Chapter 2
LANDSCAPE OF INDIAN BANKING INDUSTRY

In any country, its banking system plays a pivotal role in the country's economic development. The banking industry in India has become one of the most growth-oriented industries in recent times with the opening of large number of private and foreign banks in the country. Banks being effective catalysts of change, mobilizing the savings of people, can function as instruments for promoting economic and social development in a purposive manner. In our developing economy, banks occupy an undisputed position of importance for three important reasons. First, they take a leading role in developing other financial intermediaries and markets. Second, due to the absence of well-developed equity and bond markets, the corporate sector depends heavily on banks to meet its financing needs. Finally, in emerging markets such as India, banks cater to the needs of a vast number of savers from the household sector, which prefer assured income and liquidity and safety of funds, because of their inadequate capacity to manage financial risks.

2.1 Evolution of Commercial Banks in India

The commercial banking industry in India started in 1786 with the establishment of the Bank of Bengal in Calcutta. From 1786 till today, the journey of Indian Banking System can be segregated into three distinct phases:

- Early phase of Indian banks, from 1786 to 1969.
- New phase of Indian banking system, with the reforms after 1991.

Phase 1: Pre-nationalization Era

The first bank in India, the General Bank of India, was set up in 1786. Bank of Hindustan and Bengal Bank followed. The East India Company established Bank of Bengal (1809), Bank of Bombay (1840), and Bank of Madras (1843) as independent units and called them Presidency banks. In 1921, the three Presidency banks were amalgamated to form the Imperial Bank of India, which took up the role
of a commercial bank, a bankers' bank and a banker to the Government. The Imperial Bank of India was established with mainly European shareholders. It was only with the establishment of Reserve Bank of India (RBI) as the central bank of the country in 1935, that the quasi-central banking role of the Imperial Bank of India came to an end.

In 1860, the concept of limited liability was introduced in Indian banking, resulting in the establishment of joint-stock banks. In 1865, the Allahabad Bank was established with purely Indian shareholders. Punjab National Bank came into being in 1895 with headquarters in Lahore. Between 1906 and 1913, other banks like Bank of India, Central Bank of India, Bank of Baroda, Canara Bank, Indian Bank, and Bank of Mysore were set up. The Reserve Bank of India came into being in 1935.

During the first phase, the growth was very slow and banks also experienced periodic failures between 1913 and 1948. To streamline the functioning and activities of commercial banks, the Government of India came up with the Banking Companies Act, 1949, which was later changed to the Banking Regulation Act, 1949. The Reserve Bank of India (RBI) was vested with extensive powers for the supervision of banking in India as the Central banking authority.

Phase 2: Post-nationalization Era

Having realized that nothing short of nationalization would serve the socialistic fabric of the Indian economy; the government of India took a bold decision to bring under its direct control a substantial segment of the banking system. Four bouts of nationalization by the Government of India led to the creation of public sector banks.

Nationalization Process

- 1955: Nationalization of State Bank of India
- 1959: Nationalization of SBI subsidiaries
- 1969: Nationalization of 14 major banks
- 1980: Nationalization of six banks with deposits over Rs. 200 crore
The government in 1955 constituted the State Bank of India by nationalizing the Imperial Bank of India which started offering extensive banking facilities, especially in rural and semi-urban areas. The State Bank of India was authorized to act as the principal agent of the RBI and to handle banking transactions of the Union government and state governments all over the country. Seven banks owned by the Princely states were nationalized in 1959 and they became subsidiaries of the State Bank of India.

To better align the banking system to the needs of planning and economic policy, it was considered necessary to have social control over banks. In 1969, as a major process of nationalization, 14 commercial banks in the country were nationalized. This was an important milestone in the history of Indian banking.

This was followed by the nationalization of another six private banks in 1980. With the nationalization of these banks, 80% of the banking sector in India came under the government ownership. The nationalization of banks imparted major impetus to branch expansion in un-banked rural and semi-urban areas, which in turn resulted in huge deposit mobilization, thereby giving boost to the overall savings rate of the economy. It also resulted in scaling up of lending to agriculture and its allied sectors. However, this arrangement also saw some weaknesses like reduced bank profitability, weak capital bases, and banks getting burdened with large non-performing assets.

- Phase 3: Reforms Era

To create a strong and competitive banking system, a number of reform measures were initiated in early 1990s, mainly as a result of recommendations of a committee set up under the chairmanship of M. Narasimham and in conformity with the new economic policy of liberalization, privatization, and globalization. The thrust of the reforms was on increasing operational efficiency, strengthening supervision over banks, creating competitive conditions and developing technological and institutional infrastructure. These measures led to the improvement in the financial health, soundness and efficiency of the banking system. One important feature of the reforms of the 1990s was that the entry of new private sector banks and foreign
banks was permitted. Following this decision, new banks such as ICICI Bank, HDFC Bank, IDBI Bank and UTI Bank were set up. This phase has changed the entire landscape of Indian banking industry.

2.2 Banking Structure in India

The commercial banking structure in India consists of:

- Banking Regulator
- Scheduled Banks
- Unscheduled Banks

- Banking Regulator

The Reserve Bank of India (RBI) is the central banking and monetary authority of India, and also acts as the regulator and supervisor of commercial banks. The Reserve Bank of India is the apex bank of the system, and it was incorporated as India's central bank on April 1, 1935 under the Reserve Bank of India Act 1934. It was nationalized in 1949 to hasten the slow pace of development in the country. Today, it is the apex financial institution of the country's monetary system, banker to banks in India and statutory authority for banks in India. It oversees the functioning of all banks in India, and of the branches of banks, incorporated in India but operating in foreign countries.

- Scheduled Banks in India

Scheduled commercial banks constitute those banks which have been included in the Second Schedule of Reserve Bank of India (RBI) Act, 1934. Only those banks are included in this schedule which satisfy the criteria laid down by section 42 (6) (a) of the Act. Scheduled banks comprise scheduled commercial banks and scheduled co-operative banks. Scheduled commercial banks (SCBs) form the bedrock of the Indian financial system, currently accounting for more than three-fourths of all financial institutions' assets. SCBs are present throughout India, and their branches, having grown more than four-fold in the last 40 years now number more than 80,500 across the country (see Table 2.1). A pictorial representation of the structure of SCBs in India is given in figure 2.1.
Public Sector Banks

Public sector banks are those in which the majority stake is held by the Government of India (GOI). Public sector banks together make up the largest category in the Indian banking system. There are currently 27 public sector banks in India. They include the SBI and its 6 associate banks, 19 nationalized banks and IDBI Bank Ltd.

The State Bank of India and Its Associated Banks

In 1959, the State Bank of India (Associated Banks) Act was passed and this paved the way for creating the State Bank Group. Over the years the State Bank of India and its associated banks have expanded their business in a big way. On June 30, 2008, the State Bank of India and its Associated Banks together accounted for around 20 per cent of the total branches of all commercial banks in the country. The share of the banking business with them was roughly 30 percent.
❖ **Other Nationalized Banks**

A second category of public sector banks is of 19 nationalized commercial banks. After nationalization of New Bank of India was merged with Punjab National Bank in 1993, the number of public sector banks other than the State Bank of India and its associates declined to nineteen. The total number of branches of the nineteen nationalized banks were 37,463 as on June 30, 2008.

❖ **Private Sector Commercial Banks**

In this type of banks, the majority of share capital is held by private individuals and corporates. These are further classified as: old private sector banks and new private sector banks:

❖ **Old Private Sector banks**

All private sector banks were not nationalized in 1969, and 1980. The private banks which were not nationalized are collectively known as the old private sector banks and include banks such as The Jammu and Kashmir Bank Ltd., Lord Krishna Bank Ltd etc. In terms of branches and also the business done by them, most of the old private sector banks are much smaller than both nationalized banks and foreign banks and thus their role in the financial system of the country is just marginal.

❖ **New Private Sector Banks**

Entry of private sector banks was prohibited during the post-nationalization period. Having realized that over the years competitive efficiency has suffered in the banking sector, RBI permitted the private sector to enter into the banking system in July 1993, as part of the banking reform process and as a measure to induce competition in the banking sector. This resulted in the creation of a new set of private sector banks, which are collectively known as the new private sector banks. As at end March, 2009 there were 7 new private sector banks and 15 old private sector banks operating in India which accounted for 21.7 percent of total banking assets.
Foreign Banks

Foreign banks have their registered and head offices in a foreign country but operate their branches in India. The RBI permits these banks to operate either through branches; or through wholly-owned subsidiaries. Foreign banks in India are required to adhere to all banking regulations, including priority-sector lending norms as applicable to domestic banks. As per the Report on Trend and Progress of Banking in India (2008-09), RBI, there were 32 foreign banks with 293 branches located mainly in big cities of India as at the end of June, 2009. Besides, 43 foreign banks were operating in India through representative offices.

Regional Rural Banks

To loosen the grip of moneylenders in the countryside, a new type of banking institution called Regional Rural Banks was conceived. Each RRB is owned jointly by the Central Government, concerned State Government and a sponsoring public sector commercial bank. After the process of consolidation, there were total 86 RRBs as on March 31, 2009, as compared to 196 at the end of March 2005.

Co-operative Banks

The co-operative banking sector is the oldest segment of the Indian banking system. Co-operative banks cater to the financing needs of agriculture, retail trade, small industry and self-employed businessmen in urban, semi-urban and rural areas of India. The network of urban co-operative banks in India consisted of 1721 banks as at end-March 2009, while the number of rural co-operative banks was 1119 as at end-March 2008.

As at end of June 2009, scheduled commercial banks in India comprised 27 public sector banks (State Bank of India and its 6 Associated Banks, 19 nationalized banks and one IDBI bank, 7 new private sector banks and 15 old private sector banks and 32 foreign banks. In term of business, the public sector banks now have a dominant position. They accounted for 70.5 percent of assets, 73.9 percent of deposits, 72.7 percent of advances and 69.9 percent of investments of all scheduled commercial banks as at end March 2009.
2.3 Break-up of Bank Branches

Indian banking is no longer confined to metropolises or cities in India. Public sector banks have taken the lead role in branch expansion, particularly in the rural areas. From Table 2.1, it can be seen that:

- Public sector banks account for bulk of the branches in India (88 percent in 2009).
- In the rural areas, the presence of the public sector banks is overwhelming; in 2009, 96 percent of the rural bank branches belonged to the public sector. The private sector banks and foreign banks have limited presence in the rural areas.

Amongst the public sector banks, the State Bank of India and Associates had 16294 branches as on June 30, 2009. The nineteen nationalized banks had 39703 branches all over the country. The foreign scheduled banks operate mostly in big cities and their number of branches in the whole country is just 295. Other scheduled commercial banks are private sector banks and their branches are 8979 as on June 30, 2009.

Table 2.1
Break-up of Bank Branches (1969-2009)

<table>
<thead>
<tr>
<th>Type of Bank</th>
<th>1969</th>
<th>2004</th>
<th>2009</th>
<th>Rural branches June 30, 2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>SBI &amp; Associates</td>
<td>2462</td>
<td>13621</td>
<td>16294</td>
<td>5619 -</td>
</tr>
<tr>
<td>Nationalized Banks</td>
<td>4553</td>
<td>33359</td>
<td>39703</td>
<td>13425</td>
</tr>
<tr>
<td>Regional Rural Banks</td>
<td>...</td>
<td>14486</td>
<td>15199</td>
<td>11644</td>
</tr>
<tr>
<td>Total Public Sector Banks</td>
<td>7015</td>
<td>61466</td>
<td>71196</td>
<td>30688</td>
</tr>
<tr>
<td>Other Scheduled Commercial banks</td>
<td>900</td>
<td>5807</td>
<td>8979</td>
<td>1126</td>
</tr>
<tr>
<td>Foreign Banks</td>
<td>130</td>
<td>218</td>
<td>295</td>
<td>4</td>
</tr>
<tr>
<td>Non-scheduled Commercial Banks</td>
<td>217</td>
<td>32</td>
<td>44</td>
<td>11</td>
</tr>
<tr>
<td>Total (All Commercial Banks)</td>
<td>8262</td>
<td>67523</td>
<td>80514</td>
<td>31829</td>
</tr>
</tbody>
</table>

2.4 Management and Organisational Framework of Commercial Banks

The commercial banks in India are essentially branch-based organisations with retail outlets (branches) spread throughout the length and breadth of the country. Their structure has been, therefore, designed to manage a wide network of branches, a large number of personnel, and diverse businesses, in a competitive environment.

The organisational structure of all commercial banks is more or less of a similar nature with minor variations to suit their specific needs. It consists of three or four tiers. Banking is carried out at the branches, while the other tiers comprise the control centers of the bank. Some banks have head office, zonal office, and regional office as their control centers while some banks have resorted to the process of de-layering by shedding an intermediate layer of Zonal offices from its organisational structure in an attempt at faster decision making. Only circle office is stationed between head office and branches. This arrangement enables all senior officers to focus on core banking business instead of dividing their time between business, administration and processes. Banks can quickly respond to changing needs of the customers and have also been able to adjust with the changing environment. This structure envisages each circle office or local head office as a near autonomous management control centre.

The management of a bank vests in the Chairman/Managing Director and Board of Directors comprising professionals representing various fields of specialization, and representative of workmen, Govt. of India, R.B.I. and shareholders. The Central Board is the highest authority in the bank. It deals with matters pertaining to policy decisions, approval of plans/projects, introduction of new schemes/services, etc. The day-to-day functioning of the bank, including sanctioning of loans, approval of expenditure, etc., is dealt with by the Executive Committee of the Central Board, constituted by the Central Board.

Each Circle or local head office is headed by GM or DGM, depending upon the size of the circle. Circle Head is responsible for the operational control of the branches within the jurisdiction of that circle. While the branches of the bank are organized on customer
basis (i.e., personal banking, agricultural banking, small-scale industries banking, etc.),
the Local Head Office is structured on customer group as well as a functional basis.

In case of four tier structure, branches are supervised by regional head who can be
dGM or AGM depending upon the size of regional office. Regional offices are under
control of Zonal offices. Zonal offices report to corporate office.

A branch is that unit of the bank where the actual banking business is transacted with
the public. A branch is placed under the charge of manager, whose rank and level are
decided on the basis of factors like levels of the existing business at the branch, future
potential of business and manpower to be controlled. For a large branch, the Branch
Manager is assisted by the Managers of various divisions (which are created on the
basis of market segmentation) and other officers of suitable experience and seniority.
The relationship of the branch administration with the headquarters follows the
principle of unity of command. All directions and instructions to the branch flow
through only one person- the Regional Head or Circle Head.

The Branch Managers have been delegated with financial and administrative powers.
The nature and quantum of delegation, however, differs from branch to branch,
depending upon size of the branch, business concentration, and staff strength. For this
purpose, the branches are categorized and a specific set of powers is identified for each
category. The general objective of the categorization is that at least 80% of the
proposals received at a branch should be disposed of locally without any reference to a
higher authority. Depending upon the category of the branch, a Branch Manager of a
suitable seniority is posted at that branch.

2.5 Differences between Public and Private Sector Banks in India

There are significant differences between the nature of employment in public and
private sector banks in India:

In case of public sector banks there are fixed grades of salary, ranging from the Junior
Management grade at the lowest supervisory level to the Chairman at the top of the
pyramid. Details of various management grades are given in table 2.2. Wage hikes in
Public sector banks are decided for the entire industry in which bank employees' union play a very significant role. In case of private sector banks, there are no fixed grades of salary. They offer comparatively higher remuneration than public sector banks. Moreover, performance linked pay, promotions, and incentives also constitute a large chunk of reward system in private banks. Furthermore, glamorous designations provide additional enticement for joining private banks. The designations differ from bank to bank.

Table 2.2
Management Grades in a Nationalized Bank

<table>
<thead>
<tr>
<th>Designation</th>
<th>Grade</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chairman &amp; Managing Director</td>
<td></td>
</tr>
<tr>
<td>Executive Director</td>
<td></td>
</tr>
<tr>
<td>Chief General Manager</td>
<td>Top Executive Scale VIII</td>
</tr>
<tr>
<td>General Manager</td>
<td>Executive Scale VII</td>
</tr>
<tr>
<td>Deputy General Manager</td>
<td>Senior Managements Scale VI</td>
</tr>
<tr>
<td>Assistant General Manager</td>
<td>Senior Management Scale V</td>
</tr>
<tr>
<td>Branch Manager and Functional and Operational</td>
<td>These officials could be from any of the above mentioned grades or from the following grades, depending upon the seniority of the position:</td>
</tr>
<tr>
<td>Executives at Central Office/Local Head Offices/Regional Offices</td>
<td>Senior Management Scale IV</td>
</tr>
<tr>
<td></td>
<td>Middle Management Scale III</td>
</tr>
<tr>
<td></td>
<td>Middle Management Scale II</td>
</tr>
<tr>
<td></td>
<td>Junior Management Scale I</td>
</tr>
<tr>
<td></td>
<td>Clerical grade</td>
</tr>
</tbody>
</table>

Public sector banks offer relative job security for regular employees. This may help in attracting or retaining different types of employees. The disparate dynamics in each sector can result in different employee - reactions over time. Inspite of low salary in public sector banks, many private sector employees are now approaching these banks in
search of job security, according to K.C. Chakrabarty, Chairman and Managing Director of PNB.

There are differences between public and private sector banks in terms of exposure to legislation, legislatures, and other social and national priorities, too, although, these differences have narrowed down after the reforms of nineties.

The above-mentioned differences are likely to have different implications for the nature of leadership behaviour, satisfaction of various needs of the managers and their organisational commitment. Employee dynamics may differ across sectors. One dimension of this study relates to understanding the impact of the employment sector on leadership behaviour, need satisfaction and organisational commitment.

To summarise, this chapter has discussed in detail the nature and structure of the banking system, the management and organisational framework of the commercial banks in India, differences between public and private sector banks in India.