

Electronic Payments International

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Country Survey - India: E-payments get set for Indian summer

Despite a huge **unbanked** population and a heavily cash-dominated culture, electronic payments in India have continued to enjoy strong levels of growth over the past five years. Further improvements in India's payments infrastructure and the expansion of e-payments into rural areas are now next on the agenda. In his foreword to a recent Visa study*, HN Sinor, chief executive of Indian Banks' Association, says that India's nascent cashless payments sector - most notably, its card payments network - is already initiating far-reaching changes in both how Indians pay and how India transacts with the rest of the world.

"The cashless payments infrastructure will help us align with the global financial services industry by making our systems more efficient and cost effective," Sinor writes. "It will also help us in addressing the special challenges India faces - the large **unbanked** population, the unregulated cash economy and need for financial transparency."

The challenges in turning India into a cashless economy are vast. India's payments card network, for example, is still in its infancy despite rapid growth over the past five years. According to Sinor, India now has 44 million cardholders, and there is recent evidence that card usage - especially debit - which was traditionally used only in the large cities has now been introduced into the smaller towns and cities, and is increasingly being accepted in place of cash.

India's e-payments network

India's current electronic payments infrastructure - for both retail and consumer payments - has its roots in the 1980s when the first automated systems were put in place to handle paper transactions. However, it was not until the last decade that development in the systems really began to ramp up.

According to the Reserve Bank of India's (RBI) recent Payment Systems Vision 2005 - 2008 paper, various types of electronic clearing systems are functioning in the retail payments sector. The Electronic Clearing System (ECS), both for credit and debit operations, functions from 45 places (15 managed by the RBI and the rest by the State Bank of India). The ECS is the Indian ACH catering to bulk payments. Last year, it processed transactions worth almost INR10,000 crore (\$2.3 billion), according to the Reserve Bank of India, compared to just INR67.4 crore in 1999.

Indian EFT

On the consumer side, the Electronic Funds Transfer (EFT) system is operated by the Reserve Bank at 15 locations and typically deals with individual/single payments. These systems are governed by their respective rules.

A variant of the EFT called the Special Electronic Funds Transfer (SEFT) System is operated by the Reserve Bank to provide nationwide coverage for EFT. All these electronic fund transfer systems settle on deferred net settlement basis.

The EFT network reports similar levels of growth. EFT grew from INR0.6 crore to INR15,711 crore during the five-year period between 1999 and 2004 (see chart 1).

A few large value payment systems also function in the country. They are the Inter-Bank Cheques Clearing System (the Inter-bank Clearing), the High Value Cheques Clearing System (the High Value Clearing), the Government Securities Clearing System (the G-Sec Clearing), the Foreign Exchange Clearing System (the Forex Clearing) and the Real Time Gross Settlement (RTGS) System. With the exception of the High Value Clearings, all these systems are electronic based. However, they relate mostly to inter-bank/inter-financial institutional transactions, except the High Value Clearing where high

value customer cheques are cleared.

The RBI has made great strides in updating its payments network since 2001, when its first e-payments paper was published, but the quick evolution of the system has created its own problems. The RBI admits that "there are a large number of institutions operating with different ownership pattern having varied types of functions including processing, clearing, management and settlement."

"Due to multiplicity of operators, local practices which vary from place to place determine the conduct of clearing and settlement, and important aspects like safety, efficiency and better customer service are often compromised at the altar of operational convenience," it continues. "There is lack of co-ordination among the organisations which leads to inconsistency in the operations. This results into the wastage of available resources and also limits the scope of implementing innovations in the systems."

To address such problems the RBI recently proposed to re-assign ownership of the retail payment systems to a single separate legal entity, reflecting the model employed by most payments systems in the developed world. It is planned that the Indian retail clearing function, in its entirety, could be entrusted to a separate legal entity and the Reserve Bank could remain the settlement institution for all the clearing systems, as well as maintaining its role as the regulator and supervisor of the payment systems.

The other problem faced by the RBI is its archaic legal framework: its payments system is still based on the Negotiable Instruments Act of 1881. Recent amendments to the act have focused on new methods to process paper-based payment instruments, including additions relating to Electronic Image of a Truncated Cheque and Cheque in the Electronic Form.

The RBI admits the shift towards electronic modes of payments has created "large gaps" in the legal structure, most notably in the areas covering "netting" and "finality of settlement."

Alongside the organisational and legal overhauls, the RBI's Payments Systems Vision paper vowed to look at improving risk mitigation in the payments, placing a particular emphasis on "systematic" risk; "failure of one or more participants could lead to a domino effect, leading to settlement failures in other payment systems as well and could result in instability in the entire financial system," the RBI warned.

Other areas of the network the RBI is examining include efficiency enhancements, greater penetration into India's large rural sectors, increased customer protection and improved co-operation and co-ordination on a regional basis.

Consumer payments in India

Despite the strong advances in e-payments, an estimated 90 percent of personal consumption expenditure (PCE) in India is still made with cash. Similarly, much of the country's economy and commerce still happens outside of the government's radar, creating a sizable underground economy of both legal and illegal activities.

According to Visa, as much as 83 percent of India's non-agricultural employment falls into this area, comprising self-employment (small and unregistered enterprises), daily wage employment in informal jobs (without formal employment contracts, worker benefits or social protection) and informal employment outside informal enterprises (domestic workers, etc).

Despite being barely two decades old, India's cards industry is already sizable and growing quickly. Cards in issue have grown from just 3 million cards in 1998 to an estimated 44 million credit and debit cards in 2004 at a compounded annualised growth rate of 55 percent (see chart 3).

According to Visa, over 40 financial institutions - including government-owned public sector banks, private sector banks and multinational foreign banks - now issue payment cards, offering a range of different products including credit cards, debit cards, prepaid cards, affinity and co-branded cards. Citibank and ICICI Bank are the two largest credit cards issuers (see chart 4, page 15).

Total debit and credit card spending increased from \$1 billion in 1998 to an estimated \$23 billion in

2004, says Visa, although the vast majority (80 percent) of volumes still relate to ATM cash withdrawals, predominantly with debit cards. With total spending on cards still only accounting for just 1 percent of the country's PCE, the opportunities for growth in the industry remain enormous. According to Visa, around 30 million people are currently eligible for credit cards, a figure that is likely to increase rapidly once the country's new credit bureau (The Credit Information Bureau India Ltd, or CIBIL) takes hold.

However, it is the popularity of debit cards, which were not introduced in India until 1998, that have proved the greatest catalyst for the switch from cash to cards. According to Visa, 68 percent of payment cards in India are debit cards, having increased from just 2 percent in 1998. Over 30 million debit cards are now in circulation and their numbers are growing at more than 75 percent year on year. Around 150 million people (the total banked population in the country) are eligible for debit cards.

Meanwhile, the growth in debit has closely mirrored the rise of the ATM network, in which debit cards are used primarily for cash withdrawals. ATM numbers have grown in the past five years from 1,100 (based mainly in the large metropolitan areas) to an estimated 14,000 across the country by the end of last year (see chart 5, page 15).

"The ATM card is really the precursor to debit cards," says Visa. "For the Indian consumer, increasing familiarity with an ATM card is a step toward being more comfortable in using a debit card, for both cash withdrawals at ATMs and directly paying for purchases at merchant outlets."

Indian banks have a vested interest in migrating customers to debit cards. According to Visa, it is estimated to cost a bank INR10 to process a cash withdrawal for a walk-in customer at a branch, INR4 at an ATM and INR1 when a consumer uses a debit card at a merchant outlet.

Visa figures suggest that point of sale purchase volume on debit cards has grown from \$3 million to \$470 million in five years. It is expected that most ATM cards in India will be converted to debit cards with added functionality for point of sale usage over the next two years.

The vast majority of merchants continue to be cash-based although the number of merchants accepting cards is on the increase - reflecting Indian consumers' increasing willingness to use cards for everyday purchases as well as big ticket transactions.

According to Visa, the merchant segments that have shown highest year-on-year growth in card usage (in terms of value) are handicrafts (56 percent), consumer durables (54 percent), telecom (53 percent), department stores (52 percent), petrol (52 percent), jewellery (49 percent) and supermarkets (49 percent).

The number of card-accepting merchants reached more than 150,000 in 2004, says Visa (see chart 6). Around 150 towns and cities now accept payment cards, compared to acceptance in only the main metropolitan areas three years ago.

* Emerging India: Transition to a cashless Economy prepared by National Council of Applied Economic Research (NCAER) for Visa International Asia Pacific

Chart 4: Indian credit card market 2004

Issuer	Market share cards issued (%)	Number of cards (m)	Market share expenditure (%)	Expenditure (m)
Citibank	21	2.5	26	\$1,216
Standard Chartered	13.4	1.6	15	\$702
ICICI	21	2.5	12	\$562
Amex	not known	not known	11	\$515
HSBC	8.4	1	9	\$421

SBI	16	1.9	not known	not known
HDFC Bank	not known	0.64	not known	not known
Others (including not knowns)	20.2	1.76	27	\$1264
Total	-	11.9*	-	\$4,680

*Visa's latest 2005 figures now put the total number of credit cards in issue at 14 million

Source: Electronic Payments International estimates based on analysis of Visa, SBI, ICICI and Venture Infotek figures, March 2004