FINANCIAL SERVICES FOR THE MASSES

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Summary

Mature economies have a highly penetrated financial services industry that acts as a backbone for its growth, by bringing in most of the population under the financial umbrella. India's promise of its growth story is dependent significantly on creating a similar platform for its masses.

Initiatives like Jan Dhan Yojna and Demonetisation have pushed India towards financial inclusion in a big way - 80% of adult population has a bank account in 2017 compared to 35% in 2011. Despite rapid growth in banked population, penetration of financial products remain low in India—

→ **13% credit to GDP ratio** - *China 49%, US 78%*
→ **3.5% insurance penetration** - *China 4.6%, US 7.1%*
→ **1.5% population invests in equity** - *China 10%, US 18%*

Most of the financial products and services today are targeted towards top of the income pyramid. Driving penetration beyond that will require reimagination of products and services through technology as well as alternate modes of reach and influence. The key factors that are proving foundational to India's Fintech revolution are - digital infrastructure creation (Aadhar, UPI, National Automated Clearing House etc.) and policy impetus by the government.

Coupled with these drivers, digital adoption of financial services will be aided on the demand side by rapidly growing digitally active user base. India will have 850M digitally active consumers by 2025, 70% of them will be millennials and gen Z who prefer digital as a medium to consume products and services. Fintech will be a large market opportunity that will create many winners.

Fintech Revolution– Finance for All

Historically, financial services sector has been the backbone for any country's growth. Top 6 out of 15 largest companies by market cap in India are financial services companies, highest of any sector. This is despite having one of the lowest penetration of financial products in the world. With India's growth will come the large financial services opportunity, and technology led disruption will be at the core of this opportunity.

Rapid Rise in Banked Population

Though India's banking penetration has historically been marred by slow progress, the last few years has seen a visible uptick, spurred by a combination of digital, regulatory, and infrastructural development.

35%
Adults with Bank Account (2011)

80%
Adults with Bank Account (2017)

Between 2011 and 2017, banking penetration among individuals above the age of fifteen grew from a mere 35% to 80%, bringing it on par with China.

Financial inclusion has been growing heavily through the Jan-Dhan initiative. The initiative has created 310M new deposit accounts throughout India. Demonetization has been another strong driver, contributing to 15% penetration of bank accounts from 2016 and 2017.

Having large banked population is a the first step in the direction towards financial inclusion, but India has a long way to go as far as penetration of financial products is concerned.

Poor Financial Products Penetration

Despite rapidly growing banked population, financial product penetration has lagged.

13%
Credit to GDP ratio ***(China 49%, US 78%)***

3.5%
Insurance penetration ***(China 4.6%, US 7.1%)***

1.5%
Population invests in securities ***(China 10%, US 18%)***

In the 10 years between 2007 to 2017, India's household credit to GDP ratio flatlined from 10% to 13% whereas China's grew from 19% to 49%. The corresponding figure for the United states in 2017 stands at 78%. Moreover, only 8% of the top Indian households account for 70% of this credit. Most of India still relies on informal, unsecured sources of credit, often triggered by life events or contingencies.

Insurance penetration also remains low, with both life (2.7%) and non-life (0.8%) insurance to GDP falling well short of global averages (3.5%, 2.8%).

Less than 1.5% (<18M) of the population invest in securities, compared with almost 10% in China and 18% in the U.S. Other savings products like pension and debt also show similar levels of under-penetration.

Given the precedent of increasing financial inclusion, financial product penetration can be expected to follow suit, supported by changing customer behaviour, digital infrastructure and policy impetus. Financial institutions are today reimagining their products to suit the various customer clusters that has entered the ecosystem, with varying degree of digital maturity and financial stability.

Tailwind for Massive Fintech Opportunity

As far as the consumer behavior in context of financial services is concerned, India today presents many customer clusters with varying preferences. The same household may present a 70 year old who still prefers to visit the bank branch to check his account balance and does not trust ATMs or smartphones, a young student who likes to avail INR 40,000 loan to purchase a new smartphone from the comfort of his home, and a servant maid who is paid her salary through a digital wallet.

By 2025, 80% of India's working population age will be millennials or gen Z with strong preference towards digital channels for consumer products and services. Thus it is expected that there will be a huge demand for digitally enabled financial products and services.

This is possible if the supply side constraints to digitally onboard and serve the customers for these financial products and services are solved effectively. Currently, there are strong tailwinds in that direction in the form of–

- → Unprecedented pace of digital infrastructure creation
- → Policy impetus by government to enable Fintech

These drivers are expected to catalyze massive Fintech opportunity for India.

2017

Digital Payment
$186B
Digital Transaction Value

Digital Lending
$75B
Loans Disbursed

Wealth Management
$10B
Capital Invested Digitally

InsuranceTech
$2.4B
Premium Paid Digitally

2025

Digital Payment
$1.1T
Digital Transaction Value

Digital Lending
$650B
Loans Disbursed

Wealth Management
$75B
Capital Invested Digitally

InsuranceTech
$16B
Premium Paid Digitally

Digital Infrastructure

With increased adoption of smartphone and internet, consumers are becoming increasingly comfortable with digital mediums to access and explore products & services. While increasing number of consumers are using digital medium to access the bank account, sufficient digital infrastructure did not exist till recently to digitize the complex financial use cases like – onboarding customer with KYC, underwriting the credit, or making merchant payments. Earlier, even a simple activity such as verifying identity of a consumer required manual intervention. This changed with the creation of 1B+ digital identities of Indians through AADHAR, and today digital onboarding the consumers can happen within minutes. This in turn brought down the cost of customer acquisition by 80%. However, following Supreme Court's verdict in September 2018, eKYC for private institutions has been put on hold. Further, with the advent of UPI most of the money transfer transactions is digitally enabled and triggered on the smartphone.

1.2B
Aadhar numbers

400M
Monthly UPI transactions

UPI is the first ever government created initiative in the world that has democratized the payment infrastructure without needing any intermediator networks (Visa, Mastercard). It allows direct account to account transfer for both C2C (consumer to consumer) and C2M (consumer to merchant) cases. Instead of paying Merchant Discount Rate (MDR) of 0.9-2%, merchants are now only levied flat fees of INR 3 per transaction, without having to invest into POS machines.

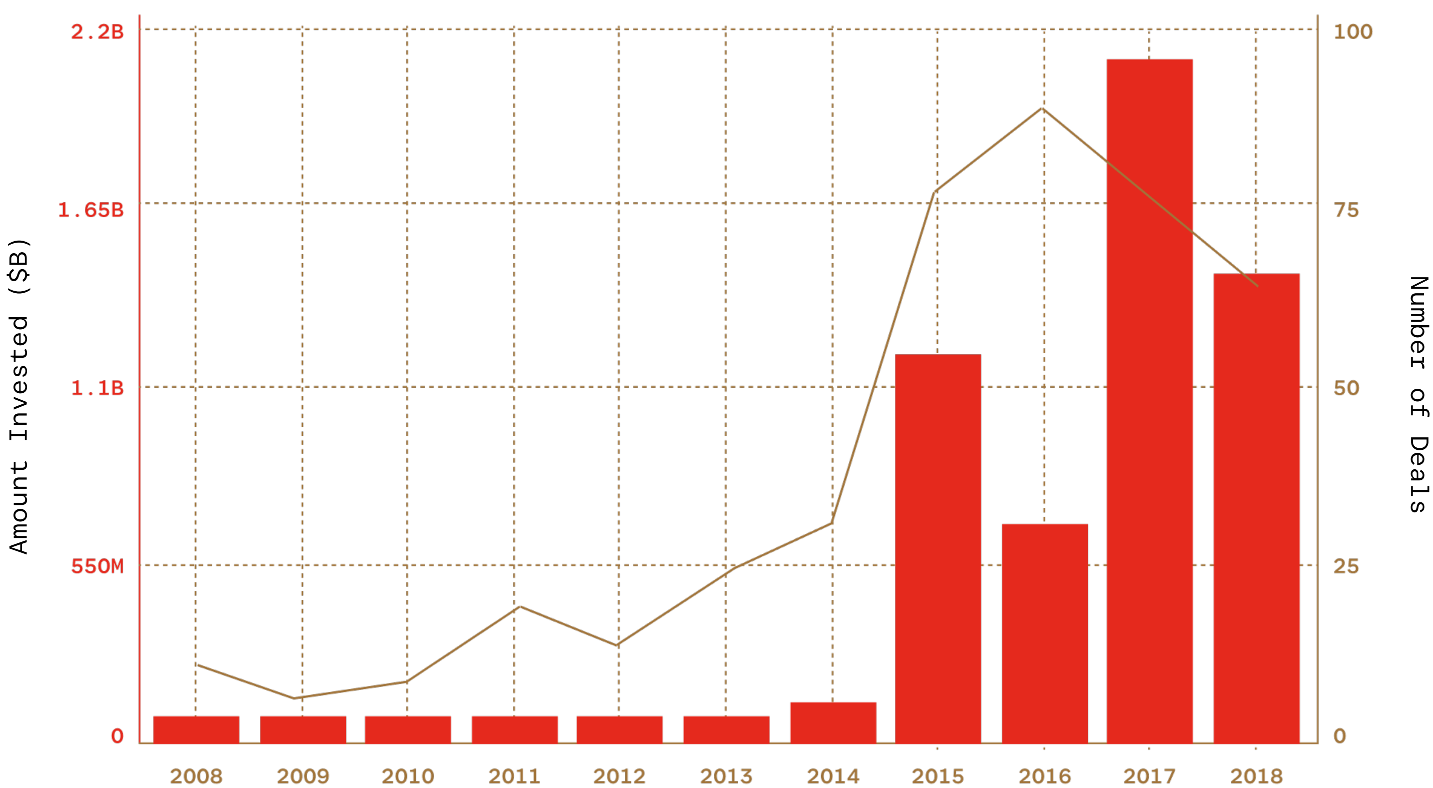
Digital payments grew from 2.5% in 2015 to 7% of GDP in 2017, and is expected to reach at least 26% by 2022. Though this number still lags behind China (35% of GDP), the momentum is palpable. BHIM UPI alone, recorded transactions worth 300M in volume in the month of August 2018. UPI 2.0, released in August 2018, incorporates several forward looking features like invoices in inbox, signed QR codes, and pay later mandates.

Policy Impetus

Apart from creating massive digital infrastructure, government has played a significant role in providing well needed policy impetus. Some of the examples include–

→ Demonetization - push to move away from cash economy
→ Tax rebates for merchants accepting more than 50% of their transactions digitally
→ $0.05 flat transaction charge for UPI as compared to 0.9-2% MDR for merchants
→ Regulating new age models - P2P lending, awarding 11 payment bank licenses. Working on the blockchain and crypto regulation.

Venture Investments in FinTech



Fintech Venture Opportunity

Fintech has attracted significant funding in recent years. $5B+ has been invested since 2015 in the sector, 50% of which has been invested into Paytm. Even outside Paytm $2.5B has gone into the sector since 2015, 2nd highest after E-commerce.

We believe India is still in its early days of Fintech opportunity, next decade will see this investment trend only accelerating.

Source: Tracxn

Venture Areas Going Forward

	Current State	*Key Venture Opportunities*
Wealth Management	Relatively new area - few transaction led platforms have emerged	Segment/Need-specific wealth management and savings products – deep solutions with advisory led approach
Lending	First generation of digital lenders have emerged – more general purpose and horizontal approach New players will emerge to target specific segments and needs building deep solutions	Segment/Need-specific lending – deep solutions
Payments	Multiple winners have emerged in both online and offline space UPI driving rapid change in the market dynamics - opening up new opportunities	UPI ecosystem players driving adoption
Insurance	Aggregator models have played out Opportunities around product innovation targeting specific segments and needs will emerge	Product innovation targeted at specific segments and needs

Focus Area– Wealth Management

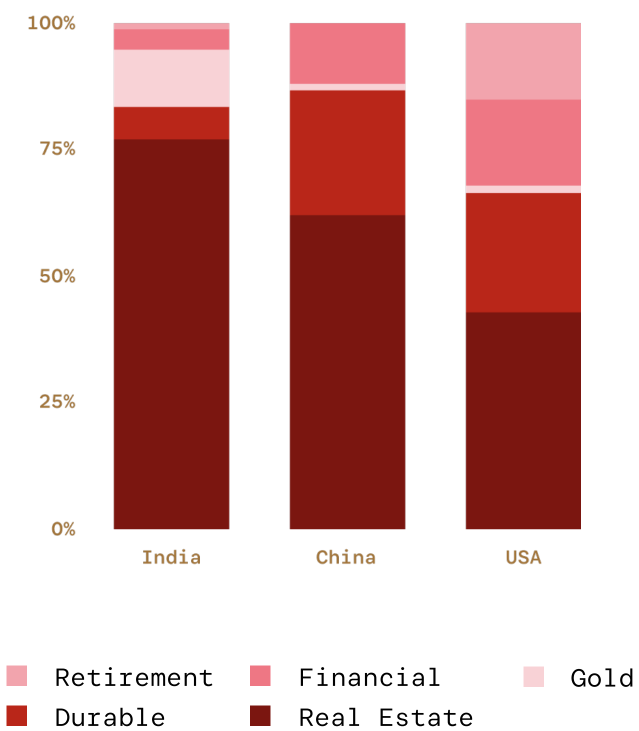
Savings is a big part of Indian consumers life, no matter whichever income class they belong to. India has 30% savings rate (US is 6.5%, China is 37%). In a country with such high savings rate, financial asset penetration is still low. Traditionally Indians have been saving in physical assets like gold and real estate. Since investing into financial assets requires literacy and understanding of the asset class, lack of high quality advisory services for masses has been one of the key factors that has impeded mass acceptance and penetration of financial assets.

Reallocation from Physical to Financial Assets

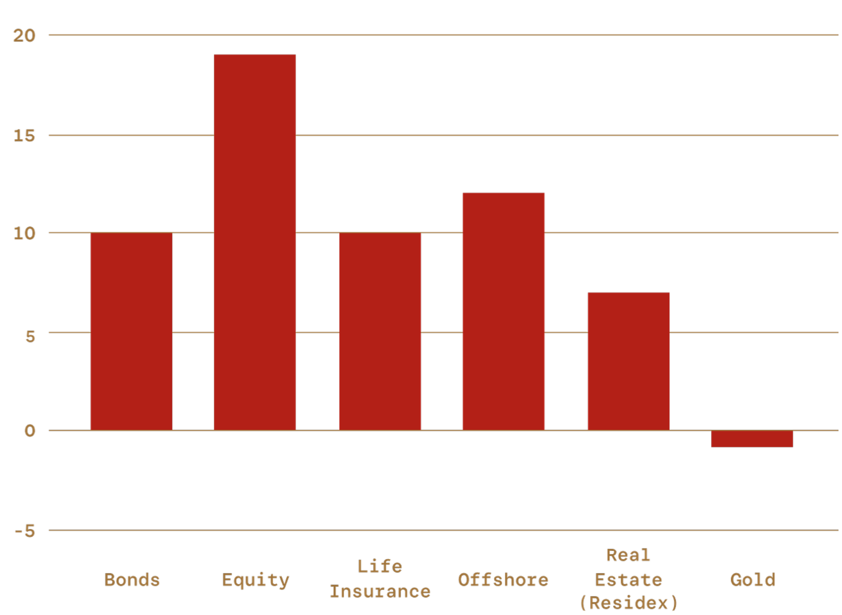
The demand for wealth management products and services is expected to grow at an immense pace in the coming decade. This growth is largely driven by both economic reasons as well as changing consumer behavior across demographics and income classes.

Culturally, India has seen an overwhelming proportion of household savings in the form of real estate and gold, which have been considered as safe assets. Real estate accounts for 77% of personal savings in India, and gold accounts for 11%. In comparison, China's allocation of real estate towards savings is 60% and gold accounts for less than 1%. However, over the last 5 years, India has seen a drop in returns of both these physical assets while financial assets are trending upward. With the younger population consuming financial assets at an exponential rate, we expect to see financial penetration increase in place of these physical assets.

House Asset Allocation (2017)



Asset Returns 2012—2017 CAGR



Today, the interest rates on savings and deposits, the traditional financial products, are declining. Gold & real estate, which have historically been India's most attractive household assets are seeing a drop in returns in the last 5 years. At the same time, investments into financial assets are looking more attractive as they're consistently 7-8% higher than the inflation rate. Thus, there is an increase in acceptance of equities & investment funds, which have now become the fastest growing asset class in India. now become the fastest growing asset class in India.

The demographics of India in the coming decade will also act as a strong tailwind for India as 69% of the population will be of ages between 15-64 with a median age of 29. The 25-44 age group also coincides with being the largest adopters of financial services and products. In the coming decade, their wealth will rise and so will their investments in financial services. This category of Indians have better digital literacy and have a higher risk appetite. Further, their openness to adopt newer products is higher.

Corporates and industry bodies today have significant focus to use digital means to enhance India's penetration of financial services. In 2018, advertising expenditure by mutual funds is expected to be over $48M as the mutual fund bodies seek to educate a sizable proportion of the population on the financial benefits of their product. The 'Mutual Funds Sahi Hai' campaign that released in 2017 saw an increase of 1.7M new customers and a 40% increase in structured investment programs (SIP) consumption.

However, there are still barriers for most of India to access professional financial advisory services due to steep fees through traditional providers. The lack of access to professional advisors for most of the population means that wealth management is an industry that is still heavily skewed towards the upper class of the income group. Therefore, a big opportunity lies with companies that are able to provide advisory services at low prices by leveraging technology.

Source: RBI | BCG Global Wealth 2018 Market Sizing Database, CEIC, BankBazaar

From Transaction to Advisory Led Management

The rising demand for financial products will be channeled through a combination of investment platforms (like brokers, banks, and trading apps) and advisory services. As participation increases and moves into tier 2+ cities, both will benefit a great deal from a move to digital, low touch service models.

Advisory *What to invest in? High IP*

Investment Platform *Access and delivery Price Sensitive*

Wealth Management 1.0— Transaction Led Platforms

Investment platforms form the delivery layer for investments, essentially providing buy and sell access to products such as equity, mutual funds, gold and so on. We are witnessing a wave of digital disruption in this space.

In equity platforms, for example, electronic discount-brokerage platforms are fast outpacing incumbents like ICICI Securities. Zerodha, which, 3 years ago, had less than 1% market, has raced to claim 9.5% of the 850M active clients, claiming the number 1 spot and surpassing ICICI bank, a traditional broker which is slowly but steadily losing market share. Similarly, Upstox saw a 200% growth in y-o-y revenue in 17-18 and is actively targeting the masses via local language integration. People from small towns and cities are increasingly getting hooked on these online platforms due to the low fees and because the hi-tech trading platform are supported even on low bandwidth connections.

Mutual Fund platforms have also witnessed a wave of digitization from players such as PayTM and Coin. In less than 2 months from its launch, Paytm claims its platform has more than 850,000 users with 65 percent of them coming from beyond the top 15 cities of India. Zerodha also launched its direct mutual fund platform, Coin, last year and claims to have close to Rs 1,100 crore ($150M) in AUM. As of March 2018, the top 20 distributors in the country accounted for just 24% of total AUM, indicating intense competition in the MF distribution space.

Being highly price sensitive with low differentiators, it has become increasingly difficult for new entrants to stand out. This has lead to commoditization across assets class platforms.

Wealth Management 2.0— Advisory Led Platforms

Advisory services on the other hand, are still dominated by expensive PMS serviceers with traditional distribution, making them unaffordable and unable to reach the next wave of savers.

Indian wealth managers are addressing a market with $1.5T of investable wealth, expected to double in the next five years. Kotak Wealth clearly leads the pack, doubling its assets to $30B over the past year. Overall, domestic players dominate the scene, accounting for a 72 per cent share of AUM last year. Although there are over 20 mainstream players, market growth has been robust, specially as real estate and gold fall down the pecking order for richer Indians.

Unlike the digital disruption underway in investment platforms, advisory services are still dominated by traditional players. Penetration remains low, given traditional players' ticket sizes are above INR 2.5M, as per law. Infact, Securities and Exchange Board of India (SEBI), is mulling to increase that limit 2-4 times, furthering the gap between traditional PMS services and the masses.

Moreover, the distribution model remains lacking in technology, and high touch. As more and more investors from lower income and tier 2+ cities start financial investments, there is a clear lack of affordable and available supply.

Venture Opportunity

India is at a very nascent stage as far as wealth management startups are concerned. So far only 12 companies have raised venture funding, and around $63M has gone into funding those companies since 2015.

With many external drivers in the ecosystem today, both on the supply and demand side, we expect to see a rapid increase of adoption on wealth management platforms and see an inflection point over the coming decade. Considering the rapidly increasing investments into financial assets by consumers we expect higher pace in scaling of startups in this space and funding to pick up in coming years.

We expect $75B to be invested digitally into financial assets, which open up a huge market opportunity for start-ups in this space.

2017

$10B

Capital invested digitally

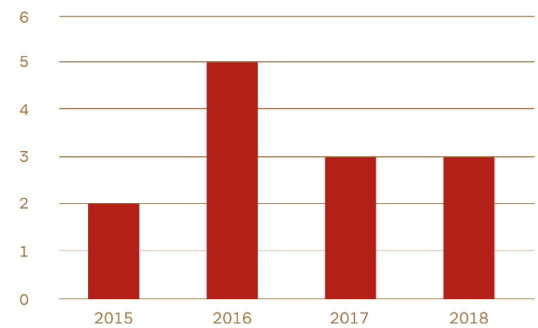
2025

$75B

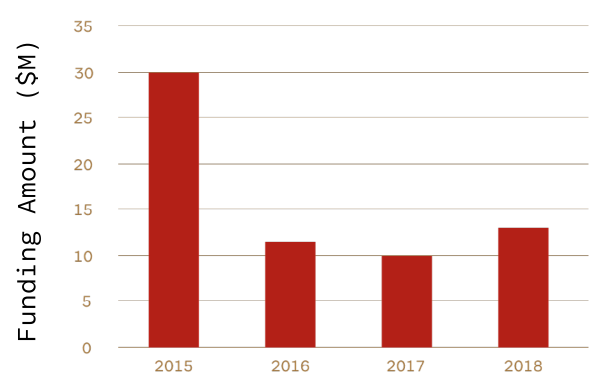
Capital invested digitally

We believe start-ups will play an important role in disrupting this space, because succeeding will require companies that can create tailored options for income segments, demographics and investor profiles as opposed to a “one solution fits all” model. The requirements of the retail investor varies significantly depending on his/her financial literacy, income, goals etc. We therefore believe there is a significant value creation opportunity for start-ups, and at least 3-5 large players will emerge to cater to this large emerging market opportunity.

No. of Companies Funded past Seed Round in Wealth Management



Total Funding per year



Source: Tracxn

Affluent/Elite

(High net worth, Large disposable incomes)

Long term asset management
Wealth creation,
Tax optimization,
Diversification of assets

Aspiring Class

(Irregular income, High volatility of cashflow)

Micro-savings
Daily savings for short term and long term goals like school fees, medical emergency, wedding

Young working middle class

(Predictable income, Savings for future big ticket expenditures)

Goal based long term savings
Kids education, Housing,
Retirement planning

Housewives

(Dependency on family breadwinner)

Savings for short term goals
Personal spending–
Festivals, Shopping,
Jewelry

Recent Investment

toffee

Sub-sector—
Insurance

What?
Started by Rohan and Nishant in 2017, ***Toffee*** *designs innovative, bit-sized, micro-insurance products for millennials called "Toffees". Toffees are highly contextualized to millennials needs like traveling, rental home, commute, gadget, fitness, backpack insurance and so on.*

Why?
The last few years have seen great money flow into the insurance distribution space. However, the next phase of disruption will be on the product end with companies reinventing the insurance product bottom up, making it more relevant to specific sub-segments of the Indian population. Infact, product innovation will truly power insurance penetration in the country.

How are they doing?
→ *Close to 50,000 customers*
→ *Average premium - INR 100*

FinTech for the Next 400M - Event Highlights

"Rural households do a variety of jobs and businesses to diversify risk – it's a very expensive way of doing so because the implication of not having the right financial products is huge. We don't have ways for these customers to manage concentrated risk that can eventually trigger bankruptcy." - Sucharita Mukherjee – CEO, Kaleidofin and CEO, IFMR Holdings (at the time)

When you are in an Industry where you know sea-change is going to come, but you don't know when, (...) those who go focus on at least one set of the market and have the quality to survive stand out - Vani Kola, MD, Kalaari Capital, discusses the keys to scaling fintech startups with Govind Rajan, then CEO of Freecharge (now COO at CueMath) and Yashish Dahiya, CEO, PolicyBazaar

"Financial services in India is going from low volume, high value, high cost to high volume, low value, low cost" - Nandan Nilekani

Pramod Verma, Chief Architect, Aadhar, talks about the potential of India Stack

kalaari
capital