Past Perfect, Future Tense?



**Themes shaping the future of Fintechs in India**

By Prateek Roongta, Rajaram Suresh and Sheetal Jasrapuria

## Will India’s Fintech growth story continue to hold true in the future?

**India’s Fintech growth story continued to hold strong in 2021, with a 157%**1 **y-o-y growth in funding.** The sector received funding worth USD 8 Billion1 in 2021 led by payments at ~USD 2.7 Billion1 closely followed by lending at

~USD 2.6 Billion1. India’s digital payment success story is evidenced by the digital transaction volume of over 28 Billion2 and a gross value over INR 320 Tn in FY 20212. Going forward, lending is likely to become even more valued given the democratization of data, and the valuation profile of Indian Fintechs is expected to shift from payments to lending. (See Exhibit 1)

**However, last few quarters in 2022 have witnessed multiple shifts in the Indian Fintech space owing largely to macroeconomic conditions.** The possibility of an impending recession and inflationary pressures across key markets have impacted the economy at large and Fintechs have been no exception. Indian Fintechs saw a drop of ~30%1 in funding in quarter ending June 2022

compared to quarter ending June 2021. On the other hand, the amount of dry powder with institutional investors (PE/ VCs) has increased by USD 3.2 Billion3 in the last 6 months4, indicating the potential flow of capital with improvement in macroeconomic fundamentals. This balanced indicators suggests, the future of Fintech will continue to be shaped by three kinds of themes



Existing secular themes that will continue to propel the Fintech growth story



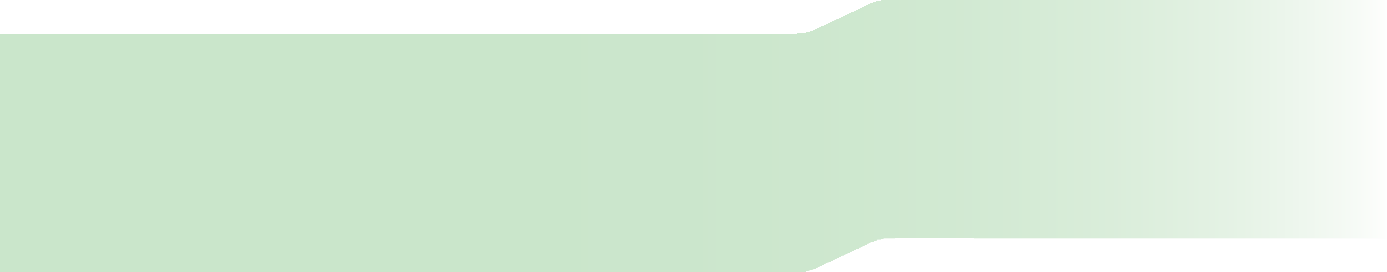
Emerging secular themes that will shape the future landscape of Fintechs



Vertical-speciﬁc themes that will shape

business models and operating models

###### Exhibit 1 - Valuation proﬁle of Fintech to tilt towards Lending from Payments with level playing ﬁelds in data



**FY 25**

**FY 21**

22%

Payments

50%

35%

Lending

13%

18%

Investment Tech

15%

6%

10%

Daily Banking



 Insurance Saas

11%

10%

5%



5%

Source: Capital IQ, Tracxn, Press Search, BCG analysis.

1

Notes: 1. In case of listed companies, latest market capitalization is taken for valuation, for unlisted companies the valuation is per last funding round;

2. 2025 projections done considering the growth rates by segments and further expected trends; 3. Total ﬁntech valuation in FY 2021 Rs 5.6 Lac Cr,

1. Source: BCG Fintech Control Tower
2. Digital transactions include NEFT, IMPS and UPI; Source: RBI
3. Source: Prequin
4. Increase is counted from December 21 to June 22

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## Secular themes that will shape the future of the Fintechs

##### Existing secular themes that will continue to propel the Fintech growth story

* + **Large addressable demand** on the back of an expanding middle-class5 (46% of all Indian households in 2025 vs. 37% in 2018)6 and rising urbanization (~36% of the population in urban areas in 2022 vs 33% in 2017)7.
  + **Unprecedented growth in data access** with growing smartphone penetration (1130 Million smartphones by 2025 vs. 600 Million in 2020)7, rising internet penetration (900 Million internet users in 2025)7 and declining cost of data.
  + **Maturing digital infrastructure, constituted by India stack, JAM trinity, UPI** has been pivotal to the Fintech growth story, building a strong core for the open-API infrastructure to follow.
  + **Pandemic-aided explosion in UPI, leading to acceleration of digital credit.** UPI transaction volumes grew 2.6x8 between April 20 and April 21 from ~1 Billion transactions to ~2.6 Billion transactions, within a year of pandemic post March 2020. UPI held over 60%8 volume share of total non-cash transactions9 in FY22. Increase in proportion of digital payments driven by UPI has created more digital data that enables robust underwriting for lending. **The pandemic also resulted in an increase in investments.** Share of active clients in digital discount brokers (Zerodha, Upstox, 5paisa) grew from 43% to 57%10 in the same timeframe.
  + **Formalization of MSME economy driven by structural reforms** like Goods and Service Tax Network (GSTN) and Trade Receivables Electronic Discounting System (TReDS). Active tax base for GST has increased from ~10M11 in July 2017 (when reforms were introduced) to ~14M11 in May 2022. The consequent digitization of MSME payments has enabled sharper credit decisioning.
  + **RBI’s thematic push on responsible innovation through its regulatory sandbox framework** to enable live testing of financial innovations at scale, while controlling risks. Notable innovations from the first three sandbox cohorts include NFC, sound waves and IVR technology to enable offline P2M payments in rural India. A fourth cohort on fraud mitigation is currently in flight.

##### Emerging secular themes that will shape the future landscape of Fintechs

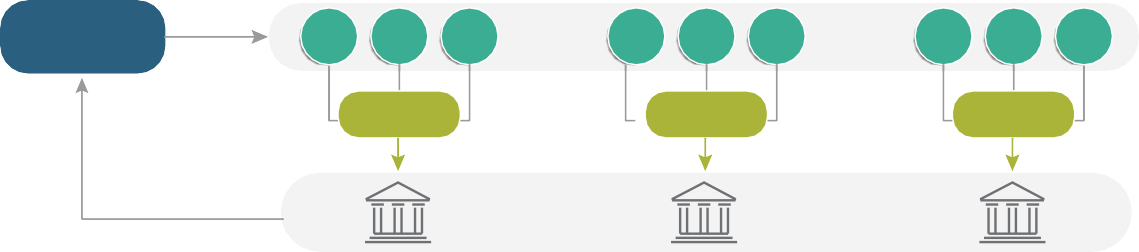
* + **The open architecture of Account Aggregator, OCEN, ONDC is expected to lead to a dramatic explosion in machine-readable data, transform data into a utility and democratize payments, credit, commerce, and savings.** As shown in Exhibit 2, the AA framework will enable seamless and secure access to standard-format data and enable portability between service providers. ONDC is expected to democratize commerce, reduce acquisition costs, improve competitiveness of small sellers and enhance price and merchant discovery of buyers; whereas OCEN is expected to dramatically improve credit access to MSMEs by enabling cash-flow- led underwriting for MSMEs, given data proliferation. In its end state, digital service providers will connect to the ringfence of regulated entities and source customers for payments, credit, and savings, while leveraging the architecture across journey stages.
  + **Fintechs seek greater value capture by integrating upstream in credit, wealth, and investment value chains; yet to see proof of concept in savings.** After successfully breaching a threshold of active customers, Fintechs aim to move upstream by seeking licenses to manufacture financial products. Key examples include Navi (from MF distribution to AMC), Slice (from co-brand credit card origination to providing capital via own NBFC) and Acko (from pure-play distribution into manufacturing motor insurance). This will significantly unlock value pools in form of lending spreads, fund management fees, insurance premia, that are multiple times larger than distribution fees. However, manufacturing will also increase regulatory scrutiny and add compliance costs. Neobanks are yet to be approved to store deposits / lend on own balance-sheet given RBI’s selectivity in handing licenses and the absence of a ‘Digital Banking License’ in India.
  + **Large non-FIs are seeking to monetize their captive customer base and maximize lifetime value by building a financial superstore, inspired by global success stories.** WeBank (China; 300 Million users)8, MyBank (China; 45 Million users)8, Kakao Bank (South Korea; 17 Million users)8 and others as in Exhibit 3 are some global success stories which Indian examples



1. Middle class households include households with annual income between 3-10L
2. Source: CCI City Income database, Statista
3. Source: Press Search
4. Source: RBI data, NPCI, BCG Analysis
5. Non-cash transactions exclude cash transactions and cash transactions at branches includes cash transactions at ATMs
6. Source: NSE handbook, HDFC Sec Inst. Research
7. Source: Press search, GST website

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###### Exhibit 2 - Open Stack along with Account Aggregator framework to lead to increased availability of data across Digital Service Providers



Consent

Transactor

Borrower

Payment

Loans

Payment Service providers

Loan Service providers

Saver

Personal finance management (PFM)

Neo-banks/ Investment advisors

Account Aggregrator

Data

P1 P2 P3

L1 L2 L3

N1 N2 N3

UPI

OCEN

API

Data

Account Aggregator framework to enable entities along the ringfence of regulation by providing seamless and secure access to user data

Increase in data availability on account of increase in digitalization of credit and commerce on account of initiatives like UPI, OCEN, ONDC & Neobanking

Source: BCG analysis

like Paytm, Bajaj Markets, Tata Neu etc., might be seeking to emulate. These superstores aim to offer a suite of payments, lending, investments and insurance products under a single app via an ecosystem of partnerships with FIs and merchants.

insurers. Kreditbee offers micro personal loans starting from INR 1,000 to new-to-credit customers in less than 15 minutes. Players like Jar, Stack, Multipl, Fello offer micro-investments (starting from INR 10), or round-up spare change from purchases and allocate into savings accounts, mutual funds, digital gold, etc.)



Two factors that stand out amongst proﬁtable

global superstores

1 Their ability to activate and engage their

captive user base at scale

2 An eﬀective lending business backed by a

robust underwriting engine

Therefore, traditional conglomerates (for e.g, Tata, Reliance) and digital platforms (for e.g, Swiggy, Zomato, Cred, Ola) with their large base of engaged user base are likely to gain prominence with superstore plays in the future.

* + **Fintechs are responding to the demographic shift and improving affluence of the ‘mass’ segment by offering innovative, ‘sachetized’ products across verticals.** for e.g, players like Bajaj Markets and Ola embed bite-sized insurance products (insurance for cab rides, mobile screen, pets, missed flights, lost baggage, etc.) in their native apps via partnership with
  + **The regulatory stance is increasingly nationalistic, pro-innovation and pro-consumer.** The RBI continues to limit the ringfence of deposit-taking institutions in its selectivity of handing out banking / NBFC licenses. However, it seeks to complement this ringfence by opening it up to service providers via an open architecture.



Three factors are key to monetize this segment

1 Turbocharge transaction volumes to reach

critical mass of monetizable base

2 Oﬀer vernacular support in UI/UX/servicing

to improve accessibility, and

3 Sharper understanding of customers to improve

portfolio quality/manage credit losses in lending

3

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###### Exhibit 3 - Super Apps in Asia-paciﬁc have evolved from diﬀerent starting positions and have had a transaction-led foray into ﬁnancial services

Non - FI Businesses FI Businesses



Geo

Ride Grocery

App Sharing Travel Messaging E-Comm Delivery Loyalty Food E-Wallet

Banking &

Insurance Lending

|  |  |
| --- | --- |
| **China** | WeChat |
| Alipay |
| Meituan |



**South East Asia**

Grab

Gojek

Core-Offering

Starting Point

All ecosystem players have a transaction-led category play for their financial businesses

Source: App Annie, Statista

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## Vertical-specific themes that will shape the

future of Fintechs

#### **PAYMENTS** is likely to be further disrupted with UPI and Credit Cards at the forefront

* + **UPI-enablement of credit cards is set to turbocharge UPI’s ubiquity in India’s digital payments ecosystem.** This move seeks to increase the use of credit cards at POS terminals via UPI, which was earlier limited only to linked accounts. While the scope is limited to RuPay credit cards as of now (dominated by public sector banks), adoption will witness a step jump when the doors are opened to Visa and Mastercard (holding over 81%12 of the total active credit cards in India), which will also bring in private sector banks. Third party apps (like PhonePe, GooglePay) would have to upgrade their merchant KYC modules given Credit Card norms are more stringent versus that for accepting QR-based UPI payments.

Ultimately, the power of acceptance will materialize at scale with the right economic models. Therefore, the question of who bears the cost of ‘acquiring’ will need to be resolved between issuers, merchants, and card networks, given UPI is positioned as ‘zero MDR.’ Additionally, the monetization models and ownership of customer data also remains to be resolved between card networks and third-party apps.

* + **The role of non-banks in driving credit card penetration remains unclear, given the evolving regulatory stance on issuance of credit cards.** As seen in Exhibit 4, monthly issuance volumes for non-banks like Slice and Uni were comparable with that of incumbents like ICICI Bank, SBI and HDFC Bank. Until now, these companies issued credit cards in partnership with NBFCs (Non-Bank Financial Companies) (who provided capital) and banks (who handled clearing, settlement and hosting the PPI). However, RBI’s recent direction, effective Jul 1st 202213, limits non-banks from loading credit lines on to PPIs unless they have a dedicated license to issue credit cards. The direction further limits non-banks’ role to marketing and distribution of credit cards. While the regulator could potentially remain open to licensing NBFCs for issuance, the stance raises questions on the viability of these Fintech business models and their role in driving credit card penetration.

###### Exhibit 4 - New age players catching up fast with traditional banks so far, regulatory curbs to deﬁne

future growth

**Total # cards issued till date (Mn)**1 **# cards issued every month (Mn)**2

16.3 0.20

12.8

13.5

8.6

7.0

1.0

0.6

0.12

0.11

0.06

0.04

0.01

0.02

HDFC ICICI Axis SBI Slice Uni One

Card

Traditional players (Banks)

HDFC ICICI Axis SBI Slice Uni One

Card

New-age players (Non-Banks)

5

Source: BCG analysis; Investor Presentations

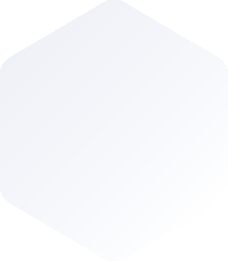
1. “Till date” in Total # cards ussued till date as “As of 31st March 22”
2. “# cards issued every month (M) as “For the month of March 22”
3. As of Aug 21, Source: Press search
4. Direction dt June 20, 2022, on Loading of PPIs through credit lines to authorised Non-bank PPI issuers

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* + **Explosion in P2M payments, driven by rapid deployment of QR codes in offline merchants and higher activation and adoption of the already acquired merchants, will increase the prominence of transaction data in underwriting credit to these merchants.** Digital merchant payments value is set to grow from USD 0.3–0.4 Trillion in 2021 to USD 2.5-2.7 Trillion by 202614 This will be driven by an increase in number of merchants using QR—from 30 Million in 2021 to 40 Million in 202614. Consequently, the relative weight of transaction data is set to increase from 10%15 (in traditional credit assessment) to about 50%15 in new-gen assessment for credit underwriting. Easy availability of merchant transaction data will lead to wider possibilities to lend to them through innovative underwriting models formulated by Fintechs.
  + **RBI’s Payment Vision 2025** on the theme of ‘E-Payments for Everyone, Everywhere, Everytime’ defines several goalposts along themes of Integrity, Inclusion, Innovation, Institutionalization, and Internalization. Exhibit 5 lists down the intended outcomes of the vision. From a Fintech perspective, this vision signals a clear regulatory lean towards innovation and growth, while potentially followed by increasing scrutiny and audit. This will consequently push Fintechs to build and strengthen capabilities like risk management, compliance, etc. which were hitherto the responsibility of licensed entities. From a regulatory perspective, the governance model for enforcing this vision is crucial to realizing the defined outcomes.



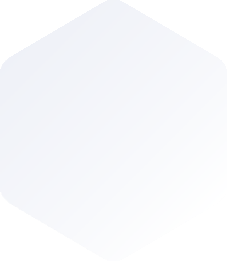
###### Exhibit 5 - Expected outcomes from Payment Vision 2025



1

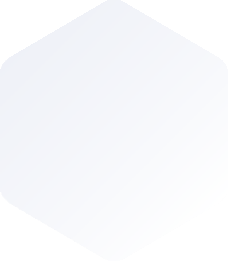
Volume of cheque

-based payments to be less than 0.25% of the total retail payments



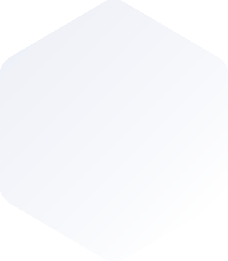
2

More than 3x increase in number of digital payment transactions



3

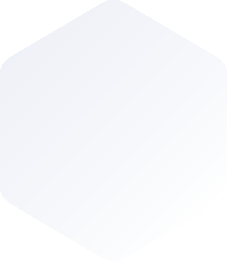
UPI to register average annual- ised growth of 50% and IMPS | NEFT at 20%



4

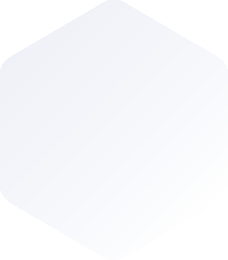
Increase of payment transaction

turn-over vis-a-vis GDP to 8



5

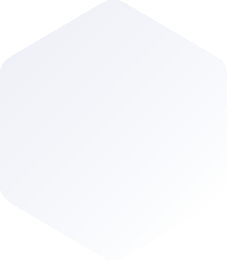
Increase in debit card transactions at POS by 20%



6

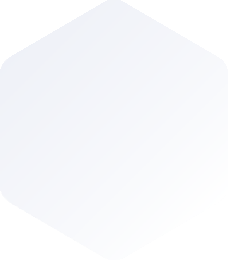
Debit card usage to surpass credit cards in terms

of value



7

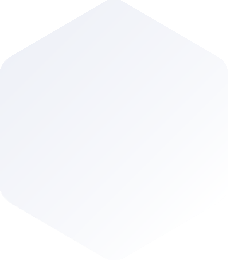
Increase in PPI transactions by 150%



8

Card acceptance infrastructure to increase to

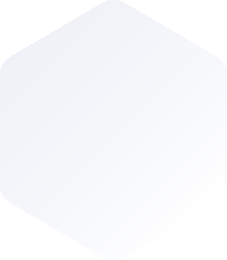
250 lakh



9

Increase of registered customer base for mobile-based transactions by

50% CAGR



10

Reduction in Cash In Circulation

(CIC) as a percentage of GDP

Source: RBI-Press release

|  |  |  |
| --- | --- | --- |
|  |  |  |
|  |  |  |

1. Source: BCG and PhonePe Pulse Analysis
2. Fintech & NBFCs taken together to avoid any skew owing to FLDG arrangements by Fintechs

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#### While access to **LENDING** is set to be democratized, the lending models will be subject to greater regulatory scrutiny

* + **The rise of embedded finance is expected to drive digital payments and credit penetration.** E-commerce marketplaces (Amazon, Flipkart), e-commerce enablers (Shopify, WooCommerce), traditional lenders (Bajaj Markets), and merchant discovery platforms (Zest, Simpl) now capture multiple stages in the journey from product discovery consideration, purchase, fulfilment and financing via BNPL. India’s BNPL disbursements are expected to grow from ~INR 100,000 Cr.19 in FY21 to over INR 700,000 Cr.19 by FY26. Increasing e-commerce penetration (~8% in FY22 to ~15% in FY2516 ) and the maturity of ONDC will act as key catalysts to this topline growth.
  + However, the viability of embedded finance remains to be proven globally. Global BNPL players (Afterpay, Affirm, Sezzle) lost 30%17 of their market cap between September to December 2021, following rising defaults and tighter regulations in Australia, UK, and rest of Europe. In India, BNPL economics hinges on subvention and / or interest incomes compensating for credit costs, customer acquisition cost and operating costs. On one hand, pureplay Fintechs continue to splurge on customer acquisition (rewards, deals) and face higher credit costs (high approval rates, NTC customers); on the other hand, existing digital platforms (for e.g., Tata Neu, Swiggy, Paytm, Ola) have an advantage in customer acquisition, credit underwriting, cost of funds. Therefore, incumbent platforms enjoy an advantage over pure-play Fintechs, who are in turn seeking to build a financial superstore platform.
  + **The combination of increasing MSME formalization, exploding machine-readable data and maturing OCEN is set to dramatically democratize credit for MSMEs.** Increasing GST penetration and the AA framework is set to drive 100x growth in machine-readable

data pertaining to MSMEs as seen in Exhibit 6. Atop this rich data layer, OCEN seeks to create an open standard. Lending Service Providers (LSPs) will act as direct selling agents as well as data providers for regulated lenders (Banks / NBFCs) and plug into the AA framework. Lenders can then integrate with these LSPs via APIs to acquire, underwrite and service these MSME loans digitally.



This has three implications:

1 Firstly, analytics capability (for customer acqui-

sition, pricing, and partnerships) becomes an

important point of diﬀerentiation for Fintechs

2 Secondly, it brings banks, NBFCs and Fintechs

closer, as collaborators and not as competitors

3 Thirdly, ownership of the customer (MSME) for

future monetization (for e.g., trade ﬁnancing, forex) will need to be resolved between the LSPs and Banks / NBFCs, given an LSP can partner with multiple Banks / NBFCs

* + Credit quality continues to be a key priority for Fintechs, given high credit costs in small-ticket disbursements, primarily sourced by digital Fintechs

**/ NBFCs.** GNPAs for all loans sourced by Fintech18 lenders in small-ticket (less than INR 25,000) loans grew by ~7x21 between March 2020 and March 2021. Through 2021, portfolios sourced by Fintechs continued to demonstrate GNPAs of ~20%19 of disbursements as illustrated in Exhibit 7. Such high credit costs add pressure on unit economics, which pushes up yields and portfolio risk in tandem. Additionally, they could also invite increased regulatory scrutiny on Fintechs’ sourcing model, loan pricing and credit policies (for e.g, FLDG). To control credit costs while managing operating expenses,

###### Exhibit 6 – Availability of machine readable data to increase for lenders, leading to democratization of

7



credit for MSMEs

Banks

Telecoms

Account Aggregator

Mutual Funds

Utility Cos.

X

Insurance

Provident fund

Consent

One time/Periodic

10x

Dat

a Sour

10x

ce Dat

a Points

=

Income tax

Digi Locker

GST

Equity invt.

Borrower

Access to standard format machine readable txn data of all accounts to any lender instantly with customer consent

100x Data

Lender (customer's choice)

Source: BCG analysis

1. Source: CCI ecommerce model, BCG CCI Digital Influence Study 2013-17, 2021 surveys (N=10000 to 20,000 each year, urban and rural coverage)
2. Sezzle alone lost as much as 90% of its market cap with share price dropping from $5.73 to $3.02, while Afterpay lost ~40% and affirm lost 18%
3. Fintech & NBFCs taken together to avoid any skew owing to FLDG arrangements by Fintechs
4. Source: CIBIL Data
5. Source: CRISIL – Yearbook on the Indian debt market 2021

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###### Exhibit 7 – Fintechs continue to see high GNPAs triggered with the onset of covid

**GNPAs for all loans have increased by ~3x from Mar'20 to Mar'21 for NBFC & Fintech lenders**

**GNPAs for small ticket loans have increased by 5-7x from Mar'20 to Mar'21 for NBFC & Fintech lenders**

GNPA as a % of AUM

All personal loan combined

GNPA as a % of Disbursements

5-7x 0.8x

26% 25%

20% 20%

Between Mar‘21 to Dec’21 GNPAs are gradually improving across ticket sizes for NBFCs & FinTech

3% 3% 4% 6%

2.75x

0.9x

11%

10%

3%

4%

16% 14%

11%

13%

Mar’19 Mar’20 Mar’21 Dec’21 Mar’20 Mar’21 Dec’ 21

<25k 25k-50k 50k-100k 100k+

Source: TransUnion CIBIL, BCG analysis

Note: Fintech & NBFCs taken together to avoid any skew owing to FLDG arrangements by Fintechs; CIBIL data for individual ﬁntech players in

anonymized format is not available

Fintechs need to be able to secure more consent- based data at scale (via OCEN) to substitute surrogate data with actual data on customer cohorts



1•

Build robust risk models that can withstand multiple credit cycles. While the ML-led Fintech models can learn faster than bank/NBFC models, the loan repayment data still flows in broadly in the same cadence across Fintechs (for e.g., monthly). Therefore, achieving model improvement is a metronomic process, iterated over time.



2•

Hyper-personalize product policy and collections model for customers via advanced analytics (for e.g., selective product access, lower limits for low-credit score customers, higher contactability thresholds for riskier customers)



3•

* **Lowering cost of funds by improving the depth of India’s debt and securitization market could dramatically improve Fintech unit economics and portfolio credit quality.** Currently, even in peak liquidity cycles, 70-80%20 of debt (by value) flows to AAA- rated NBFCs and above whereas in low liquidity cycles, debt concentration is even higher (~90%). The higher cost of funds for below AAA-rated NBFCs adds pressure on Fintech partners to source higher yield, riskier loans, increasing systemic credit risk. Thus, there is a clear benefit to establishing a vibrant debt market in India. However, this requires Fintechs to be able to

Demonstrate clear value to a debt investor, whose goals are different (e.g., loss minimization via better credit quality) from an equity investor (e.g., upside maximization via valuation gain)



1•

Price risk capital effectively, both on the liability and the asset side of the balance sheet, by leveraging data, analytics and ML



2•

Achieve a high velocity/throughput of debt funding by building a market for securitization

* Particularly, securitization is a key unlock for lowering cost of funds. Given 84%21 of India’s household wealth is locked in physical assets, securitizing them could dramatically expand availability of lending capital for Fintechs. Replacing unsecured lines with secured funding would lower funding IRR, thereby enhancing viability of Fintech business models in the long run. Building scale in securitization needs concerted policy impetus across sectors and states. A key example is Maharashtra digitizing agricultural land records via ‘7/12’, thereby opening up such asset categories for disruption.



3•

* **RBI’s focus on upholding regulatory, tech, consumer protection standards could subject Fintechs to a standard protocol of operating model with implications on growth, viability.** The working group in Nov 202122, through its working paper has noted that FLDG arrangements involve non-regulated LSPs bearing credit risk without maintaining any regulatory capital, and that there is a potential for build-up of credit and counterparty risk for regulated entities. This could limit

/ disallow the growth of FLDG based lending models deployed by Fintechs. A potential recommendation on introducing a legislation for ‘Banning of Unregulated Lending Act’ could potentially cap interest rates, especially to the riskier / NTC segments. Another recommendation urges regulated entities to maintain auditable documents of algorithms used for underwriting and obtain explicit customer consent for usage of any underwriting data. This could impact the access to data and efficacy of underwriting by Fintechs, subsequently impacting credit costs.

1. Source: RBI’s household wealth report 2017
2. Paper being the ‘Report of the Working Group on Digital Lending including through Online Platforms and Mobile Apps’

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#### **WEALTH** Fintechs are vying to educate and unlock mass investors at scale with discount-led business models

* + **India’s wealth will continue to be increasingly financialized and drive penetration of equity investing** (especially in the mass / affluent segment). Between FY14 to FY19, India’s annual gross household wealth grew by 14% (versus 6% for physical wealth). While FDs continue to hold the largest share (18%) of India’s financial wealth, the CAGR of equity MFs (39%) and alternatives (44%) has outpaced that of FDs and bonds (9%) in the same period. This is reflective of India’s MF under-penetration (12% vs. 63%23 globally), underlying returns of asset classes, changing customer attitude and behavior towards investing in equity. Between FY20 to FY25, the number of individuals entering the ‘affluent24’ band will double from ~0.5M to ~1M25. For Fintechs, a growing pyramid and addressable demand at the base poses the need for digitally educating, activating, and servicing this base at scale. Not surprisingly, this has led to proliferation of wealth techs seeking to serve the mass segment with innovative themes.
  + **Wealthtechs are activating mass investors through thematic innovation in products. However, the path to long-term viability will need a shift from discount-led to monetization-led plays and better education and engagement of existing customers.** Key thematic examples include micro-investment (Spenny), auto-investments ( Jar), robo-advisory (Stack), ecosystem integrations (Multipl), gamification ( Jar), financial literacy (Finpeg)and vernacular support (Fello). Jar enables auto-investment of spare change from purchases, into MFs, SIPs, digital gold. Spenny enables micro-investments (as low as INR 10). Stack analyses customers’ risk profile basis a questionnaire and algorithmically recommends a suitable portfolio. Multipl integrates with merchants (e.g., travel aggregators) to fulfil customers’ spending goals while helping them ringfence their savings for this purpose
  + **Technological solutioning to improve mass- investor literacy could emerge as an important growth driver versus core financial engineering of products.** Incumbents are trying to get ‘customers to do better with their money’ by embedding nudges in order flows to guard against common pitfalls (for e.g, Zerodha introduced embedded nudges on penny stock risks, which saw a marked reduction in penny stock volumes). Product offerings in equity and fixed income continue to remain standard. The key to capture this segment is to understand their needs rather than serving complicated financially engineered products they do not feel a need for.
  + **The investment thesis on Wealthtechs is indexed towards user acquisition and engagement, given the underpenetration of India’s wealth landscape, thereby increasing monetization runway for these firms**. However, to monetize wealth offering, wealth techs need to begin monetizing advisory and delivery trades. Since Zerodha’ s disruption of broking for retail investors in 2015, monetizing delivery trades has been a challenge since transaction fee is a key revenue driver. *“At some stage, we need to start charging for broking transactions- for delivery trades also—Nitin Kamath, Zerodha”*. Further, to remain cost effective in a competitive space, fintechs are aiming to keep cost of customer acquisition low for e.g, Zerodha’s customer acquisition cost is “very little to none” versus an industry average of INR 3000–5000 per customer. This has been one of the key drivers of Zerodha’s profitability in the last few years.

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Ultimately, three factors will decide viability of

these Wealthtech models:

1 Firstly, the ability to dramatically simplify

investing for ‘Bharat’ through a solid content

platform with vernacular support

2 Secondly, the ability to rapidly scale AUM and

drive annuity by keeping customers engaged, given the small-ticket sizes in this play

3 Thirdly, the propensity to transition from

‘discount’ to monetizable products like regular

MF (vs. direct MF)

1. Source: Paytm DRHP, Press Search, BCG Global Wealth Report 2021 - BCG Global Wealth Market Sizing, BCG analysis
2. Affluent band is defined as Individuals with investible wealth between INR 1 to 5 Cr
3. Source: CCI City Income Projections

PAST PERFECT, FUTURE TENSE? THEMES SHAPING THE FUTURE OF FINTECHS IN INDIA

#### Innovation **INSURANCE** will be shaped by a new regulatory regime and infrastructural enablers like NHS, AA and India Stack

* + IRDAI seeks to usher in a new regime of insurance regulations, which could unlock newer operating models, partnerships between Insurtechs and incumbents.



Key implications include:

**White-labeling:** Today, InsurTechs cannot white-label products that can be underwritten by a traditional insurer. A change in regulation could result in a one-to-many Insurer-Insurtech partnerships, likely making this a ‘winner-takes-all’ market for Insurtechs

**Digital distribution:** Today, legacy insurers cannot set up a subsidiary digital attacker—in case of a revision, these insurers can now reinvent to cover

new-age customers themselves, thereby reducing reliance on new-age Insurtechs for distribution

**Consolidation:** Today, an insurance companies cannot merge with a digital attacker to strengthen its digital presence26. Any change(s) to this guideline could potentially inﬂuence the corporate structures of key players in this space with legacy ﬁrms eyeing synergetic partnerships or M&A

* + **The AA framework and India Stack will enable end- to-end journey digitization of insurance.** This will improve efficiency and customer experience for legacy insurers, unlock greater capture for regulated Insurtechs, create downstream niches for other Insurtechs. Exhibit 8 illustrates how insurers could leverage the stack at each stage. This will have three implications for insurers and Insurtechs: Firstly,Insurers will now be able to onboard their customers faster, assess needs better (vs. being product pushers), underwrite and price risk more granularly, and simplify purchase and repayments. Secondly, regulated digital attackers (for e.g, Acko) can reduce / remove reliance form other partners and can now directly reach, understand, service customers, thereby maximizing value capture. Thirdly, other modular Insurtechs will seek to deepen their niche in specific supporting / downstream processes like video assessment, roadside assistance, in partnership with legacy insurers.
  + **The National Health Stack will significantly unlock value in Retail Health Insurance,with more Insurtechs plugging into this ecosystem.** Health insurance will expand to include OPD (Outpatient Department), customized underwriting models will become feasible based on health data / records. It opens up a possibility for insurers to create E2E health and wellness ecosystems, embedding value added services like health advisory, monitoring etc. along with health insurance. Insurtechs can partner with insurers to offer innovative product constructs and lend digital distribution capabilities. Insurtechs can also help drive down costs, streamline claims settlements, lower frauds and cost of operations for health insurance by virtue of their tech capabilities.

###### Exhibit 8 - Insurance data aggregation architecture can enable digitalization of end-to-end customer life cycle



**Customer Life Cycle**

Needs an insurance

Agrees to share data

Sees all

oﬀers

Accepts

best oﬀer

Purchase

Premium Payment

**Supported by Independent Products**

Identiﬁcation

Electronic data consent

Marketplace

Paperless contract

Transaction bank A/c

Bank mandates, auto-pay

**Aggregated under Uniﬁed Rails**

Aadhar/ e-KYC

e-Mandates, Smart contracts

UPI

e-Sign, DigiLocker

Open APIs

Account aggregator

Source: BCG analysis

1. Today, the Insurance Act doesn’t permit an insurance company to acquire more than 10% equity stake in any company

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#### **CRYPTO**, DeFi (Decentralized Finance) no longer the wild west; increasing regulator

recognition and scrutiny a double-edged sword

* + **The recent crypto market erosion has tempered stakeholder expectations; capital will continue to be constrained whereas talent pool remains resilient.** Since scaling meteoric highs in market cap in early 2021, cryptocurrencies have been weathering a period of price volatility since November 2021. In the 8 months since, the price of Bitcoin has fallen by ~70%27, and Ethereum by ~75%23. The collective erosion of market capitalization amounts to over $1 Trillion. Response to this erosion has varied across stakeholders. Retail investor confidence on cryptocurrencies and decentralized projects has taken a hit, as evidenced by the plunge in Decentralized Exchange volumes (48% down since Nov’2128) and the Total Value Locked (TVL) in DeFi protocols (66% down from $257 Billion since Nov’21). Crypto-native firms (including Coinbase, Gemini) have affected layoffs and hiring freezes, while other Fintechs like BitMEX and Robinhood have tempered their crypto aspirations. However, despite the crash and the funding outlook, developer activity has continued to hold strong, indicating a resilient talent pool.

Therefore the capital-constrained environment would act as a forcing function to eventually channel capital and talent pool to viable blockchain applications and DeFi projects. These projects should be able to demonstrate inherent value, built atop a robust, scalable infrastructure, and designed to enhance the traditional ecosystem versus try to replace it. A good example is on-chain asset tokenization.

* + **On-chain asset tokenization is expected to gain prominence across key markets.** In addition to traditional asset fractionalization, on-chain asset tokenization is focused more on illiquid assets (e.g., agri land) and private markets (e.g., pre-IPO stocks) to improve liquidity, accessibility, transparency and efficiency of such

asset classes. The total size of illiquid assets globally which can be tokenized would be $16 trillion29 by 2030. Exhibit 9 illustrates the tokenization landscape. The on- chain asset tokenization market globally surpassed $2.3 billion in 2021 and is expected to grow at a 5-year CAGR of 19% to reach $5.6 billion by 2026. As per experts, the potential of on-chain asset tokenization in Asia alone is to the tune of $3 trillion (i.e., total market cap of private unlisted assets), indicating a huge addressable market.



The global uptake of on-chain tokenization is

underpinned by three success factors

1 Clearer regulatory framework across nations

2 Concerted push to demonstrate proof of concept

and improve retail investor awareness

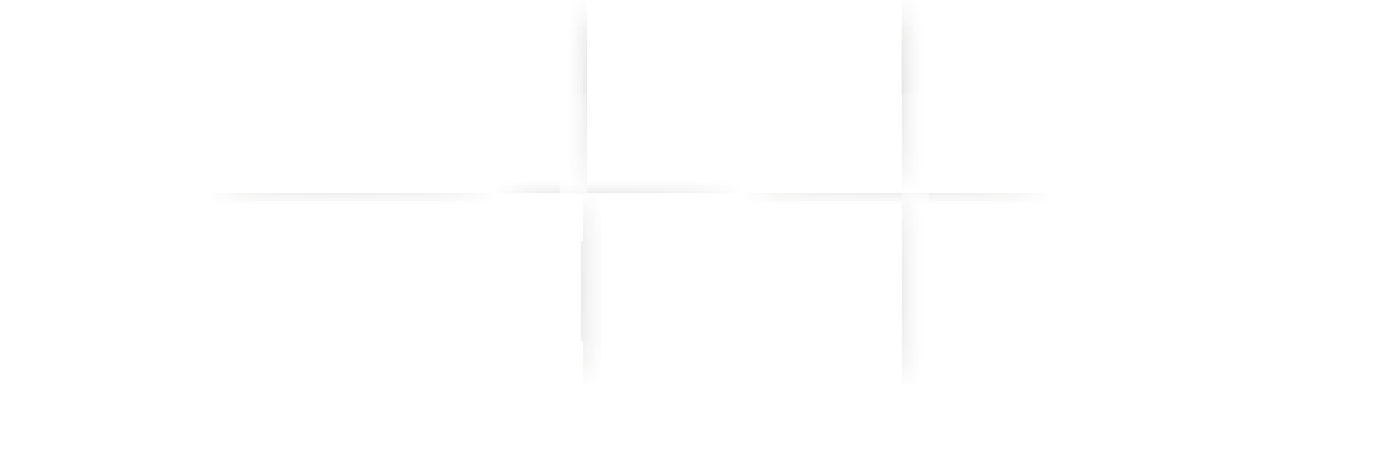
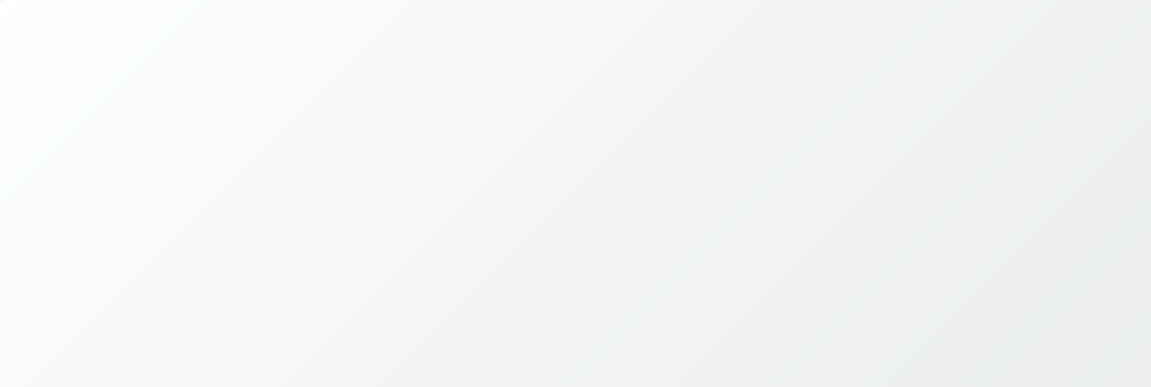
3 Standard tech protocols across tech stack to

accelerate go-to-market

* + **Large crypto Fintechs continue to operate with caution in an evolving regulatory landscape.** In the union budget the government imposed a TDS of 1% on transactions from July 1 and 30% tax on capital gains giving it some legitimacy but the talks of banning crypto in India has led some of the big names to change their domicile to Dubai/Singapore. Regulator too continues to be mindful on investor education, acquisition, KYC, dollarization of capital. After a free run for a year, the ASCI cracked down in Feb 22. It mandated that crypto ads follow a set of 12 guidelines and show a “highly risky” disclaimer. This has also led to a slowdown in funding received by Indian startups operating in the space.

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###### Exhibit 9 - Distinct diﬀerences exist today between the landscapes of traditional fractionalization and on-chain tokenization



**What is tokenized?**

**Who tokenizes it?**

**How is it tokenized?**

**Traditional asset fractionalization**

Public markets

* Real estate
* Public equity
* Private equity
* Fixed income
* Commodities
* PE ﬁrms
* Investment Banks
* AMCs
* Hedge funds

Key steps/stages involved

1. Underlying asset is fractionalized
2. Each segment listed on an exchange
3. Multiple parties' own small fractions
4. Process supervised by centralized agency (REIT, ETF, MF)

Private markets

* Pre-IPO stock • Wholesale bonds

**On-chain asset tokenization**

* SME revenues • Digital assets
* Public infra
* Private debt
* Physical art
* Exotic beverages
* Asset originator
* Tech companies
* Protocol developers

Key steps/stages involved

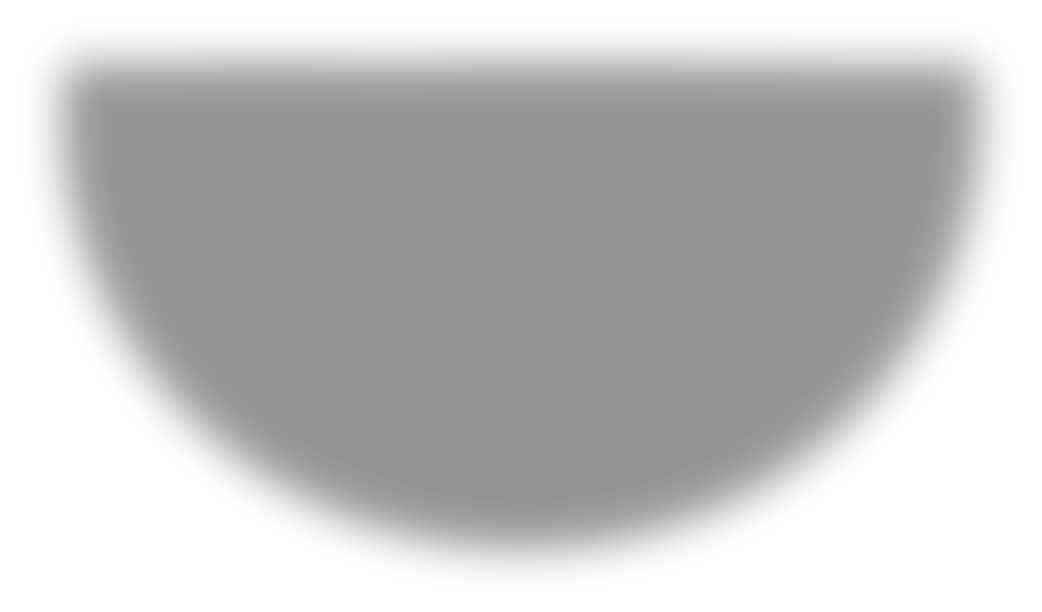
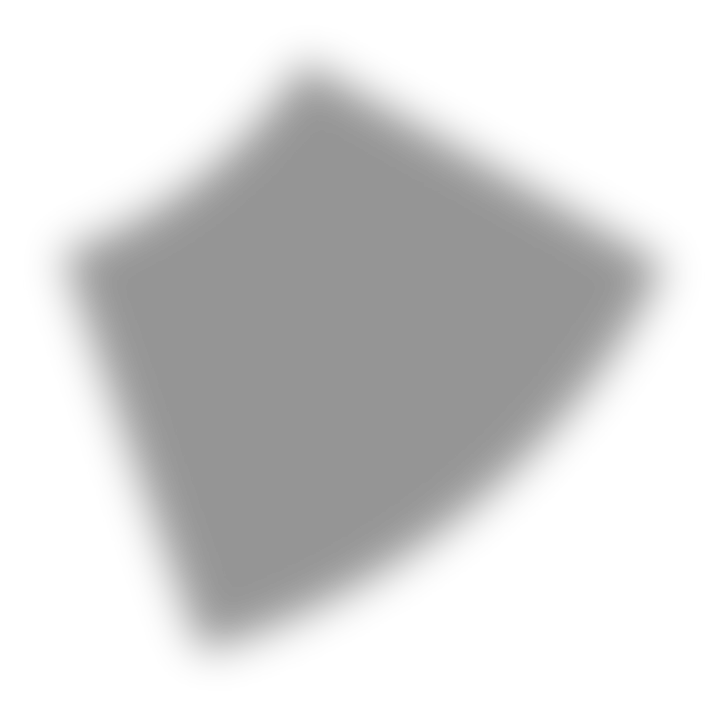
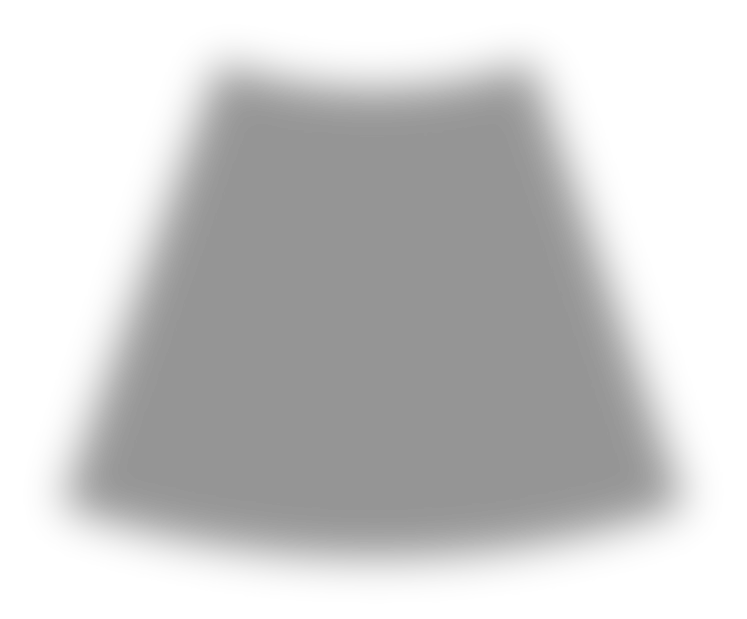
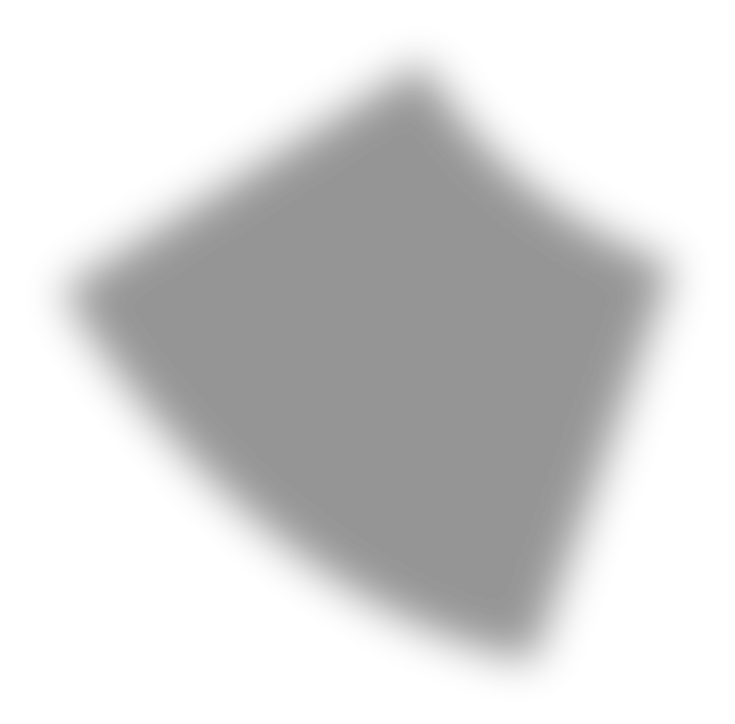
1. Assemble the ecosystem
2. Conﬁgure a token
3. Set compliance rules
4. Distribute the tokens
5. Execute corporate actions

Source: BCG analysis

1. Source: Press Search: The NewYork Times
2. Source: Press Search: The Defiant
3. Source: World Economic Forum – 2015, BCG Analysis

PAST PERFECT, FUTURE TENSE? THEMES SHAPING THE FUTURE OF FINTECHS IN INDIA

Key Takeaways



### Payments

1. Credit Card on UPI rails will further turbocharge digital payments penetration
2. While overall credit card penetration will increase, the role of non-banks is unclear; to be shaped by regulation
3. Increase in merchant base will drive P2M payments and expand credit access and sharper credit decisioning
4. RBI's Payments Vision 2025 to drive innovation and growth, although with expanded regulatory responsibilities for Fintechs

### Wealth

1. India's wealth will continue to be ﬁnancialized; underpenetrated equity and MF market will present an opportunity for Wealthtechs
2. Wealthtechs are activating the mass/aﬄuents through thematic innovation. However, the path to long-term viability will require Fintechs to charge customers for services
3. Technological solutioning and investor education will be more important growth drivers for mass segments versus pure product engineering
4. The Wealthtech investment thesis will be indexed towards user acquisition vs. monetization/proﬁtability, given the underpenetration of Indian market; however, CAC has started becoming a key diﬀerentiator to improve unit economics

### Crypto, DeFi

1. The recent crypto market erosion has tempered stakeholder expectations; capital will continue to be constrained whereas talent pool remains resilient
2. On-chain asset tokenization is expected to gain prominence across key markets. Its evolution will be shaped by regulations, standard tech protocols and the adoption by TradFis
3. Large crypto Fintechs will continue to operate with caution in an evolving regulatory landscape

### Lending

* 1. While embedded ﬁnance / BNPL will further drive digital payments and credit penetration, achieving proﬁtability at scale remains elusive
  2. Fintechs continue to strive to improve credit quality; consent-based data, robust risk models, and bespoke credit policies could be important unlocks
  3. Securitization and tapping into the debt market

could help alleviate pressure on Fintechs' cost-of-funds and therefore yields

* 1. RBI's focus on upholding regulatory standards and consumer protection could invite greater scrutiny on Fintechs' lending models (e.g., FLDG) and ultra-high yields

### Insurance

1. IRDAI seeks to usher in a new regime of insurance regulations, which could unlock newer operating models, partnerships between nsurTechs and incumbents
2. The AA framework and India Stack will enable end-to-end journey digitization of insurance, leading to greater operating eﬃciency, sharper pricing newer partnership models between insurers and InsurTechs
3. The National Health Stack will signiﬁcantly unlock value in Retail Health Insurance, with more InsurTechs plugging into this ecosystem



# Conclusion

Indian Fintechs have been the posterchild of India’s digital growth story, with their growth propelled by a surplus of capital, maturing infrastructure and favorable underlying customer demographics. The good news for Fintechs is that India’s digital infrastructure is only expected to further mature and the underlying demand growth is expected to stay strong. However the Fintechs will also have to operate in an environment with regulator(s) that are increasingly nationalistic, pro-consumer, and vigilant; licensed incumbents who are strengthening their digital capabilities; increasingly affluent and digitally-savvy customers who are hungry for their financial needs to be met digitally; and most importantly, a large base of mass customers waiting to be digitally educated and serviced. Achieving sustainable and profitable growth in this environment will be test of which Fintechs can grapple and balance these multiple stakeholders and place their customer at the centre of it all. Ultimately, customer is king.

# Glossary

|  |  |
| --- | --- |
| AI | Artificial Intelligence |
| AMC | Asset Management Company |
| AMFI | Association of Mutual Funds in India |
| API | Application Programming Interface |
| ASCI | Advertisement Standards Council of India |
| AUM | Asset Under Management |
| BNPL | Buy-Now Pay-Later |
| CASA | Current And Saving Account |
| CBDC | Central Bank Digital Currency |
| CC | Credit Card |
| DLT | Distributed Ledger Technology |
| DSA | Direct Selling Agent |
| FI | Financial Institution |
| FLDG | First Loan Default Guarantee |
| GNPA | Gross Non-Performing Assets |
| GSTN | Goods and Sevices Tax Network |
| HH | Households |
| IVR | Interactive Voice Response |
| JAM | Jan Dhan, Aadhar, Mobile |

|  |  |
| --- | --- |
| KYC | Know Your Customer |
| LSPs | Lending Service Providers |
| MDR | Merchant Discount Rate |
| MF | Mutual Fund |
| ML | Machine Learning |
| MSME | Micro, Small and Medium Enterprise |
| NBFC | Non-Banking Financial Company |
| NFC | Near Field Communication |
| NHS | National Health Stack |
| NTC | New-To-Credit |
| OCEN | Open Credit Enablement Network |
| ONDC | Open Network for Digital Commerce |
| P2M | Person-to-Merchant |
| PPI | Prepaid Instrument |
| QR Code | Quick Response Code |
| SBM | State Bank of Mauritius |
| TReDS | Trade Receivables Electronic Discounting System |
| UPI | Unified Payment Interface |

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