ICRA

NBFC – Digital Lenders

Digital lenders face the heat as funding conditions tighten

March 2024

Highlights

AUM growth of digital lenders expected to slow down significantly to 20-25% in FY2025 vis-à-vis CAGR of 60% seen in the past five years

- Digital lending* has emerged as the most talked about newly emerging asset class in the non-banking financial companies (NBFC) space in recent years. This segment has seen exponential growth; the assets under management (AUM) of ICRA's sample set of entities stood at ~Rs. 650 billion as of December 2023, increasing at a CAGR^ of 60% in the last five years. ICRA expects the AUM growth to moderate to 42-44% in FY2024 and further to 20-25% in FY2025.

- The predominant focus is on unsecured, small-ticket and small-tenor loans in the consumer (includes personal loans) and small business loan segments. The share of consumer loans has been increasing steadily over the years.

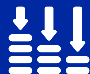
- Leveraging the strong balance sheets of partners (larger NBFCs and banks) has been a key driver of expansion, thus far. These partnerships accounted for ~30% of the AUM, as of December 2023, and are expected to become more crucial, going forward, as other funding avenues could be constrained due to the tightening funding environment.

- 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. Loan losses remain higher than other asset segments and would stay elevated in the near term (~ 5-8% on a cohort basis).

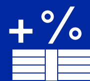
** ICRA's sample set of 13 new-age entities (ICRA rated and others), which have significant reliance on digital processes during the lifecycle of their loans; for cases where data is not available, best estimates are used; Dec 2023 numbers, wherever displayed, are on an annualised basis; ^ CAGR – Compound annual growth rate*

Highlights

Streamlining of the business model is key for improving the operating efficiency; loan losses remain elevated and are expected at ~5-8% on a cohort basis



- Access to commensurate funding would be key, going forward; the impact of regulatory tightening on incremental funding remains to be seen in the near term. Further, any adverse regulatory development, impacting partnership arrangements, can affect the fund flow and growth of these entities.



- Notwithstanding the high business yields, it is crucial to improve the operating efficiency in order to strengthen the earnings performance, as credit costs are expected to remain elevated. Currently, employee, technology and marketing/loan origination costs remain the key cost drivers.

- Entities in this segment are largely rated in the 'BBB' category, with a few entities rated 'A' and above. Rating upgrades have outweighed downgrades over the past four years. Upgrades were predominantly based on the strengthened capitalisation profiles, which provided the necessary runway for the growth plans of these entities. Weak profitability and asset quality metrics have been key constraints.

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