



REVOLUTION IN DIGITAL FINANCE

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Abstract

Digital is an unstoppable force that is redefining the financial services sector. Those institutions that know instantly what their customers and employees want can stay one step ahead of competitors. Thinking about digital strategically, and working with partners that can deliver innovation, will be key factors in long-term success. Financial services industry as a driver of economic growth. Deep capital markets and strong financial institutions give consumers easy ways to save, invest, borrow and plan for their future. Enterprises and small businesses, in turn, depend on financial institutions to raise capital for growth, efficiency, and infrastructure expansion. This cycle of saving, investing and lending is crucial for emerging economies like India to sustain economic growth. The government and the RBI who have been experimenting with various initiatives, including Jan Dhan Yojana, creation of payment banks, and Rupay to enable domestic card payments systems among other initiatives. But policy alone cannot deliver the promise of financial inclusion. Technology-led innovation in financial services is needed to enable rapid, large-scale, and positive change.

Keywords: *Digital, financial services, economic growth, savings.*

Introduction

“There are 500+ financial technology (fin-tech) start-ups in India who have collectively attracted over \$1.4B in funding since 2012. While mobile payment start-ups have garnered a lot of attention, there are many others attacking a range of services that have been the bailiwick of banks and traditional financial services providers – consumer and small business lending, remittances, wealth management, personal finance and related areas such as credit scoring and stock trading. Together, these make financial services the single largest market opportunity for start-ups in terms of economic value. Digital payment services like M-PESA, Tigo Pesa, Airtel Money, Easypaisa, B-Kash and others help advance financial inclusion because they allow providers to process frequent, low-value transactions remotely and deliver a broad range of financial services, from payments to insurance, at near marginal cost.

Initiatives for Revolution of Digital Finance in India

Two initiatives at CGAP are working to explore how digital finance can be taken further, beyond simply powering remote payments and financial services.



- Digital Finance “Plus” explores how the ability to process small-value payments digitally can help extend critical services and utilities, such as clean water, health, energy, and education, to previously underserved communities.
- Digital Finance Frontiers explores the role of digital data in the relationship between customers and financial services providers. As more and more people begin to use mobile phones and digital financial services, customers build up credit histories and data trails. With permission, providers can tap this information to get to know their customers digitally and offer them products better suited to their needs. Another initiative at CGAP, Inclusive Payment Ecosystems, focuses on country success cases in South Asia and sub-Saharan Africa where digital payments are widely used and provided in a diverse and competitive ecosystem. This involves working directly with businesses and on the regulatory and policy framework needed to protect customers while at the same time support innovation.

Despite the promise of digital financial services to reach the unbanked, challenges remain. Many providers have struggled to develop compelling products that customers actively use. An analysis of the Kenya Financial Diaries data shows that even in Kenya, where the majority of adults use mobile money, less than 1 percent of total transactions among low-income households are digital. In India, where 22 percent of the world’s unbanked resides and over 900 million mobile phone connections exist, 0.3 percent of adults use mobile money. On the data side, customers’ privacy also must be weighed and balanced with the potential of data to power new financial services.

Challenges Faced in Revolution of Digital Finance

Data access and quality:

Unlike developed markets, there are still significant gaps in financial and operational data availability in India. Lending start-ups, for example, have built impressive credit underwriting models. But they need regular access to trustworthy and high quality data to have impact. There are two issues – one of coverage (three quarters of the population does not have a credit score) and data access (many small businesses do not have reporting systems to tap into).

Co-opetition with banks:



Incumbent Indian banks are not fading away anytime soon. The reality for any fin-tech start up is the need to work with a range of banks and financial institutions. They need understanding of and access to Indian banking systems and also have to differentiate themselves from dozens of start-up peers who are lining up with the same requirements. This calls for both sales skills and domain understanding to persuade banks, in addition to great technology.

Regulations:

The good news is that both the government and the RBI view start-ups as being able to bring new ideas and technology to the table. That said, navigating the regulatory maze and securing licenses is challenging for small start-ups. A recommended way is to proactively meet and educate the regulator (SEBI, IRDA, RBI depending on the solution) and stay abreast of evolving viewpoints.

Trust:

Banks may have a lot of inefficiencies and are often lagging in technology. However, consumers do trust them. Start-ups will need to win this trust by ensuring a high quality, transparent and safe transaction experience. To scale beyond being a niche provider, these firms will also have to raise significant capital to build a national brand and a broad set of services. These challenges while non-trivial can be overcome.

Unprecedented reach:

While less than half the population may have a bank account; over 90% of consumers own a mobile phone. Smart phone sales have taken off and expected to touch 500M units in five years, providing unprecedented mobile Internet access. From start-ups to banks, every player in the financial ecosystem suddenly has reach and consumer access that was impossible even five years ago.

User behaviour of a digital generation:

In less than a decade, there has been a massive shift in consumer behaviour among a young Indian population. Starting with e-commerce, consumers are embracing a new generation of mobile Internet solutions for services ranging from taxis, music, movies and food ordering to medical care and furniture purchase, among others. It's not hard to see this extend to financial services, fundamentally changing the way Indians expect these services to be found and delivered.



Targeted high impact solutions:

Most start-ups are focusing on a specific pain point and attempting to deliver value, cost reduction, and efficiency enhancement that can attract consumers. Take lending, for example. Getting a consumer or a small business loan is a complex, frustrating, and broken process. There are start-ups reimagining the loan search and fulfillment process to make it more efficient for consumers while reducing the cost of customer acquisition for banks. Another category of fin-tech providers are building lending platforms for small business working capital loans as well as pioneering peer-to-peer lending. Lending by itself is a massive market (\$500B in 2014). Digital lending is less than 2% of the market today. There is enough promising innovation in this category to tackle the core issue of broadening credit access and banking reach for consumers and small businesses

Conclusion

There is no doubt that the role of finance and how that role is undertaken is changing rapidly. They were innovative in their use of technology and in models to meet the needs of low-income customers, and they were making progress on business viability through aggressive product roll-outs, cross-selling, and aligning their operations to digital banking. They were eager to learn what was working in other contexts, channels, and operations. They also articulated an agenda of advocacy with regulators, the need for coordination among government bodies, and the importance of governments making digital payments across all of their functions a role in building trust in many organizations and driving even greater operating efficiencies.

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