



Making financial services work for India's Next Half Billion

Roopa Kudva, Amol Warange and Siddharth Nautiyal



Index

- 1. The financial lives of the “Next Half Billion” (NHB)*
- 2. Small businesses – a growth engine short on fuel*
- 3. Improving the usage of formal financial services across NHB and MSMEs*
- 4. Promoting financial health*
- 5. Entrepreneurs reimagining business models*

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The Indian financial services industry has made great strides in the past decade. Impressive progress in improving access to formal financial services through bank accounts and an efficient, low-cost digital payments infrastructure has made India a beacon globally for financial inclusion. However, the industry continues to largely serve the urban, richer India and driving usage amongst India's "Next Half Billion"* continues to remain a challenge. The small business segment too continues to remain underserved by formal financial services.

The financial lives of the "Next Half Billion" (NHB)

As studies around the world have shown, the financial lives of lower-income populations are complex. Consumers make multiple decisions daily to manage their limited income and to stretch it to meet their needs. They seek flexible solutions that balance their need for flow (availability of cash as needed) and illiquidity (simple barriers to prevent withdrawal of any savings for discretionary purpose). Thus, they turn to expensive informal financial channels, mainly for short term borrowings.

Unsurprisingly, the Report of the Household Finance Committee (2017) constituted by Reserve Bank of India found that Indian households have less than 5% of their wealth in financial assets and insurance penetration is very low. There is also a high incidence of non-institutional debt, suggesting that households are dealing with emergencies and risks through high cost borrowings ex-post as opposed to proactively saving or insuring against risks.

Small businesses – a growth engine short on fuel

There are between 55 and 60 million micro, small, and medium-size enterprises (MSMEs) operating in India today. Collectively, MSMEs employ more Indians than any other sector except for agriculture, and over the last decade have contributed roughly one-third of India's GDP. Yet this contribution remains well below its potential - this sector can be an even more powerful growth engine for India's economy.

A significant barrier to growth has been the lack of access to formal credit. In 2018, MSME credit demand was estimated to be INR 45 L Cr (\$600 billion). Roughly 40 percent of this demand is served by the informal sector, where interest rates are at least twice as high as the formal market. An additional 25 percent of MSME borrowing is invisible—through personal proprietor loans (rather than business loans), demonstrating the shortcomings of the formal credit system.

Improving the usage of formal financial services across NHB and MSMEs

Our work with entrepreneurs and their customers and the research we have conducted has underscored the need to overcome the following barriers to usage of formal financial services:

For consumers: Demand side impediments include lack of trust in formal service providers, low consumer self-confidence in engaging with them, need for flexibility (moving seamlessly between short-term and long-term financial needs), high transaction costs and procedural impediments like paperwork and the need for multiple interactions with providers.

For formal financial institutions: Supply side challenges include lack of an easy customer discovery process, lack of underwriting capabilities for consumers/ businesses with inadequate income records and income volatility, legacy high cost structures that make servicing low ticket/ high volume business financially unviable and lack of unified framework or guidelines to provide high quality and low cost financial advice.

Promoting financial health

We also believe that the focus has to shift from just access and usage of financial services to financial health i.e. business models that have a positive impact on consumer financial health. For example, consumers should be able to use financial products and services to –

- save more
- manage liquidity shocks better
- smoothen out less predictable incomes
- manage/ cover risks more efficiently
- have a greater control on their finances

Fintech business models should enable consumers to be financially resilient and pursue income and utility enhancement opportunities at the same time.

Entrepreneurs reimagining business models

In the past few years, nimble fintech firms have emerged that leverage public data platforms (such as India Stack) and seek to serve the NHB and small businesses with low-cost low-ticket financial solutions. Fintechs use alternative/ surrogate data for credit underwriting and unbundle and re-bundle financial products that are delivered to the consumers digitally or through tech enabled distribution chains.

At Omidyar Network India, we have thoughtfully constructed our financial services portfolio backing tech led Companies that seek to improve the financial health of the NHB and MSMEs.

The table at the end highlights how our fintech portfolio of 17 start-ups¹, built alongside our global partner Flourish Ventures, has designed pioneering business models that address the usage barriers mentioned above and promote financial health.

Going forward, we will continue to back tech led models across digital/neo-banks, insurance, wealth management and liquidity management serving the NHB.

Similarly, we will continue to back businesses serving the MSMEs which are the main source of employment for the NHB. We will look for business models that serve the MSMEs across their credit needs, MSME neo-banks, and embedded finance plays i.e. business models that offer tools to MSMEs to improve their business efficiency and at the same time generate digital trails/ data that will enable the MSMEs to access formal financial markets in the future

Apart from making investments in business models that will directly serve the NHB and MSME segments, we will also continue to invest in companies that are creating market infrastructure that can be leveraged by both incumbents and new age fintechs.

With a specific India focused capital allocation, we are excited to invest in the growing fintech market in India and look forward to supporting innovative business models that will take mainstream finance to the masses.

¹ 13 investments made jointly by Omidyar Network India and Flourish Ventures. 4 investments (Varthana, Sewa Grih Rin, Swarna Pragati and Credenc) made solely by Omidyar Network India

| Segment & its impact on financial health | Lack of Trust | Flexibility | Procedural impediments | Lack of easy customer discovery | Inadequate information for underwriting |
|--|---------------|-------------|------------------------|---------------------------------|---|
|--|---------------|-------------|------------------------|---------------------------------|---|

Small Business Finance:
Promotes income enhancement opportunities

| | | | | | |
|-------------|---|---|---|---|---|
| NeoGrowth | | ● | ● | | ● |
| Indifi | | ● | ● | ● | ● |
| Vistaar | ● | | ● | | ● |
| Varthana | ● | ● | ● | | ● |
| IntelleGrow | | | ● | | ● |
| Bon | | ● | ● | ● | ● |

Consumer Finance:
Helps manage liquidity shocks

| | | | | | |
|----------------|---|--|---|---|---|
| Zest | | | ● | ● | ● |
| Swarna Pragati | ● | | ● | | ● |
| Sewa Grih Rin | ● | | ● | | ● |

Insuretech:
Helps cover risks efficiently

| | | | | | |
|-----------|---|---|--|---|--|
| Toffee | ● | ● | | ● | |
| GramCover | ● | | | ● | |

Savings:
Enables to save more

| | | | | | |
|------------|--|---|--|--|--|
| Scripbox | | ● | | | |
| Affordplan | | ● | | | |

Neo Banks:
Enables greater control on finances

| | | | | | |
|------------|---|---|---|---|---|
| Kaleidofin | ● | ● | ● | ● | ● |
| Yelo | ● | ● | ● | ● | ● |

*refers to the 500 million Indians expected to come online through their mobile phones over the next few years mainly from the lower middle income and low income segments