

# A Review on Mediating Effect of Service Quality on Non Banking Financial Institution

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## ABSTRACT

The non-banking financial companies (NBFCs) flourished in India in the decade of the 1980s against the backdrop of a highly regulated banking sector. While the simplified sanction procedures and low entry barriers encouraged the entry of a host of NBFCs, factors like flexibility, timeliness in meeting credit needs and low operating cost provided the NBFCs with an edge over the banking sector. NBFCs proliferated by the early 1990s. This rapid expansion was driven by the scope created by the process of financial liberalization in fresh avenues of operations in areas, such as, hire purchase, housing, equipment leasing and investment. The business of asset reconstruction has recently emerged as a green field within this sector following the passage of the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002. NBFCs are financial intermediaries engaged primarily in the business of accepting deposits delivering credit. They play an important role in channelising the scarce financial resources to capital formation. NBFCs supplement the role of banking sector in meeting the increasing financial needs of the corporate sector, delivering credit to the unorganized sector & to small local borrowers. All NBFCs are under direct control of RBI in India. Paper highlights on review of impact of service quality of NBFC.

**Key words:** Non banking financial institution, Classification, and its service quality & its impact on the success of NBFC.

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## I. INTRODUCTION

### Non Banking Financial Companies (NBFCs)

According to the Reserve Bank of India Amendment Act 1997 the Non Banking Finance company was defined as under:-

⇒A financial institution which is a company,

⇒A non banking institution which is a company and whose principal business is to receiving of deposits under any scheme/arrangement/in any other manner or lending in any manner and

⇒Other non banking institutions/class of institutions as the RBI may specify.

The directions apply to a NBFC which is defined to include only non-banking institution, which is any hire-purchase finance, loan or mutual benefit financial company and an equipment leasing company but excludes an insurance company/stock exchange/stock broking company/merchant banking company.

The RBI (Amendment) Act, 1997 defines NBFC'S as an Institution or company whose principal business is to accept deposits under any scheme or arrangement or in any other manner, and to lend in any manner. As a result of this new definition, a number of loan and investment Companies registered under the Companies Act by Business houses for the purpose of making investments in group of companies are now included as NBFC. The Financial intermediaries in Indian Financial System are broadly characterized by Public owned, Monopoly or Oligopoly or Monopolistic market structure and are centralized. The Indian financial system has another part which comprises a large number of private owned, decentralized, and relatively small sized financial intermediaries and which makes a more or less competitive market. Some of them are fund based, and are called (NBFCs) and some are provide financial services (NBFSCs) Both NBFIs, NBFCs are (1) Loan companies (LCs) (2) Investment companies or ICs (3) Hire-Purchase finance companies or HPFCs (4) Lease finance companies or LFCs (5) Housing finance companies (or) HFCs (6) Mutual Benefit financial companies or MBFCs (7) Residuary non-banking companies or RNBCs (8) Merchant Banks (9) Venture capital funds (10) Factors (11) Credit Rating Agencies (12) Depositories and custodial services.

## Classification of NBFCs

Classification of NBFCs as given in the Reserve Bank Amendment Act 1997, 1) Equipment leasing company (ELC): Carrying on as its Principal Business, the activity of leasing of equipment. 2) Hire Purchase finance company (HPFC): Carrying hire purchase transactions (or) financing of such transactions. 3) Housing finance company (HFC). 4) Investment Company (IC): Carrying the business of acquisition of securities. 5) Loan Company (LC): Financing by making loans and advances. (Does not include ELC, HPFC, HFC). 6) Mutual Benefit companies (MBFC). 7) Residual non-banking company (RNBC): Company which receives any deposit under any scheme or arrangement, in one lump sum or in installments by way of contributions or subscriptions or by sale of units or certificates or other instruments or in any other form according to definition of NBFC. 8) Miscellaneous non-banking companies (MNBC): Managing,

Conducting or supervising as a promoter foreman or agent of any transaction or arrangement. Ex: conducting any other form of Chit and Kuri which is different from type of business mentioned above. After the above classification the Non Banking Financial companies were re-classified twice, during 1998 it was classified as four types they were 1) Equipment leasing, 2) Hire Purchase, 3) Investment Company and 4) Loan Companies. During 2006 the NBFCs were reclassified as three types they are 1) Asset Finance companies (in this both Equipment Leasing and Hire Purchase companies were merged), 2) Investment Companies and 3) Loan Companies

Apart from those classifications, in order to operate these NBFCs smoothly certain regulations/directions were issued they are a) Regulations for deposits for NBFCs accepting deposits, b) Regulations for NBFCs not accepting deposits and c) Regulations for core investment companies to smooth functioning of their businesses as well as to give confidence to the participants as well as operators.

In a very broad sense, NBFIs would include even financial institutions like insurance companies, Life insurance Corporation of India, Unit Trust of India, Industrial Credit and Investment Corporation of India Ltd., Industrial Finance Corporation of India and Industrial Reconstruction Corporation of India Ltd., as also State Financial Corporations. But for the purpose of our present study, the scope of the term is confined to the types of financial companies enumerated in clause (p) of paragraph 2(1) of the Non-Banking Financial Companies (Reserve Bank ) Directions, 1966, which mobilize savings of the community by way of deposits or otherwise and utilize them for the purpose of lending or investment. Thus the NBFCs that we shall discuss here are hire-purchase finance, housing finance, investment, loan, miscellaneous financial or mutual benefit financial companies but excluding insurance, stock exchange or stock broking companies. Non-banking financial companies (NBFCs) encompass an extremely heterogeneous group of intermediaries. They differ in various attributes, such as, size, nature of incorporation and regulation, as well as the basic functionality of financial intermediation. Notwithstanding their diversity, NBFCs are characterised by their ability to provide niche financial services in the Indian economy. Because of their relative organisational flexibility leading to a better response mechanism, they are often able to provide tailor-made services relatively faster than banks and financial institutions.

## II. REVIEW LITERATURE

In this chapter an attempt has been made to analyse the various studies on different views of banking industry related to the present study. A number of studies have been carried out on different aspects of customer services by the researchers, economists and academicians of Indians and abroad. Some of the important studies conducted on customer services of banking sector are reviewed here. The reviews keep the researcher to identify the research gap and formulate a better analysis.

**Zeithmal et al., (1990)**<sup>1</sup> analysed profitability positions of banks and growth of client base are interlinked. With intensifying competition in the market, it is very important for the banks to understand “How customers choose their banks?”. Then only banks can take proper marketing efforts to increase client base. Improper identification of true determinants of consumers’ bank selection decision may result in poor results for marketing efforts. Management’s failure to identify customers’ desire is one kind of quality gap.

**Gerrard and Cunningham (2001)**<sup>2</sup> in their study, conducted in Singapore, investigates three important aspects of service quality. The sample customers of two specific banks, one of which is publicly quoted and one of which is fully government owned. For comparative purposes, five service quality dimensions, which the authors created, were used. The results showed that customer expectations about an excellent bank’s service quality were not significantly different as between the public sector bank and the government bank. The perceptions that consumers had about the service quality of the bank they patronized, though, showed some significant differences. The public sector bank was perceived as having a significantly better ‘services portfolio’, specifically in regard to making customers aware of its services and offering a variety of services through its Asynchronous Transfer Mode (ATM). The government bank was perceived as having better ‘staff who deliver the service’, specifically in the way the staff dressed and the efficiency with which they served customers. The five service quality dimensions were found to have better predictive capabilities for the measurement of the overall satisfaction of customers who patronised the government bank.

**Hays and Hill (2001)**<sup>3</sup> in their article explained that most experts agree that a learning organization whose employees have a clear vision of the importance of service quality and are motivated to provide that quality will achieve superior service quality. It develops a theoretical framework and conducts a cross-sectional empirical study to investigate the interrelationships among these constructs. The results indicate that higher levels of both employees' motivation/vision and organizational learning positively affect perceived service quality. Additionally, employees' motivation/vision was found to mediate the relationship between organizational learning and perceived service quality. These results highlight the importance of employees' motivation/vision in both the service and the learning process.

**Li et al., (2001)**<sup>4</sup> in their study found that as an international financial center, the banking industry in Hong Kong (HK) plays a significant role. Because of increasingly competitive pressure from domestic and overseas banks, HK banks must tightly control cost and improve quality and efficiency of operations in order to maintain profitability. For this purpose, quality management has emerged as an effective tool in recent years. In fact, it has been regarded as a vital strategic element for meeting the challenge of the new and intensified competition in the financial services industry. This paper reports the result of a survey on quality management initiatives in HK's banking industry between 1997 and 2000. The trend of changes in these years is analyzed and the results from HK are compared with those from British financial institutions. The results show that HK banks have gradually adopted quality initiatives and gained significant success in quality management over the past 3 years. They focused more on meeting service standards and providing prompt services while banking institutions in the UK focused more on understanding and meeting customers' needs.

**Newman (2001)**<sup>5</sup> in his paper presents a case study of a pioneering nationwide implementation of SERVQUAL by a major United Kingdom (UK) high street bank between 1993 and 1997 at an annual cost of one million pounds. In addition to highlighting serious weaknesses in the value of SERVQUAL as a measure of service quality and as a diagnostic tool, this study raises some of the practical difficulties entailed in its implementation. Moreover, in this particular instance, it becomes apparent that difficulties are introduced by the separation of service quality management from the management of marketing and human resources. In addition, there was a discernible lack of top management commitment, as well as obstacles in the form of functional and informational silos, which served to constrain an integrated company response to SERVQUAL criteria.

**Hussein A Hassan Al-Tamimi and Abdullah Al-Amiri (2003)**<sup>6</sup> discussed in their article that it is generally agreed that service quality in banking is a significant issue facing this industry. The objective of this study is to analyse service quality in the UAE Islamic banks and to compare service quality between the Dubai Islamic Bank and the Abu Dhabi Islamic Bank. Linear regression results indicate that there was a positive and statistically significant relationship between overall service quality and the SERVQUAL dimensions in the UAE Islamic banks. It was also found that empathy and tangibles were the most important dimensions. Analysis of covariance (ANOVA) results showed that there was no significant difference between the level of overall service quality in the Dubai Islamic Bank and the Abu Dhabi Islamic Bank. ANOVA results also indicate that there was no significant difference in the level of service quality in the UAE Islamic banks based on the customer's gender and nationality. The results indicate, however, that there was a significant difference in the level of service quality in the UAE Islamic banks based on the customer's age, education and number of years with the bank.

**Yonggui Wang et al., (2003)**<sup>7</sup> in their paper deals with although an increasing number of studies is being performed in the field of service management, less work is being done on an integrated framework of service quality and product quality, especially that supported with evidence from developing countries. As a result, little is known about the distinction between service quality and product quality, their respective antecedents, and their distinctive contributions to performance in service industries in the developing world. Generalization of related findings from developed countries is not necessarily appropriate. Unlike most related studies that are based on evidence from developed countries, this study focuses attention on the distinction between, and respective antecedents of, service quality and product quality in the Chinese context.

**Chaisomphol Chaoprasert and Elsey (2004)**<sup>8</sup> in their paper discussed that at the retail level, service quality is a key factor in consumer satisfaction with his or her bank. This article examines commitment to and emphasis within service quality. Despite the rapid growth in electronic banking it was found that in Thailand the emphasis has been on improving personal counter services. A model for investigating service in a retail banking environment is set out in the article.

**Charalambos Spathis et al., (2004)**<sup>9</sup> in their paper discussed the service quality of Greek banks on the basis of their customers' perceptions, and analyses how gender differences affect customers' perceptions of service quality dimensions such as effectiveness and assurance, access, price, tangibles, service portfolio, and reliability. The results of an empirical study of 1,260 customers of Greek banks generally support the hypothesis that gender affects service quality perceptions and the relative importance attached to various banking service quality dimensions. This paper provides important information for bank managers to use in developing operational, human resource, and marketing strategies, and in targeting those strategies in terms of the gender differences in quality perceptions among their customers.

**Ugur Yavas et al., (2004)**<sup>10</sup> in their article examines the nature of relationships between service quality, background characteristics, and satisfaction and selected behavioral outcomes by using retail banking in Germany as its setting. Study results show that service quality is at the root of customer satisfaction and is linked to such behavioral outcomes as word of mouth, complaint, recommending and switching. However, different aspects of service quality and different customer characteristics seem to be associated with different outcomes. For instance, the results suggest that tangible elements of service quality and being a female are more closely associated with positive word of mouth and commitment. On the other hand, "timeliness" aspects of service delivery are more closely related to customer satisfaction, and complaint and switching behaviors. Implications of these results to induce greater customer satisfaction, to attain higher levels of favorable outcomes and to alleviate negative outcomes are discussed.

**Mohammed Al-Hawari et al., (2005)**<sup>11</sup> explained in their paper that automated service quality has been recognised as the factor which determines the success or failure of electronic commerce. Those models currently available to measure automated service quality are limited in their focus, encompassing only one electronic channel the internet thereby ignoring attributes of the other automated service channels. In relation to the banking sector, research has identified that bank customers tend to use a combination of automated service channels. As such, this research strives to develop a comprehensive model of banking automated service quality taking into consideration the unique attributes of each delivery channel and other dimensions that have a potential influence on quality issues. The proposed model has been empirically tested for unidimensionality, reliability, and validity using factor analysis.

### III. FINDINGS

The above review literature shows that the most important service quality practice on customer satisfaction is responsiveness as it is perceived as a dominant service quality. The results reveal that the service quality dimensions of tangibles, responsiveness, reliability and assurance are positively and significantly influencing the customers overall satisfaction, while the empathy is negatively and significantly influencing the customers overall satisfaction. Thus, this present research concluded that service quality is the basic and also most important factor that influences the overall customer satisfaction. This finding reinforces the need for banks managers to place an emphasis on the underlying dimensions of service quality especially on responsiveness and should start with improving service quality in order to raise overall customer satisfaction. Further, this study is consistent with those of prior research in concluding that: service quality is a significant influence of overall customer satisfaction, and service quality dimensions are the basic factors that affect overall customer satisfaction. It is apparent that focusing on delivering high quality services and improve service quality effectively is critical for customer satisfaction. In addition, the satisfaction of customers was significantly influenced by the (Tangibles, Responsiveness, Reliability and assurance). It is thus apparent that managers of new private sector banks could make assessing and monitoring service quality in banks periodically, to enable the banks to identify where improvements are needed from the customers' viewpoint and to place an emphasis on the underlying dimensions of service quality, especially on responsiveness and should start with improving service quality in order to raise overall customer satisfaction.

### CONCLUSION

Review highlights that mediating effect of service quality of non banking financial institution plays effective role in identifying customer needs based on their socio-demographic profile, launching of various financial product according to their needs and desire with valid consent of services benefitting customers as well the financial institutions. Besides that service quality of non banking financial institution depends on digital services in order to attain accuracy and reducing the time consumptions of customers. A Service provider has to be motivated and trained to achieve the target group in turn with attractive increments and incentives. On the whole service quality ultimately relies on the risk and return analysis of financial products they reap and enjoy long term satisfaction and pleasure.

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