CHAPTER 3

LITERATURE REVIEW
LITERATURE REVIEW

Literature Review is an evaluation of what has been published on the chosen research topic and its purpose is to summarize and analyze the arguments of others on the research topic. The Chapter aims to familiarize with the theoretical concepts available with the relevant research topic. Literature Review Chapter enables to determine the various ideas and viewpoints expressed by various researchers on the relevant subject. It assists in identifying the various approaches, gaps and issues relating to the topic and helps in integrating what previous research papers disclose on the selected research topic.

Framework:
Banking plays a vital role in any economy; a strong financial system ensures financial prosperity and development of the nation. The research work aims to study the business practices followed by the Scheduled Commercial Banks in India, business practices relating to Service Quality and Innovative Practices have been dealt in depth for the research work. Banks are service oriented organizations therefore business practices relating to the area of rendering quality of service are one of the important aspect of the service industry thus the research work lays more stress on the quality of service rendered by the selected Commercial Banks. Innovations in the business practices help the organizations to stay one step ahead of the competitors the research tries to study the various innovations in the Banking sector in India. The main aim of this chapter is to present a broad comprehensive and contemporary review of the literature on the Banking Business Practices relating to Service Quality and Innovations.

The chapter will initially discuss the key terms relating to the research work, as it is essential to create and establish a concrete base for the study. The research will also review the developments in the Banking sector in India and also the importance, benefit, and significance of service quality and innovative business practices followed by the
Banks will be discussed. Review of SERVQUAL Model its significance and the application of the same in the Banking sector will also be assessed. This section of the study will also review the significance of quality service and innovations on the financial aspects of the Banks.

3.1 MEANING AND DEFINITIONS

3.1.1 Business:
The Oxford dictionary defines “Business” as a “Commercial activity or any trade considered in terms of its volume or profitability”. The term business can be explained as a Commercial Enterprise, Profession or Trade for the purpose of earning profit by providing a product or service. Business may take any form such as Sole Trading Concern, Partnership Firm, Co-operative and Joint Stock form of organisations and which may differ in terms of their organizational objectives.

3.1.2 Business Practices:
Online business dictionary defines “Business practices” as “Methods, Procedure, Process or rule employed followed by an organisation in the pursuit of its end objectives, business practices may also refer to these collectively”¹⁵. Business practices are techniques which includes set of well defined step by step activities for the performance of a given task for attaining the end objective of the organization. These techniques when implemented on regular basis within the organizations for the conduct of activities become a practice. Best practices have been defined as “Commercial or professional procedures that are accepted or prescribed as being correct and most effective”. These concepts apply to all the organizations whether the objective is earning profits or service oriented. Thus it becomes essential to understand the business practices of the organization selected for the research.

3.1.3 Profitability:
Word Profitability is a Noun derived from the word “profitable” which means business or activity yielding profit or financial gain. Profits are the excess of revenue over the expenses, which creates value to the business. Profitability is a state or a condition in

¹⁵ Definition referred from http://www.businessdictionary.com
which the company or product yields sustainable profits, it is the ratio of profits to the revenue and not just the amount of profit earned.

3.1.4 Cost Effectiveness:
The derivation of the word “Cost Effectiveness” is from an adjective cost effective meaning productive in relation to its cost. It is an examination of expenditure to determine whether money spent has been used effectively to derive value for money. Cost effectiveness can be explained as deriving maximum benefits for a given level of expenditure when limited resources are available for meeting the goals of the organizations.

3.2 THEORETICAL CONCEPT OF BUSINESS PRACTICES
Business is a modern and ethically peculiar phenomenon which was triggered by the Industrial Revolution during the 18th century. For thousands of years, business existed only at the periphery of society. Society thought little of people in business, and people in business expected little from the society, profit was their only reward and in this context profit was the only goal of business. For years business was mainly concerned with earning profits and catering to the affluent section of the society, changing business environment has compelled organizations to change their procedures and methods of conducting the businesses. Business Practices incorporate set of elements such as environmental aspects, social issues, code of business conduct and governance for the performance of activities for achieving the end results.

Business practices are conceptualized sets of coordinated business processes that organizations develop in order to perform the assigned tasks and which permit them in solving their business related problems. Business processes are stipulations which describes as of how certain things are to be performed in an organizations. Implementation of business processes over years within the organizations become organizational routines which creates capabilities as the organizations learn to perform different tasks.

16 http://www.qfinance.com
Business Practices are an integrated set of business processes for carrying out its functions and help in achieving their end result, they incorporate organizational routines and combine specific capabilities and thus create organizational competences which becomes important organizational traits which are perceived in the market. New Business Practices emerge from the dynamic business processes and the external competitive environment. The external market forces pose challenges to the business enterprises which encourages the organizations to adopt and develop the new business practices and process innovations to derive sustained competitive advantage. The overall operational success of the business depends on clearly defined vision, execution of the mission and continuous improvement in its operations which will raise the business to the next level of growth.

### 3.3 BACKGROUND OF BANKING BUSINESS PRACTICES

#### 3.3.1 Pre Liberalization Phase:

In spite of Nationalisation process and enactment of RBI Act, the independent India inherited a weak Banking and financial system, the poor performance of the Public Sector Banks, which accounted for nearly about 90% of all Commercial Banking Business, was rapidly becoming an area of concern and also the increase in the non performing asset size posed threat to the financial system of the country. Banking reforms, therefore, became an integral part of the liberalization agenda. Since 1991, India has been engaged in Banking Sector reforms which aimed at increasing the profitability and efficiency of the then 27 public-sector Banks that controlled about 90 per cent of all deposits, assets and credit. The crisis was caused by poor macroeconomic performance, characterized by a public deficit of 10 per cent of GDP, a current account deficit of 3 per cent of GDP, an inflation rate of 10 per cent, and growing domestic and foreign debt, and was triggered by a temporary oil price boom following the Iraqi invasion of Kuwait in 1990.

The reforms were initiated in the middle of a “Current Account” crisis that occurred in early 1991. The financial sector reform process comprised of two phases – the first phase is guided by Narasimham Committee I report while the second phase is based on
Narasimham Committee II recommendations\textsuperscript{18}, the aim of the former was to bring about “operational flexibility” and “functional autonomy” so as to enhance “efficiency, productivity and profitability” while the latter focused on bringing about structural changes so as to strengthen the foundations of the Banking system to make it more stable\textsuperscript{19}. The financial sector reforms brought about transformation in the business practices of the financial institutions.

3.3.2 Post Liberalization Phase:

In the year 1990 multiple chain of events such as introduction of modern technologies, competition from new players in the liberalized market place, and enhanced emphasis on governance to protect shareholder interest changed the way of Banking Business. Financial liberalization has, however, had an unpredictable effect in the distribution of Scheduled Commercial Banks in India. During the era of reforms Banks growth was restricted on urban and metro areas of the country which is evident from the fact that between 1969 and 1991 the share of the rural branches increased from 22% to 58%. In the year 2004, the corresponding figure stood at 46%. The number of Rural Bank Branches actually declined from the 1991 figure of over 35,000 branches by about 3000 branches. Between 1969 and 1991 the share of urban and metro branches fell from over 37% to less than 23\textsuperscript{20}.

The Indian financial sector reforms after 1991 brought in variety of new Banking products and services. In the Post Reform era the number of Private Sector and Foreign Banks with their technology based Banking products and services including Credit Cards, Debit Cards, Automated Teller Machines and Net Banking facilities became more prominent in India. Report of the Narasimham Committee on the Financial System (1991) Reserve Bank of India Bulletin (February, 1992) examined all aspects relating to the structure, organization and functions of the Indian financial system. It made wide ranging recommendations with a view to ensure flexibility, functional autonomy and thereby enhancing efficiency, productivity and profitability of the Banking sector and the

\textsuperscript{18} In 1998, the Narasimham Committee II has recommended a convergence of developing financial institutions with Commercial Banks and non-Banking financial institutions and also adoption of integrated system of regulation and supervision.

\textsuperscript{19} Chakrabarti Rajesh “Banking in India- Reforms and Reorganization”, College of Management, Georgia.

\textsuperscript{20} Chakrabarti Rajesh “Banking in India- Reforms and Reorganization”, College of Management, Georgia.
financial system. The unique feature of reforms was that RBI permitted Commercial Banks to diversify into non traditional Banking services which will help them in increasing the non interest income and sustaining profitability. Financial sector reforms and liberalisation made access to newer technology which brought about revolution in the Banking Sector. The retail loan market has been transformed from sellers market to buyers market, changing consumer demographics, economic prosperity and increase in the purchasing power has lead to the tremendous growth in the Retail Banking products\textsuperscript{21}.

Retail Banking is a broader concept; it refers to the trade between Commercial Banks and individual customers. Retail Banking is characterized by three basic features:

i) Multiple products like deposits, credit cards, securities and investments etc,
ii) Multiple service delivery channels such as call centre, internet and kiosk etc.
iii) Multiple customers from small businesses to corporate entities.

Banks have large business opportunities during the year 2010 -11 only 42% of the Indian household savings are in form of Bank deposits, much of the Indian savings are locked up in traditional assets such as real estates and gold which can be converted into financial assets by the Banks\textsuperscript{22}. One of the important drivers of Retail Banking growth is the changing consumer demographics. The increase in the youth population with growing disposable incomes, changing lifestyle trends, adaptability to technology and growing consumerism are factors attributable to the growth of the Retail Bank market. The Banking industry has also reacted positively to the changing customers demand, Banks have improved their processes and product offerings, customer driven strategies are adopted by the Banks, now a day’s Banks believe in “Any where”, and “Any time” Banking, there focus is on understanding the customers preferences and in building long term relationship.

Indian Banking has to adopt Universal Banking Model for better business opportunities. The end goal for the reforms was to enable liberal access to the financial sector for firms

\textsuperscript{21} Keynote address by Ms Shyamala Gopinath, Deputy Governor of the Reserve Bank of India, at the IBA - Banking Frontiers International Conference on “Retail Banking Directions: Opportunities & Challenges”, Mumbai, 28 May 2005.

\textsuperscript{22} Excerpts from the special address by Dr. K. C. Chakrabarty, Deputy Governor, Reserve Bank of India (November, 2011), at BANCON 2011, Chennai.
as well as investors; in order to achieve this end it was necessary to encourage
c ompetitions and institutional innovation. Economic growth can be sustained only if
scarce resources are mobilized efficiently and transformed effectively into productive
investments and this function is efficiently conducted by the financial intermediaries.
Assessment of Banking Sector is possible by looking after the roles and actions of
Banks, their core capabilities and their ability to meet systematic objectives which
includes increasing shareholders value, fostering financial inclusion, GDP growth,
efficiently managing intermediation costs and effectively allocating capital and
maintaining system stability. Financial sector reforms has strengthened the
fundamentals of the Indian economy, significant progress has been made in the past few
years to bring the Indian Banking closer to International standards.

Bank should discover within retail operations, Banks product development and
differentiation; innovation and customization; cost reduction; cross selling and
technological up gradation are equally important to the growth of their retail operations.
Further fee based operations globally has become one of the key drivers of Banks growth
and profitability. Non Banking Financial Companies (NBFCs) are fast emerging as an
important segment of Indian financial system. They are recognized as complementary to
the Banking sector due to their customer-oriented services; simplified procedures;
attractive rates of return on deposits; flexibility and timeliness in meeting the credit
needs of specified sectors.

Ananthakrishnan (2005) study on customer services in Banks enumerates the nature of
customer services as discriminating expectations of the customers in terms of quality of
service. Further customer service is the ability to satisfy the customer’s requirements and
needs to the fullest extent on an on going basis. Factors that attribute customer services
in Banks can be detailed as:

a) What elements of Banking services satisfies the customers

focuses on the maximization of shareholder value.
25 Excerpts by Dr. A.K Khandelwal, Chairman and Managing director, Bank of Baroda (2007) in a media
appearance on economic and financial sector reforms in India.
26 The survey conducted by FICCI (2010) on “Indian Banking system: The Current State & Road Ahead”
emphasizes on innovation in retail operations of Banks.
b) Devising quantifiable determinants  
c) Continuous improvements in identified determinants.  
d) Regular feedback to ensure alignment with customer preferences and needs.  

These factors become the contributors for enhancing the quality of the service especially Banks where customer forms the basis of the Banking business.  

Bank Customers are characterized as heterogeneous class, they come from varying socio economic and cultural background, their perceptions about Banking Services is so dynamic in nature that it differs from customer to customer or even for same customer it varies over a period of time. The factors that enable in customer retention are:  
i) Familiarity of services offered  
ii) Simplified processes and procedures  
iii) Brand image of the Banks  
iv) Value added services  
v) Ambience at the Bank Premises  
vi) Employee support and cooperation  
vii) Knowledge of competitors products and services  

These factors forms the ground work of the research problem, as Banks are dealing with the customers, these attributes influence the scale of business and cost efficiency for the Banks.  

There is a significant change in the Banking Business Post Liberalisation there is a transformation from Traditional Banking to Internet Banking which has widened the gap between the customers and Bank personnel. To sustain in a competitive environment Banks need to ponder on effective customer service and service quality to differentiate itself from its contenders.  

3.4 SIGNIFICANCE OF SERVICE QUALITY IN BANKING BUSINESS  
Peter Drucker\textsuperscript{28} states that there is only one valid purpose of existence of a business, which is to create a customer. It is not the internal structure, control systems and

\textsuperscript{28} “Business, The Ultimate Resource” Perseus Publishing
procedures that keep a business afloat but it is the customer who pays value for the services and decides what is important.

Banking is a service industry; customer is the backbone of this industry for which there is a need to attract newer and younger customers and at the same time retaining the existing customers, in this regard customer service is very important for the Banking industry. The term “Customer” is of prime importance in a service industry which has been supported by various studies. Customer and Banker is neither a relation of principal and agent nor a relation of a fiduciary nature, trust, but a simple relation – it may be one sided, or it may be two-sided – of creditor and debtor. Section 3 of ‘Negotiable Instrument Act’ says that the term ‘Banker’ includes any person acting as a Banker. To constitute a customer, there must be some recognizable dealing in the nature of regular Banking Business, only initial transaction of opening an account will not suffice the relation of Banker and customer, there has to be continuity of transactions. “Customer is a person who has the habit of resorting to the same place or person to do business” 29. RBI has initiated various measures to improve the customer service in Banks, as a regulatory body RBI has to ensure availability of financial services and products, at affordable prices on an uninterrupted basis in order to retain the financial sector stability 30.

Economic growth and liberalisation has resulted in increasing demand for financial products and services, delivery of high quality services offers Banks an opportunity to differentiate themselves from their competitors. Research has shown that service quality has been increasingly recognized as a critical factor in the success of any business (Parasuraman et al., 1988) and the Banking Sector is not an exception. In the service literature Service Quality is interpreted as perceived quality which means a customer’s judgment about a service. Service Quality can be defined as the difference between customer’s expectations for service performance prior to the receipt of service and their perceptions of the service actually received (Asubonteng et al., 1996) 31. Quality of service is positively related to the bottom line performance of an organization. Parasuraman et al. (1985) defined Service Quality as “the global evaluation or attitude of

29 Central Bank of India vs. Gopinathan Nair, the Kerala High Court specifies the definition of “customer”.
30 Special address by Dr. K. C. Chakrabarty, Deputy Governor, Reserve Bank of India at BANCON 2011 - Chennai on November 4, 2011.
overall excellence of services”; it is the difference between the customer’s expectations and customers perceptions of services delivered by the firm. Zeithaml et al. (2008) developed a conceptual model that correlates Service Quality, Customer Satisfaction and Customer Loyalty in one frame. According to the model, service quality is the outcome of reliability, assurance, responsiveness, empathy and tangibles. Customer satisfaction is influenced by the quality of service and product and price as well as the situational and personal factors also matters which stands true also for the Banking Services.

3.5 SERVQUAL MODEL

The SERVQUAL Model has been used for assessing the service quality of Retail Banking services thus it become essential to understand the origin and the framework of the scale used for measuring the service quality of Banks.

3.5.1 Origin:

Banks in India are facing an open competition under present global economy; hence Banking Industry reforms itself to improve their service quality. Service quality is the highest priority of companies aspiring to differentiate their services in a highly competitive environment. Service quality has become an essential part of organizational success due to increased customer expectations and customization of services in many markets.

The efforts in defining and measuring service quality emanated largely from the goods sector, a solid foundation for research work in the area was laid down in the mid-eighties by Parasuraman, Zeithaml and Berry (1985). Parasuraman et al (1988) defined service quality as ‘a global judgment, or attitude, relating to the superiority of the service’, and involves evaluations of the outcomes of what the customer actually receives from service and process of service act, the manner in which service is delivered. Parasuraman, Zeithaml and Berry (1985, 1988) operationalized service quality as a difference between consumer expectations of ‘what they want’ and their perceptions of ‘what they get.’ Based on this conceptualization and operationalization, they proposed a service quality measurement scale called ‘SERVQUAL’. SERVQUAL provides a technology for measuring and managing service quality (SQ). Since 1985, when the technology was first published, its innovators Parasuraman, Zeithaml and Berry, have further developed, promulgated and promoted the technology through a series of publications (Parasuraman
A Study on the Impact of Business Practices on Profitability and Cost Effectiveness of Selected Banks from Pune City

et al., 1985; 1986; 1988; 1990; 1991a; 1991b; 1993; 1994; Zeithaml et al., 1990; 1991; 1992; 1993). According to Zeithaml and Parasuraman, (2004), the measurement of service quality should be done with the purpose to identify the gaps between expectations and perceptions or the shortfalls in customers’ perceptions of services’ performance.

Service quality can thus be defined as the difference between customer expectations of service and perceived service. If expectations are greater than performance, then perceived quality is less than satisfactory and hence customer dissatisfaction occurs (Parasuraman et al., 1985). It was one of the important tools pioneered by Parasuraman et al. for the assessment of service quality which had been one of the major driving force in developing an increased understanding and knowledge about service quality. This Model has been used for the research work for assessing the gap in the quality of Banking Services for the selected Banks from Pune City, therefore understanding the framework of the Model becomes essential which has been discussed in the later paragraphs.

3.5.2 Framework of SERVQUAL:

A number of researchers have provided lists of quality determinants, but the best known determinants emanate from Parasuraman and colleagues from USA\(^{32}\), who found initially ten dimension scale which was later modified to five dimension scale viz. tangibility, reliability, responsiveness, assurance and empathy. The tangibility aspect includes the appearance of physical facilities, personnel and visual display of materials. Reliability depicts the ability to perform the promised service in time; responsiveness is concerned about the employee’s initiatives and willingness to help customers and promptness of service. Courtesy of employees and their ability to inspire trust and confidence among customers are under assurance dimension. Empathy deals with caring attitude, customization and individual attention given to customers. Development of SERVQUAL instrument is based on the gap model, the gap is calculated by deducting expectations from the perceptions. Customer expectations are pre trial beliefs about a particular service; they are formed with the aid of different sources of information which include prior exposure to the service, word of mouth, publicity about the service and

communications from the organizations (Zeithaml et al, 1990). The central idea in this model is that service quality is a function of the difference scores or gaps between expectations and perceptions. An important advantage of the SERVQUAL instrument is that it has been proven valid and reliable across a large range of service contexts.

Models of Service quality gaps:
There are seven major gaps in the service quality concept viz.:

Gap1: Customers’ expectations versus management perceptions: arises as a result of lack of market research, inadequate communications and too many levels of management.

Gap2: Management perceptions versus service specifications: majorly results from inadequate commitment to service quality, non standardization of tasks and lack of goal setting by the organisations.

Gap3: Service specifications versus service delivery: Role ambiguity results in wrong technology and personnel selection, lack of supervisory system, lack of team work and control.

Gap4: Service delivery versus external communication: arises on account of inadequate levels of communications.

Gap5: The discrepancy between customer expectations and their perceptions of the service delivered: In this case, customer expectations are influenced by the extent of personal needs, word of mouth recommendation and past service experiences. Gap arises due to the influence exerted by the customers and shortfall on the part of service provider.

Gap6: The discrepancy between customer expectations and employees’ perceptions: as a result of the differences in the understanding of customer expectations by front-line service providers

Gap7: The discrepancy between employee’s perceptions and management perceptions: as a result of the differences in the understanding of customer expectations between managers and service providers.
The first six gaps (Gap 1, Gap 2, Gap 3, Gap 4, Gap 6 and Gap 7) are identified as functions of the way in which service is delivered, whereas Gap 5 pertains to the customer and as such is considered to be the true measure of service quality on which the SERVQUAL methodology is based. Assessing service quality and better understanding how various dimensions affect overall service quality would enable organizations to efficiently design the service delivery process.  

SERVQUAL Model measures the expectations and perceptions on five dimensions which are as follows: Assurance, Empathy, Reliability, Responsiveness and Tangibles. Table 2.1 depicts the various attributes of Service Quality:

Table 3.1 Dimensions of Service Quality

<table>
<thead>
<tr>
<th>Dimensions</th>
<th>Definition</th>
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<tbody>
<tr>
<td>Reliability</td>
<td>The ability to perform the promised service dependably and accurately</td>
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<td>Assurance</td>
<td>The knowledge and courtesy of employees and their ability to convey trust and confidence</td>
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<tr>
<td>Tangibles</td>
<td>The appearance of physical facilities, equipment, personnel and communication materials</td>
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<tr>
<td>Empathy</td>
<td>The provision of caring, individualized attention to customers</td>
</tr>
<tr>
<td>Responsiveness</td>
<td>The willingness to help customers and to provide prompt service</td>
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For each dimension of service quality SERVQUAL measures both the expectation and perception of the service. Then, each of the five dimensions is weighted according to customer importance, and the score for each dimension multiplied by the weights. The Gap Score for each dimension is calculated by subtracting the expectation score from the perception score. A negative gap score indicates that the actual service (the perceived score) was less than what was expected (the expectation score). The gap score is a reliable indication of each of the five dimensions of service quality. SERVQUAL

33 Shahin Arash, “SERQUAL and Model of Service Quality Gaps: A Framework for determining and prioritizing critical factors in delivering quality services”, University of Iran.
enables service providers an indication of the level of quality of their service and areas requiring improvement.

Philip Kotler (1996) defined Customer Satisfaction as “level of a person felt state resulting from comparing a products perceived performance or outcome in violation to his or her own expectations”, so customer satisfaction can be explained as a comparative behavior between services to be received before hand and post delivery of the services. ‘Customer Satisfaction’ is a term most widely used in the business. It is a business term which explains about a measurement of products and services provided by a company to meet its customer’s expectations, it can also be seen as a company’s key performance indicator. In a competitive market place where businesses compete for customers, service quality and customer satisfaction is seen as a key differentiator and is increasingly becoming a key element of business strategy. The service quality attributes, such as: Assurances, Tangibles, Empathy and Responsiveness, all have positive relationship with customer satisfaction and business which caters to the customer needs will gain the loyalty of their customers resulting in repeat business as well as potential referrals, it also emphasized on the relation between service quality and profitability, their study revealed that investments in customer satisfaction, customer relationships and service quality lead to profitability and increased market share of Banks34.

3.6 CORRELATION BETWEEN SERVICE QUALITY AND BANKS FINANCIAL PERFORMANCE

3.6.1 Benefits of Good Service Quality:
There are a number of variables that mediate the relationship between service quality and profitability, such as customer satisfaction, customer retention, price, costs, and market share (Zeithaml, 2000). The Hesket model discusses that profit and growth are inspired primarily by customer loyalty, loyalty is the direct result of customer satisfaction, and satisfaction is largely influenced by the value of services provided to customers. The prime determinant of customer satisfaction for any service industry is the perceived

value. If the customers gain more from the product than their expectation, then customer
delight is attained\textsuperscript{35}.

The theory of Hesket model suggests four key linkages viz.:

\begin{itemize}
\item[a)] Satisfied employees in the organisation deliver quality service which meets their
customer’s demands.
\item[b)] Good quality service experienced by the customers leads to customer satisfaction.
\item[c)] Satisfied customers will be loyal to the organisation and would give positive
feedback relating to the service provider.
\item[d)] Customer loyalty leads to repurchase of services and positive work of mouth
which is likely to increase the profitability of the service provider.
\end{itemize}

The theory of Hesket has helped in determining the relationship between the service
quality, customer loyalty and profitability of Banks, it very well holds true for the Banks
considered for the research work.

Marketing literature suggest that there is a strong relation between service quality,
customer satisfaction and profitability. The study of Newman and Cowling (1996)
reports shows that the quality improvements initiatives taken by two British Banks using
SERVQUAL model and how the model improved the quality of service resulting into
substantial increase in profits\textsuperscript{36}. Committee Report on Customer Services in Banks
referred as Goiporia Committee (1991), conducted customer survey relating to Banking
services covering different categories of Bank customers, based on the survey the
Committee has made 97 wide ranging recommendations to improve the customer service
in Banks. The key factors which influence customers’ decision for selection of a
particular Bank are based on the range of services, rates, fees and prices charged.
Superior service is not sufficient to satisfy customers, value derived from the service is

\textsuperscript{35} Heskett et al. (1997) developed a model which is known as “Service Profit Chain”. The model signifies
that there is a direct and strong relationships between profits; growth; customer loyalty; customer
satisfaction; the value of goods and services delivered to customers; and employee capability, satisfaction,
loyalty, and productivity.

\textsuperscript{36} Newman Karin and Cowling Alan (1996) “Service Quality in retail Banking: the experience of two
also essential. Service excellence, identifying and meeting customer needs, providing innovative products are essential to flourish in the Banking industry\textsuperscript{37}.

### 3.6.2 Impact of Service Quality on Banks Financial Indicators:

The service sector plays an important economic role in terms of its contribution to Gross Domestic Product (GDP) as well as through the percentage of the total workforce employed in service companies Philip Kotler (2003). In service organizations, quality management practices have received increasing attention as a way of improving competitiveness. Organizations profit is a consequence of service quality; there are a number of variables that mediate the relationship between service quality and profitability, such as customer satisfaction, customer retention, price, costs, and market share (Zeithaml, 2000). Customer experience is the biggest driver of value. Customized products and tailored offerings will be one of the biggest drivers of Banks Profitability.

For sustained growth in the long run there is a need for the Banks to attract, train, develop and retain the best available talent. Quality service has a positive effect on the bottom-line performance of a firm and thereby on the competitive advantages that could be gained from an improvement in the quality of service offering, so that the perceived service exceed the service level desired by customers\textsuperscript{38}. The importance of how the service is provided can be explained by the fact that Bank services have high correlation to the attributes: it might be difficult for a customer to evaluate the outcome of a particular service; therefore he relies on the attributes associated with the process of service delivery “how”. Banks are trying to divert their customers from Bank offices to mechanized service delivery channels such as ATM’s and internet facilities which undermines the importance of human contact which is one of the essential elements for successful customer service in service industry.\textsuperscript{39} Banks should understand the customer needs to improve customer services which will be helpful in cutting down other costs.


\textsuperscript{39} Barbara Culiberg, Ica Rojsek (2010), “Identifying Service Quality Dimensions As Antecedents To Customer Satisfaction In Retail Banking”, Economic And Business Review | Vol. 12, No. 3

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Customer loyalty in case of Retail Banking is influenced by perceptions of service quality and levels of customer satisfaction because there is little perceived difference between the products and services offered, if a customer becomes loyal to a particular service provider then in future when they achieve high positions and become individuals of high net worth, then the Banks can cash on them, as they will be their major source of revenue. The study explores the relationship between customer loyalty and experiences for which a “loyalty acid test” also known as the ‘Customer Profitability Score’ is conducted by the service providers.

A. N Hexin and Yang Yi developed a model “Design of measure and appraisal model for Commercial Banks’ customer satisfaction”, which was applied on Commercial Banks in China which proved that diversity of products, business charges and human touch to services contributed significantly to customer satisfaction of the Commercial Banks in China, this model have help in assessing the attributes leading to customer satisfaction at Commercial Banks.

David Cohen, Christopher Gan in their research work confers that customers are asset to the organization, they opined that customers do not just buy core quality products or services; they also buy a variety of added value or benefits which forces the service

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41 Zillur Rahman developed the ‘Customers’ Profitability Score’, the profitability score for each customer was calculated on the basis of three parameters:
   i) Awarding 1, 2, 3 or 4 points according to the number of financial services used by the customer.
   ii) Awarding 1, 2 or 3 points for the length of time the customer has been with the Bank. Maximum points are given to the oldest customer.
   iii) Awarding 1, 2 or 3 points according to the customer’s maximum balance held at any time, maximum points given to customers falling in the highest bracket.
43 A.N Hexin, Yang Yi developed a model “Design of measure and appraisal model for Commercial Banks’ customer satisfaction”. The model had three dimensions: customer perception, customer expectations and customer loyalty. The comparison between customer perception and customer expectations and the performance of customer loyalty, ultimately reflect the customer satisfaction of Commercial Banks.
providers such as Banks to adopt a market orientation approach that identifies consumer needs and designs new products and services or to redesigns he existing ones. This also holds true for the Indian Banks as dynamism in the business has lead to varied innovative practices at Commercial Banks thus it can be understood that service quality and innovations leads towards financial prosperity. Bank prices are fixed and driven by the market place, thus, Bank management tends to differentiate themselves from competitors through service quality. Service quality is an imperative element impacting customers’ satisfaction level in the Banking industry. Customer satisfaction adds customer value which can be a strong driver of customer retention which in turn improves profitability of organization by reducing costs incurred in acquiring new customers.

Francis J. Mulhern\textsuperscript{45} study explains the fact that customer profitability is the net dollar contribution made by individual customers to the organization; the research work also focuses on measuring the life time value of customers which leads the enterprise towards generating more revenues. The success of Bank in terms of profit, market share and return on investment depend on customers’ satisfaction and customer loyalty. Andreas Soteriou, Stavros A. Zenios\textsuperscript{46} research work determines the effect of quality on profits; their study also further tries to explain the strong linkage between operational efficiency, service quality and profitability of the Commercial Banks. The authors affirm that for the Bank branches selected for their study, quality was the key driver for revenue generation. The return on service quality (ROSQ) approach developed by Roland Rust, Anthony Zahorik and Tim Keiningham\textsuperscript{47}, indicates that an effect of a service improvement effort will produce increased level of customer satisfaction, increased customer satisfaction will lead to increased behavioral intentions which in turn will increase the repurchase, customer retention and usage ultimately leading to improved profitability. Customer satisfaction and service quality perceptions affect consumer intentions to behave in other positive ways, praising the firm, preferring the company over others, increasing volume of purchases or agreeably paying a price premium. The end result of any service is to add to the revenue of the business enterprise, this relationship between the effects of

\textsuperscript{47}Zeithaml, Bitner, Gremler, Pandit, “Services Marketing”, Chapter: Service and the Bottom Line.
service on the financial indicators of any organizations can be explained with the help of a model.

Below given flow chart Figure: 3.1 “The Effects of Service” indicates service as a function of customer’s intentions, if satisfied will lead to customer retention which in return will benefit the organisation in terms of higher sales and profit margins.

The total of the discounted lifetime values of all the firms’ customers is certain to be the most important determinant of the long term value of the firm. Companies measure actual increase or decrease in revenue from retention or defection of customers by capturing the value of loyal customer, including expected cash flows over a customer lifetime or lifetime customer value. Other financials include value of price premium, volume increase, customer referrals and cross sales. Kotler (1999) states the cost of attracting a new customer may be five times the cost of keeping a current customer happy. The above dimension support the study that there exists the relationship between the services and the profits which applies to the Commercial Banks as competition has forced Banks to upgrade their products and services which has an effect on the bottom line of the Banks.

Figure: 3.1 Effects of Service
(Source: Services Marketing by Zeithaml, Bitner, Gremier, Pandit “Service and the Bottom Line”, pg: 572)
Roth, V Aleda and Jackson E William\textsuperscript{48} in “Strategic Determinants of Service Quality and Performance: Evidence from the Banking Industry” provide clear evidence that process capability and execution are major drivers of performance as they impact customer satisfaction and service quality in Banking industry. Frances Frei and Patrick T Harker\textsuperscript{49} (1999) in their study “Value Creation And Process Management: Evidence From Retail Banking” focused on process consistency in service channels as of paramount importance in customer service delivery processes and process consistency is significantly affected by human resource policies and technology that are complementary and that are aligned with the overall goals of the organization. These research papers have helped in assessing the importance of consistency in service quality and service delivery especially for the Commercial Banks.

Luciano Munari\textsuperscript{50} study on “Commercial Performance and Profitability: The Case of the Italian Banks” which discusses the linkage between customer satisfaction and profitability of Banks, the research has proved that there exist a positive relationship between customer satisfaction and profitability of Commercial Banks. Customer satisfaction is the basis of customer loyalty, and the improvement of company’s competitive position comes from the positive image of company created by word of mouth generated by satisfied customers which builds customer loyalty. Customer loyalty generates increase in cross selling which reduces customers sensitivity to prices, customer relationship management costs and promotional cost and on the other hand good reputation is gained by the organisation by satisfying its customers which also increases the number of new households who look forward them as suppliers of funds which in return increases sales and decreases the new customer acquisition costs ,the combined effort of the two is increase in organisations profit. The author developed a model which explains the relationship between customer satisfaction and profitability, the model discusses how customer satisfaction leads to customer loyalty and increase in market share. The model has been referred for the research work which has been shown in Figure: 3.2.

\textsuperscript{49} Website: www.hbs.edu accessed on 29\textsuperscript{th} December, 2011
As explained in Figure: 3.2 Service is a function of customers intentions, if achieved leads to Customer Satisfaction which enables enterprise to develop good relations with its customers; effect of which will be more number of repurchases by the customers whereby building Customer Loyalty and Brand Image which will directly impact the long term business gains, this relationship has been depicted in Figure:3.3.

![Figure: 3.2 Impact of Customer Satisfaction on Commercial Banks Profitability and Cost Effectiveness](source)

The literature pertaining to the service quality, customer satisfaction has helped the researcher in assessing the determinants which affect the Banks operational efficiency and profitability. Service quality is one of the critical success factors that influence the competitiveness of an organization. A Bank can differentiate itself from competitors by providing high quality service. Banks can create substantial value by identifying the various components of customer satisfaction which leads to improved financial performance. Investing in customer satisfaction is a cost of doing business; through careful and conscious analytical approach the return on investment in customer service can be improved gradually or maximized. Customer satisfaction and customer loyalty can be achieved if Banks cater to the expectations of the customers, the changing needs
of customers can be fulfilled by the Banks if they foster innovations in their products, processes and service delivery mechanism which make them sustainable and add to their revenue margins.

3.7 INNOVATIVE PRACTICES ADOPTED BY SCHEDULED COMMERCIAL BANKS

3.7.1 Meaning and Definition of “Innovation”:
According to the Oxford English Dictionary, ‘innovation’ derives from ‘novare’ meaning to make new or alter. Innovation in an organization goes beyond responding to change it creates change in the business environment in comparison to other organizations and becomes a sustainable competitive tool. National Knowledge Commission Report\textsuperscript{51} [2007] has explained the term “innovation” as a process by which varying degrees of measurable value enhancement is planned and achieved, in any Commercial activity. This process may be breakthrough or incremental, and it may occur systematically in a company it may be achieved by;

- Introducing new or improved goods or services
- Implementing new or improved operational processes
- Implementing new or improved organizational or managerial processes in order to improve market share, competitiveness and quality, while reducing costs.

Mohan R\textsuperscript{52} (2008) address excerpts make a reference of literature relating to different types of innovation such as business model innovation, marketing innovation, product design innovation, product pricing innovation and innovation in business practices. Indian organizations have ventured into all types of innovations, new business practices are introduced, and new process and service innovations in terms of new products and services are implemented at all levels of the organizations to gain competitive advantage. Reina Y. Arakji and Karl R. Lang\textsuperscript{53} (2010) study suggested that business practice innovation does not simply refer to the event when a new practice appears at a specific point in time, but rather it is a continuous activity viewed generally as a process which is

\textsuperscript{51} The National Knowledge Commission (2007) Report Titled "Innovation in India"
\textsuperscript{52} Excerpts from keynote address by Dr. Rakesh Mohan, Deputy Governor, Reserve Bank of India at a function organized by Entrepreneurship Development Institute of India at Ahmedabad on March 28, 2008.
endlessly refined over a period of time after its preliminary appearance which holds true for the Indian Banking Sector.

Commercial Banks are the oldest and largest financial intermediaries; they are depositories of public savings and disbursers of finance. Commercial Banking in India is unique system, the likes of which exists nowhere in the world. The truth of this statement becomes clear as one studies the philosophies and approaches that have contributed to the evaluation of Banking policy, programmes and operations. Innovations take place whenever need arises, there is an old saying that “necessity is the mother of all invention” is clearly true and evident from the overall economic reform process. Globalization has exposed Indian Banking industry to disinvestments, deregulation of interest rates and to international norms. Transparency of information and flexibility of operations is becoming increasingly necessary. Increase in the number of Banks eased the credit scenario and customers enjoy better services. Entry of foreign Banks lead state owned Banks to loose their market monopoly and face stringent competition with new giants. Since mid 1990s there has been considerable increase in the number of Bank branches and ATMs opened by foreign Banks in emerging economies. Foreign entry has been through two routes- acquisition of Domestic Banks in the host country and strategic alliances.

There has been a drastic change in the functioning of financial markets in India since the onset of financial liberalization. Consumers are demanding and receiving a larger variety of traditional and new Banking products and delivery systems. Banks have been implementing changes to their business processes, products and services and organizational structure itself. Academic literature proposes that to manage change effectively the organization need;

- To be in touch with the markets, customers, product range and competitors
- Should have adaptive leadership to promote innovation
- Implementing and managing technology effectively to support the changing environment
- Follow guidelines while implementing the change process [Brandon Bransof et. al.]
All these factors hold true in the current scenario which is evident from the changes that have taken place in the Banking Sector and which have proved to be a critical element for the research work.

According to Bernardo Bátiz-Lazo, Kassa Woldesenbet⁴⁴ (2006) study innovations and invention as synonyms, it may relate to an idea, practice, or product that is new to the end user. A product innovation could be defined as “new products or services introduced to meet external user or market need whereas process innovation is defined as new elements introduced into the organization’s service operations to render a service”. Product innovations have a market focus and are primarily customer driven. Process innovations have an internal focus, seek to develop new capabilities, competencies or routines and are primarily efficiency driven. Further their study added that incremental innovations stresses on the importance of economies of scale and scope in production and development of mass markets, incremental improvements to existing products, services and organizational routines can enhance performance, quality, and usefulness and are vital to making more competitively advanced products. Innovation in financial mediation was driven by internal developments at Banking organizations. Their findings included fundamentals which effect innovation which is primarily been driven by a desire for greater profitability, achieve competitive advantage or improving efficiency and quality of service. Dutta Soumitra and Benavente Daniela⁵⁵ innovation occurs when a firm introduces a product or process to a country for the first time, it is the implementation of a new or significantly improved product: good or service, a new process, a new marketing technique or a new organizational method of business practices. This theory hold true as the Indian Banking Sector has gone through a transformation Phase since first round of Nationalization and there exists a strong relationship between the innovations and the revenue margins of the Banks.

Rishi Meenakshi and Saxena Sweta⁵⁶ [2004] research article affirm the advances in information and telecommunication technologies have had an intense impact on the nature of Banking and in the way in that Banks and financial institutions are organised.

Technological efficiency has resulted in lower transaction costs and increased earning for Banks. Technological innovations have led to newer markets with new and existing products and varied service delivery channels to customers. Mabrouk Abir and Mamoghli Chokri 57(2010) study on Tunisian Banking Sector show that there is a strong relation between innovation and performance of Banks. The study discusses firstly that if the process of innovation is continuous and new technologies are introduced over time, innovative Banks can continue to earn higher profits on the various new or improved products, secondly less profitable Banks categorized on the basis of return on assets are more prepared to be the first one to invest in the process of innovation in order to improve their performance, but in contrast it appears that the most profitable Banks choose to replicate the innovative practices in order to reduce the costs. The literature strongly affirms the relationship between the Banking innovations and financial performance of Tunisian Banking Sector which has enabled the researcher to evaluate the effect of product and process innovations on the financial performance of the Commercial Banks in India.

Frances X. Frei, Patrick T. Harker, Larry W. Hunter 58 (1998) in their working paper relating to innovation in Retail Banking sector discusses the inclusive model for managing branches, the model states that usage of information technology combined with process design will relieve the employees from the basic tasks of Banks such as inquiries, transactions and movement of funds, the study further suggested that automation of routine activities will enable employees to concentrate on activities that are potentially high added value whereby increasing the revenue of the Banks. The working paper strongly supports the current research as it can be observed there has been technological revolution during the decade time period in the Banking sector which has changed the face of Banking operations in India.

3.7.2 Preliminary Trends on Innovative Banking Business Practices:

a) Technological innovations:

Technology driven Indian Banking is the changing phase of Banking business practices. Core Banking functions alone do not add to the bottom line of Banks; value added services are slowly but steadily emerging as a substantial opportunity for Banks to exploit the new ventures. Technology introduced the concepts such as ‘Anywhere Banking’ or ‘Automated Teller Machines’, Internet Banking and Mobile Banking. Such innovations not only will have positive impact on customer service but the fundamental benefit will be derived by the Banks by reduced cost of operation and in servicing customers efficiently over the counter branches. Technology occupies an important place relating to customer satisfaction; it supports the staff for delivering better and speedy services to customers. It plays a vital role in enhancing the products and quality of services, brand building, remittances, customer relationship management and emerging product delivery mechanism like E Banking, Tele-Banking, ATMs and credit cards.

Emergence of the concept “Cross Selling” which means selling an additional product or service to an already existing customer, the cost of cross selling to an existing customer is less than the cost of acquiring a new customer because of reduced cost of advertising which provides a pricing advantage over the competitors.

b) Structural Changes:

Outsourcing of services has emerged as a new practice in Banking Business. After the RBI directives to stop charging customers for cash withdrawals from ATMs, managing ATMs has become a costly affair for the Banks thus majority of Banks are relying on third party vendors for end to end management of ATM services and to pay vendors on

59 Excerpts from the Keynote Address by Shri Vepa Kamesam, Chairman, IDRBT and Former Deputy Governor, RBI at the Centenary Celebrations of City Union Bank Ltd., at Hyderabad

60 Nandi Rajshree (March, 2008) “Business Intelligence as a Cross Selling Tools in Banks”, Professional Banker
per transaction basis or per ATM basis. Based on high level committee reports the state owned Banks have initiated a restructuring of employee dealings, according to the new plan Banks will implement performance management system and outsource the non core activities to promote high performance culture amongst the Banks.

c) Payment and Settlement System:
E payments in India marked a growth rate of over 41% last year. RBI in recent years have taken several initiatives to develop and promote electronic payments infrastructure which includes introduction of Electronic Clearing System, Electronic Fund Transfer System, Real Time Gross Settlement System, National Electronic Fund Transfer System, Cheque Truncation System, Internet Banking, Mobile Banking and Satellite Banking. In India only 5.2% of India’s 6, 50,000 villages have Bank branches; overall the population covered by each branch has come down from 63,000 in 1969 to 16,000 in 2007, e commerce will be the key driver for reaching out the unBanked areas.

d) Product Innovations:
Only 34% of people with annual earnings below 50,000 rupees in urban India had Bank account in 2007, there is a change in the situation with Banks launching the “no-frill accounts” which requires very low or zero minimum balance. Saving account penetration is the indicator of financial inclusion, deregulation of saving deposit rates subject to each Bank offering a uniform interest rate on deposits up to Rs. 1 lakh, for deposits over one lac rupees Bank can offer differential interest rate this is a transformational reform towards enhancing rights of small retail investors from rural and semi urban areas where the ratio of Savings Bank deposits to total deposits is high around 43 to 48 percent. Deregulation of Savings Bank rates will motivate Banks to offer innovative products and improve service delivery mechanism.

For years the validity period for cheques, drafts and pay orders was six months this tenure has been reduced to three months, this measure is adopted by RBI to curb the

63 Business Standard (September, 2010), “E Payments Challenges and Opportunities”, page:12
A Study on the Impact of Business Practices on Profitability and Cost Effectiveness of Selected Banks from Pune City

practice of transferring a cheque from a person in whose favour it was originally issued to another in return for a fee\textsuperscript{65}.

e) **Financial Inclusion:**
Financial Inclusion\textsuperscript{66} also referred as Financial Exclusion has been explained in the literature as social inclusion. As per the RBI guidelines Banks are tapping the rural and unBanked segments. According to Deputy Governor Ms. Usha Thorat\textsuperscript{67} financial inclusion can be thought as not having access to Bank accounts and exclusion from the formal credit market. For people belonging to low income group both in rural and urban India to ensure that they don’t face the difficulties in opening Bank accounts, the Know Your Customer Norms have been simplified. The Banks have also introduced General Purpose Credit Cards with a limit of 25,000 rupees in rural and semi urban branches. Mechanism for one time settlement of over due amount of loans was proposed to be included in the formal financial system. Banks have permitted Non Governmental Institutions and Micro Finance Institutions as intermediaries in providing Banking and financial services through Business Correspondent Model. Banks have also taken measures for promoting financial awareness through credit counseling centers and financial education centers.

In the year 2005 RBI\textsuperscript{68} asked Banks to introduce “no frill accounts” which enable excluded people to open a saving account which is without any minimum balance and other services therefore proves less costly for the Banks and as well as individuals. Banks has introduced all account opening forms in regional languages. Technology is a

\textsuperscript{65} Economic Times (November, 2011), “New Norms for FDs, Financial Instruments”, page: 14
\textsuperscript{66} Leyshon and Thrift (1995) defines “Financial Exclusion” as those processes that serve to prevent certain social groups and individual from gaining access to formal financial system.
\textsuperscript{67} Excerpts from the Speech by Ms. Usha Thorat, Deputy Governor of the Reserve Bank of India (2007) at HMT-DFID Financial Inclusion Conference 2007, London. Website: www.bis.org
vital component for financial inclusion; it can increase the financial inclusion through following measures:

- Issue of smart cards for account opening with biometric identification
- Mobile devices ensure transactions are recorded in the Banks books on real time basis.
- Usage of information technology for processing information, credit scoring and follow up will facilitate in handling the enormous volume of transactions.
- Routing social security payments through National Rural Employment Guarantee Scheme through smart cards and provision of other lost cost remittances and insurance facilities through similar delivery channels.

f) Consolidations:

Globalization has increased new avenues and sources of revenues for the banks simultaneously increasing the competition and risks of the Banks. The risk taking ability of the Banks has assumed greater significance since financial reforms which is reflected through the Capital Adequacy Ratios and through efficient Risk Management Practices. The growing competition and changing financial needs of the customers forced banks to consolidate. Through consolidations Banks can derive the following benefits:

i) Larger volume of business which will increase the market share of Banks
ii) Increased capacity utilization will result in cost advantage for the Banks.
iii) To match the changing business practices
iv) To have presence in the global markets
v) Smaller banks can participate in the Secondary Markets.
vi) To increase the net worth of the Banks
vii) To gain a cost advantage through pooling of manpower, infrastructural facilities and customer base.

The need for higher volumes of business and market share are the critical factors for sustainability of Banks. Indian Banking Sector which is marked by the presence of abundant small and midsized Banks implies that consolidation can be an effective tool for transforming large number of small Banks to small number of large Banks.

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69 Business Standard (January, 2008)
g) Growth in Retail Banking

Banking as a whole is undergoing a drastic change, varied options for the consumer is getting translated into a larger demand for financial products and customization of services. The retail lending, especially in emerging economies showed a remarkable growth in the 1990s mainly due to rapid advances in information technology, the evolving macroeconomic environment and financial market reforms. The rise of the Indian middle class is one of the important contributing factors for retail products growth. The percentage of middle to high income Indian households is expected to rise continuously. The younger population not only has increasing purchasing power but also has the capacity to accommodate personal debt in their portfolio. Improving consumer purchasing power, coupled with more liberal attitudes toward personal debt, is contributing to India's Retail Banking Segment\(^70\). Nearly 70% of the population is below the age of 35 years which means that there is tremendous opportunity of many more people being added to the working class. Increase in the literacy rate has developed a taste for later technology, products and services, increasing usage of debit or credit cards, mobile Banking have contributed to the growth of retail Banking. Decline in the interest rate is another factor which led to the growth of retail segment\(^71\).

3.8 FINANCIAL INDICATORS OF BANKING BUSINESS

Commercial Banks play an important role in the development of the economy; the performance of the Banks can be measured on the basis of various metrics. The key indicators of operational efficiency used in the World Bank study were Return on Assets and Return on Equity, while the financial soundness parameters included capital

\(^{70}\) Excerpts from the Address by Ms. Shyamala Gopinath, Deputy Governor (May, 2005) , “Retail Banking Directions: Opportunities and Challenges”, IBA Banking Frontiers International Conference, Mumbai.

adequacy and gross NPA ratio. Ratio Analysis serves as an important financial tool for analyzing the health of the Banks, some of the important ratios are:

a) **Efficiency Ratios:**
Efficiency Ratios describes how well the financial institutions control expenses in relation to earning revenues and it also shows the productivity of the employees in terms of generating income and managing assets.

b) **Liquidity Ratios:**
It shows the probability that the Bank defaults on its payment obligations is low.

c) **Profitability Ratios:**
It measures the return to shareholders. It depicts the efficiency of the Bank in managing its assets. The profitability ratios can also be defined as the financial measurement that evaluates the capacity of a business to produce returns against the expenses and costs of business over a particular time period.

d) **Risk Ratios:**
It depicts the tendency of the Banks to take the varied risk associated with the business. A safe and sound Banking system is critical for a healthy financial market. Financial evaluation of a Bank must consider the risks that the Bank is taking in order to remain profitable.

Beyond financial measures Banks also use indicators such as market share, customer retention, customer profitability, internal indicators such as business per employee, productivity per employee and employee satisfaction. Many Banks measure profitability in terms of business segments, customer segments, types of depositors and service delivery system\(^2\).

Since 1990s Banks have moved closer to its counterparts of developed economy in terms of profitability and cost efficiency. The factors which contributed to profitability are reduction of operating costs, increase in the non interest incomes of the Banks, diversification into trading services, improvement in trading and settlement systems, technological innovations, setting up of more number of ATMs, reduction in the cash

reserve ratio and statutory liquidity ratio rates, decline in nonperforming assets and restructuring of Banks.

The ICRA Research Report on the performance of 42 Indian Banks including 26 Public Sector Banks and 16 Private Sector Banks shows how changing business practices in the Banks had made significant improvements in the net profits for the financial year 2011. The study reveals strong growth in credit but the NPA level remained steady whereas the provisioning has increased during the financial year. The funding cost of the Banks has increased on account of interest rates; higher interest rates on savings accounts especially for those Banks with high proportion of bulk saving deposits have increased the cost of funds but however Banks have managed to strike their profit balance.

Chakraborty Suman research indicates the difference in the business practices adopted by Private Sector, Public Sector and Foreign Banks. The study indicates there exists a strong correlation between fixed assets and net worth for Public Sector, Foreign Banks and Private sector Banks, further it explains that Foreign Banks manage liquidity by borrowings from money market, Private Sector Banks actively manage their assets and are aggressive in profit generation whereas public sector Banks are more concerned with liquidity and profitability and they follow a conservative strategy.

Barry Howcroft and Ali Ataullah study indicates the effect of financial sector liberalisation initiatives on the productivity of two nations India and Pakistan. The researcher had used Malmquist Total Factor Productivity Index to examine change in efficiency, productivity growth and the technological progress of commercial Banks in these two countries. The need was felt because efficiency change reveals whether an organisation is moving closer to or further away from the best practices leading edge and technical change shows whether the best practices has improved or deteriorated the

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77 Caves et al. (1982) introduced Malmquist Productivity Index to define the primal productivity measures. The measure of productivity change accommodates multi output and multi input production processes. The model is decomposed into two components: efficiency change and technological change.
productivity. The study shows there was highest productivity improvement when governments policy objectives was used, Foreign Banks showed the highest productivity whereas Public sector Banks showed very little improvement in productivity due to efficiency and technological innovation. The study reveals that changing trends in the business practices on account of liberalisation based on these facts it can be understood that changing business practices have a positive impact on the productivity of Banks.

Kajal Chaudhary 78 paper analyses the Non Performing Asset Management 79 in Public Sector and Private Sector Banks. Further it indicates the significance of nonperforming assets on the profitability, productivity, asset quality and financial management of Banks. The research indicates how risk management practices have helped the Banks in reducing the quantum of defaults over the years, adoption of such new practices have helped the Banks in reducing the costs which in turn has increased the margins for the Banks.

Dr. D. Subbarao 80 address indicates that there had been an increase in the quality of financial intermediation in the financial sector since 2003-08 which is on account of distinct improvement in Banks’ operating efficiency in recent years owing to technology up gradation and staff restructuring simultaneously there has also been a significant improvement in terms of the standard supervisory parameters: capital, asset quality, management, earnings, liquidity and systems, the net interest margin of the Indian Banking system is higher than that in some of the other emerging market economies even after accounting for mandated social sector obligations such as priority sector lending and credit support for the government’s anti-poverty initiatives.

Indian Commercial Banking Sector has shown a remarkable growth trend in its business during the past decade. It is evident from higher pace of credit expansion, increasing

79 Loans and Advances given by the Banks are assets to the Bank. But when repayment of Principal and Interest is overdue, such assets are classified as Non Performing Assets in the Financial Reports of the Banks.
80 Excerpts from the Inaugural Address by Dr. Duvvuri Subbarao, Governor, Reserve Bank of India (December, 2010), “Indian Banks Should Adopt Best Global Practices”, BANCON 2010, Mumbai.
productivity and profitability, reduction in Non Performing Assets and focus on Financial Inclusion has made Banking sector more vibrant and robust.

The changing dynamics of business practices has brought revolution in the Banking industry with simplified and hassle free procedures, effective customer service, ease in operations, multiple service delivery channels, effective risk management techniques lead to the overall development of the Banking sector which is one of the important contributors to the growth of the Indian Economy.

3.9 ROLE OF BANKING SECTOR IN THE GROWTH AND DEVELOPMENT OF INDIAN ECONOMY.

In India, the penetration of Banking Services is very low. Merely, 57% of population has access to a Bank savings account and 13% of population has debit cards and 2% has credit cards. This represents the untapped market demand for varied products and the scope for expansion for the Banks in India.

3.9.1 Market Share of Banks:

The Regional Rural Banks dominated the Banking Sector based on the Number of Banks, but Business wise Nationalised Banks were the leaders which imply that higher penetration and major Banking Services was rendered by the Nationalised Banks.

The Group Wise Market Share of Banks on the basis of Number of Banks and Business as on March, 2011 has been depicted in Table: 3.2.
Table: 3.2 Bank Group Wise Market Share

<table>
<thead>
<tr>
<th>S.No</th>
<th>Bank Group</th>
<th>Number of Banks</th>
<th>Business Wise</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>SBI and Associates</td>
<td>3.02%</td>
<td>22.35%</td>
</tr>
<tr>
<td>2</td>
<td>Nationalised Banks</td>
<td>8.62%</td>
<td>49.89%</td>
</tr>
<tr>
<td>3</td>
<td>Private Sector Banks</td>
<td>9.48%</td>
<td>17.09%</td>
</tr>
<tr>
<td>4</td>
<td>Foreign Banks</td>
<td>13.79%</td>
<td>5.02%</td>
</tr>
<tr>
<td>5</td>
<td>Cooperative Banks</td>
<td>29.74%</td>
<td>2.96%</td>
</tr>
<tr>
<td>6</td>
<td>Regional Rural Banks</td>
<td>35.34%</td>
<td>2.69%</td>
</tr>
</tbody>
</table>

Figure: 3.3 Market Share of Banks in Percentage based on Number of Banks and Business Wise

Figure: 3.3 indicate that Regional Rural Banks and Co-operative Banks constitute 65% of the total number of Banks but they only cater only 5.6% of the total business, as against this, Scheduled Commercial Banks excluding Regional Rural Banks and Cooperative Banks form only 35% of the total number of Banks but cater to around 94% of the total business of Banks. This implies the significance of Scheduled Commercial Banks as they cater to the larger segment of the Indian Population.
3.9.2 Capital Inflows:
RBI Bulletin (2011) estimates show that the total flow of financial resources from Banks, domestic Non Bank and external sources to the Commercial sector during 2010-11, at 12,00,000 crore, was 12.3 per cent higher than that in the previous year. There was a decline in non-Bank sources of funds in 2010-11 as compared with that in the previous year, the decline was due to the decline in the foreign direct investment. Although net capital inflows increased significantly to US$ 52.7 billion during April-December 2010 (US$ 37.6 billion a year ago), the composition shifted towards volatile flows such as Foreign Institutional Investors investments and trade credits. Net inflows under Foreign Direct Investment were lower. As the Current Account Deficit is expected to be significant in 2011-12, the sustainability of financing it becomes important. In July, 2010 the Base rate system was replaced by Benchmark Prime Lending Rate system.

3.9.3 Contribution towards Gross Domestic Product:
The service sector plays an important economic role both in terms of its contribution to Gross Domestic Product (GDP) as well as through the percentage of the total workforce employed in service companies (Kotler et al., 2003). All Banks whether from Public Sector, Private Sector, Foreign Banks and Co-operative Banks each have their significant role in the development of Indian economy and they function in support of Government policy of socio economic development of the masses; these Banks can be differentiated by their business objectives, customer segmentation and management perspectives which the researcher has tried to study in the current research work.

Report of the Banking (Saraiya) Commission, Government of India (1972) research on the Banking System of the country came out with its recommendations. It reviewed Banks operating procedures and methods relating to customer service, internal systems and credit procedures. The focus of the report was to find out possible ways in which the Banking system could assist economic development of the country. The total asset size of Indian Banking industry has increased more than five times for the period from March, 2000 to March, 2010 from US$250 billion to more than $1.3 trillion registering a compounded annual growth of 18% in comparison to the GDP growth of 7.2% during the same period. Consequently, the ratio of Commercial Banking assets to GDP increased to nearly 100 per cent. The business of Banks to GDP ratio has almost doubled.
The return on assets of Scheduled Commercial Banks (SCBs) was 0.6% in 2000-01 and increased to 1.1% by 2009-10. The Capital Adequacy Ratio has increased from 11.4% to 14.6% during this period. Banks have added more than 14000 branches and 41000 ATMs to their network in the last decade, besides broadening the scope of delivery channels to Internet Banking, Mobile Banking and Call Centre\textsuperscript{81}. The new generation Private Banks has now established themselves in the system and has set new standards of service and efficiency. These Banks have also given tough but healthy competition to the Public Sector Banks.

3.9.4 Financial Growth:

The economic growth coupled with the robust gains in stock markets has brought with it prosperity and wealth in the hands of Indians. The number of millionaires in India has crossed the 100,000-mark. Salaries in India have witnessed a 13-14 per cent growth, higher than that seen in China and other South East Asian countries. Banks have rolled out technology to the advantage of the customers. The growth of Indian Banks in the last decade was much higher than its preceding decade and there is no doubt that the present decade would offer even more exciting opportunities. Well developed institutions with good integrity systems and high innovative capacity contribute positively to the soundness of the Banking Sector\textsuperscript{82}.

ICRA Limited research mentioned that Indian Banks have made a progressive growth during the previous five years which is evident from the annual credit growth, profitability and trend of nonperforming assets. While annual rate of credit growth was 23% during the last five years, profitability (Average Return on Net Worth) was maintained at around 15% during the same period, while gross NPAs fell from 3.3% as on March 31, 2006 to 2.3% as on March 31, 2011. The profitability (PAT as a percentage of total assets) of Scheduled Commercial Banks has been stable at 0.9-1.1%.

\textsuperscript{81} Excerpts from the Speech Mr. M. V Nair; Chairman and Managing Director, Union Bank of India, “Indian Banking, A promising future”, Hong Kong. \\
\textsuperscript{82} Santha Vaithilingm, Mahendhiran Nair, and Muthi Samudram [2006] “Key Drivers for Soundness Of The Banking Sector: Lessons For Developing Countries” Journal of Global Business and Technology, Volume 2, Number 1, Spring 2006
over the last five years. Further, the profitability (Profit After Tax) of the Public Sector Banks has been lower which was around 0.9% than that of Private Banks around 1.4% over the same period. However, despite lower profitability, the return indicators (Return on Net Worth) of the Public Sector Banks remain higher than those of Private Banks primarily because of higher leveraging. During 2010-11, Public Sector Banks registered a Return on Net Worth of around 18%, while Private Banks reported around 14%  

Mckinsey Report  highlights that Banks should focus more on social development and incentive driven framework by introducing credit guarantees and market subsidies to encourage Public Sector, Private Sector and Foreign Banks to leverage technology to innovate and profitably provide Banking services to the unbanked areas of India. Banking becomes the great driver for GDP and employment and large section of population gain access to quality Banking Products.

**Conclusion:**

The concerned Literature shows the significant contribution made by the Banking Sector for the growth and development of Indian Economy. The business practices adopted by Scheduled Commercial Banks incorporate the objective of revenue generation supported by social growth and prosperity. The changing business practices of Banking Sector has been studied in later chapters which proves that Banking business is evolutionary in nature and Banks have to adopt these changes to sustain and maintain the financial stability. There has been a pragmatic growth in the Banking Sector which has been discussed in the given literature; in the subsequent chapter effort has been made to study the growth of the Banking Sector and the Innovations which has enabled the Banks to reach the global standards.

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83 ICRA’s view on “Indian Banking Sector”, website: [www.moneycontrol.com](http://www.moneycontrol.com)

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