

FINTECH: A MESSIAH FOR THE AILING BANKING INDUSTRY IN INDIA

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Abstract

FinTech is the latest buzzword in the area of banking and financial services. Simply put, Financial Technology or FinTech is a term used to describe the growing technological innovations in the financial sector aimed at improving the activities in the sector. FinTech has emerged as a potential disrupter in the financial sector with products and services that has well managed to challenge the domination of traditional financial institutions. With the traditional financial institutions, especially in India, undergoing a period of turbulence, which has in the last few years witnessed the growth of bad loans, dissatisfaction among the customers regarding several financial products and services, and growing loss of confidence among the public with an imminent fear of a financial crisis, the opportunity seems ripe for the emerging FinTech to take centre stage. But, in spite of its rapid growth in recent years, FinTech is still a nascent player in the Indian financial sector. Hence, a collaboration with the ailing traditional financial institutions would help provide a new direction to India's financial sector. This paper, thus, focuses on putting into perspective the role FinTech could play in helping the country's banking industry regain its lost footing in a highly dynamic sector.

Key words: FinTech, traditional financial institutions, collaboration, turbulence

I. Introduction

The last few decades has been characterised by an increase in the adoption of new technological innovations in almost all spheres of life. From smartphones to internet to even self-driving cars, technology has revolutionised the way we lead our lives. Technology has not only introduced new products and services, it has brought about a drastic change in the way we see things- our perspective or point of view has been changing rapidly thanks to technology. Our perspective about banking and finance, which basically involved the activities of savings and deposits in a physical bank, has undergone a visible change, thanks to FinTech or Financial Technology. Application of technology in the financial arena has resulted in development of products and services that has gained wider user adoption and far out-competed the traditional financial institutions. The following article analyses the ever growing presence of FinTech and its implications on the banking industry in India. It is organised into the following sections- the second section deals with the growth of FinTech in India; the third section presents a dual-analysis of FinTech as a competitor and collaborator; the fourth section delves into the solutions that FinTech provides to some core issues that plagues the banking industry in India, viz, lower penetration of banking sector and financial exclusion, the insurmountable amount of bad loans or NPAs, and security challenges in a highly vulnerable era; lastly, the fifth section concludes with a small note on the presence of a futuristic FinTech in the contemporary world.

II. The growth of FinTech in India

FinTech or Financial Technology has witnessed tremendous growth in India, transforming the financial landscape of the country. From offering online recharge services to providing a Basic Savings Bank Deposit Account (BSBDA) via online payment banks, FinTech have slowly, but steadily encroached upon traditional financial institutions niche. In the year 2016 alone, India's FinTech sector received a massive \$270 million of funding signifying the optimism among investors in a nascent yet

lucrative sector. In fact India provides a far better rate of return on investment made on FinTech projects at 29% compared to the global average of 20%. The transactional value of the FinTech sector was valued at approximately \$33 billion in 2016 and is slated to reach \$73 billion growing at a five-year compounded annual growth rate (CAGR) of 22%. The number of FinTech firms founded in the country has also nearly doubled up in the last two years.

The stunning growth in the FinTech sector can be attributed to a number of factors that includes

- **Strong Governmental Support-** a strong governmental support that has in fact introduced a slew of policies which has been leveraged by various FinTech firms such as the Start-Up India initiative that provides \$1.5 billion of funds for startups along with 100% tax exemption on profits for the startups.
- **The omnipresent Aadhaar and digital infrastructure-** the presence of Aadhaar Database that powers India Stack, an initiative which has single-handedly led the FinTech revolution in the country.
- **Accommodative regulators-** an accommodative stance adopted by the Indian regulators such RBI, SEBI and IRDA that has also allowed the FinTech sector to grow without any prohibitions.
- **Rise in the millennials-** A growing tribe of millennials switching towards digital banking solutions and services has further spurred the growth of the FinTech sector in the country.
- **A largely incompetent banking industry-** an ailing banking industry that is slowly losing its share to private entities and FinTech firms, which has visibly taken advantage of this to provide better services to its tech-savvy customers as well as deliver financial products to the underserved categories of the population.

FinTech firms have thus been provided with the much needed infrastructural, governmental and regulatory support in the country which has made it possible for the sector to boom in such a short period of time. The growth in the FinTech sector is set to continue as more and more startups emerge to fulfill the demands of a population that is steadily moving towards digitisation thanks to lower internet charges enabling faster and wider penetration of internet services even among the countryside population.

III. FinTech- a competitor or a collaborator

The rise of FinTech has not gone unnoticed among the traditional financial institutions. Banking, Financial Services and Insurance (BFSI) has usually remained the niche of such institutions for a long time. In India, the Public Sector Banks (PSBs) and the Private Sector Banks have dominated the BFSI sector for decades with the PSBs slowly losing out their market share to the latter due to their inability to outgrow the market. This has allowed new emergent players such as FinTech to stamp their foothold in this dynamic sector, providing financial services and products through innovative means even to those that remained underserved by the PSBs and Private Sector Banks. The tendency to cause such disruptions has thus resulted in FinTech to emerge as a major competitor to the traditional financial institutions.

As a competitor FinTech offers a stern competition to the traditional financial institutions in terms of services and products which are usually designed to meet the needs of the consumers. FinTech firms are more customer oriented than the traditional financial institutions, which are more focused on selling their products than customer satisfaction. The latest trends in payments led by mobile wallets such as PayTM, which is enjoying strong user adoption thanks to a convenient user interface that allows users to pay their bills or even transfer funds within seconds, stands as a testimony of FinTech firms' commitment towards customer satisfaction. FinTech firms with their latest technological inputs and solutions out-compete the traditional financial institutions that still relies on legacy systems which basically consist of outdated IT systems that are far too old to compete with the new emerging FinTech solutions. In fact such outdated systems pose a greater threat to the traditional financial institutions than FinTechs as it has in the past failed to keep the various banking frauds at bay. The best example of this is the recent Punjab National Bank (PNB) case that shook the confidence of the state-owned bank as an alleged \$1.77 billion of money was obtained through illegal means. The fraudsters basically took advantage of PNBs outdated technology which failed to record the transactions made by the fraudsters abroad thereby giving them a leeway to stash the illegal money to finance their business. Such legacy

issues remain in most of the PSBs in the country which still depend on outdated banking architecture, thereby remaining open to such fraudulent attacks which causes huge amount of monetary losses to the economy. Besides, FinTech solutions such as e-wallets and the recent Payment Banks enable those section of the society that have remained excluded from the ambit of the traditional financial institutions to avail financial services and products from the doorsteps of their houses, thereby ensuring wider penetration and adoption of financial services in the economy.

The emergence of FinTech has certainly increased the level of competition in the banking industry in recent years. Even as one ponders whether FinTech will actually replace the traditional banking institutions or not, there are certain advantages that the latter holds over the former. Firstly, banks have established a sense of trust among the people by providing financial services to generations and generations of its customers throughout the years. Secondly, FinTech is still a nascent player in the financial sector and has yet to prove its stability during periods of crisis just as banks have done, maintaining the stability of the economy even in the face of looming financial crisis. Thirdly, regulators and governments around the world tend to favour traditional banks that are tangible as against an intangible FinTech which could pose challenges with regards to social welfare. Thus, even as FinTech continues to grow rapidly with each passing year, out-competing the traditional banks in terms of innovation and technological implementation, the banks are here to stay.

Collaboration, thus, holds the key to the sustenance of both FinTech and traditional financial institutions. It creates a win-win situation for the two as FinTech firms can utilise the vast expanse of the banking network to deliver their innovative products to a much larger customer base, whereas banks, on the other hand, could outsource some of its products to the FinTech firms in order to leverage its technological solutions, thereby earning the much needed customer satisfaction. The following section analyses how FinTech solutions can be leveraged by the traditional financial institutions to solve some of the major issues that ails the banking industry.

IV. FinTech- a messiah for the ailing banking industry

The potential of FinTech firms in India is humungous. FinTech solutions can be leveraged in order to revolutionise, and provide a new direction to the country's ailing banking industry. The key issues that FinTech could provide workable solutions to are-

Financial Inclusion

Financial inclusion remains as one of the major agenda of the government as well as the RBI in the country. The idea behind bringing the financially excluded into the ambit of mainstream banking is to protect them from the exploitations of the moneylenders. Financial inclusion also enables banks to build a credit history of their borrowers which allows the banks to provide better and convenient financial services and products to them. Financial inclusion, however, still remains an elusive goal as more than 19% of the population are still unbanked, meaning that they do not even have a bank account, let alone access to financial services. The reasons for financial exclusion includes a lack of awareness among the people especially those living in the countryside, lack of brick-and-mortar bank branches in the region, as well as a lax attitude of the banks towards serving the weaker sections due to fear of a possible default on credits extended.

In recent years, the Reserve Bank of India has been advocating banks across the country to adopt technology as a means to end the problem of financial exclusion in the country. The RBI has introduced a slew of policies to enable banks to extend financial services to the remotest parts of the country. One such policy enables banks to utilize the services of Business Correspondents or intermediaries such as kirana shops in villages in order to extend their services without having to set up a branch in the region. The intermediaries could further utilise FinTech solution such as Point of Sale devices that would enable people to transfer funds as well as make payments, thereby ensuring the penetration of financial services in the region. Payment Banks is another amazing FinTech solution that has a great potential to leverage the gap between the banked and the unbanked population. With RBI granting license to the telecom operators such as Airtel, Vodafone and Idea Cellular to open the Payment Banks, opening a bank account and accessing financial services will become easier, especially for the unbanked population. Telecom operators can leverage their distribution infrastructure in rural areas to deliver financial services through

Payment Banks. FinTech could also play a key role in the success of the government's Direct Benefit Transfer (DBT) scheme that would help plug the leakage of funds in the villages. Overall FinTech solutions can help improve financial inclusion in a country which is adopting the new ways of banking thanks to growing penetration of mobile phones and internet connectivity.

Non-Performing Assets

Non-Performing Assets (NPA), or in simple terms, bad loans characterises the Indian banking industry today. NPAs are basically loans or credit whose principal or interest remains unpaid by the borrower for more than 90 days. The period varies for consumers as well as agricultural loans taken by farmers, which is classified as NPAs if unpaid for two harvesting seasons. According to RBI data, the bad loans of both Public Sector Banks (PSBs) and the private sector banks stood at around INR 8.74 lakh crore by end of September 2017. The defaulters are usually the big corporate houses that borrow large amount of credit to finance their business. As banks fail to keep a rigorous check on them, due to lack of proper mechanism, the NPAs continue to pile up causing huge amount of losses to banks as well as the economy. Even as RBI has issued strict guidelines to curb the menace of bad loans in the banking industry, the solutions offered by FinTech can provide an additional impetus to the central bank's agenda.

FinTech firms in India have started to make a foray in the lending segment, providing loans to the MSME sectors. The MSME sector has often been neglected by the traditional banks with a gap in the credit demanded and supplied amounting to Rs. 833,000 crores. MSME's in fact play a key role in the Indian economy providing employment to around 50 million people, and contributing 8% to the country's GDP. It also constitutes 40% of the country's export basket. Traditional banks have often cited the lack of credit history and documentation as a major reason for the denial of loans to the MSMEs. FinTech firms, on the other hand, have adopted technologies such as Machine Learning (ML) and Artificial Intelligence (AI) to build a borrowers profile. Psychometric tests are conducted in order to pre-screen the loan applications. FinTech firms utilise a variety of data such as socio-demographic and behavioural data along with digital extractions of insights from credit bureaus and bank statements that gives them an advantage in assessing 'non standard' customers. ML and AI also helps forecast an upcoming default which allows FinTech firms to chalk out an agreement with the borrower to prevent further defaults in the future.

FinTech solutions could, thus, allow banks to effectively manage the NPA situation in the country. Automated Data Management through ML would allow banks to track industry-wise trend of NPAs as well as forecast potential NPAs. Banks, like the FinTech firms, can use data from a variety of sources to gain insightful information on the various types of borrowers, and the risks associated with each of them. Blockchain technology has emerged as a major IT solution that can help in keeping transactions clean and transparent. Blockchains basically keep track of every transaction that takes place, thereby eliminating the scope of carrying out any kind of fraudulent transactions. Blockchains are still in the developmental stage as financial institutions and FinTech are researching and developing collaborative projects to fully exploit the potential of DLT and blockchain.

Security

The rise in cyber-attacks against the banking industry in recent times has necessitated financial institutions to deploy technologies such as bio-metrics and cyber security solutions to protect its customers from such attacks. In fact, India has been ranked as the third most vulnerable country against cyberattacks by Symantec security solutions. The reasons for the vulnerability, especially of the financial sector, lies in the fact that banking systems around the world (in India too) are usually built on a centralized database that is more vulnerable to cyberattacks as hackers can have full access to the entire banking network, once the centralised database is breached. Blockchain or Distributed Ledger System (DLS) can help strengthen the banking industry against such hackers. Distributed Ledger enable data on transactions to be stored in different locations with different people, thereby eliminating the role of a centralised authority that keeps a check against any kind of manipulation. The information in these ledgers is stored in a secure manner using cryptography and can only be accessed via keys and cryptographic signatures. Distributed ledgers are in fact difficult for hackers to attack compared to a

centralised database as hackers need to attack each copies of the ledgers distributed among a wide range of people, thereby making it almost immune to such cyberattacks. The DLS system is still in a nascent stage, and as such requires more developments as well as collaboration among the traditional financial institutions and FinTech in order to reap the benefits this amazing technology.

V. The future is now

FinTech is no longer a technology of the future. The solutions provided by FinTech are diverse, secure and cost effective, and have the potential to address key issues related to the banking industry such as increasing the outreach of financial services, improving customer experience, curbing frauds and the rise of bad loans without replacing the physical banks. Collaboration between the two would enable both to learn from each other, ultimately resulting in an improvement in customer services. FinTech firms have a great potential to succeed in India by leveraging its demographic dividend, its youth who are increasingly adopting newer technologies, along with a large population of the unbanked that would require an out-of-the-box solutions in order to help access financial services and reap the benefits of digitisation in an era of opportunities. The FinTech story in India is set to continue and revolutionize the banking industry, in ways that would surely transform the ailing industry into a robust and competitive industry.

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