Employment and Human Resource Practices in Public Sector Banks in the Nineties

Paper published in Shuji Uchikawa (ed.) - "*Labour Market and Institution in India: 1990s and Beyond*", Institute of Developing Economies, Japan, March, 2002.

Errol D'Souza[♣]

Acknowledgements: This paper has benefited from discussions with Ramesh Dutta, Biju Varkkey, Rakesh Basant, and Sebastian Morris.

[♣] Professor, Indian Institute of Management, Ahmedabad 380 015. Tel.:(079)632-4947. Email: errol@iimahd.ernet.in

Errol D'Souza
Professor
Indian Institute of Management, Ahmedabad.

I: Performance and the Structure of Employment -

The reforms of the financial sector in India have been guided by the report of the Narasimham Committee which was issued in November 1991. These reforms aimed at improving the efficiency of the banking system, introducing transparency in operations, and ensuring that the sector is operating on a sound financial footing. The Narasimham Committee drew attention to the poor loan recovery, weak capital position, high cost and low profitability of public sector banks and attributed this not to public ownership but pointed instead to the managerial and policy environment within which banks had operated (Bery, 1994). On this basis controls on interest rates were removed, the pre-emption of bank assets were reduced, and regulatory and supervisory standards were strengthened. The new norms of asset classification, income recognition, and capital adequacy requirements that were introduced resulted in many public sector banks reporting losses - as a group these banks reported a net loss of Rs. 3,293 crore in 1992-93 and Rs. 4,349 crore in 1993-94 - and the non-performing loans of these banks were found to be about 21% of their loan portfolio in 1992-93.

The public sector banks, however, constitute two sets of banks. The State Bank of India (SBI) and its seven associate banks were the only public sector banks from 1955 to 1969 when the Nationalization Act nationalized the 14 largest private sector banks and another 6 banks were nationalized in 1980.[1] The 27 public sector banks dominate the commercial banking sector with a share of 87.2% of assets in 1992-93 and 79.7% in 1999-2000. 91.3% of the bank branches in the country in 1992-93 and 89.8% of the branches in 1999-00 belonged to the public sector banks. About 65.8% of these branches of the public sector were in rural and semi-urban areas. By contrast, 57.2% of the private sector bank branches were in rural and semi-urban areas whereas foreign banks had no presence at all in these areas with all their branches located in urban and metropolitan areas[2]. The expansion of private sector and foreign banks was strictly regulated and only since 1993 have new private and foreign banks been allowed to enter the market. Currently there are 32 private sector banks (8 of them having set up since April 1994) and 42 foreign banks operating in India.

The performance of the domestic private and foreign banks has been stronger than that of the public sector banks. Many explanations have been advanced for this phenomenon ranging from them not having the burden of a large network of branches especially in low diversity business areas such as in rural areas, they have been able to introduce technology to upgrade operational efficiency, and their business strategy has concentrated more on high yielding fee based activities and advisory services. The non-performing assets of public sector banks have been considerable. At the end of 1999-00, the net NPAs of public sector banks were 7.60% of advances for public sector banks (7.22% for the SBI group), 4.58% for the private banks, and 2.12% for the foreign banks. Five public sector banks – State Bank of Bikaner & Jaipur, Indian Bank, Allahabad Bank, United Bank of India, and Dena Bank – had particularly high levels of NPAs over 10 per cent of advances, whereas six private sector banks – The Catholic Syrian Bank Ltd., The Nedungadi Bank Ltd., the Dhanalakshmi Bank Ltd., The Benares State Bank Ltd., Lord Krishna Bank Ltd., and SBI Commercial & International Bank Ltd. – had similar NPA-advances ratios. As regards capital adequacy, the minimum prescribed capital to risk-weighted assets ratio was raised to 9 per cent from the year ended March 2000 and only one nationalized bank – Indian Bank – and three private banks – the Bank of Rajasthan Ltd., the Catholic Syrian Bank Ltd., and the Benares State Bank Ltd. – did not meet this criterion.

The performance of the commercial banks is given in Table I. The profitability of the public sector banks in the decade of the nineties was much lower than that of private sector banks and foreign banks. Net profits as a percentage of working funds[3] was 0.21% for the decade of the nineties for the public sector banks as a whole. The State Bank group did better, returning a figure of 0.58% for the decade whilst the figure for the nationalized banks was 0%. These figures for the public sector banks is much lower than the 0.89% for private sector banks and 0.94% for foreign banks. The net profits of the nationalized banks were negative in 1992-93 and 1993-94 as they had to adopt the new norms of asset classification and income recognition. In the latter half of the decade the performance of the public sector banks improved – the net profits as a percentage of working funds for the public sector banks went up by 124% to 0.48% - the SBI group returned 0.72% and the nationalized banks 0.33% in the latter half of the nineties. The performance of the private sector banks and foreign banks did not improve as rapidly in the latter half of the nineties – the ratio of the profitability of private and foreign banks together to all public sector banks was 4.29 for the decade of the nineties but this halved to 2.10 for the latter half of the nineties[4].

Table I: Net Profits and Establishment Expenses

	SBI & Associates	Nationalized Banks	Private Sector	Foreign Banks	SBI & Associates	Nationalized Banks	Private Sector	Foreign Banks
	Net Profit as % of Working Funds				Establishment Expenses as % of Total Expenditure			
1990-91	0.17	0.16	0.37	1.54	21.29	18.75	26.01	7.48
1991-92	0.21	0.33	0.57	1.58	15.26	16.84	20.88	5.51
1992-93	0.22	-1.71	0.35	-2.91	17.27	15.05	18.62	4.42
1993-94	0.25	-1.98	0.57	1.52	18.58	15.21	16.94	7.87
1994-95	0.54	0.10	1.16	1.70	21.45	20.28	16.88	8.37
1995-96	0.43	-0.36	1.19	1.46	21.84	19.95	13.78	8.62
1996-97	0.82	0.41	1.13	1.20	20.15	19.92	10.92	8.53
1997-98	1.04	0.62	1.04	0.96	20.82	19.75	9.86	7.65
1998-99	0.51	0.37	0.68	0.77	19.70	19.59	9.71	8.58
1999-00	0.80	0.44	0.90	1.17	18.91	19.17	9.61	9.28
Average	0.58	0.00	0.89	0.94	19.62	18.74	11.84	7.92
Average 1995-00	0.72	0.33	0.94	1.08	20.13	19.63	10.34	8.55

Source: IBA (1999, 2001)

The source of this improved relative profitability can be investigated by examining the components of the profitability ratio. Net profits increase as long as the growth of net interest income plus other income (commission, exchange and brokerage, etc.) exceeds the growth of operating expenses and expenditures on provisioning (including contingencies). On the other hand, the growth of working funds is driven by the growth of deposits, borrowings, and other liabilities. Hence, profitability as measured by the ratio of net profits to working funds increases with an increase in (1) net interest income, and (2) other income and decreases with an increase in (1) operating expenses, (2) provisions, and (3) any component of working funds such as deposits. For the latter half of the nineties[5] it turns out that in the private and foreign banks the growth of net interest and other income was higher than that of the SBI group and nationalized banks – Table II. Despite this, the relative profitability declined due to the very large growth rates of their operating expenses and provisions. For the private and foreign banks combined the growth rate of operating expenses was 18.82% in the latter half of the nineties compared to 10.32% for all the public sector banks. Similarly, the growth rate of provisions for the private and foreign banks combined was 16.33%, much above the 2.47% of the public sector banks. In addition, the growth rate of working funds (deposits) of the private and foreign banks combined was 27.02% (21.77%), higher than that of the public sector banks' figure of 14.58% (16.18%).

Table II: Growth Rates of Components of Profitability, 1995-00.

	SBI & Associates	Nationalized Banks	Private Banks	Foreign Banks
Net Profits	23.05	16.98	16.32	9.25
Working Funds	15.13	15.15	27.02	14.30
Deposits	17.80	15.55	27.84	11.87
Net Interest Income	9.32	11.72	16.22	13.07
Other Income	9.01	14.48	26.19	15.83
Operating Expenses	9.70	10.69	19.87	17.83
Provisions & Contingencies	1.59	3.24	23.64	11.66

Source: IBA (1999, 2001)

There are three implications that derive from the data in this Table. First, the growing asset base of the private and foreign banks means that they are increasingly able to attract deposits away from the public sector banks despite the large number of bank branches that public sector banks have. In 1995-96, the public sector banks' share of total deposits raised by commercial banks was 85.43% whereas by 1999-00 it had declined to 81.9%. Also, private and foreign banks were increasingly able to raise these deposits at more favourable net interest rates – their share of net interest income which was 16.99% in 1995-96 improved to 20.23% by 1999-00. Second, the private and foreign banks have been aggressive in making expenditures that are provisioning and contingency related. This reflects possibly more sound risk-management practices and given that their capital adequacy ratios have been much higher it has contributed to making them safer financial intermediaries, thereby enabling their borrowing at lower interest rates, which contains their interest expenses. The relatively lower profitability of the private and foreign banks is therefore a result of more prudence in management and that is a tradeoff taken which needs to be part and parcel of any judgment about declining growth rates of profitability. Third, the large growth rate of operating expenses by the private and foreign banks would seem to point to their being high cost operators. However, investigation of their operating expenses shows no acceleration in establishment expenses, advertising, insurance, etc, but in other items of expenditure. Here we can conjecture that these banks have been spending heavily on technology upgradation which may have reduced their short term profitability but which will improve their longer-term returns as they leverage the technology to provide better customer support and to manage their assets. Due to these three considerations, the improved relative profitability of the public sector banks in the latter half of the nineties is not necessarily reflective of improved performance by these banks.

Table III: Turnover (Deposits + Advances) per Employee (Rs. Lakhs)

	SBI & Associates	Nationalized Banks	Private Banks	Foreign Banks
1990-91	38.49	40.22	27.37	145.32
1991-92	42.99	44.10	35.42	199.49
1992-93	47.28	48.23	43.50	233.03
1993-94	49.61	50.96	55.31	286.39
1994-95	56.59	60.09	73.73	328.19
1995-96	65.67	67.63	100.45	379.53
1996-97	72.51	76.87	131.41	450.79
1997-98	84.43	91.90	168.37	484.22
1998-99	102.45	107.44	193.05	502.75
1999-00	122.11	126.15	255.23	632.15

Source: IBA (1999, 2001)

Banking by its nature is an information (intensive) and human capital intensive industry. One of the surrogate measures of output of a bank is the net interest income which gets captured in the data on profitability. Another surrogate measure of the output of a bank is the value of deposits and loans that the bank is able to generate. The efficiency of the employees of a bank on this notion can be summarized by the ratio of the deposits plus advances (the turnover) per employee. On this count, the trends in the efficiency of the various types of banks can be gauged from Table III. Whilst the turnover per employee increased 3.1 times from Rs 38.49 lakhs per employee in1990-91 to Rs 122.11 lakhs per employee in 1999-00 for the SBI group, it increased 3.1 times for the nationalized banks, 9.3 times for the private banks, and 4.4 times for the foreign banks during the decade. In 1990-91, the turnover per employee in the private and foreign banks combined was 1.28 times that in the public sector banks. By 1994-95 the multiple was 2.1 times and by 1999-00 it was 2.56 times – i.e., the turnover per employee in the private and foreign banks doubled relative to the public sector banks during the decade. It is true that the public sector banks have a large presence in the rural and semi-urban areas where the foreign banks for instance do not even have a branch. However, even when we compare the turnover per employee amongst banks in urban/metropolitan areas, foreign and private banks are still doing more than twice better than the public sector banks in their ability to mobilize deposits and disburse advances per employee (Anand, 2000). A large rural and semi-urban presence of bank branches cannot therefore be an explanation for the much lower operational efficiency of the public sector banks. The trend growth of turnover per employee is 12.5% for the SBI group, 12.8% for the nationalized banks, 25.2% for the private banks, and 15.1% for the foreign banks for the decade.

Table IV: Trend Growth Rates of Turnover and Employees, 1995-96 to 1999-00.

	Turnover	Employees
SBI & Associates	16.00%	0.14%
Nationalized Banks	14.93%	-0.89%
Private Banks	25.75%	3.26%
Foreign Banks	11.17%	-0.12%
Old Private Banks	18.42%	1.20%
New Private Banks	43.84%	35.59%

Source: IBA (1999, 2001)

The superior performance of the private banks is emerging from the performance of the 8 new private banks that have begun operations since 1994. From Table IV, it is evident that for the period 1995-96 to 1999-00 the growth in turnover was highest for the private sector banks at 25.8%. However, even though the old private sector banks' turnover grew at 18.4% - a slightly faster rate than that of the SBI group where turnover growth was the second fastest – the new private banks turnover growth was significantly higher at 43.8%. The growth of employment in the new private banks was also significantly higher but this is to be expected given that they were setting up operations and establishing their branches. Despite the faster growth in employment in the private banks they were able to achieve an even greater growth of turnover which is attributable to their aggressive concentration on provisioning and technological upgradation referred to earlier which allowed them to reach a wider customer base and to offer a variety of financial services.

In addition, however, there are two dimensions to their employment practices which is indicative of the way human resources are managed in these banks. First, the ratio of establishment costs to total expenditure has been declining in these banks – Table I – despite their higher growth in employment. In fact, the most drastic decline in the ratio of establishment expenditure to total expenditure has been in the private banks with the ratio reducing from a high of 26.01% in 1990-91 to 9.61% in 1999-00. The establishment expenditures of the private and foreign banks have declined at a faster pace in the latter half of the decade whereas for the SBI group and the nationalized banks there was an increase in their expenditure on establishment in the latter half of the nineties. The establishment expenses as a percentage of total costs of the public sector banks in the latter half of the decade was 19.81% and this was 2.1 times the 9.5% figure for the private and foreign banks combined. The private and foreign banks have thus been able to contain their wages and salaries expenditures compared to the public sector banks despite their higher growth in employment – the productivity of each employee being much higher has contributed to this outcome.

The second distinguishing feature of employment practices in the private and foreign banks is the structural composition of the workforce. Data on employment in commercial banking is given by three categories of employment – officers, clerical staff, and subordinate staff. Amongst commercial banks the employment growth rate from 1990-91 to 1994-95 was 1.21% and this declined to –0.27% during 1995-96 to 1999-00 as they have sought to downsize. The decline in employment growth was sharpest amongst the clerical staff followed by the subordinate staff. For the officers the growth in employment was 1.81% in the first half of the decade and this declined to 0.89% in the latter half of the decade. For the clerical staff, the growth in employment was 0.80% in the first half of the decade and this slipped to –0.89% in the second half of the decade. The growth in employment of subordinate staff also declined substantially from 1.41% in the first half of the decade to –0.34% in the latter part of the nineties.

Table V-A: Composition of Employees (Percentages) - SBI & Associates

	Officers	Clerks	Subordinates
1990-91	25.27	52.16	22.58
1991-92	25.33	51.80	22.87
1992-93	25.46	51.44	23.09
1993-94	25.88	51.58	22.54
1994-95	25.66	51.13	23.21
1995-96	25.54	51.19	23.27
1996-97	25.44	50.90	23.66
1997-98	25.20	50.01	24.79
1998-99	25.29	49.95	24.76
1999-00	25.30	50.07	24.64

Source: IBA (1999, 2001)

The decline in the growth of employment amongst the clerical and subordinate cadres has been concentrated amongst the private and foreign banks – Tables VA to VD. For the SBI group and the nationalized banks the ratio of officers, clerical, and subordinate staff to total staff did not show much variation during the decade. For the decade as a whole, for the SBI group, 25.4% of the staff were officers, 51.0% were clerks, and 23.6% were subordinate staff. The composition of staff was the same for the nationalized banks with 27.9% of staff being officers, 50.7% being clerks, and 21.4% being subordinate staff. In the foreign banks and private sector banks, however, there has been growing recruitment amongst the officers' cadre with a decline in the recruitment of clerical and subordinate staff. Private banks started the decade with 24.5% of staff as officers, 54.8% as clerical, and 20.7% as subordinate staff. By the end of the decade 36.2% of the staff were officers, 45.9% were clerical, and 17.9% were subordinate staff. Similarly, foreign banks started (ended) the decade with 32.1% (61.1%) of the staff being officers, 49.8% (30.4%) were clerical, and 18.1%(8.5%) were subordinate staff. The especially noteworthy examples of the staffing pattern tilting in favour of officers is amongst the new private banks – HDFC Bank, Global Trust

Bank, UTI Bank, IDBI Bank, for instance, have no clerical and subordinate staff and 100% of the staff in these banks are officers. This is a manifestation of these banks

Table V-B: Composition of Employees (Percentages) - Nationalized Banks

	Officers	Clerks	Subordinates
1990-91	27.03	51.13	21.84
1991-92	27.19	51.17	21.63
1992-93	27.21	50.76	22.03
1993-94	27.32	50.08	22.60
1994-95	27.54	50.86	21.60
1995-96	27.86	50.57	21.57
1996-97	28.16	50.90	20.94
1997-98	28.43	50.63	20.94
1998-99	28.80	50.40	20.81
1999-00	28.99	50.33	20.68

Source: IBA (1999, 2001)

Table V-C: Composition of Employees (Percentages) - Foreign Banks

	Officers	Clerks	Subordinates
1990-91	32.06	49.82	18.12
1991-92	35.15	47.99	16.86
1992-93	36.50	47.58	15.92
1993-94	36.49	47.63	15.88
1994-95	39.41	46.71	13.87
1995-96	42.35	45.60	12.05
1996-97	47.73	41.71	10.56
1997-98	52.86	37.36	9.78
1998-99	55.28	34.68	10.04
1999-00	61.14	30.34	8.51

Source: IBA (1999, 2001)

Table V-D: Composition of Employees (Percentages) - Private Banks

	Officers	Clerks	Subordinates
1990-91	24.53	54.75	20.72
1991-92	25.09	53.87	21.05
1992-93	25.63	53.44	20.93
1993-94	25.74	53.13	21.13
1994-95	26.72	52.80	20.48
1995-96	29.62	51.53	18.84
1996-97	31.31	50.26	18.43
1997-98	32.91	48.61	18.47
1998-99	34.16	47.47	18.37

1999-00	36.22	45.89	17.88

Source: IBA (1999, 2001)

resorting to technology the operation of which requires high-skill human capital for increasing the returns to the technology which anyway enables routine tasks formerly undertaken by lower level staff to be speedily processed. Also the presence of only officers is indicative of multi-tasking which promotes flexibility in the bank and ensures long-term profitability.

Of course, making investments in information technology for banks is a process fraught with opportunities that may not result in a reduction in labour costs but which has the potential of raising revenues. Technology has many benefits in the areas of treasury and asset liability management and in the shape of ATMs as an effective delivery channel as well as a good medium for tapping new customers. Financial intermediaries have been traditionally organized around product lines such as deposit accounts, loans, credit cards, etc. As a result coordination among departments has been loose and customer information does not easily flow across the organization. Those banks that are able to integrate their databases and IT systems are in a position to create a single customer interface which facilitates cross-selling as well as improves customer retention. This boosts the productivity of a bank. Similarly, other IT investments in back-office processes have efficiency enhancing impacts such as check-imaging technology that reduces storage costs as well as check-retrieval time, automated voice response units that reduce call centre representatives and electronic payment transactions that reduce the need for tellers and back-office personnel. However, it needs to be stressed that customization and a wide choice of services that technological investments allow is no substitute for what customers care about most in their interactions with banks – reliability, service, and an institution they can trust.

The increasing pace at which private and foreign banks are reducing their workforce composition away from clerical and subordinate staff and the relative rigidity in the composition of the workforce in public sector banks points to an important distinction between the organization of the private and foreign banks on the one hand and the public sector banks on the other which definitely has an impact on their performance.

The practices of managing human resources at the officers' level are different in the public sector banks and the other banks. The practices regarding compensation, i.e., rules governing pay and pay raises, benefit structures and the practices that centre around training, staffing, hiring and selection, and job design differ substantially. To mention a few differences, public sector banks, structure compensation in such a way that there are lower differentials between employees, long-term tenure is rewarded, and there is a high base pay. In the private and foreign banks there are larger pay differentials, fewer rewards for tenure, and individual incentives are high. Public sector banks place a lot of emphasis on training whereas in the private and foreign banks training is emphasized according to necessity. In terms of staffing the public sector banks are committed to employment security and have a full time workforce whereas in the non public sector banks the staffing policy is a hire and fire at will dictated one with a part time workforce. As regards the practice of hiring and selection public sector banks invest heavily in screening whereas the practices in other banks are more market based. Finally, in terms of the practice of work organization public sector banks have relatively narrow jobs with a steep hierarchy whereas the other banks have broader jobs and a relatively flat hierarchy.

II: Human Resource Practices -

To understand the differences in the practices regarding human resource management it is necessary to examine the historical development of the institution of these practices. As Mankidy (2000) observes, in Indian banking, "from a stage of extreme exploitation of employees prior to the 1940s, the industrial relations process unfolded itself into labour militancy and crises in the 60s and 70s. Most of the human resource management practices in the industry, such as salary structure, promotion, transfer, placement, etc are the by-products of this reactive process." In the 1940s the management could extract work out of employees as there was a fear of losing the job due to the scarcity of jobs elsewhere. The employees had stretched working hours and low remuneration and there was much discontent with salary and working conditions. A landmark in this period was when the Bank of India Staff Union called the first ever strike which lasted 17 days. This led to the Divatia Award that provided employees with a number of facilities such as a pay scale, annual leave, gratuity etc that were hitherto absent. This led to many awards covering bank employees in different states as banks were under state regulation. The passing of the Industrial Disputes (Banking and Insurance Companies) Act in 1949 brought banks under the central government and uniformity in human resource practices began from then onwards. The subsequent disputes between bank employees under the umbrella of the All India Bank Employees Association (AIBEA) and bank managements led to a series of prominent awards such as the Sen Award of 1950, Sastry Award of 1953, and Desai Award of 1962. The Industrial Disputes Act allowed for settlements covering only the clerical and subordinate staff and the collective bargaining which started in the early 1960s led to the evolution of a bipartite relationship in the industry. The industry wise uniformity in service conditions and salary for officers in nationalized banks began with the Pillai Committee Report in 1979.

By the late 1960s unions in banks had become strong and militant. Also, as unionization arose in response to the poor service conditions and low salaries, they fought over issues such as promotion, wages and salaries, welfare measures such as medical facilities and different types of leaves, and over time human resource practices began to be dictated to the banks by the unions. The government in the sixties and seventies strengthened the position of workers as the government was guided by the goal of a socialist and equitable society and the role of organized labour since the Independence movement was a strong factor motivating the government's predilection in this regard. This one-sided bargaining process increased the security of employees and their militancy began to decline since the mid–80s. The liberalization of the financial sector as also the landmark agreement of the SBI management with its union in 1989 on computerization led to the introduction of decentralized bargaining[6]. Besides, employee support for unions began dwindling as evinced by the change from resorting to indefinite strikes to pursue demands to unions calling for only one-day strikes over the last decade due to their lack of confidence over support for longer duration conflicts. Finally, there has also been an attitudinal change amongst unions with their acceptance of the modernization of work practices in the emerging competitive era. The All India Bank Employees Association that had always fought against computerization in October1993 for instance agreed to signing a Memorandum of Settlement with the Indian Banks' Association that allowed banks to introduce information technology[7].

Table VI: Unions/Associations/Federations in Banks

Clerical and Subordinate Staff	Share of Membership	Officer Staff	Share of Membership
1. All India Bank Employees Association (AIBEA)	49.49%	1. All India Bank Officers Confederation (AIBOC)	73.37%
2. National Confederation of Bank Employees (NCBE)	33.62%	2. All India Bank Officers Association (AIBOA)	14.93%
3. Bank Employees Federation of India (BEFI)	8.10%	3. Indian National Bank Officers Congress (INBOC)	6.53%
4. Indian National Bank Employees Federation (INBEF)	1.73%	4. National Organization of Bank Officers (NOBO)	1.32%
5. National Organization of Bank Workers (NOBW)	2.66%		

Source: Indian Banks' Association (2000), Indian Banking Year Book, 1999.

The industrial relations structure in the banking industry is such that the management of both the public and private sector banks are organized into one body called the Indian Banks' Association (IBA). There are five major industry level trade unions in banks representing clerical and subordinate staff employees and four associations for officers – see Table VI. Collective bargaining is usually carried out at the industry level between the IBA and mainly the All India Bank Employees Association (AIBEA), the National Confederation of Bank Employees (NCBE) and the Bank Employees Federation of India (BEFI) for issues relating to clerical employees and between the IBA and All India Bank Officers’ Confederation (AIBOC) for issues of relevance to officers. In addition, it must be mentioned that the Reserve Bank of India intervenes in human resource practices by issuing various guidelines and instructions keeping in mind government policy as the principal employer of public sector banks and as a continuation of the recommendations of various working groups and committees. RBI instructions have included the setting up of the National Institute of Bank Management in 1968 as an apex institute for training and research, constituting the Banking Service Recruitment Board for recruitment, standardizing performance appraisals for public sector banks from 1993-94, etc. The government is also empowered to issue directives to public sector banks under Section 8 of the banking Companies (Acquisitions & Transfer of Undertakings) Act 1970/1980 with regard to policy matters involving public interest such as constitutional provisions regarding reservations for socially deprived classes, etc.

The recruitment in public sector banks was standardized with the introduction of the Banking Service Recruitment Boards in 1978-79 by the government. The Narasimham Committee had urged in 1991 to allow banks to make their own officer recruitment more so where special skills were required and to allow clerical recruitment to continue to take place through the Board. The subordinate staff are selected through the local employment exchange. For officers and clerical staff the number of vacancies are determined depending on business growth, branch expansion, existing pattern of staffing and wastages. However, the RBI in February 1990, following up on an earlier Ministry of Finance directive to restrict intake so as to improve productivity, has instructed public sector banks to restrict annual staff growth to 0.75%/1% depending on productivity levels. At lower levels of the job hierarchy banks have the freedom to create additional vacancies, but for additional scale IV and above officer positions prior clearance from the Ministry of Finance is required. The promotion of workers in nationalized banks from subordinate staff to clerk and from clerk to officer is at the discretion of individual banks that have entered into settlements with workers unions. With regard to the intake of employees at the officer level the public sector banks follow a closed system where promotion from within is encouraged. There are mainly two ports of entry into the profession. At the clerical level 75-100 per cent of the vacancies are filled via screening by the Banking Service Recruitment Board and at the Junior Management level 20-25 per cent of vacancies are filled via outside recruitment.

In July 1973 the government had appointed a committee to standardize the pay scales, allowances, and perks of officers. This committee, known as the Pillai Committee, submitted its report in May 1974. The government then appointed a Study Group of Bankers to make suggestions for the implementation of the report which submitted its report in 1977. The Pillai Committee report with the modifications suggested was adopted in 1979 and the Officers' Service Regulation was introduced. The Pillai Committee noted that young recruits tend to get frustrated due to the prevalence of long time scales and the absence of accelerated promotions for the meritorious. The Pillai Committee accordingly suggested seven scales in four grades, i.e. Top Management (2 scales), Senior Management (2 scales), Middle Management (2 scales) and Junior Management (1 scale) – Table VIII. The Pillai Committee recommendation of not less than 25% of vacancies in middle and senior management positions to be kept open for merit promotions to enable talented people to reach top positions in the prime of their lives was modified by the Study Group of Bankers who argued that since the executive pyramid is wide based and fairly narrow at the top in banking, the promotion to senior and middle positions should be solely on merit with the years of service required for promotion as suggested by the Pillai Committee being an eligibility criterion on the basis of which selection is to be made with weightages given to objective criteria such as service record, professional qualifications, etc. The Merit Rule thus replaced the Seniority Rule for promotions in middle and senior positions. From the viewpoint of the needs of the bank as opposed to the needs of the individual with regard to non-stagnation, four grades were identified on the basis of differences in levels of responsibility. The Top Management level is conceived as the policy making level. At Senior Management level there is total responsibility for an entire functional area in the bank such as advances or personnel. The Middle Management level is a support level for higher level managers and a tier for ensuring smooth career progression from an operational jot to semi-policy making areas. The Junior Management level would be involved with operational tasks of a supervisory nature.

Table VII: Executive Pyramid in Public Sector Banks

Scale/ Grade	Management Level	Minimum Years of Experience before promotion to next grade	Competent Authority
Clerks		2-3 years	
I	Junior Management	7 years	1 DGM (Scale VI) 2 AGM's (Scale V)
II	Middle Management	5 years	1 GM (Scale VII) 2 DGM's (Scale VI)
III	Middle Management	5 years	1 CMD/ED 2 GM's (Scale VI)
IV	Senior Management	3 years	CMD, Government, RBI Directors
V	Senior Management	2 years	CMD, Government, RBI Directors
VI	Top Management	2 years	CMD, Government, RBI Directors
VII	Top Management	2 years	
Ports of Entry: 1) Clerical (75-100 percent) 2) Junior Management (20-25 percent)			

As the system of induction, recruitment and promotion operates, it is a case of what has been labeled as an internal labour market (Doeringer and Piore,1971). In the internal labour market the system provides low skill, entry level jobs and the opportunity to learn skills on-the-job along with job ladders for promotion. Given minimally acceptable performance, managerial jobs are till retirement and pay is on the basis of job titles and seniority rather than dependent on individual attributes and is not strictly tied to performance. Internal labour markets are organized around long term employment relationships so as to enable the capturing of the benefits of the development of skills, especially when they are specific to the firm, as well as allowing the identification of abilities and worker performance in order to fill promotions. The characteristics of an internal labour market can be identified with the following practices – (1) providing own, firm-specific training, (2) an attempt to adhere to the objective of making staff permanent, (3) using internal promotion and job ladders, (4) elaborate and systematic screening and recruitment of employees, and (5) setting wages and salaries according to internal administrative procedures rather than market forces.

The underlying premise of the internal labour market approach is that employees differ in ability – one more unit of effort by different employees implies different productivity for the organization – and there is an information asymmetry in that supervisors have imperfect information about the abilities of the employees. As the ability of the employee is initially unknown, it is only the experience in the employment relationship that allows the employer to learn about such abilities, and as this learning takes place, the employee is placed in more productive jobs. In managerial employment, job changes often imply movements along the hierarchical structure of the firm and are associated with important changes in total salary and remuneration. Current performance is used to evaluate an employee's ability and to decide on future promotions and so current performance affects the rewards earned by the employee.

The promotion to a higher management level is best thought of through the lens of a tournament model (Lazear and Rosen, 1981) where the prize in terms of compensation for a position in the hierarchy is fixed in advance and is independent of absolute performance. In effect, an employee is promoted to the next higher level/grade not because he is good, but because he is better than everybody else at the current level/grade – relative performance and not absolute performance matters. A tournament is a mechanism for performing a sorting function – as individuals compete with one another the more able individual gets the promotion and individuals are sorted to their best use. Individual employees are also spurred to exert higher effort due to the higher salary that accompanies the higher position and this is a gain to the organization. Whether a tournament that offers promotions on grounds of merit alone effectively sorts individuals according to abilities and provides adequate incentives in the public sector banks is however a doubtful proposition.

The expected gain to an employee via a promotion equals the probability of promotion multiplied by the increase in the present value of lifetime earnings. In public sector banks the probability of promotion is low due to the large overstaffing. Given that many officers will fail to get promotions in the hierarchy, the Pillai Committee had recommended a single long scale at the base Junior Management level to take care of the career path and sustain the motivation of those who lose out in the tournament. However, the increase in the present value of lifetime earnings is also low in the public sector banks. This is because of the method of pay fixation and the pegging of earnings to the Pay Commission awards. First, there is a pecking order in the financial sector with the RBI which is the regulator and financial institutions that hitherto performed a developmental function being at the top of the pecking order. The State Bank group comes next due to the special function it performs of transacting the government business of both the Centre and the States. Last in the hierarchy are the other nationalized banks. The salary of the Chairman and Managing Director of the banks is fixed by the government keeping in mind parity with the Indian Administrative Service and this then becomes the ceiling on the salary that can be earned in the banks. The subordinate staff, knowing this upper limit, as well as the managerial grades that are operational (seven in all) go into the bargain of their unions such as the AIBEA and NCBE with the IBA with the objective of minimizing the distance between their earnings and that set by the government for the Chairman and Managing Director. As the settlement with the subordinate staff sets the floor for determining officers' salaries, the pay scales for the officers leaves little room for maneuverability and is sandwiched between the subordinate staff award settlement and the salary of the Chairman and Managing Director. The pay structure that emerges in the public sector banks is therefore compressed and even though the relative responsibility increases significantly as one moves up the organizational hierarchy, the relative increase in compensation does not match upto this increased responsibility. As a result, the use of promotions as they take place currently amongst the public sector banks, is not an effective mechanism for sorting out the higher ability individuals and neither do they provide incentives for increased effort. It is not surprising accordingly that many employees by-pass the opportunity for promotion and that with the emergence of the new private banks there is an incentive created for shifting jobs amongst those employees who are less risk-averse and are willing to forego job security.

There are also the more fundamental issues such as that the early years in the management cadre are spent on routine operational functions and as one goes up the ladder the developmental and policy making roles becomes more important. It could very well be the case that "the best performer at one level in the hierarchy is not the best candidate in the job one level up" (Baker et. al., 1988). The manger who is the best at operations would rarely also be the best at policy making. That the correlation of the ability to perform in a job with the ability to perform in a job lower in the hierarchy is high is questionable. As a result, employees best suited for top management jobs might lose promotions at lower management levels. Also, promotion systems do not provide optimal incentives if there is a variation in the abilities of individuals and these abilities are revealed over time as this will reduce everyone's incentive given that it is known that only those of high ability will be rewarded with the promotion. Finally, an important part of the compensation of employees in the public sector comes in the form of intangibles which should normally be included as part of the expected total value of the compensation – the quality of the working environment, leisure, relationships with co-workers, and above all, the most important component of the reward – job security. This has the potential of reducing the productivity of those employees who are of low relative ability and as pay in not linked to performance delinks the connection between outcomes for the organization and outcomes for the employees. Whereas job security has the upside that it enables a stable long-term relationship that promotes the capturing of the benefits of firm-specific investments, the downside is that no hiring occurs from outside in the internal labour market and as the abilities of co-employees is known, those who do not expect to have the opportunity to be offered a higher level job will put forth less effort and could even collude to shirk. The organization only rewards relative performance by selecting those few who perform well to move up the executive pyramid but does not reward the absolute performance of those who do not match up to the level of potential promotees, thereby encouraging them to reduce effort and shirk. With time the job motivation of such employees also reduces.

An interesting aspect about compensation policies in public sector banks is that since there is pay compression and so the more able employees' incentives are thereby blunted, one would have expected even larger within job pay for performance such as bonus incentives for incentivizing employees. Promotion rewards can be expected to be more important in fast-growing industries because as those industries grow faster more jobs will be available to feed the reward system. In mature industries competition for market share should be more intense and so promotion opportunities would not grow as rapidly, making it all the more imperative that a variable compensation such as a bonus be used in more concentrated markets. A major part of the reason for the non-existence of these types of bonus payment systems is that banking has been highly regulated which lowers the intensity of rivalry and competition and as socialistic objectives of the decentralization of bank branches became dominant and the major banks were nationalized, profit-maximization no longer became the main criterion of performance. Bureaucratic structures and internal controls began to become the prime concern of managers in nationalized banks. As banks expanded the processes and work organization shifted towards well-structured jobs and standardized procedures which go along with fixed pay compensation policies.

It would be expected that deregulation and increased competition acts as a disciplining force on the operating efficiency of nationalized banks. In the current scenario, whilst banks have considerable discretion over setting of interest rates and on deciding on the product mix, they do not however take full responsibility for their decisions. If they are undercapitalized and run into losses, they face no risk of bankruptcy as government has given an implicit insurance that the stability of the financial system will be maintained – the government's guarantee has in effect imported confidence that less care needs to be taken about the non-marketable, idiosyncratic loans made by banks (D'Souza, 2001). The outcome of this is that public sector banks have come to expect support in financial difficulties which reduces their sensitivity to efficiency and shields them from the disciplining force of competition from the non-public sector banks. As a result, even if operational freedom is fully with the public sector banks, and even if the government's stake in the capital of the banks falls to 33 percent, the management may not operate as efficiently as they possibly could. The situation was reinforced in the Budget Speech 2000 of the Finance Minister when he stated that the "public nature of the nationalized banks will continue even if the government stake drops to 33 percent". The approach adopted of reducing portfolio controls and encouraging the growth of the private and foreign banks was in order to create a more competitive environment with the expectation that this would lead to efficiency improvements.

However, the system of wage negotiations with salaries pegged to comparable levels in government, and without reference to the ability to pay of the banks has inflated the wage bills of public sector banks. It is the implicit government support to ensuring liquidity to the banks that has resulted in employee compensation growing overtime. Moreover, as the risk of bankruptcy is not borne by the bank, this has reinforced the bargain by employees for the payment of higher wages and salaries and severed the link between pay and productivity – as we saw above, establishment costs for public sector banks have been growing in the latter half of the nineties at the expense of provisioning and expenditure on technological upgradation. Thus, despite the presence of newer private banks who are more aggressive in marketing their products as well as provide a greater mix and quality of services, public sector banks have not responded adequately to this competition due to the implicit government support which reduces the risk of bankruptcy and makes the budget constraint of banks appear to be elastic enough to take care of contingencies. This translates into an employee friendly environment where the growth of employee compensation has a greater weightage in decision making than the growth in profitability.

A related aspect of compensation policy in public sector banks is that pay is compressed relative to the private sector due to the method of pay fixation as was referred to earlier. This has had the effect that public sector banks have found it very difficult to retain motivated employees and their talent pool has been subject to raiding by the private banks. This is also due to talented and not so risk-averse individuals preferring to be rewarded on the basis of performance rather than independent of it. As a result, when the private banks pay more on average and offer stronger pay-for-performance rewards, it is to be expected that talent will migrate to them. Accordingly, the low ability and risk-averse individuals will continue in public sector banks with bureaucratic compensation systems that ignore performance. It has often wrongly been argued that there are important non-monetary rewards that go along with the running of a large organization such as say SBI – power, prestige, and public visibility. However, nonmonetary rewards tend to be associated with position or rank in the organization and are fixed thereby reducing the opportunity to link them to performance. As these rewards do not vary with the value of the organization they are not effective in motivating top management from acting in the interests of maximizing the value of the organization and that affects performance.

III: Conclusions -

The profitability of the public sector banks improved in the latter half of the nineties relative to the performance of the private and foreign banks. However, their share of the total deposits raised by commercial banks declined and private and foreign banks were able to attract deposits at more favourable net interest rates. Also, private and foreign banks have been adopting sounder risk-management practices and this increased prudence on their part has led to greater expenditures on provisioning which has reduced their profitability. Moreover, private and foreign banks have been investing heavily in technological upgradation so as to provide better customer support and manage assets better. The turnover per employee in the private and foreign banks also improved over the decade and relative to the turnover per employee of public sector banks by the end of the decade it was twice the figure for the beginning of the decade – private and foreign banks improved their efficiency relatively faster during the course of the decade.

The new private banks contributed significantly to the growth in turnover amongst the private banks in the latter half of the decade. And private banks as a whole were able to reduce their establishment expenditures as a ratio of total expenditures drastically in the nineties from 26% in the beginning of the decade to 9.6% by the end of the decade. The downsizing of staff occurred mainly amongst private and foreign banks where the decline in employment was registered mainly amongst the clerical and subordinate cadres – the staffing pattern in these banks tilted in favour of officers during the course of the decade, and multi-tasking became a part of the operations of these banks. The composition of the workforce in public sector banks by contrast is still dominated by the clerical and subordinate staff which constitute three-fourths of the employees which is much larger than in the private and foreign banks. In the public sector banks the power of the unions declined throughout the decade as more decentralized bargaining began to emerge and along with the attitudinal change regarding the acceptance of modern work practices.

The labour market in public sector banks is an internal labour market where the major human resource allocation policy is promotions as there are limited ports of entry and top management positions are decided by merit and the frequency of promotions depends on vacancies. The way promotions are structured, however, they neither perform a sorting function – allocation of individuals to their best use – nor provide incentives to employees to exert the effort consonant with the higher salary that goes with the higher position. This is because the pay structure in public sector banks is compressed due to the nature of the wage setting process where unions bargain to minimize the distance between their earnings and that set by the government for the Chairman and Managing Director. Also, work culture gets adversely affected as those who do not have the opportunity to be offered a higher level job put in lesser effort and even collude to shirk. Deregulation and increased competition in such a scenario does not act as a disciplining force for enhancing the efficiency of public sector banks. With the implicit insurance by government of support in times of financial difficulty the public sector banks sensitivity to efficiency has been reduced which has resulted in a growth in establishment costs at the expense of provisioning and expenditures on technological upgradation. It is only when public sector banks perceive that the government will not be underwriting their decisions and that they face a hard budget constraint, will they have an incentive to tackle the problem of establishment costs and be able to upgrade technologies, provide better quality services, and become more efficient. The motivation for employees in an efficiently run organization cannot be solely based on rewards such as power and prestige as these are not linked to the performance of an organization. The challenge for public sector banks accordingly is to upgrade technology, downsize, shift the composition of the employees towards officers, introduce multitasking, and a stronger link between pay and performance.

References:

Anand, A. (2000). "Banking Sector Employment in India: Emerging Trends and Pattern", *Indian Journal of Labour Economics*, 43(4), pp. 1001-1012.

Baker, G.P., M.C. Jensen, & K.J. Murphy (1988). "Compensation and Incentives: Practice Versus Theory", *Journal of Finance*, 43(3), July, pp. 593-616.

Bery, S.K. (1994). "India: Commercial Bank Reform", in Shakil Faruqui (ed.) - "*Financial Sector Reforms, Economic Growth, and Stability: Experiences in Selected Asian and Latin American Countries*", The World Bank, Economic Development Institute.

D'Souza, E. (2000) - "The Relationship between Capital Markets and Human Resource Policies: Some Consequences of Flexibility", Twelfth IFCI Annual Lecture, Department of Economics, University of Mumbai, mimeo.

D'Souza, E. (2001). "Prudential Regulation in Indian Banking", in S. Arumugam (ed.) - "*Indian Capital Markets – Modern Perspectives and Empirical Evidences*", Allied Publishers Ltd., Mumbai.

Doeringer, P.B. & M.J. Piore (1971) - "*Internal Labour Markets and Manpower Analysis*", Lexington, Mass.: D.C.Health.

IBA (1999) - "Database on Indian Banking 1987-98", Economics Department, Indian Banks' Association, Mumbai, December.

IBA (2000) - "Indian Banking Year Book, 1999", Indian Banks' Association, Mumbai.

IBA (2001) - "Performance Highlights of Banks 1999-2000", Economics Department, Indian Banks' Association, Mumbai, February.

Joshi, V. & I.M.D. Little (1997) - "India's Economic Reforms 1991-2001", Oxford University Press, N. Delhi.

Lazear, E.P. & S. Rosen (1981). "Rank-Order Tournaments as Optimum Labour Contracts", *Journal of Political Economy*, October, 89, pp. 841-64.

Mankidy, J. (2000). "Human Resource Management in Banks: Need for a Paradigm Shift", *Prajnan*, Vol. XXVIII, No. 4, 357-372.

Patil, R.H. (1996) - "Contemporary Banking: Competition and Markets", Speech at 17th Bank Economists' Conference, in N. Jadhav (ed.) - "Challenges to Indian Banking, Competition, Globalization, and Financial Markets", Macmillan.

Pillai, R.V. (1974) - " Report of the Committee for Standardization of Pay Scales, Allowances and Perquisites of Officers in the Nationalized Banks with Modifications", Government of India, New Delhi.

RBI (1999) - "Trends and Progress of Banking in India, 1998-99", RBI, Mumbai.

Sen, K. and R.R. Vaidya (1997) - "The Process of Financial Liberalization in India", Oxford University Press, N. Delhi.

Varkkey, B. and A. Mankidy (1995) - "Human Resources Management in Banking Industry: A Historical Perspective", National Institute of Bank Management, March, Pune.

Verma, M.S. (1999) - "Report of the Working Group on Restructuring Weak Public Sector Banks", RBI, Mumbai.

Notes:

[1] With the merger of the New Bank of India with Punjab National Bank in 1993 there are now 19 nationalized banks.

[2] The regional rural banks and cooperative banks comprise the remaining part of the banking sector which we are not reporting on here.

[3] Net Profit = Net Interest Income + Net non-interest Income – Operating expenses – Provisions. Working Funds = Total Assets – Contra items (Bills for collection).

[4] The Net Profit as a percentage of Working Funds was 0.91% for the decade for private and foreign banks combined and for the latter half of the decade it went up by 9,4% to 1%.

[5] The periodization has been decided on the basis of two events. First, the introduction of the new norms of asset classification and income recognition resulted in the public sector banks as a group reporting a net loss in 1992-93 and 1993-94. As this is a response to new regulatory requirements and not the direct result of operational outcomes in those years, including those years in the interpretation of the data will introduce a bias. Second, new private banks were established and entered the market after April 1994 and performance results for these became available from 1995-96. On the basis of these two factors 1995-96 suggested a convenient reference point on which to segment the data for the decade.

[6] Following in the steps of the SBI, three other banks – Indian Overseas Bank, Bank of Baroda, and Vysya Bank – entered into agreements with their unions.

[7] The introduction of computers has reduced the workload in banks as tasks such as the daily balancing of books which used to take hours now takes minutes. On an average employees in computerized branches finish work two-and-half hours earlier than usual (Mankidy, 2000).