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Modernising Online Payments Regulations to Support e-Commerce in Sri Lanka

As Sri Lanka moves into upper middle income and beyond, the country aims to grow its digital economy by providing new opportunities to digital entrepreneurs and foster new efficiencies in all sectors through enhanced digital services for all. In this context, the Economic Intelligence Unit (EIU) of the Ceylon Chamber of Commerce held an interactive roundtable discussion in March 2016 with leading digital entrepreneurs who have a particular focus on e-commerce. Challenges in the online payments space were identified as a key constraint faced by them. In this fourth edition of the Strategic Insights series, the EIU looks at the current challenges faced in the e-Commerce arena with regard to online payments. The study is based on in-depth interviews and an online survey with e-commerce firms across multiple verticals, online payment service providers, and relevant government institutions.

The Growing Importance of e-Commerce

According to the United Nations Conference on Trade and Development (UNCTAD, 2015)[1], e-commerce has become important to firms in developing countries as it provides greater market reach, enhances participation in international supply chains, and improves firm-level and market efficiencies. E-commerce is being recognised as 'the great equalizer in international trade', providing new Business-to-Business (B2B) and Business-to-Consumer (B2C) opportunities that previously did not exist.

The Sri Lankan e-commerce industry has shown promise during the last five years, and experts predict the market is likely to grow from 1% of annual consumer sales in 2015 to 3% in 2018[2]. The expansion of the industry is attributed to the recent growth in mobile penetration, which has now reached 107% (2016)[3]. Despite the prospects of an expanding customer base, driven by advances in the telecom sector, Sri Lanka is far behind regional players such as India, Singapore, Malaysia, and Indonesia (see Figure 1). While the number of internet users are growing in Sri Lanka, this is yet to convert to e-commerce sales as in other countries in the region. Despite this, majority of the[4] e-commerce firms interviewed stated that they are eager to expand their domestic customer base.

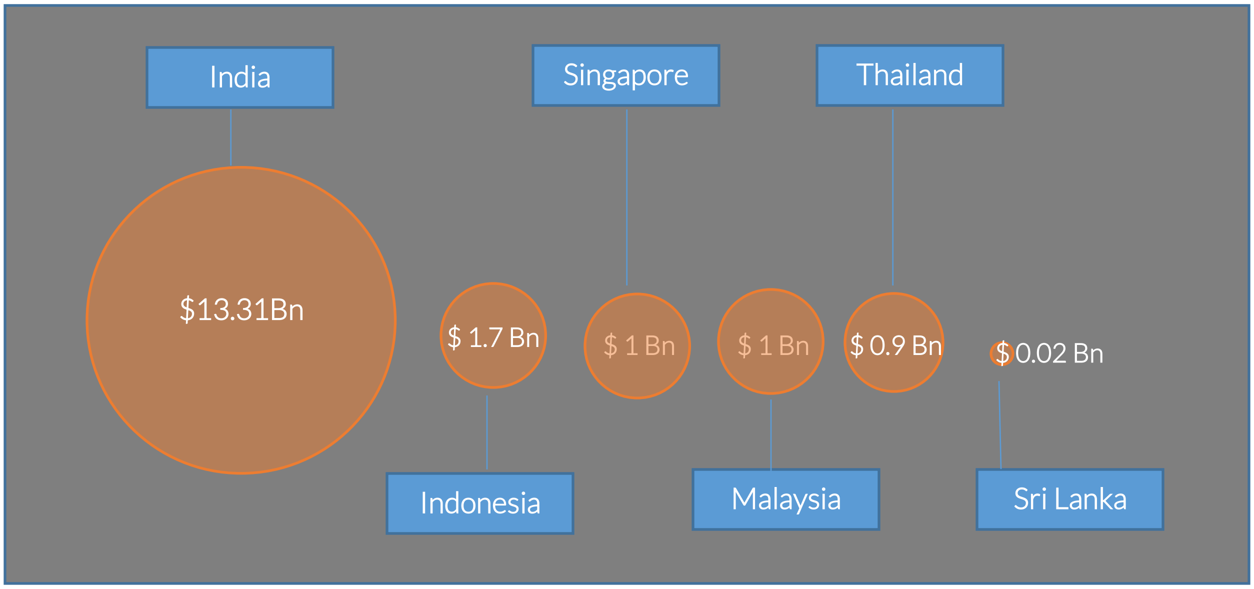
[1] UNCTAD (2015), Information Economy Report 2015: 'Unlocking the potential of e-Commerce for Developing Countries', United Nations Conference on Trade and Development: Geneva

[2] Daily News, "Online sales growing in Sri Lanka at fast pace – Google", available at http://dailynews.lk/2016/03/31/business/77914 [accessed on 04.01.2017]

[3] The Sunday Leader, 'Mobile Boom', Jan 3rd 2016, available at http://www.thesundayleader.lk/2016/01/03/mobile-boom/ [accessed on 04.01.2017]

[4] Based on interviews with e-Commerce vendors

Figure 1 – Sri Lanka Online Sales vs Regional Markets (2015)



Source: TechInAsia[5]; Daily News[6]; and EIU calculations

Although e-commerce firms are largely optimistic about the growth prospects of the market, they encounter significant operational obstacles brought on by regulatory issues. In particular, the restrictive environment for online payments was reported by leading e-commerce firms as a significant challenge to small and large players alike. E-Commerce firms and payment service providers both agree[7] that the outdated laws have held back innovation and growth in this area and this is discussed in detail in the following sections.

Online Payment Platforms in Sri Lanka – Regulatory Restrictions and Limited Market Opportunity

Most businesses in the e-commerce space reported that access to an affordable online payment platform for all businesses is key to development of the industry. The limited options for transacting online can be attributed to the restrictive regulation in Sri Lanka, which limit the type of companies eligible to provide financial services on e-commerce platforms. While the recognition, use and receipt of electronic records is regulated through the Electronic Transactions Act, No 19, of 2006, it is the Payment Cards and Mobile Payment Systems Regulation No. 1 of 2013,[8] which specifically addresses the guidelines for transacting online. According to the regulation;

"No person shall engage in the business of or function as a Service Provider except under the authority and in accordance with the terms and conditions of a license issued by the Central Bank";

[5] TechInAsia," Singapore e-commerce market to exceed S$7b in 2025: Report", available at http://www.channelnewsasia.com/news/business/singapore-e-commerce/2811118.html [accessed on 04.01.2017]
[6] Daily News, "Online sales growing in Sri Lanka at fast pace – Google", available at http://dailynews.lk/2016/03/31/business/77914 [accessed on 04.01.2017]
[7]Based on interviews with e-Commerce vendors and online payment service providers
[8] Payment Cards and Mobile Payment Systems Regulations No. 1 of 2013, Gazette No. 1813, made by the President under Section 17 of the Payment and Settlement Systems Act, No. 28 of 2005, read
with Section 11 of the said Act and paragraph (2) of Article 44 of the Constitution.

The Regulation further describes the institutions/entities eligible for receiving the license to act as a service provider and include – "*licensed commercial banks, licensed specialized banks, finance companies or an operator who provides cellular mobile telephone services under the authority of a license issued in terms of the Sri Lanka Telecommunications Act No. 25 of 1991*".

If an institution does not fall under the categories listed above, "a company registered under the Companies Act, No. 7 of 2007 having an unimpaired capital of at least Rupees One Hundred and Fifty (150) Million or such other amount determined by the Central Bank" may also be entitled to act as a financial provider and thereby be able to provide the facility to transact online. Clearly, the opportunities for providing online payment services are limited to either banks, telecommunication companies or large corporates with a significant amount of capital.

These stringent regulations pose two major barriers to e-commerce companies transacting online.

1. Internet Payment Gateways and their Unique Challenges

Licensed commercial banks are the main institutions[9] that are currently providing an online payment solution through an Internet Payment Gateway (IPG). IPGs are a virtual 'card-swiping' machine similar to those we encounter at most retail outlets in the country. IPGs are however not a simple solution and require e-commerce firms to connect to the platforms provided by the banks (also known as 'integration'). The need to connect with platforms of the banks present another level of challenges to the e-commerce firms, two key challenges they encounter include;

a) The need to contract with multiple banks to access multiple cards, and
b) The high cost of integration and maintenance

a) The need to contract with multiple banks

In order to provide online payment facilities, licensed commercial banks are required to partner with various payment card providers such as Visa, Mastercard, and American Express. Given that -

[9] According to interviews with e-Commerce vendors, Global Payments – a global provider of electronic transaction processing services- is a non-banking entity currently operating in Sri Lanka.

- customers may possess one of each of these card types, e-commerce firms are required to make all available card types accessible to their customers. However, no single bank offers all card types, and firms are required to contract with multiple banks in order to offer all available card options. The cost of integrating e-commerce platforms is considerably high and these costs may not be feasible to all e-commerce firms, especially start-ups and small businesses with limited capital.

b) The high cost of integration and maintenance

The cost of integrating an IPG is generally quite high and includes set up fees, maintenance fees, commissions on every transaction, and a mandatory fixed deposit which can range from between LRK 100,000 – 300,000 depending on the bank (see Figure 2 below). A recent study[10] revealed that the cost for maintaining an IPG for a year could amount to between LKR 75,000 and 165,000, not accounting commissions and fixed deposits.

For startups, with limited capital and tight operating margins, integrating an IPG can therefore be prohibitively expensive, given the steep costs involved. However, it must be noted that banks have justified the high fees of 3-4% as they are required to pay nearly 2% of each transaction as interchange fees to the payment card providers such as Visa, Mastercard, and American Express.

Additionally, merchants and customers alike remark that many banks' IPGs have outdated interfaces and security features; they take the customer out of the merchant's website on to an IPG website and back again, and are off-putting for customers. Several instances were reported of customers who are taken to the separate site not completing the transaction, either because they don't feel comfortable and voluntarily quit, or because the redirection from the IPG site to the merchant's site does not take place due to a technical error.

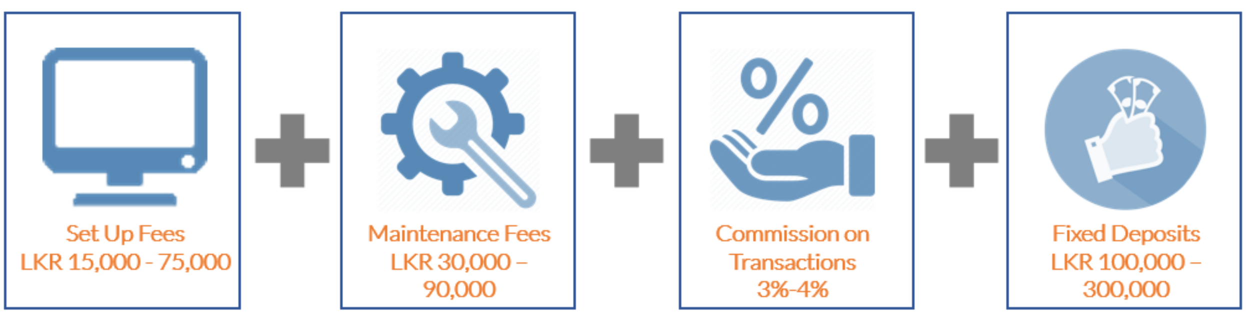


Figure 2 – Estimated Cost of Integrating and Maintaining an IPG

Source: ReadMe.lk; Interviews with banks and industry experts

[10] ReadMe, 'Payment Gateways in Sri Lanka: What you need to know'; available at http://www.readme.lk/payment-gateways-sri-lanka/ [accessed on 04.01.2017]

2. Large Capital Requirements for Facilitating IPGs

As stipulated in the Payment Cards and Mobile Payment Systems Regulation, the only other available avenue for e-commerce companies would be to develop their own IPG. However, the Payment Cards and Mobile Payment Systems Regulation stipulates, that a company should possess *"an unimpaired capital of at least Rupees One Hundred and Fifty (150) Million…" and* for e-commerce companies committing such capital in order to provide an online service would not be feasible. Majority of the e-commerce firms interviewed stated that it was extremely important that Sri Lanka amend these restrictive laws to facilitate better access to online payment platforms.

E-commerce firms interviewed also noted that some banks required them to be in business for two years prior to being able to integrate their IPG.

Alternative Payment Platforms: Attempts to Address Market Needs

Companies such as PayHere, BizPay and WebXPay have identifying the imminent need for affordable online payment mechanisms, and sought to address this gap in the market. By acting as a mediator between the IPGs facilitated by the banks and the firms requiring online payment (like e-commerce vendors), these companies have aimed to minimize the cost to a single vendor. Some of these entities were however deemed to be in violation of the Payment Cards and Mobile Payment Systems Regulation, as they had assumed the role of the 'service provider'. Consequently, these firms have ceased this service but are hopeful of revisions to the regulations to enable them to operate.

The need for an affordable online payment platform was evidenced by the response to PayHere when it entered the market. In the first two months of operation, the company received 250 pre-registrations to the platform and processed more than 1,300 payments. According to the CEO of PayHere, the company's success was attributed to the simplicity of the platform as well as the affordable charges as there was no set up or maintenance fee[11].

Way Forward

Given the need to expand the country's e-commerce industry, Sri Lanka should consider better serving this industry by facilitating affordable online payments. A key step towards this is revising existing regulations to make them less restrictive and more in line with contemporary as well as emerging needs of the digital economy. This can foster new innovation in online payments in the country, and even provide new opportunities for incumbents in the banking sector.

Meanwhile, it is also important for Sri Lanka to enable vendors and customers in the country to access globally-used online payment platforms in order to connect to the global digital economy. It is reported that the Information Communication Technology Agency (ICTA) has had discussions with 'Stripe' and 'Paypal' - both online payment platforms used globally – to provide their services in Sri Lanka, but progress on these is unknown.

[11] Based on an interview with the CEO of PayHere.

A key success factor in the advancement of online payment platforms in other economies in the Asian region was the continued dialogue that payment providers and e-commerce firms had with government regulatory authorities like the Central Bank of Sri Lanka. It is now an urgent need to bring regulations up to speed with business and customer needs, and to facilitate e-commerce as an industry that can not only foster greater consumer choice and convenience but also enhance competitiveness and market reach for SMEs.

This edition of the EIU's Strategic Insights series aims to highlight the current challenges with online payments in Sri Lanka and the importance of amending regulations in order to improve the climate for businesses in this space and strengthen investor confidence. Further in-depth research would be required to identify specific bottlenecks to the industry and strategies for overcoming these challenges. Robust and constructive dialogue with all stakeholders would be a good starting point for addressing these and paving the way for a vibrant e-commerce sector in Sri Lanka.

Prepared by the Economic Intelligence Unit (EIU) of the Ceylon Chamber of Commerce:

Author:

Shenali de Silva, Research Associate
shenali@chamber.lk

Series Editor:

Anushka Wijesinha, Chief Economist
anushka@chamber.lk