CHAPTER 1

INTRODUCTION TO THE STUDY

1.1 INTRODUCTION

Meeting the customer expectations, addressing their problems through feedback and retaining them has been a very dynamic and never ending process which the companies in the new era are dealing with. The reason is the certainty and the advantage of having old customers loyal to the company rather than getting new customers. A company’s ability to attract and retain new customers is not only related to its product or services, but strongly related to the way it services its existing customers. Rising competition has proven that opportunities are open for the one who is aiming to deliver customer delight and customers are lost when they are not satisfied. Hence a business entity must act in two fold, one to acquire the untapped customer and another very important task is to retain the old customers.

1.2 ROLE OF SERVICES IN GLOBAL SCENARIO

In modern competitive environments, services are gaining increasingly more important in the formula of both firms and countries. Globalised competition has stressed the strategic importance of satisfaction, quality and consequently loyalty, in the battle for winning consumer preferences and maintaining sustainable competitive advantage.
In the service economy especially, these prove to be key factors mutually interrelated in a causal, cyclical relationship. The higher the (perceived) service quality, the more satisfied and loyal the customers (Petruzzellis, D’Uggento & Romanazzi, 2006). The services marketing arena today is marked by the emergence of the new generation customer—a global citizen who is more exacting and individualistic, change-seeking and value conscious. His purchase preference transcends national and cultural barriers. He shares a consistent set of tastes and preferences. The value-seeking customer today is conscious of a response to the broader issues like environmental protection, human values and so on. In the service industry particularly, where often customer has a long lasting brand relationship, managing the customers’ experience processes is as important as the product being sold and the values attached to it. Today’s brand strategies have to focus on providing the best brand experience at the lowest possible cost.

In India, growth in services sector has been linked to the liberalisation and reforms of the 1990s. In the first three decades (1950s to 1970s) after India’s independence in 1947, GDP grew at an average decadal growth rate of less than four per cent. India was largely an agrarian economy. The share of services sector was small and a large number of services were government monopolies. Services sector started to grow in the mid-1980s but growth accelerated in the 1990s when India initiated a series of economic reforms after the country faced a severe balance of payment crisis. Reforms in the services sector were a part of the overall reform process, which led to privatization, removal of FDI restrictions and streamlining of the approval procedures, among others. Existing studies show that liberalisation and reforms as one of the important factors contributing to the growth of services
sector in India (Chanda 2002, Gordan & Gupta 2003, Banga & Goldar 2004 and Jain & Ninan 2010).

The share of services in India’s GDP at factor cost (at current prices) increased from 33.3 per cent in 1950-1 to 56.5 per cent in 2012-13 as per Advance Estimates (AE). Including construction, the share would increase to 64.8 per cent in 2012-13. With an 18.0 per cent share, trade, hotels, and restaurants as a group is the largest contributor to GDP among the various services sub-sectors, followed by financing, insurance, real estate, and business services with a 16.6 per cent share. Both these services showed perceptible improvement in their shares over the years. Community, social, and personal services with a share of 14.0 per cent is in third place. Construction, a borderline services inclusion, is at fourth place with an 8.2 per cent share (Anuj Bhardwaj, 2013).

Table No. 1.1: Share and Growth of India’s Services Sector  
(at factor cost) (in percentage)

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Source: Central Statistics Office (CSO).
Notes: Shares are in current prices and growth in constant prices;
Figures in parenthesis indicate growth rate; *first revised estimates,
@Second revised estimates, ^ third revised estimates, **Advance
Estimate (AE); # includes the shares and growth of trade, hotels &
restaurants and transport, storage, & communication only for 2012-13.

From the above table it is clear that about 17.2% of contribution for GDP with a growth rate of 8.6% from service sector is from Financing, insurance, real estate, & business services which includes Banking & insurance as the main contributor. The growth rate is higher than any other service sector, even Trade, hotels, & restaurants which has the highest share of GDP is having only a growth rate of 5.2%. So banking and insurance industry play a major role in the development of GDP. (India budget)\(^1\)

Success of a service provider depends on the high quality relationship with customers (Panda, 2003) which determines customer satisfaction and loyalty (Jones, 2002 as cited by Lymeropoulos et al, 2006). Research has shown repeatedly that service quality influences organizational outcomes such as performance superiority (Poretta & Thanassouli, 2005), increasing sales and profit (Levesque & Mc. Dougal, 1996; Kish, 2000; Duncan & Elliot, 2002) and market share (Fisher, 2001), improving customer relations, enhance corporate image and promote customer loyalty (Newman, 2001; Szymigin & Carrigan, 2001; Caruana, 2002; Ehigie, 2006). Furthermore, service quality and customer satisfaction were found to be related to customer loyalty through repurchase intentions (Levesque & Mc. Dougall, 1996; Newman, 2001; Caruana, 2002). Delivering quality service to customers is a must for success and survival in today’s competitive banking.

\(^1\)(http://indiabudget.nic.in)
1.3 BANKING SERVICE IN GLOBAL SCENARIO

One of the major challenges faced by banks is the ever rising customer expectation. Customer expectations are rising while their sense of loyalty is falling. The rapid advance of communication technology and electronic commerce has eroded customer loyalty by creating more convenient access to product information, purchase options and services. The service industry has always been a vital component of all economies. It has become more so in these days of globalization. Today, customers want banks that are easy to work with and convey helpful information and service through all points of customer contact. An analysis of customer data can also help identify ways to serve customers most cost-efficiently. In a world full of uncertainties and upheavals, the realization is fast gaining ground that if you continue to do business today with the methods of yesterday, you are bound to go out of business tomorrow. Banking industries worldwide are very competitive and it is difficult for retail banks to provide unique banking services as required by clients. To overcome this challenge, banks, which can be classified as service firms, can benefit from superior relationship marketing, because clients focus on the service aspect and interaction with the service provider when evaluating a service firm.

Firm–client relationships in service industries are important as they influence the satisfaction, support and retention of banking clients. Moreover, previous studies have shown that there is a significant positive relationship between the client relationships and level of service quality of banks (Rootman, 2006). Both banks and their clients can thus benefit from relationship marketing. Proper relationship marketing may result in lower marketing costs, enhanced customer satisfaction, customer loyalty and
possibly increased customer retention levels for banks (Bergeron et al. 2008; Eid, 2007; Ackermann & Van Ravesteyn, 2005; Baron and Harris, 2003; Wilmshurst & Mackay, 2002; Mudie & Cottam, 1999).

Global Consumer Banking Survey ² suggests that for banks to remain competitive, they must:

- Give customers the opportunity to choose by making promises and service offers more transparent.
- Rebalance fee structures to achieve the clarity and sustainability required by regulators and investors.
- Help customers shape their own banking experiences by improving how they provide information and advice, recruiting online affinity groups and by developing flexible loyalty programs.
- Develop models around customer needs by reprioritizing spending, including increasing the use of low-cost digital models and using more innovative technology.

As economic globalization intensifies competition and creates a climate of constant change, winning and keeping customers has never been more important. Banks need customers who are profitable and profitability depends on the bank’s ability to hang on to customers and cross-sell them into new products. Multi product relationships are critical to retain customers, as they represent greater involvement with the bank. If we reduce the costs of servicing customers whose business does not warrant additional attention, and spend more time serving customers whose business does, the overall customer portfolio can become profitable. Customer satisfaction is a key indicator of

² Global Consumer Banking Survey 2012 - Ernst & Young Global Limited
the operational and financial performance of a bank. As global competition increases and products become harder to differentiate, banks have begun moving from their product centric attitude to a customer centric one. Banks earned customers’ loyalty on the basis of personal relationships, trading on history and mutual loyalty, and on face-to-face interactions and long term knowledge of the customer as a person, not just an account number. Traditionally, marketers have been trained to acquire customers, either new ones who have not bought the product category before or those who are currently competitor’s customers. Today, the tone of the conversation has changed from customer acquisition to retention.

1.4 BANKING SERVICE - INDIAN SCENARIO

India cannot have a healthy economy without a sound and effective banking system. The banking system should be hassle free and be able to meet the new challenges posed by technology and other factors, both internal and external. Banking industry statistics have made it clear that recruiting new banking customers is a considerably larger cost to the banks as compared to retaining existing ones. Industry experts claim banks struggle with recovering acquisition costs as it is, and a high customer defection rate makes that recovery even more challenging.

Not long ago, a customer had to wait for long hours at the bank counters for getting a draft or for withdrawing his own money. Today, he has a choice. Like in every other economic option, all good things have to be paid for properly. The old private sector banks are learning new tricks of the trade;

3 http://www.ftkmc.com/banking.html
4 http://customerretention.hubpages.com/hub/Bank-Customer-Retention
the public sector banks are waking up from their slumber; and every bank has
come to realize that the name of the game is “service to the customers”. The
process of computerization and application of information technology in banks
has gained momentum. Banks are now gradually switching to Internet
banking, creating a network connecting their major branches and
administrative offices. Complete automation and focused and trained
customer attention will be one big challenge for the PSBs and a few private
banks to remain competitive with the foreign banks. The Indian banking has
finally woken up to the competitive dynamics of the ‘new’ Indian market and
is addressing the relevant issue to take on the multifarious challenges of
globalization.5

1.5 BANKING SYSTEM IN INDIA

Indian banking system in the past three decades has attained many
outstanding achievements to its credit, the foremost being putting is its
intensive reach. It's not confined to metropolises or cities in India. In fact,
Indian banking industry has reached even to the remote corners of the country.
This is often one amongst the most important aspects of India’s growth story.
The government’s regulation policy for banks has paid wealthy dividends with
the nationalization of fourteen major non-public banks in 1969. Banking these
days has become convenient and instant, with the account holder not having to
wait for hours at the bank counter for obtaining a draft or for withdrawing cash
from his account.

5kannanpersonal.com/inbank2/index.html
1.5.1 History of Banking in India

The first bank in India was established in 1786. From 1786 until today, the journey of Indian banking industry is often divided into 3 distinct phases:

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

During the primary phase, the growth was terribly slow and banks also experienced periodic failures between 1913 and 1948. There have been approximately one hundred banks, largely small ones. To outline the functions and activities of commercial banks, the government of India came up with the Banking companies Act, 1949, that was later modified to the Banking Regulation Act, 1949 as per amending Act of 1965 (Act No. 23 of 1965). The Reserve Bank of India (RBI) was vested with in depth powers for the management of banking in India as the Central banking authority. During those days, the general public had lesser confidence in banks. As an outcome, deposit mobilization was slow. Moreover, the savings bank facility provided by the postal department in India was safer, and funds were mostly given to traders. During the next phase the government took major initiatives in banking sector reforms after Independence. In 1955, it nationalized the Imperial Bank of India and began providing in depth banking facilities, particularly in rural and semi-urban areas.

The government constituted the State Bank of India to act as the principal agent of the RBI and to handle banking transactions of the Union
government and state governments everywhere the country. Seven banks owned by the Princely states were nationalized in 1959 and they became subsidiaries of the State Bank of India. In 1969, fourteen commercial banks within the country were nationalized. Within the second section of banking sector reforms, seven additional banks were nationalized in 1980. With this, 80% of the banking sector in India came under the government possession. The latest phase has introduced more products and facilities within the banking sector as a part of the reforms. In 1991, under the chairmanship of M Narasimham, a committee was formed, that worked for the liberalization of banking practices. Now, the country is studded with foreign banks and their ATM stations. Efforts are being put in place to give a satisfactory service to customers. The complete system became more convenient and swift. Time is given importance in all money transactions. The financial set-up of India has shown an excellent degree of resilience.

1.6 BANKS IN INDIA

In India, banks are segregated in different groups. Each group has its own benefits and limitations in operations. Each has its own dedicated target market. A few of them work in the rural sector only while others in both rural as well as urban. Many banks are operating in cities only. Some banks are of Indian origin and some are foreign players. Banks in India can be classified into:

- Public Sector Banks
- Private Sector Banks
- Cooperative Banks
- Regional Rural Banks
- Foreign Banks
One aspect to be noted is the increasing number of foreign banks in India. The RBI has shown certain interest to involve more foreign banks. This step has paved the way for a few more foreign banks to start business in India.\(^6\)

1.6.1 Public Sector Banks

Public Sector Banks (PSBs) are banks where a majority stake (i.e. more than 50%) is held by the government. The shares of these banks are listed on stock exchanges. 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 nationalised on 19\(^{th}\) July 1960. The next major nationalisation of banks took place in 1969 when the government of India, under Prime Minister Indira Gandhi, nationalised an additional 14 major banks. The total deposits in the banks nationalised in 1969 amounted to 50 crores. This move increased the presence of nationalised banks in India, with 84% of the total branches coming under government control. The next round of nationalisation took place in April 1980. The government nationalised six banks. The total deposits of these banks amounted to around 200 crores. This move led to a further increase in the number of branches in the market, increasing to 91% of the total branch network of the country. The objectives behind nationalisation were:

- 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

\(^6\)www.ftkmc.com/banking.html
1.6.2 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 in 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 organisational structure and are professionally managed. Thus they have grown faster and stronger since past few years.

1.6.2.1 Early 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. Most of the old private-sector banks are closely held by certain communities and their operations are mostly restricted to the areas in and around their place of origin. Their Board of directors mainly consists of locally prominent personalities from trade and business circles. One of the positive points of these banks is that, they lean heavily on service and technology and as such, they are likely to attract more business in days to come with the restructuring of the industry round the corner.
1.6.2.2 New Private Sector Banks

The banks, which came into operation after 1991, with the introduction of economic reforms and financial sector reforms are called "new private-sector banks". Banking regulation act was then amended in 1993, which 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. 200 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 and their net worth must have increased to Rs. 300 crores.7

1.6.2.3 Role of Private Banks in Indian Banking Sector

Ever since the entry of private players in the Banking sector was liberalised, the industry witnessed the entry of nine new generation' private banks. The major differentiating parameter that distinguishes these banks from all the others banks in the Indian banking industry is the level of service that is offered to the customers. These banks have generally been established by promoters of repute or by ‘high value’ domestic financial institutions. Today the private banks corner almost four percent share of the total share of deposits. Most of the banks in this category are concentrated in the high-growth urban areas in metros (that account for approximately 70 percent of the total banking business).

7 en.wikipedia.org/wiki/Public_sector_banks_in_India
Private Banks operate on very lean and efficient structures (with minimal overheads and low non-performing assets base) that allow them to anticipate customer requirements better thus preempting any competitive posturing from their public sector counterparts. These banks were among the pioneers in IT infrastructure investment forcing many public sector banks to follow suit. Concepts like “Sunday Banking”, anytime banking and flexi-banking pioneered by private banks soon became the order of the day and customer convenience has become the new marketing mantra.

1.7 COMPARISON OF GROWTH PERFORMANCE OF PUBLIC AND PRIVATE SECTOR BANKS

All the largest banks in the country had been nationalized in 1969 and 1980. Before the liberalization of financial sector in early 1990s, the public sector banks faced little competition. Their growth was assured with the growth in the economy. In the absence of competition, the public sector banks faced no pressure to modernize, or to strive for customer satisfaction. It was a seller’s market.

Post liberalization, the new private sector banks introduced the latest technologies and strived hard to win customers and retain them through excellent customer service and customer relationship practices. This enabled the private sector banks to post impressive growth figures.

The growth performance of the top banks in both public sector and private sector banks is given in the following table.
Table No. 1.2: The growth performance of the top banks in both public sector and private sector banks

<table>
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<th>NAME OF THE BANKS</th>
<th>TOTAL BUSINESS DURING 2003-2004 (RS. MILLION)</th>
<th>TOTAL BUSINESS DURING 2010-2011 (RS. MILLION)</th>
<th>COMPOUNDED ANNUAL GROWTH RATE (CAGR)</th>
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<tr>
<td>AXIS BANK</td>
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<td>3316456.3</td>
<td>0.3485</td>
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<tr>
<td>HDFC</td>
<td>481533.7</td>
<td>3685690.6</td>
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<tr>
<td>CUB</td>
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<td>ICICI</td>
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</tr>
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</table>

Average growth rate of private sector =0.2455
Average growth rate of public sector =0.1915

Source: CMIE Prowess

It can be seen from the above table that the private sector banks have achieved superior compounded annual growth rate (CAGR) even the 8 year period between 2004 and 2011.

1.8 DIFFERENCES IN CUSTOMER SATISFACTION LEVELS IN PUBLIC SECTOR BANKS AND PRIVATE SECTOR BANKS.

Previous research by Sandip Ghosh Hazra et al (2013) had concluded that customers from private sector banks seen to be satisfied and public sector banks have been losing customers to private sector banks.
Similarly Deepak Tandon et al (2012) in their analysis of one public sector bank and two private sector banks have concluded that the public sector bank is a utilitarian bank whereas the private sector bank tops in IT enablement and performance.

Previous research by Anders Gustafsson et al (2005), Rahim Mosahab et al (2010), Timothy Keiningham et al (2007) has also highlighted the causal link between customer satisfaction and customer retention.

1.9 STATEMENT OF PROBLEM

It is observed that the growth performance of public sector banks is inferior to private sector banks. The reasons for such a difference in financial performance may be due to a variety of factors such as the ability of the bank to attract new customers, retain old customer and expand their business with the bank, use technology to improve efficiencies and provide superior customer service and so on. The problem is to identify the real cause of poorer financial performance of public sector banks so that remedial actions can be taken.

1.10 THE RESEARCH QUESTION

Can the difference in financial growth performance of Public Sector and Private Sector banks be explained by differences in customer retention and what are the factors that have an impact on customer retention?
1.11 OBJECTIVES OF THE STUDY

In order to answer the research question examining the association between customer retention and growth in financial performance of public sector banks and based on previous research in the area of customer retention the following research objectives are formulated.

- To analyze the impact of Bank / Branch attributes on customer satisfaction.
- To analyze the impact of customer service characteristics on customer satisfaction.
- To analyze the impact of customer satisfaction on customer retention.
- To examine the role of customer attributes in customer retention.
- To examine the role of customer’s perception about competitors on customer retention.
- To evaluate whether there is a significant difference in the likelihood of customers leaving the bank between public sector and private sector banks.
- To identify the causes of customer’s intention to leave the bank.
- To recommend strategies to minimize customer defection.

1.12 SCOPE OF THE STUDY

The present study mainly focuses on customer satisfaction, customer retention and their relationship in public sector banks and Private Sector Banks. A comparison in respect of the above aspects of public sector banks has been made with Private Sector Banks operating in India. Bank wise comparisons have also been made to determine the best performing bank/branch.
1.13 LIMITATIONS OF THE STUDY

The study suffers from the following limitations:

- The study is confined to the respondents of Erode district only. The generalizations to a wider population or industry and cultural issues should be taken with caution.
- Since the customer data cannot be acquired from banks, sample size and methodology have been decided based upon the total population in the project area.
- Due to time constraints and to make research specific, this study has been confined to the five public sector banks and five private sector Banks operating in Erode district.

1.14 CHAPTER SCHEME

This thesis is organized into five chapters as follows:

Chapter - 1: INTRODUCTION TO THE STUDY

This chapter presents the introduction about the study, statement of the problem, the need for the study, objectives of the study, research hypotheses, scope and limitations of the study.
Chapter - 2: REVIEW OF LITERATURE

The chapter covers an objective review of past studies to describe the theory, empirical models and salient findings that defined the scope and focus of analysis of the present study.

Chapter - 3: RESEARCH METHODOLOGY

This chapter presents a brief description of the methodology adopted by the researcher. It includes the universe for the study, sampling method, data collection and statistical tools used for the analysis.

Chapter - 4: RESULTS AND DISCUSSIONS

The results of analysis of data are presented and discussed in this chapter, with reference to the objectives of the study, to draw specific inferences.

Chapter – 5: SUMMARY OF DISCUSSION ON FINDINGS AND CONCLUSION

A summary of work done and salient findings of the study are presented. The results of the test of hypotheses are presented to draw conclusions about the strategies of public sector banks to retain customers.

1.15 CONCLUSION

The Indian banking has finally woken up to the competitive dynamics of the ‘new’ Indian market and is addressing the relevant issues to
take on the multifarious challenges of globalization. Only when a customer is satisfied and delighted, then only we can look at the customer retention and referrals for new customers. It is clear that banks should try to retain customers rather than acquiring new ones. Thus the study intended to find out why the customers choose this bank and whether they are satisfied and have intention to stay.