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Understanding the Working of Banking System in India and with a Shift towards Digital Economy and the Rise of Private Banks

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***Abstract*: The Banking Policy has a lot of influence on our saving and expenditure pattern and structure of loan system of a country. Indian Banking system has grown and emerged over the years providing new schemes for the people to become financial stable and have a better lifestyle through investment and keeping their fund safe. The Banking system of India has both Public and Private banks with their own provisions of the people, where the loans and insurance policy differs from bank to bank and so it in providing services. With advancement in technology and the coming up of the UPI system, which is the greatest achievement of India and a big gateway towards digital economy. Rural Banking system is also growing and today a majority of the population in the rural region have access to a bank account and bank services where as it is still necessary to digitally educated people on banking services and provide bank literacy to the old age people and rural population , in particular in the pandemic period with everything going digital , the banking system has also changed and brought in new provisions , we need to introduce better housing loans , gold loans schemes for the poor to uplift their standard of living and make banking and transaction easy and simple of citizens.**

***Keywords*: Banking Policy, Public and Private Banks, Loans, UPI, Bank literacy, investment, Rural banking.**

1. Introduction

Monetary policy of any country enables the central bank or monetary power to manage the supply of money, cost of money rate of interest and proximity of bank credits .Monetary policy in India plays a crucial role in the economic management of the country .The Reserve Bank of India (RBI) is the central bank which controls the bank credit and supply of money. It is responsible to guarantee that the banking system meet the legitimate credit prerequisite .Growth with stability is the cornerstone of the monetary policy of India, the policy regulates the accessibility, cost and use of money. Earlier the monetary policy was focused on commanding the inflation, which was done through shrinkage of supply and credit, however this was failure, and it declined the growth of the country. RBI then adopted a new policy for growth with stability, in which RBI would provide adequate credit for escalating the needs of different sector of the economy and also command inflation .RBI make sure that the banking system provides timely and sufficient credit to all the sections at a reasonable cost. In India , the priority sector consist of agriculture , small-scale industries, weaker section and export .Monetary policy plays an important role in the in generating employment as it influences the rate of investment and allocation among different sectors. With import and export taking a turn, India's connection with the global economy is getting stronger, Earlier RBI used to set that exchange rate and also have authority over the foreign exchange market , Today RBI indirectly control external firmness through maintained flexibility .RBI influence the exchange rate by sell and purchase of foreign currencies in the open market .It also encourages savings and investment by offering a high interest rate which can mobilize savings and influence the investment in the country . As RBI controls inflation and place affordable credits to the weaker section , it can also redistribute wealth and income to the poor sections of the economy .It also regulates the Non-Banking Financial institutions like UTI , IFCI , IDBI which play an significant role in the Indian Economy .Banking system in India can be traced back to the period of 1770 when the first bank, Bank of Hindustan was formed which worked till 1829-32 , the General Bank of India which was established in 1786 , failed in 1791 . It was during the East Indian Company rule that in mid –June 1806 the Bank of Calcutta was established followed by the Bank of Bombay in 1840 and Bank of Madras in 1843. All these three banks combined and formed the Imperial Bank of India which is today known as the State Bank of India (SBI) which is the oldest bank in India. The banks in India is usually classified into Scheduled and Non-Scheduled banks .With the Reserve Bank of India being at the apex position which has come into existence since the 1935.

2. Literature Review

Banking means the accepting for the purpose of lending or

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investment of deposits of money from the public, repayable on demand or otherwise, and withdraw by cheque, draft , order or otherwise. Since the banking regulation act many other options have come. Coming to Scheduled and Non-Scheduled Banks. Scheduled Banks are those which are included in Schedule 2 of the Reserve Bank of India Act , 1934 , includes only those banks which fulfil the criteria laid down in section 42(6) (a) of the RBI Act , 1934 , minimum capital requirement of a scheduled bank is 25 Lakh rupees . On the other hand Non-Scheduled Banks which don't not come under the following criteria .Next we have the Nationalized or Public Sector Banks : PSU banks are those in which the government of India holds more than 51% of the share capital , A total of 19 banks were Nationalized by the government on 19th July , 1969 major event in the history of banking system in India , it was the right time to bring large commercial banks in the government fold to protect the deposit including these 19 and the 6 banks of the state bank group , there are 27 PSU Banks in India and the 6 banks are state bank of India and 5 associated banks, merged with the SBI and the 2 other banks which make up the PSU banks are IDBA Bank and Bharathiya Mahila Bank established in 2013whichwas merged with SBI in 2017 . The 19 PSU Banks are: Indian Bank. Indian Overseas Bank , Vijaya Bank, Canara Bank, Corporation Bank , Syndicate Bank , Andhra Bank , Bank of Baroda , Bank of Maharashtra , Central Bank of India , Punjab and Sind Bank Punjab National Bank , UCO Bank , Union Bank of India, Allahabad Bank, Dena Bank, Oriental Bank of Commerce, Bank of India and United Bank of India . Next we have the private sector banks are those in which majority of the share capital is held by the public .Public would here mean a group of individuals or a group of institutes or a group of body together to form a bank .There are further two sets of private banks: The old generation Pvt. Banks and New Generation Pvt. Banks, as some of the banks are 75 years old when they were privatized, they have been there for decades. New generation came to exist a few decades bank who are running currently with high technology and have grown substantially when it comes to assets , revenue , profit, number of banks , For instance HDFC bank ,for instance is just 20 years old and has grown with huge profits , deposit and advances and these new generation banks place high emphasis on technology and service .Mechanization was adopted by public banks in India after 1991 , where Mechanization was the future of banking system . Private banks cross sell a variety of products.

3. Findings

Times have changed and so is the definition of banks , there sell mutual funds , insurance policy 2 wheeler , four wheeler insurance , life insurance and whatever they can , and get revenue for the banks some of the new generation banks are HDFC bank, ICICI Bank, Kotak Mahindra Bank , Yes bank , Axis bank , Bandhan Bank and many other , all these are the new generation banks which started 20 years back and today almost all people have an account in any of these banks simply because of the comfort which they give to the people banking with them .Housing loans are also provided by these banks then we have the regional Rural Bank , these banks were formulated for agriculture economy and rural development .Nalshimah committee recommend set up these Banks .RRB act came into effect in 1976 , these banks are sponsored by public sector banks in which centre government shareholding is 50% , banks is 35% and state government is 15% .The cooperative banks where set up to provide finance to agriculture , rural industries and to trade and industry of urban areas but to a limited extent tribal people , small and marginal farmers, small shops have their accounts in cooperative banks.

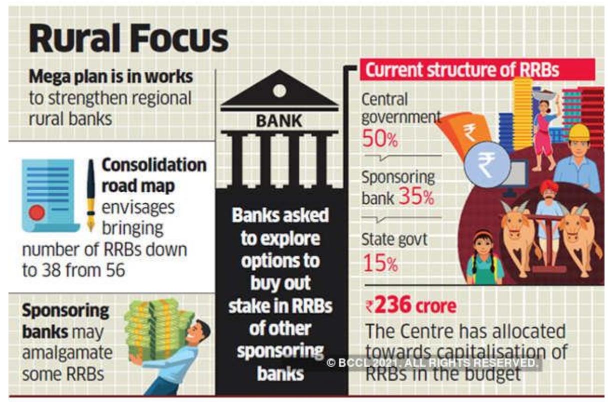

Fig. 1. Rural focus

The Banking landscape in India is to change with the government decision to privatize two public sector banks, coming after 51 years of nationalization of government owned banks in 1969, the move will give the private sector a key role in the banking sector .The Union Budget has announced the privatization of two public sector banks in addition to IDBI Banks and one generate insurance company in the upcoming fiscal. It has also announced a strategic sale for four strategic sectors-banking, insurance and financial services in which it will have a bare minimum presence, years of capital injections and governance reforms have not been able to improve the financial position of its public sector bank significantly, many of them have higher levels of stressed assets than private banks and also lag the latter on profitability, market and capitalization and divided payment record. The government front loaded rupee 70,000 crore into government run banks in September 2019, rs 80,000 crore in FY18 and rupees 1.6 lakh crore in FY19 through recapitalization bonds .In 2019 the government merged ten PSU banks into four.

Privatization of two public sector banks will set the ball rolling for a long term project than envisages only a handful of state owned banks , with the rest either consolidated with strong banks or privatized , this will free up the government , majority of owners from continuing to provide equity support to the banks year after year .The two banks that will now be privatized will be selected through a process in which NITI Aayog will make recommendation, which will be considered by a core group of secretaries on disinvestment and then the alternative mechanism. After a series of mergers and equity injections by the government, the performance of public sectors has shown improvement over the last couple of years. However, compared to private banks they continue to have high non-performing assets and stressed assets although this has started declining.

After the COVID-19 related regulatory relaxations are lifted banks are expected to report higher NPAs and loan losses ,As per the RBI's recent financial stability report gross NPA ratio of all commercial banks many increase from 7.5% in September 2020 to 13.5% 2021 , this would mean the government would again need to inject equity into weak public sector banks , the government is trying to strengthen the strong banks and also minimise their numbers through privatization to reduce its burden of support .Private banks market share in loans has risen in 2020to 36% from 21.26% in 2015 while public banks have fallen to 59.8% from 74.28% .Competition heated up after the RBI allowed more private banks since 1990s .They have expanded the market share through new products ,technology and better services and also attracted better valuations in stock market –HDFC Bank has a market capitalization of rupees 8.80 Lakh crore while SBI controls just 3.50 Lakh crore. India has 22 private banks and 10 small finance banks.

Proportion of loans lent to different Sectors (Average of Top 3 Banks)

	Industrials Loans	Retail Loans
Public Sector Banks	37.00%	13.70%
Private Sector Banks	26.90%	41.10%

Fig. 2. Proportion of loans lent to different sectors

4. Challenges

Some of the major issue of the banking system in India is low profitability , rising level of NPA , Window Dressing , Lending under political pressure and Internal share speculation ,losses in rural branches as they are running in high lost because of the prevalence of the barter system .Large over-Dues : the small branches of commercial banks are now being faced with the issue of huge overdue and advances to the farmers , the commercial banks don't have guarantee to assure that the loans and advance are going to work in the large interest of the public interest , due to high proportion of NPA and due from borrowers most of them are unable to maintain capital ratio , competition from Non-Banking Financial institution such as mutual funds, housing financial cooperation , investment companies , all these institute compete with commercial banks to attract public deposits , Competition with Foreign Banks , Gap between promise and performance , one of the backdrop of nationalised bank is its failure to sustain the desired credits and minimize credit gaps in different sectors.

Political pressure on the nationalized banks , has resulted in providing grants of loans to parties without taking into consideration credit worth , pressure from both central and state government .The presence of red tapism in the bank sector ,long delays and failure to take decisions are product of nationalisation of banks and bureaucratisation. .In the last couple of years some questions have arisen over the performance of private banks , especially on governance issue , ICICI Bank was sacked for allegedly extending dubious loans , Yes Bank CEO Rana Kapoor was not given extension by the RBI and now faces investigations by various agencies are some of the challenges in the banking system of India.

5. Future Perspective

First of we need to introduce easy loan and insurance policy for the people , in particular for the rural people , every rural village should consist of a bank within one km of its region , as in majority of the villages people have to travel or walk for more than half of the day to reach the nearest location , every farmers including women should have a bank account , we introduce to introduce awareness programme in the rural region to make people noted about the necessity to have a bank account and safety related to their money . Promote digital economy and the use of UPI in the rural region. UPI has been the greatest success of India which countries like US and China wants to learn , today majority of the people are using PhonePe , Gpay , Paytm , Amazon Pay , Bharat pe in short for making maximum transaction , the use of debit card/credit card has reduced . In the rural area with technology and internet connectivity, maximum people can earn the profit of using UPI .We need to educate both urban and rural people on different bank policies, easy ATM services need to be initiated. The rise of number of private banks today are providing benefits, well in the rural region also we need to introduce services of private banks. There is a new for an upgradation for 2 wheels and 4 wheels insurance by the banks, simple bank transaction processes. As many have face problems of network and server down problems in the bank which has delayed their payment and further opportunity. We also need to introduce easy housing loan schemes and vision for the middle class people .Due to demand of the government on unnecessary documents from the urban slums area has never allowed the people to rise from their current level.

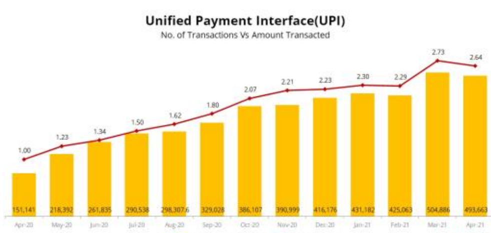

Fig. 3. Unified payments

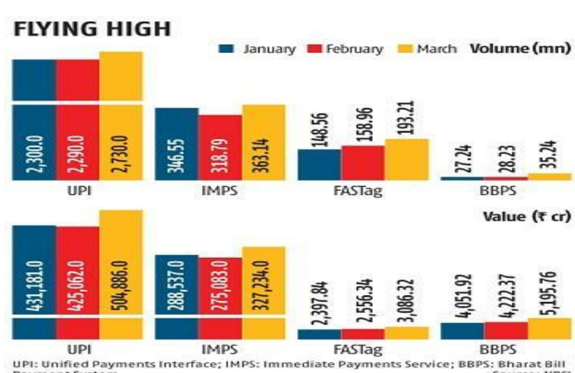

Fig. 4. Flying High

6. Conclusion

Banks have existed in India before the time of Independence , with passing years it has brought in new policies and schemes , with economic reform of 1991 , the private sectors have entered the place and today we have many private banks in our country , providing better facilitates and features compared to the government bank , currently we have seen many banks being privatised , new loans , gold loan schemes have emerged with advancement in technology the whole process of banking has changed , the rural banking system requires much improvement with adult , youth and old aged people all require online and offline banking literacy followed by the villages have to be made aware of the positive sites of the bank services and with technology reaching the rural region , today UPI is ruling the payment method in India , maximum transaction by people are done using UPI . We hope new banking schemes and loan policies bring comfort and easy transaction system for its citizens.

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