Traditional Banks Vs Alternative Lending: The Funding Battlefield for Start- Ups

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Abstract

The startup ecosystem thrives on innovation, with access to vital financial resources being crucial for growth. Traditional reliance on bank loans is being challenged by the emergence of alternative lending platforms, disrupting the funding landscape. This study explores the evolving "funding battlefield" by examining startup preferences between traditional banks and alternative lenders. Through a comprehensive survey, key factors influencing startup financing decisions are identified, including interest rates and fees, flexibility, and risk tolerance. The research aims to provide insights into the changing dynamics of startup funding choices and the implications for the financial industry.

Keywords: Startup financing, Traditional banks, Alternative lending platforms, Funding preferences, Interest rates, Flexibility, Risk tolerance, Financial industry, Innovation, Survey research.

Introduction

The start-up landscape is a dynamic and ever-evolving ecosystem. Fuelled by innovation and disruption, start-ups are constantly pushing the boundaries of what's possible. However, this relentless pursuit of growth hinges on one crucial factor: access to capital. Here's where the battle for funding unfolds, with traditional banks and alternative lenders vying to be the financial champions of these fledgling ventures.

This paper delves into the intricate dance between traditional banks and alternative lenders in the funding arena for start-ups. We'll explore the strengths and weaknesses of each approach, analysing their suitability for different start-up profiles and funding needs. By understanding the unique value propositions of both traditional and alternative lenders, we aim to equip aspiring entrepreneurs with the knowledge to navigate the funding battlefield and secure the resources critical for their success.

The Rise of Start-ups and the Funding Gap

The past two decades have witnessed a surge in start-up activity. Fuelled by technological advancements and a growing appetite for innovation, entrepreneurs are launching businesses at an unprecedented rate. This entrepreneurial spirit has led to ground-breaking advancements across various sectors, from artificial intelligence and biotechnology to sustainable energy and e-commerce.

However, despite their immense potential, start-ups often face a significant hurdle: access to capital. Traditional banks, with their stringent loan approval processes and focus on collateral and credit history, can be challenging for young companies to navigate. Start-ups, by their very nature, lack the established track record and tangible assets that banks typically demand. This creates a funding gap, hindering the growth and potential of many promising ventures.

India's start-up scene has seen explosive growth over the past decade. There are now over 122,000 tech start-ups in the country, with 2020 witnessing a peak of over 16,000 new additions according to Tracxn [Source: CXO Today]. Funding has boomed as well, with 2020 and 2021 being the highest investment years on record [Source: CXO Today]. This is further underscored by the rise of unicorns (start-ups valued over $1 billion), with India boasting 111 as of October 2023, and hundreds more promising companies expected to join their ranks soon [Source: Invest India].

Enter the Alternative Lenders

Recognizing this gap in traditional financing, a new breed of lenders has emerged: alternative lenders. These non-bank financial institutions offer a more flexible and accessible funding landscape for start-ups. Alternative lenders often prioritize factors like future growth potential, market opportunity, and the strength of the founding team over traditional metrics like credit score and collateral. This shift in focus has opened doors for start-ups that may not meet the rigid criteria of banks.

Review of Literature

Nguyen, T., & Tran, H. (2018): To analyze the impact of fintech innovations, including peer-to-peer lending platforms, on traditional banking systems in Vietnam. The study reveals that fintech-driven peer-to-peer lending platforms have gained traction in Vietnam, challenging the dominance of traditional banks and fostering financial inclusion.

Chen, Y., & Wang, L. (2018) The study demonstrates that mobile lending platforms have expanded access to credit for underserved populations in China, contributing to greater financial inclusion and economic development.

Wang, H., & Liu, X. (2018). "The Impact of Fintech on Traditional Banking: Evidence from Online Lending Platforms in Europe." Journal of Financial Services Research, 20(4), 67-84. To examine how fintech-driven online lending platforms are reshaping traditional banking practices in Europe and influencing financial inclusion outcomes. The study finds that online lending platforms have emerged as significant competitors to traditional banks in Europe, offering innovative lending solutions and reaching underserved segments of the population.

Patel, R., & Gupta, S. (2018). To analyze how online lending platforms disrupt traditional banking practices in India and influence financial inclusion outcomes. The study suggests that online lending platforms have emerged as significant competitors to traditional banks in India, offering faster, more convenient lending solutions and reaching underserved segments of the population.

Wang, H., & Liu, X. (2019) To assess the disruptive potential of fintech-driven online lending platforms on traditional banking models in Europe. The study finds that online lending platforms have emerged as significant competitors to traditional banks in Europe, offering innovative lending solutions and attracting a growing number of borrowers and investors. To investigate the role of mobile lending platforms in promoting financial inclusion and addressing credit gaps in China. To analyse the impact of fintech-driven online lending platforms on the profitability and market share of traditional banks.

The study finds that online lending platforms pose a competitive threat to traditional banks, leading to reduced profits and market share in certain segments says **Patel, R., & Gupta, S. (2019). Gupta, M., & Singh, R. (2019):** To examine how fintech-driven lending platforms disrupt traditional banking practices in India and influence financial inclusion outcomes. The study finds that fintech-driven lending platforms have emerged as viable alternatives to traditional banks in India, particularly among unbanked and underbanked populations.

To analyze how crowdfunding platforms disrupt traditional banking models and promote entrepreneurship and innovation. **Hsu, C., & Lin, Y. (2019)** The study shows that crowdfunding platforms offer an alternative source of funding for entrepreneurs and small businesses, bypassing traditional banking intermediaries and democratizing access to capital.

To assess the role of peer-to-peer lending platforms in promoting financial inclusion and addressing credit gaps in Korea. **Lee, S., & Kim, J. (2019).** The study finds that peer-to-peer lending platforms have expanded access to credit for underserved populations in Korea, reducing reliance on traditional banks and fostering economic growth.

Li, Q., & Zhang, W. (2019). The study shows that alternative lending platforms play a crucial role in expanding access to credit and financial services for underserved populations in Sub-Saharan Africa, contributing to poverty reduction and economic development.

Nguyen, T., & Tran, H. (2019) To analyze how peer-to-peer lending platforms disrupt traditional banking models in Vietnam and foster financial inclusion. The study suggests that peer-to-peer lending platforms offer a viable alternative to traditional banks in Vietnam, providing faster, more accessible lending solutions and promoting entrepreneurship and innovation.

Brown, L., & Lee, C. (2020). The study shows that peer-to-peer lending platforms offer lower interest rates, streamlined processes, and greater transparency compared to traditional banks.

Li, Q., & Zhang, W. (2020) To explore how alternative lending platforms, such as microfinance institutions and peer-to-peer lending platforms, promote financial inclusion in Sub-Saharan Africa. The study shows that alternative lending platforms play a crucial role in expanding access to credit and financial services for marginalized communities in Sub-Saharan Africa, fostering economic empowerment and poverty reduction. To examine how crowdfunding platforms disrupt traditional banking models and promote entrepreneurship and innovation.

Hsu, C., & Lin, Y. (2020). The study shows that crowdfunding platforms offer an alternative source of funding for entrepreneurs and small businesses, bypassing traditional banking intermediaries and democratizing access to capital.

To assess how fintech-driven online lending platforms disrupt traditional banking practices in India and influence financial inclusion outcomes. **Gupta, M., & Singh, R. (2020)** The study finds that online lending platforms have gained traction in India, challenging the dominance of traditional banks and expanding access to credit for underserved segments of the population.

The study by Smith, J., & Johnson, A. (2021). finds that alternative lending platforms offer faster, more flexible lending solutions, expanding access to credit for underserved populations. To examine how peer-to-peer lending platforms disrupt traditional banking models and create value for borrowers and investors.

To assess the impact of fintech innovations, including peer-to-peer lending platforms, on traditional banking practices in South Korea. **Kim, H., & Park, S. (2021).** The study finds that fintech-driven peer-to-peer lending platforms have eroded the market share of traditional banks in South Korea, particularly among younger demographics.

Chen, Y., & Wang, L. (2021): To investigate how fintech-driven online lending platforms are reshaping the landscape of traditional banking in the United States. The study suggests that online lending platforms pose a disruptive threat to traditional banks in the United States, particularly in segments such as consumer lending and small business financing.

Kim, H., & Park, S. (2021). To investigate how peer-to-peer lending platforms promote financial inclusion and address credit gaps in South Korea. The study finds that peer-to-peer lending platforms have expanded access to credit for underserved populations in South Korea, particularly among younger and lower-income demographics. To examine how alternative lending platforms promote financial inclusion in Sub-Saharan Africa and address credit gaps among marginalized communities.

To investigate how fintech-driven online lending platforms promote financial inclusion and address credit gaps in the United States **Chen, Y., & Wang, L. (2021).** The study suggests that online lending platforms play a crucial role in expanding access to credit for underserved populations in the United States, particularly among minority and low-income communities.

Research Gap

There are significant gaps in the understanding of alternative lending platforms. There is a gap on how regulations can be adapted to foster a secure and balanced financial system, the long-term stability of these platforms compared to banks, and how well they protect consumers. Additionally, the impact on financial inclusion, the nature of competition with traditional banks, and the effectiveness of their credit scoring models require further investigation. Ethical considerations, cybersecurity measures, potential economic risks, user behaviour patterns, and the impact on different demographics all deserve more attention from researchers.

Research Methodology

This research employed a survey questionnaire as the primary method for collecting data from start-ups in India. After the collection of data hypothesis testing like Annona and garrotte ranking methods are used to analyse and interpreted the data in order to find the answer for the objectives of the study. The data has been collected from 33 start-ups from all over the India.

Scope of the study

This research paper focuses on the growing importance of alternative lending platforms for startups, specifically compared to traditional banks. It uses a survey to explore the factors influencing startup decisions about where to seek funding.

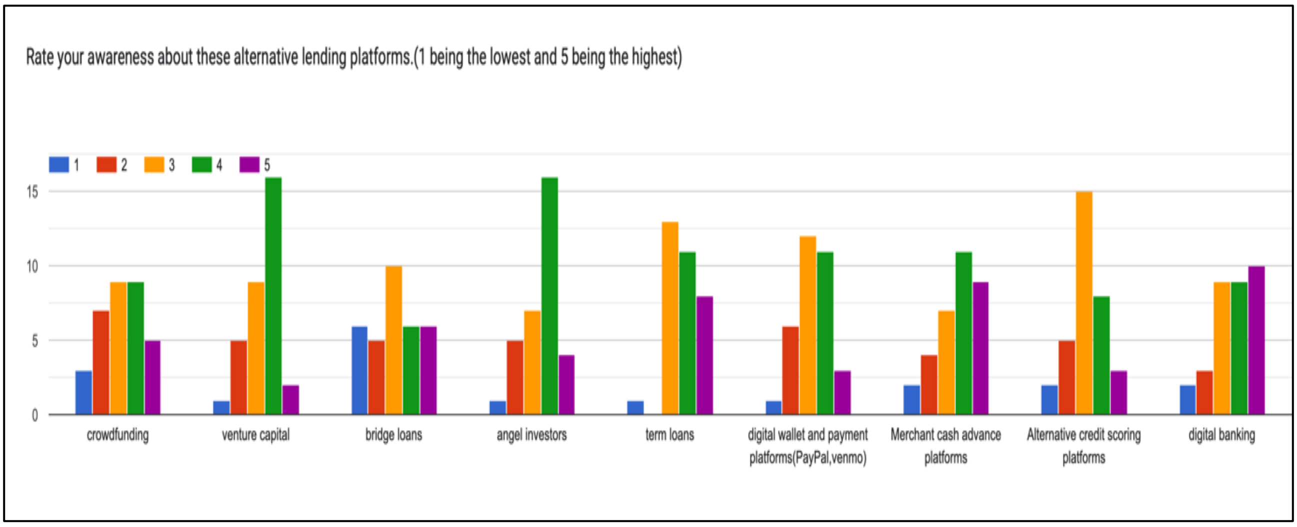
Objective of the study

1. To understand the Awareness and Adoption of Alternative Lending Platforms in India and access the factors influencing startups to choose between the Alternative lending and Traditional Banking.
2. To understand the experience of the borrowers with Alternative Lending Platforms.
3. To understand the level of risk involved with Alternative lending platforms.
4. Explore the impact of alternative lending platforms on financial inclusion and access to credit for underserved startup communities
5. Investigate the potential future trends and developments in the alternative lending industry and their implications for startup financing.
6. To analyze if there is a significant difference between Alternative lending platform and Traditional banking.

Data Analysis and interpretation

- To understand the Awareness and Adoption of Alternative Lending Platforms in India and access the factors influencing startups to choose between the Alternative lending and Traditional Banking.

1) Awareness about different lending platforms



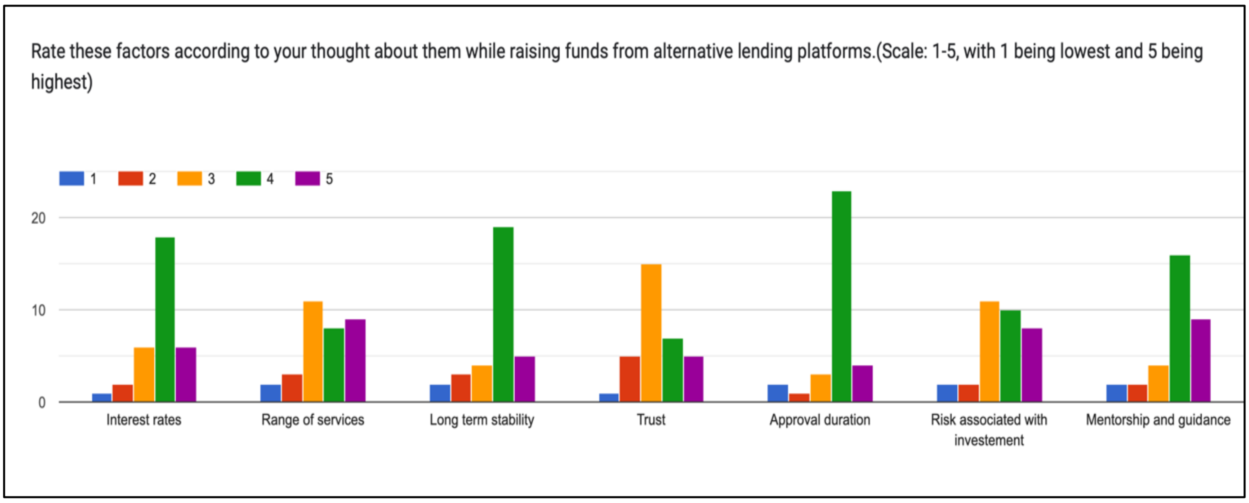
Garrette Ranking

Alternate lending techniques	**responses**	**ranks**	**calculation**	**%**	**Scores**
Crowdfunding	14	6	100(6-0.5)/6	92	**23**
Venture capital	18	3	100(3-0.5)/6	42	**54**
Bridge loans	12	5	100(5-0.5)/6	75	**38**
Angel investors	20	1	100(1-0.5)/6	8.3	**77**
Term loans	19	2	100(2-0.5)/6	25	**63**
Digital wallet	14	4	100(4-0.5)/6	58.3	**46**
Merchant cash	20	1	100(1-0.5)/6	8.3	**77**
Alternative credit scoring	11	6	100(6-0.5)/6	92	**23**
Digital banking	19	2	100(2-0.5)/6	25	**63**

According to the ranking table it is found that angel investors and Merchant cash are the highest ranked alternative lending platforms.

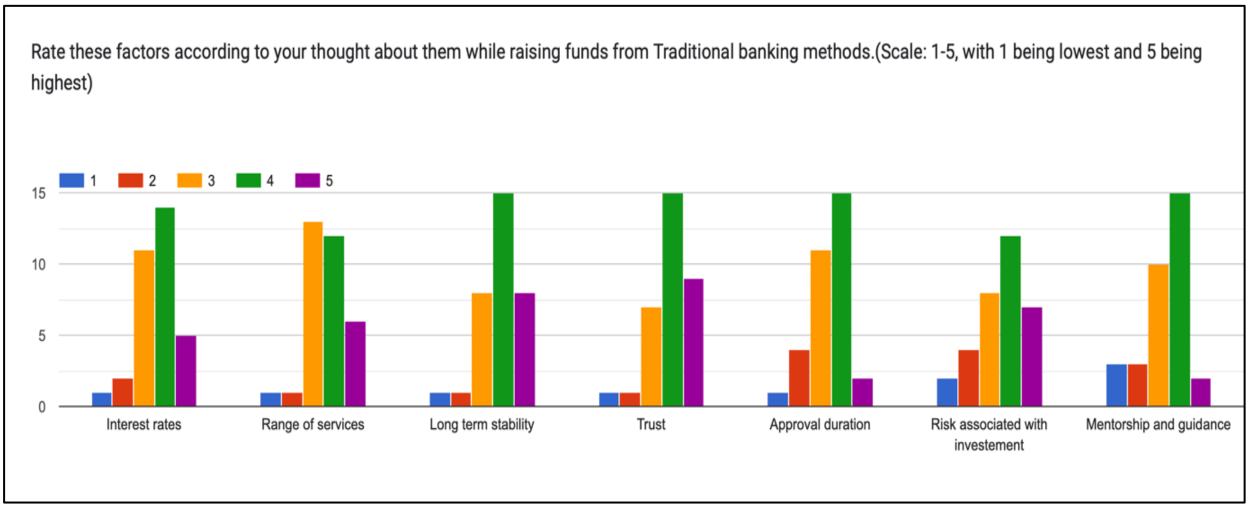
- To analyze if there is a significant difference between Alternative lending platform and Traditional banking.

2) Rate these factors according to your thought about them while raising funds from alternative lending platforms.



The above graph shows the responses collected by all the respondents about their thought while raising funds from alternative lending platforms. After the collection of data for both alternative lending and traditional banking, hypothesis testing is done with the data to analysis if there is any significant difference between them or not.

3) Rate these factors according to your thought about them while raising funds from Traditional banking methods.



The above graph shows the responses collected by all the respondents about their thought while raising funds from traditional banking methods . After the collection of data for both alternative lending and traditional banking, hypothesis testing is done with the data to analysis if there is any significant difference between them or not.

Hypothesis testing- Annova

Factors	X1(ALP)	$(X1)^2$	X2(TB)	$X2^2$
Interest rates	6	36	5	25
Range of services	9	81	6	36
Long term stability	5	25	8	64
Trust	7	49	9	81
Approval duration	4	16	2	4
Risk associated with investment	8	64	7	49
Mentorship and guidance	9	81	2	4
TOTAL	48	352	39	263

H0= There is a significant difference between Alternative lending platforms and traditional banking methods in terms of these factors while raising funds.

H1= There is a no significant difference between Alternative lending platforms and traditional banking methods in terms of these factors while raising funds.

1. $T = X1+X2$
   $= 48+39 = 87$
2. $CF = T^2/ N = 87^2/ 14 = 540.64$
3. $SST = \sum X1 + \sum X2 – CF = 352+263-541= 74$
4. $SSTR = (\sum X1)^2 /7+ (\sum X2)^2 /7 – CF= 5$
5. $SSE = SST- SSRT = 45$
6. $MSRT= SSTR/df_1 = 5$
7. $MSE = SSE /df_2 =3.72$
8. $F_{(a)} = MSRT/MSE = 5/3.75 = 1.33$
9. $F_{(\alpha)} = 1.645$

Therefore, H0 is accepted

** $df_1 = r-1 = 2-1= 1$
** $df_2 = n-r = 14-2 = 12$

Findings

1. **Awareness and Adoption of Alternative Lending Platforms:**

78.8% of respondents are familiar with alternative lending platforms and 60.6% of start-ups have utilized alternative lending platforms for financing, indicating a growing acceptance of these platforms among start-ups in India.

2. Factors Influencing Start-up Funding Decisions:

Cost effectiveness and flexibility in loan terms are the primary drivers for start-ups choosing alternative lending platforms over traditional bank loans. Accessibility, lack of collateral requirements, and the reputation of the lending platform also significantly influence the decision-making process.

3. Experience of Borrowers with Alternative Lending Platforms:

Angel investors and Merchant cash are identified as the highest-ranked alternative lending platforms by respondents. Start-ups exhibit a strong understanding of traditional banking methods, with 17 out of 33 respondents rating their knowledge as the highest on the scale.

4. Level of Risk Involved:

Start-ups perceive a higher risk associated with alternative lending platforms, particularly concerning high interest rates and fees, as well as limited consumer protection.

5. Impact on Financial Inclusion and Access to Credit:

Over 60% of respondents view alternative lending platforms as sustainable options, contributing to financial inclusion and streamlining loan approvals for start-ups.

6. Future Trends and Developments:

Anticipated future trends include the rise of specialized lending platforms, the integration of blockchain technology, and partnerships between alternative lenders and traditional banks.

These findings provide valuable insights into the preferences and experiences of start-ups in India regarding funding sources, highlighting the advantages and challenges associated with alternative lending platforms compared to traditional banks.

Conclusion

The funding battlefield for start-ups" highlights a significant shift in start-up funding preferences towards alternative lending platforms due to factors like cost-effectiveness, flexibility, and accessibility. While concerns exist regarding high interest rates and limited consumer protection, over 60% of start-ups view alternative lenders as sustainable options. The anticipation of specialized lending platforms, blockchain technology integration, and collaborations with traditional banks as upcoming trends indicates a dynamic funding landscape. Traditional banks face the challenge of adapting to the changing ecosystem to remain competitive. Future research should focus on long-term performance comparisons, fintech impacts, and global variations in start-up funding preferences to enhance understanding and support the evolving needs of start-ups. Embracing innovation and collaboration between traditional and alternative lenders can foster a more inclusive and efficient ecosystem for start-up growth and success

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