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THE EVOLVING COMPETITIVE DYNAMICS IN THE RETAIL BANKING SECTOR IN INDIA: A CASE STUDY OF KARNATAKA BANK

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Abstract

The banking industry in India is going through a unique competitive situation: on the one hand, the proliferation of new banks has increased competition multi-fold; on the other hand, given the rigid regulatory environment, banks have very little liberty to innovate products. The entry of multinational banking giants with superior service operations has further amplified the competition for customers. This paper examines the business performance of Karnataka bank during the period between 2006 and 2014 in order to bring home some of these challenges. Based on feedback from the branch managers, savings and current accounts - two classic banking products – suffered the most in the onslaught. Practicing managers as well as customers that we interviewed held that banking services in terms of customer experience ought to be improved and that various value added services could be introduced. Customers also expected reduced penalty for minimum balance and enhanced insurance cover for their accounts.

Keywords: *Retail banking, banking products, challenges, Karnataka Bank, India.*

JEL Classification: *M16, M29*

I. INTRODUCTION

Banks in India have been through big changes since the economic liberalisation that began in 1991. Opening up of the economy offered opportunities as well as increasing competition from both domestic and foreign players. To be the preferred bank means changing "good enough" and offering a unique value proposition to be a bank of customer's preference. And that means changing the way people have always done things.

This study helps in understanding why particular products - especially some 'weaker products' - are digressing the productivity of the Indian banks over a period of time. Analysis of the business of Karnataka Bank based on the performance of products like current account, savings account, fixed deposits, housing loan, education loan, vehicle loan, agricultural loan, etc., reveals certain key weaknesses that are indicative of the troubles faced by the banking sector in India. For a comparative analysis, performance indicators of other banks in the same sector who are competitors to Karnataka Bank, like Karur Vysya bank, Axis bank, and ING Vysya bank were taken into consideration.

II. BACKGROUND

Attempts have been made to study the efficiency and productivity of banking sector in developed countries (Berger and Humphrey, 1997; Berger *et al*., 1999; Isik and Hassan, 2002 a, b; Yildirim and Philippatos, 2007). However, studies analyzing the efficiency of banks in developing countries, including India, are relatively modest (Hegde, George, and Nedelea, 2007; George and Hegde, 2004). In their extensive international literature survey, Berger and Humphrey (1997) noted that the vast majority of the efficiency literature focuses on the banking markets of well-developed countries with particular emphasis on the U.S. markets. Fethi and Pasiouras (2010) provided an extensive survey on efficiency and productivity studies in banking sector published in various research journals covering the period 1998-2008. They identified 151 studies that use DEA to estimate various measures of bank efficiency and productivity growth, and 30 studies that provide similar estimates at the branch level. More than 75% of the studies focus on efficiency and productivity issues of banks in developed countries.

The literature on bank efficiency reveals mixed experiences of liberalization policies undertaken in various countries. A number of studies report the existence of efficiency gains due to liberalization programmes undertaken in various emerging and transition countries including Turkey (Zaim, 1995; Isik and Hassan, 2003), Thailand (Leightner and Lovell, 1998), Hungary (Hasan and Marton, 2003), the Central and Eastern European

(CEE) transition countries (Brissimis *et al.*, 2008), Pakistan (Ataullah and Le, 2006), and Egypt (Fethi *et al.*, 2011). However, there are few studies which show no improvement in bank efficiency over the transition period such as, Havrylchyk (2006) for Polish, Kasman and Yildirim (2006) for the CEE transition countries, Fu and Heffernan (2009) for China. Moreover, a number of studies (Burki and Niazi, 2009; Hsiao *et al.*, 2010) illustrate that the efficiency impact of the reform process may not be immediately visible or uniform over time. The efficiency may go down at first due to the initial costs of adjustment prior to improving later. Burki and Niazi (2010), for example, show that efficiency fell during the initial reform period in Pakistan due to the adjustment process before increasing in the later stages of the reform process. Similarly, Hsiao *et al.* (2010) find that the efficiency of Taiwanese banks was lower during the restructuring reform period than pre-reform period while being higher in the post-reform period.

In the Indian context, there are few studies which especially focused on the efficiency measurement of PSBs using DEA. For example, Das (1997) studied technical, allocative and scale efficiency of different PSBs for the period 1990-1996 using DEA approach. The study found decline in overall efficiency over time, decline in technical efficiency with slight improvement in efficiency. The State bank of India was found to be more efficient than other PSBs. Saha and Ravisankar (2000) analyzed the performance of Indian banks using DEA approach for a sample of 25 PSBs banks over a period 1992-1995. Their findings reveal that barring few exceptions, the public sector banks have in general improved their efficiency over the years. Other group of studies which focused on the comparison of various categories of banks based on ownership includes Bhattacharya *et al.* (1997), Sathye (2003), Sahoo *et al.* (2007), Sinha (2008), Mahesh and Rajeev (2009) and Kumar and Charles (2011).

Bhattacharya *et al.* (1997) used DEA to measure the productive efficiency of Indian commercial banks in the late 1980's to early 1990's and to study the impact of policy of liberalizing measures taken in 1980's on the performance of various categories of banks. They found that the Indian PSBs were the best performing banks, as the banking sector was overwhelmingly dominated by the PSBs, while the new private sector banks were yet to emerge fully in the Indian banking scenario. Sathye (2003) measured the productive efficiency of 94 banks in India for the year 1996-1997 by using DEA wherein, they found that the PSBs were on average more efficient than foreign banks, which in turn were more efficient than private banks. Similarly, Gupta *et al.* (2008) found that the SBI and its group have the highest efficiency, followed by private banks, and the other nationalized banks for the period 1999-2003. The results are consistent over the period, but efficiency differences diminish over period of time. Mahesh and Rajeev (2009) examined the changes in productive efficiency of Indian commercial banks for the post reform period 1985-2004. They found that deregulation has significant impacts on all three types of efficiency measures. PSBs as a group ranks first in all the three efficiency measures showing that, as opposed to the general perception, these banks are doing better than their private counterparts. Private banks, however have shown marked improvement during the post-liberalization period in terms of all three types of efficiency measures.

To sum-up, most of the studies show the evidence of affirmative gesture of reform process on the efficiency of Indian banking sector. While most of the studies provided the evidence of PSBs performing better than its counterpart, private and foreign banks, few other studies have found the PSBs as underperforming compared to other group of banks. The differences in the findings of various studies in Indian context are attributed to many factors including the selection of time period, sample size, selection of inputs and outputs variables and the orientation of efficiency measurement

III. THE STUDY

Primary data pertaining to Udupi region was used for this case study. The need for using secondary data for analysis was imperative as data from one region was not sufficient for understanding the market to identify the weaker products in overall Karnataka banks offerings. Secondary data of the bank under study for the past 5 years was used. Karnataka Bank annual and quarterly reports, Axis bank annual report, ING Vysya bank annual report, Reserve Bank of India (RBI) Rules and Regulations for Banking Business were analysed. Selected bank managers, employees, and customers were interviewed and the interview results were analysed qualitatively.

IV. FINDINGS

A. Reserves and Surplus Growth:

Reserve means a provision for a specific purpose. There are lots of unknown expenditures which can occur in current year or in future. To meet such type of expenses the business firm has to make the reserves. Surplus is the credit balance of the profit and loss account after providing for dividends, bonus, provision for taxation and general reserves etc.

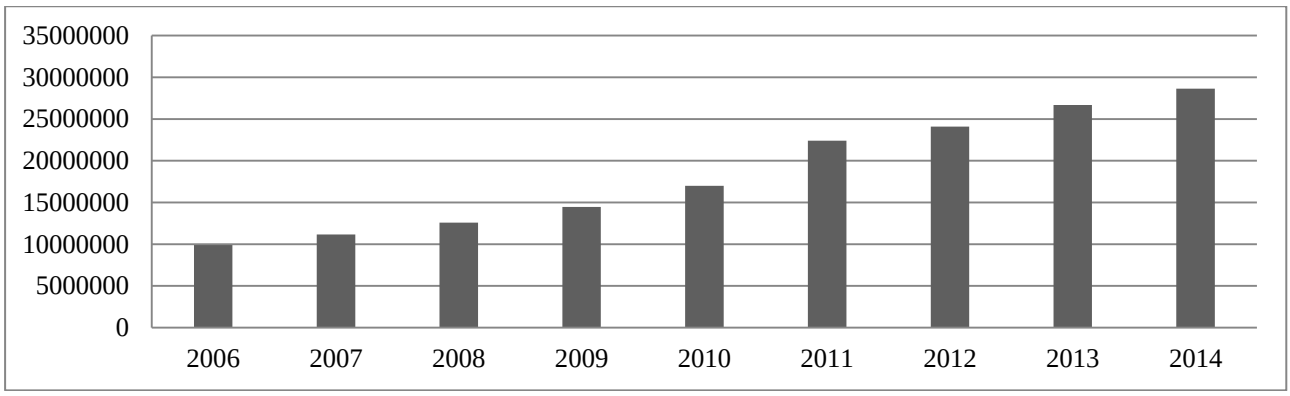

Figure 1. Reserve and surplus growth over the years

Reserves and Surplus Growth of Karnataka bank shows an upward trend. Between the years 2009 and 2011 the growth rate has been 53%. Between 2012 and 2014 the growth rate has dropped to 15%. As per data taken from Karnataka bank, Interpretations for reserve and surplus is slow upward trend we can see in figure 1.

***B) Deposits Growth**:*

Money is placed into a banking institution for safekeeping. Bank deposits are created to customers depositing money into accounts at a banking institution, such as savings accounts, checking accounts and money market accounts. Deposits growth of Karnataka Bank From 2006 to 2014 is as follows, 000' omitted.

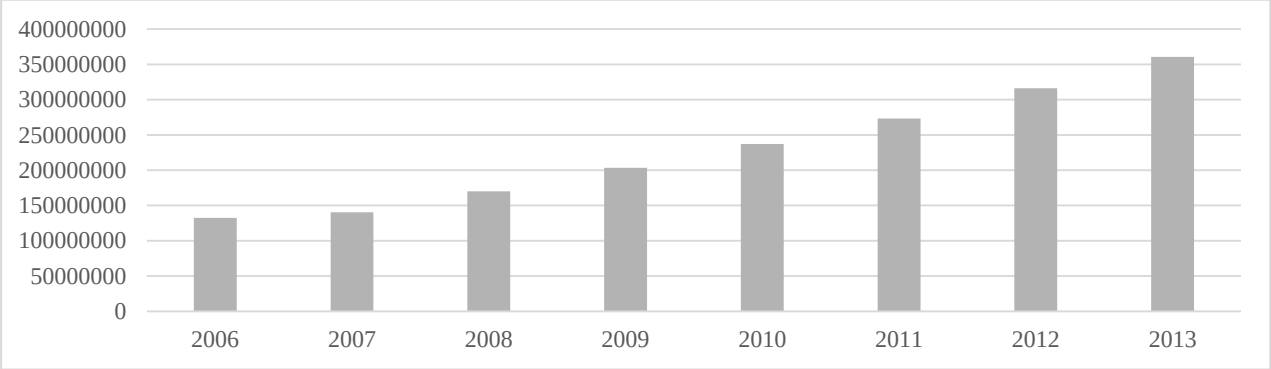

Figure 2. Deposit growth

Deposits of Karnataka bank has shown an overall upward trend upward trend. The growth in deposit rate between 2011 and 2013 is 33%, which is slightly lower than to the growth in deposit rates between 2008 and 2010 was 37%.

***C) Borrowing Growth**:*

The banks business is not to receive deposits alone but to effectively lend these deposits at higher rate of interest to the needy and generate surplus. Growth in borrowing of Karnataka Bank Ltd between 2006 to 2014 is as follows, 000' omitted.

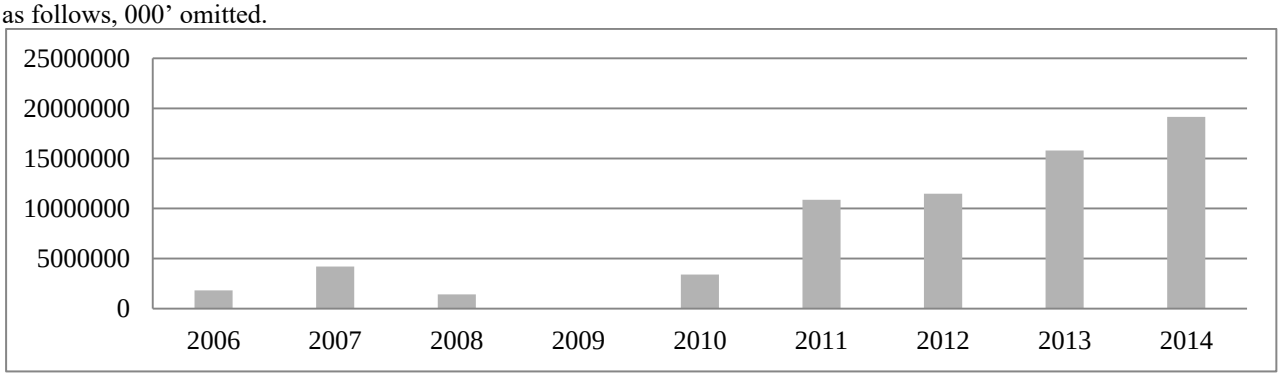

Figure 3. Growth rate in borrowings

Analysis of the chart reveals a mixed trend with the growth rate in borrowings falling to its minimum in 2009 a year in which IT industry saw a steep hit and economy took a hit globally. Between 2010 and 2011 a growth rate of 218% was recorded in borrowings which were due to the efforts of the government to revive the

economy .Then between 2011 and 2012 the growth rate in borrowings was almost stagnant with much not happening between these years. A very sharp growth rate is registered between 20112 and 2014 which stood close to almost to 67%.

D) Other Liabilities and Provisions Growth:

Other liabilities and provision is an amount set aside for the probable, but uncertain, economic obligations of an enterprise. A provision is an amount that you put in aside in your accounts to cover a future liability. Growth rate in other Liabilities and Provisions of Karnataka bank between 2012 and 2014 stood at 53%.

E) Growth of Cash and Balance with RBI:

Banks have to keep some amount of money in Reserve bank of India. Amount of growth of Cash and Balance with RBI of Karnataka Bank was almost stagnant between the years 2012 and 2013 indicating stagnation in growth. Between 2013 and 2014 there is an increase in cash and balance with RBI by around 25%.

F) Money Short Notice:

Balance with bank is balance standing to the credit of a depositor at a bank, money at call is a short-term loan that does not have a set repayment schedule, but is payable immediately and in full upon demand and Short notice nothing but money to be repaid upon a notice in which up to 14 days' time is given.

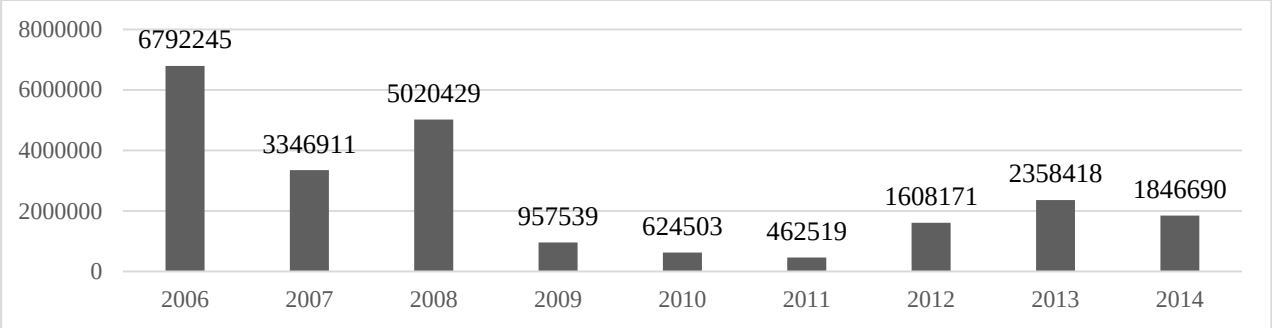

Figure 4. Money available at short notice

Balance with Bank and Money at Call and Short Notice has declined steeply between the years 2006 and 2011 except for the years 2007 and 2008.Between 2012 and 2014 the growth in balance and money at call has increased marginally and is almost of 1/3 of what it was in 2006 which indicates the money available with the banks have shrunk, which may be due to competition from other banks and many private banks entering the economy.

G) Advances Growth:

Advance is loans extended to customer of the bank for various purposes like business, agriculture, education, home, personal, vehicle loans. Growth of Karnataka bank from 2006 to 2014 is as follows, 000' omitted.

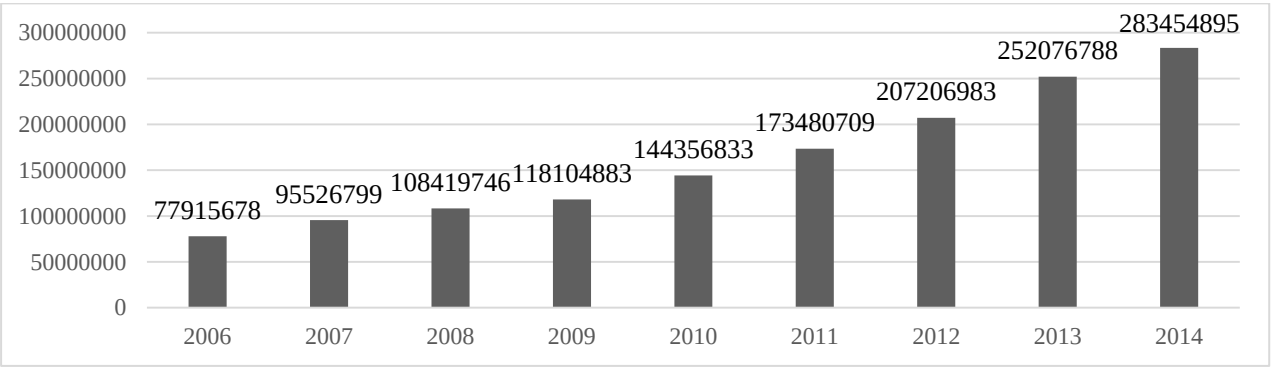

Figure 6. Growth in advances

H) Gross Earnings Growth:

Gross earnings is an accounting convention, referring to the amount of initial profit left over from total revenues for a specified time period, once cost of goods sold have been deducted. Gross Earnings growth in Karnataka bank from 2006 to 2014 is as follows, 000' omitted.

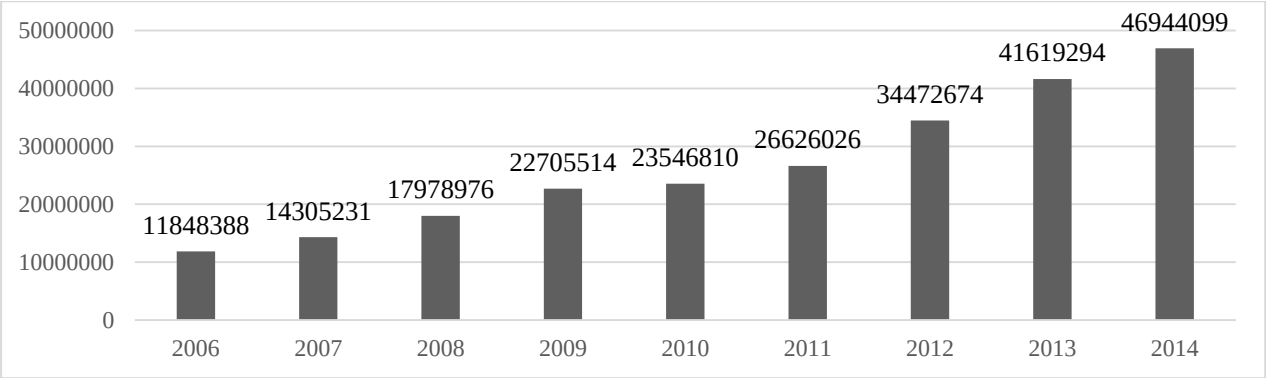

Figure 7. Growth in gross earnings

Growth in gross earnings has increased steadily between the years 2006 and 2009. Between 2009 and 2011 the growth has been stagnant which was due to increase in NPA and pressure on margins of the bank. The earnings in gross revenue between 20112 and 2013 stood at 21% whereas between 2013 and 2014 it was only around 13%.

I) Dividend Pay Out

A dividend is a payment made by a corporation to its shareholders, usually as a distribution of profits. When a corporation earns a profit or surplus, it can re-invest it in the business (called retained earnings), and pay a fraction of this reinvestment as a dividend to shareholders.

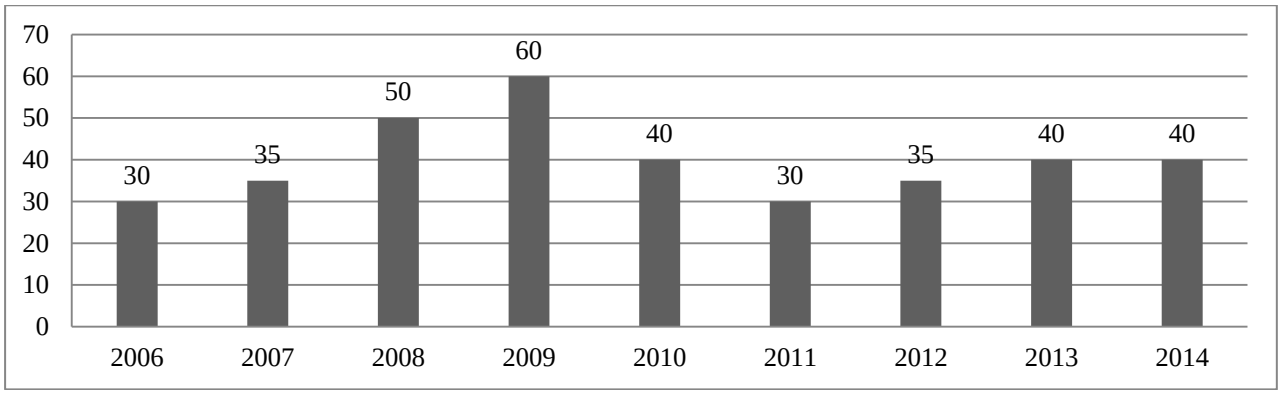

Figure 8. Dividend changes

J) Miscellaneous Other Findings

Qualitative interviews with the managers revealed that the following two products show symptoms of weakness: 1) Saving Bank Account, 2) Current Bank Account. These two products are the basic products of the core banking business. Total contributions of saving bank account and current bank account to total volume of business before 2005 was 40%. But from 2006 it started to decline. As per information's Karnataka Bank as well overall Indian banking industry experience it came down from 40% to 20% contributions. It is one of the main problems for all the banking industry. Analysis of suggestions given by the practitioners for improving the banking services revealed the following:

a) Penalty for minimum balance:

One of the biggest problems faced by customer is penalty for not maintaining minimum balance in the account by SB account holders. If customers balance drops below Rs 1000 a charge is levied. So if banks reduce or cut this penalty customer will likely to opt the saving. Better service like advances and OD facilities must be extended to MSME sector to increase the current account.

b)Less and efficient account opening process:

Opening saving bank and current account is a lengthy process is tedious. KYC norms have to be fulfilled, however some banks ask for too many documents and unnecessary formalities to take a more cautious view. Also online opening of accounts with scanned documents must be encouraged and such accounts may be activated n verifying the documents.

c) Attractive interest rate for saving and current bank account:

Customer switch funds from saving and Current account to fixed deposits or recurring deposits as current account does not carry any interest. Customer shift funds from saving to fixed deposits and recurring deposits as interest rates are higher. Banks have to advise customers o maximising their returns from their accounts.

d) Free money transfer:

Banks providing free money transfer if customer has some balance. If customer not having minimum balance banks will charge charges for money transfer. Till Rs.1, 00,000 they are charging Rs.5. If customer does not have minimum balance in their account banks will charge more money. This is also one of the reasons for customer to close their Saving account and current account. If banks provide free money transfer for customer more any amount this will overcome.

e) Insurance facility to customer:

Saving bank account and current bank accounts in banks are not secured through insurance. Up to Rs 1,00,000 banks give protection through insurance. But if a depositor has more than Rs. 1,00,000 in bank his money above the sum of Rs 1,00,000 is not covered under insurance.

f) Customer friendly banking services:

Banking is a big organization. Banking is nothing but accepting the deposits for the purpose of lending and investment. Now a day's banks involving many more activity. But banks not customer friendly now a days. In banks employees will not co-operate with customer. If employees change their mind and if their behaviour change to customer friendly, it may also helpful for ingress banking business along with improvement of saving and current account.

g) International ATM Card:

Karnataka Bank has to improve upon customer service. Providing customer service is the key to success in service industry especially banks. Karnataka Bank does not have an International Debit card. This is one reason is people moving from Karnataka Bank to other bank. In today's global economy this does not make sense. International Debit card will give unlimited withdrawal facility. In Karnataka Bank they have issuing only National Debit card In local card after 5 transactions/month in own bank ATM Centre and after 3 transactions/month in other Bank ATM centre, customer have to pay Rs 20 per each transactions. This is one of the biggest drawbacks. So if Karnataka Bank provide International Debit card it will help to ingress in saving and current account in Karnataka Bank.

V. CONCLUDING REMARKS

Overall, the performance of Karnataka Bank is better than that of most of its peers. But in some areas they are lagging as suggested in the discussion. They have an ambitious growth plan. The challenge for the banking industry in India is huge and the Karnataka bank case provides a glimpse into it. Despite the regulatory pressures for conformity, there is no substitute for banks other than improve the quality of their services and become more customer centric. Banks need to learn the fine act of balancing the regulatory need for stability and the market need for change.

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