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# Fintech industry in India

## Executive summary

E-wallets, BHIM, UPI, Payment banks... The ubiquity of these words is testimony to the increasing relevance of the financial technology industry. India is experiencing what is called technological disruption in every field and fintech is one such industry. The scope of the fintech industry extends from online payment and transaction processing to payments banks and peer to peer lending. The evolution of the fintech industry is surely going to be the highlight of the fourth industrial revolution in India. [1]

The fintech industry also aims to support one of the most promising thrusts of the Centre of financial inclusion. There is no seconding the fact that where the banks are unable to reach, mobile phones have already settled. The services generally offered by the banks are also facilitated applications which can be easily downloaded on a mobile phone. Once considered indispensable, credit cards and debit cards a.k.a. plastic money are no longer necessary to transact cashless. Also as banks become more and more wary of providing credit facilities to the informal sectors, digital lending is the way to go. The Centre's demonetization drive's thrust to a cashless economy is not unknown. Soaring valuations are the now common in the fintech space. While the unicorns in the digital economy boast of their valuations, a look at their bottom lines has another darker story to tell. A story of an uncertain future. In such a scenario, there is a dire need to analyze whether the good times are here to stay or not. It is indispensable to understand the factors that drive the valuations of the budding fintech companies and what are the hurdles they battle or they are likely to battle. As this industry grabs more limelight in the current scenario, it cannot escape the regulatory net for long. Through this white paper, we try to discuss the various reasons for the boom in this industry along with other aspects of fintech.

## Context

November 8, 2016. While the world had its eyes set on the US Presidential elections, Narendra Modi had a bigger surprise in store for the world. With few days in hand for monetizing the demonetized notes, India was buzzing with activity like never before. Different schemes were designed to get rid of the now illegal notes, some legitimate, while majority of them being illegitimate.

An excerpt of an article in a magazine read as follows:

*"This is akin to a Panchatantra-like story we might have heard of.*

*To get the crocodiles out, a man with good intentions started pumping water out from a pond. Small fishes also living in the water were highly inconvenienced breathing in 85% reduced water*

[1] As described by Mr. Mukesh Ambani at the India Today Conclave.

*but were happy as they were sure that he would get the crocodiles, and with the new rain cycle, they would live happily ever after. The crocodiles, however, are comfortably living on the land and are also waiting for the next rain cycle.*

*Now who is going to break this news to the fish? Not this honest man who despite his honesty has never ever accepted his prior mistakes and might be next planning to burn the trees to eradicate the bat flu."*

While demonetization had its own share of critiques, its pros outweighed its cons. Of course, the common man was inconvenienced to a great extent, few moments of pain are always welcome for an enduring gain. Gains? Yes, a lot of them.

Demonetization was the beginning of a gradual yet definite shift of the unorganized monetary economy to an organized cashless economy. There were many unintended benefits of the demonetization exercise. The banking sector got a super boost with swelling liquidity as the common man rushed to deposit his cash in the banks. This in turn benefitted the people as the increased supply of cash led the banks to lower the borrowing rates.

Corruption, the flagship reason for the exercise was likely to be curbed, especially in the most vulnerable sectors like construction and, real estate. There was a bigger goal of cracking down financing of terrorist activities through counterfeit notes. Increase in deposits led to greater visibility into the cash in possession of the citizens which meant more tax collections as the IT department could get hold of evaders. For the hoarders of black money, it was a double whammy. If they did not deposit money, they were likely to lose a huge sum while if they did, they were to pay a hefty penalty along with tax *(almost 45%)* though the latter left them with at least half of what they owned.

## Fintech industry – today

The global fintech market is expected to grow at an CAGR of 7.1%, and expected to be worth US$ 45 million by the end of 2020, of which the Indian fintech market is expected to contribute over US$ 2.4 billion. While it may represent less than 5% of the global fintech value, India is expected to be one of the fast growing fintech markets. Fintech companies bridge the gap in the funding scenarios, wherein the traditional financial institutions were reluctant to sanction loans to the rapidly growing small and medium enterprises *('SME')* in the country. The SME's faced hurdles in their expansion due to the traditional financial institutions' rigid eligibility criteria, long processing times, high interest rates and rigid terms and conditions, which led to the SME's approaching various informal channels for funding, which typically charge relatively higher interest rates. Cutting-edge technology allows fintech companies to offer a lot of flexibility to SME's, which enables SME's to raise smaller loans for shorter time frames and pay lower interest rates.

Demonetization has been instrumental in pushing India towards formal channels and move away from being primarily a cash - dependent economy. In 2016, India crossed the 1-billion mobile subscriber milestone which clearly indicates how quickly India is adopting new emerging mobile technologies. Finance companies are actively making use of various internet and mobile technologies that would allow them to cut operational cost and offer low- interest loans to borrowers. Various fintech lending firms offer a platform for borrowers to get loans without transacting with financial institutions. Such lending firms, on the other hand, are 100% online firms and therefore they offer low- interest rates to the borrowers. Unlike informal lenders, these lending firms offer process and fee transparency attracting more borrowers. In the wake of demonetization, such lending firms will dominate the market space as cash will no longer remain the primary source of transactions and informal lenders will eventually fade away from the market.

With better transparency in rates, advent of Aadhar based authentication and online payments, fintech lending firms are placed well to capitalize on the digital business space where every transaction is done online. These firms are also ideal for the under- banked population that has zero credit score and history. With the Government of India aggressively supporting the ambition of the Indian economy to become a cashless economy, the highlight of it being the recent demonetization drive, a robust fintech ecosystem is the need of the hour. The government initiatives have provided a much needed impetus to the fintech companies, which has seen a surge in funding and promotional initiatives. The India finech landscape comprise mainly of:

- Digital lending *(lending)*

  Digital lending companies bridge the gap created by the traditional financial institutions reluctance to providing financial support to the SME's. Digital lending companies like LendingKart, Capital Float, etc. utilizes technology and algorithms to create better financial products, improve customer experience and enable processing of loans to various SME's who faced hurdles obtained them from the traditional financial institutions.

- Payment services *(payments/consumer payments)*

  The advent of demonization has provided the much needed impetus to digital wallet companies like Paytm, Free charge, etc. Payment service companies enabled payment using smartphones.

- Savings and wealth management *(banking, trading and wealth)*

  These companies analyze various financial products and enable users to make more informed financial decisions. ScripBox and Funds India are examples of savings and wealth management companies in India.

- Insurance

  Various fintech companies enable ease of decision making for the consumer by aggregating insurance data and simplifying the application process. Further fintech companies have also enabled Insurance companies to transform itself into paperless organizations by reducing the need for paper trails for documentation purposes. Policybazaar and CoverFox are some of the few companies in this area.

- Remittance

  Inward and Outward remittance can be complex and expensive. Fintech companies automate the remittance process enabling cheaper and less complex transactions.

- Point -of - sale

  Companies in this space provide card swipe machines that enable customers to make cashless payments with ease. Several new players have emerged in this space post demonetization. Mswipe, PineLabs are some of the larger POS machine providers in this space.

Approximately 46% of Indian fintech companies are focused on payment and trade processing. By the end of 2023, transactions worth US$ 500 billion are expected to be made by non-cash means, i.e., either through traditional financial institutions or payment services. Although the traditional financial institutions market may be saturated, there is a huge growth potential when it comes to the payment service providers. The recently introduced United payment interface by NPCI is expected to redefine the future of payment systems in India. Payment service providers include the likes of Paytm, Freecharge, MobiKwik, etc.

## Factors contributing to increased digital payments:

### Internet penetration

The digital payments industry survives and thrives on the internet. As the fastest growing internet economy in the world, India is slated to add 300 million internet users by 2020.

### Usage of smart phone

India currently ranks #2 in the world with over 1 billion mobile subscriptions. Of this, approximately 240 million consumers use smart phones and this base is projected to increase to over 520 million by 2020.

### Improved O2O *(online to offline)* presence

Online shopping, bill payment and mobile recharge are the primary channels for using a digital mode of payment, which has led to consolidation amongst various Indian e-commerce companies and digital wallet companies in the past few years. The largest chunk of cashless transactions are expected to be In the form of person to merchant payments using digital wallets. These would contribute to approximately 40% of cashless transactions by 2020.

### Policy incentives

Majority banks in India have rolled out Unified Payment Interface *('UPI')* to introduce a virtual payment address, easing digital transactions between two parties. Also Reserve Bank of India's *('RBI')* decision to provide licenses to set up payment banks for the underserved population of the country will lead to an increase in the usage of digital banks and wallets in villages.

All the above factors are expected to push the use of e-wallets and other forms of fintech products for making transactions. The factors mentioned above along with the recent demonetization drive by the government should provide a much needed boost to digital transactions in India, which in turn will increase the use of e-wallet and other fintech companies. The challenge for the fintech companies will be monetization of services. While they may start charging users for transfers back to the bank accounts, consumer reactions to such charges are yet to be evaluated.

Various cashback offers and other attractive schemes have in the past encouraged various consumers to use the fintech products to make transaction online. However, these companies cannot sustain giving such offers for a long time. The usage pattern of consumers once the promotional phase ends may make certain section of the wallet users to shift back to traditional cash payments. However, there may be a large portion which may continue using these services since it is more convenient than dealing in cash.

The expected growth of the fintech industry has created a lot of traction in the investment fraternity with regards to funding fintech companies. Following is the list of the funding activity in the fintech space over the last few months:

| Company | Funding | Date | Investors |
|---|---|---|---|
| Freecharge | US $ 57.2 million | January 8, 2017 | Euro Pacific Capital Inc. |
| Lendingkart | US$ 7.7 million | June 12, 2017 | Yes Bank |
| | US$ 4.6 million | April 13, 2017 | Anicut Capital |
| Mobikwik | US$ 40 million | August 26, 2016 | Net 1 UEPS Technologies, Inc. |
| Scripbox | Undisclosed | June 30, 2016 | Omidyar Networks<br>Accel Partners |
| Coverfox | US $ 15 million | June 2, 2017 | Transamerica<br>SAIF Partners |
| Capital Float | US$ 2.3 million | April 10, 2017 | Mahindra and Mahindra Financial Services |
| | US$ 2.5 million | February 6, 2017 | IFMR Capital |

***Source:*** www.owler.com

Funding in the fintech space is characterized by relatively higher valuations. The most common multiples that are tracked in the space are:

- No of active users;
- Value of transactions conducted on the platform; &
- Recent funding received.

It is important for these fintech companies to have strong value drivers to sustain in the long run. Following are the key value drivers which assist in growth of these fintech companies:

- Number of active users
  The high number of active users has a direct impact on the company's ability to generate revenue, which leads to higher valuations.

- Customer behavior
  Only a high number of customers may not necessarily translate into higher revenues. The initial higher number of customers may be due the customer inclination to try a new service. Thus it is necessary for companies to have customers who are attracted by the products and services offered. These type of customers ensure repeat transactions, which translates in to higher valuations.

- Product differentiation
  In today's scenario, where there are several companies offering similar products and services, it is imperative that a company portfolio of products and services include those that differentiates them from the other players in the market. For example, Paytm's offering for various categories of merchant, including government toll payments and tie ups with Uber, gave them an edge over other wallet companies, since users prefer having a single service to process their digital payments.

- Multiple revenue streams
  Multiple revenue streams assist companies to better face competition and as an important value driver.

- Indirect marketing, visibility
  Tying up with several vendors assist in indirect marketing and visibility. A higher visibility transforms into a higher user base which in turns help increase revenues, e.g., Uber's tie up with PayTM, Ola with Citrus Wallet, indirectly promotes use of these wallet services.

## Hurdles for the industry

- Mistrust: One of the biggest hurdles facing the fintech industry is the problem of mistrust. This problem is more of a perception than of substance. In a nation of a billion where a major chunk of population is cash dependent, it is inherently not digestible for them to impose their trust in a system where the payment happens simply at the click of a button. The love for cash is too profound for anything else to be favored against it

- **Regulatory challenges**: Be it FEMA hurdles for P2P remittance start-ups, or pending RBI approvals for payment banks, regulatory challenges are here to stay for the fintech industry. This is the concern voiced by the founders of fintech startups as well as investors.

- **Infrastructure**: Obsolete technologies and limited reach of internet are some of the infrastructural roadblocks for the fintech industries. The very objective of financial inclusion is defeated because of poor or no network connectivity in the rural areas.

- **Lack of awareness amongst people:** The Centre stated in June last year that nearly 40% of India's population is unbanked. It is difficult to imagine someone having no banking knowledge to be able to understand or rather even have knowledge about the existence of e-wallets. What is required is mass awareness and instilling confidence in the people about the future of digital payments system and their safety.

- **Tie-up with banks:** It is still tough to find a banking partner and even after finding one it is difficult working efficiently along with the legacy systems of the banks.

- **Constraints on use of e-wallets:** Paytm allows transactions worth Rs. 20,000 per month per user. Such a miniscule limit discourages and is also irrelevant for merchants who transact such amounts in a matter of hours.

- **Fraud:** The fear of fraud, especially for e-wallet companies is not without reason. Paytm was hit by fraud in 2015. The peak level of fraud for e-wallets has been 3 to 3.5% of value, which is 15-20 times the level in e-commerce according to an Economic Times report.

## Notable acquisitions in the fintech space

In 2016, 58 deals were reported in India in fintech vis-à-vis 54 in 2015. Before moving on to discussing the deals in the fintech space, it will be a good exercise to analyze the deal drivers for the acquisitions:

- Acqui-hiring: The rationale for the acquisition is to acquire the expertise and talent of the staff rather than the product or service offerings;
- Expansion of market share; &
- Most online market places acquire fintech companies to leverage their payment platforms and provide an all in one service offering to their customers.

Citruspay, a start-up providing prepaid payments system was acquired by PayU, owned by South Africa's Naspers Group, in September 2016 for US$ 130 million in an all cash deal. It was the largest cash deal acquisition in the fintech industry. This merger, which was PayU's first acquisition, was also an acqui-hire, extending PayU's reach in technological advancements of the fintech industry.

In the following month, Binge, a Bengaluru-based fintech startup that helped its users pay restaurant bills directly through the app was acquired by vMobo, a California based marketing company.

Acquisitions in the fintech space also take place as e-commerce companies try to leverage their synergies and build their in-house payments platform. One such example is Amazon's acquisition of payment gateway Emvnatage. In March 2016, Ola acquired mobile payments company Qarth in an attempt to strengthen its mobile wallet service Ola Money. Such an acquisition throws open an additional revenue stream for Ola, with the ride hailing service still being loss making, and also puts the service in direct competition with bigger rivals such as Paytm and Freecharge.

There was consolidation in the digital lending space also in 2016. In October 2016, fintech start-up Lendingkart acquihired[2] KountMoney, an online lending marketplace for personal loans. According to Harshvardhan Lunia, Co-founder and CEO of Lendingkart Technologies, the rationale of the acquisition was to strengthen their tech backbone and leverage their data analytics expertise.

In line with its expansion program, Mumbai-based Hansa Cequity, a customer marketing company acquired InLoyal, a mobile loyalty wallet and SaaS loyalty platform which creates loyalty programmes for retail merchants and have them engaged with their customers through the wallet.

One of the early acquisitions in 2017 is French firm Ingenico Group's acquisition of Mumbai-based TechProcess Payment Services Ltd, an online and mobile payment services provider.

## How Paytm became the largest e-wallet company in India

As inspiring as is the story of Paytm founder Vijay Sharma from Aligarh to being a founder of a US$ 3 billion company, the success story of the company is equally inciting.

Paytm's success is also backed by a first mover advantage since the company was started as an online mobile recharge company in 2010 when the fintech industry was at a nascent stage in the country.

In 2016, one billion transactions were conducted on the Paytm platform and by December 2016, it had 2 million registered merchants on its platform and 147 million active transacting users. Out of its total usage, 89% was through mobile phones.

The company also claimed a 12x growth in offline commerce and claimed a share of 26 percent in overall digital payments in 2016.

[2] an act or instance of buying out a company primarily for the skills and expertise of its staff, rather than for the products or services it supplies.

The demonetization drive has been a windfall gain for Paytm post which they experienced a manifold increase in the traffic on the platform *(almost 700%).* Exploiting the opportunity at hand fully, the company also pushed its marketing spend to an entirely new level of Rs. 250 crore vis-à-vis the general monthly spend of Rs. 50 crore.

However, it is pertinent to note that despite the mounting numbers, its bottom line is nowhere close to being in the green and the founder expects the company to become profitable only by 2019.

Funding history

| Date | Round | Amount |
|---|---|---|
| | | |
| May 18, 2017 | Equity | US$ 1.4 billion |
| March 3, 2017 | Equity | US$ 200 million |
| February 8, 2017 | Equity | US$ 32.5 million |
| August 31, 2016 | Equity | US$ 60 million |
| March 14, 2016 | Debt | US$ 45 million |
| April 25, 2015 | Equity | US$ 200 million |
| March 13, 2015 | Equity | Undisclosed |

***Source:*** www.owler.com

Takeaways from Paytm's story:

- Create trust among your customers: Paytm boasts of an excellent customer service. Making themselves visible on various social media platforms to improve customer response time, they have hit the bull's eye by winning the trust of their customers.

- Appreciation: 4% of equity of Paytm has been given to the team as the founder is a staunch believer of hard work and believes that appreciation is directly linked to motivation.

- Opportunistic: Paytm knows well how to capitalize potentially advantageous situations to its benefit. This is best explained by the fact that Paytm is the largest spender on advertising among the e-wallet companies.

## Post demonetization review

On the face of it, demonetization has provided a thrust to the financial technology industry be it in terms of increase of registered users or transactions. What demonetization has also catalyzed is increased co-operation between banks and fintech companies for partnerships. Quoting Sashank Rishyasringa, co-founder of Capital Float, "It has been said that banks consider fintech startups to be competitors and disruptors. But through a partnership like this, the bank gets access to new customer segments and innovative products, while it gives us access to the balance sheet and the experience that a bank such as IDFC has."  Capital float is one of the startups that has entered into a partnership with IDFC Bank.

The demonetization thrust to the fintech industry is more of a push than a pull strategy i.e., to say that people have been forced into using fintech solutions because of being dried of cash. While a pull strategy focuses to attract the customers based on the value offerings. The latter is likely to have a longer-term impact.

## Fintech industry – the future

The global fintech industry experienced a slowdown in the first quarter of 2017. Such slowdown was in terms of deal values as well as volumes. However as per KPMG's report "Pulse of Fintech Q1 – 2017", investment in fintech increased vis-à-vis the previous quarter.

Another trend observed globally is the development of the partnership model beyond acquisitions and investments. Through partnerships, fintech companies can gain access to customer information and data which they otherwise would not be able to access.

Q1 of 2017 saw unicorn SoFI, a US-based online personal finance company raise US$ 500 million at a valuation of US$ 4.5billion while China's Rapid Finance filed for a US$ 100 million IPO in the US. Funding to venture capital-backed insurance tech companies fell 25% on a quarterly basis in Q1'17, while deal activity dropped 30%. Investment to VC-backed Bitcoin and Blockchain startups rebounded in Q1'17 to US$ 113 million after dropping to US$ 77 million in Q4'16. The largest deals over the three-month period included BitFury's US$ 30 million Series C and Veem's US$ 24 million Series B funding.

If the pace of investment in Q1'17 continues, funding to VC-backed fintech companies would drop 20% from 2016's dollar total. US fintech deal activity is on pace to fall below 2013 levels at the current run rate.

Based on the above statistics, the global fintech industry represents a gloomy picture in 2017 vis-à-vis 2016. However, the Indian scenario begs to differ. This can be attributed to the tailwinds to the industry in the form of various factors already discussed above. Also while the industry in the developed countries has matured, the industry in India is blooming and its pros are now coming to light and it is now that it is gaining momentum.

2016 was a busy year for the Indian fintech industry. Demonetization and bleeding bottom lines are likely to lead to consolidation in the fintech space in 2017 as well. As banking transactions become marginally expensive due to the increased GST rate of 18% vis-à-vis the current service tax rate of 15%, people are likely to opt for online transactions whenever possible.

# APPENDIX


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