

CUSTOMER SATISFACTION AND LOYALTY IN LATVIAN RETAIL BANKING

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Abstract

In the modern competitive environment banks create the value generally using the relational capital. Thus, customer satisfaction and loyalty are the main components of bank success in a market. The purpose of the paper is to elicit the criteria that customers use to evaluate their banks. To achieve this goal, the customers of Latvian commercial banks were surveyed. The authors used their developed questionnaire that was aimed to evaluate level of satisfaction and loyalty of bank clients, as well as to predict their future actions towards to the bank. As a theoretical basis we used Balanced Scorecard approach, RATER model, concept of Service-profit chain, concept of customer perceived value and the results of previous surveys in the area of service quality measurement. The obtained results allow distilling the most important factors of bank attractiveness for retail customers, determining the factors affecting customers' decision about suspending the relationships with the bank and completing our developed performance measurement system for a bank branch with some additional metrics.

Keywords: bank, customer satisfaction, customer loyalty.

Introduction

Modern banking business is significantly influenced by the process of globalization. The impact is expressed, mainly, in financial market liberalization that, in turn, causes an increased competition. To survive in a competitive struggle, banks should offer their customers something new and relatively cheap, because the competitive power of a bank is largely defined by the degree of its conformance to customer needs. In the information age, organizations require new capabilities for competitive success, such as customer relationships, product innovation, customized products, employee skills, motivation, and information technology.

On the opinion of many finance theorists and practitioners, shareholders' value enhancing should be an integral goal of any company, including financial institutions (Fisher, 1930; Copeland *et al.*, 2002; Helfert, 2003; Sinkey, 2007). Intangible assets, in particular the relational capital, amount to over 70 percents of company's value (Kaplan&Norton, 2003). Relational capital describes an organization's relations with customers, suppliers, investors, co-operation partners and the public (Mertins *et al.*, 2009). Relational capital keeps customers from abandoning a commercial relationship.

In a hyper-competitive market all commercial banks are faced with challenges of retaining the existing and attracting new customers. The maintaining bank's existing customer base is even more important than the ability to capture new clients. One of the reasons is that the cost of attracting a new customer is much higher than the cost of keeping existing one. Thus, customer satisfaction and loyalty are essential to bank's success. Customer loyalty is a major contribution to sustainable profit growth.

The aim of the research is to take the opinions of different groups of Latvian citizens about the service quality in Latvian banks. The objectives of the paper are to (i) study the international experience in the area of customer satisfaction and loyalty measuring, (ii) to get an insight into the quantitative parameters of customer satisfaction, (iii) to describe the current survey, which is still in progress, (iv) to analyze the results obtained from the authors' conducted survey among Latvian banks' clients, and (v) to translate the customer's requirements into measurable targets in order to involve them into bank's performance evaluation system.

This paper presents an original survey in the banking sector of Latvia. To achieve the main goal of the research, the authors of the paper developed questionnaire designed for bank clients. The respondents were randomly selected. We used the mail and in-person questionnaire methods.

The current research has linkages with our previous survey conducted in 2009. It was dedicated to employee performance appraisal in banking (Titko&Lace, 2009a). Managers of Latvian commercial banks were surveyed in order to determine the basic required characteristics for the position of a bank frontline employee. The obtained data we used to construct the skeleton of the Competency framework for the customer service specialist in Latvian commercial bank.

In the given paper the authors used Balanced Scorecard approach and the concept of Service-profit chain to link customer requirements with the bank performance measures. Using a diagnostic approach to satisfaction measurement, we examined the gap between the customers' expectations and their perceived experience of using bank services.

The results are focused on the determination of the most important factors of bank attractiveness for retail customers. The conducted research is not a customer satisfaction survey in its pure form. We did not set a goal to determine the customer satisfaction index. The main idea was to elicit the criteria that customers use to evaluate their banks. Besides, we wanted to update the performance measurement system we developed for a bank's retail department in our previous research (Titko&Lace, 2009b). We distilled the most important measures for a bank customer service centre from the viewpoint of bank staff. Now we can compare opinions of employees with the customers' position.

Customer satisfaction and loyalty in banking

Globalisation in banking sphere is attended by financial market liberalisation. It means the abolition of restrictions for foreign financial institutions' entrance into domestic banking markets that, in turn, exacerbates a competition. As for Latvia, over 75% of Latvian commercial banks are foreign-owned ("BSCEE review", 2008). Besides, the most of owners are strong international financial groups, such as SEB, Swedbank and DnB Nord that makes competition even more sharp.

Growing customers' expectations and, as consequence, an increase of cost of customer acquisition are the main problems in modern retail banking. According to E. Deming, business guru of the past century, a consumer is the most important element in the production chain. A consumer is more important than the raw material. It is easier to change supplier than to find a new consumer (as cited in Neave, 2007). As for banks, A. Damodaran considers customer deposits as a raw material, because they will be further transformed into other financial assets (Damodaran, 2007). Thus, bank customers are consumers and suppliers at the same time. And, it is doubly important for banks to retain profitable clients and to intensify the return from the existing customer base.

Customer satisfaction depends on how products and services meet or surpass customer expectation (Kotler *et al.*, 2000). It is one of the most important indexes within the frame of customer perspective in a Balanced Scorecard. The balanced scorecard concept, developed in 1992 (Kaplan&Norton, 1993) is a strategy-focused approach to performance management that includes performance measures derived from the organization's vision and strategy. According to the data of the Bain&Company research this approach is among the 10 most popular management tools in 2009 (Rigby, 2009). The balanced scorecard augments financial measures with objectives and metrics in three additional areas: customer relationships, internal processes, and learning and growth. Balanced scorecard for any company involves customer satisfaction and customer loyalty indexes as the customer measures.

The most popular index to measure customer satisfaction and loyalty in European countries is EPSI (European Performance Satisfaction Index) rating. EPSI Rating is a system to collect, analyze and disseminate information about image, preferences and perceived quality as well as loyalty of customers and other stakeholders to commercial entities and other organizations (<http://www.epsi-rating.com/>). Data about customer satisfaction according to EPSI is presented in Table 1 ("Baltic banking 2009", 2009).

Table 1. Satisfaction in banking B2C sector by country according to EPSI, 2004-2009

Country	2004	2005	2006	2007	2008	2009
Latvia	72.9	73.7	75.3	78.8	78.1	75.2
Estonia	72.4	72.7	73.5	75.4	75.6	75.4
Lithuania	84.4	78.2	80.5	81.3	82.1	78.2
Czech Republic	n/a	69.4	71.6	71.6	69.8	67.8
Denmark	74.0	73.2	74.2	76.2	73.9	68.5
Finland	75.7	75.9	74.9	78.2	76.7	77.3
Norway	69.5	71.9	70.0	68.8	69.8	69.4
Sweden	67.8	70.3	71.8	71.3	71.8	72.4
Russia	61.0	63.8	n/a	70.0	75.3	70.6

For measuring satisfaction a structural equation model has been developed. The model contains the following components: Image, Customer Expectations, Customer Perceived Product Quality, Customer Perceived Service Quality, Customer Perceived Value, Customer Satisfaction, and Customer Loyalty. The index values are in the range from 0 to 100, where 100 is the highest possible result (denotes the highest level of customer satisfaction).

As we can see from the table above, customer satisfaction in all three Baltic States is at rather high level with the range from 75 to 78 scores out of 100, that is higher than European average in banking sector (which is 72 scores). However, the index decreased compared with the previous year in almost all of the European countries, Latvia included.

Many researchers discuss the relationships between customer satisfaction, customer loyalty, and profitability of a company (Reichheld & Sasser, 1990; Storbacka *et al.*, 1994; Hallowell, 1996; Jamal & Anastasiadou, 2009; Beerli *et al.*, 2004). In particular, a professor James Heskett in 1994 proposed a concept of Service-profit chain that establishes relationships between profitability, customer loyalty, and employee satisfaction, loyalty and productivity (Heskett *et al.*, 2008). The links in the chain are as follows: Profit and growth are stimulated primarily by customer loyalty. Loyalty is a direct result of customer satisfaction. Satisfaction is largely influenced by the value of services provided to customers. Value is created by satisfied, loyal, and productive employees.

The researchers from McKinsey & Company - a global management consulting firm - in 2004 conducted a survey among the customers of European banks (Beaujean *et al.*, 2006). Over 85% of satisfied customers increased their investments or started using more of bank's offered products. In turn, 70% of clients, who had a negative experience with their bank, reduced their investments.

Fred Reichheld, the Fellow of Bain & Company, in co-operation with Satmetrix Inc. developed a concept, called Net Promoter (Reichheld, 2006). Net Promoter is both a loyalty measure and an organizational discipline. The Net Promoter score (NPS) allows categorizing customers into three groups based on their willingness to recommend a company or product to a friend or colleague (using a 0-to-10 point rating scale):

- Promoters (score 9–10) are loyal enthusiasts who will keep buying and refer others, fueling growth.
- Passives (score 7–8) are satisfied but unenthusiastic customers who are vulnerable to competitive offerings.
- Detractors (score 0–6) are unhappy customers who can damage your brand and impede growth through negative word-of-mouth.

To calculate Net Promoter Score (NPS), percentage of Detractors is subtracted from the percentage of Promoters:

$$\text{NPS} = \% \text{ OF PROMOTERS (9-10)} - \% \text{ OF DETRACTORS (0-6)} \quad (1)$$

In any case, before determination of the satisfaction index, loyalty index or any other quantitative measure, describing customers' attitude to their bank, it is necessary to detect the main factors affecting customers' behavior and perception.

The recent surveys confirm the fact that qualification and emotional intellect of bank employees is the crucial element in the process of winning customer loyalty (Rostamy, 2009; Bidmead *et al.*, 2007; Beaujean *et al.*, 2006). Despite the internet banking development, the number of customers' visits to bank branches in European countries decreased only by 1 percent during the period from 2001 to 2005 (Bidmead *et al.*, 2007).

According to F. Kotler, customer perceived value is the difference between total value of a product for customer and his total costs (Kotler, 1999). Total value involves (i) value of a product, (ii) value of services, (iii) value of servicing staff and (iv) value of image. Total costs, in turn, consist of financial costs, time costs, energy and emotional costs. Each customer tends to maximize his total perceived value and selects a bank, which can make him the best offer. For banks, the instruments for enhancing customer perceived value are employees, processes and technologies (Croxford *et al.*, 2005).

During the last years, the level of customer loyalty in banking dropped in all three Baltic countries ("Baltic banking 2009", 2009). The main reason for this decline was the recent financial turmoil that had a large negative effect on the overall bank customer satisfaction and loyalty. Also, the information about the amendments to the Law "On personal income tax", starting from 1 January 2010 ("On Amendments to the Law", 2010), aroused the very negative reaction from the customer side. Many banks raised their commissions and limited the lending. Besides, the overall level of customer satisfaction and loyalty was significantly influenced by the record loyalty drop to Parex bank that has lost more than 14 scores.

Thus, it is extremely important for banks to pay special attention to the issues of customer loyalty enhancing. The process improvement and investments in technologies are rather expensive methods to achieve this goal. We believe that the first step in the process of winning and retaining customer loyalty is service quality improvement through staff development.

Survey description and empirical results

To achieve the purpose of the given research, the opinions of Latvian citizens about their banks were analyzed. Data were collected through a confidential four-page questionnaire developed by authors. Questionnaires were mailed to randomly selected bank customers. The only one aspect was taken into account in respondent selection: age over 18 years. As primary objects for analysis five largest commercial banks of Latvia were selected AS “Parex banka” (24% of respondents), AS “Swedbank” (33% of respondents) and AS “SEB banka” (23% of respondents), because the most of respondents are customers of these banks. The main data about the survey are summarized in Table 2.

Table 2. Description of the survey

The aim of the research	To evaluate the overall bank customers’ satisfaction and loyalty level towards their banks in terms of service quality, process quality, level of technological development and product quality.
Approach	Qualitative
The source of data	Mail surveys
Instrument	Questionnaire
Number of respondents	102
The target audience	Customers of Latvian commercial banks at the age over 18 years
Location	Latvia
Period	January - February, 2010

The authors’ goal was to form an overall judgment about the service quality in Latvian commercial banks from the viewpoint of their customers. As it was said above, the aim of the research was not to determine satisfaction or loyalty index. The authors tried to distil the main factors that affect bank customer satisfaction and loyalty.

Satisfaction measures involve three psychological elements for evaluation of the product or service experience: cognitive (thinking/evaluation), affective (emotional-feeling/like-dislike) and behavioral (current/future actions) (Smith, 2007).

We involved all the elements in our developed questionnaire. The questionnaires included only closed questions, because they produce standardized data that can easily be analyzed statistically. The respondents were offered to select the appropriate variant from the authors’ formulated alternatives.

The questions can be nominally grouped into three blocks. The first group of questions aimed to evaluate satisfaction level with bank. The second group evaluated the loyalty level. And, the remaining questions were developed to determine customer actions towards their banks.

Firstly, the authors evaluated the overall satisfaction level of bank customers. The respondents were offered to answer the single question: “Overall, how satisfied are you with your bank?” Formulating the responses, we used 1 – 7 Likert-type scale (Likert, 1932), where “1” meant “very dissatisfied” and “7” meant “very satisfied”.

The goal of the next question was to determine customer willingness to recommend their bank to friends and colleagues, i.e. to determine Net Promoter Score.

The block of questions that evaluated customer future behavior was developed, based on McKinsey survey (Beaujean *et al.*, 2006). The respondents were offered to remember positive or negative experience they had ever had with their bank, and then to describe their following actions.

To determine the most sensitive moments in bank-customer relationships, the authors offered respondents to select 1 – 3 reasons for suspending the relations with bank.

Farther, respondents had to evaluate the set of factors affecting bank value perceived by customers. As a theoretical basis for question development the authors used the concept of customer perceived value (Kotler, 1999) and the data of the researches in the area of service quality evaluation.

Based on Rostamy the following components create customer total satisfaction (Rostamy, 2009):

1. Personnel: including personnel skills and knowledge, responsiveness, communication and collaboration and friendliness components;
2. Product: including product variety, refund, special services and cost components;
3. Image: including credibility, technology excellence and ability to satisfy future needs;
4. Service: including the appearance of the stores, service waiting time, services processes and service information;
5. Access: including network expansion, troubles in the services system and location of stores.

The widely know instrument for measuring service quality is SERVQUAL model, developed by Zeithaml, Parasuraman & Berry (Zeithaml, *et al.*, 1990). The main idea of the model is to measure the gap between customer expectations and experience. Initially, the model involved 10 dimensions of service quality. Later, it was modified into the RATER model.

In accordance with it, five key dimensions of service quality are:

1. Reliability (the ability to deliver the promised service dependably and accurately);
2. Assurance (the service quality that focuses on the ability to inspire trust and confidence);
3. Tangibles (focus on the elements that represent the service physically);
4. Empathy (emotional aspect of service);
5. Responsiveness (the willingness to help customers and provide prompt service).

Respondents had to evaluate their level of satisfaction with each factor and their own perceived importance of these factors. As alternatives of responses the authors also used Likert-type scales. Satisfaction was measured like in the first question. 1-5 scale was used for importance evaluation with five options: “1” - not important, “2” - relatively important, “3” - average importance, “4” - very important and “5” – highly important.

The last question was aimed to determine the gap between customers’ and bank managers’ viewpoints about the ideal bank frontline staff member. As a basis we used questions from our previous research (Titko&Lace, 2009a), which task was to draw up the profile of the ideal bank customer service specialist, i.e., to determine the qualities required to realize bank strategy effectively.

The research evidence allows making the interesting conclusions. In general, the results of the survey confirm the data of EPSI rating. Latvian consumers are loyal to their banks. About 80% of respondents have selected the answer “seldom or never” for the question “How often you think about changing your bank?” About 60% of respondents have been customers of their banks for more than 5 years (see Figure 1).

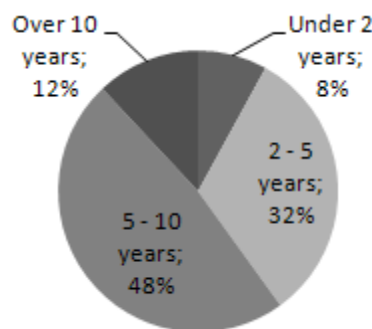


Figure 1. Time of being customer of a bank (102 clients of Latvian commercial banks)

At the same time 53 per cent of the pollees are the customers of several commercial banks that denotes to insufficient level of loyalty.

Calculating NPS index, the authors used common data without bank separation. The respondents divided into 36 per cent promoters and 29 per cent detractors. As a result, Net Promoter Score is equal to the dismal value of 7 percents.

As for satisfaction level, there is a sufficiently positive situation: 58% of respondents evaluated their overall satisfaction with own bank at 6 – 7. However, about 40 % of customers are not completely satisfied with their financial institutions. Considering the strong linkage between satisfaction and loyalty, there is a rather high likelihood of the suspending the relationships with bank in the future.

As for positive and negative experience customers have had with their banks, 34% of respondents remember the situation related to the bank, when they were faced with troubles. In turn, 53 per cent of customers had a good experience. Bank task is to increase the number of satisfied customers and to minimize

the probability of situations that can negatively impress clients. Besides, if it is not possible to avoid troubles, bank employees should mitigate the effect, solving the problem fast and effectively. Based on data of the survey, only 30 per cent of dissatisfied customers were absolutely pleased with the followed bank solution of the problem.

The interesting fact is that the positive or negative experience will not affect the future relationships between bank and most of the respondents. Respondents who replied "Yes" to the question "Can you remember positive or negative situation related with your bank?" were offered to select an answer from the authors' suggested alternatives about the possible future actions. 65 per cent of discontented customers and 72 per cent of clients who had a positive experience with their banks will take no further actions, whereas they revised the opinion about their bank.

The factors that can force customers to leave their bank are presented in Table 3. The most important factor takes the first place. We evaluated the level of importance, simply counting the votes of respondents.

Table 3. The factors affecting customers' decision about suspending the relationships with bank

Level of importance	Factor	Number of votes
1	Bank increased service fee	64
2	Not polite service	46
3	Frequent operational errors of employees	45
4	Attractive offer of another bank	37
5	Long wait in queue	18
6	Negative information about the bank in mass media	15
7	Closing the conveniently located branch	13

As for service cost, it is clear that this factor has a significant importance for customers in a period of financial crisis. However, on the authors' opinion the respondents exaggerate the value of cost factor. Many banks put up the service prices during the last year, but it did not cause loss of customers.

As we supposed, the competence, emotional intellect and empathy of bank front office staff play crucially important role in relationships between bank and its clients.

Despite the high level of customer loyalty in Latvian retail banking, about 40 per cent of respondents are ready to break with the bank, if they receive a good proposal from another bank. It means that banks have an opportunity to lure customers of competitors away, conducting an intelligent marketing policy.

To determine the most important factors of banking service quality perceived by customers, we counted the number of respondents who evaluated the level of importance at 5 (very important). The results are presented in Table 4.

Table 4. Factors determining customer perceived value of a bank

Level of importance	Service quality factor
1	Quality of bank products
2	Bank safety, guarantees
3	Emotional aspect of service (kindliness and courtesy of bank staff)
4	Service costs
5	Qualification of bank employees
6	Level of ATM's network development; Use of innovations; Usability of bank products
7	Service speed
8	The level of branch network development
9	Spent waiting time in queue
10	Bank opening hours; Request fulfilment time; Bank reputation
11	Simplicity of information acquisition
12	Variety of bank offered products and services
13	Branch environment (technical facilities, interior decoration etc.)
14	Professional appearance of front office employees
15	Bank participation in social projects

As for customers' view about an ideal bank front office staff member, the respondents almost unanimously have selected 25 – 35 years old person (82% of respondents) with the higher education in

economics, management or finance (77% of respondents) and with 1-2 work experience in banking (64%). Gender of bank employee is not essential for customers (85% of respondents).

The viewpoint of customers is concurrent with bank managers' opinion on this matter (Titko&Lace, 2009a). 78 per cent of managers of bank branches insisted on 1 -2 working experience in banking for a customer service specialist and 61 per cent of respondents considered that the higher education in economics/management/finance is absolutely necessary for this position.

Analyzing these results and service quality factors, evaluated by customers, it is clear that the key factor in bank-customer relationships is emotional component of service. Thus, it is extremely important to increase the level of emotional intellect of bank employees and to develop staff communication skills.

Conclusions

Based on survey results, authors concluded that customers of Latvian banks are very conservative and antipathetic to any changes. It helps to retain customers, but on the other hand there are some negative aspects: (i) customers are unreceptive to new products and (ii) it is difficult to reimburse lost customers.

The key factors that affect customers' decision about suspending relationships with their banks are increased service fee, bad service and operational errors of employees. Price increase is often a coercive measure. Thus, human factor becomes the main instrument of impact on customers. Also, among the most important factors of customers' perceived value of a bank are qualification and emotional intellect of bank front office staff.

At the current moment the primary task of bank executives is to develop professional qualification, emotional intellect and communication skills of customer service specialists.

Considering a difference between the customers' perceived value and what employees think the customers value (Rostamy, 2009), bank managers should (i) continuously analyze customers' needs and expectations and (ii) get this information across to the staff.

Following the lead of some British bank (Bidmead *et al.*, 2007), the authors recommend offering to fulfill short questionnaires to bank customers standing in a queue. As a pattern, it is possible to use our developed questionnaire. Firstly, it can facilitate the waiting and, secondly, it allows getting an insight into customers' view about the bank, its products and service quality. This action is also a cost-effective measure, because it does not ask for huge investments, but it can bring the useful information.

It is also critically important the employees know about the survey results. Besides, it is necessary to develop procedures describing the essential moment of the servicing process, starting with the greeting and finishing with the farewell words.

Taking into account that customers appreciate the high speed of operational performance, we recommend completing the performance measurement system (Titko&Lace, 2009b) with the metric "the operating speed of an employee". It is necessary to distil some basic daily operations and to fix the maximal time of performing.

To get the quick feedback from the customers, it is possible to introduce the in-place practice of service evaluation. For instance, customers can be offered to value their visit to a bank simply giving a grade from 1 to 10. The results could be translated into the quantitative measure for evaluating the individual contribution of each front office employee.

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