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# IF DEPOSITORS CONTINUE TO PARK MONEY WITH PRIVATE BANK, STRUCTURE OF BANKING SECTOR IN INDIA WILL CHANGE FUNDAMENTALLY

Relevant for: Indian Economy | Topic: Issues relating to Growth & Development - Banking, NPAs and RBI

The pace at which private sector banks are gaining market share at the expense of their public sector counterparts is staggering. As reported in this paper, deposits of the top eight private sector banks rose by Rs 2.68 lakh crore between July and December 2019, higher than the Rs 2.58 lakh crore increase in the top eight public sector banks. Over the past few years, incremental growth of private banks in both deposits and advances has far outstripped that of public sector banks. In 2016-19, the share of private banks in incremental deposits rose to 81 per cent, up from 19 per cent in 2011-15, while their share in incremental loans stood at 69 per cent in 2018-19. Though, at the aggregate level, public sector banks accounted for roughly 65 per cent of total deposits at the end of 2019, if these trends persist, it is conceivable that in the coming years, the share of private banks in both deposits and advances will be at par with that of public sector banks — fundamentally altering the structure of the banking sector in India.

There are several possible explanations for this dramatic shift which has accelerated post 2015. First, the Reserve Bank of India's determined push to clean up the balance sheets of public sector banks, which forced them to recognise the true extent of bad loans in the system, left them with little funds for expansion. Then, placing several of these banks under the RBI's corrective action framework restricted their banking activities. Along with these, other factors such as personalised services, the extensive use of technology, and the relatively higher interest rates offered by private banks could have aided in this shift. This shift, dubbed by some as privatisation by stealth, will have far reaching ramifications for both public sector banks as well as their owner, the government, as gains by private banks will come at the expense of public banks, leading to an erosion in their value.

So far, the government's strategy of turning around public banks, which rests on four pillars — recognition of bad loans, resolution and thus recovery of value from these stressed loans, and recapitalisation and reforms in banks — hasn't had the effect it had hoped for, largely because of the lack of reforms to address structural issues that continue to plague state-controlled banks. While improving governance standards and allowing banks to function as independent and autonomous entities should be a top priority, it is unlikely to happen with the government continuing to hold a controlling stake in banks. Since outright privatisation does not appear to be an option that is being considered, the government should consider transferring its stake to a bank holding company along the lines suggested by the P J Nayak committee. This would help create a wall between ownership and management, allowing banks the freedom to take commercially viable decisions without interference from the government.



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