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The Challenges And Opportunities Of Payment Banks In India

Author 1:

Dr. K. JANARDHANUDU

LECTURER IN COMMERCE

SGTRM GOVT DEGREE COLLEGE

YERRAGUNTALA, NANDYAL DISTRICT, AP

Author 2:

Dr. CH.SRINIVASA RAO

LECTURER IN ECONOMICS

SGTRM GOVT DEGREE COLLEGE

YERRAGUNTALA, NANDYAL DISTRICT, AP

ABSTRACT

Transforming India's banking landscape is underway. The Reserve Bank of India (RBI) envisions payment banks as a solution to serve low income households and small businesses by offering low-cost savings accounts and remittance services. The goal is to help individuals reliant on cash transactions transition to formal banking. While opening branches in every village might be expensive for traditional banks, the widespread availability of mobile phones offers a cost-effective way to deliver basic Banking services to rural areas. This initiation is also accelerate India's move towards a cashless economy. The domestic remittance market estimated at around Rs. 800-900 billion, is growing and mobile based money transfers could capture a significant portion, particularly for migrant workers. Payment banks will also support the Government's direct benefit transfer program by channeling subsidies for healthcare, education and gas directly into beneficiaries' accounts. Notably, this marks the first time private business groups have received RBI approval for banking services since nationalization. This paper explores the objectives of payment banks, the opportunities they present, and the challenges facing India's evolving banking system.

KEY WORDS

Banking services, Cashless economy, Nationalization, Traditional banks

INTRODUCTION

The economic development of any country begins with its financial and banking system, which supports both individuals and trade. Banking place a crucial role in economic growth, both directly and indirectly. Government initiatives to streamline savings and expenditures are significant contributors to a Nation's development. With the growing use of smartphone and digital platforms, payment banks have gained widespread popularity. People from various backgrounds are embracing them due to their convenience, flexibility, accessibility and increased awareness through marketing efforts. Payment banks have the potential to accelerate banking processes, thereby fostering faster economic growth. The trend of cashless transactions is growing not only among the younger population but also among high net worth individuals, professionals, homemakers, and others who have become accustomed to these banking apps. Payment banks make financial transactions easier, enabling instant money transfers and immediate shopping solutions.

Smartphones have revolutionized mobile applications, with over 3 billion users relying on user friendly apps for personal and business purposes. These apps simplify daily life, offering quick downloads and readiness for use. Payment banks represent a significant innovation in the banking sector. According to Saurabh Tripathi of BCG, while payment banks may not offer higher interest rates, they will challenge traditional banks by providing superior services. The primary goal of payment banks is to promote financial inclusion. The number of Indian people lacking bank accounts has been decreasing over the years due to initiatives like the Pradhan Mantri Jan Dhan Yojana (PMJDY) and the expansion of digital banking. In 2014, before the launch of PMJDY, approximately 40% of Indians were unbanked, translating to hundreds of millions of people. But as of 2023, the financial inclusion index and related reports suggested that the percentage of Indians without bank accounts has dropped significantly to less than 15%, meaning around 200 million people might still lack access to the formal banking.

SIGNIFICANCE OF STUDY

Information technology and mobile banking apps provide significant opportunities for both personal and commercial use. However, they also present ongoing and complex challenges. While similar services are accessible through alternatives like internet banking, modern banking services must adapt and improve to meet the evolving lifestyle of the customers. This paper explores the key objectives and benefits of payment banks and examine how mobile applications can cater to the diverse needs of various customer segments.

REVIEW OF LITERATURE

1. Goal (2015), in her article, highlighted that payment banks represent a new dimension in the Indian banking system and emphasized their significant potential to advance digital banking and promote financial inclusion.
2. Sadanshive and Katdare (2015), in their paper titled “Analysis of in principle license entities to Act as payment Bank: Financial inclusion perspectives,” payment banks play an integral role in financial inclusion. They help reach the unbanked population in rural India and low income groups, addressing gaps that traditional Bank branches in rural area cannot effectively cover.
3. Chandarana (2015), in her paper “Payment Banks - A Need of Digital India,” she examined how payment banks could revolutionize the future of Indian banking, highlighting mobile platforms as the most efficient and user- friendly medium for this transformation.
4. Kesavan (2015), in his study, emphasized that the era of digital banking driven by innovative models, holds the key to the future success of banking in India. He also stressed the importance of providing top-notch services to ensure maximum customer satisfaction and retain existing customers.
5. Pande (2015) in his work, “Payment Banks – A Newer Form of Banks to Foster Financial inclusion in India,” he suggested that payment banks could significantly enhance financial inclusion in India and play a key role in driving the development of rural areas.
6. Srinivasan and Subramanian (2015), in their paper “Payment Banks in India – Demystified”, highlighted that these payment banks facilitate the transition to cashless transactions and enable seamless transfers from bank accounts to digital wallets within the Indian banking sector.
7. Chandrabha *, Vol.5 (Iss.3): March, 2017] ISSN- 2350-0530(O), ISSN- 23943629(P) ICV (Index Copernicus Value) 2015: seventy one.21 IF: 4.321(Cosmos Impact Factor), 2.532 (I2OR) InfoBase Index IBI issue three.86Http://www.granthaalayah.com ©International Journal of analysis – GRANTHAALAYAH [176] – The involvement of major corporations and mobile tele communication companies in launching payment banks in India holds the potential to be a transformative development for the country.

OBJECTIVES

The paper aims to achieve the following objectives:

1. To explore the rules and functions of payment banks.
2. To examine the challenge faced by payment banks in comparison to branch based or online banking.
3. To identify the potential threats these banks pose to traditional banking institutions.
4. To categorize the opportunities for the future banking system in a digital or cashless economy.

METHODOLOGY

This study is conceptual and descriptive, as it relies on information gathered from various sources, including literature, official websites, research papers, newspapers, and both private and government platforms such as rbi.org.in, business standard.com, npcil.org, economictimes.com, and academic journals.

RESULTS AND ANALYSIS:

CHALLENGES:

- Payment banks are not permitted to engage in lending activities.
- Establishing and sustaining a payment Bank business model can be challenging, particularly when scaling up operations.
- The focus on financial inclusion encourages the growth of Fintech Solutions. However, the services offered by payment banks, such as fund transfers, are limited and unsuitable for handling large deposits exceeding ₹ 1 lakh.
- They are required to maintain a Cash Reserve Ratio (CRR) with the Reserve Bank of India based on their net demand and time liabilities. Additionally, they must invest at least 75% of their demand deposits in government securities or treasury bills with maturity of up to one year. For operational and liquidity management, they are allowed to hold up to 25% of their demand deposits in current or fixed deposits with other scheduled commercial banks.
- Scheduled commercial banks typically earn between 4% to 10% in net interest from working capital.
- They can also achieve up to 30% internal rate of return (IRR) on credit card and small business loans. Similarly, Microfinance institutions charge interest rates of approximately 25%. In contrast, payment banks are restricted to lending only in government securities, which generally yield a net return of 2% to 4% or even negative after accounting for the cost of funds.
- In 2016, notably three companies Cholamandalam, Sun pharma, and Tech Mahindra have surrendered their license to the Reserve Bank of India, highlighting the practical challenges in this sector.
- Customers who are familiar with IT and other digital platforms are less inclined towards payment banks, as they have alternative options available that better meet their needs.
- Major government banks like SBI and PNB enjoy high levels of trust among the masses, making it difficult for new payment banks to capture market share and establish a similar level of credibility.
- A significant challenge for payment banks is the capital requirement. They must maintain a minimum paid up equity capital of ₹ 100 crore and adhere to leverage ratio of at least 3%, it means, their external liabilities cannot exceed 33.33 times their net worth. (paid up capital and reserves)
- Additionally, promoters are required to contribute at least 40% of the paid up capital for the first 5 years of operation, posing another financial hurdle for new entrants in the sector.

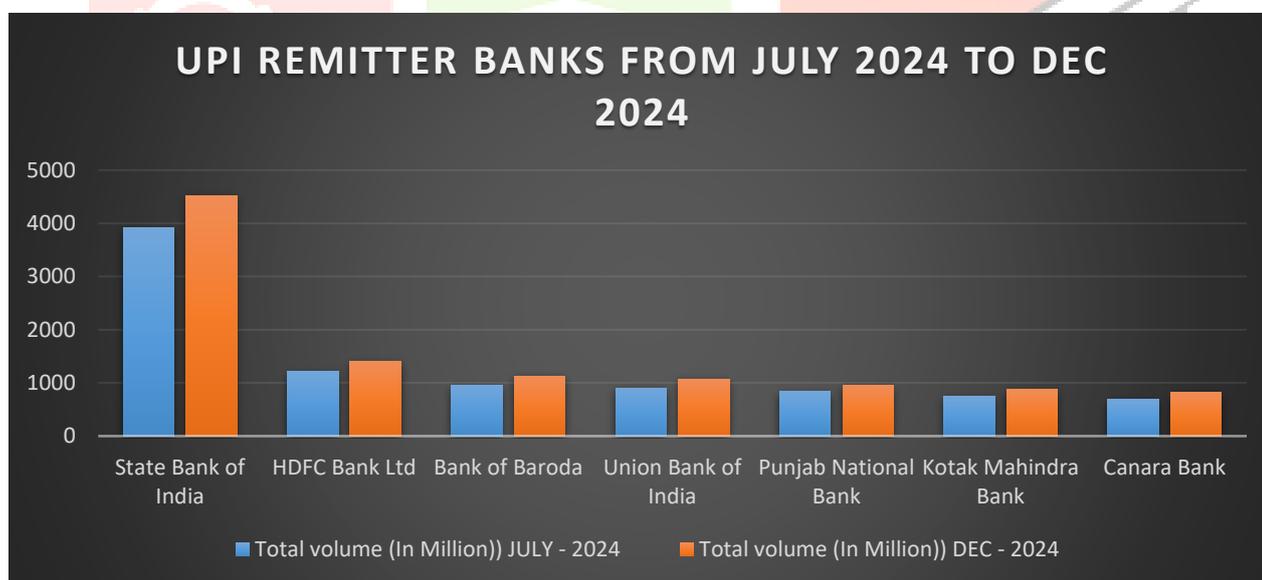
Opportunities:

- According to RBI guidelines, 25% of all branches opened annually must be in rural areas. For newer banks, this requirement has been adjusted to focus on untapped rural regions, creating significant opportunities to engage with underserved populations.
- Telecom companies like Airtel and Jio along with postal network, have a large customer base and extensive physical distribution channels, providing a competitive edge in reaching these areas.
- India has over 233 million unbanked individuals, particularly in rural areas, among bottom of the pyramid (BOP) populations and among women, presenting a substantial market for payment banks to tap into.
- Payment banks can introduce innovative services that can be easily integrated and scaled in these regions.
- They can explore cross selling opportunities for the products like water purifiers, LED bulbs, clean water solutions, or energy saving devices in rural markets.
- The regulatory framework provided by RBI offers flexibility, allowing banks to innovate while adhering to the core guidelines.

- The Reserve Bank of India and commercial banks collectively incur an annual expenditure of approximately ₹21,000 crore on currency operation costs. Out of this, the RBI allocates around ₹11,300 crore solely for printing currency. Low denomination notes often need replacement within a year due to wear
- Payment Banks are set to reduce service charges, making them a cost effective option for small transactions for most consumers.
- Unlike saving accounts in commercial banks, which require a minimum balance and offer interest rates between 3.5% and 6%, payment banks eliminate the need for maintaining a minimum balance.
- Payment banks may develop alternative payment models for retailers and consumers, focusing on minimizing transaction cost. While some banks have to charge customers a fee for cash withdrawals made at Bank branches, others impose fees for ATM cash withdrawals that exceed a specified limit.
- The number of UPI apps and banks using online remittance is increasing constantly. The following tables proves it.

UPI Remitter Banks (Top 7 Members in JULY 2024 To DEC - 2024)

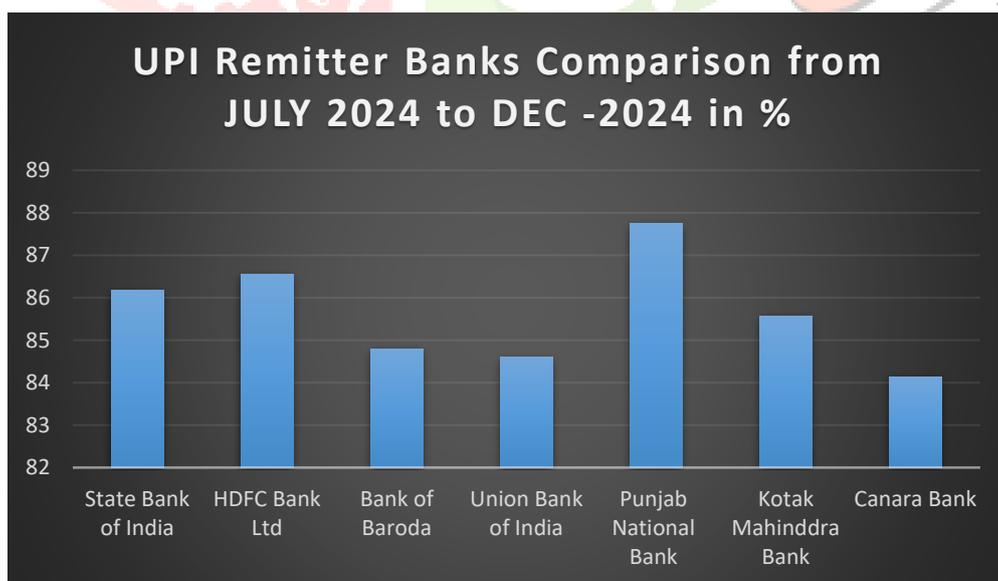
S.No	UPI Remitter Members	Total volume (In Million)) JULY - 2024	Total volume (In Million)) DEC - 2024
1	State Bank of India	3912.83	4530.13
2	HDFC Bank Ltd	1214.73	1403.46
3	Bank of Baroda	954.81	1125.93
4	Union Bank of India	905.83	1070.69
5	Punjab National Bank	837.23	954.15
6	Kotak Mahindra Bank	746.29	872.07
7	Canara Bank	688.87	818.65



The chart provides a comparison of the UPI remittance volumes (in millions) for the top banks in India during July 2024 and December 2024. Here's an analysis of the data:

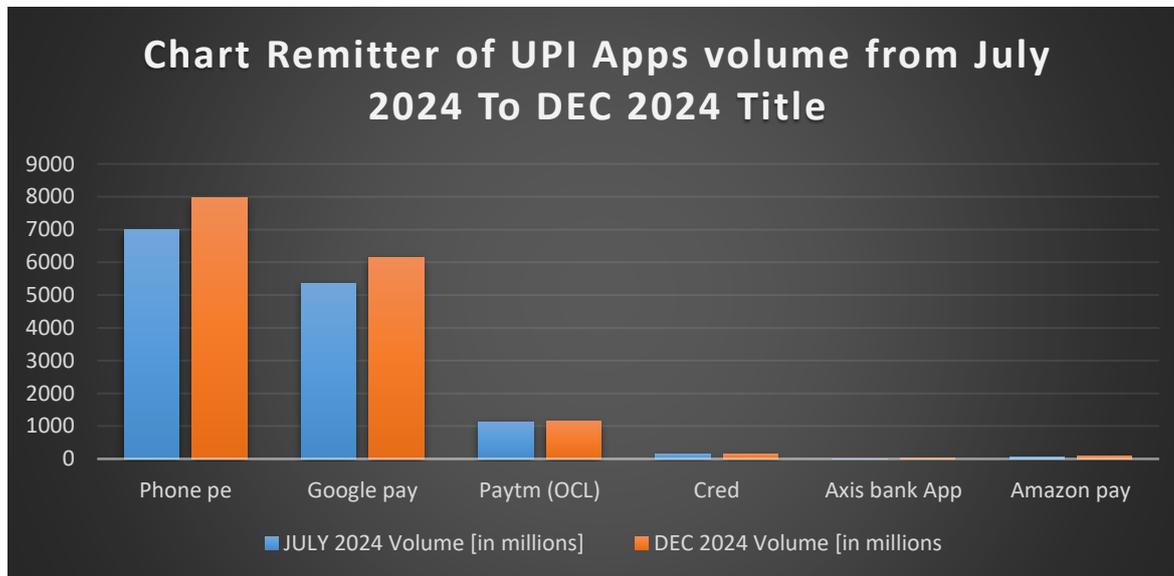
- The State Bank of India leads the chart with the highest UPI transaction volumes in both July and December 2024. There is a noticeable increase in its total volume from July 3912.83 to 4540.13 million.
- HDFC Bank holds the second position in transaction volumes a moderate growth is observed from July to December with volumes increasing from around 1214.73 to 1403.46 millions.
- The third position is held by Bank of Baroda with study growth between the two periods transaction volumes increased from around 954.81 million in July to about 1125 million in December.
- Union Bank of India has similar growth patterns to Bank of Baroda and Punjab National Bank displays consistent growth.
- Kotak Mahindra Bank exhibits slid increase in transaction volumes and Canara Bank growth pattern mirrors that of Kotak Mahindra Bank of 688.87 million to 818.65 million.
- When observing the above chart State Bank of India maintains a significant lead in UPI remittance volumes with its December volume nearly double that of the second highest Bank HDFC.
- Most banks show a steady increase in UPI transaction volumes from July to December, reflecting an overall upward trend in digital payments.

UPI Remitter Banks Comparison from JULY 2024 to DEC -2024 in %	
UPI Remitter Banks	%
State Bank of India	86.18
HDFC Bank Ltd	86.55
Bank of Baroda	84.8
Union Bank of India	84.6
Punjab National Bank	87.74
Kotak Mahindra Bank	85.57
Canara Bank	84.14



The chart compares the percentage growth in UPI remittance volumes for various banks from July 2024 to December 2024. Punjab National Bank shows the highest percentage growth in UPI remittance volumes during the given period reaching nearly 88%. HDFC Bank demonstrate significant growth close to 87% making it the second highest in percentage growth among the listed banks. While SBI manages to combine high absolute volumes with robust percentage growth, showcasing its leadership in this sector.

Remitter of UPI Apps volume from July 2024 To DEC 2024			
S.No	APPLICATION NAME	JULY 2024 Volume [in millions]	DEC 2024 Volume [in millions]
1	Phone pe	6983.97	7984.05
2	Google pay	5341.23	6140.47
3	Paytm (OCL)	1128.97	1150.96
4	Cred	142.56	143.07
5	Axis bank App	15.45	21.96
6	Amazon pay	72.41	91.94



The chart compares UPI transaction volumes (in millions) for various UPI apps from July 2024 to December 2024. Phonepe dominates the chart with the highest transaction volumes, reaching approximately 8000 million in December 2024. Its strong performance highlights its wide spread adoption and leadership in the UPI app space. Google Play ranks second with volumes exceeding 6000 million in December 2024 and it shows consistent growth and maintain a significant share of the UPI eco system. As overall apps like CRED, Axis Bank app, and Amazon pay have minimal market shares suggesting limited focus on UPI based payments.

THREATS TO PAYMENT BANKS:

- Among the payment banks that received licenses, only four are in strong position with a clear business strategy and extension networks, highlighting the challenges in this sector. Companies like Cholamandalam, Sun Pharma, and tech Mahindra have already surrendered their approvals, and according to recent reports, four more likely to follow suit.
- Transitioning to payment banks is challenging in an environment where people are accustomed to commercial banks handling high- volume transactions.
- Payment banks primarily cater to lower and middle income customers, many of whom may take longer to adapt to digital platforms. Expanding financial services to deepen their reach is expected to take around 5 to 7 years. Additionally, the viability of these banks faces risks, especially as public sector bank customers increasing shift to UPI interfaces.
- E-Wallets and mobile payment systems require a smartphone and an Internet connection, yet less than 25% of the population currently owns a smartphone.
- With traditional banks launching their own apps offering similar services, customers may prefer these over payment banks, posing a significant survival challenge for the latter.

CONCLUSION:

Traditional banks have struggled to include the large unbanked population and provide low cost convenient transaction methods. To address this gap, payment banks are stepping into occupy this vacant space. Public sector banks have also launched their own UPI applications to retain customers and handle small scale transactions effectively.

Payment banks serve as a bridge between traditional banking and rural, underserved communities. They offer a secure Avenue for individuals to channel their small savings, avoiding high risk investments or informal financial schemes like chit funds.

In conclusion, payment banks are significant step towards fostering a cashless digital economy and promoting financial inclusion. By reaching unbanked and underbanked individuals, they have the potential to transform the financial landscape and enhance accessibility for all.

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