A less-cash society

Towards a Stakeholder Centric Approach

Executive Summary

The Modi Government recently took a commendable step towards reducing the size of India's **'shadow economy'**, by debarring higher value currency notes for a prescribed period. Complementary steps have been taken previously by the Reserve Bank of India (RBI), which has envisioned a **'less-cash'** society, wherein the goals of access, convenience, consumer confidence, interoperability, and cost efficiency are given priority (as per RBI's Payment and Settlement Systems in India: Vision-2018). From the point of view of the Government, digital payments increase transparency, reduce leakages, reduce the cost of cash management and enable effective taxation, thus shrinking the size of shadow economy. For businesses, digital payments reduce time and money spent on cash management, increase consumption and add efficiencies both within enterprises and in their supply chains.

Advanced countries such as Sweden, have already made substantial progress on the path to limiting the use of cash. Cash and coins represent just 2 percent (BIS, 2015) of the Swedish economy, and importantly, Swedish businesses have shown a strong preference for electronic payments. Similarly, the South Korean Government aims to move to a cashless society by 2020. Adopting a prescriptive approach, it has mandated that all merchants install POS devices and offers consumers a value-added tax (VAT) rebate on card transactions.

> As in Sweden and South Korea, retailers in India collectively represent the single largest organised concentration of stakeholders in the digital payments ecosystem.

ALLIANCE FOR DIGITAL BHARAT

The Indian retail sector comprises of nearly 5 crore merchants, and is expected to touch INR 66 lakh crore by 2020 (BCG, 2016).

Retailers are horizontally connected to many other industries through supply chains, delivery networks and financial intermediaries, and can anchor India's push to digital payments. However, given the size of India's informal sector, as well as its systemic importance in job creation and economic growth, India's approach must be nuanced. In this context, the Confederation of All India Traders (CAIT) has taken the lead in working with relevant stakeholders towards realising the objectives enumerated under RBI's Vision-2018.

CAIT recently instituted the "Alliance for Digital Bharat" (ADB). The ADB consists of several organizations from different industries including transporters, farmers, MSMEs, hawkers, labourers, self-employed groups, as well as women entrepreneurs, consumers and other stakeholders. A multi-stakeholder conference was organised under the aegis of the ADB on 6th October, 2016, to discuss the opportunities and challenges of a less-cash ecosystem.

Stakeholders highlighted several barriers to adoption of digital payments and recommended viable incentives to ensure faster uptake. The analysis and suggestions in this white paper derive from this. The Honourable Minister for Commerce and Industries, Smt. Nirmala Sitharaman also graced the occasion with her presence, and the ADB committed to working with the Government to realise the less-cash vision.

The opportunities and challenges for India in terms of realising the vision of a less-cash society are large.

Estimates suggest that by 2020, digital payments industry will contribute 15 percent of GDP (BCG, 2016) in India. Conversely, the country has one of the highest cash to GDP ratios in the world, at 12.42 percent, much higher than China or Brazil (Fletcher School 2015). Approximately 95 percent of all transactions are conducted in cash and these large volumes of cash transactions cost approximately 1.7 percent of GDP. The regulatory ecosystem is yet to bridge these wide gaps and convert challenges into opportunities. Some of the actionable propositions for regulatory reform and awareness initiatives needed for building a less-cash ecosystem highlighted in this paper are outlined below:

The Government must clearly define the role of the regulator so that regulated entities can compete and provide the best possible services to consumers in an open market.

A targeted stakeholder engagement strategy (including literacy, adoption and usage) for merchants and consumers must be developed through platforms such as ADB so that on-boarding of users is expedited.

An interoperable, safe and secure digital payment ecosystem is a prerequisite to enhance access of the BoP and MSMEs to the financial system.

Holistic incentive frameworks for adoption of digital payments need to be designed and rolled out, in consonance with the above-mentioned stakeholder-centric strategy.

With the advent of the GST, India will seamlessly transition from being a ‘data poor’ to a ‘data rich’ economy. In this context, there is large scope for digital ecosystems to coincide with the growth of various economic corridors and a state centric strategy for digitisation of payments can complement this evolution.

This paper begins by introducing the reader to some of the structural challenges that were discussed at the conference. Thereafter it highlights the importance of developing stakeholder-centric strategies and the value of a digital payments ecosystem. It concludes with a concise synthesis of recommendations based on each section.

Removing Structural Challenges

The digital payments ecosystem is expanding rapidly with the introduction of new products and platforms. However, structural barriers to the realisation of the RBI Vision-2018 remain. Stakeholders at the ADB conference were unanimously of the view that unfettered competition between various products, platforms and services is a prerequisite for growth of the digital payment ecosystem. Competition will lead to cheaper services, increased productivity within firms and in the economy, and positive effects on innovation. Moreover, in technology-intensive and dynamic industries like those that constitute the digital payments ecosystem, regulatory intervention must remain light-touch. Therefore, the role of open, fair and robust market competition is central.

Segregation between regulated entities and the regulator is in consonance with economic theory as well as best practices in well-governed markets. For instance, the RBI's institutional independence from regulated entities such as banks is central to the process of building trust in the financial markets. While stakeholders were of the view that RBI's promotion of a robust underlying payment infrastructure through the National Payment Corporation of India (NPCI) indicates that the government is serious about its digital inclusion agenda, the promotion of a regulated product by the NPCI in the form of the RuPay card, creates conflicting pressures on a nascent digital ecosystem. Indeed "role clarity" and "preventing undue influence and maintaining trust" are recognised as two central pillars for the governance of regulators by the OECD. To quote from the OECD Best Practice Principles for Regulatory Policy (2014):

> "The assignment to a regulator of both industry development and regulatory functions…can reduce a regulator's effectiveness in one or both functions and can also fail to engender public confidence. Such conflicting functions can impair a regulator's clear role and they do not contribute to effective performance. For these reasons, the combination should be avoided."

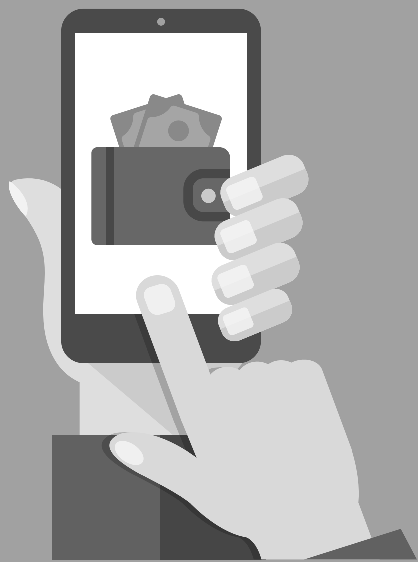
While it can be nobody's case that India, which has an "Enhanced Engagement" with the OECD, should simply replicate best practices and guidelines adopted by advanced economies, there is merit in deliberating on those practices that mirror domestic debates.

India has also taken the lead on discussing best practices with the OECD, in areas such as tax evasion and financial flows, through groups such as the G20 and BRICS. Moreover, as per the Government of India's Financial Sector Legislative Reforms Commission (FSLRC) Report in 2013, India must "ensure that access to infrastructure services is open and free of restrictive practices". It further suggests that:

> "Regulation must maintain a level playing field within the payments industry between the public sector and the private sector, and between bank and non-bank players. It would need to be neutral to the ownership and category structures of the regulated entity, in the absence of which innovation within the payments industry is liable to be stifled."

It should also be noted that the Payment and Settlement Systems (Amendment) Act, 2015 amends the Payment and Settlement Systems Act, 2007, which was enacted to regulate and supervise payment systems in India. The Amendment has extended the application of the original act to a designated trade repository, or issuer, in relation to payment systems and has extended the regulatory ambit of the RBI. Since the Government has given the RBI umbrella powers over the payment ecosystem, it is even more incumbent upon the regulator to delink itself from any role in promotion of regulated entities or indeed, distorting market forces.

Aside from challenges in fostering competitiveness, there are also systemic behavioural reasons for the preference for cash in India.



For instance, there is low willingness on the part of customers to use digital payments owing to security concerns, an overall lack of awareness among merchants of the benefits of digitalisation, and resultant insufficient backbone infrastructure (less than 10 percent of all merchants in India have POS devices). Therefore, even if beneficiaries wanted to transact digitally, avenues are limited. In this context, it is pertinent to note that digitisation in the informal economy can lead to large economy wide gains in terms of improved cash management. As per McKinsey Global Institute analysis (September 2016), the potential gains from improved cash management because of digitisation in the Indian economy are in the order of INR 3,90,000 crore.

Many of these factors are interlinked and government must partner with the private sector to build an interoperable ecosystem which enhances user choice. Without interoperability, the migration of users from cash to digital will be delayed. The adoption of technology by the unorganised sector can only be accelerated if there is faith in the underlying infrastructure and availability of options for each product or service – much like the case in the competitive smart-phone market. Moreover, without a competitive push, the present infrastructure is exposed to systemic risk, as borne out by the recent ATM breaches. In sum, it must be understood that financial products and services are global, much like other service sector value chains. Concomitantly, there is merit in adopting an ecosystem approach to regulate the dynamic payments industry.

Working with Key Stakeholders

Engagement with “various stakeholders/professionals to conduct user/customer surveys on specific aspects of payment systems” is highlighted as an important step in building best-in-class payment and settlement systems for a “less-cash” India in RBI’s Vision-2018. In keeping with a stakeholder-centric approach, the ADB is being developed as a platform for dialogue and debate, and constructive engagement between stakeholders. Therefore, it is instructive to highlight some of the stakeholder-specific challenges and opportunities here, with a view to addressing extant gaps.

From the point of view of consumers, it should be noted that through the Government’s efforts in the Pradhan Mantri Jan-Dhan Yojana (PMJDY), 53 percent (McKinsey, 2016) of all adults now have bank accounts in India. However, 25 percent of all PMJDY accounts have zero balance, and recent reports have shown that banks have put in as little as INR 1 to improve statistics. Lack of last-mile banking infrastructure compounds the problem of access to banking, particularly in rural areas, where only 27 percent of India’s villages have a bank in a five-kilometre radius (RBI, 2016).

Financial inclusion cannot be meaningful if the 80 crore or so Indians living below two dollars a day are not brought within the fold of the formal financial sector.

McKinsey Global Institute estimates that digitisation of finance can lead to 2.1 crore new jobs and an increase in GDP of INR 45.5 lakh crores by 2025. While digitalisation offers a chance for the country to leapfrog over traditional challenges related to cumbersome physical banking, digitised services are unlikely reach the base of the pyramid (BoP) unless private sector partnerships and interoperability of platforms is prioritised.

At the ADB conference, stakeholders pointed towards the dismal progress in refinancing of loans through MUDRA and its lack of interoperability as examples of the lack of emphasis on the last mile. Moreover, even though the promotion of RuPay through PMJDY has given 24 crore people access to digital payments, the usage rates remain disappointing. Acceptance infrastructure does not exist in rural areas, and concomitantly there is a dissonance between a supply side push through RuPay and adoption rates for the same. Recent measures to curb the shadow economy must be accompanied by unwavering focus on resolving last mile delivery challenges through the right mix of incentives for payment networks, platforms, product companies and users. An approach that balances competition with consumer interest and service delivery imperatives is required rather than a heavy-handed approach towards promoting government run services at the last mile.

Most BoP customers are unfamiliar with the benefits of digital payments such as the utility of building a transaction history for accessing credit and the safety and convenience that comes with digitalisation. The Government risks repeating the mistakes made in the banking sector, wherein mandatory lending targets (Priority Sector Lending) have still not led to meaningful financial inclusion on the scale required. Analogously, mandating the use of one product over another, or limiting the interoperability of programmes that can be leveraged by the private sector to build out a less cash society, will only detract from the objectives of the Vision-2018.

Merchants are important users of the digital payments ecosystem as mentioned at the outset. However, as is the case with consumers, behavioural challenges persist. For instance, the merchant community has often voiced fear of cascading taxation, harassment through audits and safety breaches. Further, there exist no incentives such as access to credit and tax rebates for merchants to offset the perceived disincentives of adoption of digital payments. Like with consumers, there is low awareness on the benefits of digital payments and the high cost of handling cash. There is therefore an urgent need to accelerate consultations, research and dissemination on the benefits of digital payments, something which ADB is suited to do.

Towards this, targeting of digital payments in the merchant community is important – so that uptake is made more seamless.

Digital payments awareness should be targeted at younger business owners given their inherent receptivity to core technologies that enable digital payments. Research suggests that those who adopt new technologies are also more likely to adopt new payment methods. Thus, various indicators could be collected – age, smartphone usage, card usage etc. – to assess potential receptivity of stakeholders to on-boarding of digital payments. Finally, it should be mentioned that awareness campaigns for on-boarding retailers should not be unidirectional. Capacity building elements such as reduction of paper work for accepting digital payments by partnering with banks and other payment intermediaries could add to the efficacy of the on-boarding process. Partner banks could lower their eligibility requirements for distribution of PoS machines on 'mission mode' across the retail segment country-wide. Only structural requirements such as an active current account with the PoS provider and a merchant's overall credibility such as not being on negative lists of card companies should be imposed. Artificial requirements such as minimum turnover should be done away with so that the banking ecosystem can also derive the benefits of a less cash ecosystem quicker.

Incentives for Merchants and Consumers

To actualise the Government's vision of a less-cash India, there is a need to dis-incentivise cash, while developing incentives for both merchants and customers to uptake digital payments. Debit cards are the most familiar digital payments solution in the merchant community followed by credit cards and then online payments (Incite Market Planning, 2015). There are robust empirical grounds to support the fact that acceptability of cashless transactions can pivot around card-based solutions in the unorganised and organised retail sector. The following suggestions are laid down keeping in mind the centrality of behavioural change among stakeholders, and are based on the various rounds of consultations within ADB's various stakeholder groups:

Cash-Flow based Credit:

As per the International Financial Corporation (IFC), there is a INR one lakh crore gap in credit in the Indian services sector of which retail is a large part. This is because of (a) inadequate information on the financial transactions and history of service sector enterprises owing to transactions in cash and (b) lack of reliable financing benchmarks. These challenges are not unique to India, and technology companies are using customer/client purchase history to assess credit eligibility in other emerging countries. For instance, analytics companies in China are using big data generated from transactions on various ecommerce platforms to generate credit ratings for small businesses. PoS device makers in India are already offering credit to merchants as incentive. With the integration of UPI by banks, and a well-established card-based infrastructure, there is enhanced scope for cash-flow based credit services. Given the potential of the UPI in revolutionizing the mandate for financial inclusion, there is a need to open the platform to all forms of electronic payment options. This will not only enhance user experience, but enable people to enjoy the benefits of interoperability. With access to a myriad of payment options, consumers can seamlessly transfer credit without being locked into using a particular platform and also not lock out people who want to transfer credit to them.
Over 20 crore MSMEs lack credit in the emerging world and they stand to be the largest beneficiaries of Over-the-Top innovations which ride on the UPI and card payments architecture, preparing for a future wherein transaction-based lending supersedes other forms.

The ADB is well placed to work with the government in enabling the move from collateral-based lending towards cash flow-based lending, through private sector partnerships and targeted outreach.

Building credit history and generating credit ratings based on cash flows can contribute significantly to bridging the MSME credit gap in India.

Fiscal Incentives:

In June 2015, the Government of India conducted a consultation for facilitating digital payments. The suggestions posed by government included: tax rebates (including rebate of a few percentage points on Value Added Tax) for merchants conducting more than 50 per cent sales through electronic means, and income tax rebates for consumers using digital payments for expenditure. There is international precedence for this. In South Korea, which aims to go cashless by 2020 and where only around 20 percent of all payments are made in cash today, digital payments-related tax breaks were introduced in a phased manner over the past two decades. As a next step, there is a need to conduct consultations at the central government level, to understand concerns of tax authorities and advocate for a framework that improves tax administration as well as reduces the use of cash for retail transactions.

Limiting Large Cash Transactions:

The Government of India has mandated that pan cards are necessary for cash transactions over INR 50,000. It is also considering banning cash transactions over INR 3 lakhs to limit the use of cash for large transactions. Tracking high-value transactions and fining violators can help curb the use of cash. Countries in the EU have used this method effectively, and Slovakia and Italy have banned cash transaction beyond Euro 300 (approximately INR 22,000), to reduce the circulation of black money.

Reducing Free ATM Transactions:

Currently, the RBI allows up to five free ATM transactions per month. Banks pay approximately INR 20 per ATM withdrawal (CDFI, 2016). The reduction of free transaction at ATMs from five to three, would save banks significant cash handling costs and curb the use of ATMs for withdrawals.

Building Reliable Telecommunication Infrastructure:

PoS machines rely on a robust telecommunication network to process transactions. In the absence of a reliable and cost effective network, merchants are not compelled to transition to digital acceptance.

Poor telecom facilities result in low transactions as well as transaction failures, making installation of devices unviable for banks as well. The government must make necessary investments to improve broadband infrastructure in the country. The actualisation of the BharatNet agenda as it was envisioned in 2015 is critical for this; and since the Broadband Plan is up for renewal – the definition of broadband itself should be revisited considering the growing data requirements for acceptance of digital payments.

Highlighting Usefulness of Big Data:

Big Data can be used by retailers through a host of different platforms to help better manage inventories and harness the potential of targeted retail through buyer profiling. Today, technologies such as cloud computing are making integration of payment solutions with business software solutions very easy. Demonstration of some of the existing solutions could prove to be a valuable part of the process of merchant on-boarding. In this connection, it should be noted that physical and digital retailing are also converging in ways that small merchants can potentially benefit from. For example, innovations such as in-aisle buying which allows buyers to capture barcodes before payment, can help streamline the check-out process even in smaller shops with high footfall. Moreover, with the advent of the Goods and Services Tax (GST), economic corridors such as the National Capital Region region extending to Jaipur; the Mumbai – Pune – Thane belt in Maharashtra; and the Chennai – Bengaluru region are poised for rapid economic growth as well as growth of financial data-points residing with state governments. The ADB can work with merchant communities and Governments in these regions and beyond, to accelerate adoption of digital payments and deploy constructive approaches to address ecosystem concerns.

Safety and Security:

Consumer and merchant grievances related to use of digital payments for everyday transactions often relate to security concerns, and have been sharply accentuated by recent ATM breaches. There is a need for Government, private sector and civil society to address the need for creation of appropriate consumer grievance forums; government-led consultations have also highlighted the need for this.

Moreover, promotion of platform interoperability and competition in the digital ecosystem can reduce systemic risk posed by reliance on Government promoted entities.

There is also scope to build on the user bias towards cards to advocate the use of digital payments, in partnership with card companies. In fact, such a structured approach to induce behavioural change has been followed in other jurisdictions as well. For instance, the Bundesbank has recently noted that "intensified activity on the part of international credit card companies has probably been instrumental" in the growing acceptability of innovative cashless payment methods in Germany.

Endnotes

- http://www.keepeek.com/Digital-Asset-Management/oecd/governce/the-governance-of-regulators_9789264209015-en#.WAxjY-h97IU
  ibid
- http://finmin.nic.in/fslrc/fslrc_report_vol1.pdf

For more on this please refer to "Who's Afraid of the Cashless Society? Belgian Survey Evidence" by Loix, Pepermans, and Van Hove, 2004

- http://www.ifc.org/wps/wcm/connect/4760ee004ec65f44a165bd45b400a808/MSME+Report-03-01-2013.pdf?MOD=AJPERES

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