Payments bank-a catalyst for financial inclusion

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Abstract
The study investigates how newly licensed payment banks can favourably achieve inclusion goals of the Indian banking regulator by engaging with marginalised and migrant groups within the population pie, as envisaged by the banking regulator. The role of digitisation in making basic financial services available to such excluded groups has been explored within the study. In addition, the article attempts to critically assess the competitive implications such a new financial institution will have on the existing full-service banks. The study is grounded on the concept of payment banks as a crucial cog in a differentiated banking regime. Secondary information extracted from occasional reports/working papers of Reserve Bank of India (RBI) has been used to gauge the efforts towards realising inclusion goals. Perspectives of CEOs and banking practitioners have provided valuable inputs as to how the banking fraternity views payment banks and perceives them as a competitive threat. As the payment banking business model necessitates forging alliances with full-service banks, implications of such strategic alliances warrant research. The present study is an initial attempt to fill this gap in the extant literature.

Keywords
Payment bank, financial inclusion, customer engagement, Indian banking

Introduction

The Indian banking sector has been marked by an exponential growth in volume and complexity over the past decade. But it remains a bitter reality that much needed basic financial services have not percolated to underprivileged and weaker sections, despite achieving sizeable advances in terms of financial viability, profitability and competi- tiveness. Reserve Bank of India (RBI) the national banking regulator keeping a strong on this matter has over the years introduced diverse financial inclusion initiatives as part of its prioritised agendas. These initiatives have been specifically aimed towards alleviating the financial condition and standards of life of the poor and disadvan- taged as documented by Thorat (2007) and Leeladhar (2006).

Financial inclusion primarily refers to the delivery of financial services to the disadvantaged and low-income groups at an affordable cost. It includes access to basic financial services such as credit, savings, insurance, and payments and remittance facilities. In India, the schemes of financial inclusion envisaged by RBI cannot be executed solely on the basis of the branch banking model. Technology adoption is inevitable if the desired inclusion targets are to be achieved within a defined time span. Online banking, mobile banking and other forms of branchless banking taking the basic financial services to the doorstep of customers are key to reaching the unbanked regions and bringing the excluded segment of the population pie into the ambit of basic financial services. According to report released by Bank of America Merrill Lynch, the mobile banking model is expected to achieve an exponential growth in India, given the fact that the nation is marked by the low penetration of bank accounts relative to high adoption of mobile phones. India has a population base of 1.2 billion with 970 million mobile phones, but close to 700 million bank accounts. Such a scenario further supports the proposition of technology-led inclusion initiatives. Over the past decade, payment initiatives such as point of sale (PoS) payments, prepaid payments, Aadhar-based payments and other forms of digital payments have facilitated ease of transaction without operating through conventional branch banking models. PoS terminals have doubled from 0.66 million in FY 2011–2012 to 1.13 million in FY 2014–2015 (CII-Deloitte Report, 2015). This in turn led to boost in transactions executed via debit and credit cards at such terminals from `1.50 trillion in FY 2011– 2012 to over `3.11 trillion in FY 2014–2015 (CII-Deloitte Report, 2015). In the non-bank prepaid payments initiatives front, the observed growth has been equally encouraging. Prepaid payment instruments (PPI) usage has grown from 62,000 million in FY 2011–2012 to 210,000 million in FY 2014–2015 (CII-Deloitte Report, 2015). These statistics forward a strong rationale behind RBI granting banking tag to payment-based models and awarding payment banking licences to 11 diverse operators ranging from small microfinance lenders and wallet-based payment operators to established firms in cellular and telecom services.The present study offers a perspective on the payment banking model and brings out its unique potential towards including the excluded within the purview of financial services. What it augers for conventional full-service banks has been additionally explored. Succeeding part of

the research has been divided into seven sections viz. financial inclusion – A reality check, payment banks: A differentiated bank variant, influx of payment banks: Reactions from the bankers, payment banks – A ray of hope for the marginalized and excluded, technology enabled customer engagement, impact on commercial banks, and conclusion & way forward.

Financial Inclusion: A Reality Check

Although the term 'financial inclusion' was first mentioned in the RBI Annual Policy Statement 2005–2006, the efforts towards bringing increasing number of people under the banking umbrella had started in the 1960s. According to The Indian Banker (2015), The financial inclusion, a multidimensional concept, is about: Ensuring both "accesses" and "delivery" of financial services to the people, especially the poor and underprivileged, and those who are residing in socio-economically backward areas. Financial services should include at least banking (deposit, loan and remittance products) and insurance products. According to Global Findex database 2014 (published by World Bank), 2 billion adults remain unbanked globally. South Asia, East Asia and the Pacific together account for more than half the world's unbanked adults. This doesn't qualify as a surprise given the fact that these two regions are base to developing world's top three populous nations— China, India and Indonesia. These three countries in aggregate account for 38 per cent of the global unbanked population. India alone comprises 21 per cent of the world's unbanked adults and about two-thirds of South Asia's. Access to finance qualifies as a critical factor in influencing people's ability to transform their production and employment activities and to alleviate poverty (Aghion & Bolton, 1997; Banerjee, 2001; Banerjee & Newman, 1993). As on March 2014, 38 per cent of bank branches and 14 per cent of ATMs were located in rural areas. Globally, the most common reason reported for exclusion (in declining order of frequency) are lack of enough money, feeling of non-requirement of an account and possession of account by a family member, accounts being cost prohibitive, financial institutions being too far way, non-availability of required documents, inability to get an account and distrust in financial institutions (World Bank, 2014). Researchers have identified several factors leading to financial exclusion. Toporowski (1987) suggests geographical proximity to nearest banking services as an important determinant of access. Kempson and Whyley (1998) reveal that the residents of remote and hilly areas are prone to financial exclusion. Kempson and Whyley (1999) and Goodwin (2000) document 'people in low-income groups, immigrants, the aged, the unemployed, the ethnic minorities, people in unorganized/informal sector as most susceptible to exclusion'. Supply and demand side barriers to financial inclusion were identified by Mehrotra, Puhazhendhi, Nair and Sahoo (2009)

Leyshon and Thrift (1995) and Carbo, Gardener and Molyneux (2007) visualise financial exclusion as 'a manifestation of the broader problem of social exclusion.' In this regard, 'achieving complete financial inclusion is not just limited to solving monetary and financial crisis of marginalized and disadvantaged people, rather its ultimate objective lies in abolishing the state of social exclusion in the economy' (Rangarajan, 2008). When denial to institutional credit makes marginalised segments of population susceptible to fall prey to loan sharks/money lenders, exclusion takes the shape of social implications. Moreover, a non-inclusive financial system hinders attainment of high economic growth rate with sustainability, ultimately resulting in serious economic implications (Mehrotra et al., 2009). Creation of an inclusive financial system demands addressing the above multidimensional forms of exclusion.

Payment Bank: A Differentiated Bank Variant

As part of the various recommendations to achieve financial inclusion, the Nachiket Mor committee constituted by RBI proposed the idea of leveraging the existing payment and wallet network towards achieving desired inclusivity in provision of financial services. These new entities will offer small savings accounts and allow payments and remittance services to various sections of the society, especially the migrant labour workforce, low-income households, small businesses and the unorganised sector. This will fulfil the need of such marginalised segments of population for basic financial services which had been traditionally left out of mainstream banking services owing to criteria such as large deposit size, identification documents, lack of accessibility to branches and low levels of awareness. The payment banks will accept deposits through basic bank accounts of up to `0.1 million from an individual. Such entities will be permitted to issue debit cards but not credit cards. In addition, these new entities can distribute mutual fund units or insurance products that are non-risk in nature. Towards enabling their credit disbursement ability, RBI has permitted payment banks to assume the role of business correspondents of universal banks and offer credit on bank's behalf. Payment banks are expected work on a low-cost framework with an interest spread as low as 3–4 per cent. Their ability to serve customers through a low operating cost structure with the help of technological innovation and infrastructure would be key to achieve profitability. In terms of the investment pattern, a payment bank is mandated to invest up to 75 per cent of its funds in government securities or treasury bills with maximum maturity up to one year. Minimum capital requirement towards establishing a payment bank has been prescribed as `1000 million. Further, an individual payment bank can maintain funds with other scheduled commercial banks as interbank deposits (in the form of current and fixed deposits). Such funds can be resorted by these entities towards operations and liquidity management. The regulator has set a promoter's initial contribution in a payment bank to 40 per cent, which will be gradually lowered to 26 per cent over a period of 12 years. Towards ensuring that such banks meet the

financial inclusion objectives and assist the marginalised and small ticket borrowers, such banks have been mandated to allocate 50 per cent of their loan portfolio to advances under `2.5 million

Influx of Payment Banks: Reactions from the Bankers

RBI's action towards licensing payment banks have garnered varied reactions from across existing full-service banks and other players in Indian financial services industry. Arundhati Bhattacharya, chairperson (State Bank of India) had set the ball rolling when she argued whether the Indian banking system has evolved enough to face the impending competitive pressure from payment banks. Further, she hinted at a possibility of RBI viewing this as an initial step towards evolvement of certain payment banks into universal banks. 'New payment banks could wean precious lowcost savings bank deposits away from the established full-service players, thus diminishing their ability to price loans at a competitive level' asserted by Bhattacharya as part of an interview published in LiveMint. According to Sachin Salgaonkar (analyst, Bank of America Merrill Lynch), e-payments will aid to soften lending rates fuelling growth over time. He further added that the expansion of rural banking post nationalisation drive of 1969 facilitated rural India to shift to cash-based transactions from barter. This ultimately led to a decline in the levels of currency held in hand by the public and a corresponding rise in the quantum of bank deposits. E-payments will cut shoe-leather costs of going to bank, reduce cash holding, push up deposit growth and help pull down lending rates. Indian payments market is valued at `15.5 trillion as in fiscal 2015 and estimated to grow 12 per cent per annum. 'The share of mobiles, at less than 0.1%, may rise to 10% in seven years; with the value of mobile banking rising 200 times to $3.5 trillion' (Merrill Lynch Report). Such statistics combined with the fact that branch banking is on the decline and internet penetration is gaining sounds sweet to the ears of bank licence winners as it indicates significant business prospects. Clarifying the regulator's stance towards awarding the licences, Dr Raghuram Rajan (former governor, RBI) mentioned that central bank authorities were also not certain as to what type of ventures would succeed as payment banks, hence the board licensed a wider gamut of players— mix of technology firms, finance companies and bankmobile aggregators.

Payment Banks: A Ray of hope for the Marginalised and Excluded

A significant aspect hindering the inclusion of marginalised and excluded groups till date has been accessibility to basic financial services. Non-inclination of banks to set up branches in the hinterland and interior regions coupled with lack of financial awareness has been a bane for the prospects of financial inclusion. National regulator RBI has always been keen to identify and tackle the root cause of financial exclusion and has taken several initiatives from time to time. With a view to frame out concrete strategies and bring out detailed vision for financial inclusion, RBI has set up a committee on comprehensive financial services for small business and low-income households under the chairmanship of Dr Nachiket Mor (member of RBI's Central Board). As part of recommendations handed out by Nachiket Mor committee, the concept of payment bank armed with digital accessibility avenues was prominently emphasized towards realizing the goal of inclusivity. The concept of payment banks finds its root within the existent PPIs providers are authorised by the regulator to receive cash deposits from customers, store them in a digital wallet and ultimately enabling customers to pay for goods and services from their e-wallet (or digital wallet). The concept of PPIs enabled significant expansion of low-value payments services among individuals who hitherto have never used banking services. A parallel economic significance of such payment facilities can be viewed in the light of additional deposits being tapped from sources which remained detached from the ambit of formal banking

Technology-enabled Customer Engagement

A majority of licence awardees being technically fortified firms are in a position to leverage their existing facilities to impart payment banking services. RBI has strategically awarded licences to various telecom operators (telcos) and mobile companies who can better engage with customers via technological medium. Telcos command strong synergies with services already being provided by them and their existing distribution and technology infrastructure can be further leveraged upon. 'It provides an opportunity to operators for increasing touch points with the existing customers and attract new ones either for existing businesses or the payment banking business or for both' (Reddy, 2015). Over the course of time this would enable increased levels of customer retention and extract greater share of current regime, such companies are paying commission to the banks on cash-out transactions: an expense which can be eliminated if they convert to payment banks. Telcos also provides an opportunity to earn additional income in the form of interests spread on deposits collected. Tie-ups between banking concerns and major telecom operators have become the order of the day combining the technology of Telcos and credit disbursing eligibility of banks. Kotak Mahindra Bank with Bharti Airtel, State Bank of India with Reliance Industries and Idea Cellular with Future Group are joining hands to set up payment banks. Till recent years, mobile

phone used to be a status symbol or lifestyle product. But during the recent decades it has turned into a necessity irrespective of age, education and financial background. A staggering one-fourth of the world's mobile market exists in India and the share of rural subscribers is around 35 per cent. This speaks of the growing potential of this segment and that its usage by the common man has become the order of the day. Rapid growth in number of mobile users and wider coverage of mobile phone networks has made this channel a key platform for extending banking services to customers. Evolution of ecosystem for payment applications is on a fast track with customer payments to taxi, e-commerce, mobile, travel and entertainment companies shifting from cash to e-wallets.

Impact on Commercial Banks

Historical appraisal of commercial banking evolution in India clearly depicts the fact that majority of the banks started operations confining to a particular state or region and later expanded across the country. But the fact remains that the lion's share of banking business comes from rural/ semi-urban areas. Majority of the existing players enjoy the huge spread on low-cost deposits (Current Account & Savings Account (CASA)) since the average interest paid on these deposits is below 4 per cent. According to Basic Statistical Return 2014 published by RBI, out of `7.87 trillion deposits of rural branches across the country, the CASA deposits stood at INR 4.26 trillion (54%). This acts as a major trigger to arouse interest of new players to enter into this segment. At present, the foremost strength of commercial banks is its stable small value account base with relatively higher low-cost deposits. However, once the payment banks commence operations, the strength will be turning into weakness as the new players are likely to poach the strong low-cost deposit segment of commercial banks especially public sector banks. This may lead to slimming down of net interest margins which no bank can afford within the current environment. The new set of banks is expected to operate extensively on technology platform to render banking services in a cost-effective manner. These banks are not only eyeing Gen-U but also Gen-Y segment since this group is closely intertwined with the technology embedded products. Thus, target customers will be existing clientele of public sector and private sector banks as well as untapped, unbanked and under-banked population segments. Although there is heat in the financial sector with regard to setting up of payment banks, public sector banks (PSBs) have not initiated any proactive steps so far to meet the competitive threat. Furthermore, the PSBs appear to be grappling with basic issues such as stressed assets and lack of capital infusion by the government. On the other hand, the new generation banks such as ICICI and HDFC are in a blur of action and launched mobile payment applications such as Pockets, Smart Buy and PayZapp to remain competitive in the fierce competitive environment. If the PSBs do not act rapidly, at least now, they tend to lose business across segments, which is likely to impact the bottom line of the banks adversely

Conclusion and Way Forward

A strong business case exists for the new set of banks given the fact that sizeable portion of the country's population remains outside the ambit of formal banking. Potential aspirants would hope to capitalise on the synergies leveraging its distribution network, client base and their brand image in the market place. Towards maintaining cost optimality, the new banks can effectively operate on mobile/ internet platform with few physical branches and enhanced focus in virtual banking. A great advantage of these banks is to provide the last-mile connectivity, which the formal players are unable to do on account of operational and structural constraints. Phenomenal boom being observed in the e-commerce space can be leveraged by banks to reach out to new customers, including those in smaller cities and villages. In addition to exploring regular advertising strategies on these websites, joint product offerings can be considered as an innovative opportunity. Tie-up with e-commerce websites and aggregators is another strategy for customer acquisition and sustained engagement. Wallet providers are likely to enter agreements with banks for operational convenience and viability. Bill Gates had once famously quoted 'Banking is necessary but Banks are not.' With the commencement of payment bank operations, the statement is bound to be a distinct reality in a short time span. To remain competitive, strategic partnerships with companies having vast retail outlets and agent network is a prerequisite for both existing commercial banks as well as new players. The proposed niche banking entities can be viewed as vehicles to achieve the desired financial inclusion objective by covering all households with basic savings bank products and micro insurance, pension and mutual funds. However, the players need to adopt appropriate cost effective, innovative and viable business models with a concept of 'high volume and low margin' leveraging technology to remain competitive in the market as endorsed by Reddy (2015). The 2020 decade is expected to be an icon for 'bank on unbanked' fuelled by the new set of players paving the way for achievement of long cherished dream of inclusive growth and engaging the hitherto excluded demography.

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