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# Clashing dreams of MDR and digital

BY [ASHWIN MANIKANDAN](#), ET BUREAU | JAN 28, 2020, 07.56 AM IST

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[Digital payments](#) growth in India in the past five years has registered a CAGR of 128%. But on a larger base and with increased penetration, the drive toward a digital economy is showing signs of plateauing. Last year, growth was 35% across all channels.

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The number of debit cards has stagnated at 900 million, while the number of UPI transactions — nearly doubling every month until 2018 — has also stabilised at singledigit monthly growth rates.

“But it is to be noted that growth is on a higher base; much more sustainable and assured. There are more industry players now and stronger fundamentals,” said [Vijay Shekhar Sharma](#), chief executive and founder, Paytm. “Any which way, the business of digitisation of retail and wholesale payments will allow incremental addition of financial services to reach places where they have not.”

It is natural for growth to slow on a larger base due to compounding effects. But it also means that customer acquisition will become more expensive.

Now, in the absence of merchant discount rate ([MDR](#)) charges, these companies will have to evolve models that depart from the traditional fee-based income. That shift in business strategy is necessary to ensure profitability for these companies, and establish them as attractive investment options. In 2019 alone, payment companies attracted \$1.6 billion worth of investments.

However, collective losses for leading payment companies, backed by Alibaba, Walmart and Amazon, exceeded \$1 billion in FY19. In all likelihood, FY20 would also be the same.

“The debate on how zero MDR will help in expansion of payment networks is for another day. There is no doubt, however, that operating a payment company without any fee income would eat into revenues, at least in the short run,” a senior executive at a leading payments company told ET, requesting anonymity.

The size of the player and nature of its operations would determine losses suffered. “Different players will be impacted in different ways,” the official said.

Paytm is the largest payments gateway in the country by far, with over 40% market share in terms of the number of transactions processed. In FY19, just its cost of acquiring new customers and merchants exceeded its revenue. The SoftBank-backed payments major had spent almost half its total expenditure on customer acquisition, at Rs 3,508 crore, which is Rs 275.88 crore more than its total operational revenue of Rs 3,232 crore. Net loss came at Rs 4,217 crore.

Similarly, Google Pay spent Rs 1,028 crore just for cashback on daily transactions in FY19. PhonePe’s loss of Rs 1,905 crore was nearly five times its revenue, whereas Amazon Pay had Rs 1,161 crore loss.

“Only those companies would survive that can provide a layer of value-added services for its customers,” said Ashneer Grover, cofounder, BharatPe. “Without a flexible and evolving business strategy, where new merchant and customer acquisition cannot be monetised, it would be hard for most companies to survive in these tough market conditions.”

BharatPe, for instance, has tied up with non-banks to provide credit facilities to the 6 lakh-plus merchants it has acquired. It uses transactional data on its platform to underwrite loans for these merchants, providing them easy credit and debt facilities.

Such neobanking services may become the norm as the payments industry moves away from bread and butter solutions. Today, all major payments companies are trying to diversify product portfolios, either offering or piloting services related to credit, insurance and even wealth management.

The challenge is not just to keep acquiring customers at hefty costs, but to face the reality that the payments business in India will fetch no gains as long as the revenue model is primarily fee-based.

“While, I am on the side of MDR becoming zero being a good thing for the merchant, the government should reimburse the people who

are acquiring merchants,” Sharma told ET in a recent interview. “Traditionally, the acquiring side has worked on a thin margin, which is the reason it has not spread to nooks and corners. If you look at Paytm’s merchant acquisition model, it has come at the cost of our equity. And we have invested ₹15,000 crore in the past.”

As opposed to those with deep pockets and funded by global giants, several domestic payment services providers are more modest and circumspect. “Why would anyone, or rather, who is that anyone that is going to acquire merchants now? On the acquiring side, who will bell the cat and give merchants POS terminals without any remuneration?” asked Anand Bajaj, chief executive, PayNearby, a payments company.

To be sure, MDR is the collective transaction fee levied from merchants processing the digital transactions by payments companies, banks and network providers such as Visa and Mastercard. Until 2019, this was capped at 0.3% of the transaction amount on payments made through UPI above Rs 1,000 and 0.6% for debit card transactions above Rs 2,000.

Finance minister [Nirmala Sitharaman](#) all but ruled out budgetary support on MDR losses at a recent private meeting with a delegation of top payments firms executives that included Paytm’s Sharma and PhonePe’s Sameer Nigam. That would raise the pressure on payments companies to alter revenue models. The message that was delivered to the six-member representation was the same given by Sitharaman in her debut budget speech in July: “Banks will be asked to invest the money they save on account of having to handle less cash, on their acquiring business and deploying POS machines,” she had then said.

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