Spurring digital payments in India

We need to understand that payments is a commercial activity and hence cannot be treated on par with banking. What is needed is an integrated payments institution to encourage competition

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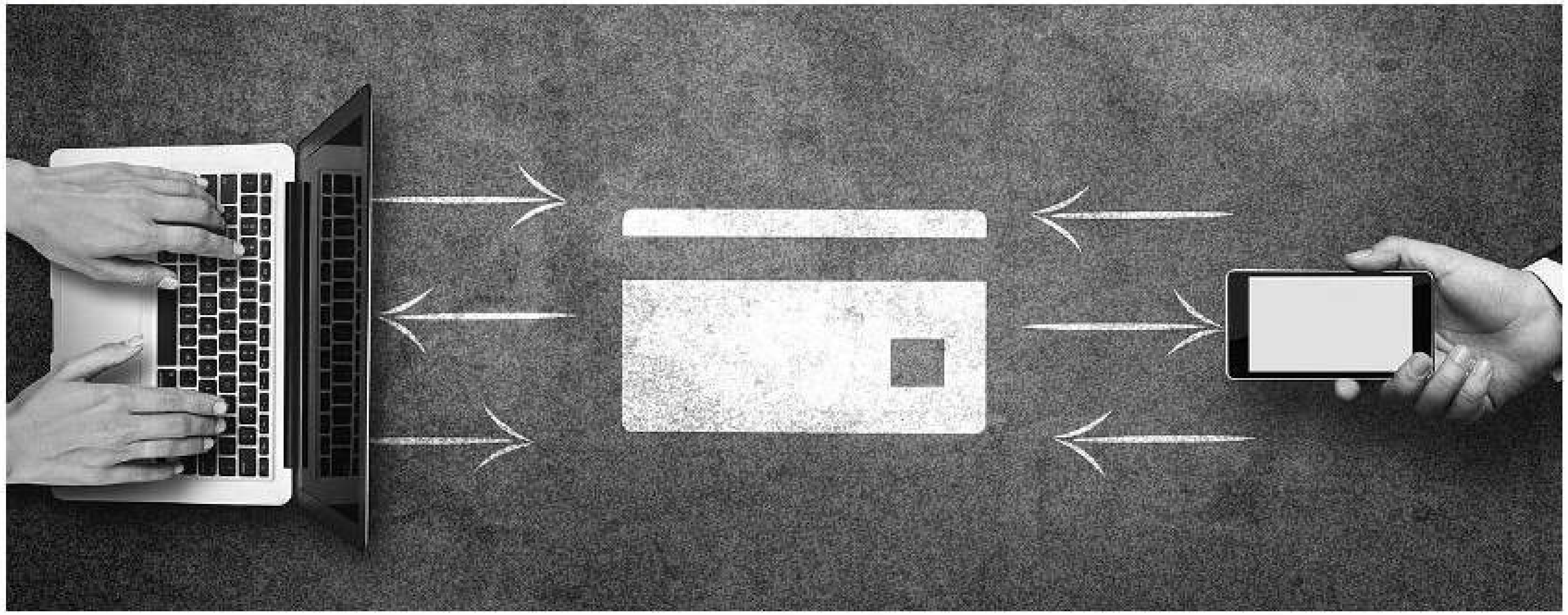

The Reserve Bank of India (RBI) recently warned of a "concentration risk" in the retail payments sector as a vast majority of the transactions were being done by a handful of digital banking giants. The Central bank added it has planned to further boost competition in the booming sector to promote pan-India payment platforms and give innovation in the industry a leg up. The RBI aired its thoughts in its "Statement on Developmental and Regulatory Policies", released in early June.

However, things may be back to square one as Indians — long used to the allure of cash — are going back to using paper currency for transactions. The euphoria of digital payments, which peaked in the months that followed the sudden and dramatic demonetisation of 80 per cent of the cash in the economy in November 2016, seems to have been short-lived in Asia's second largest economy. This is amply visible with the currency in circulation surging to ₹19,574 billion by June 22, from ₹13,352 billion at the end of March 2017 and a puny ₹9,383 billion at the end of November 2016, when demonetisation came into effect. Thus, cash became king again in India.

One of the most beneficial outcomes of demonetisation was the phenomenal surge in point-of-sale (PoS) machines. In a span of 12 months, the number of PoS terminals in the country grew to 29,00,000 terminals in September 2017, up by approximately 81 per cent, from a 16,00,000 in October 2016.

A similar hockey-stick growth curve was also witnessed in digital payments. New technologies, coupled with demonetisation facilitated the B2B market to record exponentially high annual transaction volumes. It reinvigorated digital payments and ignited collaboration between fintech companies and traditional banks. RBI data shows that after demonetisation, the volume of digital payments recorded a compound annual growth rate of 55 per cent in 2016-17.

But things are worsening now. Wallet transactions are dropping as new and stringent KYC norms put a brake on them. A 40-45 per cent drop has added to caution on the road ahead for the segment. Debit card payments raced past credit card usage in the months immediately after demonetisation accounting for about 96 per cent of all payments cards in use in the country. But with the impact of demonetisation wearing off and cash returning to the system, credit card transactions peaked to a 15-month high of ₹443 billion, as against ₹419 billion for debit card payments in March this year as per RBI data.

So, how do we get back on track? We start with basics first.

We need to start addressing digital payments as an independent vertical under the RBI's regulatory gaze. Under the current model, there is heavy dependence on the sagging shoulders of the traditional banking system, which is creaking under its own set of problems related to surging non-performing assets.

Existing non-banking companies contribute a meagre 1-2 per cent to India's digital transactions volume. The remaining 98 per cent of the business rests within the banking system and is dominated by a handful of banks. So, in a way, democratisation of payment even within the banking system has not happened yet. Therefore, there is a big need for more banks and more digital non-banks to play a bigger transactional role in a country of 1.3 billion people where only 12 per cent of the transactions are digitised at present.

Digital payments are treated exactly the way the banking industry is dealt with. There is a fundamental flaw of mixing regulations related to banking with payments. India is missing the digital bus as a huge opportunity of converting nearly 90 per cent cash payments into online is being let go off. We need more players and we need better regulation.

Beyond the banking sector, there are just a handful of players who are minimally empowered to serve the mass market. The irony lies in the fact that despite this mammoth opportunity, the current small size of market may be unviable for the existing players and yet the government is inviting new competition.

In view of the sheer market potential, payments need to be treated separately. We need to understand that payments is a commerce activity and hence cannot be treated on par with banking. Besides, low-value digital commerce should be treated on par with cash transactions, thereby evading revenue losses for the sector.

To achieve all of this, the RBI needs to create a new institutional framework. The payments industry needs an expert institution focused on driving the national agenda of going digital. This framework requires an integrated payment service model — an entity that could come from the banking or the non-banking industry. This, in turn, will create a fresh breeding ground for new competition and talent across all stakeholders. This institution should focus its undivided attention on boosting digital payments as a core activity. It shouldn't work in silos but be an integrated assembly capable of offering local and global transactions for payments and remittances, both inward and outward.

Such a mini-regulator, powered by a fully inter-operable framework for issuing and acquiring merchants, will help create a sustainably serviceable business model. This will foster growth and incubate competition while offering world-class digitisation in retail payments.

The need of the hour is to hedge boundaries around the complexities of the regulatory system, making it simple for new participants to get up and run quickly. The RBI's stance on encouraging competition is an opportunity to design a brand new regulatory framework that helps bring in advanced players and catalyses a new growth phase in the sector.

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