



# Changing preferences: UPI's dominance over digital wallets in the payments market

December 2019



# Foreword

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Dear readers,

It is our pleasure to bring to you the latest edition of PwC's Payments newsletter.

In this edition, we have analysed the current state of prepaid payment instruments (PPIs), changes in payments-related regulations and emergence of other convenient payment instruments/channels like Unified Payments Interface (UPI). We have examined the existing challenges for PPIs and how digital payments are expected to evolve, with a focus on new use cases, emerging regulations and new technologies/instruments.

We hope you will find this to be an insightful read.

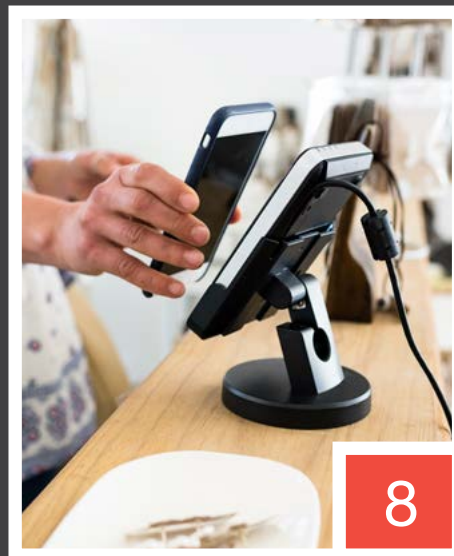
For details or feedback, please write to [vivek.belgavi@pwc.com](mailto:vivek.belgavi@pwc.com) or [mihir.gandhi@pwc.com](mailto:mihir.gandhi@pwc.com)



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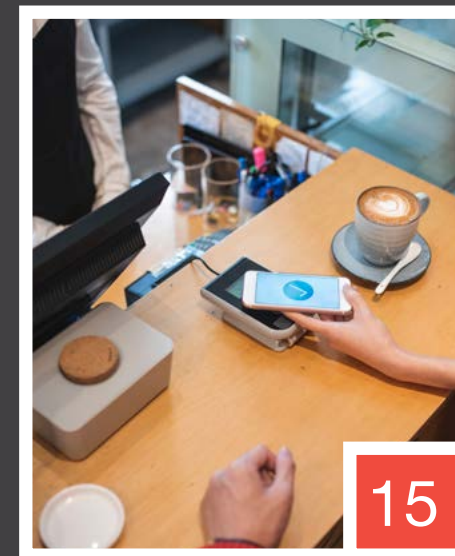
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# Introduction



# Introduction

Over the past few years, digital payments have witnessed tremendous growth in India. This growth has been largely driven by digital wallets and Unified Payments Interface (UPI). Speed and ease of access and attractive cashbacks are the reasons behind the widespread adoption of digital wallets by consumers.

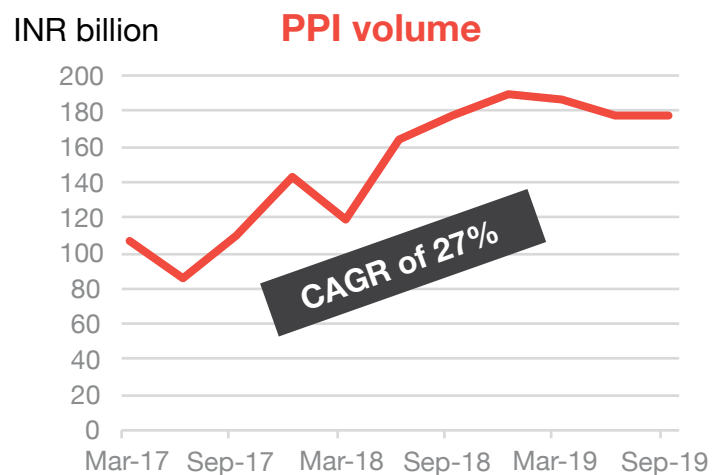
Digital wallets saw tremendous growth until 2017, while UPI has seen exponential growth in transaction volumes since that year.

Regulatory push, interoperability, virtual payment address (VPA), direct and instant transfer to bank accounts, etc., are the factors which have led to the unprecedented success of UPI.

Recent digital payment trends in India suggest that the UPI platform has been outperforming e-wallets rapidly, both in terms of value

and volume of transactions. Demonetisation proved to be an inflection point for digital payments. It also gave a big push to the adoption of e-wallets as a preferred mode of payment.

During the same time, smartphone-based faster payments modes like UPI (without the need for an additional store of value) have picked up pace. In this newsletter, we will attempt to analyse the reasons behind the wallet industry's declining popularity and growth compared to emerging payment instruments like UPI, and also assess what the future holds for payment instruments.



Source: PwC analysis







# Introduction

## Growth stagnation for digital payment instruments

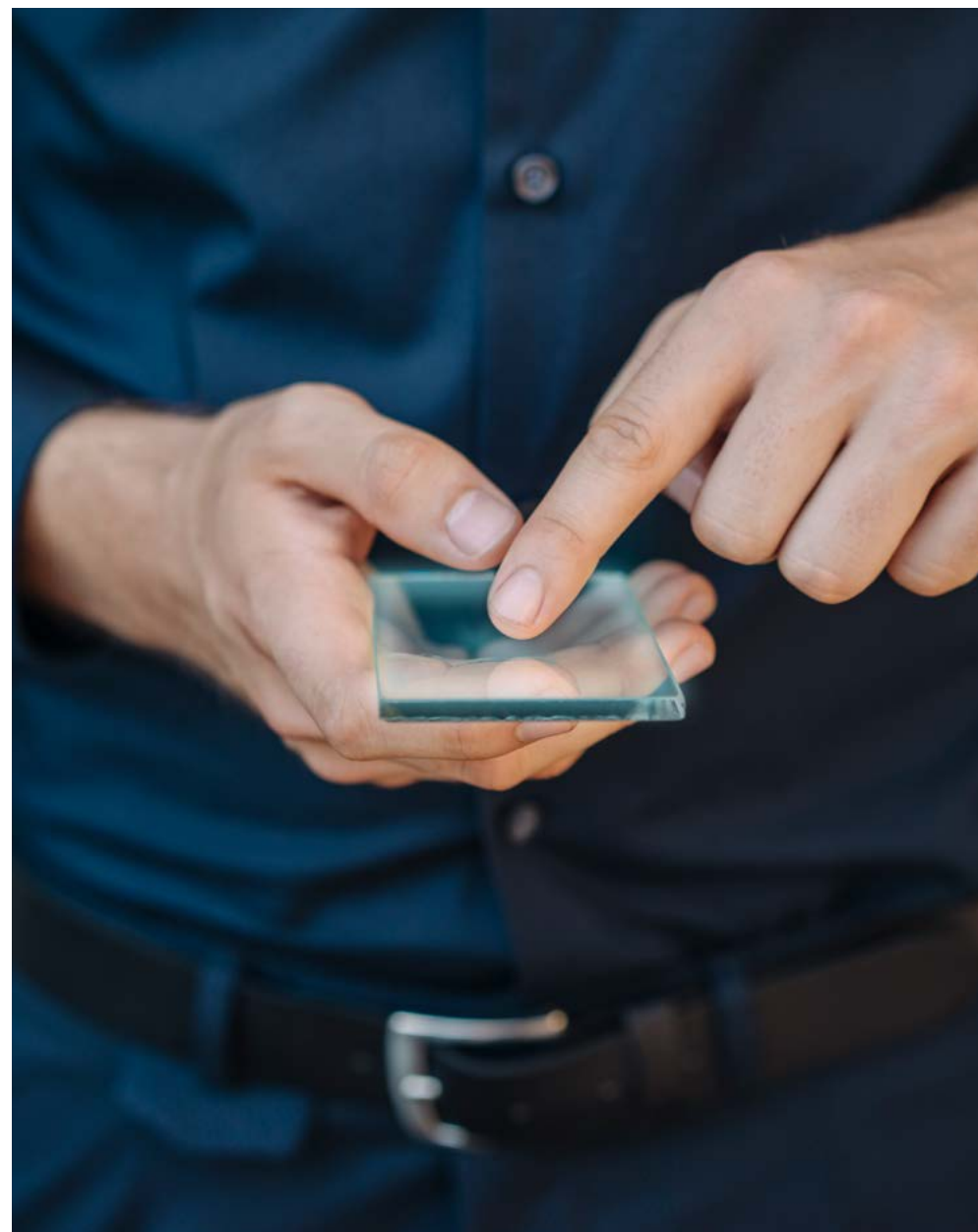
Digital wallets or e-wallets were at the core of the digital payment journey in the Indian economy till 2017. As per the Reserve Bank of India (RBI), there are 43 companies in the prepaid instrument market.<sup>1</sup>

Demonetisation created a cash crunch and thus provided a boost to digital wallets. But for the past one year, the growth has been stunted. As per the RBI's bulletins,<sup>2</sup> the volume of PPI transactions was INR 177 billion in September 2018. It grew to INR 186 billion in March 2019 but fell to INR 178 billion in September 2019. UPI transactions have gained traction and this has had an impact on the growth of digital wallets.

There are fundamental differences between the features of digital wallets and UPI-powered payment instruments. The convenience of not having to manage an additional store of value and lower merchant discount rate (MDR) for merchants have proved to be beneficial for UPI payments. Additional regulatory requirements for know your customer (KYC) details on e-wallets have hampered the growth of PPIs.

However, the RBI has introduced guidelines for new types of semi-closed PPIs. These wallets can have an outstanding balance of INR 10,000, and require the user's mobile number to be verified by a one-time password (OTP) to comply with KYC norms.

Preferences of customers are also changing as they don't want to have an additional store of value. Instead, they can leverage UPI to make payments directly from their bank accounts.



1. <https://www.rbi.org.in/scripts/publicationsview.aspx?id=12043>  
2. [https://www.rbi.org.in/scripts/BS\\_ViewBulletin.aspx](https://www.rbi.org.in/scripts/BS_ViewBulletin.aspx)



# Introduction

## Emerging payment instruments – UPI becoming more popular

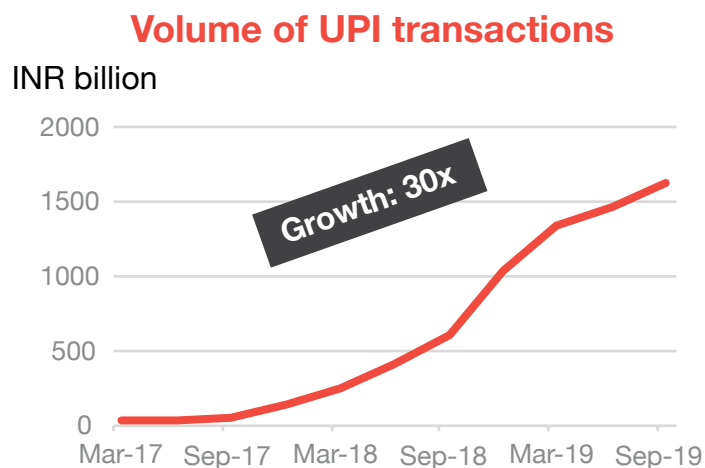
UPI provides a lot of convenience to customers, as well as merchants. Encouragement to use UPI by the National Payments Corporation of India (NPCI) and the Government of India (GoI), creation of a virtual payment address (VPA), marketing and promotion activities by FinTech players, increased participation by non-banks and interoperability have resulted in strong growth of UPI in the last two years.

As per NPCI,<sup>3</sup> the market share of UPI has increased from less than 1% in 2017 to 13% in September 2019, whereas PPI transactions accounted for to 1–2% of the market share in the last 2–3 years.

UPI has seen an exponential growth since its inception in April 2016. The entry of FinTech companies and private players in the UPI market

has further accelerated UPI's growth. In September 2017, the volume of UPI-based transactions was INR 53 billion, which grew 30 times to INR 1,614 billion by September 2019.

The Indian payments industry is expected to grow fivefold by 2023 to USD 1 trillion.<sup>4</sup> But with fast-changing market dynamics in the payments industry, digital wallets will continuously need to build new value propositions, augment their services and bring in payment adjacencies such as lending, loyalty and new businesses, to compete with faster payments.



Source: PwC analysis



3. <https://www.npci.org.in/sites/default/files/RETAIL-PAYMENTS-STATISTICS%20Nov-2019.xlsx>

4. <https://plus.credit-suisse.com/rpc4/ravDocView?docid=V7ax692AF-YEch>

A photograph showing a person's hands holding a smartphone over a payment terminal. The person is wearing a patterned shirt. The terminal is on a wooden counter. A white plate with some food is visible in the foreground. The background is slightly blurred, showing a shop or cafe environment.

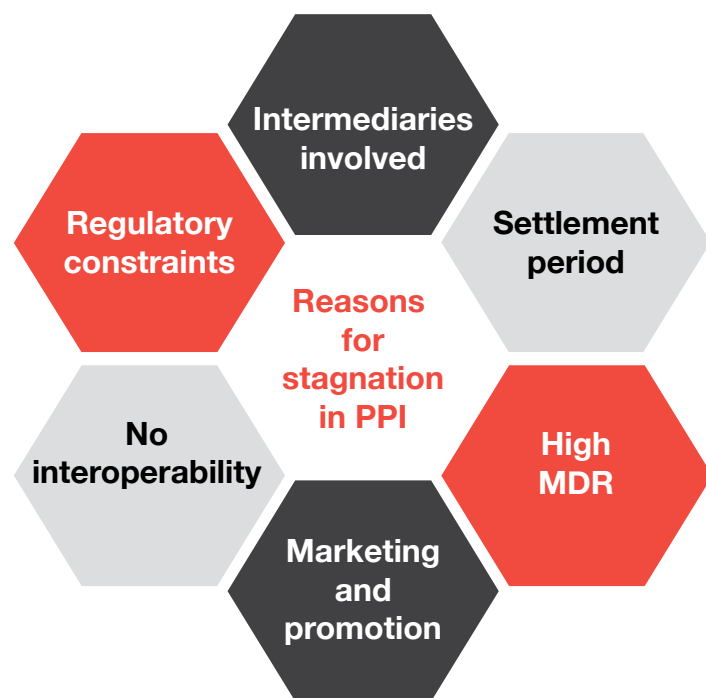
## Challenges to adoption and growth of PPIs



# Challenges to adoption and growth of PPIs

## Challenges faced by digital wallets

While there has been an overall growth in the use of digital payment systems in India, people are shifting towards bank-to-bank payment methods such as UPI, over other instruments such as e-wallets. The key reasons that are influencing customers to move away from mobile wallets have been analysed below.



Source: PwC analysis

## 1. Multiple intermediary steps involved

In digital wallets, users need to create a separate account and add money to it before beginning transactions. This adds to operational inefficiency for payments.

UPI allows frictionless transactions by directly debiting money from the user's bank account.

## 2. Longer settlement time

Digital wallets usually take T+1 day to settle payments in merchant accounts.<sup>5</sup> This leads to cash mismanagement problems and has an impact on merchants' credit cycles. In contrast, UPI instantly credits money to the beneficiary's account. Settlements can be made in multiple batches throughout the day.

## 3. High MDR

Compared to UPI, digital wallets charge merchants a higher MDR. The typical rate charged for wallet transactions is >1% of the total + GST, whereas for UPI transactions, the rate is 0.3% of the total + GST.<sup>6</sup> This encourages merchants to accept UPI payments instead of payments from e-wallets.

## 4. Cost-cutting in marketing and promotion

Digital wallet companies spent a lot to promote cashback incentives, as part of their customer acquisition strategies. Once the freebies were discontinued, customers moved to cheaper payment alternatives such as UPI.

5. <https://business.paytm.com/blog/merchant-support/>

6. <https://business.paytm.com/pricing>



# Challenges to adoption and growth of PPIs

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## 5. No interoperability

In digital wallets, both the sender and the receiver must be on the same wallet platform to make a transaction possible. UPI has overcome this feature and allows transactions on different platforms with different service providers.

## 6. Regulatory constraints

The RBI's mandate on physical verification to complete KYC norms of digital wallet users and double authorisation adds to the woes of digital wallet users.







# Way forward for digital wallets







# Way forward for digital wallets

There is no doubt that e-wallets have been losing ground to UPI rapidly over the last two years. However, all is not lost for the e-wallet industry and they need to figure out unique business offerings that can help them find their own space in the digital payments industry.

Some of the new growth opportunities which could be lucrative for e-wallets are as follows:

## 1. B2B market

India has huge potential for digital payments in the business-to-business (B2B) market. As per the Make in India website, there are almost 6.8 million micro, small and medium enterprises (MSMEs) registered on the Udyog Aadhar Memorandum.<sup>7</sup> Most of them are heavily dependent on cash transactions for their financial operations. This provides an immense opportunity for digital wallets to extend their services in the B2B space.

Due to continuous operations and financial transactions, the B2B space provides a lot of certainty to cash flows. Digital wallets can charge a small fee for managing their accounts, which invariably takes care of their bottom line.

Apart from MSMEs, there is a huge network of wholesalers and retailers, most of whom are already acquired as merchants by digital wallet players. This network can be catered to by wallet services as customers as well.

## 2. Short-term lending

Digital wallets can offer quick disbursement and accept digital documentation for short-term lending. This is a huge financial gap in the Indian economy, which conventional banks are finding difficult to fill.

This service can again be extended to retailers. Digital wallet companies already have details of transactions by merchants, which can be used for building risk profiles for lending purposes. Extension of this service will add to the revenue source of wallet companies.



7. <http://www.makeinindia.com/msme>



# Way forward for digital wallets

## 3. International remittances

Cross-border remittance is a new business opportunity for wallet players to leverage. Conventional financial institutions are inefficient with international remittances in terms of both cost and time.

Wallet players can design a solution which would enable customers to transfer money overseas quickly and at a lower transaction cost.

## 4. Expense reimbursement

Reimbursement expenses are usually managed by a standalone system. Wallet players can tie up with corporates to manage employees' expenses in the e-wallet itself. This can be clubbed with a loyalty programme. These expenses can be recorded, reconciled and reimbursed in the same application.

## 5. New target segments

Digital wallets need to empower last mile payments in India. There is still huge market potential in tier 2 and 3 cities, which is yet to be fully explored.

There are unbanked and risk-averse customers who cannot be served by UPI. Reaching out to such customers will provide the necessary growth opportunity for digital wallets.

The market potential for the digital wallet industry is huge and remains unexplored. Players who move first and innovate continuously will be able to capitalise on the opportunities.

Industry outlook will also depend on regulatory policies.

## Regulatory policy shaping the payments industry

Policies regarding KYC norms, interoperability, data localisation and transaction pricing will determine the future of the payments industry to a large extent.

There was a lot of uncertainty regarding KYC norms for PPI wallets. It started with minimal KYC, but eventually, the RBI directed that PPI wallets need to comply with full KYC norms, which increased operational costs among wallet players.

In December 2019,<sup>8</sup> the RBI introduced a semi-closed PPI. The minimum KYC requirements for operating these wallets are the user's mobile number verified by an OTP and a self-declaration. This allows users to have an outstanding balance of INR 10,000 at any point of time. But these PPIs can only be loaded by a bank account and used for purchase of goods and services and not for funds transfer.

Digital wallet providers need to actively work with regulators and policymakers to design policies for digital payments.

8. <https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=11766&Mode=0>



# Way forward for digital wallets

## Future landscape of digital wallets

The digital wallet industry is going through a stagnation phase. Strong, innovative measures/offerings need to be taken soon to sustain the wallets business. Some of the steps digital wallet players can take are:

### Consolidation

1

Industry stagnation calls for consolidation, where market leaders will look to acquire smaller players and expand their customer base both organically and inorganically. They must also rationalise pricing to set an industry standard for others to follow. This will eventually result in enhanced profitability.

### Diversification

2

The industry players will also look for new business opportunities such as the B2B payments market and lending space. They will also look to collaborate with other payment instruments such as UPI to bring out the synergies among payment channels.

### Penetration

3

Tier 2 and 3 cities are the new future markets for digital wallet players. Wallets should focus on harvesting growth from these areas. Bringing unbanked customers into the digital payments space will be another key business driver for the growth of digital wallets.

### Sell-off/exit

4

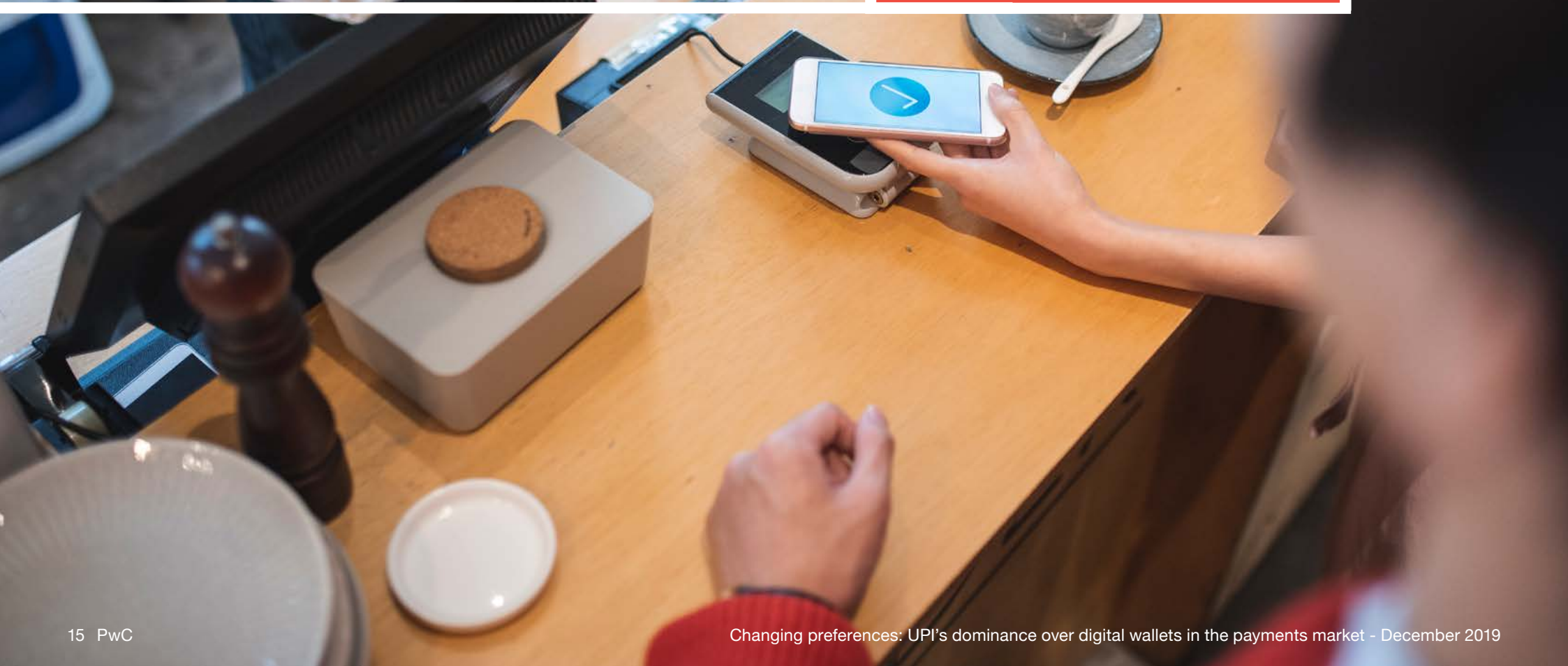
Lastly, a few players will try to acquire a large customer base by following a competitive pricing strategy. These players will either merge or sell off their business operations and existing customer base to large players.







# Payments technology updates





# Payments technology updates

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## Google wants US Fed to replicate India's UPI model

*Business Standard*

The time has come to examine exactly how The US Federal Reserve, or the Fed, should replicate India's Unified Payments Interface (UPI) model for its proposed interbank real-time gross settlement (RTGS) service, Google has recommended.

**Read more.**

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## Paytm now only app offering NEFT, IMPS, UPI, wallet and card payments

*Livemint*

With the Reserve Bank of India (RBI) making online NEFT transfers 24/7 on all days including weekends and holidays from Monday, India's digital payment leader Paytm has become the only payments app offering three ways to pay 24x7 seamlessly, within the same "Money Transfer" flow via UPI, IMPS and now NEFT mode.

**Read more.**

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## RBI to introduce new prepaid payment instrument for digital transactions up to Rs 10,000

*Economic Times*

The Reserve Bank of India's (RBI) proposal to introduce a prepaid payment instrument (PPI) for transactions up to Rs 10,000 on goods and services will give good competition to Google Pay, Paytm, PhonePe etc.

**Read more.**

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## Paytm payments bank eyes small finance model

*Times of India*

Paytm wants to convert its payments bank into a small finance bank as that will allow it to lend to its customer and build a more profitable growth model.

**Read more.**

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# Contact us

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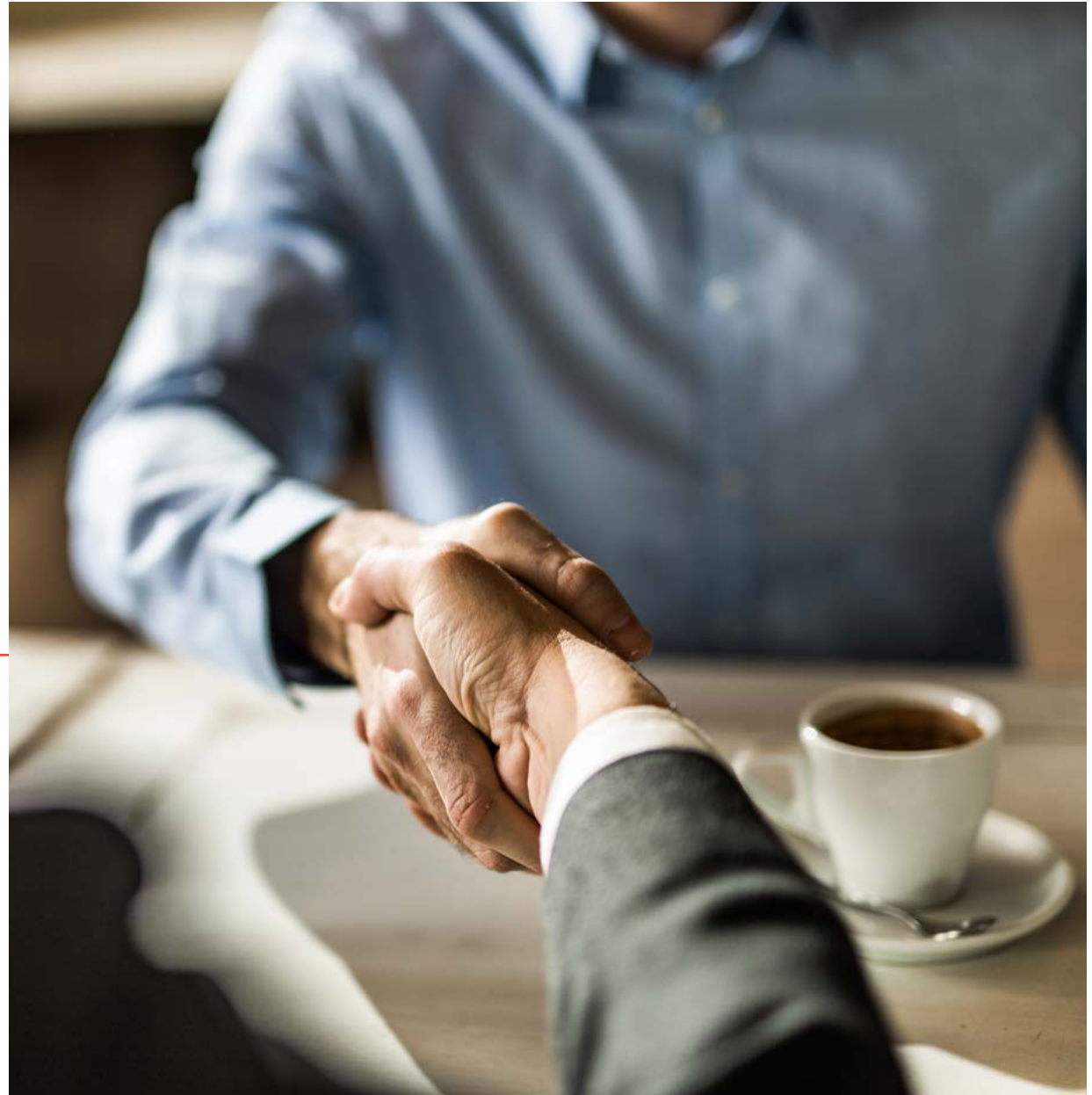
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