CUSTOMER ACCOUNT PROFITABILITY ANALYSIS OF COMMERCIAL BANKS IN NEPAL

A DISSERTATION

SUBMITTED BY
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SUBMITTED TO
OFFICE OF THE DEAN
FACULTY OF MANAGEMENT
TRIBHUVAN UNIVERSITY

FOR THE DEGREE OF DOCTOR OF PHILOSOPHY (Ph.D.)
IN MANAGEMENT

KIRTIPUR, KATHMANDU, NEPAL
SEPTEMBER, 2015

RECOMMENDATION

This is to certify that the thesis entitled **"Customer Account Profitability Analysis of Commercial Banks in Nepal"** submitted by Mr. Kapil Khanal for the award of the degree of Doctor of Philosophy to the Tribhuvan University, Faculty of Management, is a record of bonafide research work carried out by him under our supervision and guidance. It is an original piece of research work based on his personal investigation, observations and interpretation of facts.

To the best of our knowledge, this original work has not been submitted to any other institution or university for the award of any degree or diploma. The work is satisfactory and complete in every respect and the thesis is in a suitable form for submission.

We recommend that this dissertation be considered for the award of the degree of Doctor of Philosophy (Ph.D.).

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We have conducted the viva-voce examination of the dissertation

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entitled

"Customer Account Profitability Analysis of Commercial Banks in Nepal"

and found the thesis to be the original work of the student and written according to the prescribed format. We recommend the thesis to be accepted in the fulfillment of the requirement for the award of degree of Doctor of Philosophy (Ph. D.) in Management.

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DECLARATION

I do hereby declare that the thesis entitled **"Customer Account Profitability Analysis of Commercial Banks in Nepal"** being submitted by me for the award of PhD degree in management from Tribhuvan University is my original piece of work and it has not been published or submitted elsewhere for any other degree or diploma in full or part.

Kapil Khanal
September, 2015
Kathmandu

ACKNOWLEDGEMENTS

I could never envision of this thesis in this contour if my Supervisors Professor Shalik Ram Koirala, and Professor Madhav Raj Koirala, Director of M. Phil. Program, Tribhuvan University. So my heart-felt gratitude is to both supervisors for accepting me as their student and gracefully devoting their valuable time in guiding, encouraging, and supporting me to my research work. Their suggestions and comments have been the sources of inspirations to me for completing this research work. I will always remain indebted to them for their paramount cooperation.

I want to express deep sense of gratitude to Prof. Dr. Dev Raj Adhikary, Dean, Faculty of Management, T.U and Prof. Dr. Rajendra Prasad Shrestha, T.U., for their generous cooperation, advices and supports. I want to extend my gratitude to Prof. Dr. Govinda Acharya, former Dean, Prof. Dr. Kamal Das Manandar, Associate Prof. Bishnu Hari Koirala, Associate Prof. Nava Raj Adhikari, Assistant Deans, Faculty of Management, TU, for their kind cooperation and advices.

I am very much obliged to Prof. Dr. Prem Raj Pant, Prof. Dr. Puskar Bajracharya, Prof. Dr. Santosh Raj Poudyal, Prof. Dr. Radhe Shyam Pradhan, Prof. Dr. Manohar Krishna Shrestha, Prof. Dr. Sunity Shreshta, Prof. Dr. Mahendra Shrestha, Prof. Dr. Kamal Deep Dhakal, Prof. Prakash Singh Pradhan, campus chief and other members of Shankar Dev College for their valuable suggestions at my endeavors to complete this work. I am sincerely grateful to Prof. Dr. Ananta Lal Karna for his constructive suggestions provided to me. From the very beginning of this work, Prof. Dr. Vishnu Khanal, Prof. Dr. Shree Krishna Shrestha had encouraged me to complete this work and had provided me unforgettable support to my endeavor. I would like to express my gratitude to them and also to their families.

Likewise, I am very much grateful to Prof. Dr. Binod Shrestha, former member-secretary, UGC-Nepal, and to Mr. Rammani Gautam, officer, UGC-Nepal for their support to undertake this study.

Besides, I would like to express my appreciation to the University Grand Commission, Sanothimi, Bhaktapur, all the customers, employees and managers of commercial banks of Nepal, who co-operated with me by readily responding to the survey questionnaire and providing the relevant information. I am also very much indebted to reputed authors and references, whose articles provided precious materials for enriching this study.

I am thankful to Mr. Keshav Raj Sharma, Campus Chief, Mr. Choleshor Sharma, Mr. Sambhu Munankami, Mr. Santosh Lal Shrestha former Campus Chiefs; and other staffs of Tribhuvan Multiple Campus for assisting me essentially in administrative affairs during study period. I am thankful to all my friends and colleagues who have encouraged and helped me in several ways to accomplish this thesis. I want to communicate my thankful respect to my colleagues Mr. Suman Kamal Parajuli, Mr. Krishna Prasad Acharya, Mr. Rabindra Sharma, Mr. Shrimani Raj Khanal, Mr. Nirdosh Kananal, Mr. Deepak Khanal, Mr. Bal Ram Chapaign, Mr. Dhundi Raj Bhattarai, and Mr. Atindra Dahal for their valuable help and support.

Finally, I want to express my deep sense of gratitude to my mother Mrs. Ishori Khanal, who inspired and supported me prominently during my academic career. I also register my heart-felt thanks and appreciation to my wife Mukta for the prayers and supports throughout this research work. I also owe to my daughters, Sadikshya, Samikshya and son Sweekar Khanal for their extreme understanding, continuous encouragement and support to complete this research work. Similarly, I am obliged to my family members, neighbors and friends, whose good wishes have always encouraged me throughout this study.

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Kathmandu, Nepal
September, 2015

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LIST OF ABBREVIATIONS

ABC	Activity Based Costing
ADBN	Agriculture Development Bank Nepal
ATM	Automatic Teller Machine
BOA	Bank of Asia
BOK	Bank of Kathmandu
C&T	Commerz and Trust Bank Limited
CAP	Customer Account Profitability
CAPA	Customer Account Profitability Analysis
CAPM	Customer Account Profitability Management
CAR	Capital Assets Ratio
CDR	Credit to Deposit Ratio
CITIZEN	Citizen Bank Limited
CIVIL	Civil Bank Limited
CPA	Customer Profitability Analysis
DCBL	DCBL Bank Limited
EBL	Everest Bank Limited
EWS	Early Warning Signals
GDP	Gross Domestic Products
GLOBAL	Global Bank Limited
GMM	Generalized Method of Moments
HBL	Himalayan Bank Limited
IETTL	Interest Expenses to Total Loans
JANATA	Janata Bank Limited
JVB	Joint Ventures Bank
KIST	KIST Bank Limited
KUMARI	Kumari Bank Limited
LAXMI	Laxmi Bank Limited
LUMBINI	Lumbini Bank Limited
MBL	Machhapuchre Bank Limited
MEGA	Mega Bank Limited
MIS	Management Information System
NABIL	Nabil Bank Limited

NBBL	Nepal Bangladesh Bank Limited
NBL	Nepal Bank Limited
NCCB	Nepal Credit and Commercial Bank
NIBL	Nepal Investment Bank Limited
NICB	Nepal Industrial and Commercial Bank
NIM	Net Interest Margin Ratio
NMB	NMB Bank Limited
NPA	Non Performing Assets
NPL	Non Performing Loans
NRB	Nepal Rastra Bank
NSBI	Nepal SBI Bank Limited
OBS	Off Balance Sheet
PBIT	Profit before Income and Tax
PCA	Prompt Corrective Actions
PRIME	Prime Bank Limited
RBB	Rastryiya Banijya Bank
ROA	Return on Assets
ROAA	Return on Average Assets
ROAE	Return on Average Equity
ROE	Return on Equity
SBL	Siddhartha Bank Limited
SCBL	Standard Chartered Bank Limited
SCP	Structure Conduct Performance
SUNRISE	Sunrise Bank Limited

CHAPTER I
INTRODUCTION

1.1 General Background

Customer account profitability analysis is an emerging concept in strategic management accountancy which helps to develop pragmatic strategies to achieve an organizational goal. It is defined as "...the difference between the revenue earned from the customer and all the costs that can be associated with that customer" (Mulhern, 1999, p.27). To measure customer account profitability, the sales revenue from each customer must exceed the associated costs. This process highlights the importance of analysis of customer profitability, i.e. revenues and costs of individual customer.

Customer account profitability is a system that allows company to know its sources of revenues and to understand the cost structure of company (Lewis, 1993). Standard measurements of profitability derived from traditional accounting practices are inadequate to the needs of changing situation. So, precise and clear classification of cost of each customer is needed to determine the accurate profit of individual customer of a company

The customer account profitability analysis is the customer-led strategy in which the organization attempts to analyze the responses of the customers quickly (Clarke and Payne, 1993). It tries to identify profitable customers, increase the number of potential customers and retain them for a long time. The profitability does not only depend upon the regular production and selling functions, but also the satisfaction of customers, size of customers, loyalty of customers, and retention of customers. It is clear that the valued customers are the source of revenues of any organization, so, the organization should try to retain them. The clear cut classification of customers as well as costs should be made to build up appropriate strategies.

Customer account profitability analysis finds out opportunities for targeted developing cost management and profit improvement programs. Similarly, it provides a basis for well-informed decisions such as pricing, bonus plans, and discounts to customers. In a similar vein, it can help improve decision making about discounts and other benefits. It opens up possibilities for segmentation and targeting strategies based on cost and profitability of each customer.

The potential benefits of customer account profitability are frequently cited in the literature (Zeithmal, Rust and Lemon, 2001), but the issues that arise in actually implementing customer account profitability are seldom discussed. It is critical to determine customer cost and customer profitability for a company today. Knowing organization's total costs for particular processes and activities allows to reducing and controlling them. Calculating costs for a specific customer allows reducing, changing or charging for activities/services provided to them. The determination of customer costs and profitability should be performed using activity based costing techniques.

Some companies segment their customers in four different forms, platinum, gold, iron, and lead customers, based on their contributions to profits (Zeithaml, Rust, and Lemon, 2001). Storbacka (1997) proposed a two-dimensional segmentation of customers based on profitability and sale volume. Companies can subsequently develop segment-specific service concepts, based on the sales volume and profitability of customers (Zeithaml et al., 2001). Moreover, a classification based on sales volume and profitability can provide direction for customer retention and customer development programs, particularly for setting future sales target. Highly profitable customers need to be retained while small and unprofitable customers with little potential may be referred to downstream distributors.

Several authors disapprove of traditional accounting system and propose activity-based costing (ABC) as an alternative system, maintaining that it results in more appropriate cost figures (Foster and Gupta, 1994; Kaplan and Cooper, 1997). They contend that it is more logical and accurate to use actual service activities to allocate customer-oriented expenses. Customer account profitability analysis (CAPA), using ABC, identifies the activities stemming from servicing a particular customer. Using additional activity drivers, the costs of these activities are allocated to the customer that cause them, resulting in more accurate profit information (Petty and Goodman, 1996). The information provided by customer account profitability allows managers to learn more from the feedback they receive from the market, and achieve a better in shape between their budget allocations and the needs of the market.

Nevertheless, the value of ABC in decision making is often questioned. It is argued that such a system only formally captures what managers already know beforehand (Malmi, 1997). Besides accounting feedback, there are many informal ways for managers to stay informed. Sales managers interact and meet with customers. They observe customers' behaviors and keep personal records on their clients. As a consequence, they develop informal cost estimates (Malmi, 1997) enabling them to identify which customers are more profitable than others. Managers are able to combine this information with period-by-period profit feedback on prior allocation decisions, offering a powerful source of learning. Customer account profitability may not reveal any "new information" at all (Narayanan and Sarkar, 1999).

Customer account profitability analysis describes the process of allocating revenues and costs to customer segments or individual customer accounts, such that the profitability of those segments and/or accounts can be calculated. The calculation of customer account profitability amounts to an extensive activity-based costing (ABC) exercise (Foster and Gupta, 1994). The first step in ABC is the identification of cost pools, i.e., distinctive sets of activities performed within the organization (for example, procurement, manufacturing, customer service). For all cost pools, cost drivers are identified: units in which the resource consumption of the cost pool can be expressed (for example, number of purchase orders, number of units produced, number of service calls). Costs are then allocated to cost objects (such as products) based on the extent to which these objects consume cost driver units. ABC, as a cost accounting method, has revolutionized the way in which costs are allocated to products (Ryals, 2006).

Once it is accepted that not every product requires the same type and same level of activities, it is a small step to see that customers, too, differ in their consumption of resources. The size and number of orders, the number of sales visits, the use of helpdesks and various other services can be very different from one customer to another. Consequently, two customers who buy exactly the same product mix for the same prices (thus generating exactly the same profit margins on their purchases) can have different relationship costs, leading to different levels of customer profitability(Nagle and Hogan,2007).

Studies have indicated that some proportion of customers is unprofitable, at least in the short term, although the degree to which customers are profitable or unprofitable can change substantially from period to period (Wilson, 1996). Because of these period-to-period fluctuations in customer profitability, it is not a suitable measure to support decisions regarding the longer term. Therefore, marketing decisions are taken for the entire relationship with the customer and typically take into account the longer term. A more suitable measure than customer profitability is needed and recent academic attention has shifted towards customer lifetime value and customer equity as measures of the value of the customer that are appropriate to a relationship marketing context (Berger and Nasr, 1998).

Although many industries do not have customer cost and profitability analysis system, a growing number of companies are beginning to develop them and it is imperative that the companies need to develop the information regarding their customers' satisfaction, loyalty, retention, preferences and so on.

Commercial banks need to attract customers, increase a customer market share and need to retain them through providing satisfaction from their services, which is the key to bank's success (Johnson et al., 2000). Banks' customers should have a high satisfaction rate. The increasing competition is forcing the banking sector to pay much and more attention to satisfying customers.

Researchers suggest that increased levels of customer satisfaction and loyalty are frequently attributed to positive outcomes for a bank (Colgate, 1999). Measurement of the rate of customer satisfaction is also a measurement of how products and services supplied by a bank meets or surpasses customer expectation. It increases customer account profitability which is considered as a key performance indicator. This is due to the fact that one of the factors needed in order to attain high competency and also high competitiveness is a high market share through an increased, established and well-sustained customer or client population. Banks are beginning to understand the concept that their customers, the ones who purchase their products and use their services, are the primary drivers of their position on the profitability ladder.

Segmenting existing customers into distinct groups based on their rupee purchases and the product categories which they buy can reveal which accounts are contributing substantially to net profits and which should receive more or less attention relative to others. A pragmatic strategy may be developed based on the perception analysis of various customers grouped by gender, education level, age-group, income group, service and product-related psychographics, and buying behavior of competitors' products for each customer segment.

The customer account profitability analysis provides significant short- and long-term benefits for commercial banks in Nepal. In the short term, identifying high-profit and low-profit accounts enable banks which customers they must hold on to and which customers require a profit-improvement plan. In the long term, having a fundamental understanding of where and how these banks make money by developing sound tactical and strategic decisions. Most importantly, by eliminating unnecessary costs and focusing on what the banks do best and obtain greater profits both today and in the future.

Before 1980, the formal banking system in the country was dominated by government owned banks that had a monopoly in terms of their spread and operations in Nepalese banking industry. The current banking environment has, however, changed dramatically. The reform and deregulation has brought the banking sector into the competitive arena in terms of customers and products. This means strategic management decisions should take into consideration on factors that promote customer satisfaction, customer retention, customer loyalty, employee satisfaction, increased market share and firm profitability. A first step toward this is the need to understand the determinants of customer satisfaction and firm profitability. Then strategic decisions could be made to increase market share and profitability.

Commercial banks play a crucial role in facilitating the accumulation and allocation of capital by channelling individual savings into loans to government, businesses and individuals. In Nepal, the role of the banking sector in capital collection and distribution cannot be ignored. The current credit crunch has affected the performance of many banks globally (Estiri et al., 2011). Thus institutions that adopt strategies to compete better, are more likely to survive in the long run. Within the banking sector, customer satisfaction and loyalty to businesses is one way of keeping banking businesses competitive. Similarly, employee satisfaction also plays a vital role to enhance the market share and profitability of banks.

In Nepal, different forms of commercial banks are operating in the market, which are competing with each other under private, joint venture and public sector ownership. Various banks provide various offers, schemes, and services with wide range of products. Customers have range of choices where proper information can be gathered at cheap cost, and can take the advantage of such competitiveness. In the era of globalization, customers may have more choices in the products and the services. Therefore, the strategy should be developed based on the customers' segmentation.

Similarly, employee satisfaction is also a key attribute of the success of the bank. Employee satisfaction involves a high degree of motivation and inspiration, personal involvement and supportiveness (Oakley, 2004). The employee satisfaction is in turn, translated into the ability and willingness to provide the best customer service, and consequently increases customer satisfaction, as possible. An organization that is able to constantly perpetuate this synergistic relationship benefits by realizing greater customer loyalty that is translated into increased customer account profitability and ultimately increased corporate profitability.

Customer account profitability analysis is a managerial strategy. By applying this strategy, the top level management can develop several policies to retain valuable customers. This discipline also contributes in skills to develop customer relation management to increase the customer satisfaction. This discipline has been intensively used in the banking sector in different countries now days. By pursuing above benefits, this study is directed towards analysis of customers in commercial banks of Nepal. The present study is an attempt to analyse customer and employee satisfaction and their impact on the customer account profitability in the Nepalese commercial banking sector.

1.2 Statement of the Problem

The growing number of commercial banks in Nepal after 1980 in general and after 2000 in particular, has resulted in increasing competition among these banks. Consequently, increasing competition in the Nepalese banking industry has not only deterred new banks, but also distressed the existing ones. In such a situation, it is essential that the Nepalese commercial banks have to formulate and implement a strategy that is customer-focused which will attract more and more new customers and retain them so as to strengthen competitive advantage in the industry.

Modern management accounting system provides some measures by which these commercial banks can analyze their customers in terms of their profitability and categorize customers as profitable and non-profitable customers, and then focus on providing them satisfactory services so as to attract more new customers and retain the existing customers. Despite increased customer orientation and increasing customer costs in the banking industry, traditional management accounting system, however, focuses only on products, departments or regions. Therefore, the traditional management accounting system can rarely produce customer profitability information (Anandarajan and Christopher, 1987), and thereby contribute to understanding the cost of reaching and serving particular types of buyers (Johnson and Kaplan, 1991). In a traditional accounting system, marketing costs are allocated among customers using sales volume as a single cost driver.

Intensity in competition is one reason behind the increased concern for customer account profitability. Customer account profitability analysis is a useful tool in analyzing the customers in terms of their profitability. Many banks in developed countries are convinced that improving corporate profitability requires more customer contact and closer customer relationships. Further, many banks marketing professionals have directed recent attention to increasing customer satisfaction, primarily examining the links between overall satisfaction and revenues. Customer account profitability analysis attempts to bring together marketing and accounting professionals to analyze, manage, and improve customer profitability. Banks are attempting to understand better and to satisfy present and future customer demands. However, the goal is to increase customer satisfaction profitably.

Customer satisfaction has become a major challenge for the commercial banks and it has been recognized that the customer satisfaction is the major source of competitive advantage and this satisfaction also leads towards customer retention, attraction for new customers and positive word of mouth communication, as well (Arambewela and Hall 2009). In today’s highly complex and competitive environment, the survival and growth of commercial banks depends on implementing effective customer-focused strategies. The bank's management needs the best and most accurate information about customers' choices on products and customers' position that determines the bank's success. The information that is generated by a well-implemented profitability measurement process can be an effective tool to provide a competitive edge in an intensely competitive banking industry. Therefore, the present study attempts to address the following research issues:

1. What is the competitive position of commercial banks in Nepal measured in terms of capital adequacy, assets composition, credit risk, management cost, and profitability?
2. What is the level of employees' satisfaction in Nepalese commercial banks?
3. What is the level of customers' satisfaction in Nepalese commercial banks?
4. Do employees and customers' satisfaction affect customer account profitability?
5. What is the extent of relationship of customers' satisfaction and banks' competitive position in Nepal?

1.3 Objectives of the Study

The overall objective of this research is to analyze and examine the customer account profitability of commercial banks in Nepal. To achieve the main objective, the specific objectives are set forth as listed below:

1. To analyze competitive position of commercial banks measured in terms of capital adequacy, assets composition, deposit, credit risk and cost of management and their impact on bank's profitability.
2. To assess the customers' and employees' level of satisfaction in Nepalese commercial banks.
3. To evaluate the customer account profitability situation based on different socio-economic variables.
4. To measure the effects of employees and customers' satisfaction on customer account profitability
5. To identify the factors affecting customer account profitability.

1.4 Scope and Limitations of the Study

- There are many financial variables which can be used to explain the competitive position of commercial banks. This study only includes those financial ratios that have been suggested by the literature.
- There are many commercial banks in Nepal that are established in different time periods. In order to maintain homogeneity and include data from all commercial banks, therefore, the study uses only two years' data of 30 commercial banks at the end of Mid July, 2012.
- There are a lot of factors affecting customer account profitability and banks profitability. However, only few customer satisfaction and employee satisfaction variables together with some of the selected financial ratios have been used to analyze the customer account profitability of Nepalese commercial banks.

1.5 Organization of the Study

The study is organized into seven broad chapters. Each chapter contains different aspects of the customer account profitability and commercial banks. Chapter 1 focuses on introduction, statement of problem, objectives and limitations. Chapter II covers the literature review, theoretical frame work, and conceptual frame work and research gap as well. It describes the different aspects of customer account profitability related studies done in Nepal and other countries in the past. Chapter III explains the methodological aspects of the study, which deals about research design, nature and sources of data, profitability variables used in research, and hypothesis tests.

Chapter IV explains trends and status of some of the financial indicators of Nepalese banking industries. It focuses on general background, analysis of financial ratios and their effect on profitability of commercial banks in Nepal. It also compares financial performances of government, joint-venture and private commercial banks in Nepal. Chapter V describes the levels of customer and employee satisfaction of customers and employees of commercial banks. It includes introduction, theoretical background, measurement of satisfaction levels of employees and customers, demographic profiles of customers and employees, data and methodology. Customer account profitability analysis and its determinants are described in chapter VI. Basically, it covers the meaning of customer account profitability, methodology and data, analysis, customer account's profitability in relation to various socio-economic statuses of the respondents. Finally, chapter VII is concerned with summary, findings and conclusions.

CHAPTER II

REVIEW OF LITERATURE

In this chapter, various literatures related to customer satisfaction, customer retention rate, employee satisfaction, employee turnover, customer relationships, customer size, customer loyalty, resources allocation, activity based costing; customer portfolio theory, determinants of banks' profitability and customer account profitability in banking and other industries are reviewed and analyzed.

2.1 Customer Satisfaction, Loyalty, Retention and Profitability

This section deals with a link between customer satisfaction, loyalty, retention and profitability of companies. Customer satisfaction is the state of mind that customers have about a company when their expectations have been met or exceed over the lifetime of the product or service. The achievement of which indicates and leads to company loyalty and product repurchase (Cacioppo, 2000). Because the nature of customer satisfaction is more of a function of the psychological state or behavior, much care should be taken into consideration in measuring it quantitatively and also in the processing of the data. A number of benefits can be derived from customer satisfaction measurements.

Customer satisfaction can change overtime. Changes in the level of customer satisfaction could be a result of greater experience with the program components; or the changes may be associated with a reevaluation of the original experiences and the context of those experiences. Different reasons or explanation of such changes suggest that the timing of measurement is important and measuring and interpreting customer satisfaction can be challenging (Hillabrant, 2003).

Many studies suggest the need for organizations to focus on their level of service delivery to the customer. Increasingly, the only thing that separates one business from its competitors is the level of service provided (Saxby, 2006).

Firms try to attract customers and attempt to satisfy them with their products or services in order to enhance customers' loyalty. Among various methods to measure a firm's competitiveness and marketing performance, customer satisfaction is a most universally accepted measurement (Morgan, Anderson, and Mittal, 2005), as well as an influential performance metric (Kaplan and Norton, 1996). Many firms attempt to measure customer satisfaction in order to evaluate whether they meet their customers' needs better than their competitors (Fornell, Mithas, Morgeson, andKrishnan, 2006). Theoretically, it can be assumed that increasing customer satisfaction is more likely to bring positive outcomes such as increasing sales volume and market share. Thus, marketplace outcomes such as sales or market share have become a traditional method of evaluating the success of marketing strategies (Lehmann, 2004).

Measuring customer satisfaction is a relatively new concept to many companies that have been focused exclusively on income statements and balance sheets. Companies need to understand how to quantify measure and track customer satisfaction (Cacioppo, 2000). Customer satisfaction surveys are one of the primary tools for hearing the voices of the customers. It let the companies view their corporate performance through the views and perspectives of the customers (David, 2006). The most important opportunities for organizations creating or updating a customer feedback system are to be explicit about the motives and intentions regarding the use of customer feedback (Israel, 2000). Measures of customer loyalty are selected because they reflect both length (retention) and depth (cross sell) of the bank-customer relationship. Length of relationship is reported by both division-reported customer retention rates (percentage of customers who remained for long period of time) and mean customer-reported relationship tenure. Relationship depth is measured by division cross-sell rates, which record the percentage of customer households with multiple accounts (account cross sell) or multiple services (service cross sell).

An effective way to measure and gauge customer expectations and satisfaction is through the use of customer relationship management tools. Maintaining control of customer relationships is possible only through consistent implementation of classic, well-proven customer bonding techniques, such as individualized customer care and communications, rewards for customer value and loyalty, special consideration for high-value customers and customized products and services (Ferruzza, 1999). According to the literature, implementing customer relationship management strategies is the most effective way to accomplish this. Companies know they need to pay attention to their customers. They know the financial benefits that come from keeping their customers happy. And they've done their best to put satisfaction programs in place. Yet regular monitoring of various U.S. industries reveals that relatively few companies (17%, as of 2000) have improved their customer satisfaction index measured after six years (McEwen, 2005).

"Tracking customer satisfaction alone is no longer sufficient and is often misleading. But when combined with two other factors – loyalty attitudes, and needs and discretion – it can play an important role" (Gokey and Coyles, 2001). The real essence of customer loyalty is finding ways to take advantage of opportunities for customer contact and service. It is critical to tap as many as possible to create lasting loyalty (Kindinger, 2005). Many recent studies provide empirical evidence of customer loyalty as a key driver of profitability (Fornell et al., 2006). The most important basis for strategy development, however, is a comprehensive understanding of what drives customer loyalty and how strong those drivers are (Teegarden and Krok, 2006).

"There is an abundance of literature that draws the connection between the attitudes of employees and the attitudes of the customers toward the company. Numerous studies support the claim that employees with favorable attitudes provide better customer service, and in most cases, improve the quality of customers' experience" (Johnson, 2006). The research asserted that it was not enough to just deliver great customer service; it is necessary to translate their service into customer loyalty. The best way to engender a greater degree of customer loyalty is to exceed customer expectations and anticipate their needs. Expectations are constantly evolving because improvements in service shift customer demands. While customers initially appreciate better services, they quickly get used to, expect and demand them (Cleveland, 2003). Customers continued to favor organizations that provide unique, one-on-one, personalized service, whether it was delivered face-to-face or over the Internet (Colombo, 2006).

Customer retention is the activity that a selling organization undertakes in order to reduce customer defections. Successful customer retention starts with the first contact an organization has with a customer and continues throughout the entire lifetime of a relationship. A firm's ability to attract and retain new customers, is not only related to its product or services, but strongly related to the way it services its existing customers and the reputation it creates within and across the marketplace.

Customer retention is more than giving the customer what they expect; it is about exceeding their expectations so that they become loyal advocates for your brand. Creating customer loyalty puts 'customer value rather than maximizing profits and shareholder value at the center of business strategy'. The key differentiation in a competitive environment is often the delivery of a consistently high standard of customer service.

Customer retention has a direct impact on profitability. Research by John Fleming and Jim Asplund (2003) indicates that engaged customers generate 1.7 times more revenue than normal customers, while having engaged employees and engaged customers returns a revenue gain of 3.4 times the norm.

Table 2.1 presents the reviewed articles associated with these topics:

Table 2.1
Articles associated with customer satisfaction, customer loyalty, customer relationship, and customer retention and profitability

Year	**Author(s)**	**Topics**
1996	Ennew et al.	The impact of service quality and service characteristics on customer retention in banks
1997	Kangis et al.	Private and public banks: a comparison of customer expectations and perceptions.
1997	Anderson et al	Customer satisfaction, productivity and profitability: Differences between goods and services
1999	Athanassopoulos	Corporate customer behavior towards financial services
1999	Caru&Cugini	Profitability and customer satisfaction in services
1999	Söderlund&Vilgon	Customer Satisfaction and Links to Customer Profitability: An Empirical Examination of the Association Between Attitudes and Behavior
2000	Nielsen et al	Barriers to customer-oriented management accounting in financial services
2001	Chapman	Clients, customers and buyers
2001	Homburg et al	Personal characteristics as moderators of the relationship between customer satisfaction and loyalty
2001	Rampersad	75 painful questions about customer satisfaction
2001	Survey results	Customer relationship management in the Dutch private banking market
2002	Jamal and Naser	Customer satisfaction and retail banking: an assessment of some of the key antecedents of customer satisfaction in retail banking
2002	Buttle	Customer retention strategies at a UK telephone bank
2003	Visser	Customer satisfaction is dead
2003	Niraj et al	Understanding Customer Level Profitability Implications of Satisfaction Programs
2003	Farquhar	Customer retention in retail financial services: an employee perspective
2003	Gupta and Lehmann	Customers as assets
2004	Pegler et at	Seven ways to hold fast to your customers

2004	Hooi Yee Ng	Information requirements for customer relationship management: a case study in a New Zealand bank
2005	Keiningham	Does customer satisfaction lead to profitability
2005	Nagar	Measuring customer relationships: the case of the retail banking industry
2005	Lindgreen et al	Customer relationship management: the case of a European bank
2006	Wisskirchen	The customer- led bank: converting customers from defectors into fans
2006	Leverin&Liljander	Does relationship marketing improve customer relationship satisfaction and loyalty?
2006	Sabrina et al	Suppliers' willingness to end unprofitable customer relationships
2007	Allon et al	Managing customers with vague promises
2007	Detrick	Competitive banking: loyal customers lead to long term growth and profitability
2007	John Mylonakis	A Research Study of Customer Preferences in the Home Loans Market: The Mortgage Experience of Greek Bank Customers
2008	Leung	CRM implementation at Super commercial bank limited-customer , strategy, people , process and strategy
2008	Mavri and Ioannon	Customer switching behavior in Greek banking services using survival analysis
2008	Niraj et al	Understanding customer level profitability implications of satisfaction programs
2008	Kaplan and Narayanan	Customer profitability measurement and management
2009	Mary Pilecki	Customer retention is a process, not an event
2009	Fillip &Anghel	Customer loyalty and its determinants in a banking services environment
2009	Chuan Zhang &Fei Pan	The impacts of customer satisfaction on profitability: a study of state-owned enterprises in China
2009	Said et al	Customer-Focused Strategies And Information Technology capabilities: Implications For Service Quality Of Malaysian Local Authorities
2009	Sarlak&Fard	The Impact of CRM on the Customer Satisfaction in Agricultural Bank
2009	Guo	Strategies of customer relationship profitability in retail banking
2010	Nupur	E-banking and customers' satisfaction in Bangladesh: An analysis
2010	Naveed&Kashif	Customer satisfaction and awareness of Islamic banking system in Pakistan
2010	Ernst and Young	Understanding customer behavior in retail banking
2010	JayaramanMunusamy et al	Service Quality Delivery and Its Impact on Customer Satisfaction in the Banking Sector in Malaysia
2010	Titko& Lace	Customer satisfaction and loyalty in Latvian retail

		banking
2011	JenetManyiagbor	The Relationship between Customer Satisfaction and Service Quality: a study of three Service sectors in Umeå.
2012	Craig Bailey	Unlocking The Value of Your Customer Satisfaction Surveys
2012	WaqarulHaqBakhtiar Muhammad	Customer Satisfaction: A Comparison of Public and Private Banks Of Pakistan
2013	Gerald R. Faulhaber	Banking markets: productivity, risk, and customer satisfaction
2013	Phil Auerbach et al.	Banking on customer centricity: Transforming banks into customer – centric organizations.
2013	Ronak A. Mehata	Banking Services and Customer satisfaction – A Study of Public and Private Sector Banks in Navsari City
2013	P. C. Mandal and S. Bhattacharya	Customer Satisfaction in Indian Retail Banking: A Grounded Theory Approach
2013	Umma Salma , Mir Abdullah Shahneaz	Customer Satisfaction: A Comparative Analysis of Public and Private Sector Banks in Bangladesh
2013	Ronak A. Mehta	Banking Services and Customer Satisfaction – A Study of Public and Private Sector Banks in Navsari City
2013	Nazemi et al.	An Investigation and Prioritization of the Factors Affecting Customer Satisfaction with Banking Services by MCDM Method (A Case Study: Bankmeliiran, Isfahan's Branches)
2014	Ramesh Neupane	Relationship between customer satisfaction and business performance in Lloyds bank UK: a case study

2.1.1 Customer Satisfaction, Customer Loyalty and Profitability

The literature pertaining to relationships among customer satisfaction, customer loyalty, and profitability can be divided into two groups. The first, service management literature, proposes that customer satisfaction influences customer loyalty, which in turn affects profitability. Those who support their propositions include researchers such as Anderson and Fornell (1994); Gummesson (1993); Heskettet al.,(1990); Heskettet al.,(1994); Reicheld and Sasser (1990); Rust, et al. (1995); Schneider and Bowen (1995); Storbackaet al.,(1994); and Zeithamlet al.,(1990). In their studies, these researchers discuss the links between satisfaction, loyalty, and profitability. Statistically-driven examination of these links has been initiated by Nelson et al. (1992), who demonstrated the relationship of customer satisfaction to profitability among hospitals. Rust and Zahorik (1991) examined the relationship of customer satisfaction to customer retention in retail banking. The Bank Administration Institute also explored these ideas, (Roth and Van der Velde 1990, 1991).

The service management literature argues that customer satisfaction is the result of a customer's perception of the value received in a transaction or relationship – where value equals perceived service quality relative to price and customer acquisition costs (Blanchard and Galloway, 1994) – relative to the value expected from transactions or relationships with competing vendors (Zeithamlet al., 1990). Loyalty behaviors, including relationship continuance, increased scale or scope of relationship, and recommendation (word of mouth advertising) result from customers' beliefs that the quantity of value received from one supplier is greater than that available from other suppliers. Loyalty, in one or more of the forms noted above, creates increased profit through enhanced revenues, reduced costs to acquire customers, lower customer-price sensitivity, and decreased costs to serve customers familiar with a firm's service delivery system (Reicheld and Sasser, 1990).

The second relevant literature is found in the marketing domain. It discusses the impact of customer satisfaction on customer loyalty. Yi's "Critical review of customer satisfaction" (1990) concludes, "Many studies found that customer satisfaction influences purchase intentions as well as post-purchase attitude" (Yi, 1990).

The marketing literature suggests that customer loyalty can be defined in two distinct ways (Jacoby and Kyner, 1973). The first defines loyalty as an attitude. Different feelings create an individual's overall attachment to a product, service, or organization (Fornier, 1994). These feelings define the individual's (purely cognitive) degree of loyalty.

The second definition of loyalty is behavioral. Examples of loyalty behavior include continuing to purchase services from the same supplier, increasing the scale and or scope of a relationship, or the act of recommendation (Yi, 1990). The behavioral view of loyalty is similar to loyalty as defined in the service management literature. This study examines behavioral, rather than attitudinal, loyalty (such as intent to repurchase). This approach is intended, first, to include behavioral loyalty in the conceptualization of customer loyalty that has been linked to customer satisfaction and second, to make the demonstrated satisfaction/loyalty relationship immediately accessible to managers interested in customer behaviors linked to firm performance.

Both the service management and the marketing literature suggest that there is a strong theoretical underpinning for an empirical exploration of the linkages among customer satisfaction, customer loyalty, and profitability. The relatively small quantity of empirical research performed on these relationships to date (Storbackaet al., 1994) is probably the result of the paucity of organizations' measuring "soft" issues, such as customer satisfaction and customer loyalty, in meaningful ways.

2.1.2 Service Quality and Profitability

Managing customer orientation and service quality is commonly identified as being one of the most effective means of building a competitive position in a service industry and improving organizational performance (Lewis, 1993). Indeed, a managerial perspective suggests that investment in service quality and the building and maintenance of customer relationships can only be justified if it results in improved profitability (Rust and Zahorik, 1993). There is already an extensive literature dealing with the definition and measurement of service quality (Gronroos, 1984), but the linkages between service quality and organizational performance have been less thoroughly investigated (Thorpe, 1994). Evidence from the database indicates that high quality service offers result in more repeat purchases and market-share improvements while Rust and Zahorik (1993) provide evidence of a link between customer retention and market share. However, there is still empirical debate about the nature of the causal relationships linking service quality, loyalty, retention and performance although there are strong conceptual arguments for their existence (Thorpe, 1994).

The existence of a link between retention and profitability can be derived from a simple cost-benefit equation. The costs of customer acquisition are generally higher than costs of retention (Reichheld and Kenny, 1990) and this inequality is particularly in evidence in the service sector. Consequently, small reductions in customer defection rates can produce significant improvements in profitability. These improvements arise as a consequence of both cost savings and additional revenue generation.

In principle, additional revenue is generated partly because established customers would tend to spend more in the course of their association with an organization and partly because such customers are thought to be less price sensitive and more willing to pay higher prices. Non-financial benefits arise because satisfied and loyal customers will tend to engage in positive word-of mouth communication which may stimulate further customer acquisition. Cost savings may arise when the organization can meet customer needs more cost effectively as a consequence of being more knowledgeable about those customers.

A variety of factors have been identified as potentially increasing or improving customer retention rates. These factors include senior management commitment, customer-focused cultures, a clearly targeted marketing campaign and the identification of switching barriers (Clark and Payne, 1993). The motivations and behavior of customer contact staff may be of particular relevance to retention. In discussing the hidden advantages of customer retention, Reichheld and Kenny (1990) stress the importance of employee satisfaction.

Quality has been defined as superiority or excellence (Zeithaml, 1988), or, as the consumer's overall impression of the relative inferiority/superiority of the organization and its services (Bitner and Hubbert, 1994). Perceived service quality has been defined as the consumer's global attitude or judgments of the overall excellence or superiority of the service. Perceived service quality results from comparisons by consumers of expectations with their perceptions of service delivered by the suppliers. It is argued that the key to ensuring good service quality perception is in meeting or exceeding what customers expect from the service. Thus, if perception of the actual service delivered by the supplier falls short of expectation, a gap is created which should be addressed through strategies that affect the direction either of expectations or perceptions, or both (Parasuramanet al., 1985). Closing this gap might require toning down the expectations or heightening the perception of what has actually been received by the customers or a little of both. Customer expectations are beliefs about a service that serve as standards against which service performance is judged (Zeithamlet al., 1993); what customers think a service provider should offer rather than what might be on offer (Parasuramanet al., 1988). Expectations are formed from a variety of sources such as the customer's personal needs and wishes

(Edvardsson et al., 1994), the customer's personal philosophy about a particular service, by promises (staff, advertising and other communications), by implicit service promises (such as price and the tangibles associated with the service), by word-of-mouth communication (with other customers, friends, family and experts), as well as by past experience of that service (Zeithaml and Bitner, 1996).

In times of severe competition and rising customer expectations, firms are highly interested in keeping existing customers. As virtually all companies depend on repeat business, a strong interest in the antecedents of customer loyalty has evolved. Typically, customer satisfaction is thought of as an immediate antecedent to customer loyalty (Jones and Sasser, 1995). In turn, customer loyalty should lead to increasing shareholder value and asset efficiency (Rust and Oliver, 1994). Thus, achieving high levels of customer satisfaction has become a major goal for many companies.

The strong focus on customer satisfaction is based on the implicit assumption that there is a strong positive relationship between customer satisfaction and loyalty. Recently, however, the existence of this strong link has been questioned by managerial writers (Jones and Sasser, 1995). Although these authors provide fragmented evidence for high defection rates of satisfied customers, this phenomenon remains largely unexplored in academic literature (Oliver and MacMillan, 1992).

Early concepts of satisfaction research have typically defined satisfaction as a post choice evaluative judgment concerning a specific purchase decision (Bearden and Teel, 1983). The theoretical model underlying the vast majority of early satisfaction studies is some version of the confirmation/disconfirmation paradigm (Oliver and Swan, 1989).

Recent literature adds to this perspective in two ways. First, although traditional models implicitly assume that customer satisfaction is essentially the result of cognitive processes, new conceptual developments suggest that affective processes may also contribute substantially to the explanation and prediction of customer satisfaction (Westbrook and Oliver, 1991).

Second, authors have claimed that satisfaction should be viewed as a judgment based on the cumulative experience made with a certain product or service rather than a transaction-specific phenomenon (Wilton and Nicosia, 1986). Especially with regard to the relationship between customer satisfaction and loyalty, conceptualizing satisfaction as the outcome of one single transaction might be too restrictive. Dissatisfaction with a single transaction is unlikely to cause the customer to switch (Fornell, Johnson, Anderson, Cha, and Bryant, 1996). Also, a single transaction producing a state of satisfaction is unlikely to lead to long-term loyalty. Research in the growing field of relationship marketing using the construct of customer satisfaction has also focused on a cumulative rather than a transaction-specific conceptualization (Ganesan, 1994).

The modeling of loyalty has a long history in the academic literature. Within the marketing discipline, articles dealing with the subject of brand loyalty can be traced back to the early 1920s (Copeland, 1923). The majority of early loyalty studies conceptualized loyalty behaviorally, as a form of repeat purchasing of a particular product or service over time. Although some authors focused on the sequence in which brands were purchased (Brown, 1952), others measured loyalty through the proportion of purchases devoted to a given brand (Cunningham, 1956). A third group concentrated on stochastic measures like probability of purchase (Farley, 1964). Finally, some authors combined several behavioral criteria in their empirical studies (Frank, Massy, and Lodahl, 1969).

In his frequently quoted article, Day (1969) criticizes the use of solely behavior-based loyalty measures because these do not distinguish between true loyalty and spurious loyalty: "The key point is that these spuriously loyal buyers lack any attachment to brand attributes, and they can be immediately captured by another brand that offers a better deal…" (Day, 1969). Accordingly, he suggests a two-dimensional conceptualization of loyalty adding an attitudinal dimension to the behavioral component. Consistent with this perspective, Jacoby (1971) provides a conceptual definition of brand loyalty that stresses the importance of a conscious evaluation process leading to loyal behavior, thus excluding random repeat purchasing (Jacoby and co-workers, 1973). Recent research has tended to adopt this two-dimensional conceptualization of loyalty (Howard and Havitz, 1992).

Some literature, however, suggests that service quality is not a uni-dimensional construct. Rather, service quality incorporates a number of dimensions such as reliability, tangibles, responsiveness, assurance and empathy (Carman, 1990; Gronroos, 1984). Although the number and composition of service quality dimensions are likely to be dependent on service settings (Brown et al., 1993; Carman, 1990), one can argue that there are two overriding dimensions of service quality (Levesque and McDougall, 1996). The first one refers to the core aspects of the service (e.g. reliability) and the second one refers to the relational or process aspects of the service (e.g. tangibles, responsiveness, assurance and empathy) (Parasuraman et al., 1991a).This is due to the fact that reliability is mainly concerned with the outcome of service, whereas tangibles, responsiveness, assurance and empathy are concerned with the service delivery process. It is proposed that both the core and relational dimensions of service quality are likely to be antecedents of customer satisfaction (Parasuraman et al., 1991a).

2.1.3 Customer Satisfaction in Banking Industry

Increased competition in the market with little product differentiation and years of continual sales growth followed by two decades of flattened sales curves have indicated to today's sharp competitors that their focus must change (Cacippio, 2000). Customer satisfaction programs are considered to be weapons that many companies use in fighting the battles in today's marketplace (Lenz, 1999). Organizations usually invest in customer satisfaction measured because they assume that satisfied customers will engage in a number of behaviors beneficial to the company and demonstrate a long-term commitment to their brand. These behaviors and actions include but are not limited to, continuation of the customer relationship, deepening of the customer relationship through cross-selling, and referrals to new customers (Murphy, 2001). Effective usage of customer measurement and management system can build organizational value (Johnson et al., 2000). Researchers have recognized significant relationships between customer satisfaction and profitability and other economic effects. One of which relationship is the customer satisfactions influence and equivalent success with profitability.

The empirical literature on the nature of the relationship of customer satisfaction and economic benefits is still growing, but it is still in its infancy in many respects. Researchers suggest and point toward the significant relationship between customer satisfaction and economic performance in general (Fornell et al., 2006). The assumption of a customer-profit link is the heart of the service profit chain (Heskett et al., 1997). The long-term success of any business depends on providing customers with value band satisfaction that will influence them to repurchase and grow together (Lee et al., 2004).

By providing the linkage between customer satisfaction and profitability, it also provides the ultimate justification for measuring customer satisfaction (Murphy, 2001). Research has demonstrated that a highly satisfied customer is six times more likely to re-purchase than a customer who is merely satisfied (Jones and Sasser, 1995). Both marketing and neoclassical economics view consumer utility or satisfaction, as the real standard for economic growth. The extent to which buyers financially reward sellers that satisfy them and punish those that do not and the degree to which investment capital reinforces the power of the consumer are fundamental to how markets function (Fornell et al., 2006). By building strong relationships with customers, it can help reduce customer turnover rates, and thereby increasing profitability (Reicheld and Sasser, 1990) due, in part, to the fact that retaining customers is significantly less costly than acquiring new customers (Liswood, 1992).

Customer satisfaction, as suggested by empirical evidences, tends to improve repeat business, usage levels, future revenues, positive word of mouth, reservation prices, market share, productivity, cross-buying, cost competitiveness, and long-term growth and if it tends to reduce customer complaints, transaction costs, defective goods, price elasticity, warranty costs, field service costs, customer defection, and employee turnover, it seems logical to expect that these effects will eventually affect stock prices and company valuations (Fornell et al., 20006). Companies and firms have recognized that through exceeding customer expectations is a worthy goal, exceeding those expectations, profitability is necessary for long-term corporate viability. In order to understand corporate profitability, there is also a need to understand what drives shareholder value in organizations. In the current trends, companies are focusing on the relationships between employee satisfaction, customer satisfaction and corporate profitability (Epstein and Jones, 2000). A strong relationship and tie should be established and maintained in the process of achieving high customer satisfaction. Each single conflict within an organization can have far-reaching consequences in long-term customer satisfaction, and that the human element- the way an employee interacts with a customer – plays the dominant role. The mentioned factors and practices strongly support that service recovery skills and procedures are critical in maintaining customer satisfaction (Belding, 2004).

The challenge for companies is to provide customers to have smart, appropriate interactions regardless of which channels they use. The focus of bottom line growth will never relent. Firms also need to secure loyalty and increase the profitability of those clients aside from retaining their customers (Winters, 2008). Recent researches have confirmed that customer satisfaction and customer loyalty are related to key measures of financial performance, including but not limited to retention. Companies with loyal clients or customers tend to register higher customer satisfaction, increased sales, lower costs, and more predictable profit streams (Grossman, 1998).

2.1.4 Customer Satisfaction: A Comparison of the Public and the Private Sector Banks

The private sector banks seem successful to satisfy their customers with good services and they have been successful in retaining their customers by providing better facilities than public sector banks (Puja, 2010). But, still private banks need to go a long way to become customer’s first preference. In an economy of innovative technologies and changing markets, each and every service quality variable has become important. New financial products and services have to be continuously introduced in order to stay competent and private banks need to concentrate more on their credit facilities and insurance services since customers do not have a very good opinion about these facilities being offered by private banks. The public sector banks enjoy the trust of the customers, which they have been leveraging to stay in the race however they need to improve their service quality by improving their physical facility, infrastructure and giving proper soft skill trainings to their employees (Puja et al., 2010).

In the banking industry, it is necessary to increased adoption of technology to better meet customer requirements, improve efficiencies, reduce costs and ensure customer delight and it was the private sector and foreign banks which established the technological revolution in Indian banking and considering the fact that in the new economy, mind share leads to market share and mind share is influenced not only by the promotions and advertisements but more importantly on favorable customer perception which in turn is based on satisfaction with regard to products, services and interaction (Tiwary, 2011).

The private sector banks are providing more satisfactory ATM services than the public sector banks and the customer perception about productivity, security and sensitivity, cost efficiency, problem handling, compensation and contact services related to ATM service is very less in both the public sector and private sector banks, Therefore both kinds of banks should be aware about these facets of ATM service to improve customers’ satisfaction (Kumbhar, 2011). The entry of information technology into the banking industry has created a revolution and it has prompted commercial banks of India to design world-class customer service systems and practices, to meet the growing customer needs. It is interesting to note that the results are consistent with the previous studies conducted on customer service aspects, and it has been observed that the foreign and the new generation private sector banks are serving the customers better (Rengasamy et al., 2006).

2.1.5 Customers Perceptions and Expectations

Quality expectation and the valuation of services received are slightly more in the private sector banks as compared with the public sector banks. The effects for tactic since sectorial differentiation become very blurry as a result of increasing correspondence between services and struggle from linked and additional industries (Peters et al., 2004).

Service quality is one of main elements of customer satisfaction and their intention to purchase. However, the customers of the public and the private sector banks are different in terms of their perception of service quality. The private banks have been observed to be higher on dimensions of service quality: effectiveness and convenient while, the nationalized banks are better on the dimensions of price and consistency. Private bank customers are more satisfied with the services then public banks. Managers in the banking sector undertake significant efforts to conduct customer satisfaction surveys and it is appeared that customers are saying that they expect good products and quality to their banks and that may the only thing important to them (Naveed, 2009).

a. Image and Reputation of Banks

Some publicly owned banks are scoring well among customers, but overall analysis shows that satisfaction rate in customers of private banks is much higher than public sector banks and people will continue the mortgage with the private banks than the public because they are impressed by the level of honesty of the private banks (Beasty, 2005).

b. Performance of Banks

After the privatization of state-owned banks, their performances in comparison to other banking groups have increased by 95%. The performance of private banks after privatization of the state banks had significant reduction, which indicates that the share of the market of the newly privatized state-owned banks increased. Although the performance of the privatized state banks after privatization has increased significantly (Khodaei et al., 2007).

The economic reforms and the entry of private players have caused nationalized banks to revamp their services and product portfolios to incorporate new, innovative customer-centric schemes. Nowadays, due to the rise in competition, customer satisfaction is considered to be the most important thing in retail services, but there is no noteworthy difference in customer satisfaction of the public sector and the private sector banks.

c. Price and Packages

Cheque deposits and cheque clearing are most common services used by customers, the charges levied by the bank on these services are higher in private and foreign banks then in nationalized banks (Surabhi et al., 2011). Their study also shows that the customers of public banks were not much satisfied with the behavior of employee and infrastructure, while customers of private and foreign banks were not much satisfied with high charges, approachability and communication. They have also suggested that training on stress management and public dealing should be imparted to the employees of nationalized banks and nationalized banks need to improve their infrastructure and ambience to compete with private and foreign banks in India.

Credit cards have become a part of life. In recent years there was a lot of demand has been shown for credit cards and there is a lot of scope for credit cards business in India. The credit cardholders consider eleven 'very important' variables which "Satisfied" them are: Joining Fee, Annual fee, Minimum payment due, Cash withdrawal possibility, availability of ATMs, life insurance cover, card replacement fee, air insurance, baggage cover, lost card liability-after losing the card and lost card liability-before losing the card (Chennappa and Eliat, 2009).

d. Location and Infrastructure

Proper location of the bank branches is essential from the customer's point of view. When the private sector banks were compared with the public sector banks, all the private sector banks have excellent locations from business point of view compared to the public sector banks in India and for providing better service to customers. Proper trainings to the bank's staffs are also needed for rendering and gratifying services to the customers. The rigid policy of the public sector banks creates more dissatisfaction among the customers while for the private sector banks mostly the value of service is the key factor of satisfaction (Mishra et al., 2011).

e. Quality of Customer Services

First dimension of customer satisfaction for nationalized banks is service orientation but, for private banks, service orientation appeared as second dimension and they focus more on customer satisfaction and nationalized banks give more importance to flexibility in use of services, vision and competency. Also customers of nationalized banks had not been given much importance by the executives. On the other hand, customers of private banks had been offered these services right from the beginning therefore, customers of private banks are more satisfied than public banks (Mishra, 2007). The customers of nationalized banks are more satisfied with service quality, than private banks and it is required to ascertain the key success aspects in the industry, in terms of satisfaction of customers by keeping in view the growing market size and the strong competition (Mengi, 2009). The private sector banks came to existence within the last ten years with the objective of, to limit the government intervention in banks and from since then they try hard to obtain customer satisfaction even after a short period of existence. According to a survey, the result shows that the private sector banks are more popular to obtain customer satisfaction than the public sector banks (Asgarian, 2009). Satisfaction of customers is the most important forecaster of service quality of the banking sector.

Management of banks should confirm that the banking atmosphere should focus on quick and fair services to their customers. The public sector banks are contributing more credit facility to fishermen and farmers than private banks and the State Government announcement of giving the agricultural loan has given more satisfaction to the consumers of public banks (Kumar et al., 2011). The effort towards ease of banking and accessibility is preferred by the customer who is more seen in the private sector banks than the public and customer care and customer retention programs should take into consideration by the public sector banks. In Kuwait, Muslim customers are satisfied more with accessibility of ATM machines in multiple locations, funds safety, ease to use ATM machines and service quality provided, but the worse element which has been noticed in this study was that the interest rate on loans, which was the indicator of that the most of customers in Kuwait give more intention to loans (Khaled et al., 2008). Service quality is an important feature of customer satisfaction in the Indian banking industry irrespective of public sector and the private sector banks and customer satisfaction is found to be strongly associated with propensity to recommend (Bedi, 2010)

Some of the respondents choose the SBI bank, because the bank is providing more ATM facility to the customers and many of the respondents say the reason to choose the services of the SBI bank because they are good in efficient customer service, but many of the respondents are not aware of the many services provided by the SBI bank. A few of the customers deposit cash into ATM, request for cheque book in ATM, end of the day balance in mobile, etc. While some of the respondents choose the ICICI bank, because the bank is more reliable to the customers and many of the respondents are saying the reason to choose the services of the ICICI bank, because they are good in efficient customer service and efficient complaint handling. Finally, both the banks are competing equally with each other, but SBI bank is little bit below the line in customer complaints handling when compared to ICICI bank (Asgarian, 2009).

2.1.6 Customer Satisfaction-Profit Model

Bloemer *et al.* (1998) used multivariate regression analysis, and recommended a model that describes the relationship between service quality, satisfaction with bank and loyalty, taking into account the effect of the image that a bank has in the market. The results reveal that image is indirectly related to bank loyalty via perceived quality. Service quality is both directly and indirectly related to bank loyalty via satisfaction, and finally that satisfaction has a direct effect on bank loyalty.

The question of “How does a bank develop satisfied clients in order that the relationship with the bank becomes long-term?” was also investigated by Paulin *et al.* (1998). The relationship between commercial banks and client was studied using *t*-test for independent samples. The results indicated that relational as well as short-term economic variables are important for successful commercial banking and that front-line personnel may not accurately assess the client's reality.

Switching costs are increasingly used into the models of customer loyalty. According to Jones *et al.* (2002), switching costs can be thought of as barriers that hold customers in service relationships. Levesque and McDougall (1996) pointed out that customer satisfaction and retention were critical for retail banks. The study investigated the major determinants of customer satisfaction and future intentions in the retail bank sector. Some determinants, which included service quality dimension, service features, service problems, service recovery and products used, were identified by using regression models. It is concluded that service problems and the bank's service recovery ability had a major impact on customer satisfaction and intentions to switch. Krishnan *et al.* (1999) examined the drivers of customer satisfaction for financial services via a Bayesian analysis. It is found that satisfaction with product offerings is a primary driver of overall customer satisfaction. The analysis also indicated that the impact of service delivery factors, such as traditional branch offices, information technology, may differ substantially across customers segments.

Even though the terminology of the main constructs (quality perception; customer satisfaction; loyalty) is about perceptions and behavior of consumers, it should be realized that these constructs are explicitly linked to what has been labeled the employee variables. The perception of the relationship value, as a direct determinant of customer satisfaction and an indirect determinant of profitability, hinges on the trust that exists between the customer and the service provider as represented by the employees with whom the customer is in more or less frequent contact. Likewise, the perception of service quality is co-determined by the customer's perception of the employee. Although employees can be trained in politeness and helpfulness, it is probable that the general state of mind of employees is mirrored by the perceptions that consumers are holding. The general assumption therefore is that, although it is not explicitly specified in the model at this stage, employee satisfaction feeds into the model via the employee related variables that determine the main customer constructs.

Focusing on this part of the service profit chain, the empirical tests of the customer-profit model indicate positive causal relationships running from customer perception of service quality and relationship value to customer satisfaction and to customer loyalty and positive word of mouth, and ultimately profitability. Customer perception of service quality has a positive influence on customer satisfaction, and employee service attitude is more important in the customer perception of service quality. The customer perception of relationship value has a positive influence on customer satisfaction. Among the three components (social benefits, special benefits and trust) of relationship value perceived by customers, trust is considered to be most important by customers, followed by social benefits and special benefits, suggesting that trust plays a key role in managing customer relationships.

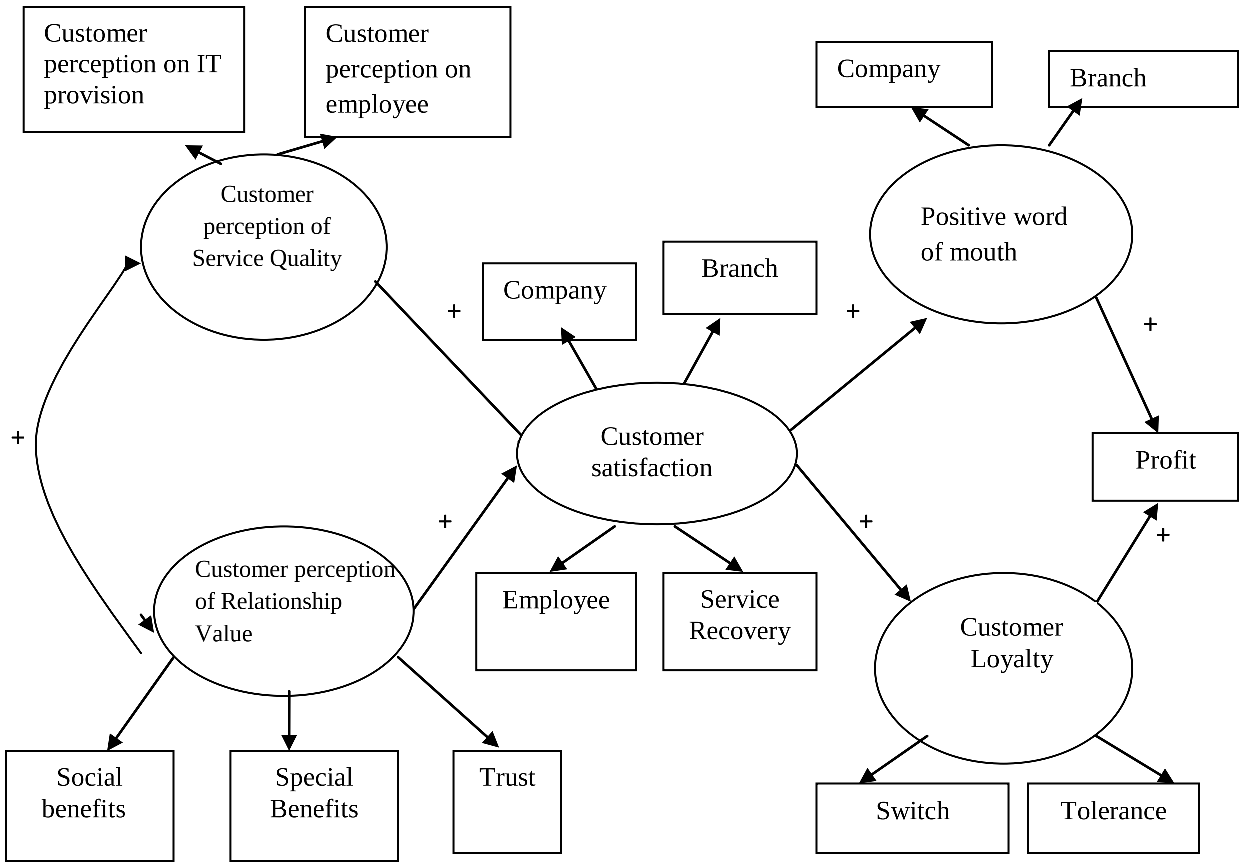

Figure 1 Customer satisfaction profit model

Source: Heskett, Sasser and Schlesinger 1997: 19.

Customer satisfaction is an important determinant of repeat purchasing behavior, and therefore it is the essential component of sustainable competitive advantage. Customer satisfaction is assumed to be one of the most important criteria for customer loyalty (Heskett et al., 1994). The empirical study of the customer-profit model has pointed out that customer satisfaction has a positive impact on customer loyalty and on the company's financial performance (profitability).

Customer satisfaction, measured by customer rating of the company, branch, employee and service recovery, can be predicted by customer perception of the service quality and service relationship value. Customer satisfaction has a positive influence on customer loyalty, in terms of both intentions to switch and tolerance to price changes. Profitability is positively influenced by customer loyalty (Xu, 2004).

In summary, as the attitude of employees and trust are prevalently instrumental in providing the basis for continued business with existing customers, and by word-of-mouth extending the customer base, a holistic view of HRM and marketing policies – rather than as distinct functions within the organization – seems to be viable.

2.2 Employee Satisfaction and Profitability

Employee satisfaction is the terminology used to describe whether employees are happy and contented and fulfilling their desires and needs at work. Many measures purport that employee satisfaction is a factor in employee motivation, employee goal achievement, and positive employee morale in the workplace.

The foundation of good human relations – the interaction between employers and employees and their attitudes toward one another – is a satisfied work force. Job satisfaction is the degree of enjoyment that people derive from performing their jobs. Many studies, including an in-depth study by the Unites States Army conclude that organizations that focus on the human resource aspect of their businesses create a high performance work place that results in satisfied employees, satisfied customers, and allow the organization to capably adapt to change.

Factors contributing to employee satisfaction include treating employees with respect, providing regular employee recognition, empowering employees, offering above industry-average benefits and compensation, providing employee perks and company activities, and positive management within a success framework of goals, measurements, and expectations.

Employee satisfaction defined as employees' feelings and thoughts about organization, work and co-workers (Beer, 1964). Locke (1976) proposed the theory of value, and suggested that employee satisfaction does not address individual desires, but associated with employee's needs or principles. In case of a good salary package, work environment and chances to prospect in the future, may positively influence the employee's loyalty and ultimately increased job satisfaction. Ivancevich et al. (1997) defined job satisfaction as the sensation and perception of the employee about his work and organization. Happy employees are more likely to be welcoming and attentive which attracts customers and the employees not satisfied with the job can lead to customer unhappiness (Hanif and Kamal, 2009).

Results of studies of job satisfaction are derived from two main sets. First, job satisfaction is associated with increased output, efficiency of the organization, loyalty with the organization, and reduced absenteeism and earnings (Ellickson and Logsdon, 2001). According to Wright and Davis (2003), job satisfaction positively affect on the ability, effort and capability of the employees however, if employees not satisfied with the job then it may cause turnover intentions, increasing costs, decreasing profits and ultimately customer unhappiness with the organization (Zeffane et al., 2008).

According to Locke (1976), there should be clear policies and strategies in the organization which makes easy for employees to understand their tasks and objectives etc because otherwise it may lead toward dissatisfaction. Elanain (2009) recently argued that UAE employees prefer clear goals and objectives, well defined lines of authority, autonomy because of their high degree of uncertainty avoidance. Abdulla et al. (2011) identified communications and job stress an important determinant of job satisfaction and found no significant influence on job satisfaction whereas significant relationship found between job satisfaction and its determinants (salary and incentives, organizational policy and strategy and nature of the work).

In addition, significant differences found between the gender, qualifications, experience, job characteristics and job satisfaction (Ahmed et al., 2010). It can be concluded that the salary, promotion and training positively and significantly influence the job satisfaction. However, employees place more emphasis on pay and promotion of the program (Butt et al., 2007). Akbar et al. (2011) confirms that empowered employees leads towards higher levels of employee satisfaction (Akbar et al. 2011). Calisir et al. (2010) found a very strong influence of job satisfaction on organizational commitment whereas job stress and role ambiguity indirectly influence the willingness of employees to leave their jobs.

Hansia (2009) concluded that the majority of people or employees agree that personality type suits the work they do, and have the opportunity to do what they do best and they are also optimistic about their personal and professional life. Hansia (2009) demonstrate that the procedures for recruitment and selection are an important predictor of job satisfaction of employees, and fair policy of recruitment and selection leads to employee satisfaction at work.

One of the indicators that show achievement toward improved employee satisfaction is success of the company and personal growth and development of employees. “Employees who feel, have ownership or power in their job, not only prove to be a beneficial employee for their direct supervisor, but also to the entire company” (Hayes 2003). A study conducted at the University of Piraeus acknowledges and discusses the dramatic changes that have taken place in organizations around the world in the past decade. Traditional hierarchies and functional structures are being reduced. Although re-engineering and downsizing initiatives are commonplace, there is increasing emphasis on enhancing employee involvement, team decision-making, and various partnership arrangements (Dimitriades 2001).

Literature provides various interpretations concerning the change organization development strategies of management in generating desired outcomes. There is the suggestion that many “change” initiatives have employee cooperation towards reaching mutual interests (Ascigil 2003). Many studies attributed a majority of improvement in the area of employee satisfaction as a by-product of improved communication within the organization. Extensive research results show that people derive greater satisfaction from their jobs and perform to a higher standard when they are engaged in their workplace. An integral and very important factor of engagement is the ability to effectively communicate (MacGregor, 2006). Another study that examined effective employee communication in the workplace highlights the fact that without communication, nothing could be accomplished. Communication involves three essential elements: a message, someone to send the message and someone to receive the message. Effective communication can only take place when the intended message reaches the intended recipient, and the message was understood with the intended meaning of the sender (Slagle, 2006).

Some of the articles related with employee satisfaction, product quality and service profitability are listed below:

Table 2.2
Some reviewed articles on employee satisfaction, product quality, service quality and profitability

Year	Author(s)	Concentration on
2002	Kristina Treytl	The impact of employee satisfaction on customer satisfaction with the sales interaction
2005	Y. Xu& R. Goedegebuure	Employee Satisfaction and Customer Satisfaction: Testing the Service-Profit Chain in a Chinese Securities firm
2007	Townsend et al	"Are they really satisfied?": an exploration of issues around employee satisfaction assessment strategies
2007	Florian et al	Does the employee–customer satisfaction link hold for all employee groups?
2008	Adeel et al	An impact of employee satisfaction on customer satisfaction in service sector of Pakistan
2010	Dr. YunusAdelekeDauda	Employee's Market Orientation and Business Performance in Nigeria: Analysis of Small Business Enterprises in Lagos State
2010	Agathee	An assessment on service quality in the Mauritian banking sector
2011	Rahman et al	The Study of Employee Satisfaction and its Effects towards Loyalty in Hotel Industry in Klang Valley, Malaysia
2012	Shahriar andRezaee	Do satisfied employees lead to better financial performance?
2013	Saleem et al	Determinants of Job Satisfaction among Employees of Banking Industry at Bahawalpur
2013	Rashid et al	Factors Affecting the Job Satisfaction of Employees in Banking Sector of Pakistan, A Generalization from District Sahiwal
2013	Veronica	The relationship between allocation of equal employee benefits and employee job satisfaction and performance at the Kenya pipeline company, Kenya

Some literatures suggest that employee recognition and motivation programs have a great deal to do with improving employee satisfaction. The main reason for providing an employee recognition program is to reap the benefits in morale and greater productivity resulting from a program that is clearly defined and in which the employees feel they can earn recognition for exceptional work (Roche, 2006). The implementation of effective award and recognition programs can create a positive working environment that encourages employees to thrive. "Recognition makes employees feel valued and appreciated, it contributes to higher employee morale, increases organizational productivity, and can aid in recruitment and retention" (Brintnall, 2005). Most of the literature made the connection between an increase in employee satisfaction and the subsequent positive impact on customer satisfaction. Recognition programs can help to define standards of performance, and establish guidelines for evaluation methods of employee behavior. Happy workers, high productivity and strong customer satisfaction characterize high performance workplaces.

Employees who are more satisfied with their job will typically deliver a better quality of service. These employees will tend to remain with the organization for longer periods of time and are then better placed to build long-term, personal relationships with customers. Customers will be more satisfied because they receive a better service, and enhanced customer satisfaction will tend to result in enhanced employee satisfaction thus creating a 'virtuous circle'. Internal marketing plays an important role in developing this self reinforcing relationship (Gronroos, 1990). An effective internal marketing strategy helps to create and maintain a customer-oriented service culture through enhancing employees' perceptions of their role and importance within the organization. In the light of the arguments advanced by Reichheld and Kenny (1990) and Clark and Payne (1993), targeting internal marketing activities at developing and retaining customer conscious, staff must be a core component of any strategy to enhance customer retention.

Job satisfaction is the discrepancy among people's expectations and wants related to the job, and what is really offered to them. Job satisfaction is very important not only for employees but also for the success of the organization (Lim, 2008) because if an employee is not satisfied with his job then he will not be loyal with the organization and dissatisfaction with a job and/or lack of loyalty to the organization, may search for other jobs (Reed et al., 1994). Job satisfaction can also define as the extent to which employees like their jobs. Studies discuss the various aspects of the employee's job satisfaction such as job, salary levels, promotion opportunities, and relationship with co-worker. Beer (1964) proposed the concept of employee satisfaction, according to him; it is the individual response or happiness of employees with objective and emotional facet of their work environment

2.2.1 Employee Satisfaction-Profit Model

The employee-profit model (developed by Heskett et al., 1997) is presented in Figure 2. As in the customer-profit model of the service-profit chain, the employee variables are relatable to attitudes that reside at the level of customers. The strongest argument here is in the case of employee satisfaction, which is directly determined by job characteristics. As the perception of what makes the job attractive may be co influenced by how others (colleagues, customers) evaluate it, it is likely that the level of appreciation by customers – especially if they are in a position to communicate their satisfaction directly to the employee – is instrumental in the satisfaction of the employee. Taking a broad perspective of rewards, consisting of financial and non-financial rewards, it is equally likely that employees' perception of the quality that they are delivering is influenced by the expressed opinions of managers, colleagues and the consumer as the final recipient and judge of their efforts.

The empirical test of the employee-profit model indicates that the internal service quality perceived by employees is a significant determinant of employee satisfaction. Five dimensions (work environment, work resources, cooperation, leadership and rewards) define the internal service quality in the model. The results suggest that employee satisfaction has a strong influence on employee turnover intention, and a somewhat less strong influence on tenure. Tenure appears to be a less important determinant of profitability.

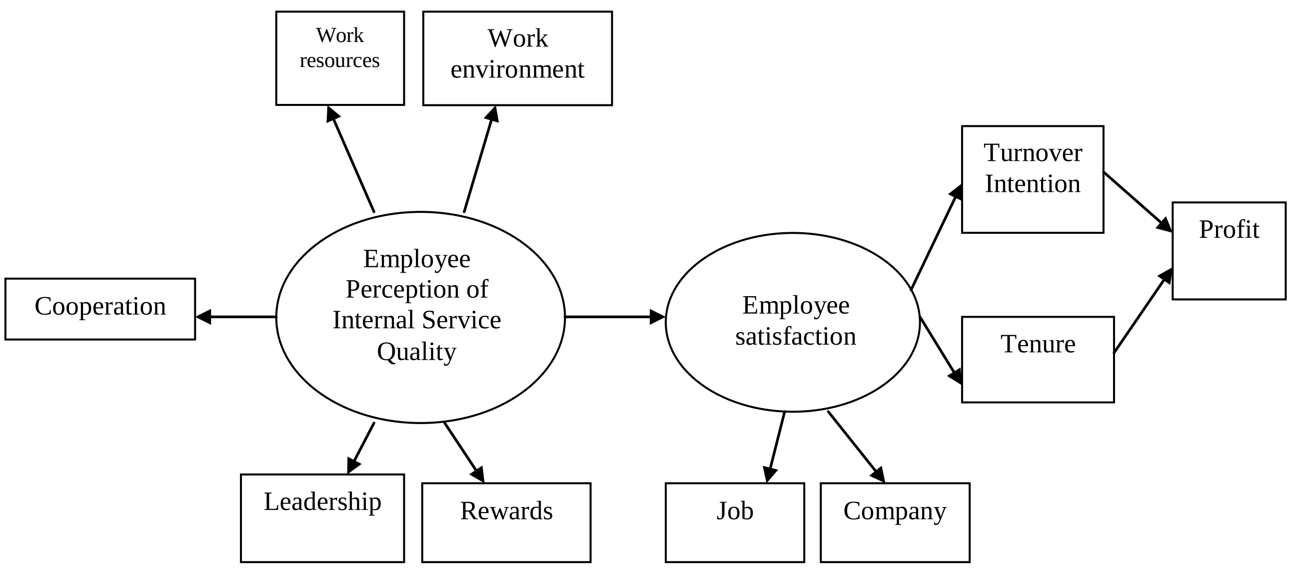

Figure 2 Employee satisfaction-profit model

Source: Heskett, Sasser and Schlesinger 1997: 19.

The study shows that employee satisfaction has a positive effect on employee loyalty and profitability of the company and that employee satisfaction is predicted by internal service quality perceived by employees. In order to make the company perform better, management should pay attention to cost efficiency measurements as well as employee satisfaction as the latter appears to significantly influence company profitability. Satisfied employees are a catalyst for alignment, as employees deliver satisfaction to customers. They also deliver value to customers and make the company competitive in its markets through their knowledge and experience. Employee satisfaction represents feelings of the employee about the job, defined as the overall evaluation of working for the company. According to the empirically tested model, employee satisfaction is a result from how well employees' financial, professional and personal needs are being met. The results indicate that if the company pays attention to those conditions that enable employees to do a good job, the profit will grow.

In summary, tests of the two interdependent models show the expected signs, that is, they provided support for the assumed strings of events in Heskett's service-profit chain that run from both employee and customer loyalty to profit. Apart from using the empirical model to check what determinants in the model are contributing most to the performance of the service company, on a more abstract level, a case can be made for making the interdependencies between the two models explicit. That is, if a method can be found to show that indeed, customer satisfaction tends to be higher whenever employees are more satisfied, and vice versa, then the argument for designing company strategies based on the mutual reinforcement of employee and customer satisfaction in the service industry gains in power.

2.3 Some Financial Ratios and Their Effects on Profitability of Banks

2.3.1 Measurement of Bank's Profitability

The focus on profitability and the rate of return on equity (ROE) of banks is a relatively recent phenomenon in many countries. It is largely since the mid-1990s that profitability and ROE have gained primacy in the strategic objectives of large sections of the banking industry. Historically, success has been measured more in terms of balance sheet size and market share rather than maximizing rates of return on capital.

Banks have often been regarded as different from firms in other industries with maximizing returns not being their primary business objective.

Profitability measures were determined based on their hypothesized relationship to customer satisfaction and loyalty. Both of the measures used, return on assets (ROA) and non-interest expense as a percentage of total revenue (NIE/Rev), reflect profit at the individual division for an analysis of similar performance measures in service firms (Roth, 1993). In the Roth's study, NIE/Rev is preferred to ROA as a more appropriate measure of profitability. Commercial bank profit can be separated into, first, the results of operations (revenue-enhancing as well as cost-incurring) which influence expenses and revenues that are not sensitive to interest rates, and second, treasury activities, which influence interest-sensitive costs and revenues.

A notable exception has been British banks, which have been earning substantial rates of return since the early 1990s: since 1993, rates of return on equity well in excess of 20 per cent have been the norm. Notwithstanding the contentious issue of how the cost of capital is to be measured, British banks have been earning substantial 'excess returns'. In the context of trends in European banking, the UK offers an interesting case study in three respects. Firstly, it outlines some of the required conditions for banks to successfully pursue ROE strategies. Secondly, it offers insights into the strategic implications of applying rigorous profitability criteria to business decisions. Thirdly, it might also point to some public policy interventions that might be needed to facilitate more ROE-orientated business strategies by banks in other European countries.

There are many reasons for the separation between customer orientation and attention to costs. A first important responsibility is attributable to the well-known consideration of product differentiation and standardization as alternative strategies. According to traditional strategic thinking, sustainable competitive advantage is based on two fundamental alternatives: differentiation or low costs (Porter, 1980; 1985). These, together with the area of activity in which a company seeks to obtain them, lead to the definition of three basic strategies for achieving greater than average performance: cost leadership, differentiation and focalization (on costs or on differentiation).

Cost leadership is intended to achieve lower overall costs with respect to competitors through different factors: the exploitation of economies of scale and experience, the control and reduction of costs, and elimination of marginal customers. This strategy concentrates on the standardization of the offer characteristics and on the attainment of large sales volumes suitable for competing in mass markets (Porter, 1980).

Differentiation tends to characterize products or services through the creation of an image that is recognized in the sector. The following can thus be considered significant: the design or image of the brand, technology, and functional characteristics of products, customer assistance, and the network of intermediaries. Differentiation tends to develop customer loyalty and reduce price sensitivity, and thus allows high unit margins to be reached (Fitzsimmons and Fitzsimmons, 1997).

Some of the reviewed articles related with the determinants of bank profitability and their effects are shown in the following table:

Table 2.3
Reviewed articles on some financial ratios and their effects on profitability of banks

Year	Author(s)	Headings
1989	Michael O. Nyong	Effects of quality on profitability of commercial banks
1998	Demirguc-Kunt& Huizinga	Determinants of commercial bank interest margins and profitability: some international evidence
1999	Ramsay et al.	Managing customer channel usage in the Australian banking sector
2000	Jayawardhena et al	Changes in the banking sector-the case of internet banking system in UK
2002	Spathis et al	Assessing profitability factors in the Greek banking sector: a multi criteria methodology
2002	Isik and Hassan	Cost and profit efficiency of the Turkish banking industry: an empirical investigation
2002	Nikiel and Opiela	Customer type and bank efficiency in Poland: implications for emerging market banking
2002	Paudel	Investing in shares of commercial banks in Nepal: An assessment of return and risk elements
2003	Kovarova	Big banking profits from small business
2003	Samy Ben Naceur	The Determinants of the Tunisian Banking Industry Profitability: Panel Evidence
2004	Goddard et al.	The profitability of European banks: a cross-sectional and dynamic panel analysis
2004	Rana	Banking and E-payment practices in Nepal
2005	G. A. Gelade& S. Young	Test of a service profit chain model in the retail banking sector
2005	Llewellyn	Competition and profitability in European banking: why

		are British banks so profitable?
2005	Rahman	Customer experience management- a case study on an Indian bank
2005	Keshar J. Baral	Health Check-up of Commercial Banks in the Framework of CAMEL: A Case Study of Joint Venture Banks in Nepal
2006	Peter et al	The internal performance measures of bank lending: a value-added approach
2006	Hughes	How banks use profitability analysis
2007	Gilbert and Wheelock	Measuring commercial banks profitability: proceed with caution
2008	Pasiouras and Zopounidis	Consolidation in the Greek banking industry: which banks are acquired?
2008	Kosmidon	The determinants of banks' profits in Greece during the period of EU financial integration
2008	McCarthy et al	How US banks can attract middle market customers
2009	Dietrich and Wanzenried	What determines the profitability of commercial banks? New evidence from Switzerland
2009	Flamini et al	The determinants of commercial bank profitability in sub-saharan Africa- IMF report
2011	Ramadan et al	Determinants of bank profitability: Evidence from Jordan
2011	Subedi	Banks report decline in net profit
2011	Akhtar et al	Factors influencing the profitability of conventional banks of Pakistan
2012	Jha and Hui	A comparison of financial performance of commercial banks: A case study of Nepal
2012	Jamal et al	Determinants of commercial banks' return on asset: panel evidence from Malaysia
2013	Dr. Aremu et al	Determinants of Bank's Profitability in a Developing Economy : Evidence from Nigerian Banking Industry
2013	SitiZulaiha et al	Determinants of Islamic Bank's Profitability in Malaysia
2013	ElsayedElsiefy	Determinants of profitability of commercial banks in Qatar
2013	Patrick Desmarès	World Retail Banking Report 2013
2013	McKinsey & Company	McKinsey Global Private Banking Survey 2013: Capturing the new generation of clients

The economics of banking literature acknowledges various determinants of bank profitability. These include the size of the bank; the extent to which the bank is diversified; the attitude of the bank's owners and managers towards risk; the bank's ownership characteristics; and the level of external competition the bank encounters (Goddard et al. 2001). Cross-sectional and dynamic panel estimation to investigate selected determinants of profitability in six major European banking sectors: Denmark, France, Germany, Italy, Spain and the UK, for the period 1992–98 were used. The results suggest that despite intensifying competition there is still significant persistence of abnormal profit from year to year. Although there are some significant size–profit relationships in some of the estimations, overall the evidence for any consistent or systematic size–profitability relationship is unconvincing. The relationship between the relative size of a bank's OBS portfolio and its profitability is positive for the UK, but negative for some other countries, where banks seem to have experienced mixed results from diversification into off-balance sheet (OBS) activity. The relationship between the capital–assets ratio and profitability is positive. Finally, although in Germany savings and cooperative banks underperformed relative to commercial banks, there is little evidence of a systematic relationship between ownership type and profitability elsewhere.

European banking is one of the few industries in which private, public and mutual firms operate together in a competitive market. However, there is little empirical guidance as to whether there are systematic differences in the performance of banks with different ownership features (Altunbas et al., 2001). Seminal work by Jensen and Meckling (1976) suggest that a lack of capital market discipline weakens owners' control over management, leaving management free to pursue its own interests with few incentives to be efficient.

Given that public and mutual banks pursue clearly stated social and economic development objectives (and are also subject to a lack of capital market discipline) one might expect them to have different performance characteristics to profit-maximizing private sector banks. Nicols (1967) and O'Hara (1981) suggest that US mutual firms are likely to be more efficient than their private sector counterparts. Mester (1989, 1993) finds that mutual firms are more efficient, while Cebenoyan et al. (1993) suggest there is no difference between the efficiency of mutual and joint stock savings and loans banks. Conflicts of interest between owners and managers may sometimes make the relationships between profitability and other variables difficult to disentangle. For example, while owners seek to maximize profit, managers might be willing to sacrifice profit so as to reduce risk by undertaking more secure activities, or to maximize utility through expense preference behavior (Berger and Hannan, 1998). Overall, while a divergence in performance features across ownership types and governance structures might be expected, there is little or no consensus in the empirical literature as to whether private banks are better performers than their mutual and cooperative sector counterparts.

Bank profitability is the function of internal and external determinants. Internal determinants can be seen as factors that are affected by the decisions of the banks' management. The quality of decision can be examined in terms of the operating performance. Variables that track the most attention in the literature to assess the operating performance are: capital adequacy, income source, credit risk, efficient management, and bank size. On the other hand, the external determinants are the factors that reflect the legal and economic environment in which the bank operates, and affects bank's performance. The main components of these factors are the industry-specific and macroeconomic factors; these factors are inflation, industry size, ownership status, competition and concentration. Flamini and Schumacher (2009) studied on the determinants of bank profitability. That paper proposes that higher returns on assets are associated with larger bank size, activity diversification, and private ownership. Bank returns are affected by macroeconomic variables, which indicate that macroeconomic policies that promote low inflation and stable output growth promote the expansion of credit. The results also indicated moderate persistence in profitability.

Thus, the research gives some support to the policy of imposing higher capital requirements in the region to promote financial stability. Athanasoglou et al. (2008) examined the effect of bank-specific, industry-specific and macroeconomic determinants of bank profitability, using an experimental framework that includes the traditional Structure-Conduct- Performance (SCP) hypothesis. To account for profit persistence, the authors applied a Generalized Method of Moments (GMM) technique to a panel of Greek banks that covers the period (1985-2001). The results showed that profitability persists to a moderate extent, indicating that departures from perfectly competitive market structures may not be that large. All bank-specific determinants, with the exception of size, affect bank profitability significantly in the anticipated way. However, no evidence was found in support of the SCP hypothesis. Finally, the business cycle had a positive, albeit asymmetric effect on bank profitability, being significant only in the upper phase of the cycle.

Using accounting analyzing, and panel regressions technique, Al-Haschimi (2007) studies the determinants of bank profitability in 10 countries. The study finds that credit risk and market power explain most of the variation in bank's profitability across these countries. Also, the study finds that macroeconomic risk has limited effects on bank's profitability. Vong and Chan (2006) examined the impact of bank characteristics, macroeconomic variables and financial structure on the performance of the banking industry of Macau. The results showed that the strength of the bank's capital is of paramount importance in influencing profitability. A well-capitalized bank is perceived to be of lower risk and such an advantage will be translated into higher profitability. On the other hand, the quality of assets, as measured by loan-loss provision affects the performance of banks negatively. In addition, banks with a large retail deposit-taking network do not achieve a level of profitability higher than those with a smaller network. Finally, with regard to macroeconomic variables, only the rate of inflation showed a great relationship with the performance of banks. Kosmidou et al. (2006) studies the impact of bank-specific characteristics, macroeconomic conditions and financial market structure on the profits of UK owned commercial bank during the period 1995-2002. The results showed that the strength of capital of these banks has a positive impact on profitability; and other important factors being the efficient management of expenditures and size of the bank. These bank-specific determinants are robust to the inclusion of additional macroeconomic and financial market measures of bank performance, which adds little to the explanatory power but it seems, however, that had positive impact on profitability. Gelos (2006) studies the determinants of bank profitability in Latin America, finds that spreads are large because of relatively high macroeconomic risk, including from inflation, less efficient banks, and higher reserve requirements.

In a study of U. S. banks, Angbazo (1997) found evidence that bank profitability is positively related to capital, non-interest income, and management quality, and negatively related to liquidity risk.

2.3.2 Competition in the Banking Industry

Competition in European banking markets has intensified significantly in recent years (De Bandt and Davis, 2000). Deregulation, technological change and the globalization of goods and financial markets have affected all aspects of the operation of banks, and accordingly have impacted on profitability. Banks are now able to participate in what were previously regarded as inaccessible domestic and foreign markets. This has caused the lines of demarcation between different types of bank (and other financial sector institutions) to become blurred, and has led to greater uniformity in the types of financial services and products available to customers. In addition, technological developments have transformed the possibilities for economies of scale and scope. As part of the globalization phenomenon, foreign bank involvement in domestic banking markets has increased, intensifying competition and reducing margins.

Banks have responded to rising competitive pressure by offering a wider range of products and services and conducting a significant proportion of their business off - balance sheet (OBS). Demsetz and Strahan (1997) examine the role of diversification in US banking and find that large banks had lower capital reserves and were more active than their specialized counterparts in high risk lines of business such as derivatives. Klein and Saidenberg (1997) find that diversified banks were less profitable on average. Hughes et al. (1999) find that while growth through product and geographic diversification reduced bank risk, efficiency tended to improve as a result of geographic diversification. Goddard et al. (2001) highlight diversification and other trends in European banking. Many banks have increased in size significantly, reduced average costs and diversified in order to maintain competitiveness on a Europe-wide scale.

Zavvos (1989) noted that the Greek banking system suffers from two problems: first, a great part of this industry (approximately75 percent) is under the control of the public sector (Provopoulos, 1995), which creates certain distortions. Second, there is an extensive intervention by the state through the appointment of governors and directors of the public sector banks, and through the introduction of sundry restricting regulations; it is unlikely, though not proven, that issues of interference would be unique to this country. Zavvos (1989) questioned whether it would be possible for banks in the public sector to keep their market in the context of changing environmental conditions. It was concluded that a great part of their custom will probably move to those foreign or the private sector banks able to offer better interest rates and better quality of service; such arguments have wide support in the literature (Watson, 1995). The public sector banking, as a result of government interference, is staffed by about 50 percent more employees per branch compared to the private sector and the gap appears to be increasing. It was not possible, within the limits of this survey, neither to make comparisons of the labor component of cost nor to evaluate performance in terms of volume, complexity or value added. Notwithstanding, costly labor-saving technology, queues appear to be increasing (Mirkos, 1996).

With the above issues in mind and seeing that these two banking sectors, private and public are competing against each other, it was deemed appropriate to explore the extent to which service expectations and perceptions compared among their clients. An analysis of the similarities and differences that might exist will help both with understanding of differentiation in the financial services sector and in the debate about the appropriateness of a particular strategy under changing conditions.

2.3.3 Different Models of Bank Profitability

Zopounidis *et al.* (1995) demonstrated a multi criteria decision-making methodology for the evaluation of the performance of a sample of 28 Greek banks over the period 1989-1992. An additive utility model was used to obtain the final ranking of the banks. The number of studies that examined the Greek banking market is limited. Most of these studies have focused on the comparative performance of banks and their efficiency (cost efficiency and economics of scale) rather than on the determinants of their profitability.

Alexakis *et al.* (1995) examined the liberalization and the profitability of the Greek commercial banks during the period 1989-1991. The results suggested that the determinants of profitability of Greek commercial banks were highly different from those in other countries during the periods of intense regulation in Greece.

Vasiliou (1996) applied the statistical cost accounting methodology to investigate the profitability differences between high-profit and low-profit of Greek banks over the period 1977-1986. He concluded that asset management and to a lesser extent liability management played a role in explaining interbank differences in profitability in Greece during the period 1977-1986.

Karafolas and Mantakas (1996) examined the cost structure and the scale of economies in the Greek banking system during the years 1980-1989 and employed a trans- logarithmic cost function which includes the size of assets, capital, labor and technological progress. The study found that although operating cost–scale economies existed, total cost–scale economies were not present. The competitive conditions in the Greek banking system over the period 1993-1995 were examined by Hondroyiannis *et al.* (1999) who used the Rosse-Panzar statistic and found that bank revenues were earned as if under conditions of monopolistic competition.

Kosmidou and Spathis (2000) examined the impact of Euro on Greek banks through a cost–benefit analysis. The results indicated increasing profits in the long-term period.

Vasiliou and Frangouli (2000) investigated the impact of financial variables (asset utilization and leverage multiplier) and concentration ratio of the Greek commercial banking market on banks' return on equity over the period 1993-1997. The results indicated that financial variables were very important determinants of banks' profitability while market structure was found to have no influence on banks' performance.

In a later study, Stathas *et al.* (2002) applied the multi criteria method PROMETHEE to rank the banks according to their financial performance over multiple criteria (liquidity, profitability, capital structure, investment activity, development) during the period 1995-1999.

The cost efficiency over the period 1993-1998 was estimated by Christopoulos *et al.* (2002). It is found that large banks were less efficient than smaller ones as well as their economic performance, bank loans and investments positively related to cost efficiency. However, Spathis *et al.* (2002) used a multi criteria methodology to investigate the differences of profitability and efficiency between small and large banks over the period 1990-1999 and found that large banks were more efficient than small ones.

Tsionas *et al.* (2003) applied data envelopment analysis to estimate economic efficiency, total factor productivity (TFP) change and technical change of the Greek banking system for the period 1993-1998. The results indicated that most of the banks operated close to best market practices, while allocative inefficiency costs appeared to be more important than technical inefficiency costs. In addition, the positive but not substantial TFP change of the Greek banking system was associated to efficiency improvement for the medium-sized banks and to technical change improvement for larger institutions.

Mamatzakis and Remoundos (2003) used a methodology based on the structure–conduct performance (SCP) framework to examine the determinants of the performance of Greek commercial banks over the period 1989-2000. Financial ratios, bank's size, and status of ownership, stock market performance, market concentration, money supply and consumer price index were used as independent variables and found that profits were mainly explained by the financial ratios. It is also reported that economics of scale and the money supply significantly influence profitability.

2.3.4 Determinants of Bank Performance

Demirguc-Kunt and Huizinga (1998, 2000) offer evidence on determinants of banks' interest spreads using data from 80 countries during the period 1988-1995. In addition to bank characteristics and the overall macroeconomic environments, they indicate that a variety of other determinants (such as taxation, deposit insurance regulation, overall financial structure and legal and institutional indicators) also explains the differences in interest margins and bank profitability. The impact of these factors is more pronounced in developing countries than in developed countries. More recently, a number of single and cross (country) studies have also been attempted to identify the determinants of bank profitability across the European continent (Horvath, 2009).

Athanasoglou et al. (2006) examine South Eastern European (SEE) banks and find a significant negative effect of credit risk and operating expenses management on bank profitability, but a significant positive association between bank capital, bank size and bank profitability. Goddard et al. (2004) investigate six major European banking sectors, in particular, Denmark, France, Germany, Italy, Spain and the UK and find a positive impact of off-balance-sheet business bank for the UK, but either neutral or negative for other countries. Staikouras and Wood (2004) report a negative effect of concentration and market share on the profitability of a sample of 685 European banks. They also conclude that the impact of the level of interest rates and bank size is negative on large banks, while significantly positive on small banks. Kosmidou et al. (2005) analyze 32 commercial banks in the UK and present evidence that efficiency plays a robust role in driving UK banks' profits besides capital strength whereas, bank size lowers margins and profits. Dietrich and Wanzenried (2009) examine Switzerland banking sector and provide evidence that better capitalized and highly efficient banks are more profitable with larger banks being slightly less profitable than medium sized banks and foreign banks less profitable than Swiss owned banks. Yu and Neus (2005) study a panel of 288 German banks and report that higher concentration rate and larger bank size in terms of assets have positive effect on profitability and that portfolio risk is a determining factor of the profit-structure relationship in the German banking market.

Conversely, Horvath (2009) finds no evidence on the impact of market power on the interest margin of Czech banks and reports that larger banks with higher capital adequacy charge lower margins and that interest margins are higher for banks with a higher loans-to-assets ratio. Athanasoglou et al. (2005), and Alexiou, and Sofoklis (2009) all investigate factors influencing the profitability of Greek banking sector over various periods between 1989 and 2002 and report conflicting findings about the impact of credit risk, bank size and inflation. All, however, agree on the significant positive relationship between bank efficiency and profitability.

Similarly, several significant findings on bank profitability in North and Latin America have been documented. An early work by Berger (1995) examines using Granger causality model, the relationship between the return on equity and the capital- asset ratio for a sample of US banks during the period 1983-1992. The analysis concludes that return on equity and capital to asset ratio tends to be positively related. Investigating whether increases in various types of noninterest income have been associated with improved or worsened bank performance, De Young and Rice (2004) using a sample of 4,712 American commercial banks during 1989 -2001 find that marginal increases in noninterest income have worsened the risk-return tradeoff for the average commercial bank in the U S during the sample period. Gelos (2006) analyses 14 Latin American economies during 1999– 2002 and concludes that higher reserve requirements, higher concentration and lower competition have positive impact on net interest margin, whereas the impact of taxation and strength of the legal framework are not significant. In the same vein, Martinez Peria and Mody (2004) investigate private banks in Argentina, Chile, Colombia, Mexico, and Peru over the period 1995-2000 and present evidence that foreign bank participation positively influences spreads indirectly, primarily through its downward effect on administrative costs and that bank concentration is positively and directly related to both higher spreads and costs.

A few important insights on determinants of African banks profitability have emerged too. Flamini et al. (2009) provide evidence from 41 Sub-Saharan Africa countries that during 1998–2006 higher capital, credit risk, bank size and increased share of services in the bank activity, inflation, and higher prices of commodities all had positive and significant effect on profitability. Oladele et al. (2012) study Nigerian banks profitability during the period 2005-2010 and conclude that cost to income ratio and equity to total asset both have significant influence on bank profitability. Similarly, Babalola (2012) investigates the profitability of 14 banks in Nigeria over the period 1999-2008 and reports positive impact of capital adequacy ratio and bank size. Atemnkeng and Joseph (2000) examine three commercial banks in Cameroon over the period 1987-1999 and report positive relationship between bank profitability and market structure, bank size and loan-deposit ratio. Olweny and Shipho (2011) evaluate a sample of 38 commercial banks in Kenya over the period from 2002 to 2008 and find that stronger capital base, higher liquidity, improved assets quality and reduced operational costs all improve profitability.

Likewise, a quite important number of studies focused on examining bank profitability in the Middle East countries have recently evolved providing evidence from investigations carried out across the region as well as across a single country. Ben Naceur and Omran (2008), for instance, examine the bank profitability across 10 middle east countries cover the period 1989- 2005 and indicate that stock market development has positive and significant impact on bank performance. In a pioneering study on the relationship between oil price shocks and bank profitability, Poghosyan and Hesse (2009) using data on 145 banks in 11 oil-exporting Middle East countries during 1994–2008 find an indirect relationship between oil price shocks and bank profitability channeled through the impact of oil price shock on the country-specific macroeconomic conditions. This impact is more evident for investment banks compared to commercial and Islamic banks. Sayilgan and Yildirim (2009) study the Turkish banking sector during the period 2002-2007 and conclude that banks' profitability is negatively affected by growing off-balance sheet assets and that bank profitability have increased along with declining inflation rate, increasing industrial production index and improving budget balance. Ben Naceur (2003) investigates the Tunisian banking sector and reports a positive effect of stock market development on bank profitability during 1980-2000, which he indicates reflects the complementarities between the banking sector and the stock market growth. Salloum and Hayek (2012) examine Lebanese banks over the period 2000-2010 and conclude that bank size, concentration, off-balance sheet activities and GDP growth rate all have significant positive impact on bank profitability. Khrawish et al. (2008) study the net interest margin of 13 Jordanian commercial banks over the period 1992- 2005 and find that bank-specific characteristics (rather than macroeconomic indicators such as inflation, growth rate in GDP) explain substantial part of the variation in banks' interest margins. Larger banks with higher capital ratio and larger loan portfolio achieved higher net interest margin. In a more recent study covering Jordanian commercial banks listed in Amman stock exchange during the period 2000 -2010, Khrawish (2011) attains almost similar findings as he finds significant positive relationship between bank size, capital and return on bank assets and equity but significant negative impact of GDP growth rate and inflation rate on bank performance.

Molyneux and Thorton (1992) were among the first who examined the determinants of banks profitability in several countries using a sample of 18 European countries over the period 1986-1989 and found a positive association between the return on equity as a dependent variable and the level of interest rates, bank concentration and the government ownership as independent variables.

Berger (1995b) and Angbazo (1997) among others examined the US banking sector. Berger (1995b) found that return on equity and capital-to-asset ratios are positively related over the period 1983-1992. The results of Angbazo (1997) for the period 1989-2003 indicate a positive association between the bank interest spread and the default risk, opportunity cost of non-interest bearing reserves, leverage and management efficiency. Similar studies were conducted in a number of emerging countries such as Colombia (Barajas *et al.*, 1999).

Demirguc-Kunt and Huizingha (1999) considered a comprehensive set of bank characteristics (such as size, leverage, type of business, foreign ownership), macroeconomic conditions, taxation, regulations, financial structure and legal indicators to examine the determinants of bank interest margins and profitability in 80 countries over the period 1988-1995. They found that: (i) well-capitalized banks have higher net interest margins and are more profitable, (ii) banking sectors, where banking assets constitute a larger portion of the GDP, have smaller margins and are less profitable and that a larger stock market capitalization to bank assets is related negatively to margins, (iii) bank concentration ratio positively affects profitability, (iv) macroeconomic factors implicit and explicit financial taxation, deposit insurance and the legal and institutional environment also explained variation in interest margins.

Following early work by Short (1979) and Bourke (1989), a number of studies have attempted to identify some of the major determinants of bank profitability. The respective empirical studies have focused their analyses either on cross-country evidence or on the banking system of individual countries. The studies of Molyneux and Thornton (1992), Abreu and Mendes (2002), Micco et al. (2007) and Pasiouras and Kosmidou (2007) investigate a panel data set. Studies of Berger et al. (1987), Neely and Wheelock (1997), Naceur (2003), Mamatzakis and Remoundos (2003) focus their analyses on single countries. The empirical results of these above-mentioned studies vary, as datasets, time periods and the investigated environment and countries differ. However, there exist some mutual elements that allow furthering categorizing the determinants of banking profitability.

Bank profitability is usually measured by the return on average assets and is expressed as a function of internal and external determinants. The internal determinants include bank-specific variables. The external variables reflect environmental variables that are expected to affect the profitability of financial institutions.

In most studies, variables such as bank size, risk and overhead costs are used as internal determinants of banking profitability. Pasiouras and Kosmidou (2007) find a positive and significant relationship between the size and the profitability of a bank. Other authors, such as Berger et al. (1987), provide evidence that costs can be reduced only slightly by increasing the size of a bank and those very large banks are often even facing scale inefficiencies. Micco et al. (2007) find no correlation between the relative bank size and the return on average assets for banks, i.e., the coefficient is always positive but never statistically significant. Another determinant of bank profitability is the risk a bank is facing. Abreu and Mendes (2002), who examined banks in Portugal, Spain, France and Germany, find that the loans-to-assets ratio, as a proxy for risk, has a positive impact on the profitability of banks. Bourke (1989) and Molyneux and Thornton (1992), among others, find a negative and significant relationship between the level of risk and profitability. This result might be explained by taking into account that financial institutions that are exposed to high-risk loans also have a higher accumulation of unpaid loans. These loan losses lower the returns of the affected banks.

Empirical evidence from Bourke (1989), Naceur and Goaied (2001, 2005), and Pasiouras and Kosmidou (2007) indicate that the best performing banks are those who maintain a high level of equity relative to their assets. The authors explain this relation with the observation that banks with higher capital ratios tend to face lower costs of funding due to lower prospective bankruptcy costs. Furthermore, overhead costs are an important determinant of profitability: the higher the overhead costs in relation to the assets, the lower the profitability of a bank (Athanasoglou et al., 2008). A further bank-specific variable is the ownership of a bank. Micco et al., (2007) found that bank ownership is influencing the performance of a bank. According to the results, state-owned banks operating in developing countries tend to have a lower profitability, lower margins and higher overhead costs than comparable privately owned banks.

When focusing on industrial countries, this relationship has been found to be much weaker. Iannotta, Nocera and Sironi (2007) point out that government-owned banks exhibit a lower profitability than privately owned banks. Demirguc-Kunt and Huizinga (2000) suggest that the international ownership of banks has a significant impact on bank profitability. Foreign banks are shown to be less profitable in developed countries. In contrast, Bourke (1989) as well as Molyneux and Thornton (1992) report that the ownership status is irrelevant for explaining bank profitability. They find little evidence to support the theory that privately-owned banks are more profitable than state-owned banks. Furthermore, Beck et al. (2005) controlled for the age of the bank since longer established banks might enjoy performance advantages over relative newcomers. Their results for the Nigerian market indicate that older banks perform worse as new entrants into the market were better able to pursue new profit opportunities.

External determinants of bank profitability used in literature are factors such as central bank interest rate, inflation, the GDP development, taxation, or variables representing market characteristics (e.g. market concentration). Most studies have thereby shown a positive relationship between inflation, central bank interest rates, GDP growth and bank profitability (Bourke, 1989; Athanasoglou et al., 2008). Furthermore, there is some evidence that legal and institutional characteristics of a country matter. The studies of Demirguc-Kunt and Huizinga (1999) report that taxation negatively affects on bank profitability. Another study by Albertazzi and Gambacorta (2006) concludes that the impact of taxation on the banking profitability is small as banks can shift a large fraction of their tax burden towards depositors, borrowers or purchasers of fee generating services. Overall, although fiscal issues are likely to exert a significant influence on banks' behavior, the taxation of the financial sector has received little attention. To measure the effects of market structure on bank profitability, the structure-conduct-performance (market power) hypothesis states that increased market power yields monopoly profits. According to the results of Bourke (1989) and Molyneux and Thornton (1992), the bank concentration ratio shows a positive, statistically significant relationship with the profitability of a bank and is, therefore, consistent with the traditional structure-conduct-performance paradigm. In contrast, the results of Demirguc-Kunt and Huizinga (1999) and Staikouras and Wood (2004) indicate a negative but statistically insignificant relationship between bank concentration and bank profits. The estimations by Berger (1995) and Mamatzakis and Remoundos (2003) do not support the structure-conduct performance hypothesis neither.

In sum, the existing literature provides a comprehensive explanation of the effects of bank specific, industry-specific and macroeconomic determinants on bank profitability. Since the data sets and the investigated environments and markets differ significantly across the various studies, it is not surprising that the empirical results vary as well.

2.3.5 Bank- Specific Determinants

a. Capital Adequacy Ratio

Capital adequacy ratio (CAR) is calculated as tier 1 capital divided by the total risk weighted assets as a proxy for bank overall capital strength as opposed to the ratio of total equity to total assets frequently used in the literature. It is believed that this ratio reflects more insights about bank total risk than does any other equity ratio as it indicates bank minimum regulatory capital charge for different types of risks, namely, credit, market and operational risks and therefore, is more likely to become subject to more scrutiny by all stakeholders equally as opposed to other equity ratios. This would be expected to have a reflection on the outlook of bank performance.

Theoretical arguments and empirical evidence, however, provide mixed results about the impact of bank capital structure on its profitability. "According to the conventional wisdom in banking, a higher capital-to-assets ratio is associated with lower profitability" Berger (1995). This is because higher capital ratio tends to reduce the risk on equity and therefore lowers the expected return on equity required by investors. Similarly, Hoffmann (2011) argues that an excessively high capital ratio could denote that banks are operating over-cautiously and ignoring potentially profitable trading opportunities, which negatively affect profitability. Conversely, Demnirguc-Kunt and Huizinga (1998) and Golin (2001) among others, indicate that banks with higher capital ratio face lower cost of funding because of lower prospective bankruptcy costs and hence experience higher profitability. In addition, Bourke (1989) reports that well capitalized banks may enjoy access to less risky sources of funds and better quality asset markets. In the same vein within the Islamic banks literature Ben Naceur and Goaied, (2008) suggest that highly capitalized banks can charge more for loans and or pay less on deposits because they face lower bankruptcy risks, which would result in higher margins and profitability. The higher amount of capital injected, the more confident customers will be and the more deposits that will be placed at the bank (Haron and Azmi, 2004).

In the presence of asymmetric information and bankruptcy costs, the way the assets are funded could affect the banks value. In a way or another well-capitalized bank may send a good signal to the market regarding its performance (Athanasoglou et al., 2006). In this regard, well-capitalized banks perceived to be safer, with lower profits commensurate with the risks, for this reason a negative relation between capital and profits is expected. On the other hand, if the profits earned are reinvested, a positive relation between capital and profits should be valid. In his study for 12 European countries, Bourke (1989) concluded a positive and significant effect of the capital adequacy on bank profitability. Berger (1995a), finds that the capital and bank profitability tend to be positively related for a sample of US banks. Also, Angbazo (1997) finds that well-capitalized banks in USA are more profitable than other less-capitalized banks. A positive relation between capital adequacy and profitability was suggested by Kosmidou (2007).

b. Operating Expenses Ratio

Closely related to operating expenses, efficient management can be considered to be one of the most important determinants of profitability, and unless banks manage to transfer their costs to the lenders, operating expenses are expected to have a negative effect on the profitability, Bourke (1989) and Athanasoglou, et al., (2008) find a positive relationship between better quality management and profitability, Brock and Rojas (2000) and Al-Haschimi (2007) in Latin American countries, found that inefficient management appears to be the prime determinant of the high spreads is expected.

For the most part, the literature on bank performance argues that poor management of expenses is one of the main contributors to poor profitability and that cost efficiency significantly improves profitability, implying a negative relationship between operating expenses ratio and profitability. Kosmidou et al., (2005), Dietrich and Wanzenried (2009) among others find that efficient cost management is a robust determinant of the banking system profitability in the UK, Greek and Swiss respectively. However, this may not always be the case, higher profitability may also be associated with higher operating expenses especially in less competitive markets where banks enjoy market power that enable them to pass on most of their overhead costs to customers through higher spreads. Gelos, (2006) and Naceur and Omran (2008) find that operating inefficiencies represent one of the main determinants of high bank spreads in Latin American countries, Tunisia and the Middle East region respectively. Naceur (2003) suggests that 87.8% of a bank's overhead costs in Tunis are passed on to depositors and lenders (in terms of lower deposit rates and/or higher lending rates). Typically, there are two ratios widely used in the literature to proxy for operational efficiency. The first ratio is the cost to income ratio measured as the operating costs of running the bank, (such as the administrative costs staff salaries and property costs, etc., excluding losses due to bad and nonperforming loans) over the total operating income. Specifically, this ratio is normally used as an indicator of management's ability to control costs as it measures cost incurred per dollar generation of income. The second ratio is the overheads efficiency ratio identified as total operating expenses of bank to total asset and is principally employed as a proxy for the average cost of non-financial inputs to banks (Fries and Taci, 2005). Gup and Walter (1989) indicate that high performance small banks in the US during the period 1982 -1987 had lower noninterest expense relative to assets than did their counterparts. In addition, following Fries and Taci (2005), they also include in their analysis the personnel cost to total assets ratio as a proxy for the price of labor capital. Furthermore, in line with Miller and Noulas (1997), they calculate the ratio of total non-interest expense (excluding personnel cost) to total expenses. They postulate that this ratio indicates the efficiency of bank management in economizing on the use of resources that generate non-interest expenses. Evaluating a sample of 201 American banks during the period 1984-1990, Miller and Noulas (1997) find that the higher the fraction of total expenses incurred through noninterest sources the strongest the negative effect is on profitability.

c. Asset Composition Ratio

Deposits and loans are the most important indicators in the bank financial statements, because they reflect the bank's primary activity. Assuming other variables constant, the higher the rate of transforming deposits into loans, the higher the profitability will be. For that, a positive relation between the loans and banks profitability are expected.

On the other hand, if increasing loans lead to higher funding requirements, a negative impact of the loan ratio on the banks profitability may accrue. In their study, Abreu and Mendes (2000) found a significant positive relation between asset composition and profitability. In contrast, Staikouras and Wood (2004) and Bashir and Hassan (2003) documented a negatively significant relation with the profitability.

Despite the fact that loan diversification may be ideally perceived as the optimum approach by financial institutions to minimize their portfolio risk, theoretical arguments on the benefits of diversification present conflicting views . According to the traditional portfolio and banking theory, an optimal bank's asset portfolio should be as highly diversified as possible to reduce their risks of suffering a costly bank failure (Hayden et al, 2006). One the other hand Abreu and Mendes (2000), argue that a highly diversified bank tends to monitor less besides that the opening out into new sectors, markets or regions imposes involves additional costs such as steep learning costs, which might undermine the intended benefits of diversification. Empirical evidence of the impact of loan portfolio diversification on bank profitability also remains inconclusive and suggests that banks face a tradeoff between diversifying and focusing their loan portfolio. Acharya et al (2006) examine the impact of sectoral and industrial loan diversification on the performance of Italian banks and find evidence that diversification of banks' assets is not guaranteed to result in a superior return performance and/or greater safety for Italian banks.

Similarly, (Hayden et al., 2006) calculate three measurements of different types of diversification (sectoral, counterparty, regional) to assess the impact of diversification on banks' profitability in the case of German banks and conclude that each measurement of diversification tends to lower German banks' returns.

d. Credit Risk Ratio

Credit risk can be defined as the potential loss of all or part of the interest owed, or the origin loan, or both together. The environment in which the bank works affects the bank's credit risk, poor legal environment leads to weak enforcement of bank rights, which leads to higher credit risk. In addition, lack of accurate information about borrowers, and weak economic growth, may expose the bank to higher credit risk.

Theoretically, the greater the exposure to credit risk, the lower is the banks profits; a negative effect of the credit risk on the banks profitability is expected. On the other hand, the credit risk may positively affect the profitability. While Athanasoglou, et al., (2008) and Miller and Noulas (1997) find that the effect of the credit risk on the profitability is negative in the USA, Al-Haschimi (2007) finds a positive effect of credit risk on Sub-Saharan African profitability.

Credit risk is broadly defined as the risk of financial loss arising from borrowers' failure to honor their contractual obligations. For banks, credit risk arises principally from lending activities, but also may arise from various other activities where banks are exposed to the risk of counter party default, such as trading and capital market debt-based securities. The importance of the quality of bank loans portfolio stems from the fact that poor loans quality may affect bank performance in two ways. One way is through its direct impact on profitability. Miller and Noulas (1997) suggest that the higher the exposure to high-risk loans, the higher the accumulation of unpaid loans and the lower the profitability. Duca and McLaughlin (1990) using a sample of U S banks conclude that variations in bank profitability are largely attributable to variations in loan loss provisions as they find little difference between the net income of the sample banks after netting out loan loss provisions.

In addition, higher credit risk increases the bank’s borrowing costs, as investors demand higher interest rates in compensation for higher risk, which negatively influences bank profitability. In the case that this risk proven uncontrollable the consequences may turn out to be even severer over the long run as a bank becomes unable to borrow at any reasonable rate and hence prevented from expanding its operations (Nguyen 2011). The other way through which credit risk influences bank performance is indirectly through the expected impact of credit risk on bank capital. Poor asset quality is perceived to cause capital erosion and increase credit and capital risks (Hassan and Bashir, 2004). Although loan loss provisions and cumulative loss reserves provide early lines of defense against bad loans, in the severe case where a bank may face a serious asset quality problem and loan loss reserves becomes insufficient to allow all bad loans to be written off, the excess will have to be written off against shareholder’s equity.

Some of the frequently used variables to control for credit risk are the ratios of loan loss provisions to total net loans and the ratio of non-performing loans to total gross loans. As these two ratios rise, bank exposure to credit risk rises along with the possibility of bank failure, which negatively affect profitability. These respectively indicate the percentage of the total loan portfolio that has been provided for but not charged off and the percentage of the total loan portfolio that has been identified as bad loans.

Almost all the literature on evaluation of bank performance indicates that the negative correlation between the credit risks controlled using these two variables and profitability. Taking into account, the fact that loan loss reserves are provided for from a direct charge to the income statement of a bank. This negative impact of an increase in this ratio on banks' profit should not be surprising. However, in the context of the risk-return tradeoff postulated according to the portfolio risk theory such a negative relationship goes against the general principle that with a higher risk comes higher return.

e. Credit-Deposit Ratio

A loan-to-deposit ratio is a measurement used in the banking industry to calculate the percentage of a bank's deposit base that it makes available in the form of loans. Laws in some nations and regions place limits on the loan-to-deposit ratio of banks and other financial institutions. In many instances, government regulators limit these ratios on a case-by-case basis. The bulk of a bank's revenue is generated through loan production. Banks raise money by agreeing to pay interest to deposit account holders. Some of those deposited funds are then lent out to consumer and business borrowers in the form of mortgages, vehicle loans and other types of credit products.

Funding costs are an important determinant of banks' net interest margins. In practice, the funding base of a bank can be broken down into some key components – capital, customer deposits, interbank borrowing, short-term wholesale borrowing (defined as debt maturing within one year) and long-term wholesale borrowing (defined as debt maturing beyond one year). For banks, customer deposits, on average, have a lower interest expense than other sources of interest-bearing liabilities (Miller and Noulas, 1997). Thus, increasing the share of liabilities held in deposits should lower interest expenses and improve bank profitability.

Among customer deposits, current accounts, being cost-free, are considered the cheapest source of funding followed by demand deposits, which are considered, less costly compared to term deposits. Hence, the more funds deposited into current and demand deposits, the higher would be the profitability. Gup and Walter (1989) analyze the performance of all small banks in the U. S. during the period from 1982 through 1987 and conclude that the high-performance small banks had a lower level of interest expense relative to assets, and a lower level of interest expense relative to interest-paying liabilities than the average bank. This was in part because they were able to gather a higher proportion of their liabilities from passbook and statement of savings. However, this impact of deposits has to be considered in light of its implication on the bank asset portfolio. Hester and Zoellner (1966) show that high demand deposits impair a bank's ability to realize capital gains on its portfolio. Banks with high proportion of demand deposits may hold high short-term securities, which are unlikely to yield large capital gains or in general increase the share of liquid assets in their portfolios to reduce their risk exposure on the asset side a strategy that would result in missing on some profitable investment opportunities. In addition, they suggest that competition for time deposits may force banks to improve services associated with checking accounts, which drive up the cost of servicing demand deposits.

In the Islamic banking literature, Haron (1996) investigates the deposit structure of five Islamic banks across five countries during 1984 to 2002 and concludes that investment accounts were the only deposit account type that had a significant relationship with all profitability measures used in the analysis. Savings accounts were found to have a significant positive relationship with return on assets only. He reports that for every 1% rise in savings account, total income increased by 0.26%. In addition, the results also indicate that current accounts have a negative relationship with return on assets but a positive impact on banks' portion of income as a percentage of total assets.

Pertaining to deposit structure, two structures are used. One is account type based structure, the same as proposed by Haron (1996) except that we combine current accounts and savings accounts in one group. In this group, two variables are included: current and savings deposits to total assets and time deposits to total assets. The second structure is sub-category counterparty-based structure. In this group, three variables are included: retail deposits to total deposits, corporate deposits to total deposits and public sector deposits to total deposits.

2.4 Customer Account Profitability Analysis

To measure customer account profitability, the sales revenue from each customer must be matched with the associated costs; this matching process highlights the dependency of accurate customer profitability on the accurate allocation of costs. Recognition of the customer account profitability has motivated banks to adopt alternative operating strategies. Segmenting customers from highly profitable to not profitable can help in creating more targeted marketing strategies. This means that a marketer can actually spread the marketing expenses in proportion to the segments from where the larger profits are coming in from. Customer account profitability is a key measure to assist in the achievement of corporate strategic objectives. The allocation of costs and revenues to individual customers, in order to arrive at the contribution of each to profits, has to be part of the customer portfolio of any supplier. Brown and Swartz, (1989), in their customer analysis, included customer profitability in their life-cycle classification of customer relationships, but they also highlighted the difficulties involved in acquiring such information. Frank (1962), on the other hand, did not use customer profitability as an element in his customer analysis. In fact he used his second matrix (customer business attractiveness vs. relative buyer/seller relationship) simply to infer that different cells of the portfolio matrix could be associated with different levels of profitability.

The impact of activity-based costing (ABC) on customer account profitability analysis (CAPA) has attracted relatively little attention in the management accounting literature. Bellis-Jones (1989) and Smith (2006) have examined the importance of customer profitability without exploring the potential usefulness of ABC in developing an accurate customer account profitability analysis.

Customer account profitability analysis is justifiable if the cost-benefit of compiling the information is favorable and the outcome of any subsequent strategic decision leads to increase in income. Strategic decisions may range from changing the delivery terms of a customer′s contract to terminating business dealings with an unprofitable customer.

Change since the mid-1980s in the form of increasing competition in the marketplace, growing financial awareness by customers, economic pressures on traditional markets and government legislation have contributed to making the market for retail financial services more open (Davis, 1994). Birch (1995) warns that "Fierce competition will lead to fewer financial service organizations, smaller banks will merge with larger ones, and many may disappear altogether". Ellwood (1994) suggests that: in the year 2000, the customer will see a banking marketplace where the blurring of identity between banks, insurance companies, and of other possible competitors that will enter in the market, will have accelerated. Customers will shop around more than ever and profitability will come under pressure. The result of this "shopping around" culture will be a higher mobility among customers buying financial products.

Differentiation will continue to lead the marketing strategy of banks, but it will be centered neither on products, as they are about the same, nor on price, as price differentials are minimal. Therefore, how will a financial institution, such as a retail bank, compete in such an environment? How will it differentiate its offerings from those of its competitors (Birch, 1995).

Financial institutions are acknowledging that unless customer needs are taken into account in designing and delivering services, technical superiority will not bring success (Zeithaml and Bitner, 1996). New marketing concepts and strategies (Ennew et al., 1993) are paying greater attention to identifying customer needs and expectations (Morgan, 1989) and offering high levels of service quality (Lewis, 1991). As argued in the literature (Brown and Swartz, 1989; Buzzel and Gale, 1987), it is probably the effective measurement, management and improvement of service quality which will enable financial institutions to achieve a differential advantage over their competitors (Lewis, 1989; 1991).

Perceived service quality is defined as the extent of discrepancy between expectation and perception of performance (Zeithamlet al., 1990). Consequently, effective management of the determinants of quality expectation and perception is required

(Berry et al., 1985). Although Zeithaml and Bitner (1996) suggest that customers might hold similar expectation levels for a spectrum of service firms in the same industry, it would be of interest to explore if service expectations are the same for sub-categories of banks.

The literature suggests that improvement of the financial position of individual clients and the dissemination of information about banking services have contributed to increasing customer expectations (Zavvos, 1989). These changes come at a time when the Greek banking industry is under pressure to operate within the norms of the single European market. To these pressures have to be added the trend towards globalization, deregulation and the abolition of several types of subsidies in the provision of financial services, fuelling competitive forces in the banking system (Gortsos, 1992).

In such an environment, maintenance of service quality and focus on customer needs are key components for strategic planning (Argyropoulos, 1996). Banks that will adapt their strategies to the new competitive conditions by improving the level of service quality, as perceived by their customers, are likely to create and gain a competitive advantage.

Costanzo (1995) observes that by prioritizing customer segments based on their profitability, banks can plan their retail delivery strategy better. Hudson (1994) suggests that customer account profitability information can be used to change delivery channels, encourage less expensive non-branch methods of banking and concentrate sales and service on the retention of profitable customers.

Previous studies (Costanzo, 1995; Hartfiel, 1996; Hudson, 1994; Lambert and Whitworth, 1996) applying activity-based costing to the banking industry has used the "number of accounts" and "the number of transactions" as cost drivers. Hudson (1994) finds that "positive profitability" households have an average of 4.0 accounts and used an average of 3.0 services, while "negative profitability" households had 4.6 accounts and used an average of 3.2 services. Lambert and Whitworth (1996) demonstrated that smaller customers had 65 per cent of the total number of transactions but generated only 19 per cent of the total revenue. This calculation basis has proved insufficiently accurate for the purposes of customer account profitability measurement, because of the inherent variation within each of these drivers. This study recognizes these difficulties and goes beyond a measurement of the number of transactions to incorporate the time (and cost) taken to conduct different types of transaction. Some of the relevant articles which are related with these issues are presented below:

Table 2.4
Some reviewed articles on customer account profitability analysis

Year	Author(s)	Concentration on
1975	Knight	Customer profitability analysis: alternative approaches toward customer profitability
1992	Nicolas Stuchfield	Modeling the profitability of customer relationships
1994	Storbacka et al	Managing customer relationship for profits
1994	David A. Yorke	The use of customer portfolio theory
1995	Smith et al	Customer profitability analysis-an activity based costing view
1996	Hallowell	The relationships of customer satisfaction, customer loyalty, and profitability.
1997	Plowman	The cost of the customer and profitability
1997	Noone et al.	Enhancing yield management with customer profitability analysis
1997	O’ Sullivan	Some of your customers are unprofitable
1998	Hart et at	Customer profitability audit in the Australian banking sector
1999	Mulhern	Customer Profitability Analysis: Measurement , Concentration and Research Direction
1999	Caru et al	Profitability and customer satisfaction in services
2001	Zeithamal et al	The customer pyramid: creating and serving profitable customers
2002	Narayanan	Customer profitability and customer relationship management at RBC financial group
2003	Gupta	Understanding customer level profitability implications of satisfaction programs
2004	Pfeifer et al	Customer life time value, customer profitability and the treatment of acquisition spending
2004	Wemer et al	Retailers at the cross-roads- how to develop profitable new growth strategies
2004	Bowman et al	Linking customer management effort to customer profitability in business market
2004	Cardinaels et al	Customer profitability analysis reports for resource allocation: the role of complex marketing environment
2004	Xevelonakis	Developing retention strategies based on customer profitability in telecommunications: an empirical study
2005	Helgesen	Customer segments based on customer account profitability
2005	Triest	Customer size and customer profitability in non-contractual relationships
2005	Raaij	The strategic value of customer profitability analysis
2005	Bonomo	Unlocking profitability in the complex company
2005	Kaplan	A balanced scorecard approach to measure customer profitability
2006	Pitta et al	A strategic approach to building online customer loyalty:

		integrating customer profitability tiers
2006	Kim et al	Customer segmentation and strategy development based on customer lifetime value: A case study
2006	Cline	The challenge of profitability measurement
2006	Ryals	Profitable relationships with the key customers: how suppliers manage pricing and customer risk
2006	Woodside and Soni	Customer portfolio analysis for strategy development in direct marketing
2006	Helm et al	Suppliers' willingness to end unprofitable customer relationships
2006	Lopez et al	The impact of customer relationship characteristics on customer switching behavior
2006	Seetharaman	How much is your customer worth? A gamma-poisson model to assess customer profitability
2006	Loesher	Implementing a customer profitability management system at Austin bank of Chicago
2006	Therese &Zofia	Customer profitability – a case study on measurement methods within a manufacturing company
2007	Mihaela	Customer account profitability analysis
2007	Paola Gritti	Customer satisfaction and competencies: an econometric study of an Italian bank
2007	Nagle and Hogan	Is your sales force a barrier to more profitable pricing?
2009	Jasmin Harvey	Customer profitability analysis: New Dimension
2013	Mark J. Epstein	Customer profitability analysis: Management Strategy

Customer account profitability analysis describes the process of allocating revenues and costs to customer segments or individual customer accounts, such that the profitability of those segments and/or accounts can be calculated. The calculation of customer account profitability amounts to an extensive activity-based costing (ABC) exercise (Cooper and Kaplan, 1991; Foster and Gupta, 1994). The first step in ABC is the identification of cost pools i.e., distinctive sets of activities performed within the organization (for example, procurement, manufacturing, customer service). For all cost pools, cost drivers are identified: units in which the resource consumption of the cost pool can be expressed (for example, number of purchase orders, number of units produced, number of service calls). Costs are then allocated to cost objects (such as products) based on the extent to which these objects consume cost driver units. ABC as a cost accounting method has revolutionized the way in which costs are allocated to products. Once it has been accepted that not every product requires the same type and same level of activities, it is a small step to see that customers, too, differ in their consumption of resources. The size and number of orders, the number of sales visits, the use of helpdesks and various other services can be very different from one customer to another. Consequently, two customers who buy exactly the same product mix for the same prices (thus generating exactly the same profit margins on their purchases) can have different relationship costs, leading to different levels of customer profitability.

If a manager bases budget allocation decisions solely on accounting reports, then customer profitability reports are expected to have an edge on traditional costing reports, since revenue and marketing support differ across customers (Mulhern, 1999). This allows managers to gear their budgets efficiently to the more profitable types of customers. Nevertheless, marketing managers typically have, in addition to formal cost data, access to other types of feedback via their past decisions and interactions with customers. Experimental evidence in a production context suggested that decision makers would not rely solely on their accounting reports (Gupta and King, 1997). Performance in this group, however, remained lower than in a group receiving a more refined activity based costing report, since participants continued to rely primarily on the biased accounting report. But recent evidence has raised doubts about the value of accurate cost data by focusing on types of feedback available in addition to outcome feedback. Dearman and Shields (2001) showed that decision makers were able to realize efficient decision performance under volume based costing reports as long as other information, including that relating to the market, their past performance, the product's cost consumption patterns or their general experience with ABC, was available. These other sources of feedback allowed the manager to correct for basis in their product cost reports.

Most companies lose 45% to 50% of their customers every five years, winning new customers can be up to 20 times more expensive than retaining existing customers (Full, 2006). The higher the level of satisfaction that customers experience, the greater the trust and confidence they show. As this trust and confidence grows, they will be less likely to move their business for a few percentage points (Castiglione 2006). When it comes to measuring their customers' satisfaction, too many companies have settled into a comfortable rut of changing their approaches to get the results they want (Columbusn, 2005). "Competitors that are prospering in the new global economy recognize that measuring customer satisfaction is a key.

Many companies nowadays make use of advanced customer relationship management (CRM) systems, which will compute customer profitability figures on the basis of sales and service data available to the system. But as these figures are only as good as the quality and comprehensiveness of the data put into the system, it is good to review the general process of customer account profitability, such that the accuracy of computed customer account profitability figures can be evaluated. The process starts with scrutinizing the list of current customers. Many customer databases contain details of customers who no longer have a relationship with the firm (Mulhern, 1999). The first step in the customer account profitability process, therefore, deals with the identification of the “active” customers in the customer database, in order to assure that costs are allocated to active customers only. Schmittlein et al., (1987) and Schmittlein and Peterson (1994) developed quite sophisticated methods to calculate the probability of a customer being an active customer, based on regency and frequency of purchases. A simpler approach would be to define active customers as all customers that have interacted with the company during a specific period, such as the last 12 months, either by placing an order or by receiving sales or service calls ((Mulhern, 1999).

Many researchers in the literature have investigated the churn behavior of the banking customers. Nha Nguyen and Gaston LeBlanc (1998) proposed a framework that investigates the effects of customer satisfaction, service quality, and value on perceptions of corporate image and customer loyalty towards the service firm. Their findings, based on structural equations modeling, showed that customer satisfaction and service quality are positively related to value and that quality exerts a stronger influence on value than satisfaction. Value is found to positively impact on image, suggesting that the banking institution should have a strong image when customers believe they are getting high value. Customer satisfaction and image perceptions are found to impact on service loyalty with satisfaction having a greater influence on loyalty than image.

Bolton (1998) examined the link between customer satisfaction and retention. His study models the duration of the customer's relationship with an organization that delivers a continuously provided service, such as utilities and financial products. By using proportional hazard regression with cross sectional and time series data describing cellular customers' perceptions, concludes that the customer satisfaction ratings elicited prior to any decision to cancel or stay loyal to the firm, is positively related to the duration of the relationship. The strength of the relationship between duration times and satisfaction levels depends on the length of customers' prior experience with the organization.

Athanassopoulos (2000), in his study proposed an instrument of customer satisfaction in retail banking services in Greece. The empirical results have confirmed that customer satisfaction is a function of service quality (staff service and corporate image), price, convenience and innovation. By using logistic regression analysis and techniques for qualitative research, he summarized that the segments of business and individual customers exhibited statistically significant differences in terms of satisfaction scores. These differences reflect the different stages of service focus that are exhibited at present alongside with the emerging competitive terms of financial services in Greece.

The essence of customer account profitability analysis is the allocation of all costs to a customer or customer relationship, rather than only the product costs. Customers that buy high-margin products will be more profitable, but differences in profitability can also come from the non-product costs. Customers can differ in their order behavior, are located in different places, make different demands with respect to service and support, and so on. This insight – although not new – first came to prominence around 1990 (Shapiro *et al.*, (1987) for an early article on the need for customer profitability information. This has led to a series of articles on the virtues of customer account profitability (Howell and Soucy, 1990; Foster *et al.*, 1996). The empirical literature on customer account profitability is less prolific but growing (Storbacka, 1997; Garland, 2002).

Customer account profitability is calculated on a single period basis, usually the last full year of the customer’s relationship with the business. The revenues and costs to serve associated with a customer are identified (Mulhern, 1999). There are problems for some companies in achieving even this snapshot view of the customer; many companies have management accounting systems that run along product lines, rather than customer, so identifying the revenues and costs associated with a customer’s purchases across an entire product range can be problematic (Hill and Harland, 1983).

Where customer revenues have to be estimated (or forecast, as in the calculation of customer lifetime value or customer equity), the RFM (Recency, Frequency, Monetary amount) approach is sometimes used. Forecasting tools and data processes may be brought into play (Ryals, 2003a). Where key customers are concerned, the amounts involved and their importance to the company usually call for more precise forecasting. In such cases, customer revenues are determined from the mix of products that customers buy and the prices that they pay. Because products and services to key customers are more likely to be heavily customized, prices may be set customer by customer. The literature suggests that it is in this situation that value-based pricing may be used.

As one of the marketing's traditional 4 Ps (product, price, promotion and place), pricing is a core element of the marketing mix. Marketers argue for value-based pricing, where the price of the product is set with regard to the value to the customer. In practice, the majority of companies price their products or services with respect to the cost of production, adding a margin (cost-plus), or they price relative to the competition (Urbany, 2001). One study of ten different pricing strategies found that cost-plus pricing was used by 56% of respondents (Noble and Gruca, 1999), more than any other pricing strategy.

Value-based pricing, also known as value-in-use pricing, sets prices depending on how much the products or services are worth to customers (Stedman, 2000). Here, price is a 'sacrifice' and the expected value to the customer is the positive value-creation of product and service attributes on the one hand, less the value-reducing aspects of price and risk (Naumann, 1995). When goods and services are sold, value is created for customers and, in exchange, they create value for companies by paying for those products or services (McTaggart et al., 1994). The level at which value-based prices are set reflects the exchange of value rather than the costs of production. The fact that most companies use pricing strategies that do not reflect the value exchange and therefore fail to connect value and price (A.T. Kearney, 2003) means that, at least in principle, companies may be under pricing their goods and services, possibly considerably (Hunt, 2002). For those companies who are both providing excellent value to customers and who are prepared to try to measure that value, the profit potential of an effective value-based pricing strategy is far greater than with any other pricing strategy (Monroe, 2004).

The literature tends to suggest that customer costs are usually divided into two; there are the direct costs associated with the products that the customer buys, and the indirect costs of serving the customer (Bolen and Davis, 1997). Of the two, it is the indirect costs, the costs to serve, that are the most intractable. Many companies find difficulty in allocating these to customers. These are the costs that are listed in the Profit & Loss account as sales and general administration (SGA) costs. They can include sales, marketing, customer service, administration, and sometimes logistics (Niraj et al., 2001). One solution is to allocate these costs proportional to the revenues that the customer generates or to the volumes purchased. The problem here is that customers vary in the service demands they place on companies. Allocating sales and general administration costs proportional to revenues or volumes will overstate the profitability of customers who are more demanding and understate the profitability of customers who are easier to deal with (Ryals, 2003b). Allocating costs to serve proportional to revenues or volumes tells a company very little more than the revenue or cost data. Certainly, it reveals nothing about the relative costs to serve and relative profitability of different customers and different purchasing behavior. This is not a problem where the sales and general administration costs are small, or where the differences in customer buying behavior are slight. However, a survey of the Fortune 500 companies in the USA revealed that sales and general administration costs were the second largest cost item after product costs and were growing up to four times as fast (Howell and Soucy, 1990). In other words, not only is the problem of sales and general administration allocation a large one, it is a growing issue.

A partial answer to the problem of SGA cost allocation is the use of standard costs. Standard costs are a calculated cost of a particular activity, such as raising an invoice for a customer. The standard cost of raising the invoice is then multiplied by the number of invoices raised to that client during the year; this gives the approximate cost of invoicing that client.

However, many companies want to calculate customer account profitability or customer lifetime value in respect of their key accounts. For key accounts, it is not the small items such as the numbers of invoices or credit notes that have the real impact on profitability. Instead, it is the cost of key account management that is the major cost to serve. A measurement tool that enables companies to recognize the differing costs to serve of its customers is activity-based costing (ABC). Originally developed by the accounting profession as a method for allocating product costs, ABC has been adopted by companies wanting to calculate the value of their customers.

The notion of portfolio management is not new in marketing and academics have discussed the product portfolio (Bordley, 2003) and the brand portfolio (Petromilli et al., 2002). The purpose of treating a set of products or brands as a marketing portfolio is to promote a debate about how the profits of the portfolio as a whole can be maximized and to determine the most efficient allocation of marketing spend (Larre´che´ and Srinivasan, 1981).

Several researchers have suggested that the customers of an organization can also be viewed as a portfolio (Rust et al.,Johnson and Selnes, 2004). Here, the objective is the maximization of customer equity (Lemon et al., 2001). The theory of portfolio management derives from the financial field and the management of portfolios of stocks and shares (Brealey, 1983). In the financial field, portfolio theorists point out that the objective of investors is not profit maximization, since profit maximization might entail unacceptable levels of risk. In fact, modern portfolio theory holds that the aim of the investor is to maximize return and minimize risk (Sharpe, 1981) and there is empirical evidence that investors do in fact behave in this way (Ferguson, 1987). Applying portfolio theory to marketing requires some consideration of the risk of the customer, and there has been some recent research into how this might be done (Dhar and Glazer, 2003).

2.4.1 Employee- Customer Satisfaction - Profit Model

The customer-profit model shows that customer variables have a positive impact on profit, while some of the customer variables have clear links to employee-related variables (trust; perception of employee attitude). Similarly, the employee-profit model shows the positive impact of employee variables on profit, while arguing that the employee variables are linked to customer-related variables (expressed satisfaction; job content). Both models provide partial evidence for the relationships put forward by Heskett's in his service profit chain. In order to complete the whole picture, a synthesis of the two models is called for employee-customer satisfaction-profit model.

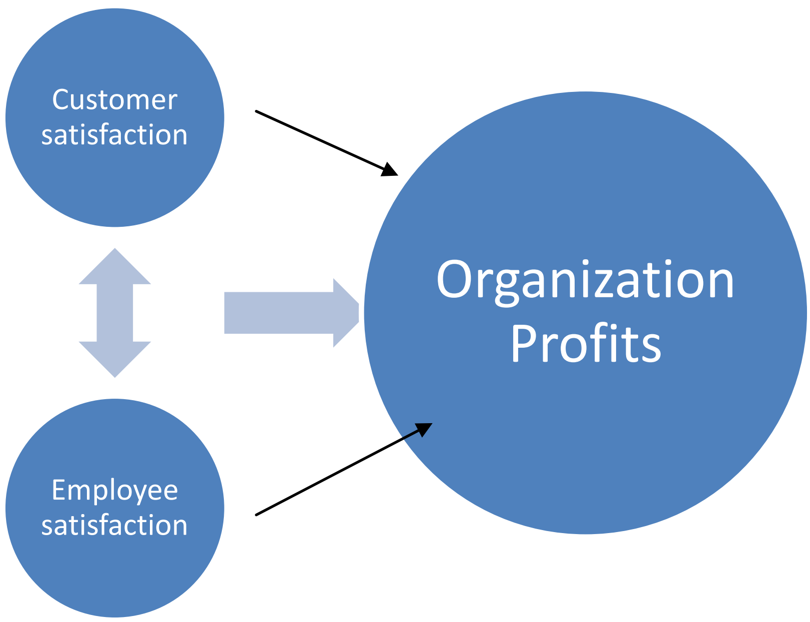

Figure 3. Employee-customer satisfaction- profit model

Source: Heskett, Sasser and Schlesinger 1997: 19

The key variables of figures 1 and 2 are used to synthesize above model for studying customer satisfaction and employee satisfaction, and their impact on profit. Reducing the models to their core in this fashion enables building a bridge between the two interdependent models as a means of testing the service-profit chain. A simplified synthesized employee-customer satisfaction model is presented in figure 3.

The added value of the synthesized model is assumed that both customer and employee satisfaction contribute directly to profitability, while recognizing that, within each company or part of the company, there are additional mechanisms leading from employee satisfaction to customer satisfaction and the other way round, that have the potential to generate accumulated effects. A strong correlation between employee and customer satisfaction implies serious rethinking of separated marketing and HRM strategies.

2.5 Conceptual Framework

To investigate the impact of customer satisfaction and employee satisfaction on customer account profitability empirically, linear regression model can be applied which are widely used in the literatures (Bourke, 1989; Demirguc-Kunt & Huizinga, 1999; Athanasoglou et al., 2005; Molyneux and Thornton, 1992). As far as the research subject is concerned, the dependent variable is the customer account profitability of commercial banks and the independent variables are customers' satisfaction, employees' satisfaction and some of the selected financial ratios such as capital adequacy ratio, operating expenses ratio, assets composition ratio, credit ratio and credit deposit ratio. Finally, by combining above theoretical frame work, the conceptual frame work has been designed as follows:

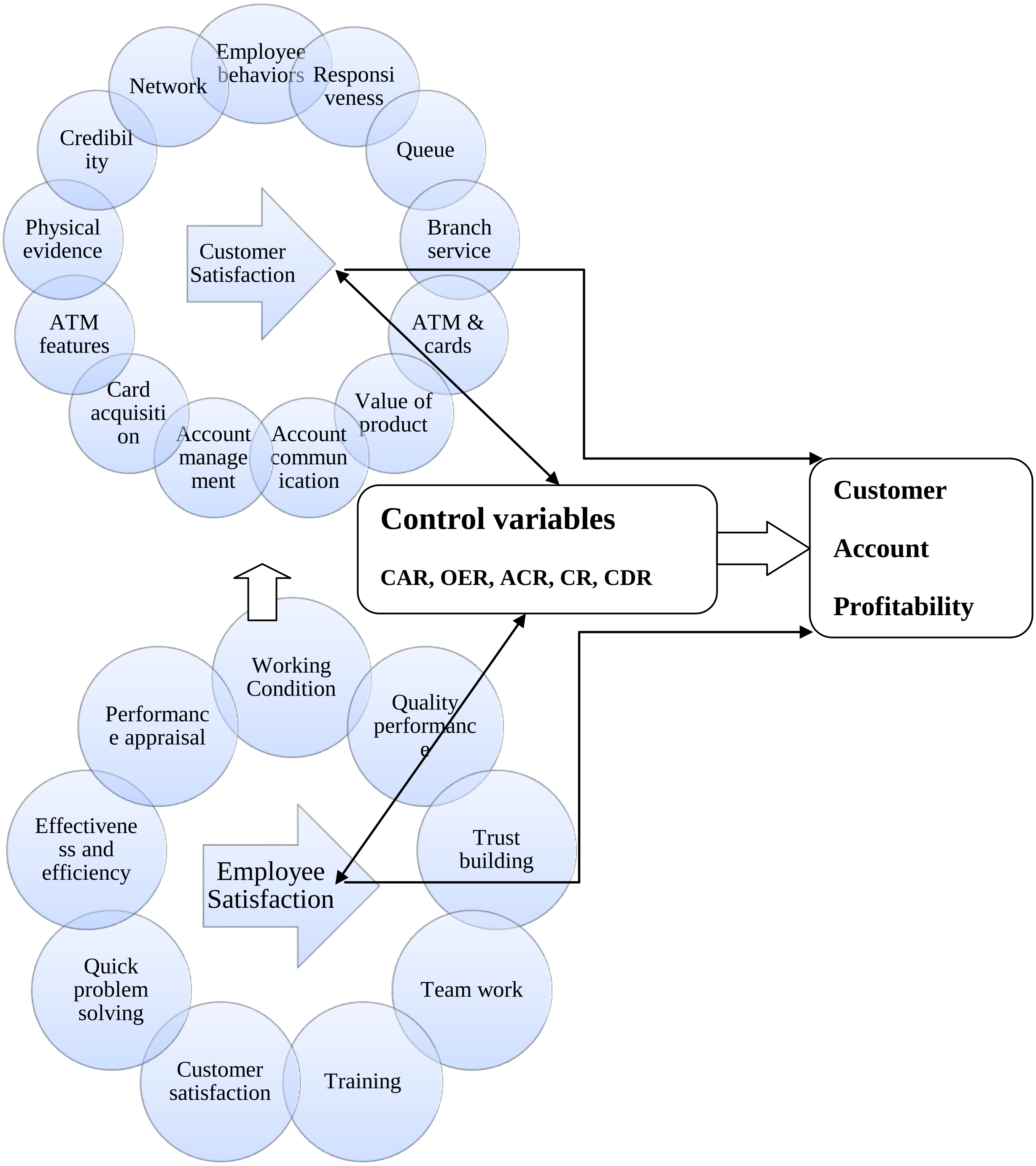

Figure 4: Conceptual framework of customers' accounts profitability in commercial banks.

Variables used in customers' satisfaction- Employees' behaviors, Effective queue management, Responsiveness, Branch service facilitators, Effective ATM and Card Procedures, Value of other products, Account communication, Effective account management, Simple account/card acquisition, Physical aspect of the ATM, Physical evidence, Credibility and Security, Network accessibility
Variables used in employees' satisfaction- Working Condition, Effectiveness & Efficiency, Quality Performance, Training, Performance Appraisal, Quick Problem Solving, Trust Building, Customer Satisfaction and Teamwork
Controlling variables- Capital Adequacy Ratio, Operating Expenses Ratio, Assets Composition Ratio, Credit Ratio, Credit Deposit Ratio
Dependent variable= Customer Account Profitability

The profitability of any commercial bank depends up on the contribution of their valued customers. Therefore, this research analyzes the customers' satisfaction variables which affect the individual customer account profitability of commercial banks. The customer satisfaction variables include Employees' behaviors, Effective queue management, Responsiveness, Branch service facilitators, Effective ATM and Card Procedures, Value of other products, Account communication, Effective account management, Simple account/card acquisition, Physical aspect of the ATM, Physical evidence, Credibility and Security, Network accessibility and attitudes of the customers towards commercial banks services. All these variables are the independent variables which have direct and indirect influence on the customer account profitability of commercial banks.

Similarly, some employee satisfaction variables are also selected and used to measure the satisfaction level of employees. These include Working Condition, Effectiveness and Efficiency, Quality Performance, Training, Performance Appraisal, Quick Problem Solving, Trust Building, Teamwork, Customer Satisfaction

To establish the relationship of customer and employee satisfaction on customer account profitability, some controllable variables namely, capital adequacy ratio, operating efficiency ratio, assets composition ratio, credit risk ratio, and credit deposit ratio are also included.

The literature has shown that the longer customers stay in a relationship with the company, the more value they generate (Reichheld, 1996b), so the period of time a relationship is maintained is one of the fundamental factors determining the value that the customer provides to the firm (Berger and Nasr, 1998; Rosset *et al.*, 2002). Customer switching behavior is consequently a serious threat to the achievement of long-term relationships (Ganesh *et al.*, 2000). Hence, firms need to study carefully the processes determining customers' switching decisions if they are to manage their customer bases successfully (Bansal *et al.*, 2005).

Relationship marketing has taken on a key role in marketing theory and practice in recent years and has postulated the importance of relationships for improving firms' profitability and future viability (Morgan and Hunt, 1994). Much of this interest can be traced to the benefits that the literature attributes to maintaining long-term relationships. Recent research has shown that continuing customers have: a lower price sensitivity (Keaveney, 1995), greater usage of the firm's services (Bolton and Lemon, 1999), greater receptivity to the firm's new products (Hawkins *et al.*, 2004), increased predisposition to engage in positive word-of-mouth and a greater resistance to competitors' persuasion attempts (Dick and Basu, 1994).

Apart from increasing the firm's revenues, continuing customers contribute to cutting its costs, since they are less expensive to serve (Ganesh *et al.*, 2000), the positive word-of-mouth they spread attracts new customers and reduces the costs needed to attract them (Keaveney and Parthasarathy, 2001), and the uncertainty in the exchanges diminishes due to the experience accumulated throughout the relationship (Heide and Weiss, 1995).

Therefore, losing a customer is a serious setback for the firm in terms of its present and future earnings. In addition to losing the benefits discussed above, the firm needs to invest resources in attracting new customers to replace the ones it has lost (advertising, promotion, initial discounts). Peters (1987) shows that it can cost five times more to acquire a new customer than to retain an old one. Consequently, retaining the current customer base is much more attractive than searching for new customers.

Costanzo (1995), Adams (1996), Soin (1996) and Hartfiel (1996) have done detail studies embracing the application of activity-based costing and customer account profitability analysis to the banking sector. Mabberley (1994) and Smith and Dikolli (1995) explore the advantages of using both in conjunction, seeking a model which can give a more accurate picture of profitability on a per-customer basis.

2.6 Research Gap

Due to the immense competition in the financial sector, every bank attempts to deliver the distinct services to the valuable customers. Those banks can survive which have core competencies strategies. As suggested by the M. E. Porter, product differentiation (service differentiation in banks), low cost leadership and quick market response are the competitive strategies (Porter, 1980). Customer satisfaction, employee satisfaction, customer account profitability, status and trend of commercial banks and determinant of bank profitability are the issues of analysis in this research. Several factors influence the customer account profitability as well as the overall profitability of commercial banks. In Nepalese context, there are a large number of articles related with profitability and financial performance of commercial banks, but no attempts have been made to analyze and measure the satisfaction level of customers as well as employees and customer account profitability. Similarly, the reviewed articles showed only tabular analysis of bank profit. There is strong need of measuring customer account profitability with some financial ratios as well as customers' and employees' satisfaction. Till now, there is no any attempt of investigation is made for exploring the real state of affairs of customer account profitability of different commercial banks in Nepal. It is assumed that this research work will be the corner stone for the further research work. Under this study, various types of analysis, evaluation and investigations have been made. This research attempts to analyze present trends and status of commercial banks, classify the different types of account holder customers on the basis of their satisfaction level and profitability, and measure the impact of customers' and employees' satisfaction on customer account profitability.

CHAPTER III
RESEARCH METHODOLOGY

This chapter deals with the research methodology so as to achieve the basic objective of the study. Therefore, it includes in detail about research design, nature and sources of data, data collecting procedures, survey of respondents and expected relationships of different variables used in the research. Similarly, it also describes the statistical tools and models applied to draw logical conclusions about customer account profitability.

3.1 Research Design

The design of the study involves the measurement of the impact of customer satisfaction, employees' satisfaction and financial performance on customer account profitability in addition to the analysis of the status and trends of some of the relevant financial ratios. The information regarding customer satisfaction derived from the interview of account holder customers selected from all commercial banks while customer account profitability is obtained from the individual customer account of the banks who are selected for the interview.

The design includes the test of relationship between customer account satisfaction from the bank services together with some of the financial variables such as capital adequacy, operating costs, assets composition, credit risk and deposit ratio as explanatory variables and customer account profitability as a dependent variable. The dependent variable is in four different forms, customers account profitability, net profits, return on assets, and return on equity. Different descriptive statistics such as simple average, standard deviation, ratios etc. are used. Similarly, different inferential statistical tools such as testing of hypotheses, regression equations, and correlation coefficients are also used. Hence, the design constitutes both descriptive and explanatory research design.

3.2 Types and Sources of Data

Two types of data primary and secondary were collected. Primary data was collected through customer and employee opinions survey while secondary data was gathered from the banks' annual reports and financial reports including profit and loss accounts and balance sheets via the internet (Nepal Rastra Bank's website), government papers and consultancy reports. In primary data, two types of questionnaires were prepared, one for account holder customer and another for bank's employees distributed to the four hundred customers and four hundred bank employees of all thirty commercial banks of Nepal at the mid July, 2012. The distribution of questionnaire was done to the different customers and employees of the commercial banks via e-mail.

3.2.1 Population

The population of the research study is all commercial banks in Nepal of mid-July, 2012. Basically, these banks are classified into three broad categories- government-owned banks, joint-ventures banks and private sector commercial banks. All types of banks are the area of concern. The financial information of all the banks is available for the year 2011 and 2012. Therefore, pooled regression is based on the data of 2011 and 2012. There were 7.1 million account holding customers and 18,800 employees working in 30 commercial banks at Mid July 2012.

3.2.2 Sampling and Sample Size

This study includes all commercial banks established as per the NRB records at the mid July, 2012. There were 30 commercial banks by the end of fiscal year 2012. All 30 banks were selected for analysis. There were 7.1 million account holder customers and eighteen thousand eight hundred employees in commercial banks at the end of 2012. Out of total account holder customers, four hundred customers were selected for study. Similarly, same numbers of employees were also selected for the study.

In determining the sample size of account holder customers, the account holder customers were stratified into two groups, male account holder customer and female account holder customer. Assuming the probability of selecting male account holder customers is P and the probability of selecting female account holder customers is Q (1-P). Using this probability and assuming 95% confidence limits and of 5% error margin, the sample size comes,

$$n = \frac{Z^2(PxQ)}{E^2}$$

Where, Z is the standard normal variation. This research is conducted under 95 percent confidence limits, which is 1.96. There is equal chance of selecting male and female customers and employees, so the values of P became 0.5 and Q became 0.5. It is prepared under 5 percent error.

For the convenience, 400 samples from each group were selected. Similar process was also adopted for determining the sample size of employees of banks for their perception analysis. There are different sample sizes in commercial banks. For representing all population of customers and employees, the proportion of population is taken. The following table gives the sample size of each bank:

Table 3.1
Selection of sample size from commercial banks

S. n	Name of bank	Type	Customer		Employee	
			Population	Sample	Population	Sample
1	NBL	Govt. owned	550000	31	2815	60
2	RBB	Govt. owned	530000	30	2550	54
3	NABIL	Joint venture	460000	26	657	14
4	NIBL	Private	475000	27	877	19
5	SCBNL	Joint venture	260000	15	435	9
6	HBL	Joint venture	280000	16	580	12
7	NSBI	Joint venture	250000	14	492	10
8	NBBL	Joint venture	210000	12	380	8
9	EBL	Joint venture	350000	20	586	12
10	BOK	Private	220000	12	484	10
11	NCCB	Private	180000	10	305	6
12	NICB	Private	160000	9	336	7
13	LUMBINI	Private	140000	8	140	3
14	MBL	Private	150000	8	492	11
15	KUMARI	Private	160000	9	347	7
16	LAXMI	Private	130000	7	205	4
17	SBL	Private	200000	11	375	8
18	ADBN	Govt. owned	525000	30	3528	74
19	GLOBAL	Private	160000	9	386	8
20	CITIZEN	Private	180000	10	291	6
21	PRIME	Private	160000	9	275	6
22	SUNRISE	Private	230000	13	472	10
23	BOA	Private	125000	7	234	5
24	DCBL	Private	210000	12	233	5
25	NMB	Private	130000	7	189	4
26	KIST	Private	325000	18	581	13
27	JANATA	Private	80000	5	156	4
28	MEGA	Private	120000	6	103	3
29	C & T	Private	70000	4	162	4
30	CIVIL	Private	80000	5	134	4
Total		**30**	**71,00,000**	**400**	**18,800**	**400**

On the basis of bank structure, commercial banks are classified as government-owned, joint venture and private sector banks respectively. The total numbers of these banks were 3, 6 and 21. Out of 400 customers, the numbers of respondents from these banks were 91, 130 and 179 respectively, which are shown in the Table 3.2:

Table 3.2
Classification of bank on the basis of bank structure

Structure	Number of respondents	Percent
Government- owned (3)	91	22.80
Joint venture (6)	130	32.40
Private (21)	179	44.80
Total (30)	**400**	**100**

Similarly, on the basis of banks' year of operations, all commercial banks are classified into three groups i.e. above 20 years, 5 to 20 years and below 5 years of operation. The total numbers of these banks are 5, 13 and 12, from banks having more than 20 years of operations, 5 to 20 years of operation and below 5 years of operation respectively at the end of 2012. The numbers of respondents from these banks are 129, 66 and 105 respectively, which are shown in Table 3.1:

Table 3.3
Classification of bank on the basis of bank's years of operation

Operations Year	Number of respondents	Percent	No. of banks
More than 20 yrs	129	32.25	5
5 to 20 years	66	16.50	13
Below 5 years	105	26.25	12
Total	**400**	**100**	**30**

A questionnaire was designed to elicit responses on the main constructs designed in this study (see appendix) to gather primary data. Next step was carried out to test the relevance of the questions. For pre test, ten questionnaire forms were distributed to the account holder customers of the banks. They were requested to fill up these forms. Based on the feedbacks from respondents, the questions were modified and eliminated vague, ambiguous and unclear questions. The same procedure was applied for collecting responses of bank employees also. The questionnaire involved questions on demographic profiles of the respondents and the opinions of services provided by the commercial banks. Five points Likert scale was used to measure the opinions of respondents.

3.3 Questionnaire for Account Holder Customers

A structured questionnaire (Appendix A) was used to collect the opinions of selected account holder customers of commercial banks. The questionnaire comprises altogether thirteen questions including dichotomous, open-end, and rating questions. It is attempted to collect information regarding respondents' profiles, satisfaction level of customers and their views on various services provided by concerned banks. For measuring the satisfaction level of account holder customers, twelve statements were included in questionnaire. Each of the statement comprises the service related features and attributes. Five points Likert scale is used to rate bank services in which 1=not satisfied, 2= less satisfied, 3= satisfied, 4= highly satisfied and 5= very highly satisfied.

3.4 Questionnaire for Banks Employees

A questionnaire (Appendix B) was also designed to collect the opinions of bank employees by including dichotomous, open, and rating questions. Fourteen questions were included in the questionnaire. On the basis of banks incentives and benefits to employees, the sampled employees' satisfaction level is measured by asking ten different situations. The same procedure was used for grouping the employees as in account holder customers.

3.5 Customer Satisfaction Variables

The customer account satisfaction is defined as a satisfaction of account holder customers from the various services provided by the banks. It is measured by a composite score obtained from the customer's ranking of various banking services. The perception in each of services (factors) is composed of various statements ranked in five point scale by the selected account holder customers for the interviews.

The factors included in the customer account satisfaction are assumed to affect customer account profitability. As commercial banks provide various types of services to the customers, customers might have different opinions and perceptions and satisfaction levels in their services. The factors included in the customer account satisfaction are given below:

3.5.1 Employees' Behavior

Within this, seven statements were asked to customers. These statements were related with the employees' behaviors towards customers. It includes the smartness of employee, their support and help for providing services to the customers. Similarly, information about some changes, terms and conditions of various products and services of banks as well as advises and offers of services, friendliness of employee, help in filling necessary documents were also included.

3.5.2 Responsiveness

This is the eagerness of employees to customers for providing better services. There are three statements for knowing the responsiveness of the employee. Promptness and accuracy in transactions, complaint registering method and complaint redresses method are the questions involved in this variable.

3.5.3 Effective Queue Management

Waiting line management is another concern for measuring the satisfaction level of customers. If there is a long queue, customers feel bore and bank will lose the goodwill. Minimum queue time, sufficient number of tellers and provision of additional tellers when busy are the raised issues in this variable.

3.5.4 Effective ATM Cards Procedures

All commercial banks provide automatic teller machine facility. Most of the customers use ATM cards to deposit and draw amount. There are six statements in this factor. Accurate execution of ATM transactions, their working condition, and accessibility of network, procedure for obtaining cards, replacement and privacy are some features of this variable.

3.5.5 Branch Service Facilitators

All commercial bank provide any branch banking system. Customers want consistent services in all branches. They need various physical resources such as transaction slips, information pamphlets, working pens and convenient hours of operations.

3.5.6 Value of Other Products Exclusive Loan

Beside loan, customers use different services and products from commercial banks. They use bank draft and money transfer/forex facilities from banks. This variable measures the satisfaction level of customers on these issues with reference to their price and competitiveness.

3.5.7 Account Communication

Customers need clear and detailed statement of account. They expect correct information on new products and services. Similarly, banks have to communicate new charges and rates of services and products. In this variable, four questions are included.

3.5.8 Effective Account Management

To resolve some queries and confusions of customers, how managers and branch managers react and are they available or not, this variable is included. Some customers need financial advice so this variable is related with these issues.

3.5.9 Simple Account/Card Acquisition

This variable measures the satisfaction level of customers for obtaining credit cards, debit cards, ATM cards and procedures for opening accounts in respective banks. It includes four statements namely, simple procedure for obtaining credit cards, debit cards, ATM cards and opening accounts in the bank

3.5.10 Physical Aspect of the ATM

ATM is a very easy and time saving tool for customers. To measure the satisfaction level, three features are included in this variable. Adequate physical security of ATM, production of withdrawal slip and account balance and problem handling assurance of employee are included in this variable.

3.5.11 Physical Evidence

To know the satisfaction level of customer towards the banks physical environment, six statements are involved within this variable. It represents the physical attractiveness of banks, which includes clean environment, attractive and well designed environment, safety, personal security, adequate parking facility, convenient branch location, use of modern equipments and well decoration.

3.5.12 Credibility and Security

This variable describes the bank reputation, financial security, confidentiality of accounts and transactions of banks.

3.5.13 Network Accessibility

There are four features in this variable. It describes about the facilities of any branch banking services (ABBS), easily accessible branch network, mobile banking and internet banking facilities provided by commercial banks.

3.6 Employee Satisfaction Variables

The bank employee satisfaction is defined as the satisfaction of bank employees in various incentive schemes of the bank provided to their employees. It is measured by a composite score obtained from the employee ranking of various incentives. The perception in each of the incentives is composed of various statement ranked in five point scale by the selected employee for interview.

Altogether, there are twelve variables which were used for measuring the satisfaction level of employees of commercial banks of Nepal. Simple descriptions and features of these variables are expressed as follows:

3.6.1 Work Condition

The term "work condition" encompasses many different aspects such as: physical work environment, management's attitude toward employees, relationship with colleagues, and working conditions. Recent research has highlighted the hypothesis that an employee's work environment can have a dramatic effect on his/her performance and attitude toward work.

3.6.2 Employee Training/Programs

Training programs should be designed to consider the ability of the employee to learn the material and to use it effectively, and to make the most efficient use of resources possible. Training can be a valuable source of motivation for an organization's employees, if administered correctly. In order to ensure the maximum effectiveness of any training program, the candidates for training must be chosen correctly and the training must be pertinent and add value for their particular employment situation (Carolina 2004). A commitment to investing in their training and development is a prudent strategic move that will not only enhance productivity, but also increase employee satisfaction.

3.6.3 Recognition

Employees were once thought to be just a normal part of the production process of creating goods and services. Today however, most organizations realize that employees are much more than just "input" as part of the business generation process, and require motivation and subsequent recognition in order to build and maintain employee satisfaction.

Motivated employees are more productive, more engaged, and are satisfied workers. Employees that are motivated have a sense of purpose and belonging, and therefore tend to exhibit greater loyalty to their respective organizations.

3.6.4 Employees Working Condition

Employee working condition has been described and defined in many ways but is generally accepted as: the process of enabling an employee to think, behave, act, react, and control their work in more autonomous ways, as to be in control of one's own destiny. Effective employee working condition not only has positive implications for employee satisfaction, but also many other organizational facets, such as customer service and retention. Employee working condition is a term that many managers and organizations think they understand, but few actually do, and even fewer really put into practice. Employee working condition is actually a culmination of many of the ideas and tenets of employee satisfaction. Many managers feel that by empowering employees, they relinquish the responsibility to lead and control the organization.

3.6.5 Trust Building

Trust and a positive work environment are important elements in developing interpersonal relations at work (Billikopf 2006). Employees gauge how they are regarded by management in many ways, but the words that managers' use and the way they are delivered are critical to employees' perceptions of whether they are respected or disrespected. A multitude of job satisfaction surveys indicate that when employees are treated with respect by the management of an organization, the organization reaps the benefits of increased retention, increased productivity, and an overall increase in job performance. However, When employees do not feel respected the results are correspondingly negative (Pounds 2006).

3.6.6 Effectiveness and Efficiency

Managers must practice what they preach and pledge tangible support to initiatives that have been planned and promoted to the employees of the organization. If an organization communicates to its employees that they are valuable and essential to the success of the company, they must act upon this notion. If these organizations fail to invest in the development of their workforce, they are sending a message that their statements are nothing but shallow and unsubstantiated talk (Frazee 2004). In an effort to stay competitive and increase margins during the recent past, organizations have focused on automation and processes. Many organizations have just focused on operational efficiency, which is only one piece of the larger business performance puzzle. The most important asset, the one that operates and manages the business, are the employees' effectiveness and efficiency of the organization. Having a motivated and satisfied workforce has a positive effect on the performance of the business

(Smith 2006). Good leadership can assure an organizational atmosphere that will accomplish business goals, and at the same time, assure a high level of employee satisfaction by maintaining a strong focus on the employees of an organization.

3.6.7 Teamwork

Teamwork is often viewed as an efficient and motivating method of coordinating and condensing the individual contributions of individuals into one cohesive outcome. In this regard, teamwork is viewed as a motivational tool for the purpose of enhancing individual input and involvement through a group of employees working together in team environments (Rodwell et al. 1998).

3.6.8 Employee Benefits

With the ability to maintain qualified and satisfied workers at a premium today, providing attractive benefits to employees is an important consideration for any organization. Due to an exponentially increasing economy and a growth in new businesses, employees in many cases, have the advantage in employment negotiations (Ruddy 2001).

3.6.9 Quality Performance

Every commercial bank wants to provide quality service to its customers. Employee satisfaction level is measured by asking five questions in this variable. Decision making authority regarding customer service, polite service to customers, employee empowerment and quality service delivery and satisfaction level of existing services provided by bank to the customers are some features of this variable.

3.6.10 Performance Appraisal

One of the major components of employee satisfaction is performance appraisal. Top management should communicate and follow transparent appraisal system to enhance the morale of employee. Within this, three features about performance appraisal are included. Top management existing practices, currently adopted appraisal system, and recognition programs are included in this variable.

3.6.11 Quick Problem Solving

Customers may face different problems during banking transactions. Quick problem solving process is very essential to render quality service. Employees should have authority and capability for addressing problems of customers. To evaluate this issue, four different dimensions are included in this variable. These are – understanding and identifying client concerns, customers complains, information available on internet to solve customer's problems and quick addressing problems respectively.

3.6.12 Customer Satisfaction

If customer satisfies, employees also satisfy. So this factor is associated with customer satisfaction concern. Dedication of management to customer satisfaction matters, conduction of customer satisfaction surveys, and evaluation of customer satisfaction level and initiation of various programs to improve customer satisfaction are some attributes of this variable.

3.7 Processing and Analysis of Respondents' Opinions

In total, four hundred questionnaires were sent and collected duly by e- mail. The responses of the customers and employees were tabulated and analyzed by using computer packages like Excel, and SPSS. To analyze the responses under yes/no questions, multiple questions, and rating questions percentage was used. Similarly, to analyze ranking questions, the weighted value based on allotted scores was used. On the basis of priorities given to each factor, a weight of 1 to 5 points was fixed. Thereafter, the computed mean value was considered as the base for overall ranking of the factors. For this study, various statistical tests like: coefficient of multiple determinations (R^2), significance test of regression coefficient (t-test), and significance test of the regression equation (F-test) were employed to arrive at a conclusion. Similarly, auto correlation, heteroscadastcity, and multicollinarity tests were also performed. Likewise, under the descriptive analysis of variables, statistical tools such as: ratio, standard deviations, mean, mode, covariance, and coefficient of correlation (r) have also been utilized.

3.8 Reliability and Validity

Internal consistency is estimated by using Cronbach's alpha (Cronbach, 1951). Cronbach's alpha is a measure of internal consistency, that is, how closely related a set of items are as a group. A "high" value of alpha is often used (along with substantive arguments and possibly other statistical measures) as evidence that the items measure an underlying (or latent) construct. It is known that a reliability coefficient of 0.50or higher is considered “acceptable" in most social science research situations. After tabulation of questionnaire, the values of Cronbach’s alpha were found 78 percent and 62 percent in customer questionnaire and employee questionnaire respectively.

3.9 Measurement of Customer Account Profitability and Employee Satisfaction

The detail information of sampled account holder customers is obtained from concerned commercial bank. These banks had provided the data related with income and expenditure of individual account holder who are selected as sample. Out of total account holder customers, some of them are depositors, some are creditors and some of them are both. Banks had paid interest to depositors and earned interest and service charges from creditors. On the basis of these data, the profit/loss of each of the individual customer was calculated. On the basis of profitability, account holder customers are grouped into five different categories. The five group of customers were, not profitable, less profitable, moderately profitable, high profitable, and very high profitable respectively.

Generally, customer account satisfaction leads to increase customer account profitability. So it is attempted to measure customers’ satisfaction level by taking responses from bank services. Customers’ response and reactions were collected by asking thirteen factors which were included in questionnaire. The aggregate value was calculated from all these factors. Then that aggregate value is converted into percent. These factors were rated into five classes as, not satisfied, less satisfied, limited satisfied, satisfied, and very high satisfied groups.

Literature review states that satisfied employees provide quality services to the customers. Customer satisfaction will increase customer account profitability and ultimately, it leads to increase financial performance of bank. For measuring the satisfaction level of employees, their responses were collected. On the basis of incentives and benefits provided by bank, their satisfaction level is measured. For that, ten factors were included in the employees' questionnaire. All collected responses were converted into percent basis, and then aggregate value is obtained. Finally, five groups of employees were named as not satisfied, less satisfied, limited satisfied, high satisfied and very high satisfied respectively.

3.10 Different Forms of Dependent Variables

The primary focus of this research is the relationship between net profits and profitability, and bank's characteristics indicators .Three measures of bank performance are used in the study: the net profits (NP), the return on assets (ROA) and the return on equity (ROE). The net profit variable is defined as the net profits earned by commercial banks in a particular fiscal year. Return on assets is a ratio computed by dividing the net income over total assets. Return on equity is a ratio computed by dividing the net income over shareholders' equity. NP, ROA and ROE have been used in most commercial banks' performance studies.

3.10.1 Return on Equity (ROE)

Return on Equity is one of the profitability ratios. It measures the profit earned per rupee of shareholders' equity. Return on equity (ROE) measures the rate of return on the ownership interest (shareholders' equity) of the common stock owners while net profit is focused on the profit earned by commercial banks.

The ROE is calculated by dividing net income by the shareholder's equity.

The formula for return on equity is,

$$= \frac{\text{Net income}}{\text{Share holders}'\text{Equity}}$$

3.10.2 Return on Assets (ROA)

Return on assets is an indicator of how profitable a company is relative to its total assets. ROA gives an idea as to how efficient management is at using its assets to generate earnings. ROA measures the profit earned per rupee of assets and reflect how well bank management use the bank’s real investments resources to generate profits. Calculated by dividing a company's annual earnings by its total assets, ROA is displayed as a percentage. Sometimes this is referred to as "Return on Investment".

The formula for return on assets is,

$$= \frac{\text{Net income}}{\text{Total Assets}}$$

ROA tells what earnings were generated from invested capital (assets). ROA for public companies can vary substantially and will be highly dependent on the industry. This is why when using ROA as a comparative measure, it is best to compare it against a company's previous ROA numbers.

The assets of the company are comprised of both debt and equity. Both of these types of financing are used to fund the operations of the company. The ROA figure gives investors an idea of how effectively the company is converting the money it has to invest into net income.

3.10.3 Individual Profitability of Selected Account Holder Customers

To analyze customer account profitability in commercial banks, this variable is considered to be very important. The profit/loss data of individual customer was obtained from concerned bank. It is assumed that there would be positive relationship between individual customer account profitability with customer satisfaction and employee satisfaction. Similarly, the relationship between customer account profitability and control variables is also established. Five financial ratios such as CAR, OER, ACR, CR and CDR were used to measure the relationship with customer account profitability in addition to their linkage with aggregate banks’ profitability. Among them, CAR, ACR and CDR will have positive impact on customer account profitability because capital is the main fund of banks which can be used to increase the assets of banks. if commercial banks have adequate capital, they can invest in fixed assets also. All physical facilities of commercial banks can be increased from their capital. Similarly, account holder customers deposit cash in commercial banks. These deposits can be invested in different sectors. This is the main source of income of commercial banks. On the other hand, operating expenses ratio and credit risk ratio would have negative impact on customer account profitability because operating expenses ratio means the ratio of operating expenses to total assets. Operating expenses include interest expenses, employees’ expenses, office operating expenses, currency exchange loss, bad loan advance written off and loan loss provision. So, high operating expenses lower the net profits of commercial banks. Credit risk ratio means the ratio of loan loss provision to total loans. Loan loss provision is the non-performing assets which cannot earn profits. So, higher rate of non-performing assets lead to low profits in commercial banks.

There are various factors which determine the profitability of commercial banks. The aggregate profitability employed in the study is in the form of return on assets (ROA), return on equity (ROE) and net profits.

In this research, the relationship between profitability and some control variables is measured. The profitability ratios of return on assets return on equity and net profits were gathered for two years 2011 and 2012. Likewise, some financial ratios such as CAR, OER, ACR, CR and CDR were also gathered for the same periods. It is expected that CAR, ACR and CDR will raise the bank’s profitability whereas OER and CR would lower down the profitability of commercial banks.

3.11 Independent Variables Included in the Model

3.11.1 Satisfaction Level of Customers

The satisfaction level of account holder customers is trying to be measured. Thirteen variables were included to measure the satisfaction level of customers. On the basis of a-5 point Likert scale, all sampled customers were classified into five groups as not satisfied, less satisfied, moderately satisfied, satisfied and highly satisfied. Then aggregate satisfaction score was calculated by converting these scores as percent basis. Finally, it is expected that there would be positive relationship between customer account profitability and satisfaction level of account holder customers.

3.11.2 Satisfaction Level of Bank Employees

On the basis of bank incentives and benefits to the employees, satisfaction level of employees is measured. To increase the satisfaction level of employees, bank services and other benefits to the employees play significant role. Altogether, nine different variables were included to collect the responses of sample employees. Finally, aggregate satisfaction level is calculated by converting all responses and opinions into percent basis. These sample employees are classified into not satisfied, less satisfied, moderately satisfied, satisfied, and highly satisfied employees. It is expected that there would be positive relationship between customer account profitability and employee satisfaction level.

3.12 Control Variables

Some of the financial ratios such as capital adequacy ratio, operating expenses ratio, assets composition ratio, credit risk ratio and credit deposit ratio are taken as control variable in analyzing customer account profitability. These ratios were also used for determining the aggregate profitability of commercial banks.

They comprise the ratio of equity capital to total assets (CAR), the ratio of operating expenses to total assets (OER), the ratio of bank's loans to total assets i.e. assets composition ratio (ACR), the ratio of non-performing loan to total loans i.e. credit ratio (CR) and the ratio of total credits to total deposits (CDR). The description and their impact on customer account profitability are described as below.

3.12.1 Capital Adequacy Ratio

It is a percentage ratio of a financial institution's primary capital to its assets (loans and investments), used as a measure of its financial strength and stability. According to the Capital Adequacy Standard set by Bank for International Settlements (BIS), banks must have a primary capital base equal at least to eight percent of their assets. It can be calculated by applying the following formula:

The formula for capital adequacy ratio is,

$$\text{Capital Adequacy Ratio} = \frac{\text{Paid up Capital}}{\text{Total Assets}}$$

It is expected that, higher the equity-to-asset ratio (CAR), the lower the need to external funding and therefore higher profitability. It also a sigh that well capitalized bank face lower costs of going bankrupt and then cost of funding is reduced. The capital adequacy ratio, which is measured by total equity over total asset, reveals capital adequacy and should capture the general average safety and soundness of the financial institution. Empirical evidence on the relation between the capital ratio and profitability is not conclusive.

3.12.2 Operating Expenses Ratio

An expense incurred in carrying out an organization's day-to-day activities, but not directly associated with production. Operating expenses include such things as payroll, sales commissions, employee benefits and pension contributions, transportation and travel, amortization and depreciation, rent, repairs, and taxes. These expenses are usually subdivided into selling expenses and administrative and general expenses.

The formula for operating expenses ratio is,

$$\text{Operating Expenses Ratio} = \frac{\text{Operating Expenses}}{\text{Total Assets}}$$

The ratio of operating expenses to total assets is used to provide information on variation in bank costs over the banking system. It reflects employment as well as the total amount of wages and salaries. OER is expected to have a negative impact on performance because efficient banks are expected to operate at lower costs.

3.12.3 Assets Composition Ratio

Bank loans (ACR) are expected to be the main source of income and are expected to have a positive impact on bank performance. Other things constant, the more deposits are transformed into loans, the higher the interest margin and profits. However, if a bank needs to increase risk to have a higher loan-to-asset ratio, then profits may decrease. In addition, as bank loans are the principal source of income, it is expected that noninterest bearing assets impact negatively on profits.

The formula for assets composition ratio is,

$$\text{Assets Composition Ratio} = \frac{\text{Total Loan}}{\text{Total Assets}}$$

3.12.4 Credit Risk Ratio

The amount of debt owed on revolving lines of credit relative to the total amount of all available credit limits on all revolving accounts. Lenders assume that borrowers with a lower debt to credit ratio are more likely to be using credit responsibly and less likely to default. A debt to credit ratio below 30% is considered good.

The formula for credit risk ratio is,

$$\text{Credit Risk Ratio} = \frac{\text{Non performing loans}}{\text{Total loan}}$$

The effect of asset quality on profitability is defined as loan-loss provisions over total loans. It is a measure of capital risk, as well as credit quality. If banks operate in more risky environments and lack the expertise to control their lending operations, it will probably result in a higher loan-loss provision ratio. Hence, the ratio is expected to have a negative relationship with profitability.

3.12.5 Credit Deposit Ratio

The amount of a bank's loans divided by the amount of its deposits at any given time is called credit deposit ratio. The higher the ratio, the more the bank is relying on borrowed funds, which are generally more costly than most types of deposits.

The formula for credit-deposit ratio is,

$$\text{Credit-Deposit Ratio} = \frac{\text{Total Credits}}{\text{Total Deposits}}$$

Credit-deposit ratio is using the ratio of loans to deposits and short-term funding since this provides a forward-looking measure of bank exposure to default and asset quality deterioration. Given that the portfolio of outstanding loans is non-tradable, credit risk is modeled as a predetermined variable in our specification. Based on standard asset pricing arguments, we expect a positive association between profits and bank risk.

3.13 Model Specification (Pooled Regression)

In this study, simple and multiple regression equations were employed to estimate the relationship of customer account profitability with customer account satisfaction level and employee satisfaction level. The same types of equations were used to determine the profitability of commercial banks in aggregate level to estimate the relationship of customer account satisfaction and employee satisfaction with bank services. First the impact of control variables on banks' aggregate profitability was computed. Then the relationship between customer account profitability with customer account satisfaction and employee satisfaction were assessed. Finally, the effects of all independent variables such as customer account satisfaction level, employee satisfaction level and control variables on customer account profitability was measured. Specifications of these equations with brief descriptions are given below:

1. Bank Aggregate Profitability with Some Financial Ratios

The following equation has been taken as base to specify the equations showing linear relationship between commercial bank profitability and some financial ratios.

$$ROA= \beta_0 +\beta_1 CAR+\beta_2 OER+\beta_3 ACR+\beta_4 CR+\beta_5 CDR+\ldots+et \qquad (1)$$

Where,

ROA=Return on Assets, CAR=Capital Adequacy Ratio, OER= Operating Expenses Ratio, ACR=Assets composition ratio, CR=Credit Risk Ratio, CDR=Credit Deposit Ratio, et= Error term

$$ROE= \beta_0 +\beta_1 CAR+\beta_2 OER+\beta_3 ACR+\beta_4 CR+\beta_5 CDR+\ldots+et \qquad (2)$$

ROE=Return on Equity, CAR=Capital Adequacy Ratio, OER= Operating Expenses Ratio, ACR=Assets composition ratio, CR=Credit Risk Ratio, CDR=Credit Deposit Ratio, et= Error term

$$\text{Net Profits}= \beta_0 +\beta_1 CAR+\beta_2 OER+\beta_3 ACR+\beta_4 CR+\beta_5 CDR+\ldots+et \qquad (3)$$

Net Profits=Aggregate Net Profits of Commercial Banks, CAR=Capital Adequacy Ratio, OER= Operating Expenses Ratio, ACR=Assets composition ratio, CR=Credit Risk Ratio, CDR=Credit Deposit Ratio, et= Error term

2. Relationship of Customer Account Satisfaction with Bank Services

$$SC = \beta_0 +\beta_1 TM +\beta_2 AQ +\beta_4 RA +\beta_5 PT +\beta_6 PI + \beta_7 CT +\beta_8 IA + \beta_9 TOT +\ldots+e \qquad (4)$$

SC= Satisfaction of Customers TM- Employees are available in a timely manner. AQ- Employees answered all of your questions SK- Employees showed sufficient knowledge of their services. RA- Employees offered relevant advice. PT- Employees are polite throughout. PI- Employees provide customers with precise information CT- Employees carry out customer transactions confidentially IA- Employees provide individualized attention to customers TOT- Employees enact transactions on a timely manner.

3. **Impact of Bank Incentives on Employees' Satisfaction**

$$SE = \beta_0 + \beta_1 BP + \beta_2 CS + \beta_3 DPS + \beta_4 CVE + \beta_5 CH + \beta_6 ATB + \ldots + et \quad (5)$$

SE= Satisfaction of Employee BP- business partner CS- level of customer support DPS- delivery of our products or services CVE- Company values employees CH- Company honesty ATB- Attitude towards bank

4. **Relationship of Customer Account Profitability with Satisfaction Level of Customers**

$$CAP = \beta_0 + \beta_1 SC + \ldots + et \quad (6)$$

Where,

CAP- Customer Account Profitability SC- Customer Account Satisfaction

5. **Impact of Control Variables and Employee Satisfaction on Customer Account Profitability**

$$CAP = \beta_0 + \beta_1 CAR + \beta_2 OER + \beta_3 ACR + \beta_4 CR + \beta_5 CDR + \beta_6 SE + \ldots + et \quad (7)$$

Where,

CAR=Capital Adequacy Ratio, OER= Operating Expenses Ratio, ACR=Assets Composition ratio, CR=Credit Risk Ratio, CDR=Credit Deposit Ratio, Satisfaction of Employee, et= Error term

6. **Impact of Control Variables and Customer Satisfaction on Customer Account Profitability**

$$CAP = \beta 0 + \beta_1 CAR + \beta_2 OER + \beta_3 ACR + \beta_4 CR + \beta_5 CDR + \beta_6 SC + \ldots + et \quad (8)$$

Where,

CAP= Customer Account Profitability CAR= Capital Adequacy Ratio OER= Operating Expenses Ratio ACR= Assets Composition Ratio CR= Credit Risk Ratio CDR= Credit Deposit Ratio SC = Customer account satisfaction et= Error term

CHAPTER IV
FINANCIAL STATUS AND TRENDS OF NEPALESE COMMERCIAL BANKS

This chapter deals with financial status and trends of commercial banks in Nepal.

4.1 Growth of Commercial Banks

Nepal Bank Limited, the first commercial bank of the country, was established in 1937 with an objective of swaying people to formal banking system from the costly services of pre-dominant moneylenders. Similarly, another commercial bank, Rastriya Banijya Bank (RBB) was established on 23 January 1966 with full government ownership. In the early 1970s, NRB encouraged both NBL and RBB to expand their branches to various parts of the country. For this purpose, NRB itself had conducted feasibility study and adopted the policy to subsidize the banks on their losses on any new branches for three year of their operations. In 1975, NRB achieved its target of having at least one branch of commercial bank in each district head quarter.

Financial development in many developing economies like Nepal still faces a number of obstacles such as macroeconomic instability, fragility of stock markets, limitation of capital markets and inefficiency of development and specialized banks. Despite some of these limitations, banking systems in underdeveloped countries remain an integral component of the general economic systems and they can be considered as a key element in any development effort.

Nepalese commercial banking sector has witnessed significant developments during the past two decades. These developments are mainly attributable to the Central Bank of Nepal, Nepal Rastra Bank. Supervisory and regulatory roles, as well as following the latest global financial practices were implemented to develop and upgrade the banking sector performance in Nepal. In Nepal, banking sector plays a key role by pushing forward the economic growth rates, through the mobilization of national savings and using them to finance productive economic sectors.

Beyond the importance of the Nepalese banking sector position as a major contributor to the gross domestic product, it also plays a major role as an engine and a key supporter to the Nepalese economy. In this sense, the efficient functioning of the banking sector has become one of the main objectives of financial reforms.

The commercial banks are currently regarded as key driver of financial institutions of Nepal. Financial services sector had commenced with the establishment of Nepal Bank Limited in 1937. After the economic liberalization in the mid-1980s, the government permitted the opening of commercial banks in joint venture with foreign banks. Since then, the Nepalese financial system has undergone rapid structural changes, with a large number of financial institutions expose and display of financial products and services.

There are presently 262 financial institutions; among them, 30 were commercial banks (NRB, 2012). The 30 commercial banks are operating under three strata which cover 11 percent of the total financial institutions. The growth of financial institutions other than commercial banks is due to the implementation of financial reform program in Nepal. The following table shows the growth of commercial banks from 1980 to 2012.

Table 4.1
Growth of financial institutions in Nepal

Year	**1980**	**1990**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**
Commercial banks	2	5	17	18	20	25	26	27	30	30
Total financial institutions	4	7	181	193	208	235	242	263	277	262
Percent of commercial banks	50	71	9	9	10	11	11	10	11	11

Source: Annual Report of Nepal Rastra Bank, 2012

Based on bank structure, the commercial banks are divided into three separate groups namely, government-owned banks, joint venture banks, and private sector banks.

4.1.1 Government-owned Banks

The three government-owned banks, Nepal Bank Limited (NBL), Rastriya Banijya Bank (RBBL), and Agriculture Development Bank (ADBL) have substantial shares in the total assets of the industry (Table 4.4) and have huge branch networks around the country. These banks have significant contribution on improving banking habit among the people at large and encourage entrepreneurship in both the urban as well as rural area. The government-owned banks are still the largest banks in all aspects from deposit and credit mobilization to the number of branches in operation.

4.1.2 Joint Venture Banks

The joint venture banks have very few branch networks and are concentrated in urban centers. JVBs started to establish since mid-1980s and there are six, Nabil Bank Ltd (NABIL), Standard Chartered Bank Ltd (SCBL), Himalayan Bank Ltd (HBL), Nepal SBI Bank Ltd (NSBI), Nepal Bangladesh Bank Ltd (NBBL) and Everest Bank Ltd (EBL) in Nepal. They have foreign equity and management participation and conducting banking business professionally. They are well in office automation and supervision

The share of total assets of the joint venture banks has increased to about 50% of total commercial bank assets (NRB, 2012). The introduction of joint venture banks infused modern banking and financial technology and new financial instrument in the financial system. However, the spillover effect of their efficient management and modern banking skills was less in the domestic banks, as per expectation.

4.1.3 Private Sector Banks

The private sector banks came in operation by late 1990s and early 2000s. There are twenty one private banks. They are owned and managed by the private sector with only Nepalese equity participation. Since they are relatively new banks, they have the opportunity to start as ‘fresh banks’ without bad loans in their portfolios and with the possibility of adopting recent banking technologies during their inception. Most of them are relatively small in asset size as well as their networks (NRB, 2012).

As at mid July 2012, the numbers of commercial banks in Nepal were thirty. The government-owned banks, which are three in numbers and have large branch networks throughout the country, have still got substantial share in the total assets of the industry. Adopting the economic liberalization in the country in early 1990s, there has been tremendous growth in the number of private sector banks. The share of these banks on total deposits, loans, and total assets has been increasing gradually (Table 4.12). The banks are becoming efficient in terms of capital, technologies, products and services and overall management.

The market size of both the joint venture and domestic private banks has been increasing at the expense of the government-owned banks, which are shrinking over time (NRB, 2012). The competition in the market is getting tougher as the number of these institutions is increasing rapidly and the market size being the same. It is felt necessary to strengthen their capacity in terms of product innovation, service delivery and public accountability. The banks should work together for raising public confidence and becoming competitive enough to retain the customers and mobilize the resources from non-banking sector to banking sector. Adequate public disclosure has become the worldwide issue and banks should properly manage varied banking risks with an assurance of safety and soundness in their operations and thereto on public deposit, Nepalese banks cannot be exception.

4.2 Status and Trend of Some of the Financial Ratios of Commercial Banks

The status of Nepalese banking industry has changed significantly over the past few decades as a result of liberalization, deregulation, advancement in information technology and globalization. The financial sector liberalization resulted into entry of new banks in the market; deregulation widened the scope of activities and delimited the banking activities; advancement in technology resulted into new ways and tools to perform banking activities; and globalization added more pressure on competitiveness of individual banks. Moreover, the banks, nowadays, are entering into non-banking markets and other financial institutions are entering into the banking markets that have traditionally been served by the banks (Pradhan, 2012).

Commercial banks play a vital role in the financial resource allocation of countries. They channel funds from depositors to investors continuously. They can do so, if they generate necessary income to cover their operational cost they incur in the due course. In other words for sustainable intermediation function, banks need to be profitable. Beyond the intermediation function, the financial performance of banks has critical implications for economic growth of country. Good financial performance rewards the shareholders for their investment. This, in turn, encourages additional investment and brings about economic growth. On the other hand, poor banking performance can lead to banking failure and crisis which have negative repercussions on the economic growth. By considering this fact, this study tries to analyze the present status and trends of some of the financial ratios of commercial banks of Nepal. These are explained in the following subsections:

4.2.1 Capital Adequacy Ratio

Capital adequacy ratio is the ratio which determines the bank's capacity to meet the time liabilities and other risks such as credit risk, operational risk etc. In the simplest formulation, a bank's capital is the "cushion" for potential losses, and protects the bank's depositors and other lenders. Banking regulators in most countries define and monitor capital adequacy ratio to protect depositors, thereby maintaining confidence in the banking system.

It is similar to leverage; in the most basic formulation, it is comparable to the inverse of debt-to-equity leverage formulations (although capital adequacy ratio uses equity over assets instead of debt-to-equity; since assets are by definition equal to debt plus equity, a transformation is required). Unlike traditional leverage, however, capital adequacy ratio recognizes that assets can have different levels of risk. High capital adequacy ratio blocks the financial institutions to create unlimited liability. It helps to maintain national and international credibility.

Capital fund is divided into two categories. They are primary capital and secondary capital. Primary capital is also known as core capital or Tier–I capital and secondary capital is Tier–II. Total capital fund is the sum of primary capital and secondary capital. Risk is assigned 0% to 100% on the on-balance sheet and off-balance sheet items according to inherent risk over them in order to calculate Risk Weighted Assets (RWA). Capital Adequacy should maintain on the basis of total risk weighted assets. The logic behind the capital adequacy is to protect the interest of public deposit as well as safeguard the banks in their critical financial position. As per the directives of Nepal Rastra Bank (NRB), commercial banks should maintain the capital adequacy 6 % in primary capital of their total risk weighted assets. They should maintain 12 % in total capital fund of total risk weighted assets (NRB, 2012). The present study considers capital adequacy ratio as a ratio of primary capital i.e. paid up capital to total assets (loans and investment).

Table 4.2
Capital adequacy ratio of commercial banks

Bank	**2011**	**2012**	**Average**	**Bank**	**2011**	**2012**	**Average**
NBL	0.70	2.90	1.80	LAXMI	7.20	6.20	6.70
RBB	1.20	1.10	1.20	SBL	6.20	5.20	5.70
NABIL	3.30	2.80	3.10	ADB/N	14.20	12.00	13.10
NIBL	3.90	4.30	4.10	GLOBAL	8.30	6.60	7.40
SCBN	3.60	3.70	3.70	CITIZEN	11.40	10.00	10.70
HBL	4.10	4.30	4.20	PRIME	10.00	8.00	9.00
NSBI	4.00	3.50	3.80	SUNRISE	11.00	10.70	10.80
NBBL	11.00	8.80	9.90	BOA	9.90	9.00	9.40
EBL	2.70	2.50	2.60	DCBL	14.70	11.20	13.00
BOK	5.30	5.40	5.30	NMBL	12.30	10.50	11.40
NCCB	9.30	7.00	8.20	KIST	10.20	8.50	9.30
NICB	5.80	5.10	5.40	JANATA	26.90	19.30	23.10
LUMBINI	14.20	14.00	14.10	MEGA	22.10	13.90	18.00
MBL	8.00	9.70	8.90	C & T	33.30	17.70	25.50
KUMARI	6.80	6.00	6.40	CIVIL	26.80	11.10	18.90
AVERAGE					**10.30**	**8.00**	**9.20**

The average capital adequacy ratio of two years of commercial banks in Nepal shows that C&T (25.5), JANATA (23.1), CIVIL (18.9) and MEGA (18.0) were maintaining higher capital adequacy ratio (more than 18%) than the rest of the other individual commercial banks. The least capital adequacy ratio was being maintained by the government owned banks, RBB (1.2) and NBL (1.8). The analysis of the ratio in 2011 and 2012 also provides similar picture. However, overwhelming majority of commercial banks (23 banks) was facing with decreasing capital adequacy ratio. The mean capital adequacy ratio was recorded at 10.3 in 2011 which had decreased to 8.0 in 2012.

The combined mean of capital adequacy ratio of two years of all commercial banks comes 9.2. The banks which maintained more than 9.2 were 13 banks and the banks which maintained less than 9.2 were 17 banks. This average capital adequacy ratio was 10.3 in 2011 which dropped down to 8.0 in 2012. The numbers of banks above and below 10.3 in 2011 were 11 and 19 banks respectively. This was also same in 2012. The capital adequacy ratio for many of the commercial banks ranges from 4 to

13. The banks maintaining more than 6 capital adequacy ratio as per the central bank directives comes 19 in number.

Most of the joint venture commercial banks had 2 to 10 percent capital adequacy ratio on an average but except ADBN, both government-owned commercial banks had below 2 percent capital adequacy ratio. All private commercial banks had lowest 5 to highest 25 percent capital adequacy ratio. It was noted that, NBL had the lowest capital adequacy ratio. Due to lowest capital fund, the bank may not be able to invest as per the demand of customers'. Similarly, C&T bank had the highest CAR which implies that if a bank does not invest capital, the idle capital can't earn anything.

4.2.2 Operating Expenses Ratio

An expense incurred in carrying out an organization's day-to-day activities, but not directly associated with production. Operating expenses include such things as payroll, sales commissions, employee benefits and pension contributions, transportation and travel, amortization and depreciation, rent, repairs, and taxes. These expenses are usually subdivided into selling expenses and administrative and general expenses. These are also called non-manufacturing expenses. The ratio of operating expenses to total assets is called operating expenses ratio. From bank's perspective, minimum ratio is desirable to obtain high profits.

Table 4.3

Operating expenses ratio of commercial banks

Bank	2011	2012	Average	Bank	2011	2012	Average
NBL	4.30	3.60	4.00	LAXMI	1.50	1.40	1.40
RBB	2.10	1.90	2.00	SBL	1.70	1.70	1.70
NABIL	1.40	1.30	1.30	ADB/N	4.70	3.60	4.10
NIBL	1.30	1.20	1.20	GLOBAL	3.50	3.20	3.40
SCBN	1.50	1.70	1.60	CITIZEN	1.50	1.50	1.50
HBL	2.20	2.40	2.30	PRIME	1.00	1.00	1.00
NSBI	1.50	1.30	1.40	SUNRISE	1.60	1.80	1.70
NBBL	1.80	1.50	1.60	BOA	1.90	2.10	2.00
EBL	1.40	1.40	1.40	DCBL	1.40	1.20	1.30
BOK	1.80	1.90	1.80	NMBL	1.30	1.30	1.30
NCCB	1.50	1.50	1.50	KIST	2.50	2.30	2.40
NICB	1.40	1.50	1.50	JANATA	2.70	2.10	2.40
LUMBINI	2.20	1.90	2.00	MEGA	2.70	2.50	2.60
MBL	2.20	1.90	2.00	C & T	2.00	2.10	2.00
KUMARI	1.70	1.50	1.60	CIVIL	2.40	1.90	2.20
AVERAGE					**2.00**	**1.90**	**1.90**

Table 4.3 shows that the average operating expenses ratio of two years of commercial banks in Nepal. ADB/N (4.1), NBL (4.0), GLOBAL (3.4) and other 10 banks (greater than 1.9) were incurring higher operating expenses ratio (more than average) than the rest of the other individual commercial banks. The least operating expenses ratio was being shown by the 3 private banks, PRIME (1.0), DCBL (1.3) and NMBL (1.3) and one joint venture bank (1.3). Surprisingly, majority of commercial banks (17 banks) were facing with decreasing operating expenses ratio. The mean operating expenses ratio was recorded at 2.0 in 2011 which had decreased to 1.9 in 2012.

The combined mean of operating expenses ratio of two years. of all commercial banks comes 1.9. The banks which were having more than 1.9 are 13 banks and the less than 1.9 were 17 banks. The average operating expenses ratio was 2.0 in 2011 which dropped down to 1.9 in 2012. The numbers of banks above and below 2.0 in 2011 were 12 and 18 banks respectively. There were 14 and 16 banks which have above and below 1.9 in 2012. The operating expenses ratio for many of the commercial banks ranges from 1.5 to 2.5. The number of banks having more than 1.5 to 2.5 operating expenses ratio were 18.

All private commercial banks had lowest 1 to highest 3.4 percent operating expenses ratio. PRIME bank had the lowest operating expenses ratio. Most of the joint venture commercial banks had 1.2 to 1.6 percent operating expenses ratio on an average but except RBB, both government-owned commercial banks had above 4 percent operating expenses ratio.

Moreover, the newly operating commercial banks (GLOBAL 3.4, MEGA 2.6) had higher operating expenses ratios. They had more than two percent operating expenses ratio on an average, which might be the reason why these banks had not been able to earn more profits as compared to the joint venture banks.

4.2.3 Asset Composition Ratio

The ratio of total loan to total assets is called assets composition ratio. Deposits and loans are the most important indicators in the bank financial statements because they reflect the bank's primary activity. Keeping other variables constant, the higher the rate of transforming deposits into loans, the higher the profitability will be. Usually, there is a positive relation between the loans and banks profitability.

Table 4.4

Asset composition ratio of commercial banks

Bank	2011	2012	Average	Bank	2011	2012	Average
NBL	47.80	48.40	48.10	LAXMI	68.00	58.40	63.20
RBB	38.90	37.50	38.20	SBL	72.10	65.00	68.60
NABIL	63.20	59.70	61.50	ADB/N	60.60	57.20	58.90
NIBL	67.90	60.90	64.40	GLOBAL	70.60	61.50	66.10
SCBN	39.10	42.80	40.90	CITIZEN	71.10	68.40	69.70
HBL	64.20	61.30	62.80	PRIME	76.20	68.30	72.20
NSBI	46.00	44.60	45.30	SUNRISE	64.80	66.30	65.60
NBBL	54.30	46.60	50.50	BOA	61.20	65.70	63.40
EBL	67.20	64.30	65.80	DCBL	69.30	63.60	66.50
BOK	67.40	60.50	64.00	NMBL	66.60	58.60	62.60
NCCB	61.30	64.50	62.90	KIST	68.20	63.70	65.90
NICB	67.10	67.30	67.20	JANATA	68.90	72.00	70.50
LUMBINI	68.10	68.20	68.10	MEGA	65.20	68.70	67.00
MBL	72.70	63.00	67.80	C & T	59.20	69.40	64.30
KUMARI	68.00	66.60	67.30	CIVIL	70.40	67.20	68.80
AVERAGE					**63.50**	**61.00**	**62.30**

In the above table (Table 4.4), the average assets composition ratio of two years of commercial banks in Nepal shows that PRIME (72.2), JANATA (70.5), CITIZEN (69.7) and other 23 banks (greater than 62.3) were keeping higher assets composition ratio (more than average) than the rest of the other individual commercial banks. The least assets composition ratio was being kept by the 2 government-owned banks, RBB (38.2) and NBL (48.1) and one joint venture bank SCBN (40.9). The analysis of the ratio in 2011 and 2012 also provides similar picture. Surprisingly, majority of commercial banks (20 banks) were facing with decreasing assets composition ratio. The mean assets composition ratio was recorded at 63.5 in 2011 which had decreased to 61.0 in 2012.

The combined mean of assets composition ratio of two years of all commercial banks comes 62.3. The banks which were keeping more than 62.3 are 23 banks and less than 62.3 were 7 banks. This average assets composition ratio was 63.5 in 2011 which went down to 61.0 in 2012. The numbers of banks above and below 63.5 in 2011 were 20 and 10 banks respectively. There were 19 and 11 banks which have above and below 61.0 in 2012. The assets composition ratio for many of the commercial banks ranges from 60.0 to 70.0. The banks keeping more than 60.0 to 70.0 percent assets composition ratio were 22.

There were four joint venture commercial banks, which had assets composition ratio between 61.5 to 65.8 percent. It is noted that, RBB bank has the lowest assets composition ratio. Basically, joint venture and newly operating commercial banks had high rate of assets composition ratio in comparison to government-owned commercial banks.

Most of the government commercial banks had 38.2 to 48.1 percent assets composition ratio on an average but all newly operating commercial banks had above 60 percent assets composition ratio.

Assets composition ratio explains how much loan is invested in different sector. This is the main source of revenue in commercial banks. The table shows that government-owned banks had the lowest assets composition ratio compared to other banks. Newly operating commercial banks had high assets composition ratio. Very high assets composition ratio may also not be beneficial to the banks because of loan issues i.e. if that loan is not recovered in time, it causes low profit.

4.2.4 Credit Risk Ratio

To mitigate risk in default of any loan and advance provided by banks, they should be maintained some provision according to the due date. Provisioning amount should maintain on the basis of classification of loan. Financial institutions have to be maintained the provision as per classification of loan. It measures the quality of assets in reference of loan and advances and contraction of profit as well. Quality of assets is decreases, when the credit of financial institutions diversifies in to non-performing assets (NPA). Such losses, from quality of assets, can be compensated by debiting the profit and can be harmonized the financial strength of those financial institutions.

Non-performing loan refers to those loans which are not paying its principle as well as interest in time or overdue more than three months. Therefore, it consists of substandard loan, Doubtful loan and bad loan. The Non-performing loan ratio indicated the relationship between non-performing loan and total loan. It measures the proportion of non-performing loan in total loan and advance. High non-performing loan ratio indicates that bank's assets are not doing well or the loan department is not so conscious while passing loan. Therefore, Lower ratio will be preferred regarding non-performing loan ratio.

Table 4.5
Credit risk ratio of commercial banks

Bank	2011	2012	Average	Bank	2011	2012	Average
NBL	5.60	5.70	5.70	LAXMI	1.20	1.40	1.30
RBB	10.50	8.70	9.60	SBL	1.40	2.00	1.70
NABIL	2.40	2.90	2.70	ADB/N	14.20	13.10	13.60
NIBL	1.50	2.00	1.70	GLOBAL	3.20	2.20	2.70
SCBN	1.30	1.40	1.30	CITIZEN	1.90	2.00	2.00
HBL	4.30	2.70	3.50	PRIME	1.20	1.50	1.40
NSBI	1.70	1.20	1.40	SUNRISE	1.20	2.10	1.70
NBBL	17.90	5.70	11.80	BOA	3.30	3.00	3.10
EBL	1.90	1.90	1.90	DCBL	2.30	2.00	2.10
BOK	2.80	2.80	2.80	NMBL	1.30	3.60	2.40
NCCB	4.30	3.10	3.70	KIST	1.40	2.40	1.90
NICB	1.50	1.60	1.60	JANATA	1.20	1.00	1.10
LUMBINI	1.60	1.30	1.50	MEGA	1.00	1.40	1.20
MBL	2.10	2.80	2.50	C & T	1.00	1.00	1.00
KUMARI	2.00	2.90	2.40	CIVIL	1.00	1.10	1.00
AVERAGE					**3.30**	**2.90**	**3.10**

The average credit risk ratio of two years of commercial banks in Nepal confirms that ADB/N(13.6), NBBL(11.8), RBB(9.6) and other 3 banks (greater than 3.1) were showing higher credit risk ratio (more than average) than the rest of the other individual commercial banks. The least credit risk ratio was being found by the 2 private banks, C&T (1.0) and CIVIL (1.0). The analysis of the ratio in 2011 and 2012 also provides similar picture. Majority of commercial banks (23 banks) were showing with decreasing credit risk ratio. The mean credit risk ratio was recorded at 3.3 in 2011 which has decreased to 2.9 in 2012.

The combined mean of credit risk ratio of two years of all commercial banks comes 3.1. The banks which were having more than 3.1 are 7 banks and less than 3.1 are 23 banks. The average credit risk ratio was 3.3 in 2011 which dropped down to 2.9 in 2012. The numbers of banks above and below 3.3 in 2011 were 7 and 23 banks respectively. There were 9 and 21 banks which had above and below 2.9 in 2012. The credit risk ratio for many of the commercial banks ranges from 1.0 to 3.0. The banks having more than 1.0 to 3.0 percent credit risk ratio were 7.

The credit risk ratio of NBBL had drastically decreased from 17.9 in 2011 to 5.7 in 2012. Similarly, the credit risk ratio of NMBL had drastically increased from 1.3 in 2011 to 3.6 in 2012. All government-owned commercial banks had highest percent credit risk ratio on an average but all newly operating commercial banks had less than

3.1 percent credit risk ratio. Besides NBBL, all joint venture commercial banks had credit risk ratio between 1.3 to 3.5 percent.

4.2.5 Credit-Deposit Ratio

The credit deposit ratio (CDR) is the ratio of the total outstanding credit in the banking system and the deposits held by them. The implication of the high credit-deposit ratio would mean banks would find it difficult to deposit rates. The margin between the interest rate the bank pays the depositors and interest rate it charges for loans represents the bank's profit. Therefore, the higher a bank’s loan-to-deposit ratio, the more money it can earn in terms of lending revenue.

Credit deposit ratio is the amount of a bank's loans divided by the amount of its deposits at any given time. The higher the ratio, the more the bank is relying on borrowed funds, which are generally more costly than most types of deposits. Nepal Rastra Bank fixed a ratio of CDR at 80 percent or below. All commercial banks are trying to maintain that standard.

To encourage financing to priority sectors, the central bank has allowed financial institutions to deduct the amount of refinanced loans from their total credit while calculating the credit to deposit ratio (CD Ratio). Nepal Rastra Bank (NRB) has said that all loans refinanced by the central bank do not require to be included as part of the total credit while calculating the CD Ratio. The central bank requires financial institutions to maintain a CD Ratio of 80 per cent, which means that banks can only lend 80 per cent of the total deposit collection.

In Mid - July 2012, the credit to deposit ratio of the commercial banks reached to 71.7 percent compared to 76.8 percent in Mid - July 2011(NRB Report, 2012). Out of total deposited sum, how much amount is invested in different sector is the ratio of credit deposit. At present, NRB has fixed the ceiling of this ratio for all commercial banks not more than 80 percent.

Table 4.6

Credit deposit ratio of commercial banks

Bank	2011	2012	Average	Bank	2011	2012	Average
NBL	56.90	52.70	54.80	LAXMI	83.40	69.40	76.40
RBB	49.80	46.00	47.90	SBL	85.20	77.30	81.20
NABIL	78.00	77.70	77.80	ADB/N	117.40	104.90	111.10
NIBL	83.10	74.60	78.80	GLOBAL	84.70	75.80	80.20
SCBN	46.60	51.10	48.80	CITIZEN	92.30	82.50	87.40
HBL	77.40	71.80	74.60	PRIME	90.10	79.90	85.00
NSBI	51.10	49.50	50.30	SUNRISE	86.80	81.40	84.10
NBBL	86.40	62.80	74.60	BOA	92.40	77.80	85.10
EBL	76.70	72.70	74.70	DCBL	96.90	75.80	86.30
BOK	82.10	72.30	77.20	NMBL	84.10	69.70	76.90
NCCB	84.20	78.10	81.10	KIST	85.00	74.00	79.50
NICB	82.40	79.00	80.70	JANATA	102.40	96.60	99.50
LUMBINI	91.70	91.00	91.40	MEGA	89.60	87.50	88.60
MBL	89.60	74.40	82.00	C & T	99.90	87.30	93.60
KUMARI	87.70	81.0	84.40	CIVIL	106.70	82.80	94.80
AVERAGE					**84.00**	**75.30**	**79.60**

Source: Annual Reports of Commercial Banks, 2011 and 2012

Table 4.6 reveals that the average credit deposit ratio of two years of commercial banks in Nepal. ADB/N (111.1), JANATA (99.5), CIVIL (94.8), C&T (93.6) and LUMBINI (91.4) were holding higher credit deposit ratio (more than 90%) than the rest of the other individual commercial banks. The least credit deposit ratio was being having by the one government owned bank, RBB (47.9). Majority of commercial banks (29 banks) was facing with decreasing credit deposit ratio. Nepal Rastra Bank has fixed a ceiling of credit deposit ratio below 80 percent in its directives, so all commercial banks were trying to decrease this ratio below 80 percent. The mean credit deposit ratio was recorded at 84.0 in 2011 which had decreased to 75.3 in 2012.

The combined mean of credit deposit ratio of two years of all commercial banks had 79.6. The banks which were maintaining more than 79.6 are 17 banks and the banks which were maintaining less than 79.6 are 13 banks. This average credit deposit ratio was 84.0 in 2011 which dropped down to 75.3 in 2012. The numbers of banks above and below 84.0 in 2011 were 19 and 11 banks respectively, but, these numbers were 17 and 13 in 2012. The credit deposit ratio for many of the commercial banks ranges from 75 to 90. The banks maintaining less than 80 credit deposit ratio as per the central bank directives comes 21 in number.

All joint venture commercial banks had 51.1 to 78.8 percent credit deposit ratio on an average but except ADBN, both government-owned commercial banks had below 55 percent credit deposit ratio. Most of the private commercial banks had more than 80 percent credit deposit ratio. It was found that, RBB, SCBN and NBL had the lowest credit deposit ratio. Due to lowest deposit amount, the bank may not be able to invest as per the demand of customers'.

If the rate of credit deposit ratio is high, it may bring the crisis of liquidity in the banks and the rate of credit risk may also be high. By keeping this effect in mind, the banks should maintain this level as optimum. Among the 30 banks, most of the newly operating commercial banks had more CDR than the average. On an average, government-owned commercial banks had minimum CDR except ADBN where as private commercial banks had maximum CDR. Within joint venture commercial banks, SCBN and NSBI had low CDR and remaining banks had around 70 to 80 percent. But most of the private sector commercial banks had more than 80 percent CDR.

4.3 Some Profitability Ratios of Commercial Banks

The profitability and efficiency also become one of the challenges faced by the banks to strengthen their financial positions in order to meet the risks associated with openness and globalization. The profitability of the bank measured by return on assets (ROA) is defined as the banks' after tax profit over the total assets; and/or its return on total equities (ROE) is defined as the banks' after tax profit over the total equities. Return on Assets ratio gives an idea of how efficient management is at using its assets to generate profit. Return on assets can vary substantially across different industries. This is the reason why it is recommended to compare it against company's previous values or the return of a similar company.

The only common rule is that the higher return on assets is, the better, because the company is earning more money on its assets. A low return on assets compared with the industry average indicates inefficient use of company's assets. Return on assets is one of the profitability ratios and is usually expressed in a percentage. It measures the ability of the bank to generate profit from its assets, while return on equity reflects the return to shareholders on their equity.

High return on equity yields no immediate benefit. The benefit comes from the earnings reinvested in the company at a high return on equity rate, which in turn gives the company a high growth rate. The benefit can also come as a dividend on common shares or as a combination of dividends and reinvestment in the company. Return on equity is presumably irrelevant if the earnings are not reinvested. Return on equity is calculated from the company's perspective, on the company as a whole.

Since much financial manipulation is accomplished with new share issues and buyback, always recalculate on a 'per share' basis, i.e., earnings per share/book value per share. Net income is considered for the full fiscal year after taxes and preferred stock dividends but before common stock dividends. Shareholders' Equity does not include preferred stocks and is used as an annual average.

To show the competitive position of commercial banks of Nepal, some profitability ratios were also used. All 30 commercial banks were selected for analysis purposes. Two years data of 2011-6-31 and 2012-6-31 were taken. The following tables show the competitive position of commercial banks with respect to return on assets, return on equity and net profits.

4.3.1 Return on Assets

Return on assets (ROA) is an indicator of how profitable company’s assets are in generating profit. The return on assets percentage shows how profitable a company’s assets are in generating revenue. This number tells what the company can do with what it has, i.e. how many rupees of earnings they derive from each rupee of assets they control. It’s a useful number for comparing competing companies in the same industry. The number will vary widely across different industries. Return on assets gives an indication of the capital intensity of the company, which will depend on the industry; companies that require large initial investments will generally have lower return on assets. ROAs over 5% are generally considered good.

Table 4.7
Return on assets of commercial banks

Bank	2011	2012	Average	Bank	2011	2012	Average
NBL	0.69	0.67	0.68	LAXMI	1.69	1.32	1.51
RBB	1.86	1.35	1.60	SBL	1.19	0.98	1.09
NABIL	2.07	2.41	2.24	ADB/N	2.41	2.35	2.38
NIBL	2.06	1.89	1.97	GLOBAL	1.25	1.06	1.16
SCBN	2.48	2.73	2.60	CITIZEN	1.78	1.70	1.74
HBL	2.86	1.88	2.37	PRIME	1.65	1.21	1.43
NSBI	0.97	0.80	0.88	SUNRISE	1.45	1.17	1.31
NBBL	3.58	4.00	3.79	BOA	0.65	0.66	0.66
EBL	1.99	1.93	1.96	DCBL	0.84	1.03	0.93
BOK	2.39	2.04	2.22	NMBL	2.20	0.46	1.33
NCCB	1.43	0.99	1.21	KIST	1.00	0.30	0.65
NICB	2.21	1.52	1.86	JANATA	0.66	0.57	0.61
LUMBINI	4.38	2.13	3.25	MEGA	0.32	0.61	0.46
MBL	0.03	0.04	0.04	C & T	0.62	0.18	0.40
KUMARI	1.09	0.97	1.03	CIVIL	0.21	0.40	0.31
AVERAGE					**1.60**	**1.31**	**1.46**

Return on assets of 30 banks had been calculated and listed above (Table 4.7). The average return on assets for all commercial banks was 1.46. The mean value of return on assets of all the banks in the year 2011 is 1.60 which was declined to 1.31 in 2012. The number of commercial banks which had recorded decreasing return on assets between 2011 and 2012 was 20 banks. None of the banks is successful to increase return on assets at 5 percent. The lowest return on assets (0.31) was faced by CIVIL bank while it was LUMBINI bank, which was successful to maintain highest return on assets (3.25). The distribution of return on assets by individual bank in 2011 and 2012 showed CIVIL bank with lowest return on assets (0.21) which increased to 0.4 in 2012 while LUMBINI bank was being appeared highest return on assets (4.38) in 2011 which was decreased at 2.13 in 2012. NBBL bank had second highest return on assets (3.58) which was successful to increase at 4 in 2012.

While taking the combined mean value as reference, 17 banks had return on assets below the mean value whereas 13 banks had return on assets above mean. Similarly in 2012, the average return on assets of the banks was 1.31 where Kist bank had the lowest (0.3) and NBBL had the highest (4.0) return on assets. 17 banks had their return on assets below the mean value whereas 13 banks had return on assets above mean value. The overall average of return on assets of the two years was 1.46. The table shows that 17 banks had less than mean return on assets and 13 banks had more than mean values. This data implies that less than 50 percent commercial banks had low return on assets in comparison to banking industrial return on assets.

The newly operating banks (CIVIL, C&T, MEGA, JANTA and KIST) had not been able to achieve that industrial average, having the return on assets less than 1 percent. Joint venture banks had more than two percent return on assets. The three government-owned commercial banks: NBL, RBB and ADBN had 0.67, 1.6 and 2.38 percent return on assets respectively. Among them, ADB/N was performing well whereas NBL had the lowest return on assets and indicates poor earnings performance. Among six joint venture commercial banks, NBBB had the highest return on assets, whereas NSBI has the lowest return on assets on an average of two years. SCBN has consistent return on assets in two years. In private commercial banks, BOK had consistent return on assets although it was not the highest. The highest return on assets of 3.25 among private commercial banks was that of Lumbini Bank Ltd.

4.3.2 Return on Equity

Return on equity (ROE) measures the rate of return on the ownership interest (shareholders' equity) of the common stock owners. It measures a firm's efficiency at generating profits from every unit of shareholders' equity (also known as net assets or assets minus liabilities). Return on equity is one of the profitability ratios and is usually expressed as a percentage. ROE shows how well a company uses investment funds to generate earnings growth. It is an indicator of company's profitability by measuring how much profit the company generates with the money invested by common stock owners. It is also known as Return on net worth. Return on equity shows how many dollars of earnings result from each rupee of equity. Return on equities between 15% and 20% are generally considered good. Return on equity varies substantially across different industries. Therefore, it is recommended to compare return on equity against company's previous values or return of a similar company. Some industries have high return on equity because they require less capital invested. Other industries require large infrastructure build before generating any revenue. It is not a fair conclusion that the industries with a higher Return on equity ratio are better investment than the lower ones. Generally, the industries which are capital-intensive and with a low return on equity have a limited competition. But, the industries with high return on equity and small assets bases have a much higher competition because it is a lot easier to start a business within those industries.

Table 4.8
Return on equity of commercial banks

Bank	**2011**	**2012**	**Average**	**Bank**	**2011**	**2012**	**Average**
NBL	100.79	22.94	61.87	LAXMI	23.57	21.09	22.33
RBB	150.07	123.37	136.72	SBL	19.28	18.81	19.04
NABIL	62.55	84.78	73.67	ADB/N	16.97	19.64	18.31
NIBL	52.43	43.75	48.09	GLOBAL	15.09	16.16	15.62
SCBN	69.59	72.86	71.23	CITIZEN	15.62	16.91	16.26
HBL	70.55	43.85	57.20	PRIME	16.48	15.08	15.78
NSBI	24.52	22.50	23.51	SUNRISE	13.20	10.95	12.07
NBBL	32.60	45.57	39.09	BOA	6.56	7.35	6.95
EBL	72.78	78.37	75.57	DCBL	5.71	9.18	7.45
BOK	44.97	37.96	41.47	NMBL	17.87	4.36	11.11
NCCB	15.34	14.13	14.74	KIST	9.85	3.51	6.68
NICB	38.00	30.06	34.03	JANATA	2.45	2.96	2.70
LUMBINI	30.76	15.21	22.99	MEGA	1.43	4.38	2.91
MBL	0.39	0.44	0.41	C & T	1.86	1.01	1.43
KUMARI	16.11	16.24	16.17	CIVIL	0.79	3.61	2.20
AVERAGE					**31.61**	**26.90**	**29.25**

The average return on equity of two years of commercial banks in Nepal shows that RBB (136.72), EBL (78.37), NABIL (73.67) and SCBN (72.86) were maintaining higher capital adequacy ratio (more than 70%) than the rest of the other individual commercial banks. The highest return on equity was being maintained by the government-owned bank, RBB (136.72) and joint venture bank, EBL (78.37). However, overwhelming more than 50 percent commercial banks (16 banks) were facing with decreasing return on equity. The return on equity was recorded at 31.61 in 2011 which has decreased to 26.90 in 2012.

The combined mean of return on equity of two years of all commercial banks comes 29.25. The banks which were maintaining more than 29.25 are 10 banks and the banks which were maintaining less than 29.25 are 20 banks. This average return on equity was 31.61 in 2011 which dropped down to 26.90 in 2012. The numbers of banks above and below 31.61 in 2011 were 10 and 20 banks respectively whereas there were 9 and 21 banks in 2012. The return on equity for many of the commercial banks ranges from 10 to 50. The number of banks which were maintaining between 15 to 20 percent return on equity were 6; which is considered as good.

Most of the newly operated private commercial banks had 1.43 to 12.07 percent return on equity on an average but except ADBN, both government-owned commercial banks had above 60 percent return on equity. All joint venture commercial banks had lowest 23.51 to highest 75.57 percent return on equity. MBL had the lowest return on equity. RBB bank had the highest return on equity. GLOBAL bank had consistent return on equity in two years. In joint venture commercial banks, SCBN had consistent return on equity although it is not the highest.

4.3.3 Net Profits

Net profit is a financial measure for banks, calculated by the amount of money the bank receives from interest on assets (commercial loans, personal mortgages, etc) minus the amount of money the bank pays out for interest on liabilities (personal bank accounts, etc). Although usually calculated for banks, this figure can also be calculated for other corporations, simply by subtracting the amount of interest paid on liabilities from the amount of interest earned from assets.

The net profits of all 30 commercial banks have been obtained from the annual reports of the commercial banks of Nepal. Net profits of these banks are used to measure the financial performance of the banks.

Table 4.9
Net profits of commercial banks (Rs. in million)

Bank	2011	2012	Average	Bank	2011	2012	Average
NBL	406.70	383.40	395.10	LAXMI	357.30	380.40	368.80
RBB	1446.20	1759.30	1602.70	SBL	304.50	303.00	303.70
NABIL	1720.90	1269.70	1495.30	ADB/N	1861.00	1608.10	1734.60
NIBL	1318.30	1263.20	1290.70	GLOBAL	353.10	226.30	289.70
SCBN	1173.20	1120.50	1146.90	CITIZEN	355.40	312.40	333.90
HBL	1052.50	1411.00	1231.80	PRIME	338.60	370.00	354.30
NSBI	471.10	458.40	464.80	SUNRISE	220.60	266.00	243.30
NBBL	915.70	655.10	785.40	BOA	147.10	131.10	139.10
EBL	1090.60	931.30	1010.90	DCBL	183.70	109.70	146.70
BOK	609.00	611.40	610.20	NMBL	87.10	357.40	222.30
NCCB	197.80	214.80	206.30	KIST	70.30	197.00	133.70
NICB	394.20	498.40	446.30	JANATA	59.20	34.30	46.70
LUMBINI	217.60	399.90	308.70	MEGA	71.50	23.40	47.40
MBL	10.80	6.40	8.60	C & T	14.20	26.00	20.10
KUMARI	260.40	239.20	249.80	CIVIL	43.30	9.40	26.40
AVERAGE					**525.06**	**519.22**	**522.14**

The average net profit of two years of commercial banks in Nepal shows that ADB/N (1734.6), RBB (1602.7), NABIL (1495.3) and NIBL (1290.7) were earning higher net profit than the rest of the other individual commercial banks. The least net profit was being earned by the private banks, MBL (8.60) and C&T (20.10). The analysis of the net profit in 2011 and 2012 also provides similar picture. However, majority of commercial banks (18 banks) was facing with decreasing net profit. The mean net profit was recorded at Rs. 525.06 in 2011 which had decreased to Rs.. 519.22 in 2012.

The combined mean of net profit of two years' of all commercial banks comes to Rs. 522.14. The banks which had earned more than average were9 banks and the banks which had earned less than that amount was 21 banks. This average net profit was Rs. 525.06 in 2011 which dropped down to Rs. 519.22 in 2012. The numbers of banks above and below Rs. 525.06 in 2011 were 9 and 21 banks respectively. Similarly, in 2012, the number of banks which had earned above and below Rs. 519.22 were same as 2011. The net profit for many of the commercial banks ranges from Rs. 8.6 to Rs. 785.4. Most of the joint venture commercial banks had earned net profit between Rs. 1010.9 to Rs. 1495.3 on an average but except NBL, both government-owned commercial banks had earned highest net profit in comparison to other banks. The newly operated private commercial banks earnings range from Rs. 20.1 to 355.3 million.

Table 4.10
Selected financial ratios by the structure of commercial banks

Type	**CAR**			**OER**			**ACR**			**CRR**			**CDR**		
	011	012	Ave	011	012	Ave	011	012	Ave	011	012	Ave	011	012	Ave
Govt. owned	5.40	5.30	5.40	3.70	3.10	3.30	49.10	47.70	48.40	10.10	9.20	9.60	74.70	67.80	71.00
Joint	4.80	4.30	4.50	1.60	1.60	1.60	55.70	53.20	54.40	4.90	2.70	3.80	69.30	64.30	66.80
Private	12.60	9.50	11.00	1.90	1.80	1.80	67.80	65.10	66.50	1.80	2.00	1.90	89.50	79.40	84.50
Average	**10.30**	**8.00**	**9.20**	**2.00**	**1.90**	**1.90**	**63.50**	**61.00**	**62.30**	**3.30**	**2.90**	**3.10**	**84.00**	**75.30**	**79.60**

Source: Annual Reports of Commercial Banks, 2011 and 2012

From the data of the year 2011, joint venture bank had the lowest capital adequacy ratio (4.80) whereas private bank had the highest i.e.12.6. However, the mean value of capital adequacy ratio of all the banks in the year 2011 was 10.3. In 2012, joint venture banks had the lowest (4.3) and private banks had the highest (9.5) capital adequacy ratio.

The average capital adequacy ratio of 2012 was 8.0. The overall average of capital adequacy ratio was 9.2 during two years' period. The table shows that government-owned and joint venture banks had less than mean capital adequacy ratio and private banks had more than mean values. Here, industrial average of capital adequacy ratio was 9.2. The average capital adequacy ratio of these banks was 5.4, 4.5 and 11 percent respectively. It indicates that private commercial banks had high capital adequacy ratio.

Similarly, in 2011, joint venture banks had the lowest operating expenses ratio (1.6), whereas government-owned bank had the highest i.e. 3.7. However, the mean value of operating expenses ratio of all the banks in the year 2011 was 2.0. In 2012, joint venture banks had the lowest (1.6) and government-owned banks had the highest (3.1) operating expenses ratio.

The average operating expenses ratio of 2012 was 1.9. The overall average of operating expenses ratio was 1.9 during two years' period. The table shows that government-owned and private banks had more than mean operating expenses ratio and joint venture banks had less than mean values. Here, industrial average of operating expenses ratio was 1.9. It is found that the average operating expenses ratios of these banks were 3.3, 1.6 and 1.8 percent respectively. It indicates that government-owned commercial banks have high operating expenses ratio.

The assets composition ratio of government-owned banks in 2011 was 49.1, which was lowest among other two types where as private banks has the highest i.e. 67.8 percent. The mean value of assets composition ratios of all the banks in the year 2011and 2012 were 63.5 and 61 percent respectively. During two years' period, the overall average assets composition ratio was 62.3. It shows that public and joint venture banks had less than mean assets composition ratio in comparison to private commercial banks.

The private sector banks had the lowest credit risk ratio (1.8) in 2011 whereas government-owned bank had the highest i.e.10.1. The same result is found in 2012. The mean value of credit risk ratio of all the banks in the year 2011 was 3.3 and in 2012, it was decreased to 2.9.

The average credit risk ratio of 2012 was 2.9. The overall average of credit risk ratio was 3.1 during two years period. The table shows that government-owned and joint venture banks had more than mean credit risk ratio and private banks had less than mean values. The result indicates that government-owned commercial banks had high credit risk ratio.

The credit deposit ratio of joint venture banks in 2011 was 69.3, which is lowest among other two types where as private banks had the highest i.e. 89.5 percent. The mean value of credit deposit ratio of all the banks in the year 2011and 2012 were 84.0 and 75.3 percent respectively. During two years' period, the overall average credit deposit ratio was 79.6. It shows that government-owned and joint venture banks had less than mean credit deposit ratio in comparison to private commercial banks.

Table 4.11
Selected profitability ratios by the structure of commercial banks

Structure	**Net profits (Rs. in million)**			**Return on Assets (%)**			**Return on Equity (%)**		
	F/Y 011	F/Y 012	Average	F/Y 011	F/Y 012	Average	F/Y 011	F/Y 012	Average
Govt-owned (3)	1238	1250	1244	1.65	1.45	1.55	89.30	55.32	72.30
Joint (6)	1070.70	974.30	1022.50	2.32	2.29	2.31	55.43	57.99	56.71
Private (21)	267.32	284.75	276.03	1.39	1.01	1.20	16.56	13.96	15.26
Average	**525.06**	**519.22**	**522.14**	**1.60**	**1.31**	**1.46**	**31.61**	**26.90**	**29.25**

In 2011, private banks had earned the lowest net profit (Rs. 267.32 million) whereas government-owned banks had earned the highest i.e. Rs. 1238 million. However, the mean value of net profit of all the banks in the year 2011 was Rs. 525.06 million. The analysis of the net profits in 2011 and 2012 also provides similar picture. The net profit of joint venture banks was declined to Rs. 974.3 million but the net profits of government-owned and private banks were slightly increased. The overall industrial average net profit was Rs. 522.14 during two years' period. The government-owned and joint venture banks had more than mean profit and private banks had less than mean values.

The return on assets of private banks in 2011 was 1.39, which is lowest among other two types whereas joint venture banks had the highest i.e. 2.32. The mean values of return on assets of all the banks in the year 2011 and 2012 were 1.60 and 1.31 respectively. During two years' period, overall average return on assets was 1.46. It shows that joint venture and government-owned banks had greater than mean return on assets in comparison to private commercial banks. The ratios of return on assets of all commercial banks were decreased in 2012.

The return on equity of public banks in 2011 was 89.3, which is highest among other two types where as private banks had the lowest i.e. 16.56 percent. The mean value of return on equity of all the banks in the year 2011and 2012 were 31.61 and 26.90 percent respectively. During the period of two years, the overall average return on equity was 29.25. It shows that government-owned and joint venture banks had more than mean return on equity in comparison to private commercial banks.

Table 4.12
Status of deposits and credits by the structure of commercial banks (Rs. in millions)

Particulars	**Total (30)**	**Public (3)**	**Joint venture(6)**	**Private (21)**
Deposit	852339	187057	259061	406221
Average deposit	28411	623552	43177	19344
Credits	598480	115235	168844	314401
Average credits	**19949**	**38412**	**28141**	**14971**

Source: Annual Reports of Commercial Banks, 2011 and 2012

Table 4.12 exhibits that the total deposit of private commercial banks comprises 47.66 percent, indicating higher deposit as compared to other two sector banks. Similarly, joint venture banks had 30.39 percent and government-owned commercial banks had only 21.95 percent. On the other hand, the credit flow of private commercial banks occupied 52.54 percent, joint-venture banks occupied 28.21 percent and remaining 19.25 percent was occupied by government-owned commercial banks in Nepal. The total deposit of all commercial banks was reached to Rs. 852339 million at the end of July, 2012. This is the total of 30 commercial banks. The banking average of these deposits was Rs. 28411.3 million. Among three types of banks, government-owned banks had highest average deposits and private commercial banks had lowest deposits. Similarly, the total credits of commercial banks reached to Rs. 598480 million at the end of July, 2012. Out of that, government-owned commercial banks had highest credits and private banks had lowest.

4.4 Financial Ratios and Their Effects on Profitability

The impacts of financial ratios on bank profitability have received much attention from academic researchers. In this context, the importance of this research study is an attempt to identify the impact of some of the selected financial ratios on bank profitability in Nepalese commercial banking industry. This study follows a study of Vong and Chan (2006), Athanasoglou et al., (2006) and Naceur (2003), among others.

To identify the impact of some of the financial ratios on profitability, three profitability measures, namely return on assets (ROA), return on equity (ROE) and net profit (NP) have been used. The first is the rate of return on average assets (ROA), calculated as net profit before tax divided by average total assets. ROA denotes banks management efficiency to generate revenue through utilizing the bank asset base and hence has emerged as a key measure frequently used in the literature for evaluating bank performance.

The second measure widely used in the literature, as an alternative measure of banks profitability is the rate of return on average equity (ROE), calculated as net profit before tax divided by shareholders' average total equity. It reflects a bank's efficiency at generating profits from every unit of shareholders' equity. However, evaluation of bank profitability based on the use ROE as a profitability indicator must not be interpreted in isolation but should be construed in the context of the bank's debt-equity relationship.

The third measure is the bank's net profit, calculated as the net interest income (the difference between the bank's interest revenues and its interest expenses). As net profit measures ex-post interest rate spread (the difference between the rate the bank charges on loans and other users. of bank credit and that the bank pays on deposits), it is considered a good proxy of banks' cost of intermediation thereby it reflects how efficiently the bank's funds are being intermediated and how profitable the bank’s interest-earning business is.

There are five financial ratios, selected for analysis. Among them, one is capital adequacy ratio. Capital adequacy ratio is the capital strength which is calculated by dividing equity over total assets. Its impact on bank profitability is found to be ambiguous. Higher the ratio, higher the profitability as there will be less need for external funds which decreases cost of capital (Molyneux, 1992). A lower capital ratio suggest a relatively risky position and negative coefficient on this variable is expected (Berger, 1995).

The ratio of operating expenses to total assets is used to measure the efficiency of banks in managing its expenses. Majority of studies suggest a negative impact of operating expenses on profitability as efficient banks are able to operate at lower cost. However, Molyneux and Thornton, 1992 observed a positive relationship between the two, suggesting that higher profits earned by firms may be appropriated in the form of higher payroll expenditure paid to more productive human capital.

Using a sample of 201 American banks during 1984-1990 Miller and Noulas (1997) analyze the effect of bank portfolio mix on large bank profitability and report insignificant negative effect of real estate loans on large bank profitability but strong positive effect between profitability and construction & land development loans and consumer loans. As far as loan portfolio risks is concerned, (Papadamou, 2008) gives some evidence from South Korea and indicate that less diversified across industries, loan portfolios are correlated with higher non-performing loan ratio. A shift from manufacture lending towards real estate and lease business lending can reduce the risk of bank loan portfolio. This can give some useful insights on how bank loan portfolio risk may affect profitability. Credit risk is calculated by dividing net non-performing assets over net advances. It is a measure of asset quality. Bad asset quality is expected to have a negative impact on profitability as it reduces interest income.

The relationship between return on assets, return on equity and net profit and selected five financial ratios (control variables) can be expressed by the following formula:

$$\mathbf{ROA = \alpha + \beta_1 CAR + \beta_2 OER + \beta_3 ACR + \beta_4 CR + \beta_5 CDR + \ldots + et} \quad \mathbf{(1)}$$

$$\mathbf{ROE = \alpha + \beta_1 CAR + \beta_2 OER + \beta_3 ACR + \beta_4 CR + \beta_5 CDR + \ldots + et} \quad \mathbf{(2)}$$

$$\mathbf{NP = \alpha + \beta_1 CAR + \beta_2 OER + \beta_3 ACR + \beta_4 CR + \beta_5 CDR + \ldots + et} \quad \mathbf{(3)}$$

Where,

ROA=Return on Assets, ROE=Return on equity, NP= Net profits α = intercept of dependent variable, β1, β2, β3, β4, β5are constants i.e., slopes of ROA CAR=Capital Adequacy Ratio, OER= Operating Expenses Ratio, ACR=Assets composition ratio, CR=Credit Risk Ratio, CDR=Credit Deposit Ratio and et= Error term

Table 4.13

Regression result: ROA as dependent variable

$(ROA)_{it}$	$= \beta_0$	$+ \beta_1(CAR)_{it}$	$+ \beta_2(OER)_{it}$	$+ \beta_3(ACR)_{it}$	$+ \beta\ 4(CR)_{it}$	$+ \beta5(CDR)_{it}+$	$+(e)_{it}$
	=2.62**	-0.08CAR**	-0.24OER*	-0.06ACR**	-0.07CR	+0.05CDR*	
S.E.	= (1.50)	(0.04)	(0.06)	(0.02)	(0.89)	(0.02)	
t	= (1.75)	(-1.79)	(-3.92)	(-2.94)	(-0.78)	(2.77)	
	R^2=0.41	F(5,54)=4.26	DW=2.08				
	Number of obs. 60		d.f.=54				

*Note: * Significant at 0.01 levels*
*** Significant at 0.05 levels*
i= 1, 2, 3, … commercial banks
t=1, 2, 3… year.

The present study hypothesized that CAR, ACR and CDR factors have significant positive relation with ROA whereas OER and CR have negative relation with ROA. The regression result shows that out of five independent variables, the sign of three independent variables namely OER, CR and CDR are as per expectation. The signs of CAR and ACR showed a negative impact on ROA which is just the opposite as per priori. The regression results from multiple regression models explain that the explanatory power of the model is reasonably high given as the R^2 is estimated at 41%. The F statistic is also statistically significant at 5 percent. The value of DW 2.08 indicates that there is no autocorrelation. It means that other variables keeping constant one unit (ratio) increases in operating expenses ratio will decrease by 0.24 units (ratio) in ROA.

Similarly, keeping other variables constant, one unit (ratio) increase in CDR will increase by 0.05 units (ratio) in ROA. Similarly, one unit (ratio) increases in ACR will decrease by 0.06 units (ratio) in ROA by keeping other variables constant. There is no significant positive relation between CR and ROA.

Table 4.14

Regression result: ROE as dependent variable

ROE_{it}	$=\beta_0$	$+\beta_1(CAR)it$	$+\beta_2(OER)it$	$+\beta_3(ACR)it$	$+\beta_4(CR)it$	$+\beta_5(CDR)it$	$+….+e t_{it}$
	=140.36*	- 2.05CAR**	-1.64OER*	-1.18ACR	+1.57CR	+0.22CDR*	
S.E	= (40.56)	(1.20)	(0.46)	(1.45)	(2.48)	(0.05)	
t	=(3.46)	(-1.72)	(-3.56)	(-0.81)	(0.63)	(4.22)	
	R^2=0.63	F(5,54) =9.95	D.W.=1.62				
	Number of obs. 60		d.f. =54				

Note: * *Significant at 0.01 levels*
** *Significant at 0.05 levels*
i= 1, 2, 3, …commercial banks
t=1, 23,…..year.

It is estimated that CAR, ACR and CDR factors have significant positive relation with ROE whereas OER and CR have negative relation with ROE. The regression result shows the sign of two independent variables namely OER and CDR are as per expectation. The signs of CAR, ACR and CR showed a negative impact on ROE which is just the opposite as per expectation.

Above table depicts regression results from multiple regression models. Here, the explanatory power of the model is reasonably high given by the R^2 at 0.63 for the ROE model. The F statistic of this model is statistically significant at 1 percent. The value of DW 1.62 indicates that there is no autocorrelation. It means, keeping other variables constant, one unit (ratio) increases in operating expenses ratio will decrease by 1.64 units (ratio) in ROE. Similarly, keeping other variables constant, one unit (ratio) increase in CDR will increase by 0.22 units (ratio) in ROE. There are no significant positive relation of ACR and CR on ROE.

Table 4.15

Regression result: Net profits as dependent variable

$(NP)_{it}$	$= \beta 0$	$+ \beta_1(CAR)_{it}$	$+ \beta_2(OER)_{it}$	$+ \beta_3(ACR)_{it}$	$+ \beta_4(CR)_{it}$	$+ \beta_5(CDR)_{it}$	$+\ldots+et_{it}$
	=2111.75*	- 82.63CAR*	-51.2OER	- 77.13ACR*	-20.41CR	+53.14CDR*	
S.E.	= (632.26)	(18.67)	(46.00)	(22.63)	(4.55)	(15.74)	
t	=(3.34)	(-4.43)	(-1.11)	(-3.40)	(-0.53)	(3.38)	
	R^2=0.68	F(5,54) = 10.29	DW = 1.54				
	Number of obs.=60		d.f.=54				

i= 1, 2, 3, …commercial banks
t=1, 23,…..year.
*Note: * Significant at 0.01 levels*
*** Significant at 0.05 levels*

This study predicted that CAR, ACR and CDR factors have significant positive relation with net profit whereas OER and CR have negative relation with net profit. The regression result shows that out of five independent variables, the sign of three independent variables namely OER, CR and CDR are as per expectation. The signs of CAR and ACR showed a negative impact on net profit which is just the opposite as per priori.

The explanatory power of the model is very high given by the R^2 at 0.68 for the net profits model. The F statistic of this model is also statistically significant at 1 percent. The value of DW 1.54 indicates that there is no autocorrelation It means that other variables keeping constant one unit (ratio) increases in capital adequacy ratio will decrease by Rs. 82.63 million in net profit. Similarly, keeping other variables constant, one unit (ratio) increase in CDR will increase by Rs. 53.14 million in net profit. There are no significant positive relations of OER and CR on net profit.

4.5 Some Challenges in Commercial Banks in Nepal

The trend of commercial banking is changing rapidly. Competition is getting stiffer and, therefore, banks need to enhance their competitiveness and efficiency by improving profitability, service quality, customer responsiveness and public accountability. Similarly, the banks also need to adopt the prudent banking practices with a conscience of self-regulation for achieving banking efficiency, reducing overall risks and ensuring the safety of public deposits. They should also encourage healthy competition and avoid imprudent practices to remain safe and sound in the long run. They have to understand the volatile nature of banking business and work collectively onto the direction of uplifting public confidence towards banking system.

The dynamism of the global financial environment requires Nepalese banks and financial institutions to support their operations with more robust tools and skills in order to mitigate risks arising from the rapid development of the financial sector. In the changing financial landscape, with advanced information/communication technology, the banks should adopt adequate risk management practices and promote self-regulated internal environment. Effective risk management has always been central to safe and sound banking activities for two main reasons. First, new technologies, product innovation, size and speed of financial transactions have changed the nature of banking. Second, there is a need to comply fully with the Basel Core Principles on Banking Supervision and to prepare a suitable environment for the implementation of the New Capital Adequacy Framework (NRB, 2008).

Supervisory assessments based on CAMELS (Capital, Asset quality, Management, Earning, Liquidity and Sensitivity to market risk) rating, compliance of prudential norms, gradual implementation of Basel core principles and enhancement in disclosure standards have more closely aligned the Nepalese banking system to international best practices. Moreover, adoption of various emerging international supervisory practices in a phase wise basis has been integrating the Nepalese banking with the global banking practices. However, with the increasing sophistication in the banking industry, compliance based supervision approach appears inadequate. The current transaction and compliance based approach to banking supervision in Nepal is largely reactive, narrow in scope and uniformly applied to all financial institutions to be supervised. It is largely on-site driven, but complemented by off-site monitoring. The average cycle of inspection, of once a year, is the same for all institutions regardless of their perceived risks. It does not provide clear yardsticks for risk assessment and allocation of resources in the supervisory processes. In this background supervisory approach and techniques stipulate the need for prioritizing the supervisory work based on the results of assessment of risks to which individual banks or banking groups are exposed. Therefore, NRB is planning to move towards

Risk Based Supervision on which supervisory resources are allocated towards more risk sensitive areas in the most efficient and productive manner possible.

Several empirical evidences show that countries with more credit extended to the private sector experienced stronger economic growth. In this sense, country's financial sector depends on its capability to develop institutions and financial instruments that can support economic growth. At this juncture, the NRB’s challenge is to build up a financial system that is supportive to growth, and dynamic enough to change and fulfill the evolving demand of the economy.

The NRB, as the apex body of banking system in Nepal, has been trying to ensure a healthy and efficient financial sector by improving regulation at par with international standard. As such, the implementation of the New Capital Adequacy Framework in Nepalese commercial banks has remained effective in terms of ensuring adequate level of capital in banking sector and almost all banks have developed reporting system. Similarly, the supervisory focus of the NRB in the latter days is on ensuring prudent banking practices in a self-regulated environment with more sensitivity towards various risks of the banking sector. By considering various internal and external factors, some of the challenges faced by the commercial banks can be described as follows:

4.5.1 Rapid Growth of the Banking Sector

Nepalese banking sector gained momentum after the liberalization process started in mid-eighties. Rapid growth in term of number as well as transaction of the banks and financial institutions has been creating new challenges every year. Number of commercial banks in mid July 2012 reached to 30 from 5 in 1990. Similarly total assets of the commercial banks increased to Rs. 1166.21 billion in mid July 2012 from Rs. 26.68 billion in mid July 1990. In the last decade, it is observed a huge change in the banking practices, banking regulation and supervision.

Such a rapid increase in the number and transaction volume of the players has introduced the growing competitive pressures in the banking system. Banks and financial institutions have limited their activities in the urban and semi urban areas despite a very low level of financial access in the remote and rural parts of the economy. Uneven geographical distribution of the banks has further increased the level of competition in the urban areas.

Banking business has been becoming more complex and challenging along with the use and introduction of modern technology, service proliferation and rising intense competition. Such a challenge demands for the increasing role of financial market players and all stakeholders as well. Domestically, there are challenges to address issues raised by the rapid pace of the banking sector; on the other hand there is a need of cautiousness towards any possibilities of transmission of vulnerabilities observed during the recent global financial crisis.

As a result of the rapid growth, overall risk exposure of the commercial banks is also increasing day by day. Some banks are facing the problem of a repeated liquidity shortfall. Asset quality of some banks seems to be degrading due to their exposure in real estate and shares. Moreover, stagnant price of the assets has further looming the position of the commercial banks. There is an urgent need for continuous improvement in the assets liability management of banks to cope with their increasing exposure in the unproductive sectors of the economy. The issues in liquidity management, assets quality and profitability are challenging to make commensurate with the growth of the financial sector.

4.5.2 Reform Process of State-owned Banks

Nepal Bank Limited and Rastriya Banijya Bank are the two commercial banks with government ownership, which is bearing a huge accumulated loss. These banks are facing the problem of significant loss of capital, weak assets quality, low profitability, over-staffing and less efficiency in overall management. Reform measures were initiated to improve the condition of these banks since 2002. After the several efforts, some positive signs of reform were observed. However, the outcomes are not up to the desired level. Still these banks have their capital level below the minimum requirement set by Nepal Rastra Bank. The capital adequacy ratios of these two banks are below industry average, whereas the operating expenses ratios and credit risk ratios are greater than other commercial banks.

It is challenging for the NRB to improve the capital position including overall functioning of Nepal Bank Limited and Rastrya Banijya Bank. The human resources of these banks need to be trained and upgraded. The numbers of staff are relatively very high which show a big deal of inefficiency inherent. Assets composition ratio and credit deposit ratio are also lesser in comparison to other commercial banks. Therefore, it is challenging on the part of the NRB to provide same level playing field to all commercial banks and ensure competitiveness through non-discriminated manner.

4.5.3 Supervision of Large Bank

Some of the Nepalese banks are in the race of aggressive growth in terms of their transactions volume including asset portfolio. After the involvement of the private sector in the Nepalese banking, some banks have grown in a rapid pace and turned into systemically large bank to make a significant impact in the financial system. Entrance of joint venture banks became the threats for public banks. Such banks have a large transaction with wide network and financial interconnectedness; it may lead to contagion effect. Similarly they provide different customized services to the customers with the help of modern technology. They have low credit risk and high return on assets. Supervisory approach is still similar to all the existing commercial banks. It is necessary to impose prudential requirements on banks commensurate with their systemic importance. There is a need of special arrangement to reduce the inherent risks associated with systemically important financial institutions.

4.5.4 Enhancing Corporate Governance in Commercial Banks

Banks are the institutions having interest of large number of stakeholders. There are shareholders, depositors, creditors, board members, employees and community as well. Appropriate level of fairness, accountability and transparency is expected from the operation of banking business. Balancing the expectations of all the stakeholders is a challenging job for the bank management. In addition to the appropriate level of corporate governance, banks need to have in place a comprehensive risk management framework to identify measure, monitor and control all other material risks. During analysis, it is found that the average credit risk ratio of public commercial banks is 9.6 percent where as these ratios of joint venture and private commercial banks are 3.8

and 1.9 percent respectively. It emphasizes the board level and senior management oversight for the sound risk management practices in the banks. The board needs a range of skills and understanding to be able to deal with banking business issues and have the ability to review the performance of management. Board needs to have an appropriate level of commitment to fulfill its responsibilities and duties. To ensure sound practice of corporate governance in the bank, board of directors and senior management need to be well equipped with adequate knowledge and experience in the banking sector.

Majority of the boards of directors are from business backgrounds with no prior banking knowledge and experience. The directors with experience of banking and government employee hold the second and third position. Almost half of the directors are from the business sector. As they are the largest fund user of the commercial banks, they possess the challenges to ensure sound corporate governance in banking sector.

4.5.5 Developing and Retaining Human Resources

Rapid growth of the banking system demands for competent human resources to cope with the challenges of modern dynamic environment. As banking activities are expanding in terms of number and volume of the transactions, there is a high demand of skilled and competent manpower. Analysis indicates that public commercial banks are suffering from over staffing problems because they have higher operating expenses ratios in comparison to other commercial banks. High staff turnover and mobility of bank employee from one bank to another has been a regular practice in the banking sector. To address the issues of human resource development in line with the growth is also a challenge.

4.5.6 Adopting International Best Practices

Banking business is turning into a global network of complex financial relationships. Nepalese banking system is integrating into global financial system day by day. In this context, it is necessary to adopt established principles and best practices developed in the global financial system. Nepal is in the gradual process of implementing Basel Core Principles and most of the principles are adopted and adjusted in the national legislation, prudential regulations, directives and guidelines. Still there are some principles which are to be adopted. Nepal has implemented new capital adequacy framework based on the Simplified Standardized Approach of Basel II. Offsite supervision has developed and implemented Early Warning Signals (EWS) to monitor the performance as well as compliance status of the Banks. At the end of July, 2012, the capital adequacy ratio of private commercial banks was reached to 9.5 percent whereas this ratio of public banks was only 5.3 percent. Risk Management Guidelines are designed and implemented incorporating broader guidelines and minimum standard for risk management based on the BCBS principles. But there is still a challenging task to move toward Risk Based Supervision (RBS) approach, developing macro prudential supervision framework, introducing forward-looking approaches to prevent the system from systemic crisis. Bank regulators and supervisors always have a challenge to acquire knowledge, skills and resources to adapt continuous change and development in the global supervisory approaches.

4.5.7 Contingency Planning and Supervisory Strategies

The banking sector is growing rapidly and new entrants are increasing the risk profile of the system. As Nepalese economy is integrating into global financial system gradually, it is exposed to external risk from the global financial crisis and internal macroeconomic vulnerabilities, which may destabilize the financial system and trigger a systemic crisis. To manage these risks more effectively, it is necessary to strengthen supervisory capacity with the adequate supervisory approaches, tools and techniques. It is felt necessary to have a crisis management framework (contingency plan) to resolve the Problem Bank in a systematic way. Bank supervisors should be well equipped with the strategies and framework for managing crisis situation with a step-by-step implementation plans for each and every resolution option.

4.5.8 Management Information System & Monitoring

Supervisory strength depends on the timely collection, analysis and interpretation of the financial data. Strong management information system is required to trace the problem timely, to develop early warning signals and to take action in a promptly basis. Supervisors have to develop a mechanism to monitor data related to liquidity and capital of the financial institutions, on a regular basis. Strengthening MIS and monitoring system in line with the rapid growth of the market is another challenge. It is necessary to develop strong MIS for monitoring overall banking system on regular basis.

4.5.9 Challenging Macroeconomic Environment

Nepalese economy is experiencing a weak performance indicated by the overall macroeconomic variables. Low economic growth, high inflation, unfavorable balance of payments, high proportion of consumption in GDP, low rate of saving, lack of investment friendly environment, energy crisis and weak industrial relationship are some of the challenges of Nepalese economy. In this context, overall business environment signals symptoms of reduced business confidence and weakened investment climate in the economy. Due to these several reasons, various sectors of the economy like agriculture, industry and services are achieving low level of growth. It seems that the growth of banking sector has not yet made significant contribution in the growth of the overall economy. Thus, there is also a challenge to channelize the resources towards productive economic activities for the sustainability of the banking sector and economy as a whole.

4.5.10 Changing Global Scenario

Global scenario is changing in a rapid pace. Banking practices, financial relationships, tastes and preferences of customers, product structures are changing in short span of time. Supervisory efforts should be directed towards managing change with the change in the global economic context in which banks operate. Technological innovation, development and global market forces are rapidly shaping the structures of banking system. Banking activities are extending beyond the national boundaries. It has increased financial inter-connectedness and contagion effect among the market players. Supervisory approaches are moving towards consolidated, cross-border and macro prudential supervision. Gradual integration of the Nepalese banking into the global financial system has further increased the need for supervisory capacity enhancement. In this backdrop, Bank Supervision Department has a challenge of managing the change-pressure brought in by the global financial environment.

4.5.11 Low Level of Nonperforming Assets

Growing number of banks and financial institutions has created a pressure of an unhealthy competition. Other sectors of the economy are not performing well since overall investment environment is not favorable. Limited number of good borrowers in the one hand as well as rising competition on the other has created the situation of cutthroat competition. Overall macro-economic indicators seem to be deteriorating since the last decade but the non-performing assets of the banks is decreasing at an incredible pace. Such scenario indicates that there might be the practice of loan ever greening to bring the NPA at a minimum level. The credit risk ratio of July, 2011 was 3.3 percent where as it was decreased to 2.9 percent on July, 2012.

Competition is as important in banking as in any other industry. As in other sectors of the economy, competition in the banking sector has implications for efficiency, innovation, pricing, and availability of choice, consumer welfare and the allocation of resources in the economy. It might be argued that given the pivotal role of banking in an economy, the role of competition in this industry is especially important because it has an impact throughout the economy.

However, there are different approaches to this issue. The standard benefits of competition and its impact on efficiency and resource allocation in an economy derive from standard industrial organization economics applied to the banking industry (Freixas and Rochet, 1997; Guzman, 2000). However, this is challenged in other studies and the arguments are outlined clearly in a recent survey by Northcott (2004).

For instance, Peterson and Rajan (1995) find that market power by banks may increase their willingness to engage in relationship banking and increase the supply of credit to new companies. They find a negative relationship between competition and relationship banking. By contrast, this is challenged by Boot and Thakor (2000), who argue that relationship banking can emerge in a highly competitive market environment. Overall, however, there is robust evidence that competition in banking is a force generating increased efficiency.

4.6 Conclusion

After analysis, it can be summed up that there is rapid growth of commercial banks in Nepal since 1980. Profitability of commercial banks of Nepal is trying to analyze by using two profitability ratios in this research.

Based on the results of the empirical analysis, bank-specific determinants such as capital adequacy ratio, operating expenses ratio, assets composition ratio, credit risk ratio and credit deposit ratio are able to explain significant part of bank profitability in Nepal. The regression result confirms that a high credit deposit ratio is affecting profit through translating the safety advantage into profit. The study also concludes that the lending activities in commercial banking sector are associated with profit, and in order to maximize the profit, commercial banks in Nepal maintaining sizable volume of lending activities.

Another finding of the study is that the operating expenses are associated with significant inverse relationship with profitability in commercial banks. An increased operating expense in Nepalese banking sector is lowering profits. So, to improve the profitability of Nepalese banks, banks should work to improve the efficiency of cost management, which according to the analysis crucially affect profits of Nepalese banks. Finally, the study concludes that the amount of impact of the bank-specific determinants on bank's profitability varies from bank to bank.

Escalating cost of operations due to inflationary pressure, exceeding liquidity resulting in lower returns, increasing provision against loan of real estate sectors, unstable socio-political environment and growing local competition have adversely affected the growth and net profit of commercial banks.

Therefore, commercial banks should continuously improve their service standards, analyze each of the cost components minutely to bring down their cost of operations, introduce new products to drive the market, and carry out cautious approach in business segments especially in credit risk assets. Lacking political stability coupled with slacking economic growth, widening trade deficit, rising inflationary rate and arousing number of defaulters in the banking industry continues to remain the major challenges ahead.

CHAPTER V

CUSTOMERS AND EMPLOYEES' SATISFACTION

This chapter presents the analyses of customers and employees' satisfaction.

5.1 Customers' Satisfaction Analysis

Customer satisfaction is a measure of how products and services provided by organization meet the expectations of a customer. It varies from person to person and service to service. In commercial banks, a customer can be defined as a user or potential user of banking services. A customer includes an account holder, or a person carrying out casual business transactions with a bank. High levels of customer satisfaction lead to reduced price sensitivity, lower chances of switching to competition, increased number of referrals and repeat purchase. This can be linked to higher revenues from the customer along with reduced costs leading to better customer profitability. The competence of a banking sector depends upon how best it can deliver services to its target customers. In order to survive in this competitive environment and provide continual customer satisfaction, the banking services providers are required to increase the quality of services. In banking business, it is seen that only 5% increase in customer retention can extend 35% profitability (Reichheld, 1996a). In this research, only account holder customers are considered for measuring the satisfaction level of customers of commercial banks.

5.1.1 Measuring Customers Satisfaction

A questionnaire was developed based on three different research studies (Uma Shankar et al., 2010). The questionnaire consisted of three different parts. The first part showed respondents' background information such as gender, age, education, occupation , income, and their banks and the second part includes level of satisfaction on various aspects of bank services such as employee behavior, responsiveness, queue management, ATM and card procedures, value of other products exclusive loans, account management and communication, card acquisition, credibility and security, technology, customer service, location, infrastructure and network accessibility. Similarly, the last part of questionnaire was associated with the further opinions of the customers on the banks' employees' behavior.

5.1.2 Economic and Demographic Characteristics

In economic and demographic characteristics of customers, their gender, age, academic qualification, occupation, income levels were included to analyze their responses. The economic and demographic characteristics of the customers of commercial banks of Nepal are residing in the Table 5.1:

Table 5.1
Percentage distribution of respondents by economic and demographic characteristics

Economic and demographic characteristics	Male %	Female %	Total respondents	Total percent
Age group				
16-30 years	33.10	30.60	130	32.50
30-45 years	38.10	45.90	160	40
Above 45 years	28.80	23.50	110	27.50
Total	**302**	**98**	**400**	**100**
Education				
SLC or below	26.10	27.60	106	26.50
Higher secondary	38.10	40.80	155	38.75
Bachelor & above	35.80	31.60	139	34.75
Total	**302**	**98**	**400**	**100**
Occupation				
Students/ or others	30.50	29.60	121	30.25
Service	21.20	15.30	79	19.75
Business	48.30	55.10	200	50
Total	**302**	**98**	**400**	**100**
Monthly income				
Below Rs 20000	20.50	16.30	78	19.50
Rs 20000-50000	23.50	23.50	94	23.50
Above Rs 50000	56	60.20	228	57
Total	**302**	**98**	**400**	**100**

Table 5.1 reveals the percentage distribution of customers by economic and demographic characteristics. Of the total 400 respondents, males were302 and remaining 98 were females. The percentages of male and female respondents were 75.5 and 24.5 respectively. The percentage of respondents between age groups 16 to 30 years, 31 to 45 years and above 45 years were 33.1, 38.1 and 28.8 percent respectively among male customers, while these percentages were 30.6, 45.9 and 23.5 percent respectively among females. The table also reveals that the highest numbers of the customers (40%) were of 30-45 years age in the both genders, followed by the customers of 16-30 years.

The education status of the male respondents shows that 26.1 percent of customers were S.L.C graduates, 38.1 percent customers were higher secondary graduates and remaining 35.8% were undergraduates and graduates. Similarly, in the case of female customers, 27.6, 40.8 and 31.6 percent of them were S.L.C., higher secondary, and undergraduates and graduates. Furthermore, 139 customers of the total 400 respondents i.e. 34.75% were graduates and post graduates. Since, it is obvious from the demographic data of education, all the customers are S.L.C. and higher level graduates who are supposed to be aware of the quality of services provided by the banks and have some sense of satisfaction.

Career wise, all respondents have been classified into three groups: students, job holders and business people. About one-half of the respondents (50%) were from business people, and the rest were students and job holders. In case of male customers, the percentage of students, job holders and business people were 30.5,21.2 and 48.3 respectively, whereas in case of their female customers, students were 29.6%, job holders 15.3%and rest were business women. Since a high majority of customers were business people and service holders (70%), they were more active in dealing with banks rather than students, who are only about one-third(30%) of the total customers.

Customers were also classified on the basis of their monthly income. As such, they were classified into three income-level groups, viz., customers having monthly income below Rs 20,000, income from Rs 20,000 to Rs 50,000 and income more than Rs 50,000. With respect to male customers, 20.5% of them had income below Rs 20,000, 23.5% of them had monthly income from Rs 20,000 to Rs 50,000, and 56% had monthly income more than Rs 50,000 respectively. Similarly, in case of female customers, 16.3 % of them had income level below Rs 20,000, 23.5% had income between Rs 20,000 and Rs 50,000 and 60.2% had more than Rs 50,000 income level. However, the bank customers who fell in the income group above Rs 20,000 constituted 80.5% of the total customers.

Table 5.2
Number of respondents by the structure of banks

Structure of Bank	Number of respondents	Percent
Government-owned (3)	91	22.8
Joint venture (6)	130	32.4
Private (21)	179	44.8
Total (30)	**400**	**100**

The commercial banks in Nepal are classified in government-owned, joint venture and private sector banks. The sample composition of the respondents customers were 22.8% from the government-owned, 32.4% from joint venture and 44.8% from the private banks. The size of respondents from the private sector banks have been the highest because of the highest number of such banks.

Table 5.3
Number of respondents by banks' year of operations

Year of operations	Number of respondents	Percent	No. of banks
Above 20 years	129	32.25	5
5 to 20 years	66	16.50	13
Below 5 years	105	26.25	12
Total 30	**400**	**100**	**30**

Commercial banks are also classified in terms of their years of operation into three groups, i.e. banks operating more than 20 years, between 5 to 20 years and below 5 years. The total numbers of these banks are 5, 13 and 12, from the group of banks having more than 20 years of operations, 5 to 20 years and below 5 years respectively. The percentages of respondents from these banks were 32.25, 16.5 and 26.25 respectively. The respondents from the banks having more than 20 years of operation were the highest.

5.1.3 Customers' Satisfaction on Bank Services

To understand the level of satisfaction of the customers of commercial banks on various attributes and services, some statements on key issues were raised and asked to sample customers. These issue statements were related to employee behavior, service charges, physical environment and quality of banking services. A five-point Likert's scale was used to analyze the responses of customers. The mean scores and level of customers' satisfaction in the bank services are presented in Table 5.4:

Table 5.4
Satisfaction level of customers on various services of the banks

Customers' responses	NS	LS	S	HS	VHS	Total %	Mean Score
Employee behavior	0.00	4.00	30.75	58.00	7.25	100	3.69
Responsiveness	0.25	10.00	23.50	49.25	17.00	100	3.73
Queue management	0.00	2.50	26.50	59.25	11.75	100	3.80
Branch services	0.00	2.00	26.50	63.00	8.50	100	3.78
ATM services	0.00	0.00	31.50	67.00	1.50	100	3.70
Loan services	0.00	0.00	33.50	63.00	3.50	100	3.70
A/c communication	0.00	0.25	46.50	52.75	0.50	100	3.54
A/c management	0.00	0.00	35.00	64.75	0.25	100	3.65
Card acquisition	0.00	0.00	35.50	62.75	1.75	100	3.66
Physical aspects of ATM	0.00	0.75	59.00	40.00	0.25	100	3.40
Physical environment	0.00	0.00	10.00	85.00	5.00	100	3.95
Credibility and security	0.00	5.75	61.00	33.00	0.25	100	3.28
Network accessibility	0.00	0.00	54.00	45.75	0.25	100	3.46

NS=Not Satisfied LS=Least Satisfied S=Satisfied HS=High Satisfied
VHS=Very High Satisfied

Table 5.4 shows that physical environment of the bank provided the customers with high level of satisfaction, as the mean score was 3.95. Of all the dimensions of bank services, physical environment includes clean, attractive and well-designed setting of the banks. Similarly, adequate safety, personal security, adequate parking area, convenient branch location and adaptation of modern technology along with attractive decoration are some features of physical environment. A majority of the respondents, i.e. 90 percent of them, were highly satisfied from the physical environment maintained by the banks. Queue management was another dimension that provided satisfaction after physical setting with the mean score of 3.8. Customers did not want to spend more time in waiting for services. All together three statements were asked to assess queue management. It comprised minimal queuing time, counters for specific transactions and accounts, and adequate tellers/counters. The survey revealed that a 71% (59.25%plus 11.75%) of the total respondent customers were satisfied from the queue management of the banks. The mean score of branch services is 3.78. This is the third rank of customer responses. In these services, five statements were asked to rank. These include adequate supply of transaction slips, information pamphlets, readily available working pens, uniform services in all branches, and convenient hours of operation, respectively. The survey shows that out of 400 customers, 71.5% (combining the percentages of high satisfied and very high satisfied) of the customers were satisfied from the branch services provided by the commercial banks.

Similarly, the mean scores of responsiveness of employees, ATM services, and loan services lie in between 3.7 to 3.73. The mean scores of employees' behavior, card acquisition, account management and account communication were 3.69, 3.66, 3.65 and 3.54 respectively. Finally, network accessibility, physical aspects of ATM and credibility and security had the mean scores below 3.5. Among all variables, customers gave least importance for credibility and security. 66.25% (49.25% plus 17%) customers are satisfied with the responsiveness of employees out of 400 customers. Promptness and accuracy in transactions, complaint registering method and complaint address method are included in responsiveness. Similarly, 68.50 (combining the percentages of high satisfied and very high satisfied) percent customers are satisfied with ATM services. Under ATM services, accuracy in execution of all ATM transactions, working conditions, network accessibility, simple procedures for obtaining ATM cards, fast replacement and privacy of ATM transactions are included in this questionnaire.

Table 5.5

Ranking of various types of bank services by level of satisfaction and gender

Perception on	**Mean scores**	
	Male	Female
Employee behavior	3.28	3.33
Responsiveness	3.33	3.39
Queue management	3.42	3.53
Branch services	3.38	3.45
ATM services	3.28	3.28
Loan services	3.35	3.36
A/c communication	3.15	3.14
A/c management	3.23	3.27
Card acquisition	3.29	3.28
Physical aspects of ATM	3.04	3.16
Physical environment	3.5	3.57
Credibility and security	2.99	2.92
Network accessibility	3.09	3.09
Composite mean score	**3.26**	**3.29**
Total respondents (400)	**302**	**98**
Total percent	**75.5**	**24.5**

Of the total 400 respondents, 302 are male (75.5%) and 98 are female (24.5%) respectively. From Table 5.5 above, it is found that female customers were slightly more satisfied (mean score 3.57) with physical environment of commercial banks than their male counterpart (mean score 3.5). In case of ATM services, both male and female customers were equally satisfied with mean score 3.28 for both genders. Similarly, it is 3.09 in case of network. In aggregate, female customers were more satisfied than male customers because the mean score of female for most of the variables are higher than that of male customers. Similarly, the mean satisfaction scores of credibility and security is below 3, which is the least among all variables. The rest of other variables had mean scores above 3.

The composite mean score of female customers was greater than that of male customers, which indicates that female customers were more satisfied than male customers in various dimensions of bank services.

Table 5.6
Mean satisfaction scores by various age groups of customers

Perception on	**Below 30 years**	**30-45 years**	**Above 45 years**
Employee behavior	3.30	3.23	3.36
Responsiveness	3.24	3.27	3.42
Queue management	3.54	3.37	3.45
Branch services	3.41	3.37	3.43
ATM services	3.28	3.24	3.34
Loan services	3.37	3.30	3.40
Account communication	3.12	3.13	3.21
A/c management	3.24	3.20	3.29
Card acquisition	3.28	3.24	3.36
Physical aspects of ATM	3.11	3.03	3.09
Physical environment	3.52	3.51	3.51
Credibility and security	2.96	2.95	3.02
Network accessibility	3.10	3.07	3.12
Composite mean score	**3.27**	**3.22**	**3.31**
Total Respondents (400)	130	160	110
Total percent (100)	**32.50**	**40**	**27.50**

The mean satisfaction score by age groups of respondents are shown in Table 5.6. Classifying the respondents into three groups on the basis of their age group viz. below 30 years, 30 to 45 years and above 45 years, the percentage of respondent in each of the group constitute 32.5, 40 and 27.5 percent respectively. Of the total respondents, the largest number respondents fall in the age group between 30 to 45 years. The responses of the customers showed that the customers below 30 years of age gave more importance to queue management followed by physical environment. Similarly, the customers above 45 years ranked branch services as an important service of the banks. The least mean score 2.96 was allotted by customers below 30 years of age to credibility and security.

The highest composite mean score was 3.31 that belong to those customers who were more than 45 years of age whereas the least composite mean score was 3.22 of customers who were between 30 to 45 years of age. The mean composite score of below 30 years age group customers was 3.27, which indicates that the customers who were more than 45 years, they are more satisfied than any other age group respondents.

Table 5.7

Mean satisfaction score by level of education

Perception on	**Level of Education**		
	SLC and below	Higher secondary	Bachelor and above
Employee behavior	3.34	3.30	3.25
Responsiveness	3.42	3.40	3.25
Queue management	3.45	3.44	3.45
Branch services	3.43	3.40	3.38
ATM services	3.35	3.26	3.27
Loan services	3.42	3.33	3.32
A/c communication	3.24	3.13	3.11
A/c management	3.26	3.24	3.22
Card acquisition	3.33	3.27	3.28
Physical aspects of ATM	3.09	3.06	3.07
Physical environment	3.54	3.52	3.49
Credibility and security	3.05	2.95	2.94
Network accessibility	3.12	3.08	3.08
Composite mean score	**3.31**	**3.26**	**3.24**
Total Respondents (400)	**106**	**155**	**139**
Total percent (100)	**26.50**	**38.80**	**34.70**

Education wise, customers were classified into 3 groups, viz. SLC or below, higher secondary and bachelor and above. Of the total 400 respondents, 106, 155 and 139 (i.e. 26.5, 38.8 and 34.7 percent) of them respondents were S.L.C. or below, higher secondary graduates and graduates and above. The customers with S.L.C. or below recorded the highest mean score of 3.54 with result to satisfaction from physical environment, and recorded the lowest score of 3.05 with respect to satisfaction from credibility and security. The customers who were higher secondary graduates recorded the highest mean score of 3.52 with respect to physical settings and recorded the lowest mean score 2.95 with respect to credibility and security. The respondents with graduates and above recorded the highest mean score of 3.49 for physical settings and the lowest mean score of 2.94 for credibility and security of the banks.

The composite mean scores of three groups of customers of different education levels were 3.31, 3.26 and 3.24 respectively, which indicates that the customers with SLC or below were more satisfied followed by customers with higher secondary and graduates and above respectively.

Table 5.8
Mean satisfaction score by occupation

Perception on	**Students & others**	**Service**	**Business**
Employee behavior	3.38	3.27	3.27
Responsiveness	3.45	3.28	3.34
Queue management	3.57	3.42	3.41
Branch services	3.44	3.36	3.40
ATM services	3.29	3.28	3.28
Loan services	3.38	3.30	3.36
A/c communication	3.13	3.08	3.19
A/c management	3.25	3.21	3.24
Card acquisition	3.27	3.25	3.30
Physical aspects of ATM	3.06	3.10	3.07
Physical environment	3.54	3.51	3.50
Credibility and security	2.94	2.93	3.00
Network accessibility	3.08	3.07	3.10
Composite mean score	**3.29**	**3.24**	**3.27**
Total respondents (400)	**78**	**94**	**228**
Total percent (100)	**19.50**	**23.50**	**57.00**

The above table (Table 5.8) reveals the occupational groups of all 400 customers, who responded their satisfaction to each of the dimensions of bank services. From the table, it is noted that among all respondents, students and others were 19.5%, service holders were 23.5% and businessmen were 57%. Students and others recorded the highest mean score of 3.57 for queue management followed by physical environment. Both service holders and businessmen recorded with the highest mean scores 3.51 and 3.5 respectively for physical environment followed by queue management.

The composite mean score shows that students and others were highly satisfied on the whole with the highest mean score of 3.29 followed by businessmen with composite mean score of 3.27 and service holders with the mean score of 3.24. From the forgone analysis, it can be deduced that students and others were slightly more satisfied than the businessmen and service holders respectively.

Table 5.9
Mean satisfaction score by monthly income

Perception on	Below Rs 20,000	Rs 20,000-Rs 50,000	Above Rs 50,000
Employee behavior	3.29	3.30	3.29
Responsiveness	3.32	3.42	3.34
Queue management	3.49	3.50	3.40
Branch services	3.38	3.42	3.41
ATM services	3.29	3.29	3.28
Loan services	3.34	3.34	3.36
A/c communication	3.08	3.14	3.19
A/c management	3.24	3.21	3.25
Card acquisition	3.28	3.17	3.34
Physical aspects of ATM	3.10	3.02	3.07
Physical environment	3.53	3.51	3.50
Credibility and security	2.95	2.83	3.05
Network accessibility	3.07	3.10	3.10
Composite mean score	**3.26**	**3.25**	**3.28**
Total respondents (400)	**121**	**79**	**200**
Total percent (100)	**30.20**	**19.80**	**50.00**

On the basis of monthly income of customers, all respondents are classified into three groups, i.e. income below Rs 20,000, between Rs 20,000 and Rs 50,000 and above Rs 50,000. Of total respondents, 121 (30.2%), 79 (19.8%) and 200 (50%) respondents had monthly income levels of below Rs 20,000, Rs 20,000 to Rs 50,000 and above Rs 50,000 respectively. Table 5.9 shows that the respondents of all three income levels had the highest mean satisfaction scores for physical environment of the banks followed by their queue management and branch services. Conversely, respondents of all three monthly income levels had the lowest satisfaction level (i.e. 2.95, 2.83 and 3.05 respectively) for credibility and security followed by physical aspect of ATM, and network accessibility respectively.

The composite mean score of those customers who earn more than Rs 50,000 per month was 3.28, which was the highest among all groups whereas the least composite mean score of customers having income between Rs 20000 to Rs 50000 per month was 3.25, which indicate that higher earning customers are more satisfied from bank services than the other monthly income groups of respondents.

5.1.4 Satisfaction Level of Customers towards Employees' Behaviors

Employees' behavior is considered to be the important factor for determining the level of satisfaction of customer. Employees' behavior includes the statements regarding courtesy, promptness in request, punctuality of employees, available of supervisors, following instructions, communication about new products and services to the customers, flexible banking hours, and cleanliness of banks and telephonic inquires. The following table (Table 5.10) depicts the opinions of customers towards the issues relating to employee behaviors.

Table 5.10
Customers' opinion towards employees' behaviors

Opinions	NS	LS	S	HS	VHS	Total	Mean
Courtesy	0.00	11.50	44.25	19.25	25.00	100	3.58
Promptness in attending request	1.25	9.75	33.00	42.75	13.25	100	3.57
Punctuality	0.00	13.00	41.50	36.5	9.00	100	3.42
Promptness in complain recovery	0.00	17.75	38.75	38.75	4.75	100	3.30
Presence of supervisors when required	0.25	15.75	42.00	28.75	13.25	100	3.39
Following instruction given by you	0.00	6.25	32.00	41.00	20.75	100	3.76
Making aware of latest products at bank	0.00	9.75	49.00	36.25	5.00	100	3.36
Extending service after banking hours	0.00	1.00	17.50	46.25	35.25	100	4.16
Cleanliness of bank	2.75	42.75	53.00	1.50	0.00	100	2.53
Telephonic inquiry from officials	0.00	23.25	33.75	31.50	11.50	100	3.31

Where, NS=Not Satisfied LS=Less Satisfied S=Satisfied HS=High Satisfied VHS= Very Highly Satisfied

It is found that overwhelming majority of the respondents (88.5% i.e. 44.25 plus 19.25 plus 25 percent) was satisfied with the courtesy showed by the bank staffs. Extending service after banking hours had the highest mean score i.e. 4.16. The percentage of customers who think the service is satisfactory constitutes nearly hundred percent. It implies that most of the respondents feel that this service is essential to the customers who may have a busy schedule or may come up with emergencies. It can thus be concluded that most of the customers like flexible service time in banks.

The second ranked statement is ‘following instruction given by you’. Its mean score was 3.76. This explains how important employee promptness and cooperation impact customer satisfaction. The mean score of cleanliness of bank was 2.53 showing a least mean score. Most of the customers were not satisfied with the banks’ cleanliness. There were four different factors, which have more than 3.5 mean scores and five other factors which had mean scores in between 3 to 3.5. Only one factor scores less than mean score.

Table 5.11
Mean satisfaction score by structure of commercial banks

Responses of customers on	Govt. owned	Joint venture	Private
Employee behavior	3.26	3.33	3.28
Responsiveness	3.36	3.36	3.34
Queue management	3.43	3.52	3.40
Branch services	3.42	3.41	3.38
ATM services	3.33	3.27	3.27
Loan services	3.37	3.34	3.35
A/c communication	3.13	3.10	3.20
A/c management	3.22	3.23	3.25
Card acquisition	3.19	3.28	3.34
Physical aspects of ATM	3.03	3.06	3.10
Physical environment	3.52	3.52	3.50
Credibility and security	2.82	2.95	3.08
Network accessibility	3.07	3.02	3.15
Composite mean score	**3.24**	**3.26**	**3.28**
Total respondents (400)	**91**	**130**	**179**
Total percent (100)	**22.80**	**32.50**	**44.70**

The numbers of commercial banks under government-owned, joint venture and private categories are 3, 6 and 21 respectively. From these banks, sample respondents were 91, 130 and 179 respectively. Of the total respondents, 22.8, 32.5 and 44.7 percent respondents were from government-owned, joint venture and the private sector commercial banks. Table 5.11 shows that the customers of government-owned banks had the highest mean score to physical environment (3.52), followed by queue management (3.43). Similarly, physical environment had the highest score (3.52) from the customers of the joint venture banks, followed by queue management (3.52).

The customers of private sector commercial banks ranked physical environment the highest, followed by queue management. The respondents of all three types of commercial banks had the least priority to credibility and security, as the mean scores of these were 2.82, 2.95 and 3.08 respectively.

The customers of private commercial banks are more satisfied than other two types of banks' customers because the composite mean score was highest (3.28). The composite mean scores of government-owned and joint venture banks were 3.24 and 3.26 respectively. Customers of government-owned commercial banks were less satisfied than others from the bank services and employees behaviors.

Table 5.12
Mean satisfaction score by banks' years of operations

Responses of customers	Above 20 years	5 -20 years	Below 5 years
Employee behavior	3.24	3.43	3.13
Responsiveness	3.32	3.48	3.18
Queue management	3.44	3.58	3.23
Branch services	3.36	3.50	3.28
ATM services	3.30	3.32	3.20
Loan services	3.31	3.42	3.29
A/c communication	3.06	3.19	3.20
A/c management	3.21	3.26	3.25
Card acquisition	3.19	3.27	3.43
Physical aspects of ATM	3.02	3.11	3.07
Physical environment	3.50	3.59	3.42
Credibility and security	2.81	2.95	3.21
Network accessibility	3.02	3.07	3.20
Composite mean score	**3.21**	**3.32**	**3.24**
Total Respondents (400)	**129**	**166**	**105**
Total Percent (100)	**32.20**	**41.60**	**26.20**

On the basis of commercial banks' year of operation, all commercial banks are classified into three groups, viz., over 20 years, between 5 years to 20 years and less than 5 years of operation. The numbers of respondents of each of the categories were 129, 166 and 105 respectively.

The customers of the banks of more than 20 years of operation had the highest score to physical environment i.e. 3.50, followed by queue management (3.44) and branch services (3.36). Physical environment had the highest mean score (3.59) ranked by the customers of bank having 5 years to 20 years of operation followed by queue management (3.58) and branch services (3.5). The customers of such banks had the least score to credibility and security (2.95). However, the customers of banks with below 5 years of operation had the highest mean score to card acquisition i.e. 3.43 and the least score to physical aspects of ATM (3.07).

The customers of the banks between 5 years to 20 years seemed to be more satisfied than other two types of banks' customers. The composite mean satisfaction score of that bank group was 3.32 which were the highest among others. The composite mean satisfaction score of newly operating commercial banks was 3.24.

Table 5.13
Customers' attitude towards employees' activities and services

Employees activities and services	Mean	Std. Dev.
Employees are available in a timely manner.	3.35	0.74
Employees greeted you and offered to help you.	4.17	0.71
Employees are friendly and cheerful throughout	2.47	0.59
Employees answered all of your questions.	3.36	0.92
Employees showed sufficient knowledge of their services.	3.58	0.98
Employees offered relevant advice.	3.61	0.86
Employees are polite throughout.	3.29	1.02
Employees provide precise information	3.33	1.10
Employees carry out transactions confidentially	3.28	0.81
Employees provide individualized attention	3.33	1.06
Employees enact transactions on a timely manner	2.49	0.52

To make customer happy and satisfied, every bank employee tries to deliver better service and maintain a cordial relations with them. Table 5.13 shows the various components of behavior of the banks' employees and customers' satisfaction. The activities and services of employees related with customers' services include eleven different statements to collect responses of customers.

It is noted from Table 5.13 that employees' greeting and helping behavior had the highest mean score i.e. 4.17 followed by 'employees offered relevant advice'(mean score 3.61), 'employees showed sufficient knowledge' (mean score 3.58) respectively, which indicated that employees were affable and cooperative and care for the needs of the customers. They treated customers with respect and were always ready to help them.

5.1.5 Overall Satisfaction Level of Customers

To measure the overall satisfaction level of the customers, a composite mean score has been determined from the factors such as employee behavior, responsiveness, queue management, branch services, ATM services, loan services, account communication, account management, card acquisition, physical aspect of ATM, physical environment, credibility and security and network accessibility.

When overall satisfaction levels of customers were measured and shown in Table 5.14, 5.15, 5.16, 5.17, 5.18 and 5.19 respectively, it was noted that the percentages of very high, high, average, less and not satisfied customers were 4.2, 28, 49.8, 11.2 and 6.8 respectively. Similarly, it was found that majority of customers (82%) were satisfied from banking services, whereas 18 percent customers were less satisfied and not satisfied. Overall satisfactions of customers from bank services of various types of customers are presented in the following tables:

Table 5.14
Percentage distribution of respondents by level of satisfaction and gender

Satisfaction level	**Male %**	**Female %**	**Total %**	**Total number**
Not satisfied	7.30	5.10	6.80	27
Less satisfied	11.60	10.20	11.20	45
Satisfied	48.30	54.10	49.80	199
Highly satisfied	27.80	28.60	28.00	112
Very highly satisfied	5.00	2.00	4.20	17
Total %	**100**	**100**	**100**	
Total Number	**302**	**98**		**400**

Table 5.14 shows the overall percent of gender wise satisfied customers. The percentage of total satisfied male customers was 81.1 percent (by combining the total share of satisfied, highly satisfied and very highly satisfied within male customers), whereas there were 84.7 percent in female respondents. Among the both genders, the percentage of satisfied customers was 82 percent. It indicates that female customers were more satisfied than their male counterparts from the services of the commercial banks.

Table 5.15

Percentage distribution of respondents by level of satisfaction and age group

Satisfaction level	16-30 years	31-45 years	45+ years	Total %	Total number
Not satisfied	4.60	5.60	10.90	6.80	27
Less satisfied	10.00	12.50	10.90	11.20	45
Satisfied	46.20	51.90	50.90	49.80	199
Highly satisfied	34.60	26.90	21.80	28.00	112
Very highly satisfied	4.60	3.10	5.50	4.20	17
Total	**100**	**100**	**100**	**100**	
Total Number	**130**	**160**	**110**		**400**

The survey reveals that the percentage of overall satisfied customers who fell in age group of 16-30 years of age was 85.4 percent (46.2 plus 34.6 plus 4.6). Similarly the percentages of 31-45 years and above 45 years age groups were 81.9 and 78.2 percent respectively. This analysis shows that the customers in between 16 to 30 years of age group were more satisfied than other two age groups. The respondents of above 45 years of age groups were unsatisfied (10.9%) with the bank services.

Table 5.16

Percentage distribution of respondents by level of satisfaction and education group

Satisfaction level	SLC or below %	Higher Sec. %	Graduate and above %	Total %	Total number
Not satisfied	5.70	8.40	5.80	6.80	27
Less satisfied	12.30	11.60	10.10	11.20	45
Satisfied	51.90	49.70	48.20	49.80	199
Highly satisfied	28.30	24.50	31.70	28.00	112
Very highly satisfied	1.90	5.80	4.30	4.20	17
Total Percent	**100**	**100**	**100**	**100**	
Total Number	**106**	**155**	**139**		**400**

The education level of customers shows that the percentages of overall satisfied customers (including satisfied, highly satisfied and very highly satisfied) with SLC or below, higher secondary and graduate and above were 82.1, 80 and 84.2 percent respectively. It indicates that the customers with graduate and above education level had the highest percent of satisfaction (84.2 percent). Education level wise, the percentage of not satisfied customers (6.8%) was insignificant.

Table 5.17

Percentage distribution of respondents by level of satisfaction and monthly income group

Satisfaction level	Below Rs 20,000	Rs 20,000 to Rs 50.000	Above Rs 50,000	Total %	Total Number
Not satisfied	5.00	3.80	9.00	6.80	27
Less satisfied	8.30	7.60	14.50	11.20	45
Satisfied	43.00	58.20	50.50	49.80	199
Highly satisfied	36.40	27.80	23.00	28.00	112
Very highly satisfied	7.40	2.50	3.00	4.20	17
Total Percent	**100**	**100**	**100**	**100**	
Total Number	**121**	**79**	**200**		**400**

The monthly income wise analysis (Table 5.17) shows that customers having income level of Rs 20,000 to Rs 50,000 group were more satisfied than the other two monthly income levels of customers having the highest percent i.e. 88.5. This is the total percentage of satisfied, highly satisfied and very highly satisfied groups. Similarly, this percent in above Rs 50000 income level group was lowest (76.5) which indicates that the percent of overall satisfied customers of this group was less than other two income level groups. The percentage of not satisfied customers was also highest (9.0) in this group.

Table 5.18

Percentage distribution of respondents by level of satisfaction and by the structure of commercial banks

Satisfaction level	Govt. owned	Joint venture	Private	Total %	Total number
Not satisfied	7.70	7.70	5.60	6.80	27
Less satisfied	8.80	5.40	16.80	11.20	45
Satisfied	49.50	53.10	47.50	49.80	199
Highly satisfied	33.00	29.20	24.60	28.00	112
Very highly satisfied	1.10	4.60	5.60	4.20	17
Total Percent	**100**	**100**	**100**	**100**	
Total Number	**91**	**130**	**179**		**400**

Table 5.18 shows that the percentages of total satisfied customers (sum of satisfied, highly satisfied and very highly satisfied) of government owned, joint venture and private sector commercial banks were 83.6, 86.9 and 77.7 percent respectively which indicates that the customers of joint venture banks were more satisfied than other two

types of banks. The percentage of not satisfied customers in government-owned and joint venture banks was the same i.e. 7.7 percent.

Table 5.19
Percentage distribution of respondents by level of satisfaction and occupational group

Satisfaction level	Student/ others	Service	Business	Total	Total number
Not satisfied	5.10	4.30	8.30	6.80	27
Less satisfied	5.10	11.70	13.20	11.20	45
Satisfied	53.80	46.80	49.60	49.80	199
Highly satisfied	29.50	33.00	25.40	28.00	112
Very highly satisfied	6.40	4.30	3.50	4.20	17
Total Percent	**100**	**100**	**100**	**100.0**	
Total Number	**78**	**94**	**228**		**400**

It is revealed from Table 5.19 that the overall satisfied customers were students group who had the highest percent i.e. 89.7. The percentages of satisfied customers of service and business professions were 84.1 and 78.5 percent respectively. All these indicate that students were more satisfied than other two occupational groups. Surprisingly, businessmen were less satisfied than respondents of other occupations because the percentage of less satisfied customer of business was the highest.

5.1.6 Factors Affecting Customer Satisfaction

The researchers are not in consensus on the factors affecting customer account satisfaction in the commercial banks. Estiri, Hosseini, Yazdani, and Nejad (2011) performed a review of the set of attributes which are capable of being incorporated in the measure of customer satisfaction for Islamic banks. With the grouping the attributes into dimensions of quality and assigning the value to various alternative structures by means of confirmatory factor analysis methodology and testing their reliability and validity, the study revealed that customer satisfaction in Islamic retail banking was dependent on two major factors, value proposition quality and service delivery quality. Singh and Kaur (2011) determined the factors that had impact on customer satisfaction as regards to the working of selected Indian universal banks.

The study conducted using the survey method shows that customer satisfaction was influenced by seven different factors – employee responsiveness, appearance of tangibles, social responsibility, services innovation, positive word-of-mouth, competence, and reliability (Singh and Kaur, 2011). The result of multiple regressions shows that three variables: social responsibility, positive word-of-mouth, and reliability have major influences on the overall satisfaction of the customer. Ganguli and Roy (2011) studied the factors affecting customer satisfaction in the Indian retail banking sector. Online structured questionnaire developed to determine the factors for customer satisfaction, the paper identifies four generic dimensions in the technology-based banking services – customer service, technology security and information quality, technology convenience, and technology usage easiness and reliability. It was found in the study that customer service and technology usage easiness and reliability had positive and significant impact on customer satisfaction.

The present study also argues positive relationships between customer's satisfaction and various factors relating to employee behavior and activities in the Nepalese commercial banks.

Table 5.20
Regression results of customers' satisfaction with bank services and facilities.

$$\mathbf{SC_i = \beta_0 + \beta_1 TM_i + \beta_2 AQ_i + \beta_3 SK_i + \beta_4 RA_i + \beta_5 PT_i}$$

$$+\beta_6 PI_i \quad + \beta_7 CT_i \quad + \beta_8 IA_i \quad + \beta_9 TOT_i \; + \ldots\ldots + et_i$$

Parameters	Value	(se)	(t)
β_0	84.14*	(4.34)	(19.41)
β_1TM	1.05TM**	(0.58)	(1.82)
β_2AQ	1.76AQ**	(0.61)	(2.89)
β_3SK	3.66SK*	(0.48)	(7.67)
β_4RA	3.44RA*	(0.54)	(6.21)
β_5PT	2.96PT*	(0.42)	(7.08)
β_6PI	4.53PI*	(0.58)	(7.76)
β_7CT	5.26CT*	(0.59)	(8.92)
β_8IA	4.45IA*	(0.43)	(10.41)
β_9TOT	3.30TOT*	(0.83)	(3.99)
R^2= 0.75	F(9,390)=126.43	DW=1.78	d.f.=390
Number of observations=400			

Dependent variable: Customer Account Satisfaction

Where

SC= Customer Account Satisfaction TM- Employees are available in a timely manner. AQ- Employees answered all of your questions SK- Employees showed sufficient knowledge of their services. RA- Employees offered relevant advice. PT- Employees *are polite throughout. PI- Employees provide customers with precise information CT- Employees carry out customer transactions confidentially IA- Employees provide individualized attention to customers TOT- Employees enact transactions on a timely manner.*

*Note: * Significant at 0.01 levels*
*** Significant at 0.05 levels*

Table 5.20 shows empirical regression results from multiple regression models. It can be observed that the explanatory power of the model in this study is reasonably high as R^2 is 0.75 indicating that 75 percent variation in the level of satisfaction is explained by variation of the independent variables included in the model. The F statistic of this model is also statistically significant at 1 percent. It confirms the hypotheses that the signs of all independents variables are positive and significant. It means all independent variables affecting positively on customer account satisfaction as per the expectation. It is found that other variables keeping constant, one percent point increase in CT leads to 5.26 percent point on the level of satisfaction of customer. Similarly, it is noted that one percent point increase in TM increase by 1.05 percent point on the level of the satisfaction of customer if other variables kept constant. The variables TM and AQ are significant at 0.05 levels while the rest of the variables are significant at 0.01 levels.

5.2 Employees' Satisfaction Analysis

It is argued that satisfied employees are more productive, innovative, committed and loyal to the firm, which in turn leads to customer satisfaction. This means that employee satisfaction has a central role in predicting profitability and organizational effectiveness. Employee satisfaction is significantly related to incentive structure and carrier development opportunities in the organization. Many firms have enthusiastically applied the operation-centric approach and demonstrated that it is an effective means for improving organizational efficiency. Nevertheless, the impact of human resources on operational systems has often been overlooked. The importance of employee attitudes, such as job satisfaction, employee loyalty, and organizational commitment, and their impacts on operational performance have largely been neglected in the extant management literature (Boudreau, 2004).

Dell (1991) illustrated customer-employee relationship as “a state of customers’ overall good feelings when they interact with sellers”. Past several studies (Garbarino and Johnson, 1999, Johnson et al., 2008, Levesque, 1996) suggested two types of customer satisfaction i.e. overall satisfaction and encounter satisfaction. Overall satisfaction comes from multiple experiences or encounters with the firm (Bitner and Hubbert, 1994), whereas, encounter satisfaction will result from the evaluation of a single, discrete interaction.

Bank customers measure their satisfaction based on a series of encounters or ongoing relationship experiences with the bank’s employees (Dell, 1991). Storbacka et al. (1994) argued that customers’ experiences gathered from all service encounters ultimately influence on their overall satisfaction. Customer-employee interaction is considered even a more vital in some countries (e.g., the Netherlands, Italy, and Kenya) than in other parts of the world where people do not like to be involved in personal interactions (Gremler and Gwinner, 2000). In Pakistan, as personal relationships hold more influence on customers, it may be assumed that customer-employee relationships have stronger impact on customers’ mind for their satisfaction than those countries where personal relationship is not an important factor.

Employees can derive satisfaction from their jobs by meeting or exceeding the emotional wants and needs they expect from their work. Therefore, managers that can recognize this and understand the many different aspects that are involved in employee satisfaction will be successful at achieving the link between employee satisfaction, customer retention and added profitability. A substantial body of research confirms the positive association between employee job satisfaction and customer satisfaction (Bernhardt et al., 2000; Harter et al., 2002).

A common characteristic of all previous research studies is that they have mainly focused on service employees who are in direct and intense customer contact, such as salespeople (Homburg and Stock, 2004, 2005), financial service consultants (Ryan et al.,1996), or service personnel from a restaurant chain (Koys, 2001).

The concept of emotional contagion has been used in marketing research to explain the link between employee job satisfaction and customer satisfaction (Homburg and

Stock, 2004). According to this concept, customers catch certain emotional states of customer-contact employees that are associated with the employee's job satisfaction.

As an example (Homburg and Stock, 2004), the level of experienced job stress is negatively correlated to the employee's job satisfaction. Thus, a highly dissatisfied employee (unconsciously) exhibits a high level of emotional tension expressed through facial expressions, vocalization, and other observable behavior. That tension faced by the customer and consequently affects the customer's satisfaction via the process of emotional contagion (Wild et al., 2001). This creates cognitive tension for the customer as well, which in turn reduces the customer's satisfaction-level.

Employees create value for their organizations through the profitable relationships they create with the organization’s customers. As the research has shown, loyal customers are profitable customers and loyal customers have an emotional connection with the organization, most often because of the employees at the organization. In order for employee value creation to even be a consideration, the employee must be satisfied with his or her employment situation. Satisfied and loyal employees deliver better customer service, make fewer mistakes, and maintain an emotional connection to the organization for which they work. “A series of service encounters between an employee and a customer will lead to a productive and profitable relationship only if the employee is able to achieve consistently high quality in the encounter” (Heskett, Sasser, and Schlessinger 1997).

Research conducted on “Call Centre Employees and Customer” showed that the private and public call centers’ employee and customer relationship are correlated indicating that call centers that have high employee satisfaction also have high customer satisfaction and call centers with low employee satisfaction also have low customer satisfaction. Therefore, service-quality management is a strong opinion that employee satisfaction impacts customer satisfaction for both the public and private sectors. Furthermore, it is demonstrated that a 1% increase in employee satisfaction represents approximately a 2% improvement in customer satisfaction (Mike, 2005).

Many times organizations assume that customers become satisfied if prices and costs are kept low. However, many of the researches have indicated that customers are willing to pay more for service and convenience. Employees create value for their organizations through the profitable relationships they create with the organization's customers. As the research has shown, loyal customers are profitable customers and loyal customers have an emotional connection with the organization, most often because of the employees at the organization (Anthony, 2007).

5.2.1 Personal and Demographic Characteristics of Employees

To achieve the objectives of the study, 400 employees from Nepalese commercial banks were selected for interview. The questionnaire was designed to collect personal information of respondents such as their gender, age, academic qualification, job position, and experience and bank structure of employees and opinions on the various incentives and career development opportunities. The detail personal profiles and demographic characteristics of the bank employees are presented in Table 5.21:

Table 5.21
Percentage distribution of respondents by personal and demographic characteristics

Personal profile details	Male %	Female %	Total	Percent
Age group				
Below 30 years	34.30	29.60	130	32.50
31 to 45 years	58.50	62.50	240	60.00
Above 45 years	7.20	7.90	30	7.50
Total	**248**	**152**	**400**	**100**
Education				
Up to Plus Two	9.70	13.20	44	11.00
Bachelor degree	56.00	58.50	228	57.00
Above bachelor degree	34.30	28.30	128	32.00
Total	**248**	**152**	**400**	**100**
Position of employees				
Assistant level	63.70	75.00	272	68.00
Manager level	36.30	25.00	128	32.00
Total	**248**	**152**	**400**	**100**
Service experience				
Below 5 years	87.10	10.50	232	58
5 to 10 years	4.800	52.60	92	23
Above 10 years	8.10	36.90	76	19
Total	**248**	**152**	**400**	**100**

Table 5.21 exhibits the percentage distribution of employees by personal and demographic characteristics. Of total respondents, there were 248 males and

remaining 152 were females. The percentages of male and female respondents were 62 and 38 respectively. Majority of the employees (92.5%), working in the commercial banks were the age group below 45 years. The percentages of male respondents from age groups below 30 years, 31 to 45 years and above 45 years were 34.3, 58.5 and 7.2 percent respectively. These percentages of female employees were 29.6, 62.5 and 7.9 percent respectively. Table 5.21 shows that more than fifty percent (60%) employees were from 31 to 45 years of age in both the genders followed by below 30 years of age.

When the education status of male employees was analyzed, it showed that there were 9.7 percent employees were found to have higher secondary level, 56 percent bachelor degree and remaining 34.3 percent above bachelor degree. In female respondents, it was found that there were 13.2 percent with higher secondary level, 58.5 with bachelor degree and remaining 28.3 with above bachelor degree. It is noted that majority of the respondents (89%) were of the group of bachelor and higher academic qualifications. It was also found that most of the employees were at least graduates. Employees who had completed their graduate level and higher education level were the main workers and service providers of the banks.

Although there were various levels of bank employees, only two levels, namely, assistant level and manager level, were used for the analysis purpose. The percentage of employees from assistant level was higher (68%) than that of manager level. The percentage of male assistant level and manger level were 63.7 and 36.3 percent respectively whereas the percentages of female assistant level and manger level were 75 and 25 percent respectively. The analysis indicates that percent of male managers is greater than female managers. However, majority of the employees were working in the assistant level.

The respondents by the service experience were classified in three categories ranges from below 5 years' of experience to above 10 years of experience. The analysis indicates that majority (81%) of the employees had less than 10 years of experience. The percentages of male respondents having below 5 years, 5 to 10 years and above 10 years of experiences were 87.1, 4.8 and 8.1 percent respectively. Similarly, among female employees, the percentages of having below 5 years, between 5 to 10 years and above 10 years of experiences were 10.5, 52.6 and 36.9 percent respectively. It was found that the percentage of female employees having more that 10 years of experience was greater than that of male employees. The analysis suggests that more than fifty percent of employees had below five years of experience and they made up the highest group of employees in the banks.

Table 5.22
Distribution of respondents by structure of commercial banks

Structure	Sample respondents	Percent	Total respondents
Govt. owned (3)	188	47	8,893
Joint venture (6)	84	21	3,130
Private (21)	128	32	6,777
Total (30)	**400**	**100**	**18,800**

All commercial banks of Nepal are stratified into 3 categories on the basis of their structure namely, government-owned, joint venture and the private sector banks. The distribution of respondents by pattern of bank ownership is shown in Table 5.22. The numbers of respondents from these banks were 188, 84 and 128 respectively. The percentages of these respondents were 47, 21 and 32 percent respectively. The total 18,800 employees are working in the commercial banks at the end of July, 2012. Of them, there were 8,893, 3,130 and 6,777 employees working in the government-owned, joint venture and the private sector commercial banks respectively. The respondents from government-owned bank were higher than those of other two categories of banks.

Table 5.23
Distribution of respondents by banks' years of operations

Years of operations	Sample respondents	Percent	No. of banks	Total respondents
More than 20 yrs	156	39	5	7,334
5 years to 20 years	172	43	13	8,250
Below 5 years	72	18	12	3,216
Total	**400**	**100**	**30**	**18,800**

On the basis of Nepalese banks' years of operation, all commercial banks are classified into three groups' namely banks with more than 20 years of operation, banks with 5 to 20 years of operation and banks with below 5 years of operation. The numbers of these banks were 5, 13 and 12 respectively in 2012. The numbers of employees working in these banks were 7,334, 8,250 and 3,216 respectively. The employee respondents selected from these banks were 156, 172 and 72 respectively.

The respondents from banks with 5 years to 20 years of operation were greater than those of other two categories of commercial banks in terms of their years of operation.

5.2.2 Employees' Satisfaction on Bank Incentives

The satisfaction level of the employees of commercial banks on incentives and other job related variables was observed by selecting four hundred respondents from all commercial banks. Some statements on key issues such as employee working condition, effectiveness and efficiency, quality performance, training, performance appraisal, quick problem solving, trust building, team work, customer satisfaction and other job related variables are included in the questionnaire and administered to sample employees of all commercial banks of Nepal. The mean scores and level of satisfaction of employees are presented in the Table 5.24:

Table 5.24
Satisfaction level of employees on bank incentives

Reaction of employees	LS	S	HS	VHS	Total %	Mean score
Employee Working Condition	7.25	57.00	35.00	0.75	100	3.29
Effectiveness & Efficiency	0.75	28.25	66.75	4.25	100	3.75
Quality Performance	2.25	26.75	62.75	8.25	100	3.77
Training	0.00	18.25	77.25	4.50	100	3.86
Performance Appraisal	1.00	30.25	52.25	16.50	100	3.84
Quick Problem Solving	5.50	56.75	37.50	0.25	100	3.32
Trust Building	2.50	47.5	47.50	2.50	100	3.50
Teamwork	4.01	41.35	51.40	3.26	100	3.54
Customer Satisfaction	6.77	30.07	58.40	4.76	100	3.61

Where, S=Limitedly satisfied S= Satisfied
HS=Highly Satisfied VHS=Very Highly Satisfied

As per Table 5.24, training appears to be most important factor for the high level of satisfaction of employees. It is observed that employees value training the most; i.e. the mean score of training was the highest (3.86). Performance appraisal appears to be the next variable with the mean score of 3.84. The responses on existing practices of performance appraisal of employees involve three different statements, top management communication, appraisal system and current recognition programs. Among nine different factors, working environment had the least mean score i.e. 3.29.

Most of the employees were not satisfied with the existing employee working condition in Nepalese commercial banks.

Table 5.25
Mean satisfaction scores by gender of employees

Reaction of employees	Mean scores	
	Male	Female
Employee Working Condition	2.89	2.95
Effectiveness & Efficiency	3.37	3.28
Quality Performance	3.40	3.24
Training	3.10	3.14
Performance Appraisal	3.56	3.44
Quick Problem Solving	2.99	2.91
Trust Building	3.16	3.15
Teamwork	3.16	3.10
Customer Satisfaction	3.29	3.14
Composite mean score	**3.21**	**3.15**

Table 5.25 shows performance appraisal had the highest mean score in both male and female respondents among all features. The mean score of this factor was higher in male employees than in female employees. It means male employees were more satisfied than their female counterparts with regards to the existing performance appraisal system of commercial banks. Similarly, quick problem solving had the lowest satisfaction score. The composite mean scores of male and female employees of commercial banks were 3.21 and 3.15 respectively, which implies that male employees were more satisfied than female employees on the incentives provided to the employees by the commercial banks.

Table 5.26
Mean satisfaction scores by various age groups of employees

Responses on	Below 30 years	30-45 years	Above 45 years
Employee Working Condition	2.88	2.92	2.92
Effectiveness & Efficiency	3.34	3.33	3.70
Quality Performance	3.41	3.31	3.31
Training	3.06	3.16	3.06
Performance Appraisal	3.57	3.48	3.56
Quick Problem Solving	2.99	2.94	2.95
Trust Building	3.09	3.21	3.01
Teamwork	3.16	3.11	3.21
Customer Satisfaction	3.25	3.23	3.18
Composite mean score	**3.19**	**3.19**	**3.21**

The respondent employees were classified into three age groups: below 30years, 30 to 45 years and above 45 years respectively. The percentages of respondents in each of the group were 32.5, 60 and 7.5 percent respectively. Out of the total respondents, the largest numbers of respondents were of the age group between 30 to 45 years.

The employees above 45 years considered effectiveness and efficiency as an important factor. Respondents of all age groups considered as second important factor was performance appraisal. The mean satisfaction scores of performance appraisal were 3.57, 3.48 and 3.56 respectively. The responses of the employees showed that employees below 30 years of age considered less important to the employee working condition.

The employees above 45 years of age were more satisfied than other age groups as the composite mean satisfaction score of this group was 3.21, which was the highest. The composite mean satisfaction scores of other two age groups were equal i.e. 3.19, which indicates that both groups were less satisfied than those employees who are more than 45 years of age.

Table 5.27
Mean satisfaction score by level of education of employees

Responses on	**Up to higher secondary**	**Bachelor**	**Post graduate**
Employee Working Condition	2.92	2.89	2.94
Effectiveness & Efficiency	3.23	3.32	3.37
Quality Performance	3.27	3.32	3.40
Training	3.09	3.12	3.13
Performance Appraisal	3.45	3.54	3.49
Quick Problem Solving	3.07	2.90	3.02
Trust Building	3.08	3.16	3.18
Teamwork	3.07	3.12	3.20
Customer Satisfaction	3.07	3.23	3.28
Composite mean score	**3.14**	**3.18**	**3.22**

Table 5.27 depicts the classification of employees in 3 groups based on their level of education. Out of total respondents, 44, 228 and 128 (i.e. 11, 57 and 32 percent) respondents had education level of higher secondary, bachelor and post graduate levels respectively. It can be seen from the table (Table 5.27) that they were satisfied with the performance appraisal in the banks where they worked.

The opinion analysis of the employees on various statements of the performance appraisal system showed that the bachelor level employees had highest score (3.54) in case of performance appraisal of the commercial banks. On the contrary, employee working condition had lowest mean satisfaction score (2.89).

The composite mean satisfaction scores of employees with plus two, bachelor level and post graduate level were 3.14, 3.18 and 3.22 respectively. Employees with post graduate were more satisfied than the other two groups; higher secondary level educations were less satisfied from the bank incentives.

Table 5.28
Mean satisfaction score by position of employee

Responses on	Assistant level	Manager level
Employee Working Condition	2.89	2.96
Effectiveness & Efficiency	3.35	3.28
Quality Performance	3.38	3.27
Training	3.10	3.16
Performance Appraisal	3.54	3.46
Quick Problem Solving	2.96	2.96
Trust Building	3.16	3.15
Teamwork	3.14	3.13
Customer Satisfaction	3.27	3.15
Composite mean score	**3.20**	**3.17**

Although there are different hierarchical levels in Nepalese commercial banks, they are, however, divided mainly into two levels, viz, assistant level and manager level. The percentages of these two levels of employees were 68 and 32 respectively.

It can be observed from table 5.28 that the mean satisfaction score of performance appraisal was highest (3.54) among both levels of employees. However, assistant level respondents were more satisfied with 3.54 scores than their superiors (3.46). The mean score of employee working condition was the least.

Assistant level respondents had the highest composite mean satisfaction score (3.20) than the manager level (3.17). It can be thus seen that assistant level respondents were more satisfied than the manger level.

Table 5.29
Mean satisfaction score by service experience of employee

Responses on	Below 5 years	5-10 years	Above 10 years
Employee Working Condition	2.89	2.96	2.92
Effectiveness & Efficiency	3.36	3.24	3.33
Quality Performance	3.39	3.26	3.32
Training	3.11	3.14	3.11
Performance Appraisal	3.52	3.52	3.50
Quick Problem Solving	2.97	2.96	2.93
Trust Building	3.14	3.17	3.19
Teamwork	3.15	3.13	3.10
Customer Satisfaction	3.29	3.13	3.19
Composite mean score	**3.20**	**3.17**	**3.18**

For experience wise analysis, all respondents were classified into three experience groups, viz, below 5 years, between 5 to 10 years and above 10 years of experience. The mean scores by experience of respondents have been presented in Table 5.29. All the three groups based on experience assigned the highest mean scores to performance appraisal, and the lowest mean satisfaction scores to working condition. Employees with less than 5 years of experience had the highest composite mean satisfaction score (3.20),whereas the least value was 3.17 of employees having experience between 5 to 10 years.

Table 5.30
Mean satisfaction score of employees by bank's year of operation

Responses on	Over 20 years	5 to 20 years	Below 5 years
Employee Working Condition	2.78	2.93	3.06
Effectiveness & Efficiency	3.32	3.40	3.13
Quality Performance	3.32	3.41	3.17
Training	3.08	3.09	3.26
Performance Appraisal	3.54	3.65	3.08
Quick Problem Solving	2.82	3.01	3.03
Trust Building	3.17	3.22	2.95
Teamwork	3.16	3.17	3.00
Customer Satisfaction	3.39	3.24	2.96
Composite mean score	**3.18**	**3.24**	**3.07**

Based on the years' of operation of commercial banks, they are grouped into 3 classes: banks with more than 20 years of operation, between 5 years to 20 years and below 5 years of operation. All respondents of these groups of banks had assigned highest mean scores to performance appraisal. The respondents of banks having 5 to 20 years of operations had assigned to performance appraisal the highest scores

(3.65). They were more satisfied than those of other groups of banks on this issue. On the contrary, employee working condition had lowest mean satisfaction score in all commercial banks irrespective of their years of operations.

Those respondents who were working in banks with 5 to 20 years of operation, they were more satisfied (composite mean score 3.24) than other groups. The respondents over 20 years of operations were least satisfied (mean score 2.78) with the working condition of employees in banks.

Table 5.31
Mean satisfaction score of employee by structure of commercial banks

Responses on	Govt. owned	Joint venture	Private
Employee Working Condition	2.85	2.93	2.98
Effectiveness & Efficiency	3.31	3.42	3.29
Quality Performance	3.34	3.40	3.32
Training	3.11	3.07	3.16
Performance Appraisal	3.53	3.65	3.40
Quick Problem Solving	2.91	2.93	3.04
Trust Building	3.19	3.26	3.04
Teamwork	3.12	3.24	3.10
Customer Satisfaction	3.24	3.46	3.08
Composite mean score	**3.18**	**3.26**	**3.16**

As is shown in Table 5.31, total respondents from government-owned, joint venture and private commercial banks were 188, 84 and 128 respectively, which were 47, 21 and 32 in percent. It is seen that the respondents of joint venture commercial banks assigned the highest mean score to performance appraisal (3.65). Among all the factors, employee working condition had the least mean score.

The employees of joint venture banks were more satisfied than other banks' employees because the composite mean satisfaction score of this group was 3.26, which was the highest among them. Similarly, the composite mean score of private banks was the least, which implies that the respondent employees from this group were less satisfied than others.

In addition, some other issues were also used to measure the satisfaction level of employees. Basically these variables are related with the various services and practices of routine banking functions. The objective behind this analysis is to measure the satisfaction of employees in day to day activities of banks.

Table 5.32
Employees attitude towards bank' incentives and benefits

Bank incentives and benefits	**Mean**	**Std. dev.**
Credits and Payments	3.27	1.09
Credits and Returns	3.23	1.03
Efforts to meet your communication needs	3.29	1.12
Business partner	2.75	0.84
Relationship with our bank's personnel	2.85	1.02
Level of customer support	3.05	1.04
Telephone support systems	2.87	1.05
Delivery of our products or services	3.33	0.97
Efforts to communicate the availability of new products	2.86	1.01

It is apparent from Table 5.32 that most of the employees were satisfied with the delivery of products and services to the customers (the mean score is 3.33, which is the highest among them). Thereafter, 'efforts to communication' had the next highest mean satisfaction score of 3.29, followed by credits and payments (3.27). Out of 10 questions, the mean satisfaction score of four questions were below average implying that the employees were less satisfied in these issues.

The following table (Table 5.33) shows the variables which are related to the attitudes of bank employees to their managerial functions.

Table 5.33
Attitudes of bank employees towards managerial functions

Attitudes of employees on	**Mean**	**Std. dev.**
Likeliness to continue working	3.62	0.99
Company values employees	2.71	1.03
Company honesty	3.08	1.18
Satisfaction of relation with boss	3.78	0.80
Company is helpful	3.05	1.06
Likeliness to provide enthusiastic referrals	3.01	0.97

As can be seen from Table 5.33, among these variables, the highest mean score was 3.78 out of 5. These employees were satisfied with the relationship they had with their boss. Five other variables had mean score more than 3, which indicated they were satisfied and had positive attitudes towards their workplace. However, the variable 'company values employees' turned out to be the lowest with a mean score of only 2.71.

Considering variability and consistency, relationship of employees with their top management was found to be the most consistent variable whereas company honesty had the highest standard deviation and was the highest fluctuating.

Finally, the following table (Table 5.34) describes the employees' responses on different variables which are connected with their motivation, career path, grievance handling, job satisfaction, working hour, management styles etc.

Table 5.34
Responses of employees on different services of commercial banks

Responses of employees	Mean	Std. dev.
Attitude towards bank	3.43	1.06
Training and development activities	3.18	0.96
Career development and grievance handling	3.26	1.10
Promotion and motivation	3.27	1.06
Labor turnover	3.14	0.89
Flexible working hour	3.26	0.90
Job enlargement, enrichment, job rotation	3.89	0.97
Extrinsic and intrinsic factors	2.98	1.08
Types of management- autocratic, democratic etc	3.20	1.16
Working hours per day	3.61	0.85
Holiday and allowances	3.19	1.11
Intra departmental relationship	3.06	0.96
Interdepartmental relationship	3.33	1.04
Communication/information system	3.24	0.76

The attitudes of bank's employees towards banks' facilities and existing managerial practices of bank management are also important factors for successful operation of these banks. Table5.34 shows that the mean score of 3 indicated the employee were satisfied on an average. Similarly, a score of more than 3 indicated satisfied and highly satisfied in these issues. Job enlargement, enrichment had the highest mean scores i.e. 3.89, whereas extrinsic and intrinsic factors had the lowest mean score.

5.2.3 Overall Satisfaction Level of Employees on Bank Incentives

The overall satisfaction level of the employees is measured by computing a composite mean score including the factors such as working environment, effectiveness and efficiency, quality performance, training, performance appraisal, quick problem solving, trust building, team work, and customer satisfaction.

When overall satisfaction level of employees was measured, the percentages of very high satisfied, high satisfied, satisfied, less satisfied and not satisfied respondent employees were 16.8, 40.2, 27.8, 13 and 2.2 percent respectively. Majority of employees (84.8% i.e. 27.8+40.2+16.8) were satisfied from bank incentives out of 400 respondents in commercial banks. Overall percentages of satisfied employees from bank incentives were presented in the Table 5.35:

Table 5.35

Percentage distribution of respondents by level of satisfaction and gender

Level of satisfaction	**Male**	**Female**	**Total %**	**Total number**
Not satisfied	1.60	3.30	2.20	9
Less satisfied	11.70	15.10	13.00	52
Satisfied	29.80	24.30	27.80	111
High satisfied	41.50	38.20	40.20	161
Very high satisfied	15.30	19.10	16.80	67
Total Percent	**100**	**100**	**100**	
Total Number	**248**	**152**		**400**

Table 5.35 reveals that the gender wise overall percent of satisfied employees. The percentage of total satisfied male employees was 86.6 percent (a sum of 29.8, 41.5 and 15.3) while this percentage of female employees was 81.6 percent. It shows that male employees were more satisfied than their female counterparts. It is noted that the overall satisfaction level of female employees was less than that of male employees.

Table 5.36

Percentage distribution of respondents by level of satisfaction and age group

Satisfaction level	**Below 30 year**	**30-45 year**	**Above 45 year**	**Total %**	**Total number**
Not satisfied	2.30	2.50	0.00	2.20	9
Less satisfied	14.60	11.20	20.00	13.00	52
Satisfied	33.10	26.70	13.30	27.80	111
High satisfied	34.60	43.80	36.70	40.20	161
Very high satisfied	15.40	15.80	30.00	16.80	67
Total Percent	**100**	**100**	**100**	**100**	
Total Number	**130**	**240**	**30**		**400**

It is apparent from Table 5.36 that the overall satisfaction level of different age groups of employees shows that the percentage of overall satisfied employees with below 30 years of age was 83.1 percent (33.10+34.60+15.40). Similarly, the percentages of employees of 30-45 years and 45 years and above age groups were 86.3 and 80 percent respectively. The employees of 30-45 years of age group were more satisfied than other age groups. It is surprising that the percentage of very highly satisfied employees was the highest (30%) in that class who falls in above 45 years of age.

Table 5.37
Percentage distribution of respondents by level of satisfaction and education

Satisfaction level	**Up to plus two**	**Bachelor**	**Above bachelor**	**Total %**	**Total number**
Not satisfied	0.00	2.60	2.30	2.20	9
Less satisfied	4.50	15.80	10.90	13.00	52
Satisfied	25.00	26.30	31.20	27.80	111
High satisfied	38.60	39.50	42.20	40.20	161
Very high satisfied	31.80	15.80	13.30	16.80	67
Total Percent	**100**	**100**	**100**	**100**	
Total Number	**44**	**228**	**128**		**400**

When overall satisfaction level of respondents by academic qualification is used, it is found that the employees with higher secondary level were more satisfied than other two groups. Of employees with different education levels, the percentage of satisfied employees was95.4 percent (25+38.6+31.8). The percentages distribution of respondents having bachelor and higher level of education had 81.6 and 86.7 percent respectively. Among respondents of higher secondary level, they seemed to be highly satisfied with the mean scores of 31.8.

Table 5.38
Percentage distribution of respondents by level of satisfaction and position

Satisfaction level	**Assistant level**	**Manager level**	**Total %**	**Total number**
Not satisfied	1.80	3.10	2.20	9
Less satisfied	14..00	10.90	13.00	52
Satisfied	28.30	26.60	27.80	111
High satisfied	40.40	39.80	40.20	161
Very high satisfied	15.40	19.50	16.80	67
Total Percent	**100**	**100**	**100**	
Total Number	**272**	**128**		**400**

The percentages of assistant and manger levels respondents were 68 and 32 respectively. The percentages distributions of satisfied assistant and manager levels employees were 84.1(combining the percentage of satisfied, high satisfied and very high satisfied) and 85.9 respectively. It can be said that the manager level employees were more satisfied than assistant level employees with respect to the bank incentives.

Table 5.39

Percentage distribution of respondents by level of satisfaction and experience

Satisfaction level	Below 5 years	5 to 10 years	Above 10 years	Total %	Total number
Not satisfied	1.70	3.30	2.60	2.20	9
Less satisfied	12.50	7.60	21.10	13.00	52
Satisfied	30.20	23.90	25.00	27.80	111
High satisfied	40.50	42.40	36.80	40.20	161
Very high satisfied	15.10	22.80	14.50	16.80	67
Total Percent	**100**	**100**	**100**	**100**	
Total Number	**232**	**92**	**76**		**400**

When service experience of employees taken as reference for classification, all respondents were grouped into three different classes namely, below 5 years, 5-10 years and above 10 years of service experience. The total percent of satisfied employees of 5 to 10 years' of service group was the highest i.e. 89.1(23.9 plus 42.4 plus 22.8). The percent of satisfied employees of above 10 years of experience was the least i.e. 76.3 percent.

Table 5.40

Percentage distribution of respondents by level of satisfaction and bank's year of operations

Satisfaction level	Above 20 years	5 years to 20 years	Below 5 years	Total %	Total number
Not satisfied	5.80	0.00	0.00	2.20	9
Less satisfied	23.10	9.30	0.00	13.00	52
Satisfied	41.70	17.40	22.20	27.80	111
High satisfied	25.60	47.70	54.20	40.20	161
Very high satisfied	3.80	25.60	23.60	16.80	67
Total Percent	**100**	**100**	**100**	**100**	
Total Number	**156**	**172**	**72**		**400**

Table 5.40 shows that respondents from newly operating commercial banks were fully satisfied with bank incentives and benefits with 100 percent (sum of satisfied, high satisfied and very highly satisfied) score of satisfaction level. Similarly, the percentage of satisfied respondent employees who were working in the banks with 20 years of operation was the lowest i.e.71.1 out of 156 respondents. It is quite surprising that there was no any percentage of not satisfied and less satisfied

respondents in newly operating banks. However, the percentage of less satisfied employees was the highest i.e. 23.1 percent in the banks with more than 20 years of operation.

Table 5.41
Percentage distribution of respondents by level of satisfaction and structure of commercial banks

Satisfaction level	Govt. owned	Joint venture	Private	Total %	Total number
Not satisfied	3.70	2.40	0.00	2.20	9
Less satisfied	12.20	34.50	0.00	13.00	52
Satisfied	30.90	34.50	18.80	27.80	111
High satisfied	38.80	23.80	53.10	40.20	161
Very high satisfied	14.40	4.80	28.10	16.80	67
Total Percent	**100**	**100**	**100**	**100**	
Total Number	**188**	**84**	**128**		**400**

Table5.41 shows that the respondents of private banks were fully satisfied because the percentage of overall satisfied employees of this group was 100 percent (combining satisfied, high satisfied and very high satisfied groups). The percentage of satisfied respondents (from above satisfied category) was 63.1 percent out of 84 respondents in joint venture banks. Within this group, 34.5 percent employees are less satisfied and 2.4 percent were not satisfied with the bank's incentives and benefits.

5.2.4 Factors Affecting Employee Satisfaction

Over the years, many studies have attempted to categorize and find out the factors that affect employee satisfaction (Abdullah et al., 2011) and found wages as the main factor for employee satisfaction, but other factors such as the promotion, recognition of work, and employees loyalty also considered. In addition, salaries and incentives are the most important determinant of employees' job satisfaction (Calisir et al., 2010). Ali and Ahmed (2009) concluded that due to the changes in reward or recognition programs, there will be a corresponding change in work motivation and satisfaction; this means that if there is a greater focus on remuneration and recognition, can have a positive impact as a result of motivation and thus lead to higher levels of job performance. Moreover positive and significant association was found between job satisfaction and management practices such as team work, independence and leadership positions (Hunjra et al., 2010).

Hanif and Kamal (2009), argued that if companies makes favorable strategies and rules for the employees related to pay scales, policy development, staff input, and the work environment, may lead to employee engagement, satisfaction and increased employee loyalty with the organization because satisfied employees are more likely to be welcoming and attentive which attracts customers and the employees not satisfied with the job can lead to customer unhappiness.

Abdulla et al. (2011) examined the relationship between job satisfaction and environmental and demographic factors and found environmental factors (such as salary, promotion and supervision) better predictors of job satisfaction as compared to demographic factors (such as sex, age and education level as well as other factors related to their work experience, such as job level, shift work, and years of experience). Ramman (2011) showed that there was no statistically significant association between demographic factors, and their working environment in travel and tourism companies in Amman and a statistically significant correlation was found between the nature of the employee's job and job satisfaction in the travel and tourism companies in Amman.

Employee satisfaction relates to the design of compensation system for a business, because payment strategies based on compensation system and should appreciate (Lai, 2011). Lai (2011) argued that an efficient compensation system result in organizational growth and expansion and exhibited a positive relationship between employee satisfaction and job-based wages, skill-based pay and performance-based pay. The study concludes that the intrinsic factors of motivation, including recognition, work, career opportunities, professional growth, responsibility, good feeling about the organization that has a significant correlation with job satisfaction, while hygiene (external) factors have no significant relationship with job satisfaction of employees satisfaction.

Table 5.42

Regression equation of employees' satisfaction on bank services

SE = β_0 +β_1BP +β_2CS +β_3DPS +β_4CVE
+ β_5CH +β_6ATB + …+et

Parameters	Coefficients	se	t
β_0	3.90	0.35	10.99
β_1BP	0.15BP*	0.05	2.86
β_2CS	-0.36CS	0.63	-0.57
β_3DPS	0.12DPS*	0.05	2.41
β_4CVE	-0.08CVE**	0.46	-1.73
β_5CH	0.15CH*	0.04	4.13
β_6ATB	-0.10ATB**	0.04	-2.30
R^2= 0.39	F(6,393)=26.55	DW=1.97	d.f.=393

Number of observations=400

*Note: * Significant at 0.01 levels*
*** Significant at 0.05 levels*

Where,

SE =Satisfaction of Employee BP= business partner CS= level of customer support DPS= delivery of our products or services CVE= Company values employees CH=Company honesty ATB= Attitude towards bank

It is observed that the explanatory power of the R^2 is 0.39 indicating that 39 percent variation in the level of satisfaction is explained by variation of the independent variables included in the model. The F statistic of this model is also statistically significant at 1 percent. It is hypothesized that the signs of all independents variables are positive and significant. The sign of CS, CVE and TB observe with a negative impact on employee satisfaction which is just the opposite as per priori.

Remaining predictors BP, DPS and CH are found with positive sign as per expectation. It is found that other variables keeping constant, one percent point increase in CH leads to 0.15 percent on the level of satisfaction of employees. Similarly, it is noted that one percent point increase in BP increases by 0.15 percent on the level of satisfaction of employees if other variables keeping constant. Likewise, one percent point increase in ATB decreases by 0.1 percent on the level of satisfaction of employees other variables keeping constant. Out of six independent variables such as business partner, level of customer support, delivery of our products or services, company values employees, company honesty and attitude towards bank used in above regression model, one independent variable i.e. level of customer support is insignificant.

The regression equation of employees' satisfaction on bank incentives is shown in the following table. During review of many studies, it is found that there is a positive relationship between employees' satisfaction and bank profitability. This study also hypothesized that there is a positive impact of employees' satisfaction on bank profitability in Nepalese context. The result of the regression equation is given below:

Table 5.43

Regression equation of bank profits with employee satisfaction

NP	**= β_0**	**+ β_1 SE**	**+ …….+ et**
	= -184.53*	+ 17.23SE*	
S.E.	= (28.83)	(7.27)	
t	= (-6.40)	(2.37)	
	R^2= 0.68	F(1,398)=15.78	
	Number of obs.=400	d.f.=398	

Where, NP= Net Profits of Bank SE= Overall satisfaction of Employee towards Bank

*Note: * Significant at 0.01 levels*

The simple regression model is shown in Table 5.43. It is found that the explanatory power of the model in this study is reasonably high. The R^2 is 0.68 indicating that 68% of variation in commercial banks' net profit is explained by the variation in the level of satisfaction of employees. The F statistic of this model is also statistically significant at 1 percent indicating the presence of regression. The sign of employee satisfaction is also positive as per the expectation. It means positive impact of employee satisfaction on the net profits of commercial banks. The regression result shows that other things remaining the same, one percent point increase in the level of employee satisfaction leads by Rs 17.23 million in the net profits of commercial banks of Nepal.

After measuring the impact of employee satisfaction on profitability of commercial banks, its extended model is used to determine the impact of employee satisfaction and some of the financial ratios such as capital adequacy ratio, operating expenses ratio, assets composition ratio, credit risk ratio and credit deposit ratio on the profitability of commercial banks. Net profit of commercial banks is affected by several factors such as CAR, OER, ACR, CR, CDR and SE. The present study hypothesized that CAR, ACR; CDR and SE factors have significant positive relation with net profit whereas OER and CR have negative relation with net profit. The given regression model explains the relationship as follows:

Table 5.44

Regression equation of net profits with control variables and employee satisfaction

Np_{it}	$= \beta 0$	$+ \beta_1 xCAR_{it}$	$+ \beta_2 xOER_{it}$	$+\beta_3 xACR_{it}$	$+\beta_4 CR_{it}$	$+\beta_5 xCDR_{it}$	$+\beta_6 xSE_{it}$	$+\ldots+et_{it}$
	=2584.33*	-121.55CAR*	-176.48OER*	-88.47ACR*	-9.5CR*	+ 67.11CDR*	-5.09SE**	
S.E.	=(194.01)	(4.42)	(15.31)	(4.06)	(4.04)	(2.25)	(2.21)	
t	= (13.32)	(-27.52)	(-11.53)	(-21.78)	(-2.35)	(29.78)	(-2.31)	
R^2= 0.92			F(6,393)=707.12	D.W.=1.97				
	Number of obs=400		d.f.=393					

Where,

NP= Net Profits CAR= Capital Adequacy Ratio OER= Operating Expenses Ratio ACR= Assets Composition Ratio CR= Credit Risk Ratio CDR= Credit Deposit Ratio SE = Satisfaction of Employee et= error term

*Note: * Significant at 0.01 levels*

*** Significant at 0.05 levels*

i= 1, 2, 3, …30th commercial banks

t=1, 23,…..tth year.

Table 5.44 reveals the regression results from multiple regression models. It is noticed that, the explanatory power of the model in this study is very high given by the R^2 at 0.92for the net profits model. The F statistic of this model is also statistically significant at 1 percent. The value of DW 1.97 indicates that there is no autocorrelation. It is predicted that the signs of CAR, ACR, CDR and SE are positive and sign of OER and CR are negative. The signs of CAR, ACR and SE show a negative impact on net profits which is just the opposite as per priori.

The regression result shows that out of six independent variables, the signs of three independent variables namely OER, CR, and CDR are as per expectation. The signs of CAR, ACR and SE show a negative impact on net profit which is just the opposite as per priori. It means that other variables keeping constant, one percent (ratio) increase in operating expenses ratio decreases by Rs 176.48 million in net profit. It is found that, keeping other variables constant, one unit (ratio) increase in CDR will increase by Rs 67.11 million in net profit. Similarly, it is noted that one unit (percent) increase in employee satisfaction will decrease by Rs 5.09 million in net profit of commercial banks, if other variables kept constant. All six variables had significant effects on net profit of commercial banks of Nepal.

5.3 Conclusion

Customer satisfaction is one of the major aspects of the Nepalese commercial banking sector. Therefore, an understanding of the factors contributing to customers' satisfaction is essential; as bank managers can check customers' satisfaction scores so as to maintain a high level of their satisfaction.

The foregone analyses showed that customer satisfaction varied according to the nature of the services and behavior of employees. The highest customer satisfaction resulted due to the physical environment of bank followed by queue management, responsiveness of employees, ATM and loan services, price charged by banks, location of bank branches and staff attitude toward problem solving of customers.

Similarly, credibility and security, network accessibility and account communication were less important for customers' satisfaction. It is noted that male customers of more than 45years of age were more satisfied than other age groups of customers. The analysis of respondents by different levels of earning groups of customer revealed that customers having low income group were more satisfied than other income-level groups. Similarly, the customers with high level of education were more satisfied than customers with low level of education.

Prospects of employees' career development in banks were the most important factor for improving employees' satisfaction and loyalty. Other factors such as recognition and rewards, teamwork and cooperation, working conditions, and relationship with supervisors' were also contributed to employee satisfaction and loyalty.

The foregone analyses also showed that performance appraisal played a critical role to increase the employee satisfaction in Nepalese commercial banks. According to Jawahar (2006), performance appraisal is an important element of satisfaction because it was positively related to job satisfaction, organizational commitment and negatively related to turnover intentions. Job satisfaction and organizational commitment fell into a broader definition of loyalty. Regarding employees’ turnover, it implied that the employee would not be loyal if the performance appraisal system was not fair and it did not accurately reflect true employee performance.

An increase in employee satisfaction could actually result in increased employee participation and had the potential of making both the employee and employer equally loyal to the bank. Basically, employees’ satisfaction was dependent on benefits package, training and development, relationship with supervisor, working conditions, teamwork and cooperation, recognition and rewards, empowerment and communication. Whereas, employees’ loyalty was a result of the satisfaction that stemmed from satisfaction variables such as recognition and rewards, working conditions, teamwork and cooperation, and relationship with supervisor.

CHAPTER VI
CUSTOMER ACCOUNT PROFITABILITY ANALYSIS

Traditional management accounting is product driven and internally focused. Modern strategic managerial accounting focuses more strongly outwardly and recognizes the important role of the customers in making an organization successful and profitable. Most management accounting systems focus on products, departments or geographical areas, while have little to do with customers. There are different degrees of focus as at the lowest level of individual customers at a more aggregate level focus on group customers and also focus on different service and distributive channels.

Management accounting may be perceived both as a limitation and/or as a support for new customer-oriented initiatives (Meadows and Dibb, 1998). Generally, the success of new systems should preferably be evaluated in terms of their use in decision-making, though researchers often rely on measures based on management evaluation of success (Foster and Swenson, 1997). In companies attempting to strengthen their customer orientation, the success of new management accounting systems should come up according to their usefulness in decision-making both for the staff units involved in customer-related decisions and for the organizational units with direct customer contact. As per development and emphasis on the marketing strategy (customer oriented strategy), the management accounting system should also come in new role which could link accounting system with customer segmentation.

A potential obstacle to the accounting support of customer orientation may be that accounting departments concentrate on budgetary control and cost allocation with other tasks being left to other departments. Typically, surveys of customer satisfaction are left to the marketing department, which on the other hand focuses less on the cost consequences of customer satisfaction. The same lack of functional integration is often found in business schools where researchers within areas such as service management, marketing and management accounting are often both physically and mentally separated. However, in recent years a number of researchers have done work in the interface between the disciplines. Storbacka (1997), for instance, has linked management accounting with marketing aspects in his work on profitability analysis and segmentation in large banks and other contributions include works by Foster et al. (1996) and Goebel et al. (1998).

In the marketing literature, customer satisfaction is regarded as a key driver of financial performance because it increases the loyalty of existing customers, reduces price elasticity, lowers marketing costs, reduces transaction costs and enhances firm reputation (Reichheld and Sasser, 1990). However, the cost consequences of increasing customer satisfaction are very often not taken into account, although recent research has questioned the assumption that profitability can be maximized by maximizing customer satisfaction (Foster and Gupta, 1997; Ittner and Larcher, 1998).

In the implementation of more market-oriented strategies, it can be a serious obstacle for many financial institutions that the existing management accounting makes it difficult to determine the actual costs of serving specific customers or customer segments. Improving cost analyses often require changes in the management accounting principles (Innes and Mitchell, 1997).

A customer account profitability analysis is an evaluation process that focuses on assigning costs and revenues to different segments of the customer, instead of assigning revenues and costs to the actual products, or the units or departments that compose the corporate structure of the producer. Approaching profitability from this angle can sometimes provide valuable insights into how each step of the process of designing, manufacturing, and ultimately selling a good or service incurs cost and generates revenue. Now a day, some businesses use a customer account profitability analysis as a means of streamlining processes so that they provide the highest degree of efficiency and return, while incurring the lowest degree of cost to compete in the market.

In actual practice, a customer account profitability analysis looks at each segment of the process of creating and selling products to various customers. The idea is to look closely at the costs that are associated with each of those segments, and compare those costs with the gains that result from the processes and procedures connected with the operation of that segment. Breaking down the task into segments makes it much easier to identify what is actually working to increase profitability with a major client or a group of clients within the customer base, as well as what elements may be inhibiting the potential for earning more revenue from those same clients.

Along with aiding in making sure that every aspect of the business operation is functioning in a way that allows for the generation of maximum profits, a customer account profitability analysis can also help in identifying factors that could have a negative impact on the future of the company. For example, most customer account profitability analysis allows for determining what percentage a given customer or group of customers actually make up of the overall client base, usually in terms of revenue generated. If the analysis makes it clear that the company is depending on two or three large customers to generate half or more of the its business volume, then steps are usually taken to diversify and expand the client base, often by attracting more small to mid-sized customers. As a result, the business is less likely to be crippled in the event that one of those major clients decides to withdraw, since the increased bank of smaller customers who are less likely to wander now accounts for a larger share of the monthly revenue.

A proper customer account profitability analysis also looks closely at how much of the company's resources are dedicated to producing goods and services for specific clients. The idea is to determine if the maximum benefit is being earned from the current use of those resources, or if there is some way to allocate a portion of those resources to other functions while still satisfying the customer. Reallocating resources also makes it possible to engage in responsible cost allocation, which in turn strengthens the business over the long term. Companies must not only be able to create high absolute value, but also high value relative to competitors at a sufficiently low cost. Competitive advantage is a company's ability to perform in one or more ways that competitors cannot or will not match.

Michael E. Porter (1980) urged companies to build a sustainable competitive advantage. But few competitive advantages are sustainable. At best, they may be leverage able. A leverage able advantage is one that a company can use as a springboard to new advantages, much as Microsoft has leveraged its operating system to Microsoft Office and then to net- working applications (Kotler et al., 1996). In general, a company that hopes to endure must be in the business of continuously inventing new advantages. Any competitive advantage must be seen by customers as a customer advantage. For example, if a company delivers faster than its competitors, this will not be a customer advantage if customers do not value speed.

The key features of customer account profitability analysis in banking sector make it more distinctive. Commercial banks must focus on building sound customer relationships and advantages. Delivering high customer value and satisfaction leads to repeat purchases and ultimately contributes high bank profitability.

Customer account profitability follows through the entire value chain: analyzing the customers in banking organization, establishing sound information system and updating data recording system. Each department is evaluated from its own value chain. Customer account profitability focuses on the multiple transactions of a customer for proper analysis. By analyzing these transactions, the bank can find the retention rate of customer. There are different types of products and services in the commercial banks. It emphasizes multiple products and services that a customer purchases/selects. One single customer can get two or more than two products and services.

This analysis also helps in identifying more demanded products/services in the bank. Bank management can make differential product/service strategies by using these data. The distinctive feature of customer account profitability is that it can separate costs so that these are customer specific. The customer account profitability uses a methodology to segregate various types of joint cost of bank. This methodology is activity based costing system. Once all joint costs are identified, relevant cost drivers and their volumes are also calculated. Then these costs are separated on the basis of customers. It can be kept at a highly aggregate level or brought down to a very granular level of individual customer. First, all resources are identified in aggregate level. Then these resources are allocated to the individual customer on granular level. It helps in identifying the cost per customer to calculate customer wise profit.

6.1 Analysis of Customer Account Profitability

In the process of computing customer account profitability, four hundred customers from various commercial banks were selected and their records of earning and expenses were collected from the banks for the period ended July, 2012. In analyzing the customers, some customers were depositors, some were creditors and some were both depositors and creditors. The records regarding customers' deposits, interest paid, credit, interest earned and service charges were obtained from the banks at the end of mid July 2012 from the respective banks. The concerned customers were also interviewed to know their reactions towards various services and their level of satisfaction.

The responses of all customers were tabulated and analyzed on the basis of their gender, age, academic qualification, income group, profession, bank's structure and bank's years of operation. This study mainly focuses on the effects of customer satisfaction and employee satisfaction on customer account profitability of commercial banks. Similarly, it also measures the effects of some of the financial ratios and customer satisfaction on the customer account profitability of banks.

Customer account profitability data of all respondents were obtained from the respective commercial banks of Nepal. These account holder customers are both depositors and creditors. Banks pay interest to depositors which are considered as expenses of banks. Similarly, they receive interest from creditors which is considered as income of banks. The customer specific profit or loss had been grouped under five point scale, very low profitable customers to very high profitable customers. It is found that the highest profitable customer contributes Rs 2, 90, 67,310 and lowest profitable customer contributes a loss of Rs 3, 22, 69,515. The details of customer types on the basis of profitability are given in the following table (Table 6.1):

Table 6.1
Distribution of account holder customers by customer account profitability

Types of customers	**Profit range (Rs)**	**No. of customers**	**Percent**
Very low profitable	-32269515 to -20002150	3	0.75
Low profitable	-29992150 to -7734785	12	3.00
Moderate profitable	-7734785 to 4532580	339	84.75
High profitable	4532580 to 16799945	33	8.25
Very high profitable	16799945 to 29067310	13	3.25
Total		**400**	**100**

In table 6.1, 84.75 percent customers were in moderate profit group. Similarly, 8.25 percent of account holders' customers constituted high profitable group of customers. The percentage of very high profitable account holder customer group was 3.25

whereas low and very low profitable customers groups were 3 percent and 0.75 percent respectively. Table 6.1 also shows that account holding majority (combining upper three scales of profitability from moderate to very high profitable group, i.e. 96.25%) of the customers of commercial banks of Nepal were profitable. This clearly shows that the bank should also consider moderate profitable group despite the fact that high and very high profitable groups provide large volume of profits.

Table 6.2
Percentage distribution of account holder customers by gender

Customer group	**Male %**	**Female %**	**Total %**
Very low profitable	0.66	1.02	0.75
Low profitable	2.65	4.08	3.00
Moderate profitable	85.43	82.65	84.75
High profitable	7.62	11.22	8.25
Very high profitable	3.64	2.04	3.25
Total %	**100**	**100**	**100**
Total Number	**302**	**98**	**400**

Table 6.1 indicates that male account holder customers were more profitable than female account holder customers. Of the total 400 account holder customers, the size of male account holder customers was 76 %(302 of 400) as against 24 %(76 of 400) of female account holder customers. Among male customers, about 4 percent customers were very high profitable and around 2 percent female customers were very high profitable customers. In comparison to male, female customers were less profitable. Similarly, the size of female customers of very low profitable groups was greater (1.02 %) than that of male customers (0.66%).

About 85% customers were moderately profitable. However, the percentage of male profitable customers was 96.69 percent (combining moderate profitable, high profitable and very high profitable), whereas the percent of female customers was 95.91 percent. From the analysis, it can be deduced that the male customers are more profitable than female customers for the commercial banks under study.

Table 6.3
Percentage distribution of account holder customers by age groups

Customer group	16-30 Years	31-45 Years	45+ Years	Total
Very low profitable	1.54	0.63	0.00	0.75
Low profitable	0.00	4.38	4.55	3.00
Moderate profitable	90.77	82.50	80.90	84.75
High profitable	4.62	8.75	11.82	8.25
Very high profitable	3.08	3.75	2.73	3.25
Total %	**100**	**100**	**100**	**100**
Total Number	**130**	**160**	**110**	**400**

Table 6.3 shows the classification of customers on the basis of their age groups. The customers are classified into 3 different age groups of 16-30 years, 31-45 years above 45 years respectively. Out of 400 customers, 33% were the age group of 16-30 years, 40% were 31-45 years and 27% were of 45 years above. The customers of below 30 years of age group were more profitable (98.47% i.e. 85.43 plus 7.63 plus 3.64) than other two age groups. It means young customers are valuable customers to the banks. The percentage of very high profitable customer was 3.75 percent, from the age group of 31 to 45, whereas the percentage of very low profitable group (16 to 30 years) customers was highest among other groups i.e. 1.54 percent. Altogether, the percentages of very high profitable, high profitable, moderate profitable, low profitable and very low profitable customers were 3.25, 8.25, 84.75, 3.00 and 0.75 percent respectively.

Table 6.4
Percentage distribution of account holder customers by education level

Customer group	SLC or below	Higher secondary	Graduate and above	Total
Very low profitable	0.90	0.60	0.72	0.75
Low profitable	1.90	5.16	1.44	3.00
Moderate profitable	83.02	86.45	84.17	84.75
High profitable	11.32	4.52	10.07	8.25
Very high profitable	2.83	3.22	3.60	3.25
Total %	**100**	**100**	**100**	**100**
Total Number	**106**	**155**	**139**	**400**

Table 6.4 exhibits the education wise analysis of profitable customers. Accordingly, customers were, by education, grouped into three different classes, up to SLC, higher secondary and graduate and above. The size of the each of the customer groups occupied about 27%, 39% and 34%, respectively. The graduate and above group

(97.84%) was more profitable customers than other two groups of customers, followed by SLC or below group (97.17%) and higher secondary level customers.

Table 6.5
Percentage distribution of account holder customers by monthly income

Customer group	Below Rs 20000	Rs 20000 to 50000	Above Rs 50000	Percent
Very low profitable	0.00	0.00	1.50	0.75
Low profitable	0.83	1.30	5.00	3.00
Moderate profitable	99.17	97.40	71.00	84.75
High profitable	0.00	1.30	16.00	8.25
Very high profitable	0.00	0.00	6.50	3.25
Total %	**100**	**100**	**100**	**100**
Total Number	**121**	**79**	**200**	**400**

Based on their monthly incomes, customers were classified into 'below Rs 20 thousand per month', 'between Rs 20 to 50 thousand per month', and 'above Rs 50 thousand per month' groups. It can be seen in Table 6.5 that just 50 percent of the total respondents were in the income group of more than Rs 50,000, followed by below Rs 20, 000 income groups and between Rs 20,000 to Rs 50,000 income group, respectively. Among these three income level groups, only customers who had more than Rs 50 thousand per month income, 6.5 % were very high profitable, 16% were high profitable, 71 % moderately profitable, 5% low profitable and remaining 1.5% were very low profitable customers.

Table 6.6
Percentage distribution of account holder customers by forms of banks

Customer group	Government owned	Joint venture	Private	Total
Very low profitable	1.09	0.00	1.12	0.75
Low profitable	4.40	0.77	3.91	3.00
Moderate profitable	84.62	89.23	81.56	84.75
High profitable	5.49	6.92	10.61	8.25
Very high profitable	4.40	3.08	2.79	3.25
Total %	**100**	**100**	**100**	**100**
Total Number	**91**	**130**	**179**	**400**

As can be seen in Table 6.6, the percentage (0.75) of very low profitable customers was negligible in the commercial banks of Nepal. Moderately profitable customers of the joint venture banks had the highest percentage of such customers (i.e. 89.23%) followed by the government-owned (84.62%) and the private sector banks. Similarly, in case of high profitable customers, the size of customers was the highest in the private sector (10.61%), followed by the joint venture (6.92%) and the government-owned banks (5.49%).Contrarily, the highest percent of very high profitable customers were in government-owned banks (4.40%), followed by the joint venture (3.08%) and the private sector banks (2.79%). On the whole, the size of moderately profitable to very highly profitable customers was highest in joint venture banks (99.25%), followed by the private sector and government-owned banks respectively.

Table 6.7

Percentage distribution of account holder customers by occupation

Customer group	Students	Job holders	Businessmen	Total
Very low profitable	0.00	0.00	1.32	0.75
Low profitable	1.28	1.06	4.39	3.00
Moderate profitable	98.72	98.94	74.12	84.75
High profitable	0.00	0.00	14.47	8.25
Very high profitable	0.00	0.00	5.70	3.25
Total %	**100**	**100**	**100**	**100**
Total Number	**78**	**94**	**228**	**400**

From Table 6.7, it is obvious that businessmen were very high profitable customers (5.7%) for commercial banks. Among businessmen, the percentage of very high profitable customers was 5.7 percent, while the size of very low profitable customers among them was 1.32 percent. Similarly, the percentage of moderate profitable businessmen was 74.12%. The percentage of moderately profitable to highly profitable customers from students, job holders and businessmen were 98.72, 98.94 and 94.29, respectively.

Table 6.8

Percentage distribution of account holder customers by banks' years of operation

Customer group	**Above 20 years**	**5-20 years**	**Below 5 years**	**Total**
Very low profitable	0.77	0.00	1.90	0.75
Low profitable	3.10	3.61	1.90	3.00
Moderate profitable	86.82	84.34	82.86	84.75
High profitable	4.65	9.64	10.48	8.25
Very high profitable	4.65	2.41	2.86	3.25
Total %	**100**	**100**	**100**	**100**
Total Number	**129**	**166**	**105**	**400**

As shown in Table 6.8, The percentage distribution (96.39%) of moderately profitable to very highly profitable customers was the highest in banks' having 5 years to 20 years of operation, followed by banks having below 5 years of operations (96.20%) and banks having more than 20 years of operations (96.12%).The percentage of low profitable customers is also negligible.

After analyzing the profitability of customers on the basis of their economic and demographic characteristics, an attempt has been made to analyze profitability in relation to satisfaction level. To achieve this objective, the respondents were grouped into 5 point scale of satisfaction and profitable groups. The detailed analysis of these findings is presented below (Table 6.9):

Table 6.9

Percentage distribution of account holder customers by their profitability and satisfaction levels

Satisfaction	**Very low profitable**	**Low profitable**	**Moderately profitable**	**High profitable**	**Very high profitable**	**Total**
Not satisfied	0	0.5	5.5	0.5	0.25	**6.75**
Limited satisfied	0	0.25	9	2	0	**11.25**
Satisfied	0.75	1.25	42	3.75	2	**49.75**
High satisfied	0	1	24.25	1.75	1	**28**
Very high satisfied	0	0	4	0.25	0	**4.25**
Total	0.75	3	84.75	8.25	3.25	**100**

Table 6.9 shows the percentage distribution of account holder customers by their profitability and satisfaction in five point scales. It is seen in the table that the number of not satisfied, limited satisfied, satisfied, highly satisfied and very highly satisfied respondents were 27 (6.75%), 45(11.25%), 199(49.75%), 112(28%) and 174.25%) respectively. Similarly, the number of 'very low profitable', 'low profitable', 'moderately profitable', 'highly profitable' and 'very highly profitable' respondents were 3 (0.75%, 12 (3%0, 339 (84.75%), 33 (8.25%) and 13 (3.25%) respectively.

The very low profitable and not satisfied customers did not exist. Similarly, the percentage of very low profitable and limited satisfied customers was also not existed. Likewise, the percentage of very highly profitable and not satisfied customers was negligible. The very highly satisfied with very highly profitable customers did not exist. The overwhelming, majority of medium profitable account holder customers fall in all groups of satisfied customers. It is noted that 82 percent (sum of satisfied, high satisfied and very high satisfied customers) customers were satisfied from the bank services.

The majorities (84.75%) of the respondents were moderately profitable and were scattered at all levels of satisfaction group. The percentage of moderately profitable with satisfied customer was 42 percent, which was the significant group of customers. There were 24.25 percent customers who were moderately profitable with highly satisfied group.

Altogether, the percentage of highly profitable customers was 8.25%. There were 3.75 percent high profitable customers who are satisfied from the banks' products and services. The percentage of high profitable and very high satisfied customers was negligible. Similarly, the percentage of limited satisfied with high profitable group was also insignificant, i.e. 2 percent.

There were 3.25 percent customers in very high profitable group. The percentage of limited satisfied and very high satisfied was nil. Similarly, the percentage of satisfied and high satisfied with very high profitable customer was 2 percent and 1 percent respectively. The percentage of low profitable customers from all satisfaction levels was only 3 percent. There were no any respondents who were very highly satisfied in this group. Remaining groups of customers are also negligible.

6.2 Satisfaction-Profitability Matrix

Satisfaction-Profitability Matrix is a framework for measuring satisfaction and assessing the profitability of an organization's customer base. Frameworks are useful as they provide a practical way to better understand business strategies. In the case of the Satisfaction-Profitability Matrix, it is a versatile approach, providing businesses with a practical means to leverage the voice of the customer for improved business performance.

From a business perspective, this matrix enables companies not only to understand some of the motivation behind the customer behavior, but also provide a better barometer of revenue, profit, risk, and an organizational call to action.

This breakdown provides a very practical and flexible way of segmenting customers. For each of these quadrants specific action plans can be drawn to dramatically improve business performance.

To measure the percent of satisfaction and percent of profitability of customers of commercial banks, all account holder customers are classified into five categories. These five groups are distributed into four quadrants satisfaction- profitability matrix, A, B, C, and D. This satisfaction-profitability matrix can be formed with high and low satisfaction and profitability on its X and Y axis. Profitability is dependent up on the satisfaction level of customers so satisfaction level is plotted in X-axis whereas profitability is plotted in Y-axis. The customers can be divided into four groups to give four quadrants, A, B, C and D.

Figure 6.1 shows the breakdown of the numbers of respondents comprising each segment. The strategies for each of the segment are described in the following sections:

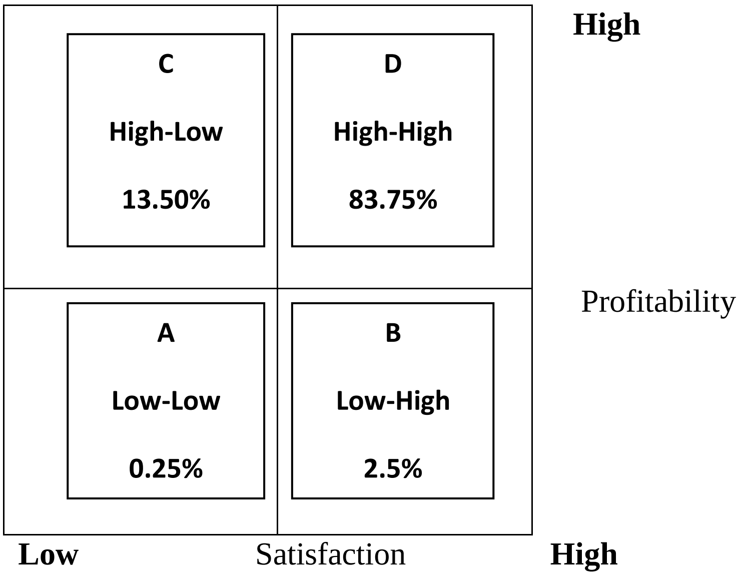

Figure 5. Satisfaction –Profitability Matrix

A (low satisfaction, low profitability)

Quadrant A is the combination of percentages of not satisfied plus limited satisfied customers combining with very low profitable and low profitable customers. There were no any customers who were not satisfied and very low profitable customers. Similarly, the percentage of limited satisfied and very low profitable customers was nil. There was 0.25% of the respondents fall in this category. These are 'lost' customers. The bank can divide them in two groups: students and others. As far as the 'others' category is concerned, the bank can show some complacency in its allocation of marketing and promotional budgets. But the category comprising of students should not be ignored. Thus the bank should focus on improving their satisfaction scores and bring them into the B quadrant.

B (high satisfaction, low profitability)

In this quadrant, satisfied, high satisfied and very high satisfied customers along with very low profitable and low profitable customers were grouped. This segment comprises those customers who were not profitable for the bank but they were very satisfied to the bank. Figure 6.1 shows that the 2.5% of customers falls into the lowest profitability zone. But there is a hidden potential in this low profitability segment. The bank should thus try to increase their satisfaction scores further so that these customers will have good feelings about with the bank and emotional ties to it so that they will continue their relationship with the bank in the future when they will be more profitable customers.

The bank should try to move these customers to the higher segment, as they may affect the decision of potential customers through word of mouth, which is a very important and credible source of information when selecting a new service provider, by making them more aware of its existing services and convincing these potential customers to use them, thus increasing their revenues with the bank.

C (low satisfaction, high profitability)

This segment, which forms a share of 13.5 per cent, represents those customers who are currently profitable for the bank today but who will shift over to competitors any time they get a better opportunity. This segment is one which can very easily make or break the bank’s market share, as the bank is most vulnerable to lose them. The bank should specifically focus on this segment and customize its service to them. The bank should try and identify that set of attributes which was rated very poorly, like extending service after banking hours, etc and try to amend them. The bank should also try to please these customers by giving them specialized service and attention, gifts and other incentives time and again to increase their satisfaction and shift them to segment D. A little effort on the part of the bank towards improving the satisfaction of this segment should reap benefits in future.

D (high satisfaction, high profitability)

This segment, with a share of 83.75 percent, represents the bank’s platinum customers. They are the bank’s most priced assets and the bank should try to develop highly personalized and customized set of services, perks and promotional schemes for them to make them feel special and cared for. They should not be taken for granted by the bank and no complacency should be shown towards them at any cost. From time to time they should be given such perks and differential treatment that makes them feel great and different from the rest. This will not only help in strengthening their current satisfaction scores but also demonstrate to customers in the other segments the benefits and special care which is available by increasing their satisfaction and profitability scores.

6.3 Regression Model for Customer Account Profitability and Satisfaction

A growing number of accounting theoreticians believed that customer satisfaction can provide incremental information, and multiple performance measures should be applied to financial sectors. However, little empirical evidence is available on the behavior of non-financial measures. Using 2-year data from 30 commercial banks of Nepal, this study provides evidence on the relationship between customer satisfaction and customer account profitability. Many of the research studies reviewed have shown a positive relationship between customer account satisfaction and customer account profitability. The present study also hypothesized that there is a positive impact of customer account satisfaction on customer account profitability in Nepalese context. The result of the test of the relationship using regression equation is given below:

Table 6.10

Regression result of customer account profitability as dependent variable and customer account satisfaction as independent variable.

CAP	**= β_0**	**+ β_1SC**		**+……..+ et**
	= -10380*	+ 4395SC*		+……..+ et
S.E.	= (762.05)	(292.23)		
t	= (-13.62)	(15.04)		
	R^2= 0.36			
		F(1,398)=226.19		
	Number of obs.=400		d.f.= 398	

Where, CAP= Customer Account Profitability SC=Customer Account Satisfaction et-errors

*Note: * Significant at 0.01 levels*

The result of the regression model shows that the explanatory power of the model is reasonably high. The R^2 is 0.36 indicating that 36% of variation in customer account profitability is explained by the variation of customer account satisfaction. The F statistic 226.19 of this model is also statistically significant at 1 percent indicating the presence of regression. The sign of customer satisfaction is also positive as per the expectation. It means that the positive impact of customer account satisfaction on the customer account profitability hypothesis is also true in Nepalese case. The regression result shows that other things remaining the same, one percent point increase in the level of customer account satisfaction leads by Rs 4,395 thousand in the customer account profitability.

The extension of the single variable analysis with the inclusion of financial ratios as the other independent variables in the model is also expected to form a strong model of customer account profitability, and customer account satisfactions and financial variables for customers' segmentation and planning for banking services. Various fragmented studies in this area have demonstrated the mixed relationship between customer account profitability and capital adequacy ratio, operating expenses ratio, assets composition ratio, credit risk ratio, credit-deposit ratio and customer account satisfaction level.

Majority of studies have examined the relationship between customer account satisfaction along with financial ratios and customer account profitability. Studies investigating the link between non-financial measures and future financial performance showed mixed results. From economists' perspective, customer satisfaction is a reflection of products and services inputs (Lancaster（1979）and Bowbrick（1992), but these inputs may not certainly improve a company's performance. To achieve high customer satisfaction, a company always needs heavy investments, which probably lower its profits. For instance, Tornow and Wiley (1991) found a negative correlation between customer satisfaction and gross profits. The study by Foster and Gupta (1997) of the association between satisfaction measures for individual customers of a beverage wholesale distributor and its current or future customer profitability also found positive, negative, or insignificant relations depending upon the questions included in the satisfaction measures or model specification (levels of percentage changes).

However, most research results actually showed that customer satisfaction is significantly related with current and future customer account profitability. Such researchers as Nelson, Rust, Zahorik, Rose, Batalden, and Siemanski (1992) have found that this positive relationship exists and it is applied to all profitability measures—earnings, net revenues, and return on assets. Plenty of empirical researches in the last decade showed that customer satisfaction was positively relevant to customer account profitability. Anderson et al. (1994) studied the relationships between customer satisfaction and the profitability of customers on Swiss commercial banks. They found that customer satisfaction and customer account profitability are of significantly positive correlation. With the research on customers, operating entities and companies, Ittner and Larcker（1998）discovered that customer satisfaction with future financial ratios and customer account profitability are highly positively correlated, and that there is evidence showing that the publication of customer satisfaction measure will yield incremental information on stock market. Banker et al.（2000）found the positive correlation between customer satisfaction and financial performance in 18 hotels run by a company. They also discovered that, when non-financial measures were included in the payment contracts, managers would attempt to keep in accordance with these non-financial measures and finally improve the corporate performance.

In the analysis by Baker et al.（2000) of a restaurant‘s 342,308 consumer responses, 3,009 employee responses, and its 12-month performance measures, no significant relationship between customer satisfaction and financial performance was found. But the analysis of time-series data revealed that a positive and significant relationship exists between changes in customer satisfaction and those in the performance of the company. This may show that the impact of an increase in customer satisfaction on profits, although obscured in the short run, is significantly positive in the long run.

Despite the fact that a substantial amount of research has focused on the impact of customer satisfaction on customer account profitability, there has been relatively little research attention given to the banking sectors. As a main domain of service industries, commercial banks are producing intangible products and have been trying to satisfy their customers with their services in accordance with their operating goals. Customer satisfaction is the very first step of commercial banks’ main operation and it is the very direct outcome of their services. In the banking industry, a motivation for the increase of customer satisfaction is more able to be the provision of a reliable signal of customer satisfaction with links to long-term performance (Fornell et al., 1996). Anderson, Fornell, and Rust (1997) argue that services are more likely than goods to have tradeoffs between customer satisfaction and profitability. Therefore, the profitability and value of banking industry would make the firm more susceptible to customer satisfaction than any other industry.

This study examines whether customer satisfaction and some of the financial ratios such as capital adequacy ratio, operating expenses ratio, assets composition ratio, credit ratio and credit deposit ratio and customer account satisfaction as the independent variables influence the customer account profitability in the commercial banks.

Therefore, the present study hypothesizes that capital adequacy ratio, assets composition ratio, credit deposit ratio and satisfaction levels of customers have a significant positive relation with customer account profitability whereas operating expenses ratio and credit risk ratio have a negative relation with customer account profitability. The regression result with the inclusion of financial ratios is given below:

Table 6.11

Regression result of customer account profitability as dependent variable with customer account satisfaction and other controlling variables.

CAP_{it}	$= \beta 0$	$+ \beta_1 CAR_{it}$	$+ \beta_2 OER_{it}$	$+\beta_3 ACR_{it}$	$+\beta_4 CR_{it}$	$+\beta_5 CDR_{it}$	$+\beta_6 SC_{it}$ $+\ldots+et_{it}$
	=5.42*	-0.12CAR*	-0.15OER*	+0.08ACR**	-0.17CR	+ 0.32CDR*	+0.58 SC*
S.E.	=(1.32)	(0.05)	(0.18)	(0.01)	(0.09)	(0.14)	(0.21)
t	= (17.24)	(11.32)	(9.68)	(2.02)	(0.87)	(6.75)	(9.21)
	R^2= 0.78			F(6,393)=114.27	D.W.=2.08		
	Number of obs=400			d.f.=393			

Where,

CAP= Customer Account Profitability CAR= Capital Adequacy Ratio OER= Operating Expenses Ratio ACR= Assets Composition Ratio CR= Credit Risk Ratio CDR= Credit Deposit Ratio SC = Customer Account Satisfaction et= Error term

i= 1, 2, 3 … commercial banks

t=1, 2, 3… year.

Note: * *Significant at 0.01 levels*

** *Significant at 0.05 levels*

The explanatory power of the model (R^2) is reasonably high as it is at 78% for the CAP model. The F statistic is also statistically significant at 1 percent. The value of DW 2.08 indicates that there is no autocorrelation. . The regression result shows that out of six independent variables, the sign of five independent variables namely OER, ACR, CR, CDR and SC are as per expectation. The sign of CAR shows a negative impact on CAP which is just the opposite as per priori. It means that other variables keeping constant one percent ratio increase in operating expenses ratio decreases by Rs 0.15 million in CAP. It is found that, keeping other variables constant, one unit ratio increase in CDR leads Rs 0.32 million in customer account profitability. Similarly, it is noted that one unit (percent) increase in customer satisfaction increases by Rs 0.58 million, other variables keeping constant. Among six variables, only credit risk ratio does not have a significant relationship with customer account profitability.

6.4 Conclusion

By analyzing customers account profitability of commercial banks in Nepal, it is concluded that the majority of the customers were moderately profitable who were dispersed in all level of satisfaction. Likewise, the percentage of very high and low profitable customers was also negligible. With the inclusion of control variables, assets composition ratio, credit deposit ratio and satisfaction of customers showed a positive impact on customer account profitability whereas, capital adequacy ratio, operating expenses ratio and credit risk ratio showed a negative impact on customer account profitability of commercial banks in Nepal. The result shows that customer satisfaction was significantly associated with customer account profitability. However, the other financial variables also played an important role in increasing customer account profitability.

CHAPTER VII

SUMMARY, MAJOR FINDINGS AND CONCLUSION

7.1 Summary

In recent years, commercial banks have been offering a number of services in order to meet the increasing needs and demands of their customers. There is no doubt that the attraction of investors in banking sector, increasing competition, advancement in technology, changing preferences of customers as well as convenience options have made banking sector more riskier and challenging. Further, to overcome the increasing competition in the banking sector, they constantly aim to increase the satisfaction level of their customers by meeting their requirements and hence, converting the satisfied customers into loyal customers.

Due to intensified economic globalization and makes an environment of constant transform, winning and keeping customers has become more significant. To realize this goal, the commercial banks undergo thorough analysis and evaluation of customer account profitability and come up with relevant marketing strategies in order to attract potential customers and retain the regular ones. On the basis of these strategies, they tend to expand their services and finally strengthen their financial performance.

Banking business is a service-oriented business which provides varieties of products and services to a diverse group of customers. Commercial banks, too, need to achieve the required level of profit by offering different range of services to its end customers. Obtaining the desired level of profit helps in the development and expansion of commercial banks.

Customer account profitability analysis is a long term strategy in which profit gained from any customer of a company is analyzed in several respects. In other words, profit gained from every customer of a company is individually calculated and the most profitable customer and non-profitable customer from among the existing customer group are screened out. The company then prepares various marketing strategies in order to retain the most profitable customer and the ways to convert non-profitable customers into profitable ones. For this, customers need to be loyal towards the company and satisfied with the services they are receiving from the company. This research has tried to study the above-mentioned facts centering the study on those main issues.

When the employees are satisfied, their motivation level is relatively high which ensures that the employees are more dedicated towards their work and provide better services to their customers as well. This further result in higher satisfaction level of customers making them more attracted towards the banks' services which, in turn, leads to higher customer account profitability. Such an assumption marks the initiation of this research study.

To achieve the main objective of the research, several articles related to this subject were reviewed where it is found that satisfaction level of employees of a bank has a positive impact on the bank's profit and the behaviors of employees play significant role to increase the satisfaction level of customers. Similarly, various researches also suggested that the capital, operating expenses, deposit and credit of the banks also have positive as well as negative impact on the bank profit.

A sample of four hundred employees and customers of the commercial banks was taken in order to measure their satisfaction levels and finally analyze the profitability of individual account holder customer. Moreover, some selected financial ratios such as capital adequacy, operating expenses, assets composition, credit risk and credit deposit ratio of commercial banks had been included in the study so as to evaluate the nature and intensity of their impacts on the customer account profitability as well as the overall profitability of the commercial banks in Nepal

In the context of Nepal, by considering the sudden growth and intense competition in the banking business from the past two decades, customers of commercial banks had been sampled and evaluated on several grounds in order to analyze their profitability. Attracting customers in any business is difficult and challenging task. To attract the customers, the way employees behave with customers play a significant role. The degrees of influence of employees' behavior on customer satisfaction and the effects of customer satisfaction on customer account profitability had also been analyzed in this study.

This study makes an attempt to show the financial performance, trend and present status of commercial banks in Nepal. Some of the financial ratios such as capital adequacy ratio, operating expenses ratio, assets composition ratio, credit risk ratio and credit deposit ratio as well as net profit along with two profitability ratios, return on assets and return on equity had been calculated and compared to find their competitive position. The effect of such ratios on return on assets, return on equity and net profit at aggregate level in addition to the effect on customer account profitability were also computed. The research is centered on profitability analysis of account holder customers of commercial banks in Nepal.

7.2 Major Findings

- It is found in the study that more than 50 percent commercial banks have low capital adequacy ratio. The capital adequacy ratio of government-owned commercial banks found lowest in comparison to other types of commercial banks. Among three government-owned commercial banks, only ADBN had satisfactory capital adequacy ratio. NBL and RBB had below two percent capital adequacy ratio, which is very low in comparison to industry average. The regression analysis of capital adequacy ratio shows that there was inverse relationship between the banks' capital adequacy ratio and their profitability. This result is consistent with the research of Berger (1995). He argued that a higher capital adequacy ratio was associated with lower profitability, because higher capital adequacy ratio had a tendency to reduce the risk on equity and therefore lowered the expected return on equity required by investors.
- More than 50 percent commercial banks had low operating expenses ratio in comparison to industry average. Government-owned and newly operating private sector banks had high operating expenses ratios. Due to high operating expenses ratios, the level of profit margin of the bank might be low. From analysis, it is found that the net profits of private banks were lower than the government-owned commercial banks. The regression result of the operating expenses ratio also had negative relationship with the profitability of banks. This finding is in tune with the findings of Miller and Noulas (1997). They found that the higher the fraction of total expenses incurred through noninterest sources, the strongest the negative effect is on profitability.

- The newly operating private commercial banks had higher assets composition ratio than the other commercial banks. The higher the assets composition ratio, the greater the amount of loan provided by the bank. Government-owned banks had lowest assets composition ratio of all the banks. Newly operating commercial banks had high assets composition ratio. Government-owned commercial banks had lowest assets composition ratio, while the private sector commercial banks had highest assets composition ratio. The assets composition ratio of the bank had negative significant impact on their profitability. This finding was consistent with the study of Staikouras and Wood (2004) and Bashir and Hassan (2003) documented a significantly negative relationship with the profitability. On the contrary, the findings of Abreu and Mendes (2000) were significant positive relationship between assets composition and profitability.
- Credit risk ratio of government-owned commercial banks is found greater than other commercial banks. It indicates that there is high chance of slow or not recovery. High credit risk ratio indicates that assets are not effectively utilized or the loan department is not alert while sanctioning loans to the customers. Therefore, lower ratio will be preferred. The regression result shows that credit risk ratio has a negative impact on bank's profitability. This finding is balanced with the research findings of Athanasoglou, et al., (2008) and Miller and Noulas (1997). They find that the effect of the credit risk on the profitability is negative in the USA. In contrast to this, Al-Haschimi (2007) finds a positive effect of credit risk on profitability in Sub-Saharan Africa.
- Overall credit deposit ratio of commercial banks was about close to NRB directives. Nepal Rastra Bank had set standard of credit deposit ratio below eighty percent. Most of newly operating commercial banks had more than the industry average. On an average, government-owned commercial banks had lowest credit deposit ratio, except ADB/N, whereas private sector commercial banks had highest credit deposit ratio. The regression result shows that credit-deposit ratio has a significantly positive relationship on profitability of commercial banks in Nepal. This result is similar to the findings of Miller and Noulas, (1997). They suggest that for banks, customer deposits have a lower interest expense than other sources of interest-bearing liabilities. Therefore,

increasing the share of liabilities held in deposits should lower interest expenses which lead to improve profitability of banks.

- It is found in the study that there is a significantly positive impact of employee satisfaction on profitability of commercial banks. This finding was consistent with the finding of Lai (2011). He argued that the satisfaction level of employee results in organizational growth by increasing the profitability of banks.
- The regression model reveals that there is a significantly positive impact of satisfaction level of customers on customer account profitability of commercial banks in Nepal. Level of customer satisfaction shows a significantly positive relationship with customer account profitability indicating that the bank has to bear expenditures for increasing satisfaction level of customers. This finding is in support of many researchers' studies such as Nelson, Rust, Zahorik, Rose, Batalden, and Siemanski (1992). They found that customer satisfaction led to increase customer account profitability. Anderson et al. (1994) studied the relationships between customer satisfaction and profitability of customers on Swiss commercial banks. Their results showed that customer satisfaction and customer account profitability are significantly positive correlation.
- The greatest importance was given to the physical environment, queue management and responsiveness. Queue management was seen to be the most important variable for the customers of joint venture banks. Customers were highly satisfied from the behavior of employees in the commercial banks. Similarly, they were also highly satisfied from the queue management system adopted in the commercial banks. The account holder customers of joint venture banks' were more satisfied than other commercial banks from the behavior of employees. Similarly, government-owned banks' customers were more satisfied than other banks from branches services. From loan services, government-owned commercial banks customers were found to be more satisfied than others. Private Banks are more popular than others in terms of net work accessibility.
- Newly operated commercial banks give proper account communication services to the customers. They were satisfied from this service. Medium aged

banks had more features in automatic teller machine in comparison to other types of commercial banks.

- Banks provide several services to the customers. Services after banks hours had been found out to be the most important variable whereas cleanliness of the bank had been given the least importance. Most of the customers were highly satisfied from the extending banking services after banking hours and courtesy of employees towards customers. Similarly, they were also highly satisfied from the instructions followed by employees which were given by them. Few customers were extremely dissatisfied due to the absence of supervisors when they required and delay addressing their requests.
- Training and performance appraisal were ranked as the first and second highly valued variables respectively. Male employees under 30 years of age who had completed their graduate level studies seemed to place the highest importance on performance appraisal and the lowest importance on employee empowerment. Employees working on the assistant level having work experience of less than 10 years in the joint venture banks placed the highest importance on performance appraisal and the lowest on employee empowerment. Female employees falling in the age group of over 45 years were more satisfied than other groups. Managerial level employees having high academic qualification were found more satisfied. Employees who had about 10 years of service experience are the most satisfied group. Private commercial banks' employees, working in middle aged banks were the most satisfied.
- Majority of account holding customers of commercial banks of Nepal were profitable. Within them, male customers were more profitable than female customers. Similarly when the age of respondents was analyzed, it is found that young customers were valuable customers to the banks.
- When education status and income capacity of respondents are considered, it reveals that the customers with graduate & above academic level were more profitable customers than other groups and the share of moderate profitable customers was higher in all the income groups of customers.
- The percentage share of very low profitable customers was negligible in the commercial banks of Nepal. The customers of all the forms of commercial

banks were enjoying with moderate profitable customers. The share of moderate profitable customers in joint venture commercial banks was highest whereas government-owned banks had highest percentage of very high profitable customers and private banks had high profitable customers among all.

- It is found that businessmen were very high profitable customers for commercial banks. Similarly, the percentage share of high and very high profitable customers from students and job holder customers was nil.
- The percentage of profitable customers of medium-aged banks was highest among other two types of commercial banks whereas the customers of low profitable and very low profitable from all banks were negligible.
- The very low profitable customers did not exist in each of the category of satisfaction except in the case of satisfied customers. Similarly, the percentage of low profitable customers was also negligible in all the categories of satisfied customers. Likewise, the number of very highly profitable customers in all categories of satisfied customers was negligible.
- The overwhelming majority of profitable account holder customers fall in all groups of satisfied customers. The very highly satisfied with very highly profitable customers did not exist. The majority of the respondents were medium profitable group who fall in all five levels of satisfaction group.
- The regression result showed that out of five independent control variables included in the model, the two independent variables, viz. credit risk ratio and credit deposit ratio had a positive significant effect on return on equity where as capital adequacy ratio, assets composition ratio and operating expenses ratio had a negative impact on return on equity of commercial banks. Similarly, in the case of return on assets as a dependent variable, capital adequacy ratio, operating expenses ratio and assets composition ratio showed a negative impact and credit deposit ratio showed a positive effect on return on assets whereas credit risk ratio does not play any significant role.
- Capital adequacy ratio, assets composition ratio and credit deposit ratio had the significant effect on average net profits of commercial banks. Among them three ratios i.e. capital adequacy ratio and assets composition ratio showed a

negative and credit deposit ratio plays a positive impact on average net profits of commercial banks.

- It reveals that there was a significant impact of some of the selected financial ratios such as capital adequacy ratio, operating expenses ratio, assets composition ratio, credit risk ratio and credit deposit ratio and satisfaction level of customer on customer account profitability of commercial banks. Level of customer satisfaction, assets composition and credit deposit ratio showed a positive relationship with customer account profitability whereas capital adequacy and operating expenses ratios showed a negative relationship with customer account profitability.
- The regression model which includes employees' satisfaction as dependent variable and six other variables such as business partner, delivery of our products and services, company honesty, level of customer support, company values employees and attitude towards bank as independent variables provided expected sign with respect to business partner, delivery of our products and services and company honesty while, the sign of level of customer support, company values employees and attitude towards bank was found a negative impact on satisfaction of employees which is just the opposite as per priori.
- The regression equation of customer account profitability as dependent variable and customer account satisfaction as independent variable confirms the positive impact of customer account satisfaction on the customer account profitability in Nepalese case too. Similarly, the extension of the model with the inclusion of control variables, customer satisfaction appears with positive relationship with customer account profitability also indicating that the bank has to bear expenditures for increasing satisfaction level of customers. All control variables were significant except credit risk.
- The regression model which includes customer account profitability as dependent variable and satisfaction level of customers and other control variables such as capital adequacy ratio, operating expenses ratio, assets composition ratio, credit risk ratio and credit deposit ratio as independent variables provided expected sign with respect to operating expenses ratio, assets composition ratio, credit risk ratio, credit deposit ratio and customer

satisfaction while, the sign of capital adequacy ratio is found a negative impact on customer account profitability which is just the opposite as per priori.

7.3 Conclusions and Implications

With the main objective of analyzing the customer account profitability of Nepalese commercial banks, this research draws some important conclusions. Despite the fact that a substantial amount of research has focused on the impact of customer satisfaction on customer account profitability, there has been relatively little research attention given to the banking sectors. As a main domain of service industries, commercial banks are producing intangible products and have been trying to satisfy their customers with their services in accordance with their operating goals. Customer satisfaction is the very first step of commercial banks' main operation and it is the very direct outcome of their services. In the banking industry, a motivation for the increase of customer satisfaction is more able to be the provision of a reliable signal of customer satisfaction with links to long-term performance (Fornell et al., 1996). Anderson, Fornell, and Rust (1997) argue that services are more likely than goods to have tradeoffs between customer satisfaction and profitability. Therefore, the profitability and value of banking industry would make the firm more susceptible to customer satisfaction than any other industry.

Managing bank profitability requires not only a customer-centric focus but also a thorough understanding and effective management of customer account profitability. Customer account profitability analysis is a strategy-linked approach to identifying the relative profitability of different customers or customer segments in order to devise strategies that add value to most-profitable customers, make less-profitable customers more profitable, stop or reduce the erosion of profit by unprofitable customers, or otherwise focus on long-term customer profitability. Managers are often surprised to find out that a small percentage of customers generate substantially more than hundred percent of profits, and the remaining customers are either breakeven or unprofitable. Using a customer account profitability analysis system replaces intuitive impressions of customer profitability with fact-based information and supporting analysis.

High levels of customer satisfaction lead to reduced price sensitivity, lower chances of switching to competition, increased number of referrals and repeat purchase. This can be linked to higher revenues from the customer along with reduced costs leading to better customer profitability. The competence of a banking sector depends upon how best it can deliver services to its target customers. In order to survive in this competitive environment and provide continual customer satisfaction, the banking services providers are required to increase the quality of services to attract and retain their valuable customers. In the context of Nepalese commercial banks, the level of customer satisfaction influences customer account profitability positively.

It is argued that satisfied employees are more productive, innovative, committed and loyal to the firm, which in turn leads to customer satisfaction. This means that employee satisfaction plays a strong central role in predicting profitability and organizational effectiveness. Employee satisfaction is significantly related to incentive structure and carrier development opportunities in the organization.

Employees can derive satisfaction from their jobs by meeting or exceeding the emotional wants and needs they expect from their work. Therefore, managers that can recognize this and understand the many different aspects that are involved in employee satisfaction will be successful at achieving the link between employee satisfaction, customer retention and added profitability. A research confirms the positive association between employee job satisfaction and customer satisfaction (Bernhardt et al., 2000; Harter et al., 2002). Bank customers measure their satisfaction based on a series of encounters or ongoing relationship experiences with the bank's employees. Storbacka et al, (1994) also argued that customers' experiences gathered from all service encounters ultimately influence on their overall satisfaction. Customer-employee interaction is considered even a more vital in some countries (e.g., the Netherlands, Italy, and Kenya) than in other parts of the world where people do not like to be involved in personal interactions. Keeping in view the results discussed above, it can be concluded that there is positive association between the employee satisfaction and customer satisfaction on the customer account profitability of commercial banks in Nepal.

Likewise, an excessively high capital ratio could denote that banks are operating over-cautiously and ignoring potentially profitable trading opportunities, which negatively affect profitability. Operating expenses are expected to have a negative effect on the profitability. Deposits and loans are the most important indicators in the bank financial statements because they reflect the bank's primary activity. Assuming other variables constant, the higher the rate of transforming deposits into loans, the higher the profitability will be. The higher the exposure to high-risk loans, the higher the accumulation of unpaid loans and the lower the profitability. Increasing the share of liabilities held in deposits should lower interest expenses and improve bank profitability.

It is concluded that capital adequacy, operating expenses and credit risk have negative influence on customer account profitability where as assets composition and credit-deposit have positive impact on customer account profitability of commercial banks. There is significantly positive effect of employees' satisfaction and customers' satisfaction on customer account profitability which signifies that higher the level of employee and customer satisfaction leads to higher degree of customer account profitability.

A customer account profitability analysis can help in identifying those factors that could have a negative impact on the future profitability of the commercial banks. Most customer account profitability analysis allows for determining what percentage a given customer or group of customers actually make up of the overall client base, usually in terms of revenue generated. If the analysis makes it clear that the bank is depending on few highly profitable customers to generate half or more of the its business volume, then steps are usually taken to diversify and expand the client base, often by attracting more small to mid-sized customers.

Finally, the services the banks offer to customers, the incentives and benefits to employees and the changes or improvement, they need to undergo so that they can retain valuable customers as well as employees. This study is summed up by categorizing and evaluating the customers on the basis of their satisfaction, status and their contribution to the banks' profits and losses.

Implications

This research study has both theoretical and practical contributions. The theoretical contribution of the study is that the customer account profitability of Nepalese commercial banks customers' satisfaction, which results due to employee satisfaction. The analysis of customer profitability is necessary to assess the achievement of banks' strategies related to customer satisfaction, employee satisfaction.

Using the model developed in conceptual framework, it is attempted to examine the impact of customer satisfaction on profitability of individual customers. This research might help the management of bank to better understand the customers and their employees. The study could be used by managers in commercial banks in developing their staffs with various programs in order to create satisfied and loyal customers and employees. This study tested the impact of satisfaction of customers and employees on customers' profitability and found out that they had significant relationships.

Direction for Future Research

By reflecting on the results of the present research work as the basis, further research can be carried out in a number of areas. To perform future research in this area, it is requested to incorporate particular aspects that can better improve the methodology as well as the empirical results and the subsequent findings and conclusion of this study. Some prominent directions for future research are as under:

- It would be worthwhile for future study to focus on segregation of customers on the basis of profitability into manufacturing sectors.
- Future study may also be conducted using new methodology and techniques for identifying profitable customers in the commercial banks.
- Future study may also be conducted to explore new model for measuring the qualitative dimension of customers, which will be better to analyze all types of customers in commercial banks.
- Future study may attempt to include several quantitative and qualitative variables to determine the customer account profitability of commercial banks.

- Future researchers might undertake similar approach to understand customer satisfaction in commercial banking under different situational contexts, viz. customer satisfaction in the case of service failure and also post-service recovery customer satisfaction. This will enable the banks to handle the delivery of their different services better.

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ANNEX I

INTERVIEW SCHEDULE FOR ACCOUNT HOLDER CUSTOMER

Hello, I am the PhD scholar of Strategic Management Accounting. I am conducting a survey for the thesis on "Customer Account Profitability Analysis of Commercial Banks in Nepal". This particular survey is being conducted to find out to what extent the competitive strategies regarding customer account profitability has been applied in commercial banking sector of Nepal.

I would like to ask you a series of questions. Your responses will be kept confidential.

Thesis Supervisors

Prof. Dr. Madhav Raj Koirala

Prof. Dr. Shalikram Koirala

Surveyor

Kapil Khanal

Name (Optional): ……………………………………………………………………………

Gender: ☐Male ☐Female

Age: ☐16-30 years ☐30-45 years ☐ Above 45 years

Education:
☐SLC or below ☐Higher Secondary ☐Bachelor and above

Occupation:
☐ Student ☐ Service ☐Business
☐ Others ………………………………

Average monthly income (in Rs.):

☐Below 20,000 ☐20,000 to 50,000 ☐Above 50,000

Location of Workplace: ……………………………………………………………………………

Name of your banks:
……………………………………………………………………………………….
Mostly banked branch:
…………………………………………………………………………………

1. Banking Services normally you are availed with : (Multiple tick question)

□Deposit □Loans □Trade Finance □Remittance
□Safe Deposit Locker □Internet banking □ Card Services □ ATM
□SMS Banking □ Insurance □ Others (specify)……….

2. Frequency of availing of bank services
□Everyday □2-3 times a week □ Once in a month □3-4 times a month □Once in 2 months □ 2-3 times in two months □2-3 times in a quarter □Once in a quarter

3. Please rank your level of satisfaction in five point scale on various services and facilities provided by the commercial banks; one for not satisfaction and five for very highly satisfaction.

1. Employees behaviors	Not satisfied	Least satisfied	Satisfied	Highly satisfied	Very highly satisfied
a. Smart well dressed tellers	1	2	3	4	5
b. Efficient, knowledgeable tellers and operational support personnel	1	2	3	4	5
c. Friendly courteous tellers	1	2	3	4	5
d. Help in filling necessary documents	1	2	3	4	5
e. Clear and full explanation of terms & conditions	1	2	3	4	5
f. Give information about changes	1	2	3	4	5
g. Offer advice and guidance	1	2	3	4	5

2. Responsiveness					
a. Promptness and accuracy in transactions	1	2	3	4	5
b. Complaint Registering method	1	2	3	4	5
c. Complaint Redressal method	1	2	3	4	5

3. Effective queue management					
a. Minimal queuing time	1	2	3	4	5
b. Counters for specific transactions & accounts	1	2	3	4	5

c. Adequate tellers/counters manned when busy	1	2	3	4	5
4. Branch service facilitators					
a. Adequate supply of transaction slips	1	2	3	4	5
b. Adequate supply of information pamphlets	1	2	3	4	5
c. Readily available, working pens	1	2	3	4	5
d. Uniform services in all branches	1	2	3	4	5
e. Convenient hours of operation	1	2	3	4	5

5. Effective ATM and Card Procedures					
a. Accurate execution of all ATM transaction	1	2	3	4	5
b. All ATMs in working order	1	2	3	4	5
c. Extensive/easily accessible ATM network	1	2	3	4	5
d. Simple procedures for obtaining ATM cards	1	2	3	4	5
e. Fast replacement of ATM card if lost/stolen	1	2	3	4	5
f. Privacy of transactions at ATM	1	2	3	4	5

6. Value of other products exclusive loan					
a. Efficient transactions for bank drafts	1	2	3	4	5
b. Competitive charges for bank drafts	1	2	3	4	5
c. Efficient transactions for money transfer/forex	1	2	3	4	5
d. Competitive charges for money transfer/forex	1	2	3	4	5

7. Account communication					
a. Clear and detailed statement of accounts	1	2	3	4	5
b. Monthly statement of account	1	2	3	4	5

c. Effective communication of any charges in rates	1	2	3	4	5
d. Information on new products and services	1	2	3	4	5

8. Effective account manager/ment					
a. Manager for more complex dealings/queries	1	2	3	4	5
b. Accurate transactions & account management	1	2	3	4	5
c. Available and helpful branch manager	1	2	3	4	5
d. Availability of financial advice	1	2	3	4	5

9. Simple account/card acquisition					
a. Simple procedure for obtaining credit cards	1	2	3	4	5
b. Simple procedure for obtaining debit cards	1	2	3	4	5
c. Simple procedure for opening accounts	1	2	3	4	5
d. Simple procedure for obtaining ATM cards	1	2	3	4	5

10. Physical aspect of the ATM					
a. Adequate physical security provided by ATM	1	2	3	4	5
b. Production of withdrawal slip and account balance	1	2	3	4	5
c. Assuring that a problem will be handled	1	2	3	4	5

11. Physical evidence					
a. Clean environment	1	2	3	4	5
b. Attractive and well designed environment	1	2	3	4	5
c. Adequate safety and personal	1	2	3	4	5

security					
d. Adequate parking nearby	1	2	3	4	5
e. Convenient branch location	1	2	3	4	5
f. Modern equipment and de´cor	1	2	3	4	5

12. Credibility and Security					
a. Bank reputation	1	2	3	4	5
b. Financial security	1	2	3	4	5
c. Confidentiality of accounts and transactions	1	2	3	4	5

13. Network accessibility					
a. Any branch banking services (ABBS)	1	2	3	4	5
b. Extensive/easily accessible branch network	1	2	3	4	5
c. Mobile banking	1	2	3	4	5
d. Internet banking	1	2	3	4	5

4. Besides above mentioned services what more services do you expect from your bank?
....
....
....
....
....

5. What are the service quality gaps that you've noted in commercial banks?
....
....
....
....

6. Please rate the bank employees' behaviors on the following features:

	Not satisfied	Least satisfied	Satisfied	Highly satisfied	Very highly satisfied
Courtesy & Politeness					
Promptness in attending request					
Punctuality					
Promptness in complaint					

recovery					
Presence of supervisors when required					
Following instructions given by you					
Making aware of latest products at bank					
Extending service after banking hours					
Cleanliness of bank					
Telephonic inquiry from officials					

7. How many banks did you seriously consider as possible alternatives before selecting one?

One ☐ Two ☐ Three ☐ More than Three ☐

8. When do you think of your bank what comes first in your mind?

Personalized service ☐ Wide branch network ☐ Customer service ☐

Computerized banking ☐ Core banking ☐ Others ☐

9. Does your bank offer competitive service charges?

Yes ☐ No ☐

10. Do they charge unnecessarily for not maintaining minimum balance in your account?

Yes ☐ No ☐

11. Customers' attitude towards employees' activities and services. (one for not satisfied and five for very highly satisfied

Employees activities and services	Not satisfied	Least satisfied	Satisfied	Highly satisfied	Very highly satisfied
Employees are available in a timely manner.					
Employees greeted you and offered to help you.					

Employees are friendly and cheerful throughout					
Employees answered all of your questions.					
Employees showed sufficient knowledge of their services.					
Employees offered relevant advice.					
Employees are polite throughout.					
Employees provide customers with precise information					
Employees carry out customer transactions confidentially					
Employees provide individualized attention to customers					
Employees enact transactions on a timely manner					

12. Does your bank implement the feedbacks given by the customers?

Yes ☐ No ☐

13. Does your bank's service improved from that of previous year?

Very significantly improved ☐ Significantly improved ☐
Somewhat improved ☐ No improved ☐ Negatively improved ☐

14. Please tick on the overall satisfaction for your bank:

Overall satisfactions	Not satisfied	Least satisfied	Satisfied	Highly satisfied	Very highly satisfied

15. Would you like to suggest any changes or improvement in any service or any feature of the bank?

! THANK YOU VERY MUCH FOR YOUR KIND SUPPORT & CO-OPERATION!

ANNEX II

INTERVIEW SCHEDULE FOR BANK EMPLOYEE

Hello, I am the PhD scholar of Strategic Management Accounting. I am conducting a survey for the thesis on **"Customer Account Profitability Analysis of Commercial Banks in Nepal".** This particular survey is being conducted to find out to what extent the competitive strategies regarding employee satisfaction has been achieved in commercial banking sector of Nepal.

I would like to ask you a series of questions. Your responses will be kept confidential.

Thesis Supervisors

Prof. Dr. Madhav Raj Koirala
Prof. Dr. Shalikram Koirala

Surveyor
Kapil Khanal

Personal Profile:

Name: -…………………………………. (Optional)

Gender: ___________

1. Age:

Below 30 Years ☐ 31 – 45 Years ☐ Above 45 Years ☐

Position: - ………………

Service duration (in this bank)………

Professional Experience. …………………………………………….

Academic Qualification:. …………………………

Name of the Bank: ___________ Email ID: ___________

2. Designation:

Manager Level ☐ Assistant Level ☐

3. Are you satisfied working in this Bank?

Completely ☐ Significantly ☐ Somewhat ☐ Not so much ☐
Not at all ☐

Satisfaction level of employees on bank incentives.
(Please tick on the following attributes)

4. Employee Empowerment

Statements	Not satisfied	Least satisfied	Satisfied	Highly satisfied	Very highly satisfied
You consider working elsewhere with better conditions.					
Senior management is available for you to help					
Employee empowerment enables the Bank to compete with its competitors in the Market.					
You have a regulated routine at work or do you organize your job that best suits you.					

5. Effectiveness & Efficiency

The amount of work I am expected to do on my job is reasonable					
I am satisfied with the productivity and efficiency of my department.					
The Management believes that employee performance is directly related to employee Empowerment.					
My department responds promptly to client requests, despite of busy workload					
I have enough involvement in decisions that affect my work					
The customers have to wait long time before speaking to a representative					

6. Quality Performance

You are allowed for making decisions regarding customer service.					
My work group consistently provides polite service even when the client is bad-tempered					
Do you think empowering the employees contributes to quality service delivery?					
Do you think your Bank provides excellent services to the customers					
Are you satisfied with the quality of the client service provided by your department					

7. Training

Employee are send for training to reduced number of errors/ complaints					
Bank conduct your need analysis before conducting any training					
Trainings you have attended have helped you with the job of encouragement					
Training has helped you to improved cross functional relationship					

8. Performance Appraisal

Top management communicated appraisal feedback to the respective employee					
I am satisfied with the appraisal system adopted currently					
I am satisfied with my department's current recognition programs					

9. Quick Problem Solving

Employees of department listen attentively to identify and understand client concerns					
You ever had complaining customers, do you feel they deserve better					
Sufficient information is available on the internet to solve customer's problems.					
The representative quickly identifies the problem.					

10. Trust Building

You are rewarded for delivering excellent services besides your monthly salary.					
This is the job in which I feel a sense of accomplishment.					
I have the support and authority to make the decisions necessary for accomplishing assigned task.					

11. Teamwork

We don't have fixed procedures; we agree on them in light of the task at hand.					
We tend to have set protocols to ensure that things are orderly (e.g., that everyone gets opportunities to have their say, to minimize interruptions and so on)					
We are keen to get on with the task at hand and not spend too much time planning our approach.					
We tend to generate lots of ideas, but many get lost because we fail to listen to them and/or reject them out of hand.					
The management ensures that we adhere to procedures, don't argue, don't interrupt and keep to the point					
Employee enjoys working together; it's fun and productive.					

12. Customer Satisfaction

Your organization has managers/staff dedicated to customer satisfaction matters.					
Your organization conduct surveys to evaluate customer satisfaction.					
Different means (questionnaire, interview, discussions) are used to evaluate customer satisfaction.					
Your organization initiated programs to improve customer satisfaction within the past year.					

13. Employees attitude towards bank' incentives and benefits

Please rate the following points on a scale of 1 to 5(5-Maximum, 1-Minimum)

Attitudes on	1	2	3	4	5
Credits and Payments					
Credits and Returns					
Efforts to meet your communication needs					
Business partner					
Relationship with our bank's personnel					
Level of customer support					
Telephone support systems					
Delivery of our products or services					
Efforts to communicate the availability of new products					

14. Attitudes of Bank Employees towards Managerial Functions

Please rate the following points on a scale of 1 to 5(5-Maximum, 1-Minimum)

Attitudes on	5	4	3	2	1
Likeliness to continue working					
Likeliness to choose again					
Company values employees					
Company honesty					
Satisfaction of relation with boss					
Company is helpful					
Likeliness to provide enthusiastic referrals					
Overall satisfaction					

15. Responses of employees on different services of commercial banks

Please rate the following points on a scale of 1 to 5(5-Maximum, 1-Minimum)

Responses on	5	4	3	2	1
1. Attitude towards bank					
2. Training and development activities					
3. Career development and grievance handling					
4. Promotion and motivation					
5. Labor turnover					
6. Flexible working hour					
7. Job enlargement, enrichment, job rotation					
8. Types of management- autocratic, democratic etc					
9. Extrinsic and intrinsic factors					
10. Working hours per day					
11. Holiday and allowances					
12. Intra departmental relationship					
13. Interdepartmental relationship					
14. Communication / information system					

16. How does your bank interact with your customer?

Telephone ☐ Mail ☐ Personally ☐ Others ☐

17. Any memorable incident with the bank:

____

THANK YOU VERY MUCH FOR YOUR KIND SUPPORT & CO-OPERATION!