



BARRIERS FOR INTERNATIONAL FINANCIAL SERVICE PROVIDERS ► 1

The financial market in India promises an enormous customer potential. Renowned international banks hence aim to get established on the subcontinent – an objective facing many difficulties. Although a tenth of the Indian population now has the main banking connection with a foreign bank, the expansion plans of international institutes meet a number of hurdles. Their activities are strictly regulated by the state: the shares in Indian banks are generally limited to a maximum of 5%, and organic growth by extending the network of branches is highly restricted. This regulation is particularly meant to provide the public Indian banks with sufficient time to make their business processes more efficient and in line with the market. The existing restrictions are not expected to be lifted before 2009.

Survey: main bank connections

New private bank group	37%
Nationalised bank group	30%
State bank group	16%
Foreign banks	11%
Old private bank group	4%
Cooperative banks	2%

RETAIL MARKET INDIA

Paradise for Foreign Banks?

Since the opening and liberalisation of the Indian economy in 1991 the gross domestic product has doubled, and the economic cycle shows no sign of weakening. Consumer demand grows even more dynamic. A new upward moving middle class has emerged. 70% of the Indian population are younger than 36 years and the subcontinent is home to 20% of the world's inhabitants under 24. The resulting growth potentials look promising for international banks.

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As a sound analysis requires in-depth knowledge of the development and structure of the Indian banking industry as well as the expectations Indians have towards their banks, the authors have conducted a survey of more than 450 urban Indian bank customers in Bangalore.

Public banks dominate the market

After the independence from the British colonial power in 1947 the Indian government at first believed that non-public banks would provide loans only to well-known clients but forget the needy part of the population. In 1955 the government thus took over the former Imperial Bank of India and re-established it as State Bank of India. In 1959 seven additional banks were incorporated into the State Bank of India. In July 1969 the Indian government nationalised all banks with deposits of more than 500m INR (about 10m EUR). This meant that 84% of all banks were in public control. By 1980 this percentage had risen to 90%.

Today some one hundred commercial banks dominate the market in India. They are distinguished by public sector banks and private sector banks.

“Last year Indians bought 1,000 tons of gold with a value of 9.9bn EUR and diamonds totalling 1.2bn EUR.”

► **1.** The banks of the public sector are the result of the nationalisation of the banking industry. They are distinguished by two groups. The state bank group (e.g. State Bank of India, State Bank of Hyderabad, State Bank of Indore) comprises the banks which had been nationalised by 1959. The nationalised bank group (e.g. Bank of India, Canara Bank, Corporation Bank) consists of the banks which were nationalised between 1969 and 1980. The banks of the private sector are in turn distinguished by the following sub-groups:

- ❑ Old private bank group (e.g. Karnataka Bank Ltd., Karur Vysya Bank Ltd., SBI Commercial and International). This group mainly comprises the smaller banks which had escaped nationalisation between 1969 and 1980.
- ❑ New private bank group (e.g. ICICI Bank Ltd., IDBI Bank Ltd., UTI Bank Ltd.): The Reserve Bank of India (RBI) granted bank licences for the first time again in 1993. The minimum required capital was 1bn INR (some 200m EUR).
- ❑ Group of foreign banks with branches in India (e.g. Citigroup, Credit Lyonnais, Deutsche Bank, HSBC, Standard Chartered).

In addition, there is the group of cooperative banks and the regional rural banks (RSB). Both groups focus on the Indian hinterland. The cooperative banks are also present in the large cities where they aim at the non-privileged Indian segment of the population, e.g. workers, handymen and small businesses. The government continues to strictly regulate the role of foreign banks in India. Their shares in Indian banks are generally not

Socio-economic classification

	School (less than 9 years)	School (up to 9 years)	High school	Some college	Under-graduate degree	Graduate degree / Ph.D.
Unskilled worker	0	0	0	1	0	0
Skilled worker	0	0	3	3	5	13
Petty trader	0	0	1	0	0	1
Clerical employee or worker / salesman	0	0	9	2	0	6
Supervisory level	0	0	1	1	0	2
Shop owner	0	0	4	1	1	5
Official / executives junior	0	0	1	13	4	51
Self employed professional	0	1	1	8	65	21
Businessman / industrialist (no employees)	0	0	0	4	3	25
Businessman / industrialist (1 .. 9 employees)	0	1	0	2	0	27
Officers / executives middle and senior	0	0	0	13	13	62
Businessman / industrialist (> 10 employees)	0	0	2	9	0	4

Men: 83%, Women: 16%, 1% no mention
 Age: < 20 years: 7%, 21 - 30 years: 59%, 31- 40 years: 25%, 41- 65 years: 7%, >65 years: 2%

Segment A: 80,5%
 Segment B: 14,7%



allowed to exceed 5% , and the possibilities of organic growth are limited due to restrictions for the opening of new branches. This regulation aims to give the public Indian banks enough time to re-organise their business processes to become more efficient and in line with the market. The existing restrictions are currently not expected to be lifted before 2009.

The India study aimed to assess customer loyalty and the trust between customers and their banks. 95.2% of the 458 participants are from the socio-economically important segments A and B. ▶ 2. These represent 27% of the urban population in India and are particularly interesting for commercial banks due to their income structure.

Indian bank customers are loyal

Traditionally, Indian bank customers are very loyal. In the past this could be explained by the missing differentiation in the nationalised Indian banking landscape. However, even today the inter-cultural comparison reveals a very high loyalty to a selected bank. The study analysed loyalty with the help of three questions:

- Does the customer intend to stay with the bank in the future?
- What is the likelihood of that customer to stay with the bank even if the pricing for bank products and services was to become more expensive?

- What is the likelihood that the customer will recommend the bank to family and friends?

The study reveals that the banks of the public sector enjoy a particularly high loyalty of their customers. ▶ 3. With the exception of the old private bank group, all other banks of the sector have at least 60% customers with a very high or high loyalty. The cooperative banks are clearly at the top with 77%. However, one has to consider that these banks pay a higher than average interest for capital investments, and at the same time charge their customers for a membership fee.

Indians are not only very loyal to their banks but also develop a high level of trust in their financial institution. Here, trust is defined as the willingness to rely on the bank as righteous partner. This trust has two sides to it: first, customers trust the bank as an institution – meaning the management, the processes and the business practises in general. Second, trust is created and lived through the contact with customer service staff. These two dimensions were analysed by six questions each. A high correlation to direct questions concerning trust was confirmed.

The finance institutions of the old private bank group are in a weaker position. However, foreign banks appear to enjoy a higher level of trust: 37% of their customers show a very high trust index.

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The national gross savings ratio established by the World Bank for India is at 22.5% of the gross domestic product and hence on international level (Germany 22.1%, USA 14.0 %). However, the savings ratio in China is on a substantially higher level (47.6%). Instead of investing their savings with banks or on the financial markets, Indians households prefer to invest in tangible assets such as real estate, life stock, gold and diamonds. Especially in the cities this is complemented by investments in luxury goods. In 2005 Indians bought a total of 1,000 tons of gold worth 9.9bn EUR and diamonds totalling 1.2bn EUR – favourite investments for tax evaders, as the public tax authorities have only registered 85,000 households with an annual income of more than 20,000 EUR. In general, Indians are still reluctant to take out loans.

This raises the question what Indians expect from their banks? The study also analysed this aspect. The requirements of customers can be divided in a number of categories. ► **4:** Category I comprises events or situations of the private realm, the family and the professional environment. This confined area is influenced by external events of the political and economic realm.

In category II the customer already has a concrete need. In category III the customer is interested in a product or service currently offered by a bank. The study comprised 34 concrete questions for these categories, which were analysed for their importance to the customers as well as the customers' current and future need for support by the bank. Based on this analysis an index for the desired orientation of the banks in terms of customer relation could be calculated. According to this, a majority of 61% of Indian customers can be allocated to category II. Only a comparatively small share of 15% desires a stronger customer relations orientation of the banks.

On average the highest expectations towards the banks exist for financial investments and especially for targeted savings for larger investments, e.g. a new car or an apartment. Less support is desired in the areas family and professional life. However, the individual categories and customer segments at times showed significant differences which offer foreign banks levers for a targeted marketing.

Indian customers prefer personal contact to dealing with machines and the internet even for relatively simple services. Only a third of all customers uses automated teller machines – but with a growing tendency.

Service quality is seen as comparatively high

In 2003 an earlier study by one of the authors looked at the service quality and climate in the three Indian banking sectors. ► **5.** Service quality is defined as the quality perceived by the customer. The measurement followed the dimensions of the SERVQUAL model as developed by Parasuraman, Berry

and Zeithaml, and involved 300 bank customers in New Delhi:

- Reliability of service delivery
- Trust in the competence and helpfulness of staff
- General appearance of the bank and of its staff
- Empathy towards the customers
- Responsiveness and fast service delivery of staff

“After 25 years of market presence in India, Deutsche Bank started with a retail offering in October 2005. The standard bank products are thereby complemented by services requiring more intense advice.”

The service climate describes the banks' service orientation from a staff perspective. This study analysed four dimensions and queried 271 bank employees in New Delhi:

- General service climate: A general description of the service climate at the banks
- Customer orientation: The way banks respond to customers
- Management practices: The actions of immediate superiors to warrant and reward customer orientation and service quality
- Customer feedback: Receiving and processing customer feedback and complaints to improve service quality

Regression analyses were able to demonstrate a statistically relevant correlation between the service climate and the perceived service quality. The service quality of the private Indian and foreign banks perceived by their customers is very similar. The public banks achieved significantly lower results.

The private Indian and foreign banks did not have relevant differences in service climate. In three dimensions the private Indian banks scored even slightly higher than the foreign banks. However, the public banks had much lower survey results in this area as well.

▶ 3					
Service Quality and Service Climate of Indian Banks					
	very high	high	middle	low	very low
State bank group	31%	44%	15%	6%	4%
Nationalized bank group	29%	49%	13%	5%	4%
Old private bank group	11%	21%	26%	32%	11%
New private bank group	23%	51%	18%	5%	4%
Foreign banks	24%	43%	18%	6%	8%
Cooperative banks	44%	33%	22%	0%	0%

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Hierarchy of customer needs

▶ 4



Source: Messner, W.: CRM bei Banken, BoD-Verlag, pp 244-7, 2005

Degree of relationship orientation of Indian bank customers



In the last few years the private Indian banks have begun to introduce best practice processes and modern processing and customer management systems to support their growth track. A continuous monitoring of their guidelines as well as the focus on teamwork and customer orientation are important success factors for these institutions. Many branch managers could be won over from the public banks. Once freed from the many hurdles common in public organisations, they have been able to create an excellent service climate.

“Indian customers value the innovative product offerings and expertise of the foreign banks.”

Indian counterparts. The objective must be to successfully break through the wall of loyalty by focussing on actual customer requirements. The results of the survey presented herein deliver first insights in that respect and describe levers for a targeted marketing. □

Cracking the wall of loyalty

Indian customers also value the innovative product offerings and expertise of the foreign bank institutions. To be successful the foreign banks hence need to fully understand their Indian customers, adjust their product and service offerings to the local requirements, and competitively engage with their private

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Loyalty to Banks in India – in %

▶ 5

		Public Banks		Private Banks		Foreign Banks	
		Average	Std. Dev.	Average	Std. Dev.	Average	Std. Dev.
Service Quality	Reliability	4,72	1,21	5,49	1,04	5,49	0,97
	Assurance	4,72	1,30	5,81	0,98	5,58	0,91
	Tangibles	3,82	1,42	5,75	0,85	6,08	0,69
	Empathy	4,21	1,38	5,46	1,13	5,34	1,06
	Responsiveness	4,14	1,48	5,44	1,08	5,60	0,96
Service Climate	Global service climate	3,15	0,72	3,80	0,73	3,68	0,65
	Customer orientation	3,42	0,72	4,01	0,70	3,84	0,80
	Managerial practice	3,59	0,91	4,13	0,76	3,85	0,86
	Customer feedback	3,13	0,91	3,52	1,09	3,71	0,83

Source: Shainesh, G., Sharma, T.: Linkages between service climate and service quality – a study of banks in India. IIMB Management Review, Sep. 2003

Service quality: 7-point scale
Service climate: 5-point scale

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