



# FINTECH DISRUPTION IN THE AUTOMOTIVE FINANCE INDUSTRY

MFGDCG – Finance and Leasing CoE

## Executive summary

FinTech is the term used to describe technologically-enabled financial innovation that has led to the advent of new business models, applications and products with an associated material effect (process improvement, cost reduction and enhanced customer experience) on financial markets and institutions [1].

Digital banking can be considered as the first step of the digitalization of traditional banking where banking services can be availed online without having to be physically present at the branch. FinTech marks the next level of digitalization where advanced technologies are used to enhance the digital experience. With changing customer preferences and aggressive digitalization across industries, FinTech innovation will only become more pervasive in daily transactions, fueled further by the COVID-19 pandemic.

This paper focuses on the impact of FinTech in the auto-finance sector. It considers the end-to-end value chain and explains relevant use cases that can be adopted by captive finance firms. It also provides strategies for captives to compete or collaborate with FinTech companies by analyzing the risks and challenges involved.

## Introduction to FinTech

Finance technology or FinTech is an emerging industry comprising companies that use internet, mobile devices, new-age software, or cloud services to perform or enable financial services [2].

FinTech is one of the fastest-growing industry segments, disrupting almost every area of finance across retail banking, e-payments, loans, credit scoring, wealth management, insurance, and stock trading.

As an industry, FinTech includes startups as well as incumbents that leverage technologies such as artificial intelligence (AI), biometrics, robotic process automation (RPA), big data, mobile apps, and smart contracts (cryptocurrency) to make processes efficient and re-order business models through innovation.

In terms of numbers, by mid-2019, the top 48 FinTech unicorns were worth over US \$187 billion[3], which is slightly over 1% of the global financial industry. Investors poured more than US \$53 billion in funding into FinTech startups worldwide in 2019[4].

FinTech is revolutionizing almost all the clusters of financial services as illustrated below.

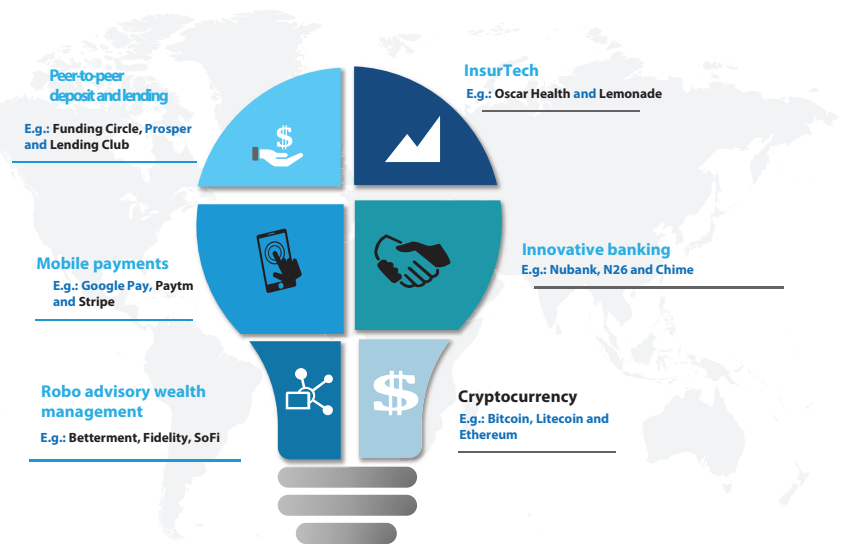
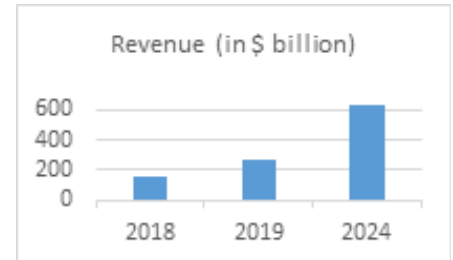


Fig 1: FinTech disruption across financial services



**FINTECH**  
VECTOR ILLUSTRATION

### Peer-to-peer (P2P) deposits and lending

– P2P lending allows individuals and businesses to borrow and lend money to each other by eliminating the middleman (financial institutions). This has made lending transparent, faster and more valuable because of greater returns for both lenders and borrowers.

- Opportunities – It offers higher returns than traditional FDs and holds promising growth in future
- Challenges – The industry is still in its nascent stage and regulations are evolving

**Mobile payments** – Thanks to FinTech, digital payments have come a long way. Internet and smartphone penetration along with better communication technologies have significantly expedited the adoption of mobile payments, which have evolved from P2P transfers to near field communication (NFC) via mobile tapping, camera-enabled QR code scanning and voice banking.

- Opportunities – Mobile payments are contactless, making it a winner in a COVID-19 scenario. Further, mobile internet penetration is expected to increase.
- Challenges – Online fraud and fraud losses are an omni-present risk with severe impact on affected customers

### Robo advisory wealth management

– An AI algorithm requests clients to fill a questionnaire to assess their goals, risk tolerance and investment horizon. On analyzing the information, the bot segments the profile and suggests a personalized financial/tax saving roadmap for a minimal fee with an option to further consult a human financial advisor

- Opportunities – Through big data technology, robo advisors are expected to manage roughly US \$2.2 trillion of the world's wealth by 2022 (2).

- Challenges – Investment/tax plans are not 100% personalized yet and robo advisors may not have solutions for unexpected crises like COVID 19

**InsurTech** – This pertains to an insurance application process that takes minutes instead of weeks, does not involve commission agents, requires no medical exams for most applicants, and uses automated underwriting and fraud detection systems. It can also provide personalized insurance premiums based on telematics-based driving data and has a claim process that takes as little as three seconds, resulting in better customer experience and a relatively cheaper policy.

- Opportunities – Post COVID, customers will prefer to buy policies online and avoid face-to-face interactions with agents
- Challenges – Building awareness and acceptance of InsurTech instead of in-person advice

**Banking** – In the banking domain, FinTech has two segments, namely, open banking-based neo banks as well as challenger banks. Regulatory changes have encouraged 'open banking' policies, leading large banks to share customer data (on request) with third parties. This has led to the creation of neo banks that are completely online. Neo banks use traditional banking infrastructure but offer faster onboarding and account opening, deeper customer understanding, lower fees, and customized banking. A neo bank

can provide a credit card by Nubank, a student loan by SoFi, and financial wellness and mobile banking by Moven. The second banking segment, challenger banks, includes 100% digital and nimble banks that provide end-to-end online services and have banking licenses. These are similar to neo banks in that they provide transparent and enhanced customer experience. For example, customers can open a current account using video chat via N26 or checking and saving accounts via Chime.

- Opportunities – Emerging markets have large unbanked populations, high mobile penetration and a growing middle class
- Challenges – The biggest barriers will be consumer trust, the high cost of acquiring new customers and meeting stringent regulations

**Cryptocurrency** – This is one of the most popular and complex FinTech use cases. Cryptocurrency is a secure virtual currency based on blockchain technology that makes it nearly impossible to counterfeit or double spend. Some examples are Bitcoin, Litecoin and Ethereum.

- Opportunities – Fund transfer between two parties will become faster, cheaper and easier because there is no need for third parties/banks
- Challenges – Price volatility, cybersecurity, legal and regulatory issues will persist



## FinTech use cases in automotive finance

In 2019, the automotive finance industry was worth nearly US \$220.18 billion with a forecast of 6.7% CAGR over the next 6 years [5]. This makes it quite a large industry in terms of revenue as well as the number of players across geographies. As per McKinsey, automotive finance is on the verge of revolutionary change, giving FinTech an opportunity to shape the future of the industry's landscape [6]. The innovations offered by FinTech companies can revolutionize every aspect of lending within the auto finance industry. It can also serve as an example of the benefits FinTech across other lending sectors.

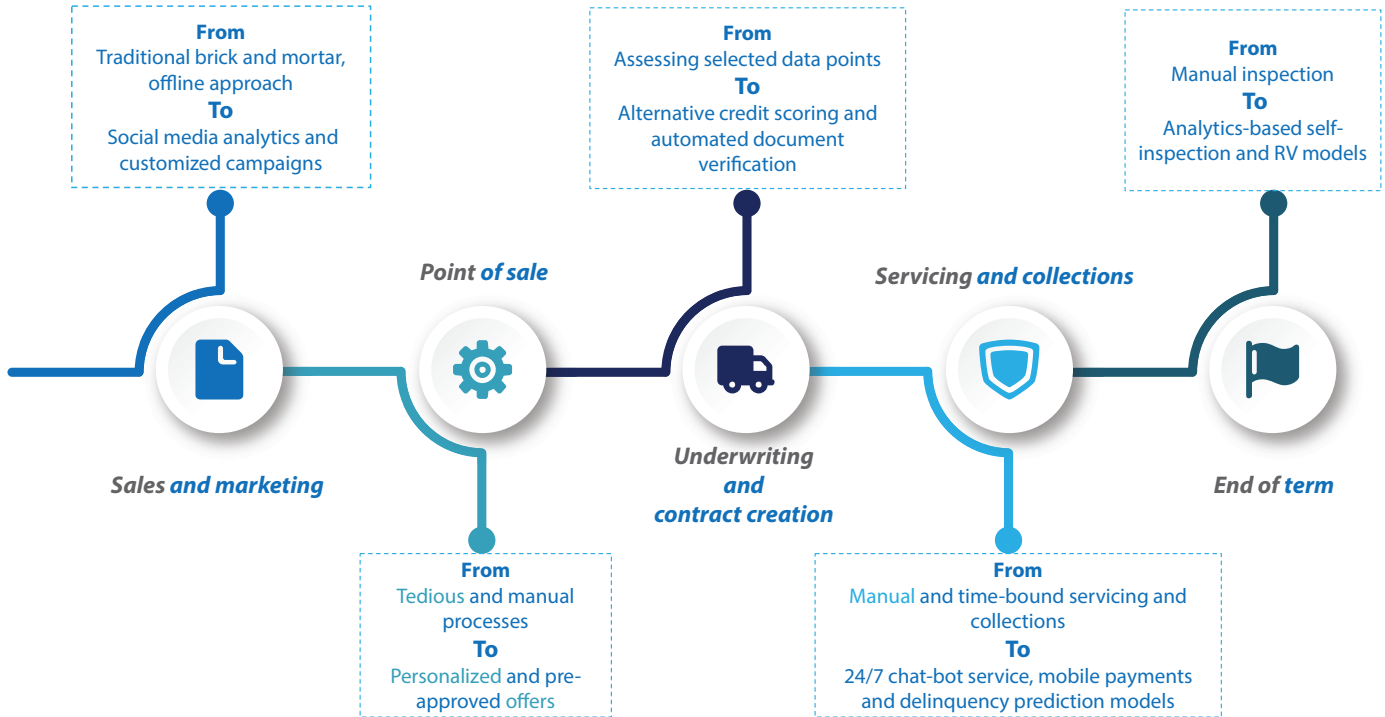


Fig 2: FinTech use cases in auto finance

# FINANCIAL TECHNOLOGY



Sales and marketing – Modern buyers are looking for better ways to start their auto finance journey using digital and intuitive marketing tools rather than traditional brick and mortar channels. Prospecting, lead generation, referrals, etc., have become more efficient with the use of social media analytics and mobile productivity tools. This will help dealers and captive finance institutions create customized campaigns.

Point of sale – FinTech companies have been able to solve the inherent challenge of tedious, manual, time consuming loan origination processes at the traditional points of sale that have sometimes led to inaccurate loan processing. They automate these processes using technologies like AI and mobile apps, thereby generating pre-qualified loan offers. This has made the lending process more personalized and customer-friendly, generating cost savings and increased revenue for auto-finance captives.

Credit underwriting – Automated underwriting has accelerated credit decisioning processes while alternative credit sourcing models use data like rent history, cell phone payments, etc., to provide auto-loans to traditionally non-banked segments. This not only generates additional sources of revenue but also reduces delinquency rates through holistic credit underwriting.

Automated document compliance – With the use of blockchain technology and machine learning algorithms that can detect subtle irregularities, FinTech players have been able to automate document verification for regulatory requirements such as KYC/AML/customer identification. They also perform customer due diligence, thereby making lending much more efficient and effective for captives.

Customer servicing – Today's customers expect 24/7 seamless service, 360-degree views for self-service, proactive intervention, and superior experience. Latest technologies like smart chatbots enhance customer engagement by identifying, retrieving and categorizing information from digitized paperwork and databases, thereby improving the handling of customer queries.

Payment – FinTech has disrupted traditional payment markets (cash, cheque and demand draft) by combining bold new business models (PayPal, Stripe, ANT Financial, Apple Pay, Google Pay) and cutting-edge technologies (QR scanning and NCP). The nature of payments has also evolved from being location-bound (cash/cheque) to device-bound.

Delinquency management – Data analytics is solving the problem of poor vehicle loan recovery rates and high operational cost of captive collection department by

introducing features like data-driven delinquency prediction and automated collection management. These features include dunning and collection strategy suggestions, customer segmentation and delinquency buckets.

Fraud detection – Traditional auto-finance companies take around 40 days to detect a fraud. In the digital era, financial institutions need systems that can track fraudulent activity in real-time. Freedzai, a FinTech company, uses machine learning to process large datasets with many variables and find hidden correlations between user behavior and likelihood of fraud. It has demonstrated 95% accuracy in fraud detection in real-time.

InsurTech – While incumbent insurers are busy meeting customer demands, InsurTech is one step ahead, pro-actively determining customer needs by studying their interactions and behavior. They are assisted by technologies such as deep learning, behavior analysis and IoT that can even recommend personalized insurance products. One example here is InsureScan, an auto-finance company that has developed a mobile app for customers to scan their license and VIN based on which multiple quotes are raised and sent to the customer who can then purchase his policy online.

## Road ahead for captives

With social distancing and work from home becoming the new normal, businesses across sectors have been greatly impacted. Digitally native FinTech companies are better equipped to ride the COVID-19 wave. Lenders will have to aggressively adopt new technologies while undergoing

digital transformation to operate more efficiently, cut costs and drive profitability in a post-COVID world.

The two major go-to market strategies for these companies in the current business environment are 'Compete' and 'Collaborate'.

COVID-19 has created an environment of uncertainty due to which many companies are under stress. Will FinTech be the 'new normal' when the economy shifts from 'respond' to 'recover' mode?

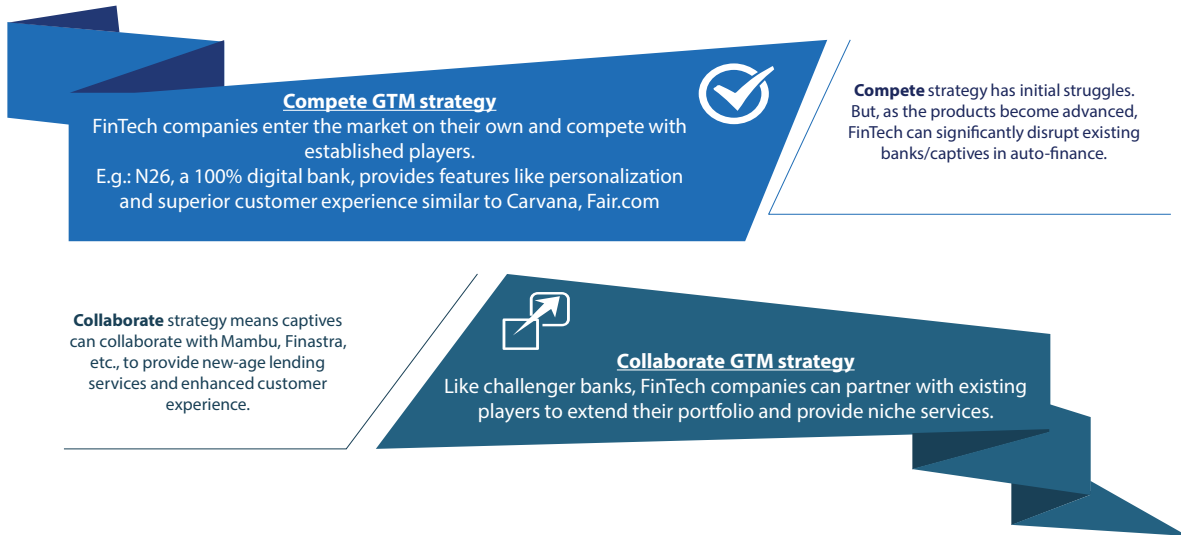


Fig 3: Collaborate versus compete model



In both cases, there are some critical features specific to the auto-finance journey that must be incorporated as part of the landscape (shown in Fig 4).

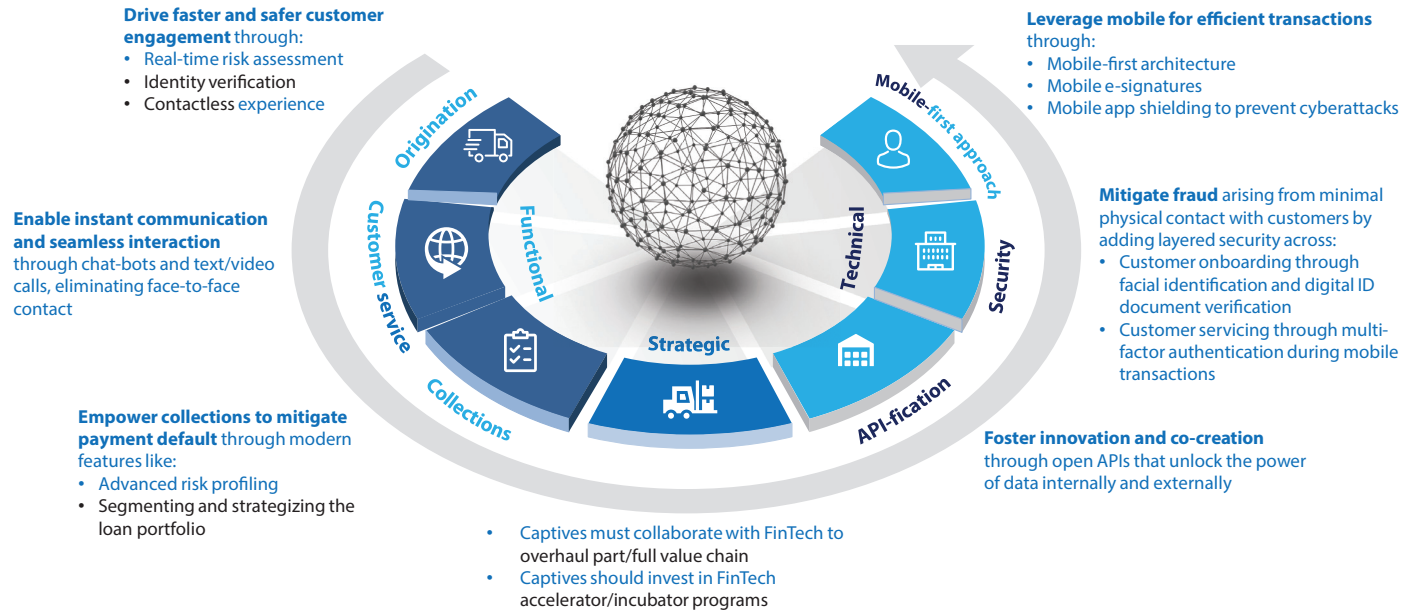


Fig 4: The road ahead for captive auto-finance companies

## Risks and challenges

With the increasing acceptance of FinTech and emerging technologies, the financial sector is becoming more interconnected and complex. This has raised certain risks and challenges under data privacy, risk governance, business models, and regulatory differences across geographical boundaries.

In the Compete model, FinTech can handle a gamut of end-to-end services. The challenges are the initial trust deficit and lack of awareness among customers about mortgage finance companies like Carvana, Fair.com, etc.

In the Collaborate model, there could be various initial adoption/implementation challenges around portfolio movement, legacy modernization and integration.



Fig 5: Risks and challenges

## Conclusion

The advent of FinTech in the auto-finance industry is intensifying competition within this space. To thrive, both FinTech players and captives need to learn from each other. Captives should assess their strengths and weaknesses and accordingly decide on a compete or collaborate plan, or a combination of both, in order to evolve an effective growth strategy.

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