ICRA

NBFC – Digital Lenders

Near-term focus on improving profitability and expanding scale via partnerships

March 2023

Highlights

Digital lenders are expected to grow at a higher rate given their small base compared to the overall NBFC-Retail sectoral growth rate of 12-14% in FY2024

Entities have largely relied on equity funding for their growth in the recent past; share of partnership book would expand in a tightened funding environment

Streamlining of the digital lending business model key for overall performance; steady-state credit loss estimated at 4-6% for the segment

- Digital lending has emerged as a new asset class in the non-banking financial companies (NBFC)* space in recent years. Starting from a small base, digital lenders have seen exponential growth in recent years. While the Covid-19 pandemic was a dampener, they were able to recover much faster than the other segments, from a growth perspective.
- Digital lenders are predominantly focused on consumer (includes personal loans) and small business loans. These loans are generally unsecured in nature and typically of very small ticket sizes and tenors. Consumer loans have ticket sizes ranging from Rs. 5,000- Rs.10 lakhs while business loans are larger (up to Rs. 2 crore).
- Digital lenders have adopted various innovative partnership models, whereby they leverage the strong balance sheets of their partners for loan growth. Co-lending / business correspondent / other partnership arrangements with banks and large NBFCs, which accounted for ~15% of their assets under management (AUM) in March 2022, are expected to increase further, going forward.
- Asset quality performance has been a key challenge for digital lenders, given the modest credit risk profiles of the target consumer segment and the evolving underwriting models. Moreover, the pandemic impacted the performance of these entities in FY2021-FY2022.
- Entities in this space incur significantly higher operating costs compared to other established NBFCs, despite their limited physical infrastructure requirement. Currently, employee and marketing/loan origination costs predominantly account for the high operating costs.
- Entities in this segment are largely rated in the 'BBB' category. While the ratings have been typically underpinned by the comfortable capitalisation, weak profitability and asset quality metrics have been key constraints.
- AUM growth in the past has been supported by sizeable capital infusion. However, with the startup funding environment tightening in recent months, a further increase in co-lending partnerships and improving profitability could become a key focus to reduce the incremental capital requirement to an extent. ICRA expects the segmental AUM to grow at a higher rate compared to the overall NBFC-Retail sectoral growth rate of 12-14% in FY2024.

** ICRA sample of 15 entities; for cases where data is not available, best estimates are used; Dec 2022 numbers, wherever displayed, are on an annualised basis*

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Thank You!