# Chapter 1
## Introduction

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## 1.1 Introduction

In a business environment that is characterized by intense competition, building customer loyalty has become a key area of focus for most financial institutions. The explosion of the services sector, changing customer demographics and deregulation and emergence of new technology in the financial services industry have had a critical impact on consumers’ financial services buying behaviour. The changes have forced banks to modify their service offerings to customers so as to ensure high levels of customer satisfaction and also high levels of customer retention. Banks have historically had difficulty distinguishing their products from one another because of their relative homogeneity; with increasing competition, the problem has only
intensified with no coherent distinguishing theme. Rising wealth, product proliferation, regulatory changes and newer technologies are together making bank switching easier for customers. In order to remain competitive, it is important for banks to retain their customer base.

This chapter introduces the background of the study followed by the statement of the problem which gives an insight into the research area. The chapter also discusses the research questions and the objectives of the study. The disposition of the thesis is presented at the end of the chapter.

1.2 Overview of Indian Retail Banking Industry

Banks play a dominant role in India’s financial system and are expected to play a key role in furthering the agenda of financial inclusion with a view to achieving inclusive growth and development. The banking system in India is as old as the Vedic times, during which period the transition from money lending to banking, it is believed, took place. During the Mughal period, the indigenous bankers played a very important role in not only lending money but also financing foreign trade and commerce. The agency houses carried out banking business during the days of the East India Company. The Reserve Bank which is the Central Bank was created in 1935 by passing the Reserve Bank of India Act 1934. The first bank in India, though conservative, was established in 1786. From 1786 till today, the journey of Indian Banking System can be segregated into three distinct phases. They are the early phase from 1786 to 1969 of Indian Banks, the nationalization of Indian Banks and up to Indian banking sector reforms and the third phase is the new phase of Indian Banking System with the advent of Indian Financial & Banking Sector Reforms.
The country followed a socialist approach for well over 4 decades after independence till the economic reforms were initiated in the country by opening the door for liberalization. The government nationalized the banks in two different phases (1969 and 1980). In 1969, fourteen major banks of the country were nationalized and in 1980, six more commercial private sector banks were taken over by the government. The nationalized banks had a social obligation of taking the banking sector to the people by expanding the bank branches and by encouraging more people to open accounts. It also had to play a supportive role to other sectors of the economy like agriculture, small scale industries and exports.

The financial sector reforms following the Narasimhan Committee Report in 1992, resulted in a lot of regulatory, structural and technological changes in the banking environment in the country. The reforms led to the introduction of internationally accepted banking practices in the country, liberalized norms for entry of private sector banks, liberalized policy towards foreign banks which wish to open offices in India, greater freedom to banks to determine their deposit and loan rates, greater freedom to banks to decide on their product range and deregulation of the interest rate structure. The Figure 1.1 shows the different phases of the evolution of the Indian Banking Industry.
Chapter 1

**EVOlUTION OF THE INDIAN BANKING INDUSTRY**

**TRIGGER EVENTS**
- Beginning of institutional banking with 3 joint stock banks

**PHASES**
- Phase 1: Pre Nationalisation Phase
- Phase 2: Era of Nationalisation and Consolidation
- Phase 3: Introduction of Indian Financial & Banking Sector Reforms and Partial Liberalisation
- Phase 4: Period of Increased Liberalisation

**MAJOR CHANGES**
- Birth of joint stock banking companies
- Introduction of deposit banking in joint stock banks
- Presidency banks and other public sector banks formed the foundation of modern banking
- State Bank of India formed from Imperial bank
- 20 SCBs nationalised in 1980
- Directed credit program to spur economic growth
- Introduction of social security
- Major changes in prudential regulations
- Interest rates deregulated
- Statutory provisions eased more and more came in streamlining the system as a whole
- FDI ceiling increased
- Roadmap for full banking reforms

**Acceptance of recommendation of the Narasimham Committee**

**Hike in the FDI ceiling for banking sector and declaration of roadmap for liberalisation**

**Phase 4 continues-more liberalisation expected**
The retail banking sector is characterized by three basic characteristics: multiple products (deposits, credit cards, insurance, investments and securities); multiple channels of distribution (call center, branch, ATM, internet banking, mobile banking) and multiple customer groups (consumer, small business, and corporate). There are currently 89 scheduled commercial banks in the country, with a total of 92114 offices. The State Bank of India and its associates include 6 banks; there are 20 nationalized banks, 20 private sector banks, (13 old private sector banks and 7 new private sector banks) and 43 foreign banks in the country as on March 2013. The Figure 1.2 shows the structure of the Indian banking industry.
Source: D & B Industry Research

Figure 1.2 Structure of the Indian Banking Industry

Retail banking in India has taken a giant leap from the days of standing in bank queues for several hours for opening a saving account, withdrawing cash from account or trying to get some fixed deposits (FD) done. A paradigm shift in banking operations has been brought in by the tremendous advances in technology and the aggressive infusion of information technology in recent years. Information technology has emerged as a strategic resource for
achieving higher efficiency, control of operations, productivity and profitability in banking operations. Banks today offer their customers not only anytime banking but also anywhere-anytime banking through the application of information technology. The financial services have increased manifold and now people have the choice to choose the service that most suitably fits the bill. The major drivers of the retail banking industry are economic growth and consequent increase in prosperity, changing consumer demographics and technological advancements. Until the banking sector reforms were introduced in 1992, the banking customers were offered standardized products and regulated interest rates. The reforms resulted in increased competition among banks in terms of product and service offerings and branch network. The influx of consumerism has resulted in increased demand of retail banking products—cards, loans, customized products and services. Traditional branch banking has changed. A number of banks have adopted a new model of branch banking, where one would find that only a small space is reserved for self service area and the rest is used for activities related to sales. With increased competition and relative homogeneity associated with banking products and services, retail banks have been finding it difficult to retain customers as customers have plenty of choices available. Pricing and basic service are becoming less important factors while customer and relationship orientation are becoming increasingly significant. Banks are now focusing on enhancing service quality and using different marketing strategies to retain customers.

1.3 Background of the Study

The financial services sector is the foundation for any economy and plays the role of mobilization of resources and their allocation. The Indian
Banking Sector is quite different from the banking system in the rest of Asia, because of the distinctive geographic, social and economic characteristics of the country. Post liberalisation and globalisation, there has been a great amount of regulatory, structural and technological changes that have taken place in the banking industry. The retail banking sector in India has emerged as one of the major drivers of the overall banking industry and has witnessed enormous growth. However, the relative homogeneity of banking products and services and the growing competition has made the banking industry very susceptible to customer switching behaviour (Chakravarty, Feinberg & Rhee, 2004). Customer switching has been related to perceptions of quality in the banking industry (Rust & Zahorik, 1993). Switching behaviour has a negative impact on the banks’ market share and profitability (Ennew & Binks, 1996) as the costs of acquiring customers are much higher than the costs of retaining customers (Reichheld & Sasser, 1990).

When customers switch, the business loses the potential for additional profits from the customer (Reichheld & Sasser, 1990), the initial costs invested in the customer by the business get wasted (Colgate, Stewart & Kinsella, 1996) and additional costs have to be incurred by the business for acquiring new customers as replacement (Fornell & Wernerfelt, 1987). These additional costs include the cost of setting up accounts; costs of explaining the procedures of the company to the customers; costs of inefficient dealings by the customer till the procedures of the business are learned (Mittal & Lassar, 1998). Besides these savings, customers who stay with a business generate increasingly more profits each year they stay with the business (Reichheld & Sasser, 1990). When customers switch, they carry along with them their revenue generating potential. Customer retention also has other advantages
such as customers are less motivated to search for alternatives; they become more resistant to persuasion by competitors and they also engage in positive word-of-mouth communication thereby benefiting the business (Dick & Basu, 1994).

Services present a more difficult situation to understand switching behavior as compared to products. This difficulty arises because of the differences between services and products which makes it difficult to understand the basis of consumer choice in the case of services. In the case of services, what is given and what is received are intangible and therefore the assessment of the value received by the customer is very subjective. There is also a high degree of heterogeneity in services as the experiential component is dominant in services. Services, often, occur in the presence of the customer and this inseparability of service production from consumption makes it impossible to evaluate services before consumption.

Over the last few years, the profile of the Indian consumer has undergone a major transformation. The traditional debt-averse Indians who lived within their thrifty means, never to venture beyond their means, seem to have given way to a new consumer who is free from all inhibitions regarding conspicuous consumption. In addition when compared with the past, consumers today are more knowledgeable, demand not only better value but also value for money. The dynamism of the environment makes customers experience various triggers which sensitize them about their relationship with their service provider. Customers today are no longer naïve to remain with a service provider and are willing to shift their purchases from one provider to
another in search of better service or courtesy or for any other variety of reasons (Roos & Gustafsson, 2007).

A McKinsey 2011 survey reported that even though 96% of Indians appeared satisfied with their banks, there was a dramatic drop in customers’ willingness to recommend their banks to other customers from 91% in 2007 to just 71% in 2011 indicating a lower loyalty to their banks. According to a survey conducted by Capgemini and EFMA, globally, nearly 10% of customers said they were likely to switch banks within the next six months, while more than 40% were not sure if they would stay with their bank in the next six months. In the Asia Pacific region alone, only 35% were sure that they would not leave their primary bank within the next six months. This means that a huge 65% of customers in the region are not confident that they will stay with their existing primary banks. This is very disturbing for banks as losing customers will impact their profits and success.

There is hardly any doubt that banks need to retain customers in order to remain competitive. Customers’ perception of service quality influences their intention (Henning-Thurau & Klee, 1997) and behaviour (Bitner, 1990). The prevailing consensus in the services literature is that switching from one service provider to another (Keaveney, 1995) involves a cognitive process that is initiated by a sensitizing stimuli called trigger (Roos, 1999). The trigger sensitizes the customer and puts the customer on a switching path. The presence of relational and contractual bonds on the other hand makes customers want to continue their relationship with the service provider. Consumer behaviour being a complex, dynamic, multidimensional process, understanding customers’ consumption process, their perception of the quality
of service they receive and their consequent behavior is rather complex and therefore developing a theory that completely explains consumer switching behaviour is difficult. It is important for banks to understand how customers form perceptions of service quality, what the different elements of service quality are, how triggers influence their perceptions of quality and how service quality and commitment influence behavioural intentions.

1.4 Statement of the Problem

Switching refers to the decision that a customer makes to stop purchasing particular products or services from a firm or stop patronizing the firm completely (Bolton & Bronkhurst, 1995; Boote, 1998). In the retail banking context, customer switching happens when customers close their account with a bank or when customers move their account from one bank to another bank. The decision to switch a service provider is not a clear cut decision made by the customer and most often not the result of a single critical incident (Keaveney, 1995). Gerrard and Cunningham (2004) argued that empirical investigation indicates that with customers of banks, switching is less likely to be as a result of a single incident because customers normally develop bonds with their banks due to the existence of their accounts and the contractual nature of the relationship (as cited in Gerrard & Doyle, 1990 and Laidlaw & Roberts, 1990). Switching is a dynamic process which involves multiple problems encountered over time (Colgate & Hedge, 2001; Keaveney, 1995). The multiple problems are not evaluated in isolation by customers in their switching decision. Keaveney’s work suggests that combination of factors interact to cause switching behavior. Switching therefore is not a static phenomenon but a complex process, an understanding of which is very
important to prevent customers from switching. Determinants of customer switching behavior are classified in literature into two broad groups of antecedents: economic or cognitive and social or affective (Bolton, Lemon & Verhoef, 2004). Economic determinants focus on the economic value of the relationship with the firm (Bolton & Lemon, 1999) and social determinants consider more social and affective aspects such as trust and commitment (Verhoef, 2003), which together constitute a relationship quality construct.

In the financial services context, service providers tend to be viewed as relatively undifferentiated because of the homogeneity of offerings, and hence service quality becomes very relevant to competitive advantage (Almossawi, 2001; Stafford, 1996). Financial services, because of the characteristics of services as opposed to products, are difficult to evaluate and their assessment depends on experience and credence quality (Parasuraman, Zeithaml & Berry 1985; Zeithaml, 1981). Parasuraman et al. (1985) argued that the service quality attributes of search, experience, and credence are used by consumers to evaluate service quality. Search attributes, such as physical facilities, appearance of personnel, and the supplier's image are considered by customers before consuming the service. Experience attributes, like responding quickly to a request and performing a service at the agreed time are assessed on the basis of the actual service experience. Finally, credence attributes like financial security of an investment cannot be determined even after repeated use of a service. In this respect, services are difficult to evaluate because they contain many experience and credence attributes and because the actual service varies from one customer to the other (Zeithaml, 1988).
Gerrard and Cunningham (2004) in their study reported that in the Asian banking market 90% of switching happens due to pricing, service quality and inconvenience. In the Indian context, pricing is largely regulated by the Reserve Bank of India and therefore service quality becomes a dominant factor for customer retention. Higher levels of service quality lead to higher revenues, increased cross-sell ratios, higher customer retention (Bennett & Higgins, 1988), customer loyalty (Lewis, 1993) and expanded market share (Bowen & Hedges, 1993). There is a constant demand for better service quality from the banking industry through better product offerings and value-added services which has led financial institutions to reexamine their current business practices (Brown & Kleiner, 1997). Customer retention can only be achieved through delivering high quality services (Lassar, Manolos & Winsor, 2000; Rust, Zahorik & Keiningham, 1995) especially under unregulated and volatile financial market conditions (Colgate & Lang, 2001). It is therefore imperative for banks to identify and manage the service quality dimensions which would lead to competitive advantage with their customers. Service quality has not been extensively explored in the Indian context (Jain & Gupta, 2004). Although researchers have studied the concept of service quality for decades, there is no single conceptualization of service quality (Cronin & Taylor, 1992; Rust & Oliver, 1994). Different researchers have focused on different aspects of service quality. Consumer behaviour is largely influenced by culture and context and hence it becomes very important to identify the indicators that form the measure of service quality. The SERVQUAL scale has been extensively used to study service quality in different settings, but Imrie, Cadogan and Mcnaughton (2002) suggested that the use of SERVQUAL scale globally be avoided and instead scales of service quality which are relevant to
the culture and context be developed. Angur, Nataraajan and Jaheera (1999) reported that the use of SERVQUAL scale has a poor fit with empirical data in the retail banking context. Perceived service quality, especially in retail banking sector, has been found to be a culture and context specific construct (Furrer, Liu & Sudharshan, 2000; Glaveli, Petridou, Liassides & Spathis, 2006) and is influenced by cultural and environmental factors.

A customer relationship is a dynamic process which involves the interaction between a service provider and customers (Bolton, 1998; LaBarbera & Mazursky, 1983; Rust, Inman, Jia & Zahorik, 1999). In this process, it is not just the purchase or exchange itself between two parties that is relevant to investigate; the entire consumption process, i.e. the influences on consumers before, during and after a purchase, are relevant to understand consumer behavior (Solomon, Bamossy, Askegaard, & Hogg, 2010). When switching is viewed as a process, there has to be a starting point for the switching process which make customers enter a switching path (Roos, Edvardsson & Gustafsson, 2004). Roos and Gustafsson (2011) argued that a cognitive process is based on an ignition and this cognitive process results later on as switching the service provider. This starting point or ignition is the switching trigger that sensitizes the customer to consider switching to another service provider (Roos et al., 2004). The triggers alert the customers to some gap in their expectations and the actual performance of the service provider which makes them reassess the service quality of the provider. The effect of triggers on service quality and how the triggers cause the evaluation process to change has not been investigated much and hence an exploration of these linkages can help to better understand the customer switching process. A focus
on triggers that influence customer relationships can help fill the gap of understanding of perception changes among customers.

Customers show favorable or unfavorable behavioral intentions towards their service provider (Ladhari, 2009; Zeithmal, Berry, & Parasuraman, 1996). Favorable behavioral intention leads to customer loyalty resulting in increased business and positive word of mouth for the service provider. Unfavorable behavioral intentions on the other hand, lead to switching and negative word of mouth (Zeithmal et al., 1996). The behavioral intentions of customers are capable of predicting actual behavior and hence can be considered to be a proxy for actual behavior (Ajzen, 1991). It is necessary for service providers to be aware of what various behavior signals indicate concerning switching so as to prevent customer switching (Roos, 1999). There is ample evidence in literature suggesting the relationship between service quality and behavioural intentions (Bansal & Taylor, 1999; Bitner, 1990; Bolton & Drew, 1991). To avoid the negative effects of customer switching and maintain a loyal customer base, service providers have been focusing on strategies to increase customers’ commitment towards the service provider. Consumer commitment is a psychological sentiment that makes the customers continue the relationship with the service provider.

Most research on service provider switching has been limited to tests of nomological, measurement, or predictive validity of service quality-satisfaction models (Bitner, 1990; Boulding, Kalra, Staelin & Zeithaml, 1993; Cronin & Taylor, 1992; LaBarbera & Mazursky, 1983; Zeithaml et al., 1996). Keaveney’s (1995) study explicitly explores the issue of service switching behaviour and provided a foundation for investigation in the area of customer
switching in service industries. The direct linkage between service quality and behavioural intention is known, however, it is important also to understand the influence of triggers on service quality perceptions and consumer commitment on the linkage between service quality and switching intentions. Thus, the present study explores the major factors leading to customer switching and examines the link among the triggers, perceived service quality, consumer commitment and switching intentions in the context of retail banking.

1.5 The Research Questions

From the background of the study and problem statement, the research questions and the objectives of the research were developed. The overall objective of the research was to develop a theoretical framework to study the linkage among switching triggers, perceived service quality, consumer commitment and switching intention.

Service quality is the consumer’s assessment of the overall superiority of the service provider and depends on the consumption process that the customer goes through. To understand customers’ overall judgment about the superiority of the service provider, it is important to understand the key underlying dimensions which customers perceive as important while assessing the quality of the service provider in the present retail banking environment. This led to the first research question:

“What are the relevant dimensions of bank service quality perceived as important by bank customers?”

Customers enter a switching path and begin to consider switching to another bank, when they experience a trigger. The triggers may arise from
different sources. To examine the influence of triggers on perceived service quality, the various triggers that bank customers experience needed to be identified. The second research question in the study was:

“What are the different switching triggers that bank customers experience which initiate them on a switching path and how do these triggers influence the different dimensions of perceived service quality?”

Banking is a sector where relational and contractual bonds exist between the bank and customer. In the relationship between a customer and retail bank, customers’ intention to switch depends on the triggers experienced, the perceived service quality of the bank and the consumers’ commitment towards the bank. This led to the last research question in the study which was:

“What are the linkages among switching triggers, perceived service quality, consumer commitment and customer switching intention?”

1.6 The Objectives of the Research

From the research questions, the following objectives were developed for the study so as to develop a theoretical framework that explains the relationships among the different variables.

1) To identify the service quality dimensions that form perceptions of service quality in customers.

2) To identify the various triggers that bank customers experience which make them consider switching to another bank and also to examine the influence of the triggers on perceived service quality.
3) To identify the linkage among switching triggers, perceived service quality, consumer commitment and switching intentions in the retail banking context.

### 1.7 Expected Outcomes of the Study

The objectives of the study were developed such that the analysis would provide valuable insights into the cognitive process of customer switching behaviour. It was expected that the study would help to understand the various dimensions of customer perceptions of service quality in the present retail banking environment and what banks can do to improve customers’ overall banking experience. The study was expected to identify switching triggers and explain the influence switching triggers have on customers’ perception of perceived service quality and also on the dimensions that form the service quality. By establishing relationships among the various variables considered, the study was expected to provide recommendations to banks with respect to the issue of customer switching behaviour in the banking industry.

### 1.8 Scope of the Research

The objective of the thesis was to examine the relationship among triggers that customers experience, their perceptions of service quality, consumers’ commitment and behavioral intentions in the contemporary Indian retail banking context through the eyes of the customer. To understand customers’ perception of these aspects, data were collected from retail banking customers alone for the purpose of analysis, though the banks’ views were considered during the qualitative work carried out prior to the main study. No respondent who is an employee of a banking organization was considered for
the final study to avoid the possibility of any bias that could affect the results adversely. The data for the study were collected from customers who have switched banks and from those who were non-switchers. The study was carried out among retail banking customers in three districts of Kerala representing the northern, southern and central geographic regions.

The retail banking sector was considered as the appropriate sector to study the linkage among triggers, perceived service quality, consumer commitment and switching intentions due to a number of reasons. The Indian retail banking industry caters to the requirements of a large number of customers with varied characteristics and is a service which customers avail on a frequent basis. There are a number of players in the market and intense competition among them to get a share of the retail pie. The presence of alternate service providers who offer similar services makes service quality all the more relevant in the industry. Being one of the major drivers of the Indian economy, the emerging trends in the financial services sector are readily adopted by the banks in the country and hence dimensions that contribute to quality perceptions keep constantly changing.

1.9 Structure of the Thesis

The structure of the thesis is as shown in Figure 1.3. The first chapter gives an overview of the Indian retail banking industry, discusses the background of the study and the statement of the problem with the objectives of the study and expected outcomes.

A review of prior research associated with consumer behaviour, switching triggers, perceived service quality, consumer commitment and
behavioural intentions are discussed in Chapter 2. It includes discussions on how customers make purchase decisions, the various triggers customers may experience and how these triggers may influence their behavioural intentions, the various aspects customers consider while assessing quality of a provider, how commitment creates an attachment to the service provider and the various antecedents of behavioural intentions.
Chapter 3 discusses the theoretical framework of the study. The chapter discusses the variables of the study, the theories underlying their relationships followed by the theoretical framework of the study and the various hypotheses which have been developed with respect to these relationships. A detailed discussion on the research methodology adopted for the study is given in Chapter 4. The chapter includes a summary of the research approach, the qualitative work carried out prior to the main study and the key findings from it, the quantitative work carried out and details of the actual survey process and the data analysis strategy.

The empirical results of the study are discussed in Chapter 5. The chapters begins with the basic findings pertaining to perceived service quality and switching triggers and then moves to the results of hypothesis testing. The final chapter, Chapter 6, discusses the main findings of the study, implications of the findings and scope for future research.