Beyond Covid-19: How Lending Businesses can Leverage Business 4.0™ as a Growth Strategy

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Abstract

Global financial markets have come under strain from the ongoing impact of the COVID-19 pandemic. In India, the BFSI sector is already feeling the repercussions, and accounting and reporting implications are expected to be felt for longer than previously anticipated. Even as the RBI extends regulatory relaxations (to mask the initial pain), the BFSI sector expects significant surge in NPAs – to the tune of Rs.50k crores in the coming months.¹ The fall in Nikkei India Manufacturing Purchasing Managers Index (PMI) to 27.4 in April from 51.8 in March is the sharpest deterioration in business conditions in 15 years.² According to a report by ICRA, about 328 companies have sought moratorium from banks.³ However, as the end of the moratorium period nears and the government prepares lockdown exit strategies, the Lending industry is keen to understand what their options are and how to plan for the future. This paper describes the model that can be adopted to ensure profitability.

This way or that?
Possible scenarios for the Indian economy

Supply chain disruptions, steep fall in consumption demand, and stress on the banking and financial sectors – the COVID-19 pandemic is ushering in an unprecedented era for the Indian economy. As the country prepares to enter the fifth phase of a nation-wide lockdown, there could be four possible scenarios\(^4\) that could play out in the economic sector:

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In this case, the crisis worsens not only in India but across the globe, with India’s GDP growth potentially dropping to 3.5-4% levels as global recession settles in.

In this somewhat optimistic scenario, after a severe March quarter, the impact on the Indian economy will be limited and FY21 GDP target will be 4.5-5%.

The third scenario paints an optimistic outlook for India, though not much for the global economy. In this case, the virus will be contained in India, but the global economic crisis would worsen, in turn, giving a boost to Indian equities. India’s GDP would grow at 4-4.5% amid a global recession.

In this scenario, the situation will be contained both in India and the rest of the world, and Indian markets may outperform. The economic impact on India would be manageable and the global economic slowdown will last 3-5 months, post which a gradual recovery will start, thanks to aggressive buyers.

When considering the impact of COVID-19 on the Indian economy, it is important to note that India isn’t the only country bearing the brunt. A recent KPMG report on the Indian economy says that if the pandemic proliferates and brings global recession, then it would be a double whammy for India due to both domestic and global demand destruction.¹

Large banks have indicated the likelihood of a spike in their non-performing assets ratio by 1.9% and credit cost ratios by 130 basis point in 2020. There’s generalized lack of buyers for stressed assets and fresh loans given to SMEs/MSMEs will be at risk if the cash flows of companies remain under pressure, lowering their loan repayment ability. According to RBI data, credit growth in almost every sector decelerated in March 2020 from a year ago as the economy was put on near standstill with the country going into a nationwide lockdown.

Microfinance lenders are hit even harder as their operations are highly field-intensive, requiring home visits and physical collection of cash — activities rendered impossible due to the lockdown. A cash shortfall for 29 microfinance institutions — accounting for 70 percent of the industry’s loan portfolio — collectively stands at about Rs 2,600 crores in the absence of any external funding support by way of equity, additional debt or extension of moratorium. These lenders have INR 8,000 crore worth of repayment obligations and operational expenditure in the quarter ending June compared with on-balance liquidity buffer of around INR 5,400 crore, according to ICRA, Ltd. Larger enterprises must come out in support of SMEs/MSMEs by ensuring full and timely payments to avoid liquidity stress. Tata Group companies for instance, are monitoring vendor payments closely under the current situation to ensure all their dues are paid on an immediate basis in order to provide liquidity.

With rampant job losses and pay cuts amidst the COVID-19 crisis, Digital Lenders aka NBFCs who typically offer short-tenured micro loans to salaried individuals are in a fix too. Consumer lending is expected to be the worst hit due to weak demand and income disruption of borrowers which will continue for months to come. The Digital Lenders’ Association of India (DLAI) is urging the government to take a two-sided approach as the constrained revenue streams on small MSMEs will put high pressure on their outflows, ultimately impacting digital lenders’ collections. DLAI has demanded a direct liquidity window to last-mile credit providers (Fintech platforms and NBFCs) to ensure timely credit supply to the most vulnerable sectors. Reducing lock-in period for pools already submitted from existing 12 months to 3 months to avoid an immediate cash crunch due to defaults and relaxation on eKYC norms and ratings could prove helpful too. Many digital lenders are now eyeing RBI’s NBFC-assistance package (worth INR 50,000 crore) to pull them out of the current slump.
Banking on technology to beat the crisis

The covid-19 crisis presents a unique opportunity to the lending industry to digitalize its business models and operations. Here’s a five-point guide to go about it:

#1 Rethink your product portfolio: For lenders, the time is ripe to sharpen their customer focus and create new products aligned to microsegments. For instance, HAPPY, a machine learning-based MSME digital lender recently launched the ‘lockdown loan’ targeting about one-fourth of India’s 69 million MSMEs. The goal is to help the affected microenterprises with seamless liquidity access.

#2 Build a digital spine: Enable digital delivery of services through adoption of microservices architecture, API integration, automation, and cloud computing. Leveraging cloud and pay-per-use models can also reduce capital investments. Lenders should increase adoption of bots to conduct financial processes such as accounts payable, account reconciliation, debt management, and salary processing to reduce human dependency. Focus on boosting the digital payment infrastructure to create a financial ecosystem for India’s unbanked and underbanked population. Aarthi Subramanian, Group Chief Digital Officer, Tata Sons, emphasizes four key areas of digital transformation opportunities across industries - new end-to-end customer journeys; increased adoption of automation in operations; improved employee engagement due to distributed workplaces; and investment in digital infrastructure as a horizontal capability.

#3 Leverage India Stack for digital enablement: The shift in consumer lending and payments habits will be fairly visible in the post Covid-19 era as minimizing human touch or interaction will be the key focus. Zaggle, a FinTech pre-paid card services provider acted upon this idea and is now rolling out virtual cards that can be used in a contact-less manner at POS terminals. The company has tied-up with multiple banks on a revenue sharing basis. ASSOCHAM also recommends that all cards (debit, credit and prepaid), newly issued or re-issued, should be activated with Domestic Card-Not-Present [CNP] and Contactless transaction options.

#4 Emphasize digital financial inclusion:
Beyond immediate relief, financial inclusion in India post COVID-19 will be a critical imperative for developmental progress as digital financial services (DFS) will ease the impact of COVID-19 on people’s livelihoods. This is a time for lenders to leverage an ecosystem approach and partner with telcos, local businesses, and others to focus on demographics, access to internet, last mile connectivity, etc. to enhance DFS’ adoption.

#5 Mitigate risks that come with increased use of the digital economy through robust cyber security initiatives, rigorous KYC, strong customer authentication (SCA), financial grade APIs, firewalls, smart networks, etc. Savvy BFSI firms are now turning to Video KYC leveraging AI-driven KYC platforms for streamlining and automating user onboarding and identity verification operations through facial recognition. Lenders must monitor stress in their portfolio at a microsegment level and plan mitigation procedures accordingly. The lending industry as well as the government should re-evaluate credit rules (reduction in statutory liquidity ratio (SLR), cash reserve ratio (CRR), etc.) to allow for deviation till full recovery. Borrowers would also require flexible structuring on loan repayments impacted due to COVID-19 due to changes in business cash flows, thus strengthening the case for loan restructuring.

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The lending industry is pivotal to economic recovery. As it becomes critical to build resilience and adaptability in the face and aftermath of the COVID-19 crisis, digital transformation across the lending landscape will take center stage. Technologies such as AI-ML and Deep Learning will also help tackle the issue of stressed NPAs by mitigating risks for lenders. At the same time, brand purpose is also becoming central to consumers as they re-evaluate their relationships with brands amidst this crisis. Lending organizations must adopt a value aggregator approach and look beyond their core products to identify and articulate the purpose behind their existence, which in turn often guides their transformation blueprint. For instance, Vitality, originally a medical insurer repositioned itself as an orchestrator of wellness to get closer to the lives of its customers. While the aftermath of the COVID-19 pandemic will undoubtedly cause paradigm shifts with long-lasting implications, scenario planning is now more important than ever to strategically forecast, plan and manage the future of lending.

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About the Author

Ravindra Asundi
Chief Technology and Architecture Lead, NBFC Platform Unit

Ravindra Asundi is the Chief Technology and Architecture Lead for the NBFC Platform Unit at TCS. He has 27 years of experience across consulting, solution development and implementation in the BFSI industry. He has wide experience in architecting large solutions in capital markets, banking & non-banking finance and insurance domains spanning across regulatory bodies, banking, institutional & retail lending, mutual funds, and investment banking.

Ravindra holds a bachelor’s degree in Computer Science & Engineering from the Veermata Jijabai Technological Institute (VJTI), Mumbai.
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Email: bfsi.marketing@tcs.com