Modi’s money(less) masterplan

INTRODUCTION

Indian Prime Minister Narendra Modi unexpectedly declared trillions worth of 500 and 1,000 rupee notes no longer legal tender. The currency crackdown was organized to make good on his campaign pledge to take on the black economy, tax evasion, corruption and terrorism (in 2013 just 1% paid taxes, while India’s tax-to-GDP ratio is half that of OECD countries). Moreover, Modi’s initiative is the next step towards India’s digital financial system.

KEY FACTS

- 90% of India’s consumer purchases are made in cash. 85% of the Indians are paid in cash, and 65% don’t have bank accounts.
- India’s villages have only 18 ATMs per 100,000 citizens, compared to a global average of 43, and above 150 for most developed countries. Furthermore, Indians are not ‘digitally literate’ as just 17% of Indians own a smartphone and 22% use the internet ‘at least occasionally’ (compared to a 43% and 67% global average respectively).
- Almost three weeks after his currency crackdown, Modi called for a gradual move towards a cashless Indian society.

ANALYSIS

Modi’s demonetization initiative is radical, as Indians have until the end of 2016 to exchange their 500 and 1,000 rupee bills - 86% of all cash in circulation - for new 500 and 2,000 rupee bills or deposit them into bank accounts. But Modi’s currency reform is a step in a bigger plan that started in August 2014, when the Indian government launched ‘Pradhan Mantri Jan Dhan Yojana’: a financial inclusion campaign that brought millions of unbanked Indians into the formal banking system. As of June 2016, 220 million bank accounts have been opened and Rs 384 billion ($5.7 billion) has been deposited. In November 2014, India started the largest national identification project of the world, by issuing every Indian a unique identity number (Aadhaar, like the Burgerservice-nummer in the Netherlands). And in August 2015 the first Aadhaar-based cashless Direct Benefit Transfer System was introduced for ration card holders to combat subsidy malpractice. In April 2016 the Reserve Bank of India announced the United Payments Interface (UPI) which allows Indians to make digital payments via a single identifier (like Aadhaar), and together with Bharat Bill Payment Scheme (an integrated platform between banks and non-bank entities that enables various digital payment methods for bills, launched in August 2016) it constitutes India’s institutional foundation for digital payments. From this ‘fintech perspective’, Modi’s currency reform is the final nudge for Indians to embrace plastic paper to introduce fintech the hard way.

India’s potential fintech market is huge, and largely untapped: 98% of all transactions by volume are paid in cash, compared to 89% for Asia-Pacific and 64% and 76% for the Eurozone and US respectively. Even before the demonetization, Google and BCG estimated in July that Indian digital payments would grow to $500 billion in 2020, ten times from what it is now. More importantly, India’s consumer class is becoming more tech-savvy and willing to use fintech: internet penetration is expected to rise from 30% in 2015 to almost 50% in 2020 India’s smartphone penetration rate will double between 2014 and 2019, while e-commerce by Millennials is growing faster in India than other emerging markets. Furthermore, the profile of the Indian digital consumer will change: they will be older, more rural and more female, creating new chances and risks for India’s fintech industry. Understanding the preferences of India’s digital consumer will be key to win in India’s fintech boom.

POTENTIAL BENEFICIARIES

- Traditional Indian banks, as huge amounts of cash fill up bank’s balance sheets.
- India’s government, as tax evasion will become harder.
- Digibanks where Indian consumers can store money, like DBS.
- Insurers, as India lacks a regulatory framework for digital payment.
- Data service companies that provide digital oxygen in India (a lot of networks crashed in the days after Modi’s announcement).
- E-commerce websites, like Paytm and Freecharge.
- E-wallets used for digital payments, like Mobikwik.
- Big data companies able to determine consumer creditworthiness using big data from digital payments, like Alibaba does in China.