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The Impact Of Fintech On Banking - Indian Economy

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Abstract:
This paper examines the potential negative effects of Fintech on the global financial services sector. Due to the broad scope of Fintech the paper focuses only on three elements i.e. block chain & crypto currencies, alternative payment methods and investment & banking and uses arguments and empirical evidence that refer to three geographic and political regions i.e. the India, in order to analyze the influence of Fintech companies on traditional financial services providers, the reasons behind Fintech's quick development and expansion along with details on the current status of Fintech regulation in the India. The analysis shows that current regulation of Fintech in the aforementioned regions is inappropriate and could lead to potential negative effects on the global financial services sector such as corruption of cyber security, infringement of data privacy and utilization of Fintech services for illegal purposes. Therefore, authorities in the India need to focus on creating suitable regulations for Fintech in order to mitigate potential negative effects. This article provides a discussion on some issues associated with digital finance – an area which has not been critically addressed in the literature. Digital finance and financial inclusion has several benefits to financial services users, digital finance providers, governments and the economy; notwithstanding, a number of issues still persist which if addressed can make digital finance work better for individuals, businesses and governments.

Key words: *Fintech, financial services, digitalization, block chain, crypto currency, payment, investment, banking.*

1.0 INTRODUCTION:

The aim of this thesis is to explore the topic regarding the potential negative effects of Fintech elements such as block chain & crypto currencies, alternative payment methods and investment & banking on the global financial services sector exemplified through the experiences of the India. This topic is significant and relevant due to the fact that the financial system and services influence many important aspects of people's daily lives and are used to complete even the smallest of transactions. Therefore, I decided to research this topic and determine the possible negative effects of Fintech's block chain & crypto currencies, alternative payment methods and investment & banking elements on the global financial services sector by focusing on examples from the India.

Impact of Fintech: GDP Multiplier, Job Creation and Cross Sector Impact:

Over the last few years Fintech has made a significant impact on the financial services sector, not only redefining the development of financial services products but also creating alternate channels of delivery, and providing the opportunity to significantly expand the reach and scope of financial services. The traditionally cash-driven Indian economy has responded well to the fintech opportunity, primarily triggered by a surge in e-commerce, and smartphone penetration. The transaction value of the Indian fintech sector was estimated to be approximately USD 33 billion in 2016 and is forecast to reach USD 73 billion in 2020 growing at a five-year CAGR of 22%*.

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Despite concerted attempts, banks have not been able to cover a significant chunk of population under the purview of financial services, which has given an opportunity to fintech companies. Many fintech companies are working in different ways to contribute toward achieving deeper financial inclusion in areas such as microfinance, digital payments, credit scoring and remittances. MSME financing is another area where Fintechs have shown early promise. The sector is witnessing the emergence of new Fintech players addressing the structural issues of information asymmetry and reducing turnaround times for underwriting loans to small businesses. Fintech also holds the promise of lowering the cost of credit, particularly by lowering operating expenses for lenders. Better KYC procedures lower due diligence costs and operating expenses. Fintech also has the potential to impact Governance in several ways. First, Fintech has the potential to increase transparency as it reduces the need for cash and more payments are made through digital means that can be better monitored. Secondly, the rise in economic activity could reduce the size of the informal sector if Governments stimulate and facilitate businesses to formalize. Thirdly, increased business activities and an improved labor market increase the Government's tax base to increase expenditure. According to research from the McKinsey Global Institute many as 300 million Indians could gain access to banking services and raise their incomes by 5 to 30 percent.

2.0 LITERATURE REVIEW:

Hans J. Blommestein, (2006) I will address in this study the future of banking. This will be done against the backdrop of revolutionary forces shaping an increasingly fast-moving banking landscape. The first part of the study focuses on the ultra-long drivers of banking structures and institutions. To that end, I will identify the long-term determinants of our rapidly changing society.

Zahra Rahmani, (2012) Mobile banking is one of the areas mobile commerce that has extensive communications with other areas of mobile commerce. The one hand, mobile banking is associated with customers and on the other hand, is capable of other firms that are active in the field of electronic commerce, provide effective financial services. In this paper we describe the definition of mobile banking, Evolution and finally to describe number of benefits for users of these services.

Marko Jaksic, (2015) This article analyzes how information technology (IT) is transforming individual banks and the entire banking industry. Even though the basic economics of banking have not changed, IT developments may lure banks into transaction banking (due to IT-driven cost efficiencies). However, banks should not give up on relationship banking. Instead, banks need to adjust themselves to consumers' new preferences for IT-driven products and use IT developments to reconfigure or even reinvent relationship banking.

3.0 DEFINING 'FINTECH'

In the past decade, Fintech managed to establish itself as a separate segment within the financial services sector. The main players in this segment are companies (usually startups), that render financial services similar or identical to the ones rendered by traditional financial intermediaries. However, unlike the traditional financial services providers, companies within the Fintech segment relay almost exclusively on employing state-of-the art technology and internet-based software, in order to fulfil their clients' needs

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Nonetheless, the Fintech segment includes many elements, which according to can be “loosely” categorized into four main segments i.e. “financing”, “asset management”, “payments” and “other Fintechs”. The four main segments along with their elements are visible in figure 1, below.

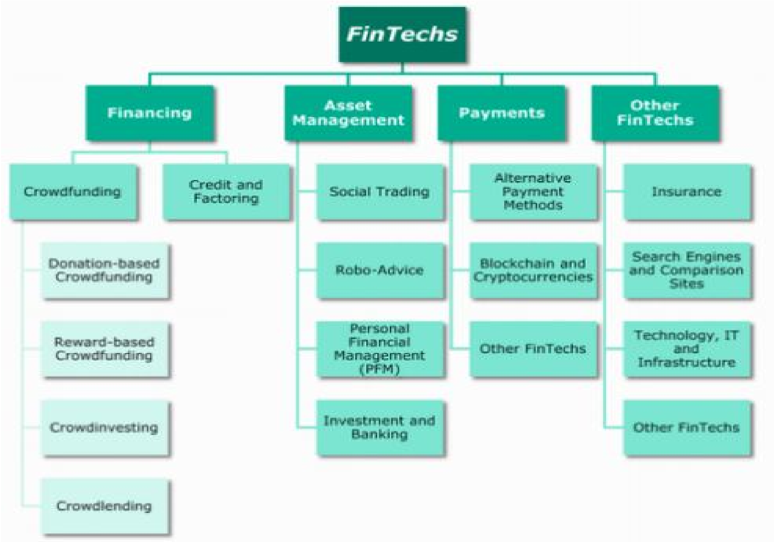

Figure 1. Segments and elements of Fintech

Due to the complexity of both the financial services sector and Fintech as a segment and due to the limited research resources, this thesis only focuses on the following three elements of Fintech: block chain & crypto currencies, alternative payment methods and investment & banking. The reasons why I limit the research to only three Fintech elements is the complexity of the topic and the fact that most relevant information and data regarding Fintech is available for the aforementioned elements. In order to provide a better insight into all of the Fintech elements included in the research and help determine the possible negative effects of Fintech.

4.0 ANALYSIS:

As with global consumers, usage of FinTech is highest among the 25—34 years age group, followed by 35—44 years, and it declines with customers aged 45 years and older. However, unlike in global markets, FinTech adoption in India is lower in the 18—24 age bracket than in the 45—54 age bracket. This could be because a large section of India’s population is in the young adult category and there is significant unemployment in this age group.

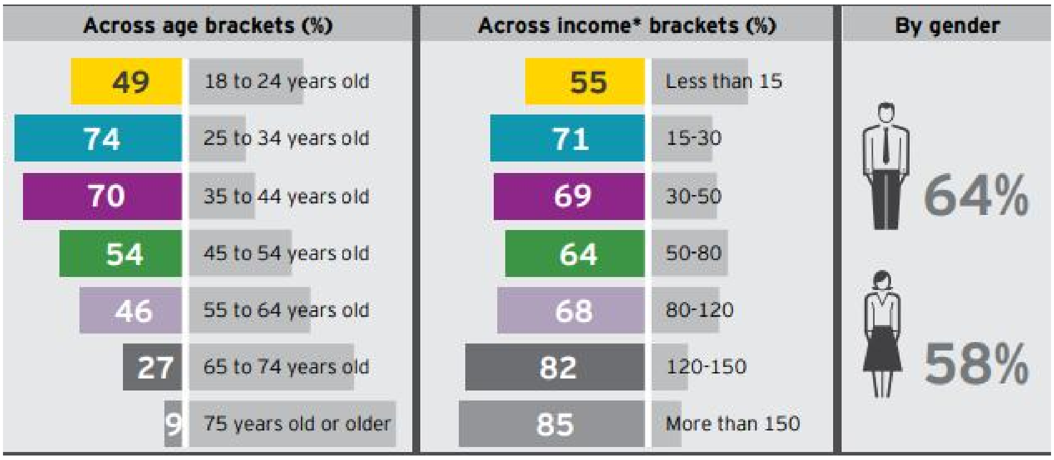

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Figure 2: India's FinTech adoption statistics across demographics

Source: EY FinTech Adoption Index 2017 Country Dashboard; Note: *Income in (US$ '000).

India's FinTech adoption rate exceeds the global averages: Regional adoption of FinTech services in India mirrors global trends. FinTech usage is significantly high in large cities in India, with a 66% adoption rate (42% globally). As FinTech firms expand their focus to tier-III and IV cities, they have started witnessing increased adoption and usage (51%). Rural India currently continues to lag behind with an adoption rate of 33% on account of a number of factors, Source: EY FinTech Adoption Index 2017 Country Dashboard; Note: *Income in (US$ '000). including poor literacy, limited access to telecom / delivery platforms and the inability to pay for even the relatively lower costs of FinTech services. However, this is expected to change over the next few years on account of a number of digital initiatives being undertaken by the Government to drive financial inclusion and direct delivery of benefits.

FinTech adoption in India - the consumer perspective: The relative ease of setting up an account with FinTech providers as compared to traditional financial services, and the ability to access a wide range of services conveniently are the primary motivators for adoption of FinTech in India. The demand for simple, convenient services and a better customer experience, compounded with low levels of affinity for traditional service providers (especially among younger consumers), has allowed FinTech firms to build presence and mindshare, driving acceptance and usage. However, the EY FinTech Adoption Index 2017 indicates that as adoption increases, and traditional players start to address the inefficiencies exposed by FinTech, Indian consumers are likely to start demanding 'bank grade' services like 24x7 access and more attractive rates and fees.

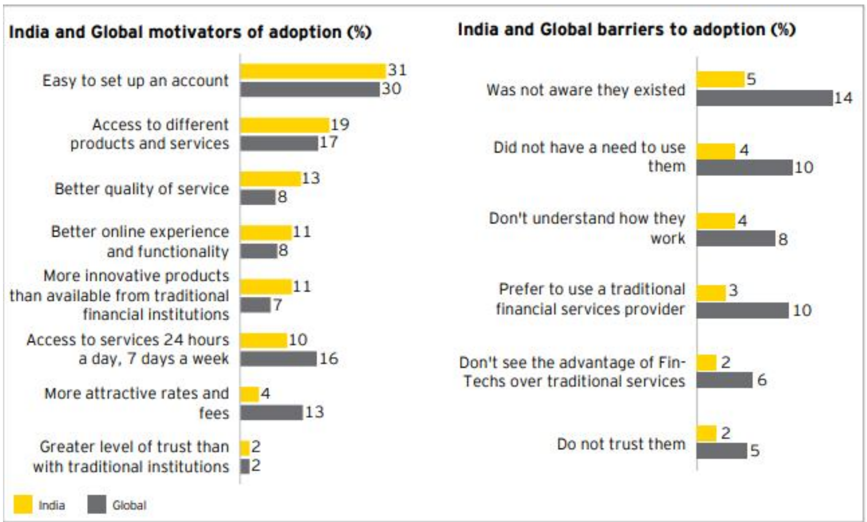

Figure 3: FinTech adoption in India - the consumer perspective

Unmet financial needs: India is one of the fastest growing economies in the world, and according to a recent report by the United Nations, its GDP is expected to grow at 7.1% in 2017 and 7.5% in 2018. The country has a wide network of institutional credit, with scheduled commercial banks (SCBs) providing significant domestic outreach through 138,294 branches (as of March 2016). However, despite this wide branch network, the financial services ecosystem still lags in terms of coverage. Over 40% of the population is not

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connected to banks and an estimated 90% of small businesses are not linked to formal financial institutions (FIs). These gaps in access to formal financial services have created a large untapped market potential for FinTech start-ups to develop a variety of offerings. Underserved by the incumbent banking and financial services system.

Table 1: Unmet financial needs

Indicator	India	Brazil	Russia	China#	South Africa	US	France	France
Commercial bank branches per 100,000 adults	13.6	20.7	32.9	8.5	10.5	32.9	37.5	14.1
ATMs per 100,000 adults	19.7	114	173	76.4	69.3	NA	107	121.1
Outstanding loans from commercial banks (% of GDP)	50.7	42.3	48.6	99.7	67.6	45.6	38.9	21.2
Outstanding deposits from commercial banks (% of GDP)	65.8	33	46.2	157.3	43.4	59.5	36.6	28.4

#Mainland China Note: Data as of 2015

Source: IMF Financial Access Survey Data, 2016

"India to clock 7.1% growth this year, 7.5% in 2018: UN report," Mint, 11 May 2017; "Fintech in India," Swissnex Report, October 2016.

"Expanding Access to Finance for Small Businesses in India," Microsave, May 2014.

Several key factors are driving the growth of FinTech in India:

Unmet financial needs: Traditional service delivery models have not been able to address the financial needs of consumers. FinTech, with its ease of usage and access, has allowed consumers to get access to these services, typically at lower costs, driving its active adoption.

Conducive environment: Regulators are interested in driving cashless / digital transactions for financial inclusion as well as control. The spread of broadband / telecom provides a platform for financial services delivery with low delivery costs and high outreach.

Increasing investments: There has been a significant increase in FinTech start-ups in India over the last two years, primarily in the payments space (driven by regulatory changes and market demand). In addition, there is increased willingness by domestic, as well as international VCs/PEs and incubators to heavily invest in this sector in India.

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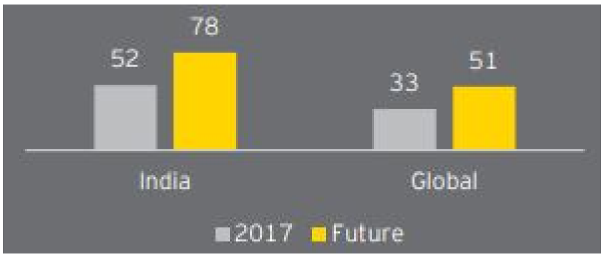
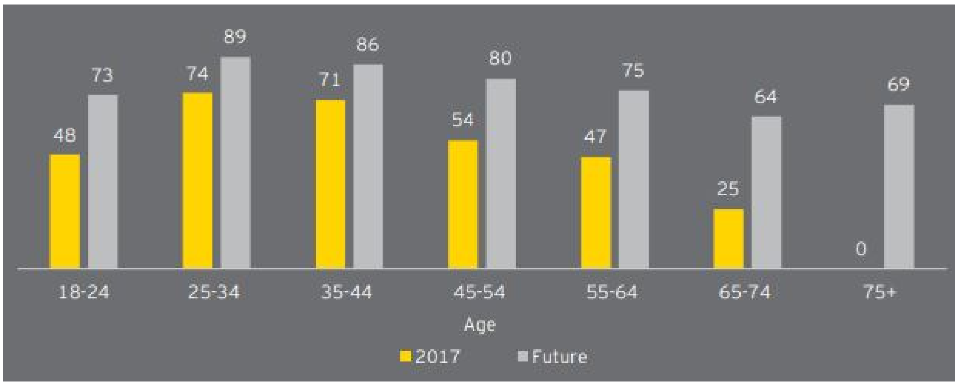
Responsive marketplace and incumbents: Globally, FinTech start-ups are disrupting the business models of incumbent financial services players. In India as in other markets, incumbents are adopting a range of strategies to deal with the risk and opportunity afforded by FinTech paradigms. These include strategic partnerships that provide the FinTech firm with access to bank clients and infrastructure to acquisitions.
consumers (individuals as well as small and medium enterprises) have already started turning to FinTech firms as alternative providers of access to payments, credit, investments, insurance etc. Even in urban areas where branches are ubiquitous, banks are often unable to live up to the increasing expectations of demanding customers. Younger customers do not have the patience to visit branches. They are looking for fully automated, simple to use, digital products and services - an area where banks are found lacking - especially when compared to the digital offerings of ecommerce firms.

Outlook of the Indian FinTech industry:

According to the EY FinTech Adoption Index 2017, India is expected reach an adoption rate of ~80%, making it the global leader in this regard.



Graph 1: Current and future adoption rates (%)



Graph 2: Future adoption by Indian users across age groups (%)

The increasing competition is going to help differentiate FinTech start-ups with sustainable financial models. While they may learn from global models, we believe that indigenous models will win not just in the domestic market, but also in similar markets globally.

5.0 CONCLUSION:

India provides an interesting opportunity for FinTech players. It has a vast market, but one that consists of multiple diverse segments from an access and adoption perspective. Consumers range from financially illiterate to extremely sophisticated global investors. Consumers may be multi-lingual or may only speak their native language. They may have access to the latest technology or may be limited to basic phones and limited internet connectivity. This creates a variety of use cases and needs. The robust ecosystem of technology, underlying platforms and skilled people (programmers, data scientists,

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researchers etc. especially those with global experience or returning to India) and government/regulatory initiatives have provided FinTech players with the opportunity to identify specific niches and the capability to address their pain points, before growing to address other market segments. While adoption will continue to increase among young adults, usage is expected to increase drastically among older generations who are opening up to the idea of conducting financial transactions digitally. This article provides a discussion on digital finance and its implication for financial inclusion and financial stability. Digital finance through Fintech providers has positive effects for financial inclusion in emerging and advanced economies, and the convenience that digital finance provides to individuals with low and variable income is often more valuable to them than the higher cost they will pay to obtain such services from conventional regulated banks.

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