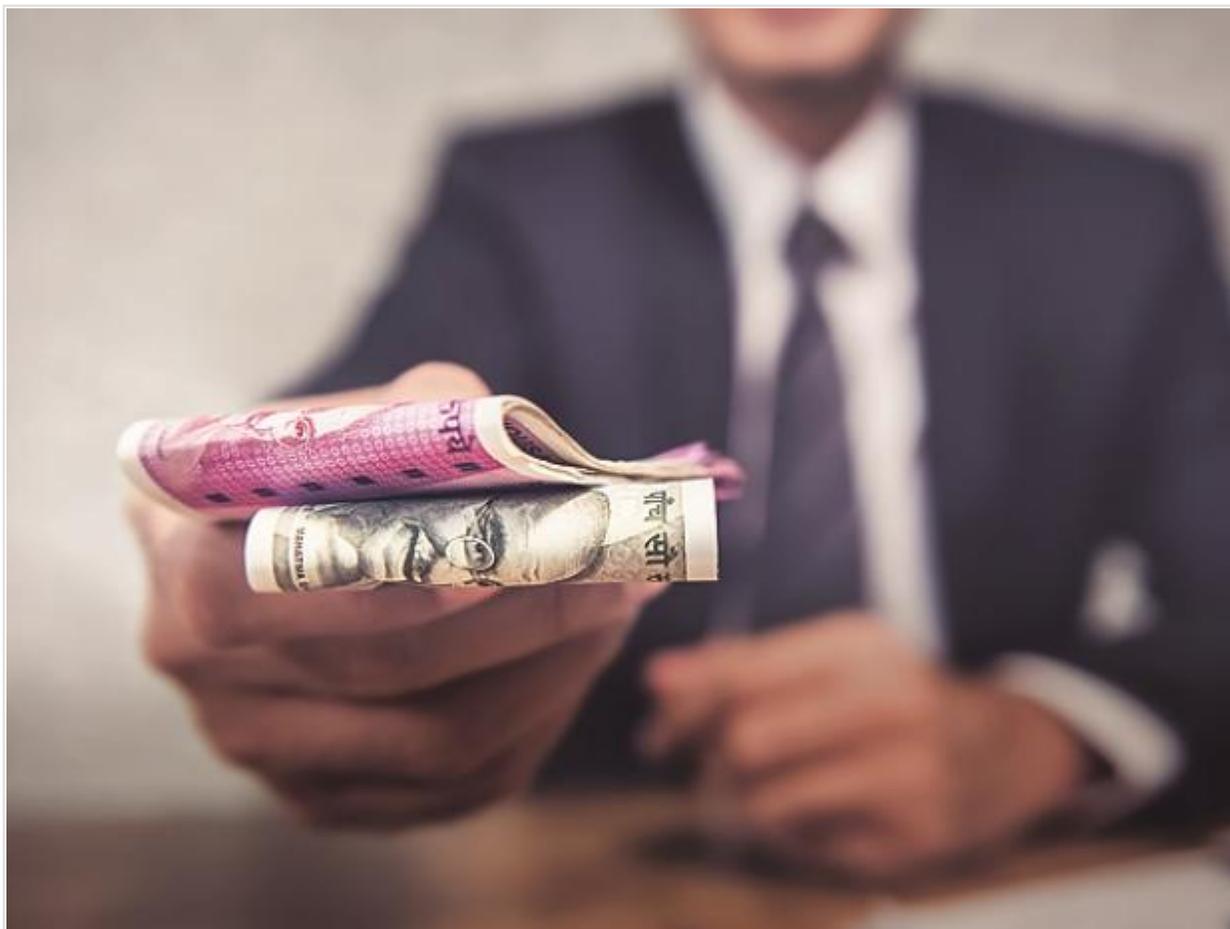


# Business Standard

## Fin-tech companies must test loan books, need NBFCs for scale

ICRA says credit to MSMEs will grow at 12% annually over the next 5 years

Advait Rao Palepu | Mumbai May 01, 2018 Last Updated at 21:30 IST



Micro, small and medium enterprises (MSMEs) today have over 100 alternative lending platforms and aggregators to choose from for availing business loans. But while the service offered is convenient, tech-enabled, efficient and flexible, experts say these lending models have not been time-tested and fin-tech companies need to partner with the legacy-large non-banking financial companies (NBFC) in order to scale up quickly and realise profits for their investors.

Several players have emerged over the past few years, from core lending platforms like Happy Loans, Capital Float, and Ziploan, to aggregators like Indifi, KredX and Biz2Credit, and peer-to-peer platforms like Faircent and LoanZen. “Right now there is a gold rush with many people coming in. A majority of these fin-tech companies have not yet gone through the entire loan cycle,” says Amit Garg, founder of MXV Consulting.

In a report, rating agency ICRA states that credit to MSMEs will grow at 12 per cent over the next five years, with the NBFCs’ share of the MSME credit market expanding to 22-23 per cent by March 2022, up from 16 per cent in March 2017.

The MSME segment has always faced a shortfall when it comes to credit supply, and ICRA estimated the segment had a large unmet credit demand of Rs 25 trillion in 2016-17.

Analysts say banks and NBFCs usually offer credit to businesses in the segment to fulfil their priority sector lending obligations. However, given that banks and legacy NBFCs have high operating costs and inflexible credit policies and processes, they find it unviable to cater to these businesses. In essence, the size of loans does not justify the transaction costs incurred by lenders in trying to service MSME borrowers. If a legacy NBFC player were to offer micro-loans or even business loans of Rs 500,000-600,000 to regular MSMEs, it would hardly add value to the company, given the higher operating costs incurred, say experts.

There is little differentiation among new MSME-focused fin-tech companies, with only a few exceptions. But the ultimate test of the lending model, experts say, is how robust their alternative credit assessments or credit score models are.

HappyLoans uses aggregator data from e-wallets, e-commerce companies, banking correspondents and point-of-sale machine vendors in order to assess a customer's repayment ability. LoanTap recognises salary patterns, so during some months the customer is charged a smaller principal servicing amount when his variable pay is low. When the customer receives a bonus he can make a bullet payment.

Saurabh Soni, business head of Happy Loans, says there is a large untapped market of potential 'mom and pop' stores in the country for his platform to cater to. There are over 600 million MSMEs registered under the Shops and Commercial Establishments Act, 1958, a majority of which remain unbanked. This especially true of MSMEs in rural areas. "Traditional NBFCs and banks cater to the top and middle of the pyramid, but not to the bottom. Because banks do not work on weekends and small entrepreneurs face working capital issues, we introduced a weekend loan product which is disbursed on Friday with repayment due on Monday or Tuesday," Soni says.

"In the financial services industry, 60-70 per cent of the challenge is with the quality of appraisals. The rest of the challenge is in collections. Right now, most of the effort is on the disbursements front and in building credit appraisal models," Garg says. "The cost of borrowing for some of these new-age fin-tech firms is very high, as the model is not time-tested. It is still an unseasoned portfolio," Jindal Haria, associate director, financial institutions, India Ratings, told Business Standard.

That means although the platforms are technologically proficient, borrower-friendly and convenient to use, one cannot evaluate the viability of these fin-tech companies. Further, these firms operate in a start-up environment and, as a consequence, they have prominent venture capitalists, private equity firms or angel investors backing them, which adds pressure to deliver results and returns.

"The best of models may collapse under high pressure, but if a fin-tech company goes through a few down cycles and still emerges profitable, it will benefit from a lower cost of funds and will be able to affirm whether its model is robust enough," Haria points out.

According to experts, fin-tech companies have two choices: either build up their loan book and compete with legacy NBFCs, which will mean a continuous rise in their cost of borrowing and further capital infusions to maintain their leverage, or they could continue to originate assets (loans) as they are doing now and partner with a big NBFC. The second option will help them scale up almost overnight and a liability partnership will allow them to sell a part of their loan book to the NBFC, shifting the risk. The NBFC benefits by gaining access to a book of small-ticket loans.

"Globally fin-tech companies have not been able to survive and prosper on their own. Wherever they have done well, it is because of a partnership," Haria adds.