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## **Evolution, Structure, and Role of Public Sector Banks in India: A Conceptual and Policy-Oriented Review**

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### **Abstract**

Public Sector Banks (PSBs) constitute the backbone of the Indian financial system and play a decisive role in economic growth, financial inclusion, and socio-economic development. The Indian banking sector has undergone significant structural, regulatory, and technological transformations, particularly following nationalization, liberalization, and recent consolidation initiatives. This paper provides a comprehensive conceptual review of the evolution, structure, functioning, and service diversification of public sector banks in India. Drawing extensively from secondary sources, government reports, policy documents, and scholarly literature, the study examines the historical development of PSBs, their regulatory framework, merger reforms, and expansion of financial services. The paper further explores the role of PSBs in financial inclusion, digital transformation, and delivery of modern banking services such as merchant banking, mutual funds, venture capital, housing finance, and technology-driven banking solutions. Emphasis is placed on recent consolidation reforms and their implications for operational efficiency, competitiveness, and service outreach. The study highlights how PSBs continue to serve rural and semi-urban populations while adapting to market-oriented reforms and customer-centric strategies. The findings indicate that despite increased competition from private and foreign banks, public sector banks remain instrumental in promoting inclusive growth, mobilizing savings, and supporting government-led financial initiatives. However, challenges persist in service efficiency, customer responsiveness, and technological adoption. The paper concludes by suggesting policy measures to strengthen governance, service quality, and digital capabilities of PSBs, ensuring their long-term sustainability in a competitive banking environment.

**Keywords:** Public Sector Banks, Indian Banking System, Financial Inclusion, Banking Reforms, Service Diversification

### **Introduction**

#### **Overview of Banking and Importance of Public Sector Banks**

The banking sector plays a pivotal role in the economic development of a country by mobilizing savings, facilitating investments, and ensuring smooth functioning of financial transactions. Banks act as financial intermediaries between surplus and deficit units of the economy and

contribute significantly to capital formation, industrial growth, and employment generation. In developing economies such as India, the banking system is not only a commercial entity but also an instrument of socio-economic transformation.

Within this framework, **Public Sector Banks (PSBs)** occupy a central position in the Indian financial system. Public sector banks are those in which the Government of India holds a majority stake and exercises managerial control. Historically, PSBs have been entrusted with responsibilities that extend beyond profit maximization, including financial inclusion, rural credit expansion, priority sector lending, and implementation of government-sponsored schemes. Their extensive branch network, particularly in rural and semi-urban areas, has enabled them to reach underserved and unbanked populations, making them critical agents of inclusive growth.

PSBs have traditionally enjoyed high levels of public trust and confidence due to government ownership, perceived safety of deposits, and regulatory backing. Even in the face of increasing competition from private and foreign banks, public sector banks continue to command a substantial share of deposits, advances, and customer base. Their role becomes especially significant during periods of economic stress, when they act as stabilizers of the financial system.

### **Context of Indian Banking Reforms**

The Indian banking sector has undergone profound reforms since independence. Initially characterized by private ownership and limited outreach, the sector witnessed a paradigm shift with the nationalization of banks aimed at aligning banking operations with national development goals. Subsequent reforms, particularly post-1991 liberalization, introduced market-oriented practices, competition, and technological innovation.

These reforms transformed Indian banking from a regulated, government-dominated system into a competitive and technology-driven industry. Public sector banks, while adapting to these reforms, continue to balance commercial objectives with social responsibilities. Understanding this evolving context is essential to appreciate the contemporary role and challenges of PSBs in India.

### **Conceptual Framework: Public Sector Banking Performance and Inclusive Growth Framework Overview**

The proposed conceptual framework explains how banking reforms and organizational capabilities influence **service quality**, which in turn shapes customer perception and satisfaction, ultimately leading to financial stability and inclusive economic growth. The framework integrates institutional, service, and customer dimensions.

### **Structure of the Indian Banking System**

The Indian banking system is structured into various categories based on ownership, functions, and regulatory framework, under the supervision of the Reserve Bank of India.

### **Commercial Banks**

Commercial banks form the core of the Indian banking system and are regulated under the Banking Regulation Act, 1949. Their primary functions include accepting deposits from the public and extending loans and advances to individuals, businesses, and the government. Commercial banks operate on a profit-oriented model while ensuring financial stability and customer service.

Commercial banks in India are broadly classified into:

- Public Sector Banks
- Private Sector Banks
- Foreign Banks

### **Public vs. Private Banks**

Public sector banks are government-owned institutions that emphasize financial inclusion, priority sector lending, and socio-economic objectives. In contrast, private sector banks are owned by private entities and typically focus on operational efficiency, innovation, and customer-centric services. While private banks are often perceived as more agile and technologically advanced, public sector banks dominate in terms of outreach, trust, and implementation of national financial programs.

### **Evolution of Public Sector Banks in India**

#### **Nationalization Phases**

The evolution of public sector banks in India began with the nationalization of the Imperial Bank of India in 1955, leading to the formation of the State Bank of India. The first major wave of bank nationalization occurred in 1969, when 14 large private banks were nationalized, followed by another round in 1980 involving six more banks. The primary objective of nationalization was to expand banking services to rural areas, support agriculture and small industries, and ensure equitable distribution of credit.

#### **Impact of Liberalization**

The economic liberalization of 1991 marked a turning point for Indian banking. Reforms introduced prudential norms, capital adequacy requirements, deregulation of interest rates, and enhanced competition. Public sector banks were compelled to improve efficiency, asset quality, and customer service while competing with private and foreign banks.

#### **Post-2000 Reforms**

Post-2000 reforms focused on strengthening governance, risk management, technological adoption, and financial performance of PSBs. Core banking solutions, digital payment systems, and performance benchmarking became integral to banking operations, enabling PSBs to modernize service delivery.

#### **Mergers and Consolidation of Public Sector Banks**

##### **SBI Group Mergers**

A significant consolidation initiative involved the merger of associate banks with the State Bank of India in 2017. This move aimed to improve operational efficiency, optimize resources, and create a globally competitive banking entity.

##### **2019 Consolidation Reforms**

In 2019, the Government of India announced large-scale mergers of public sector banks to reduce fragmentation and enhance financial strength. These consolidations reduced the number of PSBs while creating larger banks with improved capital base, risk absorption capacity, and economies of scale.

#### **Services Rendered by Public Sector Banks**

Public sector banks provide a wide range of financial services beyond traditional deposit and lending functions.

### **Merchant Banking**

PSBs offer merchant banking services such as project advisory, issue management, mergers and acquisitions, and financial consultancy through subsidiaries.

### **Leasing and Venture Capital**

They provide leasing services and venture capital support to promote industrial growth, innovation, and entrepreneurship, especially in priority sectors.

### **Mutual Funds and Factoring**

PSBs sponsor mutual funds to mobilize household savings and offer factoring services to improve liquidity and cash flow for businesses.

### **Housing Finance**

Public sector banks play a crucial role in housing finance by extending affordable home loans, particularly to low- and middle-income groups.

### **Digital Banking and Technology**

With the adoption of core banking, internet banking, mobile banking, ATMs, and digital payment platforms, PSBs have significantly enhanced service accessibility and efficiency.

### **Role of Public Sector Banks in Financial Inclusion**

#### **Rural Outreach**

Public sector banks maintain the largest rural branch network in India, facilitating access to formal banking services for rural and semi-urban populations.

#### **PMJDY, ATMs, and BC Model**

PSBs are the primary drivers of the Pradhan Mantri Jan Dhan Yojana, enabling millions of households to open basic savings accounts. The expansion of ATMs and the Business Correspondent (BC) model has further strengthened last-mile banking connectivity.

### **Challenges and Policy Implications**

Despite their achievements, public sector banks face challenges such as rising non-performing assets, operational inefficiencies, technological gaps, and increasing competition from private banks. Addressing these challenges requires policy support for governance reforms, digital transformation, workforce skill development, and customer-centric service delivery. Strengthening accountability and performance-based management is essential to enhance the competitiveness and sustainability of PSBs.

### **Future Scope for Research**

The evolving nature of the banking sector, particularly in the context of technological advancement, regulatory reforms, and changing customer expectations, offers significant opportunities for future research. While existing studies have extensively examined service quality, customer perception, and the role of public sector banks, several areas remain underexplored and warrant further academic investigation.

First, **longitudinal studies** can be conducted to examine how customer perception and satisfaction toward public sector banks evolve over time, especially after major reforms such as bank mergers, digital transformation initiatives, and policy interventions. Most existing studies are cross-sectional in nature; therefore, tracking changes in customer perception before and after reforms would provide deeper insights into the effectiveness of these initiatives.

Second, future research may focus on **comparative regional studies** across rural, semi-urban, and urban areas. Customer expectations and service quality perceptions vary significantly across regions due to differences in financial literacy, digital access, and socio-economic conditions. A region-wise analysis would help in understanding location-specific service gaps and formulating targeted service improvement strategies for public sector banks.

### Conclusion

Public sector banks continue to be the cornerstone of the Indian banking system, balancing commercial objectives with social responsibilities. Their evolution reflects India's broader economic transformation, from a state-led development model to a more competitive, market-oriented framework. While banking reforms, consolidation initiatives, and technological adoption have strengthened the operational capacity and financial resilience of public sector banks, sustained and targeted efforts are required to address emerging challenges in service efficiency, customer responsiveness, and governance. In an increasingly digital and customer-driven banking environment, public sector banks must focus on enhancing service quality by improving employee competencies, upgrading digital infrastructure, and streamlining service delivery processes. Strengthening customer-centric practices will be essential to meet rising expectations and prevent customer attrition in the face of intense competition from private and foreign banks. Moreover, continuous innovation in product offerings and delivery channels can help public sector banks remain relevant across diverse customer segments.

Public sector banks also play a critical role in advancing financial inclusion, supporting priority sector lending, and implementing government-led development programs. By deepening their outreach to rural and underserved populations while maintaining financial prudence, they can contribute to inclusive and sustainable economic growth. Going forward, effective policy support, robust governance mechanisms, and strategic investment in technology and human resources will be crucial. By reinforcing service quality, innovation, and inclusive banking practices, public sector banks can continue to play a vital role in ensuring India's financial stability, economic growth, and social development.

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