IMAP

Industry Report

Payments Industry in India
Q4 2016

Research Conducted by

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Payments Industry in India / 2016

In this issue

The Payments Industry in India has largely been driven by cash. Presently, cash transactions accounts for 78% of all transactions in the country. This status quo is set to change rapidly in the near future. The ongoing digital and technology revolution in India coupled with several progressive regulatory changes has revolutionised digital payments in India.

The Government's Digital India vision and entry of large corporates such as Reliance in the telecom sector is aiding a unprecedented growth in the Internet penetration in India. The number of internet users in India is set to double in the next 5 years from about 300 million today to 600 million in 2020. About half of the 600 million internet users are expected to transact using digital payment methods.

Digitisation of payments presents a large opportunity in the Indian context. It is estimated that the total payments via digital payment instruments will be in the range of US$ 500 billion by 2020, which is 10x the current levels in India

The Government and other regulators have been a driving force for establishing a robust digital payments system in India:

- **Unified Payments Interface (UPI)**: UPI is an open architecture set up to stitch together all payment services into one common platform. The open source platform encourages participation from every payment service provider, viz. banks, FinTechs, payment banks, e-wallets, etc.
- **Payment Bank Licences:** The Reserve Bank of India has issued 11 payment bank licences in the past one year, aiming to achieve a deeper penetration in rural markets
- **KYC Norms for small transactions**: There is no requirement for customers to undergo a KYC process for transactions upto INR 10,000 (USD 150) per month on payment wallets. This key guideline has resulted in a large adoption of e-wallets. Paytm (a leader in e-wallets in India) is the fourth largest FinTech unicorn globally with a valuation of about USD 5 billion as of the latest funding round.

India represents one of the largest market opportunities for digital payments. With a population of 1.25 billion, India accounts for roughly 18% of the global population. The two key drivers of digital payments – mobile phones and internet users are already well established in India. To date, India has about 1.0 billion mobile phone subscribers and 300 million internet users, ranking 2nd on both metrics globally.

On the road to digitisation

	Population	Mobile phone subscribers	Internet users
2015A	1,250 million (#2 globally)	1,000 million (#2 globally)	300 million (#2 globally)
2020E	1,350 million	1,200 million	650 million

Source: Digital Payments 2020 – BCG Report

India's Prime Minister, Narendra Modi, announced on 8th November 2016 that existing INR 500 (about USD 7.5) and INR 1,000 (about USD 15) banknotes would no longer be legal tender, with airports, railway stations, and hospitals only accepting them for a brief period of time.

The government made the surprise move in a bid to combat "black money," or currency that is unaccounted for, and counterfeit currency. Consumers have until December 30 to exchange their INR 500 and INR 1000 notes for new editions, while limited numbers of new INR 2,000 (about USD 30) and INR 500 (about USD 7.5) notes have been issued.

This move will be a game changer for the payments industry in India:

1. Limited availability of cash will drive people to digital alternatives. The government is restricting the number of notes a consumer can exchange to INR 4,500 (about USD 67). There are also restrictions on ATM withdrawals, and huge queues have already formed outside of post offices and banks. This means people may not be able to retrieve the new cash they need before official businesses stop accepting the old bills, which could force them to turn to other methods of payments they have not previously considered, including mobile wallets and P2P solutions.

2. The unbanked may now have no other options except digital payments. Many segments in India are unbanked, especially drivers, small grocery store (kirana) owners, small retail shop owners, and travel agent businesses. With a suddenly diminished availability of cash, these segments will be compelled to find alternatives — and many will likely turn to mobile wallets as they are typically easier to acquire than bank accounts with debit cards.

3. More digital transactions will generate more customer data. This will allow online lending platforms, alternative lenders, and other FinTech's to make better assessments of potential borrowers' creditworthiness. As a consequence, availability of credit from these FinTech's may increase.

4. A boost to the FinTech sector could help another government policy succeed. The Indian government has been promoting digital finance for some time. Earlier this year, the Reserve Bank of India (RBI) launched United Payments Interface (UPI), a tool that allows users to access multiple bank accounts and merchant payments within a single mobile app. The government is keen on a transition to a cashless economy because it could be cheaper to run, help reduce the underbanked population, and reduce financial crime as electronic payments are easier to track. Growth of the FinTech industry, and increased use of FinTech products, will only further drive the move toward a cashless economy.

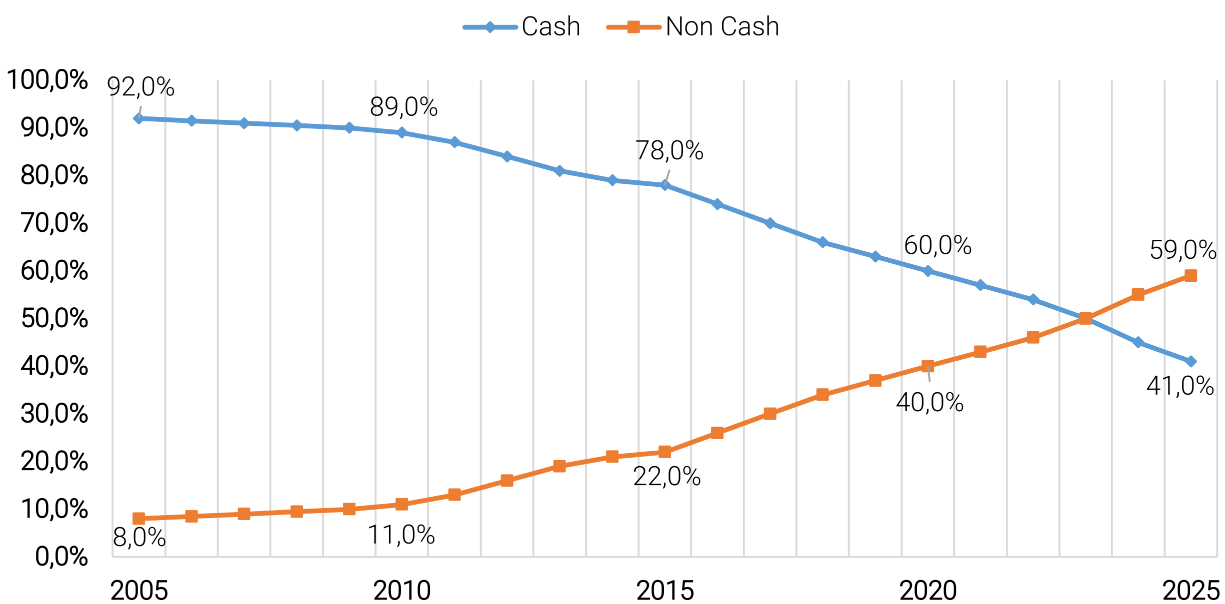
Traditionally India has been a cash economy. Currency in circulation in India accounts for 18% of the GDP versus 3.5% to 8.0% in matured markets such as the UK and USA. In 2015 cash accounted for 78% of total transactions in India, against 20%-25% in developed economies of UK, Germany and France.

But, the percentage of cash for transactions has seen a rapid decline in the past few years in India. In 2010, the percentage of cash in all payments was 89% compared with 78% in 2015. This rapid decline is a result of an increased adoption of non-cash instruments such as cards and digital payments such as mobile wallets, electronic transfers, etc.

Stored value instruments like mobile wallets (Paytm, Mobikwik, Citrus, etc) and prepaid and gift cards have made payments though internet devices convenient and easy.

Digitisation of payments is a large opportunity: It is estimated that total payments on digital platforms to be in the range of USD 500 billion by 2020, up from current estimates of USD 40-50 billion. The key driver for this rise will be a increase in the user base. The number of users in the digital payments instruments segment is estimated to be about 50-60 million, expected to rise to 300 million by 2020. Digital payment users will comprise 50% of all internet users by 2020.

Scale is critical to make a payments business model viable. Building a world-class payments business requires significant investment in technology, infrastructure and partnerships. Participating players must look to build a sizable scale over the next few years. This will drive a consolidation in the payments industry with smaller businesses being acquired by larger multinationals which will look to gain critical size for outperformance.



Source: Digital Payments 2020 – BCG Report

5/ Industry Participants

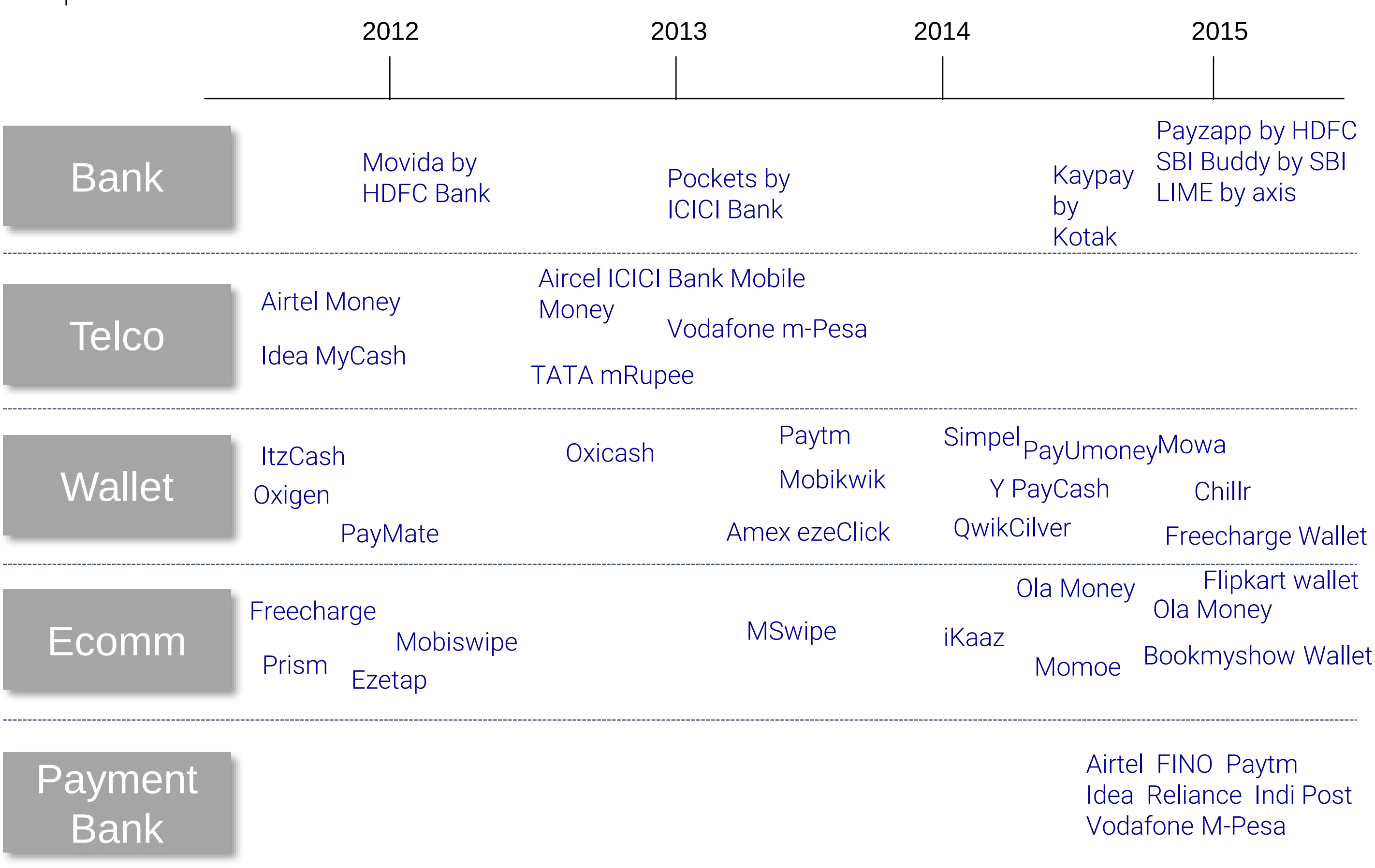
Bank-led: Banks have been integrating their banking apps with integrated bill payment solutions; most of these apps do not require a bank account to be opened with the bank – allowing for a much wider reach in the market.

Telco-led: Large telcom operators such as Airtel, Idea, Vodafone and Idea have launched mobile payment solutions with the aim to capture a large part of their already existing clientele.

Wallets: Backed by VC & PE Funding, Wallets such as Paytm, Mobikwik, Freecharge, PayUmoney, etc have spent heavily on customer acquisitions driven by discounts. Discounts have visibly reduced as companies are now looking at profitable growth. The marketing initiatives have gradually moved towards providing a wider and more seamless experience.

Wallets have found a large acceptance in unbanked/under banked areas in India. Innovative solutions such as cash pickup services and tie-ups with banks for cash loading at bank's retail branches. Wallet users are already triple the number of credit card users in India.

Payment Banks: The Reserve Bank of India (RBI) issued 11 entities approvals to set up payment banks. The scope of services of a payment bank includes demand deposits of up to INR 100,000 (USD 1500) per customer, issuance of debt/ATM cards, acting as a business correspondent to another bank, distribution of mutual funds, etc. The primary aim of a payment bank is to drive financial inclusion and provide essential financial services to the unbanked population of India.



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The exponential growth in the past few years in the payments industry in India has drawn a significant interest from global private equity funds such as General Atlantic, Temasek, Tiger Global. Building a world-class payments business requires significant investment in technology, infrastructure and partnerships.

Given the competitive nature of the industry and the race to capture the exponential growth in the user base, companies have turned to private equity funding, with deals closing in as little as 3 weeks.

But scale is critical to make a payments business model viable. The nature of the industry will allow for only limited participants.

As a result, with the industry maturing M&A activity has seen a pick up in this sector, with smaller businesses being acquired by larger multinationals which look to gain critical size for outperformance.

Company	Investor	Date	Type	Deal Value (Stake)
Billdesk	GA, Temasek	October 2016	PE	USD 150 million (Undisclosed)
Citrus Pay	PayUmoney (Naspers)	September 2016	M&A	USD 130 million (100%)
Paytm	MediaTek, Goldman Sachs	August 2016	PE	USD 60 million (1.2% stake)
Mobikwik	GMO, Japan	May 2016	Strategic	USD 50 million (undisclosed)
Bankbazaar	Amazon, Fidelity	July 2015	PE	USD 60 million (~15% stake)
Freecharge	Valiant Capital	February 2015	PE	USD 80 million (~10% stake)
Policybazaar	Tiger global, Premji Invest	April 2015	PE	USD 40 million (undisclosed)

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