INTRODUCTION

Regulatory changes in the banking industry have been phenomenal and have reduced or eliminated barriers to cross-border expansion, creating a more integrated global banking market. Structural changes have resulted in banks being allowed a greater range of activities, enabling them to become more competitive with non-bank financial institutions. Technological changes have caused banks to rethink their strategies for services offered to both commercial and individual customers.

Kangis and Voukelatos (1997) had suggested that in the future, the blurring of identity between banks, insurance companies, and other possible competitors that will enter in the market, will accelerate, and that customers will shop around more than ever and profitability will come under pressure. The result of this “shopping around” culture, according to Kangis and Voukelatos (1997), will be a higher mobility among customers buying financial products. The authors went on to say that differentiation would continue to lead the marketing strategy of banks, but it would be centred neither on products, as they would be about the same, nor on price, as price differentials would be minimal.

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It is within this rapidly changing environment as foreseen by Kangis and Voukelatos (1997) that service quality issues are compelling the attention of all banking institutions, and retail banks are striving towards increasing customer satisfaction through improved service quality. This is because it is a well-known fact that high quality service stimulates WOM (word-of-mouth) communications by current customers, enhances customers’ perception of value, boosts the morale and loyalty of employees and customers alike and lends credibility to advertising and the field sales force (Berry & Parasuraman, 1991).

Financial Sector Liberalisation in India and Service Quality

The structural reforms initiated in the real sector of the Indian economy in 1991-1992, had a corollary in the reform of the financial sector. It was felt that a robust banking sector is essential for achieving the objectives of growth and development. A liberalised economy will not be adequately served if the banking sector remains highly regulated. In short, there was a need for banking reforms in the wake of economic reforms, as efficiency in both the mobilisation and the allocation of resources was required.

The financial sector reform in India was designed to infuse “greater competitive vitality in the system”. To achieve this objective, the Narasimhan committee, among other things, recommended the liberalisation of entry norms and suggested that new banks be permitted in the private sector provided they conformed to the minimum startup capital and other requirements. The committee recommended too, a liberal policy towards allowing foreign banks to open offices in India. It was believed that the entry of foreign banks would have a beneficial impact from the point of view of improving the competitive efficiency of the Indian banking system as well as upgrading the technology. The committee also suggested that banks be encouraged to go in for term lending which was earlier considered the exclusive preserve of term lending institutions, and term lending institutions were to be permitted to provide working capital too. Since the implementation of many of the recommendations, many new private sector banks have been set up, many foreign banks too have set up shop and many more are waiting in queue to get permission from the Reserve Bank of India.

Since the reforms started, the interest rate structure has been deregulated to a great extent and banks have been given a great degree of freedom in determining their rate structure for deposits and advances, as well as their product range. Phenomenal growth in the capital market has also taken place since 1985. Non-banking finance companies have mushroomed, and have encroached upon the turf exclusively reserved for the commercial banks. Banking has also become more competitive in respect of the pricing of bank products and the location of points of sale, that is, the branch network. The end result is that market power is getting shifted from banks to their customers. The freedom of choice which bank customers did not have earlier because of standardised products and regimented interest rates has been given to the customers as a result of the changes taking place (Subramanian & Velayudham, 1997). Another interesting trend that is being observed in the Indian banking scenario today is the rush into retail banking. Shrinking margins coupled with increasing risks in corporate banking are driving this retail rush. Foreign banks and private sector banks are trying to outdo each other so as to establish themselves in the retail market, with increasingly more and more retail products, like a variety of deposit products, credit cards, debit cards, housing and personal loans, flooding the scene, aiming to satisfy the consumer in every possible way.

In a nutshell, banks are functioning increasingly under competitive pressures emanating from within the banking system as well as from non-banking institutions. The consequent increase in competition has made service quality a key differentiating factor for banks attempting to improve their market and profit positions. In fact, studies have shown that there is a positive service quality-profitability
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