CHAPTER–1

INTRODUCTION

1.1 Introduction to the Indian Banking Sector:

Banking Sector is the backbone of any financial system and economy. Commercial banks play an important role in the development of underdeveloped/developing economies by mobilization of resources and their better allocation. Indian Banking System is regulated by the central bank of the country i.e. Reserve Bank of India (RBI), which was nationalized in 1949. RBI is the primary regulator for the banking sector and the government exercises direct and indirect control over banks through RBI to protect the depositors and to stabilize the banking system. Extensive powers have been conferred on RBI under the RBI Act, 1934, and Banking Regulations Act, 1949. In 1969 the government nationalized 14 major banks to break the ownership and control of few leaders of Banking and industry over the economic power and banking system. This has resulted in balanced geographical growth of banks in rural areas and small towns, as it accounts for majority of the population. Government as the owner of the banks decided the agenda for the banks and directed the flow of the credit. The focus changed from class banking to social banking. This social transformation process though resulted in unprecedented expansion of banking and financial system. However the regulated business environment, poor quality of credit portfolio due to social lending without adequate safeguards against defaults, thin margins on social lending, disruptive tactics of trade unions, increasing number of loss making branches due to unmindful branch expansion in rural areas and other factors resulted in sacrifice of the service quality and the operational productivity and profitability of these organizations.

The banks still managed to survive due to the regulated business environment which killed the scope for competition among banks. The Indian banking system has changed a lot over the last five decades especially in the last 15 years with India taking to the path of free market economy and globalization with clear commitments under WTO (World Trade Organization) regime. A journey from private ownership and control of commercial banks
to government ownership and control by way of nationalization, has come in full circle in the wake of liberalization and introduction of new players in the shape of Private Sector Banks and Foreign Banks.

Fresh induction of public stake and corporate governance in government owned banks has brought the element of stiff competition in the environment with greater adoption of the new technologies and ideas, renewed perception of service quality along with the high degree of professional management and marketing concepts in the Indian Banking system.

Currently there are twenty eight public sector banks which account for 87% of the total bank branches (and 74% of deposits), twenty four private sector banks which account for 12% of the total bank branches (and 20% of deposits) and twenty nine foreign banks accounting for 0.45% of the branches (and 5.5% of deposits) (Indian Banks’ Association, 2007). The entry of foreign/private banks and various financial sector reforms like deregulation of interest rates, new norms on asset classification and provisioning, adoption of Basle Accord on capital adequacy coupled with other policy measures aimed at adopting best global practices has revolutionized the banking industry in India. The Public Sector Banks, which still account for the major part of the Indian Banking Industry in terms of size and reach are facing stiff competition from Private and Foreign Banks as also from the Non-Banking Financial Institutions. The Foreign Banks which form only 0.26 % of the total number of branches in India still manage to gather 5% of the total deposits.

The growing competition and highly stressed profits have not only introduced the new marketing concepts in the Indian banking sector but has also brought the customer satisfaction to the center of the focus. It has become very important for the banks to retain their existing customer base as well as to enlarge the same. It is reported that 90% of bank switching in the Asian Banking market occurs due to pricing, service quality and inconvenience. Since pricing in Indian banks is regulated it is the service quality delivered which then becomes important if the banks want to retain and attract customers.

1.2 Definition of Bank:

In general terms, banking is business activity of accepting and safeguarding money owned by other individuals and entities, and then lending out this money in order to earn a profit. The institution that is approved to carry out such business activity legally under the regulation and acts of any given country is known as Bank. A bank is a financial institute
and a financial mediator that accepts deposits and channels those deposits into lending activities, either directly or through capital markets. A bank connects customers that have capital deficits to customers with capital surpluses.

Due to their critical status within the financial system and the economy, generally, banks are highly regulated in most countries. Most banks operate under a system known as fractional reserve banking where they hold only a small reserve of the funds deposited and lend out the rest for profit. It is majorly subject to minimum capital requirements that are based on an international set of capital standards.

The statutory definition of Banking is:

The meaning of "Banking Business" is as follows:

- receiving the money from the general public through current, deposit, savings or other similar account and it is repayable on demand or with a period of call or notice of less than that period;

- paying or collecting checks drawn by or paid in by customers.

With the advent of EFTPOS (Electronic Funds Transfer at Point Of Sale), direct credit, direct debit and internet banking, the cheque has lost its dominance in most banking systems as a payment instrument. Due to this, legal theorists suggest that the cheque based definition should be extended to take account of financial institutions that offers current accounts for customers and allow customers to pay and be paid by third parties, even if they do not pay and collect checks.

1.3 Business Model:

A bank can generate profits through different ways including interest, transaction fees and financial advice. The foremost method is through charging interest on the capital that is being lent to the customers. The bank generate revenues from the variation between the level of interest it offers for deposits and other sources of funds, and the level of interest it charge in its lending activities.

This distinction is referred to as the spread between the cost of funds and the loan interest rate. Initially, profitability from lending activities was referred as cyclical and it was more
dependent on the requirements and strengths of loan customers and the stage of the
economic cycle. Fees and financial guidance comprise of a more steady income stream and banks have emphasized on these income lines to smooth their financial performance.

Governments and Banks jointly have taken many actions to make sure that Banks remain profitable with increasingly changing market conditions.

Firstly, Banking Acts has allowed banks to merge with investment and insurance houses. Integrating banking, investment, and insurance functions has permitted traditional banks to act in response to increasing consumer needs for "one-stop shopping" by facilitating cross-selling of products and banks hope that this will increase their profitability.

Banks have also extended the use of risk-based pricing from consumer lending businesses which are offering higher interest rates to those customers that have higher credit risk and thus increased chance of default on loans. This facilitates the bank to compensate the losses from bad loans, lowers the price of loans to those customers who have better credit histories, and propose them the credit products.

Third, they have increased the methods of payment processing offered to the general public and corporate clients. These products include debit cards, prepaid cards, smart cards, and credit cards. Banks make it easier for consumers to conveniently make transactions and ensure smoother consumption over time.

With easy availability credit, there is also increased risk that consumers will mismanage their financial resources and end up in accumulating excessive debt. Banks earn money from different card products via interest payments and fees taken from the consumers and transaction fees charged to the companies that accept the credit-debit-cards. This has resulted in making profit and facilitating economic development as a whole.
1.4 History of Indian Banking Sector:

Banking in India started off in the last decades of the 18th century. The first banks were The General Bank of India that started in 1786 and Bank of Hindustan, which started in 1770; both are now non-operational. The oldest bank that is still operating in India is the State Bank of India, which originated in the Bank of Calcutta in June 1806, than soon it became the Bank of Bengal. This was one of the three presidency banks; the other two being the Bank of Bombay and the Bank of Madras, all three banks were established under charters from the British East India Company. For many years the Presidency banks acted as quasi-central banks, as did their successors. The three banks merged in 1921 and formed the Imperial Bank of India and after India's independence; it became the State Bank of India in 1955.

Merchants in Calcutta established the Union Bank in 1839, but it failed in 1840 as a consequence of the economic crisis. The Allahabad Bank, established in 1865 and still functioning today, is the oldest Joint Stock bank in India.(Joint Stock Bank: A company that issues stock and requires shareholders to be held liable for the company's debt) It was not the first though. That honor belongs to the Bank of Upper India, which was established in 1863, and which survived until 1913, when it failed, with some of its assets and liabilities being transferred to the Alliance Bank of Simla.

Foreign banks too started to app, particularly in Calcutta, in the 1860s. The Comptoird'Escompte de Paris opened a branch in Calcutta in 1860, and another in Bombay in 1862; branches in Madras and Pondicherry, then a French colony, followed. HSBC established itself in Bengal in 1869. Calcutta was the most active trading port in India, mainly due to the trade of the British Empire, and so became a banking center.

The first entirely Indian joint stock bank was the Oudh Commercial Bank, established in 1881 in Faizabad. It failed in 1958. The next was the Punjab National Bank, established in Lahore in 1895, which has survived to the present and is now one of the largest banks in India. Around the turn of the 20th Century, the Indian economy was passing through a relative period of stability. Around five decades had elapsed since the Indian Mutiny, and the social, industrial and other infrastructure had improved. Indians had established small banks, most of which served particular ethnic and religious communities.
The presidency banks dominated banking in India but there were also some exchange banks and a number of Indian joint stock banks. All these banks operated in different segments of the economy. The exchange banks, mostly owned by Europeans, concentrated on financing foreign trade. Indian joint stock banks were generally undercapitalized and lacked the experience and maturity to compete with the presidency and exchange banks. This segmentation let Lord Curzon to observe, "In respect of banking it seems we are behind the times. We are like some old fashioned sailing ship, divided by solid wooden bulkheads into separate and cumbersome compartments."

The period between 1906 and 1911, saw the establishment of banks inspired by the Swadeshi movement. The Swadeshi movement inspired local businessmen and political figures to found banks of and for the Indian community. A number of banks established then have survived to the present such as Bank of India, Corporation Bank, Indian Bank, Bank of Baroda, Canara Bank and Central Bank of India.

The fervour of Swadeshi movement lead to establishing of many private banks in Dakshina Kannada and Udupi district which were unified earlier and known by the name South Canara (South Kanara) district. Four nationalized banks started in this district and also a leading private sector bank. Hence undivided Dakshina Kannada district is known as "Cradle of Indian Banking". During the First World War (1914–1918) through the end of the Second World War (1939–1945), and two years thereafter until the independence of India were challenging for Indian banking. The years of the First World War were turbulent, and it took its toll with banks simply collapsing despite the Indian economy gaining indirect boost due to war-related economic activities.

1.4.1 Post-Independence:

The partition of India in 1947 adversely impacted the economies of Punjab and West Bengal, paralyzing banking activities for months. India's independence marked the end of a regime of the Laissez-faire for the Indian banking. The Government of India initiated measures to play an active role in the economic life of the nation, and the Industrial Policy Resolution adopted by the government in 1948 envisaged a mixed economy. This resulted into greater involvement of the state in different segments of the economy including banking and finance.
The major steps to regulate banking included:

- The Reserve Bank of India, India's central banking authority, was established in April 1935, but was nationalized on January 1, 1949 under the terms of the Reserve Bank of India (Transfer to Public Ownership) Act, 1948 (RBI, 2005b).

- In 1949, the Banking Regulation Act was enacted which empowered the Reserve Bank of India (RBI) "to regulate, control, and inspect the banks in India".

- The Banking Regulation Act also provided that no new bank or branch of an existing bank could be opened without a license from the RBI, and no two banks could have common directors.

1.4.2 Nationalization:

Despite the provisions, control and regulations of Reserve Bank of India, banks in India except the State Bank of India or SBI, continued to be owned and operated by private persons. By the 1960s, the Indian banking industry had become an important tool to facilitate the development of the Indian economy. At the same time, it had emerged as a large employer, and a debate had ensued about the nationalization of the banking industry. Indira Gandhi, then Prime Minister of India, expressed the intention of the Government of India in the annual conference of the All India Congress Meeting in a paper entitled “Stray thoughts on Bank Nationalization.” The meeting received the paper with enthusiasm.

Thereafter, her move was swift and sudden. The Government of India issued an ordinance ('Banking Companies (Acquisition and Transfer of Undertakings) Ordinance, 1969') and nationalized the 14 largest commercial banks with effect from the midnight of July 19, 1969. These banks contained 85 percent of bank deposits in the country. Jayaprakash Narayan, a national leader of India, described the step as a "masterstroke of political sagacity." Within two weeks of the issue of the ordinance, the Parliament passed the Banking Companies (Acquisition and Transfer of Undertaking) Bill, and it received the presidential approval on 9 August 1969.

A second dose of nationalization of 6 more commercial banks followed in 1980. The stated reason for the nationalization was to give the government more control of credit delivery. With the second dose of nationalization, the Government of India controlled around 91% of the banking business of India. Later on, in the year 1993, the government merged New
Bank of India with Punjab National Bank. It was the only merger between nationalized banks and resulted in the reduction of the number of nationalized banks from 20 to 19. After this, until the 1990s, the nationalized banks grew at a pace of around 4%, closer to the average growth rate of the Indian economy.

1.4.3 Liberalization:

In the early 1990s, Narasimha Rao government embarked on a policy of liberalization, and had approved license to a small number of private banks. These was known as New Generation tech-savvy banks, and included Global Trust Bank (the first of such new generation banks to be established), and later it amalgamated with Oriental Bank of Banking, UTI Bank (since renamed Axis Bank), ICICI Bank and HDFC Bank. This move, along with the rapid growth in Indian economy and it has revitalized the entire banking sector in India. The rapid growth in banking was strongly contributed by all the three sectors of banks, namely, government banks, private banks and foreign banks.

The next stage of the development in the Indian banking has started with establishment with the proposed relaxation in the norms for Foreign Direct Investment, wherein all Foreign Investors in banks may be given rights to vote that could exceed the present capital of 10%, at present it has gone up to 74% with some restrictions. The new policy shuddered the Indian Banking sector completely. Previously bankers were used to the 4-6-4 method (Borrow at 4%; Lend at 6%; Go home at 4) of functioning. The new waves lead in a modern outlook and tech-savvy methods of working for traditional banks. This has led to the retail boom in India. People have not only started demanding more from their banks but also received more.

Currently, banking in India is generally referred as mature in terms of supply, product range and reach. Although reach in rural India has still remained a challenge for the private sector and foreign sector banks. As far as the quality of assets and capital adequacy is concern, Indian banks are considered to possess clean, strong and transparent balance sheets relative to other banks in similar economies in its region. The Reserve Bank of India is an independent body, with minimal pressure from the government. The policy of the Bank on the Indian Rupee is to manage volatility but without any fixed exchange rate and this has mostly been true.
The growth of the Indian economy is expected to be strong for quite some time—especially in its services sector due to the demand for banking services, especially in retail banking, mortgages and investment services as they are expected to be strong. One may also expect M&As, takeovers, and asset sales.

In current years critics have cited that the non-government owned banks are very much aggressive in their loan recovery efforts in connection with housing, vehicle and personal loans. According to the press reports, the banks' loan recovery efforts have driven defaulting borrowers to suicide.

1.5 Types of Banks

1.5.1 Scheduled Banks

Scheduled Banks in India are those banks which have been included in the Second Schedule of Reserve Bank of India (RBI) Act, 1934. RBI has included only those banks in this schedule which has satisfied the criteria laid down vide section 42 (6) (a) of the Act. As on 30th June, 1999, there were 300 scheduled banks in India having a total network of 64,918 branches. Scheduled commercial banks in India include State Bank of India and its associates (7), nationalised banks (19), foreign banks (45), private sector banks (32), co-operative banks and regional rural banks.

"Scheduled banks in India" means the State Bank of India constituted under the State Bank of India Act, 1955 (23 of 1955), a subsidiary bank as defined in the State Bank of India (Subsidiary Banks) Act, 1959 (38 of 1959), a corresponding new bank constituted under section 3 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 (5 of 1970), or under section 3 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980 (40 of 1980), or any other bank being a bank included in the Second Schedule to the Reserve Bank of India Act, 1934 (2 of 1934), but does not include a co-operative bank".

1.5.2 Commercial Banks

A commercial bank (or business bank) is a type of financial institution and intermediary. It is a bank that lends money and provides transactional, savings, and money market accounts and that accepts time deposit. Commercial bank being the financial institution performs
diverse types of functions. It satisfies the financial needs of the sectors such as agriculture, industry, trade, communication, etc. That means they play very significant role in a process of economic social needs. The functions performed by banks are changing according to change in time and recently they are becoming customer centric and widening their functions.

1.5.3 Cooperative Banks

Cooperative banking is retail and commercial banking organized on a cooperative basis. Cooperative banking institutions take deposits and lend money in most parts of the world. Cooperative banking, includes retail banking carried out by credit unions, mutual savings banks, building societies and cooperatives, as well as commercial banking services provided by mutual organizations (such as cooperative federations) to cooperative businesses. There are basically two types of cooperative banks:

(i) Urban Co-Operative Banks

(ii) State Co-Operative Banks.

1.5.4 Urban Co-operative Banks

The term Urban Co-operative Banks (UCBs), though not formally defined, refers to primary cooperative banks located in urban and semi-urban areas. These banks, till 1996, were allowed to lend money only for non-agricultural purposes. This distinction does not hold today. These banks were traditionally centred around communities, localities work place groups. They essentially lent to small borrowers and businesses. Today, their scope of operations has widened considerably.

1.5.5 State Co-Operative Banks

State Co-Operative Banks refers to banks incorporated through state legislature and wherein state government is a stakeholder to it. The purpose is to address the lending and borrowing mechanism for the people of the state.
1.5.6 Foreign Banks

A Bank based in foreign country is known as foreign bank. But if the majority holding of public listed bank is with Foreign Institutional Investors (FIIs), then also it can be termed as Foreign Bank.

1.5.7 Regional Rural Banks

The Government of India set up Regional Rural Banks (RRBs) on October 2, 1975. Initially, five RRBs were set up on October 2, 1975 which were sponsored by Syndicate Bank, State Bank of India, Punjab National Bank, United Commercial Bank and United Bank of India. Capital share being 50% by the central government, 15% by the state government and 35% by the scheduled bank. Regional Rural Banks in India s mainly focused upon the agro sector. Regional rural banks in India penetrated every corner of the country and extended a helping hand in the growth process of the country.

1.5.8 Public Sector Banks

Public Sector Banks (PSBs) are banks where a majority stake (i.e. more than 50%) is held by a government. The shares of these banks are listed on stock exchanges. There are a total of 26 PSBs in India. State Bank of Saurashtra and State Bank of Indore merged with SBI.

The objectives behind nationalization where:

- To break the ownership and control of banks by a few business families,
- To prevent the concentration of wealth and economic power,
- To mobilize savings from masses from all parts of the country,
- To cater to the needs of the priority sectors

The Central Government entered the banking business with the nationalization of the Imperial Bank of India in 1955. A 60% stake was taken by the Reserve Bank of India and the new bank was named as the State Bank of India. The seven other state banks became the subsidiaries of the new bank when nationalized on 19 July 1960. The next major nationalization of banks took place in 1969 when the government of India, under prime
minister Indira Gandhi, nationalized an additional 14 major banks. The next round of nationalization took place in April 1980. The government nationalized six banks.

1.5.9 Private Sector Banks

All those banks where greater parts of stake or equity are held by the private shareholders and not by government are called "private-sector banks". These are the major players in the banking sector as well as in expansion of the business activities India. The present private-sector banks equipped with all kinds of contemporary innovations, monetary tools and techniques to handle the complexities are a result of the evolutionary process over two centuries. They have a highly developed organizational structure and are professionally managed. Thus they have grown faster and stronger since past few years.

1.5.10 Old Private Sector Banks

The banks, which were not nationalized at the time of bank nationalization that took place during 1969 and 1980 are known to be the old private-sector banks. These were not nationalized, because of their small size and regional focus.

1.5.11 New Private Sector Banks

The banks, which came in operation after 1991, with the introduction of economic reforms and financial sector reforms are called "new private-sector banks". Banking regulation act was amended in 1993, which had permitted the entry of new private-sector banks in the Indian banking sector. However, there were certain criteria set for the establishment of the new private-sector banks, some of those criteria being:

- The bank should have a minimum net worth of Rs. 100 crores.
- The promoters holding should be a minimum of 25% of the paid-up capital.
- Within 3 years of the starting of the operations, the bank should offer shares to public.
1.6 Growth of banking industry:

TABLE 1.1 Growth of the bank in FY 2011.

<table>
<thead>
<tr>
<th></th>
<th>Public Bank</th>
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<th>Private Bank</th>
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<th>Foreign Bank</th>
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<tbody>
<tr>
<td>Deposits (Rs. Cr.)</td>
<td>1994200</td>
<td>4372985</td>
<td>551987</td>
<td>1002799</td>
<td>150750</td>
<td>240589</td>
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<td>Investments (Rs. Cr.)</td>
<td>664856</td>
<td>1328534</td>
<td>214655</td>
<td>422020</td>
<td>71471</td>
<td>165499</td>
</tr>
<tr>
<td>Advances (Rs. Cr.)</td>
<td>1440146</td>
<td>3309662</td>
<td>414751</td>
<td>797534</td>
<td>126339</td>
<td>195539</td>
</tr>
<tr>
<td>Int. Income (Rs. Cr.)</td>
<td>164185</td>
<td>366518</td>
<td>49587</td>
<td>98827</td>
<td>17924</td>
<td>28520</td>
</tr>
<tr>
<td>Int. expended (Rs. Cr.)</td>
<td>101960</td>
<td>231153</td>
<td>32856</td>
<td>57115</td>
<td>7603</td>
<td>10652</td>
</tr>
<tr>
<td>Net Int. Income (Rs. Cr.)</td>
<td>62225</td>
<td>185165</td>
<td>16711</td>
<td>35712</td>
<td>10321</td>
<td>17898</td>
</tr>
<tr>
<td>Business per employee (Rs. Lakh)</td>
<td>471.18</td>
<td>1013.63</td>
<td>695.23</td>
<td>825.26</td>
<td>974.77</td>
<td>1559.74</td>
</tr>
<tr>
<td>Profit per employee (Rs. Lakh)</td>
<td>2.76</td>
<td>5.93</td>
<td>4.65</td>
<td>8.1</td>
<td>16.13</td>
<td>27.59</td>
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Source: http://stockshastra.moneyworks4me.com/learn/indian-banking-industry-future-prospects-and-sector-overview/

In the last five years, public sector bank has grown its deposits, advances and business per employee by the highest rate – 21.7%, 23% and 21.1% respectively. As far as net interest income is concerned, private banks are ahead in the race by reporting 24.2% growth, followed by pubic banks (21.4%) and then by foreign banks (14.8%). Though the growth in the business per employee and profit per employee has been the highest for public sector banks, in absolute terms, foreign banks have the highest business per employee as well as profit per employee.

1.7 The growth drivers of the Indian Banking Industry are:

1.7.1 High growth of Indian Economy

The growth of the banking industry is closely linked with the growth of the overall economy. India is one of the fastest growing economies in the world and is set to remain on that path for many years to come. This will be backed by the stellar growth in infrastructure, industry, services and agriculture. This is expected to boost the corporate credit growth in the economy and provide opportunities to banks to lend to fulfill these requirements in the future.
1.7.2 Rising per capita income

The rising per capita income will drive the growth of retail credit. Indians have a conservative outlook towards credit except for housing and other necessities. However, with an increase in disposable income and increased exposure to a range of products, consumers have shown a higher willingness to take credit, particularly, young customers. A study of the customer profiles of different types of banks, reveals that foreign and private banks share of younger customers is over 60% whereas public banks have only 32% customers under the age of 40. Private Banks also possess a greater share of the profitable mass affluent segment.

1.7.3 New channel – Mobile banking is expected to become the second largest channel for banking after ATMs

New channels used to offer banking services will drive the growth of banking industry exponentially in the future by increasing productivity and acquiring new customers. During the last decade, banking through ATMs and internet has shown a tremendous growth, which is still in the growth phase. After ATMs, mobile banking is expected to give another push to this industry growth in a big way, with the help of new 3G and smart phone technology (mobile usage has grown tremendously over the years). This can be looked at as branchless banking and so will also reduce costs as there is no need for physical infrastructure and human resources. This will help in acquiring new customers, mainly who live in rural areas (though this will take time due to technology and infrastructure issues). It is predicted by the industry experts that mobile banking would become the second largest channel of banking after ATMs.

1.7.4 Financial Inclusion Program

Currently, in India, 41% of the adult population don’t have bank accounts, which indicates a large untapped market for banking players. Under the Financial Inclusion Program, RBI is trying to tap this untapped market and the growth potential in rural markets by volume growth for banks. Financial inclusion is the delivery of banking services at an affordable cost to the vast sections of disadvantaged and low income groups. The RBI has also taken many initiatives such as Financial Literacy Program, promoting effective use of
development communication and using Information and Communication Technology (ICT) to spread general banking concepts to people in the under-banked areas. All these initiatives of promoting rural banking are taken with the help of mobile banking, self-help groups, microfinance institutions, etc. Financial Inclusion, on the one side, helps corporate in fulfilling their social responsibilities and on the other side it is fueling growth in other industries and so as a whole economy.

1.8 Service Quality in Banking:

The Indian banking has seen momentous changes in the post independence era. It has witnessed a remarkable shift in its operating environment during the last decade. Various reform measures, both qualitative and quantitative, were introduced with an objective to revitalize Indian banking sector and to meet the future challenges. Every aspect of the functioning of the Indian banking industry, be it a customer service, resource mobilization, credit management, asset-liability management, investments, human resource development, and forex management are undergoing dramatic changes with the reforms gathering the momentum and speed. Several innovative IT-based services such as Automated Teller Machines (ATMs), electronic fund transfer (EFT), anywhere-anytime banking, smart cards, internet banking etc. are no longer alien concepts to Indian banking customers.

The market has changed drastically and has become largely customer centric. From sellers’ market the banks have been forced to operate in the buyer's market. The change has made the customer a king. The customer, in future, will continue to demand new and better products, will switch to new providers quickly, will find information easily, and may even do more and more of ‘legwork’ personally. All of these factors mean more buying power for the consumer. The key to success in the changed environment will be one's ability to reach the client at his doorsteps, and providing products and services in a customized manner. Thus, with these changes customers' expectations and perceptions of service quality are bound to change.

Today's customer is not going to settle on anything less than his/her expectations. To compete, successfully, with each other, banks are using different marketing strategies to live up to the customers’ expectations and stay ahead in the league. Banks have focused to develop strategies to differentiate themselves from their competitors and providing their
customers with high quality banking services and highly technology innovative products. Due to the rapidly changing environment, service quality and customer satisfaction is gaining the greater attention of all banking institutions.

Banking institutions are acknowledging that unless customer needs are taken into account in designing and delivering services, technical superiority will not bring success (Zeithaml and Bitner 1996). New marketing concepts and strategies are paying greater attention to identifying customer needs and expectation and offering high service quality to customer. As argued in literature of service quality, it is probably the effective measurement, management and improvement of service quality which will enable banking institutions to achieve a differential advantage over their competitors.

1.9 Need of studying Service Quality in Banking:

Customers play very important role in development of services industry particularly financial services. Therefore, customer service is an essential in the banking service to compete in the market driven environment. Measurement of service quality is difficult in banking sector as compare to the manufacturing sector as services are intangible in nature. Increasingly, service quality has used as a strategic tool by the various market players to position themselves effectively in the market.

Service quality has become a critical prerequisite for satisfying and retaining valued customers in banks. The interest is largely driven by the realization that high service quality results in customer satisfaction and loyalty with the product or service, greater willingness to recommend someone else, reduction in complaints and improved customer retention (Zeithaml et al., 1996). Further, a satisfied customer is likely to be a loyal customer who will give repeating business to the bank (Heskett et al., 1994). Most importantly, the cost of retaining current customers by improving product and services is significantly lower than the cost of winning new customers. Because of the importance of the service quality and customer satisfaction as a route to competitive advantage and corporate profitability in banking, it has become difficult to identify a single bank which has not initiated some kind of service quality improvement drive.

Also, a clear and detailed understanding of the demands of the various market segments is essential to successfully target new base (Yavas&Yasin, 2001). Undoubtedly, owing to the belief that delivery of high service quality is a must for attaining customer satisfaction and
a number of other desirable behavioral outcomes, recent years have witnessed a flurry of research exploring interrelationships between service quality and customer satisfaction. This study will expand the research in Indian banking sector. Specifically, the study will conduct a survey of Indian bank customers to develop theoretically and empirically the understanding of the relationship between Service Quality, Customer Satisfaction, retention, loyalty & commitment. This study seeks to evaluate empirically the degree of effect on service quality on customer satisfaction retention, loyalty & commitment. While studying the factors affecting service quality, attempts will be made to clarify the relationship between service quality with customer satisfaction retention, loyalty & commitment in Indian public and private sector banks.

1.10 Background of the Study:

Major reforms and transformations have happen in Indian Banking Sector in past years after the privatization and liberalization. Due to fierce competition in the financial market, bank players have started sensing the importance of the service quality an instrument in achieving competitive advantage. Banks have started utilizing significant proportion of their budget on expenditure related to the service performance such as employees training. It has been studied that once customers’ expectations are met or exceeded than customers are likely to get satisfied.

Satisfied customers are likely to become loyal to the service firm & give repetitive business to the firm. This grounded the customer commitment towards the service provider. As the cost of acquiring new customer is very high and hence it is very much essential for the banks to retain the customers for longer period of time. For effective marketing strategy formulation, an information about the customer’s perception of the service quality is very much required.

Several research has been done in past to check the service quality and this has resulted in the formulation of service quality models such as SERVQUAL and SERVPERF. But it has also been studied that, these models are not completely applicable and suitable in Indian Service Sector. Moreover, the entire service sector is very dynamic and changing from the time to time. Therefore, periodic research is needed to the study whether the quality of the service delivered by the banks are meeting the customer expectation or not.
Plentiful research have been done the field of service marketing in various service industry across the world. The studies have mainly focused on the markets of the developed countries and a few Asian markets neglecting less sophisticated Indian markets such as banking. This has motivated researchers to study an impact of service quality on customer satisfaction, retention, loyalty and commitment.

1.1 Purpose of the Study:

Service Quality is mostly researched topic that has gained considerable attention from researchers. Focusing on delivering good service quality has been main focus of the all service providers and this has helped them to position themselves effectively in market. The main problem identified in the study was that majority of the banks are not having systematic mode of evaluating and monitoring the quality of the service offered to the customer. The purpose of the study is to analyze whether the quality of service offered by their banks is meeting their expectations or not.

This research tries to get insight about what customer think about the quality of the service that they receive from their respective banks. Particularly, this research will identify those factors of the service quality that contribute and influence customer satisfaction, customer retention, customer loyalty and customer commitment. This research will examine how selected four banks – State Bank of India, Punjab National Bank, ICICI Bank and HDFC Bank perform in terms of service quality.

This research will investigate the impact of service quality on customer satisfaction, customer retention, customer commitment and customer loyalty. Moreover, service quality will also be studied based on demographic factor such as gender, age, income, occupation and education. While studying the service quality, this research will guide management of the banks about the important factors to be considers to improve the overall service quality performance.

1.12 Statement of the Problem:

A great deal of research has been done on the subject of service quality and its dimension in the context of banking sector. However, a little effort has been made to link dimensions of service quality with customer satisfaction, retention, loyalty and commitment in Indian Banking Sector. It has been found out in the literature that, SERVQUAL is not completely
applicable in Indian context and hence the major problem of the study was to identify the factors of service quality in Indian context in banking sectors. Further, problem of the study was to examine impact of service quality on customer satisfaction, retention, loyalty and commitment in Indian public and private sector banks.

1.13 Scope of the Study:

The research carried out in the thesis focus on service quality and its impact on customer satisfaction, retention, loyalty and commitment in four banks: SBI, PNB, ICICI and HDFC. Four major cities of Gujarat were selected: Ahmedabad, Baroda, Surat and Rajkot. 50 customers from each bank in each city were selected for conducting the research. The selections of the four banks were done on the basis of market capitalization value in the FY 2011. SPSS 20 and AMOS 20 software were used for analysis of the data. This research would guide the banks in improving service quality and understating its impact on customer satisfaction, retention, loyalty and commitment.

1.14 Objectives of the Study:

The following research objectives were used as the basic focus of the investigation.

1. To study the factors contributing to the Service Quality.

2. To find out correlation between service quality, customer satisfaction / Retention / Commitment & Loyalty

3. To study the impact of service quality on customer satisfaction / Retention / Commitment & Loyalty.

4. To identify important factors of service quality from the demographic perspective of customers.

5. To rank the selected banks based on the service quality.

1.15 Significance of the Study:

This study contributes to the body of literature as well as to the bank management. In an era of globalization service quality has become eminent feature of the banking services. Determining various literature of service quality, efforts were made to identify the
important factors of service quality and how it affect the customer satisfaction, retention, loyalty and commitment in selected four banks. Despite of these, it has not been sufficient to understand complicated factors of service quality and its impact on customer satisfaction, retention, loyalty and commitment due to various situation, time and customers. Due to the intense competition exist in the banking sector, the result of the study could give some suggestion to the management of the banks pertaining to the service quality and improvement in it. And hence it will ultimately lead to the customer satisfaction, retention, loyalty and commitment in the banks.

1.16 Structure of the Thesis:

This thesis comprises of chapters, and the chapters will be settled as following:

Chapter 2: Review of Literature

This chapter starts by describing the concepts of the service quality & how it affects the customer satisfaction & in turn retention, commitment & loyalty. This chapter has explored the study carried out with the reference to the Indian banking sector. Lastly this chapter provides literature review on service quality & four construct of the consumer behavior and also found out whether, there is any relationship between service quality & customer satisfaction, retention, loyalty & commitment taking Indian Banking Sector into the consideration.

Chapter 3: Research Methodology

This chapter includes the research hypothesis. This chapter has identified the suitable research design and administration of the research. The questionnaire structure, format, content, translation, the procedures of the data collection and pilot study is being discussed.

Chapter 4: Data Analysis

This chapter provides the detailed result of the analysis. To carry out data analysis, SPSS package is used & based on the research objectives as well as hypothesis suitable statistical tools are selected.

Chapter 5: Discussion of Findings,

This chapter provides a summary of the overall study and highlighting its major findings.
Chapter 6: Conclusion, Major Contribution and Scope of Further work

This chapter provides a summary of the overall study & conclusion. It also provides a theoretical & practical implication and limitations, and suggesting future opportunities for further research.