CHAPTER 4

RETAIL BANKING INDUSTRY IN INDIA – A HISTORICAL PERSPECTIVE

This chapter on retail banking industry in India comprehensively explains the Indian retail bank scenario. Starting with the history of Indian retail banking, the chapter deals with the features of select retail products, their markets along with a SWOT analysis of the different banks taken for the study. It brings out the different marketing strategies followed by different banks in satisfying customer requirements.

4.1 INDIAN BANKING SYSTEM – AN OVERVIEW

The Indian Financial System is broadly classified into two groups:-

a. Organized sector
b. Unorganized sector

4.1.1 Organized Sector

The organized financial system consists of (a) users of financial services and (b) providers of financial services. Financial institutions sell their services to households, business houses and government who are the users of financial services. The providers of financial institutions services comprises of:

i. Reserve Bank of India (RBI) or Central Bank
ii. Banks
iii. Financial institutions
iv. Money and Capital markets
v. Informal financial enterprises

The organized financial system comprises the following subsystems:

i. The banking system
   a. Public Sector
   b. Private Sector
ii. The co-operative system
iii. Development banking system
iv. Money markets
v. Financial companies/institutions

4.1.2 Unorganized Sector

The unorganized financial system comprises of moneylenders, indigenous bankers, lending pawnbrokers, landlords, traders, etc., there are also a host of financial companies, investment companies, chit funds, etc. in the unorganized sector and these are not regulated by the Central Bank or the government in a systematic manner. This banking system is an integral sub-system of the financial system of the country. It represents an important link; collecting small savings from the households and lending it to the needy.

4.2 THE RESERVE BANK OF INDIA (RBI)

The Indian Banking system has the Reserve Bank of India as the apex body for all matters relating to the banking system. It is the ‘Central bank’ of India and is the banker’s banker and banker to the Government. The functions of RBI includes issuing currency, banker to the Government, banker to other banks, framing of
4.3 THE STRUCTURE OF BANKING SYSTEM IN INDIA

The banking system in India with Reserve Bank of India as the apex body can be classified as scheduled banks and non-scheduled banks. Scheduled banks can be classified as co-operative and commercial banks. Commercial banks are classified as Indian banks and foreign banks. Indian banks are further classified as private sector banks and public sector banks. Public sector banks comprises; SBI and its subsidiaries, Nationalized banks and regional rural banks. The structure of the banking system in India is pictorially represented in Figure 4.1.

4.3.1 Non Scheduled Banks

These banks are not included in the second schedule of the Banking Regulation Act, 1965, which imply that they do not satisfy the conditions laid down by that schedule. They are further classified as:

i. Central Co-operative Banks and Primary Credit Societies.

ii. Commercial Banks
### 4.3.2 Scheduled Banks

Scheduled banks are banks, which are included in the second schedule of the Reserve Bank Act, 1934. In terms of Sec. 42(6)(a) of the Reserve Bank of India Act, a bank should fulfill the following conditions:

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1 Figures in brackets indicate number of banks in each group.
Source: Report on trend and progress of banking in India, 2001-02.
i. It must have a paid-up capital and reserves of an aggregate value of not less than Rs. 5 lakhs;

ii. It must satisfy RBI that its affairs are not conducted in a manner detrimental to the depositors;

iii. It must be a state co-operative bank or a company under Companies Act, 1956 or an institution notified by the Central government on its behalf or a corporation or a company incorporated by or under any law in force in any place outside India.

The scheduled banks enjoy certain privileges like approaching RBI for financial assistance, refinance, etc. and correspondingly, they have certain obligations like maintaining certain cash reserves as prescribed by the RBI, submission of returns, etc. Scheduled commercial banks in India comprise of, State Bank of India and its associates, the nationalized banks, foreign banks, private sector banks, co-operative banks and regional rural banks.

Scheduled banks are further sub-divided as:

4.3.2.1 Co-operative Banks

These Co-operatives are owned and managed by the state. The co-operative banking sector has been developed in the country in order to replace the village moneylenders. The co-operative banking sector in India comprises of the following:

i. State Co-operative banks

ii. Central Co-operative Banks

iii. Primary Agriculture Credit Societies

iv. Land Development Banks

v. Urban Co-operative Banks

vi. Primary Agricultural Development Banks

vii. Primary Land Development Banks

viii. State Land Development Banks
4.3.2.2 Commercial banks

These are business entities whose main business is accepting deposits and extending loans. Their main objective is profit maximization and adding shareholders value. These are further classified as:

4.3.2.2.1 Indian Banks

These banks are companies registered in India under the Companies Act. Their place of origin is in India. They are also sub-divided as:


b. Other Nationalized Banks: This group consists 20 banks of which 14 banks were nationalized in 1969 and another 6 in the year 1980. Later, New Bank of India got merged with Punjab National Bank. So at present there are 19 Nationalized banks other than State Bank of India and its associates².

c. Regional Rural banks: Established by RBI in the year 1975 of Banking Commission. It was established to operate exclusively in rural areas to provide credit and other facilities to small and marginal farmer, agricultural labourers, artisans and small entrepreneurs.

d. Old Private Sector Banks: This group consists of banks that were established by the erstwhile princely states, community organizations or by a group of professionals for the cause of economic betterment

² Banking Briefs, October 2002, State Bank Staff College, India
in their area of operation. Initially their operations were concentrated in a few regional areas. However, most of them have expanded and have their branches all over the country.

e. New Private Sector Banks: These banks were started as profit oriented companies after the RBI opened the banking sector to private investment. These banks are mostly technology driven and well managed.

4.3.2.2.2 Foreign Banks

These are banks that are registered outside India and have their origin in foreign countries but operate also in India. Some of those banks are Citi bank, Standard Chartered/ ANZ Grindlays bank, ABN Amro bank, Bank of America, American Express bank, etc.

4.3.2.2.3 Development Banks

These banks provide long-term capital for industries and agriculture. These development banks were specifically meant to satisfy the specific requirements of these sectors on a large scale. These banks are:

i. Industrial Finance Corporation of India (IFCI)
ii. Industrial Development Bank of India (IDBI)
iii. Industrial Credit and Investment Corporation of India (ICICI)
iv. Industrial Investment Bank of India (IIBI)
v. Small Industries Development Bank of India (SIDBI)
vi. SCICI Ltd.
vii. Export Import Bank of India (EXIM)
viii. National Housing Bank (NHB)
4.4 NON BANKING FINANCIAL COMPANIES (NBFC)

These are companies that mobilize and channel savings into investment. They are partly controlled by the Reserve Bank and partly by the Registrar of Companies under the Companies Act. Over years, the structure of financial institutions in India has developed and become broad based. Today, there are more than 4,58,782 institutions\(^3\) channeling credit into the various areas of the economy which include chit funds, nidhi\(^4\) etc.

4.5 HISTORY OF BANKING IN INDIA

Major milestones of Indian Banking Industry are presented in Table 4.1. It indicates the pattern of growth.

4.6 WHY RETAIL BANKING?

Until recently bankers in India focused their attention only on lending to larger accounts. Intensified competition in the market segments necessitated bankers to divert their attention from the conventional larger accounts to newer frontiers such as retail financing and thus emerged retail banking.

Retail banking refers to lending to individual customers for meeting their personal requirements such as Savings and fixed deposits, Credit cards, Loans for buying vehicles, houses and consumer durables.

4.7 HISTORICAL PERSPECTIVE OF RETAIL BANKING

Banking is as old as trade itself, but; banking origin as we know of today dates back to 1171 in Venice when the first institution similar to a modern bank was

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4. “nidhi” is a non-banking financial institution mostly in the unorganized sector.
<table>
<thead>
<tr>
<th>Dates</th>
<th>Important milestones</th>
</tr>
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<tbody>
<tr>
<td>January 1, 1949</td>
<td>The Reserve Bank of India is nationalized by an Act of Parliament</td>
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<tr>
<td>September 4, 1951</td>
<td>The government announces its plan to seek developmental loans from the World Bank.</td>
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<tr>
<td>July 1, 1955</td>
<td>The State Bank of India comes into existence, taking over the Imperial Bank operations.</td>
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<td>1956</td>
<td>Life Insurance companies are nationalized and brought under Government control.</td>
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<tr>
<td>July 3, 1964</td>
<td>IDBI is set up</td>
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<tr>
<td>June 6, 1966</td>
<td>Rupee is devalued by 36.5% to Rs.7.50 from Rs.4.76 to a dollar</td>
</tr>
<tr>
<td>1973</td>
<td>The foreign Exchange Regulation Act comes into effect.</td>
</tr>
<tr>
<td>January 11, 1978</td>
<td>Currency notes in denominations of Rs.1,000, Rs.5,000, Rs.10,000 are withdrawn from circulation.</td>
</tr>
<tr>
<td>1987</td>
<td>To mobilize resources for meeting drought related expenditure the Government of India introduces 9% Relief Bonds.</td>
</tr>
<tr>
<td>April 1988</td>
<td>To mobilize untapped rural savings a new instrument, Kisan Vikas Patra is launched.</td>
</tr>
<tr>
<td>July 9, 1988</td>
<td>National Housing bank is set up with a share capital of Rs.100 crores entirely subscribed by RBI.</td>
</tr>
<tr>
<td>July 1 &amp; 3, 1991</td>
<td>The RBI had to devalue the rupee in a two-step downward adjustment of 17.38%.</td>
</tr>
<tr>
<td>July 3, 1991</td>
<td>The bank rate, which was dormant since July 1981, is hiked from 10% to 11% and further to 12% on October 8, 1991.</td>
</tr>
<tr>
<td>November 1991</td>
<td>Narasimhan Committee on reforming the financial system presents its report. Among other things it suggests phased reduction of SLR to 25% in three years and CRR to 10% in four years.</td>
</tr>
<tr>
<td>Date</td>
<td>Event</td>
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</tr>
<tr>
<td>April 1992</td>
<td>RBI introduces risk assets ratio system for banks as a capital adequacy measure.</td>
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<tr>
<td>May 1992</td>
<td>Dual exchange rate system is instituted under Liberalized Exchange Rate Management enabling orderly transition from a managed floating regime to a market determined one.</td>
</tr>
<tr>
<td>January 8, 1993</td>
<td>FERA is amended and subsequently repeated and replaced by the Foreign Exchange Regulation (Amendment) Act, 1993. Guidelines for setting up private sector banks are issued.</td>
</tr>
<tr>
<td>March 1993</td>
<td>Rupee is made convertible on the trade account, starting the process of convertibility.</td>
</tr>
<tr>
<td>September 1993</td>
<td>New Bank of India is merged with PNB.</td>
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<tr>
<td>March 1994</td>
<td>With the receipt of a license, UTI bank becomes the first private sector Bank to start operating.</td>
</tr>
<tr>
<td>June 13, 1994</td>
<td>RBI issues guidelines on prudential norms. Banks to achieve minimum Capital adequacy ratio of 6% on their risk-weighted assets and off balance sheet items by March 31, 1995 and 8% by March 1996.</td>
</tr>
<tr>
<td>July 15, 1994</td>
<td>With the amendment to the Banking Companies (Acquisition and Transition of Undertakings) Act 1970, nationalized banks are allowed to strengthen their capital base by tapping the capital market for public contribution to their capital up to 49%.</td>
</tr>
<tr>
<td>August 1994</td>
<td>Second step towards full convertibility is taken by making the rupee convertible on the current account.</td>
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<tr>
<td>October 1994</td>
<td>Oriental Bank of Commerce becomes the first nationalized bank to access capital market to raise Rs.387.24 crores</td>
</tr>
<tr>
<td>October 1995</td>
<td>Banks are allowed to fix own interest rates on domestic term deposits with maturity of two years.</td>
</tr>
<tr>
<td>July 1996</td>
<td>The Insurance Regulatory Authority is set up to privatize the insurance sector.</td>
</tr>
<tr>
<td>May 9, 1997</td>
<td>RBI issues norms for non-banking finance companies to improve their financial health and viability; they are required to apply for registration with RBI by July 8, 1997.</td>
</tr>
</tbody>
</table>
Table 4.1 (Contd..)

<table>
<thead>
<tr>
<th>Date</th>
<th>Event Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>December 7, 1997</td>
<td>RBI constitutes a working group under the chairmanship of S.H.Khan to examine the harmonization of role and operations of development finance institutions and banks.</td>
</tr>
<tr>
<td>April 24, 1998</td>
<td>The Khan committee on the harmonization of the role and operations of development finance institutions and banks submits recommendations suggesting a gradual move towards Universal Banking.</td>
</tr>
<tr>
<td>August 9, 2000</td>
<td>Banks having a minimum net worth of Rs. 500 crores and satisfying other criteria in regard to capital adequacy are allowed to enter the insurance sector through a joint venture.</td>
</tr>
<tr>
<td>November 10, 2000</td>
<td>Guidelines for banks; financing equities is issued. Banks are allowed to invest up to 5% of its total outstanding domestic credit in capital market.</td>
</tr>
<tr>
<td>January 3, 2001</td>
<td>Revised guidelines for licensing of new banks in private sector are issued. These stipulate a minimum initial paid up capital of Rs.200 crores (to be raised to Rs.300 crores within three years of commencement of business) with a minimum 40% as contribution from the promoter.</td>
</tr>
<tr>
<td>March 15, 2001</td>
<td>Government of India reduces the interest rate payable on relief bonds issued under the 9%, 1999 scheme to 8.5%.</td>
</tr>
<tr>
<td>April 19, 2001</td>
<td>Banks permitted to formulate fixed deposit schemes specifically for senior citizens offering higher and fixed rate of interest.</td>
</tr>
<tr>
<td>April 28, 2001</td>
<td>RBI clarifies approach to Universal Banking for term lending and refinancing institutions.</td>
</tr>
</tbody>
</table>

established. It began when the Roman Republic fell short of funds during wars, with recourse to forced loans. The contributors to that loan were allowed an annual interest of four percent on the sum they had obliged to lend. A corporation was set up and christened as the Chamber of loans (later known as the Bank of Venice) to oversee this process. Subsequently in 1604, Bank of England was established in London, to provide loans to the government. Bank of Amsterdam was established in 1609, to receive deposits of gold and silver. Banking developed rapidly throughout the 18th and 19th centuries mainly in Europe, due to industrial revolution⁵.

⁵ European financial services round table (EFR-Brussels)
India has a long banking tradition dating back to the Indus Valley civilization. The banking industry can also trace its origin to as early as the Vedic period. It is believed, that the transition from money lending to banking occurred even before Manu, the great Hindu Jurist, who devoted an entire section of his work to deposits and advances and laid down rules relating to rates of interest. During the Mogul period, the indigenous bankers played a key role in lending money and financing foreign trade as well as commerce.

Table 4.2 Nationalisation: A Chronology

<table>
<thead>
<tr>
<th>Year</th>
<th>Event</th>
</tr>
</thead>
<tbody>
<tr>
<td>1949</td>
<td>Enactment of the Banking Regulation Act</td>
</tr>
<tr>
<td>1955</td>
<td>Nationalization of State Bank of India</td>
</tr>
<tr>
<td>1959</td>
<td>Nationalization of SBI subsidiaries</td>
</tr>
<tr>
<td>1961</td>
<td>Insurance cover extended to deposits</td>
</tr>
<tr>
<td>1969</td>
<td>Nationalization of 14 major banks</td>
</tr>
<tr>
<td>1971</td>
<td>Creation of Credit Guarantee Corporation</td>
</tr>
<tr>
<td>1975</td>
<td>Creation of Regional Rural Banks</td>
</tr>
<tr>
<td>1980</td>
<td>Nationalization of 6 banks with deposits over Rs.200 crore</td>
</tr>
</tbody>
</table>

4.8 INDIAN BANKING: THE GROWTH PHASE

The growth phase of Indian Bank is classified as the phase before nationalization of banks, the period after nationalization of banks and the emergence of private banks which is described below.

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6 Manu is a Hindu jurist who framed the rules and regulations for public governance in ancient India
7 Ancient Indian history by Varshney
8 Banking Compendium, Reserve Bank Administrative Staff College, Mumbai
4.8.1 Before Nationalization of Banks

The first joint stock bank, The General Bank of India, was established in the year 1786. Subsequent to this, Bank of Hinduism and Bengal Bank were set up. During the middle of the 19th century, the British East India Company established three banks: The Bank of Bengal in 1809, The Bank of Bombay in 1840, and Bank of Madras in 1843. All these operated as private shareholders banks in which the shareholders were mostly Europeans. The banks were independent units and were named as the Presidency Banks. The three Presidency banks were amalgamated in 1920, and on 27 January 1921, a new bank, the Imperial Bank of India, was established. At the same time, other banks were also being set up, notable among them are Allahabad Bank established in 1865 and Punjab National Bank Ltd. was established in 1894 with its headquarters at Lahore; were managed exclusively by Indians.

The Reserve Bank of India as a Central bank was nationalized in the year 1935 by the Reserve Bank of India Act; passed by an act of the Indian parliament. In the wake of the Swadeshi Movement, between 1906-1913, a number of other banks with Indian management were established in the country namely, Bank of India, Central Bank of India, Bank of Baroda, Canara Bank, Indian Bank, and Bank of Mysore. The last major commercial bank to be set up in this phase was the United Commercial Bank in 1943. In the period prior to Nationalization of banks, banking history in India was characterized by slow growth and periodic failures. There were as many as 1100 banks, mostly minor banks, which failed during the period from 1913 to 1948. In India, rich business families owned banks in the 60’s; some of them were the banks owned by the Tata family, United Commercial bank owned by the Birla family, and Syndicate bank by the Pais family which were owned and managed by businessmen. The only exception was the State Bank of India, which was known as the Imperial Bank of India before 1955. Businessmen, who owned these banks, channelised most deposits into their own companies, often ignoring the government’s

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9 Large business families who own large manufacturing industries in India
focus areas: agriculture. That neglect was one reason for the nationalization of banks in 1969. Another reason was the then Prime Minister of India, Mrs. Indira Gandhi’s desire to spread the banking habit in rural and semi-urban areas, freeing farmers from the clutches of usurious moneylenders. The Government of India, concerned by the frequent failures of banks in the country causing miseries to innumerable small depositors and others enacted “The Banking Companies Act, 1949”. The title of the Act was later changed as “Banking regulation Act 1949”, as per amending Act of 1965 (Act No.23 of 1965). This Act is the first regulatory step undertaken by the Government to streamline the functioning and activities of commercial banks in India. Reserve Bank of India as the Central Banking authority of the country was vested with extensive powers for banking supervision. In order to revive public confidence in the banking system, Section 45 was enacted in Banking Regulation Act in September, 1960, empowering Government of India to compulsorily amalgamate weak with stronger ones on the recommendations of RBI. After independence, Indian banking was exclusively in the private sector. Along with the Imperial Bank, there were five major banks each holding public deposits aggregating to Rs.100 crores plus; they are the Central Bank of India Ltd., the Punjab National Bank Ltd., the Bank of India Ltd., the Bank of Baroda Ltd. and the United Commercial Bank Ltd. The remaining banks were exclusively regional in character holding deposits of less than Rs. 50 crores.

4.8.2 Period after Nationalization of Banks

In 1955, the Imperial Bank of India was nationalized and re-christened as the State Bank of India by passing State Bank of India Act, 1955. The stated objective was (a) extension of banking facilities on a large scale, more particularly in the rural and semi-urban areas, (b) for diverse public purposes (c) to form State Bank of India. SBI was to act as the principal agent of the RBI to handle all banking transactions of the Union and State governments through the length and breadth of India. This step was in fact in furtherance of the objectives of supporting a powerful rural credit cooperative movement in India as recommended by the “The
All-India Rural Credit Survey Committee Report, 1954". State Bank of India was mandated to open within 5 years in rural areas a target number of branches. Government subsidized the bank for operating non-profit making branches in non-urban centers. The seven banks at that period forming subsidiaries of SBI were nationalized in the year 1959 which enabled one-third of the banking industry under the direct control of the Government of India.

On 19th July 1969 a major process of nationalization was carried, when the then Prime Minister of India, Mrs. Indira Gandhi nationalized fourteen major commercial banks in the country. Subsequent phase of nationalization was carried out in the year 1980, wherein seven banks were nationalized. This augured 80% of the banking industry under government ownership.

India’s banking system has several outstanding achievements to its credit, the most striking of which is its "reach". An extensive banking network has been established in the last three decades, where banking system is no longer confined to metropolitan cities and large towns; but banks are now impacting into the remote corners of the country. In terms of number of branches, India’s banking system is one of the largest, if not the largest in the world today. According to bank economists, during the last 28 years there has been an exponential growth of 800% in the number of branches from 7,219 to 57,000, and deposits taking a quantum jump by 11,000 per cent and advances by 9,000 per cent by the beginning of the millennium10.

An even more significant achievement is the close association of India’s banking system with India’s developmental efforts. The diversification and development of our economy, and the acceleration of the growth process, are in no small measure due to the active role that banks have played in financing economic activities in different sectors11.

10 www.rbi.org.in
11 Dr. Bimal Jalan, ex-Governor RBI in a speech delivered at the 22nd Bank Economists' conference, New Delhi, 15th February, 2001
In spite of these achievements, nationalization of banks also led to change in priorities of banks from profit to that of social development and lending to priority sectors which, lead to large non-performing assets (NPA's) thereby affecting the financial functioning.


4.8.3 Emergence of Private banks

The emergence of private banks began with the banking sector reforms of 1991. It was during the early nineties that the government changed its views on nationalization of banks and consequently allowed the formation of banks in the private sector also. The process of liberalization and deregulation set the tone for the creation of new private sector banks. In 1993-94, the Reserve Bank of India allowed new players in private sector banking, paving way for greater competition and elevation in the levels of banking service and efficiency. Amidst the wave of optimism that swept across the country, this phase saw the setting up of the new private sector banks like ICICI bank, HDFC bank, Global Trust bank, etc.
THE PRESENT SCENARIO OF RETAIL BANKING IN INDIA

In July, 1969 there were a total of 8,321 Nationalized bank branches in India which increased to 65,350 branches\(^\text{12}\) by June, 2000 which is nearly 685\% increase in three decades and presently as on January 2003 there are 67,918 scheduled commercial banks. Of the total bank branches, public sector branches forming 69.9\% accounted for a substantial 82.7\% of the business. There are a total number of 295 scheduled commercial banks in India as on June 30\(^\text{th}\) 2001.

The banking system now manages more than 10,00,000 crores of bank deposits. The bank credit stood at Rs. 4,21,479 crores as on June, 30 2000, according to the report of Trend and Progress of Banking in India published by the RBI in 2001.

Four years ago, when HDFC Bank and ICICI Bank decided to enter retail banking in a big way, not many in the banking sector took them seriously. (They were followed by UTI Bank and IDBI Bank). Today, the way in which HDFC bank and ICICI bank managed their initial years is an extraordinary story of how the upstarts stole the limelight from well-established rivals.

The results speak for themselves. In four years, the four private sector banks have mopped up Rs. 67,688 crore of deposits at a compounded annual growth rate of 64\%. This gives them a 6\% share of the total deposits in the banking system. The nationalized banks with their big branch networks were smartly out-maneuvered by an unlikely vehicle: automated teller machines (ATMs). As customers, tired of waiting in endless queues flocked to these ATMs, these private banks grabbed the opportunity. Today, the private sector banks together account for over 50\% of the ATMs in the country. "The combination of physical and electronic channels helped us widen our

\(^{12}\) Report of Trend and Progress of Banking in India 2000-01, Reserve Bank of India.
reach and also service the customer in a remote manner,” says Chanda Kochar, head of retail ICICI Bank.\textsuperscript{13}

In many ways, these private sector banks find themselves a victim of their own success. The same formula that they used to wean away deposit customers from nationalized banks is now being used against them with deadly effect. While the costs of expanding the branch and ATM networks are mounting, these banks, too, have to contend with the law of diminishing returns now. The levels of competition are catching up, virtually knocking out margins which made entry into retail so attractive even a few years ago. It’s a fact that few of these players themselves are willing to acknowledge in public. But privately, some of them concede that the situation is suddenly becoming a lot tougher.

Private banks jumped into retail primarily to raise low cost deposits so that they could lend at a higher rate to either individuals, or companies. This formed the core commercial banking function. But there was another way these banks could book profits: through treasury operations. Instead of lending money, these banks could invest in safe, risk free bonds issued by the government. It made ample sense, especially because corporations flush with funds simply didn’t need to borrow from banks.

For the past two years, despite the economic slowdown, most banks have survived due to the profits earned from treasury operations. The private banks are no exception. In 1991 UTI Bank reported a pre tax-profit of Rs.213.37 crores, with 53% of that coming from treasury operations. The core retail bank segment generated profits of Rs.36.51 crores\textsuperscript{14}. But this huge dependency on retail operations was unsustainable since sooner or later interest rates are bound to creep up, causing bond prices to fall, thus reducing the value of the bond portfolio that banks hold.

\textsuperscript{13} “India’s Best banks”, December 22. 2002, Business Today, p.72
\textsuperscript{14} “Best banks”, Nov. 25\textsuperscript{th}, 2002, Business India
The obvious answer was to develop a robust commercial banking business that could deliver steady returns. But in recent years, corporate banking margins have gradually thinned. Firms now need far less working capital than before. So banks find retail lending to be the best option available at present. For the private sector banks, the challenges are more acute. At one level, since they were late entrants, they had to invest in building a network to mop up deposits. Instead of trying to compete with the public sector banks by building branches, they opted for a mix of branches and ATMs. Not only was the cost of an ATM transaction lower for the bank, but; the 24/7 (24 working hours per day, 7 days a week) feature helped attract customers.

Now, the dynamics are changing rapidly. State Bank of India has launched a massive ATM deployment plan. Until the beginning of last year, ICICI Bank had the biggest ATM network. But within weeks of chairman K.V. Kamath inaugurating ICICI Bank’s 1000th ATM in Mumbai, SBI had installed 1000 ATMs. As of December 2002, SBI is ahead with over 1,070 ATMs (ICICI Bank contends all its ATMs are networked and accessible across the country by their customers, unlike those of SBI). Private sector bankers now admit that accessibility may no longer be a source of sustainable competitive advantage.

Private sector banks are, thus faced with a difficult situation: unless they continue to expand their network, growing their low cost deposit base will be difficult. Yet costs of expanding the network are proving to be equally prohibitive. With a huge ATM build up in the metros, saturation is now imminent. Geographically expanding into the smaller cities carries a price. Till date, aver bank managers, no one is quite sure whether building the branch and ATM network in the non metro cities is going to pay off.

Besides, in a desperate bid to build up deposits, these private banks ended up messing up their own economics. Typically, most banks prefer a larger proportion of savings and current accounts, as they are far cheaper to service than fixed deposits.
But to attract customers, most private sector banks created so called ‘sweep accounts’. Basically, these were semi fixed deposits that placed any surplus funds from a savings account in a fixed deposit that earned higher interest. While it was a great deal for customers, it added 2-3% straightaway to the bank’s costs. ICICI Bank’s sweep account Quantum Optima, for example, accounted for about 27% of total retail deposits in March 2001, up from 15% in 1999. These accounts are more costly and they basically reduce the profitability of that savings account15.

4.10 PROGRESS OF RETAIL BANKING INDUSTRY IN INDIA

Table 4.5 gives the progress of retail banking industry in India starting from 1972. The table gives the number of retail accounts, retail credit outstanding (lakhs), Number of bank branches and the number of commercial banks starting from 1972 to 1995.

In India, as on March, 2002 there were 361 scheduled commercial banks, 27 Indian public sector banks, 40 foreign banks; 196 regional rural banks, 20 land development banks; and a number of primary agricultural credit societies16. In terms of business, the public sector banks, namely the State Bank of India and the nationalized banks, dominate the banking sector.

Service delivery and Customer delight is probably one of the most debatable issues gripping the banking industry in our country. Quality in financial services sector has gained paramount importance by the increasing marketing profile of bank branch operations over time. The thrust on efficient customer service has increased manifold with the onset of competition from private players and the initiation of banking reforms in India since the early 1990s (Narasmihan Committee). Service industries are playing an increasingly important role in the overall economy.

15 December 22, 2002, Business India, p.68
16 Report on trend and progress of Banking in India, Reserve bank of India, 2001-02.
Table 4.3 Progress of retail banking industry in India

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Source: www.rbi.org.in

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17 www.rbi.org.in
The Indian banking is an essential component of the service industry. The share of banking and insurance within the service industry has burgeoned from 2.78% of GDP in 1980-81 to 6.27% in 1997-98\(^\text{18}\). Interest in the measurement of service quality is thus understandably high and the consistent delivery of superior service is the strategy that is increasingly being offered as a key to service banks to position themselves more effectively in the market place.

Service is an invisible offering which is dependent on the person who extends it. Services in Indian banks are mostly branch based in the public sector banks, while the Foreign banks are making strides into full-scale technology enabled banking like Net banking. Banking services constitute a hybrid type of offering that consists of both tangible goods and intangible services (like behavior and efficiency of the staff, speed of transactions and ambience).

As at end June 2002, there are 66,186 branches/offices\(^\text{19}\) of schedule commercial banks, as against only 8262 at the time of nationalization in 1969.

It is clear from the table that there has been steady increase in the number of branches and the banking activity over the years as the following graphs\(^\text{20}\) clearly portray.


\(^{19}\) "Developments in commercial banking", Report on trend and progress of banking in India, RBI, 2001-02.

\(^{20}\) www.rbi.org.in
Figure 4.2 Growth of Retail A/c's

Figure 4.2, gives the growth pattern of retail accounts from 1972 to 1995. There is blip during 1990 to 1995 in the number of retail accounts.

Figure 4.3 Retail Credit O/s (Lakhs)
Figure 4.3 gives the total credit outstanding from the year 1972 to 1995. The growth curve shows a steady increase in the credit outstanding of the banks during the period. The growth is seen to be steeper from 1991 onwards. This may be attributed to the liberalization of the banking sector and opening up of the banking industry to the private sector.

Figure 4.4 gives the growth pattern of commercial banks in India during the period 1972 to 1995 in India. During the period prior to 1972 there were a lot of amalgamations and mergers in the banking industry and consolidation was the norm. In the later stages stability was brought in the banking industry with nationalization of banks.
Figure 4.5 gives the growth in the number of bank branches in the country. There is a steady growth in the period 1972 to 1985 after which the growth in the number of branches slightly declined from 1985 to 1995.

As at the end of September 2002, the number of Indian bank branches operating abroad stood at 93 with 9 Indian banks (8 in public sector and 1 in private sector) operating branches abroad; while, there are 40 foreign banks operating in India with 203 branches. ²¹

With a view to provide an institutional mechanism for promoting rural and semi urban savings as well as provision of credit for viable economic activities at the local level, local area banks where established in the private sector.

²¹ Report on trend and progress of banking in India, RBI, 2001-02.
Thirteen private sector banks including foreign banks and one financial services company were given ‘in principle’ approval for acting as corporate agents to undertake distribution of insurance products on agency basis without any risk participation. One private sector bank was given approval in 2002 for participating in insurance joint venture on risk participation basis.

With a view to improve the customer service in banks, following major measures were taken by RBI in 2003\textsuperscript{22}.

a. Release of assets of deceased customers to legal survivors/claimants.

b. Introduction of accounts and documents for identification instead of insisting on introducer.

c. Banks advised to reduce delay in collection of outstation cheques.

d. Doing away with stapling of currency note packets.

e. Regular updating of savings/current accounts pass books and

f. Reversal of erroneous debits in deposit accounts.

\textbf{4.11 RETAIL BANKING PRODUCTS}

Retail banking product includes lending to individual customers for meeting their personal requirements such as savings and fixed deposits, credit cards, loans for buying, vehicles, houses and consumer durables. Some of the retail product markets are given below.

\textbf{4.11.1 The housing loan market}

Bankers are upbeat about the Housing finance market. Not without reason. Low default rates, unfulfilled demand, increased purchasing power and robust growth

\footnote{\textsuperscript{22}“Developments in commercial banking”, Report on Trend and Progress of banking in India, RBI, 2001-02.}
have made this sector promising. According to industry estimates, the housing finance market in India is witnessing an annual growth between 30-35%. During financial year 2001-02, the National Housing Bank (NHB) has estimated that housing finance companies (HFCs) and banks disbursed about Rs.13,000 crores\textsuperscript{23}. Housing shortage in India is placed at over 19 million dwelling units and the process of economic liberalization has provided an indirect benefit to this sector. With a rise in average salaries aided by booming information technology industry, the housing finance sector has been a major beneficiary. Demand for housing has also got an inducement from the improvement in individual purchasing power. Incidentally, in India the desire to own a house is now getting more pronounced at much younger age. While five or ten years ago, the average age of the borrower would be in the 40-45 years range; it is now in the early 30's. So banks are vying with each other to grab a share of this lucrative market.

4.11.2 The auto loan market

Vehicle financing, which remained largely untapped by commercial banks until recently, has been witnessing the entry of private and public sector banks along with leading non-banking finance companies (NBFCs) over the last couple of years. This has resulted in competitive interest rates, thus driving consumer demand to an extent.

Vehicle financing in India can be broadly categorized into three major segments- commercial vehicles (CVs), cars and multi utility vehicles (MUVs) and two wheelers. Construction equipment and tractors form the other segments. Till the late 90's, foreign banks and Kotak Mahindra had the entire auto loan market. Direct sales commission would seldom exceed 2.5% of the loan. Then ICICI bank came into the market and all the rules broke down. ICICI bank began offering 4.5% as commission to direct sales agents, way above the norm at the time. This meant that all DSAs

\textsuperscript{23} www.indianinfoline.com/comp/, data for sample banks
(Direct Selling Agents) migrated to ICICI bank. Such high commissions meant that agents began to pass on commissions to the customer to gain market-share. So although the official interest rate in the market was around 13-14%, effectively the customer paid only around 11% on his loan, while the rest was borne by the agent.

4.11.3 The debit card market

The dynamics of the market are changing. Card makers have resorted to innovative marketing initiatives to come out on top. The most recent development has been the explosive growth of the debit card market. Unlike a credit card, a debit card (use of the card is linked to available balance in an account) reins in the expenses and this helps the salaried class. The new generation private banks like HDFC bank have eyed the potential in the Indian banking industry through the debit card. Currently India’s banking network boasts of one of the highest bank branch penetration levels globally. With over 60,000 branches and around 130 million bank customers, the market for debit cards is very vast. Of the 2.2 million debit cards in circulation, Visa has around 1.4 million cards in circulation. Master Card has now partnered the country’s largest bank, SBI, to help expand this market. In its bid to broad base usage of the “plastic”, Visa International has already initiated an exercise in smaller towns to popularize card usage.

4.11.4 The credit card market

Plastic is the currency of choice in the consumerist society that we live in today, perhaps barring the icy polar caps, cards are all pervasive and have gained popularity as an important “payment mechanism”. The potential for the plastic is best reflected in the fact that close to 18% of the personal expenditure globally now goes through this method, as against a measly 0.5% in India as per the Report on Trend and Progress of Banking in India, RBI 2001-2002.
In the Indian context, demand for credit was slow to start with, but is now gathering momentum. Having launched its card products under the Visa franchise way back in 1987, Andhra bank is now eyeing a 1.5 lakhs credit card portfolio in the market. Meanwhile not to be left behind, banking giant State Bank of India, which has partnered GE Capital for the card business, is eyeing to be number one in this business within the next five to six years. To woo the 300 million strong Indian middle class segment, - the main base for the credit card industry, banks have resorted to innovative marketing initiatives. Standard Chartered bank, for instance, has co-branded cards with Amway, STAR TV and Syndicate bank. Co-branded cards represent a distinct shift from marketing of plain products to a targeted approach by offering niche products in the market.

Consumer loans currently stand at less than 2% of the GDP\textsuperscript{24} in India. But that is set to increase as loan portfolios are expected to grow at least 25-30% a year. But as Indian banks loosen their purse strings, they need to watch out for a disturbing trend. In many economies, an unchecked rise in personal indebtedness has tended to tip over into personal bankruptcies.

4.12 EMERGING TRENDS IN INDIAN RETAIL BANKING INDUSTRY

The Internet and mobile telephony can not only provide significant competitive advantage for Indian banks and financial institutions in an environment of increasing deregulation and globalization -- but also open the door to new competitors.

Banks need to provide products not just for the private and corporate sectors but also for the masses; here they face new opportunities and new competitors such as retailers. Banks will have to improve their responsiveness to fashion and fads, quicken launch speed, be able to change direction nimbly, and unveil a variety of loyalty schemes.

\textsuperscript{24} Banking briefs, October 2002, State bank Staff College, India
Financial product cycles are getting shorter, and there are more products to launch and support. Efficiency of operation is being supplemented by effectiveness, and an, 'in-house' mentality is giving way to the concept of the extended enterprise. This applies to ATMs, Internet banking, e-commerce gateways, CRM, mobile commerce, financial content, human resource issues, and various other banking operations and channels.

Consumer power is increasing, new intermediaries are cropping up, customer information is becoming a saleable asset, financial and geographical boundaries are diminishing with de-regulation and globalization, and customer loyalty is becoming a key competitive asset. A successfully networked bank builds customer intimacy, enhances information content, and excels in infrastructure and operations.

4.13 SWOT ANALYSIS

The following pages briefly present the strength, weakness, opportunities and threats of banks considered for the study. This study is based on interaction with bank officials.

HDFC bank

Strength

i. Excellent in branch merchandising
ii. Has second largest number of EDC’s (card accepting outlets)
iii. Has a strong brand image

Weakness

i. Does not advertise/poor in publicity
ii. Perceived as a home loan provider
iii. Lack of tie-ups with vehicle dealers
Opportunity

i. Large number of customers have experienced with HDFC home loans and so can effectively tap that segment
ii. Potential exists in NRI segment
iii. Employees are young well educated and can be easily moulded

Threat

i. ICICI bank is expanding in a major way from A class to B and C class cities
ii. Public sector banks have a greater reach
iii. ICICI opening extension counters in colleges
iv. Advertising strategy of ICICI bank

ICICI bank

Strength

i. Catering to the mass market
ii. Largest ATM network
iii. Integration of technology has been done in operations for customer benefit
iv. Aggressive marketing
v. Wide product range
vi. Very high recognition among the urban areas
vii. Wide distribution of branches all over India only second to that of State bank of India
viii. Major thrust on all growth areas like housing finance, vehicle finance and credit cards
ix. A dynamic management
Weakness

i. Branches thinly spread
ii. Due to dramatic increase in the number of customers there is a fall in the service levels
iii. Huge investment required to create infrastructure like ATM's to cope with increased number of customers

Opportunities

i. High visibility in the urban areas
ii. A very effective advertisement and promotion campaign

Threat

i. Competition from the nationalized banks and increasing presence of foreign banks
ii. Emergence of personal banking branches of State bank of India
iii. Unable to attract the segments above fifty years of age

INDIAN OVERSEAS BANK

Strength

i. Head office of the bank situated in Chennai
ii. Has a strong presence in Tamil Nadu and is the Lead bank of the state
iii. Good recognition among people due to long existence
iv. Nominal charges being levied
v. Minimum balance very low
vi. The operating charges are low because break even achieved due to long existence
vii. Has a loyal base of customers for generations
viii. Image not tainted in spite of long years of existence
Weakness

i. Less product variety
ii. Poor awareness of services offered
iii. New technology only sparingly used
iv. Promotional activities not effective
v. Functional quality of staff not as in foreign banks
vi. Environmental quality (ambience, parking space) not good
vii. Many branches not in prime location
viii. Coverage of ATM is less

Opportunities

i. The bank can capitalize on low charges and attract more customers
ii. Experienced staff, full potential to be exploited
iii. The poor performance of Indian bank in the recent past has helped IOB to attract customers from them

Threat

i. The growing prominence of new private sector banks and foreign banks
ii. Aggressive marketing strategies of the new private sector banks and Indian bank in recent years.

STATE BANK OF INDIA

Strength

i. Largest branch network in India
ii. Mass marketing
iii. Has specialized branches like personal banking division for high value customers which allows it to target different segments successfully without clash of interest

iv. A very strong brand image and brand name

v. Bank has adopted technology in a major way

vi. VRS has resulted in the bank increasing its profitability

vii. Has the second largest number of ATM’s in the country

viii. Banker to the government

ix. Has a large number of subsidiaries in allied areas like insurance, mutual fund, leasing, housing, etc.

x. Large pool of trained bank employees both at the managerial and clerical levels who can be deputed for other banks and financial areas without any impact on its own functions

xi. Has the largest number of overseas offices in foreign countries

xii. Has the largest number of branches in India and foreign countries reaching far flung areas

xiii. It has the maximum number of currency chests for ensuring adequate money supply in the different parts of the country where RBI does not have an office

xiv. Nominal charges being levied on customers

xv. Low minimum balance required

xvi. Has achieved break even long back due to long existence

xvii. Has a loyal base of true customers

Weakness

i. Image of a poor man’s bank

ii. Does not provide Value Added Services (VAS) like phone banking in all places

iii. Only 75% of the ATM’s are networked
iv. Size of the bank is also a weakness in getting timely information
v. Some of the branches are located in the rural areas due to government stipulation
vi. In majority of the branches the environment quality (ambience, parking space) not good
vii. Promotional activities not effective
viii. New technology not widely used
ix. Poor awareness of services offered
x. Limited product variety

Opportunity

i. Has seven associates through which it can increase its reach in different bank activities
ii. Being a banker to the government and to its different schemes like pension and PPF it can enlarge its client base through its connections with the government
iii. Bank can capitalize on low charges on transactions and attract newer segments of customers

Threat

i. Increase in number of private banks and foreign banks with latest technology
ii. Foreign and newly formed private banks have high technology content
iii. Aggressive marketing strategies of foreign banks to attract the existing customers
STANDARD CHARTERED/ANZ GRINDLAYS BANK

Strengths

i. Biggest foreign bank in India
ii. Largest client base for credit cards in India
iii. More proactive and have introduced a large number of new schemes and credit cards
iv. A well known brand name in India
v. Has tied up with UTI, IDBI, Citibank to access each other’s ATM’s all over India: which in Chennai totals to 74.
vi. Convenient banking hours (has a 24*365 days branch in Chennai)
vii. Service quality is perceived to be very high
viii. Good product variety
ix. High visibility
x. Accessibility to all price locations
xi. Good Environment (Ambience, parking space and seating arrangement)

Weakness

i. Perception of customers on issues relating to service has become poor
ii. Bank image got dented due to incidents like seizing of property unlawfully
iii. Very few ATM’s on ground
iv. High service charges
v. Target a very small segment
vi. Poor network
Opportunities

i. The banking industry in India has been liberalized and very few restrictions on expansion.
ii. There is a certain aura for the foreign banks in India.
iii. The retail banking industry in India is booming.
iv. Already Standard Chartered/ANZ Grindlays bank has an existing network in the major cities.
v. Target segment could be extended to cover middle income groups.
vi. Network could be increased to tap more customers.
vii. Can reduce charges to tap a larger segment.

Threats

i. The opening up of personalized branches by SBI and other banks providing facilities similar to foreign banks.
ii. Launch of marketing activities in an organized way by other banks.
iii. More banks opening 24*365 day service.
iv. Growth of newly formed private sector banks.
v. Stringent rules and regulations for foreign banks.
vi. Loyalty of Indians towards domestic players.

CITI BANK

Strengths

i. Has a strong image as an innovative and customer friendly bank.
ii. Targets upper class, upper middle and non resident Indians.
iii. Adopts and integrates new technology at a rapid pace.
iv. Second biggest base of credit cards in India a product which has good returns and has achieved a very high growth rate contributing a major share of profits.
v. Largest number of EDC's (card accepting and swapping outlets) in India. Getting significant amount of income, by way of commission
vi. Widest acceptability of credit cards in India
vii. Suvidha account has allowed Citibank to capture a large number of salary accounts
viii. Strong brand name and high recall rate amongst its target audience
ix. Large product variety customized to customers needs
x. Good co-branded credit cards eg. MTV card and IOC card
xi. Product variety is available
xii. High visibility
xiii. Technologically advanced
xiv. Good Environment (Ambience, Parking space, seating arrangement)

Weakness

i. Paucity of branches in India. Branches existing only in the metros and a few other cities like Bangalore, Hyderabad and Chandigarh.
ii. Narrow client base
iii. People perceive its services to be too expensive because of high charges
iv. Launching of the Suvidha account has created resentment among the existing elite clients due to loss of exclusive status offered by Citibank to them

Opportunities

i. The banking industry in India has been liberalized and very few restrictions on expansion.
ii. There is a certain aura for the foreign banks in India
iii. The retail banking industry in India is booming
iv. Already Citibank has an existing network in the major cities
v. Target segment could be extended to cover middle income groups
vi. Network could be increased to tap more customer segments
vii. Has the potential to reduce charges to tap a large segment

Threats

i. The growth of competitors like SCB/ANZ Grindlays in the market place has been phenomenal
ii. The opening up of personalized branches by SBI and other banks providing facilities similar to foreign banks.
iii. Launch of marketing activities in an organized way by other banks.
iv. More banks opening 24*365 day service.
v. Growth of newly formed private sector banks
vi. Stringent rules and regulations for foreign banks
vii. Loyalty of Indians towards domestic banks

4.14 SUMMARY

The retail bank operation in India is on the threshold of a boom as shown in the study. Even though the amount of money involved in retail banking is only 25-30% of the total banking transactions the profit spread is almost double and the number of accounts is more than 85% of the total number of bank accounts. As a result, it becomes all the more important for the bankers to develop a close working relationship with the huge number of retail account holders.

25 www.rbi.org.in