Growth and Knowledge Management Strategy of Indian Commercial Banks: A Non-Parametric Approach

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ABSTRACT

In this paper the author derived short run and long run optimum growth paths from short run and long run growth frontiers using Data Envelopment Analysis (DEA) and investigated the contributing growth factors for all banks also banks segregated into different groups both in short run and long run perspective. The author’s short run as well as long run findings strongly support the role knowledge capital as an important contributor to augment growth for all categories of banks. Knowledge capital forces the firms to adopt heterogeneous strategies results in heterogeneity in performance caused by barriers to imitation and inability of the firms to change the dynamic resource endowments quickly. On the contrary the finding supports the view that firm specific dynamic capabilities acquired through efficient knowledge management acts as a strategic variable for influencing performance of Indian commercial banks.

Keywords: DEA, Dynamic Capability, Growth Frontier, Indian Commercial Banks, Knowledge Management

1. INTRODUCTION

The neo-classical growth theories state that each economy has a steady state growth rate. All most all emphasis was placed on physical capital as the engine of growth, and the stability of the growth is established using flexible neo-classical production function. If the economy is not initially at stead state growth rate the economy will converge to steady state through adjustment in capital-output ratio. This growth rate is the best growth rate of the economy at a point of time, once the economy reaches the steady state per capita capital stock, per capita consumption and per capita income will not grow. These models fail to explain the determinants of long-run per capita growth. In order to overcome the limitation of the existence of long run growth the neo-classical school incorporates exogenous technological progress which is labor-augmenting in nature in the growth arena. The neo-classical growth model envisaged that each economy

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will converge to its steady state and the speed of convergence depends inversely to the distance from its own steady state. It also predicts convergence of economics i.e., economies with low per capita income relative to their steady state per capita income will grow at a faster rate. This sort of analysis completely ruled out the possibility of market failure and strategic complementarities and coordination failures. It eliminates the existence, functioning and the evolution of different economic and social institutions in nursing, augmenting and accelerating the speed for economic growth. Short run dynamics will lead to innovation and evolution in institutions in different social and economic spheres.

The models constructed by Arrow (1962) and Sheshinski (1967) incorporated the concept of learning by doing in the sphere of growth theory where knowledge gathered from learning by doing by a firm or a person will diffuse and spill over to entire economy. The endogenous growth theories developed by, Romer (1986, 1990), Lucas (1988), Rebelo (1991) showed that determinants of growth are endogenous in nature. The experience and learning with production process or investment in human capital contributes to productivity and growth. Endogenous factors cause the aggregate production function to maintain increasing marginal productivity. The main contributing factor is learning by doing, knowledge capital, and the like. Positive growth may persist indefinitely because returns to capital goods do not diminish as economies develop. These theories incorporate R&D theories, human capital, diffusion of technology and imperfect competition into the theoretical and empirical analysis of growth. These models assume technological advance results from purposive R&D activities undertaken by firm, and this action is rewarded by some form of ex-post monopoly power. The study of diffusion of technology states that the follower economies imitate the advances in technology, since imitation is cheaper than innovation and thus leads to convergence in growth rates.

The microeconomic theory tries to answer these questions of the causes of the growth of a firm and that of an industry or a service sector by emphasizing on organizational theory and economic theory. It is generally argued that performance difference arises due to heterogeneity between firms in terms of size, skill, managerial capabilities, etc. Diversities of knowledge, skill, ideas, resources, managerial interest causes diversity in firm productivity, efficiency and growth. Organizational efficiency produces competitive advantage, innovations and improves other economic and financial performance indicators. The proponents of dynamic resource based view of strategy consider that resources and firm capabilities are related to long-run competitive advantage (Wernerfelt, 1984, Dierickx and Cool, 1989; Barney, 1991). Firms through promoting and nourishing rare, heterogeneous and hard to imitate resources by the competitors produce sustainable rent generating competitive advantage. Firm characteristics and firm effects influence the variation in strategies and performance across industries and force firms to adopt heterogeneous strategies results in heterogeneity in performance caused by barriers to imitate and inability of the firms to change the resource endowments quickly. R&D efforts demonstrate the innovative competence of firms and in turn affect the firm performance through the process of conducting knowledge management. Knowledge management literature generally focuses on management’s role as strategists and implementers at the same time it suggests that managerial inaction is damaging to the success of process. The knowledge- based perspective considers knowledge as the most important strategic resource of a firm and is acknowledge as the crucial factor for enhancing the value of a firm (Grant, 1996).

Several strands of research in banking and financial institutions have conducted by researchers in the past to address the issues on the sector. The first strand investigates efficiency of the financial institutions and compares the average DMU with the best practice DMU on the frontier. Efficiency scores are used to high light the causes of low profit, high cost and low revenue of an average institution compared to the best practiced institution and several studies on merger
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