

# Fintech Revolution: A Paradigm Shift from the Traditional Sources of Finance for MSMEs in India

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## ABSTRACT

**Purpose:** This paper aims to identify the factors influencing consumerism due to disruption like COVID 19 or any other natural or man-made calamity.

**Methodology:** The research conducted consists of a qualitative (Primary) and quantitative research based on the questionnaires with consumers followed by an in-depth study of the results along with the secondary research.

**Findings:** This study highlights the various factors affecting the consumer's behavior at any point in time irrespective of the environment. This study also highlights the importance of income and brand-trust as a form of economic and social factors, which plays a major role in consumer's buying behavior.

**Practical Implications:** the researchers or managers will be able to understand are factors that are influencing consumerism so that they can adapt to the situations and respond appropriately.

**Originality/Value:** The study identifies that the consumer's psychology plays a very important role in determining their buying behavior. The economic and social factors are in turn controlled by the external environment.

**Article Classification:** Research Paper

## Keywords

Consumerism, Consumer's behavior, Economic Factors, Social Factors

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## Introduction

Even though MSME sector contributes approximately 38% of the GDP of India, it is still underserved to a large extent. Out of the total commercial lending of INR 64.45 lakh crores in Dec'19 by the financial institutions, the MSME sector share accounted for only 28% of it. As per the Confederation of Indian Industry, there are 63.3 million units of MSME in India out of which 63.05 million units are micro enterprises substantiating to 99.4% of the total MSME units. The number of small enterprises stands at 3.31 lakh units whereas the medium enterprises in India are 5000. It is to our surprise that only 14.31% of them are registered leaving 54.3 million units to be unregistered.

Out of the total debt demand of the MSME sector of INR 88.67 trillion only 20.6% of it is being met by the formal sector i.e. INR 18.3 trillion. The remaining INR 70.37 trillion of debt demand of the MSME sector is being serviced by the informal sector consisting of family, friends, moneylenders and chit fund. The MSMEs prefer informal sector of lending over banks and financial institutions due to easy access to capital and lower turnaround time of disbursal of loan

amounts. This eventually has a credit gap in the debt supply for the MSME sector of INR 28.7 trillion. The major supply and demand side constraints faced by the MSMEs for acquiring loans from the financial institutions are as follows: Demand- side constraints-

1. Information asymmetry- The MSMEs do not maintain the formalized procedure of maintain the books of accounts and there is a lack of awareness among them as to how to procure loans. Usually there is a lot of discrepancies in the report financial data and actual data which makes it difficult for them to approach banks for loans.

2. Existing Debt- The MSMEs have habit of procuring loans from the informal sources at a higher rate of interest and these loans are not disclosed to the financial institutions therefore making it risky for them to lend loans to the MSMEs.

3. Insufficient Collateral- The micro and small enterprises do not have proper and adequate collateral to take loans from the financial institutions. Even if they have collateral, they are not willing to pledge the same with the financial institutions.

Supply- side constraints-

1. High transactional cost – The financial institutions have to incur heavy costs in providing financing to the MSMEs in the form of due diligences, background checks and collections. The small ticket sizes and lower margins further make it an unpleasant scenario of the banks to lend to this sector.

2. Lack of product revolution- The financial institutions have never clearly understood the MSME sector and they have not revolutionized the products to better suit this sector. Offering the same products to MSME sector similar to large corporates with same terms and conditions is what has hindered the success of financial institutions in lending to this sector.

3. Low appetite for risk- In the recent times the NPAs of the financial institutions have been in the higher range especially for the public sector banks. As risk aversion has always been their priority they focus more on medium enterprises over the micro and small enterprises as they have more formalized records and adequate collateral.

4. Outdated underwriting process- The financial institutions still follow the same methods of evaluating the clients and carrying out their credit assessment procedure. The parameters of their evaluation need to be changed over the period of time to better assess the MSMEs.

Here is where the Fintech companies come into the picture. Fintech ecosystem started developing around the globe after the 2008 financial crisis bringing about evolution in the banking and the financial services industry. Fintech companies saw the credit gap for the various sectors in the economy and brought new products and solutions with the use of advanced technologies such as blockchain, artificial intelligence and machine learning together to better serve the customers and increase the penetration of the financial services in the economy. In India, the fintech companies tried to overcome the problems faced the financial institutions in providing the financial services and their journey began in 2013, when Capital Float and Neogrowth started their tech start-ups in India to cater to the customers in the lending sector. Today these fintech companies are no longer start-ups but effectively managed companies who are providing services in number of sectors such as – lending, payments, wealth management, personal finance management, insurance etc. In India, the fintech adoption rate stands at 87% which is much higher than the average adoption rate of 65%.

There are more than 330+ fintech companies focusing on lending. There are a few banks who have also collaborated with the fintech companies to better serve the different sectors of the economy and to dig deeper into the supply chains. The main objective of the report is to analyze the role of fintech lending in the MSME sector and prove the hypothesis that fintech and financial institutions' collaboration is necessary for saving the MSME sector.

### Literature Review

Arner, Barberis and Buckley (2016) depicted the three eras of the evolution of fintech namely - fintech 1.0(1866-1967), fintech 2.0(1967-2008) and fintech 3.0(2008-present). It stated the evolution of fintech began with the discovery of transatlantic cable and by 2007, the growth of fintech was driven by increasing digital footprint and application programming interfaces (APIs). Fintech 3.0 differentiates itself from the previous eras on the terms of speed and the provider of the financial services in the market. Fintech 3.5 is considered to be present in developed countries. It shows how technology companies have moved into the financial world and have tried to use their technical background to eliminate the inefficiencies of the existing financial system. The best example for this is China. It has seen a tremendous growth in the fintech companies turning it into the leader in the fintech market.

Gupta and Xia (2018) stated that China accounted for 49% of the total global investments in fintech market in Asia and that India is on the path of increasing adoption rate of fintech. Reduction in the cost of offering the financial services is a major determinant for the increase in the adoption rate for India. The paper focused on the ASEAN digital industry which generates around 150 billion dollars revenue every year. It's the fintech revolution that has brought upside in the market.

The fintech revolution according to Gomber, Kauffman, Parker and Weber (2018) is ongoing due to three main reasons- abundance of capital for technological innovation, start-ups developing new age technology based financial services and the use of big data analytics to develop business models. Key forces that will need to be assessed from time to time to keep a check on the fintech revolution are innovation, process disruption and services transformation. The fintechs have developed alternate parameters for assessing the

credit assessment of the buyers. This paper as given rise to a series of questions regarding how to value these parameters individually in order to value the business as a whole.

Jagtiani and Lemieux (2018) compared the loans made out by Lending Club, a fintech and other similar loans depicting that correlation between the rating grades given by Lending Club and FICO score fell from 80% to 35% over the years in 2015. This clearly shows that the use of nontraditional data has upgraded those who were earlier not eligible for loans to the category of the eligible borrowers. This paper depicts the one-sided face of the fintech industry by focusing on the positive elements but ignores the problems in online lending and the data privacy concerns one might face in providing the nontraditional data.

The fintech are starting to give the traditional financial institutions a hard time by carving out their own space and reaching even small enterprises. The research paper by Buchak, Matvos, Piskorskia and Seru (2018) has shown that the market share of fintechs in US increased from 3% in 2007 to 12% in 2015 in mortgage lending due to the use of alternate data for determining the interest rates and secondly due to taking their operations online and making them more convenient for the borrowers. Fintech lenders are charging 14-16 basis points higher than the normal interest rates for providing the convenience to the borrowers. The traditional banks have lost their market shares to the hands of fintechs. The paper cautions one against its normative interpretation. Another reason which has not been looked it into is the strict regulatory regimes followed by the banks which are responsible for the growth of fintechs.

Anand and Mantrala (2019) laid down 4 different scenarios for adoption of fintech technologies by the traditional banks to survive on the basis of the perceived level of fintech entrant’s technology centered business model innovation threat and perceived level of fintech entrant’s market centered business model innovation threat.

		Perceived level of Fintech entrant’s technology-centered business model innovation (BMI) threat	
		Low	High
Perceived level of Fintech entrant’s market-centered business model innovation (BMI) threat	Low	1: HOLD	3: ALLY
	High	2: MAKE	4: BUY or EXIT

Figure 1- Different scenarios of adoption of fintech

In the case of both the BMIs being low, there is no immediate threat and the financial institutions shall continue carrying out their existing strategies. In the second scenario where the, market centered BMI is high, the financial institutions should make strategic investments to keep themselves from losing their customer and the lower fintech centered BMI shows that it has alternate options to stop the threat of losing customers. The third scenario demands for an ally between the financial institutions and the fintechs as the customer trust their banks but the disruption caused by the fintechs can lead to a shift in the customer preferences. The financial institutions do not have enough resources to harness the same technology used by the fintechs, so it leads to an option of forming an alliance or partnership. The fourth scenario is the one with double threat and it calls for a buy or an exit action. The financial institutions can only survive such a situation by either buying out the entrant or just dropping out that particular domain from their portfolio. Currently, India and many other emerging countries are in the third scenario. In India the growth in the telecom industry and multi-fold increase in the mobile and internet connections have been the backbone of the fintech market. As per Srinivasan and Karanam (2019) digital revolution, Aadhar, GST network, Indian stack, cheaper information connectivity and access and low-cost cloud infrastructure have been the driving forces enabling the fintechs to disrupt the financial services market. Majority of the financial institutions in India are looking to partner with the fintech. MSMEs majority of which are unregistered are now financially included in the system through the help of fintechs. The penetration rate of mobile connections in India has acted as a catalyst for Fintech’s wildfire.

Although they have a lot of positive outcomes, there are still certain challenges that they face. Anusha and Priya (2019) have summarized these challenges to the following: - restrictive regulation policies, preference for cash transactions, lack of security and increased number of frauds on online platforms and lack of government support.

All of the above presented reviews, clearly point towards a collaboration between fintech and financial institutions shall enable both the parties to leverage each other's pros and act on mitigating and eliminating their shortcoming. By creating an environment of mutual help, together they can increase the Market size of the financing Industry.

### RESEARCH METHODOLOGY

An external secondary data research has been carried out including the reports from by NASSCOM, PWC, KPMG, Mckinsey, EY and BCG on the evolution of fintech in India over the years. RBI press releases, statements and CIBIL reports have also been analyzed to understand the gaps in the MSME sector which are being catered to by the fintech companies. The reason behind focusing on particularly these reports was that such reports had been created by industry professionals and leading consulting companies. These reports were based on the government released data and as well as on the basis of the surveys conducted by them across India and abroad.

It stated the evolution of fintech began with the discovery of transatlantic cable and by 2007, the growth of fintech was driven by increasing digital footprint and application programming interfaces (APIs). Fintech 3.0 differentiates itself from the previous eras on the terms of speed and the provider of the financial services in the market.

In order to select the publications to be included in the review, publications were identified through Boolean search in the Scopus database. The publications with the word Fintech and lending in their abstract, title and keywords were searched for. Out of the 117 records, the records which were cited for the greatest number of times were taken into consideration. Out of these only those publications which focus on lending to SMEs were considered. The asterisk sign was used include the variations of terms as well. Few other publications focusing on Fintech sector in India have also been included in the review.

In order to select other credible reports for research purposes, the publications from the top consulting companies as well as Industry majors on the MSME sector and the evolution of fintech were taken into the consideration.

### DATA ANALYSIS AND FINDINGS

Fintech sector set its foot in India in 2013 when Neogrowth and Capital Float starting the digital lending business. The period from 2015-2018 was a crucial one for the fintech industry. The alternate lending segment saw a growth in the funding from USD 21 million to USD 537 million. The fintech market in India is now divided into three parts-SME lending, consumer lending and online lending platforms. Unlike the SME and consumer lending platforms the online lending platforms act as aggregators. Paisabazaar.com can be considered as the Amazon of lending market in India. India's fintech sector stood at USD 65 billion in 2019 and is expected to reach USD 140 billion by 2023. The payments segment is the largest in the fintech industry followed by the alternate lending segment. There are 457 start-ups in the alternate lending segment in India. From 2015 to Q1FY2020, the fintech lending segment witnessed funding worth USD 1.695 billion. India is just second to China in the number of fintech startups and funding value.

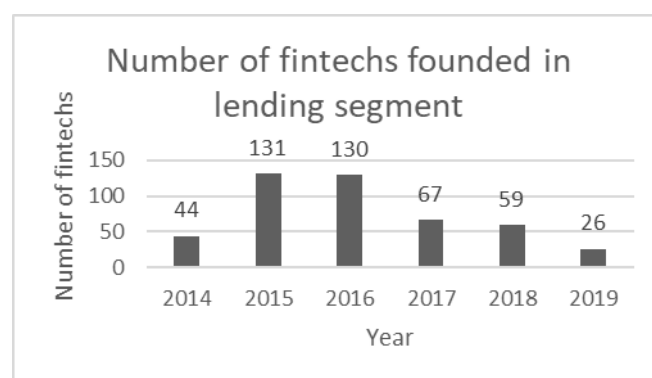


Figure 2: Number of fintechs founded in lending space over the years

(Source: India Fintech Report 2019: MEDICI)

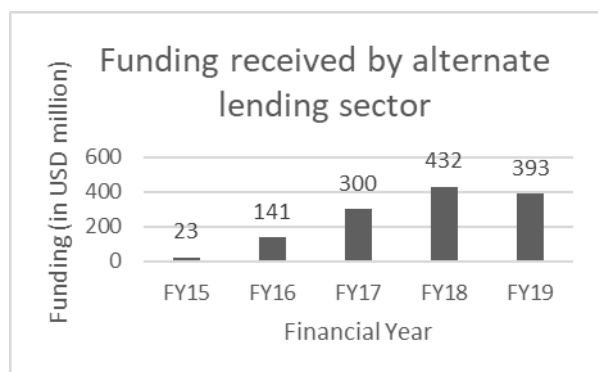


Figure 3: Funding received by fintech lending sector over the years

(Source: India Fintech Report 2019: MEDICI)

The main driving forces behind the increased adoption rate of fintechs in India have the increased internet penetration in India which as of May 2020 is estimated to be 573 million and the increased awareness among the customers. They key business models that have been operating under alternate lending are as follows:

1. P2P Lending – It aims at developing a digital platform to bring together individual and organizations borrowers and lenders. It enables the borrowers to acquire loans at a lower possible cost. P2P is still at a nascent stage in the SME sector as compared to the consumer sector. In India, P2P lending is not that popular due to lack of clarity on the regulations applicable to it. It acts as a medium for the MSMEs to get loans at a cheaper rate than the market rate and for the investors who want to earn more than the prevalent bank FD rates. The investors have the benefit of getting monthly interest as well. The Indian P2P market stood at USD 29 million.

2. Invoice Financing – It enables the MSMEs to meet their short-term borrowing requirements by getting advances against their unpaid customer invoices or accounts receivables. MSMEs find it easy to get their invoices discounted and receive early payments to meet their working capital needs. The government has set up TReDS (Trade Receivables Electronic Discount System) to make sure that the MSMEs get a recognized platform for getting their invoices financed. It has been made mandatory for companies with turnover of USD 70 million to register on the platform. Currently MSMEs discount approximately USD 140 million worth invoices per month to meet their short-term needs.

3. Crowdfunding – This model creates a tech-based platform allowing an organization or an individual to pitch their project to a number of investees and raise an external debt by depicting before them the market potential and the future income projections of the project. In India platforms like Milaap and Rang De have provided the crowdfunding platform to the farmers and the rural MSMEs to get them in touch with more relevant audience depending upon the projects they are pitching for. In India, still MSMEs find it difficult to raise funds through this platform as there are no proper guidelines from RBI in this regard.

4. Pay Later Loans – The pay later loans model was pioneered in India by companies such as Lazypay and Redcarpet. These companies enable the individuals and MSMEs for short term credit needs for instant purchases. The model enables each individual to get a particular credit limit based on KYC details of the client, post which one can shop on more than 100+ platforms, free of interest for a period of 2 weeks after which the interest is charged. MSMEs use this model only for low amount immediate purchases for administration purposes. This model is more prominent in the individual consumer segment.

5. Mobile Lending – In this business model the fintech aims at advancing loan to the customers on the basis of the credit assessment being done by leveraging the mobile data of the user and their history of digital transactions. The fintech Capital Float launched an application called walnut, which once installed scans through mobile's business transactions and on the basis of that set up your upper credit limit and interest rates. This is least trustworthy model for the clients as they believe in privacy and do not one to go through their conversations.

6. POS Lending – It stands for Point of sale lending business model. In this scenario the fintech leverages the swipe data from the point of sales machine to estimate the monthly business and the cash flows of the MSMEs from the customers and then on basis of this data they are offered financing at varied interest rates depending on case to case. The seller's data on e-commerce platforms and from the swipe machines serve as the parameter for the credibility check of the business. POS industry in India stood at USD 236 million in 2016 and is expected to continue to grow at a rate of 11% per annum till 2022.

7. Supply Chain Financing – It is the most sought-after business model by the MSMEs. Fintechs in this model tie -up with the corporates to help fund the different nodes in their supply chain – dealers, distributors and suppliers. This facility is preferable for the MSMEs dealers and distributors as they can avail financing at a much lower cost as compared to the normal market lending rates without even having to pledge their collateral. This makes it lucrative for all the parties in the supply chain to rely on the channel facility for financing. The various products of supply chain financing are cash credit, invoice and bill discounting, purchase order financing, factoring etc.

There are a significant number of prominent fintechs operating one or the other business models discussed above.

P2P Lending	Invoice Financing	Crowd-funding	Pay Later Loans	Mobile Lending	POS Lending	Supply Chain Financing
Faircent	KredX	Rang De	Lazypay	Flexiloans	Pine labs	Capital Float
Finzy	Flexiloans	Milaap	Redcarpet	SalaryDost	Neo growth	CredAble
PaisaDukan	InCred	Ketto	Simpl	Credit Mantri	Razorpay	Vyana network
Monexo	Mudra Circle	Crowdera	Slice	Phocket	Instamojo	Mintifi

Figure 4: Prominent fintech players in India (Source: India Fintech Report 2019: MEDICI)

Fintechs particularly focused on the pain points of the conventional lending and provided to the users with a better solution. They made the use of a number of technologies to overcome the problems in conventional lending. This is the reason they are called fintechs as they made an attempt at blending the provision of financial services with technology to better serve the users. The technologies which they utilized in disbursing the financial services are as follows:

1. Blockchain – According to the PWC global blockchain survey, blockchain is majorly being used into the financial services sector. Blockchain brings to the table the distributed ledger system which helps fintechs to not only reduce their infrastructural costs but also helps them in deeper integration with all parties in the supply chain. Maintaining a transparent record of all peer to peer transactions is the main feature of the blockchain which has enabled it to be used for

KYC and to prevent money laundering. Fintechs can make smart contracts with the parties with the help of blockchain, which executes itself if everything is found to be in order, thereby reducing the processing time for financing. By using blockchain the parties remain in check for the fintech companies and on real-time basis they can evaluate the credit-worthiness of the parties. Monetago, a start-up, has helped the TReDS platform to be blockchain-enabled.

2. Artificial Intelligence and Machine Learning– The MSME sector has suffered a huge credit gap because there are no customized products for the MSMEs. Same set of rates of interests and time periods available to large corporates is not suitable for micro and small enterprises. Artificial Intelligence takes this into consideration and helps the fintechs in better decision making and provides customised solutions for the users. AI helps in a better process of credit underwriting, thereby deviating from the traditional parameters of underwriting. AI helps in fraud management by flagging all the suspicious transactions after evaluating more than 200+ parameters. With the help of AI, the fintechs can target a specific set of relevant customers for their products by tracking their digital footprints. Nowadays every fintech company has their own virtual AI assistant to help the customers with all the queries they have. Predictive analytics helps in assessing the ability and the willingness of the customers to pay back.

Machine learning is a subset of Artificial intelligence which acts as a live algorithm. Financial institutions can develop a model backed by AI and ML which may use factors such as industry, location, rate of discount acceptance and rejection in such industries. With more and more data, it does a better benchmarking and determination of optimum rates of discounting. Machine learning can forecast the likelihood of a purchase order or invoice being approved and signed off and how long that process will take. That means the risk level of each invoice can be calculated instantly and accurately.

3. Robotic Process Automation – RPA involves the usage of software robots for the automation of workflow processes eventually leading to a reduction in the man-hours spent in performing the repetitive tasks. In this fast-moving world, everyone wants to save time and money, RPA helps the fintechs in meeting both

the criteria by making the loan processing exercise more efficient and reliable. RPA have the capability of reducing the loan underwriting processes to a mere 15 minutes by streamlining the processes and also eliminate the human errors by automatically matching the KYC details with different authorized parties' portals.

Integration of such technologies has enabled the fintechs to eat into the share of the financial institutions. The traditionally cash-driven Indian economy has responded well to the fintech opportunity. As per the EY global fintech index 2019, Mumbai and Delhi were ranked 10 and 16 in the global top 20 fintech hubs. Certain initiatives and steps taken by the government have helped the fintechs to up their game. Government's moves to bring India to the front foot of Digital economy have been acknowledgeable. Introduction of Aadhar and their compulsory linking with the bank accounts have helped the fintechs into accessing the biometrics records and easily conduct e-KYC processes. Over the years there have been 1.2 billion enrollments for Aadhar recognition. Aadhar enrollment has enabled the e-signing processes cutting down the loan disbursement time considerably. The Goods and services tax network (GSTN) have served as a new data source for fintechs to access the loan applications. GST regime has been difficult for the MSMEs. The implementation of GST had made it difficult for the MSMEs for the transformation but it has opened the doors to a multi-dimensional assessment of data for the fintechs. GST data keeps a transparent record of all the sales and purchase invoices making it more relevant than the traditional credit score to provide financing especially to the MSME industry. Fintechs have used GST data as new parameter for assessing the credit-worthiness of the MSMEs.

Indian stack is the digital infrastructure created by the government. It has a set of APIs that helps in linking the consumers, producers and the lenders. It has four different layer – presence less layer, cashless layer, paperless layer and consent layer. Using the Indian stack, fintechs have been prominent in making financing available to even those MSMEs which earlier could not afford financing on the basis of their credit score.

### **DISCUSSION AND FINDINGS**

Due to the lockdown announced by the government in the month of March and April to

curb the covid-19 wave, MSME sector has been hard hit with negligible savings to fall back on. With the businesses being shut, micro enterprises have been most affected. Their fixed costs are large enough to force them to operate in loss making conditions. They do not have much credit backing to support their businesses. Where legend companies such as Atlas cycles had to shut down even their last factory as they couldn't survive this lockdown, the future for the MSMEs doesn't seem bright. Even with the deferred installment payments, the MSMEs are facing problems of outstanding wages and creditors.

The finance Minister came out with a relief package for MSMEs under the Atmanirbhar scheme trying to give a boost to the sector. As a part of the scheme, the government announced the following benefits for the MSMEs to curb their hindrances due to Covid-19: -

1. Change in the definition of MSME for increasing the scope of micro, small and medium enterprises.
2. INR 3 Lakh crores collateral free loans. Borrowers up to INR 25 crores outstanding and INR 100 crores turnover can avail these loans for a tenure of 4 years with moratorium of 12 months on principal payment. It will help 45 lakh units.
3. INR 20,000 crores subordinated debt for stressed MSMEs. INR 4,000 crores to be given to CGTMSE. Banks will give debt to promoters of MSMEs to infuse as equity in the units. It will help 2 lakh units.
4. INR 50,000 crore equity funding of the MSMEs through Funds of Funds having a corpus of INR 10,000 crore.
5. Global tenders will be disallowed in government procurement tenders up to INR 200 crore.
6. Moratorium for 3 months on payment of installment and interest.
7. E-market linkages for MSMEs.

All these initiatives will help in increasing the liquidity for the MSME sector but the pace at which the implementation of the package is taking place is too slow. Till June 15,2020 only 5% of the relief package has been sanctioned. Out of the sanctioned amount of INR 17,000 crores only INR 10,000 crores have been disbursed yet. With the pace at which the execution is taking place, there is a chance that 50% of the MSME units might shut down, till the time they are able to get the financial support.

In such unexpected scenarios, a potential collaboration of the financial institutions and fintechs can help in better serving the MSME sector and prevent the shutting down of the MSMEs. All the above presented research papers depict the trend and the need for a collaborative environment between fintechs and financial institutions. As discussed by Anand and Mantrala (2019), the perceived level of fintech entrant's technology centered business model innovation threat is high and the perceived level of fintech entrant's market centered business model innovation threat is low at this time in the Indian market, making it a perfect opportunity for the financial institutions to ally with the fintechs. A collaboration between the two, can help in leveraging each other's positives and eliminate the negatives.

Fintech lenders are more focused on developing customized products and increasing the access to the finance especially for the unorganized MSMEs. Fintechs are adopting cutting-edge technologies such as open API (artificial programming interface), big data analytics that help them to cater to the unorganized sector by providing tailored products to their customers. Despite offering better financial services and benefits to the MSME sector, there still exists a trust gap between the Indians and the fintech market. A global survey by EY proves the trust gap; 47% of the respondents preferred in subscribing to the service of the fintech companies if they are in partnership with a traditional financial institution. This trust gap has led the disruption caused by the fintechs in the lending sector to be on a slower pace than in the other sectors. The financial institutions have the trust of the customers and they constant flows funds which makes them the strongest party to lend. The huge customer base which the financial institutions have acquired over the years, is what fintechs are prying on and a partnership between the two can serve each other's purposes.

There is a trend among the fintech companies as to compete with the financial institutions and not to collaborate. For this purpose, they have been actively applying for the non-banking financial company (NBFC) license which takes at least a year to bring the services to the customers as a NBFC. By partnering with a financial institution, the fintechs can reduce the market rate time by

50% and bring the timeline down to 6 months to launch their products in the market.

Financial Institutions	Fintechs
Provides conventional and standardized financing products	Providing customized innovative financing products
Use of such technologies is negligible	Use of technologies such big data analytics and blockchain
Parameters used for credit assessment- credit score and the books of accounts	Parameters used for credit assessment- GST returns, psychometric tests, Mobile data, SMS data, social media handles
Trusted by majority of the people over fintechs due to a higher year of experience.	Trust gap faced by fintech as they are new in the market
Huge customer base acquired over the years.	A small customer base
Their constant source of funds are the huge deposits with them in CASA accounts.	Have to borrow fund from NBFCs and banks to lend it further.

Figure 5: Comparison of the financial institutions and fintechs' lending business

This research paper throws light on the fintech and financial institutions collaboration benefits for the micro, small and medium segment, which has been missing in the previously published research papers in this segment. A collaboration between the two competitors shall help the government to meet its goal of saving the MSME sector from the black swan.

As per the EY global survey, by the end of year 2020, the traditional financial institutions are projected to lose approximately 28% of their business to the fintechs. But due to disruptions caused in the MSME sector, fintechs and financial institutions are going to face an increased rate of Non- performing assets (NPAs). Rather than being competitive, both of them should look at collaboration, benefitting all the parties. There are different forms available to the financial institutions in the way they can ally with the fintechs. The following are the different routes that can be taken:

1. Investment – In this route, the financial institutes directly invest their own capital into the fintech start-ups. Usually the financial institutions carry out such investments through their investment arms. Although there remains a high risk that the third parties might mismanage the confidential data of the customers, the financial institutions get an early access to the innovative products and their timeline to enter the market also cuts down.
2. Collaboration – The collaboration between the financial institutions and fintechs can be for achieving different goals. Collaboration can be in the form of a partnership or a joint-venture to develop a market place digital platform to connect

with the customers or collaboration can also to be share their technical know-hows and work together in developing new technologies and solutions. Sometimes there can be referral arrangements in P2P space where banks suggest certain fintechs where they are not able to lend due to constraint of banks policies. It benefits the financial institutions as they can get access the cutting-edge technologies used by the fintechs. This route prevents the financial institutions to make a large investment in one go and can still reap the benefits.

3. Mergers and Acquisitions – By acquiring a fintech, the financial institutions can cut short the entry time into the market to negligible. The banks do not have to spend time in developing the technologies and finance products. By making an acquisition, the financial institutions can increase their digital footprint. It enables them to acquire new customers and provides the opportunity to cross sell. But as per the EY global survey, majority of the financial institutions do not follow this route, as it involves a huge amount of capital and at the same time there is no clarity on the valuation of the fintech.

4. Joint Fintech program – In this route the banks do not get exclusivity. The fintechs in this model, partner with a number of banks and venture capital funds and provide their services with the help of resources provided by the different partners. It is not such an attractive option for the financial institutions as they have to share the ROI with other partners thus leading to small profits. But they benefit on the side of investment needed to be made on the front in the fintech.

5. Lead Fintech program – This route is similar to the joint fintech program, the only difference is that one of the financial institutions can be the leader of all the concerned partners. The leader bank has the option to set aside certain privilege deals for itself and develop the partnership on exclusive terms. The lead always has the first mover advantage in using the innovative products. All of the above comes with an extra cost that the lead bank has to bear in the form of program manager fees, training logistics, resourcing the program cycle etc.

### CONCLUSION AND SUGGESTIONS

The current pandemic situation has just increased the difficulties of the already slowing down MSME sector. Over the years, MSME

sector has faced a shortage of the supply of adequate financing due to the lack of adequate collateral, improper books of accounts and asymmetry in the information about the loans already procured by them from the informal sector. Major portion of the MSME sector has remain unregistered and has not been able to access the financing facilities from the financial institutions. Fintechs have been trying to fill the credit gap in MSME lending by using a set of their own new parameters for evaluation of the credit-worthiness of the customers. They make the use of big data analytics, blockchain, artificial intelligence, machine learning and robotic process automation to analyze the behavioral patterns of the customers by studying their GST returns, psychometric tests and social media handles. They have shifted from the traditional parameters of credit score. This has enabled them to go deeper into the MSME sector and provide financing to those who earlier were not eligible for loans.

The Fintechs have seen an increased interest from the customers due to their new customized innovative products suitable for the customers. There has been an increased investment for the fintechs especially in the payment and the lending sector over the last five years. The government initiative of developing a four-layer Indian stack has come in handy for the fintech companies to fully implement their products with ease and the implantation of Goods and Services Tax has enabled them to get a verified copy of sales and purchases of the MSME clients. Even after all these advantages the Indians lack trust on the part of the fintech market. They still believe in the traditional banks to be more secure and safe. The financial institutions have the advantage of higher year of experience and large customer base acquired over the years.

Due to the current covid-19 scenario, it has become difficult for the MSMEs to survive and the Atmanirbhar scheme launched by the government shall not be enough to save the MSMEs because they pace at which it is being implemented, half of the MSMEs might have to shut down the businesses due to high fixed costs.

Partnership between the financial institutions and the fintechs is necessary to fill up the credit gap with an increased pace. By forming an

alliance, both of them can leverage each other's advantages and eliminate the pain points in lending. One of such partnership has been between Tata capital and capital float to co-lend to the MSMEs. The financial institutions have different routes which they can take to partner with the fintechs- investment into fintech startups, collaboration with fintechs for developing a digital platform. Collaboration for developing technologies together, Acquisition of an existing fintech company, be a part of a joint-fintech program or become a leader bank on lead- fintech program. These processes of co-lending by partnering can help in saving the MSMEs to a great extent.

### LIMITATIONS

This research paper is based entirely on secondary research. No primary research in the nature of face-to-face interactions could be conducted because of the Covid-19 country-wide pandemic, with the social distancing norms having prohibited any visits to banks or financial Institutions.

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