Prospective Movement of Alternative Finance Products towards Digital Media: Challenges and Opportunities

Sanjay Sinha*

Pinky Agarwal**

***Sanjay Sinha is Head of Department of finance, ITM Business School, Navi Mumbai**

****Pinky Agarwal is Assistant Professor, Department of Finance, ITM Business School, Navi Mumbai**

Abstract

The different products of financial service industries are primarily based upon the requirements of society and hence newer and newer products keeps on emerging in the financial markets. The products of the financial market have two sources viz. Indigenous products and exotic products. Indigenous products are largely outcome of socio cultural and economic conditions prevailing in the society. Exotic products though originate in external cultural landscapes but offers a great potential in local markets also. There can be altogether a separate class of financial products that synthesizes features of these diverse financial products into one. The realm of these separate class of financial products are known as instruments of alternative finance. The products of alternative finance are distinctive in the sense that firstly, they are a welcome divergence from the traditional financial products. Secondly, they are for the financially excluded segment of the society. Thirdly, the products of alternative finance are the instruments of inclusive growth. This paper will endeavour to highlight emerging paradigm of alternative finance and mechanism of distribution of the products among beneficiaries. This research will be based upon secondary data available on the various websites and other pertinent literature. The data analysis will provide the utility of digital media in the expansion and enhancement of geographical reach of various products of alternative finance. It will further lead to empirical assessment of intrinsic strength of these products.This paper will finally conclude with identification of challenges and strategies to promote the growth of alternative finance products using digital media.

Keywords: Alternative finance, digital media, exotic and indigenous products, financial markets

Emerging landscape of Alternative Finance

Development economics has gained prominence in the aftermath of Second World War with the commissioning of organizations like World Bank, IMF, ADB etc. The basic premise behind the emergence of these institutions was to rehabilitate various economies of the world which were badly hit during the Second World War. Depending upon the political and economic ideologies, one group of nations adopted the policy of market economy whereas the other resorted to that of closed economy.

In the past 60–70 plus years of developmental history of these nations it is very evident of that capitalist economies have achieved faster rate of growth as compared to socialistic economies. There are various factors which contributed to growth of these economies inter-aliahighly developed financial markets with wide scale financial products as the major driver of growth.

India adopted the socialistic model of economic growth wherein the financial markets have limited number variety of financial products majorly in the category by banking products.

As highlighted above apart from other factors, large variety of financial products plays most significant role in economic development of developing nations and ironically enough the market depth with regards to financial products is a common feature of developing nations like India. The problem, therefore, is to have diversity in range of financial products.

The different products of financial service industries are primarily based upon the requirements of society and hence newer and newer products keeps on emerging in the financial markets. The products of the financial market have two sources viz. indigenous products and exotic products. Indigenous products are largely outcome of socio cultural and economic conditions prevailing in the society. Exotic products though originate in external cultural landscapes but offers a great potential in local markets also.

The depth in the range of financial products can be achieved either through development of indigenous products or introduction of exotic products like derivatives in the financial markets. The objective should be to provide a broad based and well diversified product range in the financial markets which can be considered as universe. The planning era in India has seen gradual and steady growth in the financial services thereby newer and newer products are continuously getting launched.

The financial products can be broadly classified into three categories – Traditional, Alternate and Alternative Financial products. Traditional Financial products include all those products which principally has its origin in the banks or corporations. Few of these products are Bank Deposits inclusive of Fixed Deposits, Recurring Deposits, Saving Accounts, Current Accounts etc. Other traditional products are equity shares, preference shares, bonus shares and other similar products. It also includes all debt products like Bonds, debentures, term loans and others.

The Alternate financial products are more complex and may not have any role of banking industry. They include Leasing, Securitization, Reverse Mortgages and others.

The universe of traditional and partly the alternative financial products is modulating in a new era in which these traditional financial services and its products have stated inching closed to normalization process thereby moving in the direction of downward spiral. In this volatile situation, promotion of the existing financial instruments may or may not have the linear functional relationship with the profitability of the organisation. The mute-point which emerges in this scenario is the fact that strength of the financial product can only act as a co-efficient in this linear relationship. In short, the combined impact of the variables may at times can give subsistence or waver thin margin of profitability. diversification in the existing financial products may not be achievable. The introduction of financial products will lead to more depths in the financial markets. In these existing set up of world economies wherein top 1% of the people command nearly 40% of the wealth, the instruments should be developed keeping an eye on the need and demand of separate class of financial products.

These separate class of financial products needs to synthesize features of several diverse financial products into one. The realm of these separate class of financial products are known as instruments of alternative finance. The products of alternative finance are distinctive in the sense that firstly, they are a welcome divergence from the traditional financial products. Secondly, they are for the financially excluded segment of the society. Thirdly, the products of alternative finance are the instruments of inclusive growth. This paper will endeavor to highlight emerging paradigm of alternative finance and mechanism of distribution of the products among beneficiaries.

The Confluence of Digital media and Alternate Finance

As per the report of RBI submitted by the Committee on Comprehensive Financial Services for Small Businesses and Low Income Households (2014), it was observed that 90% of the small business had no connection with the formal financial institution. 60% of rural and urban population did not have a functional bank account and much of the credit needs of the economy were met by the informal sector. Difficulties of access and absence of positive real return on financial saving had shifted from financial assets to physical assets and unregulated providers. This shows that there is a visible demand for a wide range of financial services by small and low income households. Thus, financial services with Digital Media can cover a wide sphere of population.

Chris Gilbert in his blog, Alternative Finance in a Digital Economy dated April 1st, 2015 has rightly said that People nowadays demand convenience and instant gratification. Online payments services, cloud security and electronic identity verification provide simplicity and speed in the alternative finance space. With the growth in internet access and smart phone use globally the opportunity for alternative finance to grow will continue

Tools and techniques of Alternative Finance

An enterprise operating in highly risky environment or start-ups face lot of difficulties in the procurement of finance from conventional banking system. Alternative finance is a boon for such fund seekers as well as the fund investors who wants to invest their surplus funds in proper channels. The instruments of Alternative Finance include Community based funding Services like Islamic Banking and Finance, Jain Community Finance, Microfinance, Digital Platforms like Crowd Funding, Peer to Peer Lending (P2P) and others.

Islamic banking and finance follows the Shari’ah as its underlying principles and Sunna as its guiding principles. It refers to the financial system of banking or banking activity that is compliant with the principles of the Shari'ah known as Fiqh al-Muamalat (Islamic rulings) and its practical application through the development of Islamic economics and overall objective of welfare of the community.

Microfinancemeans transaction of financial services with small amount of capital. Microfinance as a tool of alternative finance can broadly be understood as instruments that can bring financial inclusion. Microfinance includes Microcredit, Micro insurance and Micro savings. Microcredit refers to disbursal of loans to the beneficiaries in small denominations. The success of Grameen Bank of Bangladesh founded Prof Mohammed Yunus is an excellent example of turnaround that microcredit can bring in the lives of millions of people who are the bottom of the pyramid. In this method of disbursal of microcredit as adopted by Mohammed Yunus lead to the formation of Grameen Bank. Microcredit assists capacity building of the people and acts as an instrument for the eradication of poverty.

It also serves those people like SMEs, unemployed, marginal or poor farmers who are not aware or covered by adequate banking system. Due to the dearth of requisite collateral and credit rating from a recognized institute, microfinance, also in its form of microsavingslike Pradhammantri Jandhan Yojana are providing platforms for banking inclusion. The third pillar of microfinance is micro insurance. It provides the needed insurance services to all those people who are poor and not covered by any insurance policies. It works on the concept of sharing of risk.

Digital Platforms

Online lending is emerging area as important area of financing ventures. It has also started acting as one of the source for alternative finance. The disbursal period is virtually instantaneous and hence processing time is bare minimal. Hardly it is a matter of hours to process and within thereafter the funds are disbursed. The pace of transactions is its biggest advantage while the traditional finance route will take days or even months for disbursal of funds. The second advantage is the ease of online lending. Famous economist and former U.S. Treasury Secretary Larry Summers said at the 2015 that 'it is a Lend It conference' and that*'he expects online lenders to eventually reach more than 70 percent of small businesses'*.

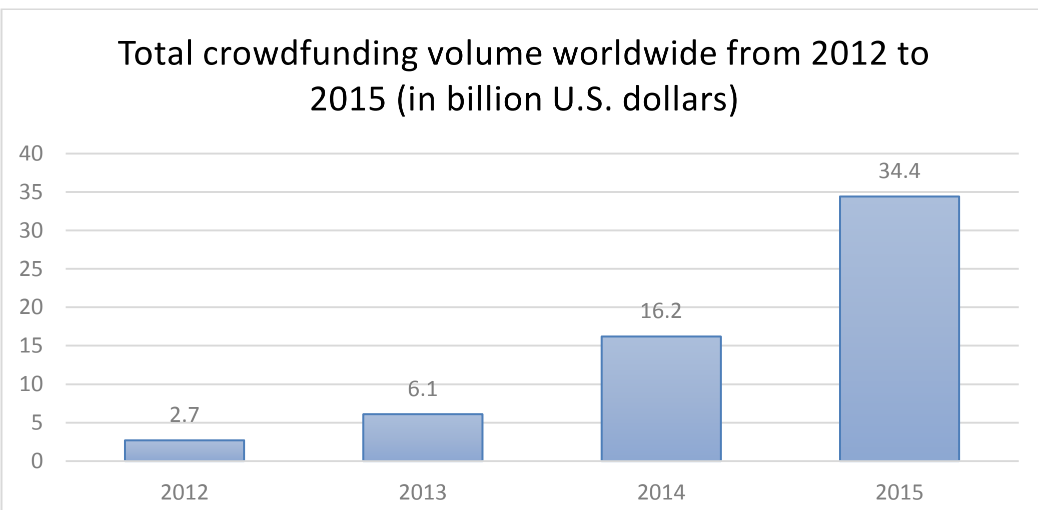
Crowd funding is one of the most popular online lending platforms. It is also known as crowd investing. The origin remains crowd sourcing wherein funds are mobilized through online platforms. In this process investors are brought together with the fund the fund seekers.

Models of Crowd funding are:

- Donation based: It is the method in which the contributor contributes selflessly towards the benevolent fund with or without rewards
- Investment based: It is the method in which the contributor claims a share in the revenue in lieu of the investment
- Equity crowd funding: It is a new vista towards fund mobilisation for the start-ups or expansion of the small ventures. Both investors and the fund seekers are brought together through platforms at a very low cost with simple regulations.

(Steven Dresner, 2014)has rightly remarked that by combining the Internet/social media with equity-based financing, it is poised to usher in a new asset class that will change how early stage and small business financing transactions are consummated

A new concept of crowdfunding is also emerging globally i.e. Islamic crowdfunding which is based on Islamic principles. The project endeavoured and product offered are halal and Shari'ah compliant. Similarly, the invested money is also in compliance with Shari'ah i.e. halal.



Source: statista.com

Peer to Peer lending(P2PL): It is also one of the digital medium of financial community that connects borrowers and investors at a lower OPEX (operating expenditure /cost). P2PL enables the SME's to procure funds from private as well as other institutions. There are different platforms namely Ratesetter, Zopa, Funding Circle. Basically, they act like mediator between the fund seekers and the investors. It is quite same as Venture Funding of the traditional Finance. The entrepreneurs having a feasible business plan but lacking capital can seekfunds for their business may reach to P2PL platforms

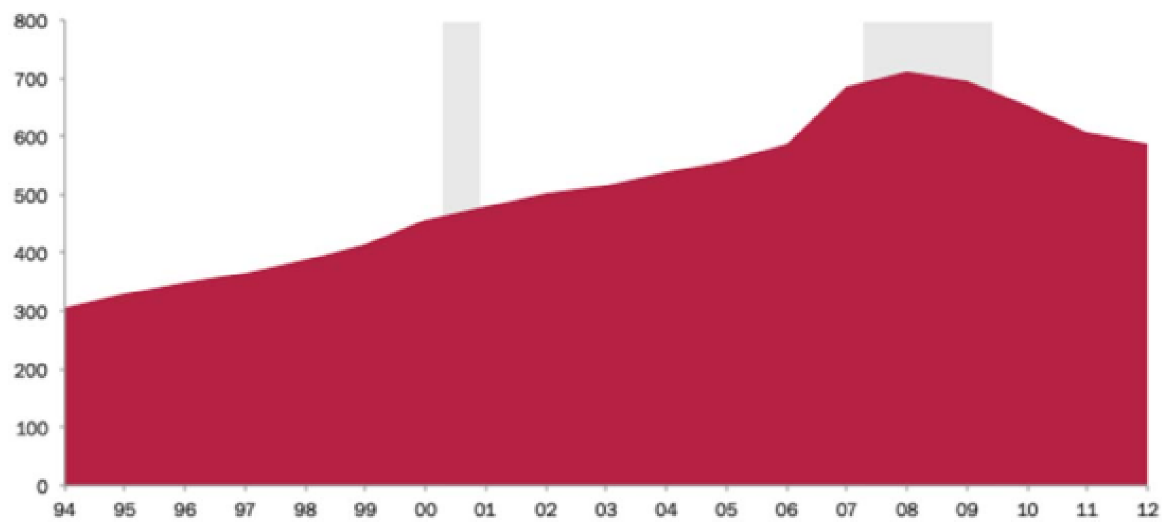
Digital media present status and its future in Fintech

As perArgov in his article on *Alternative Finance: Four Ways To Fund Your Business*,2015, most businesses (36%) are looking for funding for expansion and growth which is encouraging to see. Only 4% of the businesses that used Fundbird did so for refinancing debt.

The former Treasury Secretary, Larry Summers had delivered the keynote address at the conference Lend It 2015, "technology based businesses have the opportunity to transform finance over the next generation," and do so in a way that makes the economy more efficient and stable. His colleague at Harvard, former Small Business Administrator Karen Mills--also a speaker at the conference--provided some numbers from her research that showed just how badly innovation is needed in this area. The following chart shows how small business lending has declined since 2008, and has yet to recover:

Figure 13: Small Business Loans Down About 20 Percent Since the Financial Crisis of 2008

Small Firm Loan Balances at Banks ($ billions)

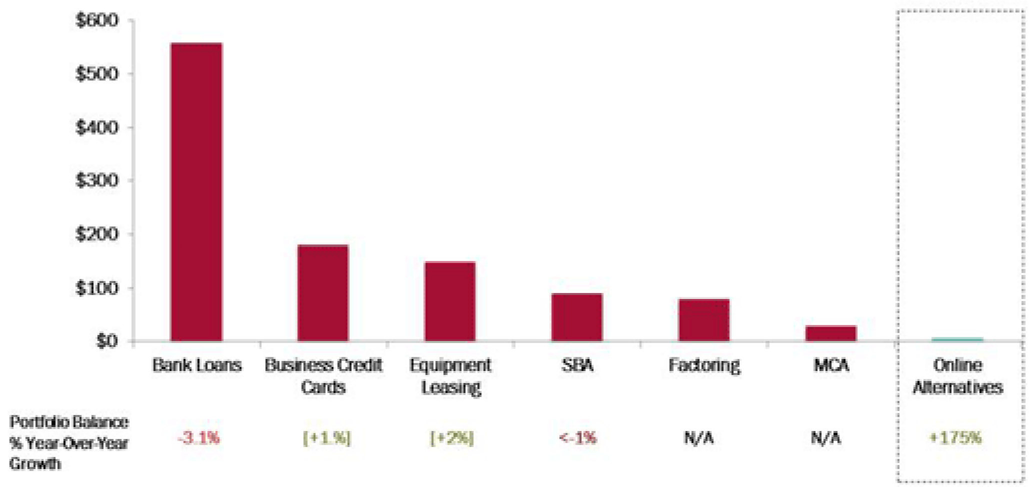


Source: Federal Deposit Insurance Corporation, Call Report Data. As of June 2012.

As per Matthews in his article *Larry Summers' full-throated endorsement of online lending*,2015- Online lending only counts for about $10 billion of $700 billion in outstanding loans, but the following chart shows how online lenders are growing quite fast

Figure 1: Online Loan Market is Small But Growing Fast

Total Debt Capital Outstanding as of 4Q 2014 for Small Businesses ($ Billions)



Source: Source: Bank loans data taken from FDIC Call Reports; SBA data sourced from SBA publicly available information; Credit card data sourced from creditcards.com; remainder sourced from interviews with industry experts, and authors' analysis.

As per the article of Shontell on *Jamie Dimon: Silicon Valley startups are coming to eat Wall Street's lunch*, 2015 -Lending Club, for example, had the largest U.S. tech IPO of 2014 . Payments startup Stripe has a multi-billion-dollar valuation and a partnership with Apple Pay. Bitcoin companies and exchanges like 21 and Coinbase are attracting tens of millions of dollars from venture capitalists. And financial planning startup LearnVest just got acquired for $250 million in cash .

Wall street journal has quoted David S. Waddell, the CEO of investment strategy firm Waddell & Associates in Memphis, "Owners are now finding that their longtime deposit relationships aren't proving as useful, as many lenders restrict loan and credit terms to keep more cash on hand. (According to the Federal Reserve's Senior Loan Officer Opinion Survey in April,2016, 75% of domestic banks said they tightened credit for small &medium firms up from 70%) In addition, credit card companies like American Express and Advanta are either tightening their terms or cutting small businesses off entirely. Hopefully, recent events and those within the last year gave entrepreneurs inspiration to locate alternative forms of capital," says Waddell.

Microcredit, or microfinance, is banking the unbankables, bringing credit, savings and other essential financial services within the reach of millions of people who are too poor to be served by regular banks, in most cases because they are unable to offer sufficient collateral. In general, banks are for people with money, not for people without.” (Gert van Maanen, Microcredit: Sound Business or Development Instrument, Oikocredit , 2004)

Current situation of Alternative Finance Products and its prospect

The global economic meltdown of 2008 can best approximate to a watershed year in the evolution of the market of Alternative finance products. The collapse of few financial institutions during the economic crisis of 2008 and bankruptcy of many more including large banking corporations lead to strict regulatory norms, stringent BASEL III Capital Adequacy Norms. Banks adopted higher credit worthiness assessment and risk analysis before disbursing funds to both business entities and individuals. This resulted in nearly drying up of the availability of funds for the newer entrepreneurial ventures and risky proposals. Many of the potential borrowers were pushed to the margins in terms of their riskiness in the repayment worthiness. However, human behaviour which is ever dynamic in nature quickly adapted the changed scenario and started looking for alternative channels of finance. Consequent to these changes, market of alternative finance started growing up and newer and newer innovative products started hitting the financial markets. The growth of alternative finance products has followed a unique pattern of evolution. The developmental history of these products has directed them two divergent paths – in one path there are products which are for lending ventures of Institutions or entrepreneurs. These products have moved towards the digital platforms. A typical example can be cited in form for Peer to Peer Lending products. Other example can be the equity based crowd funding instruments.

In the second path, there are products which are for individual. These products are available mostly in prevailing platform and follow normal mode of fund disbursal. A typical example of these products can be entire range of microfinance products like microcredit, microinsurance and microsavings. The product range includes Pradhan Mantri Jan Dhan Yojna, Pradhan Mantri Jeevan Jyoti Bima Yojna, Pradhan Mantri Suraksha Bima Yojna.

The size of microfinance market is continuously growing by leaps and bounds. Few of the reports can be quoted to have a better glimpse of the current status of microfinance industry:

As per ICRA Report,Microfinance Institutions: Industry Outlook and Performance of Microfinance Institutions(Jan, 2016) Approximately a market size Rs 1.1 trillion (as of September 30, 2015), had been covered by Self Help Group Bank Linkage Programme, Microfinance Institutions and Bandhan Bank),and a growth of 23% (annualised) during H1FY16 and 31% in FY15 been reported.

As per**Bharat Microfinance Report on Indian MFI's and SHG's released in October, 2015, p**otential size of the microfinance market is estimated at Rs. 2.8-3.4 trillion and growth rate of MFIs has been assessed at an annualised rate of 30-35% over the next three years.**Further, the report says that,** MFI's currently operate in 28 States, 5 Union Territories and 568 districts in India. The reported 156 MFI's with a branch network of 12,221 have reached out to an all-time high of 37 million clients with an outstanding loan portfolio of Rs 48,882 Crore. This includes a managed portfolio of Rs 9854 Crore. The average loan outstanding per borrower stood at Rs 13,162 and 80% of loans were used for income generation purposes.Outreach grew by 13% and loan outstanding grew by 33% over the previous year.

The online platforms are good resources for the fund seekers as well as the investors. The various platforms are continuously engaged in redesigning their platform as per the needs of the different business ventures.

Symbiotic relationship in the two biomes namely Alternate Finance and Digital Media

The alternative finance products are always simple and innovation driven. Both lending and borrowing processes remains easy and completely in line with business objectives. The alternative finance products by its nature itself involves minimal administrative and paper work and hence their operational cost remains low which makes it attractive for both borrower and lender. In a relatively short span of time i.e., around 15-17 years post the global economic meltdown the growth in the alternative finance products are phenomenal both in terms of funds transacted and development of products. The products of alternative finance now–a–days are capable enough to meet all possible demand of products emerging from the different stakeholders of society including SMEs, Newer Ventures, Community based requirements, microfinance and many more.

A salient point that emerges after the development of products is the fact that whether the products are utilizing technological channels of distribution or not? The answer of this pertinent point is careful examination of the funds transacted under these products.

The European Alternative Finance Report; (2016); '*Sustaining Momentum*'; Cambridge University; states that – " the total European online alternative finance market, which includes crowdfunding, peer-to-peer lending and other activities, grew by 92% to reach €5,431m in 2015. Excluding the United Kingdom, the largest market by a considerable margin, the European online alternative finance industry grew 72% from €594m in 2014 to €1,019m in 2015. Although the absolute year-on-year growth rate slowed by 10% (the growth rate between 2013-14 was 82%), the industry is sustaining momentum with substantive expansion in transaction volumes recorded across almost all **online alternative finance models**.

The growth of Alternative Finance products as instruments of lending through online sites is such that bankers like Vikram Pandit, the former CEO of Citigroup has become part of a group that invested $2.7 million in a P2P site called Orchard.

The Government of India is also promoting digitalization as primary mode of financial transactions. There are various Mobile apps which are getting launched to facilitate transfer of funds through digital medium. Thus, the notion that alternative finance products are suitable only for traditional platforms is fast changing and more and more such products are getting distributed through online platforms. To facilitate the prospective movement of Alternative Finance Products towards digital media, globally, the regulations w.r.t these platforms are different. In India, the Central Banker, has initiated active discussions with stakeholders to formulate and revise governing policies for smooth operations of online platforms. This move signifies that the future of the alternative finance products is on digital platforms.

To sum up the finding of this research paper, it can be said that the paper has highlighted the peculiar nature of Financial Markets and Digital Media. Their relationship is not parasitic but very much symbiotic. There are more elements of complementarity and interdependence. In other words, the relationship is not only governed by the strengths of these financial products or the channels through which they are promoted or distributed rather than the horizon itself is so broad that both these two biomes play a complementary role to each other.

References:

- Adams, C. (2014). Crowdfunding guidance and practice: Value added co-creation. *IPP Oxford*.
- Argov, S. (2015, December 14). Alternative Finance: Four Ways To Fund Your Business. *minute hack.*
- Baeck, P., Collins, L., & Zhyang, B. (2014). *Understanding Alternative Finance.*
- Crosetto, P., & Regner, T. (2014). Crowdfunding: Determinants of success and funding dynamics. *Jena Economic Research Papers*.
- Duggan, T. (n.d.). The Rise of Corporate Peer-to-Peer Funding –From Global Finance Meltdown to Global Finance Revolution, in Just Three Years. *Analysis*.
- Isaac, P. (2013). Peer-to-peer lending. *ICAI journal of New Zealand*.
- Matthews, C. (2015, April). Larry Summers' full-throated endorsement of online lending. *fortune* .
- ROCKEFELLER, M. (2015, October). New Franchise Funding Sources are Sprouting Online. *Franchising World*.
- Shontell, A. (2015, April 10). Jamie Dimon: Silicon Valley startups are coming to eat Wall Street's lunch. *business insider*.
- Steven Dresner, F. a. (2014). *Crowdfunding: A Guide to Raising Capital on the Internet.* wiley.

Websites

- http://www.businessnewsdaily.com
- https://www.criterionconferences.com
- https://betterworkingworld.ey.com
- http://www.ey.com
- https://rbi.org.in
- https://www.researchgate.net/publication