



cutting through complexity

FINANCIAL SERVICES

Payments banks: The 'challenger' banks in India

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Payments banks are expected to revolutionise financial services the way e-commerce has transformed the retail industry, through service and price differentiation, refreshing approach, choice to the customer, focus on volumes over margins, and more importantly, deconstruction of established paradigms.

With 11 new licences in the payments bank category, and with more to follow in the small finance bank division, these new banks need to be hailed as 'challenger banks', as they take on traditional banks in India.

The success of these challengers to make inroads in the domain of the strong incumbents and boost competition in retail banking is likely to depend on the way they approach the market and the value propositions they create.

Various market forces are prepping to challenge the position of established big banks and may shift the balance of power in favour of these challenger banks for selective banking services. Payments banks have the potential to be more agile and nimble, and hence are more responsive to changing market trends. With few or no legacy constraints and greater responsiveness to customer needs (and with no pressure to offer full-service banking solutions), they may attract a large pool of well-served, underserved as well as unserved customers. These banks may no doubt find it relatively easier to attract customers, but they still need to identify a profitable pool of customers and monetise these relationships.

While much of the efforts of the incumbent banks may be constrained due to traditional models being expensively built to last generations, payments banks are anticipated to offer new blood with their innovative models and a fresh 'hi-tech and hi-touch' digital approach.

This publication is an attempt to capture the emerging market trends and their likely strategic implications on the business of these challenger banks. Based on these considerations, we have simulated how a customer transaction statement for future payments banks will look like. With looming questions on their viability, we have made an earnest attempt to identify critical profitability levers for these banks and have elucidated on how some of these levers can be adjusted to improve profitability and shorten the gestation period.

We hope that both challengers as well as incumbent banks find this publication useful, as competition and collaboration is inevitable. We, at KPMG in India, wish these game changers all the best in their journey to change the face of banking and payments in India.



The bank of the future may not look like a bank

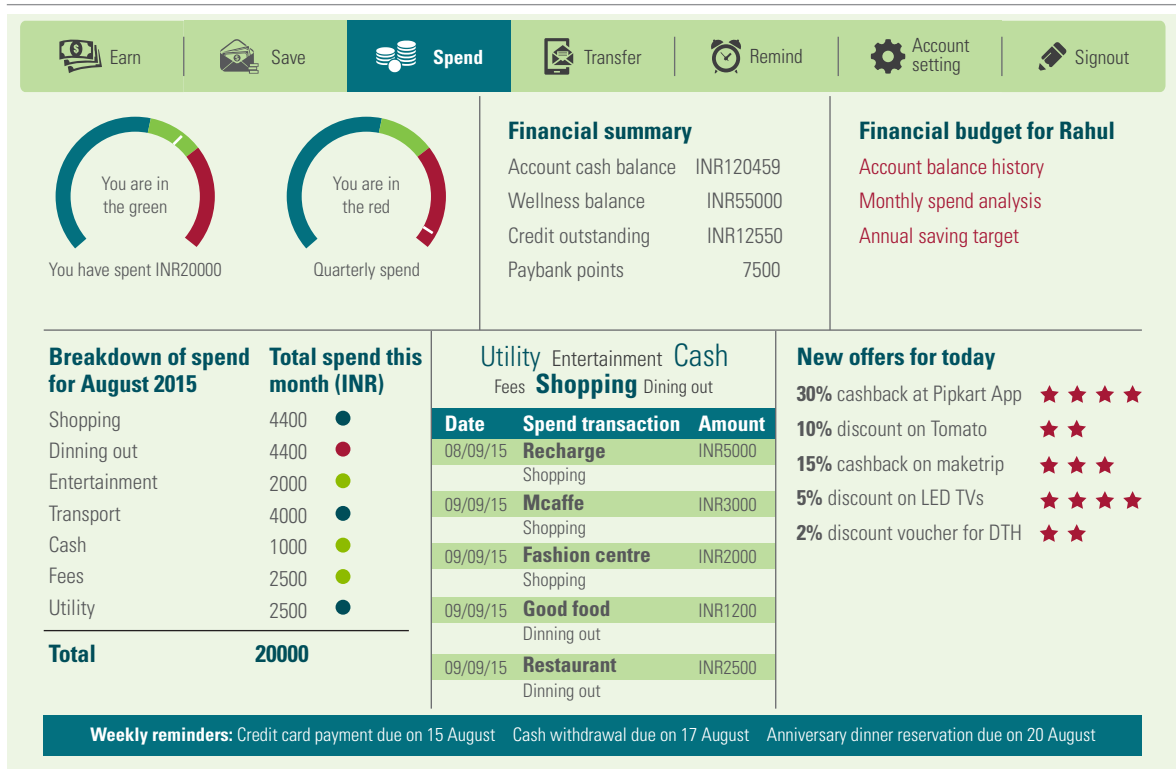
Payments banks need to envisage themselves as a multilayered platform that not only facilitates financial transactions, but also drives continuous engagement. This can be achieved through a rich repository of tools and other non-financial features and functionalities, that lead to or emanate from a financial transaction; for example, credit card payment reminders that leads to a payment or an option of cloud storage of receipts for bill payments after paying a bill.

We have conceptualised customer transaction statements for a futuristic payments bank to illustrate the suite of functionalities and used cases that these banks can offer their customers. We do believe that customers will adopt, adapt and demand more out of their banking service providers, and no way are these representations exhaustive. Incumbent banks are also building capabilities to provide these functionalities at varying degrees.

The exhibit below illustrates a snapshot of a dynamic customer transaction statement which also provides

tools for budgeting, spend analysis and tracking of expenses across categories, along with transaction history. Users can set their periodical budgets and then track expenses across categories. They also have an option of real-time alerts for curbing their instinctive purchases as per user defined pre-sets. The statement also customises offers made by merchants, based on the purchase pattern and social media activity. An example of this could be an offer for your favourite coffee outlet, if you are travelling to a new place as indicated by your social media activity and that place has that outlet.

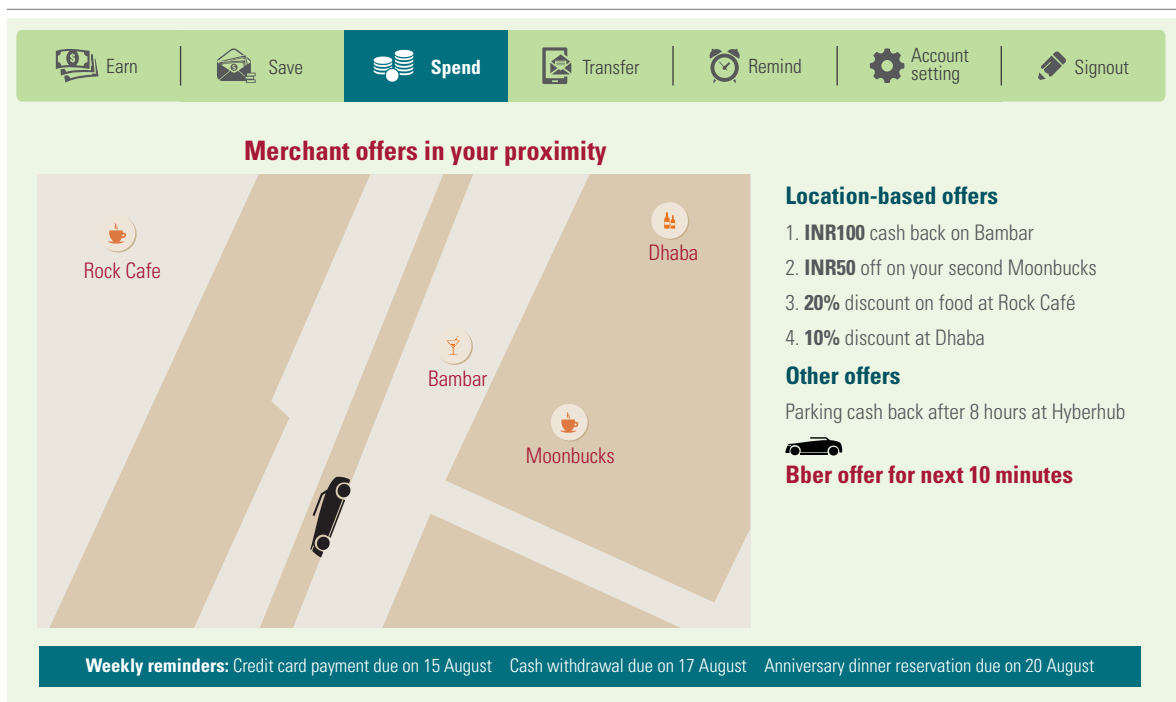
The new-age bank statement 1/3



Source: KPMG in India analysis, 2015

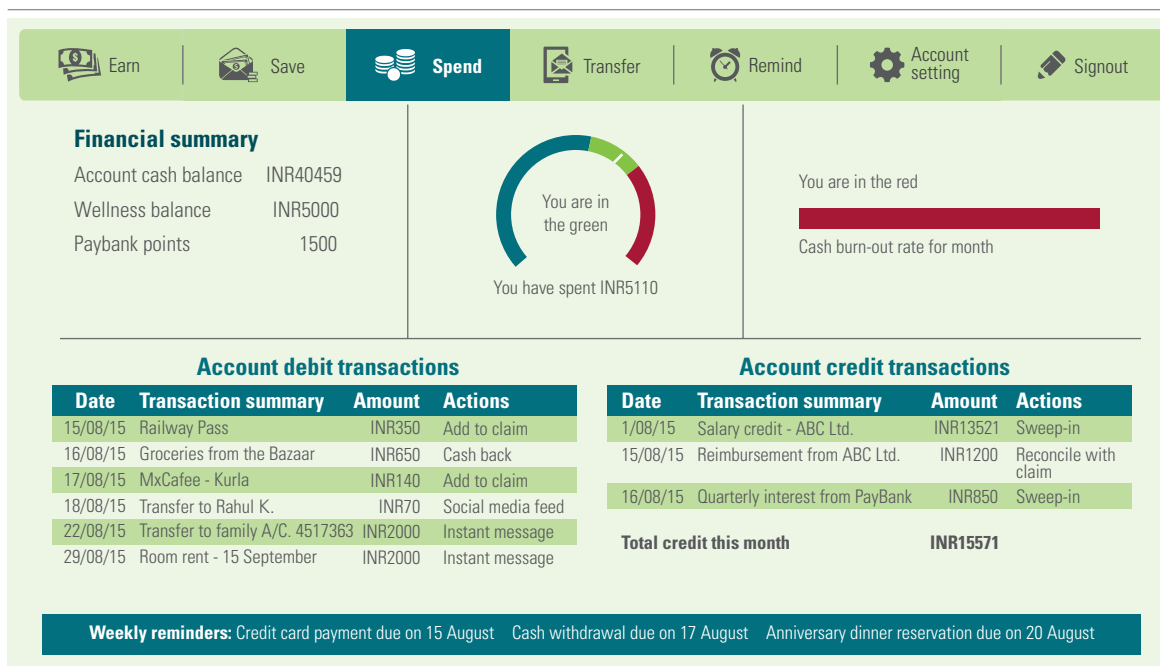
The second statement adds a geospatial layer and shows customised offers for a user based on the physical location and transaction history.

The new age bank statement 2/3



Source: KPMG in India analysis, 2015

The third transaction summary is simulated for low-income banking customers and acts as his/her budget planner as well as financial adviser.



Source: KPMG in India analysis, 2015

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Strategic considerations for payments banks

The business of payments banks hinges on providing last mile connectivity and payment facility through either physical points or through other digital interfaces, including mobile or internet-enabled platforms. The last mile connectivity approach can be analogous to a banking correspondent model with similar operating economics, and mobile-based delivery is akin to mobile banking services offered by banks. Both these approaches have been tried in India, and despite a huge potential, they have either suffered challenges around their viability or limited customer adoption. Moreover, with a limited suite of offerings and a capped deposit account, persuading customers to switch from their primary banks completely can be an uphill task. Under these circumstances, it is imperative for payments banks to address some of these challenges upfront, as they finalise their business strategy. In these subsequent sections, we have highlighted strategic considerations for payments banks before they sign-off their strategy and business models and move into operations.

Emergence of two distinctive segments within India - Payments banks can serve both

Besides offering basic deposits and remittance services, payments banks are likely to introduce smooth, real-time, secure, on-the-go approaches for facilitating retail payments. However, the interpretation of these propositions can be very different for two emerging facets of Indian consumers as described in our analysis below.

On one hand, the new breed of young, urban and internet savvy consumers are gradually shifting from internet banking and card-based payments to mobile and wallet-based payments to reap the benefits of multichannel, anytime, and any device banking. On the other hand, the rural and low-income consumer segments have limited penetration of basic banking facilities, and hence, limited awareness about how to use banking channels. Expectedly, adoption will depend on how services of payments banks resonate with emerging consumer briefs.

A comparison across two distinctive consumer segments illustrates a tale of two Indias, with different demographics, adoption patterns and challenges, and consequently, different expected propositions from new payments banks.

A tale of two Indias

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	Banked and technology savvy segment with higher internet penetration	Banked/unbanked/underbanked segment with limited access to internet facilities
Customer demographics	<ul style="list-style-type: none"> • Educated and technology savvy • Average age of 30 years • High-income segment • Mostly reside in metros, urban, or semi urban areas 	<ul style="list-style-type: none"> • Less educated with limited knowledge of using technology for availing services • Middle and lower income segment • Mostly reside in rural and semi-urban areas
Challenges faced in using new payment modes	<ul style="list-style-type: none"> • Slow/limited adoption by the banked, owing to user comfort with internet banking, ATMs/debit cards and card transactions • Lack of standardised and easy-to-use payment services • Lack of trust in mobile and wallet payments due to security and reliability issues • Existing mobile solutions do not facilitate cash-takeout 	<ul style="list-style-type: none"> • Low penetration of internet, ATMs, PoS, and other enabling infrastructure • Technology inexperience and literacy constraints • Lack of awareness about electronic and mobile payments • Cash continues to be the sole medium for effecting financial transactions
Payments banks potential propositions	<ul style="list-style-type: none"> • Secure and well encrypted payment platform • Standardised services enabled by mobile technology and enriched with data layer (white label apps to facilitate transactions) • More number of use-cases to provide compelling reasons to use digital payments, especially in Person-to-Person (P2P) and Person-to-Merchant (P2M) transactions • Customised merchant offers based on transaction history – both online and offline • Product add-ons such as cashbacks, discounts and loyalty programmes • Rich and visual tool sets for spend management and expense tracking 	<ul style="list-style-type: none"> • Access to basic banking services • Simple and intuitive payment platform with an option of multilingual interfaces • More often used, especially in Person-to-Government (P2G) and Government-to-Person (G2P) segments • A simple and dedicated domestic remittance platform • Customer education and handholding to drive adoption and facilitate usage • Onboarding of small retail merchants on the mobile payment ecosystem to effect non-cash transactions
New offerings	<ul style="list-style-type: none"> • Digital banking and payment approaches which are smooth, intuitive, functionally rich and support anytime, and any device banking • Strong set of customer incentive pull (loyalty programmes, discounts, cash backs) to drive enrolments and usage • Rich functionality and tools for spend management, etc • Integration with social media feed that understands and predicts what is needed 	<ul style="list-style-type: none"> • Route the direct benefit transfer through the mobile ecosystem to improve familiarity and adoption • Payment to/from the government on the mobile payment ecosystem (NREGA payments, small savings schemes) • Merchant acquisition services for small retail merchants in rural areas on the mobile payment ecosystem

Source: KPMG in India analysis, 2015

Payments banks have to be digital at core

Payments banks are expected to adopt digital strategies to acquire new customers and operate efficiently. However, an incremental approach to digital infrastructure may not yield the expected results, considering the structural constraints that have challenged incumbent banks in India for so long. Moreover, despite having human interface, as facilitated by the Business Correspondent (BC) network, there is still a lack of awareness of banking services and limited adoption of technology-enabled banking services in India. Payments banks have to be designed with a philosophy of 'digital at core' through which not only the front offices (customer touch points) facilitate digital interactions, but the complete banking value chain, including activities such as customer acquisition and onboarding, back-office operations, transaction processing, customer service, management reporting, employee engagement, etc., are also digitally enabled. These banks can offer a distinct digital experience to its customer, only if there is a complete coherence across different functional areas on how these digital interactions will move within the bank. Besides, providing revenue push and operational efficiency, digital interactions can also enable these banks to be more attentive to the needs of its customers. Without digital infrastructure at the core, payments banks may not be able to offer a consistent omnichannel customer experience, and consequently, may not be able to deepen their customer engagements.

BBVA's digitally driven strategy⁰¹

BBVA is a large Spanish bank with presence in Latin America and the U.S market. The bank is aggressively pursuing the digital banking strategy and now counts 30 per cent of its active customers as digital consumers - customers that primarily interact and transact through the internet or mobile channels. Of these, more than 50 per cent customers interact through the BBVA mobile app. The bank has been augmenting its digital capabilities through a series of acquisitions. It acquired multiple emerging Fintech companies, including the banking start-up, Simple, in the U.S. The bank is one of the largest investors in Fintech space and has been investing in big data and bitcoin platforms as part of its digital strategy.

Mobile first models could have an edge

With lower financial spreads, payments banks may not be able to cross-subsidise transactions to the extent that universal banks can. However, by migrating transactions to platforms with lower operating costs, it can reduce the marginal cost per transaction quite significantly, and thus, obviate the need for cross-subsidisation. As per the KPMG-UBS study⁰², mobile-based transactions are the most cost-effective as compared to other electronic and physical modes. Increasing penetration of smartphones in India is expected to remove some of the bottlenecks that have constrained adoption till now. With more intuitive interfaces and less complex payor procedures, a mobile-based transaction platform could be a key differentiator for a payments bank.

By having the right use cases, payments banks can replicate the adoption curve of mWallets, where transactions have grown more than 10 times in the last four years and doubled in the last year. Several standalone mWallets have registered 100 per cent growth in the number of users over the past six months, and currently has 15 million active users within 10 months of its launch, with close to 6.5 million users having revolving funds in their wallet.⁰³ By the time it converts into a payments bank, Paytm could have more than 50 million active users on its platform. This active user base can then provide a foundation to the new bank for offering a host of banking and related services to its large customer base.

Furthermore, mobile transaction switching and interoperability of mobile-based transaction processors can also provide a boost to the adoption of this channel. Transactions facilitated on Immediate Payment Service (IMPS) (interbank switch for mobile) have multiplied almost four times in the last one year. In May 2015, it recorded 1.46 crore transactions compared to just 35 lakh transactions in May 2014. The transaction value has also increased at the same rate with almost INR11000 crore worth of transactions being facilitated in May 2015. The average transaction size on the IMPS platform was nearly INR7500 in May 2015.⁰⁴

01. <http://www.euromoney.com/Article/3379655/Digital-banking-BBVAs-GonzalezThe-digital-banker.html?single=true>, accessed on 1 September 2015

02. <https://www.kpmg.com/UK/en/IssuesAndInsights/ArticlesPublications/Documents/PDF/Market%20Sector/Financial%20Services/kpmg-global-mobile-banking-report-july-2015.pdf>, accessed on 1 September 2015

03. <http://www.financialexpress.com/article/industry/companies/amassing-100-mn-mobile-wallet-users-wont-be-easy-for-paytm/53555/>, accessed on 1 September 2015

04. http://www.npci.org.in/testimps_analy.aspx, accessed on 1 September 2015

Physical branches need to complement digital banking

Digital banking is definitely the future of the industry, but the need of the hour is to introduce and induct the larger Indian population of first-time users to the world of technology-enabled banking services. This would require handholding and service assistance through physical interactions, and hence, physical presence in some form. The Reserve Bank of India (RBI) does not envisage payments banks as branchless banks for precisely some of these reasons. Moreover, as per the final guidelines, payments banks are also required to have at least 25 per cent of physical access points, including BCs in rural centres. With the exception of BCs, other applicants, including telcos, mWallet operators and payment processing companies could potentially face significant challenges in setting up new infrastructure facilities in rural areas, further placing pressure on profit margins.

We believe that the manifestation of RBI's requirement of physical branches could be very different for payments banks. They can leverage their existing network infrastructure, along with augmenting their reach through BCs and merchant networks, as well as introduce 'lean branches' to manage operational costs, particularly in the hinterlands. We also believe that the approach for metros and urban areas could be different and that the banks may introduce experiential banking through e-lobbies and customer hang-outs. These branches are expected to act as service stations along with showcasing products, and will be designed to enhance the brand appeal of the payments banks.

Umpqua Bank's retail design strategy⁰⁵

Umpqua Bank was a small community bank based in Portland in the U.S. Its unique retail design strategy translated the culture of a small community bank into an integrated brand experience and helped the bank grow from USD120 million to USD11 billion. While most banks focus on convenience and speed, Umpqua connected with localists, people who value community prosperity as much as their own. The bank branches are structured as part café and part community resource centres. Umpqua's retail experience highlights the concept of 'slow banking' which encourages customers to spend more time at the branch. Sponsored events include book signings, investment clubs and lectures. Umpqua Rewards is a loyalty programme that awards points for doing business with other members within the bank.

Merchant acquisition to be as central as adding new customers

Merchant acquiring will not just be an ancillary business for payments banks as it seems pivotal for its success. The much desired network effect for the transaction platform will only kick in when there is an adequate base of merchants and users on either

side of the transaction. Moreover, payments banks will have to target merchants across categories, geographies, and in both offline and online categories. These banks could potentially provide tailored services and innovative ways to structure interchange rates depending on the customer profile, transaction volumes, merchant campaigns, etc. Similarly, onboarding micro-merchants through mPoS and other low-cost infrastructure could be a differentiator, especially for telcos and BCs.

LevelUp's merchant acquisition model⁰⁶

LevelUp is a U.S based mobile payment processing company that has introduced the concept of zero transaction fees: Interchange Zero. LevelUp generates revenues when merchants run campaigns to attract new customers and offer cashbacks and discounts to their loyal customers. It takes a 40 per cent commission on the discounts and cashbacks offered by a merchant.

For example, if a merchant offers INR50 off your first purchase for a taxi ride, and after you have spent INR1000 you get another INR100 off, LevelUp will make a fee of INR20 (40 per cent) on the first discount and INR20 on the INR100 loyalty discount.

Merchants do not have to run campaigns and in that case, LevelUp is offering free processing. But the company expects a very high proportion of its merchants to run some kind of promotional offers, and hence the sustenance of its revenue model. Moreover, LevelUp reminds customers when they have not transacted at a merchant after a set period of time. On customers' birthdays, they can avail a free service, and at the end of the month customers can get an email, recapping how much they have spent and how much they have saved. Customers also have the option of leaving feedback for the merchant through the LevelUp app.

Payments banks also have to offer value added services to merchants where they not only facilitate merchant payments, but also help them generate more business by connecting them to the customers or make them more efficient by providing additional business services. To illustrate, consider this example, where a payments bank offers a free white label app for small restaurants that can be customised and used for taking and processing customer orders on a tablet or smartphone. This app can also connect to the PoS offered by the payments bank at the back-end and can further ease out the bill generation and payment processing for the restaurateur.

05. <http://www.idsa.org/awards/idea/design-strategy/umpqua-bank-design-strategy>, accessed on 1 September 2015

06. www.thefinancialbrand.com, accessed on 1 September 2015

Platform usage to drive enrolments

As per the KPMG-UBS study, users of digital banking channels, including mobile, report an increased likelihood of switching banks. Our hypothesis is that this may be due to underlying demographics factors, as these users are young, economically more active and potentially more demanding in expectations. Moreover, India has one of the youngest populations of digital banking channel users, with the average age of a user being 30 years. Therefore, a focus on only increasing customer enrolment may not yield higher revenues due to higher switching rates. Payments banks must start with focussing on increasing the usage rather than chasing customer enrolments. Their information system must also be geared to measure the active customer base and allied customer activity, apart from customer enrolments.

Social payments – usage leading to new customer enrolments⁰⁷

Venmo is a social payment mobile app that connects users' bank account and personal mobile contacts so that they can transfer funds to their contacts. To add contacts, for those who are already on Venmo, users simply search their phone contacts and friends in their social media network. To invite contacts who are not on Venmo, users send a pre-populated text to them with an invite link. The app is linked to the users' bank account, debit card or credit card and offers a one day settlement to the users' bank account.

Users can split payments and transfer funds, and every payment made appears in the Venmo newsfeeds, with information on who, when, and what for details of the transaction. Just like scrolling through Facebook newsfeed, other people on the Venmo app can see payment interactions between friends, if they are on the same network. It does not show anyone else's dollar amounts, but shows creative (and often very humorous) explanations written by the user and any likes or comments from others.

Like a status update, these transactions tell a story about what friends are up to – who went for dinner together, who shared an Uber, who got charged for concert tickets etc. Through these feeds, the app is able to insert itself into the daily rhythms of users and enjoys a very high customer engagement along with creating a network effect, thus adding more users.

The new definition of KYC for payments banks

Traditionally, banks started collecting customer information with the introduction of KYC regulations to deter fraud and money laundering and to ensure

compliance. However, KYC for payments banks will not be limited to just verifying the identity and address of a particular customer or a merchant. They will have to adopt a new approach for truly knowing their customer's expectations through their habits, purchase patterns, and online activity. These banks will have to add a layer of analytics around the Customer Information Record (CIR) that dynamically processes past transactions data, offers browsing history, as well as additional data shared by customers, including social media activity data.

Beyond compliance, this information can also provide insights that can help banks to customise offerings and also make sure that their communication is targeted at the customer in an effective manner, thereby improving this engagement. Of course, all these activities will have to be done by maintaining customer privacy and taking adequate consent at all times.

Fidor Bank - banking with friends model⁰⁸

Fidor Bank AG, based in Munich, Germany has pioneered its business model on crowdsourcing ideas, where its users not only decide what products the bank offers, but also the interest rates paid on their deposits. The bank has introduced a Facebook initiative, Like-Zins, which is the first user-driven interest rate model in retail banking. Utilising Facebook's like-button, users can directly influence the interest paid on their bank deposit in their FidorPay checking accounts. 'Liking' Fidor directly rewards customers for their activities around the bank in the social network ecosystem. The underlying rules dictate that as soon as 2000 likes are reached, the interest rate paid on the balance in the bank for the entire Fidor checking customer base is raised by 10 basis points per year, capped at a total rate of 1.5 per cent per year. The Fidor Bank Facebook community has affected the rate of interest paid on Fidor checking accounts by 0.5 to 0.7 per cent. Fidor's slogan is 'Banking with Friends'. Users are proactively asked to contribute to thinking about the future of the bank based on their preferences.

Work in progress is the new final

The business model of payments banks, encapsulating the product proposition, target customer segments, customer service channels, partnerships, etc. has to be developed in an agile and iterative manner so that it is always 'work in progress' and can undergo dynamic shifts, rather than just fine tuning. Hence, the operating model has to be premised on a lightweight approach that enables business, IT and organisation architecture to respond to external changes within weeks, rather than months and years.

07. www.thefinancialbrand.com, accessed on 1 September 2015

08. www.bankinnovation.net, accessed on 1 September 2015



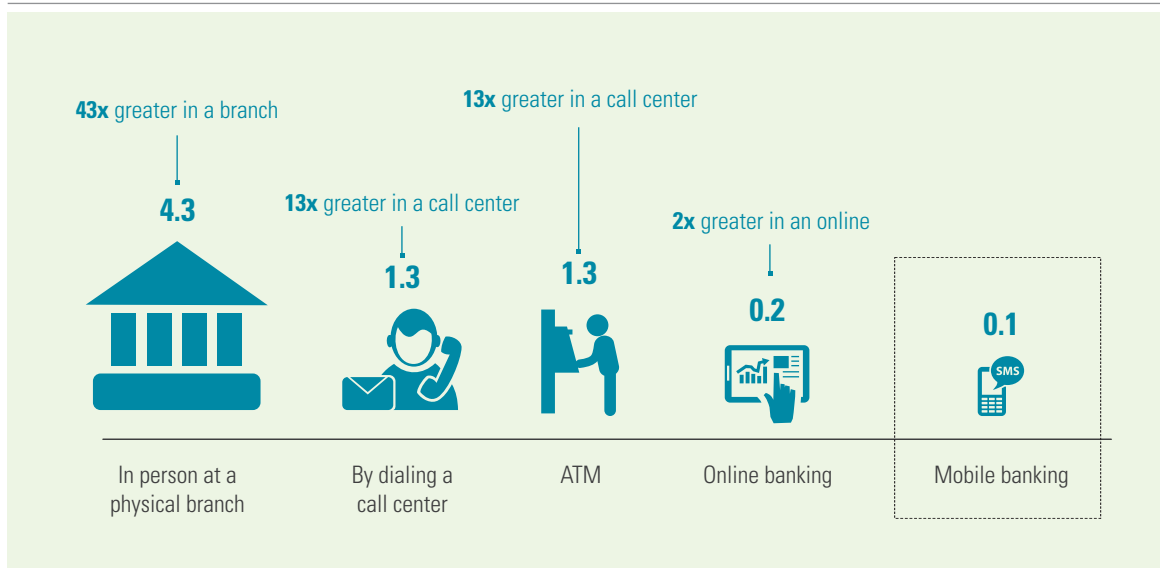
Road to success

The economic viability of payments banks has often been questioned in the absence of any fund-based business. However, the critique often fails to account for potential differences in the business and operating model of payments banks, coupled with a legacy-free IT and limited branch infrastructure. Moreover, these banks are expected to develop new capabilities and infrastructure, specifically on an asset-light premise as compared to the traditional branch-based and asset-heavy model prevalent in India. Consequently, the customer acquisition and servicing cost structures of payments banks may not follow those of a traditional bank. We expect that for the first three to five years, servicing costs of the payments banks will be lower and their customer acquisition cost will be higher than incumbent banks. So, along with keeping the thrust on transaction volumes, payments banks could also manage the levers of servicing and acquisition costs to further improve profitability, as described below.

Lower servicing cost

Profitability of payments banks is expected to be highly sensitive to transaction volumes and gaining critical mass of customers; however, the channel mix through which these transactions will be effected can also have a significant bearing on the overall profitability. Payments banks aim to push adoption of lower cost digital channels right from the start of their banking relationships. As per the KPMG–UBS study, the cost of effecting a transaction from a branch is almost 43 times, call-centre and ATM is 13 times, and internet banking is twice as compared to mobile transactions. Consequently, payments banks aim to promote and incentivise adoption and usage of mobile channels to all customer segments. Similarly, they are likely to employ digital customer service channels such as e-chats and Interactive Voice Responses (IVRs) to further lower customer service costs.

A comparison of customer servicing costs across various channels vis-à-vis the mobile channel



Source: Javelin Strategy and Research, 2013; KPMG in India analysis, 2015

Lower customer acquisition cost due to better advocacy

Traditionally, banks in India have enjoyed lower switching costs for a customer's primary bank account due to a host of reasons. As per the KPMG-UBS study, despite lower costs, customer advocacy in India has been low. This is illustrated by the net promoter score for India, which implies that although customers do not move their banking relationship to other banks, they are not as likely to recommend their bank's services to others customers in their network.⁰⁹ Payments banks are envisaged as high

engagement platforms as compared to traditional banks, and hence, are expected to enjoy higher customer advocacy, provided they are able to meet, or rather, exceed customer expectations. Higher advocacy could lower the acquisition costs of new customers. Furthermore, payments banks could also try to upsell and cross-sell to add new revenue streams using a common platform and spread the acquisition cost across multiple products.



09. <https://www.kpmg.com/UK/en/IssuesAndInsights/ArticlesPublications/Documents/PDF/Market%20Sector/Financial%20Services/kpmg-global-mobile-banking-report-july-2015.pdf>, accessed on 1 September 2015

Branchless banking by ING DIRECT Bank¹⁰

ING DIRECT Bank was a U.S. subsidiary of ING Bank and was an online-only bank that offered basic banking services, along with superior interest rates and a very low fee. Their ever popular basic checking account, ING Orange, enjoyed exceptional customer advocacy and was mostly promoted through word of mouth. To make customers comfortable about a branchless bank, it also introduced ING DIRECT Cafe - cafe styled branches where customers could know more about their services, interact with the bank staff, along with sipping their favorite coffee.

As part of global restructuring, ING divested the U.S. subsidiary to Capital One in 2012. Owing to the popularity of the ING Orange account, Capital One chose to continue with the features and functionality under a new brand name – Capital One 360.

Road to capturing transactions

Transactions are anticipated to be the holy grail for payments banks and their build-up will be due to the combined effect of new customer enrolments and the adoption of relevant use cases by customers. Our hypothesis is that most of these banks will have a large pool of captive customer base when they start operations, and customer enrolment will not be as critical a driver for them. It is the adoption of use cases that will drive transaction volumes. In the past, telcos, despite their large captive customers, have faced challenges to drive adoption and usage due to limited use cases and lack of cash-out options. Furthermore, to build competitive advantage through these use cases, payments banks may have to forge alliances and exclusive partnerships with government agencies, large merchants, large Non Banking Finance Companies (NBFCs) and Micro Finance Institutions (MFIs), etc. A robust customer use case mapping has to be designed based on the unique needs of the identified customer segments, which may help payments banks to target specific segments more effectively.

Merchant enrolment

Merchant enrolment is expected to be the key to improve adoption and usage of payment services offered by banks. Penetration of PoS infrastructure is very low in India. As per RBI data till May 2015, there are only 1.13 million PoS terminals installed in the country¹². To lower the infrastructure costs for merchants, many banks are experimenting with mPoS devices which are just an add-on to mobile phones or tablets and can be used for acquiring transactions through debit and credit cards. As per our hypothesis, lowering infrastructure cost is necessary, but not a sufficient requirement to improve merchant adoptions of PoS infrastructure. Therefore, strong propositions around merchant businesses can drive merchant enrollments, add a new revenue stream and improve the overall profitability of payments banks.

Leverage new and existing capabilities, and infrastructure

Most of the successful applicants will start with the existing infrastructure and capabilities that can be harnessed as they move to a payments bank. Depending on the business model, payments banks can leverage on the following set of capabilities as they embark on operationalisation:

- Distribution footprint - physical footprint for telcos, customer service points for BCs, and mobile app platform for mWallets
- Large captive customer base across all the channels
- Existing ecosystem for sales and service - agents and distributors may also lower customer acquisition cost
- Small merchant relationships, especially for telcos and BCs
- Technology infrastructure, where core banking functionality is being supported
- Personnel who have keen understanding and appreciation of the existing business and ethos of the current organisation
- Existing partnership and alliances that can be extended to the banking model.

10. <http://www.ing.com/Newsroom/All-news/Press-releases/PR/ING-to-sell-ING-Direct-USA-to-Capital-One.htm>, accessed on 1 September 2015

11. <https://www.bluebird.com/>, accessed on 1 September 2015

12. <https://www.kpmg.com/UK/en/IssuesAndInsights/ArticlesPublications/Documents/PDF/Market%20Sector/Financial%20Services/kpmg-global-mobile-banking-report-july-2015.pdf>, accessed on 1 September 2015



The way forward

Eleven considerations before setting up payments bank

Based on our experience in helping banks, payments companies and broader financial services players set up their businesses and grow, we have distilled our top 11 considerations as follows:

1. Protect the core and ring fence the bank build-up

Just as retaining existing customers will be as crucial as acquiring new ones, protecting business as usual will be as important as creating a sustainable banking franchise. Managing this transition with minimal disruption to existing businesses, and at the same time leveraging all the strength of existing businesses will be crucial in defining success.

2. Reassess and revalidate business strategy

Strategies developed during a limited time frame provided during the application, will require revalidation and, if necessary, redesigned to deepen business models. Newer value chains around the e-commerce ecosystem, urban corridors, MSMEs, etc. are emerging, which could have significant implications on business models. Flexible cost structures have also been evolving to significantly bring down the marginal cost of acquiring and servicing customers.

3. Build capabilities - digital at the core, human touch at the fore

Given the considerations of the Indian market place as well as customer dynamics, there needs to be a human element to the customer interface, even as the entire ecosystem needs to be digital. The interface could be voice, video or face to face but there is a need for a more human experience for better customer connect.

4. Analytics to provide once in a generation opportunity to create a customer-relevant business platform

Data driven decision-making is likely to be a digital differentiator to provide insights, to enable a more appealing approach to engage with customers.

5. FYC is the new KYC

Follow your customer will be as important in creating meaningful customer interactions as KYC is from regulatory and business considerations.

6. Relook at frugal innovation

Flexible models could leverage by reusing existing infrastructure, skill sets, networks and technologies to jumpstart some of the operationalisation activities.

7. No single window for regulatory approvals for operationalisation

This will require proactive management of multiple stakeholders, from getting the business structure aligned to the RBI guidelines, ensuring that regulatory milestones are met in a time bound manner.

8. Transformation is a big challenge and an opportunity

This is an opportunity to take a new look at skill sets, legacies, and branding and culture to build an organisation of the future. This would require an investment ahead of time. Managing internal challenges while in transition are equally important as are external ones. Players focussing on building skills, and talent and innovation are likely to be more successful than others.

9. Fintech to financial services is not what biotech is to life sciences

This is because the pace of change in technology and the opportunities it offers are extremely dynamic. Challenger banks are likely to set pace and industry standards on innovation, and hence, being nimble around operating models is crucial.

10. Growth, competition and customer demand are likely to foster collaboration and uncommon alliances

The need to address customer life cycle requirements may require alliances with traditional banks and other incumbents or even challengers; identifying the right partners with complementary skills could also be a differentiator.

11. Customer likely to be driven by value and not necessarily by price

If telecom services are taken as an example, cost differentiation is unlikely to be a compelling customer proposition, as would be service and experience differentiation.



// In summary

















As the 11 payments banks start their operationalising plans, incumbent banks are already investing in and getting ready for the retail onslaught likely to be unleashed by these challengers. However, re-deconstructing legacy technology building blocks, data warehouses and creating their digital presence across channels is going to be time consuming. So, there is this initial advantage that the challengers have

in creating a perceived edge over the incumbents and carry it over to the next decade.

Payments banks are likely to challenge the incumbents primarily on higher customer engagement, coupled with smooth transaction capabilities and volume-driven metrics. To summarise, payments banks are likely to follow the new 6Cs of banking, which can differentiate them from their incumbents.

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New 6Cs for payments banks

	Payments banks	Commercial banks
Customers 	Higher customer engagement 	
Channels 		
Culture 	alternative new innovative dynamic interesting enterprising collective different	official rigid structure tradition workforce governance bureaucracy regulation corporate
Costs 		
Capital 		Capital intensive 
Collaboration 	Many 	Few 

Source: KPMG in India analysis, 2015

Payments banks need to leverage upon customer analytics to drive contextual insights and experiences, and create stickiness which will be difficult to replicate and break. By offering location-based services, behavioural offers, customised solutions which open a 'secret window of opportunity', non-financial interactions, banking and transaction will be relegated to be a by-product of a broader customer experience. In fact, challengers will need to become the friend-in-need that follows the daily rhythm of the customers.

Variable costing models will allow challengers to invest in creating a truly omnichannel banking experience, which will take the bank to its customers. On-the-go banking – mobile and human handheld devices - are expected to reduce the differentiation between self-service and full service, while providing a smooth customer experience across multiple

channels. The challengers have the design advantage to build omnichannels that are fully integrated with the middle and back-end support systems to drive customer value.

While all the 11¹³ new entrants will get categorised as challengers, in reality, considering their pedigrees, most of them are likely to be very different from others; as seen in the bank licence wave in the 1990s, some will survive and flourish, few are likely to end up being forced into mergers. From an industry point of view, the job will be done once penetration is at par with the global average. From a unit point of view, it will mean survival, struggle, growth and finding the next platform with the focus on value creation at all times.

13. https://www.rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=34754, accessed on 1 September 2015

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