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Opinion: What makes merchants adopt digital payments?

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Merchants across the board perceive little or no cost in cash transactions, which can be settled bilaterally and are anonymous

Digital payments form the bedrock of deeper financial integration for micro enterprises, which constitute**s** 99% of India's approximately 60 million-strong micro, small and medium enterprises (MSMEs). Broader financial services, such as credit, insurance and wealth management, can be contextually and cost-effectively provided in digitized and personalized formats on top of digital transaction footprints. Such access to affordable finance can translate to financial stability and growth for business owners that are otherwise vulnerable to cash flow volatility and suffer from constrained access to capital to grow. And this can have a profound impact on job creation, economic growth and quality of life for hundreds of millions.

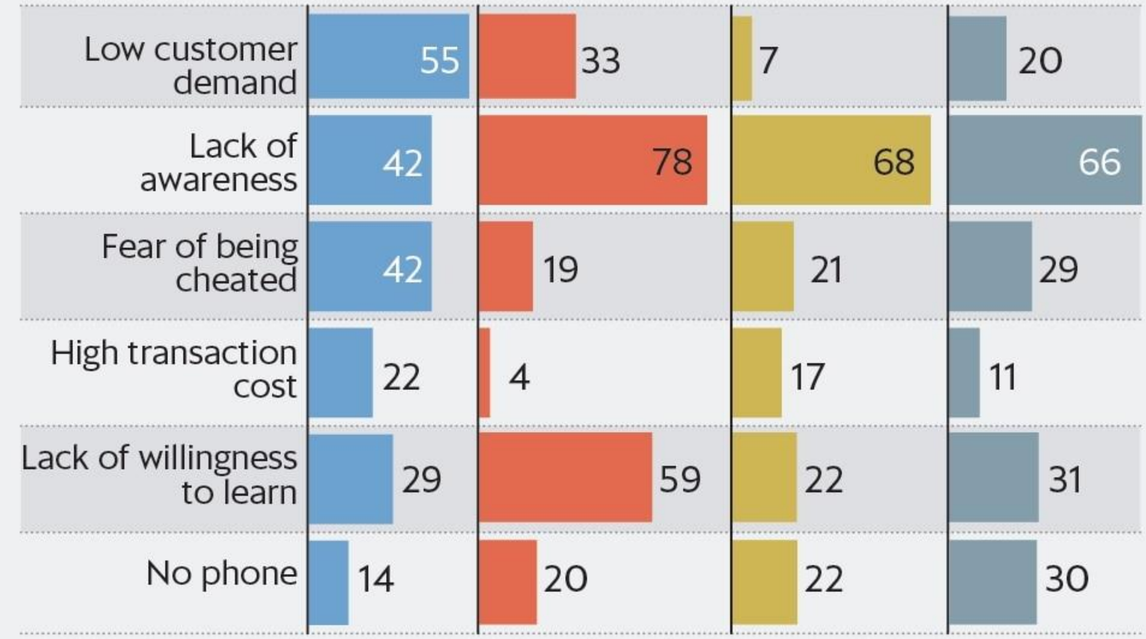
There are notable supply-side initiatives to promote electronic payments, such as the setting up of public infrastructure platforms like the India Stack. We now have interoperable and efficient payment systems such as Bhim-UPI (unified payments interface), which are becoming more reliable as they mature. It is hoped that such transactions will only become safer with the much anticipated user consent-based mechanisms to govern commercial use of data.

Despite these ambitious initiatives, however, last-mile barriers are still writ large. Behavioural factors, weak economics and low product relevancy limit usage on the ground. For entrepreneurs and retailers who have creatively coped with cash for centuries, digital money poses an economic threat to their informal businesses and, ultimately perhaps, to their very survival. And digital propositions that provide immediate, tangible value and adequate levels of trust to small businesses are simply elusive.

Digital payments: a survey of merchants' perception

Fixed-store merchants | Home-based businesses | Individual service providers | Street and roving vendors

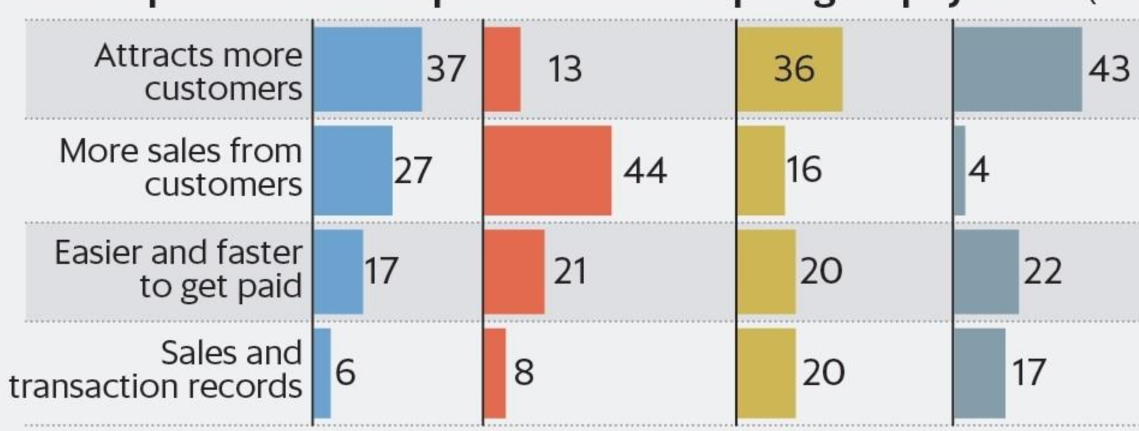
Primary reasons for non-adoption of digital payments* (in %)



*For example, 55% of fixed-store merchants cited 'low customer demand' among the top 3 reasons for non-adoption

Digital payments perception among respondents (in %)

The top reason for respondents to adopt digital payments (in %)



Source: A Catalyst-PRICE survey of 2,500 small businesses in Jaipur

To investigate potential barriers and opportunities for merchant adoption of digital payments, our organizations have surveyed 2,500 small businesses of different kinds in Jaipur over the past year. We find a staggering diversity across the micro-business landscape, which can be instrumental in developing tailored solutions. The fundamental divide lies between merchants with investments in fixed establishments versus the longer tail of home-based businesses, street and roving vendors, and individual service providers. The former tend to be formally registered, higher educated and operate at a larger scale. They are early adopters of digital payment solutions, with 42% having tried and 35% using popular solutions like wallets and internet banking. In contrast, the latter category of merchants are largely informal, illiterate, and operate on a smaller scale, showing 2-7% adoption rates. They also have much lower access to banking, smartphones and the internet, and have little awareness and understanding of digital payment solutions, as well as lower overall business confidence. Interestingly though, these businesses have significant cash footprint and demonstrate pain points around customer collections, need for working capital and the inability to save in large amounts, all of which can be addressed through appropriate digital financial solutions.

Even within these broad categories, there is variation in business and social context. Businesses with higher transaction size and turnover show greater tendency to adopt. Some businesses—for example, wholesale, convenience or speciality retail shops—also tend to have different transaction contexts and customer profiles. Illustratively, in our sample, only 13% of the dairy booth merchants had adopted digital payments versus 53% of the apparel and footwear merchants.

Our study also underscores the need for an ecosystem approach, recognizing that merchants don't make isolated adoption decisions. They factor in the preferences and constraints of their transaction counterparties, namely consumers and suppliers. Around 55% of fixed-store merchants reported lack of customer demand for digital payments as a primary reason for non-adoption; for long-tail categories, lack of awareness was by far the major obstacle. For those that saw business benefits of digital payments, the prospect of new customers and higher sales per customer were primary motivators as well. A majority of non-adopting fixed stores also indicated that they would use digital if asked to do so by their suppliers, presenting an opportunity to digitize supply chains leveraging new goods and services tax (GST) and payments (e.g., UPI) infrastructure. In short, effective merchant digitization strategies need to address local ecosystems of customers, suppliers and, perhaps, also get additional stakeholders, such as employers, local governments, and intermediary agencies like non-governmental organizations (NGOs), on board.

While much of the ecosystem focuses on the cost of cash as a rationale to go digital, we find that merchants across the board perceive little or no cost in cash transactions, which can be settled bilaterally and are anonymous. Less than 1% of the merchants reported any cash being stolen in the past year, and experienced no significant cash handling or reconciliation concerns. While there are certainly large efficiencies to be had across the other parts of the payment value chain (e.g., cash processing and logistics costs borne by banks), these are unlikely to be internalized by small merchants, especially given counterweighing factors like tax arbitrage and cash-to-digital transitional costs.

Our learnings suggest that to galvanize merchant digital payments at scale, there can be no “one size fits all" template. A niche and verticalized innovation approach, wherein solutions are customized to specific micro-segments, use cases and ecosystems, will prove more fruitful. Second, the digital value proposition needs to shift from operational efficiency to immediately realizable top-line benefits for the business. To do this, digital payments should be embedded in broader business processes that can be comprehensively digitized. After all, the best payment experiences are invisible.

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This is the first part of the Mint-Catalyst series on digital payments. The second part will discuss the learnings mentioned above, and some recommendations, in greater detail.