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Role of Payment Banks in financial inclusion

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Abstract: The purpose of the study is also to understand the issues and challenges of the new financial Payment banks. Payment banks have been successful in developing countries such as the Philippines and Kenya. In Kenya, almost two out of three adults use Vodafone M-Pesa to store money, transfer funds, or make purchases. Payment banking is lean, narrow banking. It is the future brought into the present by demonetization. Payment banks will lead towards a lean, cost-effective banking system. The Payment bank is an Indian innovation. It is a response to the problem of financial inclusion, which we have not been able to solve for so many years. In this context, the paper attempts to study the concept of Payment banks and how can they become the catalyst for financial inclusion in India. The purpose of the study is also to understand the issues and challenges of the new financial Payment banks.

Key Words: Payment banks, Financial Inclusion, cash-less economy

Introduction

India has traditionally been a cash-based economy with limited penetration of formal banking and financial services. There is reasonably high requirement of financial services among the low-income people in India, which includes the domestic remittances, access to credit, receiving government welfare payments and utility payments. Financial inclusion means that a wide scope of designated financial services is accessible to each individual and the individual is able to comprehend and utilize those services. It not only includes opening of deposit account with the bank but also creating awareness about the various financial products and guiding people to manage cash and loans obligations. These services comprise of a basic no frill banking account for deposits and withdrawals of money, small-scale advances and overdraft and life and non life insurance. Due to poverty, low income, illiteracy and insufficient information on financial services, there is low demand for financial services from the people, which leads to the financial exclusion. Travel distances to the bank branch, branch timings, burdensome procedures and documentation, inappropriate financial product, language barriers and unwelcome attitudes of the bank staff are the reasons of financial exclusion on the supply side.

Financial Inclusion in India

Over the years, RBI efforts towards financial inclusion includes priority sector lending provisions for banks, setting up of regional rural banks (RRBs) and initiating SHG- bank linkage program to expand the accessibility of financial services to the poor an disadvantaged fragments of society. In recent years, RBI introduced no-frill accounts, business facilitators and business correspondent models to improve the outreach of the banking services to the unbanked areas. It has also fixed a target for the banks to give access to formal banking services to all 74,414 villages where the population is above 2000. As on March 2012, 99.7 percent of the targeted villages with population above 2000 were covered with banking services. The Government of India and the Indian Banks' Association (IBA) jointly launched Swabhimaan in February 2011. It is a countrywide financial inclusion programme. This program has an objective to facilitate opening of bank accounts, giving need-based credit, providing remittances and to advocate financial literacy in rural areas. The present Government on 15th August 2014 launched Pradhan Mantri Jan Dhan Yojna. as its national mission on financial inclusion. This revolutionary program is aiming to bring about a comprehensive financial inclusion to all the households in the country. The program visualizes at least one all inclusive banking account for every household, financial literacy, access to credit, insurance and pension facility (Mission document, PMJDY) According to the recent statistics, 2.8 crores accounts are opened so far with Rs.39, 152.86 crores deposits and 126 lac Bank mitras under PMJDY. Subsequent schemes for insurance and pensions have attempted to extend access to a wider gamut of financial products – the Pradhan Mantri Suraksha Bima Yojana (accidental death and disability insurance), the Pradhan Mantri Jeevan Jyoti Bima Yojana (life Insurance) and the Atal Pension Yojna (pension).

Payment Banks and Financial Inclusion

Durable relationships are rarely transactional but frequent transactions could form the bedrock of solid relationships – and help achieve the federal objective of financial inclusion. Payments banks are different from regular banks. Payments Banks are permitted to offer basic bank accounts (current and savings with a balance limit of INR 100,000) but are not permitted to extend credit or issue credit cards (thus avoiding credit risk, NPA issues and insolvency). They can accept demand deposits, can issue ATM/debit cards, pay bills, provide remittance services through various channels, be the business correspondent (distributor) of another bank, can distribute financial products such as mutual funds and insurance products in a non-risk sharing basis, facilitate government welfare payments to their customers, and provide other basic banking services to individuals and small businesses. Furthermore, payments banks can only invest their money in safe government securities and other highly liquid assets. This means payment banks will theoretically be the safest of banks since they have only the government as borrower and governments do not default. This is the first time that the RBI has approved differential licensing with the intent of further financial inclusion. The move is expected to boost the government's plan of financial inclusion, with these banks acting as a bridge between bank branches and the remote customer living in a rural hamlet and thus providing 'last mile banking' services at a cheaper cost. Payments banks can reach a significantly wider range of population, who may be otherwise under banked.

Payment banks will essentially rely on technology to reach payment services to all customers, with mobiles as the carrier of banking. Mobiles have the capability to reach even where humans cannot reach. Physical bank branches (or bankers or ATMs) will still be needed for some functions - opening an account, depositing cash, etc but all the daily payment transactions can be done remotely. The mobile phone will become the virtual ATM and small-payments chequebook. In less than 10 years, every Indian will have a bank account. Payment banks are the key enablers. Brick and Mortar Banking is a capital-intensive business model and commercial banks it would be difficult for the commercial banks to open branches in the unbanked and far-flung areas, as incremental cost would exceed incremental benefit. The difference between State Bank and Airtel is simply this: both have over 200 million customers, but the reach of Airtel cannot be matched with State Bank even with their highest number of branches in the country.

Payment Banks will provide low cost services to the customers located in the remote areas with the help of Business Correspondents or Franchise Banking System. According to Crisil, east, northeast and central India offer a natural habitat for payments banks because of under-penetration of formal banking in these areas. With the arrival of payment banks including India Post will transform social welfare and subsidy schemes. The government subsidy payments to the poor whether for LPG, kerosene or even food and fertiliser can now be routed through regular and payment banks. With over 1.5 lakh post offices, India Post is already functioning in places where banks are not there and tomorrow Airtel and Vodafone will reach customers through mobile-enabled payment systems. Jan Dhan no-frills bank accounts, Aadhaar IDs and mobile banking will enable direct payments to the poor, eliminating fake recipients and will ensure cash in zero-balance accounts. Financial Inclusion and government subsidy payments are simply the biggest things to happen with the introduction of Payment Banks.

Cash-less banking system can possible through Mobile Payments. This means, over time, the mobile will perform the same role as credit and debit cards, obviating the need for too many cash payments. The main objective of demonetization by the present government is to eliminate black money from the economy. Payment banks would act as an additional tool to eliminate black money in large parts of the financial system. India is close to reaching a mobile user base of one billion, and Jan Dhan account has been opened for most of the households. The next aim for Jan Dhan would be universal adult coverage through mobile payment banking. It can be achieved in five to ten years, with the cooperation of s public and private sector in financial literacy education and empowerment of rural citizens; especially women, thus making Indian banking more inclusive.

The concept of Payment Banks seems to be finally inching closer to reality, since the first player Airtel launched its payments bank. It rolled out its pilot services in Rajasthan and subsequently in Andhra Pradesh, Telangana and Karnataka. With over 10,000 saving accounts opened within two days of it going live in Rajasthan, a majority of customers living in the semi-urban and rural areas, underlining the potential for growth of banking services in such areas. The digital and paperless Airtel Payments Bank has opened account using Aadhaar based e-KYC. Customers The Airtel mobile number also acts as their bank account number. The interest rate of 7.25 per cent per annum will apply on deposits in savings accounts. Airtel Banking points will offer bank account opening services and cash deposit and withdrawal facilities. The mobile phone has emerged as a powerful device to drive financial inclusion and advance cashless transactions in the country. Several other license-holders are accelerating their preparations for the launch of their ambitious payments banks, a financial ecosystem that is said to redefine banking and push for India's journey into a cashless economy.

Payment Banks – Issues and Challenges

Payment banks also bring some issues and challenges in India. Profits will be a challenge as margins are very thin, as these banks are required to invest 75 per cent in government securities. Payments banks are not allowed to lend. This will limit their earning potential. As income channels are limited, payments banks will be under pressure to generate volume.

Competition in the digital banking space has intensified with banks also offering digital banking to their customers. With their large customer base, they have an edge over payments banks and digital wallet players. And with the new payments solutions (Unified Payments Interface) provided by the National Payments Corporation of India, digital banking is going to be extremely competitive. NPCI's Unified Payments System is set to completely revolutionise digital money transfer by making sending money as simple as a text message.

The changes in technology have been rapid. The challenge facing Payment banks for moving toward e-payments requires building out the digital payment infrastructure through partnerships with online e-commerce and physical offline merchants, especially in rural areas, which mostly lack the required connectivity to take part in the expansion of e-payment. Thus, building franchise and managing operational risks while offering last-mile connectivity will be a challenge.

Another issue would be how well a Payment bank will position its network of cash-in/out points or low-cost and tech-heavy branches. The cash-in/out alone will not be enough for their operations in future, as these banks' sustainability and progression will ultimately depend on customers' adoption of digital cash for making transactions. Just cash-in/out services and no (or negligible) transactions would result in inactive digital accounts; whereas Payment bank's whole value proposition is based on developing a revenue model around actual payment transactions.

For Payment banks to succeed, cash driven_Indians will need to opt for digital alternatives, which will require behavioural changes above and beyond technological hurdles. Though a few e-wallet players' providers like Paytm, Mobilwik, PayUMoney are in this space in recent years but mainly in urban centres. For Payments banks, the task will be too challenging in the rural areas. Ultimately, they will require a concerted ecosystem effort and additional policy support to enhance the growth of inter linkages and missing markets.

The new payment banks may also bring additional functional risks for the industry. The payment banks may face increasing legal hassles in the treatment of customer privacy. There is a continuing debate on the extent of the usage of Aadhar Information by the private corporates to improve the speed and efficiency of payments transactions. Meanwhile, innovative business models have the potential to lead payment banks into unregulated areas, which may require enhanced supervision by the RBI.

The Way Forward

Payment Bank CEOs say the future of the business will be based on transactions, including cash withdrawals though their network of small stores across the hinterland. Fee income generated by selling financial products should be another revenue stream. Despite of the challenges facing Payment banks, it is expected that Payment Banks will open another alternative channel after Internet and mobile banking, and help improve efficiencies and reduce costs involved in catering to customers in rural and semi-urban areas. Payments banks are set to tap the potential in rural and semi urban areas. They can do almost any kind of banking with the help of mobile phones with retail customers, who constitute the bulk of the banking system. Airtel with nearly 200 million mobile users is bigger than State Bank of India in terms of its customer base, and is thus wonderfully placed to become a payments bank. Ditto for Jio or Idea or Vodafone. Similarly India Post can do the same in rural areas (it already has a payments bank licence, and has nearly 1.5 lakh physical branches). Payments (both receiving and giving) are what constitute the bulk of retail banking. The bulk of the business of regular banks is about deposits and loans, and the difference between the two rates of interest gives them their gross margins before costs. They offer wholesale banking and advisory services to big customers, and earn fees from retail customers by issuing drafts and chequebooks. They also charge fees on credit card and ATM services. But in future large parts of the retail business will move to payments banks, as payments is what the customers use banks for.

If payments become the base of the relationship, then payment banks can bring a non-banking financial company (NBFC) or a mutual fund (MF) as a partner, and create an offering that replicates a bank. NBFCs core business is lending and payment banks have competence in doing payments and mutual fund manages money well. Thus it can create a seamless combination that is good for the customer and for the bank as well. There could also be a positive rub-off on existing banks partnering with payments banks through increased access to unbanked and under-banked areas in a cost-efficient manner. Payment banks have been successful in developing countries such as the Philippines and Kenya. In Kenya, almost two out of three adults use Vodafone M-Pesa to store money, transfer funds, or make purchases. Payment banking is lean, narrow banking. It is the future brought into the present by demonetisation. Payment banks will lead towards a lean, cost-effective banking system. This is where demonetisation and the gradual reduction of the cash economy are changing the rules forever. The rush towards digital cash is likely to remain permanent and will impact the whole banking business model.

Conclusion

Payments banks have a potential to revolutionize how retail banking works in India. Mobile wallets/telecom companies have demonstrated the capability to deliver and should be able to dominate this space considering their huge distribution and retailer network (e.g. telecom companies claim to more than 15 lakh retail points). Though mobile banking has not made much headway especially in rural areas, yet compared to branch banking, ATM, mobile banking are far less expensive per transaction and more convenient for customers. Payment banks have a great potential to change the patterns of interactions between customers and banks by making banking transactions via ATMs and mobile phones self-assisted, seamless, convenient and foolproof over the payments-based architecture in India.

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