DIFFERENTIATED BANKING MODEL: PAYMENT BANKS – A STEP AHEAD IN MODERN BANKING

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ABSTRACT

For the first time in India's banking sector, the Reserve Bank of India is giving out differentiated banking licences. The in-principle go-ahead banking licenses to 11 'payments banks' is, by the RBI's own admission, an experiment — the latest in a long series of attempts to take banks to the unbanked. The push towards financial inclusion started with the nationalisation of 14 commercial banks in July 1969 through the Banking Companies (Acquisition and Transfer of Undertakings) Ordinance, 1969. Then a second round came in 1980, involving six more commercial banks. With a view to economically mainstreaming rural areas, the Indira Gandhi government established regional rural banks by means of an ordinance in 1975. But even 45 years later, all these attempts have had little success in expanding banking coverage to the desired extent and scale: only 7 per cent of India's villages have a branch of a rural or commercial bank. The policymakers seem now to have finally understood that banking inclusion cannot be just one among many businesses of a bank: it has to be the core business. The licensing condition that puts a Rs. 1-lakh cap on deposits that payments banks can receive from customers defines the market they will target - primarily the unbanked population. The RBI expects payments banks to target migrant labourers and the self-employed, besides low-income households, offering low-cost savings accounts and remittance services so that those who now transact only in cash can take their first step into the formal banking system. The responsibility of financial inclusion is now almost entirely entrusted to the private sector. Hence there will be a definite change in Indian banking in near future, all those possible developments by the entry of payment banks are discussed in this paper.

Keywords:-payment banks, RBI, payment technologies, Vodafone m-pesa, Aditya Birla Nuvo, Bharti Airtel

Introduction

For years, banking has been a distribution business though new private banks have sought to change the definition of what has been called a brick and mortar model by encouraging customers to go online and bank or use the Automated Teller Machines or ATM's for a variety of transactions. The announcement of the licencing of payment banks, made SBI and HDFC Bank to announce new products which will address this and attract more customers. Payment banks could provide that push again to these banks to change their outlook and reach out to newer customers, especially in a country which has close to 900 million mobile subscribers. This thrust made me to make this paper to enlighten people with this paper.

Review of literature

Prashanta Athma (2000), in his Ph D research submitted at Osmania University Hyderabad, "Performance of Public Sector Banks – A Case Study of State Bank of Hyderabad, made an attempt to evaluate the performance of Public Sector Commercial Banks with special emphasis on State Bank of Hyderabad. The period of the study for evaluation of performance is from 1980 to 1993-94, a little more than a decade. In this study, Athma outlined the Growth and Progress of Commercial Banking in India and. analyzed the trends in deposits, various components of profits of SBH, examined the trends in Asset structure, evaluated the level of customer satisfaction

Zacharias Thomas(1997)Ph D Thesis, 'Performance effectiveness of Nationalised Bank-A Case Study of Syndicate Bank', submitted to Kochin University (1997), Thesis studied the performance effectiveness of Nationalized Bank by taking Syndicate Bank as case study in his Ph.D thesis. Thomas has examined various aspects like growth and development of banking industry, achievements of Syndicate Bank in relation to capital adequacy, quality of assets, Profitability, Social Banking, Growth, Productivityetc

Singh R (2003), in his paper Profitability management in banks under deregulate environment, IBA bulletin, No25, has analyzed profitability management of banks under the deregulated environment with some financial parameters of the major four bank groups i.e. public sector banks, old private sector banks, new private sector banks and foreign banks,

profitability has declined in the deregulated environment. He emphasized to make the banking

Introduction

Payment Banks is a Brainchild of Nachiket Mor. Committee which was setup last year by RBI. The Committee aims to assist in widening the financial inclusion mission by bringing Small Businesses and Low Income Households into the ambit of financial services. Payments banks are niche banks set up by the Reserve Bank of India to further the agenda of financial inclusion. These banks will provide small savings accounts and payments /remittance services mainly to migrant labour workforce, low-income households, small businesses, etc. by enabling high volume-low value transactions in deposits and payments / remittance services in a secured technology-driven environment. They can accept demand deposits — current deposits and savings bank deposits — from individuals, small businesses and others.

What payment banks can and can't do

-They can't offer loans but can raise deposits of upto Rs. 1 lakh, and pay interest on these balances just like a savings bank account does.

-They can enable transfers and remittances through a mobile phone.

-They can offer services such as automatic payments of bills, and purchases in cashless, chequeless transactions through a phone.

-They can issue debit cards and ATM cards usable on ATM networks of all banks.

-They can transfer money directly to bank accounts at nearly no cost being a part of the gateway that connects banks.

-They can provide forex cards to travelers, usable again as a debit or ATM card all over India.

-They can offer forex services at charges lower than banks.

-They can also offer card acceptance mechanisms to third parties such as the 'Apple Pay.'

Who has Reserve Bank granted in-principle approval to be a payment bank?

-Aditya Birla Nuvo Ltd

-Airtel M Commerce Services Ltd

-Cholamandalam Distribution Services Ltd

-Department of Posts

-Fino PayTech Ltd

-National Securities Depository Ltd

-Reliance Industries Ltd

-Dilip Shantilal Shanghvi

-Vijay Shekhar Sharma

-Tech Mahindra Ltd

-Vodafone m-pesa Ltd

Why are they going to be a game-changer?

This is for the first time in the history of India's banking sector that RBI is giving out differentiated licences for specific activities. RBI is expected to come out with a second set of such licences — for small finance banks — and the process for those is in its final stage. The move is seen as a major step in pushing financial inclusion in the country.

It's a step to redefine banking in India. The Reserve Bank expects payment banks to target India's migrant labourers, low-income households and small businesses, offering savings accounts and remittance services with a low transaction cost. It hopes payments banks will enable poorer citizens who transact only in cash to take their first step into formal banking. It could be uneconomical for traditional banks to open branches in every village but the mobile phones coverage is a promising low-cost platform for quickly taking basic banking services to every rural citizen. The innovation is also expected to accelerate India's journey into a cashless economy.

India's domestic remittance market is estimated to be about Rs. 800-900 billion and growing. With money transfers made possible through mobile phones, a big chunk of it, especially that of the migrant labour, could shift to this new platform. Payment banks can also play a crucial role in implementing the government's direct benefit transfer scheme, where subsidies on healthcare, education and gas are paid directly to beneficiaries' accounts.

Also, this is the first time since banks were nationalized, that private sector business groups have bagged the RBI's nod for banking services.

What has the experience been in other countries?

Payment technologies have proved hugely popular in other developing countries. In Kenya, the most cited success story, Vodafone's M-Pesa is used by two in three of adults to store money, make purchases and transfer funds to friends and relatives.

A way Forward for Financial Inclusion-Payment banks

A quiet financial revolution has begun in India. Reserve Bank of India, India's central bank, has granted permission to set up payment banks to 11 Indian companies. This is with the objective of bringing new areas under financial inclusion which otherwise are neglected by traditional commercial banks. Payment banks can accept deposit up to INR .1 million, and will offer other banking services such as an issuance of ATM/debit cards, and money transfer.

Among the big names which are granted license (likely to be operational by September 2015) are India Post, Reliance Industries, Airtel, Vodafone, Tech Mahindra, Paytm, IDFC, National Securities Depositary Limited (NSDL), Fino PayTec, Cholamandalam group, and Aditya Birla Nuvo. Although India Post, with 0.15 million post offices, has already got a network in place, others are tying up with commercial banks (for instance, Reliance with State Bank of India, Airtel with Kotak Bank, etc.) to leverage their presence. The usher of payment banking system is an important step for financial inclusion in India.

In 2014, only 35% of the adults have a bank account and a meagre 8% availed loan from banks. Access to formal banking is a necessary condition for any economy to grow. It will increase saving rates, which will enable capital investment in sectors such as roads, ports, and railways. India needs to invest over USD 320 billion in infrastructure. As capital is scarce, a perfect capital market will ensure a higher return for each additional dollar of saving invested for building India's infrastructure.

Importantly, access to banking will increase the productivity of the Indian Micro, Small and Medium Enterprises (MSMEs) sector, and aid the much touted Make in India campaign for India. Only 5% of the MSMEs avail loan from institutional sources, underscoring the need for financial inclusion for the MSME sector, and to drive India's inclusive growth agenda.

Although, economists and policymakers, in general, are worried about individual well-being, and the factors affecting this well-being, they somehow seem to assume the market is perfect. All the growth models in economics, explaining why some economies grow faster than the others, have tried to explain the higher standard of living (read, per-capita income) without explicitly accounting for market imperfection. In fact, the fundamental assumption for any country to grow is to assume that the capital market is perfect – so that whatever is saved can be invested for productive purposes.

Imperfection in capital market affects distribution of income. A person who is economically poor and does not have a bank account has no other choice but to store his money in the form cash, livestock, or jewellery. The value of cash withers with inflation, jewellery run the risk of being stolen, and livestock can fall ill. All these adversely affect flow of income, and hence affect consumption smoothening.

Payment bank will be a big boon for thousands of migrant workers. In India, only 2% of the people used an account to receive money from their family member living in other regions. A survey among Indian migrant workers showed they pay a commission of 4.6% when they transfer money through informal route such as Hawala. The cost of the loan through an informal channel is also high in India. Firms/people with access to finance/capital are guaranteed with more income than the ones without access to banks and capital.

As these payment banks are backed by big corporates (some of them have already pioneered use of technology in the financial sector such as Tech Mahindra and NSDL), it will usher in a technological revolution in India. Technology helps to augment financial inclusion by making accessibility to bank and financial transactions easier. Long are the days of waiting in a long queue in banks. In a digital world financial transaction happens through a click of the mouse, and over the mobile phone.

In India, changes have already happened in three specific areas. First is the introduction of Real Time Gross Settlement (RTGS) system, enabling banks to transfer funds across all deposit accounts in real time. The newer version of RTGS has many advanced capabilities such as national electronic fund transfer (NEFT), and electronic fund transfer (EFT) across national boundaries. Second is the introduction of online automatic clearing mechanism such as BillDesk, underlying any retail transfers between the point of sale for credit/debit cards and bank automatic teller machines. And, third is the introduction of electronic clearing service (ECS) for cheques, an electronic mode of fund transfer from one bank account to another.

Payment banks will make mobile network operators (MNOs) and internet banking more popular. According to ‘Internet in India 2014’ report jointly published by the Internet and Mobile Association of India, and IMRB International, Internet users in India will cross 300 million by December 2014. The year on year growth rate registered stands at an impressive 32 percent. In rural India, the number of Internet users increased by 39 per cent to reach 101 million in October 2014. India has the third largest Internet user base in the world, after China with more than 600 million Internet users and the US with an estimated 279 million users.

For a populous country like India future strategy for financial inclusion will call for technology to reach the bottom of the pyramid, something that these payment banks can facilitate. Bringing poor people under the garb of digital banking platform will help financial transfer meant for social security payment easier. A study by McKinsey points out online payment of social security benefits will save the government USD 22 billion per year.

A study involving 2016 households in Kenya found people availing M-PESA service (banking through mobile, and the service is provided by Vodafone) are better equipped to absorb negative income shocks arising from poor health, crop failures, and job loss. Statistically comparable the household not availing M-PESA service are likely to experience a 6 – 10% reduction in consumption in response to similar income related shocks.

The future will see the emergence of contactless payment enabled through usage of near field communication (NFC) technology. NFC will enable smartphones and other devices to establish radio communication with each other by touching devices together or bringing them in close proximity. Going paperless by saving time will not only reduce transaction costs but will also play an important role for financial inclusion. Some big commercial banks such as HDFC has already started work on it.

Conclusion

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It is in the hinterland that state-run banks have had a head start. Close to 40 per cent of their branches are in rural areas and over 20 per cent in semi-urban areas while private banks lag in reaching out to this segment. This should offer a good business opportunity to the banks if they get their technology solutions right. What should work for them is their pedigree – the fact that the government owns them – adding to the trust factor. But private firms which have promoted payment banks may be more nimble and aggressive. Overall, the competition should benefit those who are on the periphery as long as regulatory oversight is good. More importantly, all this should help expand banking services to the remotest corner of the country over the medium and long term with huge economic spin offs.

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