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Market Watch

# MDR fee waiver: Jan Dhan's mascot gets a jolt

BY ASHWIN MANIKANDAN, ET BUREAU | UPDATED: JAN 08, 2020, 05.15 PM IST

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More than 90% of Indians have a mobile phone now, but hardly anyone could talk without interruptions, reflecting the poor quality of a service that comes almost for free. Something similar is brewing in the payments industry. Unlike telecommunications that's ruled by three giants, the payments industry is littered with a few Goliaths and many Davids who thrive in an ecosystem that has the potential to draw hundreds of millions of dollars in new investments and make life easier for the billion-plus Indians. Just in 2019, fintechs received \$2.6 billion in funding.

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The proliferation of fintech companies under the umbrella of Reserve Bank of India-blessed National Payments Corp of India (NPCI) achieved in the past five years what 45 years of nationalisation of banks could not – financial inclusion. When Narendra Modi became the Prime Minister in 2014 just about half the population had access to bank accounts, today over 80% of households have bank accounts and over Rs 7 lakh crore of benefits have been directly transferred to their accounts, plugging leakage estimated at around Rs 35,000-40,000 crore. But that may not be enough.

"India needs to grow digital payments," said T R Ramachandran, group country manager India and South Asia, Visa. "We are probably compared to China and other emerging market peers, arguably lagging in terms of percentage of personal consumption expenditure, which is done digitally. I believe the number is between 11% and 12%. China, for example, is at 55%. Therefore, a set of inducements for players is needed to invest in the space."

The NPCI drove financial inclusion in collaboration with state-run banks when for decades the technology service providers dominated by global giants kept it unaffordable for the common man. Anyone with just a Rs 1,000 in a bank account has a debit card to withdraw money or swipe to buy. In 2016, NPCI launched Unified Payments Interface (UPI), which was a first of its kind interoperable transaction platform, which used the IMPS rails to allow customers to make real-time payments that's provided ground for global giants such as Google, Alibaba and Walmart to compete.

The achievements did not go unnoticed. The [Bank for International Settlements](#) holds out India as a model for the rest of the world. India "offers an important case study where the results are relevant and applicable for all economies, irrespective of their stage of development," says a recent research paper from BIS.



But whether it would hold true for the future is under a cloud with the socialist hangover in policy making. The last week of 2019 saw the government making all transactions under the RuPay and the UPI payments free, dealing a vital blow to the basic principle of any business enterprise. MDR is the fee accrued by banks, and is generally levied from the merchants processing the transactions. The current MDR charges are capped at 0.6% of cardbased transactions for payments over Rs 2,000. The costs of MDR below Rs 2,000 for banks are borne by the Ministry of Electronics and Information Technology (MeitY).

For UPI transactions, these charges are capped at 0.3% of the transaction fees above Rs 100. "Banks are playing a lesser and lesser role in infrastructure expansion. Now, the disappointment is that there is this perception at a policy level that only banks are going to absorb these costs. It is completely ignoring the fact that there is a big ecosystem outside of the banks that is playing a key role in the expansion of digital payments," said Loney Antony, vice chairman, Hitachi Payments. "If you go and ask banks to reimburse the private

players on revenue lost due to no MDR, they'll simply stop deploying these terminals."

## DYNAMICS OF TRANSACTIONS

This government has probably done more to push for less cash and more digital than any other in the past. In its eagerness to push for more digital transactions, finance minister [Nirmala Sitharaman](#) came up with the idea of free transactions for the first time in her last July budget. "RBI and banks will absorb these costs from the savings that will accrue to them because of handling less cash as people move to these digital modes of payments," said Sitharaman. While the idea may be noble, it is fraught with dangers in a way that it does not catch the vitality in the role played by two key institutions — the acquirer of customers which is mostly a fintech firm, and the issuer of cards, the bank. Furthermore, the final guideline makes it applicable only for NPCI-owned platform and exempts Visa and MasterCard, the global giants which rule the world in payments systems.

"What is missing here is the recognition that merchant payments are driven by the consumer and not the merchant," says a banker who did not want to be identified. "It depends on which card the bank issues. From now on, banks would only go for either Visa or MasterCard. There's no incentive to issue RuPay." When banks were unwilling to dirty their hands, it was the small firms which went into rural India to put up QR codes, install swipe machines, put up micro-ATMs and enrolled millions for the banking services. There was an incentive to do so.

On the other hand, banks had the opportunity to issue RuPay cards, which had issuance charges less than half that of Visa or MasterCard which made it more economical. In the process, both the fintech that enrolled customers and RuPay infra provider, NPCI, were provided commissions ranged between 40 and 60 basis points, or 40 paise per Rs 100 transaction.

It is unlikely that a customer or a merchant decides not to do a transaction because of a charge of 40 paise despite huge convenience of not carrying cash. In fact, more than 75% of transactions in India are less than Rs 100 like that paying for a rickshaw ride, or paying for a sandwich, which are anyway free. In October, RuPay cards contributed 33% to volume and 28% to value of the overall 131 crore transactions worth Rs 3.8 lakh crore that happened through debit cards, RBI data shows. The question is if the company that gets the last mile connectivity and the issuing bank would get nothing, why should they perform that activity at all? "There is no future for companies depending solely on payment fees for income. The business should be in value-added services," says Ashneer Grover, CEO and cofounder, BharatPe, which is one of India's largest neo-banking platforms along with RazorPay.

## INDIA VS REST

The payments industry world over is dominated by Visa and MasterCard with their superior technology that enables secure transactions. Even in India, they were the dominant players till NPCI began issuing RuPay cards in 2014.

One of the reasons why financial services did not reach the hinterland was due to the infrastructure costs that nationalised banks couldn't afford and the high fees that the global networks were levying. Charges at ATMs were estimated to be Rs 4 to Rs 5 per transaction which were prohibitive in the 90s and cards were only for the elite customers of banks till such time NPCI arrived at the scene.

To be sure, the NPCI as a public utility institution was conceived at the RBI to facilitate the reach of banking services with the basics of economics driving its functioning. Among nations, China and Russia are the two that have developed and mandated that all domestic transactions be done on local networks on a purely commercial basis. In Russia it is MIR, and China has its China Union Pay which charges 40 basis points for QR code transactions.

Unlike China, in India the NPCI is competing with bigger and more sophisticated rivals such as Visa and MasterCard. So any charge waiver that is applied only to RuPay cards would only hurt the institution that helped government deliver on its promises to people.

## BIG IS BEAUTIFUL

The proposal to strip NPCI of payments for its network and services may be discriminatory as suggested by SBI, but it also works against an ecosystem that could kill smaller players and favour the deep pocketed firms such as Google, Amazon, Reliance Jio, which have their own payments solutions. While the smaller fintech firms, which enrol ultimate customers be it individuals or merchants, depend on these commissions for survival, the big firms which have the potential to cross-sell other products could be placed above the rest which could come up with their own problems like unethical selling practices in the future. "In the event of MDR being waived for one of the networks, such as RuPay, then there will be no scope for interchange income to the issuer of RuPay debit cards, and that will create unduly favourable situation for issuers of MasterCard and Visa debit cards," said State Bank of India in a letter to the finance secretary.

Some like Niti Aayog's Amitabh Kant believe that an Acceptance Development Fund, or a pool of regulatory fund may also be an option which can be explored by the government to soften the blow. But keeping NPCI dependent on the subsidy from the government and letting the remaining be ruled by market forces is certainly not a level playing field.

The total MDR outlay just for RuPay cards for FY20 is Rs 1,300 crore and for UPI it comes to Rs 700 crore as per NPCI estimates to the government. Estimates by Payment Council of India suggest that an industry-wide MDR cost of reimbursement may be as high as Rs 8,000 crore in FY20. When there's little evidence to suggest that it is the charges that are hampering digital payments, a rule crippling one public utility institution in relation to its commercial rivals may be like the government biting the very hand that fed it.

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