"A STUDY ON NEW INSTRUMENTS OF FINANCIAL INCLUSION PAYMENT BANKS(RBI) IN INDIA: CHALLENGES AND ISSUES"

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Abstract:

The Finance Minister, Mr. ArunJaitely, in his first Budget speech of the new Government, in July, 2014, had announced that "Differentiated banks serving niche interests, local area banks, payment banks etc. are contemplated to meet credit and remittance needs of small businesses, unorganized sector, low income households, farmers and migrant work force". On 19th August, 2015, Reserve Bank of India (RBI) announced in principle approval to eleven entities for starting Payment Banks as per the guidelines earlier circulated by them. It was for the time, RBI announced setting up of differentiated banks in the country for specified activities. Payment Banks' minimum equity capital has been stipulated at Rs. 100 crore, with minimum 40% promoter share for the first five years. These banks have to be fully networked and technology driven from the beginning, so as to subserve their basic objective to reach and service the poorer people in far flung areas. The Payment Banks have been allowed to carry out functions of accepting demand deposits up to Rs. one lac, issue of ATM cards, provide remittance facility. They have, however, been precluded from lending, issue of credit cards etc. For investment of funds garnered, they can only take recourse to Government securities and deposits in commercial banks. The objective of Payment Banks is to further the agenda of financial inclusion. The paper examines the issues and challenges facing the niche banks in meeting their objectives.

Key words: Commercial banks, financial inclusion, micro finance institutions, payment banks, technology

Introduction

The focus was clearly on furthering financial inclusion by providing (i) small savings accounts and (ii) payments/remittance services to migrant labour workforce, low income households, small businesses, other unorganized sector entities etc. This resulted into release of guidelines in November, 2014, by the Reserve Bank of India (RBI, 2014), for setting up Payment Banks in India (RBI, 2014). Applications were invited from eligible entities. 41 applicants submitted their proposals, with Business Plans, to RBI for setting up the Payment Banks (RBI Press Release dated 4th February, 2015). These included big companies like Reliance Industries, Aditya Birla Nuvo, Tech Mahindra, Government agencies like Department of Posts, National Securities Depositories Ltd., number of e-payment companies and also few high net worth individuals like Mr. DilipShanghvi and Mr. Kishore Biyani. After scrutiny of applicants by an Expert Advisory Committee, RBI on 19th August, 2015 announced in principle approval to eleven entities for starting Payment Banks (RBI Press Release 2015).

It was for the time, RBI announced setting up of differentiated banks in the country for specified activities.

Eligibility for Payment Banks

Following entities were made eligible to apply for license for Payment Banks (RBI, Press Release, 2014):

- Existing non-bank Pre-paid Payment Instrument (PPI) issuers,
- Non-Banking Finance Companies (NBFCs),
- Corporate Business Correspondents(BCs),
- Mobile telephone companies,
- Super-market chains,
- Companies,
- Real sector cooperatives owned and controlled by residents,
- Public sector entities

It was required that promoter group must possess sound track record of professional experience or running their businesses for a minimum period of five years. They were also allowed to set up a Payments Bank as a joint venture with an existing scheduled commercial bank.

Technology Requirements

These banks have to be fully networked and technology driven from the beginning, so as to subserve their basic objective to reach and service the poorer people in far flung areas.The overall focus of RBI guidelines has been to create differentiated banks which are adequately capitalized, financially inclusive and possess a competitive and sound business model.

Capital requirement

Payment Banks' minimum equity capital was stipulated at Rs. 100 crore, with minimum 40% promoter share for the first five years. The Leverage ratio has also been capped at 3%, meaning that outside liabilities of banks cannot exceed one third of their net worth.

Entities approved for Payment Banks

On 19th August, 2015, RBI set the ball rolling and granted in principle approval to eleven entities to start Payment Banks. These are:

Reliance Industries

- Aditya Birla Nuvo
- Vodafone m-pesa
- Airtel M Commerce Services
- Department of Posts
- Tech Mahindra
- National Securities Depositories Ltd.(NSDL)
- FinoPayTech
- Cholamandalam Distribution Services
- Mr. Vijay Shekhar Sharma(CEO of One Communication – PayTM)
- Mr. DilipShanghavi (of Sun Pharma)

The in principle approval granted is valid for a period of 18 months, during which time the applicants have to comply with the requirements under the Guidelines and fulfill the other conditions as may be stipulated by RBI. It may be noted that selected entities are from different sectors and have the reach, technological and financial strength to service customers in distant nook and corner of the country. There are prominent mobile operators in the approved list as it has been witnessed that penetration of mobile phones in the country has been far more than bank accounts despite many efforts launched for many years towards financial inclusion.

In the first list, it appears that pre payment issuers (PPIs), retailers and real estate companies have been excluded. RBI has given preference to telecom companies and those with business plans particularly in north east areas and entities with strong financial position.

Functions to be performed by Payment Banks:

- Acceptance of demand deposits, initially up to Rs. One lac per customer,
- Issuance of ATM / debit cards,
- Payments and remittance services through various channels,
- Business Correspondent of another bank,
- Distribution of non-risk sharing simple financial products like mutual fund units and insurance products, etc.

Prohibited Business

Payment Banks have been barred from following business:

- Acceptance of NRI deposits,
- Issue of credit cards,
- Set up subsidiaries to undertake non – banking financial activities,
- Offer other financial or non- financial services of promoters
- Lending activities

Deployment of Funds

Payment Banks will be required to invest minimum 75 per cent of its "demand deposit balances" in Statutory Liquidity Ratio (SLR) eligible Government securities / treasury bills with maturity up to one year and hold maximum 25 per cent in current and time / fixed deposits with other scheduled commercial banks for operational purposes and liquidity management. Besides, they will have to meet Cash Reserve Ratio stipulated by RBI. The requirement of 75% investment in SLR securities will create entry of additional players in Government securities market and may spur demand.

Corporate Governance Structure

The boards of these banks will have majority of independent directors. The banks have to comply with corporate governance guidelines including fit and proper criteria for directors as issued by RBI from time to time. The banks will have high powered customer grievances cell to handle customer grievances.

Technology will be the key

The business model available to payment banks is such that they will have to work on thin margins and at the same time compete with other entities for attracting deposits at competitive rates. The business will have to be volume driven with low expenses in infrastructure and establishment. Technology and innovative dispensation with use of technology will be the key driver of business of Payment Banks. All the players who have been given in principle approval for setting up Payment Banks are banking on their technological competence and extensive reach to last mile connectivity. **Transaction costs and service efficiency**

Payment Banks, though set up with the objective to deepen financial inclusion, they are going to service all type of customers and are likely to attract urban clients as well with their technological innovation and ease of service. The new breed of banks with their focus on technological innovations including mobile services are expected to lower transaction costs and also transaction time, which may put them hard on existing banks. Some of players entering in this business have already strong mark in this new banking space. Lower transaction costs and intensive digital service, coupled with efficient customer orientation will drive business model of new players. Some of entities have strong financial base to take lead in this respect.

Competition with existing banks

That is the reason all the players have tie ups with telecom or banking companies to take advantage of their expertise in furthering business opportunities in this segment. For instance, Reliance Industries has tie up with State Bank of India which has a vast network of over 16,000 branches with an extensive rural presence. Reliance also intends to use Reliance Jio's launch for new banking endeavour. Similarly, Aditya Birla Nuvo plans to take benefit of the branches of their financial services arm and the large subscriber base of their telecom unit Idea Cellular. The Department of Post has also the advantage of largest reach in the form of over 1.54 lac postal touch points across length and breadth of the country and has unmatched niche in this regard that can give it an edge if it can supplement it with technology and efficiency in sync with other players . It plans to set up an independent subsidiary to carry out new banking operations. Other financial services company, National Securities Depositories Ltd. has reliance on its17, 000 service centers. Air Tel has alliance with Kotak Mahindra Bank and benefit of its own subscriber network. DilipShanghvi of Sun Pharma group has teamed up with Telnor and IDFC for his Payment Bank venture. Vijay Shekhar Sharma (PayTM) and Vodaphone m-pesa are also niche players in digital sphere. All the players entering the business of Payment Banks are fully aware of technology providing edge in this business and taken adequate measures in pursuance to that.

Many of existing banks have expressed fears of competition for low cost deposits with new Payment Banks. Concerns have also been voiced over flight of cash from bank branches to Payment Banks to avail easy cash payment facility through Payment Banks coupled with loss of some service fees from issue of demand drafts and remittances. Even large bank like State Bank of India and ICICI Bank have felt hot competition emanating from new differentiated banks for retail deposits. This will be in addition to advent of two new universal banks viz. IDFC Bank and Bandhan Bank coming into banking space soon. The RBI Governor has tried to allay these concerns stating that new bank will play complementary role to the existing banking system by traversing the last mile. Payment banks will be useful as they will bring new players into system and may act as feeder to existing banks. However, it seems in long term these larger banks will adopt services akin to Payment Banks and upgrade their technology and come on level playing field. In will remain to be seen how this competition really fans out and different players devise strategies to meet it.

Contribution to Financial Inclusion

The key reason for financial exclusion in India is lack of financially viable business model to serve the 'Bottom of the Pyramid' customer segment in a cost effective manner (Deloitte, 2014). The void needed to be filled with a sustainable banking model with ability to reach last of poor in a cost efficient manner. The avowed objective of the new differentiated banks is to further promote financial inclusion agenda and become an active instrument in this direction at reasonable cost with use of technology including mobile phones for banking transactions and wide possible reach to the last of poor in far flung areas. The RBI Committee that went into the issue of Payment Banks had strongly felt that new system of banks was necessary if financial inclusion was to be speeded up in a meaningful manner as existing banking system could not meet this requirement effectively. Other channels prevalent in far flung areas were not cost effective or even secure for poor people in such areas.

Payment Banks can also become agents for direct transfer of many of Government benefits like gas subsidy, social security schemes etc. particularly in unbanked areas andthus aid in financial inclusion. Many migrant workers will also use these banks for money transfers to their remote households.

The existing banks particularly have been quite active in their rural operations and aiding Government objective towards financial inclusion to the extent possible with their reach. However, the objective could not be met satisfactorily. Even the introduction of Regional Rural Banks did not serve the purpose of financial inclusion for various reasons. Here again, their services were operated through branches, like commercial banks, and expansion of branch network to last of the village was wholly uneconomical. Then, how these new players on the block will help? What is expected from them is that they will be able to move more closer to the financial inclusion. The existing banks are not able to afford more than reasonable number of rural branches through which they normally operate to further their agenda of financial inclusion. But, payment banks will use technology and particularly with use of mobile phones for banking facilities, they will endeavour to bring greater number of rural residents and workers closer to formal banking arena, who so far been relying mostly on cash dealings. These banks will be expected to impact financial inclusion in much better way by extending their reach to those rural areas where normal banks have not been able to reach.

The niche banks are thus in a way going to bridge the gap between existing bank services and needs of financial inclusion. The extensive use of technology in a much pronounced way and particularly using local small merchants as their franchise may provide necessary edge to new variety of banks in fulfilling much needed fillip to the cause of financial inclusion. Many of players granted approval for new differentiated banks have already demonstrated their superior technology and many others have financial muscle to introduce it.

PradhanMantri Jan-DhanYojana – a challenge for Payment Banks

PradhanMantri Jan-DhanYojana (PMJDY, 2015) launched earlier this year claims to have mobilized 18 crore savings accounts, with 11 crore from rural areas. PMJDY has been popularized as a National Mission for Financial Inclusion to ensure access to financial services, namely, Banking/ Savings & Deposit Accounts, Remittance, Credit, Insurance, Pension in an affordable manner. Under this scheme account can be opened in any bank branch or Business Correspondent (Bank Mitr) outlet with a Zero balance. The account offers accidental insurance cover of Rs. One lac and life insurance cover of Rs.30,000. Beneficiaries of Government Schemes will get Direct Benefit Transfer in these accounts. After satisfactory operation of the account for 6 months, an overdraft facility will be permitted.

Source: Progress report of PMJDY; http://www.pmjdy.gov.in/account-statistics-country.aspx

Since PMJDY has the backing of Government machinery and is being channelized through public sector banks, it is going to pose a tough challenge to deposit mobilization by Payment Banks. Though 11 crore rural accounts have been mobilized under this scheme, about half of these are inactive and with necessary push can offer big opportunity for the new players. Government plans to cover entire country under the scheme by March, 2016. But keeping all the accounts opened as part of scheme, as active accounts over a period is going to be significant challenge.

Other Challenges to Payment Banks

Profitability

Profitability will be a huge challenge as Payment Banks will be working on thin margins. There will always be pressure of competition from similar other players and margin expansion will be a constant challenge.

Interest on Deposits

To attract deposits, interest rates matter. Those who offer higher interest rates will be more attractive to rural poor having smaller amounts to deposit. However, Payment Banks will find it difficult to offer higher interest rates as they are allowed to mainly invest only in Government securities.

Regulatory norms

Banking business always has been subject to strict regulatory provisions. The niche banks will not be excluded from it and they will have to balance their business models with the regulatory provisions that RBI may stipulate over time as the overall regulatory authority of banks in the country and in the interest of depositiors and public at large. It is also likely that some applicants particularly those operating payment systems may face dual regulation from RBI and Financial Authority.

Technological changes

New banks will have to constantly watch for new innovation in technological front by other players and be ready to adopt the same to meet competition and cost advantage.

Concept of Financial Inclusion

Over the years it has been experienced that financial inclusion can be achieved merely through deposit facilities to poor in far flung areas. Their economic condition warrants more than mere deposit facility which may be of no meaning if they have no cash to live on. In such case, they require some kind of cash loans and guidance window to start something for their livelihood. This aspect has been ignored in the scheme of Payment Banks, or may be other category of niche banks, recently announced after about a month of earlier announcement, in the form of Small Finance Banks, may fill the void.

Competition from existing commercial banks

The existing banks have already expressed being threatened by new entities for raising low cost deposits through their small rural branches. The advent of new payment banks with very low infrastructure cost and innovative technology driven business will compel the existing banks also to join the race and compete with payment banks, by gradually adopting same innovative products and services, for garnering deposits to sustain their remote branches set up for this purpose only. This is likely to put pressure on the business of new banks and threaten their sustainability.

Conclusion

Indian Government and banking system along with many other entities like Micro finance institutions, Self Help Groups (SFGs), NGOs have been making efforts at various levels to promote financial inclusion. Despite all the efforts of these entities, to promote financial inclusion, a large section of poor population remains deprived of normal banking and payment facilities. The system of Payment Banks has been the first effort of this kind from RBI in the form of private sector niche banks with clear aim to deepen the implementation of financial inclusion agenda. To be sustainable, these banks have to go low on overheads and smart on technology. The step seems to be well thought out and with clear innovative process. But in the long run, the financial inclusion dispensation will be successful only if the model used proves to be financial viable.

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