Agpaytech's Research
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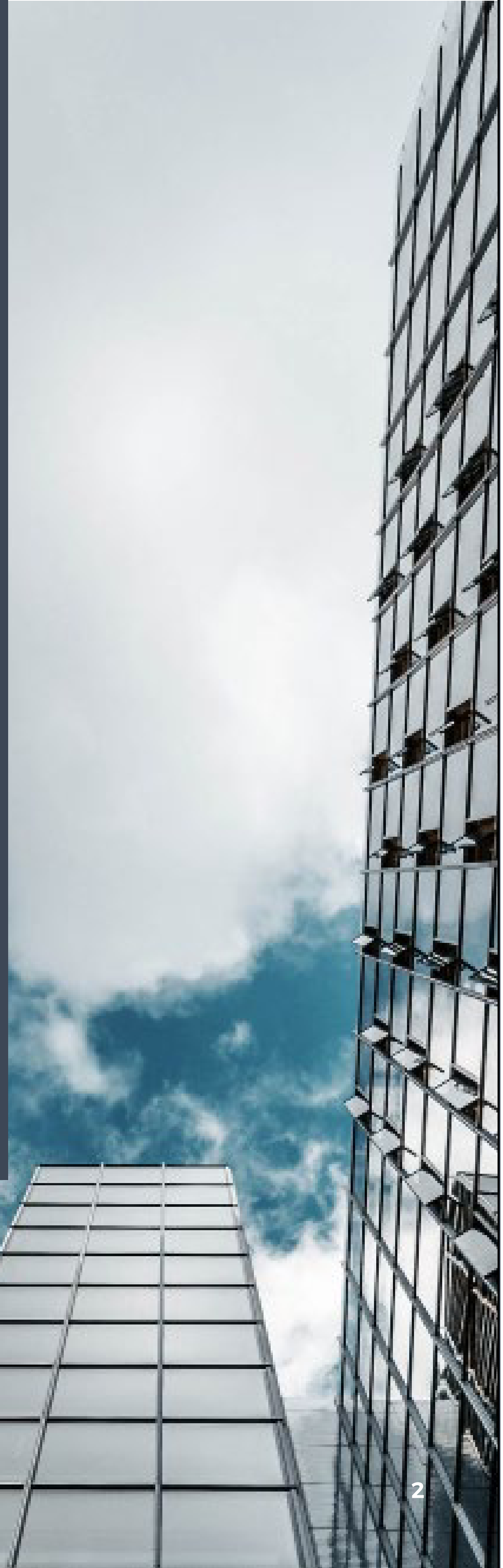
The Dynamism of the Indian Banking System

Agpaytech

Executive Summary

The Indian banking industry has witnessed significant transformations in recent years, driven by technological advancements, regulatory reforms, and changing customer expectations. Understanding the evolving landscape is crucial for stakeholders to make informed decisions and develop strategies that align with the industry's trajectory. This report provides an in-depth examination of the Indian banking system, encompassing various sectors such as cooperative, commercial, and development banks. The report explores key areas of interest, including the technology sector and financial inclusion, shedding light on the developments and opportunities within the Indian banking landscape.



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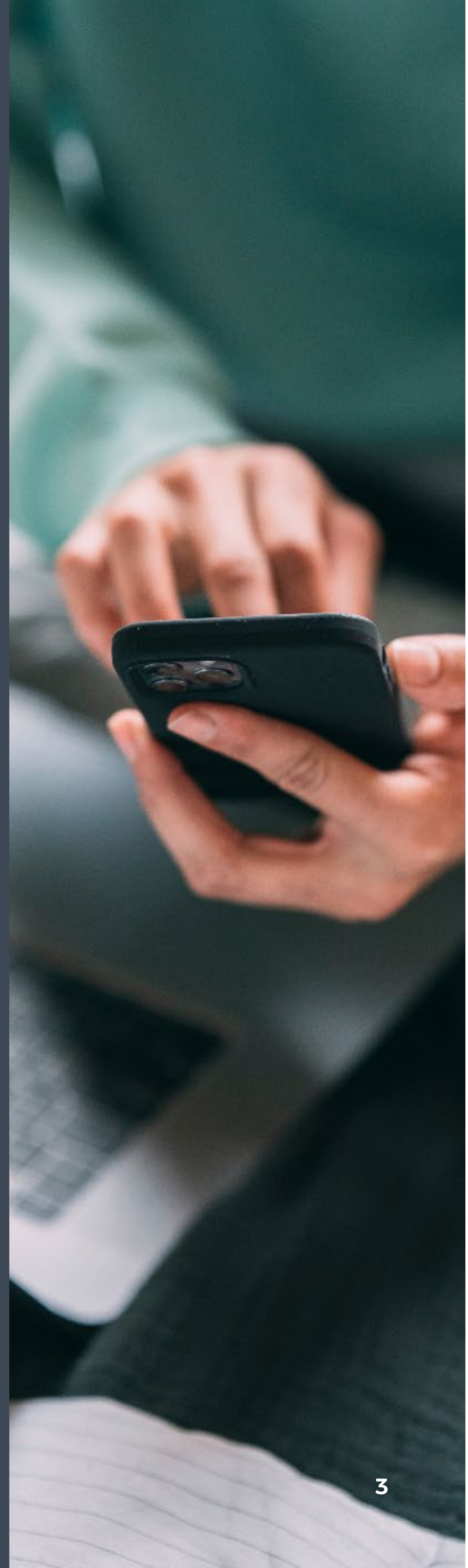
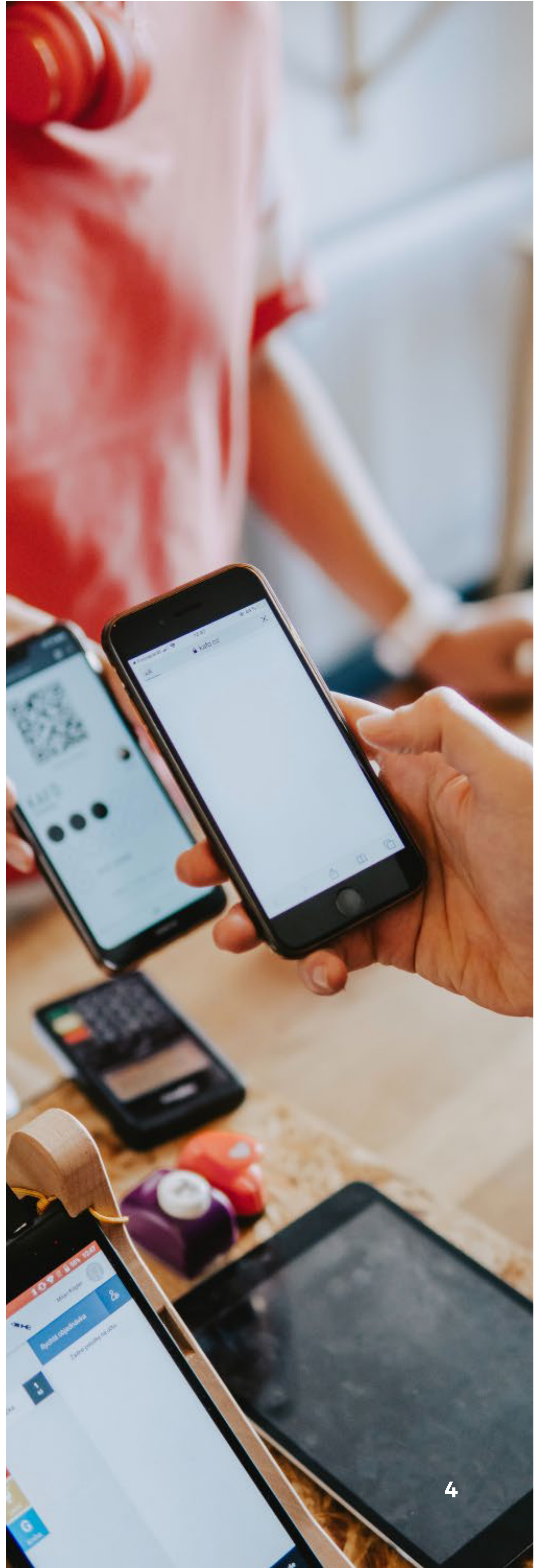


Introduction

As per the Reserve Bank of India (RBI), India's banking sector is sufficiently capitalized and well-regulated. The financial and economic conditions in the country are far superior to any other country in the world. Credit, market, and liquidity risk studies suggest that Indian banks are generally resilient and have withstood the global downturn well. The Indian banking industry has recently witnessed the rollout of innovative banking models like payments and small finance banks. In recent years India has also focused on increasing its banking sector reach through various schemes like the Pradhan Mantri Jan Dhan Yojana and Post payment banks. Schemes like these, coupled with significant banking sectors reforms like digital payments, neo-banking, a rise of Indian NBFCs, and fintech, have significantly enhanced India's financial inclusion and helped fuel the credit cycle in the country.

The digital payments system in India has evolved the most among 25 countries, with India's Immediate Payment Service (IMPS) being the only system at level five in the Faster Payments Innovation Index (FPII). India's Unified Payments Interface (UPI) has also revolutionized real-time payments and strived to increase its global reach in recent years.



The market size of the Indian Banking system

As per the Reserve Bank of India (RBI), India's banking sector is sufficiently capitalised and well-regulated. The financial and economic conditions in the country are far superior to any other country in the world. Credit, market, and liquidity risk studies suggest that Indian banks are generally resilient and have withstood the global downturn well. As of September 2021, the Indian banking system comprised 12 public sector banks, 22 private sector banks, 46 foreign banks, 56 regional rural banks, 1,485 urban cooperative banks, 96,000 rural cooperative banks, and cooperative credit institutions. The country had a total of 213,145 ATMs, with 47.5% of them located in rural and semi-urban areas.

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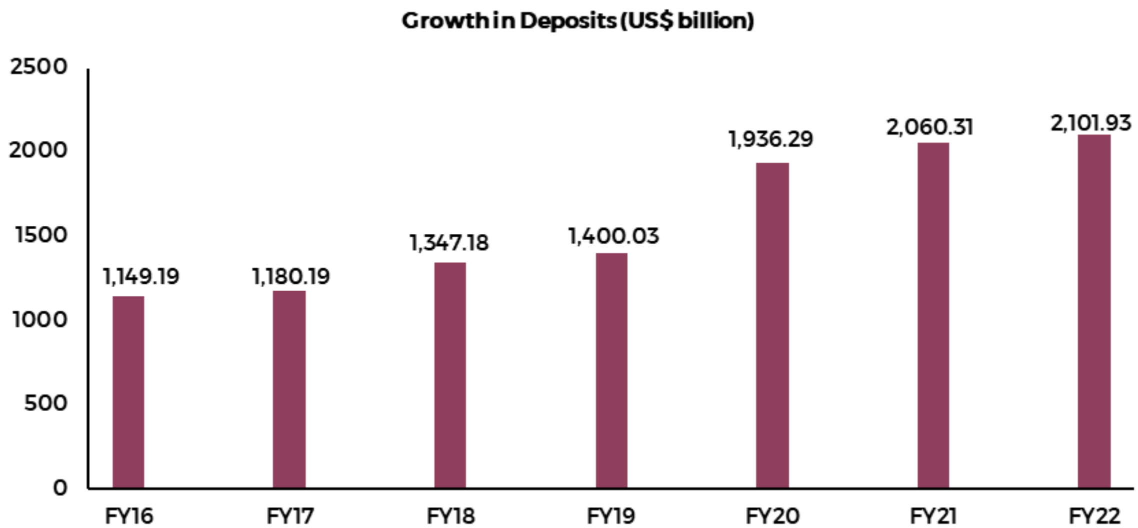
From 2020 to 2022, there was significant growth in bank assets across various sectors. The banking sector's total assets, including public and private sector banks, reached US$2.67 trillion in 2022. Specifically, the public sector banks accounted for US$1,594.51 billion in assets, while the private sector banks held US$925.05 billion in assets. Between fiscal year 2016 and fiscal year 2022, bank credit experienced a compound annual growth rate (CAGR) of 0.62%. By FY22, the total credit extended by banks had surged to US$1,532.31 billion. Deposits also witnessed substantial growth during the same period, with a CAGR of 10.92%. By FY22, bank deposits had reached US$2.12 trillion (equivalent to Rs. 173.70 trillion as of November 4, 2022).

India Ratings & Research (Ind-Ra) predicts that credit growth will reach 10% in the fiscal year 2022-23, marking a double-digit growth rate after eight years. As of November 4, 2022, bank credit stood at Rs. 129.26 lakh crore (US$1,585.09 billion). The Reserve Bank of India's statement on Sectoral Deployment of Bank Credit reveals that non-food bank credit experienced a growth of 17.6% in November 2022 compared to the previous year's 7.1%. This growth was primarily driven by robust credit demand in services, industry, personal loans, agriculture, and allied activities.

Figure 1: Indian Market Size



Source: India Brand Equity Foundation

Structure of the Indian Banking System

The banking system in India is regulated by the Reserve Bank of India (RBI), which serves as the country's central bank. The structure of the Indian banking system can be categorized into scheduled banks, non-scheduled banks, and development banks. Scheduled banks are those included in the second schedule of the Reserve Bank of India Act of 1934. These banks enjoy certain privileges and facilities provided by the RBI. Firstly, they are eligible to borrow funds or obtain loans from the RBI at the bank rate. Secondly, they automatically become members of a clearing house, facilitating the efficient clearing and settlement of transactions.

On the other hand, non-scheduled banks are not listed in the second schedule of the Reserve Bank of India Act, 1934. As a result, they do not have access to regular borrowing from the RBI for banking purposes, except in emergencies. Scheduled banks can be further classified into commercial banks and cooperative banks. Commercial banks are primarily engaged in providing

> *"They offer many services, such as deposit accounts, loans, and other banking facilities. In addition, cooperative banks are owned and operated by their members, typically individuals or small businesses"*

financial services to businesses and individuals. They offer many services, such as deposit accounts, loans, and other banking facilities. In addition, cooperative banks are owned and operated by their members, typically individuals or small businesses. These banks aim to cater to the specific needs of their members and promote their economic well-being.

Understanding the categorization of banks within the Indian banking system is essential for stakeholders and customers to differentiate between different types of banks and their associated privileges and obligations. The RBI plays a crucial role in regulating and supervising the banking system to ensure its stability, integrity, and smooth functioning.

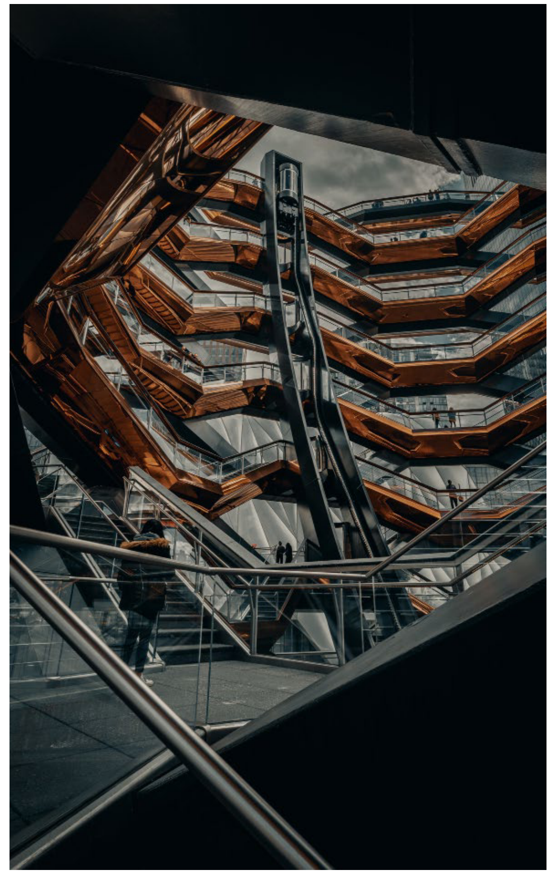
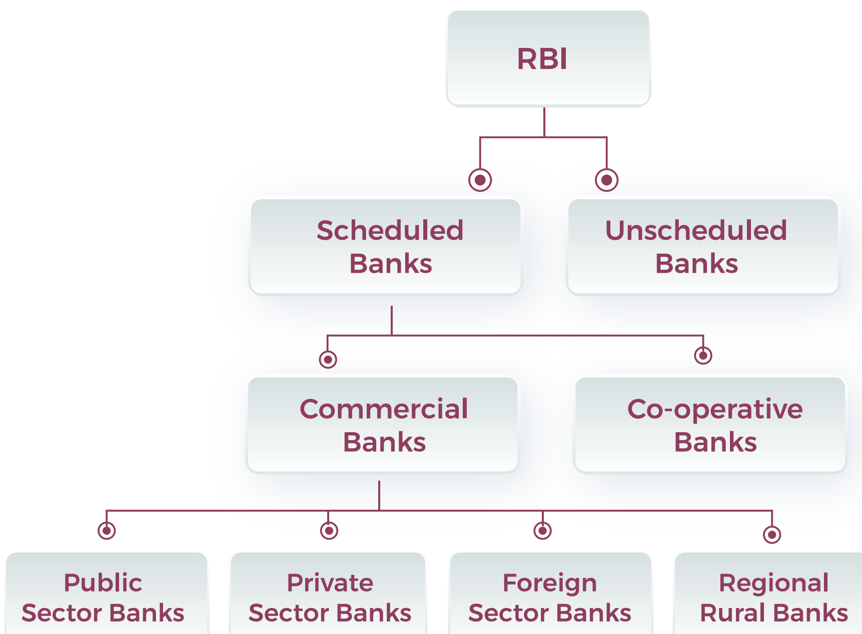


Figure 2: structure of the Indian Banking System



Source: www. Jagranjosh.com

Commercial Banks

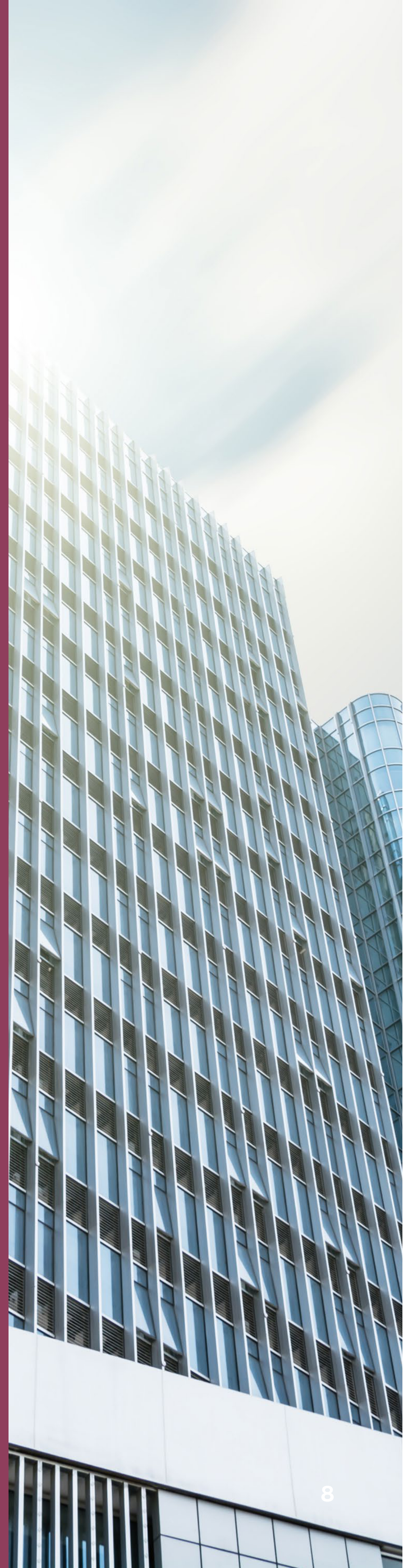
Commercial banks and financial institutions that accept deposits from the public and provide loans to earn profits. In India, commercial banks can be broadly classified into public sector banks, private sector banks, foreign banks, and regional rural banks (RRBs).

- Public sector banks are those banks in which the government holds the majority stake. However, there are currently 12 public sector banks in India. An example of a public sector bank is the State Bank of India.

- Private sector banks are those banks where private stakeholders or business houses own significant stakes in the equity. Some prominent private sector banks in India include HDFC Bank, Kotak Mahindra Bank, and ICICI Bank.

- Foreign banks have headquarters outside the country but operate as private entities in other locations. These banks must comply with regulations set by the host country's central bank and the rules prescribed by their parent organization. An example of a foreign bank in India is Citi Bank.

- Regional rural banks (RRBs) were established under the Regional Rural Banks Ordinance 1975 to ensure adequate institutional credit for agriculture and other rural sectors. The operational area of RRBs is limited to specific regions as notified by the government. RRBs are jointly owned by the Government of India, the State Government, and sponsor banks. An example of an RRB in India is the Arunachal Pradesh Rural Bank.



Cooperative Banks

Cooperative banks are financial institutions owned and operated by their members, who are both customers and owners of the bank. These banks provide a range of banking and financial services to their members. Cooperative banks primarily support agricultural activities, small-scale industries, and self-employed individuals. An example of a cooperative bank in India is the Mehsana Urban Cooperative Bank. At the grassroots level, individuals form a Credit Cooperative Society. These societies consist of borrowers and non-borrowers residing in a specific locality with a shared interest in each other's business affairs. Membership in these societies is generally open to all inhabitants of the locality, thereby bringing together individuals from various backgrounds into a collective organization. Multiple societies within an area combine to establish a Central Cooperative Bank.

Cooperative banks are further categorized into urban and rural banks. Rural cooperative banks can be classified as either short-term or long-term banks. Short-term cooperative banks include State Cooperative Banks, District Central Cooperative Banks, and Primary Agricultural Credit Societies. Long-term banks, conversely, encompass State Cooperative Agriculture and Rural Development Banks (SCARDBs) and Primary Cooperative Agriculture and Rural Development Banks (PCARDBs). Urban Cooperative Banks (UCBs) are primary cooperative banks operating in urban and semi-urban areas. They cater to customers' banking needs in these areas and provide various financial services.

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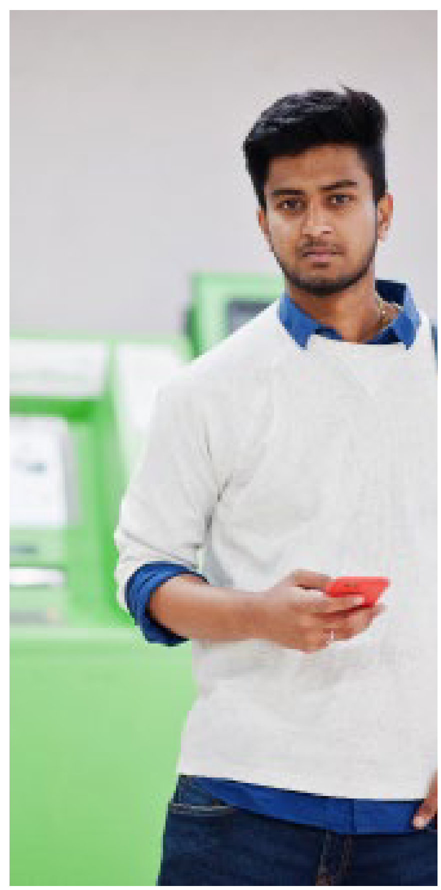

Development banks

Development banks are financial institutions that specialize in providing long-term credit to support capital-intensive investments spanning an extended period. These investments typically yield low rates of return but offer substantial social benefits. In India, the central development banks include:

- The Industrial Finance Corporation of India (IFCI Ltd) was established in 1948.
- The Industrial Development Bank of India (IDBI) was founded in 1964.
- The Export-Import Bank of India (EXIM) was established in 1982.
- The Small Industries Development Bank of India (SIDBI) was established in 1989.
- The National Bank for Agriculture and Rural Development (NABARD) was established in 1982.

The banking system of a country holds significant influence over its economic development. It is vital in fostering growth in rural and suburban areas by providing capital to small businesses and facilitating their expansion. The organized financial system comprises various entities, including commercial banks, regional rural banks (RRBs), urban cooperative banks (UCBs), primary agricultural credit societies (PACS), and more. These institutions cater to the diverse financial service requirements of the population.

Efforts by the Reserve Bank of India and the Government of India to promote financial inclusion have significantly improved access to formal financial institutions. As a result, individuals and businesses have better opportunities to benefit from the services and support offered by the banking system. It drives economic growth and plays a crucial role in reducing economic inequality by ensuring equal access to financial resources.

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Indian Banking Reforms

The Indian banking sector's performance is closely tied to the economy's overall health, perhaps more intertwined with the economy than any other sector. It is crucial in supporting various economic sectors, such as agriculture, small-scale businesses, exports, and banking activities in developed commercial areas and remote rural regions. The Indian banking system primarily focuses on enhancing asset quality, implementing sound risk management practices, and maintaining adequate capital reserves. Several reforms have been implemented in India to enhance the banking system's state, driven by economic liberalization and globalization. These reforms aim to improve operational efficiency and ensure banks' financial stability and reliability. By doing so, Indian banks strive to meet internationally recognized performance benchmarks. Furthermore, the banking sector has witnessed the emergence of e-banking, which plays a pivotal role in offering enhanced services to customers. Innovative approaches such as Internet banking, e-wallets, and mobile banking have replaced traditional transaction methods, providing clients with more convenient and efficient options.

The Indian banking sector has implemented reforms to enhance efficiency, stability, and effectiveness. Some recent reforms include:

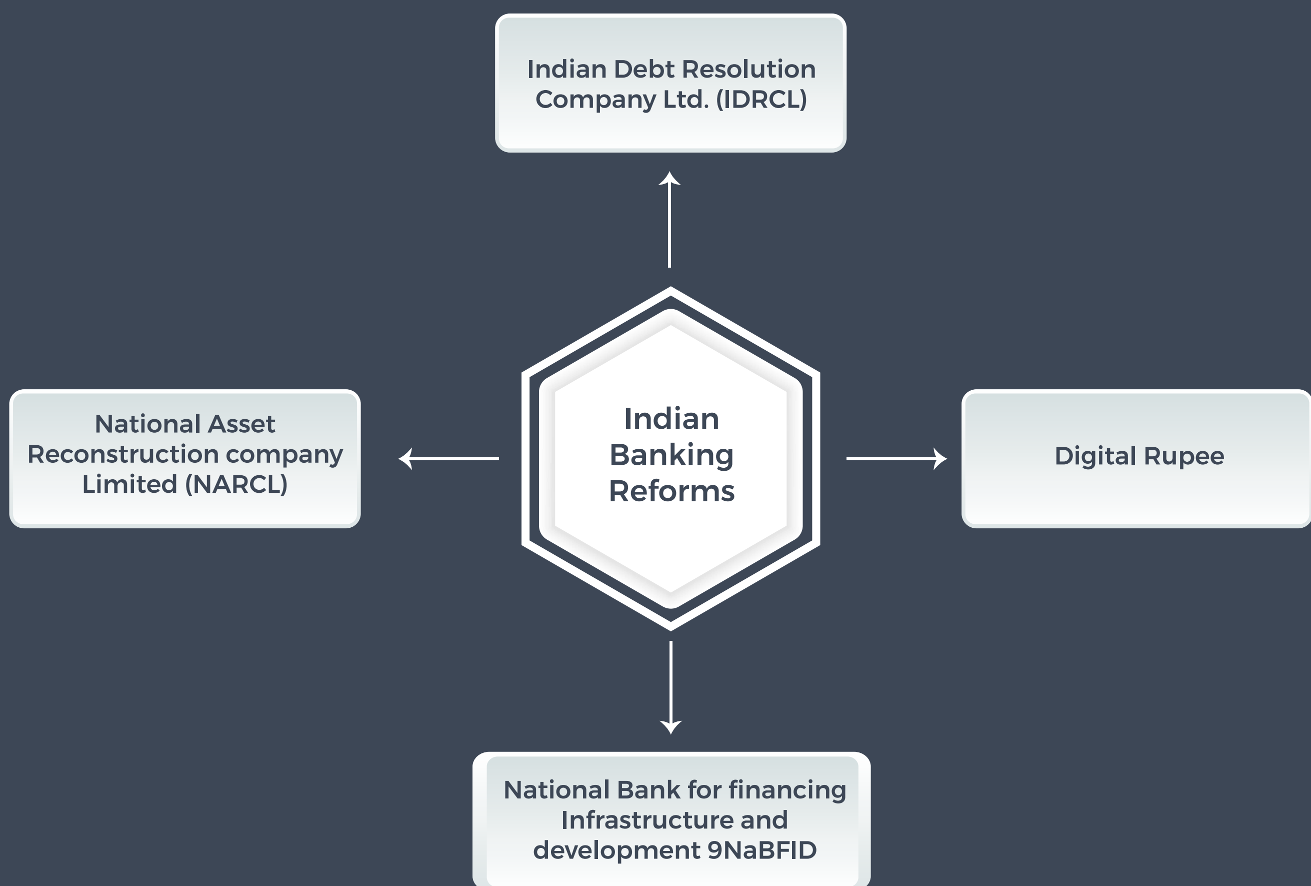
- **National Asset Reconstruction Company Limited (NARCL):** The establishment of NARCL was announced in the Union Budget 2021-22. The purpose was to create a 'bad bank' that would consolidate bad loans amounting to Rs. 500 crores (US$ 62.63 million) and above. Despite 28 existing asset reconstruction companies (ARCs) in the market, the significant and fragmented nature of bad loans held by different lenders continues to burden bank balance sheets. Therefore, alternatives like NARCL are necessary. NARCL will have a dual structure comprising an asset management company (AMC) and an asset reconstruction company (ARC) to recover and manage stressed assets. It is a collaborative effort between private and public sector banks (PSBs), with PSBs maintaining 51% ownership in NARCL. The capitalization of NARCL will be facilitated through equity from banks and non-banking financial companies (NBFCs), and the Government of India's guarantee will reduce the need for upfront capital. The India Debt Resolution Company Ltd (IDRCL) will assist NARCL.

- **India Debt Resolution Company Ltd. (IDRCL):** IDRCL serves as a service company/operational entity responsible for managing NARCL's assets with the support of turnaround experts and market professionals. NARCL will purchase assets by submitting offers to the lead bank, and after acceptance, IDRCL will be involved in managing and adding value to these assets. Public financial institutions (FIs) and PSBs will hold a 49% stake in IDRCL, with the remainder owned by private banks.

- **Digital Rupee:** The Reserve Bank of India (RBI) announced the introduction of the central bank's digital currency, the digital rupee, in the Union Budget 2022-23. Its launch is expected by the end of the current financial year. The digital rupee is projected to benefit India's digital economy significantly. A central bank digital currency (CBDC) represents a digital form or token of a nation's legal currency. By adopting the digital rupee, customers can enjoy improved liquidity, scalability, acceptance, transaction convenience, anonymity, and faster settlements. Similar to how the Unified Payments Interface (UPI) made digital cash more user-friendly, introducing the digital rupee will enhance people's access to digital currencies. Its adoption is anticipated to facilitate cross-border remittances and reduce business and government transaction costs. The digital rupee would also help mitigate settlement risks in the financial system.

- National Bank for Financing Infrastructure and Development (NaBFID): The NaBFID, established as a Development Financial Institution (DFI), is crucial in facilitating long-term infrastructure financing for India. It operates with a dual focus on developmental and financial objectives. Unlike traditional banks, DFIs do not accept deposits from the public. Instead, they raise funds from the government, market, and multilateral institutions, often backed by government guarantees. Initially, the government holds 100% of the shares in NaBFID, which may be reduced to 26% later. NaBFID operates as a corporate entity with an authorized share capital of Rs. 1 lakh crore (US$ 12.53 billion). Its primary objective is financing various projects included in India's National Monetisation Pipeline, amounting to Rs. 6 trillion (US$ 75.18 billion). Through its activities, NaBFID aims to foster economic development by supporting critical infrastructure projects and ensuring the availability of long-term financing options.

Figure 3: Indian Banking Reforms



Source: Agpaytech Research

Development in Indian Banking

The Indian banking system has witnessed significant developments in recent years, driving positive transformations in the country's financial landscape. These developments have aimed to enhance financial inclusion, strengthen regulatory frameworks, promote digital banking, and foster economic growth. Here are some critical areas of development in the Indian banking system. Since 2020, the Indian banking sector has witnessed tremendous changes and greater flexible. There have been several merger and acquisitions, UPI partnerships, increase in number of bank accounts, and other financial inclusion programmes.

Period	Activity	Examples
2022	Increase in merger and acquisition Increase in bank accounts	◆ M&A activity with an India angle hit US$ 171 billion in 2022. ◆ India's largest private bank HDFC Bank announced a transformational merger with HDFC Limited. ◆ The number of bank accounts opened under the government's flagship financial inclusion drive 'Pradhan Mantri Jan Dhan Yojana (PMJDY) reached 45.60 crore.
2021	Global hackathon, 'HARBINGER 2021 Google Pay loan access	◆ Launch of Smarter Digital Payment. ◆ Kotak Mahindra Bank acquired 9.98% stake in KFin Technologies ◆ Indian Bank 13.27% stake in the proposed National Asset Reconstruction Company Ltd. ◆ Axis Bank acquired a 9.9% share in the Max Bupa Health Insurance Company. ◆ Google Pay for Business enabled small merchants to access credit through FlexiLoans
2020	Digital lending guidelines WhatsApp and UPI Merger and Acquisition	◆ A revised code of digital lending was issued by RBI ◆ WhatsApp started UPI payments service in India ◆ HDFC Bank and Apollo Hospitals partnered to launch the 'HealthyLife Programme' ◆ Axis Bank acquired a 29% stake in Max Life Insurance ◆ Recapitalization of Regional Rural Banks

Challenges and Opportunities in the Indian Banking Sector:

The RBI's 100% Financial Inclusion Drive has garnered significant attention by emphasizing efforts to achieve financial inclusion. The State Level Bankers Committee (SLBC) has been directed to designate one or more districts, with each state identifying at least one district, for achieving 100% financial inclusion. The responsibility lies with the banks operating in these areas to ensure that all individuals who desire a bank account are provided with one, with villages allocated among different banks.

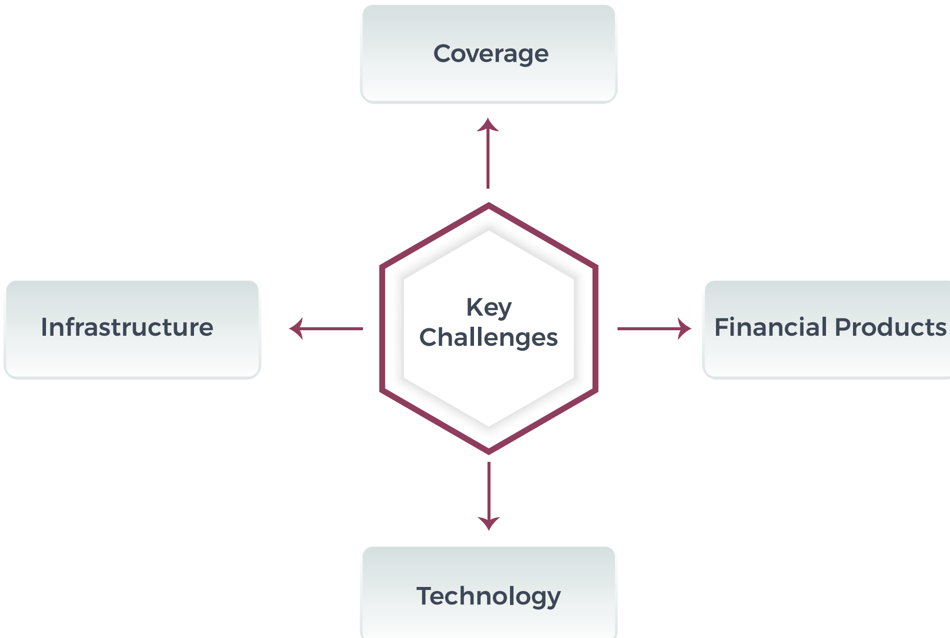
The progress of the 100% financial inclusion drive is underway nationwide. So far, SLBCs have identified 431 districts for achieving full financial inclusion. As of March 31, 2009, 204 districts in 18 states and five union territories have reported successfully reaching the target. However, the pursuit of financial inclusion encounters several key challenges, particularly in the following areas:

- Coverage: India's vast population makes achieving complete inclusivity a complex task. Migrant labourers often utilize informal channels for monetary transactions, posing a challenge in maintaining accounts within the formal banking system.
- Infrastructure: The infrastructure growth in India has not kept pace with the country's economic development and is significantly lacking. Good road, rail, digital connectivity, power, and other infrastructure facilities are crucial for operating banking outlets.
- Financial Products: Financial products need to be simple, flexible, and cater to the requirements of the masses. They should also be accessible at affordable costs to ensure widespread adoption.
- Technology: Integrating technology into the banking system is pivotal for progressing towards inclusive growth. Technology solutions should be standardized, interoperable, and cost-effective. High transaction costs associated with rural banking services can be reduced significantly by leveraging appropriate technology.

However, to overcome the barriers to inclusive growth, efforts must be focused on identifying suitable delivery or business models for financial inclusion. Traditional brick-and-mortar bank branches may not be viable for many villages, especially remote areas. Banks should explore and experiment with alternative delivery models such as satellite branches, mobile branches, business correspondents

(BCs), and mobile services to cater to the diverse needs of communities. This process may require time and patience but will ultimately contribute to achieving comprehensive financial inclusion.

Figure 4: Challenges of the Indian Banking



Source: PWC

Key Opportunities in the Indian Banking Sector:

The Indian banking sector faces non-performing assets, capitalization, technology adoption, and financial inclusion. However, it also has opportunities to leverage economic growth, technological advancements, financial innovation, and government initiatives to drive positive change and enhance its role in the country's economy.

- Economic Growth: India's strong economic growth allows banks to expand their lending and investment activities. Banks can support various sectors and contribute to overall development as the economy grows.

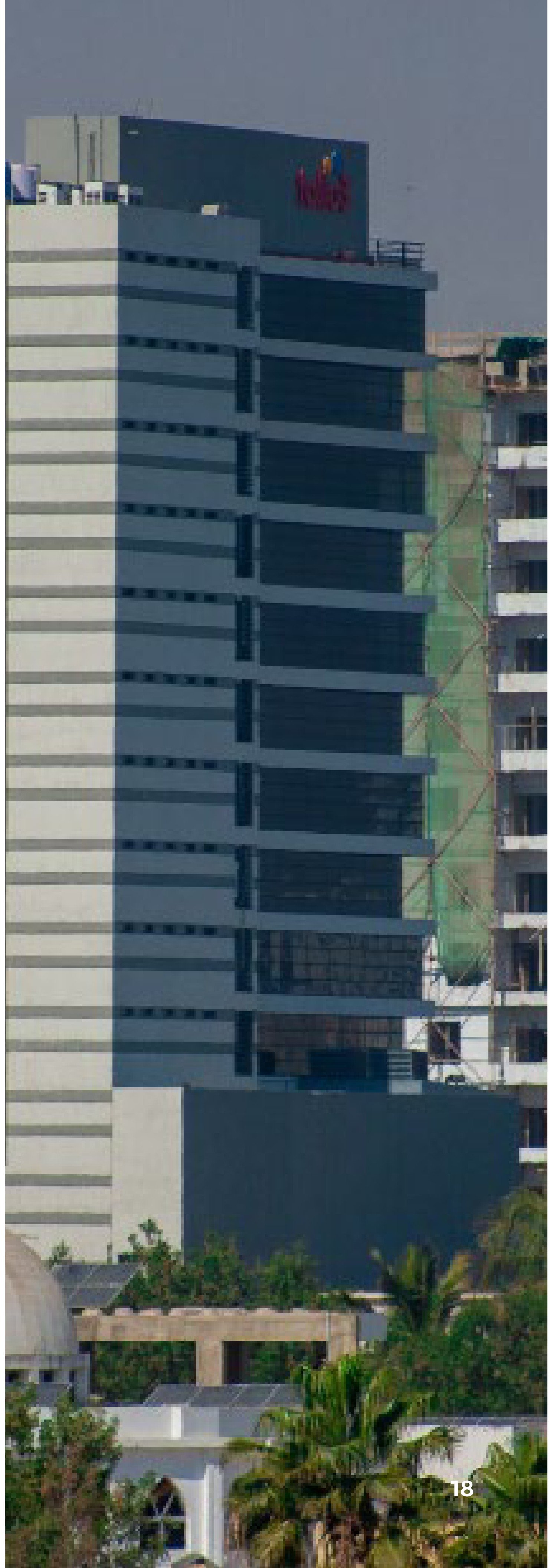
- Technological Advancements: Embracing technology and digital banking can open new avenues for Indian banks. Enhanced digital infrastructure and innovative financial products can improve efficiency, customer experience, and reach, attracting new customers and expanding market share.

- Financial Innovation: Indian banks can innovate and diversify their product offerings to cater to evolving customer needs. Banks can stay competitive and capture untapped market segments by introducing new financial instruments, services, and solutions.

- Government Initiatives: The Indian government's focus on financial inclusion and banking reforms presents opportunities for banks. Initiatives like Pradhan Mantri Jan Dhan Yojana (PMJDY) and Direct Benefit Transfer (DBT) aim to bring more people into the banking system, creating a broader customer base for banks to serve.

Conclusion

The Indian banking system has undergone significant advancements and reforms in recent years, reflecting a commitment to strengthen financial inclusion, regulatory frameworks, digitalization, and overall economic growth. Initiatives like the RBI's 100% Financial Inclusion Drive have aimed to bring banking services to every corner of the country. At the same time, technological innovations have revolutionized the way transactions are conducted, making banking more accessible and convenient for customers. However, the Indian banking system has demonstrated resilience and adaptability in addressing these challenges by adopting alternative delivery models and leveraging technology to reduce transaction costs.



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About Agpaytech

Agpaytech Ltd. is a company pioneering in the Fintech Space with a focused approach to building robust technologies for eCommerce Card Processing Solutions for Payment Service Providers (PSPs). Additionally, we provide Compliance and Regulatory Umbrella, Remittance-as-a-Service, Banking-as-a-service, Foreign Exchange, Cross Border Payments, and digital currency technology. We have partnered with multiple banks, non-banking financial institutions, and corporate organizations to create a solid service delivery model for them and their customers to ease their international remittances and payments concerns. Website: www.agpaytech.co.uk

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