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Market Watch

# Payments Banks: How RBI's move for financial inclusion quickly went downhill

BY JOEL REBELLO & ASHWIN MANIKANDAN, ET BUREAU | UPDATED: MAY 08, 2019, 11.16 AM IST

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Durable relationships are rarely transactional but frequent transactions could form the bedrock of solid relationships – and help achieve the federal objective of financial inclusion. Policymakers at Mint Road were guided by this noble thought when they granted payment bank licences four years ago to familiarise India with transaction modes that didn't use currency bills.

In theory, the central bank was doing what was needed to extend organised banking services to those left unbanked by traditional lenders. In practice, however, business models of these new-age entities were not defined with sufficient clarity to underpin sustainable operations.

Such was the fog on the windshield that four of the 11 original licence holders returned the permits within months after the Reserve Bank of India (RBI) offered them. Others are back to the drawing board, trying out several revenue streams to build cash flows that would last. These include transaction support, cash management, and cross-selling of other financial products, such as insurance and mutual funds.

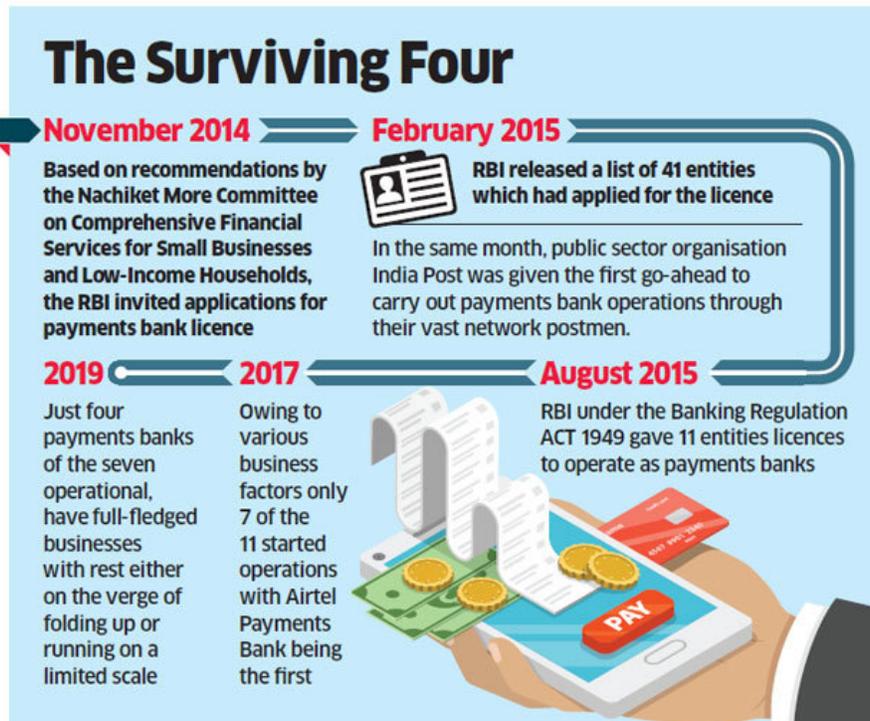
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To be sure, payment banks begin with a distinct regulatory handicap. Unlike traditional lenders, payment banks cannot keep public deposits of more than Rs 1 lakh with them. They cannot lend money either, but must invest 75% of their demand deposits in government securities.

Of the seven that now have the licence to run the business, [Fino Payments Bank](#), [India Post Payments Bank](#) and [Airtel Payments Bank](#)

have started fullfledged operations. In comparison, NSDL Payments Bank, Jio Payments Bank and Aditya Birla Payments Bank (ABPB) have operations that are limited in scale. [Vodafone](#) was also among the companies that secured a licence, but its merger with [Idea Cellular](#) resulted in regulatory complications for the entity as Idea had 49% stake in ABPB, a stake preventing the Vodafone payments bank from starting out.

The objective of giving out payment bank licences in 2015 was to “further financial inclusion by providing small savings accounts and payments/remittance services to migrant labour force, low income households, small businesses, other unorganised sector entities and other users,” according to the relevant RBI circular.

### **BANKABLE BUSINESS MODELS**

The success of the Jan Dhan Yojana since the scheme was launched has meant that opening bank accounts is no longer as lucrative as it was expected to be, forcing payment banks to figure out other alternatives.

For example, Fino Payments Bank, which was earlier running a successful banking correspondent business, has moved totally to a commission-based model, riding on transactions from small shops. Its branches have remained at 425 while more merchant outlets have been added to collect and disburse cash. “We started with 25,000 merchant outlets and have now increased to more than 1 lakh, but our branches have remained at around 425. There are another 1,20,000 to 1,50,000 third-party merchant points under partnerships. It is a variable model that pays for itself. The merchant gets commission on micro ATMs and CMS, so the merchant economy is better and customer loyalty is superb. We can also earn on both side on supply and demand,” said Rishi Gupta, CEO at Fino Payments Bank. These new banks have also had to learn the hard way to keep within the regulatory ambit.

Last year, Fino was barred from opening any new accounts after the total balance in certain accounts went above the Rs 1 lakh limit. The bank has since tied up with Suryoday Small Finance Bank to automatically transfer funds in accounts exceeding Rs 1 lakh to the small finance bank, which has no such restrictions.

Paytm and Airtel payments banks also had to suspend new account openings after they were accused of violating the KYC process mandated by RBI.

Last year’s Supreme Court judgement, which denied private companies the right to seek a person’s Aadhaar number to use the network for e-KYC, has hit these banks hard since most of them had built processes around this low-cost system.

“The difference between e-KYC and manual KYC is at least three times in terms of cost. Right now, we are doing 70% of KYC manually and we hope to be gradually able to do 90% of KYC electronically by June,” said Satish Kumar Gupta, CEO at Paytm Payments Bank.

With just its second branch launched last week, the Paytm banking network is almost entirely correspondent led, with 2 lakh banking correspondents across 550 districts in the country. Gupta said the plan is to expand to 2.50 lakh banking correspondents across more than 600 districts by the end of the fiscal.

India Post Payments Bank, the earliest to receive a licence, is relying on its readymade postal network of 1.55 lakh post offices to function as access points for its customers.

Unlike Fino and Paytm, India Post Payments Bank can also lean on the postal savings account for automatic transfer of deposits when it exceeds the stipulated Rs 1 lakh. The post office savings bank has 39 crore accounts, of which 17 crore are savings accounts.

“The margins are small, so scale is very important. Regulators have allowed us to tie up with third-party services to crosssell our products. We have partnered with Bajaj [Allianz](#) on their life insurance product, with PNB to offer loan services and we also tied up with the government on insurance products,” said Suresh Sethi, CEO at India Post Payments Bank.

Banks that had created moats have not felt the disruption as much. DCB Bank, for example, announced doubling its branch network in 2015.

“Looking back now, that enhanced network helped us to be in a better position today. The impact of payment banks has not been much because they do not have a differentiated product to offer and are paying to acquire customers like any of us. But I would still say they are a work in progress,” said DCB Bank CEO Murali Natrajan.

**THE ROAD AHEAD**

Payment Bank CEOs say the future of the business will be based on transactions, including cash withdrawals through their network of small stores across the hinterland. Fee income generated by selling financial products should be another revenue stream.

However, profits are still not in sight. "We have not broken even yet as have none of the other payment banks. The initial costs of investments and limitations on business operations have limited our operations but as more and more people start availing our services, we expect revenue growth. Talking about the future is futile, but in time our business will expand and evolve," said Sethi from India Post Payments Bank.

Fino, which had a banking correspondent model previously, has also not broken even but expects that the bank can start showing profits in the next two to three quarters.

"Year on year, we have so far seen a 45% growth in income mainly due to fees from transactions in digital, cash management and insurance business. As a bank, we expect to be in the range of Rs 400 crore profit annually. Profit is currently at a break-even level in terms of earnings before interest tax, depreciation and amortisation (EBITDA)," said Gupta from Fino.

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