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CHANGING LANDSCAPE OF BANKING SYSTEM IN INDIA: PAYMENT BANKS OPPORTUNITIES OR CHALLENGES

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Abstract:

In 2014, RBI introduced two new categories of banks into the Indian financial system, namely Payment Banks and Small Banks. The objective of introducing these new categories of banks is to provide a much needed rigour to the financial inclusion drive. The present paper outlines the institutional and policy framework for payment banks in India. It presents a detailed review of literature in this domain. It discusses the growth opportunities for these newly established entities. This paper presents insights into major areas where scope of payment banks may be broadened. It also attempts to identify major bottlenecks in the development of such banks. It presents certain challenge that existing universal banks may come across due to introduction of payment banks where real attraction is not of higher interest rates but the convenience of carrying out business transactions at finger tips. It also provides recommendations for the regulators and policymakers that might assist in developing a framework that is progressive for all the stakeholders.

INTRODUCTION

The Reserve Bank of India (RBI) formulated a committee on Comprehensive Financial Services for Small Businesses and Low Income Households in September, 2013 with a vision of improving the financial inclusion in India. The committee recommended establishment of payment banks and other differentiated banks. These banks would be set up to achieve specific vision and objectives of the government mandate. With the advent of differentiated banks by RBI in 2015 viz. Payment Banks and Small Finance Banks, the paradigm of banking sector has been changing drastically. We are presently witnessing a banking system which is a cusp of traditional banks and relatively more digitalised payment banks. People's preference to cash and the brand image of traditional banks still keeps them growing whereas some customers who are already practising digital transactions find the payment banks more innovative and transformative. However their expectations are continually rising regarding safety, transparency, quality and variety of services which in addition to payment services may be made available to them by the payment banks. For expanding the services the payment banks need to identify the types of services needed by them at various life stages. The prime motive of the Government is to bring more and more people into the net of saving. For making the various banking institutions a success, a lot of initiatives at the end of Government are also necessary. Technology improvement is a prerequisite for making the dream of smart and branchless banking come true. At the same time, it needs to be acknowledged that the importance of traditional banks would not lessen in near future. Academic literature in the domain of payment banks is extremely limited. This is primarily because payment bank is a new development into the financial system. This study evaluates the introduction of payment banks in India. It discusses the growth opportunities of these newly established financial institutions. It also identifies the major bottlenecks in the smooth operations of payment banks. The major contribution of this study is that it discusses the international practices in the domain of payment banks and identifies bottlenecks in the successful implementation of the objective for which they were introduced. The rest of the article is organised as follows: The next section presents a detailed review of literature in the area; Section 3 develops insights into international practices; Section 4 outlines the Indian scenario; Section 5 discusses the scope of the payment banks; The following section discusses the expected benefits of the payment banks; Section 7 presents the major challenges for payment banks; Section 8 discusses the challenges for the traditional banks and Section 9 concludes.

1. LITERATURE REVIEW

Few studies have analysed the concept of payment bank. In a landmark article Mas (2009) discussed the regulations for branchless banking which includes payment banks in India. The study argued that the regulatory framework needs to evolve to foster competition by a broad range of players. It also stresses that the existing regulations should be modified to reduce the cost of entry and provide scope for business model innovation. Similarly, Winn (2015)

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outlined the mobile payment mechanisms in Kenya, Brazil and India. The paper evaluates the impact of regulatory environment on mobile payments as a channel for reaching intensive financial inclusion. The article strengthens the argument that mobile payment mechanism is suitable for developing economies where the primary objective is financial inclusion. Its utility for developed economies with stringent regulations already in place is limited. There is another category of research that compare the regulatory mechanism and practices of financial institutions across various countries. Sultana (2014) evaluated the situation of mobile financial services in the context of developing economies particularly in the South-east Asia. She evaluates the existing market scenario for mobile based payment system in Bangladesh, India, Pakistan and Sri Lanka. The study also discusses the scope of such financial services in times to come. Vyas, Gaur & Singh (2016) discussed the evolution of payment banks. The study evaluates the scope of payment banks in fulfilling the objectives of financial inclusion. They also compare the Indian scenario with the success of M-Pesa in Kenya. They analyse the success of M-Pesa and identify opportunities for payment banks in India. Punjabi (2016) discusses India's e-finance revolution and its role in strengthening financial inclusion drive of the government. The study also presents a comparison between the e-finance business environment in India and China. The paper also discuss the uniqueness of the Indian environment and develop insights on how implementation of new technology based payment mechanism would benefit all its stakeholders. There are other articles that are specific to the Indian context. Manikandan and Chandramohan (2015) discuss the concept of mobile wallet in Indian context. The study also discusses the status of adoption of mobile wallet in India and major determinants for its adoption. Similarly, Goel and Manrai (2016) discuss the regulatory framework of payment banks in India. They also evaluate the electronic and mobile banking experiences in other developing countries. In a similar effort, Gupta (2016) outlined the regulatory structure of payment banks in India and discussed case studies of certain payment banks. Goel (2015) discussed the need for payment banks and its suitability in the Indian context. In a different stream of research, Kumar, Sethi and

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Krishnakumar (2015) analysed the existing business operations of payment banks and proposed a theoretical model as an improvement over the existing model. They argue that the current telecom boom along with innovation in technology can assist in reform the banking sector and provide impetus for the cause of financial inclusion.

2. INTERNATIONAL PRACTICES

The concept of payment banks has been tested in various economies across the world. These overseas experiences might provide valuable learnings for successful implementation of payment banks in India. In the European Union, payment services are provided by 'payment institutions' which allow non-banks to offer payment / remittance services only but not other banking services. Similarly, Japan also employs a payment system where non-banking institutions actively provide fund transfer services. South Africa allows comparatively large scope of banking operations to non-banking institutions. They have access to clearing system of central bank and participate as and when required. M-Pesa in South Africa is a prepaid instrument which is already operating successfully. In case of Brazil, 'payment institutions' have a minimum capital requirement of Brazilian Real 2 million and are supervised by Brazilian Central Bank. Prepaid card issuers, digital wallet providers and telecommunication companies may apply for licence of payment institutions. They may participate with central bank for clearing and settlement facilities. Financial inclusion was achieved through a public sector social service bank 'Caixa Economica Federal'. In the year 2000, around 80% of Brazilians did not have bank accounts. Bill payments and benefit transfers are handled through the network of banking correspondents, like lottery houses, construction houses, bakeries and butcher shops etc. Mobile payment system played a comparatively less role in financial inclusion effort. Instead it relied heavily on advanced combination of different ICT products and services like computers, internet access, ATM Machines etc. for financial inclusion (Winn, 2015) In case of Kenya, Vodafone's M-Pesa played a very important role in rejuvenating the economy and generates around 20% of total revenue in the country. As per the latest data available more than 75% of the population is part of its user chain.

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In this system retail agents, in the form of grocery or other shops are used for withdrawing and depositing cash. Once money comes in the account may be used for payments of bills etc. (Goel & Manrai, 2016). In Pakistan, Tameer Bank and mobile operator Telenor offer a mobile banking service called EasyPaisa and is catering to the needs of around 7 million users. It has emerged as a big branchless banking service provider in the Pakistan (Goel & Manrai, 2016). Around 90% people are still unbanked in Pakistan. State Bank of Pakistan introduced mobile financial services guidelines which outlined appropriate mix of safe, sustainable and progressive mobile financial services. State Bank of Pakistan also provides mobile financial services including loan disbursement, fund transfers, bill payment and other similar services. CNICs (Computerised National ID Cards) have been issued to customers which facilitate Inter Bank Fund Transfer (IBFT) or deposit money. However, there is dominance of cash transactions by mobile money agents on behalf of customers. State Bank of Pakistan is now set to introduce biometric verification for mobile accounts and transactions to improve transaction security and customers' convenience. (Sultana, 2014). In Bangladesh, Central Bank of Bangladesh, issued guidelines for 'Mobile Financial Services' for banks in 2011 and invited mobile operators and microfinance institutions organisations. By providing 1 million daily transactions per day, bKash have become world's largest mobile money provider. (Sultana, 2014), Central Bank of Sri Lanka (CBSL) in 2011 issued guidelines for regulating bank-led and telecommunication companies led models of mobile payments. Two types of mobile financial services, i.e., non-bank led mobile wallets and bank led mobile banking are being offered in Sri Lanka.

3. INDIAN SCENARIO

In India, Payment Banks are registered as a public limited company under the Companies Act, 2013. They are governed by the provisions of the Banking Regulation Act, 1949, Reserve Bank of India Act, 1934, Foreign Exchange Management Act, 1999, Payment and Settlement Systems Act, 2007, other relevant statutes and directives and guidelines issued by RBI and other regulators from time to time. The Payment Banks are required to maintain a net worth of Rs. 100

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crores at all times. They would have to maintain a minimum capital adequacy ratio of 15 % of its risk-weighted assets (RWA) on a continuous basis. The RBI initially screens the applications for estabilishing payment banks to ensure eligibility of the applicants. Then, an expert advisory committee (EAC) evaluates the applications and grant in-principle approval. In August 2015, 11 entities were issued licences for Payment Banks by RBI as per the recommendation of Nachiket Mor Committee on financial reforms. Since, these banks were set up with prime objective of financial inclusion, payment banks may accept deposits but would not be able provide credit to its customers. They functioning will depend on nodes like internet banking and payments, mobile phones, ATMs and point of sales. Payment Banks would be allowed to accept demand deposits and current deposits and may maintain a maximum balance of Rs. 1,00,000 per customer account. But, no NRI deposit can be accepted by them. Payment Banks can set up ATMs, BCs and mobile banking. They can offer payment and remittance services through any payment mechanism approved by RBI and may facilitate automatic payment of bills through RTGS, NEFT and IMPS services.

Payment Banks can also work as a BC of other financial institutions and serve as agents to distribute credit, insurance, pension products and mutual funds on their behalf. With the advent of payment banks, traditional banks are investing heavily towards digitalisation to prepare themselves for the competition. Traditional players in the banking industry have newly introduced many mobile apps and other services to differentiate themselves and thus compete with the payment banks. Traditional Banks have already started the internet banking services and have smoothly shifted to mobile application based services as customers may not want to go to the website for every operation (Merwin, 2015). Despite several players in the banking industry, competition is still less especially due to new KYC norms. The traditional banks enjoy such benefit as few people change banks even if services are poor and fees is high (Jagannathan, 2015). Although, digital banking is convenient to customers, but they still prefer to visit the banks personally for complex financial needs. Thus, it can be argued that the economy is reaching towards a banking

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system which will comprise of smart branches than no branches at all (Kohli and Patel, 2016). By practising clever marketing strategies, strong merchant tie ups, offering high discounts, introducing better technology and convenience the mobile wallets have already reduced the significance of traditional banks (Jain, 2016).

4. SCOPE OF PAYMENT BANKS

In India there are approximately 1 lakh bank branches of which only 5% are in rural areas. (Merwin ,2015). A large portion of rural population is migratory workers and they frequently send money back at home. Payment Banks need to plan their expansion in villages which are comparatively more digital and involve less cost with great compatibility of penetration in rural areas. Similarly, the JAM comprising Jan Dhan, Aadhaar and mobile has been the backbone of government initiative of financial inclusion in India. It provides boost to both traditional banks and telecommunication companies and now the new entrants such as payments banks also (Report by Axis Capital, 2016).The Payment Banks may associate with schemes of GOI to ensure more business and thus growth. Payment banks need to invest heavily in further digitalisation of its operations to prepare for the new competition as the traditional banks still have advantage of brand name. People still have a lot of faith on traditional banks. Only if payment banks can provide ease, quickness, transparency and security of their digital transactions, it can go a long way competing with traditional Banks. Payments Banks may also become a banking correspondent of another bank for credit and other services which it cannot offer. In many areas, these banks are competing with traditional banks and are collaborating with payment banks in other areas. Reasons like habit to use cash, complexity of digital product and lack of perception of compelling value are some of the issues which payment banks need to address to increase their penetration. Payment Banks may introduce services like physical call centres, toll free numbers, agent visits, easier refunds to magnify trust of customers on cashless digital transactions (Shah et al., 2016). Since Payment Banks have access to consumer information regarding payment amounts and pattern they are in a position to assess and identify consumer needs hence may innovate and offer right product and solution best suited to

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other financial needs apart from payments. Payment banks may partner with large merchants, financial technology company and various start-ups to provide state of the art payment solutions (Shah et al., 2016). While keeping payment at centre stage, payment banks can partner with non-banking financial companies to create an offering that replicates a bank as they are good at lending or can partner with a mutual fund (MF) as it manages money well thus can create a combination that is good for the customer and for the bank as well. Payment banks in present state are not in a position to offer high interest rates and hence should compete to offer better services (Tripathi, 2016).

5. EXPECTED BENEFITS FROM PAYMENT BANKS

The primary objective of introducing payment banks in India is to ensure and enhance financial inclusion of unbanked and underbanked population. Small business, unorganised sector, low income households, farm and migrant workforce would largely benefit by introduction of Payment Banks. These people usually require transactions of small amounts and payment bank can address this need. Payment banks may also become a mechanism through which cash benefits from the government can reach the ultimate beneficiary. They can be useful for transferring wages, subsidies or other social welfare schemes. Operations of payment banks would not only lead to microeconomic benefits to the recipients, but macroeconomic benefits to the region also. It will assist in growth and development of the area because of access to basic banking services. It would also inspire the much needed saving habits through banking sector especially in the rural areas because of the ease of accessibility. They will not only bring more money into the banking system, but also increase competition among banking institutions. The increased competition among banks would lead to further improvement in efficiency. Lower costs of operations of the payment banks would exert pressure on other full-fledged commercial banks to refrain from costly payment structure involving physical locations and tangible assets. The other commercial banks might be motivated to rely technology based low cost payment system bringing exponential growth in banking inclusion services. This would increase inclusion of both cash-addicted as well as cashless-preferring bank customers. The

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competition for state owned banks will intensify as Payment Banks are backed by digital platforms, adequate capital, zero legacy issues and higher rate of interest on deposits in near future (Bandyopadhyay, 2016). Low-cost, innovative and convenient services would compete heavily for business in rural and semi-urban areas where eventually the ultimate beneficiary would be the common people. Since Payment Banks are allowed to invest in Government securities only, the risks are minimised when compared to other financial institutions.

6. CHALLENGES FOR PAYMENT BANKS

Payment banks are financial institutions that have been introduced in India with the primary objective of achieving greater inclusion of under-banked population. However, there might be a number of challenges that need to be addressed before any success is achieved.

Awareness about the benefits of the payment banks is one of the major bottlenecks. The common beneficiary of this endeavour is an uneducated, non-technical and less-earning individual. Awareness among such people has to be created so that they are able and willing to use the services of payment banks. Also, companies that are already established in other industries like consumer goods and technology are entering payment-services sector. The basic offering of payment banks is a basic service and it becomes crucial for the service providers to have appropriate skill set to steer the payment revolution. Without the suitable combination of work force, it might not provide desirable results (Handoo, 2015).

Moreover, chance of fraud is comparatively higher in such institutions because if the payment bank account is hacked it may lead to siphoning of crores of rupees of account holders. It would be difficult for RBI to maintain adequate regulatory framework for these experimental and innovative banking advancements.

Cash addiction of Indians is another hindrance in success of payment banks. A survey conducted by Intermedia Financial Inclusion Insight (FII) 2014 revealed that 82% of Indian adults prefer cash transactions. To encourage customers towards non-cash transactions and use of payment banks, it would have to offer their services at

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extremely low or zero transaction fees (Goel & Manrai, 2016).

Operational profitability would be another major challenge for payment banks. Payment banks are not allowed to extend credit. Therefore, they would not be able to offer more than 4% interest which would not be competitive enough to motivate active participation. Payment banks may earn 1-2% on remittances and would have to survive on volume only. Profitability can be achieved through economies of scale only. However, various projects of Government of India like the Pradhan Mantri Jan Dhan Yojana increase about 21.87 million bank accounts and have considerably reduced the scope and opportunities for the Payment banks.

7. CHALLENGESFOR RADITIONAL BANKS

In India more than half population is still unbanked and prefer cash and to make a shift over from cash to digital will be a big challenge**.** Banking transactions are progressively heading towards mobile payments where technology will act as an enabler over the long run the mobile phones will perform the same role as credit and debit cards (Merwin, 2015). Since the applicants for the payment banks are from diverse fields, chances of innovations are very high. Thus, attracting the existing customers of traditional banks. At present the services provided to small depositors and borrowers by the traditional banking system are poor. Also, they have been charging higher interest rates. Newly introduced payment banks will try to grab the cheapest deposits whereas small finance banks will eye upon the highest interest paying borrowers as these differentiated banks expand across the country (Jagnnathan, 2015).

Among the emerging set of differentiated Banks, payment banks should perform better in the initial stages as they easily increase the reach of banking services by using mobile based technologies. Traditional banks currently charge high interest rates from them probably to cover risks and also because they know borrowers do not have much choice. This monopoly of traditional banks may end as payment banks and small banks enter the market (Jagnnathan, 2015). The traditional banks need to reinvent themselves and improve their ‘payments’ oriented services for existing customer base. They should either embrace the technology or should yield ground and in fact concentrate on lending. (Jain, 2016).

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8. CONCLUSION

Payment Banks in India have been introduced with the primary objective of increasing the impact of financial inclusion drive. They are a mechanism that has been developed so that transfer of funds and other basic financial services can be made available to the under-banked population of the country. To achieve this objective, payment banks will have to make huge investments into technology, product innovation, diversification of portfolios and fine pricing policy to maintain their market share and profitability (Kohli and Patel, 2016). However, the competition between traditional and payment banks will lead to widening and improvement in quality of banking services at reduced costs and which may finally result in financial inclusion. However, there still exist many challenges in the successful implementation of this endeavour. There are numerous bottlenecks that need to be addressed before the real benefits of any differentiated bank can be enjoyed by the targeted beneficiaries.

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