

Role of Fintech in the Digital Economy



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From 2010 to 2014 India's financial inclusion was "taking off" thanks to efforts by GOI and RBI. Since 2014 however, the pace quickened and a paradigm shift began happening. The fintech industry went into overdrive in both the number of start-ups as well as the investments they attracted. This coming of age was driven majorly by growing penetration of smart phones, low-cost affordable [internet](#), introduction of a clutch of payment platforms, all supported by the government through its Digital India and pro-start-up initiatives.

Evolution via a Strategic Framework

India's evolution as a progressive fintech nation instead of being an overnight miracle, happened on the back of a four stage strategy. First, the identity formalization problem was solved by the creation of Aadhaar – the unique id for every Indian citizen. Second, lack of financial inclusion was solved by ensuring everyone got a bank account or equivalent (PMJDY) to receive and store money. Third, the challenge of moving money was solved by building scalable platform(s) such as IMPS, UPI, etc).

And finally, allowing banks, fintech companies and wealth/insurance/lending players to access and innovate on platforms like UPI. This 4-stage framework led India to its fintech revolution.

Blurring of the rural-urban divide

While urban India grasped the changes aggressively, rural India where the masses reside, did not see an equal enthusiasm where driving behavioural change can be complex especially in the financial sector. Demonetization's effect on spreading awareness about the existence of such an industry on a country-wide scale cannot be contested, especially in rural India. Many private players responded quickly and scaled their operations to meet the sudden demand.

In the last few years, there have been several exciting innovations in this space, such as UPI; Aadhaar for eKYC; BharatQR for QR-based payments; biometric payments (AEPS); e-wallets by more than 50 banks; payment banks; sound-wave-based payments for rural consumers; and last-mile connectivity. These innovations highlight the fact that India is carving out a niche for itself in low-cost, large-value, fintech-driven innovation that is focused on urban and rural segments alike.

The promise of mobile internet

Today, India is the second largest online market with over 500 million [internet](#) users. Despite the large base of internet users in India, the digital penetration stands at around 26 percent, indicating a huge potential for growth. Of the half billion internet users, 293 million active internet users belong to urban India, whereas there are 200 million active users living in rural India. Currently, digital adoption is being driven by rural India with a double digit growth of 35 per cent. However, only 16 per cent of rural users access the internet for financial transactions, while in urban areas 44 per cent users access the internet for this purpose. While cash remains important, particularly in rural areas, card payments remain the biggest driver of cashless payments in India. The entry of players like Google pay and Amazon wallet drive this further. To ensure wide scale inclusivity, India needs something like Safaricom's mobile-money platform M-Pesa that has reached an estimated 96% of households in Kenya and is credited with lifting at least 200,000 Kenyan households out of poverty.

Lack of money movement due to trust and illiteracy

The acceptance of mobile digital wallets has still many steps to go, and a lot of obstacles to overcome. The trust factor is one of the integral challenges to growth of digital payments in the rural sector. Higher incidences of fraud can be one reason for people to not link their cards or other details to online banking. On the vendor side of things, as the mobile wallet companies are charging anywhere around 1% to 4% for transactions to bank accounts, merchants are wary of using mobile wallets for business transactions. Moreover, low literacy levels in poor and rural parts of the country make it problematic to push the use of mobile wallets.

Fintech innovations and startups have exploded across all segments including digital payments, lending, wealthtech, insurancetech and cybersecurity tech.

Challenges

Customers in the digitized world will seek low friction and immediacy which will be the major drivers of the digital economy. With the advent of new age technologies, there has been a marked shift in the utilities which banks provide and the loyalty which consumers exhibit. From the earlier era of Banking 1.0 to modern day app based banking, technology has increasingly been incorporated into financial transactions to meet the utility-demand equation and customer convenience.

Will fintechs “kill” the bank as an institution? Arguments on both sides are strong. Banks are responding vigorously to this technology-based onslaught. It is also argued that it’s a zero-sum game and that technology, instead of killing off traditional banks, will in fact empower them in some technological balance. The truth is somewhat more complex.

- *The issue with trust, scaling up:* The real challenge for fintechs is to gain the trust of end customers on the lines of what traditional banks enjoyed. Fintechs have it relatively easy at the start-up stage; it is the scaling-up stage which is far more difficult.
- *Collaborating with banks:* This could have led to increased fintech credibility except that fintechs essentially “unbundle” what banks do and provide expertise in specific, single domain areas and therefore is likely face increased resistance from traditional banks.
- *Blockchain technology:* Considered to be the future of financial services blockchain is yet to get off the ground in a major way for mass inclusion in the industry and the delay is due to the development of the right technology and reassurance about its security
- *Uncertainty of Regulations:* Since fintech is quite different from the traditional banking and financial setups, there are a lot of grey areas regarding the regulatory framework which can lead to a considerable delay in acquiring licences or result in large fines for violations of discretionary laws.
- *Getting Funds:* Since 2016, it has become increasingly difficult for fintech companies to attract investors, majorly owing to the fact that banks and other financial organisations set up their own fintech operations to reduce dependence on an outside service provider. The traditional banking sector looks at fintech companies as their rivals, not fully assessing the advantages fintech companies can provide them with.
- *Lack of Clear Understanding:* Fintech companies and customers are still unclear about the regulatory considerations and laws they should be working within. The general masses are sceptical about Fintech solutions and still prefer to rely on traditional banks.
- *The Fintech Space is Becoming Saturated:* With the boom in the fintech space, acquiring customers is getting more expensive, and mindshare is getting harder to come by. Brands that already have mindshare in other domains are moving into fintech.
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