International Journal of Management and Economics
www.managementjournals.net
Online ISSN: 2664-7079, Print ISSN: 2664-7060
Received: 06-11-2022, Accepted: 22-11-2022, Published: 08-12-2022
Volume 4, Issue 2, 2022, Page No. 30-35

Payment banks in India: Leveraging technology for financial inclusion

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Abstract
Payment banks are a new model of banks conceptualized by Reserve Bank of India. The main objective of payment bank is to widen the spread of payment and financial services to small business, low-income households, and migrant labour workforce in secured technology-driven environment in remote areas of the country. There are numerous bottlenecks that need to be addressed before the real benefit of payment banks. There are millions of Indians who don't have access to banking facilities. Despite of several challenges payment banks have potentialities to be a game changer within the context of India.

Keywords: financial inclusion, financial performance, nachiket mor committee, payment banks, reserve bank of India

Introduction

There are two kinds of banking licences that are granted by the Reserve Bank of India-Universal bank licence and Differentiated bank licence. Payment bank comes under a differentiated bank licence since it cannot offer all the services that a commercial bank offers. In particular, a payments bank cannot lend. It can take deposits upto Rs. 1 lakh per account and it can issue debit cards but not credit cards. Commercial banks in India like State Bank of India or ICICI Bank, do not have any such restrictions.

A Payments Bank (Airtel Payments Bank, India Post Payment Bank, etc.) is like any other bank, but operating on a smaller or restricted scale. Credit risk is not involved with the Payments Bank. It can carry out most banking operations but cannot advance loans or issue credit cards. It can accept demand deposits only i.e. savings and current accounts, not time deposits. The Payment Banks cannot set up subsidiaries to undertake non-banking financial services activities. A committee headed by Dr. Nachiket Mor recommended setting up of 'Payments Bank' to the lower income groups and small businesses.

The objectives of setting up of a payments bank is to further financial inclusion by providing small savings accounts and payments/ remittance services to migrant labour workforce, low income households, small businesses, other unorganised sector entities and other users.

Payment Banks: Niche Banks

A Payment bank is like any other bank but operating on a smaller scale without involving any credit risk. In simple terms, it can carry out most banking operations but can't offer advance loans or issue credit cards. It can accept demand deposits, offer remittance services, mobile payments, transfer/ purchases and other banking services like ATMS, Net banking and third-party fund transfer.

The Committee on Comprehensive Financial Services for small Businesses and Low Income Households which was headed by Nachiket Mor was set up by the RBI on 23rd September 2013. This committee submitted its final report on 7th January 2014. Among numerous recommendations it recommended the formation of a new type of banks called the Payments Bank. The RBI released draft guidelines on payments bank seeking comments from interested entities and the general public on 17th July, 2014. The RBI released the final guidelines on 27th of November about Payments Bank.

The objectives of setting up of payments banks as laid down by the Reserve Bank of India is to increase the financial inclusion by providing

1. Small savings accounts and
2. Payments/ remittance services to migrant labour workforce, low income households, small businesses, other unorganised sector entities and other users.

The main purpose of setting up of payment banks is to enhance financial inclusion. Payment banks are new model of banks conceptualised by the RBI. These banks can accept a restricted deposit which is currently limited to INR 1 lakh per customer and may be increased the further. These banks cannot issue loans and credit cards. Both current account and savings account can be operated by such banks. It can issue services like ATM cards, debit cards, online banking and mobile banking. Airtel has launched India's first payments bank. Paytm is the second such service to be launched.

RBI Guidelines Regarding Payments Bank

Eligible Promoters

- Existing non-bank Pre-paid Payment Instrument (PPI) issuers; and other entities such as individuals/ professionals; Non-Banking Finance Companies (NBFCs), corporate Business Correspondents (BCs), mobile telephone companies, super-market chains, companies, real sector cooperatives; that are owned and controlled by residents; and public sector entities may apply to set up payments banks.
- A promoter/promoter group can have a joint venture with an existing scheduled commercial bank to set up a payments bank. However, scheduled commercial bank can take equity stake in a payments bank to the extent permitted under Section 19 (2) of the Banking Regulation Act, 1949.
- Promoter/promoter groups should be 'fit and proper' with a sound track record of professional experience of running their businesses for at least a period of five years in order to be eligible to promote payments banks.

Scope of Activities

- Acceptance of demand deposits. Payments bank will initially be restricted to holding maximum balance of Rs. 100,000 per individual customer.
- Issuance of ATM/debt cards. Payments banks, however, cannot issue credit cards.
- Payments and remittance services through various channels.
- BC of another bank, subject to the Reserve Bank guidelines on BCs.
- Distribution of non-risk sharing simple financial products like mutual fund units and insurance products, etc.

Deployment of Funds

- The payments bank cannot undertake lending activities.
- Apart from amounts maintained as Cash Reserve Ratio (CRR) with the Reserve Bank on its outside demand and time liabilities, it will be required to invest minimum 75 percent 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 percent in current and time/fixed deposits with other scheduled commercial banks for operational purposes and liquidity management.

Capital Requirement

- The minimum capital required for payments banks shall be Rs. 100 crores. The payments bank should have a leverage ratio of not less than 3 per cent, i.e. its outside liabilities should not exceed 33.33 times its net worth (paid-up capital and reserves).

Promoter's Contribution

- The promoter's minimum initial contribution to the paid-up equity capital of such payments bank shall at least be 40 percent for the first five years from the commencement of its business.

Foreign Shareholding

- The foreign shareholding in the payments bank would be as per the Foreign Direct Investment (FDI) policy for private sector banks as amended from time to time

Other Contributions

- The operations of the bank should be fully networked and technology driven from the beginning, conforming to generally accepted standards and norms.
- The bank should have a high powered Customer Grievances Cell to handle customer complaints.

Procedure for Applications

In terms of Rule 11 of Banking Regulation (Companies) Rules, 1949, applications shall be submitted in the prescribed form (Form III) to the Chief General Manager, Department of Banking Regulation, Reserve Bank of India, 13th Floor, Central Office Building, Mumbai 400001. In addition, the applicants should furnish the business plan and other requisite information as indicated. Application will be accepted till the close of business as on January 16, 2015. After experience gained in dealing with payments banks, applications will be received on a continuous basis. However, these guidelines are subject to periodic review and revision.

Procedure for RBI Decisions

- An External Advisory Committee (EAC) comprising eminent professionals like bankers, chartered accountants, finance professionals, etc., will evaluate the applications.
- The decision to issue an in-principle approval for setting up of a bank will be taken by the Reserve Bank. The Reserve Bank's decision in this regard will be final.
- The validity of the in-principle approval issued by the Reserve Bank will be eighteen months.
- The names of applicants for bank licences will be placed on the Reserve Bank website.

Present Status of Payment Banks in India

Reserve bank of India has received a total of 41 applications for the Payments Bank license. Business entities have sought few clarifications regarding the structuring definition and FDI (foreign direct investment) and FII (foreign institutional investment) limits and branch policy. More clarity is required as to what constitute a branch. Some of the prominent names who have applied for license are given below.

India's largest lender - the State Bank of India has partnered with the country's largest company, Reliance Industries (RIL) to apply for a payments bank licence. SBI will hold 30% stake in the joint venture while RIL will be the promoter and hold the balance 70%. Vodafone has filed an application with the Reserve Bank of India for a payments bank licence. It being a subsidiary of UK parent Vodafone Group Plc needs a local partner. Vodafone's payment banking experience in Africa and Asia might give it a leg up among applicants. A Kenyan telecom operator partly owned by Vodafone i.e. Safaricom is widely considered as the biggest success story of mobile banking in developing countries. Aditya Birla Nuvo in partnership with the country’s no 3 mobile phone operator, Idea Cellular has applied for a Payments Bank license. Aditya Birla Nuvo will hold 51% while Idea will hold the balance 49% in Idea Payments Bank Ltd. if a license is granted. Kotak Mahindra Bank has tied up with Bharti Airtel which already offers a wallet service named “Airtel Money”. Further Bharti Airtel is having a network of 13 lakh touch points in about 50 million villages and covers 87 per cent of the total population.

Kishore Biyani-promoted Future Group has applied with the Reserve Bank of India. The company’s physical presence in 168 cities across the country and rural locations in Gujarat and Punjab will help reach the depositors that include women, self-employed people as well as farmers and local entrepreneurs. If the license is issued, it will partner with IDFC bank. Suvidhaa Infoserve Ltd has joined the race by applying to RBI for payment bank licence. It is the flagship company of the Rs 6,500-crore e-commerce group Suvidhaa which is the largest non-bank entity offering domestic remittance service and other payment services in India. It has a footprint of 80,000 touch points across the country catering to over 28 million unique customers annually. ITZ Cash, an Essel Group company is another applicant. It is currently offering prepaid cards in association with IDBI Bank, DCB and HDFC Bank. It allows the under-served to make bill payments, shop online or by phone and cash withdrawals at ATMs without having a bank account. Bank of India will partner with You-First Money Express Private Limited, an entity promoted by former Citi Banker to apply for the license. A Committee comprising of professionals from various fields like bankers, chartered accountants, financial analyst etc. will evaluate the applications. The final decision shall be taken by RBI.

A question arises as to why major telecom players like Airtel, Vodafone, Idea Cellular, Reliance are particularly interested in a payments bank license when it will involve huge investments and primarily cater to low income segment of the population?

The answer is that it’s a game of small money, big business. Telecom companies are eyeing a sizable chunk of the additional revenue of Rs 14,000 crore from transaction fees, primarily from the remittances and cash-outs and cash-ins un-banked customers undertake on their payments bank accounts. They are planning to levy a fee of 2-3% which will come down with number of transactions, thus providing a margin of about 1% only. Statistics suggest that there are about 180 million un-banked households with a corpus of Rs 4,32,000 crore. It is estimated that they will spend about Rs 18,000 annually, an overall amount of Rs 3,24,000 crore a year. It is only on this money that telcos can charge transaction fees. Even by charging three per cent, their revenue will turn out to be Rs 10,000 crore. Another area telcos will focus is fee from remittances which is estimated to be Rs 200,000-crore market mainly dominated by informal sector and not being reflected in official numbers (on remittances through India Post, mobile wallets, etc). Charging 2% fee will fetch them a revenue of Rs.4000 crore. They will even pay high interest i.e.7.5-8 per cent on deposits to attract investors. In short, welfare gains will accrue from the last-mile delivery channels by achieving lower costs. So one would hope that all the current last-mile players irrespective of their business, would be eager to expand their scale of operations by opening payment banks.

Consolidated Balance Sheet of Payment Banks

Payments Banks are niche banks that leverage technology for financial inclusion and are aimed at small businesses and low-income households. Their business model focuses on small remittances which are stored in digital wallets that can, in turn, be used for purchases of goods and services. Being a nascent business model that requires heavy overhead costs especially at the beginning, most of these banks are yet to turn profitable.

At end-March 2020, the number of operational Payments Banks declined to six as compared with seven in the previous year as one bank surrendered its licence. The consolidated balance sheet of Payments Banks increased in 2019-20 on a hefty increase in deposits with their share in liabilities more than doubling to 27.4 per cent from 12.3 per cent in 2018-19, despite the cap of ₹1 lakh per account. As these banks are not permitted to lend, their asset side growth was due to spurt in investments and balances with banks (Table 1).

Table 1: Consolidated Balance Sheet of Payments Banks (Amount in Rs. crore)

Item	March-18	March-19	March-20
1. Total Capital and Reserves	1,848	1,899	1,862
2. Deposits	438	882	2,306
3. Other Liabilities and Provisions	2,606	4,392	4,256
Total Liabilities/Assets	4,892	7,172	8,425

1. Cash and Balances with RBI	358	712	785
2. Balances with Banks and Money Market	1,243	1,375	2,101
3. Investments	2,449	3,136	4,077
4. Fixed Assets	236	638	353
5. Other Assets	606	1,311	1,108

Note: Data for end-March 2018, end-March 2019 and end-March 2020 pertain to five, seven and six PBs, respectively. Hence, the data are not comparable across years.
Source: Off-site returns (domestic operations), RBI.

Financial Performance of Payment Banks

Notwithstanding improvement in both interest income and non-interest income, the consolidated balance sheet of Payment Banks ended the financial year 2019-20 with losses due to high operating expenses. The limited operational space of these banks, coupled with high initial costs in setting up of the infrastructure, implied that the initial years would be invested in expanding their customer base and they will take time to break even (Table 2).

Table 2: Financial Performance of Payments Banks

(Amount in Rs. crore)

	March-18	**March-19**	**March-20**
A Income (i + ii)			
i. Interest Income	175.6	290.8	349.3
ii. Non-Interest Income	1,003.6	2,099.1	3,115.0
B Expenditure			
i. Interest Expenses	24.5	35.4	62.3
ii. Operating Expenses	1,676.8	3,265.3	4,337.4
Provisions and Contingencies			
of which,			
Risk Provisions	-6.6	2.3	2.7
Tax Provisions	1.0	16.1	-107.1
C Net Interest Income	151.2	255.4	287.0
D Profit			
i. Operating Profit (EBPT)	-522.0	-910.8	-935.3
ii. Net Profit	-517.2	-937.1	-833.0

Note: Data for end-March 2018, end-March 2019 and end-March 2020 pertain to five, seven and six PBs, respectively. Hence, the data are not comparable across years.
Source: Off-site returns (domestic operations), RBI.

Efficiency, measured in terms of cost-to-income ratio, improved while the net interest margin (NIM) declined during the year (Table 3).

Table 3: Select Financial Ratios of Payments Banks

Item	**March-18**	**March-19**	**March-20**
1. Return on Assets	-10.6	-13.1	-9.9
2. Return on Equity	-28.0	-49.4	-44.7
3. Investments to Total Assets	50.1	43.7	48.4
4. Net Interest Margin	4.5	6.1	4.8
5. Efficiency (Cost-Income Ratio)	142.2	136.6	125.2
6. Operating profit to working funds	-10.7	-12.7	-11.1
7. Profit Margin	-43.9	-39.2	-24.0

Note: Data for end-March 2018, end-March 2019 and end-March 2020 pertain to five, seven and six PBs, respectively. Hence, the data are not comparable across years.
Source: Off-site returns (domestic operations), RBI.

Remittances through Payment Banks

In 2019-20, inward and outward remittances through the UPI occupied the largest share in the total remittance business of payments banks in terms of both value and volume. In fact, more than 46 per cent of inward and 37 per cent of outward remittances in terms of value were made through the UPI channel. The second place was occupied by the IMPS channel, with 9.3 per cent of inward and 24.5 per cent of outward remittances flowing through this channel. The RTGS channel recorded strong growth with its share increasing to 13.2 per cent of outward flow and 22.2 per cent of inflow coming through it (Table 4).

Table 4: Remittances through Payments Banks (Number in thousand, amount in Rs. crore)

Channel	**2018-19**			
	Inward Remittances		**Outward Remittances**	
	Number	**Amount**	**Number**	**Amount**
1. NEFT	4,763	67,035	6,819	13,16,665
	(0.3)	(0.4)	(0.3)	(3.5)
i) Bill Payments	182	2,956	1,367	11,29,717
	(0.0)	(0.0)	(0.1)	(3.0)
ii) Other than Bill Payments	4,581	64,079	5,452	1,86,949
	(0.2)	(0.4)	(0.3)	(0.5)
2. RTGS	34	33,204	7	17,629
	(0.0)	(0.2)	(0.0)	(0.0)
3. IMPS	1,04,045	11,69,970	1,84,482	1,55,55,000
	(5.6)	(6.7)	(8.9)	(41.8)
4. UPI	13,02,082	1,60,94,995	13,17,627	2,02,64,339
	(69.8)	(92.5)	(63.6)	(54.4)
5. E - Wallets	3,98,339	24,186	5,04,639	52,249
	(21.4)	(0.1)	(24.4)	(0.1)
6. Micro ATM (POS)	8,905	3,576	165	57
	(0.5)	(0.0)	(0.0)	(0.0)
7. ATM	_	_	1,772	505
	_	_	(0.1)	(0.0)
8. Others	45,979	12,657	56,530	16,931
	(2.5)	(0.1)	(2.7)	(0.0)
Total	18,64,148	1,74,05,623	20,72,041	3,72,23,375
Channel	2019-20			
	Inward Remittances		Outward Remittances	
	Number	Amount	Number	Amount
1. NEFT	8,980	19,398	14,084	43,593
	(0.4)	(5.3)	(0.6)	(10.1)
i) Bill Payments	633	6,103	4,214	8,151
	(0.0)	(1.7)	(0.2)	(1.9)
ii) Other than Bill Payments	8,348	13,296	9,870	35,442
	(0.4)	(3.6)	(0.4)	(8.2)
2. RTGS	198	81,411	73	56,794
	(0.0)	(22.2)	(0.0)	(13.2)
3. IMPS	1,40,688	34,309	3,45,218	1,05,366
	(6.8)	(9.3)	(15.0)	(24.5)
4. UPI	14,42,274	1,70,998	14,53,701	1,60,976
	(69.4)	(46.6)	(63.2)	(37.4)
5. E - Wallets	3,39,601	23,427	4,03,157	41,274
	(16.3)	(6.4)	(17.5)	(9.6)
6. Micro ATM (POS)	47,362	16,746	694	229
	(2.3)	(4.6)	(0.0)	(0.1)
7. ATM	_	_	3,749	1,169
	_	_	(0.2)	(0.3)
8. Others	1,00,450	20,740	78,402	21,515
	(4.8)	(5.7)	(3.4)	(5.0)
Total	20,79,551	3,67,030	22,99,078	4,30,916

Note: 1. Figures in the parentheses are percentage to total; -: Nil/Negligible. 2. Data for 2018-19 and 2019-20 are not comparable as there were seven and six PBs, respectively.
Source: Off-site returns (domestic operations), RBI

Future of the Payments Banks in India

The concept of Payments Banks came as game changer within the context of India, as it aimed at inclusion of low income household within the Banking Umbrella. In the same process, RBI granted license to 11 entities to operate payments banks in the year 2015. Along with it, RBI also issued some guidelines which needed to be followed by these entities. The entities included some of the big corporate names such as:

- Aditya Birla
- Reliance Industries Limited
- Vodafone Group

- Department of Posts, and several others.

But, with the closure of Aditya Birla Payments Bank and Vodafone m-Pesa, the problems in the viability of these types of banks are coming to see the light of day. This is mainly because of the fact that they are facing tough competition from the commercial banks. Commercial Banks have a large financial backup which lure most of the customers.
The reason for the problem also includes the rigid guidelines by the RBI which is acting as a bottleneck in the growth. Some of these guidelines include:

- Complete ban on any type of lending
- Deposits by the customers cannot exceed Rs. 1 lakh
- Requirement of huge capital
- The meagre 2.5% interest is left to cover the expenditure and profits as well, because it had pay at least 4% interest.

These reasons along with the other were mentioned by the State Bank of India in its report “Payments Bank-A Case of Near Yet Too Far”, which shows the future of Payments Banks in doubt.

Conclusion

The payments-bank model is potentially an important innovation, which will help increase the scale and efficiency of the financial inclusion process. There are several concerns raised about the viability of the Payments Bank as large profitable banks are offering payment services in a big way. It is highly unlikely that the payment bank business would be their main thing, which raises doubts about the intentions of business entities. Evidence also suggests that classroom learning and teaching interest rates will not change financial behavior. But, opportunity still remains as existing banks have neglected people in providing small remittance facilities on account of the high costs and glamorous interiors. This innovation can prove successful only if proportionate regulations are applied and entities' core business interests are fully aligned with the inclusion objective, in terms of both products and delivery mechanisms. Awareness building has to be fused with the product that gets a change in behavior Investment in information technology is going to be key for service quality and efficiency. CRISIL Research and other experts suggest that telecom operators are ideal candidates to set up payments banks given their customer base and distribution networks in rural areas so RBI should consider this fact while taking final decision.

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