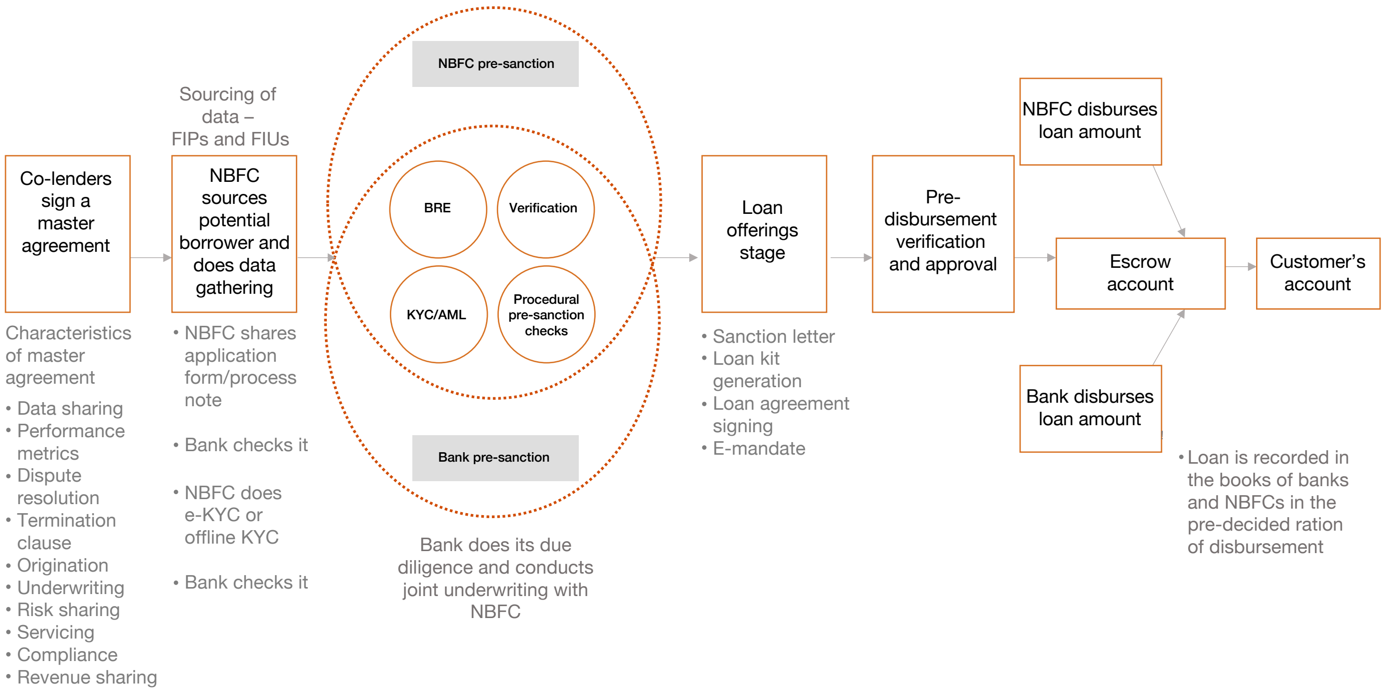
How does it work?

There are two primary business models in the co-lending space, which are explained below.

Co-lending model (CLM) 1:

- Prior to initiating any engagement, co-lenders establish a comprehensive master agreement which maps out various intricacies such as pre-determined loan disbursal ratios and their respective loan exposures.
- A collaborative effort in joint underwriting is undertaken by both parties, by conducting a detailed evaluation of the borrower's credit profile.
- Upon identifying a potential borrower, a tripartite agreement is crafted among the co-lenders and the borrower. This agreement encapsulates all the documentation, responsibilities and expectations, thereby ensuring transparency in the lending process.
- After the agreement, both co-lenders jointly service the loan and share the risks and rewards.

Figure 3: A detailed process flow of CLM 1



Source: PwC analysis

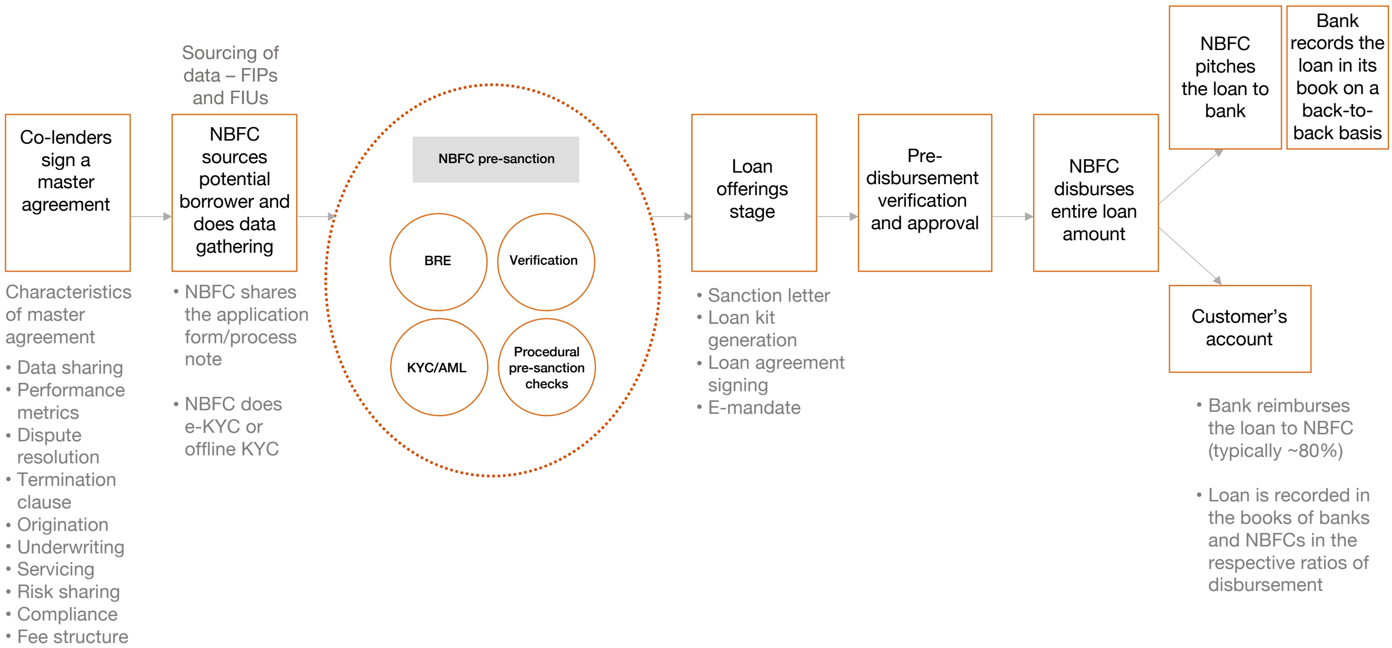
Note: FIU - financial information users; FIP - financial information providers; BRE - business rule engine; KYC - know your customer; AML - anti money laundering

The model necessitates a high degree of coordination between co-lenders, which presents an opportunity for FinTechs to capitalise on their technological expertise by facilitating seamless integration between the co-lenders and enabling joint underwriting algorithms. This model is particularly suitable for large ticket size loans, where the earnings have the potential to offset the operational and integration costs. Furthermore, this model is typically more feasible for loans that can accommodate certain lead times, as opposed to instant loans, such as pre-approved personal loans.

CLM 2:

- In this model, the NBFC takes the initiative to identify potential loan recipients.
- Based on the co-lending risk appetite, the NBFC finances the loans to the end customer.
- Following the disbursal, the NBFC presents the loan to the bank.
- The bank, in turn, reimburses the agreed-upon fraction of the loan amount (typically 80%) to the NBFC and incorporates its share into its balance sheet.[10]
- The NBFC then oversees the end consumer experience and manages the collection of loan repayments. Risks and rewards are jointly shared by both parties, as agreed upon in their arrangement.

Figure 4: A detailed process flow of CLM 2



Source: PwC analysis

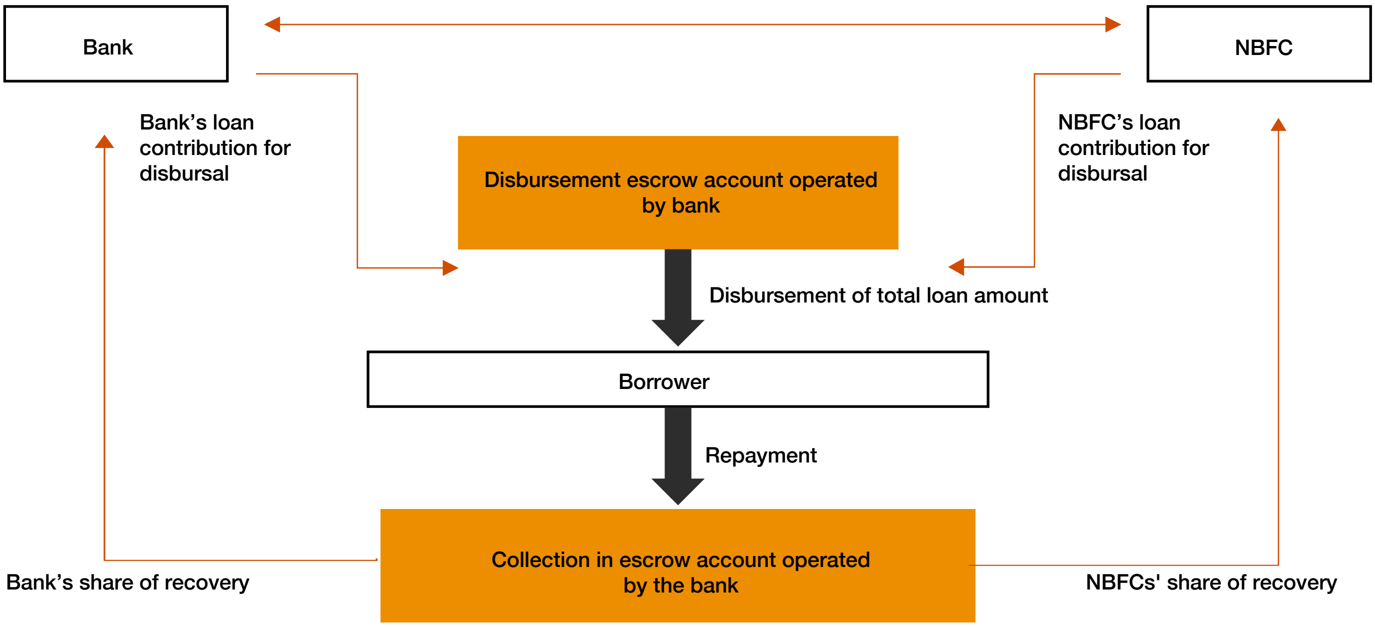
This model is a comparatively simpler than CLM 1, as the roles and responsibilities are clearly bifurcated amongst the co-lenders. Moreover, the model offers added flexibility of being able to disburse instant loans digitally due to shorter processing times.

10 https://www.financialexpress.com/business/banking-finance/co-lending-on-personal-loans-set-to-decline/3465213/

Indicative flow of cash under the co-lending setup:

- An escrow account is set up in partnership with a bank to pool respective loan contributions of the bank and the NBFC.
- Escrow account is also utilised to collect loan repayments from borrowers. The collected funds are not used for float.
- The co-lenders set up an agreement for sharing account information so as to generate a single unified statement for the borrowers.

Figure 5: Indicative flow of funds



Source: PwC analysis of policy release of public sector banks (PSBs) – Sample 1, Sample 2

Before opting for any such loans, businesses and retail enterprises are required to submit certain documents for processing co-lending credit. These are listed below.

For business

- PAN
- Aadhaar
- Registration proof
- Bank statements
- Company PAN
- Partnership deed

For retail

- PAN
- Aadhaar
- Bank statements

Advantages of co-lending

Co-lending models have an opportunity for wider adoption by lending institutions in our country. From lower cost of capital to increased reach amongst prospective borrowers, each stakeholder (banks, NBFCs, FinTechs and end-customers/ borrowers) can benefit from this arrangement as follows:

Banks:

- Increase banks' penetration in the remote regions of the country, targeting the underserved population that lacks access to capital.
- Help meet regulatory requirements like loan portfolio contribution to priority sector lending (PSL), as mandated by the RBI.
- Technologies like robotic process automation (RPA) can improve process efficiency. Such benefits can be brought about by strategic partnerships.
- Share credit risk and exposure to potential non-performing assets.
- Under CLM 2, banks get the flexibility to choose the proposal which aligns with their lending strategy.
- Provide lower cost of disbursement, especially for loans with small ticket size (as compared to some of the existing direct modes).
- Diversify and increase book size.[11]
- Foray into low penetrated, promising and growing markets such as EV financing, unsecured SME loans, and loans for agricultural and allied activities.
- Form housing finance partnerships to increase mortgage loan book of banks.

NBFCs:

- Partnering with banks typically gives them access to cheaper sources of capital.
- NBFCs can benefit from mature and tried and tested credit underwriting practices of banks.
- It helps them appeal to a wider customer base by offering competitive interest rates.
- Running successful proof of concept of managing end-to-end co-lending process with measurable success metrics has helped NBFCs improve their leverage with co-lending partners, increase number of partnerships and therefore grow their off-book loans share.
- Shared credit risk can help banks in better utilisation of funds for growth and expansion objectives.
- Reduced risk and continued risk adjusted returns can help NBFCs to improve their creditworthiness, thereby making it easier for them to raise funds.

Customers:

- Improve access to financing for consumers who belong to the informal sector and/or have limited or no access to formal credit.
- Enhance and personalise consumer experience due to technological innovations by NBFCs/FinTechs.
- End borrowers benefit from expedited loan approval and disbursal processes.
- Access to formal credit can help customers to create improve credit score, thus making it easier to access favourable loan terms in the future.

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Challenges

As co-lending evolves, the industry would need to navigate through some challenges too, such as relatively low maturity of implementation and the added complexity which arises from the involvement of an additional player in the lending processes. Some of the key challenges from the perspective of the solution model, market dynamics and end customers are explained in Figure 6.

Figure 6: Challenges within the co-lending ecosystem

Model

- Potential control issues when enforcing co-lender master agreement may impact co-lending partner negatively
- Improper implementation may result into higher costs for banks and NBFCs
- Requires high level expertise because of complexity
- Added complexity in documentation and underwriting
- Unavailability of reliable data for unsecured lending

Market dynamics

- High competitions as most NBFCs and banks are adopting
- Relatively new regulations which may evolve significantly in future
- Government and regulatory concern on growing concentration of personal loans

Customer

- Lack of familiarity among customers
- Preference for informal sources due to familiarity and proximity
- Negative views of collection practices adopted
- Lack of co-ordination, which may result in a bad experience for customers

Source: PwC analysis

Table 2: Challenges from the demand and supply sides

Demand side	Supply side
• There is a lack of availability of reliable data to build a comprehensive credit profile of a prospective borrower, which includes the low-income MSME sector. As a result, MSMEs have very limited access to funding. While FinTechs have leveraged technology to resolve this challenge, the currently available solutions are not able to meet existing demands. • There may be a lack of trust with NBFC originators due to low transparency regarding loan terms and limited visibility on repayment schedules and consequences of default. • There may be a preference among tier 3+ urban and rural customers to avail capital via informal means from regional providers due to reliable past engagements. There may also be scepticism regarding the aggressive collection practices of NBFCs which may negatively impact co-lending arrangements.	• Banks, in some cases, may fall short of their PSL targets and source their loans from NBFCs. This gives NBFCs an upper hand in co-lending negotiations in terms of share of profits and other charges levied such as processing fees and repayment delay penalty. • There may be a lack of coordination between banks and NBFCs due to differences in lending strategies, policies targeting consumer segments and technology adoption. Moreover, there may be potential control struggles to enforce one co-lender's policies onto another. • With the evolution and wider adoption of co-lending, regulations regarding the same may undergo amendments to protect the interests of all stakeholders – primarily, the end borrower. As a result, banks, NBFCs and FinTechs would have to become more flexible and agile in order to adapt to this dynamic landscape.

What are some of the areas in the co-lending value chain where FinTechs can bring about innovations?

The evolving co-lending space provides an opportunity for FinTech firms to collaborate with banks and NBFCs. It can bring about a host of technological innovations to facilitate co-lending. Some of these are highlighted below.

1. Software-as-a-service (SaaS) marketplace/ platform to facilitate discovery, foster partnerships and integrations between co-lenders

Banks can leverage established lending marketplaces where loan originators and potential lenders can partner with banks to construct and manage a lending portfolio in compliance with the regulations set forth by the RBI, particularly those pertaining to PSL. These platforms can enable application programming interface (API) integrations (for instance, disbursements, collections, etc.) for both co-lenders, thereby facilitating the exchange and consumption of information between them. This could serve as a plug-and-play solution for various parties, customised according to the terms and conditions of their partnership. The platform oversees end-to-end operations, from loan origination to tracking collections. A one-time integration process with the platform could further expedite the turnaround time (TAT) for future technological integrations with other co-lenders.

Case study: A FinTech company which offers microloans to middle- and lower-income users with customised terms, amount and payment options was searching for a co-lending partner for access to capital and offered seamless disbursement of funds. It partnered with a leading player with a SaaS marketplace model which facilitated co-lending. Post onboarding, within a week, the company was able to collaborate with multiple lenders, facilitated by a one-time integration process which helped them to provide their offerings to a few million additional customers.

2. AI/ML models to help assess borrower's creditworthiness to facilitate digital underwriting

FinTech firms can capitalise on their technological expertise to digitise the underwriting process. They can access and analyse a variety of pertinent digital records linked to bank accounts for effectively screening potential borrowers, thereby reducing the lead time for loan approval. These digital records serve as inputs for building an alternate digital lending evaluation model. Beyond income and credit scores, FinTechs can evaluate other relevant data related to spending patterns, historical account balances and cash flows to construct a more comprehensive risk profile of the borrower. In this model, the account aggregator framework can be leveraged to provide access to holistic financial data.

In the CLM 1 form of partnership, FinTechs can play a significant role as banks and NBFCs will potentially employ their unique set of criteria to screen candidates for potential loan disbursal. The aggregation of criteria from both lenders, coupled with the utilisation of advanced technologies like AI/ML, can be used to analyse multiple datapoints across different resources and build a comprehensive assessment profile and scorecard to analyse creditworthiness. This enables lenders to compare within a pool of borrowers, allowing for more informed decision-making. Gaining deeper insights about borrowers help lenders identify opportunities to tailor products to address their needs and upsell and cross-sell in the future.

Case study: A global application development firm uses AI for loan underwriting while leveraging behavioural analytics about the borrower. The firm has developed a proprietary methodology that analyses revenue and expenditure patterns and provides valuable insights which helps in the underwriting process and enhances the overall consumer experience.

3. Setting up escrow accounts to facilitate simple digital banking experience and automate payment reconciliation processes

FinTechs can partner with the lender to provide technological assistance to set up an escrow account and integrate it with the core banking solution. Compared to traditional escrow accounts provided by banks, FinTech escrow accounts may offer enhanced user experience and ease of use. Furthermore, they can help automate banking processes to overcome manual errors and delays that occur during reconciliation of funding for disbursements and repayments.

Case study: An Indian payment startup specialising in payments and API banking launched an automated escrow management solution to facilitate instant disbursal with auto reconciliation and a dashboard for managing multiple partnerships. It helped the startup in addressing delays and challenges in accounting and reconciliation for each lender, thus improving efficiency and accuracy.

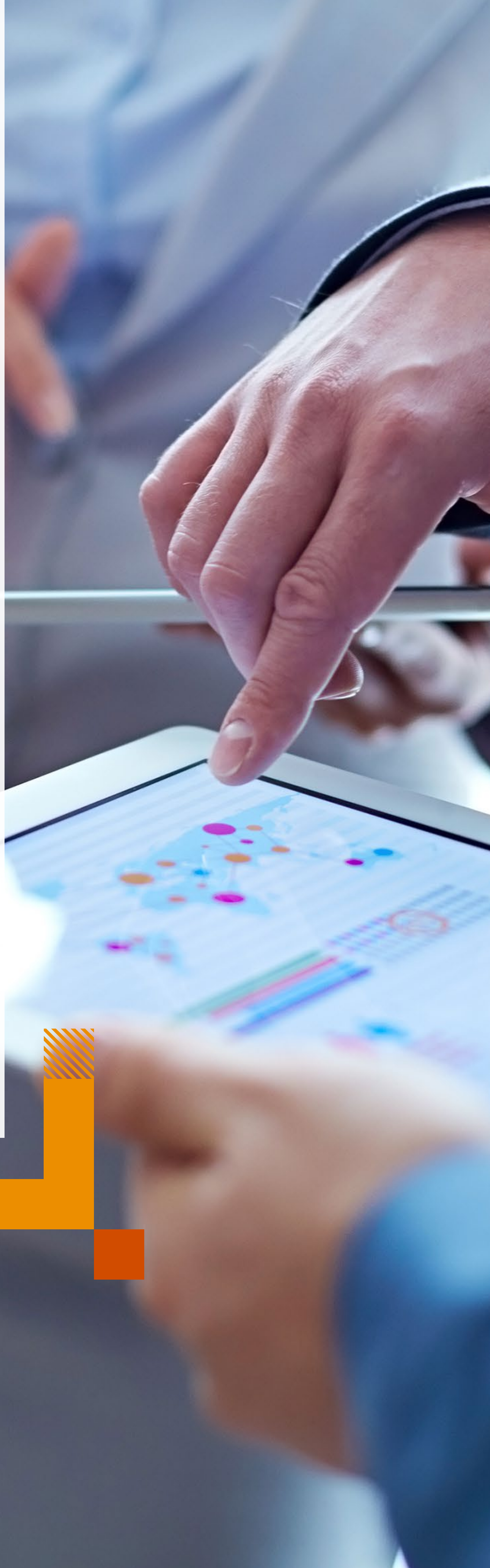
Another example is of a FinTech company which offers microloans to middle- and lower-income users with customised terms, amount and payment options. The company encountered a regulatory hurdle which blocked use of any virtual accounts for money transfer which necessitated the use of an escrow account with the lender for money transfers. To fix this, it partnered with a leading payment solutions provider to set up the digital escrow accounts to comply with the change in regulations. This enabled the lenders to disburse and collect funds from borrowers and helped in easing the reconciliation process, while keeping track of the transactions through personalised dashboards.

4. Modern API solutions for facilitating co-lending processes

APIs play a crucial role in facilitating loans via the digital route by providing lenders with the flexibility and scalability of their platforms in line with the changes in the business environment. This may help lenders to expand into new services, incorporate new technological innovations for increased efficiency and incorporate future partnerships. As a result, we see a majority of financial institutions adopting an API-first approach to banking for making their platforms future-proof, while fostering innovations in product and customer experience.

Some illustrative API solutions which can be developed to facilitate co-lending are:

- loan origination APIs to facilitate search for customers, create new and amend existing loan applications
- credit score check APIs to pull relevant customer data from credit bureau or other sources and feed into decisioning and underwriting algorithms to evaluate his/her creditworthiness
- loan collection APIs which can help co-lenders avail information about borrowers to track and facilitate loan EMI collection.



What is the way forward for co-lending business model to evolve?

1. FinTechs may acquire an NBFC licence/ company and participate as a co-lender

One of the major advantages of FinTechs is simple and personalised customer experience and visibility over the digital customer journey. With evolution and growth of co-lending practices, FinTechs may partner with banks to contribute to the origination and underwriting processes for providing affordable loans.

Under co-lending guidelines, NBFCs may act as a single point of contact for the borrower and thus be responsible for addressing all their grievances.[12] This will provide an impetus for NBFCs to have a greater role in improving the consumer experience. Although FinTechs may have limited exposure as a technology solutions provider, they can act as an important stakeholder to upgrade the co-lending experience for customers by leveraging innovative solutions and emerging technologies.

2. Co-lending model beyond PSL

To further financial inclusion objectives, the government's push and the potential for growth would nudge lending institutions to address myriads of borrowers, including those beyond the priority sector and dealing in B2C lending like personal loans. Co-lending would provide an opportunity to increase penetration into these untapped markets and enable adequate availability of capital.

3. Growth of NBFC-NBFC co-lending partnerships

Growth-stage new-age FinTech startups which acquired NBFC licences may find it difficult to partner with larger institutions (banks or NBFCs) initially due to their small loan book value. This may lead to significant initial costs associated with establishing a co-lending solution, thereby making it a non-profitable business. There is also a significant gap between large and small NBFC lenders, which can hinder an NBFC's growth objectives.[13] We may see such NBFCs partner with established NBFCs to facilitate loan servicing. Such a partnership may help them increase the distribution landscape, facilitate capital-light growth opportunities as well as reduce operational expenses. One such prospective area of NBFC-NBFC co-lending partnerships and collaboration is gold collateral secured lending for retail customers.

4. Blockchain-enabled data transparency

One of the major challenges in building a co-lending solution is the lack of a foolproof model for credit assessment due to the lack of comprehensive data, differences in policies and expectations between co-lenders. Blockchain can help in building processes for providing seamless exchange of data and building trust through added layers of security. It can facilitate coordination and transparency between the lenders through joint risk assessment. Smart contracts can be executed upon meeting certain pre-programmed objectives and agreements, which may further simplify disputes and resolution processes. With an increase in co-lending partnerships, we may also see an increase in blockchain adoption.

One such example is of a FinTech startup which leverages blockchain technology to prototype solutions under regulatory sandbox for MSME lending, in partnership with a private sector bank.

5. Unified Lending Interface (ULI) to improve efficiency and enhance cross collaboration

ULIs can help co-lending partners by exponentially improving their efficiency as the number of data extraction calls can be reduced due to direct access to relevant data on a centralised database. Improved clarity and traceability of information flow can potentially help build trust between lending partnerships. Having access to relevant and quantifiable data can help the co-lenders to assess comprehensive creditworthiness, thus helping them reduce the TAT for decision making and credit underwriting processes.

With this background, Indian LendingTech players plan to leverage ML and ULI database/APIs to quickly assess the creditworthiness using financial transaction history and alternative datapoints for streamlining their underwriting and lending distribution processes.

Moreover, banks are increasingly exploring and foraying into partnership-based models to solve challenges faced by both individuals and businesses, and they are expected to co-opt for co-lending as a viable solution to reach untapped masses. Coupled with NBFCs' and FinTechs' digital expertise and customer focused digital solutions, co-lending can emerge as a win-win strategy from both supply- and demand-side perspectives.

12 https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=11991&Mode=0

13 https://bfsi.economictimes.indiatimes.com/news/nbfc/co-lending-pacts-between-nbfcs-is-the-new-game-in-town/98776150

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Contact us

Vivek Belgavi

Partner and Leader – FinTech,
Alliances and Ecosystems
PwC India
vivek.belgavi@pwc.com

Mihir Gandhi

Partner and Leader – Payments
Transformation
PwC India
mihir.gandhi@pwc.com

Raghav Aggarwal

Associate Director – FinTech and
Innovation Strategy
PwC India
raghav.aggarwal@pwc.com

Authors

Rudra Pratap Singh

Sanjit Sarkar

Editor

Rashi Gupta

Design

Shipra Gupta

pwc.in

SG/November 2024-M&C 41897