Revolutionizing Payments Through Innovation

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From goods to grains, from metal coins to paper, from bank accounts to e-wallets, money has taken various shapes, sizes, and forms. We have evolved from a barter system (exchange goods for grains), to the token system (exchange of coins and cash on paper) to cash pooling (bank accounts and deposits) to cashless payments (credit cards, cheques, e-wallets).

With just over 50% of Indians having a bank account, India suffers from one of the lowest penetration rates for banking products/services. This has driven the demand for relatively more accessible and affordable "banking" solutions to address the vast unbanked (~50% of the population) and under-banked population.

India has traditionally been a cash-dominated economy, with cash transactions accounting for over 98% of consumer payments by volume and 68% of consumer payments by value.

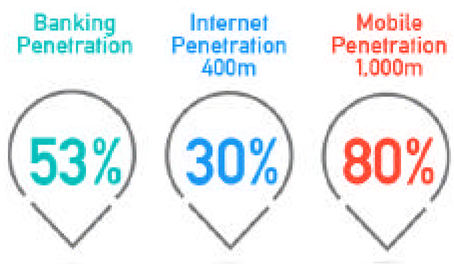
With RBI's stated intention of reducing the share of cash transactions in the economy (policy push factor) and the consumer's need for convenience (customer pull factor), the cash intensity of the Indian economy is expected to reduce to 40% of consumer payments (in value terms) by 2019.

The JanDhan-Aadhaar-Mobile (JAM) trinity will not only create bank accounts but also seed them with regular funds through direct transfers to drive transaction frequency for next 5 years. We today have 209 million bank accounts opened under the Jan-Dhan-Yojna, 975 million enrolments under Aadhaar and 1 billion mobile connections (700 mn subscribers in view of multiple SIM cards). The JAM trinity is altering the fundamental way in which money will move in India).

Supportive Environment in India

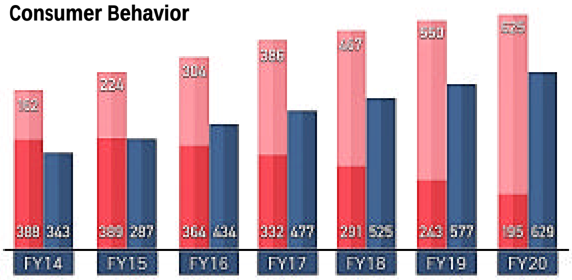
Internet penetration is growing the fastest; mobile penetration is beginning to plateau while banking penetration has got fresh impetus after the launch of the PMJDY scheme.

Demographics



Source: PMJDY, RBI, CMR & TRAI

Consumer Behavior

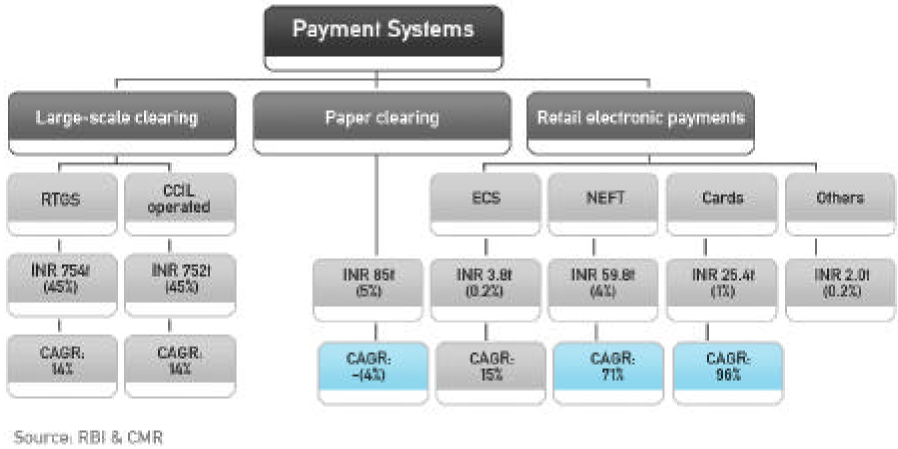


Source: PCG Research

Nos. of smartphones = Nos. of active bank accounts by 2020

According to a PwC “Disrupting Cash”Report, the cash intensity in the Indian economy is expected to reduce from ~70% to about 40% by 2019. The graph below represents the current share of cash transactions within total customer transactions (volume, value).

Current Transaction Mix – Volume



**Percentages adjacent to the value indicate corresponding share within the payments pie; CAGR refers to 5-year CAGR from 2010-15*

Emergence of alternate channels - The regulatory push

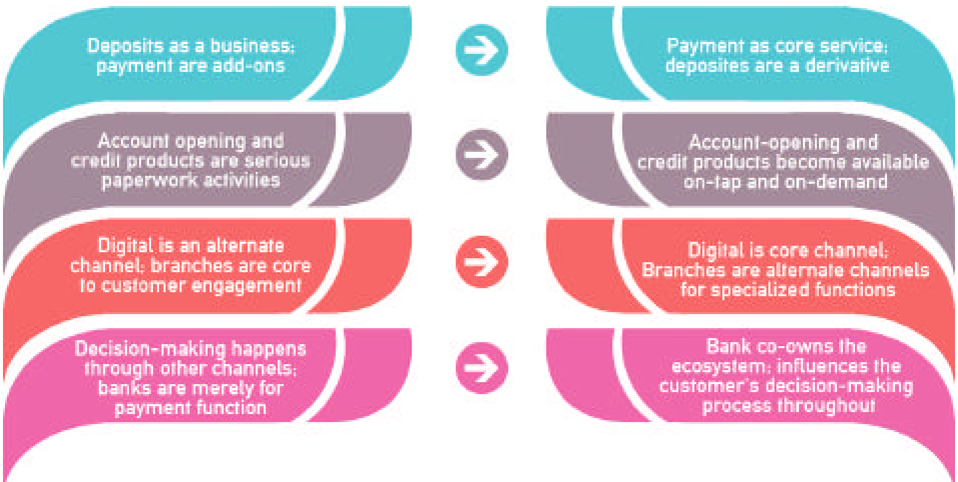
In their endeavor to enhance banking outreach (availability) and financial inclusion (access) while simultaneously reducing the cash intensity in the Indian economy, policymakers have been encouraging banks to explore and adopt various alternate channels (branchless banking) through multiple initiatives. Some of these initiatives are already beginning to bear results with the share of retail electronic transactions inching up from 1% to over 5% during the last 5-year period from FY10 to FY15. As can be seen from the graph, the 71% CAGR growth in NEFT transactions demonstrates the decidedly-permanent shift from paper-based transactions to digital transactions.

It is worth highlighting that although ‘Cards’ have exhibited a 96% CAGR over the same five-year period (2010-2015), a bulk of the card transactions (INR 22.3t; 87% of card transaction value) are still in the form of ATM withdrawals. With POS (point of sale) penetration still at 5%, I am convinced that the digital payments journey in India has just begun. With the impending reduction in cash intensity within the economy and the mushrooming of digital payment channels, I expect a tectonic shift in the transaction mix towards pure digital transactions.

“Digitally-affluent” consumers are looking to complete the “awareness to-purchase” loop on digital platforms - hence, the mushrooming of multiple payment systems. Coupled with it are the government’s financial inclusion initiatives to bank the unbanked population of the country. On 19th August 2015 RBI gave in-principle licenses to 11 payments banks & 10 SFB’s.

Even as banks build and strengthen their respective digital platforms, I believe that the next 12-18 months will be all about acquiring customers and merchants to populate their client base. Given the competitive intensity in customer acquisition, banks will need to migrate the account opening process to the digital platform in order to onboard customers quickly. The benefits of an easy-to-use, convenient digital platform generally translate into customer migration towards the digital channel.

Paradigm Shift in Banking



Source: KPMG, PWC, PCG, CMR & MOSL

Banks will migrate from an “obsession for CASA” to “focusing on transactions”. There is absolutely no benefit from dormant savings accounts if a bank cannot encourage high frequency “smart transactions”. The rules of the game are about to undergo a paradigm shift in terms of profitability metrics.

Over the next five years, banks will increasingly focus on customer profitability through metrics such as cost-per-customer and revenue per-customer. This will mean weaning away from the conventional cost per transaction metric that currently prevails in the banking system.

The Digital Banking Wave:- Mobile banking - Consumers ‘on the move’ - ‘on-the-go banking’
Of all the alternate channels that are being currently explored and experimented with mobile banking holds the greatest potential in increasing reach for banks. Mobile banking allows banks to serve customers on the move and is significantly more cost effective than traditional ‘brick and mortar’ banking. The exponential adoption of mobile banking as a transaction channel has happened largely on the back of high (and growing) penetration and usage of smartphones, especially in the metros and urban areas. This is evident in the exponential six-fold growth in mobile banking from just over INR18b in FY12 to over INR1tr in FY15.

According to the KPMG Mobile Banking 2015 report, mobile is already the largest banking channel (by transaction volume) for a majority of the banks globally. India, with a mobile banking adoption rate at over 20%, is on the cusp of a quantum leap in its mobile banking journey. To put the mobile banking opportunity in perspective, the banking system currently witnesses a monthly run rate of ~40m transactions over mobile banking. Assuming an average of 5 mobile transactions per month by a mobile-savvy user, the volume of mobile banking transactions indicates about 8m unique users that transact over this mode. An RBI publication on mobile banking pegged the number of mobile banking customers in India at 22m. Once these 14m consumers start using mobile banking, the growth will be enormous.

Challenger Banks: Today Challenger “banks” can now compete with incumbents without capital or physical presence. The ‘Uber’ moment for Indian banks is upon us. Are the traditional banks ready?

Mobile smartphone adoption is one of the drivers of changing payments patterns. Today’s mobile-first consumers expect speed, convenience and security to be integral to payments.

The digital challengers have spurred traditional banks to innovate. A number of leading banks are building payments-linked ecosystems for their customers. As the banking landscape goes digital the mantra for incumbents is “Own the interface - Own the customer - Own the wallet”. This is evident from the phenomenal growth wallets have witnessed moving from 2.01 bn in 2014 to 5.7 bn in 2015.

Brands such as Paytm, Oxigen, PayUMoney, ZipCash, Itz Cash, M-Pesa were unheard a few years back. Add to it, the specific wallets like Ola and Uber which can also be used for other transactions besides the primary transport means. The phenomenal growth taking place in this area is a clear indication of the new digital banking wave.

India is witnessing a payment revolution in the country and this massive explosion in digital payments, will help us to leapfrog into ecommerce, presenting an opportunity for Indians to switch to electronic modes of payment. The Indian government too is turning out to be a big enabler of digital payments; its Digital India program envisages a Smartphone in the hand of every Indian by 2019.