ISSN No.: 2454- 2024 (online)

International Journal of Technical Research & Science

PAYMENT BANKS AND DEMONETIZATION

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Abstract: The year 2014-15 is known to be the year of financial inclusion with Jan Dhan Yojana, 2016 marked some historic policy changes such as the GST (Goods and Service Tax) and Demonetization much recently, and finally 2017 would be the era of payment banking. This research paper will focus on the recent performance of the banking sector in India, the need to demonetize and payment banks. Attempting to dig through the history of previous demonetization moves, this paper will focus on the reviews of the move, the likely banking revolution in the country and the active role of payment banks after the recent decision to demonetize in India.
Keywords: Demonetization, Legal tender, Black money, Payment Banks, Economic Strategies

1. INTRODUCTION

Demonetization is the act of stripping a currency unit of its status as legal tender. It is necessary whenever there is a change of national currency. The old unit of currency must be wiped of and replaced with a new currency unit.
At the stroke of the midnight hour of 9 November 2016, India lost 86% of its monetary base. The country is in uproar following the bold and risky move. The aim behind the government's action was to combat tax cheating, counterfeiting and corruption. Eliminating large denominations makes it harder to hide large amounts of cash. Modi noted that the move complements the country's Swachh Bharat Abhiyan (Clean India campaign).
The move was first implemented in January 1946 when the Reserve Bank of India discontinued Rs 1,000 and Rs 10,000 notes.
Innovation and enterprise form the essence of opportunities and find reflection in every facet of our functions. With the advent of new technologies and ethos of innovation, the bankers have constantly endeavoured to develop new products and services which are most suitable to their clients or prospective clients. The evolving economic landscape and aspirations of the people have driven the planners to plan seamlessly for inclusive banking for realizing the opportunities that lie within. Considering the long outstanding need for reaching out to the far flung non-banked areas of the country, the Reserve Bank of India has done well to introduce more competition among banks by authorizing, in principle, a new kind of bank. On 19th Aug 2015, the RBI announced eleven approvals for Payment Banks, a stripped down version of a full service bank which is designed to reach people outside the span of formal banking services. In the present highly competitive banking; which demands evolving strategies to promote interest of all stakeholders, the need to cut costs in its product & services; opening of more new full-service bank's structure in far flung off areas have proved unviable. The solution therefore has been to operate banks through diverse set of players--- such as Postal Department, Telecom Companies, which promise to reach people more effectively through technological advancements.

1.1 Background

Similar demonetisation of banknote denominations have been taken in the past. In January 1946, banknotes of 1000 and 10000 rupee were withdrawn and new notes of 1000, 5000 and 10000 rupee were introduced in 1954. The Janata Party coalition government had again demonetized banknotes of 1000, 5000 and 10000 rupee on 16 January 1978 as a means to curb counterfeit money and black money.
In 2012, the Central Board of Direct Taxes had recommended against demonetization, saying in a report that "demonetization may not be a solution for tackling black money or economy, which is largely held in the form of benami properties, bullion and jewellery".
On 28 October 2016 the total banknotes in circulation in India was 17.77 lakh crore (US$260 billion). In terms of value, the annual report of Reserve Bank of India (RBI) of 31 March 2016 stated that total bank notes in circulation valued to 16.42 lakh crore (US$240 billion) of which nearly 86% (around 14.18 lakh crore (US$210 billion)) was 500 and 1000 banknotes. In terms of volume, the report stated that 24% (around 22.03 billion) of the total 90266 million banknotes were in circulation.
The role of cash and high-value bank notes in the Indian economy cannot be understated. It will not be enough to just implement demonetization. It has to be matched with a better; more streamlined and integrated tax and payments system.

2. WORKING OF PAYMENTS BANKS

These are niche banks set up by the Reserve Bank of India to further the move towards financial inclusion. These banks provide small savings accounts and payments /remittance services mainly to migrant labour workforce, low-income households, small businesses, etc. by enabling high volume-low value transactions in deposits and payments/ remittance services in a secured technology-driven online environment. They can accept demand deposits-current deposits and savings bank deposits — from individuals, small businesses and other entities. Customers will earn interest on their savings account balance. The payments banks can accept and send remittances. They are also allowed to undertake utility bill payments and can distribute MF, Insurance and Pension products. However, they cannot lend to customers or issue credit cards.

The Payments Bank are registered as a public limited company under the Companies Act, 2013, and licensed under Section 22 of the Banking Regulation Act, 1949, with specific licensing conditions restricting its activities to acceptance of demand deposits and provi-sion of payments and remittance services. They are governed by the provisions of the Banking Regulation Act, 1949, Reserve Bank of India Act, 1934, Foreign Exchange Management Act, 1999, Payment and Settlement Systems Act, 2007, other relevant Statutes and Directives, Prudential Regulations and other Guidelines/Instructions issued by RBI and other regulators from time to time, including the regulations of SEBI regarding public issues and other guidelines applicable to listed banking companies.

3. INDIA'S BANKING SECTOR

As per the Reserve Bank of India (RBI), this 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.

Indian banking industry has recently witnessed the roll out of innovative banking models like payments and small finance banks. RBI's new measures may go a long way in helping the restructuring of the domestic banking industry.

The Indian banking system consists of 26 public sector banks, 25 private sector banks, 43 foreign banks, 56 regional rural banks, 1,589 urban cooperative banks and 93,550 rural cooperative banks, in addition to cooperative credit institutions. Public-sector banks control nearly 80 percent of the market, thereby leaving comparatively much smaller shares for its private peers. Banks are also encouraging their customers to manage their finances using mobile phones.

The Reserve Bank of India gave out licenses to 11 entities in mid-2015 but by May 2016, three applicants—Tech Mahindra, Cholamandalam Finance and Dilip Shanghvi-IDFC Bank-Telenor JV—dropped out, leaving only eight in the fray: India Post, Airtel Payments Bank, Reliance Industries, Paytm Payments Bank, Aditya Birla Nuvo, Vodafone M-Pesa, Fino PayTech and National Securities Depository.

Standard & Poor's estimates that credit growth in India's banking sector would improve to 11-13 per cent in FY17 from less than 10 per cent in the second half of CY14.

3.1 Investments/Developments in the Banking Sector

Key investments and developments in India's banking industry include:

- RBL Bank Limited, an Indian private sector bank, has raised Rs 330 crore (US$ 49.6 million) from a UK-based development finance institution CDC Group Plc, which will help RBL to strengthen the capital base to meet future requirements.
- The State Bank of India (SBI) signed an agreement with The World Bank for a Rs 4,200 crore (US$ 625 million) credit facility, aimed at financing grid connected rooftop solar photovoltaic (GRPV) projects in India.
- JP Morgan Chase, the largest bank in United States by assets, plans to expand its operations in India by opening three new branches in Delhi, Bangalore and Chennai in addition to its existing branch in Mumbai.
- Canada Pension Plan Investment Board (CPPIB), an investment management company, has bought a large stake in Kotak Mahindra Bank Ltd from Japan-based Sumitomo Mitsui Banking Corporation.
- India's first small finance bank called the Capital Small Finance Bank has started its operations by launching 10 branch offices in Punjab, and aims to increase the number of branches to 29 in the current FY 2016-17.
- FreeCharge, the wallet company owned by online retailer Snapdeal, has partnered with Yes Bank and MasterCard to launch FreeCharge Go, a virtual card that allows users to pay for goods and services at online shops and offline retailers.

- Kotak Mahindra Bank Limited has bought 19.9 per cent stake in Airtel M Commerce Services Limited (AMSL) for Rs 98.38 crore (US$ 14.43 million) to set up a payments bank. AMSL provides semi-closed prepaid instrument and offers services under the 'Airtel Money' brand name.
- India's largest public sector bank, State Bank of India (SBI), has opened its first branch dedicated to serving start-up companies, in Bengaluru.
- Global rating agency Moody's has upgraded its outlook for the Indian banking system to stable from negative based on its assessment of five drivers including improvement in operating environment and stable asset risk and capital scenario.
- The Reserve Bank of India (RBI) has granted in-principle licences to 10 applicants to open small finance banks, which will help expanding access to financial services in rural and semi-urban areas.
- IDFC Bank has become the latest new bank to start operations with 23 branches, including 15 branches in rural areas of Madhya Pradesh.
- The RBI has given in-principle approval to 11 applicants to establish payment banks. These banks can accept deposits and remittances, but are not allowed to extend any loans.
- The Bank of Tokyo-Mitsubishi (BTMU), a Japanese financial services group, aims to double its branch count in India to 10 over the next three years and also target a 10 per cent credit growth during FY16.
- The RBI has allowed third-party white label automated teller machines (ATM) to accept international cards, including international prepaid cards, and said white label ATMs can now tie up with any commercial bank for cash supply.
- The RBI has allowed Indian alternative investment funds (AIFs), to invest abroad, in order to increase the investment opportunities for these funds.
- Bandhan Financial Services raised Rs 1,600 crore (US$ 234.8 million) from two international institutional investors to help convert its microfinance business into a full service bank. Bandhan, one of the two entities to get a banking licence along with IDFC, launched its banking operations in August 2015.

4. REVIEWS OF THE DEMONETIZATION MOVE

"This is a step which will make a positive difference, if the transition challenges get handled well by the administration," says Jitendra V. Singh, Wharton Emeritus Professor of Management. "We will need to be careful of potential attempts to derail this positive agenda." The International Monetary Fund (IMF) echoes those sentiments. "Of course, given the large role of cash in everyday transactions in India's economy, the currency transition will have to be managed prudently to minimize possible disruption."

According to Mauro F. Guillen, a Wharton Management Professor and Director of the School's Lauder Institute, "In the short term, the move could stifle some businesses that are legal and clean, if they use cash payments. But everyone will adjust. And while it can hurt some small businesses and individuals, it is better to do it than not."

Guillen adds that large-value currency is an "important source of problems" such as corruption, black money, terrorism and counterfeit money. "The Eurozone will be eliminating the largest euro note. The U.S. is also trying to reduce the number of 100 dollar bills in circulation."

The role of cash and high-value bank notes in the Indian economy cannot be understated. According to Reserve Bank of India (RBI) figures, as of March 2016 currency in circulation amounted to Rs16,415 billion. Of this, Rs500 notes accounted for 47.8% in value and Rs1,000 notes another 38.6%. Together, they were more than 86% of the value of the notes in circulation. That's a whopping amount to be frozen in one fell swoop.

Understandably, banks and ATMs can do only so much. There's a lot of tinkering to be done with limits and schedules of the exchange outlets and bodies authorized to take payments in old bills — state-owned electricity suppliers, for instance.

5. SCOPE FOR FURTHER STUDY

This paper has attempted to study the demonetization of Indian currency, its history, the need for effective transaction payment banking to correlate with this move and the road ahead. However there exists a further scope of studying each of these effects separately sector wise and be traced through the Indian stock market fluctuations over a period of time. Also a further study of the gold and foreign exchange fluctuations may also be studied separately to understand the effect of the demonetization move and the banking sector's performance at a later stage.

CONCLUSION

A. 2017: INDIA'S ERA OF PAYMENT BANKING

It is true that since payments banks won't be able to disburse loans, their net interest income will be limited. So, it seems that without traditional banking economics, the road for payment banking players is not lucrative. It's a long due experiment that logically follows after a agriculturally dominated traditional economy like India embraces digital payments widely.

The concept seems to be finally inching closer to reality, since the first player Airtel launched its payments bank recently. It rolled out its pilot services in Rajasthan. With over 10,000 saving accounts opened within two days of it going live, a majority of customers living in the semi-urban and rural areas have been benefited. Several other license-holders are accelerating their preparations for the launch of their ambitious payments banks-a financial ecosystem that is said to redefine banking and push for India's journey into a cashless economy. As according to the rules laid down by the RBI, the in-principal licensees would have 18 months starting from August 2015 to set up fully functional payment banks with their respective business models and the deadline is close, February 2017.

B. THE ROAD AHEAD

The Indian economy is on the brink of a major transformation, with several policy initiatives set to be implemented shortly. Positive business sentiments, improved consumer confidence and more controlled inflation are likely to prop-up the country's the economic growth. Enhanced spending on infrastructure, speedy implementation of projects and continuation of reforms are expected to provide further impetus to growth. All these factors suggest that India's banking sector is also poised for robust growth as the rapidly growing business would turn to banks for their credit needs.

Also, the advancements in technology have brought the mobile and internet banking services to the fore. The banking sector is laying greater emphasis on enhanced services to their clients and also upgrading their technology infrastructure.

Many banks, including HDFC, ICICI and AXIS are exploring the option to launch contact-less credit and debit cards in the market shortly. The cards, which use near field communication (NFC) mechanism, will allow customers to transact without having to insert or swipe.

As some licensees delved deeper, they found that the business model didn't seem attractive enough or there were other priorities that they wanted to pursue. Secondly, competition is also not a point to worry about. The real challenge is to drive the much needed attitudinal and behavioral change to access digital transactions after the anti-money laundering initiated KYC process.

With 97% cash transactions in the economy and with a fast-growing population of smartphone and data users, modeling people behavior and lessening their dependence on cash is the real challenge.

Despite the tall claims, targeting rural or low-income geographies, data availability and Aadhaar penetration are not seamless. If they have the same requirements as large banks and to our digital connect with the consumer through the mobile, it would truly tough to achieve a different level of scale.

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