DIGITAL COMMERCE – OPPORTUNITIES AND CHALLENGES

Fin-Tech Opportunities and challenges

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Abstract

The Robust development in the field of Internet allow easy participation that strengthens and extends network, technological innovations involving telecommunication ,computation and database management, common platform which has become common place in almost all the areas of commerce. There is a significant adoption of FinTech across major markets. These activities are growing rapidly but they remain small relative to overall economic activities. The factors like consumer preferences for convenience, speed, cost effectiveness and user-friendliness in financial transactions making FinTech services grow enormous in span. Since these innovations have not been tested through a full financial cycle, it is important to study both the benefits and challenges from the perspective of financial stability not only in India but also across the globe.

Key words: FinTech, Financial Innovations, Financial risks, platforms, Information technology.

Introduction

FinTech has been defined as " Financial sector innovations technology-enabled business models that can facilitate disintermediation, revolutionize how existing firms create and deliver products and services, address privacy, regulatory and law-enforcement challenges, provide new gateways for entrepreneurship, and seed opportunities for inclusive growth". [1]

Fintech initially has brought only minor disruptions to the banking market, mainly in the areas of payments, credit and personal financial advice. But changes in customer preferences, advances in technology and growing investment in FinTech set the scene for more radical change. With the growing ideas and technical innovations, it could mean a "seamless specialisation" across core elements of the value chain whereby a variety of providers combine to deliver cheaper and easier-to-use propositions to end customers. Banks must continue on their journeys of digitization. But they need not travel alone. They should be clear about where their market advantages and institutional strengths lie. Where they fall short they should look to work with the start-ups who can provide what they need.

[1] VAsant Dhar and Roger M. Stein (2017) – FinTech Platforms and Straategy- MIT Sloan School Working Paper 5183-16

During 2016-17, the Indian banking sector had to cope with the concerns about deteriorating asset quality, on the one hand, and a sharp decline in credit growth, on the other, while supporting the government in its initiatives to further reach out to the public and in promoting digitalization of the modes of payments in the economy. The branch authorization policy was revised to harmonize the treatment of different forms of bank presence for the purpose of opening banking outlets in under-served areas. Empowered by requisite legislative provisions put in place by the government, the Reserve Bank of India has been focusing on strengthening the institutional framework to address asset quality concerns by improving the recovery process and the early response mechanism. Having gained experience with the licensing of small finance and payments banks, the Reserve Bank explored the scope of introducing more differentiated banks such as 'wholesale and long-term finance banks' and also examined the regulatory challenges posed by innovations by FinTech entities in the financial landscape. Apart from focusing on the supervision of financial conglomerates and early response to asset quality deterioration, the Reserve Bank of India, formalized a framework for taking enforcement action against banks for non-compliance with guidelines and instructions issued by it.

FinTech is defined as technology-enabled innovation in financial services that could result in new business models, applications, processes or products with an associated material effect on the provision of financial services (FSB, 2017). Recent initiatives have opened up vast opportunities for both the incumbent financial institutions as well as for FinTech to introduce large scale innovations in financial services that permeate to 'last mile' touch points and boost financial inclusion. The Government of India Start-Up India programme, which aims to nurture innovations, and the India Stack platform, which offers a state-of-the-art technological framework to businesses, startups and developers aimed at presence-less, paperless and cashless service delivery, provide a conducive environment for accelerated growth of FinTech, which would pave way for leveraging new technology in the provision of financial services. From a global perspective, FinTech innovations are bringing in alternatives to fiat currency, challenging various forms of traditional financial intermediation and even the conventional monetary system. International standard setting bodies are increasingly focusing attention on understanding the opportunities and risks associated with the FinTech revolution. Table 1 brings FinTech under the regulatory ambit should provide a level-playing field and encourage financial innovations. In this context, the Reserve Bank is working on framing an appropriate response to the regulatory challenges posed by developments in FinTech in India.

The Reserve Bank of India launched a mobile friendly portal Sachet (sachet.rbi.org.in) on August 4, 2016 to help the public as well as regulators to ensure that only regulated entities accept deposits from the public. The portal can be used by the public to share information including through uploading photographs of advertisements/publicity material, raise queries on any fund raising/investment schemes, that they come across and lodge and track complaints. The portal has links to all regulators and the public can easily access information on lists of regulated entities. The portal has a section for a closed user group – the state level coordination committees (SLCCs), inter-regulatory forums for exchange of information and coordinated action on unauthorised deposit collection and financial activities. It will help in enhancing coordination among regulators and state government agencies and will serve as a useful source of information for early detection and curbing of unauthorised acceptance of deposits. The portal is designed to place the entire proceedings of SLCCs on an IT platform. It facilitates comprehensive MIS with respect to complaints received, referred to regulators / law enforcement agencies and for monitoring the progress in redressal of such complaints. Complaints relating to unauthorized deposit collection and financial activities that have been lodged in Sachet have been taken up expeditiously with respective regulators for resolution

The Committee on Payments and Market Infrastructures (CPMI) in February 2017 published a report, "Distributed ledger technology in payment, clearing and settlement - An analytical framework". The report states that DLT is viewed by many as having the potential to disrupt payment, clearing, settlement and related activities. DLT, including block chain technology, draws upon both well established and newer technologies to operate a set of synchronized ledgers managed by one or more entities. DLT may provide an alternative to the traditional centralization of database management.

Globally, technology-enabled innovations in financial services (popularly known as FinTech) have been growing rapidly in the past few years, at both retail and wholesale levels. From an analytical perspective, FinTech activities are classified into five categories of financial services: (i) payments, clearing and settlement; (ii) deposits, lending and capital raising; (iii) insurance; (iv) investment management; and (v) market support. The FinTech landscape has been evolving. Global investment in FinTech increased rapidly till 2015. Subsequently, despite moderation, it remains robust, registering US $8.2 billion in aggregate in Q3 2017 across 274 deals (The Pulse of FinTech Q3 2017, KPMG). Simultaneously, there is significant adoption FinTech across major markets. FinTech activities are also growing rapidly, as reflected in the sharp increase in the market size of FinTech credit in certain jurisdictions, although they remain small relative to overall credit in Table 1. Driving the FinTech revolution are forces, such as (i) consumer preference for convenience, speed, cost effectiveness and user-friendliness in financial interactions; (ii) technological advancement related to internet, big data, mobile telephony, and computing power; and (iii) changing financial regulations and supervisory requirements. The emergence of FinTech is also attributed to the high cost of financial intermediation by incumbents, despite significant improvements in information technology (IT), pointing towards inefficiency of the existing system. Estimates suggest that the unit cost of financial intermediation in the US has remained around 2 per cent for the past 130 years, with only a marginal decline since the crisis (Philippon, 2017). It is similarly high in other major countries like Germany, the UK and France (Bazot, 2013). This implies that the benefits of improvements in IT have not percolated to the end-users of financial services. Although the size of FinTech is small relative to the global financial services sector at present (BCBS Consultative Document, BIS, August 2017), it has the potential to transform the way that financial services are delivered and designed as well as fundamentally alter the underlying processes of payments, clearing, and settlement (Brainard, 2016). Today, it has permeated across the entire financial services value chain and in the process has demonstrated the potential to directly compete with/challenge the traditional financial intermediation by banks. The true promise of FinTech springs from its adeptness at bundling banking into its core functions of settling payments, performing maturity transformation, sharing risk and allocating capital (Carney, 2017). This potential is being driven by new entrants – payment service providers, aggregators and robot advisers, peer-to-peer lenders and innovative trading platforms. As many FinTech innovations have not yet been tested through a full financial cycle, it is important to analyse both the potential benefits and risks from the perspective of financial stability. The potential benefits include (i) decentralization and increased intermediation by non-financial entities; (ii) greater efficiency, transparency, competition and resilience of the financial system; and (iii) greater financial inclusion and economic growth, particularly in emerging market and developing economies (FSB, 2017). Potential risks include (i) micro-financial risks such as credit risk, leverage, liquidity risk, maturity mismatches and operational risks, especially cyber and legal risks; and (ii) macro-financial risks such as unsustainable credit growth, increased interconnectedness or correlation, pro-cyclicality and contagion incentives for greater risk-taking by incumbent institutions. The FSB (2017) has identified ten issues, three of which are considered as priorities for international cooperation, viz., managing operational risks from third-party service providers; mitigating cyber risks; and monitoring macro-financial risks. Moreover, it recommends that national authorities should pay attention to cross-border legal issues and regulatory arrangements, develop governance and disclosure frameworks for big data analytics, assess the regulatory perimeter and update it on a timely basis. Regulators should also encourage shared learning with a diverse set of private sector parties. Open lines of communication need to be developed across relevant authorities, build staff capacity in new areas of required expertise and study alternative configurations of digital currencies. Although many of these issues are not new, they are important for promoting financial stability, fostering responsible innovation and developing a more inclusive financial system. As regards regulation, a consensus is emerging that it should aim at creating a conducive environment for FinTech to grow without compromising investor trust and confidence, efficiency and integrity of the market and the stability of the financial system. A stock take of regulatory approaches to FinTech by the FSB reveals that the most common model is the "regulatory sandbox", where new products or services can be tested in a (controlled) environment. This is used by Australia, Canada, Hong Kong, Korea, Netherlands, Singapore and the UK, while Mexico, Turkey and Saudi Arabia are considering this model, and Indonesia is in the process of establishing a regulatory sandbox. Other approaches include "innovation accelerators" and "innovation hubs" as well as other forms of interaction, in order to promote innovation and improve interactions with new FinTech firms.

Objectives of the study

- To understand the concept of FinTech
- To Know the developments in the digital payments, generally across the globe and particularly in India through FinTech
- To estimate the progress made in FinTech globally

Methodology

The study used compound annual growth rate to estimate the progress made in the size of FinTech credit market in some countries like China, USA, UK, Japan, Australia and other countries along with India.

The study consists of FinTech developments based on secondary data. The data has been secured through websites, articles, research papers and RBI publications like Report on Trends and Progress in banks in India.

Period of study

The period of study consists of three years and base year has been taken as the year 2013 and end year is taken as the year 2015.

Table 1
SIZE OF FINTECH CREDIT MARKET BY JURISDICTION(US$ MILLION)

Countries	2013	2015	CAGR(%)
China	5547	99723	162
USA	3757	34324	109.05
UK	906	4126	65.76
Japan	79	326	60.4
Australia	12	276	184.39
Germany	48	205	62.24
France	59	201	50.47
Canada	8	71	107.14
South Korea	1	38	236.2
Singapore	0	21	175.89
India	4	20	71.0

Source: Financial Stability Board (2017), Report on 'FinTech Credit: Market Structure, Business Models and Financial Stability Implications', May 22. Published in "Report on Trend and Progress in Banking in India" 2017

Compound Annual Growth Rate is a tool used to calculate the annual growth rate over multiple time periods. The growth rate is calculated for a period of 3 years starting from 2013 to 2015. It has been observed that South Korea recorded the highest growth rate standing top by recording the CAGR of 236.2 per cent, followed by Australia that holds second position by securing 184.39 per cent growth rate. France stands in last position by recording 50.47 per cent CAGR. India recorded 71.0 percent CAGR which means a lot of efforts need to be adopted in the area to reap the benefits of FinTech by jurisdiction.

Findings, Conclusions and Suggestions

- It has been found that the CAGR of South Korea is highest among selected countries. France recorded the least position in terms of CAGR.
- India's performance is not satisfactory as it stood in fifth position from ths last.
- A lot of innovative measures must be taken in the area of FinTech in India to make it competitive globally.
- Globally, the market for FinTech is huge.
- Hundreds of millions of people will enter the digital era in the coming decades in developing countries and will require a wide array of financial services.
- What we are witnessing at the moment is the emergence of platforms for providing these services.

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