Banks develop an appetite for start-ups

Lenders taking up incubator-style roles with small investments in start-ups

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In a dimly lit auditorium, three groups were called on to the stage to polite applause. Electronic music, with the bassline turned up too high, reverbed through the speakers. A couple of them smiled as they held their award to the flashlight of two cameras. Orange, which was the hallmark colour of the company organising the event, looked to overwhelm them. There was no buzz remarking their accomplishment. It was just another thing around town.

But, the event did mark a sea change in the attitude of banks towards startups. The three had just won ICICI Bank's Appathon. The bank had received around 2,000 applications of which it had shortlisted 600 and 10 were the finalists. While the winner received ₹10 lakh, the runners-up took home ₹7.5 lakh each. The money, however, came from ICICI Bank's balance sheet. The amount, ₹25 lakh, isn't a big sum for a bank that huge. Today, start-ups are more than just a customer for banks.

In March, HDFC Bank conducted a similar exercise. Not surprisingly, similar companies were shortlisted. The standout in both cases being start-ups trying to use artificial intelligence (AI) for customer interfacing. Both HDFC Bank and ICICI Bank were coy on whether these start-ups would sign exclusive agreements with them but some amount of investment was on the table. HDFC bank had tied up with Chillr last year, which subsequently raised $6 million from Sequoia India. The startup developed a system, which helped customers pay without a wallet.

Nitin Chugh, country head, digital banking, HDFC Bank, said the bank wanted to break out from these one-off ties and open themselves to new and innovative ideas.

"Currently, investment is not on the agenda and we are working out with the companies if we want an exclusive deal with them or use as white-label products," said Chugh. ICICI Bank, too, took a similar stance but kept the door open for the possibility of future investments.

"We are looking at the possibility of funding start-ups in the future if the opportunity arises," said Rajiv Sabharwal, executive director, ICICI Bank. The bank has been particularly interested in big data and block chain-like solutions. He also added that the company works in association with various incubator programmes to identify technology that could strengthen its existing portfolio. Last year, HDFC Bank made its first investment in the online space and had maintained that it will be exploring further investment opportunity in the e-commerce/digital space. According to people familiar with the development, the bank has set up a team and has earmarked a separate fund to explore potential investment opportunities. Even smaller private sector lenders, such as Ratnakar Bank (RBL), have admitted that they are considering funding start-ups. "We are evaluating investing in financial technology firms or companies that are looking at increasing the last mile reach and are in the overall financial inclusion space. With such investments, we can accelerate our growth by partnering with start-ups in areas that we may not be very strong at and in the process also make some capital gains," said Rajeev Ahuja, head-Strategy, RBL.


ILLUSTRATION: BINAY SINHA

BIG PUSH

- HDFC Bank ties up with Chillr in 2015 to develop a wallet-like tool
- In 2015, RBL invests in Trifecta Capital's Venture Debt Fund
- In 2015, HDFC Bank makes its first investment in the online space with a potential fund in the offing
- In March 2016, HDFC Bank conducts a digital talent search to shortlist start-ups
- In April 2016, ICICI Bank holds similar workshop; shortlists three companies

Even though RBL is yet to make any direct investment in a start-up, it has already started testing the waters with an indirect investment. Last year, it invested in Trifecta Capital's Venture Debt Fund, which was set up with an aim to provide structured debt to high-growth startups that have raised Series-A or Series-B rounds of equity funding. So, are we going to see major investments coming from banks to the tune of multi-million dollars? Probably not. According to the regulations, banks can invest up to 10 per cent of equity capital in a company without Reserve Bank of India's approval. However, for any investment between 10 per cent and 30 per cent of the equity capital, the lender will need a nod from the banking regulator. The banks will typically take up incubator-style roles, with small investments, which help them acquire companies or look at a possible technology merger. And fin-tech companies will be king.

"Originally, we saw the bank's services as bundled. Now, these start-ups have disrupted that and unbundled these services," said Vidya Shankar, head, funding partnerships & alliances, 10,000 Startups, Nasscom.

Federal Bank, another private sector lender, has already opened incubation centres in some of its branches in Karnataka and Kerala that will give advice on capital, help in arranging funds and engage with startups to weed out regulatory hurdles. The bank has also set up a startup fund of ₹25 crore for the space.

Shankar added that despite the efforts of the government, India is a cash economy, which changes the concept of credit rating, for example.

"Someone regularly opting for cash on delivery can be eligible for a loan despite not having an electronic trail. This is what startups can track and a big bank cannot," he said. Shankar added that banks now have started to form partnerships for different reasons. "Some want to appear to be easy for startups to work with, while others want this technology to beat competition," he said. But why now? Last year was considered peak season for fin-tech firms. "This year the valuations are a little saner, which is why banks are interested now," laughed Shankar.