**August 2014**

**Organizational Theory, Structure and Design – Trimester End Project**

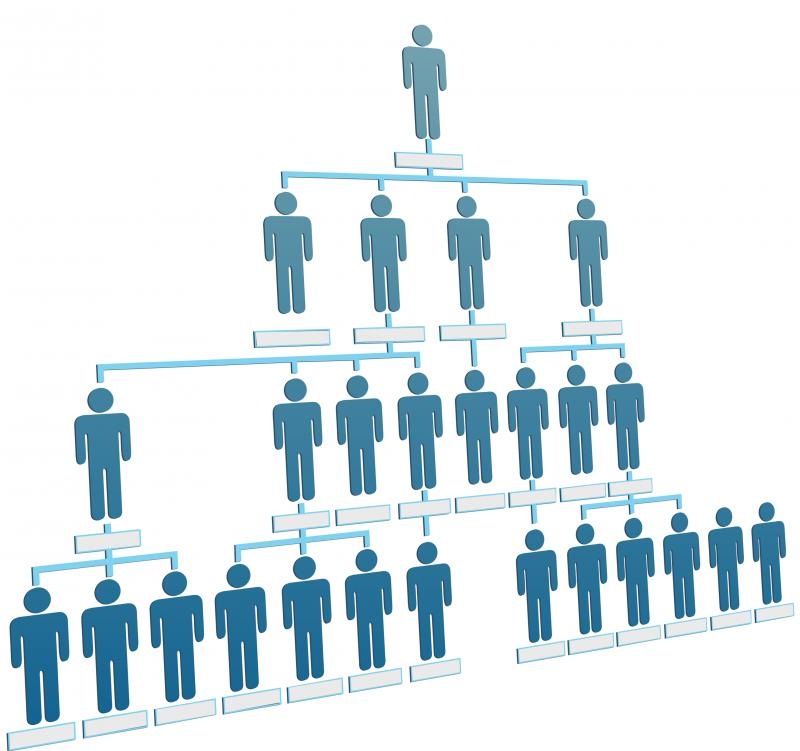
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**Environment and Structure**

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# Abstract

Environment – Structure relationship is vital from all organizations, as all of them are open systems. The purpose of this project is to study this relationship by connecting literature and theory with real life examples.

We have chosen the Indian Banking sector for the purpose of our study and corresponding organizations are – ICICI Bank, HDFC Bank, Axis Bank and Kotak Mahindra Bank.

Following studies/ frameworks in the field of Organizational Environment study have been used by us during our analysis in our project –

* **Burns and Stalker** (The Management of Innovation) – **Mechanistic** and **Organic** structures
* Analysis of Sales structural hierarchy in above mentioned four banks using **‘The Lawrence and Lorsch Model’** of differentiation and integration.
* Analysis of General environment through **STEP** **framework** (Social, Technological, Environmental and Political): this framework helped us in scanning the general environment of banking industry holistically, including regulatory impacts, legal impacts etc.

The study involved primary and secondary research methodologies, including literature review. Effectiveness of different aspect of Environment-Structure relationship has been studied by us. Employees’ perception about complexity, formalization and centralization were also recorded during our study. A critique on certain aspect of environment-structure and recent strategic shifts has also been stated in our report.

# Background

Organizational Environment corresponds to set of forces outside the organizational boundaries impacting the functioning and operations of the organization. These forces are classified as General environment forces and Specific Environment forces and depend directly on the relationship of the organization with its stakeholders.

**General Environment** constitutes forces that do not directly or overtly impact the organization. **Specific Environment** constitutes forces that directly impact the organization in its path to achieve its goals. General Environment constitutes outer boundary of the organization whereas Specific Environment constitutes the inner boundary of the organization. Specific environment depends of domain of the organization, i.e. the product and service space under which organization is operating. **[1]**

**General Environment Forces**

**Specific Environment Forces**

Contextual theory contains number of studies which try to correlate structure and structure and managerial practices of the organizations to its environment. However, the studies and theories are based on the understanding of the authors about actual and perceived environment of the organization. We have used such studies and theories during our report to illustrate the environment structure relationship in the **banking industry in India**.

Indian Banking industry has seen multiple phases of environmental change ranging from nationalization of 14 largest commercial banks in 1969 to grant of new banking licenses to IDFC and Bandhan finance in 2014. The industry has also seen major technological evolutions from the era of remote branch banking to mobile banking. Human Resource function in Indian banking is playing very important role both in terms of a support function as well as strategic business contributor. Environment plays a crucial role in the function of HR as a strategic role. From controlling attrition to market compliance, from market compensation benchmarking to relocation policy, environment gives much important data to the HR function. This study will help us substantiating the importance and impact of Environment on the structure and management practices of the banks.

# Methodology

Study predominantly involved Primary and Secondary research steps.

* Primary Study
  + Telephonic and one to one interactions
  + Bank Branch visits
  + Questionnaire – respondent methodology
* Secondary study
  + Text review
  + Literature Review
  + Online open source material – Journal, interviews, articles, etc

Limitations of study include low sample size, random sample, study conducted in time and resource constraints, hesitations of employees in sharing data, etc.

# Literature Review

The concept of Mechanistic and Organic structures was introduced by T. Burns and G.M. Stalker in 1961 in their work *The Management of Innovation*. Based on primary research using interviews and various observations, they came up with concepts of Mechanistic and Organic structures which they classified as two extreme ends of structural continuum. Degree of mechanistic characteristics and organic characteristics depends on rate of change of **environmental change**. Environmental change in this context means change in scientific technologies and the change in relevant product markets of the target firms. Mechanistic and organic structures are two facets of Contingency design theory which emphasizes the need of adaptive capability of the organization under variable degree of environmental uncertainty. Organizations tend Mechanistic in nature when the environment is relatively stable, i.e. environmental uncertainty is at a lower level. On the contrary, organizations in rapidly changing environment tend to be organic in nature (see **Exhibit 1** for characteristics of Mechanistic and Organic structures). **[2]**

Two Harvard Business School professors, Paul R. Lawrence and Jay W. Lorcsh, published a study in Administrative Science Quarterly, June 1967, titled *Differentiation and Integration in Complex Organization*. From the study, a popular model known as ‘The Lawrence and Lorsch Model’ originated which stated that the two opposing forces of organization structural complexity, i.e. Differentiation and Integration, exist in dynamic equilibrium with the environmental complexity and uncertainty. The study followed an approach on the basis of an assumption that an organization is an active system which tends to reach out and order its environmental surroundings. The study classified organization as three subsystems – sales, production and research & development. Study also segmented the organizational environment in three sectors or sub-environments – market, technical economic and scientific. The study attributed different variables to the structure – environment relationship, like Degree of Structure, Orientation of members toward each other, Time orientation and members, Goal orientation and members. Hypothesis corresponding to these attributes were developed and studied. **[3]**

In 1992, Gerald Davis of Northwestern University and Walter Powell of University of Arizona published a study paper titled *Organization-Environment Relations*. The paper critically analyzed six most influential approaches which establish relationship between structure and environment. The approaches range from contingency theory to ecology and institutional view. Their viewpoints and critical analysis of population ecology perspective of Organization-environment relationship is the matter of interest to us. They argued that changes shaped in the environment impacts the organization in that ecology dominantly over those changes which are specific to the organization itself. **[4]**

Mr. KV Kamath, Former MD and CEO of ICICI Bank, argued in 2003 edition of Colloquium debate on the topic “Indian Banking Sector: Challenges and Opportunities”, that technological innovations and evolution in the Banking industry would help in capitalizing of the business environmental opportunities. He also advocated the need to develop learning organizations, knowledge sharing structures. SS Kohli, former CMD of Punjab National Bank, also stated the need of organization agility in the times of evolving deregulated environment of the Indian Banking Industry. Participants also argued about scarcity of environmental resources like licenses, permissions, human resources etc and dependence of banks on them. **[5]**

Organizational theory provides multiple strategies through which organizations can deal with environmental forces. These strategies are classified as Internal and External. Internal strategies constitutes buffering, smoothing, forecasting and rationing while external strategies include co-opting, bargaining, cooperation, coalescing etc. The theory also contains numerous studies which states that in order to be sustainable, organizational internal environment must match with external environment. Correlation between complexity, centralization and formalization with that of environment is also established through various researches.

# Industry analysis using Burns and Stalker concept of Mechanistic and Organic structures

Traditionally, i.e. before nationalization of banks, the industry was purely mechanistic and has Low Uncertainty, but post nationalization and with advancements of private banks, the industry has gradually moved in the middle, between organic and mechanistic line. The banking industry faces changes that are complex in nature and the degree of change depends on plethora of factors, like regulator, international economic conditions, etc.

We did primary research on four companies – ICICI Bank, HDFC Bank, Kotak Mahindra Bank and Axis Bank and interviewed 23 people (7 ICICI Bank, 6 HDFC Bank, 6 Axis Bank, 4 Kotak Mahindra Bank). Four basic questions were asked to them about their viewpoint regarding Complexity, Formalization, Complexity and Span of Control in their organization. Explanation of each term was also given while taking responses in order to maintain uniformity of understanding among respondents. Following table shows the survey analysis. (see **Exhibit 2** for survey data**)**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Bank** | **Centralization** | **Formalization** | **Complexity** | **Span of Control** |
| **ICICI Bank** | 2.57  (High) | 2.71  (High) | 2.57  (High) | 2.14  (Lower Moderate) |
| **HDFC Bank** | 2.33  (Upper Moderate) | 2.67  (High) | 2.67  (High) | 2.5  (Upper Moderate) |
| **Axis Bank** | 2.17  (Lower Moderate) | 2.67  (High) | 2.33  (Upper Moderate) | 2.17  (Lower Moderate) |
| **Kotak Mahindra** | 1.75  (Lower Moderate) | 2.75  (High) | 2.5  (Upper Moderate) | 2.25  (Lower Moderate) |

\*(Scale of 3: 1 - 1.5: Low, 1.5 – 2: Lower Moderate, 2 – 2.5: Upper Moderate and 2.5 – 3: High)

Observations:

* Centralization is on High for ICICI, while for HDFC it is on Upper Moderate and for Axis and Kotak, it is at Lower Moderate level.
* Formalization is “High” for all banks
* Complexity is high for ICICI and HDFC while for Axis and Kotak, it is at Upper Moderate level
* Span of control for HDFC is Upper Moderate while for others it is at Lower Moderate level

# Analysis of impact of environment on differentiation and integration at Sales function of banks – ‘The Lawrence and Lorsch Model’

The underlying hypothesis of The Lawrence and Lorsch Model is that the internal environments of an organization must match the external environment requirements. The better the match, the more successful the firm will be. Main assumption of the study was that, all organizations are an active system. As per this model, organizations use two variables – Differentiation and Integration in order to calibrate itself with the external environment needs and wants.

Sales Business in banking consists of different types of customers. These customers are classified as per their Net Worth, which is nothing but their ability and will to invest. Broadly, customers are classified as –

* Low Net worth Individuals (LNI)
* Medium Net worth Individuals (MNI)
* High Net worth Individuals (HNI)
* Ultra High Net worth Individuals (UHNI)

Depending on the type of needs of different types of customers, Banks define various sales channels. These sales channels are customized in nature and differ from each other in terms of employee skill set, product offerings, quality of service, etc. For four banks considered in our study, following table illustrates the type of customer and segment classification –

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **ICICI Bank** | **HDFC Bank** | **Axis Bank** | **Kotak Mahindra Bank** | **Segment Description** |
| Value Banking | Classic Banking | Value Banking | Value Banking | **For LNI customers** |
| Privilege Banking | Preferred Banking | Priority Banking | Personal Banking | **For MNI customers** |
| Wealth Management | Imperia Banking | Wealth Management | Privy League Banking | **For HNI customers** |
| Private Banking | Private Banking | Privee Relationship Management | Wealth Management | **For UHNI customers** |

Structural hierarchy differs at different banks on the basis of above segmentation. Some banks have same supervisory structure for multiple segments but some have different. Following table illustrates parameters of structural hierarchy of banks we are studying –

|  |  |  |  |
| --- | --- | --- | --- |
| **ICICI Bank** | **HDFC Bank** | **Axis Bank** | **Kotak Mahindra Bank** |
| ICICI Bank has separate supervisory structures for Retail Sales (Value Banking and Privilege banking) and Wealth management business which integrates at Zonal head level. Private banking has altogether different structure | HDFC has same supervisory structure for Retail sales (Classic and Preferred Banking) and Wealth relationship management and both structures converge at Branch Manager level. Private banking has altogether different structure | Axis has concept of sales channels but all the business lines converge at level of Branch head itself with a dotted reporting structure in between. | Kotak has different supervisory structure for retail and wealth segments. Businesses converge at Zonal head level. |
| **Manpower strength -**  About 13000 VB  About 2000 PB  About 800-900 RMs  About 200 Private Bankers | **Manpower strength -**  About 10500 PB Sales  About 1500 RMs  About 500 Imperia RMs  About 150 Private bankers | **Manpower strength -**  About 9000 FDO / BDE  About 1200 Priority RM  About 350 Wealth RM  About 120 Privee RMs | **Manpower strength -**  About 3000 RO  About 200 Privy RMs  About 100 Wealth managers |

**Supervisory Structures of different banks in study**

**ICICI Bank**

**Roles -**

|  |  |  |
| --- | --- | --- |
| **VB – Value Banker**  **PB – Privilege Banker**  **RM – Relationship Manager** | **CBM – Cluster Branch Manager**  **RH – Regional Head** | **BM – Branch Manager**  **Pr. B – Private Banker**  **ZH – Zonal Head** |

**HDFC Bank**

**Roles -**

|  |  |  |
| --- | --- | --- |
| **Teller**  **PB Sales – Preferred Banker**  **PB Authorizer** | **RM – Relationship Manager**  **Imperia RM**  **BM – Branch Manager**  **Pr. B – Private Banker** | **CH - Cluster Head**  **ZH - Zonal Head**  **BBH – Business Banking Head** |

**Axis Bank**

**Roles -**

|  |  |  |
| --- | --- | --- |
| **FDO – Front Desk Officer**  **BDE – Business Development Executive**  **BSM – Branch Sales Manager** | **BOM – Branch Operations Mgr.**  **Wealth RM**  **BH – Branch Head** | **RM RH – Regional Head**  **CM – Cluster Manager**  **CH – Circle Head**  **ZH – Zonal Head** |

**Kotak Mahindra Bank**

**Roles -**

|  |  |  |
| --- | --- | --- |
| **RO - Relationship Officer**  **BRM – Branch Relationship Manager**  **BCM – Branch Circle Manager** | **PRM – Privy Relationship Management**  **PAM – Privy Area Manager**  **PCM – Privy Circle Manager** | **ZBH – Zonal Business Head**  **WM – Wealth Manager** |

**Product offerings** also vary from banks to banks. In general, products in banking sales environment are classified as – Loan Products, deposit products, insurance products and services, commercial banking products, Foreign exchange products, etc. Every bank has certain area in which it has strong foothold. Following table shows the area of strengths for the banks in study –

|  |  |
| --- | --- |
| **Bank** | **Product Portfolio** |
| **ICICI Bank** | The Bank sells product belonging to the entire value chain, e.g. Insurance (Life and General), Mutual Funds, CAPRO, Alchemy, etc |
| **HDFC Bank** | Product portfolio is almost same as that of ICICI however, specific focus is made on equity funds, life insurance, etc |
| **Axis Bank** | Products classified as Investment products and cross selling products |
| **Kotak Mahindra** | Product based on asset and mortgage business. Kotak focus segments include CASA, loan against property, etc |

# STEP Framework Analysis

The general environment of the banking industry dominates many processes and business operations of the banks. We have analyzed this impact with help of STEP framework. **[6]**

1. **Social** Factors affecting the industry
   1. Huge banking penetration, (about 67%) [7]
   2. Untapped rural markets which forms the major chunk of potential customers
   3. Priority sector lending (farmers, agriculture loans etc)
   4. Changing lifestyles – both urban and rural
2. **Technological** Factors affecting the industry
   1. Technological changes and upgrades in day to day operations
   2. Boom in Internet and mobile banking, e.g. Facebook banking apps, etc
   3. Concept of electronic branches
   4. Advanced ATM and card technologies
3. **Economic** Factors affecting the industry
   1. Rising per capita leading to more money in circulation and hence in banks
   2. More FDI, more capital reforms leading to economic boom
   3. Global economic impacts like recession, subprime crises, etc
4. **Political** Factors affecting the industry
   1. Annual fiscal policy by Govt. and corresponding budgetary measures
   2. Basel norms and procedures
   3. RBI’s monetary policy and corresponding measures and checks
   4. Stricter regulations by the regulatory bodies like RBI, SEBI, IRDA, etc
   5. Financial inclusion policy of Govt.

Above factors impact organizational structure in many ways, e.g. a need for Compliance department, need for contingency handling department, etc.

**Regulatory environment in the Indian Banking Industry**





1. **Ministry of Finance (MoF) -**

* Controls and assists the Indian BFSI sector.
* Annual Fiscal and budgetary policy.

1. **Reserve Bank of India (RBI) –**

* Established in 1935 under RBI Act, 1934.
* Responsible for annual monitory policy.
* Acts as an investment banker to the government.

1. **Securities and Exchange Board of India (SEBI) –**

* Regulates securities market in India.
* Protects investors’ interests.

1. **Insurance Regulatory and Development Authority**

* Works on the guidelines of the IRDA Act, 1999.
* Safeguards the interest of the people w.r.t. instruments like Insurances and different financial products.

# Critique and Conclusion

Banking is one of the most powerful and important sector for any economy. Because of such importance, the sector operates in many constraints and is expected to make profits in these constraints. In such kind of scenario, organizational structure plays an important role which in turn is affected by the environmental forces. During our study, we came across with various facts and figures related to the structure-environment linkage. We observed that banks are high on formalization and upper moderate to high on complexity.

ICICI Bank and HDFC Banks, two largest banks of private sector have very complex structures. These banks because of their behemoth size, impact majority of the environmental forces. Axis and Kotak are trying to carve their own niche segments. Among all the four banks in our study, Axis has the highest number of reporting channels whereas Kotak’s structure is most agile. ICICI and HDFC because of their structure have bureaucratic and mechanistic structural characteristics whereas Axis and Kotak are near organic structures.

We conclude from our study that environment – both internal and external is vital for the structure of any organization and provide a semi permeable shield to it for contingency or economic catastrophes. On the other side, it the environment if become very stable, leads to institutionalization of the organizations. Large and humongous organizations impact environment more than medium sized organizations. Role of regulatory bodies also become important in such cases.

# Exhibits

**Exhibit 1**

|  |  |  |
| --- | --- | --- |
| **CHARACTERISTIC** | **MECHANISTIC** | **ORGANIC** |
| **Task Definition** | Rigid | Flexible |
| **Communication** | Vertical | Lateral |
| **Formalization** | High | Low |
| **Control** | Centralized | Diverse |
| **Influence** | Authority | Expertise |

**Exhibit 2**

Questions used during data gathering about complexity, formalization, centralization and span of control.

Scale used – 1 (Low) | 2 (Moderate) | 3 (High)

1. Rate your organization in overall terms of specialization, horizontal and vertical differentiation, and departmentalization?

(Rate in overall manner)

1. Rate your organization in terms of degree of written rules and procedures being followed, standardization of jobs, formal code of conduct?
2. Rate your organization in terms of centralization of decision making, i.e. role of central office or central authority in the decision making process
3. Rate your organization in terms of general span of control, i.e. on an average number of direct reports reporting to the supervisor/ manager?

**Survey Results**

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **Respondent Number** | **Bank** | **Role/ Designation** | **Centralization** | **Formalization** | **Complexity** | **Span of Control** |
| Respondent 1 | ICICI Bank | Manager | 2 | 2 | 2 | 1 |
| Respondent 2 | ICICI Bank | Manager | 3 | 3 | 3 | 2 |
| Respondent 3 | ICICI Bank | Sales Officer | 3 | 3 | 3 | 2 |
| Respondent 4 | ICICI Bank | Relatioship Manager | 3 | 2 | 2 | 2 |
| Respondent 5 | ICICI Bank | Relatioship Manager | 3 | 3 | 3 | 3 |
| Respondent 6 | ICICI Bank | Sales Officer | 2 | 3 | 2 | 2 |
| Respondent 7 | ICICI Bank | Chief manager | 2 | 3 | 3 | 3 |
| Respondent 8 | HDFC Bank | Relationship Manager | 3 | 2 | 3 | 2 |
| Respondent 9 | HDFC Bank | Value Banker | 2 | 3 | 3 | 3 |
| Respondent 10 | HDFC Bank | Value Banker | 2 | 3 | 3 | 3 |
| Respondent 11 | HDFC Bank | Manager | 2 | 2 | 2 | 2 |
| Respondent 12 | HDFC Bank | Asst. Manager | 3 | 3 | 3 | 3 |
| Respondent 13 | HDFC Bank | Manager | 2 | 3 | 2 | 2 |
| Respondent 14 | Axis Bank | Manager | 2 | 2 | 3 | 2 |
| Respondent 15 | Axis Bank | Asst. Manager | 3 | 3 | 2 | 2 |
| Respondent 16 | Axis Bank | Manager | 2 | 3 | 3 | 3 |
| Respondent 17 | Axis Bank | Sales Officer | 1 | 2 | 1 | 1 |
| Respondent 18 | Axis Bank | Sales Officer | 2 | 3 | 3 | 3 |
| Respondent 19 | Axis Bank | Manager | 3 | 3 | 2 | 2 |
| Respondent 20 | Kotak Mahindra | Relationship Manager | 1 | 3 | 2 | 1 |
| Respondent 21 | Kotak Mahindra | Relationship Manager | 2 | 3 | 3 | 3 |
| Respondent 22 | Kotak Mahindra | Manager | 2 | 2 | 3 | 2 |
| Respondent 23 | Kotak Mahindra | Asst. Manager | 2 | 3 | 2 | 3 |

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