Fintech : Emerging Dons of Financial Services

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Executive Summary

Traditionally, formal credit, money and technology has been accessible only for the well-off groups in the society leaving the lower strata groups with no option but to take up the informal structure to finance their livelihood. However, in the era of digitisation and penetration of technology new age Fintech ventures are revolutionising the financial ecosystem in the world. More lately, Fintechs are bringing new technologies to market even faster and with a greater impact. Hundreds of Fintechs are focusing their technology to bring in greater transparency and efficiency in the financial world.

In the coming years, many financial technology firms will achieve even higher levels of efficiency, service provision, and growth, through innovation and adoption of new technologies, some of which may prove revolutionary.

In the first quarter of 2020, we have begun to see global investments come down, with distinct trends in different regions due to the spread of COVID-19. Broad adoption of social distancing measures, along with shutdowns of businesses deemed non-essential, impacts a wide array of companies, including manufacturing, construction, logistics, and supply chain. The fintech startups also need to cut costs and tighten their finances as VCs and investors liquidate their assets. However, Fintech proved to be transformative in this situation as the underlying trends towards servicing newer market segments through online services are accelerated by these changes. The trend towards cashless economies are furthered, as businesses stop accepting cash and hence paving way for FinTechs to boost investments.

Introduction : FinTech

Financial technology (Fintech) is used to describe new tech that seeks to improve and automate the delivery and use of financial services. Fintech is one of the fastest-growing tech sectors, with companies innovating in almost every area of finance, from payments and loans to credit scoring and stock trading. The emergence of Financial technology is changing the financial industry and threatening the existence of financial institutions. Since 2010, investments in fintech have grown more than nine-fold, with USD 43 billion invested in 2019 alone and are collectively valued at close to USD 500 billion, per last known disclosed or reported valuations.

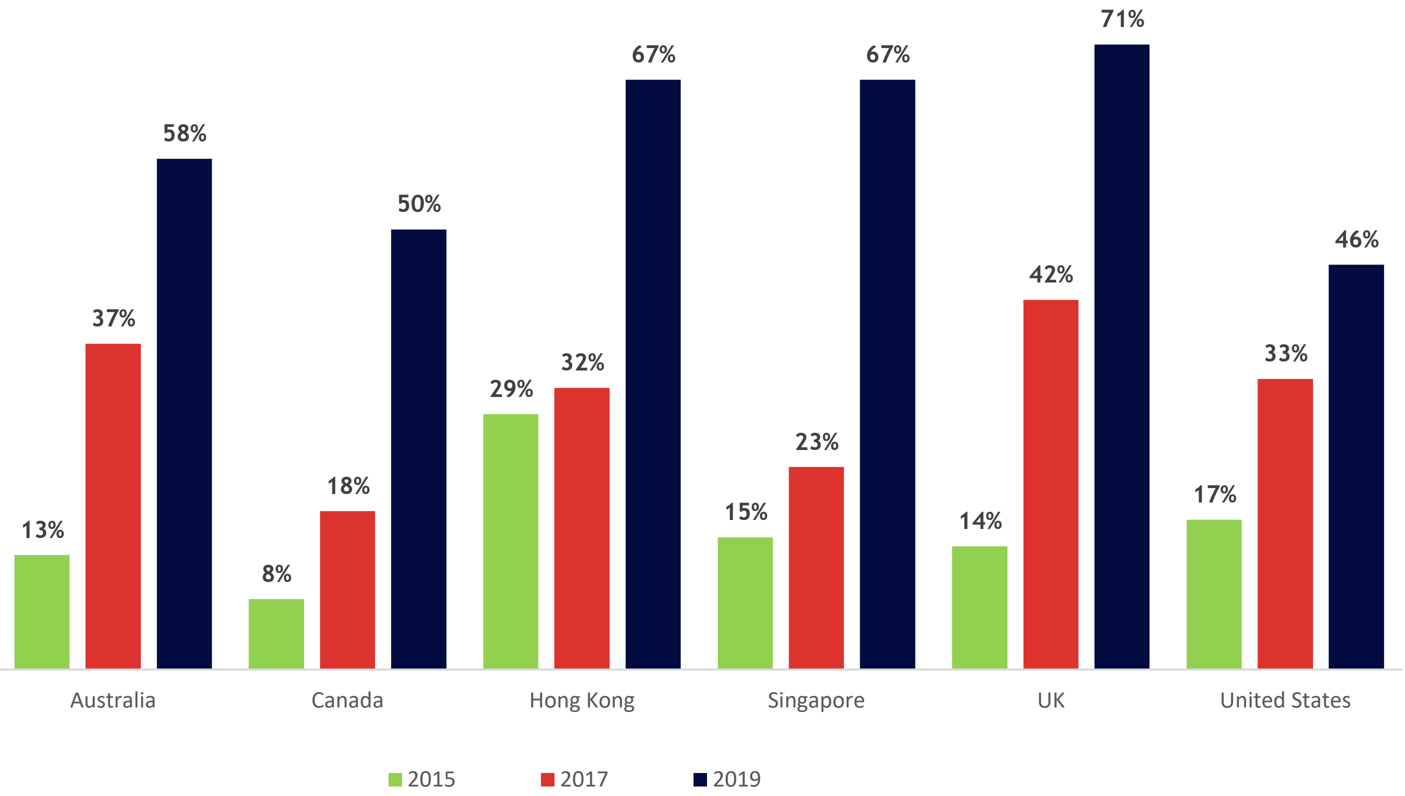
Few largest FinTech companies in the world are -

The most commonly used category being payments and money transfer with 75% consumers using at least one service. Peer to peer payments, non- bank transfers and in-store payments being the top services in the category. Apart from payments, Insurance came out to be a sector with almost half customer penetration and hence, non-financial service organizations such as vehicle sellers have added insurance as a component of their sale services. However, there is still wide headspace for penetration on verticals such as budgeting, financial planning, savings and investment services. Demographic disparities in rural areas are also an issue which needs to be tackled.

Global FinTech Landscape

The FinTech industry has grown up and grown out. No longer it is made up of only startups, there are many new-age companies in this industry that are operating globally, providing a wide array of services from payments-to-lending-to-insurance. According to research conducted by E&Y, the global adoption of fintech has increased from 16% in 2015 to 33% in 2017 to a whopping 64% in 2019. Worldwide 96% of consumers know at least one alternative fintech service for payments or to borrow money.
It is clearly evident that FinTech has caught on around the world, entering all the major economies of the world. Emerging markets are winning the race with, both China and India, the adoption rate is 87%. A step behind are Russia and South Africa both with an 82% adoption rate.

The graph indicates the adoption fintech adoption rate from 2015 to 2019 in the markets of Australia, Singapore, UK, Canada, Hong Kong, and US. Clearly, the adoption rate has increased from an average of 16% in 2015 to 60% in 2019. The adoption rate has been highest in UK from a mere 14% in 2015 to 71% in 2019.



Credits: E&Y global fintech adoption index 2019

M&A Exits in Fintech space (Q1 2020)

ACQUIRER	TARGET	DEAL SIZE
Morgan Stanley	E*TRADE	USD 13B
intuit	credit karma	USD 7.1B
VISA	PLAID	USD 5.3B
ally	CardWorks	USD 2.65B
SoFi	GALILEO	USD 1.2B
LendingClub	RADIUS BANK	USD 185m

Credits: CBINSIGHTS

Interlocking trends that will drive Fintech growth

FinTechs are providing holistic solution for customer

New age Financial firms are one of the most direct manifestations of this phenomenon by placing themselves closest to a customer's money and paycheck, providing insights on financial health and connecting to the best in class financial products

Accelerating Globalization in Fintech

Every leading innovators are scaling their business globally. One of the largest digital bank is Nubank, based in Brazil. The rise of global fintech deal activity has accelerated. Ideas originated in some location has been improved elsewhere. The number of fintech players are scaling across borders

FinTech is driving incumbents to react

96% of people are aware of fintech services. FinTech has become mainstream in the recent years. It is driving a behavior change among incumbents. Thus, incumbents are up for partnerships with these new age financial service firms.

Booming online consumer spending

With the increase e-commerce and online retail experience, people have shifted to online payment mode. The global online payments is expected to reach USD 2.9 Trillion by 2022. However, this growth could be further fueled by the novel coronavirus.

Credits: McKinsey & Company, Forbes

Winning Case: Fintech adoption by SMEs

FinTechs provide a wide range of services to SMEs. SMEs operate with FinTech solution providers to help them with their financial operations, including financing working capital, managing cash flow, and hedging against foreign currency fluctuations.

Emerging markets like China have a 61% adoption rate of fintech services. Globally, the average adoption rate stands at 25% by the SMEs. Mostly SMEs adopt fintech services to streamline operations and create credible solutions for specific challenges in their value chain.

Banks have always struggled to provide specific solutions to these SMEs and thus paving the way for new FinTechs solutions.

> Globally the average Fintech adoption rate is 25% by SMEs

One of the survey states that SMEs unlike individuals are more concerned with the features and functionality. The top three reasons stated why they would select FinTech solution over a traditional service line was, globally 66% said the extent of functionality and features, 55% said round the clock service availability, and 54% said ease in setting up, customizable, and using the service.

The emphasis on value proposition by SMEs has fueled the surge in adoption of FinTech who is providing services in niche areas, (generally referred to as monoline FinTech). These firms provide customized solutions to SMEs and target directly at their pain points- including financing, lending, billing, compliance, and accounting. This saves a lot of time for business owners and thus they are able to focus on their core competencies and run their business innovatively.

SMEs often consult their network partners before availing of a new service. The reliance on network partners by the SMEs can be used as potential marketing points for FinTech players to reach a wide base of new clients- opening new ways to provide innovative products and solutions in this underserved market.

Credits: E&Y- Banking

Indian FinTech Growth Story

India, being a country with the second-largest population, internet users have been quick to adapt to this world of financial technology. According to recent reports, India and China were the global leaders in consumer fintech adoption with an 87 percent adoption rate, compared to the global average of 64 percent in 2019.

The booming private equity and venture capital landscape in the country is laying a strong bedrock for investments in the fintech sector. In fact, Indian fintech start-ups offer the highest return on investments of around 29 percent compared to the global average of 20 percent. In 2018 alone, the sector recorded investments aggregating to around USD 350 Mn. In addition, one of the biggest investments was the USD 1.4 Bn funding for the Indian company Paytm by the Japanese conglomerate SoftBank in 2019. Other companies that received funding include insurance marketplace PolicyBazaar, SME lending platform Capital Float and payments firms Mswipe Technologies and Razorpay.

Going beyond the boom, fintech firms in India really do seem to have the potential to reshape the financial services landscape in the country. By leveraging big data, machine learning and the willingness to innovate for low-cost, large-value products, the Indian fintech players seem to be moving in the right direction.

As per Deloitte & CII's Vision 2020 report, India is heading towards a digital economy with over a billion mobile phones, 330 million internet users, and 240 million smartphones. According to Datalabs by Inc42's recently released report "Fintech Outlook 2019", there are currently 2707 fintech startups in India and USD 5.29 Bn have been invested between 2014-2018 in this sector.

Credits: Deloitte, Datalabs INC42, Statista

Key Drivers for Indian FinTech

In India, with sustained funding, both supply and demand side factors were favourable for FinTech players. In the supply side Government and regulatory support, and technological evolution and the demand side factors such as rising customer digital expectations have created a strong ground for FinTech players to advance. Some of these factors has been discussed below-

Inadequate Financial Structure

A larger part of India's population has been excluded from the access of financial products by the formal financial structure, on account of lack of financial literacy, countless paperwork, and inability of traditional players to serve this excluded market in a cost effective manner. The traditionally unbanked and underserved population that has been averse to accessing financial products is now embracing them, thus paving the path for FinTechs to serve them in an innovative and cost effective manner.

Change in Consumer Demographics, embracing digital platforms

Modern FinTech solutions are built to cater the young Indian population with innovative and faster solutions. These new profile consumers are tech-savvy and spend a considerable amount of time in the Internet (around 130 minutes per day for premium segment users) on their smartphones and are open to accessing financial products on digital platforms. These firms have to match with the rising consumer appetite for digital financial solutions with greater user experience. All these have led to financial firms offering digital solutions, pressurizing traditional business models to rethink and shake hands with new innovative FinTech startups.

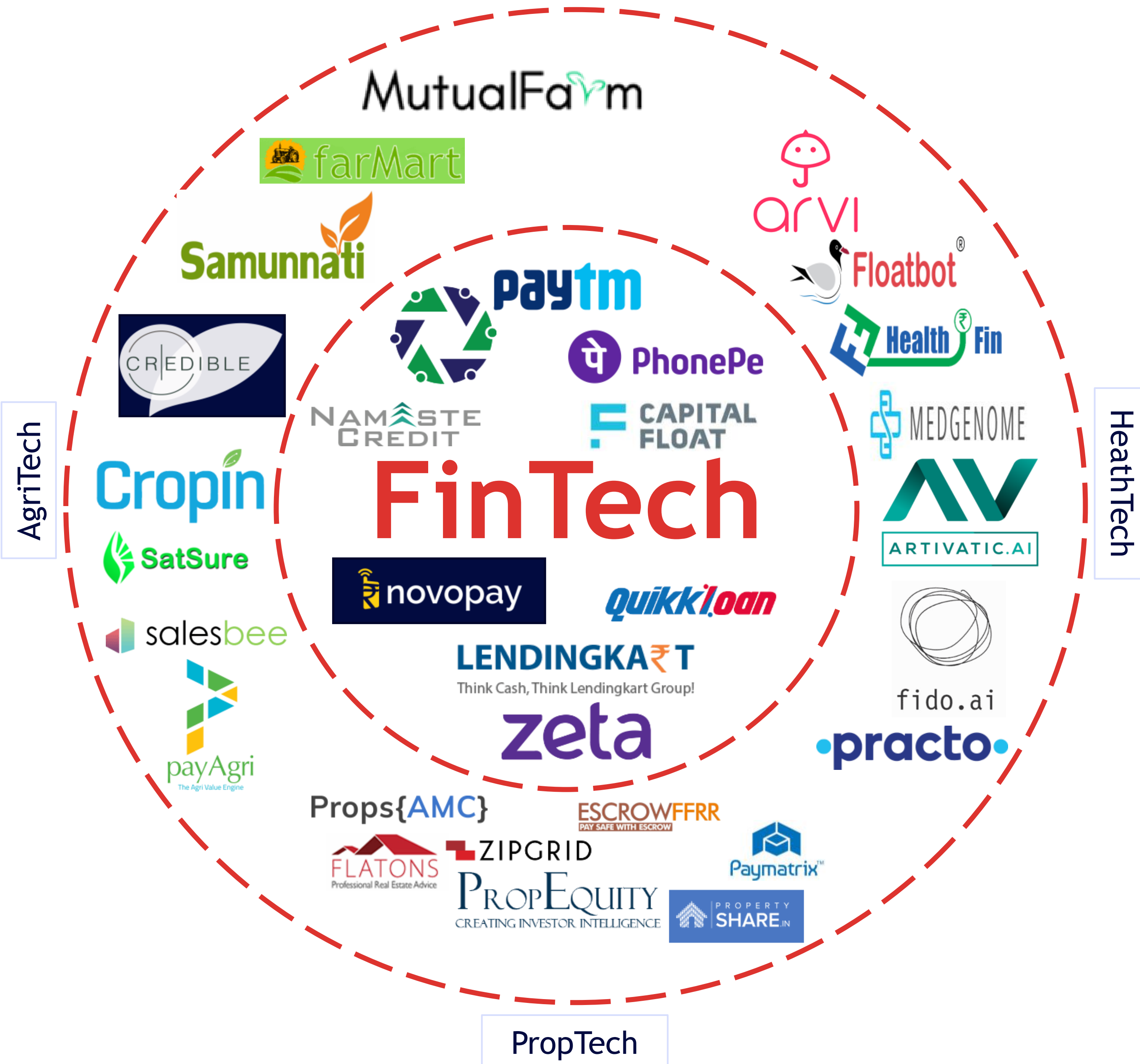
Blockchain increasing security

Security becomes a key concern in financial transactions, as they are subject to threats and critical data leaks. An E&Y report states that blockchain technology will enable greater transparency, immutability, traceability, and auditability. Blockchain will be able to provide high level of security when it comes to exchange of money and sensitive information. Writing off security concerns from financial transactions will lead to consumers embracing digital solutions.

Credits: E&Y global fintech adoption index 2019

Emerging themes intertwining with FinTech

Beyond the core segments of the financial services industry, Agriculture, Real Estate, Healthcare & Medical are witnessing a major transformation in their business model. These models are undergoing through a fundamental change using technology, getting digitally backed up, developments in data collection, storage and real-time insights, and simplification of operations and monetary transactions. The AgriTech, HealthTech, and PropTech are the three pillars of the nation- food, healthcare, and shelter for citizens. In the coming years, these firms will not only improve efficiencies in operation and production but also structure the flow of money transactions for the money players. With this the FinTech players can benefit in the organized market by providing alternative data to improve payments, processes, lending, and insurance underwriting services to become customer-centric.



Government Initiative for Financial Inclusion

Goods and Services Tax (GST) regime

With the introduction of GST, it has helped to formalise the disorganised market. Many FinTechs have capitalised from the digital footprint generated from the GSTN. The network has 1.22 Cr registered taxpayers to credit score and lend to MSMEs.
This creates a transparent cycle where buyers are mandated to have proper invoices as well as ensure that taxes have been paid by the suppliers so that they can get tax credits.
As a result, there is s greater tax compliance in the entire chain and there is a record for every transaction including sales and purchases. Such record-keeping is useful for fintech companies when they undertake credit assessment as they can cross-verify financial statements provided by the applicant with the actual data that is available in the GSTN or GST Network.

GST System Statistics

1.22 Cr
Registered Tax Payer

44.58 Cr
Total Return Filed

13.80 Cr
Total no. of Payment Transactions

121 Cr
E-Way Bill

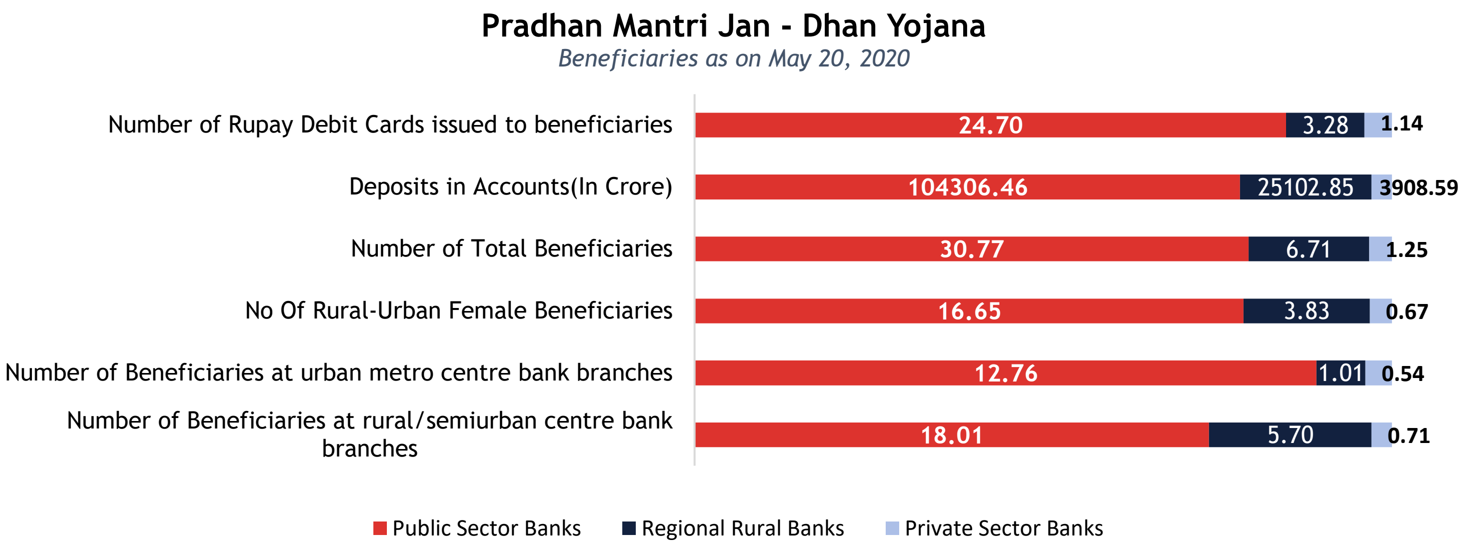
23.58 Lakh
Highest Returns Transaction in a day

9.00 Lakh
Highest Payments Transaction in a day

Credits: GSTN Website

Jan Dhan Yojana

The chief initiative by the Government, this scheme aims to educate people from weaker sections of the society and low income groups on basic financial literacy and services like savings account, insurance and pension. This scheme has resulted in a significant uptrend in the number of people with bank accounts in the country, laying the foundation for delivery of financial services for the unbanked.
The scheme has also brought in a behavioural change among unbanked consumers. This, in turn, has led to an increase in the demand for FS products, thereby creating viable opportunities for FinTechs.



Regulators : A New Friend

The regulatory bodies for financial services in India- the trinity of SBI, SEBI and IRDAI, has been soft in their approach, and haven't focused on creating much friction to innovation. The ongoing policy changes and measures have been taken to create a level playing ground for FinTechs. The RBI has been proactive in examining and setting up regulatory framework across various FinTech verticals like digital payments and P2P lending among others. Additionally, digital lending FinTechs getting into the NBFC foray is seen as a positive outcome. However, concepts related to open banking, mobile-only banks, and cryptocurrencies still are a far shot from finding discussion papers.
While SEBI and IRDA have constituted committees to study the growing impact of FinTechs in the WealthTech & InsurTech in India, there have been very little advances with setting up Sandbox or enabling disruptive innovations through proactive regulatory policies.

Credits: PMJDY- Website

Building of digital infrastructure

The launch of Unified Payments Interface (UPI) by National Payments Corporation of India (NPCI) has led to staggering growth of payment services among FinTechs and incumbent institutions. This has increased the nationwide adoptability of digital payments among consumers and merchants. The platform was used by 148 banks and witnessed 1247 million transactions worth INR 2,06,462 Cr as on March 2020, making it one of the largest payment platforms across the world. In addition, the overdraft facility launched in UPI 2.0 in 2019 the potential to push credit accessibility to thin-file customers.

Growth of UPI Platform

	March 2017	March 2020
No, of Banks on UPI	44	148
No, of Transactions on UPI (in Mn)	6.161	1246.84
Value of transactions on UPI (INR Cr.)	2391.4	2,06,462

Digital India Programme

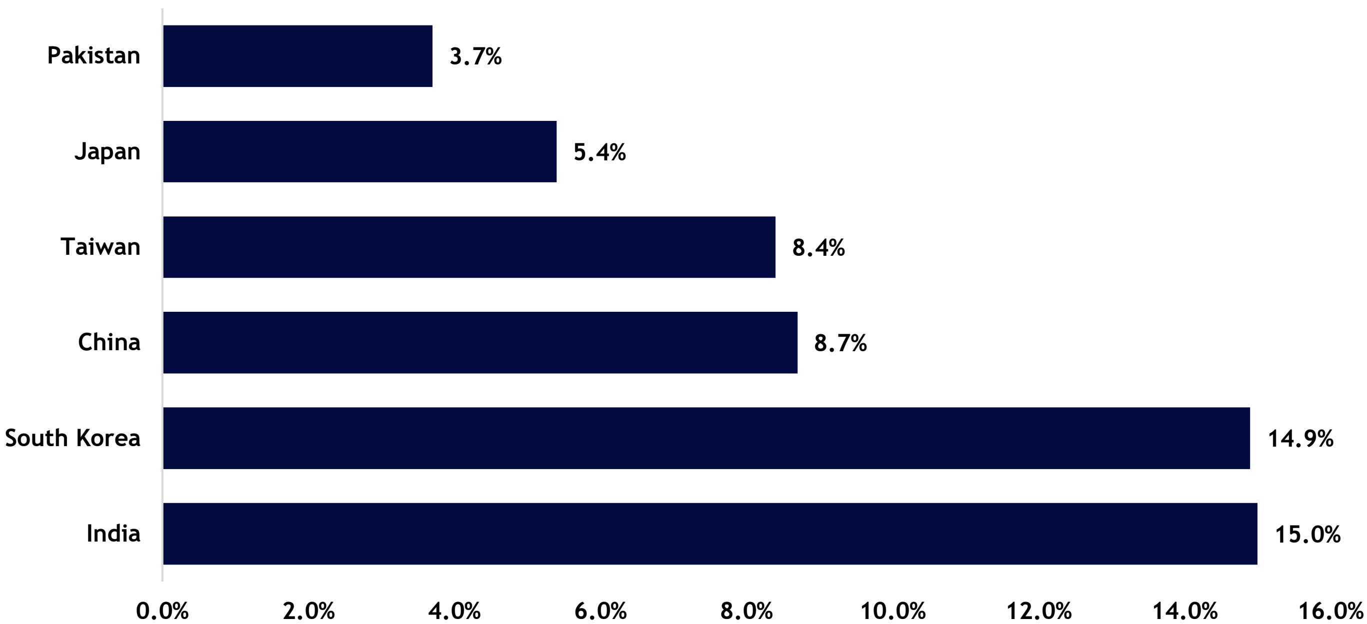
Government's initiative to push digital inclusion in the country through various literacy programs, infrastructure and ease of accessing digital services has led to digital maturity among the Indian masses. These initiatives has lead to greater financial literacy and understanding of the digital world. As a result, people have started accepting new modes of payments, FinTech solutions and thus boosting their usage.

Credits: NPCI Statistics

Startup India Initiative

The flagship initiative by Government to promote entrepreneurship and startup ecosystem in the country by regulatory and financial support has led to a growth in the number of startups in the FinTech sector. India has greater entrepreneurship culture as compared to Asian peers. The graph representing the same has been shown below.

Percentage of population involved in business start-ups in Asia in 2019, by country



Recognition of P2P lending as NBFCs and License for payment banks

The RBI provided recognition to the P2P lending segment by classifying them as NBFCs, boosting the sector's growth. The RBI has issued licenses to 11 FinTech companies to offer e-banking services like remittances, deposits and savings, paving the way for new-age branchless banking services offered by FinTechs.

In a nutshell, the Government has taken various other steps to strengthen and fertilize the Indian startup ecosystem soil. To name a few of them ASPIRE, MUDRA Bank, Ministry of Skill Development and Entrepreneurship, Atal Innovation Mission, Credit Guarantee Scheme for startups, and many other. All these schemes has helped to provide strong grounds for startups to take birth and grow. The Government aims to build a self sufficient nation through innovation and entrepreneurship. This uptick trend of entrepreneurship will create more sustainable businesses in the next decade.

Credits: Statista, Startup India

Key Bottlenecks for Indian FinTech

Cash intensive economy

Even after several policies being implemented by the government to make India a cashless economy, still there is a long way to go. There is an inclination towards cash even after so many alternatives. The population of India is the greatest obstacle to penetrate the financial products in each and every household.

Lack of Financial Awareness and Literacy

According to a global survey, about a staggering 76% of Indian adults do not understand basic financial concepts and are unfortunately financially illiterate even today. Due to this, it is difficult to win over the trust of consumers leading to less usage of Fintech applications.

Privacy and Data Security

The new buzzword in the business world “Data is the new oil” has gained immense momentum. Therefore, it becomes crucial for startups to invest heavily on data security and leaks. Earlier, data breach as happened in Facebook- Cambridge Analytica which leads to loss of customer trust. Firms driven by technology needs to keep the data security protocols in utmost priority.

Lack of Trust on financial technology

In India, there still exists a large part of the population who are not comfortable with the new ways of transacting, due to the preconceived notion around the technological stigma. A lot is yet to be achieved in terms of the adoption rate of various technologically-driven financial products.

Uncertainty in Regulation

Regulations in financial technology seek clarity and the certitude that comes from a transparent and coherent rule-making process. Ambiguous and shifting regulatory burdens can hinder financial innovation more than any other apprehension.

Adoption might be a challenge

According to the MSME Ministry’s FY19 annual report, India has 6.33 crore MSMEs out of which 6.30 crore - 99.4 percent are micro-enterprises. Majority of the businesses in India are MSMEs, therefore, FinTechs catering to each vertical in the MSME space might be a challenge as of now, considering the given operational challenges that these MSME enterprises face.

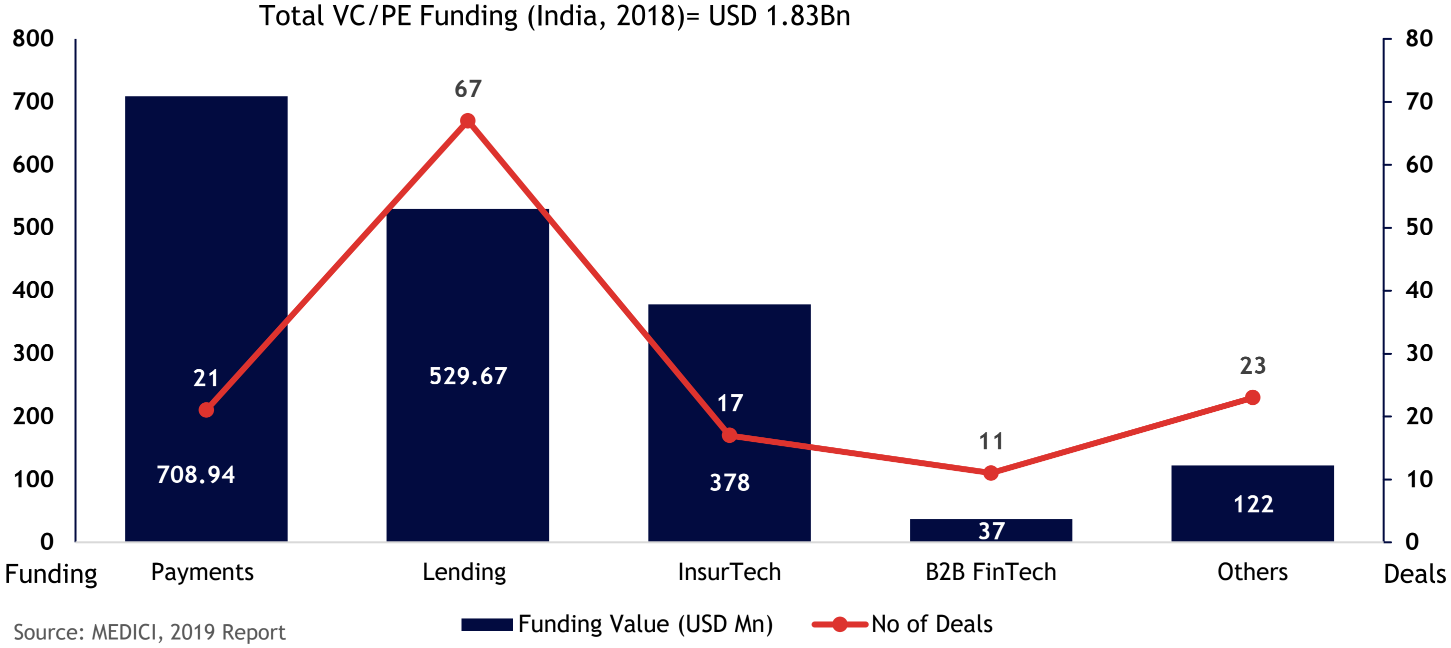
Indian FinTech Funding Canvas - Segment Overview

In the Indian FinTech market, there have been a few dominant segments that are disrupting the FS value chain by leveraging technology and innovation and offering unique solutions to customers by giving them a greater experience. Within the space, digital payments and lending have seen the greatest traction from customers as well as investors. This has mainly driven by sustained funding, government support through various schemes, and a huge underserved market.

In 2018, the Indian FinTech market attracted USD 1.83 Bn across 165 deals from VC/PE investments. Digital Payments leads with USD 708.94 Mn across 21 deals, followed by Alternative Lending with USD 529.67 Mn across 67 deals. InsurTech and B2B FinTech were the next best option for investors.

India VC/PE funding by FinTech segments in 2018 (USD million)

Total VC/PE Funding (India, 2018)= USD 1.83Bn



Source: MEDICI, 2019 Report

Top Funding Deals

Payments	Lending	InsurTech	B2B FinTech	Others
Series F, USD 356M	Series C, USD 87M	Series F, USD 200M	Series C, USD 18M	Series A, USD 10M

Credits: Medici. (2019). 2018 FinTech Funding Analysis - India. Retrieved from https://gomedici.com/2018-fintech-funding-analysis-india/ (last accessed on May 3, 2019), PWC FinTech Report

Moving Forward : The FinTech Way

A closer look at Digital Payments in India

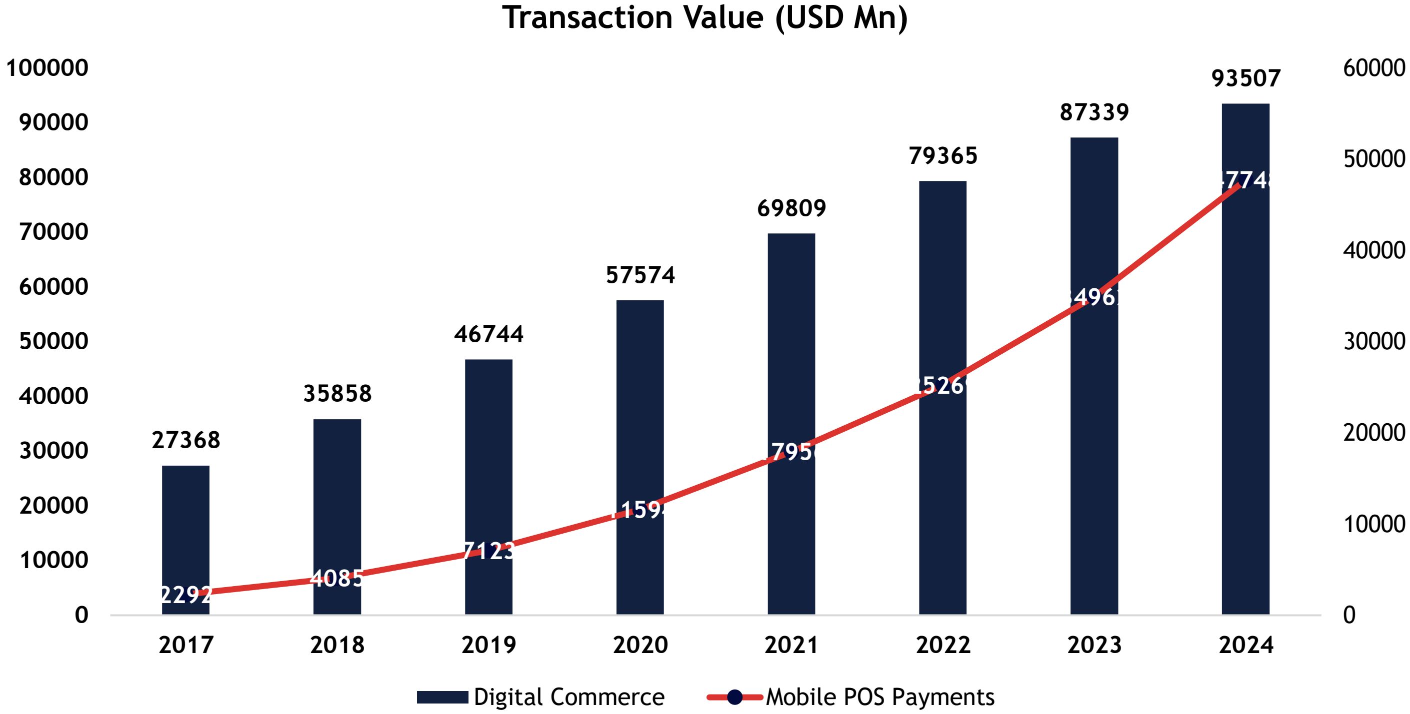
The Digital Payments market segment is led by consumer transactions and includes payments for products and services which are made over the Internet as well as mobile payments at point-of-sale (POS) via smartphone applications . The following are not included in this segment: transactions between businesses (Business-to-Business payments), bank transfers initiated online (that are not in connection with products and services purchased online), and payment transactions at the point-of-sale where mobile card readers (terminals) are used.

Highlights of the future

- Total transaction value in the Digital Payments segment amounts to USD 69,168M in 2020.
- Total transaction value is expected to show an annual growth rate (CAGR 2020-2024) of 19.5% resulting in the total amount of USD 141,256M by 2024.
- The market's largest segment is Digital Commerce with a total transaction value of USD 57,574M in 2020.
- From a global comparison perspective it is shown that the highest cumulated transaction value is reached in China (USD 1,920,536M in 2020).

Transaction Value (2020)
USD 69,168 Mn
(+28.4% y-o-y)

Users (2020)
589.5 Mn
(+12.6% y-o-y)



*The effect of COVID 19 has been considered for the forecasted period.

Concluding Thoughts

The Indian digital payments industry would need to address a few challenges before unleashing its true potential. Areas that need proper vigilance are low industry margins, primarily due to a cashback-driven culture and increased competition pulling margins down, and process inefficiencies like KYC bottlenecks. In addition, addressing the transactional security issues with proper security foundations would be utmost importance, given the sophisticated cyber frauds gaining momentum.

Going forward, to improve margins, payment product needs to be coupled with other FS services, thus increasing their visibility and getting more traction from customers. The synergy effect between the payments and lending platforms are yet to gain momentum in full steam, as FS players can leverage the rich payment transactional data for credit underwriting to disburse loans through the payments channel.

Another key measure would be a constant improvement in the back-end payments infrastructure. China is a living example that has a robust backend system. The Indian Government’s initiative of setting up of Common Service Centers (CSCs) in India is a positive step in this direction. In addition, FS players would need to upgrade their internal systems to handle the expected massive growth in digital payment volumes. Today, most of the FinTech players in India has been operating in Business to Customer (B2C) and Customer to Business (C2B). The next decade has a lot of potential in terms of emerging models- payments in the B2B, government-to-citizen (G2C) and citizen-to-government (C2G) space, FS players would need to reengineer their business models to capitalize this opportunity.

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