CHAPTER I

INTRODUCTION
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1.1. Introduction

Agriculture is the core sector of the Indian economy. It accounts for 21 percent of GDP and about two-thirds of the population is dependent on this sector. It is thus rightly said that agriculture is the backbone of our economy and its prosperity can largely be responsible for the well being of the entire economy. The vigorous growth of agriculture sector demands adequate flow of finance.

Farm finance has a place of pride in the agro-socio-economic development of the country both at micro and macro levels. Its catalytic role strengthens the farming business and augments the productivity of scarce resources. Application of new technological inputs obtained through farm finance helps boost of agricultural productivity. Farm finance can also contribute to reduction in regional economic imbalances. Thus, the role of farm finance in strengthening and development of both input and output markets in agriculture is crucial and significant. The contribution of agricultural sector to national income, foreign exchange, industry and employment is a measure of the sector’s importance in the overall economy of the country. Agriculture plays a dominant role in the Indian economy. By tradition, India is an agricultural country, which is endowed with abundant natural resources. The development of agriculture to its fullest potential is therefore,
the kingpin of Indian economy and the prosperity of India is solely dependent on agriculture. If agriculture blooms, the country prospers.

Agriculture plays a significant role in the economic development of India. Agriculture is the source of livelihood for over seventy percent of population in our country. To meet the requirements of the growing population and rapidly developing economy, agriculture has to grow fast and get modernized. This requires the use of high pay off inputs. Adoption of high yielding varieties requires large quantities of fertilizers, plant-protection chemicals, modernized equipments, and machineries, which in turn needs huge investment. The rural agricultural sector of the economy is labor-abundant, land-poor and capital scarce. So it would be very difficult to get the benefits of modernization of agriculture without adequate and timely supply of credit to the farmers.

Agricultural growth is crucial for alleviating rural poverty. Access to institutional credit to more farmers and appropriate quantity and quality of agricultural credit are crucial for realizing the full potential of agriculture as a profitable activity.

Regarding developing economies, it depends on the agricultural sector that the battle for long term economic development will be won or lost. For India even after the emergence of green revolution in the late 60’s the productivity of agriculture is very much lower than the developed countries of the world.
It is so because majority of farmers are continuing the traditional system of farming. Scientific system of farming needs huge investment of capital. Most of the farmers are poor with small landholdings and their economic resources are too much limited.

1.2. Institutional Agencies for Agricultural Credit

It is brought to notice by many studies on agricultural credit that among all the agencies involved in agricultural credit, the individual moneylenders as non-institutional agencies till recently, have been most important both from the point of view of number of loans and the volume of business. The institutional sources comprise the Co-operatives, Scheduled Commercial Banks and Regional Rural Banks (RRBs). The co-operatives provide mainly short and medium term loans to the farmers. The commercial banks including RRBs provide both short and medium term loans for agriculture and allied activities. The National Bank for Agriculture and Rural Development (NABARD) is the apex institution at the national level for agricultural credit and provides refinance assistance to the agencies mentioned above. The Reserve Bank of India as the Central Bank of the country plays a crucial role in the sphere by giving overall direction to rural credit and financial support to NABARD for its operations.
1.3. Agricultural Credit – The Role of RRBs

The working Group on Rural Banks (1975) recommended the establishment of Regional Rural Banks (RRBs) to supplement the efforts of the commercial banks and co-operatives in extending credit to rural community – small and marginal farmers, landless labourers and the rural residents of small means. The RRBs and Commercial Banks started with the basic objective of providing commercial banking in the rural areas of the country, particularly in those areas and to those sections of rural society where commercial banking facilities have not been available hitherto. The RRBs have now become an integral part of the rural banking of the country and are playing a commendable role in providing credit and banking services to the rural areas in the country.

Financial Economics is an important and necessary factor for banking development in India. Though finance is by no means a substitute for real resources, it has a crucial role in the economic development of the country. The funding strategies and profit maximisation is playing a vital role in the growth of banking sectors in India (G. Thiyagarajan and A. Arulraj, 2012). The segment of capital and money market dealing with lending and borrowing of funds, essentially for short-term purposes, is represented by commercial banking institutions. Commercial banks act as financial intermediaries, i.e. intermediaries of saving and investment. Savings intermediations are a process by which flow of savings of the community is
allocated to finance investment in the economy. The banking system which constitutes the core of the financial sector plays a critical role in transmitting monetary policy impulses to the entire economic system.

Banking is the kingpin of the chariot of economic progress. The banking system occupies an important role in a nation’s economy. A banking institution is indispensable in a modern society. It plays a pivotal role in the economic development of a country and forms the core of the money market in a developing country. The importance of commercial banks in the process of economic development has been recognized by all. The role becomes more important in planned or developing economies, like India. Banking industry is the blood vascular system of our economy. The performance of banks is completely linked to the growth of the economy, while the nature and quantum of growth is, in turn, linked to the availability of bank credit (Uppal, 2006).

In India, though the money market is still characterized by the existence of both the organized and the unorganized segments, institutions in the organized money market have grown significantly and are playing an increasingly important role. Amongst the institutions in the organized sector of the money market, commercial banks and commercial co-operative banks have been in existence for the past several decades. The Regional Rural Banks came into existence since the middle of seventies. Thus, with the
phenomenal geographical expansion of the commercial banks and the setting up of the Regional Rural Banks during the recent past, the organized sector of money market has penetrated into the rural areas as well. The structure of the Indian Banking System has undergone numerous changes since independence. Two phases of nationalization (1969 and 1980), introduction of Regional Rural Banks in 1975, and permission to New Private Sector Banks and set-up operations since 1993-94 are some of the major changes undergone (Debasish, 2005). The liberalization and globalization of Indian economy brought substantial changes in the level of competition, business environment, managing strategies and advanced technology front. India, today, is one of the fastest growing economies in the world. It is now Asia’s third largest economy and has made inroads into the global top 10 in terms of GDP. The service sector remained the main engine of the growth contributing more than 55 per cent to the GDP.

1.4. Institutional Actors in Financial Institutions in India

The banking system in India is significantly different from that of other Asian nations because of the country’s unique geographic, social and economic characteristics. India has a large population and land size, a diverse culture and extreme disparities in income, which are marked among its regions. There are high levels of illiteracy among a large percentage of its population but, at the same time, the country has a large reservoir of managerial and technologically advanced talents. Between about 30 and 35
percent of the population resides in metro and urban cities and the rest is spread in several semi-urban and rural centers. The country’s economic policy framework combines socialistic and capitalistic features with a heavy bias towards public sector investment. India has followed the path of growth-led exports rather than the “exported growth” of other Asian economies, with emphasis on self-reliance through import substitution. These features are reflected in the structure, size and diversity of the country’s banking and financial sector. The banking system has had to serve the goals of economic policies enunciated in successive five year development plans, particularly concerning equitable income distribution, balanced regional economic growth and the reduction and elimination of private sector monopolies in trade and industry. In order for the banking industry to serve as an instrument of state policy, it was subjected to various nationalization schemes in different phases (1955, 1969, and 1980). As a result, banking remained internationally isolated (few Indian banks had presence abroad in international financial centers) because of preoccupations with domestic priorities, especially massive branch expansion and attracting more people to the system. Moreover, the sector has been assigned the role of providing support to other economic sectors such as agriculture, small-scale industries, exports and banking activities in the developed commercial centers (i.e., metro, urban and a limited number of semi-urban centers).
The banking system’s international isolation was also due to strict branch licensing controls on foreign banks already operating in the country as well as entry restrictions facing new foreign banks. A criterion of reciprocity is required for any Indian bank to open an office abroad. These features have left the Indian banking sector with weaknesses and strengths. A big challenge facing Indian banks is how, under the current ownership structure, to attain operational efficiency suitable for modern financial intermediation. On the other hand, it has been relatively easy for the public sector banks to recapitalize, given the increases in nonperforming assets (NPAs), as their Government dominated ownership structure has reduced the conflicts of interest that private banks would face.

1.4.1. The Indian financial system comprises the following institutions

![Figure 1.1: Indian Banking System]
About 92 percent of the country’s banking segment is under State control while the balance comprises private sector and foreign banks.

1.5. Macro Economic Indicators in Banking Sector in India

Strengthening financial systems has been one of the central issues facing emerging markets and developing economies. This is because sound financial systems serve as an important channel for achieving economic growth through the mobilization of financial savings, putting them to productive use and transforming various risks (Beck, Levin and Loayza 1999; King and Levin 1993; Rajan and Zingales 1998; Demirgüç-Kunt, Asli and Maksimovic 1998; Jayaratne and Strahan 1996). Many countries adopted a series of financial sector liberalization measures in the late 1980s and early 1990s that included interest rate liberalization, entry deregulations, reduction of reserve requirements and removal of credit allocation. In many cases, the timing of financial sector liberalization coincided with that of capital account liberalization. Domestic banks were given access to cheap loans from abroad and allocated those resources to domestic production sectors. Since the Asian financial crisis of 1997-1999, the importance of balancing financial liberalization with adequate regulation and supervision prior to full capital account liberalization has been increasingly recognized. The crisis was preceded by massive, unhedged, short-term capital inflows, which then aggravated double mismatches (a currency mismatch coupled with a maturity mismatch) and undermined the soundness of the domestic
financial sector. A maturity mismatch is generally inherent in the banking sector since commercial banks accept short-term deposits and convert them into relatively longer-term, often illiquid, assets. Nevertheless, massive, predominantly short-term capital inflows – largely in the form of inter-bank loans – shortened banks’ liabilities, thus expanding the maturity mismatch. Further, a currency mismatch was aggravated since massive capital inflows denominated in foreign currency were converted into domestic currency in order to finance the cyclical upturn of domestic investment in manufacturing equipment, real estate and stocks (Asian Policy Forum 2000 and Yoshitomi and Shirai 2000). In other words, many share the view that the proper sequencing of financial sector and capital account liberalization is one of the most important policies in preventing another Asian-type “capital account” crisis. It is now widely accepted that capital account liberalization should follow current account and domestic financial sector liberalization (Mckinnon 1973). This sequence issue is even more important for countries such as China and India, which have not yet launched full capital account convertibility and where public-sector banks still remain dominant. In such countries, financial sector liberalization comes against more politically difficult issues than those that have already opened up their capital account to a substantial degree since they have to first restructure predominant public-sector banks.
While India’s financial reforms have been comprehensive and in line with global trends, one unique feature is that, unlike with other former planned economies such as Hungary and Poland, the Indian Government did not engage in a drastic privatization of public-sector banks. Rather, it chose a gradual approach toward restructuring these banks by enhancing competition through entry deregulation of foreign and domestic banks. This reflects the view of the Narasimham Committee that ensuring the integrity and autonomy of public-sector banks is the more relevant issue and that they could improve profitability and efficiency without changing their ownership if competition were enhanced. Since this approach was introduced, some criticisms have been expressed (Joshi and Little 1996). First, public-sector banks continue to be dominant thanks to their better branch coverage, customer base and knowledge of the market compared with newcomers. Second, public-sector banks would find it more difficult to reduce personnel expenditure because of the strong trade unions. Third, the government would find it difficult to accept genuine competition within public-sector banks. In response to these concerns, the government decided to gradually expand private-sector equity holdings in public-sector banks, but still avoided the transformation of their ownership. The 1994 amendment of the Banking Act allowed banks to raise private equity up to 49 per cent of paid-up capital. Consequently, public-sector banks, which used to be fully owned by the government prior to the reform, were now allowed to increase
nongovernment ownership. So far, only eight public-sector banks out of 27 have diversified ownership.

Meanwhile, a consensus is emerging that state ownership of banks is bad for financial sector development and growth (World Bank 2001). Based on data from the 10 largest commercial and development banks in 92 countries for 1970-1995, La Porta and others (2000) have found that greater state ownership of banks in 1970 was associated with less financial sector development, lower growth, lower productivity and that these effects were greater at lower levels of income. Barth and others (2001a, 2001b) have shown that greater state ownership of banks tends to be associated with higher interest rate spreads, less private credit, less activity on the stock exchange and less non-bank credit, even after taking into account other factors that could influence financial development. This suggests that greater state ownership tends to be anti-competitive, reducing competition from both banks and non-banks. Barth and others have also noted that applications for bank licenses are more often rejected and there are fewer foreign banks when state ownership is greater. Moreover, Caprio and Martinez-Peria (2000) have shown that greater state ownership at the start of 1980 was associated with a greater probability of a banking crisis and higher fiscal costs. With respect to privatizing banks, moreover, the World Bank (2001) takes the view that privatization can yield real benefits to economies provided that an appropriate accounting, legal and regulatory infrastructure
is in place. It should be noted that premature privatization may give rise to banking crisis. Clarke and Cull (1998) have demonstrated that Argentina promoted the privatization of public-sector banks in a reasonably developed regulatory and infrastructure environment and thus privatized banks improved productivity remarkably. Considering the implications derived from the above studies, this chapter examines whether India’s gradual approach has been successful so far by examining whether public-sector (commercial) banks have improved their performance (profitability, efficiency and soundness) in the reform period. Three types of performance indicators have been used: (a) profitability (b) cost efficiency and (c) earnings efficiency.

The second unique feature of India’s banking sector is that the Reserve Bank of India has permitted commercial banks to engage in diverse activities such as securities related transactions (for example, underwriting, dealing and brokerage) foreign exchange transactions and leasing activities. Diversification of banks’ activities can be justified for at least five reasons. First, entry deregulation and the resulting intensified competition may leave banks with no choice but to engage in risk-taking activities in the fight for their market share or profit margins. As a result, risk-taking would reduce the value of banks’ future earnings and associated incentives to avoid bankruptcy (Allen and Gale 2000). Second, banks need to obtain implicit rents in order to provide discretionary, repetitive and flexible loans. In
addition, banks attempt to reduce the extent of information asymmetry by processing inside information on their clients and monitoring their performance. Such roles are unique to the banking system and important particularly for SMEs since information on them tends to be highly idiosyncratic. Without sufficient rents, however, banks are likely to cease providing these services and the implication for SMEs and economic development can be enormous. Thus, it is important for bank regulators to ensure adequate implicit rents to banks in order to encourage them to provide such unique services. Moreover, banks may lose an opportunity to collect implicit rents if their clients switch to capital markets once they become larger and profitable.

One interesting feature of India’s banking sector is that some large public-sector banks appear to have been performing reasonably well in the post-reform period. This could be attributed to (a) the import of better risk management skills from foreign and private domestic banks (b) intensified competition, (c) the diversification effect described above (d) reorganization (for example, mergers and acquisitions) and (e) goodwill. In India, however, given the virtual absence of an exit policy, large-scale mergers and acquisitions among problematic banks have not occurred so far. It is generally thought that the entry of well-capitalized new banks is likely to improve the quality and variety of services, efficiency of bank management
and prudential supervisory capacity (Levine 1996; Walter and Gray 1983; Gelb and Sagari 1990).

The entry of foreign banks tends to lower interest margins, profitability, and the overall expenses of domestic banks in India (Clarke, Cull, D’Amato, and Molinari 2000; Claessens, Demirgüç-Kunt and Huizinga 2000). Further, Claessens, Demirgüç-Kunt and Huizinga have reported that the number of entrants matter compared with their market share, indicating that foreign banks affect local bank competition upon entry rather than after they have gained a substantial market share. Moreover, these banks may be able to provide a source of new capital for enterprises and thus reduce government restructuring costs, especially when the domestic banking sector is devastated in the aftermath of a crisis. Some studies also find that foreign banks tend to go for higher interest margins and profitability than domestic banks in developing countries, while the opposite is true in developed countries (Claessens, Demirgüç-Kunt and Huizinga 2000). On the other hand, premature deregulation and foreign entry may cause some downside effects. First, they may increase the risk of a banking crisis if there is macroeconomic or regulatory weakness, as was experienced in Argentina, Brazil and Chile in the 1970s (Demirgüç-Kunt, Asli and Detragiache 1998). Second, foreign banks may exhibit a home country bias, leading them to retreat promptly and massively at the first sign of difficulty. In the East Asian crisis, for example, it is widely believed that foreign banks, such as
City Bank, played a major role in supporting the capital outflow without consideration as to the national damage caused.

The Commercial banks play an important role in economic development of developing country. Economic development involves investment in various sectors of economy. The banks collect savings from the people and mobilize saving for investment in industrial project. The investors borrow from banks to finance the projects. Promote the growth rate through the reorientation of loan policy. Special funds are provided to the investors for the completion of projects. The banks provide a guarantee for industrial loan from international agencies. The foreign capital flows to developing countries for investment in projects. Besides normal banking the banks perform agency services for the client. The banks buy and sell securities, make rent payments, receive subscription funds and collect utility bills for the Government departments. Thus these banks save time and energy of busy people. Banks arrange foreign exchange for the business transaction with other countries. The facility of foreign currency account has resulted in an increase of foreign exchange reserves. By opening a letter of credit the banks promote foreign trade. The banks are not simply collecting funds but also serve as a guide to the customer investment of their funds. The policy of banks is an instrument in wide dispersal of credit in country.
Thus, the banking system occupies an important position in modern economic organization not merely because they have financial resources but because they have the power to influence the direction in which such resource might be employed. They can discriminate in lending policies. Bankers are regarded as “Public conservator of commercial virtues”. A country with a properly developed banking organization has a secure foundation of industrial and economic progress.

1.6. Recent Trends in Banking Sector

The last decade has seen many positive developments in the Indian banking sector. The policy makers, which comprise the Reserve Bank of India (RBI), Ministry of Finance and related government and financial sector regulatory entities, have made several notable efforts to improve regulation in the sector. The sector now compares favourably with banking sectors in the region on metrics like growth, profitability and non-performing assets (NPAs). A few banks have established an outstanding track record of innovation, growth and value creation. This is reflected in their market valuation. However, improved regulations, innovation, growth and value creation in the sector remain limited to a small part of it. The cost of banking intermediation in India is higher and bank penetration is far lower than in other markets. India’s banking industry must strengthen itself significantly if it has to support the modern and vibrant economy which India aspires to be. While the onus for this change lies mainly with bank managements, an
enabling policy and regulatory framework will also be critical to their success. The failure to respond to changing market realities has stunted the development of the financial sector in many developing countries. A weak banking structure has been unable to fuel continued growth, which has harmed the long-term health of their economies. Now the emphasize is on the need to act both decisively and quickly to build an enabling, rather than a limiting, banking sector in India. Indian banks have compared favourably on growth, asset quality and profitability with other regional banks over the last few years. The banking index has grown at a compounded annual rate of over 51 per cent since April 2001 as compared to a 27 per cent growth in the market index for the same period. Policy makers have made some notable changes in policy and regulation to help strengthen the sector. These changes include strengthening prudential norms, enhancing the payments system and integrating regulations between commercial and co-operative banks. However, the cost of intermediation remains high and bank penetration is limited to only a few customer segments and geographies. While bank lending has been a significant driver of Gross Domestic Product (GDP) growth and employment, periodic instances of the “failure” of some weak banks have often threatened the stability of the system. Structural weaknesses such as a fragmented industry structure, restrictions on capital availability and deployment, lack of institutional support infrastructure, restrictive labour laws, weak corporate governance and ineffective
regulations beyond Scheduled Commercial Banks (SCBs), unless addressed, could seriously weaken the health of the sector. Further, the inability of bank managements (with some notable exceptions) to improve capital allocation, increase the productivity of their service platforms and improve the performance ethic in their organizations could seriously affect future performance.

1.7. Banking Ombudsman Scheme of Customer Service

The issue of ‘Treating the bank customers fairly’ is gaining currency with the awakening of consumers on the issues of investor/consumer protection. Banking being a service industry it is all the more important that there is a well defined and functional mechanism to ensure fairness to the customer. That is all what the Banking Ombudsman Scheme (BO Scheme) strives for. The RBI, over the years, has undertaken a large number of initiatives on ensuring fair treatment to customers. This has taken the form of both regulatory fiats (like reining in of recovery agents, introduction of comprehensive display board, banking facilities for the visually challenged, rationalization of service charges on collection of outstation cheques, free use of ATMs etc ) as also moral suasion and class action. A minimum standard of banking practices for banks to follow when dealing with individual customers was established on introduction of the Code of Bank's Commitment to Customers in July 2006. However, a number of challenges still need to be addressed to make customer services responsive to the 'small
customer'. The actions taken by the RBI so far do not in any way dwarf the challenges that confront us in regard to fair treatment of customers. The Banking Ombudsman Scheme introduced by RBI in 1995 attempts to bridge this information and expertise asymmetry between the banks and the end user of their products and services. Having given freedom to the bank boards to decide on many issues, RBI should not be compelled by omissions and commissions by commercial banks to issue directives to them. However, there are a few ground rules which every commercial bank should be compelled to follow:

1. Minimum courtesy and behavioral standards - Extending minimum courtesy and proper behavior towards customers is one of the guiding principles and banks should follow a 'zero-tolerance' policy towards misbehavior.

2. Transparency - A minimum standard needs to be adopted towards fostering transparency by making MITC (Most Important Terms and Conditions) mandatory for all retail Products. There also should be transparency in pricing products and services.

3. Non-discriminatory policy - Banks should establish a basic standard of non-discriminatory pricing. This is based on the premise that 'new' customers cannot get preferential treatment over the 'old' customers if in the same risk category.
4. Deliver what is promised – There will always be customer service related problems, but when problems are brought to a bank's notice, priority should be given to solving the problems.

5. Allowing seamless ‘switching’ the consumer should be able to change products or switch products without incurring excessive penalty. Similarly, banks should not make it unnecessarily difficult for consumers to make claims or to complain when something goes wrong.

6. Appropriateness of 'sell' – Products and services need to be designed with the targeted customer segment in mind. The customers should be targeted appropriately, to minimize the risk that marketing might prompt customers who are unsuitable to buy such products.

7. Unreasonable customer demand - When banks find that a customer is unreasonable, they should take a firm but polite stand that what he/she wanted could not be accepted for some particular reasons.

The above seven tenets should form the guiding principles towards resolution of customer grievances. The ultimate aim of regulation is to move towards an outcome based approach where customer outcomes can be quantitatively measured and regulatory response formulated accordingly.

The Offices of the Banking Ombudsmen have been rendering excellent service over the years in redressing customer grievances in an impartial and efficient manner. The offices of the Banking Ombudsmen received
increasing number of complaints from rural and semi-urban areas during the year 2008-09. This is a testimony to the success of the awareness efforts undertaken by the Banking Ombudsmen as well as the RBI through personal/village visits, media campaign etc. While the number of complaints from rural areas increased by 65%, complaints from the semi-urban areas increased by 48%, which can be well compared against the aggregate increase of 44% in the number of complaints during the year 2008-09 (Annual Report 2008-2009, RBI Banking Ombudsmen Scheme 2006).

1.8. Customer Service Initiatives by the Reserve Bank of India

The deregulation of interest rates and product pricing by banks in India was followed up by the RBI with certain institutional, regulatory and infrastructural changes. A summary of the important initiatives taken by the RBI for improvement in customer service rendered by banks is detailed below:

- Prior to the deregulation of interest rates, when the banking industry was predominantly under Government control, the need for efficiency and courtesy in customer service was highlighted through the recommendations of the Goiporia Committee.
- The advent of the new private sector banks brought about a paradigm shift in the way banking services were delivered and the Indian
The banking consumer had the first taste of technology-driven delivery of banking services in the form of ATMs. Today, we have come a long way in this regard as much as setting up and licensing of ATMs has been deregulated. With a view to improve accessibility of banking services, the customers have been empowered to access ATMs of any bank across the country free of charge.

- The Banking Ombudsman Scheme (BOS) was formally launched in 1995 to provide an alternative cost-effective dispute resolution mechanism. The BOS has served the country and its banks’ customers well. The feedback gathered in the course of administering the scheme has been used by the RBI to modify the scheme with a view to cover the maximum customer touchpoints and products.

The growing number of complaints under the BOS is an indicator of the increasing awareness of our customers and also the timely action taken by the RBI to focus in customer-centric guidelines. All the banks are required to place in the public domain their Fair Practices Code (Lender’s liability) as directed by the RBI. The adherence to this code is to be reviewed by each bank’s Board of Directors and the overall performance of the bank in this regard is analyzed by the RBI at the time of Annual Financial Inspection (AFI) of banks. The aberrations in this regard, if any, are brought to the notice of the Senior Management through the Customer Service Department. The annual plan of branch expansion of banks is generally approved by the
concerned regulatory department after getting inputs and feedback from the Customer Service Department about the concerned bank’s track record in adhering to various customer-centric guidelines issued by the RBI. The operational guidelines issued to banks for handling card products focus on fair treatment of the customer. This was necessary given the fact that this segment of the market is still in its infancy in India. The various instructions issued to the banks that have a bearing on customer service, have been codified and put in one place in the form of a Master Circular. The RBI’s web site has a lot of information for the bank’s customers, under the head “For Common Person”. The contents in this section of the web site are available in 15 regional languages. (Annual Report 2008-2009, RBI Banking Ombudsmen Scheme, 2006).

1.9. Statement of Problem

There are two important institutions viz., the commercial banks and the cooperatives, lending to agriculturists in the area under enquiry viz., Tiruchirappalli District, Tamil Nadu State, India. The commercial banks came into the scene much later than the cooperatives, particularly after the nationalization of major commercial banks in 1969. The commercial banks which have the required resources for lending under the direction of Reserve bank of India have been asked to give priority to agricultural lending. However the cooperatives and the commercial banks, put together are not able to eliminate moneylenders and indigenous bankers who are financing at
usurious rates. But the commercial banks lending to agriculture has helped the agriculturists to reduce their borrowing from non institutional agencies. Though there has been steady progress in the performance of the commercial banks in farm credit.

In the present competitive Indian banking context, characterized by rapid change and increasingly sophisticated customers, it has become very important that banks in India determine the service quality factors, which are pertinent to the customer’s selection process. With the advent of international banking, the trend towards larger bank holding companies and innovations in the marketplace, the customers have greater and greater difficulty in selecting one institution from another. Therefore the current problem for the banking industry in India is to determine the dimensionality of customer- perceived service quality. This is because if service quality dimensions can be identified, service managers should be able to improve the delivery of customer perceived quality during the service process and have greater control over the overall outcome. Moreover, investigating the influence of the dimensions of service quality on customers’ behavioral intentions should provide a better understanding of the customer satisfaction and also help to specify measure, control and improve customer perceived service quality. Hence, to gain and sustain competitive advantages in the fast changing retail banking industry in India, it is crucial for banks to understand in-depth what customers perceive to be the key dimensions of
service quality and what impacts the identified dimensions have on customer’s behavioral intentions.

Recognition of service quality as a competitive weapon is relatively a recent phenomenon in the Indian Banking sector. Prior to the liberalization era the banking sector in India was operating in a protected environment and was dominated by nationalized banks. Banks at that time did not feel the need to pay attention to service quality issues and they assigned very low priority to identification and satisfaction of customer needs. The need of the hour in the Indian banking sector is to build up competitiveness through enhanced service quality, thus making the banks more market oriented and provide more loans to the customers as they want to improve their standard of living. Even though there have been numerous studies relevant to service quality, focused on service quality measurement and instrument development, Marketing researchers have made attempts to measure service quality since the 1980s. Further, these qualities influenced the image the customers had and this image had an effect on the process from expected quality to perceived quality.

Parasuraman et al. (1985) conducted qualitative research with twelve focus sections and several executives. They found that the subjects showed a similar pattern of perceived service quality with discrepancy between their expectation and actual service performance. Based on these findings, they
proposed a conceptual model containing five gaps. Consequentially, Parasuraman et al. (1988) later introduced the SERVQUAL instrument including 22 items in five dimensions: reliability, tangibles, responsiveness, assurance and empathy. Even though this instrument has been used in various studies, the SERVQUAL has received many criticisms from other scholars (e.g., Cronin & Taylor, 1992; Peter, Churchill, & Brown, 1993). The major concern about the SERVQUAL was its use of measurement with different scores, which resulted in different numbers of factor dimensions, improper managerial approaches, and conceptual problems (Brady, 1997). Carman (1990) and Cronin and Taylor (1992) have argued that the performance-only measure increases variance when they removed the expectation measure. Based on this result, Cronin and Taylor (1994) suggested the use of SERVPERF by arguing that only the performance part of the SERVQUAL should be included. Another weakness was that SERVQUAL did not include an outcome dimension. Even though service process has been emphasized, no attention has been paid to what customers achieved after receiving a service.

Despite many efforts and debates, there has been no consensus on the measure of service quality across industries. In order to overcome this problem, Dabholkar et al. (1996) presented the hierarchical model of service quality consisting of three levels. The first level was consumers’ overall perception of service quality. The second level included five dimensions:
physical aspects, reliability, personal interaction, problem solving and policy. The third level was a sub dimension of the second dimension. Brady (1997) conceptualized a hierarchical model of perceived service quality again based on Dabholkar et al.’s (1996) model. This present study is examining the Service Quality on Banking and Loan recovery in Commercial Banks of Delta Districts, Tamilnadu.

1.10. Research Scope and Objectives

1. To examine the demographic and socio economic environments influence the different dimensions of service quality on Banking and Loan recovery in Commercial Banks of Delta Districts, Tamilnadu.

2. To find out the relationship between the dimensions of service quality on Banking and Loan recovery in Commercial Banks of Delta Districts, Tamilnadu.

3. To identify the mediated effects on service quality on Banking and Loan recovery in Commercial Banks of Delta Districts, Tamilnadu.

4. To suggest suitable strategic model for improving service quality on Banking and Loan recovery in Commercial Banks of Delta Districts, Tamilnadu.

1.11. Research Questions

The following research questions are quite relevant to the crucial purpose of the study and seeking to understand the mediating effects of Service Quality
on Banking and Loan recovery in Commercial Banks of Delta Districts, Tamilnadu

1) What are the various factors/service dimensions affecting Service Quality on Banking and Loan recovery in Commercial Banks of Delta Districts, Tamilnadu?

2) What is the mediating factor (service dimension) for Service Quality on Banking and Loan recovery in Commercial Banks of Delta Districts, Tamilnadu?

3) What are all the relationship between the Customer Satisfaction and Service Quality?

4) What are all the most influential factor(s) for Customer Satisfaction?

1.12. Proposed Conceptualized Research Model

There are 9 dimensions were framed for this study. Those are; i) Tangibles, ii) Deposits and Schemes, iii) Location and Place, iv) Credit Facilities and Loan Recovery, v) People, vi) Technology, vii) Corporate Social Responsibility, viii) Customers Satisfaction and ix) Quality of service. Here Demographic variables, Tangibles, Deposits and Schemes, Location and Place, People, Technology, Corporate Social Responsibility and Customer Satisfaction are independent variables and Credit Facilities and Loan Recovery and Quality of service are the dependent variable. It is studied that how and what extent the independent variables make changes in the
dependent variable. The proposed conceptual research model shows the process of research as follows:

**Figure: 1 Conceptual Model**

1.13. Structure of the Thesis

**Chapter I**: This chapter deals with a general introduction and background of the study about global, national and regional trends in commercial banking industry. Besides the above, this chapter gives a brief account of the institutional factors, significance of the study, statement of problem of the study, limitations of the present study and finally outlines of the structure of the study.

**Chapter II**: Reviews literature with respect to the commercial banking service quality and the customers’ satisfaction. Presents various important factors affecting the performance contained in works of several researchers,
identifies the gap in past research, outlines the objectives of the study, the previous empirical findings and thoroughly examines the models developed to analyze.

*Chapter III*: Presents a detailed discussion of research design, the research hypotheses to be tested and the methodology used to test the critical factors affecting performances and its hypotheses present a simple conceptual model for testing the critical dimensions.

*Chapter IV*: Summarizes the outcomes of the statistical and econometrical analysis that are used to test the hypotheses.

*Chapter V*: Identifies the findings of the study pertaining to the hypotheses, the implications for the sector as a whole and individually, drawn from the findings of the research, recommendations for future research and conclusions of the study.

1.14. **Conclusion**

This chapter examined the key dimensions of Service Quality on Banking and Loan recovery in Commercial Banks of Delta Districts, Tamilnadu. The Research problem is discussed with the objectives for the study and the variables associated with conceptual model, significance of the study are clearly defined. The following chapter will review the literature of previous studies and the propositions are hypothesized to capture the dimension of the proposed model effectively.