CHAPTER I
INTRODUCTION

1.1. Introduction

The process of globalization and liberalization has strongly influenced the Indian banking sector. The ongoing banking sector reforms with their thrust on transparency, efficiency and sustainability have created a competitive environment for Indian banks by the emergence of new private sector banks and the opening up of new branches of foreign banks in India. Cost consciousness, credit management, profitability and overall efficiency have got overriding importance for the survival and growth of banking business. To achieve these, banks in India have obliged to change the objective of maximizing profits to develop long-term relationship with the customers. The challenges ahead for banks have greatly increased with increasing competition and the growing demand for a greater variety and superior quality of banking services. Today the customers are not interested in purchasing a product on the basis of its brand name, physical characteristics or price alone but quality of service also. Now an important question is raised by each bank regarding customers’ service expectations, by cutting operational costs and managing competition. After a lot of exercise and thought, they have found out “retail banking” or “personal banking,” whose superficial aim is “banking at your doorstep.” The growth of the retail banking is one area which has generated a lot of interest
primarily because of the entry of many private sector banks and foreign banks, resulting in the availability of a wide range of innovative products and services for the customers.

As a consequence, competition between banks has become more intense. Banks are continually looking at ways to improve their internal efficiency, and in turn, are trying to expand the utilization of their cheapest delivery methods. These have given a wider choice to customers, competitive pricing of products and easier access to services. Therefore, banks are under tremendous pressure to improve their services. ¹ Banks dealing in retail banking are consequently directing their strategies towards increasing service quality level which fosters customer satisfaction and loyalty through improved service quality. Private banks dealing in retail banking are pursuing this strategy, in part, because of the difficulty in differentiating based on the service offered. Typically, customers perceive very little difference in the banking products offered by private banks dealing in services as any new offering is quickly matched by competitors. ²

As service-oriented entities striving for survival in such challenging

marketing milieu, retail banks have tended to offer almost identical products and financial services.\(^3\)

1.2. Concept of Retail Banking

In the last decade, there had been important changes in the business of financial services. The banking business has undergone changes in the regulation of the sector, changes in customers’ demand for services, technological changes, and the entry of new competitors from businesses outside banking.\(^4\) Due to this, an increasingly open and competitive framework has been formed, in which many financial entities are beginning to be concerned to develop defensive strategies in order to avoid indiscriminate loss of customers. Firms should strive to maintain long-term relationships with their customers in order to obtain the advantages of a clientele loyal to the firm.\(^5\) Socio-economic advancement, technological developments and financial liberalization have encouraged retail banks to broaden their range of products and services, improve quality and extend their customer bases. The retail banking concept of broadening product bases began to acquire a new dimension during the early 1980s.

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Retail banking in India is not a new phenomenon and it has always been prevalent in various forms. For the last few years, it has become tantamount with mainstream banking for many banks. Retail banking is a major form of commercial banking which mainly involves individual customers rather than corporate clients. In order to make them economically viable and competitively strong, Indian banks are gradually providing more importance to the individual customers for increasing their resource base. Retail banking refers to provision of banking services to individuals and small business where the financial institutions are dealing with large number of low value transactions. “Retail banking” refers to the personal banking services and products provided to customers acting solely or jointly and includes basic banking activities such as deposit, loan and payment services, financial investments, foreign exchange, and other financial activities such as insurance. Retail banking is the cluster of products and services that banks provide to customers and small businesses through branches, the internet, and other channels. Retail banking products have been broadly classified into transaction and payment products, such as cheque accounts and debit cards; investment products, such as savings accounts, fixed deposits and unit trusts; credit and borrowing products, such as credit cards, home loans, overdrafts and car finance; and financial planning products such as retirement annuity plans and education policies. Retail banking is characterized by multiple products (deposits, credit cards,
insurance, investments and securities); multiple channels of distribution (call centre, branch, internet and kiosk); and multiple customer groups (consumer, small business, and corporate). Retail banking has immense opportunities in growing economies like India.

1.3. Drivers of the Growth of Retail Banking

Retail banking segment in India has been booming up late due to high liquidity, changing demographic profile, falling interest rates and increasing demand for consumers’ finance. As retail banking in India is still growing from modest base, there is a likelihood that the growth seems to get somewhat exaggerated. One, thus, has to exercise caution in interpreting the growth of retail banking in India.

Rapid advances in information technology, financial sector reforms, growth of the Indian economy, increasing per capita income, etc. have increased growth in retail banking. In the recent past, retail lending has turned out to be a key profit driver for banks with retail portfolio. In fact, retailing makes ample business sense in the banking sector. While new generation private sector banks have been able to create a niche in this regard, the public sector banks have not lagged behind. Leveraging their vast branch network and outreach, public sector banks have aggressively forayed to garner a larger slice of the retail pie. Retail loans have put comparatively less provisioning burden on banks apart from diversifying
their income streams. Decline in interest spread in corporate sector along with lower levels of NPA in retail lending has encouraged the banks to shift towards this sector in a big way. Decline in interest rates, availability of consumer goods at quite competitive and reasonable prices and income tax benefits have also contributed to the growth of retail banking. For this reason, foreign banks also prefer to lend in retail banking.

Economic prosperity and the consequent increase in purchasing power have given a fillip to a consumer boom. Changing consumer demographics indicate vast potential for growth in consumption both qualitatively and quantitatively. India is one of the countries having highest proportion of the population below 35 years of age. The BRIC report of the Goldman-Sachs, which predicted a bright future for Brazil, Russia, India and China, mentioned the Indian demographic advantage as an important positive factor for India. The percentage of middle to high Indian households is expected to continue rising. The rise of the Indian middle class is an important contributory factor for the growth of retail banking. Technological factors play a major role. The onset of superior technology forces banks to design more innovative products. Convenience banking in the form of debit cards, internet and phone-banking, anywhere and anytime banking has attracted many new customers into the banking field.
The treasury income of the banks, which strengthened the bottom lines of banks for the past few years, has been on the decline during the last two years. As said already, corporate banking has almost entered the maturity phase which led to the growth of retail segment of lending. In such a scenario, retail business provides a good vehicle of profit maximization. Considering the fact that retail’s share in impaired assets is far lower than the overall bank loans and advances, retail loans have put comparatively less provisioning burden on banks apart from diversifying their income streams. Decline in interest rates has contributed to the growth of retail credit by generating the demand for such credit.

The last few years have witnessed a high increase in students aspiring for management and professional courses, leading to a spurt in educational loans. Banks are now having a direct tie-up with the educational institutions to grab the opportunity. With the increasing market orientation of the financial system and to cope with the competition as also to benefit from the technological innovations such as e-banking, the banks are making increased use of “outsourcing” as a means of both reducing costs and achieving better efficiency. Though retail banking is untapped in rural and semi-urban areas, still retail banking is the only way to provide facilities to existing and potential customers. Thus, the combination of these factors promises substantial growth in the retail sector, which at present is in the emerging stage.
1.4. Challenges and Opportunities of Retail Banking

Retail banking in India has vast opportunities and challenges. The rise of the middle class is an important contributory factor in this regard. Improving consumer purchasing power, coupled with more liberal attitudes toward personal debt is contributing to India's retail banking segment. Increase in purchasing power of the younger population would give an immense opportunity. It has been found that younger generation is more comfortable in acquiring debt than the previous generation, thereby improving purchasing power and liberal attitude towards personal debt, and contributing to India's retail segment. The SEZs will also provide growth opportunity for retail banking. The combination of these factors promises growth in the retail sector, which at present is in the nascent stage. As retail banking offers phenomenal opportunities for growth, the challenges are equally daunting. The retail banks have to market their products aggressively. The challenge is to design and innovate the financial products which cater to the target segment needs. In future, retail banking scenario will see a huge proliferation of products. This will in turn require devising product which is easy to understand and at the same time meet the financial goals of the customers. The entry of new generation private sector banks has changed the entire scenario. The retail segment, which was earlier ignored, is now the most important of the lot, with the banks jumping over one another to give out retail loans. With supply far exceeding demand, it
has been a race to the bottom, with the banks undercutting one another. The nimble footed new generation private sector banks have been losing business to the private sector banks in this segment. PSBs need to figure out the means to generate profitable business from this segment. Another major challenge in retail banking is attraction as well as retention of customers.

In fact, retention is more difficult in this competitive environment. Customer retention favourably affects profitability. According to a research by Reichheld and Sasser in the Harvard Business Review, 5% increase in customer retention can increase profitability by 35% in banking business, 50% in insurance and brokerage, and 125% in consumer credit card market. Thus, banks need to focus on customer retention. Sustainability is another issue, which is becoming increasingly vital with respect to the growth of retail banking in India, due to excessive concentration on the top-line without regard to the quality of growth of the top-line, increasing market share by increasing risk appetite and entering the markets where a bank may not have a competitive advantage.

Technology has made it possible to deliver services throughout the branch bank network, providing instant updates to checking accounts and rapid movement of money. However, this dependency on the network has brought IT departments’ additional responsibilities and challenges in managing, maintaining and optimizing the performance of retail banking
networks. The network challenges include proper functioning of distributed networks in support of business objectives. Specific challenges include ensuring that account transaction applications run efficiently between the branch offices and data centers. Another issue of concern is the rising indebtedness, which could affect the future growth of retail banking. The banks will also have to shore up the image of their brand. A bank has to build its brand by clearly communicating what it stands for and ensure that the brand image is consistently conveyed to its customers. This would call for seamless integration of all channels to ensure optimum customer satisfaction, regardless of the channel being used. Most of the retail banks are witnessing a tremendous expansion in their customer base. However, on the other hand, there is increasing menace of hacking, phasing and farming through which scamsters are creating havoc indulging in cyber crimes on a large scale.

In a service industry, the value can be delivered at the moment of interaction with the customers. Banks, in a drive to carry on with tremendous expansion in terms of customer base, need to have requirements of the employees who are well informed about the products as well as have the necessary soft skills to deal with and satisfy the customers. It is a challenge for the banks to upgrade their existing manpower and retention or lock in the best talents for having competitive advantage in terms of human resources.