CHAPTER- FIVE
STRUCTURE OF COMMERCIAL BANKS IN INDIA

The structure of banking differs from country to country depending upon their economic conditions, political structure and financial system. Banks can be classified on the basis of volume of operations, business pattern and area of operations. They are termed as system of banking. The commonly identified system are-

(a) Branch banking
(b) Correspondent banking
(c) Chain banking
(d) Group banking
(e) Relationship banking
(f) Narrow banking
(g) Universal banking
(h) Regional banking
(i) Local Area Banks
(j) Retail banking
(k) Wholesale banking
(l) Private banking

Branch Banking: -- The Banking system of England originally offered an example of the branch banking system, where each commercial bank has a network of branches spread throughout the country. In the initial stages of banking development, each bank in
England consisted of a single office with few branches. In the process of evolution, banking organization developed in the direction of branch banking. As a result of continuous process of amalgamation and consolidation, today there exist only a few banks, of which the "Big Five" – the midland, the Lloyds, the Barclays, the Westminster and the National provincial – are most important. The Big Five of England have more than 10,000 branches and cover about 75% of the banking resources of the country.

Most of the Indian Banks are falling under this category. They are having large number of branches. All the public sector banks, i.e., nationalized banks and state bank of India and its subsidiary banks put together have nearly 60,000 branches. Banks in India require a license from Reserve Bank of India under Banking Regulation Act to open a branch as well as to start a bank itself.

Thus, branch banking consists of a few big banks with numerous branches spread over wide geographical areas. These branch banks operate under their head offices. Branch banking is also known as "demoralized banking".

**Advantages of Branch Banking:** The following are the advantages of branch banking:

(i) Benefits of large-scale operations.
(ii) Wider spreading of risks.
(iii) Efficient management.
(iv) Economy in remittance.
(v) Economy of cash reserves.
(vi) Diversification of deposits and assets.
(vii) Uniformity of interest rates.
(viii) Reduce seasonal stringency.
(ix) Fullest and proper use of resources.
(x) Extension of banking facilities to backward areas and weaker sections.
(xi) Acquiring diverse types of securities.
(xii) Provide long-term loans and advances.
(xiii) Greater mobility of organization.
(xiv) Loans and advances made on merit.
(xv) Possibility of division of labour and specialization.
(xvi) Economic conditions can be studied better.
(xvii) Bank failures will be minimized.
(xviii) Effective control by Central Bank.
(xix) Greater convenience to trade.
(xx) Public confidence.
(xxi) Equitable distribution of employment opportunities.

Let us discuss these points one by one.

Benefits of large – scale operations: -- A branch bank has all the advantages of large-scale operations. It has large resources when compared to a unit bank. It can appoint experts paying high salary and it can use modern mechanical devices in its offices for efficient working.
**Wider spreading of risks:** -- A branch bank operates over a wide area with different types of economic development. The losses of branches of one region if any can be set off against the profit of branches in other regions. In this way this risks are distributed geographically. Thus, its capacity to withstand times of depression is more than that of unit banks.

**Efficient management:** -- The branch banking system makes for greater efficiency in management. The staff members of a branch bank are more efficient and more experienced when compared to those of a unit bank. The head office arranges transfers to staff from branch to branch. Each staff member has the opportunity to work in various branches, understanding men and matters of different localities. Besides the above, the expertise at head office will be made available for all branches. In this way, the system of branch banking ensures efficient management.

**Economy in remittance:** -- Branch banking has the benefit of economy in remittance of funds. As it has branches in different localities, it need not physically transfer cash from one place to another. It can provide remittance facilities to its customer by mere transfer entries in the books of its branches. It makes the operation easy, quick and cheap.

**Economy of cash reserves:** -- Branch banking has the merit of economy of cash reserves. Cash can be transferred from one branch
to another whenever necessary. Therefore, branch can operate with lower cash balances and they avoid large amount of idle reserves/ balances.

**Diversification of deposits and assets:** -- Under branch banking system, there is greater diversification of deposits and assets because of wider geographical coverage. Diversification here means that a bank need not specialize in any particular area or particular industry. Deposits are mobilized from the area where savings are in plenty and loans are extended in the areas where funds are scarce and interest rates are high.

**Uniformity in interest rates:** -- Branch banking system ensures uniformity in interest rates. Uniformity in banking policies and easy transfer of funds to places where there is demand, results in uniform interest rates.

**Reduce seasonal stringency:** -- In agricultural countries like India, there is greater demand for funds during the seasons of agricultural operations. By a wide network of branches and transfer of funds, branch banking will be in a position to relieve such seasonal scarcity of funds.

**Fullest and proper use of resources:** -- Under branch banking, there is great scope for economic use of funds. The head office analyses the demand for funds in various localities and freely transfers its resources among its branches. At no branch, funds are...
kept idle. This enables it to earn high profits by employing its funds most economically and profitably.

**Extension of banking facilities to backward areas and weaker sections:** Under branch banking, the banking facilities are not restricted to profitable localities only but they are extended to the backward areas also. The loss arising from such localities can be compensated by the profits from other developed areas. Besides, because of the availability of resources, the requirements of weaker sections of the society are also satisfied.

**Acquiring diverse types of securities:** Branch banking has the advantage of acquiring diverse types of securities from different regions in employing funds. It can invest its funds by lending against securities of agricultural commodities, industrial goods, gold, stock, etc. It can choose a variety of securities from different localities. But a unit bank does not have this facility.

**Provides long term loans and advances:** Due to its wider area of operations, they may mobilize large resources which can be used to provide loans and advances on long term basis which is not possible in case of unit banking.

**Greater mobility of organization:** The branch banking has the greater mobility of organization. It can spread its activities to new localities by opening branches with ease.
Loans and advances made on merit: -- Under the system of branch banking loans and advances are made purely on merit and not on other considerations. The branch manager is not influenced by local pressures in granting loans and advances. He can refuse a loan to an undesirable person, without any obligation, fixing the responsibility on the head office. This is not possible in the case of a unit bank.

Possibility of division of labour and specialization: -- Because of the availability of large resources and large-scale operations it is possible to adopt division of the labour, which leads to specialization. In this way branch banking ensures the overall efficiency of the organization.

Economic conditions can be studied better: -- Under branch banking, a network of branches spread all over the country. Thus, it can have a comprehensive knowledge of the entire economic conditions of the country. It helps the banks to make proper investments.

Bank failures will be minimized: -- In the case of heavy withdrawal of funds in one branch, it can be met by transferring funds from other branches. Thus, bank failures can be avoided.

Effective control by Central Bank: -- Branch banking does not make the control by Central Banking more difficult, as it has to deal only with the Head Offices on Banks, and not with each branch.
Greater convenience to trade: -- The traders of one area can get in touch with traders in other parts of the country with ease. If the bank has branches in foreign countries, they can contact the traders in foreign countries also. This helps them to promote their business considerably.

Public confidence: -- The large scale operation and the financial viability of branch banking gains public confidence which is the foundation stone for the banking business.

Equitable distribution of employment opportunities: -- A vast network of bank branches at various places offer local employment opportunities and help local people in getting jobs.

Disadvantages of Branch Banking: -- Even though, the branch bank has many advantages as mentioned above, it is not free from criticisms. The following are the disadvantages of Branch Banking:

(i) Difficulty in management and control
(ii) Less initiative
(iii) Regional disparities
(iv) Adjustment of losses
(v) Concentration of economic power
(vi) Continuance of inefficient branches
(vii) Heavy overhead charges
(viii) Unhealthy competition
(ix) Delayed decision-making
(x) Local needs may not be satisfied in full
(xi) Other defects

We shall explain these items one by one.

**Difficulty in management and control:** -- Since the bank has many branches, spread over different places, supervision, management and control becomes more difficult.

**Less initiative:** -- The branches of the bank are not allowed to make their independent decisions. They have to follow the directives of the head office. Besides they have to refer to the matters to the head office for approval. Therefore, the branch managers cannot take initiative.

**Regional disparities:** -- In the case of unit banking system the funds are used for the particular locality alone. It cannot be transferred to other places. But, in the case of branch banking funds collected from backward areas and the villages may be transferred to the places where the profitability is high. This tendency creates regional imbalances in the country.

**Adjustment of losses:** -- In branch banking, the losses of one branch may be adjusted against the profit earned by another branch. This will affect the profitability of the organization as a whole, as loss-making branches will continue to eat into the profits of efficient branches.
Concentration of economic power: -- Under branch banking system, the financial resources may accumulate in the hands of a few who control big banks with large number of branches. This will cause concentration of economic powers in few big banks. It leads to monopoly.

Continuance of inefficient branches: -- Under unit banking system, the inefficient branches cannot survive. But, in case of branch banking, the inefficient branches may continue to operate because the losses of these branches are compensated by the profits of some other strong branches. In this way, under this system, inefficient is protected.

Heavy overhead charges: -- Establishment of branches in new areas incurs heavy overhead charges. This will affect the operational efficiency of the banks.

Unhealthy competition: -- Under branch banking, many banks may operate their branches in a particular locality where business prospects are very bright. It may create unhealthy competition among various branches of banks.

Delayed decision-making: -- In branch banking the manager of a branch cannot take the decision on his own. He has to refer to the matter to the head office seeking permission or approval. This creates red-tapism in the organization.
Local needs may not be satisfied: -- As the branch manager is not connected or familiar with local conditions, the local needs may not be attended and satisfied in full.

Other defects: --

- Preferential treatment may be shown to firms situated near head offices.
- The lower rates charged in developing regions may be adjusted by charging high rates of interest in developed regions.
- There are possibilities for mismanagement in branches, like frauds, misappropriation of funds, etc.

Correspondent banking: -- Correspondent-banking system is developed to remove the difficulties in unit banking system. It is the system under which unit banks are linked with bigger banks. The big correspondent banks are linked with still bigger banks in the financial centers. The smaller banks deposit their cash reserve with bigger banks. The bigger banks with which such deposits are so made are called correspondent banks.

Therefore, correspondent banks are intermediaries through which all unit banks are linked with bigger banks in financial centers. Through correspondent banking, a bank can carry-out business transactions in another place where it does not have a branch. This system is very common in international banking transactions. For example, if an Indian bank does not have a branch in Japan, it may
find it difficult to carry-out Japan-related import/export transactions for its customers. In such a case, the Indian bank may choose a bank in Japan as its correspondent bank to put through all its Japan-related financial transactions. This arrangement avoids the need of opening a branch in another country. Hence, it is cost effective also.

**Chain banking:** chain banking is a system of banking under which a number of separately incorporated banks are brought under the common control by a device other than holding company. This may be:

- Through some group of persons owning and controlling a number of independent banks.
- Each bank retains its separate identity.
- Each one carries out its operations without the intervention of any central organization.

The main criticism of chain banking is the lack of continuity of existence and diseconomies in its operation.

**Group Banking:** Group Banking is the system in which two or more independently incorporated banks are brought under the control of a holding company. The holding company may or may not be a banking company. Under group banking, the individual banks may be unit banks, or banks operating branches or a combination of the two.
Participating banks retain their own boards of directors, which are responsible to the supervising and regulatory authority and depositors for the proper operation of the bank. That is, each bank in the group has got a separate entity.

This system has developed in United States in 1900. it was popular and extensively developed in 1920's.

**Advantage of Group Banking:** -- The following are the advantages of the Group Banking System:

(i) Centralized Administration
(ii) Enhancement of operational efficiency
(iii) Broader market
(iv) Mobility and transfer of resources
(v) Large scale operation
(vi) Other Benefits

**Centralized Administration:** -- The participating banks enjoy the benefits of centralized administration.

**Enhancement of operational efficiency:** -- Because of Group banking system, the operational efficiency of participant banks is enhanced through shared knowledge and experience.

**Broader market:** -- Group Banking offers broader market to the small banks for their excess resources. Thus, their earning capacity and network improved.
Mobility and transfer of resources: -- In the case of crisis, the funds are transferred among participating banks. This helps them to face the financial crisis if any, more effectively.

Large-scale operation: -- Group banking paves the way for large scale operation. The member banks can get the economics of large-scale operation.

Other Benefits: -- The holding company offers the following services to the participating banks:

- Guidance of experts
- Auditing
- Investment counseling
- Combined Purchase of stationary and office equipments
- Insurance cover on deposits
- Advertising and publicity
- Tax guidance
- Other advisory services

Disadvantages of Group Banking: -- The disadvantages of the Group Banking System are as follows:

(i) Lack of effective management and control
(ii) Inefficiency of member banks protected
(iii) Less facilities
(iv) Cannot mobilize funds

Lack of effective management and control: -- Under Group banking system the control and management is not effective because the control is in direct and more flexible. It cannot offer specialized management.

Inefficiency of member banks protected: -- The inefficiency of one participating bank affects the other participating banks.

Less- facilities: -- This system cannot provide all the facilities offered by branch banking.

Cannot mobilize funds: -- Group banking does not have the capacity to mobilize funds as in the case with branch banking.

Hence, it cannot offer the same economy of operations as are offered by branch banking.

Relationship Banking: -- It is necessary for every bank to retain its big and good customers. These customers will be a source of regular income for the banks as they will be prompt and regular in repayment of loans and advances. In many cases they may be customers having large deposits with the banks. A bank's profit to a large extent depends upon retaining such honest borrowers and large depositors.
Similarly, it is also necessary to attract new customers who will be a source of income for the bank. Relationship banking refers to the efforts of a bank to promote personal contracts and to keep continuous touch with customers who are very valuable to the bank. In order to retain such profitable accounts with the bank or to attract new accounts, it is necessary for the bank to serve their needs by maintaining a close relationship with such customers. This type of banking activity gains momentum in a highly competitive banking world.

**Narrow Banking:** -- A bank engaged in multifarious activities like providing working capital, term loans, doing investment business, consumer loans, housing loans, agricultural loans, advisory services, etc., require to maintain group of knowledgeable persons and experts in each field of activity. For lack of proper appraisal of loan documents, verification of important information due to inadequate knowledge, staff or expertise the bank may slip into losing business.

Similarly, having a large number of customers may also result into many defaults in payment and consequently of more bad debts. In order to obviate such pitfalls, a bank may be concentrating only on collection of deposits and lend or invest the money within a particular region or certain chosen activity like investing the funds only in Government Securities. This type of restricted minimum banking activity is referred to 'Narrow Banking'.
Universal Banking: -- As Narrow Banking refers to restricted and limited banking activity, Universal Banking refers to broad-based and comprehensive banking activities. Under this type of banking, a bank will deal with working capital requirements as well as term loans for developmental activities. They will be dealing with individual customers as well as big corporate customers. They will have expanded lines of business activity combining the functions of traditional deposit taking, modern financial services, selling long-term saving products, insurance cover, investment banking, etc. Examples of universal bankers are Citigroup (formerly Citibank), Hong Kong and Shanghai Banking Corporation (HSBC). In Europe universal banks are known as “Bancassurance”. [All type of financial services and fund based (loans and advances) activities are undertaken by a bank under Universal Banking.]

In India commercial banks like State Bank of India, Indian Overseas Bank and other banks generally provide loans and advances for short-term to meet working capital requirements of borrowing companies. Likewise Developmental Financial Institutions like IDBI, ICICI provide only long-term finance for expansion and diversification to business activity. There is now a move to allow banks and Financial Institution to provide both short-term and long-term finance to corporates under an umbrella system known as Universal Banking.

Regional Banking: -- Small traders, Village artisans, agricultural labourers, etc. in rural and semi-urban areas around do not get
adequate credit facilities from Commercial banks since these banks are generally looking for large borrowers engaged in commercial/business activities. This type of banking leaves the rural areas undeveloped economically. In order to provide adequate and timely credits to small borrowers in rural and semi-urban areas, Central Government set up Regional Banks, known as Regional Rural Banks all over India jointly with State Governments and some Commercial Banks. As they are permitted to operate in particular region, it may help develop the regional economy.

**Local Area Banks:** -- In some cases, the regional banks set up by the government are not being run profitably for various reasons. Secondly, these banks are not meeting fully the credit requirements of regional borrowers. With a view to bring about a competitive environment and to overcome the deficiencies of regional banks, Government has permitted establishment of a new type of regional banks in rural and semi-urban centers under private sector known as 'Local Area Bank'. These banks require a low capital base of Rs.5crore only. The entire share capital has to be mobilized from private sector. They will be permitted to operate only within a region of 2 or 3 districts. Local Area Banks are yet to become operational in India as of June 1999.

**Retail Banking:** -- Retail banking is a major form of commercial banking but mainly targeted to consumers rather than corporate clients. It is the method of banks' approach to the customers for sale of their products. The products are consumer-oriented like offering a
car loan, home loan facility, financial assistance for purchase of consumer durables, etc. Retail banking therefore has large customer-base and hence, large number of transactions with small values. It may therefore be cost ineffective in a highly competitive environment. Most of the Rural and semi-urban branches of banks, in fact do retail banking. In the present day situation when leading to corporate clients lead to credit risk and market risk, retail banking may eliminate market risk. It is one of the reasons why many a wholesale bankers like foreign banks also prefer to go for consumer financing albeit for marginally higher net individuals.

**Wholesale Banking:** -- Wholesale or corporate banking refers to dealing with limited large-sized customers. Instead of maintaining thousands of small accounts and incurring huge transaction costs, under wholesale banking, the banks deal with large customers and keep only large accounts. These are mainly corporate customers. This results into few transactions with large amounts thus, resulting into cost reduction and higher fees. Foreign banks in India are mostly concentrating in wholesale banking, which is aided by fully computerized banking operations. Increased merchant banking and investment banking activities aided growth in this type of banking.

**Private Banking:** -- Private or Personal Banking is banking with people rich individual instead of banking with corporate clients. Private or Personal Banking attends to the need of individual customers, their preferences and the products or services needed by them. This may include all round personal services like maintaining
accounts, loans, foreign currency requirements, investment guidance, etc. This type of banking is investment and asset management oriented towards individuals and not addressing to the needs of industry and trade.