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EXECUTIVE BRIEFINGS
BUSINESS & MANAGEMENT: DIGITAL PAYMENTS

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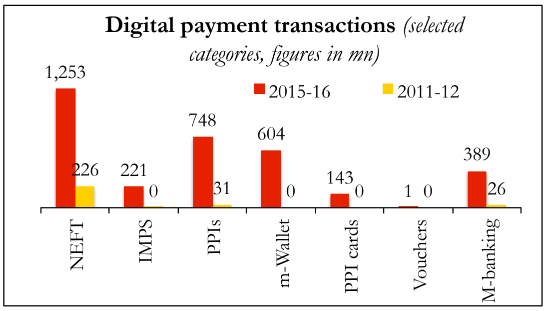
The Silent Revolution



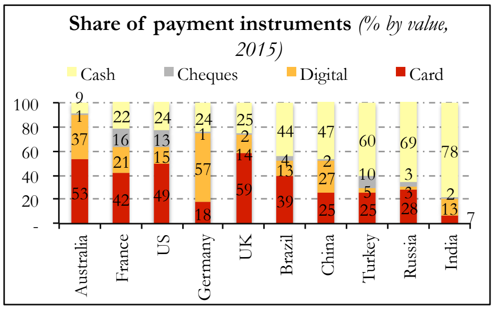
Source: Reserve Bank of India, IMA analysis.

Over the last few years, incredible changes have been taking place within India's financial system. While regulatory and media attention has largely focussed on banks, their stressed balance sheets and the need for fresh capital, a silent revolution of sorts is unfolding in the retail segment. Indian consumers have taken eagerly to new-age digital payments systems – electronic funds transfers (EFTs), Immediate Payment Services (IMPS), mobile banking and pre-paid payment instruments (PPIs) such as m-wallets, vouchers and pre-paid cards – with surprising agility. The numbers fittingly articulate the story and frankly, they are staggering. Between FY12 and FY16 for instance, NEFT (National Electronic Funds Transfer) transactions increased five-fold from 226 million to 1.25 billion; IMPS went from almost zero to 221 million; PPI grew from 31 million to 748 million and mobile banking transactions from 26 million to 389 million (see chart).

Two factors are primarily responsible for these developments. Firstly, the brisk penetration of internet availability and smart phones; and secondly, a proactive regulatory environment that did not just enable the use of new technologies but explicitly mandated it. The Reserve Bank's approach, in contrast to most other arms of Government, has been to stay at the forefront of technology rather than constantly play catch up. In addition to encouraging regulations for digital payments, the central bank was responsible for the creation of an umbrella organisation, the National Payments Corporation of India (NPCI) to act as the central switch and repository for all retail payment systems. This ensures that standards, protocols and technologies – now and in the future – will remain consistent for all types of payments across all types of entities. The problems, therefore, of incompatibility between service providers or technologies will be avoided and the sustained use of digital payments remain unhindered.

Remarkable as this growth may have been, there is yet more to come. Last month, for instance, NPCI launched what is called a Unified Payments Interface (UPI). In simple terms, UPI is a payment tool that can be thought of rather like an email ID for money. It allows money transfer instantly and at any time, to anyone with a virtual payment address, using a standard mobile app. In a sense, it integrates all other payment systems and platforms into a seamless inter-operable arrangement that makes money transfers available to practically anyone with a smart phone and bank account. With the UPI app, a consumer can link all his bank accounts into a single app, which is usually not feasible with other tools. Secondly, the user can generate an easy-to-remember virtual payment address (which looks a bit like an email address) that can be account-specific or purpose-specific and freely share that with others to send and receive payments. Like with emails, one can choose to have a single address for all transactions or multiple ones for different purposes. There is no longer a need to share confidential details like the account number nor, thankfully, a need to remember multiple identifiers like MMID number, account number, IFSC codes, branch codes, etc, which other payment systems typically insist upon.

Thirdly, UPI enables both 'push' and 'pull' transactions. This means a user can not only send money, but can also *request for money* – a particularly useful feature in the context of shopping and bill payment. Essentially, a merchant can now bill a customer by sending a payment request to the virtual address of the latter who merely has to accept the request by entering his PIN. The money transfer is instantaneous. The implications of this phenomenon are worth thinking over. Currently, India has 14 million retail outlets of which only a million are equipped with POS (point of sale) machines for accepting credit or debit cards. Therefore, despite the fact that all merchants and shoppers have bank accounts, the majority of retail transactions remain in cash – the proportion is estimated at 78% of all consumer transactions by value (see chart). With UPI, there is neither a need for a card nor a POS device – all that is needed is a smart phone and India currently has 150 million of them. The figure is likely to touch 500 million in a few years and is clearly higher than what POS systems can ever be.



Source: Digital Payments 2020: The Making of a $500 Billion Ecosystem in India, BCG-Google, July 2016.

Fourth, the UPI model is based on the concept of direct-to-bank transacting. This implies that a user's funds are always transferred to (or from) a bank account directly and therefore, *funds continue to earn interest* unlike third party wallets or apps where money typically lies idle. Other benefits include options to share bills among peers and the scheduling of future payments or collections.

In short, the UPI can potentially enable every Indian to 'digitise' his financial system and bring vast sections of India's off-grid cash economy into legitimate domains. Besides saving the nation some money (a Tufts University paper estimates that the annual cost of currency operations in India is Rs 210 billion), cutting the cash component of the economy has the obvious advantages of widening the tax base and reducing the scope for counterfeiting. India currently has a cash-to-GDP ratio of 12.04%, higher than other emerging markets such as Brazil (3.93%), Mexico (5.32%), South Africa (3.72%). It is no surprise therefore, that the UPI has been universally hailed as a game changer.

From a business perspective, the opportunities are equally striking. With UPI creating an inter-operable platform, all participants have the scope to innovate without the risk of isolation from the eco-system. Moreover, with technology acting as a leveller of sorts, competition between small and big banks, old and new ones, public and private institutions, and in fact even between banks and non-banks, will be on an even footing. The historical advantages of size, distribution or brand recognition will fall while innovation and service quality will evolve as the drivers of customer stickiness and business volumes. The availability of data on consumer spending and money management patterns opens up new prospects for cross-selling and partnerships. But most importantly, the inclusion of a large section of retail shopping into the digital fold suggests a massive increase in the overall size of the pie – a phenomenon that every organised sector retail business (whether physical or ecommerce) should take note of. India's silent revolution is about to get noisy.